

Pratt's Journal of Bankruptcy Law

LEXISNEXIS® A.S. PRATT®

JUNE 2024

EDITOR'S NOTE: GOING GLOBAL

Victoria Prussen Spears

GLOBAL BONDS, LOCAL IMPACT: INTERNATIONAL BONDHOLDERS PARTICIPATION IN MEXICAN INSOLVENCY PROCESSES

Francisco Javier Garibay Guemez and Leah Eisenberg

THE COURT OF APPEAL JUDGMENT IN THE ADLER RESTRUCTURING PLAN: PARI PASSU IS BACK!

Gregory Petrick, Bevis Metcalfe, Simon Walsh and William Sugden

"KNOW YOUR CUSTOMER," OR AGENT, OR FINANCIAL INSTITUTION, TO QUALIFY FOR THE BANKRUPTCY CODE SAFE HARBORS

Ingrid Bagby, Kathryn M. Borgeson, Michele C. Maman, Eric G. Waxman and Marc Veilleux

CONFLICTING COURT RULINGS ON SUBCHAPTER V ELIGIBILITY LEAVE SMALL BUSINESSES IN LIMBO

Patrick E. Fitzmaurice, Dania Slim and Caroline Tart

DELAWARE BANKRUPTCY COURT BREAKS WITH SISTER COURTS AND GRANTS DERIVATIVE STANDING TO CREDITORS OF A DELAWARE LLC TO SUE ITS MEMBERS AND OFFICERS

Robert Klyman, David Riley, Stephanie Cohen and Daniel Trager

NEW YORK FORECLOSURE ABUSE PREVENTION ACT: LATEST CHALLENGES AND IMPLICATIONS

Mauricio A. España, Ralph R. Mazzeo, Edward J. L. Southgate and Nicole Belenitsky



LexisNexis

Pratt's Journal of Bankruptcy Law

VOLUME 20

NUMBER 4

June 2024

Editor's Note: Going Global

Victoria Prussen Spears

145

Global Bonds, Local Impact: International Bondholders Participation in Mexican Insolvency Processes

Francisco Javier Garibay Guemez and Leah Eisenberg

148

The Court of Appeal Judgment in the Adler Restructuring Plan: Pari Passu Is Back!

Gregory Petrick, Bevis Metcalfe, Simon Walsh and William Sugden

167

"Know Your Customer," or Agent, or Financial Institution, to Qualify for the Bankruptcy Code Safe Harbors

Ingrid Bagby, Kathryn M. Borgeson, Michele C. Maman, Eric G. Waxman and Marc Veilleux

174

Conflicting Court Rulings on Subchapter V Eligibility Leave Small Businesses in Limbo

Patrick E. Fitzmaurice, Dania Slim and Caroline Tart

181

Delaware Bankruptcy Court Breaks With Sister Courts and Grants Derivative Standing to Creditors of a Delaware LLC to Sue Its Members and Officers

Robert Klyman, David Riley, Stephanie Cohen and Daniel Trager

185

New York Foreclosure Abuse Prevention Act: Latest Challenges and Implications

Mauricio A. España, Ralph R. Mazzeo, Edward J. L. Southgate and Nicole Belenitsky

192

QUESTIONS ABOUT THIS PUBLICATION?

For questions about the **Editorial Content** appearing in these volumes or reprint permission, please call or email:

Ryan D. Kearns, J.D., at 513.257.9021
Email: ryan.kearns@lexisnexis.com

For assistance with replacement pages, shipments, billing or other customer service matters, please call:

Customer Services Department at (800) 833-9844
Outside the United States and Canada, please call (518) 487-3385
Fax Number (800) 828-8341
Customer Service Website <http://www.lexisnexis.com/custserv/>
For information on other Matthew Bender publications, please call

Your account manager or (800) 223-1940
Outside the United States and Canada, please call (937) 247-0293

Library of Congress Card Number: 80-68780

ISBN: 978-0-7698-7846-1 (print)

ISBN: 978-0-7698-7988-8 (eBook)

ISSN: 1931-6992

Cite this publication as:

[author name], [*article title*], [vol. no.] PRATT’S JOURNAL OF BANKRUPTCY LAW [page number] ([year])

Example: Patrick E. Mears, *The Winds of Change Intensify over Europe: Recent European Union Actions Firmly Embrace the “Rescue and Recovery” Culture for Business Recovery*, 10 PRATT’S JOURNAL OF BANKRUPTCY LAW 349 (2014)

This publication is designed to provide authoritative information in regard to the subject matter covered. It is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional services. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

LexisNexis and the Knowledge Burst logo are registered trademarks of RELX Inc. Matthew Bender, the Matthew Bender Flame Design, and A.S. Pratt are registered trademarks of Matthew Bender Properties Inc. Copyright © 2024 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved.

No copyright is claimed by LexisNexis or Matthew Bender & Company, Inc., in the text of statutes, regulations, and excerpts from court opinions quoted within this work. Permission to copy material may be licensed for a fee from the Copyright Clearance Center, 222 Rosewood Drive, Danvers, Mass. 01923, telephone (978) 750-8400.

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
www.lexisnexis.com

MATTHEW  BENDER

Editor-in-Chief, Editor & Board of Editors

EDITOR-IN-CHIEF

STEVEN A. MEYEROWITZ

President, Meyerowitz Communications Inc.

EDITOR

VICTORIA PRUSSEN SPEARS

Senior Vice President, Meyerowitz Communications Inc.

BOARD OF EDITORS

SCOTT L. BAENA

Bilzin Sumberg Baena Price & Axelrod LLP

ANDREW P. BROZMAN

Clifford Chance US LLP

MICHAEL L. COOK

Schulte Roth & Zabel LLP

MARK G. DOUGLAS

Jones Day

MARK J. FRIEDMAN

DLA Piper

STUART I. GORDON

Rivkin Radler LLP

FRANCISCO JAVIER GARIBAY GÜÉMEZ

Mayer Brown México, S.C.

PATRICK E. MEARS

Barnes & Thornburg LLP

Pratt's Journal of Bankruptcy Law is published eight times a year by Matthew Bender & Company, Inc. Copyright © 2024 Matthew Bender & Company, Inc., a member of LexisNexis. All Rights Reserved. No part of this journal may be reproduced in any form—by microfilm, xerography, or otherwise—or incorporated into any information retrieval system without the written permission of the copyright owner. For customer support, please contact LexisNexis Matthew Bender, 9443 Springboro Pike, Miamisburg, OH 45342 or call Customer Support at 1-800-833-9844. Direct any editorial inquiries and send any material for publication to Steven A. Meyerowitz, Editor-in-Chief, Meyerowitz Communications Inc., 26910 Grand Central Parkway Suite 18R, Floral Park, New York 11005, smeyerowitz@meyerowitzcommunications.com, 631.291.5541. Material for publication is welcomed—articles, decisions, or other items of interest to lawyers and law firms, in-house counsel, government lawyers, senior business executives, and anyone interested in privacy and cybersecurity related issues and legal developments. This publication is designed to be accurate and authoritative, but neither the publisher nor the authors are rendering legal, accounting, or other professional services in this publication. If legal or other expert advice is desired, retain the services of an appropriate professional. The articles and columns reflect only the present considerations and views of the authors and do not necessarily reflect those of the firms or organizations with which they are affiliated, any of the former or present clients of the authors or their firms or organizations, or the editors or publisher.

POSTMASTER: Send address changes to *Pratt's Journal of Bankruptcy Law*, LexisNexis Matthew Bender, 230 Park Ave. 7th Floor, New York NY 10169.

Delaware Bankruptcy Court Breaks With Sister Courts and Grants Derivative Standing to Creditors of a Delaware LLC to Sue Its Members and Officers

*By Robert Klyman, David Riley, Stephanie Cohen and Daniel Trager**

In this article, the authors discuss a Delaware bankruptcy court ruling that represents a new and expansive application of a decision by the U.S. Court of Appeals for the Third Circuit with respect to derivative standing in Delaware bankruptcy court.

Judge Craig T. Goldblatt has expanded the rights of creditors to sue the members and officers of a bankrupt Delaware limited liability company (LLC) in *In re Pack Liquidating, LLC*.¹

Judge Goldblatt found that the Bankruptcy Code creates a federal right for creditor derivative standing that exists even though Delaware law does not allow creditors of debtor LLCs to sue LLC members and officers for breach of fiduciary duty. Moreover, to the extent that federal right given by the Bankruptcy Code conflicts with state law, Judge Goldblatt also held that the federal Bankruptcy Code preempted Delaware state law. In so holding, Judge Goldblatt broke with a distinguished and well-established line of Delaware bankruptcy cases that applied Delaware state law to deny such derivative standing to creditor representatives.

As a result, creditors' committees may now have a new tool to pursue fiduciary duty claims against members and officers of a bankrupt Delaware LLC.

THE DELAWARE LIMITED LIABILITY COMPANY ACT PRECLUDES CREDITORS OF AN LLC FROM ASSERTING DERIVATIVE CLAIMS FOR BREACH OF FIDUCIARY DUTY

The Delaware Limited Liability Company Act (DLLCA)² prohibits creditors from asserting derivative claims against an LLC's members and officers outside of a bankruptcy case, even if the applicable LLC is insolvent. Under the plain terms of the DLLCA, only members or an assignee of an LLC can obtain

* Robert Klyman is the Global and U.S. Co-Chair of DLA Piper's Restructuring Group. David Riley and Stephanie Cohen are associates in the firm's Restructuring Group.

¹ *In re Pack Liquidating, LLC*, Case No. 22-10797 (CTG) (Bankr. D. Del. Feb. 2, 2024).

² 6 Del. C. § 18-101, et. seq.

derivative standing to pursue actions on behalf of the LLC.³ In the seminal case of *CML V, LLC v. Bax*,⁴ the Delaware Supreme Court applied these express statutory terms and held (i) the DLLCA means what it says – namely that the DLLCA expressly limited standing for derivative actions to members or assignees of the applicable LLC, and (ii) notwithstanding the court's decision in *Gheewalla*⁵ that creditors of an insolvent corporation have standing to pursue such derivative claims against the corporation's officers and directors, the Delaware legislature did not intend the holding in *Gheewalla* to apply in the context of an insolvent LLC to create standing for creditors to pursue such derivative claims.

THREE PUBLISHED DELAWARE BANKRUPTCY CASES PREVIOUSLY APPLIED THE DLLCA AND *BAX* TO LIMIT DERIVATIVE STANDING TO MEMBERS AND ASSIGNEES ONLY

Three prior Delaware bankruptcy Court decisions applied the plain language of the DLLCA and followed the Delaware Supreme Court's holding in *Bax* to prevent creditors (or even trustees) from pursuing derivative claims on behalf of Delaware LLC debtors.⁶

***PACK* BREAKS WITH OTHER DELAWARE BANKRUPTCY CASES AND HOLDS THAT A CREDITORS' COMMITTEE MAY PURSUE DERIVATIVE CLAIMS AGAINST MEMBERS AND OFFICERS OF AN LLC**

The *Pack* debtors were organized as Delaware limited liability companies, engaging in e-commerce as third-party sellers of health, beauty, and consumer products. During the pendency of the Chapter 11 cases, the Official Committee of Unsecured Creditors (the *Pack* Committee) filed an adversary proceeding

³ Id. § 18-1002. Moreover, Section 18-1002 expressly provides that “the plaintiff [in such action] must be a member or an assignee of a limited liability company.”

⁴ *CML V, LLC v. Bax*, 28 A.3d 1037 (Del. 2011).

⁵ *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007).

⁶ See *In re Citadel Watford City Disposal Partners, L.P.*, 603 B.R. 897 (Bankr. D. Del. 2019) (where a post-confirmation trust was given authority to pursue all estate causes of action, citing *Bax* as grounds for dismissing claims for breach of fiduciary duties); *In re HH Liquidation, LLC*, 590 B.R. 211 (Bankr. D. Del. 2018) (where the creditors' committee sought breach of fiduciary duty claims against LLC managers, holding that the DLLCA and *Bax* do not permit creditors to pursue such state law derivative actions); and *In re PennySaver USA Publishing, LLC*, 587 B.R. 445 (Bankr. D. Del. 2018) (where the court treated a Chapter 7 trustee's complaint as a derivative claim, finding that the DLLCA and *Bax* barred the trustee from proceeding on the claim).

asserting breach of fiduciary duty claims against the LLC's members and officers (who were the same people serving in both capacities), as well as other claims for equitable subordination, avoidance, and recovery of fraudulent transfers and disallowance of claims.

Certain defendants filed an objection to the Pack Committee's motion for an order confirming its standing to commence an action for breach of fiduciary claims. They argued DLLCA mandates that only LLC members or their assignees can obtain derivative standing to prosecute the LLC's breach of fiduciary duties claims. The defendants' objection cited to *Bax* and the three Delaware bankruptcy court decisions, discussed above.⁷

In granting the Pack Committee standing, Judge Goldblatt applied the Third Circuit's *Cybergenics*⁸ decision and held that the question relating to the Pack Committee's standing involved a right created under the federal Bankruptcy Code and not Delaware state law; therefore, Judge Goldblatt said that the DLLCA does not preclude granting the Pack Committee standing to pursue an estate cause of action if the relief is otherwise warranted.

THE THIRD CIRCUIT *CYBERGENICS* DECISION

In *Cybergenics*, an unsecured creditors' committee sought derivative standing to pursue certain fraudulent conveyance claims (avoidance claims) on the debtors' behalf.⁹ The Delaware bankruptcy court concluded that the fraudulent transfer claims were colorable and that the debtors' refusal to prosecute them was unreasonable.¹⁰ It therefore granted the committee standing to bring the fraudulent conveyance actions under Section 544(b) of the Bankruptcy Code.¹¹

On appeal, the Delaware district court affirmed the bankruptcy court's granting of the debtors' motion to dismiss, holding that the committee could not bring suit under Section 544(b) of the Bankruptcy Code because only the debtor or trustee had standing to pursue fraudulent transfer claims.¹²

The U.S. Court of Appeals for the Third Circuit reversed, holding that the bankruptcy court could, in the exercise of its federally created equitable power under the Bankruptcy Code, authorize a creditors' committee to bring

⁷ See, e.g., D.I. 1027, 1050, 1067.

⁸ In re *Cybergenics Corp.*, 226 F.3d 237, 245 (3d Cir. 2000).

⁹ Id.

¹⁰ Id.

¹¹ Id.

¹² Id.

derivative fraudulent conveyance claims when the debtor or trustee improperly refused to do so.¹³ In so ruling, *Cybergenics* did not cite to or rely on state law; its analysis focused exclusively on rights created under federal bankruptcy law.

HOLDING IN *PACK*

Judge Goldblatt applied *Cybergenics* and concluded that the Pack Committee's standing to assert a derivative action is grounded in federal bankruptcy law, and is not dependent on any underlying state law.¹⁴ As such, the *Pack* Court held that such standing cannot be limited by state law: "[I]t necessarily follows that the authority is not affected by acts of a state legislature to limit the availability of state-law derivative actions."¹⁵ According to Judge Goldblatt, *Cybergenics* and the DLLCA "operate in separate spheres . . . [where the DLLCA] governs suits filed in the [Delaware] Court of Chancery, the authority to bring a *Cybergenics* action is a federal authority."¹⁶

Judge Goldblatt also rejected the defendants' argument that *Cybergenics* applied only to committee standing to bring an avoidance action (such as the fraudulent transfer claims) rather than breach of fiduciary duty claims.¹⁷ Instead, "the Bankruptcy Code effectively codified the established pre-Code practice of permitting bankruptcy courts to authorize derivative standing when the trustee or debtor-in-possession refused to act in the best interests of the estate . . . [and t]here is no suggestion that the pre-Code practice was limited to avoidance actions."¹⁸ In addition to *Cybergenics*, Judge Goldblatt relied upon caselaw from other circuits similarly holding that committee standing in a bankruptcy case derives from federal bankruptcy power – not state law.¹⁹

Judge Goldblatt also held, in the alternative, that to the extent the DLLCA restricted the power of a bankruptcy court to authorize a *Cybergenics* action,

¹³ Id. at 568.

¹⁴ Op. at 38.

¹⁵ Id. at 15-16.

¹⁶ Id. at 27.

¹⁷ Id. at 32.

¹⁸ Id.

¹⁹ Id. at 22 (citing *In re Commodore Int'l Ltd.*, 262 F.3d 96 (2d. Cir., 2001); *In re STN Enterprises*, 779 F.2d 901 (2d. Cir. 1988); *In re Gibson Group, Inc.*, 66 F.3d 1436 (6th Cir. 1995); *Louisiana World Exposition v. Federal Ins. Co.*, 858 F.2d 233 (5th Cir. 1988); *Fogel v. Zell*, 221 F.3d 955 (7th Cir. 2001); *In re McClatchy Co.*, Bankr. S.D.N.Y. No. 20-10418, July 6, 2020 Hr'g Tr. at 30).

such restriction would be barred and preempted by the Bankruptcy Code.²⁰ Even if the DLLCA did “[seek] to restrict the authority of a bankruptcy court to authorize a *Cybergenics* action, such efforts would be unsuccessful because it would conflict with the Bankruptcy Code and thus be preempted” by federal law.²¹

JUDGE GOLDBLATT BREAKS WITH OTHER DELAWARE BANKRUPTCY COURT DECISIONS

Judge Goldblatt noted that his decision is at odds with the three published opinions of Delaware bankruptcy courts cited above, each following the Delaware Supreme Court’s decision in *Bax* to deny standing to a non-member or assignee of an LLC to pursue a derivative claim.²² Judge Goldblatt noted that in each of these three cases, the opinions did not consider *Cybergenics* or explain how their decisions (based on *Bax* and the DLLCA) “can be reconciled with *Cybergenics*.” Though Judge Goldblatt paused at breaking with other trial courts’ decisions,²³ he “respectfully disagreed with the three published opinions in favor of adhering to the reasoning set out by the *en banc* Third Circuit.”²⁴

JUDGE GOLDBLATT APPLIED THE DLLCA TO UPHOLD FIDUCIARY DUTY WAIVERS

Under the DLLCA, an LLC operating agreement is a creature of state law.²⁵ It is well-established that the DLLCA authorizes members of an LLC to disclaim all fiduciary duties in the applicable operating agreement. By its terms, the *Pack* decision would not impact the efficacy of such a waiver – which would operate to bar a creditors committee from pursuing derivative claims for breach of fiduciary duty. According to Judge Goldblatt, the waiver is a state law substantive right which the court would respect:

Unlike the provisions addressed to who may maintain a derivative

²⁰ Id. at 27.

²¹ Id.

²² See *HH Liquidation*, 590 B.R. 211; *In re PennySaver USA Publishing*, 587 B.R. 445; *Citadel Watford*, 603 B.R. 897.

²³ The *Pack* Court also noted that other unreported Delaware bankruptcy court decisions reached the same conclusion. See, e.g., *In re Dura Automotive Systems*, Bankr. D. Del. No 19-12378, June 9, 2020, Hr’g Tr. at 45.

²⁴ Op. at 43.

²⁵ “In view of the internal affairs doctrine . . . matters of corporate law are governed by the law of the state of incorporation.” Id. at 34.

lawsuit, which are procedural in nature, the disclaimer of fiduciary duties affects the substance of the rights that the debtor would have had as of the time of the bankruptcy filing. Accordingly, to the extent state law permits the disclaimer of fiduciary duties, that is fully respected and controlling in bankruptcy, as the bankruptcy estate obtains under [Bankruptcy Code Section] 541 only those rights that the debtor held as of the time of the bankruptcy filing.²⁶

In *Pack*, the complaint alleged that the debtors' managers also served as officers.²⁷ The LLC operating agreement waived the managers' personal liability for breach of fiduciary duties in their capacity as managers.²⁸ However, the operating agreement did not waive any officer's fiduciary duties, even if those officers also served as managers.²⁹ Accordingly, Judge Goldblatt applied the fiduciary duty waiver in the LLC and held that the Pack Committee (a) could not pursue derivative claims for breach of fiduciary against managers in their capacity as such, but (b) could bring derivative claims for breach of fiduciary against Pack's officers in their capacity as officers.³⁰

POST-PACK FUTURE

The *Pack* decision is an important change in Delaware bankruptcy case law that gives creditors' committees another tool to pursue claims against members and officers of an LLC.

However, there are important limitations and other key takeaways to consider:

1. *Pack* upheld the DLLCA's enforcement of well-drafted waivers of fiduciary duty liabilities in the LLC operating agreement. Therefore, courts applying *Pack*'s reasoning may grant standing to creditors' committees to sue members and officers for breach of fiduciary duty, but only to the extent the relevant LLC operating agreement does not contain those waivers.
2. The *Pack* ruling is not binding authority on other courts in Delaware or in other jurisdictions. Members and officers of financially stressed Delaware LLCs are advised to review their operating agreements to

²⁶ Id. at 45.

²⁷ Id. at 47.

²⁸ Id.

²⁹ Id. at 47-48.

³⁰ Id.

make sure they contain appropriate waivers. If they do not contain the appropriate waivers, they are advised to consider revising them and/or ensuring that the LLC has sufficient insurance to cover the defense of its members and officers.

3. Members and board members of an insolvent LLC that do not benefit from fiduciary duty waivers in the relevant LLC operating agreement should make sure to meet, deliberate, and take into account the interests of creditors when making decisions for the LLC.
4. While *Pack* represents a new and expansive application of *Cybergenics* with respect to derivative standing in Delaware bankruptcy court, the result builds upon workarounds by certain bankruptcy judges to provide creditors' committees standing to pursue claims against members and officers of a debtor LLC. For example, in connection with the establishment of a "challenge period" to assert claims in connection with post-petition financing (e.g., deadlines by which a creditors' committee must bring any claims against the lender), bankruptcy judges in Delaware at times require debtors to stipulate to waivers of objections to derivative standing for a creditors' committee.³¹

³¹ For example, the interim cash collateral order entered in *Pack* stated, "Notwithstanding anything to the contrary in this Interim Order, any issue regarding whether creditors have the ability to file derivative suits on behalf of any Debtor that is a limited liability company is expressly reserved pending entry of the Final Order." *In re Pack Liquidating, LLC, et al.*, Case No. 22-10797 (CTG) (Bankr. D. Del. Aug. 28, 2022) [Docket No. 53] (Interim Cash Collateral Order); see also *In re Uphealth Holdings, Inc.*, Case No. 23-11476 (LSS) (Bankr. D. Del. Dec. 12, 2023) [Docket No. 61] (Interim Cash Collateral Order), [Docket No. 229] (Final Cash Collateral Order).