H.R. 1667, THE FINANCIAL INSTITUTION BANKRUPTCY ACT OF 2017

HEARING

BEFORE THE

SUBCOMMITTEE ON REGULATORY REFORM, COMMERCIAL AND ANTITRUST LAW

OF THE

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THURSDAY, MARCH 23, 2017

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to call, at 9:00 a.m., in Room 2141, Rayburn House Office Building, Hon. Tom Marino (Chairman of the Subcommittee) presiding.

Present: Representatives Marino, Goodlatte, Gaetz, Cicilline, Conyers, and Schneider.

Staff Present: Ryan Dattilo, Counsel; Andrea Woodard, Clerk; and Susan Jensen, Minority Counsel.

Mr. MARINO. Good morning. And in the interest of saving some time here, we're going to get started immediately, because we do have some from each side here.

The Subcommittee on Regulatory Reform, Commercial and Antitrust Law will come to order. Good morning, everyone. Without objection, the Chair is authorized to declare recesses of the Committee at any time.

We welcome everyone to today's hearing on H.R. 1667, the Financial Institution Bankruptcy Act of 2017.

Mr. MARINO. And I now recognize myself for an opening statement.

Before I do that, again, I want to let you know that we're going to—I'm going to do my best to stick to the 5-minute rule, because we may be running in and out of here today, and I really do not want you kind people who took your time to come here to be sitting around waiting for us to come back. And I'll keep my colleagues and myself in line to the 5-minute rule.

Last Congress, the "Financial Institution Bankruptcy Act" was reported favorably by this Committee and passed the House under suspension of the rules. This week, I reintroduced this important piece of legislation with Chairman Goodlatte, and Ranking Members Conyers and Cicilline as cosponsors. Today, we build on last year's record by taking one more opportunity to further examine it.

In the wake of the financial crisis of 2008, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act. That legislation was intended to address, among other things, the potential failure of large financial institutions. While the Dodd-Frank Act created a regulatory process for such an event, the act states that the preferred method of resolution for a financial institution is through the bankruptcy process. However, the Dodd-Frank Act only called for study of, and did not make any amendments to, the Bankruptcy Code to account for the unique characteristics of a financial institution. The legislation before us today fills that void.

The Financial Institution Bankruptcy Act is the product of years of study by industry, legal, and financial regulatory experts, as well as bipartisan review over the course of four separate hearings before the Committee. The legislation includes several provisions that improve the ability of a financial institution to be resolved through the bankruptcy process. It allows for a speedy transfer of a financial firm's assets to a newly formed company. That company would continue the firm's operation for the benefit of its customers, employees, and creditors, and ensure the financial stability of the marketplace.

This quick transfer is overseen by, and subject to, the approval of experienced bankruptcy judges and includes due process protection for parties-in-interest. The bill also creates an explicit role in the bankruptcy process for the key financial regulators. In addition, there are provisions that facilitate the transfer of derivative and similarly-structured contracts to the newly-formed company. This will improve the ability of the company to continue the financial institution's operation.

Finally, the legislation recognizes the factually and legally complicated questions presented by the resolution of a financial institution. To that end, the bill provides that specialized bankruptcy and appellate judges will be designated in advance to preside over these cases.

The bankruptcy process has long been favored as the primary mechanism for dealing with distressed and failing companies. This is due to its impartial nature, adherence to established precedent, judicial oversight, and grounding in the principles of due process and the rule of law.

We are here today as part of an effort to structure a bankruptcy process that is better equipped to deal with the specific issues raised by failing financial firms.

I look forward to hearing from today's expert panel of witnesses on the merits of the Financial Institution Bankruptcy Act and whether any further refinements to the bill are necessary.

Mr. MARINO. Now, since Mr. Cicilline is on his way, what I'm going to do is introduce our witnesses. And then, when David comes, he will make his opening statement.

So, again, good morning and thank you all for being here.

Judge Mary F. Walrath is a United States bankruptcy judge for the District of Delaware. She was appointed in 1998 and served as chief bankruptcy judge from 2003 to 2008. Prior to her appointment, Judge Walrath worked at the Philadelphia law firm of Clark Ladner Fortenbaugh & Young, concentrating in the areas of debtor/creditor rights and commercial litigation.

Judge Walrath is a founding member and co-president of the Delaware Bankruptcy American Inn of Court, a member of the Delaware Chapter of the International Women's Insolvency and Restructuring Confederation, a member of the American Bankruptcy Institute, and a fellow of the American College of Bankruptcy. She is also an editor of the Rutter Group Bankruptcy Practice Guide and an adjunct professor at St. John's Law School in Queens, New York.

Judge Walrath is also active in the National Conference of Bankruptcy Judges and is currently the president-elect of the National Conference of Bankruptcy Judges. Judge Walrath graduated from Princeton University and earned her J.D. cum laude from Villanova University. Judge Walrath clerked for the Honorable Emil F. Goldhaber, the chief judge of the U.S. Bankruptcy Court for the Eastern District of Pennsylvania.

Judge, welcome.

Judge WALRATH. Thank you.

Mr. MARINO. Dr. John B. Taylor is the Mary and Robert Raymond Professor of Economics at Stanford University, a George P. Schultz Senior Fellow in Economics at the Hoover Institution, and is the director of the Stanford Introductory Economics Center. Dr. Taylor also held positions of professor of economics at Princeton University and Columbia University.

Dr. Taylor served as senior economist on the President's Council of Economic Advisers, a member of the President's Council of Economic Advisers, and was also a member of the Congressional Budget Office's Panel of Economic Advisers.

Dr. Taylor also served as Under Secretary of treasury for international affairs, where he was responsible for currency markets, trade in financial services, foreign investments, international debt and development, and oversight of the International Monetary Fund and the World Bank.

Dr. Taylor received the 2015 Truman Medal for Economic Policy, for extraordinary contributions to the formation and conduct of economic policy; the Alexander Hamilton Award for his overall leadership at the U.S. Treasury; the Treasury Distinguished Service Award for designing and implementing the currency reforms in Iraq—I would love to have a discussion with you about that over lunch, because it would take us a couple of hours; and the Medal of the Republic of Uruguay for his work in resolving the 2002 financial crisis. He received his B.A. in economics summa cum laude from Princeton University, and a Ph.D. in economics from Stanford University.

Doctor, welcome.

Mr. Stephen Hessler is a partner in the restructuring group of Kirkland & Ellis.

His practice involves representing debtors, creditors, and investors in complex corporate Chapter 11 cases, out-of-court restructuring, acquisitions, and related trial, and appellate litigation.

In addition to practicing law, Mr. Hessler is an author and frequent lecturer on a variety of restructuring-related topics, including as a professor at the University of Pennsylvania, where he teaches a restructuring class to both law school and Wharton students.

Mr. Hessler has been recognized by both Chambers and Turnarounds & Workouts as an outstanding restructuring lawyer. Mr. Hessler received his B.A. and J.D. from the University of Michigan, where he served as the managing editor of Michigan's Law Review.

And just in case he needs any assistance, he has two handsome young gentlemen behind him, his sons, here visiting us today.

And welcome. And, Mr. Hessler, thank you for being here.

Mr. HESSLER. Thank you, Mr. Marino.

Mr. MARINO. Mr. Bruce Grohsgal is the Helen S. Balick Visiting Professor in Business Bankruptcy Law. Prior to joining Widener University, Mr. Grohsgal was a partner in the Wilmington, Delaware, office of Pachulski—you're throwing some good stuff here at me—Stang Ziehl & Jones LLP.

He has represented debtors, creditors, committees, and trustees in Chapter 11 bankruptcy cases and litigation, including the debtors in Solyndra, Global Home Products/Anchor, Chi Chi's, and Trans World Airlines, the creditors' committee in Freedom Communications, Orange County Register, and Jevic Transportation, and the Chapter 11 trustee in Le-Nature's. He previously was a partner in Wolf Block Schorr and Solis-Cohen LLP in Wilmington and Philadelphia.

Professor Grohsgal was a senior fellow at Americans for Financial Reform, Washington, D.C., and was the Chair of the Bankruptcy Section of Delaware State Bar Association. He received his B.A. from Brandeis University and his J.D. from Columbia Law School, where he was a Stone Scholar.

Professor, welcome.

And I do have to add that the judge and Professor Grohsgal are in my district, so to speak, in Pennsylvania's 10th District. And you maybe need to do a throw out for——

Judge WALRATH. Yes. I was born and raised in Wellsboro, Pennsylvania, and I have a lot of family up there. So thank you for representing their interests.

Mr. MARINO. As the crow flies, that's about 30 minutes from my place. And now it is my honor to look to my good friend, Congressman Cicilline, the former mayor of Providence, Rhode Island, and we're paisans.

So, Mr. Cicilline.

Mr. CICILLINE. Thank you, Mr. Chairman. I wanted to stop the shameless pandering of the panel to the Chairman at all costs.

Thank you, Mr. Chairman.

In 2008, the United States economy nearly collapsed as a direct result of lending practices in the housing market that were predatory, unsafe, and in many cases fraudulent. Investments in toxic securities created a cycle of failure in the housing market. The declining health of the market undermined the value of these securities, which, in turn, devastated the housing market and caused the failure of several of the Nation's largest financial institutions.

With the financial system in near collapse, large financial institutions were essentially able to blackmail the government, because these banks were so large that there was no way to break them apart, as then FDIC Chair Sheila Bair testified in 2009.

Although the true hardship caused by this widespread fraud is incalculable, we do know that it erased $10 trillion of household wealth and caused eight million Americans to lose their jobs and five million Americans to lose their homes. Rhode Island, my home State, was hit particularly hard by this recession. When I took office, the unemployment rate in Rhode Island hovered at 11.2 percent, the fifth-highest in the country.

In the wake of this economic disaster, the Dodd-Frank Act was enacted to comprehensively reform the financial system. Because of this law, which includes some of the strongest consumer protections passed since the Great Depression, the banking system is stronger, there is more transparency in consumer lending, and the Consumer Financial Protection Bureau continues to serve as an important watchdog to protect Americans against predatory lending and fraud in the financial system.

Title I of Dodd-Frank provides stability in markets by requiring large financial institutions to have a living will, to serve as a plan for the rapid and orderly resolution in the event of material financial distress or failure.

Title II ends taxpayer bailouts of banks that are too big to fail by providing financial regulators with orderly liquidation authority where a bank's collapse would have serious adverse effects on financial stability in the United States and no viable private sector alternative is available. This process expressly requires a finding by the Secretary of Treasury that the bankruptcy process would not be appropriate to resolve a distressed firm.

Leading commentators agree, however, that the U.S. bankruptcy process is not designed to accommodate the orderly resolution of a large financial institution that poses systemic risk to the entire economy. H.R. 1667, the Financial Institution Bankruptcy Act, addresses this concern by establishing a single point of entry for the resolution of an insolvent financial institution with assets exceeding $50 billion. The goal of this bill is to establish a process where a distressed financial institution could voluntarily seek bankruptcy relief while its subsidiaries continue to operate.

While I support H.R. 1667, make no mistake, I will strongly oppose any effort to combine this measure with repeal of the Dodd-Frank Act or any of its provisions.

Since this law was enacted, the economic recovery has led to the creation of more than 15 million private sector jobs, a 60 percent increase in business lending, and record performance by the Dow Jones Industrial Average. It is critical that we build on this progress through education, training, and other initiatives to promote economic opportunity. Too many Americans are still unemployed or working two or even three jobs just to get by, while Wall Street has never been better.

We must also preserve and advance the protections established by the Dodd-Frank Act, to ensure transparency and stability in the financial system, while protecting consumers.

The National Bankruptcy Conference agrees with this assessment and has previously instructed that the Dodd-Frank Act should, quote, "continue to be available even if the Bankruptcy Code is amended to better address the resolution of SIFIs, because the ability of U.S. regulators to assume full control of the resolution process, to elicit the cooperation from non-U.S. regulators, is an essential insurance policy against systemic risk and potential conflict and dysfunction among the multinational components of SIFIs.".

Moreover, should this legislation become law, Dodd-Frank provides a valuable backstop to bankruptcy through its orderly liquidation authority, which empowers the Federal Deposit Insurance Corporation to act as the receiver for large financial institutions that are too big to fail.

I thank the witnesses for appearing before us today and very much look forward to hearing your testimony.

And with that, I yield back the balance of my time.

Mr. MARINO. Thank you.

The Chair now recognizes the Chairman of the full Judiciary Committee, Mr. Goodlatte of Virginia, for his opening statement.

Chairman.

Chairman GOODLATTE. Thank you, Mr. Chairman, and I appreciate your holding this hearing.

Our Nation's financial system provides the lifeblood for industry, small businesses, and our communities to develop, grow, and prosper. Ensuring that this system functions efficiently in both good times and bad is critical to the ongoing vitality of our economy.

The 2008 financial crisis illustrated that the financial system and existing laws were not adequately prepared for the insolvency of certain institutions, which threatened the very stability of the global economy and our financial industry. There has been considerable debate over whether Congress' main response to the financial crisis—the Dodd-Frank Wall Street Reform and Consumer Protection Act—is adequate to respond to a future crisis.

Today's hearing, however, is not focused on that debate. Instead, we turn our attention to the private and public efforts to strengthen the Bankruptcy Code so that it may better facilitate the resolution of an insolvent financial firm, while preserving the stability of the financial markets.

The subject of today's hearing, the "Financial Institution Bankruptcy Act of 2017", is a reflection of these efforts. The bill is calibrated carefully to provide transparency, predictability, and judicial oversight in a process that must be executed quickly and in a manner that is responsive to potential systemic risk.

Additionally, the bill incorporates the "single point of entry" approach, which facilitates a quick transfer of assets and some of the liabilities of the financial institution's holding company to a newly formed bridge company. The consensus of experts in public and private industry believes this is the most effective and feasible method to resolve a financial institution that has a bank holding company.

The Judiciary Committee has a long history of improving the Bankruptcy Code to ensure that it is properly equipped to handle all failing companies. The Financial Institution Bankruptcy Act adds to this history by enhancing the ability of financial firms to be resolved through the bankruptcy process.

The development of the legislation before us today has been a collaborative effort and included the financial and legal communities, Members of Congress on both sides of the aisle, the Federal Reserve, the FDIC, the courts, and the Department of Treasury.

I applaud Chairman Marino for continuing this important effort to strengthen the Bankruptcy Code and for holding today's hearing.

I look forward to hearing from today's witnesses on the Financial Institution Bankruptcy Act and whether there is a need for any further revisions to the bill.

Thank you, Mr. Chairman. I yield back.

Mr. MARINO. Thank you.

Each of the witnesses' written statements will be entered into the record in its entirety. I ask that each witness summarize his or her testimony in 5 minutes or less. To help you stay within that timing, there are lights in front of you. The lights will switch from green to yellow, indicating that you have a minute left; and when it turns red, your time has run out. I will politely raise the end of the gavel just to give you a little indication, because I know you are concentrating on your statement, and that's so we can get through this so we don't have to keep you here today.

But first of all, I need to swear you in. And would you please stand and raise your right hand?

Do each of you solemnly swear to tell the truth, the whole truth, and nothing but the truth in your testimony before this Committee today, so help you God?

Let the record reflect that the witnesses have answered in the affirmative.

Judge, would you like to begin with your opening statement?

TESTIMONY OF THE HONORABLE MARY F. WALRATH, ESQ., U.S. BANKRUPTCY JUDGE, DISTRICT OF DELAWARE; PROFESSOR JOHN B. TAYLOR, PH.D., MARY AND ROBERT RAYMOND PROFESSOR OF ECONOMICS AT STANFORD UNIVERSITY, GEORGE P. SHULTZ SENIOR FELLOW IN ECONOMICS AT STANFORD UNIVERSITY'S HOOVER INSTITUTION; MR. STEPHEN E. HESSLER, ESQ., PARTNER, KIRKLAND & ELLIS, LLP; AND PROFESSOR BRUCE GROHSGAL, ESQ., HELEN S. BALICK VISITING PROFESSOR IN BUSINESS BANKRUPTCY LAW, WIDENER UNIVERSITY, DELAWARE LAW SCHOOL

TESTIMONY OF MARY F. WALRATH

Judge WALRATH. Yes. Thank you, Mr. Chairman and members of the House Judiciary Committee.

My name is Mary Walrath. I have been sitting as a bankruptcy judge in the District of Delaware since 1998. I am currently the president of the National Conference of Bankruptcy Judges, which represents all 350 bankruptcy judges.

However, I am here in my personal capacity, and I can take no position for or against any specific legislation pending before Congress. But as a bankruptcy judge, I have had experience dealing with large corporate bankruptcies and presided over the case filed by the holding company of Washington Mutual Bank.

A bill that allows for voluntary bankruptcy proceedings involving holding companies of financial institutions, even systemically important ones, before the financial institution is seized and sold is a laudable goal. There are several reasons why I believe this is good.

First, bankruptcy laws are familiar to the public. More than any other part of the Federal judicial system, the general public comes into contact most often with bankruptcy courts. In this instance, there are between 800,000 and 1.6 million bankruptcy cases filed annually, including more than 7,000 business bankruptcy cases.

In addition to the number of debtors who file bankruptcy, however, hundreds of thousands of people come in contact with the bankruptcy system, as creditors, employees, retirees, landlords, customers, and vendors of debtors in bankruptcy.

The process has become so familiar to the public that a large percentage of individuals who file bankruptcy do so without the benefit of counsel. In addition, even in the largest corporate bankruptcy cases, individuals with claims against the debtor feel comfortable enough about the process to proceed without counsel.

In contrast, few people and attorneys have ever been involved in proceedings dealing with the Federal Deposit Insurance Corporation. People just do not know what it is and have never had any experience with it.

If Congress wants to instill confidence in the public about the resolution of a systemically important financial institution, it is wise to use a process with which the public is familiar.

Second, in contrast to FDIC proceedings, bankruptcy cases are largely transparent. Today, all bankruptcy pleadings are filed electronically and are readily accessible to the public. Bankruptcy hearings are open to the public and most courts allow parties in interest, including small creditors and shareholders, to appear and to listen telephonically, even to appear and make their case without the benefit of counsel, and many have done so successfully.

It is also important that the Bankruptcy Court provides a forum for negotiation and consensual resolution without the need for a contested hearing or trial, but with the assurance that a court is available if there is not consensus. In fact, plans of reorganization in Chapter 11 are premised largely on consensus and agreement.

Third, bankruptcy courts are used to holding hearings on short notice and making expeditious rulings. In large corporate bankruptcy cases, even where assets exceed $100 million, first-day hearings are held within a day or two of a Chapter 11 filing, to address emergency matters that will keep the business operating.

The legislation before you has similar expedited notice provisions. The Bankruptcy Court should be able to handle such an expedited schedule with only minor adjustments. I would, however, strongly urge Congress to consider requiring more judges be designated to handle these matters, just to be sure there is one available when the need arises.

The legislation also asks that the Bankruptcy Court should consider the systemic risk to the markets in making its rulings. While that is not always done, the courts are fully capable of considering that factor and, if evidence is presented, making a ruling appropriately.

In addition to the advantages of a voluntary bankruptcy option, I understand the legislation seeks to avoid the necessity to borrow funds from the Treasury, even on a temporary basis. The holding company would be expected, consistent with its living will, to have sufficient funds to fund the operating entities, to assure they are viable in the event of a bankruptcy filing.

In sum, I think that the legislation properly provides an option for a holding company to either file a Chapter 11 petition, to file a Subchapter V petition, or to allow for resolution under the FDIC regime.

So thank you very much for allowing me to express my views.

Judge Walrath's written statement is available at the Committee or on the Committee Repository at: *http://docs.house.gov/meetings/JU/JU05/20170323/105758/HHRG-115-JU05-Wstate-WalrathM-20170323.pdf.*

Mr. MARINO. Thank you, Judge.

Dr. Taylor, please.

TESTIMONY OF JOHN B. TAYLOR

Mr. TAYLOR. Thank you, Mr. Chairman, other Members of the Committee, for inviting me to testify on the Financial Institution Bankruptcy Act, which in my view is an essential element of a good pro-growth economic program.

The act would make failure feasible under clear rules without disruptive spillovers. It would help prevent bailouts. It would diminish excessive risk-taking. It would remove uncertainty about an inherently ad hoc bailout process. It would also reduce the likelihood and severity of a financial crisis going forward, and I think thereby would lead to stronger economic growth.

As Judge Walrath has stated, Chapter 11 has many benefits, including its basic reliance on the rule of law. But for large complex financial institutions, it has some shortcomings. It is too slow and cumbersome to deal with the possibility of runs on failing financial institutions.

The Financial Institution Bankruptcy Act would also rely on the rule of law and strip priority rules of bankruptcy, but it would operate faster, over a weekend, and it will leave operating subsidiaries outside of bankruptcy entirely. It would do this by moving the original firm's financial operations to a new bridge company that is not in bankruptcy. It would, thus, let a failing financial firm go into bankruptcy in a predictable, rules-based manner without spillovers.

To understand how a reformed Bankruptcy Code would resolve a large financial institution, I think there is no substitute for thinking about how it would have worked in past cases, including the Lehman Brothers case. Emily Kapur of Stanford University has provided this analysis for us, and I have summarized it through her writings in my testimony that I've attached.

The Financial Institution Bankruptcy Act would work better, in my view, as a resolution device than Title II of Dodd-Frank. In that case, the FDIC would exercise considerable discretion. Even if the Title II process were used, bailouts would be likely, in the sense that the FDIC might wish to hold some creditors harmless in order to prevent spillovers. The perverse incentive effects of bailouts occur whether or not the extra payment comes from the Treasury, financed by taxpayers; from a fund financed by financial institutions; or from smaller payments for other creditors.

Moreover, under Title II, a government agency, such as the FDIC and its bridge bank, would make the decisions. In contrast, under bankruptcy reorganization, private parties, motivated and incentivized by profit-and-loss considerations, make key decisions about the direction of the new firm.

Another advantage of the Financial Institution Bankruptcy Act is that it would facilitate resolution planning under Dodd-Frank. Some of the resolution plans submitted by the large financial firms have been rejected by the Fed and the FDIC. With the Financial Institution Bankruptcy Act, the plans would be more feasible.

The issue of liquidity should be considered if the Financial Institution Bankruptcy Act were to replace Title II. The new firm might need lender of last resort support. I believe section 13(3) of the Federal Reserve Act would be available in such circumstances. And I think, when combined with the expectation of having to suffer losses imposed by a bankruptcy, the additional expectations of possible new loans afterwards would cause little moral hazard.

I think international arrangements should also be considered if the Financial Institution Bankruptcy Act were to replace Title II. For example, current European resolution authorities contemplate a parallel authority abroad in the United States. If Title II were repealed and there was no parallel authority in the U.S., then some way to cooperate internationally would have to be created.

In sum, in my view, reform of the bankruptcy law, such as with the Financial Institution Bankruptcy Act, is essential for ending government bailouts and for creating a robust financial system, and it would also create economic stability and growth. I think the Financial Institution Bankruptcy Act has clear advantages over Title II of the Dodd-Frank Act and, in fact, it would be a preferable resolution process even if Title II remained.

Thank you very much. I'd be happy to answer your questions.

Prof. Taylor's written statement is available at the Committee or on the Committee Repository at: *http://docs.house.gov/meetings/JU/JU05/20170323/105758/HHRG-115-JU05-Wstate-TaylorJ-20170323.pdf.*

Mr. MARINO. Thank you, Doctor.

Mr. Hessler.

TESTIMONY OF STEPHEN E. HESSLER

Mr. HESSLER. Thank you, Chairman Marino, Chairman Goodlatte, Ranking Member Cicilline, Members of the Committee. Thank you for inviting me to testify at today's hearing.

I am pleased to appear before this Subcommittee again regarding the Financial Institution Bankruptcy Act of 2017, also known as FIBA. It was my privilege to testify in both July 2014 and July 2015 in support of the prior iterations of FIBA, which were passed by the Judiciary Committee in September 2014 and March 2016 and by the full House in December 2014 and April 2016.

Given the comprehensive record addressing FIBA, I will not repeat my prior written and oral testimonies and will instead focus in my opening remarks on a couple of the key issues that I understand are presently the subject of particular scrutiny. First, whether FIBA should shield a covered financial corporation's board of directors from potential liability for acting in good faith to authorize a filing and asset transfer. And second, whether FIBA should provide the Federal Government with the ability to initiate an involuntary case against a failing covered financial corporation.

Turning to that first issue, director and officer liability, section 1183(c) of FIBA provides that the board of directors of a covered financial company, "shall have no liability to shareholders, creditors, or other parties in interest for a good faith filing of a petition to commence a case under the subchapter or for any reasonable action taken in good faith in contemplation of, or in connection with, such a petition or transfer under section 1185 or 1186, whether prior to or after commencement of the case."

This exculpation provision understandably may prompt some to question whether FIBA is unwarrantedly shielding directors and officers from potential liability for their actions or inactions. In my view, for the following reasons, this provision is highly justifiable.

In my experience as a practitioner representing very large Chapter 11 debtors, the knowledge, expertise, and commitment of the company's pre-petition directors and officers are indispensable to effectuating a soft landing into and orderly passage through bankruptcy. FIBA incentivizes such conduct by removing the specter of legal liability for actions taken as responsible fiduciaries.

The scope and language of section 1183(c) are both appropriately limited. The only board decisions that FIBA protects from potential liability are for a, "good faith filing of a petition to commence a case," and for, "any reasonable action taken in good faith in connection with the filing or asset transfer decision."

To that end, FIBA merely reinforces the existing requirement that a Chapter 11 filing must be made in good faith, and if it is not and the case is dismissed, FIBA offers no added protection from liability. Moreover, I believe it is manifestly sound public policy that any reasonable action taken in good faith in contemplation of, or in connection with, the filing or asset transfer decision should be protected. If it can be shown that the challenged actions were taken in bad faith or were unreasonable, the board can and should be held liable.

Importantly, FIBA does not supplant any existing remedies, both under the Bankruptcy Code or otherwise applicable law, for any board malfeasance. Any legally cognizable director and officer misconduct should be prosecutable to the fullest extent of the law, and FIBA in no way impedes the ability of law enforcement or interested parties from holding directors and officers accountable.

Turning to the second issue, prior versions of FIBA allowed the Federal Government to file an involuntary petition commencing a Chapter 11 case without the covered financial corporation's consent. I and others have testified that this grant of authority was an unnecessary and unhelpful distraction, and the version of FIBA that passed the House in April 2016 did not include this provision. Ideally, the next version of FIBA likewise will decline to give the Federal Government this ability.

Most importantly for present purposes is that the Federal Government, either through even only the threat of a Title II proceeding or through the Federal Government's other general regulatory powers, already has sufficient influence to compel a covered financial corporation to commence a Chapter 11 case without having to resort to a formal involuntary filing trigger.

And regardless of whether Title II remains in place or whether FIBA ultimately provides the Federal Government with an involuntary filing right, it is exceedingly unlikely, in my opinion, that there would ever be an involuntary case of a covered financial corporation.

As its day of reckoning gets closer, an insolvent SIFI already will be in active negotiations with its key creditor and third-party constituencies over the timing and necessity of a potential filing, and it will be highly motivated to file a voluntary case before a creditor or regulator is able to commence an involuntary proceeding.

I thank the Subcommittee for allowing me to share my views on this legislation, and I welcome the opportunity to answer any questions about my testimony.

Mr. Hessler's written statement is available at the Committee or on the Committee Repository at: *http://docs.house.gov/meetings/JU/JU05/20170323/105758/HHRG-115-JU05-Wstate-HesslerS-20170323.pdf.*

Mr. MARINO. Thank you, Mr. Hessler.

Professor Grohsgal.

TESTIMONY OF BRUCE GROHSGAL

Mr. GROHSGAL. Thank you.

Good morning, Chairman Marino, Chairman Goodlatte, Ranking Member Cicilline, Member Schneider, and the other Members of the Committee. Thank you for inviting me to testify today with respect to the Financial Institution Bankruptcy Act of 2017, often referred to as FIBA.

The goal of FIBA is to facilitate the swift and transparent resolution of a distressed financial institution under the Bankruptcy Code, a goal that I applaud. However, there are problems with this bill.

FIBA uses the special point of entry—the single point of entry strategy developed by the FDIC under Dodd-Frank to accomplish its goals. Under this strategy, as Chairman Marino stated, only the top tier holding company will file for bankruptcy. The debtor in the first 2 days of the bankruptcy case will then transfer its good assets, including the ownership interests in its solvent subsidiaries, to the newly formed bridge company.

I will focus my testimony today on five issues:

First, the "no liability" safe harbor protection that Mr. Hessler just referred to for directors under FIBA.

Second, the provisions of FIBA that will significantly weaken the balance sheet of the bridge bank, making its obtaining financing in the credit markets less likely and making taxpayer bailouts more likely.

Third, the illusory and opaque nature of the restructuring, all of which will occur within 48 hours, with most creditors and other parties left out of the process and with minimal, if any, knowledge of it or what happened in those 2 days.

Fourth, the fact that FIBA perpetuates the safe harbors for repurchase agreements, derivatives, and other qualified financial contracts, despite substantial evidence that the safe harbors should be modified or eliminated.

And fifth, the necessity of retaining the orderly resolution authority of Dodd-Frank Title II as a last but crucial resort if the financial institution's bankruptcy nonetheless poses substantial risk to the financial system. I note with respect to that point that this bill does not end Title II authority, but other bills that are being repeatedly introduced before Congress do.

I will address these five points briefly in turn.

First, FIBA gives directors "no liability" safe harbor protections from any liability for actions taken in contemplation of the bankruptcy case or transfers to the bridge company. The "no liability" safe harbor is highly likely to encourage directors to take actions that are risky, self-serving, and unnecessarily harm Main Street creditors.

In may safe harbor improvident actions taken over a substantial period of time during which the directors of a distressed financial institution are contemplating a possible bankruptcy filing. This protection is unnecessary, because directors already have strong incentives to file for bankruptcy rather than risk a Title II Dodd-Frank proceeding, including that they will be removed from office in a Title II proceeding and that they run the risk under section 210(s) of Dodd-Frank that they'll have to disgorge compensation and bonuses.

"Good faith," as used in the current Bankruptcy Code, does not safe harbor directors, "good faith," as used in U.S. corporate law, does, and I think it is inappropriate to include that in this bill.

Second, FIBA requires the transfer to the bridge company and the assumption of liabilities by the bridge company within 48 hours of the case, prior to the expiration of the 48-hour stay. The order of magnitude of this requirement can't be overestimated. JPMorgan Chase has $50 trillion, double the GDP of the United States in notional value of derivatives and other qualified financial contracts that it assumes would take 18 months to unwind. Lehman Brothers had 1.2 million different derivatives contracts with 65,000 counterparties.

The 48-hour deadline will result in the bridge company's assuming many disadvantageous contracts and leaving many advantageous contracts behind. Further, the bridge company must assume the entire amount of any debt that's collateralized even by a nominal amount of the debtor's property. These provisions can be expected to weaken the balance sheet of the bridge company, making financing in the credit markets less likely or even impossible and making taxpayer bailouts more likely.

Third, the restructuring that will occur under FIBA is, to a great extent, illusory. On the transfers to the bridge company, the Bankruptcy Court loses its jurisdiction and authority and no further restructuring will take place. And, again, that is not a typical bankruptcy process whereby there is transparency and creditor involvement, but one in which very few parties will do things that people will not be aware of.

Fourth, FIBA perpetuates the safe harbors of qualified financial contracts, which I urge Congress to reconsider.

And fifth and finally, we still need the orderly resolution process of Title II of Dodd-Frank as a last, if crucial, resort.

And I thank the Committee again for inviting me to testify today. Thank you.

Prof. Grohsgal's written statement is available at the Committee or on the Committee Repository at: *http://docs.house.gov/meet-*

ings/JU/JU05/20170323/105758/HHRG-115-JU05-Wstate-GrohsgalB-20170323.pdf.

Mr. MARINO. Thank you, Professor.

The Chair now recognizes the Chairman of the full Committee, Congressman Goodlatte, for his questioning.

Chairman GOODLATTE. Thank you, Mr. Chairman.

Mr. Hessler, I arrived late, so I may not have received all the introductions, but I note that you have some advisers and support staff behind you, and they have been very well behaved, and I wonder if you would care to introduce them to us.

Mr. HESSLER. Thank you very much, Mr. Chairman.

These are my two oldest children. Our twin 9-year-old sons are presently on spring break. And I thank the Subcommittee for providing them with what is almost certainly the most unique civics lesson for anyone in their third grade class.

Chairman GOODLATTE. I think it's great to have them here.

Mr. HESSLER. Thank you.

Chairman GOODLATTE. You had in the past had some reservations regarding the single point of entry approach. Can you take us through the evolution of your thought on that? Why did your opinion change regarding this approach? And do you believe it might be the right method to resolve a failing financial institution in bankruptcy?

Mr. HESSLER. Yes, sir. When I did testify in 2014, at that point in time the thinking around single point of entry was still evolving. I have since become very comfortable with the construct and for a few reasons in particular.

As a threshold matter, to the extent that single-point-of-entry may be an atypical Chapter 11 mechanism, SIFIs have corporate structures that themselves do not comport with conventional bankruptcy practice. There are certain of the operating subs that actually either cannot file for bankruptcy or that would be incapable of surviving a traditional bankruptcy proceeding. So the single point of entry I think actually the single point of entry approach actually facilitates the unique corporate structure of SIFIs.

Secondly, while the discrete steps of single point of entry may be a unique addition to Chapter 11, either if it's via a Subchapter V amendment or through the creation of a Chapter 14, I do think that the fact that the filing determination as well as the transfer determination that are made under the single point of entry approach, those are both subject to Bankruptcy Court approval. I think that's a critical safeguard and a critical protection that similarly is consistent with the Bankruptcy Code.

Thirdly, Mr. Chairman, again, while single point of entry would be a unique addition to the Bankruptcy Code, I think it's actually analogous to practice that to some extent is already occurring, which are rapid fire asset sales under section 363. I believe that single point of entry can actually be understood as sort of codifying an approach that's already taking place, albeit under another name.

And lastly, I think from the perspective of secured creditors and unsecured creditors and equity interest holders, the priority scheme and the enforcement of creditor rights under single point of entry is consistent with current Bankruptcy Code practice.

So, for all of those reasons, I am comfortable with it.

Chairman GOODLATTE. Thank you.

Dr. Taylor, we very much appreciate your being here today, and your work is well known to many Members of Congress, including on this Committee.

I wonder if you might give us your thoughts on this bill in the context of something like the Lehman insolvency. If that were to occur a year from now, after this law were in effect and in operation would the bill improve the resolution process for that firm?

And in that context, take some of Professor Grohsgal's criticisms and let us know whether you think that the speed, which to many of us seems essential, can be handled, given the enormity of some of the financial institutions.

Mr. TAYLOR. So I think the answer to that question is most important for this Committee and for any group thinking about this reform. So quite a while ago, we, working at Stanford Hoover Institution, thought about a counterfactual: What would have happened in 2008 had this act been passed, in the case of Lehman?

I was an extraordinarily good, thorough study by Emily Kapur at Stanford. She just received her law degree and Ph.D. in economics. She went through case by case, using a lot of the reports on the data, and showed how smooth it could have worked over the weekend. The new firm would have been operating on Monday morning with virtually no contagion, no spread. And there was enough at that point of what we call now loss-absorbing capital to make this work with the data at the time.

So I think it's a very revealing study. I recommend every Member of the Committee and others read it.

One thing about it is she was under the assumption when we ran this—we've called this Chapter 14 in the past, because there was no Chapter 14 code. We started working on this before Dodd-Frank was passed, actually. And always had the notion that it would be good to have a primary regulator available to file in the first. I listened to Mr. Hessler's remarks.

So Emily assumed that the Fed would be the primary regulator, which is how Dodd-Frank would write, and looked at gauges, mechanisms, objective indicators that the Fed could use to begin this filing.

So I think it's very important that if the bill goes back or if the conference committee eventually wants to have the primary regulator have the ability to begin the proceeding, that it be done in the most objective way possible, looking at indicators, looking at things that are—to be accountable, so that it continues this very, I think, predictable kind of process that we're all aiming for.

Chairman GOODLATTE. Thank you very much.

Thank you, Mr. Chairman.

Mr. MARINO. The Chair recognizes now the Ranking Member of the full Judiciary Committee for his opening statement.

Mr. CONYERS. Thank you, Mr. Chairman.

I would like consent to submit my opening statement and go straight to the questions, if I can.

Mr. MARINO. Without objection.

Statement submitted by the Honorable John Conyers Jr., Michigan, Ranking Member, Committee on the Judiciary. This material is available at the Committee and can be accessed on the Committee Repository at: *http://docs.house.gov/meetings/JU/JU05/20170323/105758/HHRG-115-JU05-MState-C000714-20170323.pdf.*

Mr. CONYERS. Thank you very much.

I wanted to start with Judge Walrath. I apologize for missing your presentation. But Professor Grohsgal argues that FIBA does not solve the problem of post-petition financing and that it actually makes the problem worse. What do you think of that?

Judge WALRATH. I respectfully disagree with my colleague from Delaware. I think that there are two aspects of FIBA that are important here, and the first relates to his concern about insulating the board of directors, because he suggested it would cause risky behavior.

I disagree. I think it is very important in all bankruptcy cases, but particularly in a case that would involve a systemically important financial institution, it is important for the board to act quickly. And for them to delay because they may feel that they may have some liability by delaying could be critical and could spell the death knell of the filing. It is important in all bankruptcy cases that they get counseled quickly, and if they need to restructure, to file quickly.

I think that if they file quickly enough and they follow this mechanism of transferring sufficient funds to keep the financial institution itself viable, which I understand is a construct of this legislation, it would assure that they are viable, and the public would perceive them as viable without additional financing.

Mr. CONYERS. Thank you.

Professor Grohsgal, could you give us your response, please?

Mr. GROHSGAL. Thank you, Ranking Member Conyers. I would be pleased to do so.

There is a narrow issue here and there is a broader issue. The narrow issue is that section 210(s) of Dodd-Frank presently is pretty much the only basis upon which directors can be held accountable for excessively risky and often self-serving decisions that were made in the process of dealing with the problems of a distressed company.

I would expect, as a practicing lawyer for 30 years, that if I represented one of those directors, one of the first things I would say, if a bankruptcy turned into a Title II proceeding, which it could, that pretty much any of those decisions I made was made in the interest of propping up the company in contemplation of the bankruptcy filing.

So there's nothing in this bill that doesn't make it clear that the FDIC is still free to take actions to seek to disgorge the compensation of bonuses of these executives who may have harmed Wall Street, which is the reason for 210(s). That's the narrow issue.

The broader issue, again, is that "good faith" is a term of art used in U.S. corporate law which gives capacious deference to directors of companies. The idea is to encourage risk-taking that might make that business organization a profit. It has a much different meaning in the Bankruptcy Code. There is no counterpart to it in the Bankruptcy Code that insulates directors. And, again, these directors are already very much incentivized to file bankruptcy rather than risk a Title II, the reasons being, first, that they stay in control of the company, and second, that they don't run the risk of having their compensation and bonuses disgorged.

Mr. CONYERS. Thank you.

Mr. GROHSGAL. Thank you, sir.

Mr. CONYERS. While you're at it, you acknowledge that current bankruptcy law is not optimally designed for orderly resolution of large financial institutions. Are you convinced of that?

Mr. GROHSGAL. I actually am not convinced of it. I don't think that all of the evidence is in on that. Harvey Miller, the dean, I would say, of the New York Bankruptcy Bar, for whom I had great respect and who passed away not that long ago, actually thought that the Lehman bankruptcy worked quite well. I think that that problem is overrated, frankly, or overstated.

I do think that there is something to be said for amending the Bankruptcy Code to make it better able to address these kinds of business failures. However, this bill in many ways provides for bankruptcy in name only.

That 2-day process is not a sale that we're accustomed to with respect to the sale of a business as a going concern in a bankruptcy case, where there is notice to creditors, where they have a chance to participate, where creditors committees can weigh in about it. There's no testing of the market. It's not a sale to anyone. It's simply a wholesale transfer of assets determined by the debtor and by a bankruptcy judge within 2 days to a bridge company. There's no—it's not a traditional sale at all. It's not like anything in bankruptcy.

So my problem with this, in part, is that, again, it's bankruptcy in name only. It dresses the process up as a normal bankruptcy proceeding, but it's not.

Mr. CONYERS. Look, the collapse and subsequent bankruptcy of Lehman Brothers had a catastrophic impact on the financial marketplace. And on the other hand, you appear to strongly oppose H.R. 1667. Do you think the bankruptcy law should be changed to better accommodate future Lehman Brothers?

Mr. GROHSGAL. I would note in passing that AIG also failed without going into bankruptcy, as did Bear Stearns, as did many other financial institutions, most of which did not go into bankruptcy. And to attribute what happened during the financial crisis to a single bankruptcy probably overemphasizes that issue.

But to answer your question, I think that enhancing the provisions of the Bankruptcy Code to enable a proper financial institution bankruptcy is a very good idea, and I commend this Subcommittee for—and the Committee—for attempting to do so.

There are a number of things that could actually accomplish that, I think. One would be to extend the automatic stay longer than 2 days. That would in and of itself accomplish a great deal.

The second would be to address the issue which causes these kinds of legislation to make the process happen within 2 days, which is that there's no automatic stay with respect to repurchase agreements, even those backed by mortgages. There is no automatic stay for derivatives and other qualified financial contracts, which drove the FDIC to come up with this 2-day process and which I believe probably drove this Committee, in a good faith effort to address this issue, to confront this problem.

An easy solution would be to limit or eliminate the automatic—the safe harbors for qualified financial contracts, and then we would find ourselves back in a more realistic bankruptcy environment and process.

Mr. CONYERS. Professor Grohsgal, I appreciate your comments.

And, Mr. Chairman, I yield back the balance of my time, if any.

Mr. MARINO. Thank you so much, Mr. Conyers.

The chair now recognizes the gentleman from Florida, Congressman Gaetz.

Mr. GAETZ. Thank you, Mr. Chairman, for holding this hearing. And thank you all for being here.

Judge Walrath, I'd be very interested in your thoughts on the role of transparency in the bankruptcy process, and particularly the mechanisms by which appropriate transparency measures can facilitate resolution in a Subchapter V scenario.

Judge WALRATH. Yes. As I stated, pleadings generally are public. The courtroom is open to everybody. There are a lot of press reports.

I think the more information that the public has about what is going on, the more confidence they will have in the process. In addition, the ability for anyone who has an interest in the proceeding, not just the FDIC, not just the secured lenders, but everybody affected by it.

And one compelling story was in the Washington Mutual case, a shareholder appeared in court because he felt that the plan of reorganization just was not fair, because it treated him differently from other people in his class. And he was allowed to stand up and speak. And he was absolutely right; the Bankruptcy Code is premised on fairness and equal treatment. And he won that argument.

That is a very strong—it's the hallmark of our judicial system that people will be heard. And it is clear that, even if they lose, if they feel that they have been heard by a judge in open court, they feel more confidence in the judicial system.

So that's why I think it is very important to have an open system.

Mr. GAETZ. And, Your Honor, how can that transparency facilitate resolution specifically, rather than simply lending more trust to the process? Are there circumstances where that transparency can facilitate more complete resolution of claims?

Judge WALRATH. I think that, because bankruptcy is a consensual process, by and large, a lot of what is discussed and resolved happens outside of court. But it ultimately must be revealed in court, must be presented. In bankruptcies, it is subject to the vote of affected parties.

So all of that transparency is important, and it can assist in the restructuring process. We've had multibillion-dollar companies reorganize, companies that were critical to their industry and to the American economy, all reorganized in the public eye, and I think it's critical.

Mr. GAETZ. Mr. Taylor, you spoke in your testimony of the impact of predictability on this area of law. How should we remedy the predictability challenges that contributed to the circumstances we found ourselves in in 2008?

Mr. TAYLOR. Well, I think that is a good example of the lack of predictability, because there was a bailout in the case of Bear Stearns, there was not in the case of Lehman, there was in the case of AIG. People didn't know what to expect. And to some extent, that's why we're here, to figure out a way to replace that uncertainty.

That uncertainty is very damaging to the financial markets. I think it was one of the reasons the crisis was worse than it otherwise might have been.

I think it's also very important to limit, or prevent the bailouts, and legislation like this goes a long way to doing that. There is an alternative to a bailout now that's possible so that, say, Lehman could be operating the next day without a bailout. It's very important for risk-taking, proper risk-taking.

And I think that the reliance on the rule of law that comes from the Bankruptcy Code, as Judge Walrath has indicated, is very important for establishing this. This is what's going to happen. It's not subject to the whims of a particular government agency. And I think that that's what I would stress.

And so that's the reason we got interested in it long ago. Thank you.

Mr. GAETZ. Thank you for that answer. I agree wholeheartedly.

Mr. Hessler, you spoke to the issue of the retention of existing management for a newly formed bridge or a holding company. Why is that important?

Mr. HESSLER. Well, the expertise of management, of the directors and officers, and the continuity that that provides for the company as they continue to exercise their fiduciary duties to maximize the value of the corporation, it's critical. I think it's absolutely indispensable that——

Mr. CONYERS. Turn on your mike, please.

Mr. HESSLER. Excuse me. Thank you, sir.

In fact, I think maybe the best way to examine this is a comparison of what FIBA would provide for versus what Title II would provide for. In reverse order, Title II provides for essentially just wholesale cleaning out directors and officers upon the commencement of a proceeding by the FDIC.

I think that would be disastrous for an organization. Having gone through multiple multibillion-dollar bankruptcies as debtor's counsel, the initial days of a case, even the most well-planned case, are relatively chaotic. There's a huge amount of tumult upon a filing. And to lose the expertise of the directors and officers immediately upon the commencement of that proceeding I think would be disastrous.

For that reason, I think FIBA appropriately allows for the continuation of management, which is actually consistent with Chapter 11 in its present form, which embodies the concept of a debtor in possession, which is management and the directors and officers are allowed to continue to operate the corporation, subject to existing Bankruptcy Code provisions that provide for the removal of management if, in fact, there has been any improper misconduct.

Mr. GAETZ. Thank you, Mr. Chairman.

Mr. MARINO. Thank you.

I will ask my questions now. But before I get into mine, Brad Schneider had to leave and get to somewhere else. All of us have to be in three places at one time today. But Brad wanted to know, Judge Walrath, you, in your opening statement, said we needed more judges. Can you give Brad and this panel an indication of how many more judges do you think we need?

Judge WALRATH. Well, it does provide for a minimum of 10 only.

Mr. MARINO. Yes.

Judge WALRATH. Of course, the Chief Justice could appoint more. But I think having a threshold of 20 is critical. We need—at least 2 in each circuit. So 22, 20, I think would be sufficient.

But we don't know what will happen. With only one designated judge in a circuit, the legislation requires that the hearing be held in the district where the filing occurs. To get somebody there quickly enough. You can have procedures where there's some notice that something is going to happen without it being revealed publicly. But I think two in each circuit would be critical.

Mr. MARINO. Thank you.

Mr. Hessler, based on a response by the professor, I want to ask you this. To the extent that there are bad managers, does Bankruptcy Code provide for methods to remove those managers? Number two, and are other remedies outside of bankruptcy available to parties to address improper actions by the board?

Mr. HESSLER. Yes, Mr. Chairman. The Bankruptcy Code presently expressly provides for creditors or other parties in interest to seek for the appointment of an examiner, which can conduct an investigation into the actions of management. It also provides for the potential appointment of a trustee if, in fact, the court finds that there has been improper managerial misconduct, and that trustee can actually take over for existing directors and officers and manage the case.

I have to say that is extraordinarily rare. Obstreperous creditors often threaten to bring those motions and sometimes bring those, but, you know, as Judge Walrath can probably attest, the actual appointment of a trustee to supplant and displace existing management is really extraordinarily rare.

And also, as I indicated in my testimony, in my experience, the overwhelming—I'm not even sure I can put a high enough percentage—99.9 percent of directors and officers take their fiduciary duties extraordinarily seriously and they are very, very responsible fiduciaries.

And that's why I actually think that FIBA appropriately provides for them to—as does the current Bankruptcy Code—provides for them to continue within the management of a covered financial corporation, which, again, in contrast to Title II, which provides they're all going to get fired if the FDIC commences a proceeding, even the most meritorious conduct by those fiduciaries. It's almost impossible to believe that that otherwise can't influence their thinking as they pursue responsible restructuring strategies.

Mr. MARINO. Thank you.

Let's back up here a moment, because many people are not aware of the purpose of bankruptcy and what is the upside, what is the downside. So let's go back to a law school 101 course. And would each of you, if you care to—and I'll start with the judge—give me an explanation to tell my mother, who is 84 years old and keeps telling me that, "You better do things right there, that's why I voted for you."

But explain to the public what bankruptcy is and what it does and what would happen if we didn't have a bankruptcy process, please.

Judge WALRATH. I'll try.

I think some people view bankruptcy as somebody's going to file bankruptcy and get out of paying their debts.

Mr. MARINO. Yes.

Judge WALRATH. And it's wrong and it's improper. And a lot of people who file are humiliated because of that, because they're hardworking and they got into situations where they simply cannot deal with their situation.

But I think from the business perspective, bankruptcy was passed—or has a very important position in our economy. It is the escape valve. It's the steam, let-off-the-steam valve.

Without bankruptcy, there would be little innovation in this country. Does anybody believe that Bill Gates would have dropped out of Harvard to start his company if he felt that all of his assets and his parents' assets would be forfeited and he might go to debtors' prison if he failed?

Very few people would do anything to create an invention or do an innovation, and that is what is the lifeblood of this country. We always had the West. If you failed in the East, you went a little further West. It is really what has helped build America. Our innovation is what has made us succeed.

And we need a relief valve, and that is the Bankruptcy Code, for people who do not succeed.

Mr. MARINO. Doctor, if you care.

Mr. TAYLOR. So I never went to law school.

Mr. MARINO. Congratulations.

Mr. TAYLOR. So I never took Bankruptcy 101. I've taught Economics 1 for many years.

I think that to me the Bankruptcy Code is so important because it provides a process when people get into a situation where their debt is unsustainable for one form or another. It's organized. The rule of law comes into action. You might not have written everything down in your bond agreements, but there's a way to take care of that. There's priorities that are set, so people know what they're getting into.

So from an economic perspective, I think that's extraordinarily important. Otherwise, things fall apart. You don't know what to expect. And I would stress that very highly.

The word "bankruptcy," of course, means different things to different people. But for me, it's a way that the law is being applied in situations which arise all the time. The numbers that Judge Walrath gave are amazing, the number of cases that these have handled. So it's a very important part of our economy.

Mr. MARINO. I was a prosecutor for most of my career, and I sat next—my office was right next door to the bankruptcy judge. And I saw the process. I had many discussions with them.

Thank you, Doctor.

Mr. Hessler.

Mr. HESSLER. If I could just add very quickly, I agree with everything Judge Walrath and Dr. Taylor said.

Let me focus now from a different perspective also, though, which is from the creditor's perspective. Bankruptcy is obviously essential for fixing companies.

But also what bankruptcy provides, the bankruptcy system and the Bankruptcy Code, is a very orderly, structured, transparent, and predictable set of mechanisms for creditors to enforce their rights and for them to have an avenue to seek to recover from a company what they are otherwise owed.

In my written testimony, I actually tried to address FIBA from the perspective of incentives that the debtors face, but also creditor incentives and also regulator incentives. And so I think that's a critical aspect of the bankruptcy system that shouldn't be overlooked as well, which is it's not just a safety valve for the company, it's a safety valve for creditors to otherwise seek to maximize repayment for the debts that they owed.

Mr. MARINO. Thank you.

Professor.

Mr. GROHSGAL. Thank you, sir.

First of all, I'd like to state for the record that I took my bankruptcy course when the Bankruptcy Code had been passed but was not yet effective. And my professor speculated through the whole class what all of it meant. And the miracle is he was right about a lot of it. And I remember it from time to time. I still am astonished at how predictive he was about all of this.

The Supreme Court has addressed this issue in numerous cases, going back to the 1800s. The Bankruptcy Code does not state what its purposes are, but the purposes that the Supreme Court has stated should govern the decisions by bankruptcy judges mostly are as follows.

First, the purpose of bankruptcy, especially in Chapter 11, is to maximize distributions to creditors. Second, those distributions should be made on an equitable basis in accordance with the rules set forth in the bankruptcy.

And in the case of Chapter 11, the purpose is to preserve going concerns so that businesses are preserved, their creditor relationships are preserved, businesses that rely on their custom stay in business, their employees are not fired, et cetera. And that not only helps the counterparties to that institution, to that business, but it also does maximize returns to creditors.

So going back to the 1930s, that's been the major focus of Chapter 11.

My major concern with this bill is that it could have done that a lot better, and a few things concern me especially. The first is that this wholesale transfer of qualified financial contracts, which is likely to occur in the first 2 days, will reduce distributions to creditors, because many disadvantageous contracts can be expected to be assigned and assumed to the bridge company, and many good contracts will probably be left behind.

My second concern——

Mr. MARINO. On that note, let me interrupt.

Mr. GROHSGAL. Yes, sir. Yes.

Mr. MARINO. How much time?

Mr. GROHSGAL. The edge of the knife, Chairman Marino, is that we have this thought that qualified financial contracts should be protected in the sense that they are not subject currently to the automatic stay anywhere.

My own view is that somewhere between 2 days and the 3 weeks that's afforded to most notice—for most motions—the notice period for most motions in a Bankruptcy Court, would be a vast improvement. The longer, the better. My own view is that they should be subject to the automatic stay, I'll be blunt.

But understanding that I am in the minority here at this hearing and I'm kind of standing up here for a position that I appreciate is not accepted wholeheartedly by my colleagues here or by all of you, however much longer than 2 days would vastly improve the process.

I would emphasize that a 2-day process is not transparent. A 2-day process is the inside players going in front of a bankruptcy judge who won't even have time to consider the propriety of assuming tens of thousands of qualified financial products on such short notice. So some longer period of time would be great, I think.

Mr. MARINO. We have more time than I thought we would. If you do not mind, the Ranking Member and I are going to keep you a little longer, if it's okay with you.

So I'm going to recognize the Ranking Member, Congressman Conyers.

Mr. CONYERS. Thank you, Mr. Chairman.

I have only one question. I direct it to Professor Grohsgal.

One of your main concerns about H.R. 1667 is that it reduces moral hazard by absolving a financial institution's directors from liability under a Subchapter 5 case filing. Prior iterations of FIBA considered last Congress included, to me, rather broad liability exculpation for a debtor's directors. But the current version appears to narrow that provision, as reflected in section 1183. I think you're onto that.

What are your thoughts about the current version, and do you have any recommendations for any further refinement, sir?

Mr. GROHSGAL. Yes, I do. My first thought on reading this in the prior legislation—and it appeared there too—is that if I were defending a director of a failed company that had failed twice—it first had failed because it filed a bankruptcy petition, and then failed because that bankruptcy proceeding still posed sufficient systemic risk that the FDIC and the other authorities put it into a Title II receivership—that if that happened, the first thing I would do if I was representing that director would be to say: Well, how many of the decisions were made in contemplation of the bankruptcy filing?

And my defense to the disgorgement proceeding from the FDIC would be all of those decisions were made in contemplation of the bankruptcy filing. For example, we needed to give that senior executive a million-dollar bonus so he would stay with the company and continue to work with us toward the bankruptcy and preserve the company and hopefully even avoid the bankruptcy. That would be the first thing I'd think of in defending such a person.

There's nothing wrong with that. We are advocates as lawyers to our clients. If I were on the other side representing the FDIC, I'd be arguing the opposite.

But my first concern was the narrow one I expressed previously, which is this provides a defense to that kind of a proceeding. I don't think that was this Committee's intention in writing this, but I think it's there.

My second concern is this. The bankruptcy process is already a very redemptive process for the directors and officers of a business organization. They're not held liable, they're left in control, et cetera. We don't need this. They have plenty of incentives to stay in power, to continue to govern the company. And I agree with the concept of debtor in possession. And they have a disincentive of letting the company go into Title II. So we don't need it.

And, frankly, I think that there's something to be said for the fact that Main Street was harmed by the financial crisis much more than Wall Street. And I honestly think this sends that message again, which is that the insiders are protected and the family company that cut the lawn for that financial institution is outside of the door and gets no protection at all. They are second-ranked creditors and everybody else is in on the game. That's my third concern.

Mr. CONYERS. Thank you.

Attorney Hessler, would you add anything onto what has just been said?

Mr. HESSLER. I would. I would largely disagree, pursuant to my remarks, and I don't want to belabor those too much.

I would say some narrowing of the language, I think, would be fine. I mean, to the extent it's, you know, the reference to in contemplation of or in connection with, I think some additional drafting clarification around that perhaps would be merited. I am comfortable with how it's drafted at the moment, but to the extent that folks wanted additional clarity on that.

I will say, again, we can't just always look at this solely from the perspective of the company, though. I think it's important to look at it from the perspective of creditors. And what I think 1183(c) is also helpful for is dissuading what I would call sort of strike suits by creditors; that this being in there is going to make it more difficult for them to come in and try and throw sand in the gears of the bankruptcy process by, you know, lobbing in all kinds of allegations and trying to otherwise hold up management with lawsuits.

If I can just add one other thing also, which I feel probably hasn't been addressed thus far this morning, but I think is quite critical. The 48 hours that—for the first 48 hours of the case, that's post-filing, that's when the asset transfer determination happens, the bankruptcy case is not over in 48 hours. It's merely the transfer of the assets to the bridge financial company. The equity in the bridge financial company at that point is held by the special trustee for the benefit of the creditors, who then go through a conventional Chapter 11 case.

So a FIBA proceeding is not a 48-hour proceeding. The 48 hours, that's just the starting line. And once those assets are transferred—and the 48-hour window is quite deliberately designed, given the special nature of financial company assets, which is they can't survive in bankruptcy longer than a presumed 48 hours. At that point, though, a conventional bankruptcy case does at that point occur, subject to all of the transparency, predictability, creditor rights, a plan of reorganization, the absolute priority rule, and exclusivity.

A conventional bankruptcy case then follows the transfer of the assets. And, again, to the extent that there needs to be a valuation of those assets, the equity of the bridge financial company is being held for the benefit of creditors, and it will ultimately be distributed pursuant to a plan of reorganization.

Thank you, sir.

Mr. CONYERS. Judge Walrath, would you add anything?

Judge WALRATH. I would agree with the remarks of Mr. Hessler. And there was some mention of we have sales under section 363 all the time in bankruptcy and often on a quick deadline. This allows for the transfer of those assets in order to protect them, but it's unlike the sales in bankruptcy that we normally have where the whole value of that company goes to the buyer.

Mr. Hessler is correct. The value of those transferred assets remains with the bridge company, and if that value remains, it is the creditors and the left-behind debtor who benefit from it. So nothing is being transferred out of or away from the creditors. If there is value there and it's preserved by transferring outside of the bankruptcy case, it will be for the benefit of creditors.

Mr. CONYERS. Thank you.

Did you want to add anything, Professor Taylor?

Mr. TAYLOR. Thank you, Congressman. Two things.

On the idea of moral hazard being made worse by this, it's completely opposite. The whole idea of bailouts is that people get advantage and that it creates huge risk-taking and huge moral hazard. So this is reducing it. And don't forget the creditors that get bailed out. This is really trying to prevent that. And even with the Title II, there's a possibility of that happening.

Just quickly, on the safe harbor and the 2 days, you do have to be concerned about the contagion effects if you go beyond the 2 day. Two days is already kind of a compromise. And I think—don't forget that there's a lot of concerns of the spread of this if you don't treat some safe harbor for the qualified financial contracts.

Mr. CONYERS. Professor Grohsgal, I'll give you the last word on this.

Mr. GROHSGAL. Thank you, sir.

I would respond in a couple of quick ways.

Though I agree that the bankruptcy will proceed with respect to the creditors left behind, my view is that the cake is baked. By the time the assets are transferred to the bridge bank, the damage has been done. The disadvantageous contracts have been assumed, the good contracts have been left behind, because there simply wasn't enough time to evaluate them in a stressful situation.

And I would emphasize again that this is not a typical bankruptcy and that the creditors here who are being favored, again, unfortunately, will be disproportionately Wall Street creditors over Main Street creditors.

And I want to mention one last thing which did not come up, which is there is a provision here that undoes a very important provision of Bankruptcy Code that also favors Wall Street over Main Street, and that is a provision that says that if a secured party's collateral is worth less than its claim, all it gets is the value of its collateral.

Here, the bridge bank has to further weaken its balance sheet by assuming that debt in full, again, in a way that disadvantages Main Street creditors and also weakens the balance sheet of the bank.

So I thank you for giving me the last word, sir.

Mr. CONYERS. Well, I thank all of you for your additional thoughts on this. It's a great panel of witnesses.

And I thank the chairman.

Mr. MARINO. Judge Walrath, I'm not sure if I caught it, but did you address the issue concerning the professor's issue with the 2-day?

Judge WALRATH. It would be great to have a lot more time, but what needs to be done can be done in 48 hours. We are used to dealing with debtor in possession financing, paying critical vendors, paying employees. Lots of critical motions are filed on this first day, and judges have to deal with them literally within 48 hours of that filing. We have first days approximately 24 hours after a case is filed, because we recognize a business, an operating business needs to continue to operate.

So I am not as concerned as Professor Grohsgal is about the 48-hour rule.

Mr. MARINO. Professor, I'm assuming that you don't have a problem with a bankruptcy action going to a Federal judge as quickly as possible for oversight. Am I correct in my assumption?

Mr. GROHSGAL. I'm sorry, sir. I didn't precisely follow your question.

Mr. MARINO. In my legislation, we want to get a bankruptcy case to a Federal judge as quickly as possible for oversight. You do not have a problem with that, do you?

Mr. GROHSGAL. No, Your Honor. I am a firm believer in a quick, a swift, but deliberative process for a company that is in distress, whether a regular business organization or a financial institution. One thing that Delaware early on recognized is the need for speed.

My issue is with the fact that this is so quick, with all the moving parts and all of the assets in play, that what we have is not a deliberative process. It's just too quick to do that.

Mr. MARINO. Dr. Taylor, do you want to respond to that? I noticed a little concern.

Mr. TAYLOR. I think the speed is the goal and it's outlined how it can be done. It hasn't been done yet, to be sure, but testing it out on previous cases is important. The experience of judges is important.

But the speed is essential to make this work. And the idea of opening for business on Monday morning to take account of the time zones is crucial.

Mr. MARINO. Attorney Hessler, I think in Title I—and my counsel here has been advising me on some of these issues that he's very brilliant at—but discuss the living will aspect and the benefit of that.

Mr. HESSLER. Sure. The living will, it's interesting, because part of the FIBA debate is also getting wrapped up in the Title II debate and whether Title II should be repealed from Dodd-Frank. The living wills that are found within Title I of Dodd-Frank actually are very helpful for what is contemplated by FIBA.

Again, the 48 hours that's been a lot of the focus of today's hearing that is really fast. That, however, is preceded by an extraordinary amount of planning. And the living wills require even ostensibly healthy financial institutions to be putting in place a blueprint and be putting in place a plan that there could actually be an orderly 48-hour determination for the transfer of contracts.

I actually think what's also contemplated by FIBA the way I read it is, I think what's actually anticipated is the entire book of qualified financial contracts are going to get transferred.

So to say 48 hours is too short a time period to go through what might be hundreds of thousands, if not millions of qualified financial contracts and make individual determinations, I think that is correct. I don't think that that's realistic for 48 hours, but I don't think that's what's anticipated. I think the entire book is likely to get transferred.

Mr. MARINO. Judge, what will the impact be on the 48-hour aspect if we do not have more bankruptcy judges? Will we be able to still stick to that schedule of 48 hours?

Judge WALRATH. Well, if a procedure is put in place—in Delaware, we have a procedure where if a large case is contemplated to be filed, we get several weeks' advance notice. The name of the company is never mentioned. But our clerk of court is advised, and the clerk of court puts in procedures to be sure that there is a judge available at the time that the anticipated filing is done.

In those procedures are put in place, I understand the circuit chief will be advised that a filing is anticipated. If we can have a procedure where the designated bankruptcy judge is advised that it is contemplated that there may be a filing, you need to be available, then I think it could work.

I would be nicer to have more than one person. If somebody is on vacation in Europe, for example, we might have a problem. But since they have to have the hearing in that district, you need time to get them there.

Mr. MARINO. And a lot of that's going to depend, for the most part, on the complexity and the size of that case.

Judge WALRATH. Yes.

Mr. MARINO. All right.

Well, lady and gentlemen, I want to thank you all very much for being here today. We came in just slightly under the wire. And this concludes today's hearing.

Once again, I can't tell you how much I learn from these hearings. And each of you have—you've taught me well today, and I appreciate that very much.

So without objection, all members will have 5 legislative days to submit additional written questions for the witnesses or additional materials for the record.

This hearing is adjourned.

Additional Material Submitted for the Record

Statement submitted by the Honorable John Conyers, Jr., Michigan, Committee on the Judiciary. This material is available at the Committee and can be accessed on the Committee Repository at:

http://docs.house.gov/meetings/JU/JU00/20170308/105660/HHRG-115-JU00-20170308-SD002.pdf

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115TH CONGRESS
1ST SESSION

H. R. 1667

To amend title 11 of the United States Code in order to facilitate the resolution of an insolvent financial institution in bankruptcy.

IN THE HOUSE OF REPRESENTATIVES

MARCH 22, 2017

Mr. MARINO (for himself, Mr. GOODLATTE, Mr. CONYERS, and Mr. CICILLINE) introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To amend title 11 of the United States Code in order to facilitate the resolution of an insolvent financial institution in bankruptcy.

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

SECTION 1. SHORT TITLE.

This Act may be cited as the "Financial Institution Bankruptcy Act of 2017".

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

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

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

"(A) a bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956; or

"(B) a corporation that exists for the primary purpose of owning, controlling and financing its subsidiaries, that has total consolidated assets of $50,000,000,000 or greater, and for which, in its most recently completed fiscal year—

"(i) annual gross revenues derived by the corporation and all of its subsidiaries from activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, from the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated annual gross revenues of the corporation; or

"(ii) the consolidated assets of the corporation and all of its subsidiaries related to activities that are financial in nature (as defined in section 4(k) of the Bank Holding Company Act of 1956) and, if applicable, related to the ownership or control of one or more insured depository institutions, represents 85 percent or more of the consolidated assets of the corporation.".

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

"(l) Subchapter V of chapter 11 of this title applies only in a case under chapter 11 concerning a covered financial corporation.".

(c) WHO MAY BE A DEBTOR.—Section 109 of title 11, United States Code, is amended—

(1) in subsection (b)—

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

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

(C) by adding at the end the following:

"(4) a covered financial corporation."; and

(2) in subsection (d)—

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

(B) by striking "or" before "a corporation"; and

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

(d) CONVERSION TO CHAPTER 7.—Section 1112 of title 11, United States Code, is amended by adding at the end the following:

"(g) Notwithstanding section 109(b), the court may convert a case under subchapter V to a case under chapter 7 if—

"(1) a transfer approved under section 1185 has been consummated;

"(2) the court has ordered the appointment of a special trustee under section 1186; and

"(3) the court finds, after notice and a hearing, that conversion is in the best interest of the creditors and the estate.".

(e)(1) Section 726(a)(1) of title 11, United States Code, is amended by inserting after "first," the following: "in payment of any unpaid fees, costs, and expenses of a special trustee appointed under section 1186, and then".

(2) Section 1129(a) of title 11, United States Code, is amended by inserting after paragraph (16) the following:

"(17) In a case under subchapter V, all payable fees, costs, and expenses of the special trustee have been paid or the plan provides for the payment of all such fees, costs, and expenses on the effective date of the plan.

"(18) In a case under subchapter V, confirmation of the plan is not likely to cause serious adverse effects on financial stability in the United States.".

(f) Section 322(b)(2) of title 11, United States Code, is amended by striking "The" and inserting "In cases under subchapter V, the United States trustee shall recommend to the court, and in all other cases, the".

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

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

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

"§ 1181. Inapplicability of other sections

"Sections 303 and 321(c) do not apply in a case under this subchapter concerning a covered financial corporation. Section 365 does not apply to a transfer under section 1185, 1187, or 1188.

"§ 1182. Definitions for this subchapter

"In this subchapter, the following definitions shall apply:

"(1) The term 'Board' means the Board of Governors of the Federal Reserve System.

"(2) The term 'bridge company' means a newly formed corporation to which property of the estate may be transferred under section 1185(a) and the equity securities of which may be transferred to a special trustee under section 1186(a).

"(3) The term 'capital structure debt' means all unsecured debt of the debtor for borrowed money for which the debtor is the primary obligor, other than a qualified financial contract and other than debt secured by a lien on property of the estate that is to be transferred to a bridge company pursuant to an order of the court under section 1185(a).

"(4) The term 'contractual right' means a contractual right of a kind defined in section 555, 556, 559, 560, or 561.

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

"(6) The term 'special trustee' means the trustee of a trust formed under section 1186(a)(1).

"§ 1183. Commencement of a case concerning a covered financial corporation

"(a) A case under this subchapter concerning a covered financial corporation may be commenced by the filing of a petition with the court by the debtor under section 301 only if the debtor states to the best of its knowledge under penalty of perjury in the petition that it is a covered financial corporation.

"(b) The commencement of a case under subsection (a) constitutes an order for relief under this subchapter.

"(c) The members of the board of directors (or body performing similar functions) of a covered financial corporation shall have no liability to shareholders, creditors, or other parties in interest for a good faith filing of a petition to commence a case under this subchapter, or for any reasonable action taken in good faith in contemplation of such a petition or a transfer under section 1185 or section 1186, whether prior to or after commencement of the case.

"(d) Counsel to the debtor shall provide, to the greatest extent practicable without disclosing the identity of the potential debtor, sufficient confidential notice to the chief judge of the court of appeals for the circuit embracing the district in which such counsel intends to file a petition to commence a case under this subchapter regarding the potential commencement of such case. The chief judge of such court shall randomly assign to preside over such case a bankruptcy judge selected from among the bankruptcy judges designated by the Chief Justice of the United States under section 298 of title 28.

"§ 1184. Regulators

"The Board, the Securities Exchange Commission, the Office of the Comptroller of the Currency of the Department of the Treasury, the Commodity Futures Trading Commission, and the Federal Deposit Insurance Corporation may raise and may appear and be heard on any issue in any case or proceeding under this subchapter.

"§ 1185. Special transfer of property of the estate

"(a) On request of the trustee, and after notice and a hearing that shall occur not less than 24 hours after the order for relief, the court may order a transfer under this section of property of the estate, and the assignment of executory contracts, unexpired leases, and qualified financial contracts of the debtor, to a bridge company. Upon the entry of an order approving such transfer, any property transferred, and any executory contracts, unexpired leases, and qualified financial contracts assigned under such order shall no longer be property of the estate. Except as provided under this section, the provisions of section 363 shall apply to a transfer and assignment under this section.

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

"(1) the debtor;

"(2) the holders of the 20 largest secured claims against the debtor;

"(3) the holders of the 20 largest unsecured claims against the debtor;

"(4) counterparties to any debt, executory contract, unexpired lease, and qualified financial contract requested to be transferred under this section;

"(5) the Board;

"(6) the Federal Deposit Insurance Corporation;

“(7) the Secretary of the Treasury and the Office of the Comptroller of the Currency of the Treasury;

“(8) the Commodity Futures Trading Commission;

“(9) the Securities and Exchange Commission;

“(10) the United States trustee or bankruptcy administrator; and

“(11) each primary financial regulatory agency, as defined in section 2(12) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, with respect to any affiliate the equity securities of which are proposed to be transferred under this section.

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

“(1) the transfer under this section is necessary to prevent serious adverse effects on financial stability in the United States;

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

“(3) the transfer does not provide for the transfer to the bridge company of any property of the estate that is subject to a lien securing a debt, executory contract, unexpired lease or agreement (including a qualified financial contract) of the debtor unless—

"(A)(i) the bridge company assumes such debt, executory contract, unexpired lease or agreement (including a qualified financial contract), including any claims arising in respect thereof that would not be allowed secured claims under section 506(a)(1) and after giving effect to such transfer, such property remains subject to the lien securing such debt, executory contract, unexpired lease or agreement (including a qualified financial contract); and

"(ii) the court has determined that assumption of such debt, executory contract, unexpired lease or agreement (including a qualified financial contract) by the bridge company is in the best interests of the estate; or

"(B) such property is being transferred to the bridge company in accordance with the provisions of section 363;

"(4) the transfer does not provide for the assumption by the bridge company of any debt, executory contract, unexpired lease or agreement (including a qualified financial contract) of the debtor secured by a lien on property of the estate unless the transfer provides for such property to be transferred to the bridge company in accordance with paragraph (3)(A) of this subsection;

"(5) the transfer does not provide for the transfer of the equity of the debtor;

"(6) the trustee has demonstrated that the bridge company is not likely to fail to meet the obligations of any debt, executory contract, qualified financial contract, or unexpired lease assumed and assigned to the bridge company;

"(7) the transfer provides for the transfer to a special trustee all of the equity securities in the bridge company and appointment of a special trustee in accordance with section 1186;

"(8) after giving effect to the transfer, adequate provision has been made for the fees, costs, and expenses of the estate and special trustee; and

"(9) the bridge company will have governing documents, and initial directors and senior officers, that are in the best interest of creditors and the estate.

"(d) Immediately before a transfer under this section, the bridge company that is the recipient of the transfer shall—

"(1) not have any property, executory contracts, unexpired leases, qualified financial contracts, or debts, other than any property acquired or executory contracts, unexpired leases, or debts assumed when acting as a transferee of a transfer under this section; and

"(2) have equity securities that are property of the estate, which may be sold or distributed in accordance with this title.

"§ 1186. Special trustee

"(a)(1) An order approving a transfer under section 1185 shall require the trustee to transfer to a qualified and independent special trustee, who is appointed by the court, all of the equity securities in the bridge company that is the recipient of a transfer under section 1185 to hold in trust for the sole benefit of the estate, subject to satisfaction of the special trustee's fees, costs, and expenses. The trust of which the special trustee is the trustee shall be a newly formed trust governed by a trust agreement approved by the court as in the best interests of the estate, and shall exist for the sole purpose of holding and administering, and shall be permitted to dispose of, the equity securities of the bridge company in accordance with the trust agreement.

"(2) In connection with the hearing to approve a transfer under section 1185, the trustee shall confirm to the court that the Board has been consulted regarding the identity of the proposed special trustee and advise the court of the results of such consultation.

"(b) The trust agreement governing the trust shall provide—

"(1) for the payment of the fees, costs, expenses, and indemnities of the special trustee from the assets of the debtor's estate;

"(2) that the special trustee provide—

"(A) quarterly reporting to the estate, which shall be filed with the court; and

"(B) information about the bridge company reasonably requested by a party in interest to prepare a disclosure statement for a plan providing for distribution of any securities of the bridge company if such information is necessary to prepare such disclosure statement;

"(3) that for as long as the equity securities of the bridge company are held by the trust, the special trustee shall file a notice with the court in connection with—

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

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

"(C) any material corporate action of the bridge company, including—

"(i) recapitalization;

"(ii) a material borrowing;

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

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

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

"(4) that any sale of any equity securities of the bridge company shall not be consummated until the special trustee consults with the Federal Deposit Insurance Corporation and the Board regarding such sale and discloses the results of such consultation with the court;

"(5) that, subject to reserves for payments permitted under paragraph (1) provided for in the trust agreement, the proceeds of the sale of any equity securities of the bridge company by the special trustee be held in trust for the benefit of or transferred to the estate;

"(6) the process and guidelines for the replacement of the special trustee; and

"(7) that the property held in trust by the special trustee is subject to distribution in accordance with subsection (c).

"(c)(1) The special trustee shall distribute the assets held in trust—

"(A) if the court confirms a plan in the case, in accordance with the plan on the effective date of the plan; or

"(B) if the case is converted to a case under chapter 7, as ordered by the court.

"(2) As soon as practicable after a final distribution under paragraph (1), the office of the special trustee shall terminate, except as may be necessary to wind up and conclude the business and financial affairs of the trust.

"(d) After a transfer to the special trustee under this section, the special trustee shall be subject only to applicable nonbankruptcy law, and the actions and conduct of the special trustee shall no longer be subject to approval by the court in the case under this subchapter.

"§ 1187. Temporary and supplemental automatic stay; assumed debt

"(a)(1) A petition filed under section 1183 operates as a stay, applicable to all entities, of the termination, acceleration, or modification of any debt, contract, lease, or agreement of the kind described in paragraph (2), or of any right or obligation under any such debt, contract, lease, or agreement, solely because of—

"(A) a default by the debtor under any such debt, contract, lease, or agreement; or

"(B) a provision in such debt, contract, lease, or agreement, or in applicable nonbankruptcy law, that is conditioned on—

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

"(ii) the commencement of a case under this title concerning the debtor;

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

"(iv) a credit rating agency rating, or absence or withdrawal of a credit rating agency rating—

"(I) of the debtor at any time after the commencement of the case;

"(II) of an affiliate during the period from the commencement of the case until 48 hours after such order is entered;

"(III) of the bridge company while the trustee or the special trustee is a direct or indirect beneficial holder of more than 50 percent of the equity securities of—

"(aa) the bridge company; or

"(bb) the affiliate, if all of the direct or indirect interests in the affiliate that are property of the estate are transferred under section 1185; or

"(IV) of an affiliate while the trustee or the special trustee is a direct or indirect beneficial holder of more than 50 percent of the equity securities of—

"(aa) the bridge company; or

"(bb) the affiliate, if all of the direct or indirect interests in the affiliate that are property of the estate are transferred under section 1185.

"(2) A debt, contract, lease, or agreement described in this paragraph is—

"(A) any debt (other than capital structure debt), executory contract, or unexpired lease of the debtor (other than a qualified financial contract);

"(B) any agreement under which the debtor issued or is obligated for debt (other than capital structure debt);

"(C) any debt, executory contract, or unexpired lease of an affiliate (other than a qualified financial contract); or

"(D) any agreement under which an affiliate issued or is obligated for debt.

"(3) The stay under this subsection terminates—

"(A) for the benefit of the debtor, upon the earliest of—

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

"(ii) assumption of the debt, contract, lease, or agreement by the bridge company under an order authorizing a transfer under section 1185;

"(iii) a final order of the court denying the request for a transfer under section 1185; or

"(iv) the time the case is dismissed; and

"(B) for the benefit of an affiliate, upon the earliest of—

"(i) the entry of an order authorizing a transfer under section 1185 in which the direct or indirect interests in the affiliate that are property of the estate are not transferred under section 1185;

"(ii) a final order by the court denying the request for a transfer under section 1185;

"(iii) 48 hours after the commencement of the case if the court has not ordered a transfer under section 1185; or

"(iv) the time the case is dismissed.

"(4) Subsections (d), (e), (f), and (g) of section 362 apply to a stay under this subsection.

"(b) A debt, executory contract (other than a qualified financial contract), or unexpired lease of the debtor, or an agreement under which the debtor has issued or is obligated for any debt, may be assumed by a bridge company in a transfer under section 1185 notwithstanding any provision in an agreement or in applicable nonbankruptcy law that—

"(1) prohibits, restricts, or conditions the assignment of the debt, contract, lease, or agreement; or

"(2) accelerates, terminates, or modifies, or permits a party other than the debtor to terminate or modify, the debt, contract, lease, or agreement on account of—

"(A) the assignment of the debt, contract, lease, or agreement; or

"(B) a change in control of any party to the debt, contract, lease, or agreement.

"(c)(1) A debt, contract, lease, or agreement of the kind described in subparagraph (A) or (B) of subsection (a)(2) may not be accelerated, terminated, or modified, and any right or obligation under such debt, contract, lease, or agreement may not be accelerated, terminated, or modified, as to the bridge company solely because of a provision in the debt, contract, lease, or agreement or in applicable nonbankruptcy law—

"(A) of the kind described in subsection (a)(1)(B) as applied to the debtor;

"(B) that prohibits, restricts, or conditions the assignment of the debt, contract, lease, or agreement; or

"(C) that accelerates, terminates, or modifies, or permits a party other than the debtor to terminate or modify, the debt, contract, lease or agreement on account of—

"(i) the assignment of the debt, contract, lease, or agreement; or "(ii) a change in control of any party to the debt, contract, lease, or agreement.

"(2) If there is a default by the debtor under a provision other than the kind described in paragraph (1) in a debt, contract, lease or agreement of the kind described in subparagraph (A) or (B) of subsection (a)(2), the bridge company may assume such debt, contract, lease, or agreement only if the bridge company—

"(A) shall cure the default;

"(B) compensates, or provides adequate assurance in connection with a transfer under section 1185 that the bridge company will promptly compensate, a party other than the debtor to the debt, contract, lease, or agreement, for any actual pecuniary loss to the party resulting from the default; and

"(C) provides adequate assurance in connection with a transfer under section 1185 of future performance under the debt, contract, lease, or agreement, as determined by the court under section 1185(c)(4).

"§ 1188. Treatment of qualified financial contracts and affiliate contracts

"(a) Notwithstanding sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 362(o), 555, 556, 559, 560, and

561, a petition filed under section 1183 operates as a stay, during the period specified in section 1187(a)(3)(A), applicable to all entities, of the exercise of a contractual right—

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

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

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

"(b)(1) During the period specified in section 1187(a)(3)(A), the trustee or the affiliate shall perform all payment and delivery obligations under such qualified financial contract of the debtor or the affiliate, as the case may be, that become due after the commencement of the case. The stay provided under subsection (a) terminates as to a qualified financial contract of the debtor or an affiliate immediately upon the failure of the trustee or the affiliate, as the case may be, to perform any such obligation during such period.

"(2) Any failure by a counterparty to any qualified financial contract of the debtor or any affiliate to perform any payment or delivery obligation under such qualified financial contract, including during the pendency of the stay provided under subsection (a), shall constitute a breach of such qualified financial contract by the counterparty.

"(c) Subject to the court's approval, a qualified financial contract between an entity and the debtor may be assigned to or assumed by the bridge company in a transfer under, and in accordance with, section 1185 if and only if—

"(1) all qualified financial contracts between the entity and the debtor are assigned to and assumed by the bridge company in the transfer under section 1185;

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

"(3) all claims of the debtor against the entity under any qualified financial contract between the entity and the debtor are assigned to and assumed by the bridge company; and

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

"(d) Notwithstanding any provision of a qualified financial contract or of applicable nonbankruptcy law, a qualified financial contract of the debtor that is assumed or assigned in a transfer under section 1185 may not be accelerated, terminated, or modified, after the entry of the order approving a transfer under section 1185, and any right or obligation under the qualified financial contract may not be accelerated, terminated, or modified, after the entry of the order approving a transfer under section 1185 solely because of a condition described in section 1187(c)(1), other than a condition of the kind specified in section 1187(b) that occurs after property of the estate no longer includes a direct beneficial interest or an indirect beneficial interest through the special trustee, in more than 50 percent of the equity securities of the bridge company.

"(e) Notwithstanding any provision of any agreement or in applicable nonbankruptcy law, an agreement of an affiliate (including an executory contract, an unexpired lease, qualified financial contract, or an agreement under which the affiliate issued or is obligated for debt) and any right or obligation under such agreement may not be accelerated, terminated, or modified, solely because of a condition described in section 1187(c)(1), other than a condition of the kind specified in section 1187(b) that occurs after the bridge company is no longer a direct or indirect beneficial holder of more than 50 percent of the equity securities of the affiliate, at any time after the commencement of the case if—

"(1) all direct or indirect interests in the affiliate that are property of the estate are transferred under section 1185 to the bridge company within the period specified in subsection (a);

"(2) the bridge company assumes—

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

"(B) any obligations in respect of rights of setoff, netting arrangement, or debt of the debtor that directly arises out of or directly relates to the guarantee or credit enhancement; and

"(3) any property of the estate that directly serves as collateral for the guarantee or credit enhancement is transferred to the bridge company.

"§ 1189. Licenses, permits, and registrations

"(a) Notwithstanding any otherwise applicable nonbankruptcy law, if a request is made under section 1185 for a transfer of property of the estate, any Federal, State, or local license, permit, or registration that the debtor or an affiliate had immediately before the commencement of the case and that is proposed to be transferred under section 1185 may not be accelerated, terminated, or modified at any time after the request solely on account of—

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

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

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

"(4) a transfer under section 1185.

"(b) Notwithstanding any otherwise applicable nonbankruptcy law, any Federal, State, or local license, permit, or registration that the debtor had immediately before the commencement of the case that is included in a transfer under section 1185 shall be valid and all rights and obligations thereunder shall vest in the bridge company.

"§ 1190. Exemption from securities laws

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

"§ 1191. Inapplicability of certain avoiding powers

"A transfer made or an obligation incurred by the debtor to an affiliate prior to or after the commencement of the case, including any obligation released by the debtor or the estate to or for the benefit of an affiliate, in contemplation of or in connection with a transfer under section 1185 is not avoidable under section 544, 547, 548(a)(1)(B), or 549, or under any similar nonbankruptcy law.

"§ 1192. Consideration of financial stability

"The court may consider the effect that any decision in connection with this subchapter may have on financial stability in the United States.".

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

(a) AMENDMENT TO CHAPTER 13.—Chapter 13 of title 28, United States Code, is amended by adding at the end the following:

"§ 298. Judge for a case under subchapter V of chapter 11 of title 11

"(a)(1) Notwithstanding section 295, the Chief Justice of the United States shall designate not fewer than 10 bankruptcy judges to be available to hear a case under subchapter V of chapter 11 of title 11. Bankruptcy judges may request to be considered by the Chief Justice of the United States for such designation.

"(2) Notwithstanding section 155, a case under subchapter V of chapter 11 of title 11 shall be heard under section 157 by a bankruptcy judge designated under paragraph (1), who shall be randomly assigned to hear such case by the chief judge of the court of appeals for the circuit embracing the district in which the case is pending. To the greatest extent practicable, the approvals required under section 155 should be obtained.

"(3) If the bankruptcy judge assigned to hear a case under paragraph (2) is not assigned to the district in which the case is pending, the bankruptcy judge shall be temporarily assigned to the district.

"(b) A case under subchapter V of chapter 11 of title 11, and all proceedings in the case, shall take place in the district in which the case is pending.

"(c) In this section, the term 'covered financial corporation' has the meaning given that term in section 101(9A) of title 11.".

(b) AMENDMENT TO SECTION 1334 OF TITLE 28.—Section 1334 of title 28, United States Code, is amended by adding at the end the following:

"(f) This section does not grant jurisdiction to the district court after a transfer pursuant to an order under section 1185 of title 11 of any proceeding related to a special trustee appointed, or to a bridge company formed, in connection with a case under subchapter V of chapter 11 of title 11.".

(c) TECHNICAL AND CONFORMING AMENDMENT.—The table of sections for chapter 13 of title 28, United States Code, is amended by adding at the end the following:

"298. Judge for a case under subchapter V of chapter 11 of title 11.".

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