Some see opening for creditors in Tribune 'safe harbor' ruling

Reuters
By Tom Hals
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Creditors have finally won a ruling in their favor regarding the bankruptcy code's "safe harbor" provision, which protects investors who profit from a leveraged buyout that renders a company insolvent.

The ruling by U.S. District Judge Richard Sullivan in New York found that the safe harbor did not bar individual creditors, including Aurelius Capital Management, from pursuing state court lawsuits against scores of former Tribune Co investors.

While Sullivan's ruling on Monday dismissed the case for reasons of standing, experts said his safe harbor finding could have wider implications.

"This is some pushback," said Mark Roe, a professor at Harvard Law School. It follows growing concern among academics and lawyers that the "safe harbor" provision had been expanded well beyond its original intent, Roe said.

In essence, Tribune creditors were seeking to claw back money from investors who sold their Tribune stock in a leveraged buyout led by developer Sam Zell in 2007.

The creditors alleged that the $8.2 billion LBO rendered Tribune insolvent and led to the media conglomerate's bankruptcy in 2008, which wiped out some of the creditors.

Creditors generally have a tough time undoing prebankruptcy transactions, even ones that render a company insolvent, if the deal falls within the protections of the safe harbor provision.

The law was born out of the so-called "salad oil scandal" of the 1960s, which brought down the New York Produce Exchange. It is meant to prevent turmoil in financial markets by providing certainty that settled securities trades could not be unwound, except in circumstances of intentional fraud.

In the case of Tribune, there are two parallel actions over the buyout.

A creditors' committee formed during the bankruptcy is pursuing claims for intentional fraudulent conveyance, which are not protected by the safe harbor and were not subject to Sullivan's ruling.

The committee chose not to pursue claims for constructive fraudulent conveyance, which do not require evidence of intent. Those claims are subject to the safe harbor.
Because the committee abandoned constructive fraudulent conveyance claims, they reverted to individual creditors. Those creditors brought the claims under New York state law, which does not have a safe harbor provision.

The investor defendants argued that the bankruptcy safe harbor preempts the individual creditors from pursuing their claims.

'DEATH KNEE'

Sullivan, in a 16-page opinion, disagreed, writing that the safe harbor did not bar the individual creditors from bringing their claims.

However, he went on to dismiss those claims because claims for intentional fraudulent conveyance brought by the creditors' committee were underway over the same transaction.

Edward Weisfelner, an attorney at Brown Rudnick, said the ruling was a "death knell" for the doctrine of implied preemption in such cases - in other words, that Congress intended to extend the safe harbor to state law cases.

Weisfelner is leading a similar case attacking a $12 billion LBO of Lyondell Chemical Co, which creditors argue led to its bankruptcy soon after. He said he was still studying the impact on the Lyondell case, which is pending a motion to dismiss.

Roe said he could see a situation where a trustee for the estate of a bankrupt company might be motivated to abandon constructive fraudulent conveyance claims because, in light of Sullivan's ruling, the safe harbor made them more valuable to individual creditors.

Stephen Selbst, an attorney at Herrick, Feinstein, said he expected the ruling's impact would be limited because he did not expect creditors' committees to abandon fraudulent conveyance claims and allow them to revert to individual creditors.

The Tribune ruling comes in the latest in a series of cases in which creditors sought to bring claims in state court to skirt the safe harbor defense.

Creditors of SemGroup Corp, a crude oil pipeline operator that filed for bankruptcy in 2008, attacked the sale of a derivatives portfolio to Barclays Bank for $143 million on the eve of the bankruptcy.

As in the Tribune case, the SemGroup creditors took steps to avoid the safe harbor provisions. The debtor's estate trustee declined to pursue claims for constructive fraudulent conveyance, which were then brought by a creditors' trustee.

U.S. District Court Judge Jed Rakoff in New York dismissed the SemGroup case in part for reasons unique to SemGroup. The creditors' trustee who filed the case was the same trustee who abandoned the claims on behalf of the estate. Rakoff called the move clever but said they were impermissible because of the doctrine of implied preemption.
In contrast, Sullivan wrote that Tribune's creditors are not the bankruptcy trustee by another name, finding that the safe harbor did not apply to them.

The case is In Re Tribune Company Fraudulent Conveyance Litigation, U.S. District Court for the Southern District of New York, No. 11-MD-2296.