No. 21-1006

IN THE

Supreme Court of the United States

MARC S. KIRSCHNER,

Petitioner,

v.

DENNIS J. FITZSIMONS, 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

PETER V. MARCHETTI
Counsel of Record
ASSOCIATE PROFESSOR OF LAW
TEXAS SOUTHERN UNIVERSITY-THURGOOD MARSHALL SCHOOL OF LAW
3100 Cleburne Street
Houston, Texas 77004
(617) 270-3143
Peter_marchetti@hotmail.com
Counsel for Amici Curiae

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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") and business law, 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 bedrock principles of fraudulent transfer law and agency law, by holding that the fraudulent intent of a corporation's officers to defraud the corporation's unsecured creditors could not be imputed to that corporation under Section 548(a)(1)(A) of the Bankruptcy Code (the "Code"), when: (i) the corporation's board of directors ("BOD"):

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[1] This brief is filed with the consent of the Appellate Liaison Committee for Respondents, pursuant to the September 24, 2019, Case Management Order from the U.S. Court of Appeals for the Second Circuit (ECF No. 8, Case No. 19-3049 (2d Cir., Sept. 24, 2019)). 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.

appointed a special committee ("Special Committee") that had authorization and power to approve a leveraged buyout (an "LBO"); and (ii) the corporation's officers knew that the earning projections of the target corporation being acquired through the LBO (the "Target") were false. *In re Tribune Co. Fraudulent Conv. Litig.*, 10 F.4th 147, 160-63 (2d Cir. 2021). In so holding, the Second Circuit incorrectly affirmed the District Court' dismissal of the Trustee's[2] intentional fraudulent transfer claims, even though the Trustee alleged that Tribune's officers knew that Tribune's future earnings projections—a crucial element regarding a Target's solvency following an LBO, were false.[3]

If this Court denies the Petition, at least one disastrous consequence will undoubtedly follow—shareholders that redeem their shares through an LBO ("Redeeming Shareholders") would be immunized from an intentional fraudulent transfer action if a BOD appoints a Special Committee, even if

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[2] This brief uses the term "Trustee" interchangeably to refer to either: (i) a duly appointed bankruptcy trustee under the Code or SIPA, (ii) a debtor in possession (which has the powers of a Trustee), or (iii) a similar type of trustee of a litigation trust established by a confirmed chapter 11 plan. In the context of this brief, the Trustee is bringing an intentional fraudulent transfer action on behalf of a bankruptcy estate or on behalf of a specific group of unsecured creditors.

[3] In addition to rendering an incorrect holding regarding the imputation of the officer's knowledge to the Tribune Company, the District Court seemed to engage in pre-mature fact finding at the motion to dismiss stage, depriving the Trustee of the opportunity to conduct discovery regarding his well-pled allegations. *See In re Tribune Co. Fraudulent Conv. Litig.*, 2017 WL 82391, at *6-19 (S.D.N.Y. 2017).

the BOD or a corporate officer intentionally fails to provide that special committee with all of the pertinent information (or, even worse, provides the Special Committee with incorrect information) related to the Target's future projected earnings or financial condition. This would permit and incentivize former shareholders, including "insiders" of companies purchased through risky LBO's, to 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 along with other types of fraudulent transfers, 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 to severely curtail a Trustee's ability to assert an intentional fraudulent transfer action in this fashion.

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'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.

B. Fraudulent Transfer Law

Under the Code, a Trustee, on behalf of a bankruptcy estate, has the power to avoid or claw back, *inter alia*, intentional fraudulent transfers made by the debtor to third parties within two years prior to the debtor's bankruptcy filing. 11 USC § 548(a)(1)(A).[4] Under the Code, a Trustee may also bring an intentional fraudulent transfer action under applicable state law, which generally provides a longer look-back period, such as four years. 11 USC § 544(b).[5] Fraudulent transfer law has existed since the

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[4] Under the Code, in addition to having the ability to bring an intentional fraudulent transfer action, a Trustee may also bring a constructive fraudulent transfer action. *See* 11 U.S.C. § 548(a)(1)(B). A constructive fraudulent transfer occurs where a debtor, before filing for bankruptcy (i) transfers an asset for "less than a reasonably equivalent value;" and (ii) (a) is insolvent when it makes (or becomes insolvent as a result of) that transfer; or (b) was left with "unreasonably small capital" following that transfer. *Id.*

[5] Over the past eight years, 22 states have enacted the Uniform Voidable Transactions Act (the "UVTA"). *See* Uniform Voidable

Roman Empire. *See* Lee B. Shepard, *Beyond Moody: A Re-Examination of Unreasonably Small Capital*, 57 HASTINGS L.J. 891, 895–96 (2006). Modern fraudulent transfer law traces its roots to the Statute of Elizabeth that the English Parliament enacted in 1571. *See* Kenneth C. Kettering, *Codifying a Choice of Law Rule for Fraudulent Transfer: A Memorandum to the Uniform Law Commission*, 19 AM. BANKR. INST. L. REV. 319, 320–21 (2011) (discussing history of fraudulent transfer law).

To prevail on in intentional fraudulent transfer action, a Trustee must prove that that a debtor, within two years before the date of its bankruptcy filing, made a transfer of its property or incurred an obligation "with actual intent to hinder, delay, or defraud" its creditors either: (i) while the debtor was insolvent; or (ii) which transfer or incurrence of an obligation rendered the debtor insolvent. 11 U.S.C. § 548(a)(1)(A). An example would be a debtor gifting his, her, or their assets away to a friend or family member prior to filing for bankruptcy so that those assets would not be available to satisfy the claims of the debtor's creditors. *See, e.g.*, *Sawada v. Endo*, 561 P.2d 1291, 1293 (Haw. 1977). One of the first reported famous cases exemplifying an intentional fraudulent transfer is *Twyne's Case*, where a debtor transferred his title in a herd of sheep to a friend while simultaneously retaining control over the herd. 3 Co. Rep. 80b, 76 Eng. Rep. 809 (Star Chamber 1601); *See*

Transactions Act, Uniform Law Commission, https://www.uniformlaws.org/committees/community-home?CommunityKey=64ee1ccc-a3ae-4a5e-a18f-a5ba8206bf49. The UVTA provides for a four year look back period. *Id.*

also 5 Collier on Bankruptcy ¶ 548.04 (discussing history of fraudulent transfer law).

Intentional fraud, of course, can occur through a "myriad" of different scenarios, limited only by the imagination and creativity of the perpetrator. 5 Collier on Bankruptcy ¶ 548.04. Section 548(a)(1)(A)'s requirement of actual intent "requires proof of the debtor's subjective state of mind." *Id.* However, "a court can hardly expect one who fraudulently transfers property to step up and admit it under oath." *Id.* As it is often difficult to prove that a debtor actually intended to hinder, delay, or defraud creditors, courts generally "infer fraudulent intent from the circumstances surrounding the transfer, taking particular note of . . . the badges of fraud." *In re Acequia, Inc.*, 34 F.3d 800, 805-806 (9th Cir. 1994); *In re Kaiser*, 722 F.2d 1574, 1582 (2d Cir. 1983).

Courts have considered the following badges of fraud in the context of Section 548(a)(1)(A):

> (i) the transfer or obligation was to an insider; (ii) the debtor retained possession or control of the property transferred after the transfer; (iii) the transfer or obligation was disclosed or concealed; (iv) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with a lawsuit; (v) the transfer was 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 reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (ix) the debtor was insolvent or became insolvent within shortly after the transfer was made or the obligation was incurred; (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 Collier on Bankruptcy ¶ 548.04 (citations omitted). The existence "of a single badge of fraud may spur mere suspicion", while the existence of several badges of fraud may "constitute conclusive evidence of" an intentional fraudulent transfer. *In re Acequia, Inc.*, 34 F.3d at 805-806.

If a company files for bankruptcy within two years of the consummation of an LBO transaction, a Trustee may seek to avoid or "claw back" the payments made to the Redeeming Shareholders through an intentional fraudulent transfer action. *See* 11 U.S.C. §§ 548(a)(1)(A). A fraudulent transfer action is the main method of recourse unsecured creditors have to recover in the context of a failed LBO. To ensure that a company is solvent at the time an LBO takes place, a corporation's BOD generally obtains a solvency opinion from a reputable financial firm. *See* 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, 48-49 (2018) (discussing role of solvency opinion in LBO).

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. *Id.* Projections of the Target's future earnings form a key part of a solvency opinion. *Id.* These future earnings projections generally involve an "educated guess", based on standard factors used in the financial industry, as to the amount of the Target's earnings following the LBO. *Id.* If a corporation is truly solvent at the time an LBO is consummated, a Trustee will not be able to prevail on a fraudulent transfer action against the Redeeming Shareholders if the Target later files for bankruptcy. *See In re Lyondell Chem. Co.*, 567 B.R. 55, 62, 65-67 (Bankr. S.D.N.Y. 2017).

A corporation is an inanimate entity and can only act through its authorized agents such as its officers and directors. *McNamara v. PFS (In re The Pers. and Bus. Ins. Agency)*, 334 F.3d 239, 242-43 (3d Cir. 2003) (citations omitted) [hereinafter "*McNamara*"]. Thus, in the context of an intentional fraudulent transfer, it is necessary to determine under what circumstances the knowledge of a corporation's officers or directors can be ascribed or "imputed" to the corporation. *Id.*

C. The Second Circuit's Decision in *Tribune*

The crux of the Second Circuit's erroneous holding in *Tribune* is that the fraudulent intent of a

corporation's officers and BOD cannot be imputed to that corporation under Section 548(a)(1)(A), when those officers (or BOD) appointed a Special Committee that had the requisite authorization and power to approve the LBO. *In re Tribune Co. Fraudulent Conv. Litig.*, 10 F.4th 147, 160-63 (2d Cir. 2021). It did not matter to the Second Circuit that Tribune's officers knew that the Special Committee had been provided with false future financial projections regarding Tribune's solvency and financial condition.

Instead, the Second Circuit's distorted decision, which adopted the incorrect "control test" invented by the District Court[6], would require a Trustee to prove that the Special Committee, and not Tribune's officers or BOD, had actual fraudulent intent in connection with the LBO because the Special Committee had the authority and power to effectuate the LBO. *Id.* at 159-62. Thus, according to the Second Circuit, only the intent and knowledge of the Special Committee could be imputed to Tribune, because the Special Committee had the decision-making "control" to approve the LBO. *Id.* at 160-63. No other un-reversed reported decision has adopted such a draconian rule regarding the imputation of a corporate agent's fraudulent intent to a corporation.

According to the Second Circuit's faulty construction of the Code and agency law, BODs and corporate officers, which generally qualify as "insiders" under the Code, could shield transferees

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[6] *See In re Tribune Co. Fraudulent Conv. Litig.*, 2017 WL 82391, at *6-11 (S.D.N.Y. 2017).

(including themselves) from blatant intentional fraudulent transfers by simply: (i) appointing a special committee with authority and power to approve a corporate transaction that benefits a transferee (or group of transferees) at the expense of a company's creditors; and (ii) deliberately make material misrepresentations to (or deliberately conceal material information from) that special committee regarding the company's solvency following the transaction. Examples of such transactions are risky LBO's, as occurred in this case, or the payment of corporate "bonus" payments to insiders that are made while a company is insolvent, or which could render a company insolvent.

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. Namely, it would make it virtually impossible for a Trustee in the nation's epicenter that hosts the vast majority of the nation's large chapter 11 corporate bankruptcy filings[7] to ever bring an intentional fraudulent transfer action against Redeeming

[7] The majority of corporate bankruptcy filings 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.

Shareholders that participated in a risky LBO. Under the Second Circuit's decision, Redeeming Shareholders would be immunized from an intentional fraudulent transfer action even if the debtor's officers possessed fraudulent intent, so long as the debtor's BOD simply appointed a special committee that possessed the power to approve the LBO but was not privy to all of the material information regarding the debtor's financial condition known by the debtor's officers. This result is particularly troublesome in current times. LBO's and similar transactions have recently reached a 13-year peak.[8] Moreover, higher interest rates coupled with inflation will likely lead to a wave of corporate bankruptcy filings in 2022.[9]

LBO's involve substantial "bankruptcy risk" because after an LBO is consummated, the Target is burdened with significant debt and is simultaneously depleted of cash, as that cash is used to pay the Redeeming Shareholders. *See Mellon Bank, N.A. v. Metro Communications, Inc.*, 945 F.2d 635, 645–46 (3d Cir. 1991). An LBO may especially weaken a Target's ability to pay existing and future unsecured creditors if the Target experiences a "temporary financial storm" following the LBO. *Id.* at 646-48.

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[8] *See* Miriam Gottfried, *Buyout Boom Gains Steam in Record Year for Private Equity*, THE WALL STREET JOURNAL (Nov. 28, 2021), available at https://www.wsj.com/articles/buyout-boom-gains-steam-in-record-year-for-private-equity-11638095402.

[9] *See* Vincent Ryan, *Stimulus Programs, Lender Generosity Keeping Bankruptcies at Bay*, CFO (Oct. 12, 2021), available at https://www.cfo.com/bankruptcy/2021/10/stimulus-programs-lender-generosity-keeping-bankruptcies-at-bay/.

As mentioned above, in virtually every LBO, a company obtains a solvency opinion from a reputable financial firm stating that the Target will be solvent following the consummation of the LBO. The use of future earnings projections and similar financial information regarding the financial status of the Target following the LBO are crucial factors in the preparation of a solvency opinion.

If this Court denies the Petition, corporate insiders could launder the risk associated with an intentional fraudulent transfer action simply by: (i) appointing a Special Committee to approve the controversial transaction at issue; and (ii) concealing the information relating the fraudulent nature of the transaction from the Special Committee. Such a result would not only lead to the proliferation of risky and disastrous LBO's and other types of intentional fraudulent transfers—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 also encourage large banks to aid and abet corporate looters in risky LBO's, as such banks could handsomely profit by collecting large structuring fees along with other fees and interest associated with LBO's. *See* 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, 49-50 (2018). If the Target later files for bankruptcy, those banks will be secured creditors with collateral available to

satisfy their claims, and can even earn additional fees and interest by making the debtor a debtor-in-possession loan. *Id.* Congress did not intend to severely limit the ability of a Trustee to bring an intentional fraudulent transfer to incentivize these types of results.

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, even though Tribune's officers, who ultimately cashed out their shares through the LBO, prepared sham future earnings projections, two well-known financial firms refused to issue a solvency opinion for Tribune's LBO. *See In re Tribune Co. Fraudulent Conv. Litig.*, 2019 WL 294807 at *3 to *6 (S.D.N.Y. 2019). 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. Tribune's officer's made misrepresentations to VRC regarding Tribune's financial condition. Namely, they falsely represented that Morgan Stanley, the financial advisor to the Special Committee, stated that Tribune would be solvent after the LBO. Morgan Stanley made no such statement. Furthermore, VRC used an unconventional valuation definition in its solvency opinion and charged the "highest fee it had ever charged for a solvency opinion." *Id.* at *5-6. These actions by Tribune's insiders fall under several badges of fraud, and are precisely the type of actions that

exemplify actual fraudulent intent to effectuate an intentional fraudulent transfer under Section 548(a)(1)(A).

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 activist shareholders would essentially 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. Moreover, if the decision below is not reversed, LBO's are not the only types of fraudulent transfers crafty corporate insiders could perpetrate to unjustly enrich themselves and other shareholders at the expense of general unsecured creditors.[10]

Indeed, if the decision below is not reversed, it may encourage corporate insiders to siphon substantial sums of money that would otherwise be available to pay a company's creditors by: (i) simply hiring a Special Committee to approve large corporate bonuses that will be made while a company is insolvent (or that will render the company insolvent); and (ii) providing that Special Committee with false information (or by wrongfully failing to disclose material information to that Special Committee) regarding the company's solvency. These are precisely the types of intentional fraudulent

[10] *See* William T. Vukowich, *Civil Remedies in Bankruptcy for Corporate Fraud*, 6 AM. BANKR. INST. L. REV. 439, 444 (1998) (discussing fraudulent transfers to corporate insiders).

transactions Congress empowered a Trustee to avoid through Section 548(a)(1)(A).

In such a situation, if a corporation later files for bankruptcy, under the Second Circuit's holding below, a Trustee would not be able to recover those bonus payments as intentional fraudulent transfers because the special committee, not the corporate officer or BOD, had ultimate "control" over the transaction. Likewise, under the Second Circuit's holding, officers and BOD's could immunize various other types of intentional fraudulent transfers from a Trustee's avoidance power by simply appointing a misinformed special committee to approve the transaction at issue. The universe of such fraudulent transfers would be limited only to the craftiness and imagination of corporate fraudsters.

Finally, the Second Circuit's decision would allow corporate insiders to circumvent core policies of corporate law and bankruptcy law such as the "Deep Rock" doctrine[11] and the absolute priority rule[12],

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[11] *See* James D. Cox & Thomas L. Hazen, *Treatise on the Law of Corporations* § 7:19 (3d ed. 2020) (discussing "Deep Rock" doctrine). Under the "Deep Rock" doctrine, claims of a corporation's shareholders are subordinated to the claims of creditors against an insolvent corporation. *Id.*

[12] *See* 11 U.S.C. §§ 726(a), 1129(b)(2)(B)(ii); *Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 119 S. Ct. 1411, 1415–1417 (1999). Pursuant to the absolute priority rule, a bankrupt corporation's unsecured creditors must be paid in full before that corporation's shareholders may receive any payment, unless: (i) the unsecured creditors consent otherwise; or (ii) the debtor's shareholders provide "new value" to the debtor's bankruptcy estate. *See* George H. Singer, *Supreme Court Clarifies "New*

which dictate that unsecured creditors of an insolvent corporation have priority over shareholders and must be paid in full before an insolvent corporation can make any distributions to its shareholders. By severely limiting a Trustee's ability to impute an officer's or director's fraudulent intent to a company in the context of intentional fraudulent transfers, corporate insiders could simply appoint a special committee that is either uninformed or deliberately misinformed to approve an LBO of (or similar intentionally fraudulent transfer involving) a company that is either insolvent or on the verge of insolvency. The net effect of such a transaction would allow shareholders to completely circumvent the deep rock doctrine and the absolute priority rule by allowing those shareholders to profit while the corporation's unsecured creditors are proverbially left "holding the bag."

II. THE SECOND CIRCUIT DRASTICALLY MISCONSTRUED THE LAW REGARDING THE IMPUTATION OF FRAUDULENT INTENT TO A CORORATION.

The Second noted that a "corporation can only act through its [authorized] directors and officers". *In Re Tribune Co. Fraudulent Conv. Litig.*, 10 F.4th at 160-61. Then, the Second Circuit looked to Delaware law, where Tribune was incorporated, to determine which parties had the power to act on behalf of Tribune with respect to the LBO. *Id.* The Second Circuit noted

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Value Exception" to Absolute Priority Rule - Or Does It?, 8 AM. BANKR. INST. J., Aug. 1999 at 31, 32.

that, pursuant to Delaware Law, "only the board of directors (or a committee to which the board has delegated its authority) had the power to approve [an LBO]". *Id.*

Then, the Second Circuit proceeded down a mistaken path by holding that the law requires the Trustee to prove that the Special Committee, and not Tribune's officers or BOD, had actual fraudulent intent in connection with the LBO because the Special Committee, not Tribune's officers, had the authority and power to effectuate the LBO. *Id.* at 159-62. In so ruling, the Second Circuit adopted the novel and erroneous "control test" invented by the District Court for imputation of a corporate agent's knowledge to a corporation. *Id.* Neither federal common law nor Delaware law applies this "control test" in the context of intentional fraudulent transfer actions. To the contrary, in the context of intentional fraudulent transfers, most courts impute the knowledge and intent of a corporation's officers or BOD to the corporation itself.[13]

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[13] See, *e.g.*, *In re Lyondell Chem. Co.*, 554 B.R. 635, 647 (S.D.N.Y. 2016) (applying the "general rule of imputation" that "the knowledge and actions of the corporation's officers and directors, acting within the scope of their authority, are imputed to the corporation itself"); *In re James River Coal Co.*, 360 B.R. 139, 161 (Bankr. E.D. Va. 2007) (holding that "the intent of the officers and directors may be imputed to the corporation"); *In re Blazo Corp.*, No. 93-62658, 1994 WL 92405, at *4 (Bankr. N.D. Ohio Feb. 25, 1994) (holding that because debtor's president was "acting within the scope of his authority," his "knowledge can be imputed to" the debtor).

In reaching its erroneous conclusion, the Second Circuit, like the District Court, improperly relied on the First Circuit's decision in *Consove v. Cohen* (*In re Roco Corp*.), 701 F.2d 978, 984 (1st Cir. 1983) [hereinafter "*Roco*"]. In doing so, the Court stated: "a court 'may impute any fraudulent intent [of an actor] to the transferor . . . [if the actor' was in a position to control the disposition of [the transferor's] property.'" *In Re: Tribune Co. Fraudulent Conv. Litig.*, 10 F.4th at 160-161.

The control test enunciated by the Second Circuit disregards and conflicts with common law agency principles that federal courts have consistently and traditionally applied. *Meyer v. Holley*, 537 U.S. 280, 285 (2003). In *Meyer*, this Court explained "when Congress creates a tort action, it legislates against a legal background of ordinary tort-related vicarious liability rules on consequently intends its legislation to incorporate those rules." *Id.* In the corporate context, federal courts have traditionally held that corporations are vicariously liable for the acts of their employees. *Id.* One bedrock principal of vicarious liability is that corporations "can be guilty of 'knowing' or "willful" violations of regulatory statutes through the doctrine of respondeat superior." *United States v. A&P Trucking Co.*, 358 U.S. 121, 125 (1958).

Indeed, as this Court has noted in a case interpreting the Uniformed Services Employment and Reemployment Rights Act of 1994 ("USERRA")—a supervisor's intent could be imputed to a corporation if the supervisor acted with intent "to cause an adverse employment action", even if the supervisor

lacked ultimate "control" over the employment decision at issue. *Staub v. Proctor Hospital*, 562 U.S. 411, 417-418 (2011). Thus, under common law agency principles traditionally espoused by federal courts, the knowledge of Tribune's officers regarding the intentional fraudulent transfers to the Redeeming Shareholders should be imputed to Tribune, even though those officers technically did not have ultimate decision-making power, or "control", over the LBO.

Secondly, the Second Circuit misapplied the holding in *Roco* to the facts of this case. In *Roco*, the First Circuit considered a situation in which a court could impute the intent of a *transferee* of an alleged intentional fraudulent transfer to a corporation. *Roco*, 701 F.2d at 984. It did not, however, consider a situation in which a court imputed the intent of a corporate officer to a corporate *transferor* in the context of an intentional fraudulent transfer.[14] The Second Circuit's decision, therefore, is a very significant, overly broad, and novel expansion of the holding in *Roco*.

Similarly, the facts involved in *Roco* are readily distinguishable from the facts of *Tribune*. *Roco* involved a small closely held corporation with only one shareholder, who was also the sole officer of Roco

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[14] In *Roco*, the transferee, Edward Consove ("Consove") was the former sole shareholder, officer, and director of the transferor—Roco Corporation. *Consove v. Cohen (In re Roco Corp.), 701 F.2d 978, 980-82, 984 (1st Cir. 1983)*, 701 F.2d 978, 980-82, 984 (1st Cir. 1983). Around the time of the alleged fraudulent transfer, however, it was "unclear under what authority Consove regained control [of Roco Corporation]." *Id* at 980 n. 4.

Corporation, and sole member of Roco Corporation's BOD—Consove. *Roco* at 980-82, 984. *Tribune*, on the other hand, was a large publicly traded corporation with a complex capital structure, thousands of shareholders, and different tranches of debt. Rufus T. Dorsey & Matthew M. Weiss, *Third Circuit's Warning Shot to Senior Creditors In In Re Tribune*, 39 AM. BANKR. INST. J. 14, 14-15 (Dec. 2020).

Likewise, *Roco* did not involve a complex multibillion-dollar LBO and ensuing complex chapter 11 bankruptcy case, while *Tribune* did. *Compare Roco*, 701 F.2d at 980-92, 984 with *In Re Tribune Co. Fraudulent Conv. Litig.*, 10 F.4th at 156-158. Indeed, in *Roco*, the alleged fraudulent transfer(s) resulted from an alleged simple scheme through which Consove siphoned funds to himself from the debtor, which eventually led to Roco Corporation being placed in an involuntary chapter 7 bankruptcy proceeding. The difference "between a functioning board and a closely held corporation without a functioning board . . . and the requirement that [a] Trustee demonstrate [a corporate officer's] control [over the Target's BOD] . . . have no basis in Delaware agency law." *In re Lyondell*, 554 B.R. 635, 649 (S.D.N.Y. 2016).

Furthermore, contrary to Second Circuit's holding, it is a bedrock principle of Delaware law "that the knowledge and actions of a corporation's officers and directors, acting within the scope of their employment, are imputed to the corporation itself." *Stewart v. Wilmington Tr. SP Servs., Inc.*, 112 A.3d 271, 302-03 (Del.Ch. 2015). This "rule of imputation" dictates that a corporation is deemed to possess the

knowledge of its officers and directors "even when [an officer or director] acts fraudulently or causes injury to third persons through illegal conduct." *Id.* at 303. Although it may seem severe to require a "corporation (and, ultimately, its stockholders) to answer for the bad acts of its [officers or directors], such corporate liability is essential for the continued tolerance of the corporate form, as any other result would lack integrity." *Id.*

The underlying policy for this rule of imputation is to establish "strong incentives for principles to design and implement effective systems through which agents handle and report information." *Hecksher v. Fairwinds Baptist Church, Inc.*, 115 A.3d 1187, 1205 (Del. 2015) (quoting Restatement (Third) of Agency §5.03, cmt. b (2006)). As a result, "[a]n employee's knowledge can be imputed to her employer if she becomes aware of the knowledge while she is in the scope of employment . . ." *Hecksher*, 115 A.3d at 1200-01 (citation omitted). Indeed, when officers and directors perform "everyday activities central to any company's operation and well-being—such issuing financial statements, accessing capital markets, . . . moving assets between corporate entities, and entering into contracts—their conduct falls within the scope of their corporate authority." *Kirschner v. KPMG LLP*, 15 N.Y.3d 446, 465-66 (2010).

Furthermore, the Second Circuit, in attempting to interpret Section 141 of the Title 8 of the Delaware Code, glossed over an important portion of the statute. Section 141(e) of that statute addresses special committees and "experts" retained by a corporation's

BOD. *See* Del. Code Ann. tit. 8, § 141(e) (emphasis added). The purpose of Section 141(e) is to protect corporate BOD members who, in a quest to be fully informed of all the reasonably available relevant material regarding a particular corporate transaction, rely in *good faith* on a report prepared by, *inter alia*, a special committee that the BOD chose with reasonable care. *Id.* (emphasis added). *See also* Lee Harris, *Cases and Materials on Corporations and Other Business Entities: A Practical Approach* at 251. Its purpose is not to permit officers or directors to perpetrate fraud by appointing a special committee to approve a fraudulent transaction while either providing material misinformation to, or withholding material information from, that special committee.

III. THE SECOND CIRCUIT'S DECISION RESULTS IN A SPLIT WITH THE THIRD CIRCUIT.

The Second Circuit's decision conflicts with a decision of the Third Circuit, which stated that, for purposes of an intentional fraudulent transfer action under Section 548(a)(1)(A), "the fraud of an officer of a corporation is imputed to the corporation when the officer's fraudulent conduct was . . . in the course of his employment . . ." *McNamara*, 334 F.3d at 242-43 (3d Cir. 2003) (citation omitted).[15] Most large

[15] In *McNamara*, the Third Circuit cited its previous holding in *Rochez Bros., Inc. v. Rhoades*, 527 F2d. 880, 884 (3d. Cir. 1975) for this proposition. *See also Waslow v. Grant Thornton L.L.P.*

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 the appropriate test regarding the imputation of a corporate officer's or board member's intent to a corporation in the context of an intentional fraudulent transfer action is an issue that could soon arise in many bankruptcy cases, and is a crucial issue in need of resolution.

(In re Jack Greenberg, Inc.), 212 B.R. 76, 83 (Bankr. E.D.Pa. 1997) (citing *McNamara*).

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

PETER V. MARCHETTI
ASSOCIATE PROFESSOR OF LAW
TEXAS SOUTHERN UNIVERSITY-
THURGOOD MARSHALL SCHOOL OF LAW
3100 Cleburne Street
Houston, TX 77004
(617) 270-3143
peter_marchetti@hotmail.com

Attorney for Amici Curiae Law Professors

February 14, 2022

APPENDIX

APPENDIX

Ralph Brubaker
James H.M. Sprayregen Professor of Law
University of Illinois College of Law

David Hague
Professor of Law and Associate Dean for Administration
St. Mary's University School of Law

John Patrick Hunt
Professor of Law & Martin Luther King, Jr. Research Scholar
University of California, Davis School of Law (King Hall)

Stephen J. Lubben
Harvey Washington Wiley Chair in Corporate Governance & Business Ethics
Seton Hall University School of Law

Peter V. Marchetti
Associate Professor of Law
Thurgood Marshall School of Law-Texas Southern University

Ronald Mann
Albert E. Cinelli Enterprise Professor of Law
Columbia Law School

Bruce A. Markell
Professor of Bankruptcy Law and Practice
Northwestern University Pritzker School of Law

Stephen Michael McJohn
Professor of Law
Suffolk University Law School

Charles W. Mooney, Jr.
Charles A. Heimbold, Jr. Professor of Law, Emeritus
University of Pennsylvania Carey Law School

William T. Vukowich
Professor Emeritus
Georgetown University Law Center