

Alert

Lender's Derivative Breach of Fiduciary Duty Claim Not Time-Barred Because of Its Knowledge

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A lender's ("Lender") derivative breach of fiduciary duty claims on behalf of Chapter 7 guarantor-Debtors cannot be time-barred because of Lender's knowledge of the "[d]efendants' conduct," held the U.S. District Court for the District of Delaware on June 22, 2016. *In re AMC Investors, LLC*, 2016 U.S. Dist. LEXIS 80861, *16 (Del. June 22, 2016). Reversing the bankruptcy court's dismissal of Lender's derivative suit against officers and directors, the district court explained that the "inquiry should not have turned on [Lender's] knowledge." *Id.* Instead, "the relevant inquiry turns on plaintiff's ability to discover the claim, and here, Debtors are the only plaintiffs with a breach of fiduciary duty claim against Defendants." *Id.* Delaware law, said the district court, "required the bankruptcy court to evaluate when Debtors discovered facts constituting the basis for the ... claims, or the existence of facts sufficient to put Debtors on inquiry notice." *Id.* The decision underscores the difference between a lender's direct action and a derivative action asserting a claim held by another entity.

Facts

Lending Relationship and Guarantees. Lender had advanced funds to the debtors' affiliate ("Borrower") under a 2003 Credit Agreement, obtaining a lien on Borrower's working capital and a guaranty from the debtors ("Debtors"). By 2005, Borrower "became insolvent, and its board of directors voted to cease operations and to approve an assignment for the benefit of creditors." *Id.* at *III. Lender called a default under its agreement, demanded immediate payment, and sued the guarantor-Debtors in New York State court, obtaining a \$10.7-million judgment against them in 2007. Although the guarantor-Debtors appealed, Lender filed an involuntary Chapter 7 petition against them in Delaware in 2008 and a Chapter 7 trustee was appointed for them in 2009.

Prior Non-Bankruptcy Litigation Related to Borrower. Lender brought additional "related, but unconsolidated" suits against the officers, directors and shareholders ("Defendants") of Debtors in the Southern District of New York. It asserted direct and derivative claims on behalf of the Borrower for fraud and breaches of fiduciary duty in connection with its credit agreement defaults. *Id.* at *3. The New York District Court dismissed those suits and the Second Circuit affirmed. *See In re Eugenia VI Venture Holdings, Ltd. Litigation*, 649 F. Supp. 2d 105 (S.D.N.Y. 2008), *aff'd*, 370 F. App'x. 197 (2d Cir. 2010).

Delaware Derivative Litigation Related to Guarantor-Debtors. The Delaware bankruptcy court granted Lender, "as Debtors' sole creditor in the Chapter 7 cases, derivative standing to pursue causes of action against Defendants on behalf of Debtors" in 2011. 2016 U.S. Dist. LEXIS 80861, at *4. (emphasis added). Lender then sued Defendants "on behalf of each Debtor," alleging breaches of fiduciary duty ("good faith, due care, and loyalty to Debtors") by "instituting, directing and/or failing to discover and prevent

massive fraud by the board and management of” Borrower. *Id.* In their answer, the Defendants raised several affirmative defenses, but Lender moved for partial summary judgment only “as to Defendants’ timeliness defenses based on the statute of limitation and laches.” *Id.* at *5.

The Bankruptcy Court

The bankruptcy court found that “breach of fiduciary duty claims are equitable claims bearing close resemblance to legal claims,” making “a statute of limitations analysis ... appropriate.” *Id.* at *7. Defendants argued that because Lender did not sue until 2011, its “claims [were] time-barred.” *Id.* at *8. The bankruptcy court agreed, reasoning that the record did not “justify tolling the statute of limitations.” *Id.* Under each of Delaware’s tolling doctrines, said the bankruptcy court, “the statute of limitations begins to run upon the discovery of facts constituting the basis of a cause of action or the existence of facts sufficient to put a person of ordinary intelligence and prudence on inquiry which, if pursued, would lead to the discovery of such facts.” *Id.* at *8. Because Lender “clearly knew about Defendants’ conduct” when it previously litigated in New York, the bankruptcy court denied Lender’s motion for summary judgment and held that the derivative claims were time-barred because “the tolling mechanisms recognized by Delaware courts do not apply.” *Id.*

The District Court

The only issue on appeal was Defendants’ timeliness defenses. According to the district court, in an “extremely limited holding,” the bankruptcy court erred in finding “none of Delaware’s tolling doctrines” to be “available to Debtors.” *Id.* at *17. The Lender’s “knowledge is not imputed to the Debtors for purposes of the statute of limitations analysis.” *Id.* Because “Debtors are the only plaintiffs with a breach of fiduciary duty claim against Defendants,” the key inquiry was “when Debtors discovered facts” supporting the breach of fiduciary duty claims, or when Debtors had “inquiry notice.” *Id.*, at *16.

Equally important, the court expressed “no opinion” as to the validity of other defenses that the Defendants asserted. The court therefore remanded “the case to the Bankruptcy Court for further proceedings” *Id.* at *17.

Comment

The AMC decision is limited in scope. Here, Lender sued derivatively on behalf of the guarantor-Debtors because a direct action by it would have been time-barred. AMC confirms that Lender’s derivative claims only sought to enforce the Debtors’ claims. It was not asserting its own direct claims.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or the author.

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