Emory Bankruptcy Developments Journal

Volume 38 | Issue 1

2022

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Thomas E. Plank

Recommended Citation

Thomas E. Plank, *Custodian or Not: Scrivener's Error in a Bankruptcy Code Safe Harbor*, 38 Emory Bankr. Dev. J. 51 (2022).

Available at: https://scholarlycommons.law.emory.edu/ebdj/vol38/iss1/2

CUSTODIAN OR NOT: SCRIVENER'S ERROR IN A BANKRUPTCY CODE SAFE HARBOR

Thomas E. Plank[*]

ABSTRACT

This Article analyzes a drafting error in the United States Bankruptcy Code that remained latent for 36 years until 2020. This drafting error limits a safe harbor that Congress enacted in 1984 and expanded in 2005 to protect an important segment of the securities and mortgage loan markets.

When a person becomes a debtor in bankruptcy, the Bankruptcy Code imposes an automatic stay on substantially all actions by creditors and other entities against the debtor or the debtor's bankruptcy estate. It also abrogates contractual provisions, known as ipso facto clauses, that otherwise permit a party to terminate a contract because its counterparty filed a bankruptcy petition. In most cases, these rules produce a net benefit. Congress, however, has determined that, because of the nature and importance in the financial markets of certain qualified financial contracts, the costs imposed by these rules outweigh their benefits. In particular, Congress enacted specific safe harbor provisions for "securities contracts," which are contracts for the purchase and sale of securities and mortgage loans. These safe harbors permit a financial institution (a) to liquidate, terminate, or accelerate the securities contract immediately if the counterparty became a debtor in bankruptcy and (b) notwithstanding the automatic stay, to exercise immediately its rights under any security agreement or its rights of set off and netting.

A financial institution as defined includes not only a banking institution or trust company but also includes a customer of a banking institution or trust company that acts as a custodian for the customer. Congress intended to extend the safe harbor to customers who used a banking institution or trust company as a custodian in the ordinary sense of the word—a person holding securities or mortgage loans for another. Unfortunately, the drafters of the safe harbor were

* Joel A. Katz Distinguished Professor of Law, University of Tennessee College of Law. A.B. 1968, Princeton University; J.D. 1974, University of Maryland School of Law. I have benefitted both professionally and financially serving as issuer's counsel, bankruptcy counsel and UCC counsel for sales and securitization of mortgage loans and other consumer and business receivables, first as a partner with Kutak Rock LLP from 1987 to 1994, then as a consultant for law firms, and currently as Of Counsel to Morgan, Lewis & Bockius LLP. The views expressed in this Article are my personal views informed by my practice experience as well as my research and analysis of the issues and are not the views of Morgan Lewis or any other law firm for which I serve or have served as a consultant.

not aware that the Bankruptcy Code had already given the term "custodian" a narrow and misleading definition— a "Humpty-Dumpty definition." As defined, a "custodian" is, in the words of the legislative history, a prepetition liquidator such as an assignee for the benefit of creditors or other receiver or trustee appointed to liquidate the property of a borrower that later becomes a debtor in bankruptcy.

The use of this misleading Humpty-Dumpty definition of a prepetition liquidator in the definition of financial institution produces an absurd result. It nullifies the intended extension of the securities contract safe harbor to a customer that uses a banking institution or trust company as a custodian of the securities or mortgage loans. This use of this misleading defined is a true scrivener's error that permits courts to ignore the plain language of the statute. This Article argues that courts should ignore this misleading definition of "custodian" in the definition of financial institution. Instead, they should give the term "custodian" its commonly understood, ordinary meaning. They can easily add a simple judicial amendment comparable to other Bankruptcy Code definitions that specify the ordinary meaning of a defined term as an exception to an express technical meaning.

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INTRODUCTION

This Article analyzes a drafting error in the definition of "financial institution" in the United States Bankruptcy Code.[1] This drafting error limits the safe harbors that Congress enacted to protect an important segment of the securities and mortgage loan markets.

Under the Bankruptcy Code, a financial institution may immediately terminate a contract for the purchase and sale of securities or mortgage loans—a "securities contract"[2]—if a party to the contract becomes a debtor in bankruptcy.[3] A financial institution may also immediately exercise its rights under any security agreement or its rights of set off and netting, and it is exempt from the bankruptcy trustee's power to avoid prepetition preferential or constructively fraudulent transfers.[4] These advantages arise from specific exemptions in the Bankruptcy Code—safe harbors—from the application of three provisions of the Bankruptcy Code that generally affect non-debtor parties in a transaction: (i) the abrogation of *ipso facto* clauses, which are provisions in a contract or law that permit the termination or modification of rights of a party if that party becomes a debtor in bankruptcy, (ii) the automatic stay of most acts against the debtor and the debtor's bankruptcy estate, and (iii) the bankruptcy

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1 *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Star. 2549 (1978) (codified as amended at 11 U.S.C. §§ 101–1532).

2 *See* 11 U.S.C. § 741(7)(A) (2018).

> "[S]ecurities contract" (A) means–(i) a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, 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 (whether or not such repurchase or reverse repurchase transaction is a "repurchase agreement", as defined in section 101).

Id. Securities contracts also include other agreements and transactions. *Id.* § 741(7)(A)(ii)–(ix). It excludes "any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan." *Id.* § 741(7)(B).

3 *See id.* § 555.

> The exercise of a contractual right of a stockbroker, financial institution, financial participant, or securities clearing agency to cause the 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.

Id.

4 *See infra* Part I.B.

trustee's power to avoid specific prepetition transfers of interests in property by the debtor.[5]

One important type of securities contract is known in the marketplace as a "repurchase agreement." Under a market repurchase agreement, an entity that owns securities or mortgage loans sells the securities or mortgage loans to a buyer for a price and promises to repurchase the securities or mortgage loans at a future date for a repurchase price equal to the initial purchase price plus interest.[6] If the seller becomes a debtor in bankruptcy, a financial institution, whether acting for itself as buyer or pursuant to authorization from the buyer, may immediately liquidate, terminate, or accelerate the securities contract and sell the transferred securities or mortgage loans to third parties or to itself and apply the liquidation proceeds to the repurchase price. The seller is entitled to any surplus from the liquidation and is obligated to pay the buyer any deficiency in recovering the repurchase price. The financial institution is entitled to the benefit of the safe harbors for securities contracts.

A narrower form of market repurchase agreement, defined in the Bankruptcy Code as a "repurchase agreement," also enjoys safe harbors similar to those for securities contracts. The use of the defined term "repurchase agreement" for this narrower type of market repurchase agreement is unfortunate. It creates confusion between what the market considers a repurchase agreement and what the Code defines as a repurchase agreement.[7] Specifically a "repurchase agreement" as defined under the Code is an agreement for the transfer of federal government securities, certain other specific obligations, and mortgage loans, with a simultaneous agreement by the transferee to transfer to the transferor those assets within one year after the transfer or upon demand.[8] To differentiate

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5 *See infra* Part I.A.

6 *See, e.g.*, SEC. INDUS. & FIN. MKT. ASS'N, *Master Repurchase Agreement* 1, ¶ 1 (Sept. 1, 1996), https://www.sifma.org/wp-content/uploads/2017/08/MRA_Agreement.pdf (providing that the "parties hereto may enter into transactions in which one party ('Seller') agrees to transfer to the other ('Buyer') securities or other assets ('Securities') against the transfer of funds by Buyer, with a simultaneous agreement by Buyer to transfer to Seller such Securities at a date certain or on demand, against the transfer of funds by Seller").

7 *See id.* at 11, ¶ 19(a) (expressing intent that each transaction under the agreement is both a "repurchase agreement" as defined in the Bankruptcy Code "except insofar as the type of Securities subject to such Transaction or the term of such Transaction would render such definition inapplicable and a "securities contract").

8 The Code defines repurchase agreement as an agreement:

> 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 . . . 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

this narrower type of repurchase agreement from securities contracts, I will refer to the defined repurchase agreement as a "Code repurchase agreement."

Although encompassing a narrower range of transactions, a Code repurchase agreement has one advantage over a securities contract. Any entity that is a party to a Code repurchase agreement—a "repo participant"—has the benefit of the safe harbors for Code repurchase agreements. Accordingly, the definition of financial institution is not relevant to Code repurchase agreements. Nevertheless, I also discuss the Code repurchase agreement because Congress added the definition of financial institution, extended the safe harbors under securities contracts to financial institutions, and added the full safe harbors for Code repurchase agreements in the same legislation—the Bankruptcy Amendments and Federal Judgeship Act of 1984[9]—for the same reasons.

In 2005, Congress added mortgage loans and interests in mortgage loans to the assets that were entitled to safe harbor treatment under securities contracts[10] and Code repurchase agreements.[11] This addition made sense because of the large size of the market for mortgage loans, which are generally sold at least once and often more frequently. For example, as of December 2005, there were approximately $9.4 trillion of single-family mortgage loans outstanding and $12.1 trillion of total mortgages loans (home, multifamily, commercial and farm) outstanding.[12]

> 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 thereof 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 one year after such transfer or on demand, against the transfer of funds.

11 U.S.C. § 101(47).

9 *See infra* Part II.B. *See generally* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, §§ 421, 441, 461, 463, 469, 98 Stat. 333 (1982 Supp. 2) (codified as amended 11 U.S.C. §§ 101, 362, 546, 548, 555).

10 *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(a)(2), 119 Stat. 173–74 (2005) (codified as amended at 11 U.S.C § 741(7)), *quoted supra* note 2. *See generally* Thomas E. Plank, *Toward a More Efficient Bankruptcy Law: Mortgage Financing Under the 2005 Bankruptcy Amendments*, 31 S. ILL. U. L.J. 641, 659–65 (2007) [hereinafter Plank, *Mortgage Financing Under the 2005 Bankruptcy Amendments*] (describing the application of the safe harbors to mortgage loan financing).

11 *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(a)(1)(C), 119 Stat. 171–72 (2005) (codified as amended at 11 U.S.C § 101(47)).

12 *See* BD. GOVERNORS FED. RSRV. SYS., *Flow of Funds Accounts of the United States: Annual Flows and Outstandings 2005-2009* at 86, tbl. L.217, ll. 1 & 2 (Dec. 9, 2010), https://www.federalreserve.gov/releases/z1/20101209/annuals/a2005-2009.pdf.

This volume was significantly larger than the outstanding balance of marketable U.S. Treasury securities ($4.4 trillion).[13] It was also significantly larger than the outstanding balance of bonds of non-financial corporations ($3.0 trillion) and bonds of domestic financial entities ($4.7 trillion), although a little smaller than the market value of total non-financial corporate equities ($12.7).[14] Further, because of the nature of mortgage loans, that is, loans that amortize over a period of 15 to 30 years, most originators of mortgage loans must sell the mortgage loans to entities, including Fannie Mae (the Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Association), that have access to long term financing. Pending sale of the mortgage loans, however, mortgage loan originators need short term warehouse financing for their originations. Repurchase agreements provide an efficient source of such financing.[15]

As discussed below, without the bankruptcy safe harbors for securities contracts (as well as Code repurchase agreements), a party to a securities contract would become unable to exercise its rights if the counterparty became a debtor in bankruptcy until the party could obtain relief from the bankruptcy court or until the bankruptcy case ended. The purpose for exempting the financial institution's remedies from the abrogation of the *ipso facto* clauses, the automatic stay and most of the bankruptcy trustee's avoidance powers is to protect the operation of the securities and mortgage loans markets.[16]

Sensibly enough, the Bankruptcy Code defines a "financial institution" to include any bank, savings and loan association or federally insured credit union or any trust company (or any receiver for such banking institution or trust company).[17] In addition, the definition provides that when a banking institution or trust company is acting as an agent or custodian for a customer, the customer is also a "financial institution." In using the term "custodian" the drafters undoubtedly meant a custodian in the normal sense of the word: a person that takes custody of assets under a custody arrangement for its customer.[18]

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[13] *See id.* at 80, tbl. L.209, *l.* 3, 82, tbl. L.212, *ll.* 2 & 4, 83, tbl. L.213, *ll.* 2 & 4.

[14] *See* Thomas E. Plank*, Regulation and Reform of the Mortgage Market and the Nature of Mortgage Loans: Lessons from Fannie Mae and Freddie Mac,* 60 SO. CAR. L. REV. 779, 794–99 (2009) (discussing changes in mortgage market during the 1970s and 1980s that led to the savings and loan crisis and the necessity for most originators to sell mortgage loans).

[15] *See* Plank, *Mortgage Financing Under the 2005 Bankruptcy Amendments, supra* note 10, at 665–67.

[16] *See infra* Part II.B (discussing legislative history for the safe harbor amendments).

[17] 11 U.S.C. § 101(22)(A), *quoted infra* note 126.

[18] *See, e.g.*, *Custodian*, BLACK'S LAW DICTIONARY 347 (5th ed. 1979); *see also infra* Part II.B.3 (discussing legislative history on role of custodians in the normal sense).

Unfortunately, the drafters of the amendments that enacted this particular provision were not aware that the Bankruptcy Code already had a very narrow and misleading definition of custodian. A "custodian" as defined in the Bankruptcy Code is essentially an entity, like a receiver or an assignee for the benefit of creditors under state law, that takes possession of some or all of the assets of a person that later becomes a debtor in bankruptcy to liquidate those assets and to distribute the proceeds to some or all of the person's creditors.[19] Congress included this defined term to provide a means of removing those prepetition assets from the prepetition liquidator and bringing them into the bankruptcy estate of the debtor and to address related issues, such as fees of the custodian.

As discussed below, however, applying the defined term "custodian" as a prepetition liquidator in the definition of financial institution, as a bankruptcy court did in 2020,[20] produces an absurd result. Under the provisions for the safe harbors for securities contracts, no person for whom a custodian-liquidator were appointed could ever exercise the safe harbor remedies or receive the benefits of the safe harbors. Applying the defined term "custodian" renders this part of the definition of financial institution meaningless. A true scrivener's error.

This Article will first describe the provisions of the Bankruptcy Code that would apply to repurchase agreements without the safe harbors and then will describe the safe harbor provisions of the Bankruptcy Code for repurchase agreements that are securities contracts. It then discusses the legislative history for both the initial defined term "custodian" and the later addition of safe harbors for financial institutions, including a non-financial institution for which a financial institution acts as custodian. Finally, it analyzes the two drafting mistakes that Congress made.

The first mistake was initially giving the word "custodian" a misleading, Humpty-Dumpty meaning.[21] The second mistake was later using the term in the definition of financial institution in its well-known ordinary sense that had the misleading, Humpty-Dumpty definition (as invariably happens with misleading defined terms). Applying the actual defined term in the definition of financial

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[19] 11 U.S.C. § 101(11), *quoted infra* in text accompany note 61.

[20] *See* Buchwald Capital Advisors, LLC v. Pappa (*In re* Greektown Holdings), 621 B.R. 797 (Bankr. E.D. Mich. 2020). In this case, the bankruptcy court rejected the argument that a non-financial institution was entitled to protection from avoidance of an allegedly constructively fraudulent transfer because the payment was to a financial institution because the financial institution was not a "custodian" as defined in the Code. *Id.* at 837. The court noted that the transferee did not argue that use of the defined term, custodian, was unclear, absurd or ambiguous. *Id.* at 835, 836.

[21] *See infra* notes 67–69 and accompanying text.

institution nullifies the express purpose of extending the safe harbors for securities contracts to non-financial customers who used financial institutions as ordinary custodians for the securities (and later mortgage loans) sold and to be repurchased under the securities contract. Finally, this Article suggests several simple modifications that correct the mistake. Because the mistake produces an absurd result and a judicial amendment can easily fix it, this mistake is a true scrivener's error that justifies ignoring the plain language of the text and applying the judicial amendment to the text.

I. SECURITIES CONTRACTS UNDER THE BANKRUPTCY CODE

A. The Limitations of the Bankruptcy Code

For over 400 years, bankruptcy law has sought to provide a more efficient method of resolving the social and economic problems that arise when a borrower does not have sufficient liquid assets to repay the borrower's unsecured creditors. The United States Bankruptcy Code, enacted in 1978, provides for a generally efficient method by which a borrower may become a "debtor" in bankruptcy[22] for the purpose of liquidating its interests in property—its "bankruptcy estate"[23]—under chapter 7 of the Bankruptcy Code or reorganizing its business affairs and its capital structure under chapter 11 of the Bankruptcy Code. In a chapter 7 liquidation, a third party bankruptcy trustee liquidates the debtor's bankruptcy estate and distributes the proceeds generally pro-rata to unsecured creditors.[24] Under chapter 11, the debtor as the "debtor in possession" has substantially all of the powers and duties of a bankruptcy trustee[25] and may continue to operate its business while it prepares a plan for reorganization of its operations and its capital structure and for payment to the

[22] *See* 11 U.S.C. § 301 (a debtor may seek relief from its creditors by filing a voluntary petition under the Code); *id.* § 303 (a debtor may be subject to an involuntary petition by its creditors); *id.* § 109 (a corporation, limited liability company or other legal person (other than a banking institution or insurance company) that has a domicile, a place of business, or property in the United States may be a debtor in bankruptcy).

[23] *See id.* § 541(a)(1) (providing that the commencement of a case "creates an estate . . . comprised of all legal or equitable interests of the debtor in property as of the commencement of the case."); *see also id.* §§ 541(a)(3), (6), (7) (property of the estate also includes other items, including property recovered by the bankruptcy trustee and property acquired by the estate after the commencement of the case).

[24] *See id.* § 701; *see also id.* § 702; 11 U.S.C. § 704(a)(1) (appointment of trustee); *id.* § 363(b)(1) (trustee power to use or sell property of the estate); *id.* § 725 (liquidation of property of the estate); *id.* § 726(b)–(c) (distribution of proceeds of liquidation).

[25] *Id.* § 1101(1) ("debtor in possession" means debtor or, in the rare instance, an independent trustee that the court may appoint to replace the debtor as debtor in possession); *id.* § 1107(a) (providing that, with certain exceptions, a debtor in possession has all the rights and powers and shall perform all the functions and duties of a bankruptcy trustee); *id.* § 1108 ("Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business.").

creditors, to be approved by most of the creditors and the bankruptcy court.[26] In addition, a debtor may file a chapter 11 petition to liquidate its assets and use the plan for the distribution of the liquidation proceeds.[27]

Automatic Stay. To facilitate the liquidation or reorganization of a debtor in bankruptcy, the Bankruptcy Code imposes limitations on the ability of creditors and others to interfere with the bankruptcy trustee or the bankruptcy estate. One of the most important of these limitations is the automatic stay of substantially all causes of actions and acts against the debtor or the bankruptcy estate to collect debts that arose before the commencement of the bankruptcy case. Specifically, under Section 362(a), the filing of a voluntary or involuntary bankruptcy petition operates as a stay, against all entities, of: (1) the commencement or continuation of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case or to recover a prepetition claim against the debtor; (2) any act to obtain possession of property of the estate or of property from the estate, to exercise control over property of the estate or to create, perfect, or enforce any lien against property of the estate; (3) any act to collect, assess, or recover a prepetition claim against the debtor; and (4) the setoff of any prepetition debt owing to the debtor against any prepetition claim against the debtor.[28]

For most borrowers that become subject to the Bankruptcy Code and for most transactions by those borrowers, the automatic stay makes sense. If a person operating a business that uses assets to generate revenue were to become unable to pay its debts as they come due, it could not easily reorganize under the Bankruptcy Code if secured and unsecured creditors could exercise their rights and cause the assets to be seized and sold to pay the creditors. Also, the exercise of creditor remedies could interfere with an efficient liquidation of the assets. For example, in the case of a secured creditor that is oversecured, that is, it is owed less than the value of the collateral, a foreclosure sale is likely to produce

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[26] *See id.* § 1121(a) (filing a plan); *id.* § 1123 (contents of plan); *id.* §§ 1126(b)(1)–(2) (disclosure and solicitation of approval of plan); *id.* § 1126 (acceptance of plan); *id.* § 1127 (modification of plan); *id.* § 1129 (confirmation of plan)*; id.* § 1141 (effect of confirmation of plan).

[27] The Bankruptcy Code reorganization provisions expressly recognize the use of chapter 11 for liquidation. *See id.* 1141(d)(3)(A) (providing that confirmation of a plan does not discharge a debtor that is not an individual if the plan provides for the liquidation of all or substantially all of the property of the estate); *id.* § 1129(a)(11)–(12) (providing that the court may confirm a plan only if confirmation of the plan is not likely to be followed by the liquidation or the need for further reorganization of the debtor "unless such liquidation or reorganization is proposed in the plan."); *id.* § 1141(d)(3)(A) (providing that confirmation of a plan does not discharge a debtor if "the plan provides for the liquidation of all or substantially all of the property of the estate" and certain conditions are met).

[28] *Id.* §§ 362(a)(1), (3), (4), (6), (7).

less value for the borrower's other creditors than an orderly liquidation by the bankruptcy trustee.

Nevertheless, the limitations on creditors—especially secured creditors—imposed by the automatic stay does impose a cost on creditors. In the case of secured creditors, these costs include the inability to realize on their collateral to obtain payment, the loss of current cash flow on their loans and delays in the ultimate payment of the debt owed to them. Creditors must recoup these costs to remain profitable, and they do so by raising the cost of credit, that is, they increase the interest rate.[29]

Ipso Facto Clauses. Under Section 365, the bankruptcy trustee, including the debtor in possession in a chapter 11 case, may assume or reject the debtor's obligations under executory contracts.[30] As long as the bankruptcy trustee complies with the requirements of this section, a non-debtor party to the executory contract cannot generally prevent assumption of the contract; the non-debtor will continue to be bound by the executory contract and must continue to perform under the contract until it is rejected as long as the bankruptcy trustee continues to perform.[31] Further, the non-debtor party may not terminate or modify an executory contract or the debtor's rights under an executory contract because the debtor becomes a debtor in bankruptcy.

Specifically, Section 365(e)(1) provides:

> Notwithstanding a provision in an executory contract or unexpired lease, or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified, and any right or obligation under such contract or lease may not be terminated or

[29] *See* Thomas E. Plank, *The Security of Securitization and the Future of Security*, 25 CARDOZO L. REV. 1655, 1671 (2004) [hereinafter, Plank, *The Security of Securitization*].

[30] 11 U.S.C. § 365(a) (also providing that the bankruptcy trustee may assume or reject leases). The bankruptcy trustee may also assign executory contracts and leases that it has assumed. *Id.* § 365(f).

[31] This result follows from the express terms of Section 365(a) giving the trustee the power to assume executory contracts, other provisions of Section 365 and the provisions of Section 541(a)(1) and Section 363(c). Generally, in a chapter 7 liquidation, rejection or assumption will occur relatively quickly, *see id.* § 365(d)(1), but in a chapter 11 reorganization, the bankruptcy trustee—the debtor in possession—may assume an executory contract at any time until confirmation of a reorganization plan, *id.* § 365(d)(2). The bankruptcy trustee has this power even if the debtor has been in default if it cures the default or provides assurance of cure of the default. *id.* § 365(b). A debtor's rights under an executory contract become part of property of the estate under *id.* § 541(a)(1) even though those rights are contingent upon the continuing performance of the debtor's obligations under the contract. The bankruptcy trustee—specifically, the debtor in possession—continuing the debtor's business may use property of the estate in the ordinary course of business under *id.* § 363(c)(1). The other party cannot terminate the contract because the debtor filed for bankruptcy under *id.* §§ 363(*l*) and 365(e)(1). Therefore, so long as the debtor in possession continues to perform its obligations under the contract, the other party is obligated to continue its performance.

> modified, at any time after the commencement of the case solely because of a provision in such contract or lease that is conditioned on—
>
> (A) the insolvency or financial condition of the debtor at any time before the closing of the case;
>
> (B) the commencement of a case under [the Bankruptcy Code]; or
>
> (C) the appointment of or taking possession by a trustee in a case under [the Bankruptcy Code] or a custodian before such commencement.[32]

These provisions in Section 365(e)(1) and comparable provisions in other sections[33] are commonly called "*ipso facto* clauses."

The abrogation of *ipso facto* clauses makes sense in most cases. For example, under non-bankruptcy law, if a person is a party to a contract for the purchase or sale of assets or services, and the contract is favorable to the person—that is, the person will receive more under the contract than the cost of performance—the counterparty is bound to continue to perform even though the contract has become unfavorable. For example, under a contract for the sale of widgets at twenty dollars a widget, if the market value of the widgets decreases to fifteen dollars after the contract begins, the seller will receive a contract price that is five dollars more than what it will cost the seller to perform, that is, to sell the widgets. The buyer must pay twenty dollars for the widgets even though they will be worth five dollars less than what the buyer pays.

If the seller becomes a debtor in bankruptcy, the positive value of the contract is an asset that a bankruptcy trustee in a liquidation can sell for the benefit of the debtor's unsecured creditors or the debtor in possession in a reorganization can sell or use as part of its reorganization efforts. Allowing the buyer to terminate or to modify the contract because the seller became a debtor in bankruptcy would permit the buyer to obtain a benefit of getting out of an unfavorable contract that is not available under non-bankruptcy law.

On the other hand, requiring the counterparty to continue to perform its obligations under an executory contract until there is a rejection of the contract imposes costs. The counterparty must continue to incur the costs of being able to perform–e.g., to manufacture shoes to be sold or to arrange standby financing

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32 *Id.* § 365(e)(1).

33 *See id.* § 363(l) (trustee may use, sell, or lease property of the estate notwithstanding the application of any *ipso facto* provisions); *id.* § 541(c)(2) (interests of the debtor become property of the estate notwithstanding the application of any *ipso facto* provisions).

to pay for shoes to be purchased—without knowing whether it will receive full performance or merely a claim against a debtor in bankruptcy.

Also, the rules for calculating damages for rejection of an executory contract give the debtor in possession in a chapter 11 reorganization an option and allows it to play the market to the detriment of the counterparty. If a contract is favorable to the debtor in possession because the cost of performance by the debtor in possession at market value is less than the price that it receives under the contract, the counterparty must continue to perform.[34] The debtor in possession need not assume the contract. If the market value of the performance by the debtor in possession later increases and the contract price to be received by the debtor in possession becomes less than the cost of performance, the debtor in possession will generally reject the contract. If the debtor in possession rejects the contract, the rejection constitutes a breach of the contract as of immediately before the bankruptcy petition.[35]

More significantly, the counterparty's damages for such breach would not be determined as of the date of the rejection, when the counterparty will have incurred actual damages. Instead, the damages would be determined as of the commencement of the case.[36] Because the contract at the commencement of the case was favorable to the debtor in possession and unfavorable to the counterparty, if the counterparty could terminate the contract at the commencement of the case, the counterparty would be relieved from performing a losing contract and would have no damages. Because the counterparty must continue to perform a losing contract, however, if the debtor in possession later rejects the contract when it becomes favorable to the counterparty, the counterparty would not receive any damages.[37]

Avoidance of Preferential or Fraudulent Transfers. A bankruptcy trustee may avoid several different types of transfers of property interests made by a person that later becomes a debtor in bankruptcy.[38] In particular, a bankruptcy

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34 *See supra* notes 31–33 and accompanying text.

35 11 U.S.C. § 365(g) (providing that "the rejection of an executory contract or unexpired lease of the debtor constitutes a breach of such contract or lease (1) if such contract or lease has not been assumed under this section . . . immediately before the date of the filing of the petition").

36 *Id.* § 502(g)(1) (providing that a "claim arising from the rejection . . . of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined, and shall be allowed . . . as if such claim had arisen before the date of the filing of the petition").

37 *See In re* Enron. Corp., 330 B.R. 387, 392 (Bankr. S.D.N.Y. 2005) (denying a claim for rejection of an executory contract to provide electrical power for $6,658,885, which was the amount of damages as of the date of rejection and holding that because the buyer was paying more for the electricity at the commencement of the case, a rejection as of that date would result in no damages).

38 In addition to avoiding preferential or fraudulent transfers discussed in the text, the bankruptcy trustee

trustee may avoid a prepetition transfer to or for the benefit of a creditor within ninety days before the filing of a bankruptcy petition if the transfer enables the creditor to receive more than it would have received from a Chapter 7 liquidation if the transfer had not been made.[39] The typical type of prepetition preferential transfer during the 90 days before the filing of a petition would be the payment in full of a debt owed to an unsecured creditor or the grant of a security interest to a previously unsecured creditor. Without such transfer, the unsecured creditor would almost invariably receive payment of only a portion of the debt from a chapter 7 liquidation. This power is intended to ameliorate the risk that creditors may attempt to opt-out of the collective, pro-rata distribution scheme of liquidation under the Bankruptcy Code.

In addition, a bankruptcy trustee may avoid a constructively fraudulent transfer, which is essentially a prepetition transfer made by an insolvent debtor for less than reasonably equivalent value.[40] In addition, a bankruptcy trustee may avoid a prepetition transfer made with actual intent to hinder, delay, or defraud a creditor.[41] A fraudulent transfer depletes the debtor's prepetition assets without decreasing the debtor's prepetition debts and harms the debtor's other creditors. Because value is defined for purposes of fraudulent transfers to include satisfaction or securing of a present or antecedent debt of the debtor, payment or securing a debt would almost always be reasonably equivalent value and would almost never hinder, delay or defraud other creditors. Accordingly, a prepetition payment or securing of an unsecured debt is generally not avoidable as a fraudulent transfer but could be avoided as a preferential transfer.[42]

B. The Bankruptcy Code Safe Harbors

For most companies and transactions, the benefits from the automatic stay, the abrogation of *ipso facto* clauses and the trustee's avoidance powers appear to outweigh the costs. For some companies and transactions, however, the costs

may avoid unperfected prepetition transfers of property interests and the prepetition fixing of a lien on the debtor's property. 11 U.S.C. §§ 544(a), 545.

39 *Id.* § 547(b)(1)–(5). Section 547(c) contains several exceptions to such avoidance, such as a contemporaneous exchange for new value, transfers in the ordinary course of business, and other transfers. *Id.* 547(c).

40 *See id.* § 548(a)(1)(B). As provided in 11 U.S.C. 548(a)(1), a bankruptcy trustee can also avoid an incurrence of an obligation if it is actually or constructively fraudulent.

41 *Id.* § 548(a)(1)(A).

42 *Id.* § 548(d)(1).

do outweigh the benefits.[43] Specifically, Congress has made this determination[44] for five different types of qualified financial contracts: securities contracts for the purchase and sale of securities and mortgage loans,[45] commodities contracts and forward contracts for the purchase and sale of commodities,[46] Code repurchase agreements, and swap agreements.[47] For these qualified financial contracts, Congress has provided safe harbors from the operation of the automatic say, the abrogation of *ipso facto* clauses, and most of the bankruptcy trustee's avoidance powers.

First, these safe harbor provisions provide that the exercise of a contractual right of qualified counterparties to cause the liquidation, termination, or acceleration of a qualified financial contract pursuant to an *ipso facto* clause "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."[48]

The parties who may exercise a contractual right to liquidate, terminate, or accelerate the agreement pursuant to an *ipso facto* clause varies by the type of qualified financial contract. For a Code repurchase agreement and a swap agreement, any entity that is a party to the agreement may exercise this right.[49]

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[43] In addition to the repurchase transactions described in this Article, the automatic stay on secured creditors that have a security interest in receivables imposes costs on those creditors and therefore on their obligors on the receivables that are, in my view, unnecessary and that are avoided in securitization and structured finance transactions. *See generally* Plank, *The Security of Securitization*, *supra* note 29, at 1660–71; 11 U.S.C. § 365(e)(1).

[44] See *infra* Part II.B.1 & 2.

[45] 11 U.S.C. § 741(7)(A)(i) (defining "securities contract"), *quoted supra* note 2.

[46] *Id.* § 761(4) (defining "commodities contract," which is primarily a specialized contract for the purchase and sale for future delivery of a commodity, the trading of which is regulated under federal or foreign law); *id.* § 101(25) (defining a "forward contract" primarily as a contract (other than a commodity contract) for the purchase and sale of a commodity, as defined in § 761(8), 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, with a maturity date more than two days after the date the contract is entered into"); *see also id.* § 761 (providing all of the definitions of terms describing the particular elements of a commodities contract).

[47] *Id.* § 101(53B) (defining a "swap agreement" by reference to a large number and variety of specific swap agreements, including an interest rate swap, currency swap, weather swap, total return, credit spread or credit swap).

[48] *Id.* § 555 (liquidation, termination, or acceleration of a securities contract, except if the debtor is a stockbroker or securities clearing agency by an order authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission); *id.* § 556 (liquidation, termination, or acceleration of a commodity contract or forward contract); *id.* § 559 (liquidation, termination, or acceleration of a repurchase agreement, except if the debtor is a stockbroker or securities clearing agency by an order authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission); *id.* § 560 (liquidation, termination, or acceleration of a swap agreement).

[49] *Id.* § 559 (liquidation, termination, or acceleration of a repurchase agreement by a repo participant,

For securities contracts, however, the only party that can exercise this contractual right is a "stockbroker, financial institution, financial participant, or securities clearing agency."[50]

Second, the damages arising from termination by the qualified counterparty or rejection by the bankruptcy trustee of the qualified financial contract is determined as of the date of the termination or rejection and not as of the date of the bankruptcy petition.[51] This exception to the Bankruptcy Code provision[52] determining damages for rejection of ordinary executory contracts removes the incentive of the bankruptcy trustee to obtain a benefit from an artificial determination of damages as of the filing of the bankruptcy petition, which could be before the date of the termination or rejection.

Third, several subsections and paragraphs of Section 362 exempt from the automatic stay the rights of qualified counterparties to exercise any contractual right under any related security agreement or to offset or net out any amount due in connection with qualified financial contracts.[53]

Finally, a bankruptcy trustee may not avoid prepetition preferential or constructively fraudulent transfers to financial institutions and other qualified counterparties in connection with a securities contract[54] and to other qualified

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defined as "an entity that, at any time before the filing of the petition, has an outstanding repurchase agreement with the debtor," *see id.* § 101(46)); *id.* § 560 (liquidation, termination, or acceleration of a swap agreement by a swap participant, defined as "an entity that, at any time before the filing of the petition, has an outstanding swap agreement with the debtor," *see id.* § 101(53C)).

[50] *Id.* § 555. For a commodities contract or forward contract, the only party that can exercise this right is a commodity broker, financial participant, or forward contract merchant. *Id.* § 556.

[51] *Id.* § 562(a) (providing that "if the trustee rejects a [qualified financial contract] or if a [qualified counterparty] liquidates, terminates, or accelerates such contract or agreement, damages shall be measured as of the earlier of the date of such rejection or the date or dates of such liquidation, termination, or acceleration").

[52] *See supra* notes 35–37 and accompanying text.

[53] 11 U.S.C. § 362(b)(6) (commodity contract, forward contract, or securities contract); *id.* § 362(b)(7) (repurchase agreement); *id.* § 362(b)(17) (swap agreement); *id.* § 362(b)(27) (master netting agreement); *see also id.* § 362(o) ("The exercise of rights not subject to the stay arising under subsection (a) pursuant to paragraph (6), (7), (17), or (27) of subsection (b) shall not be stayed by any order of a court or administrative agency in any proceeding under [the Bankruptcy Code].").

[54] *Id.* § 546(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 (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, 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 . . .

counterparties in connection with other qualified financial contracts.[55] Repurchase agreements often require sellers to post additional collateral or make interim payments if the value of the securities or mortgage loans transferred under the repurchase agreement declines[56] and to pay the amount of the repurchase price at the required repurchase date.[57] The ability of a bankruptcy trustee for a seller that became a debtor in bankruptcy to undo the settlement of securities or mortgage loan transactions long after they had settled would disrupt the operation of the securities or mortgage loan markets.

II. LEGISLATIVE HISTORY: CUSTODIAN VERSUS FINANCIAL INSTITUTION

The Bankruptcy Code, enacted in 1978, included a defined term "custodian" with a very limited and misleading definition and added several provisions relating to a "custodian." It also contained special provisions for the liquidation of stockbrokers and commodity brokers.[58] It did not, however, include any safe harbors for securities contracts or other qualified financial contracts, except for an exemption from the automatic stay for set off of mutual debts and claims in connection with commodity contracts and other specialized contracts, including options to purchase securities, and an exception from the trustee's avoidance powers for margin payments on commodity contracts or settlement payments by a clearing organization.[59] In 1982, Congress added the current robust safe

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> commodity contract, . . . or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

Id.

55 *Id.* § 546(f) (repo participants in the case of Code repurchase agreements); *id.* § 546(g) (swap participants in the case of swap agreements); *id.* § 546(j) (same limitation for master netting agreement).

56 *See* SEC. INDUS. & FIN. MKT. ASS'N, *Master Repurchase Agreement* 4, ¶ 4 (Sept. 1, 1996), https://www.sifma.org/wp-content/uploads/2017/08/MRA_Agreement.pdf (describing margin payments due).

57 *See id.* at 3, ¶ 2(r) (definition of repurchase price); *id.* at 3, ¶ 3(b) (confirmation of repurchase price for each transaction); *id.* at 7, ¶ 11(b) (payment of repurchase price upon event of default by seller).

58 *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, §§ 741-752, 92 Stat. 2549, 2611–15 (stockbroker liquidation) (codified at 11 U.S.C. §§ 741-751 (1976 Supp. 2)); *see id.* §§ 761-766, 92 Stat. 2549, 2615-21 (commodity broker liquidation) (codified at 11 U.S.C. §§ 761-766 (1976 Supp. 2)); *id.* §§ 101(5) and (39), 92 Stat. 2549, at 2550, 2551 (adding the definitions of stockbroker and commodity broker) (codified at 11 U.S.C. §§ 101(5) and (39) (1976 Supp. 2)); *id.* § 109(d), 92 Stat. 2549, at 2557 (codified at 11 U.S.C. § 109(d) (1976 Supp. 2) (providing that a stockbroker and a commodity broker may not be a debtor under a chapter 11 reorganization).

59 *Id.* § 362(b)(6), 92 Stat. 2549, 2570–72 (exempting from the automatic stay "the setoff of any mutual debt and claim that are commodity futures contracts, forward commodity contracts, leverage transactions, options, warrants, rights to purchase or sell commodity futures contracts or securities, or options to purchase or sell commodities or securities") (codified at 11 U.S.C. § 362(b)(6) (1976 Supp. 2)); *id.* § 764(c), 92 Stat. 2549, 2619 (providing that the trustee may not avoid a prepetition constructively fraudulent or preferential transfer "that is a margin payment to or deposit with a commodity broker or forward contract merchant or is a settlement payment made by a clearing organization") (codified at 11 U.S.C. § 764(c) (1976 Supp. 2)).

harbors for stockbrokers under securities contracts and commodity contracts, and in 1984, Congress extended the robust safe harbors for securities contracts to the newly defined financial institutions, including customers of financial institutions acting as an agent or "custodian" for the customer in connection with securities contracts. In 2005, Congress expanded the safe harbors for repurchase agreements—both securities contracts and Code repurchase agreements—to include repurchase agreements for the sale and repurchase of mortgage loans and interests in mortgage loans.[60]

A. The Definition of Custodian

Like the original Section 101(10) of the Bankruptcy Reform Act, Section 101(11) of the current Bankruptcy Code states:

> The term "custodian" means—
>
> (A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under this title;
> (B) assignee under a general assignment for the benefit of the debtor's creditors; or
> (C) trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors[.][61]

The 1978 Senate and House Reports on the Bankruptcy Reform Act, which enacted the Bankruptcy Code, describe a "custodian" as a "prepetition liquidator" of the debtor's assets for purposes of facilitating the drafting of the Bankruptcy Code:

> Paragraph (10) defines "custodian." There is no similar definition in current law. It is defined to facilitate drafting, and means prepetition liquidator of the debtor's property, such as an assignee for the benefit of creditors, a receiver of the debtor's property, or a liquidator or administrator of the debtor's property. The definition of custodian to include a receiver or trustee is descriptive, and not meant to be limited to court officers with those titles. The definition "is intended to include

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[60] *See supra* notes 10–11 and accompanying text.

[61] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 101(10), 92 Stat. 2549, 2551 (codified at 11 U.S.C. § 101(10) (1976 Supp. 2)). In 1990, subsection (10) was renumbered to subsection (11). Crime Control Act of 1990, Pub. L. No. 101-647, § 2522(e)(3), 104 Stat. 4789, 4865 (1990) (codified at 11 U.S.C. § 101(11) (1986 Supp. 4 and 2018)).

> other officers of the court if their functions are substantially similar to those of a receiver or trustee."[62]

The term "custodian" appears in ten different sections of the current Bankruptcy Code (aside from its appearance in the definition of "financial institution"). The use of the term custodian as a prepetition liquidator shows that the primary purpose of defining a custodian-liquidator was to address assets of a person that had become subject to the prepetition control of a custodian-liquidator if the person later became a debtor in bankruptcy. The custodian-liquidator would have been appointed to liquidate some or all of the prepetition assets of such person outside of the federal bankruptcy regime for the benefit of that person's creditors. If that person becomes a debtor in bankruptcy, in many instances the custodian-liquidators is obligated to turn any remaining assets held for liquidation over to the bankruptcy trustee for inclusion in the debtor's bankruptcy estate.[63] Other provisions of the Bankruptcy Code relate to the custodian-liquidator's prepetition administration of the debtor's former assets[64] or the appointment of a custodian-liquidator as an indicator of the prepetition financial condition of the debtor or as an *ipso facto* event.[65]

The term "custodian" is a poor term for the substance of the definition. The common understanding of a custodian then and now is a person that has custody of assets for any number of reasons. Therefore, a reader would not expect the term to refer to a person whose only purpose is to liquidate another person's assets for the benefit of the person's creditors and whose custody merely supports its role as liquidator. The term simply fails to provide a good sense of

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62 S. REP. NO. 95-989, at 23 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5809; H.R. REP. NO. 95-595, at 310 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6267.

63 11 U.S.C. § 543, *quoted infra* note 143.

64 *See* 11 U.S.C. § 349(b)(1) (dismissal of bankruptcy "reinstates . . . any proceeding or custodianship superseded under section 543"); *id.* § 503(b)(3)(E) (expenses of custodian allowable as administrative expense); *id.* § 542(a)(1) (turnover of property of the estate does not apply to custodian*); id.* § 545(1)(C) bankruptcy trustee's power to avoid fixing statutory liens on a debtor's property, provided that such a lien takes effect against the debtor "when a custodian is appointed or authorized to take or takes possession"); *id.* § 726(b) (priority of certain administrative expenses over expenses of custodian in distribution of property of the estate in a chapter 7 liquidation).

65 *See id.* § 303(h)(2) (appointment of custodian to take charge of substantially all of the property of the debtor within 120 days of filing of involuntary bankruptcy petition as grounds for entering order of relief); *id.* § 363(l) (invalidity of provisions permitting termination or limitation of trustee's rights to use property of the estate because of appointment of custodian); *id.* § 365(b)(2) (bankruptcy trustee not obligated to cure violation of provisions permitting termination or limitation of trustee's rights because of appointment of custodian to assume executory contract); *id.* § 365(e) (invalidity of provisions permitting termination or limitation of trustee's rights under executory contract because of appointment of custodian); *id.* § 541(c)(1) (invalidity of provisions preventing interests of the debtor in property becoming property of the estate because of appointment of custodian).

the actual definition of a prepetition liquidator. A better term would have been the term that was used in the legislative history—prepetition liquidator.[66]

The Bankruptcy Code's use of this misleading defined term violates a fundamental principal of drafting: a defined term should convey a sense of the meaning of the definition.[67] The use of misleading defined terms and their definitions—commonly referred to as "Humpty-Dumpty" definitions[68]–invariably leads both to poor drafting of statutes, regulations and documents and to subsequent failures to apply the defined terms in statutes, regulations and documents in the way intended.[69] Indeed, the use of the term "custodian" in the definition of financial institution illustrates the reasons for avoiding Humpty-

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[66] *See* S. REP. NO. 95-989, at 23 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5809; H.R. REP. NO. 95-595, at 310 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6267 (*quoted supra* in text accompanying note 62).

[67] *See* F. REED DICKERSON, THE FUNDAMENTALS OF LEGAL DRAFTING 17–18, 140–43 (2d. ed., Little, Brown & Co. 1986) (describing in detail the problems caused by using misleading definitions in which the defined term fails to give an indication of the substance of the definition). Others who specialize in legal drafting also provide the same advice. *See* PETER BUTT AND RICHARD CASTLE, MODERN LEGAL DRAFTING: A GUIDE TO USING CLEARER LANGUAGE 155–56 (2d ed., Cambridge Univ. Press 2006) (advising against the use of a "stretched definition," or, "definitions that give a word a meaning beyond what a reader would expect"); GEORGE W. KUNEY AND DONNA C. LOOPER, LEGAL DRAFTING IN A NUTSHELL 384–86 (5th 2021) (advising not to "define a term in a way that is totally at odds with its commonly accepted or dictionary meaning"); ROBERT J. MARTINEAU AND ROBERT J. MARTINEAU, JR., DRAFTING LEGISLATION AND RULES IN PLAIN ENGLISH 121 (2013) (advice to eschew a definition that includes things most people would not think that would be included, such as defining a boat to include an automobile or apple to include an orange); Office of the Parliamentary Counsel, *Drafting Guidance*, §§ 4.1.4, 4.1.5, at 31 (June 2020), https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/892409/OPC_drafting_guidance_June_2020-1.pdf (advising to "[a]void labels that are misleading," instead to try to use "a label that gives the reader some clue as to what it means" but to be careful because a poorly chosen label might affect the meaning in unwanted ways); General Assembly Of Maryland Dep't Of Legislative Reference, Maryland Style Manual For Statutory Law 31 (2018) (stating "Avoid 'Humpty Dumpty' Definitions: Do not define a term to have a meaning that is contrary to what the term normally is understood to mean.").

[68] *See generally* BUTT AND CASTLE, *supra* note 67, at 155–56 (noting that the term "Humpty-Dumptyisms" derived from Lewis Carroll's character's statement, "When *I* use a word, it means just what I choose it to mean— neither more nor less") (citing LEWIS CARROLL, ALICE'S ADVENTURES IN WONDERLAND AND THROUGH THE LOOKING GLASS 127 (Wellington Publishing 1989)); *see* DICKERSON, *supra* note 67, at 17–18, 141–43 (also referencing Humpty Dumpty's statement); *see also* KUNEY AND LOOPER, *supra* note 67, at 384–85 (noting the Lewis Carroll source for the reference to such definitions as "Humpty-Dumpty Definitions").

[69] *See* DICKERSON, *supra* note 67, at 17–18, 141–44 (discussing extensive problems); *see also* KUNEY AND LOOPER, *supra* note 67, at 384–86 (describing some of the pitfalls arising from using such definitions, including the ambiguity arising from the defined term in its conventional sense and forgetting its actual counterintuitive meaning); Thomas E. Plank, *Sacred Cows and Workhorses: The Sale of Accounts and Chattel Paper Under the U.C.C. and the Effects of Violating a Fundamental Drafting Principle*, 26 CONN. L. REV. 397, 406–12 (1994) (describing the internal drafting errors and the subsequent misapplication of Article 9 resulting from the use of misleading defined terms for the sale of accounts and chattel paper under the original Uniform Commercial Code Article 9); Thomas E. Plank, *Assignment of Receivables Under Article 9: Structural Incoherence and Wasteful Filing*, 68 OHIO ST. L.J. 231, 240–47 (2007) (same under 2001 revision of UCC Article 9).

Dumpty definitions. Given the enormity of the revision of the Bankruptcy Act of 1898 as amended,[70] this error is understandable. Nevertheless, as discussed below, it naturally led to problems when the drafters of later amendments to the Bankruptcy Code used the term custodian in its ordinary sense.

B. The Addition of the Safe Harbors for Financial Institutions

Repurchase agreements for securities, which were first used by Federal Reserve Banks in 1917, became economically more important in the securities market beginning in the 1950s, and the volume of repurchase agreements expanded dramatically in the 1970s as a result of rising interest rates and increasing issuance of United States securities.[71] Repurchase agreements helped the Federal Reserve Board implement monetary policy, financed the market making and risk management activities of securities dealers, and allowed banks, mutual funds, non-financial corporations, state and local governments, and governmental agencies to earn money by providing funds to securities dealers and other financial institutions.[72]

Although repurchase agreements have been recognized as financing arrangements, they have been structured as two transactions: a sale of securities and an obligation to repurchase securities. Also, repurchase agreements provided that the buyer could sell the securities immediately if the seller failed to repurchase the securities, the seller otherwise defaulted, or the seller became a debtor in bankruptcy. Before enactment of the safe harbors for repurchase agreements, there was considerable ambiguity about the rights of a buyer under a repurchase agreement if the seller were to become a debtor in bankruptcy.[73]

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[70] *See generally* DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (Princeton Univ. Press 2001) (examining the political history of development of American bankruptcy law in the twentieth century, including the enactment of the Bankruptcy Code of 1978).

[71] *See* Kenneth D. Garbade, *The Evolution of Repo Contracting Conventions in the 1980s,* 12 FED. RES. BANK N.Y. ECON. POL'Y REV. 27, 29–31 (2006); *see* Kenneth C. Kettering, *Securitization and Its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1640 (2008).

[72] *See* Garbade, *supra* note 71, at 29–31*; see also* S. REP. NO. 98-65, at 45 (1983) *reprinted in* 1 BERNARD D. REAMS, JR. & EUGENE M. WYPSKI, BANKRUPTCY REFORM AMENDMENTS: A LEGISLATIVE HISTORY OF THE BANKRUPTCY AMENDMENTS AND FEDERAL JUDGESHIP ACT OF 1984, PUBLIC LAW 98-353, doc. 15, at 45 (1992):

> The repo market serves a crucial function for both parties to the repo transaction. The country's major institutional and fiduciary investors make heavy use of repos. For these investors, including such entities as state and local governments, public and private pension funds, money market and other mutual funds, banks, thrift institutions, and large corporations, repos have become a vital tool of cash management.

[73] *See* Garbade, *supra* note 71, at 34–35; *see also* Kenneth C. Kettering, *supra* note 71, at 1642–43.

1. *The 1982 Legislation: Safe Harbor for Stockbrokers under Securities Contracts*

In light of the structure and the volatility of the securities and commodities markets in the early 1980s, Federal officials involved in the securities market presented to Congress their concerns about the adverse effects on stockbrokers if their counterparties under repurchase agreements became debtors in bankruptcy. There was a similar concern about commodity brokers under commodity contracts. The specific concerns were (i) the ability of a bankruptcy trustee of the counterparty to avoid margin payments (payments to be made by the seller if the value of the securities sold under a repurchase agreement declined in value before the repurchase date) or settlement payments (payments to repurchase securities) and (ii) the effect of the automatic stay preventing stockbrokers from closing out the open accounts of insolvent customers or brokers.[74]

As a result, in 1982, Congress added the following safe harbor provisions to the Bankruptcy Code: a new defined term, "securities contract,"[75] a new Section 555 to permit stockbrokers or securities clearing agencies to liquidate, terminate or accelerate a securities contract if the counterparty became a debtor in bankruptcy,[76] and other safe harbor provisions for stockbrokers and securities

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[74] H.R REP. NO. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583. The purpose of the bill is described as follows:

> The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possible threatening the collapse of the affected market.

H.R REP. NO. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583. The House Report also stated that a subcommittee of the House Committee on the Judiciary received testimony from the Chairman of the Commodity Futures Trading Commission, Commissioner of the Securities and Exchange Commission, general counsel of the Securities Investor Protection Corporation, and representatives of numerous commodities and securities brokers and clearing organizations at hearings on how the Bankruptcy Code affected the commodities and securities trading industries. As a result of those hearings, the bill that became Public Law 97-222 was introduced on November 10, 1981. H.R. REP. NO. 97-420, at 2 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 584.

[75] 11 U.S.C. § 741(7) (1982); *see also* Act of July 27, 1982, Pub. L. No. 97-222, § 8(5), 96 Stat. 235, 237 (codified as amended at 11 U.S.C. § 741 (1982)) (adding a new paragraph (7) defining a "securities contract" to mean a "contract for the purchase, sale, or loan of a security, including an option for the purchase or sale of a security, or the guarantee of any settlement of cash or securities by or to a securities clearing agency."). The definition was amended in 1984 to add the then new defined "financial institution." In 2005, the definition of securities contract was completely rewritten and broadened, but its essence was not changed. *See generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 907(a)(2), 119 Stat. 23, 173–74 (2005) (codified as amended at 11 U.S.C. § 741(7)) (*quoted supra* note 2).

[76] 11 U.S.C. § 555 (1982); *see also* Act of July 27, 1982, Pub. L. No. 97-222, § 6(a), 96 Stat. 235, 236

clearing agencies under a securities contract.[77] The House Report for this legislation stated "[t]he prompt closing out or liquidation of such open accounts freezes the status quo and minimizes the potentially massive losses and chain reactions that could occur if the market were to move sharply in the wrong direction."[78]

2. *The 1984 Legislation: Safe Harbors for Repurchase Agreements and for Financial Institutions under Securities Contracts*

The August 12, 1982, bankruptcy filing by Lombard-Wall, Inc., a government securities dealer,[79] revealed the limitations of the 1982 revisions to the Bankruptcy Code. Lombard-Wall had sold securities pursuant to repurchase agreements to various entities, including banks, non-financial corporations, and state and local governments and governmental agencies. On August 17, 1982, the bankruptcy court announced that it would treat the transfer of securities by Lombard-Wall to its counterparties under repurchase agreements as a grant of a security interest to secure a loan instead of a sale of the securities and issued a temporary restraining order prohibiting liquidation or sale of the securities pursuant to the standard liquidation provisions of the repurchase agreements.[80]

(codified as amended at 11 U.S.C. § 555). The original Section 555 as enacted by Section 6(a) of Pub. L. No. 97-222 states:

> The exercise of a contractual right of a stockbroker or securities clearing agency to cause the liquidation of a securities contract, as defined in section 741(7), 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 (15 U.S.C. 78aaa et seq.) 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.

Id. § 6(a), 96 Stat. 235, 236 (codified at 11 U.S.C. § 555 (1982)). The act added a comparable provision, Section 556, for liquidation, termination or acceleration of commodity contracts. *See id.* § 6(b).

[77] *See id.* § 3(c) (amending Section 362(b)(6) to expand the exemption from the automatic stay for setoffs by stockbrokers or securities clearing agencies under a securities contract); *see also* id. § 4 (adding a new subsection (d) to Section 546 to prevent a bankruptcy trustee from avoiding margin payments or settlement payments to stockbrokers or securities clearing agencies under a securities contract and moving the provisions of Section 764(c)(4) for commodity contracts enacted in 1978 to this subsection).

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

[79] *In re* Lombard-Wall Inc., No. 82-B-11556 (Bankr. S.D.N.Y. Aug. 12, 1982).

[80] *See* Docket, *In re* Lombard-Wall Inc., No. 82-B-11556 (copy on file with author and the Journal) ("Order signed (8/17) Re: that any Creditor Holding Securities of D-I-P, Pursuant to a Repurchase Agreement or Investment Agreement with D-I-P shall not Dispose of such Collateral, as Such Disposal Constitutes a Violation of the Automatic Stay"); *Lombard Securities With Buy-Back Plan Are Frozen by Court*, WALL ST. J., August 18, 1982, at 7; Garbade, *supra* note 71, at 35.

One month later, the court issued a bench ruling in an adversary proceeding, *Lombard-Wall Inc. v. Columbus Bank & Trust Co.* (*In re Lombard-Wall Inc.*),[81] consistent with its August 17 determination, and held that the automatic stay of the Bankruptcy Code prevented the buyer of securities, the Dauphin Deposit Bank and Trust Company, acting as trustee for an issue of Dauphin County Hospital Authority revenue bonds, from liquidating the securities without the approval of the bankruptcy court.[82]

The 1982 amendments to the Bankruptcy Code protected stockbrokers from the bankruptcy risks of its counterparties. These amendments, however, did not protect the counterparties if a stockbroker became a debtor in bankruptcy. The rulings in *Lombard-Wall* were the first to limit the buyer's ability to liquidate the securities subject to a repurchase agreement immediately upon the seller's default or bankruptcy.[83] This ruling had a significant adverse effect on the repo market and the ability of banks, non-financial corporations, mutual funds, and state and local governmental agencies to provide funds to securities brokers.[84]

Partly in response to the Lombard-Wall Inc. bankruptcy, the Federal Reserve Board proposed that Congress enact legislation that would provide a safe harbor to any party to a repurchase agreement for United States treasury securities and specific types of other securities.[85] As a result, in early 1983 Senator Robert Dole

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[81] Docket, *In re* Lombard-Wall Inc., *supra* note 80.

[82] *See In re* Lombard-Wall Inc., *supra* note 79; *see, e.g.*, S. REP. NO. 98-65, at 47 (1983), *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 47 (describing the case). *See generally* S. Hrg. 98-118, *Bankruptcy Reform: Northern Pipeline Co. v. Marathon Pipeline Co. Decision; Consumer Credit Code Amendments; Agricultural Produce Bailment Amendments; Repurchase Agreement Code Amendments; Shopping Center Tenancy Amendments; And Timesharing Agreements Amendments*, *Hearing Before the Subcomm. of the Cts. of the Comm. on the Judiciary,* 98th Cong. 332–33 (1983), *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. 94, at 332–33 (statement Regarding Proposed Repo Amendments of the Bankruptcy Code, attached to statement of Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager For Domestic Operations System Open Market Account) [hereinafter, S. Hrg. 98-118]; *see also* Garbade, *supra* note 71, at 35; Tim Carrington, *Securities in Lombard-Wall Case Termed Loan Collateral by a Bankruptcy Judge*, WALL ST. J., Sept. 20, 1982, at 10, col. 2.

[83] *See* Jeanne L. Schroeder, *Repo Madness: The Characterization of Repurchase Agreements Under the Bankruptcy Code and the U.C.C.*, 46 SYRACUSE L. REV. 999, 1008–11 (1996) (discussing the disastrous effects of the *Lombard-Wall Inc.* decision on the repurchase agreement market and on the Federal Reserve and the financial community); William F. Hagerty, Note, *Lifting the Cloud of Uncertainty Over the Repo Market: Characterization of Repos as Separate Purchases and Sales of Securities*, 37 VAND. L. REV. 401, 409–10 (1984) (stating that *Lombard-Wall Inc.* was the first case to hold that a repurchase agreement was a grant of a security interest to secure a debt).

[84] *See* Garbade, *supra* note 71, at 34–35; Kettering, *supra* note 71, at 1641; *see also supra* notes 74 & 78 and accompanying text (describing committee reports and testimony of witnesses at congressional hearings on the purpose of the safe harbor amendments).

[85] *See* Schroeder, *supra* note 83, at 1010–11. *See generally* S. Hrg. 98-118 at 318-327, *supra* note 82, *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. no 94 at 318–27 (statement of Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager, Domestic Operations System Open

introduced Senate Bill 445 which, in part, provided a safe harbor for a specific kind of repurchase agreement that was defined, confusingly enough, as a "repurchase agreement."[86] Senate Bill 445 also included provisions that broadened the safe harbor provisions for securities contracts by extending those safe harbors to a newly defined "financial institution."[87]

Senate Bill 445 was not enacted, but Congress included its provisions almost verbatim in the Senate and House Bills that resulted in the Bankruptcy Amendments and Federal Judgeship Act of 1984.[88] Title III, Subtitle F, of this Act, the "Amendments Regarding Repurchase Agreements," enacted the safe harbors provisions for the newly defined "repurchase agreements"—what I have referred to as the Code repurchase agreements.[89] Specific provisions of Title III,

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Market Account); Garbade, *supra* note 71, at 36; Letter from Paul Volcker, Chairman, Board of Governors of the Federal Reserve System, to Robert Dole, Chairman, Subcommittee on Courts of the United States Senate Committee on the Judiciary (Sept. 29, 1982), *in* REPURCHASE AGREEMENTS AND REVERSE REPURCHASE AGREEMENTS at 397–98 (Alan S. Dunning and Martin E. Lowy, cochairmen, Commercial Law and Practice Course Handbook Series no. 290, Practicing Law Institute 1982) [hereinafter, PLI REPURCHASE AGREEMENTS].

86 Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong. § 281 (1983). *in* 4 REAMS & WYPSKI, *supra* note 72, doc. No. 74 at 39–43.

87 *Id.* § 311(j) (definition of financial institution); *id.* 336(b)(3)(B) (exemption from automatic stay); *id.* 358(d) (limit on trustee avoidance power); *id.* § 366(a) (qualified counterparty for liquidation, termination and acceleration of securities contract) (1983) *reprinted in* 4 REAMS & WYPSKI, *supra* note 72, doc. No. 74 at 49-50, 59, 88, 96.

88 Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified in various sections of 11 U.S.C. (1982 Supp. 2)).

89 *See* 11 U.S.C. §§ 101(35), (36) (1982 Supp. 2) (adding two new definitions: (1) "repo participant" as a party that has the benefit of the safe harbors under a Code repurchase agreement, and (2) "repurchase agreement"); *id.* § 362(b)(7) (exempting setoff of margin payments and settlement payments under a Code repurchase agreement from the automatic stay); *id.* § 546(f) (exempting transfers of margin payments and settlement payments under a Code repurchase agreement from the trustee's power to avoid constructively fraudulent or preferential transfers); *id.* § 559 (permitting the immediate liquidation, termination or acceleration of a Code repurchase agreement by a repo participant), *as added by* Pub. L. No. 98-353, §§ 392-393, 396, 98 Stat. at 362-66 (1984). Section 101(36) defined "repurchase agreement" to mean:

> any 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 [instruments] with a simultaneous agreement by such transferee to transfer to the transferor thereof [such instruments] as described above, at a date certain within two years after such transfers or on demand, against the transfer of funds.

Id. § 101(36). This definition was substantially the same as that in S. 445 Code except for reduction of the date certain for transfer back to the transfer from two years to one year. Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong. § 281 (1983), *reprinted in* 4 REAMS & WYPSKI, *supra* note 72, doc. No. 74 at 39. This definition is also substantially the same as that in the current Code except for the later addition of mortgage related securities, mortgage loans, interests in mortgage related securities or mortgage loans, and certain qualified foreign government securities. *See* 11 U.S.C. § 101(47)(a)(i). The 1984 Act also broadened the definition of repo participant that had been in S. 445. *See* 11 U.S.C. § 101(35) (1982 Supp. 2).

Subtitle I, Technical Amendments of the Act, extended to the newly defined "financial institution" the safe harbors for repurchase agreements that were securities contracts.[90] The new definition of "financial institution" included the term "custodian":

> "[F]inancial institution" means a person that is a commercial or savings bank, industrial savings bank, savings and loan association, or trust company and, when any such person is acting as agent or *custodian* for a customer in connection with a securities contract, as defined in section 741(7) of this title, such customer[.][91]

The only significant difference between the 1984 legislation and the 1983 Senate Bill 443 was in the definition of "repurchase agreement": the maximum time for a repurchase on a fixed date was shortened from two years in Senate Bill 443 to one year in the 1984 legislation.[92]

3. The Role of a Custodian for Non-Financial Participants

The legislative history for these amendments extending the safe harbors to the parties to Code repurchase agreements and adding financial institutions to the then existing safe harbors for securities contracts demonstrates that the term "custodian" in the definition of "financial institution" was intended to mean not the "prepetition liquidator" embodied in the definition of "custodian" under then Section 101(10) and now Section 101(11), but a financial institution holding securities as a custodian (in the ordinary sense) for a customer.[93]

A primary movant for the addition of the safe harbors for Code repurchase agreements, that is, repurchase agreements for United States securities and certain other securities to be repurchased within one year or on demand, was the Federal Reserve Board. As the Chairman of the Federal Reserve Board stated, the then proposed safe harbors for Code repurchase agreements "has the same

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[90] *See* 11 U.S.C. § 101(19) (1982 Supp. 2) (adding a new definition of "financial institution"), *id.* § 362(b)(6) (adding an exemption from the automatic stay for setoff of margin payments and settlement payments in favor of a financial institution under a securities contract), *id.* § 546(e) (adding the exemption from trustee's power to avoid constructively fraudulent or preferential transfers of margin payments and settlement payments in favor of a financial institution under a securities contract), *id.* § 555 (permitting the immediate liquidation, termination or acceleration of a securities contract by a financial institution), *as added by* Pub. L. No. 98-353, §§ 421(j)(4), 441(b)(2), 461(d), 469, 98 Stat. at 368, 371, 377, 380 (1984).

[91] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421, 98 Stat. 333 (1982 Supp. 2) (codified 11 U.S.C. §§ 101(19) (1982 Supp. 2)) (emphasis added) (providing the same definition as that set forth in in S. 445, with the exception of the addition of "a" before "person").

[92] *Compare id.* § 391, *with* Omnibus Bankruptcy Improvements Act of 1983, S. 445, 98th Cong. § 281 (1983), *reprinted in* 4 REAMS & WYPSKI, *supra* note 72, doc. No. 74 at 39.

[93] *See supra* note 18 (citing the definition of custodian in the 1979 edition of Black's Law Dictionary).

objective [as the safe harbors for the then existing securities contracts, which did not extend to financial institutions] but would take a somewhat different approach. Instead of protecting certain classes of market participants, it would exempt a particular class of transactions—the repo."[94]

The Federal Reserve Board was not a public advocate before Congress for extending the safe harbor for securities contracts to financial institutions, including non-financial customers of a financial institution that acted as agent or custodian. In addition, the committee reports and testimony of witnesses did not include any specific discussion of the extension of the safe harbors for securities contracts to financial institutions or to non-financial institutions for whom a financial institution acted as agent or custodian.[95] Nevertheless, this extension was consistent with the repurchase agreement amendments, the legislative reports and the testimony. Indeed, the congressional reports described the addition of financial institutions (including non-financial customers for which financial institutions acted as agents or custodians) to the safe harbor of Section 555 as a "conforming amendment."[96]

Industry groups as well as the Federal Reserve Board supported the 1983 Senate Bill 445 and the 1984 Senate Bill 5174 that enacted the safe harbors for repurchase agreements and extended the safe harbors to financial institutions under securities contracts.[97] The Senate Report[98] and testimony before Congress[99] also described the non-financial entities as well as the financial

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[94] *See* Letter from Paul Volcker, Chairman, Bd. of Governors of the Fed. Rsrv. Sys. (Sept. 29, 1982), *supra* note 85, *in* PLI REPURCHASE AGREEMENTS at 398.

[95] *See generally* S. REP. NO. 98-65 (1983), *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15; *Bankruptcy Law and Repurchase Agreements: Hearings 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. 72 (May 2, 1984); S. Hrg. 98-118, *supra* note 82, at 332–33, *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. no 94 at 332-33; *Hearing on S. 333, A Bill to Amend Title 11 of the United States Code To Make Certain Changes in the Personal Bankruptcy Law, and for Other Purposes and S. 445, a Bill to Amend Title 11 of the United States Code, and for Other Purposes, before the Subcomm. on the Judiciary*, 98th Cong. 322 (Apr. 6, 1983), *reprinted in* 9 REAMS & WYPSKI, *supra* note 72, doc. No. 96 [hereinafter, S. Hrg. 98-574].

[96] S. REP. NO. 98-65, at 82, *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 82 (sectional analysis of the Technical and Clarifying Amendments for Section 366(a) of the Senate Bill). The Senate Report also described the addition by Section 358(d) of the Senate Bill of financial institution as a protected party in the limitation on the trustee avoidance powers as a "conforming amendment" but described the addition in Section 336(b)(3) of the Senate bill of financial institution to the exemption from the automatic stay as "stylistic changes." S. REP. NO. 98-65 at 76, 81, *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 76, 81.

[97] *See generally* notes 98–99 *infra* and accompany text.

[98] *See* S. REP. NO. 98-65 at 45 , *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 45 (referring to "heavy use" of repurchase agreements by major institutional and fiduciary investors including state and local governments, public and private pension funds, money market and other mutual funds, banks, thrift institutions, and large corporations).

[99] *See* S. Hrg. 98-118 at 340, *supra* note 82, *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. 94, at

institutions that used market repurchase agreements and that were adversely affected by the *Lombard-Wall* ruling. The legislative reports and the testimony of witnesses show that the role of custodians in market repurchase agreements on behalf of both financial and non-financial parties to repurchase agreements was commonplace.

For example, the Senate Report and testimony from an official of the Federal Reserve Bank of New York specifically noted that the repo participants entitled to the safe harbors under Code repurchase agreement would include financial institutions acting on their own behalf or on behalf of customers. Specifically, the Senate Report for Senate Bill 445 stated that the new definition of repo participant is intended to include "an entity acting for its own account or for the account of one or more other entities (whether as custodian, trustee, fiduciary, agent or in any other capacity)."[100]

These statements reflect the market practice for all repurchase agreements, not just Code repurchase agreements. It was understood that not all repurchase agreements would meet the definition of a Code repurchase agreement.[101] If a repurchase agreement required repurchase of the securities more than one year after the sale date, without any provision for repurchase on demand of the seller or the buyer, or if the securities sold under the repurchase agreement were not

340 (statement of Thomas W. Strauss, Chairman, Government and Federal Agency Securities Division, on behalf of the Public Securities Association) (describing the investment of funds in repurchase agreements by institutional investors, including mutual funds, pension funds, state and local governments, commercial banks, thrifts, corporations and other securities dealers for their own account or on behalf of others); *id.* at 333 (statement of Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager, Domestic Operations System Open Market Account) (describing uncertainty regarding the ability of certain investors to exercise remedies under repurchase agreements causing special problems for certain categories of investors, such as public housing authorities, Indian housing authorities, FHA-approved mortgagees for multifamily projects and municipal governments).

[100] S. REP. NO. 98-65, at 69, *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 69 (sectional analysis of the Repurchase Agreement). This sentence in the report is identical to the proposed section by section analysis of the definition submitted by Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager for Domestic Operations System Open Market Account at the hearings before the Senate Committee of the Judiciary on Senate Bill 445. *See* S. Hrg. 98-118, *supra* note 82, at 321–22, *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. no 94 at 321-22 (statement of Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager, Domestic Operations System Open Market Account).

[101] The reference to a "repo" in Paul Volcker's September 29, 1982, letter to Senator Dole requesting congressional action to provide a safe harbor for repurchase agreements is ambiguous. In the first part of his letter, he describes the repo as a contract for the sale and repurchase of "various kinds of securities, including U.S. government and agency securities, banker's acceptances, and CDs." Letter from Paul Volcker, Chairman, Board of Governors of the Federal Reserve System (Sept. 29, 1982), *supra* note 85, *in* PLI REPURCHASE AGREEMENTS at 397. The proposed legislation, however, addressed only repos of U.S. government and agency securities, banker's acceptances, and CDs. Letter from Paul Volcker, *supra, at* 398.

United State Treasury securities or the other securities specified in the definition of a Code repurchase agreement, the repurchase agreement would still be a securities contract.[102] Extending the safe harbors for securities contracts to financial institutions and to non-financial institution customers for whom financial institutions were acting as agent or custodian is consistent with the purpose of creating the safe harbor for Code repurchase agreements and with the legislative history noted above that such an extension was a conforming amendment.

One example of the use by state and local governments and governmental agencies of repurchase agreements in the early 1980s as a means of investing available cash were tax exempt bonds issued by the Community Development Administration of Maryland (the "CDA") to finance multi-family and single family housing for low and moderate income families.[103] The bonds were secured primarily by mortgage loans to developers of multi-family housing or by single family mortgage loans to first time home buyers. Pending distribution of the initial proceeds from the sale of the bonds and of collections on the mortgage loans securing the bonds, the bonds were also secured by the deposit of those proceeds and collections into a variety of reserve funds held by the indenture trustee for the bonds. Before and after the commencement of the Lombard-Wall Inc. bankruptcy case on August 12, 1982, the CDA issued three series of multi-family bonds in 1982 and three series of single family bonds in 1980 and 1982[104]

Under the governing documents for the multi-family bonds, the indenture trustee was directed to invest funds credited to the reserve funds in "Permitted Investments." Permitted Investments included repurchase agreements for the

102 *See* text accompanying notes 2–8 *supra*, contrasting the difference between a repurchase agreement that is a securities contract, which has no limits on the specific types of securities or times for repurchase, and a repurchase agreement that qualifies as a Code repurchase agreement, which is limited to specific categories of securities and to a repurchase within one year or on demand.

103 *See* MD. CODE ANN., Art. 41, § 266DD-6 (1981) (current version at MD. HOUS. & CMTY. DEV. CODE §§ 245-52 (2021)). I was an assistant attorney general of Maryland and the Counsel to the Maryland Department of Economic and Community Development, of which the CDA was a division, from July 1982 through December 1984, and I issued legal opinions on behalf of the Maryland Attorney General on the legality of the issuance of CDA bonds under the CDA authorizing legislation.

104 The CDA issued $32,335,000 Multi-Family Housing Revenue Bonds 1982 Series A on May 1, 1982, $16,510,000 1982 Series B Bonds on July 15, 1982, and $66,741,5000 1982 Series C Bonds on September 14, 1982, and $100,000,000 Single Family Program Bonds 1980 Series A on April 1, 1980, $42,200,000 1980 Series B Bonds on July 1, 1980, and $87,513,7000 1982 First Series Bonds on October 1, 1982. *See* Official Statement, Community Development Administration Multi-Family Housing Revenue Bonds (Insured Mortgage Loans), 1983 Series A, at 16 (Jan. 1, 1983) (copy on file with author and the Journal) [hereinafter Multi-Family Official Statement].

sale and repurchase of securities held by a "fiduciary" that would not have been qualifying securities for a Code repurchase agreement under the original 1984 Bankruptcy Code definition and the current definition of a Code repurchase agreement. Nevertheless, these securities would be qualifying securities for a securities contract under the original 1982 Bankruptcy Code definition and the current definition.[105]

The governing documents for the single-family program bonds provided for the investment of funds in "Investment Obligations" similar to those for the multi-family bonds. However, under the single-family program, the indenture trustee could invest only in repurchase agreements for the sale and repurchase of obligations of or guaranteed by the United States and obligations of a variety of U.S. governmental entities.[106] These repurchase agreements would have qualified as Code repurchase agreements under the original and current definition in the Bankruptcy Code. Pursuant to this authority under both indentures, the CDA used repurchase agreements for the investment of tens of millions of dollars of funds to be credited to the reserve funds for both the multi-family bonds and the single-family bonds.[107]

As discussed above, the commencement of the *Lombard-Wall Inc.* bankruptcy case prevented the counterparties' immediate liquidation and

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[105] These bonds were issued pursuant to a Resolution Providing for the Issuance of Multi-Family Housing Revenue Bond Program adopted by the CDA on May 1, 1982 (copy on file with the author and the Journal) [hereinafter, Multi-Family Resolution]. Under the Multi-Family Resolution "Permitted Investments" consisted of: (1) obligations of or guaranteed by the United States; (2) obligations of a variety of U.S. governmental entities; (3) public housing bonds of public agencies or municipalities secured by contracts with the United States government; (4) certificates of deposits issued by banks that met certain credit criteria; (5) notes issued by a bank-holding company having a rating of AAA or AA from the two leading rating agencies, Standard and Poor's and Moody's Investors Service; and (6) "contracts for the purchase and sale of obligations described" in the preceding clauses 1–6 that, with certain exceptions, are delivered to and held by a fiduciary during the term of the contracts. Multi-Family Resolution, *supra*, at 8–9; Multi-Family Official Statement, *supra* note 104, at 18. The obligations described in clauses (3) and (5) would not be eligible securities for a Code repurchase agreement under the original 1984 definition or the current definition. *See supra* note 89 (quoting the original definition of repurchase agreement and discussing subsequent amendments) and *supra* note 75 (quoting original definition of securities contract added in 1982 and subsequent amendments) and *supra* note 2 (quoting current definition of securities contract).

[106] *See* Official Statement, Community Development Administration Single Family Program Bonds, 1982 First Series Dated October 1, 1982, at 8–9 (definition of Investment Obligations) (copy on file with the author and the Journal) [hereinafter, Singly Family Official Statement]; CDA Single Family Program General Bond Certificate Dated May 1, 1980, at 8–9 (copy on file with the author and the Journal).

[107] As of June 30, 1982, the CDA had invested $22,818,547 of the $32,335,000 Multi-Family Bonds 1982 Series A issued in May 1982 in repurchase agreements pending the lending of these funds to multi-family developers. *See* Multi-Family Official Statement, *supra* note 104, at D-3. In addition, the CDA had invested, respectively, $12,776,429 and $6,722,403, as of June 30, 1981, and 1982, in repurchase agreements securing in part approximately $148,000,000 single family bonds then outstanding. *See* Single Family Official Statement, *supra* note 106, at C3.

termination of repurchase agreements with Lombard-Wall. The affected repurchase agreements included those entered into with the CDA. Fortunately, the CDA obtained quick relief from the automatic stay to liquidate the underlying securities sold by Lombard-Wall and held by the indenture trustee on behalf of the CDA and its bond holders.[108] Many other financial institutions, governmental units, and non-financial business entities that had entered into repurchase agreements with Lombard-Wall which had taken possession of the underlying securities directly or through a custodian or trustee also sought and obtained relief from the automatic stay.[109]

When Congress was deliberating on the 1983 and 1984 safe harbor legislation, most securities, other than United States securities, were certificated securities, that is, securities evidenced by a printed certificate.[110] Applicable state law permitted buyers to perfect their interests in certificated securities sold pursuant to market repurchase agreements by taking possession, either directly or through custodians (in the ordinary sense of the term).[111] For United States

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[108] *See* Docket, *In re* Lombard-Wall Inc., *supra* note 80 (referencing Community Development Administration adv. proc. No 82-60002-A, filed Aug. 18, 1982, closed Aug. 26, 1982).

[109] *See id.* (referencing proceedings seeking or obtaining relief from the automatic stay by numerous non-financial businesses, state and local governmental agencies, and banks, trust companies, and savings associations, including banking institutions and trust companies acting on behalf of governmental agencies).

[110] It has always been understood that a certificated security is evidenced by a "certificate," that is, a writing, and current Article 8 defines it as such. U.C.C. § 8-102(a)(4) (AM. L. INST. & UNIF. L. COMM'N 1994). Before 1977, all securities were certificated. U.C.C. § 8-102(1)(1) (AM. L. INT. & UNIF. L. COMM'N 1962) (superseded 1977) (defining a security as an "instrument"). The 1977 revision of Article 8 added provisions for uncertificated securities issued by issuers and evidenced by entry on the books and records of the issuer and a new defined term of "certificated security. U.C.C. § 8-102(1)(1) (AM. L. INT. & UNIF. L. COMM'N 1977) (superseded 1994) (defining a "certificated security" as a security evidenced by an instrument). As of 1982, the 1977 revisions to Article 8 had been adopted in New York and a several other states. *See* Harold S. Novikoff & Mitchell R. Julius, *Repurchase Agreements and Reverse Repurchase Agreements under Articles 8 and 9 of the Uniform Commercial Code*, *in* PLI REPURCHASE AGREEMENTS, *supra* note 85, at 79, 90–96.

Before the adoption of this definition in 1994, the definitions of "security" or "certificated security" were not helpful. Before 1994, the 1962 Official Text and the 1972 Official Text of Article 9, adopted in 1972 and revised in 1977, defined an instrument as (i) a "negotiable instrument" under Article 3, which is evidenced by a writing, (ii) either a "security" as defined in the 1962 version and the 1972 version of Article 8 before 1977 or a "certificated security" as defined in the 1977 version of Article 8, or (iii) other writing that met certain criteria. U.C.C. § 9-105(g) (AM. L. INST. & UNIF. L. COMM'N 1962) (superseded 2001); U.C.C. § 9-105(g) (AM. L. INST. & UNIF. L. COMM'N 1972) (superseded 2001); U.C.C. § 9-105(i) (AM. L. INST. & UNIF. L. COMM'N 1977) (superseded 2001). Hence, as to the physical nature of a certificated security, these earlier definitions were not definitions at all.

[111] *See* U.C.C. § 9-305 (Am. L. Int. & Unif. L. Comm'n 1962) (providing that a security interest in an instrument, which includes a security, may be perfected by possession and also stating "If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest") (revised in 1972 to add money and revised in 1977 to exclude "certificated securities"); U.C.C. § 8-313(1)(a) (Am. L. Int. & Unif. L. Comm'n 1977) (superseded 1994) (providing that "transfer of a security or a limited interest (including a security interest) therein to a purchaser occurs only (a) at the time he or a person designated by him acquires possession of a

securities issued in book entry form, federal regulations first promulgated in 1973 provided for perfection of an interest in such securities by a procedure that was deemed to be the equivalent of possession of physical securities.[112] As discussed below, the benefit and costs of buyers taking possession to protect their interests and the risks if they did not do so were known.

In one form of repurchase agreement, the seller delivered the securities to the buyer or the buyer's custodian. In this form of transaction, the buyer could easily liquidate the securities if the seller defaulted. However, because most securities other than United States securities were certificated securities, delivery of possession of the securities could be problematic because of the cost of and the time constraints for delivering physical possession.[113]

In another form of repurchase agreement, the seller retained possession directly or through its custodian and notified the buyer that it had segregated the securities. This arrangement facilitated transactions because there was no deliver of the physical securities. However, if the seller failed to maintain the securities as promised, the buyer would have no ability to liquidate the securities if the

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certificated security"); U.C.C. § 8-321(2) & (3) (providing that a security interest in a certificated security is perfected upon transfer as defined in Section 8-313(1)) (Am. L. Int. & Unif. L. Comm'n 1977) (superseded 1994)*; see also* Harold S. Novikoff & Mitchell R. Julius, *Repurchase Agreements and Reverse Repurchase Agreements under Articles 8 and 9 of the Uniform Commercial Code*, *in* PLI REPURCHASE AGREEMENTS, *supra* note 85, at 79, 90–95, 102–07 (discussing the provisions of the 1972 revision of Article 9 and the 1977 revision of Article 8 then in effect in New York and a few other states—which moved such provisions from Article 9 to Article 8—for perfection of a secured party's security interest in certificated securities by possession by bailee or agent).

112 The book entry regulations for United States securities in effect in 1984 specifically referred to financial institutions acting as a custodian for customers for purposes of perfecting a security interest in book entry securities:

> Where transferable Treasury securities are recorded on the books of a depositary (a bank, banking institution, financial firm, or similar party, which regularly accepts in the course of its business Treasury securities **as a custodial service for customers**, and maintains accounts in the names of such customers reflecting ownership of or interest in such securities) for account of the pledgor or transferor thereof and such securities are on deposit with a Reserve bank in a book-entry account hereunder, such depositary shall, for purposes of perfecting a pledge of such securities or effecting delivery of such securities to a purchaser under applicable provisions of law, be the bailee to which notification of the pledge of the securities may be given or the third person in possession from which acknowledgment of the holding of the securities for the purchaser may be obtained.

31 C.F.R. § 306.118(b) (1984) (first promulgated 38 Fed. Reg. 7078 (Mar. 15, 1973)) (emphasis added); *see also* Harold S. Novikoff & Mitchell R. Julius, *Repurchase Agreements and Reverse Repurchase Agreements under Articles 8 and 9 of the Uniform Commercial Code*, *in* PLI REPURCHASE AGREEMENTS, *supra* note 85, at 79, 113–14 (1985) (discussing the provisions of the federal book-entry regulations for U.S. government securities permitting pledge of book-entry securities recorded on the books of an entity which performs a custodial service for customers, citing 31 C.F.R. 306.118 and 31 C.F.R. 350(a)(3) in effect at that time).

113 *See generally* Garbade, *supra* note 71*, at* 37–39.

seller were to default and would often be left with an unsecured claim against the seller.[114]

A third form, the tri-party repurchase agreement developed in the 1970s by the investment banking firm of Salomon Brothers, struck a happy medium between the two positions. In a tri-party repurchase agreement among the seller, the buyer, and a bank acting as agent or custodian for both the seller and buyer (often the seller's clearing bank), the seller of the securities delivered securities to the bank and the buyer delivered funds to the bank. The bank would hold the securities as custodian for the buyer by crediting the seller's securities to the buyer's account and would credit the buyer's funds to the seller's account or pay them to the seller. Accordingly, the buyer had possession of the purchased securities through the bank as its custodian. Upon repurchase by the seller, the seller would deliver the repurchase price to the bank, which would credit the funds to the buyer's account or pay them to the buyer. The bank would simultaneously transfer the purchased securities from the buyer's account to the seller's account or transfer them to the seller. If the seller failed to repurchase the securities or otherwise defaulted, the bank would, upon instructions from the buyer, liquidate the securities and pay the amounts due to the buyer out of the liquidation proceeds.[115]

The committee reports and the hearings discussed the significance of buyers under market repurchase agreements taking possession or control of the related securities either directly or through a custodian. For example, in 1984 Peter D. Sternlight, executive vice president, Federal Reserve Bank of New York, submitted answers to the questions of the Chairman of the House Committee of the Judiciary about lax practices in the repurchase agreement market and the

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[114] *See id.* at 37–39; *see also In re* Beville, 67 B.R. 557, 571 (D.N.J. 1986). In *In re Beville*, two affiliated securities dealers became subject to insolvency proceedings under the Bankruptcy Code and the Securities Investor Protection Act, and the trustees for the dealers sought to characterize a large number of repurchase agreements as secured transactions and claim ownership of the securities sold under the repurchase agreements. The district court held that the repurchase agreements effected sales and not secured transactions but also held that securities held in the dealers' clearing accounts had not been delivered under applicable state law and left open the issue of whether the purchasers of these securities were unsecured creditors in the insolvency proceedings. *In re* Beville*,* 67 B.R. 557, 609–12, 616, 619 (D.N.J. 1986).

[115] *See* Garbade, *supra* note 71, at 38–39; *In re* Beville, 67 B.R. 557, 571 (D.N.J. 1986). The court briefly described tri-party repurchase agreements in which "the purchased securities are delivered by the dealer to the clearing firm which acts as an agent for both participants and maintains an account for the dealer and an account for the repo participant," relying on the report of Clifford H. Goldman, Executive Vice President of Lehman Government Securities, Inc., describing, among other things, the mechanics of repo transactions and custodial arrangements for the safekeeping of securities involved in such transactions. *In re* Beville, 67 B.R. 557, 571 (D.N.J. 1986).

likelihood that extending the safe harbors to repurchase agreements would encourage the continuation of these practices:

> Unfortunately, some participants in the repo market have not yet gotten the message about the basic elements for prudent participation in that market . . . . Many of these participants neglected the cardinal rule that investors in repos should arrange for their own custodian to take delivery of the securities they are acquiring and not merely leave it to the seller to say that some securities have been earmarked somewhere for the investor.[116]

The custodian in this statement refers to a person taking possession of securities for the benefit of a buyer under a repurchase agreement, that is, a custodian in the ordinary sense and not in the limited sense of the defined term of custodian as prepetition liquidator. The other limited uses of the term custodian in the Senate and House Reports and testimony of witness relating to the amendments adding safe harbors for Code repurchase agreements used the term in the same sense.[117]

Ironically, the Bankruptcy Amendments and Federal Judgeship Act of 1984, which enacted the safe harbors for Code repurchase agreements and the extension of the safe harbor for securities contracts to financial institutions, also revised Section 543 of the Bankruptcy Code governing the requirements for custodian-liquidators to turnover to the bankruptcy trustee property interests held by the custodian-liquidator.[118] At a hearing before the Senate Committee on the Judiciary on April 6, 1983, Professor Frank R. Kennedy submitted his views and commented on the views of Professor Vern Countryman criticizing the amendment included in Senate Bill 455, the predecessor to the safe harbor provisions of the 1984 Act.[119] Unlike the witnesses supporting the expansion of

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116 *See Bankruptcy Law and Repurchase Agreements: Hearing Before the Subcomm. On Monopolies and Commercial Law, of the H. Com. On the Judiciary*, 98th Cong. 108–09 (1984) (letter of Peter D. Sternlight, Executive Vice President, Federal Reserve Bank of New York and Manager, Domestic Operations System Open Market Account) (responding to concerns that the expansion of the safe harbors might encourage the continuation of such lax practices, the letter also noted: "With respect to some elements of good practice, such as an investor taking delivery of the securities bought under repos, the need for care is no less with or without exemption from the automatic stay.").

117 *See* S. REP. NO. 98-65 at 69, *reprinted in* 1 REAMS & WYPSKI, *supra* note 72, doc. 15, at 69 (describing a repo participant to include an entity acting "for the account of one or more other entities (whether as custodian, trustee, fiduciary, agent or in any other capacity"); S. Hrg. 98-118, *supra* note 82, at 321, *reprinted in* 8 REAMS & WYPSKI, *supra* note 72, doc. no 94 at 321 (statement of Peter D. Sternlight, Executive Vice President Federal Reserve Bank of New York and Manager, Domestic Operations System Open Market Account).

118 *See* 11 U.S.C. § 543(d).

119 *See* S. Hrg. 98-574, *supra* note 95, at 322, *reprinted in* 9 REAMS & WYPSKI, *supra* note 72, doc. no. 96 at 329 (statement of Frank R. Kennedy, Professor, University of Michigan School of Law).

the safe harbors for Code repurchase agreements and securities contracts, these professors had participated in the initial revision of the Bankruptcy Act of 1898 that culminated in the initial Bankruptcy Code of 1978.[120] They presented no testimony on the expansion of the safe harbors. Also, this hearing did not include testimony from any witnesses concerning the extension of the safe harbors that were also part of Senate Bill 445 and that were enacted by the 1984 Act.

This legislative history shows that the drafters of the definition of financial institution almost certainly meant the term "custodian" to have its ordinary meaning. Such legislative history, however, would not in my view be sufficient grounds to ignore the plain language of the statute unless the plain language of the statute produces a result that is absurd or meaningless. As discussed in the next Part, the use of the term custodian in the definition of financial institution is just such a case.

III. PLAIN LANGUAGE AND SCRIVENER'S ERROR: A CUSTODIAN IS NOT ALWAYS A CUSTODIAN

I favor a textualist approach to statutory interpretation that relies on the language of the statute.[121] There is, however, an exception. A court may depart from the plain language of the statute if the plain language of the statute produces an absurdity in light of the rest of the language of the statute that results from a mistake in the drafting that can be readily fixed.[122] Such mistake is known as the "scrivener's error."[123] Another rule of interpretation is a presumption that a particular term in a statute has the same meaning everywhere it appears.[124] This presumption, however, is rebuttable because "drafters more than rarely used the

[120] Professor Kennedy was the Executive Director of the Commission on the Bankruptcy Laws of the United States, which submitted a report and draft bill that formed the basis for the Bankruptcy Reform Act of 1978 that enacted the Bankruptcy Code. *See* S. Hrg. 98-574, *supra* note 95, at 322, *reprinted in* 9 REAMS & WYPSKI, *supra* note 72, doc. no. 96 at 322 (statement of Professor Frank R. Kennedy). Professors Kennedy and Countryman were members of a committee of the National Bankruptcy Conference that had submitted a report that became part of the Report of the House Judiciary Committee for the bill that became the Bankruptcy Reform Act of 1978. *See* H. REP. NO. 95-595, *supra* note 62, at 219 (1978).

[121] *See* ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 56-58 (2012) (summarizing the "Supremacy-of-Text Principle" that "[t]he words of a governing text are of paramount concern, and what they convey, in their context, is what the text means"). In this section, the authors state that purpose is part of the context, but the purpose must be derived from the text and described as concretely as possible, and the purpose cannot be used to contradict or supplement the text, "except in the rare case of an obvious scrivener's error." *Id.* at 56–57.

[122] *Id.* at 234–39 (summarizing the "Absurdity Doctrine[:] A provision may be either disregarded or judicially corrected as an error (when the correction is textually simple) if failing to do so would result in a disposition that no reasonable person could approve.").

[123] *Id*. at 234.

[124] *Id.* at 170.

same word to denote different concepts."[125] A scrivener's error would rebut the presumption.

Congress included the word "custodian" in the Bankruptcy Code's definition of "financial institution" only for purposes of extending to financial institutions the safe harbors for securities contracts. Interpreting the word "custodian" in the definition of "financial institution" by giving it the meaning of the Humpty-Dumpty defined term "custodian" produces an absurdity that is apparent from the language of the Bankruptcy Code provisions governing both custodians as prepetition liquidators and the safe harbors for financial institutions under securities contracts. A detailed analysis of the definitions of custodian and financial institution and their uses in the Bankruptcy Code shows the absurdity.

The definition of "financial institution" in Section 101(22) first lists a series of institutions that are essentially banking institutions and trust companies or their receivers.[126] The definition then states that, when any such entity "is acting as **agent** or **custodian** for **a customer** (whether or not a 'customer', as defined in section 741) in connection with a **securities contract** (as defined in section 741)[,]" financial institution also means such customer.[127]

The three terms "agent," "custodian," and "customer" all have well understood common meanings. The term "agent" is not defined in the Bankruptcy Code and its ordinary meaning would normally control.[128]

Although the term "customer" in this definition means a customer in the ordinary sense of "someone who buys goods or services,"[129] at the time of

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125 *See id.* at 170–72 (describing the presumption of consistent use, noting the critics of the presumption, but stating that the presumption makes sense when used pragmatically).

126 11 U.S.C. § 101(22)(A):

> The term "financial institution" means (A) a Federal reserve bank, or an entity 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 (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer.

Id.

127 *Id.*

128 *See* RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. L. INST. 2006) ("Agency is the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests assent or otherwise consents so to act."); Deutsche Bank Trust Co. Ams. v. Large Private Ben. Owners (*In re* Trib. Co. Fraudulent Convey. Litig.), 946 F.3d 66, 79 (2d Cir. 2019) (citing RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. L. INST. 2006) and applying common-law meaning to the term "agent").

129 Deutsche Bank Trust Co. Ams. v. Large Private Ben. Owners, *supra* note 128, at 79.

enactment of the initial version of this definition in 1984, the Bankruptcy Code also included a specialized definition of "customer." This definition, now in Section 741 of the Bankruptcy Code, in the subtitle governing the liquidation of stockbrokers, provided that the term "customer" included a customer of a stockbroker.[130] At that time, applying this meaning of "customer" to the definition of financial institution would not make sense. Banking institutions are not stockbrokers.[131] Trust companies would not normally be stockbrokers. If they could be stockbrokers, and the definition of customer were limited to trust companies that were stockbrokers, then the extension of safe harbors to non-financial institutions for which a financial institution acts as agent or custodian would be extremely limited.

The definition of customer in Section 741 uses the term "included" instead of "means."[132] Therefore, it is reasonable to conclude that Congress did not mean to limit this term just to customers of stockholders. Still, this drafting history illustrates the greater likelihood of scrivener's errors in later amendments to a comprehensive regulatory scheme like the Bankruptcy Code that address a particular, narrow set of problems. In 2006, Congress fixed this problem by amending the definition of financial institution to add immediately after "customer" the phrase "(whether or not 'customer', as defined in section 741)."[133] This amendment confirmed the common definition of customer of a financial institution.

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[130] 11 U.S.C. § 741(2).

> "[C]ustomer" includes—
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> (A) entity with whom a person deals as principal or agent and that has a claim against such person on account of a security received, acquired, or held by such person in the ordinary course of such person's business as a stockbroker, from or for the securities account or accounts of such entity—(i) for safekeeping; (ii) with a view to sale; (iii) to cover a consummated sale; (iv) pursuant to a purchase; (v) as collateral under a security agreement; or (vi) for the purpose of effecting registration of transfer; and
>
> (B) entity that has a claim against a person arising out of—(i) a sale or conversion of a security received, acquired, or held as specified in subparagraph (A) of this paragraph; or (ii) a deposit of cash, a security, or other property with such person for the purpose of purchasing or selling a security.

Id.

[131] Except for certain trust companies, the banking institutions referenced in the definition of "financial institution" are not subject to the Bankruptcy Code, and therefore the provisions for stockbroker liquidation would not apply. *See id*. §§ 109(b)(2)–(3)(A). *See generally* Jonathan R. Macey, *The Business of Banking: Before and After Gramm-Leach-Bliley*, 25 J. CORP. L. 691, 709–13 (2000).

[132] 11 U.S.C. § 741(2).

[133] Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5(a)(1)(A)(ii), 120 Stat. 2692, 2695 (codified as amended at 11 U.S.C. § 101(22)(A)(1)) (*quoted supra* note 126).

A. *The Absurdity from Applying the Definition of Custodian to Financial Institutions*

In contrast with the initial reference to agent and the revised reference to customer in their ordinary meanings, the term "custodian" was defined in 1978 to mean a prepetition liquidator for the benefit of creditors of a person that later became a debtor in bankruptcy.[134] The specific purpose for this definition is apparent from the language of the Bankruptcy Code as well as its legislative history. In 1984, Congress added the definition of financial institution to the Bankruptcy Code for a different, specific purpose. This purpose is expressed in the language of the amendments: to extend the safe harbor for securities contracts beyond stockbrokers to (i) banking institutions and trust companies and (ii) entities that were not banking institutions or trust companies if they used banking institutions or trust companies as agents or custodians in connection with a securities contract. Contrasting the provisions of the Bankruptcy Code defining the term "custodian" to mean a prepetition liquidator with the provisions extending safe harbors to financial institutions shows that Congress could not have intended the term "custodian" in the definition of financial institution to mean a prepetition liquidator.

A custodian as defined means a prepetition liquidator that obtains custody and control of some or all the interests in property of a person that later becomes a debtor in bankruptcy for the limited purpose of effecting a pre-bankruptcy liquidation of those property interests for the benefit of some or all of that person's creditors.[135]

A common form of prepetition liquidator included in the definition of custodian is an assignee pursuant to a general assignment for the benefit of creditors, a common form of state insolvency resolution law that predates the introduction of the Bankruptcy Act of 1898[136] but is still used under the Bankruptcy Code.[137] Under such a general assignment, a person that owes debts makes an assignment of all of the person's interests in property to an assignee

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[134] 11 U.S.C. § 101(11), *quoted supra* in text accompany note 61.

[135] *See supra* text accompanying notes 61–62 (quoting the definition and the legislative report on the meaning and purpose of the definition).

[136] Melanie Rovner Cohen & Joanna L. Challacombe, *Assignment for the Benefit of Creditors—A Contemporary Alternative for Corporations*, 2 DEPAUL BUS. L.J. 269, 269–70 (1990).

[137] *See* N.Y. DEBT. & CRED. LAW §§ 1–24 (McKinney 2021) (general assignment for the benefit of creditors); Rovner Cohen & Challacombe, *supra* note 136; David S. Kupetz, *Assignment for the Benefit of Creditors: Exit Vehicle of Choice for Many Dot-Com, Technology, and Other Troubled Enterprises*, 11 J. BANKR. L. & PRAC. 71, 72 (2001); Robert Richards & Nancy Ross, *Practical Issues in Assignment for the Benefit of Creditors*, 17 AM. BANKR. INST. L. REV. 5, 5–7 (2009).

that takes complete possession and control of the assignor's property interests and liquidates them for the benefit of the assignor's creditors.[138] Another prepetition liquidator included in the definition of custodian is a receiver that is directed to obtain possession or control of either specific property interests[139] or as much of the property interests of a person that owes debts for the benefit of specific creditors to enforce a lien on or a judgment relating to those property interests.[140]

Once a prepetition liquidator takes possession of or control over the property interests of the assignor or obligor, the assignor or obligor no longer retains any interest in or control over the property interests held by the prepetition liquidator other than the right to any potential surplus remaining after payment of the relevant creditors.[141] If the assignor or obligor later becomes a debtor under the Bankruptcy Code, Section 543 provides that a custodian-liquidator may be required to transfer those property interests to the bankruptcy trustee (which would include the debtor in possession in a Chapter 11 reorganization case)[142] for inclusion in the debtor's bankruptcy estate.[143]

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[138] N.Y. DEBT. & CRED. LAW §§ 3–4, 12–15, 19 (McKinney 2021); Rovner Cohen & Challacombe, *supra* note 136, at 270; Kupetz, *supra* note 137, at 73; Richards & Ross, *supra* note 137, at 5–7.

[139] *See, e.g.,* N.Y. C.P.L.R. 5106 (MCKINNEY 2018) (court appointment of a receiver of property subject of an action in order to enforce a judgment or to dispose of the property). *See generally* GRANT NELSON ET AL., REAL ESTATE FINANCE LAW §§ 4.33–4.42 at 221–47 (6th ed. 2015).

[140] *See, e.g.,* N.Y. C.P.L.R. 5228 (MCKINNEY 2018) (appointment of receiver to administer, collect, or sell any real or personal property in which a judgment creditor has an interest to satisfy a judgment in favor of a judgment creditor). *See generally* DAN B. DOBBS & CAPRICE L. ROBERTS, LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION 134 (3d ed. 2018).

[141] *See supra* notes 135–139 and accompanying text.

[142] 11 U.S.C. § 1107(a) (providing that, with certain exceptions, a debtor in possession has all the rights and powers and shall perform all the functions and duties of a bankruptcy trustee).

[143] *Id.* § 543(a)–(d).

> (a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.
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> (b) A custodian shall—
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> (1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and (2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian.
>
> (c) The court, after notice and a hearing, shall—(1) protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property; (2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian; and (3) surcharge such custodian,

The definition of the property of the estate under Section 541 of the Bankruptcy Code necessitates Section 543. Under Section 541(a)(1), the property of the estate consists of all of the interests of the debtor in property as of the commencement of the case.[144] If a custodian-liquidator had taken possession or control over the property of a person before that person becomes a debtor in bankruptcy, the interests in property held by the liquidator-custodian would not be property interests of the debtor as of the commencement of the case. Accordingly, those property interests would not be included in the property of the estate under Section 541(a)(1) when the person becomes a debtor in bankruptcy.[145] Instead, consistent with the primary definition of property of the estate in Section 541(a)(1), Section 541(a)(3) of the Bankruptcy Code provides that property of the estate includes property recovered by the bankruptcy trustee from a custodian-liquidator under Section 543.[146] The committee reports for the initial Bankruptcy Code also stated that Section 543 was intended to bring into property of the estate property interests formerly owned by the debtor but held by the custodian-liquidator.[147] In addition, the Bankruptcy Code provided for the

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> other than an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, for any improper or excessive disbursement, other than a disbursement that has been made in accordance with applicable law or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the commencement of the case under this title.
>
> (d) After notice and hearing, the bankruptcy court (1) may excuse compliance with subsection (a), (b), or (c) of this section if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property, and (2) shall excuse compliance with subsections (a) and (b)(1) of this section if the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.

Id.

144 *Id.* § 541(a)(1).

145 *See generally* Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L. REV. 1193, 1193–95 (1998) (noting that because the Bankruptcy Code adopts the legal understanding of "property" not as the property item but the interests in the property item, resolving the claims and rights of a debtor, the creditors, and third parties in bankruptcy requires a rigorous analysis of the specific interests of the debtor in property, including (1) distinguishing between the property item and the different property interest interests in the property item and (2) identifying the scope and substance of the property interests).

146 11 U.S.C. § 541(a)(3) (providing that property of the estate also includes "[a]ny interest in property that the trustee recovers under section . . . 543 . . . of this title").

147 S. REP. NO. 95-989 at 84–85 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5870–71; H. REP. NO. 95-595 at 370 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6326. The Senate report described Section 543:

> This section requires a custodian appointed before the bankruptcy case to deliver to the trustee and to account for property that has come into his possession, custody, or control as a custodian. "Property of the debtor" in section (a) includes property that was property of the debtor at the time the custodian took the property, but the title to which passed to the custodian.

payment of the custodian's fees and included other provisions related to the initial appointment of the custodian.

Because of the consequences of the appointment of a custodian-liquidator for some or all of the debtor's prepetition assets, applying the defined term for custodian as prepetition liquidator in the definition of financial institution makes no sense and serves no purpose. Applying this definition of custodian-liquidator would negate the extension of the safe harbor for securities contracts to non-financial entities that use a banking institution or trust company as an ordinary custodian.

Recall the three safe harbors for financial institutions under a repurchase agreement that is a securities contract. Under Section 555, a financial institution may immediately exercise its contractual rights to liquidate, terminate, or accelerate a securities contract if the counterparty became a debtor in bankruptcy.[148] Under Section 362(a)(6), a financial institution may exercise its contractual right under any security agreement or its set off or netting rights related to a security contract notwithstanding the automatic stay.[149] Under Section 546(e), the bankruptcy trustee may not avoid most prepetition transfers to the financial institution.[150]

The most common form of a repurchase agreement that is a securities contract is a contract by which the seller sells securities or mortgage loans to a buyer for a purchase price and promises to repurchase the securities or mortgage loans for a repurchase price.[151] The safe harbors protect the buyer or the seller of the securities or mortgage loans if the other party becomes a debtor in bankruptcy. As a practical matter, however, because the buyer is parting with its funds and obtaining the securities or mortgage loans against a promise of the seller to repurchase, the buyer will insist on the benefits of the safe harbors. Nevertheless, if the buyer defaults by initiating insolvency proceedings, a financial institution that is the seller will also be entitled to the benefits of the safe harbors.

S. REP. NO. 95-989 at 84–85 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5870–71.

148 11 U.S.C. § 555, *discussed supra Part I.B.*

149 *Id.* § 362(b)(6), *discussed supra Part I.B.*

150 *Id.* § 546(e), *discussed supra Part I.B.*

151 *See supra* notes 6–7 and accompanying text (describing the provisions of the SEC. INDUS. & FIN. MKT. ASS'N, *Master Repurchase Agreement* (Sept. 1, 1996) 1, ¶ 1, https://www.sifma.org/wp-content/uploads/2017/08/MRA_Agreement.pdf.

A party to a securities contract retains rights with respect to the securities contract and the related securities or mortgage loans.[152] Therefore, a non-financial buyer that qualifies as a deemed financial institution because an actual financial institution acts as its agent or ordinary custodian may exercise those rights permitted by Sections 555 or 362(b)(6) or receive those transfers under Section 546(e) without risk of avoidance. However, if the term "custodian" in the definition of financial institution means the defined custodian-liquidator, then the non-financial buyer, even if it were to qualify as a "customer" of the custodian-liquidator (a separate and questionable proposition), will not have the benefit of any of these safe harbors.

A review of all of the potential applications of safe the harbors provisions to a repurchase agreement that is a securities contract will illustrate this point. To begin, assume that on Day 1 two non-financial entities that are eligible to be debtors in bankruptcy enter into a repurchase agreement for the sale and repurchase of securities or mortgage loans. Until one of the parties becomes a debtor in bankruptcy, the safe harbors have no relevance. If one party does become a debtor in bankruptcy, the other party will not be entitled to the safe harbors for securities contracts if that party is not the customer of a financial institution acting as agent or custodian. The non-debtor party will not be able to liquidate, terminate or accelerate the repurchase agreement, to exercise any rights under a security agreement without relief from the automatic stay or to receive protection from avoidance of any pre-petition transfers to it.

The following discussion will first address the variety of results if one of the parties to the repurchase agreement, entered into on Day 1, makes a general assignment for the benefit of creditors to an assignee that is a banking institution or trust company, that is, an actual financial institution. To simplify the discussion, I will assume that the buyer makes the general assignment. The following analysis would be substantially the same if we reversed the roles.

Initial Scenario – General Assignment. Assume that on Day 30, the buyer makes the general assignment. The general assignment would vest in the assignee (an actual financial institution) all of the rights that the buyer had under the repurchase agreement. A general assignment would normally be an event of

[152] A party to a contract has both the right to performance by the counterparty and the right to remedies for breach of the contract as well as the obligation to perform its promises under the contract. A market repurchase agreement will give (a) the seller rights under the contract, including the right to repurchase the transferred assets and remedies for breach of the seller's obligations, and (b) the buyer the rights to the transferred assets and remedies for breach of the seller's obligations. *See, e.g.*, SEC. INDUS. & FIN. MKT. ASS'N, *Master Repurchase Agreement* (Sept. 1, 1996) 3–4, https://www.sifma.org/wp-content/uploads/2017/08/MRA_Agreement.pdf.

default under the repurchase agreement,[153] and the seller as the counterparty would normally have the right under non-bankruptcy law to terminate the repurchase agreement immediately and exercise its remedies. Such remedies would include demanding return of the relevant securities or mortgage loans or damages.[154] The seller would be required to look primarily to the assignee for the benefit of creditors to recover the relevant assets or damages and not to the buyer. No safe harbors are involved.

First Variation. Assume that the seller did not terminate the repurchase agreement after the buyer's general assignment on Day 30 but instead became a debtor in bankruptcy on Day 60. At that point, if the buyer would be considered a "customer" of the "custodian" as defined in the Bankruptcy Code, that is, the assignee under the general assignment, the buyer would become a financial institution that would be entitled to terminate the repurchase agreement under Section 555, to exercise any rights under a security agreement or any set off rights in connection with the repurchase agreement under Section 362(a)(6), and to receive protection from avoidance of transfers made to the buyer after the general assignment on Day 30 under 546(e).

However, because of the assignment for the benefit of creditors, the buyer would no longer have any rights under the repurchase agreement or any related security agreement, including a right to terminate, or any right to receive the repurchase price for the relevant securities or mortgage loans, and it would not be entitled to any payments made by the seller after the assignment. Those rights had been assigned to the assignee.

Hence, deeming the non-financial customer as buyer to be a financial institution because of the appointment of a financial institution as a defined custodian-liquidator renders this part of the definition a meaningless absurdity, a nullity. The buyer will never be able to use or to obtain the benefits of the safe harbors to terminate the securities contract, to liquidate the related securities or mortgage loans, to obtain the repurchase price, or to receive protection from an avoidance action. Deeming the buyer to be a financial institution because an actual financial institution became an assignee for the benefit of creditors—a custodian-liquidator—has no effect. The result would be the same if no clause were added to the definition of "financial institution" deeming a non-financial

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[153] *See id.* at 7–9, ¶ 11 (providing that an "Act of Insolvency with respect to Seller or Buyer" is one of the "Events of Default"); *id.* at 1, ¶ 2(a) (defining an "Act of Insolvency" with respect to any party to include "the making by such party of a general assignment for the benefit of creditors").

[154] *See id.* at 7–9, ¶ 11 (providing for remedies for one party after another party commits an event of default).

customer to be a financial institution if an actual financial institution were acting as a custodian for the non-financial customer.

Second Variation. Assume that, instead of becoming a debtor after the general assignment by the buyer, the seller became a debtor in bankruptcy on Day 15 before the general assignment by the buyer. The buyer is not at this time a deemed financial institution and is not entitled to the safe harbors. When the buyer makes a general assignment on Day 30, it becomes a deemed financial institution if the assignee is the custodian. As discussed above, however, the buyer will not have any right to the benefit of the safe harbors. Those rights belong to the assignee. Again, deeming the buyer to be a financial institution because an actual financial institution became an assignee for the benefit of creditors—a custodian-liquidator—is a nullity. It has no effect.

Third Variation—Custodian-Liquidator for Less Than All of Property. Assume that the custodian-liquidator obtains custody of only a portion of the buyer's property interests. This example presents two alternative situations. Under the first alternative, the custodian-liquidator liquidator does not obtain custody of the buyer's rights under the repurchase agreement or the securities or mortgage loans sold under the repurchase agreement. In this case, the safe harbors are not available to the buyer. If the rights under the securities contract or the related purchased securities, mortgage loans or cash are not included in the custodial liquidation, the safe harbor would not apply. For a non-financial entity to be deemed a financial institution, a financial institution must act as "custodian for a customer . . . in connection with a securities contract."[155] If a financial institution is appointed as a receiver, say, to take possession and control of mortgaged property owned by the buyer but subject to foreclosure or some other action, the appointment of the financial institution as a defined custodian-liquidator would not confer on the buyer the status of a deemed financial institution because the actual financial institution is acting as custodian in connection with the mortgaged real estate and not as custodian in connection the securities contract.

Alternatively, if a financial institution as receiver could be appointed to take charge of the buyer's rights under the repurchase agreement, then the analysis described in the first and second variations applies. The buyer would have no ability to exercise its rights or receive any protection under the repurchase agreement. The custodian-liquidator would hold those rights. The custodian may exercise those rights and receive those protections because it is an actual

[155] 11 U.S.C. § 101(22)(A), *quoted supra* note 126.

financial institution. Again, defining custodian to mean a custodian-liquidator makes the safe harbors unavailable to the non-financial buyer to the repurchase agreement. In either case, the language in the definition of financial institution deeming the buyer to be a financial institution because an actual financial institution became a receiver or other custodian-liquidator for part of the seller's property interests is a nullity. It has no effect.

Fourth Variation—Custodian Entering into a Repurchase Agreement. If person makes a general assignment for the benefit of creditors on Day 0, it is unlikely as a practical matter that the person would be able to enter into a repurchase agreement as a buyer or seller after that date. Having assigned all of its property interests to the assignee, it should not have any funds by which it could purchase securities as a buyer or any securities to sell as a seller.

More importantly, even if that assignor could enter into a repurchase agreement as a buyer or a seller after the general assignment to an assignee that was a financial institution, and the counterparty later became a debtor in bankruptcy, the rights of the buyer or seller under the repurchase agreement or the assets transferred—securities or mortgage loans to the buyer or funds to the seller—would not be included in the assets under the control of the custodian-liquidator. Therefore, the status of the assignee as a financial institution and defined custodian-liquidator would not make the buyer a financial institution. In this case, the financial institution would not be acting as the custodian-liquidator in connection with the repurchase agreement entered into after the general assignment.

Similarly, if the custodian-liquidator took possession or control of only a portion of the buyer's or seller's property interests—say, mortgaged real estate—before either buyer or seller entered into a repurchase agreement, the same analysis applies. The custodian-liquidator of that mortgaged property would not be acting as custodian under the repurchase agreement.

Finally, if the terms of the appointment of the relevant custodian-liquidator, whether as an assignee for the benefit of creditors or a receiver of less than all of the obligor's property interests, provided that after acquired property interests of the assignor or the obligor became subject to the possession or control of the custodian-liquidator, then the results described under the First through Third Variations would apply. There is no instance in which the portion of the definition of "financial institution" making a non-financial customer of an actual financial institution a deemed financial institution if the actual financial institution became a custodian-liquidator has any effect. This part of the definition is a nullity.

B. *An Easy Fix*

The use of the defined term "custodian" in the definition of "financial institution" is a drafting error that produces an absurd interpretation. There are several easy fixes that qualify this drafting error as a true scrivener's error. One fix would be to modify judicially the definition of "custodian" in Section 101(11) to exclude its application to the definition of "financial institution." This approach is used, for example, in Section 101(20) ("The term "farmer" means (except when such term appears in the term "family farmer") . . . .), Section 101(35)(B) ("The term 'insured depository institution' . . . (B) includes an insured credit union (except in the case of paragraphs (21B) and (33)(A) of this subsection"); and Section 101(52) ("The term 'State' includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title").

The other fix is to modify the term custodian in the definition of financial institution in Section 101(22)(A) by adding immediately after the word "custodian" the phrase "whether or not a "custodian", as defined in section 101(11)."[156] This approach appears in the definition of financial institution in the case of the term "customer".

CONCLUSION

The conflict between the general understanding of the meaning of the term "custodian" in the definition of financial institution as an entity that took possession and control of property for another and the specific definition of a custodian as a prepetition liquidator of a debtor's former assets has been around since 1984. This conflict first became public in the latter part of 2020.[157] Before this time, parties had structured repurchase agreements that are securities contracts with non-financial institutions by having a banking institution or trust company act as a custodian. In doing so, they have relied on the ordinary meaning of custodian. This reliance illustrates the problems that follow from a statute in which a term that has a well-known, ordinary meaning is given an

[156] In Buchwald Capital Advisors, LLC v. Pappa, *discussed supra* note 20, after noting that the transferee did not argue that the use of the defined term, custodian, was unclear, absurd or ambiguous, the court noted that the plaintiff argued that Congress could have used this technique to make clear that the custodian in the definition of financial institution in Section 101(22)(A) was not the term defined in Section 101(11) of the Bankruptcy Code, as it had done with the term customer. Buchwald Capital Advisors, LLC v. *Pappa (In re Greektown Holdings),* 621 B.R. 797, 836 (Bankr. E.D. Mich. 2020).

[157] *See id*. at 797, *discussed supra* note 20.

unusual or misleading definition. Both drafters and readers of statutes often are not aware of the unusual meaning of the defined term.

Courts should not lightly disregard the language of the statute as enacted nor look outside of the statute for interpretative guidance except in the case of real ambiguity. Nevertheless, courts should correct drafting errors when the resulting application of the statute as written contradicts the plain purpose of the statute as demonstrated by the language of the statute. A custodian under the definition of financial institution in Section 101(22)(A) of the Bankruptcy Code is not a custodian in Section 101(11). Unless or until Congress corrects this scrivener's error, courts should give the word custodian in the definition of financial institution its ordinary meaning.