

## Tribune State-Law Fraudulent Conveyance Litigation Update

September 25, 2013

On September 23, 2013, U.S. District Judge Richard Sullivan of the Southern District of New York issued a decision with potential implications for the interpretation of Section 546(e) of the Bankruptcy Code, the statute that protects “settlement payments” in securities transactions from avoidance claims. In a 16-page decision, the Court dismissed state-law constructive fraudulent conveyance claims brought by creditors seeking to avoid payments made to former shareholders of the Tribune Company during the Company’s 2007 leveraged buyout (“LBO”). The Court found that the plaintiffs—all individual creditors of Tribune—lacked standing to avoid those payments while the representative of the Tribune bankruptcy estate was seeking to avoid the same transfers under a different legal theory. Although the Court dismissed the claims, it also concluded that Section 546(e) only bars claims brought by a bankruptcy estate “trustee” – and does not preempt individual creditors’ state-law-based constructive fraudulent conveyance claims. If left to stand, the decision leaves open the possibility that individual creditors may assert constructive fraudulent transfer claims that the Bankruptcy Code would preclude an estate representative from asserting. The case is *In re Tribune Company Fraudulent Conveyance Litigation*, No. 11 MC 2296 (RJS) (S.D.N.Y. Sept. 23, 2013).

### The Individual Creditor Actions

Following the Tribune Company’s bankruptcy filing in 2008, representatives of the bankruptcy estate – then the Official Committee of Unsecured Creditors (the “Committee”) – sued Tribune’s former shareholders to avoid payments they received during the Company’s 2007 LBO (the “Shareholder Payments”). The estate representatives sought to avoid the transfers as intentional fraudulent conveyances (the “Committee Action”) but did not assert claims for constructive fraudulent conveyance because such claims would almost certainly have been dismissed pursuant to Section 546(e). Instead, individual creditors of Tribune subsequently filed hundreds of lawsuits in more than twenty state and federal courts seeking to avoid the Shareholder Payments under a state-law-based constructive fraudulent conveyance theory (the “Individual Creditor Actions”). The Individual Creditor Actions and the Committee Action – which was transferred from the Committee to the trustee for a litigation trust (the “Litigation Trust”) after Tribune emerged from bankruptcy – eventually were consolidated in a multi-district litigation before Judge Sullivan in the Southern District of New York.

In November 2012, the defendants in the Individual Creditor Actions moved to dismiss. They argued that the Individual Creditor Actions were preempted by Section 546(e) of the Bankruptcy Code, which precludes a bankruptcy estate from avoiding settlement payments in a securities transaction, including (according to a number of courts) LBO payments to shareholders. They also argued that Section 362 of the Bankruptcy Code divested the individual creditors of standing to assert claims seeking to avoid the Shareholder Payments while the Litigation Trust was also seeking to avoid them in the Committee Action. The District Court stayed the Committee Action while the motion to dismiss the Individual Creditor Actions was being litigated.

### Individual Creditors Lack Standing to Avoid Transfers Targeted By the Estate Representative

Judge Sullivan held that the individual creditors lacked standing to avoid the Shareholder Payments while the estate representative was seeking to attack the same transfers. He concluded that because the bankruptcy process is intended to promote a comprehensive resolution of a debtor’s affairs by consolidating claims in one entity, the Section 362 stay divested the individual creditors of standing,

precluding them from seeking to avoid the Shareholder Payments while the Litigation Trust was seeking to avoid the same payments through the estate's lawsuit. The Court rejected the plaintiffs' attempt to distinguish between intentional fraud claims and constructive fraud claims for these purposes, holding that "[u]nless and until the [estate representative] actually and completely abandons those claims, the Individual Creditors lack standing to bring their own fraudulent conveyance claims targeting the very same transactions." While the Court ordered the Individual Creditor Actions closed, the Court also ordered the Litigation Trustee and Liaison Counsel for the Committee Action defendants to submit a joint letter to address whether the Litigation Trustee will attempt to abandon its claims and whether such a step would be permissible, leaving open the possibility that the plaintiffs will attempt to revive the Individual Creditor Actions.

## State-Law Constructive Fraudulent Conveyance Claims Not Preempted By Bankruptcy Code Section 546(e)

While Judge Sullivan dismissed the claims, he rejected the defendants' arguments that the Individual Creditor Actions were preempted by Bankruptcy Code Section 546(e). Section 546(e) imposes a limit on a bankruptcy trustee's power to avoid transfers by creating a safe harbor for, *inter alia*, securities settlement payments like LBO payments to shareholders. The defendants argued that Section 546(e) impliedly preempts state-law fraudulent conveyance claims brought by creditors to avoid LBO payments to shareholders because such lawsuits disrupt the securities markets in the same manner as lawsuits by an estate representative, the very reason Congress cited in enacting Section 546(e). The defendants argued that if such state-law claims were permitted, estate representatives could routinely circumvent Section 546(e)'s limits by foregoing the claims and allowing individual creditors to assert them instead.

Judge Sullivan found that neither the language of the Bankruptcy Code nor available indicia of Congressional intent supported preemption. He reasoned that the statute explicitly prohibits only the "trustee" from pursuing such claims and that if Congress had intended to preclude individuals other than the trustee from bringing suit, it could have made this clear when it amended the statute several times over the years. Judge Sullivan likewise disagreed with the defendants' arguments based on disruption of the securities markets, reasoning that Congress plausibly could have barred one plaintiff – an estate representative – from filing suit while allowing individual creditors to proceed.

## Future Implications

The *Tribune* decision comes at a time when other attempts to avoid the reach of Section 546(e) or related statutes are pending before various courts, such as the lawsuit brought by the litigation trustee in the *Lyondell Chemical Company* bankruptcy, where a motion to dismiss is pending before the Bankruptcy Court for the Southern District of New York, and the lawsuit brought by the *SemGroup* Litigation Trust, which was dismissed by Judge Jed Rakoff and is now pending on appeal before the U.S. Court of Appeals for the Second Circuit. There will be further developments in the *Tribune* matter, either before the District Court or on appeal, and the impact of this decision – and its interaction with these other pending matters – remains to be seen. The Committee Action remains stayed at this time.

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