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In re Tribune: Defendants Successfully Challenge Individual Creditors Standing But District Court Rules that Section 546(e) Safe Harbor Does Not Bar Individual Creditors' State Law Based Constructive Fraudulent Conveyance Claims

On September 23, 2013, the US District Court for the Southern District of New York in *In re Tribune*[1] held that the individual creditor suits at issue were stayed because the Creditors' Committee was in the process of prosecuting claims for intentional fraudulent conveyance that overlapped with such suits. But on the way to that ultimate holding, the *Tribune* court also ruled that the right of individual creditors in a multidistrict litigation to assert claims for constructive fraudulent conveyance under state law was not preempted by the safe harbor provision of Section 546(e) of the Bankruptcy Code (the "*Tribune* ruling"). This ruling is somewhat troubling as it could provide a path for debtors and creditors to do an end run around the Bankruptcy Code's safe harbors that exempt certain pre-bankruptcy financial transactions from avoidance as constructive fraudulent transfers (*e.g.*, constructive fraudulent transfers that constitute "settlement payments" or transfers in connection with swaps) by permitting individual creditors to bring claims that would otherwise be barred under the Bankruptcy Code if they were brought by the debtor, a trustee, a creditors' committee or other representative of the bankruptcy estate. It remains to be seen whether other courts will decide to follow the *Tribune* court's interpretation of Section 546(e) (which, given the identical nature of the relevant statutory language, would, by extension, apply to other financial contract anti-avoidance safe harbors).[2] Recognizing the importance of the Bankruptcy Code safe harbors to the financial markets, if the *Tribune* ruling is followed, it is possible that a legislative solution to address the potential loophole in safe harbor coverage may be required.

Section 546(e) – A Key Safe Harbor Provision

Designed to minimize systemic risk and maintain the liquidity of the financial markets, Section 546 of the Bankruptcy Code contains certain safe harbors that limit a trustee's power to avoid certain transfers made by, to or for the benefit of certain identified financial market participants in connection with certain financial transactions, such as margin or settlement payments, securities contracts, swap agreements, forward contracts, repurchase agreements and commodity contracts. Section 546(e) protects "margin payments," "settlement payments" and transfers in connection with "securities contracts," "forward contracts" and "commodity contracts" made by, to or for the benefit of certain parties such as stockbrokers and financial institutions from avoidance by "the trustee" as preferences or constructive fraudulent conveyances. Over the course of time, Section 546(e)'s financial contract safe harbors have been expanded to embrace more transactions. Courts interpreting Section 546(e) have acknowledged the breadth of the coverage of this safe harbor and have largely applied the plain language of the provision to broadly immunize enumerated transactions from avoidance even where the transactions at issue arguably did not impact the financial markets.[3]

Background of the Multidistrict Litigation

One year before the Tribune Company ("Tribune") filed for bankruptcy, it completed a leveraged buyout (the "LBO") that paid more than $8.2 billion to public shareholders for their shares. In 2008, Tribune sought relief under Chapter 11 of the Bankruptcy Code in the US Bankruptcy Court for the District of Delaware (the "Bankruptcy Court"), due in large part to its heavy debt load and the steep decline of the publishing industry.

The Official Committee of Unsecured Creditors in the Chapter 11 case (the "Committee") obtained the Bankruptcy Court's authorization to stand in the shoes of the bankruptcy trustee and to file adversary proceedings for the benefit of Tribune's creditors against certain parties who received transfers in connection with the LBO (*e.g.*, shareholders of Tribune who received payment for their shares).[4] The Committee sought to avoid these transfers and certain related LBO obligations on the basis that they constituted *intentional* fraudulent conveyances (*e.g.*, transfers were made with actual intent to hinder, delay or defraud creditors).[5] In its action, the Committee, however, did not assert a claim for *constructive* fraudulent conveyance (*e.g.*, transfers made while the debtor was insolvent or that rendered the debtor insolvent in exchange for less than reasonably equivalent value). As a result, certain individual creditors (the "Individual Creditors") moved the Bankruptcy Court for relief from the automatic stay to file state-law constructive fraudulent conveyance claims outside of the bankruptcy case (such claims and actions, respectively, the "SLCFC claims" and the "SLCFC actions").[6] The Bankruptcy Court granted the relief by lifting the stay, because it found the Committee had not asserted the SLCFC claims within the applicable two-year period after the filing of the Chapter 11 case for bringing such action under Section 546(a). However, the Bankruptcy Court expressly indicated that it was making no ruling as to (i) whether the Individual Creditors would have standing to assert the SLCFC claims or (ii) whether such claims had been preempted by Section 546(e). Upon the lifting of the automatic stay, the Individual Creditors commenced the SLCFC actions in more than 20 state and federal courts. These actions were consolidated by the Judicial Panel on Multidistrict Litigation in the Southern District of New York. The targeted defendants (the "Defendants") promptly moved to dismiss the Individual Creditors' SLCFC actions.

The Ruling and Its Supporting Rationale

The Defendants made two key arguments in their motion to dismiss. First, they argued that the Individual Creditors' claims were barred by the safe harbor in Section 546(e). Second, they argued, on three separate bases, that the Individual Creditors lacked standing to assert the SLCFC claims.

In addressing the Defendants' first argument, the *Tribune* court examined the plain language of Section 546(e). The Individual Creditors argued that (i) Section 546(e), by its terms, only limits avoidance of transfers by the trustee (and by extension the debtor (or other representative of the debtor's estate)) and (ii) state-law fraudulent conveyance claims belonged to the Individual Creditors once the two-year statute of limitations period under Section 546(a) of the Bankruptcy Code to bring such claims had elapsed. Looking at the plain language of

Section 546(e), the *Tribune* court found that "[b]ecause Congress has spoken so clearly with respect to the object of the limitation in Section 546(e), [it] discerns no basis for barring SLCFC claims brought by Individual Creditors who have no relation to the bankruptcy trustee."

The Defendants next argued that, even if not expressly barred, the *Tribune* court should find that the SLCFC claims were preempted by the enactment of Section 546(e). Pointing to the legislative history and prior recent applications of Section 546(e), the Defendants urged the court to find that the SLCFC claims were impliedly preempted by Section 546(e) because recognition of the SLCFC claims would directly and effectively frustrate the expressed purposes of Section 546(e). However, the *Tribune* court found that the legislative history provided the counterpoint. The court noted that (i) Congress declined to expressly preempt the SLCFC claims even though certain parties petitioned for such an amendment, (ii) from the court's review, "Congress [had] repeatedly indicated that it did not enact Section 546(e) to protect market stability to the exclusion of all other policies," and (iii) on the eight separate occasions when Section 546(e) was amended, Congress never added language expressly preempting the SLCFC claims, even after one bankruptcy court decision, *PHP Liquidating, LLC v. Robbins*,[7] had found that, under certain circumstances, Section 546(e) permits creditors to assert the SLCFC claims. Additionally, the *Tribune* court cited another section of the Bankruptcy Code to demonstrate that Congress knows how to and is willing to expressly preempt an individual creditor's state law claims. Finding intent in Congress's inaction, the *Tribune* court believed that Congress had "struck some balance between" the policy of market stability and preservation of an individual creditor's right to commence fraudulent conveyance actions under certain circumstances. Consequently, the *Tribune* court held that Section 546(e)'s safe harbor did not bar the claims of the Individual Creditors under state-law fraudulent conveyance theories.

Ultimately, however, the Defendants prevailed on the ground that, pursuant to Section 362(a)(1) of the Bankruptcy Code, the Individual Creditors lacked standing to bring the SLCFC claims because the Committee brought intentional fraudulent conveyance claims to avoid the same transactions, and such actions are still pending.[8] Thus, the *Tribune* court concluded that "[u]nless and until the Committee actually and completely abandons [the] claims, the Individual Creditors lack standing to bring" the SLCFC claims.

The *Tribune* court's Section 546(e) ruling is seemingly at odds with the recent holding of another Southern District of New York decision in *Whyte v. Barclays Bank PLC*, a decision arising out of the bankruptcy of SemGroup and its affiliates.[9] The *SemGroup* court held that state-law fraudulent conveyance claims brought by creditors are preempted by the Bankruptcy Code's financial contract anti-avoidance safe harbors, specifically Section 546(g) of the Bankruptcy Code, notwithstanding the lack of an explicit reference in such anti-avoidance safe harbor preempting such state-law fraudulent conveyance claims. The *SemGroup* court reasoned that allowing such suits by creditors would effectively permit an end run around the Code's safe harbors from avoidance (*e.g.*, debtors could simply abandon their fraudulent conveyance claims and allow creditors to bring suit). The *Tribune* court was not persuaded by the *SemGroup* court's reasoning and distinguished *SemGroup* on the basis that, rather than individual creditors, the plaintiff in *SemGroup* was both the trustee for the estate and a representative of outside creditors and was "a creature of [SemGroup's] Chapter 11 plan." The trustee in *SemGroup* had waited until the limitations period in Section 546(a) for the estate to bring avoidance claims had expired and then sought to bring constructive fraudulent conveyance claims in its capacity as a representative for outside creditors. As a consequence, the *Tribune* court noted, the trustee "could not simply take off its trustee hat, put on its creditor hat and file an avoidance claim that Section 546(g) prohibited it from filing." In contrast, the *Tribune* court found that the Individual Creditors are not creatures of Tribune's Chapter 11 plan, and are in no way identical to a bankruptcy trustee. As such, the *Tribune* court could not find a reason why Section 546(e) should apply to limit the SLCFC claims of the Individual Creditors.

Practical Points

For practitioners, some solace should be taken in the fact that the *SemGroup* court is not alone in blocking end runs around the safe harbors.[10] In addition, perhaps the *Tribune* court's ruling on Section 546(e) may be distinguished, for now, as mere dicta since the Individual Creditors were ultimately denied standing and the decision itself, seen as an outlier in the overall body of decisions that address the Bankruptcy Code's financial contract anti-avoidance safe harbors. Nevertheless, the *Tribune* court's interpretation of Section 546(e) has potentially emboldened individual creditors to commence numerous SLCFC actions in multiple forums instead of a single action brought by committees or litigation trusts or trustees in one forum. This ruling may also encourage debtors and committees to carefully consider abandoning (or at least not bringing within the Bankruptcy Code's two-year statute of limitations period) SLCFC claims that would otherwise be exempt from avoidance so that they can be brought by individual creditors. Cnsidered along with the *PHP Liquidating* decision, the *Tribune* ruling indicates that there is some inherent uncertainty in determining whether a particular transaction that would otherwise be safe harbored would be exempt from avoidance even where the estate does not bring the claim within the Bankruptcy Code's two-year statute of limitations period. Because the Defendants prevailed, the *Tribune* court's interpretation of Section 546(e) is unlikely to be appealed.[11] If, however, the *Tribune* ruling is followed by other courts, the ruling could be a stepping-stone on the path to substantially narrowing the applicability of safe harbors such as Section 546(e) that, to date, have generally been construed quite broadly. Therefore, the *Tribune* ruling meaningfully underscores the need for potential defendants in avoidance actions to seek to carefully craft releases and assignments of claims to litigation trusts in Chapter 11 plans so that they may limit, to the greatest extent possible, the ability of individual creditors to bring SLCFC actions. Moreover, financial market participants may wish to seek congressional action to expressly close what may be a loophole in the effectiveness of the Bankruptcy Code's anti-avoidance safe harbors with respect to financial transactions.

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Endnotes

1 *In re Tribune Company – Fraudulent Conveyance Litigation*, Memorandum and Order, 1:12-mc-02296, Docket No. 159 (S.D.N.Y. September 23, 2013) ("*Tribune* decision" and the "*Tribune* court").

2 *See, e.g.*, 11 U.S.C. §546(g), which is applies to swap agreements.

3 *See, e.g.*, *Enron Creditors Recovery Corp. v. ALFA, S.A.B. de C.V.*, 651 F.3d 329 (2d Cir. 2011) (applying

plain meaning of Section 546(e) and holding that payments made to redeem commercial paper early were non-avoidable settlement payments under Section 546(e) and rejecting notion that safe harbor should be limited because transactions at issue "did not involve a financial intermediary that took title to the transacted securities and thus did not implicate the risks that prompted Congress to enact the safe harbor.").

4 The Committee claims were assigned to a litigation trust (the "Litigation Trust") by virtue of the terms of Tribune's confirmed Chapter 11 plan.

5 Section 546(e) of the Bankruptcy Code would have barred the Committee, as a representative of the estate, from successfully bringing constructive fraudulent conveyance claims.

6 Section 362(a)(1) of the Bankruptcy Code automatically stays, among other things, actions against the debtor that arose before the commencement of the bankruptcy case. Case law has construed the stay to apply to fraudulent conveyance claims, even though the claims are asserted against the debtor's transferee and not the debtor.

7 291 B.R. 603, 607 (Bankr. D. Del. 2003) ("*PHP Liquidating*").

8 The *Tribune* court also left open the possibility of the Litigation Trust amending its complaint to abandon the intentional fraudulent conveyance claims, which would effectively allow the Individual Creditors to have standing to bring the SLCFC claims.

9 494 B.R. 196 (S.D.N.Y. 2013) ("*SemGroup*" and the "*SemGroup* court"). In *SemGroup*, a litigation trust had been established in furtherance of the debtors' confirmed Chapter 11 plan. Under its terms, certain creditors and the relevant debtors and debtors' estates had assigned all of their claims to a trust. The trust was empowered to commence any and all actions arising under Chapter 5 of the Bankruptcy Code and state law avoidance claims that could have otherwise been brought by the parties who had transferred their claims to the trust. Since the subject transaction, as agreed by both sides, was a "swap agreement" and the defendant, a "financial participant," it was entitled to the protections of the safe harbor under Section 546(g) of the Bankruptcy Code. To avoid application of the safe harbor, the trustee waited until the statute of limitations period under Section 546(a) expired and then sought to proceed as a representative of creditors to bring a state-law constructive fraudulent conveyance claim. The *SemGroup* court held, however, that the trustee could not pursue such claims, as allowing such claims would frustrate the protections of the Section 546(g) safe harbor.

10 *See also*, *In re U.S. Mortg. Corp. & CU Nat. Mortg. Inc.*, 492 B.R. 784 (Bankr. D. N.J. 2013) (trustee's attempt to "re-label" the avoidance actions as state law claims for conspiracy and conversion blocked by safe harbors); *AP Services LLP v. Silva*, 483 B.R. 63, 69 (S.D.N.Y. 2012) (finding that plain language of Section 546(e) should be "construed 'extremely broadly,'" the court found that an unjust enrichment claim that was merely a repackaging of an avoidance claim was preempted by the safe harbor, but the court found that the safe harbor did not preempt claims for breach of fiduciary duty and aiding and abetting breach of fiduciary duty).

11 The Individual Creditors could also appeal the stay now in place by challenging the *Tribune* court's determination on their lack of standing to proceed but they would not seek to upset their favorable 546(e) ruling.