Study on the Resolution of Financial Companies under the Bankruptcy Code

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The Board of Governors of the Federal Reserve System (the Board) is responsible for implementing numerous provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act requires, among other things, that the Board produce reports to the Congress on a number of potential reform topics.

See the Board’s website for an overview of the Dodd-Frank Act regulatory reform effort (www.federalreserve.gov/newsevents/reform_about.htm) and a list of the implementation initiatives recently completed by the Board as well as several of the most significant initiatives that the Board expects to address in the future (www.federalreserve.gov/newsevents/reform_milestones.htm).
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Executive Summary

Under section 216 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the Board of Governors of the Federal Reserve System (the Board), in consultation with the Administrative Office of the United States Courts (the Administrative Office), must conduct a study regarding the resolution of financial companies under Chapter 7 or Chapter 11 of the Bankruptcy Code. Section 216 directs the Board specifically to study five topics, including (1) the effectiveness of the Bankruptcy Code for systemic financial companies, (2) the establishment of a special court or panel of judges for financial company bankruptcies, (3) the adoption of amendments to the Bankruptcy Code to enhance its ability to resolve financial companies, (4) the treatment of qualified financial contracts (QFCs) in U.S. insolvency laws, and (5) the establishment of a new chapter or subchapter of the Bankruptcy Code for financial companies. The five topics specified in section 216 generally correspond to specific proposals for amending the Bankruptcy Code that were presented to the Congress in connection with its consideration of the Dodd-Frank Act, specifically in connection with its consideration of the “orderly liquidation authority” (OLA) in Title II of the Dodd-Frank Act.

This study surveys existing literature regarding the five potential changes identified above, primarily as those proposals were articulated during the time period leading up to enactment of the Dodd-Frank Act. The literature generally considers a variety of hypothetical amendments to the Bankruptcy Code as they might be applied to financial companies in the future, rather than addressing empirical studies of prior bankruptcy cases. On most topics, there is more literature arguing for changes to the status quo than there is literature arguing against such changes. This gives prominence to the arguments for change and, because this study focuses on a review of the relevant literature, that prominence is reflected in this study. The Board believes, however, that the importance and significance of the changes to financial company resolution discussed in this study underscore the need for a broad and robust debate about the merits and effects of the changes reviewed by the study. Consequently, the Board has not made any recommendations, either for or against the changes discussed in the study. Instead, in keeping with the statutory direction in section 216, this study is designed as a survey of the principal arguments for and against various Bankruptcy Code amendments relating to financial companies as those arguments have been articulated to date. This study may also serve as a point of departure for further public debate and, potentially, legislative consideration of future reform.

Introduction

Structure of the Statute and the Study

Section 216(a) of the Dodd-Frank Act requires that the Board, in consultation with the Administrative Office, conduct a study regarding the resolution of financial companies under Chapter 7 or Chapter 11 of the Bankruptcy Code. Section 216(a) requires the Board to include the following topics in its study:

1. the effectiveness of Chapter 7 and Chapter 11 of the Bankruptcy Code in facilitating the orderly resolution or reorganization of systemic financial companies;
2. whether a special financial resolution court or panel of special masters or judges should be
established to oversee cases involving financial companies to provide for the resolution of such companies under the Bankruptcy Code, in a manner that minimizes adverse impacts on financial markets without creating moral hazard;

3. whether amendments to the Bankruptcy Code should be adopted to enhance the ability of the Code to resolve financial companies in a manner that minimizes adverse impacts on financial markets without creating moral hazard;

4. whether amendments should be made to the Bankruptcy Code, the Federal Deposit Insurance Act, and other insolvency laws to address the manner in which QFCs of financial companies are treated; and

5. the implications, challenges, and benefits to creating a new chapter or subchapter of the Bankruptcy Code to deal with financial companies.

During the consideration of the legislation that ultimately became the Dodd-Frank Act, debates over the provisions that became the OLA were framed in large part in terms of whether or not the Bankruptcy Code or a special resolution process was more effective for handling insolvent systemic financial companies. Some proponents of the OLA argued that the OLA was necessary in light of perceived weaknesses in the ability of the Bankruptcy Code to facilitate an orderly resolution of a systemic financial company. Some opponents of the OLA, however, contended that the Bankruptcy Code, either in its current form or with appropriate amendments, is robust enough for handling insolvent financial companies, even systemic ones, so that the enactment of the OLA was unnecessary.

This study addresses the specific topics that Congress directed the Board to study in the order in which they are set forth in the statute, after an introductory review of some of the key terms used but not defined in the statute. The study then covers the effectiveness of the Bankruptcy Code for “systemic” financial companies and proceeds from there to consideration of proposals for a special panel of judges or special masters for financial company bankruptcies. The study next considers amendments to the Bankruptcy Code for financial companies generally that could minimize adverse impacts on financial markets without creating moral hazard. The study then addresses the remaining two specific categories of Bankruptcy Code amendments: those relating to QFCs, and those relating to the creation of a new chapter or subchapter of the Bankruptcy Code to deal with financial companies.

**Significant Statutory Terms of General Applicability**

Section 201(a)(11) of the Dodd-Frank Act defines “financial company” for the purposes of Title II, and therefore for the purposes of this section 216 study. Other significant terms used in section 216, however, are not defined, including “resolution” and “reorganization.” “Systemic” and “effectiveness,” two other significant terms used but not defined in section 216, are discussed in the section below that addresses proposals relating to the “effectiveness” of the Bankruptcy Code for systemic financial companies.

**Definition of “Financial Company”**

The definition of “financial company” in section 201(a)(11) of the Dodd-Frank Act relies on a test of whether a particular company is a bank holding company, a nonbank financial company supervised by the Board, or any company “predominately engaged” in “activities that are financial in nature” (as well as any subsidiary of such a company that is not an insured depository institution or an insurance company). Section 4(k) of the Bank Holding Company Act defines specific activities as “activities that are financial in nature.” Section 4(k) also authorizes the Board to determine whether an activity is financial in nature, and specifies the factors to be considered in making such a determination. The Board’s Regulation Y, which implements section 4(k) of the Bank Holding Company Act, defines a broad range of activities that are financial in nature. These include lending money or securities, insuring, guaranteeing, or indemnifying against loss, providing financial, investment, or economic advisory services, securitizing, underwriting, dealing in or making a market in securities, and activities determined to be closely related to banking. References to “financial companies” in this study generally do not refer to insured depository institutions or to insurance companies (unless the context indicates otherwise), since

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those entities are not permitted to be debtors under
the Bankruptcy Code.

Reorganization, Liquidation, Resolution

There are three principal avenues for actively address-
ing the resolution of an insolvent financial company.
The company can be reorganized under the Bank-
ruptcy Code (in which case it generally continues to
operate), liquidated under the Bankruptcy Code, or
otherwise resolved under one of various special reso-
lution regimes. Although all three alternatives can
generally be described as “resolution,” the terms
“reorganization” and “liquidation” are most often
associated with Chapter 11 or Chapter 7, respectively,
of the Bankruptcy Code. “Resolution” in the context
of financial companies is most often associated with
special regimes that have historically been reserved
for handling the insolvency of regulated financial
entities such as insured depository institutions and
insurance companies.

The primary authority for a corporate reorganization
is Chapter 11 of the Bankruptcy Code. In a Chapter
11 reorganization, the debtor is able to negotiate with
its creditors (sometimes even before filing a peti-
tion) to confirm a plan of reorganization that will
allow for the restructuring of the debtor’s liabilities
so that the company will be able to satisfy them.
These negotiations take place in the context of a judi-
cial proceeding administered by a federal bankruptcy
judge. Once a plan of reorganization has been con-
Firmed, the company, typically under the authority of
its existing management team, will take the actions
outlined by the plan. The debtor is often then able to
emerge from bankruptcy and resume operations.

The primary authority for a corporate liquidation
is Chapter 7 of the Bankruptcy Code. In a Chapter
7 liquidation, the debtor’s assets are liquidated by a
Chapter 7 trustee, appointed by the United States
trustee or by a vote of authorized creditors, and the
proceeds of the liquidation are distributed among
the debtor’s creditors depending on the priority of their
claims. As with a Chapter 11 reorganization, the
Chapter 7 liquidation process takes place in the con-
text of a judicial proceeding administered by a fed-
eral bankruptcy judge. The debtor generally chooses
whether the case is to be a Chapter 11 reorganization
or a Chapter 7 liquidation.

There are various provisions of the Bankruptcy Code
that make certain kinds of financial companies ineli-
gible for filing a bankruptcy petition. Examples
include exclusions from eligibility for insured deposi-
tory institutions, U.S. branches and agencies of for-
ign banks, and insurance companies. Other pro-
visions of the Bankruptcy Code provide that certain
kinds of financial companies may file only a Chapter
7 (liquidation) petition, and are not eligible to file for
a reorganization under Chapter 11. Examples include
broker-dealers and commodities brokers. Furthermore, with respect to broker-dealers, the Securities
Investor Protection Corporation (SIPC) plays a par-
ticular role in a broker-dealer insolvency. Specifically,
when SIPC files an application for a protective decree
under the provisions of the Securities Investor Pro-
tection Act (SIPA), any proceedings under the
Bankruptcy Code with respect to a broker-dealer are
stayed until the conclusion of the SIPA proceeding.

The mechanism for resolution of a failed insured
depository institution is the administrative receivership
process conducted by the Federal Deposit Insurance
Corporation (FDIC). Insured depository
institutions generally are closed by their chartering
authority (the state regulator, the Office of the
Comptroller of the Currency, or the Office of Thrift
Supervision) and the FDIC is appointed as the
receiver of the closed institution. The goal of this
regime is explicitly stated in the Federal Deposit
Insurance Act (FDIA) as being to resolve the finan-
cial distress of a failed bank in the manner that is
least costly to the FDIC’s deposit insurance fund.

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tion 3102), while state-licensed branches and agencies are resolved under applicable state law (see, e.g., N.Y. Bank. L. sec-
tion 606).
14 11 U.S.C. section 109(b)(2). Insolvent insurance companies are
generally resolved under a state insolvency proceeding adminis-
tered by a state insurance commissioner.
19 See Who Is the FDIC?, www.fdic.gov/about/learn/symbol/index .html. The FDIC can also be appointed as conservator.
12 U.S.C. section 1821(c).
20 12 U.S.C. section 1823(c)(4)(A)(ii). Under certain circum-
cstances, a resolution other than a least-cost resolution may be
authorized pursuant to the “systemic risk exception.” Generally,
this exception applies if both the Board and the FDIC Board,
by a vote of at least two-thirds of their members, and the Secre-
tary of the Treasury, in consultation with the President, deter-
The FDIC has several options as receiver for resolving institution failures, but the option most used is to sell some or all of the deposits and loans of the failed institution to another institution (purchase and assumption). In purchase and assumption transactions, customers of the failed institution automatically become customers of the assuming institution. Creditors have the ability to file claims with the FDIC for non-deposit liabilities, but generally do not have standing to take any other actions in connection with the receivership. The process does not take place in a court setting, but certain aspects of it are subject to judicial review under specific circumstances.²¹

Title II of the Dodd-Frank Act introduced a new resolution regime—the OLA—to the U.S. legal landscape. The OLA will apply only in the event that the Secretary of the Treasury (after consultation with the President) determines, based on the recommendation of the Board and the Board of the FDIC, that among other things the failure of a financial company would have serious adverse effects on financial stability in the United States and that taking action under the OLA with respect to that company would avoid or mitigate such adverse effects.²² Where such a determination cannot be made with respect to a financial company that is in default or in danger of default, the Bankruptcy Code or a regulatory resolution regime (such as state laws and regulations for resolving insolvent insurance companies) would apply to handle the insolvency of the financial company.

Key Differences between the Bankruptcy Code and Regulatory Resolution

There are a number of fundamental differences between reorganization or liquidation under the Bankruptcy Code and regulatory resolution regimes. Three are noted here. First, there are differences in the objectives of the regimes. The Bankruptcy Code is designed generally to maximize the returns to creditors of the debtor or to rehabilitate the debtor, usually without regard to the impact of the bankruptcy on parties or systems not before the court. A regulatory resolution regime may allow, and sometimes may encourage, the regulators to give weight to particular creditors (such as depositors) or to external factors (such as the impact on the economy and financial markets).²³ The OLA, for example, relies for its implementation on a determination based on the likely impacts of a covered financial company’s default on financial markets and the economy.²⁴ This allows regulators to take actions in a regulatory resolution regime that are intended to limit the impact of the troubled institution’s insolvency on entities other than its creditors or on the economy and the financial system.²⁵

A second key difference is how the process is developed and clarified. The process under the Bankruptcy Code is judicial and relies primarily on case law precedent for clarification and interpretation of the Bankruptcy Code’s provisions. Regulatory resolution regimes, however, are generally developed by agencies that have the ability to issue regulations to implement statutory provisions. Regulatory resolutions may be subject to judicial review to the extent authorized by the statute, however, and are also the subject of possible case law.

A third key difference is in the mechanisms for funding the process. A Chapter 11 reorganization is often funded with debtor-in-possession financing (DIP financing), which normally involves a private source of funding that obtains priority over the debtor’s pre-petition creditors as an administrative expense or, by court order, with even higher priority.²⁷ The DIP financing provision of the Bankruptcy Code is designed to permit the debtor to continue operating to allow time to restructure its liabilities.²⁸ A regulatory resolution regime often authorizes the adminis-

²¹ The “systemic risk exception” in the FDIA is an example of taking market impact into account. See 12 U.S.C. section 1823(c)(4)(G).
²² See generally Dodd-Frank Act section 203.
²⁴ See generally Dodd-Frank Act section 203.
²⁵ Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Remarks on the Squam Lake Report: Fixing the Financial System, at 9 (June 16, 2010) (“A clear lesson from the events of the past few years—and a recommendation in the report with which we strongly agree—is that the government must not be forced to choose between the unattractive alternatives of bailing out a systemically important firm or having it fail in a disorderly and disruptive manner. The government instead must have the tools to resolve a failing firm in a manner that preserves market discipline—by ensuring that shareholders and creditors incur losses and that culpable managers are replaced—while at the same time cushioning the broader financial system from the possibly destabilizing effects of the firm’s collapse”).
²⁷ See Robert R. Bliss and George G. Kaufman, U.S. Corporate and Bank Insolvency Regimes: An Economic Comparison and
The distinction in availability of funding can become important in times of systemic stress, when market confidence is diminished and DIP financing from private sources may be less likely to be available.

**Effectiveness of the Bankruptcy Code in Systemic Situations**

Section 216(a)(2)(A) of the Dodd-Frank Act requires the Board to include in its study “the effectiveness of Chapter 7 and Chapter 11 of the Bankruptcy Code in facilitating the orderly resolution or reorganization of systemic financial companies.”

**Meaning of “Systemic” in This Context**

The term “systemic financial companies” is used only in two sections of the Dodd-Frank Act: in section 216 and in section 217, both sections requiring the Board to study the Bankruptcy Code with respect to financial companies. The term is not defined, however, in either of these sections.

Whether a firm is a “systemic financial company” in the context of “effective” resolution under the Bankruptcy Code would likely depend on a number of factors, such as: the size and leverage of the firm, the nature of its transactions, its relationships with other financial firms (specifically its interconnectedness with other firms in the financial markets), and whether other firms would be able to provide the same types and levels of services as the firm in question. These criteria are consistent with criteria that Title I of the Dodd-Frank Act requires regulators to consider when designating financial firms as “systemically important” for purposes of enhanced prudential regulation.30

**Meaning of “Effectiveness” of the Bankruptcy Code**

The term “effectiveness” is not defined in the Dodd-Frank Act or the Bankruptcy Code. The term appears both in section 216 as well as in section 202(e) of the Dodd-Frank Act, which requires separate studies, conducted by the Government Accountability Office (GAO) and the Administrative Office, regarding the bankruptcy and orderly liquidation process for financial companies under the Bankruptcy Code. Specifically, section 202(e) requires studies of “the effectiveness” of Chapter 7 or Chapter 11 in facilitating the orderly liquidation or reorganization of financial companies, ways to maximize “the efficiency and effectiveness” of the Bankruptcy Court, and ways to make the orderly liquidation process under the Bankruptcy Code for financial companies “more effective.”

By its nature, any resolution regime, including the Bankruptcy Code, must balance the interests of numerous parties with divergent interests, such as secured creditors, unsecured creditors, customers, shareholders, and the public. Consequently, the “effectiveness” of a change to the Bankruptcy Code will depend on the point of view of the party making the judgment. This study does not attempt to balance or rebalance these points of view or to judge effectiveness from any particular point of view, and instead reports the advantages and disadvantages of various changes as those advantages and disadvantages are noted or explained in the literature. This approach should allow a fuller debate about the benefits and costs of various changes, and provide the relevant legislative bodies with the perspectives needed to determine the appropriate balance that should be struck in considering changes to the Bankruptcy Code.

Commentators have made various arguments as to why the Bankruptcy Code either is or is not “effective” for the resolution of “systemic financial companies.” The arguments made by commentators for the effectiveness of the Bankruptcy Code for these companies include the following:

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30 See Dodd-Frank Act section 113.

31 In commenting on the legislative language that became section 202(e), the Judicial Conference of the United States observed that “the vagueness of, and/or lack of criteria for determining ‘effectiveness’ will hamper the ability of [the Administrative Office] and [GAO] to produce meaningful reports. Some would regard rapid payment of even small portions of claims as an effective resolution, while others would prefer a delayed payment of a greater share of a claim. There would also be significant disagreements between creditors holding different types of secured or unsecured claims as to the most effective resolution of an insolvent firm. Some would argue that effectiveness should be measured by the impact of the resolution on the larger economy, regardless of the impact on the creditors of the particular firm.” Letter from James C. Duff, Secretary, Judicial Conference of the United States, to the Hon. Patrick J. Leahy, Chairman, Committee on the Judiciary, United States Senate (Apr. 12, 2010), 156 Cong. Rec. S3688-89 (daily ed. May 13, 2010).
the Bankruptcy Code provides legal certainty, \textsuperscript{32} offering a large body of established jurisprudence that is well-articulated in advance and is applied in a predictable manner, particularly with respect to the relatively predictable application of creditor priorities and the “absolute priority rule;” \textsuperscript{33}

the Bankruptcy Code’s predictability helps ensure that risks are borne by those who contracted to bear them, encouraging appropriate risk-taking measures by the would-be debtor and appropriate risk-monitoring measures by creditors, ensuring a reduction of moral hazard and an increase in market discipline; \textsuperscript{34}

the Bankruptcy Code provides the flexibility of permitting negotiations among stakeholders both before and after the filing of a petition; \textsuperscript{35}

\begin{itemize}
  \item the Bankruptcy Code permits judicial review\textsuperscript{36} by bankruptcy judges that have expertise in handling insolvency; \textsuperscript{37}
  \item the Bankruptcy Code provides a process for distinguishing between a viable company and a company that has undergone a “fundamental rather than a financial failure,” and a “market-based judgment” as to the viability of an insolvent firm; \textsuperscript{38}
  \item the Bankruptcy Code generally leaves in place those who are presumed to have the greatest expertise concerning the debtor’s operations and processes: the debtor’s management, \textsuperscript{39} incentivizing early resolution of financial problems prior to the filing of a bankruptcy petition, because management retains some certainty that it will not be immediately replaced; \textsuperscript{40} and
  \item the Bankruptcy Code transfers control of the debtor to creditors having a stake in the optimal reorganization of the firm. \textsuperscript{41}
\end{itemize}

The arguments made by commentators for the ineffectiveness of Bankruptcy Code for systemic financial companies include the following:

\textsuperscript{32} See, e.g., Kimberly Anne Summe, “Lessons Learned from the Lehman Bankruptcy,” in \textit{Ending Government Bailouts As We Know Them} (2010), at 82 (certainty afforded to QFC termination pursuant to well-understood application of Bankruptcy Code “safe harbor” provisions), and at 89 (established jurisprudence); Thomas H. Jackson, “Chapter 11F: A Proposal for the Use of Bankruptcy to Resolve Financial Institutions,” in \textit{Ending Government Bailouts As We Know Them} (2010), at 217 (provides certainty); Peter J. Wallison, \textit{The Argument against a Government Resolution Authority}, at 15 (Pew Financial Reform Project, Aug. 18, 2009) (bankruptcy system provides a degree of certainty to creditors).

\textsuperscript{33} See, e.g., Jackson, \textit{Chapter 11F}, supra note 32, at 217 (“huge” body of bankruptcy law; follows “absolute priority rule” with “useful predictability”); Thomas H. Jackson and David A. Skeel, \textit{Bankruptcy, Banks, and Nonbank Financial Institutions} (Wharton Fin. Inst. Cent. Workshop, Feb. 8, 2010), at 56 (bankruptcy’s rules, including priority rules, are well-articulated in advance), and at 64 (Bankruptcy Code provides clearly articulated and consistent rules and priorities); Kenneth Ayotte and David A. Skeel, “Bankruptcy or Bailouts?” 35 \textit{J. Corp. L.} 469, 488 (2010) (because priority of claims is determined by bankruptcy rules, the predictability of creditor recoveries is greater); Wallison, \textit{supra} note 32, at 11 (bankruptcy rules are known in advance so creditors are aware of their rights and risks); William F. Kroener, “Expanding FDIC-Style Resolution Authority,” in \textit{Ending Government Bailouts As We Know Them} (2010), at 182 (bankruptcy provides clearer rules on creditor priorities).

\textsuperscript{34} See, e.g., Jackson, \textit{Chapter 11F}, supra note 32, at 220 (bankruptcy predictability helps to ensure ex post that risks remain where they belong which encourages appropriate risk-taking and risk-monitoring ex ante); Ayotte and Skeel, \textit{supra} note 33, at 471–72 (bankruptcy does a better job of handling moral hazard concerns); Wallison, \textit{supra} note 32, at 10 (bankruptcy assures that pre-petition creditors take some kind of loss, avoiding moral hazard and preserving market discipline), at 10–11 (bankruptcy rules are known in advance so creditors are aware of rights and risks), and at 15 (bankruptcy encourages creditors to monitor companies to which they lend, reducing moral hazard and encouraging market discipline).

\textsuperscript{35} See, e.g., David A. Skeel, \textit{The New Financial Deal} (2011), at 122 (bankruptcy relies on negotiations between debtor’s managers and its creditors and other stakeholders with clear rules and opportunities for judicial review throughout).

\textsuperscript{36} \textit{Id.} (bankruptcy relies on negotiations between debtor’s managers and its creditors and other stakeholders with clear rules and opportunities for judicial review throughout); Jackson and Skeel, \textit{supra} note 33, at 56 (all actions taken in bankruptcy reorganization process have judicial oversight and advance judicial approval necessary for important decisions with distributional consequences).

\textsuperscript{37} See, e.g., Summe, \textit{supra} note 32, at 89 (bankruptcy court features well-regarded bench); Wallison, \textit{supra} note 32, at 10 (bankruptcy judges develop expertise in all areas of insolvency and workouts, those in large cities are especially likely to have acquired the specialized knowledge necessary to resolve systemically important financial institutions), and at 11 (Lehman Brothers bankruptcy case shows that bankruptcy judges are able to handle the insolvency of a systemically important financial institution).

\textsuperscript{38} See, e.g., Jackson, \textit{Chapter 11F}, supra note 32, at 217–18 (bankruptcy sorts out financial failure from underlying failure); Wallison, \textit{supra} note 32, at 11 (bankruptcy provides market-based judgment of whether a firm is worth saving because its creditors ultimately decide the firm’s prospects of returning to viability).

\textsuperscript{39} See, e.g., Skeel, \textit{supra} note 35, at 122 (bankruptcy relies on negotiation among debtor’s management, creditors, and other stakeholders).

\textsuperscript{40} See, e.g., \textit{id.}, at 140 (early resolution of problems incentivized because managers can retain control of debtor and have protection of exclusivity period).

\textsuperscript{41} See, e.g., Jackson, \textit{Chapter 11F}, \textit{supra} note 32, at 218 (bankruptcy shifts ownership to new group of residual claimants); Ayotte and Skeel, \textit{supra} note 33, at 471 (bankruptcy allocates control to residual claimants), and at 483 (bankruptcy provides formal and informal mechanisms for creditors to exercise control, including through formal rights given to creditors’ committees, opportunities of creditors to object to asset sales, and indirect control over the debtor through negotiated covenants in DIP financing agreements).
the Bankruptcy Code process takes too long for financial companies that, by their very nature, can suffer rapid and irretrievable loss of confidence and customers as well as rapid dissipation of asset values;\textsuperscript{42}

• the Bankruptcy Code has no “bridge” company mechanism as would be available under the OLA;\textsuperscript{43}

• the complexities of a systemic financial company, including the complexity of the financial instruments that are likely to be central in the insolvency of such a company, are beyond the general ability of bankruptcy judges to handle;\textsuperscript{44}

• filing a petition under the Bankruptcy Code causes rapid runs on short-term financial instruments that systemic financial companies hold in large quantities, leading to “fire sales” of assets precipitously sold en masse in stressed financial markets and causing write-downs of similar assets held by other institutions, potentially creating further insolvencies;\textsuperscript{45} and

• the Bankruptcy Code is focused on the interests of creditors, and has neither the goals nor the mechanisms to take externalities such as effects on outside parties or the financial system into account.\textsuperscript{46}

The Lehman Brothers Holdings, Inc. bankruptcy case\textsuperscript{47} is used to support arguments about both the effectiveness and the ineffectiveness of the Bankruptcy Code for systemic financial companies. Proponents of the view that the Bankruptcy Code cannot be modified to liquidate or reorganize systemic financial companies in an orderly way often support their view by pointing to the Lehman Brothers bankruptcy as being both disorderly and a causal factor in the near collapse of financial markets in the fall of 2008. Similarly, proponents of the view that the Bankruptcy Code can function effectively for resolving systemic financial companies often support their view by pointing to the Lehman Brothers bankruptcy as being fairly smooth and having, at best, limited spillover effects. In general, there is no agreement in the legal and academic literature on whether the use of the Bankruptcy Code as the mechanism for handling the Lehman Brothers insolvency triggered the contagion that is associated with its bankruptcy filing. Similarly, there continue to be starkly contrasting views after the Lehman Brothers bankruptcy filing on the utility of specific provisions of Chapter 11 of the Bankruptcy Code when resolving large, complex financial companies.

\textsuperscript{42} See, e.g., Kroener, supra note 33, at 181–82 (indirectly suggesting that the lack of speed in bankruptcy process prevents preservation of value), and at 182 (value of assets can vary or dissipate given uncertainty about potential duration of automatic stay); Jackson, Chapter 11F, supra note 32, at 218 (judicial process like bankruptcy is too slow); Cohen and Goldstein, supra note 24, at 1 (bankruptcy court proceedings too slow), and at 3, 10 (potentially long delays in obtaining court approval of reorganization or liquidation plans; ability of creditors, management, and shareholders to participate in decisionmaking causes delays); Kenneth R. French et al., “Improving Resolution Options for SIFIs,” in Squam Lake Report (2010), at 97 (bankruptcy process ineffective for systemically important financial institutions because creditors and clients flee at the first sign of trouble); Edward R. Morrison, Is the Bankruptcy Code an Adequate Mechanism for Resolving the Distress of Systemically Important Institutions? at 13 (Columbia University Law School, Working Paper No. 362, Dec. 30, 2009) (by the time a systemically important financial institution is sufficiently distressed to consider a bankruptcy filing, its counterparties will have already made a run on its assets); Cohen and Goldstein, supra note 24, at 1 (limitations on creditor pursuit of claims in bankruptcy causes counterparties and employees to fail to do business with a systemically important financial institution as it approaches insolvency).

\textsuperscript{43} See, e.g., Kroener, supra note 33, at 182 (no “bridge” solution in bankruptcy); Too Big to Fail: The Role for Bankruptcy and Anti-trust Law in Financial Regulation Reform: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary, 111th Cong. 6 (Oct. 22, 2009) (testimony of Michael Barr, Assistant Secretary, U.S. Department of the Treasury) (suggesting that bankruptcy does not allow for creation of one or more bridge companies for systemically important financial institutions).

\textsuperscript{44} See, e.g., Jackson, Chapter 11F, supra note 32, at 218 (presumption of insufficient expertise of bankruptcy judges to handle systemically important financial institution insolvency); Morrison, supra note 42, at 14 (expertise necessary to handle systemically important financial institution insolvency is beyond the ken of bankruptcy judges; bankruptcy judges not well-equipped to handle extensive international coordination aspects of global systemically important financial institution insolvency).

\textsuperscript{45} See, e.g., John B. Taylor, “Systemic Risk in Theory and in Practice,” in Ending Government Bailouts As We Know Them (2010), at 46 (bankruptcy causes runs on repurchase agreements and fire sales of collateral underlying closed-out derivatives); Skeel, supra note 35, at 30 (bankruptcy leads to fire sales of dumped assets). Some analyses suggest that troubled institutions have gone to great lengths to avoid selling assets at fire sale prices during the most recent financial crisis. See, e.g., Nicole M. Boyson et al., Crises, Liquidity Shocks, and Fire Sales at Financial Institutions (Working Paper, June 2010).

\textsuperscript{46} See, e.g., Kroener, supra note 33, at 181–82 (bankruptcy fails to take nonfirm general costs into account; no consideration of spillover systemic effects); Jackson, Chapter 11F, supra note 32, at 218 (bankruptcy process cannot deal with impacts of bankruptcy on other institutions); Ayotte and Skeel, supra note 33, at 489 (runs on Lehman Brothers commercial paper and “breaking the buck” at money market mutual funds after Lehman Brother’s bankruptcy show systemic concerns with systemically important financial institution bankruptcies); Cohen and Goldstein, supra note 24, at 1 (bankruptcy not focused on third-party effects and systemic risk), and at 3 (creditor stays in bankruptcy have adverse effects on financial markets).

\textsuperscript{47} In re Lehman Brothers Holdings, Inc., No. 08–13555 (Bankr. S.D.N.Y. 2008).
Special Judges or Panels for Financial Companies

Section 216(a)(2)(B) of the Dodd-Frank Act requires the Board to include in its study “whether a special financial resolution court or panel of special masters or judges should be established to oversee cases involving financial companies to provide for the resolution of such companies under the Bankruptcy Code, in a manner that minimizes adverse impacts on financial markets without creating moral hazard.”

History of Bankruptcy Courts

The Bankruptcy Act of 1898 originally established the position of bankruptcy “referees,” to be appointed by U.S. district court judges, to serve as administrators for bankruptcy cases. With the passage of several statutes, most importantly the Chandler Act of 1938,48 the judicial responsibilities of referees in bankruptcy were expanded, and referees assumed more of the bankruptcy work previously performed by U.S. district court judges. In 1973, the first federal rules of bankruptcy procedure were issued, increasing the duties of referees in bankruptcy proceedings and changing the referee office title from “referee in bankruptcy” to “United States Bankruptcy Judge.”49 At this point, the referee system disappeared. Then, in 1978, Congress enacted what is now known as the Bankruptcy Code, which conferred even broader jurisdiction on bankruptcy courts.50

In 1984, the Bankruptcy Code was amended to give the federal district courts exclusive jurisdiction over bankruptcy matters.51 A district court may, by order, “refer” all bankruptcy matters to the bankruptcy court in its district.52 Nearly all bankruptcy proceedings are handled by the bankruptcy courts pursuant to such orders. District courts have issued standing orders of reference referring all bankruptcy cases in a district to the district’s bankruptcy court.

Proposal for a Special Panel of Judges in Financial Company Bankruptcy Cases

Some commentators argue that a special panel of judges should be created to hear bankruptcy cases involving those financial companies with $100 billion or more in combined assets, or involving financial companies generally.53 One such proposal recommends adding a new provision to Title 28 of the U.S. Code that would create designated district court judges in the Second and D.C. Circuits to hear bankruptcy cases involving large financial company debtors.54 Under this proposal, which is part of a larger proposal to create a new chapter or subchapter of the Bankruptcy Code for such large financial companies, the designated judges would have exclusive jurisdiction over cases involving such large financial company debtors and would be prohibited from referring or delegating such cases to bankruptcy judges. They could, however, assign “special masters” from a designated panel to hear the case and all proceedings under the case to the same extent that a bankruptcy judge could hear the case under current law.55 This proposal for a special court of district judges to hear such cases, together with special masters appointed by those judges, assertedly is needed to “ensure complete independence from any perception of influence by the financial institution, the government, or a particularly significant creditor.”56

Proposal to Permit Special Masters in Bankruptcy Proceedings

Several proposals advocate permitting the appointment of special masters in bankruptcy cases generally.57 The rules for district courts and the rules for bankruptcy courts take different approaches to the question of the appointment of special masters. Rule 53 of the Federal Rules of Civil Procedure (FRCP), applicable to cases heard in U.S. district courts, authorizes district judges to appoint special masters.

52 See 28 U.S.C. section 1334(a).
55 Jackson, Chapter 14, supra note 53, at 6.
56 Id., at 6–7.
57 Id., at 6.
58 There is a body of literature that supports the use of special masters in highly technical and scientific cases such as patent matters. These arguments lend support to the appointment of a special master in complex bankruptcy cases. See, e.g., Jay P. Kesan and Gwendolyn G. Ball, A Study of the Role and Impact of Special Masters in Patent Cases (Federal Judicial Center 2009).
in federal civil proceedings and to specify their duties.\textsuperscript{58} Rule 9031 of the Federal Rules of Bankruptcy Procedure (FRBP), applicable to cases heard under the Bankruptcy Code, prohibits the appointment of special masters in bankruptcy proceedings. The origin of FRBP Rule 9031 is unclear; the Bankruptcy Code itself is silent on the issue of special masters. Some commentators posit that, if the drafters of the Bankruptcy Code had specific and strong reasons why special masters should not be appointed in bankruptcy cases, “it is likely that they would have drafted an express statutory provision as opposed to a procedural rule” to exclude special masters.\textsuperscript{59} Nevertheless, FRBP Rule 9031 represents a departure from the general federal court practice of permitting the appointment of special masters in federal cases.

Some commentators contend that the management tool of a special master would aid in fostering the bankruptcy system goal to “secure the expeditious and economical administration of every case under the [Bankruptcy] Code and the just, speedy, and inexpensive determination of every proceeding therein.”\textsuperscript{60} In general, special masters in federal cases are private attorneys, retired judges, or academics selected to assist in the handling of a case because of exceptional conditions or complex issues. One proposal recommends amending the FRBP to provide for special masters to be appointed by bankruptcy judges in rare cases where the court is faced with complex and sophisticated questions of law and fact and where a special master may be able to contribute to complex and difficult computations, discovery matters, and settlement negotiations.\textsuperscript{61} This proposal contends that special masters can assist in the “administration of justice” and efficiency of case management, as well as in providing expertise in complex cases where such expertise is not possessed by the generalist judge.\textsuperscript{62} One commentator suggests that, with particular reference to claims determinations, a special master “may obviate the need for oral hearing . . . save time and expense, and expedite bankruptcy proceedings for other debtors who need the attention of the bankruptcy judge.”\textsuperscript{63} In this way, a special master can provide assistance on unique issues to streamline the efficiency of the case.\textsuperscript{64}

These proposals also advocate appointing special masters in rare cases where special masters “may provide the expertise when the court’s machinery is insufficient by itself.”\textsuperscript{65} According to these proposals, the busy caseload most bankruptcy judges face today provides little opportunity to develop an in-depth understanding of the complexities and nuances of a large, complex bankruptcy proceeding.\textsuperscript{66} These proposals assert that special masters can contribute significantly in the discovery phase in such cases by managing pretrial discovery.\textsuperscript{67} The proposals also suggest that special masters can contribute to multinational bankruptcy cases where there are a number of parties, extensive discovery and evidence, and foreign and domestic experts involved in the discovery phase.\textsuperscript{68} In addition, these proposals contend that special masters can have an effective role in settlement matters, because “special masters have the luxury to incorporate and introduce a wide range of flexible proposals. Without the time or the resources possessed by the private sector, courts and judges sometimes may fail to provide litigants with the highest degree of creativity or innovative procedures or ideas.”\textsuperscript{69}

\textbf{Judicial Conference Consideration of Special Masters in Bankruptcy Proceedings}

The Advisory Committee on Bankruptcy Rules\textsuperscript{70} has consistently recommended retaining FRBP Rule

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\bibitem{58} Fed. R. Civ. P. 53.
\bibitem{59} Delk, supra note 49, at 29, 56.
\bibitem{60} R. Spencer Clift, “Should the Federal Rules of Bankruptcy Procedure be Amended to Expressly Authorize United States District and Bankruptcy Courts to Appoint a Special Master in an Appropriate and Rare Bankruptcy Case or Proceeding?” 31 U. Mem. L. Rev. 353, 399 (2001).
\bibitem{61} \textit{Id.}, at 355.
\bibitem{62} Delk, \textit{supra} note 49, at 50–52.
\bibitem{64} Delk, \textit{supra} note 49, at 50–54.
\bibitem{65} Clift, \textit{supra} note 60, at 373.
\bibitem{66} \textit{Id.}, at 376.
\bibitem{67} \textit{Id.}, at 372–75.
\bibitem{68} \textit{Id.}, at 375; see also In re Dow Corning Corp., 244 B.R. 634 (Bankr. E.D. Mich. 1999).
\bibitem{69} Clift, \textit{supra} note 60, at 377–78.
\bibitem{70} The federal judiciary is authorized to prescribe the rules of practice and procedure for the federal courts, and the rules of evidence for the federal courts, subject to the ultimate legislative right of the Congress to reject, modify, or defer any of the rules. The authority and procedures for promulgating rules are set forth in the Rules Enabling Act, 28 U.S.C. sections 2071–77. The Judicial Conference of the United States is also required by statute “to carry on a continuous study of the operation and effect of the general rules of practice and procedure.” 28 U.S.C. section 331. The Judicial Conference’s Committee on Rules of Practice and Procedure, commonly referred to as the “Standing Committee,” has authorized the appointment of five advisory
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9031, despite calls for revising the rule to allow for the appointment of special masters in bankruptcy proceedings. That Committee specifically reviewed the issue of special masters in bankruptcy in 1996, and rejected the suggestion of special masters because a special master was too similar to the bankruptcy referee, and because it was already possible to appoint trustees and examiners under the Bankruptcy Code to play similar roles. These committees to assist the Standing Committee in dealing with specified legal areas. The Advisory Committee on Bankruptcy Rules is the advisory committee appointed to deal with bankruptcy rules. See Administrative Office of the U.S. Courts, “The Federal Rules of Practice and Procedure” (Oct. 2010), available at www.uscourts.gov/RulesAndPolicies/FederalRulemaking/RulemakingProcess/SummaryBenchBar.aspx.

Some commentators assert that allowing bankruptcy courts to appoint special masters would raise policy concerns with respect to the bankruptcy system itself. According to these arguments, the appointment of special masters in bankruptcy cases may lead to the court giving greater deference to findings of a special master than to those of an examiner. While a bankruptcy court might appoint a special master to determine issues of both fact and law, it would typically appoint an examiner only to make recommendations based on the examiner’s assessment of facts. Since an examiner in a bankruptcy case does not make findings of fact or conclusions of law, the bankruptcy court is not bound by the examiner’s findings and is not obligated to take action on the examiner’s report. In essence, an examiner assists the bankruptcy court but makes no determinative findings, whereas a special master typically is authorized by the court to make determinations of both fact and law. Therefore, according to such commentators, special masters are not necessary since the bankruptcy courts can appoint examiners to perform a range of enumerated duties.

Still others argue that the appointment of special masters in general, whether in district courts or bankruptcy courts, raises other issues of concern. These commentators point out that litigants may challenge the appointment of a special master and that, where special masters take on burdensome discovery tasks and issue opinions or rulings, these matters are then often outside the purview of direct control by the judge. Special masters also, according to these commentators, may add to the “bureaucratization and proliferation” of the system, especially given that examiners and trustees are already authorized. Some commentators argue that the appointment of special masters in complicated cases has become so routine as to be “an almost Pavlovian response,” suggesting that the appointment of special masters in every complicated case may not be justified.

Statutory Changes to Accommodate Financial Companies

Introduction

Section 216(a)(2)(C) of the Dodd-Frank Act requires the Board to include in its study “whether amendments to the Bankruptcy Code should be adopted to enhance the ability of the Bankruptcy Code to resolve financial companies in a manner that minimizes adverse impacts on financial markets without creating moral hazard.” As noted above, some commentators argued during consideration of the Dodd-Frank Act that the Bankruptcy Code provided an effective mechanism for handling insolvent financial companies, including insolvent systemic financial companies. In particular, some asserted that targeted amendments to the Bankruptcy Code with respect to financial companies would make the Bankruptcy Code sufficiently effective for handling the insolvencies of financial companies, even systemic financial companies, such that the OLA provisions in the Dodd-Frank Act need not be enacted. Proposals were introduced proposing to amend the Bankruptcy Code either as an alternative to, or in conjunction with, the OLA. The final legislation, however, contained the OLA, but did not contain any amendments to the Bankruptcy Code. Nevertheless, some helpful in particular cases, but that there has developed an almost Pavlovian response to the complicated case—delegation to a special master. A rethinking of traditional rulemaking philosophy, which has been marked by informal management techniques, excessive delegation, broad discretion, and trans-substantive application, seems to me a welcome alternative.”)

Id., at 2158.

proposals assert that appropriate amendments to the Bankruptcy Code for financial companies should still be considered even in light of the enactment of the OLA, because such amendments would help to make the Bankruptcy Code even more effective for financial companies and thereby reduce the perceived need to use the exceptional powers of the OLA.

Proposals to amend the Bankruptcy Code for handling insolvent financial companies, including insolvent systemic financial companies, generally fall into seven categories. One of these categories—proposals to establish a special court or panel or group of special masters to handle financial company insolvencies—is the subject of the preceding section of this study.78 Two additional categories of amendments—proposals to change the current treatment of QFCs in bankruptcy and other insolvency law,79 and proposals to establish a new chapter or subchapter of the Bankruptcy Code for financial companies80—are the subjects of subsequent sections of this study. The remaining four categories are generally as follows

1. amendments that would authorize a financial company’s primary regulator to take various actions in a bankruptcy proceeding involving that financial company;

2. amendments that would facilitate handling a financial company and all of its related affiliates and subsidiaries in a unified bankruptcy proceeding;

3. amendments involving the types and uses of financing in bankruptcies of financial companies; and

4. amendments involving section 363 of the Bankruptcy Code relating to the use, sale, or lease of estate property outside of the ordinary course of business.

These categories of amendments will be discussed in turn.

78 See “Special Judges or Panels for Financial Companies” section on pages 8–10.
79 See “Treatment of Qualified Financial Contracts” section on pages 15–18; see also Jackson, Chapter 14, supra note 53, at 31.
80 See “New Chapter or Subchapter of the Bankruptcy Code for Financial Companies” section on pages 18–20; see also Jackson, Chapter 11F, supra note 32, and Jackson, Chapter 14, supra note 53.

Involvement of Primary Regulator of Financial Company in Bankruptcy

Proposed Bankruptcy Code amendments involving the primary regulator of a financial company consist generally of three different types. These types of proposed amendments would give the primary regulator authorization to: commence an involuntary proceeding against a financial company, have standing in the bankruptcy case, and file a plan of reorganization for the financial company at any time after the filing of the petition.

Authorize the Primary Regulator to Commence an Involuntary Proceeding against a Financial Company; and Expand the Grounds upon Which the Primary Regulator May File Such a Petition

Under section 303(b) of the Bankruptcy Code, three creditors holding non-contingent undisputed claims against a person may commence an involuntary petition against that person under Chapter 7 or Chapter 11.81 An involuntary petition cannot be based on “balance sheet insolvency” of the debtor—that is, based on an entity’s liabilities exceeding its assets. Rather, section 303(h) of the Bankruptcy Code authorizes the filing of an involuntary petition against an entity based on “cash flow insolvency,” namely, based on the entity generally not paying its debts as they come due.82

A financial company’s primary regulator is in a better position, according to some commentators, than many of the financial company’s creditors to know the true financial condition of the financial company. Authorizing the primary regulator to commence an involuntary proceeding against a financial company may, according to these arguments, permit the financial company to be placed into a reorganization or liquidation more promptly than if the financial company’s creditors were to do so. This may have the potential to preserve asset value and operations necessary to maintain a going concern value for the financial company. In addition, according to these proposals, by the time three creditors of a financial company begin negotiating whether to file an involuntary petition against the financial company it will

81 11 U.S.C. section 303(b).
82 11 U.S.C. section 303(h).
be too late to do so, because the financial company’s customers and short-term creditors will have fled at the very suggestion of insolvency.

Accordingly, some commentators propose that the Bankruptcy Code be amended to authorize a financial company’s primary regulator to file an involuntary petition against a financial company. Some of these proposals also suggest that the grounds upon which an involuntary petition may be filed be expanded where a financial company and its primary regulator are concerned. Specifically, some proposals suggest that a financial company’s primary regulator should be authorized to file an involuntary petition against the financial company not only when the financial company is generally not paying its debts when they come due, but upon three additional grounds as well. First, a primary regulator should be authorized to file an involuntary petition against a financial company based on “balance sheet insolvency,” that is, when the liabilities of the financial company exceed its assets at fair market valuation. Second, a primary regulator should be authorized to file an involuntary petition against a financial company based on the financial company having unreasonably small capital. Third, a primary regulator should be authorized to file an involuntary petition against a financial company based on the intention of the primary regulator to resolve the financial company.

Authorize the Primary Regulator of a Financial Company, or the Primary Regulator of Any Subsidiary of the Financial Company, to Have Standing in the Bankruptcy Case

There is currently no specific authorization for the primary regulator of a financial company to appear in a bankruptcy proceeding of that financial company. Some commentators argue that the absence of standing for a financial company’s primary regulator in a bankruptcy proceeding involving that financial company deprives the Bankruptcy Court, and the bankruptcy proceedings generally, of the specialized expertise that the primary regulator has with respect to the financial company. Accordingly, some commentators propose that the Bankruptcy Code be amended to grant a financial company’s primary regulator, or the primary regulator of a subsidiary of the financial company, standing to appear in the case and to file motions and be heard. In particular, there are specific proposals to authorize SIPC and the Securities and Exchange Commission (SEC) to have standing in cases involving broker-dealers, whether the broker-dealer is the debtor or a subsidiary of the debtor financial company.

Authorize the Primary Regulator to File a Plan of Reorganization for the Financial Company at Any Time after the Filing of the Petition

Section 1121(b) of the Bankruptcy Code provides that only the debtor has the right to file a plan of reorganization in a Chapter 11 bankruptcy proceeding during the first 120 days after the entry of an order for relief. This period of time, referred to as “the exclusivity period,” is designed to allow the debtor some time to prepare such a plan free of interference from the introduction of competing plans filed by creditors.

Given the special expertise of a financial company’s primary regulator, some commentators argue that the primary regulator should be allowed to file a plan of reorganization in a financial company Chapter 11 case without regard to the exclusivity period. Waiting for the expiration of the exclusivity period, or even waiting for the primary regulator to file a motion to shorten the exclusivity period, could be excessive in the case of a financial company bankruptcy because of the particular speed with which a financial company’s customers and counterparties can withdraw from dealings with the company. Accordingly, some commentators propose amending the Bankruptcy Code to authorize the primary regulator to file a plan of reorganization in a financial company’s Chapter 11 case at any time, including at the commencement

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83 Jackson, Chapter 11F, supra note 32, at 227; Morrison, supra note 42, at 13–14; Jackson, Chapter 14, supra note 53, at 29.
84 Jackson, Chapter 14, supra note 53, at 30.
85 Id.
86 Jackson, Chapter 11F, supra note 32, at 228. Some or all of these grounds serve as a basis for placing an insured depository institution into receivership under federal and some state laws.
of a voluntary case or any time at or after the entry of an order for relief in an involuntary case.91

Handling a Financial Company and All of Its Related Entities in a Unified Bankruptcy Proceeding

The subsidiaries or affiliates of a debtor generally do not become debtors themselves under the Bankruptcy Code upon the filing of a bankruptcy petition by the parent (or by an affiliate). The debtor’s subsidiaries and affiliates are free, of course, to file their own bankruptcy petitions (assuming that they are eligible debtors under the Bankruptcy Code), but the cases are separate cases and are heard and adjudicated separately. By virtue of a process referred to as “administrative consolidation,” a Bankruptcy Court may arrange to hear all related cases together for administrative purposes. It is generally rare for a Bankruptcy Court to order “substantive consolidation,” a procedure whereby all of the related bankruptcy cases are merged into one large bankruptcy case and where the corporate separateness of the individual subsidiaries and affiliates vis-à-vis the debtor and each other is not respected.92

Where financial companies are concerned, insolvency proceedings can become highly fragmented. A financial holding company, and many of its unregulated subsidiaries, would generally be eligible under the Bankruptcy Code to file either for Chapter 11 (reorganization) or Chapter 7 (liquidation). An insured depository institution subsidiary of the company, however, would be subject to resolution by the FDIC under the FDIA, while a broker-dealer subsidiary of the company would be resolved under the joint operation of SIPA and Chapter 7 (liquidation). An insolvent insurance company subsidiary would be resolved under the applicable state law pertaining to the insurance company and would be administered by a state insurance commissioner. This jurisdictional separation of the various related entities with respect to insolvency proceedings creates an unnecessarily complicating state of affairs for financial company insolvencies according to some commentators. Furthermore, the inability of broker-dealers and commodities brokers to file for reorganization under Chapter 11 is itself cited as a complication, since it creates disincentives

for broker-dealers and commodities brokers to attempt a resolution or restructuring given that their only choice is to liquidate. These provisions are also seen as deleterious by some because they preclude any attempts to preserve the value of such a company for reorganization on its own or as part of a larger reorganization of its parent company.

Accordingly, some commentators propose to amend the Bankruptcy Code to allow a more unified handling of insolvency proceedings for financial companies and their related entities. Some of these proposals suggest, for example, that where a financial company has “ineligible” subsidiaries (such as insured depository institutions or insurance companies or broker-dealers or commodities broker subsidiaries), then those subsidiaries should be allowed to file bankruptcy petitions and be handled together with the related financial company (or companies) before the same Bankruptcy Court.93 Other suggestions include keeping the exclusion from eligibility for insured depository institutions but ignoring the other exclusions for subsidiary broker-dealers, insurance companies, and commodities brokers so that those subsidiaries would be eligible to be resolved together with the parent financial company.94 Still other proposals suggest that the authority of SIPC to handle customer accounts in the event of the insolvency of a broker-dealer should remain in place, but that the broker-dealer itself should otherwise be permitted to be resolved, and in particular to be reorganized under Chapter 11 of the Bankruptcy Code.95

Types and Uses of Financing

Section 364 of the Bankruptcy Code authorizes a post-petition creditor to receive priority in the distribution of the assets of the bankruptcy estate superior to all other creditors of the estate (other than creditors holding administrative claims).96 These provisions are intended to make it possible for a debtor to obtain funding to finance its reorganization notwithstanding pre-petition encumbrances on the debtor’s assets. There is no specific provision in the Bankruptcy Code, however, that authorizes government entities to extend credit on this “super-priority” basis.97 In addition, there is no provision authorizing

91 Jackson, Chapter 11F, supra note 32, at 239; Jackson, Chapter 14, supra note 53, at 30.
92 See, e.g., 2 Alan N. Resnick and Henry J. Sommer, Collier on Bankruptcy 105.09[1][d] (16th ed. 2011).
93 Jackson, Chapter 11F, supra note 32, at 229.
94 Jackson, Chapter 14, supra note 53, at 29.
95 Jackson, Chapter 14, supra note 53, at 29; Skeel, supra note 35, at 168.
97 Assuming the governmental entity otherwise had the requisite authority to extend such credit.
the use of post-petition financing for the purpose of making partial or advance payments to some or all of a debtor’s creditors if that is deemed necessary to the progress of the debtor’s resolution.

With respect to financial company debtors, some commentators suggest that the lack of clarity on permissible uses of post-petition financing makes the Bankruptcy Code less effective for financial companies. For example, it may not be possible for a financial company debtor to obtain DIP financing from a commercial source, as could be the case when financial conditions generally make it impossible for a commercial entity to make such credit available. Therefore, some commentators argue that the Bankruptcy Code should explicitly authorize a government entity to extend credit to the debtor, and should explicitly provide for the appropriate priority of the government’s claim in such a case. In addition, some commentators argue that a financial company debtor may require DIP financing not for its immediate operational needs, but in order to make pre-payments to certain classes of creditors to induce those creditors to continue to do business with the debtor. Again, the inability of the Bankruptcy Code clearly to authorize such a use of DIP financing is seen as a complication in the use of the Bankruptcy Code for financial companies.

Accordingly, some commentators propose amending the Bankruptcy Code expressly to authorize a government lender to provide DIP financing to a financial company debtor. In addition, some commentators propose amendments under which DIP financing, whether from a government or a commercial source, is explicitly authorized for the purpose of providing partial or complete payouts to some or all creditors of the debtor. In such cases, these proposals recommend that the amendments provide that the debtor must make the requisite evidentiary showing that such terms are necessary to the reorganization, that the creditors in question will not receive more by virtue of the payout than they would have received in an ordinary Chapter 7 liquidation of the debtor, and other specific evidentiary showings designed to protect the integrity of the transaction.

Changes to Bankruptcy Code Section 363

Section 363 of the Bankruptcy Code authorizes the debtor-in-possession (or a Chapter 11 or Chapter 7 trustee of the debtor) to seek an order of the Bankruptcy Court authorizing the use, sale, or lease of property of the estate other than in the ordinary course of business. This “363 sale” authority was used in the Lehman Brothers bankruptcy case for the sale of Lehman Brothers assets (specifically, its broker-dealer subsidiary) to Barclays. The 363 sale authority was also used in the Chrysler bankruptcy case. In the case of some financial companies, such as insured depository institutions, broker-dealers, or insurance companies, it may be the company’s primary regulator that has arranged for a sale of the company (or its assets) to a third party. There is no provision in the Bankruptcy Code, however, for a government entity or a primary regulator of a financial company to file a motion for an order approving a 363 sale.

Such sales have sometimes been criticized as being the equivalent of a plan of reorganization, but lacking all of the procedures and creditor protections otherwise required to confirm a plan of reorganization. These procedures include the requirement that a plan proponent file a disclosure statement about the plan’s operation along with the plan itself. In addition, creditors have the opportunity to object to the disclosure statement or to the plan itself, and plan confirmation requires certain levels of creditor approval (in terms of classes of creditors and aggregate amounts of claims). In certain cases, a 363 sale has been viewed as allowing substantially the same outcome as a confirmed plan of reorganization, such as where more than half of the stock or half of the debt of the buyer will be held by creditors or stockholders of the debtor company.

Accordingly, some commentators propose to amend the Bankruptcy Code to permit the primary regulator of a debtor financial company to have the same authority as a debtor-in-possession or a trustee to file a motion for an order approving a 363 sale of the

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98 Jackson, Chapter 11F, supra note 32, at 239; Jackson, Chapter 14, supra note 57, at 30.
99 Id.
100 Id.
debtor or the debtor’s assets. Other proposals would amend the Bankruptcy Code to preclude certain kinds of 363 sales from occurring, such as where more than half of the stock or the debt of the would-be buyer is held by creditors or stockholders of the “old” company.

**Minimizing Impacts on Financial Markets without Creating Moral Hazard**

Section 216(a)(2)(C) requires the Board to study the extent to which proposed amendments to the Bankruptcy Code for financial companies might “minimize adverse impacts on financial markets without creating moral hazard.” There is little in the existing literature, however, that weighs such proposals against each of these two concerns. There appears generally to have been more attention given in the literature to the extent to which the foregoing proposals might minimize impacts on financial markets than there has been to how those proposals might mitigate the creation of moral hazard per se. Authorizing greater involvement by a financial company’s primary regulator in a financial company’s bankruptcy could be seen by some to have the potential both to minimize adverse impacts on financial markets and to increase moral hazard. Allowing a government entity to provide DIP financing, for example, could arguably minimize adverse impacts on financial markets to the extent that a governmental entity is the only entity actually able to provide funding to the debtor. This situation is likely to arise when financial markets are already stressed and fragile, or when the size of the debtor makes obtaining private DIP financing unlikely. At the same time, however, the ability to provide government DIP financing could also be seen as a backdoor bailout, thereby increasing moral hazard. Similarly, directing or allowing a trustee in bankruptcy to consider adverse impacts on financial markets may address concerns about the effects of bankruptcy on financial stability, but may also be viewed as increasing moral hazard to the degree that creditors receive more payments than expected or payments according to different priorities than normal under the Bankruptcy Code. Conditions intended to reduce the moral hazard implications—such as assessments on financial companies or others (such as creditors) that are beneficiaries of such DIP financing, or the replacement of the financial company’s management—could be seen by some, but not by all, as addressing at least some moral hazard concerns. Nevertheless, the extent to which the foregoing proposals might minimize adverse impacts on financial markets while avoiding the creation of moral hazard is not prominently addressed in the existing literature.

**Treatment of Qualified Financial Contracts**

**Introduction**

Section 216(a)(2)(E) of the Dodd-Frank Act requires the Board to include in this study “whether amendments should be made to the Bankruptcy Code, the Federal Deposit Insurance Act, and other insolvency laws to address the manner in which qualified financial contracts of financial companies are treated.”

**Treatment of Certain Financial Market Transactions under the Bankruptcy Code**

QFCs receive special treatment under the Bankruptcy Code. The special treatment, called the “safe harbor provisions” of the Bankruptcy Code, exempts these transactions from some of the Bankruptcy Code’s principal debtor protections. For example, the safe harbor provisions exempt QFCs from the bankruptcy “automatic stay,” the provision of the Bankruptcy Code that automatically prevents creditors and others holding claims against a debtor from taking any action on the claim upon the filing of a voluntary petition. The safe harbor provisions also exempt QFCs from the “trustee avoiding powers,” that is, from the provisions of the Bankruptcy Code that allow a trustee (or a debtor-in-possession) to recover certain transfers of the debtor’s assets that were made within 90 days of filing the bankruptcy petition (“preferential transfers”) or certain “constructive fraudulent conveyances” (or “fraudulent transfers”).

Because of the safe harbor provisions, the non-defaulting QFC counterparty of the debtor can take actions to exercise its contractual rights to close out, terminate, net, and apply collateral for these transactions.

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106 Jackson, Chapter 14, supra note 53, at 30.
107 Skeel, supra note 35, at 172.
Congress enacted the safe harbor provisions of the Bankruptcy Code for QFCs because of concerns about systemic risk. Congress was concerned that, without the safe harbor provisions, other market participants who had entered into QFCs with the debtor would be exposed to such a high degree of uncertainty leading to a lack of liquidity that it would pose a potential for systemic risk. Specifically, there was concern that spillover effects from the initial insolvency could be transmitted through QFCs and significantly impair both the debtor’s counterparties and the real economy more broadly.109

**Proposals to Amend the QFC Safe Harbor Provisions of the Bankruptcy Code**

Several commentators propose changing or eliminating the safe harbor provisions for QFCs under the Bankruptcy Code. Those proposing partial or total elimination of the safe harbor provisions base their arguments on the principle of treating like transactions similarly,110 on concerns over moral hazard,111 and on concerns about systemic risk.112 These proposals argue that similar types of contracts should be treated under the Bankruptcy Code in a similar manner unless there is a compelling reason not to do so. Under this argument, certain QFCs such as repurchase agreements and some types of swaps are the equivalent of secured loans, and should receive the same treatment as secured loans under the Bankruptcy Code. Also under this argument, derivative contracts are similar to other executory contracts, that is, contracts that have not yet been performed or executed, and therefore should receive the same treatment as other executory contracts under the Bankruptcy Code. In the case of QFCs, some commentators argue that the exemption from the automatic stay coupled with provisions that are triggered upon the debtor’s insolvency through ipso facto clauses (which are standard in derivative contracts) elevates the status of QFCs in bankruptcy relative to similar contracts that are not classified as QFCs without a compelling reason for the distinction.113

Proposals for changing or eliminating the QFC safe harbor provisions also argue that those provisions have negative impacts on incentives and market discipline. According to these arguments, the exemptions from the automatic stay and trustee avoiding powers change the incentives for QFC counterparties to monitor the debtor prior to bankruptcy. Since QFC counterparties know that they can take action against the debtor on their QFC-related claims at a time when non-QFC creditor claims are stayed, QFC counterparties are likely to reduce their level of monitoring and are less likely to fully price changes in the risk of the debtor. Therefore the safe harbor provisions, according to these commentators, reduce market discipline and lead to increased risk-taking by counterparty firms and to increased risk in the financial system.

Proposals for changing or eliminating the QFC safe harbor provisions also contend that the provisions increase, rather than decrease, systemic risk because of the associated incentive effects. According to these arguments, preferential treatment of QFCs under the Bankruptcy Code changes the incentives for QFC counterparties to monitor and impose discipline on the debtor. Instead, actions that a counterparty might take to contain risk (for example, increased risk premiums, limiting exposure at default) are replaced, in part, by collateral calls as the financial distress of the debtor grows. This behavior can lead to the equivalent of counterparty runs (involving the termination of contracts and the liquidation of collateral) when the debtor files for bankruptcy. Collateral runs, according to these arguments, can both destabilize the debtor and have spillover effects on other creditors, other non-creditor firms and financial markets in general.114 In effect, according to these arguments, the QFC safe harbor provisions fail

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109 The treatment of QFCs for banks under the FDIA and for systemic financial companies under OLA is similar to that under the Bankruptcy Code with one important exception: QFCs are subject to a one business day automatic stay upon the appointment of the FDIC as receiver under both the FDIA and the OLA. During this one-day stay, the FDIC has the power to transfer QFCs to a third party, including a bridge institution. Contracts transferred to a third party, including a bridge institution, may not be considered in default under the ipso facto clauses of the contracts. The FDIC’s ability to transfer QFCs to third parties during the one-day stay is only limited by the requirement that all contracts under the same master agreement must receive the same treatment. See 12 U.S.C. section 1821(e)(8)–(11).


113 See Skeel and Jackson, *supra* note 110, at 22.

to lower systemic risk in the financial system, and simply replace one systemic risk transmission mechanism with another.

Some critics of the QFC safe harbor provisions call for a full repeal. Other critics, however, appear to argue in favor of more narrow amendments. For example, some propose retaining the exemption from the automatic stay for QFCs where the collateral is cash or cash-like assets but imposing a limited automatic stay for other types of QFCs. According to these commentators, exempting QFCs where the underlying collateral consists of cash or cash-like assets is appropriate because the collateral securing these contracts is not related to the going concern value of the firm. Furthermore, they note that cash and cash-like collateral is liquid, with little controversy over its value. Finally, they argue that, even with the exemption from the automatic stay in place, counterparties in repurchase agreement transactions continued to aggressively monitor borrowers.

Although there appears to be some consensus in proposals to retain the safe harbor provisions for QFCs with cash or cash-like collateral, there appears to be greater diversity among proposals for changing the treatment of other types of QFCs (non-cash QFCs). Some proposals would remove all of the safe harbor provisions for non-cash QFCs while others would impose an automatic stay of limited duration on non-cash QFCs. Those proposing a limited automatic stay argue that doing so would limit the risk to counterparties associated with market movements that could affect the value of their claim and limit hedge uncertainty. Some also argue that a limited automatic stay would improve transaction consistency by making the Bankruptcy Code treatment of QFCs more consistent with the treatment of QFCs under the FDIA and the OLA. During the limited stay, according to these proposals, the debtor would have the right to net, transfer, affirm, or reject contracts, but would be required to treat all QFCs under the same master agreement identically to eliminate “cherry-picking” (that is, selective assumption and rejection) of QFCs by the debtor. After the limited stay expired, QFC counterparties could exercise all of their contract rights.

Proposals to Retain the QFC Safe Harbor Provisions of the Bankruptcy Code

Supporters of the QFC safe harbor provisions present four general arguments for continuing the special treatment of QFCs in bankruptcy. These proposals are generally framed in terms of opposing the wholesale repeal of the QFC safe harbor provisions, however, and therefore do not address all of the proposals for amendments described above.

Those arguing for retaining the QFC safe harbor provisions claim that the provisions prevent systemic spillover effects associated with tying up collateral in bankruptcy. For QFCs, and especially for repurchase agreements, they argue, subjecting such contracts to the automatic stay could produce spillover effects that might result in financial markets and firms becoming illiquid. They argue that particularly in the case of the market for U.S. Treasury securities, the largest segment of the market for repurchase agreements, freezing of the market could interfere with the U.S. government’s ability to manage its debt issuances and with the Federal Reserve’s ability to implement monetary policy.

Supporters of the existing QFC safe harbor provisions also contend that the special status of QFCs in bankruptcies has implications for market risk. They argue that the elimination of the QFC safe harbor provisions could increase uncertainty in markets because these financial market transactions, especially derivatives, are critical tools used to manage and hedge financial risks. According to these arguments, dealer banks, relying on derivatives to manage their own risks and to serve as market-makers, enter
into positions in order to transfer risks from ultimate buyers to ultimate sellers. Changes in interest rates and other market-risk factors can cause the value of derivatives to fluctuate quite a bit from day to day. If the stay were to be imposed, according to these arguments, the defaulting firm’s counterparties might be forced to bear unhedgeable uncertainty—they would not be allowed to terminate their contracts with the defaulting firm, and would not know if or when some, all, or none of the amounts due to them under the contracts would be paid. If market movements caused the value of the contracts to the non-defaulting parties to increase, they continue, the non-defaulting parties would not be allowed to receive any more collateral from the defaulting firm to cover the increase in exposure.

The third principal argument advanced by those supporting the retention of the existing QFC safe harbor provisions asserts that there are only limited benefits associated with eliminating them. The automatic stay, according to these commentators, helps to coordinate creditor negotiations while preserving the going concern value of the debtor in reorganization. According to these arguments, the universe of firms that are large dealers in over-the-counter derivatives and counterparties that might be reorganized under Chapter 11 of the Bankruptcy Code may not be very large. For example, insolvent banks would be resolved under the FDIA. Covered financial companies might under exceptional circumstances be resolved under the OLA, although it is not possible to be certain before the fact which financial companies will be subject to resolution under the OLA because of the extraordinary circumstances and determinations required for its application. Securities broker-dealers and commodities brokers are both prohibited from filing for reorganization under Chapter 11. Insurance companies are resolved under applicable state law, while hedge funds and private investment funds are most often liquidated rather than reorganized. Therefore, according to these arguments, the benefits associated with repealing the QFC safe harbor provisions are unlikely to exceed the costs since the universe of entities to which the repealed provisions might apply is small.

Finally, supporters of retaining the QFC safe harbor provisions assert that markets should be allowed to protect themselves without undue interference from the Bankruptcy Code. According to these commentators, reinstating the automatic stay and trustee avoidance provisions of the Bankruptcy Code with respect to QFCs interferes with the ability of counterparties to protect themselves through enforcement of ISDA master agreements and contractual rights to seize and liquidate collateral in the event of a counterparty default.124

New Chapter or Subchapter of the Bankruptcy Code for Financial Companies

Introduction

Section 216(a)(2)(E) of the Dodd-Frank Act requires the Board to include in this study “the implications, challenges, and benefits to creating a new chapter or subchapter of the Bankruptcy Code to deal with financial companies.” Prior to the enactment of the Dodd-Frank Act, some commentators supported either the establishment of a C’s separate resolution authority for non-bank financial companies, especially systemic financial companies,125 and/or changes to the Bankruptcy Code126 to better accommodate the resolution of these companies.127 Additional academic literature published subsequent to the enactment of the Dodd-Frank Act,128 as well as some public comments received in response to the

124 See Novikoff and Ramesh, supra note 122, at 40.


127 This was the topic of Congressional hearings as well. See generally Too Big to Fail: The Role for Bankruptcy and Antitrust Law in Financial Regulation Reform: Hearing Before the Subcomm. on Commercial and Admin. Law of the H. Comm. on the Judiciary, 111th Cong. 1 (Oct. 22, 2009).

128 See Thomas H. Jackson et al., “Resolution of Failed Financial Institutions: Orderly Liquidation Authority and a New Chapter 14—Studies by the Resolution Project at Stanford University’s Hoover Institution Working Group on Economic Policy” (hereinafter Hoover Institution Working Group) (containing a preface and four papers supporting changes to the Bankruptcy Code in the form of a new Chapter 14); see also Skeel and Jackson, supra note 110.
Proposals for a New Chapter or Subchapter

One proposal, advanced prior to the enactment of the Dodd-Frank Act, suggests a special “overlay” chapter for the largest financial companies—those with a minimum asset size of $100 billion. The new chapter or subchapter would be intended to be complementary to the OLA in the Dodd-Frank Act, consistent with the “living will” provisions of Title I of the Dodd-Frank Act, and specifically designed with characteristics of financial companies in mind.

A threshold question is whether amendments to the Bankruptcy Code to enhance its application to insolvent financial companies should be made all in one chapter or in the various substantive sections of the Bankruptcy Code to which those amendments would pertain. According to proponents of a new chapter or subchapter of the Bankruptcy Code for certain financial companies, placement of such amendments in a single chapter would permit financial companies to file under the new “Chapter 14” concurrently with filing for a Chapter 7 liquidation or Chapter 11 reorganization, permitting the entire large financial company to be liquidated or reorganized under the provisions of “Chapter 14.” The primary regulator would also be authorized to commence an involuntary proceeding against a financial company under this new chapter. The substantive changes that would constitute part of a new proposed chapter or subchapter of the Bankruptcy Code are discussed in the preceding sections of this study. Accordingly, this section reviews specifically the extent to which such substantive changes should be set forth in a new chapter or subchapter, rather than reviewing the substantive changes themselves.

Benefits and Challenges in Creating a New Chapter or Subchapter

Those proposing a new chapter or subchapter to the Bankruptcy Code claim two primary benefits to such a structure. First, they claim that “[b]ecause of the special procedural and substantive rules that are perceived to be needed to make bankruptcy a robust alternative to government agency resolution for the nation’s largest financial institutions, there needs to be a mechanism, within the Bankruptcy Code, for (a) incorporating the vast majority of common Bankruptcy Code provisions in Chapters 1, 3, and 5, as well as 7 or 11, while (b) ensuring that those special procedural and substantive rules govern—and amend or override certain common Bankruptcy Code provisions—for such financial institutions.” Second, they suggest that such an approach is needed to allow more easily for consideration of these cases by Article III judges instead of by bankruptcy judges as part of a proposal to have such judges hear financial company bankruptcy cases.

The Bankruptcy Code currently provides for separate chapters and subchapters for certain categories of debtors. Chapter 9 provides for the reorganization of municipalities (which includes cities and towns, as well as villages, counties, taxing districts, municipal utilities, and school districts) and Chapter 12 provides for the adjustment of debts of family farmers and fishermen. In addition, the Bankruptcy Code features subchapters applicable to the liquidation of “stockbrokers” (broker-dealers), commodities brokers, and clearing banks, and a subchapter for the reorganization of railroads. The subchapter applicable to broker-dealers permits only a Chapter 7 liquidation, as opposed to a Chapter 11 reorganization. These broker-dealer subchapter provisions can be stayed, and then dismissed upon the filing of an application for a protective decree under the Securities Investor Protection Act of 1970. The subchapter applicable to commodities brokers grants the Commodity Futures Trading Commission a right to be heard, and the subchapter applicable to clearing brokers.

129 Public comments in response to the Board’s Notice for Information, supra note 128, at 2–4 (suggesting that a new bankruptcy process is needed for financial institutions that builds on Chapters 7 and 11).
130 See “Special Judges or Panels for Financial Companies” section on pages 8–10.
131 See Articles 1161–74; 11 U.S.C. sections 1161–74.
132 See “Authorizing the Primary Regulator to Commence an Involuntary Proceeding against a Financial Company; and Expand the Grounds upon Which the Primary Regulator May File Such a Petition” subsection on pages 11–12.
banks makes the conservator or receiver designated by the Board the trustee for the debtor. It also grants the Board or a Federal Reserve Bank the right to appear and be heard on any issue in a case under that subchapter.

The last time a chapter specifically applicable to a particular class of debtors was added to the Bankruptcy Code was in 1986, in response to a farm foreclosure crisis triggered by widespread stress in the agricultural sector. At the time, Chapter 13 was not well suited for farmers because it required filers to have “regular income” and no more than $100,000 in unsecured debts and $350,000 in secured debts. Most farmers had seasonal income and debt exceeding one or both of the Chapter 13 limits, making Chapter 13 unavailable to them. Chapter 11, on the other hand, was designed for large business reorganizations. While family farmers had more debt than individuals, they held far less than most large businesses. The small amount of debt farmers carried (relative to large businesses) made Chapter 11’s reorganization structure—forming creditors’ committees to approve the plan—too expensive and complex to use effectively. The aspects of Chapter 11 and Chapter 13 that made it impossible for most family farmers to use could not be altered without completely changing the scope of Chapter 13’s simplified rules and Chapter 11’s protections designed for debtors with large, complex debts—both of which were central to the design of each chapter. Chapter 12 resolved these issues by largely mirroring the simplified provisions of Chapter 13 while relaxing the debt and income restraints on filing, and by mirroring provisions of Chapter 11 to recognize that family farmers’ balance sheets are larger and more complex than those of a typical consumer.

Some proposals advocating a new chapter or subchapter of the Bankruptcy Code for financial companies focus primarily on large financial companies, those more likely to be designated systemic financial companies whose resolution could be the subject of the OLA provisions of the Dodd-Frank Act. To the extent the new chapter proposals assumed that bankruptcy was the sole option (rather than the presumptive option) for such companies, the existence of the OLA might reduce the need perceived by at least some commentators for a new chapter or subchapter of the Bankruptcy Code. With respect to any financial company that would be defined as eligible to file under a proposed new chapter or subchapter, there may be a risk that financial companies could exploit or manipulate the extent to which they fall inside or outside the definition of “financial company” so as to “game” the application or non-application of the system.

There would appear to be challenges or costs as well to a new chapter or subchapter of the Bankruptcy Code for financial companies, whether systemic or not. For example, the existing literature does not address the potential for additional administrative costs associated with establishing a new chapter of the Bankruptcy Code as compared to amending those provisions of the Bankruptcy Code where the subject matter arises.

Whether or not financial company amendments to the Bankruptcy Code should be made in a new chapter or subchapter, or in various places throughout the Bankruptcy Code, appears to be only sparsely addressed in existing literature. This lack of discussion may be because the literature focuses on the content of the particular bankruptcy reforms or suggestions rather than on whether those provisions should be placed in a new chapter or subchapter. It may also be the case that proposals for sets of sub-

140 11 U.S.C. section 784.
141 For a description of the factors leading up to the farm foreclosure crisis, see Thomas J. Fitzpatrick and James B. Thomson, Stripdowns in Bankruptcy: Lessons from Agricultural Bankruptcy Reform (Federal Reserve Bank of Cleveland Economic Commentary, 2010–9) (2010).
143 See 11 U.S.C. section 109(e) (as of the time of publication, these limits, adjusted pursuant to statutory mandate, are $250,000 and $750,000, respectively).
145 For a discussion of the extent to which companies formerly “gamed” the application of the former Chapter X of the Bankruptcy Act, see D. Skeel, Debt’s Dominion: A History of Bankruptcy Law in America (2003).
stantive reforms or changes are advanced under the rubric of a call for a new chapter or subchapter as a convenient way to summarize the changes rather than as an explicit desire for a new chapter or subchapter.

**Conclusion**

There is disagreement among commentators as to whether the Bankruptcy Code is currently an effective mechanism for the resolution of systemic financial companies, and both sides of this argument use the history of the Lehman Brothers bankruptcy case to support their positions. As noted earlier in this review, many scholars, practitioners, and others have argued that Congress should amend the Bankruptcy Code to make it better suited for financial companies generally or for systemic financial companies in particular. A number of specific amendments to the Bankruptcy Code have been advanced to address specific issues raised by the resolution of financial companies, covering a range of substantive provisions and issues. Some propose that assigning specified district court or bankruptcy court judges for such cases is necessary or that the Bankruptcy Code should authorize special masters particularly experienced with respect to financial companies to be appointed in such cases. Particular attention has been given by commentators to the treatment of QFCs in bankruptcy and other insolvency law, such as the FDIA. Finally, some commentators have asserted that there should be a new chapter or subchapter of the Bankruptcy Code for financial company bankruptcies, either as a convenient vehicle for the foregoing proposed amendments or because the mechanism of a new chapter or subchapter itself is necessary or appropriate. Although virtually all of these proposals were advanced while Congress was considering the legislation that became the Dodd-Frank Act, many commentators assert that various amendments to the Bankruptcy Code are still needed even after passage of the Dodd-Frank Act. Should Congress choose to consider amending the Bankruptcy Code as it applies to financial companies, these arguments and others to be raised in light of the enactment of the Dodd-Frank Act form a foundation for further exploration and consideration of the efficacy of the Bankruptcy Code as a method for resolving financial companies.