FINANCIAL MARKETS IN BANKRUPTCY COURT: HOW MUCH UNCERTAINTY REMAINS AFTER BAPCPA?

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I. INTRODUCTION

In 2005, Congress continued a tradition that can be traced back to the passage of the original Bankruptcy Reform Act. Spurred by a near crisis in the financial markets in the late 1990s, Congress passed legislation extending coverage of the parties and contracts that would be exempted from certain provisions of the Bankruptcy Code (the "Code"). In doing so, much attention was given to the fear that were a major player in the financial industry to declare bankruptcy, the counterparties to its financial contracts would be unable to exercise their contractual rights immediately. This, in turn, would lead to massive uncertainty, exposing the inherently volatile exchanges to widespread risk that could not be controlled by the contractors themselves. The amendments addressed this fear, and did so quite comprehensively. But in a few key areas, recent developments suggest they may not have gone far enough.

This Note argues that three important legislative omissions will continue to expose the financial markets to substantial uncertainty and operate contrary to Congress's intent. Part I will explain the background and purpose of the amendments. Part II will address Congress's failure to clearly manifest its intent to use industry custom as the primary interpretive tool for ambiguous contracts. This failure has left the door open for courts to undertake the very sort of analysis the amendments were designed to prevent. Part III will show that the inability to capture all relevant financial agreements within the definition of protected netting agreements has recently led to a substantial devaluing of assets during the mortgage crisis. Part IV will show that a new provision intended to clarify the timing of damages actually has injected the Code with more uncertainty. In all three cases, this Note will suggest legislative solutions where possible, and draw attention to existing law within bankruptcy and other areas of commercial law that can be used to craft judicial solutions.

II. BAPCPA AND CONGRESSIONAL INTENT

The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") was signed into law on April 20, 2005, and largely took effect beginning October 17 of that year.[1] At the time, it was labeled "the biggest overhaul of U.S. bankruptcy laws since 1978."[2] The most well-publicized purpose of the extensive amendments to the then-existing Bankruptcy Code was to make it more difficult for individuals to use Chapter 7 as a tool to erase consumer debt.[3] The amendments did so primarily by imposing more stringent paperwork requirements and mandating credit counseling before consumers could file for personal bankruptcies.[4]

The BAPCPA amendments extended beyond consumer bankruptcies, however, addressing the effect of bankruptcies of large financial institutions on the financial markets. The amendments expanded the number and type of contracts and parties that could be exempted from the automatic stay; expanded the parties who were protected from assumption or rejection by the debtor; and restricted the number of payments that could be recovered as fraudulent or preferential.[5]

Financial counterparties had been protected long before BAPCPA, but innovation in the financial markets had

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[1] U.S. Trustee Program, Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, http://www.usdoj.gov/ust/eo/bapcpa/index.htm (last visited Mar. 9, 2009).

[2] Gintautas Dumcius, *A Surge in Bankruptcy Filings Is Expected Ahead of New Law*, WALL ST. J., June 1, 2005, at D2.

[3] *Id.* (stating that BAPCPA "limits consumers' use of Chapter 7 . . . to wipe out credit-card bills or loans that aren't secured by a house or other asset").

[4] 11 U.S.C. § 521(b) (2008) (detailing the list of documents that must be filed by an individual debtor); 11 U.S.C. § 109(h) (2008) (mandating that an individual cannot be a debtor unless the individual can prove receipt of a briefing about credit counseling).

[5] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. 109-8, 119 Stat. 179 (codified as amended in scattered sections of 26 U.S.C.).

outpaced the ability of the legislative process to respond.[6] In fact, proposals similar to BAPCPA had been circulating in Congress for almost ten years.[7] The widely credited impetus for what became the financial markets provisions of BAPCPA was the 1998 collapse of the hedge fund Long-Term Capital Management, L.P. ("LTCM").[8] Months before it failed, LTCM held a portfolio of about $1.4 trillion in notional value,[9] and a possible bankruptcy petition threatened to endanger tens of thousands of counterparties.[10] This possibility was troubling enough for the Federal Reserve to arrange a meeting of creditors, who then agreed to a bailout.[11] In the aftermath of the near-crisis, a study was conducted by the President's Working Group ("PWG") in which the PWG cited the need for an expansion of protected contracts in order to prevent "great uncertainty and

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[6] *See* Thomas G. Kelch & Howard J. Weg, *Forward Contracts, Bankruptcy Safe Harbors and the Electricity Industry*, 51 WAYNE L. REV. 49, 102-03 (2005) ("[I]nnovation also brings with it an incredible proliferation of new instruments that the law cannot foresee. Forward contracts and swap agreements . . . are two instruments that hardly existed even 5 years ago.") (quoting 136 CONG. REC. H2284).

[7] *See, e.g.*, Editorial, *Bankrupt—and Responsible*, WALL ST. J., Mar. 9, 2005, at A20 (referring to Congress's "nine years of trying" to pass the bill); Michelle Singletary, *Bankruptcy Bill Lingers in the Ring*, WASH. POST, Mar. 3, 2005, at E03 (comparing the fight for bill's passage to the 1974 "Rumble in the Jungle" boxing match).

[8] Rhett G. Campbell, *Financial Markets Contracts and BAPCPA*, 79 AM. BANKR. L.J. 697, 698 (2005).

[9] Notional value is not indicative of money actually outstanding. According to a prominent investments textbook: "The participants to the swap do not loan each other money. They agree only to exchange a fixed cash flow for a variable cash flow . . . . That is why the principal is described as *notional*. The notional principal is simply a way to describe the size of the swap agreement." ZVI BODIE, ALEX KANE, & ALAN J. MARCUS, INVESTMENTS 514 n.12 (5th ed. 2002).

[10] Campbell, *supra* note 8, at 698. As summarized by Campbell, LTCM had 60,000 trades, a brokerage firm, seventy-five repurchase counterparties, fifty over-the-counter derivative counterparties, and unsecured loans with "several dozen" banks. *Id.* at 699-700.

[11] Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REG. 91, 100 (2005).

disruptions in [world financial] markets."[12] Shortly thereafter, a bill was proposed in Congress that eventually made its way into the BAPCPA amendments.[13] The PWG recommendations were given a great deal of weight in BAPCPA's drafting.[14]

A. The BAPCPA Amendments

The BAPCPA amendments were extensive, revising nearly every provision pertinent to financial contracts in the Code. The definitions in 11 U.S.C. § 101 garnered particular attention. The definitions in question—including those for "forward contract,"[15] "repurchase agreement,"[16] and "swap agreement"[17]—consist of extensive lists of the types of instruments meant to fall within the purview of the definitions.[18] In every case, BAPCPA expanded the reach of the categories, sometimes substantially. The definition of forward contract, for example, added four additional

[12] Campbell, *supra* note 8, at 700-01. *See* REPORT OF THE PRESIDENT'S WORKING GROUP ON FINANCIAL MARKETS, HEDGE FUNDS, LEVERAGE, AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT (1999), *available at* http://www.treas.gov/press/releases/reports/hedgfund.pdf. The President's Working Group consisted of the U.S. Department of the Treasury, the Board of Governors of the Federal Reserve System, the Commodities Futures Trading Commission, and the Securities and Exchange Commission. *Id.* at 700.

[13] Campbell, *supra* note 8, at 701. *But see* Edwards & Morrison, *supra* note 11 (arguing that protections do not decrease systemic risk).

[14] H.R. REP. NO. 109-31, pt. 1, at 20 (2005).

[15] 11 U.S.C. § 101(25) (2007).

[16] § 101(47).

[17] § 101(53B).

[18] All of these contracts are derivative, meaning that their value is tied to assets unrelated to the issuer (such as stocks and bonds). *See* BODIE ET AL., *supra* note 9, at 33. Generally speaking, forward contracts contemplate delivery of an asset in the future at a price agreed upon in advance. *Id.* at 740-41. Repurchase agreements, or "repos," are sales of securities in which the seller agrees to buy the securities back at a higher price. *Id.* at 986. Swap agreements are exchanges of cash flows in which the payoff depends on, for example, the performance of a fixed interest rate against a floating rate or the performance of one currency against another. *Id.* at 790-93.

subsections of agreements and combinations of agreements that can be classified as such under the Code.[19]

Critically, the amendments left some of the definitions open-ended. The new definition of forward contract now includes the phrase "or any similar agreement" at the end of the first subsection. Swap agreements were defined even more openly. The previous incarnation had included the "or any similar agreement" language;[20] the BAPCPA amendments changed this to "any agreement or transaction that is similar to any other agreement or transaction referred to in this paragraph" that "is of a type that has been, is presently, or in the future becomes, the subject of recurrent dealings in the swap . . . markets" and was one of several qualifying classes of transactions.[21]

Section 101 was also amended to include several new definitions. Notable among these was a definition of "master netting agreement."[22] A master netting agreement as now defined "provid[es] 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 [named elsewhere in the Code]."[23] A corresponding definition of "master netting participant" was added as well.[24]

BAPCPA also made corresponding revisions to the dynamic sections of the Code, extending exemptions from the automatic stay,[25] from setoff of claims,[26] and from the

[19] § 101(25)(B)-(E).

[20] 11 U.S.C. § 101(53B) (2004) (amended 2005).

[21] 11 U.S.C. § 101(53B)(A)(ii) (2007).

[22] § 101(38A).

[23] *Id.*

[24] § 101(38B).

[25] 11 U.S.C. § 362(b)(6), (7), (17) (2008). The automatic stay prevents claimants from enforcing or collecting claims against the creditor once the debtor has filed for bankruptcy, except pursuant to a court order or statutory exception. *See* 5 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 362.01(15th ed., rev. 2007).

[26] 11 U.S.C. § 553(a)-(b). Where the creditor and debtor each has claims against the other, the Bankruptcy Code allows the creditor to "set off" the mutual claims in certain situations; that is, one obligation can be applied to satisfy the other. *See* COLLIER, *supra* note 25, at ¶ 553.01.

prohibition against *ipso facto* clauses[27] to types of financial contracts that had not been previously protected. Master netting agreements were among the contracts that were protected for the first time. Finally, it included a new provision, § 562, establishing the timing of damages in cases where the trustee has rejected an executory contract or the counterparty has terminated, liquidated, or accelerated a contract with the debtor.[28]

B. Congress's Intent to Protect the Financial Markets

The financial contracts provisions of the Code demonstrate a concern of Congress regarding "systemic risk." As the Wall Street crisis of 2008 showed, this concern for systemic risk has not subsided. According to the House Report accompanying the amendments:

> Systemic risk is 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. If participants in certain financial activities are unable to enforce their rights to terminate financial contracts with an insolvent entity in a timely manner, or to offset or net their various contractual obligations, the resulting uncertainty and potential lack of liquidity could increase the risk of an inter-market disruption.[29]

The legislative history of prior amendments also demonstrates this concern. When the original definitions of "swap agreement" and "forward contract" were added to the Code in 1990, the additions were made to prevent the

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[27] 11 U.S.C. § 555 (securities contracts), 556 (commodities and forward contracts); § 559 (repurchase agreements), 560 (swap agreements), 561 (master netting agreements). *Ipso facto* clauses are provisions in contracts "providing for the termination or modification of an executory contract . . . conditioned on the debtor's insolvency or financial condition, the commencement of a bankruptcy case, or the appointment of a receiver or custodian . . . ." COLLIER, *supra* note 25, ¶ 365.07.

[28] 11 U.S.C. § 562 (2008).

[29] H.R. REP. NO. 109-31, pt. 1, at 20 n.78 (2005).

markets for such contracts from being "destabilized by uncertainties regarding the treatment of their financial instruments under the Bankruptcy Code."[30] Congress found this important because the derivatives markets are so often used by parties as a way to manage risk in the first place.[31]

The 1990 House Report also cites the heavy volatility of the financial markets as its prime concern. It observed that, due to rapid market movement, counterparties could incur substantial losses while they waited for transactions with the bankrupt party to be resolved.[32] The concern undoubtedly can be traced to the virtual oligopoly held by the largest firms. As of the second quarter of 2007, five banks represented 97% of the total notional amount and 80% of the revenues of derivatives trading.[33]

A decade after the LTCM collapse, these fears of counterparty insolvency rose again, but in far more public and dramatic fashion. During the fall of 2008, as venerable financial institutions teetered on the brink of failure, the federal government again found itself in the bailout business. This time, the government stepped in to lend $85 billion to failing insurer American International Group ("AIG"), in exchange for a 79.9% equity stake in the company.[34] Like LTCM before it, AIG was so intertwined in the financial markets that the government believed that a bankruptcy could be disastrous.[35] According to the Federal

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[30] H.R. REP. NO. 101-484, at 1 (1990).

[31] *See id.* at 4 ("The primary purpose of a forward contract is to hedge against possible fluctuations in the price of a commodity. This purpose is financial and risk-shifting in nature . . . .").

[32] *See id.* at 2 ("[I]n a matter of days, or even hours, a non-bankrupt party to ongoing securities and other financial transactions could face heavy losses unless the transactions are resolved promptly and with finality.").

[33] OFFICE OF THE COMPTROLLER OF THE CURRENCY, OCC'S QUARTERLY REPORT ON BANK DERIVATIVES ACTIVITIES, SECOND QUARTER 2007, 1 (2007).

[34] Matthew Karnitschnig et al., *U.S. to Take Over AIG in $85 Billion Bailout*, WALL ST. J., Sept. 17, 2008, at A1.

[35] *See* Suzanne Craig et al., *Street Scenes: The Players Remaking the Financial World*, WALL ST. J., Sept. 19, 2008, at A1 (stating the Treasury Department's belief that "an AIG collapse could be disastrous to the global

Reserve, "[a] disorderly failure of AIG could add to already significant levels of financial market fragility . . . ."[36] Or, in the way it was often presented at the time, AIG was "too big to fail."[37] This bailout was preceded, only by a matter of months, by government takeovers of mortgage lenders Freddie Mac and Fannie Mae,[38] as well as a government-brokered private takeover of investment bank Bear Stearns.[39] Eventually, Congress passed the Emergency Economic Stabilization Act,[40] authorizing the Treasury Department to inject $700 billion of public money into the financial markets.[41] Secretary of the Treasury Henry Paulson had testified before the House Committee on Financial Services that the bailout was necessary "to avoid a continuing series of financial institution failures and frozen credit markets that threaten . . . the very health of our economy."[42]

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economy because AIG's financial tentacles extended so deeply into world financial markets").

[36] *Id.*

[37] *See, e.g.*, David Henry, *"Too Big to Fail,"* BUS. WK., Feb. 4, 2008, at 32 (discussing the possibility of bank bailouts); David S. Hilzenrath, *Firms Too Big to Fail May Grow Stronger*, WASH. POST, Sept. 23, 2008, at D01 ("The government's recent intervention in the financial markets is separating companies into two categories: Some are too big to fail, and others are too small to bother rescuing."); Karnitschnig et al., *supra* note 34 at A1 ("This time, the government decided AIG was truly too big to fail.").

[38] *See* James R. Hagerty et al., *U.S. Seizes Mortgage Giants*, WALL ST. J., Sept. 8, 2008, at A1 (reporting the takeovers of both companies were intended to prevent turmoil in the global markets).

[39] *See* Robin Sidel et al., *The Week That Shook Wall Street: Inside the Demise of Bear Stearns*, WALL ST. J., Mar. 18, 2008, at A1 (describing the circumstances and negotiations of the Bear Stearns purchase by JPMorgan Chase & Co.).

[40] Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008).

[41] *Id.* § 115(a)(3).

[42] *Hearing on Turmoil in U.S. Credit Markets: Recent Actions Regarding Government Sponsored Entities, Investment Banks and Other Financial Institutions Before the House Committee on Financial Services*, 110th Cong. 1 (2008) (statement of Henry Paulson, Secretary of the

Given the sheer number of banks threatened with failure and the general crisis-like atmosphere of 2008, it would be a mistake to think that the workings of the Bankruptcy Code were the most important factor in this government intervention. But the BAPCPA amendments were designed to prevent financial bankruptcies from introducing systemic risk into the markets. Clearly, this fear still exists three years after the amendments were passed.

Whether or not the Code is effective at addressing systemic risk arising from bankruptcy laws—or even whether the fear is well-founded—is beyond the scope of this Note and has been addressed quite effectively elsewhere.[43] Instead, the focus here will remain on how well BAPCPA conforms to this oft-stated Congressional intent.

III. INDUSTRY CUSTOM AS AN INTERPRETIVE TOOL FOR THE BAPCPA DEFINITIONS

A. *National Gas* and the Interpretive Problems of BAPCPA

The proper interpretive approach to the BAPCPA provisions in general, and the expanded financial definitions in particular, has not yet emerged. It has been remarked that, post-amendment, "the resulting statute is confusing and its meaning anything but clear."[44] The ambiguity has led to disagreements among the few courts and commentators to take up the subject. The need to protect the diverse and innovative financial markets will often conflict with the need to respect the principles of the Bankruptcy Code.

With respect to the former point, Professor Edward Morrison and Joerg Riegel suggest that the expanded financial contract definitions are meant to be so inclusive

Treasury), *available at* http://banking.senate.gov/public/_files/PAULSON Testimony92308.pdf.

[43] *See* Edwards & Morrison, *supra* note 11, at 99-106.

[44] Hutson v. Smithfield Packing Co. (*In re* Nat'l Gas Distribs., LLC), 369 B.R. 884, 892 (Bankr. E.D.N.C. 2007).

that they no longer protect individual financial counterparties but "entire markets."[45] One important benefit of this approach is that it allows the Code to keep pace with the ever-changing financial markets. For example, the definition of swap agreement now includes "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 . . . ."[46] The italicized language was added in 2006 as part of the Financial Netting Improvements Act.[47] The legislative history of BAPCPA supports the idea that the inclusion of the "similar to any other agreement" clause was meant to avoid constant amendment as the swap market evolved.[48]

Morrison and Riegel suggest another intended consequence of the broadly inclusive protections. Under the old Code, the incomplete nature of the definitions and protections often led bankruptcy courts to assume the responsibility of analyzing the structure of a financial transaction in an attempt to determine whether or not it properly fell under a protected category.[49] Judges, however,

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[45] 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, 643 (2005).

[46] 11 U.S.C. § 101(53B)(A)(ii) (2007) (emphasis added).

[47] Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, 120 Stat. 2692 (2006) (codified as amended in scattered sections of 11, 12, and 15 U.S.C.).

[48] H.R. REP. NO. 109-31, pt. 1, at 121 (2005) (stating that the bill was "intended to provide sufficient flexibility to avoid the need to amend the definition as the nature and uses of swap transactions matured"); *see also In re* Nat'l Gas Distribs., LLC, 369 B.R. at 898 (characterizing BAPCPA as "intentionally broad in anticipation of anticipated changes" in the market).

[49] For example, under the old Code, judges often had to determine whether a repurchase that did not fall under the existing definition of "repurchase agreement" could fit under another safe harbor. *Compare* Cohen v. Army Moral Support Fund (*In re* Bevill, Bresler & Schulman Asset Mgmt. Corp.), 67 B.R. 557, 598 (D.N.J. 1986) (finding repurchase agreements to be contracts for the sale of securities), *aff'd*, 805 F.2d 120 (3d Cir. 1986) *with In re* Criimi Mae, Inc., 251 B.R. 796 (Bankr. D. Md.

are rarely qualified to conduct such inquiries into complicated financial instruments, particularly those that are not easily classifiable. The massive expansion of the protected parties—from individual contracts to markets—prevents judges from undertaking this inquiry. According to Morrison and Riegel, the new Code "places *form over substance* in characterizing protected transactions."[50] This argument is supported by the legislative history as well.[51]

At the same time, two considerations support a more restricted reading of the financial contract definitions. The first is that the safe harbor transactions run counter to the normally accepted principles of bankruptcy. Morrison and Riegel acknowledge this concern, noting that an emphasis on form over substance could lead to some transactions being protected despite being deliberately designed as bankruptcy-proof substitutes for loans.[52] This is true despite (or perhaps because of) the fact that financial contracts can be, and often are, combined in a way that their net effect replicates the action of a loan.[53] In such cases, an overly formalistic approach will result in the reordering of priorities. This is often intended, justified by the policy concerns that led to the expanded definitions in the first place. In other cases, the authors note, it may be a way for pre-existing creditors and equity holders to secure a "safe exit from an ailing company,"

2000) (finding an issue of material fact as to whether a repurchase agreement was a securities contract or a secured loan). BAPCPA included repurchase agreements as part of its definition of "security contract." 11 U.S.C. § 741(7) (2007).

[50] Morrison & Riegel, *supra* note 45, at 657 (emphasis added).

[51] H.R. REP. NO. 109-31, pt. 1, at 119 (2005) (stating that the new definition of repo agreements was to "eliminate any inquiry . . . as to whether a repurchase or reverse repurchase agreement is a purchase and sale transaction or a secured financing").

[52] Morrison & Riegel, *supra* note 45, at 657 ("A combination of contracts merits protection—regardless of its underlying economics—if the contracts are commonly recognized in the marketplace as . . . [a] type of contract protected by the Code.").

[53] *See id.* at 654 (giving the example of a combination of forward contracts).

a consequence that is contrary to the concept of bankruptcy itself.[54]

Indeed, courts were engaged in a tug-of-war over the conflicting policy provisions of the financial contract safe harbors long before BAPCPA. For example, the Code has long protected settlement payments in certain transactions from the debtor's avoidance powers.[55] Because such a protection is fundamentally contrary to the general policy of the Code, it led to wide differences of opinion between courts as to how broadly to apply the statute.[56] Courts interpreting it broadly did so on the basis of the plain language of the statute, while those which restricted its scope limited it to situations in which they felt Congress's concerns were implicated.[57]

A second countervailing consideration follows from the widely acknowledged intent of BAPCPA to insulate the financial markets. The scope of the financial contract definitions could be restricted to encompass only those contracts traded on regulated exchanges. The House Report contains some support for this argument, at least as it pertains to swap agreements: "Traditional commercial arrangements, such as supply agreements, or other non-financial market transactions . . . cannot be treated as 'swaps' under the . . . Bankruptcy Code because the parties

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[54] *Id.* at 661-62.

[55] 11 U.S.C. § 546(e) (2007).

[56] *See, e.g.*, Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Savs. & Loan Ass'n (*In re* Bevill, Bresler & Schulman Asset Mgmt. Corp.), 878 F.2d 742, 751 (3d Cir. 1989) ("[T]wo important national legislative policies are on a collision course here, and it behooves the courts of the Third Article to decide which policy Congress intended must yield.").

[57] *Compare* Lowenschuss v. Resorts Int'l, Inc. (*In re* Resorts Int'l), 181 F.3d 505, 515 (holding that "the term 'settlement payments' is a broad one that includes almost all securities transactions," including leveraged buyouts) *with* Zahn v. Yucaipa Capital Fund, 218 B.R. 656, 676 (D.R.I. 1998) (limiting the definition of "settlement payments" to transactions involving financial intermediaries). *See generally* Gerald K. Smith & Frank R. Kennedy, *Fraudulent Transfers and Obligations: Issues of Current Interest*, 43 S.C. L. REV. 709, 751-67 (1992) (discussing the application of § 546(e) to leveraged buyouts).

purport to document or label the transactions as 'swap agreements.'"[58] Such a reading can be problematic, however. Regular traders frequently engage in transactions outside of the exchanges that are recognized as part of the financial marketplace.[59] These transactions affect the same parties Congress intended BAPCPA to protect, and a failure to bring them under the safe harbors would be contrary to the purpose of the statute.

Both arguments were given credence in a 2007 case. *In re National Gas Distributors, LLC*, [60] decided by the U.S. District Court for the Eastern District of North Carolina, called into question the idea that BAPCPA had traded in judicial discretion for formalism. There, the court was confronted by a transaction between the debtor and the Smithfield Packing Company.[61] The contract at issue provided for the delivery of natural gas upon oral request by Smithfield.[62] It was a standard form contract with some modifications,[63] and was not traded on a regulated financial market.[64] The trustee sought to avoid transactions made pursuant to the contract on the basis that they were below market price and thus fraudulent transfers. The court answered two questions—whether the instrument was a "forward contract" and whether it was a "swap agreement."

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[58] H.R. REP. NO. 109-31, pt. 1, at 122 (2005).

[59] *See* Williams v. Morgan Stanley Capital Group, Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 740-41 (5th Cir. 2002) (holding that the definition of "forward contracts" excluded on-exchange contracts for future delivery of commodities but included off-exchange contracts of the same type); *see also* COLLIER, *supra* note 25, ¶ 556.02 ("Generally speaking, 'forward contracts' are contracts for the future purchase or sale of commodities that are not subject to the rules of a contract market or board of trade.").

[60] Hutson v. Smithfield Packing Co. (*In re* Nat'l Gas Distribs., LLC), 369 B.R. 884 (Bankr. E.D.N.C. 2007).

[61] *Id.* at 885.

[62] *Id.* at 887.

[63] *Id.* Specifically, it was Standard Form 6.3.1 of the North American Energy Standard Board, Inc.

[64] *Id.* at 899.

First, in lengthy dicta, the court discussed whether the agreement was properly characterized as a "forward contract," a discussion that was relevant because forward agreements are included within the definition of "swap agreement."[65] In doing so, the Court declined to follow *In re Olympic Natural Gas Co.*[66] In *Olympic*, the Fifth Circuit had adopted a definition of "forward contract" that was based on what it deemed to be the term's "traditional definition," citing a series of cases interpreting the Commodities Exchange Act ("CEA").[67] The *National Gas* court, on the other hand, rejected the use of the CEA, arguing that the term's use in the Bankruptcy Code was unique.[68] Ultimately, though, the discussion constituted mere dicta, as the trustee had conceded the transaction's status as a forward contract.[69]

Second, the court agreed with the trustee that the contract at issue did not fall under the definition of "swap agreement," and could therefore be avoided as a fraudulent transfer.[70] In characterizing the contract as "simply an agreement by a single end-user to purchase a commodity,"[71] it placed emphasis on two particular features of the agreement. First, the court emphasized the fact that the gas was to be physically delivered at the end of the contract term, comparing it to a contract between a farmer and a consumer to purchase corn at a fixed price at the end of the month.[72] It also noted that the contract at issue had never

[65] *Id.* at 892-95; *see also* 11 U.S.C. § 101(53B)(A)(i)(I) (2007).

[66] Williams v. Morgan Stanley Capital Group (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 740-41 (5th Cir. 2002).

[67] *Id.* at 741 (citing Nagel v. ADM Investor Servs., Inc., 217 F.3d 436 (7th Cir. 2000), CFTC v. Co Petro Mktg. Group, Inc., 680 F.2d 573 (9th Cir. 1982), Grain Land Coop v. Kar Kim Farms, Inc., 199 F.3d 983 (8th Cir. 1999)).

[68] *In re* Nat'l Gas Distribs., LLC, 369 B.R. at 895.

[69] *Id.*

[70] *Id.* at 900.

[71] *Id.* at 899.

[72] *Id.* at 896.

been traded on a financial market, and would affect only the parties at issue.[73]

Acknowledging the policy concerns that went into BAPCPA, the court expressed wariness of the effect that such an extension would have on the Bankruptcy Code:

> Congress certainly did not intend to create a new, equally disruptive ripple effect within the administration of bankruptcy estates . . . . If *this* agreement is a swap agreement, then many of the most important aspects of the Code, including priorities of distributions to creditors and the automatic stay, will be eviscerated in even the smallest case of a farmer who contracts to sell his hogs at the end of the month for a set price. No public purpose would be served, and the result would be wholly at odds with the established aims and order of bankruptcy proceedings.[74]

With this in mind, the court declared that any public policy reasons for including this contract within the protected definitions were secondary to the principle of "equal distribution among creditors."[75] Therefore, the court held that "[t]he word 'similar,' rather than expanding the universe of agreements that come within the umbrella of swap agreements, actually limits the agreements to those that 'bear[] a family resemblance' to the other agreements and transactions that enjoy the protections of the Bankruptcy Code."[76]

National Gas illustrates the difficult questions facing courts in classifying contracts, even after the definitions have been broadened. The concerns that led the court to restrict the scope of § 101(53B) are not idiosyncratic, and the definitions themselves do appear to stand on their own, leaving courts to resolve the questions of construction. This

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[73] *Id.* at 899.

[74] *Id.* at 899-900.

[75] *Id.* at 900.

[76] *Id.* at 899 (quoting Ayes v. Dep't. of Veterans Affairs, 473 F.3d 104, 108 (4th Cir. 2006)).

seems to contradict Congress's fear of inflicting "uncertainty" upon the financial markets.

B. Industry Custom as a Solution

These questions of construction were apparently meant to be resolved through industry custom, an interpretive tool that, though not perfect, fits well within the structure of the Bankruptcy Code. Morrison and Riegel emphasize that by including language such as "commonly known"[77] and "the subject of recurrent dealings,"[78] Congress intended for the markets to create the standard as to which contracts deserve protection.[79] Such an approach allows courts to defer classification questions to those with closer interactions with and observance of the financial markets. For instance, in reference to the distinction between "supply agreements" and swap agreements found in the legislative history,[80] Morrison and Riegel note that "these warnings . . . only underscore the importance of industry custom" in the process of sorting out protected contracts from the unprotected.[81] Nor are they the only commentators to reach this conclusion. COLLIER ON BANKRUPTCY instructs that even in the much more limited pre-BAPCPA definition, the phrase "any other similar agreement" is best "construed to cover what is generally understood in the swap market from time to time to be a swap agreement."[82] Recall that the expanded definitions were intended to allow the law to evolve in lockstep with innovative financial contracts, but at the same time to emphasize respect for the contractual form rather than the underlying substance. Congress reconciled these two

[77] *See, e.g.*, 11 U.S.C. § 101(49) (defining "security"), (51A) (defining "settlement payment").

[78] *See* 11 U.S.C. § 101(53B) (1994).

[79] Morrison & Riegel, *supra* note 45, at 643-44 ("A transaction is protected if, in the judgment of market participants, it falls within a category of transactions included in the Code and recognized in the marketplace.").

[80] H.R. REP. NO. 109-31, pt. 1, at 122 (2005).

[81] Morrison & Riegel, *supra* note 45, at 658.

[82] COLLIER, *supra* note 25, ¶ 560.02.

conflicting desires by making current market practice, rather than judges, the definitional authority.

The court's analysis in *National Gas*, with its emphasis on the absence of market trading, appears at first glance to attempt a classification based on industry custom. However, this argument is undercut by the fact that the International Swaps and Derivatives Association ("ISDA")—which may be presumed to be a more persuasive authority on derivatives industry custom than the bankruptcy court—filed an *amicus curiae* brief arguing that the contract was a swap agreement within the contemplation of the statute.[83] ISDA relied chiefly on textual arguments from the Code, but also stressed that industry custom in the financial market featured "relatively seamless trading" between contracts for physical delivery (such as the disputed transaction) and financial settlements.[84] ISDA argued that the fact that "the swap agreement safe harbor is open to physically-settled transactions is of increasing importance as the connection between cash-settled markets and physically-settled markets becomes ever closer. This is especially true in the case of transactions in energy commodities such as natural gas."[85]

Although the court in *National Gas* failed to recognize the argument from custom, the use of industry custom is frequently applied in many areas of commercial law. The most notable of these is in contract interpretation. The Uniform Commercial Code ("U.C.C.") explicitly authorizes "usage of trade" as a means to interpret an agreement between parties, defining the phrase as "any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question."[86] The U.C.C. cautions that usage of trade is not

[83] Brief of the Int'l Swaps & Derivatives Ass'n as Amicus Curiae Supporting Defendants, Hutson v. Smithfield Packing Co. (*In re* Nat'l Gas Distribs., LLC), 369 B.R. 884 (Bankr. E.D.N.C. 2007).

[84] *Id.* at 19.

[85] *Id.* at 12.

[86] U.C.C. § 1-303(c) (2004).

meant to displace established law, but only to fill in unstated provisions in contracts.[87]

In contrast to BAPCPA, the use of industry custom in the U.C.C.—and in much of commercial law—is widely seen as a way to avoid formalism, and to find the intent of the parties within the context of the industry.[88] The U.C.C. is constructed so that trade usage, along with course of performance and course of dealings, is used to supplement and even alter written provisions in contracts, especially between repeat dealers.[89] The intent of BAPCPA, of course, is the opposite; it is intended to keep judges within formalistic boundaries while at the same time removing the need to constantly amend the Code to keep up with market activity.

Formalism is itself not a characteristic inherent in the Bankruptcy Code; indeed, Mark Rosen has observed that the Code is overwhelmingly a set of nonformalistic standards, leading to a noticeable amount of variation among local bankruptcy courts.[90] By employing a set of standards rather than comprehensive rules, he argues that "the Bankruptcy Code has decided the broad policy questions but allows variations at the margins in areas where people are deeply divided."[91] Although this could be seen as in conflict with the formalistic intentions of BAPCPA, it fits well. The Code's nonformalistic nature has created the need for judges to turn to outside sources for interpretation. This principle is

[87] U.C.C. § 1-303 cmt. 3 (2004).

[88] U.C.C. § 1-303 cmt. 1 (2004) (stating that contracts are to be "read and interpreted in the light of the commercial practices and other surrounding circumstances"); *see also* Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 U. CHI. L. REV. 781, 781 (1999) ("This approach . . . has long been celebrated for its nonformalist spirit.").

[89] Ben-Shahar, *supra* note 88, at 781 (The use of trade usage, course of performance, and course of dealings "effectively permits unwritten commercial practices to vary and to erode explicit contractual provisions.").

[90] Mark D. Rosen, *Nonformalistic Law in Time and Space*, 66 U. CHI. L. REV. 622, 631 (1999).

[91] *Id.* at 632.

captured in the seminal case of *Butner v. United States*, which established that property rights are to be defined through state law unless there is a direct conflict with the Code.[92] Pursuant to this principle, bankruptcy courts have sometimes turned to industry custom where appropriate.[93]

The unique use of custom in this situation, as a way to enforce formalism rather than constrain it, can capture the benefits of both. Supporters of formalism (in statutory as well as contract interpretation) argue that it increases predictability, lowers decisional costs, and promotes planning.[94] These advantages fit the desire to protect financial markets and counterparties from systemic risk. If judges refuse to recognize the protected status of an agreement that the parties understood to fall under the safe harbor, the intent of the financial contract provisions is defeated. Furthermore, allowing industry custom to govern the determination helps avoid one of the oft-repeated criticisms of formalism, that, in the words of Judge Richard Posner, it "spares the lawyer or judge from messy encounters with empirical reality."[95] Although there are substantive discrepancies remaining (as in repurchase agreements structured to act as secured loans), the boundaries are set by what the market would recognize, rather than a court's interpretation from the four corners of the agreement.

Certainly, forcing the courts to turn to industry custom raises several important questions. First and foremost, it

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[92] Butner v. United States, 440 U.S. 48, 55 (1979).

[93] *See, e.g.*, Jonas v. Farmer Bros. Co. (*In re* Comark), 124 B.R. 806, 809 n.4 (Bankr. C.D. Cal. 1991) (using industry custom to define "repurchase agreements" and "reverse repos"); Telco Leasing, Inc. v. Patch (*In re* Patch), 24 B.R. 563, 567 (D. Md. 1982) (citing "standards and customs of the industry" as a factor in establishing the reasonableness of reliance on a financial statement). Course of dealings, also a factor under U.C.C. § 1-303, is often used to determine "ordinary course of business" in preferential transfer law. *See* Brandt v. Repco Printers & Lithographics (*In re* Healthco. Int'l), 132 F.3d 104, 109 (1st Cir. 1997).

[94] Cass Sunstein, *Must Formalism Be Defended Empirically?*, 66 U. CHI. L. REV. 636, 644 (1999).

[95] RICHARD A. POSNER, THE PROBLEMS OF JURISPRUDENCE 16, 40-41 (Harvard Univ. Press 1990).

does not entirely resolve the question of judges' institutional competency. It is still a difficult inquiry for a generalist judge to determine how the relevant market treats a contract—particularly one which incorporates elements of a "traditional commercial arrangement" such as physical delivery.[96] The financial markets are highly specialized areas of commerce, and the traders that operate within their boundaries are highly paid professionals. The *National Gas* court acknowledged its limitations at the beginning of its statutory inquiry when it stated: "'Swap agreement,' 'forward agreement' and 'forward contract' are not part of this court's or most people's 'plain meaning' vocabulary . . . ."[97] Introducing industry custom will bring the court's inquiry closer to that undertaken in traditional contract interpretation, as under the U.C.C., but will still leave the court faced with interpreting the purpose of a contract intended, largely, only for the eyes of repeat dealers and active market participants.

Also, contrary to BAPCPA's intention to reflect the ever-changing market, the use of industry custom could potentially risk stifling innovation. Lisa Bernstein, as part of a detailed study into the private law system that governs the cotton industry, discovered that arbitrators in that industry expressly avoid applying industry custom for that very reason.[98] They fear that the requirement of "regularity of observance" for finding a practice to be industry custom will cut off innovative contracts and modifications before they have a chance to be adopted within the industry.[99] The

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[96] *See, e.g.*, Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 VA. L. REV. 821, 908 n.231 ("Unfortunately, while judges may be good surrogates for the rationally ignorant consumer, they are often deficient interpreters of more specialized usages of trade.").

[97] Hutson v. Smithfield Packing Co. (*In re* Nat'l Gas Distribs., LLC), 369 B.R. 884, 892 (Bankr. E.D.N.C. 2007).

[98] Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1736 (2001).

[99] U.C.C. § 1-303 (2004). According to the comments, "regularity of observance" is intended to contemplate new usages, but also requires usage by the "great majority of decent dealers." U.C.C. § 1-303 cmt. 4.

refusal to use the provisions of § 1-303 of the U.C.C. encourages flexibility and allows participants to promote cooperative behavior.[100] In the same way, a few unfavorable rulings in bankruptcy court could stifle a potentially advantageous type of contract before it could be adopted by enough market actors to become recognized industry custom.

Despite these questions, Congress has attempted to direct courts to substitute industry custom for their own judgments as to whether a contract is properly classified as protected. The real question, then, is what tools are available to assist courts as they attempt to understand and apply industry custom.

C. The Implementation of Industry Custom

Striking the balance between the need for open-ended statutory provisions as a way to encompass as much present and future financial trading as possible and the need to limit judicial intervention is a delicate task. Nevertheless, there are some ways to ensure industry custom is respected, in keeping with Congressional intent.

The first step is a legislative one: to clarify the most confusing exception in the statute itself (and in the legislative history). Precedent exists for such a small tweak. In 2006, Congress passed the Financial Netting Improvements Act, which in part clarified the definition of "forward contract" after BAPCPA.[101] Just as easily, if

[100] Bernstein, *supra* note 98, at 1777 (stating that the refusal to employ these provisions "increases the likelihood that transactors will find it worthwhile to behave flexibly and encourages them to adopt the types of forgiving strategies that are most likely to promote commercial cooperation").

[101] Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, 120 Stat. 2692 (codified as amended in scattered sections of 11, 12, and 15 U.S.C.). The amendment attached "as defined in section 761" to the term commodity contract, and by doing so resolved a split among the courts as to the meaning of 11 U.S.C. § 101 (25). *Compare* Williams v. Morgan Stanley Capital Group, Inc. (*In re* Olympic Natural Gas Co.), 294 F.3d 737, 741 (5th Cir. 2002) (distinguishing forward contracts and futures contracts based on exchange trading), *with In re* Nat'l Gas Distribs., LLC, 369 B.R. at 895 (rejecting the Fifth Circuit's on-exchange distinction).

Congress truly did mean to exclude supply agreements and transactions outside of the regulated financial markets from the definition of swap agreements, this amendment should be codified, with the pertinent terms defined.[102] This is not to encourage a constant revision of the financial contract provisions—after all, Congress left them open-ended precisely so that the definitions could evolve, through case law, alongside the financial markets themselves. However, to allow such a provision in the House Report—with no statutory counterpart—to determine the fate of financial contracts has more potential to frustrate Congress's intent than to promote it.

To guide the use of industry custom, the onus is on courts to take a more expansive view of the available law and extrinsic evidence in categorizing the contracts before it. It cannot be overemphasized that there is already a wealth of legal standards governing the financial markets, which could easily be employed as interpretive tools. The Commodity Exchange Act is one example; regulations promulgated by the Commodities and Futures Trading Commission are another.[103] The Federal Reserve also issues useful definitions pertaining to the financial markets.[104]

It is certainly true that the differing goals and applications of the Bankruptcy Code should prevent a court from blindly adopting a definition from another area of the law, and Congress surely wished to avoid such a result in situations where it did not direct the courts to an outside

[102] *Cf.* H.R. REP. NO. 109-31, pt. 1, at 122 (2005).

[103] *See, e.g.*, Nagel v. ADM Investor Servs., Inc., 217 F.3d 436, 441 (7th Cir. 2000) (summarizing case law ascertaining what constitutes a "forward contract" under the CEA); 17 C.F.R. § 35.1(b)(1) (2008) (defining swap agreement through an exclusive list of commodities); 15 U.S.C. § 78c(41) (2007) (defining "mortgage related security").

[104] *Compare* 12 C.F.R. § 231.3(a) (2008) (defining "financial institution" as included within 12 U.S.C. §§ 401-407) *with* 11 U.S.C. § 101(22)(A) (2007) (defining "financial institution" for bankruptcy purposes).

definition.[105] The *National Gas* court reasoned this way, quoting the Supreme Court for the proposition that when such directions are absent, there is "no warrant to write them into the text."[106] However, such statutes, regulations, and the interpretations thereof regulate industries much more closely—and with a great deal more specificity—than does the Bankruptcy Code. A close investigation into the definitions employed by a regulatory scheme provides a much better insight into the types of contracts that are "the subject of recurrent dealings in the swap or derivatives markets" or, in the case of a forward contract, "any other similar agreement."

Second, the use of expert testimony can provide an easy way for courts to determine how market actors would view a particular contract. This, after all, is the traditional means by which courts solve questions about institutional competency, including in the field of bankruptcy law.[107] However, whether or not the testimony of expert witnesses should be admissible to assist in this regard is a matter of dispute. The Ninth Circuit ruled in a pre-BAPCPA case that classification of financial contracts under the Code is a matter of statutory construction rather than a matter of fact and that, therefore, expert witness testimony is unnecessary.[108] Several other circuits agree that the matter is one purely of statutory construction.[109] In contrast, the

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[105] *Cf.* 11 U.S.C. § 101(47)(A)(i) (2007) (Repurchase agreements include the transfer of "mortgage related securities (as defined in section 3 of the Securities Exchange Act of 1934) . . . .").

[106] *In re* Nat'l Gas Distribs., LLC, 369 B.R. at 895 (quoting Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 662 (2006)).

[107] Stan Bernstein, Susan H. Seabury & Jack F. Williams, *The Empowerment of Bankruptcy Courts in Addressing Financial Expert Testimony*, 80 AM. BANKR. L.J. 377 (2006) (analyzing the admission and use of expert financial testimony in bankruptcy courts).

[108] Jonas v. Resolution Trust Corp. (*In re* Comark), 971 F.2d 322, 324 (9th Cir. 1992).

[109] Lowenschuss v. Resorts Int'l, Inc. (*In re* Resorts Int'l, Inc.), 181 F.3d 505, 515 (3d Cir. 1999); Kaiser Steel Corp. v. Pearl Brewing Co. (*In re* Kaiser Steel Corp.), 952 F.2d 1230, 1237 (10th Cir. 1991).

Southern District of New York treats the question as a matter of fact to be determined at trial.[110]

Where expert testimony is admissible, it could prove invaluable. The financial industry and its academic counterparts have produced no shortage of professionals and scholars who could be called on to clarify how the industry views the disputed contracts. Further, even in jurisdictions that do not allow expert testimony on the status of financial contracts, some authors have advocated the appointment of technical advisors to the court as a useful and palatable alternative.[111] Such advisors are not involved in the actual factfinding, but rather work with the judge behind the scenes, serving as sort of "a tutor to the court."[112]

Finally, a greater potential role is available for industry groups. The *National Gas* court gave very little weight to the ISDA's intervention as *amicus curiae* or the defendant's argument that ISDA's filing of a brief signified that "the industry as a whole would recognize this contract as a swap agreement."[113] However, industry groups such as the ISDA and the Securities Industry and Financial Markets Association have a membership much closer to the day-to-day workings of the financial markets. Although such groups may fairly be perceived as biased towards their members, it is worth noting that Congress intended to protect the large market players from the systemic risk they felt would arise from a counterparty's bankruptcy. The court must weigh their credibility in due course, as with all *amici curiae*, but recognition of their superior experience with the customs and practice of the industry entitles their judgment

[110] Enron Corp. v. J.P. Morgan Secs. (*In re* Enron Corp.), 325 B.R. 671, 685-86 (Bankr. S.D.N.Y. 2005) (denying motion to dismiss on the basis that whether a settlement payment is one "commonly known in the securities industry" is a factual matter).

[111] *See* Bernstein et al., *supra* note 107, at 417 (calling technical advisors "less intrusive to the adversarial process").

[112] *Id.* ("[T]he technical advisor will not submit a written report, and will not undertake to find the relevant and material facts that are genuinely at issue.").

[113] Hutson v. Smithfield Packing Co. (*In re* Nat'l Gas Distribs., LLC), 369 B.R. 884, 896 (Bankr. E.D.N.C. 2007).

to something more than cursory consideration. Their assistance should be particularly welcomed in jurisdictions that do not admit expert witnesses on this issue.

The reluctance of the *National Gas* court to recognize the ISDA was apparently due to the court's desire to stay within the text and goals of the Code itself, and not turn to such outside sources as industry custom. We have seen that the text *implies* that industry custom should be the guide in determining what types of contracts are to be protected, but the implication is apparently not sufficient. To truly insure that this invitation is taken to heart, Congress should make explicit that a court is obligated to look to the relevant financial markets to determine whether the contract issue is of the type which will lead to uncertainty in the financial markets if subjected to the automatic stay or avoidance by the debtor.

IV. EXCLUSIONS FROM NETTING CONTRACT PROVISIONS

A. Master Netting Agreements and the Problem of Mortgage Servicing

As summarized above, BAPCPA included new provisions that, for the first time, explicitly contemplated master netting agreements as financial contracts subject to the safe harbor provisions of the Code. However, the amendments fall far short of providing full protection for such contracts. As a recent case demonstrated, the shortfall in coverage significantly devalues mortgages and similar netted transactions.[114]

A master netting agreement is a document entered into by parties who have agreed to a number of separate financial transactions. Designed to protect contractors in the event a counterparty defaults, including when the default leads to

[114] *See* Calyon N.Y. Branch v. Am. Home Mortgage Corp. (*In re* Am. Home Mortgage. Corp.), 379 B.R. 503 (Bankr. D. Del. 2008) (severing servicing rights from a mortgage contract).

bankruptcy, they are used to group together contracts that fall within the safe harbor provisions of the Code. Without such an agreement, the counterparty's right to set off is subject to the automatic stay under § 362(a)(7) of the Code, although BAPCPA also carved out exceptions for certain individual financial contracts and participants. Further, in the absence of netting, each individual contract would be subject to the debtor's right to assume or reject the contracts individually. This would expose the counterparty to significant downside, as the debtor would only assume those contracts that were in the money, and reject those that were out of the money.[115] Master netting agreements have become commonplace over approximately the last two decades.[116]

Prior to the BAPCPA amendments, there was no clear definition of "master netting agreement." This led to significant uncertainty as to what contracts could be offset against each other. Some financial contracts could have been offset—without being subject to the stay—before BAPCPA, such as commodity contracts, forward contracts, securities contracts, repurchase agreements, and swap

[115] *See* Rhett G. Campbell, *Energy Future and Forward Contracts, Safe Harbors and the Bankruptcy Code*, 78 AM. BANKR. L.J. 1, 38-39 (2004) ("The Code's result-driven premise is that the debtor or trustee should be insulated from contracts that impose burdensome liabilities upon the estate but, in the alternative, should be able to take advantage of favorable contracts that benefit the estate.").

[116] Indeed, the use of master netting agreements has become important enough that several organizations have published model netting agreements for their constituencies: the Edison Electric Institute for energy contract traders and the International Swaps and Derivatives Association for financial market participants more generally. *See* EDISON ELECTRIC INSTITUTE, MASTER NETTING AGREEMENT (2003) (on file with author); INT'L SWAPS & DERIVATIVES ASS'N, 2002 MASTER NETTING AGREEMENT (MULTICURRENCY CROSS-BORDER) (2002), *available at* http://www.isda.org/publications/isdamasteragrmnt.html. The Securities Industry and Financial Markets Association ("SIFMA") has specifically issued a cross-product master netting agreement. SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION, CROSS-PRODUCT MASTER AGREEMENT (2003), *available at* http://archives1.sifma.org/agrees/cross_product_master_agreement_2.pdf.

agreements.[117] However, the language and structures of the provisions—classified by type of contract—led to a gray area in which it was unclear whether the setoff abilities were restricted to similar financial products, or could have been extended across any eligible, protected transactions.[118]

BAPCPA resolved this uncertainty: including master netting agreements within §§ 362(b) and 561 ensured that all otherwise protected agreements included within such a contract would be subject to setoff, and that contractual rights of termination and liquidation would be honored. These rights are protected whether they take place across multiple products, multiple contracts, and even separate transactions, as long as they are included within a single netting agreement.[119] This is consistent with the policy concerns that gave rise to the amendments. The inability to offset obligations under a financial contract raises the same fears of systemic risk as the inability to promptly terminate contracts or to repay transfers avoided by the debtor. The House Report acknowledged as much: "[e]xpress 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."[120]

As expansive as the master netting agreement language provisions are, they do not receive total protection. The *ipso*

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[117] *See* 11 U.S.C. § 362(b)(6), (7) (1998). Note that these were subject to the more limited pre-BAPCPA definitions of the pertinent contracts.

[118] *See, e.g.*, EDISON ELECTRIC INSTITUTE, SURVEY OF THE LEGAL LANDSCAPE APPLICABLE TO MASTER NETTING AGREEMENTS, 22 (2002), *available at* http://www.eei.org/ourissues/ElectricityGeneration/Documents/survey.pdf (acknowledging that "some practitioners have noted that there is no express authority to net safe-harbored contracts beyond these three categories [in former § 362(b)(6)]); Morrison & Riegel, *supra* note 45, at 647 ("[W]as the Code implicitly limiting the exercise of contractual setoff rights *across* groups of products?").

[119] *See* 11 U.S.C. § 101(38A)(A) (2007) (a master netting agreement "means an agreement providing for the exercise of rights . . . 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) . . . ").

[120] H.R. REP. NO. 109-31, pt. 1, at 125 (2005).

facto provision of the amendments provides a representative example. Section 561 allows parties to master netting agreements to exercise *ipso facto* clauses, or clauses contingent on financial condition or bankruptcy, which are otherwise void under the Code.[121] However, § 561(b)(1) provides that: "[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 a right [of this type] for *each individual contract* covered by the master netting agreement in issue."[122] In many ways, a restriction of this type is a perfectly desirable position; however, the recent subprime mortgage crisis has illustrated one of the ways in which such a restriction may fall short of the policy ambitions.

As mortgage lenders finance loans through repurchase agreements, they are brought within the safe harbors through the expanded definition of repurchase agreement, which now explicitly includes "mortgage related securities . . . mortgage loans, interests" in such securities or loans, "or securities that are direct obligations of, or that are fully guaranteed by . . . mortgage loans, or interests . . . ."[123] Also within the definition of repurchase agreement is "a master agreement that provides for [one or more individual repurchase agreements], together with all supplements to any such master agreement . . . 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 [a repurchase agreement] . . . ."[124] The last clause effectively mirrors the qualification in § 101(38A)(B) that only those agreements that would be protected outside of a master netting agreement will be protected within one.

In the early days of the mortgage crisis, Richard Mason and Joshua Feltman identified a troubling issue that had

[121] *See* 11 U.S.C. § 561(a) (2007). *See generally* COLLIER, *supra* note 25, ¶¶ 365.07, 561.04.

[122] 11 U.S.C. § 561(b)(1) (2007) (emphasis added).

[123] 11 U.S.C. § 101(47)(A)(i) (2007).

[124] 11 U.S.C. § 101(47)(A)(iv) (2007).

arisen in litigation surrounding the bankruptcy of American Home Mortgage.[125] The authors pointed out that mortgages are unique in comparison to the other financial payments protected by the Bankruptcy Code because a great deal of their value is wrapped up in a provision that is not individually protected: servicing agreements.[126] Mortgage servicing is the ongoing management of a mortgage loan, including payment collection, release of liens, and insurance and tax payment.[127] Servicers are compensated by a percentage of the loan's principal.[128] As subprime lenders have failed, these servicing agreements have emerged as one of the few assets with remaining value.[129] In fact, the loan itself is drastically reduced in value when divorced from the right to service it.[130]

B. The Calyon Mortgage Contracts

In January 2008, a bankruptcy judge in Delaware issued an opinion on this very topic. In *Calyon New York Branch v. American Home Mortgage Corp.*, the plaintiff bank was seeking to acquire servicing rights to mortgage loans it had in its possession under a repurchase agreement.[131] Calyon had purchased the loans, subject to AHM's repurchase within 180 days, on a service-retained basis; that is, AHM

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[125] Richard G. Mason & Joshua A. Feltman, Mortgage Lenders and Hedge Funds: When Money Goes Bankrupt 10-13 (Sept. 26, 2007) (unpublished manuscript, on file with author).

[126] *Id.*

[127] BLACK'S LAW DICTIONARY 1034 (8th ed. 2004).

[128] *See, e.g.*, Calyon N.Y. Branch v. Am. Home Mortgage Corp. (*In re* Am. Home Mortgage Corp.), 379 B.R. 503, 510 (Bankr. D. Del. 2008) (noting that the servicer received a monthly fee of fifty basis points on the unpaid principal balance of the mortgage loans).

[129] Peg Brickley, *Mortgage Lender's Bankruptcy May Threaten Thousands of Homeowners*, WALL ST. J., Sept. 12, 2007, at A15.

[130] John J. McConnell, *Valuation of a Mortgage Company's Servicing Portfolio*, 11 J. FIN. & QUANTITATIVE ANALYSIS 433, 433 (1976) ("Contracts to service single-family residential mortgage loans for institutional investors represent the primary asset and the primary source of revenues for most mortgage banking companies . . . .").

[131] *In re* Am. Home Mortgage Corp., 379 B.R. at 508.

had retained the right to service the contracts.[132] Upon AHM's default, and pursuant to an *ipso facto* clause, Calyon asked the court to order AHM to transfer its servicing rights to its designated servicers.[133]

Responding to a request for declaratory relief, the court first determined that the agreement itself fell within the § 101(47) definition of "repurchase agreement."[134] Therefore, §§ 559 and 555 were also applicable, respectively allowing the exercise of *ipso facto* clauses and providing an exemption from the automatic stay.[135]

The court then turned to the second issue, whether Calyon could force the transfer of the servicing rights to the contracts. The court held that under New York law, the servicing rights were severable, and that neither 11 U.S.C. § 101(47), defining repurchase agreements, nor § 741, defining securities contracts, contemplated the right to service a mortgage loan to fall under the definition of a "mortgage loan" or "interest in a mortgage loan."[136] In reaching this conclusion, the court noted that § 541, which defines the property of the estate, differentiates between mortgages and interests therein, and the right to service each.[137] It also held that a servicing right constituted a separate asset and therefore was not a "related term[]" under § 101(47).[138]

In response to the severability argument, Calyon argued that "severing the servicing provisions of the Contract would improperly impair the [plaintiffs'] ability to liquidate the mortgage loans, thus, frustrating the purpose of a repurchase agreement and the safe harbor provisions."[139] This argument is parallel to an existing doctrine employed

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[132] *Id.* at 510.

[133] *Id.* at 508. Recall that *ipso facto* clauses allow for termination or modification of a contract conditioned on insolvency, financial condition, or a filing of bankruptcy. COLLIER, *supra* note 25, ¶ 365.07.

[134] *In re* Am. Home Mortgage Corp., 379 B.R. at 518.

[135] *Id.* at 518, 520.

[136] *Id.* at 520, 522-23.

[137] *Id.* at 523 (interpreting 11 U.S.C. § 541(d) (2007)).

[138] *Id.*

[139] *Id.* at 522.

by courts to deal with de facto restrictions on assignments. When the debtor has assumed an executory contract and wishes to transfer it to another party, § 365(f) of the Code facilitates the assignment by invalidating any restrictions on assignment. However, other contract provisions may be so restrictive that debtors might not be able to find a party willing to accept assignment. In cases like these, bankruptcy courts may invalidate those de facto restrictions in the same way.[140] Calyon, in exercising its right to terminate the repurchase agreement under § 559 of the Code, was placed in a position similar to the assignees protected from de facto restrictions; severing the servicing provisions left it with a contract upon which it could receive little value.[141]

Nevertheless, the court rejected this argument, noting that Calyon purchased the mortgages at a price that reflected their service-retained nature.[142] The court divined an intent by the parties to sever the servicing agreement based on the actual retention under the contract, the existence of separate consideration, and the treatment of servicing contracts as separate assets in general practice.[143]

The severability issue would have been irrelevant, however, had the servicing agreement been tied to the master agreement clause of § 101(47). In that case, Calyon would have been able to seize and transfer the servicing rights pursuant to § 559—and to realize the full value of the repurchase agreement.[144] Instead, when Calyon attempted to exercise its contractual rights to terminate the repurchase agreement and retain the mortgages in its possession, it was

[140] *In re* Fleming Cos., Inc., 499 F.3d 300, 307 (3d Cir. 2007) (declining to find a term mandating the use of a specific supply facility was a de facto restriction on assignment); *In re* Adelphia Commc'ns Corp., 359 B.R. 65, 85 (Bankr. S.D.N.Y. 2007) (applying to rights of first refusal).

[141] Calyon had intended to realize this value by immediately transferring the servicing rights to its own designated servicers, JP Morgan Chase and Canlar FSB. *In re* Am. Home Mortg. Corp., 379 B.R. at 511 n.5.

[142] *Id.*

[143] *Id.* at 521.

[144] *Id.* at 522.

left holding loans worth a fraction of their value, with AHM retaining the valuable right to service the mortgages despite their seizure. This does little to prevent systemic risk and would seem to be completely contradictory to the policy of the BAPCPA amendments. The decision was not judicial overreaching by any means—in fact, it was the most reasonable reading of the Code. Rather, it illustrates a loophole left open by Congress's reluctance to protect non-repurchase agreements that are included as part of a master repurchase agreement.

C. Expanding Netting Agreements

Effective protection of netting agreement participants begs for a legislative solution. The pertinent provisions at this time fail to fully capture the policy of BAPCPA. Instead, counterparties acting to terminate or offset agreements with debtors are not able to realize the full value of their assets, a result that threatens the very systemic risk that the ability to terminate is meant to prevent. On the other hand, allowing parties to include *any* transaction within a master netting agreement, with the promise that they will be protected, would open up the provision to significant abuse. One can imagine a scenario in which parties begin to blatantly include loan agreements alongside financial contracts and then claim that they are protected by §§ 101(38A), (25)(D), or (47)(A)(iv) of the Code.

The easiest solution, given the most obvious factual example, is to explicitly include mortgage-servicing contracts within the § 101(47)(A)(i) definition of repurchase agreements; this would by extension bring the servicing contracts within the ambit of § 101(47)(A)(iv). However, it is doubtful that this quick fix will solve the problem permanently; a more thorough solution is probably necessary. One solution, albeit imperfect, would be to take a page from the definition of "repurchase agreement" in § 101(47)(A)(i), which begins "an agreement, including related terms . . . ." In the same way, the definition of master netting agreement could be amended to say, in § 101(38A)(B), with the proposed language in italics:

> 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 any one or more of paragraphs (1) through (5) of section 561(a)[145] *or any agreements that are deemed to be necessary to preserve the full or partial value of such agreements or transactions, including those pertaining to the servicing, implementation, or termination of the agreements or transactions.*

Such language would enable an agreement meant to accompany the financial contract, but that would not on its own qualify for safe harbor protection, to be paired with the contract within a master agreement. Importantly, it would not go so far as to protect completely unrelated agreements or agreements not intended to receive protection (such as leases or commercial loans), if the agreements are included within a netting agreement for the sole purpose of circumventing the Code. Similar language could be included within the master agreement subsections of 11 U.S.C. § 101(25) and 101(47).

V. TIMING OF DAMAGES IN THE VOLATILE MARKETS

A. The Ambiguous "Commercially Reasonable Determinants" Standard

A third issue concerning dealing with damage calculations leaves open a host of novel issues which can only be determined slowly, through the development of case law. BAPCPA added § 562 to the Code, which specified the point at which damages are to be measured when a covered financial contract is rejected by the debtor or terminated by a counterparty. Prior to BAPCPA, damages were most often fixed according to the date of the filing of the petition, as

[145] 11 U.S.C. § 101(38A)(B) (2007).

with executory contracts under §§ 365(g) and 502(g).[146] The new § 562 changes this, providing that when a covered agreement is rejected, liquidated, terminated, or accelerated, damages will be measured as of the date of the debtor's rejection or the date of the counterparty's liquidation, termination, or acceleration, whichever is earlier.[147] However, it also added § 562(b), which states that: "If there are not any commercially reasonable determinants of value as of any date referred to in paragraph (1) or (2) of subsection (a), damages shall be measured as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value." In such a situation, the burden of proving that the date of rejection or termination is not commercially reasonable is placed on the party breaching the contract.[148]

The inclusion of this subsection immediately raises two litigable questions. First, what constitutes a commercially reasonable determinant of value? Second, in what circumstances will no such determinants exist? The legislative history appears to answer the first question through the second; that is, whether a measurement of value is commercially reasonable will depend on the circumstances present on the date of rejection or termination, including effects resulting from the liquidation of the contracts at issue. Said the House Report: "[I]n certain unusual circumstances, such as dysfunctional markets or liquidation of very large portfolios, there may be no commercially reasonable determinants of value for liquidating any such agreements or contracts or for liquidating all such agreements and contracts in a large portfolio on a single day."[149]

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[146] *See, e.g.*, Bank of Montreal v. Am. Homepatient, Inc. (*In re* Am. Homepatient, Inc.), 414 F.3d 614, 620 (6th Cir. 2005) (fixing damages from day before petition is filed). *But see In re* Enron Corp., 330 B.R. 387, 392 (S.D.N.Y. 2005) (fixing damages from a rejection of a forward contract).

[147] 11 U.S.C. § 562 (2007).

[148] *Id.* § 562(c).

[149] H. R. REP. NO. 109-31, pt. 1, at 135 (2005).

Within bankruptcy law, the term "commercially reasonable" is most frequently applied to the disposition of property. In this manner, it is chiefly a procedural requirement; courts are more concerned that the trustee or debtor in possession has conducted a sale through proper avenues than that he has maximized value.[150] Although courts will use a commercially reasonable sale as a proxy for the market value of the asset, it is the process and not the end result that is scrutinized.[151] Because the term is derived from state law rather than from the Bankruptcy Code, this usage is pervasive throughout commercial law.[152]

The U.C.C.'s guidance for determining commercial reasonableness illustrates the problems inherent in the use of this term of art. A disposition is commercially reasonable if the asset is disposed of (1) on a recognized market, (2) at the current market price as found on a recognized market, or (3) "otherwise in conformity with reasonable commercial practices among dealers" in that asset.[153] Of course, in the situations contemplated by § 562(b), this becomes circular; the reasonableness of pricing through the market cannot be determined by the market alone.

With no other guidance in the statute, the two situations mentioned explicitly in the House Report provide the only hints as to when Congress believed that valuation could be commercially reasonable. The first of these, market dysfunction, is a term with no legal meaning and a short, checkered legal history. In a series of 2006 cases, the Ninth

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[150] *See* Miller v. Greenwich Capital Fin. Prods., Inc. (*In re* Am. Bus. Fin. Servs., Inc.), 362 B.R. 149, 160 (Bankr. D. Del. 2007) (finding auction of assets to be a "sham" and therefore commercially unreasonable).

[151] *See In re* Excello Press, Inc., 890 F.2d 896, 904-05 (7th Cir. 1989) ("The product of a commercially reasonable sale *is* the fair market value." (emphasis in original)).

[152] *See, e.g.*, United States v. Segal, 432 F.3d 767, 777-78 (7th Cir. 2005) (finding that the settlement reached by the trustee and claimant to dispose of RICO defendant's assets was commercially reasonable); Layne v. Bank One, 395 F.3d 271, 280-81 (6th Cir. 2005) (finding NASDAQ was a "recognized market" and that the sale of shares there was commercially reasonable).

[153] U.C.C. § 9-627 (2005).

Circuit held that forward contracts for energy delivery entered into in western states during 2000 and 2001 could be voided, citing "market dysfunction."[154] The Ninth Circuit did not define the term, saying only that "market manipulation, the leverage of market power, or an otherwise dysfunctional market" represented circumstances under which the contracts could be voided.[155] On appeal, the Supreme Court rejected the use of market dysfunction as a basis for rescission in this context, calling it a "perverse rule" that would reduce the incentives to enter into such contracts in the first place.[156] Academics, meanwhile, directed pointed criticism at the Ninth Circuit's conclusory use of the term.[157] As a further concern, even if there was a standard for what market dysfunction *is*, another question would be when it begins and ends. The line-drawing problem is both obvious and acute—the functionality of markets is a spectrum, and, indeed, volatility is an inherent characteristic of financial contracts trading.

The second condition, the liquidation of large portfolios, may lead to even more litigation. Although the House Report provides no insight beyond that single phrase, Congress' fear appears to be that a portfolio liquidation may be substantial enough to depress prices on the market just by its own massive sell-off. That alone is apparently enough to render market prices unreliable as measures of value. However, in a case like that, how can it be determined that

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[154] Pub. Util. Comm'n v. Fed. Energy Regulatory Comm'n, 474 F.3d 587, 595 (9th Cir. 2006), *vacated and remanded sub nom.* Sempra Generation v. PUC, 128 S. Ct. 2993 (2008); Pub. Util. Dist. No. 1 v. Fed. Energy Regulatory Comm'n, 471 F.3d 1053 (9th Cir. 2006), *aff'd on other grounds sub nom.* Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1, 128 S. Ct. 2733 (2008).

[155] *Pub. Util. Dist. No. 1*, 471 F.3d at 1085-86.

[156] *Morgan Stanley*, 128 S.Ct. at 2746-47.

[157] Brief of William J. Baumol et al. at 9, Morgan Stanley Capital Group, Inc. v. Pub. Util. Dist. No. 1, No. 06-1457 (Nov. 28, 2007) ("The term 'market dysfunction' has no fixed meaning and, in cases like this one, is all too easily invoked to seek abrogation of contracts that were performed precisely when certainty is needed most—in crisis conditions . . . .").

the market has returned to normal? Mason and Feltman raise additional questions about the practicality of the provision as applied to the mortgage market:

> Query then whether every single unwinding of a financial contract, including mortgage repos, in August of this year is not suspect, never mind the more general question of how one determines when markets are dysfunctional? And query whether any counterparty to a holder of a "very large portfolio" will effectively be required to liquidate contracts with such holder over lengthy periods—and thus subject itself to still greater risks to its recovery—in order to avoid rendering commercially unreasonable the exercise of the very remedies which the financial contract provisions of the Code are supposed to protect?[158]

When a liquidation large enough to significantly affect a market occurs, two serious problems may present themselves. The first, as mentioned above, is that the liquidation may introduce so much volume into the market that it will depress all prices in the relevant markets—much as a firm with anticompetitive leanings might dump excess product into a market to artificially maintain low prices. The second is that because the liquidation is more likely to occur in a time of industry-wide distress, the most efficient buyers (who would otherwise place the most value on the asset) may themselves be experiencing financial difficulty. In such a situation, the market will value the asset at less than it would be worth to industry peers.[159]

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[158] Mason & Feltman, *supra* note 125, at 9-10.

[159] *See* Andrei Shleifer & Robert W. Vishny, *Liquidation Values and Debt Capacity: A Market Equilibrium Approach*, 47 J. FIN. 1343, 1353 (1992). How much of a discount a liquidation is likely to produce is dependent on the illiquidity of the asset. *Id.* at 1344. The disparity in value will be much less for a swap agreement, which is very liquid, than a kiln, which requires more expense of industry outsiders to put to its best use. *Id.* at 1344.

B. Establishing a Standard for Timing of Damages

What constitutes a commercially reasonable determinant of value—and when such values will not be available on the market—is amenable to a judicially created standard. It appears this is what Congress had in mind when it failed to provide a bright-line rule for when § 562(b) would come into effect. As it stands now, there is no standard—in bankruptcy or elsewhere—to distinguish between volatility in the ordinary course of the markets and volatility that produces enough dysfunction to render the valuation impossible. Commercial law, as discussed above, infers commercial reasonableness from the procedures and circumstances leading to the transaction. Similarly, the reasonableness of a valuation of a market-traded contract ought to be inferred from the circumstances in the market on the date of termination. This makes it crucially important to determine under what circumstances no reasonable determinants exist.

As some natural volatility is an ordinary and entirely foreseeable consequence of entering the financial markets, courts must account for this and implement a high standard for the use of § 562(b). Obviously, the statute provides for this to an extent, through the § 562(c) presumption that the market is a reasonable determinant. In keeping with this, the situations in which it can be applied should be limited with strict definitions.

As for ascertaining the presence of a dysfunctional market, it will be useful to take note of two aspects of the Ninth Circuit's energy decisions. Although these aspects were criticized by the Supreme Court, § 562 is distinguishable for two reasons. For one, Congress has contemplated an inquiry into dysfunction. More importantly, no agreements between willing parties are being rescinded. Rather, the court is attempting to determine whether an anomalous outside event has unfairly altered a damage measurement in a way that neither rational party would have anticipated at the time of contracting.

The first important idea that should be borrowed from the Ninth Circuit is that unlawful market manipulation must constitute a dysfunctional market situation.[160] That the valuation of damages under the Code should not be altered through artificial market activity seems intuitively obvious.

The second, potentially more controversial, idea that should be borrowed from the Ninth Circuit's decisions is essentially the basis of that court's decision to allow rescission: an anomalous, short-term change in the price of its assets, albeit one with clearly defined limits. When, on the date from which damages would normally be measured, the market price of the asset is experiencing a short-term, statistically significant spike or dip, the market does not provide a commercially reasonable determinant of value. Note that this definition lends itself to firm boundaries. First, the more volatile the market price is ordinarily, the more extreme the fluctuation must be for § 562 to apply. Secondly, a change that is reflective of a medium-to-long term market adjustment *is* a commercially reasonable measure of value. Market correction cannot be confused with market dysfunction; by the time the issue is presented in court, there will be sufficient post-event data to make an adequate determination. Third, as a further barrier to the invocation of the provision, the court could require evidence of an exogenous event to explain what made the market unreasonably volatile. Strict enforcement of those standards—the presence of which are easily detectable from publicly available information—should be able to effectively police § 562(b). In the event that it is found to apply, the value can be determined by the market price at the close of trading on the first day when the prices have returned to within a range of normal volatility.[161]

The case of a large liquidation is not an easy one to resolve. First, the two disparate causes discussed above

[160] *Pub. Util. Dist. No. 1*, 471 F.3d at 1086.

[161] Basic statistics can be of great assistance to the court in this endeavor. Indeed, market prices of traded derivative prices come with a large base of reliable, long-term data from which to measure, for example, standard deviations.

should be kept conceptually separate. Effects on price connected to an industry-wide downturn are commercially reasonable determinants of value. They accurately reflect a depressed state of demand in the marketplace and should not be subject to § 562(b). On the other hand, effects directly traceable to a single, large-volume liquidation—which by their nature would be short term effects, especially if done "on a single day" as Congress expressed—would, under § 562, render market price commercially unreasonable. Such a situation would be analogous to the short-term price fluctuations used to prove a dysfunctional market, and therefore the commercially reasonable measure of value should be determined as of the earliest date on which short term price depressions, in the midst of rising again, have reached a plateau.

VI. CONCLUSION

The financial contract provisions of the BAPCPA were enacted with a clearly stated aim. This aim, to extend the safe harbors of the Bankruptcy Code in order to protect the financial markets from the systemic risk and uncertainty that Congress believed would result from the bankruptcy of a major counterparty, was largely accomplished by the statute. However, several issues have begun to arise that suggest that Congress did not go far enough. The expansive industry definitions, which were intended to establish industry custom as the predominant tool for interpreting an ambiguous contract, failed to explicitly and unmistakably express that intent. The important expansion of netting agreements failed to include many agreements, such as servicing contracts, that prove to be crucial in maintaining the value of the contract in question. Finally, the inclusion of a provision that would allow courts to alter the timing of damages failed to include all but the most cursory guidance as to when it would come into play, thereby injecting unnecessary uncertainty back into the amendments.

The solutions proposed in this Note are at best imperfect, and certainly incomplete. Nonetheless, heading off the issues at this early stage, both judicially and legislatively,

and avoiding piecemeal solutions in the lower bankruptcy courts, is in line with Congress's hope to eliminate uncertainty and risk. It is hoped that both Congress and the appellate courts will recognize these holes and respond to them adequately.