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**A Transfer Made in Connection with a Securities Contract May Not Be Avoided Under
Section 546(e) of the Bankruptcy Code**

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Introduction

Under title 11 of the United States Code (the “Bankruptcy Code”), a bankruptcy trustee has the power to avoid, or claw back, certain transfers of property made before a bankruptcy filing. A trustee may avoid transfers such as those that are preferential under section 547 and fraudulent transfers under section 548.¹ Section 546(e) of the Bankruptcy Code generally provides that a transfer made by, to, or for the benefit of a commodity broker, stockbroker, financial institution, or securities clearing agency in connection with a securities contract cannot be avoided.² In 2018, the Supreme Court clarified the scope of the section 546(e) safe harbor and held that the relevant transfer to consider is the overarching transfer between the end parties, and not transfers made between financial institutions that are mere intermediaries.³

This article discusses the requirement that a payment must be made “in connection with” a securities contract for it to not be avoidable under the Bankruptcy Code. The kinds of transactions addressed are examples of transactions that have been disputed and the cases

¹ See 11 U.S.C. §§ 547, 548 (2018).

² See *id.* § 546(e).

³ See *Merit Mgmt. Grp. v. FTI Consulting, Inc.*, 138 S.Ct. 883, 888 (2018).

illustrate the approach courts take to determine whether the section 546(e) safe harbor applies. Part One discusses the definitions in the Bankruptcy Code that courts rely on when adjudicating cases involving the safe harbor provision. Part Two emphasizes that courts generally only apply the safe harbor where there is an exchange that is made to complete a securities contract. Part Three highlights that a court will not protect a transfer made that is only tangentially related to a securities contract and not a part of the deal itself.

Discussion

I. The Bankruptcy Code’s Broad Definition of “Security,” “Securities Contract,” and “Transfer”

When determining whether a transfer is made in connection with a securities contract, courts rely on the definitions set out in the Bankruptcy Code.⁴ The Bankruptcy Code defines “security” using a comprehensive list of items including notes, stocks, treasury stocks, bonds, and “other claim[s] or interest[s] commonly known as ‘security.’”⁵ The Bankruptcy Code defines “securities contract” with a list of transactions including a contract for the purchase, sale, or loan of a security or group of securities, or an option to buy, sell, or repurchase securities.⁶ The definition of securities contract also includes any agreement or transaction that is similar to or is a combination of any agreement or transaction listed in the definition.⁷

The Bankruptcy Code defines “transfer” broadly to include the creation of a lien, the retention of title as a security interest, the foreclosure of a debtor’s equity of redemption, or any

⁴ See, e.g., *In re Qimonda Richmond, LLC*, 467 B.R. 318, 322 (Bankr. D. Del. 2012).

⁵ 11 U.S.C. § 101(49)(A).

⁶ *Id.* § 741(7)(A)(i).

⁷ *Id.* § 741(7)(A)(vii)–(viii).

parting with property.⁸ Courts have held that transactions such as payments to retire debt, loan distributions, and dividend payments are all transfers under the Bankruptcy Code.⁹

II. Courts Apply the Safe Harbor Where There is an Exchange of Money Made for the Purpose of Completing a Securities Transaction

Transfers are made in connection with a securities contract even if the title of securities does not change hands and the transfer is simply made to retire debt.¹⁰ In *Enron Creditors Recovery Corp.*, Enron paid to retire some of its commercial paper, a security under the Bankruptcy Code, prior to maturity.¹¹ After Enron filed for bankruptcy, a trustee was appointed to pursue claims on behalf of the Enron estate.¹² The trustee sued to recover the payments made to retire the commercial paper.¹³ In response, the defendants argued that the payments could not be recovered because the redemption of commercial paper was a securities transaction that involved the delivery and receipt of funds and securities.¹⁴ Enron, however, argued that a transfer of title was a necessary part of a securities settlement under section 546(e).¹⁵ The court explained that there is no basis to exclude the redemption of debt securities and that Enron's payment "completed a transaction in securities."¹⁶ The court noted, "we find little support for the contention that a securities transaction necessarily involves a purchase or sale."¹⁷ Because there is no purchase or sale requirement in the statute and the transfer completed a securities transaction, the transfer was protected by the safe harbor.¹⁸

⁸ *Id.* § 101(54).

⁹ *See Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329, 335 (2d Cir. 2011); *In re Tops Holding II Corp.*, 646 B.R. 617, 682 (Bankr. S.D.N.Y. 2022); *Crescent Res. Litig. Tr. ex rel. Bensimon v. Energy Corp.*, 500 B.R. 464, 476 (W.D. Tex. 2013).

¹⁰ *See Enron Creditors Recovery Corp.*, 651 F.3d at 335.

¹¹ *Id.* at 331.

¹² *See id.* at 332.

¹³ *Id.*

¹⁴ *Id.* at 333.

¹⁵ *See id.* at 332.

¹⁶ *Id.* at 336.

¹⁷ *Id.* at 337.

¹⁸ *Id.* at 339.

Payments made to investors which are not actually used to purchase securities may still be protected by section 546(e) if the agreements fall under the Bankruptcy Code's broad definition of "securities contract."¹⁹ In the *Madoff* case, the United States Court of Appeals for the Second Circuit explained that "securities contract" includes contracts for the purchase or sale of securities, as well as any agreements that are similar or related to contracts for the purchase or sale of securities.²⁰ The court also explained that the "in connection" to a securities contract under section 546(e) is not dependent on a stockbroker's performance of that contract.²¹ The court cited to the definition under 11 U.S.C. § 741 which includes "a master agreement that provides for an agreement or transaction"²² Further, the court explained that Congress chose to use the term "securities contract," and did not use language that refers to an actual securities transaction.²³ The court held the transfers were made in connection with a securities contract regardless of the lack of purchase or sale of securities.²⁴ Thus, the transfers were not avoidable under the section 546(e) safe harbor.²⁵

The safe harbor also applies to a transfer that is a smaller piece of a larger, complex securities deal.²⁶ In *Duke Energy*, the court held a distribution of term loan proceeds that was part of a larger transaction involving the sale of a company was a transfer in connection with a securities contract.²⁷ There, the transfer at issue stemmed from an acquisition that included a credit agreement from which term loan proceeds were distributed to a holding company.²⁸ The

¹⁹ *See In re Bernard L. Madoff Inv. Sec., LLC*, 773 F.3d 411, 418-20 (2d Cir. 2014).

²⁰ *Id.* at 419.

²¹ *Id.*

²² *Id.*

²³ *Id.* at 420.

²⁴ *Id.* at 422.

²⁵ *See id.*

²⁶ *See Crescent Res. Litig. Tr. ex rel. Bensimon v. Duke Energy Corp.*, 500 B.R. 464, 476 (W.D. Tex 2013).

²⁷ *Id.*

²⁸ *Id.* at 467.

holding company then transferred the term loan proceeds back to the purchaser, Duke.²⁹ After the holding company filed for bankruptcy, a bankruptcy trustee was appointed to pursue claims on behalf of the estate.³⁰ The trustee sued Duke to recover the term loan payment that was transferred to Duke as a fraudulent transfer.³¹ Duke argued the payment was protected from avoidance under section 546(e).³² In response, the trustee argued that the payment was not made in connection with a securities contract and that it instead was a one-way standalone dividend payment.³³ The court explained section 546(e)'s language “is by its own terms very broad; in the context of avoidance of transfers it has been interpreted to mean ‘related to an agreement.’”³⁴ The court found that the sale agreement designed a large, multi-step transaction that could not close unless each individual step closed.³⁵ The court therefore held that the distribution of funds was made as part of the larger sale agreement which called for the exchange of securities.³⁶ As a result, the transfer was protected under section 546(e).³⁷

Courts have held that a payment involving the redemption of shares in a leveraged buyout is a transaction “in connection with” a securities contract.³⁸ In *In re Tribune Company Fraudulent Conveyance Litigation*, the debtor filed for bankruptcy one year after a leveraged buyout in which it paid \$8 billion to shareholders from the new leveraged buyout debt.³⁹ A bankruptcy trustee was appointed and sued to avoid the transfers.⁴⁰ The trustee argued that the

²⁹ *Id.*

³⁰ *See id.* at 469.

³¹ *Id.* at 470.

³² *Id.*

³³ *Id.* at 475.

³⁴ *Id.* at 476.

³⁵ *Id.* at 473.

³⁶ *Id.*

³⁷ *Id.*

³⁸ *See In re Tribune Co. Fraudulent Conv. Litig.*, 946 F.3d 66, 81 (2d Cir. 2019); *see also In re Nat'l Forge Co.*, 344 B.R. 340, 366 (W.D. Pa. 2006) (holding that a stock redemption payment is a payment made to complete a securities transaction and is covered by the safe harbor).

³⁹ *See id.* at 72.

⁴⁰ *See id.* at 80.

payments did not involve the purchase of shares and that the payments instead involved a *redemption* of shares.⁴¹ The court explained that the term “redemption” in the securities context means “repurchase.”⁴² The court also cited 11 U.S.C. § 741(7) which defines “securities contract” as a “contract for the purchase [or] sale . . . of a security, . . . including *any repurchase* . . .” as well as “any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph.”⁴³ Because of the wide breadth of the Bankruptcy Code’s definition, the court held payments made to redeem shares are payments made in connection with a securities contract.⁴⁴

III. Courts do not Apply the Safe Harbor Where a Transfer Lacks a Sufficient Nexus with the Securities Contract Itself and is Instead a Payment Separate from the Contract

One example of a transfer that is not protected by section 546(e) is a dividend payment to shareholders of a corporation that is paid from the proceeds of a prior securities contract.⁴⁵ In *Tops*, a group of investors acquired the debtor and caused the debtor to pay four dividends to the investors that were funded largely by selling securities.⁴⁶ After the debtor filed for bankruptcy, a trustee was appointed to pursue claims on behalf of the estate.⁴⁷ The trustee sought to avoid the dividend payments as fraudulent transfers.⁴⁸ The investors claimed the dividends were protected by the safe harbor because they were related to the sale of secured notes and a sale of secured notes is a securities contract under 11 U.S.C. § 741(7).⁴⁹ The court held that while the note offerings were securities contracts under the Bankruptcy Code’s broad definition, the dividend

⁴¹ *See id.*

⁴² *Id.*

⁴³ *Id.* at 81.

⁴⁴ *Id.*

⁴⁵ *In re Tops Holding II Corp.*, 646 B.R. 617, 682 (Bankr. S.D.N.Y. 2022); *see also In re Appleseed's Intermediate Holdings*, 470 B.R. 289, 302 (D. Del. 2012) (finding that section 546(e) could not be applied to a dividend payment made in connection with a leveraged buyout where the debtors did not receive anything in exchange).

⁴⁶ *See id.* at 639.

⁴⁷ *See id.* at 641.

⁴⁸ *Id.*

⁴⁹ *Id.* at 679.

was a completely separate one-way payment.⁵⁰ The court explained that section 546(e) applies to “a transfer that is either a ‘settlement payment’ or made ‘in connection with a securities contract.’ Not a transfer that involves. Not a transfer that comprises.”⁵¹ Therefore, the dividend made using the proceeds of the securities contract was not protected by the safe harbor because it was completely separate and not connected to the securities contract itself.⁵²

In another example, a bankruptcy court in Delaware held that deposits by a debtor to a bank to pay a letter of credit made by the bank to collateralize the debtor’s obligation to pay bondholders were not payments made in connection with a securities contract.⁵³ In *In re Qimonda Richmond*, a predecessor of the Debtors borrowed approximated \$33 million through the issuance of bonds pursuant to an indenture.⁵⁴ To collateralize the Debtors’ obligation to pay the bondholders, Citibank issued a letter of credit in favor of the indenture trustee.⁵⁵ The Debtors agreed to reimburse Citibank if the indenture trustee drew on the letter of credit or to re-pay the bonds in full prior to a draw on the letter of credit.⁵⁶ After the Debtors instructed the indenture trustee to redeem the bonds, the Debtors deposited funds into their Citibank account.⁵⁷ Citibank then debited the account and paid the indenture trustee which retired the bonds.⁵⁸ After the Debtors filed their chapter 11 petition, a bankruptcy trustee was appointed.⁵⁹ The bankruptcy trustee filed suit against Citibank to avoid the deposit and the debit.⁶⁰ In response, Citibank

⁵⁰ *See id.* at 681.

⁵¹ *Id.* at 682.

⁵² *Id.*

⁵³ *In re Qimonda Richmond, LLC*, 467 B.R. 318, 322 (Bankr. D. Del. 2012).

⁵⁴ *Id.* at 320.

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *See id.*

⁶⁰ *Id.*

argued they were protected under the 546(e) safe harbor.⁶¹ First, the court explained that the payments to Citibank were made only to secure Citibank’s exposure under the letter of credit, not to pay off bonds.⁶² Next, the court explained that a letter of credit is specifically exempted from the definition of “security” under 11 U.S.C. § 101(49)(B)(i).⁶³ The court further noted that a letter of credit may not be construed as a settlement payment under 11 U.S.C. § 741(8) because letters of credit are not a payment commonly used in the securities trade.⁶⁴ Finally, the court explained that the kind of bonds and indenture in question were not securities contracts under the Bankruptcy Code.⁶⁵ Therefore, the payments made in connection to the letter of credit were not payments made in connection with a securities contract under section 546(e).⁶⁶

Conclusion

Section 546(e) provides that a payment is protected from avoidance if it is made by, to, or for the benefit of a covered entity “in connection with” a securities contract.⁶⁷ However, this defense does not necessarily protect all payments made that have some relationship to a securities contract. In general, the safe harbor will protect a payment that is a component of a transaction or a series of transactions that results in an exchange for securities. When a payment is completely separate from the securities contract at issue, however, section 546(e) may not protect the payment from avoidance.

⁶¹ *Id.* at 321.

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *See id.*

⁶⁵ *Id.* at 323.

⁶⁶ *Id.*

⁶⁷ *See* 11 U.S.C. § 546(e) (2018).