

RESTRUCTURING, REORGANIZATION & INSOLVENCY



NOVEMBER 2007 BULLETIN

WARNING TO SECURITIZATION INVESTORS, INDENTURE TRUSTEES AND BANK SPONSORS:

THE DC CIRCUIT HAS ISSUED A SIGNIFICANT NEW DECISION, IN *BANK OF NEW YORK AS INDENTURE TRUSTEE OF THE NEXTCARD CREDIT CARD MASTER NOTE TRUST V. FDIC, AS RECEIVER OF NEXTBANK N.A.* (NOV. 13, 2007)

On November 13, 2007 the DC Circuit issued a decision which raises serious concerns as to whether securitization noteholders may rely on the "independent" or remote status of bank sponsored SPV's that hold securitized assets.

In two related appeals, the court held that the FDIC, as receiver of failed Nextbank, has the right to disregard an *ipso facto* acceleration clause contained in the Master Indenture entered into by and between the special vehicle trust which purchased Nextbank's credit card receivables, and the Indenture Trustee, BNY, to continue to honor the agreements between Nextbank and credit cardholders and to pay interest on principal to noteholders in the ordinary course. In an action brought by BNY as Trustee, BNY claimed that earlier acceleration and liquidation of the receivables would have resulted in \$800 million fewer losses suffered by Noteholders.

DC Circuit also found that the District of Columbia was an appropriate venue, despite NY forum selection and choice of law clauses in the Master Indenture, solely based on the FDIC's involvement in the case. Presumably, the FDIC will continue

to select this favorable forum in the future litigations.

The underlying facts were unexceptional. Nextbank, a wholly owned subsidiary of Nextcard, Inc., originated "Nextcard" credit cards, and then securitized the credit card receivables. This was a routine securitized transaction, pursuant to which Nextcard's subsidiary, Nextbank sold the receivables to an independent Trust, while retaining a 9% seller's interest. The Trust paid Nextbank by issuing four tranches of notes with varying risks secured by the receivables pool. BNY acted as indenture trustee for the Trust pursuant to a Master Indenture, which apparently was also executed by Nextbank, although not as a party.

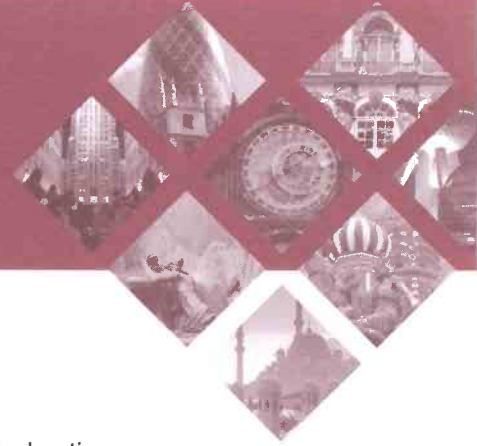
As is often the case, Nextbank acted as administrator of the Trust pursuant to an administration agreement, and as servicer pursuant to a transfer and servicing agreement. Nextbank assumed limited obligations under the Master Indenture, including the payment of indenture trustee fees.

On BNY's appeal from an injunction in favor of the FDIC and the loss of a conversion action brought against the

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FDIC, the DC Circuit concluded that the FDIC had the right to disregard an *ipso facto* acceleration clause in the Master Indenture (acceleration to be automatic upon Nextbank going into receivership) while continuing the business pursuant to 12 USC 1821(e)(1), until a financial performance default occurred.

In so holding, the DC Circuit expressly held that 12 C.F.R. § 360.6, which prohibits the FDIC from disaffirming or repudiating contracts in order to "reclaim, recover, or recharacterize" as its own property "any financial assets transferred ... in connection with a securitization" 12 C.F.R. § 360.6(b), was not violated. The Court found that the FDIC did not repudiate the Master Indenture despite the rejection of

the automatic *ipso facto* acceleration clause, and that the FDIC could continue to operate the Trust and the Master Indenture, ignoring the *ipso facto* acceleration clause.

This case constitutes a clear warning to investors and indenture trustees, that the securitization vehicles sponsored by FDIC-insured banks have greater investor risk than generally assumed.

The case does not, however, raise any new questions for non-bank securitization sponsors, because the US Bankruptcy Code generally protects securities transactions from bankruptcy court interference with respect to enforcement of *ipso facto* acceleration clauses.

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