



Distressed Debt

Appellate Division Upholds Dismissal of Complaint by Hedge Funds Holding More than \$190 Million of Defaulted Loans Against Credit Suisse, as Arranger of Financing and Administrative and Collateral Agent, for Aiding and Abetting Fraud and Breach of Fiduciary Duty

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In a decision of profound interest to hedge funds that invest in distressed companies and the banks that arrange those loans, New York's Appellate Division, First Department, has thrown out a claim that defendants Credit Suisse First Boston (USA), Inc. and Credit Suisse Securities (USA) LLC (together, Credit Suisse) aided and abetted a fraud committed by Meridian Automotive Systems, Inc. (Meridian) in a 2004 restructuring of its debt. Credit Suisse helped to arrange a refinancing of Meridian's debt. Plaintiff hedge funds purchased a portion of Meridian's debt. Less than one year later, Meridian declared bankruptcy. Plaintiffs claimed that Credit Suisse knew Meridian was insolvent at the time of the restructuring and failed to disclose it. The court held that plaintiffs failed to plead a critical element of their claim, i.e., that Credit Suisse had "substantially assisted" Meridian in committing the alleged fraud. We summarize the court's reasoning and the cautions it provides for investors and lenders in the distressed debt market. See *Stanfield Offshore Leveraged Assets, Ltd., et al., v. Metropolitan Life Insurance Company, et al.*, ____ N.Y.S. 2d____, 2009 WL 2150912, 2009 Slip Op. 05905 (App. Div., 1st Dept. 2009).

Background of the Allegations

In the spring of 2004, Meridian sought to raise \$485 million in new credit facilities. It retained Credit Suisse and Goldman Sachs (not named a defendant) to serve as "joint lead arrangers" and "joint book managers" for the new credit lines. Credit Suisse was also to serve as administrative agent and collateral agent. Meridian borrowed \$485 million, of which \$337 million was used to repay prior existing secured creditors. About \$53 million was also used to fulfill Meridian's obligations under certain pre-existing subordinated notes. Finally, about \$21 million in fees were paid by Meridian (including over \$17 million paid to Credit Suisse).

Plaintiffs consist of several Cayman Islands' hedge funds and one domestic hedge fund. Plaintiffs either were direct lenders to Meridian in the debt restructuring or purchased a portion of Meridian's debt from direct lenders. After Meridian declared bankruptcy in 2005, plaintiffs sued a number of the parties involved in the 2004 restructuring, including Credit Suisse and the prior holders of certain subordinated debt who had been repaid with a portion of the proceeds. The crux of their complaint was that Meridian had fraudulently represented that it was solvent. Plaintiffs alleged that, by arranging the 2004 restructuring, Credit Suisse had aided and abetted Meridian's fraud and aided and abetted certain breaches of fiduciary duty related to the repayment of the pre-existing subordinated debt with a portion of the loan proceeds.

Specifically, plaintiffs alleged that:

- Credit Suisse, in investor presentations and term sheets, had represented that Meridian was solvent and would represent its solvency in the loan agreements.
- Credit Suisse organized the refinancing for the already insolvent Meridian.
- Credit Suisse knew prior to the refinancing that Meridian was insolvent and would become "more insolvent" once the substantial repayments were made to the prior subordinated lenders with a portion of the new credit facility.
- Credit Suisse knew Meridian had liabilities of \$700 million and nevertheless valued the company at \$575 million to \$675 million. (The court observed that this allegation did not say whether the estimated value was net of those liabilities.)
- Credit Suisse knew that Meridian intended to repay those defendants who were holders of Meridian's prior subordinated debt "thereby deepening the insolvency of an already insolvent company".

Credit Suisse moved to dismiss the complaint for failure to state a cause of action against it. Judge Charles Ramos of the Commercial Division of the New York Supreme Court **granted** the motion on April 23, 2008, and this appeal ensued. For the reasons set forth below, the Appellate Division denied plaintiffs' appeal. (Judge Ramos also dismissed the complaint against the prior investor defendants who had allegedly "looted" Meridian in connection with the restructuring, but there is no indication of whether plaintiffs appealed that dismissal.)

Legal Analysis

Elements of a Claim for Aiding and Abetting Fraud

According to the Appellate Division, "[i]n order to plead properly a claim for aiding and abetting fraud, the complaint must allege: (1) the existence of an underlying fraud; (2) knowledge of this fraud on the part of the aider and abettor; and (3) substantial assistance by the aider and abettor in achievement of the fraud." (Internal citations omitted.) "[A]ctual knowledge of the fraud may be averred generally." (Internal citations omitted.)

Failure to Plead "Substantial Assistance" Adequately is Fatal

According to the Appellate Division, "[s]ubstantial assistance exists 'where (1) a defendant affirmatively assists, helps conceal, or by virtue of failing to act when required to do so enables the fraud to proceed, and (2) the actions of the aider/abettor proximately caused the harm on which the primary liability is predicated.'" (Internal citations omitted.)

Essentially, plaintiffs alleged that, knowing Meridian was insolvent, Credit Suisse had contacted prospective investors, distributed information about Meridian and arranged the restructuring. Although the Appellate Division did not say so explicitly, implicit in the ruling is that those actions did not in and of themselves constitute “substantial assistance”.

Instead, the court determined that “the crux of plaintiffs’ claim is that Credit Suisse assisted in the alleged fraud by failing to disclose Meridian’s insolvency.” Unfortunately for plaintiffs, they had not alleged that Credit Suisse had any obligation to disclose that information. Because Credit Suisse did not have any duty to disclose, it could not be liable to plaintiffs for failing to disclose Meridian’s insolvency. In making that determination, the Appellate Division relied on a recent ruling by the New York Court of Appeals which held that, in the absence of a fiduciary or some other independent duty to disclose, a hedge fund’s law firm was under no obligation to disclose any information about the fund’s investments to the fund’s individual investors. See *Eurycleia Partners, LP v. Kissel, LLP*, 12 NY3d 553, 2009 N.Y. Slip Op 04299, discussed in “[New York Court Rules that Limited Partners of Collapsed Hedge Fund Cannot Sue Fund’s Outside Legal Counsel for Fraud and Breach of Fiduciary Duty](#),” Hedge Fund Law Report, Vol. 2, No. 24 (Jun. 17, 2009).

Loan Document Disclaimers

The court also cited various disclaimers and other provisions contained in the loan agreements that purported to absolve Credit Suisse from responsibility:

- Plaintiffs represented that they had “independently and without reliance upon [Credit Suisse] . . . and based on such documents and information as [plaintiffs] ha[ve] deemed appropriate, made [their] own credit analysis and decision to enter into this Agreement.”
- Credit Suisse, as administrative agent, “shall not . . . have any duty to disclose, and shall not be liable for the failure to disclose, any information relating to the Borrower [i.e., Meridian] or any of its affiliates that is communicated to or obtained by the Person serving as the First Lien Administrative Agent or any of its Affiliates in any capacity.”
- “[T]he . . . Administrative Agent [i.e., Credit Suisse] shall not be responsible for or have any duty to ascertain or inquire into (i) any statement, warranty or representation made in or in connection with this Agreement or any other Loan Document, (ii) the contents of any certificate, report or other document delivered hereunder or thereunder or in connection herewith or therewith, (iii) the performance or observance of any of the covenants, agreements or other terms or conditions set forth herein or therein or the occurrence of any Default, (iv) the validity, enforceability, effectiveness or genuineness of this Agreement, any other Loan Document or any other agreement, instrument or document.”

While these provisions are featured prominently in the Appellate Division’s decision, it is unclear whether they actually played a significant role in the outcome, because the absence of a duty to disclose apparently did not turn on the terms of the loan documents. Still, immediately after determining that there could be no substantial assistance in the absence of a duty to disclose, the court also states: “Furthermore, the agreement provided that Credit Suisse did not have a duty to disclose any information relating to Meridian and could not be held liable for the failure to disclose any information. Thus, the agreement itself bars plaintiffs’ cause of action for aiding and abetting fraud based on allegations of silence or inaction.” (Internal citations omitted.)

However, the next and concluding paragraph of the opinion states: “Because the failure to plead substantial assistance is, by itself, a sufficient ground for dismissal of the complaint, we need not reach the issue of whether the complaint fails to allege adequately that Credit Suisse had actual knowledge of Meridian’s alleged underlying fraud or whether the language contained in the agreements limiting Credit Suisse’s liability preclude a claim of fraud or aiding and abetting fraud.” (Emphasis added.) The highlighted language is confusing since, immediately above, the court seems to give weight to the exculpatory language in arriving at its decision. Perhaps the issue that the court declines to reach is whether such exculpatory language would absolve a party that did in fact have a fiduciary duty to disclose information? At any rate, many New York courts appear to find provisions such as those referenced in this decision persuasive and may provide an added layer of protection to entities that provide services to hedge funds and other businesses.

For a copy of the court’s decision, [click here](#).

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