An Introduction to the Unique Issues in Bank Holding Company Bankruptcies

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On March 17, 2023, the parent of Silicon Valley Bank (SVB) filed for Chapter 11 protection in the Southern District of New York. Unlike SVB itself, its parent, as a bank holding company, was eligible for Chapter 11. In the wake of the recent SVB and Signature Bank failures, it is important for those with potential claims against the parents of failed banks to understand the distinct rules and issues in bank holding company bankruptcies. Several provisions in the Bankruptcy Code grant federal regulatory agencies like the Federal Deposit Insurance Corporation (FDIC) significant advantages relative to other creditors, and disputes involving capital commitments and tax refunds often surface in these cases.

After regulators suddenly closed SVB and Signature Bank, the U.S. government announced that the FDIC will provide direct protection of 100% of the deposits that clients held at both institutions, including uninsured amounts. While this allayed depositors' concerns regarding access to their money, the announcement also stated that "[s]hareholders and certain unsecured debtholders will not be protected." Although the announcement did not specifically identify these unprotected parties, the public holding company shareholders and parties that have a contractual relationship with the holding company, whether based on funded debt or otherwise, may fall in that category.

Below are significant distinguishing features of bank holding company Chapter 11 cases.

Section 365(o): Deemed Assumption of Capital Commitments

Section 365(o) of the Bankruptcy Code is the most noteworthy deviation from typical chapter 11 convention. This provision departs from the default rule that gives a debtor the option to assume or reject executory contracts by automatically deeming to be assumed any "commitment" by the bank holding company with a federal depository institutions regulatory agency (*e.g.*, the Federal Reserve, Office of Comptroller of the Currency or the FDIC) to maintain the capital of an insured depository institution. The "commitment" by the holding company would most likely stem from its obligation to serve as a "source of strength" — *i.e.*, an obligation to provide financial assistance to its bank subsidiary in the event of the financial distress of the bank. As a result of this automatic assumption, the debtor holding company must also immediately cure any deficit under any such commitment, or its bankruptcy case will be converted from chapter 11 to a chapter 7 liquidation proceeding in which a trustee is appointed to liquidate the debtor's assets. In such a case, FDIC claims relating to valid capital maintenance obligations will come ahead of general unsecured claims (*e.g.*, unsecured funded debt at the bank holding company as well as the bank holding company's shareholders).

Section 365(o), however, does not define a "commitment." Thus, whether a valid, enforceable commitment exists becomes an issue for bankruptcy court interpretation, based on the evidence. Several bankruptcy courts have examined whether particular communications or undertakings constitute valid, enforceable contracts and thus whether they constituted the sort of capital maintenance obligation envisioned by section 365. In two cases, courts found no enforceable commitment:

- *In re The Colonial BancGroup*, 436 B.R. 713 (Bankr. M.D. Ala. 2010) (holding that bank holding company did not make a commitment to maintain the capital of its bank subsidiary).
- *In re AmFin Financial Corp.*, Case No. 10-CV-1298, 2011 WL 2200387 (N.D. OH., June 6, 2011) (holding that the FDIC failed to present sufficient evidence that either the regulator or the holding company understood or intended for the documents at issue to create a "commitment" by bank holding company to maintain the capital of its former bank subsidiary).

In two other cases, courts held there was an enforceable obligation:

- *In re Imperial Credit Indus., Inc.*, 527 F.3d 959 (9th Cir. 2008) (finding a holding company's performance guaranty constituted a capital maintenance obligation under section 365(o)).
- *In re Overland Park Fin. Corp.*, 236 F.3d. 1246 (10th Cir. 2001) (finding holding company's stipulation in writing to regulator that it would maintain net worth of savings and loan subsidiary constituted a commitment for purposes of section 365(o)).

Thus, early assessment of any potential capital commitment can be a pivotal issue in a bank holding company's Chapter 11 case.

Section 507(a)(9): FDIC Priority Claims

In addition to the deemed assumption of capital maintenance obligations under section 365(o), the FDIC and other federal depository institutions regulatory agencies may assert entitlement to priority status for any unsecured claims resulting from such commitments, which could give the FDIC and similar agencies an extra layer of protection even if a case is converted to a chapter 7 liquidation. Priority claims are required to be paid in full before other general unsecured non-priority claims and could result in reduced recoveries to those that have unsecured claims against the bank holding company, as well as holding company shareholders.

Bank Holding Company Asset Maximization

A bank holding company may have a variety of assets under its corporate umbrella outside of the failed bank. It may own other subsidiaries operating otherwise healthy businesses — *e.g.*, an investment bank, brokerage or even a car wash.

The bank holding company may also have rights to other property such as tax refunds. In the typical bank holding company structure, the parent holding company and bank entity are counterparties to a tax-sharing agreement that memorializes these entities' rights to tax refunds. Upon the bank's failure, disputes between the holding company and the bank over the tax refund are fairly common.

Often, these cases turn on the particular language in the tax-sharing agreement between the bank and its parent, and whether such language creates a "debtor-creditor relationship," in which case the holding company is likely to own the refund, or, alternatively, a trust, bailment or agency relationship, in which case the bank (and the FDIC as receiver) is likely to own the refund.

The vast majority of tax refund ownership dispute cases between a bank holding company and the FDIC have settled, including AMCORE Financial, the ShoreBank Corporation and IndyMac Bancorp, Inc. (after the Ninth Circuit held that the bank holding company owned the tax refund). Others were litigated to judgment with mixed results (*i.e.*, the holding company winning some and the FDIC others, depending on, among other things, the language in the applicable agreement).[1]

Notably, in 2014, in response to these disputes, the FDIC updated its Interagency Policy Statement to "ensure that tax allocation agreements explicitly acknowledge that an agency relationship exists between a holding company and its subsidiary institution with respect to tax refunds attributable to the institution."

To the extent parties complied and updated their tax allocation agreements, courts may find the parties' intent weighs in favor of the bank, but seasoned practitioners who have dealt with these issues should be consulted.

[1] Skadden represented AMCORE and ShoreBank in their Chapter 11 cases and represented the Chapter 7 trustee of IndyMac.

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