PRE-BANKRUPTCY LBOs
AS FRAUDULENT TRANSFERS

Former shareholders in leveraged buyouts may be sued by the estate representative or by creditors to recover funds paid to them for their shares as fraudulent transfers under federal or state law if the debtor subsequently files for bankruptcy. The authors discuss the claims and defenses in such suits, focusing on two pending bankruptcy cases that raise, among other things, the scope of the "safe harbor" for payments made to complete a securities transaction or a securities contract.

By Trevor W. Swett III and Jeffrey A. Liesemer *

In a bankruptcy fraudulent transfer suit, a representative of the bankruptcy estate, usually a bankruptcy trustee or a debtor-in-possession, sues individuals and business entities to unwind (or “avoid”) the fraudulent transfer, and to recover the money or property that was transferred before the debtor filed for bankruptcy. If the estate representative prevails in the suit, the net proceeds of the recovery will be distributed to the debtor’s creditors according to the payment priority scheme set forth in the Bankruptcy Code.

Former shareholders of a company that has gone into bankruptcy may find themselves on the receiving end of a fraudulent transfer suit, which may come as a rude awakening to those who participated in open transactions in public markets with no expectation that the company from which they received a payment or distribution was destined for bankruptcy. Nevertheless, former shareholders may be found legally obligated to return the sums of money paid to them. This article examines the implications and risks presented to shareholders for fraudulently transferred property, focusing in particular on one type of transaction that, under certain circumstances, may be avoided as a fraudulent transfer – the leveraged buyout.

In some cases, former shareholders sued for alleged fraudulent transfers have found a so-called “safe harbor” created under amendments to the Bankruptcy Code for the protection of settlement payments in the securities markets. Creditors’ efforts to skirt that safe harbor or – depending on your point of view – to confine it within its statutory limits, are now at issue in the fraudulent transfer cases arising from two recent bankruptcies, Lyondell and Tribune Company. We discuss these cases below.

CLAWING BACK THE DEBTOR’S PROPERTY:
FRAUDULENT TRANSFER LAWS

“Fraudulent transfer law originally developed in response to a very specific problem: debtors on the

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verge of insolvency would sometimes transfer their assets to friends or relatives for nominal consideration, leaving little or no value in their estates to satisfy the claims of other creditors.\[^2\] To curb this problem, which was thought to be widespread in sixteenth-century England, Parliament in 1571 passed the “Statute of 13 Elizabeth,” making transfers made to hinder, delay, or defraud creditors illegal and void.\[^3\] The Statute of 13 Elizabeth “has been either enacted [in substance] in American statutes prohibiting such transactions or has been incorporated into American law as a part of the English common law heritage.”\[^4\] Although their roots trace back hundreds of years, fraudulent transfer laws and doctrines have significant and complex implications for modern corporate transactions.

**Types of Fraudulent Transfers**

Generally, there are two types of fraudulent transfers. The first is an actual or intentional fraudulent transfer, which occurs when debtors transfer their property with the intent to “hinder, delay, or defraud” their creditors. For this issue generally, it is the intent of the debtor that most courts regard as relevant. The knowledge or good faith of the transferee may be relevant as to other issues. Because debtors trying to shield their property from creditors rarely admit that they have intended to do so, the law recognizes certain circumstantial evidence from which fraudulent intent may be inferred, known as the *badges of fraud*. A creditor can thus establish that the debtor intended to hinder, delay, or defraud creditors by showing some or all of the following badges: (i) the transfer was to an insider; (ii) the debtor retained possession or control of the transferred property after the transfer; (iii) the transfer was concealed; (iv) before the transfer was made, the debtor had been sued or threatened with suit; (v) the transfer was of substantially all the debtor’s assets; (vi) the debtor absconded; (vii) the debtor removed or concealed assets; (viii) the value of the consideration received by the debtor was not reasonably equivalent to the value of the asset transferred; (ix) the debtor was insolvent or became insolvent shortly after the transfer was made; (x) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (xi) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.\[^5\]

The second type is a constructive fraudulent transfer. In a constructive fraudulent transfer, a creditor need not prove actual intent, but must show that the debtor transferred its property to another person in exchange for something of no value or less than fair value and (i) the debtor was insolvent when the transfer was made; or (ii) the debtor was rendered insolvent as a result of the transfer.\[^6\] Generally, a debtor is considered insolvent if the total fair value of its assets is less than the total amount of its debts.\[^7\] Another form of constructive fraudulent transfer might occur if the debtor transferred property or incurred an obligation in exchange for less than a reasonably equivalent value and (i) the debtor was engaged or was about to engage in a business or a transaction for which the debtor’s remaining assets were unreasonably small in relation to the business or transaction; or (ii) the debtor intended to incur, or believed or reasonably should have believed that it would incur, debts beyond its ability to pay as they became due.\[^8\]

**State Fraudulent Transfer Laws**

Most states in the U.S. have codified their fraudulent transfer laws in the form of either the Uniform Fraudulent Conveyance Act (“UFCA”) or the Uniform


\[^5\] Uniform Fraudulent Transfer Act § 4(b) (hereinafter, “UFTA”).

\[^6\] See, e.g., id. § 5(a).

\[^7\] See, e.g., id. § 2(a). Additionally, a debtor is presumed to be insolvent if it is generally not paying its debts as they become due. *Id.* § 2(b).

\[^8\] *Id.* § 4(a)(2).
Fraudulent Transfer Act (“UFTA”). In substance, the UFCA and the UFTA are substantially similar. Courts endeavor to apply these two statutes uniformly, looking to the legal precedents of other states as authoritative. Moreover, as explained below, bankruptcy trustees or other authorized representatives of the bankruptcy estate can assert state-law fraudulent claims derivatively, standing in the shoes of creditors, in addition to avoidance claims premised on parallel fraudulent transfer provisions contained in the Bankruptcy Code. Because state fraudulent transfer laws and the fraudulent transfer provisions of the Bankruptcy Code share the same purpose of protecting creditors, a court’s interpretation of the Bankruptcy Code provisions may be instructive as to the meaning or application of the state fraudulent transfer laws, and vice-versa.

**Broad Concept of “Transfer”**

Courts and state laws tend to give broad definition to the notion of a “transfer.” For example, the UFTA defines “transfer” as “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance.” This UFTA definition is not limitless but is obviously crafted to encompass a vast array of transactions. In addition, a debtor’s incurrence of a debt or obligation may be subject to avoidance as a fraudulent transfer.

**BANKRUPTCY: CORE CONCEPTS**

**Absent Bankruptcy, a Potential “Race to the Courthouse”**

If a debtor is facing multiple creditors seeking to collect the debts owed to them, a “race to the courthouse” by creditors may ensue – e.g., unsecured creditors, out of self-interest, may race to the courthouse in order to be the first to obtain judgments against their debtor and thereby be the first to collect the debtor’s assets in order to satisfy the debt. Needless to say, if the debtor is in dire financial straits and holds few remaining assets that are capable of being converted into cash, the creditor who reaches the debtor’s assets first is more likely to have a larger percentage of its claim paid than similarly situated creditors who act slowly. Although legal, such a state of affairs often leads to inequitable outcomes, since similarly situated unsecured creditors will have varying recoveries depending on how quickly they initiated collection against the debtor. The same concept applies to other creditor remedies, such as the fraudulent transfer laws – creditors who are the first to avoid and recover property from the debtor’s transferees are more likely to have a greater percentage of the debt owed to them paid than the slower-moving creditors.

**Bankruptcy: A Collective Proceeding Among Creditors**

Bankruptcy is intended to stop a race to the courthouse and thereby avoid its downsides. Bankruptcy law “in large measure simply requires many diverse creditors to act as one. . . [B]ecause of the presence of bankruptcy law, each creditor may have to spend less to ensure that it isn’t left behind in any ensuing race.” Bankruptcy law modifies or adjusts the creditors’ state-law rights to ensure an orderly administration of the debtor’s assets for the purposes of maximizing asset values and making an equitable distribution to creditors.

**Automatic Stay.** Once a debtor files for bankruptcy protection, a statutory stay goes into effect automatically, preventing creditors from exercising their legal rights and remedies against the debtor. Thus, the automatic stay halts the race to the courthouse. Among other things, the filing of a bankruptcy will stay “any act to collect . . . or recover a claim against the debtor.” The bankruptcy filing also stays any act to obtain possession of “property of the estate,” a topic that is

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9 The UFCA is the earlier of the two uniform laws, first adopted in 1918. The UFTA has been adopted in more than 40 states and the District of Columbia. 1 Grant W. Newton, Bankruptcy and Insolvency Accounting, Practice and Procedure § 5.40(a) at 250 (7th ed. 2009).

10 UFTA § 11 (requiring that the UFTA be construed and applied to effectuate its general purpose to make the law uniform among the states that have enacted the UFTA); UFCA § 11 (same with respect to the UFCA); see also, e.g., Farstveert v. Rudolph ex rel. Eileen Rudolph Estate, 630 N.W.2d 24, 30 (N.D. 2001).


12 UFTA § 1(12).

13 See, e.g., id. §§ 4(a) & 5(a).


17 Id. § 362(a)(6).
addressed below.18 Some courts interpret acts to “recover a claim against the debtor” to include actions against non-bankrupt transferees to avoid and recover fraudulent transfers.19 Other courts have concluded that actions to avoid and recover fraudulent transfers are stayed as acts to obtain possession of property of the estate.20 Either way, the automatic stay bars creditors from pursuing fraudulent transfer claims that, absent the bankruptcy filing, would have been available to them under state law.

Chapter 7 Liquidation. Chapter 7 of the Bankruptcy Code provides for a “straight liquidation” of the debtor’s assets. Generally, in a Chapter 7 liquidation, a trustee is appointed to take control of the debtor’s assets and to convert those assets capable of being liquidated into cash. The net proceeds of liquidation, if any, are then distributed on an equitable or pro rata basis to unsecured creditors. In most cases, individuals who file Chapter 7 are discharged from their debts at the conclusion of their case.21 Business entities, such as corporations, that file Chapter 7 do not receive a discharge of their debts.22 Instead, their business operations cease, and their assets are sold or abandoned by the Chapter 7 trustee.

Chapter 11 Reorganization. Generally, in a Chapter 11 reorganization, the debtor becomes a debtor-in-possession with most, but not all, of the powers of a Chapter 7 trustee. In a Chapter 11 reorganization, the debtor’s business operations may continue, and the debtor’s assets are administered and its debts restructured and paid in accordance with a plan of reorganization that is accepted by a vote of the creditors and is approved (confirmed) by the bankruptcy court if the plan satisfies the requirements of the Bankruptcy Code.23 If a corporate debtor remains in business in accordance with the confirmed plan of reorganization, that debtor will be discharged of its debts.24 Nevertheless, if the confirmed plan of reorganization does not provide for payment in full of the debts owed to any class of unsecured creditors, and if that class of unsecured creditors did not accept the plan, the shares or equity interests in the corporate debtor likely will be extinguished.

Absolute Priority Rule. As a general matter, a bankruptcy court cannot confirm a plan that permits equity holders to retain their interests in the reorganized debtor but fails to pay in full a class of creditors that did not vote to accept the plan.25 The requirement that dissenting creditors be paid in full before the debtor’s equity holders may retain their shares or interests in the reorganized debtor is called the “Absolute Priority Rule.” As a result of the Absolute Priority Rule, it is not uncommon for general unsecured creditors to become the new equity holders, or to find themselves among the new equity holders, of the reorganized company.

Avoidance Powers

The Bankruptcy Code grants the bankruptcy trustee, or a debtor-in-possession acting as a trustee in Chapter 11, the exclusive right to avoid and recover fraudulent transfers for the benefit of creditors. As noted above, creditors are stayed from pursuing their individual rights or claims against the recipients of fraudulently transferred property. The trustee pursues actions to avoid and recover fraudulent transfers in order to augment the bankruptcy estate for the collective benefit of all unsecured creditors of the debtor.26

Section 548 of the Bankruptcy Code is the federal fraudulent transfer law that is operative in bankruptcy cases, and it enables a trustee to avoid intentional and constructive fraudulent transfers made within two years of the debtor’s bankruptcy filing.27 Additionally, section 544(b) of the Bankruptcy Code provides in relevant part that “the trustee may avoid any transfer of an interest of the debtor in property that is voidable under applicable law by a creditor holding an unsecured claim.”28 In other words, under section 544(b), the trustee wields derivatively the avoidance rights of an actual creditor under the UFCA, the UFTA, or other law that may be applicable.

It may be more advantageous for the trustee to invoke “applicable [non-bankruptcy] law” – usually, state law –

18 Id. § 362(a)(3).
19 In re Colonial Realty Co., 980 F.2d 125, 131-32 (2d Cir. 1992).
20 In re MortgageAmerica Corp., 714 F.2d 1266, 1277 (5th Cir. 1983).
22 Id. § 727(a)(1).
23 Id. §§ 1108 & 1129(a).
24 Id. § 1141(d).
25 Id. § 1129(b).
26 See, e.g., Nat’l Am. Ins. Co. v. Ruppert Landscaping Co., 187 F.3d 439, 441-42 (4th Cir. 1999) (“As a general matter, [the trustee’s single effort eliminates the many wasteful and competitive suits of individual creditors.” (internal quotation marks omitted)).
28 Id. § 544(b)(1).
under section 544(b) in lieu of, or in addition to, section 548. For example, whereas the “reach-back” period under section 548 is two years, the UFTA provides for a longer period with respect to most types of fraudulent transfer claims, enabling the trustee to avoid transfers made within four years of the bankruptcy filing. Moreover, even if only one unsecured creditor is entitled to avoid the transfer under applicable law, the trustee may, in accordance with section 544(b), step into that creditor’s shoes and avoid the transfer, not merely to the extent of that creditor’s claim, but in its entirety for the benefit of the debtor’s unsecured creditors as a whole.

Property of the Estate

The commencement of a bankruptcy case creates an estate that is administered by the trustee or, in a Chapter 11 case, the debtor-in-possession. The estate, among other things, is composed of “all legal or equitable interests of the debtor in property as of the commencement of the case” and “[a]ny interest in property that the estate acquires after the commencement of the case.” Also included in the estate is any “interest in property that the trustee recovers” in an avoidance action. Because the Bankruptcy Code specifies that the property recovered in an avoidance action is part of the estate, as opposed to a right to avoid and recover the property, some courts hold that fraudulent transfer claims are not property of the estate. Other courts reason that the right to pursue a fraudulent transfer action on behalf of the estate and its creditors is one that is given to bankruptcy trustees (or debtors-in-possession) in their capacities as such, and therefore such rights, which never were the debtors’ in the first place prior to bankruptcy, are not property of the estate.

Nevertheless, some courts take the opposite view, determining that fraudulent conveyance claims are part of the bankruptcy estate, to be administered by the trustee, as with all other estate property. The trustee “may abandon any property of the estate that is burdensome to the estate or that is of inconsequential value and benefit to the estate.” Unless the bankruptcy court orders otherwise, property of the estate that is neither administered in the case nor abandoned remains property of the estate. If a fraudulent transfer claim that the trustee may prosecute under section 544(b) is considered property of the estate, what happens if the trustee abandons the claim? Do creditors regain the right to prosecute the claim on their own? These questions have arisen in the Lyondell fraudulent transfer litigation, which is discussed below.

Standing to Prosecute Fraudulent Conveyance Claims

As indicated above, sections 544(b) and 548 vest the bankruptcy trustee with the right to prosecute fraudulent transfer claims on behalf of the estate and for the benefit of creditors. But, in Chapter 11 reorganizations, other parties can potentially step into the trustee’s shoes and prosecute such claims. In a Chapter 11 case, the debtor-in-possession serves as the trustee and may prosecute the fraudulent transfer claims. For “cause,” such as instances of fraud or gross mismanagement by the debtor-in-possession, the bankruptcy court may displace the debtor-in-possession and appoint a Chapter 11 trustee to exercise the powers of a bankruptcy trustee in the Chapter 11 case.

In some jurisdictions, an official committee of unsecured creditors appointed in a Chapter 11 case may obtain leave of court to step into the shoes of the debtor-in-possession and prosecute the fraudulent transfer claims derivatively on behalf of the estate.

32 Id. § 541(a)(3).
33 See, e.g., Colonial Realty Co., 980 F.2d at 131; In re Saunders, 101 B.R. 303, 305 (Bankr. N.D. Fla. 1989) (“The fraudulent transfer cause of action itself is not considered property of the estate.”); see also Rajala v. Gardner, 709 F.3d 1031, 1038 (10th Cir. 2013) (fraudulently transferred property is not part of the estate until it is recovered).
34 In re Cybergenics Corp., 226 F.3d 237, 244-44 (3d Cir. 2000).
35 In re Moore, 608 F.3d 253, 261 (5th Cir. 2010) (“[T]he right to recoup a fraudulent conveyance, which outside of bankruptcy may be invoked by a creditor, is property of the estate that only a trustee or debtor in possession may pursue once a bankruptcy is under way.”) (quoting Nat’l Tax Credit Partners, L.P. v. Havlik, 20 F.3d 705, 708-09 (7th Cir. 1994)).
37 Id. § 554(d).
38 Id. §§ 1101(1) & 1107(a).
39 Id. §§ 1104 & 1106.
40 See, e.g., In re Smart World Techs., LLC, 423 F.3d 166, 176 (2d Cir. 2005); Official Committee of Unsecured Creditors of
addressing whether a creditors’ committee may pursue claims derivatively make clear that derivative standing is appropriate where the trustee or debtor-in-possession is unable or unwilling to pursue estate claims or causes of action. Indeed, derivative standing is frequently necessary to avoid the inherent conflicts of interest that exist when those with the power to pursue the claims (e.g., a debtor-in-possession) are controlled by those who may be the target of the claims (e.g., the controlling shareholder of the debtor-in-possession).

Typically, to obtain authority from the bankruptcy court to pursue the estate’s fraudulent transfer claims derivatively, a creditors’ committee has to demonstrate the existence of a colorable avoidance claim against the putative defendant and that the debtor-in-possession unreasonably refused to pursue the claim. In view of having to demonstrate colorability and unjustifiable refusal, committees sometimes face preliminary challenges to the appropriateness of the proposed avoidance action. A number of courts recognize, however, that this threshold stage is not the appropriate time to conduct a “mini-trial” on the merits of the proposed claim. Debtors-in-possession might also argue that their refusal was justifiable because of the sizeable litigation costs that the estate would have to bear if the bankruptcy court authorized the committee to move forward with the fraudulent transfer claims.

A plan of reorganization may provide for the “retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose” of any claim or interest belonging to the debtor or the estate, such as a fraudulent transfer claim. It is not uncommon for a Chapter 11 plan to vest a litigation trust established by the plan, or to vest another estate representative, with the right to prosecute fraudulent transfer claims for the benefit of creditors after the plan is confirmed and goes effective.

Given that different parties can step into the shoes of a bankruptcy trustee to prosecute fraudulent transfer claims at various points in a Chapter 11 case, we will, for purposes of this discussion, refer to the person or entity who may prosecute fraudulent transfer claims on behalf of the estate and creditors as the estate representative, regardless of whether that person or entity is the debtor-in-possession, the Chapter 11 trustee, the creditors’ committee, or a representative designated by a Chapter 11 plan.

**Where a Fraudulent Transfer Claim May Be Filed**

In determining where to file and prosecute their fraudulent transfer claims, estate representatives are not limited to the bankruptcy court where the bankruptcy case is pending (the “home court”); they may file a fraudulent transfer action on behalf of the estate in any federal district court that is competent to receive the action under non-bankruptcy venue rules. However, in cases where the amount of money or value of property to be recovered falls below a certain low-dollar threshold, the estate representative must file the fraudulent transfer action in the federal district court for the district in which the defendant resides.

Most estate representatives, nevertheless, prefer to file their fraudulent transfer claims in the home court, and such fraudulent transfer claims are most commonly filed there. Generally, in bankruptcy cases, nationwide service of process is authorized and available, so the estate representative can bring defendants from all over the country to the home court in order to litigate the fraudulent transfer action in that forum. Even though it is highly likely that the fraudulent transfer claims of an estate representative will be filed in the home court, the U.S. Supreme Court’s recent decision in *Stern v. Marshall* has cast serious doubt on traditional assumptions that home bankruptcy courts have the constitutional authority to determine the merits of fraudulent transfer claims.

**Statute of Limitations on Avoidance Claims in Bankruptcy**

In general, under Bankruptcy Code section 546(a), an estate representative has two years from the date of the

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Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery, 330 F.3d 548, 583 (3d Cir. 2003).

41 See, e.g., Cybergenics, 330 F.3d at 553.

42 *Smart World Techs., LLC*, 423 F.3d at 177.

43 7 Collier on Bankruptcy ¶ 1103.05[6][a], at 1103-31 (16th ed. 2009).


45 28 U.S.C. § 1409(c).

46 Id. § 1409(b).

47 1 Collier on Bankruptcy ¶ 4.03[4], at 4-21 (16th ed. 2012).


debtor’s bankruptcy filing to commence an action to avoid a fraudulent transfer. Once the section 546(a) limitations period runs without a fraudulent transfer action being filed, the estate representative is precluded from commencing an action. Most courts recognize that section 546(a) is a statute of limitations, not a jurisdictional bar, which makes the two-year period subject to tolling.\textfootnote{See, e.g., In re Raynor, 617 F.3d 1065, 1070-71 (8th Cir. 2010); In re Int'l Admin. Servs., Inc., 408 F.3d 689, 699 (11th Cir. 2005); In re United Ins. Mgmt., Inc., 14 F.3d 1380, 1385 (9th Cir. 1994).}

In addition to the section 546(a) limitations period, an estate representative with derivative standing under section 544(b) can only assert claims that are not time-barred under state law or other applicable non-bankruptcy law. In this respect, the section 546(a) limitations period sits on top of any other limitations period that might govern. Ordinarily, the onset of bankruptcy and the triggering of the automatic stay will suspend or delay the running of these other limitations periods. But a bankruptcy filing and the automatic stay will not resuscitate a non-bankruptcy limitations period that ran before the filing. Do individual creditors regain the right to prosecute their own fraudulent transfer actions once the section 546(a) limitations period runs (and the automatic stay is lifted to allow such prosecution)? That question has come up in the Tribune Company litigation, which is discussed below.

**LEVERAGED BUYOUTS (LBOs)**

An LBO is a “means of financing the purchase of a company (the target), through an asset sale or stock acquisition, in which the purchase price for the stock or assets of the target company is funded in significant part [directly or indirectly] by loans advanced against the target’s assets, and the debt is repaid out of the target’s future earnings or through the sale of the target’s property.”\textfootnote{2 David G. Epstein et al., *Bankruptcy* § 6-52, at 57 (1992) (alteration in original) (footnote and internal quotation marks omitted).} A leveraged buyout can take various forms.\textfootnote{See id. § 6-52, at 57 & n.2.} Here is an illustration of one form of LBO, which is fictitious but has real-world parallels:

AceCo is a publicly traded corporation. A group of investors decide to acquire AceCo by purchasing its stock. To that end, the investors incorporate a holding company whose sole purpose is to hold the acquired stock. To that end, the investors incorporate a holding company whose sole purpose is to hold the acquired shares of AceCo. The investors also finance the purchase of AceCo’s shares by obtaining a loan from the Bank, the repayment of which will be secured by liens on the assets of AceCo. The holding company uses the proceeds of the loan to acquire the AceCo shares. As a result, AceCo is taken private, but is encumbered with much more secured debt than it previously owed. In essence, as a result of the LBO, much, if not all, of the equity that was in AceCo has been converted into secured debt. This may place the unsecured creditors of AceCo, such as trade creditors or vendors, in a disadvantaged position. Whereas, prior to the LBO, the unsecured creditors would have been entitled to payment of their claims in full before the shareholders would have been entitled to extract equity value from the company, the unsecured creditors after the LBO are subordinate in payment priority to the Bank. The value of AceCo’s assets may not be enough to pay the Bank and the general unsecured creditors in full.

Thus, an LBO is a gamble for the target’s unsecured creditors.\textfootnote{Id. § 6-52, at 69.} The unsecured creditors “win (in the long run) if the target company survives and thrives. Otherwise, they lose. They are harmed just as much as if the debtor had given away the equity in its assets as a gift. The element of chance is present whether the LBO is financed by an outside lender or by the selling shareholders themselves.”\textfootnote{Id.} By contrast, “the selling stockholders are relatively sure winners in either arrangement. Their equity is translated either into money (when there is an outside lender) or secured debt (when they finance the LBO themselves). Significantly, the selling stockholders are thereby accomplishing indirectly what they could not have done directly. The stockholders themselves could not have sold the company’s assets and divided the revenue among themselves without accounting first to the company’s general creditors. Such an accounting would also have been necessary had they redeemed their stock for cash or secured debt from the target company.”\textfootnote{Id. (footnotes omitted).}

**Attacking the LBO as a Fraudulent Transfer**

If the target company finds itself in financial distress and files for bankruptcy protection, the estate representative may seek avoidance of the LBO as a fraudulent transfer. Consider the AceCo illustration again: Suppose, having taken on a considerable amount of debt, AceCo was unable to turn around its business,
and files for Chapter 11 reorganization. As the debtor-in-possession, AceCo will have the exclusive right to pursue fraudulent transfers under sections 544(b) and 548 of the Bankruptcy Code within the two-year limitations period set forth in section 546(a), unless the court transfers the capacity to pursue such claims to another estate representative. A principal target of a fraudulent transfer action would be the Bank, as AceCo would seek to avoid the debt owed to the Bank and the liens securing that debt. Another potential set of targets would be the selling shareholders, as value was pulled out of AceCo, in the form of cash and given to the selling shareholders ahead of AceCo’s unsecured creditors.

Depending on the circumstances and leaving aside for the moment the potentially available legal defenses, AceCo, as debtor-in-possession, may have a strong prima facie case of constructive fraudulent transfer: Transfers of property interests occurred when liens on AceCo’s assets were granted to the Bank and when the value of AceCo’s assets was converted into cash and given to the selling shareholders. The debt incurred by AceCo to the Bank also would be subject to avoidance. In exchange for the transfers and the debt incurred, AceCo received nothing: the loan proceeds went to the selling shareholders, not to AceCo. AceCo was rendered insolvent as a result of the LBO. As one treatise observes, “an LBO is typically constructively fraudulent whenever the insolvency is decided [by the court] in favor of the [estate representative].”

Moreover, the LBO participants’ knowledge that “the debtor-target company’s transfer would deplete its assets to the prejudice of general creditors . . . may condemn an LBO as actually fraudulent.”

**Joining Issue with Public Shareholders**

Because publicly traded securities are normally held indirectly by shareholders and in their “street name” rather than the names of the beneficial owners of the shares, how would an estate representative be able to identify the appropriate shareholders to sue? Two possible alternatives come to mind: (1) serving a subpoena for documents or testimony on a records custodian (such as The Depository Trust Company) or (2) filing a defendant class action against a class of the selling shareholders and naming a putative class representative of those shareholders as a defendant.

**Potential Defenses Available to Shareholders**

Depending on the circumstances, selling shareholders might (or might not) find the following defenses available to them in a lawsuit to avoid an LBO:

(1) *Statute of Limitations / Reach-Back Period.* The two-year limitations period under section 546(a) may have run before the estate representative filed the avoidance action. In addition, the LBO might fall outside the two-year reach-back period under section 548 (the bankruptcy fraudulent transfer provision). If the estate representative is pursuing state-law fraudulent transfer claims, as authorized by section 544(b), the LBO might also fall outside the reach-back period under applicable state law, thus precluding avoidance.

(2) *Attacking the Prima Facie Elements of the Fraudulent Transfer Case.* When appropriate, shareholders can dispute the legal elements that an estate representative must prove in order to establish a prima facie case of fraudulent transfer. For example, depending on the facts and circumstances, shareholders and other defendants might dispute allegations of actual fraudulent intent, the amount of value given in exchange for the transferred money or property, and insolvency.

(3) *Lack of Standing.* There may be facts enabling shareholders and other defendants to challenge the standing of the estate representative or other plaintiff to pursue the fraudulent transfer claim. In cases where an estate representative is wielding the avoidance rights of creditors derivatively under section 544(b), the estate representative must point to an actual creditor holding an allowable unsecured claim, who, absent bankruptcy, could have pursued the avoidance rights available under applicable non-bankruptcy law in order to collect on that claim. Such a creditor is sometimes called a “triggering”
or “golden” creditor. Thus, one potential defense may be the estate representative’s failure to demonstrate the existence of an actual creditor with a viable avoidance right under applicable non-bankruptcy law.

(4) Defendant Gave Value to the Debtor. Section 548(c) of the Bankruptcy Code provides in relevant part that “a transferee . . . that takes for value and in good faith . . . may retain any interest transferred . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer.” It could be argued that the selling shareholders in the AceCo illustration took the money in exchange for their shares in good faith if they did not know that AceCo was insolvent or would be rendered insolvent as a result of the acquisition. Nevertheless, those selling shareholders might not have a section 548(c) defense because they did not give value “to the debtor.” Moreover, section 548(c) is available as a defense to fraudulent transfer claims asserted only under section 548. It does not operate as a defense against a state-law fraudulent transfer claim asserted by the estate representative under section 544(b). Nevertheless, there may be a section 548(c) analog under state law that can be raised as a defense against a state-law fraudulent transfer claim asserted by an estate representative under section 544(b).

(5) Subsequent Transferees. Section 550(a) of the Bankruptcy Code provides that, when a fraudulent transfer is avoided under sections 544(b) or 548, the estate representative may recover, for the benefit of the estate, the transferred property or its value from (i) “the initial transferee of such transfer or the entity for whose benefit such transfer was made;” and (ii) “any immediate or mediate transferee of such initial transferee” (hereinafter, a “subsequent transferee”). The estate representative may not, however, recover from a good-faith subsequent transferee who took the transferred property for value from the initial transferee or the entity for whose benefit the transfer was made. To the extent the selling shareholders in the AceCo illustration are the beneficial owners of the shares, they might qualify as good-faith subsequent transferees under section 550(b) because the money used to acquire their AceCo shares from them would have passed through a number of intermediaries, such as securities clearing agencies and brokers, which means that they might not be treated as “initial transferees” under section 550(a). On the other hand, a court could find each of the beneficial owners of the shares to be an “entity for whose benefit such transfer was made,” and thus liable under section 550(a). A court could also find the beneficial owners to be “initial transferees” under section 550(a) if it determined that the intermediaries in the transfer, such as the clearing agencies and brokers, were not transferees, but “mere conduits.” Alternatively, a court might decide to “collapse” all of the steps or stages in the LBO transaction so as to make the beneficial owners the “initial transferees” under section 550(a) and thus liable for the payments made to them. Thus, for the reasons noted above, beneficial owners of shares or other subsequent transferees in an LBO have no solid assurance that the defense for good-faith subsequent transferees under section 550(b) will be available to them.

(6) Section 546(e) Safe Harbor. Section 546(e) of the Bankruptcy Code provides that a bankruptcy trustee may not avoid, inter alia, certain settlement payments made to complete securities transactions or certain transfers made in connection with a securities contract. In litigation growing out of two recent and notable bankruptcies – the Lyondell and Tribune Company cases to be discussed below – LBOs have been attacked as fraudulent transfers and the defendant-transferees, which include former shareholders, have raised section 546(e) as an initial defense. Before examining the section 546(e) safe harbor in detail, however, we should summarize the Lyondell and Tribune Company LBOs.


11 U.S.C. § 548(c) (emphasis added). With respect to this defense, certain stockbrokers, financial institutions, securities clearing agencies, and other specified parties that received a margin payment or securities settlement payment are deemed to have “take[n] for value” to the extent of the payment. Id. § 548(d)(2)(B).

See, e.g., UFTA § 8(d).


Wirbould Stores, Inc. v. Schottenstein, 94 B.R. 488, 503 (N.D. Ill. 1988) (finding the non-insider selling shareholders in an LBO to be subsequent, good-faith transferees under section 550(b) and therefore not subject to recovery).

Courts have held that a party receiving a transfer directly from the debtor will not be considered the “initial transferee” under section 550(a) unless that party gains actual dominion or control over the funds. E.g., In re Coutee, 984 F.2d 138, 141 (5th Cir. 1993) (per curiam).

Cf. Wirbould Stores, 94 B.R. at 502 (“collapsing” the steps of the LBO with respect to the controlling and insider shareholders and the LBO lenders).
**The Lyondell LBO**

Lyondell Chemical Company was a major petrochemicals company whose stock was publicly traded. In July 2007, an international chemicals company known as Bassell AF S.C.A., and Bassell’s wholly owned subsidiary, BIL Acquisition Holdings Limited, entered into an Agreement and Plan of Merger with Lyondell, whereby Bassell promised to purchase Lyondell for $48 per share. The acquisition and merger was financed through borrowings on credit facilities that were secured by the assets of Lyondell and many of its operating subsidiaries. On December 20, 2007, the merger closed, creating LyondellBassell Industries (“LBI”), one of the world’s largest oil refiners and petrochemical producers. The selling shareholders received approximately $12.5 billion through Citibank N.A., acting as the “paying agent.”

As part of the worldwide economic downturn in 2008, LBI saw its earnings decline, and was unable to satisfy its obligations as they came due. As a result, LBI and numerous affiliates filed for bankruptcy protection in January, April, and May of 2009. In July 2009, the creditors’ committee appointed in LBI’s bankruptcy case filed suit against, among others, former directors and officers of Lyondell and LBI, and the lenders that financed the merger / LBO. In the same proceeding, the creditors’ committee brought “on behalf of the Debtors’ estates” constructive fraudulent transfer claims under sections 544(b) and 548 against Barclays Global Investors, N.A. (“BGI”), individually and as representative of the “Shareholder Class.” In the count of the complaint asserted against BGI, the committee sought to avoid the funds paid to Lyondell’s shareholders as fraudulent transfers.

In December 2009, the Lyondell debtors reached a settlement with the LBO lenders, whereby the lenders would pay hundreds of millions of dollars to settle all claims asserted against them. The bankruptcy court approved the settlement in March 2010. In April 2010, the bankruptcy court confirmed the debtors’ plan of reorganization. Among other things, the confirmed plan provided that the “Debtors shall be deemed to have abandoned” any and all rights to pursue the state-law avoidance claims under section 544(b) against the former Lyondell shareholders. The committee then dropped the “abandoned” claims against BGI and the purported shareholder class.

The confirmed plan also created two separate trusts for the benefit of creditors. The first trust formed under the plan was the “Litigation Trust,” which was assigned and had authority to prosecute all of the pending avoidance and other claims asserted in the creditors’ committee’s action against the remaining, non-settling defendants, except for the “abandoned” state-law avoidance claims. Moreover, except for those “abandoned” claims, the plan provided that all of the debtors’ other potential avoidance claims would be assigned to the Litigation Trust or retained by the reorganized debtors. The second trust formed under the plan was the “Creditor Trust,” which received and was granted authority to prosecute on behalf of creditors the state-law fraudulent transfer claims against BGI, as putative class representative of the shareholders. These claims against BGI were the ones “abandoned” under the plan, with creditors purportedly regaining the right to pursue them. Nevertheless, instead of pursuing the claims on their own, the creditors contributed their claims to the Creditor Trust for prosecution on their behalf.

In October 2010, the trustee of the Creditor Trust filed suit in New York state court against former Lyondell shareholders, asserting only state-law fraudulent transfer claims. In November 2010, some of the shareholder defendants removed the case to federal court, which in turn, referred the case to the bankruptcy court that had jurisdiction over the Lyondell reorganization. Several motions were made to dismiss the trustee’s suit, raising a number of defenses, including the section 546(e) safe harbor. The bankruptcy court heard arguments on the motions in May 2011, but has not yet ruled on them.

**The Tribune Company LBO**

Tribune was a large media business that held dozens of TV stations and newspapers, and owned the Chicago Cubs baseball team. In 2007, investors led by real estate developer Samuel Zell took control of Tribune through an LBO that was accomplished in two steps. The first step involved a cash tender offer by a newly formed employee stock ownership plan (“ESOP”) for nearly 50% of Tribune’s shares. The “Step One” shareholders received approximately $4.3 billion. The second step involved Tribune cashing out its remaining shareholders for approximately $4 billion and merging with a Delaware corporation wholly owned by the ESOP. Most of the money paid to shareholders was borrowed from large financial institutions. Indeed, as a result of the LBO, Tribune’s debt load increased from $5.3 billion to $14 billion. The payments to shareholders were made through Depository Trust & Clearing Corporation and one or more of its subsidiaries cleared the transactions.
Tribune operated for almost a year, but amid the worldwide economic downturn, it and its subsidiaries filed for bankruptcy protection in December 2008. In October 2010, the creditors’ committee appointed in the case obtained the bankruptcy court’s permission to pursue avoidance claims on behalf of the bankruptcy estate. The committee then filed a complaint against Zell, Tribune’s officers and directors, financial advisors, and others, asserting claims for breach of fiduciary duty, payment of illegal dividends, unjust enrichment, and other legal theories. One count of the complaint named all of Tribune’s former shareholders as defendants, and sought to avoid the payments to shareholders in connection with the LBO as intentional fraudulent transfers under section 548. The committee did not allege that the payments were constructive fraudulent transfers avoidable under sections 548 and 544. The two-year limitations period under section 546(a) was allowed to run with respect to those constructive fraudulent transfer claims.

At the request of Tribune’s bondholders and a distressed debt hedge fund, the bankruptcy court lifted the automatic stay, permitting the bondholders and other Tribune creditors to pursue state-law constructive fraudulent transfer claims against the former shareholders. Although the bankruptcy court’s ruling is not entirely clear on this point, it appears that the court lifted the stay without deciding whether Tribune’s creditors had regained the right to pursue their state-law constructive fraudulent transfer claims. Starting in June 2011, plaintiffs commenced 44 actions in 21 states against more than 1,700 former Tribune shareholders, seeking to avoid under state law the billions of dollars that the shareholders received from the LBO as constructive fraudulent transfers. These actions were consolidated in the federal district court in New York City.

On July 13, 2012, the federal district court established a two-phase briefing procedure for motions to dismiss. In phase one, the defendants were permitted to file a joint motion to dismiss based on the section 546(e) safe harbor, and related preemption and standing arguments, which if successful would result in dismissal of the constructive fraudulent transfer actions in their entirety. The joint motion to dismiss was filed in November 2012, and the plaintiffs have filed a joint opposition brief. The joint motion to dismiss is still pending before the district court.

THE SECTION 546(E) SAFE HARBOR

Except in cases where an estate representative is seeking to avoid an intentionally fraudulent transfer under section 548, section 546(e) prevents, among other things, an estate representative from avoiding a “settlement payment” made to complete a securities transaction or certain transfers made in connection with a pre-bankruptcy securities contract. “Thus, for example, a settlement payment made by a stockbroker to a shareholder of the debtor (including a payment made in connection with a leveraged buyout) may be protected under section 546(e)).”

The Bankruptcy Code tautologically defines the term “settlement payment” as meaning “a preliminary payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, or any other similar payment commonly used in the securities trade.” Some courts interpret “settlement payment” broadly to mean “any transfer of cash or securities made to complete a securities transaction.” “Courts have extended the ‘safe harbor’ provisions of § 546(e) to various transactions involving publicly traded companies, including leveraged buyouts and repurchase agreements.”

Purpose of the Section 546(e) Safe Harbor

Congress enacted section 546(e) “to minimize the displacement caused in the commodities and securities markets in the event [of] a major bankruptcy affecting those industries,” and “to prevent the ‘ripple effect’ created by ‘the insolvency of one commodity or security firm from spreading to other firms and possibly threatening the collapse of the affected industry.’” “By restricting a bankruptcy trustee’s power to recover payments that are otherwise avoidable under the Bankruptcy Code, the safe harbor stands ‘at the

67 5 Collier on Bankruptcy ¶ 546.06[2], at 48 (16th ed. 2012) (footnote omitted).
69 See, e.g., In re Kaiser Steel Corp., 952 F.2d 1230, 1237 (10th Cir. 1991); In re Enron Corp., 323 B.R. 857, 866 (Bankr. S.D.N.Y. 2005).
70 In re Norstan Apparel Shops, Inc., 367 B.R. 68, 75 (Bankr. E.D.N.Y. 2007) (citing, among other cases, In re Resorts Int’l, Inc., 181 F.3d 505, 515-16 (3d Cir. 1999); In re Hamilton Taft & Co., 114 F.3d 991, 993 (9th Cir. 1997); In re Kaiser Steel Corp., 913 B.R. 846, 850 (10th Cir. 1990)).
intersection of two important national legislative policies on a collision course – the policies of bankruptcy and securities law.”

Of course, as indicated above, the section 546(e) safe harbor is not a defense against every form of fraudulent transfer. Specifically, section 546(e) cannot be invoked as a defense when the estate representative is asserting a claim for intentional fraudulent transfer under section 548. But this exception is narrow because, in a case asserting a claim for actual fraudulent transfer, the estate representative will have to prove intent to hinder, delay, or defraud creditors, rather than relying on the theory of constructive fraudulent transfer. Moreover, as noted above, the reach-back period under section 548 is only two years before the bankruptcy filing date. Thus, section 548 will not be available if the estate representative is seeking to avoid a fraudulent transfer that occurred more than two years before the bankruptcy filing. The Creditor Trust in Lyondell and the Tribune plaintiffs who have allegedly regained their right to prosecute their avoidance claims are suing shareholders on the basis of constructive fraudulent transfer, which cannot qualify for the section 548 intentional fraud exception.

**Transactions Not Implicating Public Securities Markets**

There is “much disagreement over whether section 546(e) applies to both public and non-public securities transactions.” On the one hand, the wording of section 546(e) and the accompanying definition of “settlement payment” can be read broadly so as to encompass private securities transactions. Generally, any payment to purchase a stock, including stock that is not publicly traded, may be viewed as a “settlement payment.” Moreover, an agreement to purchase stock may be viewed as a “securities contract.” On the other hand, the legislative history of section 546(e) emphasizes that the purpose of the safe harbor is to protect the public securities markets. In addition, some courts interpret the catch-all phrase “or any other similar payment commonly used in the securities trade” at the end of the definition of “settlement payment” in section 741(8) to exclude private stock transfers from the scope of the 546(e) safe harbor.

**Mere Intermediaries and Conduits**

Section 546(e) protects settlement payments “by or to (or for the benefit of)” financial institutions, stockbrokers, and other market participants identified therein. Suppose a financial institution involved in the challenged LBO merely funneled the payments to shareholders, as a “paying agent” or in a similar capacity, and thus did not take a “beneficial interest” in the transferred asset. Would the payments to shareholders still be “settlement payments” protectable under section 546(e)? Several courts have held that section 546(e) does not limit its protection to intermediaries that had a beneficial interest in the transferred property. However, one federal court of appeals decision has taken the opposite view.

**Preemption of Other State-Law Claims**

Even though the express language of section 546(e) makes it a defense against avoidance claims asserted under the Bankruptcy Code, some courts have held that, because section 546(e) is a federal law, it preempts other types of state-law claims that an estate representative may bring against shareholders, in addition to fraudulent transfer claims. These state-law claims typically are for illegal shareholder distributions, breach of fiduciary duty, and unjust enrichment. With respect to section 546(e) and these other state-law claims, courts invoking preemption commonly do so on the basis of conflict preemption; they reason that, because the state-law claims are similar to the fraudulent transfer claims and are seeking to recover the same payments that have been found unavoidable under section 546(e), allowing recovery on these claims would render the section 546(e) safe harbor meaningless and would frustrate the purpose.

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72 In re Enron Creditors Recovery Corp., 651 F.3d 329, 334 (2d Cir. 2011) (quoting Resorts Int’l, 181 F.3d at 515).

73 5 Collier on Bankruptcy ¶ 546.06[2][b][i], at 53 (16th ed. 2012) (citing cases).


76 11 U.S.C. § 741(8) (emphasis added); see MacMenamin’s Grill, 450 B.R. at 421.

77 See, e.g., In re Plassein Int’l Corp., 590 F.3d 252, 257-58 (3d Cir. 2009); In re QSI Holdings, Inc., 571 F.3d 545, 550-51 (6th Cir. 2009).

78 See In re Munford, Inc., 98 F.3d 604, 610 (11th Cir. 1996).

79 See, e.g., Contemporary Indus. Corp. v. Frost, 564 F.3d 981, 988 (8th Cir. 2009).
behind that section.\textsuperscript{80} For such reasons, preemption is invoked to block the state-law claims.

There is, however, a counter-argument to preemption when it comes to section 546(e). By its express terms, section 546(e) creates a safe harbor from avoidance claims pursued by the estate representative. If Congress wanted to preempt other state-law claims held by the bankruptcy estate, it could have written language in the statute doing so, but it did not. Section 544(b)(2) of the Bankruptcy Code, for example, creates a safe harbor against avoidance for charitable contributions, and provides further that “[a]ny claim by any person to recover a transferred [charitable] contribution under Federal or State law . . . shall be preempted by the commencement of the [bankruptcy] case.”\textsuperscript{81} Section 546(e) does not contain a similar clause, which evinces the intent of Congress not to preempt these other state-law claims. Moreover, for reasons of federalism, federal courts, including bankruptcy courts, can be reluctant to find grounds for invoking preemption.

\textbf{Section 546(e) and the Lyondell / Tribune Fraudulent Transfer Litigation}

What makes the \textit{Lyondell} and \textit{Tribune} litigation different from other cases is that the \textit{Lyondell} and \textit{Tribune} plaintiffs do not claim to be acting as bankruptcy trustees or representatives of the bankruptcy estate. By its express terms, section 546(e) applies only to “the trustee” (and, by extension, an estate representative). The plaintiffs in \textit{Lyondell} and \textit{Tribune} argue that section 546(e) does not apply to them or to their constructive fraudulent transfer claims because they are creditors, or acting on behalf of creditors, who regained their fraudulent transfer claims after those claims were “deemed abandoned” by the estate under the confirmed Chapter 11 plan (in the case of \textit{Lyondell}) or after the two-year limitations period under section 546(a) ran (in the case of \textit{Tribune}). Thus, argue the plaintiffs, based on section 546(e)’s plain language, the section 546(e) safe harbor cannot be invoked against creditors who are not acting as estate representatives.

As precedent, the \textit{Tribune} plaintiffs point to a case decided by the Supreme Court, which dealt with a Bankruptcy Code provision (section 506(c)) that vested the “trustee” with the power to surcharge the collateral of a secured creditor.\textsuperscript{82} The Court held that the term “trustee” in section 506(c) did not encompass creditors of the estate who were seeking to exercise the power to surcharge.\textsuperscript{83} The \textit{Tribune} creditors argue that the same reasoning should apply with respect to section 546(e). They also contend that limiting the scope and operation of section 546(e) to the estate representative is appropriate given the sweeping powers the representative may exercise, which pose a far greater threat to settlement payments than an avoidance claim pursued by an individual creditor, whose recovery is limited to the amount of debt owed to the creditor.\textsuperscript{84}

Several defendant-shareholders urge dismissal of the fraudulent transfer claims, arguing that the plaintiffs have contrived a “work-around” section 546(e) by positioning themselves as creditors who have “regained” their right to assert fraudulent transfer claims. If this “work-around” were accepted by the courts, they contend, it would render section 546(e) a “dead letter,” as creditors and estate representatives in the future would exploit the same “work-around” to evade the 546(e) safe harbor. Section 546(e), the shareholders contend, should not be read in a way that renders it ineffective.

The shareholders urge the \textit{Lyondell} and \textit{Tribune} courts to conclude that section 546(e) preempts the constructive fraudulent transfer claims asserted by the plaintiffs. As with the claims for illegal shareholder distributions, breach of fiduciary duty, and unjust enrichment, the fraudulent transfer claims asserted by the plaintiffs are equivalent to the fraudulent transfer claims that would have been brought by an estate representative. Since allowing recovery under these claims would render section 546(e) meaningless and would frustrate the purpose behind that section, it should be held to preempt the plaintiffs’ state-law fraudulent transfer claims.

The shareholders in the \textit{Tribune} litigation also point to legal authorities indicating that, once the two-year


\textsuperscript{81} 11 U.S.C. § 544(b)(2).

\textsuperscript{82} Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1 (2000).

\textsuperscript{83} Id. at 14.

\textsuperscript{84} See, e.g., \textit{In re Tronox Inc.}, 464 B.R. 606, 615-16 (Bankr. S.D.N.Y. 2012) (“Section 544(b) of the Bankruptcy Code . . . allow[s] a trustee to avoid a fraudulent transfer without regard to the size of the claim of the creditor whose rights and powers the trustee was asserting,” while “state fraudulent transfer laws . . . provide[] that the creditor in a fraudulent transfer action may not recover more than the amount necessary to satisfy the creditor’s [own] claim.”).
limitations period under section 546(a) expires, the right to assert fraudulent transfer claims does not “revert” to creditors to pursue on their own. For example, a bankruptcy trustee may continue to assert such claims defensively after the 546(a) limitations period has run. It would make no sense to permit the trustee to assert the claims defensively if creditors regained the right to assert them. Nevertheless, there is contrary authority suggesting that creditors do regain the right to pursue their fraudulent transfer claims.

The arguments summarized above are just illustrations of the issues raised in the Lyondell and Tribune litigation. We do not seek to comprehensively recount all of the arguments being made there. How the courts will ultimately rule remains unclear. Nevertheless, once the courts do rule on the threshold motions to dismiss, those rulings will not necessarily mark the end of the line for these legal issues; if the rulings constitute final and appealable decisions, the losing side is likely to seek relief in the appellate courts.

CONCLUSION

A loss by the shareholders on the section 546(e) issue in the Lyondell and Tribune litigations would likely have important ramifications for the securities industries. Shareholders who looked to section 546(e) for protection based on the courts’ broad interpretation of that provision may find themselves unable to reach that safe harbor if creditors are deemed to have regained their right to pursue their fraudulent transfer claims. Those facing fraudulent transfer claims from having tendered their shares without any suspicion that the issuer would be left insolvent by the transaction will no doubt wonder at the fairness of such a regimen.

But this is not necessarily a one-sided story, especially when it comes to institutional investors such as mutual funds. In some transactions, institutional investors may be shareholders who benefited from selling their shares in an LBO that led in short order to the issuer’s bankruptcy filing. In other transactions, an institutional investor may be in the role of a general unsecured creditor owning the debt securities of an entity that was over-leveraged in a buyout, and the investor’s interest may lie in enforcing against shareholders, through avoidance claims, the normal priority scheme whereby general creditors are supposed to come out ahead of the equity holders. If section 546(e) is found to preempt the state-law avoidance claims of creditors where no estate representative of the bankrupt company chose to assert those claims, LBOs will benefit from greater protection against their unwinding. A general creditor whose ox is gored may well doubt that bankruptcy should confer such a windfall on shareholders. ■

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