PREPARED STATEMENT OF

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before
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON REGULATORY REFORM,
COMMERCIAL AND ANTITRUST LAW

regarding

H.R. ___, the "Financial Institution Bankruptcy Act of 2017"

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Mr. Chairman and Members of the Subcommittee on Regulatory Reform, Commercial and Antitrust Law:

My name is Mary Walrath. I have been a Bankruptcy Judge for the District of Delaware since 1998 and served as Chief Judge of that Court from 2003 to 2008. I am currently the President of the National Conference of Bankruptcy Judges, an organization that represents almost 350 bankruptcy judges across the nation. I am also an observer to the Bankruptcy Judges Advisory Group to the Administrative Office and to the Committee on the Administration of the Bankruptcy System for the Judicial Conference, as well as various committees of the Third Circuit Judicial Council.

However, I am here in my personal capacity only and my views do not reflect the views of the NCBJ or the Judicial Conference or any other committee or organization of which I am a member. I also take no position for or against any specific legislation pending before Congress. I only wish to give you the benefit of my experience as a bankruptcy judge for 19 years (and before that as a bankruptcy lawyer for 17 years) as you consider the Financial Institution Bankruptcy Act of 2017 or any similar legislation. I cannot tell you if this legislation will work but I do know that many smart people have had input into it.

As a bankruptcy judge, I have had experience dealing with large corporate bankruptcies, with the process of transferring

assets in bankruptcy including sales of large operating businesses as going concerns, and with the allowance of claims and distributions to creditors in large cases. I also have some familiarity with the intersection of bankruptcy law and the financial markets, having presided over the case filed in 2008 (at the height of the financial crisis) by Washington Mutual, Inc., the holding company of the Washington Mutual Bank, known as WaMu.

The WaMu bankruptcy case was by many objective standards a successful case. In excess of $7 billion was distributed to creditors and shareholders. Virtually all creditors received 100% of their claims with post-petition interest and shareholders received stock and warrants in a subsidiary that was capitalized with $150 million in new money. The WaMu case did not have the issues that the bill before you now is intended to solve because the WaMu Bank had been seized and transferred by the FDIC before the holding company filed its bankruptcy proceeding. However, I think that some of the issues that became apparent in the WaMu case can shed light on the subject before you.

A bill that allows for voluntary bankruptcy proceedings involving holding companies of financial institutions (even systemically important ones) before the financial institution is seized and sold is laudable. There are several reasons why I believe that this is a good option: First, the bankruptcy laws

in this country have been around for many years and judges, lawyers, financial institutions, creditors, shareholders, prospective buyers, and the public generally are familiar with the process. Second, the bankruptcy process is transparent, largely occurring in open court, and balances the interests of all parties. Third, the bankruptcy courts are able to deal with financial crises under expedited timelines. Fourth, the bankruptcy laws provide a clearly defined process for sales of assets and transfer of executory contracts and recognize that reorganizing or selling businesses as going concerns preserves value for all parties in interest. Fifth, the bankruptcy procedure for allowance of claims and distributions of the estate's assets to creditors is well-developed and easy for creditors to navigate. Let me explain why these concepts are important and how the WaMu case (and other large corporate cases) deal with these issues.

1. Bankruptcy Laws Are Familiar

There have been comprehensive bankruptcy laws in the United States since at least 1898. Since 1978 with the passage of the Bankruptcy Code, the bankruptcy laws and courts have been utilized by individuals and companies in growing numbers to reorganize their debts and to sell their assets.

More than any other part of the federal court system, the general public comes into contact most often with the bankruptcy

courts. Annually, over the last decade, between 800,000 and 1.6 million individuals and companies filed bankruptcy (either liquidating cases or cases where they paid their creditors over time). On average, more than 7,000 chapter 11 business cases are filed annually. Even our President's companies have in the past used the bankruptcy law to reorganize their financial affairs.

In addition to the number of debtors who have filed bankruptcy cases themselves, hundreds of thousands of creditors, employees, retirees, landlords, customers, and vendors have been affected by bankruptcy cases filed by others. Those affected parties were required to file claims in bankruptcy court, to respond to motions or complaints filed by debtors in bankruptcy court that affected their rights, or to vote on a plan of reorganization which resolved their claims. Virtually everyone in the country has been affected at some point by a bankruptcy case. Even the main character in the TV show The Office "declared" bankruptcy.

The process has become so familiar to the public that a large percentage of individuals file bankruptcy cases without the assistance of counsel. (In some districts like the Central District of California or the District of Maryland, almost 25% of individual filers are pro se.)

Even in large corporate bankruptcy cases, individuals with claims against the corporation feel comfortable enough about the

process to proceed without counsel. In WaMu many of the former employees and creditors were able to successfully present their claims and arguments to the bankruptcy court on their own.

Chapter 11 of the Bankruptcy Code is also a model for the rest of the world. Many nations are studying it and passing similar laws to allow for the appropriate reorganization of business entities (as opposed to the forced liquidation that many of their old laws provide). Countless U.S. bankruptcy judges and attorneys have been involved in drafting such laws in foreign countries. In addition U.S. bankruptcy practitioners and judges have aided in the drafting of the Model Law on Cross-Border Insolvency which, among other things, seeks to have courts give effect to other nations' bankruptcy laws if they meet certain criteria.

In contrast, few people and attorneys have ever been involved in proceedings involving the Federal Deposit Insurance Corporation. Few have filed claims in such proceedings; few know what the power and jurisdiction of the tribunal is; very few have litigated claims in those proceedings. They are unlikely to even know where or how to do that. People just do not know what it is and have never had any experience with it.

If Congress wants to instill confidence in the public about the resolution of a systemically important financial institution it is wise to use a process with which the public has some

familiarity.

2. Bankruptcy Cases Are Transparent

In contrast to FDIC proceedings, bankruptcy cases are transparent. Because the bankruptcy courts were the leaders in electronic filing, today all bankruptcy pleadings, proofs of claim, transcripts of hearings, and trial exhibits are placed on a docket that is readily accessible to the public. When there are sensitive matters such as company trade secrets, there is a process under the Bankruptcy Code to seal them. However, the vast majority of pleadings are public and, therefore, all parties in interest know what is going on and can participate.

Bankruptcy hearings are open to the public and most courts allow parties in interest (including small creditors and shareholders) to listen to proceedings telephonically for a small fee. This access played a key role in the resolution of difficult issues in the WaMu case. Early in that case there was tremendous dissatisfaction and distrust of the legal system because the Bank had been seized without warning and many employees lost not only their jobs but also their pensions which were largely in the form of WaMu stock. When shareholders were allowed to participate by phone and heard the arguments that were made by the parties, they became educated about what was happening and became much more accepting of the result. This case confirmed the research that has been done to the effect that

litigants are much more satisfied with our system of justice, even if they lose, so long as they feel that their argument was heard and the court made a reasoned decision.

In WaMu, court access even extended to allowing individual creditors and shareholders to appear in court and make arguments. I remember one powerful moment when an individual who owned a small number of preferred shares stood up in court and argued that he felt the chapter 11 plan "just wasn't fair" because he was treated differently from other preferred shareholders who were large institutional investors. His objection was sustained because he was right: the concept of fairness permeates the Bankruptcy Code and requires that all creditors and shareholders of the same type receive the same treatment.

That right to appear and to be heard in a public hearing on the resolution of issues is a key component of the bankruptcy system and is what instills confidence in the judicial system. It would assist in the acceptance of a successful resolution of a systemically important financial institution.

In contrast, FDIC proceedings are cloaked in secrecy. The seizure of the bank, and sale of its assets, occurs entirely in the dark. This inevitably gives rise to a feeling that there is something to hide. Secrecy never instills confidence in the process.

It is also important that the bankruptcy court provides a forum for negotiation and consensual resolution without the need for a contested hearing or trial (but with the assurance that the latter is available if consensual resolution is not reached). Plans of reorganization are premised in large part on consensus. Parties in bankruptcy cases are used to give and take negotiations. Rarely is there a battle over principles: it is too costly and time intensive. Allowing a forum where all parties can be heard and are assured a place at the table, allows for business solutions, with the necessary guidance of judges when appropriate. A settlement that all parties have negotiated is more palatable than a ruling by the court because settlements can often encompass business solutions instead of just legal resolution. Nonetheless, without the opportunity for judicial review, parties may feel unable to assert their rights. The bankruptcy system is ideal for a complex business resolution where all parties have input, while preserving the opportunity to ask the court for a ruling on important legal rights.

3. Bankruptcy Courts Act Expeditiously

With financial institutions that have a significant impact on the public confidence in the markets, it is important to act expeditiously. Bankruptcy courts are used to holding hearings on short notice and providing expeditious rulings.

In large corporate bankruptcy cases (even in "mega" cases with assets over $100 million), "first day" hearings are held within a day or two of a chapter 11 filing to address emergency matters in order to keep the business operating, such as the Debtor's ability to use its cash to pay employees wages and critical vendors and shippers to assure that the company's flow of material and products continues and customer relationships are not disrupted. Expedited procedures are equally applicable to the sale of assets especially if the company's assets are a "melting ice cube" and the business operations have to be sold to a solvent company in order to maintain their viability. Even in the Lehman Brothers Holding, Inc., case assets were sold on an expedited basis - five days after the case was filed and a single day after the Securities Investors Protection Corporation filed an action against a trading subsidiary of the holding company.

In all large chapter 11 cases, hearings on any matter can be heard on an expedited basis to the extent that relief is necessary to avoid immediate and irreparable harm. Most bankruptcy courts have procedures for assigning cases and scheduling such expedited hearings. In our court, the clerk is notified by counsel in advance of a possible chapter 11 filing that will require an expedited hearing (without being advised of the name of the filing company). Procedures are in place to assure that a judge is available to hear the first day matters

within 24 hours of the expected filing date. Notice is provided to the largest constituents in the case: including all secured lenders, the 20 largest unsecured creditors, and the United States Trustee.

The legislation before you has similar expedited notice provisions (24 hours notice to parties with the need for a hearing and ruling within 48 hours). The bankruptcy courts should be able to handle such an expedited schedule, with some minor adjustments because of the need to have the hearing over a weekend to avoid disruption in the markets. The bankruptcy clerks' offices would have to put in place procedures like they have for first day matters so that personnel (security, court reporters and deputy clerks, as well as the bankruptcy judge) are available for the anticipated weekend hearings.

In addition, the proposal in this legislation that the chief of the circuit be advised of a possible filing and designate a judge to hear the case is not unique. The same assignment procedure exists in chapter 9 cases and it appears to have worked in those cases. Because the Circuit Courts are the ones who appoint the bankruptcy judges, they are familiar with our qualifications.

The only concern I have about the proposal is the limited number of bankruptcy judges that would be available to hear these cases. There are quite literally hundreds of bankruptcy judges

around the country who are capable of handling large cases. Many districts have rules similar to ours that allow for "first day" hearings on expedited notice. I would strongly urge that Congress consider expanding the number of judges eligible to hear these cases so that there actually is one available when the need arises.

While it may be argued that sophisticated cases need experienced judges, no judge is an expert in every area and there is always a learning curve as each case provides nuances. But all bankruptcy judges are experts at hearing the evidence presented and making an expedited ruling based on the best interests of creditors and other parties in interest. If the debtor (or the regulators) put on a case that satisfies the Code requirements, the court should be able to grant relief quickly.

4. Bankruptcy Concepts in the Legislation Are Well-known

The utilization of the bankruptcy courts in the proposed legislation (and of concepts that are familiar to bankruptcy practitioners and the public) is laudable. People are familiar with sales under section 363, with the assumption and assignment of executory contracts under section 365, with the automatic stay under section 362, with the approval of plans of reorganizations, and with the priorities of distribution Congress has set in the Code.

In the last twenty years, the preferred way to sell troubled companies and assets has been through a section 363 bankruptcy sale. The advantages are several: the sale can occur quickly before the troubled business fails completely; the sale is well-advertised and can generate substantial interest (and ultimately more money or better sale terms) from competing bidders; the sale is free and clear of liens and other interests (meaning that a buyer does not have to worry about hidden claims or legacy costs); and the sale converts illiquid assets into cash for easy distribution to creditors.

Similarly, the assumption and assignment of executory contracts is also a well-known bankruptcy concept. Literally thousands of contracts are assumed and assigned in bankruptcy cases every year. Finally, the automatic stay (which preserves the value of assets for the benefit of all creditors) is well understood by almost everyone. Using these well-known concepts in the proposed legislation assures that the public will understand the process.

The legislation adds that the bankruptcy court should also consider the systemic risk to the financial markets in making its ruling. While this is not a perspective that bankruptcy courts always consider, they are fully capable of considering it and ruling accordingly. Again it will be incumbent on the parties to present sufficient evidence for the court to make that ruling,

but that is true of every ruling the courts make. The more evidence presented in support, the more likely the public and markets will accept the ruling.

5. Claims Have Clear Priorities and Distribution Rights

In bankruptcy cases, there is an extensive body of statutory and case law governing the procedures for the allowance of claims against a debtor. There are notices (both direct and by publication) of the bankruptcy case, of the need to file a proof of claim, of the deadlines for filing cases, of the permissibility of filing late claims (where excusable neglect is shown or there is enough to pay all creditors in full), of the prima facie validity of claims that are filed, and of the burden on the debtor to object to invalid claims. There are procedures for evidentiary hearings on disputed claims, for the establishment of reserves for disputed claims, for the estimation of claims, and the disallowance of claims.

Congress has set the priority of claims, based on well-recognized policy grounds. Tax claims and wage and benefit claims have priority over general unsecured claims. Trade creditors who delivered goods within 20 days of the bankruptcy filing enjoy a priority. Domestic support obligations and loans by the Federal Reserve Bank also have priority. These priorities are well-founded in policies Congress has established (and tweaked) since the passage of the Bankruptcy Code in 1978. Since

these priorities are so well-established, distribution in payment of those claims can often happen quickly in bankruptcy.

In WaMu, there were enormous difficulties because of the pendency of the Bank proceeding. Many parties filed claims in the bankruptcy case when they only had a claim against the Bank and vice versa. Some didn't know they had a claim against the Bank and may have missed filing deadlines or wasted time and money litigating in the wrong forum. Many did not make an appearance in the correct forum or respond to motions or other pleadings that affected their rights.

The process set out in the legislation of leaving behind the claims and non-critical assets for disposition in the bankruptcy court will assure that the assets are transferred quickly (free and clear of liens) and claims are resolved fairly. Any distribution from the trust can then be done through a plan of reorganization which would allow for distribution of stock or assets.

In addition to these advantages of a voluntary bankruptcy option, I understand the legislation seeks to avoid the necessity to borrow funds from the Treasury, even on a temporary basis. The holding company would be expected, consistent with its "living will," to transfer funds to the operating companies before it files bankruptcy under subchapter V of chapter 11 to assure that the operating companies are fully viable. This is in

contrast to the procedure for resolution by the FDIC under the Dodd Frank Act, but it is dependent on the holding companies having viable living wills and being held to comply with them. If bankruptcy is filed without compliance, the public may not have confidence that the operating companies are viable. Thus, the enforcement of the living will provisions of Dodd Frank may be vital to any successful proceeding under the Bankruptcy Code, as it is proposed to be amended.

In sum I think that the legislation properly provides an option for a holding company of a systemically important financial institution to file a chapter 11 petition, to file a subchapter V petition, or to allow for resolution by the FDIC. If the bankruptcy option is chosen, I believe that the bankruptcy courts are ready and able to do their part.

Thank you very much for the opportunity to provide the Subcommittee with my views. I am happy to try to answer any questions you may have.