19-3049-cv

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

IN RE: TRIBUNE COMPANY FRAUDULENT CONVEYANCE LITIGATION.

On Appeal from the United States District Court
for the Southern District of New York

BRIEF FOR PLAINTIFF-APPELLANT

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TABLE OF CONTENTS

Page

Page

TABLE OF AUTHORITIES

Cases **Page(s)**

Cases—Continued **Page(s)**

Cases—Continued **Page(s)**

Cases—Continued **Page(s)**

Cases—Continued **Page(s)**

Statutes and Rules **Page(s)**

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

Other Authorities

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

INTRODUCTION

In 2006-2007, Tribune Company ("Tribune") was on "a four-star black-diamond [ski] run headed straight downhill." JA0186 (testimony of Tribune director). Tribune's business, as with its whole industry, had been contracting for years, with no end in sight. Tribune's controlling shareholders and its directors (all of whom owned Tribune stock) "wanted off the ski slope." So the directors decided to cash out the shareholders in a leveraged buyout ("LBO"), funded almost entirely by nearly $11 billion of new borrowings by Tribune. This left Tribune's creditors—many of which predated the LBO—facing the hazard of the ski slope from which the directors and shareholders had just escaped.

But an imposing legal obstacle stood in Tribune's way: LBOs may not render a company insolvent, and this LBO was sure to do so given Tribune's downward trajectory. So, encouraged by Tribune's advisors and controlling shareholders, management concocted forecasts projecting a dramatic turnaround. Even with those pie-in-the-sky projections, two of the best-known valuation firms refused to declare that Tribune would remain solvent after the LBO, so Tribune engaged a virtually unknown firm that would.

It took little time for Tribune's projections to be exposed as bogus. And sure enough, Tribune entered bankruptcy less than a year after the LBO. A company that was supposedly worth $13 billion at the time of the LBO was determined by the bankruptcy court to be worth only about $7 billion, leaving $8 billion of unpaid, allowed claims.

To benefit holders of those claims, the Trustee for the Tribune Litigation Trust brings this case on behalf of Tribune's bankruptcy estate. His claims include fraudulent transfer, breach of fiduciary duty, and related causes of action against Tribune's former shareholders and financial advisors.[1]

The district court dismissed each claim that was not settled. But its rulings, most of which are challenged in this appeal, are indefensible.

First, the Trustee alleged that Tribune intended, through the LBO, to hinder, delay, or defraud the company's creditors. In dismissing this claim for want of sufficient allegations of Tribune's intent, the district court refused to consider the intent of Tribune's senior-most officers in (among other things) preparing the false projections on which the LBO was predicated, looking only at the intent of the company's independent directors. That standard for imputing intent to a corporation is misguided, and it would work a sea change across a wide swath of corporate law, in both civil and criminal contexts.

Second, the district court held that Tribune, a media company, was somehow a "financial institution," bringing it within the Section 546(e) safe harbor

[1] The Trustee settled his claims against Sam Zell (the investor who arranged the LBO) and Tribune's directors and officers. The Trustee also settled his claims against hundreds of shareholders.

applicable to constructive-fraudulent-transfer claims. That holding misconstrues the definition of "financial institution" and impermissibly rests on materials outside the complaint (which, to make matters worse, plainly contradict the facts the district court found). In so doing, the district court effectively immunized all LBO transfers and thereby provided a windfall to shareholders not otherwise protected by Section 546(e).

Third, some of the claims turn on whether Tribune was insolvent at the time of, or rendered insolvent by, the LBO. The district court held that the Trustee sufficiently alleged insolvency at "Step Two" of the LBO but not "Step One." That makes no sense: The two steps formed a single transaction, so insolvency at Step Two means that the transaction, taken in its entirety, caused the insolvency. And, even were solvency appropriately tested separately at each step, Tribune committed to the Step Two obligations before it undertook Step One, making those obligations relevant to solvency at Step One.

This Court should correct these legal errors and others discussed herein, vacate the dismissals, and remand.

JURISDICTION

The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157 and 1334 and the Standing Order of the District Court for the District of Delaware referring to the bankruptcy judges of that district all cases and proceedings arising under Title 11 of the United States Code (the "Bankruptcy Code").

The Judicial Panel on Multidistrict Litigation transferred this action to the District Court for the Southern District of New York for pre-trial administration under 28 U.S.C. § 1407. On June 13, 2019, the district court issued an order under Federal Rule of Civil Procedure 54(b) providing for final judgment on all non-settled claims. Appellant filed a notice of appeal on July 12, 2019. This Court has jurisdiction under 28 U.S.C. § 1291.

ISSUES PRESENTED

I.A. Whether, for purposes of the claim that the LBO transfers were intentionally fraudulent, the intent of senior management may be imputed to the corporation only if senior management gave the final legal approval for the challenged transfers or "controlled" the independent directors who did.

B. Whether, assuming the district court's imputation theory is correct, the Trustee sufficiently alleged that Tribune's independent directors possessed an "actual intent to hinder, delay, or defraud" Tribune's creditors.

C. Whether the Trustee should have been granted leave to amend to address the court's novel intentional-fraudulent-transfer standard.

II.A. Whether, for purposes of the Trustee's proposed amendment to add claims for constructive fraudulent transfer, Tribune is a "financial institution" within the meaning of 11 U.S.C. § 101(22)(A), providing each shareholder-transferee a safe harbor defense under 11 U.S.C. § 546(e).

B. Whether amendment of the complaint to add claims for constructive fraudulent transfer would have been unduly prejudicial.

III.A. Whether, for purposes of the Trustee's breach of fiduciary duty, aiding and abetting, and unjust enrichment claims against Tribune's controlling shareholders, the complaint sufficiently alleged that Tribune was rendered insolvent as of Step One of the LBO.

B. Whether the Trustee should have been granted leave to amend the claims against the controlling shareholders.

IV.A. Whether, for purposes of the Trustee's breach of fiduciary duty, aiding and abetting, and professional malpractice claims against the company's financial advisors, the district court correctly applied the *in pari delicto* doctrine.

B. Whether the district court correctly dismissed the claims against the financial advisors for intentional fraudulent transfer regarding advisory fee payments.

C. Whether the district court correctly dismissed the Trustee's constructive-fraudulent-transfer claims regarding the payment of advisory fees.

STATEMENT OF THE CASE

The Trustee, on behalf of Tribune and for the benefit of its creditors, brought intentional-fraudulent-transfer claims against Tribune's former shareholders and other tort claims against Tribune's former directors, officers, transaction sponsors, shareholders, and financial advisors. The district court (Sullivan and Cote, JJ.) dismissed certain claims; the remaining claims were settled. The court also denied the Trustee's motion to amend his complaint to add constructive-fraudulent-transfer claims against Tribune's former shareholders. The district court's opinions are available at 2017 WL 82391 (Jan. 6, 2017); 2018 WL 6329139 (Nov. 30, 2018), reconsideration denied, 2019 WL 549380 (Feb. 12, 2019); 2019 WL 294807 (Jan. 23, 2019); and 2019 WL 1771786 (Apr. 23, 2019).

I. FACTUAL BACKGROUND

This case arises from Tribune's disastrous 2007 LBO. Tribune's shareholders, officers, directors, and financial advisors sacrificed Tribune—and its creditors—for their own enormous financial gain. The LBO gave Tribune's shareholders $8 billion in cash and left Tribune's creditors with unpaid claims of $8 billion.

A. Tribune's Two Largest Shareholders Look To Cash Out

Before its LBO, Tribune was already showing signs of extreme financial distress. The newspaper industry (approximately 75% of Tribune's revenues) was in steep decline in both circulation and advertising revenues. JA0179-JA0181. Tribune's revenues suffered even more than the overall industry's, and its stock price precipitously declined in the early 2000s.

By 2006, Tribune's largest shareholder, appellees the Chandler Trusts,[2] had lost 40% of the value of their holdings. William Stinehart, a Tribune director appointed by the Chandler Trusts, described Tribune's trajectory as "a four-star black-diamond [ski] run headed straight downhill" and ridiculed the company's plan to turn things around. JA0184, JA0186. The Chandler Trusts "wanted off the ski slope" (JA0186) and began to press Tribune's Board for a solution that would recover the greatest possible value for shareholders. The same was true for Tribune's second largest shareholder, the affiliated McCormick and Cantigny Foundations (the "Foundations," and, with the Chandler Trusts, the "Controlling Shareholders").

In September 2006, the Board created a Special Committee comprising seven of its members (the "Independent Directors"). The Special Committee "initially concentrated on transactions that would involve [Tribune's] incurring relatively modest amounts of additional debt" and "leave Tribune's shareholders

[2] The Chandler Trusts are Chandler Trust No. 1, Chandler Trust No. 2, and the Chandler Sub-Trusts. JA0164.

. . . still owning the Company." JA0145. But its mission quickly became cashing out the Controlling Shareholders.

B. The Controlling Shareholders And Board Of Directors Face Big Incentives To Approve An LBO

In early 2007, real-estate investor Sam Zell approached the Controlling Shareholders, and then the Special Committee, about taking Tribune private in an LBO. JA0189-JA0190. Tribune would incur billions of dollars in debt to cash out its shareholders, and then a newly formed employee stock ownership plan ("ESOP") would acquire the majority of the shares. JA0189-JA0190. This arrangement was designed to shelter Tribune from most federal taxes, which Zell's company believed was "the only thing that made [the buyout] financially attractive." JA0189, JA0226.

The Independent Directors instructed Tribune's management and financial advisors to solicit the views of the Controlling Shareholders on the transaction then under discussion. JA0190-JA0191. As with most LBOs, that transaction would have cashed out the shareholders in one step, when it was consummated. The Controlling Shareholders opposed the one-step deal because Tribune's stock might continue to decline before the transaction closed. JA0191. The Special Committee therefore informed Zell that any proposal must include an upfront distribution to shareholders.

In response, Zell proposed a two-step transaction. In Step One, Tribune would borrow approximately $7 billion and purchase roughly half of its outstanding shares through a tender offer. JA0216-JA0217. In Step Two, Tribune would add another $3.7 billion in debt to merge with a subsidiary of the ESOP, cancel the remaining shares, and distribute cash to the former shareholders. JA0216-JA0217. Tribune committed to both steps at the same time, in the same agreement, in advance of Step One. JA0210, JA0217. The desired tax benefits depended entirely on completing both steps. JA0226-JA0227.

Tribune's management stood to profit immensely at Tribune's expense. The LBO would allow them collectively to cash out more than $36 million of Tribune shares. JA0159. In addition, upon consummation of the LBO, Tribune's officers would receive millions of dollars in bonuses and monetary incentives, including severance payments—at least three times their annual salary, plus six times their target bonus. JA0194-JA0196.

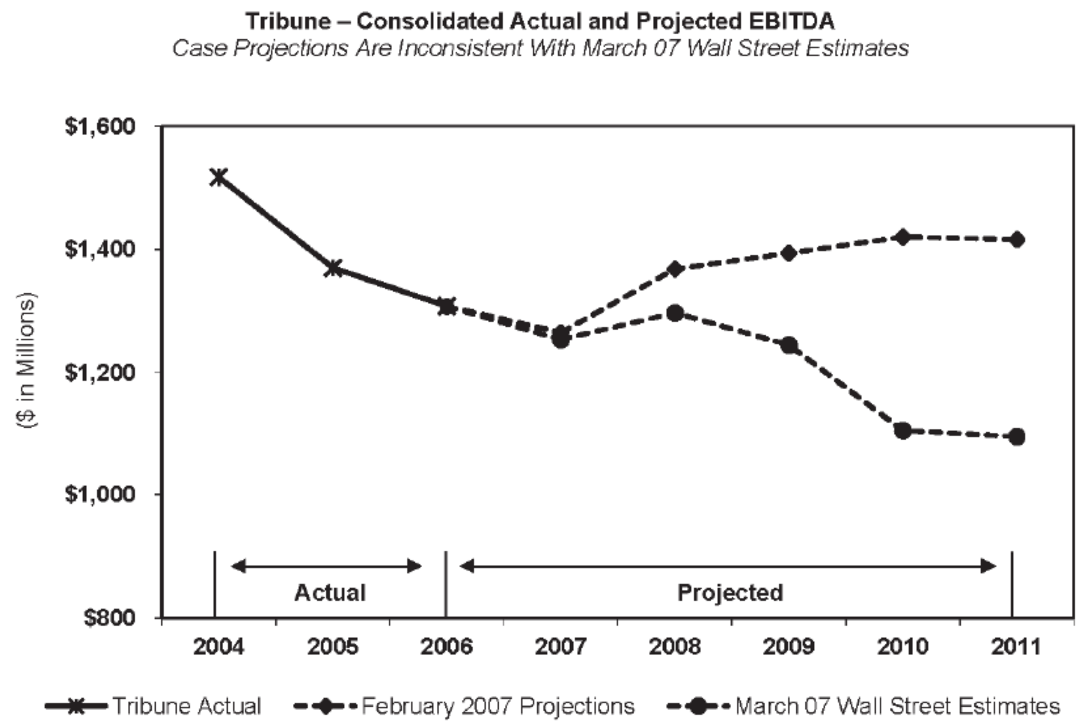
The market saw the obvious problems. The consensus was that the LBO was "way too risky" and would likely "put the company into bankruptcy." JA0192. All three credit-ratings agencies downgraded Tribune's debt, observing that the deal would be "detrimental to bondholders." JA0229. With a payday in sight, however, Tribune's Board, officers, and shareholders pressed on.

C. Tribune's Management Manipulates The Company's Financial Forecasts To Push Through The LBO

1. Tribune's Officers Create Unrealistic Financial Forecasts

The proposed LBO would leverage Tribune to more than ten times its EBITDA—a multiple that one analyst described as "angina-inducing." JA0231. Such high leverage is always dangerous, but it is especially dangerous if the company's EBITDA is in a multi-year decline, as Tribune's was.

Thus, to ensure that the Board would approve the LBO, the same officers who had bargained for special monetary incentives set out to show that Tribune would turn around. So, in February 2007, just before the Board vote, they prepared projections (the "February Projections") forecasting a dramatic rebound. Despite poor actual performance and the consensus that newspaper publishing was trending downward, management predicted that the company would *materially outperform* in the second half of 2007 compared to 2006. JA0200. For subsequent years, the February Projections forecast further growth and improved performance, with EBITDA projections that were "considerably higher than even [the] most aggressive Wall Street estimate." JA0200.



JA0201.

The officers knew the projections were baseless. For example, the officers forecast that Tribune would start raking in cash from its joint ventures, even though there was no precedent or practical rationale for that. JA0201. Tribune's point person for the ventures remarked: "[W]e have set very unrealistic expectations." JA0202. Tribune's directors also knew that management's projections were unrealistic. As director Stinehart complained, any "projected turnaround" would be "hard to believe with no proposed change in strategy and little prospect for an upturn in the core businesses." JA0184.

In March 2007, just a month after the February Projections were prepared, they were belied by the release of Tribune's *actual* results for the first two months of 2007, which were materially worse than forecast. JA0235-JA0237. But Tribune's officers elected not to correct the projections until after the Board approved the transaction. JA0235. That tactic worked. On April 1, 2007, the Independent Directors unanimously recommended that the Board approve the LBO, and the Board did so.[3] JA0226. Tribune thus agreed to cash out all of its shareholders at a lofty $34 per share. JA0178.

2. The Board Searches For A Solvency Opinion

To obtain the necessary financing, the Board needed a firm to opine that Tribune would remain solvent following the LBO. This was hard, even with the unrealistic February Projections. The Board engaged Duff & Phelps, granting it access to the firm's financials. But Duff & Phelps concluded that the LBO would render Tribune insolvent. JA0204-JA0205. The Board thus approached Houlihan Lokey, which promptly declined the assignment. JA0211.

Desperate for a solvency opinion, Tribune found a virtually unknown firm, VRC. JA0211. On April 11—ten days *after* the Board approved the LBO—Tribune engaged VRC. JA0212-JA0213. Like Duff & Phelps, VRC could not, using standard methodologies, conclude that Tribune would be solvent after the LBO. JA0212-JA0213. But VRC was willing to use a non-standard approach.

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[3] The directors appointed by the Chandler Trusts abstained, and one Independent Director was absent. Zell joined the Board after the vote.

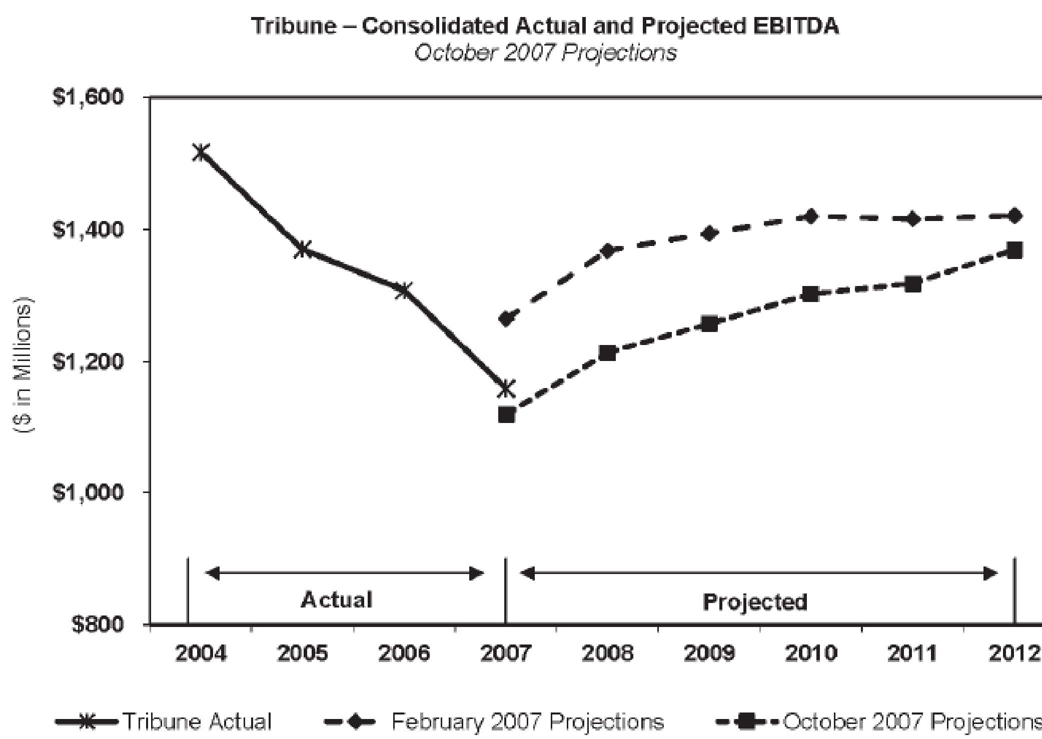
JA0238-JA0241. At the direction of Tribune's officers, VRC created a Step One solvency opinion that ignored the company's extant commitments due at Step Two and used a non-standard definition of fair value. JA0237-JA0240.

Meanwhile, reality was further discrediting the officers' financial projections. By May 2007, Tribune's publishing segment had fallen 12% short of the operating cash flow projected just months earlier. JA0233. The officers and directors knew that (JA0234-JA0235) but continued to rely on VRC's solvency opinion, which was based on the discredited February Projections. The officers downwardly revised their *internal* projections in May but did not distribute those numbers to VRC or other outsiders. JA0236. No one on the Board questioned VRC's unorthodox methodologies or the ever-widening chasm between the company's projections and actual results. JA0241-JA0242. Instead, Tribune's officers delivered VRC's flawed solvency opinion to the financing banks, certifying that Tribune would be solvent after Step One. JA0239.

D. The LBO And Subsequent Bankruptcy

On June 4, 2007, Step One closed, rendering Tribune balance-sheet insolvent, unable to pay its debts as they came due, and inadequately capitalized. JA0245. The Chandler Trusts dumped all their shares, participating in the Step One tender to the extent possible and selling their remaining shares in a block trade for nearly $4 per share below the LBO per-share price. JA0164. The directors they appointed (the "Chandler Directors") resigned from the Board.

As 2007 unfolded, Tribune's results were so poor that even Tribune's management felt the need to update the projections in October (the "October Projections"). JA0250. As shown in the graph below, compared to the February Projections, the October Projections forecast much lower EBITDA for 2007 but conveniently forecast that EBITDA would grow far more rapidly in subsequent years—in spite of unrelenting declines from 2004 through 2007. JA0251. The October Projections, like the February Projections, had no basis and contradicted industry and company trends.



JA0251.

VRC used Tribune's October Projections in its Step Two solvency opinion even though VRC's own forecasts were much lower. JA0257-JA0258. But even Tribune's fantastic new projections could not support a solvency opinion. Tribune's officers thus found ways to decrease liabilities artificially. The officers prevailed upon VRC to count some debts at only about half their $1.256 billion face value. JA0254-JA0255. But VRC still concluded that Tribune would not have enough cash to repay its debts in 2014 and 2015 unless it could refinance maturing debt. JA0255. VRC told Tribune management that it needed an outside financial advisor to represent that the company could refinance that debt. Morgan Stanley refused to do so, yet Tribune officers told VRC that Morgan Stanley had done so. JA0255-JA0256. Relying on that lie, VRC opined that Tribune would be solvent after Step Two.

On December 20, 2007, Step Two closed, leaving the company more than $13 billion in debt. Altogether, Tribune's directors and officers received more than $85 million. JA0156, JA0158. Less than a year later, Tribune filed for bankruptcy in Delaware.

II. PROCEDURAL HISTORY

In Tribune's bankruptcy case, the Official Committee of Unsecured Creditors obtained standing to assert claims of Tribune's bankruptcy estate for the benefit of its creditors. It thus filed this action in bankruptcy court in 2010. In

2011 and 2012, the Judicial Panel on Multidistrict Litigation transferred this case to the Southern District of New York.

In July 2012, the Delaware bankruptcy court confirmed Tribune's plan of reorganization, under which the Official Committee's causes of action were transferred to a litigation trust, and the Trustee succeeded the Committee as plaintiff. SA004. The Tribune cases were transferred to Judge Richard J. Sullivan in 2013 and reassigned to Judge Denise L. Cote in late 2018.

A. January 2017 Opinion Dismissing Intentional-Fraudulent-Transfer Claim Against Shareholders

The Bankruptcy Code authorizes the Trustee to avoid and recover "intentional fraudulent transfers"—transfers made by Tribune "with actual intent to hinder, delay, or defraud" its creditors. 11 U.S.C. § 548(a)(1)(A). Under that provision, the Trustee sought to recover Tribune's LBO payments to its former shareholders.

In January 2017, Judge Sullivan dismissed that claim. Rejecting Judge Cote's ruling in *In re Lyondell Chemical Co.*, 554 B.R. 635 (S.D.N.Y. 2016), he held that, in ascertaining the corporate intent of Tribune, he could consider only the intent of the individuals who finally authorized the transfers or "controlled" those who did. SA007-SA015. Here, Judge Sullivan stated, Tribune's Independent Directors formally authorized the transfers; and, because Tribune's officers did not "control" those directors, the intent of those officers (no matter how wrongful) could not be imputed to the company. SA007-SA015. Judge Sullivan concluded that the Independent Directors were not sufficiently alleged to have the requisite intent to hinder, delay, or defraud creditors. SA015-SA026. Finally, Judge Sullivan denied leave to amend the complaint to address his novel imputation standard. SA026-SA027.

B. April 2019 Opinion Denying Leave To Amend

The Trustee may also avoid and recover "constructive fraudulent transfers": those made while a debtor was insolvent (or rendered insolvent) without receiving "reasonably equivalent value" in return. 11 U.S.C. § 548(a)(1)(B). But avoidance of constructive fraudulent transfers, unlike avoidance of intentional fraudulent transfers, is subject to an affirmative defense codified in 11 U.S.C. § 546(e).

The Trustee did not initially seek to avoid the LBO payments as constructive fraudulent transfers. That was because binding precedent in this Circuit and the Third Circuit (where this action was commenced) construed Section 546(e) to preclude constructive-fraudulent-transfer claims when the transfer passed through a financial institution acting as a mere conduit. *See In re Quebecor World (USA) Inc.*, 719 F.3d 94, 100 (2d Cir. 2013); *In re Resorts Int'l, Inc.*, 181 F.3d 505, 516 (3d Cir. 1999).

Other plaintiffs, however, did seek to avoid the LBO payments as constructive fraudulent transfers. Section 546(e) applies by its terms only to constructive-fraudulent-transfer claims brought by "the trustee" under the Bankruptcy Code. Thus, in other cases, certain Tribune creditors brought constructive-fraudulent-transfer claims under *state law* against Tribune's former shareholders. Those cases were transferred with this one to the Southern District of New York. That court dismissed the creditors' cases, and this Court affirmed. *In re Tribune Co. Fraudulent Conveyance Litig.*, 818 F.3d 98 (2d Cir. 2016). It held that, under Circuit precedent, Section 546(e) applied to the transfers at issue, and that Section 546(e) preempted the creditors' state-law actions. The creditors filed a petition for a writ of certiorari.

In May 2017, the Supreme Court granted certiorari in *Merit Management Group, LP v. FTI Consulting, Inc.*, 137 S. Ct. 2092 (2017), to resolve a circuit split implicating this Circuit's Section 546(e) precedent. Thereupon, the Trustee sought leave to amend his complaint to add a constructive-fraudulent-transfer claim targeting the LBO payments. JA0508-JA0511. The district court denied the Trustee's request as premature but noted that, "[i]f, and when, the Supreme Court" abrogated this Circuit's precedent, "the Trustee would have a strong argument in support of amending his complaint." SA030.

In February 2018, the Supreme Court abrogated this Circuit's Section 546(e) precedent. *Merit Mgmt. Grp., LP v. FTI Consulting, Inc.*, 138 S. Ct. 883, 892 n.6, 897 (2018). Soon thereafter, Justices Kennedy and Thomas issued a "statement" regarding the Tribune creditors' pending cert. petition, suggesting that this Court recall its 2016 mandate. *Deutsche Bank Tr. Co. Ams. v. Robert R. McCormick Found.*, 138 S. Ct. 1162 (2018). This Court then recalled its mandate in the creditors' appeal "in anticipation of further panel review." Order, Case No. 13-3992(L), ECF No. 386 (May 15, 2018).

Meanwhile, nine days after the Supreme Court decided *Merit*, the Trustee renewed his request to amend his complaint. JA0536-JA0538. By the time the district court disposed of that renewed request, this Court had recalled its mandate in the creditors' appeal. The district court "stayed" the Trustee's request to amend pending action by this Court in the creditors' appeal. SA035.

On April 1, 2019, immediately upon learning that the Trustee had settled with most of the director and officer defendants, the district court directed the Trustee to file his motion to amend and the parties to brief the amendment issue within *twelve* days. *See* JA0831.

On April 23, 2019, the district court denied the Trustee's motion to amend on two independent grounds. First, it held that the defendants would "suffer substantial prejudice if the Trustee's proposed amendment is allowed." SA196. Second, the court held that the amendment would be futile because the Section 546(e) defense would still apply, notwithstanding *Merit*, because Section 546(e) immunizes transfers by "financial institution[s]," and Tribune was a "financial institution." SA199-SA213.

On December 19, 2019, this Court issued an amended opinion in the creditors' appeal. *In re Tribune Co. Fraudulent Conveyance Litig.*, --- F.3d ---, 2019 WL 6971499 (2d Cir. Dec. 19, 2019). It held, as it had in 2016, that Section 546(e) applies to the transfers at issue. The amended opinion based that holding on the conclusion, like the April 23 futility holding of the district court, that Tribune was a "financial institution." *Id.* at *6. As the district court did in its April 23 opinion, the panel relied entirely on documents outside the complaint. The creditors have sought rehearing and rehearing en banc.

C. November 2018 Opinion Dismissing Claims Against Controlling Shareholders And Their Representatives

In November 2018, the district court dismissed claims against the Controlling Shareholders and the Chandler Directors for breach of fiduciary duty, aiding and abetting breach of fiduciary duty, and unjust enrichment. The court held that the Trustee had standing to bring only claims that creditors could bring under Delaware law, which in turn depended on when Tribune became insolvent under Delaware law. SA045-SA046.

The court rejected the Trustee's argument that, in assessing Tribune's solvency, a court must treat the LBO as a unitary transaction. Instead, the court asked whether Tribune was insolvent at each step. SA047-SA050. It held that the

Trustee had insufficiently pleaded insolvency at Step One as a matter of Delaware law. SA050-SA051. This holding, the court reasoned, defeated the Trustee's claims against the Controlling Shareholders (the Chandler Trusts and Foundations) because (i) without alleging insolvency at Step One, the Trustee lacked standing (SA045-SA047); and (ii) the Chandler Trusts had sold their shares before Step Two, and thus the Controlling Shareholders lacked sufficient control over Tribune at Step Two (SA052).

On a motion for reconsideration, Judge Cote, who inherited the case from Judge Sullivan, reversed the standing holding. SA170. Judge Cote did not, however, disturb the holdings that the court must consider each step of the LBO separately and that the Trustee had not sufficiently alleged that Tribune was insolvent at Step One. SA171-SA175. For those reasons, she agreed that the Trustee had not stated a claim.

D. January 2019 Opinion Dismissing Claims Against Financial Advisors

In January 2019, Judge Cote dismissed the Trustee's claims against Tribune's financial advisors. Those claims were for aiding and abetting breaches of fiduciary duty, breach of fiduciary duty (against Morgan Stanley only), professional malpractice, intentional and constructive fraudulent transfers, and unjust enrichment.

Judge Cote recognized that the Trustee had sufficiently pleaded some of the claims. SA143-SA147. But, applying the imputation standard she had adopted in *Lyondell* (but which Judge Sullivan had *rejected* in dismissing the Trustee's intentional-fraudulent-transfer claim), she held that the affirmative defense of *in pari delicto* barred recovery. She declined to apply the adverse-interest exception to *in pari delicto* on the ground that the LBO had "some corporate purpose." SA152. The court separately held that the *in pari delicto* doctrine likewise barred the Trustee's claims for breach of fiduciary duty. SA179-SA180.

E. This Appeal

On June 13, 2019, the district court entered a final judgment under Federal Rule of Civil Procedure 54(b) with respect to the non-settling defendants on the dismissed claims. SA216.

There are three categories of defendants-appellees. The first encompasses Tribune's shareholders that received transfers of cash from the company in the LBO.[4] The district court dismissed the Trustee's intentional-fraudulent-transfer claim against these appellees and denied the Trustee's motion to amend to assert constructive-fraudulent-transfer claims against them.

[4] The Trustee has omitted as appellees shareholders he believes received less than $100,000.

The second category of appellees includes the Controlling Shareholders. These appellees owned at least 33% of Tribune's stock when the LBO was agreed to and received more than $2 billion of LBO transfers. They fall within the first category above but were also sued for breaching fiduciary duties, aiding and abetting breaches of fiduciary duty by Tribune's directors and officers, and unjust enrichment.

The third category comprises outside professionals Tribune hired to provide solvency opinions and other advice. The Trustee asserted claims against these appellees for aiding and abetting breaches of fiduciary duty, breach of fiduciary duty, professional malpractice, recovery of fees paid as intentional and constructive fraudulent transfers, and unjust enrichment.

SUMMARY OF ARGUMENT

I.A. The district court applied the wrong standard for identifying the individuals whose intent could be imputed to Tribune. The court decided to impute only the intent of (i) the Independent Directors, who made the final decision legally authorizing the transfer, and (ii) corporate agents who *controlled* the Independent Directors' decision. But that "control" standard is groundless. Courts charge a corporation with the intent of agents who *caused* the transfer or, alternately, of agents acting within the scope of their employment. Either standard reaches Tribune's officers. To rule otherwise would immunize transactions in which management fabricated the company's numbers but concealed that chicanery from the directors who made the final decision.

B. Even under the mistaken "control" standard, the Trustee sufficiently alleged that Tribune's Independent Directors had the requisite intent. Among other things, the directors knew that Tribune was relying on unrealistic projections and could not get an industry-standard solvency opinion; they were also paid handsomely to look the other way in approving the LBO.

C. The district court should not have dismissed the claim with prejudice. Courts *must* grant leave to amend when they dismiss a complaint for failure to allege sufficient intent. Moreover, the district court's "control" test was novel; the Trustee had no reason to anticipate it in his pleadings. Leave to amend would not have caused undue prejudice: Delay alone *never* constitutes undue prejudice.

II.A. The district court erroneously refused to permit the Trustee to amend the complaint to add a constructive-fraudulent-transfer claim following a change in controlling law. First, the court's holding that Tribune was a "financial institution," rendering its shareholders exempt from constructive-fraudulent-transfer claims, was procedurally and substantively unsound. The court improperly considered *and misread* documents outside the complaint that were neither judicially noticeable nor integral to the complaint. And the district court misunderstood, in several independently reversible respects, the relevant definition of "financial institution."

B. Second, the district court erred in holding that amendment would unduly prejudice the former shareholders. The Trustee sought to amend even *before* the Supreme Court in *Merit* made it possible to bring the claim. The district court ruled (at the defendants' request) that the Trustee's motion to amend would be *premature*. The Trustee then sought to amend as soon as *Merit* was decided, only to be thwarted again (also at the defendants' request). The Trustee was thus too early until he was held to be too late. In truth, he was neither—and, in any event, delay alone *never* constitutes undue prejudice.

III.A. The district court misapplied the state-law tests for solvency in assessing whether Tribune was insolvent at Step One. The court concluded that Steps One and Two should be viewed as independent transactions because, when Step One closed, it was not "certain" that Step Two would close. As a result, the court declined to consider the allegations about Step Two when assessing insolvency at Step One. That is wrong for two independently sufficient reasons. First, because the LBO was a unitary transaction, there is no basis to analyze the steps separately for solvency purposes. Second, even were the steps analyzed separately, assessing solvency at Step One requires consideration of the Step Two obligations, because Tribune had committed to those obligations before Step One.

B. The district court should not have dismissed with prejudice. A plaintiff is permitted to try to cure the defects identified in a court's first ruling on the sufficiency of a complaint.

IV. The district court erred in dismissing the Trustee's claims against Morgan Stanley and VRC, for the reasons stated by the Trustee in the companion case *Kirschner v. Citigroup Global Markets Inc.*, No. 19-449 (2d Cir.).

STANDARD OF REVIEW

This Court "review[s] *de novo* a district court's dismissal of a complaint under Rule 12(b)(6), accepting all of the complaint's factual allegations as true and drawing all reasonable inferences in the plaintiff['s] favor." *Giunta v. Dingman*, 893 F.3d 73, 78-79 (2d Cir. 2018). It "review[s] a district court's denial of leave to amend for abuse of discretion, unless the denial was based on futility, in which case [the Court] review[s] that legal conclusion *de novo*." *City of Pontiac Policemen's & Firemen's Ret. Sys. v. UBS AG*, 752 F.3d 173, 188 (2d Cir. 2014). An error of law constitutes an abuse of discretion. *Ragbir v. Homan*, 923 F.3d 53, 62 (2d Cir. 2019).

ARGUMENT

I. THE DISTRICT COURT ERRED IN DISMISSING THE INTENTIONAL-FRAUDULENT-TRANSFER CLAIM WITH PREJUDICE

The Trustee alleges that Tribune cashed out its former shareholders "with actual intent to hinder, delay, or defraud" its creditors. 11 U.S.C. § 548(a)(1)(A). As the complaint sets out in detail, Tribune's senior management fabricated the company's projections (JA0200-JA0202, JA0233-JA0236), lied about Tribune's ability to refinance debt (JA0255-JA0256), subscribed to bogus valuation standards that only a third-string valuation firm would touch (JA0211, JA0237-JA0241), and manipulated Tribune's balance sheet to make its liabilities appear lower (JA0254-JA0255). Those allegations—especially taken as a whole (*see In re Amaranth Nat. Gas Commodities Litig.*, 730 F.3d 170, 183 (2d Cir. 2013))—show that Tribune's management had fraudulent intent when it engineered the LBO. Neither the defendants nor the court suggested otherwise.

Notwithstanding management's chicanery, the district court declined to impute management's intent to Tribune. Adopting a test that has been rejected by nearly every court to consider it (including the Supreme Court), the district court held that the only agents whose intent matters are those who were "in a position to control the disposition of [the corporation's] property." SA008 (quotation marks omitted). Here, said the court, Tribune's Independent Directors ultimately approved the LBO, so only *their* intent, and that of any Tribune officers who "controlled" those directors, could be imputed to the corporation.

According to the district court, the Trustee had not satisfied that novel standard: Senior management was not alleged to "control" the Independent Directors, and the latter were insufficiently alleged to have their own fraudulent intent. Despite adopting a novel standard, the court then refused to permit the Trustee to amend the complaint to fix those supposed shortcomings, holding that amendment would be futile and prejudicial. SA001-SA027.

That decision should be reversed.

A. The District Court Applied The Wrong Imputation Standard, And Under The Correct Standard The Complaint Was Easily Sufficient

1. Tellingly, nearly every court to consider the district court's "control" standard for imputing corporate intent has rejected it. *Staub v. Proctor Hospital*, 562 U.S. 411 (2011), is particularly instructive. Plaintiff alleged that the defendant hospital had discharged him from employment because it was hostile to his obligations as a military reservist. Applying essentially the same rule as Judge Sullivan did here, the Seventh Circuit held that, although plaintiff's two supervisors possessed wrongful intent, the vice president of human resources—who lacked any such intent—"ma[de] the ultimate employment decision." *Id.* at

415. Because only the vice president's intent could be imputed, the Seventh Circuit ruled against the plaintiff.

The Supreme Court reversed. Although the two supervisors did not control the ultimate discharge decision, the Court, looking to "general principles of law . . . against which federal tort laws are enacted," *id.* at 418, imputed their wrongful intent to the corporation. The Court discerned two lines of imputation authority in the common law—a narrower one, in which "the malicious mental state of one agent cannot generally be combined with the harmful action of another agent to hold the principal liable for a tort that requires both"; and a broader one, which permits such aggregation. *Id*. The statute under which plaintiff brought his claim fit the former line of authority better. The Court accordingly held that, so long as plaintiff's supervisors acted with the requisite intent and were "the proximate *cause* of" plaintiff's discharge by the vice president, their discriminatory intent was imputed to the company. *Id.* at 419 (emphasis added).

Even under the narrower "proximate cause" rule applied in *Staub*, the Trustee's complaint sufficiently imputed the fraudulent intent of senior Tribune management to the corporation. When the Independent Directors approved the LBO, they relied on the misleading financial projections Tribune's officers had created. JA0232-JA0238. The Independent Directors likewise relied on VRC's solvency analyses (JA0237-JA0238, JA0241-JA0242, JA0259), which Tribune's officers had skewed by lying to VRC, directing it to make unfounded assumptions, and agreeing that it would not use industry valuation standards (JA0238-JA0239, JA0240, JA0253-JA0259, JA0264-JA0265). These acts (and others) satisfy the rule of *Staub* because they were the but-for cause of, and bear "some direct relation" to, the LBO. *See* 562 U.S. at 419 (quotation marks omitted).

But, as the Supreme Court recognized in *Staub*, federal common law in some contexts also includes an even broader imputation standard. Under that broader test, the wrongful intent of an agent acting within the scope of employment may be imputed to the corporation even if that agent did not herself proximately cause the harmful action. *Id.* at 418 (citing cases). Judge Cote adopted that broader imputation rule in *Lyondell*, 554 B.R. 635, a case very much like this one. Lyondell's CEO had knowingly presented false financial projections to his board when it was considering the challenged LBO. The bankruptcy court dismissed the action, holding that "the appropriate standard for imputation was 'whether the individual whose intent is to be imputed was in a position to control the disposition of [the transferor's] property.'" 554 B.R. at 643 (quoting *In re Lyondell Chem. Co.*, 503 B.R. 348, 388 (Bankr. S.D.N.Y. 2014)). Because Lyondell's board of directors, not its CEO, ultimately approved the LBO, the CEO's intent could not be imputed to the company. (In the present case, Judge Sullivan expressly adopted the *Lyondell* bankruptcy court's reasoning. SA008.)

Judge Cote reversed the *Lyondell* bankruptcy court. She explained that "the 'general rule of imputation'" provides that a corporation is "liable for the acts and knowledge of its agents 'even when the agent acts fraudulently or causes injury to third persons through illegal conduct.'" 554 B.R. at 647 (quoting *Stewart v. Wilmington Trust SP Servs., Inc.*, 112 A.3d 271, 303 (Del. Ch. 2015)).[5] Accordingly, because the CEO's misconduct was within the scope of his duties, and was "performed by an officer on behalf of [the] corporation," his "knowledge and intent may be imputed to Lyondell," even though the board, not the CEO, ultimately approved the LBO. *Id*. at 648, 649.[6]

This broader imputation principle—that the wrongful intent of a corporate agent acting within the scope of employment may, without more, be imputed to the corporation—is routinely applied in criminal prosecutions. For example, in *United*

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[5] Judge Cote applied Delaware law, noting that it is "consistent with the law of imputation found in other jurisdictions." 554 B.R. at 647 (citing both federal and New York law). In our view, the standard for imputation under 11 U.S.C. § 548 is set by federal law, not state law. *See In re ChinaCast Educ. Corp. Sec. Litig.*, 809 F.3d 471, 475 n.4 (9th Cir. 2015).

[6] When Judge Cote inherited the present case from Judge Sullivan, she analyzed the *in pari delicto* defense using the standard for imputation she applied in *Lyondell* and, on that basis, dismissed the Trustee's claims for breach of fiduciary duty, aiding and abetting, professional malpractice, and unjust enrichment. SA142 n.20, SA149, SA157. By contrast, Judge Sullivan *declined* to adopt Judge Cote's *Lyondell* standard for imputation, and on that basis dismissed the intentional-fraudulent-transfer claim. These rulings cannot both be correct.

States v. Shortt Accountancy Corp., 785 F.2d 1448 (9th Cir. 1986), an accountant intentionally advised a client to take an illegal deduction. He then passed the deduction information to a colleague, who unwittingly subscribed to the deduction's legality. Even though the first accountant had not taken the final step by actually filing the tax return, the court imputed his intent to the accounting corporation. *Id.* at 1454; *see also United States v. Bank of New England, N.A.*, 821 F.2d 844, 856 (1st Cir. 1987).[7]

This Court need not decide which line of authority is correct, as the complaint would pass muster under either. Senior management's intentional misconduct proximately caused the Independent Directors' votes for the LBO. And the acts of Tribune's officers, such as creating the financial projections on which the Independent Directors would rely, were within the scope of their employment. Thus, the Trustee has stated a claim.

2. By contrast, Judge Sullivan's "control" standard lacks support in the common law. As Judge Cote explained in *Lyondell*, 554 B.R. at 649, this standard was inappropriately extrapolated from a line of cases in which the fraudulent intent

[7] The Department of Justice has followed a broad imputation rule for decades. *See* Memorandum from Larry D. Thompson, Deputy Att'y Gen. at 5 (Jan. 20, 2003); Memorandum from Mark Filip, Deputy Att'y Gen. (Aug. 28, 2008); Dep't of Justice, *Civil RICO: A Manual for Federal Attorneys* 49-50 (Oct. 2007); Dep't of Justice, *Principles of Federal Prosecution of Business Organizations* § 9-28.700 (Nov. 2018).

of a *transferee* has been used to find the fraudulent intent of a *transferor*. That is why at least one court in this context has expressly rejected the imputation holding of Judge Sullivan here in favor of Judge Cote's *Lyondell* standard. *In re TMST, Inc.*, No. 09-17787, 2019 WL 6883776, at *10 (Bankr. D. Md. Dec. 17, 2019) ("[W]hen imputing *the transferee's intent*, the control test . . . applies; in all other contexts, traditional rules of agency apply.").

a. 11 U.S.C. § 548(a)(1)(A) provides in pertinent part that a trustee "may avoid any transfer . . . if the debtor . . . made such transfer . . . with actual intent to hinder, delay, or defraud any entity." Under that provision, it is ordinarily the intent of "the debtor"—the *transferor*—that counts for purposes of an intentional fraudulent transfer.

But there is a narrow exception: In rare cases, the intent of "the *transferee*" is "imputed to the debtor . . . , regardless of the actual purpose of the debtor." *In re Elrod Holdings Corp.*, 421 B.R. 700, 709 (Bankr. D. Del. 2010) (emphasis added) (quoting 5 *Collier on Bankruptcy* ¶ 548.01 (15th ed. 2009)). That exception applies if the transferee "was in a position to *control* the disposition of [the debtor's] property." *In re Roco Corp.*, 701 F.2d 978, 984 (1st Cir. 1983) (emphasis added). In that unusual setting, "the property passes, for all practical purposes, from one hand to the other of the same person." *Elrod*, 421 B.R. at 711 (quotation marks omitted). Only some fifteen cases (to our knowledge) have applied this standard at all, and, in the fraction of those finding it satisfied, the transferee owned all or almost all of the transferor's equity. *E.g.*, *In re Atomica Design Grp., Inc.*, 556 B.R. 125, 162 (Bankr. E.D. Pa. 2016).

b. In the present case, the Trustee does not rely on the intent of transferees who were not corporate agents but instead on the conduct and intent of Tribune's officers. Nonetheless, the district court extrapolated the "control" test for imputing a *transferee's* intent and deployed it to narrow the range of *transferor* personnel whose intent may be imputed to the *transferor*. That was doubly flawed.

First, this is not a transferee case. No one seeks to impute to Tribune the intent of its shareholders (the transferees). The question, instead, is the intent of the *transferor*, Tribune itself. *See TMST*, 2019 WL 6883776, at *10 (cases "addressing the imputation of intent from the *transferee* to the *transferor*" do not address "imputation generally of a corporate officer to a corporation").

Second, besides incorrectly extrapolating from transferee cases, the court misread those cases. Even in the context of a controlling transferee, no court (to our knowledge) has ever held that the *only* intent that matters is the intent of the controlling party. Indeed, many courts look to the transferee's intent only *after* holding that the transferor lacked the required intent. *E.g.*, *Elrod*, 421 B.R. at 709; *In re MarketXT Holdings Corp.*, 361 B.R. 369, 396 (Bankr. S.D.N.Y. 2007). Thus, the intent of a non-controlling party that played a part in the challenged transfer is also relevant.[8]

3. The district court's "control" test would work a sea change in broad swaths of the law. Imagine a public company—say, Enron—in which the audit committee has final approval authority over the creation of certain off-balance-sheet partnerships later determined to be fraudulent. *See* Kathleen Day, *Broken Bargain: Bankers, Bailouts, and the Struggle to Tame Wall Street* 206 (2019). Imagine, further, that management has deliberately concealed from the audit committee critical information about those partnerships, and consequently the committee does not have the requisite intent to deceive. Under the district court's imputation standard, only the audit committee, not management, has "control" over the creation of those off-balance-sheet partnerships, so only its intent counts.

Can it be that a corporation is insulated from criminal enforcement for fraudulent conduct, simply because the responsible employees shielded "controlling" officials from the requisite knowledge and intent? Or, instead, is the corporation liable because the intent of senior management—which caused the

[8] To be sure, "control" (the threshold for imputing *transferees'* intent) is the test in *other* areas of corporate law. For example, it determines when shareholders owe fiduciary duties and whether directors are "independent." The district court cited cases on such issues. SA009-SA012. But those cases do not address the issue here—whether "control" is the right test for imputing intent to a corporation.

audit committee to authorize the formation of the partnerships—may be imputed to the corporation?

This case starkly illustrates how much management can matter. Although Tribune's Independent Directors voted for the LBO, they did not make that decision in a vacuum. The officers created the financial projections critical to that vote. Even when it was clear that Tribune could not achieve the officers' projections, the officers declined to make more realistic forecasts. They instructed VRC to use those projections even though VRC's internal models took a much grimmer view. The officers also had VRC use non-standard definitions and methodologies to create a façade of solvency. And, when they could not manipulate the financial picture any further, they lied and told VRC that Morgan Stanley had agreed that Tribune could refinance maturing debt. JA0199-JA0200, JA0235-JA0236, JA0250-JA0253. The Board's decision relied on those flawed projections and the reverse-engineered solvency opinions. And VRC's solvency opinion, no less than Board approval, was required for the LBO to close.

B. Even Applying The District Court's Erroneous Imputation Standard, The Independent Directors Had The Required Intent

Even under the district court's "control" standard, the Trustee sufficiently alleged that the Independent Directors had "intent to hinder, delay, or defraud" Tribune's creditors. *See* 11 U.S.C. § 548(a)(1)(A).

To allege the required intent, plaintiffs may rely on "badges of fraud." *In re Sharp Int'l Corp.*, 403 F.3d 43, 56 (2d Cir. 2005). Such "badges" include:

> (1) the lack or inadequacy of consideration; (2) the family, friendship or close associate relationship between the parties; (3) the retention of possession, benefit or use of the property in question; (4) the financial condition of the party sought to be charged both before and after the transaction in question; (5) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt [or] onset of financial difficulties . . . ; and (6) the general chronology of the events and transactions.

In re Kaiser, 722 F.2d 1574, 1582-83 (2d Cir. 1983). "The presence of a single badge of fraud may spur mere suspicion; the confluence of several can constitute conclusive evidence of an actual intent." *Max Sugarman Funeral Home, Inc. v. A.D.B. Inv'rs*, 926 F.2d 1248, 1254-55 (1st Cir. 1991) (citation omitted).

The district court misapplied this established standard, particularly at the motion-to-dismiss stage. When assessing the badges of fraud, the court did not give due weight to the Trustee's sufficient allegation of the first and fourth badges (lack of consideration and Tribune's financial condition). *See* SA019. And it wrongly concluded, looking at certain facts in isolation, that the Trustee insufficiently alleged the second, fifth, and sixth badges.

As to the second badge (relationship between the parties), the Independent Directors themselves received more than $6 million. SA013. The district court belittled this sum as "min[u]scule" compared with the LBO. SA018. But that misdirects the eye. Paid to any handful of directors, $6 million is a lot; the district court elsewhere held that $6 million sufficed to make the directors interested in the transaction and thus susceptible to a claim for breach of fiduciary duty. SA116-SA117. In any event, the Independent Directors had relationships with the other directors and the Controlling Shareholders they represented, which together received more than $2 *billion* in the LBO. JA0156, JA0164-JA0166.

As to the fifth and sixth badges (pattern of transactions and general chronology), the district court held that Tribune's LBO was like any other. SA019-SA020. But Tribune's was worse in many ways. For example, the directors knew that Tribune was falling far short of projections and thus was unlikely to generate enough cash to service its debt (JA0232-JA0235, JA0250-JA0253); the directors knew that Zell was putting into the transaction only a sliver of equity (JA0178); the directors knew that Tribune could not obtain an industry-standard solvency opinion (SA080-SA083); and the directors in 2006 had used much more realistic downside scenarios when evaluating a transaction involving much less debt than the LBO involved (JA0219, JA0221, JA0237).

C. At A Minimum, The District Court Should Have Granted Leave To Amend

Even if the district court properly dismissed the intentional-fraudulent-transfer claim, it should not have dismissed with prejudice. An amendment would have enabled the Trustee to satisfy the court's novel imputation standard. It would also include facts, developed in discovery—allowed only after dismissal of the claim at issue, in connection with non-dismissed claims—confirming that the directors possessed the required intent. For example, before the LBO, the directors had told a consultant how bleak they thought Tribune's future was. And the outside directors acquiesced in a steep cut to projections just weeks after the LBO.

The district court denied leave to amend on futility and prejudice grounds. SA026-SA027. Errors of law tainted both grounds.

Futility. The district court dismissed for insufficiently alleging fraudulent intent under Federal Rule of Civil Procedure 9(b). SA005-SA006. In such circumstances, "failure to grant leave to amend is an abuse of discretion." *Caputo v. Pfizer, Inc.*, 267 F.3d 181, 191 (2d Cir. 2001).

The district court appears to have relied on an exception for instances in which "the defective allegations were made after full discovery in a related case" (*see Luce v. Edelstein*, 802 F.2d 49, 56 (2d Cir. 1986)), here, discovery in Tribune's bankruptcy case. SA026-SA027. But that discovery was directed at different issues and was woefully inadequate: Before the filing of the operative complaint, there had been no document production from, or interviews or depositions of, approximately half of the director and officer defendants, and no document production from the period immediately following the LBO. *See* JA0413-JA0416; JA0448. The Trustee also had not yet received the privileged documents that the bankruptcy plan assigned to him. JA0416. The lack of adequate discovery is evident from the fact that the Trustee was permitted to take significant merits discovery only well *after* the court denied leave to amend. JA0501-JA0507. In short, the Trustee had not, as the exception requires, "obtained all of the information he requested . . . with respect to the claims he sought to assert here." *See Ruffolo v. Oppenheimer & Co.*, 987 F.2d 129, 131-32 (2d Cir. 1993) (per curiam).

Rule 9(b) aside, amendment is warranted where "defects may . . . be latent, and easily missed or misperceived." *See Loreley Fin. (Jersey) No. 3 Ltd. v. Wells Fargo Sec., LLC*, 797 F.3d 160, 191 (2d Cir. 2015). That is true here. When the Trustee filed the operative complaint, no court had ever applied the district court's "control" standard for imputation. Whatever the propriety of that standard, no one can fault the Trustee for failing to anticipate it.

Prejudice. The district court cited the policy of "certainty, speed, finality, and stability of financial markets" that it believed Congress embedded in 11 U.S.C. § 546(e). SA027 (quotation marks omitted). But, even were that the policy of Section 546(e) (it is not; *see infra* at 57-58), that statute expressly exempts intentional-fraudulent-transfer claims "under section 548(a)(1)(A)"—like this one.

The district court's other rationale for its prejudice holding was "additional delay." SA027. But "[m]ere delay," without more, "does not provide a basis for a district court to deny the right to amend." *Pasternack v. Shrader*, 863 F.3d 162, 174 (2d Cir. 2017) (quotation marks omitted). Prejudice typically exists when amendment would add to substantially completed discovery. *E.g.*, *State Teachers Ret. Bd. v. Fluor Corp.*, 654 F.2d 843, 856 (2d Cir. 1981). Here, discovery was far from complete.

II. THE DISTRICT COURT ERRED IN DENYING LEAVE TO ADD A CONSTRUCTIVE-FRAUDULENT-TRANSFER CLAIM

A fraudulent-transfer claim may be either "intentional" (under 11 U.S.C. § 548(a)(1)(A)) or "constructive" (*id*. § 548(a)(1)(B)). Initially, the Trustee alleged only an intentional-fraud claim. When he made that allegation, binding precedent barred the Trustee from alleging constructive fraud. But, after *Merit* abrogated that precedent, the Trustee promptly moved to add a constructive-fraudulent-transfer claim.

The district court denied the motion on grounds of both futility and prejudice. SA181-SA213. Neither holding is valid.

A. Amendment Was Not Futile

The district court held that, notwithstanding *Merit*, 11 U.S.C. § 546(e) would immunize Tribune's shareholders from a constructive fraud claim because Tribune was a "financial institution" under the statute and the challenged transfers therefore were made by a financial institution. According to the district court, a trust company—Computershare Trust Company, N.A. ("CTC")—had processed the cash transfers Tribune made to its shareholders and had therefore served as

Tribune's "agent" in the challenged transaction. Under the definition of "financial institution" in 11 U.S.C. § 101(22)(A),[9] CTC's supposed role as Tribune's "agent" rendered Tribune *itself* a financial institution.

That holding was flawed at every turn. And it is not saved by this Court's December 2019 decision, in the creditors' *Tribune* appeal, that Tribune was a "financial institution" in connection with the LBO. *See Tribune*, 2019 WL 6971499, at *6-*9. In that case, the Trustee is not a party, the "financial institution" issue was not briefed in either the district court or this Court, and the panel did not even address two grounds for reversal here—that documents outside the complaint (if properly considered) show that CTC did not process the cash transfers, and that the statute requires a determination of agency at the time the transfers are sought to be avoided. Still more reasons why that case does not control this one are discussed below.[10]

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[9] "Financial institution" is defined in relevant part as "a Federal reserve bank, or an entity that is a commercial or savings bank, industrial savings bank, savings and loan association, trust company, federally-insured credit union, or receiver, liquidating agent, or conservator for such entity and, when any such Federal reserve bank, receiver, liquidating agent, conservator or entity is acting as agent or custodian for a customer (whether or not a 'customer', as defined in section 741) in connection with a securities contract (as defined in section 741) such customer." 11 U.S.C. § 101(22)(A).

[10] Should the Court believe that that case does control this one, use of the Court's "mini-*en banc*" procedure would be justified. *See Shipping Corp. of India Ltd. v. Jaldhi Overseas Pte Ltd.*, 585 F.3d 58, 67 n.9 (2d Cir. 2009). Mini-*en banc* overruling of a recent panel decision is warranted where the decision is

1. The District Court Improperly Relied On—And Misread—Documents Outside The Complaint To Determine What CTC Did

The district court stumbled at the get-go: It relied on documents outside the proposed amended complaint to find facts allegedly sufficient to establish the Section 546(e) affirmative defense. That is no more proper here than on a motion to dismiss. *See Thea v. Kleinhandler*, 807 F.3d 492, 496-97 (2d Cir. 2015).

The court's conclusion that amendment was futile depended on its holding that CTC was Tribune's "agent":

> The facts asserted in the [proposed amended complaint], when read *in combination with documents that are either judicially noticeable or are integral to the complaint*, establish that CTC was acting as Tribune's agent. CTC was entrusted with billions of dollars of Tribune cash and was *tasked with making payments on Tribune's behalf* to Shareholders upon the tender of their stock certificates to CTC. This is a paradigmatic principal-agent relationship.

SA210 (emphasis added).

This holding finds no support in the proposed amended complaint, which said nothing about CTC or how Tribune transferred the money. JA0836-JA1169.

"erroneous[]" and "significant" (*id.* at 67)—and the December 2019 decision is both. Decided without the benefit of any merits briefing, that holding misconstrued the "agent" and "securities contract" requirements of the definition of "financial institution." *See infra* at 46-56. And it extends Section 546(e) to nearly any case remotely involving securities—exactly the broad effect that the Supreme Court held in *Merit* the statute does not have. *See infra* at 57-58.

Plaintiffs need not plead facts relevant only to affirmative defenses like Section 546(e). *Jones v. Bock*, 549 U.S. 199, 216 (2007).

The holding therefore rests wholly on unspecified "documents that are either judicially noticeable or are integral to the complaint." SA210. Those documents appear to have been contracts between Tribune, on the one hand, and CTC and two affiliates, Computershare Shareholder Services, Inc. ("CSS") and Computershare, Inc. ("CI"), on the other. The defendants filed those contracts with their response to the Trustee's motion to amend. *See* JA2142-JA2155; JA2929-JA2941.

Neither document was judicially noticeable. Judicial notice covers only facts that "can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned." Fed. R. Evid. 201(b)(2). Which entity "ma[de] payments on Tribune's behalf to Shareholders," *see* SA210, is not such a fact. Besides, at the pleading stage, judicial notice applies only to a document's existence, not to its truth. *Staehr v. Hartford Fin. Servs. Grp., Inc.*, 547 F.3d 406, 425 (2d Cir. 2008).

Nor was either document "integral" to the complaint. "A document is integral to the complaint where the complaint relies heavily upon its terms and effect. Merely mentioning a document in the complaint will not satisfy this standard." *Goel v. Bunge, Ltd.*, 820 F.3d 554, 559 (2d Cir. 2016) (quotation marks and citations omitted). The Trustee's proffered complaint did not even *refer* to these documents.

The district court therefore violated the "strictly enforced" rule against "consider[ing] matters outside the pleadings." *Glob. Network Commc'ns, Inc. v. City of New York*, 458 F.3d 150, 155 (2d Cir. 2006) (quotation marks omitted). That alone warrants reversal: "[D]istrict courts are not free to bypass rules of procedure that are carefully calibrated to ensure fair process to both sides," and "the district court's gatekeeping procedures must . . . comply with the Federal Rules of Civil Procedure." *Palin v. New York Times Co.*, 940 F.3d 804, 812-13 (2d Cir. 2019).

The district court then made matters worse by misreading the materials on which it improperly relied. The court's "agency" finding rested on the premise that CTC was the entity "making payments on Tribune's behalf to Shareholders." SA210. But the contracts on which the district court relied explicitly assigned that task exclusively to CSS and CI, which were ordinary corporations, not banks or trust companies. The contracts went out of their way *not* to give that payment task to CTC. JA2145 (Tribune will "deposit" with CSS "an amount equal to the aggregate purchase price of all Shares," and "CSS shall thereupon . . . send a check for the purchase price . . . to each of the stockholders"); JA2930 (Tribune "shall provide to [CI] the funds necessary," and CI "shall make payment . . . in respect of such Shares by issuance of a check"). Thus, the court's conclusion that CTC performed the task—which mattered because "CTC is both a 'bank' and a 'trust company'" (SA205)—was wrong. Insofar as tasks other than processing payments are relevant, the contracts either say that CSS and CI performed the tasks or leave ambiguous which entity handled them. JA2142-JA2146; JA2929-JA2933.

2. The District Court Separately Erred In Finding That CTC Acted As Tribune's "Agent"

Even had CTC performed the stated tasks, CTC was not Tribune's agent. The contrary conclusion is irreconcilable with the established meaning of "agent" and with the statute as a whole.

a. The word "agent" has a "well-settled meaning" under common law. SA208 (quoting *DeKalb Cty. Pension Fund v. Transocean Ltd.*, 817 F.3d 393, 405 (2d Cir. 2016)). Thus, the district court assigned "agency" its common-law definition: "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control." SA209 (quoting Restatement (Third) of Agency § 1.01).

Embedded in that definition are two fundamental principles. First, agency is a *fiduciary* relationship. An agent owes a principal many fiduciary duties honed over centuries. *See* Restatement (Third) of Agency §§ 8.01-8.12. Such duties include, for example, "account[ing] for any profits realized in connection with [the agent's] representation of the principal" (*United States v. Miller*, 997 F.2d 1010, 1018 (2d Cir. 1993)), "disclos[ing] information [that] the agent should have known . . . would affect the desires and conduct of the principal" (*Evvtex Co. v. Hartley Cooper Assocs. Ltd.*, 102 F.3d 1327, 1333 (2d Cir. 1996)), and "refrain[ing] from . . . taking action on behalf of or otherwise assisting the principal's competitors" (Restatement (Third) of Agency § 8.04).

The second fundamental principle is that an agent acts *on the principal's behalf*. An agent has the "power to affect the legal rights and duties of" the principal. *Id.* § 1.01 cmt. c. That an agent has this "power to bind [the] principal" justifies the separate requirement that the principal must exercise control over the agent. *Att'y Gen. v. Irish N. Aid Comm.*, 668 F.2d 159, 161 (2d Cir. 1982) (per curiam). One prominent example of this power is that an agent may have authority to "bind[] the principal to a third person in contract." Restatement (Second) of Agency § 12 cmt. a; *see, e.g.*, *Am. Home Assurance Co. v. Hapag Lloyd Container Linie, GmbH*, 446 F.3d 313, 318 (2d Cir. 2006).

The district court erred when it ignored these fundamental principles. The sole basis for its agency finding was the (mistaken) belief that "CTC was entrusted with billions of dollars of Tribune cash and was tasked with making payments on Tribune's behalf to Shareholders upon the tender of their stock certificates to CTC." SA210. But no fiduciary duty inheres in such a relationship, even had the relationship existed. To the contrary, similarly situated entities, such as transfer and clearing agents,[11] are "generally under no fiduciary duty." *Edwards & Hanly v. Wells Fargo Sec. Clearance Corp.*, 602 F.2d 478, 484 (2d Cir. 1979). Likewise, nothing about CTC's asserted relationship with Tribune gave CTC the right to alter Tribune's legal relations.

Any doubt that these two fundamental attributes of agency were missing here would be dispelled by the documents on which the district court (improperly) relied. In those documents, CTC, CSS, and CI *opted out of fiduciary duties*: Those entities had "no duties or obligations other than those specifically set forth" in the contract, which did not list the fiduciary duties an agent would have. JA2144; JA2932. And they *opted out of the power to bind*: CTC, CSS, and CI could not "make any commitments with third parties that are binding on [Tribune] without [Tribune's] prior written consent." JA2149; JA2937. Having opted out of fiduciary duties and the power to bind, CTC, CSS, and CI necessarily opted out of any agency relationship, as contracting parties may do. *E.g.*, *EBC I, Inc. v. Goldman, Sachs & Co.*, 832 N.E.2d 26, 31 (N.Y. 2005).

b. A true principal-agent relationship would look very different. The canonical sort of relationship the statute envisions—*see supra* note 9—is one in

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[11] It is irrelevant that an entity is called an "agent" in commercial contexts. *In re Shulman Transp. Enters., Inc.*, 744 F.2d 293, 295 (2d Cir. 1984); Restatement (Third) of Agency § 1.02.

which the bank (or similar entity) manages (rather than merely holds) its customer's money. Such a relationship is "[a] fiduciary relationship," as it "involves discretionary authority" and "entrust[ing] the fiduciary with custody over property." *United States v. Chestman*, 947 F.2d 551, 569 (2d Cir. 1991) (en banc). In such a relationship, the agent could bind the principal to, say, securities contracts.

The statutory context confirms that Congress had such relationships in mind when it required that the bank or trust company be an agent. The statute applies when the bank or trust company is "acting as agent *or custodian*." 11 U.S.C. § 101(22)(A) (emphasis added). "Custodian" is defined narrowly in 11 U.S.C. § 101(11) to include only receivers, trustees, or the like that take control of the debtor's assets in insolvency situations for the benefit of the debtor's creditors. *See, e.g.*, *In re Metro. Adjustment Bureau*, 22 B.R. 67, 70 (B.A.P. 9th Cir. 1982) (noting that "custodian" entities "normally control[] all assets of the [customer]"). Unlike an agent, a custodian is in charge. But, like an agent, a custodian can bind the customer.[12]

[12] The district court ignored this context because, in its view, "*[n]oscitur a sociis* has limited application where, as here, there are just two words in a statutory phrase." SA209 n.10. No other court, to our knowledge, has so held. *See, e.g.*, *Freeman v. Quicken Loans, Inc.*, 566 U.S. 624, 635 (2012) (applying *noscitur a sociis* to a three-word list); Antonin Scalia & Bryan A. Garner, *Reading Law: The Interpretation of Legal Texts* 197-98 (2012) (praising the application of *noscitur a sociis* to a two-item list).

That Congress envisioned agents as being able to enter into securities contracts for their customers is also supported by the purpose and legislative history of Section 546(e). That statute's predecessor was enacted in response to a case permitting a fraudulent-transfer action against a clearing association. *See Merit*, 138 S. Ct. at 889-90. Congress was concerned that, through such actions, "the insolvency of one commodity or security firm" could "spread[] to other firms," destabilizing the market. H.R. Rep. No. 97-420, at 1 (1982), reprinted in 1982 U.S.C.C.A.N. 583, 583; *see generally* Peter V. Marchetti, *A Note to Congress: Amend Section 546(e) of the Bankruptcy Code To Harmonize the Underlying Policies of Fraudulent Conveyance Law and Protection of the Financial Markets*, 26 Am. Bankr. Inst. L. Rev. 1, 10-15, 20-24 (2018) (detailing legislative history). Such concerns have no place here. Tribune is a media company. The mere processing of its payments and stock certificates is ministerial, does not involve the kind of control over customers' money that would create an agency relationship, and does not affect market stability. The prohibition on avoidance of LBO transfers imposed by the district court serves only to provide a windfall to shareholders not otherwise covered by Section 546(e).

c. Nothing about the Trustee's argument is undermined by this Court's December 2019 holding in the creditors' appeal that CTC was Tribune's agent. *See Tribune*, 2019 WL 6971499, at *8. In that case, to which the Trustee was not a party, the Court reached its decision on an entirely different record. In particular, the Court did not consider the contracts in which CTC opted out of an agency relationship. In any event, to the extent that the Court held that processing of payments creates an agency relationship, that holding is incorrect, and the creditors in the other case are seeking further review. *See supra* at 20.

3. The District Court Separately Erred In Concluding That CTC "Is Acting" As An Agent

Even if CTC had been Tribune's "agent" at the time of the LBO, that still would not make Tribune a "financial institution" at the time of this litigation. The definition of "financial institution" identifies *when* the agency relationship must exist: A "customer" qualifies as a financial institution only if a listed entity "*is acting* as [the customer's] agent." 11 U.S.C. § 101(22)(A) (emphasis added). The statute covers only present-tense agency relationships. CTC's agency relationship to Tribune existed, if at all, in the past.

Congress's use of the present-tense "is acting" indicates that the inquiry should be made when the statute is applied. *See In re Fairfield Sentry Ltd.*, 714 F.3d 127, 133 (2d Cir. 2013) (use of present-tense phase "is pending" in 11 U.S.C. § 1517 requires evaluation of debtor's center of main interests "at the time [a] Chapter 15 petition is filed"); *Barscz v. Dir., Office of Workers' Comp. Programs*, 486 F.3d 744, 749 (2d Cir. 2007) (limitation to injuries that "are claimed" "unambiguously indicates that only those injuries currently being claimed can be considered"). In the context of Section 546(e), the statute is applied when the fraudulent-transfer claim is filed.

The district court rejected this argument because "[b]oth the definition of 'financial institution' and Section 546(e) itself are couched in the present tense." SA210 n.11. The Bankruptcy Code refutes that holding. Although Section 546(e) uses present-tense terminology, it leaves no doubt about what time it refers to: "before the commencement of the [bankruptcy] case," in the past. By contrast, the definition of "financial institution" in Section 101(22) offers no hint that it refers to anything but the present. And where, as here, "Congress includes particular language in one section of a statute but omits it in another . . . , it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." *Russello v. United States*, 464 U.S. 16, 23 (1983) (quotation marks omitted).

Additional statutory context further shows that the limitation of the definition of "financial institution" to the present tense was deliberate. Under other definitions in Section 101, a "disinterested person" includes a person who "is not *and was not*, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor" (*id.* § 101(14)(B) (emphasis added)); a "financial participant" includes an entity with certain qualifications either "*at the time it enters into a securities contract* [or other specified agreements], or at the time of the date of the filing of the petition" (*id.* § 101(22A)(A) (emphasis added)); and "repo participant" refers to "entit[ies] that, *at any time before the filing of the petition*," have certain agreements with the debtor (*id.* § 101(46) (emphasis added)). An earlier definition of "repo participant," which contained different but equally time-specific language, was added in the same amendments that added the "agent or custodian" language to the definition of "financial institution"—indicating that Congress used time-specific language deliberately. *See* Pub. L. No. 98-353, § 391, 98 Stat. 333, 365 (1984) ("any day during the period beginning 90 days before the date of the filing of the petition").

Congress's focus on present agency relationships makes sense. A "customer" with a *past* agency relationship is in no meaningful sense a "financial institution" for purposes of the Bankruptcy Code. This is demonstrated by 11 U.S.C. § 555, which enables a "financial institution" to "exercise [a] contractual right . . . to cause the liquidation, termination, or acceleration of a securities contract" based on a counterparty's insolvency or bankruptcy. *Id.* By including customers with a present agency relationship as "financial institution[s]," Section 101(22) enables an agent to exercise those protected contractual rights on behalf of its customer.

When properly read to encompass only present agency relationships, Section 101(22) does not make Tribune a "financial institution." The LBO was completed in 2007. By 2010, when this action was filed, any agency relationship Tribune had with CTC in connection with the LBO was long gone.

4. The District Court Separately Erred In Concluding That Step Two Of The LBO Was Completed "In Connection With A Securities Contract"

Even were the district court correct that CTC "is acting as agent" for Tribune, Tribune cannot be a "financial institution" unless CTC acts "in connection with a securities contract (as defined in section 741)." 11 U.S.C. § 101(22)(A). Step Two involved no "securities contract" thus defined, because it involved no *transfer* of securities. Rather, Tribune made the Step Two payment as a distribution to its shareholders, and the shares were canceled, not transferred. Tribune consequently was not a "financial institution" at Step Two.

As the district court correctly acknowledged elsewhere, "Tribune structured Step Two as a *merger*, rather than a purchase or redemption of stock." SA123 (emphasis added). And a merger, unlike the tender offer used in Step One, does not require that any stock change hands. As permitted by Delaware law, 8 Del. C. § 251(b)(5), Tribune's merger agreement provided that at Step Two, its remaining shares "shall be automatically cancelled and shall cease to exist." JA2164. The shares' former holders then became entitled to receive cash. JA2164. That the cash was paid upon surrender of the stock certificates (JA2164, JA2166) does not matter. Those certificates no longer represented securities, as they no longer represented "any rights . . . other than the right to receive" the cash and ceased to be transferrable. JA2164, JA2166; *see* 11 U.S.C. § 101(49) (such certificates not within the definition of "security").

The district court thus was wrong to conclude that Step Two "involved the purchase of securities" (SA211), so that CTC's actions at Step Two were done in connection with a securities contract. *See* 11 U.S.C. § 741(7)(A)(i) (defining "securities contract" to include "a contract for the purchase . . . of a security"). The Bankruptcy Code does not define "purchase." And that word's ordinary meaning is "the acquisition of title to, or property in, anything for a price." *SEC v. Sterling Precision Corp.*, 393 F.2d 214, 217 (2d Cir. 1968) (Friendly, J.) (quoting Webster's International Dictionary (2d ed. 1960)). Thus, if no one "acquire[d] title" to the stock, there was no "purchase." *Id.*; *accord, e.g.*, *Quebecor*, 719 F.3d at 99 (a company "purchase[d]" shares within the meaning of Section 741 because "it was acquiring" them). Here, the stock did not change hands; it was canceled by operation of law.

A panel of this Court was likewise wrong to hold, in its creditors'-appeal decision that is otherwise subject to further review, that Step Two involved a "repurchase" covered by the definition of "securities contract." *Tribune*, 2019 WL 6971499, at *9. The panel first erred in holding, based on *Quebecor*, that "'redemption' . . . means 'repurchase.'" *Id.* (citing *Quebecor*, 719 F.3d at 99).

Quebecor expressly did "not decide" whether a redemption of securities was necessarily a covered "repurchase." 719 F.3d at 99. In any event, insofar as "repurchase" means "purchase back" or "buy back," as the panel held (*Tribune*, 2019 WL 6971499, at *9 (quotation marks omitted)), Step Two was not a repurchase. As explained above, there was no purchase because the stock was canceled, not transferred.

Separately, the district court was incorrect to suggest that Step Two was "similar to" any of the transactions listed in the definition of "securities contract." SA210 (quoting 11 U.S.C. § 741(7)(A)(vii) (emphasis omitted)). "[T]he word 'similar,'" as used in this statute, "means 'having characteristics in common,' or 'alike in substance or essentials.'" *In re Bernard L. Madoff Inv. Sec. LLC*, 773 F.3d 411, 419 (2d Cir. 2014) (quoting Webster's Third New International Dictionary 2120 (1993)); *accord, e.g.*, *Rousey v. Jacoway*, 544 U.S. 320, 329 (2005) ("must share characteristics common to the listed" items). Here, the items listed in the definition of "securities contract" either *entail* a security changing hands (*e.g.*, "sale[] or loan of a security," 11 U.S.C. § 741(7)(A)(i)) or *contemplate* a security changing hands (*e.g.*, "an option to purchase or sell any such security," *id.*, or "any margin loan," *id.* § 741(7)(A)(iv)). Again, Step Two did not involve the transfer of a security or the prospect of such a transfer. It involved only the shares' cancellation.

5. The District Court's Errors Had Roots In A Policy Argument That The Supreme Court Has Firmly Rejected

Underlying the errors below was a misperception of the policy animating 11 U.S.C. § 546(e). That statute, the court thought, helps ensure the finality of transactions made through financial intermediaries. SA202.[13]

But *Merit* definitively rejected that view. The argument that "Congress' purpose" was to "advanc[e] the interests of parties in the finality of transactions" (138 S. Ct. at 896), the Court held, is "contradicted by the [statute's] plain language." *Id.* at 897.

Although *Merit* did not address the "financial institution" argument at issue here, it rejected a construction of Section 546(e) that would cover transactions merely made *through* certain financial intermediaries. 138 S. Ct. 888-95. Yet, under the district court's holding, merely "entrust[ing] billions of dollars" to an intermediary and "task[ing it] with making payments . . . to Shareholders" would suffice to invoke Section 546(e). SA210. That holding effectively resurrects the pre-*Merit* operation of Section 546(e). And it assumes that Congress—using not Section 546(e) itself but rather an arcane definition (of "financial institution")—

[13] The panel in the creditors' appeal reached the same conclusion before *Merit*. *Tribune*, 818 F.3d at 120-21. After *Merit*, the panel reinstated that conclusion. *Tribune*, 2019 WL 6971499, at *18-*19; *see id.* at *22 (asserting that *Merit* does not affect the conclusion). As explained in the text, the panel's conclusion is irreconcilable with *Merit*. The creditors have sought rehearing on that basis.

excluded from avoidance the many transactions made through financial intermediaries. That assumption defies credulity. "Congress does not hide elephants in mouseholes." *Cyan, Inc. v. Beaver Cty. Emps. Ret. Fund*, 138 S. Ct. 1061, 1071 (2018) (quotation marks omitted).

Moreover, the district court's holding would have widespread consequences for other provisions of the Bankruptcy Code. For example, Section 546(e) by its terms prevents avoidance not only of fraudulent transfers but also of preferential transfers under 11 U.S.C. § 547(b). Section 547(b) furthers the "central policy of the Bankruptcy Code" of "[e]quality of distribution among creditors" by "permitting a trustee in bankruptcy to avoid certain preferential payments made before the debtor files for bankruptcy." *Begier v. IRS*, 496 U.S. 53, 58 (1990). Under the district court's conception of Section 546(e), a soon-to-be debtor could shield payments from a preference action simply by having an intermediary bank process them. That conception would qualify pedestrian commercial payments for protections Congress intended only for transactions that risk destabilizing financial networks. That is fundamentally against the policies underlying the Bankruptcy Code.

B. Amendment Would Cause No Delay, And Any Delay Would Cause No Prejudice

In the alternative, the district court held that amending the complaint would unduly prejudice Tribune's former shareholders. The court reasoned that those defendants had "been in limbo" for years before it dismissed the intentional-fraudulent-transfer claim against them, and that "over two years" had passed since then. SA197 (quotation marks omitted).

The former shareholders themselves caused nearly all the delay, so it could hardly prejudice them unduly. After this action was filed in 2010, it was stayed at the request of, or with the consent of, the shareholders until 2013. In 2014, the shareholders moved to dismiss the intentional-fraudulent-transfer claim. Their motion was granted in January 2017, but that was not a final judgment, so the parties remained in the district court. In May of that year, the Supreme Court granted certiorari in *Merit*. Two and a half months later, the Trustee "diligently sought leave to [file a motion to] amend" the complaint. SA196; *see* JA0513-JA0516.[14] But the shareholders opposed, seeking delay. In August 2017, the district court said it would entertain an amendment "[i]f, and when, the Supreme Court" changed the law. SA030. In February 2018, *Merit* did change the law. Nine days later, the Trustee renewed his request to file a motion to amend. The shareholders again opposed. JA0540-JA0542. It was not until April 2019 that the district court *allowed* the Trustee to move to amend. It is the Trustee, not the shareholders, who has been prejudiced by this delay.

[14] Judge Sullivan had a "pre-motion conference" requirement. *See Loreley*, 797 F.3d at 190.

Moreover, the district court's prejudice holding is based solely on delay. And delay alone "does not provide a basis for a district court to deny the right to amend." *Pasternack*, 863 F.3d at 174 (quotation marks omitted). That is so even for amendments made years after an answer is filed. *Richardson Greenshields Sec., Inc. v. Lau*, 825 F.2d 647, 653 n.6 (2d Cir. 1987). Here, amendment would have caused no delay going forward, as the shareholders had yet even to file an answer.

III. THE DISTRICT COURT ERRED IN DISMISSING WITH PREJUDICE THE TRUSTEE'S BREACH OF FIDUCIARY DUTY, AIDING AND ABETTING, AND UNJUST ENRICHMENT CLAIMS

The Trustee alleges that the Chandler Trusts and Foundations were controlling shareholders and breached the fiduciary duties imposed by Delaware law by pushing the LBO based on a forecast that they knew to be fraudulent and by causing Tribune to incur debt that they knew would leave it insolvent. JA0301. The Trustee also asserts that, through the same conduct, they aided and abetted the directors' and officers' breaches of fiduciary duty, and were unjustly enriched. JA0303, JA0321.

The district court dismissed those claims because the Trustee lacked standing. That holding turned on the conclusion that the Trustee had failed to plead that Tribune was insolvent at Step One of the LBO for purposes of Delaware fiduciary-duty law. On reconsideration, the district court acknowledged that the

Trustee had standing, but nevertheless sustained the dismissal based on the same supposed failure to allege insolvency at Step One.

Either way, the district court erred: the operative complaint sufficiently alleges Tribune's insolvency.

A. The Trustee Sufficiently Pleaded Insolvency At Step One

In assessing the insolvency allegations regarding Step One under Delaware fiduciary-duty law, the district court incorrectly viewed Steps One and Two as independent transactions. Compounding that error, the court then refused even *to consider* Tribune's undertakings due at Step Two when assessing Tribune's solvency at Step One.

1. The LBO Was A Unitary Transaction

As the Trustee alleged, the LBO "was a unitary transaction implemented in two steps." JA0177. Steps One and Two were governed by a single merger agreement that contemplated a two-step transaction. JA0216-JA0217. The Board announced Steps One and Two together, and they were designed to depend on each other. JA0227-JA0228. The commitment letters ensuring financing for both steps were signed at the same time. JA0227-JA0228. Moreover, because of the ESOP structure's desired tax benefits, "the LBO made economic sense for its participants only if Step Two closed." JA0226.

The Trustee did not allege that the $8 billion borrowed at Step One, standing alone, rendered Tribune insolvent. Rather, the Trustee alleged that, given the structuring of the LBO and Tribune's intent to proceed with *both* steps, the additional $3.7 billion of debt and the additional $4 billion of distributions to shareholders that Tribune had already committed to incur and make just months later affected Tribune's financial condition at Step One.

Acting *sua sponte*, the district court held that Steps One and Two should be viewed independently for purposes of assessing solvency. The court acknowledged that "the relevant parties clearly knew about both steps" and "anticipated that both steps would be consummated." SA049. Nevertheless, the court stated, the LBO was not a unitary transaction because "it was never *certain* that Step Two would occur." SA049.

The district court misconstrued the standard for assessing multi-step transactions. Because Tribune was a Delaware corporation, Delaware law governs the fiduciary-duty claims. *Walton v. Morgan Stanley & Co.*, 623 F.2d 796, 798 & n.3 (2d Cir. 1980).[15] Delaware courts recognize that multiple transactions, particularly in an LBO, "may be viewed as one integrated transaction if the transactions reasonably collapse into a single integrated plan." *In re Hechinger*

[15] For this reason, the district court's solvency discussion has little, if any, bearing on Tribune's solvency under the standards of the Bankruptcy Code.

Inv. Co. of Delaware, 274 B.R. 71, 91 (D. Del. 2002) (quotation marks omitted). Although this doctrine is commonly applied in fraudulent-transfer or tax cases, it is not limited to them. *See id.* at 90-91 (concerning breach of fiduciary duty). The inquiry focuses "not on the structure of the transaction but [on] the knowledge and intent of the parties involved in the transaction." *Id.* at 91 (quotation marks omitted). Accordingly, Delaware courts "view multiple transactions as part of a unitary plan" when "'a series of separate transactions were prearranged parts of what was a single transaction, cast from the outset to achieve the ultimate result.'" *Carr v. New Enter. Assocs., Inc.*, C.A. No. 2017-0381, 2018 WL 1472336, at *7 (Del. Ch. Mar. 26, 2018) (quoting *Bank of New York Mellon Tr. Co., N.A. v. Liberty Media Corp.*, 29 A.3d 225, 240 (Del. 2011)).

Delaware law does *not* require that one part of the transaction be "certain" to occur once the other part happens. For example, *Noddings Investment Group, Inc. v. Capstar Communications, Inc.*, C.A. No. 16538, 1999 WL 182568 (Del. Ch. Mar. 24, 1999), aff'd, 741 A.2d 16 (Del. 1999), involved a spin-off and a merger. The governing contract expressly contemplated that the merger could go forward even if the spin-off did not. *Id.* at *5. Even so, because the steps were planned together and had interrelated consideration, the court held that they were "part and parcel of the same transaction." *Id.* at *7.

Instead of applying these settled Delaware standards, the district court relied on *In re Sabine Oil & Gas Corp.*, 547 B.R. 503, 541 (Bankr. S.D.N.Y. 2016). That case, mixing federal law with the laws of various states, identified "three factors to consider": "[w]hether all of the parties involved had knowledge of the multiple transactions; [w]hether each transaction would have occurred on its own; and [w]hether each transaction was dependent or conditioned on other transactions." *Id.* Although *Sabine* emphasized that the inquiry should "focus[] on the knowledge and intent of the parties" and did not identify any one factor as dispositive (*id.*), the district court in the present case treated the third *Sabine* factor as a requirement, concluding that, because Step Two was not "inevitable" after the close of Step One, the LBO was not a unitary transaction. SA050.

But neither *Sabine* nor governing Delaware case law requires "inevitability" as a necessary element for collapsing multi-step transactions. Nor would such a requirement make sense: in a multi-step transaction, each step has its own conditions; unless all steps occur simultaneously, it is always possible that a subsequent step will not occur. But, where a company plans a multi-step transaction, and that plan is consummated (despite the conditions), it should be evaluated as one transaction. Courts do not limit application of the collapsing doctrine to transactions in which all steps occur at once. *See Noddings*, 1999 WL 182568, at *1, *7.

The district court, by disregarding the knowledge and intent of Tribune's shareholders, directors, and officers, as well as the design of the Tribune LBO, misapplied the law. Delaware case law treats transactions "cast from the outset" to achieve a particular result as a unitary plan even if they are not conditioned on one another. *Carr*, 2018 WL 1472336, at *7 (quotation marks omitted). The LBO was a paradigmatic unitary transaction. The district court erred by focusing solely on whether Step Two was "certain" following Step One.

2. The District Court Misapplied The Balance-Sheet Test

Even if Steps One and Two were not treated as a unitary transaction, it would be impossible to assess Tribune's solvency at Step One without accounting for the commitments Tribune had *already* made—notably to borrow an additional $3.7 billion of debt and make an additional $4 billion distribution to its shareholders—for which performance was due at Step Two.

Under the balance-sheet test, "an entity is insolvent if it has liabilities in excess of a reasonable market value of assets held." *Quadrant Structured Prods. Co. v. Vertin*, 102 A.3d 155, 176 (Del. Ch. 2014) (quotation marks omitted). The term "liabilities" encompasses "anything for which a person is legally bound or obligated." *In re GC Cos., Inc.*, 298 B.R. 226, 230 (D. Del. 2003) (quotation marks omitted). The district court erroneously disregarded Tribune's contractual obligations at Step One. At the time of Step One, Tribune had already committed to incur debt and make distributions at Step Two. A proper balance-sheet analysis would incorporate these liabilities.

Indeed, Tribune's Step Two obligations were far more definite than traditional "contingent liabilities," which are routinely included in balance-sheet tests. *E.g.*, *In re Lids Corp.*, 281 B.R. 535, 546 (Bankr. D. Del. 2002). Courts do not ignore contingent liabilities but instead discount them "by the probability that the contingency will occur." *In re Xonics Photochemical, Inc.*, 841 F.2d 198, 200 (7th Cir. 1988). In contrast to true contingent liabilities, Tribune's contractual undertakings with regard to Step Two were fully expected to be performed. By altogether ignoring Tribune's liabilities at the close of Step One, however, the district court effectively treated them as contingent liabilities with zero chance of materializing.

Taking Tribune's liabilities into account, the Trustee pleaded balance-sheet insolvency at Step One. The Trustee expressly alleged that "[c]onsummation of Step One rendered the Company balance sheet insolvent," and that "the legal and economic reality of the LBO required that all of the debt incurred in the transaction be considered in the Step One solvency analysis." JA0238, JA0245. Tribune incurred approximately $7 billion of new debt at Step One and concurrently committed to borrow another $3.7 billion at Step Two. JA0177-JA0179. Tribune paid $4.3 billion to its shareholders at Step One and concurrently committed to pay them another $4 billion at Step Two. Tribune significantly underperformed projections for the first five months of 2007, but it did not adjust its projections accordingly before agreeing to the LBO. JA0232-JA0233, JA0237. Before Step One, two valuation firms opined that the LBO would render Tribune insolvent under traditional valuation methodologies. JA0204-JA0206, JA0211. The Trustee's allegation that Tribune was balance sheet insolvent at Step One and his ample factual context state a claim. *See, e.g.*, *In re Essar Steel Minnesota LLC*, No. 16-11626, 2019 WL 2246712, at *6 (Bankr. D. Del. May 23, 2019) (trustee's "straightforward allegation" of insolvency along with "balance of his factual allegations" sufficiently alleged insolvency).

3. The District Court Misapplied The Inability-To-Pay-Debts-When-Due Test

Step Two is likewise relevant to solvency at Step One under the other test Delaware courts use to determine solvency. That test—"inability to pay debts when due," or the "cash flow" test—provides that "a company is insolvent if it is unable to pay its debts as they fall due in the usual course of business." *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, LLC*, 864 A.2d 930, 947 (Del. Ch. 2004) (quotation marks omitted), vacated on other grounds, 875 A.2d 632 (Del. 2005). This test is "forward looking in the sense that it is not enough to be able to meet current obligations; the firm must be able to meet its future obligations as well." *In re Teleglobe Commc'ns Corp.*, 392 B.R. 561, 602 (Bankr. D. Del. 2008) (quotation marks omitted).

The district court, however, concluded that the Delaware cash-flow test turns solely on whether a corporation has met its *past* obligations. The court concluded that, "[b]ecause the Trustee never alleges that Tribune failed to pay any of its debts in a timely manner" as of Step One, the Trustee failed to plead cash-flow insolvency. SA051. In support, the district court relied exclusively on dicta in *Pereira v. Farace*, 413 F.3d 330, 343 (2d Cir. 2005).

The holding of *Pereira* was that the district court had incorrectly denied the defendants a jury trial on a bankruptcy trustee's claim for breach of fiduciary duty. 413 F.3d at 340-41. The Second Circuit then "briefly address[ed]" three issues that might "recur" on remand. *Id.* at 341. The last of those three issues was whether "the district court [had] applied an incorrect standard to determine 'cash' insolvency" (*id.* at 342-43) when it accepted the testimony of an expert witness. That witness had combined the traditional cash-flow test with a separate test (the capital-adequacy test). *Id.* at 336. The Second Circuit correctly cited *Timberlands*, 864 A.2d at 947-48, for the proposition that one test under Delaware law is that "a company is insolvent if it is unable to pay its debts as they fall due in the usual course of business." *Pereira*, 413 F.3d at 343 (quotation marks omitted). With no further citation of Delaware case law, however, the court stated that "the Delaware test looks solely at whether the corporation has been paying bills on a timely basis and/or whether its liabilities exceed its assets." *Id.*

A federal court applying state law does not definitively construe that law, but merely predicts how the courts of the state will rule. *Giuffre Hyundai, Ltd. v. Hyundai Motor Am.*, 756 F.3d 204, 209 (2d Cir. 2014). Delaware courts applying the cash-flow test have *not* limited their consideration to past debt payments but have considered whether companies will be able to pay upcoming debts or raise additional capital in the future. *See, e.g.*, *In re Geneius Biotechnology, Inc.*, C.A. No. 2017-0297, 2017 WL 6209593, at *10 (Del. Ch. Dec. 8, 2017) (company not cash-flow insolvent where "there is no evidence that it would impossible for [company] to raise capital in the future"); *Quadrant Structured Prods. Co. v. Vertin*, C.A. No. 6990, 2015 WL 6157759, at *18 (Del. Ch. Oct. 20, 2015) (company not cash-flow insolvent where evidence showed company "intended to make longer-term, higher-yielding investments" and would not "make future dividend payments" at an unsustainable level), aff'd, 151 A.3d 447 (Del. 2016); *Prod. Res. Grp., LLC. v. NCT Grp., Inc.*, 863 A.2d 772, 784 (Del. Ch. 2004) (company cash-flow insolvent where company "does not have the credit necessary to borrow at commercially reasonable rates that will enable it to meet its obligations going forward").

Tribune's Step Two obligations were not speculative. When the LBO was agreed to, even before Step One, Tribune committed to borrow an additional $3.7 billion and pay another $4 billion to its shareholders at Step Two. The inability-to-pay-debts-when-due test, applied at Step One, takes Step Two into account, along with Tribune's ability to access additional funds. The Trustee therefore pleaded that "[c]onsummation of Step One rendered the Company . . . unable to pay its debts as they came due." JA0245.

The Trustee also alleged numerous supporting facts. The publishing industry and Tribune were performing poorly. JA0180-JA0182. Major ratings agencies downgraded Tribune's debt after approval of the LBO. JA0229-JA0230. Numerous financial analysts observed that, without a miracle, Tribune could not survive. JA0230.

B. Even If The District Court Correctly Dismissed The Claims, It Should Have Granted Leave to Amend

Even if the district court correctly dismissed the claims, it should have granted the Trustee leave to amend. The Trustee asked the court for an opportunity to address any identified flaws in the Trustee's pleading before dismissal with prejudice. The court denied that request because the Trustee had not attached a proposed amended complaint or explained how the complaint's defects would be cured (SA067).

The district court abused its discretion in this regard. Federal Rule of Civil Procedure 15 provides that courts "should freely give leave when justice so requires." As the Trustee sought leave before resolution of the motion to dismiss, "there was no decision yet as to the precise defects, such that a proposed cure would have been in order as part of the request to amend." *Loreley*, 797 F.3d at 191.

The district court noted that the Trustee's balance-sheet-insolvency arguments "mostly relate to Step Two." SA050. If the court's refusal to consider Step Two was correct, the Trustee could amend the complaint to provide additional factual detail regarding Tribune's insolvency based only on Step One.

IV. THE DISTRICT COURT ERRED IN DISMISSING THE TRUSTEE'S CLAIMS AGAINST MORGAN STANLEY AND VRC WITH PREJUDICE

Morgan Stanley and VRC knowingly participated in the breaches of fiduciary duty by Tribune's management and committed professional malpractice. Morgan Stanley also abdicated its duty to advise the Special Committee that the LBO would render Tribune insolvent. The district court held that the Trustee had sufficiently alleged liability on these claims but dismissed them based on the affirmative defense of *in pari delicto*.

Additionally, Tribune paid Morgan Stanley and VRC millions of dollars in fees. The Trustee is entitled to recover those fees as fraudulent transfers. The district court dismissed these claims, too, holding that those fees were not sufficiently related to the overall LBO and that Morgan Stanley and VRC had complied with their engagement letters.

In a separate appeal—arising from the same opinion, but against different appellees—the Trustee has explained why each ruling is mistaken. *Kirschner v. Citigroup Global Markets Inc.*, Case No. 19-449, ECF No. 40 (2d Cir. June 6, 2019). That appeal will be heard in tandem with this appeal. Order, ECF No. 22 (Sept. 30, 2019). Accordingly, the Trustee hereby adopts the arguments at pages 18-54 of the *Citigroup* opening brief. *See Vietnam Ass'n for Victims of Agent Orange v. Dow Chem. Co.*, 517 F.3d 104, 124 (2d Cir. 2008).

CONCLUSION

The Court should vacate the judgment of June 13, 2019, and the orders of January 6, 2017, November 30, 2018, January 23, 2019, February 12, 2019, February 13, 2019, and April 23, 2019, and remand for further proceedings.

Dated: January 7, 2020

Respectfully submitted,

s/ Lawrence S. Robbins

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CERTIFICATE OF COMPLIANCE

Counsel certifies as follows:

1. This document complies with the Court's Order dated November 25, 2019, because, excluding the parts of the document exempted by Fed. R. App. P. 32(f), this document contains 15,965 words.

2. This document complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because this document has been prepared in a proportionally spaced typeface using Microsoft Word version 1902 (as updated by Office 365) in 14-point Times New Roman font.

Dated: January 7, 2020

s/ Lawrence S. Robbins

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CERTIFICATE OF SERVICE

Counsel certifies that the foregoing document was served in compliance with the requirements set forth in this Court's case-management order dated September 24, 2019 (Dkt. 8).

The foregoing was filed by electronic means, via the Court's ECF system, and parties may also access this filing through that system.

Dated: January 7, 2020

s/ Lawrence S. Robbins

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