Jackson & Campbell, P.C.
2300 N Street, N.W.
Suite 300
Washington, D.C. 20037-1194
202.457.1600 (p)

Court Narrows Bankruptcy Safe Harbor Provision

27 Feb 2018

In *Merit Management Group, LP v. FTI Consulting, Inc.*, the Court addressed 11 U.S.C. sec. 548(e), which allows bankruptcy trustees to set aside and recover certain transfers for the benefit of the bankruptcy estate, but not a "settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (of for the benefit of) a . . . financial institution . . . in connection with a securities contract." Often, such transfers involve several steps, and the Court was asked whether 548(e) should consider the overall transfer (A to D) or the component parts (A to B to C to D) in determining whether the safe harbor provision applied. In this case, two companies jockeying for a horse racing license decided that one would buy out the other's stock if it got the license. When the license was obtained, the stock purchase was executed, with the funds going through the parties' respective banks. But the buyer couldn't use the license in the end, because it couldn't secure a different license from the state, and it declared bankruptcy. The trustee sought to claw back the money from the stock purchase under the claim that it was constructively fraudulent. The seller argued that the transfer met the definition of 548(e), which put it out of the trustee's reach, because the transfer of money went through two financial institutions before the seller received anything. The Seventh Circuit disagreed, creating a circuit split. The Court, in a unanimous decision by Justice Sotomayor, affirmed, holding that the "overarching transfer" between the buyer and seller (i.e. A to D) is what courts must consider when applying the safe harbor provision, and not whether an intermediate step in that process involved a financial institution. Since the buyer and seller were not financial institutions, the safe harbor provision of 548(e) did not apply.

Court Narrows Bankruptcy Safe Harbor Provision

27 Feb 2018

In *Merit Management Group, LP v. FTI Consulting, Inc.*, the Court addressed 11 U.S.C. sec. 548(e), which allows bankruptcy trustees to set aside and recover certain transfers for the benefit of the bankruptcy estate, but not a "settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (of for the benefit of) a . . . financial institution . . . in connection with a securities contract." Often, such transfers involve several steps, and the Court was asked whether 548(e) should consider the overall transfer (A to D) or the component parts (A to B to C to D) in determining whether the safe harbor provision applied. In this case, two companies jockeying for a horse racing license decided that one would buy out the other's stock if it got the license. When the license was obtained, the stock purchase was executed, with the funds going through the parties' respective banks. But the buyer couldn't use the license in the end, because it couldn't secure a different license from the state, and it declared bankruptcy. The trustee sought to claw back the money from the stock purchase under the claim that it was constructively fraudulent. The seller argued that the transfer met the definition of 548(e), which put it out of the trustee's reach, because the transfer of money went through two financial institutions before the seller received anything. The Seventh Circuit disagreed, creating a circuit split. The Court, in a unanimous decision by Justice Sotomayor, affirmed, holding that the "overarching transfer" between the buyer and seller (i.e. A to D) is what courts must consider when applying the safe harbor provision, and not whether an intermediate step in that process involved a

financial institution. Since the buyer and seller were not financial institutions, the safe harbor provision of 548(e) did not apply.