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Alert

District Court Rejects Trustee's "Clever" Assignment of Fraudulent Transfer Claims to Avoid Code's Safe Harbor Defense

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U.S. District Judge Jed S. Rakoff of the Southern District of New York, applying the swap agreement safe harbor provision of the Bankruptcy Code (the "Code") §546(g), dismissed a Chapter 11 litigation trustee's state law fraudulent transfer complaint against a bank on June 11, 2013. *Whyte v. Barclays Bank, PLC*, 2013 WL2489925 (S.D.N.Y. June 11, 2013). Like the Code's "settlement payment" safe harbor in §546(e), discussed in our recent July 8, 2013 *Alert*, the "swap agreement" safe harbor "deprives a bankruptcy trustee of the power to bring" fraudulent transfer or preference claims arising out of "a [pre-bankruptcy] transfer made by or to . . . a swap participant . . . under or in connection with any swap agreement . . . ." *Id*. at * 2. Although the debtor's Chapter 11 plan documents provided that "certain creditors . . . and the relevant debtors . . . putatively assigned 'any and all' of their claims, [including fraudulent transfers], to the [litigation] Trust," the court held that the §546(g) safe harbor "impliedly pre-empts state-law fraudulent [transfer] actions seeking to avoid 'swap transactions' as defined by the Code." *Id*. at * 4. According to the court, the trustee's "clever" attempt to assert her state law rights as an "assignee," but not "as the trustee of the bankruptcy estate . . . would, in effect, render section 546(g) a nullity." *Id*. at *2.

Facts
The debtor, SemGroup, "was a large energy transport and storage company that filed" a Chapter 11 petition on July 22, 2008 in the District of Delaware. *Id*. at * 1. Five weeks prior to bankruptcy, on June 15, 2008, the debtor and the defendant bank had entered into a "novation" agreement in which the bank acquired the debtor's "portfolio of commodities derivatives traded on the New York Mercantile Exchange ("NYMEX")" for roughly $143 million. *Id*. That portfolio later became profitable, apparently causing creditors to assert that the transaction with the bank was a fraudulent transfer, "not under the Bankruptcy Code, but as defined by various provisions of New York's Debtor-Creditor law ("NYDCL")." *Id*. at *1 *2.

The Trustee's "Clever" Theory
The "Trustee [was] *not* seeking to avoid the novation under [any section] of the . . . Code." *Id*. at * 2. Had the trustee used Code §544, she "might, in the ordinary case," be able to "assert a state-law fraudulent [transfer] action" subject to the safe harbor limitation of §546(g). The parties agreed, in any event, that the novation here qualified "as a 'swap' transaction benefiting from the safe harbor of [§] 546(g)." *Id*. For that reason, the trustee chose to assert "her rights under state law as 'holder and assignee of all claims and causes of action against'" the defendant bank. *Id*. According to the trustee, §546(g) "applies only to 'an estate representative who is exercising federal avoidance powers under'" Code §544. *Id*. Thus, the safe harbor of §546(g) should, in the trustee's view, "not apply to 'claims asserted by creditors' after the bankruptcy concludes" when those claims are preserved in the reorganization plan. *Id*.

Congressional Intent
According to the court, however, "permitting a trustee that is the creature of a Chapter 11 plan to avoid a 'swap transaction' by way of a state fraudulent [transfer] action would stand as a major obstacle to the purposes and objectives of Congress in passing, and then expanding, the 546(g) 'safe harbor.'" *Id*. at * 3. Congress meant to "protect securities markets from the disruptive effects that unwinding such transactions would inevitably create. *Id*. Citing at least three Congressional enactments between 1982 and 2005 expanding the reach of the safe harbor, the court stressed that Congress had made "even more complete the protection of participants in swap transactions and swap agreements by introducing an 'extremely broad' definition of swap agreements in order to 'protect . . . *all* counterparties to these agreements.'" *Id*. citing *In re Nat'l Gas Distribs.*, 556 F. 3d 247, 253 (4th Cir. 2009) (Code definition of swap agreements "extremely broad, covering several dozen enumerated contracts and transactions, as well as combinations of them, options on them, and similar contracts or transactions."). In short, explained the court, "Congress intended to place swap transactions totally beyond the inherently destabilizing effects of a bankruptcy and its attendant litigation." *Id*.

The court stressed the impropriety of permitting the litigation trust here "to order its litigation to delay swap-avoidance actions until it might stand solely in the shoes of the creditors." *Id*. In its view, such a scheme "would not only run contrary to the expectations of the Bankruptcy Court in approving the Plan but would also make a mockery of Congress's purpose of minimizing volatility in the swap markets." *Id*.

Effect on Market
The debtor's NYMEX "portfolio eventually embraced 20 percent of the nation's crude oil inventory." *Id*. at * 4. By "wearing her non-bankruptcy hat," the trustee could, if her theory were accepted, "bring actions that would totally imperil the stability of this large corpus of swap positions," thus increasing "the risk of uncertain, unpredictable, and therefore destabilizing market volatility." *Id*. citing *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V.*, 651 F. 3d 329, 338-39(2d Cir. 2011) (applying §546(e), after observing that "[w]e see no reason to think that undoing Enron's redemption payments [totaling over $1 billion and about 200 noteholders] would not also have a substantial and similarly negative effect on the financial markets.").

Repackaging Claims Rejected
The court rejected the trustee's attempt to thwart Code §546(g) "by the simple device of conveying fraudulent [transfer] claims into a litigation trust for later use, repackaged as creditors' state law fraudulent [transfer] claims." *Id*. at * 4, citing *Contemporary Indus. Corp. v. Frost*, 564 F.3d 981, 988 (8th Cir. 2009); *In re Hechinger Inv. Co. of Del., Inc.*, 274 B.R. 71, 96 (D. Del. 2002)("Claims that Congress deemed unavoidable under sections 544(b) and 546(e) . . . cannot be avoided by simply re-labeling avoidance claims as [state law] unjust enrichment claims; if they could, the exemption set forth in section 546(e) would be rendered useless.").

Exception to Safe Harbor Inapplicable
Section 546(g), like §546(e), provides an exception to the safe harbor for avoidance claims if the debtor made the transfer with "actual intent to hinder, delay, or defraud any entity to which the debtor was . . . indebted." In her complaint, the trustee relied on the "hinder, delay, or defraud" language so as to avoid the application of the §546(g) safe harbor. Nevertheless, the court found that the trustee had alleged "no facts to support this conclusory allegation, and the Trustee has not pursued the matter further." *Id*. at * 2n.4. Relying on the language of the Code, without more, will not survive a motion to dismiss. *See* Fed. R. Bankr. P. 7009, making Fed. R. Civ. P. 9(b) applicable ("In alleging fraud . . ., a party must state with particularity the circumstances constituting fraud . . . ."); *Zahn v. Yucaipa Capital Fund*, 218 B.R. 656, 673-74 (D.R.I. 1998) (Rule 9(b) satisfied when plaintiff alleged "underlying facts, the transfers alleged to be fraudulent, the reasons those transfers are allegedly fraudulent, and the roles of defendants in the transfers"; defendants had "notice of the allegations against them . . . .").

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