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TRIBUNE MEDIA—IMPORTANT DEVELOPMENTS IN BANKRUPTCY SAFE HARBOR PROTECTIONS

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Tribune Media—Important Developments in Bankruptcy Safe Harbor Protections

By Benjamin Mintz*

The U.S. District Court for the Southern District of New York recently issued an important decision addressing the applicability of the Section 546(e) safe harbor provision to a transfer between two non-financial institutions where (a) the institution intermediating the transfer is a financial institution and (b) a party to the transaction qualifies as a "customer" within the scope of the definition of "financial institution" set forth in Section 101(22)(A). The author of this article discusses the decision.

The U.S. Bankruptcy Code allows trustees (as well as debtors in possession and other estate representatives) to avoid certain fraudulent transfers on behalf of the estate but also contains a number of safe harbor provisions that limit the exercise of avoidance powers. The Section 546(e) safe harbor provision provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract.

If applicable, this protects transferees from all avoidance claims, other than intentional fraudulent transfer claims under Section 548(a)(1)(A).

SUPREME COURT LIMITS SCOPE OF SECTION 546(e) SAFE HARBOR

In February 2018, the U.S. Supreme Court rendered a decision addressing the scope of the protections of the Section 546(e) safe harbor provision in *Merit*

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Management Group v. FTI Consulting. In *Merit*, two non-financial institutions engaged in a transfer and had used a financial institution as an intermediary. The Supreme Court overturned U.S. Courts of Appeals for the Second, Third, Sixth, Eighth, and Tenth Circuits decisions, all of which had held that a transfer is protected by the safe harbor provision of Section 546(e) so long as, in effectuating a transfer, transacting non-financial institution parties had used a financial institution as a conduit.

In its decision, the Supreme Court stated that the issue before it was to "determine how the safe harbor operates in the context of a transfer that was executed via one or more transactions, e.g., a transfer from A → D that was executed via B and C as intermediaries, such that the component parts of the transfer include A → B → C → D." The court noted that the transfer could be scrutinized as a whole (i.e., as a transfer from A → D where neither A nor D is a financial institution) or could be scrutinized taking into account the component parts of the overarching transfer (i.e., a transfer from A → B → C → D where B and C act as intermediary financial institutions between the transacting parties). The Supreme Court concluded that the plain meaning of Section 546(e) dictated that the appropriate way to analyze the transfer was holistically (i.e., A → D without taking into account the financial institution intermediaries). Accordingly, the court found that the transfer before it—which was between two non-financial institutions but conducted through a financial institution—did not fall under the protections of the Section 546(e) safe harbor provision.

In a noteworthy footnote to its *Merit* decision, the Supreme Court noted that neither party to the transaction had argued that it qualified as a "financial institution" by virtue of its status as a "customer."[1] Accordingly, the Supreme Court declined to address what impact, if any, Section 101(22)(A) would have in the application of the Section 546(e) safe harbor.

THE *IN RE TRIBUNE COMPANY FRAUDULENT CONVEYANCE LITIGATION*

On April 23, 2019, Judge Cote of the U.S. District Court for the Southern District of New York issued an important decision addressing the applicability of the Section 546(e) safe harbor provision in *In re Tribune Co. Fraudulent Conveyance Litigation*.[2] In its decision, the *Tribune* court addressed head-on the outstanding question the Supreme Court left unanswered in its footnote—the

[1] *See* 11 U.S.C. §101(22)(A) (definition of "financial institution").

[2] 2019 U.S. Dist. LEXIS 69081 (S.D.N.Y. Apr. 23, 2019).

applicability of the Section 546(e) safe harbor provision to a transfer between two non-financial institutions where (a) the institution intermediating the transfer is a financial institution and (b) a party to the transaction qualifies as a "customer" within the scope of the definition of "financial institution" set forth in Section 101(22)(A).

The *Tribune* case arose out of the leveraged buyout ("LBO") of Tribune in 2007 and its subsequent entry into bankruptcy proceedings in 2008. In effectuating the LBO, Tribune had purchased all of its outstanding stock from its shareholders and, in connection with the transaction, had transmitted the cash required to repurchase its shares to Computershare Trust Company ("CTC") pursuant to an agreement with CTC to act as a "Depositary." CTC thus acted as a "depositary" and an "exchange agent" in the transaction by both receiving cash required to repurchase Tribune shares and holding shares on Tribune's behalf.

When filing his original complaint, the trustee had determined that the transfer at issue in *Tribune* fell squarely within the Section 546(e) safe harbor provision protections as interpreted by applicable circuit court decisions and could not be avoided as a constructive fraudulent conveyance under Section 548(a)(1)(b) of the Bankruptcy Code. The complaint the trustee originally filed therefore did not include a constructive fraudulent conveyance claim.

After the Supreme Court granted *certiorari* in the *Merit Management* case, the trustee sought to amend his complaint to add a constructive fraudulent transfer claim. However, the district court rejected the trustee's request to amend his complaint as premature at that time, noting that unless and until the Supreme Court made a ruling overturning applicable precedent such claims were barred by relevant Circuit precedent. After the Supreme Court rendered the *Merit Management* decision, the trustee filed a renewed motion to amend the complaint to add constructive fraudulent transfer claims. At issue before Judge Cote in *Tribune* was whether to allow the trustee to amend his claim.

JUDGE COTE ADDRESSES IMPACT OF SECTION 101(22)(A) ON THE SECTION 546(e) SAFE HARBOR PROVISION

The *Tribune* court held that the trustee's amendment of the complaint would be futile and denied the trustee's motion to amend the complaint based on its finding that fraudulent conveyance claims, under Section 548(a)(1)(b) of the Bankruptcy Code, were barred by the Section 546(e) safe harbor provision. In finding that the safe harbor did apply to the transfer at issue in *Tribune*, the court first quoted Section 101(22)(A), which defines a financial institution as

> a Federal reserve bank, or an entity that is a commercial or savings

> bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a "customer", as defined in section 741) in connection with a securities contract (as defined in section 741) such customer[.]

The court went on to find that (1) CTC is a financial institution, (2) Tribune was a "customer" of CTC, (3) CTC acted as Tribune's "agent or custodian," and (4) CTC was acting "in connection with a securities contract." Accordingly, Judge Cote found (1) that Tribune, as a "customer" of CTC, qualified as a "financial institution" as such term is defined in the Bankruptcy Code, (2) the Section 546(e) safe harbor applied to the LBO transaction Tribune had entered into, and (3) therefore, the trustee's claims were barred by the safe harbor and the transfer being challenged by the trustee could not be avoided. The court therefore denied the trustee's motion to amend the complaint in order to add a fraudulent conveyance claim under Section 548(a)(1)(b) of the Bankruptcy Code.

THE COURT'S OTHER HOLDINGS

Before addressing the impact of Section 101(22)(A) on the Section 546(e) safe harbor provision, Judge Cote also considered a number of arguments the shareholders had made with respect to why the trustee should not be allowed to amend the complaint, including the following:

- *Judicial Estoppel*: Judge Cote held that the trustee was not estopped from bringing new claims because judicial estoppel generally only applies when a party takes "inconsistent factual positions" and the motion to amend was "occasioned by an intervening change in governing law"—the Supreme Court's *Merit Management* decision;
- *Bad Faith*: The shareholders argued that the trustee and his predecessor "made a tactical decision" to pursue state fraudulent conveyance claims instead of federal fraudulent conveyance claims under Section 548(a)(1)(b) of the Bankruptcy Code and that the trustee's motion to amend was therefore made in bad faith. The court, once again, noted that the trustee's motion to amend was the result of an intervening Supreme Court decision and therefore found that the motion to amend was not brought in bad faith;
- *Undue Delay*: The shareholders argued that the trustee should be barred from amending the complaint because he unduly delayed seeking leave

to amend. The court found, that to the contrary, the trustee had diligently sought to amend the complaint both before and after the *Merit Management* decision was rendered;

- *Undue Prejudice*: The shareholders noted that they had settled the other claims at issue in the litigation and argued that allowing a new claim against them to go forward at that time, years after litigation had been commenced and after they had settled all other claims against them, would unfairly cause them to expend significant additional resources to conduct discovery and prepare for trial. The court agreed with the shareholders' contentions, holding that "[s]tanding alone, undue prejudice to the Shareholders provides a sufficient basis upon which to deny the trustee's motion."

CONCLUSION

Although the Supreme Court in *Merit* narrowed the scope of the Section 546(e) safe harbor by ignoring financial institution intermediaries in evaluating transfers, it left open the possibility for re-expansion through the definition of "financial institution." Taking up that invitation, Judge Cote in *Tribune* extended the Section 546(e) safe harbor protection to a situation involving an intermediary financial institution that acted as agent for the transferor customer. This area of the law is expected to remain dynamic as defendants will seek broad application of the safe harbor protections. Whether the defendants can actually fit themselves or the transferor within the definition of "financial institution" will of course depend on the particular facts and circumstances surrounding the transaction. Parties, with the assistance of counsel, are also expected to attempt to structure transactions to fit them within that scope and seek to take advantage of the safe harbor protections.

The litigation trustee has filed a notice of appeal of Judge Cote's decision and judgment and that appeal is currently pending before the U.S. Court of Appeals for the Second Circuit.