



## Can an Indenture Trustee bring legal action to exercise remedies against fraudulent transfer before an Event of Default has occurred under the Indenture? This New York court says no!

By Rob Coughlin

New York County Supreme Court Justice Jennifer Schecter dismissed a fraudulent conveyance action brought by the Indenture trustee for certain of Neiman Marcus' senior notes, on the basis that no Event of Default existed at the time the action was filed and the Indenture did not grant the Trustee authority to assert claims pre-default, even where the action was brought at the direction of noteholders.<sup>1</sup>

In 2013, an investment management firm conducted a leveraged buyout of retailer Neiman Marcus, 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 "Senior Notes") issued under materially identical Indentures (the "Indentures"). Like most of the retail sector, Neiman Marcus continued to struggle. In 2017, concerned about its investment, the investment management firm attempted to strip the Company of its most valuable asset—German luxury retailer MyTheresa, a subsidiary of Neiman Marcus. The firm transferred the subsidiary to their parent for no consideration, thereby insulating the assets from the reach of other creditors, including the holders of the Senior Notes (the "Senior Noteholders"). Neiman Marcus was allegedly insolvent at the time and has remained insolvent ever since.<sup>2</sup>

After a Senior Noteholder suit in 2018 was dismissed for lack of standing, the investment management firm and Neiman Marcus sought Senior Noteholder ratification of the transfers in exchange for new notes secured by a partial lien on stock of MyTheresa and preferred equity in its parent. The exchange was effectuated through amendments to the Senior Note Indentures,

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<sup>1</sup> *UMB Bank, N.A. as Tr. for 8% Senior Cash Pay Notes Due 2021 v. Neiman Marcus Grp., Inc.*, No. 654509/2019, 2020 WL 4033014 (N.Y. Sup. Ct. July 16, 2020).

<sup>2</sup> Neiman Marcus eventually filed chapter 11 bankruptcy on May 5, 2020.

eliminating many of the Indentures' covenants and events of default and waiving all past breaches and defaults. The amendments went into effect in June 2019 with more than 90% Senior Noteholder consent.

In August 2019, the Trustee filed suit at the direction of a majority of the then-outstanding Senior Noteholders, asserting fraudulent conveyance against the parties to the MyTheresa transfers and tortious interference with contract against the investment management firm.

The firm moved to dismiss, arguing that the Trustee lacked standing to bring the action due to the absence of an Event of Default, relying on Section 6.3 of the Indentures, which provides, in what is fairly standard form: *"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."*

The Trustee countered that its receipt of majority Noteholder direction gave it standing under Indenture Section 6.5, which provides, also in standard form: *"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."*

The Court agreed with the investment management firm, finding that, because no Event of Default existed, all past breaches and defaults having been waived in the 2019 exchange transaction, the Trustee was not free to pursue remedies under Section 6.5 absent the prerequisite of an Event of Default under Section 6.3. Noting that an Indenture trustee's power and authority is generally limited to that which is provided in the Indenture and "not from any inherent authority to generally vindicate noteholders' rights,"<sup>3</sup> the Court said,

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" ... The remedies that are "available to" and powers that are "conferred on" the Trustee are set forth in other provisions of the Indentures, such as section 6.3. In all of those provisions, an Event of Default is a threshold requirement... 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.

The Court added that public policy compels this conclusion as well, noting that the matter involved "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."

Although addressing contractual terms that are typical of most Indentures, the decision by this Court applies a narrow reading in a specific set of facts. It does not necessarily foretell the

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<sup>3</sup> Describing the New York State Court of Appeals decision in *Cortlandt St. Recovery Corp. v. Bonderman*, 31 N.Y.3d at 43, 73 N.Y.S.3d 95, 96 N.E.3d 191.

availability of actions or proceedings that might be considered by or available to an Indenture Trustee prior to the occurrence of an Event of Default in other circumstances.

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