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District Court Affirms Broad Reading of the Bankruptcy Code Safe Harbors in In re Quebecor World (USA) Inc.

A recent decision of the United States District Court for the Southern District of New York affirmed a bankruptcy court decision holding that section 546(e) of the Bankruptcy Code precluded a creditors committee from avoiding an alleged preferential transfer under section 547(b) in which the debtor paid more than $376 million to purchase and redeem a series of private placement notes within ninety days of the bankruptcy filing. In In re Quebecor World (USA) Inc., No. 11 Civ. 7530(JMF), 2012 WL 4477247 (S.D.N.Y. Sept. 28, 2012), the court held that the transfer was shielded from preference avoidance pursuant to two independent safe harbors contained in section 546(e). First, the transfer was a "settlement payment" "made by or to" a "financial institution." Second, the transfer was "made by or to" a "financial institution" "in connection with a securities contract."

The court's analysis highlights several important issues for debtors and creditors involved in avoidance litigation because it affirms a broad reading and literal application of the section 546(e) safe harbors, as guided by the Second Circuit's decision in In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V., 651 F.3d 329 (2d Cir. 2011) ("Enron"), which held that early redemption payments made to holders of commercial paper qualified as "settlement payments" under section 546(e).

The Decision

1. The Facts and the Bankruptcy Court's Decision

In July 2000, Quebecor World Capital Corp. ("QWCC"), an affiliate of debtor Quebecor World (USA) Inc. ("QWUSA"), raised $371 million in a series of private placement notes (the "Notes," and the holders thereof, the "Noteholders") pursuant to two Note Purchase Agreements (the "NPAs"). The Notes were guaranteed by debtor QWUSA and non-debtor Quebecor World Inc. ("QWI," and with its affiliates, "Quebecor"). Quebecor was formerly the second largest commercial paper printer in the world.

Subsequently, Quebecor was in financial distress and at risk of breaching a debt-to-capitalization ratio covenant. Quebecor attempted to avoid the breach under the NPAs by modifying the covenant through a tender offer, but the Noteholders unanimously rejected the offer and banded together by agreeing not to sell outside the group of the then-existing

Noteholders. This agreement had the salient effect of requiring Quebecor to redeem all of the Notes, which was permitted by the NPAs, or risk default.

In September 2007, Quebecor issued a notice of redemption for all of the Notes. To fund the redemption, Quebecor drew down on a separate bank facility in the amount of approximately $376 million, which represented principal, interest, and a make-whole premium due on the Notes. For tax reasons, the transaction was structured whereby QWUSA purchased the Notes for the redemption price and wired $376 million from its bank account at Bank of America to CIBC Mellon, the trustee for the Notes, on October 29, 2007. As a result of the transaction, CIBC Mellon neither took title to the Notes nor utilized "any type of clearing mechanism to complete the transaction" because the holders returned the Notes by mailing them to QWI, "a process that dragged on for some months."

Less than ninety days later, on January 21, 2008, QWUSA filed for chapter 11 protection. The official committee of unsecured creditors commenced an adversary proceeding to avoid the $376 million payment as a "preference" under section 547(b) of the Bankruptcy Code because the Noteholders received full payment for their Notes while other creditors received significantly less. Bankruptcy Judge Peck held that under the Second Circuit's recent Enron decision, QWUSA's payment was a "settlement payment," or, alternatively, the payment was a transfer "in connection with a securities contract."[1] Accordingly, the payment was shielded from avoidance on two independent grounds.

2. The District Court Decision

District Judge Furman affirmed the Bankruptcy Court's ruling in all material respects. First, Judge Furman held that QWUSA's payment qualified as a "settlement payment," noting that:

- The Second Circuit's test under Enron for whether a payment qualifies under the "settlement payment" safe harbor "is both uncomplicated and crystal clear—a settlement payment, quite simply, is a 'transfer of cash [to a financial institution] . . . made to complete [a] securities transaction.'"

- The payment at issue easily satisfies this rule because (1) QWUSA transferred cash to purchase the Notes, (2) "QWUSA wired the money from its account at Bank of America" to CIBC Mellon, which qualifies as a "financial institution" for purposes of section 546(e), and (3) the payment was made to "complete" a

[1] Section 546(e) of the Bankruptcy Code provides, in relevant part, that: "[n]otwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . , or that is a transfer made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract . . . that is made before the commencement of the case . . . ."

securities transaction because the Notes are "securities" under the Bankruptcy Code.

- Courts should not look beyond the plain language of the Bankruptcy Code and consider other factors when analyzing section 546(e), including whether (1) the transfer involved a formal settlement process (e.g., "using broker-dealers and the DTC to effect the immediate exchange of payment and securities"), (2) the financial institution received a beneficial interest in the transfer or acted merely as a conduit, or (3) the transfer at issue was the kind that Congress originally sought to protect from avoidance—that is, transfers that pose systemic risk to the marketplace.

Alternatively, Judge Furman held that QWUSA's payment was also a transfer made to a "financial institution" "in connection with a securities contract," noting that:

- The Enron decision, which held that "redemptions" qualify as "settlement payments" under the "settlement payment" safe harbor analysis, does not hold that redemptions always qualify under different provisions of section 546(e). Rather, a "securities contract" is limited to contracts "for the purchase, sale, or loan of a security," which does not apply to contracts for redemption.

- Although QWCC initially sent a "Notice of Redemption" to the Noteholders stating that it intended to "redeem" all outstanding Notes pursuant to the NPAs, the transaction was restructured as a "purchase" of the Notes by QWUSA.

- QWUSA's "'purchase' was indisputably made 'in connection with' the NPA[s]," which plainly qualify as contracts.

In affirming, the district court reaffirms a broad reading and literal application of the section 546(e) safe harbors. The ruling also highlights that the form and structure of the transaction matters when analyzing section 546(e) defenses under current Second Circuit law. The decision also demonstrates the tension between a fundamental principle of bankruptcy law—that is, equitable distribution of estate assets to all creditors—and the need to protect against systemic risk, which the safe harbors seek to avoid.

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If you have any questions, please feel free to contact any of your regular contacts at the firm or any of our partners and counsel listed under "Bankruptcy and Restructuring" in the "Practices" section of our website (www.clearygottlieb.com).

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