

CLIENT ALERT: Redemption of Privately-Placed Notes Shielded From Clawback in Bankruptcy

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Recent federal court decisions have expanded the protections afforded to lenders of bankrupt issuers. Building on a recent Second Circuit opinion, on July 27, 2011, the Bankruptcy Court for the Southern District of New York issued an opinion in the Chapter 11 bankruptcy cases of *Quebecor World (USA), Inc., et al.*, ruling that redemption payments made to noteholders were not subject to avoidance in bankruptcy by virtue of a safe-harbor contained in the Bankruptcy Code.^[1] The case is important to noteholders whose notes have been or may be redeemed by a distressed issuer.

Background

In July 2000, Quebecor World Capital Corp. (together with each of its affiliates, "Quebecor") raised \$371 million by issuing a series of private notes (the "Notes") pursuant to Note Purchase Agreements (the "Note Purchase Agreements"). The Notes were issued through a private placement to a group of investors. Of particular significance, the Note Purchase Agreements (i) permitted Quebecor to purchase, redeem, or prepay the Notes; and (ii) provided for a make-whole premium (the "Make-Whole Premium") to be paid to the Noteholders in connection with a prepayment of the Notes. The Note Purchase Agreements also contained a capitalization covenant (the "Capitalization Covenant") which provided that an event of default arising from a breach of the Capitalization Covenant could render the Notes immediately due and payable.

Quebecor was also a borrower under a credit agreement (the "Credit Agreement") which contained a "cross-default" provision providing that acceleration of the maturity of the Notes arising from a breach of the Capitalization Covenant would constitute a breach of the Credit Agreement. To avoid a default under the Credit Agreement, as Quebecor's financial condition deteriorated, Quebecor (i) entered into an amendment to the Credit Agreement that, among other things, waived any default under the cross-

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default provision, and permitted Quebecor to draw on its line of credit under the credit facility for purposes of redeeming the Notes; and (ii) sent each Noteholder a notice that it would be redeeming all outstanding Notes pursuant to the terms of the Note Purchase Agreements. Quebecor then wired approximately \$376 million to CIBC Mellon Trust Co. (“CIBC Mellon”), the trustee for the Notes (the “Disputed Transfer”), to redeem the Notes.

On January 21, 2008, Quebecor filed for protection under Chapter 11 of the Bankruptcy Code. Thereafter, the Official Committee of Unsecured Creditors (the “Committee”) sued to avoid the Disputed Transfer as a preferential transfer pursuant to section 547 of the Bankruptcy Code.^[2] The defendants moved for summary judgment, arguing that the Disputed Transfer was exempt from avoidance pursuant to the safe-harbor of section 546(e) of the Bankruptcy Code.^[3]

Section 546(e) generally provides that “settlement payments” made by or to a “financial institution” are not subject to being avoided in bankruptcy. This provision was enacted to ensure that the public securities market would not be impacted by an issuer’s bankruptcy filing.

The Bankruptcy Court’s Opinion

In determining that the Disputed Transfer qualified for the safe-harbor exemption, the Bankruptcy Court found that the redemption payments were “settlement payments” that had been made to a “financial institution”, as those terms are defined in section 546(e) of the Bankruptcy Code. Despite attempts by the Committee to disregard the undisputed involvement of a financial institution, CIBC Mellon, in the transaction, the Bankruptcy Court first noted that “without question the Disputed Transfer was ‘made by or to (or for the benefit of) a ... financial institution,’ i.e., CIBC Mellon as trustee for the Notes.” The greater analytical challenge facing the Bankruptcy Court was whether the Disputed Transfer properly fit the definition of a “settlement payment” for purposes of section 546(e).

The Bankruptcy Court held that its decision was compelled by a recent opinion issued by the Court of Appeals for the Second Circuit in the Enron bankruptcy cases.^[4] The Bankruptcy Court concluded that “the direction given by the *Enron* majority with respect to th[e] definition [of “settlement payment”] is both uncomplicated and crystal clear—a settlement payment, quite simply, is a ‘transfer of cash ... made to complete [a] securities transaction.’” Applying this principle to the *Quebecor* facts, the Bankruptcy Court held that the Disputed Transfer qualified for the 546(e) exemption as (i) the “settlement payment” was a “transfer of cash”—the wiring of funds from Quebecor to CIBC Mellon; (ii) to a “financial institution”, in this case CIBC Mellon, that was acting as agent for the Noteholders; and (iii) the cash was transferred for securities to complete a securities transaction.

Conclusion

The law in the Second Circuit has become clear and favorable to noteholders like those in *Quebecor*. When private placement notes are redeemed, noteholders may have a complete bankruptcy defense where (i) the debtor transfers cash, (ii) to a financial institution acting as agent for the noteholders, (iii) to redeem, repurchase and cancel existing securities. In light of the expanded protections afforded to noteholders under the *Quebecor* opinion and given the possibility that a borrower may become distressed or insolvent, noteholders may be well advised to structure their transactions in a manner that falls within the safe harbor of Bankruptcy Code section 546(e). Please feel free to contact the attorneys listed below if you would like to discuss the *Quebecor* opinion further or its potential impact on particular notes.

[1] *Official Committee of Unsecured Creditors of Quebecor World (USA), Inc. v. American United Life Insurance Company (In re Quebecor World (USA), Inc.)*, --- B.R. ---, 2011 WL 3157292 (Bankr. S.D.N.Y. July 27, 2011).

[2] Section 547(b) of the Bankruptcy Code provides that the debtor may recover, among other things, money or property transferred by an insolvent debtor in the ninety days preceding bankruptcy, where the transfer (i) was made to or for the benefit of a creditor; (ii) was made for or on account of an antecedent debt owed by the debtor; and (iii) enabled the creditor to receive more than it otherwise would have under the provisions of the Code. See 11 U.S.C. § 547 (b).

[3] Section 546(e) of the Bankruptcy Code provides “Notwithstanding section ... 547 ... of this title, the trustee may not avoid a transfer that is a ... settlement payment, as defined in section ... 741 of this title, made by or to (or for the benefit of) a ... financial institution ... that is made before the commencement of the case.” See 11 U.S.C. § 546(e). Section 741(8) defines a “settlement payment” as “a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.” See 11 U.S.C. § 741(8).

[4] *In re Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, --- F.3d. ---, 2011 WL 2536101 (2d Cir. June 28, 2011).

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