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Et tu, Brute? The Downfall of Wachovia Bank and the Proper Roll of the Federal Deposit Insurance Corporation in Providing Open Bank Assistance

Angelo M Metaxatos, University of Miami

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Et tu, Brute? The Downfall of Wachovia Bank and the Proper Roll of the Federal Deposit Insurance Corporation in Providing Open Bank Assistance

By: Angelo Metaxatos

Abstract

In the autumn of 2008, our country’s banking system, crippled by risky lending practices and over-leveraging, was teetering on the precipice of widespread failure. During this period, the Federal Deposit Insurance Corporation (FDIC) played a crucial role in assisting some banks, and acting as a receiver with others. When Wachovia Bank, one of our country’s largest financial institutions, was in danger of failing at the peak of the crisis, the FDIC concluded they were “too big to fail” and took the extraordinary step of providing open bank assistance. When, as a result of this assistance, Citigroup offered to purchase Wachovia in late September, it appeared to many that the worst of the crisis was over. The worst, however, was yet to come. The resulting fight over Wachovia by Citigroup and Wells Fargo threatened to further undermine the already fragile banking industry, condensed a year’s worth of complex litigation into a span of a few weeks, and ultimately called into question the proper role of the FDIC, in providing open bank assistance.

Angelo M. Metaxatos
Managing Editor - University of Miami Inter-American Law Review
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I. Introduction

If you were looking for the specific moment in time when Wachovia turned to shit, I suppose May 8th, 2006 is as good a starting place as any. I can’t say I remember much that day, but I do remember the email. I was working for Wachovia Retirement Services in Charlotte, North Carolina, as a “Distribution Support Specialist,” until law school started in Miami that August. Business was good.

Among other things, Wachovia managed the retirement plans of a number of companies throughout the U.S.; companies like Hilton Hotels1 and

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1 See Wachovia Website, available at https://www.wachovia.com/corp_inst/hilton. (Explaining that as of January 21, 2009, Hilton’s 401K plan is no longer managed by Wachovia Retirement Services.)
Circuit City. Of course, we also managed the savings plan for Wachovia Employees. Whenever employees of these companies left their jobs, whether because of retirement, a lateral move, or because they were just plain fired, they would call me. My job would be to discuss the different distribution options they had with their 401K assets and the tax ramifications of a cash out. If these departing employees had enough money, I would also try to convince them to roll their money over into a Wachovia Individual Retirement Account. The commissions were fantastic.

As part of my job, I would also peruse a customer’s portfolio to see if they had stock in individual companies, and if they did, suggest that they take advantage of the cost basis of the stock by rolling the stock over to an IRA in-kind, thereby paying only capital gains on the difference between what they paid for the stock and what the stock was currently worth when they finally cashed the stock out. Some Wachovia employees, who had worked for First Union for many, many years, back when it was a local North Carolina Bank, had literally hundreds of thousands of dollars in Wachovia Stock, and I would recommend that they keep this stock in order to take advantage of its cost basis.

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3 See https://www.wachovia.com/401k. (demonstrating that fortunately, this is still one plan that Wachovia manages.)

4 See e.g., https://www.wachovia.com/foundation/v/index.jsp?vgnextoid=d2f56cd31e0aa110VgnVCM100004b0d1872RCRD&vgnextfmt=default.

I can't remember if I was giving this sort of awful advice⁶ to a customer when Ken Thompson, the CEO of Wachovia sent me an email that day, but I cannot discount the possibility, or the potential irony. Thompson’s email has long-since disappeared from my inbox, but the press statement it was based off, issued the prior day, is still there for all to see. The first sentence reads: “Wachovia Corporation (NYSE:WB) and Golden West Financial Corporation (NYSE: GDW), parent of World Savings Bank, said today they have signed a definitive agreement to merge, creating a leading retail banking and mortgage lending franchise in many of the nation’s most attractive growth markets.”⁷

As a North Carolinian, I had never heard of Golden West Financial before, the press release went on to explain that “Golden West is one of the nation’s largest financial institutions with assets over $125 billion as of March 31, 2006,”⁸ and that “Golden West’s World Savings Bank is the nation’s only standalone savings and loan with a "AA" debt rating.”⁹ In hindsight, the optimism of Wachovia’s press release was surpassed only by Thompson, who extolled, “[w]e feel like we are merging with a crown jewel. This is a

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⁶ At least in hindsight. I might also add that my Wachovia Savings Plan was, and still is, invested in Wachovia stock.
⁸ Id.
⁹ Id. See also, BLACK’S LAW DICTIONARY 1134 (8th ed. 2004) (defining “investment-grade rating” as “[a]ny of the top four symbols (AAA, AA, A or BAA) given to a bond after an appraisal of its quality by a securities-evaluation agency such as Moody’s. The rating indicates the degree of risk in an investment in the bond.)
transformative deal for us.”\textsuperscript{10} The market, however, disagreed, and shares of Wachovia, which closed at 59.39\textsuperscript{11} the prior Friday tumbled to 55.42\textsuperscript{12} on Monday, May 8\textsuperscript{th}, until the deal, originally brokered for $25.5 billion, dropped to $24.5 billion on the day I was reading my email.\textsuperscript{13}

Almost two years later, while I was being taken to task on the true nature of capital gains in Professor Blatt’s Federal Income Tax class,\textsuperscript{14} Wachovia was being taken to task by the bad mortgages they assumed as part of the Golden West deal. In an attempt to stop the bleeding and bolster their debt to capital ratio,\textsuperscript{15} on April 14, 2008, Wachovia announced a capital infusion of $7 billion dollars.\textsuperscript{16} This move came the same day that Wachovia

\begin{itemize}
\item \textsuperscript{11} Stock Quote, http://studio-5.financialcontent.com/mi/?Month=5&Account=charlotte&Page=HISTORICAL&Ticker=WB&Year=2006&Range=3.
\item \textsuperscript{12} Id.
\item \textsuperscript{13} Moore, supra note 10.
\item \textsuperscript{14} See Profile of Professor William S. Blatt, http://www.law.miami.edu/facadmin/wblatt.php?letter=B.
\item \textsuperscript{15} \textit{ENCYCLOPEDIA OF BANKING & FINANCE} 964-966(10th ed. 1994) (explaining that capital structure ratios provide information on the debt capacity of a company and its level of financial risk. It is measured by dividing a company’s shareholder equity by the company’s total assets. The addition of preferred stock can add “leverage” to a company’s capital structure.).
\item \textsuperscript{16} Press Release, Wachovia, Wachovia Corporation Prices $7 Billion in Concurrent Offerings of Common Stock and Convertible Preferred Stock (Apr. 14, 2008), https://www.wachovia.com/foundation/v/index.jsp?vgnextoid=c9956c772350f110VgnVCM200000627d6fa2RCRD&vgnextfmt=default&key_guid=1829d179781eb110VgnVCM100000ca0d1872RCRD. (announcing the concurrent offerings of $3.5 billion or 145,833,334 shares of common stock and $3.5 billion or 3,500,000 shares of Non-Cumulative Perpetual Convertible Class A preferred stock, Series L, with a liquidation preference of $1,000 per share).
\end{itemize}
also announced a first quarter loss of $393 million,17 compared to earnings of $1.73 billion two years earlier.18

Unfortunately for Wachovia, the bleeding would continue. In May, Wachovia was forced to restate its losses for the first quarter of 2008, admitting they were, in fact, closer to $708 million, following a closer review of its insurance portfolio.19 In June, Ken Thompson would step down as Chief Executive Officer of Wachovia, at the behest of its board,20 to be replaced later by Robert Steel, a former Under Secretary for Domestic Finance for the U.S. Department of Treasury.21 On July 22, 2008, Wachovia posted a net loss of $8.66 billion, compared to a net income of $2.34 billion just one year earlier;22 took $6.1 billion of write-downs23, and slashed its dividend to five cents a share.24

20 *Id.*
23 MERRIAM-WEBSTER ONLINE, http://www.merriam-webster.com/dictionary/write-down, (defining a write-down as a deliberate reduction in the book value of an asset (as to reflect the effect of obsolescence)).
24 Moore, *supra* note 22.
By August 12, 2008, shares of Wachovia stock had plummeted to $16 a share on news that the bank would have to cut 600 more jobs than previously expected, with all these additional job cuts coming from the bank’s troubled mortgage business.\textsuperscript{25} Keep in mind, the Friday before Wachovia bought Gold West Financial in 2006, Wachovia stock closed at 59.39.\textsuperscript{26} This means, if I advised a Wachovia employee in 2006 in my capacity as a distribution support specialist, to hold on to $100K worth of Wachovia stock in order to later take advantage of the cost basis, that $100,000 was worth $26,940 on August 12, 2008. That same day, Wachovia also announced it would have to restate its second quarter losses, from $8.66 billion to $9.11 billion, as a result of an additional $500 million recorded in legal reserves.\textsuperscript{27}

In September, things went from bad to worse. On September 9\textsuperscript{th}, Merrill Lynch downgraded its rating\textsuperscript{28} of Wachovia stock from “market perform” to “underperform.”\textsuperscript{29} The downgrade was primarily a result of the $122 billion worth of loans that Wachovia acquired from Golden West in 2006.


\textsuperscript{27} Associated Press, \textit{supra} note 25. \textit{See also}, Black’s Law Dictionary 1222 (8th ed. 2004) (Defining a legal reserve as “the minimum amount of liquid assets that a bank or an insurance company must maintain by law to meet depositors’ or claimants’ demands.)

\textsuperscript{28} Black’s Law Dictionary 1134 (8th ed. 2004) (defining “security rating” as “[t]he system for grading or classifying a security by financial strength, stability, or risk.”).

which were now suffering staggering losses tied to California’s declining real
estate market, where most of the loans originated.  

Outside of Wachovia, the assumption that some financial institutions
were simply to venerable and large to fail, was quickly disappearing. Five
days after Merrill Lynch downgraded Wachovia’s Stock, Lehman Brothers
filed for Chapter 11 bankruptcy protection. Lehman Brothers entered
bankruptcy with $613 billion worth of debt, the largest bankruptcy in
American history and more than five times larger than the previous largest
bankruptcy in U.S. history, WorldCom.  

On September 17th, reports surfaced that Wachovia and Morgan Stanley
were in talks to merge as a means of strengthening both companies’ balance
sheets, and later that day, Wachovia’s stock closed at $9.12 per share. As
September drew to an end, it became increasingly clear to investors, the
media and the government that Wachovia was in desperate need of help.

II. Anyone Want to Buy a Bank?

On Thursday, September 25th, 2008, Washington Mutual, a Seattle thrift
with 2,239 branches throughout America, became the largest bank to fail in
U.S. history. Washington Mutual’s failure came as Congress debated President Bush’s proposed $700 billion stimulus package, aimed at bolstering the beleaguered financial sector. By the close of business that day, Wachovia stock had slid another 6%, federal regulators were preparing to seize Washington Mutual’s assets, and Wachovia was in dire need of a merger. That evening, Wachovia CEO Robert Steel called Citigroup CEO Vikram Pandit to say “We’d like to talk to you.”

On Friday, September 26th, shares of Wachovia stock slid another 27% amid rumors that the major credit agencies were preparing to downgrade Wachovia’s credit ratings the next Monday, just as billions of dollars of debt were maturing. Wachovia quickly abandoned any hope of raising enough capital to keep the bank independent. The next day, Robert Steel flew from Charlotte, North Carolina, the headquarters of Wachovia, to New York City in order to initiate talks with various suitors and government regulators.

with the aid of loans or purchase of assets by the Federal Deposit Insurance Company (thus in effect constituting hidden failures)).

37 Id.
39 Sidel, supra note 36.
40 Enrich, supra note 38.
41 Id (explaining that a downgrade of Wachovia’s credit rating would subsequently increase the bank’s cost of borrowing more money).
42 Id.
44 Enrich, supra note 38.
During these talks, Wells Fargo quickly emerged as the frontrunner to buy Wachovia. Wells Fargo offered to do a deal, without government assistance, in which they would pay a premium for Wachovia stock, somewhere “in the teens” and total costs above $20 billion.45 During this period, talks with Citigroup ground to a halt, resulting from their refusal to do a deal without government assistance.46

One crucial element of the deal with Wells Fargo, however, was that the merger be completed over the weekend, before stock markets opened again and Wachovia ran the risk of having their credit rating downgraded.47 The next afternoon, however, Wells Fargo Chairman Richard M. Kovacevich threw a monkey wrench into deal, expressing concerns about the health of one of Wachovia’s smaller loan portfolios that was surprisingly unrelated to the toxic mortgage assets at the core of Wachovia’s troubles.48 These concerns, coupled with hints from federal regulators that Wells Fargo was getting “cold feet,” snowballed into a teleconference that evening in which Kovacevich refused to consummate the deal without conducting a due diligence investigation into Wachovia’s loan portfolio, an investigation which would take at least several weeks and essentially kill the deal.49

Shortly after the teleconference call, Wells Fargo literally stopped returning Wachovia’s calls and the Federal Deposit Insurance Company

45 Id.
46 Id.
47 Enrich, supra note 38.
48 Id.
49 Id.
(hereinafter ‘FDIC’) made it clear to Wachovia that they were taking over the process of finding a proper suitor for Wachovia. Several key regulators went home to take showers, and Treasury Secretary Henry Paulson, who along with New York Federal Reserve President Timothy Geithner had kept abreast of the Wachovia/Wells Fargo deal (or lack thereof), briefed the President, “warning that Wachovia’s failure could wreak further havoc on the financial system.”

III. Wachovia Needs Help, but What Kind of Help?

Before discussing the actions taken by the FDIC on Wachovia’s behalf, it may be prudent to discuss the nature of the FDIC as a regulatory body and its historical role in providing assistance to failing banks. The Federal Deposit Insurance Corporation is an independent executive agency, established by the Banking Act of 1933 to ensure the deposits of all banks entitled to federal deposit insurance.

The FDIC’s primary mission is “to maintain stability and public confidence in the United States financial system by insuring deposits up to the legal

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50 Id.
51 Id.
limit and promoting sound banking practices." In order to accomplish this mission, the FDIC performs three functions, *to wit*:

1. In its capacity as insurer, the FDIC maintains insurance funds. When a federally insured institution fails, the FDIC pays off insured deposits or, more frequently, arranges for the transfer of accounts from the failed institution into a healthy one.

2. The FDIC shares responsibility for the supervision and regulation of banks and thrifts in the United States with other federal regulators, such as the Office of the Comptroller of the Currency and Federal Reserve, and also with state banking authorities.

3. The FDIC also acts as a receiver or liquidating agent for failed federally insured depository institutions.

When the FDIC took over negotiations for Wachovia that Sunday evening, Wachovia was teetering on the precipice of failure, allowing for the

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56 Id.


58 FDIC Resolution Handbook, supra note 55.

59 Id.

FDIC to take a number of different paths. First, the FDIC could have allowed Wachovia to fail and then initiated a deposit payoff, in which case the FDIC would assume the role of receiver, sell off Wachovia’s assets on a piecemeal basis and pay-off insured deposits from the insurance fund.\(^{61}\) In a deposit payoff, however, uninsured deposits and other general creditors of the failed bank typically do not receive either immediate or full reimbursement.\(^{62}\)

Second, the FDIC could have, again, allowed Wachovia to fail, and then initiate a purchase and assumption transaction. The purchase and assumption transaction is the most common type of resolution\(^{63}\) and involves a healthy institution purchasing some or all of the assets of a failed bank or thrift, assuming some or all of the liabilities of the failed bank, and potentially receiving some assistance from the FDIC as insurer to complete the transaction.\(^{64}\) Like with a deposit payoff, however, uninsured depositors and other creditors stand to suffer big losses.\(^{65}\)

In rare situations, however\(^{66}\), the FDIC is also capable of utilizing a third kind of assistance, often referred to as open bank assistance.\(^{67}\) In an

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\(^{61}\) Id. at 2. (explaining that “[t]he receivership process involves performing the closing function at the failed bank or thrift; liquidating any remaining failed institution assets; and distributing any proceeds of the liquidation to the FDIC, to the failed institution’s customers who had uninsured deposit amounts, to general creditors, and to those with approved claims.”)

\(^{62}\) Id. at 5.

\(^{63}\) Id. at 19.

\(^{64}\) Id. at 5.

\(^{65}\) Walter, supra note 57, at 60.

\(^{66}\) Id. at 61 (noting that [until Wachovia], open bank assistance had not been utilized since 1991, after passage of the Federal Deposit Insurance Corporation Improvement Act, Pub. L. 102-242, 105 Stat. 2236 (1991)).
open bank assistance transaction, the FDIC provides financial assistance to an operating insured bank or thrift determined to be in danger of failing in order to facilitate the acquisition of the failing bank by a healthy institution. The financial assistance provided by the FDIC may involve providing a cash contribution to restore deficit capital to a positive level (referred to as “filling the hole”) or, for larger institutions, the FDIC may use a note or loan to fill the hole.

Open bank assistance is different from other kinds of assistance in a number of important ways. First, unlike with both a deposit payoff or purchase and assumption transaction, in which the bank has already failed, in open bank assistance, the bank is still a going concern. Another key difference between open bank assistance and deposit payoffs or purchase and assumption transactions, is that shareholders and other creditors such as bondholders are protected from loss because the bank never goes out of business, although their ownership interests may be severely diluted.

When Washington Mutual failed the week before, the Office of Thrift Supervision closed the bank, and the FDIC, which was named receiver,
proceeded with a purchase and assumption transaction.\textsuperscript{74} While the transaction, in which the bulk of their banking operations were sold off to JPMorgan Chase, protected depositors and came at no cost to the insurance fund,\textsuperscript{75} it also wiped out most bondholders and stockholders, sending ripples of panic through the credit markets.\textsuperscript{76}

As a result of the Washington Mutual failure, coupled with the widespread chaos rippling through the U.S. economy, regulators feared that sending Wachovia into receivership, where stockholders and bondholders would likely be wiped-out, would further weaken already very weak credit markets to the point of breaking.\textsuperscript{77} As a result, regulators concluded that open bank assistance was the only viable option.

IV. IV. The FDIC Provides Open-Bank Assistance

As mentioned earlier, open bank assistance is rarely used by the FDIC as a form of assistance to banks.\textsuperscript{78} First conceived in 1950,\textsuperscript{79} open bank assistance was more common during the Savings and Loan crisis of the late 1980’s.\textsuperscript{80} Since then, however, Congress, responding to criticism of both the costs of

\begin{enumerate}
\item \textsuperscript{75} Id.
\item \textsuperscript{76} Enrich, \textit{supra} note 38.
\item \textsuperscript{77} Id.
\item \textsuperscript{78} Walter, \textit{supra} note 57, at 61.
\item \textsuperscript{79} Federal Deposit Insurance Act, 12 U.S.C.A. § 1823(c)(1) (1950).
\item \textsuperscript{80}FDIC RESOLUTION HANDBOOK, \textit{supra} note 55, at 48, 51.
\end{enumerate}
open bank assistance, and the unfair advantage that equity holders enjoyed,\textsuperscript{81} enacted a myriad of legislation that has limited its applicability.

For instance, in the Federal Deposit Insurance Corporation Improvement Act of 1991,\textsuperscript{82} (hereinafter ‘FDICA’), Congress allowed for the use of open bank assistance only if it proved to be the “least costly”\textsuperscript{83} method to the FDIC’s insurance fund of all possible methods for resolving the situation.\textsuperscript{84} The FDIC is only allowed to deviate from this requirement in order to avoid “serious adverse effects” on economic conditions or financial stability or “systemic risk” to the banking system.\textsuperscript{85} As a result, in some instances the FDIC was compelled to undertake purchase and assumption transactions because is was less costly than open bank assistance, whereas before they might have elected for open bank assistance as a matter of discretion.\textsuperscript{86}

To further limit the use of open bank assistance, a 1993 amendment to the Federal Deposit Insurance Act of 1950,\textsuperscript{87} prohibits the use of insurance fund money in any manner that benefits shareholders of an institution that has

\textsuperscript{81} \textit{Id.} at 56 (explaining that when the FDIC provides open bank assistance, they also protect uninsured deposits and general creditors. This is protection that other sorts of institutions typically do not enjoy).


\textsuperscript{83} \textit{Id.} at §141, (establishing the ‘Least-Cost’ resolution which amends 12 U.S.C.A. §1823).

\textsuperscript{84} FDIC RESOLUTION HANDBOOK, \textit{supra} note 55, at 8 (explaining that prior to the FDICIA, the FDIC was able to select the resolution method it preferred as long as the cost of the chosen method was less than the estimated cost of paying off depositors and liquidating the failed institution’s assets).


\textsuperscript{86} The FDIC might want to provide open bank assistance, even though it is not the least costly option, \textit{inter alia}, because it may be, in their opinion, more beneficial to the U.S. economy.

failed or is in danger of failing.\textsuperscript{88} Because of these sort of refinements, open bank assistance has not been employed in the U.S. since 1993.\textsuperscript{89}

On the evening of September 28\textsuperscript{th}, however, it was clear to federal regulators that, although not the least costly option, providing open bank assistance to Wachovia was necessary to avoid both “serious adverse effects” on economic conditions or financial stability and “systemic risk” to the banking system.\textsuperscript{90} Although the FDIC already had in place a lengthy and diligent, standard operating procedure by which it typically provided open bank assistance,\textsuperscript{91} the government abandoned most of these protocols to move quickly, and the broad outlines of a deal emerged before the markets opened the following morning.\textsuperscript{92}

The agreement between Wachovia, Citigroup and the government was ironed out four o’clock Monday morning, in a meeting of the FDIC, Treasury

\begin{footnotesize}
\textsuperscript{88} FDIC Resolution Handbook, supra note 55, at 47.
\textsuperscript{89} Walter, supra note 57, at 62.
\textsuperscript{91} FDIC Resolution Handbook, supra note 55, at 6-17, (explaining that typically, a financial institution’s chartering authority sends a “failing bank letter” advising the FDIC of the institution’s imminent failure; a FDIC “planning team will visit with the bank’s CEO to discuss logistics, address senior management’s involvement in the resolution activities, and obtain loan and deposit information from the institution; a team of 5-15 FDIC resolution specialists will then visit the bank to gather additional information and analyze the institution’s condition. These specialist will then form an “information package” detailing the amounts and types of assets and liabilities that the failing institution has. Once the type of resolution is established by the FDIC, they will then begin to market the failing bank as widely as possible to encourage competition among bidders. An information meeting will then be held in which the FDIC will invite all approved bidders and then reveal both the book price and the reserve price for the various assets up for bidding. Approved bidders will then have the opportunity to conduct due diligence at the failing institution, the bidders then submit their proposals to the FDIC. The FDIC staff will then conduct a “least cost analysis” and determine the winning bid. The FDIC then submits a written recommendation to the FDIC Board of Directors who then approves the transaction. The whole resolution process generally takes between 90 and 100 days).
\textsuperscript{92} Enrich, supra note 38.
\end{footnotesize}
Department, and other federal agencies. In the deal, Citigroup would pay $1 per share to acquire Wachovia’s banking assets ($2.16 billion total), and would inherit Wachovia’s $312 billion mortgage portfolio, including the drastically overvalued Golden West Financial portfolio. In return, the government would agree to cap Citigroup’s future losses on these loans at $42 billion, with Uncle Sam absorbing the rest. The government, for its troubles, would get $12 billion worth of warrants for Citigroup stock and preferred shares.

Fifteen minutes after the meeting, a senior government official called Wachovia CEO Robert Steel to let him know who he was selling his bank to, and Mr. Steel reluctantly acquiesced. Almost two hours later, close to 6 AM, the FDIC convened an emergency meeting, in which they approved the deal. Thirty minutes after the FDIC’s approval, Citigroup and Wachovia’s boards of directors also met, and both approved the deal, only three hours before the markets opened Monday morning.

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93 Id.
95 Enrich, *supra* note 38.
96 Id.
97 Investopedia.com, http://www.investopedia.com/terms/w/warrant.asp, (defining a warrant as a derivative security that gives the holder the right to purchase securities (usually equity) from the issuer at a specific price within a certain time frame. Warrants are often included in a new debt issue as a “sweetener” to entice investors).
98 Investopedia.com, http://www.investopedia.com/terms/p/preferredstock.asp, (defining a preferred stock as a class of ownership in a corporation that has a higher claim on assets and earnings than common stock. Preferred stock generally has a dividend that must be paid out before dividends to common stockholders and the shares usually do not have voting rights).
100 Id.
101 Id.
102 Id.
As Sunday bled into Monday, Wachovia and Citigroup signed an “Agreement in Principle” to consummate their tentative union. While the details of their deal were ironed out, however, Citigroup wanted to ensure that Wachovia didn’t talk to anyone else. Therefore, as part of this agreement, Wachovia also signed an “exclusivity agreement” in which Wachovia agreed that they would not:

“directly or indirectly, (i) solicit, initiate or take any action to facilitate or encourage the submission of any Acquisition Proposal, (ii) enter into or participate in any discussions or negotiations with, furnish any information relating to Wachovia or any of its subsidiaries, assets or businesses or afford access to the business, properties, assets, books or records of Wachovia or any of its subsidiaries to, otherwise cooperate in any way with, or knowingly assist, participate in, facilitate or encourage any effort by, any third party that is seeking to make, or has made, an Acquisition Proposal, (iii) grant any waiver or release under any standstill or similar agreement with respect to any class of equity securities of Wachovia or (iv) enter into any agreement in principle, letter of intent, term sheet, merger agreement, acquisition agreement, option agreement or other similar instrument relating to an Acquisition Proposal.”

Wachovia then went on to agree that if this agreement were breached by either party, monetary damages would be inadequate and that the remedy of specific performance would be appropriate. Also crucial, the exclusivity

103 Id.
105 Id.
106 Id.
agreement commands that New York state court be the sole jurisdiction governing any dispute.\textsuperscript{107}

If Monday was a big day for Wachovia, it was an even bigger day for the U.S. economy. That day, a bipartisan coalition in the House of Representatives sunk a $700 billion bailout plan targeting the nation’s beleaguered financial system.\textsuperscript{108} The bill’s 228 to 205 defeat set off a stampede on Wall Street in which the Dow Jones Industrial Average plummeted 778 points, a one day record.\textsuperscript{109}

After this, things become a little hazy. Citigroup argues that Wachovia was dependant on the potential bailout dollars from Congress in order to stave off failure until any supposed deal was complete. Citigroup then contends that, at the request of Wachovia’s CEO and treasury personnel, they provided Wachovia with “a maximum intra-day liquidity\textsuperscript{110} of $1.3 billion as daylight overdraft lines” on Monday, September 29\textsuperscript{th}, $800 million of such

\begin{scriptsize}
\begin{footnotesize}
\textsuperscript{107} Id.
\textsuperscript{109} Id.
\textsuperscript{110} MACEY, supra note 60, at 336, (explaining that a bank that needs cash can “buy” reserves from another bank with excess reserves at the same Federal Reserve bank. The selling bank transfers the money from its reserve account to that of the buying bank. At the end of the sale period, (usually one or two business days), the buying bank repays the loan by retransferring the money to the sellers account. \textit{See also} Morten L. Bech, \textit{Intraday Liquidity Management: A Tale of Games Banks Play}, 14 FRBNY ECONOMIC POLICY REVIEW 7, 7-8 (Sep. 2008) (explaining that as the result of the dramatic increase of interbank payments through the 1980’s and 1990’s due to rapid financial innovation and increased globalization, banks have shifted from an “end-of-day” netting system to a “real time gross settlement system” in which payments are settled irrevocably, and with finality, on an individual gross basis in real time).
\end{footnotesize}
\end{scriptsize}
liquidity on Tuesday, $1.6 billion of such liquidity on Wednesday, and $1.2 billion of such liquidity on Thursday.\textsuperscript{111}

In addition, Citigroup also argues that they “supported Wachovia’s credit by engaging in a number of assignments\textsuperscript{112} and novations\textsuperscript{113} which required Citigroup to replace third parties as counterparties to Wachovia on transactions totaling approximately $12 million.”\textsuperscript{114}

Wachovia, by contrast, argued that the funding was “routine intraday funding in the ordinary course of business” and that nothing about it was either “extraordinary” or necessary to save Wachovia from failure.\textsuperscript{115}

Nevertheless, between Monday, September 29th, when Wachovia and Citigroup signed their agreement in principal, and Friday, October 3\textsuperscript{rd}, when the deal went to hell, everything appeared on the up and up, and both parties, along with dueling armies of highly-paid lawyers, worked towards making the agreement in principle, an agreement in reality.\textsuperscript{116}

What Citigroup was unaware of however, at least until it was too late, was that Selma Blair, Chairman of the FDIC, contacted Wachovia CEO Robert Steel at approximately 7:15 PM, on the evening of Thursday, October 2\textsuperscript{nd}, to give him a heads up that he could expect an acquisition proposal from Wells

\begin{footnotesize}
\textsuperscript{111} Amended Complaint at 12, Citigroup, Inc. v. Wachovia Corp. , 2008 WL 4542749, (N.Y. Sup. Ct. 2008).
\textsuperscript{112} BLACK’S LAW DICTIONARY (8th ed. 2004) (defining assignment as the transfer of rights or property).
\textsuperscript{113} BLACK’S LAW DICTIONARY (8th ed. 2004) (defining novation as the act of substituting for an old obligation a new one that either replaces an existing obligation with a new obligation or replaces an original party with a new party).
\textsuperscript{114} Complaint, supra note 111, at 13.
\textsuperscript{116} Id.
\end{footnotesize}
Fargo. According to Citigroup’s Amended Complaint, Steel then suggested to Blair that Wells Fargo could make an offer by marking up the draft Agreement and Plan of Merger that Wachovia had provided to Wells Fargo the prior week, before the first deal fell through.  

As Thursday became Friday, Citigroup lawyers labored vigorously throughout the night, under the misguided assumption that they were reaching the homestretch of their landmark deal with Wachovia. Then, at 2:15 Friday morning, Steel notified Citigroup that Wachovia had signed a definitive acquisition agreement with Wells Fargo, and refused to participate in further discussions with Citigroup. 

Five hours later, Wachovia issued a press release, which stated, *inter alia*, that:

> “Wells Fargo last night presented Wachovia with a signed and Board-approved offer to purchase Wachovia Corporation as an intact company and without government assistance in a stock-for-stock merger transaction. Under the proposal, each share of Wachovia common stock will be exchanged for 0.1991 shares of Wells Fargo common stock, representing a value of $7 per share, based on Wells Fargo’s closing stock price on Oct. 2, 2008.”

Under the terms of the Wells Fargo deal, the Wachovia employee I advised before leaving for law school, with a $100K nest egg of Wachovia

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118 *Id.*
119 *Id.* at 18.
120 *Id.* at 19.
stock on May 5th, 2006, would now receive $11,786.50 worth of Wells Fargo stock. That same day, the FDIC issued a press release of their own, in which they explained that:

“Since the close of our bidding process, Wells has apparently re-assessed its position and come forth with this new offer that does not require FDIC assistance. It should be emphasized that both the Citigroup proposal as well as the new Wells proposal would stand behind all creditors including depositors, insured and uninsured. Under either proposal, all banking customers of the merged institutions would be fully covered with no disruptions in service. The FDIC stands behind its previously announced agreement with Citigroup. The FDIC will be reviewing all proposals and working with the primary regulators of all three institutions to pursue a resolution that serves the public interest.”

Although the FDIC took the opportunity to reaffirm its support for the Citigroup deal in its press release, it is not hard to understand why the FDIC would also prefer that Wachovia go through with the Wells Fargo deal. In the Citigroup deal, the FDIC had agreed to cap Citigroup’s future losses as a result of acquiring Wachovia’s loan portfolio at $42 billion. Taxpayers were on the hook after that and would be, for obvious reasons, not particularly enthused about the idea.

With the Wells Fargo deal, however, the government could walk away, without having to guarantee Wachovia’s losses to the acquiring bank.

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122 The Friday before the Gold West Financial deal was announced. See supra text accompanying notes 11-13.
124 Enrich, supra note 38.
Wachovia’s short-term future, and hence, the short-term future of the larger financial sector, would remain secure. The taxpayers would win, the FDIC would win, Wachovia and Wells Fargo would both win; the only supposed loser would be Citigroup. Needless to say, Citigroup was pretty upset.

V. Rage! Rage Against the Dying of the Light!

By the time Citigroup collected itself, Friday’s business day was nearing an end and they were scurrying to find a judge who would hear their case over the weekend. Later that same day, Congress also passed, and the President signed into law, the Emergency Economic Stabilization Act (hereinafter ‘EESA’), a $700 billion bailout of the financial industry only slightly different than the bailout plan that failed on September 29th.

To complicate matters, section 126(c) of the EESA amended Section 13(c) of the FDIA by adding the following provision:

“(11) UNENFORCEABILITY OF CERTAIN AGREEMENTS - No provision contained in any existing or future standstill, confidentiality, or other agreement that, directly or indirectly—

(A) affects, restricts, or limits the ability of any person to offer to acquire or acquire,

(B) prohibits any person from offering to acquire or acquiring, or

(C) prohibits any person from using any previously disclosed information in connection with any such

offer to acquire or acquisition of,

all or part of any insured depository institution, including any liabilities, assets, or interest therein, in connection with any transaction in which the Corporation exercises its authority under section 11 or 13, shall be enforceable against or impose any liability on such person, as such enforcement or liability shall be contrary to public policy.”

The next day, Citigroup lawyers traveled from New York to Connecticut to gather around the dinner table of Justice Charles E. Ramos of the New York Supreme Court. Michael Helfer, Citigroup’s chief legal officer, presented Judge Ramos with a sixteen page verified complaint in which Citigroup alleged that:

1. Wachovia was liable for Breach of Contract as a result of their intentional violation of the Exclusivity Agreement that was a part of their Acquisition Agreement.

2. Wachovia and Wells Fargo were both liable for tortuous interference with a contract as a result of their violation of the same aforementioned Exclusivity Agreement.

3. Wachovia and Wells Fargo both violated § 126(c) of the EESA.

Citigroup asked Justice Ramos, inter alia, to issue an injunctive order, blocking the Wachovia-Wells Fargo merger, and compelling Wachovia to

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129 Dash, supra note 125.
130 Id. at 62-69.
131 Id. at 70-76.
132 Id. at 62-69.
133 Id. at 70-76.
134 Id.
negotiate exclusively with Citigroup.\textsuperscript{135} Shortly thereafter, David Boies and Paul Rowe, who represented Wachovia and Wells Fargo respectively, were on the phone arguing that such an order would “cause further havoc in financial markets that were already fragile.”\textsuperscript{136} The parties argued for more than two hours, after which, Justice Ramos issued an order, crossing out Citigroup’s original request and writing underneath that, “[t]he Exclusivity Termination Date under the Exclusivity Agreement is tolled pending the hearing of this motion and further order of the Court.”\textsuperscript{137} The judge’s order essentially froze things in place indefinitely, preventing any deal between Wachovia and Wells Fargo from being finalized.

After their setback, Wachovia and Wells Fargo rushed to find a federal judge willing to hear their case.\textsuperscript{138} They believed that Citibank’s reference to the EESA in their complaint presented a federal question, preempting state law and therefore also preempting Justice Ramos’ order.\textsuperscript{139} As a result, Wachovia and Wells Fargo succeeded later that day in getting Citigroup’s original action removed to U.S. district court where Citigroup then moved for a voluntary dismissal.\textsuperscript{140}

\textsuperscript{135} Id. at (a) – (b).
\textsuperscript{136} Dash, supra note 125.
\textsuperscript{137} Order to Show Cause, Citigroup Inc. v. Wachovia Corporation, et al., 08-602872 (N.Y. Co.) (Oct. 4, 2008).
\textsuperscript{138} Dash, supra note 125.
\textsuperscript{139} Id.
\textsuperscript{140} (No. 08 Civ. 8514 (DC))
Meanwhile, however, Citigroup’s lawyers had already presented Justice Ramos with a new complaint in New York state court.\textsuperscript{141} Although Citigroup struck its claim under the EESA in their new complaint,\textsuperscript{142} through a word processing error, Citigroup inadvertently left a reference to the EESA in their prayer for relief.\textsuperscript{143} Later that Saturday evening, instead of injunctively barring Wachovia from going forward with the Wells Fargo merger directly, Justice Ramos scheduled a hearing for October 10\textsuperscript{th}, a move that would again essentially freeze negotiations in place for another five days;\textsuperscript{144} four days past the date required by the Exclusivity Agreement.\textsuperscript{145}

This order would not even last a day, however, because on Sunday Justice James M. McGuire of the New York Appellate Division, 1st Department, issued an order vacating Justice Ramos.\textsuperscript{146} In his brief opinion, Justice McGuire questioned “the authority of Justice Ramos to have issued the order while physically located outside the State of New York.”\textsuperscript{147}

By Monday, October 6th, Wachovia, Wells Fargo and Citigroup had condensed what was typically a years worth of legal pleadings into a

\begin{footnotes}
\textsuperscript{142} Id. See also Dash, \textit{supra} note 125.
\textsuperscript{144} Id.
\textsuperscript{145} Wachovia-Citigroup Exclusivity Agreement, \textit{supra} note 104.
\textsuperscript{147} Id.
\end{footnotes}
weekend, and all three agreed to a litigation standstill, barring “all formal litigation activity” until 8 AM on October 8th. The two would then later agree to extend the standstill until October 10th. During this time, the parties, along with federal regulators, conducted talks in the hopes that the Wachovia could be split, with Wells Fargo acquiring around 80% of Wachovia’s deposits, but with Citigroup taking the rest.

On the 9th, however, Wachovia and Citigroup violated the standstill agreement by removing Citigroup’s second state action to federal court again, this time arguing that Citigroup’s continued reference to the EESA in their prayer for relief, although perhaps a word processing error, presented a federal question. Citigroup had had enough. They announced later that day, that although they were still seeking $60 billion of punitive and compensatory damages, they were no longer seeking injunctive relief, and

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148 Dash, supra note 125.
152 (No. 08 Civ. 8668 (LAK)).
153 Second Amended Complaint, (Index No. 602872/08).
154 Citigroup, according to sources, also grew concerned about the amount of bad assets they would have to assume as part of any deal. Michael J. de la Merced, Regulators Approve Wells Fargo Takeover of Wachovia, N.Y. TIMES, Oct. 10, 2008, http://www.nytimes.com/2008/10/10/business/10bank.html?partner=rssnyt&emc=rss.
would allow the Wachovia-Wells Fargo deal to go through.\textsuperscript{155} Wells Fargo has won.

VI. Did We Win?

The government also won, at least in the short term. Instead of having to guarantee Citigroup’s losses above $42 billion,\textsuperscript{156} potentially billions of dollars, they could simply walk away.\textsuperscript{157} Equity holders won too, which is to say, they lost less than if the FDIC had brought Wachovia into receivership.\textsuperscript{158} True, Citigroup lost, but their lawsuit for damages would go on. The story, however, does not end there.

In Citigroup’s amended complaint, they argue that, “[t]he actions of the Defendants [Wachovia, Wells Fargo and their Boards of Directors] threaten the public generally because, among other reasons, they have significantly increased the risk of future bank failures by operating to discourage or deter persons or entities from coming to the aid of failing banks.”\textsuperscript{159}

Carl Tobias, a professor at the University of Richmond School of Law, agreed on this point: “The government will have a hard time calling on companies to bail one another out in times of crisis . . . It seems like the FDIC loses some credibility if it doesn’t enforce what happened.”\textsuperscript{160}

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\textsuperscript{155} Id.
\textsuperscript{156} Enrich, \textit{supra} note 38.
\textsuperscript{157} \textit{See supra} notes 119-124 and accompanying text.
\textsuperscript{158} \textit{See supra} notes 61-65 and accompanying text
\textsuperscript{160} Dash, \textit{supra} note 125.
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This is a point that merits consideration. Prior to Wachovia, open bank assistance had not been provided by the FDIC since 1992,\textsuperscript{161} in large part, because the FDICA’s “least cost” requirement\textsuperscript{162} limited the accessibility of open bank assistance to instances in which there was a serious risk to the larger banking sector.\textsuperscript{163} As a result, open bank assistance, is now a mechanism used only when a bank or thrift is considered “too big to fail” because their failure would endanger America’s entire financial system.

In a situation like this, where the FDIC is providing emergency funding to a failing bank in the hopes that someone will come forward to rescue them, will potential bidders still come to the table, knowing that the FDIC might not aid the bidder in compelling the failing bank to stay true to any final bargain?

As it currently stands, federal banking agencies such as the FDIC have a substantial amount of power over insured depository institutions to informally coerce them into agreements.\textsuperscript{164} Section 13 of the FDIA, however, which allows for open bank assistance, does not require the FDIC to compel compliance with an FDIC-bartered transaction.\textsuperscript{165} In fact, the FDIA even goes so far as to authorize certain acquisitions, even after open bank assistance is provided.\textsuperscript{166} Specifically, the FDIA provides that if:

\texttt{“(i) at any time after August 10, 1987, the Corporation provides any assistance under}

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\textsuperscript{161}RESOLUTION HANDBOOK, supra note 55, at 166.
\textsuperscript{163}Id.
\textsuperscript{164}See generally Lars Noah, Administrative Arm-Twisting in the Shadow of Congressional Delegations of Authority, 1997 Wis. L. Rev. 873
\textsuperscript{165}12 U.S.C. § 1823.
\textsuperscript{166}Id. at (f)(3)(D).}
subsection (c) of this section to an insured bank; and

(ii) at the time such assistance is granted, the insured bank, the holding company which controls the insured bank (if any), or any affiliated insured bank is eligible to be acquired by an out-of-State banks or out-of-State holding company under this paragraph,

the insured bank, the holding company, and such other affiliated insured bank shall remain eligible, subject to such terms and conditions as the Corporation (in the Corporation’s discretion) may impose, to be acquired by an out-of-State bank or out-of-State holding company under this paragraph as long as any portion of such assistance remains outstanding."167

Therefore, compelled compliance with an FDIC brokered, open-bank assistance transaction is a matter of discretion by both the failing bank and the FDIC. What may be in the FDIC’s short-term interests, however, may not be in America’s long-term interest. Although allowing a bank like Wachovia to back out of their deal with Citigroup may minimize the FDIC’s risk of loss to their insurance fund, it may increase the risk that in future emergency situations, less potential buyers will submit a bid.

Of course, this risk is far from certain. A failing institution may be a desirable acquisition, with or without open bank assistance, for a number of reasons,168 and Wachovia could certainly argue that to the extent Citigroup was not able to compel Wachovia to go along with their agreement, it was

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167 Id.
168 For instance, an acquiring bank may view the failing bank’s assets as under-valued, and/or their liabilities as over-valued, and seize the opportunity to acquire the bank at a discount, especially with government guarantees mitigating the risk of loss.
only because the terms of their “Exclusivity Agreement” were not iron clad, and Wachovia was able to wiggle out.\textsuperscript{169} We must remember that all Wachovia agreed to do in their “Agreement in Principal” was attempt to negotiate, albeit in good faith, a deal with Citigroup.\textsuperscript{170} Once Wells Fargo stepped back into the picture with a better deal, Wachovia had a valid legal argument\textsuperscript{171} that they complied with their agreement with Citigroup, but Wells Fargo simply had a better offer.

Therefore, one could argue that the FDIC should not be required to compel compliance with an open-bank assisted transaction. Instead, the acquiring bank should instead ensure that the failing bank, in agreeing to the transaction, not be allowed to wiggle out of it. To accomplish this, the acquiring bank should simply ensure that instead of forcing the failing banks to agree to negotiate in good faith, the failing bank should have to agree to consummate the transaction in good faith, provided the broader outlines of the deal are complied with by both parties and in good faith. By doing so, the Wells Fargo’s of the world will be encouraged to make better offers up front, because they would realize that once the FDIC bidding process was over, they would not get a second swing at the piñata.

Of course, there is also a flip side of this coin. In their federal complaint,\textsuperscript{172} Wachovia also argues that the Exclusivity Agreement should not be enforced because it is contrary to public policy as embodied in Section

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\textsuperscript{169} Wachovia-Citigroup Exclusivity Agreement, supra note 104. \\
\textsuperscript{170} Id. \\
\textsuperscript{171} Complaint at 14, Wachovia Corp. v. Citigroup, Inc., No. 08-CV-8503 (S.D.N.Y. Oct. 4, 2008). \\
\textsuperscript{172} Id. 
\end{flushleft}
126(c) of the EESA. Therefore, even if Citigroup and Wachovia had an ironclad exclusivity agreement, Citigroup could have had a legitimate fear that the FDIC would find the agreement contrary to public policy as embodied by the EESA, and invalidate it!

So what exactly is the public policy underlying the implementation of Section 126(c) of the EESA? Everything happened so quickly in the autumn of 2008, that the Congressional record is sparse with regards to anything not involving the government spending $700 billion to purchase troubled assets from financial institutions, with the hope of ameliorating already seized credit markets. Towards that end, some legal scholars argue that Section 126(c) was added to the EESA, at the request of the FDIC, “in order to allow for a full range of possible buyers in case of a bank failure, including banks that may have been involved in merger discussions with another bank before that bank failed.”

If this is the case, then Section 126(c) ensures that any exclusivity agreement signed as a result of open bank assistance can be broken by the FDIC if, in their discretion, they decide it would be more beneficial to credit markets. This is bad law, and the timing of it all is incredibly suspicious. Remember, the FDIC was heavily involved in all of the negotiations between Citigroup and Wachovia, and was fully aware of the “Exclusivity Agreement”

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173 Id. at 16-20.
between the two. 176 Then, on Thursday evening, October 2nd, 2008, the FDIC approached Wachovia with a better offer for both Wachovia and the FDIC. 177 Then, the very next day, the EESA is passed into law with Section 126(c) attached, at the behest of the FDIC, which extend to both future acquisitions, as well as acquisitions commenced before the enactment of the Act, 178 like the Citigroup-Wachovia deal.

VII. Et tu, Brute?

The FDIC essentially had Congress bail them out of a bad deal when a better one came along. While a perfect storm of circumstances allowed for this maneuver to work in the context of the Citigroup-Wachovia deal, what about any future acquisitions that Section 126(c) allows for? If, in the future, credit markets seize to a grinding halt once more, and our country’s biggest banks are, once again, in danger of failing, the FDIC might have a harder time soliciting potential bidders to come to the rescue.

Why would a stronger bank come to the rescue of a weaker one, when they are well aware that even if their deal with a failing bank is brokered by the FDIC, that same FDIC might stab them in the back upon finding a better deal; and, in the process, void an otherwise valid, air-tight exclusivity agreement? The answer is, they won’t. Stronger banks will avoid unnecessary risks and run to the hills in order to shore up their own balance sheets,

176 See supra note 92-105 and accompanying text.
177 See supra note 117 and accompanying text.
leaving failing banks, that the government might consider “to big to fail,” to fail. Let us hope we don’t see open bank assistance again for a very long time.