# Exhibit A

## (Memorandum of Law)

**IN THE UNITED STATES BANKRUPTCY COURT**
**FOR THE NORTHERN DISTRICT OF ILLINOIS**
**EASTERN DIVISION**

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| In re: | ) | Chapter 11 |
| CORUS BANKSHARES, INC., | ) | Case No. 10-26881 |
| Debtor. | ) | Honorable Pamela S. Hollis |

**MEMORANDUM OF LAW IN SUPPORT OF THE FDIC-RECEIVER'S MOTION FOR SUMMARY JUDGMENT AND IN OPPOSITION TO THE DEBTOR'S MOTION FOR JUDGMENT ON THE PLEADINGS**

The Federal Deposit Insurance Corporation, as Receiver for Corus Bank, N.A. (the "FDIC-Receiver"), by and through its undersigned counsel, submits this *Memorandum of Law in Support of the FDIC-Receiver's Motion for Summary Judgment and in Opposition to the Debtor's Motion for Judgment on the Pleadings* (the "Motion").

## I. INTRODUCTION

Corus Bankshares, Inc. (the "Debtor") filed consolidated tax returns on behalf of it and its subsidiary, including Corus Bank, N.A. (the "Bank"). Due to the losses suffered by the Bank during the tax years 2008 and 2009, this consolidated tax group received tax refunds of approximately $265 million (the "Tax Refunds"). Because the Tax Refunds were generated as a result of the Bank's income, funding of tax payments, and operating losses, the Debtor has an obligation to remit the Tax Refunds to the Bank. The Debtor admits that its failure to remit the Tax Refunds would give rise to a claim. The issue presented to this Court is whether the FDIC-Receiver's claim to the Tax Refunds, as the legal successor to the Bank, is senior in priority to the claims of holders of subordinated equity-like instruments, trust preferred securities (the "TOPrS") issued for purposes of being included in the Debtor's core capital to meet strict regulatory requirements. In order to make this determination, the Court must interpret and apply

the term "money borrowed," as it is used in the subordination provisions of the underlying indentures.

The nature and basis of the FDIC-Receiver's claim, the terms of the indentures governing the TOPrS, and the regulatory scheme underlying the TOPrS unequivocally dictate that the FDIC-Receiver's claim to the Tax Refunds constitutes "money borrowed" and, therefore, is senior in priority to the claims of the TOPrS holders. Indeed, there is no other plausible explanation for the Debtor's right to temporarily hold the Tax Refunds it admittedly owes to the Bank other than to describe it as "money borrowed." The Debtor seeks to restrict the Court's consideration of that pivotal term to dictionary definitions. The Debtor's argument fails even when limited to that narrow scope. It also fails when examined in the broader context that appropriately considers the nature of the Debtor's obligation to the Bank and the regulatory scheme under which the subordination provisions arose. Accordingly, the Debtor's Motion for Judgment on the Pleadings should be denied, and the FDIC-Receiver's Motion for Summary Judgment should be granted.

## II. BACKGROUND

### A. Procedural Posture

This contested matter arises as a result of the FDIC-Receiver's *Amended Motion to Establish Priority Senior to TOPrS Debt* filed on December 9, 2011 (the "Priority Motion") [Dkt. No. 790]. The Debtor filed a response and objection to the Priority Motion on January 12, 2012 [Dkt. No. 822] (the "Debtor's Response"). Thereafter, the Debtor filed a *Motion of the Reorganized Debtor for Judgment on the Pleadings* on August 8, 2012 (the "Debtor's Motion") [Dkt. No. 894]. Simultaneously herewith, the FDIC-Receiver has filed a *Motion to Strike the Debtor's Motion for Judgment on the Pleadings or, in the Alternative, to Convert It to a Motion for Summary Judgment*. Given that the FDIC-Receiver's arguments in support of its own Motion

for Summary Judgment are essentially identical to those in opposition to the Debtor's Motion, the FDIC-Receiver files this combined memorandum of law.

The Unites States District Court for the Northern District of Illinois (the "District Court") and this Court are resolving different aspects of the dispute over the disposition of the Tax Refunds. The District Court has before it an adversary proceeding intended to determine whether the Tax Refunds are property of the estate as described in Section 541 of the Bankruptcy Code or whether they are instead held by the Debtor in trust for the benefit of the FDIC-Receiver[1] (the "District Court Litigation"). (SOF ¶ 10).[2] In that District Court Litigation, the Debtor acknowledges that it owes the FDIC-Receiver the Bank's allocated share of the Tax Refunds, but the Debtor alleges that there is a debtor-creditor relationship between it and the Bank, and thus the Tax Refunds are property of the estate and must be distributed through it to creditors, including the FDIC-Receiver, on a *pro rata* basis. (SOF ¶¶ 8-9). The *Debtor's Third Amended Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (with Technical Modifications)* [Dkt. No. 674] confirmed on September 29, 2011 (the "Confirmed Plan") provides for a distribution to creditors from the Tax Refunds should the Debtor prevail on this issue in the District Court Litigation and in the Priority Dispute described below.[3] (*See* Confirmed Plan ¶ V.B.3.).

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[1] The first adversary proceeding (Adv. P. No. 10-01362), filed by the Debtor on June 28, 2010 and subsequently withdrawn to the District Court on the request of the FDIC-Receiver, seeks a declaratory judgment regarding disposition of the Tax Refunds. (SOF ¶ 10). A second adversary proceeding (Adv. P. No. 10-01653), filed by the Debtor on August 16, 2010, and also withdrawn to the District Court on the request of the FDIC-Receiver, seeks review of the denial by the FDIC-Receiver of a receivership proof of claim filed by the Debtor in the Bank's receivership proceeding, in which the Bank asserted, among other things, the right to the Tax Refunds. (SOF ¶ 11).

[2] "SOF" refers to the *Statement of Uncontested Facts Related to the Motion for Summary Judgment* filed contemporaneously herewith.

[3] In its *Memorandum in Support of Motion for Judgment on the Pleadings* (the "Debtor's Memorandum"), the Debtor states that the FDIC-Receiver's assertions regarding allocation of the Tax Refunds are inaccurate and claims that the Debtor "is entitled to 100% of the Disputed Tax Refunds based on its own losses and worthless stock

The contested matter before this Court was initiated by the Priority Motion pursuant to Rule 9014 of the Federal Rules of Bankruptcy Procedure (the "Priority Dispute"), following the FDIC-Receiver's objection to confirmation of the Debtor's Plan of Reorganization. The Priority Dispute requires this Court to determine the relative priority of the FDIC-Receiver's claim to the Tax Refunds. The Priority Dispute concerns a claim that arises if the District Court rules that the Debtor and the Bank share a debtor-creditor relationship and the Tax Refunds are property of the Debtor's estate, against which the FDIC-Receiver has an unsecured claim.[4]

Pursuant to the Debtor's Plan of Organization as originally proposed and subsequently modified, the claim of the FDIC-Receiver was to be treated *pari passu* with the claims of unsecured creditors, including the holders of the TOPrS. (*See* Dkt. No. 456). On September 2, 2011, the FDIC-Receiver objected to such treatment, asserting that the subordination provisions in the governing indentures subordinated the TOPrS claims to the claim of the FDIC-Receiver. (*See* Dkt. No. 652). The Confirmed Plan continues to provide for such *pari passu* treatment but is subject to a post-petition hearing on the priority issue. (*See* Confirmed Plan ¶¶ III.B.4-5, V.B.3.). The FDIC-Receiver's Priority Motion initiated the contested matter that will resolve the Priority Dispute.[5]

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deductions." (*See* Debtor's Memo. at 3 n.1). The issues of allocation and ownership of the Tax Refunds are not before this Court. Nonetheless, it must be noted that the Debtor's position conflicts with loss carryback rules for consolidated groups that include insolvent financial institutions, which require the absorption of the insolvent financial institution's losses before utilization of losses by other members of the consolidated group, and the Internal Revenue Service's position on worthless stock claims when a subsidiary in a consolidated group has a tax refund claim. *See* 26 C.F.R. 301.6402-7; *see also* I.R.S. Priv. Ltr. Rul. AM2012-003 (Apr. 10, 2012), attached hereto as **Exhibit 1.**

[4] The FDIC-Receiver, of course, contests this conclusion. Nothing contained herein shall constitute an admission or waiver on the part of the FDIC-Receiver.

[5] The exact amount due to the FDIC-Receiver need not be resolved until after the Priority Dispute is decided. The FDIC-Receiver claims that the Bank was entitled to all of the Tax Refunds; the Debtor believes otherwise.

**B. Creation of the Tax Refunds**

The Internal Revenue Service (the "IRS") allows certain affiliated groups of corporations to file consolidated tax returns. This enables the affiliated group to set off losses of one entity against income of another, thus lowering the group's overall tax liability. *See* 26 U.S.C. §§1504, 1552; Treas. Reg. 1.1502-75. The income tax regulations require that the parent corporation act as an agent for its subsidiaries in connection with a consolidated filing. Treas. Reg. 1.1502-77(a). Accordingly, any tax refund that is paid directly to and in the name of the common parent discharges any and all liability of the IRS to the subsidiaries. Treas. Reg. 1.1502-77(a)(2).

Likewise, the Federal Reserve has promulgated certain regulations and policies to govern the relationship between banks and their parent holding companies. The overarching purpose of such policies is to direct the holding companies to be a source of financial strength for their subsidiary banks. (*Declaration of Richard Spillenkothen in Support of the FDIC-Receiver's Motion for Summary Judgment and in Opposition to the Debtor's Motion for Judgment on the Pleadings* (the "Spillenkothen Declaration"), a true and correct copy of which is attached to the *FDIC-Receiver's Motion for Summary Judgment* as Exhibit C, ¶ 29).[6] One policy that the Board of Governors of the Federal Reserve System (the "Federal Reserve") issued in conjunction with other federal banking regulators dictates that the amount of tax refunds a bank would receive if it filed a separate tax return shall not be diminished because the bank participated in the filing of a consolidated return. *See Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure*, 63 Fed. Reg. 64757 (Nov. 23, 1998).

Prior to September 11, 2009, when the Office of the Comptroller of the Currency closed the Bank and the FDIC was appointed as its Receiver, the Debtor and its subsidiaries, including

[6] Mr. Spillenkothen served as the Federal Reserve's Director of the Division of Banking Supervision and Regulation from 1991 to 2006. (Spillenkothen Decl. ¶ 3).

the Bank, were an affiliated group of business entities (the "Consolidated Group"). Therefore, they filed their tax returns on a consolidated basis, which enabled the Consolidated Group to benefit from certain tax privileges available to consolidated filers. (SOF ¶ 5). The Bank generated the income reported on the tax returns, and the resulting tax obligations were paid with the Bank's funds. (SOF ¶ 8). In addition, losses of the Bank created the net operating losses that generated the Tax Refunds. (*Id.*). Now, the FDIC-Receiver, as the legal successor to the Bank, and the Debtor disagree over the distribution of the Tax Refunds.

**C. Intra-Company Payment Policy Regarding Tax Returns**

The Debtor claims that a document titled "Intra-Company Payment Policy" (the "Payment Policy"), which was adopted by the Debtor's Board and dated April 25, 2007, governs the rights to the Tax Refunds. (Debtor's Memo. at 2). In the District Court Litigation, the FDIC-Receiver will dispute this assertion. For purposes of the Priority Dispute, however, the FDIC-Receiver assumes that its arguments have failed and that its claim to the Tax Refunds is based on the terms of the Payment Policy. The relevant provisions of the Payment Policy state:

> **Income Taxes**
>
> Computation
>
> Taxes for Parent and Bank are to be computed and recorded separately for both current and deferred taxes. While the calculated amounts will be combined for purposes of determining required payments, separate listings of all current and deferred assets and liabilities are to be strictly maintained. The calculations should be prepared as if both Parent and Bank filed tax returns on a separate entity basis. Accounting balances representing all current and deferred taxes shall be maintained on the respective entities books.
>
> In the event that certain items arise as a result of filing on a consolidated basis, these amounts shall be allocated pro-rata (based on taxable income) to each entity. This includes any amounts due as a result of the Alternative Minimum Tax.

> Payments
>
> Since the Parent and Bank file a combined tax return, any amounts due will be paid on a combined basis, with initial payment being made by the Bank. However, upon any payment of taxes, the Parent will, within 5 business days, reimburse the Bank for Parent's portion of the balance due. In the event that either entity's tax calculation results in a loss (thereby resulting in a tax refund), that refund will be paid, within 5 business days, by the other entity.
>
> *In the event that any tax refunds are received, they will be allocated to the respective entities based on the individual tax calculations relative to amounts previously paid (once again as if the entities filed separate tax returns).*

*See* Payment Policy at 1, attached to SOF as Exhibit 3 (emphasis added).

**D. Trust Preferred Securities**

Banks and bank holding companies must adhere to certain capital adequacy requirements in order to operate in the highly regulated banking industry. (Spillenkothen Decl. ¶ 9). Most relevant for purposes of this Priority Dispute, a bank holding company must maintain a specified level of capital. (*Id.*). The highest quality form of capital is referred to as "Tier 1" or core regulatory capital, which the Federal Reserve uses to measure the strength and financial stability of bank holding companies. *See Call v. Wells Fargo & Co.*, No. 11-5215, 2012 WL 1232132 (N.D. Cal. Apr. 12, 2012). Indeed, if a bank fails to maintain the required amount of Tier 1 capital, it is subject to significant regulatory sanctions and possible closure by its regulators. (Spillenkothen Decl. ¶ 10).

Recognizing the need to generate Tier 1 capital, banks and bank holding companies issue trust preferred securities,[7] hybrid instruments that possess qualities of both equity (for example,

[7] Trust preferred securities are issued by a subsidiary trust of the bank holding company, and the proceeds from the sale of the trust preferred securities are streamed into the bank holding company in exchange for the long-term, deeply subordinated notes, referred to as debentures, with terms identical to those of the trust preferred securities. Vincent J. Poppa (Supervising Examiner), *Trust Preferred Securities*, in 2 FED. RESERVE BANK OF PHILADELPHIA SRC INSIGHTS 2 (4th Q. 1997). The interest paid by the bank holding company on the notes, which are tax-deductible at the bank holding company level, are used to pay dividends on the trust preferred securities. *Id.* "[T]he non-bank subsidiary [trusts] can have no business or operations other than to purchase and hold the company's junior subordinated debentures and to pay the interest income received on the debentures as dividends to the holders of its securities." *Id.* Thus, effectively, the issuing trust serves as a mere conduit for exchanging cash

the holders could receive the equivalent of dividends) and debt (the issuer could deduct interest on the debt). *See* 70 Fed. Reg. 11827, 11828 (Mar. 10, 2005). In 1996, the Federal Reserve announced its approval of bank holding companies including trust preferred securities in their Tier 1 capital. The Federal Reserve, however, required trust preferred securities to meet certain strict criteria to obtain Tier 1 capital status, most importantly, that the notes (also called debentures) underlying such instruments be "deeply subordinated." *See* Press Release, FRB, 1996 WL 601940 (Oct. 21, 1996). Indeed, "a *key consideration* of the Board has been the ability of trust preferred securities to provide financial support to a consolidated [bank holding company] because of *their deep subordination*." 70 Fed. Reg. at 11829 (emphasis added). The "deep subordination" feature of trust preferred securities provides substantial capital support to the bank holding companies as it enables trust preferred securities to be "available to absorb losses more broadly than most other [instruments includable in the core capital]." *Id.*

In 2005, the Federal Reserve issued its revised rule (the "Revised Rule"), allowing bank holding companies to continue to classify trust preferred securities as Tier 1 capital and delineating criteria for such inclusion. *See* 70 Fed. Reg. 11827 (Mar. 10, 2005). In the Revised Rule, the Federal Reserve mandated that, in order to be classified as Tier 1 capital, the junior subordinated debt underlying trust preferred securities be in compliance with "the subordinated debt policy statement set forth in 12 C.F.R. 250.166" (the "Subordinated Debt Policy"). *See* 12 C.F.R. Pt. 225, App. A; *see also* 70 Fed. Reg. 11827, 11829. The Subordinated Debt Policy, among other things, states that "subordinated debt must be subordinated in right of payment to the claims of the issuer's general creditors and, for banks, to the claims of depositors as well." 12

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flows between the bank holding company and the investors in the trust preferred securities. For accounting purposes, on a consolidated basis, the trust preferred securities are carried on the balance sheet of the holding company issuing the underlying debentures as a minority interest of the bank holding company, and the subordinated note (i.e., debentures) is eliminated as intercompany debt. *Id.*

C.F.R. 250.166. Importantly, the Federal Reserve clarified that "the bank holding company debt must be subordinated to all senior indebtedness of the company. To meet this requirement, *the debt should be subordinated to all general creditors*." 12 C.F.R. 250.166 n.1 (emphasis added). This language is consistent with the Revised Rule, which states that "[a] qualifying tier 1 or tier 2 capital instrument must be subordinated to all senior indebtedness of the organization. If issued by a bank, it also must be subordinated to claims of depositors." 12 C.F.R. Pt. 225, App. A.

**E. Terms of Indentures**

The TOPrS issued by the Debtor are governed by 13 different indentures (the "Indentures"), the operative language of which is substantially identical. (SOF ¶¶ 13-14). The Debtor, through its special purpose subsidiaries, issued the TOPrS and entered into the Indentures for the express purpose of including the TOPrS proceeds as Tier 1 capital, and, indeed, the Debtor included the TOPrS proceeds into its Tier 1 capital. (SOF ¶¶ 12, 16). In fact, before issuing the TOPrS, Bankshares sought confirmation from the Federal Reserve that the TOPrS would qualify for Tier 1 treatment. (SOF ¶ 15). Moreover, the Indentures themselves expressly recognized the importance of the TOPrS in increasing the Tier 1 capital of the Debtor: the Indentures provided that if the trust preferred securities proceeds did not receive Tier 1 treatment, the debentures could be redeemed. (SOF ¶¶ 17-18).

With the goal of qualifying for Tier 1 capital status, the Indentures adhere to the Federal Reserve's requirements that the TOPrS claims must be deeply subordinated to all general creditors of the Debtors, with certain narrow exceptions. (Spillenkothen Decl. ¶ 20). Each Indenture includes a provision that substantially states, "The indebtedness evidenced by this Debenture is, to the extent provided in the Indenture, subordinate and junior in right of payment to the prior payment in full of all Senior Indebtedness, and this Debenture is issued subject to the provisions of the Indenture with respect thereto." (SOF ¶¶ 13-14). The Indentures also define

"Senior Indebtedness" to include certain debts and obligations, and they also enumerate certain obligations that are *not* included in Senior Indebtedness. (*Id*). All Indentures state that the payments to TOPrS holders are junior to, among other things, "[t]he principal, premium, if any, and interest in respect of [i]ndebtedness of the [Debtor] for money borrowed . . . " (*Id*.).

## III. THE APPLICABLE LEGAL STANDARD

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, made applicable to this contested matter through Rules 7056 and 9014 of the Federal Rules of Bankruptcy Procedure, summary judgment will be granted "if the movant shows that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a); FED. R. BANKR. P. 7056, 9014. The moving party bears the initial responsibility of informing the court of the basis for its motion and identifying the evidence it believes demonstrates the absence of a genuine issue of material fact. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323-24 (1986). While the evidence and all reasonable inferences must be construed in a light most favorable to the nonmoving party, the nonmoving party may not merely rely on its pleadings but "must set forth specific facts showing that there is a genuine issue for trial as to those dispositive matters for which it carries the burden of proof." *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 587 (1986); *Serfecz v. Jewel Food Stores*, 67 F.3d 591, 596 (7th Cir. 1995). "[T]he mere existence of *some* alleged factual dispute between the parties will not defeat an otherwise properly supported motion for summary judgment; the requirement is that there be no genuine issue of material fact." *Anderson v. Liberty Lobby, Inc*., 477 U.S. 242, 247-48 (1986); *Robin v. Espo Eng'g Corp.*, 200 F.3d 1081, 1088 (7th Cir. 2001).

## IV. ARGUMENT

In order to resolve the Priority Dispute, the Court must determine what the parties intended with respect to the priority of the claim to the Tax Refunds. To that end, the Court must

decide if the claim for the Tax Refunds is included in Senior Indebtedness or whether that claim falls within any of the categories that are excluded from Senior Indebtedness. Assuming, as it must, for the sake of this Motion that the Tax Refunds are property of the estate, the FDIC-Receiver maintains that its claim to the Tax Refunds amounts to a claim for "money borrowed," and thus "Senior Indebtedness." In coming to the opposite conclusion, the Debtor undertakes a wooden non-contextual examination of the words "money borrowed" in which it references dictionary definitions and concludes that the Tax Refunds held by the Debtor do not qualify. As demonstrated below, even the Debtor's narrow construction of the language of the Indentures cannot support its erroneous conclusion, and the Debtor's misapprehension becomes even clearer when one appropriately considers the operative context.

**A. <u>The Tax Refunds Constitute "Money Borrowed" Under the Indentures</u>**

The Debtor acknowledges that it is holding money that ultimately belongs to the FDIC-Receiver. This follows inescapably from the assertion by the Debtor, essential to its pleading in the District Court Litigation, that the Debtor and FDIC-Receiver have a debtor-creditor relationship. (Complaint, ¶ 25, *Corus Bankshares, Inc. v. Fed. Deposit Ins. Corp.*, Case No. 1:10-cv-01653 (N.D. Ill. 2010) (the "<u>Complaint</u>")). The debt owed by the Debtor to the FDIC-Receiver derives from the Tax Refunds issued by the Internal Revenue Service. The Debtor attempts to explain the debtor-creditor obligation as a generalized "contractual obligation." (Debtor's Memo. at 15). This phrase, however, answers nothing: the agreement to pay a loan is always a contractual obligation. The relevant question in the Priority Dispute is by what right does the Debtor hold these funds: Is it via a borrowing or by some other arrangement. The Debtor does not dare to venture an answer to this question because there is only one plausible explanation – the Debtor borrowed the Bank's money and has an obligation to repay it.

Indeed, the Debtor's argument fails because if this is not determined to be a loan, there is no other plausible explanation for how the Debtor obtained the money to begin with or why it should turn it over to the FDIC-Receiver. The Payment Policy reflects no consideration for a massive transfer of wealth ($265 million) from the Bank (who would have recovered the Tax Refund in the absence of the consolidated return) to the Debtor. Similarly, to the extent the Debtor actually has permanent ownership of the Tax Refunds as opposed to having temporary possession of borrowed funds, the Payment Policy references no consideration for the massive decrease to the Debtor's wealth that would occur as a result of the payment of the Tax Refunds to the Bank as a creditor. Adhering to the Debtor's admonition to look to the plain meaning of the language to determine intent, the only plausible explanation for this transaction is that the portion of the Tax Refund generated by the activity of the Bank constitutes a loan that must be repaid.

**1. The Claim Arises by Virtue of the Payment Policy**

There are several sources of guidance to explain how the issuance of the Tax Refund creates such an obligation. One should begin by looking at the underlying arrangement out of which the debt arose. As explained above, for purposes of the Priority Dispute, the FDIC-Receiver assumes that its claim to the Tax Refunds arises from the Payment Policy.[8] The Debtor contends that the Payment Policy is the basis for the debt it now owes to the FDIC-Receiver. (Complaint, ¶¶ 11, 25-26 & Exhibit A; Debtor's Response, ¶¶ 2.4 & Exhibit A; Debtor's Memo. at 2 & Exhibit B).

[8] In the District Court litigation, the FDIC-Receiver will argue, among other things, that the Payment Policy is not an agreement, is not binding and in any event, does not result in the Debtor being able to capture the Tax Refunds as property of the estate. For purposes of the Priority Motion, it is assumed that the FDIC-Receiver's arguments will fail. Nothing contained therein shall constitute an admission or waiver on the part of the FDIC-Receiver.

It is undisputed that the Bank authorized the Debtor to file a consolidated tax return. According to the Debtor, this authorization is summarized in the Payment Policy that has the following elements:

> Each taxpayer shall calculate its own individual tax liability. A consolidated return shall then be completed, but separate accounts must be maintained for each entity.
>
> The Bank shall advance money to pay the amount due under the Consolidated Return. If the Debtor owes money for its share of the Consolidated Return, it must reimburse the Bank within five days. If the return shows a loss resulting in a refund, that too shall be reimbursed to the party entitled to the refund within five days.
>
> When a refund is received, there is no five day waiting period. Instead, the funds shall be allocated as if the respective entities had filed separate returns.

*See* Exhibit 3 to SOF at 1. Thus, the entire transaction as set forth in the Payment Policy centers on the conditions under which the Bank and the Debtor will allocate and transfer tax-related obligations and receipts between themselves. There is nothing else to the transaction: no other services are rendered and no unrelated goods are exchanged. The Payment Policy merely sets out rules as to who allocates and transfers what money, when such transfers are made, and how the parties reimburse each other if they have effectively had the possession or use of the other's money in the tax resolution process.

**2. The Claim Is Subordinated by the Terms of the Indentures**

With the underlying basis for the debt in mind, the analysis next turns to the subordination provisions contained in the Indentures. As an initial matter, subordination provisions are fully enforceable in bankruptcy. 11 U.S.C. § 510(a); *see also In re Chicago, South Shore and South Bend R.R.*, 146 B.R. 421, 425, 428 (Bankr. N.D. Ill. 1992) (holding that subordination agreements are enforceable in bankruptcy); *In re Hiderliter Indus., Inc.*, 228 B.R. 848, 851 (Bankr. E.D. Tex. 1999) (holding that subordination provisions in indentures must be

enforced according to their terms to prevent junior creditors from receiving funds where they have agreed not to receive them before senior creditors).

The debt owed by the Debtor to the FDIC-Receiver on account of the Tax Refunds is "money borrowed" and, thus, constitutes Senior Indebtedness. (Spillenkothen Decl. ¶¶ 7, 21-22). The Debtor principally argues that the ordinary meaning of the words "money borrowed" should govern the outcome of this dispute. (*See* Debtor's Memo. at 8-9). Even under the definition relied upon by the Debtor, this debt qualifies as "money borrowed." The first definition for "borrow" that the Debtor provides states that to borrow is "to take something for temporary use." (*Id*. (citing BLACK'S LAW DICTIONARY 209 (9th ed. 2009))). There is no better explanation of the debt that the Debtor owes to the FDIC-Receiver. The money is not the Debtor's to keep, otherwise there would be no debtor-creditor relationship.[9] The Debtor is temporarily in possession of money that would go to the FDIC-Receiver under the Bank's separate calculation of its own taxes. It is to be allocated under the very Payment Policy the Debtor champions in the District Court Litigation.

This interpretation of "money borrowed" is supported by other indenture language. Each Indenture excludes certain limited obligations from the definition of Senior Indebtedness, primarily trade debt and other trust preferred securities. (*See* SOF ¶¶ 13-14). The fact that the Indentures fail to include tax refunds in the list of items excluded from Senior Indebtedness, while not determinative, provides support for the concept that the term "money borrowed" should not be unduly constricted. Indeed, this construction comports with the *Interagency Policy*

[9] The FDIC-Receiver does not agree with the Debtor that the Payment Policy establishes a debtor-creditor relationship. Such an arrangement would violate 12 U.S.C. § 371c, which restricts the terms of loans between a regulated bank and its bank holding company. Therefore, the FDIC-Receiver reserves the right to assert such argument in the District Court Litigation, and nothing in this Motion for Summary Judgment will operate as a waiver of any argument it may make in the District Court Litigation. For purposes of the Priority Dispute, however, the FDIC-Receiver must assume that the Debtor prevails in the District Court Litigation and a debtor-creditor relationship exists.

*Statement on Income Tax Allocation in a Holding Company Structure*, which provides, in pertinent part, that "[i]f a refund is not made to the institution within the period, the institution's primary federal regulator may consider the receivable as . . . *an extension of credit* . . . from the subsidiary to the parent." 63 Fed. Reg. 64757 (Nov. 23, 1998) (emphasis added) (citing a uniform interagency policy statement adopted by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the FDIC regarding intercompany tax allocation for banking organizations that file consolidated returns). The Interagency Policy Statement became effective several years before the first Indenture was executed, and, thus, the Debtor's failure to exclude tax refunds from Senior Indebtedness indicates the Debtor's intent to include tax refunds in the broad definition of Senior Indebtedness. *See, e.g., In re New York City Asbestos Litig.*, 838 N.Y.S.2d 76, 81 (N.Y. App. Div. 2007) (holding that, "under the standard canon of contract construction . . . that the expression of one thing implies the exclusion of the other," the express exclusions to a general provision must be understood as the only exclusions and, therefore, everything outside of the exclusions must fall within the general provision); *see also In re Kaiser Aluminum Corp.*, 350 Fed. Appx. 775, 779 (3d Cir. Nov. 2, 2009) (holding that if an indenture was intended to exclude a particular debt, that exclusion should have been listed among other express exclusions).

To avoid what would appear to be an obvious result, the Debtor claims that since it cannot identify a "borrowing event," the debt that arose under the Payment Policy cannot constitute "money borrowed." (Debtor's Memo. at 13-15). This is clearly incorrect. The Payment Policy, by its own terms, establishes a mechanism for intercorporate loans and the basis on which they shall be repaid. (*See* Exhibit 3 attached to SOF at 1). In the absence of the Bank's consent to allow the Debtor to file the consolidated tax return and receive any refund on

its behalf, the Tax Refunds would have come directly to the Bank. (Spillenkothen Decl. ¶ 23). As the parent and agent of the consolidated tax group, the Debtor receives and holds the Tax Refunds temporarily until it pays them to the Bank. *See* Treas. Reg. 1.1502-77(a)(2). Recognizing this, the Debtor apparently elected to establish a protocol when the consolidated return election was made because one party would be designated to file returns for other members of the Consolidated Group, while another member, the Bank, would make the tax payments for the Consolidated Group. (Spillenkothen Decl. ¶ 24). Similarly, one party, again the Debtor, might be the recipient of a refund even though the parties agreed that the money ultimately belonged to someone else in order to preserve the concept that each member of the consolidated group should be treated as if it filed a separate tax return of its own. (*Id.* ¶ 25).[10]

The Debtor operates under the false assumption that the FDIC-Receiver could not have loaned the money to the Debtor because the presumed ruling in favor of the Debtor in the District Court Litigation means that the Bank had no ownership interest in the tax refunds and therefore could not be a lender. (*See* Debtor's Memo. at 12). The mere fact that the Debtor holds an ownership interest sufficient to qualify as property of the estate, which is assumed for purposes of this matter, does not mean that it is the *only* party that possesses an interest in the Tax Refunds. Federal regulations, for example, provide that the FDIC-Receiver, as the statutory fiduciary of an insolvent corporation that is a subsidiary in a consolidated group, has a right to (a) file an alternative federal tax return and refund claim as the deemed agent for the consolidated group and (b) initiate a claim in the United States Court of Federal Claims if the IRS denies the refund claim. *Claybrook v. U.S.*, No. 10-734T, 2012 WL 1372107 (Fed. Cl. Apr.

[10] This approach is consistent with Federal Reserve's policy, which requires that regulated banks that file consolidated returns with their parent remain in no worse a position than if they filed separately. *See Interagency Policy Statement on Income Tax Allocation in a Holding Company Structure*, 63 Fed. Reg. 64757.

18, 2012).[11] Like the Debtor, a Chapter 7 Trustee for Downey Financial Corporation, claimed ownership of federal income tax refunds payable to a consolidated group that included a failed financial institution. The court found that the FDIC, as receiver of the institution, nonetheless had a sufficient interest in the tax refunds to secure the right to intervene in the trustee's claim against the United States. *Id*.

The Debtor's position fails to recognize that a debtor may have possession of property, sufficient to be classified as property of the estate, that it does not own. *See, e.g.*, *In re Valley Media, Inc.*, 279 B.R. 105, 123 (Bankr. D. Del. 2002) (holding that the consignee is deemed to have acquired title to the consigned goods and, therefore, the consignee has a pre-petition unsecured claim against the estate for the invoice price of the consigned goods). In this case, the fact that the Tax Refunds might become property of the estate would not eliminate the Debtor's obligation, per the Payment Policy, to allocate the Tax Refunds amongst "the respective entities based on the individual tax calculations relative to amounts previously paid (once again as if the entities filed separate tax returns)."

**3. The Regulatory Environment Supports the FDIC-Receiver's Position**

**a. The Court Should Consider Extrinsic Evidence**

The foregoing analysis is reinforced by the regulatory environment in which the Bank and the Debtor operated. The Debtor, however, urges the Court to ignore this regulatory scheme which circumscribes the priority of the TOPrS claims. (*See* Debtor's Memo. at 24). As an initial matter, this evidence is admissible because it seeks to neither contradict nor add to the language of the agreement, such as by reciting additional negotiations that were not incorporated in the final agreement. Indeed, New York law allows a party to introduce parol evidence where, as

[11] Copies of this and other unpublished opinions cited herein are attached hereto as **Exhibit 2**.

here, the party urges a meaning of a term when the term is "reasonably susceptible" to such meaning. *See, e.g., Macheda v. Household Fin. Realty Corp. of N.Y.*, No. 04-cv-0325, 2009 WL 113474, at *10 n.33 (N.D.N.Y. Jan. 15, 2009) (holding that "parol evidence may be admitted to explain the meaning of a writing when the meaning urged is one to which the written contract term is reasonably susceptible [and not to merely add or alter certain terms] or when the contract is ambiguous."). Here, the regulatory framework of the banking industry in which the parties operated explains the meaning of the categories of Senior Indebtedness included in the indentures.

Further, even if the language of an agreement is clear on its face, New York law allows extrinsic evidence to explain a latent ambiguity. *See Lerner v. Lerner*, 508 N.Y.S.2d 191, 247 (N.Y. App. Div. 1986). In *Lerner*, the court explained that

> A latent ambiguity emanates from a situation where 'the equivocality of expression or obscurity of intention does not arise from the words themselves, but from the ambiguous or obscure state of extrinsic circumstances to which the words of the instrument refer, and which is susceptible of explanation by a mere development of extraneous facts without altering or adding to the written language or requiring more to be understood thereby than will fairly comport with the extraordinary or legal sense of the words made use of.'

*Id.* (emphasis added); *see also Tieg v. Suffolk Oral Surgery Assocs.*, 769 N.Y.S.2d 599 (N.Y. App. Div. 2003) (adopting the latent ambiguity doctrine that allowed for a construction that "mostly closely effectuate[d] the purpose [of the agreement]"). Here, there is a latent ambiguity as to the meaning of "money borrowed," not from the dictionary meaning of those two words, but from the ambiguous "state of extrinsic circumstances to which the words . . . refer." *See Lerner* 508 N.Y.S.2d at 247. In other words, the term "money borrowed" (and the other terms in the subordination provisions of the indentures) arises in a specific extrinsic circumstance, namely, in the context of the Debtor seeking to comply with the Federal Reserve's "deep

subordination" requirements in order to obtain Tier 1 status. By considering these circumstances, the Court will allow "a mere development of extraneous facts without altering or adding to the written language." *See id.*

While the Debtor obviously does not want the Court to consider the highly relevant and compelling evidence regarding the regulatory framework in which the TOPrS were issued, the Debtor itself expressly recognized the importance of this regulatory scheme. As described above, Bankshares sought confirmation from the Federal Reserve that the TOPrS would qualify for Tier 1 treatment. Even more explicitly, the Indentures themselves allowed the Debtor to redeem the debentures underlying the TOPrS if the TOPrS proceeds did not receive Tier 1 treatment. (SOF ¶ 17-18).

**b. Regulatory Scheme Underlying TOPrS**

Based on the regulatory scheme discussed above and as demonstrated in the Declaration of Richard Spillenkothen, the Federal Reserve allows bank holding companies to categorize trust preferred security proceeds as Tier 1 capital expressly for the purpose of strengthening the balance sheets of bank holding companies. In order to achieve this goal, such debt must be junior to all other debt of the holding company, with the exception of certain clearly delineated types of debt. *See* 70 Fed. Reg. 11827. Thus, the debentures were permitted to be equal in rank to trade debt and to other subordinated debentures, but were intended to be junior to all other debt. *Id*. at 11833 ("[J]unior subordinated debt may be pari passu with obligations to trade creditors. In addition, junior subordinated debt underlying one issuance of trust preferred securities may be pari passu with junior subordinated debt underlying another issue of trust preferred securities.").

Furthermore, the purpose of the regulatory capital – whether in the form of equity or equity-like trust preferred securities – is to be available as a cushion to absorb losses of a

regulated institution at any time and, therefore, must be deeply subordinated (or "unencumbered" for regulatory purposes). *See Northwest Racquet Swim & Health Clubs, Inc. v. Resolution Trust Corp.*, 927 F.2d 355, 359 (8th Cir. 1991) (holding that, regardless of the industry, "the subordination effectively renders [the debt] unencumbered for regulatory purposes"); *see also In the Matter of Weis Sec., Inc.*, 605 F.2d 590 (2d Cir. 1978). Once a regulated institution applies such investments to its regulatory capital, its investors increase the institution's capital, thereby facilitating the conduct of its business by deeply subordinating their investment; any other result would undermine the regulatory protections and priorities accorded third parties that rely upon stated capital reserves. *Northwest Racquet*, 927 F.2d at 359. Indeed, the deep subordination of the TOPrS properly reflects their equity-like nature, which is the actual purpose of the TOPrS. (Spillenkothen Decl. ¶¶ 12-13). As discussed above, the TOPrS greatly resemble equity with the artificially added feature attributable to debt, that is, the interest paid on account of the underlying debentures are tax-deductible by the bank holding companies. The equity-like feature of the TOPrS becomes even more prominent in light of the fact that the TOPrS proceeds are carried on the consolidated balance sheet of the bank holding company, and the subordinated debentures are eliminated as an intercompany transaction.[12]

This regulatory scheme, which requires the TOPrS claims to be deeply subordinated to all general creditors of the Debtor may not necessarily dictate the result in the Priority Dispute, but it certainly should be considered when construing the meaning of the terms of the Indentures, including "money borrowed." Notably, the Debtor itself acknowledged that "the Debentures are subordinated to any other indebtedness of the Company that, by its terms, is not similarly subordinated." (*See* Corus Bankshares, Inc., Current Report (Form 8-K), at 2 (Sept. 21, 2005), attached hereto as **Exhibit 3**). With this backdrop – the Debtor issued the TOPrS to use the

[12] *See* Poppa, *supra* note 7, at 2.

proceeds as Tier 1 capital and the Federal Reserve required deep subordination in order to so qualify – it reasonably follows that the term "money borrowed" must encompass a wide variety of debts, including the debt owed to the Bank on account of the Tax Refunds.

**B. <u>Debtor's Remaining Arguments Are to No Avail</u>**

Beyond its attempt to analyze the language in the Indentures, the Debtor makes several other points in its Motion for Judgment on the Pleadings, none of which are sufficient to change the outcome. The Debtor relies on two recent opinions from the Central District of California to support its position that the debentures are not junior to the obligation to pay the tax refunds. *See Imperial Capital Bancorp, Inc.,* Case No. 09-19431 (Bankr. S.D. Cal. May. 24, 2012); *Siegel v. Fed. Deposit Ins. Corp. (In re IndyMac Bancorp, Inc.),* Adv. P. No. 9-01698, 2012 WL 12-1037481 (Bankr. C.D. Cal. Mar. 29, 2012), *adopted*, Case No. 12-02967, 2012 WL 1951474 (C.D. Cal. May 30, 2012). These opinions, however, are not final, binding, or persuasive. [13]

The *Imperial* court, for example, did not consider the underlying agreement between the bank and the holding company that gave rise to the repayment obligation, finding it to be inadmissible extrinsic evidence. *Imperial,* Case No. 09-19431, at 3. For the reasons explained above, this is the wrong approach. One cannot determine whether an obligation constitutes "money borrowed" without considering the obligation itself. The Debtor recognizes as much when it attached the Payment Policy to its Motion for Judgment on the Pleadings. Furthermore, the *Imperial* court failed to consider the regulatory context of the TOPrS, which is critical to understanding the meaning ascribed to the term "money borrowed" in the Indentures. Finally, the Debtor relies on *Imperial* in arguing that the borrowing could not have occurred because the

[13] The FDIC-Receiver has appealed the confirmation order entered in the *Imperial* case, which appeal is pending before the U.S. District Court for the Southern District of California as *FDIC v. Imperial Capital Bancorp, Inc.*, Case No. 12-01404 (S.D. Cal. June 11, 2012). The FDIC-Receiver also has appealed the district court's Order Adopting Accepting Bankruptcy Court's Report and Recommendation to the Ninth Circuit Court of Appeals, which appeal is pending as *FDIC v. Siegel (In the Matter of IndyMac Bancorp, Inc.),* No. 12-56218 (9th Cir. July 2, 2012).

Debtor could not borrow money without an order of the Court. (Debtor's Memo. at 19). The legality or court authorization of the borrowing, however, is irrelevant. Whether legal or not, authorized or not, the borrowing was incorporated into the prepetition Payment Policy, which established the rights of the parties.

Similarly, the Debtor's reliance on the *IndyMac* decision is misplaced because it was decided in an entirely different legal context and dealt with different legal issues. Specifically, the *IndyMac* court did not deal with the issue of priority of claims or construe the meaning of the language in the indentures. Rather, the court rejected the FDIC's argument that the tax sharing agreement could not have been a loan because the debtor failed to comply with 12 USC § 371c (the regulation that prescribes limits on loans to affiliates), finding only that the tax sharing agreement was not an "extension of credit *for purposes of section 371c*." *IndyMac*, 2012 WL 1037481 at *37 (emphasis added). As noted above, the FDIC-Receiver has appealed the *IndyMac* decision to the Ninth Circuit Court of Appeals.

The Debtor also contends that had the parties wished to include the tax refunds as borrowed money, there was language available to it that would have allowed it to make clear that the debentures were junior to all other indebtedness. (See Debtor's Memo. at 16). The language suggested by the Debtor comes from the American Bar Foundation's Model Debenture Indenture Provisions published in 1965. The Federal Reserve regulation with which the Debtor expressly sought to comply was promulgated in 1989, as subsequently supplemented in 1996 and amended in 2005. The Debtor cannot rely on the American Bar Foundation's 48-year-old Commentaries on Model Debenture Indenture Provisions and case law cited in the Debtor's Motion to support its argument of a narrow reading of the term "money borrowed" and "senior indebtedness," which is contained in the Indentures issued by the Debtor as a banking institution, because, in

addition to being published in 1965, long before the Federal Reserve's regulations and guidelines, the cited sources are not specific to the banking industry.

The Debtor also argues that the FDIC-Receiver is trying to improve its position post-bankruptcy by elevating its priority as a consequence of post-petition actions. (Debtor's Memo. at 20). This argument makes no sense. The Payment Policy, which forms the basis of the Debtor's obligation, was adopted pre-petition. If the FDIC-Receiver does not own the Tax Refunds, then, under the Payment Policy, the Debtor owes the Tax Refunds to the FDIC-Receiver.

## V. CONCLUSION

The Debtor acknowledges that it must pay the FDIC-Receiver its allocated portion of the Tax Refunds. This obligation constitutes "money borrowed" – the money being the Tax Refunds that the Debtor is obligated to allocate and remit to the Bank – and thus "Senior Indebtedness" under the Indentures. Accordingly, the FDIC-Receiver's claim to the Tax Refund is senior in priority to the claims of the holders of the TOPrS. Therefore, the Debtor's Motion for Judgment on the Pleadings should be denied, and the FDIC-Receiver's Motion for Summary Judgment should be granted.

*[Signature page follows]*

Dated: September 27, 2012
Chicago, Illinois

Respectfully submitted,

*/s/ Alan P. Solow*

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