

Client Alert

July 2013

Official Committee of Unsecured Creditors of Quebecor World (USA) Inc. v. American United Life Insurance Company, et. al. (In re Quebecor World (USA) Inc.), 2013 U.S. App. LEXIS 11615 (2d Cir. June 10, 2013)

The United States Court of Appeals for the Second Circuit (the “Second Circuit”) recently affirmed a broad reading of the safe harbor of United States Bankruptcy Code (the “Bankruptcy Code”) section 546(e), which protects from avoidance both “margin payments” and “settlement payments” as well as transfers made in connection with a “securities contract.” In *Quebecor*, the Second Circuit affirmed decisions of the bankruptcy and district courts and held that the purchase by Quebecor World (USA) Inc. (“QWUSA”) of \$376 million worth of notes issued by its affiliate, Quebecor World Capital Corp. (“QWCC”), was protected because it fell within the § 546(e) safe harbor as a transfer made in connection with a securities contract.¹ This decision marks the first time the Second Circuit or any other Circuit has considered the “securities contract” prong of § 546(e), which did not apply to the issues before the Second Circuit in its landmark ruling in *Enron*,² concerning the “settlement payment” safe harbor under § 546(e), because *Enron* was filed prior to the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) amendments.³

Case Background

Quebecor World, Inc. (“QWI”) and its subsidiaries, QWUSA and QWCC, operated a commercial printing company based in Canada, but with operations in the United States through QWUSA. In order to raise \$371 million for the Quebecor entities, QWCC issued private placement notes (the “Notes”) to appellee noteholders (the “Noteholders”) pursuant to two note purchase agreements (the “NPAs”). The Notes were guaranteed by QWI and QWUSA, and the funds were transferred to QWUSA. Pursuant to the NPAs, QWCC could prepay the notes at any time as long as certain requirements were met.⁴ QWCC’s affiliates could purchase the Notes under the NPAs as long as the prepayment requirements were satisfied. The NPAs also contained an acceleration clause providing for the acceleration of the Notes’ maturity if QWI’s debt-to-capitalization ratio fell below a certain threshold. To avoid defaulting on the Notes, which would constitute a cross-default under the company’s credit facility, QWI approved the prepayment of the Notes in 2007. Because of consequences under Canadian tax law, QWI arranged for QWUSA to purchase the Notes. Less than ninety (90) days prior to the filing of its bankruptcy petition,

¹ *Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 2013 U.S. App. LEXIS 11615 (2d Cir. June 10, 2013) (“Quebecor”).

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

³ Pub. L. No. 109-8, 119 Stat. 23 (2005).

⁴ These requirements included payment of principal, interest, and a “make whole” amount. *Quebecor*, 2013 U.S. App. LEXIS at *3.

QWUSA transferred \$376 million (the “Payment”) to the trustee for the noteholders, CIBC Mellon Trust Co. (“CIBC”), who distributed the funds to the noteholders. In exchange, the noteholders surrendered their notes to QWI.

The Official Committee of Unsecured Creditors of QWUSA (the “Committee”) commenced an adversary proceeding against the Noteholders seeking to avoid the Payment as a preferential transfer under Bankruptcy Code § 547(b). Relying on the Second Circuit’s reasoning in *Enron*, Judge Peck of the United States Bankruptcy Court for the Southern District of New York (the “Bankruptcy Court”) entered summary judgment in favor of the Noteholders, concluding that the Payment was protected from avoidance as a “settlement payment” or alternatively, as a transfer in connection with a “securities contract” under the § 546(e) safe harbor.⁵ In affirming the Bankruptcy Court’s ruling, the United States District Court for the Southern District of New York (the “District Court”) also held that the Payment was a “settlement payment” under *Enron*. Although the District Court did not agree that redemption payments could qualify as a transfer made in connection with a “securities contract,” because the Bankruptcy Court had concluded that the transaction was in fact a “purchase,” and not a “redemption,” the District Court also affirmed this alternative holding.⁶ QWUSA appealed these rulings to the Second Circuit.

The Second Circuit Decision

The Second Circuit held that the § 546(e) safe harbor applied because the Payment was a “transfer made by or to (or for the benefit of) a...financial institution...in connection with a securities contract.”⁷ In reaching its conclusion, the Second Circuit found that NPAs were “securities contracts” because they provided for the purchase and repurchase of the Notes.⁸ Unlike the lower courts, however, the Second Circuit did not address whether the Payment qualified as a “settlement payment” under § 546(e) because such an analysis was unnecessary in light of the application of the “securities contract” safe harbor. Notably, in a recent decision, the Fourth Circuit also analyzed the § 546(e) safe harbor, but did not consider whether the transfers at issue would be protected as transfers made in connection with a “securities contract” because it had already concluded that they were protected as “settlement payments.”⁹ Accordingly, together the Quebecor and Derivium decisions confirm the independence of the “securities contract” and “settlement payment” safe harbors of § 546(e).

⁵ *Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 453 B.R. 201 (Bankr. S.D.N.Y. 2011).

⁶ *Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. Life Ins. Co. (In re Quebecor World (USA) Inc.)*, 480 B.R. 468 (S.D.N.Y. 2012).

⁷ *Quebecor*, 2013 U.S. App. LEXIS at *9 (quoting 11 U.S.C. § 546(e)). Section 741(7) of the Bankruptcy Code defines “securities contract,” in part, as “a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan, any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including an interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option (whether or not such repurchase or reverse repurchase transaction is a “repurchase agreement”, as defined in section 101.” 11 U.S.C. § 741(7)(A)(i).

⁸ *Quebecor*, 2013 U.S. App. LEXIS at *9.

⁹ See *Grayson Consulting, Inc. v. Wachovia Securities, LLC, f/k/a First Union Securities, Inc., et al. (In re Derivium Capital, LLC)*, Case No. 12-1518 (4th Cir. May 24, 2013). For more information on the Fourth Circuit’s decision in *Derivium*, please see <http://bit.ly/1avSMuq>.

The Second Circuit also declined to discuss whether the Payment would still be exempt under § 546(e) if QWUSA had redeemed its own securities because like the District Court, the Second Circuit concluded that the Payment was not a redemption payment, but rather a payment for the purchase of the Notes. The Court noted that this conclusion was consistent with the wording of the NPAs, which provided that only QWCC had the right to redeem the Notes. QWCC's affiliates could purchase, not redeem the Notes, if they complied with the pre-payment provisions. Thus, the Second Circuit reasoned, QWUSA could only purchase the Notes.

The Committee argued that QWUSA did not purchase the Notes because (i) some of the Noteholders believed the transaction was a redemption and (ii) the Cooperation Agreement prevented the Noteholders from selling the Notes. Unpersuaded by these arguments, the Second Circuit concluded that the Noteholders' subjective understanding of the transaction was not dispositive and that nothing in the Cooperation Agreement prohibited the Noteholders from selling and QWUSA from purchasing the Notes in a single transaction.¹⁰ The Second Circuit also concluded that even if the Cooperation Agreement did prohibit the Noteholders from selling the Notes, the sale of such Notes would only be a breach of the agreement, not a reason to avoid the Payment.¹¹

Alternatively, the Committee argued that even if QWUSA purchased the Notes, not all of the transfers fell within the safe harbor of § 546(e) because CIBC was merely a conduit and not all of the Noteholders were financial institutions.¹² In analyzing this argument, the Second Circuit noted that it had rejected a similar argument in *Enron*, instead holding that a financial intermediary need not have a beneficial interest in the transfer for the safe harbor to apply.¹³ The Second Circuit acknowledged the circuit split¹⁴ over this issue, but clarified that "[t]o the extent *Enron* left any ambiguity in this regard, we expressly follow the Third, Sixth, and Eighth Circuits in holding that a transfer may qualify for the section 546(e) safe harbor even if the financial intermediary is merely a conduit."¹⁵ Therefore, the Second Circuit reasoned, a transfer may be either "for the benefit of" or "to" financial institution, but does not have to be both.¹⁶ The

¹⁰ *Quebecor*, 2013 U.S. App. LEXIS at *11.

¹¹ *Id.*

¹² *Id.* at *12.

¹³ *Id.*

¹⁴ The majority of circuits that have considered the issue have concluded that the plain language of § 546(e) includes any transfer to a financial institution, even if the financial institution is serving a conduit. See *QSI Holdings, Inc. v. Alford (In re QSI Holdings, Inc.)*, 571 F.3d 545, 550-51 (6th Cir. 2009); *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 987 (8th Cir. 2009); *Lowenschuss v. Resorts Int'l, Inc. (In re Resorts Int'l, Inc.)*, 181 F.3d 505, 516 (3d Cir. 1999). Only the Eleventh Circuit has taken the position that the financial institution must acquire a beneficial interest in the property transferred in order for the safe harbor of § 546(e) to apply. See *Munford v. Valuation Research Corp. (In re Munford, Inc.)*, 98 F.3d 604, 610 (11th Cir. 1996) (per curiam).

¹⁵ *Quebecor*, 2013 U.S. App. LEXIS at *12. (citing *QSI Holdings*, 571 F.3d at 550-51; *Contemporary Indus. Corp.*, 564 F.3d at 987; *Resorts Int'l, Inc.*, 181 F.3d at 516.

¹⁶ *Id.* at *13.

Second Circuit further explained that this interpretation furthers Congress's purpose in enacting the safe harbor of § 546(e): to minimize "the displacement caused in the commodities and securities markets in the event of a major bankruptcy affecting those industries."¹⁷

Implications

When read together, *Quebecor* and *Enron* reflect that the Second Circuit interprets § 546(e)'s safe harbor broadly with respect to the independent "settlement payment" and "securities contract" safe harbors. Similarly, the Fourth Circuit's *Derivium* decision reinforces the independence of the "settlement payment" and "securities contract" safe harbors.

Nevertheless, although the District Court held that the Payment would not have been protected under § 546(e) if it had been a redemption of the Notes, the Second Circuit declined to address this issue because the Payment qualified as a purchase, rather than a redemption, of the Notes. Thus, the Second Circuit has not addressed whether a redemption would constitute a "contract for the purchase, sale, or loan of a security," and thus qualify as a "securities contract" as defined in § 741(7). 11 U.S.C. § 741(7).

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¹⁷ *Id.* (quoting *Enron*, 651 F. 3d at 334) (internal citations omitted).