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# New York District Court Finds That Tribune Qualifies as Financial Institution Under Bankruptcy Code Safe Harbor Provision

On April 23, 2019, Judge Cote of the District Court for the SDNY, issued an opinion in *In re Tribune Company Fraudulent Conveyance Litigation*,[1] finding that the Tribune Company, which employed Computershare Trust Company ("CTC") to handle payments made to shareholders as part of its leverage buyout ("LBO"), would be considered a "financial institution" as defined in Section 546(e) of the Bankruptcy Code because it was the "customer" of CTC during the LBO.[2] This finding effectively insulated shareholder payments as part of the LBO from avoidance as constructive fraudulent transfers under the Bankruptcy Code. Judge Cote's opinion is notable because it is one of the first cases to address the customer/financial institution issue left open by the Supreme Court's recent decision in *Merit Management*.[3]

## BACKGROUND

As part of the LBO, Tribune repurchased its outstanding shares for approximately $8 billion. Tribune retained CTC as its "depositary" and "exchange agent" for the LBO. The LBO funds were transferred by Tribune to CTC which then made the required payments to the shareholders. Shortly after the LBO, Tribune filed for bankruptcy and during the bankruptcy case, the Tribune unsecured creditors committee ("Committee") commenced an action against the former Tribune shareholders to recover the LBO payments. At the time, the Committee sought to avoid the shareholder payments only on intentional fraudulent transfer grounds (and not on constructive fraudulent transfer grounds), because, according to the Committee, the settled Second and Third Circuit law at the time was that the scope of Section 546(e) safe harbor defense was broad and barred the assertion of constructive fraudulent transfer claims against shareholders who received LBO payments indirectly through a financial intermediary.

In February 2018, the Supreme Court in *Merit Management* rejected the Second and Third Circuit's broad view of Section 546(e) of the Bankruptcy Code.[4] It adopted a narrower interpretation of the safe harbor defense, holding that Section 546(e) does not bar constructive fraudulent transfer claims solely because payments pass through a "financial institution" intermediary. The relevant transfer for purposes of the safe harbor provision, according to the Supreme Court, is the "overarching transfer" that the trustee seeks to avoid, rather than the various intermediate subparts that may have involved a "financial institution" as a conduit.[5] The *Merit Management* decision was viewed as potentially opening the door for bankruptcy estate representatives in Circuits that previously followed the broad interpretation of Section 546(e) to pursue constructive fraudulent transfer claims against shareholders who received payments through an LBO, since LBO payments typically pass through financial intermediaries. Notably, the Supreme Court left open the question as to whether a debtor, itself, can be a "financial institution" in the LBO because it is a "customer" of a financial institution involved in the LBO transaction.[6] The Bankruptcy Code defines a "financial institution" to include not only traditional financial institutions but also "customers" of a financial institution when the institution is acting as an agent or custodian for the customer.[7]

Relying on *Merit Management*, the Litigation Trustee (as successor to the Committee) sought to amend his complaint against the shareholders to include claims for constructive fraudulent transfers. The shareholder defendants objected to the motion to amend, arguing, among other things, that *Merit Management* was not controlling because Tribune should be considered a "financial institution" in the LBO because it was a "customer" of CTC (*i.e.*, the issue left open by the Supreme Court) and, thus, the safe harbor applied and it would be futile to allow the amendment.

## DISTRICT COURT DECISION

Judge Cote concluded that the safe harbor defense in Section 546(e) still applied to the shareholder transfers because Tribune was a "financial institution" at the time of the LBO.[8] She found that *Merit Management* did not control because the Supreme Court did not address the scope of the term "financial institution" as defined by the Bankruptcy Code, and whether a debtor, itself, could be considered a financial institution.[9] Judge Cote noted that Section 101(22)(A) of the Bankruptcy Code defines "financial institution" broadly to include a customer of a bank or trust company that is acting as the customer's agent in connection with a securities contract. It was undisputed that CTC was a bank or trust company. Judge Cote then found that (i) Tribune was CTC's customer because it engaged CTC's services as depositary and exchange agent for a fee; (ii) CTC was acting as Tribune's agent, as evidenced by the deposit of "billions of dollars of Tribune cash" with CTC and its obligation to pay such cash to shareholders pursuant to the LBO; and (iii) CTC acted as Tribune's agent in connection with a securities contracts.[10] Judge Cote concluded that because Tribune qualifies as a "financial institution," the safe harbor defense applies to the shareholder LBO payments. Since it would be futile to bring constructive fraudulent transfer claims against the shareholders, Judge Cote denied the Litigation Trustee's motion to amend the complaint.[11]

## CONCLUSION

The Supreme Court's *Merit Management* decision was potentially a significant change in the law in the Circuits where transfers through protected entities had previously been insulated by Section 546(e)'s safe harbor protection. However, the Supreme Court left open the possibility that the debtor (or the counterparty to the challenged transfer) could, itself, be considered a financial institution because it was a "customer" of a financial institution involved in the transaction. In answering the question left unanswered by *Merit Management* in the way that it did, Judge Cote's opinion may have opened a new avenue of safe harbor protection for LBO payments -- as long as the company making the payments is considered a "customer" of a financial institution, and that financial institution acts, like in this case, as the company's agent in making the payments in question. According to Judge Cote "[t]his result is consistent with Section 546(e)'s goal of promoting stability and finality in securities markets and protecting investors from claims precisely like these."[12]

The Litigation Trustee will likely appeal the decision. But, for now, the *Tribune* case is very helpful precedent to employ the safe harbor protection of Section 546(e).

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[1] *In re Tribune Company Fraudulent Conveyance Litigation*, 11 md 2296 (DLC), 12 cv 2652 (DLC), 2019 WL 1771786 (S.D.N.Y. Apr. 23, 2019).
[2] *Id.* at *9-*12.
[3] The "*Merit Management*" decision refers to the United States Supreme Court's decision in *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S.Ct. 883 (2018).
[4] *See generally id.*
[5] *Id.* at 897.
[6] *Id.* at 890 n.2.
[7] 11 U.S.C. § 101(22)(A).
[8] *Tribune*, 2019 WL 1771786, at *9-*12.
[9] *Id.* at *12.
[10] *Id.* at *9-*12.
[11] *Id.* at *12. Judge Cote also found that even if *Merit Management* controlled and the safe harbor defense did not apply, the Litigation Trustee's motion to amend should still be denied because of undue prejudice to the shareholder defendants. *Id.* at *6. "Allowing the Trustee to add Federal CFT Claims against the Shareholders at this late hour would cause the Shareholders to 'expend significant additional resources to conduct discovery and prepare for trial' and would 'significantly delay the resolution of the dispute.'" *Id.* Judge Cote concluded that, "[s]tanding alone, undue prejudice to the Shareholders provides a sufficient basis upon which to deny the Trustee's motion." *Id.*
[12] *Id.* at *12.