Supp. December 6, 2018 v. 1.3

BANKRUPTCY

AND CORPORATE REORGANIZATION

LEGAL AND FINANCIAL MATERIALS

SPRING 2019 SUPPLEMENT

MARK J. ROE
FREDERICK TUNG

Insert on p. 59:

5. *Sub Rosa Plans and Structured Dismissal*. Other Code structures can implicate priority issues. Bankruptcy proceedings can be dismissed under §§ 349 and 1112(b) of the Code. As § 349 instructs, a dismissal should ordinarily leave the parties at their prebankruptcy status quo to the extent possible. A practice arose, however, in which the dismissal—often called a "structured dismissal"—would also determine some priorities, by leaving one creditor or another out of the post-dismissal structure, or by otherwise affecting priorities and value.

§ 349. Effect of dismissal

* * *

(b) Unless the court, for cause, orders otherwise, a dismissal of a case . . . —

(1) reinstates—

* * *

(B) any transfer avoided under [the preference and fraudulent conveyance provisions of the Code] . . . ;

(2) vacates any order, judgment, or transfer ordered, under [Chapter 5 of the Code]; and

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

In Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017), the Supreme Court examined structured dismissal, striking down that practice. The court rejected a bankruptcy court order approving a settlement that would dismiss a Chapter 11 proceeding but would also purport to affect the priority of prebankruptcy creditors' distributions.

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

JUSTICE BREYER delivered the opinion of the Court.

Bankruptcy Code Chapter 11 allows debtors and their creditors to negotiate a plan for dividing an estate's value. See 11 U. S. C. §§1123, 1129, 1141. But sometimes the parties cannot agree on a plan. If so, the bankruptcy court may decide to dismiss the case. §1112(b). The Code then ordinarily provides for what is, in effect, a restoration of the prepetition financial status quo. §349(b).

In the case before us, a Bankruptcy Court dismissed a Chapter 11 bankruptcy. But the court did not simply restore the prepetition status quo. Instead, the court ordered a distribution of estate assets that gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 *plan* (or in a Chapter 7 liquidation). See §§507, 725, 726, 1129. The question before us is whether a bankruptcy court has the legal power to order this priority-

skipping kind of distribution scheme in connection with a Chapter 11 *dismissal.*

In our view, a bankruptcy court does not have such a power. A distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.

I

A

1

* * *

. . . Chapter 11 foresees three possible outcomes. The first is a bankruptcy-court-confirmed plan. Such a plan may keep the business operating but, at the same time, help creditors by providing for payments, perhaps over time. See §§1123, 1129, 1141. The second possible outcome is conversion of the case to a Chapter 7 proceeding for liquidation of the business and a distribution of its remaining assets. §§1112(a), (b), 726. That conversion in effect confesses an inability to find a plan. The third possible outcome is dismissal of the Chapter 11 case. §1112(b). A dismissal typically "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"—in other words, it aims to return to the prepetition financial status quo. §349(b)(3).

Nonetheless, recognizing that conditions may have changed in ways that make a perfect restoration of the status quo difficult or impossible, the Code permits the bankruptcy court, "for cause," to alter a Chapter 11 dismissal's ordinary restorative consequences. §349(b). A dismissal that does so (or which has other special conditions attached) is often referred to as a "structured dismissal," defined by the American Bankruptcy Institute as a

> "hybrid dismissal and confirmation order . . . that . . . typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case." American Bankruptcy Institute Commission To Study the Reform of Chapter 11, 2012–2014 Final Report and Recommendations 270 (2014).

Although the Code does not expressly mention structured dismissals, they "appear to be increasingly common." *Ibid.*, n. 973.

* * *

. . . [The lower] court[s], instead of reverting to the prebankruptcy status quo, ordered a distribution of the estate assets to creditors by attaching conditions to the dismissal (*i.e.,* it ordered a structured dismissal). The Code does not explicitly state what priority rules—if any—apply to a distribution in these circumstances. May a court consequently provide for distributions that deviate from the ordinary priority rules that would apply to a Chapter 7 liquidation or a Chapter 11 plan? Can it approve conditions that give estate assets to members of a lower priority class while skipping objecting members of a higher priority class?

B

* * *

. . . [P]etitioners, a group of former Jevic truckdrivers, filed suit in bankruptcy court against Jevic[, the debtor,] and Sun[, the private equity firm that owned Jevic]. Petitioners pointed out that, just before entering bankruptcy, Jevic had halted almost all its operations and had told petitioners that they would be fired. Petitioners claimed that Jevic . . . had thereby violated state and federal Worker Adjustment and Retraining Notification (WARN) Acts—laws that require a company to give workers at least 60 days' notice before their termination. See 29 U. S. C. §2102; N. J. Stat. Ann. §34:21–2 (West 2011). The Bankruptcy Court granted summary judgment for petitioners against Jevic, leaving them (and *this* is the point to remember) with a judgment that petitioners say is worth $12.4 million. See *In re Jevic Holding Corp.*, 496 B. R. 151 (Bkrtcy. Ct. Del. 2013). Some $8.3 million of that judgment counts as a priority wage claim under 11 U. S. C. §507(a)(4), and is therefore entitled to payment ahead of general unsecured claims against the Jevic estate.

* * *

The [financial] parties reached a settlement agreement. It provided . . . a distribution that would skip petitioners [and their WARN Act and related claims]. . . . The essential point is that, regardless of the reason, the proposed settlement called for a structured dismissal that provided for distributions that did not follow ordinary priority rules.

Sun, CIT [a lender to Jevic], Jevic, and the [creditors'] committee asked the Bankruptcy Court to approve the settlement and dismiss the case. Petitioners and the U. S. Trustee objected, arguing that the settlement's distribution plan violated the Code's priority scheme because it skipped petitioners—who, by virtue of their WARN judgment, had mid-level priority claims against estate assets—and distributed estate money to low-priority general unsecured creditors.

The Bankruptcy Court [approved the structured dismissal]. The District Court affirmed the Bankruptcy Court. It recognized that the settlement distribution violated ordinary priority rules. But those rules, it

wrote, were "not a bar to the approval of the settlement as [the settlement] is not a reorganization plan." *In re Jevic Holding Corp.*, 2014 WL 268613, *3 (D. Del., Jan. 24, 2014).

The Third Circuit affirmed the District Court . . . The majority held that structured dismissals need not always respect priority. Congress, the court explained, had only "codified the absolute priority rule . . . in the specific context of plan confirmation." *Id.*, at 183. As a result, courts could, "in rare instances like this one, approve structured dismissals that do not strictly adhere to the Bankruptcy Code's priority scheme." *Id.*, at 180.

Petitioners (the workers with the WARN judgment) sought certiorari. We granted their petition.

II

* * *

. . . [T]he record indicates that the [WARN Act claims would have had at least] litigation value. CIT [the primary lender] and Sun, after all, settled the [original] lawsuit for $3.7 million, which would make little sense if the action truly had no chance of success. . . . Of course, the lawsuit—like any lawsuit—*might* prove fruitless, but the mere *possibility* of failure does not eliminate the value of the claim or petitioners' injury in being unable to bring it.

Consequently, the Bankruptcy Court's approval of the structured dismissal cost petitioners something. They lost a chance to obtain a settlement that respected their priority. . . .

III

. . . Can a bankruptcy court approve a structured dismissal that provides for distributions that do not follow ordinary priority rules without the affected creditors' consent? Our simple answer to this complicated question is "no." The Code's priority system constitutes a basic underpinning of business bankruptcy law. Distributions of estate assets at the termination of a business bankruptcy normally take place through a Chapter 7 liquidation or a Chapter 11 plan, and both are governed by priority. . . . [A] Chapter 11 . . . priority-violating plan . . . cannot be confirmed over the objection of an impaired class of creditors. See §1129(b).

The priority system applicable to those distributions has long been considered fundamental to the Bankruptcy Code's operation. . . . Roe & Tung, Breaking Bankruptcy Priority: How Rent-Seeking Upends The Creditors' Bargain, 99 Va. L. Rev. 1235, 1243, 1236 (2013) (arguing that the first principle of bankruptcy is that "distribution conforms to predetermined statutory and contractual priorities," and that [absolute] priority is, "quite appropriately, bankruptcy's most important and famous rule"); Markell, Owners, Auctions, and Absolute Priority in Bankruptcy

Reorganizations, 44 Stan. L. Rev. 69, 123 (1991) (stating that a fixed priority scheme is recognized as "the cornerstone of reorganization practice and theory").

The importance of the priority system leads us to expect more than simple statutory silence if, and when, Congress were to intend a major departure. . . . [W]e would expect to see some affirmative indication of intent if Congress actually meant to make structured dismissals a backdoor means to achieve the exact kind of nonconsensual priority-violating final distributions that the Code prohibits in Chapter 7 liquidations and Chapter 11 plans.

We can find nothing in the statute that evinces this intent. . . .

In[deed,] [in]sofar as the dismissal sections of Chapter 11 foresee any transfer of assets, they seek a restoration of the pre-petition financial status quo. See §349(b)(1) (dismissal ordinarily reinstates a variety of avoided transfers and voided liens); §349(b)(2) (dismissal ordinarily vacates certain types of bankruptcy orders); §349(b)(3) (dismissal ordinarily "revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case"); see also H. R. Rep. No. 95–595, p. 338 (1977) (dismissal's "basic purpose . . . is to undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case").

Section 349(b), we concede, also says that a bankruptcy judge may, "for cause, orde[r] otherwise." But, read in context, this provision appears designed to give courts the flexibility to "make the appropriate orders to protect rights acquired in reliance on the bankruptcy case." H. R. Rep. No. 95–595, at 338; . . . .

* * *

IV

. . . The judgment of the Court of Appeals is reversed, and the case is remanded for further proceedings consistent with this opinion.

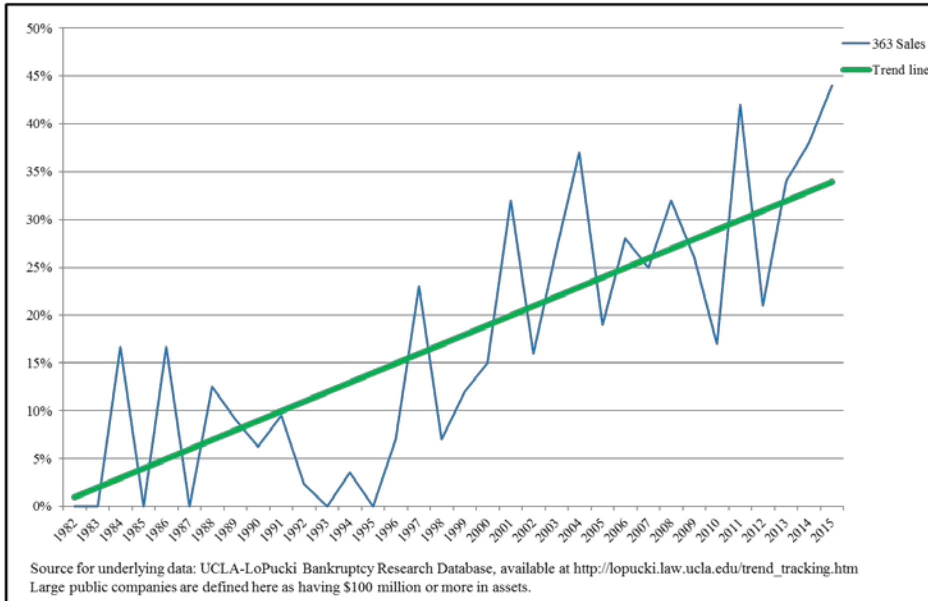
It is so ordered.

1. Section 349 says nothing about priority; the Court said § 1129 priorities must be respected. How did the Court get to its conclusion that § 1129 priorities must be respected in a dismissal?
2. While the Court in *Jevic* did not address "gift plans" or "new value" plans, the thinking in *Jevic* would bear on their viability. How so?

Insert on p. 116:

Delete on first and second line "from 1989 through 2013.[2]" and insert instead "from 1982 through 2017."

363 Sales of All or Substantially All Assets in Large, Public Company Bankruptcies, as a Percentage of all Cases Disposed, by Year of Case Disposition



Insert on p. 130, in place of the current 4.(i):

¶608: Selling under § 363?

Please replace the text's 4(i) with the following:

* * *

4. ….

(i) An obligation to the old bank lender in the amount of $6 million; an obligation to the old trade creditors for $6 million; an obligation to the original mortgage bondholders for $15 million; and a new $6 million obligation to the old subordinated debentureholders. Each of these creditors forgive Dieglom, cancelling their obligation from Dieglom.

……………………………………………………………………………………………

On p. 131, please change "$29M" at the bottom of the first column of numbers and replace it with "$27M."

Insert on p. 137:

¶613A: General Motors' Ignition Switches

On June 1, 2009, General Motors, the nation's largest carmaker, filed for bankruptcy. Forty days later "New GM" emerged via a § 363 sale of most of "Old GM's" assets and operations to "New GM." As in the Chrysler § 363 sale that summer, analyzed in ¶¶ 612–613, many of the liabilities of Old GM carried over to the New GM. At stake in the 2015-2016 litigation was whether widespread tort liability for pre-sale car accidents involving defective ignition switches should have carried over to New GM as well. The defect led cars to stall while in motion, rendering the cars' air bags, power steering and power brakes unusable. By the time of the recall, Old GM had liquidated. Though a trust had been formed to compensate Old GM's unsecured creditors, the trust might well not have had sufficient assets to answer for these liabilities.

Section 363 sales typically have the buyer taking the assets "free and clear" of all liens and other claims on the property and operations. Section 363(f) is the operative section:

§ 363. Use, sale or lease of property

* * *

(f) The trustee may sell property under subsection (b) or (c) of this section [363] free and clear of any interest in such property of an entity other than the estate only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

The bankruptcy court required GM to send direct mail notice of its proposed sale order to interested parties, including "all parties who are known to have asserted any lien, claim, encumbrance, or interest in or on the to-be-sold assets," and to publish notice in major media, including the Wall Street Journal and New York Times. Affected parties could then object to the terms of the proposed sale order. GM did not mail any notice to car owners who could have been affected by the defective ignition switches. (These switches were an engineering difficulty during 2002 to 2009, with several deaths resulting when cars stalled.)

Despite the fact that Old GM knew or reasonably should have known about ignition switch defects and the possibility of future claims arising after the 2009 sale from the defects in cars sold before 2009, the company did not mail any notice to car owners. Nevertheless, the bankruptcy court approved the sale order, moving the bulk of Old GM's assets and operations to New GM "free and clear of all liens, claims, encumbrances, and other interests of any kind or nature whatsoever, including rights or claims based on any successor or transferee liability. . . ."

In February 2014, the reorganized New GM — having been outside of bankruptcy for nearly five years — recalled a slew of defective cars, which GM had manufactured and sold prior to its 2009 bankruptcy. Car owners and others sued New GM, asserting successor liability claims — that is, asserting that New GM picked up Old GM's liability for the defective cars. New GM argued, however, that, because it bought GM's operations "free and clear," the car buyers could not bring their claims against New GM, but only against Old GM, which had few assets and value left.

Did the 363(f) "free and clear" provision bar claimants from bringing actions against New GM? The bankruptcy court concluded that the plaintiffs were not prejudiced by the defective notice, because the court would have approved the sale since the sale was "free and clear" anyway. The court enjoined the pre-sale plaintiffs from suing New GM.

The Second Circuit Court of Appeals reversed in July 2016. Elliott v. General Motors LLC (In re Motors Liquidation Co.), __ F.3d __, 2016 WL 3766237 (2d Cir. July 13, 2016). The court decided that adequate notice could well have led to a different sales order, since with notice, the ignition switch claimants would have had an opportunity to negotiate a consensual assumption with New GM. Moreover, the scope of claims that could be cut off was not unlimited and included only claims that (1) related to the assets sold, (2) had given rise to a pre-sale right to payment from GM, and (3) were sufficiently identifiable at the time of the sale. The Second Circuit then sent the case back to the bankruptcy court for further proceedings consistent with its opinion.[1]

* * *

There is a good reason to treat an arm's-length sale of a firm's assets and operations differently than a reorganization of an existing firm. In an arm's-length sale, the buyer often cannot know the full extent of potential products liability claims, even after it investigates the selling firm. In a restructuring, however, there's no similarly situated buyer to be deterred if it fears picking up unknown liabilities. The old manage-

[1] For two of several law firm memos analyzing this decision, see Reed Smith's memo, *available at* www.lexology.com/library/detail.aspx?g=40f9ea8f-3ffa-4366-b3ec-de6f1d1e7288, and Paul Weiss's, *available at* www.paulweiss.com/media/3648023/25jul16bkr.pdf.

ment, old employees, and old operations typically become the new management, employees, and operations; the new management knows what the old management knew. (However that continuity in a reorganization is not 100%, as creditors in a restructuring who do not know of the lurking liability might not have agreed to the same terms for restructuring had they known.)

While the GM chapter 11 was in form a § 363 sale, there was no true third-party purchaser (and to the extent the United States was de facto the arms-length purchaser, it makes decisions on non-commercial terms and, hence, presumably would not have wanted to cut buyers of defective cars off from claiming against new GM); indeed many other pre-filing claimants remained as claimants of the New GM, sometimes with a restructured claim. Old GM management became new GM management. There was substantial organizational continuity between old and new GM; it would not be a stretch to attribute Old GM's knowledge of defective ignition switches to New GM.

Insert on p. 144

¶617A: Structured Dismissal

Just as § 363 sales can implicate priority issues, so can judicial decisions as to how, and on what terms, to dismiss a chapter 11 proceeding.

In Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017), excerpted above in the priority discussion, the Supreme Court struck down a structured dismissal that, in addition to dismissing a chapter 11 proceeding, affected the distribution of proceeds, but did so without the consent or valuation structure of § 1129. The thinking in that decision bears on the viability of § 363 sales that affect priority and distribution.

Czyzewski v. Jevic Holding Corp., 137 S.Ct. 973 (2017)

JUSTICE BREYER delivered the opinion of the Court.

Bankruptcy Code Chapter 11 allows debtors and their creditors to negotiate a plan for dividing an estate's value. See 11 U. S. C. §§1123, 1129, 1141. But sometimes the parties cannot agree on a plan. If so, the bankruptcy court may decide to dismiss the case. §1112(b). The Code then ordinarily provides for what is, in effect, a restoration of the prepetition financial status quo. §349(b).

In the case before us, a Bankruptcy Court dismissed a Chapter 11 bankruptcy. But the court did not simply restore the prepetition status quo. Instead, the court ordered a distribution of estate assets that gave money to high-priority secured creditors and to low-priority general unsecured creditors but which skipped certain dissenting mid-priority creditors. The skipped creditors would have been entitled to payment ahead of the general unsecured creditors in a Chapter 11 *plan* (or in a Chapter 7 liquidation). See §§507, 725, 726, 1129. The question before us is whether a bankruptcy court has the legal power to order this priority-skipping kind of distribution scheme in connection with a Chapter 11 *dismissal*.

In our view, a bankruptcy court does not have such a power. A distribution scheme ordered in connection with the dismissal of a Chapter 11 case cannot, without the consent of the affected parties, deviate from the basic priority rules that apply under the primary mechanisms the Code establishes for final distributions of estate value in business bankruptcies.

* * *

. . . [T]he distributions at issue here [in the structured dismissal] . . . closely resemble proposed transactions that lower courts have refused to allow on the ground that they circumvent the Code's procedural safeguards. See, *e.g., In re Braniff Airways, Inc.*, 700 F. 2d 935, 940 (CA5 1983) (prohibiting an attempt to "short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms

of the plan *sub rosa* in connection with a sale of assets"); *In re Lionel Corp.*, 722 F. 2d 1063, 1069 (CA2 1983) (reversing a Bankruptcy Court's approval of an asset sale after holding that §363 does not "gran[t] the bankruptcy judge *carte blanche*" or "swallo[w] up Chapter 11's safeguards") . . . ; cf. *In re Chrysler LLC*, 576 F. 3d 108, 118 (CA2 2009) (approving a §363 asset sale because the bankruptcy court demonstrated "proper solicitude for the priority between creditors and deemed it essential that the [s]ale in no way upset that priority"), vacated as moot, 592 F. 3d 370 (CA2 2010) (*per curiam*).

....

. . .

1. Does the structured dismissal in *Jevic* resemble a *sub rosa* plan? See Ch. 6B. Note the court's citations of *Braniff*, *Lionel*, and *Chrysler*. Would the *Jevic* court have approved the Chrysler plan of reorganization, had it been properly challenged?

2. Does the structured dismissal resemble a gift plan? See Ch. 3E. Would the *Jevic* court be skeptical of so-called gift plans?

¶1202, p. 311, halfway down large paragraph:

Delete: “Section 502(g) will make the dress manufacturer”

Insert: “The dress manufacture could have to”

Insert on p. 318:

More on reclamation:

[Here is much of the rest of § 546(c)(1):]

[. . .] but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

Insert on p. 318, after ¶1206:

¶1206A: Priority Status of Consumer Claims

Debtors with retail customers usually want to maintain their customers' goodwill. A debtor could readily lose that goodwill by rejecting obligations to send consumers goods that the consumers had already paid for before the petition was filed, by ending frequent flyer programs (for reorganizing airlines) or rewards programs for other debtors, or by failing to honor warranty claims. Under doctrines similar to those discussed in *Kmart*, courts typically grant reorganizing debtors' motions to continue satisfying these consumer claims. The approval essentially elevates an otherwise unsecured consumer claim to an administrative expense priority. But honoring pre-petition consumer claims plausibly makes it more likely that the business would prosper and pay off the debtor's other creditors.

What if the debtor is liquidating? Continued customer goodwill is not valuable to the liquidating debtor, making a *Kmart*-type analysis inapt. For the consumer to rise above its baseline status as a general unsecured claimant, it would need to fit into one of the ten priority classes under § 507(a). Subsection (7) is the most propitious section for such consumer claimants, but it is less capacious than the reorganization standard. The claim has to arise "from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided." This "deposit" priority is limited to $2,850 per claim.

The Delaware Bankruptcy Court recently denied § 507(a)(7) priority status in the City Sports' bankruptcy for the pre-petition gift certificates that customers had bought from City Sports.[1] The court reasoned that unredeemed gift certificates are akin to open-ended money orders and store credits, and they do not resemble, say, a deposit made to purchase specific goods or services that is the substance of the § 507(a)(7) deposit priority. Based on recent cases such as *City Sports*, layaway plans and other forms of direct prepayment for goods and services to be delivered within a limited time frame are safe bets for priority treatment. But claims based on frequent flyer programs, discount programs, and warranties are not.

[1] In re City Sports, Inc., No. 15-12054 (KG), 2016 Bankr. LEXIS 2884 (Bankr. D. Del. Aug. 4, 2016)

Insert on p. 360, ¶1301 D., third line, after "State":

D. MUNICIPAL BANKRUPTCY

— but not states themselves.

Insert on p. 362, after ¶1302:

¶1303: Puerto Rico in 2016

Puerto Rico and its municipalities, at this writing, have more debt than they can plausibly repay without a bankruptcy-type restructuring process or a federal rescue. The Bankruptcy Code expressly denies Puerto Rico's municipalities the Chapter 9 protection[1] that is available to municipalities in all 50 states. Puerto Rico passed its own municipal bankruptcy act in 2014, but the Supreme Court struck it down, concluding that the Bankruptcy Code preempts "states" (including Puerto Rico, a commonwealth) from enacting their own municipal bankruptcy scheme that conflicts with federal bankruptcy law.[2] Moreover, the U.S. Constitution's Contract Clause ("No State shall . . . pass any . . . Law impairing the Obligation of Contracts") alone casts doubt over the constitutionality of such state-made bankruptcy discharge law.

In June 2016, President Obama signed the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) into law. PROMESA provides a legal channel for Puerto Rico to restructure its debt. Specifically, it establishes a Financial Oversight and Management Board and procedures through which Puerto Rico can restructure its debt. The Board's primary responsibilities include monitoring and approving development and enforcement of budgets and fiscal plans of Puerto Rico government and municipalities, serving as the representative of Puerto Rico as a debtor, and reviewing and approving any debt restructuring agreements or debt issuances of Puerto Rico. PROMESA also mandates a limited-term automatic stay of further creditor actions upon its enactment and makes most of Chapter 9 and Chapter 11 applicable to the Puerto Rico debt restructuring process. The Board is targeted to propose a debt restructuring plan to be voted on by each creditor class, which will be confirmed in court if approved by every impaired class.

---

[1] Bankruptcy Code § 101(52) ("The term "state" includes the District of Columbia and Puerto Rico . . . .").

[2] See Puerto Rico v. Franklin Cal. Tax-Free Tr., 136 S. Ct. 1938, 1946 (2016). The Bankruptcy Code structure is this: municipalities can file for bankruptcy, when authorized by their state. Bankruptcy Code § 109(c). But Puerto Rico cannot use this provision because the Code, after including Puerto Rico as a state in § 101(52): "The term "state" includes . . . Puerto Rico, *except for the purpose of defining who may be a debtor under chapter 9*. . ." (emphasis supplied). Hence, since Puerto Rico is not a state under chapter 9 and only state-authorized municipalities can file under chapter 9, the insolvent Puerto Rican municipalities cannot use chapter 9.

Insert on p. 386 at top [Retitle "G. What Rate?" to "H. What Rate?"]

G. MAKE-WHOLE PROVISIONS IN BANKRUPTCY

A borrower often wants the option to prepay its lender—to repay its loan before the maturity date. The borrower may turn out to have enough cash to prepay and have no business use for that cash. Or the loan covenants may turn out to excessively constrain the borrower, such that prepaying becomes attractive. Prepayment becomes especially attractive when market interest rates have fallen since the loan was made: the debtor can refinance its high-interest bonds with lower-interest borrowings. Lenders often agree to the borrower having a prepayment option but require that the debtor pay a premium upon redemption. Increasingly in recent years the creditors condition redemption on the lender being "made whole" for the loss of a favorable interest rate. The make-whole provision in the loan agreement assures that early redemption to take advantage of a decline in market-wide interest rates will not be profitable for the borrower. Keep in mind that the make-whole clauses are negotiated when there's a good chance that the debtor will do well; many redemptions occur when, and often because, the debtor is doing well and seeking to free itself of constraining lending terms and debt, not when the company is bankrupt.

With a make-whole provision, the debtor must pay a premium to the lender, frequently a bondholder, if the bond is redeemed before its originally-scheduled maturity. By requiring compensation to the lender for the loss of the original bargained-for rate of return, the make-whole requirement disincentivizes issuers from refinancing when interest rates drop. A typical make-whole covenant reads:

> At any time prior to [Date], [Borrower] may redeem all or a part of the Notes at a redemption price equal to 100% of the principal amount of the Notes redeemed plus the Applicable Premium [*i.e.*, the make-whole] . . . and accrued and unpaid interest.[1]

The make-whole premium is a defined term designed to compensate the lender for the benefit it had originally obtained via its original interest rate. In one deal, the make-whole premium was "calculated by subtracting the yield on a Treasury Note of comparable maturity from the note interest rate, applying the difference to the remaining principal balance at the time of prepayment, and discounting that amount to present value. Thus, it is an attempt to compensate the lender for the actual yield loss incurred upon prepayment."[2]

---

[1] Language adapted from *In re Energy Future Holdings Corp.*, 842 F.3d 247, 255 (3d Cir. 2016).

[2] *In re* Vanderveer Estates Holdings, Inc., 283 B.R. 122 (Bankr. E.D.N.Y. 2002).

While make-whole clauses were primarily designed to compensate lenders for non-bankruptcy redemptions when market interest rates decline below contractual interest rates, the clauses are contested in bankruptcy. If the firm fails and enters bankruptcy, the make-whole lenders will typically seek to obtain the make-whole premium as part of the claim. When deciding the enforceability of make-whole premiums in the bankruptcy context, courts have considered several factors, including language in the contract, solvency of the company, and the size of the premium. *In re Chemtura Corp.*, 439 B.R. 561, 600–04 (Bankr. S.D.N.Y. 2010). The Second and Third Circuits, where most of the make-whole disputes have arisen, split on the enforceability of make-whole provisions in bankruptcy cases.

The contractual interpretive problem stems from two questions. First, was the repayment of debt that bankruptcy accelerated a "redemption" that triggers the make-whole covenant? Second, was this payment effectuated by the debtor-borrower voluntarily?

The Third Circuit answered both questions affirmatively in 2016, and enforced the make-whole provision. *In re Energy Future Holdings Corp.*, 842 F.3d 247, 255 (3d Cir. 2016).

The Second Circuit ruled to the contrary in 2017. Only *pre-maturity* repayment of a debt qualifies as a "redemption" that required a make-whole payment. Bankruptcy accelerated the maturity date of the notes, establishing a new maturity date. Any debtor payment thereafter was a payment after the debt's (new) maturity and the "make-whole" clause only applied to issuer-initiated redemptions prior to the debt's maturity. Moreover, the Second Circuit held that the repayment was not "optional." *In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017).

1. Is contractual clarity the only issue at stake for make-wholes? Is a make-whole payment a payment of interest? Is it a payment of post-petition interest? See Bankruptcy Code § 502.
2. Under § 506(b) post-petition interest, as well as reasonable fees, can be claimed out of the excess security. The make-whole could also be an unreasonable penalty (if it seems excessive) or appropriate as liquidated damages because the creditor is losing out from the higher negotiated interest rate.

Insert on p. 389, in place of the full paragraph:

In *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004), which involved a chapter 13 proceeding for an individual, non-corporate bankruptcy, the Supreme Court rejected a market-based approach for cram-down interest in favor of a "prime-rate-plus" formula. *Till* was thought by many to probably apply in corporate bankruptcies as well. In the *Till* approach, when the court is cramming-down a creditor under § 1129 (where the court must determine that the creditor is getting property equal to the allowed amount of the claim), the court starts with a riskless rate of interest reflecting the duration of the new note and then adds a premium to reflect the risk of non-payment unique to the debtor.

The Second Circuit ruled in *In re MPM Silicones, L.L.C.*, 874 F.3d 787 (2d Cir. 2017), that the *Till* formula resulted in too low a rate in corporate bankruptcies. Instead, if there was a sufficiently efficient market, the market rate of interest for similar companies would be appropriate in corporate cramdowns. The court observed that other courts, including the Fifth Circuit in *In re Texas Grand Prairie Hotel Realty, L.L.C.*, 710 F.3d 324 (5th Cir. 2013), have held that markets for financing are efficient where, for example, "they offer a loan with a term, size and collateral comparable to the forced loan contemplated under the cramdown plan."

Insert on p. 418 as ¶1609A:

¶1609A: A View from the Bench: The Difficulty of Policing DIP Loan Terms—Frederick Tung, *Do Economic Conditions Drive DIP Lending: Evidence from the Financial Crisis* (SSRN 2017).

Evaluating whether a DIP loan's terms are the best available is no small task for a judge. Special institutional features of DIP lending may make it difficult for the court or junior creditors to object to aggressive lender protections. These institutional features give an edge to the debtor's pre-bankruptcy secured lender in capturing the DIP loan. Therefore, in many cases, there may be no real competition to offer DIP financing.

The pre-bankruptcy lender typically has enormous incentive to make the DIP loan because it has its existing pre-bankruptcy loan to protect. Making the DIP loan preserves this "inside" lender's control over the debtor's assets, and it enables the lender to advantage its pre-bankruptcy claim as part of the deal.[1] It also endows the inside lender with enormous influence over the debtor and the bankruptcy proceedings. In addition to this incentive structure, the pre-bankruptcy lender also enjoys an informational advantage over competing outside lenders because of its pre-bankruptcy relationship with the debtor. This up-to-date private information may enable the inside lender to underbid outside lenders should there be competition for the DIP loan. And a pre-bankruptcy lender typically has pre-bankruptcy liens on all the debtor's assets, so the debtor may have no free assets to offer an outside lender as collateral. The pre-bankruptcy lender, then, may be the only game in town—the only lender willing and able to finance the bankruptcy. Consistent with the information and incentive structures, 75% of the DIP loans in our sample come from inside lenders. For 72% of those defensive DIP loans, the pre-bankruptcy lenders enjoyed pre-bankruptcy liens on all of the debtor's assets.

Besides the typically weak competition for any given DIP loan, a rushed approval process at the outset of the case may make it more difficult for the bankruptcy court or junior claimants to challenge the debtor's generosity in its offering of lending inducements. An interim approval of the proposed DIP loan is typically made early in the case (the

[1] For example, the DIP loan agreement typically requires the debtor to acknowledge the validity of the lender's pre-bankruptcy claim and liens, to recognize its fully secured status, and to waive any potential challenges. E.g., In re Eddie Bauer, Inc., et al., Case No. 09-12099 (MFW), Final Order Pursuant to 11 U.S.C. Sections 105, 361, 362, 363 and 364 and Rules 2002, 4001 and 9014 of the Federal Rules of Bankruptcy Procedure (1) Authorizing Incurrence by the Debtors of Post-petition Secured Indebtedness with Priority over Certain Secured Indebtedness and with Administrative Superpriority, (2) Granting Liens, (3) Authorizing Use of Cash Collateral by the Debtors Pursuant to 11 U.S.C. Section 363 and Providing for Adequate Protection, and (4) Modifying the Automatic Stay, dated July 7, 2009, at 7-12.

motion is typically filed on the same day as the debtor's bankruptcy petition). The debtor and its lawyers claim that the debtor's cash needs are dire, so that a hearing is held only days after the filing, on expedited notice. The early days of a Chapter 11 proceeding are often hectic, and approving a DIP loan is only one of dozens of issues the bankruptcy court is asked to decide during the very first days. So preliminary approval of the DIP loan terms is often done in a hurry. It is for this reason that the ABI recommended that extraordinary provisions like roll-ups and milestones not be permitted in interim DIP orders (American Bankruptcy Institute 2014, 73).

Interim approval allows for credit sufficient to tide the debtor over until a more thorough vetting can be done. The hearing on the final DIP order may be more considered. This latter hearing typically occurs within a few months after the filing, after the early flurry of filings and motions has subsided. Although the final hearing gives the bankruptcy court a second opportunity to consider the DIP loan terms, the earlier interim approval may create a certain momentum favoring the status quo,[2] especially with respect to the possibility of an alternative lender.

A final difficulty for judges trying to constrain extraordinary lending inducements is the simple fact that obtaining DIP financing is good news for the debtor and its creditors, and all the bankruptcy participants in a case will typically want the debtor-in-possession to get its loan. The parties may disagree on the details, but they agree that the debtor needs the financing! The finance literature by and large finds beneficent case outcomes associated with the presence of DIP lending. A judge caught between approving a DIP order with questionable inducements or denying the debtor's financing might understandably err on the side of caution and approve the loan.

In sum, institutional factors make it difficult for judges to deny DIP loans, even if they view certain terms as value-reducing. Parties as well may hesitate to reject the DIP loan because it seems to be the only available option; the rushed nature of the interim motion makes detailed review difficult; and the positive relationship between DIP loans and case outcomes likely causes parties to be reluctant to object. These factors work jointly to increase the bargaining power of the DIP lender—a key factor in contract negotiations that can affect both price and non-price terms (Choi and Triantis, 2012). These features of DIP financing may create tough hurdles for opponents of aggressive lender protections, a predicament that helps explain critics' concerns about extraordinary inducements.

---

[2] The advance of DIP loan proceeds authorized in the interim order is subject only to the terms of the earlier order; subsequent modification in the court's final order does not change the terms of the earlier advance. 11 U.S.C. § 364(e). This makes some sense, since no lender would advance funds under terms that might later be changed. At the same time, however, once funds have been lent, the interim order may tend to "anchor" the deal terms in the face of subsequent objections.

Replace ¶1912 on pp. 497–98 with the following, to reflect the January 2017 *Marblegate* appellate decision (changes from textbook tracked), but read this *after* Assenagon in ¶1913:

¶1912: Section 316(b) Litigation

Sporadic decisions explicitly addressed the interplay between the voting prohibition in § 316(b) and exit consents, without appellate resolution until January 2017. The recent run of district court decisions interpreted § 316(b) as barring exit consent deals; the Second Circuit, on appeal, held that it did not.

In December 2014, the *Marblegate* plaintiffs sought to enjoin a transaction that would have left them with claims on a debtor unable to pay, as assets (and the debtor's liabilities to the agreeing bondholders) would be transferred to a related company; the debtor asked the bondholders to approve the transaction and accept new, lower payment terms from the new debtor. The Southern District of New York refused to enjoin the transaction, because any harm to the plaintiff would not be irreparable, as money damages paid later would be good enough. But the court then stated its serious doubts that the defendants could prevail on the merits. The judge concluded that the transaction ousted the plaintiffs' of their effective right to payment at the maturity date of the original principal amount, as no rational bondholder would stay as a claimant on an empty company if it had no effective lawsuit against the emptied defendant. Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592 (S.D.N.Y. 2014) (Failla, J.).

The *Marblegate* district court viewed the intercompany sale as "precisely the type of debt reorganization that the Trust Indenture Act is designed to preclude." Although the court recognized that its holding would make successful out-of-bankruptcy restructurings harder to achieve, it concluded that "the Trust Indenture Act simply does not allow the company to precipitate a debt reorganization outside the bankruptcy process to effectively eliminate the rights of nonconsenting bondholders."

The court viewed the text of § 316(b) as unclear, so the court turned to legislative history, taking the changing text of the section to be probative: The 1938 version required that the bond indenture adequately protect a bondholder's ability to "bring[] action to collect the principal of and interest upon the indenture securities upon their respective due date . . . ." This text was attuned to protecting only formal rights. The enacted text widened the scope, protecting "the right of any holder . . . to receive payment of the pirincipal and interest . . . ."

Two other district court decisions reached similar interpretations of § 316(b), in transactions in which the restructuring required exiting bondholders to vote to amend the indenture to eliminate restrictive covenants. With the restrictive covenants eliminated, the debtor could have

transferred all of its assets to another entity. Nonconsenting bondholders who stayed behind with the original debtor would have seen the value of their bond substantially diminished. MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507 (S.D.N.Y. 2015); Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd., No. 99 CIV 10517 HB, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999).

Other courts had read § 316(b) more narrowly, seeing § 316(b) as protecting only the formal right to receive payment from the debtor, without protecting the economic interest of the bondholder to actually be paid. In re Northwestern Corp., 313 B.R. 595 (Bankr. D. Del. 2004), concluded that § 316(b) "applies to the holder's *legal* rights and not the holder's *practical* rights to the principal and interest itself. Plaintiffs' legal rights were not impaired. . . . [T]here is no guarantee against default." The court did not halt a transfer that left the debtor unable to pay its creditors. See also YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas, No. 10-2106-JWL, 2010 WL 2680336 (D. Kan. July 1, 2010); Upic & Co. v. Kinder-Care Learning Centers, Inc., 793 F. Supp. 448 (S.D.N.Y. 1992). The Second Circuit's majority in *Marblegate* also takes this narrow view of § 316(b).

Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1, 6 (2d Cir. 2017)

Cabranes, Straub, and Lohier, Circuit Judges.

Defendant-appellant Education Management Corporation ("EDMC") and its subsidiaries appeal from a judgment following a bench trial before the United States District Court for the Southern District of New York (Failla, J.). The District Court held that a series of transactions meant to restructure EDMC's debt over the objections of certain noteholders violated Section 316(b) of the Trust Indenture Act of 1939, 15 U.S.C. § 77ppp(b). The transactions at issue, the District Court determined, stripped the nonconsenting noteholders . . . of their practical ability to collect payment on notes purchased from EDMC's subsidiaries. As a result, the District Court ordered EDMC to continue to guarantee Marblegate's notes and pay them in full.

On appeal, EDMC argues that it complied with Section 316(b) because the transactions did not formally amend the payment terms of the indenture that governed the notes. We agree with EDMC and conclude that Section 316(b) prohibits only non-consensual amendments to an indenture's core payment terms. We therefore **Vacate** the judgment and **Remand** to the District Court for further proceedings consistent with this opinion.

Background

1. Facts

* * *

In 2014 EDMC found itself in severe financial distress. Its enterprise value had fallen well below its $1.5 billion in outstanding debt. . . .

EDMC's outstanding debt consisted of both secured debt (roughly $1.3 billion) and unsecured debt ($217 million). The secured debt was governed by a 2010 credit agreement between the EDM Issuer and secured creditors (the "2010 Credit Agreement"). The 2010 Credit Agreement gave EDMC's secured creditors the right, upon default, to deal with the collateral securing the loans "fully and completely" as the "absolute owner" for "all purposes." The collateral securing the debt consisted of virtually all of EDMC's assets.

The unsecured debt, to which we will refer as the "Notes," was also issued by the EDM Issuer and governed by an indenture executed in March 2013 and qualified under the Trust Indenture Act of 1939 (the "Indenture"). The Notes were guaranteed by EDMC as the parent company of the EDM Issuer (we refer to this guarantee as the "Notes Parent Guarantee") . . . .

As EDMC's financial position deteriorated, its debt burden became unsustainable. After negotiating with EDMC, a majority of secured creditors agreed in September 2014 to relieve the EDM Issuer of certain imminent payment obligations and covenants under the 2010 Credit Agreement. The resulting agreement was a new amended credit agreement entered in the fall of 2014 (the "2014 Credit Agreement"). As consideration for these changes, EDMC agreed to guarantee the secured loans (the "Secured Parent Guarantee").

Around the same time, a group of creditors formed an Ad Hoc Committee of Term Loan Lenders (the "Ad Hoc Committee") and established a Steering Committee . . . to negotiate with EDMC.[1] The Steering Committee and EDMC eventually devised two potential avenues to relieve EDMC of its debt obligations.

The first option, which obtained only if creditors unanimously consented, was designed to result in (1) most of EDMC's outstanding secured debt being exchanged for $400 million in new secured term loans and new stock convertible into roughly 77 percent of EDMC's common stock, and (2) the Notes being exchanged for equity worth roughly 19 percent of EDMC's common stock. EDMC estimated that this first option would

[1] The Ad Hoc Committee held 80.6 percent of the secured debt and 80.7 percent of the Notes. Of that total, the Steering Committee of the Ad Hoc Committee held 35.8 percent of secured debt and 73.1 percent of the Notes.

amount to roughly a 45 percent reduction in value for secured lenders and a 67 percent reduction in value for Noteholders.

The second option would arise only if one or more creditors refused to consent. Under that circumstance, a number of events would occur that together constituted the "Intercompany Sale." Secured creditors consenting to the Intercompany Sale would first exercise their preexisting rights under the 2014 Credit Agreement and Article 9 of the Uniform Commercial Code (UCC) to foreclose on EDMC's assets. In addition, the secured creditors would release EDMC from the Secured Parent Guarantee. That release in turn would effect a release of the Notes Parent Guarantee under the Indenture. With the consent of the secured creditors (but without needing the consent of the unsecured creditors), the collateral agent would then sell the foreclosed assets to a subsidiary of EDMC newly constituted for purposes of the Intercompany Sale. Finally, the new EDMC subsidiary would distribute debt and equity only to consenting creditors and continue the business.

The Intercompany Sale was structured to incentivize creditors to consent. While non-consenting secured creditors would still receive debt in the new EDMC subsidiary, that debt would be junior to the debt of consenting secured creditors. Non-consenting Noteholders would not receive anything from the new company: though not a single term of the Indenture was altered and Noteholders therefore retained a contractual right to collect payments due under the Notes, the foreclosure would transform the EDM Issuer into an empty shell. . . .

Except for Marblegate, all of EDMC's creditors (representing 98 percent of its debt) eventually consented to the Intercompany Sale.

2. Procedural History

Marblegate, the sole holdout, sued to enjoin the Intercompany Sale on the ground that it violated Section 316(b) . . . .

Before the District Court, EDMC argued that "the right . . . to receive payment" [under Section 316(b)] is necessarily defined by the payment terms in the Indenture itself, such that Section 316(b) prohibits only nonconsensual amendments to an indenture's core payment terms. Therefore, EDMC asserted, the Intercompany Sale complied with Section 316(b) because it did not amend any Indenture term and because Marblegate's right to initiate suit against the EDM Issuer to collect payment remained intact.

In response, Marblegate contended that although the contractual terms governing Marblegate's Notes had not changed, its practical ability to receive payment would be completely eliminated by virtue of the Intercompany Sale, to which it did not consent. Section 316(b), Marblegate warned, would be rendered meaningless if issuers and secured creditors could collaborate to restructure debt without formally amending any payment terms.

The District Court initially declined to grant a preliminary injunction but believed that Marblegate was likely to succeed on the merits of its TIA claim. . . . 75 F. Supp. 3d at 615–17. After reviewing the text and legislative history of Section 316(b), the District Court concluded that . . . [even if] the payment terms of an indenture are not explicitly modified by a transaction, . . . Section 316(b) is violated whenever a transaction "effect[s] an involuntary debt restructuring." Id. at 614.

The Intercompany Sale occurred in January 2015. The foreclosure sale took place, the secured creditors released the Secured Parent Guarantee, the new EDMC subsidiary was capitalized with the EDM Issuer's old assets, and consenting bondholders participated in the debt-for-equity exchange. But Marblegate continued to hold out. And in light of the District Court's decision, EDMC and the Steering Committee refrained from releasing the Notes Parent Guarantee. . . .

Since the bulk of the Intercompany Sale was already completed, the subsequent bench trial focused on whether the District Court should permanently enjoin release of the Notes Parent Guarantee and thereby force EDMC to continue its guaranteed payment on Marblegate's Notes. On that question, the District Court ultimately sided with Marblegate by reiterating that the release of the Notes Parent Guarantee would violate Section 316(b). Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., 111 F. Supp. 3d 542, 556–57 (S.D.N.Y. 2015) . . ..

This appeal followed. At present, because EDMC was able to reduce its debt burden through the very transaction to which Marblegate objected, it currently has the assets to pay on Marblegate's Notes. Marblegate, as the owner of Notes that had been poised to receive only limited additional payments because of EDMC's pending insolvency, is now the only creditor receiving full payouts according to the original face value of its Notes.

Discussion

EDMC appeals the judgment on the ground that the District Court misinterpreted Section 316(b) of the TIA. . . . To determine whether the release of the Notes Parent Guarantee would violate Section 316(b) of the TIA, we start first with the text of that provision. . . .

1. Text

The core disagreement in this case is whether the phrase "right . . . to receive payment" forecloses more than formal amendments to payment terms that eliminate the right to sue for payment. 15 U.S.C. § 77ppp(b). We agree with the District Court that the text of Section 316(b) is ambiguous . . . .

On the one hand, Congress's use of the term "right" to describe what it sought to protect from non-consensual amendment suggests a concern with the practical ability to collect on payments. . . . Cf. F.C.C. v.

NextWave Pers. Commc'ns Inc., 537 U.S. 293, 302–03 (2003) ("[T]he plain meaning of a 'right to payment' is nothing more nor less than an enforceable obligation . . . ." (quotation marks omitted)) . . . . On the other hand, adding that such a right cannot be "impaired or affected" arguably suggests that it cannot be diminished, relaxed, or "otherwise affect[ed] in an injurious manner." See Humana Inc. v. Forsyth, 525 U.S. 299, 309–10 (1999) (quoting Black's Law Dictionary 752 (6th ed. 1990)).

To be sure, Marblegate's broad reading of the term "right" as including the practical ability to collect payment leads to both improbable results and interpretive problems. Among other things, interpreting "impaired or affected" to mean any possible effect would transform a single provision of the TIA into a broad prohibition on any conduct that could influence the value of a note or a bondholder's practical ability to collect payment. . . . It bars . . . so-called "collective-action clauses"—indenture provisions that authorize a majority of bondholders to approve changes to payment terms and force those changes on all bondholders. . . . [The question is whether it bars any more than that.]

Regardless, we agree with the District Court that the plain text of Section 316(b) is ultimately ambiguous and fails to resolve the principal question before us.

* * *

2. Legislative History

Because the text of Section 316(b) is ambiguous and the TIA's structure fails to remove the ambiguity, we turn to legislative history.

Marblegate argues that the history of Section 316(b) demonstrates Congress's broad intent to prohibit "an out-of-court debt restructuring that has the purpose and effect of eliminating *any* possibility of receiving payment under their notes." Appellee Br. 20; *id*. at 26. The District Court effectively adopted this view when it determined that "[p]ractical and formal modifications of indentures that do not explicitly alter a core term 'impair or affect' bondholders' rights to receive payment in violation of the Trust Indenture Act *only when such modifications effect an involuntary debt restructuring*." *Marblegate I*, 75 F. Supp. 3d at 614 (emphasis added and alterations omitted); *see Marblegate II*, 111 F. Supp. 3d at 554 ("[T]he purpose of the Act, as expressed consistently throughout the legislative history, was to prevent precisely the *nonconsensual majoritarian debt restructuring* that occurred here . . . ." (emphasis added)).

* * *

. . . [W]e conclude that Congress did not intend the broad reading that Marblegate urges and the District Court embraced. Starting in 1936, the Securities and Exchange Commission (SEC) published a comprehensive eight-part report examining the role of protective committees in reorganizations. . . . [We start there.]

* * *

A. The 1936 SEC Report

Two sections of the 1936 SEC Report are relevant to the competing interpretations of Section 316(b) offered by the parties on appeal. Neither section supports Marblegate's position that Section 316(b) meant to prohibit involuntary debt restructurings like foreclosures.

First, a section of the Report entitled "Protection of Minorities," confirms for us that "'no-action clauses' were one of the evils that the Trust Indenture Act was intended to address." . . . 111 F. Supp. 3d at 547 . . . . The authors of this section also fretted about majoritarian control in various reorganization contexts . . . . Notably, however, the "Protection of Minorities" section did not support legislation requiring unanimous consent for all out-of-court restructurings. Instead, it prescribed only "a more active indenture trustee in reorganization negotiations." . . . 111 F. Supp. 3d at 548.

The other relevant section of the 1936 SEC Report, entitled "Reorganization by Contract," examined collective-action clauses. . . . The section identified the holdout problem inherent in requiring unanimous consent, but explained that the proliferation of collective action clauses meant that "the next cycle of reorganizations [would] take place on a voluntary basis without supervision of any court." App'x 3419. In short, this section's focus on "reorganization by contract" supports reading Section 316(b) to prohibit amendments to core payment terms, but provides virtually no support for Marblegate's view that Section 316(b) also prohibits other forms of reorganization, such as foreclosures. . . .

B. The 1938 Testimony of William O. Douglas

In 1938 then-SEC Chairman William O. Douglas, an expert in the field of corporate reorganizations, testified before Congress in support of the proposed Trust Indenture Act of 1938. Because Douglas had been the principal draftsman of the 1936 SEC Report and the "main proponent" of the legislation before Congress, the District Court appropriately paid significant attention to his testimony.

Like the 1936 SEC Report, Chairman Douglas's testimony narrowly addressed collective-action clauses and formal amendments to core payment terms. Quoting at length from the "Reorganization by contract" section of the 1936 SEC Report and responding to the "bogey" that the proposed legislation would require unanimous consent of bondholders to amend any indenture term, Douglas assured critics of the proposed legislation that "[t]here is absolutely nothing in the bill to prevent" amendment of the indenture by a majority, with one exception, which he described as follows:

> The effect of this exception is *merely to prohibit provisions* authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for

> principal, or a reduction of his claim for interest . . . . *In other words, this provision merely restricts the power of the majority to change those particular phases of the contract.*

. . . (emphasis added); Trust Indentures, Hearings Before a Subcomm. Of the H. Comm. On Interstate and Foreign Commerce, House of Representatives on H.R. 10292, 75th Cong. 35 (1938) (statement of William O. Douglas, Commissioner, SEC). Douglas thus explained that Section 7(m)(3) of the 1938 bill (which evolved into Section 316(b) of the TIA) meant "merely" to prohibit indenture "provisions" that would allow majorities to amend core payment terms.

In holding that Section 316(b) prohibited involuntary out-of-court reorganizations like foreclosures, the District Court focused on the following additional testimony by Douglas: "Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this exception . . . . In other words, the bill does place a check or control over the majority forcing on the minorities a debt-readjustment plan." App'x 2370–71. First, in our view, *this small shard of additional testimony* related exclusively to a discussion about collective-action clauses, and we are inclined to confine it to that context. Second, we understand Chairman Douglas's use of the term "debt readjustment plan" to refer narrowly and specifically to formal changes to the contractual terms governing the debt.

* * *

D. House and Senate Reports

The House and Senate Reports on the final version of the TIA add little to our analysis but are worth briefly mentioning. Both reports repeated Douglas's assertion that Section 316(b) was intended to prevent "[e]vasion of judicial scrutiny of debt-readjustment plans." App'x 3274, 3337; H.R. Rep. 76–1016, at 56 (1939); S. Rep. No. 76–248, at 26 (1939). But both reports also confirmed that Section 316(b) "does not prevent the majority from binding dissenters by other changes in the indenture or by a waiver of other defaults." App'x 3274, 3338**.** It was, we think, clear to Congress that such changes and alterations might impair a bondholder's practical ability to recover payment without violating Section 316(b).

* * *

Conclusion

To summarize, we hold that Section 316(b) of the TIA does not prohibit the Intercompany Sale in this case. The transaction did not amend any terms of the Indenture. Nor did it prevent any dissenting bondholders from initiating suit to collect payments due on the dates specified by the Indenture.

Marblegate retains its legal right to obtain payment by suing the EDM Issuer, among others. Absent changes to the Indenture's core payment terms, however, Marblegate cannot invoke Section 316(b) to retain an "absolute and unconditional" right to payment of its notes. . . .

For the foregoing reasons, the judgment is **Vacated** and the case is **Remanded** to the District Court for further proceedings consistent with this opinion.

STRAUB, *Circuit Judge*, dissenting:

The question before this Court is whether Section 316(b) of the Trust Indenture Act (the "TIA") prohibits Defendant-appellant Education Management Corporation ("EDMC") from engaging in an out-of-court restructuring that is collusively engineered to ensure that certain minority bondholders receive no payment on their notes, despite the fact that the terms of the indenture governing those notes remain unchanged. Because the plain text of the statute compels the conclusion that it does, I would answer that question in the affirmative and uphold the judgment of the District Court. I therefore respectfully dissent.

* * *

Section 316(b) of the TIA reads as follows:

(b) Prohibition of impairment of holder's right to payment

> Notwithstanding any other provision of the indenture to be qualified, *the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security*, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, *shall not be impaired or affected without the consent of such holder* . . . .

15 U.S.C. § 77ppp(b) (emphasis added).

As delineated by the District court, "[t]he text poses two questions: what does the 'right . . . to receive payment' consist of, and when is it 'impaired or affected' without consent?" *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp.*, 111 F. Supp. 3d 542, 546 (S.D.N.Y. 2015) ("*Marblegate II*"). EDMC and the Steering Committee [for the participating lenders to the debtor] (together, "Appellants") read the text narrowly, with EDMC arguing that "[o]n its face, the statutory text is unambiguous in protecting only the 'right' of a noteholder to receive payment when due and to sue for enforcement of such payment." EDMC App. Br. 19**;** *see also* Steering Committee App. Br. 20 ("The language of the TIA demonstrates that Section 316(b) was intended to be a narrow limitation on the ability of noteholders to delegate to a Noteholder Majority the power to alter their right to payment of principal and interest through amendments of the indenture's provisions, and not a broad proscription on all out-of-court restructurings, however effected.") By contrast, Marblegate reads the text broadly, arguing that "the right to receive payment is 'impaired' or 'affected' when the ability to receive payment under the bond is stripped away—not only through formal amendment of a bond's payment terms, but also by other means." Marblegate App. Br. 24. I am persuaded by Marblegate's reading of the statute.

The terms "right," "impair," and "affect" are undefined in the TIA, so we must look to their ordinary meaning. . . . A "right" is typically defined as "[s]omething that is due to a person by just claim, legal guarantee, or moral principle," or "[a] legally enforceable claim that another will do or will not do a given act." Black's Law Dictionary (10th ed. 2014). On the basis of this definition, Appellants argue that actions only violate Section 316(b) if those actions affect the "legal entitlement" to payment — i.e. by altering the terms of the bond so that a bondholder can no longer legally *claim* the right to receive payment under their original terms. Nothing in Section 316(b), Appellants urge, entitles bondholders to *actual* payment on their notes.

This argument, however, nearly eliminates the import of the terms "impair" and "affect" and imposes qualifications in Section 316(b) that simply do not exist. The term "impair" means "to diminish the value of." *Id; see also Humana Inc. v. Forsyth*, 525 U.S. 299, 301 (1999) ("The dictionary defines 'impair' as to weaken, make worse, lessen in power, diminish, relax, or otherwise affect in an injurious manner.") The term "affect" means "to produce an effect on; to influence in some way." Black's Law Dictionary (10th ed. 2014). Even defined as a "legal entitlement" or "claim," it is unquestionable that the "right" to receive payment can be "diminished" or "affected" without actual modification of the payment terms of the indenture. By making it impossible for a company to pay the amount due on its notes, for example, the "right" to receive payment is "diminished" because it literally has been made worthless. Surely, a bondholder's right or "legal entitlement" to receive payment is impaired when actions are taken to ensure that the bondholder either consents to a change in his payment terms or receives *no* payment on his notes at all.[2] *See* Black's Law Dictionary (10th ed. 2014) (explaining that the term "impair" is "commonly used in reference to diminishing the value of a contractual obligation to the point that the contract becomes invalid *or a party loses the benefit of the contract*" (emphasis added)).

Had Congress intended merely to protect against modification of an indenture's payment terms, it could have so stated. Nothing in the language of Section 316(b), however, cabins the prohibition on impairing or affecting the "right . . . to receive payment" to mere *amendment* of the indenture. In fact, that Congress used the broad phrase "impaired or affected" implies that it did not intend Section 316(b) to be limited in its scope to mere amendments. Because we are compelled to give every term in a statute effect, our reading of the statute must account for rather than

---

[2] Of course, there are a number of actions that could be said to impair the right of noteholders to receive payment, ranging from poor business decisions at one end to deliberate attempts to devalue the business at the other. But whereas noteholders clearly give their implied consent for ordinary course business transactions and decisions to be carried out, and are compensated for the risk that the business will be run unsuccessfully by the interest that they receive on the notes, *the same cannot be said of a deliberate act to render their right to receive payment worthless*. In that latter circumstance, Section 316(b) requires the noteholder's explicit consent.

ignore this phraseology. . . . Further, Section 316(b) is written in the passive voice; its prohibition is nowhere limited to actions taken by a noteholder majority. Despite Appellants' arguments to the contrary, nothing in the text of the statute requires the narrow reading that Section 316(b) merely prohibits modification of an indenture's core payment terms (amount and due date) by noteholder majority action without consent of the individual noteholder.

* * *

. . . The Restructuring Support Agreement presented Marblegate with what the District Court rightfully deemed a Hobson's choice—to accept a modification of the payment terms of its notes, or to receive no payment at all. The Intercompany Sale, which stripped the issuers of their assets and removed the parent guarantee, ensured that no future payments of principal or interest would be made on the notes. This scheme did not simply "impair" or "affect" Marblegate's right to receive payment—it annihilated it.[3] The methodology used to accomplish that annihilation is of little interest when the end result is squarely at odds with the plain intent of Section 316(b). *See In re Olson*, 818 F.2d 34, 47 (D.C. Cir. 1987) (noting that interpreting a statute in a manner that "would undercut [its] plain intent . . . and permit the accomplishment by indirect means of a result that the statute prohibits being accomplished by direct means" would produce "an unreasonable result"). We therefore need look no further than the plain text of Section 316(b) to hold that the Intercompany Sale, as envisioned by the Restructuring Support Agreement, violates the TIA. Based on the plain terms of Section 316(b), I would hold that an out-of-court debt restructuring "impairs" or "affects" a non-consenting noteholder's "right to receive payment" when it is designed to eliminate a non-consenting noteholder's ability to receive payment, *and when it leaves bondholders no choice but to accept a modification of the terms of their bonds*.

I am cognizant of the parade of horrors that Appellants predict will result from interpreting the TIA in the manner above. However, threatening dire commercial consequences from the refusal to read a statute in a manner inconsistent with its plain language is not a sufficient basis to

[3] Appellants argue that Marblegate's right to receive payment was not annihilated, or even impaired or affected, by their actions because Marblegate still maintains a legal claim for payment and it may sue, perhaps in state court, for enforcement of that payment. But this argument misses the point. Even if Marblegate maintains a "legal claim" for payment upon which it can sue, that legal claim was surely impaired by actions that intentionally made the company unable to pay any judgment awarded against it. The effect of the Intercompany Sale was to transfer all or substantially all of EDMC's assets to a new, wholly owned subsidiary of EDMC, and EDMC explicitly warned that this meant its assets "would not be available to satisfy the claims of [dissenting] Holders." App'x 52. The Intercompany Sale thus deliberately placed EDMC's assets beyond the reach of non-consenting noteholders, while the effect of the release of the parent guarantee would be to eliminate noteholders' ability to seek payment from EDMC's guarantor. . . . Surely, . . . a bondholder's right to receive payment on its bond by the bringing of a lawsuit has been impaired or harmed when the company has rendered itself unable to satisfy any monetary judgment. While the right to sue remains intact, the ability to recover anything as a result of that suit has vanished, rendering the suit meaningless.

override the correct interpretation of the law. . . . Certain undesirable consequences might well arise from the fact that Section 316(b) prohibits actions such as those taken by EDMC in this case. But [resolution is for Congress].[4] . . .

Conclusion

Because the Intercompany Sale as proposed under the Restructuring Support Agreement would have the effect of imposing on Marblegate a choice between a modification of their core payment terms or receiving no payment at all—thereby clearly impairing Marblegate's right to receive payment under the original terms of the indenture—I would hold that it violates the plain text of Section 316(b) of the Trust Indenture Act and affirm the judgment of the District Court. . . . If Congress and the parties affected by the TIA are unsatisfied with the law's consequences, it is for Congress rather than this Court to amend it. I therefore respectfully dissent.

1. Proponents of the narrow view of § 316(b) said that a functional interpretation of § 316(b) would open the door to litigation on all kinds of tangential corporate actions that would affect the bonds' value and chance of repayment. A simple corporate dividend, for example, could and typically would reduce the bonds' chance of being repaid. But is this parade of horribles appropriate, or even one that would need congressional action? Couldn't the statute's text support a tight standard barring issuer and majority bondholder action through the bond indenture that gave individual bondholders no economic choice other than to consent to an immediate and material change in the core payment terms (but not applying to other actions outside the bond indenture that would have only an indirect impact on bond value).
2. Are there three transactions to analyze? In one, the firm asks bondholders to formally amend the bond indenture to allow bondholders to vote to change payment terms and bind dissenting bondholders to the outcome. In the second, the *debtor* transacts in a way that would damage the bondholders' likely receipt of payment, such as by declaring a dividend or selling property for inadequate consideration. In the third, the debtor offers bondholders a new bond with new payment terms and asks the exiting bondholders to change the indenture in a way that would damage dissenters such that they could not tolerate doing nothing and remaining behind. In the first and third, the bond indenture is affected; in the second, the bond indenture is not affected. (And, arguably, the actor affecting the bondholders is the debtor and not the majority of bondholders.)

---

[4] Significantly, Congress recently abandoned two proposals to amend § 316(b), first through a 2015 highway bill rider and then through an omnibus appropriations legislation rider. The proposals would have narrowed the definitions of impairment of the right to payment and the right to institute suit for nonpayment. . . . That Congress has to date declined the invitation to take up this issue does not provide this Court with a directive to override and narrow the clear language of § 316(b).

Into which of the three categories does the *Marblegate* transaction fall?

3. Is the court's reading of the legislative history as tightly determinative as it says? That is, "Douglas assured critics of the proposed legislation that '[t]here is absolutely nothing in the bill to prevent" amendment of the indenture by a majority, with one exception, which he described as follows:

> "The effect of this exception is *merely to prohibit provisions* authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for principal, or a reduction of his claim for interest . . . . *In other words, this provision merely restricts the power of the majority to change those particular phases of the contract*." (Emphasis from the court.)

4. Viewed in isolation, this quotation would be, and to the court is, determinative. But Douglas had been asked whether the statute would preclude issuers and bondholders from *amending* their indenture. In that context, Douglas's answer is less dispositive and little more than a reading of the statute itself. He said that only payment term *amendments* were barred from the class of allowed *amendments*. Ordinary amendments to incurrence covenants and dividend covenants were unaffected. He did not address the full class of prohibited actions, namely all those actions (not limited to indenture amendments) that would *impair* the holder's right to payment by twisting the dissenter's arm sufficiently to elicit consent to a change in payment terms.

   When Douglas is seen as a witness addressing only the question posed to him (what can be formally amended?), then the passage is hardly determinative but only informative of what indenture amendments are permissible.

5. And then the rest of the legislative history—in which Douglas and the House and Senate in official reports say that § 316(b) was designed to avoid bondholder majorities' efforts to avoid judicial scrutiny of recapitalization plans—should not be discarded as a mere "shard,"[5] but as filling out the full story. This part of the history points toward a conclusion that section 316(b) was seeking a rule that no changes that impair or affect payment terms would be binding without a judge in the room to check or the bondholder's own freely-given consent.

6. The court uses subsequent and contemporaneous views of the statutory architects to interpret what it sees as ambiguity. Once it does so, the court could have looked at *Case v. Los Angeles Lumber*, ¶320, supra, or even the 1938 passage of Chapter X, both of which show Douglas's, the SEC's, and the Washington reorganization thinkers' 1930s'

[5] Douglas elsewhere stated: "Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this exception . . . . In other words, the bill does place a check or control over the majority forcing on the minorities a debt-readjustment plan." The appellate court dismissed this as "small shard of additional testimony related exclusively to a discussion about collective-action clauses . . . ." In support of its "shard" characterization, the court then narrowly read Douglas's reference to a "debt readjustment plan" as applying only "to formal changes to the contractual terms governing the debt."

world-view, namely that altering payment terms needed a judge's blessing or the affected bondholder's consent.

Thus interpreted, the legislative history fits together as one consistent whole: Douglas informed Congress what kind of formal amendments were permitted and not permitted (no to payment term amendments, yes to amending other terms); the "shard" means that the statute bars a wide class of impairments other than by amendment (if they would immediately force holders to accept a change in payment terms), and the contemporaneous views of the Washington bankruptcy establishment (that changes in payment terms required a judge's ok or the holder's real consent) would be given credence.

That reading of the Douglas sequence roughly square with Judge Staub's reading of the statute's text.

7. Either way that the *Marblegate* court decided would have caused transactional problems. Its holding permits coercive tactics that at least some of the judges (the dissenter, the district court judge) thought Douglas had sought to bar. But if it had held that the statute barred such tactics (either for all issuer-initiated transactions or for exit consent transactions, or both), then there would be fewer out of court settlements and more bankruptcies.

8. The TIA as passed in 1939 did not allow the SEC to exempt classes of transactions from the TIA. The 1990 amendments to the TIA give the SEC broad exemptive authority. The SEC could, in principle, exempt bond indentures from § 316(b) if the payment terms were subject to modification via a fair vote, without including any insider or conflicted bondholder in the voting pool. See Mark J. Roe, *The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the SEC to the Table*, 129 HARV. L. REV. F. 357 (2016).

<u>Insert on p. 523, towards the bottom:</u>

¶ 1922A. Questions on the Chateaugay rule and implications

1. **<u>Debtor 1</u>** has five $40 bonds outstanding. The bonds were originally purchased from the debtor for $40 each. Four bondholders exchange their bonds for new $20 bonds (with different interest rates and other terms). These new bonds are worth $20 each.
    a. In the subsequent bankruptcy, the exchangers' allowed amount of claim is (a) $40, (b) $20, or (c) something else.
    b. The non-exchanger's allowed amount of claim is $40, (b) $20, or (c) something else.
    c. The exchangers obtain a smaller portion of the bankruptcy pie after the exchange than they would have before the exchange: true or false.

2. **<u>Debtor 2</u>** has five $40 bonds outstanding. The new bonds were originally purchased from the debtor for $40 each. (They originally carried an annual interest coupon of 10%, or $4 per bond.) Later, when the bonds have a trading value of $20 each, four bondholders exchange their bonds for new bonds with a face value of $40, but with no interest coupon and an extended maturity. The new bonds are worth $20. The debtor files to reorganize under chapter 11 later in the day of the exchange.
    a. The exchangers' allowed amount of claim is (a) $40, (b) $20, or (c) something else.
    b. The non-exchanger's allowed amount of claim is (a) $40, (b) $20, or (c) something else.
    c. The exchangers obtain a smaller portion of the bankruptcy pie after the exchange than they would have before the exchange: true or false.

3. **<u>Debtor 3</u>** has five $40 bonds outstanding. The bonds carry an original issue discount of $15 each. The bonds were issued for $25 in cash paid. When the bonds were about one-third the way to maturity (and when, hence, they would have 'accreted' about one-third of the discount, making them worth about $30 each if the company was in a good position to pay and if the market rate of interest had not changed), four of the "$30" bonds are exchanged for new $30 face value bonds with different ancillary terms. The original bonds were trading then for only $10 each, because the debtor's value had sharply declined.
    a. If the debtor files for bankruptcy later in the day of the exchange, the exchanging bondholder's allowed amount of claim is (a) $40, (b) $30, (c) $10, or (d) something else.

   b. The non-exchanging bondholder's allowed claim is (a) $40, (b) $30, (c) $10, or (d) something else.
   c. The exchangers obtain a smaller portion of the bankruptcy pie after the exchange than they would have before the exchange: true or false.

4. **Debtor 4** goes through the same exchange as Debtor 3, but it does not file for bankruptcy on the day of the exchange. The old bonds were originally set to mature 10 years after the date of the exchange. The exchanging bondholders agreed to postpone their maturity another 10 years, making their new bonds mature 20 years after the exchange.
   a. The company survives intact for another 5 years and then files for bankruptcy. In the proceeding, the exchangers' bonds have an allowed claim of approximately (a) $40, (b) $35, (c) $30, (d) $10, or (d) something else.
   b. The non-exchanger's bond has an allowed claim of approximately (a) $40, (b) $35, (c) $30, (d) $10, or (d) something else.
   c. The Debtor 4 exchangers obtain the same portion of the bankruptcy pie after the exchange as the Debtor 3 exchangers: true or false.
   d. The Debtor 4 non-exchanger obtains a larger portion of the bankruptcy pie than the Debtor 3 non-exchanger: true or false.
5. Under *Chateaugay*, the exchanging creditors are effectively receiving post-petition interest if they are seen to be "buying" their new claim for the market value of their old claim: true or false.
6. Section 502(b) bars allowed claims for post-petition interest: true or false.
7. The operative rationale for the *Chateaugay* decision applies, in principle, to face value exchanges as well as to exchanges in which the bonds' face value changes: true or false.
   a. What is *Chateaugay's* operational rationale?
   b. The *Chateaugay* court applies its decision to face value exchanges but not to non-face value exchanges: true or false.

Insert at the end of Chapter 20, on p. 539.

¶2007A: Michael Corkery & Jessica Silver-Greenberg, *Why Companies Like Toys 'R' Us Love to Go Bust in Richmond, Va.*, N.Y. Times, Nov. 14, 2017

The Toys "R" Us world headquarters are on a sprawling wooded campus next to a reservoir in Wayne, N.J. . . .

But in September, when Toys "R" Us filed for one of the largest bankruptcies of the year, it did not go to nearby Newark.

Instead, the toy company followed an increasing number of corporations—from Gymboree to a major coal company to a Pennsylvania fracking company—that are choosing to file for bankruptcy in Richmond, Va.

In recent years, Richmond has become the destination wedding spot for failed companies. The United States Bankruptcy Court there offers several features attractive to the executives, bankers and lawyers trying to get an edge in the proceedings.

First, Richmond's bankruptcy court offers a so-called rocket docket that moves cases along swiftly. Chapter 11 bankruptcy filings can be laborious proceedings that drag on for years. Gymboree's bankruptcy was completed in less than four months.

Second, the legal record in that court district includes precedents favorable to companies, like making it easier to walk away from union contracts.

But perhaps one of the biggest draws, according to bankruptcy lawyers and academics, is the hefty rates lawyers are able to charge there. The New York law firm representing Toys "R" Us, Kirkland & Ellis, told the judge that its lawyers were charging as much as $1,745 an hour. That is 25 percent more than the average highest rate in 10 of the largest bankruptcies this year, according to an analysis by The New York Times.

* * *

Companies can file for bankruptcy in a court district where they have an affiliate—a loophole that allows them to shop for the court they think will provide the best outcome.

For an affiliate to be incorporated in Virginia, it can use a "registered agent" with a local address, according to the state. For its bankruptcy filing, state records show, Toys "R" Us used a Richmond affiliate whose registered agent has an office in downtown Richmond.

Representatives for Kirkland & Ellis and Toys "R" Us declined to comment for this article. So did a spokesman for the federal bankruptcy court in Richmond.

It's not just the lawyers who stand to gain from the Toys "R" Us bankruptcy. The bankers and other professionals who helped arrange

$3.1 billion in new debt to keep the company operating in bankruptcy will collect $96 million in fees, according to a court document filed by Toys "R" Us.

Executives at bankrupt companies typically agree to the high fees, bankruptcy experts say, because they think the cost will have been worth it if the lawyers and bankers can save their business. Kirkland & Ellis has a long track record of getting companies back on their feet in bankruptcy.

The two judges in Richmond are also known for their expertise. "The judges understand the complexities of large corporate bankruptcies and can handle cases expeditiously," said Dion Hayes, a local bankruptcy lawyer.

Still, the huge fees can eat into the money that is left over for small creditors—typically vendors, suppliers and pensioners.

In the Toys "R" Us case, dozens of suppliers of scooters, rubber duckies and teething rings could lose millions in the bankruptcy.

Linda Parry Murphy, chief executive of Product Launchers, a distributor for several small toy suppliers, said her clients were owed about $1.2 million from Toys "R" Us. She worries that they may recover as little as $120,000.

"For some of these clients it was very devastating," she said.

Nationally, professional fees for bankruptcies have been increasing about 9.5 percent a year, about four times the rate of inflation, according to Lynn LoPucki, a bankruptcy professor at the University of California, Los Angeles.

Mr. LoPucki said the higher fees were fueled, in part, by court shopping.

Lawyers advising troubled companies tend to gravitate to courts that approve their fees, he said. Judges who balk at high fees see far fewer cases.

"They become pariah courts," Mr. LoPucki said.

Down the road, creditors in the Toys "R" Us bankruptcy can challenge how many hours the lawyers bill at the high rates. Another check on the costs is the United States Trustee Program, which helps oversee the process and can object if the legal bill seems unreasonable.

The vast majority of companies—more than 76 percent — now file for bankruptcy in a different state from where they are based, Mr. LoPucki said.

Delaware and New York—which have long been popular bankruptcy destinations—still see the lion's share of the filings.

But Richmond is gaining ground. In July, an article in The Virginia Lawyers Weekly declared the city a "bankruptcy haven" and quoted a local lawyer who said the high legal fees charged there would give judges in other courts a "heart attack."

Then in September, the court landed the Toys “R” Us bankruptcy.

* * *

Seeing opportunity in a consolidated toy industry, the private equity investors Bain Capital and Kohlberg Kravis Roberts and the real estate firm Vornado Realty Trust bought the company in 2005 and loaded it up with debt that today stands at $5.3 billion. It was a burden that proved too much to overcome.

Toys “R” Us has dozens of affiliates around the globe employing 64,000 people.

But when it came time to file for bankruptcy, the company opted for Richmond, where its law firm, Kirkland & Ellis, had success in the past.

The law firm had represented Patriot Coal, a coal miner based in West Virginia that filed for bankruptcy twice in four years, most recently in Richmond in 2015.

In that case, the most profitable mines went to another coal company backed by Patriot’s lenders, while the others were closed.

Mr. Barrett, the lawyer who represented the State of West Virginia in that case, was stunned by the fees.

“I remember five lawyers in one meeting, and I joked that meeting cost $10,000,” he said.

* * *

¶ 2105A: New Corporate Tax Rate.

In 2017, the highest corporate tax rate was reduced from 35% to 21%.

Major appellate results narrowed the scope of LBO fraudulent conveyance liability via § 546(e). A consensus across the Circuits formed and then, via the FTI decision in 2018, the Supreme Court reversed that wide consensus.

Delete pp. 587–601 (Section D of Chapter 22) in its entirety and replace it with the following new Section D:

D. THE SETTLEMENT PAYMENT SAFE HARBOR IN LBOS

¶ 2207: Kaiser Steel Corp. v. Charles Schwab: § 546(e).

Section 546(e) of the Bankruptcy Code states that "notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b)" —all the avoidance sections except for intentional fraud—a debtor may not avoid a transfer that is "a settlement payment, as defined in section 101 or 741 of this title, made by or to a stock broker, financial institution . . . or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1)[.]"

Section 741(8) defines a settlement payment as "a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." That is, a settlement payment is a settlement payment is a settlement payment.

And securities traders know one when they see one. Clear?

Kaiser Steel went through an LBO in 1983. Kaiser purchased its own stock from customers of Charles Schwab & Co., a securities broker. Schwab held Kaiser stock in its own name (i.e., the stock was labeled as "Schwab's" stock) but held it for its customers' benefit. Schwab deposited the stock with a clearinghouse—the organization that handles the mechanics of purchases and sales, but Schwab did so for the benefit of its own customers. Schwab instructed the clearinghouse to send to Kaiser the Kaiser securities that the clearinghouse held for Schwab (and which Schwab held for its customers). A few days later Schwab received $450,000 from Kaiser and Schwab credited its customers with those monies for the sale of their Kaiser stock.

Kaiser's post-LBO business did poorly and Kaiser went bankrupt in 1987. The debtor brought a fraudulent conveyance action, seeking to recover payments made to stockholders, including Schwab. Schwab argued, first, that it was a "mere conduit" rather than a transferee and thus was not liable due to § 550(a). Second, it argued that § 546(e) exempted the

LBO payments from constructive fraudulent conveyance liability, because the payments were settlement payments under § 546(e).

In Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990), next, the Tenth Circuit held that the payments to Schwab were settlement payments, exempt from fraudulent conveyance liability under § 546(e).

Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990)

Stephen H. Anderson, Circuit Judge.

Debtor-in-possession Kaiser Steel . . . , appeals from the district court's reversal of the bankruptcy court's order denying defendant Charles Schwab & Company, Inc. ("Schwab") summary judgment. We affirm.

* * *

The shareholders approved the LBO on January 18, 1984. As of the effective date of the merger, February 29, 1984, holders of Kaiser Steel common stock were required to tender their shares to Kaiser's disbursing agent, Bank of America, which distributed the cash and preferred stock.

Among the holders of Kaiser Steel common stock were customers of Schwab, a securities broker. Most of the certificates were in the possession of the Depository Trust Company ("DTC"), a securities clearinghouse. DTC tendered the shares to Bank of America, and received the cash and preferred stock in the surviving entity. DTC transferred the money to Schwab through the National Securities Clearing Corporation, which sponsors Schwab's participation in DTC. . . . Schwab credited its customers' accounts within a few days of receiving the funds. . . .

In 1987, Kaiser filed for bankruptcy. The debtor-in-possession commenced this fraudulent conveyance action . . . , seeking to avoid the LBO and recover the $162 million. Schwab moved for summary judgment on two grounds: that it was not liable *because it was a "mere conduit" rather than a transferee, see 11 U.S.C. § 550(a)*, and that the LBO payments were exempt from avoidance as settlement payments, see 11 U.S.C. § 546(e).

A trustee or debtor-in-possession may not avoid

> a transfer that is . . . a settlement payment, as defined in section 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution or securities clearing agency, that is made before the commencement of the case, except under section 548(a)(1) of this title."

11 U.S.C. § 546(e). Section 741(8) defines settlement payment as "a preliminary settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade." 11 U.S.C.

§ 741(8). We agree with the district court that the transfer of the consideration in the LBO was a settlement payment.

Such an interpretation "is consistent with the legislative intent behind § 546 to protect the nation's financial markets from the instability caused by the reversal of settled securities transactions." Kaiser Steel Resources, Inc. v. Jacobs, 110 B.R. at 522.

Section 546 was first enacted in 1978, and applied only to commodities markets. "Settlement payment" was [then] not defined. . . .

* * *

. . . [I]nterpreting "settlement payment" to include the transfer of consideration in an LBO is consistent with the way "settlement" is defined in the securities industry. Settlement is "the completion of a securities transaction." A. Pessin & J. Ross, Words of Wall Street: 2000 Investment Terms Defined 227 (1983); . . . New York Stock Exchange, Language of Investing Glossary 30 (1981) ("conclusion of a securities transaction when a customer pays a broker/dealer for securities purchased or delivers securities sold and receives from the broker the proceeds of a sale"); D. Scott, Wall Street Words 320 (1988) ("transfer of the security (for the seller) or cash (for the buyer) in order to complete a security transaction").[1] The Securities and Exchange Commission has taken the position before this court that the consummation of an LBO is a "settlement payment" exempted from avoidance by section 546(e).

* * *

. . . The LBO was a securities transaction. The transfer of money and preferred stock was the settlement of that transaction. Therefore, the transfers to Schwab were exempt from avoidance under section 546(e) as "settlement payment[s] ... to a ... stockbroker."

The judgment of the district court is AFFIRMED.

Consider Schwab's first argument—namely that the securities system transfers had Schwab and the other financial institutions involved acting as mere conduits. Doesn't this argument make sense? That is, Schwab and the other brokers do not take beneficial ownership of the security. They are delivery people. See the figures below.

Is the "transfer" to Schwab a "transfer" in terms of the statute? I.e., for there to be a fraudulent conveyance, doesn't there have to be a "transfer?" If it's not a "transfer," shouldn't that conclusion have ended the case? Section 101(54) says that "[t]he term 'transfer' means . . . each

[1] Some sources limit the concept of "settlement" to the consummation of routine securities transactions. . . .

mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with . . . property . . . ." Is it plausible that Schwab didn't receive property other than as an agent of its customers?

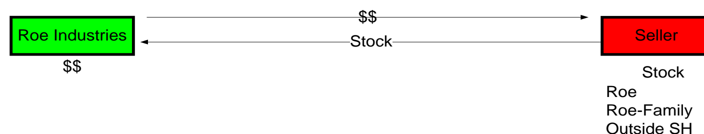
If the case doesn't end there, with Schwab a mere conduit for the actual transfer but not an actual transferee, then what do some of the brokers have to fear? See § 550 on the exposure of the initial transferee. If the clearing system receives a transfer and isn't a mere conduit, then, presumably the initial transferee is the entity that first received the cash from Kaiser.

Wieboldt distinguished controlling shareholders from distant shareholders. If the securities system were just a conduit to the initial transferees, what difference, if any, would there be between the exposure of individual shareholders and that of controlling shareholders? Wouldn't all securities sellers in the LBO transaction then be initial transferees of the buyer's cash? Consequence for fraudulent conveyance exposure?

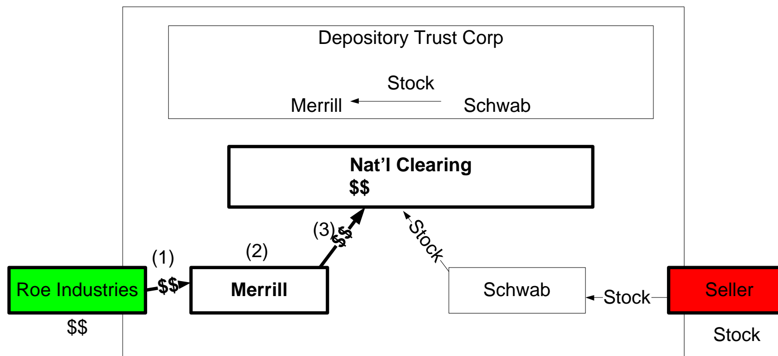
* * *

Another interpretation: When Kaiser buys from a Schwab customer, do two transactions occur simultaneously? One is Kaiser's substantive purchase from Schwab's customers of their stock. That substantive purchase is illustrated in the first figure, below, and highlighted in the last figure. The other simultaneous transaction is the movement of the stock through the securities clearing system. The second involve securities settlement payments, illustrated in the middle figure and labelled (1), (2), and (3) . The second figure illustrates the settling of the first transaction, the movement of dollars and stock that effectuates the substantive sale. Compare the first figure below with the subsequent two figures.

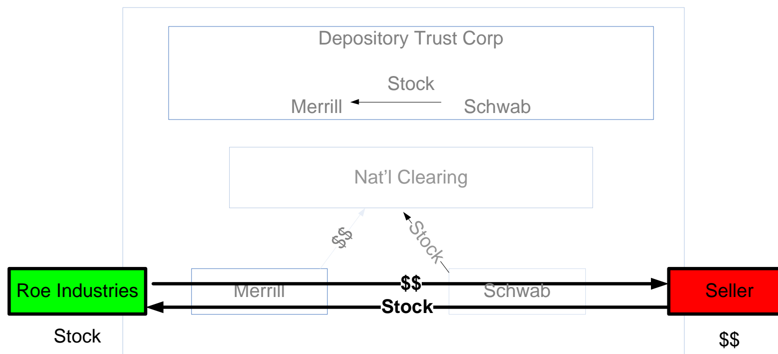
LBO of Roe Industries: The Baseline Transfer



LBO of Roe Industries:
Stock Transfers Settled Through the Securities Clearing System



LBO of Roe Industries, Buyout Independent of Purchase Channels



Consider the following scenarios:

A fraudulent conveyance occurs. The company sends the fraudulently conveyed funds via checks in the mail to the company's shareholders. Does it make sense for the court to allow the debtor to seek recovery under § 550 from the post office or the post office's employee who took the checks and moved them along to another post office employee who delivered them? Is the first postal employee an initial transferee? Is the post office the initial transferee? Are the other post office people in the delivering post office branch subsequent transferees? Or, are they all better seen as mere conduits of the cash, with the real transaction being that between the company and its shareholders?

Or, a fraudulent conveyance occurs. The company pays the stockholders by putting cash into several envelopes for delivery to the shareholders. It writes the name and address of the relevant stockholder on each envelope and contracts with the ML bicycle messenger service to deliver the envelopes, which the messengers do. Are the bike messengers

initial transferees under § 550(a)? Absent an exception, should they be tagged with fraudulent conveyance liability?

Consider the possibility that the powerful bike messenger lobby fears that a court might label the messengers as § 550 initial transferees. So they induce their friends in Congress to enact a statute that says: "Whenever an otherwise fraudulent transfer occurs, messenger delivery transactions are exempt from all liability, as long as the messengers did not intentionally participate in the fraud." One court says that this means that a transfer of stock or cash to a messenger is exempt (of course) *and that a transfer from a messenger of stock or cash to the ultimate beneficial recipient is also exempt from fraudulent conveyance liability*. But, the court says, the transfer from buyer to seller, and vice versa, is not exempt. That buyer-to-seller substantive transfer set is the core transfer from buyer to seller; it's separate from the delivery mechanism (which the statute exempts).

Same fraudulent conveyance. The company decides that delivering the cash through the ML Messengers isn't the best way to deliver so much cash. Instead, it sends the cash through Merrill Lynch, the securities firm, which is experienced in delivering the cash. Is Merrill Lynch the initial transferee?

Does *Kaiser I*, above, effectively immunize all stockholders, whether they are controlling stockholders or distant stockholders, from fraudulent conveyance liability as long as they settle their transactions through the securities clearing system? It immunizes Schwab, yes, but that's not the same question. What does *Kaiser II* do to shareholders' fraudulent conveyance exposure in an LBO?

In re Kaiser Steel, 952 F.2d 1230 (10th Cir. 1991)

Before HOLLOWAY, ANDERSON and BRORBY, Circuit Judges.

STEPHEN H. ANDERSON, Circuit Judge.

The question presented in this appeal is whether consideration *paid to shareholders* for their stock in connection with a leveraged buy out is exempt from the avoiding powers of a trustee under section 546(e) of the Bankruptcy Code, as "settlement payments" made "by or to a ... stockbroker, financial institution, or securities clearing agency." 11 U.S.C. § 546(e). In its order granting defendants' motion for summary judgment, the district court held that such payments fall within the exemption found in section 546(e). We agree and, therefore, affirm the judgment of the district court.

I. INTRODUCTION

This case involves a leveraged buy out gone bad. Making use of the modern counterpart of a centuries-old statute, Kaiser . . . seeks in the underlying action to retrieve amounts paid out to former Kaiser Steel shareholders in connection with a leveraged buy out of the company in 1984 (the "LBO"). Kaiser makes the relatively novel yet increasingly popular claim that these payments constitute a fraudulent conveyance. The current battle is much more narrow, however. It surrounds the construction of a Bankruptcy Code (the "Code") exemption that prohibits the trustee from avoiding "settlement payments" made by or to stockbrokers, financial institutions, and clearing agencies. *See* 11 U.S.C. § 546(e). Appellees, joined by the Securities and Exchange Commission ("SEC"), maintain that the section 546(e) exemption encompasses amounts paid to the shareholders in the LBO and accordingly prevents Kaiser from unwinding the transaction.

* * *

B. *History of the Case.*

* * *

On appeal, . . . we held that the payments *to Schwab* were settlement payments exempt from recovery under section 546(e). *Kaiser Steel Corp. v. Charles Schwab & Co.,* 913 F.2d 846 (10th Cir. 1990). . . . [W]e did not decide whether Schwab was a "mere conduit" rather than a transferee. *Id.* at 848.

. . . [Thereafter t]he district court . . . *sua sponte* dismissed the claims asserted against all other defendants, *including beneficial shareholders of Kaiser Steel stock and brokers trading on their own account*. . . . [A]ll appellees remaining before us are shareholders or brokers that beneficially owned the Kaiser Steel shares tendered in connection with the LBO.

II. DISCUSSION

We now must decide whether our holding in *Schwab*—that Code section 546(e) protected payments made to the financial intermediaries—should be extended to protect payments made to the beneficial shareholders.

Section 546(e) provides as follows:

> the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101[(39)] or 741(8) of this title, made by or to a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency. . . .

11 U.S.C. § 546(e) . . .

Kaiser . . . insists that even if the payments are settlement payments, payments made "by or to" one of the enumerated entities are protected under section 546(e) *only* to the extent the recipient is a participant in the clearance and settlement system (i.e., a stockbroker, financial institution, clearing agency, or some other participant). Settlement payments received by an "equity security holder," according to Kaiser, are not protected.

A. *Settlement Payments*.

We cannot accept Kaiser's argument that the payments of LBO consideration to the beneficial shareholders are not settlement payments within the meaning of the statute. Our interpretation, as always, begins with the language of the statute itself. Section 546(e) refers to section 741(8) for the definition of "settlement payment." Section 741(8), in turn, defines "settlement payment" as a "preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or *any other similar payment commonly used in the securities trade*." 11 U.S.C. § 741(8) (emphasis added).

* * *

In applying this provision, our task is to apply the term "settlement payment" *according to its plain meaning*. ("The exceptions to our obligation to interpret a statute according to its plain language are few and far between." [Authority omitted, with the] plain language conclusive unless it produces a result "demonstrably at odds with the intention of its drafters"[]. However, since even the plain meaning of a term may depend on the context within which it is given, we must interpret the term "settlement payment" as it is plainly understood within the securities industry.

* * *

Given the wide scope and variety of securities transactions, we will not interpret the term "settlement payment" so narrowly as to exclude the exchange of stock for consideration in an LBO. As the appellees and the SEC have urged, there is no reason to narrow the plain concept of "settlement" to a single type of securities transaction.

Consequently, those shareholders who tendered their shares one day after the LBO and received the LBO consideration are treated just the same under the Code as shareholders who sold their shares [to third parties] in the market one day prior to the LBO and received a settlement payment reflecting the market value of the LBO consideration. Neither type of investor will be forced to disgorge the payments several years later.

* * *

. . . Kaiser has given us no reason to replace the unambiguous language of the provision . . . .

* * *

Accordingly, for the reasons given above, the judgment of the district court is AFFIRMED.

Plain meaning: Schwab's receipt of cash for stock is a settlement in the prior figures. Plainly Schwab's delivery of cash to the stock seller is a settlement payment. Is the over-arching transfer of cash from Roe industries to the stock seller (as in the first and last diagrams) plainly a settlement payment? Isn't it nowhere close to being a settlement payment?

Kaiser II's applying § 546 to the ultimate stockholder eliminates the *Wieboldt* dichotomy—saving distant stockholders but exposing controlling stockholders who engineered the LBO transaction. All stockholders participate in what the Kaiser court concludes are securities settlements.

Would one advise the controlling stockholders in *Wieboldt*, when engineering their next transaction, to settle their buyout, even of their own, controlling stock, through a broker? The Sixth Circuit extended Kaiser's domain to settlements in buyouts of private companies, if the buyout was settled through a stockbroker. QSI Holdings, Inc. v. Alford, 571 F.3d 545 (6th Cir. 2009). The *QSI* court stated:

> When construing a statute we look first to its text. Where that language is plain, "the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." [Citations omitted.]
>
> Numerous courts, including the courts below, have acknowledged that the definition of "settlement payment" set out in § 741(8) is somewhat "circular." Nonetheless, courts have recognized that the definition is "extremely broad."
>
> With this in mind, we turn to the definition of "settlement payment." For the purposes of this appeal, the critical phrase in the definition is the final one: the payment must be one "commonly used in the securities trade." 11 U.S.C. § 741(8). . . .
>
> . . . *Kaiser Steel*[, the prior precedent most on point,] involved publicly traded securities. . . .
>
> . . . [W]e hold that nothing in the text of § 546(e) precludes its application to settlement payments involving privately held securities.

Notice the contrast between the potential solicitude for distant stockholders in *Kaiser II* and the diminished solicitude elsewhere in statute. The court evinces a desire, derived it says from the statute, to protect

securities markets. But does the statute reflect the same intense desire to protect securities markets in its § 510(b) subordination rule? Would a Congress that was consistently respectful of, and deferential to, securities markets have written both § 510(b) and § 546(e)? Presumably creditors wrote § 510(b) and the securities industry wrote § 546(e).

The Eleventh Circuit seemed unsettled by the *Kaiser II* result, holding in 1996 that payments made to the bought-out company's one-time shareholders were *not* protected by § 546(e)'s securities settlement exception. The court said that even if payment in the LBO was accomplished via settlement checks "made by or to a . . . stockbroker, financial institution . . . or securities clearing agency" (this is the language of § 546), the purpose of § 546 was to protect the system of settling securities transactions, by *exempting the intermediary institution* from fraudulent conveyance liability; its purpose was *not* to exempt stockholders from fraudulent conveyance liability. "[T]he bank here was nothing more than an intermediary or conduit. Funds were deposited with the bank and when the bank received the shares from the selling shareholders, it sent funds to them in exchange. *The bank never acquired a beneficial interest* in either the funds or the shares." Munford, Inc. v. Valuation Research Corp., 98 F.3d 604 (11th Cir. 1996). Several bankruptcy courts followed *Munford*, not *Kaiser*.

However, after the *Munford* 1996 decision, the Second, Third, Sixth, and Eighth Circuits followed *Kaiser II*, not *Munford*.

The *QSI* and *Kaiser* courts looked to the plain meaning of the words of the statute. But how plain is that meaning? First, the words refer to securities market transactions, not explicitly the buyback by a company of its own stock. If the buyout company bought stock directly from the customer, and not through a financial institution, like Schwab, § 546(e) wouldn't be in play. Isn't possible that the statute's words do *not* take the beneficial transaction out from fraudulent conveyance law but do take out the delivery system?

Second, if the meaning is plain to the *QSI* and *Kaiser II* courts, is it equally plain to the *Munford* court, referred to earlier, or the *FTI* court, whose decision is excerpted below? Even if the *QSI* court felt sure of itself, should it have hesitated, since another circuit court (namely, the *Munford* court) and several bankruptcy courts read the statute differently? If good lawyers and good judges read the words differently from the *QSI* judges, perhaps the meaning isn't so plain. Indeed, most bankruptcy courts interpreted § 546(e) differently than did *Kaiser* and *QSI*, some probably due to their policy preferences and some due to their reading the Code differently. Samir D. Parikh, *Saving Fraudulent Transfer Law*, 86 American Bankruptcy Law Journal 305 (2012).

Nevertheless, even if the current interpretations of 546(e) are questionable when they exempt the ultimate beneficial owner–seller from fraudulent conveyance liability, five of the six circuits that opined on the subject pointed in the same, plain meaning interpretive direction. Hence, the trend was clear and change would have to come from Congress or the Supreme Court.

Consider this proposal to Congress:

NATIONAL BANKRUPTCY CONFERENCE

A Voluntary Organization Composed of Persons Interested in the Improvement of the Bankruptcy Code and Its Administration

March 15, 2010

The Honorable John Conyers, Jr.
Committee on the Judiciary
United States House of Representatives
Washington, DC 20515

Re: Proposed Amendments to the Bankruptcy Code
Concerning Exemptions for Financial Contracts

Dear Mr. Chairman:

The National Bankruptcy Conference (the "Conference") is writing to you to propose amendments to the Bankruptcy Code concerning the current exemptions in the Bankruptcy Code for financial contracts. As you may know, following amendments made to the Bankruptcy Code in 2005 and 2006, there has been a significant concern raised by bankruptcy professionals, academicians and others as to whether the current exemptions for financial contracts contained in the Bankruptcy Code are unnecessarily broad. The proposals made by the Conference in this letter would narrow the exemptions for the reasons explained below.

* * *

II. Settlement Payments

Bankruptcy Code § 546(e) was designed to protect prepetition transfers under securities contracts from avoidance as preferential transfers or fraudulent transfers. For example, . . . § 546(e) protects intermediaries in the national securities clearance and payment process from avoidance exposure with respect to the transfers for which they act as intermediaries.

There has been disagreement among the courts as to the scope of the § 546(e) protection with respect to payments to shareholders in connection

with leveraged buyouts and similar transactions. Absent § 546(e), shareholders who received payouts for their stock in connection with a leveraged buyout that rendered the target company insolvent may be vulnerable to recovery of their payouts as constructive fraudulent transfers by the target company's bankruptcy estate. The recovered amounts would be available to repay the target company's unpaid creditors. Most (but not all) courts have interpreted § 546(e) sufficiently broadly as to immunize shareholders from such recoveries if they received their payouts through the national securities clearance or payment system or even merely from a bank, even though no securities contract was implicated and they are not themselves securities or payment intermediaries. The Conference believes that this result is unfair and unnecessary to protect the securities markets.

Attached hereto as Exhibit B is a draft of the suggested amendments to §§ 546 and 550 of the Bankruptcy Code to permit recourse to the beneficial holder of a security on which a settlement payment is made if the settlement payment otherwise constitutes a constructive fraudulent transfer. The proposed amendments would not affect the exemptions under those sections currently available to banks, brokers and other intermediaries who are not the beneficial holder of the security.

Yours sincerely,

Edwin E. Smith

Chair, Committee on Capital Markets

EXHIBIT B

Amend Section 546(e) as follows:

(e) Notwithstanding sections 544, 545, 547, 548(a)(l)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, . . . that is made before the commencement of the case, except

(1) a transfer that is otherwise avoidable under section 548(a)(l)(A) of this title; or

(2) a transfer that is otherwise avoidable under section 544, 545, 547, 548(a)(1)(B) or 548(b) of this title, but only to the extent such transfer is a redemption payment, principal payment, dividend payment, interest payment or other distribution on or in respect of a security, made for the benefit of the beneficial holder of the security, by or on behalf of the issuer of the security or another entity obligated with respect to the security.

* * *

Add a new Subsection (g) to Section 550 as follows:

(g) The trustee may not recover any transfer of a kind described in section 546(e)(2), except from the entity that is the beneficial holder of the security on or in respect of which such transfer is made.

Congress did not pick up the proposal and the Circuits, as noted, generally ruled that § 546(e) safe-harbored both the intermediaries and the ultimate recipients.

In 2016, the Seventh Circuit weighed in and upset the Circuit Court consensus in FTI v. Merit Mgmt. Group, 830 F.3d 690 (7th Cir. 2016). As in *Munford*, the court in *FTI* held that conduits—mere intermediaries with no beneficial interest at stake—are not transferees for avoidance purposes in general or § 546(e) in particular. Beneficial transferees would not automatically be safe harbored.

The Circuits were thus more seriously split. The Supreme Court granted certiorari.

¶ 2208: Merit Management Group v. FTI Consulting, Inc., 583 U.S. __ (2018)

JUSTICE SOTOMAYOR delivered the opinion of the Court.

To maximize the funds available for, and ensure equity in, the distribution to creditors in a bankruptcy proceeding, the Bankruptcy Code gives a trustee the power to invalidate a limited category of transfers by the debtor or transfers of an interest of the debtor in property. Those powers, referred to as "avoiding powers," are not without limits, however, as the Code sets out a number of exceptions. The operation of one such exception, the securities safe harbor, 11 U. S. C. §546(e), is at issue in this case. Specifically, this Court is asked to determine how the safe harbor operates in the context of a transfer that was executed via one or more transactions, *e.g.,* a transfer from A → D that was executed via B and C as intermediaries, such that the component parts of the transfer include A → B → C → D. If a trustee seeks to avoid the A → D transfer, and the §546(e) safe harbor is invoked as a defense, the question becomes: When determining whether the §546(e) securities safe harbor saves the transfer from avoidance, should courts look to the transfer that the trustee seeks to avoid (*i.e.,* A → D) to determine whether that transfer meets the safe-harbor criteria, or should courts look also to any component parts of the overarching transfer (*i.e.,* A → B → C → D)? The Court concludes that *the plain meaning of §546(e) dictates* that the only relevant transfer for purposes of the safe harbor is the transfer that the trustee seeks to avoid.

I

A

. . . Section 548(a)(1)(B) addresses "constructively" fraudulent transfers. . . . [T]he statute defines constructive fraud in part as when a debtor:

> (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation. 11 U. S. C. §548(a)(1).

The Code sets out a number of limits on the exercise of these avoiding powers. . . . Central to this case is the securities safe harbor set forth in §546(e).

* * *

C

. . .

Valley View proceeded with the corporate acquisition [of Bedford Downs] . . . arranged for the Cayman Islands branch of Credit Suisse to finance the $55 million purchase price as part of a larger $850 million transaction. Credit Suisse wired the $55 million to Citizens Bank of Pennsylvania, which had agreed to serve as the third-party escrow agent for the transaction. The Bedford Downs shareholders, including petitioner Merit Management Group, LP, deposited their stock certificates into escrow as well. At closing, Valley View received the Bedford Downs stock certificates, and in October 2007 Citizens Bank disbursed [a total of $55] million to the Bedford Downs shareholders . . . . All told, Merit received approximately $16.5 million from the sale of its Bedford Downs stock to Valley View. Notably, the closing statement for the transaction reflected Valley View as the "Buyer," the Bedford Downs shareholders as the "Sellers," and $55 million as the "Purchase Price." App. 30.

In the end, Valley View [failed and] . . . thereafter filed for Chapter 11 bankruptcy. The Bankruptcy Court confirmed a reorganization plan and appointed respondent FTI Consulting, Inc., to serve as trustee of the . . . litigation trust.

FTI filed suit against Merit in the Northern District of Illinois, seeking to avoid the $16.5 million transfer from Valley View to Merit for the sale of Bedford Downs' stock. *The complaint alleged that the transfer was constructively fraudulent under §548(a)(1)(B) of the Code because Valley View was insolvent when it purchased Bedford Downs and "significantly overpaid" for the Bedford Downs stock.* Merit moved for judgment on the pleadings under Federal Rule of Civil Procedure 12(c), contending that the §546(e) safe harbor barred FTI from avoiding the Valley View-to-Merit transfer. According to Merit, the safe harbor applied because the transfer was a "settlement payment . . . made by or to (or for the benefit of)" a covered "financial institution"—here, Credit Suisse and Citizens Bank.

The District Court granted the Rule 12(c) motion, reasoning that the §546(e) safe harbor applied because the financial institutions transferred

or received funds in connection with a "settlement payment" or "securities contract."[2] The Court of Appeals for the Seventh Circuit reversed, holding that the §546(e) safe harbor did not protect transfers in which financial institutions served as mere conduits. This Court granted certiorari to resolve a conflict among the circuit courts as to the proper application of the §546(e) safe harbor.[3]

II

The question before this Court is whether the transfer between Valley View and Merit implicates the safe harbor exception because the transfer was "made by or to (or for the benefit of) a . . . financial institution." §546(e). The parties and the lower courts dedicate much of their attention to the definition of the words "by or to (or for the benefit of)" as used in §546(e), and to the question whether there is a requirement that the "financial institution" or other covered entity have a beneficial interest in or dominion and control over the transferred property in order to qualify for safe harbor protection. In our view, those inquiries put the proverbial cart before the horse. Before a court can determine whether a transfer was made by or to or for the benefit of a covered entity, the court must first identify the relevant transfer to test in that inquiry. At bottom, that is the issue the parties dispute in this case.

On one side, Merit posits that the Court should look not only to the Valley View-to-Merit end-to-end transfer, but also to all its component parts. Here, those component parts include one transaction by Credit Suisse to Citizens Bank (*i.e.,* the transmission of the $16.5 million from Credit Suisse to escrow at Citizens Bank), and two transactions by Citizens Bank to Merit (*i.e.,* the transmission of $16.5 million over two installments by Citizens Bank as escrow agent to Merit). Because those component parts include transactions by and to financial institutions, Merit contends that §546(e) bars avoidance.

FTI, by contrast, maintains that the only relevant transfer for purposes of the §546(e) safe-harbor inquiry is the overarching transfer between Valley View and Merit of $16.5 million for purchase of the stock, which is the transfer that the trustee seeks to avoid under §548(a)(1)(B). Because that transfer was not made by, to, or for the benefit of a financial institution, FTI contends that the safe harbor has no application.

The Court agrees with FTI. The language of §546(e),the specific context in which that language is used, and the broader statutory structure

---

[2] The parties do not ask this Court to determine whether the transaction at issue in this case qualifies as a transfer that is a "settlement payment" . . . nor is that determination necessary for resolution of the question presented.

[3] Compare *In re Quebecor World (USA) Inc.*, 719 F. 3d 94, 99 (CA2 2013) (finding the safe harbor applicable where covered entity was intermediary); *In re QSI Holdings, Inc.*, 571 F. 3d 545, 551 (CA6 2009) (same); *Contemporary Indus. Corp.* v. *Frost*, 564 F. 3d 981, 987 (CA8 2009) (same); *In re Resorts Int'l, Inc.*, 181 F. 3d 505, 516 (CA3 1999) (same); *In re Kaiser Steel Corp.*, 952 F. 2d 1230, 1240 (CA10 1991) (same), with *In re Munford, Inc.*, 98 F. 3d 604, 610 (CA11 1996) (*per curiam*) (rejecting applicability of safe harbor where covered entity was intermediary).

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.

A

Our analysis begins with the text of §546(e), and we look to both "the language itself [and] the specific context in which that language is used . . . ." The pertinent language provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . 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 . . . inconnection with a securities contract . . . , except under section 548(a)(1)(A) of this title.

The very first clause—"Notwithstanding sections 544, 545,547, 548(a)(1)(B), and 548(b) of this title"—already begins to answer the question. It indicates that §546(e) operates as an exception to the avoiding powers afforded to the trustee under the substantive avoidance provisions. . . . That is, when faced with a transfer that is otherwise avoidable, §546(e) provides a safe harbor notwithstanding that avoiding power. From the outset, therefore, the text makes clear that the starting point for the §546(e) inquiry is the substantive avoiding power under the provisions expressly listed in the "notwithstanding" clause and, consequently, the transfer that the trustee seeks to avoid as an exercise of those powers.

Then again in the very last clause—"except under section 548(a)(1)(A) of this title"—the text reminds us that the focus of the inquiry is the transfer that the trustee seeks to avoid. It does so by creating an exception to the exception, providing that "the trustee may not avoid a transfer" that meets the covered transaction and entity criteria of the safe harbor, "except" for an actually fraudulent transfer under §548(a)(1)(A). 11 U. S. C. §546(e). By 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, not any component part of that transfer. . . .

The rest of the statutory text confirms what the "notwithstanding" and "except" clauses and the section heading begin to suggest. The safe harbor provides that "the trustee may not avoid" certain transfers. §546(e). Naturally, that text invites scrutiny of the transfers that "the trustee may avoid," the parallel language used in the substantive avoiding powers provisions. See §544(a) (providing that "the trustee . . . may avoid" transfers falling under that provision); . . . §547(b) (providing that "the trustee may avoid" certain preferential transfers); §548(a)(1) (providing that "[t]he trustee may avoid" certain fraudulent transfers). And if any doubt remained, the language that follows dispels that doubt:

The transfer that the "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." §546(e) (emphasis added). Not a transfer that involves. Not a transfer that comprises. But a transfer that is a securities transaction covered under §546(e). The provision explicitly equates the transfer that the trustee may otherwise avoid with the transfer that, under the safe harbor, the trustee may not avoid. In other words, to qualify for protection under the securities safe harbor, §546(e) provides that the otherwise avoidable transfer itself be a transfer that meets the safe-harbor criteria.

Thus, the statutory language and the context in which it is used all point to the transfer that the trustee seeks to avoid as the relevant transfer for consideration of the §546(e) safe-harbor criteria.

B

The statutory structure also reinforces our reading of §546(e). As the Seventh Circuit aptly put it, the Code "creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin." 830 F. 3d, at 694. Given 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.

As noted in Part I–A, *supra*, the substantive avoidance provisions in Chapter 5 of the Code set out in detail the criteria that must be met for a transfer to fall within the ambit of the avoiding powers. These provisions, as Merit admits, "focus mostly on the characteristics of the transfer that may be avoided." Brief for Petitioner 28. The trustee, charged with exercising those avoiding powers, 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 anyway it chooses. Instead, that transfer is necessarily defined by the carefully set out criteria in the Code. As FTI itself recognizes, its power as trustee to define the transfer is not absolute because "the transfer identified must satisfy the terms of the avoidance provision the trustee invokes." Brief for Respondent 23.

Accordingly, after a trustee files an avoidance action identifying the transfer it seeks to set aside, a defendant in that action is free to argue that the trustee failed to properly identify an avoidable transfer under the Code, including any available arguments concerning the role ofcomponent parts of the transfer. *If a trustee properly identifies an avoidable transfer, however, the court has no reason to examine the relevance of component parts when considering a limit to the avoiding power, where that limit is defined by reference to an otherwise avoidable transfer, as is the case with §546(e)*, see Part II–A, *supra*.

In the instant case, FTI identified the purchase of Bedford Downs' stock by Valley View from Merit as the transfer that it sought to avoid. Merit does not contend that FTI improperly identified the Valley View-to-Merit transfer as the transfer to be avoided, focusing instead on whether FTI can "ignore" the component parts at the safe-harbor inquiry. Absent that argument, however, the Credit Suisse and Citizens Bank component parts are simply irrelevant to the analysis under §546(e). The focus must remain on the transfer the trustee sought to avoid.

III

A

The primary argument Merit advances that is moored in the statutory text concerns the 2006 addition of the parenthetical "(or for the benefit of)" to §546(e). Merit contends that in adding the phrase "or for the benefit of " to the requirement that a transfer be "made by or to" a protected entity, Congress meant to abrogate the 1998 decision of the Court of Appeals for the Eleventh Circuit in *In re Munford, Inc.*, 98 F. 3d 604, 610 (1996) (*per curiam*), which held that the §546(e) safe harbor was inapplicable to transfers in which a financial institution acted only as an intermediary. Congress abrogated *Munford*, Merit reasons, by use of the disjunctive "or," so that even if a beneficial interest, *i.e.,* a transfer "for the benefit of " a financial institution or other covered entity, is sufficient to trigger safe harbor protection, it is not necessary for the financial institution to have a beneficial interest in the transfer for the safe harbor to apply. Merit thus argues that a transaction "by or to" a financial institution such as Credit Suisse or Citizens Bank would meet the requirements of §546(e), even if the financial institution is acting as an intermediary without a beneficial interest in the transfer.

Merit points to nothing in the text or legislative history that corroborates the proposition that Congress sought to overrule *Munford* in its 2006 amendment. There is a simpler explanation for Congress' addition of this language that is rooted in the text of the statute as a whole and consistent with the interpretation of §546(e) the Court adopts. A number of the substantive avoidance provisions include that language, thus giving a trustee the power to avoid a transfer that was made to "or for the benefit of " certain actors. See §547(b)(1) (avoiding power with respect to preferential transfers "to or for the benefit of a creditor"); §548(a)(1) (avoiding power with respect to certain fraudulent transfers "including any transfer to or for the benefit of an insider . . . "). By adding the same language to the §546(e) safe harbor, Congress ensured that the scope of the safe harbor matched the scope of the avoiding powers. For example, a trustee seeking to avoid a preferential transfer under §547 that was made "for the benefit of a creditor," where that creditor is a covered entity under §546(e), cannot now escape application of the§546(e) safe harbor just because the transfer was not "made by or to" that entity.

Nothing in the amendment therefore changed the focus of the §546(e) safe-harbor inquiry on the transfer that is otherwise avoidable under the substantive avoiding powers. If anything, by tracking language already included in the substantive avoidance provisions, the amendment reinforces the connection between the inquiry under §546(e) and the otherwise avoidable transfer that the trustee seeks to set aside.

Merit next attempts to bolster its reading of the safe harbor by reference to the inclusion of securities clearing agencies as covered entities under §546(e). Because a securities clearing agency is defined as, *inter alia*, an intermediary in payments or deliveries made in connection with securities transactions, see 15 U. S. C. §78c(23)(A) and 11 U. S. C. §101(48) (defining "securities clearing agency" by reference to the Securities Exchange Act of 1934), Merit argues that the §546(e) safe harbor must be read to protect intermediaries without reference to any beneficial interest in the transfer. The contrary interpretation, Merit contends, "would run afoul of the canon disfavoring an interpretation of a statute that renders a provision ineffectual or superfluous." Brief for Petitioner 25.

Putting aside the question whether a securities clearing agency always acts as an intermediary without a beneficial interest in a challenged transfer—a question that the District Court in [the early] *Seligson* found presented triable issues of fact in that case—the reading of the statute the Court adopts here does not yield any superfluity. Reading §546(e) to provide that the relevant transfer for purposes of the safe harbor 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 securities clearing agency. If the transfer that the trustee seeks to avoid was made "by" or "to" a securities clearing agency (as it was in *Seligson*), then §546(e) will bar avoidance, and it will do so without regard to whether the entity acted only as an intermediary. The safe harbor will, in addition, bar avoidance if the transfer was made "for the benefit of " that securities clearing agency, even if it was not made "by" or "to" that entity. This reading gives full effect to the text of §546(e).

* * *

IV

For the reasons stated, we conclude that the relevant transfer for purposes of the §546(e) safe harbor is the same transfer that the trustee seeks to avoid pursuant to its substantive avoiding powers. Applying that understanding of the safe-harbor provision to this case yields a straightforward result. FTI, the trustee, sought to avoid the $16.5 million Valley View-to-Merit transfer. FTI did not seek to avoid the component transactions by which that overarching transfer was executed. As such, when determining whether the §546(e) safe harbor saves the transfer from avoidance liability, *i.e.,* whether it was "made by or to (or for the benefit

of) a vulnerable . . . financial institution," the Court must look to the overarching transfer fromValley View to Merit to evaluate whether it meets the safe-harbor criteria. *Because 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.* The judgment of the Seventh Circuit is therefore affirmed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

....

1. Examine the charts on pages 58-59. Is the payment made "by" Roe Industries "to" the Seller of the stock, "through" Merrill, Schwab, and DTC? What prepositions does the statute use?
2. The three charts on pp. 58-59 capture the various transfers that might take place. The string of settlement transactions is illustrated in the middle of the three charts on that page. How does the Court's approach deal with the intermediary transactions?
3. Under the Court's analysis, how would the LBO lenders in *Tabor Court (Gleneagles)* and *Wieboldt Stores* have fared under the current § 546(e) safe harbor? How about the selling shareholders in *Kaiser Steel*?
4. Do *Kaiser*, *QSI*, and *FTI* all decide based on statutory plain meaning? Do they decide the same way?
5. Let's say the transfer was in an LBO with the selling stockholders including a financial institution that beneficially owned the target firm's stock. Is the transfer of cash to the selling financial institution covered by the §546(e) safe harbor, according to *FTI*? Is it a settlement payment?

APPENDIX

THE STATUTES

BANKRUPTCY ACT OF 1978
(11 U.S.C. § 101 et seq.)

§ 101. Definitions

(52) The term "State" includes the District of Columbia and Puerto Rico, except for the purpose of defining who may be a debtor under chapter 9 of this title.

§ 109. Who may be a debtor

(a) . . . [O]nly a person that resides or has domicile, a place of business or property in the United States . . . may be a debtor under this title.

* * *

(c) An entity may be a debtor under chapter 9 of this title if and only if such entity—

(1) is a municipality; [and]

(2) is specifically authorized . . . to be a debtor under such chapter by State law . . . .

§ 349. Effect of dismissal

* * *

(b) Unless the court, for cause, orders otherwise, a dismissal of a case . . . —

(1) reinstates—

* * *

(B) any transfer avoided under [the preference and fraudulent conveyance provisions of the Code] . . . ;

(2) vacates any order, judgment, or transfer ordered, under [Chapter 5 of the Code]; and

(3) revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.

§ 363. Use, sale or lease of property

* * *

(f) The trustee may sell property under subsection (b) or (c) of this section [363] free and clear of any interest in such property of an entity other than the estate only if—

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

§ 503. Allowance of administrative expenses

(c) Notwithstanding subsection (b) [pertaining to administrative expenses], there shall neither be allowed, nor paid—

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that—

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

(2) a severance payment to an insider of the debtor, unless—

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) [domestic support payment in ind'l bankruptcies]

(2) Second, administrative expenses allowed under section 503(b) . . . .

(3) Third, ...

(4) Fourth, allowed unsecured claims, but only to the extent of $12,850 [indexed] for each individual . . . earned within 180 days before the date of the filing of the petition . . . for—

(A) wages, salaries, or commissions, including vacation, severance, and sick leave pay earned by an individual; or

(B) sales commissions earned by an individual . . . acting as an independent contractor in the sale of goods or services for the debtor . . .

(5) Fifth, allowed unsecured claims for contributions to an employee benefit plan . . . arising from services rendered within 180 days before the date of the filing of the petititon . . . .

(6) Sixth, ...

(7) Seventh, allowed unsecured claims of individuals, to the extent of $2,850 [indexed] for each such individual, arising from the deposit, before

the commencement of the case, of money in connection with the purchase, lease, or rental or property, or the purchase of services, for the personal, family, or householded use of such individuals, that were not elivered or provided.

(8) Eighth, allowed unsecured claims of governmental unites, only to the extent that such claims are for—

(A) a tax on . . . income for a a taxable year ending on or before the date of the filing of the petition . . . ;

(B) a property tax incurred before the commencement of the case and last payable without penalty after one year before the date of the filing of the petititon;

(C) [other taxes].

§ 546. Limitations on avoiding powers

* * *

(c) [. . .] but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

* * *

(e) Notwithstanding sections 544, . . . , 547, 548(a)(1)(B), and 548(b) of this title, the trustee many not avoid a transfer that is a margin payment as defined in section . . . . 761 [or a] settlement payment as defined in section 101 or 741, made by or to (or for the benefit of) a . . . stockbroker, financial institution, . . . or securities clearing agency . . . .

§ 547. Preferences

* * *

(e)(2) For purposes of this section, except as provided in paragraph (3) of this subsection a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 30 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 30 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; or

(ii) 30 days after such transfer takes effect between the transferor and the transferee.

§ 761. Definitions for this subchapter

* * *

(15) "Margin payment" means payment or deposit of cash, a security or other property, that is commonly known in the . . . trade as . . . margin . . . .

Internal Revenue Code

§ 382. Limitations

(g) Ownership change

For purposes of this section—

(1) In general

There is an ownership change if, immediately after any owner shift involving a 5-percent shareholder or any equity structure shift—

(A) the percentage of the stock of the loss corporation owned by 1 or more 5-percent shareholders has increased by more than 50 percentage points, over

(B) the lowest percentage of stock of the loss corporation (or any predecessor corporation) owned by such shareholders at any time during the testing period.

(2) Owner shift involving 5-percent shareholder

There is an owner shift involving a 5-percent shareholder if—

(A) there is any change in the respective ownership of stock of a corporation, and

(B) such change affects the percentage of stock of such corporation owned by any person who is a 5-percent shareholder before or after such change.

(l) Certain additional operating rules

(5) Title 11 or similar case

(A) In general

Subsection (a) shall not apply to any ownership change if—

(i) the old loss corporation is (immediately before such ownership change) under the jurisdiction of the court in a title 11 or similar case, and

(ii) the shareholders and creditors of the old loss corporation . . . own (after such ownership change and as a result of being shareholders or creditors immediately before such change) stock of the new loss corporation . . . [sufficient to control 50 percent of the new loss corporation's stock].