SECTION 546(E) REDUX—THE PROPER FRAMEWORK FOR THE CONSTRUCTION OF THE TERMS FINANCIAL INSTITUTION AND FINANCIAL PARTICIPANT CONTAINED IN THE BANKRUPTCY CODE AFTER THE U.S. SUPREME COURT'S HOLDING IN *MERIT*

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This Article discusses and analyzes the proper framework for the construction of the terms "financial institution" and "financial participant" as defined in Sections 101(22)(A) and 101(22A) of the Bankruptcy Code (the Code), as they work in tandem with Section 546(e) of the Code. In 2018, the U.S. Supreme Court issued its long awaited decision in Merit*, which held that the language regarding transfers "made by or to (or for the benefit of) . . . a financial institution" contained in Section 546(e) does not insulate the ultimate transferee of a constructive fraudulent action (a CFTA) simply because the company being acquired (the Target) through the leveraged buyout (an LBO) uses a bank as an intermediary between itself and its redeeming shareholders (Redeeming Shareholders).* Merit *stated that in such a transaction, for purposes of fraudulent transfer law and Section 546(e), the Target, not the intermediary bank, is the "transferor." Likewise,* Merit *stated that the Redeeming Shareholder, as the ultimate recipient of the transfer, is the "transferee."* Merit *concluded that Section 546(e) does not insulate a Redeeming Shareholder from a CFTA simply because a bank or similar entity acted as an intermediary between the Target and the Redeeming Shareholder.*

Merit*, however, did not address, an important issue in this context regarding the proper construction of certain language contained in Section 101(22)(A), which*

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states that a "customer" of a financial institution will itself qualify as a "financial institution" when a financial institution, such as a bank, acts as an "agent or custodian for a customer (whether or not a 'customer,' as defined in section 741) in connection with a securities contract" (the Customer Language or the Customer as Financial Institution Defense). Following Merit*, therefore, a large cloud of uncertainty remains as to whether a Target itself qualifies as a financial institution under the Customer Language, simply because a bank or similar entity acted as an intermediary between the Target and its Redeeming Shareholders. If the Customer Language is construed in this overly broad fashion, then essentially all Redeeming Shareholders would be insulated from CFTAs, which would make it virtually impossible for Bankruptcy Trustees to recover billions to trillions of dollars for unsecured creditors in the context of companies that file for bankruptcy within a short time period after completing an LBO or a share repurchase (or share buyback) transaction.*

Courts and academics disagree on the proper construction of the Customer Language. The main misguided argument, supported by erroneous rulings of the U.S. District Court for the Southern District of New York and the Second Circuit, which drastically misconstrued the Customer Language, is that pursuant to this language a company being acquired through an LBO itself qualifies as a "financial institution," because a bank or similar entity that functioned as an intermediary between that company and its Redeeming Shareholders acted as the company's "agent" in the LBO, thus insulating the Redeeming Shareholders from a CFTA. The proper reading of Sections 101(22)(A) and 546(e), combined with knowledge of the securities lending industry, agency law, and the underlying policies of the Code's "Safe Harbors," however, belie this argument.

This Article makes the following novel argument never before raised in the academic literature regarding the interplay between Sections 101(22)(A) and 546(e): Congress inserted the Customer Language into Section 101(22)(A) to protect agent banks (Agent Banks) that act as agents for lenders in securities lending transactions (Agent SLTs). In Agent SLTs, an Agent Bank, usually a custody bank, generally holds substantial amounts of collateral for its lender-customer. Thus, in an Agent SLT, an Agent Bank generally acts as an agent and a custodian for its principal/customer—the lender of the securities. Likewise, in these transactions, the Agent Bank generally provides a guaranty to the relevant lender-customer, pursuant to which the Agent Bank agrees to indemnify the lender if the value of collateral posted by the borrower is insufficient to purchase equivalent securities to those initially loaned by the lender in the securities lending transaction (SLT) if the borrower defaults. This guaranty could be revived, making the Agent Bank liable, if after the Agent SLT is concluded: (i) the borrower files for bankruptcy; (ii) the borrower's bankruptcy trustee later files an avoidance action such as a CFTA, and (iii) the lender becomes obligated to pay the borrower's Trustee after either: (a)

settling that avoidance action pursuant to a court-approved settlement; or (b) losing the avoidance action.

Such liability to Agent Banks could upend the securities lending market (the SLM). Indeed, absent the Customer Language, an Agent Bank generally could face significant liability in an Agent SLT because one or more of the Agent Bank's "customers," such as insurance companies and pension funds, may not qualify for the protection offered by the Safe Harbor contained in Section 546(e) if the borrower later files for bankruptcy. By deeming such entities "financial institutions" in a situation where an Agent Bank acts as "an agent or custodian" for its lender-customer, Congress protected Agent Banks from liability under a revived guaranty. The SLM, like the derivatives market, is an international market that involves trillions of dollars of transactions. Agent SLTs involve agent lenders that, in many situations, are "financial institutions" that act as intermediaries between their "lending" customers and the borrowers of securities. Thus, Congress did not intend the "agent or custodian" language contained in Section 546(e) to apply to garden-variety Redeeming Shareholders in LBOs, and similar transactions such as share buybacks. This interpretation of Section 101(22)(A) is consistent with the plain language of the Customer Language and with Congress's intent in enacting, and, over the years, amending, the Safe Harbors.

This Article discusses several recent cases that have interpreted Section 101(22)(A). This Article will discuss the recent Second Circuit decision in Tribune II *and argue that it was improperly decided. Likewise, this Article will discuss recent post-*Tribune *cases. One of those cases,* Nine West*, erroneously expanded* Tribune II*. In* Greektown*, however, the Bankruptcy Court for the Eastern District of Michigan disagreed with* Tribune *and reached an opposite conclusion—that a company being purchased through an LBO does not qualify as a financial institution under the Customer Language, simply because a bank or similar entity acted as an intermediary between the Redeeming Shareholders and the company purchased through the LBO. This Article argues that* Greektown *was properly decided. The Article will also discuss recent academic literature that argues that Sections 546(e) and 101(22)(A) should be construed to insulate Redeeming Shareholders of stock in publicly traded companies, but not be construed to insulate Redeeming Shareholders in nonpublicly traded companies. This Article argues that no such distinction exists under current law.*

This Article makes a novel argument regarding the proper framework for the interpretation and application of Section 101(22)(A) and argues that it applies to lenders of securities in Agent SLTs that may not otherwise qualify as a customer of a broker dealer as defined in Section 741. Examples of such entities are: insurance companies, endowments, and pension funds. An understanding of the SLM combined with the text, structure, legislative history, and policy objectives of the Code readily and strongly support this conclusion.

The Article further argues that, even if courts do adopt this approach to Sections 101(22)(A) and 546(e), Congress should amend the Code so that it partially insulates shareholders in publicly traded securities, so long as those shareholders: (i) are not "insiders" of the debtor; and (ii) act in good faith.

Finally, this Article discusses and analyzes whether a debtor itself may qualify as a "financial participant" under Section 101(22A), thus insulating Redeeming Shareholders from constructive fraudulent transfer or preference liability (the Financial Participant Defense). Redeeming Shareholders have recently raised the Financial Participant Defense as an alternative to the Customer as Financial Institution Defense. Only two decisions have considered this defense, and each one of them reached opposite conclusions. This Article argues that the proper construction of the Code leads to the conclusion that a debtor itself may not qualify as a "financial participant."

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INTRODUCTION

In 2018, the U.S. Supreme Court issued its highly awaited decision in *Merit Management Group, LP v. FTI Consulting, Inc.*,[1] which held that Section 546(e) of the Bankruptcy Code (Section 546(e)) did not prohibit a bankruptcy trustee (a Trustee) from bringing a constructive fraudulent transfer action (a CFTA) against shareholders that redeemed

[1] Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883 (2018).

their shares (Redeeming Shareholders) through a leveraged buyout (an LBO), simply because a bank or other entity, which qualifies as a "financial institution" under the Bankruptcy Code (the Code), acted as an intermediary between the company acquired through the LBO (the Target) and its Redeeming Shareholders.[2] Applauded by Trustees, this decision seemed to clarify a circuit split regarding the scope of Section 546(e) that had existed for over twenty years.

Merit, however, did not address a crucial issue regarding the interplay between Sections 101(22) and 546(e)—can a Target itself qualify as a financial institution by qualifying, in turn, as a "customer" of a financial institution, simply because a bank or similar entity acted as an intermediary between the Redeeming Shareholders and the Target?[3] For the Target to qualify for this customer-as-financial-institution defense (the Customer as Financial Institution Defense), the bank would have to act as an "agent or custodian" for the Target in the LBO.[4]

In less than three years after the Supreme Court's decision in *Merit*, courts have reached opposite conclusions on this issue. In 2019, the Second Circuit, in *Deutsche Bank Trust Co. Americas v. Large Private Beneficial Owners* (*In re Tribune Co. Fraudulent Conveyance Litig.*) (*Tribune II*), held that a trust company acting as an intermediary between a Target and its Redeeming Shareholders qualified as a financial institution because it was a "customer" of a financial institution.[5] More recently, in 2020, the U.S. Bankruptcy Court for the Eastern District of Michigan, reached an opposite holding in *Greektown*

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[2] Before the U.S. Supreme Court's decision in *Merit*, I published a law review article regarding Section 546(e), arguing, inter alia, that the Supreme Court should rule, as it later did in *Merit*, that Section 546(e) does not insulate most Redeeming Shareholders from a CFTA simply because a bank or similar entity acted as an intermediary between a debtor-corporation and a Redeeming Shareholder in an LBO. *See* Peter V. Marchetti, *A Note to Congress: Amend Section 546(e) of the Bankruptcy Code to Harmonize the Underlying Policies of Fraudulent Conveyance Law and Protection of the Financial Markets*, 26 AM. BANKR. INST. L. REV. 1 (2018). Certain portions of that article are briefly referenced herein as they are important for historical and contextual purposes. For example, that article thoroughly discussed and analyzed the Second Circuit's erroneous decision in *Tribune I*, which that article referred to as *Tribune II*, as that decision related to Section 546(e)'s preemption of constructive fraudulent transfer actions based on state law (SLCFTAs). *Id.* at 63–68. That article, inter alia, argued that Section 546(e) does not preempt SLCFTAs. *Id.* at 63–77. In 2019, after *Merit*, the Second Circuit later vacated, revised, and reissued its *Tribune I* decision in its *Tribune II* decision. As discussed in more detail below, the only difference between *Tribune I* and *Tribune II* was the addition of approximately three to five pages of language that improperly construed Section 101(22)(A). Thus, this Article will principally focus on Section 101(22)(A).

[3] *See Merit*, 138 S. Ct. at 890 n.2.

[4] 11 U.S.C. § 101(22)(A).

[5] Deutsche Bank Tr. Co. Ams. v. Large Priv. Beneficial Owners (*In re* Tribune Co. Fraudulent Conveyance Litig.) (*Tribune II*), 946 F.3d 66, 77–78 (2d Cir. 2019).

Litigation Trust v. Papas (*In re Greektown Holdings, LLC*).[6] Likewise, academics disagree on the proper construction of Section 101(22)(A).[7] Some of those disagreements relate to the scope of the term "customer" contained in Section 101(22)(A), while others focus on the distinction between shareholders in publicly traded companies as opposed to shareholders in privately held entities (the Public vs. Private Distinction).[8]

In *Tribune II*, the Second Circuit eviscerated the Supreme Court's holding in *Merit* and turned it on its head. In the short history since *Tribune II*, several lower courts in the Second Circuit have broadly extended its holding by, inter alia, applying Sections 546(e) and 101(22)(A) to apply to any transaction that simply involves securities.[9] Such broad judicial interpretations of the customer language will result in the "exception swallowing the rule."

If *Tribune II* is not soon reversed by the U.S. Supreme Court[10] or by Congress, its holding will: (i) likely lead to a similar circuit split that existed for over twenty-five years prior to *Merit*; (ii) have a devastating impact on the ability of Trustees to successfully bring CFTAs or preference actions on behalf of general unsecured creditors against

6 Greektown Litig. Tr. v. Papas (*In re* Greektown Holdings, LLC), 621 B.R. 797, 840 (Bankr. E.D. Mich. 2020).

7 *Compare* Daniel J. Bussel, *Second Circuit Fumbles Tribune on Reconsideration,* HARV. L. SCH. BANKR. ROUNDTABLE (Jan. 13, 2020), https://blogs.harvard.edu/bankruptcyroundtable/files/2020/01/The-Second-Circuit-Misreads-101.pdf [https://perma.cc/VH89-BHXJ], *with* Irina Fox, *Back to Square One: How* Tribune *Revived the Settlement Payment Safe Harbor to Trustee Avoidance Powers in the Context of Leveraged Buyouts*, 29 NORTON J. BANKR. L. & PRAC. 295 (2020).

8 *See supra* note 7. This Article argues that the Code does not support the Public vs. Private Distinction. This Article, however, expands on an argument I made in a prior work that Congress should amend Section 546(e) so that it partially protects good faith investors in publicly traded securities that do not qualify as "insiders" under the Code.

9 *See, e.g.*, Holliday v. K Road Power Mgmt., LLC (*In re* Bos. Generating LLC) 617 B.R. 442 (Bankr. S.D.N.Y. 2020) (broadly interpreting Sections 546(e) and 101(22)(A)); *In re* Nine W. LBO Sec. Litig., 482 F. Supp. 3d 187 (S.D.N.Y. 2020) (also broadly interpreting Sections 546(e) and 101(22)(A)); SunEdison Litig. Tr. v. Seller Note, LLC (*In re* SunEdison, Inc.), 620 B.R. 505 (Bankr. S.D.N.Y. 2020); Fairfield Sentry Ltd. v. Theodoor GGC Amsterdam (*In re* Fairfield Sentry Ltd.), Ch. 15 Case No. 10-13164, Adv. No. 10-03496, 2020 WL 7345988 (Bankr. S.D.N.Y. Dec. 14, 2020). One of these decisions applied Sections 546(e) and 101(22)(A) to shield defendants from intentional fraudulent transfer liability based on state law. *See Holliday*, 617 B.R. at 478.

10 The U.S. Supreme Court recently denied a petition for certiorari seeking reversal of *Tribune II*. Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found., 141 S. Ct. 2552 (2021). As described in more detail later in this Article, prior to this denial, the U.S. Solicitor General argued that although the petition raised strong arguments, the U.S. Supreme Court should deny the petition as there was not yet a split among U.S. circuit courts of appeal on this issue. Brief for the United States as Amicus Curie at 19–23, Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found., 141 S. Ct. 2552 (2021) (No. 20-8).

Redeeming Shareholders; and (iii) actually encourage "risky" LBOs. The following table shows the recent yearly overall volume of LBOs[11]:

Year	Annual Overall Market LBO Issuance
2017	$125 Billion
2018	$150 Billion
2019	$125 Billion
2020	$84 Billion

In addition to the Customer as Financial Institution Defense, Redeeming Shareholder defendants faced with constructive fraudulent transfer liability in the context of failed LBOs have recently raised an alternative defense, which they assert shields them from constructive fraudulent transfer and preferential transfer liability—the "Financial Participant Defense." Specifically, these defendants have asserted that the debtor, at the time of the LBO, qualified as a "financial participant" under the Code, thus immunizing those defendants from constructive fraudulent transfer liability.[12] To date, only two courts have addressed the Financial Participant Defense, with each one reaching opposite conclusions.[13] As argued later in this Article, courts, in most cases, should reject this defense.

Resolution of these issues could affect the ability of future Trustees to recover literally trillions of dollars from Redeeming Shareholders on behalf of general unsecured creditors such as trade creditors, employees, and retirees. Thus, the stakes are indeed very high for current and future unsecured creditors in bankruptcies involving failed LBOs. The Covid-19 pandemic has caused, and will likely continue to cause, a large number of corporate bankruptcy filings of companies that had recently gone through an LBO or had recently engaged in share buyback transactions.[14]

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11 *See* DAVID PUCHOWSKI & ALP ZAVARO, REFINITIV LPC'S US LBO STATS–4Q20, at 4 (2021) (on file with author). *See also* Miriam Gottfried, *Buyout Boom Gains Steam in Record Year for Private Equity*, WALL ST. J. (Nov. 28, 2021, 5:30 AM), https://www.wsj.com/articles/buyout-boom-gains-steam-in-record-year-for-private-equity-11638095402 (last visited Feb. 7, 2022).

12 *See In re* Tribune Co. Fraudulent Conv. Litig. (*Tribune Customer Case*), No. 12-cv-2652, 2019 WL 1771786, at *9 (S.D.N.Y. Apr. 23, 2019); Kravitz v. Samson Energy Co. (*In re* Samson Res. Corp.), 625 B.R. 291, 301–02 (Bankr. D. Del. 2020).

13 *Compare Tribune Customer Case*, 2019 WL 1771786, at *9, *with Kravitz*, 625 B.R. at 299–300.

14 *See* Jonathan Randles, *Bankruptcy Lawyers Gear Up for Surge in Filings Due to Coronavirus Fallout*, WALL ST. J. (Apr. 2, 2020, 2:54 PM), https://www.wsj.com/articles/bankruptcy-lawyers-gear-up-for-surge-in-filings-due-to-coronavirus-fallout-11585853669 [https://perma.cc/2EY4-

This Article makes a novel argument never made before in the academic literature regarding the proper interpretation and scope of: (i) the term "customer" as used in Section 101(22)(A) (the Customer Language); and (ii) the term "financial participant" as used in Section 101(22A). Specifically, regarding the Customer Language (or the Customer as Financial Institution Defense), this Article argues that Congress intended the term "customer" as used in Section 101(22)(A), to protect agent banks (Agent Banks) that act as intermediaries in securities lending transactions (Agent SLTs) from liability associated with a "revived" guaranty. As discussed in more detail later, guarantees play a central role in Agent SLTs.

Indeed, as this Article describes in more detail below, absent the Customer Language, other specially defined terms contained in the Code's safe harbors (the Safe Harbors) that define certain protected parties (each a Protected Party),[15] may not apply to shield certain lenders of securities in Agent SLTs, like insurance companies, from CFTAs or preference actions. If a Trustee could successfully bring a CFTA or preference action against a securities lender in an Agent SLT months or years after an Agent SLT terminated, the Agent Bank could then face liability under a guaranty agreement (the Guaranty) to that lender for the amount the lender was required to pay the Trustee as a result of losing or settling the CFTA or preference action. As described in more detail below, it is standard market practice for an Agent Bank to give a Guaranty to the lender (the Agent Bank's customer) in connection with an Agent SLT.

This type of exposure faced by Agent Banks' financial market participants in Agent SLTs could lead to "systemic risk" in the financial markets, unlike the risk faced by garden-variety Redeeming

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TJQ5]; Mary Williams Walsh, *A Tidal Wave of Bankruptcies Is Coming*, N.Y. TIMES (Aug. 3, 2020), https://www.nytimes.com/2020/06/18/business/corporate-bankruptcy-coronavirus.html [https://perma.cc/2KHA-YLPY].

15 As described in more detail below, the Code contains certain "safe harbors" that insulate certain enumerated parties from avoidance actions such as: (i) commodity brokers; (ii) financial participants; (iii) forward contract merchants; (iv) repurchase participants; and (v) swap participants. *See* 11 U.S.C. § 101(6) (defining commodity broker); *id.* § 101(22A) (defining financial participant); *id.* § 101(26) (defining forward contract merchant); *id.* § 101(46) (defining repurchase participant); *id.* § 101(48) (defining securities clearing agency); *id.* § 101(53C) (defining swap participant). A financial institution is a catchall definition that protects parties not qualifying as one of those other Protected Parties. *See id.* § 101(22); *see also* Fox, *supra* note 7 (describing financial institution as a "catchall" category). Section 101(38B) of the Code, however, may protect a lender in an SLT involving an agent lender if the agreement used in the transaction qualifies as a "master netting agreement," such as a Master Securities Lending Agreement. *See* 11 U.S.C. § 101(38B) (defining master netting agreement participant); *see also id.* § 362(b)(6)–(7), (17); *id.* § 546(e)–(g); *id.* §§ 555–556; *id.* §§ 560–561 (containing the Code's safe harbors).

Shareholders. Agent SLTs, like derivative transactions and repurchase agreements, are "specialized" transactions involving trillions of dollars, intermediaries, systemically important financial market participants, and substantial amounts of collateral. This interpretation of the Customer Language is readily and strongly supported by a combination of (i) an understanding of the mechanics of Agent SLTs and the securities lending market (the SLM); (ii) the policies underpinning the "Deep Rock doctrine" and the absolute priority rule, which are central concepts in corporate law and bankruptcy law; and (iii) the legislative history, structure, and public policy underlying the Code.

This Article will discuss basic bankruptcy concepts and the legislative intent underlying the Safe Harbors. It will also discuss the Supreme Court's recent decision in *Merit* and the "financial institution" loophole that *Merit* left open. Next, the Article will discuss the Second Circuit's post-*Merit* holding in *Tribune II*, along with more recent decisions, such as the U.S. District Court for the Southern District of New York's recent decision in *Nine West*, which erroneously expanded *Tribune II*'s interpretation of the Customer Language. Likewise, the Article will discuss the recent decision in *Greektown*, which reached the opposite conclusion than the conclusion reached by courts in the Second Circuit.

This Article fills that void by providing an example of a transaction involving systemically important financial market participants to which the Customer Language clearly applies—Agent SLTs. The Article will provide a clear and detailed explanation of the mechanics of an Agent SLT and the systemic financial market participants involved in Agent SLTs. The Article will then argue that Congress inserted the Customer Language into Section 101(22)(A) to protect Agent Banks in connection with the role they play in Agent SLTs. The Article also argues that Congress should amend the Code, even if the Supreme Court ultimately reverses *Tribune II*, so that Redeeming Shareholders of publicly traded securities who do not qualify as insiders[16] are partially insulated from

16 Under the Code, the following qualify as an "insider" of a corporate debtor: (i) a director or officer of the debtor; (ii) a "person in control of the debtor;" (iii) a "partnership in which the debtor is a general partner;" (iv) a "general partner of the debtor;" or a "relative of a general partner, director, officer, or person in control of the debtor." 11 U.S.C. § 101(31)(B). The Code does not expressly define "a person in control of the debtor." *Id.* This portion of the Code's definition of "insider" is commonly referred to as the "non-statutory insider" (Non-Statutory Insider) provision. The Code does not expressly provide whether a trust or a pension fund (or 401K or similar retirement accounts) qualifies as a Non-Statutory Insider. For the purposes of this Article, the definition of "insider" does not include Non-Statutory Insiders so long as such entities, at all relevant times, acted in good faith. Furthermore, the Code does not expressly provide the date as of which "insider" status is determined for purposes of constructive

CFTAs and preference actions if they act in good faith. Finally, this Article will argue that the Financial Participant Defense should not apply to most Redeeming Shareholders.

I. BACKGROUND

A. *LBOs*

Decisions interpreting Section 546(e) have generally involved LBOs and Ponzi schemes.[17] In the near future, such litigation may also arise with respect to transactions involving "share buy-backs," which present similar concerns regarding Section 546(e)'s scope.[18] An LBO is a merger-and-acquisition technique through which an acquirer finances the acquisition of the Target's stock by obtaining a loan from a bank.[19] The acquirer simultaneously arranges for the bank to obtain a perfected security interest in all of the Target's assets, and it uses the

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fraudulent transfer liability. It does so, however, for preferential transfer liability. *See id.* § 547(b)(4)(B). Under that provision, the Code provides that for purposes of preferential transfer liability, the date of the transfer determines "insider" status (Date of Transfer Test). *Id.* This Date of Transfer Test should not apply in the context of failed LBOs. If it does, the vast majority of directors, officers, or their relatives could argue they do not qualify as Non-Statutory Insiders at the time the Target made its redemption payment under the LBO to them (i.e., at the time of the transfer) because, within several months prior to that time, the Target cancelled their shares in (and thus their voting rights permitting them to exercise control over) the debtor. If and how Congress could draft a more specific Non-Statutory Insider definition is beyond the scope of this Article. For purposes of this Article, a Redeeming Shareholder should qualify as an "insider" if that Redeeming Shareholder was an insider at any time within one year prior to the consummation of the LBO.

17 See Marchetti, *supra* note 2, at 4–8, 77–82 for a more in-depth discussion of Section 546(e) and its relation to LBOs and Ponzi schemes.

18 A share buyback is a transaction in which a corporation purchases its shares from existing shareholders. A leveraged share buyback occurs where a corporation purchasing the existing shareholders' shares obtains a loan, which may be secured by the company's assets. The corporation then uses the proceeds of that loan to buy its shares back from its existing shareholders. Share buybacks often operate to the advantage of corporate insiders. Before the recent wave of corporate bankruptcy filings caused by Covid-19, many large corporations engaged in LBO transactions and share buyback transactions. *See* Jonathan Schwarzberg, *Leverage Levels Peaking Again on US Mega Buyouts*, REUTERS (Mar. 22, 2019, 11:32 AM), https://www.reuters.com/article/leverage-climbs/leverage-levels-peaking-again-on-us-mega-buyouts-idUSL1N2190M2 [https://perma.cc/26BC-S454]; Evie Liu, *Bailouts Might Bring Bans on Stock Buybacks. Here's What It Means.*, BARRON'S (Mar. 20, 2020, 7:10 PM), https://www.barrons.com/articles/bailouts-might-bring-bans-on-stock-buybacks-heres-what-it-means-51584745840 [https://perma.cc/FW3C-VBE5].

19 *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 980 (2017) (explaining LBO process). Leveraged Recapitalizations are similar to LBOs. *See* Marchetti, *supra* note 2, at 4–8 (discussing LBOs and Ponzi schemes). For purposes of simplicity, this Article's discussion of LBOs also applies to similar transactions such as Leveraged Recapitalizations and share buybacks.

loan proceeds to "cash out" the Target's shareholders.[20] There is an inherent risk involved in LBOs that the Target may later file for bankruptcy following the LBO transaction as a result of the debt incurred by the Target to pay the Redeeming Shareholders.[21]

B. *Basic Bankruptcy Concepts*

When a party files for bankruptcy under the Code, a bankruptcy estate is created.[22] At that point a Trustee is appointed to administer the assets of the debtor for the benefit of the debtor's estate—which generally means the creditors.[23] The Code gives the Trustee the power to avoid or "claw back" (an Avoidance Action) various transfers of property from the recipients of such transfers that the debtor made within certain time periods prior to the Petition Date.[24] Such transfers may take the form of the debtor having agreed to the: (i) granting of liens; (ii) transfer of collateral; or (iii) payment of money.

Common Avoidance Actions brought by Trustees are aimed at avoiding or "clawing back" any of the following: (i) certain prepetition

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20 *See Czyzewski*, 137 S. Ct. at 980.

21 *See, e.g.*, Mellon Bank, N.A. v. Metro Commc'ns, Inc., 945 F.2d 635, 645–46 (3d Cir. 1991).

> The effect of an LBO is that a corporation's shareholders are replaced by secured creditors. Put simply, stockholders' equity is supplanted by corporate debt. The level of risk facing the newly structured corporation rises significantly due to the increased debt to equity ratio. This added risk is borne primarily by the unsecured creditors, those who will most likely not be paid in the event of bankruptcy. . . . The target corporation, however, receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation.

Id.; *see also* Marchetti, *supra* note 2, at 4–5 (discussing LBOs).

22 *See* 11 U.S.C. § 541(a)(1). The estate consists of all of the debtor's property rights. *Id.* For a more detailed description of these basic concepts, see Marchetti, *supra* note 2, at 15–20.

23 *See* 11 U.S.C. §§ 321–323. This Article uses the term "Trustee" interchangeably to refer to either: (i) a duly appointed Trustee under the Code or SIPA; or (ii) a debtor in possession (which has the powers of a Trustee). In certain situations, an Official Committee of Unsecured Creditors may have certain rights of a Trustee. *See* Off. Comm. of Unsecured Creditors *ex rel.* Cybergenics Corp. v. Chinery, 330 F.3d 548, 579–80 (3d Cir. 2003) (conferring derivative standing upon a creditors' committee). In the context of this Article, the term "Trustee" does not apply to a litigation trustee of a litigation trust established by a confirmed chapter 11 plan, if that litigation trustee is not bringing an action on behalf of the entire unsecured creditor body of a bankruptcy estate. In certain bankruptcy cases, the U.S. Trustee may appoint an equity holders' committee to represent the interests of the holders of equity of the debtor. 11 U.S.C. § 1102(b)(2). An equity holders' committee is a party in interest and may "appear and be heard on any issue" in a chapter 11 bankruptcy case. *Id.* § 1109(b).

24 *See* 11 U.S.C. §§ 544, 547–548, 555.

liens;[25] (ii) specified statutory liens;[26] (iii) preferential transfers;[27] and (iv) fraudulent transfers.[28] The policies underlying the Trustee's ability to bring Avoidance Actions are, inter alia, to: (i) prevent certain creditors from racing to "pick apart" the debtor's assets on the "eve" of the debtor's bankruptcy filing;[29] (ii) prevent a debtor that shortly plans to file for bankruptcy from favoring certain creditors to the "detriment" of other similarly situated creditors;[30] and (iii) prevent a debtor from depleting the assets of the estate by making "fraudulent" transfers of those assets to third parties prior to a bankruptcy filing.[31] Thus, Avoidance Actions are generally geared towards the maximization of distributions to the entire body of unsecured creditors of the estate as a whole, which, in many cases, only recover a percentage of the full amount of the debt they are owed.

In essence, there are two different types of fraudulent transfer actions available to a Trustee: (i) intentional fraudulent transfer actions; and (ii) CFTAs.[32] Intentional fraudulent transfers are easy to understand. An example would be a debtor gifting its property to a relative or a newly formed corporate entity before filing for bankruptcy, so that that property would not be available for distribution to its creditors.

Constructive fraudulent transfers, on the other hand, may be less obvious. A constructive fraudulent transfer occurs where a debtor, before filing for bankruptcy (i) transfers an asset for "less than a reasonably equivalent value;" and (ii) (a) is insolvent when it makes (or becomes insolvent as a result of) that transfer; or (b) was left with "unreasonably small capital" following that transfer.[33] An example of a constructive fraudulent transfer would be a corporation selling one of its assets for "less than reasonably equivalent value" and either being insolvent at the time it made that sale or rendered insolvent as a result of that sale.[34]

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25 *See id.* §§ 544, 555.

26 *Id.*

27 *Id.* § 547.

28 *See id.* §§ 544, 548.

29 *See* Lindquist v. Dorholt (*In re* Dorholt, Inc.), 224 F.3d 871, 873 (8th Cir. 2000) (stating that Congress intended Section 547 to "discourage creditors from racing to dismember a debtor" in the short period before filing for bankruptcy); 5 COLLIER ON BANKRUPTCY ¶ 547.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2009) (discussing Section 547 and its underlying policy).

30 11 U.S.C. § 547(b); *see also* Marchetti, *supra* note 2, at 18.

31 11 U.S.C. § 548.

32 *See id.* § 548(a)(1)(A)–(B).

33 *Id.* § 548(a)(1)(B).

34 *See, e.g.*, Hernandez v. Cantu (*In re* Hernandez), 150 B.R. 29, 30 (Bankr. S.D. Tex. 1993).

Under the Code, the Trustee may bring a CFTA under (i) Section 548 of the Code (Section 548)[35] and (ii) an applicable state law fraudulent transfer statute (an SLCFTA).[36] Generally speaking, the important difference between CFTAs and SLCFTAs is the "look back" period that relates to the transfer the Trustee seeks to avoid. A CFTA brought pursuant to Section 548 permits a Trustee to avoid any fraudulent transfer made within two years before the debtor's bankruptcy filing,[37] while SLCFTAs generally permit a Trustee to avoid any fraudulent transfer made within a longer time period, generally four years, before the debtor's bankruptcy filing.[38]

In situations involving failed LBOs, either a Bankruptcy Trustee or a trustee under a litigation trust established under a confirmed chapter 11 plan generally seeks to avoid the payments made by the debtor to the Redeeming Shareholders on a fraudulent transfer theory under either the Code[39] or applicable state law[40] based on either an alleged: (i) CFTA;[41] or (ii) actual fraudulent transfer action.[42]

Fraudulent transfer law is the main avenue of recourse these unsecured creditors have to recover when a company goes through an LBO and later files for bankruptcy.[43] Strong fundamental policies

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35 *See* 11 U.S.C. § 548(a)(1)(B).

36 *See id.* § 544(b)(1).

37 *Id.* § 548(a)(1).

38 *E.g.*, DEL. CODE ANN. tit. 6, §§ 1304, 1309 (West 2021). Over the past six years, twenty-two states have enacted the Uniform Voidable Transactions Act (the UVTA). *See Voidable Transactions Act Amendments—Formerly Fraudulent Transfer Act*, UNIF. L. COMM'N (2014), https://www.uniformlaws.org/committees/community-home?CommunityKey=64ee1ccc-a3ae-4a5e-a18f-a5ba8206bf49 (last visited Dec. 21, 2021). The Uniform Law Commission proposed the UVTA in 2014. *Id.* Under the UVTA, transfers that were formerly referred to as "constructively fraudulent" under the former Uniform Fraudulent Transfer Act are now simply referred to as "voidable." *See id.* For purposes of simplicity, this Article will refer to state law claims based on "constructively fraudulent" or "voidable" transfers as "SLCFTAs."

39 11 U.S.C. § 548(a)(1)(A)–(B).

40 *See id.* § 544.

41 A constructive fraudulent transfer is one made for "less than a reasonably equivalent value" that either: (i) rendered the debtor insolvent; or (ii) was made while the debtor was insolvent. *Id.* § 548(a)(1)(B).

42 *Id.* § 548(a)(1)(A). An actual fraudulent transfer is a transfer made "with actual intent to hinder, delay, or defraud" creditors. *Id.* This Article will focus on CFTAs and not on actual fraudulent transfer actions. For a discussion of issues regarding Section 546(e)'s application to certain constructive fraudulent transfers, see Marchetti, *supra* note 2, at 82–83.

43 *See* John H. Ginsberg, M. Katie Burgess, Daniel R. Czerwonka & Zachary R. Caldwell, *Befuddlement Betwixt Two Fulcrums: Calibrating the Scales of Justice to Ascertain Fraudulent Transfers in Leveraged Buyouts*, 19 AM. BANKR. INST. L. REV. 71, 72–73 (2011). In certain circumstances, those unsecured creditors could also assert claims related to breach of fiduciary duty against the debtor's board of directors (BOD) that approved the LBO. *See, e.g.*, *In re* Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292 (S.D.N.Y. 2020). Breach of fiduciary duty claims and claims related thereto are beyond the scope of this Article.

underpinning both corporate law[44] and the Code[45] support the Trustee's power to recover payments from shareholders that redeemed their shares through an LBO on behalf of the unsecured creditors. Those policies dictate that, in the context of a bankrupt company, unsecured creditors of the corporation have priority over shareholders and that those unsecured creditors must be paid in full (or consent otherwise) before the corporation can make any distributions to its shareholders.[46] In corporations liquidating outside of formal bankruptcy proceedings, the applicable doctrine is the "Deep Rock doctrine."[47] Under the Code, this priority-of-payment scheme is referred to as the "Absolute Priority Rule."[48]

C. *The Safe Harbors, Intermediaries & Specialized Financial Transactions*

The Code insulates certain technically defined parties (Protected Parties) to certain types of financial market transactions, such as derivatives, futures contracts, and SLTs, from CFTAs and preference actions. The Code does this through the Safe Harbors, which were enacted, and significantly expanded over time.[49] The Safe Harbors not only insulate Protected Parties from most Avoidance Actions, but they also exempt them from other important provisions of the Code, such as the automatic stay (the Automatic Stay) contained in Section 362 of the Code and the executory contracts provisions contained in Section 365 of the Code.[50] Basically, two types of parties qualify as Protected Parties under the Safe Harbors: (i) parties that act as intermediaries

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44 *See* JAMES D. COX & THOMAS L. HAZEN, 1 TREATISE ON THE LAW OF CORPORATIONS § 7:19 (3d ed. 2020) (discussing "Deep Rock doctrine"). *See generally* Taylor v. Standard Gas & Elec. Co., 306 U.S. 307 (1939).

45 *See* Marchetti, *supra* note 2, at 16–17 (discussing Absolute Priority Rule).

46 *See* 11 U.S.C. §§ 726(a), 1129(b)(2)(B)(ii); Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 440–43 (1999); *see also* George H. Singer, *Supreme Court Clarifies "New Value Exception" to Absolute Priority Rule—or Does It?*, 18 AM. BANKR. INST. J. 1, 31–32 (1999).

47 *See* COX & HAZEN, *supra* note 44, at § 7:19 (discussing "Deep Rock doctrine"). *See generally Taylor*, 306 U.S. 307.

48 *See* Marchetti, *supra* note 2, at 16–17 (discussing Absolute Priority Rule).

49 *See* 11 U.S.C. § 546(e)–(g), (j).

50 *See id.* §§ 362(b)(6)–(7), (17), 546(e)–(g), 555–556, 560–561. *See generally* Franklin R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REGUL. 91 (2005); Stephen J. Lubben, *Repeal the Safe Harbors*, 18 AM. BANKR. INST. L. REV. 319 (2010) [hereinafter Lubben, *Repeal the Safe Harbors*]; Stephen J. Lubben, *Derivatives and Bankruptcy: The Flawed Case for Special Treatment*, 12 U. PA. J. BUS. L. 61 (2009) [hereinafter Lubben, *The Flawed Case for Special Treatment*].

(Intermediaries) in: (a) the securities and commodities clearing and settlement system (the SCCS); and (b) similar financial market transactions; and (ii) systemically important financial market participants that are parties to financial market transactions, such as parties to swap agreements, repurchase agreements, security contracts, or forward contracts.[51] This narrow universe of entities enjoy this Protected Party status because their susceptibility to certain provisions of the Code could lead to systemic risk. The underlying policy of the Safe Harbors is to protect the financial markets from "systemic risk" that could result from the financial failure of a Protected Party, which, theoretically, could result if such a Protected Party were subject to most Avoidance Actions, the Automatic Stay, or certain other provisions of the Code.[52]

D. *The Securities & Commodities Clearing & Settlement System & Intermediaries*

Transactions involving publicly traded securities, commodities, and many derivatives involve various Intermediaries. In the case of publicly traded securities, parties that buy and sell securities do so through the Clearing and Settlement System.[53] This system involves the use of, inter alia: (i) Intermediaries like the Depository Trust & Clearing Corporation (DTCC), stockbrokerage firms, and banks, which act as intermediaries between issuers of securities and the beneficial holders of those securities in trades involving publicly traded securities; and (ii) the use of guarantees by such intermediaries.[54] Congress theorized that a domino effect of cascading bankruptcies could likely occur among large financial institutions, stock brokerage firms, clearinghouses, exchanges, or commodities dealers if a Trustee had the ability to prosecute most types of Avoidance Actions, such as CFTAs or preference actions against: (i) any one of these Intermediaries; or (ii) one of the narrowly defined systemically important financial market

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51 *See supra* note 50 and accompanying text.

52 *See* 128 CONG. REC. 15,981 (daily ed. July 13, 1982) (statement of Sen. Bob Dole); *see also* Shmuel Vasser, *Derivatives in Bankruptcy*, 60 BUS. LAW. 1507, 1509–11 (2005) (discussing underlying policy of safe harbors).

53 Likewise, parties that trade various types of derivatives and fixed income securities also use the clearing system. *See Equities Clearing Services*, DEPOSITORY TR. & CLEARING CORP., https://www.dtcc.com/clearing-services/equities-clearing-services [https://perma.cc/B9WW-U4J3]; *see also* Marchetti, *supra* note 2, at 10–15 (discussing Clearing & Settlement System).

54 Marchetti, *supra* note 2, at 10–15.

participants that qualifies as a Protected Party.[55] As a result, Congress enacted what is now Section 546(e) in 1978[56] and Section 101(22) in 1984 and amended them over a twenty-one-year period.[57]

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55 With respect to forward contracts, swap agreements, securities contracts, and repurchase agreements, financial market participants and Congress shared the concern that "systemic risk" could result if a party to such a transaction either: (i) did not have the ability to immediately terminate and net out its exposure to a bankrupt counterparty; or (ii) was susceptible to most types of Avoidance Actions. *See generally* Lubben, *Repeal the Safe Harbors*, *supra* note 50. Several leading academics and other commentators have lodged significant criticisms of the Safe Harbors arguing that the Safe Harbors should be either significantly narrowed from their current scope or repealed. *See generally* Edwards & Morrison, *supra* note 50; Bryan G. Faubus, Note, *Narrowing the Bankruptcy Safe Harbor for Derivatives to Combat Systemic Risk*, 59 DUKE L.J. 801 (2010) (arguing that the Safe Harbors should not apply to certain types of derivatives); Lubben, *Repeal the Safe Harbors*, *supra* note 50; Lubben, *The Flawed Case for Special Treatment*, *supra* note 50; Mark J. Roe, *The Derivatives Market's Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539 (2011); David A. Skeel, Jr. & Thomas H. Jackson, *Transaction Consistency and the New Finance in Bankruptcy*, 112 COLUM. L. REV. 152 (2012); Samir D. Parikh, *Saving Fraudulent Transfer Law*, 86 AM. BANKR. L.J. 305 (2012) (arguing that Section 546(e) should not apply to either beneficial holders of publicly or privately traded stock); Irina V. Fox, *Settlement Payment Exception to Avoidance Powers in Bankruptcy: An Unsettling Method of Avoiding Recovery from Shareholders of Failed Closely Held Company LBOs*, 84 AM. BANKR. L.J. 571 (2010) [hereinafter Fox, *Unsettling Method*] (arguing that Section 546(e) should apply to holders of publicly held stock, but not privately held stock). Other commentators, however, have defended the Safe Harbors, arguing that they benefit the financial system. *See generally* Mark D. Sherrill, *In Defense of the Bankruptcy Code's Safe Harbors*, 70 BUS. LAW. 1007, 1036–37 (2015) (stating that Safe Harbors lead to lower prices for consumers and benefit overall financial system); Fox, *supra* note 7; Irina Fox, *The Necessity of Protecting Public Securities Transactions: Reading Bankruptcy Code Section 546(e) to Preempt State-Law Fraudulent Transfer Avoidance Actions*, 27 NORTON J. BANKR. L. & PRAC. 123 (2018) [hereinafter Fox, *Necessity*]; Fox, *Unsettling Method*, *supra* (arguing that Section 546(e) should apply to holders of publicly held stock, but not privately held stock); Nathan Goralnik, Note, *Bankruptcy-Proof Finance and the Supply of Liquidity*, 122 YALE L.J. 460 (2012) (arguing in favor of inclusion of Safe Harbors in the Code). In 2013, Senator Elizabeth Warren and Congressman John Tierney proposed legislation in the Senate and in the House of Representatives, respectively. S. 1282, 113th Cong. (2013) (seeking to reduce systemic risk in the financial system by limiting the ability of banks to engage in certain "risky activities"); H.R. 3711, 113th Cong. (2013). Congress did not enact this proposed legislation. *Actions Overview S.1282—113th Congress (2013–2014)*, CONGRESS.GOV, https://www.congress.gov/bill/113th-congress/senate-bill/1282/actions?r=73&s=1 (last visited Jan. 9, 2022); *Actions Overview H.R. 3711—113th Congress (2013–2014)*, CONGRESS.GOV, https://www.congress.gov/bill/113th-congress/house-bill/3711/
actions?q=%7B%22search%22%3A%5B%22H.R.+4%22%5D%7D&r=75&s=1 (last visited Jan. 9, 2022).

56 *See* Enactment of Title 11 of the United States Code, Pub. L. No. 95-598, 92 Stat. 2549, 2555 (1978) (declaring the application of Section 746(c)). The prior version of what now is Section 546(e) was contained in the then-enacted version of Section 746(c) of the Code. *See id.*; *see also* Marchetti, *supra* note 2, at 20–23 (detailing Section 546(e)'s legislative history).

57 *See* Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 889–90 (2018); *see also* Marchetti, *supra* note 2, at 20–23 (detailing Section 546(e)'s legislative history). Congress amended Section 546(e) over a twenty-five-year period. *Id.* Likewise, it amended Section 101(22) over a twenty-one-year period.

E. *Specialized Financial Transactions*

Certain specialized financial transactions such as derivative transactions, e.g., swap agreements, repurchase agreements, and SLTs are documented under forms prepared by specialized trade groups composed of major financial market participants such as the International Swaps and Derivatives Association (ISDA)[58] and the Securities Industry and Financial Markets Association (SIFMA).[59] These trade groups publish specific "Master Agreement" forms that are used to document such different types of specialized financial market transactions.[60] This "Master Agreement" architecture allows market participants to document numerous transactions under certain pre-agreed terms contained in the market-standard Master Agreement widely used in the financial markets.[61] The terms of these Master Agreements may generally be amended or tailored to a particular transaction in a schedule (Schedule) to the associated Master Agreement.[62] Finally, each individual trade or transaction falling under the Master Agreement, as modified by the Schedule, is documented under a transaction or trade confirmation (a Confirmation).[63]

Likewise, these trade groups lobby and advocate for uniform rules that apply to the specialized financial transactions engaged in by their

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58 *About ISDA*, INT'L SWAPS & DERIVATIVES ASS'N, https://www.isda.org/about-isda [https://perma.cc/4D2J-KAFG].

59 *About*, SEC. INDUS. & FIN. MKTS. ASS'N, https://www.sifma.org/about [https://perma.cc/VTC3-UA8H].

60 *See* PAUL C. HARDING, MASTERING THE ISDA MASTER AGREEMENTS (1992 and 2002) 19, 21 (3d ed. 2010) [hereinafter HARDING, MASTERING THE ISDA MASTER AGREEMENTS] (discussing ISDA Master Agreement architecture); CHRISTIAN A. JOHNSON, A GUIDE TO USING AND NEGOTIATING OTC DERIVATIVES DOCUMENTATION 15–16, 24 (2005); PAUL C. HARDING & CHRISTIAN A. JOHNSON, MASTERING SECURITIES LENDING DOCUMENTATION: A GUIDE TO THE MAIN EUROPEAN AND US MASTER SECURITIES LENDING AGREEMENTS 337–39, 430–32 (2011) [hereinafter HARDING & JOHNSON, MASTERING SECURITIES LENDING]. In particular, SIFMA publishes the Master Securities Lending Agreement (the MSLA), which is used in most U.S. SLTs. *Id.* at 430. SIFMA also publishes: (i) the Master Repurchase Agreement, generally used to document Repos; (ii) the Global Master Repurchase Agreement, which is commonly used in international SLM transactions; and (iii) the Master Securities Forward Transaction Agreement (MSFTA), which is used to document transactions involving the "purchase or sale of mortgage-backed and other asset-backed securities . . . and other transactions that result or may result in the delayed delivery of securities." *MRA, GMRA, MSLA and MSFTAs*, SEC. INDUS. & FIN. MKTS. ASS'N, https://www.sifma.org/resources/general/mra-gmra-msla-and-msftas [https://perma.cc/V6M4-7DVY].

61 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 430–31.

62 SEC. INDUS. & FIN. MKTS. ASS'N, MASTER SECURITIES LOAN AGREEMENT OVERVIEW (1993), https://www.sifma.org/wp-content/uploads/2017/08/MSLA_Overview-of-the-Master-Securities-Loan-Agreement-1993-Version.pdf [https://perma.cc/36H8-AKMZ].

63 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 18.

members. One prime area that is of grave concern to these groups is bankruptcy law. Indeed, the ability of a systemically important financial market participant to enforce certain contractual terms regarding such transactions vis-à-vis one of its counterparties that is in bankruptcy proceedings may ultimately dictate the potential recovery of billions of dollars for the nonbankrupt party to such specialized transactions, including, but not limited to, SLTs.[64] The uniformity and predictability of laws applying to the SLM, commodities markets, and derivatives markets have a significant overall impact on those markets.[65] Virtually all of these transactions are backed with some form of collateral (or Margin).[66] Margin may consist of cash or securities.[67] In the United States, transactions in the SLM are documented under securities lending agreements (SLAs), such as the Master Securities Lending Agreement (the MSLA).[68]

These trade groups were and are concerned with the Code's impact on a financial market participant's right to enforce certain terms contained in the relevant industry standard transaction forms related to, inter alia, a financial market participant's ability to: (i) immediately terminate the relevant transaction(s); (ii) immediately realize and seize its collateral (as it can be volatile in nature); (iii) net the amounts receivable and payable under each transaction documented under the associated Master Agreement; and then determine whether: (a) the bankruptcy estate owes that market participant (i.e., the "in the money" position); or (b) the market participant owes the bankruptcy estate money (i.e., the "out of the money" position).[69]

Likewise, these trade groups were concerned with the ability of a Trustee to bring certain Avoidance Actions against specific financial market participants (Protected Parties) acting either as an intermediary or as a systemically important party to one of these specialized financial transactions, as such ability could result in a domino effect of bankruptcies of one or more Protected Parties, which in turn, could result in an overall meltdown of the financial markets—i.e., "systemic

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64 As described below, an SLT generally involves one or more parties acting as an intermediary in the transaction.

65 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 2–4.

66 *Id.* at xi. In Europe, however, most SLM transactions are secured by "non-cash collateral." *Id.* Like SLTs, most derivative and commodities transactions are also backed by some form of collateral. This Article will mostly focus on Margin and SLTs.

67 *Id.* at 1–2. In the United States, most SLTs are backed by cash collateral. *Id.* at xi, 9.

68 *Id.* at 51.

69 *See id.* at 49–50. Although Congress's intent in enacting, and later expanding, the Safe Harbors are important to the context of this Article, this Article will focus on the Safe Harbor contained in Section 546(e).

risk."[70] In the above types of financial market transactions, Intermediaries play central roles. Because of fears of systemic risk related to the transactions, Congress enacted, and later expanded, the Safe Harbors.

F. *Section 546(e)*

Section 546(e) is one of the Code's Safe Harbors, and it limits a Trustee's ability, in certain circumstances, to bring an Avoidance Action against certain Protected Parties such as stockbrokers, financial institutions, financial participants, and securities clearing agencies.[71] Section 546(e) provides in pertinent part:

> Notwithstanding sections 544, . . . 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 . . . stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a . . . stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.[72]

G. Merit

Beginning in the 1990s, a circuit split, and consequent uncertainty, arose regarding the following issue: does Section 546(e) bar a CFTA against a Redeeming Shareholder simply because a bank or financial

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70 *See* Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 889–90 (2018).

71 11 U.S.C. § 546(e). Certain sections of the Code, commonly referred to as the Safe Harbors, give "special treatment" to the liquidation of collateral and the payment of settlement payments made in connection with certain securities lending transactions, and in connection with certain other specialized financial transactions such as repurchase agreements, swap agreements, and other derivative transactions. *Id.* §§ 546(e)–(g), (j), 555–556, 560–561, 741(5), (7)–(8). Generally speaking, the Safe Harbors allow a party to a qualified financial contract to do the following immediately upon a bankruptcy filing of its counterparty: (i) immediately terminate any and all qualified financial contracts; (ii) set off or net among all such terminated qualified financial contracts; and (iii) seize any collateral and apply such collateral to any and all amounts owed to it under the qualified financial contracts by the party that filed for bankruptcy. *Id.*

72 *Id.* § 546(e) (internal citations omitted). For a more in-depth discussion of Section 546(e), its legislative history, and other relevant statutory provisions, see Marchetti, *supra* note 2, at 20–24.

institution acted as an intermediary between that shareholder and a company in the context of an LBO of a company that later files for bankruptcy?[73] In February 2018, the U.S. Supreme Court answered "no" to that question, and it unanimously held that Section 546(e) does not bar a CFTA simply because a bank or financial institution acted as an intermediary between a Redeeming Shareholder and a company in the context of an LBO of a company that later files for bankruptcy.[74]

Instead, *Merit* held that the only relevant transfer for purposes of Section 546(e) is the transfer the Trustee seeks to avoid—"the overarching [or end-to-end] transfer . . . not any component part of that transfer."[75] Thus, *Merit* held that, in the context of an LBO, the "transferor" for purposes of Section 546(e) was the debtor and not the intermediary bank.[76] In reaching its decision, the Court looked to Congress's intent in enacting, and later expanding, Section 546(e) of the Code, which Congress enacted in response to the *Seligson*[77] decision to protect systemically important parties such as intermediaries in the securities and commodities clearing system.[78]

Merit, however, did not resolve several other issues regarding the scope of Section 546(e). Firstly, the U.S. Supreme Court, in a footnote, expressly stated that it was not deciding whether a chapter 11 debtor itself would qualify as a "financial institution" as set forth in Section 101(22)(A) by virtue of being a "customer" of an intermediary used in an LBO, such as a bank or similar entity.[79] Secondly, *Merit* did not decide whether Section 546(e) bars a Trustee from bringing an SLCFTA.[80] Thirdly, the LBO in *Merit* involved privately held shares of stock—it did not, like the cases that are part of the *Tribune* Saga[81] or *Nine West*,[82] involve publicly traded shares of stock.

Thus, following *Merit*, when determining whether Section 546(e) applies, a court must first look to the "overarching transfer" between the debtor (i.e., the transferor) and the Redeeming Shareholders (i.e., the transferees). If either such transferor or transferee qualifies as a "financial institution" under Section 101(22), then Section 546(e) will

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73 *See Merit*, 138 S. Ct. 883.

74 *Id.*

75 *Id.* at 893–97.

76 *Id.*

77 Seligson v. N.Y. Produce Exch., 394 F. Supp. 125 (S.D.N.Y. 1975); *see* Marchetti, *supra* note 2, at 14–15, 20–21 (providing detailed discussion of *Seligson*).

78 *Merit*, 138 S. Ct. at 889–90.

79 *Id.* at 890 n.2.

80 *Merit* also did not decide whether Section 546(e) bars a litigation trustee, who does not qualify as a Trustee under the Code, from bringing either a CFTA or SLCFTA.

81 *See infra* Sections II.A.1–II.A.3.

82 *See infra* Section II.B.

bar the Avoidance Action. In the short time period that has elapsed since the Supreme Court's decision in *Merit*, a split among courts has already arisen regarding whether, under Section 101(22), a debtor that redeems its former shareholders' shares through an LBO itself qualifies as a "financial institution" simply by using a bank or similar entity as an intermediary in the LBO.[83] Thus, the issue that *Merit* seemed to have resolved has reappeared.

H. *Section 101(22)*

Section 546(e) gives "financial institutions" and certain other Protected Parties "special treatment"[84] by insulating them from CFTAs and preference actions that a Trustee can bring under the Code.[85] The underlying policy of Section 546(e) and the other Safe Harbors is to protect the financial markets from "systemic risks."[86] The term "financial institution" is defined in Section 101(22)(A).[87]

Congress added the defined term "financial institution" to the Code in 1984, by including it in a "Miscellaneous Amendments" subtitle of the Bankruptcy Amendments and Federal Judgeship Act of 1984.[88] At that time, the definition of financial institution contained "agent or customer" language similar to the Customer Language currently contained in Section 101(22)(A).[89] In 2000, Congress again amended the definition of "financial institution" by, inter alia, adding "Federal reserve bank" and the words "or receiver or conservator for such entity" into the definition.[90]

Approximately five years later, in 2005, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

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83 *Compare Tribune II*, 946 F.3d 66 (2d Cir. 2019), *with* Greektown Litig. Tr. v. Papas (*In re* Greektown Holdings, LLC), 621 B.R. 797, 802 (Bankr. E.D. Mich. 2020).

84 *See generally* Edwards & Morrison, *supra* note 50.

85 11 U.S.C. § 546(e).

86 *See* Vasser, *supra* note 52, at 1509–11 (discussing underlying policy of Safe Harbors).

87 11 U.S.C. § 101(22)(A).

88 *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 421(e), (j)(4), 461(d), 98 Stat. 333, 368, 377 (amending title 28 and title 11 of the United States Code). At that time, the term "financial institution" appeared in Section 101(19) of the Code and was defined, in pertinent part, as follows: "[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 . . . ." *Id.* § 421(j)(4).

89 *Id.* § 421(j)(4).

90 *See* Pub. L. 106-554, § 112, 114 Stat. 2763 (2000) (codified as amended at 11 U.S.C. 101(22)(A)(i)).

(BAPCPA),[91] which, along with significantly expanding the Safe Harbors, also amended the definition of "financial institution." The next amendment to the definition of "financial institution" occurred approximately one year later, in 2006, when Congress enacted the Financial Netting Improvements Act (FNIA).[92] Congress described this as a "technical" amendment, and it amended the Customer Language by adding the language "(whether or not a 'customer', as defined in section 741)" between the words "custodian for a customer" and "in connection with a securities contract."[93] The current definition of "financial institution" in Section 101(22) is:

> (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; or
>
> (B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940.[94]

I. *Section 741*

The Customer Language mentions that its definition of "customer" is not circumscribed to the definition of customer contained in Section 741, which applies in the context of liquidations of "stockbrokers." Section 741 narrowly defines a "customer" as an:

> (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

91 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

92 *See* Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, § 5, 120 Stat. 2692, 2695.

93 *Id.* The House Report accompanying the amendments made in FNIA stated that the bill made only "technical changes to the netting and financial contract provisions incorporated by Title IX of [BAPCPA] to update the language to reflect current market and regulatory practices and help reduce systemic risk in the financial markets by clarifying the treatment of certain financial products in cases of bankruptcy or insolvency." H.R. REP. NO. 109-648, pt. 1, at 1–2 (2006).

94 11 U.S.C. § 101(22) (emphasis added).

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.[95]

J. *Agency*

Notwithstanding the inapplicability of the narrow definition of customer contained in Section 741, under the Customer Language, for an entity that is a customer of a "financial institution" to also qualify as a "financial institution," a bank or similar entity must be acting as an "agent" or "custodian" for that customer in connection with a securities contract.[96] Although the Code expressly defines "custodian," it does not define "agent." Thus, the common law legal definition, and not the colloquial definition, of the term agency must be determined before Section 101(22)(A) can be properly construed and applied.

An agency relationship is defined as: "[T]he *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."[97] The relationship is a *legal concept* and is one of "status" rather than of pure contract.[98] The way the parties label their relationship "is not dispositive."[99] Therefore, a contract that simply refers to a party as an agent or labels a relationship as an agency relationship will not create an agency if the threshold elements of an agency are not satisfied.[100] Indeed, it is the substance of the relationship, not the form ascribed to it in a contract, that controls.[101] The finding of

95 *Id.* § 741(2).

96 *Id.* § 101(22).

97 RESTATEMENT (THIRD) OF AGENCY § 1.01 (AM. L. INST. 2006) (emphasis added).

98 *Id.* § 1.02 cmt. a.

99 *Id.*; *see* Pan Am. World Airways, Inc. v. Shulman Transp. Enters., Inc. (*In re* Shulman Trans. Enters. Inc.), 744 F.2d 293, 295 (2d Cir. 1984).

100 *Shulman Transp. Enters.*, 744 F.2d at 295.

101 *Id.*

an agency relationship "depends on the presence of factual elements" and "[i]t is . . . a question usually reserved to the factfinder."[102]

There are two bedrock principles of an agency relationship. Firstly, for an agency relationship to exist, the agent must have the power to act on the principal's behalf, subject to the principal's control.[103] This means that the agent must have the "power . . . to bind the principal."[104] A common example of this power to bind the principal is the agent's authority to bind the principal in a contract with a third party.[105]

Secondly, it is a fiduciary relationship.[106] Upon formation of an agency relationship, an agent will owe the fiduciary duties of care and loyalty to its principal.[107] Not every contractual relationship, however, "creates an agency relationship; in fact, most do not."[108]

K. *Custodian*

As mentioned above, the Code expressly defines the term "custodian," which appears alongside the term "agent" in the Customer Language. Under the Code, a "custodian" is defined as either a:

> (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

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102 Lang v. Morant, 867 A.2d 182, 186 (Del. 2005).

103 RESTATEMENT (THIRD) OF AGENCY § 1.01 cmts. a–c.

104 RESTATEMENT (SECOND) OF AGENCY § 1.01 cmt. c (AM. L. INST. 1958).

105 *Id.* § 12 cmt. a; *see, e.g.*, Am. Home Assurance Co. v. Hapag Lloyd Container Linie, GmbH, 446 F.3d 313, 318 (2d Cir. 2006). Furthermore, the agent must consent to act as the agent for the principal. This is a question of fact. RESTATEMENT (SECOND) OF AGENCY § 1.01 cmt. d. An agent consents to the formation of an agency relationship by "manifest[ing] assent or otherwise consent[ing] so to act" on behalf of the principal. *Id.*

106 Johnson v. Priceline.com, Inc., 711 F.3d 271, 277 (2d Cir. 2013).

107 RESTATEMENT (THIRD) OF AGENCY §§ 8.01–.12.

108 McCrann v. RIU Hotels S.A., No. 09 Civ. 9188, 2010 WL 5094396, at *3 (S.D.N.Y. Dec. 6, 2010); *see also* RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. g. Of course, it is not always easy to distinguish an agency from a mere contractual relationship. In any contractual relationship, "the parties contemplate a benefit to be realized through the other party's performance." *Id.* "Performing a duty created by contract may well benefit the other party but the performance is that of an agent only if the elements of agency are present." *Id.*

> property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.[109]

II. Recent Cases Interpreting Section 101(22)(A)

A. *The* Tribune *Saga*

The *Tribune* saga began with the issue of whether Section 546(e) preempted SLCFTAs in the context of LBOs.[110] Later, in addition to that issue, it addressed, although incorrectly, one of the major issues regarding Section 546(e) that *Merit* did not resolve[111]—whether the debtor itself would qualify as a financial institution by virtue of being a "customer" of an entity that acted as an intermediary in the LBO, such as a bank or trust company.[112] Such an interpretation of Sections 101(22)(A) and 546(e) in the context of LBOs would not only give corporate insiders a defense that is "too good to be true,"[113] but it also would immunize virtually every Redeeming Shareholder in the context of a failed LBO from constructive fraudulent transfer liability.[114]

1. *Tribune I*

In 2016, the Second Circuit issued a decision that held that, in the context of an LBO involving an intermediary bank or trust company, Section 546(e) of the Code prevented a Trustee from bringing SLCFTAs

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109 11 U.S.C. § 101(11).

110 *See In re* Tribune Co. Fraudulent Conv. Litig., 499 B.R. 310, 316–25 (Bankr. S.D.N.Y. 2013). This Article will not present an in-depth analysis of whether Section 546(e) preempts SLCFTAs. I analyzed this issue in a prior work, concluding that Section 546(e) does not preempt such actions. *See* Marchetti, *supra* note 2, at 52–77 (providing detailed analysis and discussion regarding Section 546(e)'s inapplicability to SLCFTAs and *Tribune I*). Furthermore, a litigation trustee that represents a discreet group of creditors and not the "bankruptcy estate" does not fit within the Code's definition of a Trustee. *See* 11 U.S.C. § 323; *see also* Brief of Amici Curiae Law Professors in Support of Petitioners at 18, Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found., 141 S. Ct. 2552 (2021) (No. 20-8), 2020 WL 4674300, at *18.

111 Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 890 n.2. (2018).

112 *See generally Tribune II*, 946 F.3d 66 (2d Cir. 2019).

113 *See, e.g.*, *Exploring Chapter 11 Reform: Corporate and Financial Institution Insolvencies; Treatment of Derivatives: Hearing Before the H. Subcomm. on Regul. Reform, Com. & Antitrust L. of the H. Comm. on the Judiciary*, 113th Cong. 3 (2014) (statement of Hon. Christopher S. Sontchi, U.S. Bankr. J. for Dist. of Del.).

114 *See* Marchetti, *supra* note 2, at 10, 43.

and CFTAs against Redeeming Shareholders.[115] Around this time, in *Physiotherapy*,[116] the U.S. Bankruptcy Court for the District of Delaware reached the opposite conclusion, and held that Section 546(e) did not preempt SLCFTAs in the context of LBOs.[117] The plaintiffs in *Tribune I* later filed a petition for certiorari regarding the *Tribune I* decision to the U.S. Supreme Court.[118] The U.S. Supreme Court held several conferences on that petition for certiorari. During that time period, the U.S. Supreme Court issued its holding in *Merit*. Following the Court's decision in *Merit*, on April 3, 2018, Justices Kennedy and Thomas issued a statement suggesting that, in light of *Merit*, the Second Circuit recall its mandate.[119] As discussed in more detail below, the Second Circuit did recall its mandate, and later, it issued its amended erroneous decision in *Tribune II*.[120]

2. *Tribune Customer Case*

Following *Merit*, but before the Second Circuit issued *Tribune II*, the District Court for the Southern District of New York in the *Tribune Customer Case* issued a decision interpreting Section 101(22)(A), which defines "financial institution."[121] Based on the holding in *Merit*, the trustee representing a group of individual creditors (the Tribune Trustee) sought to amend his complaint so that he could bring a CFTA against certain shareholders that redeemed their shares through the LBO of the Tribune Company (Tribune).[122] The District Court for the Southern District of New York denied that motion and held that, notwithstanding *Merit*, Section 546(e) would immunize Tribune's

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115 Deutsche Bank Tr. Co. Ams. v. Large Private Beneficial Owners (*Tribune I*), 818 F.3d 98, 105 (2d Cir. 2016). As a prior article I wrote presented a more in-depth discussion and analysis of *Tribune I* and *Physiotherapy*, I summarize those decisions here in less detail. For a more detailed description of *Tribune I* and *Physiotherapy*, see Marchetti, *supra* note 2, at 72–77.

116 PAH Litig. Tr. v. Water St. Healthcare Partners L.P. (*In re* Physiotherapy Holdings, Inc.), No. 13-12965, 2016 WL 3611831 (Bankr. D. Del. June 20, 2016). As a prior article I wrote presented a more in-depth discussion and analysis of *Tribune I* and *Physiotherapy*, this Article summarizes these decisions in less detail. *See* Marchetti, *supra*, note 2, at 72–77 (discussing *Tribune I* and *Physiotherapy*).

117 PAH Litig. Tr., 2016 WL 3611831, at *9–10.

118 Petition for Writ of Certiorari, *Tribune I*, 138 S. Ct. 1162 (2018) (No. 16-317).

119 Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found., 138 S. Ct. 1162, 1163 (2018).

120 *Tribune II*, 946 F.3d 66 (2d Cir. 2019).

121 *See Tribune Customer Case*, No. 12-cv-2652, 2019 WL 1771786, at *9–10 (S.D.N.Y. Apr. 23, 2019).

122 *Id.* at *1.

shareholders from a CFTA because Tribune qualified as a "financial institution" under Section 101(22)(A).[123]

According to the district court's faulty construction of the Code and agency law, a trust company, Computershare Trust Company, N.A. (CTC), qualified as Tribune's "agent" in the challenged transaction simply by agreeing to collect and cancel the shares of former Tribune shareholders that cashed out their shares through Tribune's LBO.[124] According to the district court, under the definition of "financial institution" in Section 101(22)(A), CTC's purported role as Tribune's "agent" rendered Tribune itself a "financial institution."[125] The district court did not cite a single case for the proposition that combination entrustment and payment constitutes "a paradigmatic principal-agent relationship."[126]

3. *Tribune II*

In December 2019, the Second Circuit issued its amended opinion in *Tribune II*, concluding, as it did in *Tribune I*, that Section 546(e) preempts SLCFTAs.[127] Much of *Tribune II* contained the same reasoning as *Tribune I*. Like *Tribune I*, the *Tribune II* court repeated its concern that subjecting investors in publicly traded equity securities to constructive fraudulent transfer liability may weaken investor confidence in the public security markets.[128] *Tribune II*, however, implemented essentially the same erroneous reasoning Judge Cote used in the *Tribune Customer Case* regarding whether Tribune itself qualified as a "financial institution" as set forth in Section 101(22)(A).[129] In *Tribune II*, the Second Circuit ultimately concluded that: (i) CTC qualified as Tribune's "agent" in the LBO simply by agreeing to act as an intermediary between Tribune and its shareholders; and (ii) CTC's role as Tribune's "agent" rendered Tribune itself a "financial institution" pursuant to the definition of financial institution set forth in Section 101(22)(A).[130] As described in more detail later in this Article, the Second Circuit's ruling in *Tribune II* was erroneous, because, inter alia, it misconstrued: (i) Section 101(22)(A); (ii) the nature of most

123 *Id.* at *10–12.

124 *Id.* at *10–11.

125 *Id.* at *10–12.

126 *Id.* at *11.

127 *Tribune II*, 946 F.3d 66, 72 (2d Cir. 2019).

128 *Id.* at 93–94.

129 *Id.* at 77–80.

130 *Id.*

relationships between banks and their customers; and (iii) agency law.[131]

On July 6, 2020, the Tribune Trustee filed a petition for certiorari (the Tribune Petition) to the U.S. Supreme Court.[132] On October 5, 2020, the U.S. Supreme Court requested that the U.S. Solicitor General file a brief regarding the Tribune Petition.[133] On March 12, 2021, the U.S. Solicitor General filed her brief, in which she agreed with many arguments made by the Tribune Trustee, but nevertheless argued that the U.S. Supreme Court deny the Tribune Petition because, other than the Second Circuit, "[n]o other circuit has addressed whether, or under what circumstances, a party may qualify as a 'financial institution' for purposes of Section 546(e) simply by retaining a bank (or similar entity) to help effectuate a securities transaction."[134] On April 19, 2021, the U.S. Supreme Court denied the Tribune Petition.[135]

Although *Tribune II*'s erroneous decision currently applies in the Second Circuit, courts in other circuits may easily reach an opposite conclusion, giving rise to a circuit split and another possibility for the U.S. Supreme Court to decide the issue. Indeed, as described in more detail below, in *Greektown*, the U.S. Bankruptcy Court for the Eastern District of Michigan, finding *Tribune II*'s reasoning unpersuasive, recently did so.[136] Ideally, Congress would soon amend Section 546(e) as suggested later in this Article. Congress, however, is unlikely to do so any time soon because of, inter alia, the number of politically divisive issues currently beleaguering Congress. In the meantime, courts in circuits outside of the Second Circuit should not follow *Tribune II*'s erroneous holding. Instead, they should follow the sound reasoning of *Greektown*, which properly interpreted Section 101(22)(A).

B. Nine West

A recent decision from the Southern District of New York expanded the holding of *Tribune II* in the context of LBOs in a case stemming from the bankruptcy filing of Nine West Holdings, Inc.[137] In *Nine West*, the district court held that Section 546(e) insulated all

131 *See infra* Section IV.D.

132 Petition for Writ of Certiorari, *Tribune II*, 141 S. Ct. 2552 (2021) (No. 20-8).

133 Order Requesting Brief, *Tribune II*, 141 S. Ct. 232 (2020) (No. 20-8).

134 Brief for the United States as Amicus Curiae at 8, 21, *Tribune II*, 141 S. Ct. 2552 (2021) (No. 20-8).

135 *Tribune II*, 141 S. Ct. 2552 (2021).

136 *See* Greektown Litig. Tr. v. Papas (*In re* Greektown Holdings, LLC), 621 B.R. 797, 827–28 (Bankr. E.D. Mich. 2020).

137 *In re* Nine W. LBO Sec. Litig., 482 F. Supp. 3d 187 (S.D.N.Y. 2020).

transfers made to a debtor's entire body of Redeeming Shareholders in an LBO from, inter alia, an SLCFTA[138] simply because the predecessor company of debtor, Nine West Holdings, Inc. (NWHI),[139] and its parent company, Jasper Parent LLC (Jasper Parent), entered into a contract with Wells Fargo, N.A. (Wells Fargo) under which Wells Fargo acted as an intermediary between NWHI and a small, distinct set of its shareholders involving only a minuscule portion, or 0.4%, of the entire LBO.[140]

In *Nine West*, payments to the Redeeming Shareholders were made in three separate ways.[141] Specifically, Jasper Parent: (i) deposited approximately $4 million with Wells Fargo so that shareholders holding paper stock certificates could receive payment on account of their cancelled shares (the Certificate Transfers);[142] (ii) deposited approximately $1.105 billion into an account at Wells Fargo, which Wells Fargo agreed to wire to the DTCC, which in turn, credited the accounts of broker-dealers in favor of other shareholders of the debtor (the DTCC Transfer); and (iii) paid $78 million to insider and employee shareholders of the debtor through NWHI's payroll system.[143]

The district court specifically found that Wells Fargo was NWHI's agent only with respect to the Certificate Transfers.[144] The district court, however, went on to erroneously hold that once Wells Fargo was found to be an agent with respect to *any* transfer connected to the LBO, here the Certificate Transfers, it qualified as an agent of NWHI so that Section 546(e) would insulate *all* transfers made in connection with the LBO from avoidance, including (i) the DTCC Transfer, in which Wells Fargo had an extremely limited nonagent role; and (ii) the Payroll Transfer, in which Wells Fargo played no role whatsoever![145]

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138 In *Nine West*, the district court also held that Section 546(e) applied to intentional fraudulent transfers asserted under applicable state law. *Id.* at 207. Section 546(e) should never apply to intentional fraudulent transfer actions brought under state law. *See* Marchetti, *supra* note 2, at 82–83 (discussing Section 546(e) and intentional fraudulent transfer actions brought under state law).

139 Prior to the LBO, NWHI was named The Jones Group, Inc. (Jones Group). *In re Nine W.*, 482 F. Supp. 3d at 190–93. Following the LBO, Jones Group was renamed NWHI. *Id.*

140 *Id.* at 200–07.

141 *Id.* at 192.

142 *See* Brief and Special Appendix for Plaintiffs-Appellants at 17, 25–26, 55, *In re Nine W.*, No. 20-3257-cv (2d Cir. Mar. 5, 2021), 2021 WL 856645, at *8, *17, *46.

143 *In re Nine W.*, 482 F. Supp. 3d at 192. Following the LBO, Jones Group was renamed NWHI. *Id.*

144 *Id.* at 201–02.

145 *Id.* at 205–08.

C. Greektown

1. Facts of *Greektown*

In October 2020, the Bankruptcy Court for the Eastern District of Michigan (Judge Oxholm) issued an opinion that reached the opposite conclusion that *Tribune II* reached.[146] *Greektown* involved the following facts. Two separate LLCs, Monroe Partners, LLC (Monroe)[147] and Kewadin Greektown Casino, LLC (Kewadin), each owned fifty percent of the membership interests in Greektown Holdings, LLC (Greektown Holdings).[148] Kewadin agreed to purchase the membership interests of Monroe's prior members (the Prior Monroe Members) by making future periodic payments to them. Kewadin financed this transaction by causing Greektown Holdings to enter into an LBO.[149]

Pursuant to the LBO, Greektown Holdings borrowed approximately $182 million from Merrill Lynch, Pierce Fenner & Smith Inc. (Merrill Lynch).[150] Greektown Holdings did this by issuing notes to Merrill Lynch, which, pursuant to a Note Purchase Agreement and related documents (collectively, the Transaction Documents), acted as, inter alia, the sole lead administrative agent for the notes.[151] Pursuant to the Transaction Documents, Merrill Lynch was able to resell all or a portion of the notes to other institutional investors.[152] Merrill Lynch wired approximately $170 million from the proceeds of the sales of the notes to the bank accounts of the Prior Monroe Members.[153] Approximately two years and six months later, Greektown Holdings

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146 *See* Greektown Litig. Tr. v. Papas (*In re* Greektown Holdings, LLC), 621 B.R. 797, 802 (Bankr. E.D. Mich. 2020).

147 Dimitrios Papas, Viola Papas, Ted Gatzaros, and Maria Gatzaros owned the membership interests of Monroe and were the actual defendants in the case. *Id.* at 802–04. Prior to this opinion, in 2015, an earlier decision from a different bankruptcy judge in the Eastern District of Michigan dismissed the litigation trustee's suit and the U.S. District Court for the Eastern District of Michigan affirmed. *Id.* at 802. The litigation trustee then appealed that decision to the Sixth Circuit, which, following the U.S. Supreme Court's decision in *Merit*, vacated and remanded the case to the bankruptcy court. *See id.*

148 *Id.* at 804.

149 *Id.* at 804–05.

150 Merrill Lynch, along with several of its affiliates, were involved in the LBO. *Id.* at 805. For purposes of simplicity, this Article refers to Merrill Lynch and/or its affiliated entities as "Merrill Lynch."

151 *Id.* at 805–07, 810–14. The Transaction Documents consisted of, inter alia, (i) a "Commitment Letter;" (ii) a "Strategic Alternatives Letter;" (iii) a "Note Purchase Agreement;" (iv) a "New Credit Agreement;" and (v) a "Flow of Funds Memorandum." *Id.* at 810.

152 *Id.* at 805.

153 *Id.*

filed for chapter 11.[154] Later, a litigation trustee appointed under Greektown's confirmed chapter 11 plan sought to avoid, on behalf of Greektown's unsecured creditors, approximately $155 million in payments made to the Prior Monroe Members by asserting, inter alia, an SLCFTA.[155]

The Prior Monroe Members moved for summary judgment, arguing that Section 546(e) barred the action.[156] Like the defendants in the *Tribune Customer Case*, *Tribune II*, and *Nine West*, the Prior Monroe Members argued that Greektown Holdings itself qualified as a "financial institution" because Merrill Lynch, a bank, acted as Greektown Holdings' "agent" in the LBO by being an intermediary between the Prior Monroe Members and Greektown Holdings in the LBO.[157] The bankruptcy court correctly rejected this faulty argument and denied the motion for summary judgment.[158] In so doing, the court analyzed the plain language of Section 101(22)(A), agency law, and the Transaction Documents.[159]

2. *Greektown*'s Analysis of *Merit* and Section 546(e)

The court analyzed *Merit*, noting that *Merit* held that, for purposes of Section 546(e), "the only relevant transfer . . . is the transfer that the trustee seeks to avoid."[160] The court then explained how in *Merit*, the Supreme Court held that, when the trustee seeks to avoid a transfer, the transfer to be avoided is the transfer from the transferor to the ultimate transferee, and not the transfer to or from any intermediary acting between the transferor and the ultimate transferee.[161] Stated differently, the court correctly noted that Section 546(e) does not immunize a transfer from avoidance simply "because a qualified intermediary acted as a conduit between the debtor and the transferee."[162]

The court noted that, in *Merit*,

> the Supreme Court determined that . . . "the relevant transfer for purposes of the [Section] 546(e) safe-harbor inquiry is the overarching transfer that the trustee seeks to avoid." . . . In so ruling,

[154] *Id.* at 805–06.

[155] *Id.* at 797.

[156] *Id.* at 802.

[157] *Id.* at 803, 809–14.

[158] *Id.* at 809.

[159] *Id.* at 806–09.

[160] *Id.* at 815 (citing Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 888 (2018)).

[161] *Id.* at 815–16.

[162] *Id.* at 816.

> the Supreme Court emphasized that [Section] 546(e) is a limitation on an otherwise avoidable transfer[.] The transfer that . . . "the trustee may not avoid" is specified to be "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. But a transfer that is a securities transaction covered under [Section] 546(e).[163]

Moreover, the court noted that *Merit* accentuated the underlying legislative intent of Section 546(e)—to protect Qualified Intermediaries.[164] The court stated:

> Congress was concerned about transfers "*by* an industry hub" specifically: The safe harbor saves from avoidance certain securities transactions "made by or to (or for the benefit of)" [Qualified Intermediaries]. . . . Transfers "*through*" a [Qualified Intermediary], conversely, appear nowhere in the statute. And although Merit complains that, absent its reading of the safe harbor, protection will turn "on the identity of the investor and the manner in which it held its investment," that is nothing more than an attack on the text of the statute, which protects only certain transactions "made by or to (or for the benefit of)" certain covered entities.[165]

The court, again pointing to *Merit*, stated that the relevant transfer was the transfer from Greektown Holdings to the Prior Monroe Members—"the transfer the trustee sought to avoid."[166] The court then analyzed the "for the benefit of" language of Section 546(e) and determined that although Merrill Lynch earned substantial profits for its role in the LBO, the Prior Monroe Members failed to establish "that Merrill Lynch received a direct, ascertainable, and quantifiable benefit

163 *Id.* at 817 (citations omitted). The court also noted that Congress's "inclusion of [Qualified Intermediaries] as covered entities under [Section] 546(e), meant Congress intended to 'protect intermediaries without reference to any beneficial interest in the transfer.'" *Id.* at 818 (citation omitted). The court further stated that the U.S. Supreme Court explained:

> [T]he relevant transfer for purposes of [Section 546(e)] is the transfer that the trustee seeks to avoid under a substantive avoiding power, the question then becomes whether that transfer was "made by or to (or for the benefit of)" a covered entity, including a [Qualified Intermediary]. If the transfer that the trustee seeks to avoid was made "by" or "to" a [Qualified Intermediary] (as it was in *Seligson*), then [Section] 546(e) will bar avoidance, and it will do so without regard to whether the entity acted only as [a Qualified Intermediary]. [Section 546(e)] will, in addition, bar avoidance if the transfer was made "for the benefit of" that [Qualified Intermediary], even if it was not made "by" or "to" that entity. This reading gives full effect to the text of [Section] 546(e).

Id.

164 *Id.* at 818.

165 *Id.* (quoting *Merit*, 138 S. Ct. at 896–97).

166 *Id.* at 821 (quoting *Merit*, 138 S. Ct. at 895).

corresponding in value to the payments to [the Prior Monroe Members]."[167] The court stated that the advisory fees and other fees Greektown Holdings paid to Merrill Lynch for its role in the LBO were "not the type of benefit contemplated by the phrase 'for the benefit of,'" but were merely "incidental to the [LBO]."[168] The court noted that the "for the benefit of" language applies to a situation where there is a "benefit to a guarantor by the payment of the underlying debt of the debtor."[169]

3. *Greektown* Properly Concludes that Merrill Lynch Failed to Qualify as Greektown's Agent in the LBO

The court then analyzed whether Greektown Holdings itself qualified as a financial institution by, in turn, analyzing whether "Merrill Lynch was acting as an agent" of Greektown Holdings in the LBO.[170] The court pointed to the definition of agency.[171] The court further noted that the comments to the Restatement (Third) of Agency explain that not every party that functions as an intermediary between two other parties qualifies as an agent.[172] Likewise, the court noted that the principal's "right to control the conduct of the agent" is "fundamental to the existence of an agency relationship."[173]

After analyzing the Transaction Documents, the court held that Merrill Lynch did not act as Greektown Holdings' agent or custodian in

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167 *Id.* at 822–23.

168 *Id.* at 823. The court noted that those "several millions of dollars in fees" did "not correspond in value" to transfers made to the Prior Monroe Members. *Id.*

169 *Id.* at 822–23 (quoting Reily v. Kapila (*In re* Int'l Mgmt. Assoc.), 399 F.3d 1288, 1292 (11th Cir. 2005)).

170 *Id.* at 823–24.

171 *Id.* at 825. The court stated that "[a]gency 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." *Id.* (alteration in original); *see also* RESTATEMENT (THIRD) OF AGENCY § 1.01.

172 *In re Greektown*, 621 B.R. at 826. Quoting the Restatement (Third) of Agency, the court noted:

> Many actors perform an intermediary role between parties who engage in a transaction. Not all are agents in any sense, and not all who are agents act on behalf of those who use the intermediary service provided. For example, an employee of a courier service who shuttles documents among parties who are closing a transaction among them is not the parties' agent simply because an intermediary function is provided.

Id. at 826 (emphasis omitted) (quoting RESTATEMENT (THIRD) OF AGENCY § 1.01 cmt. h).

173 *Id.* at 826–27.

the LBO.[174] The court further stated that it was "not persuaded by the agency analysis in [*Tribune II*] as it does not distinguish between mere intermediaries contracted for the purpose of effectuating a transaction and agents who are authorized to act on behalf of their customers in such transactions."[175] The court noted that *Tribune II* held that Tribune had control over the intermediary involved in its LBO "by merely authorizing Computershare to accept funds as part of the [LBO] and further effectuating the transaction."[176]

The court further noted that *Tribune II* did not analyze the transaction documents between Tribune and Computershare in reaching its conclusion that Computershare acted as Tribune's agent in the LBO, making it impossible to establish whether the language contained in those transaction documents was similar to the Transaction Documents involved in Greektown Holdings' LBO.[177] The court also noted that the holding in *Tribune II* would lead to the conclusion that "any intermediary hired to effectuate a transaction would qualify as its customer's agent," thus "result[ing] in a complete workaround of *Merit Management*, which opined that the safe harbor provision does not insulate a transfer simply because a qualified intermediary acted as a mere conduit."[178]

Looking to the Transaction Documents, the court noted that, although Merrill agreed to "arrange an offering of senior unsecured notes . . . to act as exclusive financial advisor to . . . [Greektown Holdings] in connection with exploring Strategic Alternatives," it did not agree to act as Greektown Holdings' agent.[179] The Transaction Documents, however, stated that "Merrill Lynch shall act as an independent contractor."[180] More importantly, however, the Note Purchase Agreement[181] executed between Merrill Lynch and Greektown Holdings expressly provided that: (i) Merrill Lynch was "acting solely as principals and [we]re not the agents or fiduciaries of [Greektown Holdings;]" and (ii) Merrill Lynch did not have any "obligation[s]" to

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174 *Id.* at 840.

175 *Id.* at 827.

176 *Id.*

177 *Id.*

178 *Id.* (citing Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 833, 897 (2018)).

179 *Id.* at 811–12. The court also noted that the Transaction Documents provided that Greektown, among other related entities, agreed to "engage Merrill Lynch . . . as its sole lead administrative agent, sole lead bookrunning manager, sole lead managing underwriter, sole tender and placement agent, sole dealer-manager, sole lead arranger or principal counterparty or exclusive financial advisor, as the case may be." *Id.* at 812 (emphasis omitted).

180 *Id.* at 812 (emphasis omitted).

181 *Id.* at 812–13. The Note Purchase Agreement was one of the Transaction Documents.

Greektown Holdings with respect to the LBO other than the "obligations expressly set forth in [the Note Purchase Agreement]."[182]

Next, the court analyzed the credit agreement (Credit Agreement),[183] which expressly provided that "[e]ach Lender [i.e., each note purchaser] hereby designates [Merrill Lynch] to act as the Administrative Agent under [the Transaction Documents] and authorizes [Merrill Lynch], in its capacity as the Administrative Agent, to act on behalf of such Lender under [the Transaction Documents]."[184] The Credit Agreement further provided that Merrill Lynch accepted its role as Administrative Agent for the other note purchasers and that the note purchasers authorized Merrill to act as their agent.[185] The Credit Agreement also stated that Merrill Lynch would not have "any right, power, obligation, liability, responsibility or duty under [the Transaction Documents] other than those" that apply to Merrill Lynch "in its capacity as a Lender" pursuant to the Transaction Documents.[186] Moreover, the Credit Agreement provided that Merrill Lynch would not have any "fiduciary relationship with any Lender."[187]

The court held that no agency relationship existed between Greektown Holdings and Merrill Lynch.[188] The court concluded that Merrill Lynch's collection and distribution of the loan proceeds pursuant to its agreement with Greektown Holdings was not sufficient to establish that Greektown Holdings "controlled" Merrill Lynch in the LBO to give rise to an agency relationship.[189] Instead, the court concluded that Greektown Holdings "merely authorized [Merrill Lynch] to perform contractual services."[190] The court further stated:

> The [Transaction Documents] do not establish that [Merrill Lynch] was "a business representative" or could "bring about, modify, affect, accept performance of, or terminate contractual obligations between Holdings and third persons." . . . In fact, [Merrill Lynch] was on the

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182 *Id.* at 812–13, 828–32 (first alteration in original) (emphasis omitted). The court noted that Merrill Lynch "owed money to [Greektown] Holdings for the Notes it had purchased." *Id.* at 829. Merrill Lynch, however, was "not holding funds as a fiduciary, but, rather, [because] it had an obligation to pay [Greektown] Holdings for the Notes under the Note Purchase Agreement." *Id.*

183 The Credit Agreement was executed among Greektown Holdings and one of its affiliates as borrowers, "various financial institutions" as the lenders, and Merrill Lynch as the "sole Lead Arranger," the "Sole Bookrunner," the "syndication agent," and the "Administrative Agent." *Id.* at 813–14, 833.

184 *Id.* at 813, 833.

185 *Id.* at 813.

186 *Id.* at 814 (emphasis omitted).

187 *Id.* at 813–14, 828–30, 832–34.

188 *Id.* at 830.

189 *Id.*

190 *Id.*

> other side of the transaction ([Greektown] Holdings as issuers and [Merrill Lynch] as purchaser; [Greektown] Holdings as borrower and [Merrill Lynch] as lender).[191]

Instead, the court found that under the Transaction Documents, Merrill Lynch acted as an agent for the other lender/note purchasers, which were on the opposite side of the transaction from Greektown Holdings.[192] The court then held that Merrill Lynch did not qualify as a custodian of Greektown Holdings. The court indicated that the Prior Monroe Members did not have any lien on the proceeds of the note sales.[193] Likewise, Merrill Lynch was not: (i) enforcing any such lien;[194] or (ii) administering any property "for the benefit of all" of Greektown Holdings' creditors.[195]

As analyzed in more detail below, *Greektown* properly construed Section 101(22) as it acts in tandem with Section 546(e). But that begs the question—why did Congress use the following language (the Customer Language) in Section 101(22)(A): "when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as *agent or custodian for a customer* . . . in connection with a securities contract . . . such customer."[196] Indeed, as mentioned above, much of that language was contained in the original definition of "financial institution," which Congress added to the Code in 1984.[197] There is one type of transaction, however, involving systemically important parties, to which the application of the Customer Language makes perfect sense—Agent SLTs, which involve agent banks.

191 *Id.*; *see also id.* at 830–34 (discussing how Transaction Documents failed to establish agency relationship between the parties).

192 *Id.* at 834.

193 *Id.* at 840.

194 The court properly noted that "when a person or entity is appointed or authorized [by contract] to take charge of property of the debtor for the purpose of enforcing a lien," such person or entity does not have to enforce that lien "for the benefit of [all] the debtor's creditors" to qualify as a custodian. *Id.* at 839; *see also* Taylor's of St. Petersburg, Inc. v. Gugino (*In re* Taylor's of St. Petersburg, Inc.), 110 B.R. 593, 596 (Bankr. M.D. Fla. 1990); Flournoy v. City Fin. (*In re* Lewis), 12 B.R. 106, 108 (Bankr. M.D. Ga. 1981). However, if a party seeks to qualify as a custodian by acting "for the purpose of general administration of [the debtor's] property," then to so qualify, that party must so act "for the benefit of [all of] the debtor's creditors." *In re Greektown*, 621 B.R. at 840.

195 *In re Greektown*, 621 B.R. at 839.

196 11 U.S.C. § 101(22)(A) (emphasis added).

197 *See supra* Section I.H.

III. SECURITIES LENDING AND THE SECURITIES LENDING MARKET

A. *Basics of SLTs*

Recall that Section 546(e) was enacted to protect Protected Parties, which generally act as: (i) Intermediaries; or (ii) systemically important financial market participants in certain specialized financial transactions whose susceptibility to certain provisions of the Code could cause "systemic risk" in the financial markets. In connection with LBOs, Section 546(e) should act to protect only the Code's narrowly defined Protected Parties, which are systemically important financial market participants, such as a bank acting as an intermediary in an LBO or an entity acting as an intermediary in the SCCS. Furthermore, although some of the transaction documents with banks or similar intermediaries involved in LBOs may qualify as a securities contract, those are not the only types of "securities contracts" to which "financial institutions" are parties. Another type of securities contract is a contract associated with the lending of securities, taking collateral, and issuing a Guaranty with respect thereto—i.e., documents used in Agent SLTs.[198] Securities contracts that are associated with Agent SLTs are routinely entered into by banks, stockbrokers, and other systemically important interconnected financial market participants in the SLM.[199]

The SLM is a worldwide business, which as of 2019, had a total estimated loan balance of over $800 billion.[200] The major "players in the [SLM] are securities houses, investment banks, fund managers, pension funds, central banks, insurance companies, broker dealers, hedge funds," and large corporations containing a significant amount of treasury stock.[201] SLTs may be structured on either: (i) an "on demand"

198 *See* 11 U.S.C. § 741(7) (defining securities contract).

199 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 10–13, 43, 45–51.

200 *See* Sam Pierson, *Securities Lending 2019 Snapshot*, IHS MARKIT (Jan. 3, 2020), https://ihsmarkit.com/research-analysis/securities-lending-2019-snapshot.html [https://perma.cc/R9W2-FKUB]; HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 2–6; *see also J.P. Morgan Asset Management Securities Lending Overview*, J.P. MORGAN ASSET MGMT., https://am.jpmorgan.com/pt/en/asset-management/institutional/insights/securities-lending [https://perma.cc/8RPW-JCMV]. As used in this Article, the term SLM does not include Repurchase Agreements (Repos), which, in substance, are similar to SLTs. *See* Onnig H. Dombalagian, *Substance and Semblance in Investor Protection*, 40 IOWA J. CORP. L. 599, 624 (2015). Under the Code, Repos are technically characterized as "repurchase agreements." *See* 11 U.S.C. § 101(47).

201 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 6. Most SLTs are short term in nature, having a duration of under one year. *Id.* at 6.

basis;[202] or (ii) a "term basis"—i.e., for an agreed-upon period of time.[203] The SLM is vitally important to both the international and the U.S. financial markets. For example, virtually every transaction involving a "short sale" of a security involves an SLT.[204] Likewise, many "prime brokerage" transactions involve an SLT.[205]

Basically, an SLT functions as follows. The lender of the securities lends those securities to a borrower.[206] The borrower, in return, posts Margin to the lender, which generally takes the form of cash or securities.[207] Even though terms such as "borrower," "lender," and "collateral" are used, documents used in the SLM generally treat the "loan" of the securities from the lender to the borrower as an "outright transfer" of lender's title to those securities to the borrower.[208] Likewise, SLAs generally treat the transfer of Margin from the borrower to the lender as an "outright transfer" of the borrower's title in that Margin to

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202 *Id.* at 8–10. SLTs that are structured on an "on demand" basis generally involve a short notice period within which the lender can demand a return of the previously lent securities from the borrower. *Id.* at 10.

203 *Id.* at 8–10. Most SLTs are structured as "on demand" transactions, meaning that a lender can recall the lent securities by giving the borrower "short notice" of the lender's right to recall the securities. *Id.* at 10. SLTs date back to the nineteenth century. *Id.* at 2.

204 *Id*. at 2. A short sale is a sale of a security that the "seller does not own." James Chen, *Short Sale*, INVESTOPEDIA (Jan. 28, 2021), https://www.investopedia.com/terms/s/shortsale.asp [https://perma.cc/MZ4D-LRGY]. In a short sale, the "seller" borrows the relevant securities or commodities from a lender and agrees to return them to the lender at an agreed upon future date. *Id.* Sellers in short sales generally bet on a decrease in the price of the relevant securities or commodities. *Id.* The lender of the relevant securities or commodities, on the other hand, maintains a "long position" in them, anticipating that their value will increase instead of decrease. *Id.* Short sales have been controversial. HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 2–4 (discussing controversial issues associated with short sales). Indeed, various regulatory disclosure requirements apply to short sales in the United Kingdom, the United States, and France. *Id.*

205 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 8. Prime brokerage transactions involve combined "services that investment banks [and other financial market participants] offer to hedge funds and other large investment clients that need . . . to borrow securities . . . to engage in netting to achieve absolute returns." James Chen, *Prime Brokerage*, INVESTOPEDIA (Mar. 16, 2021), https://www.investopedia.com/terms/p/primebrokerage.asp [https://perma.cc/ZHW2-8L6U].

206 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 8.

207 *Id.* The securities may take the form of either shares of stock or bonds. *Id.* If the lender consents, a borrower could also use certificates of deposit or a letter of credit as collateral. *Id.*

208 *Id.* at 8–9. In the case of nongovernment issued securities, the Agent Bank, on behalf of the lender, generally perfects its security interest in the Margin pursuant to Articles 8 and 9 of the Uniform Commercial Code. *See generally* CARL S. BJERRE & SANDRA M. ROCKS, THE ABCS OF THE UCC: ARTICLE 8: INVESTMENT SECURITIES (2d ed. 2004). The U.S. Treasury published regulations that apply to the transfer and pledge of U.S. Treasury securities such as U.S. Treasury bills, notes, and bonds (Treasury Securities). *See* 31 C.F.R. §§ 354, 357; 12 C.F.R. §§ 9.10, 9.12, 615.5450–.5462, 811, 1511; 18 C.F.R. § 1314; 24 C.F.R. § 350.

the lender.[209] This allows the "borrowed securities" and the Margin to either be sold or lent to other market participants by the borrower or the lender, as the case may be.[210] At the agreed-upon conclusion date of the transaction (the Maturity Date), the borrower has the obligation to return equivalent securities (Equivalent Securities) to the lender that the lender had lent to it, and the lender has the concurrent obligation to return the Margin to the borrower.[211]

Various interconnected intermediaries play a central role in the SLM, such as: (i) custody banks; (ii) prime brokers; (iii) banks; and (iv) clearinghouses and central securities depositories.[212] Custody banks generally "lend securities from the portfolios they hold on behalf of institutional investors."[213] Prime brokers, on the other hand, generally grant "access to lendable securities" to hedge funds, which are clients of the prime broker.[214] Clearinghouses and central securities depositories "clear and settle securities [transactions] and provide a number of automated services such as stock identification and tracking."[215] Large central securities depositaries settle most SLTs.[216] As a leading publication often consulted by attorneys and market participants engaging in SLTs explains:

> Intermediaries typically provide valuable services such as supplying liquidity, i.e. borrowing securities on demand and lending them on a term basis. They also offer credit enhancement and comprehensive administrative services covering mark to market calculations (advised to both the borrower and lender), checking collateral eligibility and managing it, custody of securities, inter account transfers, dealing with dividends and other corporate actions, daily reporting and protecting borrowers from recalls.[217]

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209 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 9. In the United States, the Margin generally consists of either cash collateral or high-grade securities issued by the U.S. government. VIKTORIA BAKLANOVA, ADAM COPELAND & REBECCA MCCAUGHRIN, FED. RSRV. BANK OF N.Y., REFERENCE GUIDE TO U.S. REPO AND SECURITIES LENDING MARKETS 31 (2015) (Staff Report No. 740).

210 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 9.

211 *Id.* In the context of the SLM, the term "equivalent" signifies "an identical type, class, nominal value, issue, issuer, description and amount as the securities or [Margin] originally transferred." *Id.* at 8. Equivalent securities are generally referred to as "fungible." *Id.* (emphasis omitted).

212 *Id.* at 10.

213 *Id.*

214 *Id.*

215 *Id.*

216 *Id.*

217 *Id.*

B. *Agent SLTs*

Agent SLTs generally involve an Agent Bank, which is usually a custody bank, that acts as an agent for its "principal" and "customer," the securities lender, when the securities lender loans securities to a third party typically involved in Agent SLTs, such as registered broker-dealers.[218] That broker-dealer, in turn, loans those securities to various borrowers such as hedge funds or mutual funds.[219] This agency relationship between the lender of the securities and the Agent Bank is a fiduciary relationship, in which the lender is the principal and the Agent Bank is the agent.[220] In such transactions, the lenders are the "customers" of the Agent Bank and are generally institutional investors such as: central banks, sovereign wealth funds, pension funds, endowments, insurance companies, or large corporations containing a significant amount of treasury stock.[221]

Agent SLTs generally involve the following agreements: (i) an agreement executed between the agent and its customer/lender that describes, inter alia, the terms of the agent-lending arrangement;[222] and (ii) an agreement that contains the terms applicable to the lending arrangement and the roles of the parties involved in the transaction.[223] In Agent SLTs, the lender profits by charging a fee to the borrower.[224] The Agent Bank, on the other hand, profits through a fee agreement with the lender, which is usually an agreed-upon "fixed percentage split

218 *Id.* at 10–11.

219 *Id.* at 10–12.

220 *See* Gregory J. Lyons & Michael P. McAuley, *Securities Finance: Case Study of the Regulatory Roadmap Necessary to Navigate the Challenges in the New Financial Services Environment*, 29 BANKING & FIN. SERVS POL'Y REP. 1, 2–3 (2010).

221 *See* HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 11; *see also J.P. Morgan Asset Management Securities Lending Overview*, *supra* note 200.

222 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 36. This agreement will also specify the "special lending criteria required by the lender." *Id.*

223 *Id.* at 36. This triparty agreement may sometimes be referred to as "an escrow agreement" or a "triparty custodial undertaking." *Id.* These agreements would generally qualify as "securities contracts" under the Code. *See* 11 U.S.C. § 741(7). Under the Code, transactions involving the "repurchase of securities," which in concept and substance, are similar to SLM transactions, generally qualify as a Repo documented under a Repo Agreement if pursuant to the Repo Agreement, the term of the transaction is less than 365 days. 11 U.S.C. §§ 101(47), 559. *See generally* Crédit Agricole Corp. v. Am. Home Mortg. Holdings, Inc. (*In re* Am. Home Mortg. Holdings, Inc.), 637 F.3d 246 (3d Cir. 2011) (discussing Repos).

224 *See* BLACKROCK, SECURITIES LENDING: THE FACTS 1 (May 2015), https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-securities-lending-the-facts-may-2015.pdf [https://perma.cc/9AMG-QXAC].

of the income generated by the lending activity and the reinvestment of [the Margin]."[225]

The Agent Bank generally carries out the following activities: (i) receiving requests from prospective borrowers and deciding whether to make the loan; (ii) transferring the loaned securities to the borrower's account, and (iii) collecting the Margin from the borrower and crediting it to the lender's account, which is also maintained with the Agent Bank.[226] The Agent Bank also monitors the value of the Margin on a daily basis.[227] If the value of the Margin falls below a pre-agreed upon amount, the Agent Bank will generally make a call for additional Margin from the borrower.[228] On the Maturity Date, the Agent will: (i) transfer the Equivalent Securities to the lender's account; and (ii) transfer the Margin to the borrower's account.[229] Thus, in Agent SLTs, the Agent Bank may act as both an agent for a lender and as a custodian of the Margin.[230]

An Agent Bank, similar to an intermediary in the SCCS, provides an indemnity or Guaranty to its customer (i.e., its principal—the securities lender), pursuant to which the Agent Bank agrees to indemnify the lender in an event of a borrower default (a Borrower Default)—which would occur if, inter alia, the value of the Margin posted by the borrower is insufficient to purchase Equivalent Securities on the Maturity Date.[231]

If a Borrower Default occurs, the Agent is generally obligated to liquidate the Margin and use the proceeds thereof to buy Equivalent Securities.[232] If the liquidation of the Margin does not produce sufficient proceeds to purchase those Equivalent Securities, then the Agent, under the Guaranty or the indemnity, is obligated to use its own funds "to make up the difference" between amount realized by the liquidation of

225 *Id.*

226 HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 36–37. The Agent's transfer of the securities to the borrower and the collection of the Margin from the borrower occur contemporaneously. *Id.*

227 *Id.* at 37.

228 *Id.*

229 *Id.*

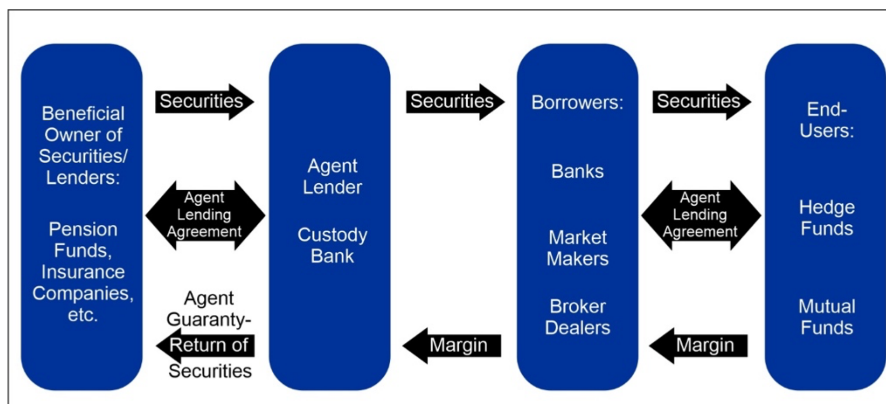
230 *Id.* at 36–37. Other types of agent lending transactions also exist. *Id.* at 573. One example would be an investment manager acting as an agent in an SLT for investment funds that desire to lend securities. *Id.* A different example would be a prime broker acting as an agent for one or more of its hedge fund clients that desire to borrow securities. *Id.*

231 *See* Josh Galper, *Why Securities Lending Indemnification Matters to Beneficial Owners*, FINADIUM (Jan. 19, 2017), https://finadium.com/why-securities-lending-indemnification-matters-to-beneficial-owners [https://perma.cc/SEH7-6P3R] (describing use of the Guaranty in SLTs); Lyons & McAuley, *supra* note 220, at 2–3; HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 11, 37.

232 *See* Lyons & McAuley, *supra* note 220, at 2–3.

the Margin and the amount required to purchase the Equivalent Securities.[233]

A diagram of the transaction may look like this[234]:



C. *Insolvency Concerns Related to Agent SLTs*

As mentioned above, one of the major concerns for financial market participants engaging in specialized financial transactions involving systemically important parties, such as swap agreements, repurchase agreements, forward contracts, and SLTs, is their ability to enforce certain rights contained in the applicable transaction documents if a counterparty to such a transaction files for bankruptcy.[235] In the case of SLTs,[236] some of those bankruptcy-related concerns are: (i) the ability to net various securities lending transactions documented under a MSLA or similar master agreement against each other to arrive at a net amount;[237] (ii) the ability to promptly liquidate the Margin and apply the associated proceeds thereof to the debtor's

233 *Id.*

234 *See J.P. Morgan Asset Management Securities Lending Overview*, *supra* note 200; *see also* Thomas A. Peters, *An Overview of Securities Lending*, KREISCHER MILLER (Jan. 6, 2012), https://www.kmco.com/resource-center/article/leading-edge/an-overview-of-securities-lending [https://perma.cc/LD6F-ZKFS].

235 *See supra* Section I.E.

236 Financial market participants in other financial market transactions such as swaps, Repos, and forward contracts also have many of these concerns. *See supra* Section I.E.

237 This is essentially the right of the lender, through the Agent, to exercise its right of setoff among all the trades documented under an MSLA or similar form, which would generally result in a net amount owed to the lender. *See* HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 35, 44–51; 11 U.S.C. § 553.

obligations; (iii) the lender's vulnerability to an Avoidance Action[238] asserted by a Trustee of the borrower's bankruptcy if the Agent, at an earlier time, liquidated the Margin and transferred the proceeds to that lender; (iv) in the situation of such an Avoidance Action, the ability of the Guaranty to be revived, making the Agent liable to the lender for the amount paid by the lender to the Trustee.[239]

IV. The Proper Framework for Interpreting and Applying the Customer Language Contained in Section 101(22)(A) Is that It Applies to Agent SLTs, Not LBOs

A. *Congress Enacted Section 101(22)(A) to Insulate Agent Banks in Agent SLTs from Liability Associated with a Revived Guaranty*

Recall that Section 546(e) prevents a Trustee from bringing a CFTA or preference action against a Protected Party if the transfer was made pursuant to a Safe Harbor transaction.[240] When a Trustee brings a CFTA or a preference action, the Trustee generally sues the "transferee" of property it is seeking to recover.[241] Generally, an intermediary is not considered a "transferee" under the Code, because an intermediary does not have a beneficial interest in the property it received from the debtor.[242] Instead, an intermediary receives that property in a bailee-like capacity, on behalf of the beneficial owner.[243]

238 *See supra* Sections I.A–I.B (discussing Avoidance Actions).

239 *See infra* notes 248–49 and accompanying text.

240 *See* 11 U.S.C. § 546(e).

241 *See id.* § 550; *see also id.* § 548(a)(1)(B). This Article mostly uses a CFTA as an example of an Avoidance Action that a Trustee could bring which could, in turn, disrupt the SLM. Other types of Avoidance Actions, such as a preference action under Section 547 of the Code, could also cause such disruption. *See, e.g.*, *id.* § 547.

242 *See id.* § 550(b); Bonded Fin. Servs., Inc. v. Eur. Am. Bank, 838 F.2d 890, 893 (7th Cir. 1988) ("When A gives a check to B as agent for C, then C is the 'initial transferee'; the agent may be disregarded."); *see also* Ralph Brubaker, *Understanding the Scope of the § 546(e) Securities Safe Harbor Through the Concept of the "Transfer" Sought to Be Avoided*, 37 BANKR. L. LETTER 1, 6–9 (2017) (discussing why intermediaries do not qualify as transferees in context of Avoidance Actions).

243 *See, e.g.*, Earhart v. Callan, 221 F.2d 160, 163 (9th Cir. 1955) ("A bailment is generally regarded as the relationship arising when personal property is delivered to another for some particular purpose upon [a] . . . contract to re-deliver the [personal property] when the purpose had been fulfilled or to otherwise deal with the [personal property] according to the bailor's directions.").

As mentioned above, the Court in *Merit* recognized this concept in its holding.[244]

As mentioned in more detail earlier in this Article, the Safe Harbors were enacted to prevent "systemic risk" in the financial markets by preventing a "domino effect" if either an intermediary in the SCCS or one of the Code's narrowly defined Protected Parties[245] filed for bankruptcy. Many, if not all, of the financial market participants in Agent SLTs, such as Agent Banks, stockbrokers, and mutual funds, generally qualify for status as one of these narrowly defined Protected Parties, such as a financial participant, stockbroker, or the "catchall" category of a "financial institution." Thus, these systemically important financial market participants would be immune to a CFTA or a preference action. This catchall category of financial institution is especially important in Agent SLTs.

As described above, Agent Banks play a crucial role in the SLM. If a borrower in an Agent SLT files for bankruptcy, the Trustee of the borrower's bankruptcy estate could bring a CFTA (or preference action) against the securities lender, seeking to claw back the value of the Equivalent Securities (or the related Margin) the debtor transferred, through the Agent Bank, to the securities lender—the transferee. The Agent Bank would most likely either: (i) not qualify as a transferee under the Code because it functioned solely in the capacity of an intermediary; or (ii) qualify as one of the Code's narrowly defined Protected Parties.[246] Certain lenders of securities however, such as endowments, insurance companies, or pension funds, may not qualify as either: (i) one of those Protected Parties; or (ii) an intermediary.

Although Agent Banks will generally qualify as either an intermediary or a Protected Party, if Section 101(22)(A) did not contain the Customer Language, neither status as an intermediary nor as a Protected Party would protect an Agent Bank from potential significant liability to the securities lender resulting from a "revived" Guaranty.[247]

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[244] Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 892–93 (2018). Section 546(e), along with "the specific context . . . and the broader statutory structure all support the conclusion that the relevant transfer for purposes of [Section 546(e)] is the overarching transfer that the trustee seeks to avoid." *Id.*

[245] As described in more detail earlier in this Article, parties to repurchase transactions, swap transactions, forward contracts, and Repos also generally qualify as Protected Parties. *See supra* notes 15, 50–51 and accompanying text.

[246] *See supra* notes 50–52 and accompanying text (discussing Safe Harbors and parties qualifying as Protected Parties thereunder).

[247] As recognized by *Merit*, such guarantees (among others in the SCCS) are the reason that Section 546(e) contains the language "or for the benefit of." *See Merit*, 138 S. Ct. at 889–90; *see also Bonded Fin. Servs.*, 838 F.2d at 895. The language contained in Section 550 that reads "the

The Guaranty could be revived if: (i) the borrower returned Equivalent Securities to the securities lender on the Maturity Date; (ii) the borrower later filed for bankruptcy; (iii) the Trustee of the borrower's bankruptcy estate later brought a CFTA (or preference action) against the securities lender (i.e., the customer of the Agent Bank), seeking to claw back the value of the Equivalent Securities (or the related Margin);[248] and (iv) the Trustee is successful in either: (a) obtaining a judgment against the securities lender;[249] or (b) negotiating a court-approved settlement of such an Avoidance Action.[250] This situation creates credit risk for the Agent Bank.[251] In this situation, an Agent could face significant losses, making it unable to complete other SLTs.

The bankruptcy filings of several borrowers in Agent SLTs would exacerbate this risk. Such numerous borrower bankruptcy filings, in turn, could cause defaults by other parties to SLTs, resulting in "systemic risk" or a "domino effect" of Agent Banks and other systemically important financial market participants that are crucial to the effective functioning of the SLM.[252] Indeed, this hypothetical

entity for whose benefit the initial transfer was made" refers to "a guarantor or debtor—someone who receives the benefit but not the money." *Id.* (internal quotes omitted). If A pays B with instructions to reduce C's loan obligation to B, then B is the "initial transferee[]" and C is "the entity for whose benefit" the transfer was made. *See id.* (internal quotes omitted). The language "the entity for whose benefit" contained in Section 550 is virtually identical to the language "or for the benefit of" contained in Section 546(e). *See* Brubaker, *supra* note 242, at 14–15. *Compare* 11 U.S.C. § 550(a)(1), *with id.* § 546(e).

248 Recall that the Agent would purchase these "equivalent securities" after liquidating the Margin provided to it by the borrower.

249 *See, e.g.*, Herman Cantor Corp. v. Cent. Fidelity Bank, N.A. (*In re* Herman Cantor Corp.), 15 B.R. 747 (Bankr. E.D. Va. 1981); Jones v. Laramore, 102 S.E. 526 (Ga. 1920); Hooker v. Blount, 97 S.W. 1083 (Tex. Civ. App. 1906); Swarts v. Fourth Nat'l Bank of St. Louis, 117 F. 1 (8th Cir. 1902); N. Bank of Ky. v. Farmers' Nat'l Bank, 63 S.W. 604 (Ky. Ct. App. 1901). *See generally* Stephen L. Sepinuck, *Revival Clauses in Guarantees: Protecting the Creditor from Preference and Fraudulent Transfer Risk*, 2 TRANSACTIONAL LAW. 1 (2012) (discussing revival of guaranty). A well-drafted Guaranty will generally include a clause providing that the Guaranty will be revived if the beneficiary of the Guaranty either: (a) settles or loses an Avoidance Action brought by a Trustee; or (b) settles a threatened Avoidance Action after receiving the "reasonable advice of its counsel" to do so. *Id.* at 1–2.

250 *See, e.g.*, SNTL Corp. v. Ctr. Ins. Co. (*In re* SNTL Corp.), 571 F.3d 826 (9th Cir. 2009). *See generally* Sepinuck, *supra* note 249 (discussing revival of guaranty). Likewise, an Agent's Guaranty could be revived if the Guaranty contains a properly drafted revival clause providing that the Guaranty will be revived if the lender/customer settles an Avoidance Action threatened to be brought by the Trustee in a demand letter. *Id.*

251 *See* BAKLANOVA, COPELAND & MCCAUGHRIN, *supra* note 209, at 41–44.

252 Lenders of securities also play a vital role in the SLM, as they provide a crucial and steady supply of the securities lent in the SLM. If they were vulnerable to a CFTA, they may be unwilling to engage in SLTs at all. Alternatively, to compensate for such a bankruptcy-related risk, those securities lenders could require higher lending fees for engaging in SLTs. This could cause a

scenario gives rise to similar bankruptcy-related concerns that arose as a result of *Seligson*, which, as *Merit* explained, caused great concern among financial market participants in the SCCS, a central and integral part of the overall financial markets.[253]

As mentioned above, such concerns led to the enactment and eventual expansion of the Safe Harbors.[254] Thus, by insulating an Agent Bank's "customer" (the securities lender in an Agent SLT, such as an insurance company or an endowment that may not otherwise qualify as a Protected Party) from constructive fraudulent transfer or preference liability, Congress prevented the rise of such contingent Guaranty liability in the first place. Without such liability, Agent Banks, which are systemically important financial market participants, could not have any liability on a revived Guaranty triggered by a Trustee having brought a preference action or a CFTA against a securities lender in an Agent SLT.

The Customer Language contains the following language relating to certain defined parties that act as "an agent or custodian" for a "customer": "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."[255]

An Agent SLT is truly a fiduciary relationship—i.e., an agency relationship, where the Agent Bank is the agent of the lender, which is also the principal.[256] If Congress did not insert the Customer Language in Section 101(22)(A), Agent Banks could face significant losses stemming from a revived Guaranty, that in turn, resulted from a lender's (i.e., the customer of the Agent Bank) loss or settlement of a CFTA or preference action. This seemingly convoluted Customer Language deems a securities lender in an Agent SLT to fit within the

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shortage of securities available to lend in the international SLM, and it could consequently adversely affect the SLM. *See, e.g.*, Chris Benedict, *What Drives Demand in Specials?*, DATALEND (May 2019), https://datalend.com/what-drives-demand-in-specials [https://perma.cc/G559-PYVD] (discussing security supply shortage).

[253] *See* Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 889–90 (2018).

[254] *See id.*

[255] 11 U.S.C. § 101(22)(A).

[256] Similarly, as illustrated in the diagram located above, the broker-dealer or "stockbroker" may also qualify as an "agent" of its borrower-customer, such as a mutual fund. *See supra* note 234 and accompanying text and graphic (illustrating an Agent SLT). Likewise, that stockbroker may also qualify as an intermediary. In a sense the borrower, such as a stockbroker, may qualify as an intermediary for an end user such as a hedge fund, which transfers Margin to the stockbroker, which, in turn, delivers that Margin to the Agent Bank. *See supra* note 234 and accompanying text and graphic.

catchall definition of a "financial institution," and thus the securities lender qualifies as a Protected Party against which a Trustee could not bring a CFTA or a preference action. As a result, an Agent Bank is insulated from liability related to a revived guaranty triggered by a CFTA (or preference action) brought against the Agent Bank's customer—the securities lender.

B. *"Customer" Definition Contained in Section 741*

Congress's inclusion of the parenthetical, "(whether or not a 'customer', as defined in Section 741)," within the Customer Language supports this construction of Section 101(22)(A).[257] The definition of "customer" contained in Section 741 is limited in scope and applies to liquidations of broker-dealers (Stockbrokers).[258] The definition of "customer" under Section 741, and under the Securities Investor Protections Act (SIPA), are: (i) very similar to one another;[259] and (ii) "narrowly defined."[260]

Stockbrokers cannot file for chapter 11 bankruptcy protection,[261] but they can, however, file for bankruptcy under subchapter III of chapter 7 of the Code.[262] Similarly, if the Stockbroker is a registered broker-dealer, which most of them are,[263] the Stockbroker could be subject to a proceeding under SIPA, which incorporates many of the provisions of the Code into SIPA.[264] Thus, many of the cases construing

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[257] 11 U.S.C. § 101(22)(A).

[258] *See id.* § 741.

[259] *See In re* Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 236 (2d Cir. 2011). *Compare* 15 U.S.C. §§ 78*lll*(2), 78fff-2(4), *with* 11 U.S.C. § 741(2).

[260] *See* Dombalagian, *supra* note 200; Stafford v. Giddens (*In re* New Times Sec. Servs., Inc.), 463 F.3d 125, 127 (2d Cir. 2006). "Lenders are simply not a class to be specially protected under SIPA and in fact were expressly excluded from the definition of customer upon the enactment of the 1978 amendments to SIPA." *Id.* at 128 (quoting *In re* Hanover Square Sec, 55 B.R. 235, 238–39 (Bankr. S.D.N.Y. 1985)). The definition of "customer" under Section 741, of course, is narrower than the definition of "customer" contained in Section 101(22)(A). *Compare* 11 U.S.C. § 741(2), *with* 11 U.S.C. § 101(22)(A).

[261] 11 U.S.C. § 109(d) (stating that Stockbrokers cannot file for chapter 11 protection).

[262] *See id.* §§ 741–753; *see also* 6 COLLIER ON BANKRUPTCY ¶ 740.01 (16th ed. 2021) (describing Stockbroker liquidations). Similarly, subchapters IV and V of chapter 7, respectively, apply to the liquidation of commodity brokers and clearing banks. *See* 11 U.S.C. §§ 761–767, 781–784.

[263] *See* 6 COLLIER ON BANKRUPTCY ¶ 740.01 (describing Stockbroker liquidations).

[264] *See* 15 U.S.C. § 78fff(b). A SIPA proceeding is basically "a bankruptcy liquidation tailored to achieve SIPA's objectives." Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC (*In re Bernard L. Madoff Inv. Sec. LLC*), 424 B.R. 122, 133 (Bankr. S.D.N.Y. 2010).

the definition of "customer" under Section 741 have arisen in SIPA cases.[265]

Congress enacted SIPA to boost public investors' confidence in the securities markets and to fortify the financial responsibility of Stockbrokers to eliminate, to the extent possible, risks leading to customer losses.[266] One of the principal risks SIPA seeks to avert is the possible domino effect of insolvencies to other financial market participants that the insolvency of a Stockbroker could cause.[267] Thus, SIPA, like the Safe Harbors, seeks to minimize "systemic risk" in the financial markets that could result from the insolvency of a party that is often central to financial market transactions—in the case of SIPA, that party is a Stockbroker. To meet this goal, SIPA created the Securities Investor Protection Corporation (SIPC), a nonprofit corporation whose members consist of most broker-dealers.[268]

SIPC administers a fund (the Customer Fund)[269] financed from mandatory contributions of its member-brokers, to be used for the purpose of reimbursing "customers" of such a Stockbroker (the Stockbroker Customers) that suffer losses caused by a Stockbroker's insolvency.[270] Once a determination is made that a Stockbroker is on the verge of insolvency, SIPC may request that a court determine that SIPA applies for the benefit of the "customers" of the failed Stockbroker.[271] Those that qualify as Stockbroker Customers have priority over the other general unsecured creditors of the failed

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265 *See generally* Dombalagian, *supra* note 200.

266 H.R. REP. NO. 91-1613, at 5255 (1970); *see also* Sec. Inv. Prot. Corp. v. Barbour, 421 U.S. 412, 415–16 (1975).

267 H.R. REP. NO. 91-1613, at 5255; *see also Barbour*, 421 U.S. at 415–16.

268 *See Barbour*, 421 U.S. at 415–16.

269 15 U.S.C. §§ 78*lll*(4), 78fff-2(c)(1)(B); *In re* Bernard L. Madoff Inv. Sec. LLC, 654 F.3d 229, 232–33 (2d Cir. 2011); *see* Dombalagian, *supra* note 200. If the Customer Fund does not contain sufficient funds to fully satisfy the customers' claims, the SIPA Trustee "administer[s] what is in effect a 'bankruptcy within a bankruptcy'" to recover funds in an attempt to fully satisfy the claims of the customers. CarVal Investors UK Ltd. v. Giddens (*In re* Lehman Brothers, Inc.), 791 F.3d 277, 281 (2d Cir. 2015); *see also* 15 U.S.C. § 78fff-2(b). If the Customer Property is "insufficient to pay customers the full amount of their allowed net equity claims, customers will share ratably with all other general [unsecured] creditors" in the residue of the debtor's property. 6 COLLIER ON BANKRUPTCY ¶ 741.03; *see also* 11 U.S.C. § 752(b)(2); 15 U.S.C. § 78fff-2(c)(1).

270 *Barbour*, 421 U.S. at 415–16. The term Stockbroker Customer, as used herein, is used to refer to a "customer" defined under either SIPA or the Code, as the case may be, without regard to the differences between those two definitions. Technically, there are differences between the definition of "customer" contained in Section 741 and in SIPA. *Compare* 11 U.S.C. § 741(2), *with* 15 U.S.C. § 78*lll*(2).

271 *Barbour*, 421 U.S. at 415–16. Once a SIPA proceeding commences, a SIPA Trustee is appointed to "return customer property . . . and liquidate the business" of the failed broker. *Id.* at 417; *see also* 15 U.S.C. § 78fff(a).

Stockbroker, and, in the case of a SIPA proceeding, have the right to take from the Customer Fund.[272]

Thus, in a proceeding involving the liquidation of a Stockbroker, either under SIPA or the Code, status as a Stockbroker Customer is a coveted status, as it allows creditors qualifying as such to have priority over the other general unsecured creditors of the failed Stockbroker, who generally recover a significantly lower percentage recovery on account of their claims than Stockbroker Customers will.[273] Logic dictates, therefore, that a Stockbroker's creditors would competitively vie for such status, as they would receive a significantly "larger piece of the pie" than the Stockbroker's other general unsecured creditors that do not qualify for "customer" status.

Courts have typically construed the term "customer" leading to Stockbroker Customer status very narrowly, and they have not construed it "in the colloquial sense of one who buys or trades" securities.[274] Instead, the term "customer" as used in Section 741 and in SIPA requires the existence of a fiduciary relationship between the creditor seeking "customer" status and the failed Stockbroker that is "the type of fiduciary relationship generally characterizing the relationship between a broker-dealer and its customer."[275] Historically, those qualifying for this preferred Stockbroker Customer status have had to demonstrate that they have "entrusted cash or securities" with a

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272 15 U.S.C. § 78*lll*(4); *In re Madoff Inv. Sec.*, 654 F.3d at 233; *see also In re* Chi. P'Ship Bd., Inc., 237 B.R. 726, 732 (Bankr. N.D. Ill. 1999); Sec. Inv. Prot. Corp. v. Stratton Oakmont, Inc., 229 B.R. 273, 278 (Bankr. S.D.N.Y. 1999); *In re* Gov't Sec. Corp., 90 B.R. 539, 540 (Bankr. S.D. Fla. 1988) (discussing priority status applicable to customers); Dombalagian, *supra* note 200, at 620–23 (describing "priority" status of customer in SIPA proceedings). In SIPA cases, the Stockbroker Customers share ratably in the proceeds of the Customer Fund to the extent of their net equity. 15 U.S.C. §§ 78*lll*(4), 78fff-(2)(c)(1)(B); *In re Madoff Inv. Sec.*, 654 F.3d at 233; *see* Dombalagian, *supra* note 200, at 620–23. Other than expressly otherwise provided under SIPA, a SIPA Trustee has the same duties as a Bankruptcy Trustee, including, without limitation, the duty to maximize the value of the Customer Fund. 15 U.S.C. § 78fff-1(b). The term "Customer Fund" is used here to refer to the amount available to those who qualify as "customers" under either Section 741 or SIPA.

273 *See* Dombalagian, *supra* note 200, at 620–23 (describing advantages of qualifying as a customer). In addition to the priority status associated with qualifying as a "customer," customer status also confers the right "to receive a SIPC advance toward their net equity claims to expedite the return of their property, pending the trustee's recovery efforts." *Id.* at 620.

274 6 COLLIER ON BANKRUPTCY ¶ 741.03; *see also In re* Lehman Brothers Inc., 492 B.R. 379, 387 (Bankr. S.D.N.Y. 2013); Sec. Inv. Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 454 B.R. 285, 305 (Bankr. S.D.N.Y. 2011) (analyzing qualification for customer status). "Customer status . . . is not a shorthand designation for anyone who conducts business through a broker-dealer." *Id.*

275 6 COLLIER ON BANKRUPTCY ¶ 741.03; *see also* CarVal Investors UK Ltd. v. Giddens (*In re* Lehman Brothers, Inc.), 791 F.3d 277, 280–82 (2d Cir. 2015).

stockbroker "for the purposes of trading securities."[276] Thus, courts have consistently held that a creditor having a mere debtor-creditor relationship with a Stockbroker does not qualify as a "customer" under either Section 741 or SIPA.[277]

Indeed, courts have held that the term "customer" in the context of Section 741 and SIPA does not always include all parties that act as "lenders of securities, even if" the lending of securities forms part of the "ordinary course" of the lender's business.[278] Section 101(22)(A) expressly provides that the definition of a "financial institution" is more expansive and not limited to the narrow confines of the definition of "customer" contained in Section 741.[279] Under Section 101(22)(A), a customer of a financial institution may itself qualify as a financial institution, but only if a bank (or similar entity) acts "*as agent or custodian* for" that customer.[280] Therefore, if Section 101(22)(A) did not contain the parenthetical, "(whether or not a 'customer', as defined in section 741)," Section 546(e) could be construed to not apply to certain lenders of securities, such as insurance companies and endowments, because Section 741's definition of customer is very narrow and may not always apply in the context of Agent SLTs.[281] This could lead to

276 *In re Lehman Brothers*, 791 F.3d at 282 (citations omitted) (discussing fiduciary relationship between Stockbroker and customer); *see also* Dombalagian, *supra* note 200, at 620–23.

277 *In re Lehman Brothers*, 791 F.3d at 284 (denying "customer" status under SIPA to counterparty to Repo with insolvent Stockbroker). In that case the Second Circuit expressly stated that the relevant transaction documents were merely "contractual" in nature and made no "mention of a fiduciary relationship." *Id.* at 279. To qualify as a "customer" under Section 741 or SIPA, "a customer's claim must 'bear the indicia of [a] fiduciary relationship' rather than 'an ordinary debtor-creditor relationship.'" *Id.* at 284 (citation omitted) (alteration in original).

278 6 COLLIER ON BANKRUPTCY ¶ 741.03; *see also* Stafford v. Giddens (*In re* New Times Sec. Servs., Inc.), 463 F.3d 125, 128 (2d Cir. 2006) (stating that a lender of securities does not qualify a "customer" under SIPA).

279 11 U.S.C. § 101(22)(A).

280 *Id.* (emphasis added).

281 *See New Times Sec. Servs.*, 463 F.3d at 127. Congress's addition of the terms "master netting participant" and "financial participant" to the Code in 2005 through BAPCPA does not change this analysis. Most securities lenders would likely qualify as either a master netting participant because they document their SLTs (or other specialized financial market contracts) under a master netting agreement as set forth in Section 101(38) of the Code. *See* 11 U.S.C. § 101(38). Likewise, many securities lenders would also qualify as a "financial participant" because they likely have one or more Qualified Agreements with the debtor or other parties to trigger the financial participant definition set forth in Section 101(22A) of the Code. *See id.* §101(22A). Major systemically important financial market participants entered into agent SLTs well before 2005. *See* HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 2. Through BAPCPA, Congress employed a "belt and suspenders" approach to protect, what it considered to be, systemically important financial market participants from systemic risk. Many other Protected Parties, such as swap participants, repurchase participants, and forward contract

liability of the Agent Banks under Guarantees associated with Agent SLTs. Thus, the definition of "customer" under Section 101(22) would encompass a lender of securities in an Agent SLT, while the definition of "customer" under Section 741 may not.

C. *A Company Being Acquired Through an LBO Does Not Qualify as a Customer Under Section 101(22)(A) Merely Because a Bank Acts as an Intermediary Between the Company and Its Redeeming Shareholders*

Congress intended to protect narrowly defined systemically important financial market participants that engage in specialized financial transactions, such as Agent SLTs, when it included the Customer Language in Section 101(22)(A). It did not intend to protect garden-variety Redeeming Shareholders from constructive fraudulent transfer or preference liability, as their potential losses resulting from such liability would not cause "systemic risk" to the financial markets. Indeed, the financial institution definition is a "catchall" category that applies to systemically important financial market participants that do not otherwise qualify, inter alia, as Stockbrokers, financial participants, swap participants, or Repo participants.

This interpretation of Section 101(22) is also supported by the "associated-words canon" or the canon of *noscitur a sociis*:

> [T]he meaning of particular terms in a statute may be ascertained by reference to words associated with them in the statute; and that where two . . . words of analogous meaning are employed together in a statute, they are understood to be used in their cognate sense, to express the same relations and give color and expression to each other.[282]

In the Customer Language, the terms "agent" and "custodian" appear alongside one another.[283] Generally speaking, the term

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merchants would also fall within the master netting participant definition or the financial participant definition because they, like large lenders of securities, either: (i) use industry-standard master netting agreements to document Qualified Transactions such as SLTs, swap agreements, or repurchase agreements; or (ii) have one or more Qualified Agreements required to be a "financial participant." *See* SEC & CFTC STAFF, JOINT STUDY ON THE FEASIBILITY OF MANDATING ALGORITHMIC DESCRIPTIONS FOR DERIVATIVES 8 & n.32 (2011); *see also* Edward J. Janger, *Treatment of Financial Contracts in Bankruptcy and Bank Resolution*, 10 BROOK. J. CORP., FIN. & COM. L. 1, 3–4, 4 n.10 (2015) (discussing master netting agreements).

282 ANTONIN SCALIA & BRYAN A. GARNER, READING LAW: THE INTERPRETATION OF LEGAL TEXTS 198 (2012); *see also* Freeman v. Quicken Loans, Inc., 566 U.S. 624, 634–35 (2012).

283 11 U.S.C. § 101(22)(A).

"custodian" under the Code refers to a receiver.[284] The definition of the term "custodian," however, also includes a "trustee, receiver or agent under applicable law . . . that is appointed or authorized to take charge of property of the debtor for the *purpose of enforcing a lien* against such property."[285] As mentioned above, in the case of many Agent SLTs, an Agent Bank will also qualify as a "custodian" because it could act as an "agent" "appointed or authorized to take charge of property of the debtor for the *purpose of enforcing a lien* against such property."[286] This would occur when the Agent Bank, which is often also the custody bank, liquidates the Margin posted by a debtor/borrower[287] in favor of the securities lender in an Agent SLT as described and illustrated above.

Likewise, Section 101(22)(B), which also defines "financial institution," provides that an investment company registered under the Investment Company Act of 1940 (the 40 Act), such as a mutual fund, qualifies as a financial institution in that catchall definition of a Protected Party.[288] As illustrated above, mutual funds are systemically important financial market participants that generally engage in SLTs and are central players in the SLM.[289] This further buttresses the argument that Congress did not intend the Customer Language contained in Section 101(22)(A) to apply to garden-variety Redeeming Shareholders in the context of LBOs. Instead, it intended the Customer Language to apply in the context of Agent SLTs.

This construction of Section 101(22)(A) is also supported by the timing of Congress's amendment of the other Safe Harbors, many of which occurred simultaneously with its enactment and amendment of Section 101(22). The U.S. Supreme Court has stated: (i) "[T]he words of a statute must be read in their context and with a view to their place in the overall statutory scheme";[290] and (ii) "a statutory term—even one defined in [a] statute—'may take on distinct characters from association with distinct statutory objects calling for different implementation strategies.'"[291] As mentioned above, Congress stated that the insertion

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284 *See, e.g.*, Bussel, *supra* note 7 (criticizing *Tribune II*).

285 11 U.S.C. § 101(11)(C) (emphasis added) (defining custodian).

286 *See id.* (emphasis added).

287 The debtor/borrower would be a borrower in an Agent SLT that filed for bankruptcy protection.

288 *Id.* § 101(22)(B).

289 *See supra* notes 189, 207 and accompanying text (describing role of mutual funds in Agent SLTs).

290 Util. Air Regul. Grp. v. EPA, 573 U.S. 302, 320 (2014) (giving defined term a narrower, context-appropriate meaning); *see also* King v. Burwell, 576 U.S. 473, 486 (2015) (Court's "duty" is "to construe statutes, not isolated provisions") (citation omitted).

291 *Util. Air Regul. Grp.*, 573 U.S. at 320 (citation omitted).

of the definition of "financial institution," and a recent amendment thereto, were "technical" in nature.

Likewise, the enactment and amendments to Section 101(22) coincided with many of the amendments to Section 546(e) and the Safe Harbors, which apply only to certain narrowly defined systemically important financial market participants that regularly enter into specialized financial transactions, such as swap agreements, forward contracts, repurchase agreements, and securities contracts. In the period between 1984 and 2006, when Congress enacted and expanded Section 101(22), the volume of SLTs increased substantially, as did the volume of Repos, swaps, and other specialized finance transactions to which the Safe Harbors apply. Thus, as Congress stated that the origin and later amendment of Section 101(22)(A), which coincided with the amendment of Section 546(e) and the other Safe Harbors, were technical in nature, its rationale at those times was not any different from its rationale in 1981—to protect narrowly defined systemically important financial market participants from preference actions and CFTAs so that a domino effect of bankruptcy filings of such parties does not occur.

Under the canon of *noscitur a sociis*, the Customer Language should be narrowly interpreted to apply to financial market participants whose insolvency could result in "systemic risk." Indeed, the Customer Language expressly mentions: (i) the customer language in Section 741; (ii) the term "custodian"; and (iii) the term "agent," which results from a fiduciary relationship—an agency. These terms appear in close proximity to one another in Section 101(22)(A). As mentioned above, courts have generally required a fiduciary relationship to exist between a party and a Stockbroker for that party to qualify as a Stockbroker Customer.

The proper use of textualism "almost always" considers the legislature's purpose in enacting a statute.[292] Legislative history is never irrelevant. Indeed, it is appropriate for a court to consult legislative history when determining the meaning of a technical term used in a statute or to "determine whether there had been an error in the way the statute was drafted. . . . to see whether *what seemed unthinkable actually was unthinkable*."[293] The convoluted Customer Language is a prime example of such a technical statutorily defined term.

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[292] *See* SCALIA & GARNER, *supra* note 282, at 56.

[293] *Nomination of the Honorable Amy Coney Barrett to Be an Associate Justice of the Supreme Court of the United States (Day 2)*, COMM. ON THE JUDICIARY, at 01:24:10 (Oct. 13, 2020) (emphasis added), https://www.judiciary.senate.gov/meetings/nomination-of-the-honorable-amy-coney-barrett-to-be-an-associate-justice-of-the-supreme-court-of-the-united-states-day-2

The text, structure, legislative history, and policy underlying Section 101(22), Section 546(e), the other Safe Harbors, and the overall Code support the conclusion that Congress did not intend the Customer Language to apply to garden-variety Redeeming Shareholders. Instead, Congress intended it to apply to securities lenders in Agent SLTs so that Agent Banks would not be liable under revived Guarantees. Although the Customer Language provides that it is not limited to the definition of "customer" contained in Section 741, it does expressly require that to qualify as a customer under Section 101(22)(A), either: (i) a fiduciary relationship of agency must exist between a bank and the entity seeking "customer" status, pursuant to which the bank is acting as an agent for that entity; or (ii) the bank must qualify as a "custodian" of that entity.[294] As mentioned above, not every contractual relationship pursuant to which a customer could entrust its property to another party qualifies as an agency relationship involving fiduciary duties to the customer.[295]

Thus, in the case of an LBO, for the Target being acquired through an LBO to qualify as a "customer" under the Customer Language, the bank acting as an intermediary between the Target and the Redeeming Shareholders must qualify as either an "agent" or custodian of the Target. This definition is similar—but not as circumscribed, as the definition of "customer" contained in Section 741 and in SIPA, which courts have narrowly construed to effectuate the legislative intent and policy underlying SIPA—to prevent systemic risk in the financial markets. Similar legislative intent and policy underpins the Safe Harbors and should apply to limited situations involving systemic risk, such as Agent SLTs—not LBOs.

Furthermore, as mentioned above, an agency is a fiduciary relationship, in which the agent agrees to act on behalf of the principal, pursuant to the principal's control. The Second Circuit held that an agreement between a company and a collection agency, pursuant to which the collection agency agreed to collect overdue invoices and

[https://perma.cc/4JEC-FMD6] ("[T]here could be instances, for example, if you were trying to determine whether a term used in a statute, how it was used, if it had a technical meaning, or how it was understood if that might be an appropriate time to consult legislative history.").

294 Recall that, in interpreting the definition of "customer" under Section 741, courts have held that the relationship between the purported "agent" and "customer" must be a fiduciary relationship and not "an ordinary debtor-creditor relationship." SEC v. F.O. Baroff Co., 497 F.2d 280, 284 (2d Cir. 1974).

295 *See* Bridgestone/Firestone, Inc. v. Recovery Credit Servs. Inc., 98 F.3d 13, 20 (2d Cir. 1996); Ironforge.com v. Paychex, Inc., 747 F. Supp. 2d 384, 396 (W.D.N.Y. 2010) ("[V]irtually all ongoing contractual relationships involve *some* degree of mutual trust, particularly where one party to the contract has temporary custody of the other party's assets or property. That does not automatically give rise to a fiduciary relationship, however.").

remit an agreed-upon portion of those collections to the company that contracted with the collection agency to do so, did not create an agency relationship.[296] In that case, the court rejected the company's argument that the collection agency was the company's agent and owed the company fiduciary duties because the collection agency "did not occupy a position of trust or special confidence . . . beyond the express agreements."[297]

Likewise, the court noted that the collection agencies' duties under the contract were "straightforward and fixed" and that any "trust and confidence" that the company placed in the collection agency related only to it "carrying out" its contractual obligations.[298] Furthermore, the court noted that the company did not rely upon the collection agency for "advice or the exercise of judgment based on superior information or professional expertise."[299] Other cases have applied this reasoning to hold that providers of services under service contracts did not qualify as agents of their customers.[300] Likewise, other courts have held that bailments[301] do not always qualify as agency relationships "even though [bailments and agency relationships] may often comprehend some similar facts."[302]

A bank or similar entity acting as an intermediary between a Target and its Redeeming Shareholders generally does not act in an "agent" capacity. Instead, the relationship between such parties is more akin to an ordinary contractual relationship or a debtor-creditor relationship.[303] In such a relationship, the bank merely has contractual

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296 *Bridgestone/Firestone*, 98 F.3d at 20.

297 *Id.*

298 *Id.*

299 *Id.*

300 *See* TD Waterhouse Inv. Servs., Inc. v. Integrated Fund Servs., Inc., No. 01 Civ. 8986, 2003 WL 42013 (S.D.N.Y. Jan. 6, 2003) (accounting services agreement describing service provider as agent failed to create an agency relationship); *Ironforge.com*, 747 F. Supp. 2d at 396 (stating that payroll services provider did not qualify as agent). In *Ironforge.com*, the court stated that a provider of payroll services under a payroll services contract did not qualify as an agent because it had "well-defined, fixed obligations under the contracts" which were "simply to withdraw funds from [the counterparty's] accounts, and then disburse those funds as necessary, to satisfy [the counterparty's] payroll and tax obligations." *Id.*

301 A bailment involves "the delivery of personal property for some particular purpose or on mere deposit under an express or implied contract that after the purpose has been fulfilled, it will be . . . otherwise dealt with according to that person's directions, or kept until it is reclaimed." 2A N.Y. JUR. 2D *Agency* § 4 (2021).

302 Monroe Sys. for Bus., Inc. v. Intertrans Corp., 650 So. 2d 72, 75–76 (Fla. Dist. Ct. App. 1994) (quoting 8 AM. JUR. 2D *Bailments* § 28 (1980)); *see also* 2A C.J.S. *Agency* § 13 (2021). The fundamental "element of agency—that one person[, the agent,] act for another[, the principal,] subject to the [principal's] control—may be wholly lacking in a bailment." *Monroe Sys.*, 650 So. 2d at 76.

303 *See infra* notes 324–27 and accompanying text.

duties to that company.[304] Likewise, the bank's obligations in such a transaction are limited to those contained in the applicable agreements, which, in many cases, do not expressly or implicitly provide that any fiduciary duties apply.[305] In an Agent SLT, however, an Agent Bank, which is a systemically important financial market participant, easily qualifies as both an "agent" and as a "custodian" of its customer—the lender of the securities.

This conclusion is also buttressed by federal banking regulations, as the Office of the Comptroller of the Currency (the OCC) has stated that a bank does not act in a "fiduciary capacity" simply by being a custodian of securities.[306] The OCC, however, expressly stated that a bank does act in a fiduciary capacity if it "exercis[es] discretion" in connection with securities lending activity—i.e., acts as an Agent Bank in an SLT.[307]

Therefore, both the plain meaning of the Customer Language and Congress's intent belie the Second Circuit's conclusion that a bank acting as an intermediary between a Target and its Redeeming Shareholders in the context of an LBO acts as that Target's "agent" so as to qualify that Target as a "customer," and, in turn, a financial institution, under Section 101(22)(A). Instead, in an LBO, the relationship between a bank and the Target generally qualifies as an ordinary contractual relationship or an ordinary debtor-creditor relationship, not an agency relationship.

Furthermore, as mentioned above, the few times Congress amended the Code's definition of "financial institution," it did so simultaneously with amendments it made to the other Safe Harbors that apply to other specialized financial transactions involving systemically important financial market participants, such as financial market participants involved in Repos, forward contracts, and derivatives transactions.[308] In a 1981 congressional hearing regarding Section 546, Bevis Longstreth, who was then a commissioner of the U.S. Securities and Exchange Commission, stated that Section 546(e) should only apply to transactions "made to finance or facilitate securities or

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304 In this scenario, there could be other rules governing the duties, rights, and obligations between a "customer" and a bank. *See infra* notes 320–23 and accompanying text (discussing contractual relationships and UCC Article 4).

305 *See, e.g.*, Greektown Litig. Tr. v. Papas (*In re* Greektown Holdings, LLC), 621 B.R. 797, 829–30, 829 n.18 (Bankr. E.D. Mich. 2020).

306 *See* COMPTROLLER OF THE CURRENCY ADM'R OF NAT'L BANKS, CUSTODY SERVICES 11 (2002) [hereinafter OCC COMPTROLLER'S HANDBOOK], https://www.occ.gov/publications-and-resources/publications/comptrollers-handbook/files/custody-services/index-custody-services.html [https://perma.cc/8AUE-CHW3]; *see also* 12 C.F.R. § 9.2(e) (2021).

307 OCC COMPTROLLER'S HANDBOOK, *supra* note 306, at 11; *see also* 12 C.F.R. § 9.2(e).

308 *See supra* Section I.H.

commodities transactions."[309] Likewise, during those hearings, Theodore H. Focht, who was, at that time, the general counsel of SIPC, cautioned Congress that Section 546(e) should not be interpreted broadly to prevent a Trustee from recovering "[avoidable] transfer[s] that should be recovered" but instead should be interpreted narrowly to apply to transfers that are "margin [transfers], mark-to-market or settlement payment, [or] a deposit to a clearing [Agency]."[310]

This legislative history further underscores the premise that the congressional intent underlying the Customer Language was aimed at protected intermediaries, such as Agents, from liability associated with their roles in the SLTs—not garden-variety Redeeming Shareholders.[311] That legislation, however, was in no way related to protecting garden-variety Redeeming Shareholders.[312] As a result, the more sensible construction of the Customer Language is that it applies to protect Agent Banks in the context of Agent SLTs. This interpretation of the Customer Language is consistent with the text, structure, legislative history, and underlying policy of the Code and the Safe Harbors—that the Safe Harbors apply only to certain narrowly defined Protected Parties and do not apply to "the vast majority of commercial entities."[313]

D. *Analysis of Court Split*

The legislative history underlying Sections 101(22)(A) and 546(e) weighs heavily in favor of a ruling consistent with *Greektown* and heavily against a ruling consistent with *Tribune II*. Any court ruling to the contrary would essentially immunize any payment made by a debtor to a Redeeming Shareholder that did not qualify as an intentional fraudulent transfer. Although compelling arguments have been made that subjecting Redeeming Shareholders in publicly traded equity securities to constructive fraudulent transfer liability may weaken

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309 *Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Com. L. of the Comm. on the Judiciary*, 97th Cong. 261 (1981) (statement of Bevis Longstreth, Comm'r, U.S. Securities and Exchange Commission); *see also* Marchetti, *supra* note 2, at 40–42 (discussing legislative history).

310 *Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Com. L. of the Comm. on the Judiciary*, 97th Cong. 285 (1981) (statement of Theodore H. Focht, Gen. Couns., Securities Investor Protection Corporation); *see also* Marchetti, *supra* note 2, at 40–42 (discussing legislative history).

311 This was one of the concerns that arose among financial market participants following *Seligson*. *See* Marchetti, *supra* note 2, at 14–15, 20 (discussing *Seligson*).

312 *See* Weisfelner v. Fund 1 (*In re* Lyondell Chem. Co.), 503 B.R. 348, 373 (Bankr. S.D.N.Y. 2014).

313 *See* HARDING & JOHNSON, MASTERING SECURITIES LENDING, *supra* note 60, at 49.

investor confidence in the public security markets,[314] the text and underlying legislative history of Section 546(e) and the other Safe Harbors do not support that conclusion.[315]

Instead, the text and legislative intent underlying the Safe Harbors indicate that Congress enacted them to protect the overall stability of financial markets by preventing a "domino effect" of bankruptcy filings by certain narrowly defined systemically important financial market participants—i.e., to prevent systemic risk.[316] Congress did not enact the Safe Harbors to insulate individual shareholders from fraudulent transfer risk associated with investing in publicly traded shares of stock so that their confidence in the financial markets would be boosted. Although subjecting Redeeming Shareholders in publicly traded equity securities to constructive fraudulent transfer risk associated with their investment could result in a minor amount of market disruption in the overall financial markets, that minor market disruption is very unlikely to result in a domino effect of bankruptcy filings by systemically important financial market participants.

A court "should not construe [a] statute in a manner that is strained and, at the same time, would render a statutory term superfluous."[317] *Tribune II* confused the narrow definition of customer contained in the Customer Language, which mentions the term "agent," by referencing "ordinary" and "dictionary" meanings of the term "customer" which have no nexus to an agency relationship whatsoever.[318] For example, in dicta, *Tribune II* erroneously pointed to the definition of "customer" contained in Black's Law Dictionary, which includes "a person . . . for whom a bank has agreed to collect items."[319] That definition of "customer" is in line with the definition used in Article 4 of the Uniform Commercial Code (the UCC), which applies to bank deposits and collections.[320] UCC Article 4 uses the term "customer" when referring to the contractual relationship between a person and a bank.[321]

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314 *See, e.g.*, *Tribune II*, 946 F.3d 66, 93–94 (2d Cir. 2019).

315 *See* Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883, 889–90 (2018); *see also Weisfelner*, 503 B.R. at 373.

316 *See* Steven L. Schwarcz, *Derivatives and Collateral: Balancing Remedies and Systemic Risk*, 2015 U. ILL. L. REV. 699, 702–11 (2015).

317 Dole Food Co. v. Patrickson, 538 U.S. 468, 476–77 (2003).

318 *See Tribune II*, 946 F.3d at 78–79.

319 *Id.* at 79 (quoting *Customer*, BLACK'S LAW DICTIONARY (10th ed. 2014)).

320 *See* U.C.C. § 4-401 (AM. L. INST. & UNIF. L. COMM'N 2002).

321 *Id.* § 4-401(a) (properly payable rule); *id.* § 4-402 (addressing wrongful dishonor of a check); *id.* § 4-103 (governing deposit contract between customer and bank); *id.* § 4-403 (governing deposit contract between customer and bank). In those situations, the person holding

The use of the term "customer," however, under the UCC, and colloquially, does not contemplate an "agency" relationship. Most relationships between a bank and a depositor (or a customer) are not agency relationships. Article 4 of the UCC construes the relationship between a bank and its customer as a "debtor-creditor" relationship. This concept is exemplified by a core commercial law concept of a bank's right of setoff vis-à-vis its "customer"[322]—i.e., a relationship where there are mutual debts owed to both the bank and the depositor/customer.[323] Such a relationship, however, does not rise to the fiduciary relationship of an agency, because it does not involve a fiduciary relationship or a right of the purported "principal," here the Target, to control the "agent," here the bank or trust company acting as an intermediary in an LBO. Thus, when a bank or similar intermediary involved in an LBO acts, it generally does not act as the Target's agent. This is readily distinguishable from the role of an Agent Bank in an Agent SLT.

Tribune II's construction of the Customer Language would render Congress's other narrow definitions of Protected Parties completely superfluous, because under *Tribune II*'s erroneous construction, Section 546(e) would shield almost every transfer made in connection with a securities contract involving a bank or similar intermediary acting, in some contractual capacity, for the transferor. Thus, under *Tribune II*, the moment a bank acts in such a capacity, the transferor would immediately transform into a "financial institution," and every transferee receiving a transfer in connection with that securities contract would be immunized from preference and constructive fraudulent transfer liability. Following *Tribune II*'s ruling, courts in the Second Circuit have recently held that both a "fashion retail company"[324] and a "power generation company"[325] qualify as financial institutions. These decisions cost unsecured creditors over $2 billion in potential recoveries from Avoidance Actions. Currently, Redeeming Shareholders in a third case pending in the Second Circuit are arguing

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the account at the bank is not deemed to be in a fiduciary relationship vis-à-vis the bank—if it was, it would not need such specialized rules as those contained in Article 4 of the UCC, as certain fiduciary duties of care and loyalty would be implied to apply to the relationship. Indeed, various provisions of Article 4 of the UCC deal with the contractual relationship that exists between a bank and its customer. Article 4, however, in no way suggests that the relationship between a bank and its customer qualifies as an agency relationship.

322 *See id.* § 4-303.

323 *See* Tavormina v. Merchs. Bank of Mia. (*In re* Gillett), 55 B.R. 675, 678–79 (Bankr. S.D. Fla. 1985) (discussing mutuality as element of setoff).

324 *In re* Nine W. LBO Sec. Litig., 482 F. Supp. 3d 187, 191–92, 202–03 (S.D.N.Y. 2020).

325 Holliday v. K Road Power Mgmt., LLC (*In re* Bos. Generating LLC), 617 B.R. 442, 450–51 (Bankr. S.D.N.Y. 2020).

that a holding company for "two nationwide retail brands," Sears and K-Mart, should qualify as a "financial institution" under *Tribune II*'s interpretation of the Customer Language.[326]

Such an interpretation would render superfluous the narrowly drafted definitions of Protected Parties to which Section 546(e) applies, such as commodity brokers, forward contract merchants, Stockbrokers, financial participants, or securities clearing agencies. If not overturned, *Tribune II*'s ruling would essentially expand Congress's protection of *only certain narrowly defined systemically important financial market participants* from preference actions and CFTAs to *almost every* person or entity involved in a securities transaction—regardless of whether that person or entity is systemically important.

Tribune II's interpretation of Section 101(22)(A) would lead to an absurd result. Such a broad interpretation of Section 101(22)(A) would result in the resurrection of many of the concerns dispelled by *Merit*, mainly allowing and encouraging parties to LBOs and many other financial transactions to easily "launder" most, if not all, of the bankruptcy risk associated with such a transaction by simply using a bank or similar entity as an intermediary in the transaction.[327] For example, such a broad interpretation of Section 101(22)(A) would encourage deal structurers to structure almost every financial transaction involving not only securities in the traditional sense, but also debt transactions, like garden-variety loans, to insulate any party to such a transaction from liability associated with a preference action or with a CFTA by simply inserting a bank as an intermediary into the transaction.[328] Recently, investors in a note issued by General Motors raised Section 546(e) as a defense to a preference action seeking to recover over $28 million in alleged preferential transfers.[329] Those investors filed a motion to dismiss, arguing that Section 546(e) insulated them from the preference action because: (i) a note is included within the Code's definition of a security;[330] and (ii) the relevant interest

326 Amended Complaint at ¶ 84, Sears Holdings Corp. v. Lampert, No. 19-ap-08250 (Bankr. S.D.N.Y. Nov. 25, 2019); *see also* Memorandum of Law in Support of the Non-Insider Defendants' Motion to Dismiss the Complaint at 17, Sears Holdings Corp. v. Tisch, No. 20-ap-07007 (Bankr. S.D.N.Y. Jan. 19, 2021).

327 *See* Marchetti, *supra* note 2, at 40–43.

328 *See* Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329, 345–47 (2d Cir. 2011) (Koeltl, J., dissenting); Charles W. Mooney, Jr., *The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When Is Safe Too Safe?*, 49 TEX. INT'L L.J. 245, 265–66 (2014); *see also* Marchetti, *supra* note 2, at 40–42.

329 Motors Liquidation Co. Avoidance Action Tr. v. JPMorgan Chase Bank, 552 B.R. 253, 263–64, 277–82 (Bankr. S.D.N.Y. 2016).

330 11 U.S.C. § 101(49)(A)(i).

rate payment was as "a transfer to a financial participant 'in connection with a securities contract.'"[331]

If *Tribune II* is not soon reversed by a statutory amendment or a decision of the U.S. Supreme Court, within the Second Circuit, where many large corporate bankruptcy filings occur, the Customer Language contained in Section 101(22)(A), combined with Section 546(e), would shield almost all investors in "stocks, bonds, commercial paper or similar debt instruments unless the purchaser (i) physically paid in cash at the closing of the transaction [without the involvement of an intermediary]; or (ii) the transaction involved actual fraudulent intent."[332] Thus, unless purchasers of securities walk into a room with a truckload of cash to pay the Redeeming Shareholders, the holding in *Tribune II* would essentially immunize Redeeming Shareholders in almost every LBO preference and constructive fraudulent transfer liability, leaving large numbers of unsecured creditors "holding the bag."[333] Moreover, a Trustee's ability to bring a CFTA against a garden-variety Redeeming Shareholder would not result in systemic risk to the financial markets.

As mentioned in a prior article, the Trustee in the *Lyondell* case recently asserted an intentional fraudulent transfer claim, which is not barred by Section 546(e), against billionaire Len Blavatnik, an insider, who allegedly received approximately $3 billion from Lyondell through its LBO, which occurred shortly before Lyondell's bankruptcy filing.[334] Ultimately, Mr. Blavatnik prevailed at trial because the Trustee failed to prove a core element of any fraudulent transfer action—that either: (i) the LBO rendered the Target insolvent; or (ii) the Target was insolvent at the time of the LBO.[335] That case did not result in any "systemic risk" from a "domino effect" of bankruptcies of systemically important

331 *Motors Liquidation Co.*, 552 B.R. at 279. The bankruptcy court in that case denied the motion to dismiss, because, according to the bankruptcy court, the record in the case was not yet adequately developed. *Id.*

332 Marchetti, *supra* note 2, at 43.

333 Indeed, in this situation, the only remedy available to a Trustee would be an intentional fraudulent transfer action, which may be very difficult to prove. *See* 5 COLLIER ON BANKRUPTCY ¶ 548.05 (discussing intentional fraudulent transfers). "[F]raudsters rarely declare their intentions openly . . . ." *Id.*

334 *See* Weisfelner v. Blavatnik (*In re* Lyondell Chem. Co.), 567 B.R. 55, 61–67 (Bankr. S.D.N.Y. 2017). The Trustee also sought recovery from companies controlled by Mr. Blavatnik. *Id.*; *see also* Tiffany Kary, *Blavatnik Not to Blame for LyondellBasell Bankruptcy*, *Judge Says*, BLOOMBERG L. (Apr. 24, 2017, 4:00 PM), https://www.bloomberglaw.com/bloomberglawnews/bankruptcy-law/X1GOGRSO000000?bna_news_filter=bankruptcy-law#jcite (last visited Dec. 23, 2021); Marchetti, *supra* note 2, at 45–48.

335 *See* sources cited *supra* note 334.

financial market participants.[336] In enacting and expanding Section 101(22), Section 546(e), and the other Safe Harbors, Congress did not intend such garden-variety investors "at the very end of the asset transfer chain" of an LBO transaction to qualify as "Protected Parties" to which the Safe Harbors should apply.[337]

If *Tribune II*'s construction and interpretation of the Customer Language contained in Section 101(22)(A) is left undisturbed, the level of "moral hazard" connected to LBOs "will likely increase, and an influx of risky LBOs may result, leaving more unsecured creditors, like trade creditors and retirees 'holding the bag.'"[338] Risky LBOs could result from the lack of incentive of a Target's board of directors to diligently obtain a solvency opinion from a reputable financial firm or accounting firm that accurately reflects the solvency of the Target.[339] Indeed, this occurred in *Tribune*.[340] Even worse, in the LBO involved in *Nine West*, the Target's board of directors voted in favor of the LBO without obtaining its own independent solvency opinion.[341]

V. CONGRESS SHOULD AMEND THE CODE TO PROTECT GOOD FAITH REDEEMING SHAREHOLDERS IN PUBLICLY TRADED SECURITIES THAT DO NOT QUALIFY AS "INSIDERS," EVEN IF *TRIBUNE II* IS ULTIMATELY REVERSED

Even if *Tribune II* is ultimately reversed,[342] Congress should amend the Code to: (i) partially insulate investors in publicly traded securities

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336 *See* Weisfelner v. Fund 1 (*In re* Lyondell Chem. Co.), 503 B.R. 348, 372–73 (Bankr. S.D.N.Y. 2014).

337 *See id.* Even without the application of Section 546(e), it is not easy for a Trustee to always prevail on a CFTA. One of the core elements of any fraudulent transfer action is that the debtor was either insolvent or rendered insolvent as a result of the alleged fraudulent transfer. 11 U.S.C. § 548(a)(1)(B)(ii)(I). To prove this lack of solvency, a Trustee will need the input of financial experts regarding the debtor's solvency at the time the alleged fraudulent transfer occurred. *See* Ginsberg, Burgess, Czerwonka & Caldwell, *supra* note 43, at 72–73.

338 Marchetti, *supra* note 2, at 49.

339 *Id.* at 48–49 (discussing solvency opinions). In most LBOs, the Target's board of directors obtains a solvency opinion from a reputable investment bank, reputable accounting firm, or similar reputable financial advisor to show that the Target will be solvent after it incurs the debt involved in the LBO. *Id.*

340 *See* Report of Kenneth N. Klee, As Examiner, Vol. 1 at 9–10, 170–78, 205–10, 236–37, 460–62, 509–12, *In re* Tribune Co., No. 08-bk-13141 (Bankr. D. Del. Aug. 3, 2010); *see also* Marchetti, *supra* note 2, at 48–49.

341 *See generally In re* Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292 (S.D.N.Y. 2020). Instead, in *Nine West*, the acquirer of the Target obtained a solvency opinion. *Id.* at 301.

342 As mentioned above, the U.S. Supreme Court recently denied the Tribune Petition. *See supra* note 10. Thus, *Tribune II* will not likely be reversed by the U.S. Supreme Court any time

from CFTAs and preference actions, who: (a) are not insiders; and (b) act in good faith (Good Faith Non-Insider Investors); and (ii) fully insulate such investors from SLCFTAs.[343] A major distinction between *Merit* and *Tribune II* is that the LBO in *Merit* involved privately traded securities, while the LBO in *Tribune II* involved publicly traded securities. Both the Second Circuit[344] and commentators[345] have expressed concerns about the ramifications that could result if a Trustee could bring a CFTA or a preference action against a Redeeming Shareholder in a Target whose securities were publicly traded.

The main arguments in favor of insulating those Redeeming Shareholders from constructive fraudulent transfer liability are that: (i) investors in publicly traded shares of stock should be able to take comfort in the "finality" of LBOs involving publicly traded companies; (ii) numerous regulatory laws such as the Securities Exchange Act of 1934 apply to publicly traded companies, which require such companies to make numerous disclosures in connection with LBOs; and (iii) investor confidence in the public equity securities markets would be weakened, resulting in a reluctance of such investors to invest in the stock market—thus leading to a lack of available "capital" for publicly traded companies.[346] These arguments are somewhat persuasive with respect to Good Faith Non-Insider Investors in publicly traded securities. The Code, however, offers no such protection to these investors, unless they qualify as one of the narrowly defined Protected Parties.[347]

There are, however, arguments in opposition. The public securities markets do not only offer equity securities as options for investors. Other available investment options, such as debt securities (or bonds) issued by publicly traded companies are widely available to investors. Under core corporate law and bankruptcy law principles such as the "Deep Rock doctrine" and the Absolute Priority Rule, creditors, which

soon. Indeed, the U.S. Supreme Court is unlikely to grant certiorari if a circuit split does not arise regarding this issue. *See* Brief for the United States as Amicus Curiae, *supra* note 10, at 19–22.

343 Marchetti, *supra* note 2, at 75–79 (discussing such an amendment).

344 *See Tribune II*, 946 F.3d 66, 92–94 (2d Cir. 2019).

345 *See, e.g.*, Fox, *supra* note 7; Fox, *Necessity*, *supra* note 55; *see also* AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11: 2012~2014 FINAL REPORT AND RECOMMENDATIONS 96–99 (2014), https://abiworld.app.box.com/s/vvircv5xv83aavl4dp4h [https://perma.cc/48FN-UTP4] (proposing that the scope of Section 546(e) should be narrowed "to foster financial stability, reduce interconnectedness, and exclude disguised financing arrangements").

346 *Tribune II*, 946 F.3d at 90–94.

347 An example would be a bank that holds shares in a Target, not as an intermediary, but as part of its proprietary trading activity. *See* Marchetti, *supra* note 2, at 6, 13, 67–68 (discussing proprietary trading).

include holders of debt securities, have priority over equity security holders. Thus, an investment in an equity security, by its nature, involves a higher level of risk than investments in debt securities.

Unlike many defendants in CFTAs, Good Faith Redeeming Shareholders generally cannot avail themselves of the "good faith defense." To utilize the good faith defense, the recipient of the alleged constructive fraudulent transfer, in addition to acting in good faith, must have given value to the debtor.[348] If available, the good faith defense permits a recipient of an alleged fraudulent transfer to retain any value it transferred to the debtor.[349] For example, in the context of Ponzi schemes, a recipient of an alleged fraudulent transfer that qualified for the good faith defense would only have to disgorge the "profit" portion of the transfer.[350] Several courts have held, however, that a corporation does not receive any value when it purchases shares from its existing shareholders.[351] Instead of gaining value, a corporation "depletes [its] assets" in such transactions.[352] The Code generally allows certain recipients of transfers in Ponzi schemes that act in good faith to avail themselves of the good faith defense, which, if proven: (i) permits them to retain the "principal" amount of their "investment"; and (ii) requires them only to return the "profit" portion of the transfer to the Trustee. Many cases, however, have held that the good faith defense does not apply to Redeeming Shareholders.

The difficulty is determining to which Redeeming Shareholders of publicly traded equity securities should Section 546(e) apply. As discussed in more detail below, Section 546(e) should not apply to Redeeming Shareholders who are insiders. That raises the following

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348 11 U.S.C. § 548(c). *See also* David Gray Carlson, *Mere Conduit*, 93 AM. BANKR. L.J. 475, 494–97 (2019) (discussing good faith transferees).

349 *Id.*

350 *See* Hayes v. Palm Seedlings Partners, 916 F.2d 528, 535 (9th Cir. 1990) (discussing new value defense).

351 *See* Gold v. Lippman, 539 F.2d 866, 870–72 (2d Cir. 1976) ("[A] repurchase of stock depletes a corporation's assets without any consideration of value to creditors moving to the corporation in return."); Consove v. Cohen (*In re* Roco Corp.), 21 B.R. 429, 434 (B.A.P. 1st Cir. 1982) ("The purchase by the corporation of its own stock is a form of shareholder distribution from which the corporation receives nothing."), *aff'd*, 701 F.2d 978 (1st Cir. 1983); Joshua Slocum, Ltd. v. Boyle (*In re* Joshua Slocum, Ltd.), 103 B.R. 610, 618–19 (Bankr. E.D. Pa.) (stating stock redemption did not provide benefit and "meant nothing more than a reduction in the Debtors' equity"), *aff'd*, 121 B.R. 442 (E.D. Pa. 1989); Vadnais Lumber Supply, Inc. v. Byrne (*In re* Vadnais Lumber Supply, Inc.), 100 B.R. 127, 136 (Bankr. D. Mass. 1989); 5 COLLIER ON BANKRUPTCY § 548.05[2][c]. A leveraged buyout that renders a company insolvent will not confer any benefit on the corporation but will solely benefit the shareholders who are cashed out and any officers, directors, and advisors who receive compensation in connection with the transaction. *See* Bay Plastics, Inc. v. BT Com. Corp. (*In re* Bay Plastics), 187 B.R. 315, 333–36 (Bankr. C.D. Cal. 1995).

352 *See Gold*, 539 F.2d at 871–72.

question—should it apply to investors in publicly traded securities who are Good Faith Non-Insider Investors? A solution to this conundrum would be an amendment to the Code that would: (i) partially insulate Good Faith Non-Insider Investors from CFTAs; and (ii) fully insulate them from SLCFTAs, which can be brought within a longer time, such as four years, after a bankruptcy filing. Pursuant to such an amendment, Good Faith Non-Insider Investors in publicly traded securities would: (i) in the case of CFTAs, only have to return the "profit" portion of the relevant transfer to the Trustee; and (ii) in the case of SLCFTAs, be completely immunized.[353]

An investor in a publicly traded company that qualifies as an "insider," however, should never be insulated from either CFTAs or SLCFTAs.[354] Several provisions of the Code treat transactions with corporate "insiders" with increased scrutiny.[355] For example, a Trustee enjoys a more relaxed burden of proof when seeking to avoid "nonordinary course" payment made by the debtor to an insider under an employment contract.[356] A golden parachute is an example of such a transfer.[357] Another example is the Trustee's ability to recover a preferential transfer made to an insider within one year of the debtor's bankruptcy filing, instead of the shorter ninety-day period that applies to most other preferential transfers.[358] Likewise, claims of insiders of defunct Stockbrokers are subordinated to claims of noninsider "customers" of the defunct Stockbroker.[359] Similarly, insiders are disqualified from voting in favor of confirming a chapter 11 plan

353 An example of proposed language regarding this amendment to the Code was discussed in a prior work. *See* Marchetti, *supra* note 2, at 75–77, app. I.

354 *See Exploring Chapter 11 Reform: Corporate and Financial Institution Insolvencies; Treatment of Derivatives, Hearing Before the H. Subcomm. on Regul. Reform, Com. & Antitrust L.*, 113th Cong. 12 (2014) (statement of the Honorable Christopher S. Sontchi, U.S. Bankruptcy Judge for the District of Delaware). In his testimony, Judge Sontchi testified that Section 546(e) should protect the securities and clearing settlement system, but should not protect Redeeming Shareholder in LBOs involving privately held companies. *Id.* at 12–16. With respect to Redeeming Shareholders in LBOs of publicly traded companies, he testified that Section 546(e) should only protect beneficial owners of public securities that "acted in good faith." *Id. But see* AM. BANKR. INST., *supra* note 345, at 97–98 (stating that Section 546(e) should protect Redeeming Shareholders in LBOs of publicly traded companies without regard to good faith).

355 To qualify as an insider, the recipient must have been an insider at the time it received the allegedly constructive fraudulent transfer. TSIC, Inc. v. Thalheimer (*In re* TSIC, Inc.), 428 B.R. 103, 116 (Bankr. D. Del. 2010).

356 *See* 11 U.S.C. § 548(a)(1)(B)(ii)(IV). In such cases, the Trustee does not have to prove that the allegedly constructive fraudulent transfer to the insider either: (i) was made while the debtor was insolvent; or (ii) rendered the debtor insolvent. *See id.*

357 *See TSIC*, 428 B.R. at 116; 5 COLLIER ON BANKRUPTCY ¶ 548.05[4] (discussing golden parachute payments).

358 *See* 11 U.S.C. §§ 547(b)(4)(B), (e)(3)(i), 550(c)(2).

359 *See id.* § 747(1).

through the Code's "cramdown" provisions, as part of an "impaired" class of creditors or shareholders.[360]

Thus, insiders, by virtue of their "insider" status, are subject to a higher level of scrutiny because, inter alia, they: (i) are privy to nonpublicly available information regarding the financial condition of the debtor; and (ii) had a level of control over the transactions into which a debtor entered. This status could permit insiders to siphon property or funds to themselves, which should instead be paid to the estate for the benefit of the estate's entire body of creditors. Likewise, such insiders can engage in unscrupulous behavior, such as not diligently obtaining a solvency opinion from a reputable financial or accounting firm for the LBO—as occurred in Tribune's LBO. Moreover, in *Nine West*, the Target's board of directors voted in favor of an LBO without obtaining its own independent solvency opinion![361] In both *Tribune* and *Nine West*, insiders profited handsomely from the respective LBOs. In both of those cases, notwithstanding the disclosure requirements mandated by securities regulatory law, insider Redeeming Shareholders received millions of dollars through those risky and unscrupulous LBOs, while creditors recovered merely a fraction of the amount of their claims. Thus, Section 546(e) should not protect insiders or other Redeeming Shareholders that do not act in good faith.[362]

VI. *TRIBUNE II* & PONZI SCHEMES

If not soon reversed, and if followed by other courts, *Tribune II*'s holding could have disastrous effects not only in the context of LBOs, but also in the context of Ponzi Schemes. As a prior work argued, Section 546(e) should not apply to insulate payment to "net winners"[363] in Ponzi schemes.[364] The erroneous ruling in *Tribune II* could apply to improperly insulate net winners in Ponzi Schemes from CFTAs. This

360 *Id.* § 1129(a)(5)(B), (a)(10).

361 *See In re* Nine W. LBO Sec. Litig., 505 F. Supp. 3d 292, 301–02, 311–15 (S.D.N.Y. 2020). In *Nine West*, the Target's board allegedly improperly relied on a solvency opinion prepared by the private equity firm that purchased the Target. *Id.* That solvency opinion allegedly contained "unreasonable and unjustified" projections regarding Nine West's solvency after the LBO. *Id.* at 301–02.

362 *See* Marchetti, *supra* note 2, at 75–77, app. I.

363 Generally speaking, a net winner is a party that "invested" in a Ponzi scheme and received a distribution from the debtor before the Ponzi scheme unraveled leaving other "investors" or "net losers" with less than a recovery received by the net winners. *See* Marchetti, *supra* note 2, at 6; *see also* Picard v. Ida Fishman Revocable Tr., 773 F.3d 411, 417 (2d Cir. 2014) (discussing net winners).

364 *See* Marchetti, *supra* note 2, at 77–83.

could result if the entity perpetrating the Ponzi scheme placed a bank or similar entity between itself and the "net winner" when the "net winner" redeemed its "investment" in the Ponzi scheme.[365] For the reasons mentioned above, as the relationship between a bank and a company using the bank as an intermediary between the Target and the Redeeming Shareholders does not qualify as an agency relationship to make the company the "customer" of a financial institution under the Customer Language, the relationship between a bank and an entity used to perpetrate a Ponzi scheme also does not so qualify.

VII. The Financial Participant Defense

As mentioned earlier in this Article, in addition to the "customer defense," Redeeming Shareholder defendants faced with constructive fraudulent transfer liability in the context of failed LBOs have raised a different defense, which they assert shields them from constructive fraudulent transfer and preferential transfer liability—the "Financial Participant Defense." Specifically, these defendants have asserted that Section 546(e) immunizes them from such liability because the debtor, at the time of the LBO, qualified as a "financial participant" under the Code, thus immunizing those defendants from such constructive fraudulent transfer liability.[366]

Like the definition of "master netting participant," the "financial participant" definition was added to the Code in 2005 through BAPCPA.[367]

The Code defines a "financial participant" as

> an entity that, at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $1,000,000,000 in notional or actual principal amount outstanding (aggregated across counterparties) at such time or on any day during the 15-month period preceding the date of the filing of the petition, or has gross mark-to-market

[365] *See, e.g.*, Fairfield Sentry Ltd. v. Theodoor GGC Amsterdam (*In re* Fairfield Sentry Ltd.), Bankr. Case No. 10-13164, Adv. No. 10-03496, 2020 WL 7345988, at *5–8 (Bankr. S.D.N.Y. Dec. 14, 2020).

[366] *See* Kravitz v. Samson Energy Co., 625 B.R. 291, 294, 296–98 (Bankr. D. Del. 2020); *Tribune Customer Case*, No. 12-cv-2652, 2019 WL 1771786, at *9 (S.D.N.Y. Apr. 23, 2019).

[367] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, 109 Pub. L. No. 8, 119 Stat. 23, at *175.

> positions of not less than $100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor or any other entity (other than an affiliate) at such time or on any day during the 15-month period preceding the date of the filing of the petition.[368]

Congress added Section 101(22A) to the Code to mitigate the potential impact of a systemically important entity's bankruptcy filing on "other major market participants."[369] In those cases, the Redeeming Shareholder defendants asserting that the debtor qualified as a "financial participant" did not argue that they were immune from constructive fraudulent transfer liability under Section 546(e) because the debtor had an outstanding Qualified Agreement directly with them. Instead, those defendants argued that the debtor had an outstanding Qualified Agreement, specifically a Qualified Swap Agreement,[370] with an unrelated third party.[371] As of the time of this writing, only two courts have considered this argument. Each one of those courts has reached opposite conclusions.

A. *The* Tribune Customer Case

The first of these cases was the *Tribune Customer Case* discussed above, where the court concluded that although the debtor qualified as a "financial institution," it did not qualify as a "financial participant."[372] In the *Tribune Customer Case*, the Redeeming Shareholders argued that Tribune itself qualified as a "financial participant"[373] because at the time of the date of its bankruptcy filing or within the preceding fifteen months, Tribune was a party to a Qualified Swap Agreement with

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368 11 U.S.C. § 101(22A)(A). A clearing organization, such as a clearing agency, also qualifies as a "financial participant." *Id.* § 101(22A)(B).

369 H.R. REP. NO. 109-31, pt. 1, at 130 (2005).

370 This Article uses the terms "Qualified Swap Agreement," "Qualified Repurchase Agreement," "Qualified Commodities Contract," "Qualified Forward Contract," and "Qualified Master Netting Agreement" to refer to a swap agreement, repurchase agreement, commodities contract, forward contract, or master netting agreement, as the case may be, with a total value any time within fifteen months of the debtor's bankruptcy filing of either: (i) at least $1 billion in notional or actual principal amount outstanding (aggregated across counterparties); or (ii) gross mark-to-market amount of at least $100 million (aggregated across counterparties).

371 *See Samson*, 625 B.R. at 297–98.

372 *Tribune Customer Case*, No. 12-cv-2652, 2019 WL 1771786, at *8–9 (S.D.N.Y. Apr. 23, 2019).

373 *Id.* at *8.

Barclays Bank.[374] The Redeeming Shareholders were not parties to any of those swap agreements.[375] The court rejected the Redeeming Shareholders' arguments and held that Tribune's swap agreements with Barclays did not qualify Tribune as a financial participant for purposes of Section 546(e) so as to immunize Redeeming Shareholders from fraudulent transfer liability.[376] In the *Tribune Customer Case*, the court reasoned that such an interpretation of Section 546(e) would render the language "with the debtor" in the "financial participant" definition superfluous.[377]

B. Samson

The Bankruptcy Court for the District of Delaware, however, in *Samson*, reached the opposite conclusion on this issue and stated that Samson, the debtor in that case, could possibly qualify as a "financial participant" based on Qualified Swap Agreements related to oil and gas

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374 Opposition of the Shareholder Defendants' Executive Committee to the Litigation Trustee's Motion to Amend at 24–25, *Tribune Customer Case*, 2019 WL 1771786 (No. 12-cv-2652) (detailing Tribune swap agreements). Under the Qualified Swap Agreement, Tribune had swap positions with Barclays Bank that had a total value of either: (i) at least $1 billion in notional or actual principal amount outstanding (aggregated across counterparties); or (ii) gross mark-to-market amount of at least $100 million (aggregated across counterparties). *Id.*

375 *See id.*

376 *Tribune Customer Case*, 2019 WL 1771786, at *8.

377 In the *Tribune Customer Case*, the court reasoned:

> [T]o be considered a financial participant, an "entity" must have entered into a covered transaction with "the debtor or any other entity (other than an affiliate)." The issue of statutory interpretation is whether the debtor—here, Tribune—may be the "entity" described at the beginning of this section. The better reading of the statute is that it cannot.
>
> The [Redeeming] Shareholders contend that this definition covers any "entity"—including the debtor—who enters into a covered transaction with "any other entity." If the "entity" described in the first part of the definition could include the "debtor," the inclusion of the term "debtor" in the second part would be puzzling. It would be unusual if not impossible for the debtor to enter into the covered transactions with itself, and the Shareholders have not identified an example of a covered transaction in which that may occur. Further, if the term "entity" is meant to include the debtor, then it would be redundant to refer to "the debtor", distinguishing it from "any other entity" in the second part of the definition. "It is one of the most basic interpretive canons that a statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant." Hedges v. Obama, 724 F.3d 170, 189 (2d Cir. 2013). The clear text of the statute thus forecloses the [Redeeming] Shareholders' argument that Tribune is a "financial participant" . . . .

Id. at *9.

swaps with third parties.[378] The court in *Samson* reasoned that the plain language of the definition of "financial participant" provides that an entity qualifies as a financial participant if that entity has a Qualified Agreement "with the debtor or any other entity (other than an affiliate)."[379] In support of this faulty reasoning, the court noted that the definitions of "swap participant" and "repo participant" require that to so qualify, a party must have a swap agreement or a repurchase agreement "with the debtor."[380] The court concluded that "a natural reading of [the Code], informed not only by the language [of Section 101(22A)] itself but also by its context . . . . supports a broad interpretation that allows debtors" to qualify as financial participants.[381] The court in *Samson*, however, held that further discovery was necessary before concluding whether Samson's gross mark-to-market positions had a value of at least $100 million at any time within fifteen months of its bankruptcy filing—i.e., whether those swap agreements were Qualified Swap Agreements.[382]

Next, the court in *Samson* discussed whether an affiliate of Samson involved in its LBO that allegedly made constructive fraudulent transfers to the Redeeming Shareholders could qualify as a "financial participant" because that affiliate guaranteed Samson's Qualified Swap agreements with Barclays.[383] Although the court noted that the Code's definition of "swap agreement" includes "any guarantee" related to a swap agreement, the court did not attempt to resolve this issue.[384] Instead, the court stated that, under the definition of swap agreement, any guarantee is limited to "an amount 'not to exceed the damages in connection with any such [Qualified Agreement], measured in accordance with [S]ection 562.'"[385] The court further stated that "[a] more developed record" regarding the valuation of that amount was required before it could decide whether a guarantor of a debtor's swap agreement could qualify as a "financial participant."[386]

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378 Kravitz v. Samson Energy Co. (*In re* Samson Res. Corp.), 625 B.R. 291, 298–301 (Bankr. D. Del. 2020).

379 *Id.* at 300–01 (emphasis omitted).

380 *Id.*

381 *Id.*

382 *Id.* at 302–03. In *Samson*, the court was ruling on the Redeeming Shareholders' motion for summary judgment and the creditor trust trustee's cross motion for summary judgment. *Id.* at 294. For a court to grant a motion for summary judgment, the moving party must demonstrate that: (i) "there is no genuine dispute as to any material fact" and (ii) it "is entitled to judgment as a matter of law." FED. R. CIV. P. 56(a); FED. R. BANKR. P. 7056.

383 *Samson*, 625 B.R. at 303–05

384 *Id.* at 304.

385 *Id.*

386 *Id.*

The court then explained that Section 562 applies to set the applicable date for calculation of the early termination amount if the debtor "*rejects* a swap agreement . . . or if a . . . financial participant . . . or swap participant liquidates, terminates, or accelerates such [swap agreement]."[387] The court ultimately stated that the record before it was insufficient to resolve this issue and that further development thereof was necessary to do so.[388] Interestingly, the court in *Samson* glossed over the plain language of Section 562, which discusses a debtor's ability to *reject* a swap agreement—not *terminate* one.[389] This flaw in its decision will be examined in more detail below.

C. *Debtors Do Not Qualify as Financial Participants*

The holding in *Samson* is extremely concerning because, if followed by other courts, it would shield a defendant from constructive fraudulent transfer liability even if that defendant's constructive fraudulent transfer liability has no nexus whatsoever to do with "systemic risk" to the financial markets. More than ninety-four percent of large corporations are parties to Qualified Swap Agreements with counterparties.[390] Large companies, financial institutions, municipalities, and other parties use these swap agreements to hedge against various types of risk, such as interest rate volatility risk, currency exchange fluctuation risk, or risk associated with commodities prices.[391] Thus, if Section 546(e) immunized all Redeeming Shareholders from constructive fraudulent transfer liability simply because a debtor had any Qualified Swap Agreement with any third party (or parties), virtually every Redeeming Shareholder holding shares in a large corporation would be immunized from such liability, regardless of whether or not that defendant's subjection to such liability would create "systemic risk."

[387] *Id.* (emphasis added). Pursuant to Section 562, the damages resulting from either the debtor's rejection of a swap agreement or a financial participant's liquidation, termination, or acceleration of a swap agreement, is measured as of the earlier of: (i) the date on which the debtor made the rejection of the swap agreement; or (ii) the date on which the financial participant effectuated the liquidation, termination, or acceleration of the swap agreement. *Id.*

[388] *Id.* In so deciding, the court partially denied the Redeeming Shareholders cross motion for summary judgement. *Id.*

[389] *See* 11 U.S.C. § 562.

[390] Julia Schieffer, *Over 94% of the World's Largest Companies Use Derivatives to Help Manage Their Risks, According to ISDA Survey*, DERIVSOURCE (Apr. 23, 2009), https://derivsource.com/2009/04/23/over-94-of-the-worlds-largest-companies-use-derivatives-to-help-manage-their-risks-according-to-isda-survey [https://perma.cc/X8YG-8SDV].

[391] *Id.*

Moreover, *Samson*'s interpretation of the term "financial participant" could have drastic consequences with regards to other types of financial market transactions to which the financial participant definition applies—such as swap agreements.[392] Recall that the definition of financial participant does not only include parties to security contracts, but also includes, without limitation, parties to swap agreements,[393] the value of which can be very volatile. Swap agreements are used by, inter alia, large corporations, banks, hedge funds, and municipalities to hedge against market changes in interest rates, currency exchange values, and commodities.[394] Generally, swap agreements, like other Qualified Agreements such as SLAs, repurchase agreements, and forward contracts, relate to assets that have volatile valuations. In a swap agreement, two parties agree "to exchange . . . cash flows" on specified dates, which are generally monthly or quarterly (each a Reset Date), "calculated by reference to an index," such as indexes related to "interest rates [or] currency rates."[395]

One of the "simplest and most common type[s] of swap [agreements]" is an "interest rate swap."[396] In a simple interest rate swap, one party to the swap agreement (the Fixed Rate Payer) agrees to "make payments equal to the interest which would accrue on an agreed hypothetical principal amount ('notional amount'), during a given period [until the applicable Reset Date], at a specified fixed interest rate."[397] The other party to the swap agreement (the Floating Rate Payer) agrees to "pay an amount equal to the interest which would

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392 In *Samson*, the debtor was not attempting to use its purported "financial participant" qualification to terminate a swap agreement. *See Samson*, 625 B.R. at 297–98. However, if other courts follow *Samson*'s erroneous ruling, future debtors may attempt to use the financial participant qualification to attempt to terminate swap agreements. Generally, most swap agreements and other derivative transactions are documented under the ISDA Master Agreement. *See* Peter Marchetti, *Amending the Flaws in the Safe Harbors of the Bankruptcy Code: Guarding Against Systemic Risk in the Financial Markets and Adding Stability to the System*, 31 EMORY BANKR. DEVS. J. 305, 318–30 (2015) (discussing the ISDA Master Agreement). A multitude of swap agreements and other derivative transactions can be documented under a single ISDA Master Agreement. *Id.* If an ISDA Master Agreement is terminated based on an event of default such as a bankruptcy filing of a party to the ISDA Master Agreement, the amounts of all derivative transactions documented under that ISDA Master Agreement are netted against each other to determine which party is in the money under the ISDA Master Agreement. *Id.*

393 11 U.S.C. § 101(22A)(A).

394 *See* CHRISTIAN A. JOHNSON, A GUIDE TO USING AND NEGOTIATING OTC DERIVATIVES DOCUMENTATION 8–14 (2005).

395 Thrifty Oil Co. v. Bank of Am. Nat'l Tr. & Sav. Ass'n, 322 F.3d 1039, 1042 (9th Cir. 2003). Swap agreements may also be entered into with respect to *indexes* based on "security or commodity prices." *Id.*

396 *Id.*

397 *Id.*

accrue on the same notional amount, during the same period, but at a floating interest rate."[398] The notional amount is not actually transferred between the parties to a swap agreement.[399]

If, on a particular Reset Date, "the fixed rate paid by the [Fixed Rate Payer] exceeds the floating rate paid by the [Floating Rate Payer], then the [Fixed Rate Payer] must pay an amount equal to the difference between [those] two rates multiplied by the notional amount, for the specified interval" to the Floating Rate Payer.[400] In this hypothetical situation, the Fixed Rate Payer would be referred to as the "out-of-the-money" party, while the Floating Rate Payer would be referred to as the "in-the-money" party.[401] However, if the amount payable by the Floating Rate Payer exceeds the amount payable by the Fixed Rate Payer, the Fixed Rate Payer would be "in the money," while the Floating Rate Payer would be "out of the money."[402]

There are two crucial dates upon which a party is deemed to be "in the money" or "out of the money." One is the Reset Date described above. The other date is the early termination date. Generally, an early termination date will arise if one of the parties to the swap agreement defaults by, inter alia, filing for bankruptcy.[403] The amount payable to an "in-the-money" party on an early termination date will generally be much higher (depending on the remaining length of the swap agreement) than the amount payable to an "in-the-money" party on a particular Reset Date, because the valuation methodology used to calculate the amount due to the in-the-money party on an early termination date takes into account the net present value of the future payments for the remaining life of the swap agreement.[404]

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398 *Id.*

399 *Id.* at 1043. Instead, it "provides the basis for calculating payment obligations" under the swap agreement. *Id.*

400 *Id.* at 1042.

401 *See* 1 ANTHONY C. GOOCH & LINDA B. KLEIN, DOCUMENTATION FOR DERIVATIVES: ANNOTATED SAMPLE AGREEMENTS AND CONFIRMATIONS FOR SWAPS AND OTHER OVER-THE-COUNTER TRANSACTIONS 219–20 (4th ed. 2002).

402 *Thrifty Oil*, 322 F.3d at 1042–43.

403 Such an event of default may be caused by other reasons, such as the bankruptcy filing by a party that guarantees the debtor's obligations under a swap agreement or the bankruptcy filing of one of the debtor's affiliates. *See* HARDING, MASTERING THE ISDA MASTER AGREEMENTS, *supra* note 60, at 56–73 (discussing events of default under ISDA Master Agreement, commonly used to document swaps). Swap agreements also contain other events of default that could result in the early termination of a swap agreement. *Id.* at 202–03. These events of default are similar to those typically found in commercial credit agreements. *Id.*

404 *See* Derivative Logic, *Terminating Your Interest Rate Swap*, PSRS, https://psrs.com/insights/terminating-interest-rate-swap [https://perma.cc/JTL9-8R7F] (discussing calculation of amount due on early termination of swap agreement); INT'L SWAP DEALERS ASS'N, INC., USER'S GUIDE TO THE 1992 ISDA MASTER AGREEMENTS 57 (1993).

Generally speaking, if one party (i.e., a debtor) to a swap agreement files for bankruptcy before the scheduled termination date of the swap agreement, the nondebtor (or nondefaulting) party to the swap agreement, if it qualifies as, inter alia, a swap participant or a financial participant, may terminate the swap agreement.[405] If, at that point, i.e., on the early termination date, the nondebtor party to the swap agreement is in the money, it may immediately seize any collateral related to the swap agreement and file an unsecured claim against the debtor's estate for any deficiency amount owed to the nondebtor party to the swap agreement.[406] On the other hand, if the debtor is "in the money" under a swap agreement on the early termination date, the nondebtor party has the option, but not the obligation, to terminate the swap agreement.[407]

During the pendency of the debtor's bankruptcy case, a swap agreement would generally qualify as an "executory contract" under Section 365.[408] In this scenario, a debtor would have one of the following rights with respect to a swap agreement: (i) the right to reject it; (ii) the right to assume it; or (iii) the right to assume and assign it to a third party.[409] If the debtor rejects a swap agreement, the debtor is not entitled to the early termination amount because the debtor's rejection of a swap

405 *See* 11 U.S.C. §§ 362(b)(6)–(7), (17), 555–556, 560–561. A nondefaulting party that qualifies as a master netting participant may also terminate the swap upon a debtor-counterparty's bankruptcy filing. *See id.*

406 *Id.* § 362(b)(6)–(7), (17); *see also* Lubben, *Repeal the Safe Harbors*, *supra* note 50, at 323.

407 During that time period, however, the nondebtor party must make all payments due to the debtor on any and all Reset Dates on which the debtor is the in the money under the swap agreement. *See* Transcript Regarding Hearing Held September 15, 2009 at 101–13, Neuberger Berman, LLC v. PNC Bank, (No. 08-13555) (Bankr. S.D.N.Y. Sept. 15, 2009). Furthermore, a nondefaulting party to a swap agreement loses its right to terminate the swap based on its counterparty's bankruptcy filing if the nondefaulting party does not terminate the swap promptly following the bankruptcy filing of its counterparty, or if applicable, its counterparty's guarantor(s) or affiliate(s). *Id.*; *see also* Peter Marchetti, *The Bankruptcy Court's Ruling in the Lehman Metavante Matter—Has the Ticking Time Bomb of* Enron vs. TXU *Exploded or Been Defused?*, 30 FUTURES & DERIVATIVES L. REP. 1 (2010) (presenting detailed discussion of *Metavante*).

408 *See* 11 U.S.C. § 365. In this scenario, a swap agreement would qualify as an "executory contract" or a contract with respect to "which performance remains due to some extent on both sides" as of the date of the debtor's bankruptcy filing. *See* 3 COLLIER ON BANKRUPTCY ¶ 365.02 (2021); Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439, 460 (1973). If the debtor assumes the swap agreement, it must cure any defaults thereunder. 11 U.S.C. § 365(b)(1)(A). Similarly, if the debtor assumes and assigns the swap agreement to a third party, the debtor must: (i) cure any defaults under the swap agreement; and (ii) provide adequate assurance of future performance. *Id.* § 365(b)(1)(B)–(C).

409 11 U.S.C. § 365.

agreement merely renders the swap agreement breached by the debtor, not terminated.[410]

If a debtor, under the *Samson* court's reasoning, could itself qualify as a financial participant, then a debtor would have the right to terminate all of its swap agreements upon its bankruptcy filing. If a debtor could do so, it could: (i) strategically file for bankruptcy on or near a Reset Date on which it would be in the money on a swap agreement (or many swap agreements documented under one or more ISDA Master Agreements); (ii) declare an early termination of ISDA Master Agreement(s); and (iii) immediately require all of its nondefaulting out of the money swap counterparties to pay the debtor the significantly higher early termination amount, as opposed to paying the debtor the much smaller amount due on a particular Reset Date. Many of those nondefaulting swap counterparties would likely be systemically important entities, such as large banks which, in this scenario, would face significant and unexpected liability linked to the terminated swap agreements that were in the money to the debtor. Most systemically important financial market participants would oppose such an interpretation of financial participant, because under this erroneous construction, systemic risk would be exacerbated.

Likewise, *Samson*'s overly broad interpretation of the term financial participant would conflict with the plain language of Sections 365 and 562. As mentioned above, it is a bedrock concept that under Section 365, a debtor may *reject* a swap agreement, but it cannot *terminate* a swap agreement.[411] Section 562, on the other hand, which the *Samson* court mentioned in its decision, provides a valuation methodology that applies if either: (i) the debtor *rejects* a Qualified Agreement; or (ii) a Qualified Party liquidates, *terminates*, or accelerates a Qualified Agreement.[412]

Section 562 does not provide any valuation methodology in the event the debtor *terminates* a swap agreement, because the debtor, under the Code, generally cannot do so. It is a well-established canon of statutory construction "that the specific governs the general."[413] This "is particularly true where . . . 'Congress has enacted a comprehensive scheme and has deliberately targeted specific problems with specific solutions.'"[414] A specific provision of a statute "governs the general 'particularly when the two are interrelated and closely positioned, both

410 *See* 3 COLLIER ON BANKRUPTCY ¶ 365.02; *see also* Marchetti, *supra* note 392, at 335–36.

411 *See* 11 U.S.C. § 365.

412 *Id.* § 562.

413 Morales v. Trans World Airlines, Inc., 504 U.S. 374, 384 (1992).

414 RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 566 U.S. 639, 645 (2012) (quoting Varity Corp. v. Howe, 516 U.S. 489, 519 (1996) (Thomas, J., dissenting)).

in fact being parts of [the same statutory scheme].'"[415] *Samson*'s construction of the financial participant definition, in the context of swap agreements, would conflict with the specific language of Sections 365 and 562, which only mention the ability of a debtor to *reject* a swap agreement, not to terminate one.

Similarly, *Samson*'s comparison of the definition of "financial participant" with the definitions of "swap participant" and "repo participant" is inapposite. As mentioned above, Congress added the definitions of "financial participant" and "master netting participant" to the Code in 2005 to protect systemic risk in the financial markets. These definitions are essentially "catchall" categories intended to apply to systemically important parties. Indeed, most swap participants, repo participants, and participants in the SLM would simultaneously qualify as one or more of the following: (i) swap participant; (ii) repurchase participant; (iii) financial participant; or (iv) master netting participant.

This is because: (i) most large corporations, banks, pension funds, and government entities generally engage in one or more of these transactions to, inter alia, hedge against sudden valuation changes in volatile markets such as interest rates; currency trading; securities trading; and commodities trading;[416] and (ii) the vast majority of Qualified Transactions entered into by them were documented under one or more "Master Netting Agreements" such as the ISDA Master Agreement, the Repo Master Agreement, a GMSLA, or a MSLA, which are widely used forms in financial market transactions. Indeed, a debtor's inability to terminate swap agreements with respect to which it was "in the money" was an issue in large bankruptcy proceedings involving debtors with large, in-the-money swap positions, such as the Lehman Brothers bankruptcy proceedings.[417] In those proceedings, Lehman did not argue that it could qualify as a financial participant. Interpreting "financial participant" to include a debtor would be contrary to Congress's intent in enacting the Safe Harbors.

The proper reading of the "financial participant" definition, instead, leads to the conclusion that a debtor cannot qualify as a financial participant. Instead, a financial participant is an entity that has a Qualified Agreement with the debtor or any other party (so long as that other party is not an affiliate of the party seeking financial participant status). This construction is consistent with Congress's goal of protecting systemically important parties from systemic risk.

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415 *Id.* (alteration in original) (quoting HCSC-Laundry v. United States, 450 U.S. 1, 6 (1981) (per curiam)).

416 *See* Schieffer, *supra* note 390.

417 *See* Marchetti, *supra* note 407 (discussing inability of Lehman Brothers Special Finance to terminate swap agreement under which it was "in the money").

CONCLUSION

As this Article has demonstrated, courts have recently grappled with the proper construction and interpretation of: (i) the term "financial institution" as defined in Section 101(22)(A); and (ii) the term "financial participant" as defined in Section 101(22A). While the recent *Greektown* decision interpreted Section 101(22)(A) properly and narrowly, several decisions within the Second Circuit have drastically misconstrued Section 101(22)(A) by interpreting it in an overly broad fashion. Likewise, at least one court has incorrectly interpreted the term "financial participant" very broadly so that a debtor could possibly qualify as a financial participant. These broad interpretations are based on faulty reasoning and have perverted the Code's priority scheme in ways not contemplated or intended by Congress. These interpretations may lead to an increase in the number of risky and unscrupulous LBOs and even nefarious incentives by participants in Ponzi schemes who seek to be "net winners."

Given the large number of recent LBOs, the issues raised in *Tribune II* and in *Samson* are likely to arise throughout the circuits. Congress should act to amend Section 101(22)(A) so that it does not apply to Redeeming Shareholders in LBOs or investors whose shares are redeemed in similar transactions such as share buybacks.[418] Until then, courts in other circuits should not follow the ruling in *Tribune II*. Instead, those courts should follow the ruling in *Greektown*. Likewise, courts should not follow the faulty holding of *Samson* regarding the construction of the term "financial participant."

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[418] This Article contains an appendix, which contains a proposed revised version of Section 101(22) that Congress should enact. Other commentators agree that Section 101(22) should be amended. *See* Bill Rochelle, *Safe Harbor Bars Foreign Liquidators from Recovering Money Stolen in the U.S.*, AM. BANKR. INST.: ROCHELLE'S DAILY WIRE (Jan. 4, 2021), https://www.abi.org/newsroom/daily-wire/safe-harbor-bars-foreign-liquidators-from-recovering-money-stolen-in-the-us [https://perma.cc/T6UF-9FMH].

APPENDIX I

A "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; or

(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940.

(C) *Notwithstanding any language to the contrary contained in (A) or (B) above, none of the following shall qualify as a financial institution: (i) an entity that, at the time the transfer was made: (a) was being acquired through a leveraged buyout; (b) was repurchasing its securities from holders thereof; or (c) was taking part in a similar transaction.*