

SDNY Bankruptcy Court Reaffirms Rigorous Pleading Standards in Lyondell LBO Fraudulent Conveyance Action

In the latest turn in the long-running LBO-related fraudulent conveyance litigation brought in connection with the Lyondell bankruptcy,¹ on November 18, 2015, Judge Robert E. Gerber of the U.S. Bankruptcy Court for the Southern District of New York (the "Court") issued a decision (the "Decision") on motions to dismiss the intentional fraudulent transfer claims and the state-law constructive fraudulent transfer claims brought by representatives for shareholders of Lyondell Chemical Company ("Lyondell") against Edward Weisfelner (the "Trustee"), trustee of two trusts established for Lyondell's creditors. In re Lyondell Chem. Co., No. 09-10023 (REG), 2015 WL 7272996 (Bankr. S.D.N.Y. Nov. 18, 2015). The Decision dismissed the intentional fraudulent transfer claims based on the failure to adequately plead the Lyondell Board's intent to defraud the company's creditors by entering into the leveraged buyout. However, the Court left in place the state-law constructive fraudulent transfer claims against former shareholders – notwithstanding securities safe harbors in the Bankruptcy Code that would generally preclude such claims – and, in the process, demarcated the boundaries between intentional and constructive fraudulent transfer claims.

Background & Procedural History

This litigation arises out of Lyondell's bankruptcy, filed shortly after it underwent a leveraged buyout transaction ("LBO") and merger. In late 2007, Basell AF S.C.A. ("Basell"), a Luxembourg-based polymer specialist,² acquired Houston-based Lyondell Chemical Company through an LBO that was, as the court noted, "100% financed by debt."³ In the transaction, Basell paid Lyondell's shareholders about \$12.5 billion, while also assuming Lyondell's existing debt.⁴ As a consequence, the post-LBO entity had over \$21 billion of secured indebtedness, just as the economic climate grew increasingly precarious. Less than a year after the LBO, Lyondell filed for Chapter 11 protection.⁵

¹ For additional background, please reference our prior Alert Memo, available [here](#).

² Basell was a subsidiary of Access Industries, Inc., a diversified holding company and investment vehicle controlled by Leonard Blavatnik, a Russian-American billionaire.

³ In re Lyondell Chem. Co., No. 09-10023 (REG), 2015 WL 7272996, at *1 (Bankr. S.D.N.Y. Nov. 18, 2015).

⁴ Chris Jasper & Jack Kaskey, Access's Basell to Buy Lyondell for \$12.7 Billion, Bloomberg, (July 17, 2007), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXLT9NxxLoFs>.

⁵ In re Lyondell Chem. Co., 402 B.R. 571, 576 (Bankr. S.D.N.Y. 2009) (providing context regarding the bankruptcy filing and Lyondell's post-LBO capital structure).

Subsequently, three adversary proceedings were filed on behalf of Lyondell's creditors by the Trustee, alleging, among other claims, that the LBO was a fraudulent transfer for the benefit of Lyondell's shareholders.⁶ In an earlier decision, the Court ruled on defendant shareholders' Rule 12(b)(6) motion to dismiss, granting it with room for the Trustee to amend, with respect to the intentional fraudulent transfer claims, which the Court found to be insufficiently pled under the applicable heightened Rule 9(b) standards, but denying it with respect to the constructive fraudulent transfer claims.⁷

The Trustee availed himself of the opportunity to amend by filing a Third Amended Complaint, which included a number of additional factual allegations, particularly focused on the knowledge and conduct of Lyondell's Board of Directors prior to the LBO. The shareholder defendants (the "Movants") again moved to dismiss the amended intentional fraudulent transfer claim for failure to adequately cure the previously identified deficiencies, as well as to dismiss the constructive fraudulent transfer claims.

The Decision

In its Decision, the Court carefully discussed the heightened applicable standards for intentional fraudulent transfers under Section 548 of the Bankruptcy Code (the "Code")⁸ as compared to constructive fraudulent transfer claims. By emphasizing that "intentional fraudulent transfer doctrine covers offenses of a wholly different nature,"⁹ the Court highlighted the differences between circumstances applicable for both types of claims.

Intentional Fraudulent Transfer Claims

The intentional fraudulent transfer claims in the amended complaint largely rested on three allegations:¹⁰ (i) The Board's "knowledge of the inflated financials underpinning the Merger and foreseeable 'dire' consequences of approving the [transaction]"; (ii) conduct by individual Board members, such as the CFO of Occidental Petroleum, an investor in Lyondell, who allegedly withdrew his challenge to the financial projections because of the conflict; and (iii) the failure by Lyondell's CEO, Dan Smith ("Smith"), to disclose his own individual negotiations with the buyer.

In determining whether those allegations were sufficient to survive a motion to dismiss, the Court first considered the pleading requirements to claim that a company entered into an

⁶ The proceedings are referred to by the Court as Fund 1, Reichman and Hofmann. The Trustee brought constructive fraudulent transfer claims in Fund 1 and Reichman, and intentional fraudulent transfer claims in all three proceedings.

⁷ Weisfelner v. Fund 1 (In re Lyondell Chem. Co.), 503 B.R. 348 (Bankr. S.D.N.Y. 2014).

⁸ Section 548 of the Code states that the Trustee may avoid transfers or obligations made with "actual intent to hinder, delay, or defraud any entity to which the debtor was or became . . . indebted" (emphasis added).

⁹ Lyondell Chem. Co., 2015 WL 7272996, at *19.

¹⁰ Id. at *4-5.

LBO or other transaction “with actual intent to hinder, delay, or defraud” its current or future creditors under Section 548(a)(1)(A) of the Code, or parallel claims brought under state law.

The Court started with the premise that the statute intends to “proscrib[e] intentional actions to injure creditors, by means of placing assets out of their reach or by other intentional steps to prevent creditors from collecting on their debts or placing obstacles in creditors’ way.”¹¹ Other acts that rise to the level of mere negligence or breaches of fiduciary duty – while potentially wrongful and ultimately seriously prejudicial to creditors – do not rise to the level of an *intentional* fraudulent conveyance.

With this backdrop, the Court discussed four approaches to demonstrating the requisite intent, ultimately concluding that the Lyondell claims did not satisfy any and dismissing the claims with prejudice.

1. **The Restatement Standard** – The Court agreed with the defendants that the Second Restatement of Torts standard – which describes “intent” as “denot[ing] that the actor desires to cause consequences of his act, or that he believes that the consequences are substantially certain to result from it”¹² – is appropriately applied. The Court rejected the Trustee’s suggestion that a plaintiff merely has to show that the harm to creditors was a “natural consequence” of the company’s action.¹³ Applying the stringent Restatement standard, the Court found that despite “sufficient” allegations to demonstrate that Lyondell’s CEO indeed intended to defraud the purchaser, the facts did “not support an intent on his part to hinder, delay or defraud creditors.” Lyondell Chem. Co., 2015 WL 7272996, at *16.
2. **“Badges of Fraud”** – The Court acknowledged that certain state statutes and other Code precedents undertake an analysis of whether sufficient “badges of fraud” – such as transactions between insiders, concealment of assets, insolvency at the time of a transaction, the existence of other pending litigation against the company – are present to circumstantially establish the company’s fraudulent intent. While no single “badge” is dispositive, “the more factors present, the stronger the inference.”¹⁴ In this case, however, the Court found that “nearly none” of the factors were present in the allegations brought by the Trustee.¹⁵

¹¹ Id. at *7.

¹² See Restatement (Second) of Torts § 8A (1965).

¹³ The Trustee based this proposition on In re Sentinel Mgmt. Grp., Inc., 728 F.3d 660, 667 (7th Cir. 2013) (finding that “[i]n our legal system, ‘every person is presumed to intend the natural consequences of his acts.’” In re Danville Hotel Co., 38 F.2d 10, 21 (7th Cir.1930)).

¹⁴ Liquidation Tr. v. Daimler AG (In re Old CarCo LLC), 435 B.R. 169, 191 (Bankr. S.D.N.Y. 2010).

¹⁵ Lyondell Chem. Co., 2015 WL 7272996, at *17.

3. **“Motive and Opportunity”** – While unilaterally insufficient to prove intent, the Court concluded that evidence of “motive and opportunity” can “provide the basis for an intent . . . when it reflects something out of the ordinary—i.e., when . . . coupled with something else, and where the Court can find the ‘strong inference’ of the requisite intent.”¹⁶
4. **Recklessness** – Rooted in analyses for demonstrating scienter in securities fraud cases, recklessness requires “a state of mind approximating actual intent, and not merely a heightened form of negligence.”¹⁷ Though allegations in the Trustee’s amended complaint – including the Board turning a blind eye to “grossly overstated” projections – are “more than enough to allege negligence,” the Court found them “insufficient to go beyond that” towards establishing intent. Lyondell Chem. Co., 2015 WL 7272996, at *18.

In the end, while broadly sympathetic to the plight of Lyondell’s creditors, the Court found it more likely that in connection with the LBO transaction, Lyondell’s Board members “were merely negligent,” but did not orchestrate a scheme to injure the company’s creditors.¹⁸

Constructive Fraudulent Transfer Claims

The Movants also sought dismissal of the separate constructive fraudulent transfer claims brought against them¹⁹ on several grounds, all of which the Court denied. Most interestingly for precedential purposes, the Movants argued that the Creditor Trust – which was assigned individual creditors’ fraudulent conveyance claims that may exist under state law – lacked standing to pursue those claims because the bankruptcy filing vested the Lyondell estate with exclusive jurisdiction to pursue those claims, which cannot revert back to creditors unless the bankruptcy case were dismissed.

The Court flatly rejected this argument, concluding that the debtors were able to abandon such claims under their reorganization plan, and that the plan properly assigned such rights from the creditors to the Creditor Trust. The Court was not concerned that allowing creditors to pursue the claims would subvert the bankruptcy priorities, and reaffirmed its prior decision that the Movants could not raise the Bankruptcy Code securities safe harbor under Section 546 as a defense, since the debtor was not the plaintiff.

¹⁶ Id. at *18.

¹⁷ S. Cherry St., LLC v. Hennessee Grp. LLC, 573 F.3d 98, 109 (2d Cir. 2009).

¹⁸ Lyondell Chem. Co., 2015 WL 7272996, at *19.

¹⁹ The fraudulent transfer claims were based on the theory that the company was insolvent and did not receive reasonably equivalent value for the transfers through the LBO.

Significance of the Decision

In bankruptcies following leveraged buyout transactions, it is common for the debtor to consider pursuing fraudulent conveyance claims against the prior shareholders. This decision is helpful to selling shareholders in that it reaffirms the stringent standards for bringing claims for intentional fraudulent conveyance, where the mere fact of a subsequent bankruptcy and loss of value for creditors in the years following the LBO is not sufficient to show actual fraudulent intent. On the other hand, the Court allowed the Creditor Trust to continue to pursue constructive fraudulent conveyance claims under state law on behalf of the individual creditors, where the Bankruptcy Code securities safe harbors generally preclude the debtor from bringing such claims against former shareholders. If this decision is upheld, it is likely that other debtors may try to reassign fraudulent conveyance claims back to their creditors under a bankruptcy plan in order to avoid the application of defenses available against the debtor under the Bankruptcy Code.

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Please feel free to contact [Lisa Schweitzer](mailto:lschweitzer@cgsh.com) (lschweitzer@cgsh.com) or any of your regular contacts at the firm if you have any questions.

Office Locations

NEW YORK

One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON

2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS

12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS

Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON

City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW

Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT

Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE

Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME

Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN

Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG

Cleary Gottlieb Steen & Hamilton (Hong Kong)
Hysan Place, 37th Floor
500 Hennessy Road, Causeway Bay
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING

Cleary Gottlieb Steen & Hamilton LLP
45th Floor, Fortune Financial Center
5 Dong San Huan Zhong Lu
Chaoyang District
Beijing 100020, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES

CGSH International Legal Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO

Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299

ABU DHABI

Al Sila Tower, 27th Floor
Abu Dhabi Global Market Square
Al Maryah Island, PO Box 29920
Abu Dhabi, United Arab Emirates
T: +971 2 412 1700
F: +971 2 412 1899

SEOUL

Cleary Gottlieb Steen & Hamilton LLP
Foreign Legal Consultant Office
19F, Ferrum Tower
19, Eulji-ro 5-gil, Jung-gu
Seoul 100-210, Korea
T: +82 2 6353 8000
F: +82 2 6353 8099