believes that, faced with all of these circumstances, Mr. Bigelow and/or Mr. Grenesko in advance of the scheduled December 4, 2007 Tribune Board meeting pushed the envelope beyond what Morgan Stanley had said to them, in order to get past the final major hurdle standing in the way of the Step Two Closing. Having succeeded in doing so, the persons involved then were able to create the impression that Morgan Stanley agreed that Tribune could successfully refinance its debt by referring to conversations between Morgan Stanley and management. Two weeks later, Tribune then went further and apparently told the Lead Banks that Morgan Stanley actually had evaluated and concurred with VRC's solvency opinion.

The Examiner's conclusions are reached without the necessity of assessing whether one or more witnesses were not candid in their interviews with respect to these issues. Presented with Mr. Whayne's rather emphatic and, the Examiner finds, credible testimony concerning what did and did not transpire and the conflicting statements made by one or more members of Tribune's senior financial management to VRC about what he had said, the Examiner attempted to determine what actually happened when those events transpired. For the above-discussed reasons, it is the Examiner's view that Mr. Whayne's version of events is more plausible and more consistent with the contemporaneous documentary record.

(iii) Did These Events Make a Difference?

Finally, the Examiner considered whether these events made any difference to the eventual Step Two Closing. This inquiry contains two subparts. First, did statements made to VRC concerning Morgan Stanley's position affect VRC's decision to issue its opinion? Second, did Tribune make false written responses to the Lead Banks and a false representation letter to VRC referencing discussions with Morgan Stanley concerning refinancing?

The first question is largely a matter of conjecture. The record shows that VRC wanted management to confer with Morgan Stanley about the refinancing question "[b]ecause [this] was a highly leveraged transaction, and we wanted to make sure that [prospective ability to refinance] was a fair assumption. So we took it very seriously. It [was] something that . . . the committee wanted to make sure . . . was looked at very closely."[161] Although Mose Rucker testified that VRC probably would have issued its solvency opinion even if Morgan Stanley in fact had not concurred with management's views on this question,[162] both Mr. Rucker and Mr. Browning further testified that had any management dishonesty regarding this matter come to light, this likely would have caused VRC to reevaluate its reliance on what management had told them about this and perhaps other matters.[163] For reasons discussed in another part of the Report,[164] however, it is exceedingly difficult for the Examiner to understand VRC's actions in the period leading up to the Step Two Closing and issuance of its solvency opinion, and the Examiner does not have a clear picture of VRC's various interactions with management during that time. The Examiner believes that, ultimately, a court need not answer the question "what if." One cannot know what would have happened had the above-described events come to light before the Step Two Closing. What is known is that this was not a tangential episode. It is worth stating again that without the management representation on refinancing satisfactory to VRC, VRC would not issue its opinion.[165] The events that did unfold lead directly to VRC's issuance of its opinion and to the Step Two Closing.

To address the second question (the truthfulness of Tribune's response to the Lead Banks and Tribune's representation to VRC regarding the refinancing question), it is necessary to focus

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161 Examiner's Sworn Interview of Mose Rucker and Bryan Browning, June 30, 2010, at 216:22-217:7.

162 *Id.* at 243:18-24 ("Because we rely upon --heavily upon our own analysis, even though we get rep letters from management or we may get rep letters from other parties. At the end of the day, our own analysis has to support those conclusions."). This testimony is consistent with the view expressed by Mr. Sell.

163 *Id.* at 305:5-10, 307:2-6 ("So you have to rely upon the veracity of management. And if you find out that you have been lied to, the question becomes: What else have you been lied about.").

164 *See* Report at § III.H.3.f.

165 Examiner's Sworn Interview of Mose Rucker and Bryan Browning, June 30, 2010, at 307:22-25.

on what these documents said as well as the background of the statements. Tribune's response to the Lead Banks dated December 7, 2007 stated:[166]

> VRC has assumed that the Company will be able to refinance its debts as they become due. This assumption is based upon a review of the forecasted total debt and guaranteed debt leverage ratios at the time of the required refinancing, recent leveraged debt multiples, and representation from the Company which states that based upon recent discussions with Morgan Stanley, the Company would be able to refinance debt in its downside forecasts without the need for additional asset sales.

Tribune's December 20, 2007 representation letter to VRC stated:[167]

> Based upon (i) management's best understanding of the debt and loan capital markets and (ii) management's recent discussions with Morgan Stanley, management believes that it is reasonable and appropriate for VRC to assume that Tribune, in the downside forecast . . . delivered to VRC via email on November 21, 2007 ("Tribune Downside Forecast"), would be able to refinance (i) any outstanding balances of Term Loan B under the Credit Agreement dated May 17, 2007, as amended (the "Credit Agreement"), that mature in 2014 and (ii) any outstanding balances under the Senior Unsecured Interim Loan Agreement to be dated as of the closing date (or any notes issued to refinance such facility) that mature in 2015, in each case, without the need for any asset sales other than those incorporated into the Tribune Downside Forecast.

Both writings referred to discussions with Morgan Stanley, without disclosing what Morgan Stanley had said. Tribune's response to the Lead Banks states the basis on which VRC assumed that the debt could be refinanced and the content of the representation Tribune would give to VRC. The Examiner does not have any specific basis to dispute that the statement represents what VRC believed at the time. Tribune's representation letter to VRC states that, based on the two stated predicate assumptions, "management" believes that the refinancing assumption is reasonable. Senior financial management certainly had discussions with Morgan Stanley about this matter and did receive precedent transaction information from Morgan

166 Ex. 281 at TRB0398562 (Memorandum from Mr. Browning and Mr. Rucker to Mr. Bigelow, dated December 7, 2007).

167 Ex. 739 (Letter from Donald Grenesko to VRC, dated December 20, 2007).

Stanley. Thus, the statement might be literally correct if, in fact, management based its belief on discussions with Morgan Stanley. The problem, however, is that the representation letter does not appear to tell the whole truth. It does not disclose that Morgan Stanley would not opine, formally or informally, on the refinancing question. If Mr. Whayne's testimony is to be believed, moreover, the letter fails to disclose that Morgan Stanley was asked and refused to ascribe to management's views on the subject of the representation. The statements apparently made by Tribune to the Lead Banks at the December 17, 2007 conference call concerning Morgan Stanley's alleged involvement in VRC's opinion provide context and raise particular concerns regarding Tribune's honesty in this matter.[168]

The Examiner recognizes that the events described in this Section occurred over a short span of time well over two years ago. Having conducted lengthy witness interviews involving the participants referred to in this Section and having reviewed the underlying documents, however, the Examiner finds that the evidence adduced shows that Tribune, acting through one or more of its senior financial management members, was not honest in this matter and that these circumstances directly related to the satisfaction of the closing conditions to Step Two. These circumstances, standing alone, might not be sufficient in the Examiner's view to support a finding of an intentional fraudulent transfer, but, considered in tandem with the other considerations discussed in this Section of the Report, do support such a finding.

Finally, the Examiner appreciates that the above phrase, "one or more senior financial management members," does not identify, by name, who was or might have acted in this fashion. The Examiner chose this phrase carefully. As discussed in the Report, as required by the

[168] In the context of evaluating the good faith of the Lead Banks for purposes of applying defenses to constructive fraudulent transfer claims, the Examiner also evaluated whether these events furnish a basis for those lenders to assert that they are entitled to good faith defense under Bankruptcy Code section 548(c). *See* Report at § IV.B.7.b.(3). to §IV.B.7.b.(8).

Bankruptcy Court's order, the Examiner conducted the Investigation on an expedited basis. It was not possible to interview (and re-interview) all of the people the Examiner would have, had he had more time. Given the compressed time frame, the Examiner simply was not able to conduct the inquiry necessary to conclusively identify specific individuals as having engaged in dishonesty. The Examiner has done his best in the Report to set forth the facts adduced in the Investigation, but determined that it would be premature to draw conclusions regarding specific individuals. The Examiner cautions that the Report's use of the phrase, "one or more senior financial management members," should not cast a shadow of suspicion on individuals who acted innocently and in good faith.

(3) Information Concerning Out-Year Growth Rate Assumptions and Valuation Implications of Such Assumptions.

As discussed in greater detail in the Report,[169] Tribune management's October 2007 forecast contained an important and, the Examiner believes, unjustifiable growth rate assumption for the years 2013 to 2017, by assuming that the consolidated growth rate of 2.4% from 2011 to 2012 (an election year) would be replicated each year from 2013-2017. The election year-inspired extrapolation growth rate was replicated for each and every year through 2017, resulting in a compounding that effectively assumed every year beyond 2012 would be an election year. Tribune Chief Financial Officer Donald Grenesko acknowledged in his sworn interview that Tribune applied the assumed growth rate across all of Tribune's business segments.[170] This

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169 *See* Report at § III.H.3.f.(1).

170 Mr. Grenesko testified: "You have to look at them individually. You have to look at the growth rates of each individual group, which is just what we did. I mean we didn't want to just broad brush some growth rate across all of our businesses." Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 191:4-9. The Examiner responded: "But isn't that what happens when you extrapolate a uniform growth rate for five years? Aren't you broad brushing the growth rate across the businesses?" Mr. Grenesko answered: "For -- by group,

resulted in a significant increase in the growth rate for the out-years from what was projected in February 2007, under which management projected out-year growth of 0.47% on a consolidated basis (using an extrapolated growth rate from 2010 to 2011). To place this assumption into further perspective, whereas Tribune was failing to meet its February 2007 projections as 2007 unfolded and the October 2007 projections assumed lower performance in the earlier years from what was projected in February, the October 2007 projections assumed a substantially accelerated growth rate starting in year 2012.

Unlike the out-year projections developed by management in Step One, the Step Two out-year projections figured prominently in VRC's Step Two valuation and were the subject of a separate Tribune representation letter by Tribune (signed by Mr. Grenesko) to VRC on which VRC relied in opining on solvency.[171] In its Step One analysis, VRC calculated enterprise cash flows for the first five years of the projection period, discounted the results to present value, and added to the present value of the discrete period cash flows the present value of the terminal period value (calculated on the basis of an exit multiple).[172] In its Step Two analysis, by contrast, VRC calculated enterprise cash flows for the first *ten* years of the projection period, discounted the results to present value, and added to the present value of the discrete period cash

yes." *Id.* at 191:10-14. (In an errata sheet dated July 20, 2010, which is appended to the transcript of Mr. Grenesko's sworn interview, Mr. Grenesko changed a portion of this testimony to add the following point: "Also, the Operating Enterprise Value in 2007 is based upon consolidated operating cash flow growth rates of 2.5% from 2012-2017. This is below the 3.1% CAGR from 2007-2012 in the October 2007 Operating Plan and below the 3.9% growth from 2011-2012.") Mr. Grenesko also furnished substantial testimony during his sworn interview regarding Tribune's assumptions on growth, which is addressed in another part of the Report. *See* Report at § III.H.3.f.(1). Although one could argue that the February 2007 model contained the opposite flaw (in effect assuming that no election would occur between 2012 and 2016), in fact the 2012 to 2016 forecast contained in the February 2007 model was consistent with Tribune's historical performance. *See* Report at § III.H.3.f.(1).

171 Ex. 739 (Seven letters from Donald Grenesko to VRC, each dated December 20, 2007). By contrast, the analog management representation letter sent to VRC at Step One makes no mention of extrapolated projections or a longer projection period. Ex. 250 (Four letters from Donald Grenesko to VRC, each dated May 9, 2007). *See* Report at § III.H.3.f.(1).

172 Ex. 271 at VRC0051430 (Mednik E-Mail, dated May 4, 2007).

flows the present value of the terminal period value (calculated on the basis of an exit multiple).[173] VRC's methodological shift (which occurred very late in VRC's valuation work) resulted in approximately $613 million in additional incremental value at Step Two.[174] At a minimum, the fact that VRC required a specific, separate Tribune representation letter underlying this assumption suggests that VRC itself recognized that this assumption merited special attention. Before the Tribune Board met on December 4, 2010 to consider VRC's opinion, at least one member of senior financial management (but not the Tribune Board) was aware that VRC had revised its analysis to include the extrapolated out-years in reaching its valuation conclusions for Tribune at Step Two.[175] Yet, the presentation materials furnished to the Tribune Board and Special Committee on December 4 and later that month never mentioned the growth assumptions for the out-years, the role these assumptions play in VRC's solvency opinion, or the fact that Tribune would be making a representation to VRC regarding these projections, and there is no evidence that these matters ever were brought to the attention of the Tribune Board or Special Committee.[176] Mr. Grenesko testified he had no understanding why a

[173] Ex. 740 at VRC0060998 (VRC Internal Review Document, Tribune Company Preliminary Solvency Analysis dated December 3, 2007).

[174] *See* Report at § III.H.3.f.(1).

[175] Ex. 888 (Bigelow E-Mail, dated December 2, 2007). Mr. Grenesko initially testified that he had no recollection of this difference. Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 195:8-196:2, 200:4-7. Later in his interview, documents presented by the Examiner refreshed his recollection, but he indicated that he did not recall whether he was aware of this difference in the December timeframe. *Id.* at 218:15-219:4.

[176] *Id.* at 175:16-21, 186:13-18, 187:8-10. (In an errata sheet dated July 20, 2010, Mr. Grenesko changed portions of his testimony addressing this point. When asked whether the model presented to the Tribune Board "included the extrapolated growth rates from 2013 to 2017 or was it only a five-year model," Mr. Grenesko originally responded: "I believe that was just a five-year." Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 175:16-21. The errata sheet, which is appended to the transcript of Mr. Grenesko's sworn interview, changes the answer to: "I believe that was just a five-year model in our plan, but I believe VRC's solvency report included projections beyond the initial five years." Similarly, when asked whether the detailed numbers for years 2013 through 2017 "were [ever] provided to the board in a board meeting," Mr. Grenesko originally responded: "I don't believe so." Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 186:13-18. The errata sheet changes the answer to: "I believe VRC's solvency reports included projections beyond the original five years."). As discussed in text, however, materials presented to the Tribune Board and the Special Committee did not disclose the out-year growth rate assumptions or their effect on VRC's solvency opinion.

draft version of VRC's analysis provided to him two days before the Tribune Board's December 4, 2007 meeting containing a discounted cash flow valuation analysis showing the assumed out-year growth rate was not presented to the Tribune Board.[177] Mr. Grenesko also testified that he had no recollection why an e-mail from Mose Rucker to him and others indicated that those materials (described by Mr. Rucker as "our internal review document") would not be shared with the Tribune Board.[178] (The Examiner did not find any evidence that the out-year growth assumptions accompanying the February 2007 projections were ever presented to the Tribune Board. As noted, however, the out-year projections did not play any role in VRC's Step One solvency opinion and were not the subject of a Tribune representation letter to VRC at Step One.)

Although the Examiner found no direct evidence that this information was purposely withheld from the Tribune Board or Special Committee in December 2007,[179] the Examiner finds it difficult to accept that the failure to apprise the Tribune Board and Special Committee of this change to the Step One solvency valuation, and to the representation given by Tribune to VRC, was unintentional.[180]

177 *Id.* at 205:4-207:8; *see also* Ex. 975 (Rucker E-Mail, dated December 2, 2007); Ex. 737 (Presentation Materials, dated December 4, 2007).

178 Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 206:14-207:8.

179 This is not surprising. Direct evidence rarely is found that a transferor set about to hinder, delay or defraud creditors. *See Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537, 550 (D. Del. 2005) ("Direct evidence of fraudulent intent, however, is often unavailable and courts usually rely on circumstantial evidence, including the circumstances of the transaction, to infer fraudulent intent.") (citing authorities), *aff'd*, 278 F. App'x 125 (3d Cir. 2008).

180 In response to the Examiner's question "why wasn't the board presented with a 10-year growth model if that was the model that was being generated for VRC and others?," Mr. Grenesko testified: "The focus of -- the focus of the group, the focus of management, I think the focus of the board was on the five years. That's where the real -- the whole bottoms up, this is how we are going to do things. That's where the whole focus was." *Id.* at 175:22-176:12. Mr. Grenesko also acknowledged that VRC was interested in the out-year projections because of the debt maturities in 2014 and 2015. *Id.* at 176:19-177:1.

(4) The October 2007 Forecast.

The Examiner also considered whether the projections produced by Tribune management in October 2007, on which VRC offered its Step Two solvency opinion, support an inference that Tribune perpetrated an intentional fraudulent transfer. The Examiner appreciates that sometimes management teams exhibit optimism in the expected performance of the businesses they operate or in their own ability to achieve projected results. Indeed, one of senior management's responsibilities is to carefully evaluate whether members of lower-tier management are being too cautious in their recommendations for forecasted performance. Mindful that those projections likely will be used to set next year bonus targets, division heads and other personnel might exhibit a downward bias in forecasting expectations for the following year. Senior management must critically review the input they receive from subordinates, and there is nothing per se improper in making changes to reflect more optimistic assumptions. More generally, there is nothing nefarious about generating projections, in good faith, that turn out to be too optimistic in retrospect. Indeed, virtually by definition, in a failed leveraged buyout transaction such as this one, the underlying projections turn out wrong. For example, the Examiner does not find any impropriety in management's February 2007 projections, even though those numbers turned out to be wrong shortly after they were issued.

The circumstances surrounding the preparation of the October 2007 forecast, however, required that the Examiner investigate management's honesty in the context of Step Two. As noted, after Step One closed, the Tribune Entities' financial performance deteriorated significantly, both in relation to comparable periods in prior years and in comparison to the February 2007 plan.[181] The Examiner evaluated whether a fair inference may be drawn that Tribune management improperly "boosted" the projected performance in the October 2007

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[181] *See* Report at § III.F.2.

forecast of certain aspects of Tribune's business in order to counteract the effect of Tribune's generally poor 2007 performance and other negative trends. In this regard, a critical observer would pay particular attention to those aspects of the October 2007 forecast that involve elements of Tribune's business as to which management had greater room to project more growth, either because the particular business segment did not have a lengthy track record or generate a predictable revenue stream or the time period itself was far enough in the future to enable management to posit a positive change in future performance. The Examiner considered whether two aspects of the October 2007 forecast fit this profile:

First, the revised October forecast (although downwardly revising near term expectations of revenue and operating profitability overall relative to the pre-existing February model) nonetheless contemplated that Tribune would significantly mitigate the effects of the secular declines then affecting the traditional publishing segment (*i.e.,* newspapers and corresponding print advertising), by substantially growing its interactive business. In fact, the October projections showed that Tribune's interactive business would create significant revenues ahead of what was assumed in the February 2007 projections starting in 2009.[182] Management's assumptions of robust growth in the interactive division had a significant impact on Tribune's projected profitability and VRC's ultimate solvency opinion at Step Two, accounting for approximately $1.77 billion or 17.4% of VRC's mid-point discounted cash flow valuation.[183]

The Examiner interviewed Timothy Landon, who headed Tribune's interactive division and served as the chief executive officer of Classified Ventures (a start-up venture in which Tribune invested) at the time of the Leveraged ESOP Transactions. Before showing Mr. Landon Tribune's October 2007 projections, when the Examiner asked Mr. Landon whether he would

182 *See id.* at § III.H.3.f.(1).

183 *See id.* at § III.H.3.f.(3).

have expected the growth rates in interactive to be greater in the February or October 2007 forecast. Mr. Landon stated that he would have expected the October forecast to be flat or lower,[184] and acknowledged that interactive performed about 4-5% below plan in 2007.[185] He expressed surprise when the Examiner pointed out that Tribune's October forecast assumed significant increases in growth in interactive after 2009 ahead of what was projected in February.[186] David Williams, who was at the time of the Leveraged ESOP Transactions the president and chief executive officer of Tribune Media Services, Inc., a Tribune subsidiary, told the Examiner that "interactive revenues are hard to forecast and hard to predict."[187] Harry Amsden, Vice President of Finance of Tribune Publishing, described interactive as more "speculative" than other aspects of Tribune's business.[188] The Zell Group viewed interactive as misguided and adding little value to Tribune.[189] Mr. Grenesko testified that the assumptions concerning increased spending on the interactive business and increased personnel devoted to

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184 Examiner's Interview of Timothy Landon, June 22, 2010 ("I would have expected that by December we were anticipating a recession, so near term revenue would be less, then some recovery, and the question is what is the slope of that recovery. I would say that the December model is the same or lower in the abstract.").

185 *Id.*

186 *Id.* ("I'm disappointed in these numbers. It's not what I would have expected. These are the only numbers that I've looked at today that I don't feel good about. The other ones were ok, even though they might've turned out wrong. But I don't believe in the logic behind this. I take responsibility for that."). Mr. Landon also told the Examiner that an appropriate discount rate to present value of the interactive division's future performance would be double digits, representing a way to quantify mathematically the probability of success on new ventures. *Id*. The Examiner found Mr. Landon, who is not currently employed by Tribune, to be a credible witness.

187 Examiner's Interview of David Williams, June 18, 2010. Mr. Williams was a credible witness.

188 Examiner's Interview of Harry Amsden, July 2, 2010. Mr. Amdsen was credible and cooperative.

189 Examiner's Interview of Samuel Zell, June 14, 2010 ("As we looked at the interactive side, they were working on a whole bunch of projects that were going to create revenue in 2016. They didn't know what they were doing. Other than it was very important. I think we have gotten rid of most of the people. And now we're working on projects that produce revenue next week."). *See also* Examiner's Sworn Interview of Nils Larsen, July 7, 2010, at 57:4-10 ("And, you know, I think the funnel of ideas was narrowed substantially, but, you know, we certainly would not have an aversion to spending capital thoughtfully. I think our view would be that working on 120 different projects at the same time was not the best use of people's time and effort."). Mr. Larsen could not recall whether he alerted management to his concerns about management's assumptions concerning interactive. *Id*. at 57:1-2, 57:11-58:10.

that business supported management's growth assumptions.[190] Much of the projected growth in interactive, however, came from shifting resources and capital (as opposed to increasing spending on interactive on an absolute basis) into what was referred in the October projections as "internal development" of revenues (which did not figure prominently in Tribune's projections for interactive in the February projections), and, as discussed in another part of the Report, VRC's own internal analysis suggested that Tribune's assumptions regarding this business were unreasonable.[191]

Although the Examiner finds that management's projections regarding the interactive business were aggressive, based on the record adduced he does not conclude that senior financial management at Tribune prepared them in bad faith. In large measure, as discussed in another part of the Report,[192] the problem, insofar as the interactive business is concerned, involves how the projected revenue stream derived from that business was valued. Although Bryan Browning and Mose Rucker of VRC testified that they discussed management's assumptions underlying this assumed growth, as also discussed in another part of the Report, VRC applied no greater discount to this revenue,[193] and there is no evidence that they ever brought to management's attention VRC's own concerns regarding the projected growth and revenue assumptions despite expressing them internally.[194] The result was to attribute an unreasonably large component of the value to the projected interactive business revenue stream, which by nature was speculative and merited a hefty discount for valuation purposes. Although the Examiner does not have a complete picture of the interactions between VRC and senior financial management at Tribune

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190 Examiner's Sworn Interview of Donald Grenesko, July 8, 2010, at 170:9-171:4, 172:16-173:2.

191 *See* Report at § III.H.3.f.(2).

192 *See id.* at § III.H.3.f and Annex A to Volume Two (DCF Valuation Analysis).

193 Examiner's Sworn Interview of Mose Rucker and Bryan Browning, June 30, 2010, at 94:5-98:6.

194 *See* Report at § III.H.3.f.(2).

during this timeframe (particularly in late October through early December, when VRC developed a detailed critical evaluation of management's projections, only to turn around and adopt those projections wholesale),[195] based on the record adduced in the Investigation the Examiner did not find evidence of complicity by management in this aspect of VRC's valuation.

A second area of inquiry involved the unjustifiable assumption contained in the October 2007 forecast concerning Tribune's performance in 2012 to 2017, which, as discussed above, VRC then used to determine solvency at Step Two.[196] The Examiner's findings concerning the reasonableness of this assumption and the effect of VRC's use of this assumption in its solvency opinion are addressed in detail in other parts of the Report.[197] The Examiner finds unconvincing the various explanations given to the Examiner by witnesses regarding this assumption, as detailed elsewhere in the Report.[198] Moreover, although Mr. Browning and Mr. Rucker testified that they discussed management's out-year assumptions,[199] there is no evidence that VRC ever contested management's assumptions directly to management. As discussed in another part of the Report, other aspects of the October 2007 projections (particularly in Tribune's classified

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195 *See id.* at § IV.E.3.c.(5). For example, as discussed previously in text, the Examiner was unable to determine what was said between VRC and senior financial management on the question whether the out-year projections, and VRC's use of those projections as a late inning addition to its valuation, would be shared with the Tribune Board.

196 It appears that the approach was undertaken at the direction of Chandler Bigelow, who in an e-mail to Rosanne Kurmaniak of Citigroup (the individual responsible for maintaining Tribune's complex projection models), suggests: "How about we make post 2012 revenue /OCF CAGRs the same as the growth assumed in 2012 for both Publishing/Broadcasting?" Ex. 889 (Bigelow E-Mail, dated September 27, 2007). In an earlier e-mail, Mr. Bigelow suggested that a reduction in the post 2012 growth assumption would be proper. Ex. 889 (Bigelow E-Mail, dated September 27, 2007). Although Ms. Kurmaniak testified that she felt that extrapolating the growth from 2012 to later years was reasonable, she acknowledged that she did not focus on the fact that 2012 was an election year and possibly an outlier. Examiner's Sworn Interview of Rosanne Kurmaniak, July 7, 2010, at 139:6-14; 140:1-4. She suggested that if something other than an extrapolation from 2012 were used, adjustments in the out-year projections would have to be made based on the timing of elections and other anticipated occurrences in those years. *Id.* at 142:20-22-143:1-13. Mr. Bigelow did not believe CGMI had any involvement in this assumption. Examiner's Sworn Interview of Chandler Bigelow, June 17, 2010, at 100:11-19. He described the out-year assumptions as being "some extrapolation." *Id.* at 15-16.

197 *See* Report at § III.H.3.f. and Annex A to Volume Two (DCF Valuation Analysis).

198 *See* Report at § III.H.3.f. and Annex A to Volume Two (DCF Valuation Analysis).

199 Examiner's Sworn Interview of Mose Rucker and Bryan Browning, June 30, 2010, at 118:3-5; 118:24-120:7.

business segment) were unreasonable in light of information available to Tribune and VRC.[200] Yet, despite reservations expressed internally, VRC simply accepted those projections as the predicate to its solvency valuation. The logical inference that the Examiner draws, and certainly that management could draw from their multi-month interactions with VRC personnel, is that VRC would accept almost any estimate of future performance that management presented to VRC.[201] Although the Investigation uncovered no direct evidence that Tribune's management was deceitful in the preparation and issuance of this aspect of the October forecast, the Examiner finds it implausible that members of Tribune's senior financial management believed in good faith that the out-year growth assumption contained in the October 2007 forecast (or the related Tribune representation letter) represented a reasonable estimate of Tribune's future performance. Rather, this assumption bears the earmarks of a conscious effort to counterbalance the decline in Tribune's 2007 financial performance and other negative trends in Tribune's business, in order to furnish a (very significant) source of additional value to support a solvency conclusion.

(5) The Tribune Board and Special Committee Deliberations.

The record shows that when the baton was handed from Tribune management to the Tribune Board and Special Committee in December 2007 to consider the question of VRC's solvency opinion, the directors failed to adequately perform their responsibilities. To be clear, the Examiner found no evidence that the Tribune Board or the members of the Special Committee intentionally engaged in any wrongdoing, but the problem is that the fiduciaries charged with ultimate responsibility for allowing Step Two to close failed to discharge their duties to carefully scrutinize the information presented by management and VRC and make an

200 *See* Report at §§ III.H.3 f.(2)., III.H.3.f.(4)., and Annex A to Volume Two (DCF Valuation Analysis).

201 *See* Report at §§ III.E.3.b., III.H.3 f., IV.B.5.d.(9)., and IV.B.5.d.(10). *See also* Annex A to Volume Two (DCF Valuation Analysis).

informed decision that Step Two was not going to render Tribune insolvent. Indeed, the only matter for the Tribune Board and Special Committee to take up in the December 2007 timeframe was whether consummation of Step Two would render Tribune insolvent, but unlike Step One, in which the Tribune Board's and the Special Committee's respective Financial Advisors actively evaluated management's projections and VRC's work product, nothing like that happened at Step Two.[202] Tribune's Financial Advisors were not even advising Tribune at this time.[203] Thus, unlike the process in which the Financial Advisors evaluated VRC's opinion in the period between the Tribune Board's April 1, 2007 approval of the Leveraged ESOP Transactions and the Step One closing, the Tribune Board took up the critical question whether the Step Two Transactions would render Tribune insolvent without retaining an outside advisor to evaluate management's projections or VRC's work.[204] Tribune's management likewise did not have a Financial Advisor to which to turn, causing members of management (including Tribune Chief Financial Officer Donald Grenesko and Tribune Treasurer Chandler Bigelow) to reach out to the Special Committee's Financial Advisor (Morgan Stanley) for guidance. Morgan Stanley, however, was not engaged to provide financial advice to Tribune, and, as previously discussed, offered relatively little assistance to management.[205] Management, therefore, was largely

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[202] Examiner's Interview of Christina Mohr, June 29, 2010; Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 20:6-13 ("Q: But in step 2, because you were not preparing a fairness opinion or any kind of opinion for that matter, you were not asked by the special committee to look at the reasonableness of the assumptions behind the projections? A: Behind the projections, no.").

[203] *See* Ex. 643 at TRB041566-67 (October 17 Tribune Board Minutes) (referring to CGMI); Examiner's Interview of Michael Costa, June 4, 2010; Examiner's Interview of Christina Mohr, June 29, 2010.

[204] Tribune General Counsel Crane Kenney expressed the view that retention of an outside advisor in connection with Step Two was unnecessary. Examiner's Sworn Interview of Crane Kenney, July 8, 2010, at 75:15-21 ("We had the financing, and we had the deal. Now it's a whole list of certificates and other things that need to be procured, which are -- in my -- if you're asking my opinion, I don't think we needed a financial adviser to basically tick and tie the last, you know, the elements of the closing."). In light of the record adduced in the Investigation, the Examiner strongly disagrees.

[205] *See* Report at § III.H.4.c.(2).(i). Morgan Stanley's December 3, 2007 request for a discretionary fee on account of its work at Step Two contains references to Morgan Stanley providing advice and services to "the Company" and "the Company's Management" in connection with financing negotiations with the Lead Banks. Ex. 1048 at

unaided as the Step Two Financing Closing Date approached and the solvency diligence questions posed by the Lead Banks became more pointed.

Tribune's Special Committee, entrusted to monitor the Leveraged ESOP Transactions, met once after the Step One Financing Closing Date, on December 18, 2007, to consider the question of Tribune's solvency and VRC's solvency opinion.[206] In their presentations to the Examiner, certain Parties cited to the Examiner the minutes from that meeting as important evidence that Tribune's directors exercised due care in connection with the Step Two Transactions, that VRC's Step Two solvency opinion was reasonable, and that the Step Two Transactions did not constitute an intentional fraudulent transfer. The minutes prepared by the Special Committee's outside counsel (set forth in detail elsewhere in the Report)[207] state that William Osborn, the Chair of the Special Committee, "requested that the representatives of Morgan Stanley comment on the solvency opinion and the analysis behind it that was just

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MS_69131 & MS_69133 (Overview of Morgan Stanley's Role in the Tribune Special Committee Review Process, dated December 3, 2007). Thomas Whayne of Morgan Stanley testified that "throughout step 1 and step 2 [Morgan Stanley was] representing the special committee," Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 51:9-10, and as part of that representation Morgan Stanley "had been asked to work . . . in this final phase with management because the banks that had been advising primarily management during the first step transaction were no longer willing to serve in that capacity. . . . " *Id.* at 25:6-11. The record reflects that Morgan Stanley did, in fact, advise the full Tribune Board regarding the Lead Banks' proposal to modify the Step Two Financing. Ex. 702 (Tribune Board Meeting Minutes, dated November 21, 2007). There is no evidence, however, that Morgan Stanley undertook representation of Tribune at Step Two, and (given the explicit provisions of Morgan Stanley's engagement letter), it would not have been reasonable for management to have assumed otherwise. *See* Ex. 25 at MS_00213 (Morgan Stanley Engagement Letter) ("Morgan Stanley will act under this letter agreement as an independent contractor with duties solely to the [Special] Committee."). *See also* Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 33:8-14 ("Q: What's your understanding of who Morgan Stanley's client was? A: Our client was the special committee. Q: And that was your only client in this case? A: Yes."); Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 22:13-22 ("Q: The special committee was [Morgan Stanley's] client, is that right? A: The special committee was the client. Q: [W]as Tribune Company the client? A: No. Q: And was the board in general the client? A: No."); Examiner's Sworn Interview of Donald Grenesko, June 25, 2010, at 57:1-5 ("Q: Had Morgan Stanley's engagement changed from being financial advisor to the special committee to being financial advisor to the entire board? A: I don't believe so, no.").

206 Morgan Stanley made presentations to the Tribune Board (the membership of which largely overlapped with the Special Committee) following the Step One Financing Closing Date. *See, e.g.*, Ex. 643 (Tribune Board Meeting Minutes, dated October 17, 2007); Ex. 727 (Tribune Board Meeting Minutes, dated December 4, 2007); Ex. 726 (Tribune Board Meeting Minutes, dated November 5, 2007); Ex. 702 (Tribune Board Meeting Minutes, dated November 21, 2007).

207 *See* Report at § III.G.1.

presented to the Board of Directors by VRC."[208] The minutes then summarize remarks made by Thomas Whayne and Paul Taubman of Morgan Stanley, culminating in Morgan Stanley's conclusion that "VRC's solvency analysis was conservative and that VRC's opinion was something upon which a director could reasonably rely."[209] Specifically, Mr. Whayne was reported to have:[210]

- "indicated that the analysis by VRC seemed thorough and appropriate,"
- "noted [that VRC's] earnings and termination value multiples for the publishing and broadcasting industries [were] consistent (but not identical) with those used by Morgan Stanley as well as Merrill Lynch and Citibank in previous advice to the Board of Directors,"
- observed that "VRC's selection of precedent transactions and its discounted cash flow analysis used metrics very similar to that previously used by each of the investment banks,"
- "commented on VRC's analysis of the net present value of [the anticipated S-Corporation/ESOP] tax savings, [including the discount rate],"
- "commented on VRC's valuation of the PHONES debt and other assets and liabilities of the Company," and
- "concluded that VRC's solvency analysis was conservative and that VRC's opinion was something upon which a director could reasonably rely."

The minutes reflect that Mr. Taubman next "reiterated the conservative nature of VRC's analysis," and "stated that the Company has additional value not represented in the VRC presentation because the Company has a number of different assets and businesses that readily

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[208] Ex. 704 at TRB0533007 (Special Committee Meeting Minutes, dated December 18, 2007).

[209] *Id.*

[210] *Id.*

could be sold for fair value and that this additional financial [flexibility] is of incremental value to a company."[211]

Like certain other aspects of the Leveraged ESOP Transactions discussed in the Report, however, what appears at first blush is not the case on closer inspection:

First, the above excerpted document is not minutes but, rather, *draft* minutes. The document is not even accompanied by a signature line, let alone a signature. Because the Special Committee never met again and never approved the draft minutes prepared by counsel,[212] no duly adopted minutes memorializing the Special Committee's proceedings on December 18, 2007 exist.[213]

Second, from the draft and official Tribune Board minutes cited by the Parties, it appears that the Special Committee met for no more than fifteen minutes. The minutes of the full Tribune Board meeting reflect that the Special Committee meeting took place while the full

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211 *Id.*

212 Examiner's Interview of Charles Mulaney, June 24, 2010. The draft minutes prepared by counsel are unsigned, as are the final, duly adopted minutes of prior Special Committee meetings. Ex. 704 (Special Committee Meeting Minutes, dated December 18, 2007). *See, e.g.*, Ex. 143 (Special Committee Meeting Minutes, dated April 1, 2007).

213 The existence of these draft minutes appears to have colored the factual record to a certain degree, with Parties and witnesses repeatedly citing and relying on Morgan Stanley's alleged use of the adjective "conservative." *See, e.g.,* Examiner's Sworn Interview of William Osborn, June 24, 2010, at 27:1-7 ("Q. Now, when you say they used the word 'conservative,' do you remember them saying that to you, or do you just remember reading that in the minutes? A. I don't – one, for me to sit here and say I remember them saying it, I can't remember that. I did see it in the minutes."); Examiner's Sworn Interview of Dennis FitzSimons, June 25, 2010, at 101:7-18 ("Q. Do you have a specific recollection that [Morgan Stanley] approved VRC's solvency opinion as conservative and appropriate, or is that based on what you read [?] A. That's what I read [in the] board minutes, yes. Q. Aside from what you read in the board minutes, do you have any independent recollection that Morgan Stanley made that claim? A. No."). The potential skewing effect of the draft Special Committee minutes extends to other matters (beyond the alleged "conservative" characterization) as well, as evidenced by correspondence the Examiner's counsel received from counsel for Dennis FitzSimons and Donald Grenesko. Ex. 1118 (Letter from George Dougherty, dated July 15, 2010). In asserting that "the contemporaneous documents conclusively show that Morgan Stanley was fully aware of Tribune's [refinancing] representation and had numerous opportunities to object to it," counsel relies on the draft December 18, 2007 Special Committee minutes: "Morgan Stanley's stated opinions that VRC's analysis was 'conservative,' 'thorough,' and 'appropriate' and that the 'VRC Opinion' was something upon which a director could reasonably rely had to be based on, at a minimum, a review of the solvency opinion letter," which referenced management's conversations with Morgan Stanley. *Id.* at 2. VRC's Step Two solvency opinion, however, is dated December 20, 2007 — two days *after* the December 18, 2007 Special Committee meeting — and there is no evidence that Morgan Stanley was furnished with a draft of the opinion.

Tribune Board meeting was in recess prior to its 3:00 p.m. adjournment,[214] and the draft minutes state that the Special Committee "convened at 2:45 p.m."[215]

Third, Mr. Whayne and Mr. Taubman told the Examiner that they had never seen the draft minutes before being interviewed by the Examiner, despite the prominent role the two of them allegedly played at the meeting.[216] Likewise, as noted previously, VRC's opinion was also never provided to Morgan Stanley.[217] (Although, unlike at Step One, VRC's opinion was not filed with the SEC, the Examiner does not believe that the failure to do so violated applicable securities laws.[218])

Fourth, and most importantly, although he did not dispute commenting to the Special Committee regarding the earnings and value multiples and precedent transactions, as well as the discount rate used by VRC in valuing the S-Corporation/ESOP tax benefits and its valuation of the PHONES Notes indebtedness,[219] Mr. Whayne stated in his interviews with the Examiner that neither he nor Mr. Taubman offered any opinion or conclusion concerning the substantive merits

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214 Ex. 11 at TRB0415685-86 (Tribune Board Meeting Minutes, dated December 18, 2007).

215 Ex. 704 at TRB0533007 (Special Committee Meeting Minutes, dated December 18, 2007). The Special Committee meeting was likely even shorter, as the Tribune Board's minutes reflect that the full Tribune Board met in executive session for an undisclosed amount of time immediately prior to the Tribune Board's 3:00 p.m. adjournment. Ex. 11 at TRB0415686 (Tribune Board Meeting Minutes, dated December 18, 2007).

216 Examiner's Interview of Thomas Whayne, June 11, 2010; Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 83:11-17.

217 Examiner's Interview of Thomas Whayne, June 11, 2010; Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 21:6-24:5; Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 89:2-90:22. Nor, as noted, was Morgan Stanley given a copy of Mr. Grenesko's refinancing representation letter referencing discussions with Morgan Stanley. *Id.* at 94:16-95:16; Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 138:3-139:22.

218 At Tribune's Section 341 meeting held after the Petition Date, the U.S. Trustee's representative asked Mr. Bigelow whether the two VRC solvency opinions were publicly filed. Mr. Bigelow replied that the first opinion was publicly filed, but the second was not, stating that "to the best of my knowledge we had no obligation to publicly file the second step of the solvency opinion." Audio Recording of Section 341(a) Meeting of Creditors, January 16, 2009. Because Step One involved the Tender Offer, Tribune included the first VRC solvency opinion in its public filings with the SEC apparently to meet the requirements of the SEC's Schedule TO and Schedule 13E-3. Step Two did not involve a tender offer, and the Examiner's analysis is that there does not appear to be any law or regulation that required Tribune to file VRC's Step Two solvency opinion with the SEC.

219 Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 127:13-131:22.

of VRC's solvency opinion, nor did he or Mr. Taubman tell the Special Committee they could reasonably rely on the fact that Tribune would be solvent after Step Two.[220] With regard to the *process* by which VRC reached its conclusions, Mr. Whayne stated that he indicated to the Special Committee that VRC's work "seemed thorough and appropriate" and appeared to be something the Special Committee "could take [a] level of comfort in" in determining that Tribune had satisfied the Merger Agreement's condition precedent of an independent solvency opinion.[221] According to Mr. Whayne, however, these remarks went *solely* to whether the work done by VRC complied with the solvency opinion condition precedent of the Merger Agreement:[222]

> [W]e were not in any way shape or form speaking to the substance of the solvency opinion. . . . The board completely understood that we weren't speaking to whether the company was solvent from a substance matter [nor] were we saying whether this opinion was right or wrong. All we were saying was from a process standpoint of fulfilling the condition the board could rely on the opinion for process not substance.

Mr. Taubman testified that he did not recall whether Mr. Whayne commented to the Special Committee on the reasonableness of VRC's solvency opinion at the Special Committee meeting, and Mr. Taubman was "more than doubtful" that Mr. Whayne characterized VRC's solvency opinion as "conservative."[223] Both Mr. Whayne and Mr. Taubman disputed that they personally characterized VRC's ultimate opinion as "conservative."[224] Mr. Taubman did acknowledge that he used the adjective "conservative" or "not aggressive"[225] in addressing "one

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220 Examiner's Interview of Thomas Whayne, June 11, 2010.

221 *Id.*

222 *Id.*; Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 134:16-137:8.

223 Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 83:1-6.

224 *See* Report at § III.H.4.c.(2).(ii).

225 Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 111:9.

specific aspect of [VRC's] analysis where they could have been more aggressive and they were not and I recall pointing that out to the members of the committee. . . . [VRC] had not assumed that if need be individual assets could be sold piece by piece." [226] "I said I had a single point to make which is on this one dimension of analysis where one could have assumed a whole host of asset sales at premium values if you went asset by asset, it didn't appear that they had done that."[227] In fact, this is almost verbatim what the draft minutes report that Mr. Taubman stated, as excerpted above, except for the comment attributed to him that he "reiterated the conservative nature of VRC's opinion,"[228] one of the two sound bites from the draft minutes cited by the Parties. Mr. Whayne offered consistent testimony:[229]

> Just to expound on one thing, you know, consistent with what I said last time the only comment that was made regarding, you know, assumption as part of the analysis that the company was making any asset sales. So I do remember that Paul made an observation that they could sell asset sales if there was – if they had liquidity issues and that was not part of VRC's analysis, but that addressed liquidity. So that was something that we discussed last time and I do recall that. So that is – that – I don't think Paul said that the nature of the analysis – he didn't say the analysis was conservative, but Paul did make the comment that there is additional value not represented in the presentation because the company has assets and business that it could sell if it got into duress. That there were additional assets – that the VRC analysis did not incorporate any analysis of potential asset sales as a way of dealing with potential liquidity issues and Paul did make the observation that from the standpoint of viewing liquidity issues only was conservative because the company, indeed, did have a number of assets, the Cubs, et cetera, that could be sold if the company needed to raise money. So as we discussed before, he

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[226] *Id.* at 84:16-85:15.

[227] *Id.* at 109:15-19.

[228] Ex. 704 at TRB0533007 (Special Committee Meeting Minutes, dated December 18, 2007).

[229] Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 130:19-132:8; Examiner's Interview of Thomas Whayne, June 11, 2010 ("I think only thing someone could've heard was that VRC opinion didn't make any assumption around if company hit an air pocket, if it could've sold assets. I think that's what's being construed as being conservative. It's consistent on what we said from day 1- asset rich but cash flow challenged given the environment.").

> did make that comment, but it was from the standpoint narrowly of the company's ability to deal with any sort of liquidity issues that can serve face in the future and not from the standpoint of the core valuation or solvency.

Others interviewed by the Examiner who were present during the December 18, 2007 Special Committee meeting had no specific, independent recollection of the term "conservative" being used by Morgan Stanley (although several individuals stated to the Examiner that they had no reason to question the accuracy of the draft Special Committee meeting minutes).[230] In contrast, Mr. Whayne and Mr. Taubman, the persons who allegedly made these comments, testified specifically that the draft minutes did not accurately represent what they said to the Special Committee.

It is undisputed that Mr. Whayne and Mr. Taubman made brief, oral observations at the December 18, 2007 Special Committee meeting. The statement in the draft minutes attributing to Mr. Whayne the conclusion "that VRC's solvency analysis was conservative and that VRC's opinion was something upon which a director could reasonably rely,"[231] however, appears to be incorrect. In the course of vigorously denying that he or Mr. Taubman ever made this statement, Mr. Whayne pointed out that having given written presentations to the Special Committee on previous occasions, but having prepared no such presentation for the December 18, 2007 Special

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230 Examiner's Sworn Interview of William Osborn, June 24, 2010, at 27:1-7 ("Q: Now, when you say they used the word 'conservative,' do you remember them saying that to you, or do you just remember reading that in the minutes? A: I don't -- one, for me to sit here and say I remember them saying it, I can't remember that. I did see it in the minutes."); Examiner's Sworn Interview of Dennis FitzSimons, June 25, 2010, at 101:7-18 ("Q: Do you have a specific recollection that [Morgan Stanley] approved VRC's solvency opinion as conservative and appropriate, or is that based on what you read[?] A: That's what I read [in the] board minutes, yes. Q: Aside from what you read in the board minutes, do you have any independent recollection that Morgan Stanley made that claim? A: No."). The author of the draft minutes stated to the Examiner that he believed the word conservative was used, but he has no specific recollection and bases his belief "on how these minutes are prepared." Examiner's Interview of Charles Mulaney, June 24, 2010. There is no evidence that the draft Special Committee meeting minutes were prepared prior to the actual meeting (as may have been the case with at least one other set of Tribune minutes). The Examiner obtained and reviewed Mr. Mulaney's invoice covering this period, and the December 2007 time records of the Special Committee's outside counsel reflect some work by counsel on the minutes the day following the meeting.

231 Ex. 704 at TRB0533007 (Special Committee Meeting Minutes, dated December 18, 2007).

Committee meeting and having offered only brief comments, neither he nor Mr. Taubman would have made the kind of definitive statements attributed to them in the minutes.[232] Considered in the context of what Morgan Stanley was doing in December 2007, the Examiner finds Mr. Whayne's and Mr. Taubman's testimony credible. The Examiner does not have a sufficient basis, however, to determine why the draft minutes state otherwise and why they were never furnished to Mr. Whayne and Mr. Taubman for review and comment. Although the Examiner cannot furnish answers to these questions, the Examiner finds that this episode is another instance in which Morgan Stanley's alleged seal of approval of VRC's Step Two solvency opinion does not withstand scrutiny.

Special Committee Chair William Osborn described Morgan Stanley's role with respect to the VRC opinion as "mak[ing] certain that the solvency opinion was appropriate and made sense so that we would have the confidence that . . . we could move forward with the second step,"[233] a characterization with which Mr. Whayne agreed.[234] This type of evaluation, however, is qualitatively different from the type of evaluation VRC made with respect to Tribune's solvency and capital adequacy. Morgan Stanley was not asked to, nor did it, undertake or present a comprehensive evaluation of VRC's Step Two solvency opinion. Moreover, neither Morgan Stanley nor any other Financial Advisor was asked to look at Tribune management's

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232 Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 134:16-137:8; Examiner's Sworn Interview of Paul Taubman, July 1, 2010, at 82:11-22.

233 Examiner's Sworn Interview of William Osborn, June 24, 2010, at 26:11-14.

234 Examiner's Sworn Interview of Thomas Whayne, July 2, 2010, at 151:1-18.

October 2007 projections,[235] the good faith and reasonableness of which are a foundation of VRC's solvency analysis.[236]

Juxtaposed against the limited consideration given by the Tribune Special Committee on December 18, 2007 on the question of solvency (on which the Tribune Board quickly reconvened and approved VRC's solvency opinion),[237] the facts and circumstances known or ascertainable by the directors made it imperative that the Tribune Board and the Special Committee carefully evaluate the opinion delivered by VRC. They knew or should have known that: (i) the Tribune Entities' financial performance had deteriorated appreciably after Step One and that the Step Two Closing would subject the Tribune Entities to $3.6 billion more debt; (ii) management's February 2007 projections had missed the mark only shortly after those projections were issued; (iii) management's October 2007 projections served as the foundation for VRC's opinion and members of senior management were to receive significant additional compensation if Step Two closed and might be looking for continued employment under the auspices of the new owners;[238] (iv) VRC was relying on management's projections as the critical underpinning of its solvency opinion;[239] (v) VRC had been required in its engagement letter to use a definition of "fair market value" and "fair saleable value"[240] that was contrary to long-established principles of sound valuation and that directly affected VRC's solvency conclusions

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[235] *Id.* at 151:19-22.

[236] *See* Ex. 267 at TRB0412757 (VRC Engagement Letter, dated April 11, 2007) (requiring that financial forecasts and projections provided to VRC must "have been prepared in good faith . . . based upon assumptions that, in light of the circumstances under which they are made, are reasonable").

[237] Ex. 4 (Tribune Board Meeting Minutes, dated December 18, 2007).

[238] *See* Report at § III.F.8.

[239] *See id.* at § III.E.3.b.(1).(ii).

[240] *See id.* at § III.E.3.b.(1).(i).

at Step Two; and (vi) market indicia were strongly suggesting that incurrence of the Step Two Debt would render Tribune insolvent.[241]

All of these circumstances served, or should have served, as red flags to the members of the Tribune Board and Special Committee that they needed to do more to discharge their responsibilities. Unfortunately, they did not.

(6) Factors that Mitigate Against the Conclusion that Step Two Constituted an Intentional Fraudulent Transfer and Conclusion.

The Examiner evaluated factual and legal considerations that weigh against the conclusion that the Step Two Transactions were an intentional fraudulent transfer.

First, as noted, nothing in the record suggests that the Tribune Board or the members of the Special Committee knowingly or intentionally committed any fraud or acts of dishonesty. However, as discussed above, there is some reason to conclude that one or more members of Tribune's senior financial management engaged in dishonesty or, at a minimum, were not candid in their dealings with the participants. As a matter of law, those acts are ascribed to Tribune for fraudulent transfer purposes.[242] Nevertheless, the Examiner notes that, unlike many other transactions found to be intentionally fraudulent, this is not a case in which the Tribune Board engaged in any kind of foul play.

Second, by all appearances, through and including the closing of the Step Two Transactions, the Zell Group remained eager to proceed with the Step Two Closing.[243] One

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241 *See id.* at §§ III.H.3.f.(4). and IV.B.5.d.(10).

242 *See* text accompanying footnotes 48-51.

243 Examiner's Interview of Samuel Zell, June 14, 2010 ("Did we think we bought a great company? We thought we bought a great opportunity. What allowed us to do it was the asset base. We convinced ourselves that the asset base, we had the value of the newspaper and TV stations as a result of 2008, we didn't know it at the time but we thought we had the raw pieces and the bases that's why we agreed to the [Tranche] X. We were intent on the Cubs, we were convinced we could sell other assets.").

could argue that if the Zell Group, a highly-sophisticated player, still was prepared to go forward and pay the approximate $56 million in net amount it had to put in to make Step Two happen, this furnished tangible evidence that the Step Two Transactions were not going to render Tribune insolvent. After all, why would Samuel Zell pay *anything* for nothing? As William Osborn, the Chair of the Special Committee testified in his sworn interview with the Examiner: "Mr. Zell had made an investment and wanted to proceed with this transaction."[244] The Examiner finds that this is a factor mitigating against a finding that the Tribune Entities perpetrated an intentional fraudulent transfer at Step Two.

Third, the LBO Lenders advanced $3.6 billion at Step Two despite the fact that the Lead Banks posed questions regarding VRC's valuation work and retained their own outside advisor. That the LBO Lenders funded this money is some evidence supporting an inference that a party other than VRC had reached a favorable conclusion regarding Tribune's solvency. On balance, however, the Examiner does not find this factor to meaningfully militate against a conclusion that Step Two was an intentionally fraudulent transfer. As discussed in another part of the Report,[245] the LBO Lenders came to Step Two with contractual baggage resulting from their commitments made at Step One to advance funds in Step Two. It would have been one thing had Tribune actually gone out and obtained fresh financing for Step Two in the fall of 2007, but what happened was that the LBO Lenders ended up honoring preexisting contractual undertakings. That the LBO Lenders had made a preexisting commitment to fund was not lost on Tribune.[246]

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[244] Examiner's Sworn Interview of William Osborn, June 24, 2010, at 41:19-20.

[245] *See* Report at §§ IV.B.7.b.(2).-IV.B.7.b.(8).

[246] *See* Examiner's Sworn Interview of William Osborn, June 24, 2010, at 38:8-18 ("So the issues became mainly around those that were underwriting the transaction, and they were large financial institutions, and generally speaking, if an institution makes a commitment, they normally live by those commitments. There were some institutions during -- starting in the period of time we're talking about but mainly going into the next year that

The legal question is whether, applying Third Circuit law governing intentional fraudulent transfers, the record supports or falls short of supporting the conclusion that the Step Two Transactions were intentionally fraudulent. As discussed previously,[247] the law in the Third Circuit furnishes only limited guidance in the leveraged buyout context. On the one hand, if the evidence shows that the debtor knew that what it was doing would render it insolvent or hinder creditors, a finding that an intentional fraudulent transfer occurred is not difficult to draw. On the other hand, when the evidence only supports the inference that insolvency or hindrance of creditors was foreseeable, something other than an intentional fraudulent transfer has occurred.[248] In the Examiner's view, the instances of dishonesty or lack of candor described above are evidence of consciousness that proceeding honestly and with candor would jeopardize the Step Two Closing. The natural consequence of proceeding in this fashion is that a transaction that should not have happened, did. It is reasonable to infer from those acts knowledge that hindering, delaying, or defrauding creditors would follow. Although there is no evidence that the Tribune Board and Special Committee acted with such knowledge, their acquiescence allowed Step Two to close when it should not have and, therefore, their actions are relevant to the intentional fraudulent transfer inquiry.

Although the Examiner recognizes that the facts adduced in the Investigation do not fit the ordinary pattern of an intentional fraudulent transfer, the combination of acts and omissions rises to what appears to be a level of impropriety—when weighed against the natural consequences formulation adopted by the Third Circuit Court of Appeals[249]—leads the Examiner

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started to back out of transactions. But I was -- I felt that there were commitments made and the institutions that made those would stand by those commitments.").

[247] *See* Report at § IV.B.4.a.

[248] *See id.*

[249] *United States v. Tabor Court Realty Corp.,* 803 F.2d 1288, 1305 (3d Cir. 1986).

to conclude that a court would be somewhat likely to find an intentional fraudulent transfer at Step Two. To summarize, those factors include that the Step Two Transactions conferred disproportionately unreasonably small consideration on the Tribune Entities and rendered them insolvent and without adequate capital, that one or more participants in the transactions appear to have engaged in acts of dishonesty proximately related to the transfers and obligations at Step Two, and that the fiduciaries charged with overseeing management did not act as a check to prevent this from happening. These were a natural recipe for failure.

5. Constructive Fraudulent Transfer Claims.

a. Examiner's General Conclusions.

Evaluation of whether the transfers and obligations comprising the Leveraged ESOP Transactions may be avoided as constructive fraudulent transfers entails a component-by-component evaluation, set forth below, of the elements of such claims and the defenses.

b. Examiner's Conclusions and Explanation Concerning Equivalence of Value Provided at Step One and Step Two—the Question of "Collapse."

Examiner's Conclusions:

It is highly likely that a court would collapse all of the transactions within each of Step One and Step Two for purposes of evaluating the equivalence of the consideration given and received by the estates. This conclusion does not necessarily mean that a court would collapse Step One and Step Two together, or determine that Step Two Debt should be included in the solvency, capital adequacy, or intention to incur debt analysis, which are discussed separately in the Report.[250]

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[250] *See* Report at §§ IV.B.5.d.(6).(i)., IV.B.5.d.(6).(iii).

Explanation of Examiner's Conclusions:

To establish a constructive fraudulent transfer claim, an estate representative must prove that (i) the debtor transferred an interest in property or incurred an obligation in return for "less than a reasonably equivalent value," and (ii) the debtor was financially unsound at the time of or as a result of the transaction, meaning that the debtor (a) was "insolvent;" (b) had "unreasonably small capital" for any business in which the debtor was or was about to become engaged; or (c) "intended" to incur or "believed" that it would incur debts "beyond the debtor's ability to pay as such debts matured."[251] The Third Circuit Court of Appeals has adopted a two-step inquiry to determine whether a debtor received reasonably equivalent value in exchange for a transfer or obligation: First, did the debtor receive *any* value from the transfer? If a court answers that question in the affirmative, the next inquiry is "whether the debtor got roughly the value that it gave."[252] The value received and given need not be equal, but a meaningful shortfall in value received will result in a finding that the debtor received less than reasonably equivalent value.[253] Whether the debtor received reasonably equivalent value is measured from the perspective of creditors.[254]

By its terms, Bankruptcy Code section 548(a)(1)(B)(i) provides for avoidance of an obligation if the debtor received less than reasonably equivalent value in exchange.[255] Notably,

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251 *See* 11 U.S.C. § 548(a)(2) (2006).

252 *Pension Transfer Corp. v. Beneficiaries Under the Third Amend. to Fruehauf Trailer Corp. Ret. Plan 003* (*In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 212-13 (3d Cir. 2006); *see also Mellon Bank, N.A. v. Metro Commc'ns, Inc.,* 945 F.2d 635, 646-47 (3d Cir. 1991).

253 *See generally United States ex rel. FCC v. GWI PCS 1, Inc. (In re GWI PCS 1, Inc.)*, 230 F.3d. 788, 806 (5th Cir. 2000); *Voest-Alpine Trading USA Corp. v. Vantage Steel Corp.*, 919 F.2d 206, 213 (3d Cir. 1990).

254 *See Mellon Bank, N.A. v. Off. Comm. of Unsecured Creditors (In re R.M.L., Inc.),* 92 F.3d 139, 152 (3d Cir. 1996); *see also In re Fid. Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 286 (Bankr. E.D. Pa. 2006) (Carey, J., sitting by designation), *aff'd*, 371 B.R. 708 (E. D. Pa. 2007); *Rosener v. Majestic Mgmt.* (*In re OODC, LLC)*, 321 B.R. 128, 135 (Bankr. D. Del. 2005).

255 11 U.S.C. § 548(a)(1)(B)(i) (2006).

unlike Bankruptcy Code sections 548(c) and 550(a),[256] the statute does not limit avoidance *to the extent* the debtor received less than reasonably equivalent value. Rather, the statute provides for avoidance of the entire obligation *if* the debtor received less than reasonably equivalent value and the other statutory prerequisites are met. Read in conjunction with Bankruptcy Code section 548(c),[257] section 548(a)(1) provides for avoidance of the entire transfer or obligation incurred, whereas section 548(c) affords the transferee a lien or the right to retain an obligation "to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation."[258] Thus, section 548(c) offers a saving grace for the good faith initial transferee to the extent that party imparted value to the debtor. Questions of good faith, in turn, should have no place in the threshold determination concerning the equivalence of the value received under section 548(a)(1) and should only be relevant "to the extent" of the value provided pursuant to section 548(c).[259] Although reasonably equivalent value and good faith are measured as of the time of the transfer or the obligation in question,[260] the two inquiries are considered separately.

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[256] 11 U.S.C. § 548(c) (2006) ("to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation"); 11 U.S.C. § 550(a) (2006) ("to the extent that a transfer is avoided . . . .").

[257] 11 U.S.C. § 548(c) (2006).

[258] 11 U.S.C. § 548(c) (2006); *see also Bayou Accredited Fund, LLC v. Redwood Growth Partners, L.P. (In re Bayou Grp., LLC)*, 396 B.R. 810, 844 (Bankr. S.D.N.Y. 2008); *NextWave Pers. Commc'ns, Inc. v. FCC (In re NextWave Pers. Commc'ns, Inc.)*, 235 B.R. 305, 309 (Bankr. S.D.N.Y. 1999) ("[T]he appropriate remedy is avoidance of the entire obligation and reinstatement of the obligation to the extent of value given" in good faith), *aff'd,* 241 B.R. 311 (S.D.N.Y. 1999), *rev'd*. 200 F.3d 43 (2d Cir. 1999); *Gil v. Maddalena (In re Maddalena)*, 176 B.R. 551, 553-55 (Bankr. C.D. Cal. 1995).

[259] 5 COLLIER ON BANKRUPTCY ¶ 548.05 (Alan A. Resnick & Henry J. Sommer eds., 16th ed.) ("This definition of value, while derived partly from Section 3 of the Uniform Fraudulent Conveyance Act, substantively revises and departs from the definition contained in former Section 67d(1)(e) of the Bankruptcy Act, which, like section 3 of the UFCA, defined 'fair consideration.' In a significant change from the 'fair consideration' standard, 'reasonably equivalent value' does not contain a good faith component.") (footnote omitted).

[260] Focusing on the avoidance of obligations, which figures prominently in the Report, section 548(a)(1) provides for avoidance of an obligation incurred for less than reasonably equivalent value "in exchange for such . . . obligation." 11 U.S.C. § 548(a)(1)(B)(i) (2006). Section 548(c) permits an obligee of an avoided obligation that takes for value and in good faith to enforce any obligation incurred to the extent such "obligee gave value to the debtor in exchange for such . . . obligation." *Id.* § 548(c) (2006). The focus on the equivalency of the value and obligee good faith is at the time of the exchange, as recognized by many cases in the context of avoidance and good faith defenses asserted in connection with transfers. *See Peltz v. Hatten*, 279 B.R. 710, 737 (D. Del. 2002) ("For purposes of considering reasonable equivalence, the critical date is the date of the transfer

Applying these provisions to the obligations incurred and value received in the Leveraged ESOP Transactions, the appropriate question to ask is whether the Tribune Entities received reasonably equivalent value in exchange for the approximate $7 billion of Credit Agreement Debt the Tribune Entities incurred at Step One, the approximate $2.1 billion of additional Credit Agreement Debt the Tribune Entities incurred at Step Two, and the approximate $1.6 billion of Bridge Debt the Tribune Entities incurred at Step Two. The Tribune Entities incurred all of the Step One Debt under the Credit Agreement as a single obligation, in exchange for which Tribune became obligated to repay the money advanced and gave the Stock Pledge to secure the Credit Agreement Debt, and the Guarantor Subsidiaries furnished their guarantees. To the extent Step One is viewed as a single, integrated transaction as a result of collapse, the specific questions for reasonably equivalency purposes are whether the Tribune Entities received any value on account of the obligations incurred under the Credit Agreement and, if so, whether, in aggregate, the Tribune Entities received roughly the value they gave. If either question is answered in the negative and the preconditions of avoidance are otherwise met, then the obligation would be avoided subject to any good faith defenses that may be asserted to the extent of exchanged value under section 548(c). The same questions and answers should apply to the Step Two Debt.[261]

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at issue."), *aff'd,* 60 F. App'x 401 (3d Cir. 2003); *see also Merrill v. Abbott (In re Indep. Clearing House Co.)*, 77 B.R. 843, 861-62 (D. Utah 1987) ("Certainly, if a defendant knew that the debtor was running a Ponzi scheme when he advanced money to the debtor or knew of the debtor's insolvency at the time of the allegedly fraudulent transfer, that knowledge might indicate a lack of good faith."); *Enron Corp. v. Ave. Special Situations Fund II, LP (In re Enron Corp.)*, 340 B.R. 180, 207 (Bankr. S.D.N.Y. 2006) ("Courts have found that the transferee does not act in good faith if the transferee had knowledge of the debtor's unfavorable financial condition at the time of the transfer."), *vacated on other grounds*, 379 B.R. 425 (S.D.N.Y. 2007); *Tavenner v. Smoot (In re Smoot)*, 265 B.R. 128, 140 (Bankr. E.D. Va. 1999) ("A person is not a 'good faith transferee' if he has knowledge of the transferor's unfavorable financial condition at the time of the transfer."), *aff'd,* 257 F.3d 401 (4th Cir. 2001).

[261] The question arises whether the LBO Lenders could assert a valid defense under Bankruptcy Code section 548(c) regarding advances for which the Tribune Entities did not receive reasonably equivalent value (such as, for example, payments to the Selling Stockholders) even if the LBO Lenders are determined to have acted in good faith. Although the section 548(c) defense focuses on the "value" the transferor gives, *see Jimmy Swaggert Ministries v. Hayes (In re Hannover Corp.)*, 310 F.3d 796, 802 (5th Cir. 2002), this section cannot be fairly construed to permit a lender in a leveraged buyout transaction, in effect, to revive under section 584(c) a

Certain case law, however, deviates from the preceding approach to questions arising under Bankruptcy Code sections 548(a)(1) and (c) in two ways. First, in the context of leveraged buyout transactions, some courts suggest that when a lender furnishes value to enable the debtor to pay "legitimate corporate purposes," [262] the portion of the obligation incurred to that lender to those amounts may not be avoided as a constructive fraudulent transfer.[263] This means that, in

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claim that is avoided under section 548(a)(1) for advances for which the debtor did not receive reasonably equivalent value. First, the plain language of section 548(c) confers a defense on the good faith transferee or obligee only to the extent such entity "*gave value to the debtor* . . . ." 11 U.S.C. § 548(c) (2006) (emphasis added). *See id.* at 802 ("Received property can be retained 'to the extent' that the 'transferee . . . gave value to the debtor.'") (citation omitted). By definition, in collapsing each step to look at substance rather than form, the Tribune Entities' incurrence of obligations to the LBO Lenders to fund payments to Selling Stockholders did not constitute value that the Tribune Entities received. *See* Report at § IV.B.5.c.(1). Second, in the specific context of a leveraged buyout transaction and the assertion of a section 548(c) defense, the Third Circuit Court of Appeals, in dictum, observed that "the reasonableness of the remedy provided by section 548(a)(2) has been questioned, but noted that "because the fraudulent conveyance laws are intended to protect the debtor's creditors, a lender cannot hide behind the position, although sympathetic, that they have parted with reasonable value." *Mellon Bank, N.A. v. Metro Commc'ns*, *Inc.*, 945 F.2d 635, 646 (3d Cir. 1991) (citing David Gray Carlson, *Leveraged Buyouts in Bankruptcy*, 20 GA. L. REV. 73 (1985), as making the case that lenders should have good faith defense of section 548(c) despite language requiring lender to have given value to the debtor). Third, several cases from lower courts within the Third Circuit have noted that the standard for "value" under section 548(c) is the same as the standard for "reasonably equivalent value" under section 548(a). *See Dobin v. Hill (In re Hill)*, 342 B.R. 183, 203-04 (Bankr. D.N.J. 2006); *Satriale v. Key Bank USA (In re Burry)*, 309 B.R. 130, 136-37 (Bankr. E.D. Pa. 2004); *accord Slone v. Lassiter (In re Grove-Merritt)*, 406 B.R. 778, 810 (Bankr. S.D. Ohio 2009) ("The extent to which a defendant "gives value" for a particular transfer is essentially the flip side of the question of whether the debtor received "reasonably equivalent value" in exchange for the transfer.") (citations omitted).

262 *HBE Leasing Corp. v. Frank*, 48 F.3d 623 (2d Cir. 1995).

263 *See HBE Leasing*, 48 F.3d at 637 ("[S]ince Petitioners have not even alleged facts that would render improper the portion of the proceeds *not* paid to the Attorneys, the transaction is not fraudulent, at least as it pertains to this much of the second mortgage."); *see also Off. Comm. of Unsecured Creditors of Sunbeam Corp v. Morgan Stanley & Co. Inc. (In re Sunbeam Corp.)*, 284 B.R. 355, 371 (Bankr. S.D.N.Y. 2002) ("Where the funds are ultimately used for legitimate corporate purposes, then the transfer is not fraudulent."). *HBE Leasing* involved an individual who advanced funds to the debtor under two mortgages, the proceeds of which from one were used to repay corporate loans owing to the debtor's insider and from another to pay attorney's fees. The debtor was a defendant in RICO litigation at the time of the transfers. The court separately evaluated the use of the proceeds from the two advances. *HBE Leasing*, 48 F.3d at 637. Regarding the proceeds from one mortgage used to pay attorney's fees, the court determined that the record supported the conclusion that the services for which the fees were incurred were for bona fide corporate purpose, but remanded the matter to the district court for further consideration whether the transfer constituted an intentional fraud. *Id*. at 639-40. When borrowings are used for purposes of paying pre-existing debt, courts that have found that reasonably equivalent value has been furnished presumably do so based on Bankruptcy Code section 548(d)(2)(a), which defines "value" to include the securing or satisfaction of an antecedent debt. 11 U.S.C. § 548(d)(2)(a) (2006). *See, e.g.*, *Atlanta Shipping Corp. v. Chem. Bank*, 818 F.2d 240, 249 (2d Cir. 1987) ("In general, repayment of an antecedent debt constitutes fair consideration unless the transferee is an officer, director, or major shareholder of the transferor."). This conclusion is correct when an obligation is incurred solely to secure or satisfy a preexisting debt, but cannot be reconciled with section 548(a)(1) requiring avoidance of an obligation where a small portion

theory, a lender that advances funds under a single loan agreement would never have to establish its good faith for the portion of the obligations or transfers that conferred reasonably equivalent value as required under section 548(c), even though in the aggregate that lender provided less than reasonably equivalent value to the debtor in exchange for the obligation incurred. Moreover, whereas the transferee bears the burden of establishing a defense under Bankruptcy Code section 548(c),[264] the estate representative has the burden of proving a lack of reasonably equivalent value.[265] In *United States v. Tabor Court Realty Corp.*,[266] however, the Third Circuit Court of Appeals rejected such an approach (albeit applying Pennsylvania's fraudulent conveyance law), endorsing the lower court's refusal to parse the consideration given by the lender toward the repayment of a creditor's claim that was guaranteed by the debtor's principal when the majority of the advanced consideration conferred no benefit to the estate.[267]

Second, courts in the Third Circuit consider the good faith of the transferee as a factor in determining reasonably equivalent value under section 548(a)(1) once they determine that a

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of an obligation is incurred to satisfy or secure a preexisting debt, but most of the obligation is incurred for purposes for which the debtor receives no value or less than reasonably equivalent value.

264 *See Hill*, 342 B.R. at 202 ("In order to successfully assert a good faith defense under § 548(c), the burden shifts to the defendant/transferee."); *see also Foxmeyer Drug Co. v. GE Capital Corp. (In re Foxmeyer Corp.)*, 286 B.R. 546, 572 (Bankr. D. Del. 2002) ("The Trustee bears the burden of proof on all of the issues pertaining to his *prima facie* case with respect to each of his fraudulent conveyance claims while the Defendants bear such burden regarding whether, for purposes of 11 U.S.C. § 548(c) and NYDCL § 278(2), they gave $575 million in good faith.").

265 *See Gen. Elec. Credit Corp. v. Murphy (In re Rodriguez)*, 895 F.2d 725, 726 (11th Cir. 1990); *Brunell v. Fed. Nat'l Mortg. Ass'n (In re Brunell)*, 47 B.R. 830, 832 (Bankr. E.D. Pa. 1985) ("However, assuming *arguendo* to the contrary, the debtors, nevertheless, have the burden of proof on the 'reasonably equivalent value' issue."), *aff'd,* 76 B.R. 64 (E. D. Pa. 1985).

266 803 F.2d 1288, 1301 (3d Cir. 1986) (finding that of the $2.9 million allegedly paid to the debtor's creditors, $700,000 was used to pay closing costs while the remaining $2.4 million was distributed to stockholders, "the district court's characterization of the transactions as a whole as fraudulent cannot reasonably be disputed").

267 In the course of so holding, the court separately found that the lender had not acted in good faith. *United States v. Tabor Court Realty Corp.,* 803 F.2d 1288, 1296 (3d Cir. 1986).

particular transfer conferred some value on the debtor. [268] These courts apply this "totality of the circumstances" analysis even though, as noted, section 548 contemplates that questions concerning good faith should only be relevant in the context of a defense under section 548(c).[269] The Examiner considers in the Report the question of good faith as a separate inquiry, recognizing, however, that a court in the Third Circuit is likely to consider the question of good faith in analyzing the presence of reasonably equivalent value.[270] The Examiner has no reason to believe that consideration by courts in the Third Circuit of good faith in the context of reasonably equivalent value under section 548(a)(1) would yield a different substantive result than if the question of good faith were properly considered only in conjunction with a defense asserted under section 548(c).

Having discussed the somewhat confusing methodologies courts have adopted to evaluate reasonably equivalent value and good faith under the applicable Bankruptcy Code provisions, the Examiner next considers the question whether a court would collapse the transactions within Step One and Step Two for purposes of reasonably equivalent value and intentional fraudulent transfer analyses. Like other leveraged buyouts, the Leveraged ESOP Transactions were structured such that, as a matter of form, consideration at Step One flowed from the LBO Lenders to Tribune as advances under the Credit Agreement (and, later at Step Two, as advances

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[268] *See Brandt v. Trivest II, Inc. (In re Plassein Int'l Corp.)*, 405 B.R. 402, 412 (Bankr. D. Del. 2009), *aff'd*, 428 B.R. 64 (D. Del. 2010); *see also Pension Transfer Corp. v. Beneficiaries Under the Third Amend. to Fruehauf Trailer Corp. Ret. Plan 003* (*In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 213 (3d Cir. 2006).

[269] Applying the analysis of section 548(c) in *Jimmy Swaggert Ministries v. Heyes (In re Hannover Corp.)*, 310 F.3d 796, 801 (5th Cir. 2002), the court in *Satriale v. Key Bank USA, N.A. (In re Burry)*, 309 B.R. 130, 135-36 (Bankr. E.D. Pa. 2004), held that the standard for "value" that must be imparted to the debtor to assert a defense under that section is synonymous with "reasonably equivalent value." *Accord In re Hill*, 342 B.R. at 203. If followed by the Third Circuit Court of Appeals, this would mean that there is little, if any, difference between the inquiries presented under section 548(a)(1) and section 548(c), in that both consider the existence of the transferee's good faith and the reasonableness of the value conferred, an observation borne out by the section 548(c) analysis presented in *Burry*.

[270] *See* Report at § IV.B.7.b.

under the Incremental Credit Agreement Facility and the Bridge Credit Agreement); then immediately from Tribune to the Selling Stockholders and to other parties. If the analysis began and ended there, no constructive fraudulent transfer claim could be sustained to avoid the LBO Lender Debt or the transfers made because there is no dispute that the lenders did indeed advance amounts to Tribune equal to the obligations that the Tribune Entities incurred.[271] Nevertheless, in appropriate circumstances, most courts will "collapse" an integrated leveraged buyout transaction for purposes of this analysis, such that the formality of the inflow to the company and immediate outflow to stockholders and other parties is disregarded.[272] With the benefit of collapse, the lenders are viewed as having remitted the consideration directly to the selling stockholders, in many instances with no corresponding value furnished to the debtor. In *Tabor Court*,[273] the Third Circuit Court of Appeals described a paradigmatic case for application of the collapse principle in this context:[274]

> McClellan, joined by the amicus, next argues that the district court erred "by collapsing two separate loans into one transaction." . . . The loan arrangement was a two-part process: the loan proceeds went from IIT to the borrowing Raymond Group companies, which immediately turned the funds over to Great American, which used

[271] One circuit court did (inappropriately) stop there. *See Jones v. Nat'l Bank (In re Greenbrook Carpet Co.)*, 722 F.2d 659, 660-61 (11th Cir. 1984). As discussed in the Report, however, most other courts have not followed suit. *See, e.g., Mellon Bank, N.A. v. Metro Commc'ns, Inc.,* 945 F.2d 635, 646 (3d Cir. 1991) (questioning the Eleventh Circuit's decision in *Greenbrook Carpet*).

[272] *See Voest-Alpine Trading USA Corp. v. Vantage Steel Corp.*, 919 F.2d 206, 212-13 (3d Cir. 1986); *United States v. Tabor Court Realty Corp.,* 803 F.2d 1288, 1298, 1302-03 (3d Cir. 1986); *Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537, 546 (D. Del. 2005) (holding that, when considering collapsing a multi-step transaction, the court should focus "not on the structure of the transaction but the knowledge and intent of the parties involved in the transaction"), *aff'd*, 278 F. App'x 125 (3d Cir. 2008); *Big V Supermarkets v. Wakefern Food Corp. (In re Big V Holdings)*, 267 B.R. 71, 92-93 (Bankr. D. Del. 2001) ("Therefore, by 'linking' together all the interdependent steps with legal or business significance rather than taking them in isolation, the result may be based 'on a realistic view of the entire transaction.'"). *See also Fid. Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 285-86 (Bankr. E.D. Pa. 2006), *aff'd,* 371 B.R. 708 (E.D. Pa. 2007); *Bay Plastics, Inc. v. BT Commercial Corp. (In re Bay Plastics, Inc.)*, 187 B.R. 315, 329 (Bankr. C.D. Cal. 1995); *Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.)*, 100 B.R. 127, 136 (Bankr. D. Mass. 1989); *Wieboldt Stores, Inc. v. Schottenstein*, 94 B.R. 488, 500-02 (N.D. Ill. 1988).

[273] 803 F.2d 1288, 1302 (3d Cir. 1986).

[274] *Id.* at 1302 (internal citations omitted); *accord HBE Leasing Corp v. Frank*, 48 F.3d 623, 635-36 (2d Cir. 1995).

> the funds for the buy-out. McClellan contends that the district court erred by not passing on the fairness of the transaction between IIT and the Raymond Group mortgagors.
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> * * *
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> The district court's factual findings support its treatment of the IIT-Raymond Group-Great American transaction as a single transaction. For example, Durkin, president of Great American, solicited financing from IIT for the purchase. The loan negotiations included representatives of all three parties. The first closing was aborted by IIT's counsel because of, *inter alia*, concern about "unknown individuals" involved with Great American. The $7 million loaned by IIT to the borrowing companies was "immediately placed in an escrow account;" "simultaneously" with the receipt of the IIT proceeds, the borrowing companies loaned Great American the cash for the buy-out and received in return "an unsecured note promising to repay the loans to the borrowing companies on the same terms and at the same interest rate as pertained to the loans to the borrowing companies from IIT."

Drawing from *Tabor Court*, courts in the Third Circuit evaluate three principal factors in determining whether collapse is appropriate when faced with transactions such as these: "First, whether all of the parties involved had knowledge of the multiple transactions. Second, whether each transaction would have occurred on its own. And third, whether each transaction was dependent or conditioned on other transactions."[275]

All three of these factors are present at Step One and Step Two. It is undisputed that the LBO Lenders that funded this indebtedness in both steps had full knowledge regarding the structure of these transactions, the sources and actual uses of funds, and the purposes of those uses. All the transactions within Step One and Step Two, respectively, closed contemporaneously: funds came into Tribune's accounts and were wired out immediately to make payments to the Selling Stockholders, the LBO Lenders, and other parties. In Step One, the repayment of the 2006 Credit Agreement indebtedness only occurred because of the

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[275] *Mervyn's, LLC v. Lubert-Adler Group IV, LLC (In re Mervyn's Holdings, LLC)*, 426 B.R. 488, 497 (Bankr. D. Del. 2010) (internal citations omitted); *see also Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Grp. (In re Hechinger Inv. Co.)*, 327 B.R. 537, 547 (D. Del. 2005) ("Each step of the Transaction would not have occurred on its own, as each relied on additional steps to fulfill the parties' intent and merge Builder's Square and Hechinger."), *aff'd,* 278 F. App'x 125 (3d Cir. 2008).

financing provided under the Credit Agreement, which was only available because of the transactions effectuated at Step One. Payments for LBO Fees and other fees and charges, and, in the case of Step Two, management bonuses, other fees and charges and, shortly after the Step Two Financing Closing Date, Advisor Fees, were all made possible because of the closings. Each transaction comprising Step One was mutually dependent and conditioned on the occurrence of each other transaction within Step One, and each transaction comprising Step Two was mutually dependent and conditioned on the occurrence of each other transaction within Step Two. In sum, these are prototypical transactions warranting collapse within each step.

Citing the decision of the District Court for the District of Delaware in *In re Plassein International Corp.*,[276] however, certain Parties contended to the Examiner that courts in the Third Circuit will only collapse a leveraged buyout transaction when there is evidence of either bad faith or intent to defraud. In *Plassein,* the bankruptcy court dismissed constructive fraudulent conveyance claims brought under sections 1304 and 1305 of the Delaware UFTA and Bankruptcy Code section 544(b) because a non-debtor made the disputed transfer.[277] The bankruptcy court explained that "[t]he Trustee seeks to avoid the implications that [the transferor] is not a debtor by arguing that the transactions are a single integrated plan and there is authority to collapse the transaction to determine fraudulent conveyance liability."[278] Thus, the *Plassein* plaintiff could only avoid the fraudulent transfers if the debtor and non-debtor were "collapsed" into a single entity under an alter ego or veil-piercing theory that required heightened

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276 *Brandt v. B.A. Capital Co. LP (In re Plassein Int'l Corp.)*, 388 B.R. 46 (D. Del. 2008), *aff'd on other grounds*, 590 F.3d 252 (3d Cir. 2009) (not discussing collapsing).

277 *See Brandt v. B.A Capital Co. (In re Plassein Int'l Corp.),* 366 B.R. 318, 326 (Bankr. D. Del. 2006), *aff'd,* 388 B.R. 46 (D. Del. 2008), *aff'd on other grounds*, 590 F. 3d 252 (3d Cir. 2009) (not discussing collapsing).

278 *Plassein*, 366 B.R. at 326.

intent.[279] In affirming the bankruptcy court's dismissal of the trustee's complaint, the district court stated: [280]

> As the Bankruptcy Court noted, courts in this Circuit have typically required proof of bad faith or intent to defraud to justify collapsing otherwise independent transactions. In this case, the Adversary Complaint does not allege bad faith or intent to defraud, and therefore, the Court cannot conclude that the Bankruptcy Court erred in dismissing it.

The context in which the question of collapse was posed in *Plassein*—an allegation that an entity operating with a similar name to the debtor actually should be treated as the debtor for fraudulent transfer purposes—cried out for evidence of bad faith, fraud, or subterfuge to support the result the estate representative was seeking. There is no contention in the Tribune cases that any third party masqueraded as the Tribune Entities in the Leveraged ESOP Transactions, and, as a result, the circumstances and legal issues presented in *Plassein* have little relevance to the current situation. More importantly, for purposes of considering application of the collapse principle here, contrary to the *Plassein* court's statement, the standard required to avoid collapse of a leveraged buyout transaction in the Third Circuit is not lack of bad faith, but lack of knowledge, as illustrated by the two circuit level opinions cited in *Plassein. Tabor Court* affirmed the lower court's findings regarding collapse of the transaction at issue because it was integrated and mutually dependent, and all participants knew what was happening.[281] Although

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279 *Id.*; *see also NetJets Aviation, Inc. v. LHC Commc'ns, LLC*, 537 F.3d 168, 183 (2d Cir. 2008) (finding sufficient evidence of fraud, illegality, or unfairness to justify treating the debtor and the non-debtor as a single entity).

280 *Plassein Int'l Corp.*, 388 B.R. at 49 (citing *Voest-Alpine Trading USA Corp. v. Vantage Steel Corp.*, 919 F.2d 206 (3d Cir. 1990); *United States v. Tabor Court Realty*, 803 F.2d 1288 (3d Cir. 1986); *Off. Comm. of Unsecured Creditors of Nat'l Forge Co. v. Clark (In re Nat'l Forge Co.)*, 344 B.R. 340, 347 (W.D. Pa. 2006), *aff'd on other grounds,* 590 F.3d 252 (3d Cir. 2009).

281 *Tabor Court Realty,* 803 F.2d at 1302. In *Tabor Court Realty*, the Third Circuit Court of Appeals agreed that the district court properly collapsed the steps of an LBO transaction in order to determine fraudulent conveyance liability and stated that the district court "looked beyond the exchange of funds between [the lender] and [the debtors]" because "the two exchanges were part of one integrated transaction." 803 F.2d at 1302; s*ee also Off. Comm. of Unsecured Creditors of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 274 B.R. at 90-91 (D. Del. 2002) ("Regardless of the various complex structures of leveraged buyouts, which often involve various loans, stock purchases, mergers, and repayment obligations,

Tabor Court also approved the lower court's findings that the lender (actually, the lender's predecessor) had not acted in good faith, the Third Circuit Court of Appeals considered lender good faith separately from the issue of collapse, looking to the integrated nature of the transaction and the knowledge of the parties:[282]

> We are satisfied with the district court's conclusion that the funds 'merely passed through the borrowers to Great American.' This necessitates our agreement with the district court's conclusion that, for purposes of determining IIT's knowledge of the use of the proceeds under section 353(a), there was one integral transaction.

Voest-Alpine Trading USA Corp. v. Vantage Steel Corp. involved a foreclosure and resale scheme perpetrated as a subterfuge designed expressly by the participants to freeze out a large unsecured creditor.[283] The Third Circuit Court of Appeals approved the lower court's findings on collapse, however, again based on the participants' knowledge of the various transactions that made the foreclosure scheme possible:[284]

> Admittedly, [the arguments made against collapsing the transactions] could have some validity where the lender is unaware of the use to which loan proceeds are to be put. That is not the case here [in Tabor Court]. IIT [the lender] was intimately involved with the formulation of the agreement whereby the proceeds of its loan were funneled into the hands of the purchasers of the stock of a corporation that was near insolvency. Try as they might to distance themselves from the transaction now, they cannot rewrite history.

At the Delaware District Court level, *Plassein* stands in contrast to the more comprehensive analysis contained in *Hechinge*r, which did not require evidence of bad faith or

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courts have found that a set of transactions may be viewed as one integrated transaction if the transactions 'reasonably collapse into a single integrated plan and either defraud creditors or leave the debtor with less than equivalent value post-exchange.'") (citations omitted).

282 *Tabor Court Realty*, 803 F.2d at 1302-03.

283 919 F.2d 206 (3d Cir. 1990).

284 *Id.* at 212-13; s*ee generally ACF-Brill Motors Co. v. Comm'r*, 189 F.2d 704, 707 (3d Cir. 1951) (stating that the question is whether "the steps … [were] so interdependent that the . . . one transaction would have been fruitless without the completion of the series"). The last case cited by *Plassein*, *Off. Comm. of Unsecured Creditors of Nat'l Forge Co. v. Clark (In re National Forge Co.)*, 344 B.R. 340 (W.D. Pa. 2006), applied *Tabor Court Realty* and *Voest-Alpine* to collapse various steps of a stock redemption plan into a single "integrated transaction" without any showing of bad faith or intent to defraud. *Id.* at 347, 349.

knowledge of fraud to collapse.[285] *Plassein* also is inconsistent with the methodology adopted in the Third Circuit to determine reasonably equivalent value, which considers the question of good faith only after it is determined that some value was given to the debtor.[286] The question of collapse goes to the threshold question whether the debtor received some value before the question of good faith is addressed.

In the context of case law in the Third Circuit on the question of collapse, *Plassein* supports the conclusion that collapse is warranted when the evidence reveals an intentional fraudulent transfer or bad faith. The weight of authority in the Third Circuit, however, does not support the further contention that collapse *requires* a showing of bad faith or knowledge of a fraudulent intent. The Examiner finds that it is highly likely a court would collapse the transactions *within* each of Step One and Step Two for purposes of analyzing reasonably

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285 *Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Grp. (In re Hechinger Inv. Co.)*, 327 B.R. 537, 547 (D. Del. 2005) ("[A]ll [of the defendants] knew about the multiple steps of the transaction. Each step of the Transaction would not have occurred on its own, as each relied on additional steps to fulfill the parties' intent and merge Builder's Square and Hechinger. Therefore, in evaluating the validity of the Transaction, the court considers it as one transaction."), *aff'd,* 278 F. App'x 125 (3d Cir. 2008). The court in *Rosener v. Majestic Management (In re OODC, LLC)*, 321 B.R. 128, 139 (Bankr. D. Del. 2005), stated:

> The Trustee in this case alleges that the effect of the series of transactions was to transfer assets of the Selling Companies to the Debtor and to impose $40 million in additional secured debt on the enterprise. Nothing was added to benefit the enterprise or the unsecured creditors as a result of the LBO. Therefore, the Trustee asserts that the transaction as a whole is avoidable because it was done with the intent to defraud the unsecured creditors of the Selling Companies (later of the Debtor) and because no consideration was given to the Debtor for incurring the additional secured debt. Undoing the transaction would leave the Selling Companies and their creditors where they began, with all their assets and without the secured debt.
>
> We agree with the Trustee that there is support for the theories on which his Complaints are founded and the relief requested. Therefore, we find it inappropriate to dismiss the Complaints.

A majority of courts outside the Third Circuit approach the question of collapse similarly and do not require actual fraud or concealment as a condition to collapse. *See Off. Comm. of Unsecured Creditors of Grand Eagle Cos. v. Asea Brown Boveri, Inc.*, 313 B.R. 219, 230 (N.D. Ohio 2004); *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co. (In re MFS/Sun Life Trust)*, 910 F. Supp. 913, 934-935 (S.D.N.Y. 1995); *In re Sw. Equip. Rental, Inc.*, 1992 WL 684872, at *14-15 (E.D. Tenn. July 9, 1992); *Daley v. Chang (In re Joy Recovery Tech. Corp.)*, 286 B.R. 54, 74 (Bankr. N.D. Ill. 2002) ("Courts will eschew appeals to form which obscure the substance of a transaction. Thus, a multilevel transaction will be collapsed and treated as a single transaction in order to determine if there was a fraudulent conveyance.").

286 *See, e.g., Pension Transfer Corp. v. Beneficiaries Under the Third Amend. to Fruehauf Trailer Corp. Ret. Plan 003* (*In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 13 (3d Cir. 2006).

equivalent value. The import of this conclusion is that, in evaluating the consequences of the Leveraged ESOP Transactions and the value that the Tribune Entities received from these transactions, a court will look to the actual uses of the advances giving rise to the LBO Lender Debt (as well as the additional funds used by Tribune) to make the payments to Selling Stockholders and on account of LBO Fees and other assorted uses.[287]

c. Equivalence of the Value Provided Regarding Specific Transfers and Obligations.

This Section evaluates each component of the consideration given and received by the participants in Step One and Step Two for purposes of assessing reasonably equivalent value under Bankruptcy Code section 548(a)(1) and defenses under section 548(c). Based on that analysis, taken together, and the significant disparity between the value the Tribune Entities received and the obligations incurred to the LBO Lenders in each of Step One and Step Two, the Examiner finds it is highly likely a court would conclude that, in the aggregate, the Tribune Entities received less than reasonably equivalent value in each of Step One and Step Two.[288]

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[287] A separate question arises concerning the consideration EGI-TRB paid in exchange for the Exchangeable EGI-TRB Note. The Exchangeable EGI-TRB Note was issued to EGI-TRB on April 23, 2010, over a month before the Step One Financing Closing Date. As discussed in another part of the Report, *see* Report at § IV.C.1., Tribune satisfied this note at Step Two when it issued to EGI-TRB the EGI-TRB Note. Since the issuance of this note preceded the Step One Financing Closing Date by over a month, and the consideration paid for the note thereby was given before the Step One Financing Closing Date, a court might determine that collapse of the Step One Transactions would not extend to the consideration paid by EGI-TRB to Tribune. On the other hand, because this note was issued as part of the Step One Transactions (a fact that was known to the participants in these transactions) and would not have been issued but for the Leveraged ESOP Transactions, and the consideration paid by EGI-TRB for this note enabled the transactions to proceed, a court might apply the collapse principle and treat this note as one of the transactions effectuated as part of the Step One Transactions for which Tribune received less than reasonably equivalent value. To the extent the obligations incurred by Tribune on the Exchangeable EGI-Note are avoidable, Tribune's repayment of that obligation at Step Two might be recoverable.

[288] This conclusion is drawn by comparing the components of reasonably equivalent value that the Debtors received from the LBO Lenders, in the aggregate, in Step One and Step Two, versus the obligations incurred to those creditors. *See United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1299 (3d Cir. 1986). At each of Step One and Step Two, the disparity is enormous.

This Section of the Report considers whether one or more of the Tribune Entities received reasonably equivalent value in exchange for certain specific transfers made at the time of the Leveraged ESOP Transactions or thereafter. The analysis in this Section assumes *arguendo* that the other prerequisites to avoidance (i.e. insolvency, inadequate capital, or intention to incur debts beyond ability to pay) are otherwise met. These questions are evaluated separately in the Report. Also, this Section does not consider the good faith of any particular transferee, which as noted previously is relevant under the "totality of circumstances" for determining reasonably equivalent value in the Third Circuit[289] and defenses under section 548(c). The Report considers questions of good faith in a separate Section of the Report, which also addresses what the Examiner's findings on good faith mean to questions of reasonably equivalent value and defenses under section 548(c).[290]

(1) Examiner's Conclusions and Explanation Concerning Obligations Incurred to the LBO Lenders to Pay Selling Stockholders at Step One and Step Two.

Examiner's Conclusions:

A court is highly likely to conclude that the LBO Lenders did not confer reasonably equivalent value on Tribune or the Guarantor Subsidiaries in the Step One Transactions or Step Two Transactions for those portions of their advances used to redeem the Selling Stockholders' Common Stock.

Explanation of Examiner's Conclusions:

Payments to stockholders to redeem stock are not transfers for which a debtor receives reasonably equivalent value because the debtor's stock is worthless to the debtor as a matter of

289 *See* Report at §§ IV.B.7.b.(1). and IV.B.5.b.

290 *See* Report at §§ IV.B.7.b.(1)-IV.B.7.b.(9).

law.[291] Thus, no value was conferred on any Tribune Entity for obligations incurred to the LBO Lenders to make these payments.

(2) Examiner's Conclusions and Explanation Concerning Obligations Incurred to Repay the 2006 Bank Debt.

Examiner's Conclusions:

A court is highly likely to conclude that the lenders under the Credit Agreement conferred reasonably equivalent value to Tribune, but not to the Guarantor Subsidiaries, in Step One for amounts borrowed to repay the 2006 Bank Debt.

Explanation of Examiner's Conclusions:

Payment of antecedent debt or advances to a debtor actually used by the company to pay valid debt is for value.[292] Because the 2006 Bank Debt represented valid antecedent debt, the repayment of that debt should constitute reasonably equivalent value to Tribune. Certain Parties nevertheless argued that Tribune did not receive any "benefit" from the repayment of the 2006 Bank Debt because: (i) the pre-existing holders of that debt were substantially the same as the LBO Lenders; (ii) the LBO Lender Debt bore a higher interest rate than the 2006 Bank Debt; and (iii) the 2006 Bank Debt was not guaranteed, whereas the LBO Lender Debt was. The question, however, is not whether repayment of the 2006 Bank Debt *improved* Tribune's position but whether the repayment constitutes "value" for purposes of the applicable statutes, which it did.

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[291] *See Robinson v. Wangemann*, 75 F.2d 756, 757 (5th Cir. 1935) ("The corporation does not acquire anything of value equivalent to the depletion of its assets, if the stock is held in the treasury, as in this case. It is simply a method of distributing a proportion of the assets to the stockholder."); *Consove v. Cohen (In re Roco Corp.)*, 21 B.R. 429, 434 (B.A.P. 1st Cir. 1982) ("Regardless of whether [a stockholder's] ownership interest had any tangible or intangible value to him, the stock was worthless to the corporation."), *aff'd*, 701 F.2d 978 (1st Cir. 1983).

[292] 11 U.S.C. § 548(d)(2)(A) (2006); *see also Atlanta Shipping Corp. v. Chem. Bank*, 818 F.2d 240, 249 (2d Cir. 1987) ("In general, repayment of an antecedent debt constitutes fair consideration unless the transferee is an officer, director, or major shareholder of the transferor."); *Aphton Corp. v. Sonefi Pasteur (In re Aphton Corp.),* 423 B.R. 76, 89 (Bankr. D. Del. 2010) ("Courts have held that when a transfer is made to pay an antecedent debt, the transfer may not be set aside as constructively fraudulent.") (footnote omitted).

As noted previously, no evidence was adduced suggesting that the 2006 Bank Debt was invalid. Accordingly (but subject to questions of good faith), the lenders under the Credit Agreement should be entitled to a claim against Tribune equal to the amount repaid. Because the Credit Agreement lenders advanced the funds to repay this debt, there would be no basis for the Bridge Facility Lenders to benefit from this repayment notwithstanding the contrary contention advanced by one Party.

Because the Guarantor Subsidiaries were not obligated on this debt, however, these entities did not receive reasonably equivalent value from advances that repaid the 2006 Bank debt.[293]

(3) Examiner's Conclusions and Explanation Concerning Obligations Incurred in Connection with the Satisfaction of the LATI Intercompany Claims.

Examiner's Conclusions:

A court is highly unlikely to conclude that the Credit Agreement lenders conferred any value on one or more Tribune Entities resulting from the LATI Note transactions effectuated at the Step One Financing Closing Date.

Explanation of Examiner's Conclusions:

One Party advocated the position to the Examiner that the satisfaction of the LATI Notes represented reasonably equivalent value to the Debtors. That Party acknowledged that even if the satisfaction of the LATI Notes could constitute reasonably equivalent value, at most this

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293 *See United States v. Gleneagles Inv. Co.*, 565 F. Supp. 556, 576-77 (M.D. Pa. 1983), *aff'd in relevant part sub nom. United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986) ("Those guarantors of the ITT loans who were not borrowing companies were, in essence, only secondarily liable on the ITT notes and loans. Nonetheless, despite the contingent nature of their obligations, the guarantees are clearly 'obligations incurred' under the [Uniform Fraudulent Conveyances] Act, and the mortgages collateralizing the guarantees are clearly conveyances. . . . No consideration at all flowed to the guarantors who were not borrowing companies.") (internal citations omitted).

would only represent value to the twenty-one Subsidiary obligors on the LATI Notes, not to any of the other Debtors. This qualification, however, does not end up making a difference because this extinguishment conferred no value to the twenty-one Subsidiaries either. As noted previously,[294] the repayment of a valid antecedent debt constitutes reasonably equivalent value for loan obligations incurred,[295] but only if the debt claimed to have been repaid is, in fact, debt. In analyzing whether an instrument is debt or equity, the Third Circuit Court of Appeals has stated:[296]

> In defining the recharacterization inquiry, courts have adopted a variety of multi-factor tests borrowed from non-bankruptcy case law. While these tests undoubtedly include pertinent factors, they devolve to an overarching inquiry: the characterization as debt or equity is a court's attempt to discern whether the parties called an instrument one thing when in fact they intended it as something else. That intent may be inferred from what the parties said in their contracts, from what they do through their actions and from the economic reality of the surrounding circumstances.

In the years preceding the Leveraged ESOP Transactions, apparently to minimize state income tax liabilities,[297] the LATI Notes were created pursuant to a series of intercompany transactions having no substantive economic effect on the Tribune Entities in general or the entities made parties to the LATI Notes in particular. Literally, capital flowed in an instant and in a circle from Tribune to LATI, then from LATI to twenty-one of Tribune's Subsidiaries, and

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294 *See* Report at § IV.B.5.c.(2).

295 11 U.S.C. § 548(d)(2)(A) (2006) ("'Value' means . . . satisfaction . . . of a present or antecedent debt of the debtor . . . ."); *see also Atlanta Shipping Corp.*, 818 F.2d at 249 ("In general, repayment of an antecedent debt constitutes fair consideration unless the transferee is an officer, director, or major shareholder of the transferor."); *Aphton Corp. v. Sonefi Pasteur (In re Aphton Corp.),* 423 B.R. 76, 89 (Bankr. D. Del. 2010) ("Courts have held that when a transfer is made to pay an antecedent debt, the transfer may not be set aside as constructively fraudulent.") (footnote omitted).

296 *Cohen v. KB Mezzanine Fund II LP (In re SubMicron Sys. Corp.)*, 432 F.3d 448, 455-56 (3d Cir. 2006); *see also Radnor Holdings Corp. v. Tennenbaum Capital Partners (In re Radnor Holdings Corp.)*, 353 B.R. 820, 838 (Bankr. D. Del. 2006) ("[T]he overarching inquiry in a recharacterization case is the intent of the parties at the time of the transaction, determined not by applying any specific factor, but through a *common sense* evaluation of the facts and circumstances surrounding a transaction . . . .").

297 *See* Report at § III.D.13.; Examiner's Sworn Interview of Chandler Bigelow, June 17, 2010, at 263:10-22.

finally from these Subsidiaries back to Tribune.[298] The fact that Tribune memorialized the intermediate step (i.e., the transfer from LATI to the twenty-one Subsidiaries) in the form of intercompany notes appears to be the only thing that distinguished that step from the others.[299] Payments (or journal entries) of interest and principal followed a reverse circular path, again having no significance other than to memorialize the periodic crediting of the note balances. The transactions effectuated on the Step One Financing Closing Date followed that same circular journey via a series of book entries. The only consequence of these transactions effectuated at Step One was to extinguish the LATI Notes—instruments that had no independent meaning in the first place.

Any tax motivations driving these transactions, moreover, do not bear on whether the LATI Notes actually represented indebtedness for fraudulent transfer analysis. For two reasons, "common sense"[300] leads to a contrary conclusion. First, from beginning to end, none of the dollar amounts circulated through the twenty-one Subsidiaries remained with those recipients.[301] As noted above, once capital passed from LATI to a Tribune Subsidiary, the Subsidiary immediately returned it to Tribune. The transactions bore no resemblance to events that ordinarily happen when parties act at arm's length.[302] Second, many if not most of the transactions relating to the LATI Notes (including the periodic repayment of principal and

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298 *See* Report at § III.D.13.

299 *See Roth Steel Tube Co. v. Comm'r*, 800 F.2d 625, 630 (6th Cir. 1986) (applying a multi-factor test to determine the nature of a claim and considering the name given the instrument as a factor); *Stinnett's Pontiac Serv., Inc. v. Comm'r*, 730 F.2d 634, 638 (11th Cir. 1984) (same); *Cohen v. KB Mezzanine Fund II, L.P. (In re SubMicron Sys. Corp.)*, 291 B.R. 314, 323 (D. Del. 2003) (same).

300 *Radnor Holdings Corp.*, 353 B.R. at 838.

301 *See* Report at § III.D.13.

302 *See Scripomatic Inc. v. United States*, 555 F.2d 364, 368 (3d Cir. 1977) ("The analysis . . . to the debt-equity question may be expressed in terms of two lines of inquiry: assuming the obligation is debt in form, (1) did the form result from an arms'-length relationship, and/or (2) would an outside investor have advanced funds on terms similar to those agreed to by the shareholder.") (citations omitted).

interest) were accomplished via accounting entries: no actual funds moved at all.[303] More importantly, the consistent course of dealing demonstrated that Tribune would furnish the amounts necessary to "repay" interest and principal on the LATI Notes, with the money immediately looped back to Tribune.[304] This was not a case in which any obligor was ever called on to pay so much as a penny from its own resources toward satisfaction of the LATI Notes.[305] This course of dealing simply does not manifest anything resembling a real economic transaction. Faced with similar circumstances, the bankruptcy court in *In re O'Day Corp.*[306] concluded "that cancellation of the Intercompany Notes did not provide fair consideration . . . . The Intercompany Notes appeared to have been created only for tax advantages conferred by the mirror subsidiary structures."

The conclusion does not change even if a court were to find that the LATI Notes constituted "debt" the moment before they were extinguished.[307] From inception to repayment, the obligors on those notes never had to use their own financial wherewithal to repay the LATI Notes. The capital always came from Tribune to the Subsidiaries and then a like amount from those entities to LATI and back to Tribune. In other words, this was a "debt" that would always be paid but never have any substance in the real world. In contrast, the guarantee obligations incurred by those Subsidiaries on the LBO Lender Debt and that replaced the LATI Notes were

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303 *See* Report at § III.D.13.

304 *See id.*

305 Indeed, although the net effect of unwinding the LATI Notes at the Step One Financing Closing Date was to shift the LATI Note "liability" from the Subsidiaries to Tribune, to the best of the Examiner's knowledge no new intercompany note ever was issued to memorialize this "debt."

306 *Murphy v. Meritor Savs. Bank (In re O'Day Corp.)*, 126 B.R. 370, 394 (Bankr. D. Mass. 1991).

307 The Examiner emphasizes that his finding that the LATI Notes do not constitute debt is presented solely in the context of the question of "value" for fraudulent transfer analysis. The Examiner expresses no opinion, and is not addressing, whether the LATI Notes constitute debt for other purposes. No Party has raised whether the intercompany liability from Tribune to LATI constitutes debt, and the Examiner similarly expresses no view on that question.

debt in every sense of the word. There was and never could be any reasonable expectation that the LBO Lender Debt would lack substance; that the satisfaction of these obligations would be as simple as merely flipping an inter-company switch and running money back and forth among the Tribune Entities in a circle; or that the LBO Lenders would act in any manner other than on an arm's length basis to enforce their full rights of repayment. The Examiner concludes that it is highly unlikely that a court would find that replacing the LATI Notes with the LBO Lender Debt constitutes reasonably equivalent value.

(4) Examiner's Conclusions and Explanation Concerning Obligations Incurred on the Revolving Credit Facility, Delayed Draw Facility and under the Credit Agreement and Bridge Facility for Satisfaction of LBO Fees, and for Payment of LBO Fees.

Examiner's Conclusions:

A court is reasonably likely to conclude that the lenders under the Credit Agreement conferred reasonably equivalent value to Tribune and the Guarantor Subsidiaries in an amount equal to amounts drawn on the Revolving Credit Facility and to Tribune only in an amount equal to amounts drawn on the Delayed Draw Facility. A court is highly likely to find that the LBO Lenders conferred some value to Tribune and the Guarantor Subsidiaries for advances used to pay the LBO Fees. The amount of that value, however, is difficult to determine.

Explanation of Examiner's Conclusions:

Of the approximately $750 million made available under the Revolving Credit Facility at Step One, approximately $237 million was drawn in a lump sum shortly before the Petition Date for general corporate purposes for the Tribune Entities under Tribune's centralized cash management system; Tribune used another approximate $100 million in borrowings under that facility to obtain letters of credit.[308] Consistent with the purpose of the Delayed Draw Facility, Tribune borrowed approximately $193 million to make payments on the Senior Notes maturing in February, October, and December 2008. Had Tribune borrowed these funds at the closing of Step One or Step Two, there would be little question that borrowings for these purposes would constitute reasonably equivalent value to Tribune.[309] However, because reasonably equivalent value is measured at the time an obligation is incurred,[310] the question arises whether the amount Tribune actually borrowed after the Leveraged ESOP Transactions "counts" toward reasonably equivalent value at the time of the transfer. In *Mellon Bank, N.A. v. Metro Communications, Inc.*,[311] the Third Circuit Court of Appeals recognized that "[t]he ability to borrow money has considerable value in the commercial world."[312] Thus, a lender confers *some value* to the debtor by making a credit facility available, even if the debtor does not immediately take advantage of that opportunity by borrowing the money.[313] Under Third Circuit authority, discussed below, however, because the value of any such "indirect benefit" must be measurable, a court will likely

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308 The Examiner understands that about $28 million of those letters of credit have been drawn since the Petition Date. Accordingly, for purposes of calculating Recovery Scenarios, the Examiner used the actual amount drawn on that Revolving Credit Facility, $265 million.

309 *See Off. Comm. of Unsecured Creditors of Sunbeam Corp. v. Morgan (In re Sunbeam Corp.)*, 284 B.R. 355, 371-72 (Bankr. S.D.N.Y. 2002) (finding that when the loan proceeds were used to refinance existing indebtedness, those transfers were not fraudulent even if viewed as a single, integrated transaction).

310 *See* text accompanying footnote 260 and Report § IV.B.7.b(1).

311 945 F.2d 635 (3d Cir. 1991).

312 *Id*. at 647. The court went on to state: "To quantify that value, however, is difficult. Quantification depends on the business opportunities the additional credit makes available to the borrowing corporation and on other imponderables in the operation or expansion of its business." *Id.* at 645. *Accord Mellon Bank, N.A. v. Off. Comm. of Unsecured Creditors of R.M.L. (In re R.M.L., Inc.)*, 92 F.3d 139, 149 (3d Cir. 1996).

313 The Third Circuit Court of Appeals therefore has implicitly rejected the approach suggested in *Rubin v. Manufacturers Hanover Trust Co.*, 661 F.2d 979, 994 (2d Cir. 1981), that a determination whether a party imparted any value to the debtor is measured at the time each borrowing occurs. However, the Third Circuit does require that the amount of the value conferred be quantifiable. *See R.M.L.,* 92 F.3d at 149 (citing *Metro Commcn's*, 945 F.2d at 646). Contrary to the contention of one Party, the Examiner does not find Bankruptcy Code section 548(d)(2)(A), which says that value does "not include an unperformed promise to furnish support to the debtor or to a relative of the debtor," relevant to this question. 11 U.S.C. § 548(d)(2)(A) (2006). That Tribune did not borrow the funds at the closing of the Leveraged ESOP Transactions does not mean that the Credit Agreement lenders made an "unperformed promise." The closing of Step One and the creation of availability under the Credit Agreement constituted a performed promise.

consider the Tribune Entities' actual use of such funds in the months following the Leveraged ESOP Transactions to make that determination. The Parties did not devote attention to the question of which of the Tribune Entities derived value from the borrowing under the Working Capital Facility shortly before the Petition Date. Because the Examiner was required to address this question in developing the Recovery Scenarios, the Examiner prorated this value among Tribune and the Guarantor Subsidiaries based on the ascribed value of these entities at the time of the borrowing on the assumption that these funds were available to fund the Tribune Entities' operations under the centralized cash management system. Regarding the Delayed Draw Facility, however, because only Tribune was liable on the Senior Notes, only Tribune received value from this borrowing to pay this valid antecedent debt of Tribune.

Turning to the LBO Fees, substantial amounts were paid at the closing of Step One and Step Two as LBO Fees from the proceeds of advances at Step One under the Credit Agreement and from proceeds of advances at Step Two under the Credit Agreement and Bridge Facility. At each of the closings of Step One and Step Two, Tribune also paid fees to various law firms, accountants, rating agencies, and other service providers. Although one Party painted with a broad brush and suggested that any and all fees paid in connection with these transactions should be recovered as constructive fraudulent transfers (without identifying the recipients by name), the Parties principally focused their advocacy on the LBO Fees and the Advisor Fees (the latter of which are discussed in the next Section of the Report). As a result, and because of the limited time available to conduct the Investigation, the Examiner focused solely on the LBO Fees and the Advisor Fees, which comprise the largest amounts paid. Analysis of the other fees would require further order of the Bankruptcy Court to enable the Examiner to supplement the Investigation and the Report.

To the extent the Tribune Entities received less than reasonably equivalent value in incurring obligations to the Lead Banks to pay the LBO Fees, so the Tribune Entities received less than reasonably equivalent value for paying those fees.[314] The former relates to the obligation incurred to the LBO Lenders to pay those fees, the latter to the payments actually made to the Lead Banks on account of LBO Fees. Because the Examiner previously has found that the transactions within Step One and Step Two should be collapsed for purposes of evaluating reasonably equivalent value, *all* of the uses of funds advanced by the LBO Lenders and paid out contemporaneously with the closings must be scrutinized, not just the payments that went to the Selling Stockholders.[315] There is no dispute that the LBO Lenders that funded these loans knew where the money was going when it was borrowed and paid out to pay LBO Fees. To the extent those payments conferred no or inadequate value to the Tribune Entities and the other prerequisites to avoidance are met, the payment obligations incurred to the LBO Lenders should be avoidable. Likewise, payments made to satisfy these avoidable obligations should be avoidable and payments be recoverable from the Lead Bank transferees.

Under applicable Third Circuit authority governing the determination of reasonably equivalent value, the first question is whether the LBO Lenders conferred any value on the Tribune Entities on account of the advances for these purposes.[316] As discussed in the Report, Tribune and the Guarantor Subsidiaries received some quantifiable value from the advances under the Credit Agreement and the Bridge Facility. Because Tribune and the Guarantor

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[314] *See United States v. Tabor Court Realty Corp.*, 803 F.2d 1288, 1301 (3d Cir. 1986).

[315] *See, e.g.*, *Tabor Court Realty Corp.*, 803 F.2d at 1301 (affirming the lower court's ruling that "the aggregate transaction was fraudulent, notwithstanding the fact that a portion of the loan proceeds was allegedly used to pay existing creditors"). The dissent took issue with this approach and would have held that the plaintiffs could not avoid the transfer of funds to repay creditors, *id.* at 1307-08 (Higginbotham, J., dissenting), but the majority disagreed. *Id.* at 1300-01.

[316] *R.M.L.,* 92 F.3d at 149.

Subsidiaries incurred the same obligation in respect of those portions of the advances under the Credit Agreement and Bridge Facility that conferred value to the Tribune Entities and those that did not, it follows that the LBO Lenders furnished *some* value to the Tribune Entities on account of these obligations.

The next question is whether Tribune or the Guarantor Subsidiaries received reasonably equivalent value in exchange for the obligations incurred to the LBO Lenders to pay the LBO Fees. The "totality of circumstances" approach adopted by the Third Circuit Court of Appeals for purposes of analyzing reasonably equivalent value requires consideration of (i) the fair market value of the benefit received as a result of the transfer, (ii) the existence of an arm's length relationship between the debtor and transferee, and (iii) the transferee's good faith.[317] Significantly, in *R.M.L.*, the Third Circuit Court of Appeal addressed the value conferred in connection with a lender commitment fee. The court rejected the contention that the inquiry begins and ends with a finding that the transferee charged a "market rate" for the value conferred: [318]

> Mellon Bank insists that the court's findings that: (1) the fees Intershoe paid were in line with market rates; (2) Mellon Bank acted in good faith; and (3) for the most part, the parties dealt at arm's length, render clearly erroneous its conclusion that Intershoe did not receive value that was "reasonably equivalent." We disagree. As our discussion of "value" should have made clear, . . . while the chance of receiving an economic benefit is sufficient to constitute "value," the size of the chance is directly correlated with the amount of "value" conferred. *Thus, essential to a proper application of the totality of the circumstances test in this case is a comparison between the value that was conferred and fees Intershoe paid.*

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317 *Pension Transfer Corp. v. Beneficiaries Under the Third Amend. to Fruehauf Trailer Corp. Ret. Plan 003* (*In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 213 (3d Cir. 2006); *Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 646 (3d Cir. 1991); *R.M.L.*, 92 F.3d at 153.

318 *R.M.L.*, 92 F.3d at 153-154; *see also Fruehauf*, 444 F.3d at 214 ("[I]ndirect economic benefits must be measured and then compared to the obligations that the bankrupt incurred.") (quoting *Metro Commc'ns*, 945 F.2d at 646).

As the court in *R.M.L.* mentioned, the Third Circuit has found that the "mere expectation" of conferring value may suffice "as long as the expectation was legitimate and reasonable."[319] The court cautioned in a subsequent case, however, that this rule "yields to common sense: in those cases where a court has sufficient evidence to conclude, based on a totality of the circumstances, that the benefits to the debtor are minimal and certainly not equivalent to the value of a substantial outlay of assets, the plaintiff need not prove the precise value of the benefit because such a calculation is unnecessary to the court's analysis."[320]

Case law at the circuit level does not provide specific guidance on how a court is to evaluate reasonably equivalent value in the context of obligations incurred to pay advisor or lender fees as part of a leveraged buyout transaction. Although the Third Circuit clearly requires that the court consider the actual value conferred by the transferee on the estate, it is uncertain what legal significance, if any, is attributed to the fact that the fees were incurred in connection with a leveraged buyout in which the debtor received less than reasonably equivalent value. In other words, are fees (and lender advances to pay those fees) that would be unassailable in an ordinary setting subject to avoidance and recovery when they are incurred as part of an otherwise constructively fraudulent leveraged buyout transaction?

The Examiner has not found any guidance in the reported case law any jurisdiction on the recovery of fees paid to a lender for making advances to the debtor in a leveraged buyout transaction. In the context of advisor fees paid in a leveraged buyout transaction, some lower courts in the Third Circuit have ruled in favor of advisors seeking to protect the payment of fees against recovery in these contexts absent a showing that (i) the performance was not worth what the advisor was paid (without reference to the value received by the debtor in the transaction) or

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319 *R.M.L.*, 92 F.3d at 152 (citing *Metro Commc'ns*, 945 F.2d at 647).

320 *Freuhauf*, 444 F.3d at 214.

(ii) the fees were outside the range of what is usual and customary.[321] The paradigmatic example to disregard the actually or constructively fraudulent context in which a third party renders a particular service arises when fees are charged by a party who unwittingly renders those services to a debtor engaged in an intentionally fraudulent scheme, such as, for example, a company that printed a prospectus for Bernie Madoff or his "company" BMSI.[322] The service rendered clearly conferred no *actual* benefit on the estate, but when the charges are commensurate with market and performed at arm's length, it is difficult to hold the transferee financially responsible for the underlying fraud. Based on the above-noted lower court decisions, lender and advisor fees (and obligations incurred in a leveraged buyout transaction to pay those fees) may be similarly insulated from recovery, even when they are made as part of a constructively fraudulent leveraged buyout transaction, as long as the fees are customary and bargained for at arm's length.[323]

The Examiner, however, does not believe that the lower court cases are consistent with the specific inquiry required under the Third Circuit's "totality of circumstances" test concerning

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321 *See Liquidation Trust of Hechinger Inv. Co. v. Fleet Retail Fin. Group (In re Hechinger Co.)*, 327 B.R. 537 (D. Del. 2005) ("Plaintiff has not come forward with any evidence to contradict this expert opinion, nor any evidence that Leonard Green did not perform its management duties or that such performance was not worth what Leonard Green was paid."), *aff'd*, 278 F. App'x 125 (3d Cir. 2008); *Brandt v. Trivest II, Inc. (In re Plassein Int'l Corp.)*, 405 B.R. at 412 (Bankr. D. Del. 2009), *aff'd*, 428 B.R. 64 (D. Del. 2010); *Off. Comm. of Unsecured Creditors of Sunbeam Corp. v. Morgan (In re Sunbeam Corp.)*, 284 B.R. 355, 372 (Bankr. S.D.N.Y. 2002). *But see Miller v. McCown De Leeuw & Co. (In re Brown Sch.)*, 386 B.R. 37, 58 (Bankr. D. Del. 2008). No Party presented evidence to the Examiner that the fees paid at Step One and Step Two to the Financial Advisors or LBO Lenders were outside the ordinary range for a transaction of this size or were not negotiated at arm's length.

322 *Balabar-Strauss v. Sixty-Five Brokers (In re Churchill Mortg. Inv. Corp.*), 256 B.R. 664, 680 (Bankr. S.D.N.Y. 2000) ("[T]he Brokers in these cases were hired and paid to produce mortgages or investors. They produced and thereby gave value, giving rise to a contractual obligation on the part of Churchill to pay the commissions here at issue. They earned what they were paid fairly and without wrongdoing. On this ground the Trustee's fraudulent conveyance claims to recover commissions from the Brokers must be dismissed as a matter of law."). *But see* footnotes 325 and 326.

323 405 B.R. at 412.

the fair market value of the *benefit received* in exchange for the transfer.[324] This inquiry strongly suggests that the court must evaluate the fees in the context in which they arise and the actual value the debtor receives from those services, not just whether those amounts were commensurate with market rates.[325] Here, a significant disparity existed between the value the Tribune Entities received in the Leveraged ESOP Transactions and the obligations incurred (with the clear majority of the consideration flowing from the LBO Lenders to Selling Stockholders in each of Step One and Step Two). The LBO Lenders (as well as the Financial Advisors) in the Leveraged ESOP Transactions, moreover, knew how the Leveraged ESOP Transactions were structured and where the money was going. They, therefore, stood in very different shoes than the purveyor of printing services to Madoff and BMSI. Faithful application of the totality of circumstances analysis should require some consideration of the actual value received by the Tribune Entities on account of the obligations incurred to pay the LBO Fees in the Leveraged ESOP Transactions.[326] Indeed, the majority of the LBO Lender advances were for purposes for which the Tribune Entities received no value for constructive fraudulent transfer purposes, let alone reasonably equivalent value. The fees representing compensation to the Lead Banks

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[324] *See, e.g., Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 646 (3d Cir. 1991).

[325] Certain case law outside the Third Circuit supports this view. *See Warfield v. Byron*, 436 F.3d 551, 560 (5th Cir. 2006) (affirming avoidance of the fees of a broker who helped provide financing to Ponzi scheme, even assuming the broker could satisfy the good faith standard and stating that "[w]e need not draw a conclusion on good faith, however, as his defense would still fail because he did not receive the transfers from RDI in exchange for reasonably equivalent value. Johnson relies on his broker services to RDI as reasonably equivalent value for the transfers he received"); *Lawrence v. Bonadio, Insero & Co. (In re Interco Sys.),* 202 B.R. 188, 194 (Bankr. W.D.N.Y. 1996) ("[I]f the facts and circumstances indicate that a payment of professional fees or other expenses by a corporation was for services or goods which solely benefitted a third party, whether it be a principal, officer or employee, and had no reasonable, good faith business judgment benefit to the corporation, that payment would be avoidable under section 548 because of a lack of reasonably equivalent value . . . .").

[326] *See Miller v. McCown De Leeuw & Co. (In re Brown Sch.)*, 386 B.R. 37, 58 (Bankr. D. Del. 2008); *Martino v. Edison Worldwide Capital (In re Randy)*, 189 B.R. 425, 441 (Bankr. N.D. Ill. 1995) ("[E]ven if a contract existed here, the services conferred no value and, in fact, enforcing a contract for selling efforts in a Ponzi scheme would only exacerbate the harm to creditors by increasing the amount of claims while diminishing the debtor's estate.") (citation and internal quotations omitted).

charged the Tribune Entities for making and arranging those advances cannot possibly be insulated from avoidance just because those fees allegedly were customary or commensurate with market rates.[327] To conclude otherwise would be to ignore the lack of reasonably equivalent value that the LBO Lenders actually conferred on the Tribune Entities on account of the underlying obligations incurred.

To determine the fair market value of the value of the benefit received from the LBO Lenders for advancing amounts to pay the LBO Fees, a court might prorate the obligations incurred to pay these amounts (and the payments themselves) based on the ratio of the reasonably equivalent value conferred on the Tribune Entities in the Leveraged ESOP Transactions to the total obligations incurred in transactions. Under this methodology applied to Step One and Tribune, for example—using rough numbers—the ratio of the reasonably equivalent value conferred on Tribune (for rounding purposes, $3 billion) to the aggregate Step One Debt incurred ($7 billion) would be multiplied by the actual obligations incurred in respect of the LBO Fees. The product would equal the value conferred by the LBO Lenders on account of advances to pay LBO Fees in Step One. Although one court adopted a proration approach to the question of recovery of interest payments on indebtedness in connection with a fraudulent transfer,[328] the Examiner, however, questions whether this approach is sensible when applied to

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327 *See generally Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 646 (3d Cir. 1991) ("The selling shareholders receive direct benefit in the LBO transaction as they are cashed out, usually at a price above the price the shares were trading shortly before the acquisition is announced. The new purchaser also benefits from the transaction by thereby achieving ownership of the corporation. The lender is attracted by the higher interest rates and *fees* usually associated with LBOs. The target corporation, however, receives no direct benefit to offset the greater risk of now operating as a highly leveraged corporation. As legal scholars have noted, the target firm may not at all reflect the Elizabethan deadbeat, but may in fact wind up as the sacrificial lamb.") (emphasis added).

328 *Pajaro Dunes Rental Agency v. Spitters (In re Pajaro Dunes Rental Agency)*, 174 B.R. 557, 599 (Bankr. N.D. Cal. 1994) ("Applying quantum meruit principles to the situation at bar, the Court holds that Spitters should return to PDRA the $19,742.42 that he was paid as interest on the portion of his note which was not exchanged for value. This amount will be added to the $458,104.45 in unsecured debt subordinated to the claims of all other unsecured creditors.").

the question of the fees at issue here (particularly advisor fees): It proceeds from the untested assumption that had Step One, for example, been a $3 billion transaction as opposed to a $7 billion transaction, the LBO Fees would have been proportionately lower on a dollar for dollar basis (as would the advisor fees).[329]

The Examiner believes that a more analytically sound approach would involve using precedent information from transactions comparable to the aggregate amount of benefit that Tribune and the Guarantor Subsidiaries derived from the Leveraged ESOP Transactions. In the course of the Investigation, however, the Examiner was unable to obtain relevant precedent information that he believes would provide meaningful guidance on this question. Rather than using limited and potentially misleading information on precedent transactions, for purposes of the Recovery Scenarios contained in Annex B to this Volume of the Report, the Examiner prorated the LBO Fees and Advisor Fees using the methodology described at the outset of this paragraph, recognizing that this is only a rough proxy for the amounts that a court might determine are appropriate under the circumstances.

Based on the lack of clarity in the law within the Third Circuit, it is not clear whether a court would adopt even the general analytical framework suggested by the Examiner. Moreover, questions of lender (and in the case of the payments received from those advances, Financial Advisor) good faith, discussed in another part of the Report,[330] undoubtedly would factor into a court's consideration of the totality of the circumstances concerning these questions. The most that the Examiner can conclude, assuming good faith *arguendo*, is that the LBO Lenders

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329 With respect to advisor fees, information adduced in the course of the investigation suggests that financial advisors generally price their fees in varying percentages based on the size of the transaction. Examiner's Interview of Michael Costa, June 4, 2010 (Merrill "had a fee scale depending on size of transaction and depending on whether representing the buyer or seller. . . .Second way is precedent transactions because fees are publicly disclosed; there was database, that we had access to where I could say okay, let me look at all advisor fees paid for recap between $1 billion and $3 billion, and I could use that to determine fees.").

330 *See* Report at § IV.B.7.b.

conferred some reasonably equivalent value on Tribune and the Guarantor Subsidiaries in respect of the LBO Fees in an amount less than the amount of the fees incurred.[331] How much less is unknown.

(5) Examiner's Conclusions and Explanation Concerning Payments Made on Account of Advisor Fees.

Examiner's Conclusions:

The law in the Third Circuit is sufficiently unclear on the standard for determining the question of the reasonably equivalent value of the payments made on the Advisor Fees such that the Examiner is unable to assess how a court is likely to rule on these payments. The Examiner leaves this question in equipoise.

Explanation of Examiner's Conclusions:

Morgan Stanley received its LBO Advisor Fees on May 9, 2007, after delivering its fairness opinion to the Tribune Board and Special Committee on April 1, 2007. Tribune, therefore, paid this fee before the Step One Financing Closing Date, not from advances under the Credit Agreement and before Tribune incurred the Step One Debt. Because these fees were paid when Tribune clearly was solvent, these fees should not be subject to avoidance and recovery. In contrast, MLPFS and CGMI received their Advisor Fees in January 2008, shortly after the Step

[331] Another question is which estate holds the right to seek to recover these transfers. The Examiner believes that to the extent these payments were made from the proceeds of advances on LBO Lender Debt at the Step One Financing Closing Date or the Step Two Financing Closing Date, it is somewhat likely that a court would treat Tribune and the Guarantor Subsidiaries as co-transferors in proportion to the relative value of those entities, such that defenses under Bankruptcy Code section 548(c) would be allocated similarly. Although a court could treat the entity from whose accounts funds were remitted to pay these fees (in this instance Tribune) as the transferor, in light of the integrated nature of the transactions effectuated within Step One and Step Two, and consistent with principles underlying collapse, the Examiner believes a court is more likely to treat both Tribune and the Guarantor Subsidiaries as having transferred these funds at the closings to effectuate these payments, just as Tribune's and the Guarantor Subsidiaries' jointly and severally and all as primary obligors incurred the LBO Lender Debt that made these payments possible. To the extent, however, that Tribune contributed funds from its own concentration accounts to pay these amounts, the Tribune estate would have the exclusive standing to recover those transfers.

Two Financing Closing Date. Those payments may be subject to avoidance and recovery by the Tribune estate (which made these payments) depending on the application of the considerations discussed in this Section. Applying the factors discussed previously as the analysis contained in the Report demonstrates, Tribune received some value in connection with Step One and Step Two. MLPFS and CGMI therefore conferred some value on those entities in rendering services relating to the Leveraged ESOP Transactions. To determine how much value these advisors imparted under the "totality of circumstances," the Examiner has examined the three relevant additional factors:

(1) Arm's length. There is no evidence to suggest that the MLPFS and CGMI interacted with the Tribune Entities on any basis other than arm's length.

(2) Good faith. Questions concerning the good faith of MLPFS and CGMI are addressed elsewhere in the Report.[332]

(3) Fair Market Value. This is a key issue, not because the fees charged by MLPFS and CGMI are objectively unreasonable, but because there is a significant issue regarding the quantification of the value received by Tribune as the result of the Leveraged ESOP Transactions. The fact that third parties, including the Selling Stockholders, were benefited by the Leveraged ESOP Transactions does not render the payments made to MLPFS and CGMI voidable, but such benefits are not properly considered in determining whether the Tribune Entities received fair value.[333] Additionally, the fees paid may be subject to avoidance and recovery (again subject to questions of good faith), if the Leveraged ESOP Transactions are

[332] *See* Report at § IV.B.7.b.

[333] *Pummill v. Greensfelder, Hemker & Gale, P.C. (In re Richards & Conover Steel, Co.)*, 267 B.R. 602, 612-14 (B.A.P. 8th Cir. 2001), *cited with approval*, *Pension Transfer Corp. v. Beneficiaries Under the Third Amend. to Fruehauf Trailer Corp. Ret. Plan 003 (In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 213 (3d Cir. 2006).

avoided in whole or in part.[334] Assuming, however, that the fees are not automatically validated because they are consistent with market standards and a fair compensation for the effort of MLPFS and CGMI, or automatically avoided because the Leveraged ESOP Transactions are avoided, the Examiner has suggested a general approach to making a determination of the value conferred by the Leveraged ESOP Transactions.[335] The Examiner recognizes, however, that a court may well choose to apply a different method of determining the fair market value of the benefit received by Tribune.

A final question arises whether the payments of the Advisor Fees to MLPFS and CGMI were "for value" for purposes of Bankruptcy Code section 548(d)(2)(A),[336] because the payments satisfied "antecedent debt" of the Tribune Entities, specifically the contractual obligations that Tribune undertook in 2006 when Tribune employed these firms. If such a defense succeeded—and if the contracts themselves could not be avoided—then any avoidance claims against MLPFS and CGMI would be determined independently from any determination of the value conferred on Tribune by the Leveraged ESOP Transactions. The Examiner finds that it is reasonably unlikely that a defense premised on satisfaction of an antecedent debt would succeed because until and unless Step Two closed, Tribune owed no debt and MLPFS and CGMI held no claim (even a contingent claim). Specifically, there is no argument, and could be none, that had

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[334] *See, e.g., Liquidation Trust of Hechinger Inv. Co. . v. Fleet Retail Fin. Group (In re Hechinger Inv. Co.)*, 327 B.R. 537 (D. Del. 2005), *aff'd*, 278 F. App'x 125 (3d Cir. 2008). *Hechinger* has been cited by certain Parties. The District Court there rejected an attempt to avoid advisory fees—emphasizing the importance of "industry standards" and its determination that the advisor expended a "significant amount of effort" —but based its holding at least in part of the fact that "[b]ecause the court finds the Transaction was not avoidable, the fees paid to Chase are also not avoidable." 327 B.R. at 553 n.24. Although there is no suggestion that the converse would be true, *i.e.*, if the transaction were avoidable, so are the fees, that is certainly a permissive inference.

[335] *See* Report at §§ IV.B.7.b.(6). to IV.B.7.b.(7).

[336] 11 U.S.C. § 548(d)(2)(A) (1996).

the Step Two Closing not occurred, Tribune would have owed any fee to MLPFS and CGMI.[337] As such, there was no antecedent debt at the time of the payment of the fees in January 2008. Likewise, the Examiner does not believe that a court is likely to find that MLPFS and CGMI hold a defense based on the fact that Tribune paid these firms a month after the Step Two Financing Closing Date; these fees clearly were paid as part of the Leveraged ESOP Transactions and, unlike the fee paid to Morgan Stanley, were paid after Tribune incurred the LBO Lender Debt and rendered insolvent.

(6) Examiner's Conclusions and Explanation Concerning Tax Savings, 401(k), and Private Company Status.

Examiner's Conclusions:

A court is reasonably likely to conclude that, at Step Two, the Tribune Entities received some reasonably equivalent value based on the tax savings made possible from the S-Corporation/ESOP structure and avoidance of annual 401(k) plan contributions. It is highly likely that a court would prorate the value derived from tax and annual 401(k) savings among the Tribune Entities based on the relative value of such entities. Although the question of how this value might be allocated between the Credit Agreement Debt and the Bridge Debt presents interesting and difficult questions, in view of the magnitude of the value conferred, the question appears to be somewhat academic. It is highly unlikely that a court would find that, at Step Two, Tribune and the Guarantor Subsidiaries received reasonably equivalent value on account of avoidance of their annual public financial statement reporting requirements.

[337] Examiner's Interview of Michael Costa, June 4, 2010; Examiner's Interview of Christina Mohr, June 29, 2010. *See In re Texaco Inc.*, 254 B.R. 536, 560 (Bankr. S.D.N.Y. 2000) ("A legal obligation that does not arise under state law until the 1990's or beyond cannot be mystically converted into a 'contingent' or 'unmatured' 'claim' as of March 23, 1988 because as of that date no 'right to payment' of any kind exists, and there is no 'liability' and no 'debt' that 'arose before' that date."). *See generally* Report at § IV.B.5.d.(6).(i).

Explanation of Examiner's Conclusions:

In applying Bankruptcy Code section 548, the Third Circuit Court of Appeals has recognized that a leveraged buyout or other complex corporate transaction may give rise to indirect benefits to the debtor that must be included in the calculation of reasonably equivalent value.[338] As noted previously, however, to constitute reasonably equivalent value the benefit must be quantifiable.[339] Moreover, value is to be determined from the perspective of creditors: "Consideration having no utility from a creditor's viewpoint does not satisfy the statutory definition."[340] As Judge Carey noted: "Because 'the purpose of fraudulent conveyance law is to protect creditors, the determination of value is looked at from the vantage point of the debtor's creditors. Thus, the inquiry focuses on what did the debtor give up and what did it receive that could benefit creditors.'"[341]

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338 *Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 648 (3d Cir. 1999) ("Because Metro did not receive the proceeds of the acquisition loan, it did not receive any direct benefits from extending the guaranty and security interest collateralizing that guaranty. However, in evaluating whether reasonably equivalent value has been given the debtor under section 548, indirect benefits may also be evaluated. If the consideration Metro received from the transaction, even though indirect, approximates the value it gave TCI, this can satisfy the terms of the statute."); *see also Mellon Bank, N.A. v. Off. Comm. of Unsecured Creditors of R.M.L., Inc. (In re R.M.L., Inc.)*, 92 F.3d 139, 149-50 (3d Cir. 1996); *Rubin v. Mfrs. Hanover Trust Co.*, 661 F.2d 979, 993 (2d Cir. 1981); *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 937 (S.D.N.Y. 1995); *Jumer's Castle Lodge, Inc. v. Jumer (In re Jumer's Castle Lodge, Inc.)*, 338 B.R. 344, 354-55 (C.D. Ill. 2006). Although these cases arise in the context of the determination of reasonably equivalent value under Bankruptcy Code section 548(a)(1), the analysis would apply with equal force to a defense asserted under section 548(c). *See, e.g.*, *Satriale v. Key Bank USA, N.A. (In re Burry)*, 309 B.R. 130, 135 (Bankr. E.D. Pa. 2004).

339 *Pension Transfer Corp. v. Beneficiaries Under the Third Amend. To Fruehauf Trailer Corp. Ret. Plan 003 (In re Fruehauf Trailer Corp.)*, 444 F.3d 203, 213 (3d Cir. 2006).

340 *Williams v. Marla (In re Marla)*, 252 B.R. 743, 759-61 (B.A.P. 8th Cir. 2000) (citing 7A Uniform Laws Annotated, Uniform Fraudulent Transfer Act § 3, Comment (1999)), *aff'd*, 267 F.3d 749 (8th Cir. 2001); *see also Jacoway v. Anderson (In re Ozark Rest. Equip. Co.)*, 850 F.2d 342, 344-45 (8th Cir. 1988) ("The concept of reasonably equivalent value is a means of determining if the debtor received a fair exchange in the market place for the goods transferred.").

341 *See Fid. Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 286 (Bankr. E.D. Pa. 2006) (citations omitted). *Accord Jimmy Swaggert Ministries v. Hayes (In re Hannover Corp.)*, 310 F.3d 796, 802 (5th Cir. 2002); *R.M.L.,* 92 F.3d 139, 150 (3d Cir. 1996); *Mellon Bank,* 945 F.2d at 646 ("The purpose of the [fraudulent transfer law in Bankruptcy Code § 548] is estate preservation; thus, the question whether the debtor received reasonable value must be determined from the standpoint of the creditors."); *Boyer v. Crown Stock Distrib., Inc. (In re Crown Unlimited Mach., Inc.)*, 2006 Bankr. LEXIS 4651, at *19-20 (Bankr. N.D. Ind. Oct. 13, 2006) ("Furthermore, since fraudulent conveyance laws are intended to protect a debtor's creditors, the

Case law outside of the Third Circuit is mixed on the question whether tax savings may qualify as an indirect benefit.[342] Statements from other cases suggest that "indirect benefits may include the synergistic effects of new corporate relationships."[343] Although the Third Circuit has not addressed whether tax benefits can constitute value, the law in the Third Circuit does not support the contention advocated by certain Parties that any such value, even if quantifiable, cannot constitute value "given by" the LBO Lenders within the meaning of Bankruptcy Code section 548(c) or value exchanged by those entities within the meaning of section 548(a)(1).[344] By definition, an "indirect benefit" is conferred *indirectly* by the transferee.

Under Third Circuit law, moreover, the dispositive question is how (and how much) the alleged indirect benefits would translate into something having actual value from a creditor's viewpoint. At a superficial level, a creditor cannot levy on or sell a tax or pension savings derived by a debtor in its operations; hence, tax benefits and avoidance of pension costs arguably do not constitute value from the perspective of creditors. However, to the extent the Tribune Entities would reduce their tax bills[345] and avoid incurring 401(k) costs, those savings would

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transaction is to be evaluated from their perspective, not that of the defendant/transferee."); *Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.)*, 100 B.R. 127, 136 (Bankr. D. Mass. 1989) (evaluating "reasonably equivalent value" as used in Bankruptcy Code § 548(a)(2)(A), and making two inquiries: first, whether the debtor, not some third party, received the required value; and second, "unlike the doctrine of consideration in contract law, that value must pass a measurement test").

342 *MFS/Sun Life*, 910 F. Supp. at 937-38 (noting that "[t]he tax benefits that a target receives as a consequence of an LBO also constitute an indirect benefit," but finding in that case that "[i]t would be sheer speculation to assume that the tax benefits and economic value of the loan could be reasonably equivalent to the $26.8 million shortfall in consideration"); *see also Kipperman v. Onex Corp.*, 411 B.R. 805, 838 (N.D. Ga. 2009) (stating that in analyzing an LBO, "courts must look beyond the actual money received to the indirect benefits to the debtor. Such benefits may include synergistic effects of new corporate relationships . . . tax benefits, [and] additional access to credit to facilitate new business opportunities ") (citations omitted). *But see Soule v. Allot (In re Tiger Petroleum Co.)*, 319 B.R. 225, 239 (Bankr. N.D. Okla. 2004) (finding that tax benefits resulting from a transaction are "granted by the tax laws and the taxing authorities" and not by the parties to the transaction).

343 *MFS/Sun Life*, 910 F. Supp. at 937; *see also Mellon Bank,* 945 F.2d at 647.

344 *See MFS/Sun Life*, 910 F. Supp. at 937; *see also Mellon Bank,* 945 F.2d at 646.

345 The Examiner found no evidence that the Tribune Entities were parties to a written tax sharing agreement. Because Tribune would be the taxpayer for federal income tax purposes, an argument could be made that any benefit from the tax savings inured solely to Tribune's benefit. However, to the extent the tax savings actually

inure to the benefit of the creditors by leaving more money on the table to satisfy their claims. Although no specific case has been found to support this conclusion, the Examiner finds that, consistent with the principles articled by the Third Circuit Court of Appeals on the question of indirect benefits, the tax savings made possible from the S-Corporation/ESOP structure and the avoidance of annual 401(k) plan contributions may qualify as value at Step Two to the extent it can be shown that these savings would benefit creditors by enhancing the value of a Tribune Entity.

The Examiner's financial advisor quantified the value of these benefits. The S-Corporation/ESOP tax benefits arise from the S-Corporation's attribute of "passing-through" corporate earnings directly and proportionally to the stockholders, combined with the fact that the ESOP does not pay taxes on the income it earns through the S-Corporation.[346] These circumstances occurred on the Merger at Step Two. The value of the tax avoidance benefit from the S-Corporation/ESOP structure may be estimated by determining the taxes that would have been paid by Tribune absent this structure, if Tribune remained a going concern. Even an insolvent company can continue to operate. Because the benefit of the structure is equal to the taxes avoided, all the factors that typically bear on the determination of tax liability are relevant to the determination of the value of the tax avoidance benefit. Of primary importance is Tribune's projected taxable income, including the projected income from Tribune's operations, the periodic interest expense associated with Tribune's capital structure, and the depreciation and tax deductible amortization that may be reasonably recognized for purposes of determining

resulted in more value remaining within the Tribune Entities for operating purposes and otherwise, it is appropriate to allocate the value attributable to these benefits among those entities proportionate to the value of the benefits conferred. The Examiner notes that this a general proposition, as a specific Debtor-entity that generated no income tax and had a high tax basis would not enjoy any benefit from these savings.

346 DAVID ACKERMAN AND SUSAN E. GOULD, *S Corporation ESOP Valuation Issues* in THE HANDBOOK OF BUSINESS VALUATION AND INTELLECTUAL PROPERTY ANALYSIS 141 (Robert F. Reilly and Robert P. Schweihs, eds., 2004).

taxable income. In addition, the treatment of certain income from Tribune's equity investments must be analyzed.[347]

Because the valuation involves income, as opposed to cash, the discount rate used to convert period benefits to present value is critical in determining the value of these benefits. Moreover, because EGI-TRB had the right to acquire a 40% ownership interest in Tribune through its exercise of the Warrant at any time after consummation of the Merger, an assumption regarding when, if ever, EGI-TRB would exercise the Warrant affects the value of the tax savings. This is because upon exercise of the Warrant, Tribune was required to sell to EGI-TRB a 40% interest in Tribune, which would reduce the tax avoidance benefit to Tribune from the ESOP ownership by a commensurate percentage. Finally, any tax benefit associated with Tribune's former capital structure or other situation-specific benefits that Tribune enjoyed before the Leveraged ESOP Transactions were consummated, but foregone as a result of the Step Two Closing, should be quantified and netted against the value of the S-Corporation/ESOP tax benefit.

Based on the projected EBITDA set forth in the DCF Valuation Analysis in Annex A to this Volume of the Report, the Examiner's financial advisor deducted net interest expense, as well as depreciation, and amortization, to determine taxable income.[348] In addition, VRC's corporate tax rate was applied in estimating the tax avoided by Tribune as a result of

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[347] For purposes of valuing the S-Corporation/ESOP structure, the Examiner's financial advisor included forecasted equity income only for Tribune's investment in TV Food Network given that: (i) forecasts of taxable income associated with Tribune's other equity investments contained in Tribune's October 2007 projections are deemed highly uncertain and, on a consolidated basis through 2006 and pro forma 2007, had not generated, collectively, any taxable equity income (excluding Comcast SportsNet), and (ii) Comcast SportsNet was anticipated to be sold. If this projected income stream were included, the value associated with the S-Corporation/ESOP structure tax savings would increase to $884.4 million, holding all else constant, although the Examiner's financial advisor believes it would be appropriate to apply a further discount to that value to account for the risk of achieving the taxable equity income associated with these investments, as forecasted by Tribune.

[348] Certain other Tribune-specific tax adjustments, as projected by Tribune, were accepted at face value as reasonable (*e.g.*, Section 199 adjustments).

consummating the Step Two Transactions. The Examiner's financial advisor also adopted VRC's estimation of the interval before EGI-TRB would be expected to exercise the Warrant (15 years) as a model parameter, although this is only an assumption.[349] The discount rate used to convert estimated avoided cash tax expense to present value is 16%, which is the rate applied by VRC in making its determination of the value of the S-Corporation/ESOP tax benefit.[350] For purposes of estimating the terminal value of the S-Corporation/ESOP tax avoidance benefit, the Examiner's financial advisor accepted the terminal growth rate of 1% that VRC estimated at 2022.

Based on this analysis, the Examiner's financial advisor determined that a reasonable value for the S-Corporation/ESOP tax avoidance benefit is $482.5 million. This value is highly sensitive to changes in critical input parameters including, for example, the discount rate applied to estimated period tax (for example, application of a higher estimated required rate of equity return would reduce the value of the benefit), and, as noted, the estimated interval before exercise of the Warrant. Thus, this is only an estimate.

With respect to the value of the benefit derived from avoidance of Tribune's 401(k) expenses, the Examiner's financial advisor used VRC's estimate of $60 million per year in savings (an estimate that the Examiner's financial advisor does not have any basis to affirm or

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349 If exercise of the Warrant is assumed to occur earlier, the value of the tax benefit to Tribune declines, in that Tribune would be entitled to only its proportional allocation of this benefit thereafter.

350 The Examiner's financial advisor believes that a 16% discount rate, which reflects a rate of return to equity (because the tax benefit determination is made based on the assumption that all debt holder periodic claims for interest are satisfied prior to, and in connection with, the determination of taxable income, and therefore before estimation of the cash flow benefits that result from the tax avoidance), is a very conservative estimation of the equity rate of return that may reasonably be applied in this circumstance. Selection of a 16% discount rate represents a conservative estimate due to the substantial amount of Tribune's post-Merger leverage. The Examiner notes that, during an exchange of questions and answers put to Tribune from the Lead Banks, the idea of discounting the S-Corporation/ESOP benefits using Mr. Zell's estimated expected rate of equity return of approximately 41% was discussed. *See* Ex. 1037 (Kapadia E-Mail, dated December 17, 2007); Ex. 1068 (Kapadia E-Mail, dated December 19, 2007). The Examiner's financial advisor believes that a persuasive case may be made to use such a discount rate if it can reasonably approximate Mr. Zell's (or an equity-based investor's) expected rate of equity return, since the determination of the value of the tax benefit is specific to Tribune and should be estimated with the implications of Tribune's actual post-Step Two capital structure in mind.

refute). The cost of the annual 401(k) contribution must be adjusted, however, for the related tax saving that Tribune previously enjoyed. Based on a 39% tax rate, the net cost of the avoided 401(k) expense is $36.6 million per year. The Examiner's financial advisor estimated the present value of this annual savings using a discount rate of 8%,[351] resulting in a present value benefit of $457.5 million.

Based on the preceding, the collective value of the S-Corporation/ESOP tax savings and the 401(k) savings is approximately $940.0 million. The value of these benefits, however, must then be netted against the benefits foregone by Tribune as a result of the Merger, namely certain cash tax saving attributes of the PHONES Notes that Tribune enjoyed prior to the closing of Step Two. The PHONES Notes tax benefits resulted from Tribune's ability to deduct interest expense for the purpose of determining taxes, but to defer the actual cash payment of a portion of the interest until the maturity of the PHONES Notes in 2029. On the maturity date of the PHONES Notes, the deferred portion of the interest obligation previously recognized for tax purposes would become due. The opportunity to defer cash interest payments until well into the future benefitted Tribune significantly. VRC calculated the structure and amount of this periodic benefit, as well as the final amounts due under the deferral strategy, in its valuation of the PHONES Notes tax deferral.[352] The Examiner's financial advisor adopted this analysis for this purpose. The discounted present value of this deferral of taxes has been estimated on the basis of the projected taxable income noted above, and the application of a discount rate of 10%[353]

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351 A discount rate of 8% is appropriate since the benefit of avoiding compensation expense is a benefit to the corporation as a whole. Therefore, pre-transaction, industry-based weighted average cost of capital is the proper rate to use to capitalize the annuity.

352 *See* Report at § III.H.3.

353 This rate is appropriate because the PHONES Notes benefit is determined after debtholders' return has been satisfied (post-interest cash tax savings). Therefore, the appropriate discount rate should reflect a pre-transaction, industry-based cost of equity.

(reflecting a cost of equity informing the weighted average cost of capital estimated by VRC). The present value of the PHONES Notes tax deferral asset, as quantified, is $371.9 million.

When the $482.5 million of S-Corporation/ESOP tax savings is added to the 401(k) savings of $457.5 million, and that sum is netted against the value of the PHONES Notes cash deferral benefit of $371.9 million that was foregone as a result of the Step Two Transactions, the net benefit to Tribune resulting from the S-Corporation/ESOP structure is approximately $568.1 million on a present value basis.

Disagreement existed among certain Parties concerning how this value would be allocated between the Credit Agreement Debt and the Bridge Debt. There is no question but that the value that was made available from these savings only occurred because Step Two happened. Approximately $2.1 billion was advanced under the Incremental Credit Agreement Facility and about $1.6 billion under the Bridge Credit Agreement at Step Two. Although it is also true that Step Two could not have occurred absent Step One (from the advances made under the Credit Agreement at Step One), the Credit Agreement lenders cannot have it both ways. It would be inequitable for the same Step One lenders who argued so vociferously against collapse of Step One and Step Two to be awarded credit for value that was generated solely at Step Two. Indeed, if the Credit Agreement lenders were to be rewarded for all the "good things" that happened at Step Two, equity would require that they take the bad with the good. Regardless of the equities, because value under Bankruptcy Code section 548(c) is the counterbalance to avoidance under section 548(a)(1), for reasons discussed in another part of the Report,[354] it is the value given *in connection with* the avoided obligation (in this instance the Step Two LBO Lender Debt) that is the object of a section 548(c) defense. Nevertheless, by operation of the Subordinated Bridge

[354] *See* text accompanying footnote 260 and Report at § IV.B.7.b.(1).

Subsidiary Guarantee, to the extent the Credit Agreement Debt is enforced at the Guarantor Subsidiary level and this value is allocated at that level, this value should be remitted to lenders under the Credit Agreement until payment in full of the Credit Agreement Debt (plus postpetition interest whether or not allowed in the Chapter 11 Cases) at the Guarantor Subsidiary level. To the extent this value is allocated at the Tribune level, it should be allocated between the $2.1 billion advanced under the Incremental Credit Agreement Facility at Step Two and the amounts advanced under the Bridge Agreement.

Finally, certain Parties also asserted that the Leveraged ESOP Transactions, which resulted in Tribune becoming a private company, permitted Tribune to avoid $20 million annually in public reporting costs (equal to a present value of $137 million, assuming a savings over a 10-year period). This argument does not withstand analysis. Although after the Merger, Tribune no longer had publicly traded stock, it continued to have publicly traded bonds, which subjected the Company to public reporting requirements.[355] Indeed, even after the Step Two Financing Closing Date, Tribune continued to file public reports at least until the Chapter 11 Cases were commenced.[356] Although Tribune conceivably could realize incremental savings by only having public bonds outstanding, no evidence was adduced to support that supposition.[357]

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[355] Trust Indenture Act of 1939 § 314(a), 15 U.S.C. § 77nnn (2006) .

[356] *See* Ex. 942 (Tribune 10-Q, dated November 10, 2008); Ex. 854 (Tribune 8-K, dated December 11, 2008).

[357] Although the April 2007 Confidential Information Memorandum refers to this potential savings, it supplies no data or breakdown of how assumed savings was determined. *See* Ex. 178 at 42-43 (April 2007 Confidential Information Memorandum).

(7) Examiner's Conclusions and Explanation Concerning Post-Step One and Step Two Payments on Account of the Credit Agreement and Bridge Credit Agreement.

Examiner's Conclusions:

A court is highly likely to conclude that, to the extent obligations incurred in the Leveraged ESOP Transactions lacked reasonably equivalent value, interest and principal payments made after those transactions but before the Petition Date on account of those obligations likewise were for less than reasonably equivalent value. It is unclear, however, how a court would rule on the question whether the Credit Agreement Agent or the Bridge Credit Agreement Agent is the initial transferee of the payments on account of the Credit Agreement Debt or Bridge Debt, respectively, for purposes of Bankruptcy Code section 550(a)(1).

Explanation of Examiner's Conclusions:

Although little case law addresses what is essentially a "fruit of the poisonous tree" analysis, there is no principled reason to treat the payments on account of obligations any differently from the underlying obligations for purposes of reasonably equivalent value. On the contrary, if an obligation is avoided as fraudulent transfer, then interest and principal payments made on account of that obligation do not satisfy any valid debt and such payments are not for reasonably equivalent value. Therefore, the payments can generally be avoided themselves as fraudulent transfers. What little case law exists is in accord.[358] It would be necessary, however,

[358] *See Kingsley v. Wetzel (In re Kingsley)*, 518 F.3d 874, 877 (11th Cir. 2008) (stating that section 550(a) is intended to "restore the estate to the financial condition it would have enjoyed if the transfer had not occurred"); *Off. Comm. of Asbestos Claimants of G-I Holdings, Inc. v. Bldg. Materials Corp. (In re G-I Holdings Inc.)*, 338 B.R. 232, 250 (Bankr. D.N.J. 2006) (same) (citations omitted); *Hirsch v. Gersten (In re Centennial Textiles)*, 220 B.R. 165, 176 (Bankr. S.D.N.Y. 1998) (same).

for a court to prorate the portion of the payment attributable to the underlying indebtedness for which Tribune received reasonably equivalent value.[359]

As a separate matter, certain Parties argued that the Credit Agreement Agent is the initial transferee of the post-Leveraged ESOP Transaction payments within the meaning of Bankruptcy Code section 550(a)(1), such that these payments may be recovered from that entity separate and apart from any potential recovery that could be obtained against the Credit Agreement lenders as immediate transferees under section 550(a)(2). Certain other Parties asserted the contrary view that the Credit Agreement Agent is not an initial transferee but rather just a stakeholder for the movement of funds from Tribune to the lenders.[360] Resolution of the issue is potentially important because it is practically much easier to seek and obtain recovery from two parties than from dozens or hundreds of individual lenders. If, however, the Credit Agreement Agent was not a transferee of such payments, then the lenders would be the initial transferees.[361] Because the Parties devoted their attention principally to the question whether the Credit Agreement Agent is the initial transferee, this Section of the Report focuses principally on that question.

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359 *See generally Pajaro Dunes Rental Agency v. Spitters (In re Pajaro Dunes Rental Agency)*, 174 B.R. 577, 599 (Bankr. N.D. Cal. 1994) (applying *quantum meruit* principles). Records reviewed by the Examiner's professionals indicate that all such payments came from Tribune concentration accounts. Thus, Tribune was the transferor for purposes of these payments. In theory, to the extent cash was swept from a Guarantor Subsidiary to these concentration accounts, such Guarantor Subsidiary should hold a corresponding intercompany claim against Tribune, which intercompany claim would be given effect in connection with the relevant Recovery Scenarios. Because, as discussed later in the Report, *see* Report at § IV.B.8.d., the Parties did not challenge the Debtors' analysis of the effect of intercompany claims in the Recovery Scenarios, the Examiner did not independently investigate this matter.

360 *See Abele v. Modern Fin. Plans Servs., Inc. (In re Cohen)*, 300 F.3d 1097, 1106-07 (9th Cir. 2002) (finding debtor's husband was not an initial transferee of a cashier's check made payable to a creditor where the husband had possession of the check but could not legally negotiate the check); *Mallory v. Citizens Bank (In re First Sec. Mortg. Co.)*, 33 F.3d 42, 44 (10th Cir. 1994) (finding bank was not an initial transferee when it received money for deposit); *Bonded Fin. Servs., Inc., v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988) (finding bank was not an initial transferee where transferor sent bank a check payable to bank's order with note directing bank to deposit check into account of a third party transferor).

361 *See Christy v. Alexander & Alexander Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*, 130 F.3d 52, 56 (2d Cir. 1997) ("Numerous courts have recognized the distinction between the initial recipient – that is, the first entity to touch the disputed funds – and the initial transferee under section 550."); *Mervyn's LLC v. Lubert-Adler Group IV, LLC (In re Mervyn's Holdings, LLC)*, 426 B.R. 96, 103 (Bankr. D. Del. 2010).

However, as noted at the end of this Section, because the relevant provisions of the Credit Agreement and Bridge Credit Agreement are substantially the same, so is the legal analysis and conclusion.

Bankruptcy law has long recognized that a party who receives money or property for the delivery to another should not be considered the transferee for avoidance purposes.[362] When the transfer in question involves the payment of money, an entity that has no ability "to put the money to [its] own purpose" is not an initial transferee.[363] In *Bonded Financial Services v. European American Bank*, [364] the Seventh Circuit Court of Appeals held that, unless the recipient of money or property has "dominion and control" over such property, the recipient is not a transferee. In that case, a currency exchange gave $200,000 to its principal, Michael Ryan, by sending the bank a check with a note to deposit the check into Ryan's account.[365] The Seventh Circuit affirmed the lower court's holding that the bank was not the initial transferee because it only acted as a financial intermediary: [366]

> [T]he minimum requirement of status as a "transferee" is dominion over the money or other asset, the right to put the money to one's own purposes. When A gives a check to B as agent for C, then C is the "initial transferee;" the agent may be disregarded.

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362 *See, e.g.*, *Carson v. Fed. Reserve Bank*, 172 N.E. 475, 482 (N.Y. 1930) ("The person to be charged with liability, if he has parted before the bankruptcy with title and possession, must have been more than a mere custodian, an intermediary or conduit between the bankrupt and the creditor. Directly or indirectly he must have had a beneficial interest in the preference to be avoided, the thing to be reclaimed.").

363 *See Off. Comm. of Unsecured Creditors v. Guardian Ins. 401 (In re Parcel Consultants, Inc.)*, 287 B.R. 41, 46-47 (Bankr. D.N.J. 2002) (holding administrator of debtor's 401(k) program was not an "initial transferee" when the administrator was "bound by the contract terms" and "distributed the funds in accordance with the contract"). *Accord Bonded Fin. Servs.*, 838 F.2d at 893 ("[T]he minimum requirement of status as a 'transferee' is dominion over the money or other asset, the right to put the money to one's own purposes."); *see also Gredd v. Bear, Stearns Sec. Corp. (In re Manhattan Inv. Fund)*, 359 B.R. 510, 519-20 (Bankr. S.D.N.Y. 2007) (citing courts adopting the *Bonded Financial* test); *Burch v. Stylish Move Sportswear Inc. (In re Factory 2-U Stores, Inc.)*, 2007 Bankr. LEXIS 3140, at *9-10 (Bankr. D. Del. Sept. 11, 2007) (Carey, J.) ("Bankruptcy courts in this district have relied upon the *Bonded Financial* test.") (citations omitted); *Argus Mgmt. Group v. GAB Robins, Inc. (In re CVOE Corp.)*, 327 B.R. 210, 216, 233 (Bankr. D. Del. 2005) (citing *Bonded Financial*).

364 *Bonded Fin. Servs.*, 838 F.2d at 893.

365 *Id.* at 891.

366 *Id.* at 893.

The court elaborated that "an entity does not have legal dominion over the money until it is free to invest that money in lottery tickets or uranium stocks."[367] Examples of entities exercising no dominion over funds may include depository banks, escrow and title companies, and attorneys holding funds in trust in connection with settlements.[368] In contrast, a circumstance warranting a finding that an entity is a transferee arises when that entity has "'dominion over the money or other asset [and] the right to put the money to [its] own purposes.'"[369]

This test announced by the Seventh Circuit Court of Appeals has been widely-adopted, but sometimes altered. In *Christy v. Alexander & Alexander Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey)*,[370] the Second Circuit Court of Appeals, in approving and applying the *Bonded* test, formulated what it called the "mere conduit test." The Second Circuit held that an insurance broker that received policy premiums from the law firm and, within several days, issued checks in the same amounts to primary insurers and reinsurers was a "mere conduit" not an initial transferee, noting:[371]

> As Finley Kumble's agent—not American Home's—A&A had no discretion or authority to do anything else but transmit the money, which is just what it did. Moreover, it is uncontested that the transfer of premium funds is an ordinary and routine financial transaction for an agency in A&A's industry, and that the transfer itself was performed here by A&A in a regular and unexceptionable way. Despite the existence of a more complex relationship, there can be no question that at that point A&A was

[367] *Id.* at 894.

[368] *Leonard v. First Commercial Mortg. Co. (In re First Alliance, Inc.)*, 228 B.R. 225, 233 (Bankr. S.D.N.Y. 1983) ("Examples of them include banks, . . . real estate escrow and title companies, . . . securities or investment brokers, . . . and attorneys holding funds in trust in connection with settlements of disputes . . . .") (internal citations omitted).

[369] *Mervyn's LLC v. Lubert-Adler Group IV, LLC (In re Mervyn's Holdings, LLC)*, 426 B.R. 96, 103 (Bankr. D. Del 2010) (citing *Bonded Financial*, 838 F.2d at 893, and *Factory 2-U Stores*, 2007 Bankr. LEXIS 3140, at *9-10).

[370] *Christy v. Alexander & Alexander Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey),* 130 F.3d 52 (2d Cir. 1997). *Accord Wheeling Pittsburgh Steel v. Keystone Metals Trading (In re Wheeling Pittsburgh Steel)*, 360 B.R. 649, 652 (Bankr. N.D. Ohio 2006) ("All indications are that Keystone was simply acting as a payment conduit between Wheeling and its services providers, having no legal right to put the money it received from Wheeling to its own use.").

[371] *Finley*, 130 F.3d at 59 (citations omitted).

> acting only to channel the funds from the premium returns and Finley Kumble to American Home.

In contrast to the "dominion and control" analysis, which focuses on the entity's control over specified funds, the Second Circuit's formulation of the "mere conduit" test focuses on whether the entity serves as an intermediary between the transferor and a third party.[372] "'Parties that act as conduits and simply facilitate the transfer of funds or property from the debtor to a third party generally are not deemed initial transferees . . . .'"[373] Thus, the Second Circuit shifted the focus from control over the money on deposit to the alleged transferee's role in moving value from one party to another.

Examining the relevant provisions of the Credit Agreement governing Borrower payments to the Credit Agreement Agent, the Credit Agreement unsurprisingly provides that payments are applied in a very specific way so as to ensure that the lenders who advanced the funds receive interest and principal owing and the borrower appropriately receives credit against the obligations it owes. Specifically, the Credit Agreement provides for Tribune to repay advances and make prepayments to the Credit Agreement Agent, which receives the payments "for the account" of a particular Credit Agreement lender.[374] Although the phrase "for the account" is not defined, read in context this means that the payments are credited to the amounts owing to a particular lender.

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372 *See Bear, Stearns Secs. Corp. v. Gredd (In re Manhattan Inv. Fund Ltd.)*, 397 B.R. 1, 34 (S.D.N.Y. 2007) ("Rather than stating that a party is an initial transferee if it exercises 'dominion and control' over the funds, the Second Circuit's version of the test states that a party is *not* an initial transferee if it was a 'mere conduit' **of** the funds.") (emphasis added).

373 *Finley*, 130 F.3d at 58 n.3 (quoting *Hooker Atlanta Corp. v. Hocker (In re Hooker Inv., Inc.)*, 155 B.R. 332, 337 (Bankr. S.D.N.Y. 1993)).

374 Ex. 179 at §§ 2.05(a), 2.05(b), and 2.13(f) (Credit Agreement) (providing that each payment "shall be applied," "shall be allocated," or "shall be made" ratably based on the principal amount owing on a specific tranche of Credit Agreement Debt). The question concerning the Credit Agreement Agent's status as conduit or transferee would have been easy to answer if the Credit Agreement Agent were the sole holder of the Credit Agreement Debt and had participated its interests to third parties, but that is not how the document or the syndicated transaction was structured.

The Credit Agreement, however, falls short of requiring the Credit Agreement Agent to distribute the actual funds it receives to the Credit Agreement lenders. No escrow or specified account is established to hold those funds pending payment to the lenders. Rather, the Credit Agreement says that once the Credit Agreement Agent receives payments it "will promptly thereafter cause to be distributed *like* funds relating to the payment of principal or interest, fees or commissions fees [sic] ratably . . . to the Lenders . . . ."[375] The Credit Agreement further authorizes the Credit Agreement Agent to assume that Tribune has timely made payment, and based thereon, "to cause to be distributed to each lender on such due date *an amount equal to* the amount then due each Lender."[376] If this assumption proves wrong, the Credit Agreement lender must repay the Credit Agreement Agent the amount received plus interest "at the Federal Funds Rate" for each day until repayment is made.[377]

Thus, although the Credit Agreement specifies how payments are to be credited and what amounts the Credit Agreement Agent is required to remit to the Credit Agreement lenders following its receipt of those payments, the Credit Agreement does not limit the Credit Agreement Agent's rights with respect to the actual funds paid by Tribune.[378] Although the Credit Agreement Agent receives the funds in its capacity as agent of the lenders, the Credit

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375 *Id.* at § 2.13(a) (emphasis added).

376 *Id.* at § 2.13(f).

377 *Id.*

378 *Off. Comm. of Unsecured Creditors v. Guardian Ins. 401 (In re Parcel Consultants, Inc.)*, 287 B.R. 41, 46-47 (Bankr. D.N.J. 2002) ("GIAC could not exert dominion and control over the funds because it was bound by the contract terms, which granted control to the individual employees participating in the plan. Moreover, GIAC was not capable of using the funds for its own purposes. It was obligated to deposit the funds at the direction of the employee participants, and not at its own discretion."). *See also Mervyn's LLC v. Lubert-Adler Group IV, LLC (In re Mervyn's Holdings, LLC)*, 426 B.R. 96, 103 (Bankr. D. Del. 2010) ("[T]he Committee does not plead in the Second Amended Complaint how Bank of America acting as trustee had 'dominion and control' over the funds. Specifically, the Committee fails to plead how Bank of America has legal title to the Notional Rent funds as opposed to mere physical possession. Bank of America acted as a financial intermediary and trustee to the Trust. It received no benefit and under the law of contracts, Bank of America is bound by the terms of the Trust and is therefore no different from a courier or an intermediary on a wire transfer; it held the Notional Rent funds only for the purpose of fulfilling an instruction to make the funds available to a third party.").

Agreement imposes no limits on the Credit Agreement Agent's dominion over or use of the funds. Rather, the Credit Agreement only obligates the Credit Agreement Agent to pay an amount equal to (i.e., "like funds") the amount received to those lenders and authorizes the Credit Agreement Agent, in effect, to extend credit to those lenders premised on receipt of payment from Tribune.

The question, then, is whether the Credit Agreement Agent would be deemed a transferee when it was free to use the actual funds paid by Tribune as it saw fit, but was obligated to pay to the Credit Agreement lenders an amount equal to those funds. Application of *Bonded Financial* suggests that the Credit Agreement Agent has "dominion and control" over the actual amounts received from Tribune and therefore should be an initial transferee. Focusing on the actual funds, the Credit Agreement does not impose any restrictions on the Credit Agreement Agent's use of those funds. In theory and quite possibly in practice, once Tribune paid principal or interest to the Credit Agreement Agent, the Credit Agreement Agent was free to spend those amounts however it pleased. Its only duty was to pay a "like" amount to the lenders. Stated differently, suppose the Credit Agreement Agent became subject to a receivership proceeding the moment after the Credit Agreement Agent received payment from Tribune but before the Credit Agreement Agent paid a like amount to the lenders. In that posited scenario, there seems little doubt but that (i) as between the Credit Agreement Agent and the lenders, the former would be a debtor and the latter creditors and (ii) Tribune would not be obligated to pay the same amount twice if the lenders were unsuccessful in extracting payment from the Credit Agreement Agent in its receivership proceeding.

On the other hand, focusing on the role played by the Credit Agreement Agent under the "mere conduit" test articulated in *Finley Kumble*, the Credit Agreement plainly obligates the Credit Agreement Agent to pay over to the lenders the same amount it received from Tribune.

The Credit Agreement Agent serves as an intermediary between Tribune and the lenders, much as the insurance broker did between the law firm and the insurance companies in *Finley Kumble*. In *Finley Kumble*, it was apparent that the broker wrote checks to the insurance companies on its own account. Yet, as a "mere conduit" the broker was not deemed a transferee in connection with the movement of money. In short, if standard adopted in *Finley Kumble* applies, the Credit Agreement Agent is almost certainly not a transferee, except to the extent it receives funds for its own account.

Although cases from lower courts within the Third Circuit have tended to focus on whether the alleged transferee exercised control over the actual funds transferred,[379] those courts have not addressed a circumstance similar to the one presented here. Because the Third Circuit Court of Appeals has not spoken on this question and the lower court cases have provided insufficient guidance, the Examiner leaves this question in equipoise. Although this question certainly is important to the Credit Agreement Agent (albeit the agent holds rights of indemnity) and, as an administrative matter, to a prospective estate representative, its outcome should not affect the Tribune Entities' recovery. If the LBO Lenders are the initial transferees, the amounts received could be identified and most could be tracked down,[380] and as initial transferees they would be subject to the same liability the Credit Agreement Agent would face if it instead were

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379 *See Nelmark v. Helms*, 2003 U.S. Dist. LEXIS 3664, at *12 (N.D. Ill. March 12, 2003) ("Although the facts here and in *Bonded* and *In re Circuit Alliance, Inc.* are arguably alike in these respects, appellants ignore other parts of the record which were not at issue in the cited cases and would readily distinguish them, for example, that they were the debtor's daughters, thus insiders, and they commingled the debtor's funds with their own funds."); *Mervyn's Holdings*, 426 B.R. at 103; *Argus Mgmt. Group v. GAB Robins, Inc. (In re CVOE Corp.)*, 327 B.R. 210, 217 (Bankr. D. Del. 2005) ("The question of the Defendant's power over the account raises a genuine issue of material fact. There is conflicting evidence concerning the extent of the Defendant's control over those funds.").

380 The Credit Agreement Agent must maintain "a register for the recordation of the names and addresses of the Lenders and the Commitments of, and principal amount of the Advances owing to, each Lender from time to time." Ex. 179 at § 8.7(d) (Credit Agreement) (register includes "(iii) the amount of any principal or interest due and payable or to become due and payable from Borrower to each Lender hereunder and (iv) the amount of any sum received by the Agent for Borrower hereunder and each Lender's share thereof.").

the initial transferee. Proceeding against each individual transferee, however, obviously would increase the costs of seeking recovery.

Although the Parties focused principally on the Credit Agreement and the Credit Agreement Agent, the issue of the Bridge Credit Agent's status as transferee or conduit was also raised. As the Bridge Credit Agreement and Credit Agreement are structured similarly, the analysis presented above is no different.[381]

d. Framing the Solvency and Capital Adequacy Analysis.

Having analyzed questions concerning reasonably equivalent value, the Report turns next to questions concerning solvency, capital adequacy, and intention to pay debts as they come due.

Bankruptcy Code section 548(a) provides that the trustee or debtor in possession may avoid the transfer of an interest in property or any obligation incurred by the debtor made or incurred on or within 2 years of the petition date, if the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation" *and* at least one of three disjunctive "insolvency" conditions is satisfied, such that the debtor:

- was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
- was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; [or]
- intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured. . . .[382]

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381 *See* Ex. 175 at §§ 2.13(a), (e) (Bridge Credit Agreement).

382 11 U.S.C. § 548(a)(1)(B)(ii)(I)-(III) (2006). Bankruptcy Code section 548(a)(1)(B)(ii)(IV), which is not excerpted in the text above, addresses transfers under employment contracts outside the ordinary course of business. 11 U.S.C. § 548(a)(1)(B)(ii)(IV) (2006).

These alternative insolvency-related requirements and the issues they raise in respect of the Leveraged ESOP Transactions are addressed below.

(1) Examiner's Conclusions and Explanation Concerning the Relevant Dates for Step One and Step Two Solvency, Capital Adequacy, and Intention to Pay Debts as They Come Due Analysis.

Examiner's Conclusions:

A court is highly likely to conclude that the Step One Financing Closing Date and Step Two Financing Closing Date are the relevant dates for conducting the solvency and capital adequacy analyses of the Tribune Entities.

Explanation of Examiner's Conclusions:

The Examiner previously has concluded that the relevant provisions of Bankruptcy Code section 548 require that reasonably equivalent value and good faith are measured at the same time that obligations are incurred and value allegedly is delivered.[383] By parity of reasoning, Bankruptcy Code section 548(a)[384] strongly suggests that the Step One Financing Closing Date and Step Two Financing Closing Date are the correct dates to measure solvency and capital adequacy of the Tribune Entities because those are the dates on which the Tribune Entities incurred obligations and made transfers in the form of payments. Although Tribune executed numerous agreements and undertook certain obligations both on April 1, 2007, when the Tribune Board approved the Leveraged ESOP Transactions, and on May 17, 2007, when Tribune entered into the Credit Agreement, conditions to closing Step One remained outstanding nevertheless, on those dates. Had these conditions not ultimately been satisfied, the Tribune Entities would not

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383 *See* text accompanying footnote 260 and Report at § IV.B.7.b.(1).

384 11 U.S.C. § 548(a)(1) (2006) (The trustee may avoid any *transfer* . . . of an interest of the debtor in property, or any *obligation* . . . incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition . . . .") (emphasis added).

have incurred the obligations and made the transfers that subsequently occurred on the Step One Financing Closing Date and Step Two Financing Closing Date.[385] Moreover, had the Tribune Entities breached a contractual undertaking to proceed with Step One and/or Step Two, they might have been subject to breach of contract claims, but they would not have incurred the obligations under the Credit Agreement (and, later, the Bridge Credit Agreement) and made the transfers effectuated when Step One and Step Two closed. It is these obligations and transfers that certain Parties have challenged as fraudulent obligations and transfers.[386]

(2) Legal Standards Governing Solvency Analysis.

Under the Bankruptcy Code, an entity is "insolvent . . . [if] the sum of such entity's debts is greater than all of such entity's property, at a fair valuation."[387] This test is commonly referred

385 *See* Report at § IV.B.5.d.(6).(i).

386 *See VFB LLC v. Campbell Soup Co.*, 482 F.3d 624, 630 (3d Cir. 2007) ("In light of that conclusion, the court determined both that the spin was not a fraudulent transfer and that, because VFI had been solvent at the time of the spin, it owed no 'fiduciary duty to future creditors of VFI.'") (citation omitted); *McNellis v. Raymond*, 420 F.2d 51, 53 (2d Cir. 1970) ("He found that various essential elements of the trustee's fraudulent conveyance claim had been satisfied, e.g., Donald's insolvency *at the time of his payments to Raymond*.") (emphasis added); *Marshall v. Showalter*, 375 F.2d 529, 531-32 (10th Cir. 1967) ("The final issue to be resolved is whether the creditors must prove appellant's insolvency at the time of the transfer, or whether it is sufficient to prove that he was rendered insolvent by the transfer. A person is insolvent 'when the present fair salable value of his property is less than the amount required to pay his debts; * * * To come within the provisions of Section 67(d) (2) (a) the transfer is fraudulent if the debtor is insolvent at the time of the transfer, or if he is rendered insolvent as a result of the transfer. These are alternative provisions. They are unambiguous. The District Court correctly construed the law as not requiring a finding of insolvency at the date of the transfer. The facts and the law support the court's conclusion that appellant's transfer to his wife of all his right, title and interest in the promissory note of the face value of $285,000.00, was made without fair consideration, and that said transfer rendered appellant insolvent. The act of bankruptcy under [Bankruptcy Act] Section 3(a) (1) occurred upon the transfer within the meaning of [Bankruptcy Act] Section 67(d) (2) (a) on June 1, 1964, within one year prior to September 4, 1964, the date of the creditors' petition for involuntary bankruptcy of appellant.") (footnote omitted); *Knippen v. Grochocinski*, 2007 U.S. Dist. LEXIS 36790, at *14 (N.D. Ill. May 18, 2007) ("Insolvency is determined at the time of the allegedly fraudulent transfer.").

387 11 U.S.C. § 101(32)(A) (2006). The Bankruptcy Code definition of insolvency is similar to those in the UFCA or UFTA. *See* UFCA at § 2(1) ("A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured."); UFTA at § 2(a). *See Moody v. Sec. Pac. Bus. Credit*, 971 F.2d 1056, 1068 (3d Cir. 1992). Although the term "fair valuation" does not expressly connote a hypothetical disposition of the debtor's property, courts have interpreted this term to posit either a going concern or liquidation disposition depending on whether the debtor is operating. *See, e.g., Travellers Int'l, AG v. Trans World Airlines, Inc. (In re Trans World Airlines, Inc.)*, 134 F.3d 188, 193 (3d Cir. 1998) ("The cases generally direct us to look at 'market value' rather than 'distress value,' but then also caution that the valuation must be analyzed 'in a realistic framework'

to as a "balance sheet test"—although this label is in some respects a misnomer. The manner in which it is applied does not necessarily depend on the values set forth on the debtor's balance sheet.[388] More broadly, the test requires that "[t]he debtor's assets and liabilities are tallied at fair valuation to determine whether the corporation's debts exceed its assets."[389] This requirement generally is understood to mean that the debtor's assets should be valued on a going concern basis, unless the company's failure was clearly imminent.[390] Unlike the "unreasonably small capital" test, discussed *infra*, the balance sheet test looks to the debtor's solvency (or insolvency) at a moment in time, as opposed to the debtor's solvency (or insolvency) at a point in the future.[391]

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considering amounts that can be realized 'in a reasonable time' assuming a 'willing seller' and a 'willing buyer.'") (quoting *BFP v. Resolution Trust Corp.,* 511 U.S. 531, 537 (1994)); *Lids Corp. v. Marathon Inv. Partners, L.P. (In re Lids Corp.),* 281 B.R. 535 541 (Bankr. D. Del. 2002) ("Therefore, assets should be valued at the sale price a willing and prudent seller would accept from a willing and prudent buyer if the assets were offered in a fair market for a reasonable period of time."); *Rand Energy Co. v. Del Mar Drilling Co. (In re Rand Energy Co.)*, 2000 Bankr. LEXIS 1607, at *5 (Bankr. N.D. Tex. July 28, 2000) ("For a debtor that is a 'going concern,' the court would 'determine the fair market price of the debtor's assets as if they had been sold as a unit, in a prudent manner, and within a reasonable time.' As a going concern, the debtor would not likely face a forced sale.") (quoting *In re DAK Indus., Inc.,* 170 F.3d 1197, 1200 n.3 (9th Cir. 1999)) (internal citation omitted)*; Durso Supermarkets v. D'Urso (In re Durso Supermarkets),* 193 B.R. 682, 701 (Bankr. S.D.N.Y. 1996). *See also* footnotes 87 and 568.

388 *See Peltz v. Hatten*, 279 B.R. 710, 743 (D. Del. 2002) ("While the inquiry is labeled a 'balance sheet' test, the court's insolvency analysis is not literally limited to or constrained by the debtor's balance sheet."), *aff'd*, 60 F. App'x 401 (3d Cir. 2003).

389 *Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 648 (3d Cir. 1999).

390 *See Moody*, 971 F.2d at 1068; *In re Am. Classic Voyages Co. v. JP Morgan Chase Bank (In re Am. Classic Voyages)*, 367 B.R. 500, 508 (Bankr. D. Del. 2007) ("'A business does not have to be thriving in order to receive a going concern valuation. Before the going concern valuation is to be abandoned, the business must be wholly inoperative, defunct, or dead on its feet.'") (quoting *Fryman v. Century Factors (In re Art Shirt Ltd., Inc.*) 93 B.R. 333, 341 (E.D. Pa. 1988)); *Fid. Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 288 (Bankr. E.D. Pa. 2006) ("[A] fair valuation of assets contemplates the conversion of assets into cash during a reasonable period of time.").

391 *See, e.g. Boyer v. Crown Stock Distrib., Inc.*, 587 F.3d 787, 794 (7th Cir. 2009) ("The difference between insolvency and 'unreasonably small' assets in the LBO context is the difference between being bankrupt on the day the LBO is consummated and having at that moment such meager assets that bankruptcy is a consequence both likely and foreseeable.") (citing *Moody*, 971 F.2d at 1069-70, 1072-73; *Kipperman v. Onex Corp.*, 411 B.R. 805, 836 (N.D. Ga. 2009)).

Traditionally, courts have looked to a variety of valuation methodologies to determine whether the value of a debtor's assets exceed its liabilities for purposes of the "balance sheet" test, including the following: [392]

- Actual Sale Price. The actual sale price methodology looks to the knowledge and due diligence performed by the acquirer of the debtor's assets, including appraisals, projections and the like, to determine whether the price at which the assets were actually sold or transferred is representative of the fair value of those assets.[393]
- Discounted Cash Flow. The discounted cash flow method of valuing a debtor "involves projections of future cash flows . . . and judgments about liquidity and the cost of capital."[394] This analysis looks to determine the value of the debtor based upon the discounted present value of the debtor's projected income. When the court is assessing the probative value of projections prepared at or around the time of the transaction, "the question the Court must decide is not whether [the] projection was correct, for clearly it was not, but whether it was reasonable and prudent when made."[395]
- Market Multiple Approach. "Under this methodology, net revenues and earnings are multiplied by an appropriate range of risk-adjusted multiples to determine the

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392 *See Iridium IP LLC v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 344 (Bankr. S.D.N.Y. 2007) (listing traditional methodologies).

393 *See MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 939 (S.D.N.Y. 1995) ("MAST proceeded with the LBO with full information and without coercion. Furthermore, other bidders expressed interest in purchasing VDAS at prices similar to that ultimately paid."); *see also Moody,* 971 F.2d at 1067 (stating that although there may be other probative evidence, "purchase price may be highly probative of a company's value immediately after a leveraged buyout").

394 *Peltz v. Hatten*, 279 B.R. 710, 738 (D. Del. 2002), *aff'd*, 60 F. App'x 401 (3d Cir. 2003).

395 *Iridium Operating LLC*, 373 B.R. 283 (Bankr. S.D.N.Y. 2007); *see also MFS/Sun Life*, 910 F. Supp. at 939 ("With the acuity that comes from hindsight, we know that the forecasts were inaccurate: VDAS failed to meet management's expectations. However, given the information that was available to VDAS at the time the Final LBO Projections were made, I find them to have been reasonable.").

company's total enterprise value."[396] These multiples may be selected, for instance, "by bench marking certain publicly traded companies, using quantitative and qualitative factors."[397]

- Comparable Transactions Approach. This methodology "examines recent transactions where companies have been bought and sold on the market."[398] This methodology may be appropriate to value a company for solvency purposes because "it is designed to yield the price the company would carry in the marketplace based on similar transactions."[399] In order to be effective, however, the sales used in the analysis must truly be comparable and the adjustments must be justified.[400]

- Adjusted Balance Sheet Approach. This approach starts with a debtor's balance sheet, typically prepared under GAAP, and makes adjustments necessary to reflect the fair value of the assets listed there. The GAAP value of assets is deemed relevant but is not determinative of their value.[401] The balance sheet is "only the starting point in the analysis" because, for example, "financial statements prepared in accordance with GAAP do not record assets at fair market value . . . 'property' may include assets not even listed on the balance sheet[, and d]ebts are recorded only to the extent they are known and quantifiable."[402]

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396 *Lids Corp. v. Marathon Inv. Partners, L.P. (In re Lids Corp.)*, 281 B.R. 535, 543 (Bankr. D. Del. 2002) ("The Market Multiple Methodology is an acceptable technique for determining solvency.") (citing additional authorities).

397 *See, e.g., Lids Corp*, 281 B.R. at 543.

398 *Id.*

399 *Id.*

400 *See id.* (rejecting a comparable transaction analysis that compared a company that had never been profitable against profitable companies, and relied on outdated transactions that were no longer relevant).

401 *See id.* at 542-43.

402 *Trans World Airlines, Inc. v. Travellers Int'l AG. (In re Trans World Airlines, Inc.)*, 180 B.R. 389, 405 n.22 (Bankr. D. Del. 1994); *see also Arrow Elecs., Inc. v. Justus (In re Kaypro)*, 230 B.R. 400, 413 (B.A.P. 9th Cir. 1999) ("There is no generally accepted accounting principle method for analyzing the insolvency of a company. . . . Although such principles are relevant, they are not controlling in insolvency determinations."); *Sierra Steel,*

In addition, a final approach looks to the markets for publicly traded securities to assess the market value of the debtor as a going concern. In a somewhat recent example of this approach, the Third Circuit Court of Appeals, in *VFB LLC v. Campbell Soup Co.*,[403] affirmed a district court decision that relied on the market capitalization of the debtor to determine that the debtor had received reasonably equivalent value for its leveraged acquisition of assets from a former parent entity. The Court of Appeals rejected appellant's contention that the market for a debtor's equity securities is an unreliable method of assessing value:[404]

> Equity markets allow participants to voluntarily take on or transfer among themselves the risk that their projections will be inaccurate; fraudulent transfer law cannot rationally be invoked to undermine that function. True, earnings projections "must be tested by an objective standard anchored in [a] company's actual performance," but such a test applies to information about a company's performance available "when [the projection is] made." Market capitalization is a classic example of such an anchored projection, as it reflects all the information that is publicly available about a company at the relevant time of valuation.

Further, the Court of Appeals found that the district court had committed no clear error by deferring to evidence of the debtor's market capitalization over the testimony of several expert witnesses utilizing other methodologies. As the court stated: "Absent some reason to distrust it, the market price is a more reliable measure of the stock's value than the subjective estimates of one or two expert witnesses."[405] Specifically, the court found that evidence of a $1.1 billion

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Inc. v. Totten Tubes, Inc. (In re Sierra Steel, Inc.), 96 B.R. 275, 278 (B.A.P. 9th Cir. 1989) (stating that "although GAAP are relevant, they are not controlling in insolvency determinations"); *Morse Operations, Inv. C. Goodway Graphics of Va., Inc. (In re Lease-A-Fleet, Inc.)*, 155 B.R. 666, 679 (Bankr. E.D. Pa. 1993) ("Courts are not required to rely upon GAAP standards when determining the issue of insolvency."); *Joshua Slocum, Ltd. v. Boyle (In re Joshua Slocum, Ltd.)*, 103 B.R. 610, 623-24 (Bankr. E.D. Pa. 1989) ("While GAAP principles do not control this court's determination of insolvency, we are inclined to accord weight to a company's treatment of its assets and liabilities according to GAAP."). This approach is derivative of the other valuation approaches.

403 482 F.3d 624 (3d Cir. 2007).

404 *See id.* at 631-33 (citations omitted).

405 *Id.* at 633 (quoting *In re Prince,* 85 F.3d 314, 320 (7th Cir. 1996)) (citing additional authorities); *see also Peltz v. Hatten*, 279 B.R. 710, 737-38 (D. Del. 2002) ("[I]n determining whether a value is objectively reasonable the court gives significant deference to marketplace values. When sophisticated parties make reasoned judgments

market capitalization of the debtor's equity—months after the acquisition and subsequent to the public disclosure of facts that may have had a negative impact on the value of debtor—was appropriate evidence that the debtor was solvent at the time of the transaction. Although not central to its holding, the court also made several observations about the market for the debtor's publicly traded debt securities.[406]

It should be noted that shortly after the Court of Appeals' decision in *VFB LLC*, the District Court for the District of Delaware held that *VFB LLC* did *not* compel application of the market capitalization approach in the case before it, even though the company's equity securities were publicly traded.[407] In *American Classic Voyages, Co. v. JP Morgan Chase Bank (In re American Classic Voyages, Co.),* however, the court did not explain its reliance on traditional forms of valuation, other than to note that the market information presented to the court actually was consistent with evidence adduced using those other methods.[408]

Somewhat surprisingly, the Parties devoted relatively little attention addressing the import of *VFB LLC* to the valuation issues presented in Question One, and even then, only obliquely. One Party relied on *VFB LLC* to argue that the auction process that preceded selection of the Zell Group is compelling evidence that the $34 per share Tender Offer price

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about the value of assets that are supported by then prevailing marketplace values and by the reasonable perceptions about growth, risks, and the market at the time, it is not the place of fraudulent transfer law to reevaluate or question those transactions with the benefit of hindsight."), *aff'd*, 60 F. App'x 401 (3d Cir. 2003); *Iridium IP LLC v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 293 (Bankr. S.D.N.Y. 2007) ("[T]he public trading market constitutes an impartial gauge of investor confidence and remains the best and most unbiased measure of fair market value and, when available to the Court, is the preferred standard of valuation.").

406 *See VFB LLC,* 482 F.3d at 628 (noting that debtor successfully issued $200 million in debt to institutional investors "despite disclosing discouraging financial data for the first nine months of FY1999, declining sales, limited advertising and product innovation, and other worrisome news"); *id.* at 632-33 (noting that the below par trading price of unsecured debt in fiscal year 2000 demonstrated that debtor was insolvent at the time, although it did not prove that debtor was insolvent in fiscal year 1999).

407 *See Am. Classic Voyages, Co. v. JP Morgan Chase Bank (In re Am. Classic Voyages, Co.)*, 384 B.R. 62, 65 (D. Del. 2008).

408 *See id.* at 65.

supports the conclusion that Tribune was solvent at Step One. This argument, however, confuses the market capitalization approach affirmed in *VFB LLC*—which looks to the capitalization of a debtor's equity as reflected in an active, public market for those securities—and the actual sale approach, which looks at the facts and circumstances of a particular transaction to determine if the sale price reached as a result of that process is a reliable indication of solvency. To the extent the Tender Offer price supports a conclusion on Step One solvency, the use of this data would represent an actual sale approach to valuation.

Another Party cited *VFB LLC* to argue that the price of Tribune's debt securities before Step One and the price of its equity securities before Step Two demonstrate that Tribune was insolvent prior to each of those steps. Not surprisingly, other Parties challenged the assumptions underlying these contentions, pointing to the trading value of Tribune's Common Stock at other times, the trading value of other debt issuances allegedly supporting a solvency conclusion, and the characteristics of yet other Tribune debt issuances (i.e. coupon, maturity) to explain why those instruments traded at levels above what would be expected if the market had judged Tribune to be insolvent.

Based on his review of the applicable law, the Examiner concludes that a court is reasonably likely to consider relevant evidence of the markets for Tribune's publicly traded securities at relevant times on the question of solvency. The Examiner does not believe, however, that a court is reasonably likely to view such evidence as conclusively determining the solvency analysis; rather, a court is reasonably likely to consider other valuation metrics, *along with market data*, to reach a conclusion on valuation. Significantly, despite wide disagreement over valuation issues, no Party advocated to the Examiner a contrary view.

The Report discusses application of the various valuation methodologies to the question of solvency in the Sections that follow.

(3) Legal Standards Governing Capital Adequacy Analysis.

The Bankruptcy Code does not define the term "unreasonably small capital" used in Bankruptcy Code section 548(a)(1)(B)(ii)(II). Courts generally have described the term as a financial condition "short of equitable insolvency,"[409] but which leaves the transferor "unable to generate sufficient profits to sustain operations"[410] so that the transferor "is technically solvent but doomed to fail."[411] Thus, the unreasonably small capital test is designed to capture those situations when a transaction may leave the debtor technically solvent, but with so few assets that inability to pay debts in the future should have been "reasonably foreseeable."[412]

In *Moody*, the Third Circuit Court of Appeals adopted the approach of *Credit Managers Association of Southern California v. Federal Co.*, and held that "the test for unreasonably small capital is reasonable foreseeability . . . whether the parties' projections were reasonable."[413] This approach does not view the projections in hindsight, but instead determines whether they were

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409 "[E]quitable insolvency" is defined as "the general inability of the corporate debtor to meet its pecuniary liabilities as they mature, by means of either available assets or an honest use of credit." *VFB LLC*, 482 F.3d at 636; *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 943 (S.D.N.Y. 1995) ("A transfer may be set aside as fraudulent if the transferor, though its assets exceed its liabilities, is rendered unable to pay its debts as they come due. This forward-looking standard is generally referred to as equitable insolvency.").

410 *See Moody v. Sec. Pac. Bus. Credit*, 971 F.2d 1056, 1070 (2d Cir. 1992); *Fidelity Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 294.

411 *See MFS/Sun Life*, 910 F. Supp. at 944 (citing *Moody*, 971 F.2d at 1070 & n.22); *see also Boyer*, 587 F.3d at 792 (finding corporation was left with unreasonably small capital when the transfer left it "with insufficient assets to have a reasonable chance of surviving indefinitely"); *Daley v. Chang (In re Joy Recovery Tech. Corp.)*, 286 B.R. 54, 76 (Bankr. N.D. Ill. 2002) ("[U]nreasonably small capital means something more than insolvency or inability to pay debts as they come due. Being left without adequate capital would mean that the transaction in issue put [the debtor] on the road to ruin."); *Pioneer Home Builders, Inc. v. Int'l Bank of Commerce*, 147 B.R. 889, 894 (Bankr. W.D. Tex. 1992) ("Although short of technical insolvency, a debtor's unreasonably small capital structure is presumed to lead eventually to insolvency, which is why it serves as grounds for treating the transfer in question as fraudulent vis-à-vis other unsecured creditors."); *Ferrari v. Barclay's (In re Morse Tools, Inc.)*, 148 B.R. 97, 133 (Bankr. D. Mass. 1992) (finding unreasonably small capital where the buyout made it almost certain the company would fail).

412 *See* Bruce A. Markell, *Toward True and Plain Dealing: A Theory of Fraudulent Transfers Involving Unreasonably Small Capital*, 21 IND. L. REV. 469, 497 (1988) (stating that unreasonably small capital exists when the non-payment of the plaintiff's claim was a reasonably foreseeable effect given, the amount of the transferor's assets and capital remaining, and reasonably foreseeable cash resources).

413 *Moody*, 971 F.2d at 1072-73 (citing *Credit Managers Assoc. v. Fed. Co.*, 629 F. Supp. 175 (C.D. Cal. 1985)).

reasonable and prudent at the time they were made.[414] In evaluating the reasonableness of the projections, courts give considerable weight to projections developed by management when there is "substantial evidence presented to show that the [b]usiness [p]lan was prepared in a reasonable manner, using supportable assumptions and logically consistent computations."[415] Independent analysis and vetting of management's projections by independent advisors is also an indicator of reasonableness.[416]

Further, the reasonableness of the projections should be measured according to an objective standard "anchored in the company's actual performance" and should look to data including "cash flow, net sales, gross profit margins, and net profits and losses."[417] In addition to this historical data, courts must "also account for difficulties that are likely to arise, including interest rate fluctuations and general economic downturns, and otherwise incorporate some margin for error."[418] The reasonable foreseeability test has been described as a "fact-based test of whether the company's cash flow forecasts are reasonable and leave enough margin for error to account for reasonably foreseeable difficulties" and a "cash flow cushion test."[419]

Finally, although a company must be adequately capitalized, it does not need resources sufficient "to withstand any and all setbacks."[420] In *Moody*, although the court voiced concerns

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414 *See, e.g.*, *Credit Managers*, 629 F. Supp. at 186-87 (finding that "[w]ith 20-20 hindsight it is clear that Crescent's cash flows did not work out as projected by GECC" but that the court's focus must not be on "what happened to Crescent, but whether the GECC projections . . . were prudent").

415 *Iridium IP LLC v. Motorola, Inc. (In re Iridium Operating LLC)*, 373 B.R. 283, 348 (Bankr. S.D.N.Y. 2007) (citing *In re Mirant Corp.*, 334 B.R. 800, 825 (Bankr. N.D. Tex. 2005)).

416 *Id.*

417 *Moody*, 971 F.2d at 1073 (citing *Credit Managers*, 629 F. Supp. at 184-86); *Kipperman v. Onex Corp.*, 411 B.R. 805, 836 (D. Ga. 2009).

418 *Moody*, 971 F.2d at 1073 (citations omitted).

419 *See* Shepard, Note, *Beyond Moody: A Re-Examination of Unreasonably Small Capital*, 57 HASTINGS L.J. 891, 892 (2006) (citations omitted).

420 *Credit Managers*, 629 F. Supp. at 187; *see also Iridium*, 373 B.R. at 345; *accord Peltz v. Hatten*, 279 B.R. 710, 747 (D. Del. 2002) ("It is clear that USN had its operating challenges, including dealing with its billing and

about the potential for abuse in leveraged buyout scenarios, the court again employed the approach adopted in *Credit Managers* test, holding "participants in leveraged buyout responsible . . . when it is reasonably foreseeable that an acquisition will fail, but at the same time takes into account that businesses fail for all sorts of reasons, and that fraudulent conveyance laws are not a panacea for all such failures."[421]

The determination of unreasonably small capital is conducted on a case-by-case basis and is likely to rely on industry-specific financial information.[422] Considerable weight often is given to management's projections or decisions made to enter into transactions.[423] Courts also consider a variety of other factors, including the following:

- Historic performance. Deviation from historical practice can support a finding of unreasonably small capital.[424] In *In re O'Day Corp.*, the court looked at two sets of projections that were prepared in connection with the alleged fraudulent

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collection problems and adjusting its planning and projections as it grew at a rapid rate. But these challenges were associated with meeting its projected growth rate and the market's expectations, not with all out business failure."), *aff'd*, 60 F. App'x 401 (3d Cir. 2003).

421 *Moody*, 971 F.2d at 1073; *see also* Markell, footnote 412, at 506 ("[B]usinesses fail for all sorts of reasons, and . . . fraudulent transfer laws are not a panacea for all such failures."). Judge Markell's statement has been cited with approval not only in *Moody,* but also in *Boyer v. Crown Stock Distribution, Inc.*, 587 F.3d 787, 793 (7th Cir. 2009); *Ring v. Bergman (In re Bergman)*, 293 B.R. 580, 584 (Bankr. W.D.N.Y. 2003); and *Salisbury v. Texas Commerce Bank, N.A. (In re WCC Holding Corp.)*, 171 B.R. 972, 986 (Bankr. N.D. Tex. 1994).

422 *See* Robert J. Stearn, Jr., *Proving Solvency: Defending Preference and Fraudulent Transfer Litigation*, 62 BUS. LAWYER 359, 388-89 (Feb. 2007) (stating that financial ratios should be evaluated and compared to similar companies) (citations omitted).

423 *Iridium*, 373 B.R. at 345, 348; *Credit Managers*, 629 F. Supp. at 183; *see also Stern v. Samuel, Son & Co., Ltd. (In re Longview Aluminum)*, 2005 Bankr. LEXIS 1312, at *21 (Bankr. N.D. Ill. July 14, 2005) (giving weight to the decisions of the debtor's principals who had their own finances and time at stake and had access to substantial professional expertise).

Similarly, weight may be given to market valuations in determining reasonableness. For example, in *Iridium*, the court discussed the market's optimistic predictions of present and future value for the debtor. The court continued, "[t]he capital markets synthesized and distilled what all the smart people of the era knew or believed to be true about Iridium. Given the overwhelming weight of that market evidence, it may be that the burden of proving . . . unreasonably small capital simply could not be met under any circumstances . . . ." 373 B.R. at 352.

424 *See Moody v. Sec. Pac. Bus. Credit, Inc.*, 127 B.R. 958, 998 (W.D. Pa. 1991) (including the company's historical capital cushion among the more relevant considerations).

transfer.[425] Before the closing of the leveraged buyout transaction, management received quarterly financial information showing a decrease in gross profit margin and a decline in EBIT.[426] Because the projections were inconsistent and irreconcilable with the debtor's recent historical financial data as well as its recent financial trends, including worst-case projections that the company would greatly exceed its average performance in the reference period, the court found that they were not reasonable.[427] The court held that the resulting inability to pay creditors was foreseeable, notwithstanding evidence of several unpredictable intervening events that could have caused the failure, including a stock market crash.[428] By contrast, in *Moody*, the court rejected the argument that the projections had ignored the most recent historical data, which included a down-turn and a break-even year in the two years preceding the transaction at issue there.[429] Finding the incorrect projections to have been reasonable when made, even given this recent history, the court noted that the company had enjoyed a pre-tax profit and had a positive cash flow prior to the transaction.[430]

- <u>Availability of Funds</u>. In determining whether there is adequate capital, courts may also consider "all reasonably anticipated sources of operating funds, which may include new equity infusions, cash from *operations*, or cash from secured or unsecured loans over the relevant time period."[431] Access to credit alone may be

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425 *Meritor v. Murphy Savs. Bank (In re O'Day Corp.)*, 126 B.R. 370, 404-05 (Bankr. D. Mass. 1991).

426 *Id.* at 406.

427 *Id.* at 405-07.

428 *Id.* at 407.

429 *Moody v. Sec. Pac. Bus. Credit*, 971 F.2d 1056, 1074 (3d Cir. 1992).

430 *Id.*; *see also Credit Managers Assoc. v. Fed. Co.*, 629 F. Supp. 175, 185 (C.D. Cal. 1985) (finding projections reasonable even where assumptions regarding collectability of accounts receivable were higher than data for the year prior to the LBO).

431 *Moody*, 971 F.2d at 1072 n.24 (citation omitted); *Peltz v. Hatten*, 279 B.R. 710, 726 (D. Del. 2002) (same), *aff'd*, 60 F. App'x 401 (3d Cir. 2003); *see also* Markell, footnote 412, at 501 (arguing that courts should focus on "a business' ability to generate sufficient cash from operations, or to issue debt or equity securities for cash").

sufficient to establish adequate capital.[432] Further, even if projections show that the debtor will not have sufficient cash to pay off principal balances on loans or notes when they come due, courts should take the possibility of refinancing into account (even for companies experiencing financial and operational difficulty).[433] Courts may even accept the possibility of asset sales as a means for a company to raise cash.[434] However, where no reasonable means of raising funds exists, the court will find that there was unreasonably small capital.[435]

- Causation. Although the statutes do not explicitly require that there be a causal connection between the transfer and failure to satisfy the creditor claims, courts generally require that such causation be shown. Clearly, the occurrence of a calamity, such as a fire or storm, could cause unforeseen difficulties,[436] but courts also look to other causes of interruption in business that are at least arguably more foreseeable.[437]
- Time Horizon. Another indication that the transfer did not cause the inadequate capitalization is evidence that the company survived for a period (often measured

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432 *Moody*, 971 F.2d at 1072 (although the LBO left the debtor with a line of credit as the sole source of operating capital, the court held the debtor was adequately capitalized); *cf. Meritor v. Murphy Savs. Bank (In re O'Day Corp.)*, 126 B.R. 370, 408 (Bankr. D. Mass. 1991) (holding that the "ability to borrow is not a substitute for operating profits" and that sums available under a revolver, which allowed the company to stay afloat for 22 months after the LBO, did not establish adequate working capital).

433 *See* Stearn, footnote 422, at 389 (citing *Peltz*, 279 B.R. at 747) (additional citations omitted).

434 *See Nasr v. Geary*, 2003 U.S. Dist. LEXIS 13887, at *64 (C.D. Cal. June 9, 2003) ("Unreasonably small assets signify an inability to generate enough cash flow from operations *and the sale of assets* to remain financially stable.") (emphasis added); *Vadnais Lumber Supply, Inc. v. Byrne (In re Vadnais Lumber Supply, Inc.)*, 100 B.R. 127, 137 (Bankr. D. Mass. 1989).

435 *See, e.g., Wells Fargo Bank v. Desert View Bldg. Supplies, Inc.*, 475 F. Supp. 693, 697 (D. Nev. 1978) (finding unreasonably small capital where, after taking on a secured loan, the only hope that the company would be able to pay creditors rested on its ability to expand sales, which was rendered impossible by the additional debt service).

436 *See* Markell, footnote 412, at 504 n.254.

437 *See, e.g.*, *Moody v. Sec. Pac. Bus. Credit, Inc.*, 127 B.R. 958, 977-78 (D. W.D. Pa. 1991) (recession and increased competition); *Credit Managers Assoc. v. Fed. Co.*, 629 F. Supp. 175, 184 (C.D. Cal. 1985) (loss of a major customer and labor strike); *Ohio Corrugating Co. v DPAC, Inc. (In re Ohio Corrugating Co.)*, 91 B.R. 430, 440 (Bankr. N.D. Ohio 1988) (industry-wide downturn).

in months) after the allegedly fraudulent transfer and was able to pay creditors during that time.[438] In *Boyer v. Crown Stock Distribution, Inc.*,[439] the Seventh Circuit Court of Appeals addressed this factor in further detail in the context of a leverage buyout in a manner that the Examiner believes is consistent with the object of the capital adequacy test, namely to test the debtor's wherewithal to pay its creditors. In *Boyer*, the court held that notwithstanding the transferor's survival for 3½ years after the LBO, the transaction was susceptible to attack:[440]

> Should the acquired company be doomed to go broke after and because of the LBO–if the burden of debt created by the transaction was so heavy that the corporation had no reasonable prospect of surviving–the payment to the shareholders by the buyer of the corporation is deemed a fraudulent conveyance because in exchange for the money the shareholders received they provided no value to the corporation but merely increased its debt and by doing so pushed it over the brink . . . .
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> [N]ew Crown started life almost with no assets at all, for all its physical assets were encumbered twice over, and the dividend plus new Crown's interest obligations drained the company of virtually all its cash. It was naked to any financial storms that might assail it. So the statutory condition for a fraudulent conveyance was satisfied–or so at least the bankruptcy judge could and did find without

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438 *See, e.g.*, *Moody v. Sec. Pac. Bus. Credit, Inc.*, 971 F.2d 1056, 1074 (3d Cir. 1992) (finding not unreasonably small capital where creditors were paid for twelve months after transaction); *MFS/Sun Life Trust-High Yield Series v. Van Dusen Airport Servs. Co.*, 910 F. Supp. 913, 945 (S.D.N.Y. 1995) (stating that where "the company remained viable so long [*i.e.* for eight months] after the LBO strongly suggests that its ultimate failure cannot be attributed to inadequacy of capital as of the date of the buyout" and finding failure resulted from rapid emergence of competition, imposition of fees, loss of business, and failure to implement growth and cost-saving strategies); *Fid. Bond & Mortg. Co. v. Brand (In re Fid. Bond & Mortg. Co.)*, 340 B.R. 266, 299-300 (Bankr. E.D. Pa. 2006) (finding projections reasonable where debtor survived 14 months after LBO); *Daley v. Chang (In re Joy Recovery Tech. Corp.)*, 286 B.R. 54, 76 (Bankr. N.D. Ill. 2002) ("Courts will not find that a company had unreasonably small capital if [it] survives for an extended period after the subject transaction.").

439 587 F.3d 787 (7th Cir. 2009) (Posner, J.).

440 *Id.* at 792-95; *see also Ferrari v. Barclays Bus. Credit, Inc., 148 B.R. 97, 133 (Bankr. D. Mass. 1992)* (holding projections unsound even when debtor stayed in business for two years because the failure was almost certain from the start); *Murphy v. Meritor Savs. Bank (In re O'Day Corp.)*, 126 B.R. 370, 408 (Bankr. D. Mass. 1991) (holding that there was unreasonably small capital even when the company stayed in business for 22 months after transaction).

> committing a clear error.
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> The fact that mistakes by the buyer hastened the company's demise is not a defense. Whether a transfer was fraudulent when made depends on conditions that existed when it was made, not on what happened later to affect the timing of the company's collapse. . . . An inadequately capitalized company may be able to stagger along for quite some time, concealing its parlous state or persuading creditors to avoid forcing it into a bankruptcy proceeding in which perhaps only the lawyers will do well.
>
> The interval was longer than in previous cases, but the defendants are unable to sketch a plausible narrative in which new Crown could have survived indefinitely despite being cash starved as a result of the terms of the LBO that brought it into being. The fact that Smith made mistakes in running the company does not weigh as strongly as the defendants think. Everyone makes mistakes. That's one reason why businesses need adequate capital to have a good chance of surviving in the Darwinian jungle that we call the market.

- <u>Additional Factors</u>. Among the other factors that courts may consider in addition to those discussed above are: (1) nature of business; (2) stable or volatile income; (3) likelihood of future growth or contraction; (4) current secured and unsecured debts; (5) likelihood of collateral of secured debt to retain, gain, or lose value; (6) likelihood of incurring substantial consensual debt in the future;**[441]** (7) if transferor is a guarantor, likelihood that primary debtors will default; (8) spending and saving habits; (9) composition of asset portfolio; (10) track record of prior incidents and claims; (11) amount of insurance; (12) type of insurance coverage;

[441] *See United States v. Gleneagles Inv. Co.*, 565 F. Supp. 556, 580 (M.D. Pa. 1983) ("We are also of the opinion that the delivery of the mortgages and guarantee mortgages to IIT occurred when the Raymond Group was engaged or about to engage in a 'business or transaction for which the property remaining in [its] hands after the conveyance is an unreasonably small capital.' 39 Pa. Cons. Stat. § 355. Both before the November 26, 1973 transaction as well as thereafter, the Raymond Group did not have the capital resources it needed to carry on its business. *Moreover, Durkin planned to continue selling the surplus lands of the Raymond Group and would therefore incur additional income tax liabilities to the United States.* The provisions of the Note Purchase and Loan Agreement were such that relatively little, if any, proceeds of the land sales would be available for general creditors. *Durkin also planned to continue the Raymond Group's coal mining operations and would therefore incur additional liabilities to trade creditors, the Anthracite Health and Welfare Fund, and the Commonwealth for backfilling obligations*.") (emphasis added), *aff'd in relevant part sub nom., United States v. Tabor Court Realty Corp.*, 803 F.2d 1288 (3d Cir. 1986).

and (13) also whether the transferor reasonably discounted the likelihood that certain assets or liabilities would materialize.[442]

(4) Examiner's Conclusions and Explanation Concerning Whether Solvency and Capital Adequacy Are Measured on an Estate-by-Estate Basis—the Impact of the Subsidiary Guarantees.

Examiner's Conclusions:

A court is highly likely to measure the solvency and capital adequacy of the Tribune Entities on an estate-by-estate basis. In conducting that analysis, however, it is highly likely that in considering these questions as applied to Tribune and the Guarantor Subsidiaries (either separately or collectively), a court would take into account offsetting assets in the form of rights of contribution, subrogation, and indemnity whether arising under contract or common law. To the extent, however, that an individual Guarantor Subsidiary was insolvent before incurring the Step One Debt, such entity's estate should be entitled to avoid such obligations. In the case of Tribune, because it was the ultimate parent of the Guarantor Subsidiaries, to the extent it discharges debt of Guarantor Subsidiaries, Tribune's value would be enhanced (vis-à-vis the increased net worth of the solvent Guarantor Subsidiaries) by the amount of any indebtedness satisfied.

Explanation of Examiner's Conclusions:

Absent a finding of veil piercing, alter ego, or substantive consolidation of the Tribune Entities' respective estates, each Debtor must be considered as a separate entity with separate

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[442] *See* John E. Sullivan III, *Future Creditors and Fraudulent Transfers: When a Claimant Doesn't Have a Claim, When a Transfer Isn't a Transfer, When a Fraud Doesn't Stay Fraudulent, and Other Important Limits to Fraudulent Transfers Law for the Asset Protection Planner*, 22 DEL. J. CORP. L. 955, 1010-12 (1997).

assets and liabilities.[443] As shown below, however, proper evaluation of the solvency and capital adequacy of the Guarantor Subsidiaries and Tribune requires consideration of the rights of contribution, subrogation, and indemnity that, in effect, give rise to offsetting assets.

(i) The Guarantor Subsidiaries.

The Credit Agreement Subsidiary Guarantee and Subordinated Bridge Subsidiary Guarantee imposed joint and several liability on the Guarantor Subsidiaries for the LBO Lender Debt.[444] As a result, if called upon, any individual Guarantor Subsidiary would be required to satisfy the full LBO Lender Debt. The Credit Agreement Subsidiary Guarantee renders each Guarantor Subsidiary unconditionally and primarily liable for the full amount of the guaranteed indebtedness. Thus, the LBO Lenders could proceed in any manner against any Guarantor Subsidiary for the full amount of the guaranteed indebtedness. If, however, any individual Guarantor Subsidiary were required to apply all of its available assets to the satisfaction of this indebtedness, the paying Guarantor Subsidiary would hold contractual and common law rights of contribution, subrogation, and indemnity against Tribune and each other.[445] These rights, in turn,

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443 *See In re Owens Corning*, 419 F.3d 195, 205 (3d Cir. 2005) ("Substantive consolidation . . . 'treats separate legal entities as if they were merged into a single survivor left with all the cumulative assets and liabilities. . . . The result is that claims of creditors against separate debtors morph to claims against the consolidated survivor.'") (citing *In re Genesis Health Ventures, Inc.*, 402 F.3d 416, 423 (3d Cir. 2005)).

444 *See* Ex. 189 at § 1 (Credit Agreement Subsidiary Guarantee); Ex. 414 at § 1 (Subordinated Bridge Subsidiary Guarantee).

445 Of note, each Guarantor Subsidiary's *contractual* contribution, subrogation, and indemnity rights against the other Guarantor Subsidiaries arose at the Step Two Financing Closing Date. *See* Ex. 7 at § 2 (Credit Agreement Subrogation Subordination Agreement; Ex. 12 at § 2 (Bridge Subrogation Subordination Agreement). In contrast, the Credit Agreement Subsidiary Guarantee, which was entered into on the Step One Financing Closing Date, only recognizes contribution, subrogation, and indemnity rights against Tribune. *See* Ex. 189 at § 7 (Credit Agreement Subsidiary Guarantee). Nonetheless, each Guarantor Subsidiary likely had common law contribution, subrogation, and indemnity rights against each other Guarantor Subsidiary at the Step One Financing Closing Date because of the joint and several nature of the obligations. *See Mfrs. & Traders Trust Co. v. Goldman (In re Ollag Constr. Equip. Corp.)*, 578 F.2d 904, 908 (2d Cir. 1978) (finding subrogation and contribution rights exist even in the absence of a contractual provision granting such rights); *Beltrone v. Gen. Schuyler & Co.*, 645 N.Y.S.2d 914, 915 (N.Y. App. Div. 1996) (holding under New York law, guarantor who pays more than proportionate share of amount of guarantee is entitled to contribution from co-guarantors); *McDermott v. City of N.Y.*, 406 N.E.2d 460, 462 (N.Y. 1980) ("[W]here payment by one person is compelled,

directly affect conclusions concerning the solvency and capital adequacy of each guarantor, even though each entity is liable for the full amount of the debt.

In re Ollag Construction Equipment Corp.[446] illustrates this principle. There, the Second Circuit Court of Appeals reversed the lower court's conclusion that a debtor was insolvent based on the lower court's failure to consider certain intangible assets of the debtor, namely, the debtor's rights of contribution and subrogation in connection with its guarantee of an affiliate's debt.[447] The court held that "contingent subrogation and contribution rights must be valued as assets in determining solvency."[448] The Third Circuit Court of Appeals adopted the same approach in *Mellon Bank, N.A. v. Metro Communications, Inc.*[449] Applied here, solvency and capital adequacy analysis of each Guarantor Subsidiary must similarly take into account each such entity's contribution, subrogation, and indemnity rights against Tribune and the other Guarantor Subsidiaries.

Viewed in this light, solvency and capital adequacy analysis of the Guarantor Subsidiaries produces the same result whether the Guarantor Subsidiaries are considered liable on the LBO Lender Debt individually or collectively as long as each Guarantor Subsidiary is solvent before the Leveraged ESOP Transactions. An example (actually adapted from one submission to the Examiner) drives home the point: Assume that three guarantors, each with an equity value of $150 (excluding the value of contribution rights from other guarantors), jointly,

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which another should have made . . . a contract to reimburse or indemnify is implied by law.") (citing *Brown v. Rosenbaum*, 41 N.E.2d 77, 81 (N.Y. 1942)).

446 578 F.2d 904 (2d Cir. 1978).

447 *Id.* at 908.

448 *Id.* (citing *Syracuse Eng'g Co. v. Haight*, 97 F.2d 573, 576 (2d Cir. 1938)).

449 *See also Mellon Bank, N.A. v. Metro Commc'ns, Inc.*, 945 F.2d 635, 648 (3d Cir. 1991) ("In valuing the cost of Metro's guaranty, the right of contribution of co-guarantors needs to be balanced against the amount of debt for which Metro is liable."); *In re Consol. Capital Equities Corp.*, 143 B.R. 80, 88 (Bankr. N.D. Tex. 1992) (finding liability on a guarantee may be offset by value of rights of contribution).

severally, and unconditionally guarantee a $300 debt. In analyzing the solvency of each guarantor, the $300 liability does not render any guarantor insolvent because each guarantor has an asset in the form of its contribution rights equal to $200 (*i.e.*, $100 from each of the other two guarantors in the event the first guarantor were required to pay the entire $300 debt). On a stand-alone basis, each guarantor has $350 in assets ($150 of equity value plus $200 in contribution rights) versus $300 in liabilities (the debt) resulting in a solvency cushion of $50 for each guarantor. This result is identical if the three guarantors are valued collectively. In that case, the guarantors have $450 in combined assets (their collective equity value) versus $300 in collective liability, resulting in a $150 collective solvency cushion ($50 for each).

A different conclusion regarding individual guarantors might result, however, if the guarantors each have a different net worth, but each is liable pro rata on the guarantee. Suppose, for example, three subsidiaries give a joint and several upstream guarantee of $300. Pre-transaction, one subsidiary has $2 of net worth, one has $5 of net worth, and one has $300 of net worth. Collectively the subsidiaries are solvent post-transaction. But if the liability is equally apportioned because each entity is equally liable on the guarantee (in other words, $100 per entity), two of the entities would be rendered insolvent. The Credit Agreement Subrogation Subordination Agreement and Bridge Subrogation Subordination Agreement, entered into in conjunction with Step Two, addressed this issue by providing that to the extent a Guarantor Subsidiary is called on to make a payment on the LBO Lender Debt, the other Guarantor Subsidiaries "shall indemnify the Claiming Guarantor in an amount equal to such payment, in each case multiplied by a fraction of which the numerator shall be the net worth . . . of the Contributing Guarantor . . . and the denominator shall be the aggregate net worth . . . of all the

Guarantors."[450] Applying this provision to the above example, the collective net worth of the three guarantors is $307. The first guarantor would have to pay 2/307ths of $300 (which is $1.95, leaving that guarantor solvent by a nickel), the second one has to pay 5/307ths of $300 (which is $4.89, leaving it solvent by 11 cents), and the third one has to pay 300/307ths of $300 (which is slightly over $293, leaving it solvent by $14). In each case, each subsidiary remains solvent. If any one of the subsidiaries had a negative net worth pre-transaction, the provision would result in none of the remaining subsidiaries being rendered insolvent, provided that the collective net worth of the solvent subsidiaries exceeds the collective liability of those solvent subsidiaries. In other words, the insolvency of any one subsidiary would not render the remaining entities insolvent if the aggregate net worth of the remaining entities exceeds the liability.

The Credit Agreement Subrogation Subordination Agreement did not exist at Step One, meaning that, in theory, if each Guarantor Subsidiary were required to honor its Subsidiary Guarantee of the Step One Debt on an equal basis (in other words in an amount equal to the Step One Debt divided by the aggregate number of Guarantor Subsidiaries) at the Step One Financing Closing Date, any one Guarantor Subsidiary could be rendered insolvent if the inclusion of its ratable share of Step One Debt, combined with such entity's other liabilities, exceeded its assets. But if the Guarantor Subsidiaries are solvent collectively based, for example, on a hypothetical sale of the Tribune Entities as a going concern, it would seem implausible that a court would ratably allocate the Step One Debt and thereby render individual Guarantor Subsidiaries insolvent. In that scenario, a court is more likely to apportion the liability in a manner that mirrors what the Credit Agreement Subrogation Subordination Agreement and Bridge

[450] *See* Ex. 711 at § 2 (Credit Agreement Subrogation Subordination Agreement); Ex.712 at § 2 (Bridge Subrogation Subordination Agreement).

Subrogation Subordination Agreement accomplished contractually at Step Two: in other words, allocate the collective liability among the Guarantor Subsidiaries in an amount equal to the proportion of each entity's net worth to the net worth of all of the Guarantor Subsidiaries. Such an approach would better represent the actual contribution of each Guarantor Subsidiary to the value derived from the hypothetical sale of the enterprise and generally would be more consistent with *Ollag* and *Mellon Bank,* which require that rights of contribution be "balanced" against the amount of debt for which each guarantor is liable.[451]

Certain Parties nevertheless argued to the Examiner that the contribution, subrogation, and indemnity rights considered in cases such as *Ollag* and *Mellon Bank* are inapposite here. Specifically, these Parties asserted that because these rights are contractually subordinated to the prior payment in full of the LBO Lender Debt, such rights cannot be considered assets of any Guarantor Subsidiary (and consequently included in a solvency or unreasonable capital analysis) until the LBO Lender Debt is first paid in full. Although these rights indeed are subordinated to the LBO Lender Debt,[452] however, this should not change the outcome of solvency or capital adequacy analysis. First, as noted, the Guarantor Subsidiaries should be valued collectively for purposes of a solvency and capital adequacy analysis. Thus, if the Guarantor Subsidiaries are solvent as a group, then the inter-guarantor subordination provisions are of no effect and disappear on the satisfaction of the LBO Lender Debt. This is another way of saying that this issue merges with the question whether the Guarantor Subsidiaries are solvent collectively.

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[451] *See also Mellon Bank*, 945 F.2d at 648. Although not directly relevant, equitable principles of marshalling also would support such a result. *See, e.g., Telefest, Inc. v. VU-TV, Inc.*, 591 F. Supp. 1368, 1382 (D.N.J. 1984) ("It has repeatedly been said that the equitable doctrine of the marshalling of assets rests upon the principle that a creditor having two funds to satisfy his debt may not, by his application of them to his demand, defeat another creditor who may resort to only one of the funds.") (citations omitted); *In re R.L. Kelly & Sons, Millers*, 125 B.R. 945, 954 (Bankr. D. Md. 1991) (applying marshalling doctrine by analogy to common fund issues).

[452] *See* Ex. 711 at § 3 (Credit Agreement Subrogation Subordination Agreement); Ex. 712 at § 3 (Bridge Subrogation Subordination Agreement).

Second, the import of the argument that the Guarantor Subsidiaries' contribution, subrogation, and indemnity rights should not be considered due to the subordination of those rights is that each Guarantor Subsidiary's assets must be compared to a liability for the entire LBO Lender Debt, but because the LBO Lender Debt need only be satisfied once, it cannot be the case that each Guarantor Subsidiary will face $11 billion in liability on the LBO Lender Debt resulting in aggregate liabilities in excess of $500 billion. The aggregate liability is $11 billion, not a multiple of that amount. The fact that each Guarantor Subsidiary is liable for this debt must be taken into consideration in evaluating the solvency and capital adequacy of each individual Guarantor Subsidiary. A court should apply the analysis of *Ollag* and *Mellon Bank*, i.e., that the rights of contribution, subrogation, and indemnity of each Guarantor Subsidiary must be included in any solvency and capital adequacy analysis, notwithstanding the existence of subordination provisions in the guarantees.

On the other side of the coin, certain Parties cited in *In re Xonics Photochemical, Inc.*[453] and its progeny for the proposition that the Guarantor Subsidiaries hold *contingent* liabilities which must be "discounted" to take into account the probability that such Guarantor Subsidiary would be called upon to "make good" on its guaranty. *Xonics* is a famous bankruptcy case authored by a famous jurist. There, Judge Posner, writing for the Seventh Circuit Court of Appeals, observed that when a company guarantees an affiliate's obligations, the guarantor incurs only a contingent liability.[454] Recognizing that any contingency involves an assessment of probability, Judge Posner reasoned that liability on a guarantee must be valued based on the

[453] 841 F.2d 198 (7th Cir. 1988).

[454] *Id.* at 200.