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Second Circuit Finds That Tribune Qualifies as Financial Institution Under Bankruptcy Code Safe Harbor Provision

On December 19, 2019, the Second Circuit Court of Appeals issued an opinion (the "2019 Opinion") arising out of the *In re Tribune Company Fraudulent Conveyance Litigation*,[1] finding that Tribune Company, which employed Computershare Trust Company ("CTC") to handle payments made to shareholders as part of its leverage buyout ("LBO"), qualified as a "financial institution" as defined in the Bankruptcy Code because it was the "customer" of CTC during the LBO.[2] This finding insulates shareholder payments as part of the LBO from avoidance as constructive fraudulent transfers under the Bankruptcy Code. The Second Circuit's opinion is notable because it is the first Circuit-level opinion to address the customer/financial institution issue left open by the Supreme Court's 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"), on behalf of the Tribune bankruptcy estate, commenced an action against the former Tribune shareholders to recover the LBO payments. The Committee initially sought to avoid the shareholder payments only on intentional fraudulent transfer grounds, and not on constructive fraudulent transfer grounds.[4] In 2011 (after the statutory deadline for the Debtor's estate to bring fraudulent transfer claims expired), the bankruptcy court granted the motion of certain creditors ("Creditor Parties") to lift the Bankruptcy Code's automatic stay so that the Creditor Parties could pursue their alleged state law fraudulent transfer claims relating to the LBO.

Ultimately, the Creditor Parties' litigation and the Committee's litigation were consolidated in a Multi-District Litigation, and the Tribune shareholders moved to dismiss the claims brought against them. The district court granted the Tribune shareholders' motion to dismiss in the Creditor Parties' litigation, holding that the automatic stay deprived the Creditor Parties of statutory standing because the Committee was suing to avoid the same transfers (albeit under different legal theories).[5] The district court rejected the Tribune shareholders' argument that the state law constructive fraudulent transfer claims were barred by the safe harbor provision of Section 546(e).[6] In an opinion issued in 2016 (the "2016 Opinion"), the Second Circuit found that, while the Creditor Parties had statutory standing to bring the claims (primarily because the automatic stay had been terminated for cause by the Bankruptcy Court), it affirmed dismissal of the state law constructive fraudulent transfer claims, holding that such claims were preempted by the safe harbor in Section 546(e) of the Bankruptcy Code.[7] In response, the Creditor Parties filed a petition for certiorari to the Supreme Court.

In February 2018, while the Creditor Parties' certiorari petition was pending, the Supreme Court decided *Merit Management*, which rejected the Second and Third Circuit's broad view of Section 546(e) of the Bankruptcy Code.[8] 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 involve a "financial institution" as a conduit.[9] Notably, however, the Supreme Court left open the question 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.[10] 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.[11]

Thereafter, two Justices on the Supreme Court issued a statement suggesting that the Second Circuit might want to recall its mandate of the 2016 Opinion or provide other relief to the Creditor Parties in light of *Merit Management*. The mandate was ultimately recalled, resulting in the 2019 Opinion.

THE 2019 OPINION

The Second Circuit—the first Circuit Court to address this issue after *Merit Management*—ruled that Tribune was a "financial institution," as defined by the Bankruptcy Code.[12] It 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.[13] After reviewing the definition of financial institution, the Second Circuit found that CTC fit that definition because it was a trust company and a bank.[14] The Second Circuit then addressed whether Tribune was CTC's customer. In holding it was, the Second Circuit found that CTC "received and held Tribune's deposit of the aggregate purchase price for the shares," and that it "received tendered shares, retained them on Tribune's behalf, and paid the tendering shareholders."[15] The Second Circuit also found that CTC was Tribune's "agent" (utilizing the common-law meaning of such term).[16] The Second Circuit then restated its conclusions from the 2016 Opinion that the constructive fraudulent transfer claims were preempted by the safe harbor in Section 546(e) of the Bankruptcy Code.[17]

CONCLUSION

While the Supreme Court's *Merit Management* decision was viewed by many as potentially signaling a shift in the law with respect to Section 546(e)'s safe harbor protection, it expressly 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 undecided by *Merit Management*, the Second Circuit's 2019 Opinion has paved a way to protect LBO payments from subsequent attacks, so 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. As the Second Circuit recognized, Section 546(e) was enacted "to protect investors from the disruptive effect of after-the-fact unwinding of securities transactions."[18] The 2019 Opinion follows this reasoning, providing protection for recipients involved in LBO transactions like Tribune where the debtor is the "customer" of the intermediary financial institution.

[1] *In re Tribune Company Fraudulent Conveyance Litigation*, Nos. 13-3992-cv; 13-3875-cv; 13-4178-cv; 13-4196-cv (2d Cir. Dec. 19, 2019).
[2] *Id.* at 23.
[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] The Committee was later replaced by a litigation trustee that was appointed pursuant to Tribune's bankruptcy plan. After *Merit Management* was decided, the litigation trustee sought to amend its complaint to add constructive fraudulent transfer claims against the Tribune shareholders. That motion was denied by the district court for the same reasons articulated in the Second Circuit's 2019 Opinion (*i.e.*, that Tribune qualified as a financial institution under the Bankruptcy Code and, thus, the transfers to the Tribune shareholders were protected by the safe harbor provision in Section 546(e) of the Bankruptcy Code; thus, any proposed amendment would have been futile). *See In re Tribune Company Fraudulent Conveyance Litigation*, 11md2296 (DLC), 12cv2652 (DLC), 2019 WL 1771786, at *9-*12 (S.D.N.Y. Apr. 23, 2019).
[5] *See In re Tribune Company Fraudulent Conveyance Litigation*, 499 B.R. 310, 322-25 (S.D.N.Y. 2013).
[6] *Id.* at 320.
[7] *In re Tribune Company Fraudulent Conveyance Litigation*, 818 F.3d 98 (2d Cir. 2016).
[8] *See generally Merit Mgmt. Grp., LP*, 138 S.Ct. 883.
[9] *Id.* at 897.
[10] *Id.* at 890 n.2.
[11] 11 U.S.C. § 101(22)(A).
[12] 2019 Opinion, at 22-29.
[13] *Id.* at 24 n.3.
[14] *Id.* at 24.
[15] *Id.* at 25.
[16] *Id.* at 27-28.
[17] The Second Circuit found that *Merit Management* "does not control our disposition of the preemption issue." 2019 Opinion, at 72.
[18] *Id.* at 62-63.