MCA v. Paine Webber

Draft Amicus Brief of The Bond Market Association

Attached is the brief prepared for filing in this case. The brief discusses whether final payments made in connection with whole loan repo transactions are protected under the "forward contract" safe harbor of the Bankruptcy Code. Because the case was settled, the brief was never filed. In order to make the arguments in this draft available to our members, we are publishing it here.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

In re: MCA FINANCIAL CORP., et al., Debtors.	Case No. 99-42172, et seq. Chapter 11 Hon. Steven W. Rhodes Jointly Administered
MCA FINANCIAL CORP., MCA MORTGAGE CORPORATION, MORTGAGE CORPORATION OF AMERICA, INC., RIMCO FINANCIAL CORP., RIMCO MANAGEMENT COMPANY, RIMCO BUILDING COMPANY, RIMCO DEVELOPMENT COMPANY, REAL ESTATE SOLUTIONS GROUP, RIMCO REALTY AND MORTGAGE, MORTGAGE CORPORATION OF AMERICA, WAREHOUSE LENDERS, INC., and PROPERTY CORPORATION OF AMERICA, Plaintiffs, v. PAINE WEBBER REAL ESTATE SECURITIES, INC., Defendant.	Adv. Proc. No. 01-4240

BRIEF OF AMICUS CURIAE THE BOND MARKET ASSOCIATION

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INTRODUCTION

The Bond Market Association (the "Association") respectfully submits this brief as amicus curiae in support of the position that whole loan[1] repurchase (or "repo") transactions are forward contracts and therefore entitled to the forward contract safe harbor protections under the Bankruptcy Code. The Association believes that a finding to the contrary could disrupt the whole loan repo market, disadvantaging mortgage borrowers and homeowners as the ultimate beneficiaries of these markets.[2]

INTEREST OF THE AMICUS CURIAE

The Association represents securities firms and banks that underwrite, trade and sell fixed-income securities in the U.S. and international markets. The Association's members deal in a wide variety of public and private fixed-income securities and collectively represent in excess of 95 percent of the initial distribution and secondary market trading of mortgage and asset-backed securities, federal agency securities and corporate bonds. Its members and their affiliates participate in both sides of the whole loan forward markets, financing mortgage lenders' origination of whole loans and their own whole loan positions through whole loan repurchase transactions and engaging in both purchases and sales of whole loans on a forward

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1 A "whole loan" simply refers to a 100% undivided interest in a mortgage loan. By contrast, mortgage-backed securities often represent divided interests in mortgage loans.

2 Consistent with that position, the Association does not take a position on any of the particular facts at issue in this proceeding. The Association acknowledges that the parties have raised procedural arguments as well as other arguments based on the specific facts of this case that ultimately may be dispositive of the motions before the Court. However, the Association's interest lies in the resolution of the broader legal issues at play rather than the resolution of the other case-specific issues presented. Therefore, while the Association submits that the forward contract safe harbors should be interpreted to include forward contracts relating to whole loans, the Association does not take a position with respect to any other issue involved in this dispute.

basis. The Association's members are also active participants in the securitization of whole loans into mortgage-backed securities.

For several decades, the Association has monitored significant issues confronting the U.S. government and other securities markets, with the goal of fostering sound credit, business and trading practices for participants in the fixed-income securities market, with the ultimate aim of increasing efficiency, facilitating market liquidity and minimizing systemic risk in the fixed-income markets. Among other activities, the Association provides a market perspective on bankruptcy and securities legislation and regulation, and undertakes numerous initiatives to improve industry practices and market efficiency. In the mortgage-backed securities context, such initiatives have included drafting market practice guidelines and standardized agreements, and working with the United States Treasury and Federal Reserve Bank of New York on projects designed to decrease costs and increase efficiency in the mortgage securitization process. The Association has also appeared as *amicus curiae* in other cases of importance to the repo markets.[3]

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[3] See, e.g., Wyle v. Howard, Weil, Labouisse, Freidrichs, Inc. (In re Hamilton Taft & Co.), 114 F.3d 991 (9th Cir. 1997); Granite Partners, L.P. v. Bear, Stearns & Co., 17 F. Supp. 2d 275 (S.D.N.Y. 1998). The United States Courts of Appeal for the Second, Third, Fourth and Ninth Circuits have accepted *amicus curiae* briefs submitted by the Association with respect to issues involving fixed-income markets. Further information regarding the Association and its members and activities can be obtained from our web site (www.bondmarkets.com).

The Association's participation as *amicus curiae* in this proceeding[4] has been prompted by its particular interest in the legal and policy issues raised herein regarding the protections afforded to participants in the forward contract markets involving whole loans. The stability and efficiency of those markets are significantly affected by the safe harbor issues involved in this case. As a result, the Association has a strong interest in ensuring that the law regarding the safe harbor protections provided to forward contracts include whole loan forward transactions so that those transactions and the markets that depend on them receive the benefits -- market stability and predictability -- envisioned by Congress. The Association is concerned that a finding that whole loan repurchase transactions are not entitled to the forward contract safe harbor protections under the Bankruptcy Code would cause uncertainty and disruption in the marketplace, ultimately resulting in higher costs to homeowners and other mortgage borrowers.

ARGUMENT

I. THE BANKRUPTCY CODE SAFE HARBORS ARE ESSENTIAL TO PROTECT THE WHOLE LOAN FORWARD CONTRACT MARKET FROM SYSTEMIC RISK

The Bankruptcy Code safe harbors permitting the exercise of liquidation and setoff rights under forward contracts and protecting against the avoidance of prepetition transfers

[4] This brief is being filed on the recommendation of the Association's Litigation Advisory Committee, Funding Division Legal Advisory Committee and Mortgage-Backed Securities Legal Advisory Committee. UBS Warburg Real Estate Securities Inc. (successor to the nominal defendant), a member of the Association, requested that the Association consider filing an *amicus* brief. UBS Warburg is represented on each of the foregoing committees, but took no part in the decision to make this filing or in the preparation of the brief. Neither UBS Warburg nor any other Association member made a monetary contribution to the cost of preparing this brief other than through general Association dues and assessments.

and offsets are essential to the primary and secondary mortgage markets, and the preservation of benefits homeowners and other borrowers derive from the existence of these markets.

Consistent with other forward contracts, whole loan repurchase transactions provide financing and liquidity through the paired sale of a commodity or other similar right or interest -- such as a mortgage loan -- with a future promise to repurchase the asset. In the case of mortgage loan repurchase transactions, a mortgage loan originator or purchaser sells the mortgage loan (or a pool of mortgage loans) to a dealer. Contemporaneous with that sale, the parties agree that on or before a certain future date, or on demand, the dealer will resell and the originator will repurchase the mortgage loan.[5] The whole loan repurchase transaction may be coupled with a "back end" purchase of the mortgage loan, pursuant to which the dealer or another party will purchase the whole loan from the originator, in order to add the mortgage loan to a pool of mortgage loans being securitized into mortgage-backed securities.

As with many other types of forward contracts, the use of whole loan repurchase transactions promotes liquidity in the marketplace by increasing the ability of dealers to finance the origination or purchase of mortgage loans. Often such whole loan repurchase transactions do not exist in isolation. Rather, they are used as an interim mechanism to finance the extension of new mortgage loans until such time as the mortgage loans are pooled and sold or securitized in a secondary market transaction, either by the original dealer or another financial institution.

The secondary market for mortgage loans -- involving lenders, investors, and government agencies -- is both highly developed and integral to the mortgage industry. About

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[5] In fact, this type of repurchase transaction is referred to as a "reverse repo" because the dealer is purchasing, rather than selling, the mortgage loan at the start of the transaction.

60 percent of single-family mortgages originated each year are funded through the sale of mortgage-backed securities. Office of Federal Housing Enterprise Oversight Report to Congress 9 (June 2003) ("OFHEO"), available at http://www.ofheo.gov/media/pdf/WEBsiteOFHEOREPtoCongress03.pdf. Accordingly, most sales of whole loans occur as part of a process of creating pools of mortgages to ultimately support the issuance of mortgage-backed securities. Id. This active secondary market does not merely involve private parties. On the contrary, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") own or guarantee 42 percent of the $7 trillion in mortgage loans currently outstanding in the domestic mortgage market. See CongressDaily, (June 25, 2003), available at 2003 WL 58356898. Whole loan reverse repurchase transactions are integral to the smooth operation of the secondary markets as they facilitate the subsequent pooling and sale of the underlying mortgages. Most significantly, the ultimate beneficiaries of these various interlaced financial transactions are individual homeowners and other borrowers. It is estimated that the Fannie Mae and Freddie Mac programs alone have resulted in reductions in the interest rates charged on non-jumbo fixed rate loans in the magnitude of 20 to 40 basis points. See OFHEO Rep. at 15.

The continued successful functioning of the secondary mortgage market depends in significant part on the ability of dealers to engage in whole loan repurchase and reverse repurchase transactions. Frustration of the ability of the parties to perform and receive the performance of obligations in whole loan repurchase transactions contrary to existing expectations may have cascading repercussions to other transactions, thereby disrupting the efficient functioning of the market as a whole and potentially creating systemic risk. The

Bankruptcy Code safe harbors promote dealers' ability to perform their contractual duties and, in doing so, also foster the stability and smooth operation of the market. In the whole loan repurchase context, both the carveout from the automatic stay for the setoff of mutual debts and claims under forward contracts and the preservation of a dealer's right to rely on ipso facto conditions to liquidate its forward contracts with a debtor further the dealer's ability to free capital from a particular whole loan repurchase transaction for use in other deals. Notably, where the underlying mortgages in a repurchase transaction have been pledged to other future transactions, such as sales or securitizations in the secondary market, any delay in closing out a repurchase transaction with a debtor will affect those other anticipated transactions as well. Given that dealers often rely on prompt closeout and exercise of remedies in order to meet their own obligations in a timely manner, delays in closing out repurchase transactions may cause dealers to default on their obligations, threatening their solvency, and creating systemic risk -- illiquidity and a chain reaction of insolvencies. By protecting dealers against the threat of avoidance of prepetition payments received or offsets taken, the Bankruptcy Code also minimizes systemic risk by promoting the dealers' solvency and ability to continue participating in and providing liquidity to the whole loan mortgage markets.

Congress repeatedly has recognized the importance of preserving orderly financial markets, for forward contracts as well as "commodity contracts," "repurchase agreements,"[6] "swap agreements" and "securities contracts." Accordingly, the safe harbors it

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[6] The Bankruptcy Code defines a "repurchase agreement" or "reverse repurchase agreement" to consist of "an agreement, including related terms, which provides for the transfer of certificates of deposit, eligible bankers' acceptances, or securities that are direct obligations of, or that are fully guaranteed as to principal and interest by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit,

has provided under the Bankruptcy Code protect parties' ability to rely on their contractual rights and on the non-avoidability of transfers and setoffs under these types of agreements notwithstanding a bankruptcy filing. In particular, the Bankruptcy Code authorizes the liquidation of securities contracts, commodity contracts, forward contracts and repurchase agreements and the termination of swap agreements solely based on a bankruptcy filing, notwithstanding the general prohibition provided in Bankruptcy Code § 365(e)(1) against the enforcement of ipso facto clauses to terminate executory contracts. See 11 U.S.C. §§ 555, 556, 559, 560. Accompanying this liquidation right is the right of forward contract merchants, stockbrokers, financial institutions and securities clearing agencies and other entities to set off certain mutual debts free from challenge in the bankruptcy proceeding. See 11 U.S.C. §§ 362(b)(6), (7) & (17), 553(b)(1). Finally, non-debtor parties to forward contracts and other similar financial transactions are granted a safe harbor from the risk of avoidance of payments received prior to a bankruptcy filing. See 11 U.S.C. §§ 546(e), (f), (g).

Congress's decision to grant these protections results from its desire to protect the stability of the relevant financial markets -- the exact concern at play in the protection of whole loan repurchase transactions. For example, the original safe harbor from avoidance actions, applicable only to commodities markets, was enacted in 1978 to "'promote customer confidence in commodities markets generally' via 'the protection of commodity market stability.'" Kaiser

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eligible bankers' acceptances, or securities with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptances, or securities as described above, at a date certain not later than one year after such transfers or on demand, against the transfer of funds." 11 U.S.C. § 101(47). The statute makes clear, however, that repurchase agreements involving government securities are not the only types of transactions provided a safe harbor since forward contracts are specifically defined to include a "repurchase transaction" and a "reverse repurchase transaction." 11 U.S.C. § 101(25) (emphasis added).

Steel Corp. v. Charles Schwab & Co., 913 F.2d 846, 849 (10th Cir. 1990) (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 8 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5794). 1982 amendments to the Bankruptcy Code served to "broaden the commodities market protections" that were designed to protect the commodities markets from the "ripple effect" caused by the insolvency of a commodities firm and to expressly extend similar protections to the securities market. H.R. Rep. 97-420, 97th Cong., 2d Sess. 1-2, reprinted in 1982 U.S.C.C.A.N. 583, 583.

The significance of the certainty and liquidity created by the safe harbor protections, and the negative consequences that likely would result from uncertainty as to their applicability, cannot be overemphasized. The best example of the potential negative market reaction to even one decision calling into question the viability of a safe harbor is what happened as a result of the decision of the United States Bankruptcy Court for the Southern District of New York in Lombard-Wall Inc. v. Columbus Bank & Trust Co. (In re Lombard-Wall Inc.), No. 82 B 11556 (Bankr. S.D.N.Y. Sept. 16, 1982). In that proceeding, shortly after the debtor filed its petition for relief, the Bankruptcy Court ruled that the automatic stay precluded a holder of government securities subject to a repurchase agreement from closing out its position.

That ruling jolted the government securities repo market from its prior assumption that such transactions "were both highly liquid and secure beyond question" and caused widespread concern that if such securities could not be liquidated without court permission, investors would be left to bear the risk of market fluctuations during any delay and substantial losses could result. See Bankruptcy Law and Repurchase Agreements: Hearings on H.R. 2852 and H.R. 3418 Before the Subcommittee on Monopolies and Commercial Law of the House Committee on the Judiciary, 98th Cong., 2d Sess. 72 (1984) (letter of Hon. Paul A. Volcker, Chairman, Federal Reserve, to Hon. Peter W. Rodino, Chairman, House Judiciary Committee). As with other similar types of financial instruments, market participants were concerned about the ripple effects resulting from the illiquidity caused by even a single bankruptcy. As one government official testified:

> A collapse of one firm involved in repo transactions could lead to the collapse of others who had been counting on the completion of the repo on schedule in order to meet their own investment or expenditure commitments. The great fear is that a chain reaction would then result because of the complex interrelation of many transactions and firms, putting at risk hundreds of billions of dollars and threatening the solvency of many institutions. This could severely test the soundness of the nation's financial system and the ability of the Federal Reserve to conduct monetary policy.

Id. at 26 (Statement of the Hon. Walter E. Fauntroy, Chairman, Subcommittee on Domestic Monetary Policy, Committee on Banking, Finance & Urban Affairs, May 2, 1984).

While it may be safe to say that not every failure of a firm involved in repo transactions would have such dire and widespread consequences, the mere uncertainty created by the Lombard-Wall decision did have a dramatic effect on the market. According to Congressional testimony, following the decision institutional participants pulled out of the market, and the narrowing of the market ultimately resulted in as much as a quarter point increase in repo rates for such transactions, a significant increase for that market. Id. at 19 (testimony of Walter E. Fauntroy, a Congressional delegate from the Dist. of Columbia). In the end, these costs were borne by the issuer of the underlying securities, the United States government. Congress acted quickly to eliminate the "cloud of doubt" hanging over repurchase agreements in light of the Lombard-Wall decision and to protect against potential ripple effects resulting from the failure of a single repo dealer, id. at 20, amending the Bankruptcy Code in

1984 to provide explicitly that government securities repurchase agreements enjoy safe harbor protections. See 11 U.S.C. § 559.

As discussed in Part II, infra, Congress did not stop there. In 1990, it revisited the protections afforded to forward contracts and expanded the types of agreements covered by those protections. Viewed as a whole, these clarifications and amendments resoundingly indicate Congress's intent to ensure that financial markets involved in forward contracts and other similar agreements are protected and insulated from the effects of the bankruptcy of an individual institution. Whole loan repurchase transactions, structured similarly to other forward contracts and having the same need for protections to decrease uncertainty, foster the smooth operation of the markets and reduce systemic risk, are entitled to the Bankruptcy Code's safe harbor protections.

II. WHOLE LOAN REPURCHASE TRANSACTIONS ARE FORWARD CONTRACTS UNDER THE BANKRUPTCY CODE

In this case, the liquidating agent Stuart Gold (the "Liquidating Agent") seeks to avoid a $949,829 payment made to defendant UBS Warburg Real Estate Securities, Inc., formerly named Paine Webber Real Estate Securities, Inc. ("Paine Webber") and to recover $460,068.25 retained by Paine Webber pursuant to a claimed right of setoff. The Liquidating Agent's ability to recover these sums depends, in part, on whether the transactions are protected under the Bankruptcy Code because they were made in conjunction with a forward contract.

A trustee's or debtor in possession's general statutory power to recover the estate's assets is specifically limited by the Bankruptcy Code safe harbor provisions applicable to forward contracts. First, a trustee has the power to seek avoidance of prepetition transfers as preferences, see 11 U.S.C. § 547, or as fraudulent conveyances. See 11 U.S.C. §§ 548(a) and (b). That avoidance power is expressly limited, however, in that the trustee may not avoid a prepetition "margin payment" or "settlement payment" that is "made by or to a commodity broker, <u>forward contract merchant</u>, stockbroker, financial institution, or securities clearing agency," except for fraudulent conveyances made with the actual intent to defraud.[7] 11 U.S.C. § 546(e) (emphasis added). Second, under Bankruptcy Code § 553, a trustee may seek recovery of a setoff taken by a creditor prepetition once certain criteria are satisfied. Again, that power is expressly limited -- a trustee may not seek recovery of

> the setoff by a . . . <u>forward contract merchant</u> . . . of any mutual debt and claim under or in connection with . . . forward contracts . . . that constitutes the setoff of a claim against the debtor for a margin payment . . . or settlement payment . . . <u>arising out of</u> . . . <u>forward contracts</u> against cash, securities, or other property held by or due from such . . . <u>forward contract merchant</u> . . . to margin, guarantee, secure, or settle . . . <u>forward contracts</u> . . . .

11 U.S.C. § 362(b)(6) (emphasis added); <u>see also</u> 11 U.S.C. § 553(b)(1). In both cases, the applicability of the safe harbor provided by the Bankruptcy Code turns on the question of whether the scrutinized transaction involved a forward contract merchant -- a person whose business consists in whole or in part of entering into forward contracts as or with merchants in a commodity (<u>see</u> 11 U.S.C. § 101(26)) -- and therefore, ultimately on whether a forward contract underlies the transaction. In the case of section 546(e), the issue also turns on whether the transfer constitutes a "margin payment" or "settlement payment."

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7 While the Bankruptcy Code permits a fraudulent conveyance action based on an actual intent to defraud to be brought against a forward contract merchant, the merchant is entitled to partial protection even in such a suit. The statute presumes the forward contract merchant "takes for value" to the extent of any margin payment or settlement payment received. 11 U.S.C. § 548(d)(2). Therefore, the forward contract merchant may retain such interests transferred as long as it took such transfers "in good faith." 11 U.S.C. § 548(c).

It is impossible to pigeonhole a narrow set of contracts that qualify as forward contracts. Rather, the broadly defined term includes the following litany of financial transactions:

> [A] contract (other than a commodity contract) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of [the Bankruptcy Code], or any similar good, article, service, right or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase transaction, reverse repurchase transaction, consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any combination thereof or option thereon.

11 U.S.C. § 101(25). Notably, forward contracts entitled to safe harbor protections do not merely consist of contracts based on commodities. On the contrary, forward contracts afforded protection include off-exchange contracts[8] for the purchase, transfer or sale of both commodities and any other "similar good, article, service, right or interest which is presently or in the future becomes the subject of dealing in the forward contract trade." 11 U.S.C. § 101(25). These additional categories, added to the Bankruptcy Code through a 1990 amendment, are intended to capture items that either are similar in nature to commodities under the Commodity Exchange Act or are traded in a similar manner. See S. Rep. No. 285, 101st Cong., 2d Sess. 8, 1990 WL 259288 (May 14, 1990).

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[8] "On-exchange" commodity contracts providing for the purchase or sale of a commodity for future delivery on, or subject to the rules of, a contract market or board of trade are expressly carved out of the scope of forward contracts provided a safe harbor under the Bankruptcy Code, although they receive similar protections as "commodity contracts." See 11 U.S.C. §§ 101(25), 546(e).

Whole loan repurchase transactions are forward contracts entitled to the Bankruptcy Code safe harbors, as the whole loans subject to these transactions are either commodities or rights and interests that are the subject of dealing in a manner similar to other forward contracts. As discussed in Part I, supra, the use of whole loan repurchase transactions and other secondary market instruments is a substantial and integral part of the mortgage industry. Mortgage loans subject to repurchase transactions are similar to other commodities traded off-exchange in that (1) dealers conduct the transactions, (2) the underlying assets – usually large pools of mortgage loans – are essentially fungible financial assets, (3) forward risk – the risk that future fluctuations in market prices will affect the value of the transaction to each party -- is created by the transactions, and (4) collateral or other credit support is often provided to account for that risk. Additionally, the failure of a mortgage originator or mortgage dealer has the potential to disrupt the larger market in which a forward contract merchant participates, and accordingly, the market likely would suffer the same adverse consequences from uncertainty as to the extension of safe harbor protections in a bankruptcy as those previously observed in other similar financial markets.

The existence of a back-end purchase option that eliminates the need for delivery in a whole loan repurchase transaction does not negate its status as a forward contract. While one historical hallmark of a forward contract has been an intent to actually deliver the underlying commodity or other interest at the settlement of the transaction, it is quite common in recent times that parties to forward contracts have opted away from actual physical delivery to instead using a netting mechanism with a resulting net payment as a convenience where further transactions are contemplated. As discussed in Part I, supra, subsequent resales often are used to move whole loans into the secondary market, where they are securitized or otherwise sold to increase liquidity in the overall mortgage industry. Indeed, these back-end purchases -- tied in timing to the settlement of whole loan reverse repurchase transactions -- are themselves forward contracts, also protected under the Bankruptcy Code safe harbors.

Recognizing that the terms of individual forward contracts may vary slightly, the decision of individual parties to use the convenience and risk reduction of netting rather than a formal delivery of the underlying mortgage loans as a mechanism to transfer the mortgage loans between two transactions -- both involving forward contracts -- should not be used a basis for disproving the existence of a forward contract. Notably, while in this case the Liquidating Agent argues that the potential for a lack of physical delivery negates the agreement's forward contract status, in Williams v. Morgan Stanley Capital Group Inc. (In re Olympic Natural Gas Co.), 294 F.3d 737 (5th Cir. 2002), the chapter 7 trustee argued the exact opposite -- that the fact that a Natural Gas Sales and Purchase Contract contemplated actual physical delivery demonstrated that it was an "ordinary" commodities contract and not a true forward contract. The Williams court rejected that argument, properly concluding that there is no third category of "ordinary" commodities contracts unprotected by the Bankruptcy Code safe harbor. As the court stated:

> We . . . conclude that the transactions here fall within the scope of § 101(25)'s definition of forward contract. The commodities market is divided into only two categories: (1) on-exchange futures transactions; and (2) off-exchange forward contracts. See 5 Collier on Bankruptcy ¶ 556.02[2], at 556-5 (Lawrence P. King ed., 15th ed. 2002) ("Thus, the terms 'commodity contract' and 'forward contract,' taken together, seamlessly cover the entirety of transactions in the commodity and forward contract markets, whether exchange-traded, regulated, over-the-counter or private.").

294 F.3d at 740-41 (citation omitted). In the case of whole loan repurchase transactions, unlike in Williams, no argument has been made that the transactions involve ordinary commodity sales contracts rather than forward market contracts. However, similar to the protections afforded in Williams, whole loan repurchase transactions should fall within the seamless coverage provided to forward contracts under the safe harbors of the Bankruptcy Code.

III. FINAL PAYMENTS UNDER WHOLE LOAN FORWARD CONTRACTS CONSTITUTE SETTLEMENT PAYMENTS

Given that whole loan repurchase transactions are forward contracts subject to the protections of the Bankruptcy Code safe harbors, any payment made upon the termination of these agreements to repurchase the underlying whole loans is a settlement payment that is not voidable as a preference. See 11 U.S.C. § 546(e).

A bankruptcy trustee's avoidance powers are expressly limited in the context of forward contracts. Specifically, section 546(e) of the Bankruptcy Code provides that notwithstanding a trustee's general power to avoid preferences under sections 547 and fraudulent conveyances under sections 548(a)(1)(B) and 548(b) of the Bankruptcy Code, a "trustee may not avoid a transfer that is a margin payment . . . or settlement payment, as defined in section 101 or 741 of this title, made by or to a . . . forward contract merchant . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title"[9] (11 U.S.C. § 546(e)). All payments typically made to a dealer under a whole loan forward contract would

[9] Section 548(a)(1)(A) provides for the avoidance of transfers of interest of a debtor in property or obligations incurred by the debtor within one year before the petition date if the debtor "made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted."

be protected by this safe harbor, as such payments would constitute either settlement payments or margin payments.

As courts have consistently recognized, the Bankruptcy Code has defined the types of settlement payments subject to the safe harbor from avoidance actions expansively. Under section 101(51A) of the Bankruptcy Code, applicable to the Code's forward contract provisions, the term "settlement payment" refers to

> a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.

An analogous scope of protection is afforded to prepetition settlement payments made by or to a commodity broker, stockbroker, financial institution or securities clearing agency (11 U.S.C. § 546(e)), or a repo participant in connection with a repurchase agreement (11 U.S.C. § 546(f)). See 11 U.S.C. § 741(8).[10] See also 11 U.S.C. § 546(g) (providing a similar safe harbor for a "transfer" under a swap agreement made by or to a swap participant).

The "extremely broad" definition of settlement payments under the Bankruptcy Code furthers the intention that the safe harbor from avoidance actions (like the analogous provisions excepting the liquidation of such contracts from the automatic stay) promotes and ensures liquidity and stability in the financial instruments markets. See Bevill, Bresler & Schulman Asset Mgmt. Corp. v. Spencer Sav. & Loan Ass'n (In re Bevill, Bresler & Schulman Asset Mgmt. Corp.), 878 F.2d 742, 751-52, 753 (3d Cir. 1989) (emphasizing legislative intent to

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[10] For the purposes of these types of transactions, a settlement payment includes 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." 11 U.S.C. § 741(8).

ensure liquidity in the government securities repo market in construing settlement payments broadly); see also Kaiser Steel Corp. v. Charles Schwab & Co., 913 F.2d 846 (10th Cir. 1990) (noting similar Congressional goal relating to other safe harbors under sections 546(e) and (f)). Consistent with that purpose, courts have rejected debtors' attempts to attack settlement payments that were not made on financial derivative contracts and cleared through a centralized system, see Williams v. Morgan Stanley Capital Group Inc. (In re Olympic Natural Gas Co.), 294 F.3d 737, 742 (5th Cir. 2002) (involving forward contract for natural gas), that were not made to complete a bilateral exchange with the debtor, see Wyle v. Howard, Weil, Labouisse, Freidrichs, Inc. (In re Hamilton Taft & Co.), 114 F.3d 991, 993 (9th Cir. 1997), or that did not involve "'the system of intermediaries and guarantees' that normal securities transactions involve," Resorts International Financing, Inc. v. Resorts International, Inc. (In re Resorts International, Inc.), 181 F.3d 505, 515 (3d Cir.), cert. denied, 528 U.S. 1021 (1999) (citation omitted).

In light of the foregoing, there is little room for doubt that a payment made to purchase whole loans at the end of a whole loan repurchase transaction is a settlement payment that is entitled to protection from avoidance as a preference under section 546(e). As discussed in Part II, supra, it should be of no consequence whether at the time such payment is due, the dealer actually delivers the whole loan or purchases the loan from the debtor and receives the net amount as payment.

CONCLUSION

For the reasons set forth above, the Liquidating Agent's motion for summary judgment should not be granted to the extent it relies on the argument that whole loan repurchase transactions are not entitled to the forward contract safe harbor protections of the Bankruptcy Code or that payments thereunder are not settlement payments.

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Respectfully submitted,

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