Proposed Bankruptcy Chapter would End Government Bailouts

Financial institutions deemed "too big to fail" may have a new avenue to eliminate debts and get square with creditors under a proposed amendment to the U.S. Bankruptcy Code.

A new bill proposed by Rep. Spencer Bachus (R-AL), called the Consumer Protection and Regulatory Enhancement Act, would create a Chapter 14 of the laws governing bankruptcy in the United States. It would allow non-bank financial institutions to restructure their debts without inflicting chaos into the financial markets.

The bill comes in response to a year of government bailout and interventions to prop up struggling firms such as Bear Stearns and AIG.

Inconsistent practices, such as the failure of Lehman Brothers, helped spur the failure of some business, while hope for government help may have contributed to the downfall of others, according to a top Congressional aide.

Daniel Flores, chief Republican counsel for the House committee that would oversee bankruptcy law, defended the bill at the American Bankruptcy Institute's 2009 Legal Symposium in Washington, D.C., according to Reuters.

"There are companies that are too big to fail and those companies need to be treated specially," Flores said, calling the proposed Chapter 14 a "simple but effective set of reforms to help us handle the bankruptcies of large, interconnected firms."

The new bankruptcy chapter would create an oversight board that would bring together struggling firms and their creditors to address complex financial issues before a bankruptcy filing, such as whether third-party derivative contracts could be a part of the filing.

Currently, derivative contracts are excluded from the bankruptcy process, leaving them as liabilities even after firms file.

"No one trusts the bankruptcy bar and the courts. That's the problem. We don't need to abandon bankruptcy, we need to abandon government intervention that can seem inconsistent and panicky," Flores said.

"When Humpty Dumpty falls off the wall, it's going to be on their dime, not the taxpayers."

If signed into law, the bill, which is currently before a House committee, would become the first amendment to the U.S. bankruptcy code since the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. The act, known as BAPCPA, also created a new Chapter 15 bankruptcy to deal with international corporations who file bankruptcy, either in the U.S. or abroad.