



## Case Alert: *In re CML V, LLC v. Bax*

### CHANCERY COURT DETERMINES THAT CREDITORS LACK STANDING TO ASSERT DERIVATIVE CLAIMS UNDER DELAWARE LLC ACT

In a case that may have significant and strategic implications for operation of limited liability companies, the Delaware Court of Chancery enforced the express provisions of Section 18-1002 of the Delaware Limited Liability Company Act (the "LLC Act") in denying a creditor standing to bring a derivative claim against holders of the subject LLC's membership interests.

In *CML*, the creditor loaned JetDirect approximately \$34 million. In the complaint, the creditor asserted the following claims against certain of JetDirect's individual member defendants (the "Defendants"): (1) breach of the duty of care by failing to consider relevant financial information; (2) bad faith by failing to engage in adequate financial controls and to disclose relevant financial information; and (3) breach of the duty of loyalty due to certain self-interested transactions. The Defendants sought dismissal of these counts based on Section 18-1002's provision that a derivative plaintiff must be "a member or an assignee." Since the plaintiff was simply a creditor, the Defendants asserted that plaintiff lacked standing to assert the claims.

The Chancery Court began its analysis by acknowledging the "dog that has not barked." Despite the unambiguous language of Section 18-1002, the Court noted with apparent disbelief that "virtually no one has construed the derivative standing provisions as barring creditors of an insolvent LLC from filing suit" (other than a footnote in a treatise and an abbreviated ruling in an unreported decision of the United States District Court for the District of Delaware). *Id.* at 8. To the contrary, the Court observed that most everyone has assumed that creditors can sue derivatively under the LLC Act, similar to the interpreted right of creditors under the Delaware General Corporation Law (the "DGCL") pursuant to both *Production Resources* and *Gheewalla*. In spite of such assumptions regarding the proper interpretation of Section 18-1002, the Court found the statute to be unambiguous and, as a result, enforceable as such.

Rather than terminating its analysis based upon this basic tenet of statutory construction, the Court went on to review: (i) similar provisions of other alternative entity statutes; (ii) the development of derivative standing provisions; and (iii) whether it should overlook the express statutory language as leading to an absurd result at odds with the purpose of the LLC Act. Finding no inconsistency between its reading of Section 18-1002 and its analysis of the aforementioned issues, the Court re-affirmed the logic of its ruling that the express language of the statute should be enforced on its terms. The Court further stressed the need to avoid the urge that commentators and courts may feel to "uncritically import requirements from DGCL into the [alternative entity] context." *Id.* at 21-22.

---

*If you have any questions or would like to discuss the decision further, please contact any of the Bankruptcy and Corporate Restructuring partners at Young Conaway. The Firm is also available for complimentary Delaware Update CLE programs to address any aspects of Delaware law that are of interest to our friends and colleagues around the country.*

[View as Web Page](#)

[Unsubscribe](#)

[Forward to a Friend](#)

#### Opinion

*In re CML V, LLC v. Bax*, No. 5373-VCL, (Del. Ch. Nov. 3, 2010) (Laster, VC)

#### The Bankruptcy and Corporate Restructuring Partners

Joseph M. Barry  
Sean M. Beach  
Robert S. Brady  
M. Blake Cleary  
John T. Dorsey  
Edwin J. Harron  
David R. Hurst  
Matthew B. Lunn  
Pauline K. Morgan  
Edmon L. Morton  
Michael R. Nestor  
James L. Patton, Jr.  
Joel A. Waite  
Sharon M. Zieg

#### About Young Conaway Stargatt & Taylor, LLP

Young Conaway Stargatt & Taylor, LLP, one of Delaware's largest law firms, counsels and represents national, international and local clients, handling sophisticated advisory and litigation matters involving bankruptcy, corporate law and intellectual property. Nearing its sixth decade, Young Conaway also guides regional businesses and individuals through a myriad of employment, real estate, tax, estate planning, environmental, and banking issues from the firm's offices in downtown Wilmington, DE.

