CLEARY GOTTLIEB

Qualified Financial Contracts And Netting Under U.S. Insolvency Laws

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The additional supporting materials referenced in this outline are available from your regular Cleary Gottlieb contacts.

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I. Applicable Insolvency Regimes.

A. Generally.

1. The Bankruptcy Code.

With specified exceptions (and subject to the Orderly Liquidation Authority ("OLA"), discussed below), all "persons" (individuals, corporations and partnerships) that reside or have a domicile, a place of business or property in the United States, as well as U.S. municipalities, are eligible for relief under the substantive provisions of the federal Bankruptcy Code (the "Code").

(a) Chapter 15.

A representative for a foreign debtor may commence proceedings under Chapter 15 of the Code ancillary to a foreign proceeding in order to administer assets located in the United States or seek other appropriate relief, including obtaining recognition of a foreign proceeding or staying execution against the debtor's United States-based assets. A foreign proceeding may only be recognized under Chapter 15 if the proceeding is a "foreign main proceeding" (defined under Section 1502(4) to mean a proceeding in the country where the debtor has its "center of main interests") or a "foreign nonmain proceeding" (defined under Section 1502(5) to mean a proceeding in the country where the debtor has an "establishment"). See 11 U.S.C. § 1517(a)(1).

The issue of whether liquidation proceedings in offshore jurisdictions in respect of hedge funds registered in such jurisdictions are entitled to recognition and relief under Chapter 15 as either "foreign main proceedings" or "foreign nonmain proceedings" had been a contentious issue. See In re Millennium Global Emerging Credit Master Fund Ltd., 458 B.R. 63 (Bankr. S.D.N.Y. 2011) (recognizing Bermuda liquidation proceedings as main proceedings); In re Basis Yield Alpha Fund (Master), 381 B.R. 37 (Bankr. S.D.N.Y. 2008) (refusing to recognize Cayman Islands proceedings in respect of Cayman Islands exempted limited liability hedge fund without evidence of debtor's center of main interest; registration in Cayman Islands is insufficient to support presumption that Cayman Islands is center of main interest); In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 374 B.R. 122 (Bankr. S.D.N.Y. 2007), aff'd, In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd., 389 B.R. 325 (S.D.N.Y. 2008) (denying any relief under Chapter 15). See also In re Sphinx, Ltd., 351 B.R. 103 (Bankr. S.D.N.Y. 2006), aff'd, In re Sphinx, Ltd, 371 B.R. 10 (S.D.N.Y. 2007) (recognition of Cayman Islands non-main proceedings). The Second Circuit has clarified that a debtor's center of main interest ("COMI") is determined as of the time the Chapter 15 petition is filed, not as of the date of the commencement of foreign proceedings, and that the court may consider the debtor's liquidation proceedings in making the

COMI determination. In re Fairfield Sentry Ltd., 714 F.3d 127, 138 (2d Cir. 2013). However, a court may also consider the period between the commencement of the foreign proceeding and the filing of the Chapter 15 petition to ensure that the debtor has not manipulated its COMI in bad faith. Fairfield Sentry, 714 F.3d at 138.

Chapter 15 is based on the UNCITRAL Model Law on Cross-Border Insolvency, and it and Section 561 expressly provide that the safe harbors for securities, forward and commodity contracts and repurchase, swap and master netting agreements (collectively, "Protected Contracts") apply to ancillary proceedings brought under Chapter 15. Entities excluded from eligibility for Chapter 7, other than foreign insurance companies, are not eligible for recognition of ancillary proceedings under Chapter 15 of the Code. Compare Agency for Dep. Ins. v. Sup. of Banks, 310 B.R. 793 (S.D.N.Y. 2004) (New York branch of Yugoslav bank can be subject to ancillary bankruptcy proceedings under pre-2005 Code). Chapter 15 proceedings, however, may be commenced in respect of a foreign bank with no branches or agencies in the United States (so long as the bank has assets in the United States), as such an entity is not excluded from eligibility under Chapter 7. See 11 U.S.C. § 109(b)(3)(B); In re Irish Bank Resolution Corporation Limited, 538 B.R. 692 (D. Del. 2015).

(b) The Code defines "corporation" to include a "business trust." In In re Secured Equip. Trust of Eastern Air Lines, 38 F.3d 86 (2d Cir. 1994), the court held that a trust created as a vehicle to facilitate a secured financing was not a business trust, and hence ineligible for bankruptcy protection because, inter alia, the trust was not created for the purpose of carrying on some kind of business or generating a profit, but to protect and preserve the res. Compare In re General Growth Properties, Inc., 409 B.R. 43 (Bankr. S.D.N.Y. 2009) (holding that a trust formed to hold real estate was an eligible debtor despite having non-transferrable interests and no employees, because it actively engaged in business and was operated to produce profit, not merely to protect the res); see also In re Kenneth Allen Knight Trust, 303 F.3d 671 (6th Cir. 2002) (holding that the standard for determining whether a trust is a business trust "consists in two propositions: first trusts created with the primary purpose of transacting business or carrying on commercial activity for the benefit of investors qualify as business trusts, while trusts designed merely to preserve the trust res for beneficiaries generally are not business trusts; and second, the determination is fact-specific, and it is imperative that bankruptcy courts make thorough and specific findings of fact to support their conclusions—findings, that is, regarding what was the intention of the parties, and how the trust operated").

Pension plans are generally not "persons" eligible for Code protection. See, e.g., In re Parade Realty, Inc., 134 B.R. 7 (Bankr. D. Haw. 1991); In re

Westchester Cnty. Civil Service Employees Ass'n, 11 B.R. 451 (Bankr. S.D.N.Y. 1990); In re Cahill, 15 B.R. 639 (Bankr. E.D. Pa. 1981).

2. Regimes Applicable to the Insolvency of Debtors Ineligible for the Code.

(a) A person may not be a debtor under Chapters 7 or 11 of the Code if it is a domestic insurance company, bank, thrift or credit union; a foreign insurance company engaged in such business in the United States; or a foreign bank, savings bank, cooperative bank, savings and loan association, building and loan association, or credit union, that has a branch or agency (as defined in Section 1(b) of the International Banking Act of 1978) in the United States.

(i) As discussed below, state law governs delinquency proceedings (typically, rehabilitation or liquidation proceedings) of insurance companies. Insurance companies are not "financial institutions" under the provisions of the Federal Deposit Insurance Corporation Improvement Act of 1991 ("FDICIA") discussed below. Although an insurance company might qualify as a "financial institution" under the provisions of the Federal Reserve Board's Regulation EE (discussed below), there is a substantial question as to whether the provisions of FDICIA supersede state law governing insurance delinquency proceedings by virtue of the McCarran-Ferguson Act. See 15 U.S.C. § 1012(b) ("No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance."); cf. U.S. Dep't of Treasury v. Fabe, 508 U.S. 491 (1993) (holding Ohio priority statute not preempted by federal superpriority statute to extent it protected policyholders); In re MF Global Holdings Ltd., 469 B.R. 177, 195 n.17 (Bankr. S.D.N.Y. 2012) ("Upon review of the New York Insurance Law and the Bankruptcy Code, the Court finds that all three requirements of the McCarran–Ferguson Act are met, and thus, section 3420(a)(1) of the New York Insurance Law [requiring an insurer to abide by an insurance policy notwithstanding the insolvency of the insured] preempts the Bankruptcy Code to the extent of any inconsistency between the two laws."). OLA, discussed below, does not apply to insurance companies; however, under OLA, the FDIC has backup authority to file a judicial action to have systemically significant insurance companies liquidated under state law if the relevant state regulatory agency has failed to do so for 60 days.

(ii) The Federal Deposit Insurance Act (the "FDIA"), discussed below, will likely govern conservatorship or receivership proceedings of institutions the accounts of which are insured by the Federal Deposit Insurance Corporation (the "FDIC"). FDIC-insured institutions are "financial institutions" under FDICIA, although FDICIA is subject to Section 11(e) of the FDIA. State law (as well as foreign law) will likely govern proceedings in respect of a state branch or agency of a non-U.S. bank. See, e.g., New York Banking Law § 606. Proceedings in respect of a federal branch or agency of a non-U.S. bank would be subject to the International Banking Act (12 U.S.C. § 3102(j)). Foreign banks as well as branches and agencies of foreign banks are "financial institutions" under FDICIA, and FDICIA would preempt any inconsistent provisions of the International Banking Act enacted before 1991 and any inconsistent provisions of state law. OLA does not apply to FDIC-insured banks.

The Federal Credit Union Act ("FCUA") will likely govern the insolvency proceedings of federally insured credit unions. Federally insured credit unions are "financial institutions" under FDICIA, though FDICIA would be subject to Section 207(c) of the FCUA. The FCUA's provisions addressing the treatment of "qualified financial contracts" are nearly identical to those of the FDIA discussed below. The "written agreement" requirements of the FCUA follow the requirements of the FDIA and have been addressed in an Interpretive Ruling and Policy Statement of the National Credit Union Administration ("NCUA") that expressly acknowledged the FDIC's policy guidance with respect to the "written agreement" requirements of the FDIA (See 68 Fed. Reg. 61735-01, Oct. 30, 2003). Although unlikely, OLA could apply to a federally insured credit union.

(iii) The Housing and Economic Recovery Act of 2008 ("HERA") significantly amended the provisions relating to the insolvency of the Federal Home Loan Banks (the "FHLBs"), the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"). In most respects, the conservatorship and receivership provisions of HERA are very similar (and in many instances identical) to the conservatorship and receivership provisions of the FDIA. The definitions of "qualified financial contract" in HERA do not, however, reflect the amendments made to the FDIA by the Financial Netting Improvements Act of 2006 (the "2006 Act"). The Federal Reserve Board has designated Fannie Mae, Freddie Mac and the FHLBs as "financial institutions" under FDICIA, though the interplay of FDICIA and HERA is unclear. OLA does not apply to the FHLBs, Fannie Mae or Freddie Mac.

(A) On September 7, 2008, the Federal Housing Finance Agency (the "FHFA"), the regulator for both Fannie Mae and Freddie Mac, appointed itself as conservator under HERA for both Fannie Mae and Freddie Mac.

(B) On June 14, 2011, the FHFA issued a final rule for conservatorships and receiverships of Fannie Mae, Freddie Mac and the Federal Home Loan Banks under HERA (see 12 CFR Parts 1229, 1237). Among other things, under this rule, claims of rescission or fraud in the issuance of equity securities are subordinated to the level of equity (similar to § 510(b) of the Code), 18 months has been established as a "reasonable time" within which the FHFA can repudiate contracts, and a Limited Life Regulated Entity—similar to a bridge entity under OLA—is allowed to obtain credit secured by assets. Unlike under OLA, the credit can be secured by assets previously encumbered to secure other obligations, including qualified financial contracts ("QFCs"), provided there is "adequate protection" for the existing lien holders.

(b) "Stockbrokers" and "commodity brokers" may not be debtors under Chapter 11 (but may be debtors under Chapter 7) of the Code. Various customer-creditors of Refco Capital Markets, Ltd. ("RCM"), an offshore unregulated division of Refco, Inc., filed a motion in the Bankruptcy Court of the Southern District of New York to convert RCM's proceedings from a Chapter 11 Reorganization to a Chapter 7 Stockbroker Liquidation on the basis that RCM was a stockbroker under Bankruptcy Code Section 101(53A). On March 14, 2006, the court (Drain, J.) delivered a bench ruling stating that RCM was a stockbroker under the Code, and was accordingly prohibited by Section 109(d) from filing under Chapter 11, and further, that no "unusual circumstances" under Section 1112(b) would compel the court to deny the motion. The Court stayed its ruling for at least 45 days to afford parties the opportunity to reach a global voluntary settlement under Chapter 11. At the end of June 2006, RCM reached a global settlement agreement, giving customer-creditors the distribution of assets that would have occurred were RCM a stockbroker under the Code. Stockbrokers and commodity brokers will likely be "financial institutions" under FDICIA, particularly under Regulation EE.

(c) Stockbrokers that are members of the Securities Investor Protection Corporation ("SIPC") (including stockbrokers that are also registered with the Commodity Futures Trading Commission ("CFTC") as futures commission merchants ("FCMs")) may also be the subject of proceedings under the Securities Investor Protection Act of 1970 ("SIPA"). Notably, the insolvency proceedings governing the liquidation of Bernard L. Madoff Investment Securities LLC, Lehman Brothers Inc., and MF Global Inc., all SIPC members, are being conducted under SIPA. See Securities and Exchange Commission v. Madoff, 2009 WL 980288 (S.D.N.Y. Dec. 15, 2008) (commencing and removing liquidation proceeding to Bankruptcy Court); SIPC v. Lehman Brothers Inc., No. 08 Civ. 8119 (S.D.N.Y. Sept. 19, 2008) (same). Stockbrokers that are members of SIPC will be "financial institutions" under FDICIA, though FDICIA is subject to SIPA's stay provisions described below. OLA could apply to stockbrokers. On February 18, 2016, the FDIC and the SEC jointly proposed rules to implement the provisions applicable to brokers or dealers under OLA. See Covered Broker-Dealer Provisions Under Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 81 Fed. Reg. 10798 (to be codified at 12 C.F.R. § 380 and 17 C.F.R. § 302).

(d) Were a commodity broker liquidated under the Code, those proceedings would be governed by subchapter IV of Chapter 7 of the Code ("subchapter IV") and the CFTC's regulations thereunder codified at Part 190 of Title 17 of the Code of Federal Regulations ("Part 190"). Because SIPA recognizes that a stockbroker may be dually registered as a commodity broker and, generally speaking, vests the SIPA trustee with specific powers and duties with respect to FCM customers as though the SIPA trustee were a trustee operating under subchapter IV, unless a provision of subchapter IV or Part 190 is inconsistent with SIPA, those bodies of law apply in SIPA proceedings in respect of a commodity broker. 15 U.S.C. § 78fff-1(a) & (b). OLA could also apply to a commodity broker, in which case subchapter IV and Part 190 would apply to the distribution of customer property. See 12 U.S.C. § 5390(m).

(e) Commodity brokers regulated by the CFTC, 1940 Act-registered mutual funds and hedge funds have been the subject of federal law court-supervised equity receiverships, including the January 2000 receivership of Manhattan Investment Fund Ltd., and the March 2001 receivership of certain funds in the Heartland Group. The Manhattan Investment Fund action involved a freeze order applicable to, among others, Bear Stearns.

B. The Dodd-Frank Act.

1. In response to the global financial crisis, on July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") (Pub. L. No. 111-203, 124 Stat. 1376, 12 U.S.C. § 5301 et seq., available at http://www.gpo.gov/fdsys/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf) was signed into law. In particular, Title II of Dodd-Frank (12 U.S.C. §§ 5381-94) created an "Orderly Liquidation Authority" that provides for the orderly resolution of financial companies (other than FDIC-insured banks and government sponsored enterprises) whose insolvency under otherwise applicable insolvency law would create systemic risk by providing for FDIC receiverships for such companies. Appointment of the FDIC as receiver would only occur following approval by designated authorities, including the Secretary of the Treasury in consultation with the President, and a twenty-four hour opportunity for review by the United States District Court for the District of Columbia. OLA is largely modeled on provisions of the FDIA. When invoked, OLA would generally supersede otherwise applicable insolvency law—which would typically be the Code.

   The Financial Choice Act, which is under consideration by the U.S. Congress, would, among other things, repeal OLA. See generally http://financialservices.house.gov/uploadedfiles/financial_choice_act_comprehensive_outline.pdf.

C. Applicability of Code "Safe Harbor" Provisions.

1. Following the amendments to the Code made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), the "securities contract," "forward contract," "commodity contract," "repurchase agreement" and "swap agreement" provisions of the Code now apply in any proceeding under Chapters 7, 9 or 11 of the Code or in any ancillary proceeding under Chapter 15.

   (a) Compare County of Orange v. Nomura Securities International, Inc., Adv. No. 94 02480 (Bankr. S.D. Cal.) (complaint dismissed) (challenging close out of repurchase agreements with municipality under Section559 under pre-2005 Code).

   (b) Compare In re: Petition of the Board of Directors of Compania General de Combustibles S.A., 269 B.R. 104 (Bankr. S.D.N.Y. 2001) (court in Section 304 proceeding under pre-2005 Code enjoined action against U.S. property even though swap participant unable to terminate swap agreement upon bankruptcy of Argentine debtor under Argentine law).

   (c) The Protected Contract provisions of the Code do not by their terms apply in equity receiverships of commodity brokers or mutual funds.

2. Certain limitations, discussed below, arise in a proceeding under SIPA.

II. Several Provisions of the Code Impair Creditors' Rights.

A. Rejection or Assumption of Executory Contract; "Ipso Facto" Clauses Unenforceable.

1. The "trustee" (including a debtor-in-possession) has the right under Section 365 of the Code to assume (and assign) or reject most executory contracts of the debtor, notwithstanding so-called "ipso facto" clauses automatically terminating contracts on the basis of the bankruptcy of a counterparty and notwithstanding clauses prohibiting the assignment thereof.

   (a) The right to assume or reject executory contracts might give a trustee the power to "cherry pick" between transactions, including those documented by the parties under a master agreement; i.e., to assume (or assume and assign) transactions favorable to the trustee and reject transactions favorable to the counterparty.

      (i) Provisions in master agreements that provide that all transactions thereunder constitute a single agreement may operate to prevent selective assumption/rejection. Cf. In re Dickinson Theatres, Inc., 2012 WL 4867220 (Bankr. D. Kan. Oct. 12, 2012) (holding that leases under master agreement were indivisible because agreement stated that it was the intent of the parties that the lease constitute an "unseverable and single lease"). Compare In re Hawker Beechcraft, Inc., 2013 WL 2663193 (Bankr. S.D.N.Y. June 13, 2013) (purchase orders under master purchase agreement were divisible from such agreement because, among other factors, the agreement did not clarify that individual purchase orders were part of the agreement and non-defaulting party was permitted to terminate only orders in respect of which a default had occurred).

(ii) A bankruptcy court found that a series of three contracts (between the same two parties) related to purchases and sales of natural gas using different pricing methods were swap contracts under a single agreement and therefore were required to be netted against one another because the contracts referred to one another, were entered into in reliance on the others, and the parties had stipulated to their being treated as one agreement. In re Enron Corp., 349 B.R. 96 (Bankr. S.D.N.Y. 2006).

(b) The Protected Contract provisions (discussed below) protect the exercise of contractual liquidation and termination rights, notwithstanding a trustee's general right to assume or reject executory contracts.

(i) If a counterparty did not exercise a liquidation or termination right, the trustee would continue to have the power to assume or reject Protected Contracts, subject, perhaps, to the provisions of FDICIA discussed below.

(ii) In the "Metavante" decision during the Lehman bankruptcy, the bankruptcy court for the Southern District of New York held that a counterparty could not suspend ordinary course payments pursuant to an interest rate swap under Section 2(a)(iii) of the ISDA master agreement by relying on conditions precedent language triggered by the bankruptcy of either Lehman's holding company or the Lehman counterparty to the swap. See In re Lehman Bros. Holdings, Inc., No. 08-13555 (JMP), Tr. 9/15/2009 (hearing regarding debtor's motion to compel performance of Metavante Corp.'s obligations under an executory contract and to enforce the automatic stay). In contrast, the Court of Appeal for England and Wales has held that Section 2(a)(iii) of the ISDA master agreement does allow a counterparty to a swap agreement to stop making payments to the defaulting party upon a Bankruptcy Event of Default, based on the notion that the right to receive contingent net payments are accruing from time to time as the quid pro quo for a continuing service. See Lomas and others v. JFB Firth Rixson Inc. and others, [2012] EWCA Civ. 419 (03 April 2012). See generally our Alert Memo available at https://www.clearygottlieb.com/~/media/cgsh/files/news-pdfs/uk-court-holds-non-defaulting-party-to-isda-master-agreement-can-withhold-net-payments-and-is-not-obliged-to-terminate.pdf. Following these decisions, ISDA and its members drafted revisions to Section 2(a)(iii) of the 1992 and

2002 master agreements to address this issue. See generally http://www.isda.org/publications/pdf/Guidance_Note_amendment_agreement.pdf.

2. Damages Calculations for Rejected or Terminated Contracts.

(a) Section 562, which was added by the 2005 Act, provides that damages upon rejection by the trustee or liquidation, termination or acceleration by the counterparty of a Protected Contract are measured as of the earlier of the date of such rejection or the date of such liquidation, termination or acceleration. See Code Section 562(a).

(i) However, if, as of either date (the date of rejection or the date of liquidation, termination or acceleration), no commercially reasonable determinants of value exist, damages are measured as of the earliest subsequent date on which such determinants exist. Code Section 562(b). The terminating creditor or the rejecting trustee has the burden of proof that no commercially reasonable determinants of value existed as of such date. See In re American Home Mortg. Holdings, Inc., 637 F.3d 246 (3rd Cir. 2011) (holding that the "discounted cash flow" method of determining damages under a repurchase agreement was a commercially reasonable determinant of value that defeated creditor's position that damages should have been measured as of a date over a year after the acceleration date).

(ii) The claim for damages calculated under Section 562 of the Code is to be allowed the same as if such claim had arisen before the date of the filing of the petition. See 11 U.S.C. § 502(g)(2).

(iii) Section 562 does not apply to customers' net equity claims in a SIPA proceeding. See SIPC v. Lehman Bros. Inc., 433 B.R. 127 (Bankr. S.D.N.Y. June 1, 2010) (in a SIPA proceeding, a financial participant is not stayed from liquidating, terminating or accelerating its securities contracts, but these rights are distinct from the determination of the participant's net equity claim under SIPA).

(iv) The rule for non-Protected Contracts may well be different. A number of courts have held that Section 502(g) requires damages flowing from a trustee's rejection of an executory contract to be fixed at or immediately before the date the bankruptcy petition is filed. See, e.g., In re IndyMac Bancorp, Inc., 2012 WL 1037481 (Bankr. C.D. Cal. Mar. 29, 2012); In re Brown, 367 B.R. 599 (Bankr. S.D. Ohio 2006); In re American HomePatient, Inc. 414 F.3d 614 (6th Cir. 2005); In re Aslan, 909 F.2d 367 (9th Cir. 1990); In re O.P.M. Leasing Services, Inc., 79 B.R. 161 (S.D.N.Y. 1987); In re Enron Corp., 330 B.R. 387 (Bankr. S.D.N.Y. 2005), aff'd, 354 B.R. 652 (S.D.N.Y. 2006). But see, e.g., In re Lavigne, 114 F.3d 379 (2d Cir. 1997); Beard v. S/E Joint Ventures, 322 Md. 225 (Ct. App. Md. 1989);

In re James R. Corbitt Co., 48 B.R. 937 (Bankr. E.D. Va. 1985) (noting in dicta that a date other than petition date may be used to compute damages for breach of contract "in proper circumstances"); In re Good Hope Chem. Corp., 747 F.2d 806 (1st Cir. 1984), cert. denied, 471 U.S. 1102 (1985).

(v) Section 502(b)(2) of the Code generally provides that a court may not allow a claim for "unmatured interest". Compare Tew v. Arizona Retirement System. 69 B.R. 608 (S.D. Fla. 1987), rev'd on other grounds, 873 F.2d 1400 (11th Cir. 1989) (buyer under repurchase agreement not entitled to recoup interest that had accrued during the two day period between the seller's pre-2005 bankruptcy petition and the buyer's liquidation of the securities purchased under the repo) with In re Thrifty Oil Co., 322 F.3d 1039 (9th Cir. 2003) (damages upon termination of swap agreement not disallowed as unmatured interest in pre-2005 case).

(b) The Code does not expressly address the enforceability of contractual damage provisions (such as "Limited Two-Way Payment" provisions) that limit the recovery of damages by the debtor from the non-defaulting party on account of the early termination of a forward or commodity contract or swap agreement based on the bankruptcy of the debtor. See Drexel Burnham Lambert Prods. Corp. v. Midland Bank PLC, 1992 U.S. Dist. LEXIS 21223 (S.D.N.Y. Nov. 10, 1992) (limited two-way payment provision found enforceable as a valid liquidated damages clause that was not unconscionable or contrary to public policy; the case was settled). See also Final Report of Trustee in In re Granite Partners, L.P., 194 B.R. 318 (S.D.N.Y. Apr. 18, 1996) (the "Askin Report") at 294–96. But cf., 12 U.S.C. § 1821(e)(8)(G); Dodd-Frank § 210(c)(8)(F) ("walkaway" clauses unenforceable under the FDIA and under OLA). The Southern District of New York has held that contractual "walkaway" provisions may be enforceable under New York non-bankruptcy law. See Brookfield Asset Mgmt., Inc. v. AIG Financial Products Corp., 2010 WL 3910590 (S.D.N.Y. Sep. 29, 2010).

(c) Similarly, the Code does not expressly address the enforceability of contractual provisions subordinating the debtor's priority of payment due to the debtor's default. However, the enforceability of such purported "flip clauses" has recently been addressed in the Lehman bankruptcy proceedings. In two cases, the bankruptcy court for the Southern District of New York held that provisions in a debt indenture under which a Lehman subsidiary's existing priority was changed on account of its parent's (and credit support provider's) insolvency were unenforceable ipso facto clauses not safe harbored by Section 560 and which, if enforced, would violate the automatic stay under Section 362(a). Lehman Bros. Special Financing Inc. v. BNY Corporate Trustee Services Ltd., 422 B.R. 407 (Bankr. S.D.N.Y. 2010) ("Perpetual"); In re Lehman Bros. Holdings Inc., 452 B.R. 31 (Bankr. S.D.N.Y. 2011) ("Ballyrock"). These cases conflicted with a decision of the United Kingdom Supreme Court, which held such subordination provisions to be enforceable under English law. Belmont Park Investments PTY Limited v. BNY Corporate Trustee Services Limited, et. al., [2011] UKSC 38. However, a different bankruptcy judge administering the Lehman bankruptcy reached a different result in subsequent cases involving different structures. That court held that Section 541 only limited the enforceability of purported "flip clauses" if the debtor is entitled to priority prior to the triggering of such clauses; by contrast, where priority "was not fixed at the outset of the transaction and remained unfixed until the [s]wap was actually terminated", the ipso facto provisions were inapplicable. The court additionally held that any modification of the debtor's rights prior to the commencement of proceedings did not violate Section 541 and that, where the priority language is incorporated into the swap documentation, Section 560's protections (discussed below) would apply. Lehman Bros. Special Financing, Inc. v. Bank of Am. Nat'l Ass'n, 553 B.R. 476 (Bankr. S.D.N.Y. 2016). An alert memorandum regarding this case is available at https://www.clearygottlieb.com/~/media/cgsh/files/alert-memos/alert-memo-pdf-version-201668.pdf.

B. Automatic Stay.

1. The filing of a petition under the Code operates as an automatic stay against the taking of actions against the debtor or its property.

   (a) In general, the automatic stay would operate to prohibit the taking of remedial actions absent court approval, such as the exercise of setoff rights or the liquidation of collateral. The stay on the exercise of setoff rights does not compel the creditor to pay its obligation to the debtor. See Citizens Bank of Md. v. Strumpf, 516 U.S. 16 (1995) (holding that the bank, in order to protect its setoff rights, may temporarily withhold payment of a debt that it owes to the debtor without violating the automatic stay).

   (b) There are certain exceptions to the operation of the automatic stay in connection with Protected Contracts, as described below.

C. Certain Transactions Can Be Avoided.

1. Preferences

   (a) The trustee generally has the ability to avoid pre-petition "preferences," "fraudulent transfers" and "unperfected" security interests, as well as certain pre-petition setoffs and post-petition transfers.

      (i) Exceptions apply to certain transfers and setoffs in respect of Protected Contracts, as described below.

(b) In general, an avoidable preference is:

(i) a transfer of an interest of the debtor in property;

(ii) to or for the benefit of a creditor;

(iii) on account of an antecedent debt;

(iv) made while the debtor was insolvent (which is presumed for the 90-day period prior to the filing of the petition);

(v) made on or within 90 days prior to the date of the filing of the petition or, in the case of a transfer to an "insider," within one year prior to the date of the filing of the petition; and that

(vi) enables the creditor to receive more than it would have received had the payment not been made and the debtor had been liquidated under Chapter 7.

(c) Exceptions exist for certain transfers for "new value" (including in exchange for the release of a security interest) or made in the ordinary course of business.

(d) The rule of Levit v. Ingersoll Rand Fin. (In re Deprizio), 874 F.2d 1186 (7th Cir. 1989), that the presence of a guarantee from an insider may extend the preference period to one year, has generally been reversed by the October 1994 amendments to the Code and by the 2005 Act.

2. Fraudulent Transfers.

(a) In general, a "fraudulent transfer" avoidable under Section 548 of the Code is a transfer that was made with actual intent to hinder, delay or defraud creditors, or that was made for less than reasonably equivalent value if the debtor was insolvent at the time of the transfer or became insolvent as a result of the transfer. The 2005 Act extended the look-back period from one year to two years for all cases filed more than one year after the date of enactment of the law.

3. Under State Avoidance Laws.

(a) As a "hypothetical judicial lien creditor" under Section 544(a) of the Code, a trustee has the ability to avoid security interests that were not perfected under applicable law at the time of the filing of the petition. Although the literal language of the Protected Contract provisions of the Code protects against the avoidance of unperfected security interests, cf. the SIPC letters, discussed below, in which SIPC requires an affidavit regarding the perfection of the counterparty's security interest in securities collateral.

4. Post-Petition Transfers.

(a) Under Section 549 of the Code, a trustee may avoid post-petition transfers of property that are not authorized under the Code or by the court. The anti-avoidance provision applicable to Protected Contracts, discussed below, does not, by its terms, apply to avoidance actions under Section 549.

5. Pre-Petition Setoff and Assignment of Claims.

(a) Under Section 553 of the Code, a trustee may avoid certain pre-petition setoffs, certain assignments of claims made to a creditor during the 90-day preference period and the incurrence of debts by a creditor in order to obtain a right of setoff. Exceptions described below apply to Protected Contracts.

D. Claims Arising From the Purchase or Sale of Securities of the Debtor or its Affiliates are Subordinated.

1. Under Section 510(b) of the Code, claims arising from the purchase or sale of a security of the debtor or of an "affiliate" of the debtor might be subject to mandatory subordination. Courts have interpreted Section 510(b) broadly to apply to a debtor's failure to sell its own securities. See, e.g., In re Betacom of Phoenix, 240 F.3d 823 (9th Cir. 2001). The interplay of Section 510(b) and the Protected Contract provisions of the Code is unclear.

III. Exceptions for Certain Financial Contracts.

There are several statutory exceptions from the foregoing provisions in the case of Protected Contracts, i.e., "securities contracts," "forward contracts," "commodity contracts," "repurchase agreements," "swap agreements" and "master netting agreements." A report issued by the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 examined these "safe harbors". See Chapter IV.E of the report, available at https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h.

A. Transactions and Agreements Covered.

1. Securities Contracts.

(a) Prior to the 2005 Act and the 2006 Act, "securities contract" was defined in the Code as follows:

> '"Securities contract' means contract for the purchase, sale, or loan of a security, including an option for the purchase or sale of a security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof) or any option entered into on a national securities exchange relating to foreign currencies, or the guarantee of any settlement of cash or securities by or to a securities clearing agency."

(i) At least one court held that reverse repurchase transactions that did not fall within the definition of "repurchase agreement" (because of the type of securities involved) could be securities contracts. In re Residential Resources, 98 B.R. 2 (Bankr. D. Ariz. 1989). Similarly, in a case involving a post-1982 but pre-1984 repurchase agreement (i.e., after the adoption of the securities contract provisions but prior to the adoption of the repurchase agreement provisions), a court held that the buyer was entitled to the anti-preference protections that are part of the securities contract provisions of the Code (although the court did not expressly hold the repurchase agreement to be a securities contract). Jonas v. Farmer Bros. Co. (In re Comark), 124 B.R. 806 (Bankr. C.D. Cal. 1991), aff'd, 145 B.R. 47 (B.A.P. 9th Cir. 1992). See also In re Hamilton Taft & Co., 114 F.3d 991 (9th Cir. 1997) (transfer under repurchase agreement covered by anti-avoidance provisions relating to securities contracts); In re Weisberg, 193 B .R. 916 (B.A.P. 9th Cir. 1996), aff'd 136 F.3d 655 (9th Cir. 1998), (holding that a margin loan benefits from the "securities contract" provisions of the Code); Granite Partners. L.P. v. Bear Stearns & Co., Inc., 17 F. Supp. 2d 275 (S.D.N.Y. 1998) (refusing to recharacterize a repurchase agreement as a secured loan where the Bond Market Association form of repurchase agreement was clear that the objective intent of the parties was that the transaction be treated as a purchase and sale, but denying motion to dismiss in respect of a repurchase agreement documented solely by an "ambiguous" confirmation); In re County of Orange, 31 F. Supp. 2d 768 (C.D. Cal. 1998) (reverse repos not collateralized loans in the context of California municipal debt limitations). But see Lombard-Wall Inc. v. Columbus Bank & Trust Co., No. 82 B 11 55 6 (Bankr. S.D.N.Y., bench decision, September 16, 1982) (prior to adoption of repurchase agreement provisions, court characterized transactions as a secured loan and buyer was thus subject to automatic stay in liquidating securities); RTC v. Aetna Cas. & Sur. Co. of Ill., 25 F.3d 570 (7th Cir. 1994) (in insurance context, concluding that repurchase and reverse repurchase agreements were in the nature of a collateralized loan); In re Criimi Mae, 251 B.R. 796 (Bankr. D. Md. 2000) (evidentiary hearing needed to decide whether a repurchase agreement was a secured loan or a purchase and sale).

(b) "Securities contract" is now defined in the Code as:

> "(A) . . . (i) a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including an interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse

repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a ‘repurchase agreement’, as defined in section 101);

(ii) any option entered into on a national securities exchange relating to foreign currencies;

(iii) the guarantee (including by novation) by or to any securities clearing agency of a settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, or mortgage loans or interests therein (including any interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such settlement is in connection with any agreement or transaction referred to in clauses (i) through (xi));

(iv) any margin loan;

(v) any extension of credit for the clearance or settlement of securities transactions;

(vi) any loan transaction coupled with a securities collar transaction, any prepaid forward securities transaction, or any total return swap transaction coupled with a securities sale transaction;

(vii) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph;

(viii) any combination of the agreements or transactions referred to in this subparagraph;

(ix) any option to enter into any agreement or transaction referred to in this subparagraph;

(x) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this subparagraph, except that such master agreement shall be considered to be a securities contract under this subparagraph only with respect to each agreement or transaction under such master agreement that is referred to in clause (i), (ii), (iii), (iv), (v), (vi), (vii), (viii), or (ix); or

(xi) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this subparagraph, including any guarantee or reimbursement obligation by or to a stockbroker, securities clearing agency, financial institution, or financial participant in connection with any agreement or transaction referred to in this subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562; and

(B) does not include any purchase, sale, or repurchase obligation under a participation in a commercial loan."

A participation in a commercial mortgage loan is not itself a securities contract, but purchase, sale and repurchase agreements involving such participations are intended to be protected.

(i) Pursuant to amendments to the Exchange Act made by Section 763 of Dodd-Frank:

(A) A security-based swap, as defined in Dodd-Frank shall be considered to be a security as such term is used in the Code;

(B) An account that holds a security-based swap, other than a portfolio margining account referred to in Dodd-Frank shall be considered to be a securities account, as that term is defined in Section 741 of the Code;

(C) The definitions of the terms "purchase" and "sale" in Dodd-Frank shall be applied to the terms "purchase" and "sale", as used in Section 741 of the Code;

(D) The term "customer", as defined in Section 741 of the Code, excludes any person, to the extent that such person has a claim based on any open repurchase agreement, open reverse repurchase agreement, stock borrowed agreement, non-cleared option, or non-cleared security-based swap except to the extent of any margin delivered to or by the customer with respect to which there is a customer protection requirement under Section 15(c)(3) of the Exchange Act or a segregation requirement. 15 U.S.C. § 78c-5(g).

Analogous changes were not made in SIPA.

(ii) In Calyon v. American Home Mortg. Corp., 379 B.R. 503, motion to amend denied, 383 B.R. 585 (Bankr. D. Del. 2008), the court held that repurchase agreements on whole mortgage loans were "securities contracts" and "repurchase agreements," but that termination of related servicing rights was not safe-harbored. In In re American Home Mortg. Holdings, Inc., 388 B.R. 69 (Bankr. D. Del. 2008), the court similarly ruled that repurchase agreements on notes secured by whole mortgage loans were both "securities contracts" and "repurchase agreements" because the notes were "interests in mortgage loans" and that liquidation of the notes did not have to comply with UCC Article 9 standards regarding sales of collateral. For more information, please see our alert memorandum available at https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/bankruptcy-court-rules-on-applicability-of-safe-harbors-and-ucc-article-9-to-repurchase-agreements.pdf.

(iii) In Picard v. Ida Fishman Recoverable Trust, 773 F.3d 411 (2d. Cir. 2014), the Second Circuit settled an apparent split among district courts regarding whether the account opening documents that customers of Bernard L. Madoff Securities were required to execute constituted "securities contracts" for purpose of the Code, even though no securities were actually purchased pursuant to those documents. Compare Picard v. Greiff (In re Madoff Securities), 476 B.R. 715 (S.D.N.Y. 2012) and Picard v. Katz, 462 B.R. 447 (S.D.N.Y. 2011) with Picard v. Madoff, 458 B.R. 87 (S.D.N.Y. 2011) and Picard v. Merkin, 2011 WL 3897970 (S.D.N.Y. Aug. 31, 2011). The court concluded that the agreements satisfied a number of the Code's "broad" definitions of securities contract, including those contained in Sections 741(7)(a)(i), (vii), (x) and (xi).

(iv) In Lehman Bros. Holdings, Inc. v. JPMorgan Chase Bank, N.A., (In re Lehman Bros. Holdings, Inc.), 469 B.R. 415, 438–39 (Bankr. S.D.N.Y. 2012), the court found that guarantees, security agreements and an account control agreement, entered into to provide additional credit enhancement to obligations incurred under an agreement that provided liquidity for securities transactions, were credit enhancements "in connection with" a securities contract and thus constituted safe-harbored "securities contracts."

(v) Bonds themselves, or the indentures pursuant to which they are issued, have been found not to be securities contracts. EPLG I, LLC v. Citibank, N.A. (In re Qimonda Richmond, LLC), 467 B.R. 318 (Bankr. D. Del. 2012) ("Although it is settled law that bonds and indentures are contracts, the Court is not persuaded that the Bonds and Indentures are securities contracts within the definitions in the Bankruptcy Code."). However, contracts to purchase bonds or notes are securities contracts. See, e.g., Official Committee of Unsecured Creditors of Quebecor World (USA) v. Am. United Life Ins. Co., 719 F.3d 94 (2d Cir. 2013); see also Motors Liquidation Co. Avoidance Action Trust v. JPMorgan Chase Bank, N.A., 552 B.R. 253 (Bankr. S.D.N.Y. 2016) (suggesting that a term loan which provided lenders the right to sell interests in the loan through assignment and which was registered, along with an accompanying note, with a CUSIP could be a securities contract depending on the content of the actual documents).

(vi) In U.S. Bank Nat'l Ass'n v. Verizon Comm., Inc., 892 F. Supp. 2d 805 (N.D. Tex. 2012), the court held that a contract under which Verizon transferred its domestic directories business to a spin-off in exchange for cash and debt was a "securities contract".

(vii) The Code does not define the term "repurchase transaction". However, the court in American Home suggested that an agreement that satisfied the definition of "repurchase agreement" would be a "repurchase transaction". See American Home, 388 B.R. 69, 84 ("As the Court has already determined that the MRA is a 'repurchase agreement' and that the Subordinated Notes are 'interests in mortgage loans,' the MRA therefore is a 'securities contract.'").

2. Forward Contracts.

(a) Prior to the 2005 Act and the 2006 Act, "forward contract" was defined in the Code (as amended in 1990) as:

> "a contract (other than a commodity contract) for the purchase, sale, or transfer of a commodity . . . or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase transaction, reverse repurchase transaction, consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any combination thereof or option thereon" (emphasis added).

(i) See In re Olympic Natural Gas Co., 294 F.3d 737 (5th Cir. 2002) (natural gas contracts are "forward contracts"); In re Borden Chem. & Plastics Operating Ltd. P'ship, 336 B.R. 214 (Bankr. D. Del. 2006) (same); In re Mirant Corp., 310 B.R. 548 (Bankr. N.D. Tex. 2004) (same).

(b) "Forward contract" is now defined in the Code as:

> "(A) a contract (other than a commodity contract, as defined in section 761) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of this title, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not

limited to, a repurchase or reverse repurchase transaction (whether or not such repurchase or reverse repurchase transaction is a 'repurchase agreement', as defined in this section), consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any other similar agreement;

(B) any combination of agreements or transactions referred to in subparagraphs (A) and (C);

(C) any option to enter into an agreement or transaction referred to in subparagraph (A) or (B);

(D) a master agreement that provides for an agreement or transaction referred to in subparagraph (A), (B), or (C), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a forward contract under this paragraph, except that such master agreement shall be considered to be a forward contract under this paragraph only with respect to each agreement or transaction under such master agreement that is referred to in subparagraph (A), (B), or (C); or

(E) any security agreement or arrangement, or other credit enhancement related to any agreement or transaction referred to in subparagraph (A), (B), (C), or (D), including any guarantee or reimbursement obligation by or to a forward contract merchant or financial participant in connection with any agreement or transaction referred to in any such subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562.

(i) In examining whether an agreement was a "commodity forward agreement" (which, following the 2005 Act, is included in the definition of "swap agreement", discussed below), the Fourth Circuit looked to the Code's definition of "forward contract" and set forth four nonexclusive elements that the statutory text of that definition required: (A) the subject of the agreement must be a commodity; (B) the delivery must be more than two days after the date of the contract; (C) the price, quantity and time terms must be fixed at the time of contracting; and (D) there must be some "relationship" between the agreement and the financial markets. In re National Gas Distributors, LLC, 556 F.3d 247, 255 (4th Cir. 2009); see also Hutson v. M.J. Soffe LLC (In re National Gas Distributors), 412 B.R. 758 (Bankr. E.D.N.C. 2009) (contract in question failed the fixed quantity requirement because it was a requirements supply contract); Hutson v. United States of America, Dept. of the Army, 415 B.R. 209 (Bankr.

E.D.N.C. 2009) (holding that forward contracts in question qualified because they had fixed price and quantity terms, but that spot contracts did not qualify). Subsequent courts have applied the National Gas elements to the determination of whether a contract is a "forward contract" within the meaning of the Code. See, e.g., Conti v. Perdue Bioenergy, LLC (In re Clean Burn Fuels, LLC), 540 B.R. 195, 205 (Bankr. M.D.N.C. 2015) (applying the National Gas standard to the definition of "forward contract" and finding corn supply contracts, except those with maturities of 2 days or fewer, to be "forward contracts"); Clear Peak Energy, Inc. v. So. Cal. Edison Co. (In re Clear Peak Energy, Inc.), 488 B.R. 647 (Bankr. D. Ariz. 2013) (applying National Gas Distributors to hold that a contract that required the debtor to build a facility to provide solar energy and to provide such energy was a "forward contract'). But see Lightfoot v. MXEnergy Electric, Inc. (In re MBS Management Services, Inc.), 690 F.3d 352 (5th Cir. 2012) (holding that a two-year "full electric requirements" contract for the purchase of electricity at a fixed price was a forward contract; rejecting the contention that a "forward contract" required a specified quantity and a specified maturity date).

(ii) See In re Magnesium Corp. of America, 460 B.R. 360, 373 (Bankr. S.D.N.Y. 2011) (stating, without holding, that a master netting contract for natural gas was a "forward contract" and was not excluded by the "commodity contract" exception because, particularly after the 2006 revisions, the term "commodity contract" as used in the "forward contract" definition should be narrowly defined to be consistent with the definition contained in section 761(4) of the Code); see also 5 Collier on Bankruptcy ¶ 556.02 (16th ed. 2010) ("the terms 'commodity contract' and 'forward contract,' taken together, seamlessly cover the entirety of transactions in the commodity and forward contract markets, whether exchange-traded, regulated, over-the-counter or private.").

(iii) The meaning of "maturity date" in the definition of forward contract has been debated. Some courts interpret "maturity date" to mean the date on which performance *may* commence. See In re National Gas Distributors, LLC, 556 F.3d 247 (4th Cir. 2009) (interpreting the "maturity date" element of a "forward contract" to require delivery of the commodity at least two days after the date on which the price is fixed); In re Magnesium Corp. of America, 460 B.R. 360, 373–74 (Bankr. S.D.N.Y. 2011) (citing Mirant, agreeing that "maturity date" means the "due date for commencement of performance"); In re Mirant Corp., 310 B.R. 548, 565 n.26 (Bankr. N.D. Tex. 2004) (concluding that "maturity date" means the date for "commencement of performance"). However, other courts have held that the "maturity date" is the date on which the buyer's obligation to pay is realized and the performance is completed. See In re Eastern

Livestock Co., 2012 Bankr. LEXIS 1469 (Bankr. S.D. Ind., Apr. 5, 2012) (holding that "maturity date" means the date on which delivery has occurred and payment to 'settle' is due); In re Cascade Grain Products, LLC, 465 B.R. 570 (Bankr. D. Or., Oct. 28, 2011) (interpreting "maturity date" in the definition of forward contract to mean the date on which ownership and risk of loss passes to the buyer); In re Renew Energy LLC, 463 B.R. 475, 480–81 (Bankr. W.D. Wis. Aug. 24, 2011) (defining "maturity date" as the "date on which delivery has occurred and payment to 'settle' is due"). More recently, the court in In re Clean Burn Fuels, LLC stated that regardless of whether "the maturity date is determined on a case-by-case basis to be the date of delivery . . . or the date on which payment is required, . . . the focus should be on when the benefit or detriments of the contract are realized." 540 B.R. 195, 205 (Bankr. M.D.N.C. 2015). See also In re Laurel Valley Oil Co., 2013 WL 832407 (Bankr. S.D. Ohio Mar. 5, 2013) (interpreting "maturity date" to be "the date on which the benefit and detriment of the contract will be realized by the parties based upon the market price at the time of delivery").

3. Commodity Contracts.

(a) Prior to the 2005 Act, "commodity contract" was defined in the Code as:

> "(A) with respect to a futures commission merchant, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade;
>
> (B) with respect to a foreign futures commission merchant, foreign future;
>
> (C) with respect to a leverage transaction merchant, leverage transaction;
>
> (D) with respect to a clearing organization, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization, or commodity option traded on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization; or
>
> (E) with respect to a commodity options dealer, commodity option."

(b) "Commodity contract" is now defined in the Code (taking into account amendments made by Dodd-Frank) as:

"(A) with respect to a futures commission merchant, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade;

(B) with respect to a foreign futures commission merchant, foreign future;

(C) with respect to a leverage transaction merchant, leverage transaction;

(D) with respect to a clearing organization, contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization, or commodity option traded on, or subject to the rules of, a contract market or board of trade that is cleared by such clearing organization;

(E) with respect to a commodity options dealer, commodity options;

(F) … (i) any other contract, option, agreement, or transaction that is similar to a contract, option, agreement, or transaction referred to in this paragraph; and

> (ii) with respect to a futures commission merchant or a clearing organization, any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization;

(G) any combination of the agreements or transactions referred to in this paragraph;

(H) any option to enter into an agreement or transaction referred to in this paragraph;

(I) a master agreement that provides for an agreement or transaction referred to in subparagraph (A), (B), (C), (D), (E), (F), (G), or (H), together with all supplements to such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a commodity contract under this paragraph, except that the master agreement shall be considered to be a commodity contract under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in subparagraph (A), (B), (C), (D), (E), (F), (G), or (H); or

> (J) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this paragraph, including any guarantee or reimbursement obligation by or to a commodity broker or financial participant in connection with any agreement or transaction referred to in this paragraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562."

(i) The addition of "any other contract, option, agreement, or transaction, in each case, that is cleared by a clearing organization" was intended to capture swaps that are required to be cleared under Title VII of Dodd-Frank. See, e.g., Moore Capital Mgmt. v. Giddens, 533 B.R. 362, 374 (S.D.N.Y. 2015) ("[I]n 2010 the Dodd–Frank Act amended the definition of commodity contract to include 'any other contract, option, agreement or transaction, in each case, that is cleared by a clearing organization.' Among other things, this subsection brought cleared swap transactions into the definition of 'commodity contract.'").

(ii) The CFTC has argued that the definition of "commodity contract" includes "only those instruments for which segregation of customer property is mandatory under the [CEA] and CFTC Regulations." See Amicus Curiae Brief of the [CFTC] in Support of the Trustee at 7, Moore Capital Mgmt. v. Giddens, 533 B.R. 362 (S.D.N.Y. 2015); see also Intervenor the [CFTC] Brief on Appeal in Support of Affirmance at 11, Secure Leverage Grp., Inc. v. Bodenstein, 558 B.R. 226 (N.D. Ill. 2016). Courts have agreed with the CFTC's position. See, e.g., Moore Capital Mgmt. v. Giddens, 533 B.R. 362, 374 (S.D.N.Y 2015) (holding that "the salient feature of the types of transactions that are defined as 'commodity contracts' in subparagraph 4 [of Section 761 of the Code]—futures, foreign futures, leverage transactions, and commodity options—is that they are exchange traded or cleared and thus subject to CFTC regulation, including the mandatory segregation of customer property"); Secure Leverage Grp., Inc. v. Bodenstein, 558 B.R. 226, 241 (N.D. Ill. 2016) (holding that retail foreign exchange contracts and over-the-counter spot metal contracts between an FCM and its customers were not "commodity contracts" within the meaning of Section 761(4) of the Code because, *inter alia*, such contracts "were not required to be held in segregated accounts").

4. Repurchase Agreements.

(a) Prior to the 2005 Act, "repurchase agreement" (which definition also applied to a reverse repurchase agreement) was defined in the Code as:

> "an agreement, including related terms, which provides for the transfer of certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States against the transfer of funds by

the transferee of such certificates of deposit, eligible bankers' acceptances, or securities with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptances, or securities as described above, at a date certain not later than one year after such transfers or on demand, against the transfer of funds."

(b) The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement) is now defined in the Code as:

"(A) . . . (i) an agreement, including related terms, which provides for the transfer of one or more certificates of deposit, mortgage related securities (as defined in section 3 of the Securities Exchange Act of 1934), mortgage loans, interests in mortgage related securities or mortgage loans, eligible bankers' acceptances, qualified foreign government securities (defined as a security that is a direct obligation of, or that is fully guaranteed by, the central government of a member of the Organization for Economic Cooperation and Development), or securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, securities, mortgage loans, or interests, with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptance, securities, mortgage loans, or interests of the kind described in this clause, at a date certain not later than 1 year after such transfer or on demand, against the transfer of funds;

(ii) any combination of agreements or transactions referred to in clauses (i) and (iii);

(iii) an option to enter into an agreement or transaction referred to in clause (i) or (ii);

(iv) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii) or (iii), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a repurchase agreement under this paragraph, except that such master agreement shall be considered to be a repurchase agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii) or (iii); or

(v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv), including any guarantee or reimbursement obligation by or to a repo participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title; and

(B) does not include a repurchase obligation under a participation in a commercial mortgage loan."

A participation in a commercial mortgage loan is not itself a repurchase agreement, but repurchase agreements involving transfers of such participations are intended to be protected. See H.R. Rep. No. 109-31, pt. 1, at 128 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 190.

(i) In Calyon v. American Home Mortg. Corp., 379 B.R. 503, motion to amend denied, 383 B.R. 585 (Bankr. D. Del. 2008), the court held that repurchase agreements on whole mortgage loans were "securities contracts" and "repurchase agreements," but that termination of related servicing rights was not safe-harbored. In In re American Home Mortg. Holdings, Inc., 388 B.R. 69 (Bankr. D. Del. 2008), the court similarly ruled that repurchase agreements on notes secured by whole mortgage loans were both "securities contracts" and "repurchase agreements" because the notes were "interests in mortgage loans" and that liquidation of the notes did not have to comply with UCC Article 9 standards regarding sales of collateral. For more information, please see our alert memorandum available at https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/bankruptcy-court-rules-on-applicability-of-safe-harbors-and-ucc-article-9-to-repurchase-agreements.pdf.

5. Swap Agreements.

(a) Prior to the 2005 Act and the 2006 Act, "swap agreement" was defined in the Code as:

"(A) an agreement (including terms and conditions incorporated by reference therein) which is a rate swap agreement, basis swap, forward rate agreement, commodity swap, interest rate option, forward foreign exchange agreement, spot foreign exchange agreement, rate cap agreement, rate floor agreement, rate collar agreement, currency swap agreement, cross-currency rate swap agreement, currency option, any other similar agreement (including any option to enter into any of the foregoing); (B) any

> combination of the foregoing; or (C) a master agreement for any of the foregoing together with all supplements."

(i) A bankruptcy court held that "Forward Freight Agreements" between two end-users and providing for a cash settlement between a contract rate and the average rate of the Baltic Freight Index were "swap agreements," notwithstanding the bankrupt's contention that a financial intermediary needed to be involved for the agreements to be "swap agreements." <u>In re Interbulk, Ltd. v. Louis Dreyfus Corp.</u>, 240 B.R. 195 (Bankr. S.D.N.Y. 1999); <u>see also</u> <u>In re Mirant</u>, 314 B.R. 347 (Bankr. N.D. Tex. 2004) ("swap agreement" referencing the pricing of newsprint).

(b) "Swap agreement" is now defined in the Code as:

> (A) . . . (i) any agreement, including the terms and conditions incorporated by reference in such agreement, which is—(I) an interest rate swap, option, future, or forward agreement, including a rate floor, rate cap, rate collar, cross-currency rate swap, and basis swap; (II) a spot, same day-tomorrow, tomorrow-next, forward, or other foreign exchange, precious metals, or other commodity agreement; (III) a currency swap, option, future, or forward agreement; (IV) an equity index or equity swap, option, future or forward agreement; (V) a debt index or debt swap, option, future, or forward agreement; (VI) a total return, credit spread or credit swap, option, future, or forward agreement; (VII) a commodity index or a commodity swap, option, future, or forward agreement; (VIII) a weather swap, option, future, or forward agreement; (IX) an emissions swap, option, future, or forward agreement; or (X) an inflation swap, option, future, or forward agreement;
>
> (ii) any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph and that—(I) is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap or other derivatives markets (including terms and conditions incorporated by reference therein); and (II) is a forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debts securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices or measures of economic or financial risk or value;

(iii) any combination of agreements or transactions referred to in this subparagraph;

(iv) any option to enter into an agreement or transaction referred to in this subparagraph;

(v) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), or (iv), together with all supplements to any such master agreement, and without regard to whether the master agreement contains an agreement or transaction that is not a swap agreement under this paragraph, except that the master agreement shall be considered to be a swap agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), (iii), or (iv); or

(vi) any security agreement or arrangement or other credit enhancement related to any agreements or transactions referred to in clause (i) through (v), including any guarantee or reimbursement obligation by or to a swap participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562."

(i) The Fourth Circuit held that the Section 101(53B)(A)(i)(VII) definition of "commodity forward agreement," now a subset of "swap agreement," should be interpreted in accordance with the Code's definition of "forward contract", which, it said, has four nonexclusive requirements: (A) the subject of the agreement must be a commodity; (B) the delivery must be more than two days after the date of the contract; (C) the price, quantity and time terms must be fixed at the time of contracting; and (D) there must be some "relationship" between the agreement and the financial markets. In re National Gas Distributors, LLC, 556 F.3d 247, 255 (4th Cir. 2009); see also Hutson v. M.J. Soffe LLC (In re National Gas Distributors), 412 B.R. 758 (Bankr. E.D.N.C. 2009) (contract in question failed the fixed quantity requirement because it was a requirements supply contract); Hutson v. United States of America, Dept. of the Army, 415 B.R. 209 (Bankr. E.D.N.C. 2009) (holding that forward contracts in question qualified because they had fixed price and quantity terms, but that spot contracts did not qualify). See also In re Eastern Livestock Co., 2012 Bankr. LEXIS 1469 (Bankr. S.D. Ind., Apr. 5, 2012) (indicating that a contract must have some relationship between it and the financial markets to be considered a "swap agreement"); McKittrick v. Nat'l Fuel Marketing, 2011 Bankr. LEXIS 1921, *4 (Bankr. D. Or. May 25, 2011) (emphasizing the statute's concern with "market-based definitions," the court refused to define a "swing-load arrangement" as a "swap agreement" because there was not sufficient evidence that the industry would define the transaction as such).

6. Master Netting Agreements.

   (a) The 2005 Act added "master netting agreements" to the Protected Contracts. "Master netting agreement" is defined in the Code as:

> "(A) . . . an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or close out, under or in connection with one or more contracts that are described in any one or more of paragraphs (1) through (5) of section 561(a) [securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements], or any security agreement or arrangement or other credit enhancement related to one or more of the foregoing, including any guarantee or reimbursement obligation related to 1 or more of the foregoing; and
>
> (B) if the agreement contains provisions relating to agreements or transactions that are not contracts described in paragraphs (1) through (5) of section 561(a), shall be deemed to be a master netting agreement only with respect to those agreements or transactions that are described in any one or more of paragraphs (1) through (5) of section 561(a)."

B. Counterparties Protected.

1. Generally.

   (a) In general, to have the full range of Code protections

      (i) with respect to "securities contracts" with the debtor, the <u>counterparty</u> must be a "stockbroker," "financial institution," "financial participant" or "securities clearing agency";

      (ii) with respect to "forward contracts" with the debtor, the <u>counterparty</u> must be a "financial participant" or "forward contract merchant";

      (iii) with respect to "commodity contracts" with the debtor, the <u>counterparty</u> must be a "commodity broker" or "financial participant";

      (iv) with respect to "repurchase agreements" with the debtor, the <u>counterparty</u> must be a "repo participant" or "financial participant";

(v) with respect to "swap agreements" with the debtor, the counterparty must be a "swap participant" or "financial participant"; and

(vi) with respect to "master netting agreements" with the debtor, the counterparty must be a "master netting agreement participant."

The failure to so qualify, however, may not impair certain anti-avoidance protections if the debtor is a "forward contract merchant," "commodity broker," "stockbroker," "financial institution," "securities clearing agency," "repo participant," "swap participant" or "financial participant."

2. Forward Contract Merchant.

(a) Prior to the 2005 Act, "forward contract merchant" was defined as a "person" (which term excludes "governmental units") "whose business consists in whole or in part of entering into forward contracts as or with merchants in a commodity . . . or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade."

(i) The court in In re Mirant Corp., 310 B.R. 548 (Bankr. N.D. Tex. 2004) held that for a counterparty to be a "forward contract merchant" it must have entered into forward contracts "as a participant seeking profit in the forward contract trade." See also In re Aurora Natural Gas, 316 B.R. 481 (Bankr. N.D. Tex. 2004) (same). But see In re Borden Chems., 336 B.R. 214 (Bankr. D. Del. 2006) (applying a seemingly less stringent standard by inferring forward contract merchant status based on the party's use of forward contracts to buy and sell the commodity).

(ii) The court in In re Mirant Corp., 303 B.R. 319 (Bankr. N.D. Tex. 2003) held that Bonneville Power Administration was a "governmental unit" and therefore not a "forward contract merchant."

(b) "Forward contract merchant" is now defined as a "federal reserve bank, or an entity [which includes governmental units] the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity (as defined in Section 761) or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade."

(i) Courts continue to cite Mirant – decided prior to the 2005 amendments – in analyzing whether a party is a "forward contract merchant." See In re Eastern Livestock Co., 2012 Bankr. LEXIS 1469, at *17–20 (Bankr. S.D. Ind. Apr. 5, 2012) (applying the Mirant standard to determine whether a creditor was a "forward contract merchant"); In re Magnesium Corp. of America, 460 B.R. 360, 375–78 (Bankr. S.D.N.Y. 2011) (same); In re Clean Burn Fuels, LLC, 540 B.R.at 209 (Bankr. M.D.N.C 2015) (same).

But see In re Laurel Valley Oil Co., 2013 WL 832407 (Bankr. N.D. Ohio Mar. 5, 2013) (citing Borden Chems. for the proposition that there is a split of authority regarding the definition of "forward contract merchant").

3. Commodity Broker.

(a) "Commodity broker" is defined in the Code as a "futures commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, or commodity options dealer, as defined in Section 761 of this title, with respect to which there is a customer, as defined in Section 761 of this title."

(i) At least one court has held that, in order for the commodity broker to take advantage of certain safe harbors, the bankrupt itself must be a "customer" of the "commodity broker" in respect of the transaction at issue. See Harpley v. A.G. Edwards & Sons, Inc. (In re Paramount Citrus, Inc.), 268 B.R. 620 (M.D. Fl. 2001)

4. Stockbroker.

(a) "Stockbroker" is defined as a "person" (which term excludes "governmental units") that has a "customer" (as defined in Section 741 of the Code) and that is engaged in the business of effecting transactions in securities for the account of others or with members of the general public, from or for such person's own account.

(i) A dealer that engaged primarily in purchases of GNMA securities with financial institutions but which had no "customer" was held not to be a "stockbroker" in In re SSIW Corp., 7 B.R. 735 (Bankr. S.D.N.Y. 1980).

(b) An entity qualifies as a stockbroker when it receives or holds securities for its customers in the ordinary course of the debtor's business. At least one court has held that a registered stockbroker operating a Ponzi scheme may nonetheless be considered a "stockbroker" for safe-harbor purposes under Section 546(e) by virtue of its legitimate trading conducted by its market making and proprietary trading divisions. SIPC v. Bernard L. Madoff Inv. Sec. LLC, 476 B.R. 715 (S.D.N.Y. 2012) (finding Madoff Securities qualified as a "stockbroker" despite its conducting a Ponzi scheme because parts of the business engaged in "legitimate trading"); Picard v. Katz, 466 B.R. 208, 211 (S.D.N.Y. 2012) (concluding Madoff Securities was a "stockbroker" because it "was a registered stockbrokerage firm"). But see In re Slatkin, 525 F.3d 805 (9th Cir. 2008) (finding that the debtor in a Ponzi scheme did not qualify as a stockbroker eligible for safe-harbor protection, noting that he was not a licensed stockbroker and did not hold himself out as having the ability to make securities trades); Wider v. Wootton, 907 F.2d 570 (5th Cir. 1990); In re Bernard L. Madoff Inv.

Sec. LLC, 440 B.R. 243 (Bankr. S.D.N.Y. 2010) (stating in dicta that the proposition that Ponzi scheme operator was a stockbroker was "dubious").

(c) Some courts have held that, in order for the stockbroker to take advantage of the safe harbors, the bankrupt itself must be a "customer" of the "stockbroker". See, e.g., In re Residential Res., 98 B.R. 2 (Bankr. D. Ariz. 1989). But see, e.g., In re Stewart Fin. Co., 367 B.R. 909 (Bankr. M.D. Ga. 2007) (holding that the debtor need not be a customer of the stockbroker in respect of the transactions at issue); In re Baker & Getty Fin. Servs., Inc., 106 F.3d 1255, 1262 (6th Cir. 1997) (holding in a different context that the determination of whether an entity is a stockbroker is not conducted "on a customer-by-customer basis").

5. Financial Institution.

(a) Prior to the 2005 Act and 2006 Act, "financial institution" was defined as a "Federal Reserve bank or an entity (domestic or foreign) that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, or receiver or conservator for such entity". In addition, a "financial institution" was defined to include a customer of such a "financial institution" where the institution acts as agent or custodian for the customer in connection with a securities contract, as well as, in connection with securities contracts, investment companies registered under the Investment Company Act of 1940, as well as certain multilateral clearing organizations.

(i) Certain state-chartered non-FDIC banking-type institutions may not be "financial institutions" under the Code. See, e.g., In re Republic Trust & Sav. Co., 59 B.R. 606 (Bankr. N.D. Okla. 1986).

(b) "Financial institution" is now defined as "a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, or conservator or entity is acting as agent or custodian for a customer (whether or not a 'customer', as defined in section 741) in connection with a securities contract (as defined in section 741) such customer." In addition a "financial institution" is defined to include "in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940."

(i) Courts have disagreed as to whether the definition of financial institution is satisfied when a leveraged buyout payment is made by wire transfer. Compare, e.g., QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.), 571 F.3d 545 (6th Cir. 2009); Loranger Mfg. Corp. v. PNC Bank, N.A. (In re Loranger Mfg. Corp.), 324 B.R. 575 (Bankr. W.D. Pa. 2005); and Lowenschuss v. Resorts International (In re Resorts International, Inc.), 181 F.3d 505, 515 (3rd Cir 1999) with, e.g., FTI Consulting, Inc. v. Merit

Mgmt. Grp., 830 F.3d 690 (7th Cir. 2016), cert. granted, No. 16-784 (May 1, 2017); Munford v. Valuation Research Crop. (In re Munford), 98 F.3d 604 (11th Cir. 1996) (holding that the safe harbors are inapplicable where the bank "was nothing more than an intermediary or conduit").

6. Repo Participant.

   (a) Prior to the 2005 Act, "repo participant" was defined as any "entity" (which term includes "governmental units") that has an outstanding repurchase agreement with the debtor on any day during the period beginning 90 days before the date of the filing of the petition.

      (i) If a transfer to a repo counterparty made prior to the 90 day pre-filing period is subject to avoidance, either as an "insider" preference or as a fraudulent transfer, the counterparty might not be protected under Section 546(f) of the Code. It might, however, have been protected under Section 546(e) of the Code if either the counterparty or the debtor is a "stockbroker," "financial institution," or "securities clearing agency." See In re Hamilton Taft & Co., 114 F.3d 991 (9th Cir. 1997) (finding that a stockbroker could rely on Section 546(e) and did not have to meet the 90-day requirement of Section 546(f) as the more specific statutory provision for repurchase agreements).

      (ii) Although it did not consider whether the counterparty was a "repo participant" under the Code, one bankruptcy court found a participant in repurchase agreements with a debtor broker-dealer to be a "customer" within the meaning of Section 741(2) of the Code, thus entitling the counterparty to priority status under Section 752. Relying on Cohen v. Army Moral Support Fund (In re Bevill, Bresler & Shulman Asset Mgmt. Corp.), 67 B.R. 557 (D.N.J. 1986) (in which the court found a counterparty in a repurchase agreement transaction to be a "customer" under SIPA), the court found the parties had contemplated a relationship in which they would trade in securities as broker-dealer and customer and the debtor had acted in a fiduciary capacity. Elkins v. Davidson (In re Swink & Co., Inc.), 142 B.R. 874 (Bankr. E.D. Ark. 1992).

      (iii) Under the revised Code, the term "repo participant" is defined as an "entity" (which term includes "governmental units") that, at any time before the filing of the petition, has an outstanding repurchase agreement with the debtor.

7. Swap Participant.

   (a) "Swap participant" is defined in the Code as an "entity" (which term includes "governmental units") that at any time before the filing of the petition has an outstanding swap agreement with the debtor.

(i) One court has held that a pre-petition assignee of a receivable arising from a terminated swap is not a “swap participant”. A62 Equities LLC v. Chohan (In re Chohan), 532 B.R. 130 (C.D. Cal. 2015).

8. Master Netting Agreement Participant.

(a) “Master netting agreement participant” is defined in the Code as an “entity” (which term includes “governmental units”) that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor.

9. Financial Participant.

(a) “Financial participant” is defined in the Code as

> “(A) an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $1,000,000,000 in notional or actual principal amount outstanding (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of the filing of the petition, or has gross mark-to-market positions of not less than $100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor or any other entity (other than an affiliate) at such time or on any day during the 15-month period preceding the date of the filing of the petition; or
>
> (B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991).”

C. Liquidation and Termination Protections.

1. Securities Contracts.

(a) Under Section 555 of the Code, the “contractual right” of a stockbroker, financial institution, financial participant or securities clearing agency to cause the “liquidation,” “termination” or “acceleration” of a securities contract because of the bankruptcy or financial condition of the debtor is not to be stayed, avoided or otherwise limited by operation of any provision of the Code or by the order of a court in any proceeding under the Code, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of SIPA or any statute administered by the SEC.

(i) "Contractual right" is defined in Section 555 (as amended by the 2005 Act) to include a "right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act), or in a resolution of the governing board thereof, and a right, whether or not in writing, arising under common law, under law merchant, or by reason of normal business practice."

(ii) Courts have held that the contractual rights protected under Section 555 (and its analogues for other types of Protected Contracts) include only those based on the bankruptcy or financial condition of the debtor. In re Amcor Funding, 117 B.R. 549 (D. Ariz. 1990); In re Enron Corp., 306 B.R. 465 (Bankr. S.D.N.Y. 2004) (same for swap agreement under Section 560); In re La. Pellets, Inc., 2016 WL 4011318 (Bankr. W.D. La. July 22, 2016) (same for Section 556).

(iii) At least one court has also held that a party to a Protected Contract must "act promptly", lest it waive its right to exercise its termination rights under the safe harbors. Transcript of Record at 111–12, In re Lehman Bros. Holdings, Inc., No. 08-13555 (Bankr. S.D.N.Y. Sept. 15, 2009) (noting that counterparty's "conduct of riding the market for the period of one year, while taking no action whatsoever, [was] simply unacceptable and contrary to the spirit of these provisions of the Bankruptcy Code"). But see In re Mirant Corp., 314 B.R. 347 (Bankr. N.D. Tex. 2004) (under circumstances of case, swap termination seven weeks post-petition still protected by Sections 362(b)(17) and 560).

2. Commodity and Forward Contracts.

(a) Under Section 556 of the Code, the "contractual right" of a commodity broker, financial participant or forward contract merchant to cause the "liquidation," "termination," or "acceleration" of a commodity contract or forward contract because of the bankruptcy or financial condition of the debtor is not to be stayed, avoided or otherwise limited by operation of any provision of the Code or by the order of a court in any proceeding under the Code.

(i) The pre-2005 Code legislative history to Section 556 indicates that the right to "liquidate" a commodity contract is only the right to close out an open position, but does not constitute the right to transfer collateral with respect thereto. Given the expansion of the definition of "commodity contract" to include related security agreements, this legislative history would seem to now be inapplicable. Furthermore, as described below, Sections 362(b)(6) and 561 in any event protect certain rights regarding the liquidation of collateral securing forward and commodity contracts.

(ii) "Contractual right" is defined in Section 556 (as amended by the 2005 Act) to include "a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant or by reason of normal business practice."

(iii) A bankruptcy court held that the Section 556 safe harbor applies only to those contractual rights and obligations triggered by the bankruptcy or financial condition of the debtor and not related rights. Specifically, Section 556 did not affect the Code's treatment of a contractual obligation of the party in default (i.e., the debtor) to object to the non-defaulting party's calculation of a settlement amount within a specified period of time as post-petition obligation subject to preservation. Calpine Energy Services, L.P., v. Reliant Energy Electric Solutions, L.L.C. (In re Calpine Corporation), 2009 WL 1578282 (Bankr. S.D.N.Y. May 7, 2009). But see Mich. State Hous. Dvlpmt. Auth. v. Lehman Bros. Deriv. Prods. Inc., 502 B.R. 383 (Bankr. S.D.N.Y. 2013) (holding that the analogous provision of the Code applicable to swap agreements protects not only the right to terminate the swap agreement but also the agreed method of liquidating such swap agreement and calculating damages).

(iv) See In re R.M. Cordova Int'l, Inc., 77 B.R. 441 (Bankr. D.N.J. 1987) (termination of contracts for purchase of coconut oil protected by Code Section 556).

(v) A court has interpreted Section 556 to require that an otherwise safe harbored contract must include a condition permitting termination without court approval under Section 365(e)(1) in order to invoke safe harbor termination protections. See, e.g., In re Clearwater Natural Resources LP, 2009 WL 2208463 (Bankr. E.D. Ky. July 23, 2009) (precluding termination of an executory forward contract for the delivery of coal). That court did not discuss the definition of "contractual right" in Section 556, which includes rights "arising under common law, under law merchant or by reason of normal business practice."

3. Repurchase Agreements.

   (a) Under Section 559 of the Code, the "contractual right" of a repo participant or financial participant to cause the "liquidation," "termination" or "acceleration" of a repurchase agreement because of the bankruptcy or financial condition of the debtor is not to be stayed, avoided or otherwise limited by operation of any provision of the Code or by the order of a court in any proceeding under the Code, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of SIPA or any statute administered by the SEC.

      (i) "Contractual right" is defined in Section 559 (as amended by the 2005 Act) to include "a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act), or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant or by reason of normal business practice."

      (ii) Section 559 provides that, if a repo participant or financial participant liquidates one or more repurchase agreements with a debtor and under the terms of such agreement has agreed to deliver assets subject to the repurchase agreements to the debtor, any excess of the market prices received on liquidation of such assets (or if not disposed of, the value of such assets at the liquidation of the repurchase agreement) over the aggregate repurchase prices and any expenses in connection with the liquidation thereof shall be deemed property of the estate, subject to the available rights of setoff. There is no analogous provision under Section 555 for repurchase transactions that qualify as securities contracts. See Sher v. JP Morgan Chase Funding Inc., 2014 WL 6390312 (Bankr. D. Md. Nov. 14, 2014) (requiring valuation of securities retained by non-defaulting party notwithstanding the debtor's consent to valuation in a separate agreement and noting that Section 559 does "not provide for any consensual opt out by the contracting parties").

4. Swap Agreements.

   (a) Under Section 560 of the Code, the "contractual right" of a swap participant or financial participant to "cause the liquidation, termination, or acceleration of one or more swap agreements" because of the bankruptcy or financial condition of the debtor, or to "offset or net out" any "termination values or payment amounts" arising under or in connection with "the termination, liquidation, or acceleration of one or more swap agreements" shall not be stayed, avoided, or otherwise limited by operation of any provision of the Code or by order of a court or administrative agency in any proceeding under the Code.

(i) Unlike the forward, commodity and securities contract and repurchase agreement provisions (but as under Section 561—which applies to forward, commodity and securities contracts and repurchase agreements), the swap agreement provisions of the Code address offset rights not only in Section 362 (in the context of exceptions from the automatic stay) but also in this termination provision.

(ii) "Contractual right" is defined in Section 560 (as amended by the 2005 Act) to include "a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act), or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant, or by reason of normal business practice."

(iii) The Ninth Circuit held in a pre-2005 case that a claim for damages upon termination of an interest rate swap agreement was not a disallowable claim for unmatured interest. Thrifty Oil Co. v. Bank of America Nat. Trust and Sav. Ass'n., 322 F.3d 1039 (9th Cir. 2003).

(iv) The Bankruptcy Court for the Southern District of New York held that a clause that allows a counterparty to suspend payments pursuant to an interest rate swap if the other party files for bankruptcy (such as Section 2(a)(iii) of the ISDA) is unenforceable. Transcript of Sept. 15, 2009 Hearing, at 99-113, In re Lehman Bros. Holdings, Inc., No. 08-01420, 2009 WL 3613072 (Bankr. S.D.N.Y. 2009) (granting Debtors' motion to compel performance of an interest rate swap agreement by Metavante Corp.); accord In re Lehman Bros. Holdings, No. 08-13555 (JMP), 2009 WL 3613072, (Bankr S.D.N.Y. Oct. 28, 2009) (discussing bench ruling). The same court held that, since the counterparty waited for a year before terminating its swap, its termination right was not protected by Section 560. But see In re Mirant Corp., 314 B.R. 347 (Bankr. N.D. Tex. 2004) (under circumstances of case, swap termination seven weeks post-petition still protected by Sections 362(b)(17) and 560).

(v) A bankruptcy court held that the anti-"cherry picking" rationale of Section 560 demands that setoff be applied to damages calculations when a debtor rejects a swap agreement. See In re Enron Corp., 349 B.R. 96, 106 (Bankr. S.D.N.Y. 2006).

(vi) One bankruptcy court has held that calculating amounts owing under a terminated swap agreement according to the method selected by the parties was an "integrated aspect of what it means to cause the liquidation of a swap agreement and necessarily . . . protected [from the Code's ipso facto provisions] by the language of Section 560". Mich. State Hous. Dvlpmt. Auth. v. Lehman Bros. Deriv. Prods. Inc., 502 B.R. 383 (Bankr. S.D.N.Y. 2013). A number of cases before the bankruptcy court for the Southern District of New York have addressed whether the same protection extends to clauses dictating priority of claims by swap counterparties, such as purported "flip clauses". Compare Lehman Bros. Special Financing Inc. v. Ballyrock ABS CDO 2007-1 Ltd. (In re Lehman Bros. Holdings Inc.), 452 B.R. 31 (Bankr. S.D.N.Y. 2011) (holding that the protection does not extend to such clauses) and Lehman Bros. Special Financing Inc. v. BNY Corp. Trustee Servs. Ltd., 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (same) with Lehman Bros. Special Financing, Inc. v. Bank of Am. Nat'l Ass'n, 553 B.R. 476 (Bankr. S.D.N.Y. 2016) (holding that similar priority provisions were protected as part of the liquidation of a swap and that Ballyrock and BNY were distinguishable because, in those cases, respectively, liquidation, termination or acceleration were not implicated and the relevant provision was not part of the swap agreement at issue).

5. Setoff and Netting.

(a) Under Section 561(a) of the Code, any "contractual right" to cause, due to the bankruptcy or financial condition of the debtor, the "termination, liquidation, or acceleration of or to offset or net termination values, payment amounts or other transfer obligations" arising under or in connection with one or more securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements or master netting agreements is not to be stayed, avoided, or otherwise limited by operation of any provision of the Code or by the order of a court in any proceeding under the Code. But, pursuant to Section 561(b), a party may exercise such contractual right to terminate, liquidate or accelerate only to the extent that such party could exercise such a right under Sections 555, 556, 559 or 560 for each individual contract covered by the relevant master netting agreement. Note, however, that Section 561(b) does not limit a party's contractual right to offset or net termination values, payment amounts or other transfer obligations arising under or in connection with terminated securities contracts, commodity contracts, forward contracts, repurchase agreements or swap agreements.

(i) Like the swap agreement provisions, the master netting agreement provisions of the Code address offset rights both in Section 362 (in the context of exceptions from the automatic stay) and in this termination provision.

(ii) "Contractual right" in Section 561 is defined to include "a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof, and a right, whether or not evidenced in writing, arising under common law, under law merchant, or by reason of normal business practice."

(iii) If the debtor is a commodity broker subject to subchapter IV of chapter 7:

(A) Then, under Section 561(b)(2)(A), a party may not net or offset an obligation to such debtor arising under or in connection with a commodity contract traded on or subject to the rules of a contract market designated under, or a derivatives transaction execution facility registered under, the CEA against any claim arising under or in connection with any instrument, contract or agreement listed in Section 561(a), except to the extent that the party has positive net equity in the commodity accounts at the debtor, as calculated under subchapter IV of chapter 7; and

(B) Under Section 561(b)(2)(B), another commodity broker may not net or offset an obligation to the debtor arising under or in connection with a commodity contract entered into or held on behalf of a customer of the debtor and traded on or subject to the rules of a contract market designated under, or a derivatives transaction execution facility registered under, the CEA against any claim arising under or in connection with other instruments, contracts or agreements listed in Section 561(a).

(C) But, pursuant to Section 561(b)(3),Sections 561(b)(2)(A) and (B) shall not prohibit the offset of claims and obligations that arise under (i) a cross-margining agreement or similar arrangement that has been approved by the CFTC or submitted to the CFTC under section 5c(c), paragraph (1) or (2), of the CEA and has not been abrogated or rendered ineffective by the CFTC, or (ii) any other netting agreement between a clearing organization, as defined in Section 761 of the Code, and another entity that has been approved by the CFTC.

(iv) Pursuant to Section 561(d), any provisions of the Code relating to securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements, or master netting agreements shall apply in a case under Chapter 15, so as to provide the same degree of enforcement and protection against avoidance as these provisions apply in proceedings under Chapter 7 or 11.

D. Setoff and Collateral Liquidation Protections.

1. Sections 362(b)(6), 362(b)(7), 362(b)(17) and 362(b)(27) of the Code except from the Code's automatic stay and the stay arising from the filing of an application for a protective decree under SIPA certain actions in connection with Protected Contracts.

   (a) Section 362(o) provides that the exercise of rights excepted from the stay under Sections 362(b)(6), 362(b)(7), 362(b)(17) or 362(b)(27) may not be stayed by any order of a court or administrative agency in any proceeding under the Code. Therefore, there are express exceptions from the ability of a Bankruptcy Court, under Section 105(a) of the Code, to issue any order that is "necessary or appropriate to carry out" the provisions of the Code, consistent with the liquidation and termination protections under Sections 555 through 560. Under the old Code, see In re Lenny Steven Smith, No. LA 84 10591 CA (C.D. Cal. May 21, 1984) (granting ex parte temporary restraining order against enforcement of margin loans by creditors; case settled prior to decision on the merits); In re Criimi Mae, 1998 Bankr. LEXIS 1624 (Bankr. D. Md. 1998) (citing telephonic hearing of debtor's request for temporary restraining order against re-registration of securities purchased under a reverse repo; court denied debtor's request upon purchaser's consent not to sell the securities without judicial authorization).

2. The 2006 Act revised Sections 362(b)(6), (7), (17) and (27) to clarify the ability of counterparties to exercise rights under security agreements and offset rights free from the automatic stay. In particular, the protected rights are the "contractual rights" of protected counterparties under "any security agreement or arrangement other credit enhancement" forming a part of or related to any commodity contract, forward contract, securities contract, repurchase agreement, swap agreement or master netting agreement or "any contractual right to offset or net out any termination value, payment amount, or other transfer obligation" arising under or in connection with such contracts or agreements.

   Before passage of the 2006 Act, Section 362(b)(6) provided an exception from the automatic stay and the stay arising from a SIPA filing for the setoff by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency of any mutual debt or claim under or in connection with commodity contracts, forward contracts or securities contracts that constitutes the setoff of a claim against the debtor for a "margin payment" or "settlement payment" arising out of commodity contracts, forward contracts or securities contracts against cash, securities or other property held by, pledged to, under the control of or due from such commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency to margin, guarantee, secure or settle commodity, forward or securities contracts.

Section 362(b)(6) now provides an exception from these stays for the exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency of any contractual right (as defined in Section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any commodity contract, forward contract or securities contract, or of any contractual right (as defined in Section 555 or 556) to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with 1 or more such contracts, including any master agreement for such contracts.

3. Before passage of the 2006 Act, Section 362(b)(7) provided an exception from the automatic stay and the stay arising from a SIPA filing for the setoff by a repo participant or financial participant of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for "any payment" due from the debtor under or in connection with a "margin payment" or "settlement payment" arising out of repurchase agreements against cash, securities or other property held by, pledged to, under the control of or due from such repo participant or financial participant to margin, guarantee, secure or settle repurchase agreements.

   Section 362(b)(7) now provides an exception from these stays for the exercise by a repo participant or financial participant of any contractual right (as defined in Section 559) under any security agreement or arrangement or other credit enhancement forming a part of or related to any repurchase agreement, or of any contractual right (as defined in Section 559) to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreements for such agreements.

   (a) Under the previous versions of Sections 362(b)(6) and (7), the definitions of "margin payment" and "settlement payment" were important in determining the scope of creditors' rights under the safe harbors of Sections 362(b)(6) and (b)(7). While these terms no longer limit the scope of a creditor's rights under Sections 362(b)(6) and (b)(7), the terms are still relevant for purposes of Section 546(e) (discussed below in Section III.E), outside the Protected Contract context.

4. Before passage of the 2006 Act, the analogous provision for swap agreements, Section 362(b)(17) and Section 362(b)(27)—which can apply to commodity, forward and securities contracts and repurchase agreements—used the phrase "any payment or other transfer of property," rather than margin or settlement payment. Section 362(b)(17) protected the setoff by a swap participant or financial participant of mutual debts and claims under or in connection with one or more swap agreements that constitutes the setoff of a claim against the debtor for "any payment or other transfer of property" due from the debtor under or in connection with any swap agreement against any payment due to the debtor from the swap participant or financial participant under or in connection with any swap agreement or against cash, securities or other property held by, pledged to, under the control of or due from such swap participant to guarantee, secure or settle any swap agreement.

   Section 362(b)(17) now protects the exercise by a swap participant or financial participant of any contractual right (as defined in Section 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any swap agreement, or of any contractual right (as defined in Section 560) to offset or net out any termination value, payment amount or other transfer obligation arising under or in connection with 1 or more such agreements, including any master agreement for such agreements.

   (a) Cf. In re Dow Corning Corporation, Case No. 95-21512 (Slip op., Bankr. E.D. Mich. March 27, 1996) (lifting the automatic stay to allow First National Bank of Chicago to set off foreign exchange payable against loan receivable).

   (b) However, in Bank of America v. Lehman Brothers Holdings Inc., 439 B.R. 811 (Bankr. S.D.N.Y. 2010), the court held that the exception under Section 362(b)(17) did not apply where collateral, pledged to mitigate overdraft risk on an unrelated account, was offset against swap exposure.

5. Before passage of the 2006 Act, the analogous provision for master netting agreements, Section 362(b)(27), protected the setoff by a master netting agreement participant of mutual debts and claims under or in connection with one or more master netting agreements or any Protected Contract subject to such agreements that constitutes the setoff of a claim against the debtor for "any payment or other transfer of property" due from the debtor under or in connection with such agreements or contracts against any payment due to the debtor from such master netting agreement participant under or in connection with such agreements or contracts or against cash, securities or other property held by, pledged to, under the control of or due from such master netting agreement participant to margin, guarantee, secure or settle such agreements or contracts, to the extent that such master netting agreement participant is eligible to exercise such offset rights under Section 362(b)(6), (7) or (17) for each individual contract covered by the master netting agreement in issue.

   Section 362(b)(27) now protects the exercise by a master netting agreement participant of any contractual right (as defined in Section 555, 556, 559, or 560) under any security agreement or arrangement or other credit enhancement forming a part of or related to any master netting agreement, or of any contractual right (as defined in Section 555, 556, 559 or 560) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with one or more such master netting agreements to the extent that such participant is eligible to exercise such rights under paragraph (6), (7) or (17) for each individual contract covered by the master netting agreement in issue.

E. Anti-Avoidance Protections.

1. Securities Contracts

(a) Before passage of the 2006 Act, Section 546(e) of the Code protected from avoidance a transfer that was a margin payment, as defined in Section 101, 741, or 761, or settlement payment, as defined in Section 101 or 741, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency, that was made before the commencement of the case, except under Section 548(a)(1)(A).

Section 546(e) now provides as follows:

> "Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title."

Thus, outside the context of Protected Contracts, determining whether a transfer is a "margin payment" or a "settlement payment" could still be relevant.

"Margin payment" is defined as any "payment or deposit of cash, a security or other property, that is commonly known to the securities trade as original margin, initial margin, maintenance margin, or variation margin, or as a mark-to-market payment, or that secures an obligation of a participant in a securities clearing agency," as a "payment or deposit of cash, a security, or other property, that is commonly known to the commodities trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, settlement payments, variation payments, daily settlement payments, and final settlement payments made as adjustments to settlement prices," and as a "payment or deposit of cash, a security or other property, that is commonly known in the forward contract trade as original margin, initial margin, maintenance margin, or variation margin, including mark-to-market payments, or variation payments."

"Settlement payment" is defined as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade," and as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade."

Unlike many of the protections afforded to Protected Contracts, there is extensive case law regarding Section 546(e).

(i) Recognizing that the definition of "settlement payment" is circular, courts have generally agreed that the "the touchstone for the application of the 'settlement payment' safe harbor is the transfer of cash or securities to complete a securities transaction". See Motors Liquidation Co. Avoidance Action Trust v. JPMorgan Chase Bank, N.A., 552 B.R. 253 (Bankr. S.D.N.Y. 2016) (holding that interest payments on notes were not subject to the protections of Section 546(e)); Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V. (2d Cir. 2011) (holding that, while a settlement payment requires "the completion of a securities transaction", it does not require a purchase or sale, but could include the redemption of notes); Contemporary Industries Corp. v. Frost, 564 F.3d 981 (8th Cir. 2009) ("We conclude that the term 'settlement payment,' as used [in Section 741(8)], encompasses most transfers of money or securities made to complete a securities transaction."); Lowenschuss v. Resorts Int'l, Inc., 181 F.3d 505 (3d Cir. 1999) ("In the securities industry, a settlement payment is generally the transfer of cash or securities made to complete a securities transaction."); In re Comark, 971 F.2d 322, 325 (9th Cir. 1992) (citing Kaiser, infra, for the proposition that "a settlement is 'the completion of a securities transaction'"); Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.3d 846 (10th Cir. 1990) ("Settlement is the completion of a securities transaction.") (internal quotation marks omitted).

(ii) One area of disagreement among courts has been whether payments made in connection with Ponzi or other fraudulent schemes are subject to the protections of Section 546(e). One court held that Section 546(e) did not protect margin or settlement payments from avoidance as constructive fraudulent transfers when made in respect of trades which were not ordinary course transfers, but rather the result of massive fraud. In re Adler Coleman Clearing Corp., 263 B.R. 406, 480–84 (S.D.N.Y. 2001). Recently, however, the Second and Seventh Circuits held that withdrawal payments to customers of Ponzi schemes were "settlement payments," even if the fund managers never effected any securities trades in connection with the transfers. Picard v. Ida Fishman Recoverable Trust, 773 F.3d 411 (2d Cir. 2014); Peterson v. Somers Dublin Ltd., 729 F.3d 741 (7th Cir. 2013); see also Picard v. Katz, 466 B.R. 208 (S.D.N.Y. 2012) (noting that Adler's reasoning "is reminiscent of the 'legal process' mode of statutory interpretation that the Supreme Court in recent years has repeatedly rejected"); SIPC v. Bernard L. Madoff Inv. Sec. LLC, 476 B.R. 715 (Bankr. S.D.N.Y. 2012), supplemented (May 15, 2012) (holding that Section 546(e) protected payments by the Madoff Ponzi scheme from avoidance because the firm "held itself out to all its customers . . . as a firm engaged in the business of effecting transactions in securities").

(iii) Another, related question courts have addressed is whether the protections afforded by Section 546(e) should be limited to payments in connection with registered public sales of securities or other payments "common" in the securities trade. A number of district and bankruptcy courts have adopted this view, including the bankruptcy court for the District of Delaware. See In re Aphton Corp., 423 B.R. 76 (Bankr. D. Del. 2010) (holding that an exchange agreement payment would have to be "commonly used in the securities trade" to qualify under Section 741(8)); see also Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.), 321 B.R. 527 (B.A.P. 9th Cir. 2005) (a transfer in a non-public, non-market transaction in illegally unregistered securities not a settlement payment); Kapila v. Espirito Santo Bank (In re Bankest Capital Corp.), 374 B.R. 333 (Bankr. S.D. Fla. 2007) (settlement payments require that the securities involved must be publicly traded, and the public market must be used); In re Crown Vantage, Inc., 2006 U.S. Dist. LEXIS 61089 (N.D. Cal. Aug. 11, 2006) (agreement by a bank to loan money is not a transaction on a public market, and does not involve the clearing process and thus not a settlement payment); GPR Holdings, LLC v. Duke Energy Trading & Mktg., LLC (In re GPR Holdings, L.L.C.), 2005 Bankr. LEXIS 1059 (Bankr. N.D. Tex. May 27, 2005) (transfers pursuant to a debt workout agreement among forward contract merchants are not settlement payments); In re MacMenamin's Grill Ltd., 450 B.R.414, 430 n.19 (Bankr. S.D.N.Y. 2011) ("Nothing in the legislative history of 11 U.S.C. § 546(e) suggests that Congress intended the 2006 amendment to § 546(e) to exempt lenders from a trustee's avoidance powers where no party was acting in its capacity as a participant in a securities market and the avoidance of the transaction would not pose any risk to any securities market, let alone that Congress implicitly intended to exempt the avoidance of a debtor's incurrence of an obligation notwithstanding the statute's failure to use such terms.").

(iv) However, in Enron-related litigation, the Second Circuit held that the definition of "settlement payment" in Section 741(8) does not limit protection for settlement payments under Section 546(e) to payments "commonly used" in the securities trade. Enron Creditors Recovery Corp. v. Alpha, S.A.B. de C.V., 651 F.3d 329 (2d Cir. 2011), affirming Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp., 422 B.R. 423 (S.D.N.Y. 2009) (extensively discussing the safe harbor for settlement payments and holding that certain commercial paper qualified as a "security" under the Code), overruling Enron Creditors Recovery Corp. v. J.P. Morgan Securities, Inc., 407 B.R. 17 (Bankr. S.D.N.Y. 2009) (repurchase of commercial paper at par, not market, where such commercial paper does not provide for early redemption was the retirement of debt and not common in the securities market; therefore, not within the scope of Section 546(e)); Enron Corp. v. Mass Mut. Life Ins. Co. (In re Enron Corp.), 325 B.R. 671 (Bankr. S.D.N.Y. 2005) (settlement payments must be common within the securities trade). The District Court decision would not seem to overrule cases involving transactions that are void under state law. See Enron Corp. v. Bear, Stearns Int'l Ltd. (In re Enron Corp.), 323 B.R. 857 (Bankr. S.D.N.Y. 2005) (a void securities agreement under the controlling state law carries no enforceable obligations to make a settlement payment); Enron Corp. v. Credit Suisse First Boston Int'l (In re Enron Corp.), 328 B.R. 58 (Bankr. S.D.N.Y. 2005) (same); Enron Corp. v. UBS AG, 2005 WL 3873897 (Bankr. S.D.N.Y. August 10, 2005) (same). See also Enron Corp. v. Int'l Finance Corp. (In re Enron Corp.), 341 B.R. 451 (Bankr. S.D.N.Y. 2006) (payments to purchase securities above market value are settlement payments unless the disparity is large enough to involve "outright illegality or transparent manipulation").

(v) The Enron decision accords with cases from other circuits holding that a "settlement payment" need not be in connection with a "securities contract" to be immune from avoidance and that payments to shareholders in an LBO are "settlement payments", irrespective of whether the purchased shares are public. See Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.), 590 F.3d 252 (3d Cir. 2009), cert. denied, 130 S. Ct. 2389 (2010) (LBO payment to a shareholder is obviously a common securities transaction and, therefore, a settlement payment, even where the securities are non-public); QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.), 571 F.3d 545 (6th Cir. 2009) (citing Contemporary Industries Corp., infra, LBO payment in respect of non-publicly traded stock, made through a financial institution, is settlement payment), cert. denied, 130 S. Ct. 1141 (2010); Contemporary Industries Corp. v Frost, 564 F.3d 981 (8th Cir. 2009) (citing Kaiser Steel Corp. v. Pearl Brewing Co. and Resorts Int'l, infra, holding the same); Elway Company, LLP v. Miller (In re Elrod Holdings Corp.), 394 B.R. 760 (Bankr. D. Del. 2008) (citing Resorts Int'l, holding the same). In Re Resorts Int'l, Inc., 181 F.3d 505 (3d Cir. 1999) (LBO payment to a stockholder made through a financial institution a settlement payment); Kaiser Steel Corp. v. Pearl Brewing Co., 952 F.2d 1230 (10th Cir. 1991); Kaiser Steel Corp. v. Charles Schwab & Co., Inc., 913 F.2d 846 (10th Cir. 1990); PHP Liquidating, LLC v. Robbins, 291 B.R. 592 (D. Del. 2003) (stock redemptions cleared through stockbrokers settlement payments); In re Hechinger Inv. Co. of Del., 274 B.R. 71 (D. Del. 2002) (following Resorts Int'l in finding LBO payment to a stockholder made through a financial institution to be a settlement payment;); Official Comm. of Unsecured Creditors v. Clark (In re Nat'l Forge Co.), 344 B.R. 340 (W. D. Pa. 2006) (following Resorts Int'l in finding stock redemptions constitute settlement payments regardless of whether redemption was subject to SEC regulations or clearance and settlement). But see Matter of Munford, Inc., 98 F.3d 604 (11th Cir. 1996) (even if LBO payments "settlement payments," not made to stockbroker or financial institution); In re Appleseed's Intermediate Holdings, LLC, 470 B.R. 289 (D. Del. 2012) (dividend payments made in connection with LBO not settlement payments where the debtor did not receive anything in exchange); Mervyn's LLC v. Lubert-Adler Group IV, LLC, 426 B.R. 488 (Bankr. D. Del. 2010) ("collapsed" transactions involving parts outside the parameters of Section 546(e) do not qualify as settlement payments, in case involving allegations of actual fraud); Global Crossing Estate Representative v. Alta Partners Holdings LCD (In re Global Crossing Ltd.), 385 B.R. 52 (Bankr. S.D.N.Y. 2008) (dividend not a "settlement payment" because payment of dividend is not a securities transaction); In re Norstan Apparel Shops, Inc., 367 B.R. 68 (Bankr. E.D.N.Y. 2007) (LBO payment that does not involve publicly traded securities or implicate public securities markets is not a settlement payment); Buckley v. Goldman, Sachs & Co., 2005 WL 1206865 (D. Mass. May 20, 2005) (Congressional objective of protecting security industry's clearance and settlement system not furthered in bringing LBO like the one at issue under the exemption simply because the funds passed through financial institutions); In re OOCD, LLC, 321 B.R. 128 (Bankr. D. Del. 2005) (payments not made to stockbroker or financial institution and did not implicate settlement and clearing systems for stock); Zahn v. Yucaipa Capital Fund, 218 B.R. 656 (D.R.I. 1998) (same); In Re Healthco Int'l, Inc., 195 B.R. 971 (Bankr. D. Mass. 1996) (LBO transfers not settlement payments); In re Integra Realty Resources, Inc., 198 B.R. 352

(Bankr. D. Colo. 1996) (transfer of shares in connection with a spin-off not a settlement payment); In re Kaiser Merger Litig., 168 B.R. 991 (D. Colo. 1994) (payment for right to purchase preferred stock that may or may not issue not a "settlement payment," even though contract "may arguably fall" within definition of "securities contract"); Wieboldt Stores, Inc. v. Schottenstein, 131 B.R. 655 (N.D. Ill. 1991) (LBO payments not settlement payments); In re REVCO D.S., Inc., 1990 Bankr. LEXIS 2966 (Bankr. N.D. Ohio Dec. 17, 1990) (questioning approach in Kaiser v. Schwab, 913 F.2d 846, under which LBO payments to selling shareholders are settlement payments); Jewel Recovery, L.P. v. Gordon, 196 B.R. 348 (N.D. Tex. 1996) (holding Section 546(e) does not apply to strictly private stock transaction); In re Grand Eagle Cos., 288 B.R. 484 (Bankr. N.D. Ohio 2003) (parties cannot convert payment under private transaction into a "settlement payment" by "funneling" payments through a financial institution); EPLG I, LLC v. Citibank, National Association (In re Qimonda Richmond, LLC), 467 B.R. 318 (Bankr. D. De. 2012) (finding transfers made to collateralize a letter of credit that provided credit support for bonds were not settlement payments, even where amounts transferred were used to redeem the bonds).

(vi) Several courts have broadly construed the phrase "settlement payment" in the context of the "repurchase agreement", "securities contract", "commodity contract" and "forward contract" provisions of the Code. See In re David, 193 B.R. 935 (Bankr. C.D. Cal. 1996) (payments into a margin account either "settlement payments" or "margin payments," even if payments could not be traced to specific settlements or margin calls); In re Hamilton Taft & Co., 114 F.3d 991 (9th Cir. 1997) ("settlement payment" includes initial transfer of securities to stockbroker under reverse repurchase agreement); In re Yeagley, 220 B.R. 402 (Bankr. D. Kan. 1998); Jonas v. RTC (In re Comark), 971 F.2d 322 (9th Cir. 1992); Jonas v. Farmers Bros. Co. (In re Comark), 124 B.R. 806 (Bankr. C.D. Cal. 1991), aff'd, 145 B.R. 47 (B.A.P. 9th Cir. 1992); Bevill, Bresler & Schulman v. Spencer Sav. & Loan Ass'n, 878 F.2d 742 (3d Cir. 1989); Cohen v. Sav. Bldg. & Loan Co. (In re Bevill, Bresler & Schulman Asset Mgmt. Corp.), 896 F.2d 54 (3d Cir. 1989) (court allowed setoff of payable arising from obligation to transfer purchased securities, which were owned by creditor but owed to debtor, against "settlement payment" receivable arising from debtor's breach of the initial sale provision of a different repurchase transaction; court did not allow setoff of payable arising from obligation to transfer income owned by debtor); In re Olympic Natural Gas, 294 F.3d 737 (5th Cir. 2002) ("settlement payment" includes net payments under a series of natural gas contracts); In re Loranger Mfg. Corp., 324 B.R. 575 (Bankr. W.D. Pa. 2005) (wire transfer to redeem 50% owner's shares); In re Mirant Corp., 310 B.R. 548 (Bankr. N.D. Tex. 2004) (termination payments under natural gas contracts); In re Financial Mgmt. Sci., Inc., 261 B.R. 150 (Bankr. W.D. Pa. 2001) (payments for securities made through "stockbroker," "financial institution" and "securities clearing agency" intermediaries at off-market prices constituted "settlement payments" protected under Section 546(e) from avoidance as fraudulent transfers); In re Stewart Fin. Co., 367 B.R. 909 (Bankr. M. D. Ga. 2007) (payments by debtor in bankruptcy in favor of a former principal's margin account cannot be avoided because they qualify as margin or settlement payments under the plain meaning of Section 546(e)); Official Comm. of Unsecured Creditors of The IT Group v. Acres of Diamonds, L.P. (In re The IT Group, Inc.), 359 B.R. 97 (Bankr. D. Del. 2006) (the plain language of Section 546(e) indicates that a transfer of cash or securities by a financial institution to complete a securities transaction is a non-avoidable settlement payment); DeGirolamo v. McIntosh Oil Co. (In re Laurel Valley Oil Co.), 2013 WL 832407 (Bankr. N.D. Ohio Mar. 5 2013) (finding that deliveries of diesel fuel under a forward contract were settlement payments for purposes of section 546(e)).

(vii) In a case involving Section 548(d)(2) and not Section 546(e), the district court held that settlement payment defense does not apply where the transfer did not benefit the debtor. In re Paramount Citrus, Inc., 268 B.R. 620 (M.D. Fla. 2001) (criticized in In re Stewart Fin. Co., 367 B.R. 909 (Bankr. M.D. Ga. 2007)).

(viii) A number of cases in the Second Circuit have adopted an approach to interpreting the securities contract and settlement payment safe harbors requiring that "the language of the safe harbors is to be strictly interpreted even when the outcome may be prejudicial to the interests of the estate and its creditors." Lehman Bros. Holdings Inc., et. al. v. JPMorgan Chase Bank, N.A. (In re Lehman Bros. Holdings Inc.), 469 B.R. 415 (Bankr. S.D.N.Y. 2012); See In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329 (2d Cir. 2011); Official Comm. Of Unsecured Creditors of Quebecor World (USA) Inc. v. American United life Insurance Co. (In re Quebecor World (USA) Inc.), 453 B.R. 201 (Bankr. S.D.N.Y. 2011); Picard v. Katz, 466 B.R. 208, 211 (S.D.N.Y. 2012) ("In any event, resort to legislative history is inappropriate where, as here, the language of the statute is plain and controlling on its face.").

(ix) The Second Circuit recently resolved a split among the circuit's lower courts as to whether Section 546(e) (and the other anti-avoidance safe harbors) protect against state law-based fraudulent conveyance actions brought by a party other than the trustee. In In re Tribune Co. Fraudulent Conveyance Litigation, 818 F.3d 98 (2d Cir. 2016) and Whyte v. Barclays Bank, No. 13-2653, 644 Fed. Appx. 60 (2d. Cir. Mar. 24, 2016), the court held that Sections 546(e) and 546(g) of the Code protect against state law-based fraudulent conveyance actions in connection with a Code proceeding, whether or not brought by the trustee. Shortly thereafter, however, the U.S. Bankruptcy Court for the District of Delaware (in the Third Circuit) declined to follow Tribune and Whyte and held that Section 546(e) does not prevent a litigation trustee, acting in the capacity of a creditor-assignee, from asserting state law fraudulent transfer claims when "(1) the transaction sought to be avoided poses no threat of "ripple effects" in the relevant securities markets; (2) the transferees received payment for non-public securities, and (3) the transferees were corporate insiders that allegedly acted in bad faith." PAH Litigation Trust v. Water Street Healthcare Partners L.P. (In re Physiotherapy Holdings Inc.), 2016 WL 3611831 (Bankr. D. Del. June 20, 2016).

2. Repurchase Agreements

   (a) Section 546(f) of the Code now protects from avoidance as a preference or constructive fraudulent transfer any pre-petition "transfer" made by or to (or for the benefit of) a repo participant or financial participant under or in connection with a repurchase agreement. Again, the 2006 Act deleted the "margin" or "settlement payment" requirement.

3. Swap Agreements

   (a) Section 546(g) of the Code now protects from avoidance as a preference or constructive fraudulent transfer any pre-petition "transfer" under a swap agreement, made by or to (or for the benefit of) a swap participant or financial participant under or in connection with any swap agreement.

      (i) "Transfer" is defined broadly in the Code to include "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or an interest in property."

      (ii) "Transfer" includes prejudgment attachments substantially related to swap agreements. Under a previous version of Section 546(g), which applied to transfers "under a swap agreement, made by or to a swap participant, in connection with a swap agreement", such attachments were deemed to fall outside the provision because they were not obtained according to the method prescribed by the swap agreement and were, therefore, not transfers "under" the swap agreement. See In re Interbulk, Ltd., 240 B.R. 195 (Bankr. S.D.N.Y. 1999). Under the current version of Section 546(g), however, which covers transfers "under or in connection with any swap agreement," such attachments are deemed to fall within the provision because they are "in connection" with a swap agreement. See In re Casa de Cambio Majapara S.A. de C.V., 390 B.R. 595 (Bankr. N.D. Ill. 2008).

      (iii) "Transfer" does not, however, include the incurrence of an obligation (which are within the scope of Section 548). See, e.g., Lehman Bros. Holdings Inc. v. JPMorgan Chase Bank (In re Lehman Bros.), 469 B.R.

415 (Bankr. S.D.N.Y. 2012). Nor does it include the exercise of setoff rights, which are addressed by Section 553 of the Code.

4. Master Netting Agreements

   (a) Section 546(j) of the Code protects from avoidance as a preference or constructive fraudulent transfer any pre-petition transfer made by or to (or for the benefit of) a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby, except to the extent that the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.

5. Fraudulent Transfers

   (a) Sections 546(e), (f), (g) and (j) do not protect from avoidance a fraudulent transfer made with actual intent to hinder, delay or defraud creditors and taken other than in good faith. See also Code Section 548(d)(2). See, e.g., In re Bayou Group LLC, 439 B.R. 284 (S.D.N.Y. 2010); In re Derivium Capital, LLC, 437 B.R. 798 (Bankr. D.S.C. 2010); In re Manhattan Investment Fund Ltd., 397 B.R. 1 (S.D.N.Y. 2007); In re Marketxt Holdings, 376 B.R. 390 (Bankr. S.D.N.Y. 2007); Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 476 B.R. 715 (S.D.N.Y. 2012), supplemented (May 15, 2012).

6. Post-Petition Transfers

   (a) Sections 546(e), (f), (g) and (j) do not protect from avoidance post-petition transfers, including transfers occurring during a contractual grace period following an involuntary filing. See generally Code Section 549(a) (providing that the trustee may avoid a post-petition transfer of property of the estate that is not authorized by the Code or a court).

7. Setoff

   (a) Section 553(b)(1) contains related provisions protecting certain otherwise avoidable setoffs in connection with Protected Contracts. Furthermore, there are now express protections in Section 553(a) in connection with Protected Contracts from any power of a trustee to avoid the pre-petition assignment of claims and incurrence of debts otherwise avoidable under Section 553(a), as long as the debts and claims are mutual. Cf. Armada (Singapore) Pte Ltd. v. North China Shipping Co. Ltd., 2010 U.S. Dist. LEXIS 11014 (S.D.N.Y. Jan. 14, 2010) (questioning whether pre-petition assignment of claim creates mutuality under New York law where debts were purchased with knowledge of insolvency for a fraction of their value); see also Wallace v. Merrill Lynch Capital Servs., Inc., 814 N.Y.S2d 566 (N.Y. Sup. Ct. 2005) (suggesting the court could use its equitable discretion to limit the ability of Merrill Lynch to set off amounts it owed to a swap counterparty subject to English administration proceedings against amounts owed it under bonds guaranteed by the counterparty, where Merrill Lynch knew or should have known at the time it purchased the bonds that party was likely insolvent).

(b) The bankruptcy court in In re SemCrude, L.P., 399 B.R. 388 (Bankr. D. Del. 2009) denied a creditor's motion to set off amounts it owed to the debtor against amounts owing to it by an affiliate of the debtor (a "triangular" setoff), holding that the obligations were not mutual under Section 553. Although arguably applicable, the application of the Code's safe harbors was not argued before the court. Subsequently, the court clarified that the above decision did not contemplate or address triangular setoff in the context of the safe harbors. In re SemCrude, L.P., No. 08-11525 (BLS) (Bankr. D. Del. Mar. 19, 2009). In the Lehman proceedings, the court has held that Section 560's language permitting the exercise of "any" contractual right notwithstanding the automatic stay does not eliminate the mutuality requirement for setoff pursuant to Section 553. In re Lehman Bros. Holdings Inc., 433 B.R. 101 (Bankr. S.D.N.Y. 2010) (no mutuality where Swedbank sought to set off pre-petition claims arising under various ISDA Master Agreements with Lehman entities against post-petition funds received from Lehman entities). Please see our alert memorandum regarding this case, available at https://www.clearygottlieb.com/~/media/cgsh/files/news-pdfs/lehman-court-holds-that-contractual-cross-affiliate-setoff-rights-are-unenforceable-in-bankruptcy.pdf. See also In re Lehman Bros. Inc., 458 B.R. 134 (Bankr. S.D.N.Y. 2011) (endorsing SemCrude's analysis and rejecting triangular setoff).

IV. Stockbroker Liquidation Under SIPA.

A. Governing Law.

1. Stockbrokers that are members of SIPC are typically liquidated in proceedings under SIPA, rather than under the Code. Systemically significant broker-dealers (i.e., broker-dealers whose insolvency under otherwise applicable insolvency law would have serious adverse effects on financial stability in the United States) may be subject to OLA. See Section VI, below. Significantly, although customer property rules under SIPA apply in an OLA proceeding for a systemically significant broker-dealer, the safe harbor rules are the OLA rules discussed in Section VI below, rather than the SIPA rules discussed immediately below. (The customer property rules under the commodity broker liquidation provisions of the Code and the CFTC's Part 190 rules thereunder would also apply to systemically significant commodity brokers under OLA.)

(a) The provisions of the Code apply in a proceeding under SIPA, see In re Gov't Sec. Corp., 972 F.2d 328 (11th Cir. 1992), cert. denied sub nom. Nat'l Union Fire Ins. Co. of Pittsburgh, Penn. v. Camp, 507 U.S. 952 (1993) (Section 541(c)(1)(B) of the Code applies in SIPA proceeding, disallowing enforcement of bond provision terminating liability in case of insolvency), but only to the extent not incompatible with SIPA, SIPC v. Lehman Bros. Inc., 433 B.R. 127, (Bankr. S.D.N.Y. 2010) (holding that SIPA trumped the Code in determining a valuation date for certain short positions in Fifth Third's prime brokerage customer account).

(b) A SIPC trustee in a stockbroker liquidation may, and typically will, seek an order barring the exercise of rights limited by the automatic stay under Section 362(a) of the Code, including termination, netting and foreclosure rights, subject to the safe harbors and the SIPC letters applicable to the exercise of rights against securities described below. See, e.g., SIPC v. MF Global Inc., No. 11 Civ. 07750 (S.D.N.Y. Oct. 31, 2011) (granting order applying Section 362 stay generally but exempting from the stay the exercise of termination, setoff and certain foreclosure rights in respect of Protected Contracts); SIPC v. Lehman Bros. Inc., No. 08 Civ. 8119 (S.D.N.Y. Sept. 19, 2008) (same). Both orders are available from your regular Cleary contacts.

B. Application of the Code Safe Harbors Under SIPA.

1. SIPA generally preserves the ability of a creditor to exercise its safe harbored rights, with one important exception. Section 78eee provides that, "[n]otwithstanding Section 362 of [the Code], neither the filing of an application . . . nor any order or decree obtained by SIPC from the court shall operate as a stay of any contractual rights of a creditor to liquidate, terminate, or accelerate a [Protected Contract], to offset or net termination values, payment amounts, or other transfer obligations arising under or in connection [therewith], or to foreclose on any cash collateral pledged by the debtor, whether or not with respect to one or more such contracts".

2. Notably, Section 78eee does not expressly preserve the right to foreclose on any non-cash collateral. As a result, the orders obtained in the MF Global and Lehman proceedings permitted counterparties to terminate, liquidate or accelerate Protected Contracts, exercise setoff rights in respect of such contracts and foreclose on any cash collateral, but stayed creditors "from foreclosing on, or disposing of, securities collateral pledged by the Defendant, . . . securities sold by the Defendant under a repurchase agreement, or securities lent under a securities lending agreement, without first receiving the written consent of SIPC and the trustee."

3. SIPC has determined, in a letter dated February 4, 1986, from Michael E. Don, Deputy General Counsel, to Robert A. Portnoy, Deputy Executive Director and General Counsel of the Public Securities Association, that, as to repurchase agreements falling within the Code definition of "repurchase agreement," the standard proposed order that SIPC will seek will still bar their immediate liquidation pursuant to insolvency default clauses, but that SIPC would consent (and would urge the trustee to consent) to their liquidation upon the receipt of an appropriate affidavit (and similar additional documentation) from the counterparty. The letter states SIPC's hope that it could make the determinations necessary for its consent to close-out

within four to five days after the initiation of a liquidation proceeding, or more rapidly in periods of particular market volatility.

(a) The letter specifically would require an affidavit of the counterparty attesting that the affiant has no knowledge of any fraud involved in the transactions and that it has a perfected security interest in the underlying securities.

(b) The letter also indicates that SIPC might perform the debtor's obligations under a repurchase agreement, in order to obtain the subject securities to satisfy customer claims.

2. Similar letters (with similar conditions) were issued by SIPC in 1988 regarding securities lending transactions. Furthermore, SIPC has more recently indicated in letters that the SIPC-obtained stay would not be sought against the liquidation by financial institution and stockbroker counterparties of cash collateral under securities lending transactions or against the drawing of letters of credit in connection therewith.

3. A similar letter (with similar conditions) was issued by SIPC in 1996 regarding repurchase transactions, whether or not falling within the Code definition of "repurchase agreement." See an alert memorandum available from your regular Cleary contacts.

4. SIPC issued a letter in June, 2002 clarifying that the 1986, 1988 and 1996 letters would also apply where the buyer (in the case of a repurchase transaction) acquires title to rather than a security interest in the underlying securities and where the securities lender (in the case of a securities lending transaction) acquires ownership of assets received as "credit support" rather than a security interest therein. The letter also extends the letters regarding cash collateral under securities lending transactions to repurchase agreements where the SIPC member being liquidated is the buyer of securities.

5. SIPC's staff has informally expressed a willingness to apply the policies discussed above to all types of counterparties and to extend the policy for obtaining relief from the stay to Protected Contracts other than repurchase transactions and securities lending transactions. This policy does not appear to have been included in any written statements from SIPC.

6. The letters referred to above regarding the standard stay order requested by SIPC in respect of repurchase and securities lending agreements are available from your regular Cleary contacts.

C. Priority of Unsecured Claims after the Exercise of Rights.

1. Under Section 753, the exercise, in the course of a stockbroker liquidation, of the rights available under the Code to a forward contract merchant, commodity broker, stockbroker, financial institution, financial participant, securities clearing agency,

swap participant, repo participant or master netting agreement participant does not affect the priority of any unsecured claim that the party may have.

2. Under Section 767, the exercise, in the course of a commodity broker liquidation, of the rights available under the Code to a forward contract merchant, commodity broker, stockbroker, financial institution, financial participant, securities clearing agency, swap participant, repo participant or master netting agreement participant does not affect the priority of any unsecured claim that the party may have.

V. Insolvency of Banks and Thrifts Under the FDIA.

A. Governing Law.

1. The receivership provisions of the Federal Deposit Insurance Act ("FDIA") will apply in most circumstances to insolvent federally and state chartered banks and thrifts, so long as such banks or thrifts are insured by the FDIC. OLA does not apply to federally insured banks and thrifts. Although the FDIA also permits the appointment of the FDIC as a conservator, due to changes made to the FDIA by Dodd-Frank, the likelihood of an FDIC conservatorship (as opposed to a receivership) is virtually nil.

2. The conservatorship and receivership provisions of the FDIA would <u>not</u> apply in the case of non-federally insured banks, thrifts, and branches and agencies of foreign banks. <u>See</u> 12 U.S.C. § 1813(a)(1) (defining "bank" as "any national bank and State bank, and any Federal branch and insured branch"); 12 U.S.C. § 1821(c)(1) (conservatorship and receivership provisions apply to "any insured depository institution"). Although there is an argument that the FDIA would apply in the case of a non-insured federal branch of a foreign bank, it does not appear that the OCC accepts this argument.

   (a) Legislation was enacted in 1993 in New York that amends the New York Banking Law provisions applicable to, among other things, the liquidation of New York branches of foreign banks. <u>See</u> NYBL § 606 et seq.

   (b) Although the OCC has rendered an opinion that collateral pledged by a foreign bank or its federal branch will break the "ring-fence" applicable to federal branch proceedings, it is not at all clear that multibranch netting will be enforceable in light of the ring-fence (except, perhaps, if FDICIA is applicable). Note that federal branch proceedings would encompass all assets of a foreign bank in the United States, including those that would otherwise be subject to a proceeding under the New York Banking Law.

3. The conservatorship and receivership provisions of the FDIA might not apply in the case of a non-FDIC conservator for a national bank acting under the Bank Conservation Act or a non-FDIC conservator for a thrift acting under the Home Owners' Loan Act.

4. State law, including state law avoidance powers, may apply in a conservatorship or receivership proceeding under the FDIA, especially in the case of a non-"federalized" proceeding for a state-chartered institution. Cf. 12 U.S.C. §§ 1821(g)(4) and 1821(c)(3) (outlining circumstances under which conservatorship and receivership proceedings will be governed by state law).

5. It is possible that the Code could apply to a state-chartered non-FDIC insured banking institution. See part III.B.5(a)(i), supra.

6. Foreign law may apply to a creditor's rights against a foreign branch of a U.S. bank or thrift. Cf. Aurelius Capital Partners, LP v. Republic of Argentina, No. 07 Civ. 2715(TPG) et al., 2010 WL 768874 (S.D.N.Y. March 5, 2010) (holding that assets in custodial securities accounts in an Argentinean branch of a U.S. bank are immune from attachment, restraint and execution by a U.S. court, on grounds that the U.S. is not the situs of the property in question under the Foreign Sovereign Immunities Act).

7. It is no longer possible for a U.S. branch of a foreign bank to be the subject of ancillary proceedings under Chapter 15 of the Code. Sections 1501(c)(1) and 109(b)(3). Compare Agency for Dep. Ins. v. Sup. of Banks, 310 B.R. 793 (S.D.N.Y. 2004). However, a foreign bank with assets in the U.S., but no branch or agency in the U.S., may be subject to proceedings under Chapter 15.

B. Provisions of the FDIA Impair Creditors' Rights.

1. Conservator's or Receiver's Right to Enforce Contracts and Stay Remedial Actions.

(a) Even though the FDIA does not contain a Code-like automatic stay, the FDIC as conservator or receiver has the ability to enforce contracts, notwithstanding contractual provisions providing for termination, default, acceleration or exercise of rights upon insolvency or appointment of or the exercise of rights or powers by a conservator or receiver. 12 U.S.C. § 1821(e)(13)(A). In addition, "no person may exercise any right or power to terminate, accelerate, or declare a default under any contract to which the depository institution is a party, or to obtain possession of or exercise control over any property of the institution or affect any contractual rights of the institution, without the consent of the conservator or receiver, as appropriate, during the 45-day period beginning on the date of the appointment of the conservator, or during the 90-day period beginning on the date of the appointment of the receiver, as applicable." Id. § 1821(e)(13)(C).

(i) The FDIC has issued a policy statement (available from your regular Cleary contacts) giving some relief from this provision in the context of certain "covered bonds."

(ii) On September 30, 2010, the FDIC promulgated a new securitization rule that provides similar relief from this provision in the case of qualifying securitizations. 75 Fed. Reg. 60,287 (codified at 12 C.F.R. § 360.06). An alert memorandum regarding the adoption of the final rule revising the securitization rule is available at https://www.clearygottlieb.com/~/media/cgsh/files/publication-pdfs/fdics-final-safe-harbor-rule-imposes-new-securitization-standards.pdf.

(b) There are statutory exceptions for, among other things, qualified financial contracts (discussed below), netting contracts under FDICIA, and Federal Home Loan Bank or Federal Reserve Bank extensions of credit. See 12 U.S.C. §§ 1821(e)(13)(C)(ii), 1821(e)(14).

(c) 12 U.S.C. § 1821(e)(13)(C) makes ipso facto clauses unenforceable for 45 to 90 days. More broadly, the D.C. Circuit, the Second Circuit and at least one district court have refused to enforce ipso facto clauses at all under 12 U.S.C. § 1821(e)(13)(A). See Bank of N.Y. v. First Millennium Bank, 607 F.3d 905 (2d Cir. 2010) (applying issue preclusion analysis and refusing to re-address the issue because prior district court decision, Bank of N.Y. v. FDIC, 453 F. Supp. 2d 82 (D.D.C. 2006), had already held ipso facto clause unenforceable under Section 1821(e)(13)(A)); Bank of N.Y. v. FDIC, 508 F.3d 1 (D.C. Cir. 2007) (holding that FDIC was permitted under Section 1821(e)(13)(A) to ignore ipso facto clause calling for acceleration and instead continue the transaction as normal); Devonshire Park, LLC v. FDIC, 2010 WL 7325248 (M.D. Fla. July 23, 2010) ("[Section 1821(e)(13)(A)] prohibits a party in a contractual relationship with an insolvent bank from invoking an ipso facto clause contained in the contract against the FDIC."). The FDIC also takes the position that 12 U.S.C. § 1821(e)(13)(A) renders such clauses unenforceable in their entirety. See 75 Fed. Reg. 27,471, 27,481 (May 17, 2010) (to be codified at 12 C.F.R. pt. 360); see also FDIC General Counsel Statement on NextBank (February 14, 2002) (FDIC view that receivership of NextBank not an enforceable "early amortization event" in credit card receivable securitization transaction). This reading of the statute does not seem to present a constitutional takings problem. See McAndrews v. Fleet Bank of Mass., N.A., 989 F.2d 13 (1st Cir. 1993) (Section 1821(e)(13)(A) provision invalidating ipso facto clause in lease does not effect an unconstitutional taking)

(i) Cf. Bank One, Tex. v. FDIC, 16 F. Supp. 2d 698 (N.D. Tex. 1998) (dispute over automatic lease termination based on "ipso facto" clause predicated on assumption that clause was enforceable).

(ii) In contrast, under the securitization rule, the FDIC has declared a policy of consenting to the exercise of contractual rights in the event that the FDIC is in monetary default under covered securitization documents or fails to pay certain damages within ten (10) days of repudiating covered securitization asset transfer agreements. See 12 C.F.R. 360.6.

(iii) Courts appear to have disagreed as to whether an assignee of the FDIC may enforce contracts under Section 1821(e)(13)(A). Compare CRE Venture 2011-1, LLC v. First Citizens Bank of Ga., 756 S.E.2d 225 (Ga. Ct. App. 2014) (suggesting that the rights under Section 1821(e)(13)(A) do not extend to an assignee of the FDIC) with Iberiabank v. Beneva 41-I, LLC, 701 F.3d 916 (11th Cir. 2012) (holding that the FDIC's enforcement of a contract after the commencement of proceedings precluded the counterparty from terminating the contract after a transfer).

(iv) At least one court has held that Section 1821(e)(13)(A) only makes ipso facto clauses unenforceable if such clauses provide for the termination of the transaction. See First Nat'l Comm. Bank v. Stearns Bank, N.A., 2013 WL 12086786 (N.D. Ga. Nov. 13, 2013).

2. Conservator's or Receiver's Right to Disaffirm or Repudiate Contracts.

(a) The FDIC has the ability to disaffirm or repudiate contracts and leases to which a depository institution is a party (12 U.S.C. § 1821(e)(1)) if:

(i) The conservator or receiver, in its discretion, determines a contract or lease to be burdensome; and

(ii) Disaffirmance or repudiation is determined by the conservator or receiver, in its discretion, to promote orderly administration of the institution's affairs.

(b) Rights are to be exercised within a "reasonable" period following appointment of a conservator or receiver. 12 U.S.C. § 1821(e)(2). What constitutes a "reasonable" period is "fact sensitive" and must be decided on a "case by case basis." See 701 NPB Assocs. v. FDIC, 779 F. Supp. 1336 (S.D. Fla. 1991); see also RTC v. CedarMinn Bldg. Ltd. P'ship, 956 F.2d 1446 (8th Cir. 1992) ("Congress specifically intended to give RTC flexibility in determining what constitutes a reasonable period for repudiation."); Village Park Office I, LLC v. FDIC, 2013 WL 1296360 (M.D. Ga. Mar. 26, 2013) (finding there to be a genuine issue of material fact as to whether the FDIC repudiated a lease within a reasonable period where record was unclear as to whether FDIC waited six months after appointment and three months after it knew that it did not intend to assume the lease); BKWSPOKANE v. FDIC, 12 F. Supp. 3d 1331 (E.D. Wash. 2014), aff'd, 2016 WL 4759176 (9th Cir. 2016) (considering whether the FDIC acted in bad faith and whether counterparty was prejudiced by delay in concluding that FDIC's repudiation of a lease 206 days after appointment was not unreasonable).

(c) The right to repudiate is not expressly limited under the FDIA to "executory" contracts, as under Section 365 of the Code. See, e.g., FDIC v. Johnson, 2012 WL 5818259 (D. Nev. Nov. 15, 2012) ("the weight of authority suggests that the FDIC can repudiate both executory and nonexecutory contracts"); Burris v. FDIC, 2011 WL 833270 (E.D. Wis. Mar. 3, 2011) (holding that the FDIC's power to repudiate is not limited to executory contracts (citing Hennessy v. FDIC, 58 F.3d 908, 919 n.8 (3d Cir. 1995))); Majeski v. RTC, No. 94-378 (NHJ), 1995 WL 115953 (D.D.C. Feb. 28, 1995) ("FIRREA explicitly gives the receiver discretion to disaffirm or repudiate 'any contract' and does not limit that discretion to situations involving executory contracts."); Emps. Ret. Sys. Of Alabama v. RTC, 840 F. Supp. 972, 984 (S.D.N.Y 1993) (holding that RTC could repudiate bonds even if "nonexecutory"). But see LaMagna v. FDIC, 828 F. Supp. 1 (D.D.C. 1993) (FDIC cannot repudiate non-executory contracts); Marsa v. Metrobank, 825 F. Supp. 658 (D.N.J. 1993) (stating, in dicta, that "a receiver is precluded from disaffirming a non-executory contract"); Fresca v. FDIC, 818 F. Supp. 664 (S.D.N.Y. 1993) (court questioned but did not render a decision as to whether FDIC could ever repudiate a non-executory contract); In re IndyMac Bancorp, Inc., 2012 WL 1037481 (Bankr. C.D. Cal. Mar. 29, 2012) ("The FDIC's power to 'repudiate' contracts was modeled after and intended to operate like a trustee's power to 'reject' executory contracts under the Bankruptcy Code."), report and recommendation adopted sub nom. In re IndyMac Bancorp Inc., CV 12-02967-RGK, 2012 WL 1951474 (C.D. Cal. May 30, 2012) (accepting findings of fact and conclusions of law of bankruptcy court). The FDIC and RTC have taken the position in policy statements that the repudiation power extends to secured debt obligations and collateralized letters of credit and put obligations. See Statement of Policy Regarding Treatment of Collateralized Letters of Credit After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver (May 26, 1995); Statement of Policy Regarding Treatment of Collateralized Put Obligations After Appointment of the FDIC as Conservator or Receiver (April 19, 1991) (available from your regular Cleary contacts); cf. Monrad v. FDIC, 62 F.3d 1169 (9th Cir. 1995) (repudiation of severance agreements valid); IBJ Schroder Bank & Trust Co., as Trustee v. RTC as Conservator for Franklin Savings Assoc., 26 F.3d 370 (2d Cir. 1994) (repudiation of secured bonds valid); Howell v. FDIC, 986 F.2d 569 (1st Cir. 1993) (repudiation of severance agreements valid). See also Security Pac. Nat'l Bank v. RTC, 63 F.3d 900 (9th Cir. 1995) (upon repudiation of subordinated debt, debtholder's claim remains subordinated); Lawson v. FDIC, 3 F.3d 11 (1st Cir. 1993) (characterizing a CD as an executory contract that could be repudiated).

(d) The FDIC's securitization rule, 12 C.F.R. § 360.6, states that, subject to the qualifications contained therein, it shall not use its powers under 12 U.S.C. § 1821(e) to repudiate or disaffirm a contract to reclaim "financial assets" (defined as "cash or a contract or instrument that conveys to one entity a contractual right to receive cash or another financial instrument from another entity") transferred by an insured depository institution in connection with a securitization or participation, nor shall it avoid an otherwise enforceable securitization or participation agreement for lack of compliance with the "contemporaneous" requirement of 12 U.S.C. §§ 1821(d)(9)(A), 1821(n)(4)(I), and 1823(e) (discussed below). See also Statement of Policy Regarding Payment of Interest on Direct Collateralized Obligations After Appointment of RTC as Conservator or Receiver (April 10, 1990) (available from your regular Cleary contacts); Treatment by the FDIC as Conservator or Receiver of Financial Assets Transferred by an Insured Depository Institution in Connection with a Securitization or Participation (August 11, 2000) (available at https://www.fdic.gov/regulations/laws/rules/5000-3900.html).

(e) See WRH Mortgage, Inc. v. S.A.S. Assocs., 214 F.3d 528 (4th Cir. 2000) (repudiation of lease released obligation on related note); Hackel v. FDIC, 858 F. Supp. 289 (D. Mass. 1994) (lease and note integrally related; therefore repudiation of lease constituted repudiation of note); Capital Guidance v. NCNB Tex. Nat'l Bank, 1991 WL 210740 (S.D. Tex. Oct. 7, 1991) (questioning whether FDIC could repudiate one of two leases where leases were part of an integral agreement).

(f) One court stated in dicta that the RTC could repudiate a contract entered into by a subsidiary of a failed thrift. Bender v. Centrust Mtg. Corp., 833 F. Supp. 1525 (S.D. Fla. 1992).

3. Damages Recoverable Upon Repudiation.

(a) 12 U.S.C. § 1821(e)(3) governs the calculation of damages in respect of contracts or leases repudiated by a conservator or receiver.

(i) There are specific rules for qualified financial contracts (discussed below), leases, contracts for the sale of real property, service contracts.

(b) Generally, damages are measured as of the date of appointment of conservator or receiver, not as of the date of repudiation. For qualified financial contracts, damages would be measured as of the date of disaffirmance or repudiation, if the creditor has not first terminated the qualified financial contract. See, e.g., 12 U.S.C. § 1821(e)(3)(A)(ii)(II) (requiring determination of liability according to the date of disaffirmance or repudiation of qualified financial contracts).

(c) Damages are limited to actual direct compensatory damages, and do not include (1) punitive or exemplary damages; (2) damages for lost profits or opportunity; or (3) damages for pain and suffering. See 12 U.S.C. §§ 1821(e)(3)(A)(i), 1821(e)(3)(B).

(i) Compare FDIC v. Craft, 157 F.3d 697 (9th Cir. 1998) (borrower can set off amounts owed under promissory note against damages from repudiation of loan commitment); McMillian v. FDIC, 81 F.3d 1041 (11th Cir. 1996) (employee had claim for severance pay); Monrad v. FDIC, 62 F.3d 1169 (9th Cir. 1995) (FDIC liable for claim for severance pay); Nashville

Lodging Co. v. RTC, 59 F.3d 236 (D.C. Cir. 1995) (holding that claim to recover reliance damages based on out-of-pocket expenses to secure repudiated contract constitutes direct compensatory damages); Office and Prof'l Emps. Int'l Union v. FDIC, 27 F.3d 598 (D.C. Cir. 1994) (union had valid claim for severance pay based on repudiation of collective bargaining agreement; court compares to treatment of standby letters of credit); DPJ Co. Ltd. P'ship v. FDIC, 30 F.3d 247 (1st Cir. 1994) (borrower entitled to reliance damages based on repudiation of loan commitment), Modzelewski v. RTC, 14 F.3d 1374 (9th Cir. 1994) (granting damages to Savings and Loan Association officer upon RTC's repudiation of salary continuation agreement where claim had vested, but denying damages to another officer whose claim had not yet vested); Loftus v. FDIC, 989 F. Supp. 2d 483 (D.S.C. 2013) (FDIC liable for employee benefit claims); Frank A. Baker, P.A. v. FDIC, 2013 WL 12097448 (N. D. Fla. Mar. 13, 2013) (FDIC liable for attorney's fees pursuant to termination provision under which attorney would receive 10% of any recovery); Font-Lacer-de-Pueyo v. FDIC, 932 F. Supp. 2d 265 (D.P.R. 2013) (claim for double damages under Puerto Rico employment discrimination statute was compensatory); MCI Commc'ns Servs. v. FDIC, 808 F. Supp. 2d 24 (D.D.C. 2011) (denying FDIC's summary judgment motion with respect to "loyalty credits" and "service and other credits" that might constitute recoverable reliance damages; allowing recovery for material and labor costs for facilities built in reliance on repudiated contract; noting that "it would be inappropriate to deny plaintiff reliance damages on the grounds that they are barred by the terms of the contract, when [the court] cannot grant them the liquidated or future profit damages the contract provided for instead"); Citibank (South Dakota), N.A. v. FDIC, 857 F. Supp. 976 (D.D.C. 1994) (repudiation of non-compete provision may give rise to provable claim for damages); Greater Midwest Builders, Ltd. v. FDIC, 2012 WL 2376848 (W.D. Mo. June 22, 2012) (FDIC liable for damages resulting from repudiation of letters of credit); Fresca v. FDIC, 818 F. Supp. 664 (S.D.N.Y. 1993) (repudiation of medical and life insurance plan gave rise to provable claim for damages); and FDIC v. Parkway Executive Office Ctr., 1998 U.S. Dist. LEXIS 275 (E.D. Pa. Jan. 9, 1998) (denying motion by FDIC to exclude evidence relating to diminution-in-value damages where FDIC repudiated a loan commitment); with ALLTEL Info. Servs. v. FDIC, 194 F.3d 1036 (9th Cir. 1999) (no future damages recoverable for repudiation of data processing contract); McCarron v. FDIC, 111 F.3d 1089 (3d Cir. 1997) (no claim for severance pay upon repudiation); Westport Bank & Trust Co. v. Geraghty, 90 F.3d 661 (2d Cir. 1996) (officers not entitled to assets in "rabbi" or "secular" trusts in connection with disaffirmed employment contracts); Hennessey v. FDIC, 58 F.3d 908 (3d Cir. 1995) (no claim for severance pay upon repudiation); RTC v. Management, Inc., 25 F.3d 627

(8th Cir. 1994) (no recovery under clause in contract that functioned as either a severance penalty or liquidated damage clause for future lost profits); Howell v. FDIC, 986 F.2d 569 (1st Cir. 1993) (officers' claims for severance pay not claims for actual compensatory damages); Lawson v. FDIC, 3 F.3d 11 (1st Cir. 1993) (no recovery for post-receivership interest on certificate of deposit "lost profits"); MCI Commc'ns Servs. v. FDIC, 808 F. Supp. 2d 24 (D.D.C. 2011) (denying recovery of expectation damages for final two years of repudiated contract; denying recovery of "indirect" damages associated with company's ongoing contractual obligations to its employees); Ravenswood, LLC v. FDIC, 2011 WL 1079495 (N.D. Ill. March 21, 2011) (holding that Parkway, supra, did not apply because claim for lost rental income constituted claim for lost-profits damages rather than diminution-in-value damages); Nashville Lodging v. FDIC, 934 F. Supp. 449 (D.D.C. 1996) (no recovery for breach of refinancing agreement); Heiko v. FDIC, 93 Civ. 8638 (LAP), 1995 U.S. Dist. LEXIS 3407 (S.D.N.Y. Mar. 15, 1995) (cost of cover not recoverable in non-QFC); Credit Life Ins. Co. v. FDIC, 870 F. Supp. 417 (D.N.H. Oct. 18, 1994) (no damages recoverable for repudiation of standby letter of credit); Crocker v. RTC, 839 F. Supp. 1291 (N.D. Ill. 1993) (no vested claim for consulting fees and bonuses upon repudiation); and Employees' Ret. Sys. of Ala. v. Resolution Trust Corp., 840 F. Supp. 972 (S.D.N.Y. 1993) (FDIC not liable for future interest on repudiated zero-coupon bonds, but plaintiffs entitled to fair market value at time of repudiation).

(ii) FDIC and RTC have consistently taken the position that "contingent" claims generally are not provable against a failed bank or thrift. See, e.g., Statement of Policy Regarding Treatment of Collateralized Letters of Credit After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver (May 26, 1995) ("Generally, contingent obligations do not give rise to provable claims against a receivership or conservatorship, and any claims based upon such obligations have no provable damages because the damages are not fixed and certain as of the date of the appointment of the receiver or conservator. . . . This Policy Statement does not change or amend the FDIC's longstanding position that standby letters of credit are contingent obligations.") (statement available from your regular Cleary contacts); Statement of Policy Regarding Treatment of Collateralized Put Obligations After Appointment of the FDIC as Conservator or Receiver (July 31, 1991) ("The FDIC has maintained a longstanding position that contingent obligations have no provable damages under the FDI Act's statutory damages limitation, if repudiated by the receiver or conservator, because the damages are not fixed and certain as of the date of the appointment of the receiver or conservator.") (statement available from your regular Cleary contacts). See also Del E. Webb McQueen Dev. v. RTC, 69 F.3d 355 (9th Cir. 1995) (claim under standby letter of credit not accrued and unconditionally fixed prior to receivership and thus priority 7 claim, subordinate to most claims, pursuant to 12 C.F.R. Part 360; RTC not required to make ratable distribution).

(iii) The FDIC has historically taken the position that post-insolvency interest, even if secured, is not recoverable. Statement of Policy Regarding Payment of Interest on Direct Collateralized Obligations After Appointment of Resolution Trust Corporation as Conservator or Receiver (April 10, 1990) (stating that a secured creditor only has the statutory right to interest that has accrued to the date of the appointment of a receiver, but that as a matter of policy, RTC would allow the interest claim of a secured creditor to accrue to the date of payment) (statement available from your regular Cleary contacts). In certain circumstances, however, courts have rejected the application of this position. FDIC v. Hickey, 757 F. Supp. 2d 194 (E.D.N.Y 2010) (ordering FDIC to pay prejudgment interest vis-à-vis a judgment that occurred after FDIC's substitution as party to the litigation at issue, where the award "would have been appropriate if the case continued against the initially named defendant," but holding that the FDIC could issue receiver's certificate in advance of a final distribution of assets); Waterview Mgmt. Co. v. FDIC, 257 F. Supp. 2d 31 (D.D.C. 2003) (requiring the FDIC to pay pre- and post-judgment interest despite the FDIC's classification of the pre- and post-judgment interest as "priority seven claims" and its assertion that "there is no money in the receivership to pay priority seven claims"; and that prejudgment interest is not expressly excluded by the statute). But see Battista v. FDIC, 195 F.3d 1113 (9th Cir. 1999) (holding that sovereign immunity bars an award of prejudgment interest against the FDIC); Sharpe v. FDIC, 126 F.3d 1147 (9th Cir. 1997) (same); Nee v. FDIC, 2012 WL 1986289 (C.D. Cal. May 31, 2012) (same); Comm. Law Corp. v. FDIC, 2016 WL 4035508 (E.D. Mich. July 28, 2016) (holding that sovereign immunity bars an award of postjudgment interest against the FDIC). Exceptions are made for qualifying securitizations in the final securitization rule. See 12 C.F.R. § 360.6(d)(4)(ii) (defining damages to include "unpaid, accrued interest through the date of repudiation").

(iv) 12 U.S.C. § 1828(k)(1) provides that the FDIC may prohibit any "golden parachute payment", which is defined as any payment or agreement to make payment for the benefit of an affiliated party pursuant to an obligation that is contingent on the party's termination and is received when the bank is insolvent, in a troubled condition or subject to the appointment of a receiver. A payment to a qualified retirement plan or one made pursuant to an approved deferred compensation plan is not a golden parachute payment. The FDIC has promulgated regulations pursuant to this provision. See 12 C.F.R. Part 359. See also Mountain Heritage Bank v. Rogers, 728 S.E.2d 914 (Ct. App. Ga. 2012) (denying severance pay as a golden parachute).

(v) Section 359.7 of these regulations provides: "The provisions of this part, or any consent or approval granted under the provisions of this part by the FDIC (in its corporate capacity), shall not in any way bind any receiver of a failed insured depository institution. Any consent or approval granted under the provisions of this part by the FDIC or any other federal banking agency shall not in any way obligate such agency or receiver to pay any claim or obligation pursuant to any golden parachute, severance, indemnification or other agreement. Claims for employee welfare benefits or other benefits which are contingent, even if otherwise vested, when the FDIC is appointed as receiver for any depository institution, including any contingency for termination of employment, are not provable claims or actual, direct compensatory damage claims against such receiver." Based on this provision, courts have denied claims for severance pay. See Cross-McKinley v. FDIC, 2013 WL 870309 (S.D. Ga. Mar. 7, 2013); Erwin v. FDIC, 2013 WL 1811924 (S.D.N.Y. Apr. 2, 2013). See also Mulholland v. FDIC, 2014 WL 2593645 (D. Co. June 9, 2014) (claims that were only payable once plaintiffs reached retirement age were barred under Section 359.7).

(d) Collateral for a repudiated claim only secures the amount of the claim upon repudiation, and no more. See, e.g., FDIC v. Mahoney, 141 F.3d 913 (9th Cir. 1998) (collateral for real estate lease); RTC v. Ford Motor Credit Corp., 30 F.3d 1384 (11th Cir. 1994) (equipment lessor entitled to no damages for repudiation of lease not entitled to collateral); Unisys v. RTC, 979 F.2d 609 (7th Cir. 1992) (same); Fleet Nat'l Bank v. FDIC, 843 F. Supp. 787 (D. Mass. 1994) (security interest in repudiated sublease); LB Credit Corp. v. RTC, 796 F. Supp. 358 (N.D. Ill. 1992) (collateral for equipment lease); LB Credit Corp. v. RTC, 1994 WL 48596 (N.D. Ill. Feb. 16, 1994) (no unconstitutional taking of pledged collateral under lease agreement where repudiation extinguished claim), aff'd 49 F.3d 1263 (7th Cir. 1995); cf. FDIC v. U.S. Trust Co., 793 F. Supp. 368 (D. Mass. 1992) (FDIC has no right to repudiate a letter of credit supporting a lease to which failed bank was a party). See also RTC v. United Trust Fund, 57 F.3d 1025 (11th Cir. 1995) (applying principle to proceeds of letter of credit drawn by lessor's assignee).

(e) Claims for damages resulting from the repudiation of a contract are, like other unsecured non-deposit claims, subordinated to the claims of depositors. See Battista v. FDIC, 195 F.3d 1113 (9th Cir. 1999) (holding that claims for damages under Section 1821(e) are subject to the distribution priority scheme set forth in Section 1821(d)).

(f) The FDIC adopted a rule, 12 C.F.R. § 360.7, governing the distribution of post-insolvency interest by receiverships with surplus funds. The rule provides that, if the receivership has surplus funds, interest on "proven creditor claims" shall be paid before any payments are made to equityholders and that the post-insolvency interest distributions are subject to the order of priority outlined in 12 U.S.C. § 1821(d)(11)(A).

4. Conservator's or Receiver's Right to Request a Stay of Judicial Actions.

(a) Although not as automatic as the Code's automatic stay, the FDIC as conservator may request, and a court shall grant, a 45-day stay of any "judicial" action to which the institution or conservator is a party, and as receiver a 90-day stay of such judicial actions. 12 U.S.C. § 1821(d)(12).

(b) At least one district court has held that this provision does not entitle the FDIC as conservator to obtain a stay against a non-judicial foreclosure on real estate. FDIC v. Columbia Sav. & Loan Ass'n, Civ. 1:89-CV-2203-JTC (N.D. Ga. Nov. 1, 1989).

5. Conservator's or Receiver's Right to Selectively Transfer Assets and Liabilities.

(a) The FDIC has the power to selectively transfer assets and liabilities, with specific exceptions for qualified financial contracts. 12 U.S.C. § 1821(d)(2)(G); see, e.g., Caires v. J.P. Morgan Chase Bank, 745 F. Supp. 2d 40 (D. Conn. 2010) (recognizing the FDIC's power to determine which assets are to be transferred and which are to be kept, but stating that liability remains with the FDIC absent a transfer thereof); Chancey v. Wash. Mut. Asset-Backed Certificates WMABS Series 2007-HE2 Trust Issuing Entity, 2010 U.S. Dist. LEXIS 77831 (D. Or. July 27, 2010) (recognizing FDIC's authority to choose not to transfer liability when it transfers related assets). This power can effectively destroy setoff rights. See, e.g., Rundgren v. Wash. Mut. Bank, F.A., 2010 WL 4960513 (D. Haw. Nov. 30, 2010) (noting that courts have uniformly held that the transferee of Washington Mutual's assets was "shielded from liability for borrower claims because liability for such claims remains with the FDIC" as receiver); In re F&T Contractors, Inc., 718 F.2d 171 (6th Cir. 1983) (holding that the FDIC as corporation could not be held liable for wrongful termination of letters of credit or for retaining collateral securing them where the FDIC as receiver had transferred its interest in the letters to the FDIC in its corporate capacity); FDIC v. Citizens Bank & Trust Co., 592 F.2d 364 (7th Cir. 1979) (holding that the Federal Tort Claims Act "withdrew the sue-and-be-sued liability of FDIC" for torts not covered by the Act), cert. denied, 444 U.S. 829 (1979); Shaffer Clark Leasing Co. v. FDIC, 1997 U.S. App. LEXIS 66 (10th Cir. 1997) (holding that company that borrowed funds from bank to purchase property that bank agreed to lease was not relieved of obligations as borrower once FDIC repudiated lease); Nashville Lodging Co. v. FDIC, 934 F. Supp. 449 (D.D.C. 1996) (borrower could not set off amounts owed under loan transferred by FDIC against damages for repudiation of related refinancing agreement by RTC); cf. Franklin Bank v. FDIC, 850 F. Supp. 845 (N.D. Cal. 1994) (holding that counterparty of failed bank could not set off amounts owed to failed bank against amounts failed bank owed it because FDIC had delivered receiver's certificate to satisfy counterparty's claim, even though payment on certificate less than 100% of claim). But see FDIC v. Marine Midland Credit Corp., 17 F.3d 715 (4th Cir. 1994) (even if bridge bank had not assumed counterclaim, claimant under participation agreement could assert recoupment). The power to transfer assets overrides contractual restrictions to the contrary. See RTC v. Charles House Condo. Ass'n, 853 F. Supp. 226 (E.D. La. 1994) (right of first refusal ineffective); StoneArch Fund IV, LLC v. Beal Bank USA, 2012 WL 1648904 (D. Min. May 2, 2012) (FDIC could transfer participation, notwithstanding contractual consent requirement); see also Waterview Mgmt. v. FDIC, 105 F.3d 696 (D.C. Cir. 1997) (right of RTC to transfer asset did not abrogate associated liability); Bank of Manhattan v. FDIC, 778 F.3d 1133 (9th Cir. 2015) (same); D-F Fund VIII, L.L.C. v. Valley Ranch Dev. Co., 1999 WL 97929 (N.D. Tex. Feb. 11, 1999) (same); Deutsche Bank Nat'l Trust Co. v. FDIC, 784 F. Supp. 2d 1142 (C.D. Cal. 2011), abrogated in part, 854 F. Supp. 2d 756, abrogation aff'd, 744 F.3d 1124 (9th Cir. 2014) (holding that the FDIA does not preempt state contract law and allowing claims for breach of contract and certain equitable claims, where FDIC did not repudiate contracts).

(i) In this regard, courts have held that the setoff of general unsecured claims would not be allowed, since this would be in derogation of a state "depositor preference" statute (i.e., a statute providing that depositors must be paid in full prior to any distribution to general unsecured non-deposit creditors). Placida Prof. Ctr., LLC v. FDIC, 512 Fed. Appx. 938 (11th Cir. 2013); FDIC v. Miller, 671 F. Supp. 1286 (D. Kan. 1987). But see FDIC v. Graham, 882 S.W.2d 890 (Tex. Ct. App. 1994) (permitting recoupment).

(ii) The FDIA provides for depositor preference in the case of all FDIC-insured institutions. 12 U.S.C. § 1821(d)(11). Accordingly, general creditors, such as unsecured derivatives creditors, are unlikely to recover anything in a receivership of an FDIC-insured institution. See, e.g., Deutsche Bank Nat'l Trust Co. v. FDIC, 744 F.3d 1124 (9th Cir. 2014) (upholding dismissal of plaintiff's claims as procedurally moot where FDIC had insufficient funds to meet "third-tier general unsecured claims"); Bith LLC v. Sardariami, , 2011 U.S. Dist. LEXIS 44830 (C.D. Cal. April 19, 2011) (dismissing plaintiff's claim as "prudentially moot because the receivership of [the insolvent entity] has insufficient funds to meet any general unsecured claims," even if plaintiff were to prevail on its claims); Rogers v. FDIC, 2011 U.S. Dist. LEXIS 62813 (E.D. Cal. June 14, 2011) (same) (recommendation of magistrate judge); cf. MVB Mortgage Corp. v. FDIC, 2010 U.S. Dist. LEXIS 68389 (S.D. Ohio June 10, 2010) (staying action pending completion of FDIC enforcement action where creditor-plaintiff would "suffer no hardship" because "the amount of unpaid depositor claims greatly outweighs the assets in the receivership estate"); Commercial Props. Dev. Corp. v. RTC, 1993 WL 541851 (E.D. La. Dec. 20, 1993) (lessor's claim for monies expended during conservatorship have priority over depositors' claims, where the claim was not deemed to be a general liability).

6. Avoidance of Preferences, Fraudulent Transfers and Other Transfers.

    (a) The FDIC may have the ability under the FDIA and other applicable law to avoid preferences, fraudulent transfers and other transfers.

        (i) 12 U.S.C. § 91, the National Bank Act preference provision, apparently applies in most cases pursuant to 12 U.S.C. § 1821(c)(2)(B), (c)(3)(B) and (c)(9)(A) (generally giving FDIC powers of conservators and receivers under other provisions of law). Section 91 voids, among others, transfers made "after the commission of an act of insolvency, or in contemplation thereof, made with a view" to prefer a creditor. 12 U.S.C. § 1828(k)(3) sets forth a parallel provision for payments to institution affiliated parties.

            (A) While most of the case law under Section 91 is relatively old, there are five relatively recent cases thereunder involving an FDIC challenge to a transfer by a national bank. Bank One, Tex., N.A. v. Prudential Ins. Co. of Am., 878 F. Supp. 943 (N.D. Tex. 1995) (pledge of collateral one year before receivership and foreclosure on collateral pursuant to ipso facto clause not preferential); First Nat'l Bank of Central Tex. v. Bank One, Tex., 1993 U.S. Dist. LEXIS 21295 (W.D. Tex. Aug. 4, 1993) (agreement tied to failure of MBank Dallas, entered into six months prior to failure, found preferential); MCorp. v. Clarke, 755 F. Supp. 1402 (N.D. Tex. 1991) (return to affiliate bank of federal funds on loan not preferential where facts did not indicate intent to create preference); MBank New Braunfels v. FDIC, 772 F. Supp. 313 (N.D. Tex. 1991) (repayment of federal funds not preferential); FDIC v. Goldberg, 906 F.2d 1087 (5th Cir. 1990) (transfer to insider on eve of insolvency void). See also FDIC v. Coleman Law Firm, No. 11 C 8823, 862 F. Supp. 2d 833 (N.D. Ill. 2012) (prepayment of legal fees under retainer agreement, made in contemplation of bank's insolvency, found preferential under Section 1821(k)(3)).

            (B) Case law is generally clear that the view to prefer is on the part of the debtor, and not the creditor, and that the creditor's knowledge or motivation is irrelevant. See, e.g., Aycock v. Bradbury, 77 F.2d 14 (10th Cir. 1935), cert. denied, 296 U.S. 589 (1935); see also FDIC v. Coleman Law Firm, 2012 WL 5429151 (N.D. Ill. Nov. 7, 2012) ("It must be remembered that the necessary 'contemplation' [under Section 1821(k)(3)] is that of the Bank . . . .").

(C) Courts have also held that this statute does not require evidence of an intent of the debtor to prefer; if the transfer has the effect of preferring a creditor, that is sufficient. FDIC v. Goldberg, 906 F.2d 1087 (5th Cir. 1990) ("The FDIC need not offer any evidence of intent to prefer if it is clear that the effect of the transaction is to grant a preference."); FDIC v. Coleman Law Firm, 862 F. Supp. 2d 833 (N.D. 2012) ("Whether a bank intends to prefer a certain creditor is irrelevant-only the preferential effect of the transfer matters.") (citing Goldberg).

(D) There is no "preference period" under the National Bank Act provision as under Section 547 of the Code.

(E) Cf. FDIC Advisory Opinion 91-2 (January 11, 1991) regarding "ordinary course of business" exception to the National Bank Act preference provision.

(ii) 12 U.S.C. § 1821(e)(12) provides that "[n]o provision of this subsection [repudiation of contracts] shall be construed as permitting the avoidance of any legally enforceable or perfected security interest in any of the assets of any depository institution except where such an interest is taken in contemplation of the institution's insolvency or with the intent to hinder, delay, or defraud the institution or the creditors of such institution." (emphasis added) There is a statutory exception for qualified financial contracts.

(A) While the provision could be viewed as affirmatively giving the FDIC the power to avoid transfers "taken" in contemplation of insolvency or with intent to hinder, delay or defraud, the provision should be viewed as a "savings" clause, i.e., even though the power to repudiate is not the power to avoid a security interest, this anti-avoidance provision does not derogate from those powers the FDIC may have to avoid transfers in contemplation of insolvency or actual intent fraudulent transfers.

(B) The RTC Policy Statement on Collateralized Borrowings supports this reading, as do certain statements in a memorandum of law filed by the RTC in IBJ Schroder Bank & Trust Co. v. RTC, 803 F. Supp. 878 (S.D.N.Y. 1992), rev'd on other grounds, 26 F.3d 370 (2d Cir. 1994). See also RTC v. Cheshire Mgmt. Co., 18 F.3d 330 (6th Cir. 1994), discussed infra. But see Comm. Law Corp. v. FDIC, 777 F.3d 324 (6th Cir. 2015) (suggesting that the provision gives the FDIC an affirmative avoidance power).

(iii) As noted above, the FDIC may have the ability under state law to avoid preferences, fraudulent transfers and other transfers. See, e.g., Section 381.74 of Title 18 of Oklahoma statutes (State Banking Commissioner may, in connection with liquidation or reorganization of an Oklahoma-chartered savings association, void any lien, other than an attorney's lien or mechanic's lien, obtained within four months of the Commissioner's taking of possession of the association, apparently even if taken for contemporaneous value and not on account of an antecedent debt).

7. Expedited Procedures for Determination of Secured Claims.

(a) The FDIA contains certain claims procedures, including "expedited" procedures for the determination of certain secured claims. 12 U.S.C. § 1821(d)(5)–(8). The effect of the claims procedures may be to delay judicial review. See, e.g., Rosa v. RTC, 938 F.2d 383 (3d Cir. 1991) (observing that the statutory exhaustion requirement is a subject-matter jurisdictional bar to judicial review), cert. denied, 502 U.S. 981 (1991). The Second and Third Circuits have held that the claims procedures apply to a claim "secured" by an attorney's retaining lien. See RTC v. Elman, 949 F.2d 624 (2d Cir. 1991); FDIC v. Shain, Schaffer & Rafanello, 944 F.2d 129 (3rd Cir. 1991).

8. Foreclosure on Property of the FDIC.

(a) The FDIA contains a provision, 12 U.S.C. § 1825(b)(2), requiring FDIC consent to foreclosure on property of the FDIC. See Portfolio FB-Idaho, LLC v. FDIC, 2011 U.S. Dist. LEXIS 14258 (D. Idaho Feb. 13, 2011) (holding that a portfolio assignment and lis pendens against the FDIC were improper because the FDIC never consented to the relevant proceedings). The FDIC and RTC have issued policy statements giving their consent to foreclosure in certain instances.

9. The Written Agreement and Related Requirements.

(a) See 12 U.S.C. §§ 1821(d)(9), (n)(4)(I) and 1823(e) .

(b) These provisions essentially codify the common-law D'Oench doctrine. D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) (holding under federal common law that secret agreements designed to deceive creditors or the FDIC or that would tend to have that effect may not be the basis for claims against the FDIC (or defenses thereto)). The doctrine, however, is not co-extensive with the statute. See, e.g., E.I. Du Pont de Nemours and Co. v. FDIC., 32 F.3d 592 (D.C. Cir. 1994) (noting that courts continue to apply the common-law D'Oench doctrine for cases that "do not fit neatly into one of the statutory provisions"), reh'g denied, 95 F.3d 458 (D.C. Cir. 1995); Acciard v. Whitney, 2010 U.S. Dist. LEXIS 143332 (M.D. Fla. Sept. 17, 2010) (referring to Section 1823(e) as the codification of the D'Oench doctrine, but noting that the two do not completely overlap). The viability of the common-law doctrine is questionable after the Supreme Court's decision in O'Melveny, infra. In fact, the federal circuit courts of appeals are currently split on the issue of whether the D'Oench doctrine is still applicable common law. Compare FDIC v. Deglau, 207 F.3d 153 (3d Cir. 2000) (D'Oench no longer applicable); DiVall Insured Income Fund, L.P. v. Boatmen's First Nat'l Bank of Kansas City, 69 F.3d 1398 (8th Cir. 1995) (same); and Murphy v. FDIC, 61 F.3d 34 (D.C. Cir. 1995) (same), with Murphy v. FDIC, 208 F.3d 959 (11th Cir. 2000) (D'Oench still good law), cert. granted sub nom. Murphy v. Beck, 530 U.S. 1306 (2000), and following settlement cert. dismissed, 531 U.S. 1107 (2001); Fed. Fin. Co. v. Hall, 108 F.3d 46 (4th Cir. 1997) (noting prior holdings that D'Oench still applies); and Inn at Saratoga Assocs. v. FDIC, 60 F.3d 78 (2d Cir. 1995) (applying D'Oench).

(c) 12 U.S.C. § 1823(e) provides that any agreement that diminishes the right, title or interest of the FDIC in an asset:

(i) must be in writing;

(ii) must be executed by depository institution and counterparty contemporaneously with the acquisition of the asset by the depository institution;

(iii) must be approved by Board of Directors or Loan Committee of the depository institution and reflected in minutes of such committee; and

(iv) must be maintained continuously, since the time of execution, as an official record of the depository institution.

(d) In Langley v. FDIC, 484 U.S. 86 (1987), the U.S. Supreme Court held that "[a] condition to payment of a note, including the truth of an express warranty, is part of the 'agreement' to which the writing, approval, and filing requirements of 12 U.S.C. § 1823(e) attach." See also Bonhomme Investment Partners v. FDIC, 2013 WL 12143972 (W.D. Mo. Oct. 29, 2013) ("Every appellate court to squarely address this issue . . . has determined that, under Langley, omissions as well as misrepresentations constitute agreements for the purpose of section 1823(e), in that claims based on omissions are premised on an implied warranty of good faith and fair dealing."). But see Fields v. Emmerich, 2014 WL 12599817 (D. Minn. Apr. 30, 2014) (holding that Section 1823(e) did not bar claims of fraud in the factum and absence of consideration because the success of either such claim would render the relevant agreement void and, in the absence of the agreement, there would be "no asset or interest to which § 1823 can apply").

(e) 12 U.S.C. § 1821(d)(9) provides that an agreement that fails to comply with 12 U.S.C. § 1823(e) shall not form the basis of, or substantially comprise, a claim against the receiver or the FDIC in its corporate capacity.

(i) 12 U.S.C. § 1821(d)(9) expands the application of these requirements from the traditional "holder-in-due-course" type cases in which an obligor on a note asserts an unwritten side agreement against the FDIC to affirmative claims against the FDIC. Cf. AFSCME v. FDIC (In re NBW Commercial Paper Litig.), 826 F. Supp. 1448 (D.D.C. 1992) (Section 1821(d)(9) did not bar fraud and Securities Act claims, but fraud claims were barred under D'Oench).

(f) Several courts have commented on the "asset" requirement of Section 1823(e). See Comm. Law Corp. v. FDIC, 777 F.3d 324 (6th Cir. 2015) (claims by law firm for unpaid attorney's fees under unrecorded fee arrangement not subject to Section 1823(e) or D'Oench); John v. RTC, 39 F.3d 773 (7th Cir. 1994) (deception in thrift's sale of home not barred by statute when only asset thrift received in non-loan transaction was cash); Murphy v. FDIC, 38 F.3d 1490 (9th Cir. 1994) (en banc) (letter of credit a liability, not an asset); E.I. Du Pont de Nemours and Co. v. FDIC, supra (escrow agreement, extended by conduct of parties, was not an asset of bank); In re Imperial Capital Bancorp, Inc., 492 B.R. 25 (S.D. Cal. 2013) (obligations of bank to reimburse holding company for payments that holding company pays to satisfy bank's tax obligations not subject to Section 1823(e)); Sung v. Mission Valley Renewable Energy, LLC, 930 F. Supp. 2d 1234 (E.D. Wa. 2013) (claims against bank for misrepresentations and omissions that caused customer to make certain investments were not barred by Section 1823(e)); Outsource Serv. Mgmt v. Ginsburg, 2010 U.S. Dist. LEXIS 129290, at *30-31 (D. Minn. Dec. 7, 2010) (finding the FDIC's "right, title, and interest as Lender" under Loan and Guaranty Agreements are "assets within the scope of § 1823(e)" to disallow claims and defenses for fraudulent inducement). See also Thigpen v. Sparks, 983 F.2d 644 (5th Cir. 1993) (Section 1823(e) does not apply to a bank's sale of an asset in a non-banking transaction because the sale of an asset could not be viewed as an agreement which tends to diminish or defeat the interests of the FDIC in an asset acquired by it and such an agreement cannot be contemporaneous with the bank's acquisition of an asset). Cf. FDIC v. Great Am. Ins. Co., 607 F.3d 288 (2d Cir. 2010) (fidelity bond constitutes an "asset" under Section 1823(e) but allowing assertion of misrepresentation defense where the rights of rescission were apparent from the face of the bond). But see FDIC v. Bryan, 171 F. Supp. 3d 1374 (N.D. Ga. 2016) (directors and officers liability insurance is an asset subject to Section 1823(e)). However, a number of courts have held that the asset limitation does not apply to the common-law D'Oench doctrine. See, e.g., Brookside Assocs. v. Rifkin, 49 F.3d 490 (9th Cir. 1995); Motorcity of Jacksonville, Ltd. v. Southeast Bank, N.A., 83 F.3d 1317 (11th Cir. 1996) (en banc), vacated on other grounds, Hess v. FDIC, 519 U.S. 1087, reinstated, 12 F.3d 1140 (11th Cir. 1997) (collecting cases).

See also the FDIC's discussion of the "asset" requirement in the policy statement referred to in V.B.9(m) below (suggesting that the asset requirement does not limit the application of Section 1821(d)(9)).

(g) Some courts have held that Section 1823(e) only applies to traditional banking or loan activities. See, e.g., John v. RTC, 39 F.3d 773 (7th Cir. 1994) (stating that "[b]y its language § 1823(e) applies only to conventional loan activities" and refusing to apply the provision to the sale of a house); see also Thigpen v. Sparks, 983 F.2d 644 (5th Cir. 1993) (Section 1823(e) does not apply to the sale of an asset in a non-banking transaction).

(h) Assignees of the FDIC as receiver are protected by these requirements, even though section 1823(e) is silent with respect to assignees. See, e.g., Kuhlmann v. Sabal Fin. Grp., 26 F. Supp. 3d 1040 (W.D. Wash. 2014) ("While the language of section 1823(e) mentions only the FDIC, federal courts have consistently explained that a private entity that purchases the assets of a failed institution from the FDIC is protected against side agreements between a debtor and original lender to the same extent as the FDIC, even though the literal language of section 1823(e) and D'Oench, Duhme does not so provide.") (internal quotation marks omitted); Fed. Fin. Co. v. Hall, 108 F.3d 46 (4th Cir. 1997); Bell & Murphy Assocs., Inc. v. Interfirst Bank Gateway, N.A., 894 F.2d 750 (5th Cir. 1990); FDIC v. Newhart, 892 F.2d 47 (8th Cir. 1989); ORL, LLC v. Hancock Bank, 2011 U.S. Dist. LEXIS 57487 (M.D. Fla. May 27, 2011); Magdaleno v. Indymac Bancorp, Inc., 853 F. Supp. 2d 983 (E.D. Cal. 2011); Hayes-Broman v. J.P. Morgan Chase Bank, 724 F. Supp. 2d 1003 (D. Minn. 2010); Caires v. JP Morgan Chase Bank, 745 F. Supp. 2d 40 (D. Conn. 2010); AAI Recoveries, Inc. v. Pijuan, 13 F. Supp. 2d 448 (S.D.N.Y. 1998); Brickwell Cmty. Bank v. Wycliff Associates II, LLC, A10-1396, 2011 Minn. App. Unpub. LEXIS 291 (Minn. Ct. App. April 5, 2011). See also Bank of the Ozarks v. Coty, 2012 WL 6184528 (S.D. Ga. Dec. 11, 2012) ("The Eleventh Circuit has not decided whether § 1823(e)(1) applies just to the FDIC, or whether it also applies to a bank that succeeds the FDIC, like Bank of the Ozarks. However, the D'Oench doctrine does apply to a successor-in-interest.").

(i) Courts have applied the written agreement requirements to claims against subsidiaries of insured institutions in FDIC conservatorship or receivership. See, e.g., Robinowitz v. Gibraltar Sav., 23 F.3d 951 (5th Cir. 1994); Sweeney v. RTC, 16 F.3d 1 (1st Cir. 1994); Oliver v. RTC, 955 F.2d 583 (8th Cir. 1992); Victor Hotel Corp. v. FCA Mortgage Corp., 928 F.2d 1077 (11th Cir. 1991); SJ Props. Suites v. Specialty Fin. Grp., 864 F. Supp. 2d 776 (E.D. Wis. Mar. 30, 2012); FDIC v. Banks, 1996 U.S. Dist LEXIS 5682 (E.D. Pa. April 30, 1996). But see Lesal Interiors, Inc. v. Echotree Assocs. L.P., 47 F.3d 607 (3rd Cir. 1995) (holding that Section 1823(e) was inapplicable to claims against a subsidiary and distinguishing the foregoing cases as cases where both D'Oench and section 1823 were invoked); cf. Sahni v. Am. Diversified Partners, 83 F.3d 1054 (9th Cir. 1996) (Section 1821(j), which prohibits judicial restraints on the FDIC's exercise of powers as receiver, applied to attempt to rescind sale of assets of failed bank's subsidiary); Robinson v. RTC (In re Landmark Land), 1997 U.S. App. LEXIS 6476 (4th Cir. 1997) (saying that anti-injunction statute would not apply to FDIC's seizure of trust's assets where FDIC had no authority to seize such assets). Courts have also applied the requirements to claims involving contracts assigned to a bank or thrift prior to its failure. See, e.g., FDIC v. Hoover-Morris Enters., 642 F.2d 785 (5th Cir. 1981).

(j) In North Arkansas Med. Ctr. v. Barrett, 962 F.2d 780 (8th Cir. 1992), the Eighth Circuit held that a security agreement forming the basis of a secured creditor's claim must meet the written agreement requirements.

(i) Acknowledging that the written agreement requirements had originally arisen out of the bank's lending function, the court nevertheless found that application of the doctrine to security agreements was consistent with the law's purpose of protecting a bank's assets, permitting the FDIC to respond quickly to a bank failure and preventing collusion between bank employees and favored customers.

(ii) Despite press reports to the contrary, the court did not appear specifically to consider whether the contemporaneity test would require that the grant of the security interest in the collateral by the bank occur contemporaneously with the bank's acquisition of the collateral, although there is language in the opinion to this effect. Instead, an examination of the lower court decision and the FDIC's briefs indicate that, although the creditor had a non-possessory 21-day security interest perfected under state law (an aggressive holding), there was no writing sufficient to meet the written agreement requirements. The FDIC did not raise the contemporaneity point and the Court did not seem to analyze it.

(k) On March 23, 1993, the FDIC adopted a policy statement (available at https://www.fdic.gov/regulations/laws/rules/5000-3500.html#fdic5000statementop8) designed to address concerns raised by North Arkansas.

(i) According to the statement, if, in general, a security agreement is undertaken in the ordinary course of business for adequate consideration as an arm's length transaction, then the FDIC as conservator or receiver will not seek to avoid an otherwise legally enforceable and perfected security interest solely because the collateral subject to the security interest "(a) was not acquired by the financial institution contemporaneously with the approval and execution of the security agreement granting the security interest and/or (b) may change, increase, or be subject to substitution from time to time during the period that the security interest is enforceable and perfected."

(A) Notwithstanding this statement, however, the FDIC stated its intention to retain the right to redeem or prepay any secured obligation of a financial institution by repudiation or otherwise.

(ii) This policy statement is consistent with advisory opinions issued by the FDIC on December 15, 1989 and April 2, 1991.

(iii) Perhaps a creditor's concern in this connection should not be so much with the FDIC, but with third parties who, in several holder-in-due-course type cases, have succeeded in asserting, as successor to the FDIC (by asset purchase), the written agreement requirements and D'Oench. See, e.g., Bell & Murphy & Assocs. v. Interfirst Bank Gateway, N.A., 894 F.2d 750 (5th Cir. 1990).

(l) Statements in North Arkansas were characterized as "broad dicta" in Thigpen v. FDIC, 983 F.2d 644 (5th Cir. 1993).

(m) The FDIC issued a policy statement regarding the written agreement requirements that contains "Guidelines for Use of D'Oench and Statutory Provisions" that, according to the FDIC, are "discretionary and evolving by nature but nevertheless will serve to moderate the circumstances" in which the FDIC will enforce the written agreement requirements. See Statement of Policy Regarding Federal Common Law and Statutory Provisions Protecting FDIC, As Receiver or Corporate Liquidator, Against Unrecorded Agreements or Arrangements of a Depository Institution Prior to Receivership (Feb. 4, 1997), available at https://www.fdic.gov/regulations/laws/rules/5000-4300.html#fdic5000statementop12. Among other things, the Guidelines provide that D'Oench and the statutory provisions may not be asserted without Washington approval where the "borrower or claimant took all reasonable steps to document and record the agreement or understanding with the institution and there is no evidence that the borrower or claimant participated in some activity that could likely result in deception of banking regulators, examiners, or the FDIC regarding the assets or liabilities of the institution."

10. No Supplemental Federal Common Law.

(a) The Supreme Court ruled that there is generally no federal common law that supplements the FDIC's rights as receiver, and, therefore, the FDIC steps into the shoes of the insolvent institution and obtains no greater rights than the institution, other than those specified in the FDIA and other relevant receivership statutes. O'Melveny & Myers v. FDIC, 512 U.S. 79 (1994). Cf. Solomon v. RTC, 513 U.S. 801 (1994) (remand on basis of O'Melveny of case involving repudiation of rent-controlled lease). See also Atherton v. FDIC, 519

U.S. 213 (1997) (holding that no federal common law governs the duty of care of a bank's officers and directors, abrogating an 1890s case setting forth federal common law corporate governance standards applicable to federally chartered banks, because there was not a significant conflict between a federal policy and state law).

11. Letters of Credit.

(a) In Murphy v. FDIC, 38 F.3d 1490 (9th Cir. 1994), the Ninth Circuit vacated its earlier decision in which it had held that a letter of credit issued by a failed bank was not enforceable because the reimbursement obligation was not collateralized in accordance with federal banking statutes.

12. Custodial Property.

(a) A Report on the treatment of custodial margin, which, among other things, addresses the treatment of customer property under the FDIA is available at https://www.newyorkfed.org/medialibrary/media/markets/Full_Report.pdf.

(b) The Eleventh Circuit recently held that the FDIA's anti-injunction provision requires a financial participant with a security interest in property to pursue its claims through the FDIC administrative claims process. Bank of America N.A. v. Colonial Bank, 604 F.3d 1239 (11th Cir. 2010) (bank denied an injunction prohibiting the disposition of certain mortgage loans and loan proceeds held in custodial trust by debtor). However, the Second Circuit recently held that holders of notes issued by a still solvent trust are not subject to the administrative claims process where they assert no claims against the debtor or against the FDIC. Bank of New York v. First Millennium, Inc., 607 F.3d 905 (2d Cir. 2010) (finding jurisdiction over claim against trust established to generate funds by defunct online credit card issuer NextBank, N.A.).

C. Exceptions for Qualified Financial Contracts.

There are several statutory and regulatory exceptions from the foregoing provisions in the case of QFCs.

1. Transactions Covered.

(a) Securities Contracts.

(i) The 2005 Act and the 2006 Act rendered the definition of "securities contract" in the FDIA consistent with that in the Code, except that the definition in the Code, unlike that in the FDIA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 11(e)(3) of the FDIA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(A) The court in Norwood Joint Venture v. RTC, Civil Action No. 89-2-950 (D. Colo. Feb. 15, 1990), concluded that a mortgage loan was itself a securities contract. Facts in that case were unusual, however, and the case involved allegations that there were tying arrangements that included mortgage loans. Under a more conventional set of facts, the court in Heiko v. FDIC, 1995 U.S. Dist. LEXIS 3407 (S.D.N.Y. Mar. 15, 1995), citing a prior version of this outline, held that a mortgage refinancing agreement was not a QFC because it was not bought or sold in a secondary market. See also FDIC v. Parent Funding Corp., 1996 WL 180196 (6th Cir. Apr. 15, 1996) (mortgage servicing agreement not a qualified financial contract); Deutsche Bank Nat. Trust Co. v. FDIC, 784 F. Supp. 2d 1142 (C.D. Cal. 2011) (holding that the portion of a pooling and servicing agreement that effected a transfer of mortgage loans is a QFC, but the portion of the agreement transferring the servicing functions was not); Nashville Lodging Co. v. FDIC, 934 F. Supp. 449 (D.D.C. 1996) (refinancing agreement was not a securities contract); Conroy v. FDIC, 1995 U.S. Dist. LEXIS 14888 (D. Mass. Sept. 15, 1995) (mortgage not a securities contract); First Fed. Sav. Bank v. Mount Maumee P'ship, 1994 Conn. Super. LEXIS 1461 (Conn. Super. Ct. June 6, 1994) (loan transaction not a securities contract); cf. Colonial Savings, F.A. v. Public Service Employees Credit Union, 2010 U.S. Dist. LEXIS 6707 (D. Colo. Jan. 27, 2010) (under analogous provisions of FCUA, loan servicing agreements do not qualify as QFCs where they do not create a partial interest in the underlying loans, but only create interest in fees for services).

(b) Forward Contracts.

(i) Made consistent with the Code definition by the 2005 Act and the 2006 Act, except that the definition in the Code, unlike that in the FDIA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 11(e)(3) of the FDIA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(c) Commodity Contracts.

(i) Made consistent with the Code definition by the 2005 Act, except that the definition in the Code, unlike that in the FDIA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 11(e)(3) of the FDIA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(d) Repurchase Agreements.

(i) Made consistent with the Code definition by the 2005 Act, except that the definition in the Code, unlike that in the FDIA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 11(e)(3) of the FDIA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(A) An FDIC regulation, 12 C.F.R. 360.5, provides that certain repurchase agreements involving qualified foreign government securities constitute "repurchase agreements". This regulation is redundant in light of the 2005 Act.

(e) Swap Agreements.

(i) Made consistent with the Code definition by 2005 Act and the 2006 Act, except that the definition in the Code, unlike that in the FDIA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 11(e)(3) of the FDIA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

2. Covered Parties.

Unlike under the Code, <u>any</u> counterparty to a QFC is entitled to the benefits of the QFC provisions.

3. Benefits of QFC Status.

(a) Exercise of Certain Rights—Generally.

(i) The QFC provisions protect the exercise of certain "self-help" rights to terminate and liquidate QFCs, rights under security arrangements in connection with QFCs, and offset and netting rights in connection with QFCs. However, the QFC provisions do not, for example, protect the right of a purchaser of securities under a hold-in-custody repo to compel delivery of the securities from the FDIC as conservator or receiver.

(ii) The FDIA does not expressly require that rights be contractual rights. Even though the FDIA does not require that rights be contractual, the written agreement requirements may make contractual rights necessary in order to benefit from the QFC protections. <u>Cf.</u> <u>FDIC v. State Bank of Virden</u>, 893 F.2d 139 (7th Cir. 1990) (setoff denied because of failure to comply with 12 U.S.C. § 1823(e)); <u>OCI Mortgage Corp. v. Marchese</u>, 774 A.2d 940 (Conn. 2001) (same).

(iii) Status as a QFC does not, as a general matter, give the creditor rights it does not possess under contract or applicable law, does not compel specific performance on the part of the FDIC and does not elevate an unsecured claim to secured status.

(b) When Exercise of Rights Is Protected.

(i) Conservatorship –

(A) QFC provisions expressly protect exercise of liquidation, termination, netting and offset rights in the event of a default "enforceable under applicable non-insolvency law" by a conservator, except for a default "solely by reason of or incidental to the appointment of a conservator for the depository institution (or the insolvency or financial condition of the depository institution for which the conservator has been appointed)."

(ii) Receivership –

(A) QFC provisions expressly protect exercise of liquidation, termination, netting and offset rights unless receiver transfers all QFCs between counterparty, its affiliates and the failed institution to another financial institution and provides notice of the transfer to the counterparty by 5 p.m. on the business day following the receiver's appointment. The 2005 Act clarifies that such liquidation, termination, netting and offset rights cannot be exercised solely due to the appointment of a receiver if by 5 p.m. on the business day following the receiver's appointment the creditor receives the notice of transfer to another financial institution. In addition, under the 2005 Act, a depository institution transferee cannot be a foreign financial institution or a branch or agency of a foreign financial institution unless the laws applicable to such financial institution, branch or agency related to qualified financial contracts are enforceable substantially to the same extent as under the FDIA.

(B) A counterparty, upon learning of a receivership, should generally take steps to ascertain the FDIC's intentions with respect to QFCs.

(C) In addition, counterparties have often received transfer notices long after a receivership occurs, due to lack of internal procedures at counterparties designed to route the notices to the responsible parties. (Often, the notices are sent to the person designated in the notice provisions of a QFC, and that person may no longer be with the firm.) Counterparties might therefore consider streamlining internal procedures and checking notice provisions in QFCs.

(D) In the case of unsecured swaps with Home Savings, the RTC, after sending a notice of transfer, sent counterparties a notice indicating that a mistake had been made and that no transfer had in fact occurred.

(E) The 2005 Act amended the notice of transfer provisions of the FDIA to clarify that the FDIC, acting as conservator or receiver, will notify a counterparty of a transfer by 5 p.m. (eastern time) on the business day following the date of the appointment of the receiver in the case of a receivership, or the business day following the transfer in the case of a conservatorship. 12 U.S.C. § 1821(e)(10)(A). A counterparty is deemed to have been notified of a transfer if the FDIC has "taken steps reasonably calculated to provide notice to such person by the time specified in [subsection 11(e)(10)(A) of FDIA]." 12 U.S.C. § 1821(e)(10)(B)(iii).

(c) Transfer of QFCs: "All or None."

(i) The receiver is required to transfer all or no QFCs between a counterparty and its affiliates and a failed institution. This is designed to preserve cross-collateralization, setoff and netting rights, <u>but</u> a counterparty may need a contractual agreement (meeting the written agreement requirements) to rely on such rights.

(ii) The concern that a conservator or receiver could selectively repudiate QFCs has been remedied by 12 U.S.C. § 1821(e)(11), which mandates that the conservator or receiver shall disaffirm or repudiate either all or none of the QFCs.

(d) Calculation of Damages.

(i) Although a conservator or receiver <u>is</u> entitled to repudiate QFCs, the damages in that event are measured as of date of repudiation, and expressly include reasonable costs of cover.

(e) "Walkaway" Clauses.

(i) The 2006 Act amended the anti-"walkaway clause" of the FDIA to clarify the ability of the FDIC, as receiver, to enforce contracts, and revised the definition of walkaway clauses.

12 U.S.C. § 1821(e)(8)(G)(ii) states that in the case of QFCs of an insured depository institution in default, any payment or delivery obligations otherwise due from a party pursuant to the QFC shall be suspended from the time the receiver is appointed until the earlier of (I) the time such party receives notice that such contract has been transferred pursuant to 12 U.S.C. § 1821(e)(8)(A); or (II) 5:00 p.m. (eastern time) on the business day following the date of the appointment of the receiver.

12 U.S.C. § 1821(e)(8)(G)(iii) defines the term "walkaway clause" to mean any provision in a QFC that suspends, conditions or extinguishes a payment obligation of a party, in whole or in part, or does not create a

payment obligation of a party that would otherwise exist, solely because of such party's status as a nondefaulting party in connection with the insolvency of an insured depository institution that is a party to the contract or the appointment of or the exercise of rights or powers by a conservator or receiver of such depository institution, and not as a result of a party's exercise of any right to offset, set off or net obligations that exist under the contract, any other contract between those parties or applicable law.

(f) Fraudulent Transfers.

(i) Unless the FDIC determines that a transfer (as now defined in FDIA) was taken with actual intent to hinder, delay or defraud creditors, that transfer may not be avoided under 12 U.S.C. § 1821(e)(12). See RTC v. Cheshire Mgmt. Co., 18 F.3d 330 (6th Cir. 1994) (anti-avoidance provision did not apply to post-receivership judgment lien). (Cheshire contains a good discussion of the QFC provisions of the FDIA.) In this regard, see also FDIC v. McFarland, 243 F.3d 876 (5th Cir. 2001) (declining to extend the principle in Cheshire to assignees of the FDIC or RTC); GWN Petrol. Corp. v. OK-Tex Oil & Gas, Inc., 998 F.2d 853 (10th Cir. 1993) (no garnishment of mineral rights proceeds in the hands of the FDIC); Midlantic Nat'l Bank/North v. Fed. Reserve Bank of N.Y., 814 F. Supp. 1195 (S.D.N.Y. 1993) ("restraining notice" not equivalent to a lien giving creditor priority); Stebbins Realty Corp. v. FDIC, 1994 WL 312916 (D.N.H. June 29, 1994) (pre-judgment attachment valid against FDIC).

(g) FDIC and RTC Policy Statements on the Written Agreement Requirements.

(i) These policy statements (the FDIC statement is available at https://www.fdic.gov/regulations/laws/rules/5000-1100.html) provide that if the following steps are taken, a QFC (and any ancillary agreement) or a "fed funds" transaction will be deemed to be in compliance.

(A) The QFC or "fed funds" transaction must be evidenced by a writing (which can be a confirmation, and which need not be signed unless otherwise required by applicable non-insolvency law) that is sent reasonably contemporaneously with the transaction.

(B) The QFC or "fed funds" counterparty relies in good faith on evidence of depository institution's authority to enter into transaction.

(1) Such evidence can consist of an extract of a board resolution, or a written representation by a depository institution official of rank of vice president or higher.

(C) The counterparty has copies of documents used to meet requirements of (A) and (B).

(ii) The policy statements do not define "fed funds" transaction.

(iii) The policy statements do not, however, eliminate other concerns, such as state statutes of fraud or concerns based on a depository institution's lack of authority to enter into a transaction.

(iv) The FDIC and RTC proposed regulations regarding QFCs that have not yet been published for comment. 58 F.R. 25412 (1993) (to be codified at 12 C.F.R. Section 1622).

VI. Insolvency of Systemically Significant Companies Under OLA.

A. Governing Law.

1. The Orderly Liquidation Authority provisions of Title II of Dodd-Frank could apply to insolvent financial companies that are systemically significant, i.e., whose insolvency under otherwise applicable insolvency law would have serious adverse effects on financial stability in the United States. The FDIC has adopted a rule, 12 C.F.R. § 380, to establish a framework for its implementation of OLA (the "OLA Rule"). An alert memorandum summarizing the key issues in the OLA Rule is available at https://www.clearygottlieb.com/news-and-insights/publication-listing/the-fdics-final-rule-implementing-certain-provisions-of-orderly-liquidation-authority.

(a) OLA applies only to "financial companies." A financial company is one that is incorporated or organized under U.S. federal or state law and is any of the following:

(i) A bank holding company;

(ii) A nonbank financial company that is regulated by the Federal Reserve Board as systemically significant; or

(iii) A company that is predominantly engaged in activities that the Federal Reserve Board has determined are financial in nature under § 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1843(k)).

(b) OLA does not apply to FDIC-insured banks, government sponsored entities (such as Fannie Mae and Freddie Mac) or state-regulated insurance companies. However, if the relevant state regulatory agency fails to place an insurance company that is systemically significant or is a subsidiary or affiliate of a systemically significant company into liquidation under state law, the FDIC can file a judicial action to place the company into liquidation under state law. See Dodd-Frank § 203(e)(3) ("Backup Authority"). On April 30, 2012, the FDIC issued a final rule providing that a mutual insurance holding company will be treated as an insurance company for the purposes of Section 203(e) of Dodd-Frank. 12 C.F.R. § 380.11; 77 Fed. Reg. 25,349.

(c) OLA only applies to certain "covered" financial companies ("CFCs"). The Secretary of the Treasury—after a recommendation by the Federal Reserve Board and FDIC (or the SEC in the case of broker-dealers or financial companies whose largest U.S. subsidiary is a broker-dealer and the Federal Insurance Office in the case of insurance companies or financial companies whose largest U.S. subsidiary is an insurance company)—must make a systemic risk determination that each of the following conditions are satisfied:

(i) The financial company is in default or in danger of default;

(ii) The failure of the financial company and its resolution under other insolvency law would have serious adverse effects on financial stability in the United States;

(iii) There is no viable private sector alternative to prevent default; and

(iv) The effect of orderly liquidation on the interests of creditors, counterparties and shareholders of the financial company is appropriate in light of the beneficial impact on financial stability.

(d) OLA could apply to all U.S. and state-organized systemically significant subsidiaries of the CFC.

(i) Exception – OLA does not apply to subsidiaries that are FDIC-insured banks or insurance companies.

(e) The FDIC has issued a rule setting forth the standard for determining whether a company is predominately engaged in activities that the Federal Reserve Board has determined are financial in nature under § 4(k) of the Bank Holding Company Act of 1956 (12 U.S.C. § 1843(k)). See 12 C.F.R. § 380.8.

B. Parallels and Differences between the FDIA and OLA, and between the Code and OLA.

1. OLA is largely modeled on the receivership provisions of the FDIA. Case law and regulatory interpretations and positions regarding provisions of the FDIA that also appear in OLA may be relevant to the interpretation of OLA. We do not repeat the analysis under the FDIA of such case law and regulatory interpretations and positions. See Part V, above.

(a) Like the FDIA, OLA authorizes FDIC receivership of insolvent financial companies.

(b) Unlike the FDIA, OLA has no conservatorship provisions.

(c) Except where noted, the provisions of OLA discussed below are identical or nearly identical to the provisions of the FDIA.

(d) Although OLA provides that creditors are to receive, at a minimum, what they would receive in a liquidation under the Code (or otherwise applicable insolvency law) (Dodd-Frank § 210(a)(7)(B)), it is unclear how that provision squares with the many specific provisions of OLA that provide for different treatment of creditors than under the Code. The OLA Rule does not address this issue.

2. In promulgating the final version of the OLA Rule, the FDIC noted that harmonization with the Code is not possible with respect to the judicial review provisions. See 76 Fed. Reg. 41,626, 41,637 (July 15, 2011).

C. Provisions of OLA Impair Creditors' Rights.

1. Receiver's Right to Enforce Contracts and Stay Remedial Actions.

(a) Even though OLA does not contain a Code-like automatic stay, the FDIC as receiver has the ability to enforce contracts, notwithstanding contractual provisions providing for termination, default, acceleration or exercise of rights upon insolvency or appointment of or the exercise of rights or powers by a receiver. Dodd-Frank § 210(c)(13). In addition, no person may exercise any right or power to terminate, accelerate or declare a default under any contract to which the CFC is a party, or to obtain possession of or exercise control over any property of the CFC or affect any contractual rights of the CFC, without the consent of the receiver, as appropriate, during the 90-day period beginning on the date of the appointment of the receiver. The OLA Rule contains procedures for obtaining such consent to foreclose on collateral. If the FDIC has not acted on the request for consent to foreclose on collateral within 30 days, consent is deemed granted under the OLA Rule. The OLA Rule also provides for "adequate protection" if the FDIC uses collateral. 12 C.F.R. §§ 380.51–380.52. Despite commenters' suggestion in a comment letter to the FDIC that "adequate protection" be clarified, no such clarification is included in the OLA Rule.

(b) There are statutory exceptions for, among other things, QFCs (discussed below), netting contracts under FDICIA and Federal Reserve Bank extensions of credit.

(c) The FDIC can enforce contracts to lend or purchase securities of the debtor, unlike under § 365(c)(2) of the Code. OLA provides that any post-receivership credit extended has administrative expense priority. Dodd-Frank § 210(c)(13)(D).

(d) OLA contains a provision, Dodd-Frank § 210(q)(1)(B), requiring FDIC consent to foreclosure on property of the FDIC as receiver. In the context of the identical FDIA provision, the FDIC issued a policy statement giving its consent to foreclosure in certain instances. See Statement of Policy on Foreclosure Consent and Redemption Rights, 57 Fed. Reg. 29491 (July 2, 1992). The FDIC staff memorandum accompanying the OLA Rule states that the FDIC will issue a similar policy statement granting advance consent. Pending that policy statement, secured non-QFC creditors will be subject to an indefinite stay.

(e) OLA renders ipso facto clauses unenforceable for 90 days, and perhaps longer. Dodd-Frank § 210(c)(13)(A), (C).

(f) OLA renders cross-defaults (including in QFCs) unenforceable in respect of guarantees in certain circumstances. Dodd-Frank § 210(c)(16). This provision is premised on a transfer of the guarantee to a bridge or solvent third party or "adequate protection" otherwise being provided. On October 16, 2012, the FDIC issued a final rule to implement Section 210(c)(16) of OLA as it relates to the treatment of certain subsidiary and affiliate cross-defaults. 77 Fed. Reg. 63,205 (codified at 12 C.F.R. § 380.01, 380.12) An alert memorandum summarizing the key issues the final rule presents is available at https://www.clearygottlieb.com/~/media/cgsh/files/news-pdfs/fdic-finalizes-rule-on-nullification-of-subsidiary-and-affiliate-cross-defaults-under-ola.pdf.

(i) The rule enforces all contracts of all subsidiaries and affiliates of the CFC that are "linked to" or "supported by" the CFC.

(A) Under the final rule, a contract is "linked to" a CFC if it contains a provision that grants a counterparty the right to close out or take other specified actions based on the insolvency, receivership or financial condition of the CFC.

(B) Under the final rule, a contract is "supported by" a CFC if the CFC, among other things, guarantees the obligations of, provides an indemnity for the benefit of, or provides a loan, capital contribution or other financial assistance to, a subsidiary for the benefit of its creditors.

(ii) The enforcement of contracts that are "supported by" the CFC would only be effective if the FDIC also transfers the relevant credit support obligations to a "qualified transferee" (a third party acquirer that is not subject to insolvency proceedings or a bridge institution) or provides adequate protection by the statutory deadline. Under the Proposed Rule, "adequate protection" includes making payments to compensate for any losses for the failure to transfer the guarantee or other support, the FDIC's provision of a guaranty or any other relief that provides the counterparty with the "indubitable equivalent" of CFC support.

(iii) The final rule provides for the enforcement of all contracts that are "linked to" the CFC without any requirement that adequate protection be provided. This may not be entirely consistent with Section 210(c)(16), which by its terms applies the requirements that the FDIC either transfer related credit support or provide adequate protection when enforcing contracts of subsidiaries or affiliates both to contracts "linked to" or "supported by" the CFC. The FDIC justifies this distinction on the theory that contracts that are simply "linked to" the CFC do not gain any benefit from such linkage that requires protection. This distinction in treatment could negatively affect a counterparty's termination, netting and setoff rights.

(iv) In May 2016, the Federal Reserve Board proposed a rule intended to ensure that stays of default rights under OLA and the FDIA apply on a cross-border basis during the resolution of a global systemically important banking organization ("GSIB") or other large bank and to address possible impediments to orderly resolution caused by cross-default rights in QFCs. The rule would (x) require U.S. GSIBs, their subsidiaries and the U.S. operations of foreign GSIBs (collectively, "covered entities") to ensure that QFCs to which they are parties provide that any default rights and restrictions on the transfer of the QFCs are limited to the same extent as they would be under the OLA and the FDIA regardless of the governing law of the agreement and (y) prohibit covered entities from entering into QFCs that would allow a counterparty to exercise certain default rights based on the insolvency or resolution of the covered entity's affiliate. See 81 Fed. Reg. 29,169. The FDIC and OCC have proposed similar rules. See 81 Fed. Reg. 55,381; 81 Fed. Reg. 74,327. Non-U.S. regulators have similarly proposed or promulgated rules to ensure the cross-border application of stays under their jurisdictions' special resolution regimes. ISDA and other industry organizations have concurrently developed contractual methods to achieve similar ends and facilitate compliance with these requirements. See generally https://www2.isda.org/functional-areas/protocol-management/protocol/24. Note that such stays may be enforceable even absent changes to existing documentation (e.g., under principles of comity) depending on the law of the jurisdiction where a challenge can be brought. These rules seek to eliminate uncertainty by requiring counterparties to affirmatively agree to be subject to the stays.

2. Receiver's Right to Disaffirm or Repudiate Contracts.

(a) The FDIC has the ability to disaffirm or repudiate contracts and leases to which a CFC is a party (Dodd-Frank § 210(c)(1)) if:

(i) The receiver, in its discretion, determines the contract or lease to be burdensome;

(ii) Disaffirmance or repudiation is determined by the receiver, in its discretion, to promote orderly administration of the CFC's affairs; and

(iii) Rights are to be exercised within a "reasonable" period following appointment of a receiver.

(b) The right to repudiate is not expressly limited under OLA to "executory" contracts, as under Section 365 of the Code.

(c) Although the rule codified in 12 C.F.R. Section 360.6 regarding participations and securitizations only applies to the FDIA, it might be relevant to an OLA analysis.

3. Damages Recoverable Upon Repudiation.

   (a) Dodd-Frank § 210(c)(3) governs the calculation of damages in respect of contracts or leases repudiated by a receiver.

      (i) There are specific rules for QFCs, debt obligations and contingent claims (discussed below), as well as leases, contracts for the sale of real property and service contracts.

   (b) Damages are measured as of the date of appointment of the FDIC as receiver, not as of the date of repudiation. Dodd-Frank § 210(c)(3)(A).

   (c) Damages are limited to actual direct compensatory damages, and do not include (1) punitive or exemplary damages; (2) lost profits or opportunity; or (3) pain and suffering. Dodd-Frank § 210(c)(3)(A), (B).

   (d) Collateral for a repudiated claim secures any claim for repudiation damages, 12 C.F.R. § 380.53, and no more. More generally, if the value of collateral exceeds the value of the claim, the claimant has a secured claim for interest on the claim, as well as for reasonable fees, costs or charges provided for under the agreement or state law. 12 C.F.R. § 380.50.

      (i) To the extent that the value of a secured claim exceeds the value of the collateral, the FDIC may treat it as an unsecured claim. <u>Id.</u>

   (e) OLA requires that the calculation of damages, in the case of debt for borrowed money or evidenced by a security, be no less than the amount lent plus accrued interest plus any accreted original issue discount as of the date of the FDIC's appointment as receiver. Dodd-Frank § 210(c)(3)(D).

      (i) Unlike in the FDIA (as interpreted by the FDIC in policy statements), the claim can include post-appointment interest, to the extent secured. Dodd-Frank § 210(c)(3)(D); 12 C.F.R. § 380.50.

   (f) Unlike the FDIA (as interpreted by the FDIC in policy statements, although not generally supported by case law), OLA provides that "contingent obligations" are provable claims. Dodd-Frank § 201(a)(4); 12 C.F.R. § 380.39; <u>see</u> Letter of July 30, 2010 from FDIC General Counsel to Seth Grosshandler (available from your regular Cleary contacts). Dodd-Frank § 210(c)(3)(E) further provides that the FDIC may by regulation provide that claims for damages arising from the repudiation of contingent obligations shall be estimated (<u>cf.</u> Section 502(c) of the Code). The FDIC's estimation of value is the amount of the allowed claim, even if the claim later becomes fixed. 12 C.F.R. § 380.39.

(i) The FDIC must estimate the value of contingent claims within 180 after the claim is filed, unless the FDIC and claimant agree to an extension. 12 C.F.R. § 380.39(c).

(ii) If the receiver repudiates a contingent obligation based on a guarantee, letter of credit, loan commitment or similar credit obligation, the damages for repudiation shall be no less than the estimated value of the claim as of the date the FDIC was appointed receiver, based upon the likelihood the contingent claim would become fixed and the probable magnitude thereof. 12 C.F.R. § 380.39(b).

(iii) The OLA Rule does not define which claims should be treated as contingent. In the preamble to the notice of proposed rulemaking released by the FDIC in October 2010, however, the FDIC stated that it "holds the view" that a guarantee is no longer contingent if the principal obligor becomes insolvent. 75 Fed. Reg. 64,174, 64,179 (October 19, 2010). The final interim rule provides that holders of contingent claims under OLA should receive no less than the amount they would have received under the Code. The rule requires that the receiver estimate the value of the claim based upon the likelihood that the contingent obligation would become fixed and the probable magnitude of the claim; however, the final OLA rule does not further define what claims will be considered contingent. 76 Fed. Reg. 4,207, 4,209 (January 25, 2011); 12 C.F.R. § 380.4.

4. Receiver's Right to Request a Stay of Judicial Actions.

(a) Although not automatic like the Code's automatic stay, the FDIC may request, and a court shall grant, a 90-day stay of any judicial action to which the CFC is a party. Dodd-Frank § 210(a)(8).

5. Receiver's Right to Selectively Transfer Assets and Liabilities.

(a) The FDIC has the power selectively to transfer assets and liabilities, with specific exceptions for qualified financial contracts. This power can effectively destroy setoff rights. <u>See also</u> 12 C.F.R. § 380.24 ("Notwithstanding any right of any creditor to offset a mutual debt owed by such creditor . . . [the FDIC] may sell or transfer any assets of the covered financial institution . . . free and clear of any such rights of setoff."). This provision of the OLA Rule appears to conflict with related statutory provisions. OLA provides that, "subject to other provisions of this title," recipients of assets transferred by the FDIC take such assets subject to any claims and rights that would be enforceable against such recipient "under applicable noninsolvency law," 12 U.S.C. § 5390(a)(1)(G)(iii), which would appear to include contractual rights to set off.

(i) Unlike the FDIA, if a transfer of liabilities destroys the mutuality of an offsetting claim, OLA gives that claim priority over the claims of other general creditors. Dodd-Frank § 210(a)(12)(F). The claim is determined as of the date of the sale or transfer. 12 C.F.R. § 380.24.

6. Avoidance of Preferences, Fraudulent Transfers and Other Transfers.

   (a) The FDIC has the ability under OLA to avoid preferences and fraudulent transfers.

   (b) OLA's provisions on avoidance of fraudulent transfers, preferences and post-receivership transfers are similar, but not identical, to those in the Code. Dodd-Frank § 210(a)(11). 12 C.F.R. § 380.9 elaborates on the standard for avoidance, harmonizing the OLA provisions with the Code provisions.

7. Expedited Procedures for Determination of Secured Claims.

   (a) OLA contains certain claims procedures, including "expedited" procedures for the determination of certain secured claims. Dodd-Frank § 210(a)(5). The effect of the claims procedures may be to delay judicial review. 12 C.F.R. § 380.38(d) (mandating that courts shall have no jurisdiction over claims unless claimant has first exhausted the administrative claims process).

8. The Written Agreement and Related Requirements.

   (a) Dodd-Frank § 210(a)(6) provides that any agreement that diminishes the right, title or interest of the FDIC in an asset:

      (i) must be in writing;

      (ii) must be executed by an authorized officer or representative of the CFC or confirmed in the ordinary course of business by the CFC; and

      (iii) must be maintained continuously, since the time of execution, as an official record of the CFC or must be proven to the satisfaction of the FDIC by the party making a claim under the agreement.

   (b) Dodd-Frank § 210(h)(7) applies the same provision to an agreement that diminishes the rights of a bridge financial company.

9. Recovery of Setoff Amount.

   (a) OLA's setoff provisions are based on those in the Code, including a provision allowing the FDIC to avoid preferential setoffs. Dodd-Frank § 210(a)(12)(B).

10. Custodial Property

   (a) The analysis of the treatment of customer property under OLA should be similar to the analysis under the FDIA.

11. Clawback of Compensation

(a) Under the OLA Rule, 12 C.F.R. § 380.7, the FDIC may file an action to recover the compensation of any current or former senior executive or director who it determines is substantially responsible for the failed condition of the financial company, which means that such person failed to act with the care that an ordinarily prudent person in a like position would have given the circumstances. The FDIC may file suit against individuals who are found substantially responsible and whose performance is determined to have resulted in financial losses to the financial company that materially contributed to the financial company's failed condition. The FDIC can recover compensation earned during the two-year period prior to the appointment of the FDIC as receiver for the financial company, except in cases of fraud, for which no time limit applies.

12. Priority and Payment Unsecured Claims

(a) Under the OLA Rule payments of unsecured claims are paid out of the receivership generally in the following order:

(i) Repayment of debt incurred or credit obtained by the FDIC as receiver for the CFC, provided that the FDIC has determined that, at the time such debt was incurred, it was otherwise unable to obtain unsecured credit for the CFC from commercial sources;

(ii) Administrative expenses of the receiver;

(iii) Any amounts owed to the United States;

(A) Only amounts which were advanced for the purpose of orderly liquidation, advanced to avoid or mitigate systemic risk or owed to the Department of Treasury for unpaid taxes qualify.

(B) Included in this category are, among others, amounts advanced by the Department of Treasury to capitalize the Orderly Liquidation Fund, debt owed to a Federal Reserve Bank and payments to satisfy FDIC guarantees of debt under its Temporary Liquidity Guarantee Program.

(C) Excluded from this category are, among others, obligations to government sponsored entities such as Fannie Mae, Freddie Mac and the Federal Home Loan Banks incurred in the ordinary course of business prior to the appointment of the FDIC as receiver.

(iv) Wages, salaries and other compensation, unless included in category 9 below, subject to a cap and certain conditions;

(v) Contributions owed to employee benefit plans, unless included in category 9 below, subject to a cap and certain conditions;

(vi) Any amounts due to creditors in respect of setoff rights impaired by the receiver's transfer of assets free from rights of setoff;

(vii) Any other general or senior unsecured liabilities of the CFC;

(viii) Any obligations subordinated to general creditors;

(ix) Any wages, salaries or other compensation to senior executives and directors;

(x) Post-insolvency interest; and

(xi) Payments to shareholders, general partners, members or other equity holders.

(b) The OLA Rule clarifies that obligations assumed by a bridge financial company (a "bridge") will be paid in accordance with the terms of such obligation, not pursuant to the claims process and priority waterfall. However, in a receivership of a bridge, any claim arising out of a breach of an agreement transferred to a bridge would have administrative expense priority under the OLA Rule. The OLA Rule also provides that any credit extended to the bridge or extended to the receiver in respect of the bridge will be treated as an administrative expense upon the receivership of the bridge, and that when the bridge is dissolved, any proceeds after the payment of the bridge's administrative expenses will be distributed to the FDIC as receiver for the predecessor CFC.

(c) The OLA Rule prohibits "additional payments" over what the holder would have received in a liquidation for holders of long-term senior debt and subordinated debt and equity holders. Holders of short-term debt may only receive additional payments if the FDIC's Board of Directors determines by vote that it is necessary. Section 380.27(a) defines "long-term senior debt" as senior debt issued by the CFC with a term of more than 360 days, except revolving lines of credit necessary to continue operations essential to the receivership or bridge.

13. Claims Procedures

(a) The OLA Rule contains detailed provisions for filing claims against the receiver. Notably, the OLA Rule provides that a claimant must generally file a claim on its own behalf and not on behalf of others. The FDIC noted that a trustee of a securitization or other structured financial transaction would be permitted to file a claim on behalf of all of the investors in such transaction, because the trustee would legally own the claim. By contrast, it appears that the lead agent bank in a syndicate would not be permitted to file a claim on behalf of all the participants in the syndicate. Further, it is likely that many creditors will be similarly situated and file similar claims. The OLA Rule provides no means for such creditors to collectively challenge the determinations of the FDIC, whether the same or different. The collective treatment of claims remains a significant area in which rules are lacking.

D. Exceptions for Qualified Financial Contracts.

There are several statutory and regulatory exceptions from the foregoing provisions in the case of QFCs.

1. Transactions Covered.

(a) Securities Contracts.

(i) Consistent with the Code definition, except that the definition in the Code, unlike that in OLA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 210(c)(3) of OLA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(b) Forward Contracts.

(i) Consistent with the Code definition, except that the definition in the Code, unlike that in OLA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 210(c)(3) of OLA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(c) Commodity Contracts.

(i) Consistent with the Code definition, except that the definition in the Code, unlike that in OLA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 210(c)(3) of OLA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(d) Repurchase Agreements.

(i) Consistent with the Code definition, except that the definition in the Code, unlike that in OLA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 210(c)(3) of OLA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

(e) Swap Agreements.

(i) Consistent with the Code definition, except that the definition in the Code, unlike that in OLA, imposes a limitation on damages in accordance with Section 562 of the Code. However, Section 210(c)(3) of OLA, similar to Section 562 of the Code, provides that damages in respect of a terminated QFC are to be measured as of the date such contract is terminated or repudiated.

2. Covered Parties.

Unlike under the Code, any counterparty to a QFC is entitled to the benefits of the QFC provisions.

3. Benefits of QFC Status.

(a) Exercise of Certain Rights—Generally.

(i) The QFC provisions protect the exercise of certain “self-help” rights to terminate and liquidate QFCs, rights under security arrangements in connection with QFCs and offset and netting rights in connection with QFCs. Dodd-Frank § 210(c)(8). However, the QFC provisions do not, for example, protect the right of a purchaser of securities under a hold-in-custody repo to compel delivery of the securities from the FDIC as receiver.

(ii) OLA does not expressly require that rights be contractual rights. Even though OLA does not require that rights be contractual, the written agreement requirements may make contractual rights necessary in order to benefit from the QFC protections.

(iii) Status as a QFC does not, as a general matter, give the creditor rights it does not possess under contract or applicable law, does not compel specific performance on the part of the FDIC and does not elevate an unsecured claim to secured status.

(b) When Exercise of Rights Is Protected.

(i) Default based on Receivership alone—

(A) Liquidation, termination, netting and offset rights are protected from the receiver’s right to enforce contracts and to assign assets and liabilities unless the receiver transfers all QFCs between the counterparty, its affiliates and the CFC to another financial institution and provides notice of the transfer to the counterparty by 5 p.m. on the business day following the receiver’s appointment. Section 210(c)(10)(B)(i) of OLA clarifies that such liquidation, termination, netting and offset rights cannot be exercised solely due to the appointment of a receiver if by 5 p.m. on the business day following the receiver's appointment the creditor receives the notice of transfer to another financial institution. In addition, the FDIC cannot transfer a QFC to a foreign financial institution or a branch or agency of a foreign financial institution unless the laws applicable to such financial institution, branch or agency related to qualified financial contracts are enforceable substantially to the same extent as under OLA. Dodd-Frank § 210(c)(9)(B).

(B) A counterparty, upon learning of a receivership, should generally take steps to ascertain the FDIC's intentions with respect to QFCs.

(C) OLA provides that the FDIC, acting as receiver, will notify a counterparty of a transfer by 5 p.m. (eastern time) on the business day following the date of the appointment of the receiver. Dodd-Frank § 210(c)(10)(A). A counterparty is deemed to have been notified of a transfer if the FDIC has "taken steps reasonably calculated to provide notice to such person by the time specified in [section 210(c)(10)(A) of OLA]." Dodd-Frank § 210(c)(10)(B)(iii).

(c) Transfer of QFCs: "All or None."

(i) The receiver is required to transfer all or no QFCs between a counterparty, its affiliates and a CFC. This is designed to preserve cross-collateralization, setoff and netting rights. Dodd-Frank § 210(c)(9)(A).

(ii) The concern that a receiver could selectively repudiate QFCs is remedied by Dodd-Frank § 210(c)(11), which mandates that the FDIC shall disaffirm or repudiate either all or none of the QFCs..

(d) Claw back from Transferred Creditors

(i) In certain circumstances, the FDIC can "claw back" from a transferred QFC (and non-QFC) creditor amounts that the creditor received in excess of the liquidation value of the QFCs in the absence of a transfer. Dodd-Frank § 210(O)(1)(D).

(ii) How this "delta" would be calculated is unclear, and transferred creditors may wish to create a record of the liquidation value of their positions at the time.

(e) Calculation of Damages

(i) Although the FDIC <u>is</u> entitled to repudiate QFCs, the damages in that event are measured as of date of repudiation, and expressly include reasonable costs of cover. Dodd-Frank § 210(c)(3)(C).

(f) "Walkaway" Clauses

(i) Section 210(c)(8)(F) of OLA states that in the case of QFCs of a CFC in default, any payment or delivery obligations otherwise due from a party pursuant to the QFC shall be suspended from the time the receiver is appointed until the earlier of (I) the time such party receives notice that such contract has been transferred pursuant to Dodd-Frank § 210(c)(10)(A); or (II) 5:00 p.m. (eastern time) on the business day following the date of the appointment of the receiver.

Section 210(c)(8)(F)(iii) of OLA defines the term "walkaway clause" to mean any provision in a QFC that suspends, conditions or extinguishes a payment obligation of a party, in whole or in part, or does not create a payment obligation of a party that would otherwise exist, solely because of such party's status as a nondefaulting party in connection with the insolvency of a CFC that is a party to the contract or the appointment of or the exercise of rights or powers by a receiver of such CFC, and not as a result of a party's exercise of any right to offset, set off or net obligations that exist under the contract, any other contract between those parties or applicable law.

(g) OLA contains some additional provisions providing additional protections to clearing organization counterparties to QFCs. Dodd-Frank § 210(c)(8)(G).

VII. Insolvency of Insurance Companies.

A. Governing Law.

1. Domestic insurance companies may not be debtors under the Code. See Code Section 109(b)(2). The only Code proceedings to which foreign insurance companies engaged in such business in the United States could be subject are proceedings under Chapter 15.
2. OLA does not apply to insurance companies. If the relevant state regulatory agency, however, fails to place an insurance company that is systemically significant or is a subsidiary or affiliate of a systemically significant company into liquidation under state law within 60 days of a determination that the company is in default or in danger of default under Dodd-Frank Section 202(a), the FDIC can file a judicial action to place the company into liquidation under state law. See Dodd-Frank § 203(e)(3) ("Backup Authority").
3. State law governs delinquency proceedings (typically, rehabilitation or liquidation proceedings) of insurance companies.

(a) Insurance insolvency statutes enacted in most states are based on either the Insurers Rehabilitation and Liquidation Model Act (the "Liquidation Act"), the

Insurer Receivership Model Act (the “Receivership Act”) or the Uniform Insurers Liquidation Act (the “UILA”), each of which was promulgated by the National Association of Insurance Commissioners (the “NAIC”),.

(b) Despite for the most part being based on one or the other of these model statutes, many differences, sometimes significant, exist between the different state statutes.

(c) Statutes enacted in certain states resemble the FDIA or the Code, without the QFC provisions, while still other states have adopted QFC provisions similar to those in the FDIA.

(d) Relatively few statutes or cases address the rights of capital market transactions counterparties.

(e) This lack of guidance creates great uncertainty for derivative counterparties.

4. The commencement of an insolvency proceeding.

(a) The commissioner in most states is authorized to commence a rehabilitation or liquidation proceeding against an insurance company when, among other things, it is in such condition that the further transaction of business would be hazardous to its policyholders, its creditors or the public.

(b) The commissioner has a significant amount of discretion in interpreting applicable statutes, and such discretion typically is exercised in a manner conducive to protecting policyholders and preserving the insurer (in a rehabilitation) or arranging an orderly disposition of its assets (in a liquidation).

B. Several Provisions of Insurance Insolvency Statutes Impair Creditor’s Rights.

1. Many statutes include provisions that address the treatment of contracts of the delinquent insurer.

(a) Statutes based on the UILA typically authorize the commission to “affirm or disavow” contracts of the insurer.

(i) Unlike Section 365 of the Code, such provisions are not expressly limited to executory contracts.

(ii) Some statutes enable the commissioner to assume or reject executory contracts of insurers.

(iii) Both the Receivership Act and the Liquidation Act provide protections for QFCs (as defined therein) analogous to the QFC provisions of the FDIA. Those QFC provisions, with some changes, have been adopted in Arizona, Colorado, Connecticut, Delaware, Illinois, Indiana, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, New

Jersey, New York, Ohio, Tennessee, Texas, Utah, Virginia and Wisconsin. We discuss the Receivership Act below.

(b) The commissioner's disaffirmance right might give the commissioner the power to "cherry pick" between transactions, including those documented by the parties under a master agreement; i.e., to assume (or assume and assign) transactions favorable to the counterparty.

(c) Some statutes provide that the commencement of a proceeding shall not be deemed to be an "anticipatory breach" of any contract of the insurer.

(i) It is unclear whether such a provision would invalidate a contractual termination provision or would merely deprive the nondefaulting party of a common law right to terminate.

(ii) Certain statutes include provisions, similar to the "anti-ipso facto" prohibitions of Section 365(e) of the Code, that invalidate contractual termination provisions based on the insolvency or financial condition of the insurer.

2. Certain statutory provisions regarding the treatment of claims against delinquent insurers may impair the rights of capital market transactions counterparties.

(a) Most statutes provide that policyholders' claims are to be paid in full before other creditors, including general creditors, receive anything from the distribution of an insolvent insurer's assets.

(b) Most statutes provide that holders of "contingent claims" do not share in the distribution of an insolvent insurer's assets. Unfortunately, most statutes do not define the phrase "contingent claim"; conceivably, it could include amounts owed in connection with certain kinds of derivatives.

3. Numerous statutory provisions may result in delay in the exercise of contractual and legal rights.

(a) Most statutes authorize the commissioner to seek a sweeping injunction of all actions against the insurer. Typically the commissioner will obtain a first day order that enjoins, inter alia, setoffs and the exercise of rights against collateral.

(b) Other typical related provisions provide that (1) no action may be brought or maintained against an insurer being liquidated and (2) no action in the nature of attachment, garnishment or levy of execution may be commenced against a delinquent insurer.

(c) In this regard, see Garamendi v. Executive Life Ins. Co., 21 Cal. Rptr. 2d 578 (Cal. Ct. App. 1993) (deeming a reverse repo with a subsidiary of a life insurance company a secured loan and applying a stay of proceedings to the subsidiary's creditors).

4. Preference Provisions.

   (a) Many state statutes include broad “preference” provisions that could possibly the used to “claw back” payments already made under certain types of derivative products, including, in certain states, without a showing of preferential intent. State fraudulent transfer statutes will likely apply in an insurer delinquency proceeding.

5. Setoff.

   (a) The applicable statutes generally provide that mutual debts and credits are to be set off. The scope of such provisions, and their applicability to capital markets transactions are, however, uncertain.

6. Priority of Pre-“Petition” vs. Post-“Petition” Accruals.

   (a) In <u>In re Mutual Benefit Life Ins. Co.</u>, 1993 N.J. Super. LEXIS 940, a New Jersey Superior Court held that certain post-“petition” amounts accrued under swap agreements constituted administrative expense claims of the highest priority. The pre-“petition” amounts, however, were general unsecured claims, subordinate to policyholder claims (even though the policyholder preference was enacted with retroactive effect).

C. Increased Legal Certainty under the Liquidation Act and Receivership Act

1. The Liquidation Act and Receivership Act attempt to increase legal certainty under the laws governing the insolvency of U.S. insurance companies.

2. Expanded Financial Contract Provisions.

   (a) The Receivership Act expands the Liquidation Act’s previous definitions of “netting agreement”, “qualified financial contract” and “transfer” with the intent of making them more consistent with definitions applicable under the FDIA and the Bankruptcy Code.

      (i) “Netting agreement” means (1) a contract or agreement (including terms and conditions incorporated by reference therein), including a master agreement (which master agreement, together with all schedules, confirmations, definitions and addenda thereto and transactions under any thereof, shall be treated as one netting agreement), that documents one or more transactions between the parties to the agreement for or involving one or more qualified financial contracts and that provides for the netting, liquidation, setoff, termination, acceleration or close out under or in connection with one or more qualified financial contracts or present or future payment or delivery obligations or payment or delivery entitlements thereunder (including liquidation or close-out values relating to such obligations or entitlements) among the parties to the netting agreement; (2)

any master agreement or bridge agreement for one or more master agreements described in Paragraph (1) of this subsection; or (3) any security agreement or arrangement or other credit enhancement or guarantee or reimbursement obligation related to any contract or agreement described in Paragraph (1) or (2) of this subsection; provided that any contract or agreement described in Paragraph (1) or (2) of this subsection relating to agreements or transactions that are not qualified financial contracts shall be deemed to be a netting agreement only with respect to those agreements or transactions that are qualified financial contracts.

(ii) "Qualified financial contract" means any commodity contract, forward contract, repurchase agreement, securities contract, swap agreement and any similar agreement that the commissioner determines by regulation, resolution or order to be a qualified financial contract for the purposes of this Act.

(A) "Commodity contract" means: (a) a contract for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a board of trade or contract market under the Commodity Exchange Act (7 U.S.C. § 1, et seq.) or a board of trade outside the United States; (b) an agreement that is subject to regulation under Section 19 of the Commodity Exchange Act (7 U.S.C. § 1, et seq.) and that is commonly known to the commodities trade as a margin account, margin contract, leverage account or leverage contract; (c) an agreement or transaction that is subject to regulation under Section 4c(b) of the Commodity Exchange Act (7 U.S.C. § 1, et seq.) and that is commonly known to the commodities trade as a commodity option; (d) any combination of the agreements or transactions referred to in this paragraph; or (e) any option to enter into an agreement or transaction referred to in this paragraph.

(B) "Forward contract," "repurchase agreement," "securities contract" and "swap agreement" have the meanings set forth in the FDIA, 12 U.S.C. § 1821(e)(8)(D), as amended from time to time.

(iii) "Transfer" shall include the sale and every other and different mode, direct or indirect, of disposing of or of parting with property or with an interest therein, including a setoff, or with the possession thereof or of fixing a lien upon property or upon an interest therein, absolutely or conditionally, voluntarily or involuntarily, by or without judicial proceedings. The retention of a security title in property delivered to an insurer and foreclosure of the insurer's equity of redemption shall be deemed a transfer suffered by the insurer.

3. Enforceability of Close-Out Provisions More Consistent with the Code and FDIA.

   (a) The Receivership Act now contains stronger concepts concerning the enforceability of early termination and close-out netting provisions, which are more consistent with the approach used in the Code and the FDIA.

   (b) There are new provisions in the Receivership Act, which eliminate any delay in the exercise of contractual legal rights by providing special protection for setoff, netting and liquidation rights despite stays or prohibitions triggered by the commencement of a delinquency proceeding.

   (c) The Receivership Act also overrides any "walkaway clause" in a netting agreement by rendering "limited two-way payment" provisions unenforceable. Thus, it is a requirement that upon termination of a netting agreement, the non-defaulting party will be required to pay to the defaulting party (the insurer) any net or settlement amounts owed to the insurer, notwithstanding any provision in the netting agreement that provides that the non-defaulting party is not required to make such payments to the defaulting party.

VIII. Bilateral And Clearing Organization "Netting Contracts" Under FDICIA.

A. FDICIA enacted specific provisions for the enforcement of netting provisions in bilateral contracts between "financial institutions" and between members of clearing organizations in accordance with the clearing organization's rules. The purpose of these provisions is to "reduce the systemic risk within the banking system and financial market" by recognizing such netting procedures as "valid and legally binding in the event of the closing of a financial institution participating in the netting procedures." FDICIA, Section 401.

   (a) FDICIA supplements the Code's provisions for Protected Contracts and QFCs with respect to financial institutions and transactions effected through clearing organizations.

   (b) FDICIA's bilateral and clearing organization netting provisions would also apply in any non-Code proceeding regarding a "financial institution"; however, as discussed below, the clearing organization netting provisions are subject to certain provisions of the FDIA, SIPA, FCUA, HERA, and the bilateral netting provisions are subject to certain provisions the FDIA, SIPA, OLA, the FCUA and HERA.

   (c) Although an insurance company might qualify as a "financial institution" under the provisions of the Federal Reserve Board's Regulation EE (discussed below), there is a substantial question as to whether the provisions of FDICIA supersede state law governing insurance delinquency proceedings by virtue of the McCarran-Ferguson Act. <u>See</u> 15 U.S.C. § 1012(b) and Part I.A.2(a)(i) above.

B. Bilateral Netting Contracts.

1. The bilateral netting provisions of FDICIA provide for the enforceability of a “netting contract” between two “financial institutions” according to the contract’s terms, i.e., only the net amount under the contract will be due and owing, notwithstanding the failure of a party to the contract and notwithstanding any stay, injunction, avoidance or similar proceeding or order.

2. “Netting contract” is defined to include any contract between two or more “financial institutions” that provides for the netting of present or future payment obligations or entitlements among the parties (including liquidation or close-out values relating to payment obligations or entitlements). The 2005 Act amended the definition of “netting contract” in FDICIA to eliminate the requirement that a netting contract must be governed by U.S. law and defined “payment” to include non-cash delivery (including to liquidate an unmatured obligation).

3. “Financial institution” means registered brokers and dealers and futures commission merchants, certain depository institutions (including certain branches and agencies as well as foreign banks), and any other institution as determined by the Federal Reserve Board (“FRB”). The FRB has determined that certain CHIPs members that are not otherwise “financial institutions” qualify as such for purposes of FDICIA. FDICIA specifically provides that affiliates of broker-dealers that are engaged in the business of entering into netting contracts may be determined by the FRB to be “financial institutions.”

4. The FRB adopted Regulation EE in 1994, which expands the definition of “financial institution” to include “a person [that] represents that it will engage in financial contracts as a counterparty on both sides of one or more financial markets and either—(1) had one or more financial contracts of a total gross dollar value of at least $1 billion in notional principal amount outstanding on any day during the previous 15-month period with counterparties that are not its affiliates; or (2) had total gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more financial contracts on any day during the previous 15-month period with counterparties that are not its affiliates. . . .” 12 C.F.R. § 231.3. “Financial contract” is defined to mean a QFC (as defined in the FDIA), “except that a forward contract includes a contract with a maturity date two days or less after the date the contract is entered into (i.e. a ‘spot’ contract).” 12 C.F.R. § 231.1.

   Because of the interplay between this definition and the “grandfather” provision of Regulation EE, there is some concern that counterparties that did not receive representations on March 7, 1994 relating to financial institution status could not rely on Regulation EE. The Associate General Counsel to the FRB issued a letter, and the FRB amended Regulation EE to reduce concerns in this regard. The FRB has determined by letters dated June 21, 1994, July 10, 1996, January 21, 1997 and July 7, 1998 that the Student Loan Marketing Association, the Farm Credit System Banks, Fannie Mae, Freddie Mac and the Federal Home Loan Banks are "financial institutions" for purposes of the netting provisions of FDICIA. It would appear that such status would be retroactive with respect to financial institutions under FDICIA, but, because of the "grandfather" provision in Regulation EE, that neither Sallie Mae, the Farm Credit System Banks, Fannie Mae, Freddie Mac, the Federal Home Loan Banks nor their Regulation EE "financial institution" counterparties can rely on such status for contracts entered into prior to June 21, 1994 (in the case of Sallie Mae and the Farm Credit System Banks), July 10, 1996 (in the case of Fannie Mae), January 21, 1997 (in the case of Freddie Mac) or July 7, 1998 (in the case of the Federal Home Loan Banks).

C. Clearing Organization Netting Contracts.

1. FDICIA protects the enforceability of provisions in the rules of a clearing organization (by including such rules in the definition of "netting contract") that provide its members (including the clearing organization itself) with termination, liquidation, acceleration and netting rights.
2. The definition of "clearing organization" is "a clearinghouse, clearing association, clearing corporation, or similar organization (A) that provides clearing, netting, or settlement services for its members and (i) in which all members other than the clearing organization itself are financial institutions or other clearing organizations; or (ii) which is registered as a clearing agency under the Securities Exchange Act of 1934, or is exempt from such registration by order of the Securities and Exchange Commission; or (B) that is registered as a derivatives clearing organization under section 7a-1 of title 7, that has been granted an exemption under section 6(c)(1) of title 7, or that is a multilateral clearing organization (as defined in section 4421 of [title 12]."

D. The 2006 Act amended Sections 403 and 404 of FDICIA (codified at 12 U.S.C. §§ 4403(a) and 4404(a) respectively) to confirm the enforceability of bilateral netting contracts and clearing organization netting contracts, notwithstanding other provisions of federal law, by adding language to ensure that parties can exercise termination, liquidation, and acceleration rights, as well as netting rights, under a netting contract.

1. 12 U.S.C. § 4403(a) now states that notwithstanding any other provision of State or Federal law (other than Section 11(e) of the FDIA, Section 210(c) of Dodd-Frank, Section 4617 of HERA, Section 207(c) of the FCUA, or any order authorized under Section 5(b)(2) of SIPA), the covered contractual payment obligations and the covered contractual payment entitlements between any 2 financial institutions shall be terminated, liquidated, accelerated, and netted in accordance with, and subject to the conditions of, the terms of any applicable netting contract (except as provided in 11 U.S.C. § 561(b)(2)).

2. 12 U.S.C.§ 4404(a) states that notwithstanding any other provision of State or Federal law (other than Section 11(e) of the FDIA, Section 207(c) of the FCUA, and any order authorized under Section 5(b)(2) of SIPA), the covered contractual payment obligations and the covered contractual payment entitlements of a member of a clearing organization to and from all other members of a clearing organization shall be terminated, liquidated, accelerated, and netted in accordance with and subject to the conditions of any applicable netting contract (except as provided in 11 U.S.C. § 561(b)(2)). “Member” is defined to include the clearing organization itself.

E. FDICIA also provides for the enforceability of security agreements related to bilateral netting contracts and clearing organization netting contracts.

1. 12 U.S.C. § 4403(f) states that the provisions of any security agreement or arrangement or other credit enhancement related to one or more netting contracts between any 2 financial institutions shall be enforceable in accordance with their terms (except as provided in Section 561(b)(2) the Code), and shall not be stayed, avoided, or otherwise limited by any State or Federal law (other than Section 11(e) of the FDIA, Section 207(c) of the FCUA, and Section 5(b)(2) of SIPA).
2. 12 U.S.C. § 4404(h) states that the provisions of any security agreement or arrangement or other credit enhancement related to one or more netting contracts between any 2 members of a clearing organization shall be enforceable in accordance with their terms (except as provided in Section 561(b)(2) of the Code) and shall not be stayed, avoided, or otherwise limited by any State or Federal law (other than Section 11(e) of the FDIA, Section 207(c) of the FCUA, and Section 5(b)(2) of SIPA). “Member” is defined to include the clearing organization itself.

F. As noted above, the bilateral netting provisions of FDICIA state that they are subject to Section 11(e) of the FDIA, Section 207(c) of the FCUA, Section 4617 of HERA, Section 5(b)(2) of SIPA and Section 210(c) of Dodd-Frank. The clearing organization netting provisions of FDICIA state that they are subject to the same provisions, with the exception of Section 210(c) of Dodd-Frank.

1. Section 11(e) of the FDIA contains express language providing that FDICIA does not preempt certain provisions of the FDIA relating to the enforceability of provisions of qualified financial contracts. Similar language appears in HERA and the FCUA.
2. In 2010, the bilateral netting provisions of FDICIA were amended to reference Section 210(c) of Dodd-Frank as a provision that is specifically not preempted by FDICIA. In contrast, the provisions of FDICIA that address clearing organization netting were not similarly amended and therefore FDICIA continues to preempt the entirety of OLA in the context of clearing organization netting.

IX. Table of Authorities.

Statutes

Cases

Regulations

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