

Delaware Court Precludes Creditors of Limited Partnership From Pursuing Derivative Claims

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In several cases since the seminal 2011 Delaware Supreme Court decision *CML V LLC v. Bax*, which held that creditors of Delaware LLCs lack standing to pursue derivative claims, the U.S. Bankruptcy Court for the District of Delaware has expanded the jurisprudence regarding the assertion of derivative claims and alternative entities. Most recently, in *Gavin/Solmonese LLC v. Citadel Energy Partners, LLC*, Judge Kevin Carey extended a series of decisions involving LLCs to the limited partnership context, finding that creditors of a Delaware limited partnership are precluded from obtaining standing under provisions of the Delaware Limited Partnership Act, as are trustees of the limited partnership who have taken an assignment of claims under a plan of liquidation.

Background

Citadel involved four debtors — a Delaware limited partnership, two North Dakota LLCs and a Wyoming LLC. The creditors committee filed an adversary proceeding asserting derivative breach of fiduciary duty and other claims against the debtors. The subsequently confirmed Chapter 11 plan created a liquidating trust and appointed a liquidation trustee to “pursue and prosecute” estate causes of action. After the liquidation trustee was substituted in as plaintiff for the committee, the debtors moved to dismiss the derivative fiduciary duty claims by challenging the liquidation trustee’s standing.

Embracing the well-established rules of statutory interpretation, the court began by examining the plain language of the Delaware Limited Partnership Act. In particular, the statute, 6 Del. C. § 17-1002, provides that a “Proper Plaintiff” in a derivative action “must be a partner or an assignee of a partnership interest.” The court concluded that the statute was dispositive and held that “creditors of limited partnerships lack standing to sue derivatively on behalf of an LP” and that the creditors committee was not an assignee of a partnership interest. The court reached the same conclusion with respect to the debtor LLCs organized under North Dakota and Wyoming law, finding that their respective derivative statutes were substantially similar to the Delaware law.

The court’s holding relied on the comparable provision of the Delaware Limited Liability Act and two recent, similar cases: Judge Kevin Gross’ 2018 decision *In re HH Liquidation, LLC* and Judge Christopher S. Sontchi’s 2018 decision *In re PennySaver USA Publishing, LLC*, both of which held that an unsecured creditors committee of a Delaware LLC lacked standing to bring derivative claims for breaches of fiduciary duties. The court noted that the innate flexibility of LLCs under Delaware law and complex relationships that govern such a legal arrangement supported its holding because Delaware law encourages sophisticated parties to achieve “bargained for rights and principles of freedom of contract.” The court also noted that “distinguishing between insolvent corporations, where creditors can sue derivatively, and insolvent LLCs, where they cannot, does not produce an absurd result as different legal principles apply to different corporate entities.”

The liquidation trustee argued that under the plan of liquidation, all estate claims, including those initiated by the creditors committee or the debtors themselves, as well as yet-to-be-filed claims, were assigned to the liquidating trust. The court recognized that assignment of a contract permits an assignee to step into the shoes of the assignor, but it does not change the fact that the creditors committee lacked standing to pursue the derivative causes of action, because it was neither a partner or member of any debtor. Accordingly, the court concluded that the liquidation trustee lacked standing as well.

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Implications

Citadel serves as an important link in the developing body of Delaware bankruptcy court opinions addressing whether and when derivative claims on behalf of Delaware alternative entities may be asserted in bankruptcy. The three sitting Delaware bankruptcy judges who have written on these issues analyze them consistently and provide essential clarity for these situations.

While bankruptcy opinions are not binding on other bankruptcy judges, the cluster of opinions signifies a consensus within the court and the possibility of further consensus among other courts, especially when dealing with entities organized under states maintaining similarly worded alternative entity statutes to Delaware.