TESTING THE BANKRUPTCY CODE SAFE HARBORS IN THE CURRENT FINANCIAL CRISIS

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INTRODUCTION

A. Derivative Transactions and Financial Contracts Are a Cornerstone of Today's Economy

Derivative transactions and financial contracts are well recognized as a critical component of our modern complex and multi-faceted economy. The evolving economy now implicates numerous types of derivative transactions and financial contracts including modern customized permutations. Critical to the functioning of the derivatives markets is the ability of parties to value their transactions on a net basis with the counterparty and to close-out and replace the transaction in the event one party defaults.[1] But for many years, it was believed that when one party to these transactions became insolvent or filed a petition for relief under Title 11 of the United States Code (the "Bankruptcy Code"), the ability of a party to terminate and close-out transactions could be uncertain.

This fear was premised on the fact that contractual provisions that trigger the right to terminate or modify an executory contract upon a party's insolvency or commencement of bankruptcy proceedings, known as *ipso facto* clauses, are ordinarily unenforceable against a debtor under section 365(e) of the Bankruptcy Code, and the exercise of such rights to recover property or act against property of the debtor is prohibited by the automatic stay under section 362 of the Bankruptcy Code.[2] Because of these restrictions, there was great concern that the derivative and

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[1] ANTHONY C. GOOCH & LINDA B. KLEIN, DOCUMENTATION FOR DERIVATIVES: ANNOTATED SAMPLE AGREEMENTS AND CONFIRMATION FOR SWAPS AND OTHER OVER THE COUNTER TRANSACTIONS 268–71 (4th ed. 2002) [hereinafter GOOCH & KLEIN]; Richard D. Bernsteing, Jessica L. Matelis & John R. Oller, *Failed Financial Institution Litigation: Remember When*, 5 N.Y.U.J.L. & BUS. 243, 272 (2009) (noting close-out netting provisions as "vital to financial institutions active in the derivatives market"); *see also* William L. Harvey, *Securing Derivatives Obligations with California Real Estate—Selected Enforcement Issues*, 3 HASTINGS BUS. L.J. 251, 261 (2007) (asserting close-out netting to be "central to the derivatives markets").

[2] 11 U.S.C. § 362 (2006); *In re* Solutia Inc., 379 B.R. 473, 485 (Bankr. S.D.N.Y. 2007) (holding section 362 prohibits "any act to obtain property of the estate"); *In re* Mirant Corp., 303 B.R. 319, 323 (Bankr. N.D. Tex. 2003) (noting section 362 "prohibit[s] acts to obtain or exercise control over property of the estate of a debtor"). Additionally, any transfers of an interest in the debtor's property in the ninety days prior to a

financial contract markets could be destabilized upon the filing of a bankruptcy petition by a counterparty. For this reason, beginning in 1982 with amendments for forward contracts, commodity contracts, and security contracts,[3] continuing in 1984 with protections for repurchase agreements,[4] and again in 1990, with protections for swap agreements and amendments to the existing protections for forward contracts,[5] Congress purposefully enacted safe harbors in the Bankruptcy Code (the "Safe Harbor Provisions") to protect the ability of certain counterparties to certain financial and derivative contracts to exercise rights to terminate, liquidate, and close-out derivative transactions and financial contracts and to foreclose against collateral posted thereunder.[6]

B. Congress' Initial Enactment of Safe Harbor Protections for Derivative Transactions and Financial Contracts

From their start, the Safe Harbor Provisions were specific in their scope. Located primarily in sections 362(b)(6), 362(b)(7), 362(b)(17),[7] 546, 556, 559, and 560 of the Bankruptcy Code,[8] they protected the ability of certain counterparties, who are parties to swap agreements,[9] forward contracts,[10] commodity contracts,[11]

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debtor's filing for bankruptcy protection may be recoverable under section 547(b) of the Bankruptcy Code. 11 U.S.C. § 547(b) (2006); *see also* H.C. Schmieding Produce Co. v. Alfa Quality Produce Inc., 597 F.Supp.2d 313, 317 (E.D.N.Y. 2009) (noting payments made up to ninety days before a debtor's bankruptcy filing to be recoverable by trustee); *In re* Caremerica, Inc., 409 B.R. 759, 765 (Bankr. E.D.N.C. 2009) (holding transfers "made within the 90-day period before the date of filing" avoidable).

[3] *See* H.R. REP. NO. 97-420, at 2 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 584–85.

[4] *See Bankruptcy Law and Repurchase Agreements: Hearing on H.R. 2852 and H.R. 3418 Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 98th Cong. (1984).

[5] *See generally* H.R. REP. NO. 101-484 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223.

[6] *See Interest Swap: Hearing on S. 396 Before the Subcomm. on Courts and Administrative Practice of the Comm. on the Judiciary*, 101st Cong. 16 (1989) [hereinafter *Interest Swap Hearing*] (statement of Marc Brickell) ("Participants in the swap market are concerned that, if a counterparty files for bankruptcy, the automatic stay and other provisions of the Bankruptcy Code could be interpreted to bar the implementation of these critical contractual provisions."); H.R. REP. NO. 97-420, at 2 (1982) ("The prompt closing out or liquidation . . . minimizes the potentially massive losses and chain reactions that could occur if the market were to move sharply in the wrong direction."); *see also* Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1648 (2008) (asserting "1990 'swap amendments' allow the solvent counterparty to a derivative contract to terminate the contract, foreclose on collateral and apply it to the debtor's obligation under the contract").

[7] The safe harbor provision protecting enforcement and swap participant's rights despite the automatic stay was initially enacted as section 362(b)(14) but later renamed as section 362(b)(17). 11 U.S.C. § 362(b)(17) (2006); *see* Bank One Corp. v. Comm'r of Internal Revenue, 120 T.C. 174, 269 (2003) (noting section 362(b)(14) changed to section 362(b)(17) in 1990).

[8] 11 U.S.C. §§ 362(b)(6), 362(b)(7), 362(b)(17), 546, 556, 559, 560 (2006) (creating bankruptcy insulating provisions for market participant financial contracts to avoid additional market defaults and bankruptcies by other market participants).

[9] Defined at 11 U.S.C. § 101(53B) (2006).

[10] Defined at 11 U.S.C. § 101(25) ("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 . . . .").

securities contracts,[12] and repurchase agreements,[13] to exercise contractual rights under *ipso facto* clauses to close-out ("Close-Out") (terminate, liquidate or accelerate) their contracts with a debtor without obtaining relief from the automatic stay and despite the general prohibition on *ipso facto* clauses.[14] Additionally, the Safe Harbor Provisions permitted certain counterparties to exercise their contractual rights to offset or net out ("Setoff") any mutual debt and claim under or in connection with any such safe harbored agreement.[15] The Safe Harbor Provisions also protected certain pre-petition transfers ("Transfers") from being avoided by the trustee or debtor-in-possession unless the transfer was made with the actual intent to defraud, delay or hinder a creditor.[16] It was these three basic rights that were viewed as critical to maintaining market stability and liquidity.[17]

Protecting the exercise of these rights through the Safe Harbor Provisions was intended to preserve liquidity and to minimize volatility in the marketplace in the event that a counterparty to such transactions might become a debtor under the Bankruptcy Code.[18] The focus was on the resolution of financial transactions: "because financial markets can change significantly in a matter of days, or even hours, a non-bankrupt party to ongoing securities transactions and other financial transactions could face heavy losses unless the transactions are resolved promptly and with finality."[19] The Safe Harbor Provisions were designed "to ensure that the swap and forward contract financial markets are not destabilized by uncertainties regarding the treatment of their financial instruments under the Bankruptcy Code."[20]

Importantly, Congress weighed the risks in enacting the initial Safe Harbor Provisions and while it recognized the importance of allowing counterparties to close-out their derivative transactions with a debtor and exercise setoffs to arrive at

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[11] Defined at 11 U.S.C. § 761(4) (2006) (enumerating list of commodities contracts covered within subsection).

[12] Defined at 11 U.S.C. § 741(7) (2006).

[13] Defined at 11 U.S.C. § 101(47) (2006).

[14] *See* 11 U.S.C. §§ 555, 556, 559, 560 (2000) (current versions at 11 U.S.C. §§ 555, 556, 559, 560 (2006)).

[15] *See* 11 U.S.C. §§ 362(b)(6), 362(b)(7), 362(b)(17), 555, 560 (2000) (current versions at 11 U.S.C. §§ 362(b)(6), 362(b)(7), 362(b)(17), 555, 560 (2006)).

[16] *See* 11 U.S.C. §§ 546(e), 546(f), 546(g), 546(j) (2000) (current versions at 11 U.S.C. §§ 546(e), 546(f), 546(g), 546(j) (2006)).

[17] *See, e.g.*, GOOCH & KLEIN, *supra* note 1, at 272; *see also* Scot Tucker, *Interest Rate Swaps and the 1990 Amendments to the United States Bankruptcy Code*: *A Measure of Certainty Within Swap Contracts*, 1991 UTAH L. REV. 581, 612–14 (1991) (describing amendment goals).

[18] *See* H.R. REP. NO. 101-484, at 1–3 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 223–25; H.R. REP. NO. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583 (determining that because of the "volatile nature [of] the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possibl[y] threatening the collapse of the affected market").

[19] *See* H.R. REP. NO. 101-484, at 2.

[20] *Id.* at 1. The concerns that Congress faced in 1990 "closely parallel[ed] those which led to the 1982 and 1984 amendments regarding securities contracts, commodity contracts, forward contracts, and repurchase agreements," which similarly "exempt[ed] the liquidation and setoff of mutual debts and claims arising under" those types of agreements. *Id.* at 2–3.

a net sum owing to either the debtor or the counterparty, it simultaneously determined that the unique nature of such financial and derivative transactions did not significantly harm the debtor or necessarily deprive it of a valuable asset needed for reorganization.[21] For example, because swap agreements are by definition hedging instruments and most debts are accelerated upon a bankruptcy filing, Congress understood that there would be little need in most circumstances for the debtor to maintain that hedge through the bankruptcy proceedings.[22] In contrast, the termination of a lease or other executory contract could deprive the debtor of a valuable asset necessary for reorganization. For these specific reasons, the motivation and necessity for the Safe Harbor Provisions outweighed the need for the traditional protections of a debtor's rights with respect to executory contracts, the automatic stay, and preferential transfers.

C. The Market Proposed Amendments for Consistency and Clarity

Because the initial Safe Harbor Provisions were enacted from 1982 to 1990 product-by-product, in a piecemeal fashion, the Bankruptcy Code contained unintentional inconsistencies with respect to the treatment of different contracts. Additionally, from 1990 to 2005, during a period of time in which the United States economy grew exponentially, Congress did not substantially amend or update the Safe Harbor Provisions to encompass new types of derivative transactions. The markets became increasingly concerned that the inconsistent and outdated Safe Harbor Provisions would not protect newer innovative contracts and counterparties' ability to close out transactions and to net obligations in the event of a failure of a large financial market participant.[23] Ultimately, these concerns prompted Congress to enact reforms to the Safe Harbor Provisions in 2005 through the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA").[24] In

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[21] *See* Tucker, *supra* note 17, at 582–83 (positing provisions' policy goals were achieved without injuring creditors).

[22] *Interest Swap Hearing*, *supra* note 6, at 69 (statement of William Perlstein, Wilmer, Cutler and Pickering) (distinguishing swap agreements and describing them as hedging transactions from a lease; also finding no need for debtors to keep hedging transactions in place when most debt obligations accelerate upon filing bankruptcy); *see also id.* at 53, 56–60 (statement of John Jerome, Milbank, Tweed, Hadley, and McCloy) (noting most chapter 11 debtors do not pay interest to unsecured creditors and therefore have no need for interest rate protection from swap agreements); *id.* at 61, 64 (statement of Frank G. Sinatra, Rebound Management Inc.) (stating interest rate swaps' significance deems necessary revision to Code).

[23] *See Bankruptcy Reform Act of 1999 Hearing* (*Part III*)*: Hearing on H.R. 883 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary,* 106th Cong. 4 (1999) [hereinafter *1999 Hearing*] (statement of Rep. James Leach) (arguing for Code amendments to avoid risk of systemic failure of large financial institutions); H.R. REP. NO. 109-31, pt. 1, at 20 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 105 (indicating amendments to Code made to avoid "systemic risk").

[24] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, PUB. L. No. 109–8, 119 Stat. 23 (2005); *see* H.R. REP. NO. 109-31, pt. 1, at 7 (listing H.R. 833 as one of many predecessors); *id.* at 20 (noting "the provisions were derived from recommendations from the President's Working Group and revisions espoused by the financial industry"); *id.* at 20 n.78 (observing H.R. 4393 is a predecessor bill). See Appendix I for a blackline of the amendments enacted by BAPCPA.

enacting reforms through BAPCPA, Congress broadened the definitions of certain safe harbored agreements, added a class of counterparties to protect large market participants, and created greater uniformity with respect to the exceptions to the automatic stay in section 362 and exceptions to the *ipso facto* prohibitions in sections 555, 556, 559 and 560. Additionally, Congress created protections for cross-product netting to allow a counterparty to net all of its obligations across multiple safe harbored contracts with a debtor.[25] BAPCPA amended the Bankruptcy Code and other relevant banking laws,[26] to "reduce systemic risk in the marketplace,"[27] and to "minimize the risk of disruption" in the event of one party's insolvency, by "allow[ing] the expeditious termination or netting of certain types of financial transactions,"[28] and by eliminating inconsistencies among the definitions and types of safe harbored agreements that were protected in the event of insolvency or the commencement of bankruptcy proceedings.[29]

In 2006, with the passage of the Financial Netting Improvements Act ("FNIA"), Congress made additional "technical changes" to the Safe Harbor Provisions "by strengthening and clarifying the enforceability of early termination and close-out netting provisions and related collateral arrangement in U.S. insolvency proceedings."[30] As with BAPCPA, Congress sought to reduce systemic risk in the financial markets by clarifying the treatment of certain transactions in the event of bankruptcy or insolvency.[31] The overall purpose in enacting FNIA was to clarify the definitions and increase consistency among the various insolvency laws so as to provide certainty and decrease the risk of systemic failure of our financial markets associated with activities in derivatives market.[32]

D. The Safe Harbors in the Current Financial Crisis

In the three years that have passed since Congress' most recent revisions (and several years since the netting amendments were proposed to Congress in 1998), the United States derivatives economy has grown exponentially. The value of the

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[25] H.R. REP. NO. 109-31, pt. 1, at 125 (defining cross-product netting as when several financial transactions between two parties are netted to maximize risk-reducing benefits, and ensuring it will be enforceable under FDIA and FCUA).

[26] In addition to amending the Bankruptcy Code, BAPCPA amended the "Federal Deposit Insurance Act, the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Federal Deposit Insurance Corporation Improvement Act of 1991, the Federal Reserve Act, and the Securities Investor Protection Act of 1971." *Id.* at 20 n.77.

[27] *Id.* at 3.

[28] *Id.* at 20.

[29] *See id.* at 119.

[30] H.R. REP. NO. 109-648, pt. 1, at 2 (2006); *see* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, 120 Stat. 2692 (2006) (stating purpose as improving "the netting process for financial contracts"); 152 CONG. REC. 129, H8651 (daily ed. Nov. 15, 2006) (statement of Rep. Baker) (highlighting advantages and importance of bill). See Appendix II for a blackline of the amendments enacted by FNIA.

[31] *See* H.R. REP. NO. 109-648, pt. 1, at 3.

[32] *See id.* at 1–2.

derivatives market in October 2008 was $531 trillion in comparison to $106 trillion in 2002, and to practically nothing two decades ago.[33] Furthermore, this nation's economy has now suffered what many feared—major failures of large derivative market participants and a great financial crisis. In the reorganization or liquidation of major market participants, the amended Safe Harbor Provisions are for the first time being evaluated and interpreted by the market, courts, debtors and counterparties. In certain cases it is clear that the recent amendments to the Safe Harbor Provisions had their intended effect; they updated the law and provided necessary clarification. In other cases, there remains ambiguity about which rights, which counterparties, and what contracts are protected, and whether the protections accomplish their goals. What appears to be clear overall is that BAPCPA and FNIA broadened the classes of protected *transactions* and *counterparties*, but did not alter the scope of previously exercisable *rights* under the Safe Harbor Provisions.

This article addresses the significant amendments to the Safe Harbor Provisions in BAPCPA and FNIA concerning derivative transactions and financial contracts, their purpose, scope, and effect. Specifically, section II describes the history behind the BAPCPA and FNIA amendments. Section III explains the specific changes to the Bankruptcy Code in further detail. Section IV examines the recent jurisprudence interpreting the relevant Safe Harbor Provisions, the uncertainties that have led to litigation, and the lessons that may be learned. Finally, section V explains certain remaining ambiguities, including questions about the scope of the Safe Harbor Provisions.

I. THE SAFE HARBOR PROVISIONS AND THE AMENDMENTS WERE INTENDED TO CLARIFY TREATMENT AND PROTECTIONS FOR DERIVATIVE TRANSACTIONS AND FINANCIAL CONTRACTS

A. The Markets Lobbied Congress for Clarifying Amendments

The concerns about potentially inconsistent treatment, because the Safe Harbor Provisions were enacted piecemeal over time and did not cover newer innovative products, prompted members of the market as early as 1993 to begin considering their reform. Members from the International Swaps and Derivatives Association ("ISDA") and the President's Working Group on Financial Markets,[34] a group formed to review and propose legislation to address the concerns of the derivatives

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[33] Peter S. Goodman, *Taking Hard New Look at a Greenspan Legacy*, N.Y. TIMES, Oct. 8, 2008, at A1.

[34] The President's Working Group's members included representatives from the Commodity Futures Trading Commission, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Securities and Exchange Commission, and the Department of Treasury, including the Office of the Comptroller of Currency. H.R. REP. NO. 105-688, pt. 1, at 1 (1998); *see also* H.R. REP. NO. 109-648, pt. 1, at 2 (stating netting provisions reflect work by President's Working Group on Financial Markets); H.R. REP. NO. 109-31, pt. 1, at 20 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 105 (acknowledging provisions stem from President's Working Group on Financial Markets).

market, lobbied Congress for amendments that would clarify, update, and improve consistency between the Safe Harbor Provisions in the Bankruptcy Code and other federal banking statutes to provide assurance as to the netting of derivative transactions and financial contracts in bankruptcy.[35] These efforts culminated in 1998 in the submission of a formal legislative proposal, which was delivered in a report to Congress on March 16, 1998, by Secretary Rubin, as Chairman of the Working Group.[36] The specific goals of that legislative proposal were to (1) "eliminate uncertainty in the interpretation of certain" Safe Harbor Provisions; (2) harmonize the Safe Harbor Provisions of the Bankruptcy Code with other federal insolvency laws where appropriate; and (3) "update [the Safe Harbor Provisions] to reflect changes in the market."[37]

Incorporating language almost verbatim from the President's Working Group's legislative proposal, in 1998 Congress introduced the Financial Contract Netting Improvements Act of 1998 (H.R. 4393),[38] and later, the Bankruptcy Reform Act of 1999 (H.R. 833),[39] both of which emphasized the need for clarity regarding orderly resolution of derivative transactions and financial contracts. Clarity in the statute was critical in the reduction of "systemic risk"—or "the risk that the failure of a firm or disruption of a market or settlement system will cause widespread difficulties at other firms, in other market segments or in the financial system as a whole."[40] While H.R. 4393 was pending, Long Term Capital Management ("LTCM"), a major hedge fund, experienced a severe liquidity crisis, lost billions in capital during the late summer of 1998, and nearly failed but for the assistance of a consortium of its own counterparties, who feared worse repercussions if LTCM were left to default.[41] The near failure of LTCM further ignited fears of a domino

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[35] *See 1999 Hearing*, *supra* note 23, at 18 (statement of Rep. Leach) (noting proposed legislation "build[s] on recommendations" from October 1993 Banking Committee minority report on derivatives and contained proposals derived from President's Working Group on Financial Markets review of current statutory provisions); *id.* at 350 (statement of Oliver Ireland, Associate General Counsel, Board of Governors, Federal Reserve System) ("Many of these provisions incorporate, or are based on, amendments to these statutes that were endorsed by the President's Working Group on Financial Markets."); H.R. REP. NO. 109-31, pt. 1, at 20, 105.

[36] Press Release, *U.S. Dep't of the Treasury, Treasury Deputy Assistant Sec'y for Fed. Fin. Roger L. Anderson Delivers Testimony to the Senate Judiciary Subcomm. on Admin. Oversight and the Courts* (May 19, 1998), *available at* http://www.treas.gov/press/releases/rr2458.html [hereinafter *Testimony of Anderson*] (reporting Rubin transmitted proposal to Congress); *see also 1999 Hearing*, *supra* note 23, at 18 (statement of Rep. Leach).

[37] *Testimony of Anderson*, *supra* note 36.

[38] *See* Financial Contract Netting Improvement Act of 1998, H.R. 4393, 105th Cong. (1998); H.R. REP. NO. 105-688, pt. 1, at 1 (1998).

[39] *See* Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong. (1999); H.R. REP. NO. 106-123, pt. 1, at 86, 93–94 (1999) (confirming H.R. 833 contained proposed amendments for consumer bankruptcies in addition to recommendations made by President's Working Group on Financial Markets).

[40] H.R. 4393, *supra* note 38; *1999 Hearing*, *supra* note 23, at 3, 5; H.R. REP. NO. 106-123, pt. 1, at 93–94 n.32; H.R. REP. NO. 105-688, pt. 1, at 2.

[41] *See 1999 Hearing*, *supra* note 23, at 14, 16 (statement of Rep. Leach) (discussing failure of Long Term Capital Management); Report of the President's Working Group on Financial Markets, *Hedge Funds,*

effect and systemic collapse if the Bankruptcy Code and the Safe Harbor Provisions were not amended.

On October 1, 1998, Alan Greenspan, then Chairman of the Federal Reserve, testified before Congress, urging it to learn from the lessons of LTCM and posing questions about how to avoid such a situation in the future.[42] In April 1999, the President's Working Group issued a report on LTCM's failure and the prevention of a collapse of the world's financial markets in the event of a recurrence.[43] That report hypothesized that in the event of LTCM's bankruptcy, the immediate close-out and netting of outstanding derivative transactions would have been critically important to the stability of the world's financial markets.[44]

Given the lessons learned from LTCM, the President's Working Group reaffirmed its support for the Financial Contract Netting Improvement Act (H.R. 4393) and recommended "expanding and clarifying the definitions of the financial contracts eligible for netting . . . and allowing eligible counterparties to net across different types of contracts, such as swaps, security contracts, repos, and forward contracts."[45] This became known more commonly as cross-product netting, meaning for example, the process by which a counterparty could net its forward contract obligations with a debtor against its swap agreement or repurchase agreement obligations with a debtor. Addressing these specific concerns, clarifying definitions, and allowing cross-product netting was believed to be vital to the growing economy. The goal of reform was to clarify that the safe harbor treatment would apply to the expanded derivative markets as they had evolved—and not alter the nature of the previous protections provided (such as allowing termination and netting despite the automatic stay and *ipso facto* clauses). Consequently, concerns that the amendments could impede a debtor's ability to reorganize were dismissed as not outweighing the need for clarification in the statute.

Leverage, and the Lessons of Long-Term Capital Management, April 1999, at 13 [hereinafter President's Working Group Report] (analyzing hedge fund steps of failure and assistance of consortium of counterparties).

[42] *See Hedge Fund Operations Before the Comm. on Banking and Financial Servs.*, 105th Cong. 40 (1998) (statement of Alan Greenspan, Chairman, Federal Reserve Board), *available at* http://www.federalreserve.gov/boarddocs/testimony/1998/19981001.htm (enumerating questions to address to policy makers to avoid future failure).

[43] *See* President's Working Group Report, *supra* note 41, at 12–13, 16–17 (discussing steps leading to hedge funds' failure and how to stabilize trading activity for future).

[44] *See id.* at 19 (positing closeout and netting may have alleviated loses and provided stability to market).

[45] *See id.* at 40. The Financial Contract Netting Improvement Act, H.R. 4393 (1998), which was ultimately included as part of BAPCPA, had "four principal purposes: [(1)] strengthen provisions of the Bankruptcy Code and FDIA that protect the enforceability of termination and close-out netting and related provisions of certain financial agreements and transactions[; (2)] harmonize the treatment of these financial agreements and transactions under the Bankruptcy Code and FDIA[; (3)] amend the FDIA and FDICUIA to clarify that certain rights of the FDIC acting as conservator or receiver for a failed insured depository institution (and in some situations, rights of SIPC and receivers of certain uninsured institutions) cannot be defeated by operation of the terms of the FDICIA[; and (4)] make other substantive and technical amendments to clarify the enforceability of financial agreements and transactions in bankruptcy or insolvency." H.R. REP. NO. 105-688, at 3–4.

B. The Safe Harbor Provisions Did Not Alter the Scope of Protected Rights

The principal amendments to the Safe Harbor Provisions in 2005 (BAPCPA) and 2006 (FNIA) with regard to the treatment of derivative and financial contracts were as follows:

- Clarify that a counterparty's right to Close-Out, Setoff and Transfer would be permitted for each protected product type (forward contracts, repurchase agreements, securities contracts, swap agreements, commodity contracts) regardless of the terminology (i.e. termination, liquidation) used;[46]
- Broaden the definitions of "swap agreement" and "repurchase agreement" to clarify the scope of those definitions;[47]
- For each protected product type, include in the definition of the product agreement, master agreements, credit enhancement and guarantees covering these agreements;[48]
- Add protections for cross-product netting and master netting agreements, agreements that allowed a party to combine already netable obligations under other safe harbored products with the debtor;[49] and
- Clarify protections for transfers and setoff rights acquired in the ninety days prior to bankruptcy in sections 546(g), 553(a)(2)(B) and 553(a)(3).[50]

As stated above, these reforms appear to have been largely clarifying in nature without making dramatic changes in the *type* or *scope* of rights protected by the original Safe Harbor Provisions. They are discussed in more detail below.

II. SPECIFIC AMENDMENTS

A. Certain Amendments were Intended to Eliminate Inconsistencies Concerning Rights to Close-out

Prior to 2005, the Safe Harbor Provisions were inconsistent in their terminology with respect to a counterparty's right to Close-Out. For example, section 556 protected a commodity broker or forward contract merchant's exercise of contractual rights to cause the *liquidation* of a commodity contract or a forward contract upon a debtor's filing of a bankruptcy petition.[51] While it was understood in

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[46] *See* H.R. REP. NO. 109-31, pt. 1, at 132 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 192.
[47] *See id.* at 128–29.
[48] *See id.* at 129.
[49] *See id.* at 131.
[50] *See id.* at 133–34.
[51] 11 U.S.C. § 556 (2000) (protecting contractual right of forward contract merchants and commodity brokers "to cause the liquidation of a commodity contract"); *see In re* R.M. Cordova Int'l, Inc., 77 B.R. 441, 448 (Bankr. D.N.J. 1987) (discussing liquidation rights conferred by former section 556); Thomas G. Kelch

the industry that the way to liquidate a forward contract with continuing obligations was to declare early termination, and then calculate the amount due under the contracts,[52] section 556 did not explicitly state "termination," leading to uncertainty about whether "termination" in addition to "liquidation" would be protected.[53] Former section 560, on the other hand, protected the right of any swap participant to cause the *termination* of a swap agreement upon a debtor's insolvency or filing of a bankruptcy petition, leading to uncertainty about whether a party could "liquidate" the transactions and supporting collateral.[54]

To address this concern and the arbitrary differences, Congress, through BAPCPA, amended sections 555 (protecting liquidation of securities contracts), 556 (liquidation of forward contracts), 559 (liquidation of repurchase agreements), and 560 (termination of swap agreements) to clarify that the exercise of contractual rights to "liquidate, terminate, or accelerate" for *each* specific product could be effected. This change provided the necessary assurance that the right to Close-Out would be protected regardless of industry-specific terminology.[55]

Additionally, Congress expanded the definition of "contractual right" in section 560, which was also incorporated by reference into sections 555, 556, and 559 and new section 561, to include rights arising "(i) from the rules of a derivatives clearing organization, multilateral clearing organization, securities clearing agency, securities exchange, securities association, contract market, derivatives transaction execution facility or board of trade; (ii) under common law . . . ; or (iii) by reason of normal business practice."[56] This amendment was intended to correspond to the definition in the "enactment of the CFMA" (the Commodity Futures Modernization Act of 2000), and thus increased consistency among the federal statutes.[57]

& Howard J. Weg, *Forward Contracts, Bankruptcy Safe Harbors and the Electricity Industry*, 51 WAYNE L. REV. 49, 84–85 (2005) (arguing former section 556 phrase "cause the liquidation" may have been drafting error or oversight).

[52] Rhett G. Campbell, *Energy Future and Forward Contracts, Safe Harbors and the Bankruptcy Code*, 78 AM. BANKR. L.J. 1, 22 (2004) (noting inherent difficulty in liquidating forward contract with continuing obligations because actual price on future performance date is unknown).

[53] *See id*. (discussing ambiguity regarding whether safe harbor for liquidation included termination).

[54] 11 U.S.C. § 560 (2000) (protecting swap participant's contractual right "to cause the termination of a swap agreement"); *see In re* Mirant Corp., 314 B.R. 347, 351 (Bankr. N.D. Tex. 2004) (discussing swap participant's right under former section 560 to terminate swap agreement); Kelch & Weg, *supra* note 51, at 87 n.219 ("No reason can be found in the legislative history or elsewhere for the anomalous use of 'terminate' in § 560.").

[55] GOOCH & KLEIN, *supra* note 1, at 304–05; s*ee also* 11 U.S.C. §§ 555, 556, 559, 560 (2006) (indicating contractual right to cause liquidation, termination, or acceleration of various types of financial agreements will not be stayed or limited by any other provision under this title); H.R. REP. NO. 109-31, pt. 1, at 132 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 192 (noting protection of rights from automatic stay is "consistent with the policy goal of minimizing systemic risk").

[56] H.R. REP. NO. 109-31, pt. 1, at 133.

[57] *See id*. (noting definition of "contractual right" in Bankruptcy Code reflects enactment of CFMA).

B. The Amendments Broadened the Definitions to Clarify Protection for Newer Product

1. Amendments to Definition of Swap Agreements

In order to address the dramatic increase in the use of swap transactions from 1990 to 2005 and the diversification of the types of swaps used, Congress updated and broadened the definition of "swap agreements" to include every conceivable type of swap transaction including customized transactions.[58] The definition of swap agreement in section 101(53B) of the Bankruptcy Code now includes equity derivatives, credit derivatives, and weather derivatives.[59] Additionally, Congress expanded the descriptions in the statute of interest rate, currency, and commodity derivatives, and added protections for futures, options or forward agreements in relation to any type of swap agreement.[60] Broadening the definitions was intended to provide certainty that newer forms of swap agreements would be included in the protections and not subject to the risk that the debtor would cherry-pick—assume one swap while rejecting another.[61] Yet, because the goal was "to protect markets, not particular types of creditors,"[62] "[t]he definition of 'swap agreement'" was not intended to include "[t]raditional commercial arrangements, such as supply agreements, or other non-financial market transactions, such as . . . residential or consumer loans . . . ."[63] The proponents of the legislation did "not want to create a situation where what is actually a loan receives special treatment just because the documentation calls the transaction a swap."[64]

2. Amendments to Definitions of Repurchase Agreement, Forward Contract, Commodity Contracts and Securities Contract

Other amendments to the definitions of safe-harbored agreements included broadening the definition of a "repurchase agreement" to include mortgage-related securities, mortgage loans and interests therein,[65] and the inclusion of "or any other

[58] *See id.* at 127–29 (providing for variety of economic transactions to be included in definition of "swap agreement").

[59] 11 U.S.C. § 101(53B)(A)(i) (2006).

[60] 11 U.S.C. § 101(53B)(A)(i)–(iii).

[61] *1999 Hearing*, *supra* note 23, at 186 (statement of Seth Grosshandler Partner, Cleary, Gottlieb, Steen & Hamilton) (positing broadening definition of "swap agreement" minimizes risk of "cherry-picking" between different types of swap agreements); *see* H.R. REP. NO. 109-31, pt. 1, at 128 (remarking amended definition will "achieve contractual netting across economically similar transactions").

[62] *Testimony of Anderson*, *supra* note 36 (noting proposed amendments to Bankruptcy Code were careful to exclude commercial loans from definition of swap transactions).

[63] H.R. REP. NO. 109-31, pt. 1, at 129 (stating commercial arrangements cannot be treated as "swaps" just because parties label them as "swap agreements").

[64] *Testimony of Anderson*, *supra* note 36.

[65] H.R. REP. NO. 109-31, pt. 1, at 127 (indicating broadened definitions conform to amended FDIA).

similar agreement" to the definitions of "forward contract," "commodity contract," "repurchase agreement," and "securities contract," for flexibility as the market matured.[66] Each of these definitions was amended to include as a single agreement any master agreement for any class of protected contracts.[67] As a result, a party could document any number or type of financial contract under the same master agreement and the master agreement would be treated as a swap agreement as it relates to a swap, a forward contract as it relates to a forward, and so on.[68]

3. Addition of Protection for Credit Enhancements

Congress also amended the definitions for each protected class of agreements to include any credit enhancement or guarantee relating to such type of agreement, thus ensuring that the arrangement or enhancement itself could be eligible for termination, liquidation, acceleration, and setoff under the Bankruptcy Code.[69] A creditor who is the beneficiary of a guarantee on a swap provided by the debtor could exercise its rights to liquidate, accelerate, terminate or setoff under the guarantee to the swap.[70] This has implications for setoffs because prior to the 2005 amendments, only setoffs under swap agreements themselves were permitted without seeking relief from the automatic stay. For example, a creditor who owed a debtor under a swap, would not have been able to set off that obligation against a claim it had against the debtor under a guarantee for a different swap, absent relief from the stay. Under the amended statue, the counterparty, assuming there is mutuality, may be able to offset a claim under a guarantee of a swap by a debtor against its obligation arising under a swap with the same debtor.[71]

4. New Category of Counterparties: Financial Participants

In enacting the Safe Harbor Provisions, Congress recognized that the "overriding goal of minimizing systemic risk" must be balanced against the debtor's need to reorganize, which is safeguarded by the automatic stay, the prohibition on *ipso facto* clauses and the right of the debtor to recover transfers from the estate

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[66] *See id.* at 128 (observing definition of "swap agreement" already contained phrase "any similar agreement").

[67] *See id.* at 163 (defining "forward contracts"); *id.* at 168 (defining "repurchase agreements"); *id.* at 171 (defining "swap agreements"); *id.* at 273–74 (defining "securities contract"); *id.* at 275 (defining "commodity contract").

[68] *See* H.R. REP. NO. 109-31, pt. 1, at 333 (2005) (affirming such agreements shall be treated as one swap agreement); GOOCH & KLEIN, *supra* note 1, at 328.

[69] *See* H.R. REP. NO. 109-31, pt. 1, at 129 (including offsets under FDIA and FCUA).

[70] *See id.* (noting that this includes agreements related to "swap agreements"); GOOCH & KLEIN, *supra* note 1, at 282*; see also* 11 U.S.C. § 101 (53B)(A)(ii) (2006) (showing definition includes similar agreements).

[71] *See* 11 U.S.C. § 362 (b)(17) (2006); 11 U.S.C. § 101(53B) (2006) (defining "swap agreement"); GOOCH & KLEIN, *supra* note 1, at 282.

immediately prior to the petition date.[72] "[B]ecause of the concerns . . . about not creating exceptions to the automatic stay unless the overriding goal of minimizing systemic risk justifies it," the legislation in amending the Safe Harbor Provisions, as proposed and enacted, "preserves the limitations on the types of entities that can benefit from the new provisions."[73]

These "counterparty limitations," specify that the rights in the Safe Harbor Provisions are only available if "a *party* meets specific criteria."[74] Prior to BAPCPA, *only* those entities that met the definition of "forward contract merchants" and "commodity brokers" could benefit from the Safe Harbor Provisions relating to "forward contracts" and "commodity contracts."[75] Some courts narrowly interpreted the definition of "forward contract merchant" as limited to an entity that engages in purchases and sales of a commodity as part of its regular operations in the forward contract trade and did not consider a "forward contract merchant" to be simply anyone or entity that had a forward contract with a debtor.[76] In contrast a "swap participant" is defined more broadly as any entity that has a swap agreement with the debtor prior to the petition date.[77] Through BAPCPA, Congress added a new class of protected persons, the "financial participant," to ensure that large market participants would benefit from the protections for financial and derivative contracts even if they did not fit the definition of "forward contract merchant" or other classes of protected persons.[78]

A "financial participant" is defined as a counterparty who has transactions with a total gross dollar value of at least $1 billion in notional principal or actual principal amount outstanding on any day during the previous fifteen-month period, or has gross mark-to-market positions of at least $100 million (aggregated across counterparties) in one or more agreements or transactions on any day during the previous fifteen-month period.[79] A financial participant receives the protections in sections 362(b)(6), 555, and 556 without regard to its ability to satisfy the protected party definitions.[80]

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[72] *See Testimony of Anderson*, *supra* note 36 (noting proposal limits types of entities that benefit from new provisions).

[73] *Id.*

[74] President's Working Group Report, *supra* note 41, at E-5.

[75] *See* 11 U.S.C. §§ 555, 556 (2000) (providing narrow definition of party entitled to benefits); *see also In re* R.M. Cordova Int'l, Inc., 77 B.R. 441, 448 (Bankr. D.N.J. 1987) (explaining section 556 and rights provided to forward contract merchants and commodity brokers).

[76] *In re* Mirant Corp., 310 B.R. 548, 570 (Bankr. N.D. Tex. 2004) (finding that purchaser on supply contract that did not regularly engage in the sale and purchase of a commodity was not a "forward contract merchant"); *cf. In re* Borden Chem., 336 B.R. 214, 224–25 (Bankr. D. Del. 2006) (finding party was a forward contract merchant because in its regular operations "acted as both a buyer and a seller of natural gas through the use of forward contracts").

[77] *See* 11 U.S.C. § 101(53C) (2006).

[78] H.R. REP. NO. 109-31, pt. 1, at 130 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 190.

[79] 11 U.S.C. § 101(22A) (2006).

[80] H.R. REP. NO. 109-31, pt. 1, at 130–31.

Congress also included "financial participants" as beneficiaries of the protections for repurchase agreements in section 559 and swap agreements in section 560, although the tests for qualifying as a repo participant or a swap participant required only a finding that the counterparty entered into a repurchase agreement or swap agreement with the debtor.[81] Congress noted that in some instances an entity could qualify as both a swap participant and a financial participant or a repo participant and a financial participant and the definitions were not mutually exclusive.[82] Financial participant also included in its definition "clearing organizations," a change that would allow clearing organizations to take advantage of the Safe Harbor Provisions, and further minimize systemic risk.[83]

C. New Provisions for Master Netting Agreements and Master Netting Participants

Perhaps the most significant change with respect to the BAPCPA amendments to the Safe Harbor Provisions,[84] and the subject of most debate,[85] was the addition of protections for cross-product netting through the addition of a new class of products, "master netting agreements" in section 101(38A), a new class of protected counterparties, "master netting agreement participants" in section 101(38B), and the addition of provisions protecting the rights to Close-Out, Setoff and Transfer by a master netting agreement participant in connection with "master netting agreements" in sections 362(b)(27), 546(j), 561 of the Bankruptcy Code.[86]

The term "master netting agreement" is defined in new section 101(38A) of the Bankruptcy Code as follows:

> (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), or any security agreement or arrangement or other credit enhancement related to one or more of the foregoing, including any guarantee or reimbursement obligation elated to 1 or more of the foregoing; and

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[81] *See* 11 U.S.C. §§ 101(46) and (53C) (2006) (defining "repo participant" and "swap participant," respectively); *see also In re* Interbulk, Ltd., 240 B.R. 195, 200, n.6 (Bankr. S.D.N.Y. 1999) (finding if agreement between parties is "swap agreement" then parties to it are "swap participants").

[82] H.R. REP. NO. 109-31, pt. 1, at 131.

[83] *See id*.

[84] *See 1999 Hearing*, *supra* note 23, at 17 (statement of Rep. James Leach) (describing netting provision as a "seminal change" based upon a "multiyear study"); *Testimony of Anderson*, *supra* note 36.

[85] *See 1999 Hearing*, *supra* note 23, at 21 (statement of Rep. James Leach) (noting some concern about cross product netting); *id.* at 360 (statement of Prof. Randal C. Picker, Vice Chair, National Bankruptcy Conference) (arguing against cross-product netting amendments).

[86] *See* H.R. REP. NO. 109-31, pt. 1, at 133. The Bankruptcy Code defines a master netting agreement participant is an entity that prior to the petition date "[wa]s a party to an outstanding master netting agreement with the debtor." 11 U.S.C. § 101(38B) (2006).

> (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), [the agreement] 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 to paragraphs (1) through (5) of section 561(a).[87]

The Congressional Report notes that a master netting agreement could be used to "(i) document a wide variety of securities contracts, commodity contracts, forward contracts, repurchase agreements and swap agreements, or (ii) as an umbrella agreement for separate master agreements between the same parties, each of which is used to document a discrete type of transaction."[88]

New section 561(b) protects the "contractual right" (as defined in section 560) of a master netting agreement participant to enforce the rights of termination, liquidation, acceleration, offset or netting that parallel the protections in product-specific sections 555, 556, 569 and 560. Specifically, section 561 provides that:

> (a) . . . the exercise of any contractual right, because of a condition of the kind specified in section 365(e)(1), to cause 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 (or the termination, liquidation, or acceleration of one or more)—
>
> (1) securities contracts, as defined in section 741(7);
> (2) commodity contracts, as defined in section 761(4);
> (3) forward contracts;
> (4) repurchase agreements;
> (5) swap agreements; or
> (6) master netting agreements,
>
> shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title.[89]

The purpose behind the protection for cross-product netting was to permit two parties to net all of their obligations across their derivative products to reach a net sum. The protections for master netting agreements "[were] designed to protect the

[87] 11 U.S.C. § 101(38A) (2006).
[88] H.R. REP. NO. 109-31, pt. 1, at 131.
[89] 11 U.S.C. § 561(a) (2006).

termination and close-out netting provisions of cross-product master agreements between parties."[90] In support of the addition of the provisions protecting cross-product netting, the Congressional Report notes:

> Cross product netting permits a wide variety of financial transactions between two parties to be netted, thereby maximizing the present and potential future risk-reducing benefits of the netting arrangement between the parties. Express recognition of the enforceability of such cross-product master agreements furthers the policy of increasing legal certainty and reducing systemic risks in the case of an insolvency of a large financial participant.[91]

Opponents of cross-product netting argued that existing protections in the Bankruptcy Code for within-product setoff and liquidations were sufficient.[92] This was because prior to BAPCPA, section 362(b)(6) permitted the cross-product netting of amounts owed under securities contracts, forward contracts and commodity contracts.[93] But it was not clear that cross-product netting was allowed across repurchase agreements and swap agreements, or repurchase agreements and forward contracts because the Safe Harbor Provision sections for those sections only allowed within-product netting.[94] Proponents for cross-product netting argued that there was "no plausible rationale for treating" cross-product netting of security agreements, commodity agreement and forward contracts differently than netting between "swap agreements and repurchase agreements."[95] Other supporters argued: "it is time for the market safe harbors to be rationalized and made consistent in their application to all financial products for all participants."[96] Additionally, because the

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[90] H.R. REP. NO. 109-31, pt. 1, at 131.

[91] *Id*. at 125.

[92] *See 1999 Hearing*, *supra* note 23, at 360 (statement of Prof. Randal C. Picker, Vice Chair, National Bankruptcy Conference) (arguing provisions providing for master netting should be deleted).

[93] *See* 11 U.S.C. § 362(b)(6) (1986) (protecting the setoff "by a commodity broker, forward contract merchant, stockbroker, financial institutions, or securities clearing agency of any" mutual debt and claim under or in comment (6) under subsection (a) of this section, of the setoff by a "commodity broker, forward contract merchant, stockbroker, financial institutions, financial participant, or securities clearing agency of any" mutual debt and claim under or in connection with commodity contracts, as defined in section 761 of this title, "forward contract[s], or securities contract[s]," as defined in section 741 of this title, that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payments, as defined in section 101 or 741 of this title, arising out of commodity contracts, forward contracts, or securities contracts against cash, securities, or other property held by, or due from such "commodity broker, forward contract merchant, stockbroker, financial institutions, financial participant, or securities clearing agency" to margin, guarantee, secure or settle commodity contracts, forward contracts, or securities contracts).

[94] *See 1999 Hearing*, *supra* note 23, at 392 (statement of Seth Grosshandler, Partner, Cleary, Gottlieb, Steen & Hamilton) (addressing emerging anomalies created by protective provisions of Bankruptcy Code).

[95] *Id.*

[96] *See id.*

United Kingdom allowed cross-product netting, these provisions furthered the goal of ensuring that the United States remained a competitive financial market.[97]

Opponents, on the other hand, argued that the "setoff across products, so called cross-product netting, or . . . master netting," was unnecessary because,

> [t]here is no indication that the absence of such cross-product netting features has led to widespread difficulties or systematic disruptions in the financial markets for such products. The expansion of these provisions would take us farther down the path of allowing sophisticated parties to opt out of bankruptcy. In addition, master netting could deprive a debtor of much-needed cash collateral, which in some instances may lead to conversion and liquidation to the detriment of other creditors.[98]

In response, Congressman James A. Leach noted that, "[w]ith regard to the cross-product netting provisions, nothing in this title expands netting to any new contracts."[99] Netting had been recognized by the Bankruptcy Code for years and "[c]ross product netting simply extends those benefits to get one net amount for all contracts that are already netable by permitting a wide variety of financial transactions between two parties to be netted . . . ."[100]

The protections for master netting agreements and cross-product netting were designed, therefore, to clarify that cross-product netting *was* allowed and to eliminate inconsistencies that could lead to uncertainties about the exercise of that right. Indeed, section 561 is specific in that it permits a master netting agreement participant to exercise the *same* rights *already permitted* for within-product netting under sections 555, 556, 569, and 560. Section 561 allows a master netting agreement participant to terminate, liquidate or accelerate or offset or net out termination values, payment amounts, or other transfer obligations arising under or in connection with one or more (or the termination, liquidation, or acceleration of one or more) of the following specifically enumerated contracts: (1) securities contracts, (2) commodity contracts, (3) forward contracts, (4) repurchase agreements, (5) swap agreements, or (6) master netting agreements. The source of the "contractual rights" protected in section 561 parallel those rights in amended sections 555, 556, 559 and 560, which include "rights arising: (i) from the rules of a derivatives clearing organization, multilateral clearing organization, securities clearing agency, securities exchange, securities association, contract market, derivatives transaction execution facility or board of trade; (ii) under common law;

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97 *Id.* at 20 (statement of Rep. James Leach).
98 *Id.* at 363 (statement of Prof. Randal C. Picker, Vice Chair, National Bankruptcy Conference).
99 *Id.* at 21 (statement of Rep. James Leach).
100 *Id*.

or (iii) by reason of normal business practice."[101] Because "contractual right" includes rights that arise by virtue of agreement, common law, or normal business practice, if a party to certain safe-harbored contracts with the debtor had not executed a master agreement covering all relevant contracts, a master netting participant may be able to invoke the normal business practice of closing out transactions and calculating a single close-out amount with respect to all contracts that would be covered by a master netting agreement.[102]

Moreover, the protections for master netting agreements, however innovative, are not unfettered. Section 561(b) carefully circumscribes a counterparty's exercise of rights under section 561 *only* to the extent that such counterparty could exercise such a right under section 555, 556, 559, or 560.[103] Additionally, section 101(38A) specifies that a master netting agreement can *only* be an agreement protecting rights already exercisable under an already protected agreement listed in section 561(a)(1)-(5).[104] The protections for a master netting agreement exclude contracts or *any portion* of a contract unrelated to an already-protected contract.[105] Furthermore, section 362(b)(27), which provides parallel exemptions to the automatic stay for master netting agreements as are contained in the other Safe Harbor Provisions, requires that *each* contract covered by the master netting agreement be eligible in its own right for a safe harbor exemption under sections 362(b)(6), 362(b)(7) or 362(b)(17).[106] Sections 546(j) and 548(d)(2)(E) also limit the protections against the trustee's avoidance powers for master netting agreements "to the extent [a] trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement."[107] If the parties have contractually waived or altered their setoff rights, section 561 does not revive them—"the netting rights of a party to a master netting agreement would be subject to any contractual terms between the parties limiting or waiving netting or set off rights."[108]

Thus, as its proponents had contended, section 561 merely *extends* the benefits already available under other Safe Harbor Provisions to allow a counterparty to net amounts under all its protected contracts with a debtor.[109] "This limitation will prevent bundling of non-[qualified] agreements under a master agreement in order to provide special . . . treatment to those agreements[,]"[110] and is consistent with the

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[101] H.R. REP. NO. 109-31, pt. 1, at 133 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193.
[102] GOOCH & KLEIN, *supra* note 1, at 331–32; *see also* H.R. REP. NO. 105-688, pt. 1, at 17 (suggesting counterparty having to establish its "contractual rights" was within normal business practice of parties).
[103] *See* 11 U.S.C. § 561(b)(1) (2006).
[104] *See* 11 U.S.C. § 101(38A) (2006).
[105] *See* 11 U.S.C. §§ 101(38A), 101(38B), 561(a) (2006).
[106] *See* 11 U.S.C. § 362(b)(27) (2006).
[107] 11 U.S.C. § 546(j) (2006); *see also* 11 U.S.C. § 548(d)(2)(E) (2006) (limiting debtor's transfer powers).
[108] H.R. REP. NO. 109-31, pt. 1, at 133–34 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193–94.
[109] *See 1999 Hearing*, *supra* note 23, at 21 (statement of Rep. James Leach).
[110] Michael H. Krimminger, *Adjusting the Rules: What Bankruptcy Reform Will Mean for Financial Markets Contracts*, Oct. 11, 2005, http://www.fdic.gov/bank/analytical/fyi/2005/101105fyi.html.

overall goal of serving the public policy of market stability by protecting particular markets rather than particular parties.[111]

D. Additional Amendments Clarified Treatment Regarding Transfers of Clams and Interests in the Debtor's Property

Additional amendments in 2005 included an exception to the provisions of both sections 553(a)(2)(B)(ii) and 553(a)(3)(C) "for a setoff of the kind described in 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561."[112] Section 553(a)(2) prohibits a setoff if the creditor obtained its claim against the debtor *via* transfer either (i) post-petition, or (ii) (a) within the 90 days preceding the petition date and (b) "while the debtor was insolvent."[113] Similarly, section 553(a)(3) denies the setoff if the creditor incurred its debt to the debtor either "(A) after the 90 days before the [petition date]; (B) while the debtor was insolvent; and (C) for the purpose of obtaining a right of setoff . . . ."[114] These sections were intended to be exceptions to the traditional rule in section 553(a) that a creditor's setoff rights of mutual pre-petition claims are preserved.[115]

The Congressional record notes that the exceptions added in 2005 to sections 553(a)(2)(B) and 553(a)(3) were intended to "clarify that the acquisition by a creditor of setoff rights in connection with swap agreements, repurchase agreements, securities contracts, forward contracts, commodity contracts and master netting agreements cannot be avoided as a preference."[116] A creditor who (i) acquires setoff rights (by virtue of a transfer of a claim or incurrence of a debt), (ii) in connection with a safe harbored contract, (iii) in the 90 days preceding

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[111] *See Testimony of Anderson*, *supra* note 36; Jonathan Keath Hance, *Derivatives at Bankruptcy: Lifesaving Knowledge for the Small Firm*, 65 WASH. & LEE L. REV. 711, 716 (2008) ("With BAPCPA, Congress renewed its contention that derivatives instruments must be afforded special consideration in order to reduce the risk of disruption in financial markets upon the bankruptcy of a key market participant."). Previous exemptions for derivatives focused on the parties, for example: forward contract merchants. The BAPCPA amendments clarified that the entire market was to be protected, not just certain parties. Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankrupt Debtors and Bankruptcy Judges*, 13 AM. BANKR. INST. L. REV. 641, 645, 648 (2005).

[112] 11 U.S.C. § 553(a)(2)(B)(ii) (2006), (a)(3)(C) (2006).

[113] 11 U.S.C. § 553(a)(2) (establishing guidelines for prohibiting setoffs).

[114] 11 U.S.C. § 553(a)(3) (explaining situations where setoffs may be denied).

[115] *See* H.R. REP., NO. 95-595, at 183, 185 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6143–44, 6145 (discussing purpose of exceptions in Bankruptcy Act). Section 553(a) preserves a creditors right to exercise a setoff in bankruptcy provided that the setoff be of mutual pre-petition claims. 11 U.S.C. § 553(a) (2006) (noting preservation of setoff rights involving mutual pre-petition claims); *see, e.g.*, Citizens Bank of Md. v. Strupft, 516 U.S. 16, 18 (1995) (holding Bankruptcy Code preserves existing rights of setoff); Official Comm. of Unsecured Creditors v. Mfg. and Traders Trust Co. (*In re* Bennett Funding Group, Inc.), 146 F.3d 136, 140 (2d Cir. 1998) (holding section 553(a) imposes additional requirements); *In re* SemCrude LLP, 399 B.R. 388, 393 (Bankr. D. Del. 2009) (stating section 553 preserves non-bankruptcy rights of creditors to setoffs).

[116] H.R. REP. NO. 109-31, pt. 1, at 134 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 194.

bankruptcy, and (iv) while the debtor was insolvent, cannot have those rights taken away as a having been a preferential transfer.

Sections 546(e) and (g) added protections for "financial participants;" moreover, section 546 clarified that transfers "under or in connection with any swap agreement" could not be avoided except in the event of actual fraud.[117] Section 546(j) added the same protections for a transfer made under or in connection with a "master netting agreement" as currently is provided for margin payments, settlement payments and other transfers received by qualified parties under section 546 and 548(d), except to the extent the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.[118]

E. FNIA Made Technical Changes

Congress enacted FNIA in 2006, only one year after BAPCPA, with the simple purpose of making "technical changes to the netting and financial contract provisions incorporated by [BAPCPA] to update the language to reflect current market and regulatory practices, and help reduce systemic risk . . . ."[119] The sponsors of the bill, Representatives McHenry (FL) and Wasserman Schultz (NC), two freshman members of Congress (who may not have witnessed the changes through BAPCPA), urged Congress to enact FNIA as a "technical bill" that both sides of the aisle and the President's Working Group could agree upon,[120] the origin of which was "grounded in the collapse of . . . Long Term Capital Management."[121] The FNIA amendments appear to have been intended to serve the same purpose as the BAPCPA amendments: "The primary goal of our legislation is to minimize systemic risk in situations when the procedure for resolving a single insolvency could trigger other failures elsewhere in the market."[122] In arguing for its adoption, Representative Baker stated:

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[117] *See* 11 U.S.C. § 546(e), (g) (2006) (explaining exceptions for financial participants of swap agreements).

[118] *See* 11 U.S.C. § 546(j) (2006) (expanding range of protected contractual rights).

[119] H.R. REP. NO. 109-648, pt. 1, at 1 (2006), *reprinted in* 2006 U.S.C.C.A.N. 1585 1585.

[120] 152 CONG. REC. H7598, H7600 (daily ed. Sept. 27, 2006) (statement of Rep. McHenry).

[121] *Id.* at H7601 (statement of Rep. Wasserman Schultz).

[122] *Id.*

> The provisions of the bill now suggested by the gentleman from North Carolina is [sic] the ability to close out what are called netting relationships to prevent the failure of one entity from causing a domino effect of more serious disruption, known as systemic risk. Absent the adoption of these provisions with the growth in size of hedge funds and in number of hedge funds, there is considerable market uncertainty as to how a bankruptcy proceeding would affect market liquidity.[123]

The FNIA amendments did not make sweeping changes, but rather were described as "minor" and intended to conform the language of the financial and netting provisions of the Bankruptcy Code to other statutes to create consistency.[124] Specifically, in connection with the FNIA, Congress further expanded the definitions of "swap agreement," "forward contract" and "securities contract" in the Federal Deposit Insurance Act ("FDIA") and the Federal Credit Union Act "FCUA"), and made conforming amendments to sections 101(22)(A), 101(22A), 101(25)(A), 101(53B) and 741(7)(A) of the Bankruptcy Code.[125] These updates were intended to revise the law through the FNIA so that some of the "newer forms of contractual arrangements" were given the same protections with respect to "financial netting."[126] "Financial netting," Congress described, "involves settling mutual obligations at their net value as opposed to each obligation's gross dollar value."[127]

Additionally, FNIA rewrote the automatic stay provisions in sections 362(b)(6), 362(b)(7), 362(b)(17) and 362(b)(27) and the provisions addressing the avoidance powers of a trustee in sections 546(e)-(g) and (j).[128] These changes were intended to merely "conform the provisions of the Bankruptcy Code to the parallel provisions of the FDIA and FCUA."[129] Congress "confirmed" by these amendments, its intent to:

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[123] 152 CONG. REC. H8650, H8651 (daily ed. Nov. 15, 2006) (statement of Rep. Baker); *see also* 152 CONG. REC. H7598, H7601 (daily ed. Sept. 27, 2006) (statement of Rep. Wasserman Schultz) ("[N]etting . . . is a critically important tool . . . which have [sic], until now, been denied to our . . . financial institutions.").

[124] *See* 152 CONG. REC. H8650 (daily ed. Nov. 15, 2006) (statement of Rep. McHenry) (stating amendments are minor).

[125] *See* H.R. REP. NO. 109-648, pt. 1, at 5–7, 18–20 (2006).

[126] *Id.* at 3.

[127] *Id.*

[128] *See* Financial Netting Improvements Act of 2006, H.R. 5585, 109th Cong. § 5 (2005) (amending sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 546(e), 546(f), 546(g), and 546(j)); H.R. REP. NO. 109-648, pt. 1, at 7–8 (explaining amendments to automatic stay and trustee avoidance powers).

[129] H.R. REP. NO. 109-648, pt. 1, at 7 (discussing FNIA changes to section 362(b)).

> protect, free from the automatic stay, all rights previously protected by Sections 362(b)(6), (7), and (17), including self-help foreclosure-on-collateral rights, setoff rights and netting rights (including foreclosure on, and setoff against, cash and securities held to margin or secure claims for margin payments and settlement payments, title transfer arrangements and the right to offset obligations owed against collateral pledged to the debtor).[130]

III. RECENT CASES INTERPRETING AMENDED SAFE HARBORS

The Safe Harbor Provisions, as amended in BAPCPA and FNIA, did not apply to bankruptcy cases commenced prior to their enactment.[131] As a result, and presumably because the amendments were intended to *clarify* treatment of derivative transactions and financial contracts (and thereby *reduce—not increase*—litigation concerning the exercise of counterparties' specified rights), there has been sparse case law interpreting the amended provisions to date. There have been, however, at least four cases decided that have addressed the amended Safe Harbor Provisions:[132] *Hutson v. E.I. du Pont de Nemours & Co.* (*In re National Gas Distributors, LLC*);[133] *Calyon New York Branch v. American Home Mortgage Corp. (In re American Home Mortgage, Inc.)*;[134] *Casa de Cambio Majapara S.A. de C.V. v. Wachovia Bank* (*In re Casa de Cambio Majapara*);[135] *Calpine Energy Services L.P. v. Reliant Electric Solutions, L.L.C.* (*In re Calpine Corp.*).[136] While not controlling outside their own jurisdictions, given the paucity of case law, these decisions may be persuasive to other courts faced with interpreting the amended Safe Harbor Provisions and in determining which parties and what products merited protection under the statute and the scope of exercisable rights. In *In re National*

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[130] *Id.*

[131] *See* H.R. 5585 § 7, 120 Stat. at 2700 (stating FNIA amendments will not apply to cases commenced before FNIA's enactment date); Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, S. 256 109th Cong. § 1501(b)(1), 119 Stat. 23, 216 (2005) (stating BAPCPA amendments will not apply to cases commenced before BAPCPA's effective date); *In re* McKinney, 457 F.3d 623, 624 (7th Cir. 2006) (dismissing appeal premised on BAPCPA because proceedings commenced before BAPCPA's effective date).

[132] As of the date this article was written. After this article was written but before publication, the Bankruptcy Court for the Southern District of New York decided a matter in the Lehman Brothers bankruptcy that addressed the safe harbor provisions. *See* Lehman Bros. Special Fin., Inc. v. BNY Corporate Servs. Tr. Ltd. (*In re* Lehman Bros. Holdings Inc.), 422 B.R. 407, 421 (Bankr. S.D.N.Y. 2010) (noting that payment priority modification in document governing distribution of payment under swap did not receive protection under section 560 because it did not "expressly deal with liquidation, termination or acceleration").

[133] 556 F.3d 247, 253 (4th Cir. 2009) (analyzing BAPCPA's expanded definition of "swap agreement").

[134] 379 B.R. 503, 520 (Bankr. D. Del. 2008) (finding contract between debtor and plaintiff qualified as "repurchase agreement" under definition expanded by BAPCPA).

[135] 390 B.R. 595, 600 (Bankr. N.D. Ill. 2008) (holding amended section 546(g) applied because defendant's transactions were transfers to swap participant in connection with swap agreement).

[136] No. 05-60200, 2009 WL 1578282 (Bankr. S.D.N.Y. May 7, 2009) (discussing which contractual rights were available under forward contract to party under safe harbor protections).

Gas Distributors, *In re American Home Mortgage*, and *In re Case de Cambio*, the courts examined the broadened definitions for the types of protected transactions and protected counterparties. In a different vein, *In re Calpine Corp*. addressed the *scope* of contractual rights exercisable by a protected counterparty. Looking at these cases alone, it seems that the Safe Harbor Provisions broadened who and what was protected but did not alter the type of rights such protected parties could exercise against a debtor.

A. The "Broader" Definition of Swap Agreement Is Not Necessarily "Clearer"

Included in the broadening of the definition of "swap agreement," was the addition of "commodity forward agreements" within that definition. The term "commodity forward agreement" is not defined, but the term "forward contract," which is a distinctly *non-swap* agreement, *is* defined in section 101(25) of the Bankruptcy Code. A "forward contract" is:

> (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 . . . .[137]

Courts have interpreted the definition of a forward contract to be inclusive of both financially and physically-settled agreements.[138]

Whether a contract is a "forward contract" or "swap agreement" may have an impact on the ability of a creditor to withstand avoidance of a pre-petition transfer under sections 544, 545, 547, 548(a)(1)(B) and 548(B) of the Bankruptcy Code. This is because the exception to recovery of pre-petition transfers in connection with forward contracts in section 546(e) of the Bankruptcy Code is limited in comparison to the similar protections for swap agreements in section 546(g). In order to receive the benefits of section 546(e) a party would have to qualify as a

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[137] 11 U.S.C. § 101(25) (2006).

[138] Williams v. Morgan Stanley Capital Group Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 742 (5th Cir. 2002) (refusing to adopt distinction between "financial" forward contracts and "ordinary purchase and sale" forward contracts); *In re* Borden Chems., 336 B.R. 214, 218–19 (Bankr. D. Del. 2006) (noting forward contracts encompass entirety of transaction in commodity and forward contracts and specifically any natural gas contract constitutes such commodity); *see, e.g.*, H.R. REP. NO. 101-484, at 4 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 226 (defining forward contract as contract for purpose of sale, transfer or purchase of commodity); S. REP. NO. 101-285, at 2 (1990) (indicating purpose of forward contract is to hedge against possible fluctuations in the price of a commodity).

"commodity broker, forward contract merchant, . . . or financial participant,"[139] as those terms are defined in sections 761(4), 101(26), and 101(22A) respectively. Additionally, section 546(e) protects from avoidance only transfers that are "margin prepayment[s]" or "settlement payment[s]," as those terms are defined in sections 101(38) and 101(51A) respectively.[140] Section 546(g), on the other hand, is much less restricted, protecting *any* "transfer[s], made by or to . . . a swap participant . . . under or in connection with any swap agreement."[141] A "swap participant" is simply an entity that prior to the petition date "has an outstanding swap agreement with the debtor."[142]

In *Hutson v. E.I. du Pont de Nemours & Co.* (*In re National Gas Distributors, LLC*), the trustee sought to avoid several pre-petition contracts for the delivery of natural gas to the debtor as constructively fraudulent transfers.[143] In defense, the customers argued that their contracts were "commodity forward agreements" within the newly amended definition of "swap agreements" in the Bankruptcy Code, and not avoidable under section 546(g).[144] Utilizing case law prior to the BAPCPA amendments, the bankruptcy court found that the contracts at issue were not within the traditional definition of a "swap agreement," which required all swap agreements to be financial in nature.[145] The contracts at issue contemplated actual

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[139] 11 U.S.C. § 546(e) (2006) (stating trustee may not avoid transfers made by or to parties such as commodity broker, forward contract merchant, or financial participant,); *see, e.g.*, PHP Liquidating, LLC v. Robbins, 291 B.R. 592, 596 (D. Del. 2003) (noting trustee cannot avoid transfers such as settlement payments); *In re* Enron Creditors Recovery Corp., 407 B.R. 17, 29 (Bankr. S.D.N.Y. 2009) (mentioning which parties trustee cannot avoid transfers from or to under section 546).

[140] 11 U.S.C. § 546(e) (indicating additional transfers receive protection under section 546(e) such as "margin prepayment[s]" or "settlement payment[s]"); *see, e.g.*, *Williams*, 294 F.3d at 739–40 (highlighting Morgan Stanley's argument that payments constituted "settlement payments" made in "forward merchant contract" as defined by section 546(e)); Am. Tissue Inc. v. Donaldson, Lufkin & Jennrette Secs. Corp., 351 F. Supp. 2d 79, 107 (S.D.N.Y. 2004) ("DLJ challenges the fraudulent conveyance claims on the ground that the monies paid by ATI were 'settlement payments' within the meaning of 11 U.S.C. § 546(e) . . . .").

[141] 11 U.S.C. § 546(g) (noting trustee may not avoid transfer, made by or to swap participant "under or in connection with any swap agreement"); *see, e.g.*, *In re* Nat'l Gas Distributor, 415 B.R. 209, 212 (Bankr. E.D.N.C. 2009) (noting Army contended that agreements related to natural gas from debtor to be "swap agreements" under section 101(53B)); Tucker, *supra* note 17, at 611 ("The amendment to section 546 specifically exempts swap-participant transfers made in connection with a swap contract from avoidance under sections 544, 545, 547, 548(a)(2), and 548(b).").

[142] 11 U.S.C. § 101(53c) (2006) (defining swap participant as entity that has "outstanding swap agreement" with debtor prior to start of bankruptcy); *see, e.g.*, *In re* Mirant Corp., 314 B.R. 347, 351 (Bankr. N.D. Tex. 2004) (highlighting debtors' acknowledgement that section 101(53B) defines "swap participants").

[143] 556 F.3d 247, 249 (4th Cir. 2009) (noting trustee seeks to avoid contracts).

[144] *Id.* at 250 (highlighting customers' argument that agreements were swap agreements protected under Bankruptcy Code).

[145] *See In re* Nat'l Gas Distributors, LLC, 369 B.R. 884, 899 (Bankr. E.D.N.C. 2007), *rev'd*, 556 F.3d 247 (4th Cir. 2009); *see also* 11 U.S.C. § 101(53B)(A) (enumerating types of agreements falling within definition of "swap agreement"); Ayes v. U.S. Dep't of Veterans Affairs, 473 F.3d 104, 108 (4th Cir. 2006) (arguing "similar" is used by Congress to limit, rather than expand definition of term). For the traditional definition of swap agreement in the market see *In re* Enron Corp., 328 B.R. 58, 69–70 (Bankr. S.D.N.Y. 2005) (citing *In re* Interbulk, Ltd., 240 B.R. 195, 201 (Bankr S.D.N.Y. 1999)) and JACK CLARK FRANCIS ET AL., THE HANDBOOK OF EQUITY DERIVATIVES 527 (1995).

delivery of the product as opposed to being traded on a financial market, and thus, were not "swap agreements" under the pre BAPCPA jurisprudence.[146]

On direct appeal, the Fourth Circuit reversed and remanded for further findings as to whether the contracts at hand were "commodity forward agreements" within the *new* definition of "swap agreement" under the Bankruptcy Code.[147] Breaking with prior jurisprudence, the Fourth Circuit concluded that commodity forward agreements, unlike other swap agreements, could be physical in nature.[148]

In reaching its decision, the Fourth Circuit turned to rules of statutory construction including legislative history and dictionary definitions for its interpretation.[149] The court analogized the definition of "commodity forward agreement" in section 101(53B), to "forward contract" in section 101(25), which courts have interpreted as having both physical and financial components and not found only in financial markets.[150] The Fourth Circuit determined that "forward contract" must have a *narrower* meaning than "forward agreement" because Congress noted that the inclusion of "forward" in the definition of "swap agreement" could refer to a "forward transaction . . . even *if not a forward contract*."[151] Additionally, *Black's Law Dictionary* distinguishes between the definition of "agreement" and "contract" and, therefore, "[e]very contract is an agreement [] but not every agreement is a contract."[152] The Fourth Circuit further held that the contracts in the *National Gas* case contained hedging components, and therefore, they were not traditional supply contracts, which "cannot be treated as swap agreements under the Bankruptcy Code."[153] Accordingly, the court found that

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[146] *See In re Nat'l Gas Distributors*, 369 B.R. at 899; H.R. REP. NO. 109-648, at 7 (2006) (reiterating Congress' intent to exclude sales-of-goods contracts from definition of "swap agreement"); H.R. REP. NO. 109-31, pt. 1, at 129 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 189 (stating traditional commercial transactions, including supply agreements, should not fall within definition of "swap agreement").

[147] *See* Hutson v. E.I. du Pont Nemours & Co. (*In re* Nat'l Gas Distributors), 556 F.3d 247, 260–61 (4th Cir. 2009).

[148] *See id.* at 258 (reasoning forward agreements may be physically settled because courts have recognized forward contracts may be physically settled); Williams v. Morgan Stanley Capital Group (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 742 (5th Cir. 2002) (rejecting distinction between financial forward contracts and purchase-and-sale forward contracts); *In re* Borden Chems., 336 B.R. 214, 221 (Bankr. D. Del. 2006) (stating forward contracts were intended to possess both financial and physical characteristics).

[149] *See In re Nat'l Gas Distributors*, 556 F.3d at 254; *cf.* BFP v. Resolution Trust Corp., 511 U.S. 531, 537–38 (1993) (using *Black's Law Dictionary* to determine meaning of statutorily undefined term); Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384, 395–96 (1951) (Jackson, J., concurring) (providing guidelines for resort to legislative history).

[150] *See In re Nat'l Gas Distributors*, 556 F.3d at 257; *In re Borden Chems.*, 336 B.R. at 218 (identifying physical delivery as central feature of forward contracts); *Williams*, 294 F.3d at 741 (stating forward contracts are not necessarily subject to rules of market or board of trade).

[151] *In re Nat'l Gas Distributors*, 556 F.3d 247, 255 (4th Cir. 2009) (citing H.R. REP. NO. 109-31, pt. 1, at 129) (emphasis added).

[152] *Id.* at 255 (citing BLACK'S LAW DICTIONARY 74 (8th ed. 2004)).

[153] *Id.* 258 (suggesting contracts potentially be treated as swap agreements because contained hedging elements; were not merely traditional supply contracts) (citing H.R. REP. NO. 109-31, pt. 1, at 122 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 183–84).

nothing in the Bankruptcy Code or the legislative history suggests that forward agreements *cannot* be physically settled and, in fact, because "forward contracts" can be physically settled, the same should be true of "forward agreements."[154] The Fourth Circuit, therefore, remanded, holding that the bankruptcy court gave the statute a more narrow reading than was required.[155]

In remanding, the Fourth Circuit noted the difficulty that the bankruptcy court would have in determining whether the contracts are "commodity forward contracts" without the benefit of developed case law or clear market-place definitions.[156] The statutory definition was broadened to such an extent that "the potpourri of agreements included in the term 'swap agreement' barely distinguish any major commercial contract from a swap agreement."[157] The court provided some guidance in the following non-exclusive elements for a "forward commodity agreement": (i) the subject must be a commodity; (ii) maturity must be more than two days after the date of entry into the agreement; (iii) the quantity, time and price must be fixed at the time of contracting; and (iv) the contract does not have to be assignable, or traded on an exchange, but must have a relationship to the financial markets.[158] The first three of these criteria are very similar to those courts have used in defining "forward contracts."[159] Thus, the last criterion, a "relationship to the financial markets," may be the *only* means for distinguishing a "forward commodity agreement" from a "forward contract."

National Gas may have partially, if not completely, erased the distinction between what is a "swap agreement" and what is a "forward contract." Parties to a "forward commodity agreement" that might not otherwise satisfy the requirements for protection from avoidance of transfers for forward contracts under section 546(e) could now benefit from the broad protections for swap agreements in section 546(g). Additionally, *National Gas* shows that despite Congress' effort to broaden the definition of swap agreements to provide certainty that the newer forms of swap

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[154] *Id.* at 258 (citing *Williams*, 294 F.3d at 742) (noting no reason to distinguish between financial forward contracts or physically settled forward contracts); *see, e.g.*, *In re Borden Chems.*, 336 B.R. at 223 (holding agreement which called for actual delivery of natural gas constitutes forward contract); *In re* Mirant Corp., 310 B.R. 548, 566 (Bankr. N.D. Tex 2004) (finding natural gas supply agreements to be forward contracts).

[155] *In re Nat'l Gas Distributors*, 556 F.3d at 258–59 (remanding and finding Bankruptcy Court's interpretation of "commodity forward agreements" within section 101(53B)(A) of Bankruptcy Code overly narrow).

[156] *See id. at* 259 ("In determining whether the contracts in this case are 'commodity forward agreements,' the bankruptcy court will not, unfortunately, have the benefit of developed case law, nor even the benefit of clear market-place definitions.").

[157] *See id.* (acknowledging wide range of transactions incorporated into statutory definition of "swap agreement" essentially include most major commercial contracts).

[158] *See id.* at 259–61 (describing elements considered statutorily necessary for characterization of transaction as "commodity forward agreement").

[159] *See In re Borden Chems.*, 336 B.R. at 218–19 (listing first three of four criteria for definition of forward contracts, and as fourth that forward contracts contemplate physical delivery)*; see also* Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983, 990 (8th Cir. 1999) (highlighting "contemplation of physical delivery" as defining characteristic of unregulated cash-forward contract); *In re Mirant Corp.*, 310 B.R. at 565 (examining subject-matter and maturity dates to determine whether agreements constitute "forward contracts").

agreements would be included in the Safe Harbor Provisions,[160] the newer forms of swap agreement were not defined, and thus, are left open to interpretation and litigation—exactly what Congress intended to avoid.[161]

B. New Definitions of "Repurchase Agreement," "Financial Participant" and "Securities Contract" Eliminate Inconsistent Treatment

Traditionally, a repurchase agreement is defined as a two-part transaction—first, an agreement to sell one of several specified products, and second, a simultaneous agreement to repurchase the sold asset at the original price plus an agreed-upon amount.[162] Prior to BAPCPA, the Bankruptcy Code specified potential "subjects" of a repurchase agreement, such as certificates of deposit and United States securities.[163] BAPCPA amended the definition of "repurchase agreement" in section 101(47) to include protections for repurchase agreements of transfers of mortgage loans and mortgage related securities, and transfers of interests in mortgage loans and mortgage related securities. The definition now reads in part,

> The term "repurchase agreement" . . . (A) means [] (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, . . . with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, . . . mortgage loans, or interests of the kind described in this clause, at a

[160] *See 1999 Hearing*, *supra* note 23, at 386–87 (statement of Seth Grosshandler, Partner, Cleary, Gottlieb, Steen, & Hamilton) (discussing how Bankruptcy Reform Act of 1999 would expand definition of "swap agreement," ensuring that swaps that are "[fundamentally] equivalent to other contracts" protected by safe harbor provisions would be entitled to same protections); H.R. REP. NO. 109-648, pt. 1, at 3 (2006) (illustrating Congressional intent to update laws so "newer forms of contractual arrangements" were given same protections with regarding "financial netting").

[161] *See In re Nat'l Gas Distributors*, 556 F.3d at 258–59; *see also In re* Casa de Cambio Majapara S.A. de C.V., 390 B.R. 595, 598–99 (Bankr. N.D. Ill. 2008) (displaying struggle to interpret section 546(g) after BAPCPA); Sarah Curley & Elizabeth Fella, *Where To Hide? How Valuation of Derivatives Haunts the Courts—Even After BAPCPA*, 83 AM. BANKR. L.J. 297, 306 (2009) (commenting on confusion *Hutson* encountered with definition of swap agreements).

[162] *See* Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer SOL Ass'n (*In re* Bevill, Bresler & Schulman Asset Mgmt. Corp.), 878 F.2d 742, 743 (3d Cir. 1989) (explaining nature of repurchase agreement); *In re* Nat'l Forge Co., 344 B.R. 340, 352 n.7 (W.D. Pa. 2006) (defining standard repurchase agreement). *See generally* 11 U.S.C. § 101(47)(A)(i) (2006) (codifying definition of repurchase agreement).

[163] *See* 11 U.S.C §101(47) ("'[R]epurchase agreement'" . . . means an agreement . . . which provides for the transfer of certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of . . . the United States . . . .").

> date certain not later than 1 year after such transfer or on demand, against the transfer of funds[.][164]

In *Calyon New York Branch v. American Home Mortgage Corp. (In re American Home Mortgage, Inc.)*,[165] the Delaware bankruptcy court examined whether a contract for the purchase and sale of bundle of mortgage loans was a "repurchase agreement" under newly-amended section 101(47) of the Bankruptcy Code, and if so, whether the entire contract including a servicing provision was entitled to protection under sections 555 and 559 of the Bankruptcy Code.[166]

The debtors argued that the transaction at issue, a purchase and sale of mortgage loans through their agent Calyon New York Branch ("Calyon"), was in the nature of secured financing and should not be considered a repurchase agreement under the Bankruptcy Code definition. The bankruptcy court found, however, that the BAPCPA amendments clearly modified the definition of repurchase agreements to explicitly include "mortgage related securities . . . mortgage loans [and] interest in mortgage related securities or mortgage loans"[167] and thus, it rejected the debtors' argument.[168]

The 2005 amendments to repurchase and reverse repurchase agreements were "intended to *eliminate any inquiry* under section 555 . . . as to whether a repurchase or reverse repurchase transaction is a purchase or sale transaction or a secured financing."[169] Because the contract was for the purchase and resale of mortgage loans, it was—*by definition*—a repurchase agreement.[170] No further inquiry was required—the Safe Harbor Provisions sections 555 and 559 applied "period."[171]

> The Court finds that Congress said what it meant and meant what it said in drafting the definition of repurchase agreement, i.e., if the criteria established in the statute are meant [sic] the contract is a repurchase agreement. No further inquiry or consideration of other contractual provision is required.[172]

The *American Home* court's decision was consistent with the legislative history, which provided that although repurchase obligations under a commercial loan do not make the loan participation agreement a repurchase agreement, "a repurchase agreement involving the transfer of participations in commercial mortgage loans with a simultaneous agreement to repurchase the participation on demand or at a

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164 11 U.S.C. § 101(47)(A)(i).
165 379 B.R. 503 (Bankr. D. Del. 2008).
166 *Id.* at 512, 518.
167 *Id.* at 513 (citing 11 U.S.C. § 101(47) (2006)).
168 *Id.* at 518.
169 *Id.* at 516 (emphasis added).
170 *Id.* at 518.
171 *In re* Am. Home Mortgage, Inc., 379 B.R. 503, 517–19 (Bankr. D. Del. 2008).
172 *Id.* at 516.

date certain one year or less after such transfer, . . . would constitute a 'repurchase agreement'. . . ."[173]

The *American Home* court determined that Calyon, as a commercial bank and one of the largest financial institutions, was a "financial participant" under the new definition in section 101(22) of the Bankruptcy Code.[174] Additionally, the contract at issue was a "securities contract" under the newly-amended definition in section 741(7), because that definition was also amended to include "repurchase or reverse repurchase transactions on . . . mortgage loan[.]"[175] Under the newly amended statute, therefore, Calyon was entitled to the protections in section 555 as well as section 559 for "the exercise of a contractual right by a financial institution . . . to cause the liquidation, termination, or acceleration of a 'securities contract.'"[176]

The court noted that "interestingly," the 2005 amendments to the definitions of "repurchase agreement" and "securities contract" made "the analysis of repurchase agreements under sections 555 and 559 and the effect of the safe harbor . . . virtually identical."[177]

Prior to 2005, parties whose contracts did not fit the definition of "repurchase agreement" under section 559 might have tried to utilize the protections for "securities contracts" under section 555 instead, attempts which would often lead to litigation.[178] Now, because the analysis is "virtually identical" it is clear that the amendments to these sections *did* eliminate the arbitrary differences in these sections and thus provided certainty about the enforcement of rights under these transactions.

Yet, the amendments to the definitions of "repurchase agreement" and "securities agreement" did not change the fact that Congress had limited the safe harbor protections in sections 555 and 559 to the exercise of rights under those specific agreements only. In addition to seeking protection to exercise its rights under the repurchase agreement itself, Calyon sought to exercise termination rights with respect to the servicing portion of the agreement, which allowed the debtor to designate the servicer of the loan. For support of its argument, Calyon contended that the definition of "repurchase agreement" includes "*related terms*" to that agreement.[179] Additionally, the definitions of "repurchase agreement" and "securities contract" include "any interest in a mortgage loan."[180] The court rejected Calyon's argument holding that the servicing provision was severable from the rest

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[173] H.R. REP. NO. 109-31, pt. 1, at 128 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 189.
[174] *In re Am. Home Mortgage*, 379 B.R at 519.
[175] *Id*. at 519 (citing 11 U.S.C. § 741(7) (2006)).
[176] *Id.*
[177] *Id.*
[178] *See id.* at 519 (noting analyses of repurchase agreements under sections 555 and 559, now identical, were different prior to 2005 amendments). *See generally* 5 COLLIER ON BANKRUPTCY, ¶¶ 555.02, 559.02 (Alan N. Resnick et al. eds., 15th ed. rev. 2006).
[179] 11 U.S.C. § 101(47)(A)(1) (2006) (emphasis added).
[180] 11 U.S.C. § 741(7)(A)(i) (2006).

of the agreement and that the agreement itself was not a "repurchase agreement," nor a "securities contract."[181] First, the court held that the servicing was separate and apart from "ownership" in the underlying mortgage, and thus, it could not be an "interest in a mortgage loan" for purposes of the definitions of repurchase agreement and securities contract.[182] Second, the court held that the servicing provision was not a "related term" because servicing was a separate asset from the repurchase agreement.[183] As a separate asset of the debtor, it should not receive safe harbor treatment intended for repurchase agreements. Additionally, the court noted that because the reference to "related terms" preceded the 2005 amendments to section 101(47) when protections for mortgage loans were added, "related terms" could not have been meant to include servicing of mortgage loans.[184]

American Home established a bright line rule with respect to what transactions are within the definition of a "repurchase agreement" or a "securities contracts" in addition to who may be a "financial participant," thus, likely reducing litigation as to these issues. Further, the court indicated that neither in their purpose nor in their effect do the Safe Harbor Provisions protect the exercise of rights under non-safe harbored transactions merely because such rights are included in safe harbored agreements. The Safe Harbor Provisions do not extend to contracts or portions of contracts that themselves are not expressly within the statutory definitions.

C. Revisions to Section 645(g) Clarify Protections for Pre-petition Transfers

Prior to the 2005, section 546(g) protected from avoidance any pre-petition transfer "under a swap agreement, made by or to a swap participant, in connection with a swap agreement[.]"[185] This protection was interpreted as requiring the counterparty to prove that the transfer was both "under" *and* "in connection with" the swap agreement.[186] "Under" meant "according to the method [specifically] prescribed" in the swap.[187] If a transfer was not "under," or *specifically prescribed in the swap,* it was not protected by section 546(g). In 2005, Congress through BAPCPA amended section 546(g) to specifically protect transfers "under *or* in connection with any swap agreement and that is made before the commencement of the case[.]"[188] In doing so, Congress appears to have expressly overridden the previously-interpreted limitation of protections for only those transfers that were

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[181] *In re Am. Home Mortgage*, 379 B.R. at 520.
[182] *Id.* at 522–23 (citing I SHORTER OXFORD ENGLISH DICTIONARY 1408 (6th ed. 2007)).
[183] *Id.* at 523.
[184] *Id.*
[185] 11 U.S.C. § 546(g) (2000).
[186] *See, e.g., In re* Interbulk, Ltd., 240 B.R. 195, 202 (Bankr. S.D.N.Y. 1999) (highlighting statute's conjunctive phrasing).
[187] *Id.* (finding pre-petition attachment was not protected by section 546(g) because it was not obtained "according to the method prescribed in the agreement itself" and, thus, was not "under" swap agreement).
[188] 11 U.S.C. § 546(g) (2006) (emphasis added).

specifically prescribed in the swap and expand the protection to any transfer "related to" a swap.

The amended statute was interpreted as having been deliberately changed by the Bankruptcy Court for the Northern District of Illinois in *Casa de Cambio Majapara S.A. de C.V. v. Wachovia Bank* (*In re Casa de Cambio Majapara*).[189] In that case, a creditor had sought and received an attachment resulting from a pre-petition default with respect to spot transactions.[190] The *Casa de Cambio* court found that the attachment was at least "related to" and "in connection with the swap agreement" and therefore, it was protected from avoidance by section 546(g).[191] The court found that because of the amendment to section 546(g), it was plainly clear that Congress no longer required that the transfer also be "under" the swap agreement or "according to the method prescribed by the agreement itself."[192] Congress' clear and deliberate amendment to section 546(g) therefore had its intended effect and a counterparty now may have more success than it previously would have had in seeking to invoke the statute's protection.

D. The Scope of the Exercisable Rights Did Not Change With the Amendments

The express language of Safe Harbor Provisions is limited in that they protect the "exercise of any contractual right" by the designated counterparty to "cause the liquidation, termination or acceleration of one or more [swap agreements, forward contracts, repurchase agreement, etc.] because of a condition of the kind specified in section 365(e) of this title."[193] Additionally, prior to the BAPCPA amendments, several courts had expressly held that the protections for the exercise of "contractual rights" are not "unqualified" and are limited to the *termination, liquidation, and/or acceleration* of safe harbored contracts and even then *only* to the extent that the contractual right is triggered by a condition specified in section 365(e)(1): (i) the insolvency or financial condition of the debtor at any time before the closing of the case; (ii) the commencement of a case under this title; or (iii) the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement.[194]

With BAPCPA, Congress amended the definition of "contractual right" in sections 555, 556, 559, 560 and 561 to include rights whether or not evidenced in

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[189] 390 B.R. 595 (Bankr. N.D. Ill. 2008).
[190] *Id*. at 596–97.
[191] *Id*. at 599 (internal quotations omitted); *see also* 11 U.S.C. § 546(g).
[192] *In re Casa de Cambio Majapara,* 390 B.R. at 598.
[193] *See* 11 U.S.C. § 560 (2006); *see also* 11 U.S.C. §§ 555–556, 559, 561 (2006).
[194] *See In re* Amcor Funding Corp., 117 B.R. 549, 551 (D. Ariz. 1990) (finding liquidation of debtor's contracts for reasons not specified on section 365(e) was not protected by safe harbors); *In re* Enron Corp., 306 B.R. 465, 472–73 (Bankr. S.D.N.Y. 2004) (denying counterparty right to commence state court action under section 560); Campbell, *supra* note 52, at 8 (acknowledging contractual right must be triggered by condition specified in section 365(e)(1)).

writing, arising under common law, under law merchant, or by reason of normal business practice.[195] Counterparties may argue that the change was intended to protect the exercise of *all* rights in a safe-harbored agreement. But in *Calpine Energy Services, L.P. v. Reliant Electric Solutions, L.L.C.* (*In re Calpine Corp.*), the Bankruptcy Court for the Southern District of New York had a chance to address the scope of exercisable rights under the Safe Harbor Provision and its holding shows no break from the prior case law.[196]

In *Calpine*, the creditor Reliant sought to enforce a provision in a Master Agreement (which the parties agreed was a "forward contract") that required Calpine to dispute any calculation of termination amounts within two days of receiving the notice of the amount due after termination upon an event of default.[197] The court found that the Master Agreement and underlying forward contracts were entitled to safe harbor protection under section 556 of the Bankruptcy Code and consequently Reliant's termination was proper.[198] As to Calpine's obligation to formally dispute the calculations, however, the bankruptcy court held that the Safe Harbor Provisions of section 556 did not extend to require Calpine to perform those obligations.[199] The court found that the obligation to dispute calculations made after termination was merely ancillary to termination—not *all* "contractual rights" are protected by the Safe Harbor Provisions.[200]

"[S]ection 556 . . . is limited to enforcing *only* those terms that trigger termination upon the occurrence of one of the three specified conditions listed in section 365(e)(1) . . . [and] rights that are merely ancillary or incidental to an *ipso facto* clause are not enforceable under section 556 of the Code."[201] Although Reliant argued that the protest clause "goes to the very heart of the termination process," the *Calpine* court found the clause to be unenforceable because it was not part of the actual "termination"—the act of closing out the transactions.[202] "[T]he plain language of section 556 of the Code does not lend itself to such an expansive reading, nor does this Court believe such a reading would be appropriate."[203] Consistent with pre BAPCPA and FNIA case law, therefore, only contractual rights

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[195] 11 U.S.C. § 560 (2006); H.R. REP. NO. 109-31, pt. 1, at 133 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193; *see* Hance, *supra* note 111, at 746 (discussing Congress's expansion of contractual rights under Bankruptcy Code).

[196] *In re* Calpine Corp., No. 05-60200, Adv. No. 08-1251, 2009 WL 1578282, at *7 (Bankr. S.D.N.Y. May 7, 2009) ("Unfortunately, the plain language of section 556 of the Code does not lend itself to such an expansive reading, nor does this Court believe such a reading would be appropriate.").

[197] *Id.* at *1–*2.

[198] *Id.* at *6–*7 ("[S]ection 556 of the Code allows a creditor to exercise a pre-petition contractual right to terminate a forward contract based upon the debtor's filing of a bankruptcy petition. However, by its terms . . . is limited to enforcing only those terms that trigger termination [under section 365(e)(1)].").

[199] *Id.* at *7.

[200] *Id.* at *6.

[201] *Id.* (emphasis added); *see In re* Am. Home Mortgage Holdings, Inc., 388 B.R. 69, 88 (Bankr. D. Del. 2008) (acknowledging non-debtor is protected by safe harbor provision if "triggered by a condition of the kind specified in section 365(e)(1) of the Bankruptcy Code").

[202] *In re Calpine Corp.*, 2009 WL 1578282, at *7.

[203] *Id.*

to *terminate, liquidate and accelerate* because of a condition specified in section 365(e) will be protected by the Safe Harbor Provisions.

The *Calpine* holding is consistent with the legislative history which reflects that

> [f]or the purposes of . . . sections 555, 556, 559, 560 and 561, it is intended that the normal business practice in the event of a default of a party based on bankruptcy or insolvency is to terminate, liquidate or accelerate securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements with the bankrupt or insolvent party.[204]

It is these "contractual rights" to "terminate, liquidate, or accelerate" that were intended to be protected by sections 555, 556, 559, 560 and 561—extraneous rights or those "ancillary" to the termination, liquidation or acceleration of a safe harbored contract are not within the ambit of the safe harbors.

IV. REMAINING AMBIGUITIES

In the above analysis regarding courts' decisions as to what is in included in the defined terms and categories of the specific safe harbored contracts, as well as the scope of protections provided, it is clear that the amendments did clear up some prior confusion. Nevertheless, arguably there is still room for interpretation—especially, for example, as was noted by *National Gas*, with respect to the lengthy list of undefined types of "swap agreements." Additionally, despite the holding of *Calpine* (and the prior jurisprudence)[205] parties are, in some cases, attempting to argue that the amended Safe Harbor Provisions expanded the scope of exercisable rights. This section examines some of the open questions and areas that may prompt counterparties to contend that uncertainties remain despite the BAPCPA and FNIA amendments.

A. Scope of Setoff Rights in Safe Harbor Provisions: Does it Encompass Cross-Affiliate Netting?

One area where counterparties may argue that the Safe Harbor Provisions created new rights is with respect to cross-affiliate setoffs or netting.[206] Cross-

[204] S. REP. NO. 106-49, at 56 (1999).

[205] *See In re* Amcor Funding Corp., 117 B.R. 549, 551 (D. Ariz. 1990) (refusing to protect liquidation of debtor's securities for reasons not specified in section 365(e) of Bankruptcy Code); *In re Calpine Corp.*, 2009 WL 1578282, at *6 (reading section 556 as protecting rights triggered by occurrences explicitly mentioned in section 365(e)(1)); *In re* Enron Corp., 306 B.R. 465, 473 (Bankr. S.D.N.Y. 2004) (interpreting section 560 as not permitting exercise of "unqualified right" in terminating swap agreements).

[206] *See* Motion of Occidental Power Services, Inc. and Occidental Energy Marketing, Inc. to Effectuate Setoff and Settle Outstanding Derivative Contracts and For Related Relief (Docket No. 4238) at 6–8, *In re*

affiliate netting is the notion that a counterparty may set off any obligation owed by it or any of its affiliates to the defaulting party with an obligation owed by the defaulting party to the counterparty or any of its affiliates.[207]

Generally, a creditor's setoff rights in bankruptcy are governed by section 553 of the Bankruptcy Code, which allows the offset of mutual pre-petition debts by permitting "entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'"[208] Courts have routinely held that under the plain language of the statute, a setoff is *only* permissible if there is mutuality between the parties, which means the debts and credits are held in the same right, between the same parties, standing in the same capacity.[209] In light of this "same parties" requirement, many courts have expressly held that triangular or non-mutual setoffs are improper under section 553.[210] Despite this express language, a counterparty may argue that it may enforce cross-affiliate setoff rights (either in a contract or under common law) under the Safe Harbor Provisions.[211]

Lehman Bros. Holdings Inc., No. 08-13555 (JMP) (Jointly Administered) (Bankr. S.D.N.Y June 29, 2009); Debtors' Objection to Motion of Chevron Products Company for Reconsideration of this Court's Opinion Dated January 9, 2009 Regarding Contractual Netting (Docket Nos. 2853, 2873) at 2, *In re* SemCrude L.P., No. 08-11525, Mem. Order of Mar. 19, 2009 (Bankr. D. Del. 2009) (denying reconsideration), 2009 WL 492795 (arguing opposing party's position that express netting agreement is outside scope of section 553(a) because of Safe Harbor Provisions).

[207] This describes "triangular" netting, meaning two or more counterparty affiliates attempt to net their obligations with respect to a single debtor. Counterparties may also attempt to assert "square" netting in which they attempt to net their obligations and the obligations of their affiliates against the debtor's obligations and the obligations of the debtor's affiliates. *See In re* U.S. Aeroteam, 327 B.R. 852, 863 (Bankr. S.D. Ohio 2005) (stating such "triangular" transactions occur when "a creditor . . . set[s] off its debt to a debtor with the latter's debt to a third party"); *see also* Sherman v. First City Bank of Dallas (*In re* United Sciences of America), 893 F.2d 720, 723 (5th Cir. 1990) (positing section 553(a)'s mutuality requirement protects against such transactions); Campbell, *supra* note 52, at 33 (stating parties attempt to execute such transactions through express contractual agreements).

[208] Citizens Bank of Md. v. Strumpf, 516 U.S. 16, 18 (1995) (quoting Studley v. Boylston Nat'l Bank, 229 U.S. 523, 528 (1913)); *see* 11 U.S.C. § 553(a) (2006) (pertaining to setoff of pre-petition debts of creditor to debtor in bankruptcy proceeding); Studley v. Boylston Nat'l Bank, 229 U.S. 523, 528 (1913) (describing setoff as "right which one party has against another to use his claim in full or partial satisfaction of what he owes to the other").

[209] *See* 11 U.S.C § 553(a) (2006) ("[T]his title does not affect any right of a creditor to offset a mutual debt owing by such creditor to debtor . . . ."); *see also* Westinghouse Credit Corp. v. D'Urso, 278 F.3d 138, 149 (2d Cir. 2002) (noting mutual debts may arise through different transactions, but must be "due to and from the same persons in the same capacity"); *In re* Westchester Structures, Inc., 181 B.R. 730, 740 (Bankr. S.D.N.Y. 1995) (stating debt mutuality is necessary before setoff can take place).

[210] *See, e.g.*, *In re United Sciences of America, Inc.*, 893 F.2d at 723 ("The mutuality requirement is designed to protect against 'triangular' set-off; for example, where the creditor attempts to set off its debt to the debtor with the latter's debt to a third party."); Elcona Home Corp. v. Green Tree Acceptance, Inc. (*In re* Elcona Homes Corp.), 863 F.2d 483, 486 (7th Cir. 1988) ("[T]he statute itself speaks of 'a mutual debt' . . . and therefore precludes 'triangular' set offs") (emphasis omitted); *In re U.S. Aeroteam, Inc.*, 327 B.R. at 864 ("[A] 'triangular setoff,' when A attempts to offset an obligation owed to B against B's debt to C, is prohibited because there is no mutuality of debt between two parties.").

[211] *See* Motion of Occidental Power Services, Inc. and Occidental Energy Marketing, Inc. to Effectuate Setoff and Settle Outstanding Derivative Contracts and For Related Relief (Docket No. 4238) at 6–8, *In re* Lehman Bros. Holdings Inc., No. 08-13555 (JMP) (Jointly Administered) (Bankr. S.D.N.Y June 29, 2009);

Potential arguments that a counterparty could make in support of cross-affiliate netting are that: (1) parties may contract around the mutuality requirement and such contractual rights should be protected by the Safe Harbor Provisions' protections for the exercise of "contractual rights" despite the automatic stay (and despite section 553(a)'s strict mutuality requirement); or (2) cross-product netting in section 561 extends to permit cross-affiliate netting of more than one party.

In the non-derivative context, the Delaware bankruptcy court recently held that parties may not contract around section 553 to create mutuality through the use of such cross-affiliate setoff provisions.[212] The counterparty in that case, Chevron Products Company, argued that it could avoid payment to one debtor on account of obligations owed it by the debtor's two affiliates. For support, Chevron argued that the parties' contracts contained cross-affiliate netting provisions that allowed them to contract around the mutuality requirement. The Delaware bankruptcy court denied stay relief holding there was no contractual exception to the mutuality requirements in section 553 of the Bankruptcy Code and that mutuality for purposes of section 553 cannot be created by contract and, thus, the cross-affiliate netting provision in that case was not enforceable.[213]

Chevron did not raise the issue of whether its contracts were derivative contracts or whether the Safe Harbor Provisions provided an exception to the requirement of strict mutuality in section 553 until after it was denied stay relief, and then, did so in the context of its motion for reconsideration.[214] Reconsideration was denied because Chevron failed to raise the argument that the safe harbors might protect its cross-affiliate setoff in its original motion—"at no point was it ever alleged that the agreements at issue were governed by a different statutory scheme pertaining to 'safe harbored' agreements" and consequently, the decision on the stay motion, "construes only § 553, [and] does not construe §§ 556, 557 or 561, and does not address directly any issue relating to 'safe harbored' contracts."[215] Accordingly, the question of whether the Safe Harbor Provisions provide an exception to the mutuality requirements of section 553 remains open.

Chevron Product Company's Motion for Reconsideration of this Court's Opinion Dated January 9, 2009 Regarding Contractual Netting at 3, *In re* SemCrude L.P., No. 08-11525, Mem. Order of Mar. 19, 2009 (Bankr. D. Del. 2009) (denying reconsideration), 2009 WL 229703 (arguing that agreements "are exceptions to and 'safe harbors' from section 553"); Martin J. Bienenstock et al., *Are Triangular Setoff Agreements Enforceable in Bankruptcy?*, 83 AM. BANKR. L.J. 325, 337–39 (2009) (discussing safe harbor protection of triangular setoffs).

[212] *See In re* SemCrude, L.P., 399 B.R. 388, 398–99 (Bankr. D. Del. 2009) (holding "no exception to the 'mutual debt' requirement in section 553 can be created by private agreement").

[213] *Id.*

[214] *See* Chevron Product Company's Motion for Reconsideration of this Court's Opinion Dated January 9, 2009 Regarding Contractual Netting at 3, *In re* SemCrude L.P., No. 08-11525, Mem. Order of Mar. 19, 2009 (Bankr. D. Del. 2009) (denying reconsideration), 2009 WL 229703 (arguing agreements were forward contracts or swap agreements that "are exceptions to and 'safe harbors' from section 553").

[215] *In re* SemCrude, L.P., No. 08-11525, Mem. Order at ¶ 6 (Bankr. D. Del. Mar. 19, 2009) (order denying Chevron's Motion for Reconsideration), *available at* , http://jweinsteinlaw.com/pdfs/Semcrude%20Reconsideration%20Order.pdf.

In looking for some inkling of Congress' intention to protect, or to not protect, non mutual setoffs and cross-affiliate netting, there is a notable absence of any mention in the legislative history for BAPCPA about either (i) altering counterparties' setoff rights in the Safe Harbor Provisions, or (ii) requiring setoffs to remain subject to the standard mutuality limitations for all setoffs in section 553(a). It is clear, however, that at least until the 2006 FNIA amendments, Congress had intended to maintain the mutuality requirement for setoffs in the Safe Harbor Provisions. Prior to 2006, each of sections 362(b)(6), 362(b)(7), 362(b)(17), and 362(b)(27) explicitly stated that setoffs protected from the automatic stay were "of a *mutual* debt and claim under or in connection with" a safe harbored agreement.[216] Additionally, the legislative history for the original provisions that permitted setoffs under both forward contracts and swap agreements reflects that Congress never intended that the exceptions to the automatic stay would protect setoffs that were not of mutual obligations between only two parties or that they would go beyond those setoffs already permitted by section 553 of the Bankruptcy Code. In testifying before Congress in support of the protections for setoffs under swap agreements in 1990, Marc C. Brickel, Chairman of ISDA, stated that the exception to the automatic stay for the netting provisions "does not interfere with the basic operation of the Bankruptcy Code, since the Code already preserves the right of setoffs, although requiring a court hearing."[217] And Congress noted that the protections for setoffs with respect to forward contracts were to allow a forward contract merchant who has a series of transaction with the "same customer" to net or setoff all its obligations.[218]

But, in 2006, when Congress rewrote each of 362(b)(6), 362(b)(7), 362(b)(17) and 362(b)(27) to make "technical changes" to conform the Bankruptcy Code's language to the FDIA and FCUA, it deleted the word "mutual" in each of these exceptions to the automatic stay.[219] These changes have prompted counterparties to argue that the deletion of the word "mutual" was Congress' express recognition of cross-affiliate setoffs in the Safe Harbor Provisions.[220] There is no discussion in the legislative history of FNIA regarding the deletion of the word mutual. What can be found, however, is Congress' statement that financial netting is the process of

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[216] 11 U.S.C. § 362(b)(6), (b)(7), (b)(17) (2000); 11 U.S.C.A. § 362(b)(27) (West 2005).

[217] *Interest Swap Hearing*, *supra* note 6, (statement of Mark C. Brickel, Chairman of the International Swap Dealers Assoc.).

[218] H.R. REP. NO. 101-484, at 4 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 226.

[219] *See* 11 U.S.C. § 362(b)(6) (extending automatic stay exception to agreements used to offset payment amount, termination value, or transfer obligation); § 362(b)(7) (allowing automatic stay exception to apply to financial participant exercising contractual right); § 362(b)(17) (mandating stay exception applies to transfer obligations under one or more swap agreement); § 362(b)(27) (2006) (articulating master netting agreement can be used to offset transfer obligations).

[220] *See In re* SemCrude, L.P., 399 B.R. 388, 398–99 (Bankr. D. Del. 2009) (rejecting parties' argument and finding plain language of § 553(a) does not expressly state there is exception to mutual debt requirement for parties and their affiliates); *see also* Bienenstock, et al., *supra* note 211, at 342 (arguing cross-affiliate netting agreements or triangular setoff agreements can create mutual debt under section 553(a) and there is no public policy against this practice).

"settling mutual obligations at their net value as opposed to each obligation's gross dollar value."[221] This statement, combined with the multiple references to the FNIA amendments as purely "technical," implies, therefore, that the omission of the word "mutual" was not intended to result in the protection of "non-mutual" netting, but rather was inadvertent and "netting" still requires the offsetting of mutual obligations.

1. Counterparties May Argue that the Protections for Master Netting Agreements in Section 561 Extend to Cross-Affiliate Netting

Counterparties may argue that the protections in section 561 for master netting agreement participants permit cross-affiliate netting.[222] On its face, section 561 contains no provision allowing non-mutual setoffs in direct conflict with the traditional mutuality requirement contained in section 553(a). The clear language of section 561 does not address the setoff of non-mutual debts, nor does it state that a party may use the contracts of its affiliates to set off debts or claims owed to or from a debtor and its affiliates. Like the other Safe Harbor Provisions, section 561 expressly addresses the exercise of certain rights by *a single party*—there is no plural designation.[223]

As stated above, it was widely recognized in the industry and by the proponents of legislation that section 561 was intended to cover cross-product netting, which is distinguishable from cross-affiliate netting, in that cross-product netting is a mutual netting across *two* parties' contracts.[224] Congress viewed cross-product netting as a mutual setoff process—"netting permits a wide variety of financial transactions between *two parties* to be netted, thereby maximizing the present and potential future risk-reducing benefits of the netting arrangement between the parties."[225] And

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[221] H.R. REP. NO. 109-648, pt. 1, at 3 (2006) (explaining financial netting reduces risk by processing financial contracts on net basis).

[222] *See* Chevron Product Company's Motion for Reconsideration of this Court's Opinion Dated January 9, 2009 Regarding Contractual Netting at 11, *In re* SemCrude L.P., No. 08-11525, Mem. Order of Mar. 19, 2009 (Bankr. D. Del. 2009) (denying reconsideration), 2009 WL 229703 (arguing parties were entitled to mutuality for setoff of debts between multiple affiliated debtors and creditors); *see also* Morrison & Riegel, *supra* note 111, at 649 (indicating Code was amended under section 561 to allow master netting agreements and expand contractual rights).

[223] 11 U.S.C. § 561 (2006).

[224] *See* Rhett G. Campbell, *Financial Market Contracts and BAPCPA*, 79 AM. BANKR. L.J. 697, 705 (2005) ("The additions dealing with cross-product netting are intended to allow such netting among all types of financial products."); *see also* Thomas J. Giblin, *Financial Markets in Bankruptcy Court: How Much Uncertainty Remains After BAPCPA?*, 2009 COLUM. BUS. L. REV. 284, 311 (noting cross-product netting is allowed if included within netting agreement and also stating it does not matter if protected rights relate to multiple products or different transactions); Morrison & Riegel, *supra* note 111, at 649 (noting that "although cross product netting enjoyed uneasy legal status prior to 2005" it is protected if exercised under master netting agreement).

[225] H.R. REP. NO. 109-31, pt.1 at 125 (emphasis added) (discussing cross-product master agreements reduce systematic risks when large financial participant become insolvent).

Congress specifically stated that the rights contained in the Safe Harbor Provisions would be "subject to limitations contained in other provisions of the Bankruptcy Code," which presumably would include the limitations in section 553(a).[226]

The history of the enactment of section 561 suggests that it does not purport to create *new* rights. As mentioned, one reason proponents lobbied for section 561 was because it only extended parties' ability to net obligations that were *already netable* under one safe harbored contract across many safe harbored contracts.[227] Specifically, the purpose was to extend existing setoff rights of mutual pre-petition claims to contracts across products between a counterparty and a debtor.

> [N]etting has been a feature of both the bankruptcy code and bank insolvency laws for a number of years . . . . Cross product netting simply extends those benefits to get one net amount for all contracts that are *already netable* by permitting a wide variety of financial transactions between *two parties* to be netted, thereby maximizing the present and potential future risk-reducing benefits of the netting arrangement between the parties.[228]

Section 561 did not implicitly or expressly intend to allow cross-affiliate netting and a counterparty may encounter difficulty establishing that right under the Safe Harbor Provisions.[229]

2. The Amendments to Section 553(a)(2)(B) and 553(a)(3) Muddy the Waters

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[226] *Id.* at 133 (indicating rights under master netting agreement are subject to limitations under Code).

[227] *1999 Hearing*, *supra* note 23, at 392 (statement of Seth Grosshandler, Partner, Cleary, Gottileb, Steen & Hamilton) ("It is unclear whether cross-product netting is permitted [under current law] . . . when the contracts involved are swaps and repurchase agreements.").

[228] *Id.* at 21 (statement of Rep. James A. Leach) (emphasis added).

[229] After this article was written, but before it was published, the bankruptcy court for the Southern District of New York addressed the interplay between section 553 and sections 560 and 561 of the Bankruptcy Code in the context of a creditor's attempt to set off prepetition obligations against postpetition deposits in the debtor's bank account. *See In re* Lehman Brothers Holdings Inc., 2010 WL 1783395, *3 (Bankr. S.D.N.Y. May 5, 2010) (Peck, J.). Bankruptcy Judge Peck held that by their plain terms sections 560 and 561 do not nullify the mutuality requirement in section 553(a), which permits setoffs of only prepetition mutual debts. *Id.* at *4-6. Further, the legislative history of sections 560 and 561 indicates that their purpose was to prevent cherry-picking and permit setoffs absent relief from the automatic stay--not to permit a party to exercise a setoff extant of the requirements in section 553(a). *Id.* at *7-8. Moreover, Judge Peck gave no credence to the argument that the "technical" amendments of the FNIA in 2006 were intended to remove the mutuality requirement and create a "fundamental change in creditor rights." *Id.* at *8. Although the matter at issue there did not concern "cross affiliate" setoffs, and the counterparty has filed a notice of appeal, the decision is likely to have a profound impact on the ability of parties to avoid the mutuality requirement in section 553(a) on the basis of a "contractual right" under section 560 and 561. *See* Notice of Appeal filed by Swedbank, A.B., dated May 6, 2010, *In re* Lehman Bros. Holdings, Inc., 08-13555 [Docket No. 8831].

Confusion arises from the new amendments to section 553(a)(2)(B) and 553(a)(3), which prohibit a setoff if it was acquired by virtue of (i) a transfer of a claim (a) within the 90 days preceding the petition date and (b) while the debtor was insolvent, or (ii) the incurrence of a debt (a) within the 90 days preceding the petition date, (b) while the debtor was insolvent, and (c) for the purpose of obtaining a right of setoff.[230] The BAPCPA amendments added to the end of both 553(a)(2)(B)(ii) and 553(a)(3)(C) the following language: "except for the a setoff of the kind described in 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561."[231] Under this language, a counterparty could argue that "affiliates can transfer claims or obligations to each other and then subtract the aggregate value of their claims against the debtor from the total amount of their obligations to the debtor, effectively exercising multi-party . . . netting."[232]

The statutory exceptions in 553(a)(2)(B)(ii) and 553(a)(3)(C) are confusing because they do not create exceptions for "transfers of claims" or the "incurrence of debt." Rather they protect "setoffs" that would result from such a transfer or incurrence—"a setoff of a kind described in 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561."[233] Certain of those sections (e.g. 555, 556) do not even mention setoffs.[234] With respect to those sections that *do* mention the exercise of setoff rights, the "setoffs of the kind" in these Safe Harbor Provisions are setoffs of "termination values or payment amounts" that arise "under or in connection with" the exercise of the contractual right to "terminate, liquidate or accelerate" the specified safe harbored agreement.[235] For anyone critically analyzing the protections in section 553(a)(2)(B)(ii) or 553(a)(3)(C), the questions become:

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[230] *See* 11 U.S.C. § 553(a)(2)–(3) (2006); *see also* Morrison & Riegel, *supra* note 111, at 649 n.55 (describing this as 90-day "mini-preference" rule).

[231] 11 U.S.C. § 553(a)(2)(B)(ii), (a)(3)(C); *see In re* Ingersoll, Inc., Nos. 03 B 72223, 05 A 96087, 2009 WL 2215101, at *3 (Bankr. N.D. Ill. July 23, 2009) (recognizing section 553 had new restrictions added to it through BAPCPA); Mark D. Sherrill, *Put Off by Setoff*: *Do the BAPCA Amendments to §553 Do More Harm Than Good?*, AM. BANKR. INST. J., Feb. 2007, at 56 (stating BAPCPA amendments to section 553 "appear simple").

[232] Morrison & Riegel, *supra* note 111, at 649 n.55; *see also* Campbell, *supra* note 52, at 52 (describing technique as "affiliate netting").

[233] 11 U.S.C. § 553(a)(2)(B)(ii), (a)(3)(C) (2006); *see In re* SemCrude, L.P., 399 B.R. 388, 393 (Bankr. D. Del. 2009) ("The Code section that governs setoff in bankruptcy, section 553, does not create a right of setoff . . . ."). *See generally* Sherrill, *supra* note 231, at 57 ("[L]iteral readings of §§ 553(a)(2) and (3) lead to puzzling consequences.").

[234] *See* 11 U.S.C. §§ 555–556 (2006) (governing liquidation, termination, and acceleration of various contracts); *see also* Campbell, *supra* note 52, at 34 ("[§§ 555–556 have] an absence of express language preserving setoff rights"); Sherri1l, *supra* note 231, at 57 ("Setoff may be a part of the process of liquidating . . . contracts, but it is not directly addressed in [11 U.S.C. §§ 555–556 (2006)] . . . .").

[235] *See* 11 U.S.C. § 362(b)(6)–(7), (17), (27) (2006) (permitting offset of "termination values or payment amounts"); 11 U.S.C. §§ 559–561 (2006) (permitting offsets of "termination values or payment amounts arising under or in connection with the termination, liquidation or acceleration of one or more" protected agreements); *see also* Hance, *supra* note 111, at 756–57 (noting Congress widened safe-harbor in response to uncertainty about netting and setoffs).

when does this protected "setoff" happen, and are the protections limited to mutual netting?

As mentioned above, Congress expected, for purposes of sections 555, 556, 559, 560 and 561, that the "normal business practice" would be to immediately terminate, liquidate or accelerate a safe harbored contract "in the event of a default" (for a condition of the kind listed in section 365(e)).[236] It seems that the setoff, which is protected under sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561 would, therefore, happen *upon* termination,[237] which itself occurs for a reason specified in section 365(e)—the insolvency or financial condition of the debtor or the filing of a bankruptcy petition. If termination happens upon the filing of a debtor's bankruptcy petition, then the counterparty and the debtor presumably would arrive at a net sum owed either to or from the debtor at that time. If a counterparty were then to transfer its net claim after that time and *after* the debtor's filing of a bankruptcy petition, any setoff right created would be void as expressly prohibited under section 553(a)(2)(A). And because the transfer of the claim happened after the debtor's filing of bankruptcy petition, there is no safe harbor exception.[238]

An issue may arise, however, when parties terminate, not because the debtor files a bankruptcy petition, but as a result of the debtor's financial condition within the 90 days *prior* to the commencement of the debtor's bankruptcy case, or because of a debtor's parent filing.[239] At that time (as in the example above), a counterparty could terminate and liquidate all of its transactions with the debtor and determine a net sum owed to or from the debtor. Such mutual netting in connection with the termination and liquidation of a swap agreement would be protected by section 560. But, then, if a counterparty is in-the-money, but aware of the debtor's impending own bankruptcy, that counterparty may attempt to assign or to transfer that claim to a third-party affiliate (which may be out of the money) for the purpose of creating a setoff right. Shortly after the transfer or assignment, the debtor counterparty files its own bankruptcy petition. The transfer or assignment may have been in exchange for consideration, which could be the full value of the claim. The result being that the counterparty and the transferee may benefit from a dollar-for-dollar realization of that claim, through the creation and effectuation of the purported setoff right—in priority over other unsecured creditors.

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[236] H.R. REP. NO. 109-31, pt. 1, at 133 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 193.

[237] *See* H.R. REP. NO. 101-484, at 6 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 228 (finding intent of 11 U.S.C. § 560 was to allow non-debtor swap participant or trustee to terminate swap agreement so mutual agreement is needed for swap agreement after filing bankruptcy petition).

[238] *See* 11 U.S.C. § 553(a)(2)(A) (codifying requirements for setoff); *see also In re* County of Orange, 183 B.R. 609, 615 (Bankr. C.D. Cal. 1995) (noting section 553 preserves common-law right of set off and burden rests with party asserting such right); *In re* Petraglia, 156 B.R. 474, 476 (Bankr. W.D. Pa 1993) (stating purpose of section 553 is "to preserve a creditor's right to setoff a matured debt in a bankruptcy context to the extent that it is permitted by state law").

[239] *See In re* Lehman Bros. Holdings, Inc., 422 B.R. 407, 411 (Bankr. S.D.N.Y 2010) (noting that parent LBHI's filing preceded many of its affiliate's filings by several weeks).

While ordinarily this trafficking of claims in an effort to improve one's position by virtue of creating a setoff right would be prohibited by section 553(a)(2)(B), a counterparty may argue that the newly-added exceptions to subsection 553(a)(2)(B)(ii), "setoff[s] of the kind described in sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561," are applicable to protect the setoff right created by the claim transfer. The same question arises under section 553(a)(3) for setoffs created by the incurrence of debt for the purpose of creating setoff rights after the parties close out their transactions with a debtor. One would think that the transfer or claims or incurrence of debt to a third party *after* the close-out of the counterparty's own transactions with a debtor is akin to a post-petition transfer of claims, to which no safe harbor exception applies.[240] One could also argue that because, on their face, sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, and 561 do not appear to permit anything other than mutual netting in connection with the close of one party's transactions with a debtor, that the "setoffs of a kind" described in those sections do not extend to multi-party netting.

The legislative history for sections 553(a)(2)(A) and 553(a)(3) does not resolve this question and makes no mention of Congressional intent to protect party's rights to transfer claims or permit multi-party netting, but it does note that Congress added the exceptions to section 553 as an effort to "clarify that the acquisition by a creditor of setoff rights in connection with swap agreements, repurchase agreements, securities contracts, forward contracts, commodity contracts and master netting agreements cannot be avoided as a preference."[241] A literal reading would indicate that the *acquisition* of rights in a derivative contract, which would permit a "setoff of the kind in sections 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561[,]" should be protected by the exceptions in 553(a)(2)(B) and 553(a)(3).[242] One could conclude that this means that if a counterparty enters into a new derivative or financial transaction in the 90 days prior to the debtor's bankruptcy and *acquires setoff rights* by virtue of entering such new contract, those setoff rights are not avoided by sections 553(a)(2)(A) or 553(a)(3). The protections for the *acquisition of setoff rights* via contract in the 90 days prior to bankruptcy could be distinguished from the *transfer of claims* to create setoff rights *after* termination and close out of the derivative transaction or financial contract. Such conclusion would be consistent with the overall policy against the trafficking of claims against a debtor and the clear prohibition on post-petition transfer of claims,

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[240] 11 U.S.C. § 553(a)(2)(A).

[241] *See* H.R. REP. NO. 109-31, pt. 1, at 134 (discussing further "section also adds setoff of the kinds described in sections 555, 556, 559, 560 and 561 of the Bankruptcy Code").

[242] *See* 11 U.S.C. § 553 (a)(2)(B)(ii), (a)(3)(C) (codifying exceptions added by Congress); B.F. Goodrich Employees Fed. Credit Union v. Patterson (*In re* Patterson), 967 F.2d 505, 509 (11th Cir. 1992) (clarifying state law determines validity of set off right, not section 553); *In re* Lawndale Steel Co., 155 B.R. 990, 994 n.4 (Bankr. N.D. Ill. 1993) (indicating trustee cannot use avoiding powers to set off judgment under section 553).

without safe harbor exception, in section 553(a)(2)(A). But the ambiguity of section 553(a)(2)(A) and 553(a)(3) may make it difficult to establish this position.

Additionally, the placement of the new language in sections 553(a)(2)(B) and 553(a)(3) has been criticized as confusing.[243] In both cases, "except for the a setoff of the kind described in 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, or 561" has been added to the last subsection of sections 553(a)(2) and 553(a)(3) implying (under a literal interpretation) that it modifies only the portion of the subsection immediately preceding it.[244] Thus, arguably only the solvency prong of 553(a)(2)(B) and the intent prong of 553(a)(3)(C) would be affected by the existence of a financial contract. While this leads to absurd results, it would nevertheless create complications with regard to any creditor seeking to use 553(a)(2) or 553(a)(3) to effect cross-affiliate setoff rights. If Congress intended to protect cross-affiliate netting by the transfer of claims and incurrence of debt in derivative transactions and financial contracts, a more logical placement for the exemption would have been at the beginning of each subsection.[245] Moreover, it seems there would be some reflection of that intent in the legislative history or in the direct language of the statute.

B. Ambiguous Drafting Of the Credit Support Provisions Can Lead to Confusion

The broadened definition of each of the safe harbored categories of products or contracts, for example "swap agreement" in section 101(53B)(vi), now includes "security agreement[246] or arrangement or other credit enhancement related to [such product]."[247] Also, a security agreement that is "related to" a swap agreement under the new definition section 101(53B)(vi) is itself a "swap agreement."

A broad reading of this language could lead one to believe that an entity that is a counterparty to a security agreement that is "related to" a swap agreement, but that is not a counterparty to an actual swap, would nevertheless be a "swap participant" entitled to protections under sections 362(b)(17) and 560.[248] Section 362(b)(17) permits a swap participant to exercise "any contractual right (as defined in section 560) under any security agreement or arrangement or other credit enhancement

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[243] *See* Sherrill, *supra* note 231, at 57 ("A bit more thought in the placement and syntax of the new language may have avoided unnecessary litigation and unpredictable consequences in years to come.").

[244] *Id.* (acknowledging literal application means subsection (a)(2)(B)(ii) would not apply to safe-harbor contracts).

[245] *Id.* at 56–57 (stressing such a change would, however, highlight fact that amendment created exception to exception).

[246] "Security agreement" is defined in section 101(50) as "an agreement that creates or provides for a security interest," and "security interest" is in turn defined in section 101(51) as a "lien created by an agreement." 11 U.S.C. § 101 (2006).

[247] 11 U.S.C. § 101(53B)(A)(vi) (defining term "swap agreement").

[248] *See In re* Casa de Cambio Majapara S.A. de N.V., 390 B.R. 595, 598 (Bankr. N.D. Ill. 2008) (construing phrase "related to" broadly); *see also* Campbell, *supra* note 224, 704–05 (noting broadness of term "related to" and observing ambiguity of "how far the 'related to' language will reach"). *See generally* Morrison & Riegel, *supra* note 111, at 648 (analyzing changes of definitions in Bankruptcy Code).

forming part of or related to any swap agreement" despite the automatic stay. "Contractual right," as defined in section 560, can include any right "whether or not evidenced in writing, arising under common law," or "by reason of normal business practice."[249]

A counterparty could potentially argue that under section 362(b)(17) it may enforce *any and all* of its contractual rights arising under a security agreement "related to" a swap agreement whether stated or under common law.[250] As support for its argument, the counterparty would argue that while "contractual right" under section 560 is limited to termination, liquidation, acceleration, offset and netting for a reason specified in section 365(e)[251]—the plain language of section 362(b)(17), in contrast, *does not specify* such a limitation, it merely cross references section 560 for the definition of "contractual right." Taking it a step further, a counterparty to a security agreement, which is in itself not a swap under any industry standard but is considered a swap under section 101(53B)(vi), could argue that section 362(b)(17) allows it to exercise *any* contractual right under its security agreement despite the automatic stay and the prohibitions on *ipso facto* clauses in the Bankruptcy Code.[252]

This interpretation could result in a counterparty receiving protection for *any* right arising out of common law or normal business practice and would not confine its protections to the exercise of merely the close out, setoff and transfer rights. This result would be dramatically inconsistent with the intentions of the drafters of the statute. The legislative history states that the inclusion of "security agreement" in the definition of a swap "ensures that any such agreement, arrangement or

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[249] 11 U.S.C. § 560 (2006).

[250] *See* Memorandum of Law of American Family Life Assurance Company of Columbus in Support of Motion for Summary Judgment at 21–22, *In re* Lehman Bros. Holdings Inc., 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (No. 09–01261) (asserting that under related security agreement Trustee has right to distribute all available assets pursuant to section 362(b)(17)); *see also* Lehman Bros. Special Fin., Inc. v. BNY Corporate Tr. Servs. Ltd. (*In re* Lehman Bros. Holdings, Inc.), 422 B.R. 407, 421 (Bankr. S.D.N.Y. 2010) (granting summary judgment for the plaintiffs and finding that the safe harbor provisions of section 560 do not protect payment priority provision in related noteholder priority payment agreement); Plaintiff Lehman Brothers Special Financing Inc. and Lehman Brothers Holdings Inc.'s Motion for Summary Judgment at 25-40, *In re* Lehman Bros. Holdings Inc., 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (No. 09–01261), 2010 WL 271161 (arguing sections 560 and 262(b)(17) do not protect modification of payment provisions according to plain language and Congress' intent); Stipulation of Dismissal of All Claims, *In re* Lehman Bros. Holdings Inc., Nos. 08–13555 (JMP) (Jointly Administered), No. 09-01242 (Bankr. S.D.N.Y. December 29, 2009); *cf.* Kettering, *supra* note 6, at 1714 n.536 (noting "contractual right" may have no limit in section 560 when referred to in section 362(b)(17)).

[251] *See In re* Calpine Corp., Nos. 05-60200, 08-1251, 2009 WL 1578282, at *6–*7 (Bankr. S.D.N.Y. May 7, 2009) (listing conditions rendering contractual rights to terminate executory contract unenforceable); *see also* Adam R. Waldman, Comment, *OTC Derivatives & Systemic Risk: Innovative Finance or the Dance Into the Abyss?*, 43 AM. U. L. REV. 1023, 1070–71 (1994) (discussing section 560 in conjunction with section 362(b) and indicating "[the] primary impact of this provision is to eliminate the applicability of § 365(e) to 'swap agreements'"); *cf.* Nevin M. Gewertz, Comment, *Act or Asset? Multiplicitous Indictments under the Bankruptcy Fraud Statute, 18 USC § 152*, 76 U. CHI. L. REV. 909, 928 (stating in bankruptcy context enforceable legal agreements may be voided and giving section 365(e)'s invalidation of ipso facto clauses as example).

[252] *See* 11 U.S.C. § 560.

enhancement is itself deemed to be a swap agreement, and therefore eligible for treatment as such for purposes of *termination, liquidation, acceleration, offset and netting* under the Bankruptcy Code, the FDIA and the FCUA."[253] It does not speak of rights extrinsic to the basic rights of *termination, liquidation, acceleration, offset, and netting*. Furthermore, with respect to rights of setoff, "the references to 'setoff' in these provisions, . . . are intended to refer also to rights to foreclose on, and to set off against obligations to return, collateral securing swap agreements[.]"[254]

A court looking at this issue, may find under the recent decision *In re Calpine*,[255] and the relevant prior jurisprudence, that the scope of exercisable rights under the Safe Harbor Provisions was intended to be, and indeed remains, limited.[256] Counterparties raising these types of arguments, therefore, can anticipate possible resistance. Nevertheless, given the ambiguity of the statute, counterparties may seize upon the inartful language to attempt to expand the scope of previously exercisable rights.

CONCLUSION

The BAPCPA and FNIA amendments were extensive in addressing numerous provisions that needed updating and clarification. In many ways, BAPCPA and FNIA addressed the markets' concern and clarified many of the past ambiguities—by broadening the definitions to include newer products, major market players, collateral arrangements and the addition of protections for cross-product netting. Nevertheless, debates about the types of agreements that are protected, the scope of rights, and the ability of parties to exercise setoff rights that would otherwise be prohibited by the Bankruptcy Code, continue to arise. Perhaps it is naïve to presume that with any legislation parties will not try to argue for an advantageous interpretation. Even with Congress legislates with the goal of providing "clarity," unanticipated ambiguity can surface from the very legislation intended to clarify. There will be more questions—and more challenges—ahead as parties resolve their disputes under the new Safe Harbor Provisions.

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[253] H.R. REP. NO. 109-31, pt. 1, at 12 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 189 (emphasis added).

[254] *Id.* at 132.

[255] 2009 WL 1578282, at *6–*7 (holding section of agreement unenforceable "because it was a post-petition obligation under an executor contract and was not a contractual right to terminate a forward contract based upon a condition of the kind specified in section 365(e)(1) of the Code").

[256] After this article was written but prior to its publication, the Bankruptcy Court for the Southern District of New York, in *In re Lehman Brothers Holdings Inc.*, rejected this type of argument raised by a counterparty and determined that section 560 does not protect the exercise of *all* contractual rights and does not extend to the protection of rights in an agreement related to a swap agreement. *In re* Lehman Bros. Holdings, Inc., 422 B.R. 407, 421 (Bankr. S.D.N.Y. 2010) (granting summary judgment for the plaintiffs and finding that the safe harbor provisions of section 560 do not protect payment priority provision in related noteholder priority payment agreement). "Because the provisions of section 560 deal expressly with the liquidation, termination or acceleration (not the alteration of rights as they then exist) and refer specifically to "swap agreements," it follows that the Noteholder Priority provisoin and Condition 44 [which modified the debtor's payment priority] do not fall under the protections set forth therein." *Id.*; *see* 11 U.S.C. § 560 (2006).

APPENDIX I

Amendments from Pub. L. No. 109-8 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

As amended, the affected Code sections read as follows (new material is *italicized* and removed material is ~~stricken~~):

I. 11 U.S.C. § 101 Definitions

In this title the following definitions shall apply:

~~(22) the term "financial institution"—~~

~~(A) means—~~

~~(i) 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 and, when any such Federal reserve bank, receiver, conservator, or entity is acting as agent or custodian for a customer in connection with a securities contract, as defined in section 741 of this title, the customer; or~~

~~(ii) in connection with a securities contract, as defined in section 741 of this title, an investment company registered under the Investment Company Act of 1940; and~~

(22) 'financial institution' means--

(A) 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, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer in connection with a securities contract (as defined in section 741) such customer; or

(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940;

(22A) The term 'financial participant' means—

(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 on any day during the previous 15-month period, 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) on any day during the previous 15-monh period; or

(B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991).

(25) *The term* "forward contract" ~~means a contract~~ means—

(A) *a contract* (other than a commodity contract) 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 transaction, reverse repurchase transaction, consignment, lease, swap, hedge transaction, deposition, loan, option, allocated transaction, unallocated transaction, ~~or any combination thereof or option thereon~~ *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.

~~(26) "forward contract merchant" means a person whose business consists in whole or in part of entering into forward contracts as or with merchants in 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;~~

(26) The term 'forward contract merchant' means a Federal reserve bank, or an entity 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.

(38A) The term 'master netting agreement'—

(A) means 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), 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 anyone or more of paragraphs (1) through (5) of section 561(a).

(38B) The term 'master netting agreement participant' means an entity 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.

(46) The term "repo participant" means an entity that, ~~on any day during the period beginning 90 days before the date of~~ *at any time before* the filing of the petition, has an outstanding repurchase agreement with the debtor.~~;~~

(47) *The term* "repurchase agreement" ~~(which definition also applies to a reverse repurchase agreement) means 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 transfer or on demand, against the transfer of funds;~~ *(which definition also applies to a reverse repurchase agreement)—*

(A) means

(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 there of 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;

(53B) ~~"swap agreements" means—~~

~~(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);~~

(A) means—

(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 or precious metals 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; or

(VIII) a weather swap, weather derivative, or weather option;

(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 markets (including terms and conditions incorporated by reference therein); and

(II) is a forward, swap, future, or option on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt 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 an 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, and

(B) is applicable for purposes of this title only, and shall not be construed or applied so as to challenge or affect the characterization, definition, or treatment of any swap agreement under any other statute, regulation, or rule, including the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, the Commodity Exchange Act, the Gramm-Leach, Bliley Act, and the Legal Certainty for Bank Products Act of 2000.

(53C) *The term* "swap participant" means an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor.~~;~~

II. 11 U.S.C. § 362(b) Changes to Section 362(b)

The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay—

(6) under subsection (a) of this section, of the setoff by a commodity broker, forward contract merchant, stockbroker, financial institution, *financial participant,* or securities clearing agency of any mutual debt and claim under or in connection with commodity contracts, as defined in section 761 of this title, forward contracts, or securities contracts, as defined in section 741 of this title, that constitutes the setoff of a claim against the debtor for 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, 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 contracts, forward contracts, or securities contracts;

(7) under subsection (a) of this section, of 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 a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, 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;

~~(17) under subsection (a) of this section, of the setoff by a swap participant, of any mutual debt and claim under or in connection with any swap agreement that constitutes the setoff of a claim against the debtor for any payment due from the debtor under or in connection with any swap agreement against any payment due to the debtor from the swap participant under or in connection with any swap agreement or against cash, securities, or other property of the debtor held by or due from such swap participant to guarantee, secure or settle any swamp agreement; or~~

(17) under subsection (a), of the setoff by a swap participant or financial participant of a mutual debt and claim 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 financial participant to margin, guarantee, secure, or settle any swap agreement;

(27) under subsection (a), of the setoff by a master netting agreement participant of a mutual debt and claim under or in connection with one or more master netting agreements or any contract or agreement 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 any contract or agreement subject to such agreements against any payment due to

the debtor from such master netting agreement participant under or in connection with such agreements or any contract or agreement subject to such agreements 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 any contract or agreement subject to such agreements, to the extent that such participant is eligible to exercise such offset rights under paragraph (6), (7), or (17) for each individual contract covered by the master netting agreement in issue; and

III. 11 U.S.C. § 546 Limitations in Avoiding Powers

(e) 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 a commodity broker, forward contract merchant, stockbroker, financial institution, *financial participant*, or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(g) Notwithstanding sections 544, 545, 547, 548(a)(1)(B) and 548(b) of this title, the trustee may not avoid a transfer ~~under a swap agreement~~, made by or to a swap participant *or financial participant*, ~~in connection with a swap agreement~~ *under or in connection with any swap agreement* and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(j) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) the trustee may not avoid a transfer made by or to a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby that is made before the commencement of the case, except under section 548(a)(1)(A) and except to the extent that the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.

IV. Changes to Sections 553, 555, 556, 559, 560, 561

11 U.S.C. § 553. Setoff

(a) Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

(1) the claim of such creditor against the debtor is disallowed;

(2) such claim was transferred, by an entity other than the debtor, to such creditor—

(A) after the commencement of the case; or

(B) (i) after 90 days before the date of the filing of the petition; and

(ii) while the debtor was insolvent (*except for a setoff of a kind described in section 362(b)(6), 362 (b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, or 561*)*;* or
(3) the debt owed to the debtor by such creditor was incurred by such creditor—
(A) after 90 days before the date of the filing of the petition;
(B) while the debtor was insolvent; and
(C) for the purpose of obtaining a right of setoff against the debtor *(except for a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(17), 362(b)(27), 555, 556, 559, 560, or 561).*
(b)(l) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), ~~362(b)(14)~~ *362(b)(l7), 362(b)(27), 555, 556, 559, 560, 561,* 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of—
(A) 90 days before the date of the filing of the petition; and
(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.
(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.
(c) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

11 U.S.C § 555. ~~Contractual right to liquidate a securities contract~~ *Contractual right to liquidate, terminate, or accelerate a securities contract*
The exercise of a contractual right of a stockbroker, financial institution, *financial participant,* or securities clearing agency to cause the ~~liquidation~~ *liquidation, termination, or acceleration* of a securities contract, as defined in section 741 of this title, because of a condition of the kind specified in section 365(e)(1) of this title shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title unless such order is authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission. ~~As used in this section, the term "contractual right" includes a right set forth in a rule or bylaw of a national securities exchange, a national securities association, or a securities clearing agency.~~ *As used in this section, the term 'contractual right' includes 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.

11 U.S.C § 556. ~~Contractual right to liquidate a commodities contract or forward contract~~ *Contractual right to liquidate, terminate, or accelerate a commodities contract or forward contract*

The contractual right of a commodity broker; *financial participant,* or forward contract merchant to cause the ~~liquidation~~ *liquidation, termination, or acceleration* of a commodity contract, as defined in section 761 of this title, or forward contract because of a condition of the kind specified in section 365(e)(l) of this title, and the right to a variation or maintenance margin payment received from a trustee with respect to open commodity contracts or forward contracts, shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by the order of a court in any proceeding under this title. ~~As used in this section, the term "contractual right" includes a right set forth in a rule or bylaw of a clearing organization or contract market or in a resolution of the governing board thereof and a right,~~ *As used in this section, the term ' contractual right' includes 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.

11 U.S.C § 559. ~~Contractual right to terminate a repurchase agreement~~ *Contractual right to liquidate, terminate, or accelerate a swap agreement*

The exercise of a contractual right of a repo participant *or financial participant* to cause the ~~liquidation~~ *liquidation, termination, or acceleration* of a repurchase agreement because of a condition of the kind specified in section 365(e)(1) of this title shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission. In the event that a repo participant or financial participant liquidates one or more repurchase agreements with a debtor and under the terms of one or more such agreements has agreed to deliver assets subject to repurchase agreements to the debtor, any excess of the market prices received on liquidation of such assets (or if any such assets are not disposed of on the date of liquidation of such repurchase agreements, at the prices available at the time of liquidation of such repurchase agreements from a generally recognized source or the most recent closing bid quotation from such a source) over the sum of the stated repurchase prices and all expenses in connection with the liquidation of such repurchase agreements shall be deemed property of the estate, subject to the available rights of setoff. ~~As used in this section, the term 'contractual right' includes a right set forth in a rule or bylaw, applicable to each party to the repurchase agreement, of a national securities exchange, a national securities association, or a securities clearing agency, and a right,~~ *As used in this section, the term 'contractual right' includes 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.

11 U.S.C § 560. ***Contractual right to liquidate, terminate, or accelerate a swap agreement*** **~~Contractual right to terminate a swap agreement~~**

The exercise of any contractual right of any swap participant *or financial participant* to cause the ~~termination of a swap agreement~~ *liquidation, termination, or acceleration of one or more swap agreements* because of a condition of the kind specified in section 365(e)(1) of this title or to offset or net out any termination values or payment amounts arising under or ~~in connection with any swap agreement~~ *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 this title or by order of a court or administrative agency in any proceeding under this title. ~~As used in this section, the term "contractual right" includes a right,~~ *As used in this section, the term 'contractual right' includes 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.

11 U.S.C § 561. ***Contractual right to terminate, liquidate, accelerate, or offset under a master netting agreement and across contracts; proceedings under chapter 15***

(a) Subject to subsection (b), the exercise of any contractual right, because of a condition of the kind specified in section 365(e)(l), to cause 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 (or the termination, liquidation, or acceleration of one or more)—
(1) securities contracts, as defined in section 741(7);
(2) commodity contracts, as defined in section 761(4);
(3) forward contracts;
(4) repurchase agreements;
(5) swap agreements; or
(6) master netting agreements,
shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by any order of a court or administrative agency in any proceeding under this title.
(b)(1) A party may exercise a contractual right described in subsection (a) to terminate, liquidate, or accelerate only to the extent that such party could exercise such a right under section 555, 556, 559, or 560 for each individual contract covered by the master netting agreement in issue.
(2) If a debtor is a commodity broker subject to subchapter IV of chapter 7—
(A) a party may not net or offset an obligation to the debtor arising under, or in connection with, a commodity contract traded on or subject to the rules of a contract market designated under the Commodity Exchange Act or a derivatives transaction execution facility registered under the Commodity Exchange Act against any claim arising under, or in connection with, other instruments, contracts, or agreements listed in subsection (a) except to the extent that the party has positive net equity in the commodity accounts at the debtor, -as calculated under such subchapter; and
(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 the Commodity Exchange Act or a derivatives transaction execution facility registered under the Commodity Exchange Act against any claim arising under, or in connection with, other instruments, contracts, or agreements listed in subsection (a).
(3) No provision of subparagraph (A) or (B) of paragraph (2) *shall prohibit the offset of claims and obligations that arise under—*

(A) a cross-margining agreement or similar arrangement that has been approved by the Commodity Futures Trading Commission or submitted to the Commodity Futures Trading Commission under paragraph (1) *or* (2) *of section 5c(c) of the Commodity Exchange Act and has not been abrogated or rendered ineffective by the Commodity Futures Trading Commission; or*
(B) any other netting agreement between a clearing organization (as defined in section 761) *and another entity that has been approved by the Commodity Futures Trading Commission.*
(c) As used in this section, the term 'contractual right' includes 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.*
(d) Any provisions of this title 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 that enforcement of contractual provisions of such contracts and agreements in accordance with their terms will not be stayed or otherwise limited by operation of any provision of this title or by order of a court in any case under this title, and to limit avoidance powers to the same extent as in a proceeding under chapter* 7 *or* 11 *of this title (such enforcement not to be limited based on the presence or absence of assets of the debtor in the United States).*

V. Changes To Definition In Sections 741 and 761

11 U.S.C § 741. Definitions For This Subchapter
In this subchapter—
~~(7) "securities contract" means contract for the purchase, sale, or loan of a security, including an option for the purchase or sale of 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;~~
(7) 'securities contract'—
(A) means—
(i) a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan or 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;

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

(iii) the guarantee 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;

(iv) any margin loan;

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

(vi) any combination of the agreement or transaction referred to in this subparagraph;

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

(viii) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), or (vii), 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), or (vii); or

(ix) 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 mortgage loan;

(8) "settlement payment" means 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

(9) "SIPC" means Securities Investor Protection Corporation.

11 U.S.C § 761. Definitions For This Subchapter

In this subchapter

(4) "commodity contract" means—

(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;

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

(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 (HI); 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;

APPENDIX II

Financial Netting Improvements Act of 2006
PUB. L. No. 109-390, 120 STAT. 2692
December 12, 2006

The Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5 (2006), amended Bankruptcy Code sections: 101(22)(A), (22A), (25)(A), (53B)(A)-(B); 362(b)(6)-(7), (17) & (27); 546(e)-(g) & (j); and 741(7)(A):

As amended, the affected Code sections read as follows (new material is <u>underscored</u> and removed material is ~~stricken~~

11 U.S.C. § 101. Definitions

In this title the following definitions shall apply:
(22) The term "financial institutions" means—
(A) 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, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (<u>whether or not a "customer," as defined in section 741</u>) in connection with a securities contract (as defined in section 741) such customer;
(22A) The term "financial participant" means —
(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 (<u>aggregated across counterparties</u>) ~~on any day during the previous 15-month period~~ <u>at such time or on any day during the 15-month period preceding the date of the filing of the petition</u>, 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) ~~on any day during the previous 15-month period~~ <u>at such time or on any day during the 15-month period preceding the date of the filing of the petitio</u>n; or
(B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991).
(25) The term "forward contract" means —
(A) a contract (other than a commodity contract<u>, as defined in section 761</u>) for the purchase, sale, or transfer of a commodity, as, to 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 transaction, or reverse repurchase transaction~~, 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;

(53B) The term "swap agreement"—

(A) means

(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 ~~or precious metals~~, precious metals, or other commodity agreement;

(VII) a commodity index or a commodity swap, option, future, or forward agreement; ~~or~~

(VIII) a weather swap, ~~weather derivative, or weather option~~ 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, or option~~ future option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt 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;

(B) is applicable for purposes of this title only, and shall not be construed or applied so as to challenge or affect the characterization, definition, or treatment of any swap agreement under any other statute, regulation, or rule, including ~~the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, the Commodity Exchange Act, the Gramm-Leach, Bliley Act, and the Legal Certainty for Bank Products Act of 2000~~ the Gramm-Leach, Bliley Act, the Legal Certainty for Bank Products Act of 2000, the securities laws (as such term is defined in section 3(a)(47) of the Securities Exchange Act of 1934) and the Commodity Exchange Act.

11 U.S.C. § 362. Automatic Stay

N.B.: Pub. L. No. 109-390 replaced paragraphs (6), (7), (17), and (27) of subsection (b); the former paragraphs are not reprinted herein.

(b) The filing of a petition under section 301, 302, or 303 of this title, or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970, does not operate as a stay —

(6) under subsection (a) of this section, of 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;

(7) under subsection (a) of this section, of 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 agreement for such agreements;

(17) under subsection (a) of this section, of 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;

(27) under subsection (a) of this section, of 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 1 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;

11 U.S.C. § 546 Limitations On Avoiding Powers

(e) 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 741 of this title, made. by or to (<u>or for the benefit of</u>) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, <u>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</u>, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(f) 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 741 or 761 of this title, or settlement payment, as defined in section 741 of this title~~, made by or to (<u>or for the benefit of</u>) a repo participant, or financial participant, in connection with a repurchase agreement and that is made before the commencement of the ,case, except , under section 548(a)(1)(A) of this title.

(g) Notwithstanding sections 544, 545, 547, '548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer made by or to (<u>or for the benefit of</u>) a swap participant or financial participant, under or in connection with any swap agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

(j) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) the trustee may not avoid a transfer made by or to (<u>or for the benefit of</u>) a master netting agreement participant under or in connection with any master netting agreement or any individual contract covered thereby that is made before the commencement of the case, except under section 548(a)(1)(A) and except to the extent that the trustee could otherwise avoid such a transfer made under an individual contract covered by such master netting agreement.

11 U.S.C. § 741. Definitions For This Subchapter

(7) "securities contract"—

(A) means

(i) a contract, for the purchase, sale, or loan of a security, a certificate of deposit, a ~~mortgage loan or~~ <u>mortgage loan</u>, 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 inducting any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option <u>(whether or not such repurchase or reverse repurchase transaction is a 'repurchase agreement,' as defined in, section 101)</u>;

(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;
~~(v)~~(vii) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph;
~~(vi)~~(vii) any combination of the agreements or transactions referred to in this subparagraph;
~~(vii)~~(ix) any option to enter into any agreement or transaction, referred tom this subparagraph;
~~(viii)~~(x) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii) (iv), (v), (vi), ~~or (vii)~~ (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), ~~or (vii)~~ (vii) (viii); or (ix); or
~~(ix)~~(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