

STATEMENT OF

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BEFORE

THE SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL

AND ANTITRUST LAW

THE COMMITTEE ON THE JUDICIARY

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.

MARCH 26, 2014

EXPLORING CHAPTER 11 REFORM:

CORPORATE AND FINANCIAL INSTITUTION INSOLVENCIES

Thank you for inviting me to testify today. I am Thomas Jackson, Distinguished University Professor and President Emeritus at the University of Rochester. Prior to moving to the University of Rochester, I was a professor of law, specializing in bankruptcy, at Stanford, Harvard, and the University of Virginia schools of law. I am the author of a Harvard Press book, *The Logic and Limits of Bankruptcy Law*, a bankruptcy casebook, and numerous articles on bankruptcy law. Recently, my work in the field of bankruptcy has focused on the use of bankruptcy in resolving systemically important financial institutions (SIFIs). In that capacity, I was co-chair of a Bipartisan Policy Center working group that produced, in May of 2013, *Too Big to Fail: The Path to a Solution*. I have also been, since 2008, a member of the Hoover Institution's Resolution Project, which has produced two books discussing how bankruptcy can be made more effective in terms of the resolution of SIFIs. And, since December, I have been a member of the Federal Deposit Insurance Corporation's Systemic Resolution Advisory Committee. I am here today in my individual capacity, and the views I express are my own, not those of any organization with which I am affiliated.

I am a firm believer that the Bankruptcy Code, with a few significant changes, can be made an important player in the resolution of SIFIs and that *both* bankruptcy law *and* the Dodd-Frank Act can be made more effective as a result. Before discussing those changes, however, I believe it is important to set out, briefly, (a) the relationship envisioned between the Dodd-Frank Act and bankruptcy law, (b) the current status of the major alternative to bankruptcy—the Orderly Liquidation Authority (OLA) of Title II of the Dodd-Frank Act, (c) why bankruptcy law, without statutory changes, cannot adequately fulfill what virtually everyone believes should be its role, and (d) why this

creates problems both for the Dodd-Frank Act’s Title I provisions for resolution plans under Section 165(d)—so-called “Living Wills”—as well as for its OLA provisions under Title II. After setting out that important backdrop, I will discuss the core of changes that I would suggest be implemented in the Bankruptcy Code in order to make it an effective alternative to the FDIC’s development of “single-point-of-entry” (SPOE) as its presumptive method of implementing OLA under Title II of the Dodd-Frank Act, thus fulfilling the intent of both Title I and Title II.

### **The Relationship Envisioned Between the Dodd-Frank Act and Bankruptcy Law**

In two key places, the Dodd-Frank Act envisions bankruptcy as the preferred mechanism for the resolution of SIFIs. The first occurs in Title I, with the provision for resolution plans under Section 165(d). Covered financial institutions are required to prepare, for review by the Board of Governors of the Federal Reserve System (Federal Reserve Board), the Financial Stability Oversight Council, and the Federal Deposit Insurance Corporation (FDIC), “the plan of such company for rapid and orderly resolution in the event of material financial distress or failure . . . .”<sup>1</sup> If the Federal Reserve Board and the FDIC jointly determine that a submitted resolution plan “is not credible or would not facilitate an orderly resolution of the company under title 11, United States Code,” the company needs to resubmit a plan “with revisions demonstrating that the plan is credible, and would result in an orderly resolution under title 11, United States Code . . . .”<sup>2</sup> The failure to submit a plan that meets these tests

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<sup>1</sup> Dodd-Frank Act § 165(d)(1).

<sup>2</sup> Dodd-Frank Act, § 165(d)(4)

can lead to restrictions, and divestiture, “in order to facilitate an orderly resolution of such company under title 11, United States Code . . . .”<sup>3</sup> For present purposes, the important point is that effective resolution plans are tested against bankruptcy law, *not* OLA under Title II of the Dodd-Frank Act. It therefore goes without saying—but is worth saying nonetheless—that the effectiveness of bankruptcy law in being able to resolve SIFIs is critically important to the development of credible resolution plans under Title I.

The second occurs in the context of the ability to initiate the OLA process under Title II of the Dodd-Frank Act. Invocation of Title II itself can only occur if the government regulators find that bankruptcy is wanting.<sup>4</sup> That is, by its own terms, bankruptcy is designed by the Dodd-Frank Act to be the preferred resolution mechanism.<sup>5</sup> The FDIC has announced that it supports the idea that bankruptcy, not OLA, should be the presumptive resolution procedure.<sup>6</sup> The ability of bankruptcy law to fulfill its intended role as the presumptive procedure for resolution, of course, turns on the effectiveness of bankruptcy law in rising to the challenge of accomplishing a resolution that meets three important goals: One that (a) both minimizes losses and

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<sup>3</sup> Dodd-Frank Act, § 165(d)(5)(A) & (B).

<sup>4</sup> Dodd-Frank Act, § 203(a)(1)(F) & (a)(2)(F); § 203(b)(2) & (3).

<sup>5</sup> Federal Deposit Insurance Corporation, *The Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*, 78 Fed. Reg. 76614 (Dec. 18, 2013) (hereafter “FDIC SPOE”), at 76615 (“the statute makes clear that bankruptcy is the preferred resolution framework in the event of the failure of a SIFI”); see Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation on Implementation of the Dodd-Frank Act before the Committee on Banking, Housing and Urban Affairs, United States Senate (December 6, 2011), available at <http://www.fdic.gov/news/news/speeches/chairman/spdec0611.html> (“If the firms are successful in their resolution planning, then the OLA would only be used in the rare instance where resolution under the Bankruptcy Code would have serious adverse effects on U.S. financial stability”).

<sup>6</sup> See Remarks by Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation, in Implementation of the Dodd-Frank Act before the Volker Alliance Program (October 13, 2013), available at <http://www.fdic.gov/news/news/speeches/spoet1313.html>.

places them on appropriate, pre-identified, parties, (b) minimizes systemic consequences; and (c) does not result in a government bail-out.

## **The Current Status of the Orderly Liquidation Authority**

Title II of the Dodd-Frank Act, containing the OLA, in many ways adopts much of bankruptcy law's provisions, with a key difference being that the resolution is handled by the FDIC, as receiver, retaining significant discretion, as compared to a bankruptcy court, subject to statutory rules that can and will be enforced by appellate review through the Article III judicial system.

But we are not in 2010, when the Dodd-Frank Act was envisioned and enacted. Much thinking and work has occurred since then, in terms of how, effectively, to resolve a SIFI *without* jeopardizing the financial system and *without* a government bailout.<sup>7</sup> Increasingly, attention has turned, in Europe as well as in the United States, on a rapid recapitalization. Europe has focused on a “one-step” recapitalization via bail-in<sup>8</sup> while the FDIC has focused, in its SPOE proposal, on a “two-step” recapitalization rather

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<sup>7</sup> A useful discussion of whether and how well Title II of Dodd Frank responded to the 2008 crisis—prior to the development of the SPOE proposal—is contained in David Skeel, *Single Point of Entry and the Bankruptcy Alternative* (forthcoming, Brookings 2014).

<sup>8</sup> Financial Stability Board, *Progress and Next Steps Towards Ending “Too-Big-to-Fail,”* Report of the Financial Stability Board to the G-20, available at [www.financialstabilityboard.org/publications/r\\_130902.pdf](http://www.financialstabilityboard.org/publications/r_130902.pdf) (Sept. 2013); Thomas Huertas, Vice Chairman, Comm. Of European Banking Supervisors and Dir., Banking Sector, U.K. Fin. Services Auth., *The Road to Better Resolution: From Bail-out to Bail-in*, speech at The Euro and the Financial Crisis Conference (Sept. 6, 2010), available at [http://www.fsa.gov.uk/library/communication/speeches/2010/0906\\_th.shtml](http://www.fsa.gov.uk/library/communication/speeches/2010/0906_th.shtml); Clifford Chance, *Legal Aspects of Bank Bail-Ins* (2011).

than a formal bail-in<sup>9</sup> Under the FDIC’s approach,<sup>10</sup> a SIFI holding company (the “single point of entry”) is effectively “recapitalized” over a matter of days, if not hours, by the transfer of virtually all its assets and liabilities, except for certain long-term unsecured liabilities, to a new bridge institution whose capital structure, because of the absence of those long-term unsecured liabilities, is both different and presumptively “sound.” The bridge institution then forgives intercompany liabilities or contributes assets to recapitalize its operating subsidiaries. Because of the splitting off of the long-term unsecured debt, the bridge institution, in the FDIC’s model, looks very much like a SIFI following a European-like “bail in”; the major difference is that in the “bail in,” the SIFI operating subsidiaries are directly recapitalized, hence the “one-step,” whereas in the FDIC’s SPOE proposal, the “recapitalized” bridge institution, a different legal entity, is formed first and effectively receives a “new” capital structure by virtue of having long-term unsecured debt left behind in the transfer to it and the bridge institution, in turn, recapitalizes (where necessary) its operating subsidiaries, hence the “two-step.”<sup>11</sup>

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<sup>9</sup> FDIC SPOE, *supra* note 5. See Federal Deposit Insurance Corporation & Bank of England, Joint Paper, *Resolving Globally Active, Systemically Important, Financial Institutions* (Dec. 10, 2012), available at <http://www.bankofengland.co.uk/publications/Documents/news/2012/nr156.pdf> (jointly proposing the single-point-of-entry approach).

<sup>10</sup> Early signs of which were foreshadowed in Randall Guynn, *Are Bailouts Inevitable?*, 29 YALE J. ON REGULATION 121 (2012).

<sup>11</sup> In part, this difference is driven by different organizational structures common to U.S. SIFI’s versus European SIFI’s—our SIFI’s are much more likely to use a holding company structure; in part this difference is driven by Title II’s liquidation “mandate.” Section 214(a) of the Dodd-Frank Act explicitly states: “All financial companies put into receivership under this subchapter shall be liquidated.” As a bankruptcy scholar, I view this latter mandate, at least in the abstract, as unfortunate. A first-day lesson in a corporate reorganization course is that “understanding that financial and economic distress are conceptually distinct from each other is fundamental to understanding Chapter 11 of the Bankruptcy Code,” Barry Adler, Douglas Baird & Thomas Jackson, *BANKRUPTCY: CASES, PROBLEMS AND MATERIALS* 28 (Foundation Press 4<sup>th</sup> ed. 2007). Avoiding a bailout requires that losses be borne by appropriate parties, identified in advance, not necessarily by liquidation of the underlying business, which may cause an unnecessary destruction of value. The

There are pre-conditions for making this work. Important among them are legal rules, known in advance, setting forth a required amount of long-term debt to be held by the SIFI that would be legally subordinate to other unsecured debt—in the sense of its debt-holders knowing that this debt would be “bailed-in” (in a one-step recapitalization) or left behind (in a two-step recapitalization).<sup>12</sup> And the effective use of a two-step recapitalization in Title II—the FDIC has promulgated for comments a working document on its SPOE proposal<sup>13</sup>—needs to straddle the tension between Title II’s liquidation mandate (literally met because, following the transfer to the bridge company, the assets of the original holding company will have been removed from the SIFI holding company, which will subsequently itself be liquidated) and the notion of limiting financial contagion and using Title II only when its results are better than would occur in bankruptcy. That said, many recognize that the FDIC’s SPOE proposal for Title II of Dodd-Frank, consistent with parallel work in Europe, is a significant development in terms of advancing the goals of avoiding “too big to fail”—a resolution process that (a) allocates losses among the appropriate parties, (b) limits systemic consequences, and (c) avoids a government-funded bail-out<sup>14</sup>

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FDIC’s SPOE strategy formally complies with the statutory requirement, by liquidating the SIFI holding company after its assets have been liquidated via the transfer to the bridge company.

<sup>12</sup> See John Bovenzi, Randall Guynn & Thomas Jackson, *Too Big to Fail: The Path to a Solution* (Bipartisan Policy Center, Failure Resolution Task Force May 2013).

<sup>13</sup> See FDIC SPOE, *supra* note 5.

<sup>14</sup> See Daniel Tarullo, *Toward Building a More Effective Resolution Regime: Progress and Challenges* (Oct. 2013), available at

<http://www.federalreserve.gov/newsevents/speech/tarullo20131018a.html> (“The single-point-of-entry approach offers the best potential for the orderly resolution of a systemic financial firm . . .”); William Dudley, President and Chief Executive Officer, Federal Reserve Bank of New York, Remarks at the Federal Reserve Board and Federal Reserve Bank of Richmond Conference, Planning for the Orderly resolution of a Globally Systemically Important Bank, p. 1 (Wash. D.C. Oct. 18, 2013) (“I very much endorse the single-point-of-entry framework for resolution as proposed by the Federal Deposit Insurance Corporation (FDIC).”); John Bovenzi, Randall Guynn & Thomas Jackson, *supra* note 12; David Skeel, *supra* note 7.

## The Inadequacies of Current Bankruptcy Law Seen in Light of SPOE

I believe the “bones” for a comparably-successful resolution of a SIFI under the Bankruptcy Code are already in place. But, without statutory revisions, such as I will be addressing in this statement, those “bones” are unlikely to translate to a competitive resolution procedure to SPOE, as developed by the FDIC, under Title II of the Dodd-Frank Act.

While it is probably the case that the original “intent” of Section 363 of the Bankruptcy Code—a provision providing for the use, sale, and lease of property of the estate—at the time of its enactment in 1978 was to permit piecemeal sales of unwanted property, Chapter 11 practice began, over time, to move in the direction of both (a) pre-packaged plans of reorganization and (b) procedures whose essential device was a going-concern sale of some or all of the business (whether prior to or in connection with a plan of reorganization), leaving the original equity and much of the debt behind and with the proceeds of the sale forming the basis of the distribution to them according to the plan of reorganization and bankruptcy’s priority rules.<sup>15</sup> While these going-concern sales don’t fit perfectly with the original vision, which assumed the Chapter 11 company would be reorganized, not sold, such sales have been used, repeatedly, as a way of continuing a business outside of bankruptcy while the claimants and equity interests, left behind, wind up as the owners of whatever was received by the

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<sup>15</sup> David Skeel, Debt’s Dominion: A History of Bankruptcy Law in America 227 (Princeton 2001); Barry Adler, Douglas Baird & Thomas Jackson, *supra* note 11, at 466-467 (“between [1983 and 2003] a sea change occurred through which an auction of the debtor’s assets has become a commonplace alternative to a traditional corporate reorganization”).

bankruptcy estate in connection with the sale. And it, at least in rough contours, has structural features in common with the two-step recapitalization that is envisioned under the FDIC's SPOE procedure.

That said, a Section 363 sale is an imperfect competitor to SPOE in its current form. While both will require identification of long-term debt (or capital structure debt) that will be left behind—and presumably that may emerge from the current Federal Reserve Board consideration of this issue—a successful two-step recapitalization essentially requires the bridge company to be able to acquire all of the remaining assets, contracts, permits, rights, and liabilities of the SIFI holding company, while preserving the businesses of the transferred, non-bankrupt, operating subsidiaries.

That seems to me very difficult to accomplish under the current Bankruptcy Code. First, because of a series of amendments designed to insulate qualified financial contracts—swaps, derivatives, and repos—from many of bankruptcy's provisions, most notably the automatic stay and the unenforceability of ipso facto clauses—there is no effective mechanism in the current Bankruptcy Code to preclude counterparties on qualified financial contracts from running upon the commencement of a bankruptcy case.<sup>16</sup> Importantly, even if most such contracts reside in non-bankrupt operating

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<sup>16</sup> Bankruptcy Code §§ 362(b)(6), (7), (17), (27), 546(e), (f), (g), (j), 555, 556, 559, 560, 561. (The FDIC SPOE proposal, consistent with statutory authorization, Dodd-Frank Act § 210(c)(8), (9), (10), (16), will override any such provisions in counterparty contracts (and subsidiary cross-default provisions); bankruptcy, being a judicial proceeding, cannot (and should not) do that without comparable statutory authorization which currently not only is missing but is expressly contradicted by provisions that exist.) While my statement today focuses on changes that are necessary in these existing protective provisions for counterparties on qualified financial contracts in the Bankruptcy Code in order to permit an effective two-step recapitalization of a SIFI holding company, I believe these existing Bankruptcy Code provisions, and their relationship to bankruptcy law more generally, needs to be rethought. See David Skeel & Thomas Jackson, *Transaction Consistency and the New Finance in Bankruptcy*, 112 COLUM. L. REV. 152 (2012).

subsidiaries of the bridge company, such creditors may have cross-default or change-of-control provisions triggered by the Chapter 11 filing of their former holding company. Nor would it be clear under existing bankruptcy law that operating licenses, permits, and the like could be transferred to the bridge company, either because it legally is a new company or because there has been a change of control of the holding company and its operating subsidiaries in derogation of change-of-control provisions or requirements applicable to individual entities.

Moreover, while the Bankruptcy Code clearly contemplates an ability to move with necessary speed, including when a provision calls for a notice and hearing before any decision (such as under Section 363(b)),<sup>17</sup> the lack of clear statutory authority for a very rapid transfer to a bridge company may leave too much—for the comfort of a SIFI *or* a regulatory body—up to the discretion of a particular judge who first gets a SIFI holding company requesting such a transfer. Nor is there a clear necessity for notice to, or hearing by, a government regulator—whether the FDIC or Federal Reserve Board, in the case of the holding company, or a foreign regulator, in the case of a foreign subsidiary that is proposed to be transferred to a bridge company. These uncertainties, even with a robust resolution plan, may inspire enough lack of confidence by the FDIC and the Federal Reserve Board so as to view the commencement of an OLA proceeding under Title II of the Dodd-Frank Act to be the preferable course—or, alternatively, lack of sufficient confidence by foreign regulators so as to acquiesce in allowing the

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<sup>17</sup> Bankruptcy Code § 102(1) provides that “after notice and a hearing” includes (B) “authoriz[ing] an act without an actual hearing if such notice is given properly and if . . . (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act . . . .”

bankruptcy process to unfold without the regulator intervening at the foreign subsidiary level.

### **The Problems These Inadequacies Create for the Dodd-Frank Act**

As noted above, resolution plans under Title I of the Dodd-Frank Act focus on bankruptcy, and Title II of the Dodd-Frank Act is, explicitly, designed to be a fall-back solution to be invoked when bankruptcy is determined to be inadequate to avoid serious financial consequences on the U.S. financial system. But if the “best” resolution process we currently envision—one that, as noted above, (a) both minimizes losses and places them on appropriate, pre-identified, parties, (b) minimizes systemic consequences, and (c) does not result in a government bail-out—involves, indeed, a recapitalization such as proposed by the FDIC with its SPOE procedure under Title II,<sup>18</sup> then there is a disconnect between design and implementation. As a result, the resolution plans will fail to do what they are supposed to do—prepare a SIFI for the most successful possible resolution—leading to OLA under Title II assuming primacy in terms of the resolution process. Moreover, the resolution plans, relentlessly focused on a bankruptcy process under Title I’s own standards, will be addressing a different set of issues and will provide little guidance to the FDIC in its OLA proceeding. To have the statutory pieces “fit” together—to have resolution plans effectively prepare a firm for resolution, to have bankruptcy serve as its intended role as the primary resolution device, and (beneficially) to have the resolution plans be relevant to a proceeding under Title II of

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<sup>18</sup> See sources cited, *supra* note 14.

the Dodd-Frank Act “just in case”—it makes sense to move, through limited but important changes to the Bankruptcy Code, from the “bones” of a successful two-step recapitalization process in the current Bankruptcy Code to a process that can deliver what it can only incompletely promise today.<sup>19</sup>

### **Proposed Amendments to the Bankruptcy Code**

What might those necessary amendments be? Attached to this statement is a proposal for adding a “Subchapter V” to Chapter 11 of the Bankruptcy Code that contains what I believe are the necessary (and useful) amendments.<sup>20</sup> I do not intend to repeat the numerous (and sometime intricate) details here, but, rather, plan to use this statement to outline the heart of what they are designed to accomplish.

At the center of effectuating a bankruptcy-based two-step recapitalization of a SIFI holding company, are two principles. First, that there is sufficient long-term unsecured debt (or “capital structure debt”) at the holding company level to be “left

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<sup>19</sup> I recognize that many may want to reduce the size and complexity of SIFIs and may see bankruptcy’s current inadequacies as one way to realize that goal. For, if bankruptcy is viewed as not adequate, then the resolution plans cannot be approved until the SIFI is reduced sufficiently in size and complexity to bring bankruptcy back into play. I think, however, it would be extremely unfortunate to mix the complex question of size (“too big”) with the separate question of how to best resolve the institutions we might have at any moment. Thus, I hope that bankruptcy law—i.e., the failure to amend it—is not used in a chess game focused on a different set of issues.

<sup>20</sup> See Appendix A. S. 1861 (Dec. 2013) has a proposal designed to a similar end, albeit with several different features. The Hoover Institution’s Resolution Project is working on a comprehensive proposal (dubbed “Chapter 14 2.0”) that picks up many of the ideas from its original proposal in *BANKRUPTCY NOT BAILOUT: A SPECIAL CHAPTER 14* (Kenneth Scott & John Taylor, eds., Hoover Press 2012), and adds to it features necessary to implement a rapid recapitalization sale. The principal (but not sole) difference is that the Resolution Project’s current work is designed to produce a more comprehensive proposal for how the Bankruptcy Code should handle *both* a SIFI at the holding company level *and* at the operating division level, while the proposal in Appendix A is focused on accommodation in bankruptcy of a SPOE-like two-step recapitalization at the holding company level.

behind” in the transfer to a bridge company so as to effectuate the recapitalization. (This is—or should be—largely an issue outside of bankruptcy law itself—and, indeed, is central to a basically rule-based application of the FDIC’s SPOE proposal under Title II of the Dodd-Frank Act. It is my understanding the Federal Reserve Board is working precisely on such a proposed requirement.) Second, that the bridge company otherwise be able to acquire all the assets, rights, and liabilities of the former holding company, including ownership of the former holding company’s operating subsidiaries.<sup>21</sup>

Thus, the “guts” of the proposed amendments I believe are necessary to place bankruptcy law where the Dodd-Frank Act—in both Title I and Title II—envisions it should be, center on a provision that substantially sharpens the nature and focus of a sale of assets under Section 363 of the Bankruptcy Code. This provision contemplates a rapid transfer to and, in effect, recapitalization of, a bridge company (e.g., within the first 48 hours of a bankruptcy case)<sup>22</sup> by a SIFI holding company (the debtor), after which the bridge company can recapitalize, where necessary, its operating subsidiaries.<sup>23</sup> If the court approves the transfer, then the SIFI holding company’s operations (and ownership of subsidiaries) shift to a new bridge company *that is not in bankruptcy*—and will be perceived as solvent by market-participants, including

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<sup>21</sup> There is a third, important, question of access to liquidity by the bridge company that, formally not a part of the bankruptcy process—and thus outside the jurisdiction of this Subcommittee—I do not address in any detail in this statement. See *infra*, note 24.

<sup>22</sup> In the Subchapter V proposal, Appendix A, Sec. 3, § 1183, commenced either under Sections 301 and 303 of the Bankruptcy Code or by the Federal Reserve Board, upon the Federal Reserve Board’s certification that (a) the institution is under defined financial stress and (b) the commencement of a bankruptcy case and a transfer to a bridge company would preserve or promote financial stability in the United States.

<sup>23</sup> The institutions that can use these new bankruptcy procedures, I would recommend, should track those who can be placed into OLA under Title II of the Dodd-Frank Act. See Appendix, Sec. 2 (amending Bankruptcy Code §§ 101, 103, & 109).

liquidity providers<sup>24</sup> because it will be (effectively) recapitalized, as compared to the original SIFI, by leaving behind in the bankruptcy proceeding previously-identified long-term unsecured debt of the original SIFI. *After* the transfer, the debtor (i.e., the SIFI holding company) remains *in bankruptcy* but is effectively a shell, whose assets usually will consist only of an interest in a trust that would hold the equity interests in the bridge company until they are sold or distributed pursuant to a Chapter 11 plan, and whose claimants consist of the holders of the long-term debt that is not transferred to the bridge company and the old equity interests of the SIFI holding company. This debtor in Chapter 11 has no real business to conduct, and essentially waits for an event (such as the sale or public distribution of equity securities of the bridge company by the trust) that will value or generate proceeds from its assets (all equity interests in the new, recapitalized entity) and permit a distribution of those equity interests or proceeds, pursuant to bankruptcy’s normal distribution rules, to the holders of the long-term debt and original equity interests of the debtor (the original SIFI holding company).

The details of accomplishing this are somewhat intricate and, of course, can vary, but it is useful, I believe, to trace the general ideas of how I envision this two-step

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<sup>24</sup> Recognizing that this liquidity is not a part of bankruptcy law, and thus not within the jurisdiction of this Subcommittee, I will not here enter into the debate over whether market-based liquidity to the bridge company, backed by existing Board lender-of-last-resort access under Federal Reserve Act § 13(3)’s “program or facility with broad-based eligibility,” in the event of a broader liquidity freeze, are sufficient. Without greater access to government liquidity—under the stringent standards set forth in John Bovenzi, Randall Guynn & Thomas Jackson, *supra* note 12—however, I can envision cases where the government may commence an OLA proceeding under Title II of the Dodd-Frank Act, in preference to bankruptcy, for the primary purpose of gaining liquidity access via the Orderly Liquidation Fund, Dodd-Frank Act § 210(n). (Appendix A contains a proposed amendment adding paragraph 15 to Federal Reserve Act § 13, to authorize, under limited circumstances and for a limited time, temporary liquidity by the Federal Reserve Board. Appendix A, Sec. 5.)

recapitalization might be implemented in bankruptcy.<sup>25</sup> The transfer motion would be heard by the court<sup>26</sup> no sooner than 24-hours after the filing (so as to permit 24-hour notification to the 20 largest holders of unsecured claims, the Federal Reserve Board, the FDIC, and the Secretary of the Treasury, and the primary financial regulatory authority—whether US or foreign—with respect to any subsidiary whose ownership is proposed to be transferred to the bridge company).<sup>27</sup> And, because the provisions must stay qualified financial contract termination (and related) rights (including those based on cross-defaults in non-bankruptcy subsidiaries) for a period to allow the transfer to the bridge company to be effective in a seamless fashion, the transfer decision essentially must be made within a designated period (e.g., 48-hours) after the filing.<sup>28</sup> There should be conditions on the ability of the court to authorize the transfer to the bridge company—but conditions that can be satisfied by advanced planning (e.g., resolution plans) or otherwise within a very short time-frame. For example, the proposal in Appendix A provides that the court can order the transfer only if it finds the transfer will (a) preserve or promote financial stability in the United States and (b) does not provide for any assumption of the long-term unsecured debt and, in addition, the Federal Reserve Board certifies that it has found that the bridge company adequately provides assurance of future performance of any executory contract, unexpired lease, or debt agreement being transferred to the bridge company.<sup>29</sup>

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<sup>25</sup> And reflected in the proposal in Appendix A, particularly Sec. 3.

<sup>26</sup> In Appendix A, the proposal includes an amendment to 28 U.S.C. § 298 to create a group of designated district judges, at least one from each circuit, to hear cases arising under Subchapter V of Chapter 11. Appendix A, Sec. 4.

<sup>27</sup> Appendix A, Sec. 3, § 1186(b).

<sup>28</sup> Appendix A, Sec. 3, §§ 1187, 1188.

<sup>29</sup> Appendix A, Sec. 3, § 1186(c)(3).

Many of the remaining provisions that I believe would need to be adopted as well, and are set out in Appendix A, are designed to permit the successful transfer of assets, contracts, liabilities, rights, licenses, and permits—of both the holding company and of the subsidiaries—to the bridge company.

First, there are provisions applicable to debts, executory contracts, and unexpired leases, including qualified financial contracts.<sup>30</sup> Conceptually, the goal of these provisions is to keep operating assets and liabilities “in place” so that they can be transferred to the bridge company (within a 48-hour window) and, thereafter, remain “in place” so that “business as usual” can be picked up the bridge company and its operating subsidiaries once it assumes the assets and liabilities.<sup>31</sup> This requires overriding “ipso facto” clauses (of the type that would otherwise permit termination or modification based on the commencement of a bankruptcy case or similar circumstance, including credit-rating agency ratings, whether in the holding company or in its operating subsidiaries),<sup>32</sup> and it requires overriding similar provisions allowing for termination or modification based on a change of control, again whether in the holding

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<sup>30</sup> See generally Appendix A, Sec. 3, § 1187 (debts, executory contracts, and unexpired leases); § 1188 (qualified financial contracts).

<sup>31</sup> I envision this including relevant tax attributes, such as a NOL carryforward. See Appendix A, Sec. 3, § 1190(b).

<sup>32</sup> Appendix A, Sec. 3, § 1188(f). While these provisions affect the contracts, permits, liabilities, and the like of entities (e.g., affiliates such as operating subsidiaries) not themselves in bankruptcy, I believe they are fully authorized (at least for domestic subsidiaries), if not by Congress’ Article I bankruptcy power, then by application of the independent (albeit related) Congressional power pursuant to the “necessary and proper” clause of Article I, as interpreted since *McCulloch v. Maryland*, 4 Wheat. 316 (1819), see also *United States v. Comstock*, 560 U.S. \_\_\_ (2010), since the bankruptcy of the SIFI cannot successfully be concluded without these provisions that permit the unimpeded transfer of the operating subsidiary’s ownership to the bridge company. (The question of foreign subsidiaries, while complex, is being actively discussion by U.S. and foreign regulators, and legislation is being discussed in Europe and elsewhere that is designed to help assure these results extend to non-U.S. operations in the case involving the resolution of a U.S.-based SIFI holding company.)

company or in its operating subsidiaries, since the ownership of the bridge company will be different than the ownership of the debtor prior to the bankruptcy filing.<sup>33</sup> These provisions need to be broader than Section 365 of the Bankruptcy Code, for at least two reasons. First, perhaps because of the limited scope of the original “purpose” of Section 363, bankruptcy doesn’t have a provision expressly allowing for the “transfer” of debt (although many debts are in fact transferred as a matter of existing practice under Chapter 11 “going concern sales”). Unlike executory contracts, which might be viewed as net assets (and thus something to “assume”) or as net liabilities (and thus something to “reject”), debt is generally considered breached and accelerated (think “rejected”) upon the filing of a petition in bankruptcy.<sup>34</sup> But, if there is going to be a two-step recapitalization, the bridge company needs to take the liabilities it would assume “as if nothing happened.” Thus, provisions designed to accomplish that need to be included.<sup>35</sup> Second, Section 365 doesn’t deal with change-of-control provisions; amendments need to add that and extend it to debt agreements as well.<sup>36</sup>

With respect to qualified financial contracts, there should be provisions in addition to those just mentioned. The stay on termination, offset, and net out rights should apply for the period from the filing until the transfer occurs, it is clear it won’t occur, or 48 hours have passed.<sup>37</sup> Because of this interregnum, when there is a likelihood that the transfer will be approved, and all of these qualified financial contracts (and related guarantees, if any) go over “in their original form” to the bridge

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<sup>33</sup> Appendix A, Sec. 3, § 1187(b)(2). This includes offsets and netting out under qualified financial contracts, § 1188.

<sup>34</sup> See David Skeel & Thomas Jackson, *supra* note 16.

<sup>35</sup> Appendix A, Sec. 3, § 1187.

<sup>36</sup> Appendix A, Sec. 3, § 1187(b)(2).

<sup>37</sup> Appendix A, Sec. 3, § 1188(a).

company, there is a requirement that the debtor and its subsidiaries shall continue to perform payment and delivery obligations.<sup>38</sup> Conversely, because the counterparty may not know for sure what the outcome will be during this interregnum, there is a provision that the counterparty may promptly “cure” any unperformed payment or delivery obligations after the transfer.<sup>39</sup>

Just as the principle of having the bridge company have the same rights, assets, and liabilities drive the provisions regarding debts, executory contracts, and unexpired leases just discussed (including qualified financial contracts), a similar provision is necessary to keep licenses, permits, and registrations in place, and does not allow a government to terminate or modify them based on an “ipso facto” clause or a transfer to a bridge company.<sup>40</sup>

## **Conclusion**

While the details are many, the concept is simple. Through modest amendments to the Bankruptcy Code, expressly enabling it to effectuate a rapid two-step recapitalization from a SIFI holding company to a bridge company (by leaving long-term unsecured debt behind), it indeed can be considered the primary resolution vehicle for SIFIs, as envisioned by the Dodd-Frank Act, limiting the role of Title II—and therefore administrative-based resolution—to the cases, that almost inevitably may occur, where we cannot contemplate today the causes or contours of the next crisis, so

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<sup>38</sup> Appendix A, Sec. 3, § 1188(b)(1).

<sup>39</sup> Appendix A, Sec. 3, § 1188(b)(2).

<sup>40</sup> Appendix A, Sec. 3, § 1189.

that the FDIC’s inevitable discretion, compared to a judicial proceeding, becomes a virtue rather than a concern.

Absent that (hopefully rare) need, however, I view the virtues of bankruptcy resolution over agency resolution to be several. First, the new company formed in the Section 363-like recapitalization sale (or transfer) is neither (a) subject to the jurisdiction of a bankruptcy court<sup>41</sup> nor (b) subject to “control” by a government agency, such as the FDIC, whereas the bridge company created in the SPOE process is effectively run, for a while at least, by the FDIC.<sup>42</sup> In this bankruptcy process, the bridge company, appropriately, faces market-discipline first and foremost; in Title II, there inevitably is a heavier layer of regulatory overlay and control. Second, and related, a bankruptcy process envisions at least the possibility that the market can determine the equity value of the new company (and thus the amount to be distributed to the creditors and old equity interests “left behind”), whereas the FDIC’s SPOE proposal relies on expert valuations for those distributions.<sup>43</sup> Third, because of language in the

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<sup>41</sup> Explicitly stated in Appendix A, Sec. 3, § 1185(f).

<sup>42</sup> See, e.g., FDIC SPOE, *supra* note 5, p. 76617 (“The FDIC would retain control over certain high-level key matters of the bridge financial company’s governance, including approval rights for . . . capital transactions in excess of established thresholds; asset transfers or sales in excess of established thresholds; merger, consolidation or reorganization of the bridge financial company; any changes in directors of the bridge financial company (with the FDIC retaining the right to remove, at its discretion, any or all directors); any distribution of dividends; any equity based compensation plans . . . . Additional controls may be imposed by the FDIC as appropriate.”). Compare this with comparable provisions in Appendix A, Sec. 3, § 1185(b)(3), where the trustee is authorized to make such decisions only after “provid[ing] notice to and consult[ing] with parties in interest in the case . . . .”

<sup>43</sup> FDIC SPOE, *supra* note 5, p. 76618 (“the SPOE strategy provides for the payment of creditors’ claims in the receivership through the issuance of securities in a securities-for-claims exchange. This exchange involves the issuance and distribution of new debt, equity and, possibly, contingent securities . . . to the receiver. The receiver would then exchange the new debt and equity for the creditors’ claims. . . . Prior to the exchange of securities for claims, the FDIC would approve the value of the bridge financial company. The valuation would be performed by independent experts . . . selected by the board of directors of the bridge financial company. Selection of the bridge financial company’s independent experts would require the approval of the FDIC, and the FDIC would engage its own experts to review the work of these firms and to provide a fairness opinion.”).

Dodd-Frank Act,<sup>44</sup> the FDIC may push on its own initiative for the replacement of management (i.e., not permit management of the former SIFI holding company take similar positions in the bridge company).<sup>45</sup> In the bankruptcy process, the Board of Directors, and management, of the newly-created bridge-company would be identified with the input both of the SIFI’s primary regulators as well as the beneficiaries of the transfer and, importantly, would be subject to the approval of the district court in an open and transparent process at the time of the transfer of the holding company’s assets and liabilities to the bridge company.<sup>46</sup> Fourth, at various points, the FDIC has discretion that can amount to ex post priority determinations (such as whether liabilities other than pre-defined long-term unsecured debt gets transferred to the bridge company)—discretion that may be useful in extraordinary cases, but that is potentially a cause for undermining market confidence in the rule of law in other circumstances.<sup>47</sup> Fifth, Title II treats the bridge company created in an OLA under Title II as a government entity, exempt from taxes;<sup>48</sup> I think that provision is a mistake, preferring the bridge company to its non-protected competitors, and should not be replicated in any bankruptcy amendments, whose goal is to have the bridge company treated “just as” the holding company was before the two-step recapitalization. Sixth, and (perhaps) finally, I am concerned—as I suspect the FDIC is as

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<sup>44</sup> Dodd-Frank Act § 206(4) (the FDIC shall “ensure that management responsible for the failed condition of the covered financial company is removed”); see also Dodd-Frank Act § 206(5) (similar provision for members of a board of directors).

<sup>45</sup> See FDIC SPOE, *supra* note 5, p. 76617 (“As required by the statute, the FDIC would identify and remove management of the covered financial company who were responsible for its failed condition”).

<sup>46</sup> Appendix A, Sec. 3, § 1185(a)(3)(ii). See also Appendix A, Sec. 3, § 1185(3)(A), where the trustee, in the case of a change in officers and directors, is required to first “provide notice to and consult with parties in interest in the case . . . .”

<sup>47</sup> See, e.g., FDIC SPOE, *supra* note 5, p. 76618 (in addition to identified categories, the FDIC retains “a limited ability to treat similarly situated creditors differently.”).

<sup>48</sup> Dodd-Frank Act § 210(h)(10) (“Notwithstanding any other provision of Federal or State law, a bridge financial company, its franchise, property, and income shall be exempt from all taxation now or hereafter imposed by the United States, by any territory, dependency, or possession thereof, or by any State, county, municipality, or local taxing authority.”).

well—that the actual use of SPOE under Title II will be subject to ex post criticism and investigation. Bankruptcy, with appropriate amendments, is in a more robust position to “do the right thing” in terms of fairly addressing the consequences of financial failure without having it necessarily lead to economic failure.

I want to thank the Subcommittee for allowing me this opportunity to present my views. It is an honor to appear before you today. I would of course be delighted to answer any questions you may have about my testimony.

**APPENDIX A:**  
**PROPOSED AMENDMENTS TO FACILITATE THE RESOLUTION**  
**OF FINANCIAL INSTITUTIONS UNDER THE BANKRUPTCY CODE:**  
**FOCUSED ON A NEW SUBSECTION V TO CHAPTER 11**

Title: To \_insert purpose\_

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

**SECTION 1. SHORT TITLE.**

This Act may be cited as the [“\_\_\_\_\_ Act of 2013”.]

**SEC. 2. GENERAL PROVISIONS RELATING TO COVERED FINANCIAL CORPORATIONS.**

(a) Definition.—Section 101 of title 11, United States Code, is amended by inserting the following after paragraph (9):

“(9A) The term ‘covered financial corporation’ means any corporation incorporated or organized under any Federal or State law, other than a stockbroker, a commodity broker, or an entity of the kind specified in paragraph (2) or (3) of section 109(b), that is—

“(A) a bank holding company, as that term is defined in section 2(a) of the Bank Holding Company Act of 1956 (12 U.S.C. 1841(a)); or

“(B) predominantly engaged in activities that the Board of Governors of the Federal Reserve System has determined are financial in nature or incidental to such financial activity for purposes of section 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(k)).”

(b) Applicability of Chapters.—Section 103 of title 11, United States Code, is amended by adding at the end the following:

“(l) Subchapter V of chapter 11 applies only in a case under chapter 11 concerning a covered financial corporation.”.

(c) Who May Be a Debtor.—Section 109 of title 11, United States Code, is amended—

(1) in subsection (b)—

(A) in paragraph (2), by striking “or” at the end;

(B) in paragraph (3)(B), by striking the period at the end and inserting “; or”; and

(C) by adding at the end the following:

“(4) a covered financial corporation.”; and

(2) in subsection (d)—

(A) by striking “and” before “an uninsured State member bank”;

(B) by striking “or” before “a corporation”; and

(C) by inserting “, or a covered financial corporation” after “Federal Deposit Insurance Corporation Improvement Act of 1991”.

### SEC. 3. LIQUIDATION, REORGANIZATION, OR RECAPITALIZATION OF A COVERED FINANCIAL CORPORATION.

Chapter 11 of title 11, United States Code, is amended by adding at the end the following:

#### “SUBCHAPTER V—LIQUIDATION, REORGANIZATION, OR RECAPITALIZATION OF A COVERED FINANCIAL CORPORATION

##### “1181. Inapplicability of other sections

“Sections 321(c) and 322(b) do not apply in a case under this chapter concerning a covered financial corporation.

##### “1182. Definitions for this chapter

“In this subchapter, the following definitions shall apply:

“(1) The term ‘Board’ means the Board of Governors of the Federal Reserve System.

“(2) The term ‘bridge company’ means a corporation whose equity securities are transferred to a special trustee under section 1185(a).

“(3) The term ‘capital structure debt’ means debt, other than a qualified financial contract, of the debtor for borrowed money with an original maturity of at least 1

year.

“(4) The term ‘contractual right’ means a contractual right of a kind defined in section 555, 556, 559, or 560.

“(5) The term ‘qualified financial contract’ means any contract of a kind specified in paragraph (25), (38A), (47), or (53B) of section 101, section 741(7), or paragraph (4), (5), (11), or (13) of section 761.

### “1183. Commencement of a case concerning a covered financial corporation

“(a) A case under this chapter concerning a covered financial corporation may be commenced by the filing of a petition with the bankruptcy court—

“(1) under section 301 or 303; or

“(2) by the Board, if and only if the Board certifies in the petition that it has determined that—

“(A) the covered financial corporation—

“(i) has incurred losses that will deplete all or substantially all of the capital of the covered financial corporation, and there is no reasonable prospect for the covered financial corporation to avoid such depletion;

“(ii) is insolvent;

“(iii) is not paying, or is unable to pay, the debts of the covered financial corporation (other than debts subject to a bona fide dispute as to liability or amount) as they become due; or

“(iv) is likely to be in a financial condition specified in clause (i), (ii), or (iii) sufficiently soon so that the immediate commencement of a case under this title concerning the covered financial corporation is necessary to preserve or promote financial stability in the United States; and

“(B) the commencement of a case under this title and the effect of a transfer under section 1186 would preserve or promote financial stability in the United States.

“(b) The commencement of a case under subsection (a)(2) constitutes an order for relief under this chapter.

“(c) In a case commenced under section 303, the court shall order relief against the debtor under this chapter if the Board—

“(1) makes a certification of the kind described in subsection (a)(2); and

“(2) consents to an order for relief against the debtor under this chapter.

## “1184. Regulators

“(a) The Board may raise and may appear and be heard on any issue in any case or proceeding under this title relevant to the regulation of the debtor by the Board or to financial stability in the United States.

“(b) The Federal Deposit Insurance Corporation may raise and may appear and be heard on any issue in any case or proceeding under this title in connection with a transfer under section 1186.

## “1185. Special trustee and bridge company

“(a) On request of the trustee or the Board, the court may order the trustee to appoint 1 special trustee and transfer to the special trustee all of the equity securities in a corporation to hold in trust for the sole benefit of the estate if—

“(1) such corporation does not have any property, debts, executory contracts, or unexpired leases, other than any property acquired or debts, executory contracts, or unexpired leases assumed, in a transfer under section 1186;

“(2) such equity securities are property of the estate; and

“(3) the court approves—

“(A) the trust agreement governing the special trustee;

“(B) the governing documents of the bridge company; and

“(C) the identity of—

“(i) the special trustee; and

“(ii) the directors and senior officers of the bridge company.

“(b) The trust agreement governing the special trustee shall provide—

“(1) for the payment of the costs and expenses of the special trustee from the assets of the trust and not from property of the estate;

“(2) that the special trustee provide—

“(A) periodic reporting to the estate; and

“(B) information about the bridge company as reasonably requested by a party in interest to prepare a disclosure statement for a plan providing for distribution of any securities of the bridge company;

“(3) that the special trustee provide notice to and consult with parties in interest in the case regarding—

“(A) any change in a director or senior officer of the bridge company;

“(B) any modification to the governing documents of the bridge company;  
and

“(C) any major corporate action of the bridge company, including—

“(i) recapitalization;

“(ii) a liquidity borrowing;

“(iii) termination of an intercompany debt or guarantee;

“(iv) a transfer of a substantial portion of the assets of the bridge company; or

“(v) the issuance or sale of any securities of the bridge company;

“(4) that the proceeds of the sale of any equity securities of the bridge company by the special trustee be held in trust for the benefit of or transferred to the estate;  
and

“(5) that the property held in trust by the special trustee is subject to distribution in accordance with the plan and subsection (e).

“(e) The special trustee shall distribute the assets held in trust in accordance with the plan on the effective date of the plan, after which time the office of the special trustee shall terminate, except as may be necessary to wind up and conclude the business and financial affairs of the trust.

“(f) After a transfer under section 1186, the special trustee shall be subject only to applicable nonbankruptcy law, and the actions and conduct of the special trustee shall no longer be subject to bankruptcy court approval.

#### “1186. Special transfer of property of the estate

“(a) On request of the trustee or the Board, and after notice and a hearing, beginning 24 hours after the commencement of the case, the court may order a transfer under this section of property of the estate to a bridge company. Except to the extent inconsistent with this section, section 363 applies to a transfer under this section.

“(b) Unless the court orders otherwise, notice of a request for an order under subsection (a) shall consist of electronic or telephonic notice of not less than 24 hours to—

“(1) the holders of the 20 largest unsecured claims against the debtor;

“(2) the Board;

“(3) the Federal Deposit Insurance Corporation;

“(4) the Secretary of the Treasury;

“(5) the United States trustee; and

“(6) each primary financial regulatory agency, as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (12 U.S.C. 5301(12)), with respect to any affiliate that is proposed to be transferred under this section.

“(c) The court may not order a transfer under this section unless the court determines, based upon a preponderance of the evidence, that—

“(1) the transfer under this section will preserve or promote financial stability in the United States;

“(2) the proposed transfer does not provide for the assumption of any capital structure debt by the bridge company; and

“(3) the Board certifies to the court that the Board has determined that the bridge company provides adequate assurance of future performance of any executory contract or unexpired leased assumed and assigned to the bridge company, and of payment of any debt assumed by the bridge company, in the transfer under this section.

#### “1187. Automatic stay; assumed debt

“(a)(1) A petition filed under section 301, 303, or 1183 operates as a stay, applicable to all entities, of the termination, acceleration, or modification of any debt (other than capital structure debt), executory contract (other than a qualified financial contract), or unexpired lease of the debtor, any agreement under which the debtor issued or is obligated for debt (other than capital structure debt), any debt, executory contract (other than a qualified financial contract), or unexpired lease of an affiliate, or any agreement under which such affiliate issued or is obligated for debt, or of any right or obligation under any such debt, contract, lease, or agreement, solely because of a provision in such debt, contract, lease, or agreement that is conditioned on—

“(A) the insolvency or financial condition of the debtor at any time before the closing of the case;

“(B) the commencement of a case under this title concerning the debtor;

“(C) the appointment of or taking possession by a trustee in a case under this title concerning the debtor or by a custodian before the commencement of the case;

“(D) a default by the debtor under any agreement; or

“(E) a credit rating agency rating, or absence or withdrawal of a credit rating agency rating—

“(i) of the debtor at any time after the commencement of the case;

“(ii) of an affiliate during the 48 hours after the commencement of the case;  
or

“(iii) while the special trustee is a direct or indirect beneficial holder of more than 50% of the equity securities of the bridge company—

“(I) of the bridge company; or

“(II) of an affiliate, if all of the estate’s direct or indirect interests in the affiliate are transferred under section 1186.

“(2) The stay under this subsection terminates—

“(A) as to the debtor, upon the earliest of—

“(i) 48 hours after the commencement of the case;

“(ii) assumption of the debt, contract, or lease under an order authorizing a transfer under section 1186; or

“(iii) a determination by the court not to order a transfer under section 1186;  
and

“(B) as to an affiliate, upon the earliest of—

“(i) entry of an order authorizing a transfer under section 1186 in which the direct or indirect interests in the affiliate that are property of the estate are not transferred under section 1186;

“(ii) a determination by the court not to order a transfer under section 1186;  
or

“(iii) 48 hours after the commencement of the case, if the court has not ordered a transfer under section 1186.

“(3) Sections 362(d), 362(e), 362(f), and 362(g) apply to a stay under this subsection.

“(b) Notwithstanding a provision in an agreement or in applicable nonbankruptcy law, an agreement under which the debtor has issued any debt, executory contract (other than a qualified financial contract), or unexpired lease that is assumed by the bridge company in a transfer under section 1186 may not be terminated or modified, and any right or obligation under the agreement, debt, contract, or lease may not be terminated or modified, as to the bridge company solely because of—

“(1) a provision in the debt, contract, lease, or agreement of the kind specified in subsection (a)(1); or

“(2) a provision in an agreement or in applicable nonbankruptcy law that prohibits, restricts, or conditions the assignment of the debt, contract, or lease or that terminates or modifies, or permits a party other than the debtor to terminate

or modify, the debt, contract, or lease on account of the assignment of the debt, contract, or lease or a change in control of any party to the debt, contract, or lease.

## “1188. Treatment of qualified financial contracts and affiliate contracts

“(a) Notwithstanding sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, and 561, a petition filed under section 301, 303, or 1183 operates as a stay, during the period specified in section 1187(a)(2)(A), applicable to all entities, of the exercise of a contractual right—

“(1) to cause the liquidation, termination, or acceleration of a qualified financial contract of the debtor or an affiliate;

“(2) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with a qualified financial contract of the debtor or an affiliate; and

“(3) under any security agreement or arrangement or other credit enhancement forming a part of or related to a qualified financial contract of the debtor or an affiliate.

“(b)(1) During the period specified in section 1187(a)(2)(A), the trustee or the affiliate shall perform all payment and delivery obligations under a qualified financial contract of the debtor or the affiliate, as the case may be, that become due after the commencement of the case. The stay provided under subsection (a) terminates as to a qualified financial contract of the debtor or an affiliate immediately upon the failure of the trustee or the affiliate, as the case may be, to perform any such obligation during such period.

“(2) A counterparty to any qualified financial contract of the debtor that is assumed and assigned in a transfer under section 1186 may perform any unperformed payment or delivery obligation under the qualified financial contract promptly after the assumption and assignment with the same effect as if the counterparty had timely performed such obligations.

“(c) A qualified financial contract between an entity and the debtor may not be assigned to or assumed by the bridge company in a transfer under section 1186 unless—

“(1) all qualified financial contracts between the entity and the debtor are assigned to and assumed by the bridge company in the transfer under section 1186;

“(2) all claims of the entity against the debtor under any qualified financial contract between the entity and the debtor (other than any claim that, under the terms of the qualified financial contract, is subordinated to the claims of general unsecured creditors) are assigned to and assumed by the bridge company;

“(3) all claims of the debtor against the entity under any qualified financial

contract between the entity and the debtor are assigned to and assumed by the bridge company; and

“(4) all property securing or any other credit enhancement furnished by the debtor for any qualified financial contract described in paragraph (1) or any claim described in paragraph (2) or (3) under any qualified financial contract between the entity and the debtor is assigned to and assumed by the bridge company.

“(d) Section 365(b)(1) does not apply to a default under a qualified financial contract of the debtor that is assumed and assigned in a transfer under section 1186 if the default—

“(1) is a breach of a provision of the kind specified in section 1187(a)(1)(E);

“(2) in the case of a breach of a provision of the kind specified in section 1187(a)(1)(E)(iii), occurs while the bridge company is a direct or indirect beneficial holder of more than 50 percent of the equity securities of the affiliate.

“(e) Notwithstanding any provision in a qualified financial contract or in applicable nonbankruptcy law, a qualified financial contract of the debtor that is assumed or assigned in a transfer under section 1186 may not be terminated or modified, and any right or obligation under the qualified financial contract may not be terminated or modified, at any time after the entry of the order under section 1186 until such time as the special trustee is no longer the direct or indirect beneficial holder of more than 50 percent of the equity securities of the bridge company, solely because of a condition described in section 1187(b).

“(f) Notwithstanding any provision in any agreement or in applicable nonbankruptcy law, an agreement of an affiliate (including an executory contract, an unexpired lease, or an agreement under which the affiliate issued or is obligated for debt) and any right or obligation under such agreement may not be terminated or modified, at any time after the commencement of the case, solely because of a condition described in section 1187(b) if and only if—

“(1) all direct or indirect interests in the affiliate that are property of the estate are transferred under section 1186 to the bridge company within the period specified in subsection (a);

“(2) the bridge company assumes—

“(A) any guarantee or other credit enhancement issued by the debtor relating to the agreement of the affiliate; and

“(B) any right of setoff, netting arrangement, or debt of the debtor that directly arises out of or directly relates to the guarantee or credit enhancement; and

“(3) any property of the estate that directly serves as collateral for the guarantee

or credit enhancement is transferred to the bridge company.

#### “1189. Licenses, permits, and registrations

“(a) Notwithstanding any otherwise applicable nonbankruptcy law, if a request is made under section 1186 for a transfer of property of the estate, any Federal, State, or local license, permit, or registration that the debtor or an affiliate had immediately before the commencement of the case and that is proposed to be transferred under section 1186 may not be terminated or modified at any time after the request solely on account of—

“(1) the insolvency or financial condition of the debtor at any time before the closing of the case;

“(2) the commencement of a case under this title concerning the debtor; or

“(3) the appointment of or taking possession by a trustee in a case under this title concerning the debtor or by a custodian before the commencement of the case.

“(b) Notwithstanding any otherwise applicable nonbankruptcy law, any Federal, State, or local license, permit, or registration that the debtor had immediately before the commencement of the case that is included in a transfer under section 1186 shall vest in the bridge company.

#### “1190. Exemption from securities laws and special tax provisions

“(a) For purposes of section 1145, a security of the bridge company shall be deemed to be a security of a successor to the debtor under a plan if the court approves the disclosure statement for the plan as providing adequate information (as defined in section 1125(a)) about the bridge company and the security.

“(b) [Tax treatment to come.]

#### “1191. Inapplicability of certain avoiding powers

“Except with respect to a capital structure debt, a transfer made or an obligation incurred by the debtor, including any obligation released by the debtor or the estate, to or for the benefit of an affiliate in a transfer under section 1186 is not avoidable under section 544, 547, 548(a)(1)(B), or 549 or under any similar nonbankruptcy law.”.

### SEC. 4. AMENDMENTS TO TITLE 28, UNITED STATES CODE.

(a) Amendment to Chapter 13.—Chapter 11 of title 11, United States Code, is amended by adding at the end the following:

#### “SEC. 298. JUDGE FOR A CASE UNDER TITLE 11 CONCERNING A COVERED FINANCIAL CORPORATION.

“(a) Notwithstanding section 295, the Chief Justice of the United States shall

designate at least 1 district judge from each circuit to be available to hear a case under title 11 concerning a covered financial corporation.

“(b)(1) Notwithstanding section 295, and except as provided in section 157, a case under title 11 concerning a covered financial corporation shall be heard by a district judge who—

“(A) is the district judge designated under subsection (a) from the circuit in which the case is pending;

“(B) if more than 1 district judge has been designated under subsection (a) from the circuit in which the case is pending, is 1 such district judge who is designated by the chief judge of that circuit to hear the case; or

“(C) if none of the district judges designated under subsection (a) for the circuit in which the case is pending are immediately available, is designated under subsection (a) from another circuit by the Chief Justice of the United States.

“(2) If the district judge specified in paragraph (1) is not assigned to the district in which the case is filed, the district judge shall be temporarily assigned to the district.

“(3) The case and all proceedings in the case shall take place in the district where the case is pending.

“(c) Notwithstanding section 157, a district court may not refer a proceeding under section 1186 of title 11, except that the district judge assigned to the case under subsection (b) may appoint the bankruptcy judge to whom the case is assigned as a special master to assist the district judge in the proceeding.

“(d) An appeal under section 158(a) in a case under title 11 concerning a covered financial corporation shall be heard by the district judge assigned to the case under subsection (b).

“(e) In this section, the term ‘covered financial corporation’ has the meaning given that term in section 101(9A) of title 11.”.

(b) Amendment to Section 1334.—Section 1334 of title 28, United States Code, is amended by adding at the end the following:

“(f) This section does not grant jurisdiction to the district courts after a transfer pursuant to an order under section 1186 of title 11 of any proceeding related to a special trustee appointed, or to a bridge company formed, under section 1185 of title 11, and after a transfer pursuant to an order under section 1186 of title 11, the district courts in the district in which a case under title 11 concerning a covered financial corporation (as defined in section 101(9A) of title 11) is pending shall not have jurisdiction over the property held in trust by the special trustee or over the property of the bridge company.”.

(c) Technical and Conforming Amendment.—The table of sections for chapter 13 of

title 28, United States Code, is amended by adding at the end the following:

“298. Judge for a case under title 11 concerning a covered financial corporation.”.

## SEC. 5. DISCOUNT WINDOW FOR CASES UNDER SUBCHAPTER V OF CHAPTER 11 OF THE BANKRUPTCY CODE.

Section 13 of the Federal Reserve Act (12 U.S.C. 342 et seq.) is amended by adding at the end the following:

“(15) Advances to Covered Financial Corporations and Bridge Companies.—Subject to such restrictions, limitations, and regulations as the Board of Governors of the Federal Reserve System may prescribe, any Federal reserve bank may make advances to any covered financial corporation (as defined in section 101(9A) of title 11, United States Code) that is a debtor in a pending case under chapter 11 of title 11, United States Code, or to a bridge company (as defined in section 1182(2) of title 11, United States Code) during any period in which the special trustee appointed under section 1185 of title 11, United States Code, is the direct or indirect beneficial holder of more than 50 percent of the equity securities of the bridge company, in the same manner and to the same extent that the Federal reserve bank may make advances to a member bank, provided that—

“(A) the covered financial corporation or bridge company is solvent and in generally sound condition at the time of each advance;

“(B) each advance is secured to the satisfaction of the Federal reserve bank; and

“(C) the rate of interest on each advance is above the market rate of interest at the time of the advance, as determined by the Federal reserve bank.”.