
Bankruptcy Code—Section 546(e) Safe Harbor

Merit Management Group, LP v. FTI Consulting, Inc., No. 16-784

A bankruptcy trustee has broad powers to avoid fraudulent transfers of a debtor's property. But the Bankruptcy Code constrains those powers in several important ways, including through a safe harbor for certain transfers by, to, or for the benefit of financial institutions or certain financial market participants in connection with securities contracts. In applying that safe harbor—§ 546(e)—the federal courts of appeals had divided over whether a defendant who was not a covered financial institution or market participant could invoke the safe harbor when an intermediary in the alleged fraudulent transfer was a covered entity, as when the transfer passed through a securities brokerage or a bank on its way to the defendant.

Today, the Supreme Court unanimously answered that question with a firm “no” in *Merit Management Group v. FTI Consulting*. The Court reasoned that § 546(e) and the broader statutory context indicate that the safe harbor analysis looks exclusively to the transfer being challenged by the trustee. If the trustee is not seeking avoidance of intermediary transfers, then the identity of those intermediaries plays no role in the analysis. The safe harbor “applies to the overarching transfer that the trustee seeks to avoid, not any component part of that transfer.” The Court was careful, however, to explain that trustees do not have a free hand to define the transfers they want to avoid. Bankruptcy Code's avoidance provisions carefully set out criteria defining the transfers eligible for avoidance. The Court also declined to address unargued but potentially significant questions regarding the definitions of “financial institution,” “settlement payment,” and “securities contract,” which could keep a wide variety of parties to securities-related transactions within the scope of § 546(e).

The Supreme Court's *Merit Management* decision rejects the expansive reading of the § 546(e) safe harbor that has prevailed in most circuits for some time and saved many significant transfers from avoidance. While financial institutions and certain financial market participants will continue to enjoy protection, bankruptcy trustees seemingly will now have greater ability to unwind securities-related transactions years after the fact if a party to the transaction enters bankruptcy.