FEDERAL PREEMPTION OF STATE CONSTRUCTIVE FRAUDULENT TRANSFER LAW APPLIED TO FINANCIAL INSTITUTIONS SERVING AS CONDUITS IN THE TRIBUNE COMPANY CASE

By David S. Kupetz[*]

I. Introduction

In *Deutsche Bank Trust Co. v. McCormick (In re Tribune Co. Fraudulent Conveyance Litig.)*,[1] the Second Circuit Court of Appeals stated that "[o]nce a party enters bankruptcy, the Bankruptcy Code constitutes a wholesale preemption of state laws regarding creditors' rights."[2] This conclusion appears to be at odds with U.S. Supreme Court precedent.[3] Upon the commencement of a bankruptcy case, the automatic stay set forth in Bankruptcy Code Section 362 does put a hold on, among other things, actions and proceedings against the debtor, the enforcement of pre-bankruptcy claims and judgments, and any act obtain possession of or exercise control

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[1]*In re Tribune Co. Fraudulent Conveyance Litigation*, 818 F.3d 98 (2d Cir. 2016) ("Tribune"), petition for certiorari filed September 9, 2016 (Doc. No. 6907).

[2]Tribune, 818 F.3d at 111.

[3]See, e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994); *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986); *Butner v. U.S.*, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

over property of the estate.[4] The automatic stay, however, is not an express preemption clause.[5] Moreover, where an express preemption clause is not present, the Supreme Court has applied the general presumption against preemption in the bankruptcy context.[6] The broad application of implied preemption of state law in *Tribune* raises concerns that the conventional presumption has been jettisoned by the Second Circuit.

Bankruptcy Code Section 546(e) provides a safe harbor for certain transferees of constructive fraudulent transfers.[7] The courts of appeals have ruled inconsistently on whether section 546(e) applies to intermediaries merely serving as conduits. Four circuits, including the Second Circuit in *Tribune*, have held that financial institutions serving simply as conduits are protected by the safe harbor.[8] In contrast, the

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[4] See 11 U.S.C.A. § 362(a).

[5] In contrast, in *Puerto Rico v. Franklin California Tax-Free Trust*, 136 S. Ct. 1938, 1946, 195 L. Ed. 2d 298, 62 Bankr. Ct. Dec. (CRR) 185, 75 Collier Bankr. Cas. 2d (MB) 1318, Bankr. L. Rep. (CCH) P 82951 (2016), the Supreme Court declined to apply the presumption against preemption, holding that the plain text of the Bankruptcy Code included a specific preemption provision that precluded Puerto Rico from enacting its own municipal bankruptcy scheme. The Supreme Court stated:

> The plain text of the Bankruptcy Code begins and ends our analysis.
>
> Resolving whether Puerto Rico is a "State" for purposes of the pre-emption provision begins "with the language of the statute itself," and that "is also where the inquiry should end," for "the statute's language is plain." . . .
>
> And because the statute "contains an express pre-emption clause," we do not invoke any presumption against pre-emption but instead "focus on the plain wording of the clause, which necessarily contains the best evidence of Congress' pre-emptive intent."

(citation omitted).

[6] In *BFP*, while the Supreme Court recognized that "[t]he Bankruptcy Code can of course override [state law] by implication," clear intent is required: "[W]here [Congress's] intent to override is doubtful, our federal system demands deference to long-standing established traditions of state regulation." BFP, 511 U.S. at 546.

[7] See 11 U.S.C.A. § 546(e).

[8] In addition to the Second Circuit (in Tribune and in *In re Quebecor World (USA) Inc.*, 719 F.3d 94, 58 Bankr. Ct. Dec. (CRR) 12, 69 Collier Bankr. Cas. 2d (MB) 1253, Bankr. L. Rep. (CCH) P 82505 (2d Cir. 2013)), the courts of appeal applying the safe harbor protection to conduits include the Third Circuit (*In re Resorts Intern., Inc.*, 181 F.3d 505, 516, 34 Bankr. Ct. Dec. (CRR) 736, Bankr. L. Rep. (CCH) P 77952 (3d Cir. 1999)), the Sixth

Seventh and Eleventh Circuits have held that the safe harbor protection only applies when the financial institution is the debtor or transferee or otherwise obtains a beneficial interest in the funds.[9] *Tribune* further entrenches the conflict between the circuits. The *Tribune* court does not question prior Second Circuit precedent providing that recipients of constructive fraudulent transfers can be shielded from claw back simply by structuring the transaction so that payment passes through a financial institution.

In *Tribune*, the Second Circuit, focusing on the words in the safe harbor statute, stated that "the language of Section 546(e) does not exempt from its protection payments by firms to intermediaries to fund ensuing payments to shareholders."[10] At the same time, the *Tribune* court determined that it would not be constrained by the plain language of the safe harbor statute limiting its scope to actions brought by a trustee.[11] Instead, it inferred that section 546(e) impliedly preempted state law.

II. Background of Constructive Fraudulent Transfer Claims Asserted in Connection with the Tribune Company Case Against Financial Institutions Serving as Conduits

In 2007, Tribune Media Company, a multimedia enterprise, was under financial stress, suffering declining revenues, profitability, and stock value.[12] Tribune's board approved a

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Circuit (*In re QSI Holdings, Inc.*, 571 F.3d 545, 551, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009)), the *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 987, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009)), and the Tenth Circuit (*In re Kaiser Steel Corp.*, 952 F.2d 1230, 1240, 26 Collier Bankr. Cas. 2d (MB) 443, Bankr. L. Rep. (CCH) P 74387 (10th Cir. 1991)).

[9] See *Matter of Munford, Inc.*, 98 F.3d 604, 36 Collier Bankr. Cas. 2d (MB) 1673 (11th Cir. 1996)and *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690, 62 Bankr. Ct. Dec. (CRR) 250, 75 Collier Bankr. Cas. 2d (MB) 1855, Bankr. L. Rep. (CCH) P 82972 (7th Cir. 2016), cert. granted, 137 S. Ct. 2092, 197 L. Ed. 2d 894 (2017).

[10] Tribune, 818 F.3d at 122.

[11] Tribune, 818 F.3d at 109.

[12] "Prior to its bankruptcy in 2008, Tribune was 'America's largest media and entertainment company,' owning numerous radio and television stations and major newspapers, including the Chicago Tribune and the Los Angeles Times." Kirschner v. Fitzsimons (In re Tribune Co. Fraudulent

leveraged buyout ("LBO") in April 2007.[13] Billionaire Sam Zell acquired Tribune through the LBO. The LBO involved Tribune borrowing more than $11 billion secured by its assets. Combined with a $350 million equity contribution by Zell, the $11 billion plus in borrowed funds was used to refinance some of Tribune's pre-existing bank debt and to buy out its shareholders for more than $8 billion at a premium to market price. "It is undisputed that Tribune transferred the over $8 billion to a 'securities clearing agency' or other 'financial institution,' . . . acting as intermediaries in the LBO transaction. Those intermediaries in turn paid the funds to the shareholders in exchange for their shares that were then returned to Tribune."[14]

Within a year after the LBO was consummated, Tribune commenced a chapter 11 bankruptcy case. At the time of the commencement of its case, Tribune's debt and contingent liabilities exceeded its asset value by more than $3 billion. During the chapter 11 case, Tribune continued to manage and operate its businesses as a debtor in possession.[15] An Official Committee of Unsecured Creditors (the "Committee") was appointed to represent the interests of unsecured creditors.[16] In November 2010, pursuant to bankruptcy court authorization, the Committee brought an action (the "Committee Action") to recover intentional fraudulent transfers "against the cashed out Tribune shareholders, various officers, directors, financial advisors, Zell, and others alleged to have benefitted from the LBO."[17] The Committee Action was brought pursuant to Bankruptcy Code Section 548(a)(1)(A) to avoid and recover

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Conveyance Litig.), 2017 U.S. Dist. LEXIS 3039, *2 (S.D.N.Y. 2017) (citation omitted).

[13] As the Second Circuit explained, "[i]n a typical LBO, a target company is acquired with a significant portion of the purchase price being paid through a loan secured by the target company's assets." Tribune, 818 F.3d at 105 n.1.

[14] Tribune, 818 F.3d at 106.

[15] A debtor in possession has essentially all of the rights, powers, and duties of a bankruptcy trustee. See 11 U.S.C.A. § 1107(a) ("Subject to any limitations on a trustee . . . a debtor in possession shall have all the rights . . ., and powers, and shall perform all the functions and duties . . . of a trustee . . .").

[16] Tribune, 818 F.3d at 106.

[17] Tribune, 818 F.3d at 106.

payments made with actual intent to hinder, delay, or defraud creditors.[18]

Separate from the Committee Action, groups of unsecured creditors requested bankruptcy court relief from the automatic stay to bring state law claims against Tribune shareholders outside of the bankruptcy case.[19] Court authorization having been obtained, suits were brought in various state and federal courts alleging that through the LBO Tribune shareholders received constructive fraudulent transfers.[20] The lawsuits were later consolidated into a single multidistrict litigation proceeding that was transferred to the Southern District of New York.[21]

In 2012, the bankruptcy court confirmed Tribune's reorganization plan (the "Plan"). The Plan provided for payment to Retiree and Noteholder unsecured creditors of approximately 33 cents on each dollar of debt. Under the Plan, the Committee was terminated and responsibility for pursuing the Committee Action seeking avoidance and recovery of intentional fraudulent transfers was assigned to the Litigation Trust established by the Plan. The Plan also provided that the state law constructive fraudulent transfer claims could continue to be prosecuted by the plaintiffs in the multidistrict litigation. The Plan specifically authorized pursuit of " 'any and all LBO-Related Causes of Action arising under state fraudulent conveyance law,' except for the federal intentional fraudulent

[18] See 11 U.S.C.A. § 548(a)(1)(A).

[19] The Second Circuit described these subsets of unsecured creditors as "(i) the Retire Appellants, former Tribune employees who hold claims for unpaid retirement benefits and (ii) the Noteholder Appellants, the successor indenture trustees for Tribune's pre-LBO senior notes and subordinated debentures." Tribune, 818 F.3d at 106.

[20] "A constructive fraudulent conveyance is, generally, a transfer for less than reasonably equivalent value made when the debtor was insolvent or was rendered so by the transfer." Tribune, 818 F.3d at 106, citing *Picard v. Fairfield Greenwich Ltd.*, 762 F.3d 199, 208–09, 59 Bankr. Ct. Dec. (CRR) 247, 72 Collier Bankr. Cas. 2d (MB) 87, Bankr. L. Rep. (CCH) P 82679 (2d Cir. 2014).

[21] See *In re Tribune Co. Fraudulent Conveyance Litigation*, 831 F. Supp. 2d 1371 (U.S.J.P.M.L. 2011).

conveyance and other LBO-related claims pursued by the Litigation Trust."[22]

After consolidation of the constructive fraudulent transfer actions in the district court, the *Tribune* shareholders file a motion to dismiss the actions. "The district court granted the motion on the ground that the Bankruptcy Code's automatic stay provision deprived appellants of statutory standing to pursue their claims so long as the Litigation Trustee was pursuing the avoidance of the same transfers, albeit under a different legal theory . . . The court held that the bankruptcy court had only 'conditionally lifted the stay.' "[23]

The district court, however, rejected the argument of the *Tribune* shareholders that Section 546(e) preempted the constructive fraudulent transfer claims. "The district court held that Section 546(e) did not bar appellants' actions because: (i) Section 546(e)'s prohibition on avoiding the designated transfers applied only to a bankruptcy trustee . . .; and (ii) Congress had declined to extend Section 546(e) to state law, fraudulent conveyance claims brought by creditors."[24]

The unsecured creditors pursuing the constructive state law fraudulent transfer claims appealed to the Second Circuit. They sought to satisfy Tribune's outstanding debt to them by clawing back Tribune's payment to the shareholders. They did not seek recovery from the financial institutions acting as intermediaries.[25]

The Second Circuit described the two issues that it would address on appeal as follows: "(i) whether appellants are barred by the Bankruptcy Code's automatic stay provision from bringing state law, constructive fraudulent conveyance claims while avoidance proceedings against the same transfers brought by a party exercising the powers of the bankruptcy trustee on an intentional fraud theory are ongoing; and (ii) if not, whether the creditors' state law, constructive

[22]Tribune, 818 F.3d at 107.

[23]Tribune, 818 F.3d at 107, citing *In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310, 314, 58 Bankr. Ct. Dec. (CRR) 134 (S.D. N.Y. 2013).

[24]Tribune, 818 F.3d at 107–108, citing In re Tribune Co. Fraudulent Conveyance Litig.,499 B.R. at 315–18.

[25]Tribune, 818 F.3d at 106.

fraudulent conveyance claims are preempted by Bankruptcy Code Section 546(e)."[26]

As discussed below, the Second Circuit made short shrift of the first issue and rejected the district court's basis for granting dismissal. However, unlike the district court, the Second Circuit found that preemption applied and that, accordingly, the district court had reached the right conclusion. Moreover, because the issue had previously been addressed by the Second Circuit, neither the district court nor the Second Circuit[27] considered whether the scope of section 546(e) includes protecting the *Tribune* shareholders when the financial institutions only served as conduits for the payments made to the shareholders in connection with the LBO.

III. Safe Harbor of Bankruptcy Code Section 546(e)

Section 546(e) of the Bankruptcy Code "provides a safe harbor protecting certain transfers from being undone by the bankruptcy trustee."[28] Section 546(e), in pertinent part with respect to the *Tribune* case, provides:

> Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a commodity broker, forward contract merchant, stockbroker, financial institution, financial participant, or securities clearing agency, . . . that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.[29]

The *Tribune* court explained that, in general, section 546(e) "shields from avoidance proceedings brought by a bankruptcy trustee transfers by or to financial intermediaries effectuating settlement payments in securities transactions or made in connection with a securities contract, except through an intentional fraudulent conveyance claim."[30] Intentional fraudulent transfers pursued pursuant to Bankruptcy Code Section 548(a)(1)(A) are excluded from the safe harbor protection.

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[26] Tribune, 818 F.3d at 98.

[27] *In re Quebecor World (USA) Inc.*, 719 F.3d 94, 58 Bankr. Ct. Dec. (CRR) 12, 69 Collier Bankr. Cas. 2d (MB) 1253, Bankr. L. Rep. (CCH) P 82505 (2d Cir. 2013).

[28] FTI Consulting, Inc. v. Merit Mgmt. Grp., LP, 830 F.3d at 691.

[29] 11 U.S.C.A. § 546(e).

[30] Tribune, 818 F.3d at 105.

There is a long history of states empowering creditors to claw back fraudulent transfers made by debtors.[31] Avoidable fraudulent transfers take two forms: intentional (where there was "actual intent to hinder, delay, or defraud") and constructive (where the transfer was not for "reasonably equivalent value" and the transferor was insolvent or rendered insolvent as a result of the transfer).[32]

While creditors are free to prosecute fraudulent transfer claims on their own outside of bankruptcy, the commencement of a bankruptcy case results in an automatic stay so that the estate's trustee can decide whether to pursue fraudulent transfer claims for the benefit of the entire estate.[33] The *Tribune* court stated that "[a]lthough fraudulent conveyance actions are against third parties rather than a debtor, there is case law, . . . stating that the automatic stay applies to such actions."[34] The *Tribune* court concluded that the automatic stay of section 362 did not bar the constructive fraudulent transfer claims at issue. The Second Circuit recognized that the bankruptcy court has the power to grant relief from the automatic stay and that a creditor who obtains relief from the automatic stay may pursue its claims outside of the bankruptcy case.[35] In this regard, the Second Circuit, in *Tribune*, stated that "under both the bankruptcy court's orders and the confirmed reorganization plan, if appellants had actionable state law, constructive fraudulent conveyance claims, assertion of those claims was no longer subject to Section 362's automatic stay."[36]

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[31] See *Peters v. Bain*, 133 U.S. 670, 685, 10 S. Ct. 354, 33 L. Ed. 696 (1890) ("The statute of Elizabeth (chapter 5) against fraudulent conveyances has been universally adopted in American law as the basis of our jurisprudence on that subject, . . . and reenacted in terms, or nearly so, or with some change of language, by the legislatures of the several States.").

[32] See, e.g., Uniform Fraudulent Transfer Act § 4.

[33] The automatic stay is set forth in 11 U.S.C.A. § 362(a).

[34] Tribune, 818 F.3d at 108 (footnote omitted), citing *In re Colonial Realty Co.*, 980 F.2d 125, 131, 23 Bankr. Ct. Dec. (CRR) 1143, 28 Collier Bankr. Cas. 2d (MB) 28, Bankr. L. Rep. (CCH) P 75283 (2d Cir. 1992).

[35] Tribune, 818 F.3d at 108–109.

[36] Tribune, 818 F.3d at 109.

Bankruptcy Code Section 544(b) empowers a trustee[37] to avoid "any transfer of an interest of a debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim."[38] "Applicable law" under section 544(b) is state fraudulent transfer law. The bankruptcy code supplements creditors' state-law fraudulent transfer causes of action empowering bankruptcy trustees with independent federal intentional and constructive fraudulent transfer avoidance powers.[39] Under Bankruptcy Code Section 548(a)(1)(A), intentional fraudulent transfers can be avoided.[40] Pursuant to Bankruptcy Code Section 548(a)(1)(B), constructive fraudulent transfers can be clawed back.[41] As pertinent in the *Tribune* case, section 546(e) imposes statutory limitations on avoidance powers involving constructive fraudulent transfers in the context of a bankruptcy case.

Section 546(e) precludes the trustee from using either section 544 or section 548(a)(1)(B) to avoid a transfer as a constructive fraudulent transfer if the transfer is a "settlement payment" made by or to specified categories of financial institutions.[42] The Second Circuit stated:

> Section 546(e) . . . expressly prohibits trustees . . . from using their Section 544(b) avoidance powers and (generally) Section 548 against the transfers specified in Section 546(e). However, Section 546(e) creates an exception to that prohibition for claims brought by the trustee . . . under Section 548(a)(1)(A) that . . . establishes a federal avoidance claim to be brought by a trustee . . . based on an intentional fraud theory. . . . [T]he Litigation Trust has brought a Section 548(a)(1)(A) claim

[37] In chapter 11 cases, the "trustee" is actually a debtor in possession, unless the court specifically appoints a trustee. Bankruptcy Code Section 1101(1) provides that a "debtor in possession" means the debtor, except when a trustee has been appointed in a case. 11 U.S.C.A. § 1101(1). Bankruptcy code section 1107(a) provides that a debtor in possession generally has all of the rights, powers, and duties of a trustee in a chapter 11 case. 11 U.S.C.A. § 1107(a).

[38] 11 U.S.C.A. § 544(b)(1). See Tribune, 818 F.3d at 112.

[39] Tribune, 818 F.3d at 112.

[40] 11 U.S.C.A. § 548(a)(1)(A).

[41] 11 U.S.C.A. § 548(a)(1)(B).

[42] 11 U.S.C.A. § 546(e).

> against the same transfers challenged by appellants' actions before us on this appeal. That claim is still pending.[43]

As discussed below, while finding ambiguities in the language of section 546(e), the *Tribune* court concluded that the purposes and history of the section reflected an intent to preempt the state law constructive fraudulent transfer claims against Tribune's cashed out shareholders.

IV. Preemption in Bankruptcy

The United States Constitution provides that Congress has the exclusive power to enact uniform bankruptcy laws.[44] Federal bankruptcy law generally trumps inconsistent state law intruding on the bankruptcy power.[45] As the Second Circuit stated in *Tribune*, "[u]nder the Supremacy Clause, Article IV, Clause 2 of the Constitution, federal law prevails when it conflicts with state law.[46] The Second Circuit, recognizing that express preemption was lacking in *Tribune*, explained that nonetheless "a preemptive effect may be inferred where it is not expressly provided."[47]

The Second Circuit focused in *Tribune* solely on the implied preemption doctrine and did not consider other types of federal preemption, stating:

> We see no need for a full discussion of various modes of analysis used to determine federal preemption, i.e., "express" preemption . . ., "field" preemption . . ., or even the branch of implied preemption that requires a showing of "impossibility" of complying with both federal and state law . . . The only relevant analysis in the present matter is preemption inferred from a conflict

[43]Tribune, 818 F.3d at 112. With respect to the claim brought by the Litigation Trust, in In re Tribune Co. Fraudulent Conveyance Litig., the district court subsequently dismissed the actual fraudulent transfer claims finding that the requisite fraudulent intent had not been sufficiently alleged. 2017 U.S. Dist. LEXIS 3039, *60.

[44]U.S. CONST., art. I, § 8, cl. 4.

[45]*In re City of Stockton, California*, 526 B.R. 35, 50 (Bankr. E.D. Cal. 2015), aff'd in part, dismissed in part, 542 B.R. 261, Bankr. L. Rep. (CCH) P 82900 (B.A.P. 9th Cir. 2015) ("The Supremacy Clause operates to cause federal bankruptcy law to trump state laws, including state constitutional provisions, that are inconsistent with the exercise by Congress of its exclusive power to enact uniform bankruptcy laws"). See U.S. CONST., art. VI, cl. 2 for the Supremacy Clause.

[46]Tribune, 818 F.3d at 109.

[47]Tribune, 818 F.3d at 109.

between state law and the purposes of federal law, as discussed in the text.[48]

A federal statute may preempt a state statute if the federal statute is "so pervasive as to make reasonable the inference that Congress left *no room* for states to supplement it."[49] A "clear and manifest" intention of Congress is required, however, for implied preemption of state law.[50] Whether Congress has exercised its authority to preempt state law in a specific situation is a matter of congressional intent.[51] The *Tribune* court stated that "[p]reemption is always a matter of congressional intent, even where that intent must be inferred."[52] Frequently the intent of Congress with regard to a specific statutory provision is not expressly stated and may be unclear, leaving courts to interpret Congressional intent.

Bankruptcy Code Section 544(b)(1) authorizes a trustee to avoid "any transfer of an interest of the debtor in property . . . that is voidable under applicable law" — i.e., state law.[53] This "strong arm power" of section 544(b) empowers a bankruptcy trustee (or debtor in possession)[54] to invoke state fraudulent transfer law to claw back a debtor's prepetition transfers. "Strong arm powers under § 544(b) are substantive rights granted by the Bankruptcy Code and come into exis-

[48]Tribune, 818 F.3d at 110, n.5.

[49]See *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230, 67 S. Ct. 1146, 91 L. Ed. 1447 (1947) (emphasis added); see also *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 160, 83 S. Ct. 1210, 10 L. Ed. 2d 248 (1963).

[50]*Bates v. Dow Agrosciences LLC*, 544 U.S. 431, 449, 125 S. Ct. 1788, 161 L. Ed. 2d 687, 60 Env't. Rep. Cas. (BNA) 1129, 35 Envtl. L. Rep. 20087 (2005).

[51]*Sherwood Partners, Inc. v. Lycos, Inc.*, 394 F.3d 1198, 1200, 44 Bankr. Ct. Dec. (CRR) 24, 53 Collier Bankr. Cas. 2d (MB) 743, Bankr. L. Rep. (CCH) P 80222 (9th Cir. 2005) ("Congress has broad authority to preempt state laws, but whether Congress has done so in a particular instance is a matter of congressional intent.").

[52]Tribune, 818 F.3d at 110, citing *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 516, 112 S. Ct. 2608, 120 L. Ed. 2d 407, Prod. Liab. Rep. (CCH) P 13199, 17 U.C.C. Rep. Serv. 2d 1087 (1992).

[53]11 U.S.C.A. § 544(b)(1).

[54]Pursuant to 11 U.S.C.A. § 1107(a), a debtor in possession has virtually all the rights and powers of a bankruptcy trustee. "Debtor in possession" is defined in 11 U.S.C.A. § 1101(1).

tence with the filing of the bankruptcy petition."[55] Further, Congress did not intend for federal bankruptcy law to occupy the entire field of fraudulent transfer recoveries. In fact, the trustee's strong arm power under Bankruptcy Code section 544(b) is designed so that the trustee can pursue such recoveries obtainable under state law. State law is preempted, however, when it is "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[56]

As discussed above, section 546(e) serves as a limitation on the trustee's avoidance powers. The central question in *Tribune* was whether the safe harbor of section 546(e) protecting Tribune's cashed out shareholders preempted the state law, constructive fraudulent transfer claims brought against them.[57] The Second Circuit's penultimate conclusion was that "[o]nce a party enters bankruptcy, the Bankruptcy Code constitutes a wholesale preemption of state laws regarding creditors' rights."[58] This conclusion appears to conflict with U.S. Supreme Court precedent.[59]

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[55] *In re Metropolitan Mortg. & Securities Co., Inc.*, 344 B.R. 138, 141, 46 Bankr. Ct. Dec. (CRR) 187 (Bankr. E.D. Wash. 2006).

[56] *Pacific Gas and Elec. Co. v. State Energy Resources Conservation & Development Com'n*, 461 U.S. 190, 204, 103 S. Ct. 1713, 75 L. Ed. 2d 752, 18 Env't. Rep. Cas. (BNA) 1991, 52 Pub. Util. Rep. 4th (PUR) 169, 13 Envtl. L. Rep. 20519 (1983) (quotation omitted). See also Tribune, 818 F.2d at 110 (same quotation), quoting *Hillman v. Maretta*, 133 S. Ct. 1943, 1949–50, 186 L. Ed. 2d 43 (2013).

[57] The *Tribune* court, however, states that "[w]hile the issue before us is often described as whether Section 546(e) preempts state fraudulent conveyance laws, . . . that is a mischaracterization. Appellants' state law claims were preempted when the Chapter 11 proceedings commenced and were not dismissed." *Trib*une, 818 F.3d at 111. This characterization, however, seems to conflate the effect of the automatic stay with preemption.

[58] Tribune, 818 F.3d at 111.

[59] See, e.g., *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994) ("BFP"); *Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986); *Butner v. U.S.*, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

In *BFP v. Resolution Trust Corp.*,[60] the Supreme Court observed, in a bankruptcy case involving contentions of preemption, that where Congress's "intent to override is doubtful, our federal system demands deference." In *BFP,* the Supreme Court addressed the issue of whether the Bankruptcy Code trumped state foreclosure law. State foreclosure law allowed sales for less than "fair market value," while then-section 548(a)(2)(A) of the Bankruptcy Code authorized the trustee to avoid transfers where the debtor received less than "reasonably equivalent value." The Supreme Court addressed the question of whether the requirement of "reasonably equivalent value" under the Bankruptcy Code preempted state law allowing for foreclosure sales for less than "fair market value."

The *BFP* court stated that "[t]o displace traditional state regulation . . ., the federal statutory purpose must be 'clear and manifest,' . . . Otherwise, the Bankruptcy Code will be construed to adopt, rather than to displace, pre-existing state law."[61] The court concluded that

Congress had not clearly intended to override state foreclosure law which it perceived to have peacefully coexisted with fraudulent transfer law for hundreds of years. Recognizing that the Bankruptcy Code can't override state law by implication, the Supreme Court held that "where the intent to override is doubtful, our federal system demands deference to long-standing established traditions of state regulation."[62] In contrast, the *Tribune* court ignored the long history of state law providing a basis for creditor recovery for fraudulent transfers made by debtors.[63] Instead, the Second Circuit focused on the "history of significant federal presence" in the

[60] *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 546, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994).

[61] *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 544, 114 S. Ct. 1757, 128 L. Ed. 2d 556, 25 Bankr. Ct. Dec. (CRR) 1051, 30 Collier Bankr. Cas. 2d (MB) 345, Bankr. L. Rep. (CCH) P 75885 (1994) (citations and footnote omitted).

[62] BFP, 511 U.S. at 546.

[63] In BFP, the Supreme Court explained that "[t]he modern law of fraudulent transfers had it origin in the Statute of 13 Elizabeth, . . . English courts soon developed the doctrine of 'badges of fraud' " . . . and that through 1980 "Fraudulent transfer law and foreclosure law enjoyed over

regulation of creditors' rights.[64] Such history seems equally applicable in *BFP* where the Supreme Court reached the opposite conclusion on preemption.

Prior to *BFP*, in *Midlantic National Bank v. New Jersey Department of Environmental Protection*,[65] the Supreme Court found that the Bankruptcy Code does not preempt all state laws regulating debtor-creditor relations. More specifically, it held that 28 U.S.C.A. § 959(b),[66] requiring a bankruptcy trustee to manage property in her possession in accordance with state law, "supports our conclusion that Congress did not intend for the Bankruptcy Code to pre-empt all state laws that otherwise constrain the exercise of a trustee's powers."[67] This view would seem to conflict with the approach of the *Tribune* court premised upon the guiding principle that the "Bankruptcy Code constitutes a wholesale preemption of state laws regarding creditors' rights." It could be argued, however, that section 959(b) is not addressed to "state laws regarding creditors' rights."

In *Butner v. United States*,[68] the Supreme Court explained that property interests, regardless of whether being addressed in a bankruptcy case, are created and defined by state law. "Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a

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400 years of peaceful coexistence in Anglo American jurisprudence . . ." 511 U.S. at 540–42.

[64]Tribune, 818 F.3d at 111 (quotation omitted).

[65]*Midlantic Nat. Bank v. New Jersey Dept. of Environmental Protection*, 474 U.S. 494, 505, 106 S. Ct. 755, 88 L. Ed. 2d 859, 13 Bankr. Ct. Dec. (CRR) 1262, 13 Bankr. Ct. Dec. (CRR) 1269, 13 Collier Bankr. Cas. 2d (MB) 1355, 23 Env't. Rep. Cas. (BNA) 1913, Bankr. L. Rep. (CCH) P 70923, 16 Envtl. L. Rep. 20278 (1986).

[66]Section 959(b) provides: "Except as provided in section 1166 of title 11, a trustee, receiver or manager appointed in any cause pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee, receiver or manager according to the requirements of the valid laws of the State in which such property is situated in the same manner that the owner of possessor thereof would be bound to do if in possession thereof."

[67]Midlantic National Bank, 474 U.S. at 505.

[68]*Butner v. U.S.*, 440 U.S. 48, 54–55, 99 S. Ct. 914, 59 L. Ed. 2d 136, 19 C.B.C. 481, Bankr. L. Rep. (CCH) P 67046 (1979).

bankruptcy proceeding."[69] Moreover, the Supreme Court explained that this presumption against preemption of state law, "prevent[s] a party from receiving a windfall merely by reason of the happenstance of bankruptcy."[70] It could be concluded that the application of the safe harbor of section 546(e) to preempt state constructive fraudulent transfer law affords the Tribune shareholders with such a windfall.

Where, as in *Tribune*, an express preemption clause is not present, the Supreme Court has applied the general presumption against preemption in the bankruptcy context.[71] Moreover, "for preemption to occur in a field traditionally occupied by the states, there must be a 'sharp' conflict between state law and federal policy."[72] The *Tribune* court stated that "[t]he presumption against inferring preemption is premised on federalism grounds and, therefore, weighs most heavily where the particular regulatory area is 'traditionally the domain of the state law.' "[73] While recognizing that federal law coexists peaceably with and, often expressly incorporates state laws regulating the rights and obligations of debtors and creditors (including section 544(b), making state law avoiding transfers available to the bankruptcy trustee), the Ninth Circuit has stated that "[t]here can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject' . . ."[74]

Similarly, the *Tribune* court found there to be an overriding

[69]Butner, 440 U.S. at 55.

[70]Butner, 440 U.S. at 55.

[71]In BFP, while the Supreme Court recognized that "[t]he Bankruptcy Code can of course override [state law] by implication," clear intent is required: "[W]here [Congress's] intent to override is doubtful, our federal system demands deference to long-standing established traditions of state regulation." BFP, 511 U.S. at 546.

[72]*Witco Corp. v. Beekhuis*, 38 F.3d 682, 687, 39 Env't. Rep. Cas. (BNA) 1545, 25 Envtl. L. Rep. 20007 (3d Cir. 1994). See also *Marshall v. Marshall*, 547 U.S. 293, 308, 126 S. Ct. 1735, 164 L. Ed. 2d 480, 46 Bankr. Ct. Dec. (CRR) 122, Bankr. L. Rep. (CCH) P 80505 (2006) (recognizing the probate exception as described in *Markham v. Allen*, 326 U.S. 490, 494, 66 S. Ct. 296, 90 L. Ed. 256 (1946)).

[73]Tribune, 818 F.3d at 110, quoting Hillman, 133 S. Ct. 1950.

[74]Sherwood Partners, Inc. v. Lycos, 394 F.3d at 1201. In *Sherwood*, the Ninth Circuit Court of Appeals, by a divided court, held that a California

federal interest at issue. Under the circumstances, this conclusion is questionable. The Second Circuit recognized the "full conflict" between the Bankruptcy Code's general (and usually predominant) "goal of maximizing the assets available to creditors" . . . and the underlying purpose of section 546(e) "to protect a national, heavily regulated [securities] market by limiting creditors' rights."[75] Further, ignoring any state law concerns, the Second Circuit stated:

> [T]he policies reflected in Section 546(e) relate to securities markets, which are subject to extensive federal regulation. The regulation of these markets has existed and grown for over eighty years and reflects very important federal concerns.
>
> In the present matter, therefore, there is no measurable concern about federal intrusion into traditional state domains. Our bottom line is that the issue before us is one of inferring congressional intent from the Code, without significant countervailing pressures of state law concerns.[76]

In contrast, the Seventh Circuit in *FTI Consulting, Inc.*, in a case like *Tribune* where payments were made through financial institutions (or other entities named in section 546(e)) as mere conduits, rejected the view that under such circumstances an important federal interest to protect the securities market from systemic risk exists.[77] Addressing the concern about a "ripple effect" underlying the purpose for the

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state statute authorizing an assignee for the benefit of creditors to void a preferential transfer is preempted by the federal Bankruptcy Code. The Ninth Circuit majority's theory was that because the right to void preferences was granted by state law to the assignee, but not to an individual creditor, the state statute "trenched too closely" on the federal bankruptcy power, which thus preempted the state law. Since the Ninth Circuit's decision in *Sherwood*, a number of courts, including California state courts, have declined to follow *Sherwood* and have concluded that *Sherwood* was wrongly decided. See *Haberbush v. Charles and Dorothy Cummins Family Ltd. Partnership*, 139 Cal. App. 4th 1630, 43 Cal. Rptr. 3d 814 (2d Dist. 2006); *Credit Managers Ass'n of California v. Countrywide Home Loans, Inc.*, 144 Cal. App. 4th 590, 598, 50 Cal. Rptr. 3d 259 (4th Dist. 2006); *APP Liquidating Company v. Packaging Credit Company*, 2006 U.S. Dist. LEXIS 60195 (E.D. WI. 2006); *Ready Fixtures Co. v. Stevens Cabinets*, 488 F. Supp. 2d 787 (W.D. Wis. 2007); *BDI Liquidating Co., Inc. v. Quest Graphic, LLC*, 2007 WL 2492740 (E.D. Wis. 2007); and *Spector v. Melee Entertainment, LLC*, 2008 Del. Super LEXIS 48, *17 (2008).

[75]Tribune, 818 F.3d at 122–23.

[76]Tribune, 818 F.3d at 112.

[77]FTI Consulting, Inc., 830 F.3d at 696–97.

safe harbor, the Seventh Circuit stated that even if the debtor's bankruptcy were to "spread" to the shareholder defendant in the constructive fraudulent transfer action brought in that case, "there is no evidence that it would have any impact on Credit Suisse, Citizens Bank [Credit Suisse and Citizens Bank were the financial institutions involved soley as conduits who triggered application of section 546(e)], or any other bank or entity named in section 546(e)."[78] The same conclusion could have been reached in the *Tribune* case. However, with little consideration of the role of the financial institutions as mere conduits, the *Tribune* court concluded that "the purposes and history of . . . [*section* 546(e)] necessarily reflect an intent to preempt the claims before us."[79]

In *Lyondell Chemical Company*[80] took a different approach. In that case, the bankruptcy court did not apply the interpretation adopted by *Tribune* that section 546(e) covers all transfers by or to financial intermediaries that are settlement payments or in connection with a securities contract. Instead, the court stated that section 546(e) does not include "LBO payments to stockholders at the very end of the asset transfer chain, where the stockholders are the ultimate beneficiaries of the constructively fraudulent transfers, and can give the money back to injured creditors with no damage to anyone but themselves."[81]

Rejecting this approach, the *Tribune* court went in search of legislative purpose and found that "[t]he broad language used in Section 546(e) protects transactions rather than firms, reflecting a purpose of enhancing the efficiency of securities markets in order to reduce the cost of capital to the American economy.[82] Viewing the threat of cashed out shareholders in a context where the company subsequently tanked and creditors were left unpaid from an apocalyptic perspective, the Second Circuit stated:

> A lack of protection against the unwinding of securities transactions would create substantial deterrents, limited only by the

[78] FTI Consulting, Inc., 830 F.3d at 696–97.

[79] Tribune, 818 F.3d at 118.

[80] *In re Lyondell Chemical Company*, 503 B.R. 348 (Bankr. S.D. N.Y. 2014), as corrected, (Jan. 16, 2014).

[81] Lyondell Chemical Company, 503 B.R.at 372–73.

[82] Tribune, 818 F.3d at 121.

> copious imaginations of able lawyers, to investing in the securities market. The effect of appellants' legal theory would be akin to the effect of eliminating the limited liability of investors for the debts of a corporation: reduction of capital available to American securities markets. . . .
> Given the occasional volatility of economic events, any transaction buying out shareholders would risk being attacked as a fraudulent conveyance avoidable by creditors if the firm faltered. . . . Tender offers, which almost always involve a premium above trading price, . . . would imperil cashed out shareholder if the surviving entity encountered financial difficulties.[83]

Finding "no history of the use of state law, constructive fraudulent conveyance actions to unwind settled security transactions, either after a bankruptcy or in its absence",[84] the *Tribune* court inferred preemption based not on express statutory language, but rather based on (i) what it identified as strong policy reasons for protecting shareholders even in situations where creditors are left holding the bag, and (ii) overarching statements that appear to take the unacknowledged form of field preemption. However, creditors' longstanding power to pursue state law fraudulent transfer claims derives from state law. Whether Congress stripped away that power without expressly saying so is a serious question to which it would seem that there should be a strong presumption against an affirmative response.

The Second Circuit never mentions the core bankruptcy concept embodied in the absolute priority rule that creditors have priority over and are to be paid before shareholders. Further, claims of shareholders on account of their equity interests are generally subordinated.[85] By insulating the cash out of shareholders of insolvent entities or entities rendered insolvent by such payments, the traditional concept of priority treatment in insolvency and bankruptcy situations can be turned on its head. Under these circumstances, the absolute priority rule is not so absolute.

V. Application of Section 546(e) Safe Harbor to Conduits

The *Tribune* court did not directly address the question of

[83] Tribune, 818 F.3d at 121–22.

[84] Tribune, 818 F.3d at 124.

[85] See 11 U.S.C.A. § 510(c).

whether the section 546(e) safe harbor protects transfers that are simply conducted *through* financial institutions (or the other entities named in section 546(e)), where the entity is neither the debtor nor the transferee, but only the conduit. The Second Circuit had previously held in *In re Quebecor World (USA) Inc.*,[86] that safe harbor protection applies under such circumstances. Accordingly, the merits of the issue was not reviewed in *Tribune*. As stated above, four other circuits are in agreement with the broad application of section 546(e) adopted by the Second Circuit.[87] In the first as well as the most recent court of appeals decisions squarely addressing the scope of section 546(e), the Eleventh and Seventh Circuits have held that the safe harbor does not protect transfers that merely pass *through* a financial institution.[88] As a result of this split in the circuit courts regarding the scope of section

[86] *In re Quebecor World (USA) Inc.*, 719 F.3d 94, 98, 58 Bankr. Ct. Dec. (CRR) 12, 69 Collier Bankr. Cas. 2d (MB) 1253, Bankr. L. Rep. (CCH) P 82505 (2d Cir. 2013) (holding safe harbor extends to private parties involved in the actual exchange where a financial institution was trustee).

[87] See *Contemporary Industries Corp. v. Frost*, 564 F.3d 981, 987, 51 Bankr. Ct. Dec. (CRR) 157, Bankr. L. Rep. (CCH) P 81473 (8th Cir. 2009) (finding section 546(e) is not limited to public securities transactions, in protecting from avoidance a chapter 11 debtor's payments that were deposited in a bank in exchange for shareholders' privately-held stock pursuant to a leverage buyout, as settlement payments made to a financial institution); *In re QSI Holdings, Inc.*, 571 F.3d 545, 551, 51 Bankr. Ct. Dec. (CRR) 222, Bankr. L. Rep. (CCH) P 81528 (6th Cir. 2009) (ruling that although a bank was only acting as an exchange agent in connection with a leverage buyout, this was "sufficient to satisfy the requirement that the transfer was made to a financial institution"); *In re Resorts Intern., Inc.*, 181 F.3d 505, 516, 34 Bankr. Ct. Dec. (CRR) 736, Bankr. L. Rep. (CCH) P 77952 (3d Cir. 1999) (stating that any "requirement that the 'commodity brokers, forward contract merchants, stockbrokers, financial institutions, and securities clearing agencies' obtain a 'beneficial interest' in the funds they handle . . . is not explicit in section 546"); *In re Kaiser Steel Corp.*, 952 F.2d 1230, 1240, 26 Collier Bankr. Cas. 2d (MB) 443, Bankr. L. Rep. (CCH) P 74387 (10th Cir. 1991) (rejecting the argument that "even if the payments were settlement payments, § 546(e) does not protect a settlement payment 'by' a stock broker, financial institution or clearing agency, unless that payment is to another participant in the clearance and settlement system and not to an equity security holder").

[88] *Matter of Munford, Inc.*, 98 F.3d 604, 36 Collier Bankr. Cas. 2d (MB) 1673 (11th Cir. 1996); *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690, 62 Bankr. Ct. Dec. (CRR) 250, 75 Collier Bankr. Cas. 2d (MB) 1855, Bankr. L. Rep. (CCH) P 82972 (7th Cir. 2016), cert. granted, 137 S. Ct. 2092, 197 L. Ed. 2d 894 (2017).

546(e), if the Supreme Court grants certiorari in *Tribune*, the issue will be squarely before the court.

In the most recent appeals court decision addressing the scope of section 546(e), the Seventh Circuit in *FTI Consulting, Inc.*, began its analysis in what it labeled "the obvious place," the text of section 546(e). The Seventh Circuit found key language in section 546(e) to be ambiguous. That was found to be the case for the words "by or to", "made by or to", and "for the benefit of." The plain language of the statute is unclear what these phrases mean with regard to payments. "When a person pays her bills using an electronic bank transfer, the funds could be set to be sent 'by' the owner of the account or by the bank. Similarly, a transfer through a financial institution as intermediary could reasonably be interpreted as being 'made by or to' the financial institution or 'made by or to' the entity ultimately receiving the money . . . These multiple plausible interpretations require us to search beyond the statute's plain language."[89]

Finding that the phrase "for the benefit of," which was added to the safe harbor of section 546(e) in a 2006 amendment, also to be ambiguous, the Seventh Circuit stated:

> It could refer to a transaction made *on behalf of* another entity, or it could mean a transaction made *nearly involving* an entity receiving an actual financial or beneficial interest. The latter reading suggests the transactions between parties other than the named entities receiving a financial interest (but related to those entities) are also included in the safe harbor — otherwise the additional parenthetical would be redundant. If the former interpretation is used, *FTI's* argument that the whole phrase refers only to named entities receiving a financial interest — whether or not the entity received the actual transfer of property — is plausible."[90]

Because of the ambiguities of the language of section 546(e) regarding whether the safe harbor was meant to include intermediaries, the Seventh Circuit turned "to the statute's purpose and context for further guidance."[91] The court stated:

> The language of the statute, standing alone, does not point us

[89]FTI Consulting, Inc., 830 F.3d at 692.

[90]FTI Consulting, Inc., 830 F.3d at 693.

[91]FTI Consulting, Inc., 830 F.3d at 693, citing *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133, 120 S. Ct. 1291, 146 L. Ed. 2d 121 (2000) (courts must interpret "statute as a symmetrical

> in one direction or the other. In particular, it is unclear whether the safe harbor was meant to include intermediaries, or if it is limited to what we might think of as the real parties in interest—here, the first and the final party posssessing the thing transferred. We therefore turn to the statute's purpose and context for further guidance.[92]

The FTI Consulting, Inc., court examined the structure of Chapter 5 of the Bankruptcy Code. The Seventh Circuit explained:

> While section 546 covers limitations on a trustee's avoidance powers, other sections — in particular sections 544, 547, and 548 — set out types of transfers that a bankruptcy trustee can avoid. Section 550 describes how to recover the funds from transfers that are avoidable. The trustee's avoidance powers serve the broad purpose of ensuring the equitable distribution of a debtor's assets.[93]

The avoidance provisions in Chapter 5 apply to transfers made by the debtor. Accordingly, the Seventh Circuit considered whether "transfers 'made by' a named entity in section 546(e) ought also to refer to a transfer of property by the debtor."[94]

The safe harbor limitation on the avoidance powers should not be broader than the underlying powers themselves. "Chapter 5 creates both a system for avoiding transfers and a safe harbor from avoidance — logically these are two sides of the same coin. It makes sense to understand the safe harbor as applying to the transfers that are eligible for avoidance in the first place."[95] The Seventh Circuit discussed that in

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and coherent regulatory scheme, and fit, if possible, all parts into a harmonious whole") (internal quotation marks and citations omitted); and *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 809, 109 S. Ct. 1500, 103 L. Ed. 2d 891, 10 Employee Benefits Cas. (BNA) 2097, 89-2 U.S. Tax Cas. (CCH) P 9456, 63 A.F.T.R.2d 89-1174 (1989) "It is a fundamental cannon of statutory construction that the words of the statute must be read in their context and with a view to their place in the overall statutory scheme.").

[92]FTI Consulting, Inc., 830 F.3d at 693.

[93]FTI Consulting, Inc., 830 F.3d at 693.

[94]FTI Consulting, Inc., 830 F.3d at 693.

[95]FTI Consulting, Inc., 830 F.3d at 693.

Bonded Financial Service, Inc. v. European American Bank,[96] a case where it did not address the section 546(e) safe harbor specifically, it "defined 'transferee' as an entity with 'dominion over the money' or 'the right to put the money to one's own purposes . . . [and] found that a bank that 'acted as a financial intermediary' and 'received no benefit' was not a 'transferee' within the meaning of Chapter 5 of the Bankruptcy Code."[97]

"Because the safe harbor is meant to protect covered entities against avoidance where it might occur, the fact that sections 544, 547, and 548 permit avoidance only where the transfer represents an actual obligation means that 546(e) provides a safe harbor only where the debtor has incurred an actual obligation to the covered entity."[98] Under this reasoning of the Seventh Circuit, financial intermediaries serving simply as conduits (like the financial institution in *Tribune*) would fall outside the scope of the safe harbor protection. Such entities are not the beneficiary of any actual obligation of the debtor.

Bankruptcy Code section 550 sets forth how the trustee may recover avoidable transfers.[99] "The trustee can recover the property or its value from the 'initial transferee' or 'any immediate or mediate transferee.' . . . It protects good faith transferees who did not know of the avoid ability of the transfer and 'any immediate or mediate good faith transferee of such transferee.' "[100] The *FTI* court announced that "[w]e see no reason why the unavoidability provisions should be broader than defenses to recovery; if anything, the opposite should be true."[101]

The Seventh Circuit explained that the question how money may be recovered is different from whom money may be recovered, stating:

> Although mediate transferees may be required to return funds

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[96] *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 893, 17 Bankr. Ct. Dec. (CRR) 299, 18 Collier Bankr. Cas. 2d (MB) 155 (7th Cir. 1988).

[97] FTI Consulting, Inc., 830 F.3d at 695.

[98] FTI Consulting, Inc., 830 F.3d at 694.

[99] 11 U.S.C.A. § 550.

[100] FTI Consulting, Inc., 830 F.3d at 695, citing 11 U.S.C.A. § 550.

[101] FTI Consulting, Inc., 830 F.3d at 695.

> to which they are not entitled under the Bankruptcy Code's avoid ability provisions, mediate transferees are not eligible for the safe harbor because they lack a financial stake comparable to that of a debtor or a party to whom a debt is owed. Section 550 also contains a good-faith exception to protect unknowing mediate transferees, and so such transferees should not need the safe harbor.[102]

The *FTI Consulting, Inc.* court next turned to the history of section 546(e). The Seventh Circuit concluded that the history supports a narrower reading of the scope of the safe harbor to exclude conduits and that this will not create problems in the financial services markets. The Seventh Circuit summarizes the statute's history as follows:

> Congress first enacted the safe harbor in response to a New York federal district court decision: *Seligson v. New York Product Exchange*, 394 F.Supp. 125 (S.D.N.Y. 1975). In *Seligson*, the trustee of a commodity broker's bankruptcy estate sued the New York Produce Exchange and the New York Produce Exchange Clearing Association to recover payments the broker made to the Association in connection with cottonseed oil futures which declined in value drastically . . . The court denied summary judgment, finding a triable issue of fact and the questions whether the Association was a "transferee" within the meaning of the Bankruptcy Code's avoidability provisions, and whether the Exchange could be held liable because of its relationship with the Association . . .
>
> Congress responded in 1982 by creating the safe harbor, which enabled financial institutions that were recipients of transfers of the kind that took place in *Seligson* to invoke a safe harbor from avoidance. Pub. L. No. 97-222, § 4, 96 Stat. 235 (1982). Congress later expanded the safe harbor to other types of actors in the securities industry, including financial institutions. *See*, Pub. L. No. 98-353, § 441, 98 Stat. 333 (1984). Nothing it did, however, indicated that the safe harbor applied to those institutions in their capacity as intermediaries. The safe harbor has ample work to do when an entity involved in the commodities trade is a debtor or actual recipient of a transfer, rather than simply a conduit for funds . . .
>
> Congress' discussion of the 2005 amendments to the [Bankruptcy] Code . . . reemphasized the safe harbor's purpose as reducing "systemic risk in the financial market place." H.R. Rep. 109-31 (1), at 3, *reprinted in* 2005 U.S.C.C.A.N. 88, 89.[103]

The Seventh Circuit found that while it had previously

[102] FTI Consulting, Inc., 830 F.3d at 695.

[103] FTI Consulting, Inc., 830 F.3d 696.

ruled that section 546(e) is to be interpreted broadly,[104] "that does not mean there are no limits."[105] It announced that it "will not interpret the safe harbor so expansively that it covers any transaction involving securities that uses a financial entity as a conduit for funds."[106] It reasoned that Congress could have written the statute differently to make it clear that the safe harbor covers mere conduits. "If Congress had wanted to say that acting as a conduit for a transaction between non-named entities is enough to qualify for the safe harbor, it would have been easy to do that. But it did not."[107]

Further, the *FTI Consulting, Inc.*, court was "not troubled" by "any potential ripple effect through the financial markets" by clawing back funds from the defendant shareholder and stated "[n]or are we persuaded that the repercussions of undoing a deal like this one outweigh the necessity of the Bankruptcy Code's protections for creditors."[108] This contrasts dramatically with the *Tribune* court's cataclysmic concerns about systemic devastation if conduits are not protected by the safe harbor.

VI. Plain Language

The *Tribune* court acknowledged that it went beyond the plain language of the statute by applying section 546(e) to creditors seeking to claw back payments. The Second Circuit stated "Section 546(e)'s reference to limiting avoidance by a trustee provides appellants with a plain language argument that only a trustee . . . and not creditors acting on their own behalf, are barred from bringing state law, constructive fraudulent avoidance claims."[109] Nonetheless, the *Tribune* court stated:

> [W]e believe that the language of Section 546(e) does not necessarily have the meaning appellants ascribe to it. Even if that meaning is one of multiple reasonable constructions of the statutory scheme, it would not necessarily preclude preemption

[104] *Grede v. FCStone, LLC*, 746 F.3d 244, 246, 59 Bankr. Ct. Dec. (CRR) 65, 71 Collier Bankr. Cas. 2d (MB) 451 (7th Cir. 2014).

[105] FTI Consulting, Inc., 830 F.3d 696.

[106] FTI Consulting, Inc., 830 F.3d at 697.

[107] FTI Consulting, Inc., 830 F.3d at 697.

[108] FTI Consulting, Inc., 830 F.3d at 696–97.

[109] Tribune, 818 F.3d at 109.

because a preemptive effect may be inferred where it is not expressly provided.[110]

The Second Circuit further found that the plain language of section 546(e) referring to avoidance actions brought by a "trustee" was not actually plain, since "a reader of Section 546(e), at the time of its enactment, would not have necessarily concluded that the reference only to a trustee . . . meant that creditors may at some point bring state law claims seeking the very relief barred to the trustee . . . by Section 546(e).[111] This more of an policy evaluation than an application of the plain language of the statute. The *Tribune* court rationalizes that "[t]here is little apparent reason to limit trustees . . . to intentional fraud claims while not extinguishing constructive fraud claims but rather leaving them to be brought later by individual creditors."[112] However, as the Seventh Circuit pointed out in *FTI*, Congress could have included plain language in the statute providing that the safe harbor covers conduits. Similarly, Congress could have included language in the statute extending the section 546(e) safe harbor to actions brought under state law (by creditors) that could previously have been pursued by the trustee.[113] It did not.

The majority view followed, without questioning, in *Tribune* allows transactions to be structured in a manner where cashed out shareholders can be insulated. This approach promotes a windfall for transferees receiving fraudulent transfers who are shielded from liability when the transfer simply passes through a financial institution.

VII. Conclusion

Federal bankruptcy law coexists with and incorporates state fraudulent transfer law through the trustee's strong arm power granted under section 544. Congress has expressed a clear intent to regulate bankruptcy and maximize the bank-

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[110] Tribune, 818 F.3d at 109.

[111] Tribune, 818 F.3d at 113.

[112] Tribune, 818 F.3d at 115.

[113] See, e.g., *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 7, 120 S. Ct. 1942, 147 L. Ed. 2d 1, 36 Bankr. Ct. Dec. (CRR) 38, 43 Collier Bankr. Cas. 2d (MB) 861, Bankr. L. Rep. (CCH) P 78183 (2000).

ruptcy estate for the benefit of creditors. Further, this intent is promoted through the trustee's strong arm power under section 544 to avoid fraudulent transfers under state law. In potential conflict with this purpose, is the intent underlying the safe harbor of section 546(e) to protect the securities market from systemic risk. Further, also in potential conflict with the safe harbor is a long history of state laws empowering creditors to claw back fraudulent transfers made by debtors.

In *Tribune*, inferring implied preemption based on policy grounds, the Second Circuit found that Bankruptcy Code section 546(e) preempted state law constructive fraudulent transfer actions. The *Tribune* court concluded that, under section 546(e), cashed out shareholders receiving LBO monies while the debtor was insolvent, or rendered insolvent by the payments, are insulated from state law constructive fraudulent transfer claims when the payments pass through financial institutions acting merely as conduits. As a result, with creditors being left unpaid and shareholders allowed to retain payments cashing them out, the ordinary rule of absolute priority in bankruptcy (creditors get paid ahead of equity holders) appears to be turned on its head. Moreover, the Second Circuit actually appears to be taking a field preemption approach and seems, in conflict with Supreme Court precedent, to be jettisoning the presumption against preemption that ordinarily applies in bankruptcy cases.

While finding that the language of Section 546(e) does not exempt from its protection payments by firms to intermediaries to fund ensuing payments to shareholders, the *Tribune* court determined that it would not be constrained by the plain language of the safe harbor statute limiting its scope to actions brought by a trustee. Instead, it inferred that section 546(e) impliedly preempted state law. Such preemption was justified on a policy basis. In contrast, the Seventh Circuit, in the *FTI* case, took a different view and was “not troubled” by “any potential ripple effect through the financial markets” by clawing back funds from a cashed out shareholder. In both *Tribune* and *FTI* no recovery was sought from the intermediary financial institutions. Under the *Tribune* approach, transactions could simply be structured (as many are) to insulate shareholders from fraudulent transfer liability by simply passing payment through a financial intermediary. Under these circumstances, protecting creditors' rights would seem to be the stronger policy concern.