SDNY Distinguishes Supreme Court, Holds Tribune Company's Leveraged Buyout Falls Within Section 546(e) Safe Harbor Provision

August 20, 2019

By Kevin C. Maclay, Todd E. Phillips, and Nathaniel R. Miller

The District Court for the Southern District of New York has ruled that a trustee could not amend a complaint to add federal constructive fraudulent transfer claims because those claims were preempted by the safe harbor provision of the Bankruptcy Code.[1] The District Court found, under a plain language reading of the safe harbor provision, 11 U.S.C. § 546(e), that Tribune Company ("**Tribune**") was protected as a "financial institution" because it was a "customer" of a "financial institution."[2] In so finding, the District Court distinguished *Merit Management Group, LP v. FTI Consulting, Inc.*, in which the Supreme Court held that a court must look to the overarching transfer to evaluate whether it meets the safe-harbor criteria and rejected the idea that a bank or trust company acting as an intermediary for a financial transaction could invoke the safe harbor provision.[3]

Background

This case arises from Tribune's longstanding Chapter 11 bankruptcy that began in 2008.[4] In 2007, Tribune participated in a two-step leveraged buyout in which it purchased all of its outstanding stock from its shareholders for about $8 billion.[5] Tribune used Computershare Trust Company, N.A. ("**CTC**") as an intermediary in the transactions.[6] Shortly thereafter, Tribune and many of its subsidiaries experienced financial difficulties, and filed Chapter 11 bankruptcy in December 2008.[7]

In June 2011, the Bankruptcy Court granted creditors relief from the automatic stay to allow them to pursue state law constructive fraudulent conveyance claims against Tribune's shareholders.[8] In response, multiple classes of creditors initiated suits against the shareholders

[1] *In re Tribune Co. Fraudulent Conveyance Litig.*, No. 11md2296 (DLC), 2019 WL 1771786, at *12 (S.D.N.Y. Apr. 23, 2019).

[2] *Id.* at *9-11.

[3] *Id.* at *3, 12 (citing *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883, 891-93 (2018)).

[4] *Id.* at *1.

[5] *Id.*

[6] *See id.*

[7] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *1.

[8] *Id.*

to claw back funds transferred to the shareholders during the leveraged buyout.[9] The suits were consolidated by the Judicial Panel on Multidistrict Litigation in front of Judge Richard Sullivan of the District Court for the Southern District of New York, who granted Tribune's motion to dismiss the state-law fraudulent conveyance claims on the grounds that section 362(a)(1) of the Bankruptcy Code deprives individual creditors of standing to challenge the same transactions that the Official Committee of Unsecured Creditors of Tribune (the "**UCC**") was simultaneously seeking to avoid.[10] The Second Circuit affirmed Judge Sullivan's decision, but on different grounds, holding that the fraudulent conveyance claims were preempted by the section 546(e) safe harbor provision of the Bankruptcy Code.[11]

Months later, the Supreme Court granted certiorari in *Merit Management Group, LP v. FTI Consulting, Inc.* to determine the scope of the § 546(e) safe harbor provision.[12] Section 546(e) bars a trustee from asserting a claim for constructive fraudulent conveyance with respect to a "settlement payment . . . made by . . . [a] financial institution [or] financial participant," or "a transfer made by . . . [a] financial institution [or] financial participant . . . in connection with a securities contract."[13] In that case, the Supreme Court held that "the relevant transfer for purposes of § 546(e) safe-harbor inquiry is the overarching transfer" without regard to any intermediary entities or the component parts of the transfer.[14] Therefore, the holding meant that if the overarching transfer was made "by," "to," or "for the benefit of" a covered entity, such as a financial institution, the trustee cannot set aside and recover that transfer.[15] In contrast, if a covered entity only served as an intermediary in the transaction, the safe harbor provision does not apply.[16] Notably, the Supreme Court specifically declined to address whether an entity qualifies as a "financial institution" by virtue of its status as a "customer" under § 101(22)(A).[17]

In response to the Supreme Court's ruling in *Merit Management*, the trustee in the Tribune litigation sought permission to file a motion to amend the complaint to add federal constructive fraudulent transfer claims.[18]

---

[9] *Id.*

[10] *Id.* at *2.

[11] *Id.*

[12] *Id.* at *2.

[13] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *7 (quoting 11 U.S.C. § 546(e)).

[14] *Merit Mgmt. Grp., LP*, 138 S. Ct. at 892.

[15] *Id.* at 885, 887, 889.

[16] *See id.* at 887-88.

[17] *Id.* at 890 n.2.

[18] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *3.

The District Court's Analysis

In determining whether it was appropriate to give leave to amend the complaint,[19] the District Court first found that the trustee acted in good faith and did not unduly delay.[20] The court then looked to the other factors, undue prejudice and futility, to determine whether to allow the trustee to amend.

The court determined that the amended complaint would cause undue prejudice to the shareholders[21] because it would require the shareholders to "expend significant additional resources to conduct discovery and prepare for trial" and would "significantly delay the resolution of the dispute."[22] Further, it would bring into question the strong presumption that stock transactions are final, which in turn would affect the speed, finality, and stability of financial markets.[23] Ultimately, the District Court felt that it would be unfair to the shareholders to bring a new claim against them over two years after the only claim against them had been dismissed.[24]

The District Court then directed its attention to the futility analysis, concluding that the amendment would be futile because the federal constructive fraudulent transfer claims are barred by section 546(e), notwithstanding the Supreme Court's holding in *Merit Management*.[25]

In its analysis, the court first noted that there was no dispute that the transfers at issue were "settlement payments" made "in connection with a securities contract" "by" Tribune.[26] The parties disagreed, however, over whether Tribune was an entity covered by section 546(e), i.e., either a financial institution or a financial participant.[27]

Tribune is not a "financial participant", the District Court held, based on the "clear text" of the statute.[28] However, the court found that Tribune met the definition of a "financial

---

[19] A court in the Second Circuit can deny leave to amend a complaint "for good reason, including futility, bad faith, undue delay, or undue prejudice to the opposing party." *Id.* (quoting *Kim v. Kimm*, 884 F.3d 98, 105 (2d Cir. 2018)).

[20] *Id.* at *5-6.

[21] *Id.* at *6.

[22] *Id.*

[23] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *6.

[24] *Id.*

[25] *Id.* at *7.

[26] *Id.* at *8.

[27] *Id.*

[28] *Id.* at *8.

institution" because of its business relationship with CTC. It ruled that CTC is a "financial institution" because it is both a "bank" and "trust company."[29] The District Court then concluded that Tribune was also a "financial institution" under the statute because: (1) Tribune was a "customer" of CTC; (2) CTC was acting as Tribune's "agent or custodian"; and (3) CTC was acting "in connection with a securities contract."[30]

The District Court rejected the trustee's argument that the "spirit" of the *Merit Management* decision precluded Tribune from being defined as a "financial institution."[31] The trustee argued the overarching transfer was from Tribune to its shareholders, none of which appeared to be "financial institutions" on their face.[32] Thus, he argued that CTC was an intermediary in the transaction, and its status as a financial institution was not relevant to the analysis.[33] The District Court held, however, that the Supreme Court specifically declined to address whether an entity qualifies as a "financial institution" by virtue of its status as a "customer" under § 101(22)(A).[34] The District Court held that the plain language of that statute compelled it to conclude that Tribune was a "financial institution" because of its relationship with CTC, a "financial institution."[35]

Conclusion

On July 12, 2019, the trustee appealed the District Court's decision to the Second Circuit. The case is currently pending.

It will be interesting to see whether the Second Circuit and subsequent courts follow the *Tribune* court's approach, or if, conversely, those cases take a different view of the implications of the Supreme Court's decision in *Merit Management*. One other case to date has analyzed the safe harbor provision since *Merit Management*.[36][37] There, the Bankruptcy Court in the

[29] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *9 (quoting 11 U.S.C. § 101(22)(A)).

[30] *See id.* at *9-11.

[31] *See id.* at *12.

[32] *See id.* at *11-12.

[33] *See id.* at *11.

[34] *Id.* (quoting *Merit Management*, 138 S. Ct. at 890 n.2).

[35] *In re Tribune Co. Fraudulent Conveyance Litig.*, 2019 WL 1771786, at *12.

[36] *In re Centaur, LLC*, 595 B.R. 686, 698 (Bankr. D. Del. 2018), *motion to reconsider denied*, 2019 WL 2122952 (May 13, 2019).

[37] Two other cases requested additional briefing from parties regarding safe harbor controversies in light of *Merit Management*. *In re Fairfield Sentry Ltd.*, 596 B.R. 275, 315 (Bankr. S.D.N.Y. 2018); *In re 45 John Lofts, LLC*, 599 B.R. 730, 748 (Bankr. S.D.N.Y. 2019). A third case remanded the case to the bankruptcy court with the directive to apply *Merit Management*. *In re Greektown Holdings, LLC*, 765 F. App'x. 132 (6th Cir. 2019).

District of Delaware held that the safe harbor did not apply when the overarching transfer did not include a financial institution.[38]

Kevin C. Maclay and Todd E. Phillips are Members of Caplin & Drysdale's Bankruptcy and Complex Litigation practice groups. Nathaniel R. Miller is an Associate in both groups.

---

[38] *In re Centaur, LLC*, 595 B.R. at 698.