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Leveraging Bankruptcy Preference Defenses: Trade Creditor Payments, Earmarking, Critical Vendors, Claim Waivers, Set-Offs

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1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

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Advanced Preference Litigation: Leveraging Key Defenses

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Elements of a Preference

- **Bankruptcy Code § 547(b) defines a preference as:**
  - **a transfer of the debtor's interest in its property,**
  - **to or for the benefit of a creditor,**
  - **on account of an antecedent or existing debt that the debtor owed to the creditor,**
  - **made while the debtor was insolvent (rebuttable presumption of insolvency during the 90 days prior to the petition date), and**
  - **on or within 90 days prior to the bankruptcy filing (or within one year if to an insider) that enables the creditor to receive more than such creditor would have received if the case were a Chapter 7 liquidation proceeding**

Attacking the Prima Facie Case

- **Was there a transfer of a debtor's interest in its property?**
- **Was the transfer on account of an antecedent debt?**
- **Did the transfer occur within the 90 days preceding the filing (or 1 year period for insiders)?**
- **Was the debtor insolvent?**
- **Was the creditor fully secured?**
- **See In re Transvantage Solutions, Inc., et al., 2016 WL 5854197 (Bankr. D. NJ 2016) (examining elements)**

100% Plan Payment

- **§ 547(b)(5) requires that the debtor prove that the preferential transfer enabled the creditor to receive more than such creditor would have received if the case were a Chapter 7 liquidation proceeding.**

- **In cases where the distribution is one-hundred percent, the allegedly preferential transfers did not enable the creditor to receive more that it would have received in a liquidation, and thus § 547(b)(5) cannot be satisfied.**

***See* 5 *Collier on Bankruptcy* ¶ 547.03[7] (16th Ed. 2010)**

Burden of Proof and Statute of Limitations

Burden of Proof

- **The trustee or debtor-in-possession has the burden of proof on each element of a preference under Bankruptcy Code § 547(b)**

- **A defendant has the burden of proof on the affirmative defenses under Bankruptcy Code § 547(c)**

Statute of Limitations (Bankruptcy Code § 546)

- **A preference action must be filed before a bankruptcy case is closed and before the later of**
  - **2 years after entry of the order for relief (usually filing date); or**
  - **1 year after the appointment or election of a trustee**

Pleading Requirements and Motions to Dismiss

Pleading requirements generally:

- **Complaint must contain "enough facts to state a claim to relief that is plausible on its face . . . to raise a right to relief above the speculative level"**
- **Complaint that offers "labels and conclusions" or "a formulaic recitation of the elements of a cause of action will not do."**
- **"Nor does a complaint suffice if it tenders 'naked assertion[s]' devoid of any 'further factual enhancement.'"**

Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009)

Bell Atlantic Corp. v. Twombly, 550 U.S. 544, 570 (2007)

Pleading Requirements and Motions to Dismiss

- **Although bankruptcy trustees are generally allowed more leniency in pleading than other plaintiffs, some courts have applied the *Twombly/Iqbal* analysis to dismiss a trustee's preference complaint.**
  - Gellert v. The Lenick Co. (In re Crucible Materials Corp.), Adv. No. 10-55178 (Bankr. D. Del. July 6, 2011) (dismissing complaint that had "only conclusory allegations parroting the statutory language of section 547" but granting leave to amend)
  - Mervyn's LLC v. Lubert Adler Group IV, LLC (In re Mervyn's Holdings, LLC), Adv. No. 08-51402 (Bankr. D. Del. Mar. 12, 2010) (denying leave to amend after dismissing a complaint under *Twombly/Iqbal* standards; complaint was facially implausible and certain allegations therein where "patently untrue")
  - In re MCG Limited P'ship, 545 B.R. 74 (Bankr. D. Del. 2016) (finding compliant insufficient due to lack of description of business relationship and antecedent debt but granting motion to amend).

Pleading Requirements and Motions to Dismiss

- **Despite the factual specificity required in pleading, courts may grant plaintiffs leave to amend complaints to include additional facts and allow the amendment to relate back to the date of filing.**

–Courts have held that if a complaint indicates an intention to pursue all preference period transfers, an amended complaint with additional transfers will relate back.) - In re Circuit City Stores, Inc., 515 B.R. 302 (Bankr. E.D.Va. 2014).

Pleading Requirements and Motions to Dismiss

- **In a jointly administered case, is the debtor that *paid* each transfer identified?**
- **In a jointly administered case, is the debtor that *incurred the debt paid for by each* transfer identified?**
- **Is each transfer identified by check number or identified as a wire? Is the check date and clear date listed?**
- **Is the actual antecedent debt identified? In many cases the invoice number and invoice date can provide this information. In other cases other documents may have to be identified to connect the transfer to antecedent debt.**
  - Examples: Shipping documents, contracts

Pleading Requirements and Motions to Dismiss

- **In addition to referencing the presumption of insolvency for non-insider cases, is there other information on insolvency that may be included?**
  - Example: Allegations about a debtor's financial difficulties
- **When alleging that the transfers allowed the defendant to receive more than it would have under a Chapter 7 liquidation, are there schedules and proofs of claims that can be referenced that can provide support for this element?**

Pleading Requirements and Motions to Dismiss

- **Motions to dismiss can provide for potential settlement**
  - Consider a motion to dismiss if the actual payments are not detailed
  - Complaint should specify which debtor made the payment – cross reference for party that had antecedent debt
  - Creditor will generally have better understanding of facts regarding relationship than the plaintiff
  - Opportunity to assert defenses and separate suit from other preference suits.
  - Were causes of action retained in a plan?
  - Is the motion to dismiss worth the time/money

Stern v. Marshall (as it relates to preference actions)

- **In *Stern,* the Supreme Court held that a bankruptcy court lacked the constitutional authority to enter a final judgment on a state law counterclaim that was not resolved in the process of ruling on a creditor's proof of claim.**

- **Courts are split on the issue of whether *Stern* applies to preference actions in cases where the defendant has not filed a proof of claim.**

  - Courts favoring the application of ***Stern*** to preference actions have reasoned that, when a creditor who has not filed a proof of claim is sued in a preference action, it is a matter of private right that requires the exercise of the judicial power of the United States, a power that cannot be exercised by a non-Article III judge.

  - Courts disfavoring the application of Stern to preference actions have reasoned that, the public rights exception applies to preference actions, ***Stern*** does not remove the bankruptcy courts' authority to enter final judgments on core bankruptcy matters, and the entire purpose of the preference actions is to enforce the Bankruptcy Code's equality of distribution.

Statutory Defenses to a Preference

Ordinary Course of Business
Bankruptcy Code § 547(c)(2)

The Ordinary Course of Business Defense

11 U.S.C. 547 § (c)(2)

- **Transfer must be for a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee <u>AND</u> either:**
- **Made in the ordinary course of business or financial affairs of the debtor and transferee (Subjective Test) <u>OR</u>**
- **Made according to ordinary business terms (Objective Test)**

Ordinary Course of Business
Bankruptcy Code § 547(c)(2)

- **<u>In re Molded Acoustical Products, Inc.</u>, 18 F.3d 217 (3d Cir. 1994) - "Ordinary business terms" refers to range of terms that encompass practices in which firms similar in some general way to the creditor in question engage, and only dealings so unusual as to fall outside this broad range should be deemed extraordinary and outside the scope of § 547(c)(2); duration of the parties' relationship is logically pertinent to the touchstone of statutory policies underscoring § 547(c)(2).**
- **"Ordinary" not defined. Deviation does not have to be beneficial.**
- **"Fairness" is not a defense to preference action. <u>In re Vission, Inc</u>. 400 B.R. 215 (Bankr. E.D. Wis. 2008).**

Ordinary Course of Business
Bankruptcy Code § 547(c)(2)

- **Purpose of Exception**
  - **Leaves normal financial relations undisturbed**
  - **Protects payments that do not result from unusual debt collection or payment practices**

Ordinary Course of Business
Bankruptcy Code § 547(c)(2)

- **Lack of prior transactions is not a per se bar to the ordinary course defense.**
- **If there were no transactions before the 90 day preference period, some courts look to the terms of the parties' contract to determine whether payments are ordinary. In re Forman Enterprises, Inc., 293 B.R. 848 (Bankr. W.D. Pa. 2003); In re Conex Holdings, LLC, 2014 WL 5139240 (Bankr. D. Del. Oct. 14, 2014)**
- **Some courts, however, have held that historical periods shorter than one year are insufficient to establish a historical baseline. In re Sierra Concrete Design, Inc., 463 B.R. 302 (Bankr. D. Del. 2012).**
- **A change in ownership of defendant can require the use of a different historical period. In re Sterry Industries, Inc., 553 B.R. 96 (Bankr. W.D.TX 2016) (relevant period was period under new ownership after payment terms changed).**

Ordinary Course Of Business – Subjective Prong – Section 547(c)(2)(A)

- **Ordinary Between Parties (Subjective Test)**
- **Comparison of parties' relationship during the 90 days prior to the petition date (the "Preference Period") to the time period before the Preference Period (the "Historical Period").**
- The greater the deviation in payment time from the Historical Period, the less likely a defendant will be able to satisfy the subjective prong.

Subjective Prong – Various Types of Analyses

- **Endless potential for calculation and no set standard**
  - **Range method (using the Historical Period data, take the lowest and highest number of days from invoice date to payment date to get the range. Any payment during the preference period that falls within that range is ordinary).**
  - **Average payment period widely used (compare the average time of payment after the issuance of an invoice during the Historical and Preference Periods. To determine which payments are ordinary, review the range of payments centered around the Historical Period average and also groups the payments in buckets by age. In re Am. Home Mtg. 476 B.R. 124 (Bankr. D. Del. 2012) and In re Conex Holdings, 2014 WL 7205203 (Bankr. D. Del. Dec. 18, 2014).**

Subjective Prong – Various Types of Analyses

- Weighted Average Analysis

- **The weighted average is calculated by multiplying the amount of the invoice by the days it took to get paid and then dividing that value by the total amount of the invoices in the data set.**
- **As the weighted average takes into account the relative invoice amount and generates an average based on the days to payment and the amount of payments, it may be a more comprehensive method than the straight average method.**

Preference Defenses: Ordinary Course Of Business

- **In re Powerwave Technologies, Inc., Adv. Proc. No. 15-50085 (Bankr. D. Del. Apr. 13, 2017)**
  - **Defendant argued in favor of using the "Range" and "Batch" Methods.**
  - **Plaintiff argued in favor of using "Days Sales Outstanding", "Inter-Quartile" and "Standard Deviation".**
  - **Countless variations for calculations – structure one that is beneficial, but makes sense**

Subjective Prong: Choosing the Relevant Historical Period

- **The following choices, based on what produces the best outcome for the client, should be considered:**

  –12-month prior history;

  –24-month prior history.

  Case law supports the view that the comparative historical baseline should be based on the time frame when the debtor was financially healthy. Thus, a longer historical period is usually preferable because it is more likely to reflect the parties' dealing when the debtor was financially healthier.

Preference Defenses: Ordinary Course Of Business

- **Subjective Test risk management**
  - **Management while credit deteriorating v. litigation after suit (be proactive)**
  - **Change of payment method (check, wire, FedEx, mail)**
    - **Try to encourage consistency**
  - **Change in credit terms**
    - **Springing COD terms, shortening terms, enforcing prior credit limits**
  - **Threats to stop shipment, dunning letters**
    - **Consider documentation in litigation – debtors records likely to be poor – most cases will settle before depositions**
  - **Receiving a preferential payment always better than not receiving payment**

Preference Defenses: Ordinary Course Of Business

- **Pressure for payment does not necessarily exclude payments from ordinary finding. (In re Archway Cookies, 435 B.R. 234 (Bankr. D. Del. 2010)**
  - **Pressuring the debtors into payment during the preference period by requiring payments on past due invoices before shipment of new goods was consistent with the historical dealings between the debtors and the defendant.**
  - **Debtors' payment practices in preference period - including holding checks, voiding checks, and preferring certain vendors over other vendors – did not take transactions out of ordinary because they were not applied to this creditor. Subjective test reviews transaction only between debtor and creditor, not all other creditors.**
  - **Creditors can benefit from pushing for consistency of payment.**

Preference Defenses: Ordinary Course Of Business

- **Refusing to ship until invoices are paid does not necessarily constitute unusual collection practices and pre-preference period refusals can bolster ordinary course defense. In re Elrod Holdings Corp., 426 B.R. 106 (Bankr. Del. 2010).**
  - Be vigilant on enforcing rights with all customers.
- **Change of payment terms, enforcement of credit limits, and projects requiring faster invoicing may be relevant to ordinary course defense. In re Sierra Concrete Design, Inc., 2015 WL 4381571 (Bankr. D. Del. July 16, 2016).**
- **Holistic approach to parties' relationship may be required. In re AES Thames, LLC, 547 B.R. 99 (Bankr. D. Del. 2016) (Business relationship of continuing to do business with creditor was of the type the ordinary course defense was intended to protect).**

Example of Ordinary Course Analysis - Distribution

(a) 90 Day Preference Period (8/15/02-11/15-02)
(b) 1 Year Prior to Preference Period (8/14/01-8/14/02)
(c) 5 day increments)

	(a)	(a)	(a)	(a)	(b)	(b)	(b)	(b)
# Days from Invoice to Payment	**Dollar Amount 90 Day Preference Period (8/15/02-11/15/02)**	**% of Total Amount 90 Day Preference Period (8/15/02-11/15/02)**	**Number of Invoices 90 Day Preference Period (8/15/02-11/15/02)**	**% of Total Invoices 90 Day Preference Period (8/15/02-11/15/02)**	**Dollar Amount 1 Year Prior to Preference Period (8/11/01-8/14/02)**	**% of Total Amount 1 Year Prior to Preference Period (8/14/01-8/14/02)**	**Number of Invoices 1 Year Prior to Preference Period (8/14/01-8/14/02)**	**% of Total Invoices 1 Year Prior to Preference Period (8/14/01-8/14/02)**
0-10	$0.00	0.00%	0	0.00%	$629.78	0.18%	1	0.28%
11-15	$3,385.16	4.36%	6	6.59%	$34,612.98	10.00%	29	8.12%
16-20	$7,213.64	9.28%	4	4.40%	$67,188.68	19.41%	88	24.65%
21-25	$41,167.18	52.97%	33	36.26%	$102,912.41	29.72%	83	23.25%
26-30	$9,006.02	11.59%	21	23.08%	$41,325.05	11.94%	42	11.76%
31-35	$7,157.87	9.21%	8	8.79%	$28,000.62	8.09%	26	7.28%
36-40	$4,498.87	5.79%	10	10.99%	$2,659.22	0.77%	10	2.80%
41-45	$4,768.21	6.13%	3	3.30%	$15,872.47	4.58%	27	7.56%
46-50	$186.91	0.24%	3	3.30%	$17,199.32	4.97%	17	4.76%
51-55	$286.82	0.37%	2	2.20%	$11,149.34	3.22%	8	2.24%
56-60	$0.00	0.00%	0	0.00%	$21,478.19	6.20%	8	2.24%
61-65	$52.14	0.07%	1	1.10%	$1,073.54	0.31%	8	2.24%
66-70	$0.00	0.00%	0	0.00%	$61.80	0.02%	1	0.28%
71-75	$0.00	0.00%	0	0.00%	$645.22	0.19%	4	1.12%
76-80	$0.00	0.00%	0	0.00%	$1,413.12	0.41%	5	1.40%
Total	**$77,722.82**	**100.00%**	**91**	**100.00%**	**$346,221.74**	**100.00%**	**357**	**100.00%**

Example of Ordinary Course Calculation – Average, Weighted Average and Range

	• Preference Period	• Historic Period
• **Average**	• **28.59**	• **30.2**
• **Weighted Average**	• **26.02**	• **28.42**
• **Range**	• **12-65**	• **10-173**

Example of Ordinary Course Analysis – Distribution

- **Possible Defense Arguments**

	Range	Preference Period	Historic Period
% of Amount Paid	11-25	59.13%	66.61%
% of Invoices Paid	16-30 0-30	59.66% 68.06%	63.74% 70.33%

Intersection of Collection of A/R and Bankruptcy Preference Law

- **Q: Should I take payment on old invoices from a client I believe is likely to file bankruptcy within the next couple of months?**

Preference Defenses: Ordinary Course Of Business Ordinary Business Term

- **Objective Test - Defining the Industry**
  - **Creditor has options – creditor's industry, debtors' industry, market as a whole, submarkets, etc.**
  - **General business standards / sound business practice?**
  - **Most decisions will not directly and narrowly define the industry – leaving room for interpretation by later courts.**
  - **Uncertainty provides creditor with flexibility**

Preference Defenses: Ordinary Course Of Business Ordinary Business Term

Defining the Industry Standard

- **Expert testimony (must satisfy Federal Rules of Evidence)**
- **Evidence of competitors payment practices may be proprietary and difficult to obtain – creditors given some latitude.**
- **Burdens of discovery**
- **Use of Credit Industry Data (*e.g.*, Credit Research Foundation; Dun & Bradstreet; Risk Management Association; Trade Credit Group) to Support Ordinary in the Industry Defense**

The Preference Defenses: Ordinary Course Of Business

Prepetition Settlements/Plan Payments:

- **Most courts have indicated that payments made pursuant to a settlement agreement do not per se remove the payments from the ordinary course defense.**
- **Analysis is very factual. See Prudential Real Estate and Relocation Services, Inc. v. Burtch (In re AE Liquidation, Inc.), 2015 WL 5301553 (D. Del. Sept. 10, 2015).**

Subsequent New Value
Bankruptcy Code § 547(c)(4)

- **Subsequent New Value**

Section 547(c): The trustee may not avoid a transfer –

(4) to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor --

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

- **Unpaid Invoices (identified sometimes by proofs of claim)**
  - **Always count as subsequent new value**
- **Paid Invoices subsequent to "preference" payment**
  - **Split in jurisdictions whether paid invoices count as new value**

Subsequent New Value
Bankruptcy Code § 547(c)(4)

- **If the amount of new value equal or exceeds the prior avoidable transfer a negative number cannot be carried forward as a defense against a subsequent transfer**
  - In re Chez Foley, Inc., 211 B.R. 25 (Bankr. D. Minn. 1997); In re Winter Haven Truss Co., 154 B.R. 592 (Bankr. M.D. Fla. 1993)

- **Split of authorities whether or not the subsequent new value must remain unpaid for purposes of § 547(c)(4)**
  - Majority View (3rd, 4th, 5th, 6th, 8th, 9th and 10th circuits) allow defendants to assert both paid and unpaid new value
  - Minority View (1st, 2nd, 7th and 11th circuits) allow only unpaid new value to be asserted as a defense

Subsequent New Value
Bankruptcy Code § 547(c)(4)

- **New value must come from defendant ("such" creditor) unlike contemporaneous exchange defense where new value which may come from 3rd party**
- **Indirect New Value: the new value to the debtor need not be direct; it may come to the debtor indirectly through a debtor subsidiary**
  - Rubin v. Mfrs. Hanover Trust Co., 661 F.2d 979, 991-92 (2d Cir. 1981) (recognizing new value given to a 3rd party may confer economic benefit upon and preserve debtor's net worth)
  - In CareerCom, Corp. v. U.S. Dep't of Educ., 215 B.R. 674 (Bankr. M.D. Pa. 1997) (finding new value need not be direct benefit to subsidiary debtor who may partake of benefit indirectly)

When Did I Get Paid? When Did I Give "Something For Nothing"?

- **A preferential transfer occurs on the date that the check clears the bank or a wire is issued.**
- **Unlike payments, New Value is generally counted on the day services are provided or goods are shipped to the debtor.**

Subsequent New Value Analysis – Remains Unpaid

Transaction Date	Transaction Type	Transaction Amount	Allowed New Value	Net Preference Claim
4/1/2014	Check	$1,000		$1,000
4/15/2014	Invoice	$1,000	$0 (due to fact invoice was paid by 4/28 check)	$1,000
4/28/2014	Check	$1,000		$2,000
5/14/2014	Invoice	$1,000	$0 (due to fact that invoice was paid by 5/28 check)	$2,000
5/28/2014	Check	$1,000		$3,000
6/15/2014	Invoice	$1,000	$1,000 (invoice not paid)	$2,000

Subsequent New Value Analysis – Subsequent Advance Approach

• Transaction Date	• Transaction Type	• Transaction Amount	• Allowed New Value	• Net Preference Claim
• **4/1/2014**	• **Check**	• **$1,000**		• **$1,000**
• **4/15/2014**	• **Invoice**	• **$1,000**	• **$1,000**	• **$0**
• **4/28/2014**	• **Check**	• **$1,000**		• **$1,000**
• **5/14/2014**	• **Invoice**	• **$1,000**	• **$1,000**	• **$0**
• **5/28/2014**	• **Check**	• **$1,000**		• **$1,000**
• **6/15/2014**	• **Invoice**	• **$1,000**	• **$1,000**	• **$0**

Contemporaneous Exchange
Bankruptcy Code § 547(c)(1)

- **Defense applies when the transfer was intended by the debtor and creditor to be a contemporaneous exchange for new value given to the debtor by the creditor and was in fact a substantially contemporaneous exchange. See Dietz v. Calandrillo (In re Genmar Holdings, Inc.), 776 F.3d 961 (8th Cir. 2015).**
- **The most common example of this is a cash on delivery transaction.**
- **New value is defined by the Bankruptcy Code to include money or monies worth in goods, services, new credit, or release of property previously transferred, but it does not include an obligation substituted for an existing obligation.**
- **"substantially contemporaneous" is a flexible concept requiring a case by case inquiry.**

Contemporaneous Exchange
Bankruptcy Code § 547(c)(1)

- **A transaction can be substantially contemporaneous even if some temporal separation exists; generally transfers within a range of 1 to 14 days may be "substantially contemporaneous" if there is requisite intent to be contemporaneous and there is a good reason for the delay**
- **New value may come from a 3rd party (not defendant)**
  - **Jones Truck Lines, 130 F.3d 323, 327 (8th Cir. 1997) (noting § 547(c)(1) allows 3rd party to deliver contemporaneous new value)**
  - **Manchester v. First Bank & Trust Co. (In re Moses), 256 B.R. 641, 652 (B.A.P. 10th Cir. 2000) (same)**

Enabling Loan Exception
Bankruptcy Code § 547(c)(3)

- **A lien in the debtor's property cannot be avoided to the extent the lien secures new value given at or after the signing of the security agreement to enable the debtor to acquire the property**
- **The lien must be perfected on or before <u>30 days</u> after it became effective (i.e. attached to the property) to apply**
- **Note: under UCC § 9-317(e), a PMSI or purchase money security interest is entitled to super-priority if perfected within 20 days after the debtor receives possession of the property**

No Improvement in Secured Position
Bankruptcy Code § 547(c)(5)

- **Trustee may not avoid a transfer of a perfected lien in inventory, receivables or proceeds, except to the extent it improved the secured creditor's collateral position in the 90 days prior to the petition date, which prejudices other creditors holding unsecured claims.**

- **For non-insiders, this exception only applies to the transfer of a perfected lien for the benefit of that creditor during the 90 days preceding the bankruptcy filing.**

Small Preference Safe Harbor
Bankruptcy Code § 547(c)(8) and (9)

- **The Bankruptcy Code provides defendants with a complete defense to a preference where the aggregate value of the challenged transfers is less than (i) $6,225* for primarily non-consumer debts, and (ii) $600 for primarily consumer debts. 11 U.S.C. § 547(c)(8)-(9).**
- **Amount subject to adjustment every 3 years by the Judicial Conference.**
- **ABI Commission to Study the Reform of Chapter 11 recently recommended that the Bankruptcy Code be amended to increase cap to $25,000 for non-consumer debts.**
- **Transfers may need to be related to same antecedent debt to be aggregated to meet threshold. Slobodian v. U.S. (In re Net Pay Solutions, Inc., (3d Cir. 2016).**

Venue of Proceedings
28 U.S.C. § 1409(b)

- **An adversary complaint seeking to avoid aggregate transfers of less than (i) $12,475* for primarily non-consumer debts, and (ii) $18,675* for primarily consumer debt, must be commenced in the district court in which the non-insider defendant resides**
- **Subject to adjustment every 3 years by the Judicial Conference**
- **ABI Commission to Study the Reform of Chapter 11 recently recommended that the Bankruptcy Code be amended to increase amount to $50,000.**

APPLICATION OF SPECIFIC STATUTORY AND NON-STUATORY PREFERENCE DEFENSES

Payments to Corporate Insiders

- **§ 547(b)(4) extends the preference period to one year prior to the petition date for insiders.**
- **§ 101 (31) defines "Insider" with a non-exhaustive list, including directors, officers, persons in control, general partners, or relatives.**

Payments to Corporate Insiders

- **Definition leaves room for argument.**
- **Some institutions have many people that may technically be considered "officers" – there is potential to argue that they are not "officers" for one year lookback if not in control. It is possible to have a title and not be an "insider". In re NMI Sys., 179 B.R. 357 (Bankr. D.C. 1995).**
- **Potential to be a "non-statutory insider". In re U.S. Medical, 537 F.3d 1272 (10th Cir. 2008).**
- **There will be a focus on whether or not transactions were at arms-length.**

Payments to Corporate Insiders

- **Insiders will often seek a release in a confirmed plan. (potential for defense costs)**
- **Corporation could be responsible for indemnifying the directors and officers.**
- **Payments that would be preferences to insiders often will also have a fraudulent conveyance/fraudulent transfer component.**
- **Presumption of insolvency only for 90 day period. (difficult to prove otherwise)**
- **Possible exposure when insider is guarantor of payment made to non-insider creditor (non-insider creditor is insulated by § 547(i)**

Earmarking Defense

- **New funds "earmarked" to pay a certain creditor**
- **Based on the theory that there was diminution of the debtor's assets available to pay creditors, because no property interest of the debtor was transferred**
- **Some Circuits uses 3 part test: (i) agreement between debtor and 3rd party that new funds will be used to pay specific debt; (ii) agreement performed, (iii) no diminution**
- **Some courts impose additional requirement that debtor must not have exercised control over the funds**

Earmarking Defense

- **New creditor using its own funds to step into shoes of former creditor with no net impact on estate**
  - In re Kalmar, 276 B.R. 214 (Bankr. S.D. Ohio 2002); In re Messamore, 250 B.R. 913 (Bankr. S.D. Ill. 2000)
- **Defense does not apply if debtor simply borrows money to pay a debt of its own choosing**
  - In re Neponset River Paper Co., 231 B.R. 829 (1st Cir. B.A.P. 1999); *In re Cox & Schepp, Inc.*, 523 B.R. 511 (Bankr. W.D.N.C. 2014)
- **Defense may apply if new creditor steps into secured position occupied by former creditor, but not if secured debt replaces unsecured debt**
  - In re Heitkamp, 137 F.3d 1087 (8th Cir. 1998)
- **Earmarking is strictly construed and the estate must not have ability to disburse funds other than as allegedly earmarked. In re Vaso Active Pharmaceuticals., Inc., 537 B.R. 182 (D. Del. 2015).**

Earmarking Defense

- **For example, a subcontractor on a construction project may have a lien on a building for payment of the work he did. The subcontractor gets paid and releases the lien. The subcontractor is unaware that the money he received came from a bank who has a mortgage on the building. In fact, the bank released funds to the debtor in order for the subcontractor to be paid and his lien released. One secured creditor (the bank) was substituted for another secured creditor (the subcontractor who had a lien). By virtue of the earmarking defense there is no preferential payment.**

Mere Conduit Defense

- **Defendant may not be held liable as a transferee of a preference if was a mere conduit; if the funds or property in question merely passed through that party's hands**
  - In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey, 130 F.3d 52 (2d Cir. 1997) (debtor's insurance broker was a mere conduit for insurance premiums)
  - In re Reeves, 65 F.3d 670 (8th Cir. 1995); In re Bullion Reserve of N. Am., 922 F.2d 544 (9th Cir. 1991) (party must have exercised dominion and control over the property to be liable as transferee)
  - In re Chase & Sanborn Corp., 848 F.2d 1196 (11th Cir. 1988) (bank was a mere conduit and had no right of control over or beneficial interest in funds transferred)

EARMARKING v. CONDUIT

	Conduit Defense	Earmarking Defense
Funds/Property Flow	Debtor ->Defendant->Third Party	Third Party->Debtor->Defendant
Defendant's Argument Concerning "Transfer"	Debtor->Third Party	Third Party -> Defendant
Underlying Concept	Defendant was not an initial transferee or an immediate or mediate transferee of the initial transferee	Transfer was not of property in which debtor had an interest
Inquiry	Was defendant merely acting as a non-stakeholder intermediary in the transfer of property from the debtor to a third party?	Did payment/transfer of property result merely in substitution of a new creditor for an old creditor and, accordingly, did not increase debtor's liabilities or reduce the debtor's assets?

EARMARKING v. CONDUIT CONTINUED

	Conduit Defense	Earmarking Defense
Elements	Either (1) the defendant did not have the ability to redirect the transferred funds; or (2) the defendant had a duty or obligation to a third party that prohibited defendant's use of the funds on his own account prior to transfer.	The 4 elements are (1) the existence of agreement between new creditor and debtor conditioning new funds on use to pay antecedent creditor, (2) new creditor advances funds, (3) new credit is at same or lesser priority as antecedent debt of creditor being paid, and (4) in some jurisdictions, payments the defendant received be traceable back to payments made by the new creditor.

EARMARKING v. CONDUIT CONTINUED

	Conduit Defense	Earmarking Defense
Key Document	Agreement of defendant with third party	Agreement of third party with debtor
Who is “Initial Transferee”	Third Party for whom defendant acted as agent	There is no “Initial Transferee” since no “Transfer” by debtor occurred
Applicable Bankruptcy Code Sections	550	547(b)
Affirmative Defense	No – Relates to Prima Facie Case	No – Relates to Prima Facie Case
Who has knowledge of defense	The defendant necessarily has the information forming basis for the conduit defense. Plaintiff may not be aware of the existence of or terms of the agency relationship between the defendant and the actual initial transferee	Debtor will have knowledge of the factual basis for the earmarking defense. Debtor must have made agreement with third party providing debtor funds/property to satisfy obligation to defendant. In fact, the defendant may have no knowledge whatsoever of the agreement between the debtor and the ultimate source of the funds used to pay the defendant.

Assumed Contract Defense

- **In the Matter of Superior Toy & Manufacturing., *Inc.*, 78 F.3d 1169, 1174 (7th Cir. 1996) court held that "a chapter 7 trustee cannot bring a preference suit to recoup payments made pursuant to a validly assumed executory contract."**

- ***Superior Toy* has been followed in most jurisdictions including the Delaware. Ramette v. BCBSM, Inc. (In re Electronics Technology Group, Inc.), 1997 WL 631067 (Bankr. D. Minn. 1997);Guiliano v. Almond Investment Co. (In re Carolina Fluid Handling Intermediate Holding Corp.)., 467 B.R. 743 (Bank. D. Del. 2012).**

Critical Vendor Defense

- **Critical vendor order should expressly waive preference claims and give creditors, such as a committee, notice and an opportunity to object.**
  - **In re Primary Health Sys., Inc., 275 B.R. 709 (Bankr. D. Del. 2002) (dismissing preference claim due to prior order authorizing debtor to pay pre-petition claims to creditor)**
  - **In re Zenith Industrial Corp., 319 B.R. 810, 814 (Bankr. D. Del. 2005) (rejecting critical vendor defense as too speculative)**
  - **In re Fultonville Metal Products Co., 330 B.R. 305 (Bankr. M.D.Fla. 2005) (finding fact issues precluded summary judgment on critical vendor defense, including whether order contemplated waiver and creditors had opportunity to object)**

Involuntary Bankruptcy Issues

- **Creditors who seek to have a debtor placed in involuntary bankruptcy should consider whether they will face any preference exposure from a future trustee and whether that risk is worth the potential benefits of the involuntary.**
- **Counsel who represent a petitioning creditor should also disclose these risks to other creditors seeking to join in the petition, or at the very least should make it very clear in written communications who the client is and who is receiving legal advice about the filing of an involuntary.**

Effect of § 503(b)(9) on New Value

- **§503(b)(9) generally provides an administrative claim for the value of goods received by a debtor within 20 days of the petition date**
- **§547(c)(4) limits the new value defense to situations where the creditor gave new value "on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;"**
- **Is the §503(b)(9) claim an otherwise unavoidable transfer made by the debtor to the creditor?**

Effect of § 503(b)(9) on New Value

- **Some courts are concerned that creditors will "double dip" from the estate by making a section 503(b)(9) administrative claim for the value of goods received within twenty days before a debtor's filing *and* asserting a new value defense for those same goods in an adversary proceeding. In re Circuit City Stores, Inc., 515 B.R. 302 (Bankr. E.D.Va. 2014).**

- **At least one court in favor of allowing double-dipping has reasoned that prohibiting double dipping would compel creditors to choose between exercising their rights to assert section 503(b)(9) administrative expense claims or preserving their new value defenses. Forcing creditors to make that choice could chill their willingness to do business with troubled entities. In re Commissary Operations, Inc., 421 B.R. 873 (Bankr. M.D.Tenn. 2010).**

Effect of Reclamation on New Value

- **Reclamation (a seller's right to reclaim goods) is a state law-based claim codified in section 2-702(2) of the Uniform Commercial Code.**
- **Once a buyer files bankruptcy, Section 546(c) preserves this right but provides additional requirements that a seller must comply with to enforce its reclamation rights in the bankruptcy proceeding.**
- **New value given by a creditor must be reduced to reflect its reclamation claim (because the new value given to the debtor prepetition must be discounted to reflect the right of reclamation preserved by Section 546(c)). In re Phoenix Rest. Grp., Inc., 2004 WL 3113719 (Bankr. M.D.Tenn. Dec. 16, 2004)**
- **Impact of superior liens on the inventory impacts the value of the reclamation claim**

Effect of Critical Vendor Payments on New Value

- **Courts are divided on the issue of whether creditors that are repaid post-petition under critical vendor orders can assert a new value defense for the related invoices.**

Effect of Critical Vendor Payments on New Value

- **Wage orders treated similar to critical vendor orders. In re Friedman's, 55 Bankr. Ct. Dec. 228 (Bankr. D. Del. Nov. 30, 2011).**
  - **Roth provided temporary staffing services.**
  - **Roth received $81,997 during the preference period.**
  - **Roth provided an additional $100,660 of services during the preference period that were not paid.**
  - **Roth was paid $72,412 postpetition pursuant to an employee wage order.**
  - **Liquidating trust argued that the postpetition payment reduced the new value defense.**

Effect of Critical Vendor Payments on New Value

- **Freidman's (cont.).**
  - **Bankruptcy Court (Judge Sontchi) held that the preference analysis becomes fixed on the petition date under New York City Shoes, Inc. v. Bentley Int'l Inc., 880 F.2d 679 (3d Cir. 1989) and thus new value defense not impacted by wage order payments.**
  - **Third Circuit found New York City Shoes references to be dicta, but affirmed based on the plain meaning of the statute. 738 F.3d 547.**
  - **Third Circuit's plain meaning analysis rested on context and policy of the code, as opposed to the specific language of the section.**
  - **Third Circuit acknowledged that other courts divided.**

Can an Administrative Expense Claim be Used to Offset Preference Liability

- **In re Quantum Foods**
- **Setoff or Disguised New Value**
- **Analyzing the Setoff**
- **502(d) Analysis**

Transactions Impacting Preferences

- **Preferences can be impacted by plans of reorganization or sales under section 363 of the Bankruptcy Code.**
- **The largest trade creditors are likely the most significant preference targets.**
- **These same parties are likely to have an opportunity to sit on a creditors' committee.**
- **The creditors' committee (or significant trade creditors) can influence whether preferences are retained in a sale or plan.**

Targets of Preferences

- **Increasingly professionals are becoming the targets of preference actions.**
- **Lawyers, accountants, and other professionals historically have erratic payment histories that don’t lend themselves well to ordinary course of business defenses.**
- **Receivables should be managed to the extent possible.**
- **Retainers can be managed to limit preference exposure.**

Claim Waivers under 502(h)

- **Return of preference funds entitles creditor to §502(h) claim.**
- **Trustees/debtors will seek a waiver of all claims, including §502(h).**
- **Value of 502(h) claim needs to be considered in preference settlements.**

Claim Waivers under 502(h)

- **Valuing 502(h) Claims**
  - **Method of payment of unsecured claims will be set forth in the plan.**
    - **Often difficult to estimate**
  - **Disclosure statements will often have a range of recovery**
  - **If other settlements are public defendants can share information on valuation**
  - **Claims traders will often have market for claims – floor on value**
  - **Causes of action may have progressed to a point where they can be valued**
  - **Operating reports**

Section 502(d) of the Bankruptcy Code

- **Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(i), 542, 543, 550, or 553 of this title.**

Section 502(d) of the Bankruptcy Code Continued

- **Alfred T. Giuliano v. Mitsubishi Digital Electronics America, Inc. d/b/a Mitsubishi Digital Electronics (In re Ultimate Acquisition Partners, LP, et. al.) (Adv. Proc. No. 11-52663 (MFW)).**
- **A debtor or trustee "wishing to avail itself of the benefits of section 502(d) must first obtain a judicial determination on the preference complaint."**
- **Consider raising at motion to dismiss stage.**
- **Difference of opinions as to how far the action needs to have progressed before 502(d) is applicable.**

Settlement Payments Defense
Bankruptcy Code § 546(e)

Section 546(e) of the Bankruptcy Code provides a safe harbor from the avoidance by a bankruptcy estate representative of certain transfers made by or to, *inter alia*, a stockbroker, financial institution, or securities clearing agency, except in cases alleging an *actual* intent fraudulent transfer under Section 548(a)(1)(A) of the Bankruptcy Code.

Section 546(e): "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 margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), commodity contract, as defined in section 761(4), or forward contract, that is made before the commencement of the case, except under section 548(a)(1)(A) of this title."

Settlement Payments Defense
Bankruptcy Code § 546(e)

- **Congress enacted section 546(e)'s safe harbor in 1982 as a means of "minimiz[ing] the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries." Enron Creditors Recovery Corp. v. Alfa S.A.B. de C.V., 652 F.3d 329, 334 (2d Cir. 2011). (quoting H.R. Rep. 97–420, at 2 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583).**

Settlement Payments Defense
Bankruptcy Code § 546(e)

- *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F.3d 329 (2d Cir. 2011):

- **Prior to filing for chapter 11 on December 2, 2001, in New York, Enron paid more than $1.1 billion to retire certain of its unmatured, unsecured, and uncertified commercial paper.**

- **Debtor brought adversary proceeding to avoid redemption payments on preference and fraudulent transfer theories.**

- **Enron argued that the redemption payments were not "settlement payments" under section 546(e) of the Bankruptcy Code because: (i) the payments were not "commonly used in the securities trade," as required by the definition of "settlement payment" in section 741(8) of the Bankruptcy Code; (ii) the redemption payments were made to retire debt and not to acquire title to commercial paper, meaning no title to the securities changed hands, as required for a transaction to be considered a "settlement payment"; and (iii) the payments did not involve a financial intermediary that took title to the securities, and therefore they did not create the risks to the financial markets that prompted Congress to enact the safe-harbor provisions.**

Settlement Payments Defense
Bankruptcy Code § 546(e)

- *In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013)
- Unsecured creditors committee sought to avoid and recover, as a preferential transfer, prepetition payments ($376 million) received by institutional noteholders in connection with debtors' repurchase and subsequent cancellation of privately-placed notes.

  "In *Enron*," "we cited the Third, Sixth, and Eighth Circuits' decisions with approval and concluded that 'the absence of a financial intermediary that takes title to the transacted securities during the course of the transaction is [not] a proper basis on which to deny safe-harbor protection.' " "To the extent *Enron* left any ambiguity in this regard," Judge Chin ruled, "we expressly follow the Third, Sixth, and Eighth Circuits in holding that a transfer may qualify for the section 546(e) safe harbor even if the financial intermediary is merely a conduit."

Settlement Payments Defense
Bankruptcy Code § 546(e)

- *In re Bernard L. Madoff Inv. Securities LLC*, 773 F.3d 411 (2d Cir. 2014)
  - Trustee appointed in liquidation under Securities Investor Protection Act of business of registered securities brokerage firm who sought to recapture prior transfers made by broker-dealer to customers.
  - Because Sections 546(e) and 741(7) (defining "securities contract") do not contain a purchase or sale requirement, whether or not Madoff's broker-dealer actually transacted in securities is not determinative. Section 546(e) only requires that a transfer be broadly related to a "securities contract," not that it be connected to an actual securities transaction.

Settlement Payments Defense
Bankruptcy Code § 546(e)

· There are decisions in the Third, Sixth, and Eighth Circuits that apply the safe harbor to leveraged buyouts of *private* companies and where transactions involve financial intermediaries who served only as conduits. *See In re Plassein Int'l Corp.*, 590 F.3d 252, 257–59 (3d Cir. 2009); *In re QSI Holdings, Inc.*, 571 F.3d 545, 549–50 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986 (8th Cir. 2009).

· In contrast, the 7th and 11th Circuits have held that the safe harbor did not apply in the context of an LBO transaction where the bank merely acted as a conduit. *FTI Consulting Inc. v. Merit Mgmt. Grp., LP,* 830 F.3d 690 (7th Cir. 2016) (discussed on slide 35 *infra*); Munford *v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996).

Settlement Payments Defense
Bankruptcy Code § 546(e)

In re Tribune Co. Fraudulent Conveyance Litigation, Nos. 13– 3992–cv, 13–3875–cv, 13–4178–cv, 13–4196–cv, 2016 WL 1226871 (2d Cir. Mar. 29, 2016)

Facts:

·LBO resulted in $8 billion cash-out of Tribune Media Company's ("Tribune") shareholders. The funds were first transferred to financial intermediaries who then made distributions to shareholders for their shares. Tribune filed for bankruptcy within a year of LBO.

Settlement Payments Defense
Bankruptcy Code § 546(e)

- In the *Tribune* case, representatives of the Tribune bankruptcy estate sued Tribune's former shareholders to avoid payments the shareholders received during the Company's 2007 leveraged buyout. The estate representatives pursued intentional fraudulent conveyance claims, but did not assert claims for constructive fraudulent conveyance because Bankruptcy Code Section 546(e) barred the "trustee" from bringing such claims. Instead, individual creditors of Tribune subsequently filed state law constructive fraudulent conveyance claims in hundreds of lawsuits in more than twenty courts; the cases were consolidated in the U.S. District Court for the Southern District of New York before Judge Richard J. Sullivan.
- Noting that the text of the statute is ambiguous as to whether claims brought by someone other than a trustee or other estate representative are precluded, the Circuit looked to the structure of the Bankruptcy Code and legislative history to determine that the congressional purpose of the statute was fatally at odds with the appellants' theory. The Circuit identified the congressional purpose of Section 546(e) to be the promotion of certainty, speed, finality, and stability in the securities markets. Therefore, the Circuit wrote, "the idea of preventing a trustee from unwinding the specified transactions while allowing creditors to do so, but only later, is a policy in a fruitless search of a logical rationale."

Settlement Payments Defense
Bankruptcy Code § 546(e)

·*PAH Litig. Trust v. Water St. Healthcare Partners L.P. (In re Physiotherapy Holdings, Inc.),* 2016 WL 3611831, No. 15-51238 (Bankr. D. Del. June 20, 2016)

Facts:

·The *Physiotherapy* adversary proceeding arose out of a reverse merger transaction that resulted in, among other things, the payment of approximately $248.6 million to certain selling shareholders of Physiotherapy Holdings, Inc. After the transaction closed, Physiotherapy's new owners investigated accounting disparities, and Physiotherapy's income and adjusted EBITDA deteriorated. In April 2013, Physiotherapy defaulted on the senior notes issued in connection with the merger transaction, and in November 2013, Physiotherapy initiated its bankruptcy case.

·Litigation Trustee (as assignee of the bankruptcy estate claims as well as the noteholders' claims) brought state and federal fraudulent transfer claims against former controlling private equity sponsors and certain other minority shareholders of the debtors to recover payments made to the shareholders in connection with the LBO of the debtors.

Settlement Payments Defense
Bankruptcy Code § 546(e)

Facts (cont'd):

·The Litigation Trustee argued, among other things, that: (i) Section 546(e) is inapplicable to state law fraudulent transfer claims assigned by the noteholders to a litigation trust post-confirmation; (ii) the payments to shareholders were not "settlement payments" or "securities transactions" because they received certificates redeemable for cash prior to consummation of the LBO, and such certificates were not securities; and (iii) Section 546(e) does not apply to the sponsor defendants because they were allegedly complicit in the fraud.

Opinion:

· **With respect to the policies underlying the safe harbors, the *Physiotherapy* Court stated that "both the written decisions and legislative history suggest that sections 546(e) and 546(g) were enacted to further augment the protections against systemic risk codified in the initial safe harbors." The *Physiotherapy* Court expressly disagreed with the Second Circuit's conclusion that one purpose of the safe harbors is promoting finality for individual investors. Instead, the *Physiotherapy* Court concluded that mitigating systemic risk is the purpose of the safe harbors.**

Settlement Payments Defense
Bankruptcy Code § 546(e)

·**Opinion (cont'd)**

· Second, the *Physiotherapy* Court addressed the argument that Section 546(e) does not bar the state law constructive fraudulent conveyance claims because the claims are brought on behalf of creditors, not on behalf of the "trustee." The *Physiotherapy* Court noted that other provisions of the Bankruptcy Code expressly apply to parties other than the trustee, and expressly preempt state law by incorporating phrases such as "notwithstanding any applicable law.

· Third, the *Physiotherapy* Court indicated that the alleged bad faith of the defendants "implicated additional policy concerns relevant to the preemption analysis" and the Court did "not believe that Congress intended to protect bad-faith transferees in situations such as this."

Settlement Payments Defense
Bankruptcy Code § 546(e)

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

Facts:

·The debtors, a racetrack operator and its affiliates, merged with a competitor by acquiring all of the competitor's shares in exchange for $55 million. The debtors borrowed money from Credit Suisse and other lenders to fund the acquisition. Thereafter, following the racetrack operator's failure to obtain a gambling license, the debtors filed for bankruptcy protection.

·The exchange of the $55 million for the shares took place through Citizens Bank of Pennsylvania, the escrow agent for the transaction.

·FTI Consulting, Inc., as litigation trustee, brought suit against one of the significant former shareholders, alleging that the debtors' transfer of approximately $16.5 million (30% of the $55 million), was an avoidable transfer under Sections 544, 548(a)(1)(B) and 550 of the Bankruptcy Code.

Settlement Payments Defense
Bankruptcy Code § 546(e)

Facts (cont'd):

·The defendants asserted that the transfer was protected by Section 546(e) as a "settlement payment" made "in connection with a securities contract" because the funds transferred to the defendants passed through Citizens Bank and Credit Suisse.

·The trustee argued that Section 546(e) was not applicable to transactions simply conducted through financial institutions (or other enumerated entities named in Section 546(e)), where the entity is neither the debtor nor the transferee but only the conduit.

·The district court agreed with the defendants' argument and granted judgment on the pleadings in their favor.

Settlement Payments Defense
Bankruptcy Code § 546(e)

Opinion:

·The United States Court of Appeals for the Seventh Circuit reversed the district court's decision on appeal, concluding that Section 546(e) does not provide a safe harbor against the avoidance of transfers where the purported enumerated entity referenced in Section 546(e) merely acts as a conduit for the non-enumerated entities.

·As an initial matter, the court found that the plain language of Section 546(e), namely, the clause "by or to (or for the benefit of)" was ambiguous since it was unclear whether the provision would apply to intermediaries that facilitate a given transaction on behalf of the "real parties in interest."

Settlement Payments Defense
Bankruptcy Code § 546(e)

Opinion:

·The court then reviewed similar provisions in the Bankruptcy Code and the legislative history, and ultimately concluded that they supported a narrow reading of Section 546(e), notwithstanding the fact that five federal circuit courts, including the Second and Third Circuits, had interpreted Section 546(e) to include the conduit situation.

·On May 1, 2017, the U.S. Supreme Court granted the defendant's cert petition to decide the conflict in the circuits on the "conduit" issue.