

ALERTS

Second Circuit Holds Bankruptcy Code Safe Harbor Insulates Sellers of Enron Commercial Paper from Preference and Fraudulent Transfer Liability

June 29, 2011

The U.S. Court of Appeals, in a 2-1 decision on June 28, 2011, held that Bankruptcy Code § 546(e), which exempts a “Settlement Payment” from a bankruptcy trustee’s avoiding powers, insulated two sellers of Enron Corporation’s commercial paper from suit despite Enron’s early pre-bankruptcy redemption. *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, ___F.3d ___, 2011 WL 2536101 (2d Cir. June 28, 2011) (2-1). In a victory for investors who sell the commercial paper of insolvent companies in the secondary market, the defendant noteholders will not have to return payments that they received from their stockbroker.

Relevance to Commercial Paper Market

Affirming the District Court’s reversal of a bankruptcy court decision, the Second Circuit agreed that the Enron litigation trust’s fraudulent transfer and preference complaint against Alfa and ING investment funds must be dismissed. On “an issue of first impression in the courts of appeals,” it held that Bankruptcy Code § 546(e), “which shields ‘settlement payments’ from avoidance actions in bankruptcy, extends to [Enron’s] payments to redeem its commercial paper prior to maturity.” *Id.* at *1.

Facts

Shortly before Enron sought bankruptcy relief in late 2001, it paid out more than \$1.1 billion to retire some of its unsecured commercial paper prior to its maturity date. After bankruptcy, Enron sued 200 former noteholders and institutions (who initially received Enron's payment and were also sued) to recover payments they received one day prior to the maturity date of the notes. Alfa and ING were the only two remaining defendants in the eight-year-old commercial paper litigation, the rest having settled.

Alfa's Defense

Alfa argued that, as a noteholder, it was entitled to keep the money because of the "safe harbor" provision in Bankruptcy Code § 546(e). It never dealt with Enron, but only bought the commercial paper from its broker, and, at the broker's request, sold it back to the broker.

Court's Holding

The Second Circuit demolished Enron's legal arguments: its "proposed exclusions from the reach of § 546(e) have no basis in the Bankruptcy Code." *Id.* According to the court, the "plain language" of the Bankruptcy Code extends to commercial paper, and the "settlement payment" made to Alfa, which it defined as "any transfer that concludes or consummates a securities transaction," was insulated from attack. The securities industry, moreover, considered the transfers here as "settlement payments." Indeed, they were consummated under the standard clearing mechanism for transactions in commercial paper "using the customary mechanism of the Depository Trust Company." *Id.* at *4.

Though made within 90 days of Enron's filing for Chapter 11, the court found that the redemption payments to Alfa "completed a transaction in securities" and were thus "settlement payments." Disagreeing with the bankruptcy court and Enron "that redemption payments are not settlement payments" because they retired debt "and were not [made] to acquire title to the commercial paper," the court stressed that the Bankruptcy Code imposed no "purchase or sale" requirement. *Id.* at *8-*9.

The Dissent and Enron's Argument

Enron had argued that (a) there was no settlement payment, (b) commercial paper is not a security, and (c) the Bankruptcy Code's "safe harbor" provision did not apply. The dissenting judge, agreeing that the

issue here “has never been decided previously by any court of appeals,” deemed the majority’s broad definition of “settlement payment” to “threaten . . . routine avoidance proceedings in bankruptcy courts.” *Id.* at *10.

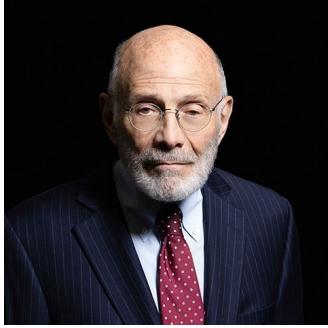
SRZ represented Alfa, S.A.B. de C.V., one of the successful parties on this appeal.

Authored by Michael L. Cook.

If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

This information has been prepared by Schulte Roth & Zabel LLP (“SRZ”) for general informational purposes only. It does not constitute legal advice, and is presented without any representation or warranty as to its accuracy, completeness or timeliness. Transmission or receipt of this information does not create an attorney-client relationship with SRZ. Electronic mail or other communications with SRZ cannot be guaranteed to be confidential and will not (without SRZ agreement) create an attorney-client relationship with SRZ. Parties seeking advice should consult with legal counsel familiar with their particular circumstances. The contents of these materials may constitute attorney advertising under the regulations of various jurisdictions.

Related People



**Michael
Cook**

Of Counsel
New York

Practices

BUSINESS REORGANIZATION

Attachments

[!\[\]\(ec9132f1d27c8919987d92907322654d_img.jpg\) Download Alert](#)