SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: COMMERCIAL DIVISION PART 54

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UMB BANK, N.A., AS TRUSTEE FOR THE 8% SENIOR CASH PAY NOTES DUE 2021 AND FOR THE 8.750%/9.500% SENIOR PIK TOGGLE NOTES DUE 2021,

Plaintiff,

- v -

NEIMAN MARCUS GROUP, INC.,MARIPOSA INTERMEDIATE HOLDINGS LLC,NEIMAN MARCUS GROUP LTD, LLC,MYT PARENT CO., MYT HOLDING CO., THE NEIMAN MARCUS GROUP LLC, ARES PARTNERS HOLDCO LLC,ACOF OPERATING MANAGER III, LLC,ACOF OPERATING MANAGER IV, LLC,ARES CORPORATE OPPORTUNITIES FUND III, L.P., ARES CORPORATE OPPORTUNITIES FUND IV, L.P., ACOF MARIPOSA HOLDINGS LLC,JOHN DOES 1-10,

Defendants.

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INDEX NO. 654509/2019

MOTION SEQ. NO. 002

DECISION & ORDER ON MOTION

HON. JENNIFER G. SCHECTER:

The following e-filed documents, listed by NYSCEF document number (Motion 002) 56-62, 63, 64, 67, 68, 69, 70, 80, 83, 99-106, 109-119

were read on this motion to DISMISS .

Defendants Ares Partners Holdco LLC, ACOF Operating Manager III, LLC, ACOF Operating Manager IV, LLC, Ares Corporate Opportunities Fund III, L.P., Ares Corporate Opportunities Fund IV, L.P., and ACOF Mariposa Holdings LLC (collectively, Ares) move to dismiss the complaint based on, among other things, lack of standing. Plaintiff UMB Bank, N.A. (the Trustee), supported by amici curiae, opposes the motion.

The motion is granted.[1]

Background

In 2013, Ares conducted a leveraged buyout of retailer Neiman Marcus (the Company), funded in part by more than $1.5 billion of Cash Pay Notes and PIK Notes that were set to mature in 2021 (collectively, the Notes). The Notes, which were not in default when this action was commenced, are governed by materially identical indentures (Dkts. 2, 4 [the Indentures]). Plaintiff is the Trustee.

In 2014, the Company, which has struggled along with much of the retail sector, acquired MyTheresa, a German luxury retailer that has outperformed the rest of the Company (Complaint ¶¶ 50-51, 56-60). According to the Trustee, in 2017, Ares was concerned about its investment and sought to strip the Company of MyTheresa--its most valuable asset--to keep it out of reach of the Company's creditors, including the holders of the Notes (the Noteholders) (*see* ¶ 66). In March 2017, the Company disclosed that it changed the designation of the entities that owned MyTheresa to Unrestricted Subsidiaries, permitting conveyance of the equity of this successful business despite the Indentures' restrictive covenants, which otherwise would have prohibited such transfers (¶¶ 67-68). The Company did not follow through until September 2018, when it disclosed that it

[1] Defendants Neiman Marcus Group, Inc., Mariposa Intermediate Holdings LLC, Neiman Marcus Group LTD LLC, The Neiman Marcus Group LLC, MYT Parent Co. and MYT Holding Co. (collectively, the Neiman Marcus Defendants) also moved to dismiss (Dkt. 56, Seq. 001). That motion cannot be decided now due to the automatic bankruptcy stay (*see* Dkts. 122, 123, 125). The standing issue was briefed comprehensively in the Neiman Marcus Defendants' papers, which were adopted by Ares and were fully addressed by plaintiff (*see* Dkt. 105 at 18). The court considered all of those arguments.

conveyed the MyTheresa subsidiaries to its parent for no consideration, insulating the lucrative assets from the Noteholders as a source for repayment (*see* ¶¶ 71-74). Based on its publicly disclosed financial statements, the Company was allegedly insolvent at the time of those conveyances and has remained insolvent ever since (¶¶ 76-77).

In December 2018, one of the Noteholders filed a Texas lawsuit challenging the conveyances. That action was dismissed for lack of standing (¶ 95).[2] Shortly thereafter, Ares and the Company sought the Noteholders' ratification of the transfers in exchange for new notes with a partial lien on the stock of MyTheresa and preferred equity in its parent company as part of an exchange transaction that would extend the Notes' maturity date to 2024 (¶¶ 96-97). This was to be effectuated through amendments to the Indentures that would eliminate many of the covenants and events of default (¶¶ 98-101). The amendments would also waive all past breaches and defaults (¶ 103).

The amendments went into effect in June 2019 after more than 90% of the Noteholders consented (¶ 112). Shortly thereafter, in August 2019, the Trustee commenced this action asserting causes of action for actual and constructive fraudulent conveyance against the defendant entities that were parties to the MyTheresa transfers and tortious interference with contract against Ares.

Ares moves to dismiss, arguing that the Trustee lacks standing to bring this action. It relies on section 6.3 of the Indentures, which provides:

[2] Individual lenders often lack standing based on a no-action clause in the indenture, which limits the ability of a noteholder to sue (*see Eaton Vance Mgmt. v Wilmington Sav. Fund Soc., FSB*, 2018 WL 1947405, at *6-7 [Sup Ct, NY County Apr. 25, 2018], *affd* 171 AD3d 626 [1st Dept 2019]).

> **If an Event of Default occurs and is continuing**, the Trustee may pursue any available remedy to collect the payment of principal of or interest on the Notes or to enforce the performance of any provision of the Notes, this Indenture (including sums owed to the Trustee and its agents and counsel) and the Guarantees (Dkt. 2 at 80-81 [emphasis added]).

Ares contends that because the Trustee does not allege an Event of Default, it cannot pursue an action on behalf of the Noteholders.

The Trustee insists that it has standing because a majority of the outstanding Noteholders directed it to commence this action in accordance with section 6.5 of the Indentures, which sets forth:

> Holders of a majority in principal amount of the then outstanding Notes may direct the time, method and place of conducting any proceeding for **any remedy available to the Trustee or of exercising any trust or power conferred on the Trustee** (Dkt. 2 at 81 [emphasis added]).

The Trustee maintains that sections 6.3 and 6.5 each grant it power to take action under two different circumstances: section 6.3 permits it to act on its own after an Event of Default and section 6.5 grants it the ability to take action at the direction of Noteholders without the default prerequisite. The Trustee emphasizes that, if it cannot sue and aggrieved individual Noteholders cannot sue, then defendants' actions would effectively be immunized until an Event of Default.

Focusing on the text of section 6.5, Ares responds that commencement of this pre-default lawsuit is not a "remedy available to the Trustee" nor is it an exercise of a "trust or power" that has been conferred on the Trustee. It urges that section 6.5 is therefore inapplicable. Ares maintains that section 6.5 only comes into play once the Indentures have

expressly authorized the Trustee to pursue a remedy or exercise certain power and that they only do so here after there has been an Event of Default.

Based on the Indentures' unambiguous terms, Ares is right.

Discussion

On a motion to dismiss, the court must accept as true the facts alleged in the complaint and all reasonable inferences that may be gleaned from them (*Amaro v Gani Realty Corp.*, 60 AD3d 491 [1st Dept 2009]). 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, LLC v Brody*, 1 AD3d 247, 250 [1st Dept 2003], citing *Guggenheimer v Ginzburg*, 43 NY2d 268, 275 [1977]). If a defendant moves to dismiss based on documentary evidence, the motion will succeed only if such "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]).

Whether the Trustee has standing to assert pre-Event-of-Default fraudulent conveyance and tortious interference claims is a question of first impression in New York.[3]

[3] The only case to consider the question was *U.S. Bank N.A. v U.S. Timberlands Klamath Falls, L.L.C.* (2004 WL 1699057 [Del Ch July 29, 2004] [*Timberlands*]), where the court held that the trustee did not have standing based on section 6.3 and lacked the inherent power to assert a claim prior to an event of default (*see id.* at *3-4). Section 6.5 was not expressly addressed in that case. The trustee in *Timberlands* amended after an event of default was properly alleged (864 A2d 930, 939 [Del Ch 2004]). That may well occur here (*see* Dkt. 125 at 2), albeit in a new action (*see Rizack v Signature Bank, N.A.*, 169 AD3d 612, 613 [1st Dept 2019], citing *Varga v McGraw Hill Fin., Inc.*, 147 AD3d 480, 481 [1st Dept 2017]). The other cases cited are inapposite. In *Akanthos*

The words actually used in the Indentures are ultimately dispositive (*Cortlandt St. Recovery Corp. v Bonderman*, 31 NY3d 30, 44 [2018]). In *Cortlandt St. Recovery Corp.*, based on a provision almost identical to section 6.3, the New York State Court of Appeals held that an indenture trustee has standing to assert a post-event-of-default claim because "an attempt to secure payment, and resolution . . . is of interest to the entire class of security holders" (*id.*). Significantly, the Court concluded that the trustee's standing derived strictly from the indenture, not from any inherent authority to generally vindicate noteholders' rights (*id.*; *see also Timberlands*, 2004 WL 1699057, at *4). The analysis turned on "the plain language of the indenture," because an indenture trustee is not a traditional common law fiduciary but rather "a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture" (*Cortlandt St. Recovery Corp.*, 31 NY3d at 39, 44; *see AG Capital Funding Partners, L.P. v State St. Bank & Trust Co.*, 11 NY3d 146, 156 [2008] ["The corporate trustee has very little in common with the ordinary trustee.... The trustee under a corporate indenture" has "rights and duties defined, not by the fiduciary relationship, but exclusively by the terms of the agreement"]).[4] A trustee's power and authority is thus generally limited to that which is provided in the indenture.

Capital Mgmt., LLC v CompuCredit Holdings Corp. (677 F3d 1286 [11th Cir 2012]), the issue was whether there was a basis to permit noteholders (not the trustee) to assert claims that are subject to the indenture's no-action clause. In *U.S. Bank N.A. v Windstream Servs., LLC* (2019 WL 948120 [SDNY Feb. 15, 2019]), while it was eventually held that there was an event of default that was not waived (*see id.* at *21-22), defendants did not argue that the trustee lacked standing prior to an event of default and section 6.5 was never raised.

[4] The Indentures' limitations on pre-Event-of-Default obligations is consistent with the extremely limited role an indenture trustee ordinarily plays prior to an event of default (*AG Capital*, 11 NY3d at 156 [collecting cases noting that trustees' pre-default duties are ministerial and that they merely

The Court of Appeals was clear, moreover, that post-default, the indenture broadly authorized the trustee to pursue "any available remedy," including fraudulent conveyance claims, "to remedy an injury common to all noteholders arising from the failure" to repay (*Cortlandt St. Recovery Corp.*, 31 NY3d at 43; *see* Dkt. 2 at 80-81 ["the Trustee may pursue any available remedy **to collect** the payment of principal of or interest on the Notes or **to enforce** the performance of any provision of the Notes"] [emphasis added]). After all, a payment default deprives noteholders of the money they are owed, and if repayment can only occur by pursuing a fraudulent conveyance claim, the trustee must be the one to bring it.

Here, by contrast, the Trustee could not bring the action pursuant to section 6.3. When this action was commenced, the Noteholders had not suffered a missed payment, the Notes had not matured, and there had been no default. Nor could it maintain this suit based on Section 6.5.

Section 6.5 is not an independent source of authority for the Trustee to act. It simply details how Noteholders may direct the Trustee to conduct "any proceeding for any remedy" that is already "**available to the Trustee** or of exercising any trust or power" already "**conferred on the Trustee**" (Dkt. 2 at [emphasis added]). The remedies that are "available to" and powers that are "conferred on" the Trustee are set forth in other

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must avoid conflicts of interest]; *see Cece & Co. v U.S. Bank N.A.*, 153 AD3d 275, 280 [1st Dept 2017]). Likewise, it is only after an event of default that a trustee is charged with fiduciary obligations, which undermines the notion that a trustee has inherent authority to protect the noteholders prior to an event of default by pursing fraudulent conveyance claims (*see BlackRock Allocation Target Shares: Series S. Portfolio v Wells Fargo Bank, N.A.*, 47 F Supp 3d 377, 395 [SDNY 2017] [an event of default "is transformative"]).

provisions of the Indentures, such as section 6.3. In all of those provisions, an Event of Default is a threshold requirement. This is true of section 6.3's scope of authority and it is the first condition of the no-action clause set forth in section 6.6. Read as a whole, including sections 7.1(a) and 7.1(b) that address the "Duties of the Trustee" after an Event of Default (*see id.* at 82-83), it is clear that the Indentures only permit Trustee actions after an Event of Default (*see Beal Sav. Bank v Sommer*, 8 NY3d 318, 325 [2007]). Nowhere in the Indentures is any pre-Event-of-Default Trustee action contemplated. Section 6.5 only allows Noteholders to direct the Trustee with regard to "any remedy" that the Indentures make available to it, and the Indentures only make the remedy of asserting tort claims available if "an Event of Default occurs and is continuing."

When the Trustee brought this suit, it lacked the ability to take action to secure payment. While there are certainly prophylactic benefits to unwinding pre-Event-of-Default fraudulent conveyances, had the parties wished to confer that right on the Trustee, they could have easily done so expressly in the Indentures (*see Cortlandt St. Recovery Corp.*, 31 NY2d at 46).[5]

[5] There can be profound disagreement among noteholders about the best prospects for repayment. This is not the first time that noteholders overwhelmingly consented to allegedly fraudulent conveyances (*see Eaton Vance*, 2018 WL 1947405, at *3-4). That so many sophisticated investors consented suggests there may be a benefit to prohibiting pre-Event-of-Default actions. Such disagreements are precisely what no-action clauses are meant to address (*see id.* at *8 ["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"] [emphasis added]; compare *Emmet & Co.*, 49 Misc 3d at 1070-71 [challenged transaction violated indenture]). Along with the no-action clause, the Indentures provide limited, explicit situations when the Trustee may act. The court is unaware of any case where a trustee was permitted to act without express contractual authorization. The concerns amici raised do not support adoption of a

Public policy compels this conclusion as well. These are sophisticated parties engaged in a sophisticated commercial transaction involving a Trustee with authority stemming solely from their own intricate agreements. Their contracts must be enforced in the most predicable manner consistent with their clear terms (*Quadrant Structured Prod. Co. v Vertin*, 106 A3d 992, 997 [Del 2013] ["An important requirement for properly functioning public debt security markets is that the rights pertaining to those securities be certain and predictable to both investors and issuers"]; *see 159 MP Corp. v Redbridge Bedford, LLC*, 33 NY3d 353, 359-60 [2019] ["By disfavoring judicial upending of the balance struck at the conclusion of the parties' negotiations, our public policy in favor of freedom of contract both promotes certainty and predictability and respects the autonomy of commercial parties in ordering their own business arrangements"]). In this complex commercial context, general notions of equity cannot be used to deviate from this mandate (*see Greenfield v Philles Records, Inc.*, 98 NY2d 562, 570 [2002] ["a court is not free to alter the contract to reflect its personal notions of fairness and equity"]). Any negative market consequences can be easily remedied. Deal documents can provide trustees with broader pre-default rights, and the market can price deals accordingly.[6] It is in the

new and different rule, which would undermine the public policy of certainty for contracting parties and enforcement of expectations through strict adherence to the indenture's terms.

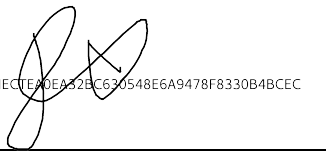
[6] It has been nearly 20 years since *Timberlands*; yet, no one suggests that there was any resulting market havoc, outcry or panic or that borrowers have subsequently systematically engaged in fraudulent conveyance schemes without consequence. After all, the plan does not work unless, as here, the lenders overwhelmingly agree--a democratic check, consistent with the collective design of an indenture that, in addition to the market, should mitigate the proliferation of the most nefarious plans. Additionally, noteholders are not necessarily altogether without a remedy. They simply contracted to wait for a default before the Trustee can pursue recovery.

contracting parties' hands. The market is better suited to address these concerns at the outset rather than courts creating new rules that do not comport with settled law and expectations.[7]

Because the Trustee lacks standing to commence a pre-Event-of-Default action, dismissal of all claims is mandated without prejudice to the proper commencement of a new action (*see Rizack*, 169 AD3d at 613).[8]

Accordingly, it is ORDERED that the motion to dismiss the complaint is granted and the Clerk is directed to enter judgment dismissing the claims asserted against Ares without prejudice; and it is further

ORDERED that the claims against the Neiman Marcus Defendants are severed and the action shall be marked disposed subject to the Trustee's right to seek restoration or to proceed in a new action if the automatic stay is lifted.



7/16/2020
DATE

JENNIFER G. SCHECTER, J.S.C.

CHECK ONE: [X] **CASE DISPOSED** [ ] **NON-FINAL DISPOSITION**
[X] **GRANTED** [ ] **DENIED** [ ] **GRANTED IN PART** [ ] **OTHER**

[7] One of the only policy exceptions that permits deviating from a no-action clause is the statutory right of a noteholder to pursue timely payment of principal and interest (*Marblegate Asset Mgmt., LLC v Educ. Mgmt. Fin. Corp.*, 846 F3d 1 [2d Cir 2017]). That policy is not implicated here since (at least until the bankruptcy) all payments have been timely made. That this exception was enacted by statute further suggests that courts should not easily vary the unambiguous terms of an indenture. Additional restrictions on an indenture's preconditions to action, if warranted, should be the product of legislation.

[8] The defect is one of standing, not merely capacity (*see Cortlandt St. Recovery Corp.*, 31 NY3d 30; *Varga*, 147 AD3d at 481, citing *Nomura Asset Acceptance Corp. Alternative Loan Trust v Nomura Credit & Capital, Inc.*, 139 AD3d 519, 520 [1st Dept 2016]; *Southern Wine & Spirits of Am., Inc. v Impact Envtl. Eng'g, PLLC*, 80 AD3d 505, 506 [1st Dept 2011]).