ALERT

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High Court Tightens Section 546(e) Safe Harbor for Securities Transaction Payments

The U.S. Supreme Court issued a highly anticipated ruling resolving a long-standing circuit split over the scope of the Bankruptcy Code's "safe harbor" provision exempting certain securities transaction payments from avoidance as fraudulent transfers. In *Merit Management Group LP v. FTI Consulting Inc.*, the unanimous Court held that section 546(e) of the Bankruptcy Code does not protect transfers made through a financial institution to a third party regardless of whether the financial institution had a beneficial interest in the transferred property. Instead, the relevant inquiry is whether the transferor or the transferee in the transaction sought to be avoided are financial institutions themselves.

Section 546(e) provides that a pre-bankruptcy transfer "made by or to (or for the benefit of) a … financial institution," among other entities, in connection with securities contracts may not be avoided as a fraudulent transfer, unless the transfer was made with the actual intent to hinder, delay, or defraud creditors. The general purpose of the provision is to prevent "the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1 (1982).

The Seventh and Eleventh Circuits have held that section 546(e) does not apply to transfers involving financial institutions that receive no beneficial interest in the property transferred. By contrast, the Second, Third, Sixth, Eighth, and Tenth Circuits have concluded that section 546(e) applies even if the financial institution involved is merely a "conduit" for the transfer of funds from the debtor to another party.

Writing for the unanimous Court, Justice Sotomayor sided with the Seventh and Eleventh Circuits, thus rejecting the rule that long had prevailed in, among other places, New York and Delaware bankruptcy courts. She stated that "the plain meaning of section 546(e) dictates that the only relevant transfer for purposes of the safe harbor is the transfer that the trustee seeks to avoid"—i.e., the transfer to the ultimate transferee, as distinguished from intermediate transfers to financial institutions acting merely as conduits between the debtor and the ultimate transferee.

Because the litigants did not contend that either the debtor in *FTI Consulting* or its shareholder transferees were "financial institutions" or other entities covered by section 546(e), the Court ruled that the transfer at issue falls outside the safe harbor.

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