American Bankruptcy Institute

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Safe-Harbor Issues After *Lehman*

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CONCURRENT SESSION

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ABI Safe Harbor Panel CLE Materials

The safe harbors were initially enacted to protect commodities clearing agencies from massive liability based on the theory that avoidance of margin payments could present significant systemic risk in the derivatives market. American Bankruptcy Institute Commission to Study the Reform of Chapter 11, Final Report and Recommendations 94 (2014), available at http://commission.abi.org/full-report (citing S. Rep. No. 95-989, at 8 (1978), reprinted in 1978 U.S.C.C.A.N. 5787) (noting that the safe harbors "find their origins in sections 362(b)(6) and 746(c) of the Bankruptcy Code to promote stability in the commodities market"). Although the safe harbors were later amended to include other securities, the one constant was the idea that "certain protections are necessary to prevent the insolvency of one commodity or securities firm from spreading to other firms and [possibly] threatening the collapse of the affected market." H.R. Rep. No. 97-420, at 1.

This year marks the 10-year anniversary of the Lehman Brothers bankruptcy cases. The unwinding of Lehman Brothers' derivative transactions was not surprisingly a difficult process, and many disputes relating to that process and the safe harbors in general have been brought to the courts over the last ten years.

Section 546(e)

- *Merit Management Group, LP v. FTI Consulting, Inc.,* 138 S.Ct. 883 (2018)[1]

  - Under consideration in *Merit Management* was a transfer from Valley View Downs ("VV") to Bedford Downs Management ("BD") to purchase all of BD stock. VV arranged for its bank, Credit Suisse, to wire the money to Citizens Brank, a third party escrow agent. Citizens subsequently disbursed the money in installments, one of which went to Merit Management, a shareholder of BD.

  - VV subsequently filed bankruptcy and FTI was appointed as trustee for a litigation trust. FTI sought to avoid the transfer as constructively fraudulent under section 548(a)(1)(B) of the Bankruptcy Code. Merit contended the transfer was safe harbored under section 546(e) as a "settlement payment . . . made by or to (or for the benefit of)" a covered "financial institution" – in this case, Credit Suisse and Citizens Bank. The district court agreed.

  - The Seventh Circuit reversed, holding that section 546(e) doesn't protect transfers that are simply conducted through financial institutions "where the entity is neither the debtor nor the transferee but only the conduit."

  - Although the Supreme Court affirmed, it held that the Seventh Circuit wrongly put the "proverbial cart before the horse" by analyzing the "by or to (or for the benefit of)" language of section 546(e) before identifying the relevant transfer to be tested. Instead, the Supreme Court instructed that, when determining whether

[1] For a more detailed discussion of the *Merit Management* decision please see the attached ABI Journal article at Exhibit A.

section 546(e)'s safe harbor saves the transfer from avoidance, the only relevant transfer is the one the trustee seeks to avoid. In other words, courts should focus on the overarching transfer from A [VV] to D [Merit], and not component parts of that overarching transfer (i.e., the transfer from A [VV] to B [Credit Suisse] to C [Citizens] to D [Merit]). Since neither VV nor Merit were "financial institutions" or other covered entities, the transfer fell outside of the safe harbor.

- In footnote 2 of the opinion, the Supreme Court noted that Merit had failed to contend that it or the debtor qualified as a "financial institution" by virtue of being a "customer," and thus refused to address what impact section 101(22)(A) might have in the application of the safe harbor. No doubt this footnote will play a prominent role in future litigation.

Significant Cases Involving *Merit Management* Currently on Appeal

The following is a very brief summary of two cases directly involving *Merit Management* that are currently on appeal in the Second and Sixth Circuits.

A. Tribune Company Fraudulent Conveyance Litigation: [2]

- The Tribune Company Fraudulent Conveyance Litigation, currently pending in the Second Circuit, arose out of an $8 billion leveraged buyout.

- Shortly after Tribune filed bankruptcy, the bankruptcy court granted the unsecured creditors committee standing to sue former Tribune shareholders. Because the section 546(e) safe harbor includes constructively fraudulent transfers and excludes intentional fraudulent transfers, the committee brought suit only under section 548(a)(1)(A) of the Bankruptcy Code, which permits a trustee to avoid any transfer made or incurred "with actual intent to hinder, delay or defraud . . . ."

- Separately, in an effort to "work around" section 546(e) with respect to constructive fraudulent transfers, certain large unsecured creditors prevailed on the bankruptcy court to lift the automatic stay to permit them to bring state law constructive fraudulent transfer claims (among other claims) against former shareholders outside of the bankruptcy proceedings. Suits were thereafter initiated in various state and federal courts, which were ultimately consolidated into a single, multidistrict litigation case in the United States District Court for the Southern District of New York.

- Upon Tribune's emergence from bankruptcy, the automatic stay terminated and the multidistrict litigation moved forward. The defendants moved to dismiss arguing, *inter alia*, that the individual constructive fraudulent transfer claims were impliedly preempted by section 546(e) and, in any event, that the individual claimants lacked standing to bring such claims.

[2] For a more detailed description of the *Tribune* case and related issues, please see Exhibit B.

- The district court granted the motion to dismiss based upon a lack of standing. The Second Circuit affirmed on other grounds, holding that section 546(e) impliedly preempted the prosecution of the individual creditors' claims. The individual creditors appealed to the Supreme Court and, while their Petition for Writ of Certiorari was pending, *Merit Management* was decided. As a result, the petition for certiorari was deferred to allow the Second Circuit or the District Court to consider whether to recall the mandate, entertain a Federal Rule of Civil Procedure 60(b) motion to vacate the earlier judgment, or provide any other available relief.

- Appellants/Petitioners filed a motion to recall mandate with the Second Circuit. On May 15, 2018, the Second Circuit "ordered that the mandate in this case is recalled in anticipation of further panel review." As of September 18, 2018, no briefing schedule has been issued.

B. In re Greektown Holdings, LLC: [3]

- The Greektown Holdings fraudulent transfer litigation, currently pending in Sixth Circuit, arose out of the bankruptcy of Greektown Casino, one of three casinos located in Detroit, Michigan, and its parent holding company and various affiliates.

- As of February 2005, most of the Casino's equity was ultimately owned by the Sault Ste. Marie Tribe of Chippewa Indians ("Tribe") through various intermediary entities, including Monroe Partners, LLC ("Monroe") and Kewadin Greektown Casino, LLC ("Kewadin"). The former part-owners of Monroe were owed substantial amounts by Monroe and Kewadin, but not by the Casino. Those debts had to be paid by the end of 2005 or the former shareholders could (among other remedies) compel the Tribe to sell its interests in the Casino.

- From September to December 2005, the Tribe, Monroe, and Kewadin undertook a series of transactions that resulted in payments to the former shareholders totaling approximately $160 million. A new entity, Greektown Holdings, LLC ("Holdings"), was formed and given a 100% ownership interest in the Casino. Monroe and Kewadin became Holdings' owners. Holdings took on an additional $185 million in debt by selling senior notes to investors. Merrill, Lynch & Co. underwrote the offering and its affiliate, Merrill, Lynch, Pierce, Fenner & Smith ("MLPFS"), was an initial purchaser of the new notes. Holdings used the proceeds of the note sale to pay dividends to its owners (Monroe and Kewadin) who, in turn, used most of the dividend funds to pay the former shareholders $149.5 million directly and $9.5 million indirectly.

- On May 29, 2008, the Casino, Holdings, Monroe, Kewadin, and several related businesses filed Chapter 11 bankruptcy petitions. On May 28, 2010, the official

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[3] For a more detailed description of the *Greektown* case and related issues, please see Exhibit B.

committee of unsecured creditors of the bankrupt entities (later replaced by Buchwald Capital Advisors LLC as the Litigation Trustee) brought an adversary proceeding to recover from the former shareholders the amounts transferred directly or indirectly to them in December 2005 under section 544(b) and Michigan law, and to recover the transferred amounts under section 550.

- The former shareholders responded that the transfers were protected from avoidance by §546(e) because the transfers went from the Debtor's account at MLPFS to Chase and Comerica, the banks where the former shareholders had their bank accounts.

- The bankruptcy court granted summary judgment to the former shareholders, agreeing that the transactions fell within section 546(e)'s safe harbor. The Litigation Trustee appealed to the district court arguing that the payments were not "made by or to" a financial institution, citing the Seventh Circuit's very recent decision in *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016), *aff'd and remanded*, 138 S. Ct. 883 (2018). On January 23, 2018, the district court affirmed, concluding that *Merit Management* was in conflict with the Sixth Circuit's opinion in *QSI Holdings*, holding: "Unless and until the Sixth Circuit changes its position on this issue, this Court must follow *QSI* and concludes that MLPFS qualifies as a financial institution in this case, regardless of the nature of its role in handling the funds that were the proceeds of the sale of Notes under the [note purchase agreement]."

- The Supreme Court granted certiorari in *Merit Management* while the Litigation Trustee's appeal was pending in the district court. Shortly after the Litigation Trustee appealed to the Sixth Circuit, the Supreme Court issued its decision.

- In light of the *Merit Management* decision, the Litigation Trustee filed a motion for summary vacatur which the Sixth Circuit denied on September 18, 2018. Although it denied the motion, the court set a tight briefing schedule, whereby all briefing should be completed by December 11, 2018. Given this briefing schedule, a Sixth Circuit decision will likely precede any decision in the *Tribune* case.

Merit issue to consider in opinion work

- Footnote 2 of *Merit* provides that the Court is not addressing the impact of section 101(22)(A) of the Bankruptcy Code. Under the literal language of that provision, a customer -- not otherwise protected by a safe harbor -- can be viewed as a protected entity when a transaction is structured so that a financial institution acts as an agent or custodian in connection with the transaction. Taken literally, if an unprotected customer uses a financial institution as its collateral agent in a securities contract transaction to which the customer is a party, the customer may be considered a financial institution. *Merit* did not address this issue. Firms may wish to evaluate opinion practice concerning these circumstances.

<u>546(e) preemption of state laws</u>

- Given section 546(e)'s language, estates and individual creditors have cooperated - tacitly and overtly - to hand over the power to creditors (and well-funded committees and liquidation trusts) to bring avoidance actions that would otherwise be barred under 546(e) - including by assigning state law claims to creditors and trusts.

- **Issue - Does 546(e) only preclude a *trustee* or *debtor* bringing an avoidance action - or does it also preclude, through the pre-emption doctrine, anyone bringing in avoidance action in a bankruptcy?**

    - Second Circuit - <u>NO</u>. The statute pre-empts creditors' end-runs around the statute by cooperating with estates to bring actions on their own. *See Tribune*.

        - Facts - a committee and ad hoc groups of creditors brought avoidance actions against LBO transfers. The Southern District of New York found that the creditors could proceed with the action because they were not a trustee and were not preempted. *In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310 (S.D.N.Y. 2013).

        - This created a SDNY Split -

            - *Whyte v. Barclays Bank PLC*, 494 B.R. 196 (S.D.N.Y. 2013) (liquidation trust preempted)

            - *Weisfelner v. Fund 1 (In re Lyondell Chem. Co.)*, 503 B.R. 348 (Bankr. S.D.N.Y.) (not preempted)

            - *In re Tribune Co. Fraudulent Conveyance Litigation*, 499 B.R. 310 (S.D.N.Y. 2013) (not preempted).

        - The Circuit found that the causes of action brought under a section 5 statute (whether or not it incorporates a state law cause of action) are federal actions. *Id.* at **112-113.

        - Circuit found that "Every congressional purpose reflected in Section 546(e), however narrow or broad, is in conflict with [the creditors] legal theory [to circumvent section 546(e)]. Their claims are, therefore, preempted," and that the use of the word trustee was broad to preempt other claims. *In re Tribune Co. Fraudulent Conveyance Litig*., 818 F.3d 98, 119 (2d Cir. 2016).

    - Delaware Bankruptcy Court - <u>YES; IN SOME NARROW CIRCUMSTANCES</u>. *In re Physiotherapy Holdings, Inc.*, 2017 WL 6524524 (D. Del. Dec. 21, 2017).

        - Court disagreed that policy reason for safe harbor was finality for investors - and instead found purpose was to mitigate systematic risk. *Id.* at 18.

  - Court discussed that other provisions of the Bankruptcy Code expressly apply to non-trustee parties, and expressly preempt state law by incorporating phrases such as "notwithstanding any applicable law. *Id.* at 20-21.

  - Court looked at specific facts and found that the alleged bad faith of the defendants in its case was not something Congress wanted to protect.

  - Holding - "a litigation trustee may assert state law fraudulent transfer claims in the capacity of a creditor-assignee when: (1) the transaction sought to be avoided poses no threat of 'ripple effects' in the relevant securities markets; (2) the transferees received payment for non-public securities, and (3) the transferees were corporate insiders that allegedly acted in bad faith. When these three factors are present, a finding of implied preemption is inappropriate."

  - So - the holding is narrow - but has LBOs in its crosshairs. Still, for mega-cases like *Lehman*, a Court might find that the ripple effect might exist. For forward contracts, the case has questionable impact as these most often do not involve an insider as a transferee.

- District of South Carolina - IN DICTA, YES; and *Tribune* was an "extravagant expansion" of the safe harbors. *Ashmore for Wilson v. Dodds*, 262 F. Supp. 3d 341, 354 (D.S.C. 2017).

  - Case was not a bankruptcy case but a party sued by a court reciever sought the safe harbor of 546(e).

  - Court held - "In enacting the Bankruptcy Code, federal lawmakers decided to make § 546(e)'s safe harbor provision apply only to bankruptcy trustees. . ."

  - And called *Tribune* - "the most extravagant expansion of the safe harbor provision."

<u>Section 560 Decisions (safe harbor protecting swap termination payments)</u>[4]

- Judge Peck decisions finding that CDO provisions that subordinated swap termination payments to LBSF were unenforceable ipso facto clauses not covered by the safe harbor:

  - *Lehman Bros. Special Fin. Inc. v. BNY Corp. Tr. Serv. Ltd*., 422 B.R. 407 (Bankr. S.D.N.Y. 2010) ("BNY") (denying defendant's motion for summary judgment)

    - This case involved a swap agreement. The bankruptcy court held that both section 365(e)(1) and section 541(c)(1)(B) barred a contractual

[4] Please see <u>Exhibit C</u> for a more detailed description of the *Lehman* decisions and related issues.

reversal of priorities as a result of a bankruptcy filing. In reaching this conclusion, the court used broad language, stating that it is "axiomatic that ipso facto clauses are, as a general matter, unenforceable."

- Judge Peck found that section 560 did not apply because the priority provisions at issue "did not comprise part of the swap agreement," and thus the provisions governing the liquidation were not a part of the swap agreement.

- *Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007-1 Ltd.*, 452 B.R. 31 (Bankr. S.D.N.Y. 2011) ("Ballyrock") (denying defendants' motion to dismiss).

  - The Ballyrock Notes were secured by collateral which was held in trust. The issuer also entered into swap transactions with LBSF, under which the events of default included the bankruptcy filing of the issuer, LBSF and LBHI (who was LBSF's credit support provider).

  - As a result of the LBHI bankruptcy petition filing, the swap transactions were terminated, the Ballyrock Notes were accelerated and the collateral was liquidated.

  - The court found that the relevant swap transactions provisions were unenforceable ipso facto clauses.

  - Also, consistent with its decision in BNY, the court decided that the provisions were an alteration or elimination of LBSF's existing distribution rights and not a liquidation, termination or acceleration as required under the swap safe harbor. As such, they were not protected by the swap safe harbor.

- Judge Peck later entered a decision finding contractual provisions specifying the method of calculating the settlement amount under a swap agreement are protected by the Bankruptcy Code's safe harbors.

  - *Michigan State Housing Development Authority v. Lehman Brothers Derivatives Products Inc. and Lehman Brothers Holdings Inc. (In re Lehman Bros. Holdings Inc.)*, 502 B.R. 383 (Bankr. S.D.N.Y. 2013)[5]

    - The right to terminate the swap clearly fell within the safe harbor protections but the question before the Court was whether the non-debtor counterparty was entitled to utilize the contractual method of calculating the settlement amount as part of liquidationfell within the safe harbor protections under Section 560 of the Bankruptcy Code, which permits "the liquidation, termination or acceleration" of swap agreements.

[5] Please see Exhibit C for a more detailed written description of the this case and related issues.

- The Court distinguished the *BNY* case, the Court held that a "flip clause" that subordinated payments due to LBSF as a result of its bankruptcy filing was an unenforceable ipso facto clause that was not protected by Section 560. In that case, the flip clause was contained in a supplemental agreement that was not part of the swap agreement, and the Court determined that the flip clause did not expressly deal with liquidation, termination or acceleration. Conversely, in this case, the Court found that *BNY* was inapplicable because the Liquidation Paragraph was part of the Swap Agreement and the Liquidation Paragraph dealt expressly with the liquidation of the Swap Agreement. The Court noted that the act of liquidating and the method of calculation "are so tightly intertwined to the point that liquidation without a defining methodology is impossible to perform."

- The Court similarly found that *Ballyrock* was distinguishable because that case also dealt with a provision that altered payment priorities and that did not directly deal with liquidation, termination or acceleration.

• Judge Chapman decision finding that CDO provisions that subordinated swap termination payments to LBSF *were* covered by the safe harbor:

  o *Lehman Bros. Spec. Fin. Inc. v. Bank of America Nat'l Assoc., et al. (In re Lehman Brothers Holdings Inc., et al.)*, Adv. Pro. No. 10-03547 (SCC), 2016 Bankr. LEXIS 2405 (Bankr. S.D.N.Y., June 28, 2016)

    - The September 15, 2008, bankruptcy filing of LBSF's parent, Lehman Brothers Holdings, Inc. (LBHI), caused LBSF to become a defaulting party under the swap agreements. Issuers then terminated their swaps with LBSF based on the default. Termination of the swaps gave noteholders a priority claim on the collateral. LBSF filed for bankruptcy three weeks later.

    - In those transactions where the collateral was liquidated and distributed to noteholders before LBSF's bankruptcy filing, the parties and the court termed it a "pre-pre" transaction. When the termination occurred before LBSF's bankruptcy but the liquidation and distribution occurred afterwards, the court termed it a "pre-post" transaction. Finally, "post-post" transactions were when the early termination and distribution of collateral both occurred subsequent to LBSF's bankruptcy.

    - For both "pre-pre" and "pre-post" transactions, the modification of LBSF's rights was trigged by LBHI's earlier bankruptcy filing, and therefore before LBSF's bankruptcy and before the Bankruptcy Code's limitation on the enforceability of ipso facto was applicable to LBSF. In so holding, the court declined to adopt Judge Peck's "singular event" analysis contained in the *BNY* decision.

- With respect to the "post-post transactions" if LBSF was in the money under a swap, it had priority in the waterfall from the outset, ahead of the noteholders. However, that priority was lost if LBSF became the defaulting party under the swap. The court explained this type of waterfall modified LBSF's right to payment and was therefore an unenforceable ipso facto clause.

- The court found that the ipso facto clause was, however, covered by the safe harbor.

- The court rejected LBSF's argument that the safe harbor's use of the term "liquidate" did not include distribution of the proceeds of the liquidated collateral. Instead, the court explained that "the plain meaning of [section 560] protects both the act of liquidating and the manner for carrying it out." Explaining further, the court stated that the Second Circuit and courts in the circuit have repeatedly noted in cases decided subsequent to *BNY* and *Ballyrock* that the safe harbors require a "broad and literal interpretation." The court stated that "a broad reading of the safe harbors is consistent, and goes hand-in-hand, with congressional intent in creating (and subsequently expanding) the safe harbors to promote the stability and efficiency of financial markets."

- The court also noted that the payment provisions at issue were clearly a part of the swap agreements, a fact that made them distinguishable from the *BNY* and *Ballyrock* decisions. In those cases, Judge Peck had concluded that the payment provisions of the transaction documents were not incorporated into the swap agreements, giving rise to the argument that they were beyond the scope of the safe harbor's protection of swap agreements.

o *Affirmed by: Lehman Brothers Special Financing Inc. v. Bank of America National Association,* No. 17-cv-01224, 2018 WL 1322225 (S.D.N.Y. Mar. 14, 2018)

- Judge Schofield affirmed Judge Chapman's decision and held that the safe harbor provisions of Section 560 of the U.S. Bankruptcy Code protect swap termination payments made pursuant to such market-standard payment priority provisions.

- Consistent with the Supreme Court's approach in its recent decision in *Merit Management*, Judge Schofield focused heavily on the text of the statute, concluding that under "the most sensible literal reading," the Section 560 safe harbor applied to the distributions at issue.

- The District Court explained that the "plain meaning of liquidate" must, in the context of this case, mean "bring[ing] the swap agreement to an end by distributing the [c]ollateral pursuant to the Priority Provisions."

- The Court also addressed LBSF's contention that the Bankruptcy Court's analysis of Section 560 was inconsistent with Judge Peck's rulings in *BNY* and *Ballyrock*. Rejecting this argument, Judge Schofield explained that *BNY* and *Ballyrock* were not controlling authority and were in any event distinguishable "because, unlike here, the provisions at issue [in *BNY*] were not part of the swap agreement."

- Furthermore, Judge Schofield observed that reading Section 560 to protect the distribution of collateral pursuant to the Priority Provisions was consistent with Judge Peck's more recent interpretation of that safe harbor in *Michigan State Housing*.

- This case is currently pending appeal to the Second Circuit.

<u>Section 562/Loss Calculation</u>

There are very few cases which address section 562 of the Bankruptcy Code. The *American Home Mortgage Holdings, Inc.* case in the Bankruptcy Court and the United States Court of Appeals for the Third Circuit are summarized below.

In re Am. Home Mortg. Holdings, Inc., 411 B.R. 181 (Bankr. Del. 2009)[6]

- This case involved a repurchase agreement. The bankruptcy court disallowed the proofs of claim filed by Calyon.

- Calyon argued that, at the time of the termination and acceleration of the repurchase agreement, there were no commercially reasonable determinants of value and therefore, the valuation of the loan portfolio had to be based upon the market value once the market stabilized which was more than a year after the termination and acceleration of the repurchase agreement. Section 562(b) provides that if there are no commercially reasonable determinants of value as of the acceleration date, then any damages must be measured "as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value." 11 U.S.C. §562(b).

- Judge Sontchi noted that the legislative history of section 562 was extremely sparse. "Although it expected that in most circumstances damages would be measured as of the date or dates of either rejection or liquidation, termination or acceleration, in certain unusual circumstances, such as dysfunctional markets or liquidation of very large portfolios, there may be no commercially reasonable determinants of value for liquidating any such agreements or contracts or for liquidating all such agreements and contracts in a large portfolio on a single day." H.R. Rep. No. 109-31 at 134-35 (2005).

- Judge Sontchi ruled that the statute is ambiguous as to "whether (i) the damage calculation is limited to either selling the assets or checking the market price of those assets; or (ii) damages may be measured by some other commercially reasonable

[6] Please see <u>Exhibit D</u> for a more detailed written description of the case and related issues.

method."

- American Home submitted a discounted cash flow analysis as of the acceleration date as its evidence of a commercially reasonable determinant of value. The Court held that Calyon had failed to rebut this evidence, even though Calyon's evidence established that the loan portfolio could not have been sold for a reasonable price on the acceleration date.

- Calyon's proofs of claim were disallowed because the value of the loan portfolio on the acceleration date, based on the discounted cash flow analysis, exceeded the repurchase price on the acceleration date.

Credit Agricole Corp. v. Am. Home Mortg. Holdings Inc. (In re Am. Home Mortg. Holdings, Inc.), 637 F.3d 246 (3d. Cir. 2011).

- The Third Circuit affirmed the Bankruptcy Court's decision.

- "We find the Bankruptcy Court's analysis persuasive. It stated that the market price should be used to determine an asset's value when the market is functioning properly. It is only when the market is dysfunctional and the market price does not reflect an asset's worth should one turn to other determinants of value."

- The Court further noted "if Congress had intended § 562 to be limited to market or sale price, it would have said so."

<u>Derivative Termination Disputes</u>

Not all disputes that Lehman encountered in closing out its derivatives transactions involved Bankruptcy Code provisions. Sometimes the issue was simply interpretation of the contracts' termination provisions.

In re Lehman Bros. Holdings Inc. and Lehman Bros. OTC Derivatives Inc. v. Intel Corp. (In re Lehman Bros. Holdings Inc.), No. 13-01340, 2015 WL 7194609 (Bankr. S.D.N.Y. Sept. 16, 2015)

- This case involved a forward share repurchase agreement between Intel and LOTC. LOTC was to buy and deliver to Intel a fixed number of Intel shares on a certain date. Intel "prepaid" $1 billion for the shares. LOTC was unable to deliver the shares on the delivery date, so Intel terminated the repo and kept its $1 billion. LOTC sued to recover funds from Intel.

- At issue was whether Intel had calculated its damages under the agreement appropriately. The parties had chosen Loss and Second Method as the methods to calculate termination payments.

- The bankruptcy court held that the Loss methodology gives the non-defaulting party discretion in its calculation of loss, so long as such calculations are reasonable and in good faith. Rejecting LOTC's argument to the contrary, the court held that Loss does not necessarily require the non-defaulting party to take into account market quotations or prices of the securities subject to the repo in calculating its damages.

Lehman Bros. Int'l (Eur.) v. AG Fin. Prods., Inc., No. 653284/2011, 2018 WL 3432593 (N.Y. Sup. Ct. July 2, 2018)

- This case involved credit default swaps LBIE had purchased from Assured.
- LBIE commenced its administration proceeding in September 2008. More than 9 months later, Assured provided LBIE with notice of an Event of Default based on the commencement of LBIE's administration. Assured designated July 23, 2009 (the date of the notice) as the Early Termination Date.
- At issue was whether Assured calculated its damages under the swaps appropriately. The parties had chosen Market Quotation and Second Method as the methods to calculate termination payments.
- While Market Quotation method requires the non-defaulting party to obtain quotes from reference market-makers, the credit default swap provided that if less than three quotations were provided, it would be deemed that the Market Quotation calculation of damages could not be determined and the non-defaulting party could use the Loss method instead.
- While Assured made a prima facie case for why the Loss methodology should apply in calculating its damages, the court was not persuaded that Assured's calculation of such Loss was reasonable, reserving that issue for a trial.
- The court held that, while the Loss provision in the ISDA Master Agreement allows a non-defaulting party to calculate Loss without reference to market prices, it does not mean that the non-defaulting party's decision to "ignore market prices can never be unreasonable or undertaken in bad faith".

Setoff

- *In re Lehman Bros. Holdings, Inc.*, 433 B.R. 101 (Bankr. S.D.N.Y. 2010)
  - o Judge Peck held that, absent mutuality of obligation, funds on deposit with a bank are not protected by the safe-harbor provisions and cannot be used to set off an obligation allegedly owed by the debtor under a master swap agreement. "A contractual right to setoff under derivative contracts," Judge Peck wrote, "does not change well established law that conditions such a right on the existence of mutual obligations." According to the judge, "[M]utuality is baked into the very definition of setoff."
- *In re Lehman Brothers Inc.*, Case No. 08-01420 (JMP) (SIPA), slip op. (Bankr. S.D.N.Y. Oct. 4, 2011)
  - o Judge Peck held that a contractual right to effect a cross-affiliate setoff is unenforceable in bankruptcy. The court found that mutuality is a requirement for

both common law and contractual setoff under Section 553 of the Bankruptcy Code, and that the contract did not create mutuality for purposes of Section 553. The court further held that the safe harbor provisions for swaps and other derivatives contracts in the Bankruptcy Code do not permit a party to exercise a contractual right to setoff where there is no mutuality.

***Lehman* issue relevant to opinion work**

- Many of the Lehman derivative litigations focused on failure to terminate in a commercially reasonable manner, or that the payment calculation was skewed by soliciting bids from market makers. Firms may want to evaluate their opinion practice in regards to these situations.

Forward Contract Merchants

- Statutory Framework:
    - Forward Contract Merchants have rights under the Code to take actions that would otherwise violate the automatic stay and are protected from avoidance actions that are not actual fraudulent transfers. Section 326(b)(6); 546(e).
    - Forward Contract Merchant is a Defined Term in the Bankruptcy Code under 101(26)
        - (26) The term "forward contract merchant" means a Federal reserve bank, or an entity the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity (as defined in section 761) or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade.
        - **Sub-Definitions -**
        - "commodity" is broadly defined - (defined at 101(25) through 11. U.S.C. 761).
            - "means wheat, cotton, rice, corn, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions. . .and motion picture box office receipts (or any index, measure, value, or data related to such receipts), and all services, rights, and interests (except motion picture box office receipts, or **any index, measure, value or data related to such receipts) in which contracts for future delivery are presently or in the future dealt in.**"

        - "forward contract" (defined at 101(25)

            - The term "forward contract" means a contract (**other than a commodity contract**) for the purchase, sale, or transfer of a commodity, as defined in section 761(8) of this title, or any similar good, article, service, right, or interest which is presently or in the future becomes the subject of dealing in the forward contract trade, or product or byproduct thereof, with a maturity date more than two days after the date the contract is entered into, including, but not limited to, a repurchase transaction, reverse repurchase transaction, consignment, lease, swap, hedge transaction, deposit, loan, option, allocated transaction, unallocated transaction, or any combination [or master agreement] thereof or option thereon....

        - "commodity contract" (11 U.S.C. 761(4))

            - Defined as a contract on a formal contract market or board of trade (and subject to the rules) of trade for a commodity.

- **Precedent** -

- Strict Approach -

    - More than a "pepppercorn" of business

        - *In re Magnesium Corp. of America*, 460 B.R. 360 (Bankr. S.D. N.Y. 2011)

            - One cannot be a "forward contract merchant" with only a small amount of activity (described by the court as a "peppercorn") in entering into commodity forward contracts, not every person who enters into forward contracts is forward contract merchant and that to successfully the invoke safe harbor defense a defendant had to show that this entity was a merchant in the forward contract "trade," which entered into such contracts to generate profit.

        - *In re Mirant Corp.*, 310 B.R. 548, 567 (Bankr. N.D. Tex. 2004)

            - Without references to "business" and "merchant," the definition of "forward contract merchant" could as easily have been "a person that enters into forward contracts." This is the interpretation Defendant suggests the court give Code section 101(26), i.e., any person that enters into forward contracts is a forward contract merchant. However, to adopt this construction would violate the judicial corollary to Occam's Razor: that each word in a statute has significance and must be given meaning in construing the statute

    - Acting as an end-user or producer is not acting as a forward contract merchant. *In re Magnesium Corp. of America*, 460 B.R. 360 (Bankr. S.D. N.Y. 2011).

- More Liberal Approach
  - One can be a forward contract merchant even if they are an end user or producer. *In re MBS Management Services, Inc.*, 430 B.R. 750, 53 Bankr. Ct. Dec. (CRR) 74 (Bankr. E.D. La. 2010), affirmed *In re MBS Mgmt. Services, Inc.*, 690 F.3d 352, 356–57 (5th Cir. 2012).
    - Statutory and Policy Reason - Per Fifth Circuit -
      - "[A]rguments. . .that payments debtors make on "ordinary supply contracts" should not be protected. . . are immaterial when laid against the statutory text."
      - [Regardless],... [F]orward contracts are negotiated between industry participants and forward contract merchants. The industry participants are either producers or users of the commodity who sell or purchase the commodity in advance to hedge against price fluctuations. Forward contract merchants create or manage commodity markets by providing a place for industry participants to buy or sell a commodity in advance of its actual production. *In re MBS Mgmt. Services, Inc.*, 690 F.3d 352, 356–57 (5th Cir. 2012)
  - Party found to be a forward contract merchant when evidence showed it "acted as both a buyer and a seller of natural gas through the use of forward contracts." *In re Borden Chemicals & Plastics Operating Ltd. P'ship*, 336 B.R. 214, 225 (Bankr. D. Del. 2006) (Quoting Colliers)
    - "Congress's addition of the phrase "in whole or in part" had the effect that "essentially any person that is in need of protection with respect to a forward contract in a business setting should be covered, except in the unusual instance of a forward contract between two nonmerchants who do not enter into forward contracts with merchants."
  - Forward contract merchant established by showing two contracts with debtor were forward contracts. *In re Renew Energy LLC*, 463 B.R. 475, 55 Bankr. Ct. Dec. (CRR) 106, 66 Collier Bankr. Cas. 2d (MB) 636, Bankr. L. Rep. (CCH) ¶ 82061 (Bankr. W.D. Wis. 2011).
  - Forward contract merchant status determined because party acted as forward contract merchant in transactions with the debtor. *In re Clean Burn Fuels, LLC*, 540 B.R. 195, 210 (Bankr. M.D.N.C. 2015), amended, 11-80562, 2016 WL 5874964 (Bankr. M.D.N.C. Oct. 7, 2016), amended, 11-80562, 2017 WL 1194452 (Bankr. M.D.N.C. Mar. 30, 2017).
  - Focus should be on transactions with debtor and not on the whole to determine status as forward contract merchant. *In re Eastern Livestock Co., LLC*, 2012 WL 4210347 (Bankr. S.D. Ind. 2012).

Exhibit A

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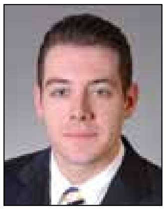
Merit: Safe-Harbored No More?



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On Feb. 27, 2018, the U.S. Supreme Court ruled in the matter of *Merit Management Group LP v. FTI Consulting Inc.*,[2] resolving a circuit split and deciding whether the § 546(e) safe harbor applies when a "financial institution" is only a "mere conduit" for a transfer between otherwise nonprotected parties. The Court unanimously found that the safe harbor does not apply, such that a transfer can be unwound, if the transfer is between nonprotected parties and the funds simply move through a financial institution without benefiting it.

The holding affirms the prior ruling in this case by the Seventh Circuit Court of Appeals, though on different grounds, and overrules prior decisions of the Second, Third, Sixth, Eighth and Tenth Circuit Courts of Appeals, which had held in favor of a more expansive view of the safe harbor and declared that if one intermediary involved in the transfer at issue is a financial institution, then the transfer is safe-harbored — even if all parties involved in the transfer are not protected entities. However, the Court did note that an argument existed that might have changed the outcome (more on that later).

Background

Valley View Downs LP sought to operate a "racino" in Pennsylvania. Valley View entered into an agreement with Bedford Downs Management Corp. to purchase all of Bedford Downs's stock for $55 million after it obtained the necessary state racing license.[3] The state granted the license, and thereafter, Valley View arranged for its bank, Credit Suisse, to wire $55 million to Citizens Bank of Pennsylvania, a third-party escrow agent.[4] Citizens Bank disbursed the $55 million in separate installments. One installment totaling $16.5 million went to Merit Management Group LP, a shareholder of Bedford Downs, as consideration for its stock.[5]

Valley View later filed for bankruptcy, and FTI Consulting was appointed to serve as the trustee for a litigation trust.[6] FTI sought to avoid the transfer from Valley View to Merit, arguing that it was constructively fraudulent under § 548(a)(1)(B) of the Bankruptcy Code.[7] Merit contended that the transfer was safe harbored under § 546(e) as a "settlement payment ... made by or to (or for the benefit of)" a covered "financial institution" — in this instance, Credit Suisse and Citizens Bank.[8]

The District Court and Seventh Circuit Decisions

The district court found that the financial institutions transferred or received the funds in connection with a "settlement payment" or "securities contract," and therefore held that the § 546(e) safe harbor applied.[9] The court found that the requirements of the statute were satisfied, as "a transfer that is 'by or to' a financial institution is just that: a transfer where a financial institution sends or receives funds."[10]

The Seventh Circuit Court of Appeals reversed, holding that the safe harbor did not protect a transfer in which financial institutions served as mere conduits.[11] The Seventh Circuit framed the issue as being "whether the section 546(e) safe harbor protects transfers that are simply conducted through financial institutions (or the other entities named in section 546(e)) where the entity is neither the debtor nor the transferee but only the conduit,"[12] therefore looking beyond the statute's text to its underlying purpose. After conducting a review of the statute's purpose and historical context, the Seventh Circuit determined that Merit's position would throw the avoidance powers and safe harbor out of balance by "render[ing] any transfer non-avoidable unless it were done in cold, hard cash."[13]

The Seventh Circuit noted that the purpose of § 546 is to (1) "protect ... the market from systemic risk and allow ... parties in the securities industry to enter into transactions with greater confidence" and (2) "prevent one large bankruptcy from rippling through the securities industry."[14] The court held that "[w]hile Valley View's settlement with Bedford resembled a leveraged buyout, and in that way touched on the securities market, neither Valley View nor Merit were parties in the securities industry."[15] Accordingly, the circuit court declined to "interpret the safe harbor so expansively that it covers any transaction involving securities that uses a financial institution or other named entity as a conduit for funds."[16] In so holding, the Seventh

1 Nothing in this article constitutes an opinion or view of the authors, Dentons or any of their clients.
2 *See Merit Mgmt. Grp. LP v. FTI Consulting Inc.*, 2018 WL 1054879 (Feb. 27, 2018).
3 *Id.* at 6.
4 *Id.*
5 *Id.*
6 *Id.*
7 *Id.*
8 *Id.*
9 *FTI Consulting Inc. v. Merit Mgmt. Grp. LP*, 541 B.R. 850, 859 (N.D. Ill. 2015).
10 *Id.*
11 *FTI Consulting Inc. v. Merit Mgmt. Grp. LP*, 830 F.3d 690, 691 (7th Cir. 2016).
12 *Id.*
13 *Id.* at 695.
14 *Id.* (citing *Grede v. FCStone LLC*, 746 F.3d 244, 252 (7th Cir. 2014)).
15 *Id.* at 696.
16 *Id.*

Circuit noted that "if Congress had wanted to say that acting as a conduit for a transaction between non-named entities is enough to qualify for the safe harbor, it would have been easy to do that. But it did not."[17]

The Supreme Court's Decision

While the Supreme Court affirmed the Seventh Circuit's ruling, it took a different approach of statutory interpretation. The Court found that the lower courts had mistakenly "put the proverbial cart before the horse" by analyzing the "by or to (or for the benefit of)" language of § 546(e) before identifying the relevant transfer to be tested in that inquiry.[18]

Justice Sonia Sotomayor, writing for the Court, said that the question presented was, "when determining whether the section 546(e) securities safe harbor saves the transfer from avoidance, should courts look to the transfer that the trustee seeks to avoid (*i.e.*, the transfer from A to D) to determine whether that transfer meets the safe harbor criteria, or should courts look also to any component parts of the overarching transfer (*i.e.*, the transfer from A to B to C to D)?"[19] The Court concluded that the plain meaning of § 546(e) dictates that the only relevant transfer for the purpose of the safe-harbor analysis is the transfer that the trustee seeks to avoid[20] — in this instance, the transfer from A to D.

Here, FTI identified the purchase of Bedford Downs' stock by Valley View from Merit as the transfer it sought to avoid.[21] Merit, in its response, instead focused on whether FTI could ignore the component parts of the transfer as qualifying it for the safe harbor.[22] However, Merit did not argue that FTI improperly identified that transfer as one to be avoided. Absent that argument, the Court found that "the Credit Suisse and Citizen Bank component parts are simply irrelevant to the analysis under section 546(e)" and instead focused on the transfer the trustee sought to avoid.[23]

Merit argued that by including the parenthetical "(or for the benefit of)," Congress meant to abrogate the Eleventh Circuit's decision in *In re Munford Inc.*,[24] which held that the § 546(e) safe harbor was inapplicable to transfers in which a financial institution acted only as an intermediary.[25] In response, the Supreme Court found that (1) Merit cited no authority for this contention, and (2) there was a simpler explanation — the language, which is common in other avoidance provisions, ensures that the scope of the safe harbor and the scope of the avoiding powers match.[26]

In addition, Merit argued that since § 546(e) includes reference to a "securities clearing agency," which is defined as an intermediary for payments made in connection with securities transactions, the statute must be read to protect transfers involving intermediaries without any beneficial interest in the transfer.[27] A contrary interpretation would render that provision as being superfluous. The Court took issue with Merit's assumption that securities clearing agencies always act as intermediaries without a beneficial interest and found that its reading of the statute would not yield any superfluity. The Court reasoned that if a trustee sought to avoid a transfer "made by or to (or for the benefit of)" a securities clearing agency otherwise covered by § 546(e), the safe harbor would bar such an action regardless of whether the securities clearing agency was an intermediary.[28]

Lastly, Merit focused on the purpose of the statute and argued that Congress intended to take a "comprehensive approach to securities and commodities transactions" that "was prophylactic, not surgical," to "advance the interests of parties in the finality of transactions."[29] The Supreme Court reasoned that "even if this were the type of case in which the Court would consider statutory purpose," the plain language of the safe harbor contradicts Merit's interpretation because while the statute saves from avoidance certain securities transactions made by or to (or for the benefit of) covered entities, it does nothing to save transfers "through" a covered entity.[30]

Applying its analysis, the Court concluded that the relevant transfer for purposes of the § 546(e) safe harbor is the transfer that FTI sought to avoid from Valley View to Merit — with all of the other component parts of that transaction being irrelevant to the analysis.[31] Since the parties did not contend that either Valley View or Merit were "financial institutions" or otherwise covered entities, the Court concluded that the transfer fell outside of the safe harbor and so affirmed.[32]

Insights — and an Important Footnote

In its first decision addressing the § 546(e) safe-harbor provision, the Supreme Court has essentially closed what could be perceived as a loophole in certain circuits where transfers had previously been safe-harbored simply because they went through covered entities. The Court found that using an escrow agent does not preclude a trustee from recovering a constructively fraudulent transfer under § 548 when the trustee is seeking to recover from the ultimate recipient of the transfer but not from an intermediary financial institution.

Accordingly, if a covered intermediary serves as a conduit in the overarching transfer between nonprotected parties that the trustee seeks to avoid, the safe harbor will not protect the ultimate transferee. As a result, an immediate impact of the case is likely to be an increase in the number of avoidance-action claims filed in the Second, Third, Sixth, Eighth and Tenth Circuits, which had interpreted the § 546(e) safe harbor more expansively.

In addition, this decision will likely have a significant impact on how avoidance actions are prosecuted and defended. The Supreme Court has made it clear that the relevant transfer to be reviewed against the language of the safe harbor is "the specific transfer that the trustee seeks to avoid." As such, plaintiffs are likely to be more careful in how they frame their avoidance actions in order to limit the scope of the safe-harbor defense.

17 *Id.* at 697.
18 *Merit Mgmt. Grp. LP v. FTI Consulting Inc.*, 2018 WL 1054879 at 7.
19 *Id.* at 3.
20 *Id.*
21 *Id.* at 10.
22 *Id.*
23 *Id.*
24 98 F.3d 604, 610 (11th Cir. 1996).
25 *Merit Mgmt. Grp. LP v. FTI Consulting Inc.*, 2018 WL 1054879 at 10.
26 *Id.*
27 *Id.* at 11.
28 *Id.*
29 *Id.* at 12.
30 *Id.*
31 *Id.*
32 *Id.*

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Notably, however, the Court in a footnote commented that Merit had failed to contend that either itself or the debtor qualified as a "financial institution" by virtue of its status as a "customer." Therefore, the Court refused to "address what impact, if any, section 101(22)(A) would have in the application of the section 546(e) safe harbor." Section 101(22)(A) provides that where one of the listed financial institutions is acting as agent or custodian for a customer, the customer itself is a protected "financial institution." Through this footnote, the Court signaled that it was aware that this additional argument could have been made by Merit, and it could have changed the outcome of the decision.

Consequently, there can be little doubt that future avoidance action defendants will assert this argument in the hopes that their transfer will remain within the protections of the safe harbor. As a result, the impact of the decision might be more limited. abi

Exhibit B

STATUS OF CERTAIN SIGNIFICANT CASES INVOLVING
***MERIT MANAGEMENT* CURRENTLY ON APPEAL**

Because it can take a considerable amount of time for fraudulent transfer actions to progress through the bankruptcy system, it may be several years before the effects of the Supreme Court's decision in *Merit Management Group, LP v. FTI Consulting, Inc.* are more fully understood. In the meantime, however, two significant fraudulent transfer cases are now awaiting further consideration from their respective Courts of Appeal in light of *Merit*. Below is a summary of their procedural posture.

I. TRIBUNE COMPANY FRAUDULENT CONVEYANCE LITIGATION

The first of these cases -- the Tribune Company Fraudulent Conveyance Litigation (Case No. 13-3992(L)) -- is currently pending in the Second Circuit and arises out of a failed leveraged buyout ("LBO") whereby more than $8 Billion was transferred to Tribune Company shareholders. Less than a year after the LBO was consummated, the Tribune Company filed its bankruptcy petition in the United States Bankruptcy Court for the District of Delaware.

The Tribune Company bankruptcy case and the ensuing fraudulent conveyance litigation were incredibly complicated, involving multiple courts, innumerable parties, and remarkable lawyering on the part of all significantly involved counsel. At the risk of factual oversimplification, shortly after the bankruptcy was filed, the bankruptcy court granted the unsecured creditors committee standing to sue former Tribune shareholders. Because the section 546(e) safe harbor includes constructively fraudulent transfers and excludes intentional fraudulent transfers, the committee brought suit only under section 548(a)(1)(A) of the Bankruptcy Code, which permits a trustee to avoid any transfer made or incurred "with actual intent to hinder, delay or defraud . . . ." Separately, in an effort to "work around" section 546(e) with respect to constructively fraudulent transfers, with the consent of the committee, certain large unsecured creditors prevailed on the bankruptcy court to lift the automatic stay to permit them to bring state law constructive fraudulent transfer claims (among other claims) against former shareholders outside of the bankruptcy proceedings. Suits were thereafter initiated in various state and federal courts, which were ultimately consolidated into a single, multidistrict litigation case in the United States District Court for the Southern District of New York. *In re Tribune Co. Fraudulent Conveyance Litigation*, 831 F.Supp.2d 1371 (J.P.M.L. 2011).

In 2012, the bankruptcy court confirmed a plan of reorganization that created a litigation trust to continue to prosecute the intentional fraudulent transfer claims brought by the committee during the case. The plan also separately provided that the claims of individual creditors pending in the multidistrict litigation could continue and that nothing in the plan was intended to impair the rights of individual creditors to pursue constructive fraudulent transfer claims disclaimed by the bankruptcy estate. Upon Tribune's emergence from bankruptcy, the automatic stay terminated and the multidistrict litigation moved forward. The defendants moved to dismiss arguing, *inter alia*, that the individual constructive fraudulent transfer claims were impliedly preempted by section 546(e) and, in any event, that the individual claimants lacked standing to bring such claims.

The district court granted the motion to dismiss. While the district court held that section 546(e) does not preempt state law fraudulent transfer claims brought by individual creditors, the court nevertheless held that the individual creditors lacked standing to pursue individual claims while the litigation trust's separate claims against the shareholders were still pending. *See In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310 (S.D.N.Y. 2013). The Second Circuit affirmed on other grounds, holding that section 546(e) impliedly preempted the prosecution of

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the individual creditors' claims. *See In re Tribune Co. Fraudulent Conveyance Litig.*, 818 F.3d 98 (2d Cir. 2016).

The individual creditors appealed to the Supreme Court and, while their Petition for Writ of Certiorari was pending, the Supreme Court issued its opinion in *Merit Management Group, LP v. FTI Consulting, Inc.* As a result, Justices Kennedy and Thomas issued the following statement on the Petition:

> The parties are advised that consideration of the petition for certiorari will be deferred for an additional period of time. This will allow the Court of Appeals or the District Court to consider whether to recall the mandate, entertain a Federal Rule of Civil Procedure 60(b) motion to vacate the earlier judgment, or provide any other available relief in light of this Court's decision in *Merit Management Group LP v. FTI Consulting, Inc.*, 583 U.S. __ (2018). The petition for certiorari in this case was pending when the Court decided Merit Management. The Court of Appeals or the District Court could decide whether relief from judgment is appropriate given the possibility that there might not be a quorum in this Court. *See* 28 U.S.C. § 2109.

Consistent with statement of Justices Kennedy and Thomas, Appellants/Petitioners filed a motion to recall mandate with the Second Circuit. On May 15, 2018, after extensive briefing, the Second Circuit "ordered that the mandate in this case is recalled in anticipation of further panel review." As of September 18, 2018, no further orders or opinions have been issued.

II. IN RE GREEKTOWN HOLDINGS, LLC

The Greektown Holdings fraudulent transfer litigation (Case No. 18-1167) arose out of the bankruptcy of Greektown Casino, one of three casinos located in Detroit, Michigan, and its parent holding company and affiliate entities.

As of February 2005, most of the Casino's equity was ultimately owned by the Sault Ste. Marie Tribe of Chippewa Indians (the "Tribe") through various intermediary entities. Those Tribe-owned intermediaries included Monroe Partners, LLC ("Monroe") and Kewadin Greektown Casino, LLC ("Kewadin"). Dimtrios and Viola Papas and Ted and Maria Gatzaros (the "Papas and Gatzaros Defendants") were the former part-owners of Monroe to whom Monroe and Kewadin, but not the Casino or Greektown Holdings, owed substantial debts. Based on a refinancing agreement in early 2005, Monroe and Kewadin owed the Papases $94,860,000 and the Gatzaroses $55,000,000. Those debts had to be paid by the end of 2005 or the Papas and Gatzaros Defendants could (among other remedies) compel the Tribe to sell its interests in the Casino.

From September to December 2005, the Tribe, Monroe, and Kewadin undertook transactions that resulted in payments to the Papas and Gatzaros Defendants totaling approximately $160 million. A new entity, Greektown Holdings, LLC ("Holdings"), was formed and given a 100% ownership interest in the Casino. Monroe and Kewadin became Holdings' owners. Holdings took on an additional $185 million in debt by selling senior notes to investors. Merrill, Lynch & Co. underwrote the offering and its affiliate, Merrill, Lynch, Pierce, Fenner & Smith ("MLPFS"), was an initial purchaser of the new notes. Holdings used the proceeds of the note sale to pay dividends to its owners (Monroe and Kewadin) who, in turn, used most of the dividend funds to pay the Papas and Gatzaros Defendants $149.5 million directly and $9.5 million indirectly.

Monroe, Kewadin, and the Papas and Gatzaros Defendants set out these transactions in a contemporaneous document called the "Flow of Funds Memorandum." As summarized by the district court, that memorandum "acknowledged ... 'that for the sake of efficiency, the following actual net transfers were made,' by Holdings through their bank account at MLPFS: (1) $90,491,741.62 to the Papases . . .; [and] (2) $55,000,000 to the Gatzaroses." The Papases received their transfer in an account at Chase Manhattan Bank ("Chase"). The Gatzaroses received theirs in an account at Comerica Bank ("Comerica").

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On May 29, 2008, the Casino, Holdings, Monroe, Kewadin, and several related businesses filed Chapter 11 bankruptcy petitions. On May 28, 2010, the official committee of unsecured creditors of the bankrupt entities (later replaced by Buchwald Capital Advisors LLC as the Litigation Trustee) brought an adversary proceeding to recover from the Papas and Gatzaros Defendants the amounts transferred directly or indirectly to them in December 2005 under 11 U.S.C. §544(b) and Michigan law, and to recover the transferred amounts from the Papas and Gatzaros Defendants under 11 U.S.C. §550.

The Papas and Gatzaros Defendants responded that the transfers are protected from avoidance by 11 U.S.C. §546(e), which creates a safe harbor for certain transfers "by or to (or for the benefit of)" entities that are "financial institution[s]" or other covered entities and, in this case, MLPFS is a financial institution, as are Chase and Comerica, the banks where the Papas and Gatzaros Defendants had their bank accounts.

On November 24, 2015, the bankruptcy court granted summary judgment to Papas and Gatzaros Defendants on their §546(e) defense, finding that, as a matter of law, the transfers at issue each met the statutory definitions both of "a ... settlement payment ... made by or to ... a ... financial institution" and of "a transfer made by or to... a ... financial institution ... in connection with a securities contract." Section 546(e). The bankruptcy court reasoned that, because the funds moved from Holdings' account at MFPLS to the Papas and Gatzaros Defendants accounts at Chase and Comerica, the transfers were made "by" MFPLS and were made "to" Chase and Comerica.

The bankruptcy court rejected the Litigation Trustee's reliance on *In re Munford, Inc.*, 98 F.3d 604 (11th Cir. 1996), which had held that when a financial institution acts as "nothing more than an intermediary or conduit," the §546(e) safe harbor does not apply. In so doing, the

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bankruptcy court observed that *Munford's* holding had been "rejected by multiple Circuit Courts of Appeals, including the Sixth Circuit" in *QSI Holdings, Inc. v. Alford*, 571 F.3d 545 (6th Cir. 2009).

The Litigation Trustee appealed to the district court and again argued that the payments were not "made by or to" a financial institution, citing the Seventh Circuit's very recent decision in *FTI Consulting, Inc. v. Merit Management Group, LP*, 830 F.3d 690 (7th Cir. 2016), *aff'd and remanded*, 138 S. Ct. 883 (2018). On January 23, 2018, the district court affirmed, concluding that *Merit Management* was in conflict with *QSI Holdings*, and rejected the Litigation Trustee's attempt to distinguish the latter case, explaining: "Unless and until the Sixth Circuit changes its position on this issue, this Court must follow *QSI* and concludes that MLPFS qualifies as a financial institution in this case, regardless of the nature of its role in handling the funds that were the proceeds of the sale of Notes under the [note purchase agreement]." The court further observed that "MLPFS's role here, in any event, went beyond simply being the conduit of the funds from one account to another" because "MLPFS was the underwriter, initial purchaser of the Notes, the agent for the other purchasers of the Notes and the recipient of the Note proceeds."

The Supreme Court granted certiorari in *Merit Management* while the Litigation Trustee's appeal was pending in the district court. Shortly after the Litigation Trustee appealed to the Sixth Circuit, the Supreme Court issued its *Merit Management* decision. The Litigation Trustee filed a motion for summary vacatur, arguing that *QSI* was no longer good law in light of the *Merit Management* decision. According to the Litigation Trustee, it seeks only to avoid transfers from Holdings to the Papas and Gatzaros Defendants under §544, and to recover the transferred funds or the value of those funds from the Papas and Gatzaros Defendants under §550. Neither the transferor (Holdings) nor the transferees (the Papas and Gatzaros Defendants) are financial institutions or other covered entities and, in light of the Supreme Court's decision, the roles of financial institutions such as MLPFS, Chase, and Comerica in the "component part[s]" of the transaction are no longer relevant.

On September 18, 2018, the Sixth Circuit denied the Litigation Trustee's summary vacatur motion, holding:

> Buchwald intends to argue that the bankruptcy court erred in granting, and the district court erred in affirming, summary judgment to the Defendants on their § 546(e) defense. In particular, Buchwald seeks this summary vacatur because the Supreme Court abrogated *QSI* in *Merit*. Buchwald has not yet briefed its appeal however, and it is not clear from the civil appeal statement that this is the only issue on appeal. And even if the appeal does rest on the Merit issue alone, a decision on the merits, rather than summary vacatur, will better guide this and lower courts on the issue in the future.

Also on September 18, 2018, the Sixth Circuit set a briefing schedule, whereby all briefs should be submitted by December 11, 2018. Given the Sixth Circuit's briefing schedule, it appears likely that its decision will precede any decision in the *Tribune* case.

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Exhibit C

Relevant Bankruptcy Code Provisions

Under the Bankruptcy Code, *ipso facto* clauses—contract provisions that modify the rights of the debtor due to filing for bankruptcy—are generally unenforceable. Section 365(e) of the Bankruptcy Code provides:

> an executory contract ... of the debtor may not be terminated or modified, and any right or obligation under such contract ... may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such contract ... that is conditioned on ... the commencement of a case under this title[.]

11 U.S.C. § 365(e)(1).

Section 363 preserves the right of a debtor or a bankruptcy plan to use property of the estate

> notwithstanding any provision in a contract, a lease, or applicable law that is conditioned ... on the commencement of a case under this title concerning the debtor ... and that effects, or gives an option to effect, a forfeiture, modification, or termination of the debtor's interest in such property.

11 U.S.C. § 363(1).

Section 541 invalidates *ipso facto* clauses by providing that a debtor's interest in property

> becomes property of the estate ... notwithstanding any provision in an agreement, transfer instrument, or applicable nonbankruptcy law ... that is conditioned on ... the commencement of a case under this title ... and that effects or gives an option to effect a forfeiture, modification, or termination of the debtor's interest in property.

11 U.S.C. § 541(c)(1).

Section 560 of the Bankruptcy Code protects a swap participant's right to unwind a swap transaction pursuant to an *ipso facto* clause that otherwise would be unenforceable. The provision states:

> The exercise of any contractual right of any swap participant or financial participant to cause the liquidation, termination, or acceleration of one or more swap agreements because of a condition of the kind specified in section 365(e)(1) of this title ... shall not be stayed, avoided, or otherwise limited by

> operation of any provision of this title or by order of a court ... in any proceeding under this title.

<u>Review of Flip Clause Litigation</u>

In 2009 and 2010, Lehman filed several adversary proceedings relating to synthetic collateralized debt obligation ("CDO") transactions that had been structured and marketed by Lehman. While the details of each CDO transaction varied, the main structure of each was generally the same.

For each CDO transaction, a Lehman affiliate would create a special purpose entity ("SPE") issuer that issued one or more series of notes into the market. The issuer used the sale proceeds from the notes to purchase various investments to serve as collateral to secure repayment of the notes. The issuer also entered into one or more credit default swaps with Lehman Brothers Special Financing Inc. ("LBSF") whereby the issuer sold credit protection on certain reference entities to LBSF. LBSF made periodic fixed premium payments to the issuer under the swap for such protection, and the issuer used these payments to help fund interest payments made to the noteholders under the notes. Lehman Brothers Holdings Inc. ("LBHI") served as credit support provider for LBSF under the swap.

The collateral held by the issuer was also used to secure obligations to LBSF under the swap. The trustee to the notes indenture held the collateral in trust for both the noteholders and LBSF and also held and controlled certain of each SPE issuer's rights to the collateral and under the swaps. The notes indenture contained provisions (referred to as the "Priority Provisions") that governed the order in which the collateral proceeds should be distributed to noteholders and LBSF in different circumstances. If the transaction was at maturity or terminated early due to an issuer/noteholder default, then Lehman would have priority to the collateral in the distribution waterfall. However, if LBSF were the defaulting party under the swap agreement, then the distribution waterfall provided that the noteholders received payment ahead of LBSF. Bankruptcy filings by either LBHI or LBSF were among the listed events of default under the swap agreements. This priority flip between the noteholders and Lehman is what is sometimes referred to as the "flip clause."

LBHI filed for bankruptcy on September 15, 2008. LBSF filed for bankruptcy on October 3, 2008. Many of the CDO transactions were terminated by the SPE issuers in connection with the bankruptcy cases.

English Litigation

The first court decision relating to the flip clause was issued in England. Saphir, one of the SPE issuers party to a CDO transaction with LBSF, terminated its swap agreement with LBSF on December 1, 2008, citing the bankruptcy filing as the relevant event of default. In 2009, Perpetual, a holder of credit-linked synthetic portfolio notes issued by Saphir, commenced litigation in England to determine the priority of its rights under the documents governing that transaction. This particular transaction was governed by English law. The trust deed (similar to an indenture) contained the Priority Provisions described above.

Ultimately, in July 2011, the UK Supreme Court held that (i) the flip clause was valid and enforceable as a matter of English law and did not offend a common law anti-deprivation rule that is intended to prevent parties from removing assets from an entity upon its bankruptcy filing (similar to the Bankruptcy Code's invalidation of *ipso facto* clauses, discussed below), and (ii) in any event, LBHI's bankruptcy filing was a "triggering event" which occurred on September 15, 18 days before LBSF filed for bankruptcy, making the anti-deprivation rule inapplicable. At the time LBSF filed for bankruptcy, it no longer had priority with respect to the collateral so that LBSF did not lose any rights or assets due to its bankruptcy filing.

<u>First Bankruptcy Court Decision – *BNY*[1]</u>

While the English litigation was still pending, LBSF filed an adversary proceeding in the U.S. in connection with its bankruptcy case against BNY Corporate Trustee Services Limited ("BNY") in its capacity as trustee of the Perpetual notes. LBSF sought among other things a declaration that the flip clause was unenforceable as an *ipso facto* clause and that LBSF was entitled to payment from the collateral ahead of noteholders.

LBSF filed a motion for summary judgment, and in January 2010, the bankruptcy court ruled for LBSF, holding that the flip clause constituted an unenforceable "*ipso facto*" clause, invalided by section 365 of the Bankruptcy Code. In so ruling, the bankruptcy court (contrary to the finding in the English litigation) held that LBSF had not lost its priority right to the collateral at the time its parent LBHI filed for bankruptcy. Instead, the bankruptcy court held that flip clause (contained in the Priority Provisions) only became effective at the point when the indenture trustee had liquidated the collateral and was ready to make distributions to LBSF or the noteholders, as applicable. Because the sale of collateral happened only after LBSF filed for bankruptcy, the bankruptcy court held that as of LBSF's bankruptcy filing date, it still held a priority right to the collateral. Accordingly, the bankruptcy court held that the Priority Provisions' modification of LBSF's right to priority solely as a result of a bankruptcy filing constituted an unenforceable *ipso facto* clause and any attempt to enforce such provision would violate the automate stay.

The bankruptcy court went on to hold that distribution of the collateral did not fall within

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1 *Lehman Bros. Special Fin. Inc. v. BNY Corp. Trustee Servs. Ltd. (In re Lehman Bros. Holdings Inc.) ("BNY"),* 422 B.R. 407 (Bankr. S.D.N.Y. 2010) (JMP).

the scope of the "safe harbor" provisions of the Bankruptcy Code, which would have otherwise upheld the noteholder priority notwithstanding the *ipso facto* provision by which LBSF lost that right. BNY had argued that the Priority Provisions in the trust deed (indenture) comprised part of the swap agreement because they were incorporated by reference, but the bankruptcy court rejected this argument, stating that there was no reference in the swap documents to the trust deed or the Priority Provisions and, as such, neither fell within the scope of the protection given by Bankruptcy Code section 560.

BNY appealed the bankruptcy court's decision to the district court, but the parties ultimately settled and BNY withdrew its appeal before any decision was made by that court.

Second Bankruptcy Court Decision - *Noteholders*[2]

In the same year that the bankruptcy court issued it *BNY* decision, Lehman commenced another adversary proceeding, this time against approximately 250 noteholders, issuers and indenture trustees in connection with 44 CDO transactions, seeking to recover approximately $1 billion that was distributed to noteholders after Lehman filed for bankruptcy. The majority of these CDO transactions were governed by New York law. A group of noteholders filed a motion to dismiss the complaint, arguing that (1) the Priority Provisions were not unenforceable *ipso facto* clauses because they did not modify LBSF's rights after its bankruptcy filing and (2) even if the Priority Provisions were unenforceable *ipso fa*cto clauses, the distributions to noteholders were protected by the safe harbor provisions of the Bankruptcy Code. Certain indenture trustee defendants joined the noteholders' motion.

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2 *In re Lehman Bros. Holdings Inc. ("Noteholders")*, 553 B.R. 476 (Bankr. S.D.N.Y. 2016) (SCC).

While this adversary proceeding was brought before the same bankruptcy court as the one that issued the *BNY* decision, by the time the noteholders' motion to dismiss was filed there was a new bankruptcy judge. This judge ruled for the noteholders. In finding for the noteholders, the bankruptcy court's ruling included three independent holdings. First, only the Priority Provisions that were used in "Type 1" transactions, not "Type 2" transactions, constituted unenforceable *ipso facto* clauses. Second, even if the language of the Priority Provisions in the "Type 2" transactions did contain *ipso facto* clauses, the Bankruptcy Code only invalidates such clauses that modify a debtor's rights *after* the filing of bankruptcy, and therefore did not apply to any transactions where LBSF lost its priority right to the collateral before it filed for bankruptcy, upon receiving a notice of early termination from the issuer. And finally, even if the Priority Provisions were unenforceable *ipso facto* clauses, the safe harbor provisions of section 560 of the Bankruptcy Code nonetheless protected the distributions made based on those provisions.

<u>Type 1 versus Type 2 Transactions</u>. The language of the Priority Provisions differed slightly, but materially, in the CDO transactions. In "Type 1" transactions, the Priority Provisions provided that LBSF had an automatic right to payment priority ahead of the noteholders unless the conditions for an alternative priority (such as an LBSF default) were satisfied.[3] Enforcement of the Priority Provisions in these transactions based on a LBSF bankruptcy filing would effect an *ipso facto* modification of LBSF's rights. In "Type 2" transactions, however, the bankruptcy court found that neither LBSF nor the noteholders had a

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[3] *See Noteholders*, 553 B.R. at 492.

default priority position to the collateral, and priority was only determined upon termination of the swap. In essence, there was a toggle between two waterfalls, and which waterfall was to be used was only established at that time of "Early Termination."[4] Accordingly, the bankruptcy court held that there was no *ipso facto* modification of LBSF's rights in respect of Type 2 transactions because LBSF held only a contingent right to payment under one of two waterfalls at the time of its bankruptcy filing; it did not "lose" a priority position due to its filing.

Termination of Swap Before or After LBSF Bankruptcy Filing. The fact that a transaction included a "Type 1" *ipso facto* Priority Provision was not the end of the story. The bankruptcy court then considered the time at which the swap was terminated. With respect to 37 of the 39 Type 2 transactions, the issuers had sent notices terminating the swaps with LBSF *before* LBSF filed for bankruptcy. In applying the Bankruptcy Code's *ipso facto* provisions,[5] the bankruptcy court held that the relevant petition date was the petition date of the debtor whose rights had been modified under the contract—LBSF.[6] Accordingly, to the extent that enforcement of the Priority Provisions resulted in a modification of LBSF's rights *before* LBSF filed for bankruptcy, such modification was not a violation of the Bankruptcy Code sections

4 *See Noteholders*, 553 B.R. at 493.

5 11 U.S.C. § 365(e)(1); 11 U.S.C. § 363(l); 11 U.S.C. § 541(c)(1).

6 In holding that the relevant date was the LBSF bankruptcy filing date, and not the bankruptcy filing date of its parent LBHI two weeks earlier, the bankruptcy court refused to adopt the "singular event" theory that was adopted by the bankruptcy court in the *BNY* decision. *See BNY*, 422 B.R. at 420 (noting that in the Lehman Brothers bankruptcy cases, the Bankruptcy Code's protections of the anti-*ipso facto* provisions could be triggered not only by the bankruptcy filing of the debtor at issue, but also by the bankruptcy filing of a related entity); see also *Lehman Bros. Special Fin. Inc. v. Ballyrock ABS CDO 2007–1 Ltd. (In re Lehman Bros. Holdings Inc.) ("Ballyrock"),* 452 B.R. 31 (Bankr. S.D.N.Y. 2011) (JMP) (holding that changes to the Priority Provisions based on termination of swap agreement with LBSF before its bankruptcy filing and based solely on the bankruptcy filing of its parent LBHI were not enforceable as *ipso facto* provisions under the "singular theory" adopted in BNY).

365(e)(1), 541(c)(1) or 363(l). The bankruptcy court then determined that the modification of LBSF's rights occurred upon the "Early Termination" of the swap when notice of termination was provided by the issuer. The court reasoned that LBSF's priority ahead of noteholders in the Priority Provisions turned on whether LBSF was the defaulting party under the swap, and LBSF became that defaulting party when an event of default occurred and a notice of such event of default was provided by the issuer.[7]

Safe Harbors Protected Distributions. Finally, the bankruptcy court held that to the extent that enforcement of Priority Provisions in any of the transactions—Type 1 or Type 2—resulted in a prohibited *ipso facto* modification of LBSF's rights under the swap, the distributions to noteholders were nonetheless protected by the safe harbor embodied in section 560 of the Bankruptcy Code. In so holding, the bankruptcy court rejected arguments by Lehman that (1) distribution of the collateral did not constitute the exercise of a right to cause the "liquidation, termination or acceleration" of a swap, as permitted by section 560 and (2) the fact that the trustees, not the issuers, distributed the collateral took such action outside the scope of the safe harbor protection.

The bankruptcy court first noted that the term "liquidation" was not defined in the Bankruptcy Code and therefore should be interpreted by the court based on its ordinary or common meaning. As had been argued by the noteholders, multiple dictionaries define

[7] Again, in ruling that LBSF's rights were modified upon the termination of the swap, the bankruptcy court disagreed with the earlier decision made in the *BNY* case. In that case, the bankruptcy court had ruled that LBSF's and the noteholders' respective priority to the collateral was only determined in connection with the realization or enforcement of the collateral underlying the swap. *BNY*, 422 B.R. at 418.

"liquidation" to include the payment of proceeds of the liquidation, which the court found persuasive.[8] The bankruptcy court's finding that the safe harbors protected distribution of the proceeds broke from the bankruptcy court's ruling in *BNY*, so the court expanded on this analysis, referring to the *Michigan* decision (discussed herein) and other decisions after the *BNY* decision that had interpreted the safe harbor provisions more broadly.[9] The fact that the trustees had discretion to not distribute the collateral upon termination did not change the court's findings—liquidation of the collateral was required by termination of the swaps and distribution thereafter by the trustees completed that liquidation. Whether each step was legally mandated did not change the fact that each was an "integral part of the overall process of liquidating the Swaps."[10]

Finally, the fact that the trustees themselves were not party to the swap agreements did not remove their actions from protection under section 560 of the Bankruptcy Code. The court noted that the obligation to pay LBSF and/or the noteholders from the collateral proceeds was an obligation of the issuer under the transaction documents, with the trustee holding the collateral only in trust. The trustees' distribution of the collateral on behalf of the issuers therefore did not

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8 The court found that indenture including the Priority Provisions was incorporated by reference into the swap agreement.

9 *Noteholders*, 422 B.R. at 504 (citing *Picard v. Ida Fishman Revocable Trust (In re Bernard L. Madoff Inv. Sec. LLC)*, 773 F.3d 411, 419 (2d Cir. 2014) (noting that Congress intended the safe harbor in section 546(e) "to sweep broadly") and *Enron Creditors Recovery Corp. v. Alfa, S.A.B. de C.V. (In re Enron Creditors Recovery Corp.),* 651 F.3d 329, 336 (2d Cir. 2011) (rejecting debtor's narrow interpretation of section 546(e) that "would result in commercial uncertainty and unpredictability at odds with the safe harbor's purpose and in an area of law where certainty and predictability are at a premium"). *See also Tribune,* 818 F.3d at 121 (confirming sweeping breadth of section 546(e) safe harbor).

10 *Noteholders*, 422 B.R. at 505.

preclude application of the safe harbors.

District Court Affirms the Second Bankruptcy Court Decision

Lehman appealed the bankruptcy court's decision this time, and almost two years later the District Court for the Southern District of New York affirmed the bankruptcy court's decision.[11] The district court held that, assuming that the Priority Provisions were *ipso fact*o clauses, they were nonetheless protected by the safe harbor provided in section 560 of the Bankruptcy Code.[12] As part of this holding, the district court found that (1) the term "liquidation" includes the distribution of collateral, not just the calculation of payments owed upon termination, and (2) the fact that the trustees were the parties that actually distributed the collateral did not mean that such distribution right was not a contractual right "of" the issuers—the swap participants—for purposes of section 560.

Like the bankruptcy court, the district court started its analysis considering what actions fall within the scope of "liquidation" under section 560 by referring to various dictionaries, which define "liquidation" to mean "bringing an undertaking to an end or paying or distributing its assets."[13] Under this meaning, the district court held that liquidation of the swap agreements plainly included the distribution of the collateral pursuant to the Priority Provisions.

LBSF tried to argue that "liquidation" in section 560 could only mean "calculation" of

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11 *Lehman Bros. Special Financing Inc. v. Bank of America National Association, et al., (In re Lehman Bros. Holdings Inc.),* No. 17 Civ. 1224 (LGS), 2018 WL 1322225 (S.D.N.Y. March 14, 2018)

12 Although the bankruptcy court had focused mainly on the statutory language, the district court also reviewed the legislative history for section 560, and noted that the purpose of this section is "to protect securities markets from the disruptive effects that unwinding swap transactions in bankruptcy would case." *In re Lehman Bros. Holdings, Inc*., 2018 WL 1322225, at *4 (internal citations omitted).

13 *In re Lehman Bros. Holdings, Inc*., 2018 WL 1322225, at *6.

the amounts owing upon termination and not the ultimate distribution of the collateral proceeds, but the district court was not persuaded. The district court noted that LBSF's argument relied on a single definition of "liquidation" when other definitions were more appropriate to this case. Moreover, LBSF's reliance on earlier bankruptcy court decisions in *BNY* and *Ballyrock* were not appropriate because the decisions were either distinguishable or did not take into account the bankruptcy court's more recent decision in *Michigan*.

LBSF also argued that the issuers had no contractual rights to enforce the Priority Provisions and distribute the collateral and, therefore, such contractual rights were not protected by section 560, which applies to rights belonging to swap participants—in this case, the issuers, not the trustees. The district court rejected this argument and, agreeing with the bankruptcy court's analysis, held that the fact that the trustees exercised the rights to enforce the Priority Provisions did not mean that the rights did not belong to the issuers. The court noted that the issuers had assigned such rights to the trustees under the transaction documents, so when the trustees took action to terminate the swaps and distribute the collateral, they were exercising rights of the issuers.

Lehman thereafter appealed the district court's decision, and the appeal is pending before the Court of Appeals for the Second Circuit.

Exhibit D

In re Lehman Bros. Holdings Inc., 502 B.R. 383 (Bankr. S.D.N.Y. 2013)

Michigan State Housing Development Authority ("MSHDA") commenced a litigation against debtor, Lehman Brothers Special Financing Inc. ("LBSF") to recover certain funds paid to LBSF by the indenture trustee for the bonds issued by MSHDA. LBSF counterclaimed against MSHDA and sought recovery of additional funds from MSHDA relating to the liquidation of certain interest rate swaps.

MSHDA was a party to an ISDA Master Agreement with Lehman Brothers Derivative Products Inc. ("LBDP") under which there were twenty two separate interest rate swap transactions. In September, 2008, the ISDA Master Agreement and all of the interest rate swap transactions thereunder were assigned by LBDP to LBSF with the agreement of MSHDA. On October 3, 2008, LBSF filed for Chapter 11.

The schedule to the ISDA Master Agreement provided that a bankruptcy proceeding by either counterparty is a "Trigger Event". The ISDA Master Agreement provided that the Market Quotation method would be used to calculate the settlement amount in the event of an Early Termination (as defined in the ISDA Master Agreement).[1] However, the schedule for the ISDA Master Agreement provided that upon the occurrence of a Trigger Event, the settlement amount would instead be calculated based upon the "Mid-Market" method.[2] However, when the ISDA Master Agreement was assigned to LBSF, the assignment agreement provided that, in the event of a non-payment or bankruptcy filing by LBSF, the settlement amount would be calculated using the Market Quotation Method.

On November 5, 2008, MSHDA sent a letter declaring an Event of Default due to LBSF's bankruptcy filing and specifying November 5, 2008 as the Early Termination Date. MSHDA calculated the settlement amount in accordance with the Market Quotation method and paid LBSF $36,346,426. In the litigation, LBSF claimed that it was owed in excess of $59 million based upon the Mid-Market method. LBSF argued that while MSHDA's exercise of its contractual right to terminate the interest rate swaps fit within the safe harbor provision (section 560 of Title 11 of the United States Code (the "United States Bankruptcy Code")), MSHDA's

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1 The settlement amount is calculated on the basis of quotations obtained from "Reference Market-makers". Reference Market-makers is defined in the ISDA Master Agreement as "four leading dealers in the relevant market selected by the party determining the Market Quotation in good faith (a) from among the dealers of the highest credit standing which satisfy all the criteria that such party applies generally at the time in deciding whether to offer or to make an extension of credit and (b) to the extent practicable, from among dealers having an office in the same city."

2 Under the Mid-Market method, the settlement amount is calculated using "Market Rates and Volatilities and by polling the Dealer Group as required, to be the mid-market value of the Transaction as of the close of business (New York time) on the Early Termination Date". Market Rates and Volatilities is defined in the ISDA Master Agreement as "in the case of interest rates and volatilities, the interest rates and volatilities obtained from the Telerate and Reuters screens where practicable and from polling the Dealer Group and, in the case of foreign exchange rates and volatilities and other pricing parameters, the foreign exchange rates and volatilities and other pricing parameters obtained from polling the Dealer Group. In each case, for all rates, volatilities or other parameters obtained, at least five members of the Dealer Group shall be polled, the highest and lowest of such returns (including, in the case of interest rates and volatilities, the rates and volatilities obtained from the Telerate and Reuters screens, if any) shall be discarded and the simple mathematical average of the remaining values shall be used to perform the applicable determination."

contractual rights to utilize the Market Quotation method for the determination of the settlement amount were not protected under section 560. [3]

The Bankruptcy Court held that LBSF's interpretation of section 560 of the Bankruptcy Code was too narrow. The Bankruptcy Court noted that section 560 contains the phrase "the exercise of any contractual right" and thus, "the act of liquidation, termination, or acceleration must be performed in accordance with a contractual provision in the swap agreement…Unless the act of liquidation is performed in accordance with some agreed method, the right to liquidate is disconnected and loses all practical meaning." Id. at 394. Additionally, the Bankruptcy Court noted that LBSF had failed "to explain why a commercially acceptable method chosen by the parties themselves should not be respected". Id. The Bankruptcy Court also held that "allowing a non-debtor counterparty to use the contractual method of liquidation promotes the systemic goals of the safe harbor - to provide stability and certainty to the markets upon the insolvency of a counterparty and to enable the parties themselves to liquidate collateral in a contractually prescribed manner." Id.

In re Am. Home Mortg. Holdings, Inc., 411 B.R. 181 (Bankr. Del. 2009), aff'd by Credit Agricole Corp. v. Am. Home Mortg. Holdings Inc. (In re Am. Home Mortg. Holdings, Inc.), 637 F.3d 246 (3d. Cir. 2011)

Calyon New York Branch ("Calyon") and the debtors American Home Mortgage Holdings, Inc. and its affiliates (collectively, "American Home") were parties to a repurchase agreement (the "Repurchase Agreement"). Under the Repurchase Agreement, Calyon purchased certain mortgage loans from American Home. On August 1, 2007, Calyon served American Home with a notice of default and accelerated the Repurchase Agreement (the "Acceleration Date"). American Home was obligated to repurchase the loans owned by Calyon under the terms of the Repurchase Agreement. American Home did not repurchase the loans and filed for bankruptcy. Calyon brought an adversary proceeding before the Bankruptcy Court seeking a declaratory judgment that the Repurchase Agreement is a "repurchase agreement" as defined in section 101(47) of the Bankruptcy Code. On January 4, 2008, the Bankruptcy Court held that the Repurchase Agreement was a "repurchase agreement" and that Calyon's rights thereunder were not stayed, avoided or otherwise limited with respect to ownership of the loans. Calyon filed proofs of claim in the total amount of $1,154,579,324.68. American Home objected to the proofs of claim.

Calyon argued that no commercially reasonable determinants of value existed on the Acceleration Date because the only appropriate valuation is the market or sale value, the market was in distress and the loans had deficiencies that would affect salability. Id. at 186. Calyon argued that section 562(b) of the Bankruptcy Code was applicable. Section 562(b) provides that if there are no commercially reasonable determinants of value as of the Acceleration Date, then any damages must be measured "as of the earliest subsequent date or dates on which there are commercially reasonable determinants of value." 11 U.S.C. §562(b). Calyon argued that there were no commercially reasonable determinants of value until August 15, 2008.

[3] It does not appear that LBSF argued that the Market Quotation method was not a commercially reasonable determinant of value so section 562 of the Bankruptcy Code was not implicated.

American Home argued that there were at least two commercially reasonable determinants of value as of the Acceleration Date, a discounted cash flow analysis and market analyses that Calyon had obtained. Since these methodologies value the loan portfolio at or above the repurchase price, Calyon had no damages claim.

The Bankruptcy Court first examined the meaning of "commercially reasonable determinants of value". Calyon argued that the only relevant determinants are "those that provide evidence of the asset's market price, such as the price actually received in a sale, the price available from a generally recognized source, the most recent bid quotation from that source, or expert testimony regarding the market price." In re Am. Home Mortg. Holdings, Inc., 411 B.R. at 188. American Home argued that Calyon's definition was too narrow. "Had Congress wished to limit the inquiry to the market or sale price of an asset it would have used more limited language than using the broad phrase 'commercially reasonable determinants of value'." Id. at 189. The Bankruptcy Court held that "commercially reasonable determinants of value" was ambiguous. Id. at 190.

The Bankruptcy Court noted that the legislative history of section 562 was extremely sparse. "Although it expected that in most circumstances damages would be measured as of the date or dates of either rejection or liquidation, termination or acceleration, in certain unusual circumstances, such as dysfunctional markets or liquidation of very large portfolios, there may be no commercially reasonable determinants of value for liquidating any such agreements or contracts or for liquidating all such agreements and contracts in a large portfolio on a single day." H.R. Rep. No. 109-31 at 134-35 (2005). Id. at 190. The Bankruptcy Court noted that the statute is ambiguous as to "whether (i) the damage calculation is limited to either selling the assets or checking the market price of those assets; or (ii) damages may be measured by some other commercially reasonable method." Id. at 191.

Calyon's argument was that "if assets cannot be sold in a commercially reasonable manner or the market price does not fairly reflect the asset's value, the only choice is to wait for a reasonable sale or opportunity for the market to right itself." Id. at 192. In Calyon's case, it took over a year for the market to right itself. The Bankruptcy Court held that such interpretation of the Bankruptcy Code would result in a moral hazard that section 562 was designed to prevent, allowing the counterparty to hold the asset for a significant period of time after the termination and acceleration of the repurchase agreement with the risk of the loss falling on the debtor. Id. at 191.

American Home submitted a discounted cash flow analysis as of the Acceleration Date as its evidence of a commercially reasonable determinant of value. The Bankruptcy Court held that Calyon had failed to rebut this evidence, even though Calyon's evidence established that the loan portfolio could not have been sold for a reasonable price on the Acceleration Date. Id. at 193. Calyon's proofs of claim were disallowed because the value of the loan portfolio on the Acceleration Date, based on the discounted cash flow analysis, exceeded the repurchase price on the Acceleration Date. Id. at 199.

The Third Circuit affirmed the Bankruptcy Court's decision. "We find the Bankruptcy Court's analysis persuasive. It stated that the market price should be used to determine an asset's value when the market is functioning properly. It is only when the market is dysfunctional and the market price does not reflect an asset's worth should one turn to other determinants of value." 637 F.3d at 257. The Court further noted "if Congress had intended § 562 to be limited to market or sale price, it would have said so." Id. at 258.

In re Lehman Bros. Holdings Inc. and Lehman Bros. OTC Derivatives Inc. v. Intel Corp. (In re Lehman Bros. Holdings Inc.), No. 13-01340, 2015 WL 7194609 (Bankr. S.D.N.Y. Sept. 16, 2015)

In August, 2008, Intel Corporation ("Intel") entered into a forward share repurchase arrangement with Lehman Brothers OTC Derivatives Inc. ("LOTC"). On August 29, 2008, Intel paid LOTC $1 billion as a "prepayment" and in return LOTC agreed to purchase and deliver to Intel a fixed number of shares of Intel's stock on September 29, 2008. The parties entered into an ISDA Master Agreement with respect to the share purchase transaction (the "Transaction"). LOTC purchased Intel shares but, due to the general insolvency events affecting Lehman entities worldwide, it was unable to deliver the shares to Intel on September 29. Intel exercised rights under the ISDA Master Agreement and Confirmation (as defined below), terminated the Transaction and kept the $1 billion. LOTC filed for bankruptcy on October 5, 2008. LOTC and LBHI (as defined below) sued Intel to recover certain funds.

In addition to the ISDA Master Agreement, the parties entered into a confirmation (the "Confirmation"). The Confirmation and the ISDA Master Agreement provided that Lehman Brothers Holdings Inc. ("LBHI") was a guarantor of LOTC's obligations. The Confirmation also provided for an Early Termination Date if either LOTC or LBHI filed for bankruptcy and indicated that, for the share purchase transaction, LOTC and Intel had elected Second Method and Loss[4].

In the adversary proceeding, Intel argued that the ISDA Master Agreement allowed it to calculate damages as it sees fit, so long as its calculation was made reasonably and in good faith. Intel asserted damages of $1,001,966,256, the $1 billion prepayment plus unearned interest, and asserted a claim for the unearned interest against LOTC and LBHI. LOTC argued that the fair market value of the undelivered shares on the delivery date which was $873 million was the appropriate method of calculating damages and thus, Intel should return the difference between that amount and $1 billion to LOTC.

Section 6(e)(i)(4) of the ISDA Master Agreement provided that "If the Second Method and Loss apply, an amount will be payable equal to the Non-defaulting Party's Loss in respect of this Agreement." The Bankruptcy Court rejected LOTC's interpretation of Loss as mandating that Intel's Loss equal the fair market value on September 29, 2008 of the shares of Intel common stock that Intel would have received if the Transaction has settled. The Bankruptcy Court held that "non-defaulting parties are afforded discretion in choosing a method to calculate Loss, so

[4] Loss is defined in the ISDA Master Agreement as the amount that a party reasonably determines in good faith to be its total losses and costs (or gain in which case expressed as a negative number) in connection with the ISDA Master Agreement or that Terminated Transaction or group of Terminated Transactions. "A party will determine its Loss as of the relevant Early Termination Date, or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets." Id. at *7 citing ISDA Master § 14.

long as such calculation is ultimately performed 'reasonably and in good faith'." Id. at *19. The Bankruptcy Court applied the definition of "reasonable" in Black's law dictionary which is "fair, proper or moderate under the circumstances". After examining Intel's calculation methodology, the Bankruptcy Court determined that Intel's calculation of its Loss was performed reasonably.[5] Id. at *24.

Lehman Bros. Int'l (Eur.) v. AG Fin. Prods., Inc., No. 653284/2011, 2018 WL 3432593 (N.Y. Sup. Ct. July 2, 2018)

Lehman Brothers International (Europe) ("LBIE") purchased credit default swaps from AG Financial Products Inc. ("Assured") on various reference bonds and securities. At the time of the commencement of LBIE's administration proceeding in the United Kingdom on September 15,2008, there were 28 credit default swap transactions (the "Transactions") outstanding under an ISDA Master Agreement signed by Assured and LBIE. The parties were also signatories to a confirmation for each Transaction (each a "Confirmation").

The ISDA Master Agreement contained an Event of Default definition which included the appointment of an administrator …for all or substantially all of its assets. However, Assured did not provide notice of the Event of Default caused by the commencement of LBIE's administration proceeding until July 23, 2009 (9 months later) and designated July 23,2009 as the Early Termination Date (as defined in the ISDA Master Agreement and Confirmations) for the Transactions. The parties had elected in the ISDA Master Agreement and the Confirmations to use Market Quotation and the Second Method to calculate the payment.

The Market Quotation method required Assured to obtain quotations from Reference Market-makers.[6] The ISDA Master Agreement provided that if there are fewer than three quotations provided, then it will be deemed that the Market Quotation method in respect of the Terminated Transaction or group of Terminated Transactions cannot be determined. Id. at *3. The ISDA Master Agreement authorizes Assured to use an alternative Loss method to calculated the termination payment in the event that "a Market Quotation cannot be determined or would not (in the reasonable belief of the party making the determination) produce a commercially reasonable result." Id.

Assured retained Henderson Global Investors Ltd. to design and execute an auction of the Transactions intended to satisfy the Market Quotation process. There were no bids made on the Transactions. Therefore, Assured took the position that Market Quotation method could not be used and instead applied the Loss method. LBIE alleged in the lawsuit that the auction was poorly designed and poorly run and that Assured did not act in good faith. The Court determined that Assured had made a prima facie case for the use of Loss under these circumstances and that LBIE had failed to provide evidence of a breach of the implied covenant of good faith and fair dealing or a breach of contract because of Assured's use of the Loss method to calculate damages. Id. at *5.

[5] LOTC did not dispute Intel's good faith.

[6] See footnote 1 for the definition.

The Court also ruled that the language of the definition of Loss in the ISDA Master Agreement was not ambiguous to the extent that it provides that Loss need not be calculated using market quotations in every case. Id. at *11-2. However, the Court held that it was ambiguous as to whether Assured's calculation of Loss was "reasonably determined". Id. at *14.

Assured calculated Loss based upon its "loss of bargain" by calculating the present value of the premiums that LBIE would have paid to Assured over the remaining time period for the Transactions, assuming no Early Termination (as defined in the ISDA Master Agreement and Confirmations), minus any shortfalls in principal or interest payments on the securities underlying the Transactions that Assured would have paid to LBIE over the remaining time period for the Transactions, assuming no Early Termination. LBIE submitted evidence of market practice from four experts. The experts all opined that Loss should be calculated by using market prices to approximate the cost of a replacement transaction. The Court held that, while the Loss provision in the ISDA Master Agreement allows a non-defaulting party to calculate Loss without reference to market prices, it does not mean that the non-defaulting party's decision to "ignore market prices can never be unreasonable or undertaken in bad faith". Id. at *12-3. Thus, the Court reserved for trial the issue of whether Assured's calculation of Loss was reasonable, noting that while Assured's methodology appeared to be a reasonable method for calculating the value to Assured of the terminated Transactions, the Court was not certain that it was a reasonable method of calculating Assured's loss of bargain. Id. at *17.