II. Orderly Liquidation Authority

A. Introduction

In response to the bailouts of financial institutions deemed "too big to fail" during the financial crisis in 2008, Title II of the Dodd-Frank Act creates a new resolution authority for large financial institutions whose failure could threaten the United States economy. This Orderly Liquidation Authority ("OLA") replaces bankruptcies for affected financial institutions, vesting federal receivership powers in the FDIC similar to the FDIC's existing powers to take over insured depository institutions.

The OLA, however, raises significant issues. The OLA will replace a predictable, transparent judicial bankruptcy process with an unpredictable, untested agency process. The OLA also alters shareholder and creditor rights, particularly unsecured creditor rights, from those in traditional bankruptcy proceedings. Consequently, rather than mitigating future financial crises, OLA and its uncertain impact on creditor rights could bring about the very financial instability that Dodd-Frank was intended to resolve.

B. Bailouts, Bankruptcies and the Financial Crisis

In the wake of the 2008 financial crisis, a general consensus emerged that the failure of financial institutions that were "too big to fail" and the costly bailouts they required resulted from the failure of the U.S. Bankruptcy Code ("Code") to provide for their orderly resolution.[1] Experts often cite the Lehman Brothers bankruptcy, which caused the largest drop on Wall Street since the September 11, 2001 terrorist attacks, as proof that traditional bankruptcies are inadequate in the case of large financial firms.[2] This line of argument

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[1] *See* Donna Borak, *FCIC: Will Dodd-Frank Stop Future Bailouts?* AMERICAN BANKER. September 3, 2010, at 3 (indicating that if Dodd-Frank had been in place the government would have "had a detailed resolution plan" and "seized and unwound [Bear Stearns, Lehman, and AIG]."); *see* Chann, *infra* note 3.

[2] Alex Berenson, *Wall St.'s Turmoil Sends Stock Reeling*. N. Y. TIMES Sep. 16, 2008, at C7; *See* Michelle Harner, *Dodd-Frank Forum: Who Benefits from the New Resolution Authority*, THE CONGLOMERATE (Sept. 28, 2010, 8:31 AM) *available at:* http://www.theconglomerate.org/2010/07/dodd frank-forum-who-benefits-from-the-new-resolution-authority.html.

holds that in the case of Lehman, bankruptcy courts were too cumbersome and lacked the expertise to efficiently grapple with the firm's complex financial structure.[3]

As a result of the Code's perceived shortcomings and the continued threat to the US financial system posed by failing financial firms, Title II of the Dodd-Frank Act creates the OLA, a new resolution authority for large and complex financial institutions whose failure could destabilize the foundations of United States economy.[4] Functionally, the OLA may replace bankruptcies for affected financial institutions, vesting federal receivership powers in the FDIC similar to the FDIC's existing powers to take over insured depository institutions.[5] But the OLA's greater purpose is to ensure that financial institutions are not "too big to fail," thereby stabilizing and restoring market discipline to the US financial system.[6]

C. OLA Resolution Authority

1. Determination of Entities Subject to OLA

A "financial company" is subject to Title II's alternative resolution authority.[7] The OLA defines a "financial company" as any company incorporated or organized under any provision of federal or state law and is: (i) a bank holding company as defined in section 2(a) of the Bank Holding Company Act of 1956 ("BHCA");[8] (ii) a non-bank financial company supervised by the U.S. Federal Reserve Board of Governors ("FRB");[9] (iii) any company that is predominantly engaged in activities that the FRB has determined are

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[3] Sewell Chann & Binyamin Appelbaum, *They've Got It: Fixes for the Financial System*, N.Y. TIMES, Apr. 24, 2010, at WK3, *available at* http://www.nytimes.com/2010/04/25/weekinreview/25chan.html.
[4] *See 2010 U.S. bank failures now 125*. UNITED PRESS INTERNATIONAL, Sep. 18, 2010, http://www.upi.com/Business_News/2010/09/18/2010-US-bank-failures-now-125/UPI-41181284826535/.
[5] Joseph Gabai, *Dodd-Frank, Title: Where the FDIC and the "Orderly Liquidation Authority" Meet the Bankruptcy Code*, p. 1, August 31, 2010, *available at* http://www.mofo.com/files/Uploads/Images/100831TitleII. pdf.
[6] *Id.*
[7] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 201(a)(11), 124 Stat 1376 (2010) (to be codified at 12 U.S.C. § 5381).
[8] *Id.* at § 201(a)(11)(B)(i) (to be codified at 12 U.S.C. § 5381).
[9] *Id.* at § 201(a)(11)(B)(ii) (to be codified at 12 U.S.C. § 5381).

financial in nature or incidental thereto (i.e., 85 percent of their annual gross revenues are derived from activities that are "financial in nature);[10] or (iv) any subsidiary of the above that is predominately engaged in activities that the FRB has determined are financial in nature or incidental thereto (not including subsidiaries that are insured depository institutions or insurance companies).[11]

2. Systemic Risk Determination

To initiate an alternative liquidation under the OLA, a covered financial company must pose a "systemic risk."[12] In order to make this determination, the FDIC and FRB must recommend, either on their own initiative or at the request of the Secretary of the Treasury ("Secretary"), the appointment of the FDIC as a receiver for a covered financial company.[13] At least two-thirds of the FRB members and FDIC board of directors must approve this recommendation. The recommendation must address the following criteria: (i) whether a company is in default or in danger of default; (ii) the effect that the default of the financial company would have on financial stability in the United States; (iii) the effect that the default of the financial company would have on economic conditions or financial stability for low income, minority, or underserved communities; (iv) a recommendation regarding the nature and the extent of actions to be taken; (v) whether a private sector alternative to prevent the default of the financial company exists; (vi) why a case under the Bankruptcy Code is not appropriate for the financial company; (vii) the effects on creditors, counterparties and shareholders of the financial company; and (viii) whether the company satisfies the definition of a financial company under section 201.[14]

Based on the FRB and FDIC recommendation, the Secretary in consultation with the President of the United States must then determine whether to appoint the FDIC as receiver for the covered

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[10] *Id.* at § 201(a)(11)(B)(iii) (to be codified at 12 U.S.C. § 5381); Mark A. McDermott. *Orderly Liquidation Authority*, p. 1, *available at:* http://skadden.com/newsletters/FSR_Orderly_Liquidation_Authority.pdf

[11] *Id.* at § 201(a)(11)(B)(iv) (to be codified at 12 U.S.C. § 5381).

[12] *Id.* at § 203(a) (to be codified at 12 U.S.C. § 5383).

[13] *Id.* at § 203(a)(1(A) (to be codified at 12 U.S.C. § 5383).

[14] *Id.* at § 203(a)(2) (to be codified at 12 U.S.C. § 5383).

financial company in danger of default.[15] The OLA stipulates that a financial company is in default or in danger of default if (i) a bankruptcy case has been, or likely will promptly be, commenced with respect to the covered financial company; (ii) the financial company has incurred, or is likely to incur, losses that will deplete all or substantially all of its capital, and there is no reasonable prospect for the company to avoid such depletion; (iii) the assets of the financial company are, or are likely to be, less than its obligations to creditors and others; or (iv) the financial company is, or is likely to be, unable to pay its obligations (other than those subject to a bona fide dispute) in the normal course of business.[16]

3. Appointment of FDIC as Receiver

The OLA is designed to swiftly appoint the FDIC as a receiver for a covered financial company.[17] Once the Secretary determines that a financial company poses a systemic risk, the Secretary must notify the financial company and the FDIC.[18] If the financial company's board of directors consents or acquiesces to the appointment of the FDIC as receiver, the FDIC becomes the receiver.[19] Board members cannot be liable to shareholders or creditors for acquiescing in or consenting in good faith to the FDIC's appointment as receiver.[20]

If the defaulting financial company's board does not consent to the appointment of FDIC as receiver, "the Secretary shall petition the United States District Court for the District of Columbia ("Court") for an order authorizing the Secretary to appoint the Corporation as receiver."[21] The covered financial company must receive notice of the Secretary's filing and will have an opportunity to oppose the petition.[22]

When reviewing the Secretary's petition, the Court must determine whether the Secretary's findings that the covered financial

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[15] *Id.* at § 202(b) (to be codified at 12 U.S.C. § 5382).
[16] *Id.* at § 203(c)(4) (to be codified at 12 U.S.C. § 5383).
[17] Gabai, *supra* note 5, at 4.
[18] Dodd-Frank, *supra* note 7, at § 202(a)(1)(A)(i) (to be codified at 12 U.S.C. § 5382).
[19] *Id.* at § 202(a)(1)(A)(i) (to be codified at 12 U.S.C. § 5382).
[20] *Id.* at § 207 (to be codified at 12 U.S.C. § 5387).
[21] *Id.* at § 202(a)(1)(A)(i) (to be codified at 12 U.S.C. § 5382).
[22] *Id.* at § 202(a)(1)(A)(iii) (to be codified at 12 U.S.C. § 5382).

company 1) is in danger of default; and 2) satisfies the definition of a financial company were arbitrary and capricious.[23] If the Court determines that the Secretary's findings were arbitrary and capricious, the Court must provide the Secretary a written statement supporting its reasoning and allow the Secretary the opportunity to amend and re-file.[24] If the Court rules that the Secretary's findings were not arbitrary and capricious, or the Court does not make a determination within twenty four hours of receipt of Secretary's petition, the petition will be granted.[25]

Both the Secretary and a covered financial company have thirty days to appeal the Court's decision on an expedited basis.[26] However, the Court's decision is not subject to stay or injunction pending appeal.[27] Once the FDIC becomes the receiver, the Code no longer applies and the covered financial company's liquidation is administered exclusively under Title II.[28] Given the abbreviated period allowed for review of a Secretary's petition and the fact that the FDIC's appointment cannot be enjoined, the practical opportunity to review the FDIC's appointment as receiver is extremely limited.

D. Liquidation Process

1. FDIC Powers

The OLA grants the FDIC broad powers. As one commentator states, "once the FDIC is appointed receiver of a covered financial company, it assumes virtually complete control over the liquidation process, the role of the courts in the core receivership process ends and only limited avenues exist for challenging the various ancillary decisions that the FDIC may make . . ."[29] Many of the FDIC's receivership powers mirror those

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[23] *Id.* at § 202(a)(1)(A)(iv) (to be codified at 12 U.S.C. § 5382).
[24] *Id.* at § 202(a)(1)(A)(iv)(II) (to be codified at 12 U.S.C. § 5382).
[25] *Id.* at § 202(a)(1)(A)(v)(I) (to be codified at 12 U.S.C. § 5382).
[26] *Id.* at § 202(a)(2)(A) (to be codified at 12 U.S.C. § 5382).
[27] *Id.* at § 202(a)(1)(B) (to be codified at 12 U.S.C. § 5382).
[28] James H.M. Sprayregen & Stephen E. Hessler, *"Orderly Liquidation Authority" Under the Dodd-Frank Act: The United States Congress's Misdirected Attempted to Ban Wall Street Bailouts*, INSOL WORLD, at 21, (Third Quarter 2010), *available at*: http://www.kirkland.com/siteFiles/Publications/ARTICLES%20-%20PRINTING%20ALLOWED%20-%20INSOL%20World%20-%20Sprayregen_Hessler.pdf.
[29] McDermott *supra* note 10, at 3.

available in a traditional bankruptcy and include the authority to succeed to all rights, titles, powers and privileges of the covered financial company and its assets;[30] take over the assets of and operate the covered financial company;[31] collect all obligations and money owed to the covered financial company;[32] resolve claims to creditors;[33] and repudiate or assign contracts entered into by a financial company.[34]

The OLA, however, also invests the FDIC with new powers without analogs in traditional bankruptcy. For example, the FDIC can create a "bridge financial company" ("BFC") to acquire the assets and liabilities of the covered financial company as receiver or in anticipation of its appointment as receiver.[35] The FDIC requires no court, creditor, or shareholder approval to create a BFC.[36] A board of directors appointed by the FDIC manages a BFC.[37] A BFC is not a permanent entity.[38] The FDIC grants a BFC a charter for two-years that can be extended for up to three additional years.[39]

In addition, whereas the Code requires creditors with similar claims to be treated equally, the OLA empowers the FDIC to treat similarly situated creditors differently.[40] The FDIC may treat similar creditors dissimilarly for a number of reasons, including to maximize the value of the company's assets, or to minimize the amount of any loss realized upon the sale or disposition of the company.[41] Thus, while the FDIC may not pay similarly situated unsecured creditors less than they would in a liquidation under Chapter 7, the FDIC can favor certain unsecured creditors over others.[42]

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[30] Dodd-Frank, *supra* note 7, at § 210(a)(1)(A)(i) (to be codified at 12 U.S.C. § 5390).
[31] *Id.* at § 210(a)(1)(B)(i) (to be codified at 12 U.S.C. § 5390).
[32] *Id.* at § 210(a)(1)(B)(ii) (to be codified at 12 U.S.C. § 5390).
[33] *Id.* at § 210(a)(2) (to be codified at 12 U.S.C. § 5390).
[34] *Id.* at § 210(c)(1) (to be codified at 12 U.S.C. § 5390).
[35] *Id.* at § 210(h)(1)(A) (to be codified at 12 U.S.C. § 5390).
[36] *Id.* at § 210(h)(2)(E)(ii) (to be codified at 12 U.S.C. § 5390).
[37] *Id.* at § 210(h)(2)(B) (to be codified at 12 U.S.C. § 5390).
[38] Gabai *supra* note 5, at 7.
[39] *Id.*
[40] Spraygen & Hessler, *supra* note 28, at 22; Dodd-Frank, *supra* note 7, at § 210(b)(4) (to be codified at 12 U.S.C. § 5390).
[41] Dodd-Frank, *supra* note 7, at § 210(b)(4)(A) (to be codified at 12 U.S.C. § 5390).
[42] Spraygen & Hessler, *supra* note 28, at 22.

2. Orderly Liquidation Fund

Still smarting from the costly bailouts of 2008, Congress expressly required that "taxpayers shall bear no losses from the exercise of any authority under" Title II of the Dodd-Frank Act.[43] Consequently, the OLA ultimately requires the financial sector to subsidize the FDIC's new resolution powers. The OLA establishes in the Treasury Department a separate fund called the Orderly Liquidation Fund ("Fund") available to the FDIC.[44] If a covered financial company's assets are not sufficient to fund its liquidation, the FDIC may borrow from the Fund after reaching an agreement with the Secretary about a specific plan for repayment.[45] The Fund will be largely supported through assessments on financial companies with more than $50 billion in total assets and nonbank financial companies supervised by the FRB.[46]

3. Unsecured Creditor Claim Priorities

The OLA's prioritization of unsecured creditor claims deviates from the Code. First, the FDIC will reimburse its own administrative expenses before addressing any unsecured creditor claims.[47] The OLA also changes the priority scheme between unsecured creditors. The Code gives priority to 502(f) claims, which arise in the ordinary course of the debtor's business or financial affairs (i.e. a company's unsecured debts to other businesses), over all other unsecured claims.[48] Under the OLA, however, 502(f) claims are subordinated to two unsecured claim classifications: 1) unpaid wages and benefits up to $11,725 non-executives earned 180 days prior to the FDIC appointment of receiver; and 2) contributions owed to employee benefit plans.[49]

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[43] Dodd-Frank, *supra* note 7, at § 214(c) (to be codified at 12 U.S.C. § 5394).
[44] *Id.* at § 210(n) (to be codified at 12 U.S.C. § 5390).
[45] *Id.* at § 210(n)(9)(A) (to be codified at 12 U.S.C. § 5390).
[46] *Id.* at §§ 210(n)(2) (to be codified at 12 U.S.C. § 5390) and §210(o)(1) (to be codified at 12 U.S.C. § 5390).
[47] *Id.* at § 210(b)(1) (to be codified at 12 U.S.C. § 5390).
[48] 11 USCA § 507(a)(3) (West 2010).
[49] Dodd-Frank, *supra* note 7, at § 210(b)(1) (to be codified at 12 U.S.C. § 5390).

4. Management Liability

Motivated by public dissatisfaction with Wall Street, Congress included several provisions in the OLA that create significant potential liability for management of covered financial companies.[50] First, "management responsible for the financial company will not be retained" by the company.[51] The OLA mandates the FDIC to "take all steps necessary and appropriate to assure that all . . . management . . . having responsibility for the condition of the financial company bear losses consistent with their responsibility, including actions for damages, restitution and recoupment of compensation and other gains not compatible with such responsibility."[52] Perhaps most interesting, the FDIC may seek to ban a senior executive or director from the financial services industry for more than two years if such a person (i) violates a law or regulation; (ii) participates in "any unsafe or unsound practice"; or (iii) breaches their fiduciary duty.[53]

E. The OLA: Resolution at Creditors' Expense?

The new resolution authority established by the OLA significantly alters liquidation proceedings for covered financial companies. Like any major change to an established system, the OLA's departure from traditional bankruptcy has engendered criticisms. For example, some commentators question the wisdom of replacing a predictable and transparent judicial bankruptcy process with an untested agency process.[54] Other concerns, however, focus on the OLA's substance, particularly the OLA's treatment of unsecured creditors.

Unsecured creditors face uncertainty about whether a defaulting financial institution will be liquidated under Chapter 7 or the OLA.[55] Compounding this uncertainty is the fact that financial

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[50] *See* Spraygen & Hessler, *supra* note 28, at p. 22.
[51] Dodd-Frank, *supra* note 7, at § 204(a)(2) (to be codified at 12 U.S.C. § 5384).
[52] *Id.* at §204(a)(3) (to be codified at 12 U.S.C. § 5384).
[53] *Id.* at § 213(b)(1) (to be codified at 12 U.S.C. § 5393).
[54] *See* Chann & Applebaum *supra* note 3.
[55] Interview with Randall Guynn, *Ending Too Big to Fail*, WALL ST. J., Aug. 27, 2010, *available at* http://online.wsj.com/video/ending-too-big-to-fail/9F800511-CD66-4CF8-AED0-D663490D78CC.html.

companies that have already commenced bankruptcy proceedings can be removed from bankruptcy proceedings and placed into the OLA process.[56] Thus, even creditors pressing claims under a current Chapter 7 proceeding cannot be sure that the OLA will not be invoked at a later date, thereby subjecting their claims to FDIC scrutiny.

Another concern for creditors involves judicial review of disallowed claims. While the OLA allows creditors to file suit on disallowed claims, the OLA does not specify how the FDIC's disallowance of the claim will be subject to judicial review.[57] The OLA also deviates from judicial review under bankruptcy by requiring creditors to file suit in the district where a covered financial company's principal place of business is located.[58] By requiring creditors to challenge disallowed claims in the district court where the defaulting financial company's principal place of business is located, creditors may be forced to pursue litigation in an unfamiliar and inconvenient jurisdiction.[59]

Unsecured creditors must also be wary of the many provisions that are inconsistent between the OLA and Chapter 7. For example, the OLA maintains a flat prohibition on oral contracts, which are applicable under Chapter 7 if enforceable under state law.[60] The OLA also contains special provisions involving the enforceability of written contracts.[61] Such discrepancies between Chapter 7 and the OLA could significantly impact unsecured creditors' claims.

F. Conclusion

The ultimate impact of the OLA will largely depend on judicial interpretation and agency rule-making.[62] The OLA may be

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[56] *See* Gabai *supra* note 5, at 3-5.
[57] Dodd-Frank, *supra* note 7, at § 210(a)(4)(A) (to be codified at 12 U.S.C. § 5390).
[58] Spraygen & Hessler, *supra* note 28, at 22.
[59] Dodd-Frank, *supra* note 7, at § 210(a)(4)(A) (to be codified at 12 U.S.C. § 5390); Harner *supra* note 2.
[60] Interview with Randall Guynn, *supra* note 55.
[61] *Id.*
[62] *See* Joe Adler, *FDIC Plots Large-Firm Resolutions: Agency must develop new system, identify targets, hire staff,* AMERICAN BANKER, July 7, 2010 ("[T]he agency is required to issue several rules to ensure a new structure is up and running soon.").

the ideal mechanism for handling the liquidation of financial firms that would otherwise be "too big to fail." But given the uncertainties surrounding Title II, its limited opportunity for judicial review and its treatment of creditors, some commentators believe the OLA could create as many problems as it solves. For example, one can imagine a situation where unsecured creditors, fearing lack of creditor protection under the OLA, abandon a covered financial company at the first hint of default, thereby creating the financial instability that the new resolution authority was designed to prevent.[63] Whether or not this disaster scenario comes to pass, regulators and financial companies alike should be vigilant about the OLA.

Adam Mayle[64]

[63] *Financial reform in America: The hand of Dodd*, THE ECONOMIST, March 20, 2010 ("The threat of being wiped out in bankruptcy could cause creditors to flee both the troubled firm and any firms like it, precisely the sort of panic the resolution regime is meant to avoid.").

[64] Student, Boston University School of Law (J.D. 2012).