

FDIC Receivership of Failed Banks: Pitfalls for Landlords and Letter of Credit Beneficiaries

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With bank failures on the rise, Landlords of weak or failed banks will find it helpful to understand the Federal Deposit Insurance Corporation ("**FDIC**") receivership process, specifically - the key differences between FDIC receivership and bankruptcy. In addition, Landlords who have received security in the form of a letter of credit ("**LOC**") need to be aware of potential limitations on collection following the issuer's failure.

The FDIC resolution and receivership process is used to value and market a failed bank, close the failed bank and pay insured depositors (or arrange for a healthy bank assumption). Typically, the resolution involves an FDIC arranged assumption by a healthy bank of all or a portion of the failed bank's assets and liabilities (which include, at a minimum, the insured deposits of the failing bank). The receiver then liquidates assets remaining after the transaction and distributes the proceeds to the costs of the receivership, to the FDIC as subrogee of the insured depositors and, to the extent any proceeds remain, to creditors with allowed claims.

A. The Basic Rules

While many of the concepts are similar to bankruptcy, the Federal Deposit Insurance Act (the "**Act**") grants the FDIC receivership powers that are substantially broader and stronger than those of a bankruptcy trustee – think "Super Receiver." Critical differences include:

1. **Nature of Proceeding.** Unlike bankruptcy, FDIC receivership is not a court proceeding. The FDIC administers and disposes of the failed bank's assets without advance notice to creditors or via public hearing. Review of the FDIC's actions by a court is only available in very limited circumstances.
2. **Stay of Action.** Unlike bankruptcy, the stay of judicial actions and proceedings against the failed bank is not automatic. The FDIC must request a stay and the court handling the legal proceeding must grant it for 90 days.
3. **Repudiation of Leases, LOCs and Contracts;** A bankruptcy trustee may only reject executory contracts within the relevant time period provided under the Bankruptcy Code. For commercial leases, the time period is 120 days, subject to extension for 90 days without landlord consent. In contrast, the FDIC as receiver may repudiate any contract within a "reasonable" period of time so long as it deems the contract burdensome and repudiation would promote orderly administration. LOCs are not exempt. It has been the FDIC's long standing position that standby LOCs are contingent obligations that do not support an allowable claim unless the right to draw occurred prior to the receivership. If the right to draw precedes the receivership, the beneficiary will have either a unsecured claim or, if the LOC was collateralized, a secured claim. If the right to draw occurs after the receivership, the FDIC may not allow the claim even if the LOC is collateralized; however, in such event, the beneficiary may be able to argue that the LOC should be honored to the extent of the collateral because doing so would not be burdensome and repudiation would interfere with the intended security. In terms of repudiation timing, "reasonableness" will vary with the circumstances, but several published decisions regard 90 to 180 days acceptable. Although the receiver will be liable for damages, those damages are limited to direct damages. There are no accelerated, consequential or loss of profit damages. For a repudiated lease, the landlord may only claim rent due as of the receiver's appointment and rent accruing thereafter until repudiation. In contrast to bankruptcy law which generally allows a claim for one year of future rent, no claim for rent accruing after repudiation is allowed.

4. **Administrative Priority.** In a bankruptcy, the debtor's obligations under a lease that arise post-petition, such as rent, must be paid current by the bankruptcy trustee, and therefore have priority over other unsecured claims. Although expenses which the FDIC considers administrative are given payment priority, the rental owed post-receivership and before repudiation is not necessarily an administrative expense. "Administrative expenses of the receiver" only include expenses "that the receiver determines are necessary and appropriate to facilitate the smooth and orderly liquidation or other resolution of the institution."
5. **The Claims Process.** In a bankruptcy, the interests of the bankruptcy estate, debtor and creditors are separately represented and the bankruptcy judge applies statutes and rules to the interests of all parties. In contrast, the FDIC both makes and implements the rules which govern its review of claims, is not subject to judicial supervision and, with limited exceptions, its decisions are not reviewable by any court.

The claims process consists of notice of the receivership, a period for filing claims and a period for review by the FDIC. If the claim is not proven to the satisfaction of the FDIC, it is disallowed. Claims filed after the cut-off which is set by the FDIC (which must be at least 90 days after the initial publication) are disallowed. The only recourse with respect to a disallowed claim is for the creditor, within 60 days after disallowance, to seek administrative review (which requires the FDIC's consent), alternative dispute resolution per procedures established by the FDIC or to file suit in U.S. District Court.

6. **Assignment and Assumption.** The FDIC as receiver has the power to transfer any asset of the failed institution without any approval or consent. Thus, unlike the assumption and assignment of an unexpired lease in bankruptcy, the receiver is not constrained by requirements for adequate assurance, the terms of transfer are generally not disclosed, and the landlord has no notice or opportunity to object. Further, there are no cure requirements for assumption. The FDIC may assign a lease in default to an acquiring bank and the landlord is left to pursuing its remedies against the new tenant.

B. Tips for Landlords with Bank Leases

In recognition that many of the creditor protections that exist in a bankruptcy proceeding do not exist in a FDIC receivership, landlords of banks weakened by the current economic conditions should:

Monitor the tenant's payment of rent and the status of the bank. Do not rely on receiving notice from the FDIC or tenant. Upon the appointment of a FDIC as receiver, landlords should immediately seek to clarify with the FDIC whether the post-receivership rent is entitled to an administrative priority. Finally, the landlord should promptly file its claims to start the FDIC review period.

C. Tips for LOC Beneficiaries

Landlords in possession of LOC security should investigate the financial condition of the issuing bank and whether the LOC is collateral backed. If the issuing bank is not financially strong, the landlord should exercise whatever lease rights it may have to cause the tenant to replace the LOC with a cash security deposit, a replacement LOC from an approved bank or to draw the LOC. Landlords should also reevaluate and/or update their LOC lease provisions and their practice of accepting LOCs as security for a tenant's performance.