

## **ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11**

### **Financial Contracts, Derivatives and Safe Harbors Advisory Committee**

Full Committee Meeting

January 25, 2013

New York, New York

#### MINUTES/SUMMARY

The Financial Contracts, Derivatives and Safe Harbors Advisory Committee ("Committee") of the ABI Commission held a full committee meeting on Friday, January 25, 2013, at the New York offices of Cleary Gottlieb. *The following individuals participated in the meeting:* Co-Chair The Hon. James M. Peck, Co-Chair Seth Grosshandler, Commissioner Donald S. Bernstein, ABI Executive Director Samuel J. Gerdano, Lawrence Brandman, Mark C. Ellenberg, Stephen J. Lubben, Mark J. Roe, The Hon. Christopher S. Sontchi, Kimberly Summe, Shmuel Vasser, Co-Reporter Edward R. Morrison, Co-Reporter Eric G. Waxman III, and Commission Research Fellows Temi R. Kolarova and Knox L. McIlwain. Jeffrey Amico, a paralegal at Cleary Gottlieb was also in attendance.

Mr. Grosshandler called the meeting to order at 11:00 a.m. (ET) and the meeting adjourned at approximately 4:00 p.m. (ET). The following matters were discussed during the course of the meeting.

*Opening Remarks:* Judge Peck and Mr. Grosshandler welcomed the Committee members, provided a brief re-cap of the December meeting, and obtained approval of the public minutes from the December 2012 meeting. Mr. Grosshandler said that the Committee would spend most of its time on specific reforms and Judge Peck highlighted the great breadth of issues and policy questions to be addressed. At this meeting, the Committee would complete its review of Preliminary Assessment subtopics, identify specific safe harbor issues to be addressed by subcommittees, and discuss potential witnesses for the ABI Commission's May meeting.

#### Topics from the Preliminary Assessment:

Prior to the December meeting, subtopics from the Preliminary Assessment of Safe Harbors for Qualified Financial Contracts were assigned to Committee members, who prepared discussions/overviews of the assigned subtopics for presentation. The Committee resumed and completed its review of the subtopics that began in December.

*Assumption or Rejection of Qualified Financial Contracts:* Judge Sontchi and Mr. Grosshandler led an in-depth discussion of the potential treatment of QFCs if the safe harbors were amended to allow a period of time for the debtor to decide whether to assume or reject the QFCs, rather than allow for immediate liquidation. Mr. Grosshandler described the treatment of QFCs in other regimes, such as banks under the Federal Deposit Insurance Act and large financial institutions under the Orderly Liquidation Authority. Judge Sontchi addressed the time periods and procedural issues attendant to a decision whether to assume or reject QFCs and adequate protection concerns. Messrs. Morrison and Roe compared treatment of QFCs in the absence of safe harbors. Judge Peck and Mr. Grosshandler discussed the *Metavante* case, where a counterparty deferred the close-out of a QFC.

*Avoidance Power Safe Harbors for QFCs.* Should payments, collateral transfers, and netting/setoff be exempt from avoidance attack? Judge Peck and Mr. Vasser led the discussion of this question and related issues. Judge Peck addressed the potential conflict between (i) immunization of transfers from avoidance under the safe harbors with (ii) bankruptcy policies favoring debtor rehabilitation, maximization of recoveries/distributions, and equitable distribution across creditors with similar priority. He cited as illustrative the *Quebecor* case where prepetition payments on notes were not subject to avoidance due to application of Bankruptcy Code section 546(e) and current Second Circuit law. Mr. Vasser addressed the scope of the protection and led an in-depth discussion of tripartite setoff rights. Several committee members examined alternatives to setoff and related transaction costs.

*Realization on Collateral and Netting.* Assuming close-outs for QFCs are permitted, should the immediate realization on collateral also be permitted under the safe harbors? Messrs. Waxman and Morrison discussed different proposed treatments that depend on the type of QFC, the liquidity of the collateral, and the availability of self-help remedies.

*Bank Holding Companies, Broker-Dealers, Commodity Brokers, and Other Financial Debtors.* Mr. Grosshandler made brief remarks about the different insolvency regimes and the desire to promote coordination among them.

*Claims in respect of QFCs.* Judge Sontchi and Mr. Grosshandler led an extended discussion about determining a counterparty's claim for damages related to QFCs. Mr. Grosshandler noted inadequacies under Bankruptcy Code section 562 and Judge Sontchi addressed the *American Home* decision and the application of discounted cash flow analysis. Messrs. Ellenberg and Vasser spoke to the application of UCC Article 9 and valuation based on market measures.

*Delays in the Exercise of Safe Harbor Termination Rights.* Judge Sontchi and Messrs. Brandman and Grosshandler led a discussion concerning the timing of close-out rights, the *Metavante* decision, and the rights under standard transaction documentation.

*One Way Payment Provisions.* Judge Peck and Mr. Vasser evaluated QFC provisions that deprive a defaulting party of the benefit of the contract even if the defaulting party is "in the money." The discussion that followed favored a two way payment approach.

*Subcommittees and Potential Witnesses for Commission Meeting.*

The Committee concluded its evaluation of the Preliminary Assessment subtopics and then turned to specific issues and formation of subcommittees. Messrs. Ellenberg, Roe and Vasser comprise a subcommittee to address issues under Bankruptcy Code section 546(e), (f), and (g). Judge Sontchi and Messrs. Grosshandler and Morrison comprise a subcommittee to address issues under Bankruptcy Code section 562. The Committee also began identifying potential witnesses to provide statements about QFCs and safe harbors to the ABI Commission at its May 2013 meeting.

*Conclusion/Next Meeting:* Judge Peck and Mr. Grosshandler thanked all participants for their attendance and contributions. The next Committee meeting will be Monday, February 25, 2013, from 10:00 a.m. (ET) to 3:00 p.m. (ET) at the New York offices of Cleary Gottlieb.