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Supreme Court's *Merit Management* Ruling Highlights Potential Alternative Path to Safe Harbor

Possible application of Section 101(22)(A) to safe harbor's covered entity requirement raises important questions for future transferee defendants.

Key Points:

- *Merit Management* raises the possibility that customers of “financial institutions” may qualify for protection under Section 546(e) safe harbor even if they would not otherwise meet Section 546(e)'s covered entity requirement.
- Treating customers of “financial institutions” as covered entities could broaden the scope of safe harbor.
- Further analysis of *Merit Management* is available in the *New York Law Journal* article “[Safe Harbor After 'Merit Management.'](#)”

In Footnote 2 of *Merit Management Group, L.P. v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018), the US Supreme Court may have suggested another avenue for future transferee defendants that are not otherwise covered entities to argue that they should be protected by Section 546(e). (Latham provides broader analysis of the case's implications in the *New York Law Journal* article “[Safe Harbor After 'Merit Management.'](#)”)

In a footnote in its opening brief, *Merit*, quoting Section 101(22)(A), noted that “[i]f a financial institution ‘is acting as agent or custodian for a customer ... in connection with a securities contract,’ the customer is treated as a financial institution.”¹ Even though *Merit* dropped this definition in a footnote, and did not assert it as a basis for protection under Section 546(e), the Court flagged Section 101(22)(A) in its opinion.² After quoting Section 101(22)(A) in full, the Court noted that the “parties here do not contend that either the debtor or petitioner in this case qualified as a ‘financial institution’ by virtue of its status as a ‘customer’ under Section 101(22)(A),” and thus the Court did not address “what impact, if any, Section 101(22)(A) would have in the application of the Section 546(e) safe harbor.”³

In doing so, the Court pointed out that, under the definition of “financial institution,” any “customer” of a financial institution in connection with a securities contract could argue that it is thereby a financial institution for the purposes of Section 546(e). Notably, Section 101(22)(A) does not define the term “customer,” stating that it applies “whether or not” such customer is “a ‘customer,’ as defined in section 741.” This application of Section 101(22)(A) to Section 546(e) safe harbor raises a few issues worth

noting. First, it could generally allow for transferees of public securities to argue that they should be treated as financial institutions for the purposes of Section 546(e), since the ultimate customer in a public securities transaction ordinarily is the beneficial owner of such securities, with a financial institution holding legal title. Second, it raises the question of whether a customer of a financial institution would be treated as a financial institution for the purposes of Section 546(e) with respect to unrelated transfers, or if such customer is only treated as a financial institution with respect to the specific transfer in which a financial institution was acting as agent or custodian in connection with a securities contract. On the other hand, future courts might decline to use this application of Section 101(22)(A) to Section 546(e), since taken to a logical extreme, it could potentially become an exception that swallows the rule by allowing any non-covered entity in a public securities transaction to be protected by Section 546(e).

Consequently, while *Merit Management* raises the possibility that future transferee defendants who are customers of financial institutions could argue that they should be treated as financial institutions pursuant to Section 101(22)(A), and are thus protected by Section 546(e), given the thorny statutory interpretation and policy issues involved, the success of such arguments remains to be decided.

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Endnotes

¹ Merit Opening Brief at 45 n. 14.

² *Merit Management*, 138 S.Ct. 883 at *3 n. 2.

³ *Id.*