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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

E-Trade $23M Contract Win Bests Deutsche Appeal

By **Samuel Howard**

Law360, New York (April 1, 2010, 4:11 PM ET) -- A federal appeals court has brushed aside Deutsche Bank AG's challenge to a district court judgment awarding E-Trade Bank roughly $17.5 million in damages and $5.5 million in attorneys' fees for Deutsche Bank's overvaluation of a recreational vehicle loan business it sold in 2002.

Flatly rejecting Deutsche Bank's arguments, the U.S. Court of Appeals for the Second Circuit affirmed the $23 million judgment Tuesday, concluding that E-Trade is indeed entitled to recover amounts it overpaid on the $60 million deal, rather than addressing the contractual grievances through a post-closing price adjustment process.

"According to Deutsche Bank, the district court impermissibly disturbed the 'final, binding and conclusive' closing balance sheet by concluding that E-Trade's breach of contract claim was instead amendable to the indemnity provisions in the stock purchase agreement. We are not persuaded," the appeals court said.

E-Trade's claims relate to Deutsche Bank's failure to comply with accounting conventions and assumptions and patently fall within the purchase agreement's indemnification provisions, not its purchase price adjustment provisions, the appeals court concluded.

E-Trade Bank's entitlement to damages is not altered by the fact that it was compensated for the amount it overpaid when later selling the unit to E-Trade Financial Corp., the Second Circuit said.

The appeals court also found that the contract preserves E-Trade's right to attorneys' fees in the case and backed the district court's "thoughtful and comprehensive" contemplation of the $5.5 million fee award.

Douglas P. Lobel, counsel for E-Trade and partner at Cooley Godward Kronish LLP, applauded the decision to make E-Trade whole by affirming the full award, with interest and attorneys' fees.

"The opinion confirms what E-Trade has contended throughout this five-year saga: that Deutsche Bank used inflated financials to sell E-Trade a company that was worth far less than E-Trade paid," Lobel said.

E-Trade sued Deutsche in 2005 over its purchase of Deutsche Recreational Asset Funding Corp., a special purpose entity that owns the equity interest in certain recreational vehicle loan securitizations.

In June 2009 the U.S. District Court for the Southern District of New York concluded that Deutsche Bank ran afoul of a covenant in the Drafco sale agreement to prepare a closing balance sheet in accordance with U.S. generally accepted accounting principles, overstating the deferred tax rate by more than $11 million.

Deutsche Bank's own accountant acknowledged the faulty calculations, referring to the deferred tax audit as "garbage in, garbage out," according to the appeals court.

Deutsche's reference and closing balance sheets for the transaction represented that the value of Drafco's deferred tax asset was $15.3 million. E-Trade purchased the stock of Drafco for roughly $60 million, including the $15.3 million value, according to the brokerage.

In fact, as of the December 2002 closing date, Drafco's deferred tax asset had a value of less than $1 million, the complaint said.

A spokesman for Deutsche Bank declined to comment Thursday on the appeals court decision.

The case was heard by Judges Reena Raggi, Peter W. Hall and Gregory W. Carman.

E-Trade is represented by Cooley Godward Kronish LLP.

Deutsche is represented by Skadden Arps Slate Meagher & Flom LLP.

The case is E-Trade Financial Corp. v. Deutsche Bank AG, case number 09-3029, in the U.S. Court of Appeals for the Second Circuit.

--Additional reporting by Chris Norton