



Ambiguity and Bad Policy: Should Sec. 546(e) of the Bankruptcy Code be Applied to Leveraged Buyouts of Private Companies?

Stephen E. Schilling

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Ambiguity and Bad Policy: Should § 546(e) of the Bankruptcy Code be Applied to Leveraged Buyouts of Private Companies?

*Stephen E. Schilling**

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* J.D. University of Dayton School of Law, 2010; B.A. University of Pittsburgh, 1992. The author works in Cincinnati, Ohio, as a Judicial Law Clerk for the Honorable Michael R. Barrett, United States District Judge, Southern District of Ohio. Special thanks are due to Professor Jeffrey W. Morris, Samuel A. McCray Chair in Law, University of Dayton School of Law. His help, guidance, and inspiration made this paper possible.

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I. INTRODUCTION

Ever since corporate raiders of the 1980s first used leveraged buyouts (LBOs) to take over public companies there has been tension about the morality, business sense, and legality of LBOs.¹ From their controversial beginnings, a debate has raged over whether LBOs are fraudulent transfers.² This debate has played out in the legal arena of bankruptcy courts, which have long considered LBOs to be potentially fraudulent conveyances.³ This debate has continued for at least twenty-five years, and it endures to this day with no sign of resolution.⁴ One of the most recent and interesting battles in this long-run-

1. Steven N. Kaplan, *The Evolution of U.S. Corporate Governance: We Are All Henry Kravis Now*, 1 J. PRIVATE EQUITY 7, 7 (1997).

2. See generally Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985); David Gray Carlson, *Leveraged Buyouts in Bankruptcy*, 20 GA. L. REV. 73 (1985).

3. See *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1291 (3d Cir. 1986), cert. denied, 483 U.S. 1005 (1987) ("[T]his case represents the first significant application of the UFCA to leveraged buy-out financing.").

4. See *id.*

ning war is the Sixth Circuit's decision *QSI Holdings, Inc. v. Alford (QSI III)*.⁵

Throughout most of the 1990s, the burning question was whether Bankruptcy Code § 546(e)⁶ could protect LBOs of public companies from being overturned as fraudulent transfers.⁷ That battle is nearly over, and the pro-LBO forces are winning. Today, in a majority of circuits that have considered the question, § 546(e), which provides that a transfer that is a settlement payment made by or to a stockbroker or a financial institution may not be avoided,⁸ has been held to bar trustees from overturning LBOs as constructively fraudulent conveyances.⁹ The next phase of the war is the battle over whether § 546(e) applies to LBOs of private companies.

As recently as 1999, it was unclear whether § 546(e) could protect an LBO of a privately held corporation.¹⁰ In fact, at that point the trend was that § 546(e) did *not* shield LBOs of private companies. The only two cases to directly consider the question both held that

5. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010). The story of *QSI Holdings* was told in three separate opinions from three courts: *Quality Stores, Inc. v. Alford (In re Quality Stores, Inc.) (QSI I)*, 355 B.R. 629 (Bankr. W.D. Mich. 2006); *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731 (W.D. Mich. 2007); and *QSI III*, 571 F.3d 545.

6. Unless otherwise noted, all statutory citations are to the Bankruptcy Code, Title 11 of the United States Code. 11 U.S.C. (2006).

7. See, e.g., *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990); *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992); *Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322 (9th Cir. 1992); *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505 (3d Cir. 1999), *cert. denied*, 528 U.S. 1021 (1999); *Wieboldt Stores, Inc. ex rel. Raleigh v. Schottenstein (In re Wieboldt Stores, Inc.)*, 131 B.R. 655 (N.D. Ill. 1991); *Jewel Recovery, L.P. v. Gordon (In re Zale Corp.)*, 196 B.R. 348 (N.D. Tex. 1996); *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 195 B.R. 971 (Bankr. D. Mass. 1996).

8. 11 U.S.C. § 546(e) (2006).

9. Based strictly on appellate court cases (no district or bankruptcy court cases) that specifically have applied § 546(e) to LBOs (and not to swap agreements, forward contracts, etc.) the current circuit split breaks down as follows. Applying § 546(e) to shield LBOs of *private* companies are the Third (*Brandt v. B.A. Capital Co. (In re Plassein Int'l Corp.)*, 590 F.3d 252 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 2389 (2010)), Sixth (*QSI III*, 571 F.3d 545), and Eighth Circuits (*Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986 (8th Cir. 2009)). The Tenth Circuit (*In re Kaiser Steel*, 952 F.2d 1230) has applied § 546(e) to shield LBOs of *public* companies. Only the Eleventh Circuit (*Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604 (11th Cir. 1996), *cert. denied*, 522 U.S. 1068 (1998)) has ruled that § 546(e) is not available to shield *public or private* LBOs. The First, Second, Fourth, Fifth, Seventh, and Ninth Circuits, along with the District of Columbia and Federal Circuits, have heard no cases applying § 546(e) to LBOs (although some have applied § 546(e) in other situations).

10. Mark J. Thompson, *In Re Resorts International, Inc.: Third Circuit Effectively Bars Application of Fraudulent Conveyance Statute to Payments to Public Shareholders in Leveraged Buyouts*, SIMPSON THACHER & BARTLETT LLP, Aug. 4, 1999, at 5, available at <http://www.stblaw.com/content/publications/pub393.pdf>.

§ 546(e) did not apply to privately held entities.¹¹ But since then, there has been a significant shift in the law. What happened in *QSI*—§ 546(e) being applied to the LBO of a closely held corporation¹²—is a relatively recent development in the long battle between LBOs and § 546(e).¹³

The issue in *QSI* was “whether § 546(e) of the Bankruptcy Code applies to privately traded securities.”¹⁴ This was an issue of first impression for the Sixth Circuit.¹⁵ Finding no difference in the Code between publicly and privately traded securities, the Sixth Circuit held that § 546(e) applies to privately traded securities.¹⁶

When deciding whether § 546(e) should be applied to LBOs of privately held entities, three questions arise: Is the Sixth Circuit’s holding justified by the statutory language? Is it justified by congressional intent? And, is it good public policy? The applicability of § 546(e) to LBOs of privately held entities based on the statutory language and congressional intent is ambiguous. Furthermore, it is bad public policy. Because statutory language and congressional intent do not yield a definitive answer, policy should be the deciding factor.

Part II of this paper sets out the history and legally significant details of LBOs and concludes with an analysis of all three *QSI* decisions. Part III investigates the three issues of this paper’s thesis: (1) whether the statutory language justifies applying § 546(e) to LBOs of private companies; (2) whether congressional intent justifies applying § 546(e) to LBOs of private companies; and (3) whether applying

11. *Jewel Recovery*, 196 B.R. at 353 (“[Section] 546(e) does not apply to this [private] transaction . . .”); *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 677 (D.R.I. 1998) (“Private transactions lack the impact on the public market trading systems that Congress intended to protect by § 546(e).”). Even as late as 2003 it appeared that an LBO of a privately held company would never be protected by § 546(e). Official Comm. of Unsecured Creditors v. Asea Brown Boveri, Inc. (*In re Grand Eagle Cos., Inc.*), 288 B.R. 484, 494–95 (Bankr. N.D. Ohio 2003).

12. *QSI III*, 571 F.3d at 547 (“[W]e now hold . . . that § 546(e) is not limited to publicly traded securities but also extends to transactions . . . involving privately held securities.”).

13. Although it is not widely recognized (it may not be recognized at all), the first published decision to apply § 546(e) to an LBO of a private company was from April 7, 2005. *Loranger Mfg. Corp. v. PNC Bank (In re Loranger Mfg. Corp.)*, 324 B.R. 575, 585–86 (Bankr. W.D. Pa. 2005). However, this case was not a traditional LBO—it was more of a leveraged stock buyback. *Id.* at 578. The company borrowed money to redeem the shares of one of its owners. *Id.* It fit the mold of an LBO case nonetheless. Other cases applying § 546(e) to LBOs of private companies quickly followed. See, e.g., Official Comm. of Unsecured Creditors v. Clark (*In re Nat’l Forge Co.*), 344 B.R. 340 (W.D. Pa. 2006). *National Forge* was decided a mere four months before the Western District of Michigan Bankruptcy Court offered the first *QSI* decision. *Quality Stores, Inc. v. Alford (In re Quality Stores, Inc.) (QSI I)*, 355 B.R. 629 (Bankr. W.D. Mich. 2006) (Oct. 26, 2006).

14. *QSI III*, 571 F.3d at 547.

15. *Id.*

16. *Id.*

§ 546(e) to LBOs of private companies is good public policy. Part III concludes that because the statutory language and congressional intent is ambiguous, the wisest policy choice should control, and § 546(e) should not be applied to LBOs of private companies.

II. BACKGROUND

A. *What is an LBO?*

In a leveraged buyout, “a company is sold to a small number of investors, typically including members of the company’s management, under financial arrangements in which there is a minimum amount of equity and a maximum amount of debt.”¹⁷ Stated more simply, it is the purchase of a company with borrowed funds secured by the company’s assets.¹⁸

The characteristics of an LBO often include the following: (1) the majority of the purchase price is paid by loans from a third party; (2) those loans are to be repaid with cash flow generated by the purchased entity; (3) the loans are secured by liens on the stock or assets of the purchased entity; (4) the buyer usually invests only a small amount of capital as equity into the deal; (5) the purchased company’s balance sheet is highly leveraged; and (6) the buyer has no personal liability for the debt.¹⁹ The typical LBO structure takes one of three basic forms: (1) a direct sale to the buyer; (2) a cash merger with the buyer; or (3) a stock purchase by the buyer that may be followed with a merger.²⁰ Regardless of how it is structured, the buyer pays the selling stockholders for their shares.

Prior to the 2009 financial collapse,²¹ LBOs were rebounding in popularity. “In 2006, LBOs, on a dollar basis, have accounted for 27 percent of all U.S. mergers and acquisitions, as compared to 14 percent in 2005 and just 10 percent in 2000. Indeed, of the 10 largest LBOs in U.S. history, eight occurred in 2006.”²² Unsurprisingly considering the easy lending practices of the time, many of these LBOs added heavy debt loads to the target companies “that in some cases may require the targets to devote at least half of their yearly cash flow

17. *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1292 (3d Cir. 1986).

18. BLACK’S LAW DICTIONARY 228 (9th ed. 2009).

19. David W. Morse, *Legal Issues in Leveraged Acquisitions: From the Lender’s Perspective*, in *MERGERS & ACQUISITIONS 2010: TRENDS AND DEVELOPMENTS*, at 325, 329 (PLI Corporate Law & Practice, Course Handbook Ser. No. 1781, 2010), available at Westlaw 1781 PLI/Corp 325.

20. *Id.*

21. See Steven Pearse, *Accounting for the Lack of Accountability: The Great Depression Meets the Great Recession*, 37 HASTINGS CONST. L.Q. 409, 420 (2010).

22. Gregory G. Hesse, *Section 546(e) and the Return of the LBO*, 26 AM. BANKR. INST. J. 22, 22 (2007).

to meet the interest payments.”²³ While the following discussion of LBOs begins with an historical overview, the risks and rewards of LBOs are a modern phenomenon that will remain with us for years to come.

1. LBO History

The law of fraudulent conveyances began in 1571 with the English Parliament’s enactment of the Statute 13 of Elizabeth.²⁴ This law sought to stop debtors from transferring property to another with the intent of defrauding creditors.²⁵ Even back to that original statute, transfers for good consideration were bona fide.²⁶ However, the law’s biggest flaw as originally conceived was that fraudsters are usually smart enough not to leave behind evidence of their intent. As a way to counter this, courts established “badges of fraud,” which were legal shortcuts used to prove actual fraud.²⁷ When present, badges of fraud made a transfer presumptively invalid.²⁸

The history of applying fraudulent transfer law to LBOs began with one particularly influential case from the mid-1980s: *United States v. Tabor Court Realty Corp.*²⁹ This case involved the first significant application of the Uniform Fraudulent Conveyance Act³⁰ to a failed LBO.³¹ In *Tabor*, the Third Circuit ruled that a trustee could bring

23. *Id.*

24. John C. Murray & Paul L. Hammann, *Creditors’ Rights Issues in Loan Transactions*, in TITLE INSURANCE 2002: MASTERING CRITICAL ISSUES FACING BUYERS, SELLERS & LENDERS, at 483, 486 (PLI Real Estate Law & Practice, Course Handbook Ser. No. 484, 2002), available at Westlaw 484 PLI/Real 483. *But see* Frank R. Kennedy, *Involuntary Fraudulent Transfers*, 9 CARDOZO L. REV. 531, 535 (1987) (discussing fraudulent conveyances under Roman law).

25. Murray & Hammann, *supra* note 24.

26. Kennedy, *supra* note 24, at 537.

27. Michael L. Cook, et al, *Fraudulent Transfers*, in RECENT DEVELOPMENTS IN DISTRESSED DEBT, RESTRUCTURING AND WORKOUTS 2011, at 533, 562 (PLI Commercial Law & Practice, Course Handbook Ser. No. 933, 2011), available at Westlaw 933 PLI/Comm 533; *see also* DOUGLAS J. WHALEY & JEFFREY W. MORRIS, PROBLEMS AND MATERIALS ON DEBTOR AND CREDITOR LAW 18 (3d ed. 2006).

28. Cook, *supra* note 27.

29. *United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1291 (3d Cir. 1986). There were prior decisions in this case under a different name decided by a lower court that were influential as well. *United States v. Gleneagles Inv. Co.*, 565 F. Supp. 556 (M.D. Pa. 1983); *United States v. Gleneagles Inv. Co.*, 571 F. Supp. 935 (M.D. Pa. 1983); *United States v. Gleneagles Inv. Co.*, 584 F. Supp. 671 (M.D. Pa. 1984).

30. UNIF. FRAUDULENT TRANSFER ACT prefatory note (1984), available at <http://www.law.upenn.edu/bll/archives/ulc/fnact99/1980s/ufta84.pdf> (indicating that the Uniform Fraudulent Conveyance Act was the predecessor to the more recent Uniform Fraudulent Transfer Act).

31. *Tabor Court Realty*, 803 F.2d at 1291 (“[T]his case represents the first significant application of the UFCA to leveraged buy-out financing.”); Lisa G. Beckerman & Robert J. Stark, *LBOs and Fraudulent Conveyances: The Third Circuit Does an About Face*, 2000 NORTON

fraudulent conveyance claims against parties who orchestrate LBOs.³² Today, applying fraudulent transfer law to failed LBOs seems like a natural conclusion of the law, but this was not the case at the time. The *Tabor* court ignored weighty advice to the contrary in making its decision,³³ and it ignored the lead of other cases it could have followed.³⁴ *Tabor* was particularly groundbreaking³⁵ because in spite of the early criticism,³⁶ less than ten years later one court confidently declared, “courts now uniformly hold that fraudulent conveyance laws apply to LBOs.”³⁷ What courts had never done prior to 1986—apply fraudulent transfer laws to failed LBOs—became standard procedure by 1995. *Tabor* and cases that followed,³⁸ in effect turned LBOs into a badge of fraud³⁹—a factual situation that raises a presumption of fraud. The presence of an LBO does not raise a firm presumption of fraud in all LBOs, but nonetheless, “[m]ost courts that have consid-

BANKR. L. ADVISER (West Group, Rochester, N.Y.), no. 2, Feb. 2000, available at <http://www.akingump.com/docs/publication/105.pdf>.

32. Beckerman & Stark, *supra* note 31.

33. *Id.* (citing Baird & Jackson, *supra* note 2, at 852 (“A firm that incurs obligations in the course of a buyout does not seem at all like the Elizabethan deadbeat who sells his sheep to his brother for a pittance.”)).

34. Credit Managers Ass’n of S. Cal. v. Fed. Co., 629 F. Supp. 175 (C.D. Cal. 1985). *Credit Managers* was decided less than a year before *Tabor* on a similar issue—applying § 5 of the Uniform Fraudulent Conveyance Act to a failed LBO. *Id.* at 177, n.1. It reached the opposite conclusion. *Credit Managers* held that the LBO in question was not a fraudulent transfer. *Id.* at 189.

35. Anthony Michael Sabino, *Applying the Law of Fraudulent Conveyances to Bankrupt Leveraged Buyouts: The Bankruptcy Code’s Increasing Leverage over Failed LBOs*, 69 N.D. L. REV. 15, 28 (1993); D. Christopher Carson, *Analyzing and Pursuing Fraudulent Transfer Claims*, in UNDERSTANDING FRAUDULENT TRANSFERS: LEADING LAWYERS ON NAVIGATING FRAUDULENT TRANSFER CLAIMS, DEVELOPING AN EFFECTIVE LITIGATION STRATEGY, AND RESPONDING TO RECENT TRENDS AND DEVELOPMENTS, at *6 (2009), available at 2009 WL 2510926.

36. See, e.g., Baird & Jackson, *supra* note 2, at 854–55; *Credit Managers*, 629 F. Supp. 175; Kupetz v. Cont’l Ill. Nat’l Bank & Trust Co., 77 B.R. 754 (C.D. Cal. 1987). See also Iannacone v. Foothill Capital Corp. (*In re Hancock-Nelson Mercantile Co.*), 95 B.R. 982, 993–96 (Bankr. D. Minn. 1989) (discussing the resulting controversy and ultimate influence of the *Tabor* decision).

37. MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Serv. Co., 910 F. Supp. 913, 933 (S.D.N.Y. 1995).

38. Kupetz v. Wolf, 845 F.2d 842 (9th Cir. 1988); Ohio Corrugating Co. v. Sec. Pac. Bus. Credit (*In re Ohio Corrugating Co.*), 70 B.R. 920 (Bankr. N.D. Ohio 1987); Vadnais Lumber Supply, Inc. v. Byrne (*In re Vadnais Lumber Supply*), 100 B.R. 127 (Bankr. D. Mass. 1989); Ferrari v. Barclays Bus. Credit, Inc. (*In re Morse Tool, Inc.*), 108 B.R. 389 (Bankr. D. Mass. 1989); Aluminum Mills Corp. v. Citicorp N. Am., Inc. (*In re Aluminum Mills Corp.*), 132 B.R. 869 (Bankr. N.D. Ill. 1991); Ohio Corrugating Co. v. DPAC, Inc. (*In re Ohio Corrugating Co.*), 91 B.R. 430 (Bankr. N.D. Ohio 1988). See Sabino, *supra* note 35, at 22–28, for a discussion of how each of these cases related to the development of the fraudulent transfer doctrine being applied to LBOs.

39. Barry L. Zaretsky, *Fraudulent Transfer Law as the Arbiter of Unreasonable Risk*, 46 S.C. L. REV. 1165, 1188 (1995).

ered the issue have decided that fraudulent transfer law should apply to LBOs.”⁴⁰

2. Avoidability of LBOs

Under the caselaw that developed following *Tabor*, it became common to apply fraudulent transfer law to LBOs.⁴¹ In the typical LBO, a company (the target) is purchased with loans secured by the target’s own assets.⁴² If this new debt burden causes the target to have no reasonable prospect of survival, the result is usually bankruptcy.⁴³ If the target declares bankruptcy thereafter while the assets are still encumbered, the unsecured creditors will not satisfy any part of their claims from a sale of the assets.⁴⁴ If the LBO can be blamed for dooming the target to unavoidable bankruptcy, “the payment to the shareholders by the buyer of the corporation is deemed a fraudulent conveyance because in exchange for the money the shareholders received they provided no value to the corporation but merely increased its debt and by doing so pushed it over the brink.”⁴⁵ Accordingly, when an LBO results in too high of a debt burden, a court may deem it fraudulent thereby making the LBO subject to avoidance by a trustee in bankruptcy.⁴⁶

LBOs can be risky because the newly structured company has a significantly higher debt to equity ratio.⁴⁷ This risk, however, is not borne by the company’s new owners; rather, it is carried by the unsecured creditors who stand to lose everything in liquidation.⁴⁸ Because the lender nearly always assumes a senior lien position, it is only at risk to the point it is undersecured.⁴⁹ This risk structure makes LBOs attractive to buyers, sellers, and lenders alike because these parties bear none of the risk (or at least very little as compared to creditors).⁵⁰

A fundamental principle of corporate and bankruptcy law is that creditors should be paid before ownership.⁵¹ An LBO can short-cir-

40. *Bay Plastics, Inc. v. BT Commercial Corp. (In re Bay Plastics, Inc.)*, 187 B.R. 315, 334 (Bankr. C.D. Cal. 1995).

41. *See supra* note 38.

42. *Boyer v. Crown Stock Distribution Inc.*, 587 F.3d 787, 791–92 (7th Cir. 2009).

43. *Id.* at 792.

44. *Id.*

45. *Id.*

46. *Id.*

47. *Mellon Bank, N.A. v. Metro Commc’ns, Inc.*, 945 F.2d 635, 645–46 (3d Cir. 1991).

48. *Id.* at 646.

49. *Id.*

50. *Id.*

51. *Morse, supra* note 19, at 332 (“‘debt’ before ‘equity’”); *see also* 11 U.S.C. § 507 (2006).

cuit that principle by, in effect, paying equity before debt.⁵² Fraudulent conveyance law protects creditors by giving them a way to reverse an LBO. In applying fraudulent conveyance law to an LBO, courts analyze the transaction with creditors' interests in mind.⁵³

B. *LBOs and Fraudulent Transfer Law*

Under the Bankruptcy Code, a trustee (or a debtor-in-possession in a Chapter 11 case)⁵⁴ has certain powers to avoid a variety of prepetition transactions.⁵⁵ This includes the power to avoid fraudulent transfers under § 548.⁵⁶ Section 548(a)(1)(A) avoids transfers where there is an “actual intent to hinder, delay, or defraud.”⁵⁷ However, proving

52. Morse, *supra* note 19, at 329.

53. *Id.* at 333.

54. 11 U.S.C. § 1107(a) (2006); Bay Plastics, Inc. v. BT Commercial Corp. (*In re* Bay Plastics, Inc.), 187 B.R. 315, 321–22 (Bankr. C.D. Cal. 1995). Additionally, “[u]nder certain circumstances, an official committee of creditors appointed in a chapter 11 case may also be authorized by the bankruptcy court to do so on behalf of the estate.” Mark G. Douglas, *No Avoidance of Payments by Financial Institution to LBO Shareholders Absent Actual Fraud*, 1 JONES DAY BUS. RESTRUCTURING REV., No. 2, May 2002, at 9, available at <http://www.jonesday.com/files/Publication/f0274ad3-760f-4b6a-a2b5-7af9a43020e1/Presentation/PublicationAttachment/e3605820-7e11-44a9-8f6f-d1bf6580a024/BR%20Review%20V1No2.pdf>; 4 NORTON BANKR. L. & PRAC. 3d § 67:14 (West 2011).

55. *Bay Plastics*, 187 B.R. at 321. While § 548 makes a transfer avoidable, it is § 550 that empowers the trustee to recover the avoided property. 11 U.S.C. § 550 (“[T]o the extent that a transfer is avoided under section . . . 548 . . . the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property”).

56. *Id.* In its entirety, § 548(a) reads as follows:

(a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

(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;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

11 U.S.C. § 548(a) (2006).

57. 11 U.S.C. § 548(a)(1)(A) (2006); 4 NORTON BANKR. L. & PRAC. 3d § 67:14 (West 2011).

actual intent can be difficult.⁵⁸ In the alternative, § 548(a)(1)(B) provides an opportunity to prove constructive fraud.⁵⁹

In addition to federal bankruptcy law, a trustee may avoid transactions under state law.⁶⁰ This is useful because § 548 only reaches back two years from the date the bankruptcy petition is filed.⁶¹ State fraudulent transfer laws typically have statute of limitations of four to seven years.⁶²

Every state has either a common law variety of the Statute of Elizabeth or a codification of the Uniform Fraudulent Conveyance Act (UFCA) or the more modern Uniform Fraudulent Transfer Act (UFTA).⁶³ UFTA § 5 states as follows:

(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.⁶⁴

This language is similar to § 548(a)(1)(B).⁶⁵ Rather than prohibiting actual fraud, like § 548(a)(1)(A), § 548(a)(1)(B) and § 5 of the UFTA prohibit constructive fraud.⁶⁶ Fraud is presumed once the elements of § 548(a)(1)(B) are proved.⁶⁷

Parsing § 548(a)(1)(B) into its elements, it permits the avoidance of any transfer of an interest in property or any obligation that was made or incurred within the two years before the bankruptcy petition is filed

58. Douglas, *supra* note 54.

59. 11 U.S.C. § 548(a)(1)(B) (2006).

60. Douglas, *supra* note 54. Section 544(b) allows a trustee to “avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim” 11 U.S.C. § 544(b) (2006).

61. 11 U.S.C. § 548(a)(1) (2006). Prior to the 2005 BAPCPA amendments to the Code, it was only a one-year reach back. 11 U.S.C. § 548 (West 2005).

62. Bay Plastics, Inc. v. BT Commercial Corp. (*In re* Bay Plastics, Inc.), 187 B.R. 315, 322 (Bankr. C.D. Cal. 1995); *see, e.g.*, CAL. CIV. CODE § 3439.09 (Deering 2011); OHIO REV. CODE ANN. § 1336.09 (LexisNexis 2011).

63. Hydee R. Feldstein & Francis J. Aquila, *Caveat Emptor: Distressed Acquisitions Yield Rewards, But Risks Too*, in GOING PRIVATE 2010: DOING THE DEAL RIGHT, at 311, 315 n.2 (PLI Corporate Law & Practice, Course Handbook Ser. No. 1796, 2010), available at Westlaw 1796 PLI/Corp 311.

64. UNIF. FRAUDULENT TRANSFER ACT § 5(a), available at <http://www.law.upenn.edu/bll/archives/ulc/fnact99/1980s/ufta84.pdf>.

65. *See* 11 U.S.C. § 548(a)(1)(B) (2006).

66. *In re* Fruehauf Trailer Corp., 444 F.3d 203, 210 (3d Cir. 2006).

67. *Id.*

(or longer if applying state law).⁶⁸ Once those initial hurdles are cleared, avoidance is permitted if the debtor receives less than a reasonably equivalent value in exchange and one of the following three things occur: (1) the debtor was insolvent on the date of the transfer or obligation or became insolvent as a result; (2) the debtor was engaged or was about to engage in a business or transaction for which the debtor's remaining capital was unreasonably small capital; or (3) the debtor believed he was incurring or intended to incur debts beyond his ability to pay.⁶⁹ Accordingly, what is "reasonably equivalent value,"⁷⁰ along with either insolvency,⁷¹ "unreasonably small capital,"⁷² or "debts beyond the ability to pay,"⁷³ becomes critical to this analysis. As such, applying § 548(a)(1)(B) is primarily a factual analysis.⁷⁴

Considering once again the influence of *Tabor*,⁷⁵ at the same time courts began to apply fraudulent transfer laws to LBOs, § 546(e) was beginning its long march towards protecting those same failed

68. 11 U.S.C. § 548(a)(1) (2006); Official Comm. of Unsecured Creditors v. Citicorp N. Am. (*In re TOUSA, Inc.*), 422 B.R. 783, 858 (Bankr. S.D. Fla. 2009).

69. 11 U.S.C. § 548(a)(1)(B)(i)–(ii) (2006); *In re TOUSA*, 422 B.R. at 858.

70. "The test used to determine reasonably equivalent value in the context of a fraudulent conveyance requires the court to determine the value of what was transferred and to compare it to what was received." *In re TOUSA*, 422 B.R. at 865 (quoting *Barber v. Golden Seed Co.*, 129 F.3d 382, 387 (7th Cir. 1997)).

71. The term "insolvent" means "that the sum of [an] entity's debts is greater than all of such entity's property, at a fair valuation . . ." 11 U.S.C. § 101(32)(A) (2006); *In re TOUSA*, 422 B.R. at 858.

72. *Moody v. Sec. Pac. Bus. Credit, Inc.*, 971 F.2d 1056, 1070 (3d Cir. 1992). "[U]nreasonably small capital' . . . refer[s] to the inability to generate sufficient profits to sustain operations. Because an inability to generate enough cash flow to sustain operations must precede an inability to pay obligations as they become due, unreasonably small capital would seem to encompass financial difficulties short of equitable solvency." *Id.*

73. *In re TOUSA*, 422 B.R. at 875. "The 'inability to pay debts' prong of section 548 is met if it can be shown that the debtor made the transfer or incurred an obligation contemporaneous with an intent or belief that subsequent creditors likely would not be paid as their claims matured." *Id.* at 862 (quoting *WRT Creditors Liquidation Trust v. WRT Bank, Litig. Master File Defendants (In re WRT Energy Corp.)*, 282 B.R. 343, 415 (Bankr. W.D. La. 2001)).

74. 4 NORTON BANKR. L. & PRAC. 3d § 67:4 (West 2011). See, e.g., *Dixon v. Ruth (In re Gluth Bros. Constr., Inc.)*, 424 B.R. 368, 377 (Bankr. N.D. Ill. 2009) ("[T]he Plaintiff has offered no factual allegations to support its claim that the Debtor was insolvent at the time of the transfer or became insolvent because of the transfer."); *Angell v. Burrell (In re Caremerica, Inc.)*, 409 B.R. 759, 767 (Bankr. E.D.N.C. 2009) ("In the absence of such factual content, the trustee cannot show that avoidance of transfers under the theory of constructive fraud is plausible."); *Fehrs v. Fehrs (In re Fehrs)*, 391 B.R. 53, 74 (Bankr. D. Idaho 2008) ("The determination of 'reasonable equivalence' is largely a factual question and, in order to determine whether a fair economic exchange has occurred, the court must analyze all the circumstances surrounding the transfer in question.").

75. See *supra* Parts II.A.1–2.

LBOs.⁷⁶ Even among some of the early cases following *Tabor's* groundbreaking application of fraudulent transfer law, § 546(e) was an issue.⁷⁷ Accordingly, courts were pursuing a dual path of legal development. On one path, courts applied fraudulent transfer laws to LBOs. On a nearly contemporaneous path, courts protected those same LBOs from fraudulent transfer laws by applying § 546(e).

C. *In re QSI Holdings, Inc.*

The Sixth Circuit's decision in *QSI* represents one of the latest cases to apply § 546(e) to protect failed LBOs from fraudulent transfer law. The issue was "whether § 546(e) of the Bankruptcy Code applies to privately traded securities."⁷⁸ The difference between *QSI* and most other cases, and what made it an issue of first impression in the Sixth Circuit, was the holding that "§ 546(e) is not limited to publicly traded securities but also extends to transactions . . . involving privately held securities."⁷⁹

QSI began with a 1999 LBO of Quality Stores, Inc. (Quality) by Central Tractor Farm and Country, Inc. and its parent company, CT Holdings, Inc. (collectively the CT Parties).⁸⁰ Quality was a private corporation operating a chain of 112 agricultural products retail stores located primarily in rural communities in and around the Midwest.⁸¹ Quality's products included a mix of niche retail items of interest to part-time and hobby farmers, homeowners, and do-it-yourselfers.⁸² Central Tractor Farm and Country, Inc. with 232 stores, operated within the same retail market.⁸³ Both companies were profitable on their own.⁸⁴

Quality and the CT Parties entered into a merger agreement that paid Quality's shareholders in cash and stock for their equity inter-

76. Sabino, *supra* note 35, at 39.

77. See, e.g., *Kaiser Steel Corp. v. Jacobs (In re Kaiser Steel Corp.)*, 105 B.R. 639 (Bankr. D. Colo. 1989), *rev'd*, 110 B.R. 514 (D. Colo. 1990), *aff'd sub nom. Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990); *Wieboldt Stores, Inc. ex rel. Raleigh v. Schottenstein (In re Wieboldt Stores, Inc.)*, 131 B.R. 655, 663 (N.D. Ill. 1991).

78. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 547 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

79. *Id.*

80. *Id.*

81. Final Brief of Appellees Joan R. Gowell, et al. at 5–6, *QSI III*, 571 F.3d 545 (No. 08-1176), 2008 WL 4570172; *Quality Stores, Inc. v. Alford (In re Quality Stores, Inc.) (QSI I)*, 355 B.R. 629, 631 (Bankr. W.D. Mich. 2006).

82. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 6.

83. *Id.*

84. *Id.*

ests,⁸⁵ as is typical of any LBO. The total purchase price was approximately \$208 million, with the shareholders to receive \$111.5 million in cash and \$91.8 million in stock.⁸⁶ The CT Parties also agreed to assume and pay \$42.1 million of Quality's existing debt.⁸⁷ Of interest was the fact that some of Quality's employees were shareholders through the company's Employee Stock Ownership Trust (ESOT).⁸⁸ The assets of the merged entity, named Quality Stores, Inc.,⁸⁹ were pledged as collateral to a bank syndicate⁹⁰ that financed the merger.⁹¹

To complete the transaction, the CT Parties enlisted the help of HSBC Bank USA (HSBC) to act as an exchange agent.⁹² The CT Parties entrusted HSBC with the \$111.5 million in cash, and HSBC collected the shares of Quality Stock, paying each of them in turn.⁹³ HSBC then transferred the securities to the CT Parties.⁹⁴ This simple use of a financial institution was crucial to the case's outcome.⁹⁵

When the deal closed in March 1999,⁹⁶ the new company implemented a costly expansion plan to open twenty-five to fifty new retail stores a year.⁹⁷ It remained in business for two and a half more years, until October 2001.⁹⁸ The decision to expand, and presumably the company's high debt load, led to "severe financial and liquidity problems,"⁹⁹ which in turn caused a group of creditors, including some of the banks who were part of the syndicate that originally funded the LBO, to file an involuntary bankruptcy petition.¹⁰⁰ The debtor voluntarily filed for Chapter 11 relief shortly thereafter.¹⁰¹

85. *QSI I*, 355 B.R. at 631.

86. *Id.*

87. *Id.*

88. *Id.*

89. CT Holdings changed its name to QSI Holdings, Inc. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11.

90. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11.

91. Corrected Opening Brief of Appellants at 6, *QSI Holdings, Inc. v. Alford (QSI I)*, 382 B.R. 731 (W.D. Mich. 2007) (No. 1:06-cv-876), 2007 WL 1369910.

92. *QSI I*, 355 B.R. at 632.

93. *Id.*

94. *Id.* Note that the ESOT shareholders had an additional step because a trustee, LaSalle Bank, held most of the ESOT stock. LaSalle tendered the shares to HSBC, receiving cash in return, which LaSalle then distributed to the ESOT shareholders. *Id.*

95. *Id.* at 631 ("[T]he legal issue presented is whether the transfers from the disbursing agent to the Defendants are exempt from avoidance because they constitute 'settlement payments' made by a 'financial institution' under § 546(e).").

96. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11.

97. *QSI I*, 355 B.R. at 632.

98. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11.

99. Corrected Opening Brief of Appellants, *supra* note 91, at 7.

100. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11.

101. Corrected Opening Brief of Appellants, *supra* 91, at 7.

1. *QSI's* Arguments and Reasoning

Two years after filing, the debtor sought to avoid the merger transaction and recover the funds paid to Quality's shareholders.¹⁰² The defendants moved for summary judgment asserting that the LBO transfers were settlement payments made by a financial institution and therefore exempt from avoidance under § 546(e).¹⁰³

As with this paper's thesis,¹⁰⁴ each argument about the applicability of § 546(e) to failed LBOs generally revolves around three issues: plain meaning, congressional intent, and policy. The same is true with the arguments and analysis in the three *QSI* opinions.¹⁰⁵

102. Final Brief of Appellees Joan R. Gowell, et al., *supra* note 81, at 11. It sought to avoid and recover the LBO transfers as constructively fraudulent under §§ 544, 550 and the Michigan Uniform Fraudulent Transfer Act. *QSI I*, 355 B.R. at 632. See also *supra* Part II.B (description of §§ 544, 550 and its relationship to state fraudulent transfer laws).

103. *QSI I*, 355 B.R. at 632. Note that this case was decided under the pre-BAPCPA amendments to the Code because it was initiated in 2001. *Id.* at 631 n.1. This had two notable effects. First, the version of § 548 effective at that time only had a one-year reach back, therefore making it unavailable. 11 U.S.C.A. § 548 (West 2005). Second, there were differences between the old and new versions of § 546(e). See 11 U.S.C.A. § 546(e) (West 2010); 11 U.S.C.A. § 546(e) (West 2006). The most current version became effective December 12, 2006. 11 U.S.C.A. § 546(e) (West 2010). The text of the version effective between December 11, 2006, and June 19, 1998 read as follows:

(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 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 under section 548(a)(1)(A) of this title.

11 U.S.C.A. § 546(e) (West 2006). The text of the current version reads as follows:

(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.

11 U.S.C.A. § 546(e) (West 2010) (new language in italics). These differences are largely unimportant for the purposes of this paper, however, one ramification relating to congressional intent will be discussed *infra* Part III.B.2.

104. See *supra* Part I.

105. See *Quality Stores, Inc. v. Alford* (*In re Quality Stores, Inc.*) (*QSI I*), 355 B.R. 629 (Bankr. W.D. Mich. 2006); *QSI Holdings, Inc. v. Alford* (*QSI II*), 382 B.R. 731 (W.D. Mich. 2007); *QSI Holdings, Inc. v. Alford* (*In re QSI Holdings, Inc.*) (*QSI III*), 571 F.3d 545 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

a. Plain Meaning

The bankruptcy court, the district court, and the Sixth Circuit each framed the issue in *QSI* within the plain meaning of the statutory language.¹⁰⁶ Section 546(e) currently states that “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 . . . financial institution . . . that is made before the commencement of the case”¹⁰⁷ The § 101(51A) definition of “settlement payment” applies to forward contract provisions and is inapplicable here,¹⁰⁸ so that leaves the definition in § 741.

i. The Definition of “Settlement Payment”

Section 741(8) defines “settlement payment” as a “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.”¹⁰⁹ Each *QSI* court recognized that this definition is both “‘somewhat circular,’”¹¹⁰ and “‘extremely broad.’”¹¹¹ The courts lift this interpretation from a particularly influential Tenth Circuit case, *Kaiser Steel Corp. v. Charles Schwab & Co.*, which involved publicly traded securities.¹¹² As noted by the *QSI* bankruptcy court,¹¹³ *Kaiser* reasoned that the breadth of the definition of settlement payment included any sort of transfer considered a settlement payment in the

106. *QSI I*, 355 B.R. at 631 (“[W]hether the transfers from the disbursing agent to the Defendants are exempt from avoidance because they constitute ‘settlement payments’ made by a ‘financial institution’ under § 546(e).”); *QSI II*, 382 B.R. at 737 (“[W]hether the term ‘settlement payment’ as defined exempts the payments made in the LBO of Quality Stores, Inc., to acquire the privately held shares of stock.”); *QSI III*, 571 F.3d at 549 (“[W]hether payments made to purchase *non-public* securities in a leveraged buyout can be exempted from avoidance pursuant to section 546(e) of the Bankruptcy Code by merely funneling [them through] a financial institution.”).

107. 11 U.S.C. § 546(e) (2006). The language of § 546(e) applied in *QSI* was slightly different. See *supra* note 103. These slight differences have no effect on the present discussion.

108. *QSI II*, 382 B.R. at 737 n.4; 11 U.S.C. § 101(51A) (2006) (“[S]ettlement payment’ means, for purposes of the forward contract provisions of this title”).

109. 11 U.S.C. § 741(8) (2006). Note that the § 741(8) definition of settlement payment was unchanged by BAPCPA. See 11 U.S.C.A. § 741(8) (West 2006).

110. *QSI I*, 355 B.R. at 633; *QSI II*, 382 B.R. at 740; *QSI III*, 571 F.3d at 549.

111. *QSI I*, 355 B.R. at 633; *QSI II*, 382 B.R. at 740; *QSI III*, 571 F.3d at 549.

112. *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 847–48 (10th Cir. 1990) (“The definition in section 741(8), while somewhat circular, is ‘extremely broad,’ in that it clearly includes anything which may be considered a settlement payment.”) (citation omitted) (quoting *In re Beville, Bresler & Schulman Asset Mgmt. Corp.* (Beville, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass’n), 878 F.2d 742, 751 (3d Cir. 1989)). More will be said about *Beville* below in the Analysis section. See *infra* Part III.A.1.b.

113. *QSI I*, 355 B.R. at 633–34.

securities industry.¹¹⁴ And because a “[s]ettlement is ‘the completion of a securities transaction,’” *Kaiser* held that the term settlement payment includes a securities transfer that occurs in an LBO.¹¹⁵ The Sixth Circuit agreed, noting that “the critical phrase in the definition [of settlement payment] is the final one: the payment must be one ‘commonly used in the securities trade.’”¹¹⁶ This was meant “‘as a catchall phrase intended to underscore the *breadth* of the § 546(e) exemption.’”¹¹⁷ Each *QSI* court therefore determined, as did *Kaiser*, that the definition of settlement payment is broad enough to include LBO securities transfers.¹¹⁸

ii. Public versus Private LBOs

That broad definition of settlement payment led directly to the question of whether it is also broad enough to include a private securities transaction.¹¹⁹ Here again, arguments in favor of the statute’s supposed plain meaning won. As the district court stated, “[N]othing in the plain language of the statutes limits the application of the exemption to public transactions.”¹²⁰ The Sixth Circuit agreed, stating that “nothing in the text of § 546(e) precludes its application to settlement payments involving privately held securities.”¹²¹ The breadth of § 546(e) and the § 741(8) definition of settlement payment made this result possible. As the district court noted, “[m]erely because the statutory definition is broad does not render it ambiguous.”¹²²

iii. Absurd Results?

Would such a broad reading of “settlement payment” lead to a result sufficiently absurd to warrant not enforcing its plain meaning?¹²³ The Sixth Circuit never answered this question directly, and the bankruptcy court did not consider it except to conclude that “the plain lan-

114. *Kaiser Steel*, 913 F.2d at 848.

115. *Id.* at 849. (“[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.”).

116. *QSI III*, 571 F.3d at 549 (quoting 11 U.S.C. § 741(8) (2006)).

117. *Id.* at 550 (quoting *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986 (8th Cir. 2009)).

118. *QSI I*, 355 B.R. at 634; *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731, 740–41 (W.D. Mich. 2007); *QSI III*, 571 F.3d at 549 (6th Cir. 2009).

119. *QSI I*, 355 B.R. at 634; *QSI II* (W.D. Mich.), 382 B.R. at 741; *QSI III*, 571 F.3d at 549.

120. *QSI II*, 382 B.R. at 741.

121. *QSI III*, 571 F.3d at 550.

122. *QSI II*, 382 B.R. at 741.

123. *QSI I*, 355 B.R. at 633 (“‘When the language is clear, no further inquiry is necessary unless applying the plain language leads to an absurd result.’”) (quoting *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505, 515 (3d Cir. 1999)); *QSI II*, 382 B.R. at 739; *QSI III*, 571 F.3d at 549.

guage of § 546(e) does not lead to an unjust or absurd result.”¹²⁴ The district court, on the other hand, considered the question in detail.¹²⁵ It determined that the breadth of the statutory definition “leaves to the courts the task of winnowing out those transactions that do not comport with the statutory provisions or congressional intent and thus lead to an absurd result.”¹²⁶ However, the district court ultimately ruled that the equities were on the side of Quality’s shareholders, “many of whom are mid- and lower-level ESOT employee-shareholders, whose stock payments would be voided in favor of the creditors.”¹²⁷ Therefore, there were no absurd results.¹²⁸

iv. “Financial Institution”

Another plain-meaning argument considered was based on the § 546(e) requirement that the settlement payment be made by a “financial institution.”¹²⁹ All three courts considered the argument that the transfers were not made by a financial institution because the disbursing agent, HSBC, never had a beneficial interest in the LBO consideration.¹³⁰ If HSBC never had dominion or control over the funds it disbursed, then the courts could have ruled that it was nothing more than an intermediary or a conduit and that the CT Parties made the transfer, not the financial institution HSBC.¹³¹ In essence, plaintiffs argued that, as is required by § 550, HSBC was not a “transferee” in the LBO transaction.¹³² All three courts found this unpersuasive because the language of § 546(e) contains no requirement that a financial institution acquire a beneficial interest in the funds it handles.¹³³ HSBC may have been an intermediary and a conduit, but nowhere does it state that such a role is impermissible—the courts ruled that it was still a transfer by a financial institution as § 546(e) requires.

124. *QSI I*, 355 B.R. at 634–35.

125. *QSI II*, 382 B.R. at 741–42.

126. *Id.* at 741.

127. *Id.* at 742.

128. *Id.*

129. 11 U.S.C. § 546(e) (2006). The plaintiffs conceded that HSBC was a financial institution. Petition for a Writ of Certiorari at 4, *QSI Holdings, Inc. v. Alford*, 130 S. Ct. 1141 (2010) (No. 09-439), 2009 WL 3308849.

130. *Quality Stores, Inc. v. Alford (In re Quality Stores, Inc.) (QSI I)*, 355 B.R. 629, 635 (Bankr. W.D. Mich. 2006); *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731, 742 (W.D. Mich. 2007); *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 550 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

131. *QSI I*, 355 B.R. at 635; *QSI II*, 382 B.R. at 742; *QSI III*, 571 F.3d at 550–51.

132. *QSI III*, 571 F.3d at 551; 11 U.S.C. § 550 (2006).

133. *QSI I*, 355 B.R. at 634; *QSI II*, 382 B.R. at 742; *QSI III*, 571 F.3d at 551.

b. Congressional Intent

Each *QSI* court also considered Congress's intent.¹³⁴ They reasoned that the broad definition of settlement payment furthered a policy of protecting securities markets from harm that might occur if bankruptcy trustees have the power to unwind settled securities transactions.¹³⁵ Congress could have addressed the breadth of § 546(e) and the definition of settlement payment, but it has not done so.¹³⁶ Instead, Congress chose statutory language that was inclusive, leaving it to the courts to winnow out transactions that lead to absurd results.¹³⁷ Furthermore, as the Sixth Circuit stated, "[N]othing in the statutory language indicates that Congress sought to limit that protection to publicly traded securities."¹³⁸ Each court therefore felt that it was Congress's intent to protect securities markets from the harm that would result if LBOs could be unwound years after they occurred.¹³⁹ As the Sixth Circuit stated, "The value of the privately held securities at issue is substantial and there is no reason to think that unwinding that settlement would have any less of an impact on financial markets than publicly traded securities."¹⁴⁰ However, the truth of this statement is far from certain.

c. Policy

Policy considerations of fairness and the potential for abuse particularly troubled the bankruptcy court.¹⁴¹ Judge Gregg noted that, "Although the result in . . . this adversary proceeding may seem 'unfair,' it is not 'unjust' given the language of the Bankruptcy Code."¹⁴² The law as he applied it permits transferees to make what would otherwise be fraudulent LBO transactions, thereby opening up the possibilities of abuse.¹⁴³ Judge Gregg sounded particularly conflicted when he wrote the following: "As a voice from the rivers and forests of Michigan, this judge hopes that Congress will reassess § 546(e)."¹⁴⁴ The dis-

134. *QSI I*, 355 B.R. at 634; *QSI II*, 382 B.R. at 741-42; *QSI III*, 571 F.3d at 550-51.

135. *QSI I*, 355 B.R. at 634; *QSI II*, 382 B.R. at 741-42; *QSI III*, 571 F.3d at 550.

136. *QSI I*, 355 B.R. at 634.

137. *QSI II*, 382 B.R. at 741.

138. *QSI III*, 571 F.3d at 550.

139. *QSI II*, 382 B.R. at 743 (citing *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1241 (10th Cir. 1991)); *QSI I*, 355 B.R. at 634-35; *QSI III*, 571 F.3d at 550.

140. *QSI III*, 571 F.3d at 550.

141. *QSI I*, 355 B.R. at 634.

142. *Id.* at 635 n.5.

143. *Id.*

144. *Id.*

strict court and Sixth Circuit showed no similar concerns that an “unfair” result was reached.¹⁴⁵

2. *QSI*'s Holding

The bankruptcy court held that the LBO payments made to the Quality shareholders were settlement payments made by a financial institution under § 546(e).¹⁴⁶ Therefore, they were not subject to avoidance as constructively fraudulent transfers.¹⁴⁷ It then enforced the summary judgment on all parties *sua sponte*—even on the non-moving parties—because § 546(e) applied to all defendants equally.¹⁴⁸ The district court agreed, finding no basis for reversal of the grant of summary judgment.¹⁴⁹ The Sixth Circuit affirmed the judgment,¹⁵⁰ noting that “§ 546(e) is not limited to publicly traded securities but also extends to transactions, such as the leveraged buyout at issue here, involving privately held securities.”¹⁵¹ The Supreme Court denied a writ of certiorari on January 19, 2010.¹⁵² As one commentator noted, “The main lesson to be learned from *Quality Stores* is that proceeds from an LBO should be ‘funneled’ through a financial institution as a ‘settlement payment’ to increase the possibility the payments will be shielded from fraudulent transfer scrutiny.”¹⁵³

III. ANALYSIS

Did the Sixth Circuit and its two lower courts make the right decision in *QSI*? When considering whether § 546(e) should properly be applied to LBOs of privately held companies, three questions arise: (1) Is the result justified by the statutory language? (2) Is it justified by congressional intent? And, (3) is it good public policy? Applying § 546(e) to the LBOs of private companies may be justified by the statutory language and congressional intent. However, it is a close question, and the better conclusion is that they are both ambiguous. Furthermore, it is not good public policy. Congress’s policy may be sound when applied to publicly traded securities, but it loses its rationale and purpose when applied to privately traded securities.

145. *Id.*; *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731, 742 (W.D. Mich. 2007); *QSI III*, 571 F.3d at 550.

146. *QSI I*, 355 B.R. at 636.

147. *Id.*

148. *Id.*

149. *QSI II*, 382 B.R. at 743.

150. *QSI III*, 571 F.3d at 551.

151. *Id.* at 547.

152. *QSI Holdings, Inc. v. Alford*, 130 S. Ct. 1141 (2010).

153. Hesse, *supra* note 22, at 23.

A. Plain Meaning?

Does the statutory language justify applying § 546(e) to LBOs of private companies? Courts are decidedly split on this question, but the plain meaning of § 546(e) cannot definitively justify applying it to LBOs of private companies. The text of section 546(e) reads as follows:¹⁵⁴

(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.¹⁵⁵

As it applies to an LBO, the key language in § 546(e) is that the trustee may not avoid a transfer that is a “settlement payment” made “by or to” a “financial institution,” except under § 548(a)(1)(A).¹⁵⁶ One court recognized three conditions for the § 546(e) defense to apply.¹⁵⁷ First, the prepetition transfer must be a settlement payment; second, the transfer must be made by or to a financial institution; and third, the transfer must not be made with actual intent to hinder, delay, or defraud.¹⁵⁸

1. “Settlement Payment”

The definition of settlement payment is crucial to § 546(e). There are two statutory definitions of settlement payment—§ 101(51A) and § 741(8)—but § 741(8) applies to LBO transactions.¹⁵⁹ Section 101(51A)’s definition only applies to forward contracts.¹⁶⁰ Section

154. The task of statutory analysis “begins where all such inquiries must begin: with the language of the statute itself.” *United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 241 (1989).

155. 11 U.S.C. § 546(e) (2006).

156. *Id.*

157. *Loranger Mfg. Corp. v. PNC Bank (In re Loranger Mfg. Corp.)*, 324 B.R. 575, 583 (Bankr. W.D. Pa. 2005).

158. *Id.* Note that no other case has so explicitly recognized these elements.

159. Thomas G. Kelch, *Forward Contracts, Bankruptcy Safe Harbors and the Electricity Industry*, 51 WAYNE L. REV. 49, 101 (2005).

160. *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731, 737 n.4 (W.D. Mich. 2007) (“The definition of § 101(51A) applies to forward contract provisions under the Bankruptcy Code and is inapplicable to the circumstances of this case.”). It is noteworthy that § 101(51A) is consid-

741(8) states: “[S]ettlement payment’ means 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”¹⁶¹

Courts have stated that this definition is “circular and cryptic,”¹⁶² “as opaque as it is circular,”¹⁶³ and that “[e]ssentially, it provides that a settlement payment is a settlement payment.”¹⁶⁴ The only thing that saves the definition from being a “meaningless tautology”¹⁶⁵ is its concluding phrase: “or any other similar payment commonly used in the securities trade.”¹⁶⁶ Therefore, the next question is what is a settlement payment as commonly used in the securities trade? To answer that, one must know something about settlement in the securities trade.

a. The Clearance and Settlement System

“Clearance and settlement” refers to a national system established by the Securities and Exchange Commission¹⁶⁷ where parties agree on the terms of a securities trade and then arrange for the delivery and payment required by that trade.¹⁶⁸ After any securities trade is executed, a trade comparison is done whereby buyers and sellers (broker-dealers) agree on terms and confirm that a contract exists.¹⁶⁹ Trade

ered broader than § 741(8) because it includes “net settlement payments,” which are not a part of § 741(8). Kelch, *supra* note 159, at 101. For a case defining “forward contract” see *Hudson v. E.I. duPont de Nemours & Co. (In re National Gas Distrib.)*, 556 F.3d 247, 255 (4th Cir. 2009). For a case defining “settlement payment” in relation to a forward contract see *Olympic Natural Gas Co. v. Morgan Stanley Capital Group Inc. (In re Olympic Natural Gas Co.)*, 294 F.3d 737, 742 (5th Cir. 2002).

161. 11 U.S.C. § 741(8) (2006). Section 101(51A) reads as follows:

The term “settlement payment” means, for purposes of the forward contract provisions of this title, a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.

Id. § 101(51A).

162. Zahn v. Yucaipa Capital Fund, 218 B.R. 656, 675 (D.R.I. 1998).

163. Brandt v. Hicks, Muse & Co. (*In re Healthco Int’l, Inc.*), 195 B.R. 971, 983 (Bankr. D. Mass. 1996).

164. Zahn, 218 B.R. at 675.

165. Official Comm. of Unsecured Creditors v. Lattman (*In re Norstan Apparel Shops, Inc.*), 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007).

166. 11 U.S.C. § 741(8) (2006).

167. Neil M. Garfinkel, *No Way Out: Section 546(e) is No Escape for the Public Shareholder of a Failed LBO*, 1991 COLUM. BUS. L. REV. 51, 63–64 (1991).

168. Richard C. Strasser, *Issues in Securities Regulation*, 2 J. OF BANKR. L. & PRAC. 436, 438 (1993).

169. *Id.*

comparison is generally the responsibility of the marketplace where the trade occurs.¹⁷⁰ Next, most trades clear through a continuous net settlement accounting system under which the clearing agency¹⁷¹ nets each member's sales and purchases to arrive at a daily net deliver or receive obligation and a daily net settlement payment obligation.¹⁷² Finally, clearing members settle their net obligations with the clearing agency.¹⁷³ "[T]he trades are settled" when funds and securities are delivered in satisfaction of the obligations.¹⁷⁴ This final settlement can take place up to three days after the date of the trade.¹⁷⁵

Partly because of this delay between when a trade takes place and when it is settled, it is critical to the system's success that all obligations are guaranteed.¹⁷⁶ Buyers make guarantees, sellers make guarantees, and at the same time, the clearing agency guarantees the obligations of them both in case either (or both) defaults.¹⁷⁷ This system insures against the risk that a clearing member will default on its obligations.¹⁷⁸ However, when securities markets experience extreme volatility or when a member declares bankruptcy there is a risk that the failure of one clearing member could cause a ripple effect that forces other clearing members to default, thereby threatening the integrity of the entire system.¹⁷⁹ Part of section 546(e)'s purpose is to help ensure this system's stability by protecting such transactions from the Code's preference and fraudulent transfer provisions.¹⁸⁰

b. Influential Cases that Define Settlement Payment

This system only relates to publicly traded securities. Where a securities transaction is entirely private, such as in an LBO of a privately held company (where a bank acts as an agent to collect securities and distribute cash to securities holders), it is difficult to see how the purpose of protecting the national clearance and settlement system has any relationship to that LBO.¹⁸¹ On the other hand, if the view is

170. *Id.*

171. *See* 11 U.S.C. § 101(48).

172. Strasser, *supra* note 168.

173. *Id.*

174. Garfinkel, *supra* note 167, at 64.

175. *About Settling Trades in Three Days: T+3*, U.S. SEC, <http://www.sec.gov/investor/pubs/tpus3.htm> (last modified May 21, 2004).

176. Garfinkel, *supra* note 167, at 64.

177. *Id.* at 64-65; Strasser, *supra* note 168, at 438.

178. Strasser, *supra* note 168, at 438.

179. *Id.* at 438-39; Garfinkel, *supra* note 167, at 65.

180. Strasser, *supra* note 168, at 439.

181. In fact, as many cases do, it is entirely possible to conclude that because there is no relationship between the purpose of protecting this clearance and settlement system, § 546(e)

taken that settlement payments are merely payments that complete or conclude a transaction,¹⁸² as the statute suggests,¹⁸³ then the purpose behind the law is irrelevant as long as that interpretation accords with the Code's plain meaning. The Tenth Circuit considered this interpretive riddle in *Kaiser Steel Corp. v. Pearl Brewing Co.*,¹⁸⁴ which was one in a series of cases¹⁸⁵ that were the first to apply § 546(e) to shield an LBO from fraudulent conveyance law,¹⁸⁶ albeit in relation to a publicly traded company.¹⁸⁷

The transfers in *Kaiser* were typical for any LBO: a private group of outside investors purchased all outstanding shares of Kaiser Steel's publicly traded stock paying, in part, with a bank loan secured by the corporation's assets.¹⁸⁸ The stock was collected by a disbursing agent, Bank of America (a "financial institution"), and the shareholders were each paid.¹⁸⁹ When Kaiser filed a Chapter 11 petition approximately three years later, it commenced a fraudulent-conveyance action to avoid the LBO and recover the shareholders' payouts.¹⁹⁰ The issue before the court was whether the consideration paid to share-

should therefore not apply to private securities transactions. *See, e.g.*, Official Comm. of Unsecured Creditors v. Lattman (*In re Norstan Apparel Shops, Inc.*), 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007) (holding that because the transfer in question did not involve "publicly traded securities or otherwise implicate the public securities markets, the transfer is not a 'settlement payment' within the meaning of § 741(8) of the Bankruptcy Code"). This will be considered in more detail below. *See infra* Part III.B.

182. Kelch, *supra* note 159, at 96. Note that cases have held that a "settlement payment" includes partial and interim settlement payments as well. *Jonas v. Resolution Trust Corp.* (*In re Comark*), 971 F.2d 322, 325–26 (9th Cir 1992) (defining settlement payment as "any transfers that occur during the settlement process"); *Wyle v. Howard* (*In re Hamilton Taft & Co.*), 176 B.R. 895, 899 (Bankr. N.D. Cal. 1995), *aff'd*, 114 F.3d 991 (1997) (holding that settlement payment "includes any transfer of cash or securities toward completion of a securities transaction"). This fits within the plain meaning of § 741(8), which includes the words, "a preliminary settlement payment, a partial settlement payment, [and] an interim settlement payment." 11 U.S.C. § 741(8) (LexisNexis 2011).

183. 11 U.S.C. 741(8) (2006) ("a final settlement payment").

184. *Kaiser Steel Corp. v. Pearl Brewing Co.* (*In re Kaiser Steel Corp.*), 952 F.2d 1230 (10th Cir. 1991).

185. *Kaiser Steel Corp. v. Jacobs* (*In re Kaiser Steel Corp.*) 105 B.R. 639 (Bankr. D. Colo. 1989), *rev'd*, 110 B.R. 514 (D. Colo 1990), *aff'd sub nom.* *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990); *Kaiser Steel Corp. v. Pearl Brewing Co.* (*In re Kaiser Steel Corp.*), 952 F.2d 1230, 1235 (10th Cir. 1991). *See also supra* note 112.

186. Garfinkel, *supra* note 167, at 60–61 ("This defense was one of first impression. To the circuit court's knowledge, no one had ever attempted to apply section 546(e) to an LBO.").

187. *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 847 (10th Cir. 1990).

188. *Kaiser Steel Corp. v. Pearl Brewing Co.* (*In re Kaiser Steel Corp.*), 952 F.2d 1230, 1235 (10th Cir. 1991).

189. *Id.* at 1235–36.

190. *Id.* at 1236.

holders was exempt from avoidance under § 546(e) as settlement payments.¹⁹¹

In defining settlement payment, the court first noted that the definition attempts to “encompass all ‘settlement payments’ commonly used in the securities trade.”¹⁹² With the acknowledgement that what is “commonly used in the securities trade” is key language, the court considered the nature and procedures of the national clearance and settlement system.¹⁹³ It identified two specific types of settlement payments: “street-side settlements,” which take place within the clearance and settlement system between brokers and the clearing agency, and “customer-side settlements,” which occur between brokers and their customers.¹⁹⁴ The original purpose behind § 546(e)’s enactment may have been to protect street-side settlements between brokers and the clearing agency, but as the *Kaiser* court recognized, Congress used no such language to exclude customer-side settlements.¹⁹⁵ Additionally, § 741(8) applies to settlement payments made in repurchase agreements, which are not trades on an exchange and which involve an entirely different settlement process.¹⁹⁶ This indicates that there is not necessarily a link between what a settlement payment is and the clearance and settlement system, although there is a policy link.

The plain meaning of the statute therefore suggests no clear intent to limit the definition to a street-side settlement strictly within the clearing and settlement system. As the *Kaiser* court noted, “While the leveraged buy out may not be a ‘routine’ securities trade . . . we cannot deny what in substance took place here. The LBO was a securities transaction, varying only in form from the various other ways in which a shareholder’s equity interest can be sold.”¹⁹⁷ In other words, a security may be sold in numerous ways. In each way it is sold, it will inevitably include a settlement payment, because a settlement payment is nothing more than “the completion of a securities transaction.”¹⁹⁸ Therefore, whenever a security is sold, regardless of the manner in which it is sold, that transfer results in a settlement payment, and that in turn shields it from avoidance by § 546(e). It is no

191. *Id.*

192. *Id.* at 1237.

193. *In re Kaiser Steel*, 952 F.2d at 1235, 1237–38; *see also supra* Part III.A.1.a.

194. *In re Kaiser Steel*, 952 F.2d at 1237–38.

195. *Id.* at 1239.

196. *Id.* *See infra* note 260.

197. *Id.* at 1239–40.

198. *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (quoting ALLEN H. PESSIN & JOSEPH A. ROSS, WORDS OF WALL STREET: 2000 INVESTMENT TERMS DEFINED 227 (Dow Jones-Irwin 1983)).

wonder, then, that the Tenth Circuit found that the definition of settlement payment is “‘extremely broad.’”¹⁹⁹

But what of the case that the Tenth Circuit relied on to determine that the definition of settlement payment is extremely broad? This case, *Bevill, Bresler & Schulman Asset Management Corp. v. Spencer Savings & Loan Association*,²⁰⁰ has also turned out to be an extremely influential case in the battle between LBOs and fraudulent conveyance law²⁰¹ because it discusses some of the legislative history behind § 546(e) and the definition of settlement payment.²⁰²

199. *Id.* at 848 (quoting *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.* (*Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*), 878 F.2d 742, 751 (3d Cir. 1989)).

200. *Kaiser* also relied on *Blanton v. Prudential-Bache Securities (In re Blanton)*, 105 B.R. 321 (Bankr. E.D. Va. 1989), but that case has proved much less influential in cases applying § 546(e) to LBOs. William C. Rand, *In Re Kaiser Steel Corporation: Does Section 546(e) of the Bankruptcy Code Apply to a Fraudulent Conveyance Made in the Form of an LBO Payment?*, 19 *FORDHAM URB. L.J.* 87, 97 (1991) (“The Tenth Circuit in *Kaiser* relied on both *In re Blanton* and *In re Bevill* to extend a broad definition of ‘settlement payment’ to the equity securities markets.”).

201. *In re Bevill*, 878 F.2d at 751. *Bevill* has been cited by nearly every major case considering the definition of settlement payment and whether § 546(e) shields LBOs from fraudulent transfer law. *See, e.g.*, *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 848 (10th Cir. 1990); *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1237 (10th Cir. 1991); *Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322, 323 (9th Cir. 1992); *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505, 515 (3d Cir. 1999); *In re QSI Holdings, Inc. (QSI III)*, 571 F.3d 545, 549 (6th Cir. 2009); *Jonas v. Farmer Bros. Co. (In re Comark)*, 145 B.R. 47, 49 (9th Cir. B.A.P. 1992); *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 535 (9th Cir. B.A.P. 2005); *Kaiser Steel Res. Inc. v. Jacobs (In re Kaiser Steel Corp.)*, 110 B.R. 514, 522 (D. Colo. 1990); *Wieboldt Stores, Inc. ex rel. Raleigh v. Schottenstein (In re Wieboldt Stores, Inc.)*, 131 B.R. 655, 663 (N.D. Ill. 1991); *Jewel Recovery, L.P. v. Gordon (In re Zale Corp.)*, 196 B.R. 348, 353 (N.D. Tex. 1996); *Jackson v. Mishkin (In re Adler, Coleman Clearing Corp.)*, 263 B.R. 406, 475 (S.D.N.Y. 2001); *Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Grp. (In re Hechinger Inv. Co. of Del.)*, 274 B.R. 71, 85 (D. Del. 2002); *Official Comm. of Unsecured Creditors v. Clark (In re Nat'l Forge Co.)*, 344 B.R. 340, 352 (W.D. Pa. 2006); *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 736 (W.D. Mich. 2007); *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423, 430 (S.D.N.Y. 2009); *Kaiser Steel Corp. v. Jacobs (In re Kaiser Steel Corp.)* 105 B.R. 639, 651 (Bankr. D. Colo. 1989), *rev'd*, 110 B.R. 514 (D. Colo. 1990), *aff'd sub nom. Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990); *Jonas v. Farmer Bros. (In re Comark)*, 124 B.R. 806, 809 (Bankr. C.D. Cal. 1991); *Ames Dep't Stores, Inc. v. Wertheim Schroder & Co. (In re Ames Dep't Stores, Inc.)*, 161 B.R. 87, 92 (Bankr. S.D.N.Y. 1993); *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 195 B.R. 971, 983 (Bankr. D. Mass. 1996); *Mishkin v. Ensminger (In re Adler, Coleman Clearing Corp.)*, 218 B.R. 689, 703 (Bankr. S.D.N.Y. 1998); *In re the It Group, Inc.*, 359 B.R. 97, 100 (Bankr. D. Del. 2006); *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68, 75 (Bankr. E.D.N.Y. 2007); *Brandt v. B.A. Capital Co. (In re Plassein Int'l Corp.)*, 366 B.R. 318, 323 (Bankr. D. Del. 2007).

202. *In re Bevill*, 878 F.2d at 747.

c. The Legislative History of Settlement Payment

Although *Bevill* dealt with § 546(f)²⁰³ in a repurchase-agreement transaction,²⁰⁴ to interpret § 546(f) the court had to delve into the legislative history of § 546(e), which was a precursor to that section.²⁰⁵ When Congress amended the Bankruptcy Code in 1982 to create § 546(e),²⁰⁶ it was “concerned about the volatile nature of the commodities and securities markets, and decided that certain protections were necessary to prevent ‘the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected market.’”²⁰⁷ As Congress stated, part of its purpose was “intended to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.”²⁰⁸ The 1982 legislative changes to

203. Section 546(f) is very similar to § 546(e). Where § 546(e) prevents avoidance of margin payments or settlement payments by or to a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant or securities clearing agency, § 546(f) prevents avoidance of margin payments or settlement payments made by or to a repo participant in connection with a repurchase agreement. 11 U.S.C. § 546(e)–(f) (2006). They both use the term settlement payment. *Id.*

204. A repurchase agreement, otherwise known as a repo, is a “short-term loan agreement by which one party sells a security to another party but promises to buy back the security on a specified date at a specified price.” BLACK’S LAW DICTIONARY 1419 (9th ed. 2009). The *Comark* court elaborates as follows:

In a Repo arrangement, the dealer sells specified securities to a purchaser, but also agrees to repurchase the securities later at the original price, plus an agreed upon additional amount usually representing interest on the original purchase price. A Reverse Repo basically is the reverse: the dealer buys securities and agrees to resell the securities to the seller in the future. Reverse Repos can function as a loan. The seller receives cash for the securities, but must repurchase the securities in the future at the same price. Thus, the securities “sold” to the dealer can be viewed as being collateral for a loan.

In re Comark, 971 F.2d at 323 (citation omitted). See 11 U.S.C. § 101(46)–(47).

205. *In re Bevill*, 878 F.2d at 747.

206. Section 546(d), which later became the current § 546(e), originated with § 764(c), which was repealed. H.R. REP. NO. 97-420, at 3 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 585, 1982 WL 25042. The *Comark* court noted, “Section 546(e) was enacted originally as § 546(d) in 1982 by Public Law No. 97-222. In 1984, this provision [§ 546(d)] was redesignated as section 546(e).” *In re Comark*, 145 B.R. at 51 n.10. Neil M. Garfinkel explains further:

Section 546(e) has its origins in a 1975 New York district court case, *Seligson v. New York Produce Exchange*, [394 F. Supp. 125 (S.D.N.Y. 1975)] in which the court refused to find that a 12 million dollar margin payment made by a bankrupt commodities broker was exempt from the avoiding powers of the broker’s trustee in bankruptcy. In response to *Seligson*, Congress incorporated section 764(c) into the new Bankruptcy Code, intending to provide protection from the types of claims represented by *Seligson*.

Garfinkel, *supra* note 167, at 61 (citations omitted). See also *Rand*, *supra* note 200, at 102.

207. *In re Bevill*, 878 F.2d at 747 (quoting H.R. REP. NO. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042).

208. H.R. REP. NO. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042.

“broaden the commodities market protections and expressly extend similar protections to the securities market”²⁰⁹ was consistent with the policy behind parts of the 1978 enactment of the Bankruptcy Code to protect the commodities market and insure its stability.²¹⁰

With that background in mind, the *Bevill* court examined the definition of settlement payment, which it reasoned is “extremely broad.”²¹¹ This, the court noted, was consistent with Congress’s intention that a settlement payment should include the purchaser paying for the securities as well as the transfer of the securities by the dealer.²¹² In addition, settlement payment “includes transfers which are normally regarded as part of the settlement process, whether they occur on the trade date, the scheduled settlement day, or any other date in the settlement process for the particular type of transaction at hand.”²¹³

In actuality, other than concluding that the definition of settlement payment is extremely broad based on a statement of policy in the legislative history, *Bevill* has no relationship to § 546(e) or LBOs.²¹⁴ One commentator in particular has recognized this and criticized the *Kaiser* court for relying so heavily on *Bevill*.²¹⁵ Another commentator criticized a broad reading of settlement payment based on § 546(e)’s legislative history, stating, “Section 546(e)’s legislative history . . . is hardly dispositive as to whether payments to selling shareholders may be settlement payments.”²¹⁶ Both of these criticisms are correct.

209. *Id.*

210. *Id.* at 2.

211. *In re Bevill*, 878 F.2d at 749, 751.

212. *Id.* at 752.

213. *Id.*

214. *See generally id.* *See also* Beckerman & Stark, *supra* note 31 (“[Section] 546(e) does not, on its face, suggest Congress intended to immunize cashed out shareholders from a fraudulent conveyance attack. Nor does the legislative history indicate that Congress had such intention.”); Rand, *supra* note 200, at 92–93 (“The *Kaiser* decision unfairly relied on the persuasive authority of the *In re Blanton* and *In re Bevill* decisions. These cases involved different markets and different sections of the Bankruptcy Code.”).

215. Sabino, *supra* note 35, at 51.

The Third Circuit in *Bevill*, *Bessler* was factually distinguishable in that the court was: a) dealing with federal government securities “repo” agreements, not payouts to the selling shareholders of an LBO target company; b) confronted with a defunct brokerage, not a failed LBO under attack as a fraudulent conveyance; and c) most importantly, the Third Circuit explicitly decided its proceeding under a different exception to the trustee’s avoiding powers. The *Schwab* and *Kaiser* rationales are therefore seriously misplaced in terms of the common law they both prominently relied upon.

Id.

216. Michael L. Cook, Brad J. Axelrod & Geoffrey S. Frankel, *The Judicially Created “Innocent Shareholder” Defense to Constructive Fraudulent Transfer Liability in Failed Leveraged Buyouts*, 43 S.C. L. REV. 777, 803 (1992).

However, despite these and other attacks on *Kaiser*,²¹⁷ it is conventional wisdom that “§ 546(e) was enacted to protect the nation’s financial markets against instability caused by the reversal of settled securities transactions.”²¹⁸ Besides giving us this general policy, the legislative history is unhelpful in interpreting the statutory language of § 546(e) or the meaning of the term settlement payment. Congress stated nothing specific about how courts should apply either § 546(e) or § 741(8). Furthermore, the legislative history is silent on the subject of LBOs or whether § 546(e) should shield them from fraudulent conveyance law.²¹⁹

d. “Commonly Used in the Securities Trade”

Going back to the definition of settlement payment in § 741(8),²²⁰ does the phrase “commonly used in the securities trade” shine light on whether the plain meaning of the statute justifies applying § 546(e) to LBOs of private companies? The Sixth Circuit in *QSI* noted that this is the critical phrase in the definition of settlement payment.²²¹ It is the only thing that keeps § 741(8) from being hopelessly circular.²²²

One might first assume that expert evidence could be helpful in determining how settlement payment is commonly used in the securities trade. If common usage defines the term, it seems fitting to hear expert testimony on that usage. The Tenth Circuit in *Kaiser* apparently reviewed expert testimony on the record as to the meaning of settlement payment,²²³ but despite that, at least one court has properly held that this is unnecessary.²²⁴ Courts instead treat the meaning of settle-

217. See, e.g., Garfinkel, *supra* note 167, at 60–61; Gerald K. Smith & Frank R. Kennedy, *Fraudulent Transfers and Obligations: Issues of Current Interest*, 43 S.C. L. REV. 709 (1992); Rand, *supra* note 200, at 87; Jane Elizabeth Kiker, *Judicial Repeal of Fraudulent Conveyance Laws: Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846 (10th Cir. 1990), 14 HAMLINE L. REV. 453 (1991).

218. *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009).

219. See H.R. REP. NO. 97-420 (1982), reprinted in 1982 U.S.C.A.N. 583, 1982 WL 25042; *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 850 (10th Cir. 1990) (“Neither LBOs nor other exceptional transactions were even mentioned in any of the discussions of the securities industry in the reports, debates, and hearings on the bill.”).

220. 11 U.S.C. § 741(8) (2006) (“‘[S]ettlement payment’ means 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 . . .”).

221. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 549 (6th Cir. 2009), cert. denied, 130 S. Ct. 1141 (2010).

222. *Official Comm. of Unsecured Creditors v. Lattman (In re Norstan Apparel Shops, Inc.)*, 367 B.R. 68, 76 (Bankr. E.D.N.Y. 2007).

223. See *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 850 n.6 (10th Cir. 1990).

224. *Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322, 324 (9th Cir. 1992).

ment payment as a question of statutory interpretation.²²⁵ Nevertheless, settlement payment “should be given its established meaning in that industry.”²²⁶ It is simply that a court will make that decision, not an expert.²²⁷

As courts have done,²²⁸ referring to a dictionary to define settlement payment would seem helpful. However, the results yield only broad generalities.²²⁹ The dictionaries the Tenth Circuit in *Kaiser* consulted give the following definitions: “the completion of a securities transaction”;²³⁰ “finishing up of a transaction or group of transactions”;²³¹ “the completion of a transaction, wherein securities and corresponding funds are delivered and credited to the appropriate accounts”;²³² “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”;²³³ and “transfer of the security (for the seller) or cash (for the buyer) in order to complete a security transaction.”²³⁴ Although these definitions suggest limits, given their generality, it is not surprising that the Sixth Circuit agreed that “commonly used in the securities trade” is “a catchall phrase intended to underscore the *breadth* of the § 546(e) exemption.”²³⁵

225. *Id.*; *Wyle v. Howard, Weil, Labouisse, Friedrichs Inc. (In re Hamilton Taft & Co.)*, 176 B.R. 895, 899 n.2 (Bankr. N.D. Cal. 1995), *aff'd*, 196 B.R. 532 (N.D. Cal. 1995), *aff'd*, 114 F.3d 991 (9th Cir. 1997) (citing *Comark*).

226. *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009).

227. The key significance of this is that whether a transaction is a settlement payment may be determined as a matter of law on summary judgment. *In re Comark*, 971 F.2d at 324–25.

228. *See, e.g., Kaiser Steel*, 913 F.2d at 849; *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1238 (10th Cir. 1991); *Alfa, S.A.B. de C.V. v. Enron Creditors Recovery Corp. (In re Enron Creditors Recovery Corp.)*, 422 B.R. 423, 430 (S.D.N.Y. 2009).

229. *Kaiser Steel*, 913 F.2d at 849.

230. *Id.* (quoting ALLEN H. PESSIN & JOSEPH A. ROSS, *WORDS OF WALL STREET: 2000 INVESTMENT TERMS DEFINED* 227 (Dow Jones-Irwin 1983)).

231. *Id.* (quoting DAVID M. BROWNSTONE & IRENE M. FRANCK, *THE VNR INVESTOR'S DICTIONARY* 279 (1981)).

232. *Id.* (quoting GROUP OF THIRTY, *CLEARANCE AND SETTLEMENT SYSTEMS IN THE WORLD'S SECURITIES MARKETS* 86 (1989)).

233. *Id.* (quoting NEW YORK STOCK EXCHANGE, *LANGUAGE OF INVESTING GLOSSARY* 30 (1981)).

234. *Kaiser Steel*, 913 F.2d at 849 (quoting DAVID L. SCOTT, *WALL STREET WORDS* 320 (Houghton Mifflin Co., 1st ed. 1988)).

235. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 550 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010) (quoting *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 986 (8th Cir. 2009)).

While the Sixth Circuit recognized that settlement payment is broadly defined, the court also recognized that it is limiting.²³⁶ *QSI* involved “a transaction with the characteristics of a common leveraged buyout involving the merger of nearly equal companies”²³⁷ This, it implied, is a transaction that is common in the securities trade.²³⁸ The court contrasted that common type of LBO with the transaction in *In re Norstan Apparel Shops, Inc.*²³⁹

In *Norstan*, the LBO in question was of a closely held S-Corporation.²⁴⁰ Two individuals controlled the company.²⁴¹ One was the president and director, controlling fifty percent of *Norstan*’s shares, and the other was the treasurer and secretary, controlling the other fifty percent.²⁴² The Sixth Circuit in *QSI* contended that this LBO “lacked many of the indicia of transactions ‘commonly used in the securities trade.’”²⁴³ Apparently, the Sixth Circuit focused on the fact that there were only two shareholders in *Norstan*²⁴⁴ and unwinding that transaction would not “implicate public securities markets,”²⁴⁵ while *QSI* had approximately 170 shareholders.²⁴⁶ That the number of shareholders makes a difference is a debatable point, especially given that both companies were privately held.²⁴⁷ It may not be common, but it is certainly not unheard of for closely held corporations run by a small number of individuals to be the targets of LBOs. Is there a qualitative difference between a company with two shareholders and a company with 170 such that will affect the plain meaning of the statute? It is hard to see how that makes a difference to the statute’s supposed plain meaning. The Sixth Circuit skirts these issues and never explains why the transaction in *QSI* is common but the one in *Norstan* is not.²⁴⁸ In fact, the court conflates several arguments

236. *See id.* *See also* KSC Recovery, Inc. v. First Boston Corp. (*In re Kaiser Merger Litig.*), 168 B.R. 991, 1001 (D. Colo. 1994) (“[W]hile the definition of ‘settlement payment’ is broad, it is not boundless.”).

237. *QSI III*, 571 F.3d at 550.

238. *Id.*

239. Official Comm. of Unsecured Creditors v. Lattman (*In re Norstan Apparel Shops, Inc.*), 367 B.R. 68 (Bankr. E.D.N.Y. 2007).

240. *Id.* at 73.

241. *Id.* at 72.

242. *Id.*

243. *QSI III*, 571 F.3d at 550.

244. *In re Norstan*, 367 B.R. at 72.

245. *QSI III*, 571 F.3d at 550.

246. *Id.* at 547.

247. *In re Norstan*, 367 B.R. at 73; *QSI Holdings* (6th Cir.), 571 F.3d at 547.

248. *See generally QSI III*, 571 F.3d 545. The district court and the bankruptcy court in *QSI* also neglected a discussion of how the phrase “commonly used in the securities trade” relates to a plain meaning interpretation. *See QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731 (W.D.

throughout its short discussion, using notions of what is common in the securities trade along with points of plain meaning and the policy argument that the transaction in *QSI* could impact financial markets just as severely as the unwinding of any publicly traded security.²⁴⁹

The District Court in *QSI* takes the discussion a bit further where it notes that the phrase “commonly used in the securities trade” allows courts to do a case-by-case analysis.²⁵⁰ In cases where abuse seems obvious, this language allows courts to refuse to apply § 546(e) protection.²⁵¹ If a transaction is illegal or somehow abusive, it can never rightly be called common.²⁵² Other courts have also taken this approach.²⁵³

In a Ninth Circuit case, *In re Grafton Partners*,²⁵⁴ the transaction in question was a withdrawal of capital contributions out of a Ponzi scheme.²⁵⁵ The Bankruptcy Appellate Panel held that a “non-public transaction in illegally unregistered securities are not ‘commonly used in the securities trade.’”²⁵⁶ The panel noted that the legislative history states that “a settlement payment made by a clearing organization” cannot be avoided “except where the transfer was made with intent to hinder, delay, or defraud other creditors and was not taken in good faith.”²⁵⁷ With this background, the panel concluded that, “[i]f integrity and compliance with securities laws are to be preserved . . . then trades in illegally unregistered securities must flunk the common usage test.”²⁵⁸ *Grafton* held that “the term ‘settlement payment’ implies trades that comply with the securities laws.”²⁵⁹ Despite the apparent soundness of this approach, *Grafton* has nonetheless been criticized for looking beyond statutory language and attempting to discern con-

Mich. 2007); *Quality Stores, Inc. v. Alford* (*In re Quality Stores, Inc.*) (*QSI I*), 355 B.R. 629 (Bankr. W.D. Mich. 2006).

249. *QSI III*, 571 F.3d at 550.

250. *QSI II*, 382 B.R. at 742.

251. *Id.* at 743.

252. *Id.*

253. *Kipperman v. Circle Trust F.B.O.* (*In re Grafton Partners, L.P.*), 321 B.R. 527, 529 (9th Cir. B.A.P. 2005); John J. Monaghan, *Settlement Payments in Financial Industry Transactions: How Safe is the Harbor?*, ABI FIN. & BANKING COMMITTEE NEWSL. (Am. Bankr. Inst., Alexandria, Va.), Aug. 2007, at 381, 386, available at <http://www.abiworld.org/committees/newsletters/financebank/vol4num2/3.pdf>.

254. *In re Grafton Partners*, 321 B.R. at 527.

255. *Id.* at 529. Actual fraud under § 548(a)(1)(A) was not an issue before the B.A.P. in this case. *Id.* at 532 n.5.

256. *Id.* at 529.

257. *Id.* at 538 n.20 (quoting H.R. REP. NO. 97-420, at 3 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 585, 1982 WL 25042).

258. *Id.* at 538.

259. *In re Grafton Partners*, 321 B.R. at 539.

gressional intent.²⁶⁰ Such criticism seems hollow and pointlessly formalistic in the face of clearly illegal²⁶¹ unregistered securities.

The Bankruptcy Court for the Southern District of New York took a similar approach to *Grafton* in two Enron cases.²⁶² In *Enron Corp. v. J.P. Morgan Securities, Inc. (Enron I)*,²⁶³ there was a series of transactions where Enron redeemed over \$1.1 billion of its outstanding commercial paper.²⁶⁴ Enron completed these transactions less than a month before it filed for bankruptcy.²⁶⁵ The court first recognized that the phrase “commonly used in the securities trade”²⁶⁶ in the definition of settlement payment saves it from “circularity” and provides it meaning.²⁶⁷ With this foundation, the court considered three crucial allegations.²⁶⁸ First and most importantly as it relates to what is common in the securities trade, Enron made the payments prior to the maturity date of the commercial paper, contrary to the terms of its offering.²⁶⁹ Second, the payments were at significantly higher prices than current market rates.²⁷⁰ Third, the commercial paper holders coerced Enron to pay off the paper early due to the public announcements about the company being in a severe financial crisis.²⁷¹ Because the court concluded that “to qualify as a settlement payment protected by section 546(e) . . . the payment must be common in the securities trade,” it could not dismiss the proceedings.²⁷² A trial was required to determine the facts behind whether the transactions were common in the securities trade.²⁷³

260. *Contemporary Indus. Corp. v. Frost (In re Contemporary Indus. Corp.)*, No. BK98-80382, 2007 WL 5256918, at *4 (Bankr. D. Neb. June 29, 2007).

261. The principals of the Ponzi scheme in *Grafton* confessed. *In re Grafton Partners*, 321 B.R. at 529.

262. Monaghan, *supra* note 253, at 386. This source explores three Enron cases, but only two deal sufficiently with the “commonly used in the securities trade” issue to warrant discussion here.

263. *Enron Corp. v. J.P. Morgan Sec., Inc. (In re Enron Corp.) (Enron I)*, 325 B.R. 671 (Bankr. S.D.N.Y. 2005).

264. *Id.* at 680.

265. The last payment was on November 6, 2001. *Id.* Enron declared bankruptcy on December 2, 2001. Kurt Eichenwald with Diana B. Henriques, *Enron's Many Strands: The Company Unravels; Enron Buffed Image to a Shine Even as It Rotted from Within*, N.Y. TIMES, Feb. 10, 2002, § 1.

266. 11 U.S.C. 741(8) (2006).

267. *Enron I*, 325 B.R. at 685.

268. Because the court was ruling on a motion to dismiss, it was forced to accept Enron's allegations as true. *Id.* at 686.

269. *Id.* at 685.

270. *Id.* at 686.

271. *Id.* at 686.

272. *Enron I*, 325 B.R. at 687.

273. *Id.*

The transaction in *Enron Corp. v. International Finance Corp. (Enron II)*²⁷⁴ was a complicated collateralized loan obligation in which Enron and its affiliates monetized a portfolio of loan facilities and issued several classes of notes.²⁷⁵ Because of payment defaults on the underlying loans, the portfolio of loan facilities declined in value.²⁷⁶ However, due to put options²⁷⁷ that Enron had granted, it was forced to purchase the outstanding notes at face value plus accrued interest, which was significantly above current market value.²⁷⁸ These transfers were accomplished through Chase Manhattan Bank and Bear, Stearns²⁷⁹—financial institutions.²⁸⁰ During the bankruptcy proceedings, Enron sought to avoid these transfers as constructively fraudulent under § 548(a)(1)(B).²⁸¹ The defendants filed motions to dismiss seeking the protection of § 546(e).²⁸² The court followed its earlier decisions where it determined that what is “commonly used in the securities trade” is the defining phrase in the § 741(8) definition of settlement payment.²⁸³ “As such, to discern whether a payment is protected by the safe harbor provisions, a court must examine the operation of trades in the securities industry.”²⁸⁴ As in *Enron I*, the court thought that this was an example of Enron overpaying for something in the marketplace to protect its credit rating.²⁸⁵ But because the transactions at issue here “did not involve outright illegality,” as in *Grafton*,²⁸⁶ “or transparent manipulation,” as in *Enron I*,²⁸⁷ “even if the payments made for the purchase of the securities were above mar-

274. *Enron Corp. v. Int'l Fin. Corp. (In re Enron Corp.) (Enron II)*, 341 B.R. 451 (Bankr. S.D.N.Y. 2006).

275. *Id.* at 454.

276. *Id.*

277. A “put option” is “[a]n option to sell something (esp. securities) at a fixed price even if the market declines; the right to require another to buy.” BLACK’S LAW DICTIONARY 1204 (9th ed. 2009).

278. *Enron II*, 341 B.R. at 454–55.

279. *Id.*

280. *Id.* at 458 (“The Defendants have presented excerpts from the records of various public or quasi-public bodies establishing that . . . Bear, Stearns is a stockbroker, and that Chase is a financial institution. All of the transactions involved transfers either to or from Chase . . . and/or Bear, Stearns.”).

281. *Id.* at 455. See *supra* Part II.B for a discussion of § 548(a)(1)(B) and constructively fraudulent transfer law.

282. *Id.*

283. *Enron II*, 341 B.R. at 457.

284. *Id.* at 457 (citing *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 538 (9th Cir. B.A.P. 2005)).

285. *Id.* at 459.

286. *In re Grafton Partners*, 321 B.R. at 541 (“The fact that the transfer was a transaction in an illegally unregistered security can hardly be described as a ‘payment commonly used in the securities trade.’”).

ket value, the facts as alleged are not sufficient to take these payments out of the realm of settlement payments commonly used in the securities industry”²⁸⁸ Enron may have made a bad deal, the court seemed to say, but that is nonetheless common in the securities trade and therefore protected by § 546(e).²⁸⁹

Based on these cases and others,²⁹⁰ an important key to the plain meaning of the term settlement payment is a rejection of transactions that involve “outright illegality or transparent manipulation.”²⁹¹ A transfer that is simply a bad deal may seem suspicious, but such deals are undeniably common. However, where a transfer is contrary to established law, calling it “common” and protecting it from avoidance seems a clear perversion of the Bankruptcy Code.

A plain-meaning argument against this interpretation of what is common in the securities trade is briefly recognized, but not addressed, in another Enron case, *Enron Corp. v. Bear, Stearns International Ltd (Enron III)*.²⁹² Section 546(e) states that “the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to . . . a . . . financial institution . . . except under section 548(a)(1)(A) of this title.”²⁹³ Thus, § 546(e) does not protect fraudulent transfers, which are avoidable under § 548(a)(1)(A). One could interpret that specific exclusion as an acknowledgement that fraudulent transfers are settlement payments.²⁹⁴ If illegal transfers are not settlement payments and therefore not protected by § 546(e), then the language,

287. *Enron Corp. v. J.P. Morgan Sec., Inc. (In re Enron Corp.) (Enron I)*, 325 B.R. 671, 686 (Bankr. S.D.N.Y. 2005) (“[E]vidence must be presented on the issue of whether the Transfers were the result of the defendants’ manipulation.”).

288. *Enron II*, 341 B.R. at 459.

289. *See id.*

290. *See, e.g., Enron Corp. v. Credit Suisse First Boston Int’l (In re Enron Corp.)*, 328 B.R. 58 (Bankr. S.D.N.Y. 2005) (debtor’s payment to acquire its own shares did not qualify as settlement payment). Yet another Enron case dealt with this same issue. In *Enron Corp. v. Bear, Stearns Int’l Ltd. (Enron III)*, 323 B.R. 857 (Bankr. S.D.N.Y. 2005), the transaction was a complicated equity forward swap where Enron bought 323,000 shares of its own publicly traded stock from Bear, Stearns. *Id.* at 860; Monaghan, *supra* note 253, at 386. The nearly \$26 million purchase price was paid on August 22, 2001, less than four months before Enron declared bankruptcy. *Enron III*, 323 B.R. at 860; Eichenwald & Henriques, *supra* note 265, § 1. The issue was whether the payment, which violated a state statute that prohibits distributions by a corporation while insolvent on account of its stock, can be a settlement payment protected from avoidance by § 546. *Enron III*, 323 B.R. at 876. The court held that where the transaction is void under state law, there was no securities transaction to complete and no settlement payment could result, *id.* at 879, “[t]herefore, the payment could not be considered a settlement payment that qualifies for protection from avoidance under section 546(e) of the Bankruptcy Code.” *Id.*

291. *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 539 (9th Cir. B.A.P. 2005).

292. *Enron III*, 323 B.R. at 877. This is the same case discussed at length in footnote 290.

293. 11 U.S.C. § 546(e) (2006).

294. *Enron III*, 323 B.R. at 877.

“except under section 548(a)(1)(A) of this title”²⁹⁵ is superfluous. Why list that exclusion if the definition of settlement payment already excludes illegal transfers? This argument is too clever by half,²⁹⁶ although it may appeal to a particularly formalistic, plain-meaning-oriented court. The problem with this argument is that the side making it will inevitably be defending an illegal transfer.

Getting back to LBOs, the completion of an LBO of a publicly traded company is undoubtedly a common occurrence in the securities trade, as the Sixth Circuit in *QSI* suggests.²⁹⁷ As the Third Circuit stated, “A payment for shares during an LBO is obviously a common securities transaction . . . ,” and “[d]espite the fact that payments to shareholders in an LBO are not the most common securities transaction, we see no absurd result from the application of the statute’s plain language and will not disregard it.”²⁹⁸ But is it also true that an LBO of a privately held company is common in the securities trade? It is hard to see why the determination of “common in the securities trade” depends on whether the LBO concerns a private or public company. One may be more prevalent than the other, but both are common transactions. If a public-company LBO is common, then a private-company LBO may be common as well. But how common must a transaction be for it to be common in the securities trade? This question does not have an obvious answer.

The phrase “commonly used in the securities trade,”²⁹⁹ does not perfectly clarify whether an LBO of a privately held company should be excluded from § 546(e)’s protection. At best, it informs us that where an LBO is so unusual (or so illegal) as to fall outside the bounds of what is “normal” within the industry, only then should such an LBO not enjoy § 546(e)’s protection. As the district court in *QSI* put it, “until such time as Congress deems it prudent or necessary to amend the statute, the courts will continue to winnow out those exceptional cases at the far end of the spectrum where the exemption is unwarranted.”³⁰⁰ However, by the standard of the above-discussed

295. 11 U.S.C. § 546(e) (2006).

296. “There is something inherently distasteful about really clever lawyers overreaching.” Official Comm. of Unsecured Creditors v. Citicorp N. Am. (*In re TOUSA, Inc.*), 422 B.R. 783, 864 n.51 (Bankr. S.D. Fla. 2009).

297. See *QSI Holdings, Inc. v. Alford* (*In re QSI Holdings, Inc.*) (*QSI III*), 571 F.3d 545, 550 (6th Cir. 2009), cert. denied, 130 S. Ct. 1141 (2010).

298. *Lowenschuss v. Resorts Int’l, Inc.* (*In re Resorts Int’l, Inc.*), 181 F.3d 505, 516 (3d Cir. 1999).

299. 11 U.S.C. § 741(8) (2006).

300. *QSI Holdings, Inc. v. Alford* (*QSI II*), 382 B.R. 731, 743 (W.D. Mich. 2007).

cases, an LBO of a privately held company appears to be just as common in the securities trade as an LBO of a publicly held company.

e. The Meaning of Settlement Payment is Ambiguous

It is now clear that the term settlement payment truly is a broad statutory definition. If one accepts that settlement payment is broad enough to include an LBO of a public company, then there is nothing in the language of the statute to keep one from concluding that settlement payment is also broad enough to include an LBO of a private company. The role of the clearance and settlement system³⁰¹ has convinced some courts to rule that private securities do not come under the scope of what is a settlement payment,³⁰² but this overreaches. Besides giving us the general policy that “§ 546(e) was enacted to protect the nation’s financial markets against instability caused by the reversal of settled securities transactions,”³⁰³ the legislative history is unhelpful. Congress stated nothing specific about how courts should apply either § 546(e) or § 741(8), and it was silent on the topic of LBOs or whether § 546(e) should shield them from fraudulent transfer law.³⁰⁴ Neither is the phrase “commonly used in the securities trade”³⁰⁵ useful in finding a distinction between LBOs of public and private companies. Courts have used that phrase to exclude certain transactions under unusual circumstances,³⁰⁶ but there is no firm authority to suggest that LBOs of private companies are not just as common as LBOs of public companies. If public company LBOs are common, and they undoubtedly are,³⁰⁷ then private company LBOs are probably common also.

The *QSI* district court correctly stated that “nothing in the plain language of the statutes limits the application of the exemption to public transactions.”³⁰⁸ Everyone who has asked that question has searched the definition of settlement payment, and no such limiting language exists. Furthermore, both the Fifth and Ninth Circuits have

301. See *supra* Part III.A.1.a.

302. See, e.g., *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 676–77 (D.R.I. 1998); *Buckley v. Goldman, Sachs & Co.*, No. Civ.A.02-CV-11497RGS, 2005 WL 1206865, at *7 (D. Mass. May 20, 2005); *Official Comm. of Unsecured Creditors v. Asea Brown Boveri, Inc. (In re Grand Eagle Cos., Inc.)*, 288 B.R. 484, 494–95 (Bankr. N.D. Ohio 2003).

303. *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 985 (8th Cir. 2009).

304. See *supra* notes 213–18 and accompanying text.

305. 11 U.S.C. § 741(8) (2006).

306. See *supra* Part III.A.1.d.

307. *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999) (“A payment for shares during an LBO is obviously a common securities transaction, and we therefore hold that it is also a settlement payment for the purposes of section 546(e).”).

308. *QSI Holdings, Inc. v. Alford (QSI II)*, 382 B.R. 731, 741 (W.D. Mich. 2007).

ruled that repo and forward contract transactions are shielded by § 546(e) without questioning whether they involve public or private securities.³⁰⁹ This brings up the otherwise only implied point that § 546(e) and § 741(8) apply to many types of transactions and are in no way limited strictly to LBOs.³¹⁰ This, however, is a minor point. The crucial factor is that no plain language limits § 546(e) to exclude protection of LBOs of private companies. At the same time, however, there is no specific language stating that § 546(e) should extend to protect LBOs of private companies. Is it enough to say that just because private LBOs are not specifically excluded that it is plain that they should be included in § 546(e)'s protection? The Sixth Circuit has made that leap, but it is not plain. In fact, when viewed objectively, § 741(8) is ambiguous. Applying § 546(e) to the LBOs of private companies may or may not be justified by the statutory language of the definition of what is a settlement payment. There is no clear and plain language to make a definitive determination either way. As the above analysis shows, any determination either way is a heightened form of supposition and guesswork, and reasonable observers will naturally disagree.

2. "By or To" a "Financial Institution"

Apart from the definition of settlement payment, another plain-meaning argument applies to the question of whether statutory language justifies applying § 546(e) to LBOs of private companies. Section 546(e) states that "a trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency . . ." ³¹¹ Do the requirements that a transferee be "a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency" ³¹² limit § 546(e)'s applicability to LBOs of private companies? Does the plain meaning of the phrase, "by or to (or for the benefit of)" ³¹³ also limit § 546(e)'s applicability to LBOs of private companies? The answer to both of those questions is no.

309. *Id.* (citing *Jonas v. Resolution Trust Corp. (In re Comark)*, 971 F.2d 322 (9th Cir. 1992) and *Olympic Natural Gas Co. v. Morgan Stanley Capital Group Inc. (In re Olympic Natural Gas Co.)*, 294 F.3d 737 (5th Cir. 2002)).

310. *See* 11 U.S.C. §§ 546(e), 741(8) (2006).

311. *Id.* § 546(e).

312. *Id.*

313. *Id.*

- a. What is “a Commodity Broker, Forward Contract Merchant, Stockbroker, Financial Institution, Financial Participant, or Securities Clearing Agency”?

In considering the named parties that payment must be made by or to for a transfer to be protected from avoidance, one immediately sees that it applies to an incredibly broad range of the financial industry. Section 101 defines each of the parties named in § 546(e): commodity broker,³¹⁴ forward contract merchant,³¹⁵ stockbroker,³¹⁶ financial institution,³¹⁷ financial participant,³¹⁸ and securities clearing agency.³¹⁹ These definitions include commission merchant, foreign futures commission merchant, clearing organization, leverage transaction merchant, commodity options dealer, federal reserve bank, commercial bank, savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, receiver, liquidating agent, investment company, and many other more detailed financial market participants.³²⁰ The definition of “financial institution” is a useful example:

(22) The term “financial institution” means—

(A) a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a “customer”, as defined in section 741) in connection with a securities contract (as defined in section 741) such customer; or

(B) in connection with a securities contract (as defined in section 741) an investment company registered under the Investment Company Act of 1940.³²¹

It is hard to imagine that any U.S. bank currently in existence would not fit within this definition. The overwhelming breadth of this and the other definitions means that who is or is not a party subject to § 546(e)’s protection is rarely a litigated issue.³²² This language, therefore, does not limit § 546(e)’s applicability to LBOs of private companies.

314. 11 U.S.C. § 101(6) (2006).

315. *Id.* § 101(26).

316. *Id.* § 101(53A).

317. *Id.* § 101(22).

318. *Id.* § 101(22A).

319. 11 U.S.C. § 101(48).

320. *Id.* § 101(6), (22), (22A), (26), (48), (53A).

321. *Id.* § 101(22) (citation omitted).

322. This author has not found even one such case.

b. A Beneficial Interest in the Funds

The way the “by or to” a “financial institution” language more frequently comes up is best illustrated by the influential Eleventh Circuit case, *Munford v. Valuation Research Corp.*³²³ The transaction in *Munford* was a traditional LBO of a publicly held company.³²⁴ A group of investors, with funding from Citicorp, paid seventeen dollars per share through a financial institution within the securities clearance and settlement system, Citizens & Southern Trust Company.³²⁵ Thirteen months after the LBO, the new corporation filed for Chapter 11 protection.³²⁶ The issue before the court was “whether the LBO payments received in exchange for shares constituted a settlement payment within the meaning of section 546(e).”³²⁷ Reversing the district court’s holding,³²⁸ a divided panel of the Eleventh Circuit held that as a matter of first impression, § 546(e) did not protect from avoidance the LBO payments made to the shareholders.³²⁹

In so holding, the court skipped the typical discussion of the plain meaning of settlement payment by presuming that the LBO payments were settlement payments.³³⁰ Instead, it focused on the “made by or to” a “financial institution” language in § 546(e).³³¹ The court conceded that a financial institution was involved in the transaction, but it opined that it was “nothing more than an intermediary or conduit” because “[t]he bank never acquired a beneficial interest in either the funds or the shares.”³³² The court reasoned that a trustee may only avoid a transfer to a “transferee.”³³³ Because the bank never acquired a beneficial interest in the funds it paid to shareholders, it was not a transferee in the transaction.³³⁴ As the court stated, “the transfers/payments were made *by* Munford *to* shareholders. None of the entities listed in section 546(e) . . . made or received a transfer/pay-

323. *Munford v. Valuation Research Corp.* (*In re Munford, Inc.*), 98 F.3d 604 (11th Cir. 1996); See also *supra* note 200 and accompanying text.

324. *In re Munford*, 98 F.3d at 606.

325. *Id.* at 606–07.

326. *Id.* at 607.

327. *Id.* at 608.

328. *Id.* at 609.

329. *In re Munford*, 98 F.3d at 606.

330. *Id.* at 610.

331. 11 U.S.C. § 546(e) (2006); *In re Munford*, 98 F.3d at 610.

332. *In re Munford*, 98 F.3d at 610.

333. *Id.* (citing 11 U.S.C. § 550 (2006)).

334. *Id.* (citing *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1200 (11th Cir. 1988) (“When banks receive money for the sole purpose of depositing it into a customer’s account . . . the bank never has actual control of the funds and is not a section 550 initial transferee.”)).

ment.”³³⁵ Therefore, whether the payment was a settlement payment was irrelevant.³³⁶ The court decided that § 546(e) was not applicable because “the LBO transaction did not involve a transfer to one of the listed protected entities.”³³⁷ This, in turn, makes the fact of whether or not a financial institution acquires a beneficial interest in the funds at issue a threshold question before § 546(e) can be applied.³³⁸

Another case decided shortly before *Munford* by a Massachusetts Bankruptcy Court, *In re Healthco International Inc.*, made a similar decision with a fuller discussion.³³⁹ As a way to escape a proxy contest, the company’s stock was sold to a “white knight”³⁴⁰ in an LBO.³⁴¹ This white knight was Hicks, Muse, an investment-banking firm that specialized in LBOs.³⁴² Hicks, Muse paid each shareholder fifteen dollars per share, a portion of those funds coming from secured bank loans.³⁴³ As the court stated, the LBO left Healthco with “huge new indebtedness,” and “[a]ll those who participated in the LBO knew, or should have known, that the transaction would leave Healthco insolvent and with unreasonably small capital.”³⁴⁴ Just over two years after the deal closed, Healthco filed for Chapter 11 relief.³⁴⁵

The *Healthco* court held that § 546(e) did not apply to the LBO in question.³⁴⁶ It reasoned that, first, neither Healthco nor any of the selling shareholders were the type of entities named in § 546(e).³⁴⁷ Second, and more importantly, the court held that “section 546(e) applies only to a ‘transfer’ made by or to one of the named entities.”³⁴⁸ Citing § 550, it reasoned, “An avoided ‘transfer’ is recoverable only from a ‘transferee.’”³⁴⁹ And a “transferee” does not include “a party who acts only as a conduit in a transfer and acquires no beneficial

335. *Id.*

336. *Id.*

337. *In re Munford*, 98 F.3d at 610.

338. *Id.*

339. *Brandt v. Hicks, Muse & Co. (In re Healthco Int’l, Inc.)*, 195 B.R. 971 (Bankr. D. Mass. 1996).

340. A “white knight” is “[a] person or corporation that rescues the target of an unfriendly corporate takeover, esp. by acquiring a controlling interest in the target corporation or by making a competing tender offer.” BLACK’S LAW DICTIONARY 1734 (9th ed. 2009).

341. *In re Healthco*, 195 B.R. at 976.

342. *Id.* at 978.

343. *Id.* at 979.

344. *Id.*

345. *Id.*

346. *In re Healthco*, 195 B.R. at 981.

347. *Id.*

348. *Id.*

349. *Id.* While § 548 makes a transfer avoidable, it is § 550 that empowers the trustee to recover the avoided property. 11 U.S.C. § 550 (2006).

interest in the property.”³⁵⁰ Again, acquiring a beneficial interest in the property is the key here. As examples of this principle in action, the court noted that “a bank is protected in receiving a check which is endorsed to it but destined for its depositor’s account,” protection is given to “a clearinghouse in receiving funds for a customer’s account,” and protection is given to a lawyer “receiving settlement funds which he places in an escrow account and disburses to his client.”³⁵¹ The court further stated that “a party who exercises no control over the transferred property and claims no beneficial interest in it should not be held responsible for having received a fraudulent transfer,” noting that this is consistent with principles of agency law.³⁵²

The *Healthco* court seems to have missed a potentially important point in these examples. In these situations, the law protects an otherwise innocent party from being deemed a transferee who might be liable. There, the law acts to protect certain parties who took part in a transaction that a trustee might otherwise avoid. That, however, is the same type of situation where § 546(e) applies. Section 546(e) protects settlement payments from being avoided.³⁵³ Just as in the above examples, it protects certain entities from being entangled within the trustee’s avoidance powers.³⁵⁴ The judicially created doctrines the *Healthco* court cites therefore serve the same purpose § 546(e) does, yet the court does not recognize this point.³⁵⁵

A more substantial criticism of cases like *Healthco* and *Munford* was voiced in the *Munford* dissent.³⁵⁶ As Chief Judge Hatchett stated, “I believe the majority . . . chose to disregard the plain language of section 546(e) in order to create a new exception to its application.”³⁵⁷

350. *In re Healthco*, 195 B.R. at 982.

351. *Id.* Note that the *Healthco* court also included this: “[O]f particular relevance here [is the example of] a stockbroker who receives and disburses customer funds payable to a selling shareholder in a leveraged buyout.” *Id.* It then cited a particular *Kaiser* case: *Kaiser Steel Resources, Inc. v. Jacobs (In re Kaiser Steel Corp.)*, 110 B.R. 514, 520–21 (D. Colo. 1990). Recall that there were multitudes of opinions resulting from the *Kaiser* bankruptcy. See *supra* note 185 and accompanying text. However, the *Healthco* court appears to have misread this particular *Kaiser* case. While *Kaiser* did discuss the defendant’s liability as an “initial transferee” under § 550, *id.* at 519–21, it went on to hold that “[e]ven if Schwab [the Defendant] can be considered an initial transferee, the ‘settlement payment’ exception of § 546(e) should be broadly construed to cover the payments in this case.” *Id.* at 523. The *Healthco* court may not have misread *Kaiser* entirely, but it at least appears to have not read it completely.

352. *In re Healthco*, 195 B.R. at 982.

353. 11 U.S.C. § 546(e) (2006).

354. See *id.* § 546(e).

355. See *In re Healthco*, 195 B.R. at 971.

356. *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 614 (11th Cir. 1996) (Hatchett, C.J., dissenting in part).

357. *Id.*

This has been the more influential result of *Munford*, as recognized by a case from the Third Circuit, *In re Resorts International, Inc.*³⁵⁸

In *Resorts*, after an LBO and a subsequent bankruptcy, the debtor sought restitution of funds transferred to a shareholder claiming that the payment was, among other things, an avoidable transfer by a bankrupt entity.³⁵⁹ The issue was whether the payment to the shareholder was a settlement payment and therefore protected from the application of fraudulent conveyance law by § 546(e).³⁶⁰ The *Resorts* court first determined that “[a] payment for shares during an LBO is obviously a common securities transaction, and we therefore hold that it is also a settlement payment for the purposes of § 546(e).”³⁶¹ With that decided, it went on to examine *Munford*’s holding that § 546(e) is inapplicable unless the financial institution in the transaction acquired a beneficial interest in the funds.³⁶² The Third Circuit rejected *Munford*’s holding, instead deciding to follow the apparent plain meaning of the statute.³⁶³ It stated:

The majority in *Munford* seems to have read into section 546(e) the requirement that the ‘commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies’ obtain a ‘beneficial interest’ in the funds they handle for the section to be applicable. This requirement is not explicit in section 546.³⁶⁴

The court also made the same point about *Munford*’s treatment of § 550.³⁶⁵ Because it found no absurd result in applying the statute’s plain language, which does not specifically require a transferee to obtain an interest in the funds handled, the court held that “section 546 applies to the transaction and prevents its avoidance under section 548(a)(1)(B).”³⁶⁶ The Sixth Circuit in *QSI* engaged in a nearly identical analysis, and like *Resorts*, it rejected *Munford*.³⁶⁷ It adopted the view that the plain meaning of the statute does not “‘expressly require that the financial institution obtain a beneficial interest in the

358. *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999).

359. *Id.* at 508–09. The facts of this case only relate to the LBO tangentially. For a more thorough review of these otherwise confusing facts see Thompson, *supra* note 10, at 1–2.

360. *In re Resorts*, 181 F.3d at 514.

361. *Id.* at 516.

362. *Id.* (quoting *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996)).

363. *Id.*

364. *Id.*

365. *In re Resorts*, 181 F.3d at 516 n.11.

366. *Id.* at 516.

367. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 551 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010).

funds.’’³⁶⁸ After the *Resorts* decision, *Munford*’s reasoning has not been accepted by any other court.³⁶⁹

Resorts is important not only because it rejected the reasoning in *Munford*. It was the first appellate court case after *Kaiser* (which was heavily criticized³⁷⁰) to agree with *Kaiser* that LBO payments to shareholders were settlement payments under § 546(e).³⁷¹ Before the Third Circuit decided *Resorts* in 1999, *Kaiser* looked like an outlier and the application of § 546(e) to LBOs seemed to have no future. In part because of the Third Circuit’s influence in bankruptcy cases,³⁷² *Resorts* began a trend that eventually convinced many other circuit courts, the Sixth with *QSI* being one of the latest.³⁷³

c. Wire Transfers

Despite its rejection, *Munford* nevertheless raises an interesting point about transferees in fraudulent transfers. Under normal circumstances, the law will not protect an otherwise fraudulent transfer from avoidance merely because it was accomplished by a wire transfer through a financial institution.³⁷⁴ Under § 546(e), however, one court has taken this idea to its most logical extreme holding that because only banks can perform wire transfers, anytime a wire transfer is involved, that necessarily means there is a settlement payment made by or to a financial institution and therefore § 546(e) is applicable. This holding is from a bankruptcy court within the Third Circuit, *In re Loranger Manufacturing Corp.*³⁷⁵

In *Loranger*, the transaction was a buyout of a closely held, private company.³⁷⁶ The company itself took out a loan from PNC Bank and used it to redeem a fifty-percent ownership share of a former officer, director, and shareholder.³⁷⁷ Faced with intentional and construc-

368. *Id.* (quoting *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009)).

369. *See, e.g., Contemporary Indus. Corp.*, 564 F.3d at 984; *QSI III*, 571 F.3d 545; *Brandt v. B.A. Capital Co. (In re Plassein Int’l Corp.)*, 590 F.3d 252 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 2389 (2010)).

370. *See supra* notes 214–17 and accompanying text.

371. *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505, 515 (3d Cir. 1999).

372. *Thompson, supra* note 10, at 5.

373. *See supra* note 9. As of April 2011, the Third, Sixth, Eighth, and Tenth Circuits have held that § 546(e) can be applied to shield LBOs. Only the Eleventh Circuit has ruled otherwise.

374. *See* 11 U.S.C. § 548 (2006); UNIF. FRAUDULENT TRANSFER ACT §§ 4–5, 8–9 (1984) *available at* <http://www.law.upenn.edu/bll/archives/ulc/fnact99/1980s/ufta84.pdf>

375. *Loranger Mfg. Corp. v. PNC Bank (In re Loranger Mfg. Corp.)*, 324 B.R. 575 (Bankr. W.D. Pa. 2005).

376. *Id.* at 578.

377. *Id.* For a summary of the somewhat confusing facts of *Loranger*, *see Official Comm. of Unsecured Creditors v. Clark (In re Nat’l Forge Co.)*, 344 B.R. 340, 368 (W.D. Pa. 2006).

tively fraudulent transfer claims, the transferee moved for dismissal arguing that the transfers were settlement payments under § 546(e) and therefore not subject to the trustee's avoidance powers.³⁷⁸

After the plaintiff conceded (apparently by mistake)³⁷⁹ that the transaction at issue was a settlement payment, the court focused on the question of whether the payment was made by or to a financial institution.³⁸⁰ It first determined that there was “no doubt” that PNC Bank is a financial institution under the meaning of § 546(e) and that the transaction was accomplished by a wire transfer.³⁸¹ Then, following the precedent in *Resorts* and brushing off arguments that “there is no reported case that has extended the protection of section 546(e) to a bank that merely facilitates a wire transfer,”³⁸² the bankruptcy court based its decision solely on § 546(e)'s apparent plain meaning. It held that “[a] wire transfer was involved, and only banks . . . can perform wire transfers. Thus, the . . . payment. . . was a securities settlement payment in a leveraged buyout, and it was made by . . . a financial institution as defined in § 546(e).”³⁸³

The result in *Loranger* may border on an absurd result. Based on *Loranger's* expansive view of § 546(e), “the only way payments to shareholders pursuant to an LBO would be subject to constructive fraudulent transfer risk is if the settlement payment was made with cash.”³⁸⁴ Such a result appears to be an absurdity, which justifies disregarding the language of the statute.³⁸⁵ The court, however, did not see it that way³⁸⁶—for it, the plain meaning was clear.

d. “By or To” a “Financial Institution” Conclusion

Resorts and *Loranger* propose that based solely on the plain meaning of the statute, there is nothing to restrict § 546(e) from being applied to the LBOs of privately held entities. As some courts have argued with the definition of settlement payment,³⁸⁷ there is nothing

378. *In re Loranger*, 324 B.R. at 577–78.

379. *Id.* at 583.

380. *Id.* at 584.

381. *Id.*

382. *Id.* at 585.

383. *In re Loranger*, 324 B.R. at 585–86.

384. Gregory G. Hesse, *Failed LBOs, Recovering Payments to Shareholders*, LAW360 (Jan. 13, 2009), http://www.hunton.com/files/tbl_s47Details%5CFileUpload265%5C2411%5CFailed_LBOs_HesseLaw360_011409.pdf.

385. *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999) (seeing no absurd result from the application of the statute's plain meaning and therefore not disregarding it).

386. *In re Loranger*, 324 B.R. at 585–86.

387. *See supra* Part III.A.1.e.

in § 546(e)'s mandate that a settlement payment be made "by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency"³⁸⁸ that suggests excluding LBOs of private entities. Courts have attempted to avoid this result by adding a "beneficial interest" in the funds requirement,³⁸⁹ but that goes beyond the language of the statute.³⁹⁰ However, just because LBOs of private entities are not specifically excluded, that does not necessarily mean that they should be included. As was the case with the meaning of settlement payment, the language of § 546(e) is ambiguous—it is capable of supporting two reasonable, yet opposing, conclusions. *Munford's* rejection may have been premature.

3. Plain Meaning Conclusion

Many courts have gone far down the road towards using plain meaning to read § 546(e) broadly and literally. The Third Circuit in particular has led the way.³⁹¹ Courts within that circuit have held that even in a case that does not involve a leveraged buyout, publicly traded stock, or involvement with a clearing agency, § 546(e) is still broad enough to protect from avoidance a settlement payment made by a financial institution, even where the financial institution's only connection to the transaction is through a wire transfer.³⁹² With the addition of *QSI, Contemporary Industries Corp. v. Frost* from the Eighth Circuit,³⁹³ and *In re Plassein International Corp.* from the Third Circuit,³⁹⁴ the trend is that plain-meaning arguments are being used to decide that § 546(e) is available to shield LBOs of privately held companies from avoidance.

388. 11 U.S.C. § 546(e) (2006).

389. See *supra* Part III.B.1. *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996).

390. *In re Resorts*, 181 F.3d at 516; *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545, 551 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009).

391. Official Comm. of Unsecured Creditors v. Acres of Diamonds (*In re The It Group, Inc.*), 359 B.R. 97, 101–02 (Bankr. D. Del. 2006). *In re The It Group* characterizes *In re Resorts*, 181 F.3d at 515, as "concluding that the plain language of § 546(e) indicates that 'a transfer of cash or securities [by a financial institution] made to complete a securities transaction' is a non-avoidable settlement payment." See *id.* at 100.

392. *Id.* at 101–02 ("Although this case does not involve a leveraged buyout, publicly traded stock, or a clearing agency, the Third Circuit's holding in *Resorts* mandates a conclusion that section 546(e) is broad enough to protect from avoidance a 'settlement payment . . . made by . . . [a] financial institution.'") (quoting *In re Resorts*, 181 F.3d at 515–16; 11 U.S.C. § 546(e) (2006)).

393. *Contemporary Indus. Corp.*, 564 F.3d 981.

394. *Brandt v. B.A. Capital Co. (In re Plassein Int'l Corp.)*, 590 F.3d 252 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 2389 (2010)).

These arguments state, first, that the term settlement payment truly is a broad statutory definition. If one accepts that settlement payment is broad enough to include an LBO of a public company,³⁹⁵ then there is nothing in the language of the statute to keep one from concluding that settlement payment is also broad enough to include an LBO of a private company. Simply put, no plain language limits § 546(e) or § 741(8) to exclude protection of LBOs of private companies. Second, there is nothing in § 546(e)'s mandate that a settlement payment be made "by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency"³⁹⁶ that suggests excluding LBOs of private entities. According to this view, the plain meaning of the statutory language justifies applying § 546(e) to LBOs of private companies.

The more appropriate view is that these arguments go too far. Just because LBOs of private entities are not specifically excluded from § 546(e)'s protections does not make it plain that § 546(e) should be applied to protect such private LBOs. The term "plain meaning" implies that something is apparent on its face and incapable of reasonable disagreement. By this standard, § 546(e) is far from plain—it is ambiguous. One cannot definitively say one way or the other whether it should shield LBOs of private companies.

B. *Congressional Intent*

We have already seen how the legislative history is unhelpful in interpreting the plain meaning of § 546(e) or § 741(8).³⁹⁷ Congressional intent nonetheless plays a role in § 546(e)'s application. Does congressional intent justify applying § 546(e) to LBOs of private companies? Many courts have asked this question, but any answer is a speculative guess. A complete consideration of Congress's intent does not definitively answer whether § 546(e) should apply to LBOs of private companies.

An example of how some courts have used congressional intent to specifically exclude private transactions from § 546(e) protection can be seen in *Zahn v. Yucaipa Capital Fund*.³⁹⁸ The transaction in *Zahn* was a typical LBO of a privately held company³⁹⁹ funded by a loan

395. See *supra* Parts II.A.1-2.

396. 11 U.S.C. § 546(e) (2006).

397. See *supra* Part III.A.1.c.

398. *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656 (D.R.I. 1998).

399. *Id.* at 676 ("[T]he stock at issue was not even publicly traded.").

from a bank syndicate secured by the target company's assets.⁴⁰⁰ Several years later, the company filed for Chapter 11 reorganization.⁴⁰¹ The trustee, alleging that the LBO payments constituted fraudulent transfers, contended that the LBO caused the company's bankruptcy.⁴⁰²

The issue in *Zahn* was whether § 546(e) exempts the transfer from the reach of the trustee's avoidance powers.⁴⁰³ After deciding that the § 741(8) definition of settlement payment "defies plain meaning,"⁴⁰⁴ the court went on to consider the nature of the clearance and settlement system.⁴⁰⁵ The court concluded that discussion by noting, "The need to preserve the stability of this system led Congress to create the § 546(e) exception to the trustee's avoidance powers."⁴⁰⁶ It then invoked congressional intent stating, "Against this background, it appears unlikely that Congress intended the term 'settlement payment' to cover the present transfers."⁴⁰⁷ Relying on this congressional intent, the court ruled that "the stock at issue was not even publicly traded. The stock transfers thus had no connection whatsoever to the clearance and settlement system, and allowing avoidance would have no impact at all on that system."⁴⁰⁸ Other courts have taken this same position,⁴⁰⁹ and this argument is commonly made by parties attempting to limit § 546(e)'s application.⁴¹⁰ Stated differently, the argument proposes that because the transfer of privately held stock does not go through the clearance and settlement system or implicate its guaran-

400. *Zahn v. Yucaipa Capital Fund (In re Almac's, Inc.)*, 202 B.R. 648, 651 (D.R.I. 1996). *Zahn's* facts are given in a prior opinion by the same court. *Zahn*, 218 B.R. at 661 ("The Court's prior opinion provides an extensive review of the facts of this case.") (citing *In re Almac's*, 202 B.R. at 651-53).

401. *In re Almac's*, 202 B.R. at 651-52.

402. *In re Almac's*, 202 B.R. at 653.

403. *Zahn*, 218 B.R. at 675. Many other issues were discussed in *Zahn*, but none is relevant here.

404. *Id.*

405. *Id.* at 675-76. See *supra* Part III.A.1.a for a similar discussion.

406. *Id.* at 676.

407. *Id.*

408. *Zahn*, 218 B.R. at 676.

409. See, e.g., *Jewel Recovery, L.P. v. Gordon (In re Zale Corp.)*, 196 B.R. 348, 353 (N.D. Tex. 1996) (finding that while private transaction may fit definition of "settlement payments," it would not implicate clearance and settlement process, and thus application of § 546(e) would be inconsistent with statutory scheme); *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 195 B.R. 971, 983 (Bankr. D. Mass. 1996) (finding that one-time distribution in complete liquidation of stock interest was "not what Congress had in mind in enacting section 546(e)," where there was no showing of a guaranty by a securities clearing agency).

410. See, e.g., *QSI Holdings, Inc. v. Alford*, 382 B.R. 731, 739 (W.D. Mich. 2007) ("Plaintiffs argue that the § 546(e) exemption for settlement payments is limited to publicly traded securities and that Congress did not intend to exempt transactions such as an LBO of privately held stock . . .").

tees, Congress could not have possibly meant for § 546(e) to shield such private stock transfers.

The most significant problem with this argument comes from the statute itself. The Sixth Circuit in QSI recognized this where it stated, “[N]othing in the statutory language indicates that Congress sought to limit that protection to publicly traded securities,”⁴¹¹ although it can be argued that the “commonly used in the securities trade language” is such a limitation. A recent commentator recognized another problem:

If settlement payments can exist only where there is a clearing process and exposure on guaranties, then settlement payments could never exist relating to forward contracts that do not involve any clearing process, which includes most all such contracts. This would appear contrary to Congress’ intent, since the statute refers to settlement payments relating to forward contracts and forward contract merchants and does not make any reference to the need for a clearing agency.⁴¹²

1. Legislative History

Is *Zahn’s* holding a true reflection of congressional intent? Did Congress truly intend for § 546(e) to only apply to transfers that went through the clearance and settlement system? As discussed above,⁴¹³ Congress’s general purpose behind § 546(e) was that it was “intended to minimize the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries.”⁴¹⁴

Section 546(e) began as § 764(c) in the 1978 overhaul of the Bankruptcy Code.⁴¹⁵ The legislative history of § 764(c) stated, first, that the new § 764 only applied in Chapter 7 cases.⁴¹⁶ More importantly, it stated that § 764(c) “insulates variation margin payments and other deposits from the avoiding powers except to the extent of actual fraud under section 548(a)(1). This facilitates prepetition transfers and protects the ordinary course of business in the market.”⁴¹⁷ At that time, Congress only intended for settlement payments to include those

411. *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.) (QSI III)*, 571 F.3d 545, 550 (6th Cir. 2009), cert. denied, 130 S. Ct. 1141 (2010).

412. Kelch, *supra* note 159, at 99 (citing 11 U.S.C. §§ 362(b)(6) & 546(e) (2000)).

413. See *supra* Part III.A.1.c.

414. H.R. REP. NO. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042.

415. *Id.* at 3.

416. H.R. REP. NO. 95-595 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6347, 1977 WL 9628.

417. *Id.* at 6348 (1977).

transfers that occur in the ordinary course of business.⁴¹⁸ This has caused some to conclude that § 546(e), § 764(c)'s descendant, should be interpreted narrowly to exclude LBO payments.⁴¹⁹

However, in 1982, § 764(c) was repealed and replaced with § 546(d).⁴²⁰ As became a trend, with the 1982 changes Congress "broaden[ed] the commodities market protections and expressly extend[ed] similar protections to the securities market."⁴²¹ Although some at the time claimed that the new § 546(d) "did not expand the underlying provisions of former section 764(c),"⁴²² this is not entirely accurate. As the House Report stated, "The new section § 546(d) reiterates the provisions of current section 764(c)."⁴²³ But at the same time it stated that, "[t]he new section also encompasses both stockbrokers and securities clearing agencies."⁴²⁴ The underlying provisions may not have changed, but Congress expanded its scope.

Congress again amended § 546 in 1984.⁴²⁵ This time, the old § 546(d) was renumbered to become the current § 546(e),⁴²⁶ and § 546(f) was added to protect margin payments and settlement payments made to repo participants in connection with repurchase agreements.⁴²⁷ In addition, "financial institution" was added to § 546(e)'s list of entities, and the § 741(8) definition of settlement payment added the phrase "final settlement payment."⁴²⁸ With these changes, Congress once again furthered a general policy of expanding what is not subject to the trustee's avoidance powers.

After amending § 546(e) in 1986 to insert a comma,⁴²⁹ § 546(g) was added in 1990 to protect transfers under swap agreements from avoid-

418. Rand, *supra* note 200, at 98.

419. *Id.* at 97.

420. H.R. REP. NO. 97-420, at 3 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 585, 1982 WL 25042.

421. *Id.* at 2.

422. Rand, *supra* note 200, at 102 (citing COLLIER ON BANKRUPTCY § 546.05 (Alan N. Resnick & Henry J. Sommer eds., 15th ed. rev.)).

423. H.R. REP. NO. 97-420, at 3 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 585, 1982 WL 25042.

424. *Id.*

425. Rand, *supra* note 200, at 95.

426. *Jonas v. Farmer Bros. Co. (In re Comark)*, 145 B.R. 47, 51 n.10 (9th Cir. B.A.P. 1992).

427. Rand, *supra* note 200, at 95; Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, Title III § 393, (1984 HR 5174). *See supra* note 203.

428. *Kipperman v. Circle Trust F.B.O. (In re Grafton Partners, L.P.)*, 321 B.R. 527, 534 (9th Cir. B.A.P. 2005) (citing Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, Title III §§ 461(d) & 482(6), (1984 HR 5174)).

429. Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 1009 Stat. 3088, Title II § 283(l) (1986 HR 5316).

ance.⁴³⁰ Similar to § 546(e), this amendment's purpose was "to ensure that the swap and forward contract financial markets are not destabilized by uncertainties regarding the treatment of their financial instruments under the Bankruptcy Code."⁴³¹ Once again, Congress implemented a policy of protecting financial markets from the effects of bankruptcy. As the House Report stated, "U.S. bankruptcy law has long accorded special treatment to transactions involving financial markets, to minimize volatility," and "[a]s new financial instruments have been developed, Congress has amended the 1978 Bankruptcy Code to keep pace in promoting speed and certainty in resolving complex financial transactions."⁴³²

After more minor changes to § 546(e) in 1994⁴³³ and 1998,⁴³⁴ § 546 was amended in 2005 to add a subsection to "prohibit[] a trustee from avoiding a warehouse lien for storage, transportation, or other costs incidental to the storage and handling of goods."⁴³⁵ Section 546 was also amended "to provide that transfers made under or in connection with a master netting agreement may not be avoided by a trustee except where such transfer is made with actual intent to hinder, delay or defraud and not taken in good faith."⁴³⁶ Neither of these changes relate to § 546(e), the definition of settlement payment, or LBOs, but as with previous changes, it indicates a congressional intent to expand what is protected from the trustee's avoidance powers. More importantly, Congress also amended § 546(e) in 2005 to add the term "financial participant" to the list of entities that may make or receive a settlement payment.⁴³⁷ Once again, § 546(e)'s scope was expanded.

430. Bankruptcy Act Amendment of 1990, Pub. L. No. 101-311, 104 Stat. 267, Title I § 103 (1990 HR 4612).

431. H.R. REP. NO. 101-484, at 1 (1990), *reprinted in* 1990 U.S.C.C.A.N. 223, 223, 1990 WL 92539.

432. *Id.* at 2.

433. *See* Bankruptcy Reform Act of 1994, Pub. L. 103-394, 108 Stat. 4106, Title II § 204(b) (1994 HR 5116).

434. *See* The Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. 105-183, 112 Stat. 517, § 3(c) (1998) (1998 S 1244).

435. H.R. REP. NO. 109-31(I), at 87 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 153, 2005 WL 832198.

436. *Id.* at 132. A "'master netting agreement' is defined as 'an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or close out, under or in connection with one or more contracts . . .,' including swap agreements, forward contracts and commodity contracts." *The Effect of the New Bankruptcy Code on Safe Harbor Transactions*, McDERMOTT NEWSLETTERS (McDermott Will & Emery), Nov. 29, 2005, http://www.mwe.com/index.cfm/fuseaction/publications.nldetail/object_id/2546b8ca-c8ea-414b-b23c-e1936175ca82.cfm.

437. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, Title IX § 907(o)(2), (3). *See also* Mark G. Douglas, *The Evolution of a Majority Rule: Two Circuits Rule Payments to Shareholders in Private LBOs Shielded from Avoidance by*

The most recent changes to § 546(e) in 2006 added the “(or for the benefit of)” language after the “made by or to” phrase.⁴³⁸ This change made it clear that not only is a settlement payment “made by or to” a financial institution unavoidable, but it is also unavoidable if it is “for the benefit of” that financial institution.⁴³⁹ In addition, Congress added a long clause to the middle of § 546(e) to include “a transfer . . . in connection with a securities contract . . . commodity contract . . . or forward contract”⁴⁴⁰ Once again, Congress intended to “help reduce systemic risk in the financial markets by clarifying the treatment of certain financial products in cases of bankruptcy or insolvency.”⁴⁴¹

2. Congress’s Intent

Viewed in isolation, each of these legislative changes appears insignificant. But viewed as a whole, it is apparent that Congress has continually expanded the exceptions to the trustee’s avoidance powers. Congress may have never envisioned that § 546(e) would shield LBOs from avoidance when it revised the law in 1982 or in 1984 when it enacted the repo amendments, or even in 1990 when it added the swap amendments,⁴⁴² but this is uncertain. Congress is omniscient in theory, but this is far from true in fact. Whether Congress was aware of how § 546(e) would be applied is therefore a debatable point with no clearly discernable answer based strictly on the record. One may speculate, but that only yields a guess, educated though it may be.

What is more certain is the policy Congress had in mind as it made these legislative changes. Congress stated as follows in 1982:

The commodities and securities markets operate through a complex system of accounts and guarantees. Because of the structure of the clearing systems in these industries and the sometimes volatile nature [of] the markets, certain protections are necessary to prevent the insolvency of one commodity or security firm from spreading to other firms and possible [sic] threatening the collapse of the affected market.

Settlement Payment Defense, 8 JONES DAY BUS. RESTRUCTURING REV. No. 5, at 4, 5 (2009), available at <http://www.jonesday.com/files/Publication/b50abd60-7594-4b87-ae0c-4786373877de/Presentation/PublicationAttachment/48ea26e3-2442-49b7-971d-4afa1de9c999/BRR%20Sept.-Oct.%202009.pdf>.

438. 11 U.S.C. § 546(e) (2006); Financial Netting Improvements Act of 2006, Pub. L. No. 109-390, 120 Stat. 2691, § 5(b) (Westlaw, 2006 HR 5585).

439. 11 U.S.C. § 546(e) (2006).

440. *Id.*; see *supra* note 103 for the full text comparing these changes.

441. H.R. REP. NO. 109-648 (Part 1), at 1-2 (2005), 2006 WL 6165926.

442. Rand, *supra* note 200, at 103.

The bankruptcy code now expressly provides certain protections to the commodities market to protect against such a “ripple effect.”⁴⁴³

A private stock sale may not implicate the “complex system of accounts and guarantees”⁴⁴⁴ of the clearance and settlement system, but as the Tenth Circuit in *Kaiser* recognized, “[t]he danger of a ‘ripple effect’ on the entire market is at least as inherent in the avoidance of an LBO as it is in the avoidance of a routine stock sale.”⁴⁴⁵ And if there is a danger of such a ripple effect in the LBO of a public company, as was the issue in *Kaiser*, there may be the same danger for the LBO of a private company. In discussing such a private LBO, the Eighth Circuit stated, “[W]e can see how Congress might have believed undoing similar transactions *could* impact those markets, and why Congress might have thought it prudent to extend protection to payments such as these.”⁴⁴⁶ The reversal of any LBO payments could impact the nation’s financial markets because at least a portion of such payments would likely be reinvested.⁴⁴⁷ But this could be true of nearly any fraudulent transaction. Beyond the broad policy of protecting markets against negative ripple effects, it is uncertain if Congress specifically had LBOs, public or private, in mind when it enacted and revised § 546(e), but it is at least possible that such a concern could have been a factor.

What is also more certain is that when Congress acted in 2005 and 2006, it was an established fact that § 546(e) was being applied to public company LBOs. Recall that the Tenth Circuit in *Kaiser* and the Third Circuit in *In re Resorts* both applied § 546(e) to the LBOs of publicly held companies as early as 1991 and 1999 respectively.⁴⁴⁸ The timing for courts applying § 546(e) to privately held LBOs is different as the first case to make that leap from public to private LBOs was *In re Loranger* on April 7, 2005.⁴⁴⁹ Other cases applying § 546(e) to

443. H.R. REP. NO. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042.

444. *Id.*

445. *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 849 (10th Cir. 1990) (citation omitted) (citing H.R. REP. NO. 97-420, at 1 (1982), *reprinted in* 1982 U.S.C.C.A.N. 583, 583, 1982 WL 25042).

446. *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009).

447. *Id.*

448. *Kaiser Steel Corp. v. Pearl Brewing Co. (In re Kaiser Steel Corp.)*, 952 F.2d 1230, 1240–41 (10th Cir. 1991); *Lowenschuss v. Resorts Int’l, Inc. (In re Resorts Int’l, Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999).

449. *See supra* note 12; *Loranger Mfg. Corp. v. PNC Bank (In re Loranger Mfg. Corp.)*, 324 B.R. 575, 585–86 (Bankr. W.D. Pa. 2005).

LBOs of private companies quickly followed *Loranger*, and the pace has hastened ever since.⁴⁵⁰

Furthermore, since Congress's most recent change to § 546(e) in 2006, three circuit courts have acted to apply § 546(e) to the LBOs of privately held companies.⁴⁵¹ While each of these cases is of recent vintage, perhaps too recent for Congress to act, their outcomes were telegraphed by bankruptcy courts and district courts that ruled identically.⁴⁵² This alone is not solid evidence that Congress intended for § 546(e) to be applied to the LBOs of privately held companies. However, in combination with all its other indications of intent, it is possible to argue that Congress has intentionally decided not to act, perhaps because decisions such as *QSI* have served Congress's broad policy of protecting financial markets from bankruptcy-related disruptions. The counter to this, of course, is that Congress has demonstrated the ability to expand the law when it desires and if it did not create an amendment to protect LBOs specifically then it did not intend to protect them.⁴⁵³ But why should Congress make a specific exception for LBOs when one possible interpretation of the plain meaning of the statute is broad enough to include them? Congress may not have actively wished for § 546(e) to apply to the LBOs of publicly held companies, but it has done nothing to keep that from happening. Overall, these arguments provide a weak indication of congressional intent.

3. Congressional Intent Conclusion

Congressional intent does not justify applying § 546(e) to LBOs of private companies. Each piece of the legislative history puzzle alone is ambiguous and inconclusive. However, it is possible to make an argument in favor of congressional intent justifying the application of § 546(e) to LBOs of private companies. Over the years, Congress has continually amended § 546, and each time it has expanded its coverage. This alone is a reflection of Congress's intent. Congress's most

450. See, e.g., Official Comm. of Unsecured Creditors v. Clark (*In re Nat'l Forge Co.*), 344 B.R. 340 (W.D. Pa. 2006); Quality Stores, Inc. v. Alford (*In re Quality Stores, Inc.*), 355 B.R. 629 (Bankr. W.D. Mich. 2006); Brandt v. B.A. Capital Co. (*In re Plassein Int'l Corp.*), 366 B.R. 318, 325 (Bankr. D. Del. 2007); Contemporary Indus. Corp. v. Frost (*In re Contemporary Indus. Corp.*), No. BK98-80382, 2007 WL 5256918, at *5 (Bankr. D. Neb. June 29, 2007).

451. Applying § 546(e) to shield LBOs of private companies are the Third Circuit (Brandt v. B.A. Capital Co. (*In re Plassein Int'l Corp.*), 590 F.3d 252 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 2389 (2010))), the Sixth Circuit (*QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010)), and the Eighth Circuit (*Contemporary Indus. Corp.*, 564 F.3d at 986).

452. See, e.g., *Quality Stores (Bankr.)*, 355 B.R. at 636; *In re Plassein*, 366 B.R. at 326.

453. Rand, *supra* note 200, at 103.

recent 2006 changes also reflect this intent to expand what is protected from a bankruptcy trustee's avoidance powers. Finally, faced with court action applying § 546(e) to the LBOs of privately held companies, Congress has failed to react and make its will clear.

However, congressional silence and inaction are not strong indications of intent. A complete consideration of Congress's intent does not definitively determine whether § 546(e) should apply to LBOs of private companies. Congress has said nothing directly on this topic one way or the other. Arguments may be made in both directions, but none are strong enough to permit a firm conclusion. As with the statutory language, congressional intent is ambiguous.

C. Public Policy

As the *Resorts* case indicates, "Section 546 is at the intersection of 'two important national legislative policies . . . on a collision course'—the policies of bankruptcy and securities law."⁴⁵⁴ The statutory language and congressional intent of applying § 546(e) to the LBOs of privately held companies is ambiguous, but can it be justified by considerations of good public policy? The issue is debatable based on one's values, but all told, applying § 546(e) to LBOs of privately held entities is not good public policy.

1. Conflict within the Law

As a first general point, § 546(e) creates tension between bankruptcy policies that allow a trustee to avoid transactions involving preferential or fraudulent transactions and policies that protect settled securities transactions.⁴⁵⁵ This displays the inconsistency in the Bankruptcy Code that § 546(e) creates and reveals why so many courts have struggled with its application. As the *QSI* district court stated, "Given the cross purposes of bankruptcy creditors and former shareholders or other prebankruptcy payment recipients, the § 546(e) exemption has become a battleground of semantics and legal frameworks as litigants and the courts attempt to establish its limits within the statutory language."⁴⁵⁶ Section 546(e) renders Congress's policies inconsistent, which inevitably leads to legal conflict. "Consequently, some 25 years after the enactment of the exemption from avoidance for settlement payments in the securities trade, the courts

454. *Lowenschuss v. Resorts Int'l, Inc.* (*In re Resorts Int'l, Inc.*), 181 F.3d 505, 515 (3d Cir. 1999) (quoting *In re Bevill, Bresler & Schulman Asset Mgmt. Corp.* (*Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n*), 878 F.2d 742, 751 (3d Cir. 1989)).

455. *QSI Holdings, Inc. v. Alford* (*QSI II*), 382 B.R. 731, 738 (W.D. Mich. 2007).

456. *Id.*

continue to be a forum for disputes over the construction of §§ 546(e) and 741(8).⁴⁵⁷ This is a waste of resources and a drag on our economic and legal system (at least as it touches LBOs and bankruptcy courts). For this reason alone, Congress should make its will known, clearly and unambiguously, on one side or the other.

The same criticism can be leveled against the U.S. Supreme Court, which has consistently refused to address this issue. It has denied petitions of certiorari in *Kaiser*, *Munford*, *Resorts*, *QSI*, and *Plassein*.⁴⁵⁸ For those who believe that the Supreme Court has a duty to resolve insoluble circuit splits,⁴⁵⁹ the Court is neglecting its duty.

A concrete result of this conflict is that courts have been reluctant to apply § 546(e) because the policy behind it is flawed. Courts have trouble believing that Congress actually intended to shield privately held securities from fraudulent transfer law. The policy makes little sense, so some courts assume it must be an absurd result. This leads to further legal conflict and uneven and unsure application of the law.

Another result is venue shopping. The effect of venue shopping in bankruptcy is a controversial topic,⁴⁶⁰ but if one accepts that it is harmful, then § 546(e) surely exacerbates the problem because “[t]he application of the settlement payment defense in the context of an LBO has been far from uniform.”⁴⁶¹ The Third Circuit in particular⁴⁶² has led the way in applying § 546(e) to shield LBOs of all kinds. On

457. *Id.*

458. *Kaiser Steel Corp. v. Pearl Brewing Co.* (*In re Kaiser Steel Corp.*), 952 F.2d 1230 (10th Cir. 1991), *cert. denied*, 505 U.S. 1213 (1992); *Munford v. Valuation Research Corp.* (*In re Munford, Inc.*), 98 F.3d 604 (11th Cir. 1996), *cert. denied sub nom.* DFA Inv. Dimensions Grp., Inc. v. Munford, Inc., 522 U.S. 1068 (1998) and *cert. denied sub nom.* Munford v. Munford, Inc., 522 U.S. 1068 (1998); *Lowenschuss v. Resorts Int’l, Inc.* (*In re Resorts Int’l, Inc.*), 181 F.3d 505 (3d Cir. 1999), *cert. denied sub nom.* Sun Int’l N. Am., Inc. v. Lowenschuss, 528 U.S. 1021 (1999); *QSI Holdings, Inc. v. Alford* (*In re QSI Holdings, Inc.*) (*QSI III*), 571 F.3d 545 (6th Cir. 2009), *cert. denied*, 130 S. Ct. 1141 (2010); *Brandt v. B.A. Capital Co.* (*In re Plassein Int’l Corp.*), 590 F.3d 252 (3d Cir. 2009), *cert. denied*, 130 S. Ct. 2389 (2010).

459. See generally LISA A. KLOPPENBERG, *PLAYING IT SAFE: HOW THE SUPREME COURT SIDESTEPS HARD CASES AND STUNTS THE DEVELOPMENT OF LAW* (New York Univ. Press 2001) (detailing the different mechanisms the Supreme Court uses to avoid deciding an issue and discussing the Court’s reasons behind these avoidances, such as judicial economy).

460. See generally LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (The Univ. of Michigan Press 2006); Stephen J. Lubben, *Delaware’s Irrelevance*, 16 AM. BANKR. INST. L. REV. 267 (2008); Theodore Eisenberg & Lynn M. Lopucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967 (1999).

461. Ronald R. Sussman & Michael Klein, *Do Wire Transfers Really Protect Shareholders in Private LBOs? Not in the 2d—and Perhaps Other—Circuits*, J. OF CORP. RENEWAL, (2008), available at http://64.27.92.38/files/tbl_s5SiteRepository/FileUpload21/1406/Article%20-%20May%2008%20-%20JCR%20Sussman%20Klein.pdf.

462. See *supra* text accompanying notes 389–92.

the other hand, the Eleventh Circuit has refused entirely to apply § 546(e) to LBO payments.⁴⁶³ The results of any particular case could therefore depend entirely on the venue where the case is decided.⁴⁶⁴ This situation leads to uneven and unsure application of the law.

2. Shareholders Bear No Risk

It is well established that LBOs often end disastrously, especially in an economic downturn.⁴⁶⁵ Some of the same things that make LBOs attractive, namely low capital requirements for the acquiring entity, synergy gains by expanding operations, efficiency gains by eliminating excessive diversification, improved management and operating efficiency, and the benefits of leveraging,⁴⁶⁶ can also make them potential mistakes. As in any leveraged transaction, the lender takes enormous risks. If the deal works out profitably, the lender is safe. But if profits are illusory and bankruptcy results, the lender stands to bear the loss, or at least a portion of it where it is undersecured.

For the selling stockholders in an LBO, § 546(e) makes their role entirely risk-free. Under normal circumstances, a selling stockholder might be reluctant to vote for or approve an LBO that could end up dooming the company out of fear that a bankruptcy trustee will later avoid the transaction.⁴⁶⁷ Section 546(e) removes that risk. It transfers all risk away from the sellers. As one commentator put it, "The avoidance of LBO payments would prevent stockholders from enjoying the illicit rewards of fraudulent transfers and would cause stockholders to consider tender offers more carefully and reject offers likely to invite bankruptcy."⁴⁶⁸ Sometimes, stockholders can appear as innocent bystanders to an LBO they had no power to stop. In such situations, it is natural to view them as less responsible for an LBO that later fails.⁴⁶⁹ This is less likely to occur in the case of a privately held company, especially where there are a small number of stockholders. Nevertheless, allowing bankruptcy trustees to avoid LBOs can transfer the risk of bankruptcy from creditors, where it stands now, to stockholders

463. *In re Munford*, 98 F.3d at 606. See *supra* Part III.A.2.a.

464. Sussman, & Klein, *supra* note 461.

465. See Nicholas Riccio, *Recent LBO Stories: High Leverage, Low Ratings, and Bad Timing*, STANDARD & POOR'S, RATINGS DIRECT, Mar. 26, 2009, at 13, available at http://www.businessweek.com/investor/content/mar2009/pi20090325_847041.htm ("It's hard to look at most recent LBOs as successful by any measure. In our view, only a few did pretty well and showed some progress from a credit quality perspective.")

466. *Leveraged Buy-out—Company Acquisition Method*, VALUE BASED MGMT., http://www.valuebasedmanagement.net/methods_leveraged_buy-out.html (last visited Apr. 17, 2011).

467. Rand, *supra* note 200, at 104.

468. *Id.*

469. Douglas, *supra* note 54.

where it belongs. This would deter stockholders from gambling with creditors' money.⁴⁷⁰ While § 546(e) may protect the stability of equity securities markets, it decreases the stability of debt markets.⁴⁷¹ By transferring some risk to lenders, that decreases the desire to lend and inhibits the free flow of capital, and that hurts everyone in the economy, regardless of one's proximity to an LBO.

In some circumstances, LBOs can be positive forces in the economy and policies that protect them should therefore be encouraged. Two eminent names in bankruptcy scholarship have looked upon LBOs favorably.⁴⁷² In 1985, Professors Douglas G. Baird and Thomas H. Jackson wrote a seminal article that concluded, "Fraudulent conveyance law should never apply to armslength transactions, even if it appears after the fact that the debtor's actions injured the creditors."⁴⁷³ One of their points was that new management can be an enormous benefit to a company, especially when those new managers are personally invested in the enterprise.⁴⁷⁴ If creditors can retroactively attack LBOs, this will be a deterrent, even for those LBOs that would otherwise be in everyone's best interests.⁴⁷⁵ Baird and Jackson's views are not universally held however. Other commentators have concluded that "the constructive fraud provisions do not necessarily lead to over-deterrence of justified takeovers. Indeed, the reverse is true: absence of fraudulent conveyance remedies could under deter unjustified LBOs."⁴⁷⁶ Where LBOs are truly positive—where they are not overly risky in other words—those LBOs will continue as normal. Ending § 546(e)'s protection will only deter overly risky LBOs.

A full review of the tax consequences of LBOs are beyond the scope of this paper, but it may be true that the debt incurred by an LBO can act as a tax shelter.⁴⁷⁷ This, however, is yet another aspect of shifting the risk of an LBO. Once again, the risk is shifted to a party who had no vote in approving or denying an LBO. Here, the risk is shifted to tax-collecting entities, which ultimately is to the detriment of taxpayers. Instead, the risk should lie where traditional prin-

470. Rand, *supra* note 200, at 104.

471. *Id.*

472. See Baird & Jackson, *supra* note 2.

473. *Id.* at 854.

474. Credit Managers Ass'n of S. Cal. v. Fed. Co., 629 F. Supp. 175, 179 n.6 (C.D. Cal. 1985) (citing Baird & Jackson, *supra* note 2).

475. *Id.* (citing Baird & Jackson, *supra* note 2).

476. Jenny B. Wahl & Edward T. Wahl, *Fraudulent Conveyance Law and Leveraged Buyouts: Remedy or Insurance Policy?*, 16 WM. MITCHELL L. REV. 343, 344 (1990).

477. Garfinkel, *supra* note 167, at 53. However, note that the current length and complexity of 26 U.S.C. § 163 puts this proposition in doubt.

ciples of corporate law say it should rest—with the equity holders.⁴⁷⁸ It is axiomatic to say that debt should be paid before equity.⁴⁷⁹ The policy behind § 546(e) turns that well-worn principle on its head.

3. An Issue of “Fairness”

There is also an issue of fairness here: “[W]ho should lose the value of his investment, the shareholder who voted for the fraudulent buyout or the innocent bondholder whose trust was violated”?⁴⁸⁰ A sophisticated lender should be in a good position to conduct due diligence and protect its investment, but what of other creditors who have no say in an LBO? Unsecured creditors and especially pre-LBO creditors have no vote in approving a pending LBO. The risk of a post-LBO company’s debt is borne most by unsecured creditors who are least likely to be paid in a resulting bankruptcy.⁴⁸¹ The LBO lender, who normally assumes a senior position, carries a certain amount of risk to be sure, at least where it is undersecured.⁴⁸² But it seems particularly unfair for a selling shareholder to ignore due diligence and walk away with profits while leaving creditors to bear the loss when the debt-ridden edifice collapses. This injustice is even more galling where syndicates of lenders reap huge fees up front, all justified by the riskiness of the loan—the riskier, the more potential profit. Unsecured creditors reap no such rewards.

The *QSI* bankruptcy court recognized this “unfairness.”⁴⁸³ The law “permits transferees of an otherwise possibly avoidable fraudulent conveyance to insulate themselves from liability by using a financial institution to effectuate the settlement payment in exchange of their stock in an LBO transaction.”⁴⁸⁴ This could lead to obvious abuse. As the bankruptcy court opined, this may not be “unjust” in light of the language of the Code, but it is almost certainly “unfair.”⁴⁸⁵ Given that the Code is actually ambiguous rather than “plain” as the bankruptcy court ruled, this unfairness is magnified to the point where it is unjust.

478. Morse, *supra* note 19, at 332 (“‘debt’ before ‘equity’”).

479. *Id.*

480. Rand, *supra* note 200, at 104.

481. *Mellon Bank, N.A. v. Metro Commc’ns, Inc.*, 945 F.2d 635, 645–46 (3d Cir. 1991); Myron M. Sheinfeld & David H. Goodman, *LBO: Legitimate Business Organization or Large Bankruptcy Opportunity?*, 2 J. OF BANKR. L. & PRAC. 799, 805 (1993) (“If the LBO is allowed to stand, the loss will be borne by the unsecured or subordinated creditors.”).

482. *Mellon Bank*, 945 F.2d at 646.

483. *Quality Stores, Inc. v. Alford (In re Quality Stores, Inc.) (QSI I)*, 355 B.R. 629, 635 n.5 (Bankr. W.D. Mich. 2006).

484. *Id.*

485. *Id.*

4. Risk of Fraud, Especially for Private Companies

Fraud in an LBO is always a concern, but it is a special risk when dealing with the LBO of a closely held company. Section 546(e) in particular “provides a unique opportunity for owners of closely held corporations to insulate their receipt of corporate distributions from later avoidance.”⁴⁸⁶ As an extreme example, a sole shareholder of a corporation could redeem his or her stock, causing the company to become insolvent, yet be protected by § 546(e) in bankruptcy, fearing only an intentional fraudulent conveyance action under § 548(a)(1)(A).⁴⁸⁷

The knowledge that risky LBOs are protected by § 546(e) may tempt otherwise intelligent businesspeople into obviously unsound deals simply because they know § 546(e) will protect them. It may even tempt otherwise honest businesspeople to work the edges of actually fraudulent behavior, knowing that § 546(e)’s “loophole” will protect a certain level of deceit. One commentator states, “The main lesson to be learned from *Quality Stores [QSI]* is that proceeds from an LBO should be ‘funneled’ through a financial institution as a ‘settlement payment’ to increase the possibility the payments will be shielded from fraudulent transfer scrutiny.”⁴⁸⁸ If the law gives an honest person a legal way to do something that otherwise is unfair, the virtue and morality we expect (or at least hope for) from our business leaders will quickly fall by the wayside. Using the loophole for profit, whether ill gained or not, will become the norm, fairness be damned. As one court put it, a plain reading of § 546(e) “would essentially convert that statutory provision into a blanket transactional cleansing mechanism for any entity savvy enough to funnel payments for the purchase and sale of privately held stock through a financial institution.”⁴⁸⁹ In a nutshell, this is the problem with the policy that § 546(e) puts into effect. This is an unwise policy, especially given the ambiguity of the statute’s language and the uncertainty of Congress’s intent. The law magnifies the risk of fraud because it implicitly encourages it.

486. John F. Carlton, *Courts Split in Interpretation of §546(e) Avoidance Action Defense*, ABI PUBLIC COMPANIES & CLAIMS TRADING COMMITTEE NEWSL., (Am. Bankr. Inst., Alexandria, Va.) Oct. 2007, available at <http://www.abiworld.org/committees/newsletters/publicComp/Vol4Num3/Courts.html#2>.

487. *Id.*

488. Hesse, *supra* note 22, at 23.

489. Official Comm. of Unsecured Creditors v. Asea Brown Boveri, Inc. (*In re Grand Eagle Cos., Inc.*), 288 B.R. 484, 494 (Bankr. N.D. Ohio 2003).

5. Policy Conclusion

Applying § 546(e) to protect LBOs of privately held companies is an unwise policy choice. The current unsettled situation leads to uneven application of the law, venue shopping, and unnecessary legal conflict. More importantly, the risks of LBOs going bad are borne almost entirely by unsecured creditors who have no power to approve or disapprove LBOs. This encourages unnecessarily risky LBOs and results in unfairness. In the particular circumstance of privately held companies, § 546(e)'s cleansing effect magnifies the risk of fraud. It essentially makes constructive fraud legal, and it encourages actual fraud because by merely funneling LBO payments through the proper conduit, selling shareholders need not fear a bankruptcy trustee's powers of avoidance. All these factors make applying § 546(e) to protect LBOs of privately held companies a bad policy choice.

IV. CONCLUSION

When considering the Sixth Circuit's decision in *QSI* and the question of whether § 546(e) should be applied to LBOs of privately held entities, three conclusions can be made. First, the statute's lack of plain meaning does not justify applying § 546(e) to LBOs of private companies. The term settlement payment should properly be given a broad definition, and there is nothing in § 546(e) to specifically exclude LBOs of private entities, but neither is there any language to specifically include them. Second, congressional intent does not justify applying § 546(e) to LBOs of private companies because Congress has not expressed its will directly. Although Congress has effected a broad policy choice to protect securities markets and it has not acted to overturn case law, that is not enough to reasonably conclude that Congress intends for § 546(e) to protect LBOs of private companies. Third, applying § 546(e) to protect LBOs of private companies is an unwise policy choice. The uneven and unsettled application of § 546(e) that creates unnecessary legal conflict, the unfairness of who bears the risk when an LBO goes bad, and the increased danger of fraud when § 546(e) is applied to closely held corporations all combine to make this a bad policy choice. Therefore, when applying § 546(e) to the LBOs of private companies, the ambiguity of the plain meaning and congressional intent arguments should give way, and the wisest policy choice should control. Section 546(e) of the Bankruptcy Code should not be applied to LBOs of private companies.