

Lucky Bucks, Lessons Learned: Three Takeaways for Directors, Officers and Equity Holders in Distressed Situations

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Sometimes a case comes along that brings together a number of issues that repeatedly arise in distressed litigation and thus serves as a helpful checklist of things that could go wrong. The recent Delaware bankruptcy court decision in *LB NewHoldCo, LLC and Lucky Bucks, LLC v. Trive Capital Management LLC* offers just such a case. Below, we provide a brief overview of the case and highlight three takeaways that directors, officers and controlling shareholders—and their advisors—should bear in mind at each stage of a company’s life cycle: (i) when preparing organizational documents; (ii) when entering into a leveraged or other strategic transaction; and (iii) if everything falls apart, when drafting a release in a bankruptcy plan of reorganization.

The Plaintiffs were successors in interest to Lucky Bucks, LLC, an operator of coin-operated amusement machines, which filed for chapter 11 in June 2023. The Plaintiffs alleged that the prepetition directors, officers and later controlling equity holder (Trive Capital Management and affiliates, “Trive”) looted the company and fraudulently inflated its financials to induce lenders to provide financing, which was used to fund over \$400 million across two distributions to these insiders.

Following plan confirmation, the Plaintiffs sued certain of Lucky Bucks’ directors and officers and Trive (the “Defendants”) for, among other things, actual fraudulent transfer, breach of fiduciary duty, and aiding and abetting breach of fiduciary duty. While the Delaware bankruptcy court dismissed some of the claims and narrowed the dispute, much of the lawsuit survived and will now presumably head into discovery.

Takeaway 1: Review and, If Necessary, Update Organizational Documents to Comply with Best Practices

The Court’s ruling serves first as a reminder of the importance of taking care with that foundational step in a corporate entity’s life: drafting of the entity’s organizational documents.

In seeking to dismiss the fiduciary duty and aiding and abetting claims, the Defendants argued that the relevant Plaintiff-debtor entities' organizational documents—one a Delaware entity and the other a Georgia entity—had waived all fiduciary duties. The claims arising out of the Delaware entity were dismissed, while the claims arising out of the Georgia entity survived; the difference in outcome turned on the language in those entities' respective organizational documents.

With respect to the Delaware entity, a Delaware LLC, the LLC Agreement (the "HoldCo Agreement") expressly waived all fiduciary duties of the LLC's managers, as is permitted by Delaware law. The Court rejected the Plaintiffs' argument that the HoldCo Agreement modified this waiver when, in separate provisions, the HoldCo Agreement did not extend exculpation and indemnification to the LLC's managers in cases of bad faith, fraud, willful misconduct or willful breach of the Agreement. The Court explained that "duty modification, exculpation, and indemnification provisions perform different functions." The Court therefore enforced the HoldCo Agreement and dismissed the claims relating to asserted breaches of fiduciary duties with respect to the Delaware entity.

The result was the opposite with respect to the Georgia entity, a Georgia LLC. There, the Plaintiffs sued certain of the Defendants in their capacity as *officers* of that entity. That LLC Agreement (the "LB Agreement") "plainly" waived fiduciary duties for directors, in the Court's view, but, crucially, exempted *officers* from that waiver, as allowed by Georgia law. Put differently, while the entity's directors held no fiduciary duties, its officers did. As such, the Court declined to dismiss the counts against the officer-Defendants for breaches of their fiduciary duties to the Georgia entity on the basis that they had been waived.

In sum, parties seeking to limit their liability should ensure that organizational documents maximize fiduciary duty waivers to the extent permitted by state law and do so expressly and completely.

Takeaway No. 2: Some Fraudulent Transfer Claims Can Prove Difficult to Dismiss at the Pleading Stage

The Court declined to dismiss the actual fraudulent transfer claims, demonstrating the relative ease with which such claims might survive a motion to dismiss even in the face of what may be strong defenses to those claims on the merits: ratification and the failure to state a claim.

Ratification posits that a lender's authorization, or "ratification," of a transfer estops the lender, or those suing on its behalf, from later challenging the transfer. The Plaintiffs rebutted this theory by alleging that material facts were withheld from the lenders at the time of authorization. The Court agreed, holding that dismissal would require a fuller examination of the totality of the facts and circumstances of what the lenders knew at the time they authorized the transfer.

The Court also rejected the Defendants' second argument, that the complaint failed to state a claim. As the Court noted, "[b]ecause debtors rarely admit fraudulent intent, courts must usually infer it" through circumstantial evidence. Such circumstantial evidence is typically pleaded through "badges of fraud, *i.e.*, circumstances so commonly associated with fraudulent transfers that their presence gives rise to an inference of intent." Although at least some Defendants argued that Federal Rules of Civil Procedure Rule 9(b)'s ("Rule 9(b)") heightened pleading standard for fraud claims should apply, the Court did not take up this line of argument or even mention Rule 9(b) in its opinion, instead appearing to adopt Federal Rules of Civil Procedure Rule 8's more lenient pleading standards.

The Court declined to dismiss the claim based on the presence of two badges of fraud: (1) the transfers occurred while the debtors were insolvent; and (2) the transfers involved a substantial portion of the debtors' assets. Together, these were sufficient to survive a motion to dismiss.

The decision suggests that at least some courts might not require plaintiffs to satisfy a higher pleading standard for actual fraudulent transfer claims at the motion to dismiss stage. Would-be targets of such claims should be aware of the potentially higher litigation risk in these jurisdictions. To be sure, even if in some instances actual fraudulent transfers can be easy to plead, proving that an actual fraudulent transfer occurred has historically been far more difficult.

With respect to the ratification argument, the Court's decision serves as a hopefully unnecessary reminder to borrowers not to withhold material information when seeking lender authorization. For lenders, documenting the information provided—such as through representations and warranties accompanying transfer approvals—can help preserve a record for future disputes.

Takeaway No. 3: As a Final Failsafe, Check Your Plan Releases Carefully

Finally, the Defendants argued that the causes of action against them must be dismissed because they were released as part of the confirmed plan of reorganization (the "Plan").

In the Plan, the relevant debtor entities released “Released Parties” “from any and all Claims and Causes of Action...” (the “Release”). However, this was qualified in the same sentence by the following carveout (the “Carveout”):

...other than Claims and liabilities resulting therefrom arising out of or relating to any act or omission of a Released Party that constitutes actual fraud, willful misconduct, or gross negligence, in each case, solely to the extent determined by a Final Order of a court of competent jurisdiction.

(OpCo Plan, Art. VIII, § 1.2)

The parties did not dispute that the Defendants qualified as Released Parties. Rather, they differed on whether the language in the Carveout functioned to exclude claims for actual fraud from the Release. The Plaintiffs argued that the Carveout must operate this way; otherwise, it would produce the absurd result that the Carveout only carved out claims among debtor entities, even though such claims were addressed elsewhere in the Plan.

The Defendants argued that the Carveout did not exclude the Plaintiffs’ claims from the Release for two reasons: (1) the plain language of the Carveout excluded only “Claims”—which the Plan defined as claims against the debtors and not as claims held by the debtors (or their successors) against non-debtor parties, such as directors or officers—from the Release and did not exclude “Causes of Action,” which would have included the Plaintiffs’ claims; and (2) the Carveout required a non-debtor third party to obtain a final order for actual fraud before the Plaintiffs could enforce it against the Released Parties.

The Court rejected the second of these arguments as not required by the plain language of either the Release or Carveout.

With respect to the textual analysis, the Court agreed with the Defendants that the Carveout excluded only Claims and not Causes of Action from the Release and thus the plain language would seem to bar the Plaintiffs’ claims. However, the Court noted that this would lead to the absurd result raised by the Plaintiffs. The Court also pointed to the fact that, at a prior status conference, counsel for the Defendants had not objected to Plaintiffs’ counsel’s statement that the Carveout functioned to exclude claims for fraud from the Release.

The Court found that neither interpretation was persuasive without either rewriting the plain language or potentially upsetting the parties’ expectations. In a footnote, the Court hypothesized that the issue may have arisen from the inadvertent use of the defined term “Claim” instead of the more general, lowercase “claim” in the Carveout. That is, the

drafters of the plan might have inadvertently limited the Carveout to only claims against the debtors (the definition of “Claims” in the plan) and in effect released claims against the Released Parties *even for actual fraud*. The Court noted a similar possible confusion elsewhere in the Plan between “claim” and “Claim” that would have made that provision unconfirmable if construed according to the Defendants’ theory with respect to the Carveout.

In light of the ambiguity in the Carveout, the Court found that the Release, as written, did not clearly preclude the causes of action against the Defendants and declined to dismiss the claims on release grounds. This outcome could have been avoided had the plan drafters carefully scrubbed the Release and Carveout to ensure they were fully preserving, or releasing, claims as expected.

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Please do not hesitate to contact us with any questions.



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