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Alert

Eleventh Circuit Bars Noteholders' Fraudulent Transfer Suit Because of Indenture's "No-Action Clause"

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The U.S. Court of Appeals for the Eleventh Circuit held on April 25, 2012, that "the language of [a] no-action clause [in an indenture] controls, [barred individual] noteholders from bringing" fraudulent transfer claims against the issuer of the notes, its directors and officers. *Akanthos Capital Management, LLC v. Compucredit Holdings Corp*., ___ F.3d ___, 2012 WL 1414247, *1 (11th Cir. April 25, 2012). Reversing the district court, the Court of Appeals essentially agreed with the defendants that only the indenture trustee could sue.

The plaintiffs were "hedge funds that hold [allegedly the majority of the outstanding] notes," asserting creditor status under Georgia's version of the Uniform Fraudulent Transfer Act. *Id*. Their notes were issued under a trust indenture with a "standard 'no-action clause'," barring noteholders from pursuing "any remedy with respect to this Indenture or the Securities," subject to only two exceptions (the usual "trustee demand" and the "right to payment" exceptions).

Issue
New York law governed the terms of the indenture, and the parties agreed that neither of the exceptions to the "no-action clause" applied. The district court denied the defendants' motion to dismiss, reasoning that (a) the plaintiff noteholders "constituted a majority" and thus satisfied "the purpose of the [no-action] clause to prevent suits not in the majority's best interest"; (b) the issuer had stated "its intent to pay a dividend" to insiders; and that (c) the plaintiffs' claims "were extra-contractual," outside "the terms of the [no-action] clause" which "contemplated a contractually-defined Default predicating a suit." *Id*., at *2. When the unsuccessful defendants sought interlocutory review by the Eleventh Circuit, the district court certified the following legal question for disposition by the appellate court: "Under New York law, may noteholders sue under Georgia's Uniform Fraudulent Transfer Act where the noteholders have not complied with the conditions precedent to filing suit specified in the 'no-action clause' in the trust indentures governing the notes?" *Id*.

Defendants' Non-Party Status Irrelevant
The Court of Appeals first rejected the plaintiffs' argument that the defendant insiders who were not parties to the indentures could rely on the no-action clause in the indenture. Relying on cases around the country applying New York law, the court held that "Directors and Officers may assert that the no-action clause prevents Plaintiffs from bringing this suit." *Id*., at *5. In the words of the Delaware Chancery Court when applying New York law, plaintiffs who buy bonds "consent . . . to no-action clauses" and thus "waive their rights to bring claims that are common to all bondholders, and that waiver applies equally to claims against non-issuer defendants as to claims against issuers." *Id*., quoting *Feldbaum v. McCrory Corp.*, 1992 WL 119095, at *8 (Del. Ch. June 2, 1992). Moreover, the Eleventh Circuit explained that the no-action clause "bars the pursuit of '*any* remedy with respect to this Indenture or the Securities.'" *Id*. (emphasis in original text).

No-Action Clause Covers Extra-Contractual Claims
New York law also does not exempt "extra-contractual fraudulent transfer claims . . . from the operation of the no-action clause." *Id*., at *6. The Delaware Chancery Court in *Feldbaum* held that fraudulent transfer claims "could only be properly brought by the trustee." *Id*., citing *Feldbaum*, at *8. Because these claims arise from transactions by issuers of bonds that "assert injuries arising from the bondholder status of plaintiffs . . . [,] [plaintiffs] are hurt derivatively . . . . and thus should share any remedy they receive on a *pari passu* basis with other bondholders." *Id*., at *6, quoting *Feldbaum*, at *8. *Accord*, *Lange v. Citibank, N.A*., 2002 WL 2005728, Del. Ch. (August 13, 2002) (applying New York Law) (nature of claim asserted by noteholders not determinative as to whether no-action clause applied; "what is determinative is whether the claim is one with respect to the Indenture or the Debentures themselves."), *Id*., at *7; *Ernst v. Film Production Corp*., 148 Misc. 62, 264 N.Y.S. 227, 229 (N.Y. Sup. Ct. 1933) (no-action clause barred fraudulent transfer claims because plaintiffs purported "to speak for all the bondholders and not for themselves alone").

No Indenture Trustee Conflict
When an indenture trustee has a conflict of interest or an "unjustifiable unwillingness" to pursue the fraudulent transfer remedy, however, courts have created an exception under New York law allowing noteholders to sue. 2012 WL 1414247, at *7. Because of the "absence of" any such "allegations of trustee misconduct" here, the Eleventh Circuit found "no persuasive reason to deviate from" established authority holding that "no-action clauses bar fraudulent [transfer] claims." *Id*., at *8.

Majority Ownership of Notes Immaterial
The court also rejected the lower court's reliance on the plaintiff's "majority ownership of the notes" as a ground for disregarding the no-action clause. No-action clauses undoubtedly serve to "protect against the exercise of poor judgment by a single bondholder or a small group of bondholders, who might otherwise bring the suit against the issuer that most bondholders would consider not to be in their collective economic interest." *Id*., quoting *Feldbaum*, 1992 WL 119095, at *5-6. Here, however, the indenture was "complete, clear and unambiguous on its face" and had to be "enforced according to the plain meaning of its terms." *Id*., quoting *Greenfield v. Philles Records, Inc.*, 98 N.Y. 2d 562, 750 N.Y.S. 2d 565, 780 N.E.2d 155, 170 (2002). The no-action clause here is "absolute: noteholders 'may not pursue any remedy with respect to this Indenture or the Securities' unless they complete the conditions precedent allowing them to fall within one of the two stated exceptions." 2012 WL 1414247, at *8. Because, among other things, the plaintiffs admitted that there was no default under the indenture, *Id*., at *11 n.3., the court found no exception to the applicability of the no-action clause.

The Eleventh Circuit stressed that parties include no-action clauses in indentures "to deter suits brought by the minority," to prevent unnecessary litigation, and to protect "the issuer from a multiplicity of lawsuits." *Id.*, at *9. Because "[m]ajority ownership offers no guarantee that those purposes are fulfilled," it constitutes no "reason to allow noteholders to bring suit when they do not fall within a stated exception" to a no-action clause. *Id*.

No Issuer Misconduct
The Eleventh Circuit also rejected the plaintiffs' reliance on the so-called "prevention doctrine." The plaintiffs argued that the issuer had "made it impossible" for them "to comply with one of the conditions of the trustee demand exception" — namely, the requirement that they "wait sixty days after making a demand on the [indenture] trustee . . . ." The issuer had "announced its intent to pay a dividend less than sixty days in advance . . . ." *Id*., at *2.

First, the plaintiffs assumed "the risk that fulfillment of the condition precedent could be prevented" when they bought the notes. *Id*., at *10. Moreover, the issuer "escaped no duty by failing to give sixty-days notice." *Id*. The "prevention doctrine" requires some "wrongful" conduct, but the issuer here gave the requisite notice (20 days) before issuing a dividend, complying with the terms of the indenture. *Id*.

Uniform Interpretation Important
Finally, the no-action clause here "is a standard provision present in many trust indentures" that had, according to the court, to be given a "consistent, uniform interpretation." *Id*., at *11, quoting *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1048 (2d Cir. 1982). By uniformly interpreting standard contract language, the court intended to ensure the "effective functioning of our financial markets" and "stability." *Id*. Because the plaintiffs could find "no persuasive, legally grounded reason to depart from the

established law that no-action clauses are generally applicable," the court reversed the district court, ordering dismissal of the complaint. *Id*.

Comments

1. The plaintiffs here raised every conceivable argument, convincing the district court of their merit. But, as the Eleventh Circuit stressed, courts applying New York law strongly favor no-action clauses in indentures.

2. Indeed, some courts have stretched in the past few years to bar suits and other acts by individual noteholders despite the seemingly flexible language of the indenture. *See*, *e.g.*, *Beal Savings Bank v. Sommer*, 8 N.Y.3d 318, 321, 333-34 (2007)((4-1) (affirmed dismissal of suit by one lender in syndicated loan because other "required lenders" had settled; they had right to sue through their agent; lenders "intended to act collectively"; *but* dissent argued majority misread documents to deprive minority lender of right to sue; nothing in documents gave agent exclusive right to sue or showed a "surrender of individual lenders' right to sue"; to the contrary, documents recited that "each lender severally agrees to make loans," and that no "right or remedy" given the "Agent . . . is intended to be exclusive of any other right or remedy . . . in . . . other Loan Documents or at law and equity."); *In re Metaldyne Corp*., 409 B.R. 671 (Bankr. S.D.N.Y. 2009) (agent given authority to release collateral in event of default; overruled single lender's objection to agent's credit bid for collateral); *In re GWLS Holdings, Inc*., 2009 WL 453110 (Bankr. D. Del. 2009) (same; unanimous voting requirement for release of collateral, amendments, waivers not applicable).

3. The plaintiff noteholders in *Akanthos* still have a remedy. Their claims "may be asserted by the Indenture Trustee." *Lange v. Citibank, N.A*., 2002 WL 2005728, at *7 (Del. Ch. 2002).

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