ORDERLY LIQUIDATION AUTHORITY: A NEW INSOLVENCY REGIME TO ADDRESS SYSTEMIC RISK

Hollace T. Cohen *

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") was enacted on July 21, 2010.[1] A key element of the Dodd-Frank Act is Title II, entitled Orderly Liquidation Authority.[2] Title II of the Dodd-Frank Act is a new insolvency regime intended to end "too big to fail" bailouts by providing the United States government with the ability to appoint the Federal Deposit Insurance Corporation (the "FDIC") as receiver to administer the orderly liquidation of a nonbank financial company or bank holding company whose failure presents systemic risk to the financial stability of the United States.[3]

Title II of the Dodd-Frank Act creates a process for the liquidation of systemically important nonbank financial companies that are eligible to be debtors under the United States Bankruptcy Code[4] (the "Bankruptcy Code") that replaces the long-established

* Partner, Troutman Sanders LLP, New York, New York. J.D., New York University. Ms. Cohen's practice includes the representation of secured and unsecured creditors, including lenders, bondholders, indenture trustees, trade creditors, lessors and lessees of real and personal property, and acquirers of assets in bankruptcy cases and out-of-court restructurings. Ms. Cohen would like to thank Brett Goodman, who also practices at Troutman Sanders, for his assistance with this article and Richard Lieb for his insightful comments.

1. Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S.C.).

2. 12 U.S.C.A. §§ 5381–94 (West 2011).

3. *Id*. § 5384(a). The types of entities that may be subject to Title II include bank holding companies, investment banks, insurance companies, and registered securities broker-dealers. *See id*. § 5381(a)(7), (11), (13).

4. *See* 11 U.S.C. § 101-1532 (2006). Companies eligible to be debtors under § 109 of the Bankruptcy Code may be liquidated under Chapter 7, *id.* §§ 701–784, or reorganized or liquidated under Chapter 11 of the Bankruptcy Code, *id.* §§ 1101–1174. As discussed below, certain provisions of Title II also apply to the orderly liquidation of registered broker-dealers that are otherwise subject to liquidation under the Securities Investor Protection Act ("SIPA") and to insurance companies that are subject to applicable state insurance insolvency laws. *See infra* notes 46–52 and accompanying text.

means for the liquidation of such companies under Chapter 7 or Chapter 11 of the Bankruptcy Code.[5] As discussed herein, liquidation under Title II is a game changer for the creditors and equity security holders of the financial company, as well as for other interested parties and the covered financial company itself.[6] The rights of creditors, equity security holders, and counterparties of the covered financial company vary significantly from those under the Bankruptcy Code.[7] Because of the basic differences of the Title II regime as compared with the provisions of the Bankruptcy Code, those who enter into credit arrangements or other contractual relationships with a financial company should be aware that, if at some time in the future a determination is made to appoint the FDIC as receiver for the financial company, they will enjoy different, and in some cases substantially lesser, rights than if the liquidation were to proceed under the Bankruptcy Code.

Title II of the Dodd-Frank Act was enacted against the backdrop of, among other things, the events of September 2008, when the federal government faced concerns over the potential disruption of the stability of the United States financial system as a result of the financial condition of such institutions as Lehman Brothers Holdings Inc. ("Lehman"); its wholly owned broker-dealer subsidiary, Lehman Brothers, Inc. ("LBI"); and American International Group, Inc. ("AIG").[8] The United States government made the decision not to bail out either Lehman or LBI.[9] As a result, Lehman and certain of its subsidiaries commenced proceedings under Chapter 11 of the Bankruptcy Code on September 15, 2008,[10] and the Securities Investor Protection Corporation

5. *See* 11 U.S.C. §§ 701–784 (regarding Chapter 7 liquidation); *id.* §§ 1101–1174 (regarding Chapter 11 reorganization).

6. *See infra* Part II.

7. *See infra* Part VIII.

8. *See Examining the Causes of the Current Financial and Economic Crisis of the United States and of the Collapse of Lehman Brothers: Hearing Before the Financial Crisis Inquiry Commission* (2010) (statement of Harvey Miller, Senior Partner, Weil, Gotshal & Manges, LLP) [hereinafter Testimony of Harvey Miller]; CONG. OVERSIGHT PANEL, JUNE OVERSIGHT REPORT: THE AIG RESCUE, ITS IMPACT ON THE MARKETS, AND THE GOVERNMENT'S EXIT STRATEGY 7 (2010).

9. *See* Testimony of Harvey Miller, *supra* note 8, at 7. More than a year earlier, in June of 2007, the decision was made to bail out Bear Stearns & Co., Inc. and its broker-dealer subsidiary due to concerns over the effect that proceedings under existing insolvency regimes might have on the United States financial system. *Id.* at 17.

10. *Id.* at 2.

("SIPC") commenced a proceeding for the liquidation of LBI under the Securities Investor Protection Act ("SIPA")[11] on September 19, 2008.[12]

Conversely, only a few days after the filing of the Chapter 11 cases of Lehman and certain debtor affiliates (the "*Lehman Cases*"),[13] the United States government "bailed out" AIG because it was perceived as "too big to fail."[14] The United States government initially invested $80 billion in AIG and, in the end, a total of more than $100 billion through a loan from the Federal Reserve Bank of New York and funds provided by the United States Department of the Treasury (the "Treasury").[15] In return, the Treasury received more than ninety percent of the equity of AIG in the form of shares of AIG preferred stock that were convertible into AIG common stock.[16]

The filing of the Lehman Cases—followed shortly thereafter by the commencement of "approximately 80 insolvency proceedings affecting Lehman subsidiaries and affiliates . . . in 18 foreign countries"—had a profoundly disruptive effect on financial markets.[17] The crisis of confidence in United States financial markets resulted in illiquidity for many banks and other financial companies that were already suffering from significant potential losses with respect to, among other things, mortgage loans and securitized real estate investments. For example, on September 25, 2008, the Office of Thrift Supervision announced the seizure of the largest savings bank in the United States, Washington Mutual Bank.[18] Washington Mutual Bank was placed into FDIC re-

11. 15 U.S.C. § 78aaa–lll (2006).

12. Testimony of Harvey Miller, *supra* note 8, at 13–14.

13. Voluntary Petition, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2008), ECF No. 1.

14. *See* Testimony of Harvey Miller, *supra* note 8, at 16, 19.

15. *Id*. at 19.

16. Andrew R. Sorkin, *Breaking Even on A.I.G.*, N.Y. TIMES, Oct. 5, 2010, at B1. The Chief Restructuring Officer at the Treasury then projected that as a result of sales of assets and the conversion of AIG preferred stock issued into shares of AIG common stock, followed by sales of common stock over time, the federal government may ultimately recoup its entire investment in AIG. *Id*.

17. *See* Testimony of Harvey Miller, *supra* note 8, at 12–13. Additional United States subsidiaries and affiliates of Lehman filed for proceedings under Chapter 11 of the Bankruptcy Code after September 15, 2008. *See id*.

18. Press Release, Office of Thrift Supervision, Washington Mutual Acquired by JPMorgan Chase (Sept. 25, 2008) [hereinafter OTS Press Release]; *see also Examining the Causes of the Current Financial and Economic Crisis of the United States and of the Col-*

ceivership and then sold to JPMorgan Chase for approximately $1.9 billion.[19] Washington Mutual, Inc., the parent holding company of Washington Mutual Bank, then filed for proceedings under Chapter 11 of the Bankruptcy Code on September 26, 2008.[20]

Following the events of September 2008 that caused a downward turn in financial markets, the debt and equity markets also became concerned over the financial condition of Wachovia Corporation ("Wachovia").[21] As a result of Wachovia's inability to raise capital and impending loss of liquidity, Wachovia entered into discussions with Citigroup, Inc. ("Citigroup") and Wells Fargo & Company ("Wells Fargo") regarding a possible merger.[22] As noted by Robert Steel, the former Chief Executive Officer of Wachovia, "[T]he failure of those negotiations could have resulted in Wachovia filing for bankruptcy and the national bank being placed into FDIC receivership."[23] In fact, FDIC Chairman Sheila Bair confirmed to Steel that "Wachovia's [financial] situation posed a systemic risk to the banking system, and the FDIC was prepared to exercise its powers under Chapter 13 of the Federal Deposit Insurance Act[24] [the "FDIA"] to effect an open bank assisted transaction" with Citigroup.[25] However, shortly after Wachovia entered into an agreement in principle with Citigroup for the acquisition of the national bank, Wells Fargo reassessed the value of Wachovia and offered to acquire the shares of Wachovia's common stock for seven dollars per share, thereby obviating the

lapse of Lehman Brothers: Hearing Before the Financial Crisis Inquiry Commission (2010) (statement of Robert K. Steel, former CEO of Wachovia Corp.) [hereinafter Testimony of Robert Steel].

19. Testimony of Robert Steel, *supra* note 18; *see also* OTS Press Release, *supra* note 18, at 3.

20. Voluntary Petition, *In re* Washington Mutual, Inc., No. 08-12229 (Bankr. D. Del. Sept. 26, 2008), ECF No. 1; *see also* Dan Fitzpatrick & Robin Sidel, *Crisis on Wall Street: J.P. Morgan Sweeps WaMu Executive Suite—Many of Top Brass Will Leave Friday; Layoff News by Dec. 1*, WALL ST. J., Oct. 3, 2008, at C2.

21. *See* Sheila C. Bair, *Legislative Update: FDIC Chair Describes New Resolution Authority*, 29-8 AM. BANKR. INST. J. 10, 72 (2010) [hereinafter *Legislative Update*] ("[T]he rapidly deteriorating financial condition of both WaMu and Wachovia was in large part triggered by other high-profile failures, most notably the bankruptcy of Lehman Brothers.").

22. Testimony of Robert Steel, *supra* note 18, at 2–3.

23. *Id*. at 3. Wachovia was the parent of Wachovia Bank, N.A.

24. 12 U.S.C. §§ 1811–1835a (2006). Under § 1823 of the FDIA, the FDIC has the power to assist in the sale of assets of an insured depository institution to another insured depository institution. *Id*. § 1823(c).

25. Testimony of Robert Steel, *supra* note 18, at 4.

need for a transaction assisted by the FDIC.[26] On October 3, 2008, Wells Fargo announced its merger with Wachovia.[27]

Many other banks and nonbank financial companies were impacted by the financial crisis. To stem the financial crisis and bring stability to the financial system, Congress enacted the Troubled Asset Relief Program ("TARP") on October 3, 2008,[28] which allowed the Treasury to purchase or insure up to $700 billion of "troubled assets" of banks, bank holding companies, and auto companies.[29] Ultimately, $386.4 billion of the TARP funds were used to provide liquidity to numerous financial and automotive companies.[30]

Following these events, the prevailing perception of the public and certain regulators was that the use of federal funds to "bail out" systemically important financial companies in order to keep those companies from undermining the financial stability of the United States economy unfairly transferred the risk of the loans and equity interests of the creditors and shareholders of troubled financial companies to taxpayers.[31] Moreover, some expressed concerns that the expectation of bailouts of entities deemed "too big to fail" led to moral hazard.[32] Financial companies deemed

26. *See id*. at 4–5.

27. News Release, Wells Fargo, Wells Fargo, Wachovia Agree to Merge (Oct. 3, 2008), https://www.wellsfargo.com/press/2008/20081003_Wachovia; *see also* Testimony of Robert Steel, *supra* note 18, at 6.

28. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, §§ 101–136, 122 Stat. 3765, 3767–800 (codified as amended at 12 U.S.C. §§ 5211–41 (2006 & Supp. III 2009)).

29. *Id*. § 101(a)(1), 122 Stat. 3767 (codified as amended at 12 U.S.C. § 5211(a)(1)).

30. Deborah Soloman, *A Bank Bailout Some Won't Exit*, WALL ST. J., Sept. 30, 2010, at C1 (reporting that "of the $386.4 billion [of TARP funds] the Treasury invested, about $199 billion already had been repaid" and that the "Congressional Budget Office estimates that TARP will ultimately cost $66 billion, while the Treasury estimates about $105 billion"). According to some governmental officials, "the U.S. may ultimately make money on its AIG investment." *Id*. On the other hand, "[m]any of the 600 remaining banks [that received TARP funds] are still too weak to repay the U.S." *Id.*; *see also*, Randall Smith et al., *U.S.'s Citi Profit: $12 Billion—Treasury Sells Last of Common Shares from Bailout*, WALL ST. J., Dec. 7, 2010, at C1 (reporting that the federal government realized "a profit of $12 billion" on an investment of $45 billion through a public offering of the shares of common stock received by the federal government in connection with its loan to Citigroup).

31. *Establishing a Framework for Systemic Risk Regulation: Hearing Before the S. Comm. on Banking, Hous., & Urban Affairs,* 111th Cong. 13 (2009) (statement of Daniel Tarullo, Federal Reserve Board Governor) (testifying that allowing losses to be imposed on creditors and shareholders "is critical to addressing the too-big-to-fail problem and the resulting moral hazard effect"). This concern is reflected in the purposes of the orderly liquidation authority in § 5384(a). 12 U.S.C.A. § 5384(a) (West 2011). *See infra* Part I.

32. *Establishing a Framework for Systemic Risk Regulation: Hearing Before the S.*

"too big to fail" were believed to have a competitive advantage over other financial companies that were not viewed as systemically important in obtaining funding at a time of financial distress.[33]

Another prevalent view was that the insolvency regimes available to resolve large, complex, nonbank financial entities and bank holding companies were "not designed to protect the stability of the [United States] financial system."[34] The goal, therefore, was to enact legislation that would provide an alternative to federal bailouts and a mechanism for the orderly liquidation of systemically important financial companies under a new insolvency regime that would include many of the features of the FDIA, which applied exclusively to insured depositary institutions (i.e., banks and savings and loans companies).[35] While the FDIA allowed the FDIC to place insured depository institutions into receivership and provide for the orderly liquidation of their assets, there was no comparable statute for bank holding companies and nonbank financial companies that were as systemically significant as the banks and savings and loan companies subject to the FDIA.[36] Unlike insured depository institutions, insurance companies were subject to insolvency proceedings under state insurance insolvency laws, registered broker-dealers were subject to proceedings under SIPA, and other United States companies (including the parent holding company of one or more depository institutions and other nonbank financial companies) were eligible to be a debtor under the Bankruptcy Code.[37]

Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 6–7 (2009) (statement of Sheila Bair, Chairman, Federal Deposit Insurance Corporation) [hereinafter July 2009 Bair Statement].

33. *Id.* at 13 ("Large firms are able to raise huge amounts of debt and equity and are given access to the credit markets at favorable terms without consideration of the firm's risk profile. Investors and creditors believe their exposure is minimal since they also believe the government will not allow these firms to fail.").

34. *Regulating and Resolving Institutions Considered "Too Big to Fail": Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs,* 111th Cong. 52 (2009) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) [hereinafter May 2009 Bair Statement].

35. *Systemically Important Institutions and the Issue of "Too Big to Fail": Hearing Before the Financial Crisis Inquiry Commission* (2010) (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) [hereinafter 2010 Bair Statement].

36. *Id.* at 11–15.

37. *See* Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 64,173, 64,174 (proposed Oct. 19, 2010) (to be codified at 12 C.F.R. pt. 380).

Title II of the Dodd-Frank Act thus resulted from the perceived absence of any insolvency regime capable of handling the complexities of liquidating large nonbank financial companies and bank holding companies without adversely affecting the stability of the United States financial system. As described in the April 30, 2010 Report of the Senate Committee on Banking, Housing and Urban Affairs accompanying the predecessor bill to the Dodd-Frank Act:

> Title II establishes an orderly liquidation authority to give the U.S. Government a viable alternative to the undesirable choice it faced during the financial crisis between bankruptcy of a large, complex financial company that would disrupt markets and damage the economy, and bailout of such financial company that would expose taxpayers to losses and undermine market discipline.[38]

Title II of the Dodd-Frank Act provides an alternative regime to the Bankruptcy Code for "covered financial companies" that would otherwise be subject to the Bankruptcy Code.[39] It incorporates many of the powers of the FDIC found in §§ 11 and 13 of the FDIA[40] but also includes certain provisions of the Bankruptcy Code in order to provide certain rights afforded to creditors under the Bankruptcy Code.[41] Title II facilitates a regime which gives broad authority and discretion to the FDIC, as receiver, to accomplish the liquidation of the systemically significant financial company with minimal involvement or oversight by judicial au-

---

> These disparate insolvency regimes were found to be inadequate to effectively address the actual or potential failure of a financial company that could adversely affect economic conditions or financial stability in the United States. In such a case, financial support for the company sometimes was the only viable option available for the Federal government to avoid or mitigate serious adverse effects on economic conditions and financial stability that could result from the company's failure.

Id.

38. CHRISTOPHER DODD, THE RESTORING AMERICAN FINANCIAL STABILITY ACT OF 2010, S. REP. NO. 111-176, at 4 (2010).

39. *See infra* Part II for a discussion of the companies that may be subject to Title II of the Dodd-Frank Act.

40. 12 U.S.C. §§ 1821, 1823 (2006 & Supp. III 2009).

41. 12 U.S.C.A. § 5389 (West 2011) ("To the extent possible, the [FDIC] shall seek to harmonize applicable rules and regulations promulgated under this section with the insolvency laws that would otherwise apply to a covered financial company."). Under Title II, the FDIC may also be appointed a receiver of a "covered broker or dealer" or an "insurance company" that is determined to be a "covered financial company," so that rule-making must take into account the applicable insolvency regime whether that be the Bankruptcy Code, SIPA, or state insurance insolvency laws. *Id.* §§ 5383(e), 5389. The term "State" is defined in § 2(16) of the Dodd-Frank Act. *Id.* § 5301(16).

thorities. This is in stark contrast to proceedings under Chapter 11 or Chapter 7 of the Bankruptcy Code, which require judicial approval of transactions that are not in the ordinary course of business of the debtor, such as sales of assets and post-petition financing of a debtor's operations and administrative expenses.[42] Such matters require notice to creditors and other parties in interest and an opportunity for parties in interest to be heard.[43]

Because most systemically significant entities that might become subject to liquidation under Title II of the Dodd-Frank Act are entities that would otherwise be subject to the Bankruptcy Code, and because the rights of creditors are significantly more limited under the orderly liquidation authority, Title II requires that before the FDIC may be appointed as receiver of a financial company, a non-judicial evaluation be made as to why a case under the Bankruptcy Code is not appropriate for the financial company.[44] Once a determination is made by the Secretary of the Treasury (the "Secretary") and the FDIC is appointed as receiver of a covered financial company, any proceedings under the Bank-

42. 11 U.S.C. §§ 363(b), 364(b), (d) (2006). In a case under Chapter 7 of the Bankruptcy Code, a trustee will be responsible for the liquidation of the debtor; however, many large and complex cases that involve the liquidation of the debtor, including that of Enron Corp. and its affiliated debtors (the "*Enron Cases*") and the *Lehman Cases*, were commenced as proceedings for reorganization under Chapter 11 of the Bankruptcy Code. *See, In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2008), ECF No. 1; Voluntary Petition, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. Dec. 2, 2001), ECF No. 1. In both the Enron Cases and the Lehman Cases, the debtors remained in possession in proceedings under Chapter 11 even though assets were being liquidated and operations were being wound down. In *Enron*, the bankruptcy court confirmed the debtors' Fifth Amended Joint Plan of the Affiliated Debtors. Findings of Fact and Conclusions of Law Confirming Supplemental Modified Fifth Amended Joint Plan of Affiliated Debtors Pursuant to Chapter 11 of the United States Bankruptcy Code and Related Relief, *In re* Enron Corp., No. 01-16034 (Bankr. S.D.N.Y. July 15, 2004). Unsecured creditors in those cases have benefitted from the appointment of a committee of unsecured creditors that represents the interests of unsecured creditors in such cases. 11 U.S.C. § 1102(a)(1). The creditors' committee is empowered under § 1103 of the Bankruptcy Code to, among other things, "consult with the trustee or debtor in possession concerning the administration of the case, investigate the acts, conduct, assets, liabilities, and financial condition of the debtor [and] the operation of the debtor's business, . . . [and] participate in the formulation of a plan [of reorganization or liquidation]." *Id.* § 1103(c)(1)–(3). The unsecured creditors' committee has the right to be heard on all matters in a case under Chapter 11. *Id.* § 1109.

43. 11 U.S.C. §§ 363(b), 364(b), (d) (2006).

44. *See* 12 U.S.C.A. § 5383(a)(2)(F) (West 2011) (setting forth one of the matters to be covered in the written recommendation required in connection with the determination by the Secretary of the Treasury to seek the appointment of the FDIC as receiver of a covered financial company). It would appear that such criterion would not apply to a registered broker or dealer or an insurance company since those entities may not be a debtor under the Bankruptcy Code.

ruptcy Code will be dismissed and none may be commenced during the pendency of receivership under Title II.[45]

Title II also contains provisions concerning the FDIC's appointment as receiver of a covered financial company that is a covered broker or dealer that would be subject to SIPA[46] or an insurance company that would be subject to state insurance insolvency laws.[47] However, in the case of a covered broker or dealer or an insurance company, Title II does not completely supplant the existing insolvency regime or the authority of the governmental entity charged with the oversight of such entities. For example, in the case of a covered broker or dealer, Title II contains provisions relating to the role of the FDIC as receiver,[48] the appointment of SIPC as trustee (rather than an individual from the private sector),[49] and modifications of and amendments to discrete provisions of SIPA and of the Bankruptcy Code that are incorporated by reference under SIPA.[50]

The role of the FDIC as receiver is more limited in the case of the liquidation of a covered financial company that is an insurance company. The appropriate regulator under applicable state law, rather than by the FDIC, will carry out the liquidation of an insurance company determined to be a covered financial company

45. *Id.* § 5388(a). For a discussion concerning the determination required for the appointment of the FDIC as receiver under § 5383, see *infra* Part III.

46. 12 U.S.C.A. § 5381(a)(7) (defining a "covered broker or dealer" as a "covered financial company that is a broker or dealer that (A) is registered with the [SEC] under section [15(b) of the Securities Exchange Act of 1934] and (B) is a member of SIPC").

47. *Id.* § 5381(a)(13) (defining "insurance company" as "any entity that is (A) engaged in the business of insurance; (B) subject to regulation by a State insurance regulator; and (C) covered by a State law that is designed to specifically deal with the rehabilitation, liquidation, or insolvency of an insurance company").

48. *See, e.g., id.* § 5385(b).

49. *Id.* § 5385(a).

50. *See, e.g.*, *id.* § 5385(b)(1) ("SIPC shall have no powers or duties with respect and liabilities transferred by the [FDIC] from the covered broker or dealer to any bridge financial company established in accordance with this title."); *id.* § 5385(b)(2) (limiting powers of SIPC, as trustee, so as not to impair or impede exercise of certain powers and duties of the FDIC, as receiver). "To the extent consistent with [SIPA], a liquidation proceeding [under SIPA] shall be conducted in accordance with . . . [the provisions] of chapters 1, 3, and 5 and subchapters I and II of chapter 7 of [the Bankruptcy Code]." 15 U.S.C. § 78fff (2006). Notwithstanding that fact, the provisions of Title II with respect to qualified financial contracts (as defined in 12 U.S.C.A. § 5390(c)(8)) will be governed by 12 U.S.C.A. § 5390, including those relating to the right of the FDIC to repudiate and transfer qualified financial contracts under § 5390(c), rather than the comparable provisions of the Bankruptcy Code. 12 U.S.C.A. § 5385(b)(4). The priorities under § 5390(b) of Title II, rather than § 726 of the Bankruptcy Code, will apply to certain claims. *See id.* § 5385(g)(2).

unless such state regulator does not file the appropriate judicial action under state law within sixty days after designation of the insurance company or its parent as a covered financial company.[51] In such case, the FDIC has "the authority to stand in the place of" the State regulator and "file the appropriate judicial action to place [the insurance] company into orderly liquidation under" applicable state law.[52]

Since most financial companies to which Title II applies would otherwise be eligible debtors under the Bankruptcy Code, and since Title II provides a comprehensive alternative insolvency regime for such entities, this article does not consider the modifications effected by Title II to a SIPA liquidation or an insurance company insolvency proceeding under state law. Instead, this article focuses on the provisions of Title II applicable to covered financial companies that would otherwise be eligible for liquidation under the Bankruptcy Code.

This article summarizes various key provisions of Title II, including determining which entities may become a covered financial company, the procedures for the appointment of the FDIC as receiver of a covered financial company, the powers and duties of the FDIC as receiver, procedures for determining creditor claims, the priority of distributions, and the manner in which the liquidation of a covered financial company will be funded. This article also considers the potential impact on creditors and other stakeholders of the broad powers and duties of the FDIC as receiver and how certain rights, protections, and priorities afforded to creditors and other stakeholders under Title II of the Dodd-Frank Act differ from the rights, protections, and priorities provided to creditors and other stakeholders under the Bankruptcy Code. This latter comparison is significant to creditors of, and counterparties to contracts with, financial companies that now may be subject to Title II, since those entities entered into agreements with financial companies prior to the enactment of Title II based upon their expectation that their rights would be determined under the Bankruptcy Code and the well-developed body of case law concerning its provisions. It is also important for those entities that will contract with systemically important nonbank financial companies in the future to consider the potential impact that a

51. 12 U.S.C.A. § 5383(e).
52. *Id.*

receivership under Title II would have on their rights as creditors or counterparties of a covered financial company.

One of the challenging aspects of considering the potential impact of Title II on creditors and other stakeholders of nonbank financial companies that are eligible to be a debtor under the Bankruptcy Code is that many provisions of Title II are subject to the enactment of rules and regulations that are necessary for implementing and clarifying its terms.[53] Since most of those regulations have yet to be promulgated, the impact of Title II on creditors and other stakeholders will continue to evolve. It is possible that many regulations may further "harmonize" certain provisions of Title II with the provisions of the Bankruptcy Code. It is also possible that the very significant differences between the provisions of Title II and those of the Bankruptcy Code will cause creditors of nonbank financial companies that face future financial crises to be more amenable to finding private sector alternatives, including restructuring of debt and consent to sales of assets, in order to avoid the uncertainties posed by this new and as yet untested insolvency regime.

53. *Id.* § 5389 (granting authority to the FDIC in consultation with the Financial Stability Oversight Council (the "Council"), formed pursuant to Title I of the Dodd-Frank Act, to "prescribe such rules and regulations as the [FDIC] considers necessary or appropriate to implement this [title], including rules and regulations with respect to the rights, interests, and priorities of creditors, counterparties, security entitlement holders, or other persons with respect to any covered financial company or any assets or other property of or held by such covered financial company, and address the potential for conflicts of interest between or among individual receiverships established under this [title] or under the Federal Deposit Insurance Act"). There are numerous instances in which the provisions of Title II call for regulations. For example, the definition of what constitutes a "financial company" under § 5381(a)(11) is dependent upon regulations to be proposed by the FDIC in consultation with the Secretary. *Id.* § 5381(a)(11), (b). In addition, § 5385(h) grants joint authority to the FDIC and the Securities and Exchange Commission (the "SEC"), after consultation with SIPC, to issue rules to implement § 5385. *Id.* § 5385(a)–(b), (h); *see also* Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 64,173, 64,179–80 (proposed Oct. 19, 2010) (to be codified at 12 C.F.R. pt. 380) (requesting not only comments to Proposed Rule 380 but also answers to questions seeking to identify topics where additional regulations would be necessary). The FDIC issued an interim final rule (the "Interim Final Rule") that made certain modifications to Proposed Rule 380, posed questions and sought comment with respect to certain aspects of the Interim Final Rule. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4214 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380). Additions to Proposed Rule 380 are set forth in Orderly Liquidation Authority, 76 Fed. Reg. 16,324–45 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

I. THE PURPOSE OF THE ORDERLY LIQUIDATION AUTHORITY FOR COVERED FINANCIAL COMPANIES

Section 5384(a) outlines the purpose of the orderly liquidation authority originally enacted in the Dodd-Frank Act as follows: "to provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard."[54]

Section 5384 further indicates that the authority provided in Title II is to

> be exercised in the manner that best fulfills such purpose, so that—
>
> (1) creditors and shareholders will bear the losses of the financial company;
> (2) management responsible for the condition of the financial company will not be retained; and
> (3) the [FDIC] and other appropriate agencies will take all steps necessary and appropriate to assure that all parties, including management, directors, and third parties, having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution, and recoupment of compensation and other gains not compatible with such responsibility.[55]

As discussed below, these purposes are evident in many of the provisions of Title II of the Dodd-Frank Act. Section 5386, entitled Mandatory Terms and Conditions for all Orderly Liquidation Actions, as if to hammer home those concepts, seeks to assure consistency between the actions of the FDIC and the stated objectives in § 5384.[56] Section 5386 requires that the FDIC, in taking action under Title II, "determine that such action is necessary for purposes of the financial stability of the United States, and not for the purpose of preserving the covered financial company."[57] Section 5386 further provides that (i) shareholders are not to receive payment until all "other claims" and the orderly liquidation fund[58] (which may provide funding for the liquidation)

54. 12 U.S.C.A. § 5384(a).

55. *Id.* § 5384(a)(1)–(3).

56. *See id.* § 5386(1).

57. *Id.* Unlike Chapter 11 of the Bankruptcy Code, which seeks to foster the reorganization of a company in distress, this provision makes clear that United States financial stability is the primary goal of Title II of the Dodd-Frank Act. *Id.*

58. Section 5390(n)(1) provides for the establishment in the Treasury of a separate

are fully paid, (ii) unsecured creditors bear losses in accordance with priorities established under § 5390,[59] (iii) management and members of the board of directors (or body performing similar functions) "responsible for the failed condition of the covered financial company" are to be removed,[60] and (iv) the FDIC is not to "take an equity interest in or become a shareholder of any covered financial company or any covered subsidiary."[61]

II. COMPANIES THAT MAY BE SUBJECT TO TITLE II OF THE DODD-FRANK ACT

Companies that may be subject to Title II of the Dodd-Frank Act are limited to financial companies whose failure may pose systemic risk by virtue of their size and the nature of their business.[62] Such determination is made by the Secretary in consultation with the President of the United States[63] (the "President") based on criteria that, for the most part, are not subject to judicial review.[64] In the case of a nonbank financial company that is

fund (the "Orderly Liquidation Fund"), which is to be "available to the [FDIC] to carry out the authorities" given the FDIC under Title II. *Id.* § 5390(n)(1). The fund is to be used for "the cost of actions authorized by" Title II, including the cost of the orderly liquidation, "payment of administrative expenses, and payment of principal and interest" on obligations issued by the FDIC to the Secretary, "and the exercise of the authorities of the [FDIC] under [Title II]." *Id.* Section 5394 provides that no taxpayer funds are to be used to prevent liquidation of any financial company, funds expended in the liquidation of a financial company are to be recovered from disposition of assets or shall be the responsibility of the financial sector through assessments, and taxpayers are to bear no losses from the exercise of the liquidation authority. *Id.* § 5394(a)–(c).

59. Under § 5390(b)(1), any amounts owed to the United States are second in priority after the administrative expenses of the receiver, "unless the United States agrees or consents otherwise." *Id.* § 5390(b)(1)(A)–(B).

60. *Id.* § 5386(4).

61. *Id.* § 5386(6). Thus, under Title II, the assistance of the federal government in effecting the orderly liquidation is limited to debt financing from the Treasury. The inability of the FDIC to take "equity" is consistent with the preamble of the Dodd-Frank Act which states that the Act is "to protect the American taxpayer by ending bailouts." Dodd-Frank Wall Street Reform and Consumer Protector Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified at 12 U.S.C. § 5301). As noted above, in the "bailouts" of AIG, Citigroup, and other financial companies, the United States government received preferred and/or common equity in return for taxpayer funds, and taxpayers, rather than the creditors and stockholders of those companies, bore the primary risk of repayment. *See supra* notes 16, 30. Of course, the issuance of equity to the United States government had a substantial dilutive effect on the equity of the bailed-out companies. No such investment is permitted under the Dodd-Frank Act. 12 U.S.C.A. § 5386(6).

62. *See* 12 U.S.C.A. § 5383(a)(2).

63. *Id.* § 5383(b).

64. *Id.* § 5383(b)(1)–(7); *see infra* Part III.C.

eligible to be a debtor under the Bankruptcy Code, the Secretary's determination is preceded by a recommendation of the FDIC and the Federal Reserve Board (the "FRB").[65] Eligibility to be classified as a covered financial company is dependent upon the nonbank financial company satisfying the definition of "financial company" in § 5381(a)(11), which provides that

> The term "financial company" means any company that—
>
> (A) is incorporated or organized under any provision of Federal law or the laws of any State;
>
> (B) is—
>
> (i) a bank holding company, as defined in [section 2(a) of the Bank Holding Company Act of 1956],[66] and
>
> (ii) a nonbank financial company supervised by the Board of Governors [of the Federal Reserve System];[67]
>
> (iii) any company that is predominantly engaged in activities that the [FRB] has determined are financial in nature or incidental thereto for purposes of [section 4(k) of the Bank Holding Company Act], other than a company described in clause (i) or (ii) [68] or

65. *Id*. § 5383(a)(1)(A)–(B).

66. 12 U.S.C. § 1841(a) (2006). Section 2(a) of the Bank Holding Company Act (the "BHCA") provides that a bank holding company includes "any company which has control over any bank or over any company that is or becomes a bank holding company" under the BHCA. *Id*. § 1841(a)(1). A company

> has control over a bank or over any company if [it] (A) . . . directly or indirectly . . . has power to vote 25 per centum or more of any class of voting securities of the bank or company; (B) . . . controls in any manner the election of a majority of the directors or trustees of the bank or company; or (C) the [FRB] determines, after notice and opportunity [to be heard], that the company directly or indirectly exercises a controlling influence over the management or policies of the bank or company.

Id. § 1841(a)(2).

67. Section 5352 of the Dodd-Frank Act indicates that the Council (established by § 5321) may determine which "U.S. nonbank financial companies" are to be (i) supervised by the FRB and (ii) subject to prudential standards based upon the Council's determination "that material financial distress at the U.S. nonbank financial company or the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the U.S. nonbank financial company could pose a threat to the stability of the United States." 12 U.S.C.A. § 5323(a)(1). As noted above, these may include investment banks (subject to the Bankruptcy Code), insurance companies (subject to state insurance company insolvency laws) or registered securities brokers or dealers (subject to SIPA). *See supra* notes 46–47 and accompanying text; *see also* 12 U.S.C.A. § 5311(a)(4)(B) (defining "U.S. nonbank financial company"); *id.* § 5311(a)(4)(D) (defining "nonbank financial company supervised by the FRB").

68. Under the Dodd-Frank Act, the term "predominately engaged in financial activities" means that either the gross annual revenues (on a consolidated basis) from activities that are "financial in nature" represent at least eighty-five percent of its consolidated gross revenues or eighty-five percent of its consolidated gross assets. 12 U.S.C.A. § 5311(a)(6). The BHCA defines "financial in nature" as including "lending, exchanging, . . .

> (iv) a subsidiary of any of the foregoing that is predominantly engaged in activities that the Board of Governors has determined are financial in nature or incidental thereto for purpose of [section 4(k) of the Bank Holding Company Act] (other than a subsidiary that is an insured depository institution or an insurance company).[69]

A farm credit system institution chartered under and subject to the Farm Credit Act of 1971, as amended, and any federal home loan bank, Freddie Mac, and Fannie Mae are expressly excluded from the definition of a financial company.[70]

Section 5381(b) further provides that:

> [f]or [the] purpose of the definition of the term "financial company" under subsection (a)(11), no company shall be deemed to be predominantly engaged in activities that the [FRB] has determined are financial in nature or incidental thereto for purposes of section [4(k) of the Bank Holding Company Act], if the consolidated revenues of such company from such activities constitute less than 85 percent of the total consolidated revenues of such company, as the [FDIC] in consultation with the Secretary, shall establish by regulation. In determining whether a company is a financial company, under [Title II], the consolidated revenues derived from the ownership or control of a depository institution shall be included.[71]

A "covered financial company" is defined as "a financial company for which a determination has been made under section 5383(b), and . . . does not include an insured depository institution,"[72] which would be subject to the insolvency regime under the FDIA.[73]

investing, . . . or safeguarding money or securities[;] [i]nsuring, guaranteeing, or indemnifying against loss, . . . providing, and issuing annuities[;] . . . [p]roviding financial [and] investment services; . . . issuing or selling instruments representing pools of assets permissible for a bank to hold directly[;] [u]nderwriting, dealing in, or making a market in securities." 12 U.S.C. § 1843(k)(4)(A)–(E) (2006).

69. 12 U.S.C.A. § 5381(a)(11)(B). Proposed Rule section 380.8 establishes standards for determining if a company is "predominately engaged in financial activities." Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,338–39 (Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

70. 12 U.S.C.A. § 5381(a)(11)(C).

71. *Id.* § 5381(b). Proposed Rule section 380.8 would apply a "two year test" for determining whether a financial company meets the "less than 85 percent of total consolidated revenues" requirement, defines "total consolidated revenues," and defines "financial activity" to broaden its scope for the purpose of such determination. Orderly Liquidation Authority, 76 Fed. Reg. at 16,338-39.

72. *Id.* § 5381(a)(8)(A)–(B).

73. 12 U.S.C. § 1814.

III. SYSTEMIC RISK DETERMINATION REQUIRED FOR THE APPOINTMENT OF THE FDIC AS RECEIVER OF A COVERED FINANCIAL COMPANY

The appointment of the FDIC as receiver of a "covered financial company" is a multiphase process. Section 5383 sets forth the elements for the recommendation and the vote required for a determination by the Secretary, in consultation with the President, that the FDIC should be appointed as receiver of a financial company.[74] The first step of this process is based on a recommendation by specifically designated entities, in the case of a determination to appoint the FDIC as receiver of a financial company, a covered broker or dealer, or an insurance company.[75]

A. *Vote and Recommendation Required*

"On their own initiative, or at the request of the Secretary, the [FDIC] and the [FRB]" may, upon a two-thirds vote of the members of the respective boards of the FDIC and the FRB, make a recommendation as to "whether the Secretary should appoint the [FDIC] as receiver for a financial company" that is neither a covered broker or dealer nor an insurance company.[76]

Section 5383(a)(2) requires that the recommendation contain:

> (A) an evaluation of whether the financial company is in default or in danger of default;
> (B) a description of the effect that the default of the financial company would have on financial stability in the United States;
> (C) a description of the effect that the default of the financial company would have on economic conditions or financial stability for low income, minority, or underserved communities;
> (D) a recommendation regarding the nature and the extent of actions

74. *Id.* § 5383(a)–(b).

75. *Id.* § 5383(a)(1).

76. *Id.* In the case that the financial company or its "largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter)" is a covered broker or dealer, the SEC and the FRB, "at the request of the Secretary, or on their own initiative" may make a recommendation upon a vote of at least two-thirds of the members of the FRB then sitting and of the commissioners of the SEC then serving and in consultation with the FDIC. *Id.* § 5383(a)(1)(B). If the financial company is an insurance company or its "largest United States subsidiary (as measured by total assets as of the end of the previous calendar quarter)" is an insurance company, the designation must be approved by the Director of the Federal Insurance Office (formed pursuant to the Dodd-Frank Act) and at least two-thirds of the members of the FRB and in consultation with the FDIC. *Id.* § 5383(a)(1)(C).

> to be taken under [Title II] regarding the financial company;
> (E) an evaluation of the likelihood of a private sector alternative to prevent the default of the financial company;
> (F) an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial company;
> (G) an evaluation of the effects on creditors, counterparties, and shareholders of the financial company and other market participants; and
> (H) an evaluation of whether the company satisfies the definition of a financial company . . . .[77]

The requirements in subparagraphs (E), (F), and (G) that the FDIC and the FRB consider whether a private sector alternative could prevent default, evaluate why a case under the Bankruptcy Code would not be appropriate, and assess the impact of Title II on creditors and other stakeholders as well as other market participants[78] indicates an awareness that proceedings under Title II, rather than the Bankruptcy Code, may have negative consequences for creditors and other stakeholders and that a receivership under Title II should only be recommended after consideration of those factors.

B. *Determination by the Secretary*

Upon such recommendation and vote, the Secretary, in consultation with the President, may determine to appoint the FDIC as receiver, if the Secretary determines that the following criteria are met:

> (1) the financial company is in default or in danger of default;
> (2) the failure of the financial company and its resolution under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States;
> (3) no viable private sector alternative is available to prevent the default of the financial company;
> (4) any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants as a result of actions to be taken under [Title II] is appropriate, given the impact that any action taken under [Title II] would have on financial stability in the United States;
> (5) any action under section [5384] would avoid or mitigate such adverse effects, taking into consideration the effectiveness of the action in mitigating potential adverse effects on the financial system, the

77. *Id.* § 5383(a)(2)(A)–(H).
78. *Id.* § 5383(a)(2)(E)–(G).

> cost to the general fund of the Treasury, and the potential to increase excessive risk taking on the part of creditors, counterparties, and shareholders in the financial company;
> (6) a Federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments that are subject to the regulatory order; and
> (7) the company satisfies the definition of a financial company under section [5381].[79]

Section 5383(c)(4) provides that, for the purposes of Title II, a financial company is considered to be "in default or in danger of default" if, as determined in accordance with § 5383(b):

> (A) a case has been, or likely will promptly be, commenced with respect to the financial company under the Bankruptcy Code;
> (B) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion;
> (C) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or
> (D) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.[80]

The differences between the recommendation to the Secretary under § 5383(a)(2) and the "determination" of the Secretary under § 5383(b) indicate that a higher level of scrutiny is required by the Secretary to reach such determination.[81] While § 5383(a)(2)(C) calls for "a description of the effect that the default of the financial company would have on financial stability,"[82] the Secretary must determine that the "resolution of the financial company under otherwise applicable Federal or State law would have serious adverse effects on financial stability in the United States."[83] Similarly, while § 5383(a)(2)(G) calls for "an evaluation of the effects on creditors, counterparties, and shareholders of the financial

79. *Id.* § 5383(b). While these criteria are joined by the word "and," it is by no means clear that each and every one of these criteria would have to be met. *See id.*

80. *Id.* § 5383(c)(4). Since the term "in default or in danger of default" is used both in the recommendation by the applicable regulatory agency under section 5383(a) and the determination by the Secretary under section 5383(b), it is curious that the term itself refers only to "as determined in accordance with subsection (b) [of section 5383]." *See id.* § 5383(a)–(b).

81. *Compare id.* § 5383(a)(2) (detailing the required components of a written recommendation of the FDIC and FRB to the Secretary), *with id.* § 5383(b) (detailing factors to be considered by the Secretary in making the determination of whether to appoint the FDIC as receiver for a financial company).

82. *Id.* § 5383(a)(2)(C).

83. *Id.* § 5383(b)(2).

company and other market participants,"[84] § 5383(b)(4) requires the determination that "any effect on the claims or interests of creditors, counterparties, and shareholders of the financial company and other market participants *as a result of actions to be taken* under [Title II] is appropriate, given the impact [such actions] would have on financial stability in the United States."[85] Inherent in this evaluation is an acknowledgement that concerns for the financial stability of the United States economy take precedence over the effect Title II may have upon the rights and interests of creditors and other stakeholders that would otherwise apply in a case under the Bankruptcy Code.

C. *Notification of Determination and Judicial Review*

Once the Secretary determines to appoint the FDIC as receiver of the covered financial company, the Secretary must notify the covered financial company and the FDIC of such determination.[86] The Secretary will appoint the FDIC as receiver "if the board of directors (or body performing similar functions) of the covered financial company acquiesces or consents to the appointment of the [FDIC] as receiver."[87] Section 5387 protects members of the board of directors (or other body performing similar functions) of a covered financial company by providing that they will not be liable to shareholders or creditors of the financial company for acquiescing or consenting in good faith to the appointment of the FDIC as receiver.[88]

"If the [members of the] board of directors (or body performing similar functions) of the covered financial company [do] not acquiesce or consent to [such appointment] . . . ," the Secretary will file with the United States District Court for the District of Columbia (the "District Court") a petition seeking an order authorizing the Secretary to appoint the FDIC as receiver.[89] The petition is filed under seal,[90] and the financial company is provided confi-

84. *Id.* § 5383(a)(2)(G).
85. *Id.* § 5383(b)(4) (emphasis added).
86. *See id.* § 5383(c)(1)(C); *id.* § 5382(a)(1)(A)(i).
87. *Id.* § 5382(a)(1)(A)(i).
88. *Id.* § 5387.
89. *Id.* § 5382(a)(1)(A)(i).
90. *Id.* § 5382(a)(1)(A)(ii).

dential notice and opportunity for a confidential hearing before the District Court.[91]

While the Secretary is to present to the District Court all relevant findings and the recommendation made pursuant to § 5381(a)(11), the scope of the District Court's review is limited to whether the Secretary's determination that the "covered financial company is in default or in danger of default and satisfies the definition of a financial company" is "arbitrary and capricious."[92] If the District Court concludes that the Secretary's determination of these two requirements is not arbitrary and capricious, it is to "issue an order immediately authorizing the Secretary to appoint the [FDIC] as receiver of the covered financial company."[93] If the District Court finds that such determination of the Secretary is arbitrary and capricious, the District Court must provide a "statement of each reason supporting [the District Court's] determination and afford the Secretary an immediate opportunity to amend and refile the petition" for the appointment of the FDIC as receiver of the financial company.[94] If twenty-four hours pass after receipt of the petition without any decision being rendered by the District Court, the petition will be granted by operation of law, the FDIC will be appointed as receiver, and liquidation under Title II will commence without further notice or action.[95]

The United States Court of Appeals for the District of Columbia (the "Court of Appeals") has jurisdiction for an expedited ap-

---

91. *Id.* § 5382(a)(1)(A)(iii).

92. *Id.*

93. *Id.* § 5382(a)(1)(A)(iv).

94. *Id.* § 5382(a)(1)(A)(iv)(II).

> Not later than 24 hours after the appointment of the [FDIC]as receiver for a covered financial company, the Secretary shall provide written notice of the recommendations and determinations . . . to the Majority Leader and Minority Leader of the Senate and the Speaker and the Minority Leader of the House of Representatives, the Committee on Banking, Housing, and Urban Affairs of the Senate, and the Committee on Financial Services of the House of Representatives.

Id. § 5383(c)(2). Other reports concerning the progress of the orderly liquidation are required to be made to the United States Congress and the public within sixty days after the appointment of the FDIC as receiver and not less than quarterly thereafter. *Id.* § 5383(c)(3)(A)–(B).

95. *Id.* § 5382(a)(1)(A)(v). "The District Court shall establish such rules and procedures as may be necessary to ensure the orderly conduct of proceedings, rules and procedures including to ensure that the twenty-four hour deadline is met and that the Secretary [is given] an ongoing opportunity to amend and refile petitions under subsection (a)(1)." *Id.* § 5382(b)(1).

peal of the District Court's decision filed by either the Secretary or the financial company within thirty days of the decision of the District Court, but the District Court's decision is final and will not be subject to any stay or injunction pending appeal.[96] The Court of Appeal's scope of review is the same as that of the District Court.[97]

Upon the filing of a petition for writ of certiorari within thirty days of the decision of the Court of Appeals, the Supreme Court of the United States has discretionary jurisdiction to review the decision of the Court of Appeals on an expedited basis, and the scope of review is similarly limited to that of the District Court and the Court of Appeals.[98] The orderly liquidation under Title II will continue during the pendency of any appeals.[99]

Section 5388(a) provides that, upon the appointment of the FDIC as receiver, not only will any pending bankruptcy proceeding with respect to a covered financial company will be dismissed upon notice to the bankruptcy court but also "no such case or proceeding may be commenced with respect to a covered financial company at any time while the orderly liquidation is pending."[100] Section 5388(b) provides for the revesting of assets of a covered financial company that have vested in any other entity as a result of any case under the Bankruptcy Code,[101] provided that "any order entered or other relief granted by a bankruptcy court prior to the date of appointment of the [FDIC] as receiver [is to have] the same validity as if an orderly liquidation had not been commenced."[102]

96. *Id.* § 5382(a)(1)(B), (a)(2)(A).

97. *See id.* § 5382(a)(2)(A)(iv).

98. *Id.* § 5382(a)(2)(B).

99. *Id.* § 5382(a)(1)(B) ("The decision [of the District Court] shall not be subject to any stay or injunction pending appeal.").

100. *Id.* § 5388(a).

101. *Id.* § 5388(b).

102. *Id.* § 5388(c). This suggests that any sale orders or financing orders entered in a case pending under the Bankruptcy Code prior to entry of an order appointing the FDIC as receiver should be given the same effect as such orders would have under the Bankruptcy Code. It is possible, depending on the language of a debtor in possession financing order, that the FDIC might argue that any superpriority claims granted to a debtor in possession lender (the "DIP Lender") should rank junior to the receiver's administrative expenses and amounts owed to the United States. *See id.* § 5390(b)(1)(A), (B). On the other hand, if the FDIC were to determine to enforce the credit agreement with the DIP Lender as a contract to extend credit, then any valid and enforceable obligation to repay such debt would be entitled to administrative priority treatment. *See id.* § 5390(c)(13)(D). Moreover,

There is no apparent limitation on how long after a case under Chapter 7 or 11 of the Bankruptcy Code is commenced a determination to appoint the FDIC as receiver under Title II may be made. However, as a practical matter, a recommendation and determination likely will be made under § 5383 at the outset of a case under the Bankruptcy Code because whether or not a financial company is systemically important should be evident at that time.

IV. APPOINTMENT OF FDIC AS RECEIVER OF A FAILING COVERED SUBSIDIARY

Once the FDIC has been appointed as receiver of a covered financial company, the FDIC and the Secretary are given authority to appoint the FDIC as receiver of any failing "covered subsidiary of the covered financial company."[103] Section 5381(a)(9) defines "covered subsidiary" as "a subsidiary of a covered financial company, other than (A) an insured depository institution;[104] (B) an insurance company;[105] or (C) a covered broker or dealer.[106] Subsection (a)(1)(E)(i) of § 5390 provides that:

> In any case in which a receiver is appointed for a covered financial company under section [5382], the [FDIC] may appoint itself as receiver of any covered subsidiary of the covered financial company that is organized under Federal law or the laws of any State, if the [FDIC] and the Secretary jointly determine that—
>
> (I)the covered subsidiary is in default or in danger of default;
>
> (II) such action would avoid or mitigate serious adverse effects on the financial stability or economic conditions of the United States; and

if the debtor in possession financing is secured, then the secured claims would not be subordinate to those of the FDIC, since secured claims, to the extent of the value of the collateral, are to be unaffected by the provisions of the Title II concerning priority of claims. *Id.* § 5390(b)(5); *see also id.* § 5390(b)(1) (outlining the order of priority for unsecured claims).

103. *See id.* § 5390(a)(1)(E)(i).

104. An insured depository institution is subject to the FDIA. 12 U.S.C. § 1811 (2006).

105. Section 5383(e), entitled treatment of insurance companies and insurance company subsidiaries, provides that "if an insurance company is a covered financial company or a subsidiary or affiliate of a covered financial company, the liquidation or rehabilitation of such insurance company, and any subsidiary or affiliate of such company [that is an insurance company is to] be conducted as provided under applicable State law." 12 U.S.C.A. § 5383(e).

106. *Id.* § 5381(a)(9)(C). The orderly liquidation of a covered broker or dealer would be governed by the provisions of *id.* § 5385.

> (III) such action would facilitate the orderly liquidation of the covered financial company.[107]

Therefore, once the FDIC is appointed as receiver of a covered financial company, the FDIC, in consultation with the Secretary, has broad discretion to place any entity that is a covered subsidiary of a financial company that meets these three criteria into liquidation under the Dodd-Frank Act without seeking the consent of the board of directors (or other similar body) of the subsidiary or obtaining the District Court order required with respect to covered financial companies. Section 5390(a)(1)(E)(ii) provides that if the FDIC is appointed as receiver of a covered subsidiary, "the covered subsidiary shall thereafter be considered a covered financial company . . . and the [FDIC] shall thereafter have all the powers and rights with respect to that covered subsidiary as [the FDIC] has with respect to a covered financial company . . . ."[108]

The discretion given to the FDIC to extend its authority to a failing subsidiary of a covered financial company is significant to creditors and counterparties of systemically important subsidiaries of financial companies since such creditors' and counterparties' rights may become subject to the provisions of Title II as well, even though the covered subsidiary itself might not qualify as a covered financial company.

V. CERTAIN POWERS AND DUTIES OF THE FDIC

A. *Power to Operate the Covered Financial Company, Dispose of Assets, and Certain Other Powers*

Upon appointment of the FDIC as receiver of a covered financial company, the FDIC succeeds to "(i) all rights, titles, powers, and privileges of the covered financial company and its assets, and of any stockholder, member, officer, or director of such company; and (ii) title to the books, records, and assets of any previous receiver or other legal custodian of such covered financial company."[109] The role of the FDIC as receiver of a financial company under Title II is similar to its role in insolvency proceedings

107. *Id.* § 5390(a)(1)(E)(i) (outlining additional powers with respect to failing subsidiaries of a covered financial company).
108. *Id.* § 5390(a)(1)(E)(ii).
109. *Id.* § 5390(a)(1)(A).

of an insured depository institution under the FDIA.[110] Title II reposes great authority in the FDIC as receiver to "take over the assets of and operate the covered financial company with all of the powers of the members or shareholders, the directors, and the officers of the covered financial company, and conduct all business of the covered financial company, [and] to perform all functions of the covered financial company" in its name.[111] The FDIC's exercise of its powers over the assets of the financial company is not subject to judicial approval.[112]

The FDIC is given express authority under Title II to "collect all obligations and money owed to the covered financial company"[113] and may "contract for assistance in fulfilling any function, activity, action, or duty of the [FDIC]."[114] In managing the assets and property of a covered financial company, the FDIC must do so in a manner "consistent with maximization of the value of the assets in the context of the orderly liquidation,"[115] however, its actions are not subject to judicial oversight.[116]

B. *Power to Liquidate, Merge, and Transfer Assets and Liabilities*

The FDIC has the power, subject to all legally enforceable security interests and security entitlements with respect to assets held by the covered financial company, to "liquidate . . . and wind-up the affairs of a covered financial company [as it deems appropriate], including taking steps to realize upon the assets of the covered financial company."[117] The FDIC may sell the assets to one or more third parties or form a bridge company under § 5390(h) and transfer any asset (or liability subject to certain limitations) to the bridge financial company.[118] The FDIC may also

110. Compare, for example, *id.* § 5390(a)(1)(A)–(N), with 12 U.S.C. § 1821(d)(2)(A)–(K) (2006 & Supp. III 2009), wherein, among other things, the FDIC similarly succeeds to "all rights, titles, powers, and privileges of [an] insured depository institution."

111. 12 U.S.C.A. § 5390(a)(1)(B)(i), (iii).

112. *Id.* § 5390(a)(9)(D).

113. *Id.* § 5390(a)(1)(B)(ii).

114. *Id.* § 5390(a)(1)(B)(v). The FDIC may utilize the private sector to manage or dispose of the covered financial company's assets. *Id.* § 5390(a)(1)(L).

115. *Id.* § 5390(a)(1)(B)(iv).

116. *Id.* § 5390(a)(9)(D).

117. *Id.* § 5390(a)(1)(D). *See* discussion *infra* Part VII concerning Proposed Rules relating to the rights of secured creditors.

118. 12 U.S.C.A. § 5390(a)(1)(D) (referencing *id.* § 5390(h)).

"merge the covered financial company with another company; or . . . transfer any asset or liability of the covered financial company . . . without obtaining any approval, assignment, or consent" of any court or stakeholder; however, the right to merge or transfer assets or liabilities of the covered financial company is subject to any applicable federal agency approval, including antitrust review.[119]

The lack of judicial oversight of such transactions is similar to the authority of the FDIC under the FDIA, but is in stark contrast to proceedings under the Bankruptcy Code. In bankruptcy proceedings, transactions involving any use, sale, or lease of property of a debtor, other than in the ordinary course of business, require court approval after notice to creditors and other parties in interest and an opportunity for such parties in interest to be heard.[120] Title II sets some guidelines for the FDIC concerning disposal of assets. In disposing of assets, the FDIC must, "to the greatest extent practicable," execute its powers in a way that:

> (i) maximizes the net present value return from the sale or disposition of such assets; (ii) minimizes the amount of any loss realized . . . (iii) mitigates the potential for serious adverse effects to the financial system; (iv) ensures timely and adequate competition and fair and consistent treatment of offerors;[121] and (v) prohibits discrimination on the basis of race, sex, or ethnic group in the solicitation and consideration of offers.[122]

Section 5390(a)(1)(G)(iii) provides that "[s]ubject to the other provisions of [Title II], any transferee of assets . . . , including a bridge financial company, shall be subject to such claims or rights [of setoff] as would prevail over the rights of such transferee in such assets under applicable noninsolvency law."[123] However, the

119. *Id.* § 5390(a)(1)(G).

120. *See, e.g.*, 11 U.S.C. § 363(b) (2006).

121. Unlike under the Bankruptcy Code, the sale process will play out entirely behind the scenes without any opportunity for creditors or interest holders to challenge the fairness of the sale procedures. 12 U.S.C.A. § 5390(a)(1)(G). Nor will creditors be able to have a court determine whether the assets are being sold to the offeror that made the "highest or best offer." *See id.* § 5390(a)(9)(D). However, the lack of judicial oversight may allow the process to proceed more quickly. Moreover, the sale of assets or operations that are financial in nature, such as a custody business, may involve special considerations for maintaining the financial stability of the United States and a determination of what is "best" from that standpoint, rather than from the standpoint of what maximizes the value of the estate for the benefit of its creditors, may be appropriate under the purposes of Title II. *See supra* notes 54–57 and accompanying text.

122. 12 U.S.C.A. § 5390(a)(9)(E).

123. *Id.* § 5390(a)(1)(G)(iii).

FDIC is permitted to "sell assets free and clear of the setoff rights of any party . . . ."[124] In such case, the party will have a claim subordinate in right of payment to administrative claims of the FDIC, claims of the United States, and certain employee claims enumerated in subparagraphs (C) and (D) of § 5390(b)(1) but ahead of other general and senior unsecured claims in subparagraph (E), "in an amount equal to the value of such setoff rights."[125]

C. *The FDIC's Incidental Powers as Receiver; Employment of Private Persons*

To assist the FDIC in carrying out its responsibilities in the management and disposition of assets from the covered financial company, the FDIC is given not only powers specifically granted to it as receiver under Title II but also such incidental powers necessary to carry out its duties under Title II.[126] The FDIC "may utilize the services of private persons, including real estate and loan portfolio asset management, property management, auction marketing, legal, and brokerage services, if [they] are available . . . and the [FDIC] determines that utilization of such services is practicable, efficient, and cost effective."[127]

D. *Coordination with Foreign Financial Authorities*

In exercising any of its powers, the FDIC must take into account the international aspects of the financial company's operations and assets. Section 5390(a)(1)(N) requires that where a covered financial company has assets or operations in a country other than the United States, the FDIC is to "coordinate, to the maximum extent possible, with the appropriate foreign financial authorities regarding the orderly liquidation of any covered financial company."[128]

---

124. *Id.* § 5390(a)(12)(F). *See infra* Part VII discussing priorities of claims.
125. 12 U.S.C.A. § 5390(a)(12)(F).
126. *Id.* § 5390(a)(1)(K).
127. *Id.* § 5390(a)(1)(L).
128. *Id.* § 5390(a)(1)(N); *see also id.* § 5390(k) (concerning powers of the FDIC with respect to the conduct of foreign investigations).

E. *Certain Legal Rights of the FDIC*

1. Right to Obtain Stays of Actions

The FDIC holds certain legal rights protective of the assets of the covered financial company and its work as receiver. Once the FDIC has been appointed as receiver, a court will grant the FDIC's request for "a stay in any [legal] action or proceeding in which [the] covered financial company is or becomes a party," for not more than 90 days.[129] This limited breathing space differs from the automatic stay under § 362(a) of the Bankruptcy Code,[130] which, subject to certain exceptions goes into effect immediately upon filing a petition under §§ 301, 302, or 303 of the Bankruptcy Code.[131] The automatic stay remains in effect throughout a case under Chapter 7 or Chapter 11 of the Bankruptcy Code unless a creditor or other party in interest succeeds in meeting the specific criteria in § 362(d) or (f) of the Bankruptcy Code required for the bankruptcy court, after notice and a hearing, to grant relief from the automatic stay.[132]

2. Subpoena Power

The FDIC is given broad subpoena authority to "exercise any power established under § 1818(n) of the [FDIA], as if the [FDIC] were the appropriate Federal banking agency for the covered financial company, and the covered financial company were an insured depository institution."[133]

3. Rights with Respect to Appeals

As receiver, the FDIC is required to "abide by any final, non-appealable judgment of any court of competent jurisdiction that was rendered before the appointment of the [FDIC] as receiver."[134] However, the FDIC has "all the rights and remedies available to

129. *Id.* § 5390(a)(8). *See also infra* Part VI for a discussion of the ninety day stay of the exercise of certain rights of contractual counterparties under § 5390(c)(13).
130. *See* 11 U.S.C. § 362(a) (2006).
131. *Id.*; *see also id.* § 362(b) (outlining the exceptions to § 362(a)).
132. *See id.* § 362(d), (f) (2006 & Supp. III 2009).
133. 12 U.S.C.A. § 5390(a)(1)(J) (referring to 12 U.S.C. § 1818(n)).
134. *Id.* § 5390(a)(9)(A).

the covered financial company" prior to the appointment of the FDIC as receiver, including the right to remove any case to federal court as well as all rights of appeal.[135] The FDIC will not be subject to any requirement to post any bond if it chooses to pursue its rights or remedies.[136]

4. Prohibition Against Attachment and Execution

Title II prohibits any court from issuing an order of attachment or execution with respect to assets of a covered financial company in the possession of the FDIC as receiver.[137] This is necessary to preserve the rights of the receiver in assets of the covered financial company since any stay of judicial proceedings under § 5390(a)(8) is limited to ninety days.[138]

5. Limitation on Judicial Review

Title II precludes judicial review (except as otherwise provided therein) of "any claim or action for payment from, or any action seeking a determination of rights with respect to, the assets of any covered financial company" as well as "any claim relating to any act or omission of such covered financial company or the [FDIC] as receiver."[139]

6. Expansion of Statute of Limitations

The tools given to the FDIC to pursue claims of the covered financial company or the FDIC as receiver against third parties include the expansion of the statute of limitations for actions brought by the FDIC[140] and the revival of expired state causes of

135. *Id.* § 5390(a)(9)(B)(i).

136. *Id.* § 5390(a)(9)(B)(ii).

137. *Id.* § 5390(a)(9)(C).

138. *Id.* § 5390(a)(8).

139. *Id.* § 5390(a)(9)(D). *See infra* Part VI for a discussion of the limited rights of creditors to judicial review with respect to disallowance of their claims.

140. *See* 12 U.S.C.A. § 5390(a)(10)(A) (providing that the statute of limitations applicable to any action brought by the FDIC as receiver is (i) the longer of six years from the date the claim accrues or the applicable state law limitation period for contract claims and (ii) the longer of three years from the date the claim accrues or the applicable state law limitation period for tort claims). The expansion of applicable statutes of limitations under Title II is different than that under § 108 of the Bankruptcy Code. Section 108(a) provides that

action for tort claims arising from fraud or intentional misconduct resulting in unjust enrichment or substantial loss to the covered financial company, so long as the statute of limitations under state law has not expired more than five years before the date of appointment of the FDIC as receiver.[141]

F. *Termination of Rights and Claims of Stockholders and Creditors*

To assure the FDIC that stockholders and creditors will not be able to interfere with the orderly liquidation process, § 5390(a)(1)(M) provides that the FDIC as receiver must:

> terminate all rights and claims that the stockholders and creditors of the covered financial company may have against the assets of the covered financial company or the [FDIC] arising out of their status as stockholders or creditors, except for their right to payment, resolution, or other satisfaction of their claims.[142]

Section 5390(a)(1)(M) further provides that the FDIC is to ensure that all losses are borne by the unsecured creditors and shareholders of the covered financial company "consistent with the priority of claims provisions under [§ 5930(b)]."[143]

VI. DETERMINATION, RESOLUTION, AND PAYMENT OF CLAIMS

To the extent that funds are available, the FDIC is required to "pay all valid obligations . . . that are due and payable at the time of the appointment of the [FDIC] as receiver, in accordance with the prescriptions and limitations of [Title II]."[144] This means that

---

> If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the debtor may commence an action, and such period has not expired before the date of filing of the petition, the trustee may commence such action before the later of (1) the end of such period, including any suspension of such period occurring after the commencement of the case; or (2) two years after [the commencement of the case]."

11 U.S.C. § 108(a) (2006). Title II has the effect of exposing those who deal with financial companies to the risk of litigation for a longer period of time than under the Bankruptcy Code.

141. 12 U.S.C.A. § 5390(a)(10)(C).

142. *Id.* § 5390(a)(1)(M). As discussed below, § 5390(a)(2) through 5390(a)(7) address rights of creditors with respect to the determination, resolution, and payment of their claims. *See id.* § 5390(a)(2)–(7).

143. *Id.* § 5390(a)(1)(M).

144. *Id.* § 5390(a)(1)(H).

payment of obligations must comport with other provisions of Title II that deal with the payment of claims,[145] including, but not limited to, the procedures for determination and payment of proven claims in § 5390(a)(2)–(7),[146] the treatment of similarly situated creditors under §§ 5390(b)(4), 5390(d)(4) and 5390(h)(3)(E),[147] and the priority scheme under § 5390(b).[148]

A. *Claim Determination Procedures*

1. Establishment of Bar Date for Filing Claims

Title II requires that the FDIC publish notice to creditors of a covered financial company for the filing of claims together with proof by a specified date (the "bar date") which is to be "at least 90 days after the date of publication of such notice."[149] The FDIC is also required to mail notice to creditors of the bar date.[150]

2. FDIC's Determination of Claims

Prior to 180 days after the FDIC receives a claim (unless extended by agreement with the claimant), the FDIC must give the claimant notice of allowance or disallowance of the claim.[151] However, a claim will be deemed to be disallowed if the FDIC fails to notify the claimant of the disallowance of the claim within the 180 day period.[152] Any claim filed after the date specified in the notice of bar date filed by the FDIC will be disallowed, provided

145. *See id.*

146. *Id.* § 5390(a)(2)–(7).

147. *Id.* §§ 5390(b)(4), (d)(4), (h)(3)(E).

148. *Id.* § 5390(b).

149. *Id.* § 5390(a)(2)(B)(i). Such notice must be republished one and two months after the initial publication. *Id.* § 5390(a)(2)(B)(ii).

150. *Id.* § 5390(a)(2)(C). Proposed Rule section 380.33 would permit the FDIC, after notice of bar date by publication and mailing has been given, to communicate "by electronic media with any claimant who expressly agrees to such form of communication." Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,343 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380). Proposed Rule section 380.33 also requires notice to any claimant discovered after the claims bar date, with such claimant required to file its claim within 90 days of the notice mailed to such claimant. *Id.*

151. *Id.* § 5390(a)(3)(A). Mailing of notice is sufficient under § 5390(a)(3)(A)(iii) but Proposed Rule section 380.37(a) would also permit electronic notice where a claim is filed electronically. Orderly Liquidation Authority, 76 Fed. Reg. at 16,343. Proposed Rule section 380.34 details the procedures for filing a claim. *Id.*

152. 12 U.S.C.A. § 5390(a)(3)(A)(ii).

that the FDIC may consider any such claim if "the claimant did not receive notice of the appointment of the receiver in time to file such claim" and the "claim is filed in time to permit payment."[153]

3. Disallowance of Claims

The FDIC is authorized to "disallow any portion of any claim by a creditor or claim of a security, preference, setoff, or priority which is not proved to the satisfaction of the [FDIC]."[154] However, the FDIC may not disallow, in whole or in part, "any extension of credit from any Federal reserve bank or the [FDIC] to any covered financial company; or . . . any legally enforceable and perfected security interest in the assets of the covered financial company securing any such extension of credit," subject to the limitations for undersecured claims.[155]

To the extent that the amount of a claim exceeds the fair market value of the property of a covered financial company that secures the claim, the excess will be treated as an unsecured claim, and no payment may be made on the unsecured portion of the claim until payment is made on all unsecured claims.[156]

4. Filing Suit is Required Absent Notice of Allowance of Claim

Although the filing of a claim constitutes the commencement of an action under any applicable statute of limitations,[157] a claimant who has not received notice that its claim is allowed must file suit on the claim in the United States district court or territorial court where the principal place of business of the covered financial company is located, or continue an action that was commenced before the date of appointment of the FDIC as receiver in the court where the suit is pending within sixty days of the earlier of (i) the end of the 180 day period (or any extension thereof) for the FDIC's determination of disallowance or (ii) the date

153. *Id.* § 5390(a)(3)(C).

154. *Id.* § 5390(a)(3)(D)(i).

155. *Id.* § 5390(a)(3)(D)(iii).

156. *Id.* § 5390(a)(3)(D)(ii).

157. *Id.* § 5390(a)(3)(E)(i). The filing of a claim will "not prejudice any right of [a] claimant to continue any action [that] was filed before" the appointment of the FDIC as receiver. *Id.* § 5390(a)(3)(E)(ii).

of notice of any disallowance.[158] Failure to bring such suit within such time period will render the disallowance final "and the claimant [will] have no further rights or remedies with respect to such claim."[159]

5. Comparison of Claim Resolution Process under Title II and the Bankruptcy Code

The FDIC is given authority under Title II to review claims and either allow or disallow claims in whole or in part.[160] This unilateral authority is similar to that granted to the FDIC under the FDIA[161] and to the SIPC trustee under SIPA.[162] This authority differs significantly from the authority afforded Chapter 7 trustees[163] or Chapter 11 debtors in possession[164] under the Bankruptcy Code with respect to allowance or disallowance of claims.

The methodology for resolving claims under Title II also differs significantly from that of the Bankruptcy Code. Under the Bankruptcy Code, a claim is deemed allowed unless a party in interest, including the Chapter 7 trustee or debtor in possession, files an objection to the claim with the bankruptcy court.[165] Only if the claimant fails to respond to the objection, or the bankruptcy court sustains the objection of the trustee or debtor in possession, as applicable, after the claimant has had an opportunity to respond

---

158. *Id.* § 5390(a)(4)(A)–(B). See Proposed Rule section 380.38 concerning procedures for seeking determination of disallowed claims. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,343–44 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

159. 12 U.S.C.A. § 5390(a)(4)(C).

160. *Id.* § 5390(a)(3)(D).

161. *See* 12 U.S.C. § 1821(d)(3)–(5) (2006); 15 U.S.C. § 78fff-2(a)–(b).

162. *See* 12 U.S.C.A.§ 5385(a)(2)(D).

163. *Compare id.* § 5390(a)(3)(D) (stating "the [FDIC] may disallow any portion of any claim"), *with* 11 U.S.C. § 704(a)(5) (stating that a trustee must "examine proofs of claim and object to the allowance of any claim that is improper").

164. *Compare* 12 U.S.C.A. § 5390(a)(3)(D) (stating "the [FDIC] may disallow any portion of any claim"), *with* 11 U.S.C. § 502(a) (permitting any party in interest, including a debtor, a Chapter 7 trustee, or any creditor to object to a claim). *See* 11 U.S.C. § 1109(b) (defining the term "party in interest").

165. 11 U.S.C. § 502(a). The Chapter 7 trustee or debtor in possession bears the burden of proof with respect to its objection; only if the debtor meets its burden does the creditor have the burden of overcoming the objection. 3–51 Collier Bankr. Prac. Guide (MB) ¶ 51.09 (2010). The foregoing also applies to any other party in interest that objects to a claim. *Id.*

and to appear and be heard with respect to the objection, is the claim disallowed in whole or in part.[166]

Under Title II, a claimant who would contest a claim determination by the FDIC must timely file a suit (or continue an action if such action were pending with respect to the claim prior to the appointment of the FDIC as receiver) "in the district or territorial court of the United States for the district [where] the principal place of business of the covered financial company is located."[167] Thus, unlike the Bankruptcy Code where the debtor or trustee must take action to object to a claim and must in its objection establish sufficient, credible facts to rebut the prima facie presumption of the validity of the claim before the burden of proof reverts to the creditor,[168] under Title II, the creditor has the burden of initiating a challenge to the FDIC's disallowance in whole or in part of its claim.[169]

B. *Expedited Procedure for Certain Secured Claims*

1. Expedited Treatment in Some Instances; Allowance or Disallowance

Title II requires the FDIC to "establish a procedure for expedited relief . . . for any claimant that alleges [that it has] a legally valid and enforceable or perfected security interest in property of a covered financial company . . . and that irreparable injury will occur" if the procedure for resolution of claims under § 5390(a)(3) is followed.[170] While § 5390(a)(5) provides an expedited process for

166. 11 U.S.C. § 502(b). Except as provided in subsections (e)(2), (f), (g), (h), and (i) of § 502(b), if an objection to a claim is made, "the court after notice and a hearing, shall determine the amount of such claim . . . and shall allow such claim in such amount," subject to the limitations in subparagraphs (1)–(9) of § 502(b). *Id.* Section 502 establishes the bases for allowance and disallowance of a claim by the court. *See, e.g.*, *id.* § 502(d), (e)(1) (providing "the court shall disallow any claim . . . .").

167. 12 U.S.C.A. § 5390(a)(4)(A).

168. *See* Lundell v. Anchor Constr. Specialists, Inc. (*In re* Lundell), 223 F.3d 1035, 1038–40 (9th Cir. 2000).

169. *See* 12 U.S.C.A. § 5390(a)(3)(D) (regarding the FDIC's authority to disallow claims); *id*. § 5390(a)(4) (regarding the action to be taken by a creditor to obtain a judicial determination of the claim); *see also id.* § 5390(a)(5).

170. *Id*. § 5390(a)(5)(A). There is no indication of what would satisfy the requirement of irreparable injury. Failure of the FDIC to maintain assets securing a claim that results in decline in the value of such assets may be one such situation depending on the date used for the valuation of collateral. *See* Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4,207, 4,212 (Jan.

determining a claim that is faster than the process under § 5390 (a)(3),[171] there appears to be no means for secured creditors to obtain an immediate determination of the validity, perfection, and priority of their secured claims or the value of their collateral. Proposed Rule section 380.53 would require the FDIC to determine within ninety days of the date of the request by the secured creditor for expedited relief "whether to allow or disallow such claim, or any portion thereof, or . . . whether such claim should be determined pursuant to the [regular] procedures [under § 5390(a)(3)]."[172] If the claim is disallowed, the notice must state "each reason for the disallowance and the procedure for obtaining a judicial determination."[173] However, expedited determination of secured claims is entirely within the discretion of the FDIC.[174]

2. Remedy Upon Disallowance

A claimant that seeks expedited determination of its secured claim may file suit (or continue a suit filed prior to the date of the FDIC's appointment as receiver) seeking a determination of the claimant's rights with respect to its security interest (or any security entitlement) "after the earlier of (i) the end of the 90-day period beginning on the date of the filing of a request for expedited relief" or (ii) the date of the FDIC's denial of the claim or a portion thereof.[175]

The creditor must either file suit, or a motion to renew a previously filed suit within thirty days from the date such action or motion may be filed.[176] Otherwise, the secured claim will, to the

25, 2011) (to be codified at 12 C.F.R. pt. 380). Section 380.2 of the Interim Final Rule establishes that the FDIC will use the fair market value of collateral as of the date the FDIC was appointed as receiver; however, the FDIC seeks comment on whether such valuation date should be used for all types of collateral, or only government securities or other publicly traded securities. *Id.*

171. *Compare* 12 U.S.C.A. § 5390(a)(5) (detailing the process for the "expedited determination of claims"), *with id.* § 5390(a)(3) (outlining the standard procedure for the resolution of claims).

172. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,344 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

173. 12 U.S.C.A. § 5390(a)(5)(B).

174. *Id.* § 5390(a)(9)(D).

175. *Id.* § 5390(a)(5)(C). It is unclear whether denial (or disallowance) of the claim is necessary to bring the suit or whether the right to bring suit applies in the event that the FDIC determines that the procedures under § 5390(a)(3) should apply to the claim.

176. *Id.* § 5390(a)(5)(D).

extent not allowed, be deemed disallowed as of the end of such period.[177]

3. Tolling of Statute of Limitations

The filing of a claim with the FDIC whether under § 5390(a)(3) or § 5390(a)(5) will constitute the commencement of an action and will, therefore, toll the applicable statute of limitations.[178] Subject to the FDIC's rights under § 5390(a)(8), the filing of a claim will "not prejudice any right of the claimant to continue any action which was filed before the appointment of the [FDIC] as receiver."[179]

4. Comparison of Secured Creditor's Bankruptcy Code Rights and Rights Under Title II

As noted above, to the extent that a claim is determined to be undersecured under the expedited determination process, no payment may be made on the "unsecured portion of the claim, [except] in connection with the disposition of all claims of unsecured creditors."[180] However, there is no provision under Title II comparable to § 362(d) of the Bankruptcy Code that allows a secured creditor to seek to lift the automatic stay so that it can foreclose on the assets that secure its debt,[181] or § 363(k) of the Bankruptcy Code, which allows the secured creditor to credit bid its debt in a sale of the assets securing such debt if it believes that the proceeds from a sale would not properly value its claim.[182] Because Title II is intended to leave to the FDIC the maximization of the value of the covered financial company's assets[183] and

177. *Id.*

178. *Id.* § 5390(a)(3)(E)(i), (5)(E)(i).

179. *Id.* § 5390(a)(3)(E)(ii), (5)(E)(ii); *see also supra* note 129 and accompanying text (discussing § 5390(a)(8)).

180. *Id.* § 5390(a)(3)(D)(ii)(II). *Compare id.*, *with* 11 U.S.C. § 506(a)(i) (2006) (bifurcating a claim between a secured claim to the extent of the value of the collateral securing the claim and an unsecured claim for the balance). Under § 506(a), a claim that is subject to setoff under § 553 is a secured claim "to the extent of the amount subject to setoff." 11 U.S.C. § 506(a)(1). However, rights of setoff (if assets are sold by the FDIC free of setoff right) will only be entitled to priority over general and senior liability claims. *See* 12 U.S.C.A. § 5390(a)(12)(F).

181. *See* 11 U.S.C. § 362(d) (2006 & Supp. III 2009).

182. *Id.* § 363(k).

183. 12 U.S.C.A. § 5390(a)(1)(B)(iv).

no judicial approval of sales of assets or merger transactions is required,[184] unless (i) the secured creditor can convince the FDIC to sell the assets to it for what the secured creditor believes is the fair market value or (ii) the FDIC determines to assume the secured debt or have a bridge financial company assume the secured debt,[185] the secured creditor's only remedy appears to be to bring an action under § 5390(a)(5) or § 5390(a)(3), as applicable, if the creditor disagrees with the FDIC's valuation.[186]

Other issues remain with respect to the amount of a secured creditor's claim. Title II also does not specify whether interest and other charges, including legal fees, accrued or incurred after appointment of the FDIC as receiver may be paid to secured creditors to the extent that the value of their collateral exceeds the debt as provided under § 506(b) of the Bankruptcy Code.[187] However, § 5390(c)(3)(D) of Title II provides that where the FDIC repudiates a debt obligation that is secured by property of a value greater than the amount of the claim for principal and accrued interest (and accreted original issue discount to the date of appointment of the receiver), interest on the claim will be paid to the date of repudiation.[188] Moreover, it is unclear to what extent the requirement under § 5390(a)(7)(B)—that creditors of a covered financial company eligible to be a debtor under the Bankruptcy Code receive no less than they would receive in a case un-

184. *Id.* § 5390(a)(1)(G)(i).

185. *Id.* § 5390(h)(1)(B)(i).

186. The FDIC has proposed a number of rules that address the rights of secured creditors and the FDIC with respect to the secured creditor's collateral, some of which will have a bearing on the valuation of the secured claim. For example, Proposed Rule section 380.51 deals with the right of a secured creditor to seek the consent of the FDIC to obtain possession of or exercise control over its collateral, or to foreclose upon or sell its collateral. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,344 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380). Proposed Rule section 380.53 clarifies that the FDIC may sell collateral free and clear of the security interest in such collateral, with the security interest attaching to the proceeds and the right of the secured creditor, in the event of a sale, to acquire the property by credit bidding the amount of its claim. *Id.* Further, Proposed Rule section 380.54 provides to the FDIC a right of "redemption from security interest," which permits the FDIC to pay the secured creditor in cash the fair market value of the collateral "free and clear of such security interest." *Id.* at 16,344.

187. *See* 11 U.S.C. § 506(b).

188. 12 U.S.C.A. § 5390(c)(3)(D). Since interest on a secured claim is to be paid to the date of repudiation, it would appear that, to the extent that a secured creditor challenges the FDIC's determination of value, interest that accrues or original issue discount that accretes after the date of repudiation of the debt but before payment of such claim may not be able to be paid, unless § 5390(a)(7)(B) of Title II would protect the right to such payment to the extent that such interest and accreted original issue discount would be paid in a case under Chapter 7 of the Bankruptcy Code. *See id.* § 5390(a)(7)(B).

der Chapter 7 of the Bankruptcy Code[189]—would be protective of the rights of secured creditors to payment of interest, fees, expenses, and other charges that accrue or are incurred after the appointment of the FDIC as receiver. Notwithstanding the language of § 5390(c)(3)(D) relating to the amount of a claim arising from a debt obligation upon repudiation,[190] an argument could be made that all post-receivership interest and charges to the date of payment by the FDIC should also be paid up to the value of the collateral so long as the requirement in § 5390(a)(7)(B) applies to both secured and unsecured claims.

C. *Payment of Claims*

Under § 5390(a)(7)(A), the FDIC as receiver has the discretion to pay creditor claims to the extent that funds are available, "in such manner and amounts as are authorized under [§ 5390]," so long as such claims "are (i) allowed by the [FDIC]; (ii) approved by the [FDIC] pursuant to a final determination" under the regular or expedited claim determination procedures under § 5390(a)(3) and § 5390(a)(5), respectively, "or (iii) determined by the final judgment of a court of competent jurisdiction."[191] The FDIC may pay dividends on proven claims at any time, and the FDIC may not be held liable "by reason of [any] such payment or for failure to pay dividends to a claimant whose claim is not proved at the time of any such payment."[192]

This provision is intended to allow payments to creditors with proven claims even if there are other claims that have yet to be proved.[193] Such advance payment of unsecured claims is not permitted in a liquidation under Chapter 7 since § 726(a)(1) of the Bankruptcy Code provides that commencement of distributions of property of the estate is to begin with respect to priority claims on the earlier of (i) ten days after mailing to creditors of the trustee's

189. *Id.* § 5390(a)(7)(B) (referring to § 5390(d)(2)–(3)).

190. *Id.* § 5390(c)(3)(D).

191. *Id.* § 5390(a)(7)(A). Proposed Rule section 380.20 defines "allowed claim" as "a claim against the receivership that is allowed by the [FDIC] or upon which a final nonappealable judgment has been entered in favor of a claimant against a receivership by a court with jurisdiction to adjudicate the claim." Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,340 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

192. *Id.* § 5390(a)(7)(C).

193. *See id.*

final report, or (ii) the date on which the trustee commences final distribution.[194]

Section 5390(a)(7)(D) permits the FDIC to establish rules with respect to the payment of post-insolvency interest, including establishment of an interest rate, provided that such interest may not be paid until the principal amount of all creditor claims is satisfied.[195]

The term "principal amount" is not defined in Title II[196] and it is unclear whether the term refers to the full amount of the allowed claim including any claim for unpaid interest to the date of the appointment of the FDIC or the date of repudiation of a contract, as applicable. However, Proposed Rule section 380.25, which addresses post-insolvency interest, clarifies that principal amount is "the full allowed claim amount, including any interest that may have accrued to the extent the interest is included in the allowed claim."[197] While the plain language of § 5390(a)(7)(D) could be read to apply to both secured and unsecured claims, based on Proposed Rule section 380.21, the provision concerning post-insolvency interest would apply to unsecured claims and be comparable to the right of unsecured creditors to be paid interest in a liquidation under Chapter 7 of the Bankruptcy Code.[198]

1. Required Payment Amount

As noted above, § 5390(a)(7)(B) provides that in no event shall a creditor be paid "less than the amount that the creditor is en-

194. *See* 11 U.S.C. § 726(a)(1) (2006). Similarly, under Chapter 11, with few exceptions, pre-petition unsecured claims will not be paid until a plan has been confirmed. *See* Bruce S. Nathan, *Payment of Pre-Petition Unsecured Trade Claims During a Chapter 11 Case*, ALLBUSINESS (Apr. 1, 2000), http://www.allbusiness.com/accounting/3486332-1.html.

195. 12 U.S.C.A. § 5390(a)(7)(D).

196. *See id.*

197. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,342 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

198. 12 U.S.C.A. § 5390(a)(7)(D); *see also* Orderly Liquidation Authority, 76 Fed. Reg. at 16,341. *Compare id., with* 11 U.S.C. § 726(a)(5) (allowing payment of interest on unsecured claims, at the legal rate from the date of the filing of the petition, to the extent that all priority claims, unsecured claims, subordinated claims, late filed claims, and penalty and punitive damage claims have been paid in full). Under the Bankruptcy Code, post-petition interest on secured claims would be paid at the contractual rate up to the value of the collateral that secures the claim. 11 U.S.C. § 506. *See also* Orderly Liquidation Authority, 76 Fed. Reg. at 16,341 (indicating that post-insolvency interest applies to unsecured claims).

titled to receive under" § 5390(d)(2) or (d)(3).[199] Section 5390(d)(2) provides that:

> The maximum liability of the [FDIC], acting as receiver . . . to any person having a claim against the [FDIC] as receiver or the covered financial company . . . shall equal the amount that such claimant would have received if (A) the [FDIC] had not been appointed receiver [of the] covered financial company; and (B) the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code."[200]

Although § 5390(d)(2) and (d)(3) speak of the "maximum liability" of the FDIC as receiver for a covered financial company to any person having a claim against the FDIC as receiver or the covered financial company, the Senate Report for the predecessor bill indicates that, in fact, the "maximum liability" under § 5390(d)(2) is intended to be the minimum amount that must be paid to a creditor of the covered financial company on its claim.[201]

2. Issues Related to Determination of "Required Payment Amount"

Nonetheless, we are still left with the conundrum of how the FDIC is to determine what each creditor would have been paid in the hypothetical Chapter 7 case[202] and under what circumstances

---

199. 12 U.S.C.A. § 5390(a)(7)(B).

200. *Id.* § 5390(d)(2). Section 5390(d)(2) also applies to covered financial companies that would be liquidated under "any similar provision of State insolvency law applicable to the covered financial company." *Id.* Section 5390(d)(3) relates to the maximum liability of the FDIC with respect to certain claims against a covered broker or dealer. *Id.* § 5390(d)(3).

201. S. REP. NO. 111-176, at 61 (2010) (discussing the priority of expenses and unsecured claims under § 5390(b), stating: "All claimants that are similarly situated in the expenses and claims priority shall not receive less than the maximum liability amount defined in subsection (d)"). One article suggests that whether the requirement under § 5390(a)(7)(B) "will be read as a limitation on the U.S. priority [under § 5390(b)(1)(B)] is uncertain." Renée Dailey & Katherine Lindsay, *The Dodd-Frank Act: The New World of Systemically Risky Financial Companies and What It Means for Creditors*, 22 BNA BANKR. L. REP. 1283 (2010). The statement suggests that if § 5390(a)(7)(B) is the overriding principle with respect to payment of claims, it may trump rights of priority accorded the United States under § 5390(b)(1)(B).

202. Section 1129(a)(7)(A) of the Bankruptcy Code and the case law relating to it may provide helpful precedent for determining what the recovery to a creditor in a hypothetical Chapter 7 case would be. Section 1129(a)(7)(A) provides that, as a condition for confirmation of a plan of reorganization,

> [w]ith respect to each impaired class of claims or interests . . . each holder of a claim or interest of such class (i) has accepted the plan; or (ii) will receive or retain under the plan on account of such claim or interest property of a value,

and in what forum a creditor could challenge the FDIC's determination that the amount paid to a creditor in respect of its claim is "no less than" the amount it would receive in a case under Chapter 7 of the Bankruptcy Code. It appears that such challenge could be made in connection with a creditor challenge of the FDIC's determination of its claim so long as the distributable assets of the covered financial company are known by both the creditor and the FDIC. However, Title II does not require that the FDIC provide to each creditor a calculation of what it contends the creditor would receive on its claim in a case under Chapter 7 of the Bankruptcy Code.[203]

It appears that but for the requirement in § 5390(a)(7)(B) that creditors receive no less than they would receive in a case under Chapter 7 of the Bankruptcy Code,[204] under a strict application of the priorities established in § 5390(b)(1),[205] certain unsecured creditors might receive less under Title II than they would under Chapter 7 of the Bankruptcy Code because the priority scheme under Chapter 7 is different from that under § 5390(b) of Title II.[206] For example, claims arising from rights of setoff would be treated as secured claims under § 506(a) of the Bankruptcy Code and, therefore, have priority over all unsecured claims, including administrative and priority claims.[207] However, under § 5390(a)(12)(F), certain claims arising from setoff would be subordinate to claims payable under subparagraphs (A), (B), (C) and (D) of § 5390(b)(1).[208] If funds were insufficient to pay all administrative and priority claims in subparagraphs (A) through (D) of § 5390(b)(1), then the setoff claim under § 5390(a)(12)(F) would not be paid under Title II,[209] even though it would, as a secured claim,

> as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7.

11 U.S.C. § 1129(a)(7)(A) (2006). Section 1129(a)(7)(B) applies to secured creditors that make an election under § 1111(b) of the Bankruptcy Code. *Id.* § 1129(a)(7)(B); *see also* 7-1129 Collier on Bankr. (MB) ¶ 1129.02[7] (2010) (concerning the factors considered in determining whether the recovery under a plan of reorganization of a dissenting creditor meets the requirements of § 1129(a)(7), i.e., the "best interests test").

203. *See supra* note 189 and accompanying text.

204. 12 U.S.C.A. § 5390(a)(7)(B).

205. *Id.* § 5390(b)(1); *see infra* Part VII discussing the priority of claims.

206. *See supra* notes 188-190 and accompanying text.

207. *See* 11 U.S.C. § 506(a); *see also supra* notes 124-125 and accompanying text.

208. *See* 12 U.S.C.A. § 5390(a)(12)(F).

209. *See id.*

have to be paid under the Bankruptcy Code before payment of administrative and priority claims,[210] *unless* the requirement under § 5390(a)(7)(B) trumps the priority provisions of § 5390(b)(1) and it could be shown that the creditor with setoff rights would receive less than it would in a Chapter 7 case.[211] In addition, since the priority provisions of § 726 of the Bankruptcy Code differ from those provided in § 5390(b)(1) (A) and (B),[212] it is possible that certain claimants would, but for the requirement in § 5390 (a)(7)(B),[213] receive less than they would receive in a liquidation under Chapter 7.

Furthermore, Title II and the Bankruptcy Code have different means of measuring the amount of certain claims, such as claims in respect of qualified financial contracts, that may effectively result in a different recovery on such claims.[214] Since both § 5390(a)(7)(B) and § 5390(d)(2) speak in terms of what a "claimant" or "creditor" would have received,[215] differences in claim amounts would appear to be relevant to the minimum amount a creditor is entitled to receive. A further difference in the determination of claims arising from qualified financial contracts under Title II and the Bankruptcy Code is that while the Bankruptcy Code only permits termination or rejection of such contracts between the debtor and the nondebtor counterparty,[216] Title II permits disaffirmance or repudiation of qualified financial contracts between the debtor and the nondebtor counterparty *or its affiliates*.[217] Thus, while close-out netting under the Bankruptcy Code would apply to qualified financial contracts between the debtor and the nondebtor party, Title II would also apply to qualified financial contracts with affiliates and would appear to permit cross-affiliate close-out netting to the extent provided under the relevant qualified financial contracts.[218] Therefore, the amount

210. *See* 11 U.S.C. § 1129(b)(2)(A)–(B).

211. 12 U.S.C.A. § 5390(a)(7)(B), (a)(12)(F), (b)(1)

212. *Compare* 11 U.S.C. § 726, *with* 12 U.S.C.A. § 5390(b)(1)(A)–(B).

213. 12 U.S.C.A. § 5390(a)(7)(B) (requiring that a creditor receive at least as much as it would under a Chapter 7 liquidation under the Bankruptcy Code).

214. *Compare* 11 U.S.C. §§ 561(a), 562 (concerning rights of close-out netting and determination of claims arising from the early termination or rejection of qualified financial contracts), *with* 12 U.S.C.A. § 5390(c)(3), (11) (concerning the calculation of damages and disaffirmance or repudiation of qualified financial contracts).

215. 12 U.S.C.A. § 5390(a)(7)(B), (d)(2).

216. *See* 11 U.S.C. § 561(b)(1).

217. 12 U.S.C.A. § 5390(c)(11)(A).

218. *See id*.

that a counterparty to one or more qualified financial contracts would receive under Title II in respect of its claim may differ from the amount it would have received in a liquidation under Chapter 7 of the Bankruptcy Code.

Given these issues, regulations are necessary to clarify (i) how the calculations called for in § 5390(a)(7)(B) and § 5390(d)(2) are to be made; (ii) whether or under what circumstances the FDIC must provide a creditor with a calculation of what it believes the creditor would receive on its claim under Chapter 7 of the Bankruptcy Code, and; (iii) under what circumstances and in what forum a creditor might seek to enforce its right to be paid no less than it would receive under Chapter 7 of the Bankruptcy Code. It would also be helpful if regulations clarified how, if the amount paid to any creditor under Title II was less than the amount that the creditor would receive under Chapter 7 of the Bankruptcy Code, such amount would be funded, especially if the proceeds from the disposition of the assets of the covered financial company were insufficient to pay higher priority claims (including amounts owed to the United States under § 5390(b)(1)(B)).[219]

VII. Priority of Claims

A. *In General*

Section 5390(b)(1) provides the following priorities for the payment of unsecured claims, including the undersecured portion of secured claims, against the covered financial company or the FDIC as receiver:

> (A) Administrative expenses of the [FDIC as] receiver[;]
> (B) Any amounts owed to the United States, unless the United States agrees or consents otherwise[;]
> (C) Wages, salaries, or commissions including vacation, severance, and sick leave pay earned by an individual (other than [senior executives and directors]), but only to the extent of $11,725 for each individual (as indexed for inflation, by regulation of the [FDIC]) earned not later than 180 days before[220] the date of appointment of the

219. *Id.* § 5390(b)(1)(B); *see* also discussion *infra* Part VII.

220. The words "not later than 180 days before" (as contrasted with the words "within 180 days before" under 11 U.S.C. § 507(a)(4) and (a)(5)), could be read to include wages preceding the 180th day before appointment of the receiver. *See* 11 U.S.C. § 507(a)(4)–(5). However, it is likely that such reading was not intended since the legislative history indicates that the treatment of employee claims (other than those of senior executives) was to

> [FDIC] as receiver[;]
> (D) Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the [FDIC] as receiver, to the extent of the number of employees covered by such plan, multiplied by $11,725 (as indexed for inflation, by regulation of the [FDIC]) less the aggregate amount paid to such employees under subparagraph (C) plus the aggregate amount paid by the receivership on behalf of such employees to any other employee benefit plan[;]
> (E) Any other general or senior liability of the covered financial company (which is not a liability described under subparagraph (F), (G), or (H))[;]
> (F) Any obligation subordinated to general creditors (which is not an obligation described under subparagraph (G) or (H))[;]
> (G) Any wages, salaries, or commissions, including vacation, severance, and sick leave pay earned, owed to senior executives and directors of the covered financial company[;]
> (H) Any obligation to shareholders, members, general partners, limited partners, or other persons, with interests in the equity of the covered financial company arising as a result of their status as [such equity interest holders].[221]

What qualifies as claims in the first two levels of priority is significant because they relate to the funds that must be recouped by the FDIC and the federal government before other creditors are paid anything.

"Administrative expenses of the receiver" are defined in § 5381 of Title II as including "(A) the actual, necessary costs and expenses incurred by the [FDIC] as receiver for a covered financial company in liquidating a covered financial company; and (B) any obligations that the [FDIC] as receiver . . . determines are necessary and appropriate to facilitate the smooth and orderly liquidation of the covered financial company."[222] Section 5390(a)(15) provides that payment of "any final . . . judgment for monetary damages entered against the [FDIC] as receiver for a covered financial company for the breach of an agreement executed or approved by the [FDIC] after the date of its appointment shall be paid as an administrative expense of the [FDIC]."[223]

be the same as that under the Bankruptcy Code. *See* Conference Report, 156 CONG. REC. E1347, E1348 (daily ed. July 15, 2010) (statement of Rep. John Conyers Jr.).

221. 12 U.S.C.A. § 5390(b)(1).

222. *Id.* § 5381(a)(1).

223. *Id.* § 5390(a)(15). Proposed Rule section 380.22 clarifies the scope of the definition and indicates that the items listed therein are not exclusive. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,341 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt.

It is not clear from the language of § 5390(b)(1)(B) whether "amounts owed to the United States" include not only amounts funded by the Treasury pursuant to Title II, but also taxes, penalties, fines, environmental liabilities, unfunded pension liabilities, and other amounts owed to the United States government.[224] Proposed Rule section 380.23 clarifies that amounts advanced by the Treasury or any other department, agency, or instrumentality of the United States, whether advanced before or after the appointment of the FDIC as receiver are "owed to the United States" for the purposes of § 5390(b)(1)(B), as are amounts owed to such U.S. governmental entities under guaranties of debt pursuant to certain federal guarantee programs.[225] Amounts owed to the United States also include unsecured accrued and unpaid taxes, and the amount of any unsecured debt owed to a federal reserve bank and extensions of credit by the FDIC including under § 5384(d).[226] Under § 507(a)(8) of the Bankruptcy Code, certain unsecured claims of governmental units (both federal and state) are given priority over unsecured claims, subject to the categories and limits set forth therein.[227] Therefore, claims of the United States that were otherwise nonpriority unsecured claims under the Bankruptcy Code may be elevated and could have a significant impact on the recovery of other unsecured claims, including claims of states for taxes unless § 5390(a)(7)(B) precludes such result. The supplemental information section to the Interim Final Rule indicates that § 5390(d)(2) should have that effect, stating "In addition, creditors also are guaranteed that they will receive no less than they would have received if the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code."[228]

It is also unclear what qualifies as "subordinated debt" under § 5390(b)(1)(F). The use of the term "obligation" suggests that sub-

380). See also *infra* notes 236-239 and accompanying text for a discussion of the grant pursuant to § 5390(b)(2) of administrative expense status to debt obtained by the FDIC in the case that credit is not otherwise available from commercial sources. See also *infra* note 321 and accompanying text for a discussion of § 5390(c)(13)(D) concerning administrative expense treatment of obligations under contracts to extend credit assumed by the FDIC.

224. *See* 12 U.S.C.A. § 5390(b)(1)(B).

225. Orderly Liquidation Authority, 76 Fed. Reg. at 16,341.

226. *Id.*

227. 11 U.S.C. § 507(a)(8).

228. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4,207, 4,209 (Jan. 25, 2011) (to be codified at 380 C.F.R. pt. 380).

paragraph (F) is intended to give effect to contractual subordination of debt.[229] However, in many instances, contractual subordination will be to limited types of debt such as "money borrowed indebtedness" and not to trade debt. It is, therefore, unclear how subordination will be given effect under subparagraph (E) where only senior debt and not all unsecured debt has the benefit of the subordination (*i.e.*, whether senior creditors that have the benefit of contractual subordination will receive a higher recovery than general creditors would under the Bankruptcy Code). The use of the words "subordinated to general creditors" in subparagraph (F) raises a similar question as to the treatment of subordinated claims since contractual subordination may not apply to general creditors but only to creditors whose claims are contractually senior.[230]

Moreover, it should be noted that § 510 of the Bankruptcy Code recognizes the subordination of three types of subordinated debt (i) contractually subordinated debt; (ii) mandatorily subordinated debt that relates to claims for damages arising from rescission of a purchase or sale of a security due to, among other things, fraud (often involving a claim relating to an equity interest); and (iii) debt that may be equitably subordinated based upon the inequitable conduct of the creditor up to the amount of the harm caused by the inequitable conduct.[231] It is unclear whether these other forms of subordination are to be recognized under § 5390(b)(1)(E) of Title II. Certain provisions of Title II partially address these issues. For example, § 5390(b)(1)(H) subordinates obligations to equity interest holders based on their status as equity interest holders to all other unsecured claims.[232] Such obligations may be subordinated under § 510(b) of the Bankruptcy Code.[233] However, there is no provision in Title II concerning subordination of rescission claims of debt holders to other unsecured claims.[234] The subordination in § 5390(b)(1)(G) of claims of senior executives and directors for wages, salaries and commissions could be likened to equitable subordination but no showing of inequitable conduct is required nor is there any limitation of the subordination of such

229. 12 U.S.C.A. § 5390(b)(1)(F).
230. *Id.*
231. *See* 11 U.S.C. § 510(a)–(c).
232. 12 U.S.C.A. § 5390(b)(1)(H).
233. 11 U.S.C. § 510(b).
234. *See* 12 U.S.C.A. § 5390(b)(1).

claims to the harm caused.[235] The subordination in subparagraph (G) is, however, consistent with the purpose under § 5386(4) that senior executives and directors having responsibility for the financial condition of the financial company bear losses consistent with their responsibility rather than their inequitable conduct.[236]

B. *Priority of Post-Receivership Financing Indebtedness and Unsecured Claims of the United States*

The FDIC may obtain credit or take on debt on behalf of a covered financial company if it is "unable to obtain unsecured credit for the covered financial company from commercial sources."[237] All administrative expenses are subordinate to this commercially obtained credit or debt.[238]

This may be likened to the superpriority administrative expense claims often given to lenders that provide debtor in possession financing in cases under Chapter 11 of the Bankruptcy Code.[239] Proposed Rule section 380.21 makes clear that repayment of unsecured debt incurred by the FDIC under § 5390(b)(2) will have priority over all other administrative expenses.[240]

Under § 5390(b)(3), unsecured claims of the United States have priority over liabilities of the covered financial company that count as regulatory capital.[241]

C. *Treatment of Claims of Similarly Situated Creditors and Additional Payments*

1. Creditors Similarly Situated

Section 5390(b)(4) provides that all claimants that are similarly situated under paragraph (1) are to be "treated in a similar manner, except that the [FDIC] may take any action (including mak-

235. *Id*. § 5390(b)(1)(G).
236. *Id*. § 5386(4).
237. *Id*. § 5390(b)(2).
238. *Id*.
239. *See, e.g*., Monarch Air Serv., Inc. v. Solow (*In re* Midway Airlines, Inc.), 383 F.3d 663, 669 (7th Cir. 2004).
240. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,340 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).
241. 12 U.S.C.A. § 5390(b)(3).

ing payments subject to subsection (o)(1)(D)(i))" that would treat claims of similarly situated creditors differently if:

> (A) the [FDIC] determines that such action is necessary—
>
> (i) to maximize the value of the assets of the covered financial company;
>
> (ii) to initiate and continue operations essential to implementation of the receivership or any bridge financial company;
>
> (iii) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or
>
> (iv) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company; and
>
> (B) all claimants that are similarly situated under [§ 5390(b)(1)] receive not less than the amount provided in [§ 5390(d)(2) or (d)(3) as applicable].[242]

The reference to "[a]ll claimants . . . similarly situated under [§ 5390(b)(1)]" indicates that this provision applies only to the treatment of unsecured creditors or the undersecured portion of a secured claim and that the amount received is to be compared against the amount such claimant would receive based on the priorities in § 5390(b)(1).[243] The reference in subsection (b)(4)(B) to § 5390(d)(2) requires that similarly situated claimants receive no less than they would in a case under Chapter 7 of the Bankruptcy Code.[244]

---

242. *Id.* § 5390(b)(4). Notably, the FDIC is given the right to recoup or clawback any such payments if such payments "are necessary to pay in full the obligations issued by the [FDIC] to the Secretary . . . within 60 months of the date of issuance of [the] obligations." *Id.* § 5390(o)(1)(B) (referring to *id.* § 5390(o)(1)(D)). Such clawback is limited to the difference between the amount the creditor was paid and the amount it would have received "solely from the proceeds of the liquidation of the covered financial company under [Title II]." *Id.* § 5390(o)(1)(D)(i)(I)–(II). Both § 5390(b)(4) and § 5390(h)(5)(E) require that similarly situated creditors receive no less than the amount they would receive under § 5390(d)(2) (i.e., under Chapter 7 of the Bankruptcy Code, in the case that the financial company is eligible to be a debtor). *See id.* § 5390(b)(4)(B), (h)(5)(E)(ii), (d)(2). It is unclear how that may be determined at the time of the additional payment, since such payment is likely to be made at the outset of the case. It is possible, however, that the FDIC may contend that Chapter 7 would involve a "disorderly liquidation" and that an orderly liquidation under Title II will preserve greater value for creditors than a Chapter 7, as may be the case where the transfer of qualified financial contracts to a bridge financial company or third party may forestall claims arising from early termination of those contracts. On the other hand, creditors might counter that they would receive a greater recovery under Chapter 7 because sales of assets might generate a higher price in an open auction process or the different priority of their claim under the Bankruptcy Code would result in a greater recovery on their claim than that under Title II.

243. *Id.* § 5390(b)(4).

244. *Id.* § 5390(b)(4)(B) (referencing § 5390(d)(2)). The reference to § 5390(d)(3) applies to the treatment of certain claims under SIPA.

However, in the event that the proceeds from the liquidation of the covered financial company are insufficient to pay higher ranking claims, the amounts paid pursuant to § 5390(b)(4)(B) will be subject to recoupment under § 5390(o)(1)(D)(i).[245] Two other provisions also allow certain creditors to be paid more than other similarly situated creditors holding claims of equal priority.[246]

2. Additional Payments Permitted

Section 5390(d)(4)(A) provides that the FDIC:

> may make additional payments or credit additional amounts to, or with respect to, or for the account of, any claimant or category of claimants of the covered financial company, if the [FDIC] determines that such payments or credits are necessary or appropriate to minimize losses to the [FDIC] as receiver from the orderly liquidation of the covered financial company.[247]

Such payments may be made to claimants or credited "to a company other than a covered financial company or a bridge financial company established with respect thereto in order to induce such other company to accept liability for such claims."[248] Such payments, however, are subject to the limitations that they may not exceed the "face value" amount of a proven claim[249] and the FDIC's rights to make assessments to claw back any amounts paid in excess of what the creditor would have received from the FDIC "on such claim solely from the proceeds of the liquidation of the covered financial company under Title II."[250] Section

245. *Id.* §5390(o)(1)(D)(i); *see infra* note 250 and accompanying text for a further discussion of § 5390(o)(1)(D)(i).

246. *See* 12 U.S.C.A. § 5390(d)(4)(A), (h)(5)(E).

247. *Id.* § 5390(d)(4)(A).

248. *Id.* § 5390(d)(4)(C).

249. *Id.* § 5390(d)(4)(B)(i). The "face value" amount indicates that no premium is to be paid on the claim. Thus, a creditor may receive payment in full of the proven claim even though other creditors holding claims of the same priority receive far less than the face amount of their claims.

250. *Id.* § 5390(o)(1)(D)(i). The language "solely from the proceeds of the liquidation of the covered financial company" in § 5390(o)(1)(D)(i)(II) suggests that the amount so determined to be assessed might be different than what would be received in a liquidation under Chapter 7 of the Bankruptcy Code because what is realized by a creditor from the proceeds of the liquidation under the priority scheme of § 5390(b)(1) may be less than what would be received by the creditor under Chapter 7. *See id.* § 5390(o)(1)(D)(i)(II); *see also supra* notes 202–218 and accompanying text. This too should be clarified by regulation relating to the effect of § 5390(a)(7)(B) and its relationship to the clawback under § 5390(o)(1)(D)(i).

5390(d)(4) makes clear that the fact that certain creditors receive additional payments does not entitle other similarly situated creditors to payments in excess of their statutory priority, "any other provision of Federal or State law, or the Constitution of any State" notwithstanding.[251]

3. Treatment of Similarly Situated Creditors by Bridge Financial Companies

Section 5390(h)(5)(E), entitled "equitable treatment of similarly situated creditors," has a requirement similar to that in § 5390(b)(4) regarding transfer to a bridge financial company of any assets or liabilities of the covered financial company.[252] It requires that, in connection with the exercise by the FDIC of its rights to transfer assets and liabilities of a covered financial company to one or more bridge financial companies, a bridge financial company treat creditors similarly situated under § 5390(b)(1) in a similar manner.[253] The FDIC, however, may take any action, including making payments in respect of such creditor's claim, subject to rights of recoupment under § 5390(o)(1)(D)(i), that does not comply with that requirement if

> (i) the [FDIC] determines that such action is necessary—
>
> (I) to maximize the value of the assets of the covered financial company;
>
> (II) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or
>
> (III) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company; and
>
> (ii) all creditors that are similarly situated under [§ 5390(b)(1)] receive not less than the amount provided under [§ 5390(d)(2) or 210(d)(3).][254]

4. Interim Final Rule Concerning Treatment of Similarly Situated Creditors

One of the first issues that the FDIC sought to address by way of regulation is the treatment of similarly situated unsecured

251. 12 U.S.C.A. § 5390(d)(4)(B)(ii).
252. *See id*. § 5390(h)(5)(E).
253. *Id*.
254. *Id*. § 5390(h)(5)(E)(i)–(ii).

creditors. The FDIC recently issued an Interim Final Rule ("Interim Final Rule"), section 380.2 of which identifies the types of general and senior liability claims that will not be eligible to receive special treatment under § 5390(b)(4), 5390(d)(4) and 5390 (h)(5)(E).[255] The Interim Final Rule became effective on January 25, 2011.[256] The supplementary information section accompanying the Interim Final Rule indicates that the exercise of the discretionary right to pay similarly situated creditors differently is to be utilized by the FDIC to maintain essential operations under Title II, since it would be expected that such action could "minimize losses and maximize recoveries in any liquidation, while avoiding a disorderly collapse."[257] Examples given of what may be considered essential to the implementation of the receivership or a bridge financial company include "the payment of utility and other service contracts and contracts with companies that provide payments processing services."[258] It is suggested that these contracts are necessary to allow the bridge financial company to maximize the value of the assets of the receivership. The supplementary information section further notes that "[a]ssets and operations that are necessary to maximize the value in the liquidation or prevent a disorderly collapse can be continued seamlessly through the bridge financial company" since such contracts "can-

255. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4215 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380.2).

256. *Id.* at 4208.

257. *Id.* at 4211.

258. *Id.* These payments appear to be similar to payments to "critical vendors" allowed under case law interpreting § 105 of the Bankruptcy Code. *See, e.g.*, *In re* Corner Home Care, Inc., 438 B.R. 122, 126 (Bankr. W.D. Ky. 2010) (discussing the various views on prepayments of unsecured claims under § 105(a) of the Bankruptcy Code). *But see*, *In re* Kmart Corp., 359 F.3d 866, 871, 874 (7th Cir. 2004) (vacating a critical-vendor order entered by the lower court, stating "preferential payments to a class of creditors are proper only if the record shows the prospect of benefit to other creditors"). Title II does not have a provision comparable to § 503(b)(9) of the Bankruptcy Code, which treats as an administrative expense "the value of any goods received by the debtor within 20 days before the date of commencement of a case under [the Bankruptcy Code] in which the goods have been sold to the debtor in the ordinary course of such debtor's business." 11 U.S.C. § 503(b)(9) (2006). Presumably that is because the primary functions of a financial company do not involve the purchase of goods for use in manufacturing or for resale. Nonetheless, financial companies also buy goods and several cases have held that what constitutes a good may be determined with reference to the definition of goods in section 2-105(1) of the Uniform Commercial Code. *E.g.*, *In re* Erving Industries, Inc., 432 B.R. 354, 365–66, 370 (Bankr. D. Mass. 2010) (holding that "the appropriate meaning of *goods* under § 503(b)(9) [of the Bankruptcy Code] corresponds with the meaning given to that term in § 2-105(1) of the UCC" and that electricity is a "good" within this definition).

not be terminated simply because they are assumed by the bridge financial company."[259] The FDIC has authority to require contracting parties to continue to perform if the contracts are needed to continue the operations transferred to the bridge financial company, so long as the bridge financial company continues to perform.[260]

As to additional payments under § 5390(b)(4), 5390(d)(4) and 5390(h)(E)(5), Interim Final Rule section 380.2 would distinguish between "long-term senior debt," defined as "senior debt issued by the covered financial company to bondholders or other creditors that has a term of more than 360 days,"[261] and short-term unsecured debt. Interim Final Rule section 380.2 provides that long-term senior debt would "not include partially funded, revolving or other open lines of credit that are necessary to continuing operations essential to the receivership or any bridge financial company, nor to any contracts to extend credit enforced by the receiver under section 5390(c)(13)(D)."[262] As noted above, § 5390(c)(13)(D) permits the FDIC to enforce any contract to extend lines of credit to the covered financial company and agree to repay the lender under the credit agreement as an administrative expense.[263] Moreover, to the extent that a line of credit is secured, the secured creditor should be entitled to recover the amount of its secured claim equal to the value of its collateral ahead of all administrative claims.[264] The supplementary information section to the Proposed Rule that preceded the Interim Final Rule notes that continuation of lines of credit may be more efficient and "reduce the demands for funding from the Orderly Liquidation Fund."[265]

259. Orderly Liquidation Authority Provisions, 76 Fed. Reg. at 4209.

260. *Id.*

261. *See id.* at 4215.

262. *See id.*

263. 12 U.S.C.A. § 5390(c)(13)(D) (West 2011). To the extent that the FDIC cannot obtain unsecured credit from commercial sources it "may obtain credit or incur debt on [behalf] of [a] covered financial company" from commercial sources that will "have priority over any or all administrative expenses of the receiver under [§ 5390(b)(1)(A)]." *Id.* § 5390(b)(1)(A), (b)(2). By contrast, under § 365(c) of the Bankruptcy Code, a Chapter 7 trustee or debtor in possession may not assume or assign any executory contract—that is to make a loan or extend other debt financing or financial accommodations—to or for the benefit of the debtor. *See* 11 U.S.C. § 365(c).

264. 12 U.S.C.A. § 5390(b)(5).

265. Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 64,173, 64,178 (proposed Oct. 19, 2010) (to be codified at 12 C.F.R. pt. 380).

Interim Final Rule section 380.2 provides that the FDIC, when exercising its discretion under § 5390(b)(4), 5390(d)(4), or 5390(h)(5)(E) to pay certain creditors is not to exercise such authority in a manner that would result in payment of:

> (1) [h]olders of long-term senior debt who have a claim entitled to priority of payment . . . under 12 U.S.C. 5390(b)(1)(E); (2) [h]olders of subordinated debt who have a claim entitled to priority of payment . . . under 12 U.S.C. 5390(b)(1)(F); (3) [s]hareholders, members, general partners, limited partners, or other persons who have a claim entitled to priority of payment . . . under 12 U.S.C. 5390(b)(1)(H); or (4) [o]ther holders of claims entitled to priority of payment . . . under 12 U.S.C. 5390(b)(1)(E) [i.e., general and senior unsecured claims] unless the [FDIC], through the affirmative vote of a majority the members of the Board of Directors then serving, and in its sole discretion, specifically determines that additional payments or credit amounts to such holders are necessary and meet all of the requirements under § 5390(b)(4), (d)(4), or (h)(5)(E), as applicable.[266]

Interim Final Rule section 380.2 also provides that the FDIC board's authority to make such a determination "cannot be delegated."[267]

However, the supplementary information section of the Interim Final Rule notes that the distinction between long-term senior debt and other debt does not mean that short-term debt will be provided with additional payments under § 5390(b)(4), 5390(d)(4) or 5390(h)(5)(E).[268] It simply gives the FDIC as receiver authority to make such additional payments.[269] Much attention was given to Proposed Rule section 380.2 and those who provided comments, in response to the Proposed Rule, expressed concern that knowledge by market participants that short-term unsecured debt may receive additional payments while long-term senior debt may not, will mean that financial companies will be unable to attract long-term debt when they would need it most or, at least, at a reasonable price.[270] It was consequently suggested that the Proposed Rule might result in lenders limiting loans to short-term debt and

266. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4215 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

267. *Id.*

268. *Id.* at 4211.

269. *Id.*

270. *Id.* at 4212.

thereby hasten a financial company's need for governmental intervention and, ultimately, the appointment of the FDIC as receiver pursuant to Title II.[271]

The supplementary information section to the Interim Final Rule makes clear that as general creditors, holders of short-term debt "normally will receive the amount established and due under section [5390(b)(1)], or other priorities of payment specified by law."[272] The supplementary information section further indicates that "[w]hile holders of shorter term debt may receive additional payments, [such payments] will be evaluated on a case-by-case basis" and the FDIC Board must "determine that [such] additional payments or credit amounts are necessary and meet all requirements under [5390](b)(4), (d)(4) or (h)(5)(E), as applicable."[273]

D. *Treatment of Secured Claims*

Section 5390(b)(5) provides that the priorities provided under § 5390(b) will "not affect secured claims or security entitlements in respect of assets or property held by the covered financial company, except to the extent . . . [of] the difference between the [amount of] the claim and the amount realized from the security."[274]

The formulation "amount realized from the security" suggests that the value of collateral securing a claim will be determined by what is ultimately realized from the sale or other disposition of the security.[275] However, the value of collateral may be determined on an expedited basis pursuant to § 5390(a)(5) or under the general claim determination procedures under § 5390(a)(3), and it appears that nothing precludes determinations of value being made by the FDIC as receiver without a sale of the collateral having occurred (subject to challenge by the secured creditor).[276]

271. Public Comment from Gus Sauter, Managing Dir. and Chief Inv. Officer, Vanguard, to Robert Feldman, Fed. Deposit Ins. Corp. (Nov. 8, 2010), *available at* http://www.fdic.gov/regulations/laws/federal/2010/10c07Orderliq.PDF.

272. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4211 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

273. *Id.*

274. 12 U.S.C.A. § 5390(b)(5) (West 2011).

275. *See id.*

276. *See id.* § 5390(a)(3), (5).

Moreover, § 5390(a)(3)(D)(ii), which addresses payments to undersecured creditors, speaks in terms of the "fair market value" of property securing an undersecured claim rather than the "amount realized."[277]

Interim Final Rule section 380.2 also provides that "[p]roven claims secured by a legally valid and enforceable or perfected security interest or security entitlement in any property or other assets of the covered financial company shall be paid or satisfied in full to the extent of such collateral."[278] However, to the extent that a claim exceeds "the fair market value of such property or other assets," it is to be "treated as an unsecured claim and paid in accordance with the priorities in [§ 5390(b)] and otherwise applicable provisions."[279] The only guidance that the Interim Final Rule gives with respect to valuation of assets is that the "fair market value [of collateral is to] be determined as of the date the [FDIC] was appointed receiver of the covered financial company."[280] The FDIC seeks comment on whether the date of appointment of the FDIC as receiver should "be used as the valuation date for all types of collateral, or only government securities or other publicly traded securities."[281] It also seeks comment on "[w]hat additional guidelines would be useful in creating certainty with respect to establishment of [the] fair market value of various types of collateral for secured claims."[282]

It appears that where there is a sale, a sale will determine value. Proposed Rule section 380.54 would have the lien of a secured creditor attach to the proceeds of a sale of the collateral and the proceeds would be "remitted to the claimant within a reasonable time after sale."[283] However, Proposed Rule section 380.55, which gives the FDIC a right of redemption of a security interest, does so based on the "fair market value" of the property subject to the security interest, indicating that different means of valuation of a

277. *Id.* § 5390(a)(3)(D)(ii).

278. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4215 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

279. *Id.*

280. *Id.*

281. *Id.* at 4214.

282. *Id.*

283. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,345 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

secured claim will apply depending on the circumstances.[284] How value is determined by the FDIC where there is no sale of the security remains unknown.

VIII. RIGHTS OF RECEIVER WITH RESPECT TO EXISTING CONTRACTS AND RELATED OBLIGATIONS

A. *Rights of Repudiation and Disaffirmance of Contracts and Leases Generally*

Sections 5390(c)(1) and (2) provide the FDIC with authority to repudiate or disaffirm "any contract or lease to which the financial company is a party" within a reasonable period of time where continued performance is too burdensome and it would "promote the orderly administration of the affairs of the covered financial company."[285] Unlike § 365 of the Bankruptcy Code, which requires that for a contract or lease to be assumed or rejected, it must be "executory,"[286] i.e., that there remain unperformed obligations by both parties to the contract.[287] There is no such requirement under Title II for a contract or lease to be repudiated or disaffirmed.[288]

As under the FDIA, with few exceptions,[289] damages for disaffirmance or repudiation of a contract are "actual direct compensa-

284. *Id.*

285. *Id.* § 5390(c)(1)–(2).

286. 11 U.S.C. § 365(a) (2006). The term "rejection" under the Bankruptcy Code is comparable to "repudiation" under Title II. *Compare* 11 U.S.C. § 365(a), *with* 12 U.S.C.A. § 5390(c). Section 365 of the Bankruptcy Code contains many protections for nondebtor counterparties to executory contracts not only with respect to rejection but also assumption and assignment of executory contracts that are not provided in Title II. *See*, *e.g.*, 11 U.S.C. § 365(b), (f) (requiring the curing of defaults and adequate assurance of future performance for assumption or assignment of an executory contract or lease). In a case under Chapter 7 of the Bankruptcy Code, § 365(d)(1) deems rejected any lease or executory contract that is not assumed or rejected within 60 days after the order for relief, unless the bankruptcy court extends the time for cause. *Id.* § 365(d)(1). However, the only timing requirement under § 5390(c)(2) is that a contract or lease be repudiated or disaffirmed "within a reasonable period of time." 12 U.S.C.A. § 5390(c)(2).

287. BLACK'S LAW DICTIONARY 652 (9th ed. 2009).

288. *See* 12 U.S.C.A. § 5390(c)(1) (providing that the FDIC as receiver may disaffirm or repudiate *any* contract or lease) (emphasis added).

289. Special provisions apply with respect to the measure of damages for the repudiation of (i) "qualified financial contracts" as defined in § 5390(c)(8)(D), (ii) debt obligations, and (iii) contingent obligations, as well as leases as to which the covered financial company is lessee or lessor and contracts for the sale of real property. *Id.* § 5390(c)(3)(C)–(E), (c)(4)–(5); *see also id.* § 5390(c)(8)(D)(i) (defining the term qualified financial contracts).

tory damages . . . determined as of the date of the appointment of the [FDIC] as receiver[,]" or in the case of any qualified financial contract, as of "the date of the disaffirmance or repudiation of such contract or agreement."[290] The claim for damages "does not include punitive or exemplary damages, damages for lost profits or opportunity, or damages for pain and suffering."[291]

B. *Measure of Damages for Certain Contracts and Leases*

1. Measure of Damages for Repudiation or Disaffirmance of Debt Obligations

If the FDIC repudiates any debt obligations "for borrowed money or evidenced by a security, actual direct compensatory damages shall be no less than the amount lent plus accrued interest plus any accreted original issue discount as of the date the [FDIC] was appointed receiver."[292] Additionally, a secured creditor will be entitled to payment of accrued interest on its allowed secured claim to the date of repudiation "to the extent that an allowed secured claim is secured by property the value of which is greater than the amount of such claim and any accrued interest."[293]

290. *Id*. § 5390(c)(3)(A)(ii). Section 5390(c)(8)(D)(i) defines "qualified financial contract" as "any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement and any similar agreement that the [FDIC] determines by regulation, resolution, or order to be a qualified financial contract for purposes of [paragraph (D) of § 5390(c)(8)." *Id*. § 5390(c)(8)(D)(i).

291. *Id*. § 5390(c)(3)(B).

292. *Id*. § 5390(c)(3)(D). Under the Bankruptcy Code, debt obligations may not be rejected because they are not executory in nature, since the purchaser of the debt obligation will have fulfilled all of its performance obligations upon payment for the debt. *See* 11 U.S.C. § 365(g) (2006).

293. 12 U.S.C.A. § 5390(c)(3)(D). Proposed Rule section 380.52(a) clarifies that repudiation of a contract secured by property "shall not be construed as permitting avoidance of any legally enforceable and perfected security interest in the property." The security interest will instead "be deemed to secure any claim for repudiation damages." Proposed Rule section 380.52(b) further provides that "the [FDIC] . . . may consent to the exercise of any legal or contractual rights against the property, including liquidation, for the purpose of applying the value of the property or its proceeds up to the amount of the allowed claim for damages." Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,344 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

2. Measure of Damages for Repudiation or Disaffirmance of Qualified Financial Contracts

In the case of repudiation or disaffirmance of qualified financial contracts under Title II, damages for disaffirmance or repudiation will be limited to actual direct compensatory damages, which "include normal and reasonable costs of cover or other reasonable measures of damages utilized in the industries for such contract" determined as of the date of disaffirmance or repudiation.[294] In exercising its rights of disaffirmance or repudiation of any qualified financial contract, the FDIC is required to either:

> (A) disaffirm or repudiate all qualified financial contracts between . . . (i) any person or any affiliate of such person; and (ii) the covered financial company in default; or (B) . . . none of the qualified financial contracts . . . (with respect to such person or any affiliate of such person).[295]

3. Measure of Damages for Repudiation or Disaffirmance of Contingent Obligation

The FDIC may, by rule or regulation, prescribe that:

> In the case of any contingent obligation of a covered financial company consisting of any obligation under a guarantee, letter of credit, loan commitment, or similar credit obligation . . . actual direct compensatory damages shall be no less than the estimated value of the claim as of the date the [FDIC] was appointed receiver of the covered financial company, [and that] such value is measured based on the likelihood that [the] contingent claim would become fixed and the probable magnitude thereof.[296]

Unlike the FDIA, which does not provide for the payment of contingent claims,[297] but like the Bankruptcy Code, Title II recognizes the right to prove contingent claims. The term "claim" is defined in § 5381(a)(4) of Title II as "any right to payment, whether

294. 12 U.S.C.A. § 5390(c)(3)(C).

295. *Id.* § 5390(c)(11).

296. *Id.* § 5390(c)(3)(E).

297. Section 1821(e) of the FDIA, which relates to contracts entered into before the appointment of a receiver, does not have a provision comparable to § 5390(c)(3)(E), which provides for damages arising from repudiation of contingent obligations. *See* 12 U.S.C. § 1821(e).

or not such right is . . . contingent," similar to the manner in which "claim" is defined in § 101(5)(A) of the Bankruptcy Code.[298]

In Interim Final Rule section 380.4, the FDIC addresses the provability of contingent claims under Title II. The supplementary information section indicates that the text of the Proposed Rule was revised in response to comments that the Proposed Rule was ambiguous and to clarify that the treatment of contingent claims under Title II parallels their treatment under the Bankruptcy Code.[299] Interim Final Rule section 380.4, paragraph (a) provides that the FDIC may not disallow a claim "solely because the obligation [of the covered financial company] is contingent."[300] It further provides that "To the extent [an] obligation is contingent, the [FDIC] shall estimate the value of the claim . . . based upon the likelihood that [the] contingent obligation would become fixed and the probable magnitude [of the claim]."[301] The supplementary information section notes that § 502(c) of the Bankruptcy Code "requires estimation of any claim the liquidation of which would unduly delay the administration of the estate."[302] Neither the Bankruptcy Code nor the Interim Final Rule specifies a time by which a contingent claim should be estimated.[303] However, the FDIC has solicited comments regarding whether it "should designate a specific time during the receivership for the estimation of contingent claims."[304] Under paragraph (b) of Interim Final Rule section 380.4, if the FDIC repudiates a "guarantee, letter of credit, loan commitment, or similar credit obligation" that is contingent as of the date of the receiver's appointment, "the actual direct compensatory damages for repudiation shall be no less than the estimated value of the claim as of the date the [FDIC] was appointed receiver of the covered financial company."[305] Interim

298. *Compare id.* § 5381(a)(4) (defining the term "claim" as inclusive of contingent rights to payment), *with* 11 U.S.C. § 101(5)(A) (2006) (defining the term "claim" as inclusive of contingent rights to payment).

299. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4213 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

300. *Id.* at 4216.

301. *Id.*

302. *Id.* at 4213 (citing 11 U.S.C. § 502(c)).

303. *See id.*; *see also* 11 U.S.C. § 502(c).

304. Orderly Liquidation Authority Provisions, 76 Fed. Reg. at 4213. The claim determination procedures in § 5390(a)(2)–(5) do not provide for estimation of contingent claims and would appear to apply to all claims. *See* 12 U.S.C.A. § 5390(a)(2)–(5) (West 2011).

305. Orderly Liquidation Authority Provisions, 76 Fed. Reg. at 4216.

Final Rule section 380.4 reiterates the language of § 5390(c)(3)(E), stating that the "value is measured based upon the likelihood that such contingent claim would become fixed and the probable magnitude thereof," but provides no guidance as to how such measurement is to be made.[306]

4. Damages for Repudiation or Disaffirmance of Leases Under Which the Covered Financial Company is the Lessee

Damages for disaffirmance or repudiation of leases[307] in which the covered financial company is the lessee will include post-receivership contractual rent accruing to "the later of the date [that] notice of disaffirmance or repudiation is mailed; or the disaffirmance or repudiation becomes effective, unless the lessor is in default of the lease."[308] The lessor is not entitled to "damages under any acceleration clause or other penalty provision" and its claim for pre-receivership rent will be limited to a "claim for any unpaid rent, subject to all appropriate offsets and defenses, due as of the date of the appointment of the receiver."[309] Accordingly, a lessor of nonresidential real property or of other real or personal property that is repudiated under Title II would likely have a significantly smaller unsecured claim than it would have if its claim were rejected under Chapter 7 or Chapter 11 of the Bankruptcy Code.[310]

5. Damages for Repudiation or Disaffirmance of Leases Under Which the Covered Financial Company is the Lessor

In the case of leases for real property under which the covered financial company is the lessor and where the lessee is not in de-

306. *Id.*; 12 U.S.C.A. § 5390(c)(3)(E).

307. 12 U.S.C.A. § 5390(c)(4). Section 5390(c)(4) does not distinguish between leases of real and personal property and would appear to apply to both. *See id.*

308. *Id.* § 5390(c)(4)(B)(i).

309. *Id.* § 5390(c)(4)(B)(ii)–(iii).

310. Damages for repudiation of a lease of nonresidential real property would be less than damages for rejection of such lease under the Bankruptcy Code. Pursuant to § 502(b)(6) of the Bankruptcy Code, the lessor of such rejected lease would have an administrative claim for any unpaid post-filing date rent accrued to the date of rejection, as well as a general unsecured claim for pre-petition accrued unpaid rent and unaccrued post-petition rent subject to the cap provided under the same section. 11 U.S.C. § 502(b)(6) (2006). Under the Bankruptcy Code, there is no cap on the damages arising from the rejection of a lease of personal property. *Id.* § 365(d)(5).

fault as of the date of repudiation, the lessee "may either (i) treat the lease as terminated by such repudiation; (ii) or remain in possession of the leasehold interest for the balance of the term of the lease, unless the lessee defaults . . . after the date of such repudiation."[311] The provisions of § 5390(c)(5) relating to real property leases for which the covered financial company is lessor, including the obligation to pay contractual rent and rights of offset, are similar to the rights and obligations of the lessor and lessee of real property under § 365(h) of the Bankruptcy Code.[312]

C. *Repudiation or Disaffirmance of Contracts for Sale of Real Property and Service Contracts*

Title II also has provisions relating to repudiation of contracts for sale of real property and with respect to service contracts.[313] In the case of service contracts, any claim for services rendered before the appointment of the FDIC will be "deemed to have arisen [on] the date . . . the receiver was appointed" and will be treated as an unsecured claim.[314] If the receiver accepts services from the provider after its appointment, the party will be paid for pre-repudiation services and the amount will be treated as an administrative expense.[315] However, acceptance by the FDIC as receiver of such services will "not affect the right of the [FDIC] to repudiate [the] contract at any time after such performance."[316]

311. 12 U.S.C.A. § 5390(c)(5).

312. *Compare* 11 U.S.C. § 365(h)(1), *with* 12 U.S.C.A. § 5390(c)(5).

313. *See* 12 U.S.C.A. § 5390(c)(6)–(7).

314. *Id*. § 5390(c)(7)(A).

315. *Id*. § 5390(c)(7)(B); *see also* Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4215 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

316. 12 U.S.C.A. § 5390(c)(7)(C). Interim Final Rule section 380.3 addresses personal service agreements with employees (including collective bargaining agreements). Orderly Liquidation Authority Provisions, 76 Fed. Reg. at 4215. "Personal service agreement" is defined in section 380.3(a)(1) as "a written agreement between an employee and a covered financial company, covered subsidiary or a bridge financial company setting forth the terms of employment." *Id*. Section 380.3(c) of the Interim Final Rule clarifies that a personal service agreement does not continue to apply to employees in connection with a sale or transfer of a subsidiary or certain operations or assets of the covered financial company unless such agreement is expressly assumed by the acquiring party. *Id*. at 4216. Section 380.3(e) makes clear that payment of employees does not apply to "senior executives" (as defined in Interim Final Rule section 380.3(a)(2)) or directors of the covered financial company, nor does a personal service agreement impair the ability of the FDIC to recover compensation from such senior executives or directors. *Id*.; *see also id*. at 4215 (defining the term "senior executive" under Interim Final Rule section 380.3(a)(2)).

D. *Enforcement of Contracts of a Covered Financial Company and Contracts Guaranteed by a Covered Financial Company*

1. Enforcement of Contracts of a Covered Financial Company

As a general matter under § 5390(c)(13), the FDIC may enforce any contract of a covered financial company for which it is the receiver,

> notwithstanding any provision of the contract providing for termination, default, acceleration, or exercise of rights upon, or solely by reason of, insolvency, the appointment of . . . the [FDIC] as receiver, the filing of the petition pursuant to [§] 5382(a)(1) of [Title II], or the issuance of the recommendations or determination, or any actions or events occurring in connection

with a systemic risk determination under § 5383.[317] This power excludes liability insurance contracts for directors or officers and financial institution bonds but does not affect the FDIC's rights under other applicable law with respect to those contracts.[318]

A contract provision providing for termination, default, or acceleration by reason of insolvency, the appointment of the FDIC as receiver, or another similar triggering event is referred to as an *ipso facto* clause.[319] Except as otherwise provided by § 5390, during the ninety-day period beginning the date of appointment of the FDIC as receiver, no person may use any *ipso facto* clause triggers, including (i) the insolvency of the financial company, (ii) the appointment of the receiver, or (iii) similar circumstances, "to terminate, accelerate, or declare a default under any contract to which a covered financial company is a party, . . . or to obtain possession of or exercise control over any property of the covered financial company or affect [the company's] contractual rights . . . without the consent of the [FDIC]."[320]

Section 5390(c)(13)(C)(ii) excepts the rights of counterparties to qualified financial contracts to terminate, liquidate, or accelerate such contracts in accordance with § 5390(c)(8)(A) and to net qualified financial contracts pursuant to the Federal Deposit Insur-

317. 12 U.S.C.A. § 5390(c)(13)(A). *But see id.* § 5390(c)(8)(A), (F) (concerning the rights of early termination and acceleration applicable to qualified financial contracts).

318. *Id.* § 5390(c)(13)(A)-(B).

319. "Ipso facto clause" is defined as "A contract clause that specifies the consequences of a party's bankruptcy." BLACK'S LAW DICTIONARY 905 (9th ed. 2009).

320. 12 U.S.C.A. § 5390(c)(13)(C)(i).

ance Corporation Improvement Act ("FDICIA") from the ninety day limitation.[321]

2. Contracts to Extend Credit

Notwithstanding the foregoing limitations, "if the [FDIC] as receiver enforces any contract to extend credit to the covered financial company or bridge financial company," the FDIC is required to pay "any valid and enforceable obligation to repay such debt . . . as an administrative expense of the receivership."[322]

3. Enforcement of Contracts Guaranteed by the Covered Financial Company

The powers of the FDIC extend not only to enforcement of the obligations of covered subsidiaries but also to contracts of subsidiaries and affiliates, whose obligations are guaranteed, supported by, or linked to the covered financial company. In the case that the obligations of a subsidiary or affiliate are guaranteed or otherwise supported by or linked to the covered financial company, the obligee of any such contract may be precluded from exercising any contractual rights of "termination, liquidation, or acceleration of such contracts, based solely on" an *ipso facto* clause.[323] This will be the case if:

> (i) such guaranty or other support and all related assets and liabilities are transferred to and assumed by a bridge financial company or a third party (other than a third party for which a conservator, receiver, trustee in bankruptcy or other legal custodian has been appointed, or which is otherwise the subject of a bankruptcy or insolvency proceeding) no later than 5:00 p.m. on the business day next succeeding the appointment of the FDIC as receiver of such covered financial company, or (ii) the FDIC, as receiver, otherwise provides adequate protection with respect to such obligations.[324]

This provision gives the FDIC authority, subject to the terms of § 5390(c)(16), to enforce contracts of solvent subsidiaries that do not meet the criteria necessary to qualify as a "covered subsid-

321. *Id.* § 5390(c)(13)(C)(ii) (referencing 12 U.S.C. §§ 4401–4405 (2006)).

322. *Id.* § 5930(c)(13)(D). *Compare id.*, *with* 11 U.S.C. § 365(c)(2) providing that debtors in possession or trustees may not assume or assign any executory contract or unexpired lease of the debtor if "such contract is a contract to make a loan, or extend other debt financing or financial accommodations, to or for the benefit of the debtor").

323. 12 U.S.C.A. § 5390(c)(16)(A).

324. *Id.*

iary" so the FDIC may avoid liability on claims guaranteed or otherwise supported by or linked to the covered financial company.[325] There is no provision in Title II comparable to § 361 of the Bankruptcy Code that specifies what constitutes "adequate protection" of an interest of an entity in property of the debtor.[326] It would be helpful if a regulation indicated what would constitute adequate protection of guaranty rights, including where the guaranty is not secured by property of the guarantor or a third party.[327]

E. *Treatment of Qualified Financial Contracts*

The provisions of Title II with respect to qualified financial contracts are similar to the provisions of the FDIA governing such contracts. The definition of the terms "qualified financial contract," "securities contract," "commodity contract," "forward contract," "repurchase agreement," and "swap agreement" follow the definitions of those terms in the FDIA.[328] As previously discussed, special provisions apply to the repudiation of qualified financial contracts and the enforcement of the counterparty's rights of early termination and close-out netting under such contracts.[329] These special provisions are created in recognition of the "safe harbors" provided for such contracts under the FDIA, the Bankruptcy Code and FDICIA due to the systemic importance of qualified financial contracts to the United States financial markets.[330]

Subject to the rights of the FDIC as receiver to transfer qualified financial contracts under § 5390(c)(9) and (10), § 5390(c)(8)(A) permits the exercise by a counterparty of:

325. *Id.*

326. *See id.*; 11 U.S.C. § 361.

327. A regulation setting forth what constitutes adequate protection would also be helpful because § 5390(h)(16)(D), governing the authority of a bridge financial company to obtain credit, requires a showing of "adequate protection" as a requirement for priming the lien of a secured creditor. 12 U.S.C.A. § 5390(h)(16).

328. *Compare id*. § 5390(c)(8)(D), *with* 12 U.S.C. § 1821(e)(8)(D)(i)–(vi) (reflecting substantially similar definitions).

329. *See supra* Part VIII.A.

330. *See* Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankrupt Debtors and Bankruptcy Judges*, 13 AM. BANKR. INST. L. REV. 641, 642 (2005) (noting the view that "safe harbors" are necessary for the protection of financial markets and that without them "markets might suffer serious shocks—perhaps even a systemic liquidity crisis, causing markets to collapse—when debtors enter bankruptcy").

> (i) any right that such person has to cause the termination, liquidation, or acceleration of [such contracts] . . . ; (ii) any right under any security agreement or arrangement or other credit enhancement related to one or more qualified financial contracts . . . ; or (iii) any right to offset or net out any termination value, payment amount, or other transfer obligation arising under . . . [one] or more [qualified financial contracts], including any master agreement for such contracts or agreements.[331]

However, a counterparty is prohibited from terminating, liquidating, or netting such contracts solely because of insolvency, the company's financial condition, the appointment of the FDIC as receiver, or for any reason "incidental to the appointment . . . of the [FDIC] as receiver . . . (I) until 5:00 p.m. (eastern time) on the business day following the date of the appointment [of the receiver;] or (II) after the person has received notice that the contract has been transferred pursuant to [§ 5390(c)(9)(A)]."[332]

This limitation on the rights of the counterparty to a qualified financial contract is intended to give the FDIC an opportunity to sell such contracts to a third party or transfer them to a bridge financial company in order for the FDIC to preserve value and limit claims under such contracts (as it may under the FDIA).[333] There is no similar suspension of rights of early termination, liquidation, and acceleration of such contracts under the Bankruptcy Code.[334] One of the shortcomings of the Bankruptcy Code in the *Lehman Cases* is that the unfettered right of counterparties to terminate qualified financial contracts upon the occurrence of an *ipso facto* event is believed to have caused the loss of as much as $75 billion in value.[335]

331. 12 U.S.C.A. § 5390(c)(8)(A).

332. *See id.* § 5390(c)(10)(B)(i). If no transfer occurs, then rights of early termination and close-out netting may be exercised by the non-defaulting party. *See id.* § 5390(c)(8)(A).

333. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4209 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380) (referring to §5390(c)(10) and stating "As in the FDI Act, derivatives contracts that are needed to continue operations can be transferred to the bridge [financial company] and cannot be terminated and netted by counterparties. This is an important tool to avoid market destabilization because, unlike the Bankruptcy Code, it can prevent the immediate and disorderly liquidation of collateral in a period of market distress").

334. *See, e.g.*, 11 U.S.C. §§ 555–556, 559–560 (2006) (allowing the exercise of a contractual right to liquidate, terminate, or accelerate certain financial contracts).

335. 2010 Bair Statement, *supra* note 35, at 13; *see also* Report of Anton R. Valukas, Examiner, at 725, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (Bankr. S.D.N.Y. Mar. 11, 2010).

In addition, § 5390(c)(8)(F)(ii) suspends "the payment or delivery obligations otherwise due from a party pursuant to the qualified financial contract" beginning at the time of the FDIC's appointment as receiver "until the earlier of (I) the time . . . such party receives notice [pursuant to § 5390(c)(10)(A)] that such contract has been transferred . . . ; or (II) 5:00 p.m. (eastern time) on the business day following . . . the appointment of the [FDIC] as receiver."[336]

After 5:00 p.m. on the business day following the appointment of the FDIC as receiver, the non-defaulting party may exercise rights of early termination and close-out netting of any qualified financial contract that has not been sold to a third party or transferred to a bridge financial company, including the application of collateral to satisfy its claim.[337] However, to the extent the nondefaulting counterparty has an unsecured claim as a result of such early termination, it will be subject to the procedures for determination and payment of such claims under § 5390(a)(3), (4) and (7).[338] Moreover, to the extent that a qualified financial contract would suspend, condition, or extinguish the payment obligation of the non-defaulting counterparty upon an *ipso facto* clause, such "walk away" clauses are not enforceable.[339] The prohibition of enforcing "walkaway" clauses is found in both the FDIA and in §§ 403 and 404 of the FDICIA.[340] While there is no comparable "walkaway" clause in the Bankruptcy Code, the bankruptcy court in the *Lehman Cases* held that a creditor may not suspend payments under a qualified financial contract if it fails to determine whether to terminate the qualified financial contract and further held that the non defaulting counterparty must exercise its right of early termination reasonably promptly after the *ipso facto* event.[341]

In making any transfer of qualified financial contracts, the FDIC as receiver must either

336. 12 U.S.C.A. § 5390(c)(8)(F)(ii). As in the case of the comparable provision under the FDIA, the purpose of this provision is to allow the FDIC to effect the sale of qualified financial contracts to a third party or the transfer of such contracts to a bridge financial company in order to avoid losses from the early termination of qualified financial contracts pending their sale or other disposition. *See id.* § 5390(a)(1)(B)(iv), (h)(2)(E), (h)(5).

337. *See id.* §5390(c)(8)(A)(ii).

338. *See id*. § 5390(a)(3)–(4)(7).

339. *Id.* § 5390(c)(8)(F)(i).

340. *See* 12 U.S.C. §§ 4403–4404(h).

341. *See* Transcript of Hearing, *In re* Lehman Bros. Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2009) (No. 5261).

> (i) transfer . . . (I) all qualified financial contracts between any person or any affiliate [thereof] and the covered financial company . . . ; (II) all claims of such person or any affiliate . . . against [the] covered financial company under . . . ; (III) all claims of [the] covered financial company against such person or any affiliate thereof under . . . ; and (IV) all property securing or any other credit enhancement for

such qualified financial contract to a single financial institution (other than one that is in receivership or insolvency proceedings), or "(ii) transfer none of the qualified financial contracts, claims, property, or other credit enhancement[s]."[342]

IX. AVOIDANCE POWERS OF THE FDIC

A. *General Powers and Defenses Applicable to Preferential Transfers, Fraudulent Transfers, Post Receivership Transfers, and Setoff*

The FDIC has the power under Title II to sue to avoid preferences, fraudulent transfers, post receivership transfers not authorized by the FDIC as receiver, and improper setoffs.[343] These avoidance powers are substantially similar to those afforded to Chapter 7 trustees and debtors in possession in liquidations or reorganizations under Chapter 7 and Chapter 11, respectively, of the Bankruptcy Code.[344] To the extent that any such transfer is

342. 12 U.S.C.A. § 5390(c)(9)(A). Special provisions apply to the transfer of qualified financial contracts to a foreign bank, financial institution, or agency thereof and to the transfer of qualified financial contracts that are cleared by or subject to rules of a clearing organization. *See id.* § 5390(c)(9)(B)–(C).

343. *See id.* § 5390(a)(11)–(12).

344. *See* 11 U.S.C. §§ 547–549, 553 (2006). One difference in the terms applicable to the avoidance of fraudulent transfers for actual fraud under § 5390(a)(11)(A) of Title II from § 548(a)(1)(A) of the Bankruptcy Code is that under § 5390(a)(11)(A) one of the bases for constructive fraudulent transfer (such as insolvency) is required in addition to proof of actual intent to hinder, delay, or defraud creditors of the covered financial company. *Compare* 12 U.S.C.A. § 5390(a)(11)(A), *with* 11 U.S.C. § 548 (a)(1)(A). This difference in language may be a typographical error. One difference in the provisions relating to preferential transfers under the Bankruptcy Code is that the ninety-day period (or the one-year period for insiders) runs from the time of the appointment of the FDIC as receiver. *Compare* 12 U.S.C.A. § 5390(a)(11)(B), *with* 11 U.S.C. § 547(b)(4)(A)–(B). Another difference with respect to preferential transfers is that a transfer is deemed "made when such transfer is so perfected that a bona fide purchaser from the covered financial company against whom applicable law permits [the] transfer to be perfected cannot acquire an interest in the property transferred that is superior to [that of] the transferee" (or if perfection does not occur prior to the appointment of the receiver, it will be deemed to occur immediately before the receiver's appointment). 12 U.S.C.A. § 5390(a)(11)(H)(i)(II). Section 547(e)(1)(B) of the Bankruptcy Code applies to the "hypothetical lien creditor" standard.

avoided, the FDIC as receiver "may recover . . . property transferred, or, if a court so orders, the value of such property (at the time of such transfer) from (i) the initial transferee of such transfer or the person for whose benefit such transfer was made; or (ii) any immediate or mediate transferee . . . ."[345]

The defenses afforded to creditors and their transferees with respect to such avoidance actions under the Bankruptcy Code are, for the most part, afforded to creditors and their transferees under Title II. The FDIC may not recover "from (i) any transferee that takes for value, including in satisfaction of, or to secure, a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or (ii) any immediate or mediate good faith transferee of such transferee."[346] Title II affords a "transferee or obligee from which the [FDIC] seeks to recover a transfer or to avoid an obligation" the same defenses to avoidance and recovery of preferential transfers, fraudulent transfers, and unauthorized post-receivership transfers as a transferee or obligee has under §§ 547, 548, and 549 of the Bankruptcy Code.[347]

The FDIC's authority to recover a transfer or avoid an obligation shall be subject to (i) § 546(b) (timing of post-filing perfection of an interest in property); (ii) § 546(c) (reclamation); (iii) § 547(c) (defenses to preferences of contemporaneous exchange for new value, ordinary course of business, and subsequent new value); and (iv) § 548(c) (rights of good faith transferee for value) under the Bankruptcy Code.[348]

Title II does not incorporate the "safe harbor" language of the Bankruptcy Code, which precludes a trustee from avoiding transfers with respect to (i) securities contracts, commodity contracts,

11 U.S.C. § 547(e)(1)(B). Proposed Rule section 380.9 corrects the inconsistent treatment of transferees under Title II and Chapter 7 or 11 of the Bankruptcy Code and provides that the bona fide purchaser standard will apply to fraudulent transfers and preferential transfers of real property (other than fixtures) and the hypothetical lien creditor standard will apply to preferential transfers of personal property and fixtures. Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,330 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380). Section 547(e)(2) of the Bankruptcy Code provides for a transfer to take place at the time it takes effect between transferor and transferee if it is perfected within thirty days after that time. 11 U.S.C. § 547(e)(2). This thirty-day grace period also applies under Proposed Rule section 380.9. Orderly Liquidation Authority, 76 Fed. Reg. at 16,330.

345. 12 U.S.C.A. § 5390(a)(11)(D)(i)–(ii). *Compare id.*, *with* 11 U.S.C. § 550(a).

346. 12 U.S.C.A. § 5390(a)(11)(E). *Compare id.*, *with* 11 U.S.C. § 550(b).

347. 12 U.S.C.A. § 5390(a)(11)(F)(i).

348. *See id.* § 5390(a)(11)(F)(ii); *see also* 11 U.S.C. §§ 546(b)–(c), 547(c), 548(c).

or forward contracts; (ii) repurchase agreements; (iii) swap agreements; and (iv) master netting agreements,[349] and with respect to certain payments and transfers concerning contracts constituting "value" for purposes of § 548.[350] However, under a slightly different approach, the FDIC may not avoid "any transfer of money or other property in connection with any qualified financial contract with a covered financial company" unless "the transferee had actual intent to hinder, delay, or defraud such company, the creditors of such company . . . or the [FDIC] as receiver [for the covered financial] company."[351]

B. *Treatment of Rights of Setoff*

Creditors of a covered financial company retain setoff rights on terms generally similar to those applicable under the Bankruptcy Code.[352] However, a key distinction is that "the [FDIC] as receiver . . . may sell or transfer any assets [to a third party or bridge financial company] free and clear of the setoff rights of any party," thereby destroying mutuality.[353] Moreover, instead of the right to setoff being treated as a secured claim (as it is treated under the Bankruptcy Code),[354] a party whose collateral is sold or transferred free of setoff rights is limited to a claim ranking below administrative expenses of the receiver, amounts owed to the United States (unless the United States agrees otherwise), and wages, salaries, or commissions, and certain employee benefit amounts owed to employees up to the statutory cap per individual that are earned not later than 180 days before the appointment of the FDIC as receiver.[355] Therefore, any claim arising from loss of rights of setoff will have priority immediately above claims of unsecured creditors that have general and senior liability claims. In addition, since such setoff rights result in an unsecured claim, those claims will be subject to the provisions concerning determination and payment of unsecured claims in § 5390(a)(2)–(7).[356]

349. *See* 11 U.S.C. § 546(e)–(f), (g), (j).
350. *Id.* § 548(d)(2)(B)–(E).
351. 12 U.S.C.A. § 5390(c)(8)(C).
352. *Compare id.* § 5390(a)(12), *with* 11 U.S.C. § 553.
353. 12 U.S.C.A. § 5390(a)(12)(F).
354. *See* 11 U.S.C. § 506(a)(1).
355. *See* 12 U.S.C.A. § 5390(a)(12)(F).
356. *Id.* § 5390(a)(2)–(7).

As noted above, it may be appropriate for a regulation to clarify whether the requirement under § 5390(a)(7)(B)—that all creditors receive no less than they would under Chapter 7 of the Bankruptcy Code[357]—will apply to the situation where no funds are available from the *liquidation* of a covered financial company under Title II to pay a creditor's claims for setoff,[358] by providing the creditor with a recovery equal to that which it would have received in a case under Chapter 7 of the Bankruptcy Code. Another difference in the treatment of a right of setoff in a case under the Bankruptcy Code is that the creditor, whose setoff right is treated as a secured claim under § 506 of the Bankruptcy Code, may petition the bankruptcy court to lift the automatic stay in order to realize its right of setoff.[359] If such creditor succeeds in having the stay lifted, it may be able to be paid sooner than other creditors as a result of exercise of its right of setoff.

X. BRIDGE FINANCIAL COMPANIES

A. *Formation of and Transfer of Assets and Liabilities to Bridge Financial Companies*

The FDIC, as receiver of one or more covered financial companies, is empowered to create one or more "bridge financial companies"[360] to succeed to selected assets and liabilities of the covered financial company as well as rights and privileges of the covered financial company.[361] A bridge financial company has the authority to purchase assets, assume liabilities, and perform any of the functions of a covered financial company as determined by the FDIC.[362] This may be accomplished without notice to, input from, or consent of any creditors or shareholders and without approval from any court.[363] The transfer of any assets or liabilities of a covered financial company to a bridge financial company "(including [those] associated with any trust or custody business)" is "effective without any further approval under Federal or State law, as-

357. *See supra* notes 207-210 and accompanying text.
358. *Id*.
359. *See* 11 U.S.C. § 506.
360. *See* 12 U.S.C.A. § 5390(h).
361. *Id*. § 5390(h)(1)(B), (2)(E)(i).
362. *Id*. § 5390(h)(1)(B).
363. *See id*. § 5390(h)(2)(E)(ii).

signment, or consent with respect thereto."[364] The FDIC may also "provide for a bridge financial company to succeed to and assume any rights, powers, authorities, or privileges of the covered financial company" and such succession is "effective without any further approval under Federal or State law, assignment, or consent with respect thereto."[365]

The formation of the bridge financial company ostensibly allows the FDIC to segregate, and continue the operation of, assets subject to the related liabilities necessary for a viable enterprise. The bridge financial company is similar to the mechanism available to the FDIC under the FDIA, which establishes a bridge bank,[366] and to mechanisms under state laws applicable to insurance company insolvency, which allow the segregation and preservation of good assets for sale or other disposition.[367]

B. *Management and Funding of Bridge Financial Company*

The bridge financial company is to be managed by a board of directors, appointed by the FDIC, and may follow the corporate governance rules of the State of Delaware or the state in which the applicable covered financial company is organized or incorporated.[368]

The bridge financial company does not need to be funded with capital or surplus,[369] although the aggregate amount of liabilities assumed by a bridge financial company "may not exceed the aggregate amount of the assets . . . that are transferred to, or purchased by, the bridge financial company . . . ."[370] In addition, "the [FDIC] may make available to the bridge financial company, subject to the [orderly liquidation plan provided in § 5390(n)(9)], funds for the operation of the bridge financial company in lieu of

364. *Id.* § 5390(h)(5)(A), (D). This contrasts with transfers of assets of a covered financial company to third parties who are subject to certain antitrust notifications and clearances. *Id.* § 5390(a)(1)(G)(i)–(ii). However, antitrust notifications and clearances will apply to a merger of a bridge financial company with, or sale of a bridge financial company's assets to, a third party. *Id.* § 5390(h)(11).

365. *Id.* § 5390(h)(2)(E).

366. *See* 12 U.S.C. § 1821(n) (2006) (describing the creation of bridge banks).

367. *See, e.g.*, MISS. CODE ANN. § 83-15-9 (West 2011).

368. 12 U.S.C.A. § 5390(h)(2)(B), (F).

369. *Id.* § 5390(h)(2)(G)(i).

370. *Id.* § 5390(h)(5)(F).

capital."[371] "If the [FDIC] determines such action is advisable, [it] may cause capital stock or other securities of [the] bridge financial company . . . to be issued and offered for sale in such amounts and on such terms and conditions as the [FDIC] may . . . determine."[372]

The FDIC may, subject to the orderly liquidation plan, provide funding to facilitate mergers or consolidations of bridge financial companies with other non-bridge financial companies.[373] It may also facilitate the sale of a majority of the bridge financial company's capital stock to another company, or eighty percent or more of the stock to a person other than the FDIC or another bridge financial company.[374] The FDIC also may provide funding for the assumption "of all or substantially all of the liabilities of the bridge financial company . . . or the acquisition of all or substantially all of the assets of the bridge financial company, [in each case] by a company that is not a bridge financial company, or other entity permitted under applicable law."[375] In addition, the FDIC may also provide funding to "facilitate the acquisition by a bridge financial company of any assets, or the assumption of any liabilities, of a covered financial company."[376]

A bridge financial company is authorized to "obtain unsecured credit and issue unsecured debt."[377] If it is not able to do so, then with the approval the FDIC, the bridge financial company may obtain credit or issue unsecured debt that:

> (i) [has] priority over any or all obligations of the bridge financial company; (ii) [is] secured by a lien on property of the bridge financial company that is not otherwise subject to a lien; or (iii) [is] secured by a junior lien on property of the bridge financial company that is subject to a lien.[378]

371. *Id.* § 5390(h)(2)(G)(iv).
372. *Id.* § 5390(h)(2)(G)(iii).
373. *Id.* § 5390(h)(9), (13)(A).
374. *Id.* § 5390(h)(9), (13)(B)–(C).
375. *Id.* § 5390(h)(13)(D).
376. *Id.* § 5390(h)(9).
377. *Id.* § 5390(h)(16)(A). The FDIC may assume an outstanding credit agreement of the covered financial company and transfer it to a bridge financial company if that would be less expensive than obtaining new credit for a bridge financial company. *See supra* note 322 and accompanying text.
378. 12 U.S.C.A. § 5390(h)(16)(B).

If the bridge financial company can only obtain credit by granting a senior or equal lien on property of the bridge financial company that is subject to a lien, the bridge financial company may only do so (i) upon notice and hearing before a court of the United States that has jurisdiction to conduct such hearing, and (ii) if such court determines "there is adequate protection of the interest of the holder of the lien on the property with respect to which such senior or equal lien is proposed to be granted."[379] The rights of a counterparty to a qualified financial contract may not be impaired by any credit or debt obtained or issued by a bridge financial company, other than the priority of any unsecured claim arising from such default relative to "the bridge financial company's obligations in respect of such credit or debt, unless the counterparty consents in writing to any such impairment."[380]

C. *Treatment of Similarly Situated Creditors by a Bridge Financial Company*

Title II requires that the FDIC treat similarly situated creditors equally when transferring the assets or liabilities of the covered financial company to a bridge financial company, subject to substantially the same exception as that under § 5390(b)(4).[381] The FDIC may not comply with that requirement and

> may take action (including making payments, subject to [the claw back provision of] subsection (o)(1)(D)(i)), if the [FDIC] determines that [(i)] such action is necessary (I) to maximize the value of the assets of the covered financial company; (II) to maximize the present value return from the sale or other disposition of the assets of the

379. *Id.* § 5390(h)(16)(C). *Compare id.* § 5390(h)(17) ("the reversal or modification on appeal of an authorization . . . to obtain credit or issue debt, or of a grant . . . of a priority or a lien, does not affect the validity of any debt so issued, or any priority or lien so granted, to an entity that extended such credit in good faith . . . unless such authorization and the issuance of such debt, or the granting of such priority or lien, were stayed pending appeal"), *with* 11 U.S.C. § 364(e) (2006) (providing protection similar to that under Title II for the validity of debt incurred and any priority or liens granted in respect of debtor in possession financing by a lender that extended credit in good faith absent a stay pending appeal).

380. 12 U.S.C.A. § 5390(h)(16)(E).

381. *Compare id.* § 5390(h)(5)(E) ("[A]ll creditors of a covered financial company that are similarly situated under subsection (b)(1) [shall be treated] in a similar manner."), *with id.* § 5390(b)(4) ("All claimants of a covered financial company that are similarly situated under paragraph (1) shall be treated in a similar manner."). In addition, § 5390(b)(4) permits the FDIC to base its action on a determination that payment is "necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company." *Id.* § 5890(o)(1)(D)(i); *see id.* § 5390(h)(5)(E); (b)(4)(A)(ii).

> covered financial company; or (III) to minimize the amount of any loss realized upon the sale or other disposition of the assets; and (ii) all creditors that are similarly situated under [§ 5390(b)(1)] receive not less than the amount

they would have received if the covered financial company had been liquidated under Chapter 7 of the Bankruptcy Code.[382]

D. *Termination of Bridge Financial Companies*

A bridge financial company will terminate at the end of two years from the date its charter is granted, unless terminated earlier pursuant to § 5390(h)(13)–(14), subject to three additional one-year extensions, at the discretion of the FDIC as receiver.[383] The bridge financial company will "terminate upon the earliest of . . . the merger or consolidation of the bridge financial company with a company that is not a bridge financial company; . . . the sale of a majority of [its] capital stock" to a company (or eighty percent, or more, of its capital stock to a person) other than the FDIC or another bridge financial company, or the assumption of all of its liabilities "by a company that is not a bridge financial company, or the acquisition of all or substantially all of [its] assets" by a company other than a bridge financial company or "other entity permitted under applicable law."[384] If the status of the bridge financial company has not previously been terminated by the transactions enumerated in § 5390(h)(13)(A), (B), (C), or (D), it may be dissolved by the FDIC at any time.[385] Otherwise, the FDIC is required to promptly dissolve the bridge financial company at the end "of the 2-year period following the date the bridge financial company was chartered, or any extension" of such period.[386]

XI. FUNDING FOR ORDERLY LIQUIDATION

Upon appointment of the FDIC as receiver, the FDIC has the discretion to make funds available for the orderly liquidation of the covered financial company, "subject to the conditions set forth

382. *Id.* § 5390(h)(5)(E).
383. *Id.* § 5390(h)(12).
384. *Id.* § 5390(h)(13)(A)–(D).
385. *Id.* § 5390(h)(15)(A)(i).
386. *Id.* § 5390(h)(15)(A)(ii).

in section [5386] . . . and subject to the [repayment] plan described in section [5390](n)(9)."[387] The funds provided include funds which may be used for:

> (1) making loans to, or purchasing any debt obligation of, the covered financial company or any covered subsidiary; (2) purchasing or guaranteeing against loss the assets of the covered financial company or any covered subsidiary, directly or through [a bridge financial company] established . . . for such purpose; (3) assuming or guaranteeing the obligations of the covered financial company or any covered subsidiary to 1 or more third parties; (4) taking a lien on any or all assets of the covered financial company or any covered subsidiary . . . to secure repayment of any transactions conducted [for such funding]; (5) selling or transferring all, or any part, of such acquired assets, liabilities, or obligations of the covered financial company or any covered subsidiary; and (6) making payments pursuant to [§ 5390](b)(4), (d)(4), or (h)(5)(E).[388]

All funds so provided are given priority either as administrative expenses of the FDIC or as monies owed to the United States under § 5390(b)(1)(A) or (B).[389]

A. *Orderly Liquidation Fund*

Section 5390(n)(1) provides for the establishment in the Treasury of an Orderly Liquidation Fund which is to be available for the FDIC to borrow funds to carry out its rights and duties under Title II, "including the orderly liquidation of [the] covered financial compan[y], payment of administrative expenses, [and] the payment of principal and interest" on obligations issued by the FDIC as receiver to the Secretary.[390] To initially fund the Orderly Liquidation Fund, the FDIC has authority to issue obligations to the Secretary.[391]

The Secretary is authorized to purchase and/or sell any obligations issued by the FDIC.[392] All such purchases and sales are to "be treated as public debt transactions of the United States."[393]

387. *Id*. § 5384(d).
388. *Id*.
389. *Id*. § 5390(b)(1)(A), (B).
390. *Id*. § 5390(n)(1).
391. *Id*. § 5390(n)(5)(A).
392. *Id*. § 5390(n)(5)(B), (D).
393. *Id*. § 5390(n)(5)(E).

The proceeds of the sale of such obligations will "be deposited into the Treasury of the United States as miscellaneous receipts."[394]

The maximum obligation that may be incurred by the FDIC for each covered financial company may not exceed:

> (A) . . . 10 percent of the total consolidated assets of the covered financial company, based on the most recent financial statement available, during the 30-day period immediately following the . . . appointment of the [FDIC] as receiver (or a shorter time period if the [FDIC] has calculated the amount described under [(B)]); and
> (B) . . . 90 percent of the fair value of the total consolidated assets of [the] covered financial company that are available for repayment after [such thirty-day period].[395]

Calculation of the maximum obligation that may be incurred requires regulatory guidance and, as provided by § 5390(n)(7), such regulations are to be promulgated by the FDIC and the Secretary in consultation with the Council.[396]

B. *Orderly Liquidation and Repayment Plans*

The Secretary may not provide any funding to the FDIC "unless an agreement is in effect between the Secretary and the [FDIC] that . . . provides a specific plan and schedule" for repayment of the amount borrowed and demonstrates that the FDIC will be able to repay the outstanding balance to the Treasury, with interest accruing on such balance within sixty months.[397] However, the FDIC, with the approval of the Secretary, may extend the repayment schedule if it determines the "extension is necessary to avoid a serious adverse effect on the financial system of the United States."[398]

The Orderly Liquidation Plan (the "Orderly Liquidation Plan") outlines how funds are to be used, including under § 5384(d), § 5390(h)(2)(G)(iv) (operating funds for a bridge financial company in lieu of capital), and § 5390(h)(9), (pertaining to funding of a transaction that would facilitate the termination of a bridge financial company through merger or consolidation, sale of stock,

394. *Id.*
395. *Id.* § 5390(n)(6).
396. *Id.* § 5390(n)(7).
397. *Id.* § 5390(n)(9)(A)–(B), (o)(1)(B).
398. *Id.* § 5390(o)(1)(C).

assumption of all or substantially all of the liabilities of a bridge financial company, or sale of substantially all of the assets of a bridge financial company in each case by a company that is not a bridge financial company, or "facilitate the acquisition by a bridge financial company of any assets, or the assumption of any liabilities, of a covered financial company").[399]

The Secretary is required to consult with, and report to, the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives on the terms of any repayment schedule and provide a report to such committees within thirty days from the date any amount is provided through the Secretary's purchase of obligations issued by the FDIC as receiver.[400]

C. *Imposition of Assessment*

The FDIC is required to impose risk-based assessments pursuant to § 5390(o), if such assessments are needed to repay the obligations of the FDIC to the Treasury "within 60 months of the date of issuance of [the] obligations" to the Secretary, subject to extension, if the FDIC, with the approval of the Secretary, extends the period.[401] The FDIC must "determine[ ] that an extension is necessary to avoid a serious adverse effect on the financial system of the United States."[402] The FDIC must first "impose assessments . . . on any claimant that received additional payments or amounts from the [FDIC] pursuant to [§ 5390](b)(4), (d)(4), or (h)(5)(E), except for payments or amounts necessary to initiate and continue operations essential to implementation of the receivership or any bridge financial company."[403] These essential payments cannot "include the provision of financing, as defined by rule of the [FDIC], to third parties."[404] The assessments must be imposed in order to recover, on a cumulative basis, the difference between

> the aggregate value the claimant received from the [FDIC] on a claim . . . (including pursuant to [§ 5390] (b)(4), (d)(4), and (h)(5)(E)),

399. *Id.* § 5390(n)(9)(A), (h)(2)(G)(iv), (h)(9).
400. *Id.* § 5390(n)(9)(B)(ii).
401. *Id.* § 5390(o)(1)(B)–(C).
402. *Id.* § 5390(o)(1)(C).
403. *Id.* § 5390(o)(1)(D)(i).
404. *Id.* § 5390(o)(1)(E).

> as of the date on which such value was received, and . . . the value the claimant was entitled to receive from the [FDIC] on such claim solely from proceeds of the liquidation of the covered financial company under [Title II].[405]

As noted above, it is unclear (i) whether the amount to be recouped is based upon the difference between the amount received and the amount that would be paid on such claim in a case under Chapter 7 of the Bankruptcy Code (i.e., the "Maximum Liability")[406] or (ii) whether the failure to refer to § 5390(d)(2) is meant to require a calculation based upon the priority scheme under § 5390(b).[407] However, § 5390(b) should apply since it would comport with the requirement in § 5390(a)(7)(B) that applies to all unsecured creditors.[408]

To the extent that the funds to be recovered from such creditors are insufficient to pay in full the amount required to be paid within sixty months, the FDIC, after taking into account certain risk-based assessment considerations set forth in § 5390(o)(4),[409] may impose assessments on "(I) eligible financial companies[ ] and (II) financial companies with total consolidated assets equal to or greater than [$50 billion] that are not eligible financial companies."[410] The term "eligible financial companies" is defined as "any bank holding company with total consolidated assets equal to or greater than [$50 billion] and any nonbank financial company supervised by the [FRB]."[411] The FDIC must notify each financial company of its assessment and the financial company must make payment in accordance with rules adopted for such purpose.[412]

Section 5390(o)(6) requires rulemaking by the FDIC, in consultation with the Secretary, concerning assessments and provides that the regulations so prescribed are to

> take into account the differences in risks posed to the financial stability of the United States by financial companies, the differences in the liability structures of financial companies, and the different bases for other assessments that such financial companies may be

405. *Id*. § 5390(o)(1)(D)(i).
406. *Id*. § 5390(d)(2).
407. *See id*. § 5390(b).
408. *See id*. § 5390(a)(7)(B), (d)(2)–(3).
409. *Id*. § 5390(o)(1)(B), (o)(4).
410. *Id*. § 5390(o)(1)(D)(ii).
411. *Id*. § 5390(o)(1)(A).
412. *Id*. § 5390(o)(3), (6).

> required to pay, to ensure that assessed financial companies are treated equitably.[413]

The Council must recommend a risk matrix to the FDIC and the FDIC must take into account such recommendation in establishing the risk matrix to be used in making assessments.[414]

XII. TIME LIMIT ON RECEIVERSHIP AUTHORITY

Section 5382(d) provides that the appointment of the FDIC as receiver is to terminate three years after the date of its appointment.[415] This time period may be extended by the FDIC for up to one additional year if the Chairperson of the FDIC certifies in writing to the Senate Committee on Banking, Housing, and Urban Affairs and House Committee on Financial Services that:

> continuation of the receivership is necessary
> (A) to —
>> (i) maximize the net present value return from the sale or other disposition of the assets of the covered financial company; or
>> (ii) minimize the amount of loss realized upon the sale or other disposition of the assets of the covered financial company; and
>
> (B) to protect the financial system of United States.[416]

The appointment of the FDIC may be extended for yet another year if the Chairperson of the FDIC, with the concurrence of the Secretary, submits the certifications required for the initial extension.[417] The appointment may be extended for a second time

> solely for the purpose of completing ongoing litigation in which the [FDIC] as receiver is a party . . . if (A) the Council determines that the [FDIC] used its best efforts to conclude the receivership [within the previously extended period, and]; (B) the Council determines that the completion of longer-term responsibilities in the form of ongoing litigation justifies the need for an extension . . . .[418]

However, the FDIC's receivership must terminate within ninety days of completion of the litigation.[419]

413. *Id.* § 5390(o)(6).
414. *Id.* § 5390(o)(4).
415. *Id.* § 5382(d).
416. *Id.* § 5382(d)(1)–(2).
417. *Id.* § 5382(d)(2)–(3).
418. *Id.* § 5382(d)(4)(A)–(B).
419. *Id.* § 5382(d)(4).

Other provisions may require the receivership to continue for more than five years whether or not litigation is pending. For example, under § 5390(o), the FDIC is to "charge one or more risk-based assessments . . . [as] necessary to pay in full the obligations issued by the [FDIC] to the Secretary . . . within 60 months[,]" provided that such deadline may be extended "if the [FDIC] determines that an extension is necessary to avoid a serious adverse effect on the financial system of the United States."[420] As noted above, the life of a bridge financial company may be extended for up to a total of five years from the date of its charter which may or may not coincide with the date of the appointment of the FDIC as receiver.[421]

XIII. TREATMENT OF OFFICERS, DIRECTORS, AND EMPLOYEES

Among the mandatory terms and conditions for all orderly liquidations is that the FDIC, in taking action, shall ensure that management and members of the board of directors (or body performing similar functions) "responsible for the failed condition of the covered financial company are removed, if such members have not already been removed at the time" of the appointment of the FDIC as receiver.[422] This is in contrast with Chapter 11 of the Bankruptcy Code, where the debtor in possession, through its officers, continues to operate the company and to negotiate and conduct all sales of assets.[423] Under the Bankruptcy Code, current management of the debtor will continue in their positions unless removed by the debtor's board of directors or until the bankruptcy court determines on motion of a party in interest pursuant to § 1104 of the Bankruptcy Code that cause exists to appoint a Chapter 7 or 11 trustee.[424] Such cause includes "fraud, dishonesty, incompetence, or gross mismanagement of the affairs" of the debtor by the existing management of the debtor.[425]

420. *Id.* § 5390(o)(1)(B)–(C).

421. *Id.* § 5390(h)(12)–(13).

422. *Id.* § 5386(4)–(5).

423. *See* 11 U.S.C. §§ 1107–1108 (2006); *id.* § 1108 note (Legislative Statements) (stating that § 1107 "applies to give the debtor in possession all the rights and powers of a trustee . . . under chapter 11; this includes the power of the trustee to operate the debtor's business under [§] 1108").

424. *See id.* § 1104(a), (e).

425. *Id.* § 1104(a)(1).

The theme of holding senior management accountable for its acts continues in § 5390(b)(1), which effectively subordinates the claims of senior executives and directors of the covered financial company for "wages, salaries, or commissions, including vacation, severance, and sick leave pay earned" below the claims of general and senior unsecured creditors and claims based on any obligations subordinated to general or senior creditors.[426] The only claims that are lower in priority are claims for post-insolvency interest test and the claims of equity holders arising out of their ownership of equity interests.[427] The subordinated treatment of the compensation related claims of senior executives and directors is different from equitable subordination of insider claims under § 510(c) of the Bankruptcy Code because there is no requirement under Title II to show that senior executives or directors had engaged in inequitable conduct which harmed other creditors.[428] It appears that a judgment was made by Congress that senior executives and directors should be held responsible for the financial condition of the covered financial company whether or not they themselves engaged in inequitable conduct.

The term "senior executive" is not defined in the Dodd-Frank Act. In clarifying the ability of the FDIC to retain employees, but not senior executives, under personal services agreements referenced in § 5390(c)(7)(B),[429] the Interim Final Rule section 380.3 defines "senior executive" as:

> any person who participates or has authority to participate (other than in the capacity of a director) in major policymaking functions of the company, whether or not: The person has an official title; the title designates the officer an assistant; or the person is serving without salary or other compensation. The chairman of the board, the president, every vice president, the secretary, and the treasurer or chief financial officer, general partner and manager of a company are considered executive officers, unless the person is excluded, by resolution of the board of directors, the bylaws, the operating agreement or the partnership agreement of the company, from participation (other than in the capacity of a director) in major policymaking

426. 12 U.S.C.A. § 5390(b)(1)(G).

427. *Id.* § 5390(b)(1)(H); *see also* Orderly Liquidation Authority, 76 Fed. Reg. 16,324, 16,337 (proposed Mar. 23, 2011) (to be codified at 12 C.F.R. pt. 380).

428. *Compare* 11 U.S.C. § 510 note (Legislative Statement) (discussing § 510(c)(1)), *with* 12 U.S.C.A. § 5390(b)(1)(G).

429. 12 U.S.C.A. § 5390(c)(7)(B).

functions of the company, and the person does not actually participate therein.[430]

Section 5390(s) provides for the recoupment of compensation from senior executives and directors who are "substantially responsible" for the failure of the covered financial company.[431] The FDIC as receiver "may recover from any current or former senior executive or director substantially responsible for the failed condition of the covered financial company any compensation received during the 2-year period preceding" the receivership.[432] There is no time limit for recoupment in the event of fraud.[433] The FDIC is required to perform a cost benefit analysis in deciding whether to facilitate such a recoupment, weighing "the financial and deterrent benefits of such recovery against the cost of executing the recovery."[434] The FDIC must prescribe regulations to implement the recoupment, "including defining the term 'compensation' to mean any financial remuneration, including salary, bonuses, incentives, benefits, severance, deferred compensation, or golden parachute benefits, and any profits realized from the sale of the securities of the covered financial company."[435]

Section 5390(f) sets forth the circumstances under which a covered financial company's directors and officers "may be held personally liable for monetary damages in any civil action . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross

430. Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4207, 4215 (Jan. 25, 2011) (to be codified at 12 C.F.R. pt. 380).

431. 12 U.S.C.A. § 5390(s). This provision does not define the term "substantially responsible." *See id*. It is unclear what showing must be made to establish the degree of responsibility or whether the fact that a person was the president or chief financial officer of the financial company is sufficient to render the person substantially responsible. *Compare id*., *with* 11 U.S.C. § 548(o)(1) (permitting a trustee to avoid, among other things, "any transfer to or for the benefit of an insider . . . under an employment contract" of an interest of the debtor in property, or "any obligation . . . incurred by the debtor, that was made or incurred on or within 2 years before the [petition date], if the debtor voluntarily or involuntarily . . . received less than reasonably equivalent value in exchange for such transfer or obligation; and, . . . made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business"). *See also* 11 U.S.C. § 101(31)(B)(i)–(ii) (defining "insider" as a "director of the debtor" or an "officer of the debtor").

432. 12 U.S.C.A. § 5390(s)(1).

433. *Id*.

434. *Id*. § 5390(s)(2).

435. *Id*. § 5390(s)(3).

negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law."[436]

Such actions may be brought by, on behalf of, or at the request of, the FDIC, acting as receiver or based on a cause of action conveyed by the covered financial company or its affiliate in connection with the receivership.[437] The FDIC also retains all other causes of action under other applicable law.[438]

Section 5390(g) further provides that:

> [i]n any proceeding related to any claim against a director, officer, employee, agent, attorney, accountant, or appraiser of a covered financial company, or any other party employed by or providing services to a covered financial company, recoverable damages determined to result from the improvident or otherwise improper use or investment of any assets of the covered financial company shall include principal losses and appropriate interest.[439]

Regulations are necessary to clarify what the term "principal losses" includes and how and from what date interest is to be calculated (i.e., whether the applicable rate of interest is the judgment rate under applicable state or federal law, or some other rate such as the rate for post-insolvency interest, and whether interest is to be computed from the date of judgment or some other date).

Section 5390(j) provides for expedited consideration of any appeals of an order entered in a case brought by the FDIC against officers, directors, employees, or agents of a covered financial company.[440]

Section 5390(r) prohibits "[p]ersons who engaged in improper conduct with, or caused losses to [the] covered financial compan[y]" from purchasing assets of the covered financial company.[441] Such persons include not only any person (including any officer or director) who defaulted on obligations to the covered financial company that exceed $1,000,000 in the aggregate, engaged in fraudulent activity in connection with such obligations, and "proposes to purchase any such asset in whole or in part [us-

436. *Id.* § 5390(f)(1)–(2).
437. *Id.* § 5390(f)(1).
438. *Id.* § 5390(f)(3).
439. *Id.* § 5390(g).
440. *Id.* § 5390(j)(1).
441. *Id.* § 5390(r)(1).

ing] the proceeds of a loan or advance of credit from the [FDIC] or from [the] covered financial company[,]" but also to "any person who participated, as an officer or director of [the] covered financial company or [its affiliate], in a material way in any transaction that resulted in a substantial loss to [the] covered financial company."[442] However, the provisions of § 5390(r) are not to preclude

> the sale or transfer by the [FDIC] of any asset of any covered financial company to any person, if the sale or transfer of the asset resolves or settles, or is part of the resolution or settlement, of 1 or more claims that have been, or could have been, asserted by the [FDIC].[443]

Section 5393 authorizes a ban on a senior executive or director of the covered financial company from further participation in the financial industry for two years or longer if the person, prior to the appointment of the FDIC as receiver, violated, among other things, any law, regulation, or cease-and-desist order, engaged in "any unsafe or unsound practice in connection with any financial company" or breached its fiduciary duty.[444] A senior executive or director may be notified via written notice from the FRB or the FDIC (if the covered financial company was not supervised by the FRB) of the agency's intent to ban the person from any further participation "in the conduct of the affairs of any financial company for a period of time determined by the appropriate agency" commensurate with the executive's or director's violation.[445] The conduct must have involved "personal dishonesty" or "demonstrate[d] willful or continuing disregard . . . for the safety or soundness of [the financial] company."[446] The violation, practice, or breach must have contributed to the failure of the company and the senior executive or director must have "received financial gain or other benefit [because] of [the] violation, practice, or breach."[447]

In these myriad ways, these provisions assure that the FDIC has ample powers to hold senior executives and directors of covered financial companies accountable for the company's losses for

442. *Id.*
443. *Id.* § 5390(r)(3).
444. *Id.* § 5393(b)(1).
445. *Id.* § 5393(a), (c).
446. *Id.* § 5393(b)(3).
447. *Id.* § 5393(b)(2).

which they are found responsible through subordination of their claims for compensation, and actions for damages, restitution and recoupment.[448] While a Chapter 7 trustee or a debtor in possession in a case under Chapter 7 or Chapter 11 of the Bankruptcy Code may pursue all claims of the debtor for any fraud, misconduct, or wrongdoing by any senior executive or director,[449] there are no provisions of the Bankruptcy Code that expressly provide for actions against officers and directors for damages arising from such conduct. Nor is there any ban on the right of senior executives or directors to acquire assets of the debtor under the Bankruptcy Code. However, under the Bankruptcy Code, any proposed transaction with an insider that is not in the ordinary course of business must be approved by the bankruptcy court after providing notice to all creditors and other parties in interest and a hearing.[450]

XIV. THE RELATIONSHIP OF TITLE I TO TITLE II

Title I of the Dodd-Frank Act ("Title I") provides tools by which the FDIC may prepare for the orderly liquidation of a systemically important financial company if the financial condition of such financial company deteriorates to the point that it presents risk to the financial stability of the United States.

Section 172 of Title I amended § 1820 of the FDIA to provide for enhanced supervision and prudential standards for nonbank financial companies supervised by the FRB and bank holding companies with at least $50 billion in assets.[451] Most significant for Title II is the requirement that such financial companies periodically provide to the FRB, the Council, and the FDIC the resolution plan of such company for its orderly liquidation in the event of material financial distress or failure.[452] Section 5365(d) outlines information which must be provided in the resolution plans, including "full descriptions of the ownership structure, as-

448. *Id.* § 5384(a)(3).

449. 11 U.S.C. § 1104(a)(1) (2006).

450. *Id.* § 363(b).

451. 12 U.S.C.A. § 1820.

452. *Id.* § 5365(d)(1)–(2). These resolution plans, often referred to as "living wills," provide a roadmap for the orderly liquidation of a financial company. *See* Implementing Certain Orderly Liquidation Authority Provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 64,173, 64,176 (proposed Oct. 19, 2010) (to be codified at 12 C.F.R. pt. 380).

sets, liabilities and contractual obligations of the [financial] company."[453] The resolution plan of a covered financial company should, therefore, provide the FDIC with the information needed to make prompt determinations in advance of its appointment as receiver of a covered financial company with respect to the operations or assets that should be transferred to one or more bridge financial companies to continue systemically important operations and allow for an orderly liquidation of assets that maximizes recoveries and minimizes losses.[454]

The resolution plan would also provide information concerning qualified financial contracts and other contracts that could be either transferred to and assumed by a bridge financial company or sold to a third party.[455] The information provided would also assist the FDIC in identifying appropriate acquirers of essential operations of systemically important financial companies so that the sale of assets of a covered financial company might be effected in a prompt and nondisruptive manner, much as transfers of operations of insured depository institutions are effected under the FDIA.[456] In addition, § 1820 of the FDIA, as amended by § 172 of Title I, provides the FDIC with backup examination authority if the board of directors of the FDIC determines that a special examination is necessary for the purpose of implementing the FDIC's orderly liquidation authority to assist it in preparing for the resolution process.[457]

XV. CONCLUSION

A review of the orderly liquidation authority under Title II as compared to a liquidation under either Chapter 7 or Chapter 11 of the Bankruptcy Code is a study in contrasts resulting from the different goals and purposes of the two statutes. The purpose of the Bankruptcy Code is to maximize recoveries to creditors and other stakeholders, while a primary purpose of Title II is to avoid a disorderly liquidation that could have an adverse effect on the financial stability of the United States. As a result of these different goals, Title II will likely have a profound effect on the rights

453. 12 U.S.C.A. § 5365(d)(1)(B).
454. *See* Orderly Liquidation Authority Provisions, 75 Red. Reg. at 64,175–76.
455. 12 U.S.C.A. § 5365(d)(1).
456. *See* Orderly Liquidation Authority Provisions, 75 Fed. Reg. at 64,177.
457. 12 U.S.C.A. § 1820(b)(3)(A).

of creditors, other stakeholders, and the debtor itself as they exist under the Bankruptcy Code. Title II evidences Congress's keen awareness of this issue, since Title II specifically provides for the study of both the Bankruptcy Code and Title II to determine whether amendments to the Bankruptcy Code (as well as the FDIA and other insolvency laws) could effectively address many of the concerns with respect to the effect the liquidation of systemically important financial companies on the financial stability of the United States without abandoning significant rights of creditors and other stakeholders under the Bankruptcy Code.

Section 216 of Title II calls for the FRB, in consultation with the Administrative Office of the United States Courts, to conduct a study regarding the resolution of financial companies under Chapter 7 and Chapter 11 of the Bankruptcy Code.[458] The issues to be studied are:

> (A) the effectiveness of chapter 7 and chapter 11 of the Bankruptcy Code in facilitating the orderly resolution or reorganization of systemic financial companies;
> (B) 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. . . .;
> (C) 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;
> (D) whether amendments should be made to the Bankruptcy Code, the [FDIA], and other insolvency laws to address the manner in which qualified financial contracts of financial companies are treated; and
> (E) the implications, challenges, and benefits to creating a new chapter or subchapter of the Bankruptcy Code should be created to deal with financial companies.[459]

Section 5382(e) directs the Administrative Office of the United States Courts and the Comptroller General of the United States to monitor activities of the District Court (presumably in connec-

458. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 216, 124 Stat. 1376, 1519 (2010).

459. *Id*. Section 216(b) requires that the report be submitted to the Committees on Banking Housing, and Urban Affairs and the Judiciary of the Senate and the Committees on Financial Services and the Judiciary of the House of Representatives (the "Congressional Committees") summarizing such studies "[n]ot later than 1 year after the date of enactment of the [Dodd-Frank] Act, and in each successive year until the fifth year after the date of enactment of [the Dodd-Frank] Act." *Id*.

tion with any future application by the Secretary for liquidation of a systemically important financial company under Title II) and to conduct separate studies regarding the bankruptcy and orderly liquidation process for financial companies eligible to be a debtor under the Bankruptcy Code, including "(i) the effectiveness of chapter 7 or chapter 11 of the Bankruptcy Code in facilitating the orderly liquidation or reorganization of financial companies . . . [and (ii)] ways to make the orderly liquidation process under the Bankruptcy Code for financial companies more effective."[460]

Of the issues identified for study, some appear relatively simple to address. One could envision an amendment to the Bankruptcy Code that provides for a suspension of the rights of early termination and close-out netting under qualified financial contracts for one business day following the filing of a case under Chapter 7 or Chapter 11 of the Bankruptcy Code of a systemically important financial company so that the FDIC or other appropriate regulatory body could propose the transfer of such contracts to a third party. Other issues are more difficult to address, such as the role a bridge financial company might play in the context of a case under the Bankruptcy Code and how that entity might be funded. Ultimately, these studies may result in finding a middle ground that would preserve the rights of creditors and other stakeholders under the Bankruptcy Code, while providing greater certainty that the resolution process under the Bankruptcy Code would not adversely affect the financial stability of the United States, thereby obviating the need for governmental bailouts.

The issues outlined above are worthy of study, but at least for the immediate future the focus must be on Title II itself and on the regulations that will clarify and implement its provisions so that creditors and other stakeholders can understand the implications of a determination by the Secretary that a financial company eligible to be a debtor under the Bankruptcy Code should instead be liquidated under Title II.

460. 12 U.S.C.A. § 5382(e). Section 5382(e) also calls for periodic reports to the Congressional Committees within one year after the enactment of the Dodd-Frank Act and annually thereafter for two years, followed by a report every fifth year after the date of enactment. *Id.*