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The trustee strikes back: Greektown decision may limit safe harbor defenses

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JANUARY 13, 2021

A recent decision from a Michigan bankruptcy court shows potential limits to Safe Harbor defenses to clawback actions and may provide new hope to trustees and other clawback plaintiffs that seek to push back against defendant-friendly decisions in the Second Circuit.

A critical hurdle for defendants seeking to invoke the Safe Harbor as a defense to a fraudulent conveyance action is to show that either the transferor or the transferee was a Qualifying Entity, such as a Financial Institution.

The decision, *In re Greektown Holdings, LLC*, highlights the importance of appropriately and carefully drafting documentation to reduce the exposure of participants to subsequent clawback actions.

BACKGROUND

Greektown arose from the 2005 financial restructuring of a Detroit casino. One set of owners agreed to buy out the other owners of the holding company and $50 million of the $95 million purchase price was deferred pending a refinancing. The holding company sold $182 million of unsecured notes and paid a portion of the proceeds to the bought-out equity holders.

In 2008, the casino and its holding company (Greektown Holdings) filed chapter 11 petitions. A litigation trustee sought to avoid the payments as fraudulent conveyances under state law. In 2015, the bankruptcy court granted defendants' summary judgment motion, based on the bankruptcy Safe Harbor, and the district court affirmed.

While an appeal to the Sixth Circuit Court of Appeals was pending, the Supreme Court decided *Merit Management Group, LP v. FTI Consulting, Inc.*, which, as described in our earlier alert,[1] interpreted certain portions of the Safe Harbor with a result that was favorable to plaintiffs and overruled what had been the rule in a majority of circuits, including the Sixth Circuit. The Sixth Circuit then remanded *Greektown* for reconsideration in light of *Merit Management*.

BANKRUPTCY COURT RULING ON REMAND

On remand, the defendants based their Safe Harbor defense on the Second Circuit's post *Merit Management* decision in *In re Tribune.* As described in our earlier alert,[2] following *Merit Management*, a critical hurdle for defendants seeking to invoke the Safe Harbor as a defense to a fraudulent conveyance action is to show that either the transferor or the transferee was a Qualifying Entity, such as a Financial Institution.

The *Tribune* defendants successfully established that the Qualifying Entity requirement was satisfied because the debtor/transferor was a customer of Computershare, itself a Financial Institution, which had been acting as an agent or custodian for the debtor/transferor.

As described in our earlier alert,[3] several lower courts in the Second Circuit have applied *Tribune* to dismiss clawback actions. Following the *Tribune* model, the *Greektown* defendants argued that Greektown Holdings was a customer of Merrill Lynch, a Financial Institution, and that Merrill Lynch had been acting as an agent or custodian for Greektown Holdings.

The ability of bankruptcy trustees to use *Greektown* as a vehicle to challenge *Tribune* may depend upon whether *Greektown*'s distinguishing of *Tribune* is based on legal grounds or factual ones.

The bankruptcy court rejected this analysis and denied the motion. It concluded that the agreements did not establish an agency relationship between Merrill Lynch and Greektown Holdings. Merrill Lynch was the initial purchaser of notes issued by Greektown Holdings, and sold some of the notes to other lenders,

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which the court considered to make Merrill Lynch a lender to Greektown Holdings rather than its agent.

As such, Merrill Lynch was accorded many titles, including Sole Bookrunner, Sole Lead Arranger and Syndication Agent, but was not expressly designated an agent for Greektown Holdings. Indeed, one of the agreements contained an express provision that the lenders, including Merrill Lynch, were not agents or fiduciaries of Greektown Holdings.

The court also rejected the defendants' alternative argument that Merrill Lynch was a custodian. It interpreted "custodian" as used in Bankruptcy Code section 101(22)(A) based on the definition in section 101(11), which limits "custodian" to mean (i) a trustee or receiver appointed in a non-bankruptcy case, (ii) an assignee for the benefit of creditors, or (iii) a receiver appointed to enforce a lien against property. Unfortunately for the defendants, none of these categories fit Merrill Lynch's role.

Greektown highlights the importance of prophylactic measures in the drafting of documentation for financial transactions.

Since the defendants failed to establish that Merrill Lynch was either an agent or custodian, the court denied their summary judgment motion.

CONCLUSIONS

The ability of bankruptcy trustees to use *Greektown* as a vehicle to challenge *Tribune* may depend upon whether *Greektown*'s distinguishing of *Tribune* is based on legal grounds or factual ones.

While the *Greektown* court clearly questioned the ruling of the Second Circuit, its comments in that regard may be dicta because the facts are distinguishable. The role of Merrill Lynch in *Greektown* as lead lender, bookrunner and arranger is distinguishable from the role of Computershare in *Tribune* as a depository for a public tender offer.

Greektown's definition of "custodian" raises interesting questions. From a formal perspective the court's logic is unassailable as the term is expressly defined in section 101. However, the context and usage cast doubt on whether Congress, when amending the "Financial Institution" definition in section 101(22)(A), intended such a narrow definition.

Apart from section 101(22)(A), "custodian" is used in only two Bankruptcy Code sections (sections 303(h) and 543), and both of those sections clearly deal with a custodian that has been appointed to take charge of the debtor's property.

By contrast, section 101(22)(A) applies when a Financial Institution "is acting as agent or custodian for a customer ... in connection with a securities contract," suggesting that it refers to a contractual custodianship rather than a custodianship created as a collection device. The *Greektown* definition comes close to turning the "custodian" prong of section 101(22)(A) into a nullity.

Greektown highlights the importance of prophylactic measures in the drafting of documentation for financial transactions. While the documentation for the *Greektown* transactions (like the documentation in other leading cases, such as *Tribune*, *Nine West* and *Boston Generating*) was prepared years before *Merit Management* and *Tribune* developed the Safe Harbor caselaw, transactional lawyers now should incorporate the lessons learned from these cases in a way that helps protect participants from subsequent clawback attack.

Notes

[1] https://bit.ly/3oDdBgT

[2] https://bit.ly/38ECXFH

[3] https://bit.ly/3i4QxFn

This article was published on Westlaw Today on January 13, 2021.

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