

## YCST PORTFOLIO COMPANY GROUP TREND WATCH



**Delaware Court of Chancery Opinion *Quadrant Structured Products Company, LTD v. Vertin*, C.A. No. 6990-VCL (Del. Ch. May 4, 2015) Provides Further Guidance on Creditor Standing to Bring Derivative Claims on Behalf of Insolvent Corporations.**

In its May 4, 2015 opinion in *Quadrant*, the Delaware Court of Chancery denied a motion for summary judgment made by the directors and the 100% stockholder of Athilon Capital Corp. The motion sought dismissal of derivative claims brought by the holder of Athilon's senior debt securities, Quadrant Structured Products Company, Ltd. The defendants argued that Quadrant lacked standing to bring derivative claims on behalf of Athilon, contending that for a creditor to have derivative standing the company on whose behalf the creditor sues must be insolvent at the time of suit and continuously thereafter.

The Court held that there is no continuous insolvency requirement for creditors to have standing to bring derivative claims. If a creditor can show that the company was insolvent at the date the suit was brought, a creditor has standing even if the company regains solvency during the pendency of the lawsuit. In addition, the Court affirmed the use of the balance sheet test for determining whether a company is insolvent for the purpose of determining creditor standing. In doing so, it rejected the argument that the "irretrievable insolvency" test (which is required for the appointment of a receiver) should be used to determine creditor standing to bring a derivative claim.

The Court acknowledged that its holding that there is no continuous insolvency requirement for creditor derivative claims was one of "first impression" and the Delaware Supreme Court has yet to speak on the issue. Nonetheless, together with the Court's October 1, 2014 opinion in *Quadrant*, holding that creditors need not show contemporaneous ownership to have derivative standing, the May 4<sup>th</sup> opinion provides guidance on the often murky issue of creditor standing to bring derivative claims. In holding there are no continuous insolvency or

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contemporaneous ownership requirements limiting a creditor's derivative standing, it may appear that the Court is creating creditor derivative standing with fewer limitations than stockholder derivative standing. However, in a thorough and clear review of the creditor derivative cases of the last decade, the Court suggests that the actual claims that creditors can successfully pursue are, as a practical matter, quite narrow -- in essence breaches of the duty of loyalty through self-interested transactions and waste claims.

Lawyers and advisors to distressed companies and their stakeholders will want to study closely the May 4<sup>th</sup> opinion and the Court's earlier opinions in *Quadrant*. In particular, *Quadrant* suggests that most transactions between a parent or a controlling stockholder and a distressed company will be subject to entire fairness review, and that once a distressed company becomes balance sheet insolvent, the distressed company's creditors will gain broad and durable standing to pursue these claims derivatively.

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