Reassessing the Impact of *Merit Management* on the Section 546(e) Safe Harbor

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In a recent decision, S.D.N.Y. Bankruptcy Judge Michael E. Wiles reexamined the breadth and scope of the Section 546(e) safe harbor provision in light of the Supreme Court's 2018 decision in *Merit Management, LP v. FTI Consulting, Inc.* Judge Wiles' decision limits the applicability of the Section 546(e) safe harbor by refusing to collapse a series of transfers based on the economic substance of the overarching transaction instead focusing on the transfer that the plaintiff trustee seeks to avoid.

Section 546(e) provides a safe-harbor from claims to avoid transfers pursuant to 11 U.S.C. §§ 544, 545, 547, 548(a)(1)(B), and 548(b) where the transfer is (i) "[a] ***settlement payment*** … made by or to (or for the benefit of) … a financial institution [or] a financial participant,…" and/or (ii) "made by or to (or for the benefit of) … a financial institution [or] a financial participant, ***in connection with a …***

securities contract,…" 11 U.S.C. § 546(e) (emphasis added). In its unanimous *Merit Management* decision, the Supreme Court explained that the scope of the Section 546(e) is limited to the transfer that the plaintiff seeks to avoid:

The language of 11 U.S.C.[] § 546(e), the specific context in which that language is used, and the broader statutory structure all support the conclusion that ***the relevant transfer for purposes of the § 546(e) safe-harbor inquiry is the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions***.

Merit Mgmt., 583 U.S. at 378 (emphasis added). The Supreme Court's proclamation was made in the context of an argument that a corporation's acquisition of a competitor's stock was made "by, to or for the benefit of a financial institution" simply because the money and shares flowed through banks. *Id.* The Supreme Court held that the "transfer that the trustee [sought] to avoid"**–** the acquisition itself – was not subject to the safe harbor simply because components of that transfer were made through financial institutions. *Id.* at 378, 386.

While *Merit Management* is often cited for the proposition that a transfer is not protected by Section 546(e) simply because the transfer includes financial conduits, less attention has been paid to the Supreme Court's ensuing limitation. The Supreme Court continued:

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.***

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….the [Bankruptcy] Code "creates both a system for avoiding transfers and a safe harbor from avoidance—logically these are two sides of the same coin." … 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***.

Id. at 380–81 (emphasis added).

In *In re IIG Global Trade Finance Fund LTD (in Official Liquidation)*, Adv. Case No. 23-01165 (MEW), 2024 WL 4751276 (Bankr. S.D.N.Y. Nov. 8, 2024), the liquidators of two Cayman investment funds (the "Funds") sought to avoid transfers by those funds to a Delaware statutory trust ("TFT") made in exchange for "participation interests" in loans held by TFT (the "Transfers"). *IIG Global.* 2024 WL 4751276 at *2-3. TFT had purchased those loans from its affiliate, TFFI, which had originally acquired the loans by selling $220 million of notes. *Id.* Deutche Bank Trust Company Americas ("DBCTA") had served as the indenture trustee on the TFFI note offering. *Id.* at *1. When TFT received the Transfers from the investment funds, it immediately paid them to DBCTA, which itself paid out funds to the TFFI Noteholders. *Id.* at *3, *9.

On a motion to dismiss, the *IIG Global Trade* defendants conceded that, in isolation, the transfers by the Funds to TFT were not subject to Section 546(e), but argued that the safe-harbor applied because TFT was merely a nominal participant in a larger transaction, namely the payment of cash from the Funds the Noteholders to redeem the TFFI Notes. *Id.* at *9. Judge Wiles was thus asked whether *Merit Management* required the court to collapse all of the underlying transactions and to treat them as one.

To resolve the issue, Judge Wiles performed an in-depth analysis of *Merit Management*, observing that the "Supreme Court held that in applying section 546(e) a court should focus on 'the overarching transfer that the trustee seeks to avoid under one of the substantive avoidance provisions.'" *IIG Global*, 2024 WL 4751276 at *13 (citing *Merit Mgmt.*, 583 U.S. at 378). As Judge Wiles described it, the defendants argued that "*Merit Management* [ ] (and the reference in that decision to the "overarching transfer" that the trustee sought to avoid) compels me to collapse the entire series of transfers that occurred in this case, and compels me to ignore all of the separate sets of transfers that are alleged, in order to decide if section 546(e) applies." *IIG Global*, 2024 WL 4751276 at *14. **But Judge Wiles rejected that argument, writing "[t]hat is not a proper reading of *Merit Management*."** *Id.* Judge Wiles then examined the differences between the facts at bar in *Merit Management* versus the facts present in *IIG Global*, concluding that the *IIG Global* defendants were focused on facts bearing on the alleged subsequent transferees (DBCTA/Noteholders), but not the Transfers subject to the fraudulent transfer claims, which were between only the Funds and TFT. *Id.*

Continuing his analysis, Judge Wiles declared that "[t]here is ***nothing in Merit Management that amounts to a command to look at subsequent transfers*** as though they ***determinethe applicability of section 546(e) to the initial transfers that a trustee seeks to avoid***." *Id.* (emphasis added). Rather, Judge Wiles declared that "**Merit Management quite clearlycommands that** in deciding whether section 546(e) applies ***[the court] should look at the transfer that the plaintiff seeks to avoid*** and ***whether that transfer "itself" was a payment to a protected entity*** of a kind that invoked the protections of section 546(e)." *Id.* (emphasis added). Judge Wiles then observed that the *IIG Global* defendants urged him "to let the [*IID Global*] [d]efendants re-define the transactions in order to try to bring them within the scope of section 546(e). That is exactly what the Supreme Court said in *Merit Management* that [Judge Wiles] should not do." *Id.*

Judge Wiles then meticulously reviewed and distinguished the other cases that the *IIG Global* defendants cited to in support of their arguments, which included decisions at from the Bankruptcy Court for the Southern District of New York, the District Court for the Southern District of New York and "a recent non-precedential summary order issued by the Second Circuit Court of Appeals". *IIG Global*, 2024 WL 4751276 at *15-18 (referring to *Holliday v. Credit Suisse Sec. (USA) LLC (In re Bos. Generating, LLC)*, No. 21-2543-br, 2024 WL 4234886 (2d Cir. Sept. 19, 2024)). He observed that "those cases involved facts that (like *Merit Management*) are very different from the facts in [*IIG Global*]." *IIG Global*, 2024 WL 4751276 at *14

While this flash will not address Judge Wiles' review and discussion of each of those cases, it is worth noting that Judge Wiles observed that

There are points in the various *Boston Generating* decisions that discuss *Merit Management* as though it prohibits courts from focusing on the "component" parts of a transaction, but that is not what *Merit Management* held. The Supreme Court held in *Merit Management* that if a trustee

attacks a "component" part of a transaction the trustee must establish that the elements of a fraudulent transfer are established, but otherwise it held that courts should look no further than the transfer that a trustee seeks to challenge.

IIG Global, 2024 WL 4751276 at *17.

Finally, after reviewing a number of other cases, Judge Wiles concluded his discussion of Section 546(e), writing:

The Supreme Court confirmed in *Merit Management* that in challenging a transfer a trustee must identify characteristics of a challenged transfer that actually make it subject to avoidance, and in that sense a trustee is not free to define a "transfer" in any way the trustee chooses. In this case… *Merit Management* makes clear, under these circumstances, that section 546(e) is not applicable.

IIG Global, 2024 WL 4751276 at *17.

It remains to be seen whether other jurists will adhere strictly to *Merit Management* and examine Section 546(e) arguments in a highly case-specific manner that resists an overbroad reading of that safe harbor provision. However, Judge Wiles decision in *IIG Global* provides a roadmap to do so, and represents a step in paring back Section 546(e)'s perceived scope.

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