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RESTRUCTURING AND FINANCE DEVELOPMENTS

Federal District Court Reinstates Fraudulent Transfer Challenge to Lyondell LBO

In a significant set of decisions, the U.S. District Court for the Southern District of New York has reinstated a fraudulent transfer claim to recover approximately $6.3 billion in distributions made to Lyondell Chemical shareholders in connection with Lyondell's leveraged buyout. The decisions demonstrate that, despite the Bankruptcy Code's "safe harbor" for securities transactions, LBOs may still be subject to challenge on fraudulent transfer grounds where the seller's management is alleged to have acted with the actual intent to hinder, delay or defraud creditors.

As explained in prior client memos (*see* memo of March 29, 2016 and memo of June 12, 2013), the Bankruptcy Code's "safe harbor" provisions significantly limit fraudulent transfer challenges to transactions related to securities contracts. The federal appeals court in New York, moreover, has specifically applied the safe harbors to payments made to shareholders in connection with leveraged buyouts. The safe harbors, however, are expressly *not* applicable to claims under section 548(a)(1)(A) of the Bankruptcy Code, which permits recovery of transfers by the debtor within two years of a bankruptcy if made by the debtor with the "actual intent to hinder, delay or defraud" creditors.

The buyout of Lyondell closed in December 2007. Within months of closing, the company was in distress, and it filed for bankruptcy in January 2009. A trustee for creditors subsequently brought fraudulent transfer claims, including actual-intent claims, against former shareholders of Lyondell who received payments through the LBO. The complaint alleged that, in negotiating financing for the LBO and obtaining approval for the transaction, Lyondell's CEO had knowingly presented financial projections that were inflated and not achievable. Despite that allegation, the bankruptcy court dismissed the actual-intent fraudulent transfer claim. The court concluded that, for purposes of a fraudulent transfer claim, an individual's intent can only be imputed to a corporation if the individual was "in a position to control the disposition of [the debtor's] property." According to the bankruptcy court, only Lyondell's board of directors had that authority under Delaware law, and the board as a whole was not alleged to have acted with fraudulent intent.

On July 27, 2016, the District Court reversed the dismissal, and on October 5, 2016, it refused to reconsider the reversal. The District Court held that, under Delaware agency law, corporations are liable for the actions of their agents "even when the agent acts fraudulently or causes injury" and regardless of whether a board vote is needed to approve the action. The District Court concluded further that the complaint adequately pleaded Lyondell's "actual intent to hinder, delay or defraud" creditors, because it alleged facts showing that an agent of the debtor, namely the CEO, believed that harm to creditors was "substantially certain" to result from the transaction. As a result of the District Court's decision, the fraudulent transfer claim will proceed to discovery and trial.

Lyondell serves as a reminder to market participants that, even in jurisdictions where the Bankruptcy Code "safe harbors" are construed broadly, the safe harbors do not provide limitless protection from fraudulent transfer claims. At the same time, given the unusual facts of *Lyondell*, including the short time between the LBO and the bankruptcy and the allegations of deceptive conduct, *Lyondell* opens the door only narrowly to similar suits directed at other transactions.

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