

**TOO BIG TO FAIL: THE ROLE FOR BANKRUPTCY  
AND ANTITRUST LAW IN FINANCIAL REGULA-  
TION REFORM (PART II)**

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**HEARING**

BEFORE THE

SUBCOMMITTEE ON COURTS AND  
COMPETITION POLICY

OF THE

COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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CIAL REGULATION REFORM (PART II)**

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**TUESDAY, NOVEMBER 17, 2009**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON COURTS AND  
COMPETITION POLICY  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittee met, pursuant to notice, at 1:02 p.m., in room 2237, Rayburn House Office Building, the Honorable Henry C. “Hank” Johnson, Jr. (Chairman of the Subcommittee) presiding.

Present: Representatives Johnson, Conyers, Coble, Chaffetz, and Goodlatte.

Staff present: (Majority) Christal Sheppard, Subcommittee Chief Counsel; Anant Raut, Counsel; Elisabeth Stein, Counsel; Rosalind Jackson, Professional Staff Member; and (Minority) Stewart Jeffries, Counsel.

Mr. JOHNSON. This hearing on the Committee on the Judiciary, Subcommittee on Courts and Competition Policy will now come to order.

Without objection, the Chair is authorized to declare a recess.

Today the Subcommittee holds its second hearing examining the implications of companies that are “Too big to Fail.” During our first hearing in April, we asked two questions: Are there such things as institutions that are too big to fail? And if so, do they represent a failure of the antitrust laws?

At the time, our panel of experts concluded that yes, there are companies whose size makes them systematically significant in our economy. However, the antitrust laws don’t need to be changed on account of these companies.

If anything, these companies merit greater enforcement of the antitrust laws that currently exist.

Our country remains in the grip of a grim economic downturn. Since the collapse of Lehman Brothers in September of 2008, the unemployment rate in my home State of Georgia has climbed from 6.6 percent to 10.2 percent today. The metropolitan Atlanta area has lost more than 124,000 jobs during that time.

Today we have before us several pieces of legislation proposed by the Treasury to systematically unwind these large companies once they are on the verge of failure.

The Administration points to the collapse of companies like Lehman Brothers and warns that this new authority is vital to preventing another big company from bringing down the economy as it goes under.

I, for one, am skeptical. The legislation proposed by the Treasury raises a number of troubling issues under this Subcommittee's jurisdiction.

The resolution authority would, in some instances, sidestep anti-trust oversight entirely.

Decisions about which competitor gets a failing company's assets could be made without the input of the antitrust enforcement agencies, creating a new generation of too big to fail companies requiring another multibillion-dollar bailout down the road.

Courts which have traditionally played a pivotal role in the normal bankruptcy process would also have their oversight diminished.

Decisions about the distribution of assets could be made without a judge watching over the process to make sure that the shareholders and the general public are treated fairly.

In the wake of great crises, whether financial or national security in nature, it is tempting for new Administrations to dismiss existing law as inadequate and claim that new approaches and new powers are necessary for a new kind of threat.

But what we have learned is that agencies empowered with emergency authority can't be solely responsible for determining when and how it gets used. Checks and balances are a necessary restraint on the powers granted by Congress.

I hope that our discussion today will help us better understand what protections need to be built into this proposed resolution authority to ensure that it is used sparingly and in the best interests of the American public.

I now recognize my colleague Howard Coble, the distinguished Ranking Member of the Subcommittee, for his opening remarks.

Mr. COBLE. I thank you, Mr. Chairman.

And good to have the panelists with us today.

Mr. Chairman, thank you for calling today's hearing, which is the second that this Subcommittee has held on the role of antitrust in correcting the current economic crisis.

Last April, you will recall we heard from former acting assistant attorney general Deb Garza that antitrust laws did not create the current economic crisis, and the antitrust division was capable of conducting antitrust review of proposed asset sales under the TARP plan. That is the Troubled Asset Relief Program.

Last month I attended a Commercial and Administrative Law Subcommittee hearing on the role of the bankruptcy law and anti-trust in resolving the existing financial crisis.

At that hearing, under direct questioning from Chairman Conyers, representatives of the Treasury Department and the Federal Deposit Insurance Commission told the Subcommittee that the Administration's bill did not alter antitrust review of any proposed sale of assets in a government takeover of a failing financial entity.

However, it appears from a subsequent markup by the Financial Services Committee and through written statements of at least

some of the witnesses here today that this proposal does alter anti-trust review.

So my question to all the witnesses is does this bill alter anti-trust review and, if so, how is it altered, and does it protect consumers?

The proposed resolution authority that is before this Congress does not change my mind about the wisdom or lack thereof of governmental bailouts. The Constitution gives Congress the authority to establish bankruptcy laws and procedures, and in my estimation the bankruptcy system has many more public checks and balances.

It is my understanding, Mr. Chairman that many of our colleagues on the Financial Services Committee and on the Judiciary Committee have suggested some changes to the bankruptcy laws to address this kind of large-scale financial crisis that we faced last year.

Personally, I am far more comfortable with that approach to this issue, because it is non-biased. It is proven and reliable. And it provides a solid foundation from which businesses can recover.

In any event, I would like to thank you, Mr. Chairman, and Chairman Johnson for protecting the Committee's jurisdiction with respect to bankruptcy and antitrust laws.

These well-established laws have been the bulwark of America's capitalist system and any financial services reform should stem from their well-accepted principles.

And, Mr. Chairman, I am going to have to depart imminently because I am scheduled to handle two bills on the floor, but the distinguished gentleman from Utah has promised to stand in for me, if that is okay. And I yield back.

Mr. JOHNSON. I thank the gentleman for his statement.

And I now recognize John Conyers, a distinguished Member of the Subcommittee and also the Chairman of the Committee on Judiciary.

Mr. CONYERS. Thank you very much, Chairman Johnson.

And to my colleagues here, this is a hearing that is part of the larger financial regulatory reform package that we have jurisdiction over. That is, as I have explained, Title 7, improvements to regulation of over-the-counter derivatives, and Title 12, enhanced resolution authority.

And I am grateful for the four witnesses that are here.

Now, to me, our jurisdiction has been delineated. The Chairman of Finance Committee, Chairman Frank, has assured us that our determinations in these two titles will be adhered to.

At the same time, we have the larger issue, and I don't know how we go about taking both of these things into consideration. I think it is a mistake for us to think only narrowly in terms of our two titles in the bill, because ultimately we will all be collectively voting on the larger bill.

And we have had hearings. I have two folders of hearings of the Committee. Some have been in your Committee. I think one has been in Chairman Cohen's Committee.

And we have circling overhead—and I would encourage the witnesses to feel free to go beyond the titles that we have actual jurisdiction. But I have got a notebook that tries to lay out the larger

positions on this financial regulatory reform, which is coming now after more than a trillion dollars has already been expended.

I mean, somebody needs to help me understand how we just thought about regulatory reform and the horse is out of the barn.

Now, Chris Dodd and Barney Frank have two seriously different views about this thing. And Charles Schumer has yet another position on this. And the gentleman, I think, from Alabama, Shelby, has a position on this. The Nobel economist Joseph Stiglitz has a very distinct view about this.

And so to me, Chairman Johnson and my colleagues, what becomes important here is that we try to understand the relationship between what is in our jurisdiction and what everybody else is thinking and doing both in the other body and in the House—the Finance Committee, the Committees on the—in the Senate.

And of course, the Administration has its team that is sort of omnipresent in this whole situation.

So I am going to submit an opening statement and look forward to the testimony from our witnesses. Thank you.

[The prepared statement of Mr. Conyers follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN CONYERS, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN, CHAIRMAN, COMMITTEE ON THE JUDICIARY, AND MEMBER, SUBCOMMITTEE ON COURTS AND COMPETITION POLICY

The financial regulatory reform package incubated in the Treasury Department and hatched in the Financial Services Committee appears to be in ailing health.

The effort to regulate financial derivatives, the complex and highly speculative instruments at the heart of the meltdown last year, and the effort to create a new Consumer Financial Protection Agency to protect Americans from abusive, deceptive, and predatory lending, are both being targeted by lobbyists intent on weakening them.

If the lobbyists succeed—and right now they appear to be gaining—this important effort will be squandered, and the resulting legislation won't be worth supporting.

Turning to the proposed new special resolution authority for the FDIC to take over failing financial institutions that are so interconnected to the wider financial system that their failure puts the wider system at undue risk, there is another danger—that if we are not careful, we will end up throwing some fundamental American values overboard. We need to make sure that doesn't happen.

We must ensure that the rights of innocent citizens who get caught up in the tangents of a giant financial institution's far-flung activities are not cast aside, while favored interests are allowed to jump to the head of the line and grab the lion's share.

We must preserve full-strength antitrust authority against anticompetitive mergers, so we don't wake up with just a handful of financial institutions that are even more gargantuan than the ones we started with.

To ensure these values are protected, we can't just turn everything over to a government liquidator and stand back.

We need to preserve the role of bankruptcy law in providing fair treatment for all who have claims against the financial institution, not just the favored few.

And we need to preserve the role of the antitrust laws, in all of their vitality.

If extraordinary powers are needed to respond to a systemic financial emergency, we should make sure that those powers are triggered only when there truly is such an emergency. We should make sure that those powers are limited in scope and duration—that they displace the important American values reflected in the bankruptcy and antitrust laws, if at all, only to the limited extent, and only for the limited duration, that is necessary for responding effectively to the emergency.

And we should make sure that any harm to those values that results from the exercise of those powers should be reversible once the emergency has subsided.

We need to keep in mind that this is not about bailing out Wall Street.

It is not about helping the institutions that brought us this crisis pay their brokers billions of dollars in new bonuses. It is not about funneling money to those institutions as counterparties in derivative contracts, as a just-released report by the



TARP Inspector General indicates Secretary Geithner was instrumental in doing last year when he was head of the Federal Reserve Bank in New York.

It is not about excusing those institutions from giving struggling homeowners a chance at reasonable mortgage terms that avoid needless foreclosures.

I for one am not comforted by Goldman Sachs Chairman and CEO Lloyd Blankfein's recent statement insisting that he is just a banker "doing God's work" and that his mammoth company is fulfilling "a social purpose."

Resurgent Wall Street profits and bonuses clearly are not trickling down to Main Street, or Woodward Avenue.

In Detroit, the unemployment rate is nearly 28 percent. 195 homes there are being taken into the foreclosure process each day. One in three people in my district are at or below the poverty line.

Let's not forget the lessons of the Gramm-Leach-Bliley Act of 1999 and the Glass-Steagall Act of 1933. Ten years ago, Gramm-Leach-Bliley repealed the firewall set up in Glass-Steagall between the casino on Wall Street and the private investment engines of Main Street. The repeal allowed for the creation of giant financial supermarkets that could own investment banks, commercial banks, and insurance firms, thereby clearing the way for consolidation into companies too big and intertwined to fail.

It also led to deregulation that helped cause the current economic crisis.

I support the efforts in the Financial Services Committee to build the regulatory infrastructure needed to protect our economy against ever again being held hostage to fears that irresponsible financial giants are too big to fail.

Our job in the Judiciary Committee is to ensure that this is accomplished in an effective and responsible manner that respects these other important American values.

So I am pleased that the Courts and Competition Subcommittee is continuing our examination into these issues. I hope our witnesses today can shed light on three issues in the legislation to establish special resolution authority for financial institutions that pose undue systemic risk.

First, are there adequate antitrust safeguards? We don't want our response to a financial crisis to lead to even larger and more concentrated institutions, with less competition, and higher prices for consumers.

FDIC Special Advisor for Policy Michael Krimminger's statement before our Committee last month that "in a systemic context, there can be cases in which there is an override of the anti-competitive consequences" was troubling to those who care about our economic freedoms.

Those considerations need to be carefully reconciled, not set against each other. I hope our witnesses can address how to maintain meaningful antitrust values under the new resolution mechanism.

Second, are there fair and balanced protections for those affected by the insolvency?

The standard should be the protections set out carefully in our Bankruptcy Code. Any departures from those Bankruptcy Code protections should be few, and justified, and each carefully limited in scope and duration to what is necessary to avert the systemic financial crisis.

The Financial Services Committee bill is modeled on the authority given to the FDIC when a bank with FDIC-insured deposits fails.

But the powers and priorities that are appropriate when FDIC-insured deposits are a dominant factor may not be appropriate when there is a greater variety of competing claims and claimants—labor contracts, pensions, and garden variety business debts, to name just a few.

So while a receiver should have the power to act quickly to conserve systemically critical assets and liabilities, that power should be exercised in a manner that respects the rights of other innocent parties.

I hope our witnesses today can address how to fairly protect these rights in the context of the need for quick action in a financial emergency, and create a measure of predictability that will enhance stability.

Third, is there appropriate judicial review to guard against arbitrary and unfair government action?

Under the Bankruptcy Code, it is a court that appoints a trustee to act as conservator or liquidator, oversees the trustee, and ultimately reviews and approves the process by which the business is reorganized or liquidated and claims are resolved.

Under the Financial Services Committee bill, once the failure of the business is deemed to be a systemic risk to the financial system, the new conservator or receiver takes over.

Any bankruptcy proceedings are abruptly terminated, and new bankruptcy proceedings are precluded.

Instead of an open process, under uniform rules, with direct court oversight, we have an opaque process, under procedures that give the conservator or receiver broad discretion.

I hope our witnesses can address how to make the resolution process more transparent and predictable, under appropriate judicial review.

Clearly, the status quo, where too-big-to-fail institutions have privatized gains and received taxpayer-subsidized losses, is not acceptable.

We need a workable mechanism to allow large, complex, interconnected, global financial companies to fail when they should, while managing the ripple effects.

But we need to ensure that due process, fairness, transparency, and pro-competition principles are core ingredients of that mechanism.

I commend the collaboration between Courts and Competition Policy Subcommittee Chairman Hank Johnson and Commercial and Administrative Law Subcommittee Chairman Steve Cohen in putting together this third in a series of important and thought-provoking hearings on the too-big-to-fail issue, and I look forward to the testimony.

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Mr. JOHNSON. Thank you, Mr. Chairman.

I now recognize the gentleman from Utah, Mr. Chaffetz, for his statement.

Mr. CHAFFETZ. Well, thank you. Thank you, Mr. Chairman.

And thank you, Chairman Conyers and Ranking Member Coble.

And I appreciate the witnesses being here today. This is a very, very important subject and topic. I want to do more hearing than making a statement.

I just wish to wholeheartedly support the verbal comments Chairman Conyers made and some of the deep concerns about the various approaches to this.

I, too, have some concerns I would appreciate being addressed and I am sure you share many of these as well. I want to make sure we are staying within the constitutional duties and bounds that we are—have been given in our Constitution.

I worry about our troubled firms getting even bigger. You know, one of the amazing statistics through all this is we talk about too big to fail—is if you actually go back and analyze these firms, we have less firms and they are even bigger than ever, and so have—through our public policy actually made the situation more vulnerable as opposed to actually solving it.

Obviously, we want to ensure the American people that we are doing—be good stewards of their money. I have serious troubles and concerns with the TARP, and the bailouts, and the so-called stimulus, and things that have gone on in the past.

I want to make sure that we are maximizing transparency. I think one of the benefits that—through going through bankruptcy, as painful and as derogatory as that term might be, there are certainly benefits in terms of exposure in going through a process.

We have seen companies, large companies, very successfully go through the bankruptcy process and then go on to thrive.

And I want to make sure that we don't—aren't injecting politics into it. I think to the degree we can have an even hand and that public policy is not driven by political maneuvering, the better the system will be.

So again, thank you, Chairman, for calling this hearing. I look forward to the interaction and appreciate you all being here today. Thank you. Yield back.

Mr. JOHNSON. I thank the gentleman for his opening statement.

All Members' opening statements will be included in the record. And I would like to enter into the record a statement from our esteemed colleague, the Chairman of the Commercial and Administrative Law Subcommittee, Mr. Steve Cohen of Tennessee.  
[The prepared statement of Mr. Cohen follows:]

PREPARED STATEMENT OF THE HONORABLE STEVE COHEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE, AND CHAIRMAN, SUBCOMMITTEE ON COMMERCIAL AND ADMINISTRATIVE LAW

I applaud Chairman Hank Johnson and the Subcommittee on Courts and Competition Policy for continuing the House Judiciary Committee's inquiry into the Administration's proposal for enhanced resolution authority to wind-down failing, systemically important non-bank financial institutions. Several weeks ago, I presided over Part I of this hearing series before the Subcommittee on Commercial and Administrative Law. During that hearing, my Subcommittee posed some tough questions to Administration officials concerning the need for resolution authority for such nonbank institutions as well as the numerous bankruptcy, administrative law, and antitrust concerns raised by the Administration's proposal. We also heard from several bankruptcy and antitrust experts who further elaborated on these concerns.

The Administration's resolution authority proposal would create an alternative to the bankruptcy system for dealing with failing non-bank financial institutions that are so interconnected with the Nation's financial system that their disorderly failure would destabilize the national and global financial systems. The ordinary bankruptcy process, it is said, would be too slow to deal with the imminent collapse of such institutions and would create too much uncertainty in the financial markets. The proposed resolution authority would be modeled on the authority of the Federal Deposit Insurance Corporation to wind-down failing commercial banks.

While I understand the Administration's desire for the authority to act quickly to stave off dangerous shocks to the Nation's financial system, I am concerned that its proposed resolution process lacks the transparency and due process safeguards of the bankruptcy process. I am not unsympathetic to the argument that some type of authority for the executive branch to act quickly in the face of the impending failure of a systemically important nonbank financial institution is important. What I am not yet convinced of is that an alternative to bankruptcy is needed with respect to the claims resolution process—that is, the process that occurs after a failing firm has been stabilized and its core assets have been sold to a third party or transferred to a bridge holding company. I am particularly concerned about the effect of the Administration's proposal with respect to claims for employee and retiree compensation and benefits.

I am also deeply concerned about the creation of the Financial Services Oversight Council, which, under the legislation, would not be an "agency" for purposes of any State or Federal law and, therefore, not subject to the Administrative Procedure Act and other restrictions on agency power. As I have said before in other contexts, as a legislator for more than 30 years, such vast expansions of unfettered executive power trouble me greatly. The formation of the Council should be reconsidered. Even if not eliminated, there should be far greater Congressional oversight authority over the Council's activities.

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Mr. JOHNSON. With his oversight over the bankruptcy laws, Chairman Cohen shares our interest and concerns regarding the proposed reform legislation. And without objection, I will so include his statement.

Now, I am now pleased to introduce the witnesses for today's hearing. Our first witness is Professor Chris Sagers. Professor Chris Sagers is an Associate Professor of Law at the Cleveland Marshall College of Law in Cleveland, Ohio. He is an expert in the fields of antitrust and corporate law.

Welcome, Professor Sagers.

Our next witness is Mr. Edwin Smith. Mr. Smith is a Partner at the law firm of Bingham McCutchen LLP. He is here today testifying on behalf of the National Bankruptcy Conference.

Welcome, Mr. Smith.

Next we have Mr. Michael A. Rosenthal, who is a partner at the law firm of Gibson Dunn & Crutcher LLP. Mr. Rosenthal is co-chair of the firm's business restructuring and reorganization practice group.

Welcome, Mr. Rosenthal.

And finally, we have Professor Charles Calomiris. Professor Calomiris is the Henry Kaufman Professor of Financial Institutions at Columbia Business School.

Welcome, Professor Calomiris.

Thank you all for your willingness to participate in today's hearing. Without objection, your written statements will be placed into the record, and we would ask that you limit your oral remarks to 5 minutes.

You will note that we have a lighting system that starts with a green light. At 4 minutes, it turns yellow and then red at 5 minutes.

After each witness has presented his or her testimony, Subcommittee Members will be permitted to ask questions subject to the 5-minute rule limit.

Professor Sagers, please begin your testimony.

**STATEMENT CHRISTOPHER L. SAGERS, ASSOCIATE PROFESSOR OF LAW, CLEVELAND-MARSHALL COLLEGE OF LAW, CLEVELAND, OH**

Mr. SAGERS. Thank you, Mr. Chairman and Members of the Committee. It is, again, my pleasure and privilege to be here.

I am glad that the larger question has been asked about what is an appropriate approach to this problem overall, rather than the specific antitrust questions that I was asked to talk about.

I wish I was competent to give some plenary answer to that question and I am not. But I can answer one big question that is relevant to it. And I have to begin by disagreeing with something that Ms. Garza said. Her comment was quoted again here today.

I am not sure this is a very widely held view or a very popular one, but Ms. Garza, again, was acting assistant attorney general for antitrust in the Justice Department.

She was also chair of the Antitrust Modernization Commission a couple years ago. She is an eminent figure in antitrust and I am sure that many, many people share her view.

I happen to think that she is wrong in that she said antitrust didn't cause this problem. I would be the last person to say that antitrust is the only explanation for this problem, but let me say one thing.

We have thousands and thousands of Federal statutes and regulations, and we have precisely one that is designed to deal with the size and power of private entities, and that is Clayton Act Section 7.

Clayton Act Section 7 nominally has applied to all the many mergers and acquisitions that gave rise to TBF—excuse me, TBTf firms. It has never been applied in a way that has taken into consideration systemic risk.

Many people right now would say it is impossible for that to be done. It shouldn't be done. My basic point here today is that that

being the case, we don't have any law anywhere to deal with this problem.

Dealing with that problem is a much bigger question, I suppose, than I could really talk about in 5 minutes. It is not addressed in my written testimony, so I won't pursue it.

But for what it is worth, that issue is not on the table right now anywhere. And I personally think it is a serious problem with the overall approach to financial regulatory reform.

Having said all that, I only have a couple of minutes left to summarize the rest of my testimony. So let me say, rather than digging into the details of what is quite a complicated issue, I think that everything I had to say in what I—my written submission and anything I would have to say today in person basically addresses one big issue.

And that is that there is an attitude that has become quite common, especially among the courts and, first among them, the Supreme Court that antitrust, however venerable and useful it might be in some circumstances, is generally a bit of a tedious problem. It is costly, it is clumsy and it is to be avoided whenever it can.

With respect, I happen to believe that that is incorrect. And as a peripheral observer of this Committee's process during the last couple of months, I am very pleased to say my impression is that that sense is shared by at least some Members of the Committee, and my impression is, then, that that is shared by Members of both parties, at least from what I have been able to observe, and that makes me very happy.

The problem is I happen to think that that attitude is reflected in this bill in many ways. It is not anywhere explicitly stated in any of the Administration's bills, but—and it may not have been deliberate, but my impression generally is that throughout most of the Administration's financial regulatory reform package, the attitude has been "we should avoid or limit antitrust wherever possible because it will get in the way of other regulatory objectives."

My sense, again, is that that is unfortunate both because I think that the difficulty that is said to be associated with antitrust in these markets is overstated, and maybe more importantly, because competition issues, issues of concentration and collusion in financial markets, are actually pretty serious, and not only in the—with respect to the sort of systemic risk problems I began with.

They are also serious in more traditional—the more traditional sense that those problems limit allocational efficiency in these markets in serious ways.

[The prepared statement of Mr. Sagers follows:]

PREPARED STATEMENT OF CHRISTOPHER L. SAGERS



## Cleveland State University

Cleveland-Marshall College of Law  
2121 Euclid Avenue  
Cleveland, Ohio 44115  
(216) 687-2344

**STATEMENT OF CHRISTOPHER L. SAGERS**  
Associate Professor of Law, Cleveland State University

**Before the**  
**SUBCOMMITTEE ON COURTS AND COMPETITION POLICY**

**of the**  
**COMMITTEE ON THE JUDICIARY,**  
**UNITED STATES HOUSE OF REPRESENTATIVES**

**Concerning**  
**"TOO BIG TO FAIL: THE ROLE FOR ANTITRUST AND BANKRUPTCY LAW**  
**IN FINANCIAL REGULATION REFORM, PART II"**

**November 17, 2009**

Chairman Johnson and members of the Subcommittee, my name is Chris Sagers and I am a professor of law at Cleveland State University in Cleveland, Ohio. With my gratitude I am pleased to offer these thoughts on antitrust aspects of the Administration's proposed financial regulatory reforms. I applaud the emphasis that Judiciary

Subcommittees have given this year to antitrust issues, because I believe that our competition policy is in need of attention.<sup>1</sup>

I will address antitrust aspects of (1) Title VII of the Administration's financial regulatory reform package, entitled the Over-the-Counter Derivatives Markets Act of 2009 ("OTC Act"); and (2) Title XII, The Resolution Authority for Large, Interconnected Financial Companies Act of 2009 ("Resolution Bill").<sup>2</sup> I have been asked to address the explicit ways in which these bills modify the antitrust laws, and such other consequences they might have on antitrust through the "implied repeal" doctrine or otherwise. I have studied the law of antitrust exemptions and immunities throughout my career. I was co-author, with Peter Carstensen of the University of Wisconsin, of the American Bar Association's book *Federal Statutory Exemptions from Antitrust Law* (2007), and Professor Carstensen and I were called for testimony on exemptions issues before the Antitrust Modernization Commission ("AMC") in 2006. I have also published articles concerning statutory exemptions in the ocean shipping, airline and railroad industries, as well as judicially created antitrust exemptions like the *Parker* and *Noerr-Pennington* doctrines.

### Summary

While I applaud the Administration's effort to bring much needed regulatory oversight back to financial markets, it is fairly clear that the drafters of these bills did

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<sup>1</sup> I do not represent any party with any interest in this matter. I have received no compensation in connection with this or any prior Congressional testimony, I appear here at my own expense, and the views expressed are my own. I submit this testimony at the request of counsel for the Subcommittee.

<sup>2</sup> I was also asked to consider antitrust aspects of Title X of that package, entitled the Consumer Financial Protection Agency Act of 2009 ("CFPA Bill"). I will not address the CFPA Bill in any detail here, because it does not appear to raise significant antitrust problems. The only risk I see is that because it would create a new regulatory authority with power over conduct that might also violate antitrust, it may limit antitrust through the "implied repeal" doctrine. I will address that doctrine in detail with respect to the OTC Bill, and I will explain in footnotes what consequences I think it may pose for the CFPA Bill. *See infra* note 35.

have much concern for antitrust or competition in drafting them.<sup>3</sup> I believe there are specific, technical antitrust problems in both of these bills, and also an overarching antitrust problem as to the Administration's entire financial reform package.

1. *OTC Bill*. Even though it contains no explicit exemptions or modifications of antitrust, the OTC Bill is fairly likely to immunize anticompetitive conduct from antitrust under either the implied repeal doctrine or the Supreme Court's recent *Trinko* decision.<sup>4</sup>

In my opinion two modifications of this bill would be very wise. First, it contains five specific provisions requiring that entities subject to it comply with certain "antitrust considerations" whenever they make rules or agreements. These provisions, however pro-competitive they may superficially appear, are likely to serve very little purpose other than immunizing anticompetitive conduct. They should be removed. Second, the general antitrust savings clause contained in the bill should be modified to ensure that it survives certain reasoning in the *Trinko* opinion.

2. *Resolution Bill*. From the antitrust perspective there are two significant criticisms of this bill. First, it would make one potentially very significant change to the familiar review of mergers under the Hart-Scott-Rodino Act ("HSR"). Second, as to every other situation it incorporates a system of bank merger law that is itself inadequate.

As to HSR, the bill would make two changes:

- (1) Where a financial holding company ("FHC") that is put into federal receivership owns both bank and non-bank assets—as will usually be the case—sales of its non-bank assets would be forced into a super-fast period of review with the benefit of only very limited information

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<sup>3</sup> See *infra* note 74; see also U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009) (88-page report explaining Administration's financial regulatory reform package, including the Resolution Bill, which never mentions antitrust and only very obliquely discusses competition).

<sup>4</sup> *Verizon Comm'ns, Inc. v. Law Offices of Curtis V. Trinko*, 540 U.S. 398 (2004).



(whereas under current law those sales would be subject to the familiar HSR process); and

- (2) Where particular exigencies are found to exist, those transactions could be exempted from any antitrust review whatsoever.

As to the other criticism, the Resolution Bill preserves our Byzantine, idiosyncratic and dubious system of bank merger law. The sense of general disappointment in this system was captured in the thoughts of an eminent banking scholar at a recent Symposium:

What I have seen [in the last fifteen years] is that the number one bank in the country will merge with the number five bank in the country and create a multi-state institution, with billions of dollars in assets, and if it is found to violate the antitrust laws, the solution is to knock off half a dozen branches in the Peoria area or something like that, which makes me wonder: Do we really have an effective law of antitrust for banks?<sup>5</sup>

But indeed the Reslution Bill not only preserves this system, it does so in a context in which competition risks are most acute. The transactions to take place under the bill will almost by definition involve the largest entities, within markets that are already the most concentrated and interdependent, and they will at least sometimes result in making those entities even *bigger*.

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But a larger criticism is that neither these bills nor the rest of the Administration's financial regulatory reform package appears to conceive of competition itself as any part of the solution, or seeks meaningfully to constrain the breathtaking consolidation that has

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<sup>5</sup> *Panel Discussion I: The Development of Bank Merger Law, Symposium: The Antitrust Aspects of Bank Mergers*, 13 FORDHAM J. CORP. & FIN. L. 511, 512 (2008) (comments of Professor Carl Felsenfeld, Fordham Law School).

been the salient feature of financial institutions markets since the 1980s. These bills simply take entities that are Too Big To Fail (“TBTF”) as a given or a necessary evil.

Admittedly, in this particular context—the search for better regulatory solutions in the financial sector—competition could not fix some persistent and difficult problems. On the one hand, as to some financial products price competition is already fierce and yet those markets are rife with problems needing regulatory attention. And on the other hand, even where price competition is not healthy, merely improving it will not solve all the problems they present. And yet, as it will be my goal to show, competition in the financial sector, along with reinvigorated regulatory oversight, must be a component of policy. It is needed to generate efficiency, encourage innovation and product quality, and to reduce risk.

Competition and the encouragement of deconcentration could in reasonable, easy to imagine ways be made part of a solution to TBTF dilemmas. In fact, the Administration’s reform package happens quietly to include one important step in that direction. Another Title of the package contemplates that regulators will from time to time designate systemically significant firms as “Tier 1 Financial Holding Companies,” a step that would subject those firms to enhanced (and more costly) prudential oversight. The drafters observe that in addition to the hoped-for risk reduction, this designation will have the effect of “compel[ling] these firms to internalize the costs they could impose on society in the event of failure.”<sup>6</sup> But the more important benefit is that by creating and actually using this designation, the government will raise the costs of bigness itself. In this particular context opposition to bigness in and of itself is not just knee-jerking populism, and rather goes to the central problem of the current financial crisis.

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<sup>6</sup> TREASURY REPORT, *supra* note 3, at 20.

## Analysis

### **I. Antitrust in the OTC Bill**

The OTC Bill sets up regulatory controls on derivatives markets that in some specific ways are either similar to the constraints that antitrust would impose or are in tension with it. Without careful drafting, either sort of provision could limit the applicability of antitrust to the transactions in question.

#### **A. Specifics of the Legislation**

The bill enhances regulatory oversight of derivatives trades outside of formal markets, which under current law are largely unregulated. It does this by describing a set of entities that will exist to make those markets work and subjecting them to various registration, prudential and oversight requirements. It contemplates that these entities will be regulated by either the Securities and Exchange Commission (“SEC”) or the Commodity Futures Trading Commission (“CFTC”).

As to each of the entities the bill contemplates, it requires that they adopt whatever rules and procedures they are permitted to adopt subject to certain “antitrust considerations.” There are five of these “antitrust considerations” provisions, and they are nearly identical:

- (a) Section 713(b)(3) (adding a new subsection (2)(N) to 7 USC 7a-1(c)), concerning “derivatives clearing organizations”;
- (b) Section 717 (adding a new 7 USC 4s(j)(5)), concerning “swap dealers and major swap participants”;
- (c) Section 719 (adding a new 7 USC 5h(e)(10)), concerning “swap execution facilities”;
- (d) Section 753(b) (adding a new section 3B(e)(10) to the Securities Exchange Act of 1934), concerning “alternative swap execution facilities”; and
- (e) Section 753(d) (adding a new section 15F(j)(5) to the ’34 Act), concerning “security-based swap dealers and major security-based swap participants.”

Each provision requires that the particular entity to which it applies, “[u]nless necessary or appropriate to achieve the purposes of this Act, . . . shall avoid (A) adopting any [rule or process, depending on the context] or taking any actions that result in any unreasonable restraints of trade; or (B) imposing any material anticompetitive burden . . . .”

The SEC and CFTC would apparently be empowered to take action against these various entities for agreements or rules that would be in violation of these “considerations.”

The bill also contains a general antitrust savings clause. Section 733 of the bill<sup>7</sup> provides in full as follows:

Nothing in the amendments made by this title shall be construed to modify, impair, or supersede the operation of any of the antitrust laws. For purposes of this subtitle, the term “antitrust laws” has the same meaning given such term in subsection (a) of the first section of the Clayton Act, except that such term includes section 5 of the Federal Trade Commission Act to the extent that such section 5 applies to unfair methods of competition.

**B. Competition Issues: Implied Repeal and the *Trinko* Decision**

Since the beginning of federal antitrust, defendants have argued that they should be excused from it because they are subject to some other federal regulatory regime.<sup>8</sup> Until quite recently the courts were almost uniformly hostile to these arguments and they did not often succeed. The courts long observed the “cardinal principal” that “repeals by

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<sup>7</sup> It is not quite clear why this provision appears in Subtitle A of the bill, even though it purports to apply to the whole of Title VII. (Sections 732-34 are actually all quite general and apply to the whole Title, but appear only in subtitle A; § 757 seems similarly out of place.)

<sup>8</sup> Among the very first important antitrust cases to reach the Supreme Court was one in which several railroad defendants argued that their price-fixing agreement was exempt because they were separately regulated by the Interstate Commerce Commission. The Court rejected that argument, *see United States v. Trans-Missouri Freight Ass’n*, 166 U.S. 290 (1897), and it was an ironic one light of the fact that alleged abuses by railroads were among the chief motivations for the Sherman Act.

implication are not favored,”<sup>9</sup> and said that repeals of antitrust are “strongly disfavored . . . .”<sup>10</sup> Even where Congress explicitly calls for them, limitations on antitrust are at least nominally disfavored by the courts,<sup>11</sup> and a broad consensus, across the political spectrum, continues to hold that they are rarely justified.<sup>12</sup>

And yet, the Supreme Court has always been willing to entertain the possibility that Congress intends some other statute to constitute an “implied repeal” of antitrust. As originally envisioned, implied repeal was to be reserved for cases of “plain repugnancy between the antitrust and regulatory provisions . . . .”<sup>13</sup> It was to be found “only if necessary to make [some other statute] work, and even then only to the minimum extent necessary.”<sup>14</sup> Historically the courts rejected almost all such pleas,<sup>15</sup> except where some

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<sup>9</sup> *Silver v. NYSE*, 373 U.S. 341, 357 (1963) (quoting *United States v. Borden*, 308 U.S. 188, 198 (1939)).

<sup>10</sup> *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 350 (1963).

<sup>11</sup> *See, e.g., Union Lab. Life Ins. Co. v. Pireno*, 458 U.S. 119, 126 (1982) (narrowly construing the McCarran-Ferguson Act); *FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 733 (1973) (narrowly construing the Shipping Act of 1916); *U.S. v. McKesson & Robbins, Inc.*, 351 U.S. 305, 316 (1956) (narrowly construing the Miller-Tydings and McGuire Act exemptions for resale price maintenance); *Chi. Prof'l Sports Ltd. P'ship v. NBA*, 961 F.2d 667, 671-72 (7th Cir. 1992) (because “special interest legislation enshrines results rather than principles,” the “courts read exceptions to the antitrust laws narrowly, with beady eyes and green cycshades.”).

<sup>12</sup> Limits on antitrust have long been opposed by the enforcement agencies, the Antitrust Modernization Commission and its many predecessors, and the ABA Section of Antitrust Law. *See generally* AM. BAR ASS'N, SECTION OF ANTITRUST L., FEDERAL STATUTORY EXEMPTIONS FROM ANTITRUST LAW (2007); ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 333-37 (2007); Stephen Calkins, *Antitrust Modernization: Looking Backward*, 31 J. CORP. L. 421 (2006) (discussing history of opposition to antitrust limitations by the AMC's predecessor commissions); Albert A. Foer, *Putting the Antitrust Modernization Commission Into Historical Perspective*, 51 BUFF. L. REV. 1029 (2003) (same); <http://www.abanct.org/antitrust/at-comments/comments.shtml> (collecting the ABA Antitrust Section's many congressional and other policy statements over the years opposing various antitrust limitations).

<sup>13</sup> *United States v. Phila. Nat'l Bank*, 374 U.S. 321, 350-51 (1963).

<sup>14</sup> *Silver*, 373 U.S. at 357.

<sup>15</sup> *See Otter Tail Power Co. v. United States*, 410 U.S. 366 (1973) (holding exclusionary conduct by an incumbent electric power company subject to antitrust notwithstanding the power of the Federal Power Commission to order interconnection services by incumbents, to allow access by competing power companies); *Seatrain Lines*, 411 U.S. at 726 (narrowly reading antitrust exemption under Shipping Act of 1916); *Phila. Nat'l Bank*, 374 U.S. at 321 (holding bank merger subject to Clayton Act § 7 notwithstanding merger review authority of the Office of the Comptroller of the Currency, under the recently adopted Bank Merger Act of 1960); *California v. Fed. Power Comm'n*, 369 U.S. 482 (1962) (rejecting immunity for merger of natural gas concerns from Clayton Act § 7 challenge, even though Federal Power Commission had concurrent review authority); *United States v. Radio Corp. of Am.*, 358 U.S. 354 (1959) (holding an

agency was given explicit power to oversee conduct plainly in violation of antitrust,<sup>16</sup> and there was apparently some requirement that the agency actually used its oversight power.<sup>17</sup>

However, in recent times the Court has shown an apparently much greater willingness to find implied repeal, and seems less concerned about finding explicit and irreconcilable conflict between antitrust and some other statute. In its decision two years ago in *Credit Suisse Securities, LLC v. Billing*,<sup>18</sup> the Court seems to have eased its longstanding test quite a bit. At least with respect to questions involving securities regulation, the Court explicitly changed its inquiry from a search for “plain repugnancy” to a search for “clear incompatibility,”<sup>19</sup> and held that clear incompatibility exists where:

- (1) the antitrust challenge is to “an area of conduct squarely within the heartland of securities regulations”;
- (2) there is “clear and adequate SEC authority to regulate”;
- (3) there has been “active and ongoing agency regulation”; and
- (4) there is some “serious conflict between the antitrust and regulatory regimes.”<sup>20</sup>

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agreement to exchange television stations subject to antitrust challenge even though it was approved by the Federal Communications Commission); *Borden*, 308 U.S. at 188 (holding conspiracy among milk producers’ cooperative and various milk distribution businesses subject to antitrust notwithstanding oversight powers of Secretary of Agriculture under the Agricultural Adjustment Act, the Capper-Volstead Act, and § 6 of the Clayton Act); *Trans-Missouri*, 166 U.S. at 290 (finding price-fixing agreement among railroads subject to antitrust notwithstanding that they were also subject to regulation by the Interstate Commerce Commission).

<sup>16</sup> See *Gordon v. NYSE*, 422 U.S. 659 (1975) (finding immunity for securities exchange rules fixing brokerage commission rates, but only where Securities Exchange Act of 1934 explicitly empowered SEC to regulate such rates and SEC actively did so); *United States v. Nat’l Ass’n of Secs. Dealers*, 422 U.S. 694 (1975) (finding immunity for vertical restraints on distribution of mutual fund shares in secondary markets, but only where Investment Company Act of 1940 explicitly empowered SEC to oversee such restraints).

<sup>17</sup> *Borden*, 308 U.S. at 198 (holding that mere regulatory authority vested in a federal official, even if “plenary,” does not in itself grant antitrust immunity); cf. *Gordon*, 422 U.S. at 692-93 (Stewart, J., concurring) (noting that, in the concurring Justices’ view, the Court did not and never had held that immunity could be found merely on the basis of an unexercised power in some federal official).

<sup>18</sup> 551 U.S. 264 (2007).

<sup>19</sup> 551 U.S. at 275.

<sup>20</sup> 551 U.S. at 285.

What seems especially problematic is not so much the specific result in the case,<sup>21</sup> as the potential consequences of the new formulation. Given the breadth of the SEC’s jurisdiction, elements 1-3 should be fairly easy for most defendants to meet.<sup>22</sup> Moreover, the Court implied that “conflict,” under element 4, requires only that the pendency of an antitrust suit—taking into consideration the costs and risks of false positives that the Court claimed would exist—would “prove practically incompatible with the SEC’s administration of the Nation’s securities laws . . . .”<sup>23</sup> Over Justice Stevens’s objection,<sup>24</sup> the Court held that the difficulties imposed on market participants in complying with both antitrust and securities regulation would constitute the requisite “conflict.”

A related case is the Court’s 2004 decision in *Verizon Commc’ns, Inc. v. Law Offices of Curtis V. Trinko*.<sup>25</sup> Plaintiff challenged the allegedly exclusionary conduct of a “Baby Bell” telephone company, which was said to have frustrated access into local telephone markets of would-be competitors, as had been required by the Telecommunications Act

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<sup>21</sup> The challenged conduct involved agreements amongst syndicates of underwriters relating to how they would market securities in initial public offerings (“IPOs”). As the Court pointed out, much of the challenged conduct was subject to explicit statutory oversight powers, and was also the focus of existing and proposed regulations. Thus, for better or worse, the actual result in *Credit Suisse* could follow from a straightforward application of the *Gordon* and *NASD* decisions, discussed in notes above.

<sup>22</sup> Importantly, the Court seemed to hold that conduct is in the “heartland,” and therefore satisfies element number 1, merely where it is important to securities markets. The Court held that syndicated underwriting—including collusively anticompetitive restraints—was important in this sense because certain efficiencies arise when an issuance is underwritten jointly. See 551 U.S. at 276. But the efficiencies the Court identified were no different than in any other, garden-variety joint venture arrangement.

<sup>23</sup> 551 U.S. at 277. The Court’s discussion of the costs of antitrust and their relevance to “clear incompatibility” appears at *id.* at 282-85.

The Court also added the highly novel observation that the availability of *private* relief under the securities laws should be relevant to whether antitrust applies to the challenged conduct. 551 U.S. at 277. That seems rather a large change, since it will frequently be the case that that anticompetitive conduct could be the gravamen for more than one cause of action.

<sup>24</sup> 551 U.S. at 288 (Stevens, J., concurring) (“Surely I would not suggest . . . that either the burdens of antitrust litigation or the risk ‘that antitrust courts are likely to make unusually serious mistakes’ . . . should play any role in the analysis”).

<sup>25</sup> 540 U.S. 398 (2004).

of 1996 (“1996 Act”).<sup>26</sup> Notwithstanding a very broad antitrust savings clause—providing that “nothing in this Act or the amendments made by this Act shall be construed to modify, impair, or supersede the applicability of any of the antitrust laws”<sup>27</sup>—the Court wrote that “careful account must be taken of . . . pervasive federal and state regulation” in any given case, and that a “factor of particular importance is the existence of a regulatory structure designed to deter and remedy anticompetitive harm.”<sup>28</sup> Because under 47 U.S.C. § 271—a provision added by the 1996 Act, and therefore subject to its savings clause—the FCC could condition a Baby Bell’s entry into long-distance service on its compliance with the competitiveness rules of the 1996 Act, the Court found it unwise to permit antitrust liability on the grounds alleged. In other words, even a very broad, very explicit antitrust savings clause will not stop the Court from taking “the existence of a regulatory structure” as a reason for constraining antitrust liability, at least where that structure has some theoretical potential to “remedy anticompetitive harm.”

Accordingly there is a significant chance, under *Credit Suisse* and its predecessors and under *Trinko*, that the OTC Bill would immunize anticompetitive conduct. Under the bill, participants in OTC derivatives markets will be pervasively regulated and will inevitably face some difficulties in knowing whether specific conduct is legal under both antitrust and OTC derivatives market regulation (seemingly the new test for “conflict”

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<sup>26</sup> Pub. L. No. 104-104, 110 Stat. 56 (Feb. 8, 1996), now codified at scattered sections of U.S.C. The “Baby Bells” were parts of the former AT&T organization, which had been broken up in a prior antitrust suit, and they were largely prohibited after that break-up from providing long distance telephone service. The Baby Bells by and large owned the only infrastructure capable of providing communications access to homes and businesses, and that infrastructure would have been prohibitively expensive to duplicate. They therefore held effective monopoly over local service. The 1996 Act required them to provide access to their infrastructure so that would-be competitors for local service could enter their markets.

<sup>27</sup> 110 Stat. 143, 47 U.S.C. § 152 note.

<sup>28</sup> 540 U.S. at 411-12.



under *Credit Suisse*.) In fact, the OTC Bill’s “antitrust considerations” provisions, however pro-competitive they may superficially appear, seem well tailored to ensure that outcome. In both the implied immunity cases and particularly in *Trinko* the Court has found it relevant whether some administrative apparatus exists to enforce competition values, and therefore to replace antitrust. Moreover, the antitrust savings clause currently contained in § 733 of the bill is not well drafted to overcome the reasoning in *Trinko*. In fact, it is nearly identical.

Antitrust immunity under the OTC Bill is potentially quite a bad consequence, because concentration and collusion are serious problems in financial markets. The vast bulk of derivatives business has been concentrated in a small number of large financial companies, a fact that poses both systemic risks and more traditional anticompetitive concerns.<sup>29</sup> More traditional securities exchanges and their appurtenant businesses have been characterized by anticompetitive conduct throughout their history,<sup>30</sup> as have banks and other financial institutions.<sup>31</sup>

On the other hand, one might wonder whether preemption of antitrust might actually be tolerable in this case, since there would be another federal enforcement regime—either

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<sup>29</sup> See generally FRANK PARINYO, *INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS* (2002).

<sup>30</sup> See generally JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* (2d ed. 1995); HANS R. STOLL, *REGULATION OF SECURITIES MARKETS: AN EXAMINATION OF THE EFFECTS OF INCREASED COMPETITION* (1979); Arthur E. Wilmarth, Jr., *The Transformation of the U.S. Financial Services Industry, 1975-2000: Competition, Consolidation, and Increased Risks*, 2002 U. ILL. L. REV. 215.

<sup>31</sup> Prior to 1944, when it was made clear that banks could be subject to U.S. antitrust law, they engaged in open and extensive price-fixing as to deposit rates, and even thereafter they apparently did not work very hard to conceal price-fixing until well into the 1960s. See Bernard Shull, *The Origins of Antitrust in Banking: An Historical Perspective*, 41 ANTITRUST BULL. 255, 263 (1996). (During the 19th century the Supreme Court had held that the business of insurance was not within “interstate commerce” for constitutional purposes, *Paul v. Virginia*, 75 U.S. 168 (1868), and it widely was presumed that other financial businesses were not, either. The Court reversed this rule as to insurance in *United States v. S.E. Underwriters Ass’n*, 322 U.S. 533 (1944), and, again, it was presumed that the reversal would be effective as to other financial businesses as well. See Shull, *supra*, at 260-63.)

the CFTC or the SEC—empowered to enforce “antitrust considerations.” History suggests that that instinct would be a very poor one. Industry-specific regulators have generally tended to be weak and ambivalent enforcers of competition, much to the frustration of Congress and outside observers. As one pertinent example, for the first forty years of its existence the SEC facilitated an uninterrupted, naked price-fixing conspiracy as to brokerage commission rates, which by universal acknowledgement increased those rates astronomically and distorted the organization of the securities markets. The Commission did not relent and finally allow competition until 1975, by which time commission rates had become the focus of litigation in the U.S. Supreme Court,<sup>32</sup> direct congressional intervention, and extensive public and congressional criticism.<sup>33</sup>

Accordingly, competition values would be well served by two changes to the OTC Bill. First, the “antitrust considerations” provisions should be removed completely. They seem likely to serve very little purpose except immunizing anticompetitive conduct.

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<sup>32</sup> *Gordon*, 422 U.S. at 659.

<sup>33</sup> The fixing of NYSE member commission rates actually began with the agreement that created the exchange in the first place—the so-called Buttonwood Tree Agreement of 1792, which was little more than a naked price-fixing conspiracy. As originally enacted, the Securities Exchange Act of 1934 authorized the SEC to regulate “the fixing of reasonable rates of commission, interest, listing and other charges.” Ch. 404, Title I, § 19(b), 48 Stat. 898 (June 6, 1934). For the next forty years the Commission oversaw a system of fixed commission rates, in which it was periodically asked to approve increases. It ordinarily did so without inquiry. Admittedly, in 1961 it began a process of study that would lead to the end of fixed commissions. However, the process took nearly fifteen years—the Commission largely ended commission rate fixing in 1975, when it adopted Exchange Act Rule 19b-3—and it proceeded only under prodding and criticism from an impatient Congress, *see* SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, SECURITIES INDUSTRY STUDY 4 (1972) (containing report of the Subcommittee on Securities critical of SEC for delay in addressing rate-fixing and lack of clarity in the Commission’s various statements); H.R. REP. No. 92-1519, pp. xiv, 141, 144-145, 146 (1972) (report of the House Commerce Committee stating similar criticisms). Indeed Congress itself was finally forced to take action in 1975 to fully complete the process of deregulation of commission rates. *See* Pub. L. No. 94-29, § 16, 89 Stat. 146 (1975) (replacing the Commission’s original rate regulation authority with an entirely new provision largely prohibiting commission rate fixing).

Second, the savings clause in § 733<sup>34</sup> should be modified along lines like the following:

Nothing in the amendments made by this title shall be construed to modify, impair, or supersede the operation of any of the antitrust laws. No court shall be permitted to determine that because of the particular structure of circumstances of any industry that the antitrust laws are modified, impaired or superseded with respect to any entity or organization identified in this title by reason of any provision of this title. For purposes of this subtitle, the term “antitrust laws” has the same meaning given such term in subsection (a) of the first section of the Clayton Act, except that such term includes section 5 of the Federal Trade Commission Act to the extent that such section 5 applies to unfair methods of competition.<sup>35</sup>

## II. Antitrust in the Resolution Bill

The Resolution Bill contemplates a system under which, in emergency circumstances, the Federal Deposit Insurance Corporation (“FDIC”) would be empowered to take over a failing financial holding company that is determined to have systemic significance to the economy. The bill in certain ways would impose severe constraints on the ability of antitrust law—the only one of our thousands of federal statutes with any hope of controlling the size and power of private entities—and would do so in just that context in which competitive and systemic risks seem most important. These limitations on antitrust seem very serious and unfortunate. Competitiveness in the financial sector is important, and in that special context it plays two distinct roles. First, these markets’ lack of “competitiveness,” in the sense that they lack numerous competitors, has been a key contributor to the increase in world-wide systemic financial risk. The fewer financial institutions there are, given their growing interconnectedness,

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<sup>34</sup> For what it may be worth, I believe it would be advisable to move this provision to a new § 702, or to some other place that makes clear that it applies to the entire Title, rather than just to Subtitle A.

<sup>35</sup> As I mentioned, *see supra* note 2, I believe the implied repeal doctrine and *Trinko* pose some risks as to the CFPA Bill as well. That bill would create a new regulatory authority with power to regulate conduct that could also implicate antitrust. While the risks here seem smaller than under the OTC Bill, I believe it would be wise to include an antitrust savings clause identical to the one I suggested in the text in the CFPA Bill as well.

the more likely that failure of one of them will pull down many others.<sup>36</sup> Second, competition is the only discipline for price and output of the many products and services financial institutions provide so that our system of savings, investment and corporate finance works.

#### **A. Competition in the Financial Sector**

On any measure, U.S. financial markets have transformed completely since the early 1970s. There is little doubt that the transformation is irreversible.<sup>37</sup> Change began most prominently with deregulatory steps in the 1970s that were designed to remove regulatory barriers to competition in banking and securities, which caused them to lose access to traditional sources of legally protected, supra-competitive revenues. Insurance companies began to face similar pressures as well.<sup>38</sup> Then, throughout the 1980s and 1990s, regulators gradually loosened restraints on the lines of business in which traditional financial institutions could engage. Geographical restraints on banking were loosened as well, and interstate branching was generally authorized by Congress in 1994.<sup>39</sup> The crowning event so far has been the adoption of the Gramm-Leach-Bliley Act (“GLB”)<sup>40</sup> in 1999, which finally permitted banking businesses to branch into unrestricted securities

<sup>36</sup> See generally Wilmarth, *supra* note 30, at 316-17.

<sup>37</sup> See, e.g., Shull, *supra* note 31, at 257 (so arguing).

<sup>38</sup> The major step in banking was to lift rules that set very low maximum interest rates for deposits. This was accomplished by repeal of the Federal Reserve Board’s Regulation Q in the 1980s. In the securities industry the most important deregulatory step was in 1975, when congressionally mandated SEC action finally prohibited the centuries old practice of stock exchange members of fixing the brokerage commissions they charged their clients for executing securities trades. The Securities and Exchange Commission prohibited fixed commissions on May 1, 1975 by adopting its Rule 19b-3, 17 C.F.R. § 240.19b-3. In insurance the problem was that changing interest rates and the growing availability of competing consumer investment products caused consumers to lose interest in traditional life insurance. As to all these changes, see generally Wilmarth, *supra* note 30.

<sup>39</sup> Interstate branching was authorized in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994, Pub. L. No. 103-328, 108 Stat. 2338 (Sept. 29, 1994) (codified in scattered sections of 12 U.S.C.). The Riegle-Neal Act permitted states to “opt out” of the Act in several respects, but most did not do so. For the most part, BHCs are free to hold banks in multiple states and individual banks are free to engage in interstate branching.

<sup>40</sup> Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999), now codified at scattered provisions of U.S. Code.

and insurance businesses. Though we may tend to forget it now, arguments supporting all of these regulatory changes were framed relentlessly in the language of *competition*, and indeed one early version of the GLB bill actually bore as its formal short name the Financial Services *Competition Act*.<sup>41</sup>

However, while the increased competition that resulted from these reforms should have been and for a time was fairly unequivocally pro-consumer, it also caused certain unforeseen consequences. The loss of legally protected sources of excess profits caused the traditional institutions to invade one another's geographic and line-of-business territories in search of new revenues. But this new competitiveness also set off a mad scramble of consolidation, which has generally been seen as an effort to stave off competitive inroads.<sup>42</sup> Thus we have seen waves of consolidation in banking and other financial markets since the early 1980s that, from the aggregate national perspective, has increased concentration substantially. Indeed, a large wave of mergers during the 1990s involved a whole series of bank and financial institution combinations each of which was the single largest merger of its kind to date.<sup>43</sup>

One salient trait of this merger wave has been that the larger mergers, and especially the very large mergers of financial conglomerates, have had disappointing economic results.<sup>44</sup> In part this reflects what appear simply to be significant scale and scope

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<sup>41</sup> Financial Services Competition Act of 1997, H.R. 10, 105th Cong., 1st Sess. (Jan. 7, 1997) (emphasis added).

As for the competition rhetoric that always surrounded the bill, see for example H.R. REP. NO. 106-434 (1999) (conference report); S. REP. NO. 106-44 (1999) (committee report accompanying bill that would be enacted as Gramm-Leach-Bliley Act); H.R. REP. NO. 105-164 (1997) (committee report accompanying H.R. 10, 105th Cong., 1st Sess. (1997)).

<sup>42</sup> See sources cited at n. 38, *infra*.

<sup>43</sup> See Robert Kramer, Speech Before the Section of Antitrust Law, American Bar Association, "Mega Mergers" in the Banking Industry (April 14, 1999); Stephen A. Rhoades, *Competition and Bank Mergers: Directions for Analysis From Available Evidence*, 41 ANTITRUST BULL. 339 (1996).

<sup>44</sup> Wilmarth, *supra* note 30, at 272-79.

diseconomies in bank operation beyond a certain size.<sup>45</sup> Much of this failure among the larger conglomerate mergers also has resulted from the mistaken prediction of consumer enthusiasm for “one-stop shopping” in financial products.<sup>46</sup> There is no serious doubt that—since the claimed efficiencies probably aren’t the real goal of these mergers—some part of the motivation has been the self-interest of managers, who among other things seek the implicit federal subsidy of TBTF status.<sup>47</sup>

As a result of this period of consolidation, the financial sector has come to have an essentially two-tiered structure. Banking for consumers and small to mid-size businesses remains a predominantly local affair, engaged in by smaller and regional banks, and to a lesser extent by branches of larger banks. But large scale banking—major commercial loans, loan syndications, mass-marketed commodity products like credit cards and mortgages—is mainly now the domain of very large banks. Moreover, there remains a two-tiered aspect to bank concentration. While aggregate concentration in banking—the number of entities representing banking business nationally—has increased dramatically during the period of transformation, concentration in local banking markets has remained relatively constant throughout that period.<sup>48</sup> That, though, is not necessarily cause for much optimism, as it also seems widely acknowledged that local banking has always been subject to some concentration and is prone to some market power.<sup>49</sup> Concentration

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<sup>45</sup> *Id.* at 279-81.

<sup>46</sup> *See id.* at 432.

<sup>47</sup> *See* Rhoades, *supra* note 43, at 340-41; Wilmarth, *supra* note 30.

<sup>48</sup> *See* Shull, *supra* note 31, at 257.

<sup>49</sup> *See* Shull, *supra* note 31. As to market power in local banking markets, see Wilmarth, *supra* note 30, at 293-300. Interestingly, the one isolated context in which short-term stock price improves for both an acquiring and a target bank in large bank mergers, and that is where the two banks previously competed in the same geographic markets. *Id.* at 293

is also prevalent in other sectors, as among investment banks and securities dealers,<sup>50</sup> and the immense global duopoly that now dominates the credit rating business.<sup>51</sup>

On top of this evidence concerning concentration, there also remains persistent evidence of serious, collusive anticompetitive conduct among financial institutions. Prior to 1944, when it was made clear that banks could be subject to U.S. antitrust law,<sup>52</sup> banks engaged in open and extensive price-fixing as to deposit rates, and even thereafter they apparently did not work hard to conceal price-fixing until well into the 1960s.<sup>53</sup> Other financial markets have been rife with collusion as well. Indeed, the New York Stock Exchange (“NYSE”) is generally said to find its origin in a naked horizontal price-fixing conspiracy, and throughout its history it was governed by a series of explicit (and for the most part legally protected) price and output restraints, which were enforced by horizontal boycotts. In more recent times anticompetitive conspiracies have been more secretive, of course, but major conspiracies plainly persist in the financial sector, like the spectacular rings of fraud and collusion among Wall Street firms broken up by the New York Attorney General during the past 15 years.<sup>54</sup>

Still, having said all that, assessing the price competitiveness of financial product markets is complex. Traditional banking products—taking deposits and making loans—

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<sup>50</sup> See generally FRANK PARTNOY, *INFECTIOUS GREED: HOW DECEIT AND RISK CORRUPTED THE FINANCIAL MARKETS* (2002).

<sup>51</sup> See Thomas J. Fitzpatrick, IV & Chris Sagers, *Faith-Based Financial Regulation: A Primer on Oversight of Credit Rating Organizations*, 61 ADMIN. L. REV. 557 (2009).

<sup>52</sup> During the 19th century the Supreme Court had held that the business of insurance was not within “interstate commerce” for purposes of the Commerce Clause jurisdiction of Congress, *Paul v. Virginia*, 75 U.S. 168 (1868), and it widely was presumed that other financial businesses were not, either. The Court reversed this rule as to insurance in *United States v. S.E. Underwriters Ass’n*, 322 U.S. 533 (1944), and, again, it was presumed that the reversal would be effective as to other financial businesses as well. See Shull, *supra* note 31, at 260-63.

<sup>53</sup> See Shull, *supra* note 31, at 263.

<sup>54</sup> See generally JOEL SELIGMAN, *THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE* (2d ed. 1995); HANS R. STOLL, *REGULATION OF SECURITIES MARKETS: AN EXAMINATION OF THE EFFECTS OF INCREASED COMPETITION* (1979); Wilmarth, *supra* note 30.

is fairly prone to market power wherever concentration increases. Entry is thought to be difficult not only because it requires regulatory approval, but because traditional banking involves a “relational” aspect under which consumers smaller business clients value long-term relationships and personal attention.<sup>55</sup> However, some financial products have come to be effectively commodity-like, in that they can be mass-marketed directly to consumers. Examples include mortgages, consumer loans, and credit cards. It is thought that because the products can be sold at low cost and entry is easy, price competition as to these products tends to be fierce. Thus, the core business of smaller banks is thought by many—including DOJ and the bank regulators—to be much less competitive than the core businesses of very large banks and financial conglomerates. But, as will be explained below, this narrow focus on specific products—which happens to guide current bank merger law—may be importantly incomplete.

## B. Specifics of the Legislation

1. *In General.* The Resolution Bill contemplates that the Secretary of the Treasury will, when certain specified exigencies arise, determine that the default of a financial company (“FC”) would pose systemic consequences.<sup>56</sup> Upon that finding the Secretary

<sup>55</sup> See Wilmarth, *supra* note 30.

<sup>56</sup> As a practical matter FCs are defined to include (1) bank holding companies (“BHCs”); and (2) financial holding companies within the meaning of the Gramm-Leach-Bliley Act (“FHCs”). See Resolution Bill at § 1602(9). BHCs, which are primarily governed by the Bank Holding Company Act, 12 U.S.C. §§ 1841-50, include any corporation, partnership, or other entity that holds control of one or more banks. BHCs are ordinarily permitted to engage only in banking or activities that are closely related to banking, like some limited securities and insurance work. Only a company that complies with the terms of the Bank Holding Company Act may own control of a bank, and it must first seek approval of the Federal Reserve Board before it may do so. See 12 U.S.C. §§ 1841(a), 1842, 1843. See generally CARL FEI.SENFELD, BANKING REGULATION IN THE UNITED STATES (2004).

FHCs, by contrast, were a creation of the Gramm-Leach-Bliley Act of 1999, Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999), now codified at scattered provisions of U.S. Code (GLB). Prior to GLB, no bank or BHC was permitted to own any non-banking asset except those engaged in a handful of activities specified by the Federal Reserve Board (FRB) as “closely related to banking,” like trust services, data processing, or the operation of an ATM network. See 12 U.S.C. § 1843(c)(8); 12 C.F.R. § 225.28(b). But following GLB, an FHC can own both banking entities and non-bank affiliates, which can engage in a whole series of



may invoke either of two federal corrective measures, one of which is to place the FC under the control of the FDIC as its receiver.<sup>57</sup> The conservator/receiver would then hold a number of powers to resolve the FC's crisis, among them being to merge the FC with another company or transfer any of its assets.<sup>58</sup> There lie the Act's antitrust consequences. Mergers of banks, BHCs and other financial institutions, and transfers of their assets, are subject to Clayton Act § 7, which prohibits mergers and acquisitions whose effect "may be substantially to lessen competition, or to tend to create a monopoly," 15 U.S.C. § 18.<sup>59</sup> They are also subject to a complex series of special statutory rules that will require either review under the HSR process or a pre-transaction review process that roughly mirrors it, under banking regulatory law. (Non-bank transactions are usually subject to HSR. Bank and BHC transactions are ordinarily

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financial activities, like insurance, securities underwriting, and merchant banking. To qualify as an FHC, a firm must first be approved by the FRB as a BHC, and then file a declaration of intent to act as an FHC with the FRB. FHCs must maintain certain minimum capitalization and managerial standards to retain their FHC status, but there is no requirement they first receive FRB approval. *See* 12 U.S.C. 1843(l)(1). That last fact is relevant to the antitrust treatment of mergers and acquisitions involving FHCs. *See infra* note 77.

With one limited exception, no other business in the United States may own both banking and non-banking businesses. The exception is that national banks may own operating subsidiaries that engage in a more limited schedule of the same non-banking financial activities open to FHCs. *See* CARL FELSENFELD, *BANKING REGULATION IN THE UNITED STATES* 106.9 – 106.15 (2004).

<sup>57</sup> *See* Resolution Bill at § 1604. The bill provides that the FDIC may be appointed either as receiver or "qualified receiver," with more power to preserve the ailing FC outside of liquidation, but the latter appointment can be made only if the Secretary of the Treasury overcomes a "strong presumption" against it. The other corrective measure provided for under the Resolution Bill is that, whether or not a conservator/receiver is appointed, FDIC may make loans or provide other assistance to the BHC. *Id.* at § 1604(a).

<sup>58</sup> First, the conservator/receiver may cause the seized company to be merged into another or may transfer any of its assets. *See id.* at § 1609(a)(1)(G)(i). Second, the conservator/receiver may create a "bridge financial company," which would be a temporary, federally chartered corporation fully controlled by the FDIC, to which to transfer the assets of a seized entity. Following creation of the bridge FC, either the entire company or its assets would be transferred to their ultimate owner. *See id.* at § 1609(h).

<sup>59</sup> There was actually uncertainty on this point during the first half of the twentieth century, but it was resolved by the seminal decision in *United States v. Phila. Nat'l Bank*, 374 U.S. 321 (1963). *Philadelphia National Bank*, which remains a fundamental decision in merger law generally, established that bank mergers are subject to Clayton Act § 7, even if they have been previously approved by a federal banking regulator. *See generally* Shull, *supra* note 31, at 260-75.

exempt from it, though in some cases they are not.<sup>60</sup> Where they are exempt, they are subject to a separate system of merger review that applies only to banks and BHCs.<sup>61</sup>)

The Resolution Bill deals with these antitrust issues in two explicit, identical provisions. Presumably, they were included simply to make clear that antitrust continues to apply to the FDIC's remedial actions, even though they are ordered by a federal entity. For the most part these provisions preserve the existing system of bank merger review, and indeed they are written in such a way as mainly just to reference that system obliquely. Existing bank merger law requires that bank and BHC mergers and significant acquisitions cannot proceed until the parties seek permission to the appropriate federal banking regulator.<sup>62</sup> The responsible bank regulator must request and consider the views

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<sup>60</sup> See generally SECTION OF ANTITRUST LAW, AM. BAR ASS'N, BANK MERGERS AND ACQUISITIONS HANDBOOK 1-12 (2006) [hereinafter "BANK MERGER HANDBOOK"]; Yvonne S. Quinn, *Practical Aspects of Defending Bank Mergers Before the Federal Reserve Board and the Department of Justice*, 62 ANTITRUST L.J. 91 (1994).

<sup>61</sup> That law differs from the more familiar HSR review in four main respects. First, bank mergers are one of only four situations in U.S. law in which the antitrust agencies share their merger review duties with an industry specific regulator. (The other three are railroad mergers, certain electricity mergers, and telecommunications.) See AMC REPORT, *supra* note 12. Second, bank merger law is virtually unique in that an otherwise anticompetitive merger can be approved if it is found to be in the "public interest." Next, if DOJ decides to formally challenge a bank merger, it must file a lawsuit within 30 days of receipt of the parties' application. Its lawsuit during that period forces an absolute and automatic stay on the proposed transaction for the pendency of litigation, but if DOJ fails to sue within 30 days, then neither DOJ nor any other party can ever challenge the merger itself on antitrust grounds. Finally, bank merger law allows the responsible bank regulator to determine that one of the banks might imminently fail, in which case the regulator can speed the process up, or, in some cases, do away with antitrust review entirely. See generally ABA BANK MERGER HANDBOOK, *supra* note 60, at 5-33.

<sup>62</sup> The identification of the appropriate regulator is itself a complex little statutory problem. It will most often be the Federal Reserve Board, as it is given authority over acquisitions by BHCs of any bank, 12 U.S.C. § 1842, as well as most acquisitions by state bank members of the federal reserve system, *id.* at § 1828(c)(2)(B). But if the acquiror is a national bank or a District of Columbia bank the regulator is the Office of the Comptroller of the Currency; if the acquiror is either a state bank that is federally insured by not a member of the federal reserve system, or is any federal insured bank that seeks to acquire a non-insured entity, the regulator is the Federal Deposit Insurance Corporation; and if the acquiror is a thrift the regulator is the Office of Thrift Supervision. *Id.* at § 1828(c)(2).

Technically, the particular rules that apply to any given bank merger or acquisition depend on exactly what is being transferred and to whom. Because FDIC remedial actions under the Resolution Bill might both cause the merger of an entire FC or merely the transfer of some of its assets, a given case under the Act might involve a merger of two FCs or the transfer of bank or banking related assets to another BHC or to a financial holding company. In each case the appointed regulator could be different, and the precise rules that apply could vary. But overall the same substantive standard would apply, and the overall process would be roughly the same.

of both the Justice Department (“DOJ”) and the other bank regulatory agencies as to competitive issues. They prepare their opinions under a process that largely tracks the analysis that the antitrust enforcement agencies perform in HSR review, though with one significant substantive difference: regulators can approve an otherwise illegally anticompetitive bank merger if they find its competitive costs to be “clearly outweighed in the public interest by the probable effect of the transaction in meeting the convenience and needs of the community to be served.”<sup>63</sup> In any case, this system of bank merger rules contains a series of safety-valve provisions, which allow the responsible bank regulator to speed up the approval process substantially, and even to exclude antitrust review entirely, where it finds there to be a risk of imminent failure of one of the banks.

The Reolution Bill’s approach to competition review is to provide that this whole process of merger review will occur as it ordinarily would, except that the Act automatically triggers all the emergency time period provisions, and it also makes one potentially significant modification. The Act’s two, identical antitrust provisions provide that:

- (1) If a receiver transaction “requires approval by a Federal agency,” then it cannot be consummated before the 5th calendar day after the approval is made.
- (2) Where such an approval requires a “report on competitive factors,” then DOJ must be notified “promptly,” and DOJ must then provide the report within 10 days of the request.
- (3) If a transaction requires an HSR filing, then the antitrust review agency must make its determination within 30 days after receipt of the filing, and it may not seek any extension of time or make any “second request” for additional information.
- (4) If the Treasury Secretary and Federal Reserve Chairman determine that a conservator/receiver transaction must proceed “immediately,” in

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<sup>63</sup> 12 U.S.C. § 1828(c)(5)(B).

order “to prevent the [BHC’s] probable failure,” then no regulatory approvals or antitrust review are required at all and it may consummate with no delay.

See Act § 1209(a)(1)(G)(ii); § 1209(h)(10). The one significant modification of existing law—a potentially massive and dangerous modification—is in items 3 and 4. I will address that below.

An important aspect of existing bank merger law—which has consequences both for the process of review and for the substantive standards applied—is that there has been a substantial amount of interagency coordination to make bank merger review work. Much of this was necessary because bank merger law read literally, would allow approval of mergers under time frames that could be extremely burdensome for DOJ. There is also plenty of room in the law for what could have been disruptive substantive conflicts among the agencies, and indeed disagreements arose between DOJ and the banking regulators in the early 1960s, almost as soon as the present bank merger review framework was put in place.<sup>64</sup> The consequence has been certain formal agreements among DOJ and the banking regulators,<sup>65</sup> as well as informal norms, like the common practice of merging parties of providing DOJ with their application materials well before the banking regulator is legally required to do so.<sup>66</sup>

Why exactly the special system of bank merger review persists is a bit of a mystery. It has long been clear that, for reasons of its own, “Congress . . . has determined to deal with banking in a manner different from other forms of ‘commerce . . . .’ ”<sup>67</sup> Banking

<sup>64</sup> See Shull, *supra* note 31, at 274.

<sup>65</sup> See U.S. DEP’T OF JUSTICE, BANK MERGER COMPETITIVE REVIEW—INTRODUCTION AND OVERVIEW(2000) [hereinafter “DOJ REVIEW POLICY”] (a document initially agreed to among DOJ and the banking regulators in 1995, which governs both the process and substantive standards applicable to the review).

<sup>66</sup> See Quinn, *supra* note 60, at 93-94.

<sup>67</sup> Adolph A. Berle, Jr., *Banking Under the Antitrust Laws*, 49 COLUM. L. REV. 589, 590 (1949).

thus remains one of only four industries in which the antitrust enforcement agencies must share merger review with an industry-specific regulator,<sup>68</sup> and is virtually unique in that anticompetitive mergers can be approved on a finding of “public interest.” But the explanation exactly *why* that should be has changed over time and is not at the moment particularly persuasive. During the nineteenth century and the early part of the twentieth banking policy was dominated by explicit “destructive competition” arguments, of the sort that at one time supported broad antitrust exemptions and invasive economic regulation in sectors throughout the economy, including transportation, communications, utilities, insurance, and banking. (Those arguments are now largely dead, as applied to any industry other than one that can credibly claim natural monopoly effects, and for this reason much of the U.S. economy has been deregulated since the 1970s.) But by the time the bank merger review legislation was initially adopted, between 1956 and 1966, Congress’s overriding concern was the alarming growth in (for the times) very large bank holding companies. At that time, there remained substantial doubt that bank mergers could be subject to Clayton Act § 7, even under the recent Celler-Kefauver amendment of 1950,<sup>69</sup> and banking law also imposed much more severe limits on the extent to which banks could compete with each other.<sup>70</sup> In other words, the law was originally set up to impose *more* competitive discipline on bank mergers than was thought to be available. Now, however, it imposes less invasive (or at least more rushed and less information-intensive) review than might be available were banks and BHCs simply subject to the same

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<sup>68</sup> See AMC REPORT, *supra* note 12, at 363-64. The others are certain aspects of electricity, in which merger review is shared with the Federal Energy Regulatory Commission, telecommunications, in which merger review is shared with the Federal Communications Commission, and the special case of the railroads, in which mergers are subject solely to review by the Surface Transportation Board. *See id.*

<sup>69</sup> *See infra* note 35.

<sup>70</sup> *See infra* note 21-22.

rules as the rest of American industry. To the extent that this persistent difference in treatment has any theoretical foundation, it is different than the one that originally underlay bank merger law. It now appears to be justified by some sense that banks need special *protection* from competition policy, because their failures are damaging to communities and impose taxpayer costs through the deposit insurance system. In other words, to the extent that bank merger review law has any current justification, it has reverted to the old fear of destructive competition.<sup>71</sup>

2. *The Change to HSR Review.* A separate issue is the one significant change the Resolution Bill would make to existing merger law. At a hearing held October 22 before the Subcommittee on Commercial and Administrative law, the question was raised and discussed at some length whether the bill would make any changes to antitrust at all. The answer is, unequivocally, yes. The Resolution Bill would modify existing antitrust law, and it would do so in a way that is potentially *breathhtaking*.

At the hearing, Administration witnesses<sup>72</sup> were asked whether there would be any modification. I believe they answered in perfectly good faith,<sup>73</sup> but their replies were in one major respect legally incorrect, and, overall, seriously misleading. In both their written and in-person testimony, both witnesses implied that the Resolution Bill would simply preserve “existing bank failure law” in most respects. In effect, they said that the special, idiosyncratic regime of bank merger review that currently exists would just be

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<sup>71</sup> See Shull, *supra* note 31; Lawrence J. White, *Banking, Mergers, and Antitrust: Historical Perspectives, and the Research Tasks Ahead*, 41 ANTITRUST BULL. 323 (1996).

<sup>72</sup> Michael S. Barr, Assistant Secretary of the Treasury for Financial Institutions, and Michael Krimminger, Special Advisor for Policy of the Federal Deposit Insurance Corporation.

<sup>73</sup> Neither Secretary Barr nor Mr. Krimminger purported to be an antitrust specialist, and, in their defense, the law in this respect is extremely complex.

extended a bit to cover resolution of failing bank holding companies, which might happen to own some non-bank assets.<sup>74</sup>

This is incorrect. On the one hand, it is true that the Resolution Bill in many cases merely incorporates existing bank merger law, which in many respects is idiosyncratic and under emergency conditions can be made to go rather fast.<sup>75</sup> However, the bill would exempt transfers of *non-bank* financial entities from the ordinary HSR process that currently governs them, and subject them to a new, hybrid HSR process would be very fast and very limited. The bill would do this notwithstanding that the transfers at stake might involve some of the largest mergers of financial institutions in U.S. history.

While this end result can be generalized simply enough, the legal details driving it turn out to be exceedingly complex. For the sake of clarity I explain every bit of the complexity in the footnotes. It is complex in part because the FCs to which the bill's resolution authority would apply would include companies that are permitted to own both

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<sup>74</sup> In reply to questions, both witnesses said that the Resolution Bill would not modify the antitrust review regime that currently applies in "bank failure" situations, though they apparently acknowledged that the bill would extend it to transactions to which it does not currently apply. *See* Hearing Transcript at 2:38:00 (testimony of Michael S. Barr) ("In our judgment the proposal mirrors the proceedings that are used with respect to bank failure law. So in the event of the need for merger and acquisition there's a process for appropriate Department of Justice review. As under existing bank failure law there are emergency exceptions . . . Those would apply also in this case . . . In our judgment . . . they are the same as currently provided under bank failure law. We're extending the exact type of regime that exists today with respect to antitrust review to this narrow context and in our judgment that's appropriate."); Hearing Transcript at 2:39:12 (testimony of Michael Krimminger) ("With regard to antitrust protections . . . there typically is a requirement to go through Department of Justice review on bank failures, but there can be exceptions . . . In a systemic context there can be cases in which there is an override of the anticompetitive consequences.")

The witnesses' written statements did not specifically address antitrust, a fact perhaps reflecting the Administration's lack of concern for competition issues in this overall reform effort. But in both statements they implied that the Resolution Bill would simply follow (with some possible, unspecified modifications) existing law. *See* Statement of Michael S. Barr, at 4 (Oct. 22, 2009) (not specifically addressing antitrust, but noting that the overall resolution process would simply follow "the approach long taken for bank failures."); Statement of Michael Krimminger, at 2 (Oct. 22, 2009) (noting only that "our antitrust and bankruptcy laws will continue to play a key role in ensuring robust competition in our free economy").

<sup>75</sup> *See supra* note 61.

bank and non-bank financial entities.<sup>76</sup> It is also complex because knowing when HSR applies and when it does not—especially in the banking context—is extremely thorny.<sup>77</sup>

<sup>76</sup> See *supra* note 56.

<sup>77</sup> The best simple summary that can be given is that, again, most bank mergers and acquisitions are exempt from HSR, *see* 15 U.S.C. § 18a(c)(7), but most transfers of non-banking financial institutions are subject to HSR, regardless of whether the acquirer or seller happens to be a bank or BHC.

But to be clear, a receiver attempting to resolve a failing FC could cause any of a complicated set of different transactions that might in one way or another trigger an HSR filing. Where a resolution involves transfer of an entire FC to one buyer, the DOJ or FTC would review the non-banking parts of the transaction under the normal HSR process. *See* 16 C.F.R. § 802.6(b) (rule of the FTC’s Premerger Notification Office providing that in all “mixed” transactions involving some assets exempt from HSR and some not, the non-exempt portions will be reviewed under the normal HSR process); Premerger Not. Off., FTC, Formal Interpretation 17, 65 FED. REG. 17,880 (Apr. 5, 2000) (clarifying that this rule would apply to mixed acquisitions by FHCs). In other cases, the failing FC will be broken up and sold to different buyers. The banking pieces of the FC would have to be sold to entities legally permitted to own banks; most such transfers would be exempt from HSR and would be reviewed under the existing bank merger review process (though not all of them, because occasionally acquisitions of bank stock or assets are subject to HSR; *see* below). The non-banking pieces could be bought by all different sorts of buyers, and the merger review rules that would apply will depend on who the buyer is. The possibilities are:

- (1) Any transfer of a non-banking asset to any buyer that is not itself a bank or a BHC would trigger HSR. For example, an FC that owns securities underwriting business might sell it to a competing firm that is not itself owned by a financial holding company that also owns banks. Under current law, such a transfer would be simply a garden variety HSR transaction.
- (2) The situation is more complex where the acquirer is either a bank or another FHC that owns banks. (Strictly speaking, the only bank that could purchase non-banking assets would be a national bank that makes the purchase through a subsidiary. *See supra* note 56.) Sometimes HSR applies to such acquisitions and sometimes it does not, as follows:
  - (a) Under current law, if the acquiring entity is an FHC, then its acquisition of non-bank entities is fully subject to HSR. *See* 12 U.S.C. § 1843(k)(6) (providing that an FHC may commence non-banking “financial” activities without prior FRB approval); 15 U.S.C. § 18a(c)(8) (providing the HSR applies to FHC acquisitions of non-banking financial entities that are exempted from FRB prior approval).
  - (b) However, if an FHC, a BHC that is not permitted to act as an FHC, or a national bank acquires a non-banking entity, *and* that acquired entity engages in activities “closely related to banking or managing or controlling banks” as defined in Federal Reserve Board regulations, then the acquirer may elect *either* to make an HSR filing or apply for FRB approval. *See* 12 U.S.C. § 1843(c)(8); 12 C.F.R. § 225.28(b). “Closely related” activities include such things as trust services, data processing, and ATM network operation.
- (3) Finally, there will be cases in which transfers of *banking* assets will be subject to HSR review. Bank acquisitions are exempt from HSR only where they are subject to pre-merger review by a banking regulator. *See* 15 U.S.C. § 18a(c)(7), (c)(8). But they are reviewed by banking regulators only where the acquisition of control is itself large enough to trigger the bank merger review statutes. It is possible that an acquirer could acquire a share in the voting stock of a banking entity that is too small to trigger bank merger review but large enough to trigger HSR review. For example, a BHC may acquire up to 5% of the voting stock of a bank without FRB approval. *See* 12 U.S.C. § 1842. But if value of the stock is \$50 million or more (as it would be if the target bank’s total voting securities are worth more than \$1 billion) and the BHC has total assets or annual net sales of more than \$10 million (as seems likely), then the transaction is reportable under HSR. *See* STEPHEN M. AXINN ET AL., ACQUISITIONS UNDER THE HART-SCOTT-RODINO ANTITRUST IMPROVEMENTS ACT § 6.06[3][f] (2006).

*See generally id.* at § 6.06[3][g]; ABA BANK MERGER HANDBOOK, *supra* note 60, at 8-9.



But the bottom line remains that under this bill, transfers of very big financial companies would be subjected only to a hybrid HSR process so fast and so constrained as to constitute no meaningful antitrust review at all.

The Act reaches this result in two identical provisions. They first provide the following as to any transfers made by a federal conservator/receiver under the Act:

If a filing is required under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 with the Department of Justice or the Federal Trade Commission, the waiting period shall expire not later than the 30th day following such filing notwithstanding any other provision of Federal law or any attempt by any Federal agency to extend such waiting period, and no further request for information by any Federal agency shall be permitted.

Resolution Bill at § 1609(a)(1)(G)(ii)(I); § 1609(h)(10)(A). Both of the identical provisions then continue with the following, separate rule:

If the Secretary, in consultation with the Chairman of the Federal Reserve Board, has found that the [FDIC] must act immediately to prevent the probable failure of the covered bank holding company involved, the approvals and filings [that would otherwise be required under the Resolution Bill] . . . shall not be required and the transaction may be consummated immediately by the [FDIC].

*Id.* at § 1609(a)(1)(G)(ii)(II); § 1609(h)(10)(B).

This is a big change. Under HSR, both parties to an acquisition must make an initial application on the agencies' "Form HSR-1." The application gives the agencies a chance to decide whether the transaction would violate § 7 of the Clayton Act. It therefore requires detailed discussion of the parties' markets, their market shares, and their competitors. So long as the agencies deem the filing complete, it triggers a statutory waiting period under which the parties may not consummate their transaction earlier than 30 calendar days after the filing is received.

As a practical matter, the agencies approve the vast majority of transactions before them during this initial 30-day waiting period. However, where they believe that a transaction may pose substantial competitive risks, they routinely take a few months and occasionally as much as a year or more to consider them. They also enjoy the benefit of interviews, depositions, interrogatories, and document production requests, all of which they may direct to the parties or to third persons. They enforce those disclosure requests through what are in effect very powerful civil discovery tools.<sup>78</sup>

All of this remains true, incidentally, even of transactions involving firms that are in financial distress or even in bankruptcy. HSR still applies in these cases, without any meaningful differences. Bankruptcy law makes only a small timing modification in some cases.<sup>79</sup>

But under the Resolution Bill, this would all be quite different. The agencies would have 30 (presumably calendar) days to make their judgment, period. They must make that judgment solely on the basis of the information initially given on Form HSR-1, and

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<sup>78</sup> See generally AXINN ET AL., *supra* note 77, at §§ 7.04 – 7.05.

<sup>79</sup> By 1994 amendments, the bankruptcy code provides that where a bankruptcy trustee causes a transfer of assets that would trigger an HSR filing, the trustee must make the filing, but that the initial waiting period and other procedures operate as if the transfer were a “cash tender offer.” The HSR causes review of cash tender offers to proceed more quickly than review of other transactions, but otherwise works in the ordinary way. The cash tender offer rules are in no way like the super-fast, constrained review under the Administration’s resolution authority bill. See 11 U.S.C. § 363(b)(2); see generally AXINN ET AL., *supra* note 77, at § 7.03[3][a][iii]. In fact, a purpose of the 1994 amendments was to make clear that the agencies retain their power to make second requests even where the seller is a trustee in bankruptcy. See *id.* at § 7.04[3].

The fact that the firm in receivership is “failing” is of antitrust significance only in that, were an acquisition of that failing entity challenged under Clayton Act § 7, the merging parties might be able to raise the so-called “failing firm” defense. On HSR review, the agencies will consider whether a failing firm defense could be raised successfully if an agency were to challenge a transaction under § 7. A persuasive failing firm argument might cause the agencies to terminate an HSR review more quickly than they otherwise would, but the availability of the defense does not otherwise alter the HSR process. See U.S. DEP’T OF JUST. & FTC, HORIZONTAL MERGER GUIDELINES § 5 (1997).

there is a serious possibility under the bill as written that that might amount to only whatever information the FDIC decides is enough.<sup>80</sup>

### C. Competitive Consequences

However infrequently the government might use its new powers under the Act, any government remedy that causes yet further concentration in these already highly concentrated markets should be taken as a grave matter. Indeed, conservator/receiver transactions under the Act will normally involve transactions in which, at least at the national aggregate level, concentration issues are particularly acute. Virtually by definition they will involve the largest entities in already concentrated, interconnected markets, because by definition those entities will be systemically significant.

Incidentally, while the Resolution Bill does not explicitly exempt or affect the antitrust treatment of collaborative conduct, it is relevant to that conduct. Elementary theory suggests that collusion is easier the fewer competitors there are in any given market.<sup>81</sup> If the bill facilitates more consolidation then it will aggravate the risk of collusion.

1. *Incorporation of Bank Merger Law.* Because the Resolution Bill deals with competitive issues in part by simply incorporating existing bank merger law, assessment

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<sup>80</sup> A possibly serious issue of interpretation under the Resolution Bill is whether the agencies could have any say at all in how much information must be included with the HSR-1 filing. Under current law, the agencies can deem an initial filing incomplete and demand a revised filing, in which case the statutory time period does not begin until the subsequent filing is made. 16 C.F.R. § 803.10(c)(2). But the bill provides that once the filing is made (which presumably would be made on Form HSR-1), the waiting period “shall expire not later than the 30th day following such filing,” and that once the filing is made, “no further request for information . . . shall be permitted.” This might indicate that no matter what information is included, the agencies would have no recourse to deem the filing incomplete.

<sup>81</sup> See U.S. DEP’T OF JUSTICE & F.T.C., HORIZONTAL MERGER GUIDELINES § 2.1 (1997); DENNIS W. CARLTON & JEFFREY M. PERLOFF, MODERN INDUSTRIAL ORGANIZATION 132-45 (3d ed. 2000); George Stigler, *A Theory of Oligopoly*, 72 J. POL. ECON. 44 (1964).

begins with the existing system. Criticism of that system has been extensive.<sup>82</sup> It has focused in large part on the substantive standard the regulators follow, first formulated during the sharp narrowing of antitrust enforcement of the 1980s and ultimately codified by agreement among DOJ and the bank regulatory agencies in 1995.<sup>83</sup> While nominally that standard is more or less the same ordinarily applied under Clayton Act § 7 and HSR, DOJ and the bank regulators have decided that the only serious competitive issues in bank mergers concern the credit needs of small and mid-sized businesses. In the regulators' view both consumers and large business have sufficient alternatives for their needs that consolidation in those areas simply will not restrict competition.

Accordingly—while in and of itself this fact is not a criticism—DOJ's actual enforcement of antitrust against bank mergers is vanishingly slight. DOJ has not formally challenged a bank merger since 1993, and on average it requests divestiture concessions in only about one out of the 1000 or more bank mergers it reviews each year.<sup>84</sup> Somewhat more directly in critique of the agencies' approach is the poor economic performance of most of the large bank mergers and especially the super-sized conglomerate mergers that they approve. That performance is important because a guiding premise of bank merger law has been the conviction that larger banks, other things equal, are more economically efficient and desirable than small ones. That is, the

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<sup>82</sup> Peter C. Carstensen, *A Time to Return to Competition Goals in Banking Policy and Antitrust Enforcement: A Memorandum to the Antitrust Division*, 41 ANTITRUST BULL. 489 (1996); Peter C. Carstensen, *Restricting the Power to Promote Competition in Banking: A Foolish Consistency Among the Circuits*, 1983 DUKE L. J. 580; Felsenfeld, *supra* note 5; Margaret E. Guerin-Calvert, *Current Merger Policy: Banking and ATM Network Mergers*, 41 ANTITRUST BULL. 289 (1996); *See generally* AMC REPORT, *supra* note 12, . at 363-64 (criticizing all statutory limits on merger review in regulated industries, calling for full application of Clayton Act § 7 and the HSR to all such mergers, and calling for full competition review authority as to such mergers to be returned to the antitrust enforcement agencies).

<sup>83</sup> That policy is contained in DOJ REVIEW POLICY, *supra* note 65.

<sup>84</sup> Gregory J. Werden, *Perceptions of the Future of Bank Merger Antitrust: Local Areas Will Remain Relevant Markets*, 13 FORDHAM J. CORP. & FIN. L. 581, 582 (2008) (reviewing records of DOJ bank merger reviews).

currently very permissive approach effectively begins with a strong presumption that mergers will be efficiency enhancing. In quite a lot of these mergers that premise is evidently false, and there being no pro-competitive motive for these transactions the question remains what their other motives might be and whether they should have relevance to an antitrust policy.

Indeed, while large bank and financial institution mergers tend not to produce anything *good* for the economy, they do appear to give merging parties some market power. This may be true not only as a consequence of immediate increase in concentration in those local markets to which the current merger review policy is calibrated. As my collaborator Peter Carstensen has frequently pointed out, there may be significant constraints associated with the fact that local branches in a given market are acquired by a national firm, even if the acquisition does not cause any substantial, immediate change in concentration there.<sup>85</sup> Moreover, it is now widely accepted in the industrial organization literature that firms that experience multiple contacts—firms that compete in many markets, and face each other in more than one—are more prone to oligopolistic interdependence than might otherwise be thought to be the case on the basis of concentration levels alone.

But, as mentioned, a wholly separate concern, that is in some sense a competitive one, is increasing systemic risk and the related problem of increasing numbers of TBTF firms. Even though American law really contains only one, isolated rule that could hope to constrain this problem in banking and financial markets—Clayton Act § 7, as applied through our regime of bank merger law—the government has refused to use it to reduce risk. Indeed, strenuous TBTF objections were made to DOJ in its review of the

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<sup>85</sup> See Carstensen, *supra* note 82.

Citicorp/Travelers merger of 1998—the largest financial merger in history at the time, the first major merger of banking and non-banking businesses since the Great Depression, and one of the largest mergers in world history—but DOJ’s view as that “this [w]as primarily a regulatory issue to be considered by the [Federal Reserve Board.]”<sup>86</sup> The merger was approved in all respects.

2. *The HSR Limitation.* The transactions at issue are certain to be complex, because by definition the firms at stake will be systemically significant and are likely to hold massive assets throughout the entire world. Moreover, the risk of getting the analysis wrong is significant. The assets to be sold will be large and the buyer will ordinarily be a very large competitor (or else it would lack the resources to buy all or part of a systemically significant financial holding company) that might be well positioned to use them to anticompetitive ends.<sup>87</sup> Bear in mind that the two federal agencies that perform HSR review are already responsible for oversight of *every other significant merger and acquisition in the entire U.S. economy*. It is hard to imagine how they could provide any meaningful check on anticompetitive transfers under these circumstances.

3. *In Application.* Having laid out all that regulatory detail, let us consider a practical example. The company that is now Citigroup has been the beneficiary of four different, ad hoc government bailouts since the Great Depression. Assuming that it can regain stability following the current rescue, it will remain an immense entity. Though it has shed some of the assets that as of 1998 made it the largest financial firm in world history—most importantly the Travelers insurance company, which it spun off in 2002—

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<sup>86</sup> Kramcr, *supra* note 43, at 6.

<sup>87</sup> As Mr. Krimminger made clear, the FDIC would be obliged in making any transfer to find the highest bidder for the assets in question. But much of the time the highest bidder will be the firm that can use the assets to their most anticompetitive and therefore most profitable end.

and though it intends to sell more, Citigroup retains about 200 million business and consumer customers in more than 140 countries. Along with its core banking business, the company apparently intends to retain a large investment banking operation, a global private banking/wealth management operation, and significant businesses in hedge funds, private equity, and other investment vehicles. Also, though it apparently intends to sell them, for the time being it retains the Smith Barney brokerage firm, the large life insurance and financial services firm known as Primerica, and significant businesses in real estate and consumer finance.<sup>88</sup> But Citigroup remains a severely troubled institution, and if the Resolution Bill were to pass there is no small chance that it would be the first firm put into a federal receivership. If so, when a buyer is found for Citigroup's traditional banking businesses, their transfer would be subject only to review by the FRB under existing bank merger law, and the Resolution Bill would automatically trigger the emergency time periods contained in that law. In other words, the FRB would probably make its decision in about one or two months, and the DOJ would have to provide a "report on competitive factors" *in ten days* of FRB's request for it.<sup>89</sup> These decisions would have to be made about transfer of a firm that, by number of customers, remains the world's single largest bank.<sup>90</sup> Then, when buyers are found for the non-banking parts, DOJ would get a filing on Form HSR-1, which really might include only as much or as little information as the conservator/receiver wants to give, and must decide within 30

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<sup>88</sup> See generally Andrew Martin & Gretchen Morgenson, *Can Citigroup Carry Its Own Weight?*, N.Y. TIMES, Nov. 1, 2009, at BU1 (discussing Citigroup's history of government rescues and its current state); <http://www.citigroup.com/citi/business/> (company website explaining its current businesses).

<sup>89</sup> Resolution Bill §§ 1209(a)(1)(G)(ii)(I) and 1209(h)(10)(A) both trigger this 10-day competition report provision. That provision is also available under existing bank merger law where the responsible bank regulator determines that one of the banks might fail; the Resolution Bill triggers it automatically.

<sup>90</sup> All the same would be true of the many lines of Citigroup's business that are "closely related" to banking, and therefore exempt from HSR, like some of its real estate investment businesses, much of the Smith Barney brokerage business, mergers-and-acquisitions advisory functions, and some other affairs. See 12 C.F.R. § 225.28.

days whether it would be anticompetitive to sell a large range of non-banking assets, including a massive securities underwriting operation and the Primerica firm, which among other things manages tens of billions of dollars of life insurance obligations for six million clients. Finally, if the Treasury Secretary and the FRB Chairman deem there to be emergency conditions, then *all* of Citigroup, one of the world's largest financial institutions, could be sold to one or many buyers *with no antitrust review of any kind*. The last part is the most breathtaking. Recent events make it seem likely that in many cases of failing, systemically significant FHCs the federal government will consider there to be an "emergency."

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All of this criticism, it should be added, is wholly aside from the fact that our antitrust law currently refuses to consider concentrations of *power* as of any relevance. It focuses instead purely on costs and elasticities in narrowly defined relevant markets (as if allocational efficiency were a concept even yet dreamed of by the Congress of 1890). That is a bit of a shame in this context, as many of the major bank and financial holding company mergers since the boom began in the 1980s have been among *the largest consolidations of wealth and power in U.S. history*. Of course, though it was not always so,<sup>91</sup> addressing that concern through antitrust is a ship that for the time being has definitely sailed. But why we have convinced ourselves that the Congress of the United States should be prohibited from caring about concerns of this magnitude, and making them part of some coherent federal policy, is beyond me.

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<sup>91</sup> See, e.g., Robert Pitofsky, *The Political Content of Antitrust*, 127 U. PA. L. REV. 1051 (1979) (article by longtime FTC Chairman and leading antitrust academic, arguing that one of the purposes of antitrust should be to constrain unwelcome concentrations of private *power*, in addition to improving allocational efficiency in specific markets).



One final and completely separate issue deserves mention, as it relates to competition policy. The Resolution Bill contains a special provision that requires the FDIC to consider certain policy goals to guide the use of its powers, and among these goals is the protection of competition. This provision will be irrelevant on any practical level. The Act requires the conservator/receiver to exercise all of its § 1209 powers in accordance with a list of six policy aspirations, *see* § 1609(a)(10)(E), and one of them is to “ensure[] timely and adequate competition and fair and consistent treatment of [potential buyers of the failing BHC],” *id.* at § 1209(a)(10)(E)(v). For two reasons this provision will lack meaning. First, the other five values the conservator/receiver may consider are different, equally vague, and sometimes inconsistent with the competition duty. Most importantly, the conservator/receiver is directed, “to the greatest extent practicable,” to “maximize[] the net present value return from the sale or disposition of . . . assets.” *Id.* at § 1209(a)(10)(E)(i). At least some times the acquiror who would be most willing to pay for assets held by the conservator/receiver will be the one who can use them most anticompetitively, because their use in that acquiror’s hands will lead to supra-competitive profits. Second, the duty is effectively unenforceable by any party that would have any concern for competition. Even assuming there could be a plaintiff with standing, and even assuming judicial review is available,<sup>92</sup> it seems extremely unlikely

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<sup>92</sup> The conservator/receiver would constitute an “agency” under the Administrative Procedures Act (“APA”), and its final actions would therefore ordinarily be subject to judicial review under 5 U.S.C. § 702. However, given the ambiguity and range of discretion implied in these six factors, the conservator/receiver’s asset sales under the Act might conceivably be exempt from review as being “committed to agency discretion by law,” 5 U.S.C. § 701(a)(2). That exception applies to decisions made under “statutes are drawn in such broad terms that in a given case there is no law to apply.” *Citizens to Preserve Overton Park v. Volpe*, 401 U.S. 402, 410 (1971).

any decision of the conservator/receiver would ever be reversed for failure to give effect to these six factors.<sup>93</sup>

### **Conclusion**

Both under the traditional bank merger review and the new, hybrid HSR review, the time constraints and the magnitude of the transactions will ensure that major transactions under the Resolution Bill will not get meaningful antitrust review. This is sufficiently clear to beg the question why the Act fails just to exempt these transactions from antitrust altogether; it is fairly clear that the bill's drafters have no concern for it.<sup>94</sup> Presumably doing so explicitly would have seemed too impolitic. But if outright exemption from antitrust review is in some way a bad thing, then one must acknowledge that the procedures in the Resolution Bill are also inadequate, as they will reach much the same result.

But this reflects a much larger consideration: the Administration's financial regulatory reform package largely ignores competition as any part of any solution. This is a shame, because consolidation and concentration are part of some of the financial sector's worst problems.

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<sup>93</sup> The decision would be subject only to the very deferential standard of review under APA § 706(2)(A), that the decision be upheld unless it was "arbitrary [or] capricious." A decision by a federal agency is "arbitrary or capricious" where (1) the agency failed to consider those factors in making its decision that are made relevant by the underlying legislation, or (2) the agency failed to show that its decision drew some rational connection between facts contained in the record at the time of the decision and the policy actually adopted. *See Overton Park*, 401 U.S. at 416.

<sup>94</sup> *See supra* note 4; *see also* U.S. DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009) (88-page report explaining Administration's financial regulatory reform package, including the Resolution Bill, which never mentions antitrust and only very obliquely discusses competition).

Mr. JOHNSON. Thank you, Professor Sagers.  
Mr. Smith, would you proceed, please?

**TESTIMONY OF EDWIN E. SMITH, BINGHAM McCUTCHEM, LLP,  
ON BEHALF OF THE NATIONAL BANKRUPTCY CONFERENCE,  
FAIRFAX, VA**

Mr. SMITH. Thank you.

Mr. JOHNSON. I think we have an elementary school student handling our audiovisual, so give us just a second.

Mr. SMITH. Can you hear me on this microphone? Why don't I proceed, then? Thank you.

Can you hear me now? Okay. Thank you, Mr. Chairman and Members of the Committee, and my name is Edwin Smith. I am here on behalf of the National Bankruptcy Conference.

For those of you who don't know, the National Bankruptcy Conference is a nonprofit, nonpartisan self-supporting organization of about 60 lawyers, academicians and judges.

We have historically advised Congress on bankruptcy issues, and so we are before you today to talk about the resolution authority issues that are under discussion in the current bill.

Part of our concern as a member of the National Bankruptcy Conference relates to, of all things, avoiding bankruptcy. What we have noticed is that where you start devising back-end rules like you are talking about with the resolution authority, that tends to affect the availability and cost of credit.

To the extent that rules are not transparent, to the extent that they are uncertain, to the extent that they are unfair, what that does is it tends to make lenders more reticent about extending credit or doing so, if they do so at all, at much higher prices.

And we have seen many, many companies avoid bankruptcy because they were able to get credit. They were able to get credit at affordable rates. They were able to address short-term needs. They were able to reorganize.

And one of the things that we really would hate to see in a resolution authority bill are rules that tend to discourage the availability of credit or to increase the price of credit because we are afraid that what that might do is to increase the systemic risk that you are all trying to avoid.

Now, what is it about the resolution authority discussions today that raise these issues as transparency, certainty and fairness? One is if there is going to be a system where there are too-big-to-fail companies that get identified, that should be transparent.

It should be apparent for extenders of credit to know in advance when they are thinking of extending credit whether someone is going to be on the list and, if so, whether they are going to be subject to this entire scheme.

To the extent that they don't know that, then they are going to have to make their credit decisions based on that lack of transparency, and that is going to increase the cost of credit or probably decrease its availability.

We also are looking at certainty. How can these rules create certainty? And one of the things that is of concern is what happens when the Federal agency comes in and it rescues an organization

that is too big to fail. It might find a buyer. It might create some sort of a bridge entity.

But it would take the core systemic risk assets, as we understand them, and put them somewhere else—in a buyer, in a bridge entity. And then there would need to be at that particular point some claims resolution process. There would have to be a way of dealing with the assets that are left behind and the unassumed liabilities.

And those rules are going to have to be very certain. And we think that the bankruptcy rules are actually in much better shape right now to deal with the assets that are left behind than the proposed FDIC rules, which we don't think are as well known, or as developed or as detailed as what you see in bankruptcy.

And then we think the process has to be a fair process. If creditors are concerned that the process is unfair, once again they are going to be reluctant to extend credit or to do so—if they do so, they would do so at a higher price.

We think, once again, the bankruptcy rules for dealing with the assets and unassumed liabilities that are left behind are much fairer to deal with that, not only just because they are more well known and well developed and more detailed, but also there are open proceedings. People get judicial review. The standards for review are much tighter than would be in the case of an administrative proceeding.

And then as a matter of fairness, we have a rule in the bankruptcy code that says where you have a Chapter 11 plan and one creditor would be worse off under the plan than it would be on liquidation, that plan cannot be confirmed. And that was done out of fairness, with constitutional implications.

There should be a similar rule here. If a creditor would get less under these rules that you are devising now—the creditor should be no worse off than it would be if the entity were liquidated, as a matter of fairness.

Thank you, gentlemen.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF EDWIN E. SMITH

Testimony of

**Edwin E. Smith**<sup>1</sup>

on behalf of the

**National Bankruptcy Conference**

before the

**Subcommittee on Courts and Competition**

of the

**House Judiciary Committee**

111th Congress

for Hearings on

**"Too Big to Fail: The Role of Bankruptcy and Antitrust Law in  
Financial Regulation Reform, Part II"**

November 17, 2009

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<sup>1</sup> Chair of the Capital Markets Committee of the National Bankruptcy Conference. Partner and Co-Chair of the Financial Services Area, Bingham McCutchen LLP. The views expressed in this testimony are expressed solely on behalf of the National Bankruptcy Conference and do not necessarily represent the views of Mr. Smith or of Bingham McCutchen LLP or any of its clients.

The National Bankruptcy Conference (the "Conference") appreciates the opportunity to participate in these hearings on financial regulation reform. The Conference is a voluntary, non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

The Conference understands that, given the turmoil in the capital markets following the collapse of Lehman Brothers and the concerns expressed about whether the existing tools available to the federal government are sufficient to address systemic risk following the possible collapse of one or more other large financial institutions in the future, the federal government should have additional tools available to it. In fact, the Conference supports the promulgation of a statutory and regulatory resolution scheme by which federal regulatory agencies would be able to identify a large financial institution (an "identified financial institution") and its affiliates whose collapse would threaten U.S. and international capital markets and by which, in the face of an imminent collapse of the identified financial institution and its affiliates, a federal agency would be equipped and have the power to rescue the core business of the identified financial institution and its affiliates with a view to mitigating or even eliminating that risk.

However, the Conference also believes that whatever resolution scheme is devised must (a) be transparent as to which financial institutions would be subject to the resolution scheme, (b) create certainty for extenders of credit to the identified financial institution and its affiliates by establishing clear rules that would apply to the scheme and (c) provide rules which are fair to creditors of the identified financial institution and its affiliates. Otherwise, credit would be less likely to be available to a financial institution and its affiliates that could be subject to the

resolution scheme or would be less likely to be available at a lower price. In the absence of credit being available or being available at lower price, the Conference is concerned that the financial distress of the financial institution and its affiliates will only be exacerbated, and the risk of a collapse of the financial institution and its affiliates and the systemic risk following that collapse will only be greater.

The Conference expresses this concern, because in its experience many debtors currently eligible for relief under the Bankruptcy Code often avoid bankruptcy by receiving sufficient credit to address immediate needs in the short term and, in the longer term, to achieve rehabilitation outside of bankruptcy. When credit is so extended under these circumstances, often bankruptcy is avoided. If credit that a debtor requires to meet short term needs and to rehabilitate itself is not be available or is available only at a price that makes rehabilitation unworkable, there is a much larger risk that bankruptcy will be inevitable.

Discussed below are the elements of transparency, certainty and fairness that the Conference believes should be considered as an integral part of any such resolution scheme in order not to discourage the extension of credit at manageable rates.

Transparency as to those subject to the resolution scheme

Those extending credit to a financial institution and its affiliates will need to know, before extending credit, whether the financial institution is an identified financial institution. Whether the financial institution is an identified financial institution will be a critical factor that any extender of credit to the financial institution and its affiliates will want to consider in deciding whether to extend credit to the financial institution and its affiliates and on what terms.

An extender of credit will invariably take into account the risk that its debtor will not be able to repay the credit extended. It will make the credit available and price the terms of the

credit based on the statutory and regulatory scheme by which the debtor will be rehabilitated or liquidated if it becomes unable to pay its debts. For example, a lender extending credit to a borrower who is eligible to be a debtor under the Bankruptcy Code will make credit available to the borrower and will price the terms of the credit based on the bankruptcy rules that would apply in the event that the borrower became a debtor under the Bankruptcy Code.

If an extender of credit to a financial institution and its affiliates does not know whether the financial institution is an identified financial institution, it will not know what rules would apply if the financial institution or one of its affiliates experiences financial distress to the point where it must be rehabilitated or liquidated. The result would likely be that the credit extender would need to take into account in its credit decision the possibility that either the resolution scheme for identified financial institutions would apply or the more traditional bankruptcy and insolvency rules, such as those in the Bankruptcy Code, would apply. The multiple sets of rules that might apply in the case of the financial distress of the financial institution and its affiliates would require the extender of credit to examine each set of rules and to base its credit decision on the rules in each scheme that are least favorable to the extender of credit. This approach would likely lead to less credit being extended to the financial institution and affiliates or, if credit is extended, higher pricing and in any event greater transaction costs. And the result would be the case even for a financial institution that is not an identified financial institution, or for one of its one its affiliates, if it appear to extenders of credit as if the financial institution *might* be an identified financial institution.

Accordingly, the Conference urges that the resolution scheme to rescue or liquidate identified financial institutions contain a mechanism by which it will be publicly known whether a financial institution is an identified financial institution. The Conference also urges that the



resolution scheme contain a mechanism by which there is advance notice to the public when a financial institution becomes or ceases to be an identified financial institution.

The Conference recognizes that, if a financial institution becomes an identified financial institution after credit is extended to the financial institution or one of its affiliates, the core salutary value of the advance notice that the financial institution is an identified financial institution will not be as great. The credit decision by the extender of credit will already have been made. But advance notice to the public that a financial institution has become an identified financial institution will still enable the market to adjust over time. The extender of credit will have the opportunity to modify the terms of the credit, if so permitted, or to crystallize its position by selling the credit to a buyer at a price that adjusts for the credit risk.

In any event, to the extent that a financial institution is already subject to prudential regulation, the advance notice of a financial institution being designated as an identified financial institution may be easier to effect and, indeed, may be more predictable to the market.

#### Certainty as to the rules that would apply

It is not only necessary that those extending credit to a financial institution know whether the identified financial institution is an identified institution. They will also need to know with certainty, before extending credit to an identified financial institution and its affiliates, what rules will be applied to the rescue or liquidation of the identified financial institution and its affiliates should a rescue or liquidation become necessary. To the extent that the rules are unclear or underdeveloped, the extender of credit will be uncertain what the rules are and how they will be applied. That uncertainty will also likely decrease the availability and increase cost of credit to the identified financial institution and its affiliates.

The Conference raises this issue primarily with respect to the claims resolution process affecting creditors of an identified financial institution and its affiliates. Once the core, systemic risk related assets of an identified financial and its affiliates are transferred under the resolution scheme to a buyer or to a bridge entity, some assets and unassumed liabilities will invariably be left behind.

There will be significant uncertainty for creditors of an identified financial institution and its affiliates if the creditors will be subject to two different claims resolution sets of rules, including different priority rules, depending upon whether an identified financial institution and its affiliates are the subject of a federal intervention or are debtors in bankruptcy cases without federal intervention. Applying the rules in the Bankruptcy Code for liquidating the assets left behind and distributing the proceeds of the liquidation to creditors of the identified financial institution and its affiliates whose liabilities are not assumed in the transfer would eliminate that uncertainty. There would be one set of rules that would apply for the claims resolution process regardless of whether the identified financial institution and its affiliates were subject to federal intervention or were debtors in bankruptcy cases without federal intervention.

Even beyond avoiding the possible application of two different sets of rules for the resolution claims process, certainty would be more likely to be achieved by using the Bankruptcy Code rules for the claims resolution process. The Bankruptcy Code rules are more detailed than those applicable to a federal bank receivership. For example, the preference rules in the Bankruptcy Code consist of a well detailed section, Bankruptcy Code § 547, that contains the elements of a preference as well as the defenses to a preference claim. Section 550 of the Bankruptcy Code explains against whom a preference claim may be made. Similar details are lacking in a federal bank receivership where the only preference rule is one based on an intent to

prefer. Like concerns exist in the area of secured claims, the computation of the amount of claims, fraudulent transfers, executory contracts and priorities where the Bankruptcy Code rules are much more detailed compared to the rules of a federal bank receivership.

The Bankruptcy Code rules are not only more detailed than those for a federal bank receivership. They have also been stress tested by a very large body of judicial interpretations. This is much less the case for the rules of a federal bank receivership since claims resolution procedures are administrative and the opportunity for judicial review is much more limited.

Furthermore, the rules of the Bankruptcy Code are well known to judges and to lawyers and other professionals. The Bankruptcy Code and its rules of procedure are widely published, are interpreted by published cases, are studied in law schools and are the subject of numerous periodicals. This is not nearly the case for rules of a federal bank receivership.

It is understandable that the rules for a federal bank receivership are not as detailed, well developed or well known as those applicable to federal bankruptcy case. In most federal bank receivership, once depositors are paid, there are few, if any, assets left to pay general unsecured creditors. As a result, there has been less of a need for the rules of a federal bank receivership to be as detailed, developed and well known as the rules applicable in a bankruptcy case. But under the resolution scheme being considered there may be substantial assets of an identified financial institution and its affiliates left behind to be liquidated and distributed to the creditors of the identified financial institution and its affiliates. The need under this scheme for the rules to be detailed, well developed and well known is much more acute if greater certainty for creditors is to be achieved. The Conference believes that the Bankruptcy Code rules, being detailed, well developed and well known, already provide that greater certainty.

Fairness to creditors

The rules by which creditors are treated when a financial institution and its affiliates are rescued or liquidated must be fair. If the rules are regarded as unfair, there will be much less of a willingness for credit to be extended to identified financial institutions and its affiliates or for credit to be extended at cheaper rates.

The Conference regards the Bankruptcy Code rules for resolving claims against an identified financial institution and its affiliates as being inherently more fair than those applicable to a federal bank receivership. This is certainly true merely because the Bankruptcy Code rules are more detailed, developed and well known than the rules for a federal bank receivership. But it is also true with respect to the standards used in claims resolutions. In an administrative process, the administrator is given broad latitude in making decisions short of acting in an arbitrary or capricious manner. Under the Bankruptcy Code the bankruptcy judge applies the law and the facts and can be reversed by an appellate court on the merits even though the bankruptcy judge had not acted in an arbitrary or capricious manner.

Speed of resolution is also a factor in fairness. A creditor whose claim is resolved quickly will feel more fairly treated than a creditor whose claim is resolved only after a lengthy process. The Conference believes that the Bankruptcy Code procedures are more likely to resolve claims quickly than an administrative process. With an administrative process the creditor will need to exhaust administrative remedies before seeking judicial intervention. Under the Bankruptcy Code judicial intervention is available at the outset.

There is also the view that the Bankruptcy Code claims resolution process is fairer because it is more transparent. Claims are litigated in open court and with a public record. Each creditor has an opportunity to observe how other creditors are being treated and to make its case to the court if its believes that is not being treated fairly with respect to other creditors. This is:

may be less true for administrative procedures associated with a federal bank receivership where proceedings are not as public and the record of the proceedings is not as accessible.

There is one other fairness issue that merits discussion. While some compromise of a creditor position may be necessary for the greater good of the financial system, the compromise should not be without limits. In a Chapter 11 case under the Bankruptcy Code a plan of reorganization cannot be confirmed over the objection of a single creditor if that creditor is not receiving as much under the plan as it would receive if the debtor were liquidated a Chapter 7 case. This provision is grounded in a notion of fundamental fairness, with Constitutional implications.

As matter of fundamental fairness, there should be similar limited protection for creditors of an identified financial institution and its affiliates. The resolution scheme should not be used in such a way so as to deprive a creditor of what the creditor would have received had the identified financial institution and its affiliates been liquidated without federal intervention under the scheme. The resolution scheme should provide a mechanism for making the determination of what the creditor would have received in a liquidation of the identified financial institution and its affiliates and for compensating the creditor to the extent that the creditor is receiving less under the resolution scheme.

#### Conclusion

Without the resolution scheme providing these elements of transparency, certainty and fairness, the Conference is concerned that credit will be less available to identified financial institutions and their affiliates or will be available at a higher price and that, as a result, the very risks that the resolution scheme wishes to avoid will be more likely to occur.

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Mr. JOHNSON. Thank you, Mr. Smith.  
Now we will hear from Mr. Rosenthal.

**TESTIMONY OF MICHAEL A. ROSENTHAL,  
GIBSON, DUNN & CRUTCHER, LLP, NEW YORK, NY**

Mr. ROSENTHAL. I will try to use—let me try to use this microphone. It seems to be better.

Chairman Johnson, other Members of the Subcommittee, thank you for inviting me to testify today. I have spent 30 years in my legal career focusing on representation of financially distressed debtors and their creditors in a wide variety of industries.

I believe that in addition to crafting a resolution regime that assures that there is no institution that is too big to fail, there should be two overarching goals of the legislation.

The first relates to flexibility. We need to give the government the ability to act quickly to construct solutions to problems with these companies.

The second, though, relates to predictability. Market stability requires predictable results. And if creditors are unable to rely on the predictability of expected returns, they may either restrict credit extensions, as Mr. Smith said, or extract excessively high risk premiums.

While reform is clearly complicated, I firmly believe the foundation for reform should be the simple principle that absent compelling public policy reasons to the contrary, we should base a new system as much as possible on what market participants know, understand and have relied on.

The new system must accomplish the goal of managing or restoring market stability, but do so in a way that does as little violence as possible to creditor expectations.

Congress essentially has two existing regimes to choose from, the FDIA, which is used to resolve bank failures, and the bankruptcy code, which is used to resolve virtually all other business failures.

The proposed legislation draws primarily from the FDIA but, in my view, could benefit significantly from the adoption of more features of the bankruptcy code.

In part, this is because the bankruptcy code's concepts, including those that govern the judicial review of creditor claims, work better in the face of a system-shaking failure of a non-bank entity.

And in part, this is because creditors of these companies understand and have structured and priced their transactions on their expectations about the application and the predictability of the bankruptcy code.

The revisions to the legislation that I have proposed, taken together, create a hybrid between the FDIA and the bankruptcy code. They marry the bankruptcy code's basic creditor protections, including judicial review, transparency, predictability, with the FDIA's flexibility to address quickly the systemic repercussions of the failure of a significant financial entity.

There are two distinct phases of a covered financial company's collapse which must be addressed by the legislation. The first is the initial phase, which is the crisis, where the FDIC must be given flexibility and discretion to act quickly and decisively to avert the crisis.

We have proposed that during this 30-or-so-day-period, short period, the FDIC could act without contemporaneous oversight by a court. But after the financial crisis has been averted, a second

phase of the process begins. During this second phase, the FDIC must administer the underlying liquidation of the failed entity, including resolution of any disputes with creditors.

We have proposed that the FDIC's actions during this second phase would be subject to the oversight of the bankruptcy court. The bankruptcy court would apply the same procedures, precedents and adjudicative process that it employs every single day and that market participants already know, understand, rely on and expect.

Time doesn't permit a discussion of the other specific changes that I have recommended, but they are summarized in my testimony and its—and its attachments.

These changes include incorporation of the bankruptcy code's concepts regarding claim determinations, preference in fraudulent conveyances, contract rejections, reporting, valuation and treatment of secured claims.

While you might ultimately enact a resolution system that is more administrative in nature than I have outlined, I encourage you even then to implement as many of the recommendations as possible to minimize the disruption to creditors' expectations.

I commend the Committee for taking the time to consider this important topic and, again, appreciate the opportunity to speak with you today.

[The prepared statement of Mr. Rosenthal follows:]

PREPARED STATEMENT OF MICHAEL A. ROSENTHAL

**Testimony of  
Michael A. Rosenthal  
Co-Chairman, Business Restructuring and Reorganization Practice Group  
Gibson, Dunn & Crutcher, LLP**

**before the  
Subcommittee on Courts and Competition Policy  
of the  
House of Representatives Committee on the Judiciary  
for its Hearing on: Too Big to Fail —  
The Role for Bankruptcy and Antitrust Law in Financial Regulation Reform, Part II**

**November 17, 2009**

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Chairman Johnson, Ranking Member Coble, other Members of the Subcommittee, thank you for inviting me to testify before you today. My name is Michael Rosenthal and I am the Co-Chair of the Business Restructuring and Reorganization Practice Group at the law firm of Gibson, Dunn & Crutcher LLP.

I have been in practice for over 30 years and have spent my entire career in the distressed restructuring field representing debtors, creditors, and distressed asset sellers and acquirers in a wide variety of different industries. During this recent financial and credit crisis, my colleagues and I have been active in representing and providing advice to entities regarding their rights and exposure related to difficulties in the financial services sector, including issues related to loan restructurings, spin-offs, derivative products, securitizations, and customer account issues. Among others, I am presently representing PricewaterhouseCoopers AG, Zurich, in its capacity as bankruptcy liquidator for Lehman Brothers Finance, SA, and various other large, public companies in the chapter 11 and related cases involving Lehman Brothers and its affiliates, as well as certain directors of DaimlerChrysler in connection with the Chrysler bankruptcy. I want to note that the views I express today are my own and that they do not necessarily reflect the views of my firm or the firm's clients.

I want to applaud the subcommittee for addressing this critically important - and highly technical - issue today. While many other issues associated with financial regulatory reform have received more attention, no issue is of greater importance to the stability of our financial markets.

I appreciate the opportunity to be heard on this crucial issue, and believe that there are two over-arching goals of the proposal. The first relates to flexibility: we need to give the government the ability to act quickly to construct solutions, and to ensure that no institution is too big to fail. The second relates to predictability: market stability requires predictable results, particularly when times are bad, and particularly when the results relate to financial actors that do business across broad bands of our economy.



We all recognize that creating a system to manage the failure of our largest financial participants, if done right, is extremely complicated. The incredible diversity of transactions in which systemically-significant institutions engage in today's marketplace demands a highly nuanced and transaction-specific approach to resolve the rights of creditors, debtors, and taxpayers, and at the same time, preserve systemic stability.

But there are also first principles that set the foundation on which reform is built. And we need to get these right or the structure will not stand the test of time, and future financial crises. Let me talk about one key principle on which a new resolution authority regime can be built, and then discuss other, more specific points as time permits.

The key principle is this: market stability. Absent compelling public policy reasons to the contrary, we should base a new system, as much as possible, on what the market knows and understands. As Congress considers how to construct a system for resolving systemically-significant institutions, it has two existing regimes to choose from -- the Federal Deposit Insurance Act, which is used to resolve banks, and the Bankruptcy Code, which is used to resolve virtually all other businesses that fail.

I believe that, while both regimes are appropriate in certain circumstances, the proposed legislation could benefit from the adoption of more features of the Bankruptcy Code. In part, this is the case because the Bankruptcy Code has features, including those that govern the judicial review of creditor claims, that work better in the face of a system-shaking failure, and in part because businesses and other creditors throughout the economy are familiar with the Bankruptcy Code, and see it as more stable and predictable.

While the FDIA and the Bankruptcy Code have many similarities in treatment of claims, the credit markets would not - and indeed, could not - assume that creditor claims would receive identical treatment under the FDIA. As a result, under current proposals, credit would be needlessly displaced for at least several years while the law and rules of the new regime were worked out through practice.

Bankruptcy courts adjudicate claims disputes as part of their day to day responsibilities. Bankruptcy courts determine these disputes in a transparent, predictable and expedited fashion, pursuant to established procedures and governed by an already well developed body of case law. Market participants understand, and have structured and priced their transactions on their expectations about these procedures and precedents. These expectations regarding how their claims will be dealt with under the Bankruptcy Code are essential to their ability to manage systemic, industry and counterparty risk so that they are not forced to deal with the double impact of the financial crisis along with the destabilization of their own unexpected losses and uncertainty. This ability to foresee, plan and reserve for known risks is crucial to overall market stability. Absent being able to rely on those expectations, markets are likely to contract in the face of uncertainty, as we saw after the bankruptcy of Lehman Brothers, and market stability will take longer to restore, in part because market participants will have to plan for a more uncertain regime, even where the likelihood of being under it is extremely low, in terms of determining pricing and other terms for new transactions. Therefore, the dispute resolution process under the

new regime should follow the Bankruptcy Code's established procedures and precedent to the greatest extent possible.

Our proposed revisions, taken together, would create a hybrid between the FDIA and the Bankruptcy Code, by incorporating some of the basic creditor protections provided by the Bankruptcy Code, including judicial oversight, predictability and transparency, which are crucial to maintaining market stability, while still empowering the federal agency with the flexibility to address the failure of systemically significant financial companies quickly to minimize adverse systemic repercussions. While you might ultimately embrace a resolution system that is more administrative in nature than what we have recommended, I encourage you, even then, to incorporate into that system as many of these recommendations as possible and, particularly, those that implement best what market participants already know, understand and expect, such as access to ready and effective judicial review with established precedent and rules, especially with respect to claim determinations, transparency, adequate protection, contract rejection and avoidance rules similar to those in the Bankruptcy Code.

In view of the scope and complexity of the issues you are addressing, my colleagues and I have prepared a set of materials, which are appended hereto, which we ask that you include in the record of this hearing. These materials are (a) an Overview Memorandum and (b) a side-by-side chart comparing the Bankruptcy Code, Federal Deposit Insurance Act, and the Senate Banking Committee's recently proposed legislation addressing Enhanced Resolution Authority as part of the Restoring American Financial Stability Act of 2009 (the "Bill"). We hope these background materials will be of use to you as you consider the best ways to restore market stability in times of systemic financial crisis. We see these materials as works in progress and will continue to revise them, and to that end we welcome any and all thoughts you may have.

#### **Key Determinations**

We have identified two main sets of issues that we believe should be addressed by policymakers as the proposed legislation moves forward. The first set of issues relate to flexibility, by giving the FDIC or other federal agency the authority it needs to act quickly to avert a financial crisis, and the extent to which it will be empowered to take such actions (the crisis powers) without oversight by a court.

The second set of issues relate to maintaining market stability, by providing predictable rules and processes by which the covered financial company will ultimately be liquidated after the FDIC or other federal agency has transferred or sold such company's assets or taken other actions to avert a financial crisis. This second set of issues highlights the rights of creditors and other counterparties, how disputes will be resolved and who will administer the covered financial company and/or bridge company after the crisis has been averted.

In our recommendations, we have focused on a hybrid approach, which gives the FDIC or other federal agency flexibility and discretion to act as it determines is necessary for the first thirty days of the resolution process without intervention by any supervising court. After the initial "crisis" period, the liquidation and claims process would continue to be managed by the FDIC or other federal agency, but under the oversight of a supervising court, which we believe should be the bankruptcy court applying procedures and precedent of the Bankruptcy Code, which market participants already know, understand and expect.

### Summary of Proposed Changes

Let me walk us through some of the specific changes that we recommend to the proposed legislation. These are all designed to provide the FDIC or other federal agency with the flexibility required to ensure systemic stability, and at the same time protect as much as possible market predictability and legitimate creditor expectations:

1. **The Exclusive Period:** The Bill empowers the Treasury to appoint the FDIC or other federal agency with exclusive authority, broad discretion and power to address systemic risk and to resolve the business of a covered financial company. In order to give the FDIC, or other federal agency, both flexibility and discretion to act at the commencement of a case involving a covered financial company, we have suggested amending the Bill to include an initial thirty (30) day exclusive period during which the FDIC or other federal agency can make decisions and take actions for the covered financial company that are outside the ordinary course of business, with Treasury approval, but without approval from the supervising court (the "Exclusive Period"). Treasury can extend the Exclusive Period for up to 3 additional fifteen (15) day periods upon a request from the FDIC or other relevant federal agency.

Based on the disclosure required in Section 3 (below), and as described in Section 2 (below), for a limited period of time after the Exclusive Period, decisions made and actions taken by the FDIC or other federal agency during the Exclusive Period can be reviewed by the supervising court and creditors injured by those decisions and actions can seek redress. However, a sale or transfer to a third party purchaser or transferee acting in good faith cannot be reversed.

2. **Judicial Review:** In order to give creditors of Covered Financial Companies quicker and more direct access to judicial review of claims determinations by the FDIC or other federal agency, we have suggested revisions to allow direct review of decisions by such resolution authority by a supervising court. The United States Bankruptcy Court for the judicial district in which the chief executive office, assets or center of main interests of such covered financial company are located, or where it is incorporated, would be likely candidates to be the supervising court. After the Exclusive Period, the actions of the FDIC or other federal agency for the covered financial company that are not in the ordinary course of business must be approved by the supervising court after notice and a hearing, and such court would have sole jurisdiction over all matters with respect to the covered financial company. Any actions would be on adequate notice to creditors, so that they will have an opportunity to be heard.

3. **Transparency and Disclosure:** We have suggested requiring the covered financial company, through the FDIC or other federal agency, to file schedules of assets and liabilities, and a statement of financial affairs, in essentially the same form as would be required in a case under the Bankruptcy Code. The schedules and statement of financial affairs would be required to be filed within thirty (30) days after the termination of the Exclusive Period in sufficient detail to enable the judicial review described in paragraph 2 (above). In addition, the covered financial company, through the resolution authority will be required to file a report detailing any assets or liabilities transferred to a Bridge Company, within five (5) days of such

transfer. All of these documents, together with other information typically required in a bankruptcy case, would be publicly available.

4. **Treatment of Creditors and Claims:** The Bill provides that the maximum liability that the FDIC or other federal agency would have as receiver to any person having a claim against it will be what such claimant would have received in a liquidation under the Bankruptcy Code. We have suggested revisions to the Bill to more closely provide to creditors the same rights that they would have if the covered financial company were liquidated under chapter 7 of the Bankruptcy Code. These rights include rights with respect to claims procedures, avoidance actions, priority of distribution, and the right to be heard by the supervising court regarding claims disputes.

5. **Treatment of Secured Claims and Security Entitlements:** We have revised the Bill to include a methodology to ensure protection of secured claims. The proposed adequate protection provisions in the Bill require that secured creditors receive at least what they would have received if the covered financial company had been liquidated under chapter 7 of the Bankruptcy Code (i.e., the value of their collateral). We have included language to ensure that this determination would generally be made pursuant to the same principles used to satisfy the best interest test under section 1129(a)(7)(A)(ii) of the Bankruptcy Code, and would be subject to review by the supervising court if the secured creditor disagrees with the determination by the FDIC or other federal agency.

6. **Valuation:** As described above, the Bill caps the FDIC or other federal agency's liability to any creditor at the liquidation value of the creditor's claim, taking into consideration the value of any collateral that secures such claim. The Bill does not clearly identify the methodology used to value the collateral. We have revised the Bill to provide that collateral is valued by the methodologies used in cases under the Bankruptcy Code. A creditor may dispute the valuation of its secured claim, and such dispute will be determined by the supervising court using methods applicable in cases under the Bankruptcy Code.

7. **Disputed Claims:** The Bill provides that the FDIC or other federal agency will determine claim amounts, but is not clear as to whether there would be any judicial review of such determination. We have revised the proposed language to clarify that the FDIC or other federal agency will make the initial determinations regarding the amount and validity of creditors' claims, and to provide that any creditor that disagrees with this determination is entitled to an expedited judicial determination of its claim by the supervising court.

8. **Preferences and Fraudulent Transfers:** The Bill provides that the FDIC or other federal agency may avoid transfers made in contemplation of insolvency or where there is an intent to hinder, delay or defraud the covered financial company or its receiver (whether the FDIC or other federal agency), however, these standards are not defined. As such, we have suggested that the fraudulent conveyance provisions of the Bankruptcy Code be adopted in the Bill to take advantage of the extensive body of case law governing fraudulent transfers. The Bill does not provide for reversal of transactions that would be preferences under the Bankruptcy Code. We suggest that the Bankruptcy Code preference provisions also be incorporated in the Bill.

9. **Automatic Stay and QFCs:** Given the complexity and the number of QFCs to which a covered financial company will likely be a party, this is one area where we believe the current treatment under the Bankruptcy Code should be carefully considered. We agree that the automatic stay on the exercise of contractual termination, liquidation and netting rights, based on the appointment of the FDIC or other federal agency as receiver or the insolvency or financial condition of the covered financial company, should apply for three (3) days, while the FDIC or other federal agency determines whether to terminate or transfer the QFCs of the covered financial company. We suggest giving the FDIC or other federal agency the ability to guarantee obligations under a QFC so that contracts that are valuable to the estate can be maintained. In the event the FDIC or other federal agency either guarantees or transfers a QFC, the counterparty would no longer be entitled to terminate, liquidate, or net such contract solely by reason of the appointment of the FDIC or other federal agency as receiver, or the insolvency or financial condition of the covered financial company.

10. **Contract Assumption/Rejection:** We suggest that the Bill incorporate the Bankruptcy Code's provisions regarding assumption, assignment and rejection of executory contracts and unexpired leases, including the treatment of rejection damage claims and the limitations on the types of contracts and leases that can be assigned.

11. **Precedent and Rulemaking:** The Bill authorizes, but does not require, that the FDIC or other federal agency prescribe comprehensive rules and regulations to implement the Bill. To provide greater certainty to creditors, we recommend that comprehensive rules and regulations be required to be promulgated. We would encourage you to require the FDIC or other federal agency to use notice and comment rule making for any rules that it promulgates. In addition, we suggest that relevant precedent under the Bankruptcy Code and Bankruptcy Rules be used to govern a proceeding involving a covered financial company.

Mr. Chairman, distinguished Members of the Subcommittee, you have an important task at hand. I commend you for taking the time to see that it is accomplished thoughtfully, and with the goal of promoting market stability in good times as well as bad.

Once again, I want to express my appreciation for the opportunity extended by the Subcommittee to testify at this Hearing, and I welcome any questions that you have, either at this time or later in the process.

## ATTACHMENT 1

GIBSON, DUNN &amp; CRUTCHER LLP

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**OVERVIEW OF RESOLUTION AUTHORITY FOR LARGE,  
INTERCONNECTED FINANCIAL COMPANIES ACT OF 2009**


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*Last revised: November 14, 2009*

## INTRODUCTION

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On October 27, 2009, the House Financial Services Committee and Treasury Department released a revised draft of the legislation titled the Resolution Authority for Large, Interconnected Financial Companies Act of 2009 and on November 10, 2009, the Senate Banking Committee released the Title II Enhanced Resolution Authority provisions in the Restoring American Financial Stability Act of 2009 (the "Bill").<sup>1</sup> Both drafts respond to the view that the federal government lacked adequate legal tools in 2008 to deal with the impending failures of major non-bank financial companies, including

AIG and Lehman Brothers, and that the absence of such tools significantly worsened disruptions to the financial system and the economy. The proposed legislation would break new ground by creating a non-Bankruptcy Code framework for providing both financial assistance to help failing and failed bank holding companies and operational assistance in managing the reorganization or liquidation of such large, systemically connected companies.

The proposed legislation is modeled after the "systemic risk exception" of the Federal Deposit Insurance Act (the "FDIA"). This exception was also used as the model for the Housing and Economic Recovery Act enacted in July 2008 (the "HERA"), which strengthened regulations and injected capital into Fannie Mae/Freddie Mac. The Bill empowers the Treasury to appoint the Federal Deposit Insurance Corporation (the "FDIC") or in some cases another entity for resolving a covered financial company ("CFC"), with broad discretion and power to manage such a company and to minimize the resolution's impact on the U.S. economy.

Treasury Secretary Tim Geithner, Member of the Board of Governors of the Federal Reserve System Daniel K. Tarullo, and FDIC Chairman Sheila Bair testified before the House Financial Services Committee on October 29, 2009, in support of the creation of a resolution regime for bank holding companies and other financial companies. In his testimony, Secretary Geithner highlighted the need for better tools to manage future financial crises. He stated that "in all but the rarest of cases, bankruptcy will remain the dominant tool for handling the failure of non-bank financial firms" and that the administration's proposal "produces a strong, accountable supervision of all our major financial firms and imposes costs not on the taxpayer but with the risk-takers where they belong." He also said that the proposal would "[make] sure that taxpayers are not on the hook for any losses that might result from the failure and subsequent resolution of a large financial firm" as it gives the government "the authority to

<sup>1</sup> Both drafts are very similar with respect to the Enhanced Resolution Authority provisions, but we will primarily reference the Senate Banking Committee draft. Where there are significant differences between the drafts, we will highlight these, and will also reference earlier drafts of the legislation as needed.

## GIBSON, DUNN &amp; CRUTCHER LLP

recoup any such losses by assessing a fee on large financial firms.” He predicted that this would reduce moral hazard by making the owners, creditors and counterparties who would bear these costs more vigilant and prudent.

Governor Daniel K. Tarullo, in his statement on October 29, 2009, also supported the Administration’s proposal and stated that it provides the government with important new tools to restructure or wind down a failing firm in a way that passes losses to shareholders and creditors of the firm while mitigating the risks to financial stability. These tools would allow the government to sell assets, liabilities, and business units and transfer systemically significant operations to a new bridge entity. He reiterated that the Federal Reserve Board (“Fed”) should retain its long-standing authority to address broader liquidity needs when necessary to maintain financial stability, stating that, in the recent crisis, the Fed’s ability to establish broad-based liquidity facilities proved critical in containing the severe market pressures that threatened the financial system as a whole. It should be noted that the Bill proposed by the Senate Banking Committee foresees the creation of a new agency, the Financial Institutions Regulatory Administration (“FIRA”), which would take the role provided for the Fed under the Administration’s proposed legislation.

Chairman Bair expressed support for using a credible resolution authority to increase market discipline, where stockholders and bondholders would bear the losses. She supported imposing some haircuts on secured creditors to promote market discipline, limit costs to the receivership and distribute market losses more broadly, stating that the priority protection given to secured creditors under the Bankruptcy Code and the FDIA creates incentives to rely excessively on short-term secured financing, with creditors “looking more to the value of their collateral than the credit worthiness of counterparties in making credit decisions.” She continues to support the creation of a pre-funded resolution fund created from *ex ante*, risk-based assessments, which would be managed by the FDIC. She also highlighted that *ex post* funding would not be risk-sensitive, might take capital out of other institutions when they can least afford it, and would excuse the failing institution from ever paying an assessment.

To understand the proposals by the Administration and the Senate Banking Committee, it is useful to compare them not only to the FDIA but also to the federal Bankruptcy Code (the “Code”). By displacing the Code as the legal framework for resolving CFCs and their subsidiaries, the proposed legislation raises a number of legal and practical issues concerning how the resolution of such companies would unfold and how this new regime would affect counterparty expectations for dealings with CFCs experiencing financial distress. If the new legislation were to create significant new uncertainties among market participants, the terms, pricing and valuation of past and future transactions would potentially be affected. A Federal Reserve memorandum accompanying a previous alternate version of the Bill noted that the “resolution regime directly and significantly affects preexisting contractual and property rights. While this regime must be outside the Bankruptcy 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*.” Our analysis of these proposals will consider how they might apply to a wide range of companies that now operate based on the assumption that they would be subject to the Code and the extent to which the Bill approach would effect substantial changes to the Code outcome or, alternatively, provide substantially parallel results to the Code by different methods.

This memorandum summarizes the principal features of the Bill and the powers available to the FDIC in resolving a CFC failure. It compares the principal elements of the Bill with the FDIA and then with the Code. In doing so, it is our hope to provide more insight into the changes the Bill may bring to the financial regulatory landscape.

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This overview has a companion piece—a Gibson, Dunn & Crutcher LLP side-by-side that compares significant provisions of the Bill with parallel provisions (if any) of the Code and FDIA. It will be referred to herein as “Chart A.”

## CURRENT LAW

**Current Law:**

- **FDIA** – Governs FDIC-insured banks and thrifts.
- **SIPA** – Governs regulated broker-dealers that are members of SIPC.
- **State Insurance Laws** – Govern state insurance companies.
- **Bankruptcy Code** – Governs most non-regulated entities.

Under the current regime, no single set of laws controls the governance of the restructuring and liquidation of a financial company and its unregulated parent or subsidiaries, which can result in uncertainty.<sup>2</sup> The FDIA governs FDIC-insured banks and thrift companies and is administered by the FDIC. The Securities Investor Protection Act (“SIPA”) and chapter 7 of the Code govern broker-dealers that are members of the Securities Investor Protection Corporation (“SIPC”). State insurance insolvency and guaranty laws, which vary from state to state, govern the liquidation and reorganization of regulated insurance companies. Finally, the Code governs the liquidation and restructuring of most non-regulated entities, including holding companies and affiliates of regulated financial firms. Generally, the proposed Bill would mean that while the Code continued to generally apply to large, systemically significant financial companies, in certain situations, such companies could be subjected to a separate regime.

## SUMMARY OF THE BILL

**Commencing a CFC Resolution.****The resolution authority applies to a “Financial Company,” which includes:**

- A company which has control over any bank or over any company that is a bank holding company or is predominantly engaged in financial activities for the purpose of the Bank Holding Company Act of 1956.
- A company designated in section 102 of the Restoring American Financial Stability Act of 2009 as a “specified financial company” subject to heightened prudential supervision; or
- Any subsidiary of the above (other than an insured depository institution, registered broker or dealer or an insurance company).

Under the Bill, initiation of the resolution regime begins when the FIRA and the FDIC (or the SEC if the CFC or an affiliate is a broker-dealer) issue a written recommendation for the initiation of the proceedings. The recommendation requires the 2/3 vote of the FIRA board then serving and the 2/3 vote of the members of either the FDIC or the SEC, as applicable.<sup>3</sup> The Secretary of the Treasury (in consultation with the President) must then determine that (a) the CFC is “in default or is in danger of default,” (b) failure of the CFC and its resolution under otherwise applicable federal or state law would have serious adverse effects on the financial stability or economic conditions in the United States and (c) actions by the FDIC would avoid

<sup>2</sup> For example, Lehman Brothers Holdings Inc. (“LBHI”), the parent of Lehman Brothers Inc. (“LBI”), a regulated broker-dealer, is the subject of a chapter 11 case under the Code, while LBI is the subject of a chapter 7 case and a SIPA proceeding administered by the same bankruptcy court hearing the LBHI case. Similarly, the FDIC resolutions of Washington Mutual Bank and IndyMac Bank are accompanied by chapter 7 liquidation cases under the Bankruptcy Code at the parent holding company levels.

<sup>3</sup> The Administration proposal would have the Fed in the role of FIRA. As such, it would be the Fed rather than FIRA who would determine whether to issue a recommendation that the CFC be the subject of a resolution.



or mitigate such adverse effects. If the above standards are satisfied, the Secretary of Treasury must appoint the FDIC as the receiver of the CFC and commence the resolution process.<sup>4</sup>

#### *Covered Financial Company.*

A Financial Company is "covered" if it is determined that its failure could have "serious adverse effects" on financial stability or economic conditions. (a "Covered Financial Company" or "CFC")

The Bill's resolution regime applies to a "Financial Company," as defined by Section 201(6), that is "covered" by virtue of a determination by the Treasury Secretary that, among other things, its failure "would have serious adverse effects on financial stability or economic conditions in the United States." The resolution regime could apply to any company that has control over any bank and all companies identified as specified financial companies as defined in

Section 102 of the proposed Restoring American Financial Stability Act of 2009. The Bill's resolution authority would also extend to any subsidiary of such company, other than subsidiaries that are insured depository institutions, registered brokers or dealers or insurance companies (which would remain subject to the applicable existing resolution regimes).

An earlier draft bill released by the Treasury Department would have extended resolution authority applicability to a broader set of "financial companies," which would have included, among other things, savings and loan and insurance holding companies. Under the earlier Treasury draft, a commercial company that controls a savings and loan (a savings and loan holding company) would have been considered a "Financial Company." The current proposal appears to assume that other components of the Administration's overarching regulatory reform program will be implemented, reflecting the Administration's proposal to terminate federal and state savings associations and to convert savings and loan holding companies to bank holding companies.

#### *Options for Resolving a Financial Company.*

Under Section 203 of the Bill, once the FDIC is appointed as receiver it has broad discretion to extend credit to, buy assets from, provide guarantees to, or acquire equity interests in the CFC or any subsidiary, with the approval of the Treasury Secretary. The FDIC may take any of these actions either directly or through an entity established by the FDIC for such purpose (a "Bridge Company"). In making these decisions, the FDIC must consider the effectiveness of the action in mitigating adverse effects for the purpose of financial stability and not for the purpose of preserving the CFC. The FDIC must also ensure that the shareholders and unsecured creditors bear losses and that existing management of the CFC is removed.

This authority means that the FDIC will be able to sell healthy units or assets to financially strong companies. However, it is an open question whether a procedure would be developed similar to the FDIC's typical method of closing a bank on a Friday and effecting an immediate purchase-and-assumption ("P&A") transaction with a healthy bank in which all insured deposits (and, more recently, all deposits) and certain assets and counterparty relationships are transferred before the opening of business on Monday. This approach allows the FDIC 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

<sup>4</sup> The Administration proposal included the concept of a qualified receiver, similar to a conservator under the FDIA, however the Bill now proposes only a receivership, as it contemplates the liquidation of the CFC, not its rehabilitation.

sorting contractual and counterparty relationships with parties other than depositors, with the goal of realizing amounts that can be paid to claimants in accordance with the claims priorities in the FDIA. CFCs will vary in their business lines and asset/liabilities structures and will, of course, have no insured depositors (although they may have an insured depository institution or insurance company subsidiary that will have depositors and policyholders with preferred legal status under applicable law). While the Bill creates an obligation for the FDIC to consult with the regulators of the CFC and its covered subsidiaries for the purpose of ensuring an orderly resolution of the CFC and covered subsidiaries, as well as the primary regulators of any subsidiaries that are not covered, and coordinate treatment of such subsidiaries, the FDIC will not necessarily have the same access to information about the CFC that the FDIC has about depository institutions, which is based on quarterly call reports and periodic examinations. These differences may make it less feasible for the FDIC to effect a significant restructuring within days of its initial takeover. This may be part of the reason why the Bill provides that FDIC will be appointed as receiver and provides no role for the FDIC to act as conservator.

As a receiver, the FDIC would have control over the day-to-day operations of the corporation as well as control over significant corporate actions. The FDIC can merge, sell or transfer any assets, liabilities, or obligations on the terms and conditions it deems appropriate without obtaining any approval, assignment or consent, except where Federal agency approval is required as part of an antitrust review. It may also place the CFC in liquidation and proceed to realize on its assets, in such manner as it deems appropriate, including through a Bridge Company.

#### *Funding of Assistance and Repayment.*

##### **Funding of Assistance:**

- Assistance drawn from a newly created Systemic Resolution Fund.
- The Fund is initially established by obligations issued by the FDIC to the Treasury and sold as public debt transactions by the Treasury.
- Assistance from the Fund is repaid from the proceeds of the resolution of the CFC and then by risk-based assessments on CFCs with over \$10 billion in non-FDIC assessed liabilities.

Under the Bill, the FDIC, once appointed as receiver, would have the authority to provide financial assistance to the CFC drawn from a newly created Systemic Resolution Fund (the "Fund"), with the approval of the Treasury. § 208(n)(1). The Fund would be established initially from obligations issued by the FDIC and sold to the Treasury. It would be replenished subsequently from the proceeds of the resolution of the CFC, including the sale of assets, and then from special assessments imposed on other financial companies with greater than \$10 billion in total assets, on a consolidated basis, on a graduated basis that assesses financial companies with greater assets at a higher rate. Assessments would be set in reference to the financial company's risk factors, which include the different categories and concentration of assets and

liabilities, leverage, size, complexity, risk profile, interconnectedness to the financial system, threat to the stability of the financial system of the assessed financial company, and any other consideration the FDIC deems appropriate.

It is not clear how the Congressional Budget Office would fund the Fund's initial capitalization and whether a budget point of order would lie against the Bill. Although the Fund's capitalization would not take place with appropriated dollars, there would have to be an initial outlay by Treasury, which would likely score for Federal budget purposes.

As noted previously, FDIC Chairman Sheila Bair has expressed a preference for *ex ante* assessments on banks to capitalize a resolution fund. She contends that *ex ante* assessments are likely to impose greater discipline on financial companies and are fairer in the sense that, companies receiving assistance likely would not end up making payments to the Fund *ex post*.

***Powers Over Third-Party Claims.*****FDIC Power over Third Party Claims:**

- Claims process.
- Can avoid fraudulent transfers and security interests.
- May treat creditors unequally if necessary to preserve U.S. financial stability.
- Claims against the FDIC must only be paid what would be received if the CFC were liquidated under the Code or state insolvency law.

**Claims Process.** Under the Bill, all third parties with claims against the CFC in receivership must present their claims to the FDIC. As the receiver, the FDIC has the power to determine all claims against the CFC, and can allow or disallow a claim, in part or in whole, which it determines has not been proved to its satisfaction. § 208(a)(2). The FDIC must make such determination within 180 days from the date such claim is presented, although such time may be extended by agreement with the claimant. § 208(a)(4)(A). The Bill is unclear regarding the level of judicial review, if any, which would be permitted of the FDIC's claims determinations, as

one provision provides a 60-day period to appeal any claims (§ 208(a)(5)(B)) while another indicates that there will be no judicial review (§ 208(a)(4)(D)(iv)). The proposed claims process under the Bill differs from the one provided under the Code. In general, the Code provides that all third parties with claims must present their claims to the debtor by a set bar date. In the event that the debtor seeks to disallow a timely submitted claim, the Bankruptcy Court would review the claim and determine whether the claim should be allowed or disallowed after notice and an opportunity for a hearing. Under the claims process in the FDIA for a receivership, creditors would submit claims to the FDIC, as receiver, who determines whether or not to allow such claim. Although the FDIA is unclear regarding the level of judicial review, if any, case law indicates that judicial review is available after exhaustion of the administrative claim process by the FDIC. In addition, unlike a process under the Code, where pre-petition claims (subject to certain exceptions) are paid at the end of the case, under the Bill the FDIC shall pay all valid obligations of the CFC that are due and payable at the time the FDIC is appointed as receiver, to the extent that funds are available. § 208(a)(1)(G).

**Fraudulent Transfers.** The FDIC, as receiver, may avoid any interest transferred, including any security interest granted, within five years prior to the appointment of the FDIC, if the transfer was made "with the intent to hinder, delay, or defraud the covered financial company or the [FDIC]." § 208(a)(12)(A). There is also a provision that permits avoidance of security interests granted in contemplation of the CFC's insolvency or with the intent to hinder, delay or defraud the CFC or its creditors; no time period is specified for such transfers and no standards are set forth to determine whether the transfer or grant of security interest was made "in contemplation of the CFC's insolvency." § 208(c)(12)(A). There are no provisions in the Bill that specifically target transfers to insiders or preferential transfers, as there are in the Code.

**Unequal Treatment.** Similarly situated creditors are treated similarly unless the FDIC determines that unequal treatment is necessary to maximize the value of the company's assets, minimize losses, or contain adverse effects on the financial stability of the U.S. economy. § 208(b)(4). The only limitation set forth is that a creditor must receive what it would receive if the entire CFC were liquidated under the Code or any state insolvency law (herein, the "Liquidation Amount"). § 208(d)(2). If liquidated under the Code, the Liquidation Amount would likely be the amount a creditor would receive under a chapter 7 liquidation and the claim would be paid to the extent money is available at the priority level relevant to that claim. The FDIC is also authorized to designate any obligation as an administrative expense, which has the highest priority among unsecured claims, that it determines is "necessary and appropriate" for the smooth and orderly liquidation or other resolution of the CFC. § 208(b)(6)(B). No remedies are set forth for creditors alleging that they have received unequal treatment.

**Maximum Liability Cap.** Under the Bill, the Liquidation Amount is the maximum amount that could be owed by the FDIC to any claimant, and is based on what such claimant would have received if the CFC had not been the subject of resolution proceedings under the Bill but had been liquidated under the Code or any State insolvency law. § 208(d)(2)(B).

#### ***Powers Over Contracts.***

Under the Bill, the FDIC has significant powers over the contracts of the company in receivership and its counterparties.

**Contract Repudiation.** The FDIC has 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. § 208(c)(1). The receiver will only be liable for damages limited to “actual direct compensatory damages” measured “as of” the date the receiver is appointed, and damages for profits, lost opportunity, pain and suffering and punitive damages are not allowed. § 1609(c)(3)(A) and (B). Payment of attorney’s fees do not appear to be allowed. These are specific provisions regarding leases and other real estate contracts, service contracts, and, most importantly, “qualified financial contracts.”

**Continuation of Contracts.** The FDIC can enforce any contract (other than a financial institution bond or a D&O insurance contract) and require performance by the counterparty of its contractual obligations despite termination rights due to insolvency or financial condition of the company (*ipso facto* provisions). § 208(c)(13)(A). The FDIC, however, cannot reinstate a contract that was terminated before appointment of the FDIC.

**Agreements Against the Interest of the FDIC.** No agreement that tends to diminish or defeat the interest of the FDIC as receiver in any asset acquired by the FDIC shall be valid against the FDIC, unless the agreement is in writing, executed by an authorized officer or representative of the CFC, and has been since the time of its execution an official record of the company. § 208(a)(7). This provision is less stringent than the common law standard under the *D’Oench Duhme* case, which is codified in the FDIA.

#### ***Finality of the FDIC’s Actions.***

##### **Judicial Review:**

- The FDIC’s decisions are subject to limited judicial review during the resolution process.
- Company may challenge the appointment.
- Extent of ability of creditors to seek judicial review of determinations is unclear.
- Other pending legal actions are terminated or stayed.

**Judicial Review.** The Bill 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 Bill or at the request of the receiver of the CFC. § 208(e). The Bill also removes jurisdiction of courts over actions for payments and determination of rights with respect to assets that the FDIC, as receiver, controls. The CFC may bring an action in the U.S. District Court to challenge the appointment of a receiver within 30 days of such appointment. § 204. As described above, it is unclear whether claimants can seek judicial review of a disallowance of a claim by the FDIC or of the

amount of the claim awarded, as two provisions in the Bill on this are in direct conflict. Under the similar FDIA provisions, claimants have brought suits against the FDIC to challenge claims determinations and have been awarded damages by the courts based upon the standards and methods for determining damages for breach of contract long used by state and federal courts. However, the express discretion granted to the FDIC may provide a basis for reviewing courts to give deference to the FDIC’s determinations and actions.

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**Termination of Legal Actions.** The proposed legislation terminates all federal or state bankruptcy actions of the bank holding company. § 206. On application of the FDIC as receiver, any court with jurisdiction over a non-criminal judicial action to which the company is a party shall grant a stay of such action for 90 days with respect to all parties. § 208(a)(9).

**Director and Officer Liability.** Directors and officers will not be liable to the shareholders or creditors of the CFC for acquiescing to the appointment of the FDIC as receiver, or to the acquisition, combination, or transfers of assets or liabilities by the FDIC as receiver under § 208. § 205. This immunity does not prohibit liability for other actions by the directors and officers.

**Qualified Financial Contracts.**

**Qualified Financial Contracts include:** securities contracts, commodity contracts, swaps, options, futures, forward contracts, repurchase agreements and the related credit support, including guarantees.

**Receiverships.** When the FDIC is appointed as a company's receiver, counterparties to Qualified Financial Contracts ("QFCs") are generally stayed 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 third business day following the date of the appointment or after the person has received notice that the QFC has been transferred to another financial institution, which is not the subject of a receivership, bankruptcy or other insolvency proceeding. § 208(c)(10)(B)(i). The three-day 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 which is not the subject of receivership, bankruptcy or other insolvency proceeding, including a Bridge Company. § 208(c)(9)(A). QFC counterparties can terminate for other defaults, such as non-payment or non-performance under the QFCs.

**Bridge Bank Holding Companies.**

**The FDIC can transfer** part or all of the assets, liabilities, etc. of the CFC to a Bridge Company in order to obtain the highest value. The remaining company may be liquidated.

The FDIC, as receiver, can organize a Bridge Company which can partly, or fully, assume the rights, assets, liabilities, powers, authorities or privileges of the CFC, at the FDIC's sole discretion, and does not require consent of the counterparties. § 208(h).

Contracts that are non-assignable without consent under applicable agreements or laws, such as personal services contracts, or contracts for financial accommodations (both of which are protected from assignment without consent under the Code), are not exempt from transfer. § 208(h)(5)(D). The Bill 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 and the present value of return from the sale of assets, minimize the amount of any loss from the sale or contain any serious adverse effects to the U.S. economy. § 208(h)(5)(E). The Bill may create uncertainty for creditors, because the FDIC may transfer their claims or the assets securing their claims to the 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 Bill does not provide any methodologies or judicial review for valuing claims or collateral securing such claims or any processes to contest the values assigned by the FDIC.

## THE BILL COMPARED TO THE FDIA

Because the Bill is based on the FDIA, there are significant similarities between the FDIA and the Bill. Under both the FDIA and the Bill, the FDIC has the power as a receiver to operate, reorganize or liquidate the company. (See the sidebar for more similarities between the FDIA and the Bill.) Chart A provides a more thorough comparison between the FDIA, the Bill and the Code.

**Under the Bill and the FDIA, the FDIC can:**

- + Arrange transactions that sell assets or units to healthy firms;
- + Repudiate "burdensome" contracts;
- + Hear and allow or disallow claims;
- + Avoid and recover fraudulent transfers;
- + Claim superior priority to claims of a trustee or third party in a bankruptcy action;
- + Pay limited damages for repudiation of contracts;
- + Repudiate *ipso facto* clauses;
- + Create bridge banks and bridge companies;
- + Limit a counterparty's rights under qualified financial contracts; and
- + Vary from normal procedures when invoking the "systemic risk exception."

**Differences Between the Bill and the FDIA.****Differences between the FDIA and the Bill:**

- FDIA applies only to insured depository institutions while the Bill applies to CFCs, which can be in a wide variety of industries.
- The FDIA protects depositors while the Bill is intended to protect the U.S. economy and the global financial marketplace.
- Unless the FDIA systemic risk exception is used, it has to adhere to the "least cost" resolution test. The Bill provides no check on the expenses of a resolution.
- The FDIC hears and allows or disallows claims subject to judicial review, as provided in the case law. The Bill does not clearly provide for judicial review of claims.
- The FDIC Deposit Insurance Fund is funded *ex ante*, while the Systemic Resolution Fund is funded by *ex post* assessments.
- The FDIC has one way to determine what to do with QICs under the FDIA but three under the Bill.

Despite the numerous similarities between the FDIA and the Bill, there are notable differences between the two.

**Scope of Coverage.** The FDIA applies only to insured depository institutions, a class of institutions that each must hold FDIC deposit insurance. The market and all counterparties understand that insured depository institutions are subject to thorough regulatory supervision and an FDIA insolvency regime. By contrast, the only common thread among potential CFCs is the possibility that an adverse future event could have serious ripple effects for the financial system or the economy. While some CFCs may be regulated as the holding company of a bank and some may have "source of strength" responsibilities, they are a far more diverse set of companies, with a diverse set of subsidiaries. Until recently, creditors of potential CFCs had no expectations that different rules could apply. However, the most difficult issues arise

by applying a regime designed for insured depository institutions, where the FDIC is typically the largest creditor, to CFCs that have significant non-governmental creditors.

**Commencement of Actions.** Under the FDIA, FDIC appointment as a conservator or receiver occurs under the framework of the "prompt corrective action" regime for insured depository institutions. The FDIA does provide for a systemic risk determination as the basis for resolution actions not generally permissible under the normal bank resolution scheme in the FDIA.

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**Assistance.** Financial assistance under the FDIA generally comes from the Deposit Insurance Fund, which is funded from *ex ante* assessments on insured depository institutions. The FDIC does have back-up lines of credit from the Treasury to supplement the FDIC fund.<sup>3</sup> Under the Bill, the Treasury and, once appointed as receiver, the FDIC would have the authority to provide financial assistance to the CFC from the new Systemic Resolution Fund. The Fund is initially established by obligations issued by the FDIC to the Treasury and sold as public debt by the Treasury and replenished from amounts received first through the resolution process of the CFC, including the proceeds of the sale of or income from the assets of the CFC and the proceeds of the transfer of any securities. If the FDIC cannot recoup the funds expended from the Systemic Resolution Fund from funds generated from the resolution process, the difference shall be recouped through risk-based assessments on financial companies with over \$10 billion in total assets. § 203(c) and § 208(o). The Bill also includes provisions that are intended to shift cost to shareholders and unsecured creditors.

**Least Cost Resolution Test.** Except when a systemic risk exception is authorized (as was done for the first time in 2008), the FDIC must meet a statutory “least cost resolution” standard when determining the resolution of a failed bank, which includes an estimation of the cost of liquidation and the terms of any P&A transaction with a healthy bank. In almost every case, a P&A transaction in which a strong bank takes over all insured deposit accounts (and, more recently, all deposits), assets and other obligations, as negotiated, occurs simultaneously with the action to place the failed bank into a receivership. Some of these transactions are supported by FDIC assistance and some include a payment by the successor to the FDIC. The Bill has a less demanding and novel standard: the Treasury and the FDIC must consider only the effectiveness of mitigating adverse effects on the economy, and ensure that shareholders are not paid until all other claims are paid, unsecured creditors are not prevented from bearing losses and the former management is removed. § 203(d).

**Documentation Requirements.** The Bill significantly relaxes the *D’Oench Duhme* documentation requirements codified in the FDIA. The Bill requires only that a contract be in writing, executed by the company’s authorized officer or representative and have an official record of the company since its execution. § 208(a)(7). By contrast, the FDIA requires extensive documentation recognizing the validity of a contract in FDIA proceedings.

**Priority of Unsecured Claims.** Under the FDIA, the claims of depositors (and the FDIC as subrogee for depositor claims paid) are given priority over other unsecured creditors. Such depositor preference is not relevant in the Bill because no potential CFC is an insured depository institution. The Bill gives priority to claims of the United States against the CFC (e.g., for assistance payments) over other unsecured creditors. In addition, the Bill 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.

**Maximum Liability Cap.** Under the Bill, a claimant is entitled to receive only the Liquidation Amount. Under the FDIA, a claimant is entitled to receive the amount it would receive in a liquidation of the institution without a transfer of the assets to a Bridge Company or the purchase of such assets by the FDIC, as determined by the FDIC, but are only paid to the extent that funds are available at that particular FDIC priority level.

<sup>3</sup> In addition, as exercised for the first time in 2008, the Federal Reserve has its own extraordinary assistance powers. The Bill does not limit these powers and their role under the new regime.

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**Chartering of Bridge Companies.** These provisions are largely parallel, although the proposed Bill authorizes the FDIC to create Bridge Companies with a federal corporate charter. Under the FDIA, the Office of the Comptroller of the Currency provides a standard national bank charter to a bridge bank.

**Stay of Legal Actions.** The FDIC can temporarily enjoin any judicial action, whether it is criminal or civil against a bank being resolved under the FDIA. Similarly, the appointment of the FDIC terminates any bankruptcy actions automatically, and the FDIC as receiver can request that the court overseeing any non-criminal judicial action grant a stay for 90 days.

## THE BILL COMPARED TO THE BANKRUPTCY CODE

The Bankruptcy Code governs the vast majority of the insolvency cases in the United States involving non-regulated entities. Generally, in a chapter 11 case (reorganization) under the Bankruptcy Code, the board of directors and management of the debtor remain in control of the company as debtor in possession ("DIP"). In a case under chapter 7, a trustee is appointed to liquidate the debtor's business and/or assets. The bankruptcy court plays a critical role in both chapter 7 and chapter 11 cases. Among other things, it must approve actions taken by a DIP or trustee outside the ordinary course of business and, in a chapter 11 case, must confirm the plan of reorganization under the standards set forth by the Code. Creditors are represented in the process and have input in the Court's decisions. By contrast, the Bill grants the FDIC broad discretion to manage the operations of a covered financial company, with little judicial oversight and no opportunity for creditor participation during the resolution process.

At a fundamental level, bankruptcy is intended to protect creditors' rights as the debtor either liquidates or reorganizes. In contrast, the FDIA protects depositors. The Bill by contrast is not intended to protect any one group of creditors, but instead is intended to protect confidence in the banking system and to stabilize the financial system. As such, the legal and procedural aspects of these regimes should be compared and assessed against this backdrop. See Chart A for such comparison. Below are several notable differences.

**Assistance.** No governmental assistance is available to companies under the Code.

**Powers of the Organization or Persons in Charge of the Company.** Once the FDIC is appointed as a receiver, it replaces existing management, is charged with the operation of the company and needs no approval from any governing body, such as a board of directors or court, to operate, make contracts or otherwise control the CFC. The FDIC may provide certain forms of assistance to the CFC, including guarantees of the CFC's obligations.

By contrast, while the DIP or a chapter 11 trustee can operate the company in the ordinary course of business, almost all actions outside the normal course of business require Bankruptcy Court approval. Similarly, many actions by a chapter 7 trustee are subject to bankruptcy court approval, with an opportunity for creditors to be heard.

**Judicial Review.** Under the Bill, judicial review is limited during the resolutions process, but litigation regarding claims determinations may be possible. In contrast, 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. Bankruptcy Court rulings are subject to appeal.

**Priority of Unsecured Claims.** Treatment of unsecured claims vary greatly between the Bill and the Bankruptcy Code. While both the Bill and the Code require administrative expenses to be paid in full, before unsecured claims are paid, under the Bill, any debt owed to the United States government must be repaid in full before any other unsecured creditors are paid. In contrast, the Code places a higher priority



on certain employee and tax claims, but does not require all obligations to the United States government be paid in full before any other creditors are paid. If the United States has entered into an ordinary contract with the debtor, under the Code, the United States may be a general unsecured creditor of the debtor, where under the Bill, any obligations owed to it would be paid first.

Secured Claims. Claims under the Code are secured up to the value of the collateral. Over-secured creditors' claims receive post-petition interest on the claim. The value of the collateral is determined in light of the purpose of the valuation. Thus, valuation for reorganization purposes will be based on reorganization value. Under the Bill, the FDIC can reject all or a portion of any secured claim that is not proven to its satisfaction. The FDIC may not avoid a legally enforceable or perfected security interest in the assets of the CFC unless such interest was taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or its creditors. The FDIC is silent as to the methods to value the collateral securing a claim.

Unequal Treatment of Similarly Situated Creditors. Under the Bill, the FDIC can treat similarly situated claimants unequally if the FDIC determines that unequal treatment is necessary to maximize the value of the CFC's assets, minimize losses, or contain adverse effects on the financial stability of the U.S. economy. In contrast, a guiding principle of the Code is that similarly situated creditors must be treated similarly.

Fraudulent Transfers. Under the Bill, the FDIC has a right to avoid a transfer of an interest that was made within five years of the date the FDIC was appointed as a receiver if the transfer was made with the intent to hinder, defraud, or delay the company or the FDIC. It is unclear whether state fraudulent conveyance laws are applicable in the resolution regime. The Bill also allows the FDIC to avoid any security interest taken in "contemplation of the CFC's insolvency." The Bill provides no guidance on the meaning of "in contemplation of" and unlike the fraudulent transfer provision, contains no temporal limitations with respect to such transfers. For example, under the Bill as drafted, it would be possible to avoid a transfer completed ten years prior to a CFC's insolvency.

The Code provides for two types of fraudulent transfers: "actual fraud," which involves the intent to defraud creditors, and "constructive fraud," which involves a transfer, made in exchange for inadequate consideration. A fraudulent transfer may be avoided if it was made or incurred on or within two years before the date of the bankruptcy filing. In addition, the Code also provides for the avoidance of preferences, which are transfers made to or for the benefit of a creditor, for or on account of an antecedent debt made while the debtor was insolvent, which results in the creditor receiving a greater distribution than it otherwise would have in a hypothetical chapter 7 distribution, made within the 90 days (or one year if the transferee was an insider) prior to the date of the filing of the bankruptcy petition. State fraudulent conveyance laws are incorporated by reference under the Code.

Assumption/Rejection of Contracts. Under the Bill, the FDIC can assume and/or assign any contracts, without consent of the counterparty, and can reject contracts it determines are "burdensome." Under the FDIA, contract determinations have been litigated, and courts have applied contract law remedies when determining whether the FDIC as receiver appropriately determined the remedy and award for its contract repudiation/breach.

The Code allows the DIP/trustee, with approval of the Bankruptcy Court, to reject burdensome executory contracts (contracts where continuing obligations exist for both parties to the contract) or, alternatively, assume and/or assign such contracts if it is in the best interest of the estate and if the DIP/trustee cures any default, compensates for any damages resulting from such default and provides adequate assurance of future performance under the contract. Generally, contracts may be assumed or assigned without consent

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of the counterparty unless applicable law prevents it or the contract is one for financial accommodations to the debtor.

**Maximum Liabilities Cap.** Under the Bill, a creditor's recovery on a claim is capped at the Liquidation Amount, or the amount a creditor would receive if the entire CFC were liquidated under chapter 7 of the Code or state insolvency law. By contrast, a claimant's recovery under chapter 11 of the Code is not limited to such claimant's chapter 7 recovery and, indeed, chapter 11 reorganizations generally yield reorganization value that results in increased recoveries to creditors above the chapter 7 recovery amount.

**Qualified Financial Contracts.** As discussed above, the treatment of QFCs is complex, but generally, where the FDIC is appointed as receiver, the non-CFC counterparties to QFCs are stayed for no longer than three days from exercising their contractual rights to terminate, accelerate, set-off and net, or enforce their security interests in collateral, based solely on the receivership, the insolvency or the financial condition of the CFC. By comparison, the Code does not stay QFC counterparties' ability to exercise their contractual rights to terminate or accelerate the obligations of parties, enforce security interests, or set-off the mutual debts and claims.

*We regard this memorandum and the accompanying chart as a work in progress. The length and complexity of the proposed bills and the complexity and ramifications of the issues involved mean that there are probably issues that we have not discussed that should be included. Further, although we have worked hard to make these materials an accurate discussion of this legislation, we may not have succeeded in every instance. ACCORDINGLY, WE WELCOME—INDEED INVITE—YOUR COMMENTS AND CRITICISMS. Our websites will allow you to access updated versions of this memorandum, and we encourage you to communicate your comments, corrections, and thoughts directly to us via e-mail at the addresses below. Or, of course, you may contact any of us the old-fashioned way: by telephone or by fax, at the numbers listed below. We look forward to hearing from you.*

*Chuck Muckenfuss, Michael Bopp, Michael Rosenthal and Janet Weiss*

Cantwell F. Muckenfuss, III  
(202) 955-8514  
[CMuckenfuss@gibsondunn.com](mailto:CMuckenfuss@gibsondunn.com)

Michael Bopp  
(202) 955-8256  
[MBopp@gibsondunn.com](mailto:MBopp@gibsondunn.com)

Janet M. Weiss  
(212) 351-3988  
[JWeiss@gibsondunn.com](mailto:JWeiss@gibsondunn.com)

Adam Chen  
(212) 351-2327  
[AChen@gibsondunn.com](mailto:AChen@gibsondunn.com)

Michael A. Rosenthal  
(212) 351-3969  
[MRosenthal@gibsondunn.com](mailto:MRosenthal@gibsondunn.com)

Rachel Castelfino  
(212) 351-2403  
[RCastelfino@gibsondunn.com](mailto:RCastelfino@gibsondunn.com)

Aditi Prabhu  
(202) 955-8252  
[APrabhu@gibsondunn.com](mailto:APrabhu@gibsondunn.com)

Also contributing to these materials is Robert C. Eager, Potomac Banking Consulting, and Retired Former Partner, Gibson, Dunn & Crutcher LLP – 202-329-4897; [roberteager@gmail.com](mailto:roberteager@gmail.com) or [reager@retiredpartner.gibsondunn.com](mailto:reager@retiredpartner.gibsondunn.com)

## ATTACHMENT 2

## GIBSON, DUNN &amp; CRUTCHER LLP

DRAFT Last Revised November 15, 2009\*

## CHART A

## Overview and Comparison of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

On November 10, 2009, the Senate Banking Committee released draft legislation on the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009 (the "Bill"). This topic was also addressed in proposed Resolution Authority for Large, Interconnected Financial Companies Act of 2009, released on October 27, 2009. The proposed legislation would create a new federal scheme to permit the U.S. government to exercise broad authority and discretion to assist, reorganize or wind down an institution that is deemed to be at risk of insolvency and would pose a threat to U.S. financial stability. The Administration, U.S. Department of the Treasury (the "Treasury") and federal banking agencies believe that the current legal framework for addressing the failure of a large, complex, financial organization is inadequate and not designed to protect the stability of the financial system. The Bill covers bank holding companies and non-bank financial companies that have the potential to pose systemic risks to the U.S. economy but that are not currently subject to the resolution authority of the Federal Deposit Insurance Corporation ("FDIC"). It is patterned after the resolution provisions of the Federal Deposit Insurance Act ("FDIA"). Neither the federal Bankruptcy Code nor any applicable state insolvency law would apply to companies resolved under this proposed regime.

Treasury Secretary Tim Geithner, Member of the Board of Governors of the Federal Reserve System Daniel K. Tarullo, and FDIC Chairman Sheila Bair testified before the House Financial Services Committee on October 29, 2009, in support of the proposed legislation. Secretary Geithner stated that "in all but the rarest of

cases, bankruptcy will remain the dominant tool for handling the failure of non-bank financial firms" and that the Bill "produces a strong, accountable supervision of all our major financial firms and imposes costs not on the taxpayer but with the risk-takers where they belong."<sup>1</sup> He also said that the Bill gives the government "the authority to recoup any such losses by assessing a fee on large financial firms."<sup>2</sup> He predicted that this would make the owners, creditors and counterparties more vigilant and prudent. Governor Daniel K. Tarullo supported the Bill for allowing the government to sell assets, liabilities, and business units and transfer systemically significant operations to a new bridge entity, quickly in order to restructure or wind down a failing firm in a way that passes losses to shareholders and creditors of the firm while mitigating the risks to financial stability.

Chairman Bair expressed support for using a credible resolution authority to increase market discipline, where stockholders and bondholders would bear the losses, supporting haircuts on secured creditors to promote market discipline, limit costs to the reorganization and distribute market losses more broadly. She continues to support the creation of a pre-funded resolution fund, managed by the FDIC, created from *ex ante*, risk-based assessments. The following chart compares the Bill to the Bankruptcy Code and the FDIA, including (i) the financial companies covered, (ii) the grounds for exercising resolution powers, (iii) the resolution powers available to the FDIC, (iv) special provisions concerning qualified financial contracts and (v) the Regulatory Agency's authority to handle claims from creditors, with limited judicial oversight.

\* If it is required, this chart can be worked in progress, due to the length and complexity of the proposed bill. We have worked hard to make these materials separate, but may not have succeeded in every instance. The chart will be revised as further sections or amendments emerge. WE WELCOME YOUR COMMENTS AND FEEDBACK. Please do us directly to us via email at the addresses on the back page or by phone. **Chuck Mackinnon, Michael Hoop, Michael Rosenthal and Janet H. Ross**

Bankruptcy Code		The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<b>GENERAL OVERVIEW</b>			
<b>Supervisory entity ("Regulatory Agency")</b>	<p>The Bankruptcy Courts, subject to the appellate jurisdiction of the federal district courts, circuit courts, and the Supreme Court. 11 U.S.C. § 105</p> <p>The Office of the United States Trustee, a division of the Department of Justice (the "UST"), is charged with oversight of the administrative issues in bankruptcy. A local representative of the UST is typically assigned to monitor every chapter 11 case. The UST is concerned with protecting creditors' rights, and typically appoints an official committee of unsecured creditors consisting of creditors holding the largest claims against the debtor.</p>	<p>The Federal Deposit Insurance Corporation ("FDIC") for most covered financial companies ("CFCs") or the Securities Exchange Commission ("SEC") if the CFC, or an affiliate thereof, is a broker or dealer registered with the SEC. § 208(b)(A). As the Bill refers to the FDIC, we will use that reference as well, with the understanding that if the SEC were appointed as the Regulatory Agency, it would likely have similar powers.</p> <p>The FDIC has broad powers over the process prescribed in the Bill. There is minimal court supervision and judicial review.</p>	<p>The Federal Deposit Insurance Corporation ("FDIC").</p> <p>The FDIC has broad powers over the process prescribed in the FDIA. There is minimal court supervision and judicial review.</p>
<b>Laws governing the proceedings</b>	<p>Title 11 of the United States Code (the "Bankruptcy Code"), the Federal Rules of Bankruptcy Procedure ("FRBP"), and Local Rules for each jurisdiction.</p>	<p>The Bill. The Bill permits, but does not require, the FDIC to enact rules or regulations, in consultation with the Agency for Financial Stability to be established pursuant to other portions of the Restoring American Financial Stability Act of 2009, § 207.</p>	<p>The Federal Deposit Insurance Act, with limited regulations passed by the FDIC.</p>
<b>Judicial precedent</b>	<p>Significant judicial precedent.</p>	<p>The FDIC may use the regulations adopted pursuant to the Federal Deposit Insurance Act ("FDIA") with respect to the determination of claims for a covered CFC. § 208(a)(3)(B). The FDIC would also act pursuant to its discretion and any results or regulations promulgated by the FDIC. Some precedent applicable to the FDIA and the Housing and Economic Recovery Act of 2008, which provides for the resolution of Fannie Mae, Freddie Mac and the Federal Home Loan Banks, may apply.</p>	<p>Some judicial precedent.</p>

<sup>1</sup> We have included comments by the FDIC in footnotes to reflect ongoing concerns they may have with respect to the proposed legislation.

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

Who is covered	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p>The Bankruptcy Code applies to individuals or other "persons" who reside, are domiciled or have a place of business or property in the United States, with the exception generally of banks and savings and loan associations, railroads and insurance companies. Municipalities (chapter 9) and entities with pending foreign bankruptcy proceedings (chapter 15) may also seek relief under the Bankruptcy Code. 11 U.S.C. § 109.</p> <p>Insurance companies are governed by state insurance insolvency codes. Broker-dealers that are members of the Securities Investor Protection Corporation ("SIPC") are subject to the Securities Investor Protection Act ("SIPA"), but may also file chapter 7 liquidation cases under the Bankruptcy Code.</p> <p>Although generally the Bankruptcy Code would continue to apply to most financial companies, the Bill would make the Bankruptcy Code unavailable to a financial company if the Treasury elected to put such financial company into an FDIC receivership under the Bill. The appointment of the FDIC as receiver for the CFC would automatically terminate any bankruptcy case in progress. § 206, 2</p>	<p>The Bill applies to any financial company that is incorporated or organized under Federal or any State law, and:</p> <ul style="list-style-type: none"> <li>is a bank holding company, as defined in section 2(a) of the Bank Holding Company Act of 1956;</li> <li>any specified financial holding company, as defined in section 102 of the Restoring American Financial Stability Act of 2009 that has been subjected to heightened prudential standards under section 107 of such Act;</li> <li>is predominantly engaged in activities that are financial in nature or incidental thereto for the purposes of section 4(k) of the Bank Holding Company Act of 1956; or</li> <li>any subsidiary of the above (other than an insured depository institution, registered broker or dealer or an insurance company) § 201(6).</li> </ul> <p>The Bill uses the FDIA's definition of "subsidiary," which is defined as a company that is "owned or controlled directly or indirectly by another company." This includes any service corporation.</p>	<p>The FDIA governs FDIC-insured bank or thrift subsidiaries. The Bill would not affect the entities that are subject to an FDIC proceeding.</p>	<p>A conservator or receiver may be appointed without a systemic risk determination if the grounds specified in the FDIA apply. 12 U.S.C. § 1821(c)(5). Generally, the FDIC is required to meet a statutory "least cost</p>
<p><b>Commencement of proceedings</b></p>	<p>An eligible entity may elect to file a voluntary bankruptcy petition. 11 U.S.C. § 301. Although solvent companies can be debtors, the Court may dismiss the case based on bad faith filing.</p>	<p>The Bill provides that the Financial Institutions Regulatory Agency ("FIRA"), to be established under other provisions of the Restoring American Financial Stability Act and the FDIC (or the SEC, as applicable), each with a 2/3 vote of approval, will</p>	<p>The FDIC has commented that Congress may wish to consider making CFCs ineligible to be debtors under the Bankruptcy Code, to avoid any issues involved with dismissing a pending bankruptcy case. They point out that bankruptcy cases are not terminated but are dismissed. They also comment that the Bill should be amended to provide for treatment of any relief provided in a bankruptcy case.</p>

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

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	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	<p>Three or more entities, each of which holds an unsecured, non-contingent, undisputed claim, which aggregate to at least \$13-475, can file an involuntary petition, which may be contested by the debtor/company. Any disputes will be evaluated by the Bankruptcy Court which will make a finding as to whether the company is paying its debts as they come due. If there are fewer than 12 such creditors, a single creditor holding at least \$13-475 in unsecured, non-contingent, undisputed claims, may file the involuntary petition. 11 U.S.C. § 303.</p>	<p>commence a case by issuing a joint written recommendation. § 202(a)(1). Under the earlier Administration proposals, the Federal Reserve Board (the "Fed") would take the role of FIRA. The Secretary of Treasury (in consultation with the President) must determine, based on such recommendation, (1) that the financial company is in default or in danger of default; (2) the failure and resolution of the financial company under otherwise applicable federal or state law would have serious adverse effects on the financial stability or economic conditions in the U.S.; and (3) any actions under the Bill would avoid or mitigate such adverse effects. § 202(b).</p> <p>This determination will take into consideration the effectiveness of the action in mitigating adverse effects, the cost to the general fund of the Treasury and the potential to decrease excessive risk taking on the part of creditors, counterparties and shareholders in such financial companies. § 202(b)(3).</p>	<p>resolution" standard when determining how to resolve a failed bank, which includes evaluating the costs of liquidation. However, the FDIC has broader powers if there is a systemic risk determination that (a) the FDIC's compliance with the "least cost resolution" requirements for government assistance with respect to an institution would have serious adverse effects on economic conditions or financial stability and (b) any assistance under 12 U.S.C. § 1823 would avoid or mitigate such adverse effects. 12 U.S.C. § 1823(c)(4)(G). In the event of this determination, the FDIC may then take action or provide assistance under § 1823 as necessary to avoid/mitigate such effects. This determination requires the recommendation of the FDIC and the Fed, and approval of the Secretary of Treasury, in consultation with the President.</p>
<p><b>Reporting requirements</b></p>	<p>The Bankruptcy Court issues orders and final judgments, which are public documents.</p>	<p>The Comptroller General of the U.S. shall review and report to Congress any determination to use the resolution authority. § 202(c)(2).</p> <p>The Secretary of the Treasury shall provide written notice to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives within 30 days after the determination has been made that the financial company should be a CFC and subject to FDIC receivership under the Bill. § 202(c)(3).</p> <p>The FDIC shall maintain a full accounting of each receivership or other disposition of any CFC. The FDIC shall file an annual report to the Secretary and the Comptroller General, which shall be made available upon request to the public. § 208(a)(16).</p>	<p>If the FDIC suspends dividends from excess amounts in the Deposit Insurance Fund, the FDIC must submit such determination to the Committee on Banking, Housing, and Urban Affairs of the Senate and the Committee on Financial Services of the House of Representatives within 270 days after making such determination. Pub. L. 109-173, § 5, Feb. 15, 2006, 119 Stat. 3666.</p>

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

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Funding	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	<p>There is no provision for statutory government funding.</p> <p>Subject to Bankruptcy Court approval, the company may use its available cash or obtain post-petition funding to provide for its funding requirements during the reorganization process. Such funds are provided by third-party lenders.</p> <p>If necessary, the Bankruptcy Court can authorize the debtor to grant the DIP lender a priming lien, which has priority over pre-bankruptcy liens and is a claim with super-priority over administrative expenses incurred during chapter 11 and over all other claims.</p>	<p>The Bill creates a separate Systemic Resolution Fund (the "Fund") in the Treasury, which is available for the payment of administrative expenses and assistance for the costs of actions under the BIF. § 208(a)(1).</p> <p>The Fund is initially established by public debt transactions issued by the FDIC and sold to the Secretary. § 208(a)(3). The Fund is subsequently replenished through amounts received through the resolution process and risk-based industry assessments on certain financial companies. § 207(c). No financial company will be assessed if it has less than \$10 billion in total assets on a consolidated basis. The FDIC will assess each financial company with over \$10 billion in total assets on a consolidated basis, on a graduated basis that assesses financial companies with greater assets at a higher rate. In addition, the FDIC will also base assessments generally affecting financial companies on factors such as the economic conditions on subsidiaries of financial companies that are insured depository institutions, members of SIFC, insurance companies, risk profile, interconnectedness to the financial system, threat to the stability of the financial system of the assessed financial company, take into account the extent and type of off-balance sheet exposures of such financial companies, and distinguish among the different classes of assets or types of financial companies and any other consideration the FDIC deems appropriate. § 208(o).</p> <p>Regulations regarding assessments are to be passed by the FDIC, in consultation with the Secretary and the Agency for Financial Stability (to be established under the Restoring American Financial Stability Act. § 208(o)(5). Earlier drafts of the legislation had the Fed in the role of the Agency.</p>	<p>Financial assistance is funded from the deposit insurance fund. 12 U.S.C. § 1821(a)(4).</p> <p>The FDIC, in seeking to provide assistance to an institution or other prescribed actions, must determine that such action is necessary and will incur the least cost to the FDIC. 12 U.S.C. § 1823(c)(4).</p> <p>The FDIC may borrow money from the Treasury for funding the insurance fund. The FDIC may also sell its obligations to the Federal Financing Bank and also borrow from insured depository institutions and federal home loan banks. 12 U.S.C. § 1824.</p> <p>The FDIC Board of Directors sets assessments by considering the FDIC's operating costs, estimated case resolution expenses and income, the projected effects of the payment of assessments on institutions risk factors under the risk-based assessment system, and other factors the Board deems appropriate. 12 U.S.C. § 1817(b)(2)(B).</p> <p>Risk factors in the "risk-based" assessment system are based on the probability the FDIC will incur a loss from an institution, the likely amount of loss, and the revenue needs of the FDIC. 12 U.S.C. § 1817(b)(1)(C).</p> <p>An institution is not barred from the lowest-risk category in the risk-based assessment system solely because of its size. 12 U.S.C. § 1817(b)(2)(D).</p>

	Bankruptcy Code	The Proposed Bill ("BRF")	Federal Deposit Insurance Act ("FDIA")
<b>Management</b>	In chapter 11, the board and management of the debtor continue to operate the company as a debtor-in-possession (the "DIP") and is entitled to propose a plan for the reorganization or the liquidation of the debtor. Under certain circumstances, a trustee may be appointed. 11 U.S.C. §§ 322 and 1104.  In a chapter 7 case (bankruptcy liquidation), a trustee administers the liquidation of the assets of the debtors. 11 U.S.C. §§ 322, 701, 702, 703.	The Secretary of the Treasury may appoint the FDIC or the SEC as the receiver of the covered CFC except that, where the predominant subsidiary of the CPC (as measured by total assets at the end of the previous calendar quarter) is not a broker or dealer, the FDIC is to be the Regulatory Agency. § 208(a).  As a receiver, the FDIC is the liquidator of the company, and is authorized to operate the CFC in order to realize assets, including through a sale or transfer of the assets, including to a bridge financial company ("Bridge Company"), § 208(a)(1).	An institution's charter determines which agency appoints the receiver.  The FDIC may appoint itself the sole receiver or conservator. 12 U.S.C. § 1821(c)(4).  As a conservator, the FDIC takes operational control of the company to preserve it. 12 U.S.C. § 1821(c)(2)(A)(v). Similar to chapter 11 bankruptcy.  As a receiver, the FDIC is the liquidator of the company. 12 U.S.C. § 1821(c)(2)(A)(vi).
<b>Rulemaking authority</b>	Congress alone amends the Bankruptcy Code, with the federal judiciary to prescribe the rules of practice, procedure, and evidence for the federal courts, subject to the right of Congress to reject, modify, or defer any Bankruptcy Rules that have been adopted. The various bankruptcy courts may cause their own Local Rules. The FRBP governs procedural aspects of a case.	The FDIC, in consultation with the Agency for Financial Stability, may promulgate rules or regulations to implement the Bill, but is under no direction to do so. § 207.  The FDIC may prescribe rules and regulations regarding the allowance or disallowance of claims by the FDIC, and providing for administrative determination of the claims, and review of such determination. § 208(a)(3)(A). The FDIC may also elect to adopt the FDIC regulations with respect to the determination of claims, as if the CFC were an insured depository institution. § 208(a)(3)(B).  The FDIC may prescribe rules to establish a uniform interest rate for, or to make payments of post-insolvency interest to creditors holding proven claims against the receivership estates of a CFC following satisfaction by the receiver of the principal amount of all creditors' claims. § 208(a)(8)(C).	The FDIC may prescribe such regulations as the FDIC determines to be appropriate regarding the conduct of conservatorships or receiverships. 12 U.S.C. § 1821(d)(1).
<b>Coordination with other Regulators</b>	No obligation	The FDIC as receiver shall consult with the regulators of the CFC and its covered subsidiaries for the purposes of ensuring an orderly resolution of the CFC and the primary regulators of any subsidiaries of the CFC that are not covered subsidiaries and coordinate the treatment of such	No obligation



Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	<p>solvent subsidiaries and the separate resolution of other insolvent subsidiaries under other governmental authority as appropriate. The FDIC may consult with any outside experts. § 205(b).</p>	
<b>POWER GRANTED TO DIP/FDIC/TRUSTEE</b>		
<p><b>Power of the DIP/FDIC/Trustee</b></p> <p>The trustee or DIP is the successor in interest to the rights, title, assets and affairs of the debtor and can manage them in the ordinary course of business. The DIP/trustee also obtains the books and records of the debtor.</p> <p>The DIP or trustee must seek the approval of the Bankruptcy Court for any transactions that are deemed "outside the ordinary course of business," including one-off transactions such as post-petition loans and the sale of significant operating assets.</p> <p>Court approval for transactions "outside the ordinary course of business" is determined by the best-interest-of-the-estate standard.</p> <p>The DIP/trustee is a fiduciary for the creditors and shareholders of the company and is required to comply with significant operating and reporting requirements under the Bankruptcy Code, the FRBP and the Local Rules of the relevant jurisdiction.</p> <p>The DIP/trustee is required, among other things, to:</p> <ul style="list-style-type: none"> <li>perform all functions of the company in the company's name;</li> <li>collect all assets, obligations and money due to and collect and evaluate claims against, the estate;</li> <li>preserve and conserve the assets</li> </ul>	<p>Once the Secretary of the Treasury has determined (1) the CFC is in default or danger of default, (2) failure would have serious adverse effects on U.S. financial stability or economic conditions, and (3) any actions under § 203 would avoid or mitigate such adverse effects on the financial system or economic conditions, it shall appoint the FDIC as receiver. Once the FDIC is appointed, it has the discretion, with the approval of the Secretary, to take the following actions for the emergency stabilization of the CFC:</p> <ul style="list-style-type: none"> <li>make loans to, or purchase debt obligations of, the company or its subsidiaries;</li> <li>purchase or guarantee against loss the assets of the CFC or its covered subsidiaries, directly or through an entity established by the FDIC for that purpose;</li> <li>assume or guarantee the obligations of the CFC or its subsidiaries to third parties;</li> <li>acquire equity interest or security of the CFC or covered subsidiaries;</li> <li>take liens on assets of the CFC or its covered subsidiaries, including a first priority lien on all unencumbered assets of the CFC or its covered subsidiaries to secure repayment of any transactions conducted under § 203; or</li> <li>sell or transfer the CFC's or any covered subsidiaries' assets. § 203(c)(1) to (6).</li> </ul>	<p>The FDIC, as conservator or receiver, succeeds to the company's:</p> <ul style="list-style-type: none"> <li>rights, titles, powers and privileges of the company and of any stockholder; and</li> <li>title to the books, records, and assets of any previous receiver. 12 U.S.C. § 1821(d)(2)(A).</li> </ul> <p>The FDIC, as conservator or receiver, may:</p> <ul style="list-style-type: none"> <li>take over the assets and operate the company;</li> <li>collect all obligations and money due to the company;</li> <li>perform all functions of the company in the company's name, and</li> <li>preserve and conserve the assets and property of the company. 12 U.S.C. § 1821(d)(2)(B).</li> </ul> <p>Typically, the FDIC arranges a purchase-and-assumption ("P&amp;A") transaction for insured healthy bank at the time a receivership is established.</p> <p>The FDIC can:</p> <ul style="list-style-type: none"> <li>prescribe;</li> <li>make loans to</li> </ul>

Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p>and property of the estate;</p> <ul style="list-style-type: none"> <li>pay all expenses arising post-petition, including wages, and taxes;</li> <li>maintain insurance, as directed by the UST;</li> <li>close pre-petition accounts and open at least one post-petition account, which indicates that the debtor is operating as a DIP, at a bank that agrees to comply with the UST reporting requirements;</li> <li>file schedules, creditors matrices (with addresses for notification), and statements of financial affairs. These are generally publicly available but can be filed under seal. FRBP 1007;</li> <li>file operating reports with the UST. FRBP 2015(a)(3); and</li> <li>notify creditors of the bankruptcy proceeding and major developments.</li> </ul> <p>The DIP/trustee may not do the following, without Bankruptcy Court approval:</p> <ul style="list-style-type: none"> <li>pay pre-petition debts;</li> <li>pay professionals and advisors without a Bankruptcy Court order;</li> <li>sell assets outside the ordinary course of business. 11 U.S.C. § 363 and FRBP 4001;</li> <li>use cash collateral without the consent of secured creditors or the</li> </ul>	<p>The FDIC, as receiver, succeeds to the:</p> <ul style="list-style-type: none"> <li>rights, titles, powers and privileges of the CFC and of any stockholder, member, officer or director of the CFC and its assets; and</li> <li>title to the books, records, and assets of any previous receiver or legal custodian of the CFC. § 208(a)(1)(A).</li> </ul> <p>The FDIC, as receiver, will operate the CFC and may take the following actions without the approval of the Secretary:</p> <ul style="list-style-type: none"> <li>take over the assets and operate the CFC;</li> <li>collect all obligations and money due to the CFC;</li> <li>perform all functions of the CFC in the company's name;</li> <li>preserve and conserve the assets and property of the CFC;</li> <li>provide by contract for assistance in fulfilling any function, activity, action or duty of the receiver;</li> <li>merge the CFC with another company; or</li> <li>transfer any asset or liability of the CFC without any approval, assignment, or consent with respect to such transfer. § 208(a)(1)(B) and (F)(i).</li> </ul> <p>A CFC (or any covered subsidiary thereof) that receives assistance is not a federal department, agency or instrumentality for the purposes of statutes that confer powers or impose obligations on government entities. § 208(h)(8)(A). Employees of such CFC with an appointed receiver are not considered federal employees solely by their employ ment by the CFC. § 208(h)(8)(B). The</p>	<ul style="list-style-type: none"> <li>make deposits in;</li> <li>purchase the assets or securities of;</li> <li>assume the liabilities of;</li> <li>or make contributions to</li> </ul> <p>any insured depository institution if such action (a) is taken to prevent the default of such institution, (b) is taken to restore the institution to normal operations, or (c) will decrease the threat of instability to several such institutions, so long as the FDIC uses the least cost resolution. 12 U.S.C. § 1823(c).</p> <p>FDIC can merge or transfer any asset or liability in default without any approval, assignment, or consent, and is not bound by non-assignability provisions. 12 U.S.C. § 1823(d)(2)(G). Relief is limited to damages.</p> <p>The FDIC can provide assistance to the institution before the appointment of a conservator or receiver, as long as it is the least costly resolution. 12 U.S.C. §§ 1823(c)(8) and (c)(4).</p> <p>The conservator or receiver can offer any asset of the institution for sale to the FDIC or as security for loans from the FDIC. 12 U.S.C. § 1823(d). Proceeds from such sale or loan shall be used to pay the institution's claims.</p> <p>The FDIC can conduct certain emergency acquisitions if severe financial conditions threaten the stability of a significant number of savings associations or savings associations with a significant amount of resources, without meeting the least cost resolution test, under the terms and as authorized under</p>

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<b>Foreign investigations</b>	<p>Bankruptcy Court, 11 U.S.C. § 363(c)(2), and</p> <ul style="list-style-type: none"> <li>obtain credit or incur secured or unsecured debt without Court approval. 11 U.S.C. § 364 and FRBP 4001.</li> </ul> <p>A trustee or DIP may be authorized by the Court to act in any foreign country on behalf of an estate. 11 U.S.C. § 1505. A foreign representative can also apply for recognition of foreign proceedings and can obtain access to federal bankruptcy proceedings. 11 U.S.C. §§ 1515 and 1509. Chapter 15 of the Bankruptcy Code contains provisions relative to proceedings in foreign jurisdictions and the rights of foreign representatives to appear and be heard in U.S. bankruptcy courts.</p>	<p>Bridge Company is exempt from taxes. § 208(b)(9). Unlike the FDIA, there is no provision in the Bill that requires the FDIC to seek the least costly resolution.</p> <p>The FDIC shall coordinate with the appropriate foreign financial authorities regarding the resolution of any subsidiaries of the CFC that are established in a country other than the United States. § 208(a)(1)(L).</p> <p>The FDIC may request the assistance of any foreign financial authority and provide assistance to any foreign financial authority and maintain an office to coordinate foreign investigations for the purpose of carrying out any power, authority, or duty with respect to a CFC. § 208(k).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>12 U.S.C. § 1823(k).</p> <p>The FDIC may request the assistance of any foreign financial authority and provide assistance to any foreign financial authority. The FDIC may also maintain an office to coordinate foreign investigations. 12 U.S.C. § 1818(v).</p>
<b>Judicial review of DIP/FDIC/trustee's actions</b>	<p>The Bankruptcy Court must approve all out-of-the-ordinary-course actions by the DIP/trustee. In addition, any creditor or the UST can file a motion or objection with respect to certain actions in the bankruptcy case.</p> <p>The DIP/trustee may object to any creditor's proof of claim, for cause. FRBP 3007. The Bankruptcy Court, after notice and a hearing, determines the nature and amount of such claim as a contested matter. 11 U.S.C. § 502(b).</p> <p>The Bankruptcy Court has jurisdiction over adversary proceedings, which are actions</p>	<p>The CFC may bring an action in U.S. District Court within 30 days of the appointment of the FDIC as receiver to challenge the appointment of and remove the receiver. Such review is limited to the appointment of the receiver. § 204.</p> <p>There are inconsistent sections related to the availability of judicial review over claims determinations made by the FDIC. § 208(a)(5)(A) seems to provide that claims that are disallowed are reviewable in U.S. District Court 60 days from the date of the notice of disallowance, or at the end of the 180-day period in which the FDIC has to review claims.</p> <p>On the other hand, § 208(a)(4)(E) seems to provide</p>	<p>The company may bring an action in U.S. District Court within 30 days of the appointment of a conservator or receiver to challenge the appointment of the conservator or receiver. 12 U.S.C. § 1821(c)(7).</p> <p>Claimants can request a judicial determination or an administrative hearing to review the FDIC's determinations. Final determinations in administrative hearings are subject to judicial review. 12 U.S.C. § 1821(d)(6).</p> <p>There are inconsistent sections related to the availability of judicial review over claims determinations made by the FDIC in 12 U.S.C. § 1821(d). However, cases</p>

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

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Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p>that cannot be handled by motion in the bankruptcy case, but instead require the filing of a separate complaint. FRBP 7001 lists types of actions that require an adversary proceeding.</p>	<p>that there is no judicial review over the FDIC's disallowance of any claim, claim of security, preference, or priority that is not provided to the satisfaction of the FDIC. Note that parallel inconsistencies are found in the FDIA.</p> <p>Cases under the FDIA, which contains similar language, suggest that judicial review is available after exhaustion of the administrative claim process with the FDIC.</p> <p>Unless provided in the Bill, no court has jurisdiction over any claim or action for payment from, or action seeking a determination of rights with respect to, the assets of any company for which the FDIC has been appointed as its receiver, or any claim relating to any act or omission of the company or FDIC as receiver. § 208(a)(10)(D).</p> <p>No court may take any action to restrain or affect the exercise of powers or functions of the receiver, unless specifically provided in the Bill or at the request of the FDIC. § 208(c).</p> <p>The notice of appeal of any order, entered in any case brought by the FDIC against a CFC's director, officer, employee, or any other person employed by or providing services to such company, shall undergo expedited proceedings and be filed not later than 30 days after entry of the order and heard not later than 120 days after the date of the notice of appeal. The appeal shall be decided no later than 180 days after the date of the notice of appeal. § 208(j)(1).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>interpreting these sections suggest that judicial review is available after exhaustion of the administrative claim process with the FDIC.</p> <p>Unless otherwise provided, no court has jurisdiction over any action for payment from, or determination of rights with respect to, the assets of any company for which the FDIC has been appointed as its receiver, or any claim relating to any act or omission of the company or FDIC as receiver. 12 U.S.C. § 1821(d)(1)(D).</p> <p>An appeal of any order, entered in any case brought by the FDIC against a company's director, officer, employee, or any other person employed by or providing services to such company, shall undergo expedited proceedings and be filed within 30 days after entry of the order and heard 120 days after the date of the notice of appeal. 12 U.S.C. § 1821(g).</p> <p>No court may issue an attachment or execution over the assets that are in the possession of the FDIC as receiver. 12 U.S.C. § 1821(d)(1)(c).</p>
<p>Suspension of other legal actions</p>	<p>The FDIC's placement as receiver terminates any federal bankruptcy or state bankruptcy actions, and no such case or proceeding may be commenced with</p>	<p>FDIC can direct a court to temporarily stay any judicial action, criminal or non-criminal. 12 U.S.C. § 1821(d)(12).</p>

Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p>police and regulatory proceedings) against the debtor are automatically, and without the need for a specific request, stayed. No such actions can proceed without the Bankruptcy Court lifting the automatic stay, which remains in place until the case is dismissed or closed. 11 U.S.C. § 362.</p> <p>The automatic stay applies to non-judicial actions, including the enforcement of a judgment, any act to obtain possession of property of the estate, any act to create, perfect, or enforce any lien against property of the estate, any act to collect, assess, or recover a pre-petition claim, and the setoff of any pre-petition debt against any claim against the debtor. The automatic stay terminates when the property is no longer part of the estate, the Court lifts the stay, or the case is dismissed or closed. 11 U.S.C. § 362.</p>	<p>respect to the CFC while the FDIC is acting as receiver under the Bill. § 206.</p> <p>Upon the request of the FDIC, any court where a non-criminal judicial action, to which the CFC is or becomes a party, is pending shall grant a stay to all parties for 90 days. § 208(a)(9).</p>	
<p><b>Reversal of claims</b></p> <p>The DIP/trustee has the power to bring lawsuits and avoidance actions, including fraudulent conveyance and preference claims, but cannot revive claims where the statute of limitations has expired before the filing. The Bankruptcy Code contains provisions for extending the statute of limitations, commencement of actions and</p>	<p>The FDIC can bring an action on certain tort claims where the state statute of limitations has expired not more than 5 years before the appointment of the FDIC as receiver. The claim must arise from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the CFC. § 208(a)(1)(C).</p> <p>The provisions of the BIF are substantially similar to</p>	<p>Within 5 years of the appointment of the FDIC as receiver or conservator, the FDIC can bring an action on certain tort claims even though the state statute of limitations has expired. The claim must arise from fraud, intentional misconduct resulting in unjust enrichment, or intentional misconduct resulting in substantial loss to the eligible</p>

<sup>3</sup> The FDIC has commented that the proposed legislation references a "termination" of any pending bankruptcy cases, which does not reflect the fact that bankruptcy cases are generally dismissed, not terminated, causing everything to revert to the status quo ante before the bankruptcy was commenced. They point out that consideration should be given to any fast day relief, including DIP financing, entered by the Bankruptcy Court. As an alternative, they propose making specified financial companies that would be eligible to be CFCs ineligible to be debtors under the Bankruptcy Code. They also believe it would be helpful to clarify that when a pending bankruptcy case is "terminated" the Bankruptcy Court will be divested of jurisdiction over the CFC debtor and its estate, and that property of the estate will revert to the CFC, from the DIP/trustee.

<sup>4</sup> The FDIC has suggested deleting the limitation to "non-criminal" judicial actions to conform it to the FDIA where the FDIC can stay any judicial action, criminal or non-criminal. The FDIC has stated that it does not want to waste money and resources in defense of prosecutions of criminal offenses committed by the CFC or those acting on its behalf.

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	response dates but only if those periods have not expired to file the bankruptcy case is filed. 11 U.S.C. § 108.	those of the FDIA	12 U.S.C. § 1821(d)(4)(c)
<b>Director and officer liability</b>	Directors and officers of a company owe fiduciary duties to the company. When the company is solvent, shareholders can bring an action for breach of those duties. When the company is insolvent, creditors can also bring an action for breach of those duties. Directors can be held liable for taking actions that are not in the best interest of the estate or for failing to take actions that are in the best interest of the estate. Failing to file a bankruptcy case to protect valuable assets of the company may be the basis of a breach of fiduciary duty claim.	Directors and officers are not liable to the shareholders or creditors for acquiring or consenting in good faith to the appointment of the FDIC and acquisitions, combinations, or transfers of assets or liabilities taken by the FDIC. § 205. Director and officers of a CFC may be held personally liable for monetary damages in any civil action for gross negligence, including intentional tortious conduct, as defined under applicable state law. § 208(f). In claims proceedings involving any director, employee, or service provider, damages due to "improvident or otherwise improper use or investment" of any assets include principal losses and appropriate interest are recoverable. § 208(g). The provisions of the Bill are substantially similar to those of the FDIA.	Directors and officers are not liable for acquiring to the appointment of the FDIC and acquisitions, combinations, or transfer of assets taken by the FDIC. 12 U.S.C. § 1821(c)(12). Directors and officers may be personally liable for actions for gross negligence or "intentional tortious conduct." 12 U.S.C. § 1821(k). In claims proceedings involving any director, employee, or service provider, damages due to "improvident or otherwise improper use or investment" of any assets include principal losses and interest are recoverable. 12 U.S.C. § 1821(l).
<b>Creditor claims</b>	The DIP/trustee cannot unilaterally disallow any claim or portion of a claim. The DIP/trustee will file a list of creditors and their claims and, in addition, receive and evaluate claims submitted by creditors. Claims are deemed allowed unless contested. If contested, the Bankruptcy Court, after notice and a hearing, determines the nature and amount of such claim as a contested matter, and may allow or disallow some or all of any such claim. 11 U.S.C. § 502.	<b>CLAIMS AGAINST THE COMPANY</b> The FDIC, as receiver, may determine claims by creditors. § 208(a)(2)(A). The FDIC, as receiver, shall promptly publish a notice to creditors of the CFC, to present their claims with proof, to the receiver by a date specified in the notice, which shall be not earlier than 90 days after the date of publication of such notice. The notice will be republished one and two months after the initial publication. § 208(a)(2)(B). The FDIC shall determine whether to allow or disallow a claim within 180 days of the filing of such claim with the FDIC. § 208(a)(4)(A)(i). Extensions of such time may be agreed to in writing between the FDIC and the claimant. § 208(a)(4)(A)(ii). The FDIC may	The FDIC may allow or disallow any claim as a receiver. 12 U.S.C. § 1821(d)(5). The FDIC may disallow any portion of the claim that is not proved to the FDIC's satisfaction. 12 U.S.C. § 1821(d)(5)(D). See Judicial Review above for the limited role of the court in the claims process.

	Bankruptcy Code	The Proposed Bill ("Bill")	Federal Deposit Insurance Act ("FDIA")
		<p>disallow any portion of a claim that is not proved to the FDIC's satisfaction. § 208(a)(4)(D)(ii).</p> <p>Credit extensions from the Federal Reserve or the Treasury to a CFC and any legally enforceable or perfected security interest with respect to such credit extensions shall not be disallowed.</p> <p>§ 208(a)(4)(D)(iii).</p> <p>The FDIC may prescribe rules to establish a uniform interest rate for, or to make payments of post-insolvency interest to creditors holding proven claims against the receivership estates of a CFC following satisfaction by the receiver of the principal amount of all creditors' claims. § 208(a)(8)(C).</p> <p>See Judicial Review above for the limited role of the court in the process.</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	
Post-commencement claims	<p>Post-petition claims are treated as administrative claims and paid in full no later than the effective date of the plan; post-petition claims are paid before pre-petition claims.</p>	<p>Final judgment for money damages against the FDIC for contracts executed or approved after the date of the FDIC's appointment shall be paid as an administrative expense (the highest priority for unsecured claims). § 208(a)(15).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>Final judgment for money damages against the FDIC for contracts executed or approved by the conservator or receiver after the date of its appointment shall be paid as an administrative expense. 12 U.S.C. § 1821(d)(20).</p>
Claims preceding commencement	<p>The payment of pre-petition claims is generally done through the plan of reorganization, although the Bankruptcy Court can permit early payment of certain pre-petition claims, such as critical vendor claims, if that is in the best interest of the estate. The Bankruptcy Code sets out the priority of distributions and how much a class of creditors must receive before distributions may be made to a more junior class.</p>	<p>The FDIC as receiver shall pay all valid obligations of the CFC that are due and payable at the time the FDIC is appointed, to the extent funds are available and subject to the prescriptions and limitations of the Bill. § 208(a)(1)(G).</p> <p>This is subject to the limitation in § 208(d)(2) that maximum liability is capped at the amount a claimant would have received if the CFC had not been the subject of a determination under the Bill and had been liquidated under the Bankruptcy Code (claims are valued at face but are only paid to the</p>	<p>Claims due and payable preceding commencement under the same process and are treated the same as other claims, with no mandate for payment. Uses the procedure of 12 U.S.C. § 1821(c).</p>

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<b>Shareholder claims</b>	<p>In a chapter 11 reorganization, creditors may receive considerably more than liquidation value as the value of a business as a going concern may greatly exceed its liquidation value.</p> <p>Shareholders are entitled to recover a distribution if there are sufficient assets in the estate to pay in full claimants with a higher priority. While the debtor remains in possession in a chapter 11 case, it is managed by its board of directors and duly authorized officers. The directors and officers have to act in the best interest of the estate as a whole, however, as they also owe fiduciary duties to creditors in the insolvency context.</p>	<p>The Bill terminates all rights and claims that stockholders and creditors of the CFC have against its assets, except rights to payment, resolution, or other satisfaction of their claims as permitted under the section, by operation of law on the appointment of the FDIC. The Bill also provides that the FDIC shall ensure that emergency stabilization actions under § 203 will not prevent the shareholders from bearing losses. § 208 (a)(1)(K).</p>	<p>Shareholder claims arising from their status as stockholders receive the lowest priority, after payment of other unsecured claims. 12 U.S.C. § 1821(d)(11).</p>
<b>Secured claims</b>	<p>Secured claims are secured up to the value of the collateral. An over-secured creditor's claim will include post-petition interest on the claim. 11 U.S.C. § 506.</p> <p>As noted below, the value of the collateral will be determined in light of the purpose of the valuation. Thus, the valuation may differ depending on the context in which the valuation arises.</p> <p>Secured party's collateral can be used if there is a demonstration of adequate protection of the interest of such party.</p>	<p>The FDIC may disallow any portion of any claim by a creditor or claim of security, preference, or priority which is not provided to its satisfaction. The FDIC cannot disallow a portion of a legally enforceable or perfected security interest securing an extension of credit from any Federal Reserve bank or the Treasury Secretary. § 208(a)(4)(D)(i) and (ii)(II).</p> <p>Claims proven to the satisfaction of the FDIC are secured up to the fair market value of the collateral. § 208(a)(4)(D)(ii).</p> <p>The value of collateral in a liquidation may be significantly less than its value in a reorganization. No valuation methodology is included.</p> <p>The FDIC may not reject any legally enforceable or perfected security interest in the assets of the CFC unless such interest was made in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the CFC or its creditors. § 208(c)(12).</p> <p>The provisions of the Bill are substantially similar to</p>	<p>The FDIC may disallow all or part of any security not provided to its satisfaction, with the exception of any extension of credit from any Federal home loan bank or Federal Reserve bank to any insured depository institution, or any security interest in the assets of the institution securing any such extension of credit. § 1821(d)(5)(D)(i) and (ii).</p> <p>Claims proven to the satisfaction of the FDIC are secured up to the fair market value of the secured collateral and the amount a claimant would have received if the company had been liquidated under the FDIA. 12 U.S.C. § 1821(d)(5)(D)(ii)(I).</p> <p>The value of collateral in an FDIA liquidation may be significantly less than its value in a reorganization.</p> <p>Claims of Federal Home Loan Banks and secured claims are paid before unsecured claims.</p>



	Bankruptcy Code	The Proposed Bill ("Bill")	Federal Deposit Insurance Act ("FDIA")
<b>Under-secured creditors</b>	Generally, the portion of the claim that exceeds the value of the collateral is considered to be an unsecured claim and this portion has the same priority as other unsecured claims. 11 U.S.C. § 506. As noted above, the value of the collateral will be determined in light of the purpose of the valuation, and may differ depending on the context.	The FDIC, as receiver, may treat the portion of any claim which exceeds the fair market value of such collateral as an unsecured claim, and may not make payment with respect to such unsecured portion other than in connection with a disposition of all unsecured claims. § 208(a)(4)(D)(ii). The provisions of the Bill are substantially similar to those of the FDIA.	The FDIC may not avoid any legally enforceable or perfected security interest in any of the assets of any depository institution unless such interest was taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or its creditors. 12 U.S.C. § 1821(c)(11).
<b>Unsecured claims</b>	Unsecured claims have the following priority in descending order: <ul style="list-style-type: none"> <li>• administrative expenses;</li> <li>• priority wage/commission claims (\$10,950 per individual);</li> <li>• priority claims for employee benefit plan (shares the \$10,950 cap above);</li> <li>• priority claims of governmental units;</li> <li>• priority claims based upon any commitment by the debtor to a Federal depository; and</li> <li>• general unsecured claims. 11</li> </ul>	Unsecured claims have the following priority, in descending order: <ul style="list-style-type: none"> <li>• administrative expenses of the receiver;</li> <li>• amounts owed to the United States, unless the U.S. agrees or consents otherwise;</li> <li>• general or senior liabilities of the company;</li> <li>• obligations subordinated to general creditors;</li> <li>• obligations to persons with interests in the equity of the company as a result of their status as a shareholder, member, etc. § 208(b)(1).<sup>5</sup></li> </ul> Similarly situated creditors for each type of unsecured claim shall be treated similarly unless the FDIC determines that the treatment is necessary to	The portion of the claim that exceeds the fair market value of the collateral in a secured claim may be treated as an unsecured claim and this portion has the same priority as other unsecured claims. 12 U.S.C. § 1821(d)(5)(D)(i).

<sup>5</sup> The FDIC has suggested including this provision and conforming it to the priority order set forth in the FDIA. This provides that administrative claims will have first priority, followed by any obligation owed to the Treasury, the FDIC or any debt obligation that is guaranteed by the FDIC. Next comes any general or senior liabilities followed by any subordinated obligations, and finally shareholder claims.

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

	Bankruptcy Code	The Proposed Bill ("BRF")	Federal Deposit Insurance Act ("FDIA")
<p><b>Payment of claims</b></p>	<p>U.S.C. § 507.</p> <p>Similarly situated creditors are to be treated similarly under the plan, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest. 11 U.S.C. § 1123. Under section 105 of the Bankruptcy Code, the Bankruptcy Court has the power, under certain circumstances, to treat similarly situated creditors dissimilarly, e.g., by providing that critical vendors who agree to provide post-petition credit terms to a debtor may be paid in full for pre-petition claims.</p>	<p>maximize the value of the company's assets, minimize the losses, or contain adverse effects on the financial stability of the U.S. economy. § 208(b)(4). All similarly situated creditors must receive not less than the Liquidation Amount. § 208(d)(2).</p> <p>"Administrative expenses" includes any obligations that the receiver determines are necessary and appropriate to facilitate the smooth and orderly liquidation or resolution of the FPC. § 208(p)(o)(B).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA, with the exception of (1) the preferential treatment of depositors by the FDIA and of amounts due to the U.S. government under the Bill, and (2) the fact that the FDIC can decide to treat similarly situated creditors differently, if it determines such treatment is necessary.</p>	<p>Receiver may pay authorized claims allowed by the receiver, approved by the FDIC, or determined by the final judgment of a court. 12 U.S.C. § 1821(d)(10)(A).</p> <p>The receiver has the sole discretion to pay dividends on proven claims. No liability shall attach for failing to pay dividends on an unproven claim. 12 U.S.C. § 1821(d)(10)(B).</p> <p>The minimum requirement is that the claimant receive at least the amount that would be provided with the liquidation of the assets and liabilities of the institution without a transfer of the assets or liabilities to a Bridge Company or the purchase of such assets or liabilities by the FDIC (such claims are valued according to the determinations of the FDIC but are only paid to the extent funds are available at that particular FDIC priority level). 12 U.S.C. § 1821(f)(2).</p>
<p><b>Payment of claims</b></p>	<p>All claims are paid pursuant to the terms of the confirmed plan.</p> <p>Holders of secured claims may request relief from the automatic stay to foreclose on their collateral for cause or upon a demonstration that the debtor has no equity in the collateral and that it is not essential to the debtor's reorganization. 11 U.S.C. § 362.</p> <p>The general rule is that if senior classes consent to their distribution, junior classes may receive distributions so long as the members of such senior consenting classes receive at least as much as they would in a chapter 7 liquidation, however, if a class does not consent to its distribution, it is entitled to be paid in full before any junior class can receive any recovery.</p> <p>Certain pre-petition claims, such as those</p>	<p>The FDIC may pay authorized claims allowed by the receiver, approved by the FDIC, or determined by the final judgment of a court. § 208(a)(8)(A).</p> <p>The receiver has the sole discretion to pay dividends on proven claims. No liability shall attach for failing to pay dividends on an unproven claim. § 208(a)(8)(B).</p> <p>The FDIC may prescribe rules to establish a single uniform interest rate for, or to make payments of post-insolvency interest to creditors holding proven claims following satisfaction of the principal amount of all creditor claims. § 208(a)(8)(C).</p> <p>The minimum requirement, however, is that the claimant would receive at least the Liquidation Amount.</p> <p>The provisions of the Bill are substantially similar to those of the FDIA, with the exception of the standards used to determine the minimum amounts</p>	<p>Receiver may pay authorized claims allowed by the receiver, approved by the FDIC, or determined by the final judgment of a court. 12 U.S.C. § 1821(d)(10)(A).</p> <p>The receiver has the sole discretion to pay dividends on proven claims. No liability shall attach for failing to pay dividends on an unproven claim. 12 U.S.C. § 1821(d)(10)(B).</p> <p>The minimum requirement is that the claimant receive at least the amount that would be provided with the liquidation of the assets and liabilities of the institution without a transfer of the assets or liabilities to a Bridge Company or the purchase of such assets or liabilities by the FDIC (such claims are valued according to the determinations of the FDIC but are only paid to the extent funds are available at that particular FDIC priority level). 12 U.S.C. § 1821(f)(2).</p>

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	owed to employees and to the government for certain taxes, are afforded priority treatment. Priority pre-petition claims are paid after administrative claims but before payment of general unsecured claims.	due to claimants.	
<b>Disposition of assets</b>	Ordinary course dispositions of assets, i.e., those dispositions that are in the ordinary course of the debtor's day-to-day business operations, may occur without Court approval. Sales outside the ordinary course must be approved by the Bankruptcy Court under 11 U.S.C. § 363 or the plan. 11 U.S.C. § 1123. Assets may be sold free and clear of all liens under 11 U.S.C. § 363 or the plan. Both types of sales are subject to Court approval under the "best interest of the estate" standard which seeks to maximize the value of the assets for the benefit of the estate.	In the disposition of assets, a receiver shall: <ul style="list-style-type: none"> <li>maximize its net present value return from sale or disposition of assets;</li> <li>minimize losses in the resolution of cases;</li> <li>minimize the cost to the general fund of the Treasury;</li> <li>mitigate serious adverse effects to the financial system and U.S. economy;</li> <li>ensure competition and fair treatment; and</li> <li>prohibit discrimination. § 208(e)(1)(E).</li> </ul> The provisions of the BIF are substantially similar to those of the FDIA, with the exception of the fact the FDIC has no duty to maximize the availability and affordability of residential real property to low and moderate income individuals.	In the disposition of assets, a conservator or receiver shall: <ul style="list-style-type: none"> <li>maximize its present value return from sale of assets;</li> <li>minimize losses in the resolution of cases;</li> <li>ensure competition and fair treatment;</li> <li>prohibit discrimination; and</li> <li>maximize the availability and affordability of residential real property to low- and moderate-income individuals. 12 U.S.C. § 1821(d)(1)(E).</li> </ul>
<b>Maximum liability of the FDIC/DIF/trustee</b>	No creditor is entitled to be paid more than 100% of its claim, plus interest (if applicable). Any excess available after all creditors are paid such amount inures to the benefit of shareholders. A secured party receives the value of the collateral. The value of the collateral will be determined in light of the purpose of the valuation. Thus, value in the context of treatment under a reorganization plan may be determined to be far more than the liquidation value of such collateral.	Maximum liability of the FDIC is capped at the Liquidation Amount (defined above). § 208(d)(2). This will likely be pursuant to chapter 7 of the Bankruptcy Code. The FDIC may, as receiver and with the approval of the Secretary, make additional payments or credit additional amounts to any claimant if necessary to minimize losses to the resolution of the CFC or prevent or mitigate serious adverse effects to the financial stability of the U.S. § 208(d)(3). When liquidating any CFC or Bridges Company, the FDIC, as receiver, shall apply the provisions of subchapter III of chapter 7 of the Bankruptcy Code.	Liability is capped at the amount claimant would receive in a liquidation of the institution without a transfer of the assets to a Bridge Company or the purchase of such assets by the FDIC (such claims are valued according to the determinations of the FDIC but are only paid to the extent funds are available at that particular FDIC priority level). 12 U.S.C. § 1821(o)(2).

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p><b>Fraudulent conveyances</b></p>	<p>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 2 years before the date of the filing of the petition, if:</p> <ul style="list-style-type: none"> <li>(a) made with the intent to hinder or defraud a creditor (actual fraud); or</li> <li>(b) in exchange for the transfer, the debtor received less than "reasonably equivalent value," and the debtor was unable to pay debts either at the time the transfer was made or as a result of the transfer itself (constructive fraud). 11 U.S.C. § 548.</li> </ul> <p>The DIP/trustee can recover the property transferred, or the value of such property, from the initial transferee or any immediate or mediate transferee of such initial transferee, unless the subsequent transferee took for value and without knowledge of the voidability of the transfer avoided. 11 U.S.C. § 550.</p> <p>The Bankruptcy 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. 11 U.S.C. § 544(b). The applicable statute of limitations under state statutes may be 4 years or more.</p>	<p>for the distribution to any "customer" of all "customer name securities" and "customer property" as if such company was a debtor, if the company is a stockbroker and not a member of the SIPC, or apply the provisions of subchapter IV of chapter 7 of the Bankruptcy Code as if such company was a debtor, if the company is a commodity broker. § 208(m).</p> <p>The FDIC may avoid a transfer of interest that was made within 5 years of the date the FDIC was appointed as a receiver if the person who made the transfer did so with the intent to hinder, defraud, or delay the CFC or the FDIC. § 208(a)(12)(A).</p> <p>The FDIC can recover the property transferred or value of the property (at the time of the transfer) from the initial transferee or others in the chain of transfer. § 208(a)(12)(B).</p> <p>The FDIC cannot recover from any transferee that takes for value, including satisfaction or securing of a present or prior debt, in good faith or any immediate good faith transferee of such transferee. § 208(a)(12)(C).</p> <p>The rights of the FDIC to recover or assets from fraudulent transfers supersedes the rights of any trustee in bankruptcy or any other person under the Bankruptcy Code. § 208(a)(12)(D).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>FDIC may avoid a transfer of interest that was made within 5 years of the date the FDIC was appointed as a conservator or receiver if the person who made the transfer did so with the intent to hinder, defraud, or delay the institution, the FDIC or any other federal banking agency. 12 U.S.C. § 1821(d)(17)(A).</p> <p>Avoiding a fraudulent conveyance allows the FDIC to recover the property transferred or the value of the property from either the initial transferee or any immediate transferee of the initial transferee. 12 U.S.C. § 1821(d)(17)(B).</p> <p>The FDIC cannot recover from any transferee that takes for value, including satisfaction or securing of a present or prior debt, in good faith or any immediate good faith transferee of such transferee. 12 U.S.C. § 1821(d)(17)(C).</p> <p>The avoidance rights of the FDIC are superior to any rights of a trustee or any other party. 12 U.S.C. § 1821(d)(17)(D).</p>

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p><b>Avoiding security interests and other preferential transfers</b></p>	<p>The Bankruptcy Code allows the avoidance of preferential transfers. A preference is a transfer 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 a year if the creditor was an "insider." 11 U.S.C. § 547.</p> <p>Preferential transfers may include payments of amounts due to existing creditors or grants of new security interests to secure obligations owed to existing creditors. 11 U.S.C. §§ 547. Defenses include that the transfer was made for new value or in the ordinary course of business.</p>	<p>The FDIC cannot avoid any otherwise legally enforceable or perfected security interest in the company's assets unless such interest was taken in contemplation of the CFC's insolvency or with the intent to hinder, delay, or defraud the institution or its creditors, or any legally enforceable interest in customer property. § 208(e)(12). There is no discussion or definition of what constitutes "in contemplation of the company's insolvency."</p> <p>The Bill does not contain any general preference avoidance provision.</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>The FDIC cannot avoid any otherwise legally enforceable or perfected security interest in any of the institution's assets unless such interest was taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or its creditors. 12 U.S.C. § 1821(e)(12).</p>
<p><b>Attachment of assets</b></p>		<p>The FDIC may request a court to issue an order (in accordance with Rule 65 of the Federal Rules of Civil Procedure) to place the assets of any person designated by the FDIC under the control of the court and appoint a trustee to hold such assets. §208(e)(13).</p>	
<p><b>Contracts</b></p>	<p>A DIP/trustee may reject, assume, or assume and assign to a third party the debtor's interest in pre-petition executory contracts (contracts where performance remains due on both sides), even if the debtor is in default under the contract at the</p>	<p><b>CONTRACTS WITH THE COMPANY</b></p>	
		<p>No agreement that diminishes or defeats the interest of the receiver in any asset is valid unless the agreement is in writing and executed by an authorized officer or representative of the CFC and has been an official record of the CFC since the time of its execution. § 208(a)(7). Thus, oral contracts</p>	<p>No agreement is valid against the FDIC's interest as receiver unless the agreement:</p> <ul style="list-style-type: none"> <li>• is in writing;</li> <li>• was executed contemporaneously with the acquisition of the asset by the</li> </ul>

Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	<p>time of the bankruptcy filing. If a debtor wishes to assume/assign an executory contract, it must "cure" all defaults, compensate for any damages sustained and provide adequate assurance of future performance. There are some executory contracts which cannot be assumed or assigned (without the consent of the non-debtor party) because they are financial accommodations contracts or because applicable law excuses performance to an assignee of the debtor (personal services contracts). 11 U.S.C. § 365.</p> <p>Contracts must be in writing only if they fall within the statute of frauds. Thus, some oral contracts are enforceable.</p>	<p>against the interest of the FDIC are not enforceable. These standards are similar to, though not as strict as, the parallel provisions of the FDIA.</p> <p>The FDIC may repudiate any contract or lease to which the CFC is a party, which was executed before the appointment of the FDIC where contract performance is "burdensome" and the repudiation of the contract will promote the orderly administration of the CFC's affairs. § 208(c)(1). The FDIC has a "reasonable" time from the date of its appointment as receiver to exercise such right. § 208(c)(2).<sup>6</sup></p> <p>This shall not apply with respect to extensions of credit from any Federal Reserve Bank or the FDIC to any CFC or to any security interest in the assets of the CFC securing such extension of credit. § 208(c)(4).<sup>7</sup></p> <p>The provisions of the Bill are substantially similar to those of the FDIA, with the exception of the scope of the entities whose contracts with respect to extensions of credit may not be repudiated.</p>	<p>institution and a counterparty:</p> <ul style="list-style-type: none"> <li>was approved by the board of directors of the institution or its loan committee and the approval is reflected in the minutes of the board or committee; and</li> <li>has been continuously an official record of the depository institution. 12 U.S.C. § 1825(c) (codifies the <i>Dyrenick, Duhme</i> case standards).</li> </ul> <p>The FDIC may repudiate any contract executed before the appointment of the FDIC where contract performance is "burdensome" and the repudiation of the contract will promote the orderly administration of the company's affairs. 12 U.S.C. § 1821(e)(1).</p> <p>This shall not apply with respect to extensions of credit from any Federal Reserve and Federal home loan banks to any insured depository institution or any security interest in the assets of the institution securing such extension of credit. § 1821(e)(14).</p>
<p><b>Damages for repudiation</b></p>	<p>If the contract is rejected, it will give rise to a pre-petition unsecured claim for damages, which may be paid <i>pro rata</i> rather than in full. Rejection claims for some types of contracts, such as long-term leases and employment contracts, are limited to</p>	<p>Damages for contracts executed or approved by the FDIC after its appointment as receiver shall be paid as an administrative expense. § 208 (b)(15).</p> <p>Damages for repudiation of a contract are limited to actual, direct compensatory damages, determined at the date of the appointment of the FDIC or</p>	<p>Damages for repudiation of a contract are limited to direct compensatory damages, determined at the date of the appointment of the FDIC. 12 U.S.C. § 1821(e)(3)(A)(D). But courts have determined that the amount of recover liability can be affected by post-</p>

<sup>6</sup> The FDIC has recommended that the "reasonable period" be clarified, to allow the receiver to consider the complexity of the contract, the potential for sale of the contract to a third party, and the condition of the CFC's records.

<sup>7</sup> The FDIC has proposed adding extensions of credit from any Federal home bank as well. Prior versions of the legislation included extensions of credit from the Fed and the Treasury.

	Bankruptcy Code	The Proposed Bill ("BR")	Federal Deposit Insurance Act ("FDIA")
	<p>defined time periods.</p> <p>Executory contracts first assumed by a debtor but subsequently rejected give rise to an administrative claim for a portion of the damages. Administrative claims must be paid in full by the debtor on or before the effective date of the plan. 11 U.S.C. § 503.</p>	<p>repudiation of the contract for qualified financial contracts. § 208(c)(3)(A).<sup>8</sup></p> <p>There is no liability for other damages, including punitive or exemplary damages, lost profits, and pain and suffering, and, presumably, attorney's fees. § 208(c)(3)(B).</p> <p>Compensatory damages for repudiated Qualified Financial Contracts ("QFCs") shall include normal and reasonable costs of cover or other reasonable measure of damages used in the industry. § 208(c)(3)(C).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>insolvency events.</p> <p>There is no liability for other damages, including punitive, lost profits, and pain and suffering. 12 U.S.C. § 1821(c)(3)(B). Courts have construed this to mean that there is no liability for attorney's fees.</p> <p>Claimant under a contract repudiated by the FDIC must prove its damages to obtain compensation.</p>
<b>Contract enforcement</b>	<p>The DIP/trustee is the successor to the debtor's interest in any contracts and may enforce such interest. Before assumption or rejection, the non-debtor party to the agreement has to perform the agreement, and the DIP/trustee is generally obligated to timely perform the debtor's current obligations. Generally, termination provisions effective on the filing of a case under the Bankruptcy Code or in the event of insolvency are not enforceable, an exception exists for such termination provisions in the context of QFCs, financial accommodations contracts or contracts where applicable law excuses performance to an assignee of the debtor (personal services contracts).</p>	<p>The FDIC as receiver may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond. § 208(c)(13)(A).</p> <p>For the first 90 days of a receivership, the other party to a contract with a CFC may not exercise any right to terminate, accelerate, or declare a default on the contract or obtain possession or control over any property of the CFC without the FDIC's consent. § 208(c)(13)(C)(i). This provision does not apply to director or officer liability insurance contracts, financial institution bonds, or to the rights of parties to certain qualified financial contracts or certain contracts under the FDIC Improvement Act. After the 90-day stay, a counterparty may exercise any such rights. § 208(c)(13)(C)(ii).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>The FDIC as conservator or receiver may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond. 12 U.S.C. § 1821(c)(13)(A).</p> <p>For the first 45 days of a conservatorship and the first 90 days of a receivership, the other party to the contract may not exercise any right to terminate, accelerate, or declare a default on the contract without the FDIC's consent. 12 U.S.C. § 1821(c)(13)(C).</p> <p>Director or officer liability insurance contract, financial institution bond, certain qualified financial contracts, or certain contracts under the FDIC Improvement Act are exceptions. After the 45- or 90-day stay, a counterparty may exercise any such rights.</p>
<b>Service contracts</b>	<p>No separate provision. Treated as any other executory contract. See above.</p>	<p>Service contracts for performances before the FDIC's appointment are treated as claims and</p>	<p>Service contracts for performances before the FDIC appointment are treated as claims and</p>

<sup>8</sup> The FDIC has suggested adding language to provide that claims for repudiation damages should be classified as general unsecured claims as is done under the FDIA.

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	Generally, though, services performed after the petition date will be paid as an administrative expense. The contract can be rejected even if performance has been accepted prior to such rejection.	deemed to have arisen on the date of the FDIC's appointment. § 208(c)(7)(A). Services accepted by the FDIC and performed after the FDIC's appointment shall be paid as per the contract, which shall be treated as an administrative expense. § 208(c)(7)(B). <sup>9</sup> Service contracts can be repudiated despite acceptance or performance of the contract. § 208(c)(7)(C). The provisions of the Bill are substantially similar to those of the FDIA.	deemed to have arisen on the date of the FDIC appointment. 12 U.S.C. § 1821(e)(7)(A). Services accepted by the FDIC and performed after the FDIC appointment shall be paid as per the contract, which shall be treated as an administrative expense. 12 U.S.C. § 1821(e)(7)(B). Service contracts can be repudiated despite acceptance or performance of the contract. 12 U.S.C. § 1821(e)(7)(C).
<b>Property contracts</b>	The DIP/trustee may assume, reject or assume and assign to a third party the debtor's interest in any pre-petition unexpired lease, subject to the obligation to cure any defaults, compensate for damages and provide adequate assurance of future performance. 11 U.S.C. § 365. Rejection damages claims under long-term leases are limited. The Bankruptcy Code contains complex provisions related to the rejection of license agreements, land contracts and the like, and the rights of the counterparties thereto.	Leases can be repudiated but the counterparty cannot assert a claim for lost profits. § 208(c)(4). Assignment and sale of land contracts are allowed. § 208(c)(6)(C). The provisions of the Bill are substantially similar to those of the FDIA.	Leases can be repudiated but the counterparty cannot assert a claim for lost profits. 12 U.S.C. § 1821(e). Assignment and sale of land contracts are allowed. 12 U.S.C. § 1821(e)(6)(C).
<b>Qualified Financial Contracts ("QFCs")</b>	The Bankruptcy Code provides "safe harbors" for Qualified Financial Contracts, which are defined as securities contracts, forward contracts, commodity contracts, repurchase agreements, swap agreements, and other similar agreements. Credit	Qualified Financial Contracts are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements or other similar agreements determined by the FDIC, or order to be a QFC. § 208(c)(8)(D).	Qualified Financial Contracts are securities contracts, commodities contracts, forward contracts, repurchase agreements, swap agreements or other similar agreements. 12 U.S.C. § 1821(e)(8)(D)(i). If the FDIC is appointed as the receiver,

<sup>9</sup> The FDIC has proposed the addition of "to the extent such terms represent, as determined by the Corporation, a reasonable and customary rate for such services." This language is to protect the receiver from having to pay excessive compensation for an essential service that cannot be readily replaced, such as data processing or loan servicing.



Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009

Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p>support, including guarantees, issued in connection with these QFCs are also protected.</p> <p>Non-debtor counterparties may, immediately and without seeking relief from the automatic stay, exercise their contractual rights under Qualified Financial Contracts 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 Bankruptcy Code, in order to protect the estate of the debtor. In addition, any deliveries or settlements made pursuant to these Qualified Financial Contracts are protected from being avoided as either preferential or fraudulent transfers, provided that they were not made with an intent to defraud.</p>	<p>After the FDIC is appointed as receiver, the non-CFC counterparty to a QFC must wait until 5:00 p.m. of the third business day following such appointment to exercise any right to terminate, liquidate or net such contract solely because of the FDIC's appointment as receiver, or for the insolvency or financial condition of the CFC. § 208(c)(10)(B)(i)<sup>10</sup>. Earlier drafts of the proposal used the one-day period used in the FDIA.</p> <p>During this time, the FDIC may choose to transfer the QFCs to one financial institution for which a conservator, receiver, trustee or other legal custodian has not been appointed, including a Bridge Company under § 208(c)(9)(A). After such transfer, the counterparty cannot terminate the QFC based on the transfer or the appointment of the FDIC. § 208(c)(10)(B)(ii). After the waiting period has elapsed, and the QFCs have not been transferred to another financial institution (as set forth above), the counterparties may then exercise their rights to terminate, liquidate or accelerate the contract, exercise any rights under a related security agreement or exercise its rights to set-off or net amounts due in connection with such QFCs, as set forth in § 208(c)(8)(A), § 208(c)(10)(B)(i).</p> <p>The FDIC may not avoid a transfer of money or property, in connection with any QFC with a CFC, unless the transferee had actual intent to hinder, delay or defraud the CFC, creditors or receiver for the CFC. § 208(c)(8)(C)(ii).</p> <p>The FDIC, as receiver, must choose to repudiate all QFCs between the company and any person, or affiliate of that person, or disaffirm none of those QFCs. § 208(c)(11). This provision is to ensure that</p>	<p>parties to QFCs can terminate, liquidate, or accelerate the contract, exercise any right under a security agreement related to the contract, or exercise any right to a transfer obligation with one or more such contracts that is related to the termination, liquidation, or acceleration of a qualified financial contract. 12 U.S.C. § 1821(c)(8)(A)(i). The party must wait until 5:00 p.m. the following business day of the appointment of the receiver, to exercise any right to terminate, liquidate or net such contract solely because of the FDIC's appointment as receiver.</p> <p>During this time, the FDIC may choose to transfer the QFCs to a third party, at which time the counterparty cannot terminate the QFC based on the transfer or the appointment of the FDIC. 12 U.S.C. § 1821(c)(10)(B)(i).</p> <p>If the FDIC is appointed as the conservator, a party to a QFC may not terminate, liquidate, or net such contract solely by reason of the appointment of a conservator for the institution or the insolvency or financial condition of the institution for which the conservator has been appointed. 12 U.S.C. § 6(e)(10)(B)(ii).</p> <p>The FDIC may not avoid a transfer of money or property in connection with any QFC with a CFC, unless the transferee had actual intent to hinder, delay or defraud such institution, the creditors of such institution, or any conservator or receiver appointed for such institution. 12 U.S.C. § 6(e)(8)(C)(i).</p>

<sup>10</sup> In earlier drafts, the FDIC has suggested inserting a provision to provide that the FDIC has the authority, and sole discretion, to limit any right under any security agreement or arrangement or other credit enhancement to not less than 80% of the termination value, payment amount or other transfer obligation under any QFC. They state that this is to ensure that there will be sufficient funds to reimburse the FDIC and other government agencies for losses incurred in the resolution of the CFC in receivership.

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Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
	<p>The FDIC is not "clergy-picking" only those QFCs in its favor.</p> <p>When transferring QFCs, the FDIC can transfer all QFCs, claims and property securing the QFC or other credit enhancement between any person or affiliate and the CFC, or transfer none of the QFCs, claims, property, or credit enhancements.</p> <p>§ 218(c)(9)(A).</p> <p>Clauses that suspend conditions, or extinguish a payment obligation of a party due to a party's status as a non-defeating party ("walk away clauses") are unenforceable in QFCs. § 218(c)(8)(F).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA, with the exception of the three day, rather than one-day period to review such QFCs after the appointment of the FDIC as receiver.</p>	<p>The FDIC, as conservator or receiver, must choose to repudiate all QFCs between the institution and any person, or affiliate of that person, or disqualify none of those qualified financial contracts. 12 U.S.C. § 1821(c)(11).</p> <p>The FDIC, as conservator or receiver, can transfer all QFCs, claims, and property securing the credit between the company and a party, or none of the QFCs. The FDIC cannot transfer these assets or liabilities to a company in bankruptcy or that has a conservator or receiver. 12 U.S.C. § 1821(c)(9).</p> <p>Damages for repudiation are determined as of the date of the repudiation of the contract and includes the cost of cover.</p> <p>Clauses that suspend conditions, or extinguish a payment obligation of a party due to a party's status as a non-defeating party ("walk away clauses") are unenforceable in qualified financial contracts. 12 U.S.C. § 1821(c)(8)(G).</p>
<p><i>Ipsa facto</i> clause</p> <p>To protect the debtor's estate, provisions allowing a counterparty to terminate a contract or a lease with the debtor because the debtor is insolvent or has filed for bankruptcy will generally not be enforced. 11 U.S.C. § 365(e). There are exceptions, however, including QFCs, personal services contracts, and contracts for financing accommodations.</p>	<p>The FDIC, as receiver, may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond, notwithstanding any provision that would otherwise allow counterparties to terminate, treat as a default, accelerate or exercise any other rights upon, or solely because of, the insolvency or appointment of the FDIC as receiver. As such, <i>ipso facto</i> clauses are not enforceable at the counterparty's discretion.</p> <p>There are no exceptions for personal services contracts, IP licenses, or financing contracts. § 218(c)(13).</p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>Conservator or receiver may enforce any contract, other than a director's or officer's liability insurance contract or financial institution bond, notwithstanding any provision that would otherwise allow counterparties to terminate, treat as a default, accelerate or exercise any other rights upon, or solely because of, the insolvency or appointment of the FDIC as conservator or receiver. 12 U.S.C. § 1821(c)(12)(A). Thus, <i>ipso facto</i> clauses are not enforceable at the counterparty's discretion. The FDIC may choose to enforce the contract irrespective of any <i>ipso facto</i> clause.</p> <p><i>Ipsa facto</i> clauses create a provable claim for</p>

	Bankruptcy Code	The Proposed Bill ("BIF")	Federal Deposit Insurance Act ("FDIA")
<p><b>Confidentiality agreements</b></p>	<p>Generally, actions taken and decisions made in a bankruptcy case must be disclosed and are publicly available. Under certain circumstances, the Bankruptcy Court may enter an order protecting the disclosure of proprietary and trade secret information.</p>	<p>The FDIC may not enter into any agreement or approve any protective order which prohibits the FDIC from disclosing the terms of a settlement, administrative or other action from damages or restitution brought by the FDIC as receiver, § 208(f).<sup>11</sup></p> <p>The provisions of the Bill are substantially similar to those of the FDIA.</p>	<p>damages in the time of reorganization because the states of the parties were permanently fixed at the time of default. The counterparty can seek to file a claim for the contract.</p> <p>The FDIC may not enter into any agreement or any protective order which prohibits the FDIC from disclosing the terms of a settlement brought by the FDIC as conservator or receiver. 12 U.S.C. § 1821(s).</p>
<p><b>Bridge Bank Holding Company ("Bridge Companies")</b></p>	<p>No concept of bridge companies to hold assets, although 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 only holds non-operating assets and litigation claims, but not the operating assets of a business.</p>	<p><b>BRIDGE COMPANIES</b></p> <p>Bridge Companies may assume liabilities, purchase assets, and perform other temporary functions of the corporation. § 208(b)(1)(B).</p> <p>The FDIC, as receiver, may transfer any of the company's assets and liabilities to one or more Bridge Companies. § 208(f)(5)(A). The Bridge Company will work to maximize the net asset value of the transferred assets and liabilities. The company left behind would be liquidated.</p> <p>The FDIC can create Bridge Companies with federal charters. § 208(b)(2)(A).</p> <p>The FDIC appoints the board of directors of the Bridge Company. § 208(b)(2)(B).</p> <p>A Bridge Company be treated as a CFC in default at such times and for such purposes as the FDIC may determine. § 208(b)(4).</p> <p>The Bridge Company can operate without any</p>	<p>The FDIC can create "bridge banks." 12 U.S.C. § 1821(d)(2)(F)(ii).</p> <p>The Office of the Comptroller of the Currency provides national charters for bridge banks. 12 U.S.C. § 1821(o)(1)(A).</p> <p>The bridge bank does not have federal status. 12 U.S.C. § 1821(o)(6).</p> <p>Bridge banks may assume defaulting deposits, assume other liabilities, purchase assets, and perform other temporary functions of the institution. 12 U.S.C. § 1821(o)(1)(B).</p> <p>The FDIC appoints the board of directors of the bridge bank. 12 U.S.C. § 1821(o)(2)(D).</p> <p>The FDIC-controlled institution can transfer any assets and liabilities of the institution to the bridge bank. 12 U.S.C. § 1821(o)(3)(A).</p> <p>The FDIC does not have to give the bridge</p>

<sup>11</sup> The FDIC has suggested qualifying this requirement with added language stating: "Unless otherwise required by law or ordered by a court of competent jurisdiction" in order to protect the receiver from liability if compelled by law or a court to disclose settlement information.

Bankruptcy Code	The Proposed Bill ("BRF")	Federal Deposit Insurance Act ("FDIA")
	<p>capital or surplus. The FDIC can cause the Bridge Company to issue capital stock and securities. If the FDIC determines that such action is advisable, § 208(b)(2)(G).</p> <p>The FDIC shall treat all similarly situated creditors of a Bridge Company in a similar manner in transferring any assets or liabilities of the CFC to a Bridge Company. § 208(b)(5)(E). The FDIC does not have to comply with the above section if (i) the FDIC determines that such actions are necessary to maximize the value of the assets of the CFC, maximize the present value of return from the sale of assets, minimize the amount of any loss from the sale or to contain or address serious adverse effects to financial stability and (ii) all similarly situated creditors receive not less than the maximum liability amount.</p> <p>Bridge Companies can obtain unsecured credit and issue unsecured debt. § 208(b)(15)(A).</p> <p>If a Bridge Company is unable to obtain unsecured credit or issue unsecured debt, the FDIC may 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. § 208(b)(15)(B). The FDIC may, after notice and a hearing, authorize the Bridge Company to obtain debt secured by a senior or equal lien on property of the Bridge Companies if the Bridge Company is unable to otherwise obtain such credit and there is adequate protection of the interest of the holder of the lien on the property on which the senior or equal lien is proposed to be granted. § 208(b)(15)(C).</p>	<p>bank any capital to operate. The FDIC can make available to the bridge bank funds for its operation. 12 U.S.C. § 1821(a)(5).</p>

<p>Overview of the Enhanced Resolution Authority in the Restoring American Financial Stability Act of 2009</p>	<p>GIBSON, DUNN &amp; CRUTCHER LLP</p>
<p>Bankruptcy Code</p>	<p>The Proposed Bill ("Bill")</p>
<p>Federal Deposit Insurance Act ("FDIA")</p>	
<p>We regard this chart as a work in progress, due to the length and complexity of the Bill. Please comment directly to us via e-mail at the addresses below or by phone.</p>	
<p><b>Chuck Mackenfuss, Michael Bopp, Michael Rosenthal and Janet Weiss</b></p>	
<p>Michael Bopp (202) 953-5256 MBopp@gibsondunn.com</p> <p>Janet Weiss (212) 357-3988 JWeiss@gibsondunn.com</p> <p>Adam Chen (212) 357-2327 AChen@gibsondunn.com</p>	<p>Canwell F. Muekenius, III (202) 953-8574 CMuekenius@gibsondunn.com</p> <p>Michael A. Rosenthal (212) 357-3060 MRosenthal@gibsondunn.com</p> <p>Rachel Castriello (212) 357-2403 RCastriello@gibsondunn.com</p> <p>Aditi Prabhu (202) 953-8532 APrabhu@gibsondunn.com</p>
<p>Also contributing to these materials is Robert C. Fager, Partner, Banking Consulting, and Retired Former Partner, Gibson, Dunn &amp; Crutcher LLP - 202-529-4867, robert.fager@gmail.com or robertf@retiredpartner.gibsondunn.com.</p>	

Mr. JOHNSON. Thank you, Mr. Rosenthal.  
And last, but not least, Professor Calomiris?

**TESTIMONY OF CHARLES W. CALOMIRIS, HENRY KAUFMAN  
PROFESSOR OF FINANCIAL INSTITUTIONS, COLUMBIA BUSI-  
NESS SCHOOL, NEW YORK, NY**

Mr. CALOMIRIS. Thank you, Mr. Chairman, distinguished Mem-  
bers. It is a pleasure to appear here today.

I am going to address briefly in my oral comments two issues—  
the best way to reform laws and regulations governing the resolu-  
tion of large, complex, non-bank financial institutions, and sec-

only, some antitrust issues related to the approval of bank mergers.

With respect to the first, I want to focus a bit on the decision-making process in reality that produces bailouts. Experience has shown that political risk aversion favors bailouts even when they are not necessary and is too generous in the bailouts when they are performed.

Which regulator will be willing to risk a systemic meltdown on their watch and face the potential political backlash that would accompany it if they have ready-made taxpayer funds that they can pay out instead?

Creditors of failing non-bank financial institutions are aware of policy-makers' risk aversion, demonstrated by the series of bailouts beginning in 1984, with what is now widely regarded as a political and regulatory overreaction to the failure of Continental Bank, the first example of the application of the too-big-to-fail doctrine.

Creditors use that risk aversion to exaggerate their own vulnerability to shocks and to obtain more generous protection from taxpayers.

A Washington Post article that came out today, written after my testimony, has the following quote in it in discussing the AIG bailout and why creditors received no haircuts in the AIG bailout.

Quote—this is a quote from the New York Fed's general counsel, who was part of the negotiation—"In its negotiations with its counterparties, AIG just didn't have the same bargaining power that it did with the Federal Reserve standing in the background. The only sensible outcome was to give them what they were legally entitled to." In other words, zero haircuts.

I would be happy to talk with you more about that. But what the general counsel of the New York Fed is saying is when the Fed is involved, we are just not tough negotiators. And I think that is exactly what happened in the AIG bailout.

Bailouts, as most recently illustrated by AIG's experience, keep counterparties and creditors whole because there is no way, short of bankruptcy, under current law to force them to bear a loss.

In other words, the game of chicken between government agencies and creditors is one that the government is likely to lose, as they did with AIG's creditors, when trying to convince creditors to share in losses, which means taxpayers end up bearing all the loss.

Now, there is broad consensus that this status quo is not acceptable, and we all understand it is not going to be changed just by bold statements. Reform must create a means to transfer the control of assets and operations of a failed institution in an orderly way while ensuring that shareholders and creditors of the failing firm suffer large losses.

Those outcomes are essential if the resolution of failure is to avoid significant disruptions to third parties and also avoid bailout costs to taxpayers accompanying the—the bailout.

Two approaches have been suggested—one, bankruptcy reforms, and two, the creation of an administrative resolution authority.

Critics of creating an administrative resolution authority rightly argue that placing discretionary authority over resolution in a regulator is likely to institutionalize generous, too-big-to-fail protection, just as I have argued it would.

But despite the arguments that I believe favor bankruptcy reform as an approach, it is not clear whether the government can credibly pursue a pure bankruptcy approach even if doing so were economically desirable.

The problem is a political one. An economically defensible tough-love bankruptcy system might encourage, for reasons associated with political risk aversion, ad-hoc resolutions to occur outside the reform bankruptcy process, just like AIG.

And for that reason, I believe it would be desirable to establish a hybrid bankruptcy resolution approach which predefines and thereby constrains the way administrative resolution would occur.

I am part of a bipartisan task force put together by the Pew Trusts, which is about to release a report, a large part of which has to do with how to structure such a bipartisan compromise that would create this hybrid resolution. And I will be happy to discuss it more. It is referenced a bit in my testimony.

I know I am running out of time. I want to focus briefly on what to do about antitrust. In my testimony, I describe my own experience as an advisor to the attorneys general of Massachusetts and Connecticut and the problem there with the politicization of the antitrust process in the case of the Fleet-BankBoston merger.

My conclusion from that is that we need to have undivided authority vested in the Justice Department Antitrust Division, and it needs to have budgetary autonomy. The Fed needs to get out of the process, and we need to make sure that the Justice Department is politically protected. Thank you very much.

[The prepared statement of Mr. Calomiris follows:]

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PREPARED STATEMENT OF CHARLES W. CALOMIRIS

Statement of

Charles W. Calomiris,

Henry Kaufman Professor of Financial Institutions,

Columbia Business School,

Before the Subcommittee on Courts and Competition Policy,

Committee on the Judiciary,

United States House of Representatives,

November 17, 2009



Chairman Conyers, it's a pleasure to appear before you and the Committee today. I will address two broad sets of issues: (1) the best way to reform laws and regulations governing the resolution of large, complex nonbank financial institutions, and (2) antitrust issues related to the approval of bank mergers.

#### **I. The Resolution of Failures of Large, Complex, Nonbank Financial Institutions**

In the wake of the ad hoc bailouts of AIG and Bear Stearns, and the bankruptcy of Lehman, policy makers seeking to avoid having to make the choice between undertaking taxpayer-financed bailouts of risk takers and permitting potentially disruptive liquidations are struggling over whether and how to improve the resolution process for nonbank financial institutions.

One approach would be just to do nothing, have the government resolve never to assist failing nonbank financial institutions, and let the chips fall where they may. What is wrong with that approach?

Some argue that we learned from Lehman's failure the necessity of being prepared to assist a failing nonbank financial firm in order to avoid the costs borne by others from its failure. Lehman, according to that view, illustrates how a large, complex firm's failure can disrupt the broader network of financial transactions. Such a failure may entail opaque losses on counterparties and creditors of the failed institution, and a scramble for liquidity in response to those opaque losses can ensue, increasing the haircuts set in markets on illiquid collateral and raising demands for cash. This can cause risky asset prices to fall, driving down bank equity capital, and causing counterparties and lenders to contract the supply of contracts and loans, or to become insolvent. Such disruptions can have significant social costs.

People who are skeptical of the possibility of such costs should remember that the London clearing banks voluntarily pooled their resources to bail out an investment bank in 1890 (Barings) just to avoid the potential disruption that its failure might have had on their positions. French bankers orchestrated a similar privately funded bailout of the Paris Bourse in 1882. Bankers put their own money

on the line because they perceived the risks of a liquidity crisis resulting from the failure of a large nonbank financial institution as real.

Whether the costs to the financial system were actually large in the case of Lehman Bros., however, is a matter of lively debate. There was lots of news happening around the time of Lehman's failure, not least of which were the many dire public statements by the Fed Chairman and the Treasury Secretary, which had a palpably negative effect on market sentiment and caused fear to spread throughout the financial system. As many financial experts, including Stanford's John Taylor and, Richard Sylla of NYU's Stern School, have argued, the approach taken to "selling" the nation on the TARP plan displayed a lack of cool-headed leadership, which magnified the effects of financial shocks and encouraged panic.

Furthermore, better financial policies between March and September 2008 likely would have prevented Lehman's failure from occurring in the first place, rendering a bailout unnecessary. Whether or not one supports the bailout of Bear Stearns in March 2008, it was known in March 2008 that Lehman was at risk; financial regulators should have pressed Lehman and other investment banks to raise capital in the spring or summer of 2008, when markets for raising capital were open and when Lehman's and others' stock prices were still high. If policy makers had forced Lehman to raise substantial equity capital in the spring or summer of 2008, its failure could have been avoided. Lehman's decision not to raise capital, and instead to sit on its hands for six months to see whether its stock price would improve, reflected its belief that it would also obtain a bailout. Moreover, if policy makers had been able in March 2008 to credibly commit not to bail out Lehman, Lehman likely would have decided on its own to raise capital in the spring or summer of 2008. It is reasonable to conclude that the Lehman failure was avoidable, and was caused by bailout expectations. Thus, it is hard to argue from that perspective that Lehman's failure teaches us the advantages of generous bailout policies.

Despite these legitimate arguments in favor of the avoiding nonbank financial firm bailouts, there are legitimate reasons to doubt the *feasibility* of such a commitment, even if one believed that it would be desirable to do so. Many

economists, politicians and regulators *believe* that the costs of Lehman's failure were large, and that spillover costs could be similarly large for a nonbank financial firm's failure in the future. It is hard to imagine what evidence could be produced to disprove those beliefs, even if they are wrong. The genie is out of the bottle, and even if it would be better for us to just let the chips fall where they may (and there is a respectable argument that it would be better), under the current rules of the road, worries about "systemic risk" will likely result in more decisions to prevent failure.

This is especially true when one considers the decision making process that produces bailouts; experience has shown that political risk aversion favors bailouts even when they are not necessary. Which politician or regulator will be willing to risk a systemic meltdown on their watch and face the potential political backlash that would accompany it? Creditors of failing nonbank financial institutions are aware of policy makers' risk aversion (demonstrated by the series of bailouts, beginning in 1984 with what is now widely regarded as a political and regulatory overreaction to the failure of Continental Bank – the first example of the application of the too-big-to-fail doctrine); creditors will use that risk aversion to exaggerate their own vulnerability to shocks, as a means to obtain more free protection from the government (i.e., avoiding "haircuts").

Bailouts, as most recently illustrated by AIG's experience, keep counterparties and creditors whole because there is no way short of bankruptcy under current law to force them to bear a loss. In other words, the game of chicken between government agencies and creditors is one that the government is likely to lose (as they did with AIG's creditors) when trying to convince creditors to share in losses, which will mean taxpayers will bear all the losses. The "holding up" of taxpayers by threatening regulators and politicians with the prospects of dire consequences for society if even small amounts of loss are borne privately has large social costs; not only do taxpayers suffer inordinate losses, the incentives from that loss-sharing arrangement lead to excessive risk taking by too-big-to-fail firms in the future.

There is broad consensus that this status quo is not acceptable, and it will not be changed by bold statements alone. We cannot simply pretend that under current laws our policy makers can (or should) commit *never* to bailout insolvent nonbank financial firms. *Reform must create a means to transfer the control of assets and operations of a failed institution in an orderly way, while ensuring that shareholders and creditors of the failing firm suffer large losses. Those outcomes are essential if the resolution of failure is to avoid significant disruptions to third parties, and also avoid bailout costs to taxpayers and accompanying moral-hazard costs.*

Two approaches to addressing the problem have been suggested: (1) bankruptcy reforms that are tailored to the needs of nonbank financial institutions (an approach favored by most Republicans in Congress, and exemplified by H.R. 3310), and (2) the creation of an administrative resolution authority (which is favored by most Democrats). After reviewing the pros and cons of these two approaches, I will show that a hybrid – bankruptcy reform with a resolution authority loophole – may be a superior policy choice than either of the two approaches currently on the table.

Critics of creating an administrative resolution authority rightly argue that placing discretionary authority over resolution in a regulator is likely to institutionalize too-big-to-fail protection, given the aversion to imposing losses on creditors that we have seen over the past 25 years of U.S. bailout history. That insight is central to the argument that bankruptcy reform, rather than the establishment of a resolution authority, is the best means to eliminate too-big-to-fail protection.

But, despite the arguments that I believe favor the bankruptcy reform approach, it is not clear whether the government can credibly pursue a pure bankruptcy approach, even if doing so were desirable. The problem is a political one: An economically defensible, “tough-love” bankruptcy system might encourage (for reasons associated with political risk aversion) *ad hoc* resolutions to occur outside the reformed bankruptcy process (i.e., a repeat of AIG).

For that reason, I believe it would be desirable to establish a hybrid bankruptcy/resolution approach, which pre-defines (and thereby, *constrains*) the way resolution would occur outside of bankruptcy, if it were to occur. If, to avoid ad hoc bailouts, the creation of some form of resolution authority loophole is desirable, it should be crafted, and can be crafted, to substantially limit the risk of taxpayer loss and the adverse incentives consequences that accompany it. Below, I discuss the pure bankruptcy approach, the pure resolution authority approach, and the hybrid bankruptcy/resolution authority approach that I am recommending.<sup>1</sup>

*The Pure Bankruptcy Reform Approach:* House Republicans have made a good start toward bankruptcy reform in H.R. 3310, but I would add several elements to address shortcomings of existing law as applied to complex nonbank financial institutions. Those shortcomings include: (1) the need for international coordination in establishing jurisdictions over assets (deciding which courts control which assets), (2) proper ways to structure payments on maturing contracts and debts, and debtor-in-possession (DIP) financing, to ensure continuing liquidity in the market for counterparties and creditors, and (3) the need to avoid the gaming of creditors' voting rules due to the hedging of creditors' exposures through derivatives positions.

With these problems in mind, my additional suggested bankruptcy reforms would focus on (1) establishing "living wills" of financial firms, approved in advance by regulatory authorities and governments in the relevant countries, so that locations of assets and jurisdictions are clear, (2) improving the rules governing payment of maturing debts and DIP financing so as to limit damage to third parties from frozen assets (e.g., using conservative valuations of the institutions' assets to permit fractional payouts to short-term debt holders in an amount less than the estimate of their ultimate recoveries, on the condition that they relinquish their claim to additional payments in the future), and (3)

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<sup>1</sup> The hybrid approach outlined below reflects discussions I have participated in as a member of the Pew Trusts Task Force on Financial Reform. The approach is broadly consistent with the proposal put forth in the forthcoming report of the Task Force, "A Bi-Partisan Policy Statement," although the Pew Task Force did not offer details for an appropriate triggering mechanism for administrative resolution.

establishing new voting rules for creditors in bankruptcy that would better encourage efficient renegotiation.

*The Pure Resolution Authority Approach:* The motivation for a new resolution authority, administered by a financial regulator – which is supported by the Obama Administration and many Democrats in Congress – begins from the premise that bankruptcy reform (especially cross-country coordination) will take time, will be too inflexible, will not prevent financial network disruption, and thus, will not prevent the holding up of taxpayers via bailouts to avoid those disruptions.

I am not convinced that the technical problems alleged by critics of bankruptcy reform would make bankruptcy reform unworkable; I believe that the problems of international coordination are challenging but not intractable, and that it is possible to make significant improvements to the bankruptcy code that would speed efficient and timely renegotiations, while avoiding significant disruption to counterparties and creditors.

But, as I noted before, I see a political risk from relying only on bankruptcy reform: a tough-love bankruptcy regime might encourage regulators or politicians in the future to choose ad hoc bailouts instead of relying on bankruptcy, either because of special-interest pressures, or because policy makers are extremely risk averse about spillover effects. If that happened, then bankruptcy reform would not accomplish its central objective of avoiding taxpayer-funded bailouts.

For that reason, it is worth considering how resolution authority might be helpful as a supplement to bankruptcy reform. The key problem with the resolution authority alternative currently being advocated, however, is that it is likely to be abused, either as the result of pressures from special interests or as the result of the risk aversion of political or regulatory actors in the midst of the crisis. Resolution authority as it has been proposed would be too generous and would institutionalize the too-big-to-fail problem, rather than avoid it.

*A Better, Hybrid Approach:* Under a proposed hybrid approach (which is closely related to a recent proposal put forward by the Pew Trusts Task Force on

Financial Reform, of which I am a member), the new bankruptcy process would be employed unless strict criteria were met to trigger a resolution process.<sup>2</sup> The resolution process would (1) impose 100% haircuts on stockholders and minimal, significant haircuts on all creditors and counterparties (say, 20%), which would ensure that creditors and counterparties would be more careful in granting credit to high-risk firms, (2) require ex post funding of the costs to taxpayers by the large financial institutions that presumably benefit from the use of the resolution authority (say, the 100 largest financial institutions), up to an amount equal to half of the aggregate net worth of those institutions, and (3) require both that Congress vote to allow the resolution authority to use taxpayer funds to backstop privately funded protection, and that a (value-weighted) majority of the financial institutions that would be liable for the cost of the resolution also vote in favor of using the resolution authority.<sup>3</sup>

A time-honored principle of incentive-compatible bailouts is that government should take a *senior stake* in support of a coalition of private sector firms, who bear the first tier of losses during bailouts. That approach underlay the successful resolutions of the Paris Bourse in 1882 and Barings in 1890. It is also broadly consistent with the rules governing assistance to many U.S. banks from the Reconstruction Finance Corporation (RFC) in the 1930s. RFC assistance forced stockholders of banks receiving preferred stock investments from the government to accumulate additional equity capital (which protected the government from extreme loss) as a condition for receiving preferred stock assistance. In other words, *in crafting its bankruptcy/resolution policy reforms, government can and should rely on the self-interested behavior of market participants to prevent the institutionalization of too big to fail.*

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<sup>2</sup> As proposed by the Pew Trusts Task Force on Financial Reform, "A Bi-Partisan Policy Statement," November 2009, interim liquidity support could be provided for a brief period of time pending the decision over whether to opt for administrative resolution.

<sup>3</sup> It is possible to argue for different voting thresholds. A super-majority threshold could be justified on the grounds that only extremely severe ramifications for the financial system should give rise to the administrative resolution mechanism. A less-than-majority threshold could be justified on the grounds that resolution would prevent others, notably consumers and borrowing firms, from suffering costs of a credit crunch even when the majority of banks would not want to risk absorbing losses to prevent a credit crunch.

The proposed hybrid approach depoliticizes the decision to employ administrative resolution by forcing the private sector to share decision making authority, and *financial responsibility*, for bailouts. If the private sector were forced to pay for bailouts, and were given a role in deciding whether to implement bailout authority, we would be able to avoid politically driven excessive risk aversion when deciding whether a bailout is really necessary and how large the haircuts to creditors should be. This was precisely the logic applied by the designers of FDICIA in 1991; FDICIA required that support to distressed banks by the FDIC beyond what could be justified in a least-cost resolution calculation would have to be paid for by a special assessment on surviving banks, proportionate to their outstanding deposits. That was meant to ensure that the surviving banks bearing both the costs of bailouts and the benefits of reduced “systemic risk” would lobby to prevent unnecessary bailouts from occurring.<sup>4</sup>

## **II. The Inadequacy of Antitrust Enforcement in Approving Bank Mergers**

With respect to the second topic of today’s hearing, namely the potential for improving antitrust enforcement of bank mergers, I would stress that current antitrust regulation in banking is inadequate, and that – while expedited approval of mergers during a crisis is desirable – it would be undesirable to permit the proposed expedited approval of bank mergers under emergency circumstances without also substantially improving regulatory oversight of bank mergers.

The Fed and the Justice Department share responsibility for antitrust enforcement when approving bank mergers, but in practice, the Fed has played the dominant role, and both regulators generally have been a rubber stamp. I want to emphasize, lest I be misunderstood, that bank consolidation, deregulation of interstate branching, and the deregulation of bank powers restrictions played no adverse role in fostering risk taking during the recent crisis. Furthermore, for the most part, mergers during the past three decades, and the deregulation of bank powers that has permitted universal banking, have been

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<sup>4</sup> My understanding of the logic of the FDICIA special-assessment requirement is based on conversations with my colleagues on the Shadow Financial Regulatory Committee, especially with Professor Ken Scott of Stanford Law School, who is widely regarded as the originator of this idea.



helpful in serving the multi-product needs of bank customers, and in *promoting efficiency and competition* in local bank lending markets, as the research on the effects of bank consolidation on loan pricing has shown.<sup>5</sup> But that has not always been the case.

In one case with which I am familiar, the merger of the only two banks of any significant size in New England, the merger was not desirable from the perspective of many bank customers. In the merger of Fleet and BankBoston in 1999, middle-market borrowers in New England opposed the merger. I was able to show in my analysis of the effects of the merger on the loan market that they were right to do so. My study and affidavit predicted that a merger of the two banks would cause interest rates to rise by roughly a full percentage point for middle market borrowers. That estimate was corroborated by subsequent research that showed that, in fact, the merger caused middle market borrowers' interest rate spreads to rise by more a full percentage point.<sup>6</sup>

I was involved in the Fleet-BankBoston merger as a consultant to the Attorneys General of Massachusetts and Connecticut. Despite the concerns and evidence of anti-competitive effects, the merger was pushed through as the result of political pressures applied to regulators, including pressure from at least one highly influential member of Congress. Justice Department officials, in conversations in which I participated, initially supported action to prevent the merger, or at least to force a carve out of some of the middle market business of the combined entity in a way that would have encouraged another competing bank to enter the market to purchase the carved out assets, which would have included a substantial portfolio of middle-market business loans. Under political pressure, the Justice Department backed down. I was told by one of the state Attorneys General that a member of Congress threatened budgetary consequences for the Antitrust Division if they did not back off, and under the

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<sup>5</sup> See, for example, Ricardo Correa, "Bank Integration and Financial Constraints: Evidence from U.S. Firms," Board of Governors of the Federal Reserve System, March 2008, and Isil Erel, "The Effect of Bank Mergers on Loan Prices: Evidence from the U.S.," *Review of Financial Studies* (forthcoming), 2009.

<sup>6</sup> Charles W. Calomiris and Thanavut Pornrojngkool, "Monopoly-Creating Bank Consolidation? The Merger of Fleet and BankBoston," National Bureau of Economic Research Working Paper 11351, May 2005.

circumstances, the Attorneys General did not feel that they had sufficient authority to stop the merger or materially change its structure.

The Federal Reserve has also been a rubber stamp for mergers, so long as (1) the mergers did not violate the Fed's measure of excessive concentration in the local deposit market, and (2) activist community groups and their allies in Congress did not oppose the mergers. The first, deposit-market-share, condition is not an adequate measure of competition, since it applies only to deposit shares in each neighborhood, not to loans or other products, and it does not distinguish loans by relevant market niches (e.g., large corporate, middle-market, small business, consumer). It is easy to satisfy the local deposit market share condition by spinning off a few branches in a few neighborhoods, and doing so has no effect on competition in the regional loan market for mid-sized companies.

In my experience, the attention paid by the Fed to activist groups largely reflects Fed concerns about offending members of Congress; those concerns gave rise to the infamous use of pre-merger contracts between merging banks and well-organized community activists (e.g., ACORN), which were common during the merger wave. Merging banks paid those groups to support their mergers, whether or not the merger was in the interest of other local consumers or in the interest of small and medium-sized firms. This bribery/extortion racket was a national disgrace.

We need to empower antitrust enforcement of banking mergers by placing antitrust responsibility *entirely* in the Antitrust Division of the Justice Department, and by *ensuring budgetary autonomy* of that Division, which would insulate enforcement from the political pressures that have been applied in support of mergers by monopoly-seeking banks and rent-seeking self-appointed community groups. Once that reform has been accomplished, expediting the merger approval process under crisis conditions would make sense, but until and unless we fix the merger approval process, streamlined approval will just make abuses worse.

Antitrust concerns relating to bank lending to middle-sized firms are especially worrying now, given the small number of large banks that operate in many local communities. Large banks provide unique services for mid-sized

businesses in their states. To ensure competition in lending to these important customers, which are the backbone of the American economy, ideally there should be at least three or four banks of significant size, and with substantial middle market lending capabilities, operating in each region of the country. Our current regulatory structure has produced a different outcome in some regions, and without improvements in the antitrust process, this is liable to become worse.

### **III. Summary of Opinions**

In summary, I believe that a hybrid bankruptcy/resolution approach to reforming the framework within which resolutions of failed nonbank financial firms occur would be the most desirable way forward. That approach would avoid the risk of institutionalizing too-big-to-fail protection (the main risk of the pure administrative-resolution approach to reform), and would avoid the unwitting encouragement of ad hoc bailouts as an alternative to bankruptcy (the main risk of a pure bankruptcy approach to reform).

A properly structured hybrid approach would prevent excessive private sector risk taking (i.e., moral hazard) by credibly allowing nonbank financial firms to fail in most cases, and by imposing substantial losses on their creditors. It would remove the risk of large costs to taxpayers from bailouts, would force the private sector to bear almost all the costs of bailouts, and it would avoid unnecessary bailouts motivated by excessive political risk aversion.

With respect to antitrust policy, while the vast majority of consolidation in the financial services industry over the past three decades has been beneficial to bank clients, there are notable exceptions (the most obvious of which was the anticompetitive merger of Fleet and BankBoston). That merger was pushed through by special interests – monopoly-seeking banks, rent-seeking consumer activist groups, and politicians aligned with them – acting against the broader interests of consumers and firms. In some regions of the country – most obviously, in New England – there are too few large banks able to offer a full bundle of products and services to middle-market borrowers.

We need to improve the bank merger approval process, which has become too politicized to be reliably effective. *We should remove the Fed from oversight of bank mergers and give the Antitrust Division of the Justice Department undivided authority, budgetary independence, and a mandate to avoid the creation of monopoly power, especially in middle-market lending.* Once that is done, it would make sense to permit expedited consideration of bank mergers during financial crises. But until that is done, expedited approval would magnify the politicization of the merger process and the potential for the creation of undesirable monopoly power.

My discussions of nonbank financial firm bailouts and bank antitrust policy have something in common: They begin by recognizing that crafting good policy is not just a matter of resolving technical questions related to economic efficiency; rather, these policies are subject to political risks can affect, and have affected, their implementation. We must design bailout and antitrust policies better than we have in the past, to minimize the potential for undesirable outcomes driven by political processes.

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Mr. JOHNSON. Thank you.

Professor Sagers, proponents of the bill have argued that this bill has essentially the same limitations on antitrust as the FDIA, and wanted to ask you, since we are now in the questioning period and all Members will abide by the 5-minute rule, is that accurate?

Mr. SAGERS. Yes, in one important respect it is incorrect. As I explain in my written statement, it is a very complicated question, but a simple answer is that the claim that the bill does not modify current antitrust review—that claim is incorrect for the simple reason that under current law transfers of banking assets—“banking assets”—are subject to a special regime of antitrust review which is undertaken by both the banking agencies and the Justice Department jointly.

And in some respects it is a little bit different than the more familiar merger review process under the Hart-Scott-Rodino Act and sometimes it can be made to go a little bit faster than HSR review.

However, where non-banking assets are transferred in almost all cases, including some securities and insurance businesses, other financial businesses—when those transactions occur, the ordinary Hart-Scott-Rodino process applies.

And importantly, when the Justice Department or the Federal Trade Commission reviews a transaction, reviews a transfer of non-banking assets, they have a lot of power. They have a lot of essentially civil discovery power to force the merging parties to disclose information. They can also request information from third parties.

And I believe, most importantly, they can essentially force the merger—force the transaction to slow down so that they can take the time they feel they need to address anticompetitive concerns. Okay.

So that is the piece that would be changed under bill under the resolution authority where FDIC causes the sale of some non-banking asset that is owned by a failing financial company in receivership.

That transaction would be subject to HSR, except that the agencies would not be permitted to make the so-called second request for more information, which has the result of both giving them more information and slowing the process down.

As I explained, I happen to think that is really a pretty big deal. It is a pretty big change, because in effect the agencies are going to be forced to review what could be very large mergers or acquisitions in 30 calendar days, with probably quite limited information.

Mr. JOHNSON. Thank you.

I would like to ask everyone on the panel to respond to this question, starting with Professor Calomiris. Does the resolution authority have the effect of institutionalizing too-big-to-fail companies as part of the economy? And is this a problem?

Mr. CALOMIRIS. It all depends, Mr. Chairman, on how it is structured. If it is a backstop protection, as I am proposing, and, crucially, if there is a requirement of minimal haircuts to creditors and, furthermore, if triggering the use of the resolution authority has to be approved by Congress and, finally, if the large financial institutions that presumably benefit from this protection have to pay for it after the protections applied, so it is not the taxpayers paying for it but the financial system, then I think we can say it doesn't institutionalize too big to fail.

But if you don't add all those caveats, you will institutionalize too big to fail.

Mr. JOHNSON. Thank you.

Mr. Rosenthal?

Mr. ROSENTHAL. Yes. I believe it does not institutionalize too big to fail but, again, subject to the statements that I made before, that we need to layer onto what is already—what has already been proposed bankruptcy code concepts that impose judicial restraint in some instances, that impose factors that limit the ability of the regulator to go too far and that subject companies to restrictions that they and their creditors agree to.

Mr. SMITH. Let me try this one. Thank you, Mr. Chairman. I also agree that this should not institutionalize too big to fail, especially if creditors and shareholders will be suffering a loss as part of the process.

The only caveat I have relates to what happens when you have a business that, at its core, relates to systemic risk and where it may be necessary to transfer the assets of that business with certain liabilities being assumed.

Now, if you are one of the creditors who is extending credit to one of the businesses that does not fall into that category, you know that you are going to suffer a loss even if the business is too big to fail.

But if you are one of those creditors who is extending credit to the part of the business that is a core systemic risk asset, I think there needs to be a lot of thought given as to whether that creditor's claim is going to be assumed in its entirety as part of the rescue process and, if so, whether there is an element of institutionalizing the too big to fail scheme for that creditor that needs to be taken into account.

So I would suggest caution in that area. But as a general matter, this is legislation that one hopes would never be invoked in the future.

Mr. JOHNSON. Yes. Thank you, Mr. Smith.

And, Professor Sagers?

Mr. SAGERS. Thank you. I really would just repeat what Professor Calomiris said. It seems to me the question really depends on how the act is administered.

The act seems to me to give one agency an extraordinary amount of flexibility and its administration, it seems to me, is going to be subject to some degree to changing political forces, depending on changes in Administrations.

I would add that I think that problem, like other problems, could be improved under this act if it is—if it strengthens antitrust review under Hart-Scott-Rodino Act.

Mr. JOHNSON. All right. Thank you, gentlemen. My time has expired.

I will now proceed to Mr. Chaffetz for questions.

Mr. CHAFFETZ. Thank you, Chairman.

I would ask, actually, unanimous consent to insert into the record, if I could, a statement from the Ranking Member of the overall Judiciary Committee, Member Lamar Smith. If I could insert those into the record—

Mr. JOHNSON. Without objection.

[The prepared statement of Mr. Smith follows:]

PREPARED STATEMENT OF THE HONORABLE LAMAR SMITH, A REPRESENTATIVE IN  
CONGRESS FROM THE STATE OF TEXAS, AND RANKING MEMBER, COMMITTEE ON THE  
JUDICIARY

Statement of Judiciary Committee Ranking Member Lamar Smith  
Subcommittee on Courts and Competition Policy  
Hearing on Too Big to Fail: The Role for Bankruptcy and Antitrust  
Law in Financial Regulation Reform, Part II  
Tuesday, November 17, 2009  
(Final)

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**Before enacting reform legislation that might invite  
the next financial meltdown, Congress should take a  
long look at the 2008 collapse and learn from the facts.**

**The Financial Services Committee has begun  
marking up a bill known as the Financial Stability and  
Improvement Act. That legislation establishes a  
resolution authority for large financial institutions.**

**This authority codifies the federal government's ability to take over and wind down the liabilities of failed financial institutions. It does so without meaningful reference to the Bankruptcy Code. And it eliminates traditional antitrust review of proposed asset sales in the name of efficiency.**

**For over a hundred years, the Bankruptcy Code has been America's trusted means for dissolving or reorganizing failed firms. Why, then, do current proposals seek to replace it?**

**Typically, it is claimed that it was Lehman Brothers' bankruptcy that triggered the widespread financial panic of September 2008. If bankruptcy triggered the panic, goes the argument, we have to look beyond the Bankruptcy Code to reform the financial system.**



**The so-called “Lehman Brothers” claim, however, is a myth. As we heard during the recent Commercial and Administrative Law Subcommittee hearing, the market took Lehman Brothers’ bankruptcy more or less in stride.**

**What triggered systemic financial panic was subsequent action by the Treasury and the Federal Reserve. These agencies’ actions signaled to investors that the government anticipated a market collapse, but did not yet have an adequate plan of action.**

**In a self-fulfilling prophecy, it was only after the Treasury and the Fed ratcheted everyone up into a panic that the market then panicked and not after their earlier decision to let Lehman Brothers go into bankruptcy.**

**Other government actions also contributed to the panic. These included the government's inconsistent treatment of Bear Stearns and AIG—which it bailed out—and Lehman Brothers, which it did not. This inconsistent treatment set the market's expectations on a frightening roller coaster that produced deep confusion.**

**Conditions for trouble also had long been growing because of sustained government distortions of the market. From the Community Reinvestment Act to Fannie Mae and Freddy Mac and on, the government helped produce the 2007-2008 credit crisis that set the stage for panic.**

**The bottom line is this—America has no need to avoid the Bankruptcy Code as a means to resolve failed financial institutions. What America should renounce is government control that lets federal agencies and government employees determine behind closed doors what companies live and die in our economy.**

**H.R. 3310, the House Republicans' Consumer Protection and Regulatory Enhancement Act, takes this policy to heart. It ends billion dollar bailouts and writes a new chapter in the Bankruptcy Code to resolve failed financial institutions other than banks. The new chapter includes special provisions designed to make our good Bankruptcy Code even better.**

Mr. CHAFFETZ. Thank you, Mr. Chairman.

I want to go back to you, Mr.—Professor Calomiris—am I pronouncing your name properly? I hope so. Okay.

Mr. CALOMIRIS. Calomiris, yes.

Mr. CHAFFETZ. Yes. Are you familiar with H.R. 3310 and what that uses as the foundation for reform in the bankruptcy code? Could you talk specifically to that and your impression of that?

Mr. CALOMIRIS. Yes. I have reviewed it. I couldn't recite every part of it to you from memory, but I liked it. But I don't think it goes far enough. I mentioned three things in my testimony that I think would be additional reforms to the bankruptcy process, especially as applied to a new—let's call it Chapter 14—applied to non-bank financial institutions.

And so I could go over those. One of them has to do with dealing with voting problems that have emerged in the recent CIT bankruptcy case.

So we have to worry now about creditors who have offsetting hedged positions or maybe even over-hedged positions so that they have an incentive in disrupting the bankruptcy process. So you might want to change the law so that your net position determines your voting power, not your gross position as a creditor.

That is just one example, and that is not just for financial institutions. We need to be worrying about that more broadly.

We also have to worry about the problem of international coordination. And it is not good enough just to say let's worry about it. We actually have to figure out a way over a short period of time that we can figure out where assets are going to reside.

A big problem in the Lehman bankruptcy was that a lot of assets came back overnight. Nobody knew, are they part of the New York jurisdiction or are they going back to other countries?

You have to have as part of the living will that is being proposed—and I support that idea—cooperation, pre-agreement among regulators in advance, as to how they are going to figure out where assets and liabilities reside if the bankruptcy happens.

And I had another point, but I will stop there talking.

Mr. CHAFFETZ. Okay.

Mr. Rosenthal, I want to give you a moment here to expand on this idea of flexibility but predictability and how those two are able to balance in such a way to achieve what we are trying to achieve. Can you—

Mr. ROSENTHAL. Yes, and actually, interestingly, the way we have tried to come up with the hybrid approach could be implemented through a new regime, or it could also be implemented through a revision to the bankruptcy code.

What we have envisioned here to get flexibility is have a period of time—call it an exclusive period, a crisis period—where the FDIC—whatever the regulatory agency is—takes over the business, does what it has to do in terms of selling it to—or transferring it, or capitalizing it to avert a financial crisis, without supervision of a court, which enables the action to be taken quicker, doesn't require all of the notice of the bankruptcy proceeding. That is the flexibility.

But then you come to the point of how is the rest of the case going to continue, and is there any judicial supervision or over-

sight, even on an after-the-fact basis, of the actions that were taken during the exclusive period.

So the way that we have built in the predictability is to say that all of the things that would occur after this initial period are effectively managed and run and supervised the same way they would be under the bankruptcy code—bankruptcy court is there, bankruptcy court looks at the thing.

And even the actions that were taken during that initial period could be brought forward later before the bankruptcy court if a creditor was able to demonstrate that as a result of the actions that were taken it is in a worse position down the road than it was in on day one if the actions had not been taken.

Mr. CHAFFETZ. Okay. Thank you.

Sorry, time is so short. Going back to Mr. Calomiris, if I could, please, let's talk a little bit about the case study that is first and foremost on a lot of people's mind, which is AIG.

I just want to give you a moment to further expand on that thought, and know that we probably have less than a minute here before my time expires.

Mr. CALOMIRIS. Well, I think the really important lesson from the combination of AIG and Lehman was, first of all, that a big part of the problem with Lehman, which was related to—they all happened simultaneously—was the anticipation of protection.

And Lehman would have gone to the market in March of 2008 and raised capital after the Bear Stearns failure if it didn't expect to be protected. That is the big lesson. We don't want to have that expectation.

And then AIG proved it. Even though Lehman didn't get protected, that was a mistake that—you know, many people regard as a mistake. I don't, but the problem is now people do regard that as a mistake, and the solution to it is going to look—unless we have very hard language that prevents it, it is going to look a lot like AIG.

AIG's UBS counterparty was willing to take a 2 percent haircut. That was very, very big of them—willing to take a 2 percent haircut on their positions. Nobody else was.

And the Fed spent, as far as I can tell, about 30 seconds negotiating with them and then decided to tell UBS they didn't even have to take the 2 percent haircut they offered because they decided it was simpler for them just to make a one-size-fits-all, nobody takes a haircut.

That sent a hugely bad message to creditors in the future. It was unnecessary. But what I want to emphasize is not that, you know, Tim Geithner was a bad guy because he did that. What I want to emphasize is he wasn't playing with his money. He was playing with mine and yours.

And he is not a very tough negotiator because as a regulator his incentives will always be to do that. That is what we need to be worried about if we empower discretionary authority outside of bankruptcy.

Now, some people on the panel here have talked about the need to protect creditors' rights. I understand that, and I favor reform of the bankruptcy code as the dominant way to do this.

But I also worry about protecting taxpayers' rights.

Mr. CHAFFETZ. Thank you.

Thank you, Mr. Chairman. I appreciate your indulgence in allowing us to go over time a little bit. Thank you.

Mr. JOHNSON. Certainly. Thank you, Mr. Chaffetz.

Now I recognize the esteemed gentleman from Michigan, the Chair of the Judiciary Committee, the honorable John Conyers.

Mr. CONYERS. Thank you.

One of the problems is that the Finance Committee is marking up their bill right now, and I keep thinking about the barn door syndrome here. And I am trying to figure out what this Committee—this part of Judiciary can do about it and what—when I meet with Chairman Frank that we want to keep working on.

So at the same time that I am omitting the fact that we should have really held this part of the hearing before them so that they got an idea—their frame of reference is fixed. All this good testimony they may look at some day after it.

I see that bankruptcy is being minimized in this regulatory finance package. I see that we are going to have a situation where we may be sorry about not being strong enough.

I am impressed with the witnesses here who I hear telling me that it is more than about patching up the system, it is the—it is to put in safeguards so that this won't happen again.

You can patch it up—and this isn't the first time we have been to the brink either. All of you know better than we—we can create a remedy, a regulatory remedy, that still makes the same thing that doesn't limit the possibility of this happening again.

So the question that I have for you four is what more can we do, and of course, I don't ever stop—we are not going to stop just because they are marking up their bill. There is going to be lots of negotiations. Only heaven knows what the other body is going to produce.

There will be a rules committee where lights frequently go out. There will be a conference committee. So I want you to tell me what we ought to do, because we haven't mentioned Glass-Steagall and the little sorry Bliley effort that succeeded it.

I mean, I am not comfortable about this, and I want you to give me not only your best advice here today, but I would like the honor of us being in touch as this moves down the road.

This isn't going to happen before next year. I know there is great intentions for moving with swiftness.

Sagers and Calomiris, why don't you start off this discussion?

I ask unanimous consent for a little more time, Mr. Chairman.

Mr. JOHNSON. Without objection.

Mr. SAGERS. Yes. Thank you, Mr. Chairman. I hate to be a one-trick pony, and I also sort of hate to say this, because I really don't know how controversial this sort of thing might be to say.

I take heart that if I understand him, Professor Calomiris said something similar. I personally think that the regime of bank merger law we have right now needs to be reopened, and I would favor getting rid of it.

To the extent that it ever had a justification, it is now a very strained justification that I think many people don't find very persuasive, and bank mergers could take place under the ordinary Hart-Scott-Rodino Act.

That leaves open the large problem, though, that as the Justice Department and the banking agencies have interpreted their duties under bank merger law—that is, as they have understood their substantive job in reviewing bank mergers, which undoubtedly would—they would carry over.

I mean, if you do away with bank merger law and say everything is subject to Hart-Scott-Rodino, the same theoretical approach that has been applied under bank merger law would continue to be applied under Hart-Scott-Rodino, unless Congress were to take some action to correct that.

And the problem is traditionally both the banking regulators and the Justice Department for a long time have believed—and in their defense, they believe it on the basis of a fair amount of empirical evidence—they believe that, by and large, competition issues relevant to Section 7 just aren't very serious in these markets.

That is, the only cases in which we have serious competition issues are in local markets serving consumers, mainly, the sort of retail lending needs of consumers and small businesses. Everything else we can take to be presumptively highly competitive and therefore those mergers don't raise any concerns.

I am not really prepared to offer ideas on how that should be corrected, but I think that it is mistaken even in the traditional respect—that is, it is mistaken even in its assumptions about whether particular banking markets are competitive.

But also, let me just reemphasize—this is a bit of a pie in the sky sort of argument that academics get to make and nobody else does because they are difficult, I guess. But we don't have any laws, really, that directly deal with the problem of systemic risk being increased by mergers and acquisitions.

When companies get together and get bigger, thereby increasing systemic risk, to my knowledge there is no really effective regime other than Clayton Act Section 7 to address that, and Clayton Act Section 7 hasn't been used in that way.

Mr. CONYERS. But banks are exempted under Hart.

Mr. SAGERS. That is true.

Mr. CONYERS. You haven't mentioned that. I mean, you keep relying on it, but they have got a hole as big as a tank to drive through Hart-Scott-Rodino.

Mr. SAGERS. Yes, and my suggestion would be issue number one ought to be closing that loophole. Technically, bank mergers are subject to this—a substantive standard, a legal substantive standard very similar to the one that is applied under Clayton Act Section 7.

Mr. CONYERS. Well, technically, but it doesn't happen in real time.

Professor Calomiris?

Mr. CALOMIRIS. Yes. I agree with you about the loophole. The way I experienced it, which I described in my testimony, was that I was working for the attorneys general of Massachusetts and Connecticut.

And I showed them in my study—I predicted that if they allowed Fleet and BankBoston to merge, middle market borrowers, meaning the backbone firms, small businesses and middle-market businesses in the U.S.—would experience an increase of a full 1 percent

on their loans' cost if they did, and that that is who was complaining about the merger.

It wasn't hidden. Those were the people complaining, and those were the people who were going to suffer. After the merger happened, it went up exactly 1 percent. So it wasn't rocket science. It wasn't difficult to see.

What was lacking was the political will, because the problem is mergers create a lot of cookies, and people like cookies, and they come, frankly, to Congress and they ask people to help them get some of the cookies.

And then in this case the Antitrust Division of the Justice Department was leaned on by a Member of Congress, who said, "If you guys fight this, it is going to hurt you in your budget for antitrust."

And it was a very embarrassing thing for the Antitrust Division, because I am on the phone with them 1 day, and they are ready, gung-ho, and the next day they say, "We are not gung-ho anymore." And that is why I emphasize—I am not a lawyer but I am an economist, so I emphasize budgetary independence. If you are serious about this, that is what it is going to take, because that is where—what I saw.

Now, I want to say another—

Mr. CONYERS. Now, what is this piece of history—how does this tie into the regulatory reform act that is being—is on the stove being cooked up right now?

Mr. CALOMIRIS. It should be added in, and I don't see it.

Mr. CONYERS. What should be added in?

Mr. CALOMIRIS. The kind of reform that, in my view, would take away from the Fed and place in the Antitrust Division undivided authority and budgetary autonomy to strengthen protection for all the various consumers, including businesses and small businesses.

And I think, really, the biggest concern right now—I think Professor Sagers agreed with me, or someone did—is these middle-sized businesses which in many parts of the country are not getting served. You need to have a couple, at least, or three or four large banks in every location to be able to have real competition for middle market lending, and we don't have that.

Mr. CONYERS. Mr. Rosenthal, how do you weigh in on this discussion?

Mr. ROSENTHAL. Mr. Chairman, first, I think this issue is not going to go away. If you are lucky enough that it disappears in the rules committee, maybe, but I think we have a problem that needs a resolution.

We have the bankruptcy code that deals with the rights of creditors. We have the FDIA that deals with the rights of depositors. Neither one of those deal with systemic risk.

So I think if you want to be—if you want to be productive and you do not think that you can overcome the majority with respect to a bill that takes power out of the bankruptcy code and creates a new resolution authority, then you have to make proposals that build in the protections that we have been talking about.

So for example, we have—and we would love to talk to you about it further—I have done some summaries of changes that would be inserted into this bill that would, in fact, provide the protections—



a number of the protections that Mr. Smith and I at least talked about in terms of judicial—

Mr. CONYERS. For example?

Mr. ROSENTHAL [continuing]. Review, claims determination. For example, a provision that would require judicial review, that would, in effect, make the bankruptcy court the arbiter of decisions from—you know, after this exclusive period that I was talking about.

A provision that would require that claims determinations first be the subject of a negotiation between the FDIC, but if they could not reach a resolution then you would do what we do in the bankruptcy code—court all the time. You would go to the bankruptcy court and you would say, “Bankruptcy court, decide how this—decide this claim. What is the amount of the claim?”

Issues about valuation—clearly, secured creditors bargain for collateral to support their obligations.

The bill deals somewhat with the rights of secured creditors, but it doesn't say how you would value their claims. We would build in—we think you should build in provisions that if you can't agree with the regulatory authority about the value of the secured claim, you go to the bankruptcy court.

Mr. CONYERS. Can the rest of our witnesses buy into that modification?

Mr. SMITH. I certainly can. This was, indeed, part of my testimony on behalf of the National Bankruptcy Conference. But I do want to add something in terms of the broader perspective that you are raising, Mr. Conyers. You were saying how can this legislation be devised so that what happened doesn't happen again.

And looking at this purely from the bankruptcy standpoint is almost like asking an undertaker what he could have done to have prevented the death of the deceased. The bankruptcy is the back-end side of things.

And there is an important element that Mr. Rosenthal has mentioned, which is you want to have transparent, clear, fair rules for creditors to ensure predictability so that the market starts to adjust for true credit risk and does not take into account the fact that there are no consequences for creditors who make bad credit decisions, as Professor Calomiris had mentioned.

But even beyond that, part of this bill has to be prudential regulation at the outset, maybe in the area of antitrust that was just discussed, but maybe broader regulation as well, so that there are limits on some of the risk-taking that can be made in this economy. Thank you.

Mr. CALOMIRIS. I want to give a hopeful note here and tell you that in about 2 days the Pew Trusts bipartisan task force on financial reform is going to release a report. I am a member of that.

It is a bipartisan group. Democrats who are members of that include Alice Rivlin, former vice governor of the Fed; Alan Blinder, also former vice governor of the Fed; Bob Litan; Rodgin Cohen, Sullivan & Cromwell; Morris Goldstein.

We have about a dozen people, and we have reached consensus. We have a platform. It is not identical to the Frank bill. It is not identical to the Dodd bill. It does share a lot in common with them.

There are good ideas in those bills. But the details are not often very good.

Intellectually, what you are seeing here today, I think, is a lot of consensus across the aisle, and what is really interesting is I have lived through that for the past 6 months in the Pew task force.

I think if Congress would just slow down on both sides of—both houses, and just listen to that bipartisan consensus, you could do a lot better than either of those bills. And I think the problem is the devil is in the details, and he really is in those details right now. We need to fix those.

Mr. CONYERS. Yes, we will be looking forward to the Pew report.

And I thank you for the time, Mr. Chairman. Could I just close with one—let me just ask you, we have got some strong personalities involved in this legislation—Dodd, Frank, Shelby—and I wish Stiglitz could have been here to join you to make it five instead of four.

How do you separate out what we have been talking about from what they seem to be advocating?

Mr. CALOMIRIS. I am willing to take a crack at it. I think that there are good things, as I said, in—I have talked to people on both sides of the aisle, and I am actually very hopeful. I think people can come together on a bipartisan consensus. I really do.

I don't think that any of the positions and the differences are insurmountable. I think I don't want to speak out of school and mention particular lawmakers that I have talked to, but I am actually confident of it.

I think the key, though, is don't rush it through. Give it a little bit of time. Instead of trying to get a bill done by February that is going to have to be done on an egotistical or partisan basis, give it till March or—and you will have a bipartisan one.

Mr. ROSENTHAL. I would agree with that, and I will just point to one provision of the bill. If you look at the proposal—and this is in a number of the proposals—frankly, all of the proposals that have been introduced—you see one provision that says claim determinations are not subject to judicial review, and you see another proposal that says claim determinations are subject to judicial review.

I think that highlights what Professor Calomiris has been saying, that you need to take the time to go through this legislation and, one, make it consistent and, two, make sure that it embodies characteristics that both guard against systemic risk, which I think everybody would agree is a problem, and that protect creditors' interests as well.

Mr. CONYERS. Well, look, the Chairman on the—in the other body has a seriously different view from the Chairman in this body. I am glad to have words of hope. And I mentioned Mr. Shelby. I know he doesn't—I don't say I know—I think he doesn't agree with either one of them.

So let's work through this a little bit. None of them are saying what you have been saying about bankruptcy and how we resolve—how we make Hart-Scott-Rodino more effective. Glass-Steagall—that is like something out of the past. I am not sure how far memory goes back on these subjects.

So I don't know where the optimism seems to be coming from. I just hope you are right, but it is not at all clear to me.

So I thank you, Mr. Chairman, for your indulgence.

Mr. JOHNSON. Thank you, Mr. Chairman.

There is a call to have a second round of questions, so I will begin that second round with Mr. Chaffetz.

Mr. CHAFFETZ. Thank you. I appreciate it, Mr. Chairman—such an important subject.

I want to just offer one kind of two-part question, and then if you can just kind of go down the line and—and address it, do you think that an extended period of legal uncertainty could actually undermine the availability of credit to businesses as we try to emerge from the current recession?

And the second part of that is if you think that another melt-down hits before the legal uncertainty is cleared up, the legal uncertainty could actually impair our ability to control such a melt-down?

I would appreciate your perspective on that. Just kind of left from right.

Mr. SAGERS. You know, thank you. I guess my immediate reaction is in studying this bill, and in studying a lot of related legal topics, that is precisely the kind of concern that is consistently—I am not saying it is true in this case, but it is consistently overstated with rhetorical purposes in mind—that is, with achieving certain consequences.

I gather a person stating such an argument, at least during a period like this one, when policy reform is on the table, would be making that claim with the point of urging haste.

I think that would be a mistake in this case, and I just want to sort of incorporate something Professor Calomiris said on this before. I think he said it well, and he is much more expert in it than I am. Thank you.

Mr. SMITH. Thank you. I come at this from a long history of law reform where I was advised very early on that one of the primary goals of law reform is to do no harm. And it is very easy to try to address a specific problem and find out that you are creating other problems that are totally unforeseen.

I think there is a greater risk here in haste. It is true that a period of uncertainty will affect the availability of credit and will affect the cost of credit, but that problem could be compounded if the wrong legislation were enacted.

Mr. ROSENTHAL. I would agree with that. I think that there is more problem—yes, I think there is—it is worse and you compound the problem to rush to judgment and implement legislation which itself may be very uncertain than whatever legal uncertainty currently exists.

We have a system that does work to some extent. It may have some problems, but we know the system. We understand the system. Creditors understand the system. Businesses understand the system. Courts understand the system.

Courts worked through Lehman, even though they had to work, you know, all night, day and night, for weeks. They worked through Lehman. They worked through G.M. They worked through Chrysler. And they did it quickly.

So to me, you would delay a decision and come to a more reasoned decision than rush something through.

Mr. CALOMIRIS. I agree with what has been said by the other three. I would just point to a couple of things.

When we had the clarification after September 2008 by FASB of how they—the regulations in terms of mark to market would be applied—that clarification was extremely helpful to the markets, because it told people that they didn't have to go into a death spiral of valuation based on some existing market price. That resolved a very big legal uncertainty about the appropriate way to apply that, and it was very helpful.

I would also say that the stress tests resolved a regulatory enforcement uncertainty. More than they provided information about the condition of the banks, they really told us how the regulators were planning to behave toward the banks, and that was hugely beneficial.

So what we know from just looking at the recent crisis is moments of regulatory enforcement uncertainty or rules uncertainty can be devastating.

And I also agree with Mr. Rosenthal that actually aside from the issues associated with international coordination of which assets belong where, the Lehman bankruptcy actually gives us a fairly good feeling about the ability of the bankruptcy code to deal with things.

So I look at it as we have workable problems. We have problems that we could actually deal with but that we need to focus on.

Mr. CHAFFETZ. Yes, I yield to Mr. Goodlatte.

Mr. GOODLATTE. Yes, I wanted to follow up. Do you think that if they had made that clarification much earlier in this process that it would have had that same settling beneficial effect that you noted that it had when they finally got around to doing that late last fall?

I mean, we here in the Congress struggled with this all through this crisis, and the votes we had on bailout bills and so on, saying that market to market was a significant contributor to the uncertainty and that addressing that early and quickly would have had a very salutary effect?

Mr. CALOMIRIS. Yes, I do.

Mr. GOODLATTE. Thank you.

Mr. CHAFFETZ. And let me just say, Mr. Chairman, as I wrap up, I appreciate the kind of what I perceive as unanimous conclusion that it is most important to get it right rather than get it done fast, that there are unintended consequences of overreacting and reacting too quickly without understanding all of the ramifications.

I think that is precisely the point that I would like to make, that there is a system that, by and large, works, that no doubt there needs to be reform, and we are trying to address that.

But, Mr. Chairman, we ought to be understanding—thoroughly understanding each and every act and consequence so that we don't misstep and create unintended consequences that we will suffer from for years to come. So thank you for your time.

Mr. JOHNSON. Thank you, Congressman.

I have got a couple of questions. In the case of a non-bank entity that is too big to fail, who—how would the process work under the

bill that is being marked up now in Financial Services? How would this work?

And I will say that when a bank is teetering on the brink of insolvency you would have, you know, some notices that would have gone out to the bank saying you need to do this, or you need to do that, and then after a period of time then the regulators would swoop in, I guess without notice, and take over the bank, and then find some entity that would purchase the bank.

What would be the process of determining what entity is too big to fail, why—who would make that assessment, and—I will rest with that. And anyone who wants to answer that question is certainly welcome to.

Mr. SMITH. I will start off by saying that my understanding of how the too-big-to-fail institution would be identified would be—we will know it when we see it, if I understand it, that there are a number of different agencies that need to collaborate in the form of a council that would make that judgment, and the bill spells out the factors that need to be taken into consideration.

But in the end of the day I would be curious whether the other panelists see things differently—it is a pure judgment made by the best authorities who could view the problem.

Mr. ROSENTHAL. And, Mr. Chairman, if you—some of the attachments to my testimony reflect an overview of—and a comparative summary of how that decision gets made under the current bill.

It is basically a recommendation by the FDIC, approved by the Secretary of the Treasury, in consultation with the President, and they have to make certain findings about that collapse would be—you know, would cause a systemic difficulty. That is the technical things that happen.

The practical things that happen I think are a little different. We know how bank failures occur because we have a whole—a number of years of precedent about how banks are taken over. It is a little bit unclear how, as a practical matter, this would occur.

But you would expect that it wouldn't be swooping in, you know, in—at midnight for companies that are this large and this significant, that there would be significant discussions between the FDIC or the Fed or—and others—

Mr. JOHNSON. Including the target?

Mr. ROSENTHAL. I would think so, because just as there was with Lehman, you know, just as there undoubtedly was with Bear, just as there has been with AIG, I think there would be discussions with the target company to see if there were ways to avert the problem short of declaring the company to be a systemically significant company and subjecting it to this resolution authority.

But ultimately, if there were no other—there were no other solution, or if management of the company, for example, were unwilling to implement other solutions, then I could see these recommendations being made.

Remember that in a bankruptcy, the way you get into bankruptcy is that the—either your creditors put you in through the filing of an involuntary or the company voluntarily files a bankruptcy case. There isn't a provision, at least in current law, for the FDIC or the Treasury or the United States to put a company into bankruptcy.

What this new regime would do is say that there would be discussions—if the company wouldn't take the action that the government wanted, or there wasn't an action short of—you know, short of using this authority, that you could use this authority to resolve these companies and essentially depose management.

Mr. CALOMIRIS. Under what I think is going to be reported on Friday by the Pew task force, it would work the following way—similar in some ways to the resolution authority in the two different bills right now, but I think the details are kind of important.

First of all, let's say that on a particular day, Friday, a non—a large non-bank financial institution looks like it is in trouble, it is having problems. How do we know that? What would happen is it would have trouble finding counterparties to deal with it in the market.

And then I would expect the President, in consultation with the Secretary of the Treasury, would decide whether he wanted to appeal to Congress to make this firm exempted from the bankruptcy. So now we can go in one of two ways.

If the President decides not to, then what happens in bankruptcy? Under the Chapter 14 as I would see it reformed, the Fed would be able to do debtor-in-possession financing during a—some period of time while the bankruptcy court was able to take charge of the process.

There are already QFCs. Certain contracts are exempted from a bankruptcy stay. It might make sense to change the rules a little bit to allow people who are willing—short-term contracts that are maturing to take large haircuts in exchange for also being exempted as QFCs are.

There are lots of interesting details, because we don't want the financial system to freeze up because of the networking of claims that have to be traded. So there may be some reforms for the bankruptcy process—I didn't get through all of them—that are helpful in that.

Then, or if we are not going to go in that direction, if the President thinks we need to have a resolution authority, it is going to now proceed in a way where the creditors know that by law they cannot be made whole because, for example, under the Dodd bill—the Dodd bill now says there has to be a minimal haircut.

Unfortunately, it gives a loophole that says that unless the FDIC decides there is a systemic problem they can waive that. So there are lots of problems. I don't support that loophole.

But if they did proceed that way, creditors would know that either way they are going to have a loss. That would be very beneficial. And I would predict that the resolution authority—the regulator—would end up imposing the legally mandated minimum loss. They are not going to be aggressive enough.

And so it is—if you put in that minimum loss, then they will be imposed. And if you don't put it in, it won't be imposed.

Mr. JOHNSON. Let me ask this question. Assuming a target has been in negotiations with the resolution authority, but then decides that it is in its best interest to file a Chapter 11 petition, which I suppose has an automatic stay feature—okay—would the resolution authority under the current bills being considered have authority to trump the bankruptcy court?

Mr. ROSENTHAL. Yes. What happens is that the—if resolution authority is exercised, then that company becomes ineligible to be a debtor in a Chapter 11 case. So it effectively trumps the bankruptcy code.

Mr. JOHNSON. All right. I have no further questions.

Next, Mr. Chairman, anything further?

I will say that the—we may as well bring this to a close. I do appreciate you all's appearance before us today and I would like to thank you for your testimony.

Without objection, Members will have 5 legislative days to submit any additional written questions which we will forward to the witnesses and ask that you answer as promptly as you can, to be made a part of the record.

Without objection, the record will be kept open for 5 legislative days for the submission of any other—any additional materials.

Today's hearing raised a number of important issues and certainly there—I don't know if February or March or April would be sufficient time to iron out all of the details.

But as we consider this proposed legislation, we would do well to consider whether the absence of sufficient antitrust and judicial protections in emergency situations creates larger problems that it—than it seeks to solve.

And with that, this hearing of the Subcommittee on Courts and Competition Policy is adjourned.

[Whereupon, at 2:34 p.m., the Subcommittee was adjourned.]

