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Eighth Circuit Follows Second Circuit and Affirms Broad Safe Harbor Protections for Bank Customers

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In *Kelley v. Safe Harbor Managed Account 101, Ltd.*,[1] the Eighth Circuit Court of Appeals endorsed a broad view of parties protected from avoidance claims related to certain derivative and financial contracts ("QFCs"), including a securities contract (*e.g.*, purchase and sale of securities).

In a case arising from the Thomas Petters Ponzi scheme, the St. Louis-based appellate court found that (a) a note purchase agreement "fit plainly" within the statutory definition of a securities contract (*e.g.*, purchase and sale of a security), [2] and (b) the customer of a financial institution is a safe harbor-protected entity if the financial institution acts as a custodian for the customer.[3]

In its ruling, the Eighth Circuit becomes the first Circuit Court to endorse the Second Circuit Court of Appeals' view, espoused in its *Tribune* decision,[4] that bank customers are within the protections afforded parties to a safe harbor-protected transaction if the bank acts as agent or custodian for the customer.

The Bankruptcy Code provides broad protections to specified parties under QFCs, including nonavoidance of related transfers, including margin and settlement payments. *See, e.g.*, 11 U.S.C. § 546(e) (transfers related to securities contracts). Financial institutions (*e.g.*, banks) and financial participants (*e.g.*, entities conducting certain high-value transactions) are among the protected parties. The safe harbor provisions are broadly worded with the goal of protecting financial and securities markets from turmoil. Issues include what parties are protected in complex, multiparty transactions.

Over four years ago, in *Merit Management v. FTI Consulting*,[5] the Supreme Court unanimously held that (a) avoidance action protections do not extend to transfers

in which banks or other financial institutions serve as intermediaries or "mere conduits" in multi-step securities transactions that are ultimately between two non-financial institutions and (b) the relevant transfer in a multistep transaction is the overarching transfer and not any component.

But *Merit's* impact, thought by some commentators to narrow safe harbor protections, has been constrained, in part, because the justices declined to address a substantial gap in the analysis – could non-financial institutions qualify for safe harbor protections if they were customers of financial institutions?

In its *Tribune* decision, the Second Circuit marched through that gap, finding that customers of an intermediary bank acting as an agent and as a depository in connection with a leveraged buyout transaction met the definition of a financial institution and were protected from constructive fraud claims.[6]

In *Kelley*, the Eighth Circuit affirmed a lower court determination that a bank acted as a custodian, receiving and disbursing funds in connection with a note purchase agreement; consequently, the recipients of the transfers were safe harbor-protected entities.[7]

Comment

Case law examining the scope of safe harbor protections is not extensive. The statutory language is broad and generally construed in accordance with its plain meaning. QFCs in the influential Second Circuit enjoy the wide and deep safe harbor afforded by *Tribune* and its progeny. The Eighth Circuit's endorsement of the Second Circuit's approach likely affirms the continued vitality of broad application of safe harbor protections. The Supreme Court may not soon revisit these issues, as it denied a certiorari petition for review of the *Tribune* decision.[8]

[1] No. 20-3330, 2022 WL 1177748, at *1 (8th Cir. Apr. 21, 2022).

[2] *Id.* at *5; see 11 U.S.C. § 741(7)(A)(i).

[3] *Kelley*, 2022 WL 1177748, at *4; *see* 11 U.S.C. § 101(22)(A).

[4] *In re Trib. Co. Fraudulent Conveyance Litig.*, 946 F.3d 66 (2d Cir. 2019).

[5] 138 S. Ct. 883, 892-93 (2018).

[6] *Id.* at 79-80.

[7] *Kelley*, 2022 WL 1177748, at *4. The Eighth Circuit remanded on the issue whether the payments were made in connection with a securities contract. The District Court erroneously construed the payments transfer trail. However, the appellate court noted that 546(e) sets a low bar for the required relationship between the securities contract and the transfer sought to be avoided. We will monitor the remand proceedings.

[8] *Deutsche Bank Tr. Co. v. Robert R. McCormick Found.*, 141 S. Ct. 728 (2020); *Deutsche Bank Tr. Co. Americas v. Robert R. McCormick Found.*, 141 S. Ct. 2552 (2021).