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Supreme Court Declines to Review Second Circuit's Tribune Decision, Leaving Intact Tribune's Safe Harbor Defense to Clawback Actions

On April 19, 2021, the United States Supreme Court denied a petition for certiorari from the Second Circuit's decision in *In re Tribune Company Fraudulent Conveyance Litigation* ("*Tribune II*"),[1] leaving intact the Second Circuit's decision upholding the safe harbor defense to avoidance actions under the Bankruptcy Code. In *Tribune II*, the Second Circuit held that the safe harbor under section 546(e) of the Bankruptcy Code shields transfers from avoidance where the transferor utilizes a financial institution as its agent in connection with the challenged transfer (*i.e.*, the transferor is a customer of the financial institution).

The *Tribune II* decision preserved the broad scope of the section 546(e) safe harbor after the Supreme Court's unanimous 2018 decision in *Merit Management Group, LP* v. *FTI Consulting, Inc.*[2] There, the Supreme Court held that the presence of a financial institution as a "mere conduit" in a transfer does not protect the overall transfer from avoidance. But the Court left open the question of whether the transfer is protected when the transferor is the financial institution's "customer." *Tribune II* holds that the plain text of Section 546(e) protects such transfers from avoidance.

Background and *Tribune* Avoidance Litigation

Section 546(e) creates a safe harbor from avoidance actions (other than intentional fraudulent conveyances) for transfers that are (i) settlement payments or (ii) payments related to a securities contract, when such transfers are "made by or to (or for the benefit of) . . . financial institutions."[3] In *Merit Management*, the Supreme Court limited the scope of the safe harbor to protect only the "overarching" transfer that is the target of avoidance, rejecting a view adopted by many circuit courts, including the Second Circuit, that the presence of a financial institution as transfer conduit (*i.e.*, because money was wire transferred to or from an account at a qualifying bank) triggered application of the securities safe harbor. Stated generally, the Supreme Court concluded that where an "A" → "D" transfer is executed by way of "B"

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1 946 F.3d 66 (2d Cir. 2019).

2 138 S.Ct. 883 (2018), 2018 WL 1054879, at *12 (Feb. 27, 2018).

3 Bankruptcy Code section 101(22) defines "financial institution" to include, among other things, "an entity that is a commercial or savings bank, . . . trust company, . . . and, when any such . . . 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." 11 U.S.C. § 101(22)(A).

and "C" as intermediaries (*i.e.*, A → B → C → D), the safe harbor analysis (and, thus, its protection) is only properly applied to the overarching transfer, that is the A → D transfer (even if either of the intermediary entities, B or C, are covered entities to which the safe harbor would apply).

However, the Supreme Court expressly left open the question of whether the securities safe harbor shields transfers where the transferor itself qualifies as a "financial institution" by virtue of its status as a customer of a financial institution that acts as its agent.[4] Thereafter, the Second Circuit concluded that section 546(e) protects transfers where the transferor qualifies as a "financial institution" by virtue of its status as a customer of a financial institution that acts as the customer's agent, reasoning that the Bankruptcy Code's definition of "financial institution" includes, among other things, a "customer" of a financial institution where such financial institution acts as the customer's "agent" in connection with a securities contract.

The Second Circuit's *Tribune II* decision revisited its prior 2016 decision in *In re Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d 98 (2d Cir. 2016) ("*Tribune I*"), where the Second Circuit affirmed the dismissal of certain state law avoidance claims on the basis that section 546(e) applied to the payments at issue because financial institutions covered by section 546(e) had served as intermediaries. The transfer at issue involved Tribune's repurchase of its stock from existing shareholders through a trust company and bank, Computershare Trust Company, N.A. ("CTC"). In *Tribune I*, the Second Circuit also held that section 546(e) bars constructive fraudulent transfer claims under state law.

In issuing its *Tribune II* opinion and revisiting *Tribune I*, which it recognized was abrogated by the Supreme Court,[5] the Second Circuit reaffirmed its bottom-line holding that the safe harbor precluded the clawback action. In reaching its decision, the Second Circuit focused its inquiry on whether the debtor (the transferor) could claim protection under the safe harbor due to its status as a "customer" of a financial institution when the financial institution is acting as its "agent" in connection with a securities contract. To determine whether Tribune was CTC's customer, the Second Circuit adopted a plain meaning of the term "customer," referring to prior Second Circuit precedent recognizing that a customer is "someone who buys goods or services," including "a person . . . for whom a bank has agreed to collect items." The Second Circuit concluded that Tribune was a "financial institution" because (i) it was a "customer" of CTC, Tribune's

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4 Notwithstanding Justice Breyer's recognition at oral argument of the "very puzzling" issue, the Supreme Court declined to address the impact, if any, of a debtor's status as a "financial institution" by virtue of it being a "customer" since the petitioner did not argue that it could dictate the outcome in the case. *See Merit Mgmt. Grp.*, 2018 WL 1054879, at *5 n.2; *Merit Mgmt. Grp.*, No. 16-784, Oral Arg. Tr. at 15-16 (Nov. 6, 2017).

5 The Second Circuit also recognized that *Merit Management* abrogated *In re Quebecor World (USA) Inc.*, 719 F.3d 94 (2d Cir. 2013), in which the Second Circuit concluded that the safe harbor was applicable where entities covered by section 546(e) served as intermediaries.

depositary in connection with the leveraged buyout, under either definition and (ii) CTC was Tribune's "agent" with respect to the leveraged buyout transaction.

The plaintiffs petitioned for certiorari in the Supreme Court arguing, among other things, that the *Tribune II* decision undermines *Merit Management* by maintaining the vitality of the "conduit" theory which the Supreme Court had rejected. Similarly, the Acting Solicitor General argued that the Second Circuit's interpretation would render *Merit Management* "a virtual nullity" since the safe harbor would apply to virtually every transfer made in connection with a securities contract. Nevertheless, the Acting Solicitor General recommended that the Supreme Court not weigh in on the issue at this juncture since no other circuit-level courts have done so.[6] In April 2021, the Supreme Court denied the petition.

Application by Other Courts

Several lower courts within and outside of the Second Circuit have followed *Tribune II*'s guidance in applying section 546(e)'s safe harbor. In particular, courts have followed *Tribune II* to dismiss avoidance claims involving leveraged recapitalizations,[7] leveraged buyouts,[8] and the receipt of transfers implicated in the Bernie Madoff Ponzi scheme.[9] Outside of the Second Circuit, the United States District Court for the District of Minnesota also followed *Tribune II* in dismissing an action relating to a debtor's alleged fraudulent transfer to an investment fund.[10] However, the United States Bankruptcy Court for the Eastern District of Michigan has declined to follow *Tribune II*, focusing on the agency analysis.[11]

Implications

While the Supreme Court's *Merit Management* decision could have been interpreted to significantly limit application of the section 546(e) safe harbor, *Tribune II* reaffirms its applicability to transfers where the transferor entity can establish that it was a "customer" of a financial institution and that such financial institution acted as the entity's "agent" in connection with a securities contract.

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6 Brief for the United States as Amicus Curiae, *Deutsche Bank Trust Co. Ams.* v. *Robert R. McCormick Foundation*, No. 20-8 (Mar. 12, 2021).

7 *In re Boston Generating LLC*, 617 B.R. 442 (Bankr. S.D.N.Y. 2020).

8 *In re Nine West LBO Securities Litigation*, 482 F. Supp. 3d 187 (S.D.N.Y. 2020).

9 *Fairfield Sentry Limited* v. *Theodoor GGC Amsterdam*, 2020 WL 7345988 (Bankr. S.D.N.Y. Dec. 14, 2020).

10 *Kelley* v. *Safe Harbor Managed Account 101, Ltd.*, 2020 WL 5913523 (D. Minn. Oct. 6, 2020).

11 *In re Greektown Holdings, LLC*, 621 B.R. 697, 827 (Bankr. E.D. Mich. 2020).

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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