TITLE II: Orderly Liquidation Authority

A. Overview: Orderly Liquidation Authority

Title II of the Act creates a non-Bankruptcy Code framework for providing both financial assistance to help failing and failed BHCs and operational assistance in managing the liquidation of such large, systemically connected companies (the "Orderly Liquidation Authority" or "Liquidation Authority"). The purpose of the Orderly Liquidation Authority is to "provide the necessary authority to liquidate failing financial companies that pose a significant risk to the financial stability of the United States in a manner that mitigates such risk and minimizes moral hazard." **Sec. 204(a) (p. 81)**. The Act empowers the Treasury to appoint the FDIC as receiver to liquidate a covered financial company (a "CFC"), with broad discretion and power to manage such company and minimize the liquidation's impact on the U.S. economy.

The new liquidation authority supplants the Bankruptcy Code (the "Code") as the statutory regime for the failure of large, systemically significant financial companies. Most financial companies will operate under the Code. However, if the collapse of a financial company could threaten the U.S. economy, such company will be placed into the new regulatory regime.

If the legislation creates significant new uncertainties among market participants, the terms, pricing, and valuation of past and future transactions could potentially be affected. A 2009 Fed staff memorandum correctly notes that the "resolution regime directly and significantly affects preexisting contractual and property rights. While this regime must be outside the Code in order to allow the resolving agency to be responsive to the circumstances of the specific financial crisis that motivated use of the regime, it must still operate in a manner that respects the rule of law *and that is perceived as such*."

Because both the Code and the Act could apply to the same company, differences between the Code and the Act are noted below and such *differences are noted in italics.*

B. Application of Orderly Liquidation Regime to Covered Financial Companies

The Act's liquidation regime applies to a "financial company," as defined by Section 201(a)(11), which includes a company incorporated or organized under federal or any state law that is:

i. A BHC;

ii. A NBFC supervised by the Fed;

iii. A company that is predominantly engaged in activities that the Fed has determined are financial in nature or incidental thereto for purposes of Section 4(k) of the BHC Act; or

iv. Any subsidiary of the above that is predominantly engaged in activities that the Fed has determined are financial in nature or

> incidental thereto for purposes of the BHC Act Section 4(k), other than a subsidiary that is an insured depository institution or insurance company; and

that is not a Farm Credit System institution, a government entity or regulated entity, as defined under Section 1303(20) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992. **Sec. 201(a)(11) (p. 70)**. For a company to be classified as a financial company due to its activities that the Fed has determined are financial in nature or incidental thereto, 85% or more of the company's revenue must come from such activities. **Sec. 201(b) (p. 71)**. The FDIC may appoint itself as receiver for any subsidiary (other than an insured depository institution, a covered broker or dealer (a "CBD") or an insurance company) of a CFC if the FDIC and Secretary jointly determine that the subsidiary is in default or in danger of default, appointing the FDIC as receiver of the subsidiary would mitigate the negative effects on the U.S. economy and such action would facilitate the orderly liquidation of the CFC. **Sec. 210(a)(1)(E) (p. 88)**.

While the Act excludes subsidiaries of a financial company that are insurance companies from the definition of "financial company," insurance holding companies are not excluded and could fall within the purview of the Act. Insurance companies are resolved under state law, but the FDIC could stand in the place of a state regulatory agency for the resolution of such insurance company under state law if the regulatory agency fails to file for judicial action within 60 days of the FDIC's appointment as receiver. **Sec. 203(e) (p. 81)**.

Under the Code, an eligible entity may file a voluntary petition for relief under the auspice of the Code. Although solvent companies can be debtors under the Code, generally only insolvent debtors seek protection, and the Bankruptcy Court, on a proper showing, may dismiss a bad faith filing. Three or more entities holding undisputed, noncontingent, liquidated unsecured claims (each in excess of a minimal dollar amount) against a company may file an involuntary petition requesting entry of an order for relief under the Code against such company. A company that is the subject of an involuntary petition may oppose the entry of an order for relief under the Code. (See below for further details on involuntary petitions.)

C. Initiation of Orderly Liquidation Authority

Under the Act, initiation of the liquidation regime begins when the FDIC and the Fed makes a recommendation as to whether the Secretary should appoint the FDIC as receiver for a financial company. The recommendation is required to include a number of items, including an evaluation of whether a CFC is in default or danger of default and a description of the effect that default would have on the financial stability of the United States. The Fed and the SEC make the recommendation if the company or its largest subsidiary is a broker or dealer; the Fed and the FIO would make the recommendation if the company or its largest subsidiary is an insurance company. The Secretary then determines, based on the written recommendation and after consultation with the President, whether (a) the financial company is in default or danger of default; (b) the failure of the financial company would have serious negative effects on U.S. financial stability; (c) private sector alternatives would not prevent the default of the CFC; (d) any effect on the claims and interests of creditors, counterparties and shareholders of the financial company and other market participants would be appropriate given the impact of such actions on the U.S. economy; (e) actions under the Act would avoid or mitigate such adverse effects; (f) a federal regulatory agency has ordered the financial company to convert all of its convertible debt instruments; and (g) the company is a "financial company" under Section 201. **Sec. 203(a)-(b) (pp. 77-78)**.

If the above standards are met, the Secretary then petitions the Court for an order authorizing the Secretary to appoint the FDIC as receiver of the financial company if the board of directors of the CFC does not acquiesce or consent to the FDIC's appointment as receiver of the CFC; if the board consents to the appointment, the Secretary appoints the FDIC as receiver without petitioning the Court. If the Court finds the Secretary's determination is not "arbitrary and capricious" in this hearing, in which the CFC may contest the Secretary's findings, the Court would then issue an order immediately authorizing the Secretary to appoint the FDIC as receiver for the CFC and to commence the resolution process. If the Secretary's determination is "arbitrary and capricious," the Court immediately provides the Secretary with a written statement of the reasons behind its determination and provides the Secretary with an immediate opportunity to amend and refile the petition. If the Court does not make a determination on the petition within 24 hours of its filing, the petition is granted by operation of law and the liquidation of the CFC would commence. Once the order is granted, the FDIC, as receiver, resolves the CFC under Title II of the Orderly Liquidation Authority. **Sec. 202(a)-(b) (pp. 71-74)**. If the CFC is a CBD, then the Securities Investor Protection Corporation (the "SIPC") is also appointed as the trustee and special liquidation rules would apply. **Sec. 205(a) (pp. 82-83)**.

In contrast, there is no procedure for a non-creditor, including the Treasury Department, the Fed, or the FDIC, to commence a case under the Code against a company. A voluntary bankruptcy petition may be filed by any eligible debtor. Involuntary petitions may be filed by three or more creditors who hold unsecured, non-contingent, undisputed claims which aggregate to at least $13,475. Involuntary petitions may be contested by the debtor/company. An involuntary petition will be granted, and an order for relief entered, if the Bankruptcy Court finds that the company is not paying its debts as they come due. If a company has fewer than 12 such creditors, a single creditor holding at least $13,475 in unsecured, non-contingent, undisputed claims may file the involuntary petition.

D. Powers of the Receiver Over the CFC

Upon initiation of the liquidation proceedings, the Act gives the FDIC as receiver significant power over a CFC. The FDIC, as receiver, can:

i. Take over the assets of and operate the CFC;

ii. Collect all obligations and money due to the CFC;

iii. Perform all functions of the CFC in the company's name;

iv. Manage the assets and property of the CFC;

v. Provide by contract for assistance in fulfilling any function, activity, action, or duty of the receiver;

vi. Merge the CFC with another company;

vii. Provide for the exercise of any function by any member or stockholder, director, or officer of the CFC;

viii. Organize a bridge financial company (a "Bridge Company"); or

ix. Transfer any asset or liability of the CFC without any approval, assignment or consent with respect to such transfer. **Sec. 210(a)(1)(B)-(G) (pp. 87-89)**.

Unlike the FDI Act, there are no provisions in the Act that require the receiver to seek the least costly resolution in the liquidation of an insured depository institution.

In a chapter 11 case (reorganization) under the Code, the debtor continues to be managed and operated by the old board and management of the company, which is entitled to propose a plan for the reorganization or liquidation of the company. When management and the old board continue in this capacity, the debtor is known as the debtor-in-possession (the "DIP"). Upon the occurrence of certain events, the DIP may be displaced and a chapter 11 trustee may be appointed to manage and operate the business of the company. By contrast, in a chapter 7 case (liquidation), a trustee is appointed when the case is initially commenced and that trustee administers the liquidation of the assets of the company. In either case, the DIP or trustee is the successor in interest to the rights, titles, assets, and affairs of the debtor.

In a chapter 11 case, the DIP or trustee is authorized to operate the business of the debtor and take actions in the ordinary course of business, without court approval. Transactions or actions "outside the ordinary course of business," such as post-petition loans and the sale of significant operating assets, require the approval of the Bankruptcy Court. By contrast, a chapter 7 trustee has more limited operating authority. In general, the court reviews out-of-the-ordinary-course transactions to determine if they are in the best interests of the estate. Actions outside the ordinary course of business include, without limitation:

i. Paying pre-petition debts;

ii. Paying professionals and advisors without a Bankruptcy Court order;

iii. Selling assets outside the ordinary course of business;

iv. Using cash collateral without the consent of secured creditors or the Bankruptcy Court; and

v. Obtaining credit or incurring secured or unsecured debt without Court approval.

E. Orderly Liquidation Fund

The FDIC, as receiver, has the authority to provide financial assistance to the CFC from a newly established Orderly Liquidation Fund (the "Fund"). **Sec. 204(d) (p. 82)**. The Fund is capitalized only after the FDIC is appointed as receiver of a CFC through FDIC-issued debt securities sold to the Treasury. For the first 30 days after the CFC's appointment as receiver, the FDIC is able to issue obligations of an amount equal to 10 percent of the total consolidated assets of the CFC. After 30 days, the FDIC can issue obligations for an amount that is equal to 90 percent of the fair value of the total consolidated assets of each CFC that are available for repayment. The FDIC can issue the latter amount sooner than 30 days if it can calculate the total consolidated assets of each CFC before the 30-day period after its appointment.

Under the Act, the FDIC recoups its expenditures from the Fund from proceeds received through the liquidation process and assessments on claimants and financial companies. Expenditures from the Fund have super-priority status among claims of its applicable priority level. Assessments for the Fund are placed initially on any claimant that received additional payments due to the FDIC's preferential treatment of such claimant in the liquidation process—except for payments or amounts necessary to initiate or continue operations essential to the receivership or any bridge company; such preferential treatment is allowed under the Act if necessary to minimize losses in the liquidation of the CFC. These assessments equal the amount the claimant received from the FDIC minus the amount the claimant was entitled to recover solely from the liquidation of the CFC under Title II (or the amount the claimant would have received from a chapter 7 liquidation under the Code). If assessments on unequally treated claimants and proceeds from the liquidation process are insufficient to recoup the Fund's expenditures, the FDIC <u>must</u> issue risk-based assessments on BHCs and financial companies with over $50,000,000,000 in consolidated assets and NBFCs supervised by the Fed. **Sec. 210(n)-(o) (pp. 134-140)**.

To impose assessments, the FDIC requires financial companies to make information available to it to enable it to determine the scope of risk-based assessments. The size of an assessment is based on a risk matrix in which the FDIC must take into account the economic conditions generally affecting financial companies, other assessments imposed on the company, the extent the financial company has benefitted from the orderly liquidation and use of the Fund under the Act, the risks presented by the financial company to the U.S. financial stability, any risks presented by the company in the previous 10 years that contributed to the failure of the CFC and other factors the FDIC or the Council deem appropriate. Assessments are imposed on a graduated basis, with financial companies having greater assets assessed at a higher rate. The FDIC is required, in consultation with the Secretary, to impose rules and regulations to administer assessments. **Sec. 210(n)-(o) (pp. 134-140)**. The Act prohibits the use of taxpayer funds to prevent the liquidation of the CFC. **Sec. 214 (p. 146)**.

The Code does not provide for any government funding for companies undergoing the liquidation or reorganization process.

F. Judicial Review By Article III Courts

1. Judicial Review Generally

The Act limits the role of courts during the resolution process. In general, "no court may take any action to restrain or affect the exercise of powers or functions of the receiver," unless specifically provided in the Act. Any remedy against the FDIC is limited to money damages determined in accordance with the Act. **Sec. 210(e) (p. 123)**.

Under the Code, all aspects of a case are subject to judicial review from the onset of a bankruptcy proceeding. The Bankruptcy Court must affirmatively grant prior approval of non-ordinary courses of action by the DIP or the trustee. In addition, creditors can seek relief from the Bankruptcy Court related to various other matters. Bankruptcy Court rulings are subject to appeal to the District Court and, thereafter, to the Circuit Court.

2. Judicial Review of the Initiation of the Liquidation Authority and Appointment of Receiver

As discussed above, the Act provides for judicial review of the Secretary's determination to commence the Orderly Liquidation Authority. The Secretary is required to petition the Court to appoint the FDIC as receiver if the CFC does not acquiesce to the FDIC's appointment. The Court evaluates the Secretary's determinations under an arbitrary and capricious standard; if the Secretary's determination is not arbitrary and capricious then the Court issues an order for the appointment of the FDIC as receiver. The Court is required to make its decision within 24 hours of receipt of the petition; if no decision is made within 24 hours, the FDIC's appointment is automatically granted.

The Act also provides judicial review of the Court's decision to grant an order for the appointment of the FDIC as receiver. The CFC or the Secretary can file, no later than 30 days after the decision of the Court, an appeal of the Court's decision to the U.S. Court of Appeals for the District of Columbia Circuit. A petition for *writ of certiorari* to review a decision by the D.C. Circuit could be filed with the Supreme Court no later than 30 days after the date of the final decision of the Court of Appeals. Review of the Court's determinations by the D.C. Circuit and the Supreme Court would be limited to whether the Secretary's determination that the CFC is in default or in danger of default and the CFC is a financial company is arbitrary and capricious. **Sec. 202 (pp. 71-76)**.

There is no Code analogue to this provision.

3. Judicial Review of Claim Determinations

The Act allows a claimant to contest a claim determination by the FDIC in the district court for the district where the principal place of business of the CFC is located. Such claim would need to be brought to the district court within 60 days of the FDIC's allowance or disallowance of the claim. **Sec. 210(a)(4) (pp. 93-94)**.

The Code, and its accompanying rules, establishes court-supervised procedures for the filing and resolution of disputes relative to claims. Unlike district court under the Act, the Bankruptcy Court is very involved in the claims process.

G. The Claims Process

At the heart of the dissolution authority is the resolution of creditors' claims against the CFC. All parties with claims against the CFC are required to present their claims to the FDIC. As the receiver, the FDIC has the power to determine all claims against the CFC and can disallow a claim, in part or in whole, which it determines has not been proved to its satisfaction. The FDIC is required to make such determination within 180 days from the date such claim is presented, although such time may be extended by agreement with the claimant. **Sec. 210(a)(2)-(3) (pp. 91-93)**.

The proposed claims process under the Act differs significantly from the one provided under the Code. The DIP or trustee does not make the initial determination on claims, leaving creditors to file litigation challenging such determination. Under the Code, the debtor files schedules indicating to whom and how much it believes it owes. If a creditor agrees with the amount for which it is scheduled, it needs to take no action and will be granted an allowed claim. If a creditor disagrees with the scheduled amount or desires to make an additional claim, it may, within a set bar date, file a proof of claim reflecting the amounts that the creditor believes it is owed. In the absence of an objection from the debtor, a creditor's claim is allowed in the amount of the proof of claim filed by the creditor. If the debtor disputes any proof of claim, it has the affirmative burden to file a claims objection with the Bankruptcy Court. The creditor may respond to the claims objection and the Bankruptcy Court would resolve these claim disputes. The decisions of the Bankruptcy Court are subject to appeal.

1. Secured Claims

The Act generally protects security interests granted to secured creditors where the CFC holds the assets or property that is subject to such security interests, and it provides that such secured creditors <u>must</u> be secured up to the fair market value of their collateral. As such, a secured creditor has the first claim to the fair market value of the assets that secure such creditor's claim. The FDIC treats the portion of any claim that exceeds the fair market value of such collateral as an unsecured claim and does not make payment with respect to such unsecured portion other than in connection with a disposition of all unsecured claims.

The FDIC's maximum liability for the deficiency claim of a secured creditor is limited to what such creditor would have been entitled to receive if the CFC had been liquidated under chapter 7 of the Code and the Orderly Liquidation Authority was not commenced. This amount is determined by the FDIC. The Act contains no express provision as to the point in time at which such fair market value is measured. Thus, there may be disagreement about the appropriate measurement date for the fair market value of the collateral and even whether fair market value is evaluated assuming initiation or absence of the Orderly Liquidation Authority on another CFC.

Under the Act, the FDIC cannot reject any legally enforceable or perfected security interest in the assets of the CFC unless such interest was a fraudulent or preferential transfer. The FDIC cannot disallow any portion of a legally enforceable or perfected security interest securing an extension of credit from any Federal Reserve Bank or the Secretary. **Sec. 210 (a)(3)(D), 210(c)(12), and 210(d) (pp. 93, 120, and 122-123)**.

The FDIC can prime a secured creditor's collateral position under the Act in order to obtain credit for a Bridge Company. However, in doing so the FDIC is required to provide such creditor with adequate protection, and the FDIC has the burden of proof on whether adequate protection has been provided. **Sec. 210(h)(16) (pp. 131-132)**. The title precludes avoidance of any legally enforceable and perfected interests in customer property. **Sec. 205(d) (p. 84)**.

Under the Code, secured creditors are secured up to the value of the collateral. The value of the collateral is determined in light of the purpose of the valuation. Unlike the Act, under the Code there is a deep and developed body of case law precedent as to how collateral is valued under different circumstances. A secured party's collateral can be used if there is a demonstration of adequate protection of the interest of such party. The Code also contains statutory parameters for "adequate protection" and a deep and developed body of case law precedent as to what constitutes adequate protection under different circumstances.

a. Unsecured Claims

The Act creates a priority structure for unsecured claims similar to that in the FDI Act. Unsecured claims have the following priority, in descending order:

i. Administrative expenses of the receiver;

ii. Any amounts owed to the United States;

iii. Wages, salaries, or commissions earned not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);

iv. Contributions owed to employee benefit plans arising from services rendered not later than 180 days before the date of appointment of the FDIC as receiver ($11,725 per individual);

v. General or senior liabilities of the CFC;

vi. Obligations subordinated to general creditors;

vii. Any wages, salaries or commissions owed to senior executives and directors of the CFC;

viii. Obligations to persons with interests in the equity of the CFC as a result of their status as a shareholder, member, etc. **Sec. 210(b)(1) (p. 103)**.

As discussed above, the Act gives priority to claims of the United States against the CFC over other unsecured creditors. In addition, any amount owed to the FDIC from expenditures from the Fund will be given super-priority status among all creditors at the expenditure's appropriate priority level. **Sec. 204(d) (p. 82)**. Similarly situated creditors for each type of unsecured claim will be treated similarly unless the FDIC determines that dissimilar treatment is necessary to maximize the value of the CFC's assets, initiate and continue operations essential to the CFC or a Bridge Company, maximize the present value return from the sale of assets, or minimize losses to the CFC's assets. **Sec. 210(b) (pp. 103-105)**. The Act allows any obligation "necessary and appropriate" for the smooth resolution of the CFC to qualify as an administrative expense, which is given the highest priority level among unsecured creditors. **Sec. 201(a)(1) (p. 69)**. All similarly situated creditors receive not less than the amount they would receive under a chapter 7 liquidation (as discussed below). **Sec. 210(d)(2) (p. 122)**.

There are significant differences in the treatment of unsecured claims under the Act and the Code. The first significant difference relates to the guidance provided in each statute as to what is an allowable claim. The Code has numerous provisions that provide parameters for what claims will be allowed and, in some instances, limitations on the amounts for which such claims will be allowed. A deep body of precedent provides further guidance on these parameters. No similar provisions or precedent exist relative to the Act. The Code's guidance on claims lends more certainty and transparency to the Code's procedures than to those under the Act.

The second major difference is that the Code, unlike the Act, does not permit similarly situated creditors to be treated dissimilarly. While some court-enacted doctrines enable a debtor to pay pre-petition creditors when it is necessary for the successful continuation of the debtor's business, these payments are authorized only when the Bankruptcy Court determines that such payment will enhance or preserve the value of the debtor's business which will inure to the benefit of all creditors; thus, there is no concept of cherry-picking the payment of one creditor to achieve a goal, such as a systemic resolution goal, that is not in the best interests of all creditors.

Finally, although the distributional priorities under the Act and the Code differ, both require administrative expenses to be paid in full before unsecured claims are paid. However, under the Act, any debt owed to the U.S. government or to the Fund must also be repaid in full before unsecured claims are paid. In contrast, the Code pays <u>certain</u> employee, tax, and other claims before unsecured claims, but does not require <u>all</u> obligations to the U.S. government to be paid in full before any other creditors are paid. For example, if the United States had entered into a contract with a debtor and that contract was rejected, under the Code, the damages claim owed to the United States would be treated like any other general unsecured claim; under the Act that claim would be paid before general unsecured claims.

2. Valuation of Claims

The Act establishes that the maximum liability to any person having a claim against the FDIC (acting as receiver for a CFC) will be the amount such claimant would have received if the FDIC had not been appointed receiver and the CFC had been liquidated under chapter 7 of the Code (or under a similar provision of State insolvency law). The Act does not identify the methodology used to value the collateral, nor does it provide any other rights for creditors to fully participate in the process, including disputes over the amount a creditor would receive from the liquidation of the assets. The FDIC can make additional payments to a claimant if the FDIC determines that such actions would minimize losses to the FDIC as receiver. **Sec. 210(d)(2) (p. 122)**.

The Act contains special provisions for the valuation of customer claims in the resolution of a CBD. The Act resolves all customer claims of CBDs in the same manner and for the same amount as the Securities Investor Protection Act (the "SIPA"). Any obligation of a CBD to a customer relating to customer property would be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Sec. 205(f), 210(d)(2) (pp. 85, 122)**.

By contrast, the Code is meaningfully different in two key respects. First, a claimant's *recovery under chapter 11 (reorganization) of the Code is not limited to such claimant's chapter 7 liquidation recovery and, indeed, chapter 11 reorganizations generally yield reorganization value that results in increased recoveries to creditors above the chapter 7 liquidation recovery amount. Second, the Code leaves to the determination of the Bankruptcy Court whether a creditor is actually receiving what they are entitled to receive under the Code; by contrast, under the Act, there is no mechanism for court review of the determination of the FDIC as to how much a claimant with an allowed claim is entitled to be paid.*

H. Contracts

The Act grants the FDIC the power to repudiate "burdensome" contracts and leases of the CFC, within a reasonable time, if it determines such repudiation will promote the orderly administration of the CFC. The FDIC's ability to repudiate any contract because it is "burdensome" does not apply to any extension of credit from the Fed or the FDIC to the CFC, or to any security interest in the assets of the CFC securing such extension of credit. The receiver will be liable only for "actual direct compensatory damages" measured "as of" the date the receiver is appointed; recoveries for profits, lost opportunity, pain and suffering, and punitive damages are not allowed.

The FDIC can enforce any contract (other than a financial institution bond or a director and officer insurance contract) and require performance by the counterparty of its contractual obligations despite termination rights due to the insolvency or financial condition of the company (*ipso facto* provisions). Further, for the first 90 days of a receivership, the other party to a contract with a CFC will not be able to exercise any right to terminate, accelerate, or declare a default to the contract or obtain possession or control over any property of the CFC without the FDIC's consent; such "hold" does not apply to director or officer liability insurance contracts, financial institution bonds, the rights of parties to certain qualified financial contracts ("QFCs") or certain contracts under the FDIC Improvement Act. The FDIC, however, cannot reinstate a contract that was terminated before the appointment of the FDIC. **Sec. 210(c) (pp. 105-122)**.

The Act also adopts a less stringent version of the *D'Oench Duhme* doctrine, codified in the FDI Act, to contracts against the interest of the FDIC. Under the Act, any agreement that tends to diminish or defeat the interest of the FDIC as receiver in any asset acquired by the FDIC is not valid unless the agreement (a) is in writing, (b) was executed by an authorized officer or representative of or confirmed in the ordinary course of business by the CFC, and (c) has been an official record of the CFC since the time of its execution or the party claiming under the agreement provides documentation of such agreement and its authorized execution by the CFC. **Sec. 210(a)(6) (p. 95)**.

Under the Code, if a contract is rejected, it will give rise to a pre-petition unsecured claim for damages, which may be paid *pro rata* rather than in full. Rejection of claims for some types of contracts, such as long-term leases and employment contracts, are limited in terms of the amount that will be allowed. Executory contracts first assumed by a debtor but subsequently rejected give rise to an administrative claim for a portion of the damages. The Code does not mirror the *D'Oench Duhme* doctrine's contract requirements, and contracts not in writing or authorized by an officer of the CFC may be enforceable. Unlike the Act, the Code prevents the assignment of certain types of contracts, including contracts where applicable law excuses a party from accepting performance from or rendering performance to a debtor and contracts for financial accommodations, without consent of the non-debtor party. Similarly, the Code has specific provisions to ensure that, prior to assuming and assigning contracts, the debtor must cure all defaults, compensate for damages, and provide adequate assurance of future performance. No such protections exist under the Act.

1. Qualified Financial Contracts

The Act has special rules for QFCs, which are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements, or other similar agreements that the FDIC determines by regulation, resolution, or order to be a QFC. When the FDIC is appointed as a company's receiver, counterparties to QFCs are prohibited from exercising their contractual rights to terminate, accelerate, set off, and net or enforce their security interests in collateral, where such rights are solely by reason of or incidental to the appointment of the FDIC as receiver or the insolvency or financial condition of the CFC, until 5:00 p.m. on the next business day following the date of the appointment. This period is intended to give the FDIC time to choose whether to transfer all or none of the QFCs, claims and property of any counterparty and its affiliates to another financial institution, including a Bridge Company. If the FDIC chooses to transfer a counterparty's QFCs, then the counterparty cannot terminate, accelerate, set off, and net or enforce their security interests in collateral due to the appointment of the FDIC as receiver or the insolvency or financial condition of the CFC. However, all QFCs, claims, and property securing the QFC or other credit enhancement between any counterparty or affiliate and the CFC would be transferred to a single financial institution; the FDIC cannot selectively pick and choose which QFCs made to a single counterparty are transferred. QFC counterparties can terminate for other defaults, such as non-payment or non-performance under the QFCs.

If the waiting period elapses and the FDIC does not elect to transfer the QFCs to another financial institution, counterparties can then exercise their rights to terminate, liquidate, or accelerate the contract, exercise any rights under a related security agreement, or exercise their rights to set off or net amounts due in connection with such QFCs. However, "walk-away" clauses, or clauses that suspend conditions or extinguish a payment obligation of a party due to the party's status as a non-defaulting party, are not enforceable under the Act.

Under the Act, the FDIC cannot avoid a transfer of money or property in connection with any QFC unless the transferee had actual intent to hinder, delay, or defraud the CFC, creditors, or receiver of the CFC. The Act allows preference and fraudulent conveyance challenges to QFCs, as well as challenges for set-off rights. Damages for repudiated QFCs include normal and reasonable costs of cover or other reasonable measure of damages used in the industry. **Sec. 210(c)(8)-(11) (pp. 108-119)**.

The Code provides "safe harbors" for QFCs and QFC counterparties. Non-debtor counterparties may, immediately and without seeking relief from the automatic stay, exercise their contractual rights under QFCs to (i) terminate or accelerate the obligations of the parties and liquidate and realize against any collateral held to secure the debtor's obligations and (ii) set off mutual debts and claims. These rights would typically be restricted under the Code in order to protect the estate of the debtor. In addition, any deliveries or settlements made *pursuant to these QFCs are protected from being avoided as either preferential or fraudulent transfers, provided that they were not made with an intent to defraud.*

I. Bridge Financial Companies

The Act allows the FDIC to organize one or more "Bridge Companies" and transfer any of the CFC's assets and liabilities to those Bridge Companies. The purpose of such transfer is to help the Bridge Companies maximize the net asset value of the transferred assets and liabilities and to separate the good assets and liabilities from the bad. The remaining company left behind is liquidated. This approach is mirrored after the FDI Act's "good bank-bad bank" approach, in which a bridge bank is used to protect depositors and provide significant business continuity for the "good" portion of the failed bank, leaving the FDIC receivership as the legal vehicle for sorting contractual and counterparty relationships with parties other than depositors, with the goal of maximizing amounts that can be paid to claimants. The Act provides that the aggregate amount of liabilities of a CFC that are transferred to a Bridge Company could not exceed the aggregate amount of assets of the CFC that are transferred to, or purchased by, the Bridge Company.

Under the Act, Bridge Companies are created with a federal charter with a board of directors appointed by the FDIC. Bridge Companies partly or fully assume the assets, rights, liabilities, powers, authorities, and privileges of the CFC. A transfer of a CFC's assets or liabilities does not require the consent of the counterparties. Contracts that are not assignable without consent under applicable agreement or laws are not exempt from transfer. Bridge Companies can obtain unsecured credit and issue unsecured debt. If a Bridge Company is unable to obtain unsecured credit or issue unsecured debt, the FDIC can authorize it to obtain secured credit or issue debt with priority over any or all of the other obligations of the Bridge Company, secured by a lien on property that is not otherwise subject to a lien or secured by a junior lien.

The Act requires the FDIC to treat all similarly situated creditors of the CFC equally when transferring the assets or liabilities of the company to a Bridge Company, unless unequal treatment is necessary to maximize the value of assets, maximize the present value of return from the sale of assets, or minimize the amount of any loss from the sale of assets. All such similarly situated creditors receive at least the Liquidation Amount. The Act may create uncertainty for creditors because the FDIC may transfer their claims or the assets securing their claims to a Bridge Company for less than fair value or, in the case of a secured creditor, without adequate protection of such creditor's secured claim. The Act does not provide any methodologies or judicial review for valuing claims or collateral securing such claims or any process to contest the values assigned by the FDIC. **Sec. 210(h) (pp. 123-132)**.

The Code does not contain the concept of a Bridge Company to hold assets. However, often a plan of reorganization will distribute certain assets to a liquidating trust, which will liquidate those assets and distribute them as provided in the plan. Generally, a liquidating trust holds primarily non-operating assets and litigation claims and not the operating assets of a business.

J. Fraudulent Transfers

The Act allows the FDIC to void a transfer of any interest of the CFC in property or obligation that is a fraudulent transfer. A transfer is to be deemed fraudulent if it was made (a) within two years before the appointment of the FDIC as the receiver; (b) with the actual intent to hinder, delay, or defraud the CFC or FDIC or the CFC received less than reasonably equivalent value in exchange; and (c) when the CFC was insolvent or became insolvent as a result of the transfer, the CFC was engaged in a transaction that would have resulted in an unreasonably small amount of capital remaining with the CFC, the CFC intended to incur debts that would leave the CFC with an inability to pay its debts when they became due, or such transfer was made to or for the benefit of an insider.

The FDIC can recover the property transferred or value of the property from the initial transferee or from any immediate or mediate transferee. The FDIC cannot recover from any initial transferee that takes for value, without knowledge of the transfer's potential voidability or any immediate or mediate good faith transferee of such initial transferee.

The Act allows a transferee the defenses provided under Sections 546(b) and (c), 547(c) and 548(c) of the Code. Transfers exempt from avoidance from these defenses include those made with certain perfected security interests, made in the reclamation of goods by a seller, that are contemporaneous exchanges for new value and with transferees that take the transfer for value and in good faith. The transferee also has the same defenses available to such transferee in an action brought under Sections 547, 548 and 549 of the Code. As such, Section 546(e), which protects settlement payments from avoidance and is a defense to an action under Sections 547, 548 and 549, appears to have been incorporated as a defense as well. **Sec. 210(a)(11) (pp. 98-100)**.

The DIP/trustee may avoid any transfer of an interest of the debtor in property, or any obligation by the debtor, made or incurred on or within two years before the date of the filing of the petition, if (a) made with the intent to hinder or defraud a creditor (actual fraud) or (b) in exchange for the transfer, the debtor received less than "reasonably equivalent value," and the debtor was unable to pay its debts either at the time the transfer was made or as a result of the transfer itself. The Code also allows actions to be brought under applicable state fraudulent conveyance statutes if such actions are commenced within the applicable fraudulent conveyance statute of limitations. The applicable statute of limitations under state statutes may be four years or more.

K. Preferential Transfers

The Act allows the FDIC to avoid a transfer of an interest of the CFC in real property that is a preferential transfer. A transfer is deemed preferential if it is made (a) to benefit the creditor, (b) on account of an antecedent debt, (c) while the CFC was insolvent, (d) 90 days on or before the FDIC became receiver (or between 90 days and one year if the creditor was an insider at the time of transfer), and (e) so that the transfer enabled the creditor to receive more than it would have during liquidation. For the purposes of avoiding a preferential transfer, the Act presumes the CFC is insolvent 90 days before the appointment of the FDIC as receiver.

The FDIC can recover the property transferred or the value of the property from the initial transferee or from any immediate or mediate transferee. The FDIC cannot recover from any initial transferee that takes for value, without knowledge of the transfer's potential voidability or any immediate or mediate good faith transferee of such initial transferee. A transferee would have the defenses provided under Sections 546(b) and (c), 547(c), and 548(c) of the Code, noted above, and would have the same defenses available to such transferee in an action brought under Sections 547, 548, and 549 of the Code. **Sec. 210(a)(11) (pp. 98-100)**.

Under the Code, the DIP or trustee may avoid a transfer of an interest of the debtor in any property to or for the benefit of a creditor, on account of an antecedent debt, which was made while the debtor was insolvent, that enables such creditor to receive more than it would have otherwise received, if that transfer was made within 90 days before the date of the filing of the petition. This period is extended from 90 days to one year if the creditor was an "insider." In addition, under Section 544 of the Code, the trustee is authorized to avoid transfers under applicable state law, which often provides for longer time periods. The Code provides that interests in any type of property, not merely real property, are subject to avoidance, in contrast with the Act.

Preferential transfers may include payments of amounts due to existing creditors or grants of new security interests to secure obligations owed to existing creditors. Defenses include that the transfer was made for new value or in the ordinary course of business. While the Act provides similar defenses, it fails to incorporate an important defense found at Section 546(e) of the Code. That section provides that the DIP/trustee may not avoid a transfer that is a margin payment or a settlement payment. This is a potentially significant omission which impacts, among others, financial institutions or security clearing agencies (and their transferees) that receive settlement payments under forward contracts.

L. Set-Off Rights

Under the Act, a creditor can enforce its rights under applicable law to offset a mutual debt owed by the creditor to the CFC that arose before the FDIC was appointed as receiver. Such setoff, however, is not enforceable if (a) the claim of the creditor is disallowed, (b) the claim was transferred by an entity other than the CFC to the creditor after the FDIC was appointed as receiver or after 90 days before the date on which the FDIC was appointed as receiver and while the CFC was insolvent (except for a setoff in connection with a QFC), or (c) the debt owed to the CFC was incurred by the CFC after 90 days before the date on which the FDIC was appointed as receiver, while the CFC was insolvent and for the purpose of obtaining a right of setoff against the CFC (except for a setoff in connection with a QFC).

The FDIC, however, can object to any portion of any setoff that is not proven to its satisfaction. Further, the FDIC can sell or transfer any assets free and clear of any set-off rights of a party. Such creditors receive an unsecured claim equal to the setoff at a priority level junior to certain priority claims but senior to other senior or general liabilities of the CFC. **Sec. 210(a)(12) (pp. 100-101)**.

*The same creditor has far greater protections under the Code. While the set-off rules are largely the same—*i.e.*, the requirement for mutual debt and limitations on the right of setoff—*

under the Code, a party with set-off rights is treated much the same as a secured creditor. Unlike the Act, set-off rights cannot be evaded by sale or transfer of an asset free and clear of set-off rights and there is no concept of subordination of a valid set-off claim.

M. Liquidation of Covered Brokers and Dealers

As noted above, if an Orderly Liquidation Authority commences on a CBD, the FDIC will be appointed as the receiver of the CBD and the SIPC will be appointed as the trustee for the CBD. As the trustee, the SIPC is tasked with filing for a protective decree under the SIPA and liquidating the CBD. The SIPC has the powers and duties provided under the SIPA for trustees. Such powers and duties, however, do not apply to assets and liabilities that are transferred to a Bridge Company. The SIPC's powers do not abridge the FDIC's powers to make funds available to the CFC; organize, establish, operate, or terminate any Bridge Company; transfer assets and liabilities; enforce or repudiate contracts; take any action related to a Bridge Company; or determine claims.

All customer claims of CBDs will be resolved in the same manner and for the same amount as under the SIPA. Any obligation of a CBD to a customer relating to customer property will be paid in an amount that is at least as beneficial to the customer as if the CBD had been subject to a proceeding under the SIPA or by delivering the securities to the customer. **Sec. 205 (pp. 82-85)**. The Act sets the maximum liability for a customer of a CBD at the amount the customer would have received from its customer property in a case initiated by the SIPC under the SIPA, determined on the close of business of the day the FDIC is appointed as receiver. **Sec. 210(d)(3) (p. 122)**.

N. Mandatory Terms for All Orderly Liquidations

The Act requires the FDIC, in taking any action under the Orderly Liquidation Authority, to: (a) determine that such action is necessary for the financial stability of the United States; (b) ensure that the shareholders of the CFC do not receive payment until all other claims and the Fund are paid; (c) ensure that unsecured creditors bear losses in accordance with their priority order; (d) ensure that management responsible for the failed condition of the CFC are removed; (e) ensure that members of the board of directors responsible for the failed condition are removed; and (f) not take an equity interest in the CFC. **Sec. 206 (pp. 85-86)**.

O. Recoupment of Senior Executive and Director Compensation

The Act allows the FDIC to recover from any current or former executive or director substantially responsible for the failed condition of the CFC any compensation received from two years prior to appointment of the FDIC as receiver. In cases of fraud, no time limit would exist for the FDIC's ability to recover such compensation. **Sec. 210(s) (p. 142)**.

P. Reporting Requirements

The Act requires several reports:

i. Within 60 days after the appointment of the FDIC as receiver, the FDIC is required to prepare reports on the CFC's assets and liabilities. Such reports will be filed with several House and Senate committees and published online.

ii. The FDIC is required to maintain a full accounting of each receivership of any CFC and file an annual report on such receiverships to the Secretary and the Comptroller General. The Comptroller General will review and report to Congress any determination to use the Orderly Liquidation Authority and, along with the Administrative Office of the United States Courts, conduct a study regarding the orderly liquidation process for financial companies under the Code.

iii. The Comptroller General is required to conduct a study regarding international coordination relating to the liquidation of financial companies under the Code.

iv. The FDIC Inspector General will conduct audits and investigations on the liquidation of the CFC by the FDIC under Title II.

v. The Inspector General of the Treasury will conduct audits and investigations on the actions taken by the Secretary relating to the liquidation of a CFC under Title II.

vi. The Inspector General of the CFC's primary federal regulatory agency or the Fed (if no federal regulatory agency exists) will issue a written report evaluating the effectiveness of the agency or the Fed in supervising the CFC. **Sec. 202(e)-(g), 203(c) (pp. 75-76 and 78-80)**.