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KEY ISSUES IN STANDING TO CHALLENGE LIABILITY MANAGEMENT-RELATED TRANSACTIONS

In this article, the author discusses key issues in creditor standing to challenge (or otherwise bring litigation related to) liability management-related transactions. The author begins by providing an overview of "no-action" clauses in credit agreements and bond indentures and describes how such clauses may be used by defendant lenders and/or borrowers to seek dismissal of certain litigation claims brought by plaintiff individual or minority lenders and bondholders. The author also discusses some recent decisions that address the application of no-action clauses generally, the difference between direct and derivative claims and how creditor standing is affected by the bankruptcy process.

By Michael R. Handler *

"Liability management" transactions[1] that directly or indirectly disadvantage certain creditor constituencies and/or that preceed chapter 11 cases that impair undersecured or general unsecured creditors are frequently the subject of lawsuits brought by or on behalf of such creditors. Given the pick-up in restructuring activity generally *and* the prevalence of liability management transactions structured around prioritizing some creditor constituents over others, lawsuits in and outside of chapter 11 challenging such transactions will likely become more frequent and potentially play a large role in affecting restructuring outcomes and economic recoveries in connection therewith. But a slam dunk lawsuit brought by a party without standing will not go anywhere. In simple terms, standing is the litigant's ability as a matter of applicable law to prosecute a particular cause of action before a court.[2] Standing is analyzed on a claim-by-claim basis; indeed, as will be discussed below, a litigant may bring a lawsuit in response to a liability management transaction that alleges multiple causes of action, but may be found to have standing to assert some of the causes of action, but not others. As also discussed below, a lender or bondholder (or group of lenders or bondholders) may

[1] "Liability management" is an industry term used to refer to transactions that allow a company to borrow to refinance or restructure outstanding debt or otherwise mitigate downside risk related to its balance sheet and operations.

[2] *Allen v. Wright*, 468 U.S. 737, 750 (1984) ("In essence, the question of standing is whether the litigant is entitled to have the court decide the merits of the dispute or of particular issues.").

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FORTHCOMING

● **WINNING THE WILD WEST: CRYPTOCURRENCY, WEB3, AND THE NEW UCC ARTICLE 12**

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lose standing to bring certain claims once a company files for chapter 11.

This article provides a brief and practical overview of the basics of creditor standing to bring litigation related to liability management-related transactions, including by examining some recent case law related thereto. Part I provides an overview of the basics of creditor standing and collective action/no-action clauses (referred to herein synonymously and interchangeably). Part II discusses some recent decisions that examined whether no-action clauses barred minority lenders from challenging certain priming/up-tier and "drop-down" financing liability management transactions. Part III examines the difference between direct and derivative claims on creditor standing generally and in the context of bringing or continuing prosecution of litigation relating to pre-bankruptcy liability management transactions in a chapter 11 case of the relevant obligor or "Loan Party."[3] Part IV provides a brief conclusion with some recommendations for creditors in respect of evaluating litigation challenging or seeking redress related to a liability management-related transaction.

I. THE BASICS OF LENDER STANDING AND NO-ACTION CLAUSES

Standing is assessed on a claim-by-claim basis. Generally speaking, creditors frequently challenge liability management-related transactions by asserting four categories of claims: (1) breach of contract claims, (2) actual or constructive fraudulent transfer claims, (3) breach of fiduciary duty claims, and (4) other common law tort claims (e.g., claims relating to fraudulent inducement or misrepresentation). Breach of contract claims are direct claims, although the nature of the claim and the scope of the no-action action provision will determine whether an individual lender or bondholder has standing. Actual or constructive fraudulent transfer claims may be direct or derivative claims, depending upon whether the borrower has filed for bankruptcy (as further discussed below). Breach of fiduciary duty claims are usually derivative claims if brought by a creditor. Other common law tort claims can be direct or derivative, depending upon whether the plaintiff is asserting it as the direct victim of the tort, or instead on behalf of the debtor's estate.

Even if a bondholder or lender has a direct claim, it may be found to have contractually waived its standing to bring such a claim based on no-action clauses, which are contained in most loan agreements and bond indentures. With respect to a loan agreement, the no-action action provision will generally provide that an individual lender shall not take any action or exercise rights or remedies with respect to the "collateral" or any of the loan party's property without the prior written consent of the administrative agent. How such language is drafted is important. For example, some no-action clauses may include arguably ambiguous language that vests "all powers, rights and remedies" under the loan agreement in the agent, where the intent is arguably just referring to such powers, rights, and remedies with respect to collateral and not all rights under the loan agreement writ large.[4] Importantly, such provisions may provide that the underlying no-action action provision are "for the sole benefit of the Lenders and shall not afford any right to, or constitute a defense available to, any Loan Party."[5] A narrow no-action action provision,

[3] "Loan Party" or "Credit Party" typically refers to a domestic subsidiary of a borrower that guarantees the underlying debt, as compared to a non-Loan Party Restricted Subsidiary, which is often a foreign subsidiary, does not guarantee the debt, but is subject to the loan agreement's restrictive covenants.

[4] For example, in the original Mitel credit agreement, which is currently the subject of litigation in New York Supreme Court relating to an up-tier transaction, the no-action provision provides as follows: "the Borrower, the Administrative Agent, the Collateral Agent and each Secured Party [i.e., lender] hereby agree that (a) no Secured Party shall have any right individually to realize upon any of the Collateral or to enforce the Guarantee, *it being understood and agreed that all powers, rights and remedies hereunder may be exercised solely by the Administrative Agent, on behalf of the Secured Parties in accordance with the terms hereof and all powers, rights, and remedies under the Security Documents may be exercised solely by the Collateral Agent*. . . ." *Ocean Trails CLO VII, et al. v. MLN TopCo Ltd., et al.*, Mitel Def.'s Mem. Supp. Mot. Dismiss 8, No. 651327/2023 (N.Y. Sup. Feb. 1, 2017) (emphasis added). It is likely the "it being understood" clause modifies the rights with respect to Collateral, but it could be drafted more clearly.

[5] *See, e.g., Eaton Vance Management v. Wilmington Sav. Fund Soc., FSB*, No. 654397/2017, 2018 WL 1947405, at *2 (N.Y.

which only vests the agent (acting at the direction of the "Required Lenders" or in its own discretion) with the right to exercise remedies and take action with respect to collateral or property of a "Loan Party," is preferred from the perspective of preserving individual lender rights.

Similarly, bond indentures frequently provide that an individual bondholder cannot exercise remedies or file a lawsuit in respect of any claim arising under the indenture (including with respect to the securities issued pursuant to the indenture) other than to enforce the right to payment unless the following general conditions have been satisfied: (1) a noteholder gives the indenture trustee written notice that a "Default" has occurred and is continuing; (2) holders of a certain threshold of notes — usually at least 25% and up to a majority — have made a written offer of indemnity or offer security to the indenture trustee for any costs incurred by the indenture trustee; and (3) the indenture trustee does not respond to the request of the noteholders within a specified period of time upon receipt of the notice and offer of security or indemnity.[6]

Like those contained in loan agreements, "no action" clauses in indentures vary in terms of scope; some may only limit/apply to breach of contract claims under the indenture, whereas others may have language prohibiting any lawsuit related to the indenture or the securities issued in connection therewith.[7] Secured notes may have similar "no action" language with respect to exercising remedies or taking any action against collateral as well.

In general, no-action clauses are intended to prevent individual creditors from pursuing litigation or exercising remedies for their individual interests to the detriment of the bondholders and lenders as a collective whole.[8] However, whereas no-action clauses may have originated to *protect* the collective interests of all lenders, they can also be used as a weapon by majority creditor groups in coordination with borrowers to leverage their exclusive rights to obtain better economic treatment in the context of liability management transactions.

II. LACK OF STANDING AS BASIS OF DISMISSAL OF LIABILITY MANAGEMENT-RELATED LITIGATION

Recent New York Supreme Court case law generally supports the proposition that an individual plaintiff will have standing to bring an action to enforce a "sacred right" (i.e., a right of the lender protected from waiver or amendment by a majority of lenders without such affected lender's consent) unless the original terms of the no-action provision expressly vest the agent with such enforcement right. However, an individual lender *may not* have standing to bring a claim challenging or seeking damages related to a transaction implicating a "Required Lender" consent or an action specifically delegated to the agent.[9] The New York Supreme Court's decisions in *J.Crew, Trimark and Boardriders* concerning the applicability of no-action clauses under New York law in lawsuits brought by minority lenders in response to liability management-related financings underscore some of the key issues courts look at in

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Sup. Ct. Apr. 25, 2018) (citing 2014 J.Crew Credit Agreement no-action clause).

[6] *Akanthos Capital Management, LLC v. CompuCredit Holdings*, 677 F.3d 1286, 1289 (11th Cir. 2012) (applying no-action clause with 25% collective action requirement and 60-day trustee notice and standstill requirement); *Quadrant Structured Prods. Co., Ltd. v Vertin*, 23 N.Y.3d 549, 557 (N.Y. 2014) (applying no-action clause with 50% collective action requirement and 60-day trustee notice and standstill requirement).

[7] *Quadrant*, 23 N.Y.3d at 561 (N.Y. 2014).

[8] Janet M. Weiss, *The Time Bomb in Your Indenture — No Action Clauses and Creditor Standing* 6 (2014) (citing *In re Dura Auto.*

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Sys. Inc., 379 B.R. 257, 263 (Bankr. D. Del. 2007); *see also Cortlandt St. Recovery Corp. v Bonderman*, 31 N.Y.3d. 30, 43 (N.Y. 2018) ("The inclusion of such a clause in an indenture makes it more difficult for individual bondholders to bring suits that are unpopular with their fellow bondholders. A no-action clause achieves these goals by delegating the right to bring a suit enforcing rights of bondholders to the trustee, or to the holders of a substantial amount of bonds, and by delegating to the trustee the right to prosecute such a suit in the first instance. These clauses also ensure that the proceeds of any litigation actually prosecuted will be shared ratably by all bondholders.") (internal citations and quotation marks omitted).

[9] *See, e.g., LCM XXII Ltd. v. Serta Simmons Bedding, LLC*, 21 Civ. 3987 (KPF), 2022 WL 953109, at *14 (S.D.N.Y. Mar. 29, 2022) (holding that no-action provision that prohibits individual lender from "realiz[ing] upon any of the Collateral or to enforce the Loan Guaranty" does not prohibit a breach of contract lawsuit brought by an individual lender). The J.Crew, Trimark and Boardriders decisions, discussed *infra* also support such a proposition.

applying no-action clauses at the request of defendants seeking to dismiss such lawsuits for lack of standing.[10]

At a high level, J.Crew involved a liability management financing transaction structured around J. Crew Group Inc. transferring certain J.Crew intellectual property to an "Unrestricted Subsidiary" as an investment and having such Unrestricted Subsidiary issue new notes secured by such intellectual property.[11] The Unrestricted Subsidiary notes were used to raise new money and to retire "holdco" notes (i.e., structurally subordinated to the debt issued and guaranteed by the operating subsidiaries) at a discount to par via an exchange. J.Crew itself filed a declaratory judgment action seeking an order that the transaction was permitted under the senior term loan credit agreement in response to term loan lenders organizing and threatening to bring their own lawsuit.[12] Ultimately, J.Crew and a group of term loan lenders constituting the "Required Lenders" reached a settlement whereby J.Crew made a $150 million par paydown on its existing term loans (funded, in part, by the new $300 million term loan and the new notes issued by Unrestricted Subsidiary), increased the applicable interest rate and amortization, and tightened certain restrictive covenants in the existing term loan facility.[13] The settlement was documented and consented to in an amended and restated senior term loan credit agreement whereby 85% of term loan lenders participated (which was well in excess of "Required Lenders").[14]

Certain term loan lenders holding approximately 10% of the term loans did not participate in the settlement by signing the amended and restated term loan credit agreement. Instead, they filed a lawsuit against the senior term loan agent and J.Crew Group Inc. and various of its affiliates in the New York Supreme Court alleging, among other things, breach of contract claims, intentional fraudulent conveyance claims under sections 276 and 278 of the New York Debtor and Creditor Law ("DCL"), and fraud claims related to the Unrestricted Subsidiary financing transaction.[15] Notably, as part of the amended and restated senior term loan credit agreement, the no-action action clause was amended to specifically apply to any action relating to the "Specified Liability Management Transactions" and removed the language providing that the no-action action provision was "for the sole benefit of the Lenders."[16]

Whereas the defendants conceded that the minority lenders had standing to assert breach of contract claims with respect to the sacred right provisions contained in section 10.01(e) and 10.01(f) of the credit agreement,[17] the court granted the defendants' motion to dismiss the intentional fraudulent transfer claim and fraud claim on the basis that the credit agreement's no-action clause barred such claims because they related to collateral and the agent acting at the direction of the Required Lenders had consented to the transactions that were the subject of the lawsuit.[18] The court applied the amended no-action

[10] Given that most loan and bond indentures are governed by New York law, the New York Supreme Court's decisions should be very influential to other courts applying New York law. Further, many loan agreements and bond indentures require that any breach of contract lawsuit be brought in New York court. An "Unrestricted Subsidiary" refers to subsidiary designated pursuant to the terms of a loan agreement as such, that is not subject to any of the covenants contained in the loan agreement.

[11] For a more detailed overview of the J.Crew drop-down transaction, *see* King & Spalding, Private Credit & Special Situations Hub, *How Did They Do It?: J.Crew & The Original Trap Door* (https://www.kslaw.com/attachments/000/008/521/original/How_did_they_do_it_J._Crew.pdf?1611586444).

[12] *J.Crew Group, Inc., et al. v. Wilmington Savings Fund Society*, FSB, No. 650574/2017 (N.Y. Sup. Feb. 1, 2017).

[13] *J.Crew Group, Inc., et al. v. Wilmington Savings Fund Society*, FSB, Compl. at ¶ 67, No. 654397/2017 (N.Y. Sup. June 22, 2017).

[14] *Eaton Vance*, 2018 WL 1947405, at *3.

[15] *Id.* at *1.

[16] *Id.* at *3 n.10.

[17] *Id.* at *11 ("Next, plaintiffs' declaratory judgment claim must be dismissed as duplicative of their breach of contract claims. As discussed, it is undisputed that plaintiffs are not barred by the noaction [sic] clause from asserting a claim that their unanimous consent rights were violated and, if they prevail on this claim, they may seek redress for the challenged transactions." Sections 10.01(e) and (f) provide that "the written consent of *each Lender*" (i.e., unanimous consent) is required for "any transaction or series of related transactions," pursuant to sections 7.04 or 7.05, which involve transfers of "*all or substantially all*" of the Collateral or the Guaranty.) (emphasis added).

[18] *Id.* at *2. (The collective action provision provided, in relevant part, that "Each Lender agrees that it shall not take *or institute any actions or proceedings,* judicial or otherwise, for any right or remedy against any Loan Party under any of the Loan Documents . . . *with respect to any Collateral or any other*

provision (rather than the pre-amendment no-action provision) since the amendment to the no-action provision did not require unanimous consent of the lenders.[19] Plaintiffs did not dispute that the amended no-action provision applied, but argued that demand futility obviated the issue of whether the no-action clause barred the lenders from bringing the claims.[20] The plaintiffs argued that, under the relevant demand futility law doctrine, they could bring claims that were barred by the no-action clause if a demand to the agent to do so as required by the no-action clause would be futile.[21] The court rejected this argument, finding that applicable "demand futility law" would only apply if the plaintiff alleged particularized facts that the agent's decision not to file claims "was the product *of its own* (as opposed to the J.Crew Defendants') bad faith, gross negligence, or willful misconduct," and that the agent "could not have impartially considered a demand for permission to sue the J.Crew Defendants for their alleged fraud."[22]

Whereas the applicability of the amended no-action provision in the J.Crew liability management litigation was ancillary to the court's decision on standing due to the fact that (1) the defendants did not challenge the plaintiffs' standing to sue for breach of contract claims with respect to sacred rights and (2) the plaintiffs tried to get around the amended no-action clause on a legal theory of "demand futility" rather than argue the original no-action clause should apply, such issue was front and center in the lawsuits brought by the minority lenders to Boardriders, Inc. and Trimark USA arising from priming financing liability management transactions. In both cases, a majority lender group of senior secured first lien term lenders agreed to provide new money financing secured by a priming lien on "term loan priority collateral".[23] These financing transactions were effectuated by the majority lender group, using their power as "Required Lenders," entering into amendments to the existing first lien term loan credit facility to subordinate the existing first lien term loan credit facility to the new, super-priority credit facility, and directing the existing first lien term loan credit facility agent to enter into a new intercreditor agreement with the super-priority lien credit facility agent to implement the same.[24] In both Boardriders and Trimark, the existing first lien term loans held by the majority lender group constituting "Required Lenders" were exchanged in a purported "open market" purchase transaction for second-out super-priority lien loans, such that the non-participating first lien term loan credit facility lenders were layered by both the new money first-out super-priority lien term loans *and* the exchanged second-out super-priority lien term loans. As part of the amendments, the majority lender group and the borrower amended the no-action clauses in both existing first lien term loan credit agreements to make it harder for individual lenders to sue thereunder, ostensibly in anticipation of minority lenders bringing lawsuits to challenge the legality of the priming financing transactions.

In Trimark, the original credit agreement contained a narrow "no-action" provision that prohibited lenders from bringing suit in their own name "to realize upon any of the Collateral or to enforce any Guarantee of the Secured Obligations," requiring instead that such actions be pursued by the agent.[25] The amended credit agreement imposed substantial new restrictions on the non-participating first lien lenders' ability to bring a lawsuit to enforce their rights. The no-action provision set forth in Section 9.18 of the credit agreement was amended to "preclude[] any First Lien Lender from 'tak[ing] or institut[ing] any actions or proceedings, assert[ing] *any other Cause of Action'* not only against TriMark but also, 'in a notable departure from industry norms,' the Lender Defendants."[26] Instead, as the court

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property of any such Loan Party, without the prior written consent of the Administrative Agent.") (emphasis added).

[19] *Id.* ("Since amendment of the no-action clause does not require unanimous consent of the Lenders, but only consent of the Required Lenders (which indisputably was procured), the no action clause applicable to this action is the version in the 2017 Amendment.").

[20] *Id.* at *4, n. 12.

[21] *Id.*

[22] *Id.* at 10. (emphasis added).

[23] "Term loan priority collateral" refers to the collateral securing the term loans on first priority basis, which is generally all off the assets of the Loan Party other than its cash, accounts,

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accounts receivable, and inventory (to the extent that there is an ABL, as was the case in Trimark).

[24] *Audax Credit Opportunities Offshore Ltd. v TMK Hawk,* No. 565123/2020 (JMC), 2021 WL 3671541 (N.Y. Sup. Ct. Aug. 16, 2021) and *ICG Global Loan Fund 1 DAC v. Boardriders, Inc.*, No. 655175/2020, 2022 WL 10085886 (N.Y. Sup. Ct. Oct. 17, 2022) for relevant background facts. The author is counsel to the plaintiffs in Boardriders..

[25] *Audax Credit Opportunities Offshore Ltd.*, 2021 WL 3671541, at **5.

[26] *Id.* (emphasis supplied).

noted, "'the remaining First Lien Lenders purportedly had to direct [the Administrative Agent] to sue.'"[27] The no-action provision was further amended to prohibit the agent from proceeding with such an action "unless the Lenders post a cash indemnity 'of not less than the sum of (x) all fees, costs and expenses **that** the Administrative Agent determines, in its sole discretion, could foreseeably be incurred in connection with such action and (y) the amount of any claims, obligations, or liability, via counter-claims or otherwise, that the Administrative Agent determines, in its sole discretion, could foreseeably could be awarded to the defendants in connection with such action.'"[28]

In its decision on the Trimark defendants' motion to dismiss, the New York Supreme Court addressed the defendants' argument that the plaintiffs did not have standing to assert their claims "because they failed to comply with the amended no-action provisions requiring plaintiffs to pre-fund a cash indemnity and request the Administrative Agent to initiate litigation on their behalf."[29] In declining to enforce the no-action provision as amended, the court first noted that "[n]o-action provisions are enforceable, first and foremost, because they reflect an *ex ante* agreement to sacrifice certain individual rights for the "salutary purpose" of benefiting the venture as a whole."[30] The court further noted that in this case, taking the plaintiffs' allegations as true, there was no *ex ante* agreement to the no-action provisions or salutary benefit. Instead, the court noted, "Plaintiffs signed on to the substantially narrower no-action provisions in the original credit agreement and did not consent to the amendment."[31] Moreover, the amended provisions "lack[ed] any semblance of an arm's-length agreement because the lender defendants allegedly crafted them with a view to immediately exiting the contract, thus gaining the protective benefit of the no-action provisions' amended terms without ever having to abide by them as parties to the contract."[32] The court distinguished the application by the court in *J.Crew* of the amended no-action provision in part due to the fact that the amendment to the term loan credit agreement that changed the no-action provision was not instrumental to the disputed transaction (i.e., the *Trimark* plaintiffs were challenging the transaction and related term loan amendment that, among other things, amended the no-action provision, whereas in *J.Crew* the plaintiffs were challenging a transaction that preceded the amendment that amended the no-action provision).[33]

The New York Supreme Court in Boardriders also declined to dismiss a lawsuit challenging the liability management-related priming financing transaction and, in doing so, found that the minority lender plaintiffs had standing to bring such lawsuit notwithstanding a no-action clause that, if applied in its amended form, would have barred such suit.[34] The no-action clause at issue in Boardriders required any lender bringing a lawsuit against any Loan Party to "(i) act through the Administrative Agent with respect to any of plaintiffs' claims pursuant to Section 12.23 of the Amended Credit Agreement and (ii) post a cash indemnity pursuant to Section 12.01(c) of the Amended Credit Agreement."[35] Like in Trimark, the court distinguished the defendants' citation to *Eaton Vance* in support of the applicability of an amended no-action clause. The court reasoned that "[t]he dispute in *Eaton Vance* did not require the court to consider whether the no-action clause was unenforceable, rather, the court was presented with the question of whether the plaintiffs' claims fell into the no-action clause."[36] The court agreed with the plaintiffs' position that the pre-amended version of the no-action clause contained in the credit agreement "only prohibits actions against the Company or any other obligor concerning 'any Collateral or any other property of the Borrower.'"[37] Thus, the court applied the pre-amended no-action clause rather than the amended no-action clause, as the latter was alleged to have been "amended in bad faith to prevent plaintiff from suing to enforce their rights under the Credit Agreement."[38]

[27] *Id.*

[28] *Id.* at **6.

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.*

[33] *Id.* at **7.

[34] *Boardriders, Inc.*, 2022 WL 10085886.

[35] *Id.* at *6.

[36] *Id.*

[37] *Id. See, also, LCM XXII Ltd.*, 2022 WL 953109, at *14 (holding that strict construction of no-action clause that provides "no Secured Party shall have any right individually to realize upon any of the Collateral or to enforce the Loan Guaranty" does not action breach of contract action where "seek damages and injunctive relief stemming from an allegedly improper transaction".).

[38] *Boardriders, Inc.*, 2022 WL 10085886, at *6.

III. DIRECT V. DERIVATIVE CLAIMS; STANDING IN CHAPTER 11

As noted in the introduction, standing is analyzed on a claim-by-claim basis. A claim-by-claim analysis looks at standing requirements embedded in the underlying cause of action, as well as contractual limitations, such as no-action clauses discussed above. As discussed above, breach of contract claims are direct claims because they arise under a contract the putative plaintiff is a party to and are asserted by the plaintiff in its own right.[39] A breach of fiduciary duty claim against directors and officers is typically asserted by creditors on a derivative basis because the directors and officers do not owe fiduciary duties to creditors; they owe fiduciary duties to the corporation itself for the benefit of shareholders.[40]

A. Breach of Fiduciary Duty Claims

Under Delaware law, which is the most commonly applicable corporate law to large U.S. corporations, the creditors of an *insolvent* corporation have standing to maintain derivative claims against directors and officers of a corporation for breaches of fiduciary duties on behalf of the corporation.[41] Upon insolvency — which must be established by the plaintiff seeking standing by alleging that the corporation's liabilities exceed its assets, or that it is unable to pay its debts as they become due — the fiduciary duties of directors and officers shift from being owed to the corporation for the benefit of shareholders to the corporation for the benefit of all of the corporation's residual claimants — which encompass its shareholders *and* creditors.[42] There is not a basis to establish derivative standing under Delaware law based on a corporation being within the "zone" or "vicinity" of insolvency.[43] Thus, in the context of alleging that authorization of a liability management transaction constituted a breach of fiduciary duties of the directors and/or officers, the creditor bringing such claim will have to plead facts establishing that the corporation is insolvent in order to establish derivative standing. Note that creditors of a limited liability company incorporated under the Delaware Limited Liability Act or a limited partnership incorporated under the Delaware Limited Partnership Act may not have derivative standing, as courts have upheld language in the underlying statutes limiting standing to sue to its member or a member's assignee both inside and outside of bankruptcy.[44]

B. Fraudulent Transfer Claims

State fraudulent transfer law generally provides a creditor of an obligor (i.e., a borrower or guarantor) that is insolvent or operating with unreasonably small capital the right to file an actual or constructive fraudulent transfer claim in connection with a transfer where the borrower or guarantor did not receive reasonably

[39] Note that if the plaintiff is not a party to a contract and is asserting standing as a third-party beneficiary to such contract and there is no express third-party beneficiary clause in the contract, such plaintiff may not have standing to bring such direct contract claim.

[40] *Prod. Res. Gp., L.L.C. v. NCT Gp., Inc.,* 863 A.2d 772, 776 (Del. Ch. 2004) ("The fact that the corporation has become insolvent does not turn such claims into direct creditor claims, it simply provides creditors with standing to assert those claims. At all times, claims of this kind belong to the corporation itself because even if the improper acts occur when the firm is insolvent, they operate to injure the firm in the first instance by reducing its value, injuring creditors only indirectly by diminishing the value of the firm and therefore the assets from which the creditors may satisfy their claims.").

[41] *Id.*

[42] *Id.* at 791. *See also Quadrant Structured Products Company, Ltd. v. Vertin*, 115 A.3d 535, 539 (Del. Ch. 2015) ("To bring a

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derivative action, the creditor-plaintiff must plead and later prove insolvency under the traditional balance sheet or cash flow tests.") (citing *Geyer v. Ingersoll Publ'ns Co.,* 621 A.2d 784, 789 (Del. Ch. 1992)).

[43] *Quadrant Structured Products v. Vertin,* 115 A.3d at 546 ("There is no legally recognized zone of insolvency with implications for fiduciary duty claims. The only transition point that affects fiduciary duty analysis is insolvency itself.") *See also North American Catholic Educational Programming Foundation v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) ("When a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners.").

[44] *CML v. Bax,* 28 A.3d 1037 (Del. 2011) (holding that creditors cannot bring derivative claims on behalf of a Delaware LLC pursuant to the Delaware Limited Liability Act); *In re: HH Liquidation, LLC*, 590 B.R. 211 (Bankr. D. Del. 2018) (finding that creditors' committee lacked standing to bring derivative claims for breach of fiduciary duty on behalf of debtor LLCs); *Gavin/Solmonese LLC v. Citadel Energy Partners*, LLC, 2019 Bankr. LEXIS 1375 (Bankr. D. Del. May 2, 2019) (disallowing standing for a limited partnership's creditors of a debtor governed and formed under the Delaware limited partnership statute).

equivalent value.[45] For example, in J.Crew, the minority lenders brought actual and constructive fraudulent transfer claims under New York DCL against certain J.Crew affiliates on the basis that the J.Crew Loan Party transferor of the intellectual property did not receive reasonably equivalent value in exchange for transferring the J.Crew trademarks to the Unrestricted Subsidiary while the J.Crew Loan Party transferor was insolvent and made with actual intent to defraud the creditors of J.Crew, including the term loan lenders.[46] Although the minority term loan lenders would have standing as creditors under New York DCL to bring the fraudulent transfer claims, they were found to have contractually waived such right pursuant to the no-action provision in the amended term loan credit agreement (as discussed above).[47]

C. Effect of Chapter 11 on Standing to Bring Direct Claims

Even if a creditor or group of creditors has colorable direct claims relating to a pre-petition liability management transaction, it may not be able to bring them during the pendency of a Loan Party obligor's chapter 11 case as long as the automatic stay is in place.[48] When a company files for bankruptcy, the automatic stay provisions of the Bankruptcy Code set forth in Section 362 operate to prevent creditors from pursuing their own remedies against property of the debtor's estate.[49] Estate property includes "all legal or equitable interests of the debtor in property as of the commencement of the case" and "[a]ny interest in property that the trustee recovers under section 329(b), 363(n), 543, 550, 553, or 723 of this title."[50] Fraudulent transfer actions are covered in Section 550(a).[51] In addition to the enumerated types of claims set forth in Section 541, courts have ruled that any claim "based on rights 'derivative' of, or 'derived' from, the debtor's typically involves property of the estate."[52] Claims against non-debtor third parties for an injury "that is particularized as to them" can be pursued by creditors notwithstanding the automatic stay unless the automatic stay has been extended for cause to protect claims against such third parties or the disposition of estate property.[53] In determining whether a claim is based on rights derivative of, or derived from, the debtor's property interests, courts "inquire into the factual origins of the injury, and, more importantly, into the nature of the legal claims asserted."[54]

For example, in connection with the chapter 11 cases of *Revlon, Inc*. and certain of its subsidiaries, the U.S. Bankruptcy Court for the Southern District of New York dismissed various "equitable relief" claims against *Revlon, Inc*. and various other debtors and non-debtors brought by lenders holding more than 50% of the term loans under Revlon's 2016 term loan credit agreement for lack of standing. The basis was that such claims sought relief in connection with pre-petition liability management financing transactions that could be pursued by the trustee (in this case the debtor-in-possession itself).[55] Such equitable relief claims sought to unwind the amendments and related agreements that it entered into in connection with the Ares financing transaction in 2020 and the "Brandco" financing transaction in 2020, both of which allegedly transferred hundreds of millions of dollars of intellectual property assets from the collateral package securing the 2016 term loans.[56] The plaintiffs' complaint sought a court

[45] *See, e.g*., New York (DCL § 274, Transfer or obligation voidable as to present creditor), Delaware (6 Del. C. § 1304, Transfers fraudulent as to present and future creditors); California (CA Civ Code § 3439.04, Transfer made or obligation incurred fraudulent as to creditor; determining actual intent).

[46] *J.Crew Group, Inc., et al. v. Wilmington Savings Fund Society, FSB,* Compl. Counts VI (DCL § 276, 278), VII (DCL §§ 273 and 278), and Count VIII (DCL §§ 273 and 279), No. 654397/2017 (N.Y. Sup. June 22, 2017). Counts VI (DCL § 276, 278), VII (DCL §§ 273 and 278), and Count VIII (DCL §§ 273 and 279).

[47] *Infra* notes 17-22 and accompanying discussion.

[48] Note that a litigant's "standing" to pursue causes of action that become the estate's property means its statutory authority under the Bankruptcy Code, not its constitutional standing to invoke the federal judicial power. *In re Wilton Armetale, Inc.,* 968 F.3d 273, 281 (3rd Cir. 2020).

[49] *In re Tronox Inc.*, 855 F.3d 84, 99 (2d Cir. 2017); *In re Wilton Armetale, Inc.*, 968 F.3d 273, 278 (3d Cir. 2020).

[50] 11 U.S.C. §§ 541(a)(1), 541(a)(3).

[51] 11 U.S.C. § 550(a) ("[T]o the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property. . . .").

[52] *In re Bernard L. Madoff Inv. Securities LLC*, 740 F.3d 81, 88 (2d Cir. 2014).

[53] *Id.*

[54] *Id.* at 89.

[55] *In re Revlon Inc.*, No. 22-10760 (DSJ), 2023 WL 2229352, at *4 (Bankr. S.D.N.Y. Feb. 24, 2023).

[56] *Id.* at *1-2.

order unwinding the 2020 BrandCo Transaction and restoring the 2016 Term Loan Facility agent's first-priority liens on all intellectual property that Revlon used as collateral to facilitate the 2020 BrandCo.[57] The court dismissed the equitable relief claims on the basis that plaintiffs sought remedies that, if granted, "necessarily would involve some combination of restoring property to the estate and securing financial recoveries from counterparties to transactions with the estate, most or all of which could also be sought by the estate itself as either 'the property transferred' or 'the value of such property.'"[58] Although creditors may seek derivative standing to pursue estate claims,[59] or have claims abandoned or assigned to them in connection with a chapter 11 plan or sale transaction,[60] the *Revlon* decision underscores that a direct claim available to an individual or group of lenders prior to the bankruptcy petition, even if already commenced prepetition, could effectively disappear upon the relevant company's bankruptcy.

IV. CONCLUSION

Although the concept of creditor standing is relatively straightforward, there may be tremendous complexity and nuance based on applicable law, facts, and circumstances, and the nature of the claims the creditor is seeking to assert. Given the numerous pending liability management-related lawsuits both inside and outside of the chapter 11 context, challenges to creditor standing will continue to be front and center of many of these litigations. Individual creditors and creditor groups, in consultation with their counsel, should afford standing-related issues the highest priority in their analysis of the cost and benefits of commencing or continuing litigation and in mapping out their conflict resolution strategy more generally. Moreover, lenders and bondholders negotiating loan agreements and bond indentures or reviewing such agreements in advance of a potential investment should afford no-action clauses the same high priority as other clauses associated with leakage risk, such as negative and financial covenants. ■

[57] *Id.*

[58] *Id.* at *16.

[59] *In re Platinum Corral, LLC,* No. 21-00833-5-JNC, 2021 WL 4695327, *3 (Bankr. E.D.N.C. Oct. 7, 2021) (explaining case law in Second, Third, Fifth, Sixth, and Seventh circuits that allows derivative standing for creditors, including creditors' committees).

[60] *See, e.g., In re Wilton Armetale, Inc.,* 968 F.3d at 284 ("When, as here, the abandoned property is a cause of action, the right to assert it 'revert[s] back to the prior holder.'") 5 Collier on Bankruptcy ¶548.02[5][a] (16th ed. 2020).

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