Eaton Vance Mgt. v Wilmington Sav. Fund Socy.
2018 NY Slip Op 30727(U)
April 25, 2018
Supreme Court, New York County
Docket Number: 654397/2017
Judge: Shirley Werner Kornreich
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SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: PART 54

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EATON VANCE MANAGEMENT, AGF FLOATING RATE INCOME FUND, EATON VANCE CDO X PLC, EATON VANCE CLO 2014-1 LTD, DAVINCI REINSURANCE LTD., EATON VANCE FLOATING-RATE INCOME PLUS FUND, EATON VANCE SENIOR FLOATING-RATE TRUST, EATON VANCE FLOATING-RATE INCOME TRUST, EATON VANCE INTERNATIONAL (CAYMAN ISLANDS) FLOATING-RATE INCOME PORTFOLIO, EATON VANCE SENIOR INCOME TRUST, EATON VANCE SHORT DURATION DIVERSIFIED INCOME FUND, EATON VANCE INSTITUTIONAL SENIOR LOAN FUND, EATON VANCE LIMITED DURATION INCOME FUND, EATON VANCE FLOATING RATE PORTFOLIO, RENAISSANCE INVESTMENT HOLDINGS LTD., EATON VANCE VT FLOATING RATE INCOME FUND, SENIOR DEBT PORTFOLIO, HIGHLAND CAPITAL MANAGEMENT LP, BRENTWOOD CLO LTD., EASTLAND CLO LTD., GRAYSON CLO, LTD., GREENBRIAR CLO LTD., ROCKWALL II, STRATFORD CLO, LTD., and WESTCHESTER CLO, LTD.,

Plaintiffs,

-against-

WILMINGTON SAVINGS FUND SOCIETY, FSB, as Administrative Agent and Collateral Agent, J. CREW GROUP, INC., CHINOS INTERMEDIATE HOLDINGS A, INC., CHINOS INTERMEDIATE HOLDINGS B, INC., J. CREW INTERNATIONAL, INC., J. CREW OPERATING CORP., J. CREW INC., GRACE HOLMES, INC., H.F.D. NO. 55, INC., MADEWELL INC., J. CREW VIRGINIA, INC., J. CREW INTERNATIONAL CAYMAN LIMITED, J. CREW DOMESTIC BRAND, LLC, J. CREW BRAND HOLDINGS, LLC, J. CREW BRAND INTERMEDIATE, LLC, and J. CREW BRAND, LLC,

Defendants.

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Index No.: 654397/2017

DECISION & ORDER

SHIRLEY WERNER KORNREICH, J.:

Motion sequence numbers 004 and 005 are consolidated for disposition.

Defendant-administrative agent, Wilmington Savings Fund Society, FSB (WSFS), moves, pursuant to CPLR 3211, to dismiss the claims asserted against it in the amended complaint (the AC). Seq. 004. The other defendants (collectively, the J. Crew Defendants)[1] separately move for partial dismissal of the claims asserted against them in the AC. Seq. 005. Plaintiffs oppose both motions. For the reasons that follow, defendants' motions are granted.

I. Factual Background & Procedural History

As this is a motion to dismiss, the facts recited are taken from the AC (Dkt. 94) and the documentary evidence submitted by the parties.

The plaintiffs in this action are senior creditors of J. Crew Group, Inc. (the Company), a well-known apparel retailer. They collectively own approximately 10% of the Company's term loan,[2] which was originally governed by a credit agreement dated March 7, 2011.[3] Plaintiffs are at odds with the majority of the holders of the term loan, some of which also own Senior PIK Toggle Notes (the PIK Notes), which were issued in November 2013 by defendant Chinos

[1] "The 'J. Crew Defendants' are J. Crew Group, Chinos Intermediate Holdings A, Inc., Chinos Intermediate Holdings B, Inc., J. Crew International, Inc., J. Crew Operating Corp., J. Crew Inc., Grace Holmes, Inc., H.F.D. No. 55, Inc., Madewell Inc., J. Crew Virginia, Inc., J. Crew International Cayman Limited, J. Crew Domestic Brand, LLC, J. Crew Brand Holdings, LLC, J. Crew Brand Intermediate, LLC and J. Crew Brand, LLC." Dkt. 115 at 6 n.3. References to "Dkt." followed by a number refer to documents filed in this action on the New York State Courts Electronic Filing system (NYSCEF).

[2] "On October 19, 2017, two funds managed by Eaton Vance [the first named plaintiff] voluntarily discontinued their claims against the Defendants, without prejudice, thereby slightly decreasing Plaintiffs' aggregate holdings." Dkt. 144 at 10 n.6, citing Dkts. 106 & 107; *see* Dkt. 147 at 9.

[3] The debt structure was put in place in connection with the Company's 2011 going-private transaction in which two private equity firms bought out the public shareholders. *See* AC ¶ 35. The original credit agreement, pursuant to which Bank of America, N.A. was the administrative agent (as discussed herein, WSFS is the current administrative agent), provided for $1.2 billion of senior secured financing. *See* AC ¶ 36.

Intermediate Holdings A, Inc. (Holdings A). Holdings A is the parent and controlling shareholder of defendant Chinos Intermediate Holdings B, Inc., which is the parent and controlling shareholder of the Company.

After the PIK Notes were issued, the parties entered into an Amended and Restated Credit Agreement dated March 5, 2014. *See* Dkt. 119 (the 2014 Agreement).[4] It provides that the Company's debt is secured by defined Collateral, which includes its intellectual property (e.g., trademarks) held by certain subsidiaries. *See id.* at 19-20. The 2014 Agreement prohibits the transfer of Collateral to any entity that is not a "Restricted Subsidiary" (a term, it should be noted, used nearly 200 times in the 2014 Agreement).[5]

Article IX of the 2014 Agreement governs the obligations of the Administrative Agent (which, as noted, is now WSFS). *See* Dkt. 119 at 150. WSFS is protected by an extensive exculpatory clause set forth in section 9.03. *See id.* at 151-53.[6] Section 9.03(a) disclaims any fiduciary or implied duties on the part of WSFS. *See id.* at 152. Section 9.03(b) further disclaims any obligation to take any discretionary act not expressly required under the contract (such as directions provided by the Required Lenders, discussed below). *See id.* Importantly, the second-to-last paragraph of section 9.3 provides:

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[4] The 2014 Agreement is governed by New York law. *See* Dkt. 119 at 177. The court notes that the parties often refer to the 2014 Agreement as the "Term Loan Agreement" or TLA.

[5] Restricted Subsidiary is defined as "any Subsidiary of the Borrower other than an Unrestricted Subsidiary." *See* Dkt. 119 at 56-57. Unrestricted Subsidiary is defined as each Securitization Subsidiary **and** "any Subsidiary of the Borrower designated by the board of directors of the Borrower as an Unrestricted Subsidiary pursuant to Section 6.14 subsequent to the date hereof, in each case, until such Person ceases to be an Unrestricted Subsidiary of the Borrower in accordance with Section 6.14 or ceases to be a Subsidiary of the Borrower." *See id.* at 64. Section 6.14 restricts the ability of the Board to designate a Restricted Subsidiary an Unrestricted Subsidiary, for example, by prohibiting such restriction in case of a default or requiring a certain leverage ratio for a test period. *See id.* at 119.

[6] It is undisputed that the terms of section 9.3 are enforceable under New York law.

> The Administrative Agent **shall not be liable** for any action taken or not taken by it (i) **with the consent or at the request of the Required Lenders** (or such other number or percentage of the Lenders as shall be necessary, **or as the Administrative Agent shall believe in good faith shall be necessary, under the circumstances as provided in Sections 10.01 and 8.02)** or (ii) **in the absence of its own gross negligence or willful misconduct** as determined by the final judgment of a court of competent jurisdiction, in connection with its duties expressly set forth herein.

Id. (emphasis added).[7]

Article X begins by addressing how the contract may be amended. *See id.* at 160. Section 10.01 provides that signed written consents from "Required Lenders" are necessary for most changes. *See id.* at 160-63. Required Lenders are defined "as of any date of determination, Lenders having more than 50% of the sum of the (a) outstanding Loans and (b) aggregate unused Commitments; provided that the Loans of any Affiliated Lender shall in each case be excluded for purposes of making a determination of Required Lenders." *See id.* at 56. That said, 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. *See id.* at 161 (emphasis added).[8]

Section 10.19 is a "no-action" clause that provides:

> 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 or the Secured Hedge Agreements (including the exercise of any right of setoff, rights on account of any banker's lien or similar claim or other

[7] As discussed herein, this classic broad exculpatory clause shields WSFS from liability unless plaintiffs can plead with particularity acts that would give rise to a non-exculpated claim. In the face of such an exculpatory clause, a derivative plaintiff seeking to plead demand futility (as plaintiffs are attempting) must demonstrate that the exculpated party faces a credible threat of the imposition of liability, or else demand will not be deemed futile.

[8] Sections 7.04 and 7.05 govern the transfer of the Collateral and, as explained herein, the alleged breach of these sections was at issue in the Prior Action. *See* Dkt. 119 at 132-37.

> rights of self-help), or institute any actions or proceedings, or otherwise commence any remedial procedures, **with respect to any Collateral or any other property of any such Loan Party, without the prior written consent of the Administrative Agent** (which shall not be withheld in contravention of Section 9.04). The provision[s] of this Section 10.19 are for the sole benefit of the Lenders and shall not afford any right to, or constitute a defense available to, any Loan Party.

Id. at 178-79 (emphasis added).[9]

Toward the end of 2016, the Company sought to restructure its debt in a series of transactions (the details of which are irrelevant to this motion). To oversimplify, the collateral backing the 2014 Agreement was allegedly transferred to Unrestricted Subsidiaries, thereby impairing the secured status of the term lenders (such as plaintiffs). After various term lenders objected, the Company and various of its subsidiaries, on February 1, 2017, filed an action in this court against WSFS in which they sought a declaratory judgment that the disputed transactions are not violative of the 2014 Agreement. *See J. Crew Group, Inc. v Wilmington Savings Fund Society, FSB*, Index No. 650574/2017 (the Prior Action), Dkt. 1. On March 24, 2017, WSFS, acting at the direction of certain of the term lenders, filed an answer in which it impleaded other affected subsidiaries and in which it asserted counterclaims challenging the legitimacy of the subject transactions. *See* Prior Action, Dkt. 29. A discovery schedule was set at an April 20, 2017 preliminary conference. *See* Prior Action, Dkt. 33.

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[9] As discussed herein, the J. Crew Defendants contend section 10.19 bars all of plaintiffs' claims except those based on the violation of their unanimous consent rights under section 10.01(e) and (f). It is undisputed that plaintiffs have standing to assert a direct claim for breach of contract for the alleged consent violation. Dkt. 147 at 8 (conceding that plaintiffs "have threshold standing to pursue this claim"); *see* Dkt. 150 (3/8/18 Tr. at 25-26) (same concession on the record at oral argument); *see also id.* at 62 ("Mr. Greenblatt [the J. Crew Defendants' counsel]: They don't get to go back and look at permitted investments and all of the stuff that was in the prior first stage of the transaction, **unless** they can show that there was a transfer of all or substantially all because that is the only thing that would give them each lender rights under the terms of the agreement.") (emphasis added).

On June 12, 2017, the Company publicly announced a private exchange offer in which the PIK Notes would be swapped for new senior secured notes and preferred stock. The Company also announced that it was soliciting the consent of its lenders to enter into amendments to the 2014 Agreement in which, *inter alia*, the term lenders would ratify the disputed transactions at issue in the Prior Action. Ultimately, as discussed herein, approximately 85% of the term lenders – including many that caused WSFS to file counterclaims in the Prior Action – consented.

On June 22, 2017, approximately 12% of the lenders that refused to consent filed the instant action and moved by order to show cause for a temporary restraining order (TRO) and preliminary injunction barring the amendments and proposed transactions. The court refused to issue a TRO, instead scheduling a pre-closing preliminary injunction hearing for June 28, 2017. *See* Dkt. 19. After the hearing, the court denied injunctive relief. *See* Dkt. 59 (6/28/17 Tr.). The plaintiffs then sought a stay from the Appellate Division, which was denied by order dated July 10, 2017. *See* Dkt. 64. The transaction closed. This entailed the execution of an amendment to the 2014 Agreement, dated July 13, 2017. *See* Dkt. 120 (the 2017 Agreement).[10] As required by the 2017 Agreement, the Company and WSFS filed a stipulation discontinuing the Prior Action on July 17, 2017. *See* Prior Action, Dkt. 52.

Plaintiffs take issue with both the late 2016 and July 2017 transactions, which they allege involved the transfer of "all or substantially all" of the Collateral and/or the Guaranty. Hence, they argue their consent – which they did not provide – was required under sections 10.01(e) and (f) of the 2014 Agreement. The J. Crew Defendants do not dispute that the 2017 Agreement could not vitiate this unanimous consent requirement, if required. Nonetheless, they argue the

[10] A redline against the 2014 Agreement was filed. *See* Dkt. 120 at 476.

subject transactions did not involve enough of the Company's assets to trigger the "all or substantially all" threshold. That said, as noted earlier, they recognize that if plaintiffs prove that such threshold was indeed exceeded, the transactions would have been violative of the 2014 Agreement because they would have been effectuated without plaintiffs' consent, and plaintiffs would have standing to seek redress for this breach. However, they correctly maintain that plaintiffs lack standing to sue for breach of sections 7.04 and 7.05 (prohibiting disposition of the Collateral) if the alleged breach did not involve "all or substantially all" of the Collateral.[11]

On August 7, 2017, WSFS and the J. Crew Defendants moved to dismiss the original complaint in this action. Those motions were withdrawn after the parties agreed to permit plaintiffs to amend. Plaintiffs filed the AC on September 7, 2017, asserting six causes of action, numbered here as in the AC: (1-2) breaches of the 2014 Agreement, asserted against the J. Crew Defendants; (3) breach of the 2014 Agreement, asserted against WSFS; (4) a declaratory judgment that the subject transactions are violative of the 2014 Agreement; (5) intentional fraudulent conveyance under sections 276 and 278 of the New York Debtor and Creditor Law (DCL), asserted against the J. Crew Defendants; and (6) fraud, asserted against the J. Crew Defendants. *See* Dkt. 94. On the fifth and sixth causes of action, plaintiffs seek to avoid application of the no-action clause by pleading that making a demand on WSFS would have been futile.

[11] Given this posture, discovery is proceeding in two phases. In the first phase, the parties are taking discovery on the "all or substantially all" issue to ascertain whether plaintiffs' consent was required. If plaintiffs prevail on this issue, there will be a second round of discovery on the merits of the claims under sections 7.04 and 7.05. The bifurcation seeks to avoid litigating the very claims the 2017 Agreement was meant to put to rest. Should plaintiffs prove that such settlement was invalid because their consent was required, they will be permitted to litigate their claims under sections 7.04 and 7.05.

Defendants filed the instant motions to dismiss the AC on October 20, 2017. WSFS argues that plaintiffs have not stated a claim against it because all of its challenged actions were undertaken in its role as Administrative Agent, expressly permitted by the 2014 Agreement, and, most importantly, exculpated from liability under section 9.3 of the 2014 Agreement. WSFS also argues that the declaratory judgment claim is duplicative.

The J. Crew Defendants argue that most of the claims in the AC are barred by the no-action clauses in the 2014 and 2017 Agreements.[12] That said, as discussed herein, the J. Crew Defendants concede that plaintiffs have standing on their threshold claim – that the transfers at issue in the Prior Action and those ratified by nearly 90% of the term lenders allegedly are null and void because such transfers required plaintiffs' consent. The J. Crew Defendants also concede that if plaintiffs prevail on this threshold issue, they have standing and have stated a claim for breach of sections 7.04 and 7.05. Consequently, all that is at issue on the J. Crew Defendants' motion is whether plaintiffs can maintain their declaratory judgment, fraudulent conveyance, and fraud claims. The J. Crew Defendants argue that the no-action clause forfeits standing and, in any event, such claims should be dismissed as duplicative. The J. Crew Defendants also seek dismissal of the claims asserted against defendants Grace Holmes, Inc., H.F.D. No. 55, Inc., Madewell Inc., and J. Crew Virginia, Inc. (collectively, the Madewell Defendants).

The court reserved on the motions after oral argument. *See* Dkt. 150 (3/8/18 Tr.).

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[12] The 2017 Agreement broadened the no-action clause in section 10.19. *See* Dkt. 120 at 631. Plaintiffs do not dispute that the 2017 Agreement's version expressly bars the AC's fifth and sixth causes of action (though, as noted, they maintain that demand futility obviates this issue). 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.

II. Discussion

A. Legal Standard

On a motion to dismiss, the court must accept as true the facts alleged in the complaint as well as all reasonable inferences that may be gleaned from those facts. *Amaro v Gani Realty Corp.*, 60 AD3d 491 (1st Dept 2009); *Skillgames, LLC v Brody*, 1 AD3d 247, 250 (1st Dept 2003), citing *McGill v Parker*, 179 AD2d 98, 105 (1st Dept 1992); *see also Cron v Hargro Fabrics, Inc.*, 91 NY2d 362, 366 (1998). The court is not permitted to assess the merits of the complaint or any of its factual allegations, but may only determine if, assuming the truth of the facts alleged and the inferences that can be drawn from them, the complaint states the elements of a legally cognizable cause of action. *Skillgames*, *id.*, citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 (1977). Deficiencies in the complaint may be remedied by affidavits submitted by the plaintiff. *Amaro*, 60 NY3d at 491. "However, factual allegations that do not state a viable cause of action, that consist of bare legal conclusions, or that are inherently incredible or clearly contradicted by documentary evidence are not entitled to such consideration." *Skillgames*, 1 AD3d at 250, citing *Caniglia v Chicago Tribune-New York News Syndicate*, 204 AD2d 233 (1st Dept 1994). Further, where the defendant seeks to dismiss the complaint based upon documentary evidence, the motion will succeed if "the documentary evidence utterly refutes plaintiff's factual allegations, conclusively establishing a defense as a matter of law." *Goshen v Mutual Life Ins. Co. of N.Y.*, 98 NY2d 314, 326 (2002) (citation omitted); *Leon v Martinez*, 84 NY2d 83, 88 (1994).

B. WSFS's Motion (Seq. 004)

Plaintiffs claim that WSFS breached the 2014 Agreement by ratifying the disputed transactions, entering into the 2017 Agreement, and stipulating to dismiss the Prior Action.

WSFS argues that these claims are barred the 2014 Agreement's exculpatory clause. The court agrees.

Section 9.3 provides that WSFS cannot be held liable under the 2014 Agreement for acts, as here, taken at the direction of Required Lenders regarding section 10.01 if WSFS did not act in bad faith or engage in gross negligence or willful misconduct. *See* Dkt. 119 at 152. Neither gross negligence nor willful misconduct are alleged in the AC. While the expression "bad faith" appears twice in the AC, in paragraphs 2 and 52, it is alleged as against "all" of the defendants and is pleaded in conclusory fashion. Even if the AC could be construed liberally to allege bad faith by the J. Crew Defendants (an issue the court need not and does not decide), the AC lacks any allegation suggesting bad faith on the part of WSFS. Likewise, plaintiffs' 35-page opposition brief lacks even a single mention of bad faith, gross negligence, or willful misconduct. *See* Dkt. 144. Plaintiffs, thus, have failed to meaningfully address this dispositive issue. It is not hard to see why.

WSFS is disinterested in the outcome of the subject transactions and this case. It is a neutral agent of the parties to the 2014 Agreement that has mere ministerial duties to carry out its specified obligations thereunder. *NMC Residual Ownership L.L.C. v U.S. Bank N.A.*, 153 AD3d 284, 288 (1st Dept 2017) ("[i]t is well recognized by the Court of Appeals that an indenture trustee owes the security holders a duty to perform its ministerial functions with due care."), citing *AG Capital Funding Partners, L.P. v State St. Bank & Trust Co.*, 11 NY3d 146, 156 (2008). Plaintiffs do not suggest otherwise. Rather, plaintiffs contend that WSFS was wrong to accept the J. Crew Defendants' position that they had the requisite (i.e., majority, but not unanimous) consents to ratify the subject transfers. While the merits of that claim remain at issue with respect to the J. Crew Defendants, plaintiffs do not allege that WSFS's agreement

with the J. Crew Defendants was the product of bad faith. WSFS had to make a time-sensitive decision about who was correct and made a judgment call.[13] *See* Dkt. 119 at 152 (WSFS not "required to take any action that, in its opinion or the opinion of its counsel, may expose such Agent to liability or that is contrary to any Loan Document."). At most, it may have been guilty of ordinary negligence, conduct excused by the 2014 Agreement's exculpatory clause.

WSFS was required to act at the direction of Required Lenders to discontinue the Prior Action and follow their direction to sign off on amendments to portions of the 2014 Agreement that indisputably did not require unanimous consent. *See* Dkt. 120 at 633. By contrast, as discussed herein, plaintiffs lacked the right to dictate WSFS's litigation strategy under the no-action clause. Plaintiffs have no basis to contend that WSFS following these directions from the Required Lenders was a product of bad faith, gross negligence, or willful misconduct (nor, as noted, do plaintiffs argue to the contrary in their brief). To be sure, the discontinuance of the Prior Action does not affect the viability of plaintiffs' direct claims against the J. Crew Defendants for breach of the 2014 Agreement (though, as discussed, they must first establish standing by prevailing on the "all or substantially all" issue).[14] However, plaintiffs' failure to plead facts that permit a reasonable inference that WSFS engaged in any non-exculpated act warrants dismissal of the claims asserted against WSFS.[15]

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[13] WSFS could not have punted. It would have been unreasonable for WSFS to wait until final adjudication of this action, as the proposed restructuring desired by nearly 90% of the Lenders would have fallen apart. WSFS had to pick a side. That it did not pick plaintiffs' side is not, in of itself, nefarious.

[14] The court need not address the effect of the discontinuance on the viability of plaintiffs' other claims because, as discussed herein, plaintiffs lack standing to assert them.

[15] As noted earlier, WSFS also argues that the plaintiffs' declaratory judgment claim is duplicative. This is addressed further below.

C. The J. Crew Defendants' Motion (Seq. 005)

The J. Crew Defendants seeks dismissal of plaintiffs' claims of fraudulent conveyance and fraud on the ground they are barred by the 2017 Agreement's no-action clause.

It is well settled that no-action clauses, such as section 10.19 of the 2017 Agreement, are strictly enforced where applicable. *Quadrant Structured Prods. Co. v Vertin*, 23 NY3d 549, 560 (2014); *Walnut Place LLC v Countrywide Home Loans, Inc.*, 96 AD3d 684, 684-85 (1st Dept 2012). Equally settled are the policies behind their existence and reasons for enforcement. As the Court of Appeals recently explained:

> 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.

Cortlandt St. Recovery Corp. v Bonderman, 2018 WL 942335, at *6 (NY Ct App Feb. 20, 2018) (internal citations and quotation marks omitted); *see Anato Opportunity Fund I, LP v Wells Fargo Bank, N.A.*, 153 AD3d 1161, 1162 (1st Dept 2017) ("The [no-action] clause is not unenforceable as violative of public policy, given its salutary purpose of preventing undue expense to certificate holders and inconvenience to the investment vehicle in general. Nor is it unconscionable.") (citation omitted).

Even where, as here, a complex loan structure with different tranches of secured debt creates the possibility of divergent interests among the lenders, if the lenders expressly agree to delegate to an agent the exclusive right to bring legal action to enforce the lenders' rights, courts will hold the parties to their bargain. *See Emmet & Co. v Catholic Health E.*, 37 Misc3d 854, 860-61 (Sup Ct, NY County 2012) ("Barriers to action by individual bondholders serve an

important purpose by both preventing expensive lawsuits that do not have the support of a substantial portion of the creditors while also centralizing the prosecution of lawsuits whose benefits should properly accrue to all bondholders."), *aff'd*, 114 AD3d 605 (1st Dept 2014). An agreement to be bound by such a "collective design" applies where, as here, litigation decisions are to be made by a designated Administrative Agent that must act at the direction of contractually defined Required Lenders, even where there is a risk of "potentially unequal treatment." *See Beal Sav. Bank v Sommer*, 8 NY3d 318, 321-32 (2007). Hence, if a lender asserts a claim that falls within the scope of the no-action clause, the court will dismiss the claim for lack of standing. *See, e.g., Rimrock High Income Plus (Master) Fund, Ltd. v Avanti Commc'ns Group PLC*, 157 AD3d 543 (1st Dept 2018).

Plaintiffs do not dispute that their fraudulent conveyance and fraud claims concern the Collateral. Accordingly, section 10.19 of the 2017 Agreement bars plaintiffs from maintaining these claims.[16] *See* Dkt. 120 at 631 (prohibiting Lenders from "institut[ting] any actions or proceedings ... for any right or remedy or assert[ting] any other Cause of Action ... with respect to any Collateral" without prior permission from WSFS). Nonetheless, plaintiffs argue that they may assert these claims because it would be futile, under section 10.19, to demand permission from WSFS to do so. They contend that, like a stockholder seeking to assert a derivative claim that belongs to the corporation, they may establish the right to prosecute a claim if they can establish demand futility.

The J. Crew Defendants, citing federal cases, contend that New York law allows for no such thing. *See RJ Capital, S.A. v Lexington Capital Funding III, Ltd.*, 2011 WL 3251554, at *6-

[16] While the court agrees with the J. Crew Defendants that section 10.19 of the 2014 Agreement also bars these claims, the court need not separately address that version of the no-action clause because, as discussed in n.12, *supra*, section 10.19 was properly amended pursuant to the 2014 Agreement by virtue of the consents of the Required Lenders.

8 (SDNY 2011) (rejecting claim for demand futility based on conflicted indenture trustee), citing *Cruden v Bank of New York*, 957 F2d 961, 968 (2d Cir 1992). They observe that there is scant controlling New York authority that applies the concept of demand futility, a creature of corporate law, to structured finance contracts where, among other differences with the corporate context, the parties are not in a fiduciary relationship.

Plaintiffs respond by citing an old Appellate Division case that suggests finding demand futility under these circumstances is not categorically out of the question. *See Campbell v Hudson & Manhattan R.R. Co.*, 277 AD 731 (1st Dept 1951), *aff'd*, 302 NY 902 (1951). In *Campbell*, the Appellate Division recognized that the collective action design of a no-action clause was well-established and enforceable. *See id.* at 734 (collecting cases). The Court held, however, that investors could bring a derivative action if the indenture trustee "acts in bad faith" or entirely abdicates its responsibility under the governing contract. *See id.* at 734-35.[17] Notably, in *Campbell* (in stark contrast to the instant case), the trustee actually took the side of the plaintiff and declined to ask for dismissal of the complaint. *See id.* at 735-36.[18]

Campbell, however, lacks controlling progeny to guide the court in deciding whether the requisite circumstances of demand futility are present. Plaintiffs recognize this and turn to the Delaware Court of Chancery for guidance. *See Cypress Assocs., LLC v Sunnyside Cogeneration*

[17] This rule is akin to a situation where a trustee or a trust "refuse[s] to perform their duty." *See Velez v Feinstein*, 87 AD2d 309, 315 (1st Dept 1982).

[18] A recent Appellate Division decision indicates *Campbell* remains good law, though that case reiterates demand futility in this context will not be found if the plaintiff does not allege that the trustee acted in bad faith or improperly abdicated its responsibilities. *See In re Part 60 Put-Back Lit.*, 146 AD3d 566, 568 (1st Dept 2017).

Assocs. Project, 2006 WL 668441 (Del Ch 2006) (Strine, V.C.).[19] In *Cypress*, the court held that a bondholder subject to an indenture's no-action clause was nonetheless permitted to proceed with its claim derivatively, under certain circumstances, if it pleaded demand futility. *See Cypress*, 2006 WL 668441, at *6.[20] A review of the facts giving rise to the *Cypress* court's finding of demand futility reveal that the instant case is distinguishable. As plaintiffs themselves explain:

> In Cypress, a majority of bondholders supported an indenture amendment requiring 80% approval. One holder who owned enough bonds to block the amendment withheld consent. The borrower, much like [the Company] here, then determined that it could proceed without the consent of the 80% and entered into the amendment with the trustee acting under the direction of the majority. In a subsequent lawsuit brought by the minority bondholder challenging the validity of the amendment on the ground that the requisite 80% consent had not been obtained, chancery court denied that portion of a motion to dismiss based on the indenture no-action clause. Noting the "lack of fit" between the indenture's restriction on individual suits and provisions enabling a minority to block amendment, the court held that the no-action clause did not bar the individual suit challenging the amendment.

Dkt. 144 at 21 (internal citations omitted). Thus, similar to the situation in *Campbell*, there was an abdication of the trustee's responsibility under the governing contract.

> Plaintiffs argue that "[t]he Cypress analysis applies here" because:
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> In this case, carved out from the collective design are distinct individual Lender rights. The [2014 Agreement] expressly grants each Lender an individual right with respect to certain amendments, waivers, and consents to departures from the [2014 Agreement]. Plaintiffs exercised that right by withholding consent. Demand that [WSFS] take action **to enforce their individual right** was rendered futile by the authorization given to [WSFS] by a majority. [WSFS] acting under the direction of a consenting majority cannot simultaneously represent the conflicting

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[19] Where there is a gap in New York law on an issue of this nature, this court looks to Delaware for guidance. *See Ficus Investments, Inc. v Private Capital Mgmt., LLC*, 61 AD3d 1, 9 (1st Dept 2009).

[20] It should be noted that the indenture in *Cypress* was governed by Utah law. *See id.* at *5. That fact was not determinative, as the court found Utah law to be in accord with Delaware law and relied on Delaware law in assessing the issue of demand futility. *See id.* at *7.

> position of a Non-Consenting Lender. Adopting [the Company's] interpretation of the No-Action Clause as requiring a Lender to seek [WSFS's] consent prior to enforcing a purely individual right would require a futile act.

Id. at 21-22 (emphasis added; internal citations omitted).

Plaintiffs' argument is inapposite to the question of whether plaintiffs' non-contractual fraudulent conveyance and fraud claims are barred by the subject no-action clause. The court in *Cypress* merely held that a no-action clause does not bar a claim by a minority lender to enforce its consent rights. *Cypress* did not hold that demand futility may be established on any other cause of action merely because the trustee is allegedly conflicted.[21] Such an argument is incompatible with the Court of Appeals' holding in *Beal* and the Second Circuit's holding in *Cruden*. Neither *Cypress* nor any other case cited by plaintiffs support the notion that demand under a no-action clause may be excused on claims sounding in fraud, where the requisite consents to effectuate a ratification were procured – that is, claims beyond the scope of contractual violations. Nor do plaintiffs cite any authority holding that, despite plaintiffs being disproportionately worse off relative to the other lenders by virtue of the subject transactions, they may nonetheless challenge such transactions under the DCL if their consent was not required under section 10.01. On the contrary, unequal outcomes suffered by lenders who agreed to participate in a debt structure with a collective design is not a basis to claim demand futility. *See Beal*, 8 NY3d at 321-32.

This sensible rule is based on the reality that what generally impels dissenters to seek relief from a no-action clause is the belief that their interests diverge from the majority. Inherently part of the trustee's job is the resolution of competing claims of lenders with divergent interests. If a divergence in lenders' interests was enough to overcome a no-action clause, such a

[21] In any event, as explained below, WSFS was not actually conflicted.

basis to establish demand futility would routinely render no-action clauses ineffective. Unsurprisingly, New York courts have held that, even where one class of lenders is made worse off by a challenged transaction, so long as those lenders' contractual rights are not alleged to have been violated and the trustee is not alleged to have engaged is misfeasance or abdication of its responsibilities, the no-action clause will bar their suit. *Beal*, 8 NY3d at 321-32; *see Emmet & Co.*, 37 Misc3d 854, *aff'd*, 114 AD3d 605.

Here, too, the very reason plaintiffs seek to evade the no-action clause is because they disagree with WSFS's determination that the J. Crew Defendants procured the requisite consents to engage in the subject transactions. To be sure, it is undisputed that the plaintiffs in this action do not lack standing to sue for the alleged violation of their consent rights. The J. Crew Defendants concede that, without regard to whether circumstances of demand futility are present, plaintiffs have standing to directly assert breach of contract claims based on transactions requiring their consent under sections 10.01(e) and (f). Ergo, there is no dispute as to plaintiffs' standing on the type of claim at issue in *Cypress*. In fact, the parties are taking discovery on and litigating the question of whether the subject transactions involved "all or substantially all" of the Collateral.

Nonetheless, if the "all or substantially all" threshold was not exceeded, plaintiffs' consent rights were not violated and plaintiffs would have no claim for redress. If plaintiffs do not prevail on their "all or substantially all" claim, they cannot have the right to challenge the subject transactions on any other ground, such as that they are fraudulent under the DCL (e.g., that they were made without fair consideration). Section 10.01 of the 2014 Agreement permits Required Lenders (i.e., less than all) to ratify transactions that do not require unanimous consent. Section 10.19 precludes the other lenders from challenging such ratification.

That said, even if WSFS's status as a conflicted decisionmaker could justify a finding of demand futility, plaintiffs have not actually demonstrated that WSFS is conflicted. In other words, that this case involves dissenting lenders rather than shareholders is not outcome determinative because application of the normal corporate demand futility standard would lead to the same conclusion. The very Delaware corporate law invoked by *Cypress* is clear and well-settled regarding whether demand would be futile where the party upon whom demand must be made is, as here, protected by a broad exculpatory clause.[22]

Since plaintiffs challenge the ability of WSFS to consider their demand based on WSFS's involvement in the subject transactions, the applicable standard is that set forth in *Aronson v*

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[22] New York has its own demand futility standard applicable to corporate derivative claims. "The controlling case in New York on demand futility [i.e., *Marx v Akers*, 88 NY2d 189 (1996)] establishes that there are three types of circumstances in which shareholders may proceed with derivative claims in the absence of a demonstrated attempt to persuade the board to initiate an action itself." *In re Comverse Tech., Inc.*, 56 AD3d 49, 53 (1st Dept 2008). To plead demand futility, "[t]he complaint must allege with particularity that '(1) a majority of the directors are interested in the transaction, or (2) the directors failed to inform themselves to a degree reasonably necessary about the transaction, or (3) the directors failed to exercise their business judgment in approving the transaction.'" *Id.*, quoting *Marx*, 88 NY2d at 198. That said, New York has less developed caselaw on demand futility than Delaware and, as noted, is silent on demand futility in this specific context. It appears that all the Appellate Division caselaw on pleading demand futility in the face of an exculpatory provision or corporate charter involved the application of Delaware law. *See, e.g., Asbestos Workers Philadelphia Pension Fund v Bell*, 137 AD3d 680, 682-84 (1st Dept 2016). Nonetheless, the Appellate Division has consistently held there to be no New York public policy problem with enforcing Delaware demand futility pleading standards or enforcing exculpatory clauses governed by Delaware law. *Capone v Castelton Commodities Int'l LLC*, 148 AD3d 506, 507 (1st Dept 2017); *see City of Roseville Employees' Ret. Sys. v Dimon*, 135 AD3d 566 (1st Dept 2016) ("The complaint fails to allege particularized facts showing the substantial likelihood of defendants' personal liability as a result of any intentional misconduct."). Likewise, New York law has long permitted the enforcement of contractual exculpatory clauses so long as claims for gross negligence and intentional misconduct are not waived. *Abacus Fed. Sav. Bank v ADT Sec. Servs., Inc.*, 18 NY3d 675, 682-83 (2012); *Banc of Am. Secs. LLC v Solow Bldg. Co. II*, 47 AD3d 239, 244 (1st Dept 2007). As discussed, the subject exculpatory clause permits liability for such malfeasance and, hence, is in accord with New York law. In sum, the court will apply the clear, settled standard that a Delaware court would use to evaluate the pleading sufficiency of plaintiffs' demand futility allegations in this case.

Lewis, 473 A2d 805 (Del 1984). *See Lenois v Lawal*, 2017 WL 5289611, at *9 (Del Ch 2017) ("*Aronson* applies when the plaintiff challenges an action taken by the board that would consider demand."). "To successfully plead demand futility under [*Aronson*], a plaintiff must allege **particularized facts** sufficient to **raise a reasonable doubt** that (1) the directors [who would consider the demand] are disinterested and independent [or] (2) the challenged transaction was otherwise the product of a valid exercise of business judgment." *See id.* (emphasis added). "The point of this inquiry is to assess whether plaintiff has 'create[d] a reasonable doubt that 'the board of directors could have properly exercised its independent and disinterested business judgment in responding to a demand,' had one been made." *Park Employees' & Ret. Bd. Employees' Annuity & Benefit Fund of Chicago v Smith*, 2017 WL 1382597, at *5 (Del Ch 2017), quoting *Rales v Blasband*, 634 A2d 927, 934 (1993). "At the pleading stage, a lack of independence turns on whether the plaintiffs have pled facts from which the director's ability to act impartially on a matter important to the interested party can be doubted because that director may feel either subject to the interested party's dominion or beholden to that interested party." *Sandys v Pincus*, 152 A3d 124, 128 (Del 2016) (citation and quotation marks omitted).

Here, as discussed, plaintiffs do not plead any facts suggesting that WSFS is anything other than a disinterested administrative agent. Plaintiffs, however, contend that WSFS faces liability for acquiescing to the J. Crew Defendants. In other words, WSFS allegedly faces "personal consequences from the outcome of the litigation." *See Beam v Stewart*, 845 A2d 1040, 1049 (Del 2004). If so, demand on WSFS could be excused, but not if all that can be reasonably inferred from the complaint is a mere theoretical possibility of liability. *See Lenois*, 2017 WL 5289611, at *19. The plaintiff must allege particularized facts indicating that WSFS's actions exposes it to a "**substantial likelihood** of personal liability." *In re Qualcomm Inc. FCPA*

Stockholder Deriv. Lit., 2017 WL 2608723, at *2 (Del Ch 2017) (emphasis added). Doing so is extremely difficult where, as here, WSFS is contractually "exculpated from liability for certain conduct." *Ryan v Armstrong*, 2017 WL 2062902, at *15 (Del Ch 2017). "[A] serious threat of liability may only be found to exist **if the plaintiff pleads a non-exculpated claim** against [WSFS]." *Id.* (emphasis added). Under this standard, plaintiffs must make "particularized allegations" that permit the conclusion that WSFS faces a "credible threat of the imposition of liability" on a non-exculpated claim. *See id.* at *2.

Plaintiffs have not done so. As discussed, plaintiffs have not stated a non-exculpated claim against WSFS based on its conduct in relation to the disputed transactions (ratifying the disputed transactions, entering into the 2017 Agreement, and stipulating to dismiss the Prior Action). While plaintiffs have questioned whether WSFS correctly decided that unanimous consent was not required and that the challenged transactions did not involve "all or substantially all" of the Collateral (an issue, again, the court does not reach at this juncture), plaintiffs do not allege that WSFS's decision was the product *of its own* (as opposed to the J. Crew Defendants') bad faith, gross negligence, or willful misconduct. Consequently, even assuming the truth of all well pleaded allegations in the AC, WSFS is exculpated because, at most, it made a mistake and was negligent.

In conclusion, since plaintiffs have not alleged that WSFS faces a credible threat of liability for a non-exculpated act, plaintiffs have no basis to contend that WSFS could not have impartially considered a demand for permission to sue the J. Crew Defendants for their alleged fraud. Plaintiffs, therefore, have not pleaded demand futility and, consequently, lack standing under the no-action clause. This is true regardless of whether one applies traditional corporate demand futility standards or the Appellate Division's bad faith/complete abdication standard.

Simply put, a minority lender cannot claim a trustee is conflicted if the trustee has no skin in the game, is not likely to face any liability for its actions, and did not abandon its duties under the contract. Here, WSFS clearly did not abandon its role as Administrative Agent, is not faced with any non-exculpated claim, and is not alleged to have acted in bad faith. Thus, pursuant to the no-action clause, WSFS controls the rights to prosecute the fraudulent conveyance and fraud claims asserted in this action by plaintiffs. Such claims, therefore, are dismissed.

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 no-action 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. In the event they prevail, plaintiffs seek monetary damages and/or injunctive relief. A declaratory judgment claim as to the merits of plaintiffs' breach of contract claims, therefore, must be dismissed as duplicative. *See Cherry Hill Market Corp. v Cozen O'Connor P.C.*, 118 AD3d 514, 515 (1st Dept 2014), citing *Apple Records, Inc. v Capitol Records, Inc.*, 137 AD2d 50, 54 (1st Dept 1988) ("A cause of action for a declaratory judgment is unnecessary and inappropriate when the plaintiff has an adequate, alternative remedy in another form of action, such as breach of contract.").

Finally, the J. Crew Defendants argue that the claims asserted against the Madewell Defendants should be dismissed because "the [AC] does not contain a single allegation of purported wrongdoing against any of these entities and mentions them only once in passing." *See* Dkt. 147 at 22 n.14. In their opposition brief, plaintiffs do not defend the pleading sufficiency of the claims asserted against the Madewell Defendants and, therefore, the claims against them are dismissed. Accordingly, it is

ORDERED that the motions to dismiss by Wilmington Savings Fund Society, FSB, and the Madewell Defendants are granted, the Clerk is directed to enter judgment dismissing the claims asserted in the amended complaint against Wilmington Savings Fund Society, FSB, Grace Holmes, Inc., H.F.D. No. 55, Inc., Madewell, Inc., and J. Crew Virginia, Inc., with prejudice, and the claims against the remaining defendants are hereby severed and shall continue; and it is further

ORDERED that the balance of the J. Crew Defendants' motion to dismiss is granted, and the third through sixth causes of action in the amended complaint are dismissed with prejudice; and it is further

ORDERED that within one week of entry of this order on NYSCEF, the parties are to jointly call the court to discuss the status of discovery.

Dated: April 25, 2018

ENTER:

J.S.C.

SHIRLEY WERNER KORNREICH
J.S.C