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THE POTENTIAL IMPLICATION OF THE SUPREME COURT'S HOLDING IN MERIT MANAGEMENT

The Supreme Court's Merit *decision is its first holding regarding the scope of the safe harbors in the U.S. Bankruptcy Code for securities contracts and other financial contracts. The authors discuss the case and then turn to (1) the discretion of a bankruptcy trustee to determine what constitutes a transfer for purposes of the Code's avoidance provisions; (2) preemption of avoidance actions under state law; (3) the definition of "financial institution" in the Code; and (4) textualism in interpreting the scope of safe harbor protections.*

By Brandon M. Hammer and Reshama J. Patel *

In *Merit Management Group, LP v. FTI Consulting, Inc.*,[1] the U.S. Supreme Court issued its first ever holding regarding the scope of the safe harbors in the U.S. Bankruptcy Code for securities and other financial contracts. The safe harbors provide two general kinds of protection. First, they protect the exercise by certain specified counterparties ("Protected Parties") of close-out, netting, and collateral rights under a financial contract, notwithstanding the Code's automatic stay, anti-ipso facto provisions, and other limitations on creditors' rights. Second, the safe harbors protect from many of the Code's avoidance provisions transfers made under or in connection with a financial contract that are to, by, or for, the benefit of a Protected Party. The Protected Parties for each type of protected financial contract differ.

Merit concerned the latter. In particular, it addressed the scope of Section 546(e). That provision states in relevant part that a bankruptcy "trustee may not avoid a transfer that is a margin payment . . . or settlement payment . . . made by or to (or for the benefit of) [a financial institution] or that is a transfer made by or to (or for the benefit of) [a financial institution] in connection with a securities contract[.]"[2] In its unanimous decision in *Merit,* the Supreme Court held that Section 546(e) does not apply merely because the challenged transfer is completed through a financial institution.

In reaching this holding, *Merit* settled a long-standing circuit split. However, the Court's holding, as well as the supporting reasoning and other dicta, raise questions regarding (i) the discretion of a bankruptcy trustee to

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

[2] 11 U.S.C. § 546(e).

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determine what constitutes the relevant transfer for purposes of the Code's avoidance provisions; (ii) the applicability of the safe harbors to avoidance actions brought under state law; (iii) the definition of "financial institution" for purposes of the Code; and (iv) textualism as an appropriate method of analysis for safe harbor inquiries. Following a brief overview of the case, we discuss each of these issues in turn.

I. OVERVIEW OF THE CASE

Facts:

Merit concerned the acquisition by Valley View Downs, LP of all of the shares of its competitor, Bedford Downs Management Corp., for $55 million in a cash-for-stock agreement. In order to finance the acquisition, Valley View borrowed funds from a lending bank and several other lenders. At closing, the lending bank transferred the acquisition price to another bank, which acted as the escrow agent. The escrow bank then transferred cash payments to the shareholders of Bedford Downs, one of which was Merit Management Group ("Merit"), which received $16.5 million.[3]

Bankruptcy Proceedings:

Valley View shortly thereafter entered into bankruptcy proceedings, and FTI Consulting, Inc. was appointed trustee of the debtor's litigation trust. FTI sought to avoid the $16.5 million transfer to Merit as a constructively fraudulent transfer under Section 548(a)(1)(B) of the Code.[4]

Merit moved to dismiss the trustee's avoidance action on the basis that the Code's safe harbors immunized the transfer from claims of constructive fraudulent conveyance. Merit pointed to Section 546(e), which, as noted above, bars a bankruptcy trustee from avoiding under Section 548(a)(1)(B) (among other provisions) a settlement payment or transfer in connection with a securities contract, if the settlement payment or transfer is "made by or to (or for the benefit of) a financial institution" or any other Protected Party.[5]

The trustee did not dispute that the $16.5 million was a settlement payment or transfer in connection with a securities contract (*i.e.*, the cash-for-stock agreement). At issue was whether the transfer was "by or to" a "financial institution" or other Protected Party. Merit did not contend that either it or Valley View was such a Protected Party.[6]

Instead, Merit argued that the transfer fell within the protections of Section 546(e) because the lending bank and escrow bank were "financial institutions" as defined in the Code, and the $16.5 million was transferred by the lending bank, and both by and to the escrow bank.[7]

The District Court and Seventh Circuit Decisions:

The district court agreed with Merit and dismissed the trustee's claims.[8] The Seventh Circuit reversed the district court's decision and held that Section 546(e) does not protect transfers "that are simply conducted *through* financial institutions (or other entities named in Section 546(e)), when the entity is neither the debtor nor the transferee but only the conduit."[9]

In arriving at its holding, the Seventh Circuit focused on the "ambiguous" text of Section 546(e) and its purpose, stating that "the safe harbor's purpose is to protect the market from systemic risk and allow parties in the securities industry to enter into transactions with greater confidence — to prevent one large bankruptcy from rippling through the securities industry."[10] By

[3] *FTI Consulting, Inc. v. Merit Mgmt. Grp., LP.*, 541 B.R. 850, 852 (N.D. Ill. 2015).

[4] *Id.* at 853.

[5] *FTI Consulting, Inc*., 541 B.R. at 853; *see also* 11 U.S.C. § 546(e). The other Protected Parties include a commodity broker, forward contract merchant, stockbroker, financial participant, and securities clearing agency.

[6] *FTI Consulting, Inc.*, 541 B.R. at 853-54.

[7] *Id.* at 854.

[8] *Id.* at 860.

[9] *FTI Consulting, Inc. v. Merit Mgmt. Grp., LP*, 830 F.3d 690, 691 (7th Cir. 2016).

[10] *Id.* at 696 (citation and quotation omitted).

contrast, it reasoned, the case before it presented no systemic risk concerns.

The Seventh Circuit acknowledged that its holding departed from the views of a number of its sister courts; the Second, Third, Sixth, Eighth, and Tenth Circuits had held that Section 546(e) applied even when the financial institution acted merely as a conduit.[11]

The Supreme Court's Decision:

In a unanimous decision authored by Justice Sotomayor, the Court affirmed the Seventh Circuit's decision, concluding that Section 546(e) does not apply to the trustee's attempt to avoid the transfer between Valley View and Merit.[12] In coming to this conclusion, the Court did not address the question often framed in safe harbor litigation: whether Section 546(e) should apply when a financial institution is a "mere conduit" or intermediary to a transfer.[13] Nor did the Court find the language of Section 546(e) ambiguous, as the Seventh Circuit did, or engage in a policy-driven analysis employed by other courts.

Instead, the Court reframed the question and adopted the arguments of the trustee in holding that the only relevant transfer for purposes of the safe harbor is the transfer that the trustee seeks to avoid, which in this case was the "end-to-end" transfer (*i.e.*, Valley View → Merit) and that courts should not "look to any component parts of the overarching transfer" (*i.e.*, Valley View→ lending bank → escrow bank → Merit).[14]

The Court came to this holding through a highly textual analysis. The Court noted that "[t]he language of § 546(e), the specific context in which that language is used, and the broader statutory structure all support the conclusion that the relevant transfer for purposes of the § 546(e) safe-harbor inquiry is the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions."[15]

The Court first looked at the text of Section 546(e), which begins with "[n]otwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title."[16] The Court reasoned that this language clarifies that the safe harbor is nothing more than an exception to a trustee's avoidance powers under the Code.[17] The Court found that "[b]y referring back to a specific type of transfer that falls within the avoiding power, Congress signaled that the exception applies to the overarching transfer that the trustee seeks to avoid," and not to any individual transaction comprised in that transfer.[18]

The Court then turned to the statutory structure, and, in particular, the fact that Section 546(e) appears in the same statutory chapter of the Code as the avoidance provisions. The Court notes, "[g]iven that structure, it is only logical to view the pertinent transfer under § 546(e) as the same transfer that the trustee seeks to avoid pursuant to one of its avoiding powers."[19]

Finally, the Court briefly turned to the underlying purpose of Section 546(e). Merit argued that Congress intended the statute to be a broad, prophylactic measure to protect the securities and commodities markets, and that it would be antithetical to that purpose for its application to depend on "the identity of the investor and the manner in which it held its investment," rather than "the nature of the transaction generally."[20] The Court stated that the statute flatly contradicted Merit's position

[11] *In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981 (8th Cir. 2009); *In re QSI Holdings, Inc.*, 571 F.3d 545 (6th Cir. 2009); *In re Resorts Int'l, Inc.*, 181 F.3d 505 (3d Cir. 1999); *In re Kaiser Steel Corp.*, 952 F.2d 1230 (10th Cir. 1991).

[12] *Merit Mgmt. Grp.*, 138 S. Ct. at 897.

[13] *Compare Merit Mgmt. Grp.*, 138 S. Ct. at 892 with *FTI Consulting Inc.*, 830 F.3d at 691.

[14] *Merit Mgmt. Grp.*, 138 S. Ct. at 888.

[15] *Id.* at 892-93.

[16] 11 U.S.C. § 546(e).

[17] *Merit Mgmt. Grp.*, 138 S. Ct. at 893.

[18] *Id.* This reading was further supported by the final clause of Section 546(e), which creates an exception to the safe harbor for actually fraudulent transfers under Section 548(a)(1)(A), since the exception similarly focuses on the transfer that the trustee seeks to avoid. *Id.* The Court also focused on Section 546(e)'s language that the trustee may not avoid "a transfer that *is*" a settlement payment or made in connection with a securities contract. *Id.* at 894 (emphasis in original). In the Court's view, this "dispels [any] doubt" that the statute's focus is the overall transfer that the trustee seeks to avoid rather than its constituent parts, because the statute focuses only on transfers that *are* settlement payments or made in connection with securities contracts, not transfers that "involve" or "comprise" them. *Id.*

[19] *Merit Mgmt. Grp.*, 138 S. Ct. at 894.

[20] *Id.* at 896.

because it specifically targets transfers "by or to (or for the benefit of)" financial institutions and other Protected Parties.[21] The Court suggested that if Congress had intended Section 546(e) to apply to transfers made "through" a financial institution, rather than simply by, or to, or for, the benefit of a financial institution, it would have included language to that effect.[22]

Having concluded that the proper focus is on the transfer the trustee seeks to avoid, and that the transfer at issue in the instant case was the purchase of Bedford Downs's stock by Valley View from Merit, the Court concluded that "[b]ecause the parties do not contend that either Valley View or Merit is a 'financial institution' or other covered entity, the transfer falls outside of the § 546(e) safe harbor."[23]

II. CONSEQUENCES OF THE COURT'S HOLDING FOR DETERMINING WHAT CONSTITUTES A TRANSFER

The Court's statement that a court should begin the analysis of whether the Section 546(e) safe harbor applies with "the transfer that the trustee seeks to avoid" could raise the question as to whether trustees may strategically frame transfers for purposes of Section 546(e) or even one of the substantive avoidance provisions of the Code. The Court addressed this possibility by saying that the "trustee . . . must establish to the satisfaction of a court that the transfer it seeks to set aside meets the characteristics set out under the substantive avoidance provisions. Thus, the trustee is not free to define the transfer that it seeks to avoid in any way it chooses."[24]

However, consider the following example: A sells certain securities to B, which is a Protected Party. In a separate transaction, B then sells those same securities to a third party, C, at a slightly higher price to make a spread. Neither A nor C is a Protected Party.

This fact pattern can be distinguished from what was at issue in *Merit* because, in this case, B acted for its benefit as principal, while, in *Merit*, the lending bank and escrow bank were simply facilitating a payment that Valley View sought to make to Merit.

[21] *Id.*

[22] *Id.* at 897.

[23] *Id.*

[24] *Id.* at 894.

However, the definition of transfer in the Code includes "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with [ ] property"[25] and does not clearly distinguish between the type of transfers involved in *Merit* and the more independent transfers in this example. Further, nothing in the Code's substantive avoidance provisions specifically identifies where a transfer begins and ends.

As a result, if A subsequently enters into insolvency proceedings under the Code, its trustee could seek to frame the relevant transfer as A to C. The Court's decision does not make clear how to distinguish such an action from FTI's attempt to avoid the transfer from Valley View to Merit.

Nevertheless, there are a number of reasons why this strategic framing should not succeed, at least in this fact pattern. First, Section 550 contemplates that, for each transfer that the trustee is able to avoid, there is an "initial transferee" from which the trustee may recover. Although the trustee may also recover from subsequent transferees (referred to as "immediate" and "mediate" transferees in the Code), recovery is not available if the immediate or mediate transferee took for value, in good faith and without knowledge of the voidability of the transfer avoided.[26] In the foregoing example, B would likely be viewed as the initial transferee and C as the immediate transferee.[27]

This concept of an initial transferee, as well as the fact that Section 550 makes it easier to recover from the initial transferee, suggest that the "transfer" the trustee seeks to avoid must end at the first party that satisfies the "initial transferee" definition. Were it otherwise, as in were A's trustee able to leapfrog B and frame the relevant transfer as A to C, such a possibility would eliminate the Code's protections for mediate and immediate transferees. Indeed, there is a long line of

[25] 11 U.S.C. § 101(54)(D)(i).

[26] 11 U.S.C. § 550(b)(2).

[27] *In re: Finley, Kumble, Wagner, Heine, Underberg, Manley Myerson & Casey*, 130 F.3d 52 (2d Cir. 1997); *Geltzer v. D'Antona (In re: The Cassandra Croup)*, 312 B.R. 491 (Bankr. S.D.N.Y. 2004); *Securities Investor Protection Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293 (Bankr. S.D.N.Y. 1999); *Gropper v. Unitrac, S.A. (In re Fabric Buys of Jericho, Inc.)*, 33 B.R. 334 (Bankr. S.D.N.Y. 1983); *Seligson v. New York Produce Exch.*, 394 F.Supp. 125 (S.D.N.Y. 1975); *Security First Nat'l Bank v. Brunson (In the Matter of Coutee)*, 984 F.2d 138 (5th Cir. 1993).

cases limiting the ability of a trustee to shorten a transfer by seeking recovery against a party that was merely a conduit because such shortening would similarly allow the trustee to recover from a party that Congress did not intend to be liable (at least where certain requirements are met).[28] By the same token, a trustee should not be able to lengthen a transfer over the head of a non-conduit like B in this example.[29]

Second, although the language of the substantive avoidance provisions does not expressly delineate where a transfer ends, their language should, as the Court argued, still prevent the trustee from framing avoidance actions in a way that leapfrogs the true initial transferee. Section 548, for instance, allows the trustee to avoid "any transfer. . . of an interest of the debtor in property." The transfer from A to C would not constitute a transfer of A's interest in property since at the time C received securities from B, C was receiving B's interest in property.

Thus, although trustees may attempt to use *Merit* as an opportunity to strategically frame avoidance actions going forward, *Merit* does not give the trustee that discretion.

III. WHAT DOES *MERIT MANAGEMENT* MEAN FOR STATE LAW CONSTRUCTIVE FRAUDULENT TRANSFER CLAIMS?

After the decision for *Merit Management* was issued, two Supreme Court justices, then Justice Anthony Kennedy and Justice Clarence Thomas, issued a "statement" suggesting that the Second Circuit reconsider its decision in *In re Tribune Co. Fraudulent Conveyance Litigation*.[30] In that case the court resolved a lower court split in the Second Circuit that had engendered some uncertainty as to whether the Code's safe harbors protected against state law-based fraudulent conveyance actions brought by a party other than the trustee. The court held that Section 546(e) of the Code preempts state law-based fraudulent conveyance actions in connection with a Code proceeding, whether or not brought by the trustee. The Second Circuit's analysis looked to how allowing the state-law based fraudulent conveyance action to proceed would disrupt the federal purpose behind Section 546(e) or the safe harbors more generally.[31]

Although the decision in *Merit Management* did not address the preemptive effects of Section 546(e), the Supreme Court's decision could affect the Second Circuit's analysis as to whether allowing the state law action to proceed would disrupt the federal purpose behind Section 546(e). This is because if the same action were to be brought under federal law, Section 546(e) might not apply following the *Merit* decision. However, the Supreme Court's decision should not disrupt the Second Circuit's analysis when the safe harbors would be applicable were the action brought under federal law.

IV. "CUSTOMER" AS A FINANCIAL INSTITUTION

As discussed above, Merit did not contend that either it or Valley View was a financial institution. However, during oral argument, it became apparent that such an argument could have potentially prevailed. The statutory definition of "financial institution" includes not only a bank but also any customer of a bank when the bank is acting as an agent or custodian for the customer in connection with a securities contract.[32] During oral argument, Justice Breyer identified that, based on the foregoing definition, Valley View may have been a "financial institution" because the two banks that facilitated the transfer of the purchase price arguably acted as agent for Valley View, which was their customer.

Paul D. Clement, representing FTI in front of the Supreme Court disputed this interpretation on the basis that the definition of "financial institution" only covers customers when the bank is acting as agent or custodian, not when the bank has in the past acted as an agent or

[28] *In re: Finley, Kumble, Wagner, Heine, Underberg, Manley Myerson & Casey*, 130 F.3d 52 (2d Cir. 1997); *Geltzer v. D'Antona (In re: The Cassandra Croup)*, 312 B.R. 491 (Bankr. S.D.N.Y. 2004); *Securities Investor Protection Corp. v. Stratton Oakmont, Inc.*, 234 B.R. 293 (Bankr. S.D.N.Y. 1999); *Gropper v. Unitrac, S.A. (In re Fabric Buys of Jericho, Inc.)*, 33 B.R. 334 (Bankr. S.D.N.Y. 1983); *Security First Nat'l Bank v. Brunson (In the Matter of Coutee)*, 984 F.2d 138 (5th Cir. 1993).

[29] *See, e.g., Seligson v. New York Produce Exch*., 394 F.Supp. 125 (S.D.N.Y. 1975) (holding that the debtor could not bring a fraudulent transfer action against a clearing agency that acts as agent but requiring that further factual development was needed to establish whether an agency relationship existed).

[30] *In re Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d 98 (2d Cir. 2016).

[31] *Id.* at 119 ("Unwinding settled securities transactions by claims such as appellants' would seriously undermine — a substantial understatement — markets in which certainty, speed, finality, and stability are necessary to attract capital.").

[32] 11 U.S.C. § 101(22).

custodian. Therefore, he argued that perhaps Section 546(e) may have applied while the money was still at the escrow bank; however, in the case at hand, the banks had already completed their performance in the transfer.

The Court ultimately elected not to consider the foregoing arguments on the grounds that the parties did not properly raise the issue. However, a federal district court for the Southern District of New York did recently address this issue in *In re Tribune Co. Fraudulent Conveyance Litigation*.[33] The case involved a public company, Tribune, which repurchased its own shares through a tender offer and a subsequent merger in connection with a two-step leveraged buyout. In connection with the repurchases, Tribune appointed Computershare Trust Company, N.A. to act as depositary and exchange agent. In its roles as depositary and exchange agent, CTC accepted and held tendered shares on Tribune's behalf, and paid the purchase price to the tendering shareholders.[34] Shortly after the merger, Tribune entered into bankruptcy proceedings.

The trustee did not originally bring a claim for constructive fraudulent transfer since the controlling law in the Second Circuit was that Section 546(e) barred such a claim considering the share repurchase payments were made *through* CTC, a financial institution. However, following the Supreme Court's holding that transferring a settlement payment through a financial institution did not suffice to bring the payment within the scope of the safe harbors, the trustee sought to amend the complaint to add a claim for constructive fraudulent transfer under Section 548(a)(1)(B) against the former shareholders of Tribune.[35]

On April 23, 2019, the district court denied the trustee's motion to amend the complaint based in part on the ground of futility. The court reasoned that, because Tribune was a customer of a bank that acted as its agent in connection with the share repurchases, Tribune was a financial institution. Thus, Section 546(e) barred the constructive fraudulent conveyance action.

Since it was not disputed that CTC was both a bank and a trust company, the court focused on: (1) whether Tribune was a "customer" of CTC; (2) whether CTC was acting as Tribune's "agent or custodian;" and (3) whether CTC was acting in connection with a securities contract.[36] To address the first question, the court looked to the ordinary meaning of "customer" since the term is not defined in the Code for purposes of the "financial institution" definition. Dictionaries contemporaneous with the enactment of the addition of "financial institution" to the Code as well as current definitions define "customer" to include a person who purchases services or goods. Since Tribune purchased CTC's services, the court reasoned, Tribune was CTC's customer.[37]

Next, the court concluded that CTC was acting as Tribune's agent. Since agent is also not defined in the Code, the court looked to common law, under which "'[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 to so act.'"[38] The court determined that, since CTC was entrusted with billions of dollars of Tribune cash and was responsible for making payments to Tribune's shareholders on its behalf, it established a "paradigmatic principal-agent relationship."[39]

Finally, the court determined that CTC was acting in connection with securities contracts since both the tender offer and merger involved the repurchase of stock from Tribune's shareholders. Therefore, the court held that Tribune was a "financial institution" because it was a customer of a bank that acted as agent for Tribune in connection with securities contracts.[40]

In arriving at its holding, the court specifically rejected the trustee's argument that reading the definition of "financial institution" to cover Tribune would run against the spirit of *Merit*; the court noted that the Supreme Court specifically declined to address the scope of the definition of "financial institution."[41] The court also declined to follow a timing argument of the kind Paul Clement posed to the Supreme Court, *i.e.*, that the definition of "financial institution" does not cover

[33] 2019 WL 1771786 (S.D.N.Y. Apr. 23, 2019). Although both arise out of the same bankruptcy and share repurchases, this litigation is distinct from the state law-based fraudulent conveyance actions discussed above.

[34] *Id*. at 2-3.

[35] *Id.* at 2.

[36] *Id*. at 25.

[37] *Id*. at 25-28.

[38] *Id*. at 28-29 (quoting Restatement (Third) of Agency § 1.01 (2006)).

[39] *Id*. at 29-30.

[40] *Id*. at 33.

[41] *Id*. at 32.

customers when the bank has in the past acted as an agent or custodian. The court determined that the argument is "without merit." Since the definition of "financial institution" and Section 546(e) are written in the present tense, the court held, the Code only requires that the bank or trust company act as agent at the time the transfer is made.[42]

Finally, the court briefly also noted that its holding is consistent with the purpose behind Section 546(e) to "promot[e] stability and finality in securities markets and protect[] investors from claims precisely [like the one at hand]."[43] The trustee argued that Tribune was not a "systemically important" institution, but the court pointed to the fact that Tribune was a publicly traded, Fortune 500 company and that the trustee sued over 5,000 shareholders to unwind securities transactions.

Given this recent *Tribune* decision, the impact of *Merit* may be more limited. Additionally, future bankruptcy cases concerning Section 546(e) may similarly focus on the definitions of the Section 546(e) Protected Parties (*i.e.*, who counts as a financial institution, financial participant, etc.).

Although *Tribune* provides an indication of what relationship may exist for a customer to be a "financial institution" for purposes of the Code, it leaves open a number of questions. First, as noted above, the "financial institution" definition includes a customer not only when a bank acts as agent for the customer, but also when a bank acts as "custodian" for the customer. Unlike "agent," "custodian" is defined in the Code. However, "custodian" is defined as "(A) receiver or trustee of any of the property of the debtor, appointed in a case or proceeding not under [the Code]; (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 property, or for the purpose of general administration of such property for the benefit of the debtor's creditors."[44] Nonetheless, it would not make sense to apply this definition in the context of the financial institution definition because it is extremely unlikely that a bank or other institution listed in the first part of the "financial institution" definition would act as a receiver or trustee for a customer. Therefore, it would be appropriate to define "custodian" as well as "agent" by reference to the common law.

Additionally, the court did not consider other possible arrangements that may give rise to the agency or custodian relationship that the "financial institution" definition requires. It bears noting in this regard that one of the reasons that the "agent or custodian for a customer" language may have been included in the definition of "financial institution" is to protect agent lenders. Agent lenders are custodial banks that hold securities on behalf of their customers. Such customers typically authorize the agent lenders to lend the securities held in custody to third parties. The agent lenders enter into such transactions as agent, and they also generally separately guarantee the obligations of the third-party borrowers to their customers on behalf of whom they were holding the lent securities in custody.

Since an agent lender is therefore liable if a third-party borrower fails to perform, an agent lender needs to have the ability on behalf of the customer to liquidate, terminate, accelerate, or otherwise close out a defaulting third-party borrower's loan, execute (foreclose) on and liquidate the collateral, and net such collateral against the third-party borrower's obligations to the customer. In the absence of the "agent or custodian for a customer" language, it is not entirely clear that agent lenders would be able to exercise such close-out netting rights because the rights belong to their customers, who are not, standing on their own, Protected Parties.

V. TEXTUALISM

Although the Court's focus on the text of the Code in *Merit* led to a narrowing of the scope of the protection afforded by Section 546(e) in that case, its textualist approach can also lead to a broader reading of the safe harbor provisions, given that the protections for close-out rights are very broadly worded.

For example, Section 555 of the Code provides that:

> The exercise of a contractual right of a stockbroker, financial institution, financial participant, or securities clearing agency to cause *the liquidation, termination, or acceleration* of a securities contract, as defined in section 741 of [the Code] . . . shall not be stayed, avoided, or otherwise limited by operation of any provision of [the Code] or by

[42] *Id* at 30 n. 11.

[43] *Id* at 33.

[44] 11 U.S.C. § 101(11).

> order of a court or administrative agency in any proceeding under [the Code] . . . .[45]

Under the canon of construction that avoids statutory interpretations that render a clause or provision meaningless,[46] each of "liquidation," "termination," and "acceleration" must be given independent meanings. Therefore, a broad range of close-out rights may be protected under a textualist reading of the safe harbor provided for in Section 555.

Section 362(b)(6) similarly provides an exemption from the automatic stay for any:

> exercise by a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency of *any contractual right* (as defined in section 555 or 556) under any security agreement or arrangement or other credit enhancement forming a part of or related to any . . . securities contract, or of any contractual right (as defined in section 555 or 556) to offset or net out any termination value, payment amount, or other transfer obligation arising under or in connection with 1 or more such contracts, including any master agreement for such contract[.][47]

"[A]ny contractual right" could be read to encompass a broad range of rights that are embedded within contracts.

The definitions of the terms used in the safe harbors can also be interpreted broadly under a textualist approach. For example, a textualist approach can promote a broad reading of who can constitute a "customer" within the definition of "financial institution." One literal reading could mean that "financial institution" encompasses any customer of a bank, which could lead to a very broad interpretation of Section 546(e) and other safe harbors that include a "financial institution" in the list of Protected Parties.

The definitions of "securities contract" and other financial contracts are also broadly worded to contemplate the additional types of transactions that may form over time and ought to be encompassed within such definitions. For example, the definition of swap agreement is extremely broad, including 10 different groups of transactions. It also includes "any similar agreement that becomes the subject of recurrent dealings in the derivatives markets" and is a "forward, swap, future, option, or spot transaction on one or more rates, currencies, commodities, equity securities, or other equity instruments, debt securities or other debt instruments, quantitative measures associated with an occurrence, extent of an occurrence, or contingency associated with a financial, commercial, or economic consequence, or economic or financial indices, or measures of economic or financial risk or value."[48] The open-ended nature of the definition leaves room for a wide variety of different instruments to qualify as "swap agreements."

VI. CONCLUSION

Many of the implications of the Supreme Court's decision in *Merit* with respect to the Code's safe harbors remain uncertain. As the reconsideration of *Tribune* demonstrates, future litigation may cause courts to re-examine established precedents regarding the scope of the safe harbors. In particular, courts may reconsider the breadth of transactions, parties, and rights protected by the safe harbors, and the extent to which the safe harbors, preempt state law. Courts will likely also confront questions about where a transfer subject to an avoidance action begins and ends. ■

[45] 11 U.S.C. § 555 (emphasis added).

[46] *United States v. Menasche,* 348 U.S. 528, 538–539 (1955)("It is our duty 'to give effect, if possible, to every clause and word of a statute.'") (quoting *Inhabitants of Montclair v. Ramsdell,* 107 U.S. 147, 152 (1883)).

[47] 11 U.S.C. § 362(b)(6) (emphasis added).

[48] 11 U.S.C. § 101(53B).