No. 20-8

IN THE

Supreme Court of the United States

DEUTSCHE BANK TRUST COMPANY AMERICAS, ET AL.,

Petitioners,

v.

ROBERT R. MCCORMICK FOUNDATION, ET AL.,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

BRIEF OF AMICI CURIAE LAW PROFESSORS IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

Page(s)

STATEMENT OF INTEREST 1

INTRODUCTION AND SUMMARY OF ARGUMENT 1

BACKGROUND 3

A. Background on LBO's 3

B. The Securities Clearing and Settlement System 4

C. *Seligson* 6

D. Section 546(e) 7

E. *Merit Management Group v. FTI Consulting* 9

F. The Second Circuit's Decision in *Tribune II* 10

ARGUMENT 11

I. DENIAL OF THE PETITION WOULD LEAD TO AN ABSURD RESULT. 11

II. SECTION 546(E) DOES NOT PREEMPT PETITIONERS' SLCFTA'S. 18

III. THE SECOND CIRCUIT ERRED BY DRASTICALLY MISCONSTRUING THE TERM "FINANCIAL INSTITUTION." 23

Table of Contents--Continued **Page(s)**

IV. THIS COURT HAS GRANTED CERTIORARI IN OTHER CASES WHERE A CIRCUIT SPLIT DID NOT EXIST. **25**

CONCLUSION.. **26**

APPENDIX: LIST OF AMICI CURIAE **1a**

TABLE OF AUTHORITIES

Page(s)

Cases

Bonito Boats, Inc. v. Thunder Craft Boats, Inc.,
489 U.S. 141 (1989)..19

Czyzewski v. Jevic Holding Corp.,
137 S. Ct. 973 (2017)..3

Deutsche Bank Tr. Co. Ams., et al. v. Large Private Beneficial Owners, et al.
818 F.3d 98 (2d Cir. 2016)....................................10

Deutsche Bank Tr. Co. Ams., et al. v. Large Private Beneficial Owners, et al.
946 F.3d 66 (2d Cir. 2019) 10, 11

Enron Creditors Recovery Corp. v. Alfa,
651 F.3d. 329 (2d Cir. 2011)..................................13

Freeman v. Quicken Loans, Inc.,
566 U.S. 624 (2012). 24

Green v. Bock Laundry Machine Co.,
109 S. Ct. 1981(1989)...12

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,
530 U.S. 1 (2000)...19, 20

In re Kaiser Steel Corp.,
952 F.2d 1230 (10th Cir. 1991)................................5

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In re Lyondell Chemical Co.,
503 B.R. 348, (Bankr. S.D.N.Y. 214)....................18

In re Physiotherapy Holdings, Inc.,
No. 13-12965, 2016 WL 3611831
(Bankr. D. Del. June 20, 2016)..............................20

In re Tribune Co. Fraudulent Conveyance Litig.,
499 B.R. 310 (S.D.N.Y. 2013) 19, 20

In re Tribune Company Fraudulent Conveyance Litigation,
2019 WL 294807 (S.D.N.Y. 2019) 22

Klein & Co. Futures, Inc. v. Board of Trade of the City of New York, et. al,
127 S. Ct. 2431 (2007)...25

Medtronic, Inc. v. *Lohr*,
518 U.S. 470 (1996)...18

Merit Management Group v. FTI Consulting,
138 S. Ct. 883 (2018)......................................passim

Seligson v. N.Y. Produce Exch.,
394 F.Supp. 125 (S.D.N.Y. 1975) 6, 7, 17, 24

Travelers Indem. Co. v. Bailey,
557 U.S. 137 (2009)...25

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United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.,
484 U.S. 365 (1988)..17

Statutes and Rules

11 U.S.C. § 101 8

11 U.S.C. § 101(11)..23

11 U.S.C. § 101(22)(A) .... passim

11 U.S.C. § 323 ....2, 18

11 U.S.C. § 506(c) 19, 20

11 U.S.C. § 544 8

11 U.S.C. § 544(b)(1). 3

11 U.S.C. § 544(b)(2). 19

11 U.S.C. § 546(e) .... passim

11 U.S.C. § 548 3

11 U.S.C. § 548(a)(1)(A) 9

11 U.S.C. § 548(a)(1)(B) 3, 8

Statutes and Rules--Continued **Page(s)**

11 U.S.C. § 548(b) 8

11 U.S.C. § 741 ....8, 10

11 U.S.C. § 741(7) 9

11 U.S.C. § 761 8

11 U.S.C. § 764(c) 7

H.R. Rep No. 420, 97th Cong., 2d Sess. 261 (1982). ..7

H.R. Rep. No. 595, 95th Cong., 1st Sess. 392 (1977). 7

H.R. Rep. No. 97-420 (1982)...............................5, 6, 8

Pub. L. No. 95-598, 92 Stat. 2549. 7

U.S.C.C.A.N. 583, 583 ....6, 8

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Brief for Amici Curiae Law Professors in Support of Plaintiff-Appellant, *In re Tribune Company Fraudulent Conveyance Litigation*, 2020 WL 419555 (C.A. 2)...23

Cf. Stephen J. Lubben, *Subsidizing Liquidity or Subsidizing Markets? Safe Harbors, Derivatives, and Finance*, 91 AM. BANKR. L.J. 463 (2017).......21

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Disclosure under the Principles for Financial Market Infrastructures, DTCC (Dec. 2016), http://www.dtcc.com/~/media/Files/Downloads/legal/policy-and compliance/DTC_Disclosure_Framework.pdf.........5

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Peter V. Marchetti, *A Note to Congress: Amend Section 546(e) of the Bankruptcy Code to Harmonize the Underlying Policies of Fraudulent Conveyance Law and Protection of the Financial Markets*, 26 AM. BANKR. INST. L. REV. 1, 10-15 (2018)................8

Other Authorities--Continued **Page(s)**

Restatement (Third) of Agency §1.01 23

STATEMENT OF INTEREST[1]

Amici curiae respectfully file this brief in support of the petition for certiorari (the "Petition"). *Amici,* whose names and affiliations are set forth in alphabetical order in the attached Appendix, are law professors whose scholarship focuses on, *inter alia*, the text, structure, legislative history, and policy objectives of the Bankruptcy Code (the "Code"), as well as on the practical economic impact of the bankruptcy system. Accordingly, *amici* have a strong interest in the proper interpretation of the Code and the effective implementation of the public policies bankruptcy law is designed to promote.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Second Circuit erred in this case by drastically misconstruing the term "financial institution" set forth in Section 101(22)(A) of the Code ("Section 101(22)(A)"). Specifically, the Second Circuit erroneously held that the "safe harbor" contained in section 546(e) of the Code ("Section 546(e)") preempts state law constructive fraudulent transfer actions ("SLCFTA's") simply because a debtor hired a bank or a trust company to act as a conduit between itself and the holder of its securities in a leveraged buyout ("LBO").

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[1] Counsel for all parties have consented to this filing. No counsel for a party authored this brief in whole or in part, and no party or their counsel made any monetary contribution toward the preparation or submission of this brief.

The Second Circuit incorrectly reasoned that: (i) a corporation selling its shares through an LBO qualified as a "customer" of a bank or a trust company, thereby triggering the application of Section 546(e); (ii) Section 546(e) preempts SLCFTA's by, *inter alia*, ignoring Section 323 of the Code ("Section 323") and improperly using selective snippets of the legislative history underlying Section 546(e); and (iii) Congress intended Section 546(e) to protect *investors* in securities markets, instead of simply protecting entities that act as *conduits* in the securities and commodities clearing and settlement system (the "Securities Clearing System"). The Second Circuit's faulty decision eviscerates this Court's recent opinion in *Merit Management Group v. FTI Consulting*, 138 S. Ct. 883 (2018) ("*Merit*").

If this Court denies the Petition, at least two disastrous consequences will undoubtedly follow. First, former shareholders, including "insiders" of companies purchased through risky LBO's, will get a windfall, while unsecured creditors of those companies will merely recover, if anything, a small percentage of the amounts they are owed. Secondly, more companies, at the behest of their insider shareholders, will engage in even more risky and disastrous LBO's, as the Second Circuit's ruling would encourage those insiders to loot companies at the detriment of those companies' unsecured creditors. Congress did not intend such a sweeping construction of the term "financial institution" that would, in turn, permit Section 546(e) to be applied so broadly.

BACKGROUND

A. Background on LBO's

As this court has recognized, an LBO is a merger and acquisition technique through which an acquirer finances its acquisition of the target (the "Target") company's stock by obtaining a loan from a bank. *See Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 980 (2017). The acquirer simultaneously grants the bank a perfected security interest in all of the Target's assets, and uses the loan proceeds to "cash out" the shareholders of the Target. *Id.* LBO transactions involve significant "bankruptcy risk". Following the LBO, the Target becomes saddled with significant debt that did not exist before the LBO. *Id.* The incurrence of this debt drains the Target of substantial amounts of cash that could otherwise be used to pay the Target's unsecured creditors, which are often comprised of trade creditors, tort claimants or retirees. Those unsecured creditors may suffer significant financial losses, while the Target's former shareholders enjoy the profits made from the LBO.

Under the Code, if a company files for bankruptcy following the completion of the LBO transaction, the "Trustee"[2] may seek to avoid or "claw back" the payments made to the former shareholders of the Target through a constructive fraudulent transfer action under both Section 548 and a SLCFTA. *See* 11 U.S.C. §§ 548(a)(1)(B); 544(b)(1). If the Trustee does not bring a SLCFTA within two years from the date of

[2] In this brief, Trustee means a duly appointed bankruptcy trustee or a debtor-in-possession under the Code.

the debtor's bankruptcy filing or if the automatic stay is lifted for this purpose, unsecured creditors, who had the right to bring SLCFTA's on an individual basis, may regain the right to do so. In many instances, as has occurred in this case, a litigation trust may be created as a part of a confirmed chapter 11 plan giving certain individual creditors, not the Trustee, the right to bring SLCFTA's.

A fraudulent transfer action is the main method of recourse unsecured creditors have to recover in the scenario of a failed LBO. To protect shareholders from constructive fraudulent transfer actions, a corporation's board of directors (the "BOD") generally obtains a solvency opinion from a reputable financial or tax firm. Such a solvency opinion generally provides that the Target, following the LBO, will generate enough revenue both to service the debt created by the LBO and to pay the Target's unsecured creditors.

B. The Securities Clearing and Settlement System

The term "financial institution", the proper construction of which is a central issue in this case, works in tandem with Section 546(e), the underlying policy of which is to protect intermediaries in the Securities Clearing System.

Prior to the 1970's, a sale of a security involved the use of physical stock certificates. As the volume of security trades substantially increased, a "paperwork crisis" on Wall Street ensued. This resulted in securities brokers suffering serious delays in maintaining their daily trade records. As a result,

what is now known as the Depository Trust & Clearing Corporation (the "DTCC") was formed, which, acting through its affiliates and subsidiaries, clears and settles virtually all trades in equity securities, corporate and municipal debt securities, fixed income securities, and derivatives.[3]

When buyers and sellers trade shares of stock, they do not directly face each other. Instead, intermediaries such as brokerage firms and clearing agencies act as intermediaries between buyers and sellers of securities. Cede and Co., a subsidiary of the DTCC, is named as the holder of legal title to virtually all shares of publicly traded stock that is traded on an exchange.[4] In this system, even though one broker may enter into various trades with various other brokers, the money and securities are exchanged almost as if it were one transaction through the DTCC. The DTCC, in turn, holds the stock in "street name" by listing the amount of a particular stock held by each participating broker-dealer.[5]

The Securities Clearing System uses a series of guarantees among the various intermediaries in the system.[6] H.R. Rep. No. 97-420, at 1 (1982), reprinted

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[3] *See Introduction to DTCC*, DTCC, http://3197d6d14b5f19f2f440-5e13d29c4c016cf96cbbfd197c579b45.r81.cf1.rackcdn.com/collection/papers/2010/2010_0701_DTCCServices.pdf (last visited Oct.18, 2017).

[4] *Disclosure under the Principles for Financial Market Infrastructures*, DTCC (Dec. 2016), http://www.dtcc.com/~/media/Files/Downloads/legal/policy-and-compliance/DTC_Disclosure_Framework.pdf.

[5] *See id.*

[6] *See In re Kaiser Steel Corp.*, 952 F.2d 1230, 1237-38 (10th Cir.

in 1982 U.S.C.C.A.N. 583, 583. The buyer's broker guarantees the payment of money for the securities. The seller's broker, on the other hand, guarantees that it will deliver the securities. The DTCC, acting as the intermediary between the two brokers, guarantees the quick transfer of both the money and the securities. If any of the parties to this transaction default, i.e., if a buying broker defaults by failing to pay money, then the DTCC must still perform its obligations, i.e., to pay the selling broker. The DTCC would obtain this money from a "clearing fund" maintained by its members.

C. *Seligson*

As this Court noted in *Merit*, following the establishment of the Securities Clearing System and after the bankruptcy filing of Ira Haupt & Co. ("Haupt"), which at that time was a major commodities broker, concern arose among market participants regarding the domino effect that a bankruptcy filing of a member of the Securities Clearing System would have on the entire system. *Merit*, 138 S. Ct. at 889-90; *Seligson v. N.Y. Produce Exch.*, 394 F.Supp. 125 (S.D.N.Y. 1975). In *Seligson*, the trustee of Haupt's bankruptcy estate filed an avoidance action against the New York Produce Exchange and the New York Produce Exchange Association to recover margin payments that Haupt had made to those entities prior to its involuntary bankruptcy filing. *Seligson*, 394 F Supp. at 126-27. Haupt made those payments in connection with commodities futures contracts that were cleared and

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1991); H.R. Rep. No. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583.

settled through those clearing associations, which moved for summary judgment. *Id.* at 134-37. The district court denied that summary judgment motion. *Id.*

The *Seligson* decision caused major concern for market participants in the Securities Clearing System. Those participants feared that if the normal rules of bankruptcy applied to one of them, and if one of them filed for bankruptcy, a Trustee could unwind the whole transaction, and attempt to claw back any fees and margin paid to those members while they were acting solely as intermediaries within the Securities Clearing System. This would place other members of the system at financial risk simply because they acted as intermediaries. Likewise, such "bankruptcy risk" could lead to a domino effect of bankruptcies in financial markets that could, in turn, severely debilitate the entire financial market, leading to a severe market meltdown.[7]

D. Section 546(e)

As this Court noted in *Merit*, in 1978, Congress enacted Section 764(c) of the Code[8], which was the predecessor to Section 546(e), in response to concerns surrounding the *Seligson* decision. *See Merit*, 138 S. Ct. at 889-90. Initially, that legislation applied only to intermediaries in the commodities clearing and settlement system and immunized any margin payment(s) made to a commodity broker or forward

[7] *See* H.R. Rep No. 420, 97th Cong., 2d Sess. 261 (1982). *See also* H.R. Rep. No. 595, 95th Cong., 1st Sess. 392 (1977).
[8] Pub. L. No. 95-598, 92 Stat. 2549, 2555.

contract merchant.[9] Over a period of approximately 25 years, Congress amended and broadened that legislation, and it eventually became what is now Section 546(e), so that it would also apply to entities functioning as intermediaries in the securities markets. *See id.*; *see also* Peter V. Marchetti, *A Note to Congress: Amend Section 546(e) of the Bankruptcy Code to Harmonize the Underlying Policies of Fraudulent Conveyance Law and Protection of the Financial Markets*, 26 AM. BANKR. INST. L. REV. 1, 10-15, 20-24 (2018) (detailing legislative history).

The legislative history indicates that the underlying policy of Section 546(e) is to protect intermediaries in the Securities Clearing System such as brokerage firms, banks and trust companies ("Qualified Intermediaries"), from systemic risk.[10] The current version of Section 546(e) provides in pertinent part:

> Notwithstanding sections 544, . . . 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, made by or to (or for the benefit of) a . . . stockbroker, financial institution, financial

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[9] *Id.*

[10] *See* H.R. Rep. No. 97-420, at 2 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583 (the House Report provides in pertinent part: "If a firm [which functions as an intermediary in the securities clearing and settlement system] is required to repay amounts received in settled securities transactions, it could have insufficient capital or liquidity to meet its current securities trading obligations, placing other market participants and the securities markets themselves at risk.").

> participant, or securities clearing agency, or that is a transfer made by or to (or for the benefit of) a . . . stockbroker, financial institution, financial participant, or securities clearing agency, in connection with a securities contract, as defined in section 741(7), . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title. 11 U.S.C. § 546(e).

E. *Merit Management Group v. FTI Consulting*

In *Merit*, this Court unanimously held that Section 546(e) would not insulate a settlement payment by a debtor to its shareholders that redeemed their shares through an LBO from constructive fraudulent transfer liability simply because a Qualified Intermediary acted as a conduit between the debtor and the debtor's shareholders. *Merit*, 183 S. Ct. 883 (2018). In *Merit,* this Court held that the only relevant transfer for purposes of Section 546(e) is the transfer the Trustee seeks to avoid—"the overarching [or end-to-end] transfer, and not any component part of that transfer." *Id*. at 893-97. Thus, *Merit* held that the "transferor" for purposes of Section 546(e) was not the Qualified Intermediary, but instead was the debtor. *Id*. *Merit*, however, did not consider whether a debtor would qualify as a "financial institution" by virtue of being a "customer" of a bank or a trust company. *Id*. at 890, n. 2.

Merit addressed constructive fraudulent transfer claims brought by a Trustee under the Code. It did not, however, address SLCFTA's. As a result of this Court's decision in *Merit* and a statement issued by

Justices Kennedy and Thomas, the Second Circuit recalled its mandate resulting from its 2016 opinion in this matter, which held that Section 546(e) preempted SLCFTA's. *Deutsche Bank Tr. Co. Ams., et al. v. Large Private Beneficial Owners, et al. (In re Tribune Co. Fraudulent Conveyance Litig.) (Tribune I*), 818 F.3d 98, 106 (2d Cir. 2016). The Second Circuit, amended its 2016 opinion 19 months later, but it still erroneously reached the same conclusion as it did in *Tribune I*—i.e., that Section 546(e) preempts SLCFTA's. *Deutsche Bank Tr. Co. Ams., et al. v. Large Private Beneficial Owners, et al. (In re Tribune Co. Fraudulent Conveyance Litig.) (Tribune II*), 946 F.3d 66 (2d Cir. 2019).

F. The Second Circuit's Decision in *Tribune II*

The crux of the Second Circuit's erroneous holding in *Tribune II* is that, notwithstanding *Merit*, Section 546(e) preempts SLCFTA's because Tribune qualified as a "financial institution" under Section 101(22)(A).[11] *See Tribune II,* 946 F.3d at 77-81. According to the Second Circuit's faulty construction of the Code, a trust company, Computershare Trust Company, N.A.

[11] "Financial institution" is defined in relevant part as: "a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or 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) (emphasis added).

("CTC"), qualified as Tribune's "agent" in the challenged transaction simply by agreeing to act as a conduit between Tribune and its shareholders. *Id.* According to the Second Circuit, under the definition of "financial institution" in Section 101(22)(A), CTC's purported role as Tribune's "agent" rendered Tribune itself a "financial institution." *Id.*

ARGUMENT

I. DENIAL OF THE PETITION WOULD LEAD TO AN ABSURD RESULT.

If this Court denies the Petition, the Second Circuit's decision will lead to absurd results that Congress did not intend when it enacted Section 546(e). Namely, it would make it virtually impossible for an unsecured creditor to ever bring a SLCFTA against shareholders who redeemed their equity securities through a risky LBO. That result is particularly troublesome in current times. The Coronavirus, which has essentially shut down most of our nation's economy, coupled with the large number of recent LBO's[12] and similar leveraged transactions, such as share repurchases,[13] are expected to cause a dramatic increase in the number of corporate

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[12] *See* Jonathan Schwarzberg, *Leverage Levels Peaking Again on US Mega Buyouts*, REUTERS (Mar. 22, 2019), available at https://www.reuters.com/article/leverage-climbs/leverage-levels-peaking-again-on-us-mega-buyouts-idUSL1N2190M2.

[13] *See* Evie Liu, *Bailouts Might Bring Bans on Stock Buybacks. Here's What It Means*, BARRONS (Mar. 20, 2020), available at https://www.barrons.com/articles/bailouts-might-bring-bans-on-stock-buybacks-heres-what-it-means-51584745840.

bankruptcy filings. Most of these bankruptcy filings will likely occur in the Bankruptcy courts situated in New York—the nation's financial epicenter. *See* Jonathan Randles, *Bankruptcy Lawyers Gear Up for Surge in Filings Due to Coronavirus Fallout*, THE WALL STREET JOURNAL (Apr. 2, 2020), available at https://www.wsj.com/articles/bankruptcy-lawyers-gear-up-for-surge-in-filings-due-to-coronavirus-fallout-11585853669.

A court's objective in construing a statute is to give effect to the Legislature's intent. In doing so, a court construes the statutory text according to its plain meaning, unless the plain meaning leads to absurd results the Legislature could not possibly have intended. *See Green v. Bock Laundry Machine Co.*, 109 S. Ct. 1981, 1994-95 (1989). In misconstruing the term "financial institution", the Second Circuit held that when a company hires a bank or a trust company to act as a conduit or intermediary between itself and its shareholders in an LBO, that company itself suddenly goes through some sort of metamorphosis and becomes a "financial institution" because the intermediary purportedly "is acting as an *agent or custodian*" for the company.

Every LBO involves the use of a bank or similar financial institution as a conduit between the Target and the redeeming shareholders. If this Court denies the Petition, the Second Circuit's decision will allow any shareholder that redeems its stock through an LBO to claim that the debtor and the Qualified Intermediary are one and the same, thus insulating the transfer from a SLCFTA under Section 546(e). This would essentially permit any transferee to

launder the bankruptcy risk associated not only with LBO's, but also with virtually any transaction involving securities, commercial paper, and possibly even loan transactions, by simply inserting a bank between the parties to the transaction. *See Enron Creditors Recovery Corp. v. Alfa*, 651 F.3d. 329, 346 (2d Cir. 2011) (Koeltl, D.J., dissenting); *see also* Charles W. Mooney, Jr., *The Bankruptcy Code's Safe Harbors for Settlement Payments and Securities Contracts: When is Safe Too Safe?*, 49 TEX. INT'L L.J. 245, 265-66 (2014).

Indeed, the Second Circuit's opinion mischaracterized the legislative history and Congressional intent underlying Section 546(e). In its faulty attempt to justify its erroneous conclusion that Section 546(e) protects investors in addition to Qualified Intermediaries, the Second Circuit cited only certain snippets of the Congressional testimony of Bevis Longstreth, who was then a Commissioner of the Securities and Exchange Commission (the "SEC"). Likewise, it failed to mention the Congressional testimony of Theodore H. Focht, who was, at the time, the general counsel of the Securities Investor Protection Corporation ("SIPC"). Portions of Commissioner Longstreth's testimony that the Second Circuit omitted in its opinion support the conclusion advocated by the Petitioners. In 1981, during a Congressional Hearing regarding proposed legislation that eventually became Section 546(e), Commissioner Longstreth testified as follows:

> Proposed new Code Section [546(e)], which contains the basic exemptions from the preference and fraudulent transfer provisions of the Code,

> refers to, among other things, "deposits" as one of the types of payments by or to a broker or clearing agency which cannot be avoided. In light of the rapidly expanding new financial services and products today being offered by brokers to their customers—many of which are not related to traditional securities activities—it should be made clear in either the bill itself or in the accompanying legislative history, that the only "deposits" intended to be protected are those made to finance or facilitate securities or commodities transactions.[14]

Similarly, during those same hearings, Mr. Focht testified:

> While we support these amendments, we believe there is one ambiguity which we would urge the committee to clear up before they are adopted. Perhaps this can be accomplished by a discussion in the committee report rather than by changing the language of the proposed amendments. The proposed amendment to section 546 of the Bankruptcy Code would prevent a trustee from avoiding a transfer which is a deposit made by or to a commodities broker, forward contract merchant, stockbroker, or securities clearing agency. The word "deposit" is undefined. It is, in my view, too ambiguous a word and might be used to defeat a trustee's attempt to recover a preferential transfer that should be recovered.

[14] *Bankruptcy of Commodity and Securities Brokers: Hearings Before the Subcomm. on Monopolies and Commercial Law of the H. Comm. on the Judiciary*, 97th Cong. 165, at 261 (1981) ("*Hearings*") (testimony Bevis Longstreth, Commissioner, SEC).

> The committee report, I believe, could clarify this matter by making it clear that a preferential payment which is neither a margin, mark-to-market or settlement payment, nor a deposit to a clearing fund should continue to be recoverable by a trustee as it is under existing law.[15]

This legislative history further underscores the premise that the Congressional intent underlying Section 546(e) was aimed at protecting *Qualified Intermediaries* from systemic risk—not *investors*. As explained above, Congress's main concern was that the ability of a Trustee to bring an avoidance action against a Qualified Intermediary could cause the insolvency of another Qualified Intermediary such as a commodity broker, a stock broker or a clearing association, which, in turn, could spread to one or more other Qualified Intermediaries, leading to a domino effect of insolvencies of those Qualified Intermediaries in the financial markets. *See Merit*, 138 S. Ct. at 889-90.

Although *Merit* did not address the construction of the term "financial institution" at issue here, *Merit* did reject a construction of Section 546(e) that would insulate a payment by a debtor to a holder of securities issued by the debtor from a constructive fraudulent transfer action simply because a Qualified Intermediary acted as a conduit between the debtor and the holder of the debtor's securities. Instead, as mentioned above, *Merit* held that the only relevant transfer for purposes of Section 546(e) is the transfer

[15] *Hearings*, *supra*, note 14, at 285 (testimony of Theodore H. Focht, General Counsel, SIPC).

that the Trustee seeks to avoid under one of the Code's avoidance provisions—the "overarching" or end-to-end transfer, not any component part of that transfer. *Merit,* 138 S. Ct. at 892-95.

In *Merit*, this Court expressly rejected an interpretation of Section 546(e) that would allow a shareholder redeeming its shares of stock in a debtor through an LBO to successfully launder the bankruptcy risk of a potential future constructive fraudulent transfer action by simply inserting a Qualified Intermediary between itself and the debtor. Instead, *Merit* focused on the overarching transfer, and held that the "transferor" for purposes of Section 546(e) was not the Qualified Intermediary, but instead was the debtor. *Merit*, 138 S. Ct. at 893-97. The Second Circuit, by misconstruing the term "financial institution" as it did in its decision, essentially held that a transferor-debtor itself becomes a Qualified Intermediary by simply hiring that Qualified Intermediary to act as a conduit in an LBO transaction. Such a construction of the term "financial institution" turns this Court's opinion in *Merit* on its head.

The proper use of textualism "almost always" considers the legislature's purpose in enacting a statute. *See* Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 56 (2012). *Merit*, in keeping with this principle, interpreted Section 546(e) according to its plain text and used the text of Section 546(e) to ascertain Congress's purpose. Interpreting Section 101(22)(A) directly contrary to that purpose would not be a faithful application of textualism. Instead, it would

be an exercise in interpreting discrete words in one section of a statute without regard to either: (i) their place in the larger statutory framework; or (ii) Congress's evident purpose as shown in the text of related provisions—here, Section 546(e).

Taking into account this Court's interpretation of Section 546(e) in *Merit*, and considering how the Second Circuit's interpretation of Section 101(22)(A) would undermine *Merit*, it would be fully consistent with textualism to consider Congress's purpose in enacting Section 546(e). Such consideration would be a faithful application of textualism's proper and sophisticated principles. Indeed, statutory interpretation is a "holistic endeavor," and the operation of related statutory provisions must be considered in interpreting text. *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365, 371 (1988).

In reaching its conclusion in *Merit*, this Court looked to the legislative history and purpose underlying Section 546(e). *Merit*, 138 S. Ct. at 889-90. Indeed, this Court noted that Congress, in enacting Section 546(e), was concerned with the systemic risk that could occur as a result of the holding in *Seligson*. *Id*. Such systemic risk could result if a Trustee could bring a constructive fraudulent transfer action against a Qualified Intermediary in the Securities Clearing System, which could impede that intermediary's ability to perform its guarantee—one of a system of guarantees through which the Securities Clearing System functions. A "domino effect" of bankruptcy filings by broker-dealers, clearing associations, or similar parties could then

ensue.

II. SECTION 546(E) DOES NOT PREEMPT PETITIONERS' SLCFTA's.

Pursuant to the Code's plain language, the Petitioners do not qualify as a Trustee so as to trigger the application of Section 546(e). Section 323, which the Second Circuit failed to mention, expressly provides that the Trustee in a bankruptcy case "is a representative of the estate." 11 U.S.C. §323. Here, the Petitioners could never qualify as a Trustee under the Code, because they do not represent the "estate". Instead, they represent a discrete group of unsecured creditors.

Likewise, the legislative history of Section 546(e) supports the conclusion that Congress did not intend to preempt SLCFTA's. State fraudulent transfer law, which traces its roots to the English statute of Elizabeth and involves a state's police power, has existed in the United States since the Revolutionary War, hundreds of years before Federal bankruptcy law existed. *In re Lyondell Chemical Co.*, 503 B.R. 348, 362 (Bankr. S.D.N.Y. 2014). State and Federal fraudulent transfer law "have coexisted for 75 years." *Id*. at 363. Federal law does not preempt state law involving the historic police powers of the States "unless that was the clear and manifest purpose of Congress." *Medtronic, Inc.* v. *Lohr*, 518 U.S. 470, 471 (1996).

Congress was well aware of a creditor's ability to bring a SLCFTA: (i) when it enacted Section 546(e); and (ii) throughout the 25 year period when it

expanded Section 546(e)'s scope eight times. Indeed, in 1976, the Commodity Futures Trading Commission (the "CFTC") lobbied Congress to amend Section 546(e) so that it would expressly preempt SLCFTA's. *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310, 318 (S.D.N.Y. 2013). Notwithstanding the CFTC's efforts, Congress refused to expressly preempt SLCFTA's. The case for preemption is weak where "Congress has indicated its awareness of the operation of state law in a field of federal interest, and has nonetheless decided [not to expressly preempt the state law at issue]." *Bonito Boats, Inc. v. Thunder Craft Boats, Inc.,* 489 U.S. 141, 166–167 (1989). Indeed, Congress has expressly preempted SLCFTA's with respect to certain charitable contributions, but refused do so regarding other types of transactions. *See* 11 U.S.C. §544(b)(2).

The express language of Section 546(e) applies only to Trustees, not to individual creditors. In *Hartford Underwriters*, which the Second Circuit failed to cite, this Court expressly rejected an analogous argument that a Code provision applicable to "the trustee" covered other unsecured creditors. *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). There, this Court interpreted Section 506(c),[16] which allows a Trustee to surcharge a secured creditor's collateral in certain limited circumstances. *Id*. Using a textual approach in *Hartford Underwriters,* this Court held that an individual creditor could not use Section 506(c) to surcharge the collateral of a secured creditor, because the plain language of Section 506(c) stated that the

[16] *See* 11 U.S.C. §506(c) ("Section 506(c)").

"trustee" may bring such an action, and did not expressly authorize an individual creditor to do so. In *Hartford Underwriters*, this Court reasoned that where a statute expressly "'names the parties granted [the] right to invoke its provisions, . . . such parties only may act.'" *Id*. at 7. The Delaware Bankruptcy Court, using, *inter alia*, this reasoning, disagreed with the reasoning employed by the Second Circuit and held that Section 546(e) does not bar SLCFTA's. *See In re Physiotherapy Holdings, Inc.*, No. 13-12965, 2016 WL 3611831 (Bankr. D. Del. June 20, 2016) at *7-8. Most large corporate bankruptcy cases are filed in either New York or Delaware. FEDERAL JUDICIAL CENTER, A GUIDE TO THE JUDICIAL MANAGEMENT OF BANKRUPTCY MEGA-CASES 1 (2d ed. 2009). A split between New York and Delaware as to whether Section 546(e) preempts SLCFTA's, an issue that could soon arise in many bankruptcy cases, is a crucial issue in need of resolution.

If this Court uses the same textualist approach as it used in *Hartford Underwriters,* a simple conclusion would logically follow—Section 546(e) does not bar an individual creditor's right to bring a SLCFTA. If a party named in a power-granting provision of a statute is the only party entitled to act, it would logically follow that a party named in a provision that limits that party's power would be the only party whose power the statute limits. *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. at 316. Indeed, if Congress intended to bar the ability of an individual creditor to bring a SLCFTA, Congress would have drafted the pertinent part of Section 546(e) to read "*neither the trustee nor any creditor* may avoid a transfer" instead of drafting Section 546(e) in

the manner it did.

An unsecured creditor's ability to bring a SLCFTA against shareholders that redeemed their shares through an LBO would not result in systemic risk. Those shareholders may lose the profit they would have made through the LBO, but such a loss would not result in a domino effect of bankruptcy filings of Qualified Intermediaries in the Securities Clearing System. *Cf.* Stephen J. Lubben, *Subsidizing Liquidity or Subsidizing Markets? Safe Harbors, Derivatives, and Finance*, 91 AM. BANKR. L.J. 463, 473-74 (2017). Unlike *Merit*, this case involves SLCFTA's, which are not funded by a bankruptcy estate, as is the case when a Trustee brings a SLCFTA. Instead, when an individual unsecured creditor successfully brings a SLCFTA, the portion of the transaction that is ultimately avoided is the portion of the transaction that relates to that creditor's unsecured claim—not the amount of the entire transaction as would be the case if a Trustee successfully brings a SLCFTA on behalf of the entire bankruptcy estate.

If this Court denies the Petition, it would make it virtually impossible for an unsecured creditor to ever bring a SLCFTA against shareholders who redeem their equity securities through a high-risk LBO, unless the purchaser walks into the closing with a giant bag of cash to pay the selling shareholders. Such a result would not only lead to the proliferation of risky and disastrous LBO's—it would encourage them! Insider controlling shareholders could loot companies at the expense of those companies' creditors with impunity.

Allowing the decision below to stand could encourage large banks to aid and abet corporate looters in these transactions, as such banks could handsomely profit by collecting large structuring fees along with other fees and interest associated with LBO's. Congress did not intend Section 546(e) to be applied so broadly.

The conduct of Tribune's BOD prior to the LBO, at minimum, raises issues of bad faith and is very concerning. As mentioned above, obtaining a solvency opinion from a reputable financial firm as part of an LBO is standard market practice. In this case, based on sham future earnings projections prepared by Tribune insiders, who ultimately cashed out their shares through the LBO, two well-known financial firms refused to issue a solvency opinion for Tribune's LBO. *See In re Tribune Company Fraudulent Conveyance Litigation*, 2019 WL 294807 (S.D.N.Y. 2019) at *3 to *6. Nevertheless, Tribune's BOD went "opinion shopping" and aggressively sought out any financial firm that would issue a solvency opinion supporting the LBO. It ultimately hired Valuation Research Corporation ("VRC"), an obscure financial firm that used an unconventional valuation definition and charged the "highest fee it had ever charged for a solvency opinion." *Id*. at *5-6.

If the decision below is allowed to stand, it would encourage companies in the future to engage in similar "opinion shopping" behavior. It would also encourage companies to engage in more risky LBO's, because shareholders would be able to "buy" a solvency opinion from any firm willing to issue one, regardless of its accuracy or methodology, and later

cash out their shares at the expense of unsecured creditors that would be left with limited, if any, recourse against those shareholders.

III. THE SECOND CIRCUIT ERRED BY DRASTICALLY MISCONSTRUING THE TERM "FINANCIAL INSTITUTION."

The plain language of Section 101(22)(A), which defines "financial institution," expressly provides that a "customer" qualifies as a financial institution when a bank or trust company "*is acting as agent or custodian*" for that customer. 11 U.S.C. §101(22)(A) (emphasis added). Here, CTC never acted as Tribune's agent. An agency relationship requires that an agent owe fiduciary duties to its principal and act subject to the principal's control. Restatement (Third) of Agency §1.01. Here, relevant transaction documents executed between CTC and Tribune expressly disclaimed any fiduciary duties. Therefore, the parties' relationship qualified as a simple contractual relationship.[17]

The legislative history and the purpose of Section 546(e) support the conclusion that to qualify as an agent for a customer, the agent has the power to control or take charge of the customer's assets. Section 101(22)(A) states that a customer will qualify as a financial institution if a bank or trust company acts "as an agent *or custodian* for a customer." 11 U.S.C. §101(22)(A) (emphasis added). Section 101(11)

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[17] This argument was made in more detail in a related case. *See Brief for Amici Curiae Law Professors in Support of Plaintiff-Appellant*, *In re Tribune Company Fraudulent Conveyance Litigation*, 2020 WL 419555 (C.A. 2) at *22-29.

of the Code defines "custodian", in pertinent part, as a "trustee, receiver or agent . . . that is appointed or authorized to take charge of property of the debtor . . . for the purpose of general administration of such property for the benefit of the debtor's creditors." In this case, CTC could not have qualified as a "custodian" as it never acted "for the benefit of the debtor's creditors." Pursuant to the "associated-words canon" or the canon of *noscitur a sociis*:

> "[T]he meaning of particular terms in a statute may be ascertained by reference to words associated with them in the statute; and that where two . . . words of analogous meaning are employed together in a statute, they are understood to be used in their cognate sense, to express the same relations and give color and expression to each other." Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 197-98 (2012). *See also Freeman v. Quicken Loans, Inc.,* 566 U.S. 624, 635 (2012).

While Congress may have intended that Section 546(e) apply in some scenarios where a Financial Institution acts as an agent for a customer that is an undisclosed principal, this scenario is not one of them. Congress enacted Section 546(e) to address the concerns of market participants regarding systemic risk following *Seligson*. *See Merit*, 138 S. Ct. at 889-90. Here, unlike *Seligson*, the Petitioners are not attempting to bring a SLCFTA against CTC or any other Qualified Intermediary. Instead, they seek to sue the shareholders that redeemed their shares through the LBO.

IV. THIS COURT HAS GRANTED CERTIORARI IN OTHER CASES WHERE A CIRCUIT SPLIT DID NOT EXIST.

If this Court does not resolve the "financial institution" issue in this case, a circuit split will likely ensue quickly because, as mentioned above, a surge in bankruptcy filings of highly leveraged companies is expected to occur soon. Refusing to grant the Petition will undoubtedly lead to a circuit split like the one that existed before *Merit*. In the past, this Court has granted *certiorari* in the absence of a circuit split regarding such important issues. *See, e.g.*, *Klein & Co. Futures, Inc. v. Board of Trade of the City of New York, et. al,* 127 S. Ct. 2431 (2007); *Travelers Indem. Co. v. Bailey*, 557 U.S. 137, 141 (2009).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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