

January 2021

## Reconciling the Dormant Conflict: Crafting a Banking Exception to the Fraudulent Conveyance Provision of the Bankruptcy Code for Bank Holding Company Asset Transfers

Cassandra Jones Havard

Follow this and additional works at: <https://digitalcommons.du.edu/dlr>

---

### Recommended Citation

Cassandra Jones Havard, Reconciling the Dormant Conflict: Crafting a Banking Exception to the Fraudulent Conveyance Provision of the Bankruptcy Code for Bank Holding Company Asset Transfers, 75 Denv. U. L. Rev. 81 (1997).

This Article is brought to you for free and open access by the University of Denver Sturm College of Law at Digital Commons @ DU. It has been accepted for inclusion in Denver Law Review by an authorized editor of Digital Commons @ DU. For more information, please contact [jennifer.cox@du.edu](mailto:jennifer.cox@du.edu), [dig-commons@du.edu](mailto:dig-commons@du.edu).

# RECONCILING THE DORMANT CONFLICT: CRAFTING A BANKING EXCEPTION TO THE FRAUDULENT CONVEYANCE PROVISION OF THE BANKRUPTCY CODE FOR BANK HOLDING COMPANY ASSET TRANSFERS

CASSANDRA JONES HAVARD\*

## I. INTRODUCTION

Banking law and bankruptcy law clash. This is most evident when a bank holding company (parent company)<sup>1</sup> becomes insolvent *after* it has made an asset transfer<sup>2</sup> to its financially troubled bank subsidiary.<sup>3</sup>

The Bankruptcy Code (Code) governs the insolvency proceedings of the bank holding company.<sup>4</sup> Predictably, the parent company's trustee,

---

\* Associate Professor of Law, Temple University Law School. B.A., 1978, Bennett College; J.D., 1981, University of Pennsylvania. I am grateful for the helpful comments of Rick Greenstein and Rafael Porrata-Doria on an earlier draft of this article, for the research assistance of Michael Adler and Todd Winneck, and for the financial assistance of the Temple University School of Law.

1. A parent company or bank holding company is a "company which has control over any bank or over any company that is or becomes a bank holding company . . . if the company directly or indirectly owns, controls, or has power to vote 25 per centum . . . of any voting securities . . ." 12 U.S.C. § 1841(a)(1)-(2) (1994). *See generally* Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L.J. 287 (1996) (stating the nonoperating parent company ownership of operating subsidiaries is the norm in banking law, as well as in other industries).

2. "Asset transfer" is the bankruptcy reference describing the shifting of capital from a debtor to a creditor. The term correlates to banking law's capital maintenance obligation when the parent company making the transfer is insolvent or becomes insolvent as a result of the transfer. A parent company that controls an undercapitalized bank subsidiary may implement a Capital Restoration Plan (CRP), which sets forth how the parent company will recapitalize or basically infuse funds into the bank subsidiary.

3. "Bank subsidiary" refers to federally insured depository institutions commonly called banks and thrifts.

4. The Bankruptcy Code, 11 U.S.C. §§ 101-1330 (1994) (providing a priority scheme designed to treat all creditors equally). *See* Nathanson v. NLRB, 344 U.S. 25, 29 (1952) ("The theme of the Bankruptcy Act is 'equality of distribution' and if one claimant is to be preferred over others, the purpose should be clear from the statute."); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) (explaining ratable distribution among creditors is one of bankruptcy law's primary purposes); William T. Bodoh & Michelle M. Morgan, *Inequality Among Creditors: The Unconstitutionality of Successor Liability to Create a New Class of Priority Claimants*, 4 AM. BANKR. INST. L. REV. 325, 347-49 (1996) (explaining that state successor liability claim, which operates to give certain creditors a windfall over others, is also in direct conflict with well-established principles of federal preemptions under the Code and extension of such liability should be left to Congress pursuant to its exclusive jurisdiction on the issue of bankruptcy); Donald R. Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541, 602 (1993) (stating that the policy of equality flows from concern for "the welfare of unsecured creditors who lack influence" and signifies a normative commitment to rational planning).

appointed for the protection of *all* the creditors of the bankrupt entity,<sup>5</sup> uses the fraudulent conveyance provision of the Code to have any asset transfers that were made to the bank subsidiary returned to the debtor's estate.<sup>6</sup> The good faith exception to that provision will protect the asset transfer only if the parent company made the transfer for "good and fair consideration."<sup>7</sup>

The banking laws govern the regulation of the entire banking industry, including the insolvency of a financial institution.<sup>8</sup> The banking laws, arguably, provide preferential treatment<sup>9</sup> for the Federal Deposit

5. S. REP. NO. 95-989, at 49 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5835; H.R. REP. NO. 95-595, at 177-78 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138.

6. Fraudulent conveyance law applies where the debtor receives *less than reasonably equivalent value* in exchange for the assets transferred or the obligations incurred, if the debtor was or became insolvent, after giving effect to the transfer or obligation. 11 U.S.C. § 548(a)(2)(A) (1978). Under the traditional analysis, an insolvent bank subsidiary cannot exchange reasonably equivalent value when its parent company makes an asset transfer. *See discussion infra* Part III.B.1.

11 U.S.C. § 547(b) (1994) states that the Code also provides for avoidance of a transfer under the preference provisions. Under that provision, the usual 90-day period is extended to one year for an affiliate or insider, such as a bank subsidiary. 11 U.S.C. §§ 101(2)(B), 101(31)(E) (1994). Assuming that the elements of that section are met, a possible defense to a preference recovery is that the transfer was made in the ordinary course of business. *See John C. Deal et al., Capital Punishment: The Death of Limited Liability for Shareholders of Federally Regulated Financial Institutions*, 24 *CAP. U. L. REV.* 67, 121 (1995) (arguing that the ordinary course of business defense may fail given the amount of the transfers and presuming that the financial institution solvency status is weakened continually over the one-year period).

The fraudulent conveyance provision is the focus of the proposed amendment because its focus on the value of the exchange between the debtor and the transferee correlates with the enterprise liability theory, the premise of parent company liability. *See discussion infra* Parts IV-V.

7. *See discussion infra* Part II.B.1.

8. *See generally* *Fidelity Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982) (describing the comprehensive framework that Congress has granted to the [bank regulators] as broad discretionary powers to regulate the industry, and referring to the regulatory scheme as "cradle to . . . grave" regulation).

When a bank subsidiary fails, the regulatory scheme provides for the appointment of a receiver for the orderly distribution of the financial institution's assets. 12 U.S.C. § 1821(c) (1994). It is the financial institution's receiver that reviews the trustee's request to have the parent company's assets returned to the parent company's estate. *See discussion infra* Part II.A.3.a. regarding *MCorp Financial, Inc. v. Board of Governors of the Fed. Reserve Sys.*, 900 F.2d 852 (5th Cir. 1990) *aff'd in part, rev'd in part*, 502 U.S. 32 (1991) (denying bank holding company's application to the bankruptcy court for an automatic stay of the regulatory agency's administrative proceedings upon filing of bankruptcy petition and finding that the district court had no jurisdiction over the claim because it was not ripe for judicial review until the conclusion of the administrative proceedings).

9. Many courts have expressed dissatisfaction with the incongruence between the banking insolvency laws and the bankruptcy laws, which seem to give the Federal Deposit Insurance Corporation (FDIC) uncontrollable powers. *See FDIC v. Continental Fin. Resources, Inc. (In re Continental Financial Resources, Inc.)*, 154 B.R. 385, 388 (D. Mass. 1993) (holding compliance with the Financial Institutions Reform, Recovery and Enforcement Act's (FIRREA) administrative claims procedure is not required before bankruptcy court can hear complaints that do not fall within the definition of claims under FIRREA but that are incident to FDIC's claims against its debtor); *FDIC v. Purcell (In re Purcell)*, 150 B.R. 111, 114 (D. Vt. 1993) (explaining that because a provision in FIRREA's administrative claims procedure referring to "claims" applies only to claims by creditors, the provision does not prevent the bankruptcy court from exercising jurisdiction over debtor's cause

Insurance Fund as a failed financial institution's potentially largest unsecured creditor.<sup>10</sup> Banking law allows the parent company to make an asset transfer to avoid the threat of mandated restrictions.<sup>11</sup> It also gives an unfulfilled payment a priority status in bankruptcy.<sup>12</sup> The rules do not state, however, under what circumstances an unfunded capital obligation ought to be allowed. The legality of the asset transfer when a parent company seeks bankruptcy protection is a crucial question for the banking industry.

Establishing an accord when the parent company and its bank subsidiary are both financially troubled requires a recognition of the interrelatedness of the financial resources of the parent company and its bank subsidiary.<sup>13</sup> This approach, which examines the enterprise as a unit, requires close control and monitoring by the parent company of its subsidiary's operations. Specifically, Congress should legislate a fraudulent conveyance exception for parent company asset transfers. Such a provision would require a determination of enterprise liability by either banking regulators or the parent company. The banking regulators must establish that the parent company, through interaffiliate transactions, is risking the capital of the bank subsidiary. Alternatively, the parent company may elect to declare its choice of corporate operation as an integrated enterprise, routinely using the bank subsidiary assets to maximize

---

of action against FDIC as receiver for failed bank); *All Season's Kitchen, Inc. v. FDIC* (*In re All Season's Kitchen, Inc.*), 145 B.R. 391, 393 (Bankr. D. Vt. 1992) ("[W]e believe that the new legal theory being advanced by FDIC and RTC in Bankruptcy Courts across the country threatens the efficient functioning of the federal Bankruptcy system."); *In re Gemini Bay Corp.*, 145 B.R. 350, 352 (Bankr. M.D. Fla. 1992) (holding FIRREA does not preclude the bankruptcy court from exercising jurisdiction over the resolution of creditor's objections to FDIC's claim against debtor's estate because the claim does not involve FDIC's claim against assets of the failed institution).

10. 12 U.S.C. § 1823 (1994) (stating that while the federal government guarantees that the deposit insurance fund will meet its obligations to depositors, taxpayers are ultimately liable).

The FDIC is commonly the largest creditor of the receivership estate. The FDIC operates in dual capacities: as FDIC-Corporate and FDIC-Receiver. When an institution fails, the FDIC-Corporate pays insured depositors. It then becomes a general creditor in the receivership estate of the failed institution for the amount that it has paid to insured depositors. 12 U.S.C. § 1821(f) (1994). The FDIC-Receiver satisfies secured claims. It "stands in the shoes" of the member institution and liquidates the assets for distribution to the creditors. Unsecured creditors, such as the FDIC-Corporate, are paid ratably. 12 U.S.C. § 1821(g) (1994). Member institutions fund the FDIC by paying insurance premiums based upon the financial institution's deposit base. 12 U.S.C. § 1817(b) (1994).

11. Capital-based regulations impose stringent regulatory controls, including dividend and growth restrictions and forced conservatorship. There are five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. See Federal Deposit Insurance Corporation Improvement Act of 1991 § 38(b)(1), 12 U.S.C. § 1831(o)(b)(1) (1994).

12. The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) gives a priority status to unfunded capital maintenance obligations. 11 U.S.C. § 365(o) (1994). See discussion *infra* Part III.C.

13. Bankruptcy law labels the concept substantive consolidation. See *infra* note 141 and accompanying text. This article posits that there should be a pre-petition recognition of the relatedness of the enterprise given the moral hazard of federal deposit insurance in the banking industry.

profits and diversify losses of the entire undertaking.<sup>14</sup> Either situation would immunize an asset transfer should the parent company file for bankruptcy protection. The bankruptcy court's jurisdiction over these particular assets of the debtor parent company's estate would be limited to an evidentiary review for procedural sufficiency. FDIC-Receiver would cease to have a review function over these assets. Moreover, if FDIC-Corporate assesses cross-guarantee liability against the sister institutions, the asset transfers would serve as a credit against the amount of the liability. Legally, such a proposal may be the only way that a capital-weakened parent company, that decided pre-bankruptcy to shore up its bank subsidiary, may avoid the fraudulent conveyance provision.

Part II of the article identifies the statutory basis for the dormant conflict between Titles 11 and 12. Specifically, this section lists the broad array of somewhat identical discretionary powers that both the bankruptcy court and the banking regulatory agencies have as trustee and receiver for insolvent corporations and financial institutions, respectively. Part II concludes with an analysis of the cases in which these discretionary powers of the trustee and the receiver have come into conflict.

Part III discusses the bankruptcy of the Bank of New England Corporation (BNEC). The factual history of this case provides an example of the types of legal issues that an insolvent holding company faces under the banking laws when it files for protection under the Bankruptcy Code. The section ends by specifying post-BNE legislative reforms designed to address issues raised during the liquidation of that failed enterprise.

Part IV identifies the statutory rights that creditors have under the fraudulent conveyance law, including the good faith exception. Finally, Part V proposes an amendment to the current regulatory scheme that would require asset transfers from an insolvent holding company. It posits that the policies supporting the good faith exception are not compromised by the concomitant goal of protecting the Federal Deposit Insurance Fund. The banking enterprise exception establishes a procedure for regulatory assets transfers that is reviewable by the bankruptcy court, and operates as a credit against cross-guarantee liability. The proposed change will more closely merge the policies and purposes of the two schemes that converge when a bank holding company becomes insolvent.

---

14. Most parent companies maintain the capital status of their bank subsidiaries voluntarily because it is in the best interest of the enterprise. H. Rodgin Cohen, *Easing FDICIA's Burden: A Holding Company Level Approach to Compliance*, 11 No. 21 BANKING POL'Y REP. 1, 29 (1992) (suggesting that mandating compliance with many banking regulations at the parent company level would be cost-effective and consistent with the exercise of parent company control). *But see* Helen A. Garten, *Subtle Hazards, Financial Risks, and Diversified Banks: An Essay on the Perils of Regulatory Reform*, 49 MD. L. REV. 314 (1990).

## II. THE STATUTORY CONFLICTS: EQUITABLE AND LEGAL REMEDIES

### A. *Equitable Relief*

The confluence of the bankruptcy protection and the bank regulatory authority raises the issue of the interaction between the automatic stay and the anti-injunction provision.<sup>15</sup> Among the protections that a debtor seeks by filing a bankruptcy petition is a restraint from creditors pursuing repayment of debts. The automatic stay provision of the Bankruptcy Code provides this protection. However, if the debtor is a parent company with an outstanding capital maintenance commitment, the bank failure regulatory scheme allows administrative intervention that could upset those insolvency procedures. As regulators of parent companies, the Federal Reserve and OTS have broad power to charge the failure to follow any banking law or regulation as an unsafe and unsound practice and to issue a cease and desist order to halt the particular practice.<sup>16</sup> One question that needs to be answered is which statutory scheme, bankruptcy or bank failure law, controls the debtor parent company's unfunded capital obligation.

#### 1. The Bankruptcy Trustee's Powers: 11 U.S.C. § 362—The Automatic Stay<sup>17</sup>

The filing of a petition in bankruptcy, without any further action, results in a suspension of legal proceedings as an operation of law.<sup>18</sup> This anti-injunction power is in the form of an automatic stay. The automatic

15. 11 U.S.C. § 362 (1994) (explaining the automatic stay provision); 12 U.S.C. § 1821(j) (1994) (describing the anti-injunction provision). See discussion *infra* Part II.

16. 12 U.S.C. § 1818(c)(2) (1994).

17. The automatic stay provision provides in pertinent part:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title . . . operates as a stay, applicable to all entities . . . .

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay . . . .

(4) under subsection (a)(1) of this section, of the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power;

(5) under subsection (a)(2) of this section, of the enforcement of a judgment, other than a money judgment, obtained in an action or proceeding by a governmental unit to enforce such governmental unit's police or regulatory power, . . .

11 U.S.C. § 362(a), (b)(4)-(5) (1994).

18. The Code provides two options for debtors hoping to seek relief and protection from creditors. One option, a Chapter 7 liquidation, allows the debtor to obtain a complete discharge or release from liability on all pre-bankruptcy debt. In Chapter 7 proceedings, there is a court-appointed trustee who manages the debtor's estate. The trustee removes the debtor from control of its property and then takes charge of all nonexempt property of the debtor, converts it into cash and equitably distributes the proceeds to creditors. 11 U.S.C. § 721 (1994).

The other option, a Chapter 11 reorganization, allows the debtor to make a court-approved schedule of payments to its creditors over time. In Chapter 11 proceedings, the debtor may maintain management of its estate. However, in either proceeding, the bankruptcy court oversees most of the decisions of the trustee or the debtor regarding the management of the estate. The court also hears claims raised by creditors regarding the management of the estate. 11 U.S.C. §§ 1101-1102 (1994).

stay prevents the commencement or continuation of any action or proceeding against the debtor or the property of the estate; any act to create, perfect, or enforce a security interest in the debtor's property; and any act to collect, assess, or recover a claim against the debtor or the property of the estate.<sup>19</sup> There are several exceptions to the issuance of an injunction. Noteworthy is that issuance of the injunction is not authorized if the operation of the stay will serve to undercut a governmental unit's police or regulatory powers.<sup>20</sup>

## 2. The Anti-Injunction Power: 12 U.S.C. §§ 1818(i)<sup>21</sup> and 1821(j)<sup>22</sup>

The federal banking laws empower the bank regulatory agencies to regulate the supervision and operation of federally insured financial institutions.<sup>23</sup> As administrative agencies with broad supervisory powers, their regulatory processes operate free from judicial interference until there is a final agency action. The administrative agencies have an anti-injunction power similar to that found in bankruptcy.<sup>24</sup>

The banking laws also provide for the reorganization and liquidation of insolvent financial institutions.<sup>25</sup> Specifically, they provide for the appointment of the FDIC as conservator or receiver.<sup>26</sup> As receiver, the FDIC has an anti-injunction power that bars courts from taking any action by regulation or order that would restrain or affect the powers or

---

19. 11 U.S.C. § 362(a) (1994).

20. 11 U.S.C. § 362(b) (1994). See discussion *infra*, Part II.A.3.a. regarding *MCorp*. Recently, creditors have begun negotiating a pre-petition agreement waiving the court's impost of the automatic stay. See Rafael Efrat, *The Case for Limited Enforceability of a Pre-Petition Waiver of the Automatic Stay*, 32 SAN DIEGO L. REV. 1133 (1995); cf. William Bassin, *Why Courts Should Refuse to Enforce Pre-Petition Agreements That Waive Bankruptcy's Automatic Stay Provision*, 28 IND. L. REV. 1 (1994).

21. 12 U.S.C. § 1818(i) restricts jurisdiction of the courts, stating that "[n]o court shall have jurisdiction to affect by injunction or otherwise the issuance or enforcement of any notice or order under any such section, or to review, modify, suspend, terminate or set aside any such notice or order." 12 U.S.C. § 1818(i) (1994).

22. Section 1821(j) provides, "[e]xcept as provided in this section, no court may take any action except at the request of the Board of Directors by regulation or order, to restrain or affect the exercise of powers or functions of the [FDIC] as a conservator or a receiver." 12 U.S.C. § 1821(j) (1994).

23. The federal banking agencies have the authority to impose administrative sanctions whenever there is (1) an unsafe or unsound practice; (2) a violation of a law, rule or regulation, any condition imposed in writing by the agency in connection with the granting of an application or other request, or any other written agreement entered into with the agency. See 12 U.S.C. § 1818(b) (1994).

24. Section 1818(i)(1), which is analogous to § 1821(j), is the anti-injunction provision available to federal banking regulators.

25. 12 U.S.C. § 191 (1994).

26. The Federal Reserve also regulates state-chartered banks that are members of the Federal Reserve system. 12 U.S.C. § 248(a) (1994). The Office of the Comptroller of the Currency (OCC), an agency within the Department of the Treasury, charters and supervises national banks. 12 U.S.C. § 21 (1994). It also makes the determination of when to close those institutions. 12 U.S.C. § 191 (1994).

functions of the FDIC, except at the request of the FDIC.<sup>27</sup> By giving the receiver absolute control over the affairs of the insolvent financial institution, Congress has precluded judicial intervention into the receiver's exercise of its discretionary powers.<sup>28</sup>

### 3. The Automatic Stay vs. the Anti-Injunction Power

The federal banking agencies have wielded their substantial powers skillfully, albeit with an air of unseemliness. Three cases that follow examine the bank regulatory agencies' successful challenges to the operation of the automatic stay in bankruptcy.

#### a. MCorp v. Board of Governors of the Federal Reserve System (MCorp)<sup>29</sup>

The jurisdictional conflict between the courts and the bank agency was first tested in *MCorp*. *MCorp* addressed and resolved the issue of whether the Bankruptcy Code's automatic stay was applicable to internal administrative agency provisions.<sup>30</sup>

MCorp, a Texas bank holding company in voluntary bankruptcy, filed for application of the automatic stay to enjoin the Federal Reserve from continuing two administrative proceedings concerning its affairs.<sup>31</sup> MCorp operated a system of twenty-five subsidiary banks throughout the state of Texas.<sup>32</sup> Prior to its bankruptcy, the Federal Reserve had issued cease and desist orders requiring MCorp to restore the capital levels of several MCorp bank subsidiaries.<sup>33</sup> Arguing that the administrative

---

27. 11 U.S.C. § 362(a) (1994).

28. Many commentators have described the FDIC's powers as receiver for an insolvent financial institution as "superpowers" because they are analogous to the bankruptcy court's broad sweep of discretion under the Code. See generally Richard F. Broude, *The Unstoppable Force Meets the Immovable Object: FIRREA and the Bankruptcy Code*, 715 PLI/COMM 559 (1995); Steven Khadavi, *The Viability of Maintaining Successful Actions Against the RTC and the FDIC*, 63 GEO. WASH. L. REV. 665 (1995); Carol Anne Sennello, *FIRREA's Damage Provisions: Inequitable, Unnecessary and Costly to Boot*, 45 DUKE L.J. 183 (1995); Peter P. Swire, *Bank Insolvency Laws Now That It Matters Again*, 42 DUKE L.J. 469 (1992); Jeffrey S. Westin, *Contract Repudiation and Claim Determination Under FIRREA: The Need for FDIC Restraint and Legislative Reform*, 12 ANN. REV. BANKING L. 557 (1993).

29. 101 B.R. 483 (Bankr. S.D. Tex. 1989), *rev'd in part and vacated in part*, 900 F.2d 852 (5th Cir. 1990), *rev'd on other grounds*, 502 U.S. 32 (1991).

30. *MCorp*, 101 B.R. at 483.

31. The Federal Reserve brought an administrative action requiring the holding company to inject capital into its failing bank subsidiaries. The holding company, which filed for bankruptcy after the beginning of the administrative proceedings, sought the protection of the bankruptcy court's automatic stay provision to terminate the administrative agency's proceedings.

32. Because Texas had restrictions on branch banks, MCorp, like many bank holding companies, chose the holding company structure to evade those restrictions. See generally Robert Charles Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787 (1979) (discussing the holding company structure in the context of government regulation).

33. The Federal Reserve and the FHLBB, which is now OTS, interpreted their respective chartering statutes to permit net worth maintenance agreements and the source of strength condition. See 12 U.S.C. § 1467(a), (e)(2) (1994) (thrifts); 12 U.S.C. § 1842(c) (1994) (banks) (authorizing an



agency no longer had jurisdiction given its insolvency, the parent company sought the protection of the bankruptcy stay.<sup>34</sup> Claiming that the stay was inapplicable to an internal, ongoing agency proceeding, the Federal Reserve barred application of the stay under section 1818(I)(1).<sup>35</sup> The Supreme Court concluded that the stay did not operate under two exceptions: (1) in furtherance of regulatory or governmental proceedings and (2) powers.<sup>36</sup> The Court's ruling exempted the administrative proceedings from the automatic stay until there was final agency action.<sup>37</sup>

*MCorp* did not specifically address whether the bankruptcy court should have concurrent jurisdiction over a final administrative proceeding. On close examination of the bankruptcy regime, there is no jurisdictional conflict between the administrative agency and the bankruptcy court. Not only does the Code give the bankruptcy court exclusive jurisdiction over the property of the debtor's estate,<sup>38</sup> the bankruptcy court exercises concurrent jurisdiction in analogous situations.<sup>39</sup>

---

evaluation of the projected financial and managerial ability of a potential parent company's current and future financial ability to assist the bank or thrift in maintaining its capital). Using net worth maintenance agreements (thrifts) or regulatory orders based on the source of strength condition (banks), the regulators ordered the parent company to transfer funds to an insolvent subsidiary. See Cassandra Jones Havard, *Back to The Parent: Holding Company Liability for Subsidiary Banks—Discussion of the Net Worth Maintenance Agreement, the Source of Strength Doctrine, and the Prompt Corrective Action Provision*, 16 CARDOZO L. REV. 2353, 2370-91 (1995). Several financial institutions that received such orders challenged the authority of the regulatory agencies to issue them, alleging that the orders were unspecific regarding the amount of the financial commitment and/or when it became effective. See generally Leonard Bierman & Donald R. Fraser, *The "Source of Strength" Doctrine: Formulating the Future of America's Financial Markets*, 12 ANN. REV. BANKING L. 269 (1993); Craig L. Brown, *Board of Governors v. MCorp Financial, Inc.: Evaluating the Source-of-Strength Doctrine*, 21 HOFSTRA L. REV. 235 (1992); Kieran J. Fallon, *Source of Strength or Source of Weakness?: A Critique of the "Source-of-Strength" Doctrine in Banking Reform*, 66 N.Y.U. L. REV. 1344 (1991); James F. Groth, *Can Regulators Force Bank Holding Companies to Bail Out Their Failing Subsidiaries?—An Analysis of the Federal Reserve Board's Source-of-Strength Doctrine*, 86 NW. U. L. REV. 112 (1991).

34. *MCorp*, 101 B.R. at 485.

35. 12 U.S.C. § 1818(i)(1), which is analogous to section 1821(j), is the Federal Reserve Board's anti-injunction statute. See *supra* text accompanying notes 21, 22.

36. 11 U.S.C. § 362(b)(4), (5) (1994). See *supra* text accompanying note 17.

37. 11 U.S.C. § 362(b)(4), (5) (1994).

38. 28 U.S.C. 1334(b) (1994).

39. The Supreme Court agreed with the Fifth Circuit's interpretation that the statute's specific application is limited to jurisdictional confrontations between district courts. Perhaps hinting at its leanings, the Court said, "prosecution of the Board proceedings, prior to the entry of a final order and prior to the commencement of any enforcement action, seems unlikely to impair the Bankruptcy Court's exclusive jurisdiction over the property of the estate protected by 28 U.S.C. § 1334(d)." *Board of Governors of the Fed. Reserve Sys. v. MCorp Fin., Inc.*, 502 U.S. 32, 42 (1991).

b. *Carlton v. FirstCorp, Inc.*<sup>40</sup>

In *Carlton v. FirstCorp, Inc.*, the Fourth Circuit Court of Appeals held that the Code's automatic stay provision would not operate to stay an ongoing administrative action by the OTS.<sup>41</sup> The court found that the anti-injunction provision of 12 U.S.C. § 1818(I)(1) precluded the bankruptcy court from interfering with internal agency proceedings as well as temporary cease and desist orders.<sup>42</sup> The effect of the court's ruling was to let stand an OTS order requiring the transfer of a solvent savings and loan to a capital-deficient one.

FirstCorp owned two institutions, First of Raleigh and First of Durham.<sup>43</sup> When the Raleigh institution became insolvent (First of Durham remained financially sound), OTS placed it in federal receivership.<sup>44</sup> It also issued a temporary cease and desist order seeking a payment from the parent company of \$45 million, the amount needed to restore the institution to solvency.<sup>45</sup>

FirstCorp sought an injunction to suspend enforcement of the temporary cease and desist order and filed for protection under Chapter 11 of the Code.<sup>46</sup> The parent company requested an order from the bankruptcy court confirming that the automatic stay provisions of the Code suspended the internal OTS administrative proceedings and the temporary cease and desist order.<sup>47</sup> The bankruptcy court held that the automatic stay applied to both the ongoing OTS proceeding and to the temporary order.<sup>48</sup> The district court reversed the bankruptcy court's decision holding that the automatic stay applied neither to the administrative proceeding nor to the temporary order.<sup>49</sup>

---

40. 967 F.2d 942, 943 (4th Cir. 1992). FirstCorp, Inc. was a savings and loan holding company in North Carolina that owned and operated two savings and loan associations, First of Durham and First of Raleigh. The Federal Home Loan Bank Board (FHLBB), the designated regulator prior to the passage of FIRREA, conditioned the acquisition of the Raleigh institution on FirstCorp's maintaining the institution's net worth at appropriate levels.

41. *FirstCorp*, 967 F.2d at 946.

42. *Id.*

43. *Id.* at 943.

44. *Id.*

45. *Id.* at 944, n.3. OTS, as the regulator of savings and loan holding companies, then ordered the parent company to minimize the Raleigh institution losses. Specifically, OTS ordered FirstCorp to immediately transfer its stock in the Durham subsidiary to a subsidiary of the Raleigh institution and cancel and return two capital notes to the Raleigh institution that FirstCorp had received in exchange for the 1987 capital infusion of \$13.4 million. OTS also issued a "Notice of Charges" charging FirstCorp with committing an "unsafe and unsound practice" because it failed to maintain the Raleigh institution's net worth as agreed at the time of acquisition.

46. FirstCorp filed for the injunction in federal district court as authorized under the statute. The statute gives the affected institution ten days to request a court order to set aside, limit, or suspend enforcement of the administrative order. See 12 U.S.C. § 1818(c)(2) (1994).

47. *Carlton*, 967 F.2d at 942.

48. *In re FirstCorp, Inc.*, 122 B.R. 484, 491 (Bankr. E.D.N.C. 1990).

49. *In re FirstCorp, Inc.*, 129 B.R. 450, 452 (E.D.N.C. 1991).

The Fourth Circuit, in *FirstCorp*, extended the *MCorp* rule and held that the automatic stay provision of the Code is inapplicable to a temporary cease and desist orders under 12 U.S.C. § 1818(I)(1).<sup>50</sup> *FirstCorp* argued that the temporary cease and desist order was distinguishable from an ongoing administrative proceeding because it is a demand for the parent company to transfer assets of the bankruptcy estate immediately.<sup>51</sup> The circuit court explicitly rejected this argument.<sup>52</sup> The court did, however, limit its ruling to the application of the automatic stay to section 1818(I)(1).<sup>53</sup> The court expressly declined to make a ruling on whether the temporary cease and desist order is subject to the *MCorp* rule, falling within the *exceptions* to the automatic stay.<sup>54</sup>

The circuit court found in *FIRREA* that the RTC had exclusive jurisdiction to resolve the issues arising out of the failure of savings and loan institutions. It interpreted 12 U.S.C. § 1821(j) as absolute by prohibiting courts from restraining or affecting the RTC's right to manage, contract, and dispose of assets.<sup>55</sup> The court distinguished the two regulatory schemes by explaining that *FIRREA*'s focus is liquidation, while Title 11 is reorganization.<sup>56</sup> That distinction was significant in determining the limits of the bankruptcy court's equitable powers. The court stated, "[t]he comprehensive scheme of *FIRREA* indicates Congress' intent to allow the RTC full rein to exercise its statutory authority without injunctive restraints imposed by bankruptcy courts or district courts in other proceedings."<sup>57</sup>

---

50. *Carlton*, 967 F.2d at 946. The *In re FirstCorp* appeal raised two issues. The first, an issue of first impression, was whether the automatic stay provision was applicable to the temporary cease and desist order. The other issue, whether the automatic stay was applicable to internal administrative proceedings, had been resolved by *Board of Governors of the Fed. Reserve Sys. v. MCorp Fin.*, 502 U.S. 32 (1991). See *infra* Part II.A.3.a.

51. *Carlton*, 967 F.2d at 946.

52. The court instead based its decision on the existing laws and congressional policy supporting the regulation of the nation's banking system. It seemed significant to the court that the regulatory scheme provided the bank holding company with injunctive relief for temporary cease and desist orders as well as with an appeal process. The opinion concluded by stating that though "a comprehensive scheme governing the oversight of financial institutions, from administrative control through judicial review of the administrative agency's actions, and by explicitly making the scheme exclusive, Congress intended to exclude other methods of interfering with the regulatory action." *Id.* at 946.

53. *Id.*

54. 11 U.S.C. § 362(b)(4)-(5) (1994). See *Carlton*, 967 F.2d at 946, n.5.

55. *In re Landmark Land Co.*, 973 F.2d 283, 287 (4th Cir. 1992).

56. *In re Landmark Land Co.*, 973 F.2d at 288.

57. *Id.* at 290. In a related matter, *RTC v. FirstCorp, Inc.*, 973 F.2d 243 (4th Cir. 1992), the parent company was required to cure immediately the deficiency in its capital maintenance obligation for its subsidiary savings and loan institution as a prerequisite to maintaining its capital maintenance agreement, pursuant to 11 U.S.C. § 365(o) (1994).

c. *In Re Landmark Land Co., Inc. vs. RTC*<sup>58</sup>

Landmark Land Company (Landmark), which wholly owned Oaktree Savings Bank (Oaktree), caused or permitted six subsidiaries of Oaktree to file Chapter 11 petitions.<sup>59</sup> The OTS ordered Landmark, a nondebtor, to withdraw the bankruptcy petitions of the subsidiaries pursuant to 12 U.S.C. § 1818(i)(1).<sup>60</sup> Two days later, OTS declared Oaktree insolvent and appointed the RTC as receiver.<sup>61</sup> The RTC organized New Oaktree and applied to OTS for chartering.<sup>62</sup> The subsidiaries successfully obtained a preliminary injunction preventing RTC from assuming control of them.<sup>63</sup> Specifically, the injunction prevented the receiver from calling or initiating shareholder meetings of its subsidiaries, changing management, or interfering with the subsidiaries' orderly operations.<sup>64</sup> When the RTC moved to dismiss the temporary restraining order, the district court denied the motion and converted the TRO into a prelimi-

---

58. *In re Landmark Land Co.*, 973 F.2d at 283. See also Richard F. Hewitt, Jr., *In re Landmark Land Co.: A Landmark Roadblock for Bankruptcy Courts v. Federal Regulators?*, 45 S.C. L. REV. 68 (1993); *Landmark Land Co., v. OTS*, 990 F.2d 807 (5th Cir. 1993). OTS issued an order limiting directors' authority and freezing the assets of directors and their family members. The directors then sought to enjoin enforcement of the order. The court found that the district court abused its discretion in granting an injunction where it failed to apply the four criteria for entertaining a preliminary injunction. *Id.*

59. *In re Landmark Land Co.*, 973 F.2d at 287.

60. Landmark filed suit in the district court in Louisiana seeking to enjoin OTS from enforcing the order to withdraw the bankruptcy petitions of the subsidiaries. The Louisiana District Court enjoined the OTS, transferring the proceeding to the district court in South Carolina. The case went to the Fifth Circuit Court of Appeals on mandamus review, with OTS seeking to vacate the order of the Louisiana District Court. OTS argued that, although the cease and desist order required the parent court to withdraw the bankruptcy petitions, the district court lacked jurisdiction over administrative proceedings involving bank regulation and supervision. Furthermore, OTS contended that properly issued cease and desist orders could not be "related" to the bankruptcy proceedings because those orders would have no effect on the bankruptcy. See *Landmark Land Co. v. OTS*, 948 F.2d 910 (5th Cir. 1991) (stating that the district court supervising the bankruptcy proceeding could not exercise jurisdiction under 28 U.S.C. § 1334(b) to enjoin OTS's enforcement of an administrative order under 12 U.S.C. § 1818(I)(1)).

61. *In re Landmark Land Co.*, 973 F.2d at 287.

62. OTS used a purchase and assumption agreement in resolving the failure of Oaktree. Under that agreement, New Oaktree purchased all of RTC's right, title, and interest in Oaktree's assets, including its wholly owned subsidiaries. OTS then appointed RTC as conservator of New Oaktree. *Id.* at 284-85.

63. The subsidiaries initially received a temporary restraining order from the bankruptcy court against Oaktree, preventing it from calling a shareholder's meeting to elect new members to their board of directors. When OTS appointed the RTC as receiver, the subsidiaries moved to have the temporary restraining order converted into a preliminary injunction. The subsidiaries argued that the RTC's plan was to liquidate the assets of the subsidiaries to the disadvantage of the subsidiaries' creditors. *Id.* at 287-88. The bankruptcy court justified its actions in restraining the RTC as a need to protect the shareholders' interests and debtors' rights. *Id.*

64. The RTC issued a temporary cease and desist order against one of the subsidiaries, Landmark Land Company, Inc. and its four directors. The temporary cease and desist order was accompanied by a notice of charges for a permanent cease and desist order, removal and prohibition order, and civil penalties. The temporary cease and desist order was enjoined by the Eastern District of Louisiana, and the case was transferred to the District Court of South Carolina. *Landmark Land Co.*, 948 F.2d at 911.

nary injunction, preserving the separate status of the subsidiaries.<sup>65</sup> The court of appeals vacated that injunction.<sup>66</sup>

The circuit court determined that the issue of whether the bankruptcy court could issue the injunction was merely a question of statutory interpretation.<sup>67</sup> By finding that the plain language of the statute was consistent with its legislative history, the court decided that the RTC properly used its powers and the anti-injunction provisions barred any equitable relief.<sup>68</sup> The court reasoned that:

Congress has delegated the responsibility of resolving failed thrifts to the RTC, and resolution of a failed thrift requires control over all of the thrift's assets. Because the anti-injunction provision specifically precludes equitable interference, the district court may not prevent the RTC from exercising its lawful ownership rights based on the court's determination that current management is best suited to rehabilitate the thrift's bankrupt subsidiaries.<sup>69</sup>

The court's ruling effectively confined the parties' relief to a legal remedy. Those remedies are found in the receivership's claims procedure.<sup>70</sup>

---

65. *Id.*

66. *In re Landmark Land Co.*, 973 F.2d at 287, 290.

67. *Id.* at 289-90.

68. *Id.* at 287-90.

69. *Id.* at 290. The court distinguished *In re American Continental Corp.*, 105 B.R. 564 (D. Ariz. 1989) (declining to follow *In re American Continental Corp.* because the court found that the district court should have sustained the RTC's motion to dismiss the subsidiaries' voluntary petition for relief under Chapter 11, stating that the denial of the motion to dismiss was an interference with RTC rights and functions, and deciding that its statutory interpretation was also inconsistent with the RTC's statutory rights and functions). *In re Landmark Land Co.*, 973 F.2d at 289. The liquidation of Lincoln Savings and Loan Association (Lincoln) also raised issues involving the jurisdiction of the Code and the bank regulatory agencies. One day before FHLBB placed Lincoln into conservatorship, eleven wholly owned subsidiaries of Lincoln filed Chapter 11 petitions. FSLIC-conservator replaced management at the subsidiaries. Four months later, the FHLBB placed Lincoln in receivership and transferred its assets to a newly chartered savings and loan association. The RTC, as successor to the conservator of the newly chartered association, moved to disallow the Chapter 11 cases. The district court denied the motion and preserved the separate status of the subsidiaries. The circuit court vacated that injunction. *Id.*

70. See *infra* Part II.B.2 for discussion of 12 U.S.C. § 1821(d)(3)-(11) (1994).

## B. *The Legal Remedies*

### 1. The Trustee's Avoidance Power under 11 U.S.C. § 548<sup>71</sup>

The Bankruptcy Code provides for avoidance of asset transfers under preference and fraudulent conveyance provisions.<sup>72</sup> A debtor or its trustee may avoid transfers in which the creditor received more than it would be eligible to receive under the liquidation rules of Chapter 7 of the Bankruptcy Code.

A debtor or trustee in bankruptcy can avoid transfers that were actually or constructively fraudulent. Section 548 recognizes that transfers made in the year prior to bankruptcy may result in either actual fraud [(a)(1)]<sup>73</sup> or constructive fraud [(a)(2)],<sup>74</sup> meaning that the transfers were made without the transferor receiving "reasonably equivalent value."<sup>75</sup>

The Code provides an exception to the requirement that there be a reasonable exchange for value. The good faith exception gives the non-debtor party an opportunity to prove that the transaction was absent of fraudulent intent. If the transferee can prove a lack of intent to avoid the bankruptcy process by showing a legitimate exchange or bargain, the trustee must recognize the validity of that exchange and cannot avoid the transaction.<sup>76</sup>

---

71. 11 U.S.C. § 548 provides, in relevant part:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily-

(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548 (1994).

72. 11 U.S.C. § 547-48.

73. 11 U.S.C. § 548(a)(1).

74. 11 U.S.C. § 548(a)(2).

75. *Id.* See discussion *infra* Part IV.

76. The "good faith exception" provides, in relevant part:

[A] transferee or obligee of such transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d)(1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so

## 2. The FDIC-Receiver's Avoidance Power and Claims Procedure under 12 U.S.C. § 1821<sup>77</sup>

Analogous to the bankruptcy trustee's powers under section 362 is the FDIC's fraudulent conveyance provision, 12 U.S.C. § 1821(d). It allows the federal agency, acting as receiver, to avoid certain transfers of property, interests in property, or obligations incurred by, among others, a person who is a debtor of an FDIC-insured institution.<sup>78</sup> Two conditions must be met in order for the section to be applicable: (1) the transfer must be made or the obligation incurred within five years of the FDIC's appointment as receiver and (2) the transfer must be made or the obligation incurred with the intent to hinder, delay, or defraud the insured depository institution, receiver, or federal banking agency.<sup>79</sup> Furthermore, the FDIC has the right to recover fraudulently transferred property or its value for the benefit of the insured depository institution.<sup>80</sup> That right is "superior to any rights of a trustee or any other party (other than a party which is a Federal agency) under Title 11."<sup>81</sup>

12 U.S.C. § 1821 also operates as a jurisdictional bar for a court to act on claims regarding the assets of a failed financial institution's assets.<sup>82</sup> The statute grants the FDIC as conservator or receiver successor status to decide claims against the insolvent institution.<sup>83</sup> In its capacity as receiver, the statute authorizes the FDIC to exercise "all rights, titles, powers, and privileges of the insured depository institution . . . with respect to the institution and the assets of the institution."<sup>84</sup>

The statute and implementing regulations create an administrative process for determining the claims against the assets of a failed institution.<sup>85</sup> Specifically, until a creditor exhausts the administrative claims

perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

11 U.S.C. § 548(c)-(d)(1) (1994).

77. 12 U.S.C. § 1821 (1994).

78. 12 U.S.C. § 1821(d)(17)(A).

79. *Id.*

80. 12 U.S.C. § 1821(d)(17)(B).

81. 12 U.S.C. § 1821(d)(17)(D). The FDIC thus precedes all other claimants, except federal agencies, in collecting from the bankruptcy estate of the transferee. Swire, *supra* note 28, at 486.

82. 12 U.S.C. § 1821(d)(3)-(11).

83. 12 U.S.C. § 1821(d)(3).

84. 12 U.S.C. § 1821(d)(2)(A)(i).

85. Courts have read FIRREA to contain a "mandatory exhaustion requirement" that "preclude[s] suit on a claim that was not first presented to the [FDIC]." *Office and Prof'l Employees Int'l Union Local 2 v. FDIC*, 962 F.2d 63, 66 (D.C. Cir. 1992). *See also Meliezer v. RTC*, 952 F.2d 879, 882 (5th Cir. 1992) (holding that 12 U.S.C. § 1821(d)(13)(D) "clearly establishes a statutory exhaustion requirement"); *Rosa v. RTC*, 938 F.2d 383, 391-92 (3d Cir. 1991) (finding statutory exhaustion requirement in language of 12 U.S.C. § 1821).

In enacting FIRREA, "Congress expressly withdrew jurisdiction from all courts over any claim to a failed bank's assets that are made outside the procedure set forth in section 1821." *FDIC v. Shain, Schaffer & Rafanello*, 944 F.2d 129, 132 (3d Cir. 1991). *See Brady Development Co. v.*

process, a court lacks jurisdiction to hear “all suits seeking payment from the assets of the affected institution; all suits seeking satisfaction from those assets; and all actions for the determination of rights vis-à-vis those assets.”<sup>86</sup> The jurisdictional bar affects legal and equitable remedies and operates against creditors as well as debtors.<sup>87</sup> The claims process requires the receiver to publish a notice to the failed institution’s creditors informing them of the deadline for presentation of claims,<sup>88</sup> to mail a “similar” notice to “any creditor shown on the institution’s books,”<sup>89</sup> and to make a determination allowing or disallowing the claim within 180 days.<sup>90</sup> Administrative or judicial review is available for any disallowed claim.<sup>91</sup> This claims procedure applies even when the entity filing the claims has filed a petition for bankruptcy.

---

RTC, 14 F.3d 998, 1003 (4th Cir. 1994) (noting that Congress chose to place jurisdictional limits on the power of federal courts with respect to matters involving failed savings and loans under FIRREA).

86. *Marquis v. FDIC*, 965 F.2d 1148, 1151-52 (1st Cir. 1992). The court noted that “FIRREA makes participation in the administrative claims review process mandatory for all parties asserting claims against failed institutions,” and “where a claimant has . . . failed to initiate an administrative claim within the filing period, the claimant necessarily forfeits any right to pursue a claim against the failed institution’s assets in any court.” *Id.* (internal citation omitted).

87. FIRREA’s jurisdictional bar has been litigated in the circuit courts and has been applied to various claims. *See National Trust for Historic Preservation in the United States v. FDIC*, 21 F.3d 469 (D.C. Cir. 1994) (noting that 12 U.S.C. § 1821(j) does not bar suit to the extent of seeking a declaratory judgment instead of an injunction); *Carney v. RTC*, 19 F.3d 950, 957-58 (5th Cir. 1994) (holding that section 1821(j) deprived the court of jurisdiction regarding claims of injunctive relief and declaratory judgment); *Lloyd v. FDIC*, 22 F.3d 335, 336-37 (1st Cir. 1994) (holding that a debtor’s suit for equitable reformation or cancellation of a mortgage contract is subject to the jurisdictional bar of section 1821(d)(13)(D)); *Henderson v. Bank of New England*, 986 F.2d 319, 320-21 (9th Cir. 1993) (holding that claims by unsuccessful credit card applicants are subject to jurisdictional bar of section 1821(d)(13)(D)); *Meliezer*, 952 F.2d at 883 (holding that a mortgagor’s claim of negligence by a financial institution for allowing mortgagor to assume insufficient fire insurance was subject to the jurisdictional bar of section 1821(d)(13)(D)); *RTC v. Elman*, 949 F.2d 624, 626-27 (2d Cir. 1991) (holding that law firm’s assertion of retaining a lien in order to retain custody of a client’s legal files is subject to the jurisdictional bar of 12 U.S.C. § 1821(d)(13)(D)); *Freeman v. RTC*, No. C-93-4215-VRW, 1994 WL 398515, at \*1-2 (N.D. Cal. 1994) (holding that claimant’s cross claims were barred by the “60-day statute of limitations contained in 12 U.S.C. § 1821(d)(6)(B)”; *see also Ward v. RTC*, 996 F.2d 99, 104 (5th Cir. 1993) (“Like injunction, rescission is a ‘judicial restraint’ that is barred by [12 U.S.C.] § 1821(j).”).

88. 12 U.S.C. § 1821(d)(3)(B) (1994).

89. 12 U.S.C. § 1821(d)(3)(C).

90. 12 U.S.C. § 1821(d)(5)(A). Although claims that are untimely filed must be disallowed, there is an exception for those that are filed late because the claimant did not receive notice of the appointment of the receiver in time to file a claim prior to the bar date. The receiver has the discretion to review those claims, provided there is time to permit payment of the claims. 12 U.S.C. § 1821(d)(5)(C). The statute does not provide a basis for this exception, which means that, even if the receiver fails to mail the required notice, the claimants must still exhaust their administrative remedies. *See* 12 U.S.C. § 1821(d)(3)(C). *See also Meliezer*, 952 F.2d at 882 (holding that 12 U.S.C. § 1821(d)(13)(D) “clearly establishes a statutory exhaustion requirement”).

91. *See* 12 U.S.C. § 1821(d)(6)(A)(i)-(ii) (explaining that a claimant seeking judicial review of the receiver’s decision may file an action in federal district court within 60 days after the receiver has disallowed an administrative claim or at the expiration of the 180-day period allowed for processing the administrative claim, whichever comes first).



### III. BNE: A PARADIGM

The ongoing BNE litigation provides an illustration of the substantive conflict between the two statutory schemes.<sup>92</sup> The conflict of procedure and doctrine becomes more distinct by analyzing the fraudulent conveyance claim and the receiver's administrative review of that claim.

#### A. *Factual History and the Trustee's Claims*

The Bank of New England Corporation (BNEC) was a bank holding company that owned three bank subsidiaries: Bank of New England (BNE), Connecticut Bank and Trust Co. (CBT), and Maine National Bank (MNB).<sup>93</sup> BNE, the largest of the banks, which had substantial real estate investments in New England, began to deteriorate.<sup>94</sup> The parent company, BNEC, pursuant to regulatory orders, made asset transfers in an attempt to shore up BNE's capital deficiency.<sup>95</sup> Despite these efforts, a series of events led to a fast and serious decline.<sup>96</sup> By July 1989, BNEC and BNE had both become insolvent.<sup>97</sup> CBT and MNB both remained solvent and of substantial value to BNEC.<sup>98</sup>

---

92. The failure of BNE resulted in a flurry of litigation. In addition to the ongoing district court litigation discussed herein, the bankruptcy trustee filed a claim in the federal court of claims alleging an unconstitutional taking due to the cross-guarantee claim. In *Branch v. United States*, 69 F.3d 1571, 1582-83 (Fed. Cir. 1995), the Court of Appeals reversed the decision of the court of claims which held that the cross-guaranty provision of FIRREA—directing that when bank failure causes loss to federal bank insurance fund, sister banks owned by same bank holding company may be liable for loss—did not result in prohibited taking of property under Fifth Amendment, even though assessment resulted in bank's insolvency and seizure by government. The court decided that Branch must show that the cross-guarantee assessment was itself a "per se" taking in order for the claim to succeed. *Id.*

93. *Branch ex rel. Conn. Bank & Trust Co. v. FDIC*, 825 F. Supp. 384, 390-91. (D. Mass. 1993) [hereinafter *BNE-I*].

94. See *Failure of the Bank of New England: Hearings Before the House of Representatives Comm. on Banking, Finance and Urban Affairs*, 101st Cong., 2d Sess. 24,26 (1991) (statement of Robert Clarke, Comptroller of the Currency, discussing the damage that banks, including BNE, suffered because the housing market dropped in New England).

95. See *BNE-I*, 825 F. Supp. at 393.

96. In July 1989, OCC released its most recent examination of BNE, which indicated that BNE's combination of uncontrolled growth and poor quality loan performance had led to its insolvency. BNEC, which wholly owned BNE, became insolvent at about the same time due to its loss in value in the bank subsidiary. *Id.* at 392-93.

Through a series of regulatory orders, the regulators began in early 1990, to control virtually all the operations at BNEC. In February 1990, the Federal Reserve entered a cease and desist order concerning BNEC's management, which included the appointment of a new Chief Executive Office, satisfactory to the regulators. OCC, at the same time, entered a cease and desist order against BNE; April and May, 1990 OCC entered the same cease and desist orders against CBT and MNB; finally, in May 1990, OCC issued an order against two other BNEC subsidiary banks, BNE-Old Colony and BNE-West. *Id.* at 394.

97. *Id.*

98. *Id.* at 393.

The BNEC Board of Directors (Board) took several measures to improve the capital status of BNE.<sup>99</sup> In December 1989, when BNE's losses exceeded one billion dollars,<sup>100</sup> the Board began "The Asset Distribution Program," selling significant assets to its subsidiary banks.<sup>101</sup> In February 1990, the Federal Reserve and the OCC issued regulatory orders that effectively controlled all management decisions and the daily operations over the entire BNEC system.<sup>102</sup>

On January 3, 1991, BNEC and BNE issued a statement of fourth quarter operating losses.<sup>103</sup> The report of losses to the public led to massive depositor withdrawals at CBT and MNB.<sup>104</sup> In an effort to stop the depositor runs at CBT and MNB, federal regulators issued a series of regulatory orders that resulted in the OCC declaring BNE insolvent and appointing the FDIC as receiver.<sup>105</sup> BNEC filed a Chapter 7 petition in bankruptcy.<sup>106</sup>

---

99. *Id.* (stating that the BNEC Board of Directors were acting on the advice of the federal regulators, who had a daily presence at BNE from the fall of 1989). The Federal Reserve entered into a Memorandum of Understanding (MOU) in November 1989 that required BNEC to act as a source of strength to its subsidiary banks. *Id.* at 393 n.4. See *infra* text accompanying note 124.

100. *BNE-I*, 825 F. Supp. at 393.

101. *Id.* BNEC transferred approximately \$500 million in assets through this program. The asset transfers were wide and varied ranging from proceeds from public debt offerings, general asset dispositions, and mergers of subsidiary banks into BNE, to transfers from BNEC non-bank subsidiaries, tax refunds, prepaid expenses, and proceeds from use of trademarks. *Id.* at 394.

102. The Bank Subsidiaries that received regulatory orders included: BNEC, BNE, CBT, MNB, BNE-Old Colony and BNE-West. *Id.* at 393-94.

103. *Id.* at 394. BNEC and BNE released reports showing operating losses of \$450 million to their respective regulatory agencies. News media reported the performance problems the following day. *Id.*

104. The district court opinion described the customer lines as similar to the ones of the Great Depression: "For the first time since the Great Depression and the creation of the federal deposit insurance system, depositors literally lined up outside the offices of a major federally insured bank seeking to withdraw their funds." *Id.*

105. The FDIC actions followed MNB and CBT's sale of \$1.48 billion and \$133.4 million of federal funds, respectively, to BNE. *Id.*

After BNE was declared insolvent, the FDIC as receiver for BNE (FDIC-BNE) immediately valued the federal funds loan from CBT to BNE at zero, allowing the OCC to declare CBT insolvent and appoint the FDIC as receiver (FDIC-CBT). That action allowed FDIC-BNE to value the MNB federal funds loan at zero. FDIC-BNE then filed a Notice of Assessment against MNB, which remained solvent, demanding payment of \$1 billion under the FDIC's cross-guarantee provision. 12 U.S.C. § 1815(e) (1994). The amount was based upon the FDIC's estimated loss as receiver for BNE. Since MNB was unable to meet this demand, OCC declared MNB insolvent and appointed the FDIC as receiver (FDIC-MNB), combining the three receiverships into FDIC-Receiver I. FDIC-Receiver I organized insolvent BNEC bank subsidiaries into separate Bridge Banks. Those banks were used to transfer, through purchase and assumption transactions, most of the assets and liabilities of the failed banks. FDIC-Receiver I then authorized the BNEC Board of Directors to file a voluntary Chapter 7 bankruptcy petition. *BNE-I*, 825 F. Supp. at 394-95.

The assessment against MNB under the cross-guarantee provision was the FDIC's initial use of this power by the FDIC as a receiver. A cross-guarantee assessment causes the failure of sibling financial institutions by assessing them with the amount of the capital deficiency of the failed institution. The regulatory agencies can then treat the bank subsidiaries as a single unit. The provision has been challenged as an unconstitutional taking under the Constitution. See generally Jennifer J. Alexander, *Is the Cross-Guarantee Constitutional?*, 48 VAND. L. REV. 1741 (1995)

The bankruptcy court appointed Dr. Ben Branch as the trustee of the estate of BNEC.<sup>107</sup> He brought claims against the FDIC in its corporate and receivership capacities and against Fleet Bank of Massachusetts (Fleet), the ultimate purchaser of the failed BNE.<sup>108</sup>

The trustee's common factual allegations alleged that BNE was insolvent and pending failure when the FDIC required BNEC to transfer a majority of its assets to BNE.<sup>109</sup> The trustee alleged that the FDIC made the transfers with actual intent to hinder, delay, or defraud BNEC's creditors, and/or that it was made at a time when BNEC was insolvent, or was rendered insolvent thereby, in exchange for less than reasonably equivalent value.<sup>110</sup> The trustee sought recovery of the various transfers on the grounds that they were fraudulent transfers.

The complaint went on to state the claims against the transferees.<sup>111</sup> The trustee's claims against the FDIC-Receiver alleged that the receiver was liable as the initial transferee of the assets.<sup>112</sup> The trustee claimed that the FDIC-Corporate benefited because its liability to insured depositors of BNE would be reduced as a result of the transfers.<sup>113</sup> The trustee's claims against the ultimate acquirer of the failed group, Fleet, alleged that the Fleet Banks were liable as subsequent transferees on the grounds that they did not acquire the transferred assets in good faith.<sup>114</sup>

---

(concluding that the provision does not effect a taking without just compensation); Jennifer B. Arlin, *Of Property Rights and The Fifth Amendment: FIRREA's Cross-Guarantee Reexamined*, 33 WM. & MARY L. REV. 293 (1991) (concluding that the cross-guarantee provision opens the door to government abuse); Jeffery M. Cooper, *Out On a Limb: FIRREA's Cross-Guarantee Provision "Takes" Root in Branch v. United States*, 33 HOUS. L. REV. 299 (1996) (concluding that the Court of Federal Claims was correct in finding the provision unconstitutional); Tracy A. Helmer, *Banking on Solvency: The Takings Power of FIRREA's Cross-Guarantee Provision*, 30 VAL. U. L. REV. 223 (1995) (concluding that the FDIC, by making assessments on solvent subsidiaries without a proper showing of fraud or wrongdoing, is taking property without just compensation under the Takings Clause of the Fifth Amendment).

106. *BNE-I*, 825 F. Supp. at 395.

107. *Id.* at 391. BNEC filed for bankruptcy January 7, 1991, the day after BNE failed. The creditors' claims totaled \$700 million. *Id.* at 395-96.

108. Branch notified potential bidders of his intent to file fraudulent conveyance claims for those assets transferred from BNEC, CBT, and MNB. The Bridge Banks operated until July 1991, when OCC closed them and appointed the FDIC as receiver (FDIC-Receiver II). FDIC-Receiver II sold the operations of all three former BNEC subsidiaries to Fleet Banks of Massachusetts. *Id.* at 395.

109. *Id.* at 392-93.

110. *Id.* at 395.

111. The fraudulent conveyance provision allows the trustee or debtor in possession to recover the asset transfer from the initial transferee or from a subsequent transferee, when appropriate. 11 U.S.C. § 548(a)(2) (1994).

112. *BNE-I*, 825 F. Supp. at 401.

113. *Id.*

114. The good faith defense exception is available to subsequent transferees under 11 U.S.C. § 548(c). *See infra* note 155.

## B. *The District Court Decisions*

### 1. BNE-I: The Asset Transfer Decision<sup>115</sup>

The BNEC trustee determined that a crucial issue in the initial resolution of the BNEC bankruptcy proceeding involved recovery of the \$2 million in asset transfers made under BNEC's Asset Distribution Program (Program). Specifically, the trustee alleged that the regulatory agencies required the transfers of BNEC's assets to reduce the insurance liability of FDIC-Corporate when BNE failed. The trustee buttressed this claim by the fact that BNE was actually insolvent in 1989, but was not declared insolvent by the regulatory agencies until almost two years later, in 1991.<sup>116</sup>

As a threshold matter, the court faced an issue of subject matter jurisdiction. The FDIC contended that the questioned asset transfers were nonreviewable agency orders.<sup>117</sup> The FDIC termed the trustee's inquiry regarding the transfers an "impermissible collateral attack." Relying on statutory procedures, the FDIC's argument was two-fold. First, the agency contended that the trustee failed to request judicial review of the administrative agency orders in a timely fashion. Second, the agency argued that the questioned orders were explicitly exempted from review because BNEC had consented to the issuance of the challenged orders.<sup>118</sup>

In *BNE-I*, the district court recognized the authority of a bankruptcy court to review asset transfers made pursuant to administrative procedures, based on its analysis of the authorizing language in the regulatory orders.<sup>119</sup> That decision thwarted the regulators' arguments that the asset transfers were invulnerable under the Code.

The court's decision addressed two jurisdictional claims: whether the banking regulatory process precluded an avoidance action by the bankruptcy trustee; and, alternatively, whether the asset transfers, because they were required by regulatory orders, were immune from attack under the Code.<sup>120</sup>

The regulators moved to have the claims dismissed, arguing that the trustee's actions were an unwarranted and impermissible collateral attack, interfering with the agency's supervisory powers under section 1818(h)(2). Specifically, the FDIC argued that the cease and desist orders were protected administrative agency orders and as such were subject to

---

115. *BNE-I*, 825 F. Supp. at 384.

116. *BNE-I*, 825 F. Supp. at 392-93.

117. *Id.* The FDIC based this argument on 12 U.S.C. section 1818(h)(2) (1994).

118. *BNE-I*, 825 F. Supp. at 398. The FDIC also argued that BNEC, by consenting to the Federal Reserve's order, sanctioned the request that BNEC act as a "source of strength" to its bank subsidiaries sanctioned the asset transfers. *Id.*

119. *Id.*

120. *Id.*

judicial review under administrative agency procedures, furthering them beyond the avoidance powers of the bankruptcy trustee.<sup>121</sup> To allow the avoidance claim to proceed, in essence, they argued, permitted for an improper review of the regulatory agencies' legal authority.

The court ruled that the claims were reviewable under the Code.<sup>122</sup> The court distinguished the agency's authority to *require* or authorize the regulatory orders from its authority to execute the manner of the transfer or the amount. The court found the trustee's challenge an appropriate assessment of the "discretionary execution" of the orders.<sup>123</sup> Because the Federal Reserve and OCC orders failed to "define the manner of transfer or the specific assets to be transferred," those orders did not require the challenged asset transfers.<sup>124</sup> The court found that because the challenged orders did not mandate the specifics regarding the asset transfer, i.e., neither the amounts nor the manner, the trustee's claims did not attack the agencies' exercise of discretionary, supervisory authority.

On the second jurisdictional issue, the agencies defended the asset transfers as valid enforceable orders made in compliance with regulatory authority. As such, they contended, the orders automatically met the fraudulent conveyance prerequisite, making them transfers made in "good faith and for fair consideration."<sup>125</sup> Alternatively, the agency argued that the federal banking statutes, not the Code, govern the issue. The court declined to reach this issue based on its previous finding that

---

121. *Id.*

122. *Id.* at 399.

123. *Id.* at 398.

124. *Id.* at 398-99. In a footnote in the opinion, the court detailed the specificity found in the orders:

The FED C & D Order provides in pertinent part: [BNEC] shall submit to the [FED] a written plan to improve the capital positions of the consolidated organization and each of the Subsidiary Banks . . . The plan shall, at a minimum, address and consider: . . . (e) [BNEC's] responsibility to act as a source of financial strength to its Subsidiary Banks and, in connection therewith, to use its assets to provide whatever additional capital support to all its Subsidiary Banks as may be required by the Reserve Bank in a manner consistent with the [FED's] Policy Statement on the responsibility of bank holding companies to act as sources of financial strength to the subsidiary banks. Along with their post-hearing brief, the defendants submitted two "capital maintenance plans," allegedly created by BNEC pursuant to the FED C & D Order and FED MOU. These plans make specific reference to some, but not all, of the challenged asset transfers, and the FED C & D Order contains language which might arguably convert at least the second plan into an "Order" under section 1818. Theoretically, this Court could consider the plans either as public records of the FED, or as external evidence used to determine the Court's subject matter jurisdiction. At this juncture, however, this Court declines to do either. As Branch justifiably argues, the plans were submitted after the presentation of briefs and oral argument and are technically outside the scope of the supplemental briefs requested by the Court. Branch was thus provided no adequate opportunity to respond to the plans. Moreover, although the Court doubts that the plans are concocted, the defendants have presented no affidavits supporting their authenticity. For these reasons, the Court cannot in good conscience consider the plans for the purposes of the present motion.

*Id.* at 399 (internal citations omitted). See discussion *infra* Part V.B regarding the business judgement rule's applicability to this issue.

125. *Id.*

the orders and agreements did not require the specific transfers that BNEC made to its subsidiary banks. Therefore, the court also found that the Code was the applicable law governing the review of these particular claims.<sup>126</sup>

## 2. BNE-II: Exhaustion of Administrative Remedies<sup>127</sup>

After the regulator's motion to dismiss, the court requested additional information regarding the trustee's filing of administrative claims.<sup>128</sup> FDIC-Receiver alleged that some of those claims were barred for failure to exhaust the administrative process. The subject claims involved the downstream asset transfers from BNEC to BNE while both were insolvent. The trustee sought recovery of the transfers, which were detailed in the proof of claims filed with the Bankruptcy Court, under the fraudulent conveyance provisions of the Code as well as under state common law.<sup>129</sup> FDIC-Receiver alleged that the claims were barred because the trustee had failed to exhaust administrative remedies before filing the federal district court action.<sup>130</sup>

FDIC-Receiver disallowed the claims during the administrative process. Specifically, FDIC-Receiver found that Branch failed to provide sufficient information detailing the specificity of the transactions. FDIC-Receiver denied the claims on those grounds.

Branch contended, and the district court found, that the downstreamed transfers listed in the proof of claims sufficiently identified the claims because they all related directly to the challenged transactions.<sup>131</sup> Furthermore, the court found the receiver's failure to acknowledge the legitimacy of the claims appeared to be an obstruction to FIRREA's administrative process for the equitable distribution of claims.<sup>132</sup> In fact, the court found that the downstreamed assets from the bank holding company were made while the banks were insolvent and thus no reasonably equivalent value was given for the transfer, making the transfers fraudulent conveyances.<sup>133</sup> Interestingly, in *BNE-II*, the court concluded that the challenged transfers were made in good faith and for fair consideration.<sup>134</sup> This determination preserved the legitimacy of the transfers and bolstered the FDIC's argument that they were immune from challenge because they were made pursuant to regulatory orders.

---

126. *Id.*

127. *Branch ex rel. Conn. Bank & Trust Co. v. FDIC*, 833 F. Supp. 56 (D. Mass. 1993) (hereinafter *BNE-II*).

128. *BNE-II*, 833 F. Supp. at 57.

129. *Id.* at 58.

130. *Id.* at 57.

131. *Id.* at 60-62.

132. *Id.* at 59.

133. *Id.* at 58.

134. *Id.* at 62.

### C. *Post-BNE Legislation*

Congress took aggressive steps in post-FIRREA legislation to ensure that regulators would be able to enforce the previously ambiguous capital maintenance obligations.<sup>135</sup> Some of those reforms were designed to address issues left unresolved by the failure of BNE. The Crime Control Act and FDICIA appear beneficial to regulatory enforcement of the obligations.<sup>136</sup> These recent legislative initiatives attempt to strengthen the capital maintenance commitment by making the obligation a nondischargeable debt,<sup>137</sup> removing the obligation's eligibility as an exemption,<sup>138</sup> requiring the trustee to assume the obligation and immediately cure it, if necessary,<sup>139</sup> and making the obligation a priority among unsecured claims.<sup>140</sup>

Specifically, if the bank holding company has either "recklessly or maliciously" failed to discharge a capital maintenance commitment, that debt is nondischargeable.<sup>141</sup> In a Chapter 7 liquidation, a capital maintenance commitment claim receives priority over other unsecured claims. Finally, section 365(o) requires a debtor parent company to assume and perform a capital maintenance commitment according to its terms.<sup>142</sup> In effect, these provisions give the regulatory agencies' priority rights that are superior to those of other creditors.

The BNE litigation also raised the issue of whether regulatory authorization to make the challenged asset transfer ought to protect it from an avoidance action in bankruptcy.<sup>143</sup> Specifically, a parent company may have restored the capital of its bank subsidiary, i.e., made an asset transfer, within a year became insolvent itself and a trustee moved to avoid the transfer. Congress addressed this in part in FDICIA by creating or authorizing the parent company to make a limited asset transfer.<sup>144</sup>

The prompt corrective action provision (PCA)<sup>145</sup> is a legislative initiative intended to address the issues of parent company control while

---

135. See *supra* note 11.

136. See *supra* note 118.

137. 11 U.S.C. § 523(a)(12) (1994).

138. *Id.* § 522(c)(3) (1994).

139. *Id.* § 365(o) (1994).

140. *Id.* § 507(a)(9) (1994).

141. *Id.* § 523(a)(12) (1994). *Tinker v. Colwell*, 193 U.S. 473 (1904), has defined "willful" to mean deliberate or intentional; cases holding that a looser "reckless disregard" standard should be applied were explicitly overruled. H.R. REP. NO. 95-595, at 365 (1977).

142. 11 U.S.C. § 365(o) (1994). "In a case under chapter 11 of this title, the trustee (or debtor in possession) shall be deemed to have assumed . . . and shall immediately cure any deficit under, any commitment by the debtor to a Federal depository institutions regulatory agency . . . to maintain the capital of an insured depository institution . . ." *Id.*

143. See discussion *supra* Part III.B.

144. 12 U.S.C. § 1831o(e)(2)(E) (1994).

145. 12 U.S.C. § 1831o.

also conserving the financial viability of the deposit insurance fund. This statutory provision, which becomes effective whenever a bank subsidiary becomes undercapitalized,<sup>146</sup> allows the parent company to make corrective interventions at its discretion.<sup>147</sup> The capital commitment is of a limited amount and arguably of limited duration.<sup>148</sup> If the parent company chooses not to recapitalize the institution, the bank subsidiary may be subject to stringent regulatory controls.<sup>149</sup>

Congress, through PCA, provided managers of failing institutions with an incentive to operate the bank with risk-free rather than high risk strategies.<sup>150</sup> Requiring that more of a bank's capital be at risk, Congress put more of bank shareholders' funds at risk as well as those of the insurance fund. The legislative intent also indicates that Congress meant to give the parent company the option of selling, recapitalizing, or liquidating.<sup>151</sup> By requiring parent company intervention at the earliest indication of a decline in capital and by specifying the amount of the obligation, regulators exercise less discretion over the regulation of the institu-

---

146. A financial institution is subject to this provision if it is categorized as either *undercapitalized*, *significantly undercapitalized*, or *critically undercapitalized*. See FDICIA, 12 U.S.C. § 1831o(b)(1). An institution falling in one of these three categories must submit a capital restoration plan to its primary federal regulator in a timely manner. See 12 U.S.C. § 1831o(e)(2). The plan must explain in detail how the institution will rebuild capital, specifying year-to-year target levels for capital growth. The plan must be based on realistic assumptions, describe activities that are likely to succeed, and not expose the institution to appreciably increased risk. The plan must also describe the types and levels of activities in which the institution will engage and contain such other information as regulators require. When regulators classify a bank as undercapitalized, several discretionary and mandatory corrective intervention actions take place. These corrective interventions increase in severity as the institution's undercapitalization becomes more critical. See 12 U.S.C. § 1831o.

147. The prompt corrective provision did not abolish the highly controversial regulatory tools that regulators previously used to mandate the parent company's restoration of its bank subsidiary's capital. See discussion *supra* Part II and accompanying notes.

148. The statute requires that the parent company infuse the amount necessary to bring the institution into capital compliance "as of the time when the institution fails to comply with a [capital restoration] plan . . ." 12 U.S.C. § 1831o(e)(2)(E)(II). The parent company must also guarantee compliance with the capital restoration plan for four consecutive quarters. 12 U.S.C. § 1831o(e)(2)(C)(ii). The statute limits the amount of the guarantee liability to 5 percent of the depository institution's total assets at the time it becomes undercapitalized, or the amount necessary to bring the institution into compliance with all capital standards. 12 U.S.C. § 1831o(e)(2)(E)(i); see also Prompt Corrective Action, 57 Fed. Reg. 44,866, 44,902 (1992) (amending 12 C.F.R. § 325.104(h)(1)(i)) (explaining the final rules implementing the system of prompt corrective action as established by the Federal Deposit Insurance Corporation Improvement Act of 1991)).

149. See *supra* notes 85, 87.

150. Moral hazard describes the disincentive that deposit insurance provides for managers of a failing institution to jeopardize the insurance fund while seeking profits for the institution. Because the depositors' funds will be protected even if the institution fails, managers are willing to gamble with the institution's funds in a high stakes, "win big or lose big" strategy, which, if the institution loses, depletes its capital. See S. REP. NO. 102-167, at 32-33 (1991).

151. Cf. Eric J. Gouvin, *Shareholder Enforced Market Discipline: How Much is Too Much?* 16 ANN. REV. BANKING L. 311, 350 (1997) (criticizing the regulatory agencies' various protections against moral hazard and arguing that in the aggregate they amount to "regulatory overkill").



tion should the parent company choose not to recapitalize the institution.<sup>152</sup>

A parent company may have chosen to shore up its undercapitalized bank subsidiary under PCA. If the parent company becomes a debtor under the Code, its decision to recapitalize its bank subsidiary will be scrutinized and the transfer may be subject to an avoidance action.<sup>153</sup> Although a PCA-type infusion may be a "regulatory-approved" asset transfer, as the *BNE* court described it, the present bankruptcy scheme undermines the transfer as a fraudulent conveyance.<sup>154</sup>

#### IV. THE FRAUDULENT CONVEYANCE RULE<sup>155</sup>

While current provisions of the Bankruptcy Code give regulators stronger enforcement mechanisms for capital obligations, they are juxtaposed against the Bankruptcy Code's preexisting statutory scheme regarding the avoidance of asset transfers. The *BNE* decisions left unclarified a crucial issue: When a bank holding company becomes a debtor after making an asset transfer pursuant to regulatory authority, can that transfer find protection in the bankruptcy scheme? Enforcement of the capital maintenance obligations may pose a conflict between the interests of the financial institution's creditors, which may include the appropriate banking agency, and the institution's holding company's creditors, which may include the same banking agency. A trustee of the holding company may try to avoid a capital maintenance commitment or a payment to a bank subsidiary as a fraudulent conveyance under section 548 of the Code.<sup>156</sup> Only if the capital maintenance obligation falls within the good

---

152. The statute prevents an institution from paying dividends or management fees that cause the institution to become undercapitalized as a result of the distribution. See FDICIA, 12 U.S.C. § 1831o(d) (1994). As the Senate Report explains, this provision protects the insurance fund by preventing institutions from depleting capital for the benefit of shareholders. See S. REP. NO. 102-167, at 35 (1991). An undercapitalized institution must submit within 45 days a capital restoration plan and the regulatory agency must review that plan within 60 days. 12 U.S.C. § 1831o(e)(2)(D). See generally Richard S. Camell, *Prompt Corrective Action Under the FDIC Improvement Act of 1991*, in *Litigating For and Against the FDIC and the RTC 1992*, 27 (PLI, Comm. Law & Practice Course Handbook Series No. 625, 1992) (discussing the provisions of the Prompt Corrective Action); Nina Cortell, *Aspects of Financial Institutions Exposure*, in *Responsibility of the Corporate Parent for the Activities of a Subsidiary 1990*, 165 (PLI, Corp. Law & Practice Course Handbook Series No. 706, 1990) (discussing the financial institutions' regulatory framework as applied to the parent/subsidiary relationship).

153. See 11 U.S.C. § 548 (1994).

154. *Id.*

155. These rules apply with equal force to the trustee of a bankruptcy estate or to a debtor in possession. *Id.*

156. Prior to the passage of the Crime Control Act in 1990, the payment of a capital obligation after its breach raised an issue of the applicability of section 547 of the Bankruptcy Code. This provision allows the bankruptcy trustee to reduce the amount of an asset transfer given by the debtor to the creditor prior to bankruptcy if that creditor receives more than it would have been entitled to in a Chapter 7 proceeding. 11 U.S.C. § 547(b) (1994). The Crime Control Act amended the Bankruptcy Code to give any outstanding amount due under a capital maintenance obligation a higher priority status. 11 U.S.C. § 507(a)(9) (1994). However, if the individual owners of the holding company are

faith exception to this statutory provision will the regulatory agency be successful in enforcing even the more specific capital maintenance obligation.<sup>157</sup>

The payment of a capital obligation, in part or in full, may raise an issue of the applicability of section 548 of the Code.<sup>158</sup> The Code does not provide immunity for transfers made pursuant to regulatory orders.<sup>159</sup> Section 548 provides the bankruptcy trustee with an avoidance remedy for asset transfers made within one year of a debtor's bankruptcy filing.<sup>160</sup> If the trustee is successful in filing the avoidance petition, the trustee will be able to augment the debtor's estate by the amount of the asset transfer in question.<sup>161</sup>

Section 548(a) provides the trustee with a remedy based upon actual or constructive fraud.<sup>162</sup> Under section 548(a)(1), the actual fraud provision, also called the subjective test, the debtor bank holding company must have made the asset transfers with the "actual intent to hinder, delay and defraud."<sup>163</sup> Arguably, the fact that regulatory agencies issue orders requiring capital obligations makes them involuntary transfers.<sup>164</sup> The trustee may elect not to proceed under the actual fraud provision because that claim may be more difficult to prove.<sup>165</sup>

---

responsible for funding the obligation and they use section 507 to secure a better priority, section 547 would apply and the trustee would have one year in which to recover the asset transfer as an avoidable preference. See 11 U.S.C. § 547 (1994).

157. See 11 U.S.C. § 548(e) (1994).

158. The trustee may also pursue an asset transfer challenge under state law pursuant to the Uniform Fraudulent Conveyance Act of 1918, 7A U.L.A. 427 (1985 & Supp. 1997) (amended by the Uniform Fraudulent Transfer Act of 1984, 7A U.L.A. 639 (1985 & Supp. 1997)). These statutes incorporate the state law substantive and procedural requirements into the fraudulent conveyance rule of the Bankruptcy Code. See 11 U.S.C. § 544(b) (1994). See generally Robert K. Rasmussen, *Guarantees and Section 548(a)(2) of the Bankruptcy Code*, 52 U. CHI. L. REV. 194 (1985) (stating that the focus of examination in determining whether a fraudulent transfer was made under section 548(a)(2) should be between the debtor and the obligor because it is the obligor, not the lender, that benefits from the debtor's guarantee).

159. This was one of the arguments set forth by the trustee in the BNEC case. See *supra* Part III.B and accompanying notes.

160. 11 U.S.C. § 548(a) (1994).

161. The trustee has one year following the avoidance of the transfer to initiate an action against the transferee. 11 U.S.C. § 550(f) (1994).

162. See Michael L. Cook, *Fraudulent Transfer Liability Under the Bankruptcy Code*, 17 HOUS. L. REV. 263, 270, 276-77 (1980) (characterizing actual fraud as a subjective test and constructive fraud as an objective test).

163. 11 U.S.C. § 548(a)(1) (1994).

164. Breach of a capital maintenance obligation allows the appropriate regulatory agency to issue a cease and desist order against the parent company under section 1818(I) and then proceed with an administrative hearing. See *supra* Part II.A.2 and accompanying notes.

165. This section may in fact be applicable if the insiders of the parent holding company are themselves liable for any capital deficiency. See John C. Deal et al., *Capital Punishment: The Death Of Limited Liability For Shareholders Of Federally Regulated Financial Institutions*, 24 CAP. U. L. REV. 67, 124 (1995). Any transfers that a debtor bank holding company makes when it is nearing insolvency may be problematic considering the fiduciary duties that directors may owe to creditors. See *infra* Part IV.

The involuntary payment of a capital obligation by a debtor bank holding company may pose a less questionable claim under the test for constructive fraud of section 548 (a)(2). Under this test, the trustee must prove that the debtor bank holding company received "less than a reasonably equivalent value"<sup>166</sup> and, most likely, that the debtor bank holding company either was insolvent or was made insolvent due to the transfer or obligation.<sup>167</sup>

The issue of fraudulent conveyance has had limited exposure in the bank holding company context. Courts analyzing the issue in the holding company context have engaged in a two-part analysis. Those courts look first to whether the parent company received an indirect benefit based upon the transfer. Then, they assess the value of that benefit. The discussion that follows analyzes recent cases addressing benefit and value in the holding company context. It then addresses the good faith defense. The section concludes by analyzing these concepts in the bank holding company context.

#### A. *Evaluating the Asset Transfer: The Parent Company's Benefit*

What underlies the section 548 requirement that a transferor receive an exchange of reasonably equivalent value is the policy of the Bankruptcy Code to maintain the debtor's estate for the benefit of its creditors.<sup>168</sup> Consistent with this policy, the debtor's return benefit may be direct or indirect, but it must have a proportionate value. In the holding company context, the benefit will most likely be an indirect one, and measuring its equivalent value may depend on the financial position of the subsidiary.

When a parent company makes an asset transfer to its subsidiary, it is "downstreaming" assets to the subsidiary. This acceptable common corporate practice increases the value of the subsidiary and, ultimately, increases the parent company's net worth.<sup>169</sup> Thus, although the parent

---

166. 11 U.S.C. § 548(a)(2)(A) (1994).

167. See *supra* note 71.

168. See generally Elizabeth Warren, *Bankruptcy Policy Making in an Imperfect World*, 92 MICH. L. REV. 336 (1993) (discussing the conflicting policy objectives of the bankruptcy system and arguing for a careful assessment of the presumptions underlying those objectives when considering reforms).

169. Intercorporate guarantees are essentially third-party contracts. In addition to the "downstream" guarantee, there is an "upstream" guarantee by a subsidiary of its parent's debt and a "cross-stream" guarantee by a corporation of an affiliated corporation's debt. See Rasmussen, *supra* note 158, at 207 (1985).

In the bankruptcy context, courts apply a third-party beneficiary test when determining whether the debtor received reasonably equivalent value from an intercorporate guarantee. Under this analysis, cross-stream and upstream guarantees do not meet the benefit test unless the corporations have failed to maintain separate corporate identities, thereby allowing the court to disregard corporate separateness and treat the corporations as a single entity. See generally Jack F. Williams, *The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guarantees: Fraudulent Transfer Law as a Fuzzy System*, 15 CARDOZO L. REV. 1403 (1994)

company may not receive a direct exchange of value, it should eventually benefit from the transfer.<sup>170</sup>

B. *Evaluating the Asset Transfer: Measuring "Reasonable Equivalence"*<sup>171</sup>

A guarantee is a financing vehicle that commits a non-borrower to agree to repay a loan in the event of a default by the borrower. Typically, a parent company will guarantee an obligation of a subsidiary. The value of these transactions is difficult to assess because the transfer may involve indirect benefits. Courts may use either the net worth maintenance or the identity of interest doctrines when reviewing whether the debtor holding company has made a permissible transfer.

1. The Net Worth Maintenance Theory

Using the net worth maintenance theory to decide whether the parent company has received an indirect benefit depends on the financial condition of the subsidiary. The leading case interpreting the holding company's benefit using the net worth maintenance theory is *Rubin v. Manufacturer Hanover Trust Co.*<sup>172</sup> The Second Circuit ruled that determining whether the debtor holding company has received an economic benefit begins by determining whether the holding company's guarantee of its subsidiary's debt has maintained the financial position of the subsidiary.<sup>173</sup>

The Court of Appeal's ruling reversed the district court, which did not consider the financial condition of the subsidiary.<sup>174</sup> Instead, the court concluded that the debtor holding company had a "vital interest" in the financial affairs of its affiliate. Under that analysis, the district court found that the debtor holding company always received an indirect benefit when it guaranteed its subsidiary's loan.<sup>175</sup>

---

(discussing the intercorporate guarantee, downstream guarantee, upstream guarantee, and cross-stream guarantee); Barry L. Zaretsky, *Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*, 46 S.C. L. REV. 1165 (1995) (discussing the development of fraudulent transfer law and constructive law provisions).

170. The parent company may only receive an exchange of value when its subsidiary is solvent. See *supra* note 6.

171. 11 U.S.C. § 548 (a)(2)(A) (1994).

172. 661 F.2d 979, 991-92 (2d Cir. 1981) (holding that even though a bankrupt corporation had guaranteed loans that the bank issued to its subsidiary, trustees of the bankrupt corporation brought suit against the bank to recover the value of certain funds and securities of the corporation that the corporation had given as collateral for those loans). *Rubin* was decided under the section 67(d) of the Bankruptcy Act of 1898, which arguably was unchanged by the Bankruptcy Code. See also *Harman v. First Am. Bank of Md.*, 956 F.2d 479, 485 (4th Cir. 1991) (finding *Rubin's* indirect benefit rule applicable under section 548 of the Bankruptcy Code).

173. *Rubin*, 661 F.2d at 991.

174. *Id.* at 993.

175. *Rubin v. Manufactures Hanover Trust Co.*, 4 B.R. 447, 456-57 (Bankr. S.D.N.Y. 1980).

The Second Circuit's analysis of indirect benefit focused on comparing the obligation given to the third party with the obligation assumed by the holding company.<sup>176</sup> To result in a benefit, the exchange between the holding company and the parent company must correlate.<sup>177</sup> Following this analysis, an equivalent nexus shores up the benefit to the holding company, and thereby makes the transfer permissible.

After the decision in *Rubin*, several courts adopted the approach of evaluating the subsidiary's financial position as a result of the parent company's transfer. In light of this, courts began considering the degree or the nature of the subsidiary's insolvency. In *Duque Rodriguez v. Avanca (In re Rodriguez)*,<sup>178</sup> the "deep insolvency" of the subsidiary supported a determination that the debtor parent company would not receive a benefit and that the parent company's asset transfer decreased the holding company's own net worth, harming the holding company's creditors.<sup>179</sup> Elaborating on the bankruptcy court's conclusion, the Eleventh Circuit<sup>180</sup> affirmed that the "terminal insolvency" of the subsidiary controlled the parent company's choice in paying the subsidiary's debt. The lack of financial viability of the subsidiary meant that the parent company's contribution on behalf of the subsidiary would not sustain the subsidiary's net worth.<sup>181</sup> Given that ultimate result, the parent company would never receive a benefit and the transfers were voidable under section 548.<sup>182</sup>

---

176. *Rubin*, 661 F.2d at 991-93.

177. *Id.* at 989 (holding that there must be an approximate worth between the benefit received and the obligation exchanged).

178. 77 B.R. 937, 939 (Bankr. S.D. Fla. 1987) (relying on 11 U.S.C. § 548(a)(2), the trustee of a bankrupt corporation sought avoidance of the transfer of \$42,000 from the corporation to the defendant, which was made two months prior to the commencement of bankruptcy action). The courts have considered the degree of insolvency of the subsidiary in determining the parent company's benefit after paying a subsidiary company's obligation. *Id.*

179. "In view of General Coffee's then terminal insolvency, the net worth of Domino was diminished by the transfer and the innocent creditors of Domino were in fact harmed by the transfer." *Rodriguez*, 77 B.R. at 939.

180. *Rodriguez v. Murphy (In re Rodriguez)*, 895 F.2d 725, 728-29 (11th Cir. 1990) (explaining that a trustee brought action to render certain payments made by a holding company to a defendant on behalf of its subsidiary's trustee contending that the debtor holding company did not receive "reasonably equivalent value" for payments and the court emphasized that the decisive issue is whether by paying its subsidiary's debt, the holding company received an economic benefit that was sufficient to preserve the holding company's net worth); see also *Butcher v. First Nat'l Bank (In re Butcher)*, 57 B.R. 101 (Bankr. E.D. Tenn.) *rev'd on other grounds*, 78 B.R. 520 (1986) (examining a trustee's filed action against First National Bank seeking to avoid preferential and alleged fraudulent transfers to creditors however, the complaint was dismissed on grounds that the action was time barred by the statute of limitations).

181. "Only if Domino shared in the enjoyment of either of these benefits can the payments have conferred an 'economic benefit' upon Domino such that its net worth was preserved by the payments." *Rodriguez*, 895 F.2d at 728.

182. *Id.* at 726-28.

## 2. The Identity of Interest

The identity of interest or enterprise doctrine evaluates whether the parent company and its subsidiary have combined their operations or enterprise in such a way that their financial condition is indistinguishable.<sup>183</sup> When this occurs, the parent company will undoubtedly receive an indirect benefit.<sup>184</sup>

Under this theory, courts are more concerned with the *actual* operations of the parent and subsidiary corporations as opposed to their legal status.<sup>185</sup> If the corporations are commonly controlled and behave as though they are one enterprise rather than as a related group,<sup>186</sup> bankruptcy law allows the combination of the two corporations.<sup>187</sup> Disregarding the corporate separateness of a parent company and its bank subsidiary will benefit the subsidiary's creditors to the disadvantage of the parent company's creditors. The asset transfer made by the holding company would thereby have a greater priority than the other debts of the holding company. As with the net worth theory, there must be a definable benefit to the debtor holding company.

---

183. See generally J. Stephen Gilbert, *Substantive Consolidation in Bankruptcy: A Primer*, 43 VAND. L. REV. 207 (1990) (explaining the requirements for substantive consolidation and its consequences in bankruptcy proceedings); Patrick C. Sargent, *Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue*, 44 BUS. LAW. 1223 (1989) (asserting that when analyzing substantive consolidation of a parent company and its subsidiary, court should identify whether the subsidiary is a separate entity or just an extension of the parent company); William H. Thornton, *The Continuing Presumption Against Substantive Consolidation*, 105 BANKING L.J. 448 (1988) (arguing against substantive consolidation of a parent company and its subsidiary in bankruptcy).

184. *McNellis v. Raymond*, 287 F. Supp. 232 (N.D.N.Y. 1968), *rev'd on other grounds*, 420 F.2d 51 (2d Cir. 1970). Trustee brought action to recover alleged fraudulent transfers by debtor to defendant. The court found that proceeds of a loan made by defendant to a subsidiary company formerly owned by defendant's father were placed in debtor's account, thus allowing debtor to postpone the date of bankruptcy. Therefore, payments made by debtor to defendant were not fraudulent because of the indirect benefit conferred on debtor by placement of the loan in its account. *But see Jones v. National City Bank of Rome (In re Greenbrook Carpet Co.)*, 722 F.2d 659 (11th Cir. 1984). Although the bank knew that a loan given to bankrupt company in satisfaction of a security interest held by the bank would be used for the benefit of a subsidiary company which the bank had refused to make a loan, such knowledge did not render payments by debtor fraudulent transfers. The court found that the transfer between the debtor and the defendant-bank were supported by fair consideration. *Id.* at 661.

185. Enterprise liability, considered primarily a tort law doctrine, places liability for negligence arising out of the enterprise on the owners of the enterprise. See Gregory C. Keating, *The Idea of Fairness in the Law of Enterprise Liability*, 95 MICH. L. REV. 1266 (1997); Robert L. Rabin, *Some Thoughts on the Ideology of Enterprise Liability*, 55 MD. L. REV. 1190 (1996).

186. This is a common practice in the banking industry among related subsidiaries that may engage in such transactions within the specific regulatory context.

187. The bank regulatory agencies have authority under both the Bankruptcy Code and FDICIA to use similar powers. Under section 507 of the Bankruptcy Code, unfulfilled capital maintenance obligations receive a higher priority than other unsecured debts. 11 U.S.C. § 507 (1994). Thus, if a bank holding company files a bankruptcy petition, the regulatory agency will be entitled to receive a portion of the bankrupt's estate to satisfy this obligation. Similarly, FDICIA's prompt corrective action provision authorizes the appropriate regulatory agency to request an assurance of capital maintenance before its bank subsidiary becomes insolvent. See *supra* note 105.

If the downstream transfer of assets depends on the financial position of the subsidiary in order to be an avoidable transfer, the trustee will be successful in avoiding the transactions. The pre-bankruptcy use of funds by a debtor holding company, even if made in compliance with regulatory orders, violates the bankruptcy policy of preserving the estate of the debtor for the equal treatment of all creditors. Even if the transfer were for less than a "reasonably equivalent value," the trustee seeking to avoid it must prove that, as a result of that transaction, the debtor company was financially weakened.

### C. *The Debtor's Financial Status after the Transfer*

A court evaluating the financial status of a debtor after it has made a transfer for less than reasonably equivalent value has a choice of three tests. The court may determine the value of the company by determining whether as a result of the transfer 1) the transferor was insolvent or rendered insolvent, 2) the transferor was left with unreasonably small capital, or 3) the transferor intended to incur debts beyond its ability to pay them.<sup>188</sup> The tests are specific and their results depend on the circumstances surrounding the transaction. The Code gives a court great flexibility in choosing the applicable test.

#### 1. The Transferor was Insolvent or Rendered Insolvent

The insolvency test requires an assessment of the debtor's capital at the time of the transfer. The court's choice and application of a measure are crucial to determining the validity of the transfer.<sup>189</sup> Courts commonly choose either a going concern value or a liquidation value.<sup>190</sup>

The going concern measure evaluates the business assets as a composite. This measure evaluates the present and future earnings potential of those assets and includes an assessment of the firm's contingent li-

---

188. Subsection 548(a)(2)(a)-(B)(iii) is often viewed as a substitute for the actual fraud provision of section 548(a)(1) because it requires a lower standard of proof. Although both types of cases are difficult to prove, section 548(a)(2)(a)-(B)(iii) requires only the debtor's subjective belief that it would be unable to pay its debts. *See supra* note 6.

189. The party seeking to avoid the transfer has the burden of proof of establishing the insolvency of the company as a result of the transfer. *See Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 650 (3d. Cir. 1991) (stating once creditor had met burden of proving its secured status, debtor had burden of proving that transfer was avoidable as preference); *First Nat'l Bank v. Minnesota Util. Contracting, Inc. (In re Minnesota Util. Contracting, Inc.)*, 110 B.R. 414, 419 (D. Minn. 1990) (explaining trustee of bankrupt company has burden of proving each element of fraudulent transfer claim by preponderance of the evidence); *Ohio Corrugating Co. v. DPAC, Inc. (In re Ohio Corrugating Co.)*, 91 B.R. 430, 440 (Bankr. N.D. Ohio 1988) (holding creditor committee failed to sustain its burden of proving that debtor was insolvent even though reconstituted balance sheet indicated that debtor was insolvent at the time of the leveraged buyout).

190. *See James F. Queenan, Jr., The Collapsed Leveraged Buyout and the Trustee in Bankruptcy*, 11 CARDOZO L. REV. 1, 16 (1989) (discussing the different methods of valuation).

abilities.<sup>191</sup> Its objective is to make a fair market value assessment, unless such an assessment would be unwarranted because the debtor is wholly inoperative.<sup>192</sup> Its projection is based on obtaining a multiple of a ratio of stock proceeds to earnings for a similar business and the debtor's current annual earning capacity.<sup>193</sup>

A liquidation value measure operates from the premise that the business is decreasing its capital base by selling its assets in a piecemeal fashion.<sup>194</sup> Most courts are reluctant to use the liquidation measure if the business is still a going concern, fearing that its use will result in an inadequate assessment.<sup>195</sup> Courts use this measure only if the business clearly lacks an ability to generate revenue.<sup>196</sup>

## 2. The Transferor was Left with Unreasonably Small Capital

The test of whether the debtor had "unreasonably small capital" after the transfer is a test of capitalization. The court "examines the relationship, if any, between the amount of capital remaining in the business in the period after the transfer and the business ability to continue operations during that period in the same manner as it conducted them before."<sup>197</sup> Essentially a court analyzes the debtor's financial projections to decide if they are reasonable. The party challenging the asset transfer will be successful if she is able to prove that either the debtor's cash flow was insufficient or the transferee relied upon unreasonable financial projections.<sup>198</sup>

There is in the bankruptcy regime a sole exception to a claim of fraudulent conveyance based on the good faith of the receiving party. The next section examines how courts have interpreted that provision.

---

191. *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988) (suggesting that contingent liabilities must be reduced to their present value); *cf.* *Chase Manhattan Bank v. Oppenheim*, 440 N.Y.S.2d 829, 831 (N.Y. Sup. Ct. 1981) (treating the guarantee as matured and not reducing it).

192. *Bergquist v. Anderson-Greenwood Aviation Corp.*, 56 B.R. 339, 385-86 (Bankr. D. Minn. 1985), *aff'd in part and remanded in part*, 850 F.2d 1275 (8th Cir. 1988) (using balance sheets prepared on a going concern); *Fryman v. Century Factors*, 93 B.R. 333, 341 (E.D. Pa. 1988).

193. *Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 647 (3d Cir. 1991); *In re Vadnais Lumber Supply, Inc.*, 100 B.R. 127, 132 (D. Mass. 1989); *Bergquist*, 56 B.R. at 386.

194. *Covey v. Commercial Nat'l Bank & Trust*, 960 F.2d 657, 661 (7th Cir. 1992); *In re Bellanca Aircraft*, 56 B.R. 339 (D. Minn. 1985).

195. *Covey*, 960 F.2d at 661.

196. *Id.* at 661. The Seventh Circuit Court of Appeals suggests that before using a liquidation value under section 548(a)(2)(B)(1), a court should ask "What would a buyer be willing to pay for a debtor's entire package of assets and liabilities?" A positive price indicates that the firm is solvent and a going concern value should be used; a negative price indicates that the firm is insolvent and a liquidation value should be used. *Id.*

197. *Barrett v. Continental Ill. Nat'l Bank & Trust*, 882 F.2d 1, 4-5 (1st Cir. 1989) (citing *Widett v. George*, 148 N.E.2d 172 (Mass. 1958)).

198. *Murphy v. Meritor Sav. Bank*, 126 B.R. 370, 407 (D. Mass. 1991); *Credit Managers Ass'n v. Federal Co.*, 629 F. Supp. 175 (C.D. Cal. 1985).



#### D. *The Good Faith Defense*

While the trustee seeking to avoid an asset transfer will have the burden of proof, the transferee may meet that challenge with a good faith defense under section 548(c).<sup>199</sup> This exception to the fraudulent conveyance rule forecloses a trustee's right to recover property from a transferee who received the transfer "for value and in good faith."<sup>200</sup> The defense allows an inquiry into the recipient's good faith. Specifically, the transferee must show that it gave a fair consideration, which may have been less than "reasonably equivalent," in good faith.<sup>201</sup> Thus, while the "reasonably equivalent value" standard is strictly an inquiry regarding worth, the good faith exception also focuses on the fairness of the exchange.<sup>202</sup>

When a court applies the good faith exception, it first must make a determination that a fair consideration was exchanged.<sup>203</sup> The court engages in the same "value" assessment discussed regarding reasonably equivalent value.<sup>204</sup>

---

199. 11 U.S.C. § 548(c) provides in relevant part:

Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 . . . a transferee . . . that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

11 U.S.C. § 548(c) (1994). Subsection (d)(2)(a) defines value as: "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor" 11 U.S.C. § 548(d)(2)(A) (1994). See generally Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725 (1984) (discussing the policies that support a trustee's avoiding powers). The courts have not provided a clear definition of how the value of the obligation that a parent company has incurred on behalf of its subsidiary should be measured. Cf. RASMUSSEN, *supra* note 158. Rasmussen argues that the reasonable equivalence measure under section 548(a)(2) actually creates two separate categories of transactions. One category evaluates a transaction that decreased the debtor's net worth because the debtor did not receive a reasonably equivalent value. The other category evaluates the transaction to determine whether it impaired the rights of the debtor's creditors. *Id.*

200. 11 U.S.C. § 548(c) (1994).

201. *Id.*

202. The Code repealed the explicit requirement of good faith founded in the earlier statute. See Bankruptcy Act of 1898, ch. 541, § 67(d), 30 Stat. 544, 564 (1898) (amended by Chandler Act, ch. 575, § 67(d), 52 Stat. 840, 877 (1938) (repealed 1978)). Section 548 now requires that the conveyance have a 'reasonably equivalent' value. 11 U.S.C. § 548 (d)(2)(A) (1994).

203. *McColley v. Rosenberg*, 76 B.R. 342, 349 (S.D.N.Y. 1987) (explaining that no consideration was exchanged where transfers were made to principal of a corporation and his family without ever benefitting the corporation); *In re Jacobs*, 60 B.R. 811, 815 (M.D. Pa. 1985) (stating that where no consideration was exchanged at the time of the transfer, transferee may not assert good faith exception); *Consumers Credit Union v. Widett*, 29 B.R. 673, 675 (D. Mass. 1983) (finding transferee, who was aware of borrower's solvency, and who exchanged reasonably equivalent value, but took a security interest in debtor's property, as not meeting the burden of proof). See generally Note, *Good Faith and Fraudulent Conveyances*, 97 HARV. L. REV. 495 (1983) (arguing that courts have expanded the applicability of the good faith component of the test, with some courts even using it inappropriately in place of an assessment of whether fair consideration was exchanged).

204. *In re American Lumber Co. v. First Nat'l Bank*, 5 B.R. 470, 477 (D. Minn. 1980) (stating that a good faith transfer must have "earmarks" of an arm's length transaction).

The rule requires a court to make a factual determination regarding the transferee's intent to hinder or defraud creditors.<sup>205</sup> The court must examine the bargaining situation surrounding the transaction to determine whether the transferee knew of the debtor's weakened financial condition.<sup>206</sup> That test varies from circuit to circuit; most courts do not require actual knowledge, but will charge a transferee with a "reason to know" standard if the transferee's failure to draw the inference would result in bad faith.<sup>207</sup>

Some courts analyze the transferee's intent by determining whether the transferee actually knew or should have known that the transaction would be damaging to creditors.<sup>208</sup> The issue of the transferee's knowledge is always a factual inquiry.<sup>209</sup>

---

205. *In re American Lumber Co.*, 5 B.R. at 477; *In re Jacobs*, 60 B.R. at 814-15.

206. *In re S & W Exporters, Inc. v. Faberge, Inc.*, 16 B.R. 941, 946 (S.D.N.Y. 1982) (finding that a debtor's receipt of reasonably equivalent value did not protect conveyance from avoidance where transferee had knowledge, actual and/or inferred, of debtor's "unfavorable financial condition").

207. *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1304 (3rd Cir. 1986) (adopting an imputed knowledge standard); *In re Greenbrook Carpet Co.*, 22 B.R. 86, 90-91 (N.D. Ga. 1982) ("Good faith may be lacking because of a transferee's knowledge of a transferor's unfavorable financial condition at the time of the transfer."); *Consumers Credit Union*, 29 B.R. at 677 (citing *McWilliams v. Edmonson*, 162 F.2d 454 (5th Cir. 1947) (stating that a "lender's knowledge of borrower's insolvency prohibits a finding that he is a good faith transferee")). Most courts are willing to find good faith if the conveyance is a payment on an antecedent debt. *Boston Trading Group, Inc. v. Burnazos*, 835 F.2d 1504, 1508-09, 1512-13 (1st Cir. 1987).

208. *In re Maddalena*, 176 B.R. 551, 555 (C.D. Cal. 1995) (explaining that good faith is an objective test requiring that transferee either knew or should have known that transaction was deceptive).

209. Several courts have adopted the factors suggested in the decision *In re Southern Industrial Bank Corp.*, 99 B.R. 827 (Bankr. E.D. Tenn.), *aff'd*, 115 B.R. 930 (E.D. Tenn. 1989). They are:

First, were the transactions at issue within the ordinary course of the defendants' business? . . .

Second, what was the nature and extent of the defendant's relationship with the debtor? If the defendant had an established or insider relationship with the debtor, the defendant's good faith is less likely . . .

Third, what did the defendant know or what should the defendant have known about the effect that the transactions at issue would have on the debtor and its creditors? If the defendant knew or should have known that the transaction would have an adverse effect on the debtor and its creditors, good faith will be difficult to show . . .

Sub-issues here might include:

(A) Was the transaction in the ordinary course of the debtor's business? If it was not, then there is a greater likelihood of an adverse effect on creditors, and the defendant should probably exercise greater care.

(B) What information was available to the defendant regarding the debtor's insolvency? If information was available indicating insolvency, it would be less likely that the defendant acted in good faith.

Fourth, did the defendant violate any legal or professional ethical duties in the transaction at issue? If so, good faith will be more difficult to establish.

Fifth, did the defendant improperly retain any of the property or otherwise benefit from the transactions at issue? . . .

Sixth, did the defendant participate in the transaction with an honest and innocent intention?

*Id.* at 839-39 (internal citations omitted).

In the bank holding context, the good faith defense requires an examination of the relationship between the debtor parent company and its capital-deficient bank subsidiary.<sup>210</sup> Although the parent company may have received an indirect benefit by virtue of the transfer, it is the bank subsidiary, and explicitly its creditors including the insurance fund, that must quantify that benefit as well as prove an absence of bad faith.

E. *The Parent Company's Indirect Benefit: Forbearance from Regulatory Action*

The theories that allow a debtor parent company to make a protected pre-bankruptcy transfer to its subsidiary require an enhancement of the parent company's financial status.<sup>211</sup> Both the identity of interest and net worth theories recognize an indirect benefit to a debtor parent company when it makes a pre-bankruptcy transfer to its solvent subsidiary.<sup>212</sup> Similarly, the good faith exception allows an inquiry into the parent company's good faith in making the transfer, while still requiring that there be a quantifiable exchange of value.<sup>213</sup> Under either of the theories, the value of the indirect benefit to the debtor bank holding company when it makes a transfer to its financially troubled bank subsidiary is somewhat problematic.

The parent company's capital contribution restores value to the bank subsidiary.<sup>214</sup> The restoration of value at the subsidiary level directly benefits its creditors as well as the insurance fund. The bank holding company regulatory scheme promotes the capital infusion, because, by definition, the parent company and its affiliated subsidiaries share an identity of interest.<sup>215</sup> The regulatory scheme also implicitly sanctions the

The Fourth Circuit Court of Appeals adopted a different standard. *Gilmer v. Woodson*, 332 F.2d 541 (4th Cir. 1964) (stating that a transferee's good faith is not challenged if the conveyance was for an antecedent debt rather than for a present consideration). The *Southern Industrial* factors have limited application under a *Gilmer* test. *Gilmer*, 332 F.2d at 548.

210. *In re Greenbrook Carpet Co.*, 22 B.R. at 90. The court stated:

The term, 'good faith,' does not merely mean the opposite of the phrase 'actual intent to defraud.' That is to say, an absence of fraudulent intent does not mean that the transaction was necessarily entered into in good faith. The lack of good faith imports a failure to deal honestly, fairly and openly.

*Id.* (citation omitted).

211. See discussion *supra* note 33 (discussing operation of the net worth maintenance or enterprise theory).

212. See discussion *supra* note 33 and *infra* Part V.B.

213. *In re Wes Dor*, 996 F.2d 237, 242 (10th Cir. 1993) (stating that inquiries into whether a "quantifiable exchange of value" occurred is largely a question of fact to which considerable latitude must be given to the trier of fact, and affirming the bankruptcy court's finding that "quantifiable exchange of value" includes the securing of an antecedent debt of a wholly-owned subsidiary by a bank through the parent company).

214. *In re Carousel Motels, Inc.*, 160 B.R. 993, 1000 (Bankr. S.D. Ohio 1993).

215. See *In re Carousel Motels, Inc.*, 160 B.R. at 1000. See also Board of Governors of Fed. Reserve Sys. v. First Lincolnwood Corp., 439 U.S. 234, 251-52 (1978). The Court stated:

The Board has frequently reiterated that holding companies should be a source of strength to subsidiary financial institutions. It has used the substantial advantages of bank

transfer between the parent company and the direct beneficiaries, i.e., the bank subsidiary's creditors, including the insurance fund. The banking regulatory structure, by permitting the parent company to serve as a proxy for liability upon the bank subsidiary's decline, creates the identity of interest between the parent company and the bank subsidiary's creditors.<sup>216</sup> Yet, because the parent company receives only an indirect benefit, the good faith exception mandates a fair value for the transaction. The existing banking regulatory structure does not provide a different measure for the proxy arrangement. The difficulty in quantifying the mandated indirect exchange suggests the need for an alternative approach in the banking context.

#### V. CRAFTING A BANK EXCEPTION TO THE FRAUDULENT CONVEYANCE PROVISION

The banking regulatory structure arguably requires parent companies to make an asset transfer or capital infusion that the Code labels a fraudulent conveyance. The existing bankruptcy regime does not protect a pre-bankruptcy parent company asset transfer.<sup>217</sup> The dormant conflict raises the issue of how these two bodies should authorize the debtor parent company's pre-bankruptcy transfers to its insolvent subsidiary.<sup>218</sup>

Examining the economic identities of the parent and its bank subsidiary is crucial to resolving the conflict. This proposal recommends amending the Code to include a *banking enterprise exception*, which has a three-pronged effect. First, the exception explicitly recognizes the singular nature of banking conglomerates operating collectively with the

holding-company status to induce applicants to improve their own and their subsidiaries' capital positions. . . . Congress has been apprised of this consistent administrative practice, . . . and has not undertaken to change it.

*Id.* (citations omitted).

216. *In re Carrousel Motels, Inc.*, 160 B.R. at 1000.

217. The enforceability of the capital restoration plan is unaffected by whether the bankruptcy of the parent company precedes that of the banking subsidiary. In *MCorp*, both the parent company and the majority of its bank subsidiaries were insolvent when the Federal Reserve Board issued the regulatory orders requiring the parent company to make the transfers. See discussion *supra* Part II.A.B. To the contrary, the insolvency of BNE preceded the insolvency of BNEC by several months. BNEC was book solvent when the banking regulators required it to make capital infusion into BNE. See discussion *supra* note 71.

218. Although Congress intended through the prompt corrective action provision to enact a more enforceable capital maintenance obligation, it may have created a more scurrilous one. The source of strength condition, arguably, is mandatory, not discretionary. Failure to comply with the regulatory agency orders regarding source of strength has resulted in issuance of cease and desist orders for engaging in an unsafe and unsound banking practice under 12 U.S.C. § 1818(b). See discussion *supra* note 96 (noting that the Federal Reserve issued orders to parent company of failing bank subsidiaries requesting transfers pursuant to source of strength requirement).

To the contrary, the prompt corrective action provision, arguably, is discretionary. The parent company decides to submit a capital restoration plan for regulatory review, yet its failure to comply with the approved plan would subject the parent company and the bank subsidiary to regulatory sanctions. See *supra* note 151 and accompanying discussion.

sanctioned use of federally insured funds.<sup>219</sup> Second, it is consistent with the Code's overall goal to provide an equitable distribution of the debtor's estate to its creditors.<sup>220</sup> Finally, it provides a balance of power between the FDIC-Receiver and the bankruptcy court regarding the review function of the asset transfer.<sup>221</sup> The unique structure of the banking industry requires this specific change to balance the parent company's use of the bank subsidiary funding in order to protect the business decision of the parent company to make the transfer and to limit the powers of the FDIC-Receiver.

#### A. *The Proposal: The Banking Enterprise Exception*

The banking enterprise exception to the fraudulent conveyance provision offers protection from a trustee's avoidance action to recover a pre-bankruptcy asset transfer to a failed bank subsidiary.<sup>222</sup> It provides the federal banking agency with a defense for the parent company's decision to shore up an insolvent bank subsidiary upon a showing that the parent company, and its bank and nonbank subsidiaries operated as an economic unit.<sup>223</sup> Upon a showing of an economic enterprise operation, the bankruptcy court must recognize the deposit insurance fund as a valid transferee and may not enter an order to return the asset transfer to the debtor parent company's estate.<sup>224</sup> This finding also limits the actions of the bankruptcy trustee. The trustee of a debtor parent company may not file an avoidance action against FDIC-Corporate as a subsequent transferee of pre-bankruptcy assets.<sup>225</sup> Additionally, the proposed change would eliminate the FDIC-Receiver's review function as to these particular assets, except to provide a certification stating the amount of the asset transfers, thereby allowing for an offset or credit of any cross-guarantee assessment that may be imposed against a solvent bank subsidiary in the enterprise.<sup>226</sup> The bankruptcy court has jurisdiction over the claim, reviewing it for legal sufficiency. Thus, the powers of the administrative agency are more properly aligned with those of the bankruptcy court.

---

219. See discussion *infra* Part V.A.

220. See discussion *infra* Part V.B.

221. See discussion *infra* Part V.C.

222. See generally *Branch v. F.D.I.C.*, 825 F. Supp 384 (D. Mass. 1993).

223. *BNE-I*, 825 F. Supp. at 384.

224. *Id.*

225. This finding would also provide avoidance action protection to any subsequent purchaser of holding company assets.

226. See *infra* note 229.

## B. *Inter-Affiliate Transactions as Routine Business Practice*

Banking laws allow the banking conglomerate to operate as a single economic enterprise.<sup>227</sup> However, because the regulatory structure does not mandate that the parent company pool its affiliate funds to reduce losses, the permissive regulatory structure can contribute to a bank subsidiary's failure.<sup>228</sup>

The regulatory process provides a limited policing mechanism to govern the transactions between a bank subsidiary and its affiliates. Section 23 is the statutory scheme that regulates transactions between affiliates.<sup>229</sup> Section 23A regulates the parent company's potential for abusive conduct in transactions between bank and nonbank subsidiary corporations.<sup>230</sup> Section 23B establishes the standards for the terms and conditions of affiliate transactions.<sup>231</sup>

Transactions between commonly owned bank and nonbank subsidiaries must meet qualitative and quantitative requirements. The qualitative restrictions result in a fair market exchange of value, including requirements of full collateralization and no individual transaction exceeding 10 percent of the bank subsidiary's capital and surplus.<sup>232</sup> The quantitative

---

227. See generally Phillip I. Blumberg, *The Increasing Recognition of Enterprise Principles in Determining Parent and Subsidiary Corporation Liabilities*, 28 CONN. L. REV. 295 (1996). Pooling profits is equivalent to the bank maintaining subsidiary's capital if the parent company has used the banking subsidiaries assets for other subsidiaries. However, if the parent company has made transfers among bank and nonbank subsidiaries, the interests of the FDIC may not be protected. *Id.* at 326.

228. 12 U.S.C. § 1821 (1994) (explaining that the cross-guarantee provision addresses this issue in part when the bank fails by allowing the FDIC to assess liability for the cost of the failure of an institution against commonly owned bank subsidiaries).

229. Section 23A of the Federal Reserve Act, 12 U.S.C. § 371c, applicable to all national banks and FDIC insured institutions, identified certain types of transactions between affiliates as risky, e.g., loans, credit, various forms of financial support, and limits the institution's use of capital for these transactions. Originally passed in 1933 as part of the Bank Act of 1933 (Glass-Steagall Act), it evidenced the concern that commercial banks and investments should be separate. In the Bank Affiliate Act of 1982, Congress specifically amended the provision to allow more flexibility and movement of funds. See 12 U.S.C. § 371c (1994).

230. The statute defines "affiliate" generally as any company that controls the bank or any other company that is controlled by the company or shareholders that controls the bank. "Control" is deemed to exist with direct or indirect ownership of or power to vote 25 percent or more of any class of voting security of a company, control over the election of a majority of the directors of a company, or the exercise of a controlling influence over the management and policies of a company, as determined by the Federal Reserve. 12 U.S.C. § 371c(b)(3)(A) (1994). See 12 U.S.C. § 371c-1(d) (1994) (generally incorporating into Section 23B the definitions set forth in Section 23A); see also 12 C.F.R. § 563.41(b)(3)(i)(B) (1997) (regulation applicable to savings associations specifying additional circumstances under which "control" may be found). 12 U.S.C. § 371c(b)(1) (1994). The "affiliate" definition also includes any company of which a majority of the directors also constitute a majority of the directors of the institution or any company that controls the institution. 12 U.S.C. § 371c(b) (1994).

231. 12 U.S.C. § 371c-a (1994).

232. Section 23A is one of several regulations that monitors the conduct of the parent company regarding its bank subsidiary. Congress has identified, and circumscribed the parent company's potential for abusive conduct in several critical areas. These include capital adequacy regulations as

restrictions have a similar scope of protectiveness. Those provisions restrict the bank subsidiary's total interaffiliate transactions to no more than 20 percent of its capital and surplus.<sup>233</sup> Within these limitations, however, the bank and nonbank subsidiaries may operate as a single enterprise.<sup>234</sup> Section 23A arguably favors transactions between bank subsidiaries owned by the same parent company.<sup>235</sup> The so-called "sister-bank" exemption excuses 80 percent of commonly controlled bank subsidiaries from complying with the quantitative limitations of section 23A.<sup>236</sup> Section 23B broadens the scope of section 23A in its inclusion of "covered transactions"<sup>237</sup> and by requiring that the terms and circumstances of a transaction with a bank subsidiary be on as favorable terms as those to comparable institutions, or in good faith.<sup>238</sup>

Transactions between subsidiaries may benefit the entire enterprise.<sup>239</sup> They provide operational flexibility, such as easing geo-

addressed in 12 U.S.C. § 2154 (1994); insider loans in 12 U.S.C. § 84 (1994); and removing wealth from the bank in 12 U.S.C. § 248 (1994). Section 23 specifically addresses transactions between a nonbank affiliate subsidiary and a bank subsidiary.

Of the several restrictions addressing the quality of the assets, the requirements include that the interaffiliate transaction be: 1) not of "low-quality," 12 U.S.C. § 371c(a)(3) (1994); 2) on terms and conditions consistent with safe and sound banking practices, 12 U.S.C. § 371c(b)(10) (1994); and 3) secured by collateral having a value of at least 100 percent of the amount loaned, 12 U.S.C. § 371c(b)(4) (1994). The statute prohibits a banking subsidiary from any individual transaction that exceeds 10 percent of its capital and surplus. 12 U.S.C. § 371c(1)(A) (1994).

233. 12 U.S.C. § 371c(a)(1)(B) (1994). 12 U.S.C. § 23(d)(1) (1994).

234. 12 U.S.C. section 371c(a)(1)(B) (1994) & 12 U.S.C. section 23(d)(1) (1994).

235. Section 23A will not prohibit transactions between commonly owned bank subsidiaries if they do not involve low-quality assets. *See* 12 U.S.C. § 371 c(d)(1) (1994). *See generally* Veryl Victoria Miles, *Banking Affiliate Regulation Under Section 23A of the Federal Reserve Act*, 105 *BANKING L.J.* 476 (1988).

236. 12 U.S.C. § 371c(d)(4) (1994).

237. Covered transactions with affiliates also include (1) sale of assets or securities to an affiliate, (2) the payment of money or the furnishing of services to an affiliate under contract, lease, or otherwise, (3) any transaction in which an affiliate acts as agent or broker or receives a fee for its services to the institution or any other person, and (4) any transaction (or series of transactions) with a third party if an affiliate has a financial interest in the third party or is a participant in the transaction or series of transactions. 12 U.S.C. § 371c-1(a)(2) (1994).

238. *See Orders Issued Under Section 4 of the Bank Holding Company Act Metrocorp, Inc.*, 79 *Fed. Res. Bull.* 352 (April 1993). The Federal Reserve rejected Metrocorp's proposal to engage in nonbanking activity through its affiliate, MAC, because approval of such proposal would be in violation of, and inconsistent with, section 23B which was intended to prevent unsafe or unsound banking practices. The Board found that Metrocorp could not have in good faith provided services to an unaffiliated armored car service without determining the actual cost of such services, but nonetheless charging a flat fee. *See also* *FDIC v. Benson*, 867 F. Supp. 512 (S.D. Tex. 1994). The FDIC brought suit against officers and directors of bank for their alleged negligence in connection with bank loans. As receiver for insolvent bank, FDIC has same rights and privileges of creditors, shareholders and depositors, therefore by suing the defendants, FDIC was acting in its capacity as bank's subrogee. However, absent proof that defendants knew of actual fraud or concealment, Texas business judgment rule protects the defendants from liability. *Id.*

239. The bank regulators become aware of violations of Rule 23A and 23B only during the examination process. That process is itself bifurcated. The FDIC, OTS, and OCC are the examiners of the bank subsidiary and the Federal Reserve is responsible for the parent company and any

graphical restrictions and lowering the cost of obtaining loans for the bank subsidiary. The bank subsidiary is a ready purchaser of loans to increase its asset portfolio, and the nonbanking subsidiary is a willing seller to meet cash flow needs.<sup>240</sup>

Although a parent company routinely uses the bank subsidiary's low-cost funds, its conduct is not defensible as profit-maximizing for the bank subsidiary under certain circumstances. Abusive parent company conduct may include: 1) relying on core deposits for group funding needs; 2) making loans from banking operations; 3) allowing a bank subsidiary to have a temporary liquidity crisis, thereby requiring borrowing from the Federal Reserve; 4) placing new profit-generating enterprises in nonbank subsidiaries; 5) allowing a nonbank subsidiary to purchase services from banks at low or no profit margins; or 6) allocation of bank profits, including distribution of dividends and new loans to nonbank operations.<sup>241</sup>

Supporting the statutory scheme allowing the use of bank subsidiary funds is the presumption that the examination process will deter the parent company from engaging in, or will detect the parent company's at-

---

nonbank subsidiary. Failure to comply with the requirements of Rule 23A and 23B may result in enforcement proceedings based on violation of safety and soundness standards or in civil monetary penalties for the bank's management. See discussion of section 1818 *supra* Part II.A.2. Although the Federal Reserve has primary authority to interpret 12 C.F.R. § 250.250, OTS, OCC, and FDIC, because of their primary jurisdiction over depository institutions, also construe this regulation as well as Sections 23A and 23B. See Joseph P. Daly, *Asset Purchases from Affiliates: The Federal Reserve's Interpretive Exemption from Limits on Affiliate Transactions*, 113 BANKING L.J. 601 (1996).

240. See Sean J. Geary, *The Credit Transaction*, in *Basics of Banking Law 1991*, at 197 (PLI, Comm. Law & Practice Course Handbook Series No. 593, 1990).

241. A transaction involving a bank subsidiary and its nonbank affiliate may not be readily identifiable and would not necessarily be detected in the examination process. A former banking regulator, who favored tighter controls of transactions under Section 23, has outlined the potential for abuses. Improper transactions that may be risky fall into two categories. One category involves transactions that may be profitable to the parent company, but which expose the bank subsidiary to undue risk of failure. Commonly, a parent company may allow its troubled bank subsidiaries to misprice business transactions. For example, a bank subsidiary may charge excessively low loan rates, or transfer assets for book value rather than market value. Similarly, a parent company may allow its bank subsidiary to declare a high dividend, and then use those funds only for nonbank operations. The second category involves improper transactions between the bank and nonbank subsidiary. A parent company may allow its nonbank subsidiaries to make risky loans with a bank subsidiary or the parent company may overcharge bank subsidiaries for management or data processing services. Impermissible transactions are not always easy to detect through the regulatory examination process.

Furthermore, the differing jurisdiction of the regulatory agencies may make a prohibited transaction even more difficult to uncover. The Federal Reserve Board regulates the parent company and the nonbank subsidiary, while the OCC and the FDIC regulate the bank subsidiary.

In *Fitzpatrick v. FDIC*, 754 F.2d 569 (6th Cir. 1985), the FDIC found that there was blatant abuse of interaffiliate funding which was detectable because the institution was insolvent. The court also stated that loans from a member bank to its affiliates must be secured by a collateral which is only met by perfected security interest. Here, the bank director approved loans that exceeded the lending limits and violated the collateral requirements; the court held that the imposition of a \$1,000 civil penalty was not arbitrary and capricious. *Id.*



tempt to camouflage or disguise, the restricted transaction.<sup>242</sup> The examination process, however, serves as a notification only after the deleterious conduct has occurred.

The principle question perhaps becomes one of public statutory policy. A parent company that owns a bank subsidiary is responsible for maintaining its regulatory capital. The banking statutes have a fixed determination of what constitutes undercapitalization.<sup>243</sup> The asset transfers mandated under the banking statutes draw an imprecise correlation between the undercapitalized subsidiary and interaffiliate transfers. Furthermore, that correlation, arguably, is based on the presumption that those transfers contributed to a decline of the banking subsidiary's capital.<sup>244</sup>

Evaluating the funding needs of the subsidiary that receives the transfer becomes critical to determining whether there is abusive conduct in the use of federal depository funds and balances these concerns regarding pairing the capital infusion with the interaffiliate transactions.<sup>245</sup> To determine if the parent company's decision is in the best interests of the bank subsidiary making the transfer, the regulations must include an evaluation of the parent company's conduct at the time of the transaction. Specifically, when the bank funds are shifted or transferred, there should be an assessment regarding whether the receiving subsidiary uses them for investment opportunities or for working capital needs.<sup>246</sup> The evaluation requires the parent company to support its decision to make the transfer at the time of the transaction.<sup>247</sup> A defensible decision is one in which the parent company can show that it used low-cost bank funds for investment purposes.<sup>248</sup> A non-defensible decision is one in which the low-cost bank funds were used for working capital.<sup>249</sup> As a matter of routine business analysis, there should be an assessment, perhaps, a stan-

---

242. See generally John T. Rose & Samuel H. Talley, *Bank Transactions with Affiliates: The New Section 23A*, 100 BANKING L.J. 423 (1983); John T. Rose & Samuel H. Talley, *Section 23A of the Federal Reserve Act: Issues Surrounding Financial Transactions Between a Bank and Affiliated Companies*, ISSUES IN BANK REG., Summer 1978, at 8.

243. 12 U.S.C. § 1821 (1994).

244. The Federal Reserve Board's regulatory order requiring the capital infusion does not identify which interaffiliate transactions have resulted in a decline of the banking subsidiary's capital. That order simply seeks to restore the financial institution's capital adequacy by readjusting a portion of the banking subsidiary's debt as equity. One such method is to infuse, into the banking subsidiary, the amount of capital needed to meet the statutory requirement.

245. Under 12 C.F.R. § 250.250, transactions between the bank and nonbank affiliate may be exempt from rule 23A if three conditions are met: a commitment by the bank prior to the affiliate's commitment to make the loan, an independent credit evaluation by the bank, and the absence of a blanket advance commitment by the bank. See 12 C.F.R. § 250.250 (1997). That section has been interpreted through federal reserve rulings to distinguish the use of funds for investment and working capital purposes. See Daly, *supra* note 239, at 608-11.

246. See Daly, *supra* note 239, at 607.

247. 12 C.F.R. § 250.250(c) (1997).

248. *Id.*

249. *Id.*

standardized range, of the effect on or risk of loss to the subsidiary because of an interaffiliate transaction. Should the bank subsidiary become insolvent, this analysis should yield a correlation between the bank subsidiary's unprofitable posture and the risky or abusive parent company conduct. The lack of a nexus between the operation of the enterprise and the default, and insolvency of the bank subsidiary will allow the bankruptcy trustee to establish that the questioned asset transfer was a fraudulent conveyance, not a routine business transaction protected from an avoidance action.

A transfer made to satisfy working capital needs should not be subject to an avoidance action under the Code. Whether the transfer is used as working capital, can be determined by evaluating whether the parent company has engaged in either beneficial conduct or wrongful conduct. Beneficial conduct describes the parent company's decision to elect to describe its corporate operation as an integrated economic enterprise.<sup>250</sup> This means the parent company acknowledges that it routinely uses the bank subsidiary assets to maximize the profits and diversify the losses of the conglomerate.<sup>251</sup> Moreover, the designation means that the parent company is willing to use enterprise resources, e.g., nonbank subsidiary funds, to assist a bank subsidiary that becomes insolvent.<sup>252</sup> Wrongful conduct describes the appropriate bank agency's determination that the operation functions as an integrated economic enterprise. The appropriate bank regulator must establish that the parent company through interaffiliate transactions jeopardized the capital of the bank subsidiary. This requires an assessment of the parent company's conduct to determine the restrictions on transactions between bank subsidiaries. Specifically, the bank subsidiary's regulator reviews the parent company's record of interaffiliate transactions to evaluate compliance with the parent company's internal policies and guidelines.<sup>253</sup> Those standards should address how

---

250. See Cohen, *supra* note 14.

251. One author argues that holding company level compliance is a more cost-effective means of complying with FDICIA's increased regulatory and compliance costs. See Cohen, *supra* note 14. This model suggests that the parent company makes the capital infusion because it is in the best interest of the enterprise to keep the bank subsidiary well-capitalized. *Id.* at 31.

252. This theory is consistent with the investment-backed expectations of investors of a regulated industry, such as banking. The burden of proof follows the party that elects to make the determination. The parent company is allowed to make the declaration because it may be in its best interest not to have the transfer avoided. This situation might arise if, the parent company, at the time the filing of its bankruptcy petition, has solvent bank subsidiaries. Under the proposed change, recognition of a pre-bankruptcy parent company asset transfer as valid operates as a credit against a cross-guaranty assessment made to a solvent bank subsidiary in the same enterprise.

253. These pre-established guidelines and policies are not subject to regulatory approval. See Daly, *supra* note 239, at 605. See also Mark D. Rollinger, *Interstate Banking and Branching Under the Reigel-Neal Act of 1994*, 33 HARV. J. ON LEGIS. 183 (1996) (discussing new correspondent banking rules).

the parent company evaluates the effect of interaffiliate transactions on a bank subsidiary's capital performance.<sup>254</sup>

Enterprise liability seems appropriate when the parent company has made a decision that creates a *material* risk of loss to the federal deposit insurance fund.<sup>255</sup> The banking enterprise exception is premised on the conglomerate's risky use of federally insured funds as a routine business practice. Parent company obligation is appropriate in those circumstances where the parent company has engaged in abusive or risky use of deposit funds within its operation.<sup>256</sup> Requiring the parent company to monitor its own operations is an appropriate policing mechanism. The parent company becomes responsible for ensuring the reasonable use of federally insured funds.<sup>257</sup> The parent company closely regulates its own conduct determining the effect on the bank subsidiary.<sup>258</sup> By carefully assessing the risk of interaffiliate transactions, a parent company may decide to avoid certain transactions, restructure others or engage in risky ones knowing that those could be costly.

The nexus between the interaffiliate transfers and the bank subsidiary's decline is implicitly articulated by the banking regulatory

---

254. The parent company is allowed to make the declaration because it *may* be in its best interest not to have the transfer avoided. This situation might arise if, at the time the filing of its bankruptcy petition, the parent company has solvent bank subsidiaries. Under the proposed change, recognition of a pre-bankruptcy parent company asset transfer as valid operates as a credit against a cross-guaranty assessment made to a solvent bank subsidiary in the same enterprise. See discussion *infra* Part V.C.

In *Credit Lyonnais Bank Nederland v. Pathe Comms. Corp.*, 1991 WL 277613, at \*1, \*34 (Del. Ch. Dec. 30, 1991), Chancellor Allen ruled that directors of a corporation that is in the vicinity of insolvency have an obligation to creditors as well as shareholders. The "vicinity of insolvency" issue is germane to this discussion because the requirement that the parent company make a judgment in the best interests of the bank subsidiary defines the parent company's fiduciary duty on behalf of the subsidiary in a way that also creates a fiduciary obligation to the insurance fund as a creditor.

255. See discussion of cross-guarantee provision *supra* note 241. Limited liability protects related corporations from collective responsibility for financial losses. Corporate law disregards limited liability only if the holding company system is using the corporate structure as a veil or sham for other fraudulent business. See generally Christopher W. Frost, *Organizational Form, Misappropriation Risk, and the Substantive Consolidation of Corporate Groups*, 44 HASTINGS L. J. 449 (1993); Henry Hansmann & Reinier Kraakman, *Toward Unlimited Shareholder Liability for Corporate Torts*, 100 YALE L.J. 1879 (1991); Larry E. Ribstein, *Limited Liability and Theories of the Corporation*, 50 MD. L. REV. 80 (1991).

256. See Havard, *supra* note 33, at 2363-64.

257. In an earlier piece, I posited that an alternative means for securing the capital infusion needed for a troubled bank of a multi-bank holding company system—temporary consolidation of the financial institutions in the holding company structure. I proposed factors that the FDIC should apply to determine whether the subsidiaries in the multi-bank holding fail to have separate economic identities. Such a finding would result in a temporary suspension of the charter in order for consolidation to occur. *Id.* at 2399, 2408-10.

258. See Gouvin, *supra* note 151, at 351-53 (arguing that the effect of such parent company or shareholder monitoring results in an overzealousness by the regulatory agencies to protect the insurance fund to the disadvantage of the private market and the self-policing of those shareholders).

structure.<sup>259</sup> The correlation, evidenced in the prompt corrective action provision, values the tangible and intangible benefits of bank holding company affiliation.<sup>260</sup> Furthermore, that *regulatory-permissible* asset transfer incorporates a legitimate business responsibility: the pooling of funds to meet the bank subsidiary's safety and soundness concerns.<sup>261</sup> Thus, the parent company's decision to shore up its bank subsidiary ought to be immune from attack by its own shareholders.

### C. *Economical Use of the Parent Company's Resources*

An asset transfer or capital infusion that reduces the debtor parent company's estate ought to be unavoidable in limited circumstances.<sup>262</sup> Viewing the exchange as one made within the collective conglomerate warrants valuing the capital infusion as payment for a prior liability, an improperly capitalized interaffiliate transaction.<sup>263</sup> Satisfying the banking enterprise exception measures the transfer's value to the conglomerate operation. Viewing the conglomerate collectively also supports the argument that the insurance fund's equitable interest is greater than that of the debtor parent company's estate. The payment is a cost of doing business, or a decision that the parent company made well before the transfer actually occurred.

Recognizing the asset transfer as a valid pre-petition obligation prevents the costs of interaffiliate transfers from being shifted to the FDIC.<sup>264</sup> The downstream contribution is another decision to shift losses or maximize profits within the group.<sup>265</sup> The banking enterprise exception ex-

---

259. This policy choice operates even when the parent company has become insolvent because the parent and subsidiary corporations are a single operation based on the realities of their corporate financial structure. See Blumberg, *supra* note 227, at 308-10.

260. Havard, *supra* note 33, at 2686-88.

261. Bankruptcy law uses substantive consolidation to join the resources of related corporations to enlarge the debtor's estate to satisfy the claims of creditors. Blumberg, *supra* note 227, at 328-29. See also John C. Deal, et. al., *Capital Punishment: The Death of Limited Liability for Shareholders of Federally Regulated Financial Institutions*, 24 CAP. U. L. REV. 67, 129 (1995).

262. The Federal Reserve's regulatory order based on the source of strength doctrine does not identify which interaffiliate transactions have resulted in the decline of the banking subsidiary's capital. That order simply seeks to restore the financial institution's capital adequacy by readjusting a portion of the banking subsidiary's debt as equity, e.g. infuse the amount of capital into the banking subsidiary needed to meet the statutory requirement. FDIC IMPROVEMENT ACT, H.R. NO. 103-330, reprinted in 1991 U.S.C.C.A.N. 1901, 1917-1935.

263. This policy choice operates even when the parent company has become insolvent because the parent and subsidiary corporations are a single operation based on the realities of their corporate financial structure. See Havard, *supra* note 33, at 2409-10.

264. Emeric Fischer, *Banking & Insurance—Should Ever the Twain Meet?* 71 NEB. L. REV. 726, 771 (1992).

265. Three types of intercorporate guarantees exist: (1) a guarantee by a parent corporation or principal shareholder of a subsidiary's debt (a "downstream" guarantee); (2) a guarantee by a subsidiary of its parent's or principal shareholder's debt (an "upstream" guarantee); and (3) a guarantee by a corporation of an affiliated corporation's debt (a "cross-stream" guarantee). See generally Phillip I. Blumberg, *Intragroup (Upstream, Cross-stream, and Downstream) Guaranties Under the Uniform Fraudulent Transfer Act*, 9 CARDOZO L. REV. 685 (1987).

tends enterprise liability to the parent company's decision to fund an insolvent bank subsidiary.<sup>266</sup> To the extent that the parent company has engaged in the beneficial use of the bank subsidiary's deposit funds, its decision to pool enterprise resources to strengthen its financial condition is a protected business judgment.<sup>267</sup> The funding needs and uses of the bank subsidiary are justifiable diversions of group finances.

The questioned asset transfer should withstand an attack alleging violation of the business judgment rule because of the industry practice allowing bank holding companies to engage in inter-affiliate transactions. The financial decline of the bank subsidiary has several attendant losses. The reputation of the enterprise suffers if the bank subsidiary fails.<sup>268</sup> The interdependent bank and nonbank businesses deteriorate.<sup>269</sup> The business practices of the particular bank holding company demonstrates the frequency of the transactions within that enterprise. The nature of the relationship between the parent company and the bank subsidiary, prior to bankruptcy, ought to make the parent company's decision less vulnerable to shareholders' attack.<sup>270</sup>

#### D. *Limiting the FDIC-Receiver's Function*

The FDIC-Receiver has been highly successful in defending challenges brought by the trustee regarding the exercise of its discretionary powers. Arguably, Congress has camouflaged which body of law "trumps" or controls the procedural jurisdiction of the debtor parent company. A reasoned approach suggests that the two statutory schemes share the grant of jurisdiction.<sup>271</sup> By carefully parsing the statutory language, it appears that Congress has created equitable remedies that are congruent. The bank regulatory agencies are not subject to the automatic

---

266. Lissa Lamkin Broome, *Redistributing Bank Insolvency Risks: Challenges to Limited Liability in the Bank Holding Company Structure*, 26 U.C. DAVIS L. REV. 935, 987 (1993).

267. See Gouvin, *supra* note 1; see also Patricia A. McCoy, *The Notional Business Judgment Rule in Banking*, 44 CATH. U. L. REV. 1031 (1995); Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 GEO. WASH. L. REV. 175 (1995); Mark David Wallace, *Life in the Boardroom after FIRREA: A Revisionist Approach to Corporate Governance in Insured Depository Institutions*, 46 U. MIAMI L. REV. 1187 (1992).

268. See Garten, *supra* note 14, at 371.

269. *Id.* at 362.

270. The interbank liabilities regulation which requires a bank to develop internal policies and procedures to control exposure in correspondent banking relationships provide bank directors with a safe harbor for the implementation of those policies. 12 U.S.C. § 250 (1994).

271. The Code's automatic stay provision does not address its interaction with FIRREA's bar of judicial intervention. The Second Circuit distinguished *MCorp* in *In re Colonial Realty Co. v. Hirsch*, 980 F.2d 125 (2d Cir. 1992), finding that there was no section 362 exemption available to the FDIC-receiver because the FDIC was suing for damages and recovery of property. The court reasoned that the debtor retains no legal or equitable interest in fraudulently transferred property. Thus holding that the automatic stay applied to the FDIC-receiver's efforts to exercise its powers to avoid asset transfers. *In re Colonial Realty Co. v. Hirsch*, 980 F.2d 125 (2d Cir. 1992); *Carroll v. Tri-Growth Centre City, Ltd.*, 903 F.2d 1266 (9th Cir. 1990).

stay because the stay occurs by operation of law.<sup>272</sup> The language of section 1821(j) prohibits a court from interfering with the powers and duties of the receiver. Yet, section 362, the automatic stay provision, does not require court action. Instead, the stay is merely activated to control litigation involving the debtor.<sup>273</sup> Therefore, since the stay is self-operating, it literally entails no court action, and thus, results in no violation of the anti-injunction power of the receiver under section 1821(j).

This interpretation, however, would require the FDIC-Receiver to pursue its claims, such as funding a capital maintenance obligation, against the debtor in the bankruptcy court, as suggested by the *MCorp* decision. This concurrent jurisdiction, applicable only to final agency actions, would result in the bankruptcy court's exercising final relief to the claims of the FDIC-Receiver.<sup>274</sup> The question then becomes whether the existing bankruptcy scheme provides an unacceptable frustration of the FDIC-Receiver's efforts to resolve the failure of an insolvent bank. In the terms of this article, the question becomes whether the claims process should govern the trustee's claims against FDIC-Corporate for fraudulent conveyances.

The receiver's grant of jurisdiction should not be equivalent to the bankruptcy court's jurisdiction in this context. The existing bank insolvency scheme invests the receiver with a dual status: successor and adjudicator. Not only is the receiver a fiduciary of the failed institution's assets for the protection of the creditors, the receiver is also a judge of the merits of those creditors' claims. This intrinsic conflict of interest requires a fairer process.<sup>275</sup> By enacting the banking exception, Congress could provide creditors with an objective, preliminary review of claims.<sup>276</sup>

The FDIC-Corporate receives priority status as an unsecured creditor whenever it must contribute funds due to a financial institution's insolvency.<sup>277</sup> Unsecured creditors receive the liquidation value of their

---

272. Richard F. Hewitt, Jr., *In Re Landmark Land Co.: A Landmark Roadblock for Bankruptcy Courts v. Federal Regulators?*, 45 S.C. L. REV. 68, 78-79 (1993); J. Van Oliver & John Sparacino, *Chapter 11 and Financial Institutions: Super Powers and Super Problems for Banks, Regulators and Bank Holding Companies*, in *Banking Law Series* 1993 at 197 (PLI Comm. & Practice Course Handbook Series No. 651, 1993).

273. *In re Colonial Realty Co.*, 980 F.2d at 137.

274. Roy C. Snodgrass, III & Shawna L. Johannsen, *Banking Law*, 46 S.M.U. L. REV. 935, 947-48 (1993).

275. See *supra* Part II.B.2. (discussion of administrative and judicial review of receiver's determination of claims).

276. As in the present bankruptcy scheme, a creditor could appeal to the appropriate federal district court for a review of the bankruptcy court's decision. See *supra* Part V.C.

277. The FDIC-receiver (receiver) usually chooses between two resolution methods. The receiver may choose to liquidate the failed institution and distribute the proceeds to creditors. See 12 U.S.C. § 1821(d)(2)(E) (1994). Or, the receiver may sell all or a portion of the failed institution to a healthy institution using a purchase and assumption transaction. § 1821(d)(2)(G) (1994). FIRREA requires that the FDIC use the "least costly alternative." 12 U.S.C. § 1823(c)(4)(A) (1994).

claims. Assumed creditors may receive full satisfaction of their claims.<sup>278</sup> The FDIC-Receiver decides whether to allow or disallow all claims, including secured and unsecured priority claims. The receiver's disallowance of a claim precludes judicial review of that claim.<sup>279</sup>

Both the Code and FIRREA are concerned with fair distribution and timely resolution of creditors' claims. Both the receiver and the bankruptcy court have a specialized expertise in winding up the affairs of failed businesses and entities. Both have a state policy objective of ensuring unity in that procedure. Although invested with similar powers and jurisdiction, neither is an expert at the other's job. The insolvency of a parent company that has made an asset transfer or capital maintenance payments in the year preceding its insolvency requires the skill of both.

Concurrent jurisdiction, to the extent that it directs a consistent, equitable review of such a claim, would resolve the dormant conflict. Both the bankruptcy court and the receiver should have jurisdiction to review *de novo* the claim by a parent company or its trustee that the transfer of funds to the bank subsidiary should be avoided. Other procedural matters should also be uniform, namely, the time deadlines for filing and the opportunity to appeal to the district court for a review of the determination.

The grant of jurisdiction to both the bankruptcy court and the banking receiver should be limited to a determination of the amount, not the validity of the claim. Both should be charged with evaluating the particular claim as it fits into the failure resolution process. Accordingly, if the FDIC has filed a cross-guarantee assessment, the capital maintenance obligation should operate as a "credit" against that liability. The Federal Reserve or OTS, the holding company regulators, would be responsible for filing a statement of outstanding liability whenever a parent company becomes bankrupt. This statement would document the outstanding liability under the guarantee plan as well as a schedule of past payments.

---

278. See 12 U.S.C. § 1821(i)(2)-(3) (1994). The supplemental payments come from the Bank Insurance Fund, if the failed institution is a bank and from Savings Association Insurance Fund (SAIF) if the failed institution is an S & L. 12 U.S.C. § 1823(e) (1994).

279. 12 U.S.C. § 1821(d)(5)(E) (1994). To be proven, a claim must (1) be in writing, (2) have been executed contemporaneously by the depository institution and the claimant, (3) be approved by the board of directors or the loan committee of the institution and reflected in the minutes, and (4) have been kept continuously as an official record of the institution. 12 U.S.C. § 1823(e) (1994).

For claims proven to the receiver's satisfaction, FIRREA allows a claimant to seek administrative or judicial review within 60 days of the receiver's determination of the claim or 180 days of the date that the FDIC was appointed receiver, whichever is shorter. 12 U.S.C. § 1821(d)(6). FIRREA also directs the FDIC to establish procedures for expedited determination of time-sensitive claims as well as "low cost" and "expeditious" alternative dispute resolution procedures. *Id.* See Note, *Unsecured Creditors of Failed Banks: It's Not a Wonderful Life*, 104 HARV. L. REV. 1052, 1067-71 (1991) (arguing that FIRREA's liability limit provisions are an unnecessary power of the receiver, allowing the receiver to limit, arguably, parent company claims, given the cross-guarantee provision).

The receiver would have the responsibility of determining whether there has been compliance with the guarantee and providing the bankruptcy court with a certification of the amount of the offset against cross-guarantee liability.

To the extent that a parent company seeks to have the bankruptcy court provide equitable relief, the bankruptcy court should be barred. The operation of the automatic stay would unfairly forestall the resolution of a claim. The parent company ought to be estopped from challenging capital maintenance payments in the bankruptcy scheme. Allowing equitable relief at this juncture sanctions a detrimental change to the creditors of the bank subsidiary.

The assumption of a capital maintenance obligation by the parent company provides a basis for bankruptcy court jurisdiction because there is no issue about the enforceability of the obligation. A parent company's decision to recapitalize its bank subsidiary resolves the finality issue under the administrative process. In particular, the parent company that contests an obligation is challenging the amount, not the validity, of the obligation.<sup>280</sup>

The bank regulatory agencies have defended the claims against fraudulent conveyance by arguing that the transfers were made pursuant to valid regulatory orders.<sup>281</sup> This argument sanctions the transfers recapitalizing the bank subsidiary as a means of enforcing safe and sound banking practice.<sup>282</sup> However, without the banking exception as a predicate, this argument fails. The good faith exception cannot support a claim based merely on exercising the requisite authority. Even given valid regulatory orders, the exemption, under a traditional analysis, requires that the transferee show an exchange for value. In a parent-subsidiary relationship, that exchange requires solvency. Without the banking exception, the bankruptcy court, when called upon to review the receiver's determination, would not be able to sustain its decision based on valid exercise of regulatory authority.

Moreover, when there is an outstanding capital maintenance obligation, and the bank subsidiary and parent company become insolvent, the receiver files a proof of claim to recover the outstanding debt; the trustee files to recover past payments. In essence, because of the outstanding obligation, the parent company's estate is a debtor of the receivership. If the parent company's estate must satisfy any unfunded capital mainte-

---

280. A parent company that is funding a capital maintenance obligation pursuant to the prompt corrective action provision, presumably, is not contesting the legitimacy of the obligation in the same manner that bank holding companies did under the source of strength or the net worth maintenance theories. *See supra* Part III.C.

281. *See supra* Part III.A (discussing BNE's trustee claims that transfers were fraudulent conveyances).

282. *See supra* Part II.A.2 (discussing 12 U.S.C. § 1818(i)).



nance obligation as a prerequisite to reorganization,<sup>283</sup> the parent company's status to the receivership may not require compliance with FIRREA's administrative claims process.<sup>284</sup> Yet, if the claim is resolved in the bankruptcy court, it may be disallowed, creating an unfair disadvantage for the creditors of the bank subsidiary.<sup>285</sup>

## VI. CONCLUSION

Undergirding the body of banking laws are policies that Congress has adopted in order to protect the safety and soundness of the nation's banking system, including the taxpayer funded insurance fund. This system of federal regulation of the nation's financial institutions requires a parent company to either maintain the capital adequacy of its bank subsidiary or relinquish control. The effect of this obligation is to shore up the financial institution's capital and, in case of its failure, to decrease the amount that FDIC-Corporate must pay to insured depositors. A dormant conflict of policy and of law ensues when a parent company that has made the asset transfer also becomes insolvent. The formal priority scheme of the Code, designed to treat all creditors equally, clashes with the banking law's preferential treatment of the insurance fund as an unsecured creditor. The conflict raises a specific issue: When a bank holding company becomes a debtor after making an asset transfer pursuant to regulatory authority, can that transfer find protection in the bankruptcy scheme?

Although this conflict appears to beg the question as to which body of law should control, a closer examination of the banking laws reveals that Congress has made that choice. While recognizing bankruptcy's dual goals of protecting the debtor and ensuring equal treatment of all creditors, Congress, through the established cradle to grave regulation of financial institutions has given the public creditor—the insurance fund—more protection than any single private creditor.

Congress must fill the gap between its articulated policy choices and its existing legislation. A consistent regulatory scheme requires amending the current bankruptcy regime to protect from avoidance any asset transfer made by a now debtor parent company to its insolvent bank subsidiary. The provision would parallel the requirements of the Bankruptcy

---

283. See *supra* Part III.C (discussing 12 U.S.C. § 365(o)).

284. See *supra* Part II.B.2 (discussing 12 U.S.C. § 1821(d)).

285. The trustee can thus prove the preference and, because the dividend is highly unlikely to result in payment of the claim in full, the FDIC's claim cannot be allowed. As those things go, not too bad a result for the estate. Another court has held in this situation that, by filing a proof of claim for the balance of the debt, the RTC availed itself of the privileges of the bankruptcy court, and that section 106(a) of the Bankruptcy Code created an independent ground for bankruptcy court jurisdiction. Richard F. Broude, *The Unstoppable Force Meets the Immoveable Object: FIRREA and the Bankruptcy Code*, in 17TH ANN. CURRENT DEVS. IN BANKR. & REORGANIZATION at 559 & 572-73 (PLI Comm. & Practice Course Handbook Series No. 715, 1995).

Code's good faith exception to the fraudulent conveyance provision by creating a separate exception for a banking enterprise asset transfer. Specifically, Congress should legislate procedures that banking regulators must comply with before requiring a debtor parent company to make asset transfers to a bank subsidiary. If the requirements of the exception are met, the assets supporting the transfer would be immune from an avoidance action. Legally, such a proposal may be the only way that the FDIC may avoid the fraudulent conveyance provision.

As in the BNEC bankruptcy proceedings, a bankruptcy trustee, in exercising its fiduciary obligation to distribute the estate for the benefit of all creditors, has an obligation to seek to avoid the transfer. Without a legislative change, a court reviewing the asset transfer must return it to the estate of the debtor for the benefit of the creditors. The concomitant result will be that a parent company that is not itself extremely well capitalized will be unwilling to make a capital infusion at all, particularly since that parent company also may face claims that its decision to shore up a capital-weakened bank subsidiary is violative of the business judgment rule.

Congress undoubtedly did not mean to discourage parent companies from making capital infusions. It may not have envisioned that a parent company that chooses to do so may itself become insolvent. The banking enterprise exception provides a basis for the asset transfer. It merges the two statutory schemes by balancing the policy interests of the two regulatory schemes while allowing the parent company to define its fair obligation to its capital-weakened bank subsidiary. FIRREA's seeming prohibition against judicial intervention and the Code's silence on the issue underscore the need for a more definitive approach that addresses the scope of administrative jurisdiction when a parent company with an outstanding capital maintenance obligation has filed for the protections of the bankruptcy process.

