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**A Lender's Knowledge of Alleged Breaches of Fiduciary Duties Shall Not Be Imputed Upon Debtors in a Statute of Limitations Analysis**

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**Introduction**

Section 541 of the United States Bankruptcy Code (the "Code") provides in part that the debtor's estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case."<sup>1</sup> The debtor's interests include "whatever causes of action the debtor may have possessed prior to the petition date."<sup>2</sup> In certain circumstances, a creditor may obtain the right to bring claims of the debtor. In such a case, generally the creditor is stepping into the shoes of the debtor, and the creditor is subject to all defenses proffered by the defendant that would apply had the debtors themselves instituted the action.<sup>3</sup> Thus, if the debtors were precluded from bringing a claim because of a statute of limitations defense, the creditors would also be barred from bringing the same claim. Ultimately, solely the knowledge of the debtor, not the creditor suing on behalf of the debtor's estate, is germane to a statute of limitations analysis, as evidenced by the case of *In re AMC Inv'rs LLC*, 551 B.R. 148, 155 (Bankr. D. Del. 2016),

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<sup>1</sup> 11 U.S.C. § 541(a)(1).

<sup>2</sup> *In re Physiotherapy Holdings, Inc.*, 2016 WL 3611831, at \*13 (Bankr. D. Del. 2016).

<sup>3</sup> *Official Comm. of Unsecured Creditors v. R.F. Lafferty & Co.*, 267 F.3d 340, 356 (3d Cir. 2001).

which addressed a creditor's knowledge of alleged breaches of fiduciary duties by officers and directors.

When considering the knowledge of the debtor in the context of a statute of limitations analysis, the statute will begin to run when the plaintiff discovers, or by "reasonable diligence should have discovered his injury."<sup>4</sup> The Third Circuit set forth a three-step analytical framework to scrutinize whether a party is under inquiry notice.<sup>5</sup> The analysis includes the "(1) precise nature of the claims now being asserted, (2) whether an objectively reasonable person would have realized the need to investigate further, and (3) what information such an inquiry would have disclosed."<sup>6</sup> If a Plaintiff is not under inquiry notice and has no knowledge of the claim during the applicable statute of limitations, tolling mechanisms may apply.<sup>7</sup>

In *In re AMC Investors*, the Delaware district court reversed the bankruptcy court's decision granting summary judgment in favor of the officers and directors (the "Defendants") of AMC (the "Company") because Eugenia, as the sole creditor, was granted derivative standing to file suit on behalf of the debtors of the Company.<sup>8</sup> Prior to being granted derivative standing, Eugenia filed involuntary Chapter 7 bankruptcy petitions against the debtors, in which orders for relief under Chapter 7 were entered in 2009.<sup>9</sup> In 2011, Eugenia was granted derivative standing to sue on behalf of the debtors and brought a claim for breach of fiduciary duty against the Company in the Delaware bankruptcy court.<sup>10</sup>

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<sup>4</sup> *Pomeranz v. Museum Partners, L.P.*, 2005 WL 217039, at \*3 (Del. Ch. Jan. 24, 2005).

<sup>5</sup> *EBS Litig. LLC v. Barclays Glob. Inv'rs, N.A.*, 304 F.3d 302, 305 (3d Cir. 2002).

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *See In re AMC Inv'rs, LLC*, 551 B.R. 148, 151 (Bankr. D. Del. 2016).

<sup>9</sup> *See id.*

<sup>10</sup> *See id.*

In 2015, the bankruptcy court granted summary judgment in favor of the Defendants, which was based on the Defendants' statute of limitation defense.<sup>11</sup> The bankruptcy court held that Eugenia's claim was time-barred because Eugenia knew about Defendants' conduct in 2005.<sup>12</sup> Eugenia and the debtors (collectively, the "Plaintiffs") appealed summary judgment.<sup>13</sup> The Delaware district court, in reversing the bankruptcy court's decision, pointed out that the bankruptcy court's "... determination that none of Delaware's tolling doctrines are available to Debtors was incorrect based solely on Eugenia's knowledge."<sup>14</sup> Thus, the district court held that a creditor's knowledge of alleged breaches of fiduciary duties should not be imputed upon debtors in a statute of limitations analysis.<sup>15</sup>

This memorandum will explore the district court's holding and its implications in light of the appeal filed by the Defendants to the Third Circuit on July 26, 2016. Part I of this memo will discuss the statute of limitations analysis set forth by both the bankruptcy court and the district court. Part II will discuss the statute of limitations analysis under New York law. Part III will discuss the larger implications of these differing statute of limitations' analyses regarding section 541 claims as well as the appeal to the Third Circuit and the current status of this case.

## **I. The Differing Analyses of the Delaware Courts**

### *A. The Delaware Bankruptcy Court's Analysis*

In 2011, Eugenia was granted derivative standing to sue on behalf of the debtors and brought a claim for breach of fiduciary duty against the officers, directors, and/or shareholders of

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<sup>11</sup> *See id.* at 152.

<sup>12</sup> *See Eugenia VI Venture Holdings Ltd. V. Maplewood Holdings LLC (In re AMC Investors, LLC)*, 524 B.R. 62, 80-81 (Bankr. D. Del. 2015).

<sup>13</sup> *See AMC*, 551 B.R. at 153.

<sup>14</sup> *Id.* at 155.

<sup>15</sup> *See id.*

the Company in the Delaware bankruptcy court.<sup>16</sup> The bankruptcy court noted that a court sitting in equity is not bound by a legal statute of limitations under Delaware law.<sup>17</sup> Nevertheless, because equity follows the law, certain circumstances call for the court to apply a statute of limitations through analogy.<sup>18</sup> The bankruptcy court reasoned that a statute of limitations analysis was appropriate because alleged breaches of fiduciary duty are equitable claims that bear “a close resemblance” to legal claims.<sup>19</sup> Under Delaware law, breach of fiduciary duty claims have a three-year statute of limitations.<sup>20</sup> The statute of limitations period begins to run from the date of the alleged harm.<sup>21</sup>

Plaintiff’s breach of fiduciary duty claims derive from the Defendants’ alleged mismanagement of the Company from 2003 to 2005.<sup>22</sup> The bankruptcy court then reasoned that Plaintiff’s claims would be time-barred unless Plaintiff could establish a basis for tolling the statute of limitations.<sup>23</sup> The three bases for tolling the statute of limitations under Delaware law are: “(1) inherently unknowable injuries, (2) fraudulent concealment, and (3) equitable tolling following a breach of fiduciary duties.”<sup>24</sup> The statute of limitations will begin to accrue “upon the discovery of facts constituting the basis of the 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 a discovery of such facts.”<sup>25</sup>

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<sup>16</sup> *See id.* at 150.

<sup>17</sup> *See AMC*, 524 B.R. at 80.

<sup>18</sup> *See In re Lyn*, 483 B.R. 440, 452 (Bankr. D. Del. 2012).

<sup>19</sup> *See Vichi v. Koninklijke Philips Elec. N. V.*, 2009 WL 4345724, at \*16 (Del.Ch. Dec. 1, 2009).

<sup>20</sup> 10 Del.C. § 8106.

<sup>21</sup> *Bren v. Capital Realty Grp. Senior Hous. Inc.* 2004 WL 370214 (Del. Ch. 2004).

<sup>22</sup> *See AMC*, 524 B.R. at 80.

<sup>23</sup> *See id.*

<sup>24</sup> *See id.* at 81.

<sup>25</sup> *Vichi*, 2009 WL 4345724, at \*17.

The bankruptcy court cited *Bren v. Capital Realty Grp. Senior House, Inc.*, in which the Chancery Court determined that the statute of limitations could not be tolled merely because of a plaintiff's lack of standing.<sup>26</sup> Ultimately, the bankruptcy court held that Eugenia's knowledge would be imputed to the debtors and, because Eugenia knew about the Defendants' alleged breach in June 2005, the statute of limitations would not be tolled.<sup>27</sup> Accordingly, the bankruptcy court found that the Plaintiffs' claim was time-barred and granted summary judgment in favor of the Defendants.<sup>28</sup>

*B. The Delaware District Court's Analysis*

On appeal, the Delaware district court concluded that Eugenia's knowledge of the Defendants' alleged breach could not be imputed upon the debtors.<sup>29</sup> Principally, the Plaintiff's argued that the bankruptcy court did not explain its reasoning as to why Eugenia's knowledge should be imputed to the debtors.<sup>30</sup> Further, Plaintiff maintained that a statute of limitations does not run for a corporate entity, such as the Debtors, under Delaware law "until at least one innocent party has knowledge of the facts constituting the cause of action and obtains standing to sue on its behalf."<sup>31</sup> Notably, during the statute of limitations period, Eugenia did not have standing to allege the breach of fiduciary duty claims against Defendants.<sup>32</sup> The Defendants disputed Plaintiff's claim by arguing that any potential tolling of the statute of limitations would cease once a plaintiff, who may derivatively sue for the debtors, became aware of the breach.<sup>33</sup>

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<sup>26</sup> *Bren*, 2004 WL 370214, at \*4.

<sup>27</sup> *See AMC*, 524 B.R. at 81.

<sup>28</sup> *See id.*

<sup>29</sup> *AMC*, 551 B.R. at 155.

<sup>30</sup> *See id.* at 153.

<sup>31</sup> *Id.*

<sup>32</sup> *AMC*, 524 B.R. at 80.

<sup>33</sup> *See AMC*, 551 B.R. at 153.

Because Eugenia became aware of the potential breach in 2005, Defendants argue that Plaintiff's claim should be barred as untimely.<sup>34</sup>

The district court's analysis began by noting that the bankruptcy court applied the proper standards for a statute of limitations analysis for a court sitting in equity.<sup>35</sup> However, the district court held that the bankruptcy court erred in its statute of limitations analysis, in that its inquiry should not have been based on Eugenia's knowledge.<sup>36</sup> Because the Debtors are the true plaintiffs who have a valid claim for breach of fiduciary duty against the defendants, "the relevant inquiry turns on a plaintiff's ability to discover the claim."<sup>37</sup> Regarding the Debtors' ability to toll the statute of limitations, the district court relied on *Kahn v. Seaboard Corporation*, where the court stated "reasonable reliance upon the competence and good faith of others who have assumed legal responsibilities towards a plaintiff have not infrequently been held sufficient to toll the running of an applicable statute of limitations."<sup>38</sup> Ultimately, the court found that Eugenia's knowledge should not have been imputed to the Debtors for purposes of determining whether any of the tolling doctrines were available to the Debtors.<sup>39</sup>

## **II. Statute of Limitations Analysis Under New York Law**

The procedural posture of *AMC* shows that both parties agreed with the three bases for tolling the statute of limitations followed under Delaware law, i.e., (1) inherently unknowable injuries, (2) fraudulent concealment, and (3) equitable tolling following a breach of fiduciary duties.<sup>40</sup> The conflict between these adversaries derived from the question of whether Eugenia's

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<sup>34</sup> *See id.*

<sup>35</sup> *AMC*, 551 B.R. at 154.

<sup>36</sup> *See id.* at 155.

<sup>37</sup> *See id.*

<sup>38</sup> 625 A.2d 269, 275 (Del.Ch. 1993).

<sup>39</sup> *See id.*

<sup>40</sup> *See AMC*, 524 B.R. at 81.

knowledge, as a lender to the Company, should be imputed to the Debtors of the Company.

Under Delaware law, the applicability of any tolling doctrine depends upon a plaintiff's ability to discover or perceive the alleged harm.<sup>41</sup> As outlined by the Delaware district court, because the Debtors solely have a viable claim against the Defendants, the applicability of any tolling doctrine will depend upon the Debtors knowledge of the alleged breach of fiduciary duty.<sup>42</sup> Nevertheless, the facts of *AMC* may cause an alternate outcome in different jurisdictions.

For example, akin to Delaware law, New York law recognizes breach of fiduciary duty claims as claims in equity. Under New York law, section 213(7) of the New York Civil Practice Law and Rules ("CPLR") would be applicable under the *AMC* facts. For non-derivative breach of fiduciary duty claims, CPLR § 213(1) and CPLR § 214(3) are the germane sections of the CPLR, and the applicability of these sections depends upon the relief being sought. However, because Eugenia brought it as a derivative claim, CPLR § 213(7) applies. CPLR § 213(7) states, an action must be brought within six years that is "... by or on behalf of a corporation against a present or former director, officer or stockholder for an accounting, or to procure a judgment on the ground of fraud, or to enforce a liability, penalty or forfeiture, or to recover damages for waste or for an injury to property or for an accounting in conjunction therewith."<sup>43</sup>

As with Delaware law, which depends upon the amount of time that has passed, under New York law a plaintiff's derivative claims could be time-barred, as breach of fiduciary claims accrue upon the date of the breach.<sup>44</sup> However, a claim for breach of fiduciary duty is tolled as long as the fiduciary relationship persists.<sup>45</sup> A breach of fiduciary duty claim does not accrue

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<sup>41</sup> See *AMC*, 551 B.R. at 155.

<sup>42</sup> See *id.*

<sup>43</sup> CPLR § 213(7).

<sup>44</sup> See CPLR § 213(7).

<sup>45</sup> See *St. John's Univ., N.Y. v. Bolton*, 757 F. Supp. 2d 144, 169 (E.D.N.Y. 2010).



until “until the fiduciary has openly repudiated his or her obligation or the relationship has been otherwise terminated.”<sup>46</sup> Considering the same facts as in the *AMC* case, the Company became insolvent in 2005 and the board of directors voted to end operations, the fiduciary relationship between the Company and the Debtors ceased in 2005.<sup>47</sup> Akin to Delaware law regarding tolling a limitations statute, if a plaintiff possesses relevant knowledge that would place the plaintiff under the duty to inquire further into a potential breach of fiduciary duty, the statute of limitations will not be tolled.<sup>48</sup>

The facts of the *AMC* case applied under either New York law or Delaware law would yield a similar result. Because Eugenia originally brought suit in the Southern District of New York in 2005, it is clear that they had the requisite knowledge regarding the alleged claims for breach of fiduciary duty.<sup>49</sup> As Eugenia’s claims against the Company were dismissed by summary judgment, they commenced the present suit on behalf of the Debtors in 2011.<sup>50</sup> The Delaware district court’s analysis, as is applied in New York, places the impetus upon the Plaintiff to show that 1) they did not have the requisite knowledge of facts that would support a breach of fiduciary duty and 2) they were not placed on inquiry notice. Because statute of limitations analyses are analyzed in courts of equity in both Delaware and New York, focusing on the knowledge of the underlying Plaintiff in a derivative suit is the most just result.

### **III. Larger Implications & Conclusion**

The *In re AMC Investors* holding affects intricate procedural issues regarding legal claims brought through section 541 of the Code. A party that brings a claim through section 541

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<sup>46</sup> *Golden Pacific Bancorp v. FDIC*, 273 F.3d 509, 518 (2d Cir. 2001).

<sup>47</sup> *See AMC*, 551 B. R. at 149.

<sup>48</sup> *Gleason v. Spota*, 194 A.D.2d 764, 765 (1993).

<sup>49</sup> *See AMC*, 524 B.R. at 80-81.

<sup>50</sup> *See AMC*, 551 B.R. at 151.

on behalf of a debtor assumes the debtor's interest in the claim.<sup>51</sup> In other words, a legal claim brought through section 541 is solely the debtor's cause of action. Therefore, all relevant tolling inquiries and statute of limitations' analyses apply to the debtors and not the creditor acting on the debtors' behalf.<sup>52</sup> Thus, this holding causes section 541 claims to be analyzed without any regard to the interests of the party instituting the claim on the debtors' behalf.

On January 31, 2017, the appeal to the Third Circuit was dismissed for lack of jurisdiction because the district court's order was not a final order.<sup>53</sup> Finality in the prior proceedings was necessary for the Third Circuit to have jurisdiction to hear this appeal.<sup>54</sup> Although the appeal has been dismissed for lack of jurisdiction and as of March 19, 2017 no new documents have been filed, the statute of limitations and imputation of knowledge analyses will both be dependent upon the Debtors knowledge of any alleged breaches of fiduciary duty by the officers and directors of the Company.

Under both New York and Delaware law, the relevant inquiry for (1) a statute of limitations analysis and (2) imputation of knowledge are fact-specific inquiries. The specific facts of each case will dictate whether the statute of limitations will be tolled or whether the knowledge of one party in a suit should be imputed to another. Ultimately, the court may find that the Debtors had knowledge of the alleged breach of fiduciary duty. This knowledge would cause the claim to be untimely. However, if the Debtors did not have the requisite knowledge of the claim, the statute of limitations would be tolled and their claim would likely proceed. The Appellant-Defendants may file another appeal any day, but as of now, this matter is closed.

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<sup>51</sup> *R. F. Lafferty & Co.*, 267 F.3d at 356.

<sup>52</sup> *AMC*, 551 B.R. at 155.

<sup>53</sup> *In Re AMC Investors, LLC, et al*, 16-3193.

<sup>54</sup> *See id.*