The Banking Law Journal

VOLUME 129 NUMBER 6 JUNE 2012

HEADNOTE: LENDERS' EXERCISE OF "SOLE DISCRETION"
Steven A. Meyerowitz 481

GOOD FAITH AND LENDERS' EXERCISE OF CONTRACTUAL "SOLE DISCRETION"
Thomas J. Hall and Stacey Trimmer 483

BANK REGULATORS TACKLE LEVERAGED LENDING
Derrick D. Cephas, Heath P. Tarbert, and Dimia E. Fogam 495

FSA: BANKS HAVE "MORE WORK TO DO" ON ANTI-BRIBERY COMPLIANCE
Robert Plotkin, Vivian Robinson, Adam Greaves and Kurt E. Wolfe 504

FINANCIAL AND TRADE SANCTIONS: WHAT BANKS NEED TO KNOW
Peter Burrell, Rita Mitchell, and David Savell 510

DELAWARE COURT BLOCKS SALE OF BANK STRIPPED OF ITS "CRITICIZED ASSETS"
Robert S. Reder, David Schwartz, and Julie Constantinides **522**

IMPLICATIONS OF THE CFPB'S FIRST ANNUAL REPORT REGARDING THE FAIR DEBT COLLECTION PRACTICES ACT
Robert E. Bostrom, Gary L. Goldberg, Stephen F.J. Ornstein, Scott D. Samlin, and Jennifer Maree 529

REVISITING THE LENDER'S RECOVERY TOOLBOX: REMEDIES OF SETOFF AND RECOUPMENT
Kelly E. Waits 536

A TROUBLING BANK BALANCE — COMPETING DUTIES FOR BANKS WHEN MAKING SUSPICIOUS ACTIVITY REPORTS
Peter Burrell, Rita Mitchell, and David Savell 542

LANDMARK GERMAN BANKRUPTCY REFORM LAW CREATES OPPORTUNITIES FOR STAKEHOLDERS
Bernd Meyer-Löwy, Leo Plank, Carl Pickerill, and Florian Bruder 548

COMMUNITY BANKS: 12 STRATEGIES FOR RAISING CAPITAL IN A CAPITAL POOR ENVIRONMENT
Victoria Pool 555

BANKING BRIEFS
Terence G. Banich 565

EDITOR-IN-CHIEF
Steven A. Meyerowitz
President, Meyerowitz Communications Inc.

BOARD OF EDITORS

Paul Barron
Professor of Law
Tulane Univ. School of Law

George Brandon
Partner, Squire, Sanders & Dempsey LLP

Barkley Clark
Partner, Stinson Morrison Hecker LLP

John F. Dolan
Professor of Law
Wayne State Univ. Law School

Stephanie E. Kalahurka
Hunton & Williams, LLP

Thomas J. Hall
Partner, Chadbourne & Parke LLP

Michael Hogan
Ashelford Management Serv. Ltd.

Kirk D. Jensen
Partner, BuckleySandler LLP

Mark Alan Kantor
Washington, D.C.

Satish M. Kini
Partner, Debevoise & Plimpton LLP

Douglas Landy
Partner, Allen & Overy LLP

Paul L. Lee
Partner, Debevoise & Plimpton LLP

Jonathan R. Macey
Professor of Law
Yale Law School

Martin Mayer
The Brookings Institution

Julia B. Strickland
Partner, Stroock & Stroock & Lavan LLP

Heath P. Tarbert
Partner, Weil, Gotshal & Manges LLP

Marshall E. Tracht
Professor of Law
New York Law School

Stephen B. Weissman
Partner, Rivkin Radler LLP

Elizabeth C. Yen
Partner, Hudson Cook, LLP

Bankruptcy for Bankers
Howard Seife
Partner, Chadbourne & Parke LLP

Regional Banking Outlook
James F. Bauerle
Keevican Weiss Bauerle & Hirsch LLC

Recapitalizations
Christopher J. Zinski
Partner, Schiff Hardin LLP

Banking Briefs
Terence G. Banich
Member, Shaw Gussis Fishman Glantz Wolfson & Towbin LLC

Intellectual Property
Stephen T. Schreiner
Partner, Goodwin Procter LLP

The Banking Law Journal (ISSN 0005 5506) (USPS 003-160) is published ten times a year by A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207. Periodicals Postage Paid at Washington, D.C., and at additional mailing offices. Copyright © 2012 THOMPSON MEDIA GROUP LLC. All rights reserved. No part of this journal may be reproduced in any form — by microfilm, xerography, or otherwise — or incorporated into any information retrieval system without the written permission of the copyright owner. Requests to reproduce material contained in this publication should be addressed to A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207, fax: 703-528-1736. For subscription information and customer service, call 1-800-572-2797. Direct any editorial inquires and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., PO Box 7080, Miller Place, NY 11764, smeyerow@optonline.net, 631.331.3908 (phone) / 631.331.3664 (fax). Material for publication is welcomed — articles, decisions, or other items of interest to bankers, officers of financial institutions, and their attorneys. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.
POSTMASTER: Send address changes to The Banking Law Journal, A.S. Pratt & Sons, 805 Fifteenth Street, NW., Third Floor, Washington, DC 20005-2207.

Delaware Court Blocks Sale of Bank Stripped of Its "Criticized Assets"

ROBERT S. REDER, DAVID SCHWARTZ, AND JULIE CONSTANTINIDES

A Delaware court determines that a "good bank/bad bank" structure violates "boilerplate" successor obligor provisions of an indenture.

In *In re BankAtlantic Bancorp, Inc.*,[1] the Delaware Court of Chancery recently permanently enjoined the proposed sale of a troubled financial institution via a "good bank/bad bank" structure on the basis that it would violate "boilerplate" successor obligor provisions in indentures governing the terms of outstanding public securities. As is typically the case, the indentures prohibited the transfer of "all or substantially all" of the issuer's assets unless the purchaser assumed the issuer's obligations under the related securities. The court considered both quantitative and qualitative factors in determining that the proposed sale of only the bank's performing assets constituted a transfer of substantially all of its assets and, because the purchaser was not required to assume the payment and other obligations under the indentures, the transaction would trigger a default under the indentures. In so ruling, the court conflated the three steps into which the sale transaction was separated and emphasized that so-called "boilerplate" indenture provisions will be given their accepted commercial meanings regardless of whatever nuances the issuer might build into the language.

Robert S. Reder has been serving as a consulting attorney for Milbank, Tweed, Hadley & McCloy LLP since his retirement as a partner in March 2011, and is an adjunct professor at Fordham Law School. David Schwartz is of counsel and Julie Constantinides is an associate in the firm's Global Corporate Group, resident in the New York office.

Published by A.S. Pratt in the June 2012 issue of *The Banking Law Journal.*
Copyright © 2012 THOMPSON MEDIA GROUP LLC. 1-800-572-2797.

BACKGROUND

BankAtlantic Bancorp, Inc. ("Bancorp"), whose stock trades on the New York Stock Exchange, was formed in 1994 to serve as a bank holding company for BankAtlantic, a federally chartered savings bank. Bancorp has no meaningful assets other than the stock of BankAtlantic, so its success depended on the bank's results. Bancorp's top two officers, Alan Levan and John Abdo, own a majority of the voting shares of Bancorp's controlling stockholder. Beginning in 2002, Bancorp sought to grow BankAtlantic's business by developing its brand and increasing core deposits.

To help finance its growth strategy, Bancorp raised approximately $285 million through the issuance of trust preferred securities ("TruPS") traded on the Nasdaq Stock Exchange. The TruPS were issued by 13 wholly-owned trust subsidiaries, the sole assets of which consisted of junior subordinated notes issued by Bancorp pursuant to the terms of substantially identical indentures — all but one of which was governed by New York law — with an institutional trustee. The terms of the TruPS mirrored the terms of the junior subordinated notes, such that interest payments on the junior subordinated notes could be used by the related trust subsidiary to make corresponding dividend payments on the TruPS. To protect the TruPS investors, the indentures "generally prohibit[] Bancorp from transferring all or substantially all of its assets" unless Bancorp complies with the "Successor Obligation Provision" requiring the purchaser to assume "the due and punctual payment of all payments due on all of the [junior subordinated notes] in accordance with their terms…." Under then current banking regulations, Bancorp was permitted to treat the junior subordinated notes as equity capital while simultaneously deducting TruPS dividend payments as interest expense for tax purposes.

In the face of substantial losses in BankAtlantic's loan portfolio, which was concentrated in the hard hit Florida real estate market, Bancorp's stock price fell from $142.42 at the beginning of 2007 to a low of $1.39 in March 2009. In 2008, Bancorp began to defer interest payments on the junior subordinated notes, which in turn forced BankAtlantic to stop paying dividends on the TruPS. When Bancorp failed to raise much-needed capital through rights offerings and asset sales, and under intense pressure from the Office of Thrift Supervision, Bancorp embarked on a whole company sale process in the fall of 2010. The sale process had limited success, but did attract one bid that Levan

found to be inadequate and was rejected by the Bancorp board of directors.

By July 2011, Levan and his financial advisors decided to employ a "good bank/bad bank" structure to make BankAtlantic more attractive to prospective bidders. Prospective bidders were advised that Bancorp would consider only offers with an "effective deposit premium" in excess of 10 percent, payable not in cash but rather through exclusion from the sale of "'criticized assets,' such as non-performing loans and foreclosed real estate." These assets would be retained and managed by Bancorp in a newly-established vehicle known as Retained Assets LLC. Bancorp also would retain the payment obligations in respect of the junior subordinated notes.

Only one bidder, BB&T Corporation, met Bancorp's demand for a 10 percent deposit premium, and on November 1, 2011, Bancorp announced the sale of BankAtlantic to BB&T. Three sequential steps would be required to accomplish this sale:

- First, BankAtlantic would transfer the "criticized assets" to Retained Assets, LLC;
- Second, BankAtlantic would distribute the membership interests in Retained Assets, LLC to Bancorp; and
- Third, Bancorp would transfer the stock of BankAtlantic to BB&T.

The market reacted favorably to the announcement of the transaction and Bancorp agreed to bring current the deferred TruPS dividend payments. Nevertheless, later that month, both the indenture trustees and individual TruPS holders brought suit against Bancorp, alleging that the transaction violated the successor obligor provisions of the indentures. As a remedy, plaintiffs sought either an injunction of the sale of BankAtlantic to BB&T or an order requiring BB&T to comply with the successor obligor provisions.

THE COURT'S ANALYSIS

Analysis of the Successor Obligor Provision

The court first considered whether the sale to BB&T, as structured, would violate the successor obligor provisions of the indentures under principles of

New York contract law. The court explained that indenture provisions generally contain "market-facilitating boilerplate language" that is "not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties…." As such, "[c]ourts strive to give indenture provisions a consistent and uniform meaning because uniformity in interpretation is important to the efficacy of the capital markets." In interpreting such "boilerplate" provisions, the court "will not look to the intent of the parties, but rather the accepted common purpose of such provisions."[2] Further, the court explained that successor obligor provisions are included in indentures "because, if the issuer transferred substantially all of its assets, then 'the obligor named in the indenture would cease to operate the business to which, in practical effect, the debentureholders have looked for payment of the debentures.'"

Against this backdrop, the court embarked on both a "quantitative and qualitative" analysis of the relevant factors to determine whether the transaction constituted a sale of substantially all of the assets of Bancorp requiring BB&T to assume Bancorp's obligations under the indentures consistent with the successor obligor provisions. The court explained that "[a]t times, the quantitative percentage of assets sold may be so low that examining the qualitative factors is unnecessary." But "[i]n the typical case involving a significant sale, however, a court will need to weigh both quantitative and qualitative factors as a totality."

Quantitative Analysis

Bancorp argued that the transaction would not constitute a sale of substantially all its assets on the basis that "BankAtlantic (the 'good bank') is worth nothing, while Retained Assets LLC (the 'bad bank') is worth $606.9 million." This argument was premised on Bancorp's contention that BB&T was delivering "zero consideration" for the assets it was receiving because no cash was changing hands.

The court refused to view as separate the "three interrelated transactions" that would culminate with the sale of BankAtlantic — devoid of the "criticized assets" — to BB&T. To the contrary, "none of the transactions can take place unless all three take place." If it accepted Bancorp's argument, the court explained, it "would pave an easily traveled superhighway around the substantially all test" that "future transaction planners" could utilize to "side-

step the restriction whenever a subsidiary had sufficient assets to distribute consideration to the parent."

Consistent with this approach, the court cited book value data in Bancorp's public filings in determining that Bancorp was conveying between 85 percent to 90 percent of its assets to BB&T. The court found that Bancorp's position that "BankAtlantic will be made less valuable, rather than more valuable, by shedding the Retained Assets is counterintuitive and inherently suspect." Rather than receiving "zero consideration" for the BankAtlantic stock, the court declared, "Bancorp gives the stock of BankAtlantic and gets membership interests in Retained Assets LLC. One is consideration for the other."

Qualitative Analysis

Bancorp argued that "Retained Assets LLC will continue most of the lines of business that [Bancorp's] subsidiaries have historically engaged in." In contrast, the court pointed out that BankAtlantic was Bancorp's "only operating asset" and its sale to BB&T would "change fundamentally the nature of Bancorp's business." While there might be "high-level similarities between the lines of business that BankAtlantic currently conducts and the lines of business in which Retained Assets LLC will engage," the court noted, "a continuing conceptual resemblance is not sufficient" to rebut the conclusion that Bancorp was proposing to sell substantially all of its assets. Rather, when all is said and done, Bancorp "would cease to operate the business to which, in practical effect, the holders of [TruPS] looked for payment." The court characterized this as the "guiding inquiry when evaluating a transaction qualitatively…."

Based on its analysis of these various quantitative and qualitative factors, the court concluded that Bancorp's sale of BankAtlantic to BB&T "will constitute a transfer of substantially all of Bancorp's assets." Moreover, because BB&T is not assuming Bancorp's obligations under the junior subordinated notes, the transaction "will breach the Successor Obligation Provision" of each of the indentures.

FASHIONING A REMEDY

Because the sale as structured would trigger an event of default under the indentures, the court recognized that the trustees would have the right to

accelerate $290 million in payments on the junior subordinated notes. The court also recognized that “Bancorp cannot pay off the accelerated debt.” In the court’s view, this represented a threat of “irreparable harm” to the TruPS holders that warranted equitable relief.

Bancorp’s contention that such a remedy would cause an even greater hardship to Bancorp did not dissuade the court. According to the court, “a party cannot ‘abrogate a contract, unilaterally, merely upon a showing that it would be financially disadvantageous to perform it; were the rules otherwise, they would place in jeopardy all commercial contracts.’… This is particularly so for indentures, which provide the holders of unsecured debt with their only protections. Companies will find it more costly and difficult to raise financing if the contractual protections in an indenture can be ignored when the issuer faces financial difficulty. That is precisely when creditors most need their contract rights.”

On this basis, the court entered an order “permanently enjoining Bancorp from consummating the sale.”

CONCLUSION

The *BankAtlantic* decision affirms that novel sale structures may not be used to evade the basic contractual rights of debtholders under an indenture. When a court labels the language of an indenture as “boilerplate,” arguments that the parties intended a meaning contrary to accepted commercial expectations will likely fall on deaf ears. The recognition by the *BankAtlantic* court of the sanctity of so-called “boilerplate” provisions should be of comfort to investors in public securities who are rarely given an opportunity to negotiate the terms of their investments, and will facilitate the ability of companies to utilize this important source of financing for their capital needs.

POSTSCRIPT

Less than one month after the court enjoined the transaction, BB&T and Bancorp restructured their deal so as to avoid triggering the successor obligor provisions of the indentures. Under the revised terms, BB&T agreed to assume the payment obligations under the TruPS and, in return, will receive

a 95 percent preferred interest in a new entity holding $500 million in risky loans that Bancorp originally planned to house in Retained Assets LLC.

NOTES

[1] Consol. C. A. No. 7068-VCL (Del. Ch. Feb. 27, 2012).

[2] In this connection, the court cited the recent decision of the Delaware Supreme Court in *Bank of N.Y. Mellon Trust Co. v. Liberty Media Corp.*, 29 A.3d 225 (Del. 2011), also applying New York contract law.