GIBSON DUNN

April 29, 2019

S.D.N.Y. DECISION MAY HAVE SIGNIFICANT IMPACT ON BANKRUPTCY CODE "SAFE HARBOR" FOR SECURITIES TRANSACTIONS

To Our Clients and Friends:

On April 23, 2019, in *In re Tribune Co. Fraudulent Conveyance Litigation*, 2019 WL 1771786 (S.D.N.Y. Apr. 23, 2019) ("*Tribune*"), Judge Denise Cote of the District Court for the Southern District of New York held that the Bankruptcy Code "safe harbor" provision in 11 U.S.C. § 546(e) prevents a plaintiff from clawing back payments that Tribune Company ("Tribune") made to public shareholders in 2007 as part of a go-private transaction.[1] Section 546(e) bars a trustee from asserting a claim for constructive fraudulent transfer to avoid (or undo) a "settlement payment" (i.e., a payment for securities) made by or to certain protected entities ("Covered Entities"), including a "financial institution."[2]

The decision is important because it is one of the first, if not the first, to specially address footnote 2 in *Merit Management Group, LP v. FTI Consulting, Inc.*, 138 S. Ct. 883 (2018), which opinion was viewed as severely limiting the scope of the safe harbor.

I. Supreme Court Decision in *Merit Management*

On February 27, 2018, the Supreme Court in *Merit Management* held that the safe harbor does not protect a transfer that merely passed *through* a Covered Entity, where neither the transferor nor the transferee is itself a Covered Entity.[3] By way of footnote 2, the Supreme Court expressly avoided addressing whether, because the Bankruptcy Code defines a "financial institution" to include the "customer" of a "financial institution" under certain circumstances,[4] the safe harbor protects a transfer made by or to a party that constitutes a protected "customer" but is not otherwise a Covered Entity.[5] That was the issue decided in *Tribune*.

II. Background in *Tribune*

In 2007, Tribune, a public company, consummated a tender offer and then went private through a merger six months later. In the tender offer, Tribune borrowed funds and transmitted the cash required to repurchase approximately 50% of its outstanding shares to Computershare Trust Company, N.A. ("CTC"), which acted as "Depository." CTC, on Tribune's behalf, then accepted and held tendered shares and paid out $34 per share to tendering shareholders. In the merger, CTC acted as an "Exchange Agent" and performed essentially the same function.

One year after the merger, on December 8, 2008, Tribune and various subsidiaries commenced chapter 11 bankruptcy cases. A litigation trust was established pursuant to Tribune's chapter 11 plan, and the trustee ("Trustee") pursued a claim to recover the tender offer and merger payments from Tribune's

former shareholders, alleging that the payments constituted an actual fraudulent transfer under 11 U.S.C. § 548(a)(1)(A).[6] The Trustee did not bring a claim for constructive fraudulent transfer because he acknowledged that, based on controlling Second Circuit law at the time, the safe harbor barred the claim because the payments went *through* CTC.[7] After the Supreme Court rejected that theory in *Merit Management*, the Trustee filed a motion for leave to amend his complaint to add a claim for constructive fraudulent transfer.

III. District Court Held That Section 546(e) Protects Tribune's Shareholder Payments Because They Were Made By a "Financial Institution" (i.e., Tribune)

Judge Cote denied the Trustee's motion for leave to amend on grounds including futility, holding that the safe harbor still bars the Trustee's proposed claim, notwithstanding *Merit Management*, because Tribune constituted a "financial institution." That conclusion rested on four premises: (1) it was "undisputed" that CTC is a "financial institution" because it is a "bank" and "trust company"; (2) Tribune was CTC's "customer" based on the "ordinary meaning" of that term because "Tribune engaged the CTC's services as depositary in exchange for a fee" and "was a 'purchaser' of CTC's 'services'"; (3) CTC acted as Tribune's "agent," based on the "well-settled meaning of th[at] common-law term[]," because "CTC was entrusted with billions of dollars of Tribune cash and was tasked with making payments on Tribune's behalf to Shareholders upon the tender of their stock certificates to CTC," which "is a paradigmatic principal-agent relationship"; and (4) "CTC acted 'in connection with a securities contract,'" which is broadly defined to include any agreement to repurchase securities, as Tribune had done.[8]

The Trustee argued that "reading the definition of 'financial institution' to cover an entity like Tribune would run counter to the spirit of the Supreme Court's decision in *Merit Management*, which rejected the idea that a bank or trust company acting as a 'mere conduit' can be sufficient ground to invoke the safe harbor provision."[9] Rejecting that argument, Judge Cote noted that "the Supreme Court specifically declined to address the scope of the definition of 'financial institution,'" and, ultimately, "[t]he text of Section 101(22)(A) compels the conclusion that Tribune itself was a 'financial institution.'"[10]

IV. Takeaways from *Tribune*

The customer-as-financial-institution argument accepted in *Tribune* offers a potential defense to a claim for constructive fraudulent transfer, which is most important in situations where neither the transferor nor the transferee is otherwise a Covered Entity. It remains to be seen whether other courts will follow *Tribune*,[11] and, if so, whether its holding will be extended beyond large public securities transactions (as in *Tribune*) to small public or private transactions where a bank facilitates a payment for securities (as in *Merit Management*). In any event, *Tribune* signals a potential step toward regaining some of the safe harbor's protective ground that appeared lost in *Merit Management*.

---

[1] Gibson, Dunn & Crutcher LLP represents certain shareholders and directors in this litigation.

[2] 11 U.S.C. § 546(e).

[3] 138 S. Ct. 883. The decision is discussed in greater detail in our previous client alert. *See* Garza, Oscar, Rosenthal, Michael & Levin, Douglas, *Supreme Court Settles Circuit Split Concerning Bankruptcy Code "Safe Harbor"* (Mar. 5, 2018).

[4] *See* 11 U.S.C. § 101(22)(A) ("The term 'financial institution' means . . . 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* . . . in connection with a securities contract . . . *such customer*[.]") (emphasis added).

[5] *See* 138 S. Ct. at 890 n.2 ("The parties here do not contend that either the debtor or petitioner in this case qualified as a 'financial institution' by virtue of its status as a 'customer' under § 101(22)(A). . . . We therefore do not address what impact, if any, § 101(22)(A) would have in the application of the § 546(e) safe harbor.").

[6] The actual fraudulent transfer claim was dismissed on January 6, 2017. *See In re Tribune Fraudulent Conveyance Litig.*, 2017 WL 82391 (S.D.N.Y. Jan. 6, 2017).

[7] *Tribune*, at *2 ("The law in the Second Circuit at that time was that section 546(e) applied to any transaction involving one of the financial entities listed in that section, 'even as a conduit.'") (quoting *In re Quebecor World (USA) Inc.*, 719 F.3d 94, 100 (2d Cir. 2013)).

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

[9] *Id*. at *12.

[10] *Id*.

[11] *Tribune* is also subject to appeal.

Gibson, Dunn & Crutcher's lawyers are available to assist with any questions you may have regarding these issues. For further information, please contact the Gibson Dunn lawyer with whom you usually work, any member of the firm's Business Restructuring and Reorganization practice group, or any of the following:

Oscar Garza - Orange County, CA (+1 949-451-3849, ogarza@gibsondunn.com)
Douglas G. Levin - Orange County, CA (+1 949-451-4196, dlevin@gibsondunn.com)
Matthew G. Bouslog - Orange County, CA (+1 949-451-4030, mbouslog@gibsondunn.com)

Please also feel free to contact the following practice group leaders:

Business Restructuring and Reorganization Group:
David M. Feldman - New York (+1 212-351-2366, dfeldman@gibsondunn.com)
Robert A. Klyman - Los Angeles (+1 213-229-7562, rklyman@gibsondunn.com)
Jeffrey C. Krause - Los Angeles (+1 213-229-7995, jkrause@gibsondunn.com)
Michael A. Rosenthal - New York (+1 212-351-3969, mrosenthal@gibsondunn.com)

© 2019 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice.