STATEMENT OF

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BIG BANK BANKRUPTCY: 10 YEARS AFTER LEHMAN BROTHERS

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Introduction

Mr. Chairman and members of the Committee, thank you for inviting me to testify at today's hearing. My name is Steve Hessler, and I am a partner in the Restructuring Group of Kirkland & Ellis LLP. We primarily represent major corporations as company counsel in insolvency matters, though my practice also includes representing creditors, equity holders, investors, and other third parties in a wide variety of highly complex distressed situations. I have served clients from a range of industries, including financial services, energy, telecommunications, gaming and hospitality, manufacturing, and real estate—and these cases have included some of the largest and most challenging bankruptcies in history.

Beyond my client representations, I teach a class each fall at the Wharton School at the University of Pennsylvania to graduate business and law and undergraduate students on distressed investing. I am also a founder of the University of Pennsylvania Institute for Restructuring Studies, a multidisciplinary think tank that addresses topical corporate insolvency issues and seeks to influence the public policy debate in a manner that has practical application for investors, practitioners, regulators, and scholars. I also previously served as the Co-Chairman of the Advisory Board on Administrative Claims, Critical Vendors, and Other Pressures on Liquidity for the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, and as a member of the Local Bankruptcy Rules Committee for the Southern District of New York.

Please note the views expressed in my testimony, written and oral, are solely my own, and are not offered on behalf of my firm, any client, or other organization.

I have lectured and published on a number of insolvency topics, including, of most relevance, how to address most effectively the restructuring of a failing systemically important financial institution ("SIFI").[1] To that end, I am pleased to appear before the Committee regarding S. ___, the "Taxpayer Protection and Responsible Resolution Act" (also referred to, as explained below, as "Chapter 14"). It was also my privilege to testify before the House Judiciary Committee in July 2014, July 2015, and March 2017 in support of the substantively identical legislation the "Financial Institution Bankruptcy Act of 2017" ("FIBA"), which was passed by the House Judiciary Committee in September 2014, March

[1] More specifically, I have written about and critiqued the authority provided by Congress within Title II of the Dodd-Frank Act. *See* Stephen E. Hessler & James H.M. Sprayregen, *Too Much Discretion Exacerbates 'Too Big To Fail,'* WHO'S WHO LEGAL (July 2011); James H.M. Sprayregen & Stephen E. Hessler, *Orderly Liquidation Authority Under the Dodd-Frank Act: The United States Congress's Misdirected Attempt to Ban Wall Street Bailouts*, INSOL WORLD (Third Quarter 2010); James H.M. Sprayregen & Stephen E. Hessler, *Failing to Be Too Big to Fail*, THE DEAL (May 20, 2010).

In May 2011, I co-wrote a white paper, *Too Much Discretion To Succeed: Why A Modified Bankruptcy Code Is Preferable To Title II Of The Dodd-Frank Act*, that was submitted to the Federal Reserve in response to its request for comments relating to the Dodd-Frank Act's Section 216 study regarding the resolution of financial companies under the Bankruptcy Code. That document is available at https://www.federalreserve.gov/SECRS/2011/June/20110607/OP-1418/OP1418_053111_80002_310357154 312_1.pdf and a related interview with the WALL STREET JOURNAL from June 2011 is available at http://online.wsj.com/video/fatal-flaws-in-the-dodd-frank-act/7CEFEDBE-0240-4771-A463-83E32996BC92.html.

Other applicable publications include: *How Not to Clean Up a Bank Failure*, AMERICAN BANKER (September 20, 2017); *A Better Idea for Bankrupt Big Banks*, WALL STREET JOURNAL (April 24, 2017); *The Trump Administration & Bankruptcy Reform – What to (Possibly) Expect*, REORG RESEARCH (February 8, 2017); *Subchapter V - The Next Major Chapter 11 Reform?*, REORG RESEARCH (October 9, 2014).

Lastly, I was an organizer of or participant in various conferences that examined related issues, including: "*Lehman* & *WaMu*—Ten Years Later: Lessons Learned and Planning Ahead," October 9, 2018, at the University of Pennsylvania Law School; "Resolution of Systemically Important Financial Institutions Under the Bankruptcy Code," December 7, 2016, at the Wharton School at the University of Pennsylvania; "The Rule of Law in Restructuring," October 28, 2016, and "Government Participation in Resolution Processes," March 11, 2016, all hosted by the Penn Restructuring Institute; "Cabining Contagion: Addressing SIFI Failure Through OLA and its Alternatives," October 24, 2012, at New York University Law School; and the "Financial Firm Bankruptcy Workshop," conducted by The Federal Reserve Banks of Richmond and Philadelphia, on July 25-26, 2011, in Charlotte, North Carolina.

2016, and April 2017—and passed by the full House in December 2014, April 2016, and April 2017.[2]

Described summarily, the Taxpayer Protection and Responsible Resolution Act would add a Chapter 14 to the Bankruptcy Code that establishes a process akin to Chapter 11—which provides for the reorganization of corporations—but specifically for failing major banks. Because the existing House record on this legislation is extensive, I will not set forth here a recitation of all of the bill's provisions. Further, I have been asked by Committee counsel to address certain discrete yet important issues that may benefit from greater explanation. These include:

- whether Chapter 14 should provide the Federal Government with the limited ability to initiate an involuntary case against a small subset of failing covered financial corporations—and what consequent impact this authority may have on directors and officers to pursue responsible and timely restructuring options; and

- the effect of enacting Chapter 14 on the potential utilization of Title II of the Dodd-Frank Act, which provides an alternative liquidation authority to Federal regulators—and how the availability of these complementary resolution regimes could have comparative benefits for all of a SIFI's stakeholders.

Accordingly, my testimony predominantly will discuss these points—and is organized as follows. ***First***, while not repeating my prior submissions (which provided a more detailed overview of Chapter 14), I will briefly summarize how the legislation provides SIFI debtors with critical reorganization tools designed to address the unique

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[2] My prior testimonies are available at:

https://judiciary.house.gov/wp-content/uploads/2016/02/Hessler-Testimony.pdf;

https://judiciary.house.gov/wp-content/uploads/2016/02/Hessler-Testimony-1.pdf; and

https://judiciary.house.gov/wp-content/uploads/2017/03/Hessler-Testimony.pdf;

and are incorporated herein.

exigencies of a major bank failure—and how Chapter 14 does not disturb vital current Chapter 11 protections. ***Second***, I will address the above-specified issues: government filing ability, and the likely interplay between Chapter 14 and Title II, and explain why Chapter 14 presents the most viable (and needed) bankruptcy reform option.

I. Chapter 14—In Summary

Again, while I refer the Committee to my previous testimonies, which described at greater length Chapter 14's operational design, for this hearing, the following is a very high-level description of how it works—including what Chapter 14 adds to Chapter 11—and what it retains.

A. Incremental Tools

1. Single Point of Entry

The central feature of Chapter 14 is the "single point of entry" approach that would allow a failing covered financial corporation to file for Bankruptcy Code protection to effect a quick separation of "good" assets from "bad" assets. This would happen through the rapid postpetition transfer of the good assets to a non-debtor bridge financial company whose equity is held by a trust that is managed by a special trustee for the benefit of creditors. The bad assets would then be liquidated by the debtor within the Chapter 14 case—and both the transfer and liquidation are subject to Bankruptcy Court approval.[3]

[3] Sections 1405-06.

2. Bankruptcy Court Judges

Importantly, Chapter 14 provides these cases will be administered by a jurist selected from a pool of predetermined experienced Bankruptcy Court judges, within the established practice and precedent of the Bankruptcy Code.[4]

3. Qualified Financial Contracts

Lastly, the Bankruptcy Code presently exempts counterparties to qualified financial contracts ("QFCs," such as derivatives, swaps, repos, *etc*.) from section 362's automatic stay against termination[5]—which means a bankruptcy filing by a covered financial corporation could be marked by chaos at the outset if QFC counterparties are able to terminate and enforce immediately their rights in the debtor's assets. Chapter 14 addresses this issue by subjecting QFCs to the Bankruptcy Code's automatic stay for 48 hours.[6]

B. Retained Chapter 11 Protections

Beyond Chapter 14's key additions to Chapter 11, equally important are the core debtor protections of Chapter 11 that Chapter 14 does not disturb. These include, most prominently:

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4 Section 298.

5 11 U.S.C. § 362.

6 Sections 1407-08. While it is fair to ask whether it is commercially viable to require a debtor to make transfer and assignment decisions about a covered financial corporation's entire book of QFCs essentially immediately upon a filing, Chapter 14 imposes a workable construct on this front, for the following reasons: the post Dodd-Frank Act development of "living wills," the fact that the broader asset transfer decision itself must be made within 48 hours, the expectation that all QFCs will be transferred to the bridge company, and that Chapter 14's 48-hour stay actually offers more robust protection than both the present Bankruptcy Code automatic stay safe harbors and Title II.

1. Absolute Priority Rule

In contrast to Title II, which allows for similarly situated creditors to receive dissimilar economic treatment,[7] Chapter 14 does not alter the absolute priority rule, a bedrock principle of Chapter 11 that ensures the fair and equitable treatment of creditors by requiring that stakeholders with similar legal rights must receive the same treatment, and that junior creditors or interest holders may not receive any recovery until senior creditors are paid in full.[8]

2. Exclusivity

Chapter 14 also does not impair a Chapter 11 debtor's exclusive right to file a plan of reorganization.[9] This means the Federal Reserve, the Federal Deposit Insurance Corporation ("FDIC"), and other regulators to which Chapter 14 confers standing,[10] like all parties in interest, have the right to object to a debtor's requests for exclusivity extensions, or to file a motion to terminate exclusivity for "cause,"[11] but the Federal Government appropriately must first obtain Bankruptcy Court permission before abrogating a debtor's prerogatives on these fundamental restructuring decisions.

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7 12 U.S.C. § 5390(b)(4)(B).

8 *See* 11 U.S.C. § 1129.

9 *See* 11 U.S.C. § 1121(d)(1).

10 Section 1404.

11 11 U.S.C. § 1121.

3. Management Continuity

Chapter 11 embodies the concept of a "debtor in possession" maintaining the authority to operate the company postpetition.[12] Although I describe below the proper scope of protections for a covered financial corporation's senior executives, suffice to say that Chapter 14, unlike Title II, does not mandate the post-filing firing of directors and officers, which is key to ensuring stability and thereby maximizing the value of the estate before and during its restructuring.[13]

II. Addressing Key Issues

As noted above, I have been informed of two points in particular that deserve further attention—the limited ability of the federal government to initiate a case under Chapter 14, and the likely interplay between Chapter 14 and Title II. Below I address each of these issues in turn.

A. Federal Government Ability To File

Initial versions of FIBA expressly allowed the Federal Government (specifically, the Board of Governors of the Federal Reserve) to file an involuntary petition commencing a bankruptcy case without the covered financial corporation's consent, and included a complex (and temporally truncated) scheme, with very limited notice provisions, for the debtor (or stakeholders) to challenge the filing. I and others have testified this grant of authority was an unnecessary and unhelpful distraction—and the versions of FIBA that passed the House in April 2016 and April 2017 did not include the provision.

[12] 11 U.S.C. §§ 1107, 1108.

[13] *See infra* § II.B.1.(a).

That said, the present version of proposed Chapter 14 does provide the Federal Government the narrow ability to initiate an involuntary bankruptcy case of certain covered financial corporations: specifically, the approximately 8-10 so-called "GSIBs" (*i.e.*, globally systemically important bank holding companies).[14] While I remain skeptical of this grant of authority, it is, for the following reasons, hardly a fatal flaw, insofar as it is exceedingly remote the involuntary filing right would ever be exercised, even against this small subset of SIFIs, and this issue should not be an impediment to Chapter 14's passage.

As a gating item, it bears reminding that Title II already gives the Federal Government an involuntary filing right[15]—albeit for a regulator-administered ***liquidation***, not a Bankruptcy Code ***reorganization***. That said, and as discussed further below, I acknowledge that, while Chapter 14 itself has no direct effect on Title II, any debate on the former also implicates the viability of the latter. But most important for present purposes is that the Federal Government, either through even only the prospect of a Title II proceeding or its other general regulatory powers, already has sufficient influence to compel any covered financial corporation (including a GSIB) to commence a voluntary Chapter 14 case, without having to resort to a formal involuntary filing trigger.

To further illustrate: regardless of whether Title II remains in place or whether Chapter 14 ultimately provides the Federal Government with an involuntary filing right, it is massively unlikely there would ever be an involuntary case of a covered financial corporation. This is because, although under existing Bankruptcy Code provisions involuntary Chapter 11 cases can be initiated by under- or unsecured creditors in limited

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14 Sections 1403(a)(2), (b), (c).

15 12 U.S.C. § 5382(a).

circumstances,[16] these are incredibly rare in the context of major corporations. Debtors often are effectively (but still voluntarily) "forced" into commencing Chapter 11 because of funded debt maturity or interest payment deadlines that, if unmet, would give rise to creditors' rights to foreclose on collateral or otherwise prompt a cascading series of cross defaults. Accordingly, as this day of reckoning gets closer, an insolvent corporation already will be in active negotiations with its key creditor and other constituencies over the timing and necessity of a potential filing—and it will be highly motivated to file a voluntary case before any creditor is able to commence an involuntary proceeding.

Undoubtedly this same dynamic will be present in the context of distressed covered financial corporations and the Federal Reserve (among other regulators and counterparties)—meaning, it is essentially unthinkable that a SIFI would be thrust suddenly and previously unaware into the circumstance of defending its viability or undergoing an involuntary restructuring. And Chapter 14 likewise reflects this commercial reality, by requiring:

> Counsel to the entity that may be a debtor or the Board shall provide, to the greatest extent practicable and without disclosing the identity of the potential debtor, sufficient confidential notice to the Director of the Administrative Office of the United States Courts and the chief judge of the court of appeals embracing the district in which the case will be commenced regarding the potential commencement of a case under this chapter . . . .[17]

My experience as a debtor's counsel leads me to believe strongly these prefiling discussions—among the company, its largest creditors, regulators, and other key parties in

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[16] 11 U.S.C. § 303.

[17] Section 1403(c).

interest—about the path of a potential, ***voluntary*** bankruptcy case—would already be underway and highly active in advance of the petition date.

Given this well-established practice of prepetition coordination, I expect the prelude to a Chapter 14 case would occur similarly. And thus the prospect of an involuntary GSIB proceeding is not needed to generate what is otherwise optimal: a planned and voluntary filing by a covered financial corporation seeking to stay ahead of its regulators, and creditors, and ensure control of its Chapter 14 case.

B. Interplay Between Chapter 14 & Title II

While I have been and remain critical of Title II, any debate over its viability or continuation should not impede the prospects for Chapter 14's enactment. Notably, assuming Title II does remain, the availability of Chapter 14's provisions would make it far less likely that Title II ever will be invoked, which actually is consistent with Congress's intent—***as expressed within Title II***—to utilize the Bankruptcy Code's reorganization powers first and a regulatory liquidation process only as a last resort.[18] And although

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[18] *See* 12 U.S.C. § 5383(a)(2)(F) (providing any recommendation by the Federal Government for a Title II proceeding shall contain "an evaluation of why a case under the Bankruptcy Code is not appropriate for the financial company").

Similarly, the Treasury Department, in its February 21, 2018 Report to the President of the United States Pursuant to the Presidential Memorandum Issued April 21, 2017, generally "recommend[ed] retaining [Title II] as an emergency tool for use under only extraordinary circumstances"—subject to various reforms—but further "conclude[d] unequivocally that bankruptcy should be the resolution method of first resort." U.S. TREASURY, ORDERLY LIQUIDATION AUTHORITY AND BANKRUPTCY REFORM, at 2.

Importantly, the Treasury Department likewise endorsed the "adoption of a Chapter 14 bankruptcy process [because] it will further guarantee that [Title II] is truly the option of last resort." *Id*. at 3-4.

> Chapter 14 bankruptcy would narrow the path to [Title II] by mitigating the potentially destabilizing effect of the bankruptcy of a large financial firm. In this respect, the Chapter 14 process would build on the resolution planning process under Title I of the Dodd-Frank Act and other post-crisis developments that have made U.S. financial companies more readily resolvable in bankruptcy . . . . While Treasury has proposed reforms to the resolution planning framework and capital and liquidity requirements, these developments

Chapter 14 is a needed and beneficial bankruptcy reform regardless of Title II, any uncertainty as to Title II makes Chapter 14's adoption even more essential.

The touchstone analytical framework for evaluating Chapter 14 should not be as a standalone proposal, but rather Chapter 14 as compared to the other SIFI insolvency resolution regimes at issue—namely, Chapter 11 in its current form, Chapter 11 as amended by Chapter 14, and Title II. As I have testified previously, among those alternatives, Chapter 14 is the best-designed option, both structurally and philosophically, to advance the private and public policies that animate the reorganization of a covered financial corporation. In other words, Chapter 14 is most likely to maximize estate value for the benefit of stakeholders, while safeguarding against the broader economic contagion that could result from the unmitigated failure of a SIFI. To explain further, I will assess briefly the varying incentives these available restructuring options present for debtors, creditors, and regulators.[19]

> have better prepared financial companies for resolution outside [Title II], and Chapter 14 would complement that work.

Id. at 4.

[19] *Cf*. Jeffrey M. Lacker, President, Fed. Reserve Bank of Richmond, Address at Louisiana State Univ. Graduate Sch. of Banking, *From Country Banks to SIFIs: The 100-Year Quest for Financial Stability* (May 26, 2015), at 5:

> The long-term solution [to the "too big too fail" problem] is not more regulation. Instead, it's to restore market discipline so that financial firms and their creditors have an incentive to avoid fragile funding arrangements. Two conditions are necessary to achieve this. First, creditors must not expect government support in the event of financial distress. Second, policymakers must actually allow financial firms to fail without government support. If we can make unassisted failures manageable, policymakers could credibly commit to foregoing rescues, thereby improving private sector incentives.

1. Debtor Incentives

As described above, in my experience representing very large Chapter 11 debtors, perhaps the most important component of a successful corporate restructuring is for directors and officers not to wait to address the company's increasing insolvency. Contrary to this goal are Title II's series of punitive measures for these individuals—dismissal upon commencement of a case, accompanied by the potential clawback of compensation and ban from future employment, *etc*.—that paradoxically will dissuade leadership from making the hard decisions to safeguard and enhance estate value.

(a) Director & Officer Liability

Section 1403(d) of Chapter 14 provides:

> The members of the board of directors (or body performing similar functions) of a covered financial company shall not be liable to shareholders, creditors, or other parties in interest (not including governmental units), for—
>
> (1) A ***good faith*** filing of a case under this chapter; or
>
> (2) For any ***reasonable*** action taken, on or before the date on which a case is commenced under this chapter, in good faith solely or primarily in preparation, authorization, or effectuation of such a filing or transfer under section 1405 or section 1406.[20]

This exculpation provision understandably may prompt some to question whether Chapter 14 is unwarrantedly (and problematically) shielding directors and officers from potential liability for their actions (or inactions). It is my strong view, however, for the following reasons, that this provision is highly justifiable.

[20] *Id*. (emphasis added).

(b) Debtor In Possession

First, as a threshold matter, and as I have testified before, the knowledge, expertise, and commitment of the company's prepetition directors and officers are indispensable to effectuating a soft landing into, and orderly passage through, bankruptcy. To that end, the Bankruptcy Code authorizes the "debtor in possession" to continue to manage the businesses postpetition,[21] not to insulate executives from responsibility for their actions, but to ensure the decisionmakers of distressed corporations are not dissuaded from pursuing the difficult but necessary restructuring decisions that may result in a Chapter 11 filing.

In other words, it is distinctly beneficial to motivate directors and officers to confront the corporation's problems as early as practicable and to pursue diligently all viable restructuring options. Chapter 14 helpfully incentivizes such conduct by removing the specter of legal liability for actions taken as responsible fiduciaries.

(c) Limited Scope & Language

Second, the scope and language of section 1403(d) are appropriately limited. Again, the only board decisions that Chapter 14 protects from potential liability are for a "good faith filing" and for "any reasonable action taken, on or before the date on which a case is commenced under this chapter, in good faith solely or primarily in preparation, authorization, or effectuation of such a filing".[22]

As an initial matter, the Bankruptcy Code already provides that a Chapter 11 case may be dismissed "for cause," which has been interpreted to include a "bad faith" filing

[21] 11 U.S.C. §§ 1107, 1108.

[22] Section 1403(d).

(such as commencing a case without a legitimate economically rehabilitative purpose).[23] Thus Chapter 14 merely reinforces the existing requirement that a bankruptcy filing must be made in good faith—if it is not, and the case is dismissed, Chapter 14 offers no added protection from liability.

Moreover, it is manifestly sound public policy that "any reasonable action taken . . . in good faith" in preparation, authorization, or effectuation of a filing ***should*** be protected. Here as well, if it can be shown that the challenged actions were taken in bad faith or were unreasonable, the board could be liable. And to state further the obvious, the language of section 1403(d) does not at all encompass any hypothetically improper conduct that may have led to the filing—it only covers the ***good faith*** filing and asset transfer determinations. Put simply, Chapter 14 does not bestow extraordinary or unwise protections for bad faith or unreasonable board actions.

(d) Other Remedies

Finally, Chapter 14 properly does not supplant other existing remedies, both under the Bankruptcy Code or otherwise applicable law, for any board malfeasance. In stark contrast, for example, Title II requires that, upon placement of the financial company into receivership, all directors and officers shall be dismissed, potentially subject to clawback of compensation, and possibly banned from future industry employment.[24] Within Title

[23] 11 U.S.C. § 1112(b)(1).

[24] Specifically, Title II mandates that "management responsible for the condition of the financial company will not be retained" and the FDIC and other agencies "will take all steps necessary and appropriate" to ensure that management "bear losses consistent with their responsibility" for the failure of the financial company. 12 U.S.C. § 5384(a). The FDIC may seek to recover from any current or former senior executive or director "any compensation" received within two years of the FDIC appointment date. 12 U.S.C. § 5390(s)(1). The FDIC also may seek to ban directors or executives from participating in the "affairs of any financial company," for a period of no less than two years, for violating any laws or breaching their fiduciary duties. 12 U.S.C. § 5393(c)(1).

II's punitive construct, directors and officers are perversely discouraged from pursuing formal restructuring options (that will trigger their dismissal), which is a distinctly negative dynamic.

Chapter 14, on the other hand, exercises admirable restraint in not vilifying, much less outright disqualifying, a covered financial company's existing leadership from continuing to serve the debtor in possession—subject to already applicable Bankruptcy Code grounds for penalty as merited. For instance, if the leadership of a Chapter 11 debtor (including a covered financial corporation under Chapter 14) has acted in a manner that justifies its removal, the Bankruptcy Code already provides ample tools for doing so and installing an examiner or trustee.[25] And, of course, Chapter 14 does not preclude suits for breach of fiduciary duty, or other shareholder derivative claims against directors and officers, for unlawful actions. To be clear, any director and officer misconduct should be prosecutable to the fullest extent of the law—and Chapter 14 in no way impedes the ability of law enforcement or interested parties from holding directors and officers accountable for any legally cognizable misdeeds.

In sum, Chapter 14 strikes the right balance between encouraging covered financial corporation boards to make responsible restructuring decisions, without undue concern for potential legal liability (that could lead to delay or otherwise erode estate value, while exacerbating broader market instability), and not diminishing third-party rights to seek recourse for legitimately culpable conduct. Chapter 14's express allowance for

[25] *See, e.g.*, 11 U.S.C. § 1104(a)(1) (providing the court shall order the appointment of a trustee or examiner to assume and perform the management duties of the debtor "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case").

management to continue to operate the debtor in possession—and/or manage the bridge company—to maximize stakeholder recoveries is the proper approach to incentivize management and align their interests with creditor and other stakeholder constituencies.

2. Creditor Incentives

As to creditor incentives, the key challenge is to craft a scheme of enforceable recovery rights and value distribution priority that favorably influences lender behavior. As I have previously testified, the "moral hazard" targeted by Title II results when creditors are incentivized to make risky loans because governing legal and regulatory regimes operate to privatize gains but socialize losses. Investors will engage in increasingly speculative behavior if they are reasonably assured they will enjoy outsize profits if an investment succeeds, but the government will shield them from outsize harms if it fails.

To the extent that Title II requires "[a]ll financial companies put into receivership under [Title II] shall be liquidated" and "[n]o taxpayer funds shall be used to prevent the liquidation of any financial company under this [title],"[26] it does (arguably) follow that public dollars will not be used to "bail out" a failing covered financial corporation. But lenders care about being repaid in full; they are not concerned with whether the borrower survives or which entity, private or public, funds the repayment.

Further, Title II expressly authorizes the dissimilar treatment of similarly situated creditors.[27] And because any excess costs of liquidation will be funded by assessments on third-party financial companies,[28] Dodd-Frank essentially allows regulators to pay

[26] 12 U.S.C. § 5394(a).

[27] 12 U.S.C. § 5390(b)(4).

[28] 12 U.S.C. § 5390(o)(1)(B).

creditors whatever amounts are deemed necessary to stabilize the economy, according to the economic and political priorities of that current Administration.

Chapter 14, on the other hand, provides to creditors clear rules, that build upon the established provisions of Chapter 11, applied by experienced and neutral Bankruptcy Court judges. Accordingly, creditors will make their investment decisions with at least an informed understanding of (and confidence in) the enforceability and priority of repayment rights, based on the transparency and predictability of Chapter 11, if the borrower needs to restructure. So understood, Chapter 14 augments Chapter 11's promotion of knowledgeable—and hopefully rational—creditor behavior.

3. Regulator Incentives

Divining regulator incentives may be more difficult, as these actors are charged with advancing the public good, not safeguarding economic self-interest. That said, it seems fairly logical to assume that, in the absence of Chapter 14, if a SIFI is failing, the Federal Government almost certainly will initiate a Title II proceeding, given the Bankruptcy Code does not currently provide an expansive grant of standing to the Federal Government to participate in Chapter 11 cases.[29] The Code does give a limited right to be heard to the Securities and Exchange Commission (the "SEC"),[30] but unless the Federal Government has a financial stake in the debtor, regulatory bodies do not have standing to appear, in their capacity as regulators, and pursue their public interest mandates in SIFI

[29] 11 U.S.C. § 1109(b) ("A party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter.").

[30] 11 U.S.C. § 1109(a) ("The Securities and Exchange Commission may raise and may appear and be heard on any issue in a case under this chapter, but the Securities and Exchange Commission may not appeal from any judgment, order, or decree entered in the case.").

cases under Chapter 11. As between Chapter 11 in its present form and Title II, it would be rational for regulators to prefer the resolution regime that facilitates their most robust involvement.

Chapter 14, however, appropriately addresses this present limitation by providing the Federal Reserve, the SEC, the Office of the Comptroller of the Currency, and the FDIC "may raise and may appear and be heard on any issue in any case or proceeding under" Chapter 14.[31] Moreover, Chapter 14 further provides "[t]he [bankruptcy] court may consider the effect that any decision in connection with this chapter may have on financial stability in the United States."[32]

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In sum, even if Title II remains an available option indefinitely, Chapter 14's express grant of standing to the Federal Government, and consideration of the public interest pursuant to a SIFI restructuring, makes it plausible (if not likely) the applicable regulators would permit a Chapter 14 proceeding by declining to exercise their Title II commencement rights.

Conclusion

Thank you again for inviting me to appear before you today. I appreciate the Committee allowing me to share my views. And I welcome the opportunity to answer any questions about my testimony.

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[31] Section 1404.

[32] Section 1413. As I have previously noted, a historical analogue to Chapter 14, and its stated goal of protecting the public interest, are the Bankruptcy Code provisions that include the "public interest" as an applicable factor in a debtor's decisions in railroad cases. *See* 11 U.S.C. § 1165 (requiring that "[i]n applying sections 1166, 1167, 1169, 1170, 1171, 1172, 1173, and 1174 of this title, the court and the trustee shall consider the public interest in addition to the interests of the debtor, creditors, and equity security holders").