ALERT MEMORANDUM

District Court Rejects Claims of Actual Fraudulent Conveyance in *Tribune*; Creates Dueling Tests in SDNY for Imputing Intent

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In a recent decision in the *Tribune* fraudulent conveyance litigation in the Southern District of New York, the court dismissed claims of actual fraudulent conveyance, holding that an officer's intent could not be imputed to the company where he did not control the challenged transaction. The holding creates a split among Southern District authorities over the appropriate test for determining when an individual's intent can be imputed to a company to prove an actual fraudulent conveyance.

In *Tribune*, Judge Sullivan found that an officer's conduct can only be imputed to their employer for purposes of establishing a claim for actual fraudulent conveyance when the officer is "in a position to control the disposition of [the transferring entity's] property, thereby effectuating the underlying offense."[1] This led to the dismissal of the Tribune trustee's claim of actual fraudulent conveyance, which stemmed from more than $8 billion in transfers of shareholder interests in connection with Tribune's 2007 leveraged buyout. The *Tribune* decision departs from a July 2016 decision in *In re Lyondell Chem. Co.*, in which Judge Cote rejected the *Tribune* formulation of the test and endorsed a more expansive one that focused on whether as a matter of state law, the officer was acting in the scope of their employment.[2] Below, we discuss the *Tribune* decision, its break from the *Lyondell*, and the implications of the new divide for fraudulent conveyance claims in New York.

If you have any questions concerning this memorandum, please reach out to your regular firm contact or the following authors:

NEW YORK

James L. Bromley
+1 212 225 2264
jbromley@cgsh.com

Sean A. O'Neal
+1 212 225 2416
soneal@cgsh.com

Luke A. Barefoot
+1 212 225 2829
lbarefoot@cgsh.com

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

[1] Opinion and Order, *In re Tribune Co. Fraudulent Conveyance Litig.*, Case No. 12-mc-02296-RJS (S.D.N.Y. Jan. 6, 2017) (the "*Tribune* Op.") at 8.
[2] *In re Lyondell Chem. Co.*, 554 B.R. 635 (S.D.N.Y. 2016)

Background

The *Tribune* decision relates to a dispute over nearly $8 billion of payments made to the shareholders of the Tribune Company ("Tribune") in connection Tribune's 2007 leveraged buyout. After Tribune's 2008 bankruptcy filing, Tribune's litigation trustee (the "Trustee") sought to recover those and other payments made to shareholder defendants on Tribune's behalf. The Trustee alleged that the shareholder transfers constituted actual fraudulent conveyances under 11 U.S.C. §§ 548(a) and 550(a) of the United States Bankruptcy Code, which allow a trustee to nullify or "avoid" transfers of a debtor's property that occurred within two years of a bankruptcy filing with "an actual intent to hinder, delay, or defraud" the debtor's creditors.[3] Actual fraudulent conveyance claims are particularly important in cases such as *Tribune*, where the securities transactions are likely safe-harbored from constructive fraudulent conveyance claims,[4] which do not require any intent.

In the case of corporate debtors, courts must examine the intent and actions of those involved in the transfer in order to determine whether the transfers were made with the "actual intent" required under the Bankruptcy Code. In order to meet this intent standard, the Trustee submitted that the intent of Tribune's public shareholders—who voted in favor of leveraged buyout and the transfers—was irrelevant, and instead focused on, in relevant part, certain of Tribune's officers (the "Officers"). The Trustee and the Defendants offered competing standards for the imputation of an officer's intent. The Trustee urged the Court to find that an officer's intent is *always* attributable to their company while the Defendants argued that the only intent that can be imputed to a company is that of the directors tasked with explicitly authorizing the transfer.[5] Ultimately, the Court declined to adopt either approach, charting a middle course and rejecting Tribune's attempt to impute the intent of the Officers to Tribune.

[3] *Tribune* Op. at 5-6.
[4] 11 U.S.C. §546(e).
[5] *Id.* at 9.

The *Tribune* Decision

The Court began its January 6, 2017 opinion by noting that the Second Circuit Court of Appeals had yet to articulate a test for determining when an officer's intent can be imputed to their corporation for purposes of an actual fraudulent conveyance claim.[6] Turning to the standards proposed by the parties, the Court found that both were too categorical and insufficiently appreciated the complex relationships between officers and directors.[7] For example, the Court observed that the Defendants' approach, which would exclude officers' intent entirely, was too restrictive because it "effectively disregards any influence on the Board that [officers] may have exercised."[8] By contrast, the Court found that a rule that would always impute an officer's intent, as advocated by the Trustee, failed to account for companies with diverse management and did not address "any necessary distinctions between officers and directors in instances where the distinction matters."[9]

In the absence of a binding precedent, and having rejected the parties' proposals, the Court adopted the reasoning of the First Circuit Court of Appeals, and certain New York district and bankruptcy courts, which impute an officer's intent where a plaintiff establishes that the officer "by reason of the ability to control members of the board, caused the critical mass to form an actual intent to hinder, delay or defraud creditors."[10] Further, where the officer in question does not own a majority of the company's shares, which would establish actual control over the board, the Court determined that a plaintiff must show the officer had "such formidable voting and managerial power that [the officer], as a practical matter, [is] no differently situated than if [they] had majority voting control."[11]

[6] *Id.*
[7] *Id.*
[8] *Id.* (citing *In re Lyondell Chem. Co.*, 503 B.R. 348, 388 (Bankr. S.D.N.Y. 2014)).
[9] *Id.*
[10] *Id.* at 9 (internal citations and quotations omitted).
[11] *Id.*

Applying this framework to the facts at issue, the Court determined that the Trustee had not pleaded facts sufficient to impute the intent of the Officers to Tribune.[12] The Court also went on to find Tribune's intent allegations as to Tribune's independent directors insufficient to withstand the Defendants' motion to dismiss.[13] Finally, the Court declined to grant leave to file a sixth amended complaint, determining that "it is unlikely that the deficiencies" highlighted by the Court were unforeseen by the Trustee, and that further amendment would prejudice shareholder defendants.

Contrast with *Lyondell*

While the *Tribune* decision is notable for its dismissal of the Trustee's actual fraudulent conveyance claims, it is the Court's explicit dismissal of a July 2016 decision by Judge Denise Cote that is most important for practitioners in future litigation. In *Lyondell*, Judge Cote rejected a bankruptcy court's proposed test for the imputation of officers' intent—which mirrored the analysis later adopted in *Tribune* —favoring instead a more expansive standard under which "the knowledge and actions of [a] corporation's officers and directors, [if] acting within the scope of their authority, are imputed to the corporation itself."[14] The *Lyondell* court relied heavily on principles of Delaware agency law, and noted that other courts' decisions that evaluate whether the officer had the ability to control the company's decision makers did not focus the nature of the officer's employment or address "the general rule under Delaware agency law" that an officer's knowledge and actions are imputed to their company when acting within the scope of their authority.[15] Thus, in the *Lyondell* court's estimation, those decisions, including the First Circuit decision cited in *Tribune*, were inapposite.

The *Tribune* Court appears to have been entirely unpersuaded by this distinction. Indeed, its rejection of the district court decision in *Lyondell* is relegated to a single footnote that praises the *Lyondell* bankruptcy court's logic as "highly compelling," noting that while the bankruptcy court opinion was overturned, the rationale of that reversal is not binding precedent, and thus the Court would continue to apply the bankruptcy court's "persuasive" analysis.[16]

Broader Implications

While the *Tribune* and *Lyondell* standards may appear somewhat similar in their conceptual approach, their application may lead to starkly different outcomes.

The *Tribune* decision sets a high bar for plaintiffs, who will only prevail if they can establish that an officer had actual or *de facto* control over the company's decisions. As seen in *Tribune* itself, this may prove particularly difficult in corporations with increased use of independent directors to consider and approve company decisions, as is typically the case with insider transactions. It also does not definitively address a concern raised in *Lyondell*: directors often only have the information provided to them by their company's officers. Thus, although an officer may not have the practical ability to control a board of directors, they may have significant ability to shape the flow of information to the board. While *Tribune* discusses the possibility of an officer engaging in outright falsification or manipulation of information, it remains to be seen whether a more nuanced form of information control would be enough to satisfy the standard articulated in *Tribune*.

By contrast, the *Lyondell* decision would have courts impute the intent of any officer acting within the scope of their employment. This places enormous pressure on decision makers' due diligence, as even the most scrupulous board of directors may not be able to discern the nefarious intent of an officer. This is particularly true where agency law typically provides somewhat limited recourse for companies seeking to avoid liability for their officers' wrongdoing.

As the *Tribune* Court notes, neither its opinion or the *Lyondell* opinion are binding on courts outside their respective cases. Nevertheless, the disparate analyses have set the stage for continued disagreement among

[12] *Id*. at 15.
[13] *Tribune* Op. at 20, 26.
[14] *Lyondell*, 554 B.R. at 647.
[15] *Id.* at 649.
[16] *Tribune* Op. at 8, n 9.

district and bankruptcy judges as to the appropriate standard in actual fraudulent conveyance cases, and have given potent arguments for the parties' use at the Second Circuit should either opinion be appealed.

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