RELEVANT CASES

FEBRUARY 11, 2015 INN OF COURT PRESENTATION

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS COMPANY, LTD., Individually and Derivatively on behalf of Athilon Capital Corp.,	)	
Plaintiffs,	)	
v.	)	C.A. No. 6990-VCL
VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, and EBF & ASSOCIATES, LP,	)	
Defendants.	)	

OPINION

Date Submitted: July 22, 2014
Date Decided: October 1, 2014

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LASTER, Vice Chancellor.

Plaintiff Quadrant Structured Products Company, Ltd. ("Quadrant") owns debt securities issued by defendant Athilon Capital Corp. ("Athilon" or the "Company"), a Delaware corporation. Quadrant alleges that Athilon is insolvent and that the individual defendants, who are members of Athilon's board of directors (the "Board"), should wind up the Company's business and dissolve the entity. Quadrant contends that instead, the Board has found ways to transfer value preferentially to Athilon's controller, defendant EBF & Associates ("EBF"). In this action, Quadrant has asserted breach of fiduciary duty claims derivatively against the Board and EBF. Quadrant has also asserted fraudulent transfer claims directly against EBF and its affiliate, Athilon Structured Investment Advisors, LLC ("ASIA"). The defendants have moved to dismiss the complaint. Their motion is denied to the extent that Quadrant has challenged specific transfers of value to EBF or ASIA. To the extent that Quadrant has challenged the Board's business decision to take on greater risk, the motion to dismiss is granted.

I. FACTUAL BACKGROUND

The facts are drawn from Quadrant's verified amended complaint (the "Complaint" or "Compl.") and the documents it incorporates by reference. At this procedural stage, the Complaint's allegations are assumed to be true, and Quadrant receives the benefit of all reasonable inferences.

A. The Company And Its Business Model

Athilon is a credit derivative product company created to sell credit protection to large financial institutions. The Company's wholly owned subsidiary, Athilon Asset Acceptance Corp. ("Asset Acceptance"), wrote credit default swaps on senior tranches of collateralized debt obligations. The Company guaranteed the credit swaps that Asset Acceptance wrote. In a typical transaction, Asset Acceptance sold protection to a bank in the form of a credit swap that referred to a designated pool of investment grade debt securities, known as "Reference Obligations." If the pool of Reference Obligations suffered net losses that exceeded a contractually defined figure, then Asset Acceptance was liable up to a fixed limit. The Company was liable as the guarantor of Asset Acceptance's performance.

To obtain and maintain a AAA/Aaa credit rating, which was essential to the Company's business model, the ratings agencies required the Company to have a limited business purpose and to adopt and follow operating guidelines for its business (the "Operating Guidelines"). The Amended and Restated Certificate of Incorporation for the Company (the "Athilon Charter") limits its business to "guaranteeing or providing other forms of credit support for the obligations of its subsidiaries" and activities related to that business. The Amended and Restated Certificate of Incorporation for Asset Acceptance (the "Asset Acceptance Charter") limits its business to "transactions judged by [Asset Acceptance] to be credit default swaps" and activities related to that business.

Both the Athilon Charter and the Asset Acceptance Charter require that their businesses be "conducted in compliance with the Operating Guidelines." The Operating Guidelines:

- limit the business activities of the Company and Asset Acceptance;
- impose structural, portfolio, and leverage constraints on their operations;

- establish ratings categories for the collateralized debt obligations covered by the credit swaps written by Asset Acceptance and guaranteed by the Company;
- cap the aggregate notional amount of any single credit swap;
- limit the permissible maturity of credit swaps;
- limit the nature of credit events that could give rise to payment obligations under the credit swaps;
- restrict the Company to investing in short-term, low-risk securities, such as U.S. government and agency securities, certain Euro-dollar deposits, bankers' acceptances, commercial paper, repurchase transactions, money market funds, and money market notes with high short-term ratings;
- require that its portfolio contain sufficient assets to cover all liabilities; and
- define certain Suspension Events relating to capital shortfalls, leverage ratios, downgrades in counterparty credit ratings, and the insolvency, bankruptcy, or reorganization of the Company or Asset Acceptance.

The Operating Guidelines provide that if a Suspension Event is not timely cured, then the Company enters runoff. Once in runoff, the Company can no longer pay dividends or write new guarantees for credit swaps. While in runoff, its operations are limited to paying off outstanding swap transactions as they mature. After the runoff process is complete, the Operating Guidelines obligate the Company to liquidate.

B. The Company's Capital Structure And Financial Difficulties

To fund its business, the Company secured approximately $100 million in equity capital and $600 million in long-term debt. The debt was issued in multiple tranches comprising $350 million in Senior Subordinated Notes, $200 million in Subordinated Notes, and $50 million of the Junior Subordinated Notes. Depending on the series, the Notes will mature in 2035, 2045, 2046, or 2047. Interest payments on all of the Notes are deferrable at the Company's option for up to five years. Each class of Notes is subordinate to the Company's credit default swap obligations. On the strength of its $700 million in committed capital, the Company guaranteed more than $50 billion in credit default swaps written by Asset Acceptance.

Two of the credit swaps that Asset Acceptance wrote referenced residential mortgage-backed securities, rather than corporate debt obligations. In late 2008, the Company paid $48 million to unwind the first swap. In 2010, the Company paid $320 million to unwind the second swap. The termination payments wiped out over half of the Company's committed capital, including all of its equity capital and 65% of its long-term debt.

The effects of the 2008 financial crisis inflicted broader and more permanent damage on the Company. After Lehman Brothers filed for bankruptcy in September 2008, financial institutions no longer entered into credit swaps with entities that lacked substantial capital and could not post adequate collateral. As a result of the financial crisis, the Company and Asset Acceptance no longer could engage in the only business that their charters and the Operating Guidelines permitted them to pursue.

At the end of 2008, the Company and Asset Acceptance lost their AAA/Aaa ratings. By August 2010, the Company and Asset Acceptance no longer had any investment grade debt or counterparty credit ratings. Under the Operating Guidelines, the loss of its AAA/Aaa ratings and significant capital deficiencies forced the Company into runoff.

C. EBF Takes Over An Insolvent Company

The collapse of the credit derivative industry caused the Company's securities to trade at deep discounts, reflecting the widely held view that the Company was insolvent. EBF purchased all of the Company's Junior Subordinated Notes, then bought all of the Company's equity in 2010. By doing so, EBF gained control over the Company and its Board.

After acquiring control over the Company, EBF placed Vincent Vertin on the Board. Vertin is a partner at EBF who concentrates on EBF's investments in credit derivative product companies, and the Complaint alleges that Vertin's compensation is tied to the performance of EBF's in credit derivative product companies.

EBF also placed Michael Sullivan on the Board. Sullivan is an in-house attorney for EBF. Like Vertin, Sullivan concentrates on EBF's investments in credit derivative product companies.

EBF placed two other individuals on the Board whom EBF designated as independent directors. One is Brandon Jundt, a former employee of EBF. The other is J. Eric Wagoner.

The fifth and final Athilon director is Patick B. Gonzalez, the CEO of the Company.

Quadrant purchased debt securities issued by the Company after the EBF takeover. Quadrant acquired Senior Subordinated Notes in May 2011 and Subordinated Notes in July 2011.

D. Transfers Of Value From The Company To EBF

The Complaint alleges that the Company had been insolvent for some time before the EBF takeover. The Complaint alleges that the Company continues to be insolvent and cannot return to solvency because the credit default industry has collapsed, and the Athilon Charter, the Asset Acceptance Charter, and the Operating Guidelines prohibit the Company from engaging in other lines of business. At this point, the Company consists of a legacy portfolio of guarantees on credit default swap contracts written by Asset Acceptance that will continue to earn premiums until the last contracts expire in 2014 or shortly thereafter.

According to the Company's Consolidated Statement of Financial Condition as of September 30, 2011 (the "September 2011 Financials") the Company carries $600 million in debt, excluding its outstanding credit swaps, against assets with a saleable value of only $426 million. The Company's GAAP shareholder's equity was stated at negative $660 million as of that same date. At the time of the filing of the Complaint, the Company was rated BB by Standard & Poor's and Ba1 by Moody's.

The Complaint alleges that a well-motivated board of directors faced with these circumstances would maximize the Company's economic value for the benefit of its stakeholders by minimizing expense during runoff, then liquidating the Company and returning its capital to its investors. The Complaint alleges that instead, the EBF-controlled Board is using the Company's assets to benefit EBF.

The Complaint alleges that the Board has transferred value from Athilon to EBF by continuing unnecessarily to make interest payments on the Junior Notes, which EBF owns. The Board has the authority to defer interest payments on the Junior Notes without penalty for a period of time that would exceed the term of the remaining credit swaps. Once the last credit swap expires, the Operating Guidelines require that the Company liquidate. The Junior Notes are currently out of the money and would not recover anything in an orderly liquidation. The Company therefore has no reason to pay interest on the Junior Notes, because by the time the interest would be due, the Company will have dissolved and liquidated with the Junior Notes taking nothing. The Complaint alleges that an independent Board presented with this situation would defer payments of interest on the Junior Notes to conserve assets for the Company's more senior creditors. But because EBF holds the Junior Notes, the EBF-controlled Board has continued paying interest.

The Complaint also alleges that the Board has transferred value from Athilon to EBF by causing the Company to pay excessive fees to ASIA, which EBF indirectly owns and controls. In 2004, Athilon and Asset Acceptance entered into a services agreement with ASIA. In 2009, before the EBF takeover, the Company paid approximately $14 million in fees under the services agreement. After the Company entered runoff, the scope of ASIA's services substantially diminished and its fees should have decreased. Instead, after the EBF takeover, the fees paid to ASIA climbed dramatically and far exceeded market rates. In 2010, the Company paid $23.5 million in fees to ASIA, including a $2.5 million service fee to EBF. The market rate for ASIA's services would be $5-7 million per year. In 2011, Quadrant offered to provide comparable services for a flat fee of $5 million plus an estimated $2 million in costs for third party professionals.

The Board rejected Quadrant's offer without taking any action to investigate it and has not reduced the fees it pays to ASIA.

The Complaint similarly alleges that the Board has transferred value from Athilon to EBF through a software license agreement. In 2004, the Company entered into a software license agreement with ASIA. In 2009, the license agreement fee was $1.25 million. In 2010, after the EBF takeover, it increased to $1.5 million. The Complaint alleges that the software license fee is well above market and exceeds what it would cost for the Company to build the licensed capital models from scratch.

Finally, the Complaint alleges that the Board is changing the Company's business model to make speculative investments for the benefit of EBF. Under the Athilon Charter, the Asset Acceptance Charter, and the Operating Guidelines, the Company only can invest in highly-rated, short-term debt securities. In May 2011, the Board sought permission from the rating agencies to amend the Operating Guidelines to loosen the Company's investment restrictions and expand its permitted investments. The rating agencies confirmed that the amendments would not cause a downgrade in Athilon's already low credit rating. The Complaint alleges that the Board subsequently took steps to amend the Operating Guidelines to permit Athilon to invest in longer-dated and riskier investments.

As an example of the shift in investment strategy, Athilon repositioned a portion of its auction rate securities portfolio in the first quarter of 2011. In doing so, Athilon sold securities with a par value of $25 million and purchased other securities that were not as highly rated and did not carry the short-term maturities that Athilon's original Operating Guidelines required.

The Complaint alleges that by adopting an investment strategy that involves greater risk, albeit with the potential for greater return, the Board is acting for the benefit of EBF and contrary to the interests of other stakeholders, such as the Company's more senior creditors. Because EBF owns the Company's equity and Junior Notes, which are currently underwater, EBF does not bear any of the risk if the investment strategy fails. Only Quadrant and the other more senior creditors bear the downside risk. If the riskier investment strategy succeeds, however, then EBF will capture the benefit.

E. Procedural History

Despite having yet to move beyond the pleadings stage, this case has amassed an extended procedural history. Quadrant commenced this action on October 28, 2011, and filed the currently operative Complaint on January 6, 2012. The defendants moved to dismiss the Complaint, arguing among other things that Quadrant failed to comply with no-action clauses in the indentures that governed Quadrant's notes. The arguments that Quadrant made before this court about the no-action clauses had been addressed and rejected in two well-known Court of Chancery opinions, *Feldbaum v. McCrory Corp.*, 1992 WL 119095 (Del. Ch. June 2, 1992) (Allen, C.), and *Lange v. Citibank N.A.*, 2002 WL 2005728 (Del. Ch. Aug. 13, 2002) (Strine, V.C.). Finding those opinions to be directly on point, this court granted the motion to dismiss by order dated June 5, 2012.

Quadrant appealed. Before the Delaware Supreme Court, Quadrant advanced new arguments about how specific language of the no-action clauses in the Athilon notes differed from the no-action clauses at issue in *Feldbaum* and *Lange*. This court had not had the chance to address those arguments, which were raised for the first time on appeal. Finding the record "insufficient for appellate review," the Delaware Supreme Court remanded and directed this court to write a report addressing the newly raised arguments. *Quadrant Structured Prods. Co. v. Vertin*, No. 388, 2012 ¶ 1 (Del. Feb. 12, 2013). In light of the new arguments, this court's report concluded that the no-action clauses in the Athilon notes did not apply to Counts I through VI and IX of the Complaint, or to Count X to the extent that it sought to impose liability on secondary actors for violations of the other counts. The report concluded that the no-action clauses continued to bar Counts VII and VIII of the Complaint, as well as Count X to the extent it sought to impose liability on secondary actors for violations of the indentures. Dkt. 95.

After receiving the report, the Delaware Supreme Court certified the two questions at the heart of its analysis, which were governed by New York law, to the New York Court of Appeals. *Quadrant Structured Prods. Co. v. Vertin*, 2013 WL 5962813, at *5 (Del. Nov. 7, 2013). In an opinion issued earlier this year, the New York Court of Appeals agreed with the analysis set forth in the report. *Quadrant Structured Prods., Co. v. Vertin*, 23 N.Y.3d 549 (N.Y. 2014).

With the certified questions answered, the Delaware Supreme Court issued a decision applying the reasoning of this court's report and the New York Court of Appeals. As a technical matter, the Delaware Supreme Court's decision reversed the original dismissal of the complaint. *Quadrant Structured Prods. Co. v. Vertin*, 93 A.3d 654 (Del. 2014) (TABLE). The Delaware Supreme Court did not reach the other, independent grounds that the defendants had advanced in favor of dismissal. The case returned again to this court for a decision on those other arguments.

II. LEGAL ANALYSIS

The defendants' motion seeks to dismiss the Complaint for failing to state a claim on which relief can be granted. *See* Ch. Ct. R. 12(b)(6). In a Delaware state court, the pleading standards for purposes of a Rule 12(b)(6) motion "are minimal." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011).

> When considering a defendant's motion to dismiss, a trial court should accept all well-pleaded factual allegations in the Complaint as true, accept even vague allegations in the Complaint as "well-pleaded" if they provide the defendant notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any reasonably conceivable set of circumstances susceptible of proof.

Id. (footnote omitted). The operative test in a Delaware state court thus is one of "reasonable conceivability." *Id.* at 537 (footnote and internal quotation marks omitted). This standard asks whether there is a "possibility" of recovery. *Id.* at 537 n.13. The test is more lenient than the federal "plausibility" pleading standard, which invites judges to "'determin[e] whether a complaint states a plausible claim for relief' and 'draw on ... judicial experience and common sense.'" *Id.* (alteration in original). Under the Delaware test, a trial court commits reversible error by assessing plausibility. *See Cambium Ltd. v. Trilantic Capital P'rs III L.P.*, 36 A.3d 348, 2012 WL 172844, at *2 (Del. Jan. 20, 2012) (ORDER) ("The Court of Chancery erred by applying the federal 'plausibility' standard in dismissing the amended complaint.").

A. Counts I and II: Breach Of Fiduciary Duty Against The Directors And EBF

In Counts I and II of the Complaint, Quadrant asserts claims for breach of fiduciary duty derivatively on behalf of the Company against the directors and EBF. Count I alleges that the directors breached their duty of loyalty and committed corporate waste by (i) continuing to pay interest on the Junior Notes held by EBF, (ii) paying excessive service and license fees to EBF or ASIA, and (iii) changing the Company's business model to take on greater risk under a strategy where EBF will benefit from any upside as the sole holder of the Junior Notes and the Company's equity, but the Company's more senior creditors including Quadrant will bear the cost of any downside. Count II alleges that EBF has breached its duty of loyalty by engaging in the same actions that are the subject of Count I. The challenges to the failure to defer interest and the payment of excessive fees state claims. The challenge to the Board's change in business strategy does not.

1. Creditor Standing To Assert A Breach Of Fiduciary Duty Claim

Count I and II constitute an attempt by Quadrant, a corporate creditor, to assert claims for breach of duty against corporate fiduciaries. The directors of a Delaware corporation owe fiduciary duties to the corporation they serve. When determining whether directors have breached their fiduciary duties, Delaware corporate law distinguishes between the standard of conduct and the standard of review.[1] "The standard

[1] *See* William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Function Over Form: A Reassessment of the Standards of Review in Delaware Corporation Law*, 56 Bus. Law. 1287, 1295–99 (2001); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of* Van Gorkom *and its*

of conduct describes what directors are expected to do and is defined by the content of the duties of loyalty and care. The standard of review is the test that a court applies when evaluating whether directors have met the standard of conduct." *In re Trados Inc. S'holder Litig. (Trados II)*, 73 A.3d 17, 35-36 (Del. Ch. 2013).

"[T]he standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value." *Id.* at 40-41. In a solvent corporation, the residual claimants are the stockholders. Consequently, in a solvent corporation, the standard of conduct requires that directors seek prudently, loyally, and in good faith to "to manage the business of a corporation for the benefit of its shareholder[ ] owners." *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007).

As residual claimants and the ultimate beneficiaries of the fiduciary duties that directors owe to the corporation, stockholders have standing in equity to bring claims derivatively on behalf of the corporation for injury that the corporation has suffered. When a corporation is insolvent, its creditors become the beneficiaries of any initial increase in the corporation's value. *Id.* at 101. The stockholders remain residual claimants, but they can benefit from increases in the corporation's value only after the

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Progeny as a Standard of Review Problem, 96 Nw. U. L. Rev. 449, 451–52 (2002); *see also* E. Norman Veasey & Christine T. Di Guglielmo, *What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments*, 153 U. Pa. L. Rev. 1399, 1416–25 (2005) (distinguishing between the standards of fiduciary conduct and standards of review).

more senior claims of the corporation's creditors have been satisfied. "The corporation's insolvency makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value." *Id.* at 101-102 (internal quotation marks omitted). Because the creditors of an insolvent corporation join the class of residual claimants, "equitable considerations give creditors standing to pursue derivative claims against the directors of an insolvent corporation." *Id.* at 102.

Before the Delaware Supreme Court's landmark decision in *Gheewalla*, it was not clear whether directors of an insolvent corporation owed fiduciary duties directly to creditors. In what had long been the Delaware Supreme Court's leading pre-*Gheewalla* decision, the high court stated that:

> An insolvent corporation is civilly dead in the sense that its property may be administered in equity as a trust fund for the benefit of creditors. The fact which creates the trust is the insolvency, and when that fact is established, the trust arises, and the legality of the acts thereafter performed will be decided by very different principles than in the case of solvency.

Bovay v. H.M. Byllesby & Co., 38 A.2d 808, 813 (Del. 1944). The *Bovay* decision could be interpreted to hold that upon insolvency, the beneficiaries of the directors' fiduciary duties shifted from the corporation's stockholders to its creditors, and that after insolvency directors had a fiduciary obligation to preserve value for the benefit of creditors that creditors could enforce.[2] Interpreted in this manner, *Bovay*'s trust fund

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[2] An elliptical aside in a later Delaware Supreme Court decision provided some support for the reading. *See City Investing Co. Liquidating Trust v. Cont'l Cas. Co.*, 624 A.2d 1191, 1194 (Del. 1993) ("Even though the entity was civilly dead, its assets, like those of an insolvent corporation, were subject to administration in equity as a trust fund for the benefit of its creditors."). Other jurisdictions applied the trust fund doctrine in precisely this fashion. *See, e.g., Fed. Deposit Ins. Corp. v. Sea Pines Co.*, 692 F.2d 973, 976-77 (4th Cir. 1982) ("[W]hen the

doctrine would resemble English law, which imposes personal liability on directors for wrongful trading, which occurs when the directors have continued to operate the company after the point they knew, or should have known, that there was no reasonable prospect of the company avoiding liquidation.[3]

In 1991, Chancellor Allen penned his famous footnote 55 in the *Credit Lyonnais* opinion. *Credit-Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, 17 Del. J. Corp. L. 1099, 1055 n.55 (Del. Ch. Dec. 30, 1991). The influential aside stated:

> The possibility of insolvency can do curious things to incentives, exposing creditors to risks of opportunistic behavior and creating complexities for directors. Consider, for example, a solvent corporation having a single asset, a judgment for $51 million against a solvent debtor. The judgment is on appeal and thus subject to modification or reversal. Assume that the only liabilities of the company are to bondholders in the amount of $12 million. Assume that the array of probable outcomes of the appeal is as follows:

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corporation becomes insolvent, the fiduciary duty of the directors shifts from the stockholders to the creditors."); *Automatic Canteen Co. of Am. v. Wharton*, 358 F.2d 587, 590 (2d Cir. 1966) ("[D]irectors of an insolvent corporation occupy a fiduciary position toward the creditors, just as they do toward the corporation when it is solvent. We hold them trustees of the corporation's property on behalf of the creditors, so that as a class the creditors should be able to follow the property into the hands of the directors, here acting for the parent."); *Davis v. Woolf*, 147 F.2d 629, 633 (4th Cir. 1945) ("The law by the great weight of authority seems to be settled that when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors and that they then can not by transfer of its property or payment of cash, prefer themselves or other creditors"); *N.Y. Credit Men's Adjustment Bureau v. Weiss*, 305 N.Y. 1, 7, 110 N.E.2d 397, 398 (1953) ("If the corporation was insolvent at that time it is clear that defendants, as officers and directors thereof, were to be considered as though trustees of the property for the corporate creditor-beneficiaries.").

[3] Insolvency Act 1986 (UK) c 45, § 214. *See generally* Paul L. Davies, *Principles of Modern Company Law* 217-24 (8th ed. 2008); David Kershaw, *Company Law in Context* 729-39 (2009); Sabrina Bruno, *Personal Liability of Corporate Directors Under English Common Law and Italian Civil Law*, 2 U.C. Davis J. Int'l L. & Pol'y 37, 74-78 (1996).

	Expected Value of Judgment on Appeal	Expected Value
25% chance of affirmance	$51mm	$12.75
70% chance of modification	$4mm	$2.8
5% chance of reversal	$0	$0

Thus, the best evaluation is that the current value of the equity is $3.55 million. ($15.55 million expected value of judgment on appeal—$12 million liability to bondholders). Now assume an offer to settle at $12.5 million (also consider one at $17.5 million). By what standard do the directors of the company evaluate the fairness of these offers? The creditors of this solvent company would be in favor of accepting either a $12.5 million offer or a $17.5 million offer. In either event they will avoid the 75% risk of insolvency and default. The stockholders, however, will plainly be opposed to acceptance of a $12.5 million settlement (under which they get practically nothing). More importantly, they very well may be opposed to acceptance of the $17.5 million offer under which the residual value of the corporation would increase from $3.5 to $5.5 million. This is so because the litigation alternative, with its 25% probability of a $39 million outcome to them ($51 millon – $12 million = $39 million) has an expected value to the residual risk bearer of $9.75 million ($39 million x 25% chance of affirmance), substantially greater than the $5.5 million available to them in the settlement. While in fact the stockholders' preference would reflect their appetite for risk, it is possible (and with diversified shareholders likely) that shareholders would prefer rejection of both settlement offers.

But if we consider the community of interests that the corporation represents it seems apparent that one should in this hypothetical accept the best settlement offer available providing it is greater than $15.55 million, and one below that amount should be rejected. But that result will not be reached by a director who thinks he owes duties directly to shareholders only. It will be reached by directors who are capable of conceiving of the corporation as a legal and economic entity. Such directors will recognize that in managing the business affairs of a solvent corporation in the vicinity of insolvency, circumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.

Id.[4]

Read against the backdrop of *Bovay* and the trust fund doctrine, footnote 55's expression of concern about insolvency "exposing creditors to risks of opportunistic behavior" and its recognition that "the right (both the efficient and the fair) course" for directors of an insolvent corporation might diverge from what stockholders would want re-invigorated the notion that directors of an insolvent corporation owed fiduciary duties directly to creditors with the potential for creditors to bring breach of fiduciary duty claims against directors if the latter made business decisions that favored stockholders. Judicial opinions after *Credit-Lyonnais* spoke of the directors of an insolvent corporation owing fiduciary duties to the corporation's creditors.[5] This language suggested to some

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[4] Footnote 55 used the phrase "solvent corporation in the vicinity of insolvency." *Id.* Until *Gheewalla*, debate raged over this concept, which cases and commentators often referred to as the "zone of insolvency." *See, e.g., U.S. Bank N.A. v. U.S. Timberlands Klamath Falls, L.L.C. (Klamath Falls),* 864 A.2d 930, 948 (Del. Ch. 2004), *vacated on appeal*, 875 A.2d 632 (Del. 2005) (TABLE); *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 174 (Del. Ch. 2006) (Strine, V.C.), *aff'd sub nom., Trenwick Am. Litig. Trust v. Billett*, 931 A.2d 438 (Del. 2007) (TABLE); *Blackmore P'rs, L.P. v. Link Energy LLC*, 2005 WL 2709639, at *3 (Del. Ch. Oct. 14, 2005); Neil Ruben, *Duty to Creditors in Insolvency and the Zone of Insolvency: Delaware and the Alternatives*, 7 N.Y.U. J. L. & Bus. 333 (2010). In *Gheewalla*, the Delaware Supreme Court discarded the zone, holding that "[w]hen a solvent corporation is navigating in the zone of insolvency, the focus for Delaware directors does not change: directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for the benefit of its shareholder owners." 930 A.2d at 101. After *Gheewalla*, actual insolvency is the relevant transitional moment. Of course, the point at which a corporation becomes insolvent remains debatable, is difficult to perceive in real-time, and can only be determined definitively by a court in hindsight. I suspect that when Chancellor Allen spoke of "the vicinity of insolvency," he intended to recognize these practical ambiguities, rather than to expand the law. Regardless, given *Gheewalla*'s rejection of the zone, this decision speaks only in terms of insolvency.

[5] *See In re NCS Healthcare, Inc., S'holders Litig.*, 825 A.2d 240, 256 (Del. Ch. 2002) ("as directors of a corporation in the 'zone of insolvency,' the NCS board members also owe fiduciary duties to the Company's creditors"), *rev'd sub nom., Omnicare, Inc. v. NCS*

that creditors of an insolvent corporation, like stockholders, might be able to assert direct claims for breach of fiduciary duty.

In a decision issued in 2004, then-Vice Chancellor, now Chief Justice Strine sought to clarify matters. *See Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772 (Del. Ch. 2004). He explained that Chancellor Allen had "attempted to emphasize that directors [of an insolvent corporation] have discretion to temper the risk that they take on behalf of the equity holders." *Id.* at 788. "The *Credit-Lyonnais* decision's holding and spirit clearly emphasized that directors would be protected by the business judgment rule if they, in good faith, pursued a less risky business strategy. . . ." *Id.* "In other words, *Credit Lyonnais* provided a shield to directors from stockholders who claimed that the directors had a duty to undertake extreme risk so long as the company would not technically breach any legal obligation." *Id.*

As to claims by creditors, the Chief Justice explained that even after insolvency, "directors continue to have the task of attempting to maximize the economic value of the firm." *Id.* at 791. He noted that "the fact of insolvency does necessarily affect the constituency on whose behalf the directors are pursuing that end," and that after insolvency, creditors become the initial residual claimants. *Id.* If directors breach their

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Healthcare, Inc., 822 A.2d 397 (Del. 2002); *Geyer v. Ingersoll Publ'ns Co.*, 621 A.2d 784, 787 (Del. Ch. 1992) ("neither party seriously disputes that when the insolvency exception does arise, it creates fiduciary duties for directors for the benefit of creditors"); *id.* at 790 ("fiduciary duties to creditors arise when one is able to establish the fact of insolvency"); *see also In re Hechinger Inv. Co. of Del.*, 274 B.R. 71, 89 (D. Del. 2002) ("At the moment a corporation becomes insolvent, however, the insolvency triggers fiduciary duties for directors for the benefit of creditors.").

duties by harming the firm, then creditors have standing to assert the firm's derivative claim.

> No particular creditor would have the right to the recovery; rather, all creditors would benefit when the firm was made whole and the firm's value was increased, enabling it to satisfy more creditor claims in order of their legal claim on the firm's assets . . . Thus, regardless of whether they are brought by creditors when a company is insolvent, these claims remain derivative, with either shareholders or creditors suing to recover for a harm done to the corporation as an economic entity . . . .

Id. He held out the possibility, however, that under limited circumstances a creditor (or class of creditors) might be able to allege a direct claim if the directors of the insolvent firm took action that frustrated the ability of a particular creditor to recover, to the benefit of other stakeholders. *Id.* at 797; *see id.* at 800 ("I am not prepared to rule out the possibility that [the creditor plaintiff] can prove that the [insolvent company's] board has engaged in conduct towards [the creditor plaintiff] that might support a direct claim for breach of fiduciary duty by it as a particular creditor.").

In *Gheewalla*, the Delaware Supreme Court settled the debate over whether directors of an insolvent corporation owe fiduciary duties directly to creditors. The high court held creditors of an insolvent corporation may sue derivatively, but they "have *no right to assert direct* claims for breach of fiduciary duty against corporate directors." 930 A.2d at 103 (emphasis in original). Creditors of a solvent corporation have no right to assert direct claims for breach of fiduciary duty either, so as a practical matter *Gheewalla* holds that directors never owe fiduciary duties directly to creditors. *See id.* As the Delaware Supreme Court explained, creditors do not need direct fiduciary protection because "creditors are afforded protection through contractual agreements, fraud and fraudulent conveyance law, implied covenants of good faith and fair dealing, bankruptcy law, general commercial law and other sources of creditor rights." *Id.* at 99. In addition, the high court explained that recognizing a direct fiduciary duty to creditors "would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation [and] create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors." *Id.* at 103.

In light of *Gheewalla*, I do not believe it is accurate any longer to say that the directors of an insolvent corporation owe fiduciary duties to creditors. It remains true that insolvency "marks a shift in Delaware law," but

> that shift does not refer to an actual shift of duties to creditors (duties do not shift to creditors). Instead, the shift refers primarily to standing: upon a corporation's insolvency, its creditors gain standing to bring derivative actions for breach of fiduciary duty, something they may not do if the corporation is solvent, even if it is in the zone of insolvency.

Robert J. Stearn, Jr. & Cory D. Kandestin, *Delaware's Solvency Test: What Is It and Does It Make Sense? A Comparison of Solvency Tests Under the Bankruptcy Code and Delaware Law*, 36 Del. J. Corp. L. 165, 171 (2011). The fiduciary duties that creditors gain derivative standing to enforce are not special duties to creditors, but rather the fiduciary duties that directors owe to the corporation to maximize its value for the benefit of all residual claimants. *Gheewalla*, 930 A.2d at 101.

2. Pleading Insolvency

Under *Gheewalla*, Quadrant gains standing to bring a derivative claim by pleading that the Company is insolvent. A plaintiff can plead insolvency through allegations that meet either the "balance sheet" test or the "cash flow" test. *See Klamath Falls*, 864 A.2d at 947. *See generally* Stearn & Kandestin, *supra*, at 21. Under the balance sheet test, an entity is insolvent if it "has liabilities in excess of a reasonable market value of assets held." *Trenwick*, 906 A.2d at 195 n.74 (Del. Ch. 2006) (internal quotation omitted); *accord Blackmore P'rs,* , 2005 WL 2709639, at *6; *Geyer*, 621 A.2d at 789. In a mature company, the existence of "a great disparity between assets and liabilities . . . at least raises an issue of material fact as to whether the company was insolvent" sufficient to survive a motion to dismiss. *Klamath Falls*, 864 A.2d at 948.

The Complaint's allegations support a reasonable inference that Athilon has been insolvent under the balance sheet test since before the EBF takeover. The Complaint alleges that the Company started with only $100 million in equity capital, borrowed six times that much in the form of long-term debt, and then leveraged its equity capital another 500 times writing credit default swaps. The Complaint describes substantial payments that the Company made to unwind two unsuccessful swap transactions for mortgage backed reference obligations, starting with a $48 million payment in 2008 that wiped out half of the Company's equity capital, followed by a $320 million payment in 2010 that exceeded six times its remaining equity capital. The Complaint explains that in light of the demise of the credit product company business model due to the financial crisis, the Company has no realistic prospect of returning to solvency. The Complaint further explains that by the end of 2008, the Company and Asset Acceptance lost their AAA/Aaa ratings and entered runoff, and by August 2010, the Company and Asset Acceptance no longer had any investment grade debt or counterparty credit ratings.

Focusing on the September 2011 Financials, the Complaint alleges that the Company had $600 million of outstanding bond debt and assets with a fair saleable value of only $426 million. Ironically, the Company in its reply brief disputes the accuracy of this allegation by asserting that the Company's liabilities were actually $747 million—$147 million greater than what the Complaint alleges.

These facts adequately plead insolvency under the balance sheet test. The defendants have sought on several occasions to introduce material outside of the Complaint which they say defeats the pleading-stage inference of insolvency. For the court to consider these submissions would require converting the motion to dismiss into a motion for summary judgment. They have not been considered.

3. The Contemporaneous Ownership Requirement

Gheewalla indicates that the derivative claims that creditors gain standing to assert are no different than the derivative claims that stockholders could assert. The defendants reason that creditors therefore should have to comply with the same requirements that stockholders must meet, such as the contemporaneous ownership requirement. This decision need not determine whether creditor-plaintiffs should have to comply with other substantive legal doctrines, such as demand excusal or demand refusal, because the defendants have not raised them. The contemporaneous ownership requirement, however, is a statutorily imposed limitation that applies by its terms only to stockholder-plaintiffs. It does not apply to creditors.

Section 327 of the Delaware General Corporation Law imposes the contemporaneous ownership requirement. 8 *Del. C.* § 327. It states:

> In any derivative suit instituted by a stockholder of a corporation, it shall be averred in the complaint that the plaintiff was a stockholder of the corporation at the time of the transaction of which such stockholder complains or that such stockholder's stock thereafter devolved upon such stockholder by operation of law.

Id. The contemporaneous ownership requirement has a similarly sounding counterpart—the continuous ownership requirement—which is a judicially created doctrine. *Lambrecht v. O'Neal*, 3 A.3d 277, 284 (Del. 2010). The continuous ownership requirement requires that a stockholder-plaintiff hold shares in the corporation from the commencement of the breach of fiduciary duty lawsuit until its completion. *Id.*

Section 327 is "the only statutory provision [in the Delaware General Corporation Law] dealing with derivative actions." 2 Edward P. Welch et al., *Folk on the Delaware General Corporation Law* § 327.1, at GCL-XIII-42 (5th ed. Supp. 2007). It does not, however, provide stockholders with standing to assert derivative claims. Rather, Section 327 limits derivative standing to a subset of those stockholders who otherwise would have standing to sue at common law.[6]

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[6] *CML V, LLC v. Bax*, 28 A.3d 1037, 1044 (Del. 2011) (explaining that Section 327 "does not create derivative standing. Rather, it merely limits derivative standing to those stockholders who owned their stock at the time of the allegedly wrongful transaction or whose stock devolved upon them by operation of law from a person who owned the stock at that time."); *accord Schoon v. Smith*, 953 A.2d 196, 201 (Del. 2008) ("Section 327 *does not create the right to sue*

Court of Chancery Rule 23.1 implements Section 327 procedurally by requiring that a stockholder plaintiff plead compliance with the statute. Rule 23.1(a) provides that "the complaint shall allege that the plaintiff was a shareholder . . . at the time of the transaction of which the plaintiff complains or that the plaintiff's shares . . . devolved on the plaintiff by operation of law." Ch. Ct. R. 23.1(a). Through this procedural mechanism, compliance with Section 327 can be addressed on the pleadings rather than at a later stage of the case. Rule 23.1 does not create or provide an independent basis for the contemporaneous ownership requirement. By statute, a Court of Chancery Rule is not permitted to alter substantive law. *See* 10 *Del. C.* § 361(b) ("[R]ules shall be for the purpose of securing the just and, so far as possible, the speedy and inexpensive determination of every such proceeding. The rules shall not abridge, enlarge or modify any substantive right of any party.").

The General Assembly enacted Section 327 in 1945. In doing so, the General Assembly altered Delaware law by restricting a stockholder's ability to sue for fiduciary wrongs that pre-dated his stock ownership. "Under the Delaware Law as it existed prior to the enactment of this statute, in order to maintain a derivative action, a stockholder was not required to be the owner of the shares at the time of the transaction of which he complained." *Rosenthal v. Burry Biscuit Corp.*, 60 A.2d 106, 110 (Del. Ch. 1948) (Seitz,

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derivatively, but rather restricts that right." (emphasis in original) (internal quotation marks omitted)); *Harff v. Kerkorian*, 324 A.2d 215, 218 (Del. Ch. 1974) ("It must be recognized, however, that § 327 does not create the right to sue derivatively but rather restricts that right."), *aff'd in part, rev'd in part on other grounds*, 347 A.2d 133 (Del. 1975).

V.C.) (citing cases). The United States Supreme Court originally created the contemporaneous ownership requirement as a matter of equity in 1881 to prevent corporations from manufacturing diversity jurisdiction for claims against third parties. *See Hawes v. Oakland*, 104 U.S. 450, 461 (1881). That problem did not confront state courts (and it still doesn't). Consequently, "many courts, including Delaware, did not follow the rule of the *Hawes* case [*viz.*, the contemporaneous ownership requirement]." *Burry Biscuit*, 60 A.2d at 111.

For Delaware courts at common law not to adopt the contemporaneous ownership requirement comported with Delaware law regarding the assignment of claims. Equitable claims for breach of fiduciary duty, such as those typically asserted in derivative actions, are freely assignable under Delaware law. A right of action is assignable under Delaware law if it is the type of claim that would survive the death of the assignor and pass to his personal representative. *See Indus. Trust Co. v. Stidham*, 33 A.2d 159, 160-61 (Del. Super. 1942). By statute in Delaware, "[a]ll causes of action, except actions for defamation, malicious prosecution, or upon penal statutes, shall survive. . . ." 10 *Del. C.* § 3701. When a stockholder sells shares, the right to bring a cause of action for breach of fiduciary duty, and the right to benefit from any remedy obtained on that a cause of action, are property rights associated with the shares that pass to the buyer as an incident of the transfer of shares. Even after the adoption of Section 327, Delaware courts continue to recognize that the right to bring a claim for breach of fiduciary duty, including derivatively, is a property right associated with a share of stock and freely assignable. *In re Emerging Commc'ns., Inc. S'holders Litig.*, 2004 WL 1305745, at *29-

30 (Del. Ch. May 3, 2004, revised June 4, 2004) (Jacobs, J. (sitting by designation)) (approving assertion of litigation rights by stockholder that purchased those rights from other stockholders). Delaware courts can grant defendants broad, class-wide, transactional releases precisely because these property rights are attributes of the shares and pass with the transfer of shares, thereby moving from the holder who owned them at the time of the wrong to "their transferees, successors, and assigns." *In re Phila. Stock Exch., Inc.*, 945 A.2d 1123, 1139 (Del. 2008); *accord In re Prodigy Commc'ns Corp. S'holders Litig.*, 2002 WL 1767543, at *4 (Del. Ch. July 26, 2002) ("[W]hen Beoshanz sold his shares in the marketplace, the claim relating to the fairness of the then-proposed transaction passed to his purchaser, who enjoyed the benefits of the settlement."); *In re Triarc Cos., Class & Deriv. Litig.*, 791 A.2d 872, 878-79 (Del. Ch. 2001) (explaining owners of stock who sell their shares are "viewed as having sold their interest in the claim with their shares").

Section 327 thus "effected a substantial change in the Delaware Corporation Law." *Burry Biscuit*, 60 A.2d at 110. Before its passage, a stockholder could sue for wrongs pre-dating the acquisition of stock. "After its passage, a stockholder filing a derivative action was required to allege and therefore to prove that he was a stockholder at the time of the transaction of which he complained, or that his stock devolved upon him by operation of law." *Id.* Thus, "[t]he equitable standing of a stockholder to bring a derivative action was judicially created but later restricted by [Section 327]." *Schoon*, 953 A.2d at 204; *accord CML V*, 28 A.3d at 1044.

"It is well-settled that unambiguous statutes are not subject to judicial interpretation." *Leatherbury v. Greenspun*, 939 A.2d 1284, 1288 (Del. 2007). "If the statute as a whole is unambiguous and there is no reasonable doubt as to the meaning of the words used, the court's role is limited to an application of the literal meaning of those words." *Id.* (internal quotation marks omitted); *accord Friends of the H. Fletcher Brown Mansion v. City of Wilmington*, 34 A.3d 1055, 1059 (Del. 2011). By its terms, Section 327 applies only to stockholders. The plain language of the statute does not apply to other corporate constituencies, like creditors, who can under limited circumstances bring derivative claims. "[W]hile [Section 327] should be construed so as to reasonably effectuate its primary purpose—to discourage a type of strike suit—it should not be construed so as to unduly encourage the camouflaging of transactions and thus prevent reasonable opportunities to rectify corporate aberrations." *Schoon*, 953 A.2d at 203-204 (quoting *Maclary v. Pleasant Hills, Inc.*, 109 A.2d 830, 833 (Del. Ch. 1954)).

For reasons that I have discussed elsewhere, I do not believe that a coherent and credible policy justification has ever been offered for Section 327's limitation on the ability of stockholders to assert pre-transfer claims. *See* J. Travis Laster, *Goodbye to the Contemporaneous Ownership Requirement*, 33 Del. J. Corp. L. 673 (2008). The purposes that have been proffered for Section 327's limitation on stockholder standing (i) ignore the two-fold nature of the derivative action, *id.* at 676-77, (ii) conflict with Delaware law on the assignability of claims, *id.* at 680-81, (iii) do not match up with how the statute operates, *id.* at 682-84, 688-91, or (iv) stand in tension with financial and economic theory, *id.* at 685-88. Section 327 is obviously the law of Delaware, and this court is bound to apply the law as enacted by the General Assembly. But applying Section 327 as enacted is a different thing than expanding it to apply to a class of plaintiffs that the language nowhere mentions. Rather than enforcing the literal meaning of the statute in accordance with its terms, applying it to creditors would re-write Section 327 expansively.

Extending Section 327 to creditors also would stand in tension with the ability of creditors to assert claims that pre-date the point when they acquire standing to sue. For stockholders, standing to sue and stock ownership are synonymous, and Section 327 prevents stockholders from asserting claims that arose before they acquired their stock ownership. For creditors, standing to sue depends on two inputs: creditor status (analogous to stock ownership) and corporate insolvency. In his *Production Resources* decision, Chief Justice Strine explained while serving as a Vice Chancellor that creditors are *not* prevented from bringing derivative claims that pre-date the corporation's insolvency. After positing a situation in which a firm becomes insolvent "*after* the acts that are alleged to have been fiduciarily improper," he explained that a creditor in that situation would be included within "the class of those eligible to press the claim derivatively." *Prod. Res.*, 863 A.2d at 792 (emphasis in original). Later in the same decision, the Chief Justice again posited situations when directors engaged in fiduciary wrongdoing before the firm became insolvent and noted that after the firm became insolvent, the claim could be "asserted by creditors" or by a trustee in bankruptcy. *Id.* at 794. This makes sense as a matter of policy because one of the rationales for conferring standing on creditors recognizes that once the corporation reaches the point of insolvency, the creditors become the primary beneficiary of any increase in the value of the corporation. *Gheewalla*, 930 A.2d at 102; *Prod. Res.*, 863 A.2d at 792. Stockholders have less incentive to sue because the recovery is less likely to benefit them. *Trenwick*, 906 A.2d at 195 n.75. It is entirely possible, perhaps even likely, that breaches of fiduciary duty that cause, hasten, or otherwise contribute to insolvency will have occurred before the point of insolvency in fact. If creditors lack standing to assert claims that pre-dated the point of insolvency, then the number of possible plaintiffs will be few: stockholders will lack the incentive, and creditors will lack the ability. Because of how they gain standing to sue, creditors can and should be able to assert claims that arose before they gained standing. To extend Section 327 to creditors would conflict with this approach.

Importantly, it does not necessarily follow from this analysis that a creditor-plaintiff need not comply with other substantive doctrines applicable to derivative actions, such as demand excusal and demand refusal. As with Section 327, Court of Chancery Rule 23.1 implements the substantive requirements of demand futility and demand refusal as pleading requirements by providing that "[t]he complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action the plaintiff desires from the directors or comparable authority and the reasons for the plaintiff's failure to obtain the action or for not making the effort." Ch. Ct. R. 23.1(a). By its terms, Rule 23.1 only applies to "a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated corporation." Ch. Ct. R. 23.1(a). The rule later defines "an unincorporated association" to include "a statutory trust, business trust, limited liability company and a partnership (whether general or limited)," and a "member" to include "a person permitted by applicable law to bring a derivative action to enforce a right [of] such unincorporated association." Ch. Ct. R. 23.1(e).

Although Rule 23.1 does not mention creditor-plaintiffs when addressing either contemporaneous ownership or demand futility and demand refusal, the underlying substantive rules do not preclude a requirement that creditor-plaintiffs comply with these doctrines. A corporate claim is an asset of the corporation, so authority over the claim ordinarily rests with the board of directors. *See* 8 *Del. C.* § 141(a); *Zapata Corp. v. Maldonado*, 430 A.2d 779, 782 (Del. 1981). The doctrines of demand excusal and demand refusal protect the board's authority under Section 141(a) and prevent a derivative plaintiff from usurping the board's prerogative to decide how to handle a corporate claim.[7] These substantive doctrines flow from the "two-fold" nature of the derivative suit. *Aronson*, 473 A.2d at 811. "First, it is the equivalent of a suit . . . to compel the corporation to sue. Second, it is a suit by the corporation . . . against those

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[7] *See Aronson v. Lewis*, 473 A.2d 805, 811 (Del. 1984). In *Brehm v. Eisner*, 746 A.2d 244 (Del. 2000), the Delaware Supreme Court overruled seven precedents, including *Aronson*, to the extent they reviewed a Rule 23.1 decision by the Court of Chancery under an abuse of discretion standard or otherwise suggested deferential appellate review. *Id.* at 253 n.13. The *Brehm* Court held that, going forward, appellate review of a Rule 23.1 determination would be *de novo* and plenary. *Id.* at 253. *Aronson* and the other six precedents otherwise remain good law. This decision does not rely on any of them for the standard of appellate review and therefore omits the cumbersome subsequent history regarding *Brehm*.

liable to it."[8] For a plaintiff obtain the right to compel the corporation to sue, the plaintiff must establish demand futility or demand refusal as a matter of substantive Delaware law. *Accord Ainscow v. Sanitary Co. of Am.*, 180 A. 614, 615 (Del. Ch. 1935) (Wolcott, C.) (citing *Sohland v. Baker*, 141 A. 277, 281-82 (Del. 1927)). Rule 23.1 does not create the demand requirement; it is merely the "procedural embodiment of this substantive principle." *Rales v. Blasband*, 634 A.2d 927, 932 (Del. 1993); *accord Kamen v. Kemper Fin. Serv., Inc.*, 500 U.S. 90, 96-97 (1991) (holding that the underlying demand requirement is substantive and the Rule 23.1 pleading requirement is procedural).

Because Rule 23.1 is procedural, whether a creditor would need to satisfy the demand excusal or demand refusal requirements depends not on Rule 23.1 but rather on the underlying substantive principle of law, just as whether a creditor must satisfy Section 327 turns not on Rule 23.1 but on the substantive language of the statute. The requirements of demand futility or demand refusal flow from Section 141(a), which

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[8]*Aronson*, 473 A.2d at 811; *accord Schoon*, 953 A.2d at 201-02 (tracing history of derivative action and explaining its dual nature); *Spiegel v. Buntrock*, 571 A.2d 767, 773 (Del. 1990) (citing the "two-fold" nature of the derivative action); *Sternberg v. O'Neil*, 550 A.2d 1105, 1124 n.41 (Del. 1988) ("The normal derivative suit was 'two suits in one: (1) The plaintiff brought a suit in equity against the corporation seeking an order against it; (2) to bring a suit for damages or other legal injury for damages or other relief against some third person who had caused legal injury to the corporation.'" (quoting Robert C. Clark, *Corporate Law* 639–40 (1986))); *Kaplan v. Peat, Marwick, Mitchell & Co.,* 540 A.2d 726, 730 (Del. 1988) (describing the "two-fold" nature of the derivative action); *Zapata*, 430 A.2d at 784 (citing "the 'two phases' of a derivative suit, the stockholder's suit to compel the corporation to sue and the corporation's suit"); *Harff*, 324 A.2d at 218 ("The nature of the derivative suit is two-fold: first, it is the equivalent of a suit by the stockholders to compel the corporation to sue; and second, it is a suit by the corporation, asserted by the stockholders in its behalf, against those liable to it."); *Cantor v. Sachs*, 162 A. 73, 76 (Del. Ch. 1932) (Wolcott, C.) (explaining that a derivative suit has "two phases—one is the equivalent of a suit to compel the corporation to sue, and the other is the suit by the corporation . . . against those liable to it.").

makes the authority of the board of directors paramount. Section 141(a) does not distinguish between stockholders, creditors, or other corporate constituencies. It is therefore possible that creditors could be required to comply with the doctrines of demand futility and demand excusal.

This court has previously declined to address whether a creditor seeking to bring a derivative action must comply with the requirement to show demand excusal or demand refusal, noting that arguments could be made both in favor of and against applying these doctrines to creditor-plaintiffs. *Prods. Res.*, 863 A.2d at 796. This decision need not address this issue either, because the defendants did not raise demand futility or demand refusal as an objection to Quadrant's derivative claims. This decision discusses these doctrines only to make clear that its holding on Section 327 does not dictate the non-application of demand doctrines to creditor claims. This decision holds that Section 327 does not apply to creditor suits based on the plain language of the statute, and its analysis is limited to the contemporaneous ownership requirement that Section 327 imposes.

4. The Derivative Claim For Paying Interest On The Junior Notes

Counts I and II identify three decisions by which the members of the Board allegedly breached their duties to the Company. The first was the decision to continue paying interest on the Junior Notes. The allegations on this issue state a claim on which relief can be granted.

To determine whether directors have made a decision that breached their fiduciary duties, a Delaware court examines their actions through the lens of a standard of review. "Delaware has three tiers of review for evaluating director decision-making: the business judgment rule, enhanced scrutiny, and entire fairness." *Reis v. Hazelett Strip-Casting Corp.*, 28 A.3d 442, 457 (Del. Ch. 2011). Which standard of review applies will depend initially on whether the board members:

> (i) were disinterested and independent (the business judgment rule), (ii) faced potential conflicts of interest because of the decisional dynamics present in particular recurring and recognizable situations (enhanced scrutiny), or (iii) confronted actual conflicts of interest such that the directors making the decision did not comprise a disinterested and independent board majority (entire fairness). The standard of review may change further depending on whether the directors took steps to address the potential or actual conflict, such as by creating an independent committee, conditioning the transaction on approval by disinterested stockholders, or both.

Trados II, 73 A.3d at 36.

Delaware's default standard of review is the business judgment rule, a principle of non-review that "reflects and promotes the role of the board of directors as the proper body to manage the business and affairs of the corporation." *In re Trados Inc. S'holder Litig. (Trados I)*, 2009 WL 2225958, at *6 (Del. Ch. July 24, 2009). The rule presumes that "in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." *Aronson*, 473 A.2d at 812. Unless one of its elements is rebutted, "the court merely looks to see whether the business decision made was rational in the sense of being one logical approach to advancing the corporation's objectives." *In re Dollar Thrifty S'holder Litig.*, 14 A.3d 573, 598 (Del. Ch. 2010) (Strine, V.C.). "Only when a decision lacks any rationally conceivable basis will a court infer bad faith and a breach of duty." *In re Orchard Enters., Inc. S'holder Litig.*, 88 A.3d 1, 34 (Del. Ch. 2014).

Entire fairness is Delaware's most onerous standard of review. It applies when a plaintiff rebuts one or more of the presumptions of the business judgment rule. It also applies "[w]hen a transaction involving self-dealing by a controlling shareholder is challenged. . . ." *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1239 (Del. 2012). Unless the defendants implement protective procedural devices, they "bear the burden of proving that the transaction with the controlling stockholder was entirely fair to the minority stockholders." *Id.*

In the current case, the standard of review for evaluating the decision to continue paying interest on the Junior Notes is entire fairness with the burden of proof on the defendants. The Complaint alleges that the Board had the ability to defer interest payments on the Junior Notes, that the Junior Notes would not receive anything in an orderly liquidation, that EBF owned all of the Junior Notes, and that the Board decided not to defer paying interest on the Junior Notes to benefit EBF. A conscious decision not to take action is just as much of a decision as a decision to act. *See Hubbard v. Hollywood Park Realty Enters., Inc.*, 1991 WL 3151, at *10 (Del. Ch. Jan. 14, 1991) ("From a semantic and even legal viewpoint, 'inaction' and 'action' may be substantive equivalents, different only in form."); *accord Krieger v. Wesco Fin. Corp.*, 30 A.3d 54, 58 (Del. Ch. 2011). A decision to act and a conscious decision not to act are thus equally subject to review under traditional fiduciary duty principles. *See Spiegel*, 571 A.2d at 773-74 ("[A] conscious decision by a board of directors to refrain from acting may be a valid exercise of business judgment. . . ."); *Aronson*, 473 A.2d at 813 (equating "a conscious decision to refrain from acting" with a decision to act).

By virtue of the decision not to defer interest, funds flowed from the Company to EBF. As the owner of 100% of the Company's equity, EBF controlled the Company and stood on both sides of the transaction. Delaware law imposes fiduciary duties on those who effectively control a corporation.[9] When a controller owns 100% of a corporation's equity and the subsidiary is solvent, the interests of the corporation and its fiduciaries are fully aligned with those of the controller. The fiduciary duties of the directors and officers require that the subsidiary be managed for the benefit of the controller, and the fiduciary duties imposed on the controller self-referentially require the same thing. It is therefore accurate to say, when the subsidiary is solvent, that "in a parent and wholly-owned subsidiary context, the directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interests of the parent and its shareholders." *Anadarko Petroleum Corp. v. Panhandle E. Corp.*, 545 A.2d 1171, 1174 (Del. 1988).

A transfer of value from a solvent subsidiary to the holder of 100% of the equity cannot give rise to a fiduciary wrong. Before the transfer, the 100% stockholder owned

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[9] *See Kahn v. Lynch Commc'n Sys. Inc.*, 638 A.2d 1110, 1114 (Del. 1994) (holding that 43% stockholder that exercised actual control over subsidiary could be liable for breach of fiduciary duty); *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 109-10 (Del. 1952) (citing "the settled rule of law that Hilton as majority stockholder of Mayflower and the Hilton directors as its nominees occupy, in relation to the minority, a fiduciary position in dealing with Mayflower's property"); *Keenan v. Eshleman*, 2 A.2d 904, 908 (Del. 1938) (affirming imposition of liability on directors for management fees paid by corporation to second corporation that was its controlling stockholder, where directors also controlled the controlling stockholder; "The conception of corporate entity is not a thing so opaque that it cannot be seen through; and, viewing the transaction as one between corporations, casual scrutiny reveals that the appellants, in fact, dealt with themselves to their own advantage and enrichment. The employment of Consolidated by Sanitary was merely the employment by the appellants of themselves to do what it was their plain duty to do as officers of Sanitary."); *accord S. Pac. Co. v. Bogert*, 250 U.S. 483, 487-88 (1919) (imposing fiduciary duties on controlling stockholder).

the value indirectly and beneficially. After the transfer, the 100% stockholder owned the value directly. The sole residual claimant and exclusive beneficiary of the duties that the corporate fiduciaries owe is in the same position before and after the transaction. The sole residual claimant has not been harmed, and the transfer by every measure is entirely fair. But "[w]hen a corporation is *insolvent,* . . . its creditors take the place of the shareholders as the residual beneficiaries of any increase in value." *Gheewalla*, 930 A.2d at 101 (emphasis in original). Directors continue to have an obligation to maximize the value of the firm, but now a transfer of value to the sole stockholder does not inure to the ratable benefit of all of the residual claimants. The payment now transfers value previously owned beneficially and indirectly by all of the residual claimants to the party in control of the corporation.

Delaware courts have held that challenges to similar transfers from an insolvent subsidiary to its controller state a derivative claim for breach of fiduciary duty. In *Shandler v. DLJ Merchant Banking, Inc.*, 2010 WL 2929654 (Del. Ch. July 26, 2010), Chief Justice Strine, writing as a Vice Chancellor, held that a bankrupt corporation could sue its controlling stockholder and the directors affiliated with the controlling stockholder for breaching their fiduciary duty of loyalty by approving a transaction in which the corporation sold a business unit to an affiliate of its controlling stockholder. *Id.* at *1, *12. Similarly in *Production Resources*, then-Vice Chancellor Strine held that a complaint's allegations about specific transfers between an insolvent corporation and its *de facto* controller pled non-exculpated derivate claims, including allegations about payments to companies owned by the *de facto* controller. 863 A.2d at 777, 799-800.

Older authorities support the ability of a derivative-action plaintiff to challenge specific transfers as a breach of fiduciary duty. For example, Chancellor Wolcott stated that "[i]f an insolvent corporation should undertake to turn its assets over to stockholders, leaving creditors unpaid, I think no dissent can be found to the proposition that the law would condemn the effort." *Asmussen v. Quaker City Corp.*, 156 A. 180, 181 (Del. Ch. 1931). Subsequently, in *Pennsylvania Co. for Insurance on Lives and Granting Annuities v. South Broad St. Theater Co.*, 174 A. 112 (Del. Ch. 1934), Chancellor Wolcott held that an indenture trustee who sued on behalf of bondholders stated claim for breach of duty against an insolvent corporation's board of directors that made a preferential transfer to an entity affiliated with the corporation's controlling stockholder. *Id.* at 115-16.

Based on these authorities, Counts I and II state a derivative claim for breach of fiduciary duty to the extent they challenge the failure to defer interest on the Junior Notes. The defendants will have the burden of proving that the failure to defer interest on the Junior Notes was entirely fair.

5. The Derivative Claim For Paying Excessive Fees Under The Services Agreement And Software License

The second act identified in Counts I and II as a breach of fiduciary duty is the Company's payment of excessive service and license fees to ASIA. These allegations state a claim, and the analysis parallels the explanation regarding the Junior Notes. The Complaint alleges that EBF, the Company's controller, owns ASIA, and that the payment of service and license fees to ASIA diverts value from the Company to EBF. Compl. ¶ 80. The Complaint alleges that the fees that the Company is paying exceed market rates.

Id. ¶¶ 85-87. EBF stands on both sides of the transaction, making entire fairness the governing standard of review with the burden of proof on the defendants.

6. The Challenge To The Board's Risk-On Business Strategy

In their third variation, Counts I and II allege that the defendants breached their fiduciary duties by amending the Operating Guidelines to permit Athilon to invest in riskier securities and make speculative investments. Quadrant alleges that EBF benefits from this strategy because it will enjoy the upside if the strategy succeeds while suffering none of the downside if the strategy fails. Given the Company's insolvency, Quadrant alleges that faithful fiduciaries would pursue a conservative strategy and prepare for liquidation. In effect, this aspect of Counts I and II asserts a variant of *Bovay*'s trust fund doctrine. In my view, this aspect of Count I and II does not state a claim.

Current Delaware law does not require the Board to shut down Athilon's business and manage towards a near-term dissolution for the benefit of creditors. Notwithstanding a company's insolvency, "[t]he directors continue to have the task of attempting to maximize the economic value of the firm." *Prod. Res.*, 863 A.2d at 791.

> Even when a firm is insolvent, its directors may, in the appropriate exercise of their business judgment, take action that might, if it does not pan out, result in the firm being painted in a deeper hue of red. The fact that the residual claimants of the firm at that time are creditors does not mean that the directors cannot choose to continue the firm's operations in the hope that they can expand the inadequate pie such that the firm's creditors get a greater recovery. By doing so, the directors do not become a guarantor of success.

Trenwick, 906 A.2d at 174. "Even when the firm is insolvent, directors are free to pursue value maximizing strategies, while recognizing that the firm's creditors have become its residual claimants." *Id.* at 175. "If the board of an insolvent corporation, acting with due diligence and good faith, pursues a business strategy that it believes will increase the corporation's value, . . . it does not become a guarantor of that strategy's success." *Id.* at 205. "Rather, in such a scenario the directors are protected by the business judgment rule." *Id.*; *accord Shandler*, 2010 WL 2929654, at *14. At the same time, Delaware law also recognizes that:

> [t]he maximization of the economic value of the firm might, in circumstances of insolvency, require the directors to undertake the course of action that best preserves value in a situation when the procession of the firm as a going concern would be value-destroying. In other words, the efficient liquidation of an insolvent firm might well be the method by which the firm's value is enhanced in order to meet the legitimate claims of its creditors.

Prod. Res., 863 A.2d at 791 n.60. Here too the business judgment rule would protect a board's decision to pursue an efficient liquidation.

Quadrant does not appear to dispute that the business judgment rule could apply to the Board's decisions. Instead, Quadrant argues that the Board's risk-on business strategy will favor EBF and disfavor the Company's creditors because of their relative positions in the Company's capital stack. Quadrant contends that because EBF controls the Company, the defendants have the burden to prove that their decision to pursue a riskier strategy was entirely fair to the Company.

In a sense, this argument can be conceived of as a reverse-*Trados* theory. In *Trados*, this court examined the decision by a board of directors to enter into a merger agreement that triggered special rights held by preferred stockholders to receive a liquidation preference. *See Trados I*, 2009 WL 2225958, at *8 (treating directors as interested for pleading purposes in transaction that benefited preferred stockholders when "each had an ownership or employment relationship with an entity that owned Trados preferred stock"). Three of the directors on the board faced the dual-fiduciary problem that the Delaware Supreme Court identified in *Weinberger v. UOP, Inc.*, 457 A.2d 701, 710 (Del. 1983), where the Delaware Supreme Court held that there "[t]here is no dilution of [fiduciary] obligation where one holds dual or multiple directorships." *Id.* If the interests of the beneficiaries to whom the dual fiduciary owes duties are aligned, then there is no conflict of interest. *See, e.g.*, *Van de Walle v. Unimation, Inc.*, 1991 WL 29303, at *11 (Del. Ch. Mar. 7, 1991). But if the interests of the beneficiaries diverge, the fiduciary faces an inherent conflict of interest.[10] "There is no 'safe harbor' for such divided loyalties in Delaware." *Weinberger*, 457 A.2d at 710.

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[10] *See Krasner v. Moffett*, 826 A.2d 277, 283 (Del. 2003) ("[T]hree of the FSC directors . . . were interested in the MEC transaction because they served on the boards . . . of both MOXY and FSC."); *McMullin v. Beran*, 765 A.2d 910, 923 (Del. 2000) ("The ARCO officers and designees on Chemical's board owed Chemical's minority shareholders 'an uncompromising duty of loyalty.' There is no dilution of that obligation in a parent subsidiary context for the individuals who acted in a dual capacity as officers or designees of ARCO and as directors of Chemical." (footnote omitted) (internal quotation marks omitted)); *Rabkin v. Philip A. Hunt Corp.*, 498 A.2d 1099, 1106 (Del. 1985) (holding that parent corporation's directors on subsidiary board faced conflict of interest); *Weinberger*, 457 A.2d at 710 (holding that officers of parent corporation faced conflict of interest when acting as subsidiary directors regarding transaction with parent); *see also Rales*, 634 A.2d at 933 (explaining for purposes of demand futility that "'[d]irectorial interest exists whenever divided loyalties are present'" (quoting *Pogostin v. Rice*, 480 A.2d 619, 623 (Del. 1984)); *Goldman v. Pogo.com, Inc.*, 2002 WL 1358760, at *3 (Del. Ch. June 14, 2002) ("Because Khosla and Wu were the representatives of shareholders which, in their institutional capacities, are both alleged to have had a direct financial interest in this transaction, a reasonable doubt is raised as to Khosla and Wu's disinterestedness in having voted to approve the . . . [l]oan."); *Sealy Mattress Co. of N.J., Inc. v. Sealy, Inc.*, 532 A.2d 1324, 1336 (Del. Ch. 1987) (same).

In a solvent corporation, the standard of conduct for directors requires that they act as fiduciaries "to promote the value of the corporation for the benefit of its stockholders."[11] The dual-fiduciary problem arises in a solvent corporation when directors face a conflicting fiduciary interest that diverges from promoting the value of the corporation for the benefit of the undifferentiated equity. In *Trados*, the interests of the directors' affiliated entities diverged from the interests of the common stockholders because those entities owned preferred stock with special rights. The directors consequently faced a conflict of interest and had to establish that their decision to approve a merger that triggered the preferred stock's special rights was entirely fair. *See Trados I*, 2009 WL 2225958, at *8.

As Quadrant sees it, when a corporation is insolvent, creditors become the principal residual claimants. This means that directors who are also fiduciaries for a sole or controlling stockholder, or even a large common holder, face the dual-fiduciary problem in a context where the interests of the primary residual claimants (the creditors) diverge from those of the equity. In a reverse of the situation in *Trados*, the duty of loyalty to the common stockholders creates the conflict. If a director held a material

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[11] *eBay Domestic Hldgs., Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010); *accord Gheewalla*, 930 A.2d at 101 ("The directors of Delaware corporations have the legal responsibility to manage the business of a corporation for the benefit of its shareholder[ ] owners."); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) (citing "the basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders"); *see also* Leo E. Strine, Jr. et al., *Loyalty's Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 Geo. L.J. 629, 634 (2010) ("[I]t is essential that directors take their responsibilities seriously by actually trying to manage the corporation in a manner advantageous to the stockholders.").

amount of common stock, the same argument would apply, although due to the director's personal financial interest rather than because of the dual-fiduciary problem.

The fault in this reasoning lies not in the theory, but in its application to business decisions that generally affect the value of the entity as a whole and which do not confer specific benefits on the directors themselves or, in dual-fiduciary situations, on the competing beneficiaries of fiduciary duties. When there are direct and specific benefits, the theory applies, as exemplified by cases like *Shandler* and *Production Resources* that have applied the entire fairness test to decisions approving transfers from an insolvent entity to its equity holders, and by this decision's analysis of the continued payments on the Junior Notes and the service and license fees. *See* Parts II.A.4 & 5, *supra*. But when directors make decisions that appear rationally designed to increase the value of the firm as a whole, Delaware courts do not speculate about whether those decisions might benefit some residual claimants more than others.

For solvent corporations, a similar principle can be seen in decisions holding that equal treatment of stockholders operates as a presumptive safe harbor for corporate fiduciaries, including controlling stockholders and directors, even when those fiduciaries allegedly have divergent economic interests. In *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971), minority stockholders established at trial that all of the directors of a 97%-owned subsidiary were dual-fiduciaries who also served as directors, officers, or employees of the parent or other parent-controlled entities. *Id.* at 719. The plaintiffs showed that "[f]rom 1960 through 1966, Sinven paid out $108,000,000 in dividends ($38,000,000 in excess of Sinven's earnings during the same period)," and the Court of

Chancery found that "Sinclair caused these dividends to be paid during a period when it had a need for large amounts of cash." *Id.* at 720-21. The plaintiffs argued that the dividends were paid with the bad faith motive of furthering the parent's need for cash rather than the best interests of all stockholders. The Court of Chancery applied the entire fairness test and held that the defendants had not met the test. *Id.* at 721.

On appeal, the Delaware Supreme Court reversed. In doing so, the high court distinguished between situations involving differential treatment of the controlling stockholder and situations involving equal treatment.

> We do not accept the argument that the intrinsic fairness test can never be applied to a dividend declaration by a dominated board, although a dividend declaration by a dominated board will not inevitably demand the application of the intrinsic fairness standard. If such a dividend is in essence self-dealing by the parent, then the intrinsic fairness standard is the proper standard. For example, suppose a parent dominates a subsidiary and its board of directors. The subsidiary has outstanding two classes of stock, X and Y. Class X is owned by the parent and Class Y is owned by minority stockholders of the subsidiary. If the subsidiary, at the direction of the parent, declares a dividend on its Class X stock only, this might well be self-dealing by the parent. It would be receiving something from the subsidiary to the exclusion of and detrimental to its minority stockholders. This self-dealing, coupled with the parent's fiduciary duty, would make intrinsic fairness the proper standard by which to evaluate the dividend payments.
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> Consequently it must be determined whether the dividend payments by [the subsidiary] were, in essence, self-dealing by [the parent]. The dividends resulted in great sums of money being transferred from [the subsidiary] to [the parent]. However, a proportionate share of this money was received by the minority shareholders of [the subsidiary]. [The parent] received nothing from [the subsidiary] to the exclusion of its minority stockholders. As such, these dividends were not self-dealing. We hold therefore that the Chancellor erred in applying the intrinsic fairness test as to these dividend payments. The business judgment standard should have been applied.

Id. at 721-22 (citations omitted).

More recent Delaware cases have applied *Sinclair* in cases involving solvent corporations, while recognizing that equal treatment is not an absolute safe harbor. A fiduciary's personal motives for a transaction can give rise to a breach of duty of the duty of loyalty in the form of a violation of the requirement to act in good faith, which is "a subsidiary element, *i.e.,* a condition, of the fundamental duty of loyalty." *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 370 (Del. 2006) (internal quotation marks omitted). "A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation."[12] "[A] range of human motivations . . . can inspire fiduciaries and their advisors to be less than faithful to their contextual duty to pursue the best value for the company's stockholders." *In re El Paso Corp. S'holder Litig.*, 41 A.3d 432, 439 (Del. Ch. 2012) (Strine, C.). "Greed is not the only human emotion that can pull one from the path of propriety; so might hatred, lust, envy, revenge, . . . shame or pride. Indeed any human emotion may cause a director to place his own interests, preferences or appetites

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[12] *In re Walt Disney Co. Deriv. Litig.*, 906 A.2d 27, 67 (Del. 2006); *accord Stone*, 911 A.2d at 369 ("A failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation . . . ."); *see Gagliardi v. TriFoods Int'l, Inc.*, 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996) (Allen, C.) (defining a "bad faith" transaction as one "that is authorized for some purpose *other than* a genuine attempt to advance corporate welfare or is *known to constitute* a violation of applicable positive law") (emphasis in original); *In re RJR Nabisco, Inc. S'holders Litig.*, 1989 WL 7036, at *15 (Del. Ch. Jan. 31, 1989) (Allen, C.) (explaining that the business judgment rule would not protect "a fiduciary who could be shown to have caused a transaction to be effectuated (even one in which he had no financial interest) for a reason unrelated to a pursuit of the corporation's best interests").

before the welfare of the corporation."[13] It is not enough, however, for a plaintiff simply to argue in the abstract that a particular director has a conflict of interest or is acting in bad faith because she is affiliated with a particular type of institution that may be pursuing a particular business strategy or have a particular interest. There must be specific allegations and later, actual evidence sufficient to permit a finding that the director faced a conflict or acted with an improper purpose on the facts of the case.[14]

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[13] *RJR Nabisco*, 1989 WL 7036, at *15. For example, Delaware cases recognize that a need for liquidity "may lead directors to breach their fiduciary duties." *In re Answers Corp. S'holder Litig. (Answers I)*, 2012 WL 1253072, at *7 (Del. Ch. Apr. 11, 2012); *see McMullin v. Beran*, 765 A.2d 910, 922-23 (Del. 2000) (reversing grant of motion to dismiss where complaint alleged that controlling stockholder and its director designees sacrificed value in a sale to achieve controlling stockholder's goal of obtaining near-term liquidity and significant component of the transaction consideration in cash); *N.J. Carpenters Pension Fund v. Infogroup, Inc.*, 2011 WL 4825888, at *4, *9-10 (Del. Ch. Sept. 30, 2011) (denying motion to dismiss where the plaintiff alleged that the director who was also a large stockholder sacrificed value in sale because he needed liquidity to satisfy personal debts and fund a new venture); *In re TeleCorp PCS, Inc. S'holders Litig.*, Cons. C.A. No. 19260-VCS, at 16 (Del. Ch. June 17, 2002) (TRANSCRIPT) (Strine, V.C.) ("What [these large stockholders] weren't entitled to do was to use their influence as fiduciaries to procure liquidity from AT&T Wireless on the backs of public stockholders in an unfair merger."); *see also In re S. Peru Copper Corp. S'holder Deriv. Litig.*, 52 A.3d 761, 780 (Del. Ch. 2011) (Strine, C.) (considering large stockholder's desire for liquidity when evaluating performance of affiliated special committee member as part of assessment of entire fairness of transaction with controller; stating "Although I am not prepared on this record to find that Handelsman consciously agreed to a suboptimal deal for Southern Peru simply to achieve liquidity for Cerro from Grupo Mexico, there is little doubt in my mind that Cerro's own predicament as a stockholder dependent on Grupo Mexico's whim as a controller for registration rights influenced how Handelsman approached the situation."), *aff'd sub nom Americas Mining v. Therault*, 51 A.3d 1213 (Del. 2012).

[14] *See In re Morton's Rest. Gp., Inc. S'holders Litig.*, 74 A.3d 656, 667 (Del. Ch. 2013) (Strine, C.) (dismissing complaint challenging sale that was the product of a lengthy and thorough pre-signing market check in which plaintiff conceded that "all logical buyers were made aware . . . and that they all had the time and fair opportunity to bid" and rejecting allegation that private equity firm "typically flips companies it invests in every three to five years" and favored a sale to achieve liquidity for the investors in one of its funds and to invest in a new fund); *Trados II*, 73 A.3d at 54 ("At trial, the plaintiff could not rely on general characterizations of the VC ecosystem. The plaintiff had to prove by a preponderance of

Cases like *Shandler*, *Production Resources*, *Trenwick,* and *Gheewalla* treat decisions that benefit the firm as a whole similarly, thereby rejecting the proposition that a plaintiff can rebut the business judgment rule as to matters of ongoing business strategy by alleging that the directors own material amounts of common stock, or are dual-fiduciaries who owe competing duties to a large equity holder or even a sole or controlling stockholder. In *Shandler*, then-Vice Chancellor Strine dismissed a claim that director-defendants affiliated with a controlling stockholder breached their fiduciary duties by causing an insolvent corporation "to take a reckless and value-destroying gamble so as to provide a chance for [the controlling stockholder] to recoup value for its . . . equity." 2010 WL 2929654, at *13. The Chief Justice explained that "the mere fact that the company was not able to avoid ultimate insolvency does not, in itself, mean that there was not a good faith basis to take a chance on survival if the board viewed that as the best option to maximize [the insolvent entity's] value." *Id.* at *14 n.127. Although a majority of the directors were employees of the controlling stockholder, the Chief Justice held that "[e]ven when [the entity] was insolvent, the board was entitled to exercise a good faith business judgment to continue to operate the business if it believed that was what would maximize [the entity's] value." *Id.* at *14. The decision affected the value of

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evidence that Prang was not disinterested or independent in this case."); *In re Synthes, Inc. S'holder Litig.*, 50 A.3d 1022, 1036 (Del. Ch. 2012) (Strine, C.) (applying general rule of equal treatment where controlling stockholder received same consideration as minority in third party sale to dismiss challenge to transaction; recognizing there could be "very narrow circumstances in which a controlling stockholder's immediate need for liquidity could constitute a disabling conflict of interest irrespective of pro rata treatment" but rejecting liquidity-based interest given lack specific allegations in complaint).

the entity as a whole and did not confer any direct or specific benefits on a fiduciary, a party affiliated with a fiduciary, or on a particular class of residual claimants. Neither the directors' affiliation with the controller, nor the allegation that the controller benefitted generally from continuing to operate the business was sufficient to rebut the business judgment rule and elevate the standard of review to entire fairness.

In *Production Resources*, again writing as a Vice Chancellor, Chief Justice Strine considered claims that the directors and officers of Production Resources Group, L.L.C. ("PRG"), an insolvent entity, were operating the company for the benefit of Carole Salkind, the company's *de facto* controlling stockholder. 863 A.2d at 775, 781. Two of the four directors were members of management, earned substantial salaries, and were deemed beholden to Salkind. The complaint alleged specific transfers of value to Salkind, but also alleged that PRG's board and officers had acted improperly by continuing to operate the firm for Salkind's benefit. Notwithstanding the presence of a controlling stockholder and the absence of a disinterested and independent board majority, Chief Justice Strine treated the claims regarding the continued operation of the firm as breaches of the duty of care for which the defendants were exculpated. *Id.* at 776-77, 793. Here too, the decision to continue operating affected the entity as a whole. In a footnote, the Chief Justice Strine expressed doubt that:

> there is a magic dividing line that should signal the end to some, most, or all risk-taking on behalf of stockholders or even on behalf of creditors, who are not homogenous and whose interests may not be served by a board that refuses to undertake any further business activities that involve risk. As a result, the business judgment rule remains important and provides directors with the ability to make a range of good faith, prudent judgments about the risks they should undertake on behalf of troubled firms.

Id. at 788 n.52. By contrast, as noted previously, the Chief Justice held that the complaint's challenges to specific transactions with Salkind pled non-exculpated derivative claims, including regarding payments to Salkind's family companies, the payment of hefty salaries to insiders, the continued subordination of other creditors to Salkind, and the issuance of excessive shares to Salkind beyond the number authorized by the company charter. *Id.* at 777, 799-800.

In *Trenwick*, then-Vice Chancellor Strine did not actually rule on the viability of derivative claims asserted by a litigation trustee appointed in a bankruptcy proceeding, because he held that the complaint had not adequately pled facts supporting a rational inference that the subsidiary on whose behalf the plaintiff sought to assert the claims was insolvent. 906 A.2d at 195. The litigation trustee had sought to sue the subsidiary's sole stockholder in its capacity as the subsidiary's controller and the members of the subsidiary's board, all of whom were executive officers of the parent. *Id.* at 200. In an extensive footnote, the Chief Justice explained that the business judgment rule would protect the business decisions made by the board of an insolvent firm.

> [W]hen a corporation is solvent, the notion that the directors should pursue the best interests of the equityholders does not prevent them from making a myriad of judgments about how generous or stingy to be to other corporate constituencies in areas where there is no precise legal obligation to those constituencies. I do not understand this complexity to diminish when a firm is insolvent simply because the residual claimants are now creditors.

Id. at 195 n.75. The complaint had alleged dual-fiduciary status on the part of all of the subsidiary directors, so if entire fairness applied simply because (i) the directors of the insolvent corporation were dual fiduciaries and (ii) the complaint alleged that the board chose a riskier business strategy to benefit its sole equityholder, it seems likely that the Chief Justice would have mentioned it. Instead, he spoke consistently in terms of the business judgment rule as the operating standard of review.

Finally, to hold otherwise and treat directors as interested in pursuing a riskier business decision that allegedly benefitted the equity holder such that the standard of review would escalate to entire fairness would be inconsistent with the explanation the Delaware Supreme Court gave in *Gheewalla* for declining to recognize the existence of fiduciary duties owed directly to creditors.

> Recognizing that directors of an insolvent corporation owe direct fiduciary duties to creditors, would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation. To recognize a new right for creditors to bring direct fiduciary claims against those directors would create a conflict between those directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it, and the newly recognized direct fiduciary duty to individual creditors.

930 A.2d at 103. If a creditor-plaintiff could sue derivatively and establish a lack of director independence and disinterestedness by alleging that the director who owned equity or who owed duties to a large stockholder adopted a risky business strategy to benefit the common stock, the directors of an insolvent corporation would face precisely the same type of fiduciary conflict that *Gheewalla* sought to avoid.

Given these authorities, I do not believe that Quadrant can rebut the business judgment rule by alleging that the Board has decided to pursue a relatively more risky business strategy to benefit its sole common stockholder, EBF. Although the Company is insolvent, and although the directors are dual-fiduciaries, the Board does not face a conflict between the interests of the primary residual claimants (the creditors) and the interests of secondary residual claimants (the stockholders). The fact that Vertin is a principal of EBF and Sullivan is an employee of EBF makes their dual-fiduciary status all the more readily apparent, but it does not alter the analysis. Under this court's precedents, the directors are not deemed conflicted on the theory that a riskier business strategy will benefit EBF and harm Athilon's creditors.

As an alternative basis for rebutting the business judgment rule, Quadrant makes the more traditional argument that the Complaint alleges facts supporting an "inference that rational persons acting in good faith as the directors of an insolvent firm would not proceed in this manner." *Prod. Res.*, 863 A.2d at 800. The Complaint does not support an inference that no rational person would take on additional risk in the form of potentially higher yielding investments. Depending on the nature of the investments, a riskier strategy could return greater value for the Company and all of its residual claimants, including its creditors. The Complaint does not contain sufficient allegations to call into question the rationality of a riskier investment approach.

7. Waste

Counts I and II also contend that the foregoing actions constitute waste. "That the complaint states a loyalty claim does not mean that it also states a claim for waste." *In re The Student Loan Corp. Deriv. Litig.*, 2002 WL 75479, at *4 (Del. Ch. Jan. 8, 2002) (Strine, V.C.). "The pleading burden on a plaintiff attacking a corporate transaction as wasteful is necessarily higher than that of a plaintiff challenging a transaction as 'unfair' as a result of the directors' conflicted loyalties. . . ." *Harbor Fin. P'rs v. Huizenga*, 751

A.2d 879, 892 (Del. Ch. 1999) (Strine, V.C.). For a waste claim to survive a motion to dismiss, a plaintiff must show "economic terms so one-sided as to create an inference that no person acting in a good faith pursuit of the corporation's interests could have approved the terms." *Sample v. Morgan*, 914 A.2d 647, 670 (Del. Ch. 2007) (Strine, V.C.).

Counts I and II do not state claims for waste to the extent they challenge the Board's alleged risk-on business strategy. As stated in the previous section, a rational person could choose to take on greater risk with the goal of achieving greater return.

By contrast, Counts I and II state claims for waste to the extent they challenge the non-deferral of interest on the Junior Notes and the excessive fees paid under services agreement and software license. According to the Complaint, the Board could have charted a course that would result in the Company never having to pay anything to EBF as the sole holder of Junior Notes, making the non-deferral of interest an act of beneficence. Whether that proves to be the case will be determined at a later stage. If the Complaint's theory is correct, then it is reasonably conceivable that the non-deferral of interest could constitute waste. Similarly, the excessive fees could fall so far beyond market standards as to amount to waste. While that seems improbable, it is reasonably conceivable.

As a practical matter, it is unlikely that waste will be a relevant theory of relief. It is hard to conceive of a situation where the challenged transactions would not constitute a breach of fiduciary duty, but would constitute waste. Conversely, if the challenged transactions are found to constitute a breach of fiduciary duty, then the waste claim becomes superfluous. Nevertheless, as a strict pleading matter, the waste claims can proceed.

8. The Present Inability To Apply Section 102(b)(7)

For the reasons stated, Counts I and II state well-pled claims for breach of fiduciary duty and waste to the extent they challenge the non-deferral of interest payments on the Junior Notes and the payment of excessive fees for services and software. The defendant directors seek dismissal of these claims on the ground that they are exculpated from liability by a provision in the Athilon Charter. *See* 8 *Del. C.* § 102(b)(7). Three of the directors cannot invoke Section 102(b)(7) because the Complaint pleads that they were not independent of EBF. For the other two directors, the court cannot now determine whether they are entitled to exculpation.

Section 102(b)(7) authorizes the certificate of incorporation of a Delaware corporation to eliminate or limit "the personal liability of a director *to the corporation* or its stockholders for monetary damages for breach of fiduciary duty," subject to enumerated exceptions. *Id.* (emphasis added). When creditors assert derivative claims for breach of fiduciary duty, they are seeking to impose personal liability on directors of the corporation, so Section 102(b)(7) potentially applies. *Prod. Res.*, 863 A.2d at 793-95.

Because EBF is interested in the payment of interest on the Junior Notes, the Complaint sufficiently pleads that Vertin, Sullivan, and Gonzalez lacked independence from EBF. A plaintiff may allege a lack of independence by pleading facts showing that directors depend on an interested controller for their income or employment. *See Student Loan Corp.*, 2002 WL 75479, at *3 n.3 ("[T]he remuneration a person receives from her full-time job is typically of great consequence to her."); *see also Shandler*, 2010 WL 2929654, at *12 (finding that complaint pled duty of loyalty claim against director-defendants who "derived their primary source of income" by working for controller and who approved an interested transaction with the controller).

The Complaint alleges that Vertin is an EBF partner and that his compensation is tied to the performance of EBF's investments in credit derivative product companies. Compl. ¶ 7. The Complaint alleges that Sullivan is an attorney employed by EBF and depends on EBF for his primary source of income. *Id.* ¶ 8. The Complaint alleges that Gonzalez is the CEO of Athilon and depends on EBF for his position and primary source of income. *Id.* ¶ 9. These allegations are sufficient to call into question the independence of Vertin, Sullivan, and Gonzalez, rendering exculpation under Section 102(b)(7) potentially unavailable and resulting in the denial of the motion to dismiss as to these defendants.

The Complaint does not plead facts that would be sufficient to rebut the business judgment rule as to Jundt and Wagoner. In a transaction governed by the business judgment rule, the plaintiff has the burden at the pleadings stage to allege facts sufficient to rebut the presumptions of loyalty and good faith that protect the directors. Absent well pled facts supporting a breach of the duty of loyalty, a court can apply Section 102(b)(7) summarily at the pleadings stage. *Malpiede v. Townson*, 780 A.2d 1075, 1094-96 (Del. 2001); *see Emerald P'rs v. Berlin (Emerald II)*, 787 A.2d 85, 90 (Del. 2001) (describing *Malpiede* as addressing the proper application of a Section 102(b)(7) provision "in a pretrial procedural context, when the applicable standard of judicial review was the business judgment rule.").

The claims that have survived are not governed by the business judgment rule. Under controlling Delaware Supreme Court precedent, entire fairness governs interested transactions between a corporation and its controller, even if a special committee of independent directors *or* a majority-of-the-minority vote is used, because of the risk that when push comes to shove, directors who appear to be independent and disinterested will favor or defer to the interests and desires of the majority stockholder. *See Lynch*, 638 A.2d at 1116-17.

> In colloquial terms, the Supreme Court saw the controlling stockholder as the 800–pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support).

In re Pure Res., Inc., S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002) (Strine, V.C.). Particularly in controlling stockholder transactions, there is the risk that "that the outside directors might be more independent in appearance than in substance." *In re Cox Commc'ns, Inc. S'holders Litig.*, 879 A.2d 604, 619 (Del. Ch. 2005) (Strine, V.C.); *accord Kahn v. Tremont Corp. (Tremont I)*, 1996 WL 145452, at *7 (Del. Ch. Mar. 21, 1996) (Allen, C.) (noting that a controlling stockholder transaction "of course is the context in which the greatest risk of undetectable bias may be present"), *aff'd in pertinent part, rev'd on other grounds, Kahn v. Tremont Corp. (Tremont II)*, 694 A.2d 422 (Del. 1997).

The entire fairness test helps uncover situations where facially independent and disinterested directors have failed to act loyally and in good faith to protect the interests of the corporation and the stockholders as a whole and instead have given in to or favored the interests of the controller. *See Tremont II*, 694 A.2d at 428-29. By independently reviewing the procedural and substantive fairness of the transaction with the burden of proof on the defendant directors, the court can identify those situations and, if necessary, impose a remedy. *Id.* What this means for purposes of Section 102(b)(7) is that when a case involves a controlling stockholder with entire fairness as the standard of review, and when there is evidence of procedural and substantive unfairness, a court cannot summarily apply Section 102(b)(7) on a motion to dismiss to enter judgment in favor of facially independent and disinterested directors. Under those circumstances, it is not possible to hold as a matter of law that "the factual basis for [the] claim *solely* implicates a violation of the duty of care." *Emerald P'rs v. Berlin (Emerald I)*, 726 A.2d 1215, 1224 (Del. 1999) (emphasis in original). Rather, "the inherently interested nature of [the transaction becomes] inextricably intertwined with issues of loyalty." *Emerald II*, 787 A.2d at 93; *accord Tremont II*, 694 A.2d at 428 (explaining that in such a case, "the underlying factors which raise the specter of impropriety can never be completely eradicated and still require careful judicial scrutiny."). Depending on the results of discovery, the court potentially will need to conduct a trial, determine whether the transaction was entirely fair, and if not, "identify the breach or breaches of fiduciary duty upon which liability for damages will be predicated in the *ratio decidendi* of its determination that entire fairness has not been established." *Emerald II*, 787 A.2d at 94 (internal quotation marks omitted). Only then can the court conduct the director-by-director analysis necessary to determine who is exculpated from liability. *Id.* "The director defendants can avoid personal liability for paying monetary damages only if they have established that their failure to withstand an entire fairness analysis is exclusively attributable to a violation of the duty of care." *Id.* at 98. The burden of making this showing in an entire fairness case "falls upon the director." *Emerging Commc'ns*, 2004 WL 1305745, at *40; *accord Gesoff v. IIC Indus., Inc.*, 902 A.2d 1130, 1165 (Del. Ch. 2006) ("[I]n an entire fairness case where the court has found that a challenged transaction is not entirely fair, a director seeking to rely on the exculpatory provision must show that any liability of his is exclusively attributable to a violation of the duty of care." (internal quotation marks omitted)).

There are no indications in this case that the defendants deployed any procedural protections to limit the influence of EBF and its representatives on the Board over the challenged decisions regarding the non-deferral of interest on the Junior Notes or the excessive fees paid under the services agreement and software agreement from the influence of EBF. It is reasonably conceivable at this procedural stage that the alleged breaches of fiduciary duty that Jundt and Wagoner committed by making the challenged decisions were not "exclusively attributable to a violation of the duty of care," *Emerald II*, 787 A.2d at 98, making it reasonably conceivable that exculpation could be unavailable for these directors. The motion to dismiss is therefore denied as to Jundt and Wagoner as well.

B. Counts IV and V: Fraudulent Transfer

In Counts IV and V, Quadrant asserts claims under the Delaware Uniform Fraudulent Transfer Act ("DUFTA") based on the non-deferral of interest on the Junior Notes and the payment of excessive fees under the services agreement and software license agreement. In asserting its fraudulent transfer claims, Quadrant relies on Section 1304 of DUFTA, which provides a cause of action to both present and future creditors. Quadrant also relies on Section 1305 of DUFTA, which provides a cause of action only to present creditors.

Section 1304(a) identifies two grounds on which a transfer could be fraudulent as to both present and future creditors. Quadrant relies only on the first ground, set forth in Section 1304(a)(1), which states:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (1) With actual intent to hinder, delay or defraud any creditor of the debtor . . . .

6 *Del. C.* § 1304(a)(1). Section 1304(b) of DUFTA identifies a non-exclusive list of factors for a court to consider when evaluating "actual intent." They include whether:

> (1) The transfer or obligation was to an insider;
>
> (2) The debtor retained possession or control of the property transferred after the transfer;
>
> (3) The transfer or obligation was disclosed or concealed;
>
> (4) Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

(5) The transfer was of substantially all the debtor's assets;

(6) The debtor absconded;

(7) The debtor removed or concealed assets;

(8) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) The transfer occurred shortly before or shortly after a substantial debt was incurred; and

(11) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Id. § 1304(b).

Section 1305 identifies two additional grounds on which a transfer could be fraudulent as to present creditors. Quadrant relies only on both. Section 1305(a) states that:

> [a] transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

Id. § 1305(a). Section 1305(b) states that "[a] transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time and the insider had reasonable cause to believe that the debtor was insolvent." *Id.* § 1305(b).

1. The Interest Payments On The Junior Notes

Quadrant challenges the non-deferral of interest payments on the Junior Notes under Section 1304(a)(1) and Section 1305(b). Both theories state claims.

a. Section 1305(b)

Taking the theories in reverse order, a cause of action under Section 1305(b) will exist if (i) the transfer flowed from a debtor to an insider, (ii) the debtor was insolvent at the time of the transfer, (iii) the insider had reasonable cause to believe that the debtor was insolvent, and (iv) the plaintiff was a creditor at the time of the transfer. The definition of "insider" includes "[a] person in control of the debtor." *Id.* § 1301(7). The Complaint adequately pleads that EBF controls Athilon through its 100% ownership of Athilon's equity, its two employees on the Board, and its influence over Athilon's CEO. The Complaint therefore adequately pleads that EBF is an insider and that the continued payment of interests on the Junior Notes constituted a transfer to an insider.

For purposes of DUFTA, a plaintiff can establish insolvency by showing that "the sum of the debtor's debts is greater than all of the debtor's assets, at a fair valuation." *Id.* § 1302(a). This test is the same as Delaware's common law balance sheet test. For reasons previously discussed, the Complaint adequately pleads that Athilon is insolvent under the balance sheet test and has been since Lehman's bankruptcy and the onset of the financial crisis. *See* Part II.A.2., *supra*.

The Complaint contains allegations supporting a reasonable inference that EBF knew that Athilon was insolvent. Athilon had lost its AAA/Aaa ratings and been in runoff pursuant to its Operating Guidelines since at least 2009, before EBF acquired Athilon's equity in 2010. Compl. ¶ 54. EBF used this opportunity to purchase Athilon's outstanding Junior Notes, which were trading at a steep discount. *Id.* ¶¶ 45, 46. When EBF later acquired control of 100% of Athilon's equity, Athilon had a negative net worth. *Id.* ¶ 48. When the Complaint was filed, Athilon had a sub-investment grade issuer credit rating of BB and a sub-investment grade counterparty credit rating of Ba1 from S&P and Moody's respectively. *Id.* ¶ 57. These allegations support the inference that EBF had reasonable cause to believe that Athilon was insolvent. Since acquiring control over Athilon, EBF has maintained representatives on its Board, giving EBF detailed insight into Athilon's financial performance. *See id.* ¶ 49.

Finally, the Complaint pleads that Quadrant has been a creditor "at all relevant times." Compl. ¶ 3. In an earlier version of the Complaint, Quadrant alleged that it became a creditor of Athilon in May 2011. Section 1305 only provides a cause of action to plaintiffs who were already creditors at the time of the transfer. The defendants read DUFTA as imposing the equivalent of a contemporaneous creditor requirement that would bar Quadrant from asserting claims that arose before it owned the notes.

The plain language of the statute, however, refers to the time when the claim arose, not when the party challenging the transfer acquired the claim. DUFTA defines a "claim" expansively as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." 6 *Del. C.* § 1301(3). The right to payment under the Notes arose when the Company issued them. The creditor referred to in the statute is simply the current holder of the claim. As long as the claim itself arose prior to the transfer, the current holder can be a transferee or assignee of the claim. "The right to attack a conveyance as being in fraud of creditors is not personal to the original creditor, but may be exercised by his or her successors or assignees."[15]

Quadrant has a right to payment, which arose between 2004 and 2007 when the Notes were issued, not in 2011 when Quadrant purchased them. As a successor in interest to the original noteholders' claims, Quadrant has standing to assert fraudulent transfer claims under Section 1305(b). The defendants are correct that in light of the one year statute of limitations imposed for claims brought pursuant to Section 1305, Quadrant can only recover for transfers that occurred on or since October 28, 2010, one year before the filing of the Complaint. 6 *Del. C.* § 1309(3).

b. Section 1304(a)(1).

Quadrant also challenges the non-deferral of interest under Section 1304(a)(1). A cause of action under this section will exist if the transfer was made with "actual intent to delay, hinder or delay any creditor of the debtor." 6 *Del. C.* § 1304(a)(1). Intent is a question of fact. 37 C.J.S. Fraudulent Conveyances § 76. The Complaint must plead facts from which it is reasonably conceivable that the defendants acted with the requisite

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[15] 37 C.J.S. Fraudulent Conveyances § 51; *see Interim Capital, LLC v. Chiangi*, 2010 WL 1793140, at *3 (Conn. Super. Ct. Mar. 31, 2010) (permitting assignee who acquired loan after allegedly fraudulent transfer to assert a fraudulent transfer claim); *Collin Cnty. Nat. Bank of McKinney v. Murphy*, 92 S.W.2d 491, 493 (Tex. Civ. App. 1936) ("Can the purchaser of a debt attack a conveyance as fraudulent, if the original owner of the debt could have done so? The overwhelming weight of authority answers this question in the affirmative."); *Brandon v. Faria*, 279 P. 192, 193 (1929) (holding that an assigned of a creditor could assert fraud in previous conveyance from husband to wife); *Nat'l Sur. Co. v. Fowler*, 114 So. 408, 408 (1927) (allowing appellants as assignees of the notes executed by defendant to the original creditors to maintain a fraudulent transfer suit).

intent. Section 1304(b) provides a non-exclusive list of indicia that can be considered for that purpose.

"In all averments of fraud . . . , the circumstances constituting fraud . . . shall be stated with particularity." Ch. Ct. Ch. R. 9(b). "Intent," however, "may be averred generally." *Id.* "Rule 9(b) does not require an exhaustive cataloguing of facts but only sufficient factual specificity to provide assurance that the plaintiff has investigated ... the alleged fraud and reasonably believes that a wrong has occurred." *Bernstein v. IDT Corp.*, 582 F. Supp. 1079, 1085 (D. Del. 1984) (internal quotation marks omitted). "The actual intent of the parties to the conveyance is of no consequence since [6 Del. Code § 1304] establishes an external test of constructive or legal fraud. . . ." *China Res. Prod. (U.S.A) Ltd. v. Fayda Int'l., Inc.*, 788 F. Supp. 815, 818 (D. Del. 1992) (internal quotation marks omitted). In order to state a fraudulent transfer claim, Quadrant must generally plead facts showing intent to defraud with specific supporting facts describing the circumstances of the transfer. *See Geyer*, 621 A.2d at 792 n.5.

The allegations of the Complaint adequately support a pleading stage inference of fraudulent intent. The Complaint alleges that EBF sought to deprive creditors, including Quadrant, of access to the Company's assets that would otherwise be available to satisfy their claims. Compl. ¶ 160. The Complaint further alleges that EBF knew that any transfers would have the effect of hindering and defrauding the Company's creditors. *Id.* The Complaint identifies several indicia of fraud, including (i) the Company's insolvency, (ii) EBF's insider status, and (iii) the lack of any need to continue paying interest on the Junior Notes. *Id.* ¶¶ 160, 165, 166.

2. The Service And License Fees

Quadrant challenges the service and license fees under Section 1304(a)(1), Section 1305(a), and Section 1305(b). All three theories state a claim. Much of the analytical work already has been done in connection with analyzing the continuing interest payments and applies equally to the service and license fees.

a. Section 1305(b)

Proceeding again in reverse order, Quadrant challenges the service and license fees as fraudulent transfers in violation of Section 1305(b). To reiterate, a cause of action under Section 1305(b) will exist if (i) the transfer flowed from a debtor to an insider, (ii) the debtor was insolvent at the time of the transfer, (iii) the insider had reasonable cause to believe that the debtor was insolvent, and (iv) the plaintiff was a creditor at the time of the transfer. With one exception, the same analysis that governs these elements for purposes of the deferred interest payments applies to the service and license fees. The only difference is that the transfers flowed from the debtor to ASIA rather than directly to EBF. The question is therefore whether ASIA should be treated as an insider for pleading purposes.

Section 1301(7)(d) defines "insider" as "[a]n affiliate or an insider of an affiliate as if the affiliate were the debtor". 6 *Del. C.* § 1301(7)(d). Section 1301(1)(b) defines "affiliate" as:

> A corporation, 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by the debtor or a person who directly or indirectly owns, controls or holds with power to vote 20 percent or more of the outstanding voting securities of the debtor . . . .

Id. § 1301(1)(b). ASIA is an insider for purposes of Section 1305(b) because Quadrant has adequately alleged that ASIA is an affiliate of EBF. The Complaint alleges that ASIA is ultimately owned and indirectly controlled by EBF. Compl. ¶ 80. The Complaint further alleges that EBF owns 100% of Athilon's equity. *Id.* ¶ 48. As such, ASIA is "[a] corporation, 20 percent or more of whose outstanding voting securities are directly or indirectly owned, controlled or held with power to vote by . . . [EBF] who directly or indirectly owns, controls or holds with power to vote 20 percent or more of the outstanding voting securities of [Athilon]." 6 *Del. C.* § 1301(1)(b). ASIA is, therefore, an insider for purposes of Section 1305(b), and Quadrant has stated a claim that payments which took place on or after October 28, 2010, constituted a fraudulent transfer in violation of Section 1305(b).

b. Section 1305(a)

Continuing in reverse order, a cause of action under Section 1305(a) will exist if (i) the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange, (ii) the debtor was insolvent at the time of or rendered insolvent by the transfer, and (iii) the plaintiff was a creditor at the time of the transfer. The same analysis that governed the issues of insolvency and creditor status continues to apply. The only question is whether the Complaint sufficiently alleges that Athilon did not receive "reasonably equivalent value" for the service and license fees.

The Complaint adequately alleges that Athilon did not receive reasonably equivalent value for its service fees transferred to ASIA. The Complaint alleges that, after

Athilon entered runoff mode, the scope of ASIA's services diminished yet ASIA's fee increased after the EBF takeover. Compl. ¶¶ 84-85. Athilon allegedly transferred $23.5 million in annual service fees to ASIA in 2010, which included a $2.5 million service fee paid directly to EBF. *Id.* ¶ 86. The Complaint alleges that these service fees exceed market rates of approximately $5-$7 million annually. *Id.* ¶¶ 87-88. The Complaint further alleges that the Board rejected Quadrant's offer to perform equivalent services for only $5 million per year and has continued to pay disproportionately high fees to ASIA. *Id.* ¶¶ 89, 91-92.

Similarly, the Complaint adequately alleges that Athilon did not receive reasonably equivalent value for the annual software license fee transferred to ASIA. The Complaint alleges that the annual software license fee increased from $1.25 million in 2009 to $1.5 million in 2010. ¶ 94. This annual fee allegedly exceeds the cost of contracting a third party to build software from scratch. ¶ 95. The disparity between the fees paid to ASIA and the value of the software license received by Athilon support an inference that Athilon did not receive reasonably equivalent value in return. Therefore, the Complaint states a claim that the payment of these fees constituted a fraudulent transfer in violation of Section 1305(a).

c. Section 1304(a)(1).

Finally, a cause of action under Section 1304(a)(1) will exist if the transfer was made with "actual intent to delay, hinder or delay any creditor of the debtor." 6 *Del. C.* § 1304(a)(1). As noted, intent is a question of fact, so the Complaint must plead facts from which it is reasonably conceivable that the defendants acted with the requisite intent when paying the service and license fees. In doing so, the Complaint may refer to the non-exhaustive list of factors enumerated in Section 1304(b) that support a finding of intent. *See id.* § 1304(b).

The Complaint states sufficient facts about the service and license fees paid to plead a claim. Quadrant alleges facts supporting an inference that the value of the services and software received by Athilon was not reasonably equivalent to the value of the fees it paid to ASIA. *See id.* § 1304(b)(8). Quadrant alleges that these fees far exceeded market pricing. Compl. ¶¶ 80-98, 159, 165-168. According to the Complaint, the annual market rate for service fees was $5-7 million, yet the Company paid $23.5 million. *Id.* ¶¶ 88-92. The Company also pays in excess $1 million to use ASIA's software when it could have built the models from scratch for less. *Id.* ¶¶ 94-95.

The Complaint pleads additional facts that speak to other factors indicating actual intent under Section 1304(b). Quadrant alleges facts showing that the service and license fees were paid to an insider by virtue of ASIA's affiliate status. *See* Part II.B.2.a., *supra*; 6 *Del. C.* § 1304(b)(1) ("[t]he transfer or obligation was to an insider"). Quadrant adequately pleads that Athilon is insolvent under the balance sheet test and has been since the financial crisis in 2008. *See* Part II.A.2., *supra*; 6 *Del. C.* § 1304(b)(9) ("[t]he debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred"). As such, Quadrant has stated a claim that Athilon's payment of service and license fees to ASIA constituted a fraudulent transfer in violation of Section 1304(a)(1).

C. Count IX: Constructive Dividends

Count IX of the Complaint alleges that the Company's payment of excessive service and license fees to ASIA constitute constructive dividends paid indirectly to EBF, its sole equity holder. Count IX alleges that because the dividends were paid while the Company was insolvent, the payments violated Sections 170 and 174 of the DGCL.[16] Section 170(a) requires that dividends be paid (i) out of surplus or (ii) "[i]n case there shall be no such surplus, out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year." 8 *Del. C.* § 170. Section 174 makes directors personally liable for the declaration of an unlawful dividend "to the corporation, and to its creditors in the event of its dissolution or insolvency, to the full amount of the dividend unlawfully paid, or to the full amount unlawfully paid for the purchase or redemption of the corporation's stock, with interest from the time such liability accrued." *Id. C.* § 174(a). Delaware law does not recognize a claim for constructive dividends.

When evaluating claimed violations of the DGCL, Delaware law takes a formal and technical approach.

> As a general matter, those who must shape their conduct to conform to the dictates of statutory law should be able to satisfy such requirements by satisfying the literal demands of the law rather than being required to guess about the nature and extent of some broader or different restriction at the risk of an ex post facto determination of error. The utility of a literal approach to statutory construction is particularly apparent in the

[16] 8 *Del. C.* §§ 170 & 174. The Complaint also claims a violation of Section 173, which states that "[n]o corporation shall pay dividends except in accordance with this chapter" and provides that "[d]ividends may be paid in cash, in property, or in shares of the corporation's capital stock." *Id.* § 173. The citation to Section 173 does not add anything to the constructive dividend theory, which stands—and in this case falls—under Sections 170 and 174.

> interpretation of the requirements of our corporation law—where both the statute itself and most transactions governed by it are carefully planned and result from a thoughtful and highly rational process.
>
> Thus, Delaware courts, when called upon to construe the technical and carefully drafted provisions of our statutory corporation law, do so with a sensitivity to the importance of the predictability of that law. That sensitivity causes our law, in that setting, to reflect an enhanced respect for the literal statutory language.

Speiser v. Baker, 525 A.2d 1001, 1008 (Del. Ch. 1987) (Allen, C.), *appeal refused*, 525 A.2d 582 (Del. 1987) (TABLE). Although formalism across many domains has ceded the analytical high ground to legal realism or other more pragmatic approaches,

> the entire field of corporation law has largely to do with formality. Corporations come into existence and are accorded their characteristics, including most importantly limited liability, because of formal acts. Formality has significant utility for business planners and investors. While the essential fiduciary analysis component of corporation law is not formal but substantive, the utility offered by formality in the analysis of our statutes has been a central feature of Delaware corporation law.

Uni-Marts, Inc. v. Stein, 1996 WL 466961, at *9 (Del. Ch. Aug. 12, 1996) (Allen, C.).

One of the formalistic methods of reasoning associated with statutory analysis under the DGCL is the "bedrock doctrine of independent legal significance." *Warner Commc'ns Inc. v. Chris-Craft Indus., Inc.*, 583 A.2d 962, 970 (Del. Ch. 1989) (Allen, C.), *aff'd*, 567 A.2d 419 (Del. 1989) (TABLE). Under this doctrine, "action taken in accordance with different sections of that law are acts of independent legal significance even though the end result may be the same under different sections." *Orzeck v. Englehart*, 195 A.2d 375, 377 (Del. 1963). "The mere fact that the result of actions taken under one section may be the same as the result of action taken under another section does not require that the legality of the result must be tested by the requirements of the second section." *Id.* at 365-66; *accord Fed. United Corp. v. Havender*, 11 A.2d 331, 338 (1940). *See generally* C. Stephen Bigler & Blake Rohrbacher, *Form or Substance? The Past, Present, and Future of the Doctrine of Independent Legal Significance*, 63 Bus. Law. 1 (2007).

The declaration of a dividend is a specific corporate act governed by specific sections of the DGCL. 8 *Del. C.* §§ 170, 172, 173, 174. Other sections of the DGCL extend the restrictions governing the payment of dividends to redemptions of equity. 8 *Del. C.* §§ 160, 173, 174. No section of the DGCL extends the restrictions governing the payment of dividends to other transactions between a corporation and stockholders, including its sole stockholder. Rather than expanding the statutory sections governing dividends and stock redemptions to other types of transactions, Delaware law evaluates claims about improper transfer payments and self-dealing under the rubric of fiduciary duty. *See Horbal v. Three Rivers Hldgs., Inc.*, 2006 WL 668542, at *3 (Del. Ch. Mar. 10, 2006) (rejecting effort to recast compensation to insiders as a "*de facto* dividend"; observing that "[n]o Delaware court has ever recast executive compensation as a constructive dividend nor (to my knowledge) has any Delaware court recognized such a cause of action to exist. . . ."); *see also Keenan v. Eshleman*, 2 A.2d 904, 912 (Del. 1938) (declining to treat management fees paid by corporation to entity controlled by directors "as a fund for a dividend in which the dissenting stockholders are to share").

Quadrant has identified one case in which a federal district court held that a transfer payment to a stockholder could be construed as an illegal dividend under Delaware law. *Growe v. Bedard*, 2004 WL 2677216 (D. Me. Nov. 23, 2004). The plaintiffs in *Growe* argued that a controlling stockholder used a services agreement to "pull[] large sums of money out of [a subsidiary] while it was insolvent" and that those payments "should be characterized as an illegal dividend ... under Section 174." *Id.* at *12 (internal quotation marks omitted). The *Growe* court denied the defendant directors' motion for summary judgment, finding that the payments "could be characterized as dividends" and noted further that the services agreement could be "simply a tool for vacuuming assets out of the failing [subsidiary] and into its shareholder. . . ." *Id.* To the extent the *Growe* court construed Section 174 to apply to the services agreement, I respectfully disagree with its analysis and do not believe the decision accurately reflects Delaware law. That does not mean that the plaintiffs in *Growe* had no remedy or that the services agreement in *Growe* could not aptly be regarded at the summary judgment stage as "simply a tool for vacuuming assets out of the failing [subsidiary] and into its shareholder. . . ." *Id.* It rather means that the framework Delaware law would use to evaluate such a claim is breach of fiduciary duty, not an expansive reading of the term "dividend" under Section 174.

Quadrant can challenge the payment of service and license fees to ASIA as breaches of fiduciary duty. The same allegations do not state a claim for a statutory violation of the provisions governing dividends.

D. Counts III and VI: Injunctive Relief

In Counts III and VI, Quadrant pleads what purport to be separate claims seeking injunctive relief. Count III seeks a permanent injunction to the extent Quadrant prevails on the breach of fiduciary duty theories asserted in Counts I and II. Count VI seeks a permanent injunction to the extent Quadrant prevails on the fraudulent transfer theories asserted in Counts IV and V.

Injunctions are a form of relief, not a cause of action. This court will determine what remedy (if any) it will award after deciding the merits of Quadrant's claims, taking into account the wrongs (if any), the nature of the harm, the facts and circumstances, and any other equities of the case. As a technical matter, Counts III and VI are dismissed because they seek remedies rather than assert claims.

Other than cleaning up the pleadings, this ruling has no effect on the case. In the remedial stage of this action, Quadrant may seek injunctive relief, and the court has not ruled out the possibility of a permanent injunction, if warranted. The defendants have argued that all of the wrongs that Quadrant has identified could be remedied by an award of money damages, which negates the requirement of irreparable harm necessary to support injunctive relief. Given the allegations about Athilon's insolvency, it is possible that the Company would not have sufficient resources to pay a money judgment, making injunctive relief appropriate. *See Gimbel v. Signal Co.*, 316 A.2d 599, 603-604 (Del. Ch. 1974) (finding irreparable harm where defendant directors face large money damages claims and "it is doubtful that any damage claim against the directors can reasonably be a meaningful alternative [to a permanent injunction]"). A permanent injunction also may be appropriate under other circumstances, such as to halt a continuing wrong. It is premature at this stage to rule out the possibility of injunctive relief.

E. Count X: Conspiracy

In Count X, Quadrant alleges a civil conspiracy involving the members of the Board, EBF, and ASIA. This count is a fall-back theory designed to impose secondary liability on any of the alleged wrong-doers who can avoid liability under one of the primary theories, but who still knowingly participated in the underlying wrong. Only Counts I, II, IV, and V have survived the motion to dismiss, so only those counts are relevant to Count X.

Counts IV and V assert fraudulent transfer theories. Under Delaware law, a "conspiracy cannot be predicated on fraudulent transfer . . . ."[17] To the extent Count X seeks to impose secondary liability based on primary wrongs pled in Counts IV and V, it fails to state a claim on which relief can be granted.

This leaves Counts I and II, which assert claims for breach of fiduciary duty against the members of the Board and EBF. A claim for conspiracy to commit a breach of fiduciary duty is usually pled as a claim for aiding and abetting, and although there are differences in how the elements of the two doctrines are framed, it remains unclear to me how the two diverge meaningfully in substance or purpose.[18] If a defendant has acted in a

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[17] *Cornell Glasgow, LLC v. LaGrange Props, LLC*, 2012 WL 3157124, at *5 (Del. Super. Aug. 1, 2012); *accord Edgewater Growth Capital P'rs, L.P. v. H.I.G. Capital, Inc.*, 2010 WL 720150, at *2 (Del. Ch. Mar. 3, 2010) (Strine, V.C.) (holding that the Uniform Fraudulent Transfer Act "does not create a cause of action for aiding and abetting, or conspiring to commit, a fraudulent transfer"); *see also Trenwick*, 906 A.2d at 203 (noting that "[d]espite the breadth of remedies available under state and federal fraudulent conveyance statutes, those laws have not been interpreted as creating a cause of action for aiding and abetting. Rather . . . the only proper defendants in a fraudulent conveyance action under federal bankruptcy law or Delaware law are the transferor and any transferees.") (internal quotation marks omitted).

[18] *See Malpiede*, 780 A.2d at 1098 n.82 (noting in reference to underlying claim for breach of fiduciary duty that "[a]lthough there is a distinction between civil conspiracy and

fiduciary capacity, then that defendant is liable as a fiduciary and not for aiding and abetting. But if a defendant proves that it is not a fiduciary or has not acted in a fiduciary capacity as to the matter in dispute, then the defendant could be liable for aiding and abetting. Given that the individual defendants are directors of Athilon and EBF owns all of its equity, it seems likely that they will be liable as fiduciaries or not at all, but there perhaps could be a circumstance where EBF might have acted in a non-fiduciary capacity and be liable for aiding and abetting. *Cf. OTK Assocs. v. Friedman*, 85 A.3d 696, 719-20 (Del. Ch. 2014) (noting that allegations of complaint could support theory that alleged controller acted as fiduciary and breached its duties, or controller could demonstrate that it sufficiently disabled itself to act solely as a third party).

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aiding and abetting, we do not find that distinction meaningful here"); *Carsanaro v. Bloodhound Tech., Inc.*, 65 A.3d 618, 642 (Del. Ch. 2013) (finding claims for aiding and abetting a breach of fiduciary duty and conspiracy to commit a breach of fiduciary duty to be "functionally equivalent"); *Triton Const. Co., Inc. v. E. Shore Elec. Servs., Inc.*, 2009 WL 1387115, at *17 (Del. Ch. May 18, 2009) (finding that claim for aiding and abetting breach of fiduciary duty duplicated claim for civil conspiracy), *aff'd*, 988 A.2d 938 (Del. 2010) (TABLE); *Allied Capital Corp. v. GC–Sun Hldgs., L.P.*, 910 A.2d 1020, 1038 (Del. Ch. 2006) (Strine, V.C.) (stating that "courts have noted that in cases involving the internal affairs of corporations, aiding and abetting claims represent a context-specific application of civil conspiracy law"); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 2005 WL 583828, at *7 (Del. Ch. Feb. 4, 2005) (equating claim for aiding and abetting breach of fiduciary duty with conspiracy to commit breach of fiduciary duty), *aff'd*, 906 A.2d 114 (Del. 2006); *Weinberger v. Rio Grande Indus., Inc.*, 519 A.2d 116, 131 (Del. Ch. 1986) ("A claim for civil conspiracy (sometimes called 'aiding and abetting') requires that three elements be alleged and ultimately established. . . ."); *Gilbert v. El Paso Co.*, 490 A.2d 1050, 1057 (Del. Ch. 1984) (identifying the same elements for "a claim of civil conspiracy" as for aiding and abetting), *aff'd*, 575 A.2d 1131 (Del. 1990); *but see Metro. Life Ins. Co. v. Tremont Gp. Hldgs., Inc.*, 2012 WL 6632681, at *18-20 (Del. Ch. Dec. 20, 2012) (analyzing claim for aiding and abetting a breach of fiduciary duty separately from conspiracy to commit a breach of fiduciary duty); *Hospitalists of Del., LLC v. Lutz*, 2012 WL 3679219, at *15-16 (Del. Ch. Aug. 28, 2012) (same).

ASIA has not been sued for breach of fiduciary duty. The Complaint adequately alleges that ASIA is controlled by EBF such that for pleading purposes, the EBF's knowledge should be imputed to ASIA. The Complaint also adequately alleges that Vertin and Sullivan are employees and agents of EBF, such that their knowledge would be imputed for pleading purposes both to EBF and to its controlled affiliates, like ASIA. Counts I and II of the Complaint plead claims for breach of fiduciary duty against the individual defendants and EBF. Count X therefore pleads a claim against ASIA for aiding and abetting, at least to the extent that Counts I and II relate to ASIA's alleged role as a conduit for the tunneling of value from Athilon to EBF.

The motion to dismiss Count X is therefore denied to the extent it seeks to impose secondary liability on the individual defendants, EBF, and ASIA for the underlying wrongs pled in Counts I and II, and to the extent the individual defendants and EBF are not held liable as fiduciaries on the primary claims.

III. CONCLUSION

Counts I, II, IV, and V state claims on which relief can be granted to the extent they challenge the non-deferral of payments on the Junior Notes and the service and license fees paid to ASIA. Count X states a claim for secondary liability in connection with the underlying wrongs pled in Counts I and II. The other counts of the Complaint are dismissed.

13-2187
In Re: Motors Liquidation Co.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

August Term, 2013

(Argued: March 25, 2014 Question Certified: June 17, 2014
Question Answered: October 17, 2014 Appeal Decided: January 21, 2015)

Docket No. 13-2187

In Re: MOTORS LIQUIDATION COMPANY, et al.,

Debtor,

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF MOTORS LIQUIDATION COMPANY,

Plaintiff-Appellant,

-v.-

JP MORGAN CHASE BANK, N.A., individually and as Administrative Agent for various lenders party to the Term Loan Agreement described herein,

Defendant-Appellee.

Before:

WINTER, WESLEY, AND CARNEY, *Circuit Judges.*

Direct appeal pursuant to 28 U.S.C. § 158(d)(2) from an order of the United States Bankruptcy Court for the Southern District of New York (Gerber, U.S.B.J.) holding that a mistaken UCC-3 termination statement was unauthorized and therefore not effective to terminate a secured lender's interest in a debtor's property. We conclude that although the termination statement mistakenly identified for termination a security interest that the lender did not intend to terminate, the secured lender authorized the filing of the document, and the termination statement was effective to terminate the security interest. REVERSED and REMANDED.

ERIC B. FISHER (Barry N. Seidel, Katie L. Weinstein, Jeffrey Rhodes, *on the brief*), Dickstein Shapiro LLP, New York, NY, *for Plaintiff-Appellant*.

JOHN M. CALLAGY (Nicholas J. Panarella, Martin A. Krolewski, *on the brief*), Kelley Drye & Warren LLP, New York, NY, *for Defendant-Appellee*.

PER CURIAM:

We assume familiarity with our prior certification opinion, *Official Committee of Unsecured Creditors of Motors Liquidation Co. v. JP Morgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 755 F.3d 78 (2d Cir. 2014), and the resulting decision of the Delaware Supreme Court, *Official Committee of Unsecured Creditors* *of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A.*, ___ A.3d ___, 2014 WL 5305937 (Del. Oct. 17, 2014). We restate the most salient facts.[1]

BACKGROUND

In October 2001, General Motors entered into a synthetic lease financing transaction (the "Synthetic Lease"), by which it obtained approximately $300 million in financing from a syndicate of lenders including JPMorgan Chase Bank, N.A. ("JPMorgan"). General Motors' obligation to repay the Synthetic Lease was secured by liens on twelve pieces of real estate. JPMorgan served as administrative agent for the Synthetic Lease and was identified on the UCC-1 financing statements as the secured party of record.

Five years later, General Motors entered into a separate term loan facility (the "Term Loan"). The Term Loan was entirely unrelated to the Synthetic Lease and provided General Motors with approximately $1.5 billion in financing from a different syndicate of lenders. To secure the loan, the lenders took security interests in a large number of General Motors' assets, including all of General Motors' equipment and fixtures at forty-two facilities throughout the United

[1] These undisputed facts are drawn from the record and from the Bankruptcy Court's decision below, *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 486 B.R. 596 (Bankr. S.D.N.Y. 2013).

States. JPMorgan again served as administrative agent and secured party of record for the Term Loan and caused the filing of twenty-eight UCC-1 financing statements around the country to perfect the lenders' security interests in the collateral. One such financing statement, the "Main Term Loan UCC-1," was filed with the Delaware Secretary of State and bore file number "6416808 4." It "covered, among other things, all of the equipment and fixtures at 42 GM facilities, [and] was by far the most important" of the financing statements filed in connection with the Term Loan. *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 486 B.R. 596, 603 n.6 (Bankr. S.D.N.Y. 2013).

In September 2008, as the Synthetic Lease was nearing maturity, General Motors contacted Mayer Brown LLP, its counsel responsible for the Synthetic Lease, and explained that it planned to repay the amount due. General Motors requested that Mayer Brown prepare the documents necessary for JPMorgan and the lenders to be repaid and to release the interests the lenders held in General Motors' property.

A Mayer Brown partner assigned the work to an associate and instructed him to prepare a closing checklist and drafts of the documents required to pay off the Synthetic Lease and to terminate the lenders' security interests in General Motors' property relating to the Synthetic Lease. One of the steps required to unwind the Synthetic Lease was to create a list of security interests held by General Motors' lenders that would need to be terminated. To prepare the list, the Mayer Brown associate asked a paralegal who was unfamiliar with the transaction or the purpose of the request to perform a search for UCC-1 financing statements that had been recorded against General Motors in Delaware. The paralegal's search identified three UCC-1s, numbered 2092532 5, 2092526 7, and 6416808 4. Neither the paralegal nor the associate realized that only the first two of the UCC-1s were related to the Synthetic Lease. The third, UCC-1 number 6416808 4, related instead to the Term Loan.

When Mayer Brown prepared a Closing Checklist of the actions required to unwind the Synthetic Lease, it identified the Main Term Loan UCC-1 for termination alongside the security interests that actually did need to be terminated. And when Mayer Brown prepared draft UCC-3 statements to terminate the three security interests identified in the Closing Checklist, it prepared a UCC-3 statement to terminate the Main Term Loan UCC-1 as well as those related to the Synthetic Lease.

No one at General Motors, Mayer Brown, JPMorgan, or its counsel, Simpson Thacher & Bartlett LLP, noticed the error, even though copies of the Closing Checklist and draft UCC-3 termination statements were sent to individuals at each organization for review. On October 30, 2008, General Motors repaid the amount due on the Synthetic Lease. All three UCC-3s were filed with the Delaware Secretary of State, including the UCC-3 that erroneously identified for termination the Main Term Loan UCC-1, which was entirely unrelated to the Synthetic Lease.

A. General Motors' Chapter 11 Bankruptcy Filing

The mistake went unnoticed until General Motors' bankruptcy in 2009. After General Motors filed for chapter 11 reorganization, JPMorgan informed the Committee of Unsecured Creditors (the "Committee") that a UCC-3 termination statement relating to the Term Loan had been inadvertently filed in October 2008. JPMorgan explained that it had intended to terminate only liens related to the Synthetic Lease and stated that the filing was therefore unauthorized and ineffective.

On July 31, 2009, the Committee commenced the underlying action against JPMorgan in the United States Bankruptcy Court for the Southern District of

New York. The Committee sought a determination that, despite the error, the UCC-3 termination statement was effective to terminate the Term Loan security interest and render JPMorgan an unsecured creditor on par with the other General Motors unsecured creditors. JPMorgan disagreed, reasoning that the UCC-3 termination statement was unauthorized and therefore ineffective because no one at JPMorgan, General Motors, or their law firms had intended that the Term Loan security interest be terminated. On cross-motions for summary judgment, the Bankruptcy Court concluded that the UCC-3 filing was unauthorized and therefore not effective to terminate the Term Loan security interest. *In re Motors Liquidation Co.*, 486 B.R. at 647–48.

B. *Prior Certification Opinion*

On appeal to this Court, the parties offered competing interpretations of UCC § 9-509(d)(1), which provides that a UCC-3 termination statement is effective only if "the secured party of record authorizes the filing." JPMorgan reasoned that it cannot have "authorize[d] the filing" of the UCC-3 that identified the Main Term Loan UCC-1 for termination because JPMorgan neither intended to terminate the security interest nor instructed anyone else to do so on its behalf. In response, the Committee contended that focusing on the parties' goal misses the point. It interpreted UCC § 9-509(d)(1) to require only that the secured lender authorize the act of filing a particular UCC-3 termination statement, not that the lender subjectively intend to terminate the particular security interest identified for termination on that UCC-3. The Committee further argued that even if JPMorgan never intentionally instructed anyone to terminate the Main Term Loan UCC-1, JPMorgan did literally "authorize[] the filing"—even if mistakenly—of a UCC-3 termination statement that had that effect.

In our prior certification opinion we recognized that this appeal presents two closely related questions. First, what precisely must a secured lender of record authorize for a UCC-3 termination statement to be effective: "Must the secured lender authorize the termination of the particular security interest that the UCC-3 identifies for termination, or is it enough that the secured lender authorize the act of filing a UCC-3 statement that has that effect?" *In re Motors Liquidation Co.*, 755 F.3d at 84. Second, "[d]id JPMorgan grant to Mayer Brown the relevant authority—that is, alternatively, authority either to terminate the Main Term Loan UCC-1 or to file the UCC-3 statement that identified that interest for termination?" *Id.*

Recognizing that the first question—what is it that the UCC requires a secured lender to authorize—seemed likely to recur and presented a significant issue of Delaware state law, we certified to the Delaware Supreme Court the following question:

> Under UCC Article 9, as adopted into Delaware law by Del. Code Ann. tit. 6, art. 9, for a UCC-3 termination statement to effectively extinguish the perfected nature of a UCC-1 financing statement, is it enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?

Id. at 86. The second question—whether JPMorgan granted the relevant authority—we reserved for ourselves, explaining that "[t]he Delaware Supreme Court's clarification as to the sense in which a secured party of record must authorize a UCC-3 filing will enable us to address . . . whether JPMorgan in fact provided that authorization." *Id.* at 86–87.

C. *The Delaware Supreme Court's Answer*

In a speedy and thorough reply, the Delaware Supreme Court answered the certified question, explaining that if the secured party of record authorizes the filing of a UCC-3 termination statement, then that filing is effective regardless of whether the secured party subjectively intends or understands the effect of that filing:

> [F]or a termination statement to become effective under § 9-509 and thus to have the effect specified in § 9-513 of the Delaware UCC, it is enough that the secured party authorizes the filing to be made, which is all that § 9-510 requires. The Delaware UCC contains no requirement that a secured party that authorizes a filing subjectively intends or otherwise understands the effect of the plain terms of its own filing.

Official Comm. of Unsecured Creditors of Motors Liquidation Co., 2014 WL 5305937, at *5. That conclusion, explained the court, follows both from the unambiguous terms of the UCC and from sound policy considerations:

> JPMorgan's argument that a filing is only effective if the authorizing party understands the filing's substantive terms and intends their effect is contrary to § 9-509, which only requires that "the secured party of record authorize[ ] the filing."
>
> . . .
>
> Even if the statute were ambiguous, we would be reluctant to embrace JPMorgan's proposition. Before a secured party authorizes the filing of a termination statement, it ought to review the statement carefully and understand which security interests it is releasing and why. . . . If parties could be relieved from the legal consequences of their mistaken filings, they would have little incentive to ensure the accuracy of the information contained in their UCC filings.

Id. at *3–4 (first alteration in original) (footnote omitted).

DISCUSSION

The Delaware Supreme Court has explained the sense in which a secured party must "authorize[] the filing" of a UCC-3 termination statement. What remains is to answer the question we reserved for ourselves in our prior certification opinion: Did JPMorgan authorize the filing of the UCC-3 termination statement that mistakenly identified for termination the Main Term Loan UCC-1?

In JPMorgan's view, it never instructed anyone to file the UCC-3 in question, and the termination statement was therefore unauthorized and ineffective. JPMorgan reasons that it authorized General Motors only to terminate security interests related to the Synthetic Lease; that it instructed Simpson Thacher and Mayer Brown only to take actions to accomplish that objective; and that therefore Mayer Brown must have exceeded the scope of its authority when it filed the UCC-3 purporting to terminate the Main Term Loan UCC-1.

JPMorgan's and General Motors' aims throughout the Synthetic Lease transaction were clear: General Motors would repay the Synthetic Lease, and JPMorgan would terminate its related UCC-1 security interests in General Motors' properties. The Synthetic Lease Termination Agreement provided that, upon General Motors' repayment of the amount due under the Synthetic Lease, General Motors would be authorized "to file a termination of any existing

Financing Statement relating to the Properties [of the Synthetic Lease]." J.A. 2151. And, to represent its interests in the transaction, JPMorgan relied on Simpson Thacher, its counsel for matters related to the Synthetic Lease. No one at JPMorgan, Simpson Thacher, General Motors, or Mayer Brown took action intending to affect the Term Loan.

What JPMorgan intended to accomplish, however, is a distinct question from what actions it authorized to be taken on its behalf. Mayer Brown prepared a Closing Checklist, draft UCC-3 termination statements, and an Escrow Agreement, all aimed at unwinding the Synthetic Lease but tainted by one crucial error: The documents included a UCC-3 termination statement that erroneously identified for termination a security interest related not to the Synthetic Lease but to the Term Loan. The critical question in this case is whether JPMorgan "authorize[d] [Mayer Brown] to file" that termination statement.

After Mayer Brown prepared the Closing Checklist and draft UCC-3 termination statements, copies were sent for review to a Managing Director at JPMorgan who supervised the Synthetic Lease payoff and who had signed the Term Loan documents on JPMorgan's behalf. Mayer Brown also sent copies of the Closing Checklist and draft UCC-3 termination statements to JPMorgan's counsel, Simpson Thacher, to ensure that the parties to the transaction agreed as to the documents required to complete the Synthetic Lease payoff transaction. Neither directly nor through its counsel did JPMorgan express any concerns about the draft UCC-3 termination statements or about the Closing Checklist. A Simpson Thacher attorney responded simply as follows: "Nice job on the documents. My only comment, unless I am missing something, is that all references to JPMorgan Chase Bank, as Administrative Agent for the Investors should not include the reference 'for the Investors.'" J.A. 921.

After preparing the closing documents and circulating them for review, Mayer Brown drafted an Escrow Agreement that instructed the parties' escrow agent how to proceed with the closing. Among other things, the Escrow Agreement specified that the parties would deliver to the escrow agent the set of three UCC-3 termination statements (individually identified by UCC-1 financing statement file number) that would be filed to terminate the security interests that General Motors' Synthetic Lease lenders held in its properties. The Escrow Agreement provided that once General Motors repaid the amount due on the Synthetic Lease, the escrow agent would forward copies of the UCC-3 termination statements to General Motors' counsel for filing. When Mayer Brown e-mailed a draft of the Escrow Agreement to JPMorgan's counsel for review, the same Simpson Thacher attorney responded that "it was fine" and signed the agreement.

From these facts it is clear that although JPMorgan never intended to terminate the Main Term Loan UCC-1, it authorized the filing of a UCC-3 termination statement that had that effect. "Actual authority . . . is created by a principal's manifestation to an agent that, as reasonably understood by the agent, expresses the principal's assent that the agent take action on the principal's behalf." Restatement (Third) of Agency § 3.01 (2006); *accord Demarco v. Edens*, 390 F.2d 836, 844 (2d Cir. 1968). JPMorgan and Simpson Thacher's repeated manifestations to Mayer Brown show that JPMorgan and its counsel knew that, upon the closing of the Synthetic Lease transaction, Mayer Brown was going to file the termination statement that identified the Main Term Loan UCC-1 for termination and that JPMorgan reviewed and assented to the filing of that statement. Nothing more is needed.

CONCLUSION

For the foregoing reasons, we REVERSE the Bankruptcy Court's grant of summary judgment for the Defendant and REMAND with instructions to the Bankruptcy Court to enter partial summary judgment for the Plaintiff as to the termination of the Main Term Loan UCC-1.

IN THE SUPREME COURT OF THE STATE OF DELAWARE

OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF MOTORS LIQUIDATION COMPANY,	§	No. 325, 2014
Plaintiff-Appellant,	§	Certification of Question of Law from the United States Court of Appeals for the Second Circuit C.A. No. 13-2187-bk
v.	§	
JPMORGAN CHASE BANK, N.A., Individually and as Administrative Agent for various lenders party to the Term Loan Agreement described herein,	§	
Defendant-Appellee.	§	

Submitted: October 8, 2014
Decided: October 17, 2014

Before **STRINE**, Chief Justice; **HOLLAND** and **RIDGELY**, Justices; **LASTER**, Vice Chancellor;* and **COONIN**, Judge,* constituting the Court *en Banc*.

Upon Certification of Question of Law from the United States Court of Appeals for the Second Circuit. **CERTIFIED QUESTION ANSWERED.**

Norman M. Powell, Esquire, Elena C. Norman, Esquire, John J. Paschetto, Esquire, Richard J. Thomas, Esquire, Young Conaway Stargatt & Taylor, LLP, Wilmington, Delaware; Eric B. Fisher, Esquire (*argued*), Barry N. Seidel, Esquire, Katie L. Weinstein, Esquire, Dickstein Shapiro LLP, New York, New York; Jeffrey Rhodes, Esquire, Dickstein Shapiro LLP, Washington, District of Columbia, for Plaintiff-Appellant.

Gregory P. Williams, Esquire (*argued*), Brock E. Czeschin, Esquire, Susan M. Hannigan, Esquire, Richards, Layton & Finger, P.A., Wilmington, Delaware; John M. Callagy, Esquire, Nicholas J. Panarella, Esquire, Martin A. Krolewski, Esquire, Kelley Drye & Warren LLP, New York, New York; Steven O. Weise, Esquire, Proskauer Rose LLP, Los Angeles, California, for Defendant-Appellee.

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* Sitting by designation under Del. Const. art. IV, § 12.

Francis A. Monaco, Jr., Esquire, Ryan C. Cicoski, Esquire, Womble Carlyle Sandridge & Rice LLP, Wilmington, Delaware; Richard M. Kohn, Esquire, Jonathan N. Helfat, Esquire, Commercial Finance Association, for *Amicus Curiae* Commercial Finance Association.

STRINE, Chief Justice:

I. INTRODUCTION

The United States Court of Appeals for the Second Circuit ("Second Circuit") has certified the following question of law important to a dispute pending before it:

> Under UCC Article 9, as adopted into Delaware law by Del. Code Ann. tit. 6, art. 9, for a UCC-3 termination statement to effectively extinguish the perfected nature of a UCC-1 financing statement, is it enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?[1]

We more precisely answer by assuming that by the term "effectively extinguish," the Second Circuit asks whether reviewing the termination statement and knowingly approving it for filing has the effect specified in § 9-513 of the Delaware's version of the Uniform Commercial Code ("UCC"), which is that "the financing statement to which the termination statement relates ceases to be effective."[2] Based on that understanding and for reasons we explain more fully, the unambiguous provisions of Delaware's UCC dictate that the answer is that "it [is] enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest."[3] Under the Delaware UCC, parties in commerce are entitled to rely upon a filing authorized by a secured lender and assume that the secured lender intends the plain consequences of its filing.

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[1] *In re: Motors Liquidation Co.*, 755 F.3d 78, 86 (2d Cir. 2014).
[2] 6 *Del. C.* § 9-513(d).
[3] *Id.*

II. THE EVENTS LEADING TO THE CERTIFIED QUESTION

The dispute pending before the Second Circuit turns on the effect of a UCC termination statement – a "UCC-3 termination statement" – filed with the Delaware Secretary of State on behalf of General Motors Corporation.[4] That termination statement, by its plain terms, purported to extinguish a security interest on the assets of General Motors ("term loan security interest") held by a syndicate of lenders, including JPMorgan Chase Bank, N.A. ("JPMorgan"). But neither JPMorgan nor General Motors subjectively intended to terminate the term loan security interest when General Motors filed the termination statement. General Motors' counsel for a separate "synthetic lease" financing transaction, Mayer Brown LLP, had inadvertently included the term loan security interest on the termination statement that it filed in the process of unwinding the synthetic lease. According to JPMorgan, no one at General Motors, Mayer Brown, or Simpson Thatcher Bartlett LLP (JPMorgan's counsel for the synthetic lease transaction) noticed this error, even though individuals at each organization reviewed the filing statement before the termination statement was filed on October 30, 2008. Under the stipulated question, we are also to assume that JPMorgan itself reviewed the termination statement and knowingly approved its filing.

After General Motors filed for reorganization under Chapter 11 of the Bankruptcy Code, JPMorgan informed the unofficial committee of unsecured creditors ("Creditors Committee") that a UCC-3 termination statement relating to the term loan had been

[4] These factual details are taken from the Second Circuit's opinion certifying the question of law to this Court and from the appendices submitted by the parties.

inadvertently filed. On July 31, 2009, the Creditors Committee commenced a proceeding against JPMorgan in the United States Bankruptcy Court for the Southern District of New York (the "Bankruptcy Court"), seeking, among other things, a determination that the filing of the UCC-3 termination statement was effective to terminate the term loan security interest and thus render JPMorgan an unsecured creditor on par with the other General Motors unsecured creditors. JPMorgan contested that argument, asserting that it had not authorized the termination statement releasing the term loan security interest, and that the statement was erroneously filed because no one at General Motors, JPMorgan, or the law firms working on the synthetic lease transaction recognized that the unrelated term loan security interest had been included on the statement.

On cross-motions for summary judgment, the Bankruptcy Court found for JPMorgan on various grounds, including that JPMorgan had not empowered Mayer Brown to act as its agent in releasing the term loan security interest in the sense that it had only authorized Mayer Brown to file an accurate termination statement that released security interests properly related to the synthetic lease transaction.[5] Because neither JPMorgan nor General Motors intended the legal consequences of the UCC-3 termination statement, the Bankruptcy Court found that the UCC-3 filing was not authorized and therefore was not effective to terminate the term loan security interest.[6]

The Creditors Committee appealed to the Second Circuit, arguing, among other things, that Mayer Brown was authorized as JPMorgan's agent to file the UCC-3

[5] *Official Comm. of Unsecured Creditors of Motors Liquidation Co. v. JPMorgan Chase Bank, N.A. (In re Motors Liquidation Co.)*, 486 B.R. 596, 606 (Bankr. S.D.N.Y. 2013).
[6] *Id.*

termination statement. Most pertinent for present purposes, the Creditors Committee argued that the only issue is whether JPMorgan had authorized the *filing* of the UCC-3 termination statement. So long as JPMorgan had authorized the statement to be filed, the termination of all identified security interests, including the term loan security interest, would be effective.

The Creditors Committee also contended that JPMorgan's argument that a party can authorize a filing and then later claim that it had not authorized the filing because it failed to catch an error in the statement is inconsistent with the plain language of § 9-513 of Delaware's UCC. That language states in pertinent part that "upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective."[7]

By contrast, JPMorgan took the position that a party may authorize a specific document to be filed on its behalf, but that such authorization does not cause the termination statement to be effective if errors in the statement resulted in the release of a security interest that the party did not subjectively intend to release.

The Second Circuit has indicated that it would be helpful to have an answer from this Court regarding this aspect of the parties' dispute. That answer may avoid any need for the Second Circuit to address the parties' disagreement as to whether Mayer Brown was authorized to act as JPMorgan's agent to file the UCC-3 termination statement, or provide some useful clarity if the agency issue must be addressed. Accordingly, the Second Circuit has certified the following question:

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[7] 6 *Del. C.* § 9-513(d).

> Under UCC Article 9, as adopted into Delaware law by Del. Code Ann. tit. 6, art. 9, for a UCC-3 termination statement to effectively extinguish the perfected nature of a UCC-1 financing statement, is it enough that the secured lender review and knowingly approve for filing a UCC-3 purporting to extinguish the perfected security interest, or must the secured lender intend to terminate the particular security interest that is listed on the UCC-3?[8]

The question is precise, and we read it as asking us to assume what it literally says, which is that the secured party of record has itself reviewed and knowingly approved the termination statement for filing. In its briefs and at oral argument, JPMorgan attempted to reframe the certified question by asking us to consider the issues of agency law that come into play whenever an entity, such as JPMorgan, acts through agents, be they employees, outside lawyers, or UCC-filing-service representatives. JPMorgan argued about whether a filing would be authorized if a secured party granted authority to an agent to file a termination statement for one security interest but not another, but the agent mistakenly filed a termination statement for both. That is not the question we have been asked to address, and the Second Circuit has said it will consider the fact-based question of whether Mayer Brown had authority as JPMorgan's agent to file the termination statement after it receives our answer to its more precise question. The question certified to us assumes that the secured party of record "review[d] and knowingly approve[d] [the termination statement] for filing." We will answer the question as our judicial colleagues have framed it.

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[8] *In re: Motors Liquidation Co.*, 755 F.3d 78, 86 (2d Cir. 2014).

III. ANALYSIS

"The most important consideration for a court in interpreting a statute is the words the General Assembly used in writing it."[9] The provisions of Delaware's UCC that are relevant to and support our conclusion are succinct. Section 9-513 of the UCC states:

> (d) *Effect of filing termination statement.* Except as otherwise provided in Section 9-510, upon the filing of a termination statement with the filing office, the financing statement to which the termination statement relates ceases to be effective.[10]

In turn, § 9-510 makes plain that a termination statement is effective only if the statement was filed by a person who is entitled to do so under § 9-509:

> (a) *Filed record effective if authorized.* A filed record is effective only to the extent that it was filed by a person that may file it under Section 9-509.[11]

The final step in the relevant statutory chain is § 9-509(d)(1), which addresses who may file amendments, which include termination statements:[12]

> (d) *Person entitled to file certain amendments.* A person may file an amendment other than an amendment that adds collateral covered by a financing statement or an amendment that adds a debtor to a financing statement only if:
> (1) the secured party of record authorizes the filing; or
> (2) [circumstances inapplicable to the facts of this case].[13]

"[U]nambiguous statutes are not subject to judicial interpretation."[14] The unambiguous terms of these UCC provisions make clear that if a "secured party of record

[9] *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 950 (Del. Ch. 2013).
[10] 6 *Del. C.* § 9-513(d).
[11] 6 *Del. C.* § 9-509(a).
[12] *See* 6 *Del. C.* § 9-102(a)(80) (defining a "termination statement" as an "amendment of a financing statement").
[13] 6 *Del. C.* § 9-509(d)(1).

authorizes the filing [of a termination statement],"[15] then the filing is "effective"[16] "upon the filing of a termination statement with the filing office."[17] At that time, "the statement to which the termination statement relates ceases to be effective."[18] In other words, for a termination statement to have the effect specified under § 9-513 of the Delaware UCC, it is enough that the secured party authorizes the filing. JPMorgan's argument that a filing is only effective if the authorizing party understands the filing's substantive terms and intends their effect is contrary to § 9-509, which only requires that "the secured party of record authorize[] the filing."[19]

This unambiguous language promotes sound policy. It is fair for sophisticated transacting parties to bear the burden of ensuring that a termination statement is accurate when filed.[20] It would be strange and inefficient for the UCC to make the effectiveness of a termination statement depend on whether the secured party subjectively understood

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[14] *Leatherbury v. Greenspun, D.O.*, 939 A.2d 1284, 1288 (Del. 2007).
[15] 6 *Del. C.* § 9-509(d)(1).
[16] 6 *Del. C.* § 9-510(a).
[17] 6 *Del. C.* § 9-513(d).
[18] *Id.*
[19] *See also* U.C.C. § 9-518 cmt. ("If the person that filed the record was not entitled to do so, the filed record is ineffective, regardless of whether the secured party of record files an information statement. Likewise, if the person that filed the record was entitled to do so, the filed record is effective, even if the secured party of record files an information statement.").
[20] *See, e.g.*, *Graham v. State Farm Mut. Auto. Ins. Co.*, 1989 WL 12233, at *2 (Del. Super. Jan. 26, 1989) ("[F]ailure to read a contract in the absence of fraud is an unavailing excuse or defense and cannot justify an avoidance, modification or nullification of the contract or any provision thereof.") (internal citation omitted); *Hicks v. Soroka*, 188 A.2d 133, 140–41 (Del. Super. 1963) ("If one voluntarily shuts his eyes when to open them is to see, such a one is guilty of an act of folly (in dealing at arm's length with another) to his own injury; and the affairs of men could not go on if courts were being called upon to rip up transactions of that sort.") (internal citation omitted).

the terms of its own filing and the effect that the filing would have on the security interests the filing's own words address.[21]

As a matter of ordinary course, parties who sign contracts and other binding documents, or authorize someone else to execute those documents on their behalf, are bound by the obligations that those documents contain.[22] Certainly, there are doctrines that allow parties who sign documents they do not understand to escape the consequences

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[21] *See, e.g.*, *ACF 2006 Corp. v. Merritt*, 2013 WL 466603, at *4 (W.D. Okla. Feb. 7, 2013), ("Although strict adherence to the [UCC] requirements may at times lead to harsh results, efforts by courts to fashion equitable solutions for mitigation of hardships experienced by creditors in the literal application of statutory filing requirements may have the undesirable effect of reducing the degree of reliance the market place should be able to place on the [UCC] provisions. The inevitable harm doubtless would be more serious to commerce than the occasional harshness from strict obedience.") (citation omitted), *aff'd*, 557 F. App'x 747 (10th Cir. 2014); *In re Silvernail Mirror & Glass, Inc.*, 142 B.R. 987, 989 (M.D. Florida 2013) ("The Termination Statement gave all indications to the world that [the creditor] was terminating its security interest in all its collateral. The filing of a Termination Statement is a method of making the record reflect the true state of affairs so that fewer inquiries will have to be made by persons who consult the public records. . . . [E]ven if [a] Termination Statement did not reflect the parties' true intent, it would be materially misleading to a potential creditor relying on the public records [to ignore the statement] and therefore [it] should not be set aside.").

[22] *See* 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 31.5 (4th ed. 2003) ("As a general principle, all adults are presumed to be capable of managing their own affairs, and the question whether a bargain is smart or foolish, or economically efficient or disastrous, is not ordinarily a legitimate subject of judicial inquiry. If freedom of contract means anything, it means that parties may make even foolish bargains and should be held to the terms of their agreements. A contract is not a non-binding statement of the parties' preferences; rather, it is an attempt by market participants to allocate risks and opportunities. [The court's role] is not to redistribute these risks and opportunities as [it sees] fit, but to enforce the allocation the parties have agreed upon. While the parties to a contract often request the courts, under the guise of interpretation or construction, to give their agreement a meaning which cannot be found in their written understanding, based entirely on direct evidence of intention, and often on hindsight, the courts properly and steadfastly reiterate the well-established principle that it is not the function of the judiciary to change the obligations of a contract which the parties have seen fit to make. . . . Unless the contract is voidable due to mistake, fraud, unconscionability, or another invalidating cause, or invalid in whole or in part due to illegality or another violation of public policy, the court must enforce it as drafted by the parties, according to the terms employed. . . .").

in certain circumstances, such as mutual mistake or reformation.[23] But as the Creditors Committee points out, had the General Assembly wished to give secured parties who authorize filings a safety valve against their own failure to comprehend the terms of their filings, it could have written § 9-509(d)(1) to state, for example, that "a person may file [a termination statement] . . . only if . . . the secured party of record authorizes the filing *and intends to terminate the security interests identified in that filing.*" Or the General Assembly could have provided that the secured party must "authorize and *understand the filing.*" The General Assembly did not write the statute in either way, and it would be improper for us to engraft such a condition on § 9-509, especially when the statutory language is unambiguous.[24]

Even if the statute were ambiguous, we would be reluctant to embrace JPMorgan's proposition. Before a secured party authorizes the filing of a termination statement, it ought to review the statement carefully and understand which security interests it is releasing and why. A secured party is the master of its own termination statement; it works no unfairness to expect the secured party to review a termination statement carefully and only file the statement once it is sure that the statement is correct.[25] If

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[23] *See e.g.*, *id.* § 70.106 (4th ed. 2003) ("A contract may be rescinded where there is a clear, bona fide, mutual mistake regarding a material fact or law."); *id.* § 70.20-21 ("Reformation of a written instrument is available where, because of a mutual mistake of fact, the instrument fails to express the real agreement between the parties.").

[24] *See Stifel Fin. Corp. v. Cochran*, 809 A.2d 555, 560 (Del. 2002) ("[T]his court should be chary about reading words into a statute that the General Assembly could have easily added itself.") (quoting *HMG/Courtland Props., Inc. v. Gray*, 729 A.2d 300, 306 (Del. Ch. 1999)).

[25] If a party files a termination statement that is inaccurate, it may follow the procedure established by the UCC to correct the record. Section 9-518 of Delaware's UCC authorizes a person to file an "information statement" (or a "correction statement" under the UCC) if the person believes that the existing record is inaccurate or a statement has been wrongly filed.

parties could be relieved from the legal consequences of their mistaken filings, they would have little incentive to ensure the accuracy of the information contained in their UCC filings.

We recognize that the UCC is a system of notice filing and that such a system contemplates that later lenders may need to conduct diligence to determine that a filing was authorized by the secured party of record. But consistent with the purpose of setting up a notice system, one of the most important roles the UCC plays is facilitating the efficient procession of commerce by permitting parties to rely in good faith on the plain terms of authorized public filings.[26] The UCC thus enables the crafting of contractual arrangements that generate wealth and the investment of capital in commercial enterprise because parties are able to rely on a clear and predicable set of rules to govern their transactions.[27]

To hold that parties cannot rely upon authorized filings unless the secured party subjectively understood the effect of its own action would disrupt and undermine the

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6 *Del. C.* § 9-518. The information statement has no legal effect in terms of restoring the filing statement. But it does give public notice that the erroneously filed record is unreliable. *See id.*; 11 ANDERSON U.C.C. § 9-518:5 (3d. ed. 2013). To restore the security interest its mistaken filing released, the secured party must perfect the security interest anew by filing a new financing statement. *See, e.g.*, *U.S. v. Lincoln Sav. Bank (In re Commercial Millwright)*, 245 B.R. 597, 601 (Bankr. N.D. Iowa 1999).

[26] *See, e.g.*, WEST'S ALR DIGEST SECURED TRANSACTIONS § 82.1 (2014) ("The purpose of the filing requirements for perfection of security interests is to guarantee that third parties will have notice of existing security interests in collateral, thus protecting credit transactions."); *U.S. v. Lincoln Sav. Bank (In re Commercial Millwright)*, 245 B.R. 597, 601 (Bankr. N. D. Iowa 1999) ("Perfection is intended to protect outside parties by providing clear notice.").

[27] *See, e.g.*, *In re Hickory Printing Group, Inc.*, 479 B.R. 388, 397 (Bankr. W.D.N.C. 2012) ("Lenders are bound by the effects of UCC termination statements, even when such termination statements are filed in error, because the entire purpose of the UCC system is to provide public notice of secured interests without requiring the parties to look behind or beyond the four corners of the public filing.").

secured lending markets. It is not clear to us how an inquiring party would find out whether a secured party understood and intended the consequences of its own filing. In the normal course of business, which is what the Delaware UCC embraces as appropriate policy, a party who causes a document to be executed and filed on its behalf is expected to understand what the filing says, the effect the filing will have, and that its own act of causing the document to be executed and filed will signal to others that the filing party subjectively intends for the filing to have the effect resulting from plain terms.[28] If we were to embrace JPMorgan's theory, no creditor could ever be sure that a UCC-3 filing is truly effective, even where the secured party itself authorized the filing, unless a court determined after costly litigation that the filing was in fact subjectively intended.

It therefore may not be coincidental that JPMorgan did not confront the language of the UCC directly, but instead devoted most of its answering brief and the bulk of its presentation during oral argument to addressing a question that is not before us. In its brief, JPMorgan dilated mostly on whether General Motors (and its counsel Mayer Brown) was authorized to act as JPMorgan's agent in filing the UCC-3 Termination Statement.[29] But the Second Circuit has asked us to assume that the secured party itself—JPMorgan—"*review[ed] and knowingly approved* for filing a UCC-3 purporting

[28] *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS § 157 (1981) ("Generally, one who assents to a writing is presumed to know its contents and cannot escape being bound by its terms merely by contending that he did not read them; his assent is deemed to cover unknown as well as known terms."); *see also In re Lortz*, 344 B.R. 579, 585 (Bankr. C.D. Ill. 2006) ("As with all perfection laws, which focus on third party perceptions and clarity and certainty of notice, the intent of the secured party is not relevant to questions of perfection and errors can be fatal."); *In re Clean Burn Fuels, LLC*, 492 B.R. 445, 465 (Bankr. M.D.N.C. 2013) ("The [UCC] permits third parties to rely on the record to determine whether a perfected security interest exists.").
[29] *See* Answering Br. at 18-24.

to extinguish the perfected security interest." We accept that assumption and refuse JPMorgan's invitation to answer a separate, fact-laden question that is not properly before us. As the Second Circuit made clear, it will address that issue itself after it receives the answer to the narrow question put to us.

Thus, for the reasons we have articulated, for a termination statement to become effective under § 9-509 and thus to have the effect specified in § 9-513 of the Delaware UCC, it is enough that the secured party authorizes the filing to be made, which is all that § 9-510 requires. The Delaware UCC contains no requirement that a secured party that authorizes a filing subjectively intends or otherwise understands the effect of the plain terms of its own filing. The Clerk is directed to transmit this opinion to the Second Circuit.

23 N.Y.3d 549
Court of Appeals of New York.

QUADRANT STRUCTURED PRODUCTS CO., LTD., Individually and Derivatively on Behalf of Athilon Capital Corp., Appellant,
v.
Vincent **VERTIN** et al., Respondents.

June 10, 2014.

Synopsis
Background: Noteholder, individually and derivatively on behalf of corporate issuer of notes covered by trust indentures, sued issuer's purported indirect parent company, purported parent's affiliate, issuer's board of directors, and issuer as nominal defendant, asserting, inter alia, claims for breach of fiduciary duty, fraudulent transfer, breach of implied covenant of good faith and fair dealing, tortious interference with contractual relations, and civil conspiracy. The Delaware Court of Chancery, 2012 WL 2051753, dismissed complaint based on noteholder's failure to comply with indentures' no-action clauses. Noteholder appealed. The Delaware Supreme Court remanded with directions. The Court of Chancery, 2013 WL 3233130, issued report on remand, holding that motion to dismiss should be granted in part and denied in part.The Delaware Supreme Court, — A.3d ——, 2013 WL 5962813, certified questions of New York law to the New York Court of Appeals.

Holdings: The Court of Appeals, Rivera, J., held that:

[1] no-action clauses of trust indentures, which do not refer to claims arising under the securities, do not apply to such claims, and

[2] no-action clauses in the case at bar did not apply, in absence of default.

Certified questions answered.

West Headnotes (10)

[1] **Corporations and Business Organizations**
Indenture trustee

An "indenture" is essentially a written agreement that bestows legal title of the securities in a single trustee to protect the interests of individual investors who may be numerous or unknown to each other.

Cases that cite this headnote

[2] **Corporations and Business Organizations**
Actions

A trust indenture's no-action clause that specifically precludes a securityholder who fails to comply with that clause's preconditions from initiating any action for enforcement of contractual claims arising under the indenture, but that omits reference to claims arising under "the securities," does not preclude a securityholder's independent common law or statutory claims.

1 Cases that cite this headnote

[3] **Corporations and Business Organizations**
Nature of obligation

A trust indenture is a contract.

1 Cases that cite this headnote

[4] **Corporations and Business Organizations**
Construction, operation, and effect in general

Interpretation of trust indenture provisions is a matter of basic contract law.

1 Cases that cite this headnote

[5] **Contracts**
Language of Instrument

In construing a contract, the court looks to its language, for a written agreement that is complete, clear, and unambiguous on its face must be enforced according to the plain meaning of its terms.

1 Cases that cite this headnote

[6] **Corporations and Business Organizations**
Actions

A no-action clause in a trust indenture is construed to give effect to the precise words and language used, for the clause must be strictly construed.

Cases that cite this headnote

[7] **Contracts**
Language of Instrument

Even where there is ambiguity, if parties to a contract omit terms, particularly, terms that are readily found in other, similar contracts, the inescapable conclusion is that the parties intended the omission.

1 Cases that cite this headnote

[8] **Contracts**
Language of contract

Where the language of the contract is clear, the court relies on the terms of the document to give effect to the parties' intent.

1 Cases that cite this headnote

[9] **Corporations and Business Organizations**
Actions

Limitations on individual securityholder suits serve the primary purpose of a no-action clause in a trust indenture, which is to protect issuers from the expense involved in defending individual lawsuits that are either frivolous or otherwise not in the economic interest of the corporation and its creditors.

Cases that cite this headnote

[10] **Corporations and Business Organizations**
Actions

No-action clauses of trust indentures for notes issued by corporation, which clauses applied only to contractual claims arising under the indentures, and which indentures triggered the trustee's duties only upon an event of default, did not preclude a noteholder, individually and derivatively on behalf of corporate issuer, from bringing claims seeking damages and injunctive relief for breaches of fiduciary duty, fraudulent transfer, breach of covenant of good faith and fair dealing, intentional interference with contractual relations, and conspiracy, against issuer's purported indirect parent company, purported parent's affiliate, issuer's board of directors, and issuer as nominal defendant, relating to alleged scheme to ensure that junior noteholders were paid, despite their inferior status vis-a-vis plaintiff noteholder's senior notes; there had been no default, and instead, the action was seeking to avoid default on senior notes held by plaintiff noteholder.

1 Cases that cite this headnote

Attorneys and Law Firms

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***552 OPINION OF THE COURT**

RIVERA, J.

In response to the first certified question from the Supreme Court of the State of Delaware, we conclude that a trust indenture's "no-action" clause that specifically precludes enforcement of contractual claims arising under the indenture, but omits reference to "the Securities," does not bar a securityholder's independent common-law or statutory claims. Accordingly, we answer the second question in the affirmative.

I.

The Delaware litigation underlying the certified questions is a reminder of the continued effects of the 2008 financial crisis and the economic fallout associated with the utilization of complex financial instruments that mask investment risk levels (*see generally* Kristin N. Johnson, ***553** *Things Fall Apart: Regulating the Credit Default Swap Commons*, 82 U. Colo. L. Rev. 167 [2011]; Brendan Sapien, *Financial Weapons of Mass Destruction: From Bucket Shops to Credit Default Swaps,* 19 S. Cal. Interdisc. L.J. 411 [2010]). Against this backdrop of high-stakes securities transactions and downward spiraling financial fortunes, the certified questions present for our consideration familiar efforts to prohibit individual lawsuits of securityholders, by the use of a contractual provision referred to as a "no-action" clause.

II.

Quadrant Structured Products Company, Ltd. (**Quadrant**)[1] sued several defendants in the Delaware Court of Chancery for alleged wrongdoing related to notes purchased by **Quadrant** and issued by defendant Athilon Capital Corp. (Athilon),[2] a business which plaintiff alleges is now insolvent. Defendant EBF & Associates, LP (EBF) acquired Athilon in 2010, installed and now controls its Board. Like **Quadrant**, EBF holds certain Athilon issued securities. Defendants moved to dismiss the suit as barred by a no-action clause contained in the indenture agreement governing **Quadrant's** notes. The notes and indenture were a necessary part of Athilon's financing scheme, which has its roots in Athilon's initial formation. Athilon was founded in 2004 with $100 million in equity and, along with its wholly owned subsidiary Athilon Asset Acceptance Corp., sold credit derivative **products** in the form of "credit default swaps" which afforded credit protection for large financial institutions.[3] These credit default swaps provided ****690** that Athilon would pay the ***554** purchaser in the case of a default on the debt that was the subject of the swap. As a risk containment measure, Athilon's operating guidelines mandated that it invest conservatively, and that when certain "suspension events" occurred, enter "runoff mode"—a period during which it could not issue new credit swaps and was required to pay off existing swaps as claims arose.

As part of its capital raising strategy, Athilon incurred debt through the issuance of a series of securities,[4] as relevant here, consisting of $350 million in senior subordinated notes, $200 million in three series of subordinated notes and $50 million in junior notes.[5] Athilon raised $600 million in capital through this debt **structure**. Debt subordination is common in commercial finance, and as the name of these different classes of notes implies, payment of senior subordinated notes takes priority over payment of junior notes.[6] **Quadrant** owns certain classes of ***555** these subordinated notes, including senior subordinated notes, while EBF owns junior notes.

[1] As part of this debt financing, Athilon entered agreements, referred to as trust indentures (indentures), with two separate Trustees, who serve as third-party administrators of the issuance of the securities.[7] An indenture is essentially a ****691** written agreement that bestows legal title of the securities in a single Trustee to protect the interests of individual investors who may be numerous or unknown to each other (*see generally* George G. Bogert & George T. Bogert, The Law of Trusts and Trustees § 250 at 280 [2d ed. rev. 1992]). As is typical of these agreements, the Athilon indentures set forth Athilon's obligations as the issuer of the securities, the securityholders' rights and remedies in the case of

Athilon's default on the provisions of the indenture, and the duties and obligations of the Trustee (*see* Thomas Lee Hazen, The Law of Securities Regulation § 19.1 at 467 [6th ed.], citing 15 USC § 77ccc [7] ["The contract, or 'indenture,' identifies the rights of all parties concerned, as well as the duties of the trustee (a third-party administrator), the obligations of the borrower, and the remedies available to the investors"]).

By 2008, Athilon had undertaken $50 billion in nominal credit default risk, far exceeding its $700 million in capital reserves, which consisted of the $100 million in equity and $600 million in security debt. **Quadrant** contends that at this rate a mere 0.2% loss on the collateralized debt obligations covered by Athilon's credit default swaps would strip Athilon of its equity and render it insolvent.[8] Indeed, in the aftermath of the 2008 financial crisis, in early 2009, Athilon and its subsidiary ***556** sustained several suspension events and entered into runoff mode as per its operating guidelines.

In October 2011, **Quadrant** sued Athilon, Athilon's officers and directors, EBF, and EBF affiliate Athilon **Structured** Investment Advisors LLC (ASIA), asserting various counts directly and derivatively as a creditor of Athilon. **Quadrant** asserted claims for breaches of fiduciary duty, seeking damages and injunctive relief, and also asserted fraudulent transfer claims against EBF and ASIA. According to **Quadrant**, EBF acquired Athilon in 2010, and controls the Athilon Board by virtue of having installed its board members. **Quadrant** claimed that the Board failed to preserve Athilon's value in anticipation of liquidation in 2014 when the last credit swap was set to expire, and instead took actions in direct contravention of its duties, but which favored EBF and its affiliate. Specifically, **Quadrant** alleged that the EBF-controlled Board paid interest on the junior notes, notwithstanding that Athilon agreed to defer interest payments on these notes and that junior notes would not receive a return during liquidation. As a consequence, EBF received payment on its junior notes, to the detriment of senior subordinated securities, including **Quadrant's** subordinated notes. **Quadrant** also alleged the Board paid ASIA above-market-rate service fees to manage Athilon's day-to-day operations.

The Court of Chancery characterized Athilon's investment strategy as "high risk" and "contrary to the terms of Athilon's governing documents," which was designed to ensure EBF benefitted financially, regardless of the risk associated with ****692** the investment, and regardless of the status of the EBF junior notes (***Quadrant Structured** Prods. Co., Ltd. v. **Vertin**,* 2013 WL 3233130, at *2, 2013 Del. Ch. LEXIS 152, at *7 [June 20, 2013, CA No. 6990–VCL]). All the while, the owners of the senior notes suffered the loss of the failed high-risk investment.[9]

Defendants moved to dismiss, asserting that **Quadrant's** claims were barred by a no-action clause (Athilon clause) contained in article 7, § 7.06 of the indenture governing the subordinated notes. The Athilon clause provides:

> "*Limitations on Suits by Securityholder.* No holder of any Security shall have any right by virtue or by ***557** availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless such holder previously shall have given to the Trustee written notice of default in respect of the series of Securities held by such Securityholder and of the continuance thereof, as hereinbefore provided, and unless also the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding shall have made written request upon the Trustee to institute such action or proceedings in its own name as trustee hereunder and shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby and the Trustee for 60 days after its receipt of such notice, request and offer of indemnity shall have failed to institute any such action or proceedings and no direction inconsistent with such written request shall have been given to the Trustee pursuant to Section 7.08 hereof within such 60 days."

Defendants argued that the clause permitted only Trustee-initiated suits upon request of a majority of securityholders, and prohibited individual securityholder actions. In support of this argument defendants relied on *Feldbaum v. McCrory Corp.,* 1992 WL 119095, 1992 Del. Ch. LEXIS 113, 18 Del. J. Corp. L. 630 (June 1, 1992) and *Lange v. Citibank, N.A.,* 2002 WL 2005728, at *1, 2002 Del. Ch. LEXIS 101, at *1–2 (Aug. 13, 2002, CA No. 19245–NC), Delaware Court of Chancery cases applying New York law, wherein the court dismissed the respective plaintiffs' claims based on a no-action clause. The clauses at issue in those cases barred a securityholder's action "with respect to this Indenture *or the Securities* unless [specified conditions are met]" (*Feldbaum,* 1992 WL 119095, at *5, 1992 Del. Ch. LEXIS 113, at *17, 18 Del. J. Corp. L. at 641; *Lange,* 2002 WL 2005728, at *5, 2002 Del. Ch. LEXIS 101, at *16 [emphasis added]).

The Delaware Chancery Court dismissed **Quadrant's** complaint, citing *Feldbaum* and *Lange* (***558** ***Quadrant Structured*** *Prods. Co., Ltd. v.* ***Vertin,*** 2012 WL 2051753, 2012 Del. Ch. LEXIS 300 [June 5, 2012, CA No. 6990–VCL]). On appeal to the Delaware Supreme Court, **Quadrant** asserted for the first time that the *Feldbaum* and *Lange* clauses were distinguishable because the clauses in those cases specifically mentioned claims ****693** arising under both the indenture *and* "the Securities," whereas the Athilon clause only applies to claims under the indenture. Therefore, the clause did not bar common-law or statutory claims arising under the securities. The Delaware Supreme Court remanded the case back to the Court of Chancery, ordering it "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture" (***Quadrant Structured*** *Prods. Co., Ltd. v.* ***Vertin,*** 2013 WL 8858605, at *2, 2013 Del. LEXIS 380, at *5–6 [Feb. 12, 2013, No. 338, 2012]; *see* —— A.3d at ——, 2013 WL 5962813, at *8, 2013 Del. LEXIS 570, at *23).

Thereafter, the Court of Chancery issued a Report on Remand in which the court concluded that the no-action clause applies only to contractual claims arising under the indenture. After a thorough analysis of New York cases and *Feldbaum* and *Lange,* the court found the Athilon clause differed from a *Feldbaum* and *Lange*-type clause, and only extended to actions or proceedings where a securityholder claims a right by virtue or by availing of any provision of the indenture. The court, therefore, concluded that the majority of **Quadrant's** claims were not barred under the clause, and that dismissal was warranted with respect to two claims and partial dismissal with respect to a third because only those claims arose under the Athilon indenture.[10]

Upon receipt of the Report, the Delaware Supreme Court certified the following questions to us:

> "(1) A trust indenture no-action clause expressly precludes a security holder [,] who fails to comply with that clause's preconditions, from initiating any action or proceeding upon or under or with respect to 'this Indenture,' but makes no reference to actions or proceedings pertaining to 'the Securities.'
>
> ***559** "The question is whether, under New York law, the absence of any reference in the no-action clause to 'the Securities' precludes enforcement only of contractual claims arising under the Indenture, or whether the clause also precludes enforcement of all common law and statutory claims that security holders as a group may have.
>
> "(2) In its Report on Remand ..., the Court of Chancery found that the Athilon no-action clause, which refers only to 'this Indenture,' precludes enforcement only of contractual claims arising under the Indenture. The question is whether that finding is a correct application of New York law to the Athilon no-action clause" (—— A.3d at ——, 2013 WL 5962813, at *5, 2013 Del. LEXIS 570, at *14–15).

Pursuant to section 500.27 of the Rules of Practice of the Court of Appeals (22 NYCRR), we accepted both certified questions (***Quadrant Structured*** *Prods. Co., Ltd. v.* ***Vertin,*** 22 N.Y.3d 1008, 980 N.Y.S.2d 379, 3 N.E.3d 717 [2013]).

III.

A.

[2] In response to the first question, for the reasons discussed in detail below, we conclude that a no-action clause which ****694** by its language applies to rights and remedies under the provisions of the indenture agreement, but makes no mention of individual suits on the securities, does not preclude enforcement of a securityholder's independent common-law or statutory rights. We reach this conclusion based on the legal standards applicable to indenture agreements, as well as the analyses of no-action clauses in *Feldbaum* and *Lange,* and cases from New York.

[3] [4] A trust indenture is a contract, and under New York

law "[i]nterpretation of indenture provisions is a matter of basic contract law" (*Sharon Steel Corp. v. Chase Manhattan Bank, N.A.,* 691 F.2d 1039, 1049 [2d Cir.1982]; *see also* Thomas Lee Hazen, The Law of Securities Regulation § 19.1 at 467 [6th ed.] [referring to indenture as a contract]; *Racepoint Partners, LLC v. JPMorgan Chase Bank, N.A.,* 14 N.Y.3d 419, 902 N.Y.S.2d 14, 928 N.E.2d 396 [2010] [same]; *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.,* 11 N.Y.3d 146, 866 N.Y.S.2d 578, 896 N.E.2d 61 [2008] [same]).

[5] [6] In construing a contract we look to its language, for "a written agreement that is complete, clear and unambiguous on its ***560** face must be enforced according to the plain meaning of its terms" (*Greenfield v. Philles Records,* 98 N.Y.2d 562, 569, 750 N.Y.S.2d 565, 780 N.E.2d 166 [2002]; *accord J. D'Addario & Co., Inc. v. Embassy Indus., Inc.,* 20 N.Y.3d 113, 118, 957 N.Y.S.2d 275, 980 N.E.2d 940 [2012]; *Vermont Teddy Bear Co. v. 538 Madison Realty Co.,* 1 N.Y.3d 470, 475, 775 N.Y.S.2d 765, 807 N.E.2d 876 [2004]; *W.W.W. Assoc. v. Giancontieri,* 77 N.Y.2d 157, 162, 565 N.Y.S.2d 440, 566 N.E.2d 639 [1990]; *Nichols v. Nichols,* 306 N.Y. 490, 496, 119 N.E.2d 351 [1954]). As the case law further establishes, we read a no-action clause to give effect to the precise words and language used, for the clause must be "strictly construed" (*Cruden v. Bank of N.Y.,* 957 F.2d 961, 968 [2d Cir.1992] [citation omitted]; *cf. Feldbaum,* 1992 WL 119095, at *7–8, 1992 Del. Ch. LEXIS 113, at *25, 18 Del. J. Corp. L. at 645; *Lange,* 2002 WL 2005728, at *7, 2002 Del. Ch. LEXIS 101, at *20–22; *Cruden v. Bank of N.Y.,* 1990 WL 131350, at *12, 1990 U.S. Dist. LEXIS 11564, at *35 [S.D.N.Y., Sept. 4, 1990, Nos. 85 Civ. 4170(JFK), 85 Civ. 4219(JFK), 85 Civ. 4570(JFK), 87 Civ. 5493(JFK)]; *Victor v. Riklis,* 1992 WL 122911, at *6 n. 7, 1992 U.S. Dist. LEXIS 7025, at *20 n. 7 [S.D.N.Y., May 15, 1992, No. 91 Civ. 2897(LJF)]; *McMahan & Co. v. Wherehouse Entertainment, Inc.,* 859 F.Supp. 743 [S.D.N.Y.1994]).

[7] Even where there is ambiguity, if parties to a contract omit terms—particularly, terms that are readily found in other, similar contracts—the inescapable conclusion is that the parties intended the omission. The maxim *expressio unius est exclusio alterius,* as used in the interpretation of contracts, supports precisely this conclusion (*see generally* Glen Banks, New York Contract Law § 10.13 [West's N.Y. Prac. Series 2006]; *see also In re Ore Cargo, Inc.,* 544 F.2d 80, 82 [2d Cir.1976] [where sophisticated drafter omits a term, *expressio unius* precludes the court from implying it from the general language of the agreement]).

Applying these well established principles of contract interpretation, and with the understanding that no-action clauses are to be construed strictly and thus read narrowly, we turn to the language of the no-action clause presented by the certified question. The no-action clause here states that no securityholder "shall have any right *by virtue or by availing of any provision of this Indenture* to institute any action or proceeding at law or in equity or in bankruptcy or otherwise *upon or under or with respect to this Indenture....*" The clear and unambiguous text of this no- ****695** action clause, with its specific reference to the indenture, on its face limits the clause to the contract rights recognized by the indenture agreement itself. Further supporting this construction of the clause is the sole textual reference to securities, which is contained in the clause's provision for a ***561** Trustee-initiated suit for a continuing "default in respect of the series of Securities."[11] This part of the no-action clause permits the trustee to sue in its name, after notice by a securityholder of a continuing default and upon approval of the suit by a majority of securityholders. Thus, the clear import of the no-action clause is to leave a securityholder free to pursue independent claims involving rights not arising from the indenture agreement.

This no-action clause, with its specific limit on the enforcement of indenture contract rights, is in contrast to no-action clauses which extend beyond the four corners of the indenture agreement to cover securities-based claims. As the cases illustrate, where the no-action clause refers to both the indenture and the securities the securityholder's claims are subject to the terms of the clause, whether those claims be contractual in nature and based on the indenture agreement, or arise from common law and statute.

Thus, in *Feldbaum,* where the no-action clause stated, in pertinent part, that "[a] Securityholder may not pursue *any remedy with respect to this Indenture or the Securities* unless [specified conditions are met]" (1992 WL 119095, at *5, 1992 Del. Ch. LEXIS 113, at *17, 18 Del. J. Corp. L. at 641), the court held that the clause barred the securityholders' fraud and breach of contract claims against the issuers of the securities (1992 WL 119095, at *2–3, 1992 Del. Ch. LEXIS 113, at *7–10, 18 Del. J. Corp. L. at 636–638). The court concluded that by its language the no-action clause barred not only contractual claims arising from the indenture itself, but also any claims individuals may have based on their status as securityholders (1992 WL 119095, at *7–8, 1992 Del. Ch. LEXIS 113, at *26–27, 18 Del. J. Corp. L. at 645).

***562** Similarly, in *Lange,* the court dismissed plaintiffs' claims as barred by a trust indenture no-action clause that provided "[a] Securityholder may not pursue a remedy with respect to this Indenture or the Securities unless [specified conditions are met]" (2002 WL 2005728, at *5, 2002 Del. Ch. LEXIS 101, at *16). Plaintiffs in *Lange* were a group of securityholders who sued the issuer for having sold off its subsidiaries for an unfair value (2002 WL 2005728, at *1, 2002 Del. Ch. LEXIS 101, at *1–2). Plaintiffs sought to rescind the sales or disgorge the proceeds arguing, inter alia, breach of the issuer's fiduciary duty. The court applied the reasoning in *Feldbaum* to find that the no-action clause barred all claims "with respect to the Indenture or the Debentures themselves" (2002 WL 2005728, at *7, 2002 Del. Ch. LEXIS 101, at *21).

The decisions in *Feldbaum* and *Lange* relied on the language of the clause, which was broad enough to encompass conditions on enforcement of indenture and securities-based ****696** claims (*Feldbaum,* 1992 WL 119095, at *6, 1992 Del. Ch. LEXIS 113, at *17–18, 18 Del. J. Corp. L. at 641; *Lange,* 2002 WL 2005728, at *7, 2002 Del. Ch. LEXIS 101, at *20–22). Here, unlike the *Feldbaum* and *Lange* clauses, the Athilon no-action clause omits the phrase "or the Securities," indicating its coverage is limited to the indenture and rights thereunder.

Decisions from New York further support this interpretation of the words contained in the no-action clause. For example, in *General Inv. Co. v. Interborough R.T. Co.,* 200 App.Div. 794, 193 N.Y.S. 903 (1st Dept.1922), plaintiff sought to recover payment on five promissory notes. Defendant argued the no-action clause barred recovery, relying on language in the clause that provided:

> "No holder of any note hereby secured shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of this indenture, or for the execution of any trust hereof, or for the appointment of a receiver, or for any other remedy hereunder, unless such holder [meets specified requirements]" (*id.* at 796, 193 N.Y.S. 903 [emphasis omitted]).

The Appellate Division held that the no-action clause did not bar plaintiff's suit because the clause applied to proceedings arising from the enforcement of the indenture and plaintiff's action "is not to affect, disturb or prejudice the lien of the ***563** collateral indenture or to enforce any right thereunder" (*id.* at 801, 193 N.Y.S. 903).[12]

In *Cruden,* plaintiffs sought to assert fraud and civil claims under the Racketeer Influenced and Corrupt Organizations Act (RICO) against the issuer. Defendants argued a no-action clause barred their claims. The clause therein provided:

> "No holder of any Debenture shall have any right by virtue of or by availing himself of any provision of this Indenture to institute any action or proceedings at law or in equity or in bankruptcy or otherwise, upon or under or with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder...." (1990 WL 131350, at *12, 1990 U.S. Dist. LEXIS 11564, at *35–36.)

Although reversing in part, the Second Circuit agreed with the District Court's conclusion that plaintiffs' fraud and RICO claims were not made under the indenture and, thus, could not be barred by the no-action clause (*Cruden,* 957 F.2d at 968).[13]

In contrast, in *Victor,* the District Court dismissed plaintiff's RICO claims as barred by a no-action clause (1992 WL 122911, at *1, 1992 U.S. Dist. LEXIS 7025, at *2). The clause at issue, similar to the clause in *Feldbaum,* prohibited "any remedy with respect to [the] Indenture or the Securities" unless specified conditions were met (1992 WL 122911, at *6, 1992 U.S. Dist. LEXIS 7025, at *19 [emphasis omitted]). The District Court distinguished the clause from the no-action clause in *Cruden* because the former was "not as broad as the one [here]" (1992 WL 122911, at *6 n. 7, 1992 U.S. Dist. LEXIS 7025, at *20 n. 7).

In *McMahan,* a no-action clause barred actions seeking "any remedy with respect to [the] Indenture or the Securities" (859 F.Supp. at 747). Plaintiffs brought federal securities claims arguing, inter alia, that they were entitled to immediate tender of their securities as a consequence of the ****697** issuer's merger with two other entities. The District Court held federal securities laws preclude application of a no-action clause to plaintiffs' federal securities claims, allowing those claims to proceed, but ***564** concluded the state law claims were properly barred by the no-action clause (*id.* at 749).[14]

As these cases illustrate, a no-action clause, like the Athilon clause, that refers only to actions under the indenture, is limited by its language to indenture-based contract claims. However, a no-action clause similar to the clauses in *Feldbaum* and *Lange,* that refers specifically to claims and remedies arising under the indenture and the securities, applies to all claims, except those excluded from coverage as a matter of law. Here, the Athilon no-action clause when strictly construed and afforded its plain meaning, makes no reference to the securities, and therefore does not apply to claims arising outside the scope of the indenture. Accordingly, we agree with the Delaware Chancery Court's Report on Remand that *Feldbaum* and *Lange* are distinguishable, and the Athilon no-action clause applies only to contract claims under the indenture, not to **Quadrant's** common-law and statutory claims.

[8] Defendants argue that under New York law, what matters is the parties' intent, not any "legal talismans," and that the parties' intent was for the no-action clause to apply to all individual securityholder suits. This is no argument at all, for under our law where the language of the contract is clear we rely on the terms of the document to give effect to the parties' intent (*see J. D'Addario & Co.,* 20 N.Y.3d at 118, 957 N.Y.S.2d 275, 980 N.E.2d 940; *Vermont Teddy Bear Co.,* 1 N.Y.3d at 475, 775 N.Y.S.2d 765, 807 N.E.2d 876; *Nichols,* 306 N.Y. at 496, 119 N.E.2d 351). As we have discussed, the no-action clause is clear on its face and applies to indenture contract claims only. The New York cases upon which defendants rely fail to persuade us otherwise, for they involve rights under the indenture, or securityholder rights which a no-action clause may not abridge as a matter of law (*see e.g. Greene v. New York United Hotels, Inc.,* 236 App.Div. 647, 648, 260 N.Y.S. 405 [1st Dept.1932] [petition for receivership dismissed as defective; debentureholder failed to plead compliance with no-action clause for claims of past-due payment]; *Emmet & Co., Inc. v. Catholic Health E.,* 37 Misc.3d 854, 856, 951 N.Y.S.2d 846 [Sup.Ct.N.Y. County 2012] [claim arising under indenture]; *Walnut Place LLC v. Countrywide Home Loans, Inc.,* 35 Misc.3d 1207[A], 2012 N.Y. Slip Op. 50601[U], 2012 WL 1138863 [Sup.Ct.N.Y.County 2012] [claim against Trustee]). The reasoning in these cases provides no basis to alter our ***565** conclusion that a no-action clause that omits language specifically referencing the securities does not extend to a securityholder's common-law and statutory claims.

Nevertheless, defendants argue that, regardless of the actual words used, the language of the no-action clause includes all securityholder actions. Defendants essentially argue that references to the indenture should be interpreted to include the securities, and that to do otherwise will upset the parties' expectations. These arguments are unsupported by the no-action clause itself.

In support of their argument that indenture also means securities, defendants point to the purpose of the no-action clause, which they argue is to prevent unpopular duplicative suits, by channeling ****698** all securityholder claims through the Trustee. They contend that a no-action clause prohibits what they call the "lone ranger" lawsuit: individuals asserting claims that foster the interests of minority securityholders at the potential expense of the majority's interest. **Quadrant's** suit, defendants argue, is exactly the type of litigation the no-action clause is intended to prevent. Given this understanding of the intent of the no-action clause, the omission of the words "the Securities" is logical because they would be superfluous, adding nothing to the already expansive coverage of the clause.

Defendants are correct that generally a no-action clause prevents minority securityholders from pursuing litigation against the issuer, in favor of a single action initiated by a Trustee upon request of a majority of the securityholders (*see* American Bar Foundation, Commentaries on Indentures § 5.7 at 232 [1971] [discussing proposed no-action clause in model indenture, finding "(t)he major purpose of this (proposed no-action clause) is to deter individual debentureholders from bringing independent law suits for unworthy or unjustifiable reasons, causing expense to the Company and diminishing its assets"]).

[9] As the court in *Feldbaum* noted, limitations on individual securityholder suits serve the primary purpose of a no-action clause, which is "to protect issuers from the expense involved in defending [individual] lawsuits that are either frivolous or otherwise not in the economic interest of the corporation and its creditors" (1992 WL 119095, at *6, 1992 Del. Ch. LEXIS 113, at *20, 18 Del. J. Corp. L. at 642). These limitations further "protect[ ] against the risk of strike suits" (*id.*). Indeed, a no-action ***566** clause "make[s] it more difficult for individual bondholders to bring suits that are unpopular with their fellow bondholders" (1992 WL 119095, at *5, 1992 Del. Ch. LEXIS 113, at *19, 18 Del. J. Corp. L. at 642). The no-action clause achieves these goals

> "by delegating the right to bring a suit enforcing rights of bondholders to the trustee, or to the holders of a substantial amount of bonds, and by delegating to the trustee the right to prosecute such a suit in the first instance. These clauses also ensure that the proceeds of any litigation actually prosecuted will be shared ratably by all bondholders" (1992 WL 119095, at *6, 1992 Del. Ch. LEXIS 113, at *21, 18 Del. J. Corp. L. at 643 [citation omitted]).

However, even defendants admit that the Athilon clause is not a complete bar to any and all securityholder suits. There are claims which, by law, cannot be prohibited by a no-action clause, most notably claims against the trustee (*see e.g.* 15 USC § 77*ooo* [d] ["The indenture ... shall not contain any provisions relieving the indenture trustee from liability for its own negligent action, its own negligent failure to act, or its own willful misconduct"]; *see also Cruden,* 957 F.2d at 968 [no-action clause will not bar securityholder suit against Trustee because "it would be absurd to require the debenture holders to ask the Trustee to sue itself"]).

Defendants appear to argue that the enactment of the Trust Indenture Act of 1939 (TIA) eliminated the need to reference the securities in a no-action clause because the TIA prohibits the clause from barring a securityholder's action against the Trustee for breach of duties recognized by the TIA, or for past-due interest or principal on the securities (*see* 15 USC § 77ppp [b]). Of course, as **Quadrant's** case illustrates, a securityholder may have claims apart from claims against the Trustee, or for past-due payments. Moreover, as long as the indenture does not violate or conflict with the TIA, the parties may **structure** the indenture agreement to address ****699** their respective interests and obligations, including placing limits on certain claims of right.

Most significant here is that the no-action clause, by its own terms, is concerned with minority holders' actions in the case of a default by the issuer of the securities. The no-action clause requires a written request for the Trustee to commence an action or proceeding *regarding a default* with respect to the series of securities held by the noteholder and approval by a majority ***567** of securityholders.[15] Logically then, the no-action clause applies when the Trustee is authorized to decide whether to act; it cannot serve as an outright prohibition on a suit filed by a securityholder in the case where the Trustee is without authorization to act. Otherwise, the purpose of the no-action clause—to avoid duplicative suits and protect the majority interests by mandating that actions be channeled through the Trustee—would be subverted (*Feldbaum,* 1992 WL 119095, at *6, 1992 Del. Ch. LEXIS 113, at *19, 18 Del. J. Corp. L. at 642). This is what the parties intended. Of course, they were free to not limit the no-action clause in this way. Here, therefore, the purpose of the Athilon no-action clause is not frustrated where the Trustee is without authority to act.

Defendants' argument that interpreting the no-action clause to exclude certain claims would upset the contracting parties' expectations is unpersuasive. The indenture itself defines "indenture" and "securities" separately, recognizing them as distinct.[16] Therefore, defendants' functional equivalency argument is merely another version of the argument we have already rejected on the law: that the parties intended other than what the words in the document mean. As our law makes clear, we rely on the unambiguous terms of the agreement when construing contract provisions like the indenture no-action clause (*see J. D'Addario & Co.,* 20 N.Y.3d at 118, 957 N.Y.S.2d 275, 980 N.E.2d 940; *Vermont Teddy Bear Co.,* 1 N.Y.3d at 475, 775 N.Y.S.2d 765, 807 N.E.2d 876; *Nichols,* 306 N.Y. at 496, 119 N.E.2d 351). **Quadrant's** claims are based not on the indenture agreement—under which the Trustee administers the debt issuance by Athilon—but rather arise from **Quadrant's** status as a securityholder. The parties could not have expected otherwise, given the plain language of the clause. If the parties sought to prohibit these types of suits, they were free to include them within the Athilon no-action clause.

We also note that in 2000, the Ad Hoc Committee for Revision of the 1983 Model Simplified Indenture produced a model no-action clause which provides "[a] Securityholder may pursue a remedy with respect to this Indenture or the Securities only if ***568** [the holder complies with the terms of the clause]" (55 Bus. Law 1115, 1137–1138 [2000]). By its terms, the no-action clause references the indenture and the securities. Even this broad model clause is not without limits. In its commentary to this provision, the Committee states: "[t]he clause applies, however, only to suits brought to enforce contract rights under the Indenture or the Securities, not to suits asserting rights arising under other laws" (*id.* at 1191). The Committee intended the model no-action clause to limit ****700** only contract rights, not to encompass all securityholder suits. We express no opinion on whether no-action clauses should be so narrowly construed, but note only that parties sophisticated and well versed in this area of the law—like the parties here—are well aware of these commentaries and, thus, we find unsupportable defendants' argument that a construction of the no-action clause that permits **Quadrant's** claims to proceed would be unsettling to the parties' expectations.

B.

[10] The second certified question asks whether the Vice Chancellor's Report on Remand correctly interpreted New York law. We answer this question in the affirmative. In its complaint, **Quadrant** asserts individual and derivative claims seeking damages and injunctive relief for breaches of fiduciary duty, fraudulent transfer, breach of covenant of good faith and fair dealing, intentional interference with contractual relations, and conspiracy. Essentially, **Quadrant** claims that Athilon's Board, installed and controlled by EBF, acted pursuant to a scheme which ensures that the junior securityholders are paid, despite their inferior status vis-à-vis **Quadrant's** senior notes, and, as a consequence, payment of the junior securities imperils payment of the senior securities. As described by **Quadrant**, Athilon's actions are an effort to siphon off as much capital as possible, as quickly as possible, for the benefit of EBF. Thus understood, the

Trustee cannot address these claims because the Trustee's duties, as per the indenture, are only triggered upon an event of default—exactly what **Quadrant** seeks to avoid, at least with respect to the senior securities.

Accordingly, the Vice Chancellor correctly concluded that, with the exception of two claims and part of a third, the no-action clause did not bar plaintiff's action. The claims the Vice Chancellor found viable are those that the Trustee cannot assert, as they are not based on any default on the securities. ***569** Specifically, the Vice Chancellor correctly found that those claims sounding in breach of contract and arising from the indenture are barred—requiring the majority securityholders to bring those actions through the Trustee.

IV.

Accordingly, the certified questions should be answered in accordance with this opinion.

Chief Judge LIPPMAN and Judges GRAFFEO, READ, SMITH, PIGOTT and ABDUS–SALAAM concur.

Following certification of questions by the Supreme Court of the State of Delaware and acceptance of the questions by this Court pursuant to section 500.27 of this Court's Rules of Practice, and after hearing argument by counsel for the parties and consideration of the briefs and the record submitted, certified questions answered in accordance with the opinion herein.

Parallel Citations

23 N.Y.3d 549, 16 N.E.3d 1165, 992 N.Y.S.2d 687, 2014 N.Y. Slip Op. 04114

Footnotes

1 **Quadrant** is a Cayman Islands limited liability company with its principal place of business in Connecticut.

2 Athilon is a Delaware corporation with its principal place of business in New York.

3 A credit default swap is a financial instrument that serves as "a promise by one party to pay another party in the event that a third party defaults on its debt" (Jeremy C. Kress, *Credit Default Swaps, Clearinghouses, and Systemic Risk: Why Centralized Counterparties Must Have Access to Central Bank Liquidity,* 48 Harv. J. on Legis. 49, 52 [2011] [citation omitted]). A credit default swap contract "obligates a protection buyer to make periodic premium payments to a protection seller, who in turn must pay the buyer if one or more underlying reference entities experiences a credit event [such as default, bankruptcy or credit rating downgrade]" (*id.* [citation omitted]). Such financial instruments were viewed with skepticism and concern by some critics who feared "that a spike in interest rates could trigger a 'derivatives tsunami' that would bring all of the major banks to their knees and cause a 'blowup' in world credit markets" (Robert F. Schwartz, *Risk Distribution in the Capital Markets: Credit Default Swaps, Insurance and a Theory of Demarcation,* 12 Fordham J. Corp. & Fin. L. 167, 170 [2007] [citation omitted]).

4 A security is

> "any note, stock, treasury stock, security future, security-based swap, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited" (15 USC § 78c [a][10]).

5 A "note" is defined as "A written promise by one party (the *maker*) to pay money to another party (the *payee*) or to bearer" (Black's Law Dictionary [9th ed. 2009]).

6 "[T]he basic concept of a subordination agreement is simple: It is the subordination of the right to receive payment of certain indebtedness ... prior [to] payment of certain other indebtedness (the senior debt) of the same debtor. Put another way—in the

circumstances specified in the subordination agreement, the senior debt must be paid in full before payment may be made on the subordinated debt and retained by the subordinating creditor" (Dee Martin Calligar, *Subordination Agreements,* 70 Yale L.J. 376, 376 [1961]).

7 Deutsche Bank Trust Company serves as Trustee under the indenture governing subordinated notes, and The Bank of New York serves as Trustee pursuant to the indenture governing senior subordinated notes (*see* ***Quadrant Structured*** *Prods. Co., Ltd. v.* ***Vertin,*** — A.3d —, —, 2013 WL 5962813, at *2, 2013 Del. LEXIS 570, at *5 [Nov. 7, 2013, No. 338, 2012]).

8 A collateralized debt obligation is a type of asset-backed security (*see* Neal Deckant, *X. Reforms of Collateralized Debt Obligations: Enforcement, Accounting and Regulatory Proposals,* 29 Rev. Banking & Fin. L. 79, 80 [2009]). The underlying assets are "pooled together, split into subordinated repayment rights ('tranches'), rated by a credit rating agency and sold to investors" (*see* Neal Deckant, *Criticisms of Collateralized Debt Obligations in the Wake of the Goldman Sachs Scandal,* 30 Rev. Banking & Fin. L. 407, 410 [2010] [citation omitted]).

9 The Court of Chancery described a strategy "that amounts to a 'heads EBF wins, tails everyone else loses' bet. If the high-risk investments succeed, then the underwater Junior Notes and equity will benefit. If the investments fail, then the more senior tranches of Notes will bear the loss" (***Quadrant,*** 2013 WL 3233130, at *2, 2013 Del. Ch. LEXIS 152, at *7).

10 Specifically, the court identified as subject to dismissal count VII, which alleged breach of the implied covenant of good faith and fair dealing; count VIII, which alleged tortious interference with the implied covenant referenced in count VII; and part of count X, which alleged civil conspiracy relating to all other counts in **Quadrant's** complaint (*see* ***Quadrant Structured*** *Prods. Co., Ltd. v.* ***Vertin,*** 2013 WL 3233130, at *23, 2013 Del. Ch. LEXIS 152, at *84–85 [June 20, 2013, CA No. 6990–VCL]).

11 Specifically, section 7.06 of the indenture provides that no action may be commenced

> "unless such holder previously shall have given to the Trustee written notice of default in respect of the series of Securities held by such Securityholder ..., and unless also the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding shall have made written request upon the Trustee to institute such action or proceedings in its own name as trustee hereunder ... and the Trustee [after 60 days] ... shall have failed to institute any such action or proceedings and no direction inconsistent with such written request shall have been given to the Trustee pursuant to [the indenture] within such 60 days...."

12 This Court affirmed without discussion of the no-action clause (*see General Inv. Co. v. Interborough R.T. Co.,* 235 N.Y. 133, 139 N.E. 216 [1923]).

13 The Second Circuit reversed the District Court's ruling that some of plaintiffs' claims against the Trustees were time-barred (*Cruden,* 957 F.2d at 978).

14 The Second Circuit affirmed, but remanded back to the District Court for a recalculation of damages under the Securities Act of 1933 (*McMahan & Co. v. Wherehouse Entertainment, Inc.,* 65 F.3d 1044, 1051 [2d Cir.1995]).

15 The requirement of notice to the Trustee and majority securityholder approval makes sense because litigation by a minority securityholder upon a default is an attempt to secure payment, and resolution of the matter is of interest to the entire class of securityholders.

16 Section 1.01 defines "Indenture" as "this instrument as originally executed," and "Securities" as the "Series A Notes and the Series B Notes," i.e., the notes purchased by plaintiff securityholder.

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2013 WL 5962813
Only the Westlaw citation is currently available.

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Supreme Court of Delaware.

QUADRANT STRUCTURED PRODUCTS CO., LTD., Individually and Derivatively on behalf of Athilon Capital Corp., Plaintiff Below, Appellant,
v.
Vincent VERTIN, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner, Athilon Capital Corp., Athilon Structured Investment Advisors LLC, EBF & Associates, LP, Defendants Below, Appellees.

No. 338, 2012. | Submitted: Oct. 23, 2013. | Decided: Nov. 7, 2013.

Synopsis
Background: Noteholder, individually and derivatively on behalf of corporate issuer of notes covered by trust indentures, sued issuer's purported indirect parent company, purported parent's affiliate, issuer's board of directors, and issuer, as nominal defendant, alleging, inter alia, breach of indentures' implied covenant of good faith and fair dealing, tortious interference with issuer's obligations under indentures, and civil conspiracy. The Court of Chancery, 2012 WL 2051753, dismissed complaint based on noteholder's failure to comply with indentures' no-action clauses. Noteholder appealed. The Supreme Court remanded with directions. The Court of Chancery, 2013 WL 3233130, issued report on remand, holding that motion to dismiss should be granted in part and denied in part.

Holding: Sitting en banc, the Supreme Court, Jacobs, J., held that certification, to New York Court of Appeals, of questions addressing which claims were barred by indentures' no-action clauses was warranted.

Questions certified.

West Headnotes (1)

[1] **Courts**
Annulling decisions

Certification of questions to New York Court of Appeals was warranted, in noteholder's action to enforce trust indentures governed by New York law, as to whether lack of reference to actions on securities in an indenture's no-action clause barring action by security holder that failed to comply with preconditions precluded only claims under indenture or barred all common-law and statutory claims of security holder, and whether no-action clauses applicable to noteholder, which referred only to "this Indenture," barred only contractual claims under indentures; no controlling precedent existed, answers would be determinative of noteholder's case however they were resolved, and need existed for certainty in New York law, which controlled many instruments governing publicly traded debt securities. 22 NYCRR 500.27(a).

2 Cases that cite this headnote

Court Below: Court of Chancery of the State of Delaware, C.A. No. 6990.
Upon appeal from the Court of Chancery. **CERTIFICATION OF LEGAL QUESTIONS TO THE NEW YORK COURT OF APPEALS.**

Attorneys and Law Firms

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LLP, Wilmington, Delaware; Of Counsel: Philippe Z. Selendy, Nicholas F. Joseph (argued), and Sean P. Baldwin, Esquires, Quinn Emanuel Urquhart & Sullivan, LLP, New York, New York, for Appellees Athilon Capital Corp., Athilon Structured Investment Advisors LLC, Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt and J. Eric Wagoner.

Before HOLLAND, BERGER, JACOBS and RIDGELY, Justices, and SCOTT, Judge* constituting the Court en Banc.

Opinion

JACOBS, Justice:

***1** Pending before this Court is an appeal from an order of the Delaware Court of Chancery dismissing a complaint. The plaintiff below, appellant, Quadrant Structured Products Company, Inc. ("Quadrant"), holds certain Notes issued by Athilon Capital Corp. ("Athilon"), an allegedly insolvent Delaware corporation. The Notes are long term obligations covered by two separate trust indentures that are governed by New York law. The defendants-below are EBF & Associates, LP ("EBF"), which indirectly owns 100% of Athilon's equity;[1] Athilon Structured Investment Advisors ("ASIA"), an affiliated EBF entity, Athilon's board of directors, and (as a nominal defendant) Athilon.

In a two paragraph order issued on June 5, 2012, the Court of Chancery granted the defendants' motion to dismiss Quadrant's complaint, on the ground that all claims alleged therein were barred for failure to comply with the "no-action" clauses in the Athilon trust indentures. The dismissal order, a copy of which is attached to this Certificate as Exhibit A, cited two Court of Chancery decisions that the court found "directly on point": *Feldbaum v. McCrory Corp.,* 1992 WL 119095 (Del.Ch. June 1, 1992) and *Lange v. Citibank, N.A.,* 2002 WL 2005728 (Del.Ch. Aug. 13, 2002). In both cited cases the Court of Chancery, applying New York law, held that those bondholder actions were barred by the no-action clauses of the respective trust indentures that governed the bonds at issue.

The plaintiff, Quadrant, appealed to this Court. By order dated February 12, 2013, this Court remanded the case to the Court of Chancery with directions to analyze the significance under New York law (if any) of the differences between the wording of the no-action clauses at issue in the two cited cases and in this Athilon case. A copy of this Court's remand order is attached to this Certificate as Exhibit B.

On June 20, 2013, the Court of Chancery, in a detailed and highly textured analysis of relevant New York case law, issued a Report on Remand, a copy of which is attached to this Certificate as Exhibit C. In its Report, the Court of Chancery held that: (i) "the language of the Athilon no-action clause distinguishes this case from *Feldbaum* and *Lange,*" and (ii) the motion to dismiss should be denied except as to two (and part of a third) of the ten Counts of the Quadrant complaint. The matter was then returned to this Court, and was re-argued before us on October 23, 2013.

Section 500.27(a) of the Court of Appeals Rules of Practice authorizes certification of cases to the New York Court of Appeals "[w]henever it appears to ... a court of last resort of any other state that determinative questions of New York law are involved in a case pending before that court for which no controlling precedent of the Court of Appeals exists...."[2] We have concluded that a resolution of the appeal before us depends on dispositive and unsettled questions of New York law that, in our view, are properly answered in the first instance by the New York Court of Appeals. Our reasons for so concluding are set forth below.

I. *STATEMENT OF FACTS*[3]

A. Nature of the Case

***2** Athilon, a Delaware corporation, was formed in 2004 and (through a subsidiary) sold credit derivative products—in the form of "credit default swaps"[4] covering senior tranches of collateralized debt obligations to large financial institutions. To finance those activities, Athilon raised (in addition to its initial equity capital) $600 million of debt capital consisting of $350 million in senior subordinated notes, $200 million in subordinated notes, and $50 million in junior notes (collectively, the "Notes"). The Notes are long term obligations covered by two separate indentures; one created in 2004 between Athilon and Deutsche Bank Trust Company Americas as Indenture Trustee; and the other, created in 2005 between Athilon and The Bank of New York, as Indenture Trustee. Because for present purposes the indentures are substantively identical, they are referred to singly as "the Indenture."

Athilon's organizational documents limit its permissible lines of business to selling credit default swaps, and require compliance with strict operating guidelines. Those guidelines mandate that if a "Suspension Event"[5] occurs and remains uncured, then Athilon must enter into "runoff" mode, meaning that Athilon cannot write new business and must pay off existing credit default swaps as they mature.

Before the financial crisis of 2008, Athilon underwrote over $50 billion in nominal credit default risk, but on a highly leveraged basis. Measured against Athilon's equity, Athilon's leverage ratio was a stratospheric 506:1. At that level, a 0.2% loss on the collateralized debt obligations covered by Athilon's credit default swaps would wipe out its equity cushion and render Athilon insolvent, at least on paper. Even so, the rating agencies gave Athilon "AAA/Aaa" counterparty credit ratings and investment grade debt credit ratings.

In 2008, Athilon found itself in distress and by the end of that year had lost its AAA/Aaa ratings. By 2010, Athilon had unwound two credit default swaps at a cost of approximately $370 million—more than three times Athilon's equity capital. By August 2010, Athilon no longer held any investment grade debt or counterparty credit ratings. Under its operating guidelines, Athilon entered permanent "runoff" mode.

With Athilon in distress, the trading prices of its debt securities fell precipitately. That enabled EBF to acquire a large position in the junior notes at a significant discount. In August 2010, EBF acquired control of 100% of Athilon's equity, and installed Athilon's current board of directors. Those directors, the complaint alleges, are dominated and controlled by EBF. Quadrant acquired its position in the Notes in May 2011, nine months after EBF took control.

In its complaint Quadrant alleges that as of September 30, 2011, Athilon's shareholders' equity, measured according to GAAP, stood at a negative $660 million. Quadrant alleges that Athilon is insolvent and has no prospect of returning to solvency, because it can only sell credit default swaps and because the market for that business has collapsed for enterprises, like Athilon, that hold no collateral.

*3 At the heart of Quadrant's lawsuit is its claim that in these circumstances, a properly motivated board of directors would preserve Athilon's value for orderly liquidation in 2014, when the last credit default swap expires. The EBF board designees, however, are (according to Quadrant) pursuing strategies designed to benefit EBF and its affiliates at the expense of the remaining classes of Note holders. Specifically, the directors have caused Athilon to continue paying interest on the junior notes (which EBF holds), even though Athilon had a contractual right to defer those interest payments and those notes would receive nothing in an orderly liquidation. Athilon's directors also allegedly agreed to pay ASIA above-market fees to manage Athilon's day-to-day operations. The Court of Chancery characterized Quadrant's claim thusly:

> Together, the EBF designees and ASIA have embarked on a high-risk investment strategy, contrary to the terms of Athilon's governing documents, that amounts to a "heads EBF wins, tails everyone else loses" bet. If the high-risk investments succeed, then the underwater Junior Notes and equity will benefit. If the investments fail, then the more senior tranches of Notes will bear the loss."[6]

In October 2011, Quadrant filed this Court of Chancery action against EBF and its affiliates and against Athilon and its officers and directors. As amended, the complaint contained ten Counts. For present purposes, the relevant fact is that only two of those Counts—Counts VII and VIII—and part of a third, Count X, seek to enforce rights under the Indenture.[7] The balance of Quadrant's claims for relief are based on either Delaware fiduciary or statutory law.

B. Circumstances Out of Which The Questions of New York Law Arise

The circumstances out of which the questions of New York law arise are as follows: The basis of the defendant's motion to dismiss the complaint was (and is) that all of the claims asserted in Quadrant's complaint are barred by the no-action clause of the Indenture, which is governed by New York law. The no-action clause pertinently provides that:

> No holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless such holder ... [complies with specified conditions].

It is undisputed that Quadrant did not comply with the conditions set forth in the Athilon no-action clause before filing suit. In support of their motion to dismiss the complaint, the defendants relied on the two cases previously cited, *Feldbaum v. McCrory Corp.* and *Lange v. Citibank, N.A.* In those cases, the Delaware Court of Chancery, applying New York law, dismissed both actions on the ground that they were barred by the respective indenture no-action clauses. In its June 5, 2012 order (Exhibit A to this Certificate), the court granted the motion to dismiss, citing *Feldbaum* and *Lange* as "directly on point," but without engaging in any analysis.

*4 On appeal to this Court, Quadrant argued that the no-action clauses in *Feldbaum* and *Lange* indentures were "substantially different" from the no-action clause in the Athilon Indenture. Specifically, the no-action clauses in *Feldbaum* and *Lange* barred actions to enforce not only rights arising under the respective indentures, but also "any remedy with respect to this Indenture *or the Securities*."[8] In contrast, the Athilon no-action clause bars only actions to enforce rights "upon or under or with respect *to this Indenture*."[9] Absent from the Athilon no-action clause is the phrase "or the Securities"—language that was contained in the no-action clauses in the *Feldbaum* and *Lange* indentures.

By Order dated February 12, 2013 (Exhibit B to this Certificate), this Court determined that the current record was insufficient for appellate review, and remanded the case to the Court of Chancery with instructions "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture." The Remand Order further instructed that "[t]he analysis should include a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here." This Court retained jurisdiction to consider the implications of the Report on Remand.

On June 20, 2013, the Court of Chancery issued its 55 page Report on Remand (Exhibit C to this Certificate). In that Report the Court of Chancery, after extensively analyzing the New York case law, concluded—contrary to its earlier conclusion—that:

> [A]s a matter of New York law, the differences between the Athilon [no-action] [c]lause and the *Feldbaum/Lange* clause are significant.... the Athilon Clause does not apply to Counts I through VI and IX of the Complaint, or to Count X to the extent it seeks to impose liability on secondary actors for violations of the other counts. The clause applies to Counts VII and VIII of the Complaint, subject to the outcome of Quadrant's other arguments on appeal.[10]

The case was then returned to this Court, which held a supplemental oral argument on October 23, 2013, to enable the parties to argue the implications of the Report on Remand. Quadrant argued that the Report on Remand correctly decided the dispositive New York law issues, and that the order of dismissal should be modified to conform to the conclusions in that Report. The defendants, however, maintained that that Report was legally incorrect and that the Court of Chancery's June 5, 2012 order of dismissal reflected the correct construction of New York law. Neither party was able to identify any decision by the New York Court of Appeals (or any lower New York court) that directly addresses, let alone disposes, of the questions of New York law this Court is being asked to decide.[11] Those questions are not controlled by precedent. Moreover, however those questions may be resolved, the answers will be determinative of the case before us. For those reasons, and because of the need for certainty in the law controlling the instruments that govern publicly traded bonds, this Court unanimously determined that the New York Court of Appeals should have the opportunity to decide those questions in the first instance.

II. *THE QUESTIONS OF NEW YORK LAW, NOT CONTROLLED BY PRECEDENT, THAT MAY BE DETERMINATIVE*

*5 A resolution of the appeal before us depends upon the answer to two questions of New York law that are not controlled by precedent. This Court certifies the following questions to the New York Court of Appeals:

> (1) A trust indenture no-action clause expressly precludes a security holder who fails to comply with that clause's preconditions, from initiating any action or proceeding upon or under or with respect to "this Indenture," but makes no reference to actions or proceedings pertaining to "the Securities."
>
> The question is whether, under New York law, the absence of any reference in the no-action clause to "the Securities" precludes enforcement only of contractual claims arising under the Indenture, or whether the clause also precludes enforcement of all common law and statutory claims that security holders as a group may have.

(2) In its Report on Remand (Exhibit C), the Court of Chancery found that the Athilon no-action clause, which refers only to "this Indenture," precludes enforcement only of contractual claims arising under the Indenture. The question is whether that finding is a correct application of New York law to the Athilon no-action clause.

III. *WHY THESE ISSUES SHOULD BE ADDRESSED BY THE COURT OF APPEALS AT THIS TIME*

In our national securities markets, the law governing many (if not most) publicly traded debt securities is a creature of New York law. Important rights and requirements pertaining to those securities are expressed in indentures that are, and for over a century have been, governed by New York law. As a consequence, New York has a very strong interest in assuring that those markets function properly. An important requirement for properly functioning public debt security markets is that the rights pertaining to those securities be certain and predictable to both investors and issuers. The New York Court of Appeals is the most authoritative tribunal empowered to adjudicate definitively the rights and requirements contained in indentures governed by New York law. For that reason, and because New York has the stronger interest in this issue, in contrast to that of Delaware, it is appropriate that the Court of Appeals be afforded the opportunity to adjudicate the certified issues in the first instance.

Moreover, the certified questions, which test the boundaries of a no-action clause's coverage, are most frequently raised in actions asserting non-contractual claims that arise under the law of the issuer's state of organization. As a consequence, those questions are often decided by non-New York courts—as evidenced by the Delaware cases interpreting the no-action clauses contained in New York bond contracts. Because the certified questions have not been raised directly before New York courts (as the dearth of case law suggests)—but are raised frequently before courts in sister states—it is particularly important that the New York Court of Appeals give guidance to those latter courts by addressing these questions on certification at this time.

3

***6** We direct the Clerk of this Court to send this opinion to the Clerk of the New York Court of Appeals, as our certificate, together with the parties' briefs and appendices. We will take no further action in this appeal until after the New York Court of Appeals acts on this certification request.

EXHIBIT A

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS COMPANY, LTD., Individually and Derivatively on Behalf of Althilon Capital Corp., Plaintiff,

v.

VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALES, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENTS ADVISORS LLC, and EBF & ASSOCIATES, LP, Defendants.

C.A. No. 6990–VCL

ORDER GRANTING MOTION TO DISMISS

WHEREAS the defendants have moved dismiss the complaint, the Court has reviewed the motions and related briefing and authorities, and oral argument is unnecessary in light of this Court's precedents,

IT IS HEREBY ORDERED this 5th day of June, 2012, that

1. The complaint is DISMISSED in Light of the plaintiff's failure to comply with the no-action clauses in the indentures governing the debt instruments that the plaintiff holds. *See Lange v. Citibank, N.A.,* 2002 WL 2005728, 2002 Del. Ch. Lexis 101 (Aug. 13, 2002); *Feldbaum v. McCrory Corp.,* 1992 WL 119095, 1992 Del. Ch. Lexis 113 (June 1, 1992) (Allen, C.). The decisions in *Lange* and *Feldbaum* are directly on point.

2. The Court has not reached any of the other grounds asserted for dismissal.

/s/ Vice Chancellor Laster
Vice Chancellor Laster

EXHIBIT B

IN THE SUPREME COURT OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS CO., LTD., Individually and Derivatively on behalf of Athilon Capital Corp., Plaintiff Below, Appellant,

v.

VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, EBF & ASSOCIATES, LP, Defendants Below, Appellees.

No. 338, 2012

Court Below: Court of Chancery of the State of Delaware

C.A. No. 6990 VCL

Submitted: Feb. 5, 2013

Decided: Feb. 12, 2013

Before **STEELE,** Chief Justice, **HOLLAND, BERGER, JACOBS** and **RIDGELY,** Justices, constituting the *Court en Banc.*

ORDER

This 12th day of February 2013, upon consideration of the briefs of the parties, and their contentions in oral argument, it appears to the Court that:

1. Quadrant Structured Products Co., Ltd., the plaintiff-below ("Quadrant"), appeals from a Court of Chancery order granting a motion to dismiss by the defendants, who are Athilon Capital Corp. ("Athilon"), Athilon's officers and directors, EBF & Associates, LP ("EBF"), and Athilon Structured Investment Advisors LLC ("ASIA") (collectively, "defendants"). We conclude that the current record is insufficient for appellate review. Accordingly, the case must be remanded to the Court of Chancery to issue an opinion stating its reasons for concluding that Quadrant's claims are barred by the no-action clause in the indenture governing the Athilon securities that Quadrant holds.

*7 2. In October 2011, Quadrant, a holder of Athilon debt securities, brought this action asserting claims against Athilon and its officers and directors, and against EBF (a partnership that indirectly controls Athilon) and ASIA (an EBF affiliate that manages Athilon on a day-to-day basis). On June 5, 2012, based solely on the parties' briefs, the Court of Chancery granted the defendants' motion to dismiss Quadrant's Amended Complaint.[1]

3. The order dismissing the Amended Complaint consists of two short paragraphs which conclude that dismissal was warranted "in light of the plaintiff's failure to comply with the no-action clauses in the indentures governing the debt instruments that the plaintiff holds."[2] The order cited, as "directly on point,"[3] two Court of Chancery opinions decided under New York law, *Lange v. Citibank, N.A.*[4] and *Feldbaum v. McCrory Corp.*[5] No reasons were stated to support the conclusion that those cases were directly on point. This appeal followed.

4. This Court reviews *de novo* a trial court's grant of a motion to dismiss.[6] On appeal, Quadrant claims that *Lange* and *Feldbaum* are not controlling, because the no-action indenture clause in those cases were critically different from the no-action clause in the Athilon indenture at issue here ("Athilon Indenture"). Therefore, Quadrant argues, by concluding that the Athilon no-action clause barred this lawsuit, the Court of Chancery erred as a matter of law.

5. In *Feldbaum,* the Court of Chancery, applying New York law, held that a no-action clause in an indenture constituted a waiver by the bondholder-plaintiffs of their right to prosecute an action against the debtor-defendants without first satisfying the conditions prescribed by the no-action clause.[7] The *Feldbaum* indenture provided that "[a] Securityholder may not pursue any remedy with respect to this Indenture *or the Securities* " unless certain conditions were first satisfied.[8] Because the bondholder-plaintiffs had not complied with those conditions, the court dismissed the claims covered by the indenture's no-action clause.[9]

6. In *Lange,* the Court of Chancery granted the defendants' motion for judgment on the pleadings, similarly because the plaintiffs, a group of debenture holders, had failed to comply with a no-action clause in the applicable indenture, which also was governed by New York law.[10] The no-action clause, which contained language identical to that in *Feldbaum,* provided that "[a] Securityholder may not pursue a remedy with respect to this Indenture *or the Securities* " unless the debenture holder first satisfied certain conditions.[11]

7. In this case, the Athilon Indenture, which is also governed by New York law, is worded differently from the indentures at issue in *Lange* and *Feldbaum.* The Athilon Indenture provides that "[n]o holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise *upon or under or with respect to this Indenture,* " unless certain conditions are first satisfied.[12] Unlike the no-action clauses in *Lange* and *Feldbaum,* the no-action clause in the Athilon Indenture does not contain the phrase "or the Securities."[13] The absence of that phrase, Quadrant argues, critically distinguishes *Lange* and *Feldbaum* and renders them noncontrolling. That argument presents a litigable issue that merits analysis by the Court of Chancery in the first instance.

***8** 8. The Court of Chancery order of dismissal did not address the differences between the respective no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture. Presumably the court found those differences to be not legally significant, but the order does not explain why. Nor does the order cite to, or discuss, applicable New York case law that would support the court's implicit view that the New York courts would find those differences legally insignificant.[14] For these reasons, and at this juncture, the record does not adequately lend itself to informed appellate review.

9. Accordingly, we remand this action to the Court of Chancery to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture. The analysis should include a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here.

NOW, THEREFORE, IT IS ORDERED that the judgment of the Court of Chancery is **REMANDED** for further proceedings in accordance with this Order. Jurisdiction is retained.

BY THE COURT:

/s/ Jack B. Jacobs
Justice

EXHIBIT C

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS COMPANY, LTD., Individually and Derivatively on Behalf of Athilon Capital Corp., Plaintiff,

v.

VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT, J. ERIC WAGONER, ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, and EBF & ASSOCIATES, LP, Defendants.

C.A. No. 6990–VCL

REPORT PURSUANT TO DELAWARE SUPREME COURT RULE 19(c)

Date Submitted: March 22, 2013

Date Decided: June 20, 2013

Lisa A. Schmidt, Catherine G. Dearlove, Russell C. Silberglied, Cory D. Kandestin, Robert L. Burns, Susan M. Hannigan, RICHARDS, LAYTON & FINGER, P.A., Wilmington, Delaware; Harold S. Horwich, P. Sabin Willett, Samuel R. Rowley, BINGHAM McCUTCHEN LLP, Boston, Massachusetts; *Attorneys for Plaintiff Quadrant Structured Products Company, Ltd.*

Philip A. Rovner, Jonathan A. Choa, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Philippe Z. Selendy, Nicholas F. Joseph, Sean P. Baldwin, QUINN EMANUEL URQUHART & SULLIVAN, LLP; New York, New York; *Attorneys for Defendants Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner, Athilon Capital Corp., and Athilon Structured Investment Advisors LLC.*

Collins J. Seitz, Jr., Garrett B. Moritz, Eric D. Selden, SEITZ ROSS ARONSTAM & MORITZ LLP, Wilmington, Delaware; *Attorneys for Defendant EBF & Associates, LP.*

LASTER, Vice Chancellor.
Plaintiff Quadrant Structured Products Company, Ltd. ("Quadrant") owns notes issued by defendant Athilon Capital Corp. ("Athilon"). Before filing this lawsuit,

Quadrant did not comply with the no-action clauses in the indentures governing its notes. The defendants moved to dismiss on that basis, and Quadrant responded with arguments that this Court rejected in *Feldbaum v. McCrory Corp.,* 1992 WL 119095 (Del.Ch. June 1, 1992), and *Lange v. Citibank, N.A.,* 2002 WL 2005728 (Del.Ch. Aug.13, 2002). At the time, Quadrant did not distinguish the language of the Athilon no-action clause from the clause at issue in *Feldbaum* and *Lange.* I granted the motion, observing that *Feldbaum* and *Lange* were "directly on point."

***9** On appeal, Quadrant argued that the Athilon clause differs critically from the *Feldbaum/Lange* clause because the former refers only to claims under the indenture, but the latter referred to both the indenture and the notes. By order dated February 12, 2013, the Delaware Supreme Court directed me "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses."

For the reasons set forth herein, Quadrant has persuaded me that the language of the Athilon no-action clause distinguishes this case from *Feldbaum* and *Lange.* Had Quadrant previously made this argument, I would have relied on the no-action clause to dismiss only Counts VII–VIII and part of Count X, and then reached the defendants' other grounds for dismissing the remaining counts.

I. FACTUAL BACKGROUND

The facts are drawn from Quadrant's verified amended complaint (the "Complaint" or "CC") and the documents it incorporates by reference, including (i) an indenture dated as of December 21, 2004, between Athilon and Deutsche Bank Trust Company Americas, as Trustee, governing the Subordinated Deferrable Interest Notes, Series A and B, and (ii) an indenture dated as of July 26, 2005, between Athilon and The Bank of New York, as Trustee, governing the Senior Subordinated Deferrable Interest Notes, Series A, B, C and D. For present purposes, the indentures are substantively identical, so I refer to them singly as the "Indenture." Quotations are from the 2004 indenture.

A. Athilon's Corporate Structure And Business Model

Athilon is a Delaware corporation with its principal place of business in New York, New York. Athilon and its wholly owned subsidiary, Athilon Asset Acceptance Corp. (jointly, the "Companies"), were formed in 2004 to sell credit default swaps to financial institutions. Through its subsidiary, Athilon wrote credit default swaps covering senior tranches of collateralized debt obligations. At the parent level, Athilon guaranteed the swaps.

Athilon was financed originally with $100 million of equity capital. It raised another $600 million of debt capital, comprising $350 million in senior subordinated notes, $200 million in subordinated notes, and $50 million in junior notes (collectively, the "Notes"). The Notes are long-term obligations that will mature, depending upon the series, in 2035, 2045, or 2047. Interest payments on the Notes are deferrable for up to five years at Athilon's option. All of the Notes rank in priority below Athilon's credit default swap obligations.

The Companies' organizational documents limit their permissible lines of business to selling credit default swaps and require compliance with strict operating guidelines. The Companies only can invest in high quality securities of short duration, and their portfolios must be sufficient at all times to cover any credit default swaps and the Notes. The guidelines mandate that if a "Suspension Event" occurs and remains uncured, then the Companies must enter "runoff" mode. When in that status, the Companies cannot write new business and must pay off existing credit default swaps as they mature.

B. The Business Model Fails.

***10** Before the financial crisis of 2008, market participants discounted the risks faced by credit derivative product companies, enabling Athilon to underwrite over $50 billion in nominal credit default risk. Measured against its $700 million in committed capital, Athilon operated with a vertiginous leverage ratio of 71:1. Measured against Athilon's equity, Athilon's leverage ratio was a stratospheric 506:1. At that level, a 0.2% loss on the collateralized debt obligations covered by Athilon's credit default swaps would wipe out its equity cushion and render Athilon insolvent, at least on paper. The rating agencies gave the Companies "AAA/Aaa" debt ratings and investment grade counterparty credit ratings.

In 2008, the Companies found themselves in distress, and they lost their AAA/Aaa ratings at the end of that year. By early 2009, the Companies had sustained several Suspension Events. In 2010, Athilon unwound two credit default swaps at a cost of $370 million, more than three times its equity capital. By August, the Companies no longer held any investment grade debt or counterparty credit ratings. Under the operating guidelines, the Companies entered permanent runoff mode.

C. The EBF Takeover

With Athilon in distress, the trading prices of its debt securities fell precipitously. EBF & Associates, LP ("EBF") seized the opportunity to purchase a large position in the riskiest tranche of Notes (the "Junior Notes") at a significant discount. In August 2010, EBF acquired 100% of Athilon's equity. EBF installed the current board of directors, which the Complaint alleges is dominated and controlled by EBF. In May 2011, nine months after EBF took control, Quadrant acquired its position in the Notes.

Quadrant alleges that Athilon is insolvent. Excluding its outstanding credit default swaps, Athilon continues to carry $600 million of debt, but its assets allegedly have a fair market value of only $426 million. As of September 30, 2011, Athilon's shareholder's equity, measured according to GAAP, stood at negative $660 million. The Complaint alleges that Athilon has no prospect of returning to solvency because it can only sell credit default swaps, and the market for that business has collapsed.

Quadrant argues that under the circumstances, a properly motivated board of directors would preserve Athilon's value for orderly liquidation in 2014, when the last credit default swap expires. The EBF designees on the Athilon board, by contrast, are pursuing strategies designed to benefit EBF and its affiliates. They have caused Athilon to continue paying interest on the Junior Notes, notwithstanding the right to defer those payments and the fact that the Junior Notes would receive nothing in an orderly liquidation. They also agreed to pay Athilon Structured Investment Advisors LLC ("ASIA"), an EBF affiliate, above-market service fees to manage Athilon's day-to-day operations. Together, the EBF designees and ASIA have embarked on a high-risk investment strategy, contrary to the terms of Athilon's governing documents, that amounts to a "heads EBF wins, tails everyone else loses" bet. If the high-risk investments succeed, then the underwater Junior Notes and equity will benefit. If the investments fail, then the more senior tranches of Notes will bear the loss.

D. The Quadrant Complaint

***11** In October 2011, Quadrant filed suit against Athilon, its officers and directors, EBF, and ASIA. As amended, the Complaint contained ten counts:

• Count I asserted a derivative claim on behalf of Athilon against the individual defendants for breaching their fiduciary duties by (i) continuing to pay interest on the Junior Notes; (ii) paying above-market service and license fees to EBF; (iii) departing from an appropriately conservative capital investment strategy; and (iv) causing Athilon to violate its organizational documents and operating guidelines.

• Count II asserted a derivative claim against EBF for aiding and abetting the breaches of fiduciary duty alleged in Count I.

• Count III sought a permanent injunction barring the individual defendants from causing Athilon to pay the interest and fees identified in Count I.

• Counts IV and V challenged the payment of interest and fees under the Delaware Fraudulent Transfer Act ("DFTA").

• Count VI sought a permanent injunction under the DFTA against the continuing payment of interest and fees.

• Count VII contended that by taking the actions detailed in Count I and elsewhere in the complaint, Athilon breached the implied covenant of good faith and fair dealing that inheres in the Indenture.

• Count VIII asserted that EBF had tortiously interfered with Athilon's obligations under the Indenture.

• Count IX asserted that Athilon paid constructive dividends in violation of Delaware law and sought to recover those payments from the individual defendants.

• Count X asserted a claim for civil conspiracy against EBF and ASIA for actions taken in concert with the individual defendants.

Quadrant brought Counts I–III derivatively in its capacity as a creditor of an insolvent corporation. Quadrant brought Counts IV–VIII directly in its capacity as a creditor. Quadrant brought Counts IX and X both directly and derivatively. In Counts I–VI and IX, Quadrant relied solely on its status as a holder of the Notes. In Counts VII and VIII, Quadrant relied on the Indenture. In seeking to impose secondary liability under Count X, Quadrant relied on the Notes and the Indenture to the same degree as the related primary counts.

The defendants moved to dismiss the Complaint on a variety of substantive and procedural grounds. In their lead argument, the defendants invoked the no-action clause in the Indenture, which states:

> *Limitations on Suits by Securityholder.* No holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless such holder previously shall have given to the Trustee written notice of default in respect of the series of Securities held by such Securityholder and of the continuance thereof, as hereinbefore provided, and unless also the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding shall have made written request upon the Trustee to institute such action or proceedings in its own name as trustee hereunder and shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby and the Trustee for 60 days after its receipt of such notice, request and offer of indemnity shall have failed to institute any such action or proceedings and no direction inconsistent with such written request shall have been given to the Trustee pursuant to Section 7.08 hereof within such 60 days....

***12** Dkt. 32 Ex. A. § 7.06 at 51–52 (the "Athilon Clause"). Quadrant admittedly did not comply with the Athilon Clause before filing suit. Relying on *Feldbaum, Lange,* and their progeny, the defendants pointed out that no-action clauses have resulted in pleadings-stage dismissals of precisely the types of claims that Quadrant asserted.

To avoid the Athilon Clause, Quadrant argued that it governs "only those suits that arise from a default" and not other types of claims. Ans. Br. at 10. Quadrant also argued that to enforce the Athilon Clause "would operate to ban (not merely channel through a particular plaintiff) a range of personal noteholder claims that spring from the law of fiduciary duties, fraudulent transfer, securities, and other sources of law, none of which requires a note default as a prerequisite to suit," thereby converting the Athilon Clause into a covert release of claims and leaving noteholders without a remedy. *Id.* at 13. Quadrant likewise contended that the Athilon Clause applied only to suits *against* the issuer and not to derivative actions brought by creditors on the issuer's behalf. *Id.* at 15. In its only response to *Feldbaum,* Quadrant asserted that under that decision, a no-action clause would bar a noteholder suit only "so long as 'the trustee is capable of satisfying its obligations.' " *Id.* at 10 (quoting *Feldbaum,* 1992 WL 119095, at *6). According to Quadrant, the trustee could not fulfill its obligations because the trustee only could sue following an "Event of Default," and no "Event of Default" had yet occurred. *Id.* at 10–11. Quadrant did not contend that the language of the Athilon Clause differed meaningfully from the language of the clause at issue in *Feldbaum* and *Lange.*

After reviewing the briefing and the authorities cited by the parties, I concluded that *Feldbaum* and *Lange* addressed the points Quadrant had raised. By order dated June 5, 2012, I dismissed the action with prejudice, observing that *Feldbaum* and *Lange* were "directly on point." Dkt. 60 (the "Dismissal Order").

E. The Appeal

Quadrant appealed. Before the Delaware Supreme Court, Quadrant reiterated the arguments rejected in *Feldbaum* and *Lange,* noting that both were Court of Chancery decisions and that the issues presented questions of first impression for the high court. *See* Appellant's Op. Br. at 1. Quadrant also argued for the first time that *Feldbaum* and *Lange* "construed substantially different contracts" and that the Athilon Clause applied "only to claims that arise from the governing indenture itself." *Id.* at 2. In support of this new contention, Quadrant observed that the *Feldbaum/Lange* clause "applied not only to rights under its indenture, but also to 'any remedy with respect to ... the Securities.' " *Id.* at 16–17 (quoting *Feldbaum,* 1992 WL 119095, at *5–6; citing *Lange,* 2002 WL 2005728, at *5). Quadrant also relied on *Victor v. Riklis,* 1992 WL 122911 (S.D.N.Y. May 15, 1992), as giving dispositive meaning to the absence of the phrase "or the Securities." Appellant's Op. Br. at 19–20. Quadrant had not cited *Victor* before this Court.

***13** By order dated February 12, 2013, the Delaware Supreme Court determined that "the current record is insufficient for appellate review." *Quadrant Structured Prods. Co. v. Vertin,* No. 388, 2012, ¶ 1 (Del. Feb. 12, 2013) (the "Remand Order"). The Delaware Supreme Court explained that "[o]n appeal, Quadrant claims that *Lange* and *Feldbaum* are not controlling, because the no-action indenture clause in those cases were [sic] critically different from the no-action clause in the Athilon indenture at issue here." *Id.* ¶ 4. The high court observed that the no-action clauses in both *Lange* and *Feldbaum* provided that "[a] Securityholder may not pursue a remedy with respect to this Indenture *or the Securities* " without satisfying the conditions set forth in the clause. *Id.* ¶ 5 (quoting *Feldbaum,* 1992 WL 119095, at *5 (emphasis in original)), ¶ 6 (quoting *Lange,* 2002 WL 2005728, at *5 (emphasis in original)). The Delaware

Supreme Court observed that the Athilon Clause "is worded differently from the indentures at issue in *Lange* and *Feldbaum* " and that "[u]nlike the no-action clauses in *Lange* and *Feldbaum,* the no-action clause in the Athilon Indenture does not contain the phrase 'or the Securities.' " *Id.* ¶ 7. The Delaware Supreme Court remanded the case to this Court with instructions "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon indentures." *Id.* ¶ 9. The Remand Order stressed that "[t]he analysis should include a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here." *Id.* The Remand Order did not instruct this Court to address any of the other arguments raised by Quadrant on appeal. Pursuant to Supreme Court Rule 19(c), the Delaware Supreme Court retained jurisdiction to consider the implications of this Court's report.

II. LEGAL ANALYSIS

In accordance with the Remand Order, this opinion first considers the plain language of the Athilon Clause and the *Feldbaum/Lange* clause. It then reviews (i) authorities that have construed no-action clauses under New York law, (ii) other instructive Delaware precedents, and (iii) authoritative commentary. Because the linguistic distinction that Quadrant raised on appeal appears to have analytical heft, the opinion concludes by applying the language of the Athilon Clause to the ten counts in the Complaint.

A. The Plain Language Of The Clauses

"[U]nder New York law interpretation of indenture provisions is a matter of basic contract law." *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C.,* 2004 WL 1699057, at *2 (Del.Ch. July 29, 2004) (internal quotation marks omitted). "The best evidence of what parties to a written agreement intend is what they say in their writing. Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Greenfield v. Philles Records, Inc.,* 98 N.Y.2d 562, 750 N.Y.S.2d 565, 780 N.E.2d 166, 170 (2002) (citation and internal quotation marks omitted).

***14** For purposes of plain language analysis, the Athilon Clause can be parsed as follows:

> No holder of any Security
>
> 1.0 shall have any right by virtue or by availing of any provision of this Indenture
>
> 2.0. to institute any action or proceeding at law or in equity or in bankruptcy or otherwise
>
> 3.0 upon or under or with respect to this Indenture, or
>
> 4.0 for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder,
>
> unless [the holder complies with specified conditions].

See Dkt. 32 Ex. A. § 7.06 at 51–52. The *Feldbaum/Lange* clause used different language: "A Securityholder may not pursue any remedy with respect to this Indenture or the Securities unless [the Securityholder complies with specified conditions]." *Feldbaum,* 1992 WL 119095, at *5; *accord Lange,* 2002 WL 2005728, at *5 ("A Securityholder may not pursue a remedy with respect to this Indenture or the Securities unless [the Securityholder complies with specified conditions]."). The operative question posed by the Remand Order is whether subparts 1.0 through 4.0 of the Athilon Clause give it a different scope than the simpler language of the *Feldbaum/Lange* clause.

Subpart 1.0 of the Athilon Clause defines the sources of rights governed by the clause. Under this subpart, no "holder of any Security shall have any right by virtue or by availing of any provision of this Indenture." As a matter of plain language, the Athilon Clause does not speak to other rights that the holder of a Security may have, such as rights under or by virtue of the Security itself. It likewise does not address rights that might exist under the common law, state statutes, or federal statutory schemes like civil RICO or the federal securities laws. The *Feldbaum/Lange* clause does not contain language resembling subpart 1.0 and is not limited to any subset of potential rights. It applies to any right that any Securityholder might have, regardless of its source, to the extent the Securityholder invokes it to "pursue any remedy with respect to this Indenture or the Securities." In this respect, the Athilon Clause is narrower than the *Feldbaum/Lange* clause.

Subpart 2.0 of the Athilon Clause identifies the types of actions or proceedings that would fall within the clause if the "holder of any Security" asserted a right "by virtue or by availing of any provision of this Indenture." This aspect of the Athilon Clause encompasses "any action or proceeding at law or in equity or in bankruptcy or otherwise" that falls within the scope of the clause. The *Feldbaum/Lange* clause does not contain language resembling subpart 2.0. Just as the *Feldbaum/Lange* clause is not limited to any subset of potential rights, it is not limited to any particular type of action or proceeding. It rather applies to any action or proceeding that any Securityholder might bring to the extent the Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Along this dimension, given the broad language of the Athilon Clause, the two provisions appear equivalent.

***15** Subparts 3.0 and 4.0 of the Athilon Clause impose additional limitations on its scope. As noted, under subparts 1.0 and 2.0, the Athilon Clause extends to any "action or proceeding" in which the plaintiff asserts a "right by virtue or by availing of any provision of this Indenture." Under subparts 3.0 and 4.0, the "action or proceeding" also must be one in which the plaintiff (i) sues "upon or with respect to this Indenture" (3.0) or (ii) seeks as a remedy "the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder" (4.0). As a matter of plain language, the Athilon Clause only applies to actions or proceedings involving certain types of claims (those "upon or under or with respect to this Indenture") or those seeking certain types of remedies ("the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder"). The plain language of the term "hereunder" refers to the Indenture, which appears in both the immediately preceding subpart (3.0) and in the first subpart (1.0). The *Feldbaum/Lange* clause does not contain any language limiting the types of claims a Securityholder might bring, nor does it call out specific remedies. Rather, it applies broadly to any action or proceeding to the extent that a Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Here too, the Athilon Clause is narrower than the *Feldbaum/Lange* clause.

As a matter of plain language, the differences between the Athilon Clause and the *Feldbaum/Lange* clause appear significant. The Athilon Clause applies only when the holder of a Security asserts "any right by virtue or by availing of any provision of this Indenture" and only to an "action or proceeding" in which the holder sues "upon or under or with respect to this Indenture," seeks a particular remedy available under the Indenture, or otherwise seeks "appointment of a trustee, receiver, liquidator, custodian or other similar official." The *Feldbaum/Lange* clause applies broadly to any action or proceeding that any Securityholder might bring to the extent that the Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Under the *Feldbaum/Lange* clause, it does not matter what source of rights the Securityholder invokes or the nature of the claim that the Securityholder asserts.

B. Cases Addressing Athilon Clauses Under New York Law

The Remand Order calls for "a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here." Remand Order ¶ 9. New York courts have been interpreting no-action clauses for over one hundred years.[1] Under New York law, no-action clauses are "strictly construed."[2] New York decisions indicate that the specific language of the no-action clause matters and that a no-action clause will not encompass causes of action, theories, or remedies that do not fall within its terms.

***16** Before the adoption of the Trust Indenture Act of 1939 (the "TIA"), New York courts frequently considered whether a no-action clause in an indenture could restrict a bondholder from seeking to recover on the bond for past due payments of principal and interest.[3] New York courts consistently held that absent contractual language to the contrary, the holder of a debt instrument enjoyed creditors' rights derived from the debt instrument (whether labeled "bonds," "notes," or "debentures") distinct from the trustee's rights against the underlying collateral derived from the security instrument (whether labeled an "indenture," "mortgage," or "deed of trust"). As in the current case, the no-action clause almost invariably appeared in the security instrument and not in the debt instrument.

Anyone who has purchased a home using traditional bank financing will recognize the distinction between a debt instrument and the security instrument: the borrower signs a debt instrument in the form of a promissory note reflecting the debt, and the borrower separately executes a mortgage that secures the debt by creating a lien against the home. *See* 1 *Mortgages and Mortgage Foreclosure in N.Y.* § 4:8 (2012) ("[A] corporation bond is a promise to pay, exactly as is the mortgage bond signed by the individual homeowner; the mortgage securing it is a securing lien on designated property in exactly the manner of the mortgaged homestead."). If the borrower defaults, the bank can proceed *in rem* by foreclosing on the mortgage, sue the borrower *in personam* on the promissory note, or both. *See, e.g., Manley v. MAS Assocs., LLC,* 968 A.2d 492 (Del.2009) (TABLE) (dual *in personam* and *in rem* proceeding); *Wells Fargo Bank, N.A. v. Williford,* 2011 WL 5822630, at *3 (Del.Super.

Nov. 17, 2011) (*in rem* proceeding); Louis S. Posner, *The Trustee and the Trust Indenture: A Further Study,* 46 Yale L.J. 737, 768 (1937) ("[B]onds and mortgages, though evidencing but one debt, nevertheless constitute two distinct promises giving rise to two separate causes of action, [such that] the trustee, whose legal relations are held confined to the mortgage, has no enforceable rights at law on the indebtedness").

Nineteenth century lawyers used the traditional real estate mortgage as a model when their corporate clients needed to raise long-term debt to fund major infrastructure projects like canals and railroads. *See Commentaries, supra* note 3 at 4. "The adaptation of the traditional real estate mortgage to this purpose was a work of marvelous ingenuity and a development of the greatest significance in the economic growth of the United States." *Id.* at 5. A further practical problem for publicly traded debt was the need to

> afford bondholders the benefits of a mortgage lien on the assets and yet provide in an orderly fashion for a multiplicity of bondholders holding ... securities, subject to change of ownership through trading in the bonds. The answer was found in the conveyance of the real estate and other mortgageable assets of the corporation to a trustee for the benefit of all bondholders.

***17** *Id.; see* 1 Ralph A. McClelland & Frederick S. Fisher, Jr., *The Law of Corporate Mortgage Bond Issues In Conjunction With A Typical Indenture Of Mortgage And Deed Of Trust Securing Bonds* 2 (1937) [hereinafter *Bond Issues*] ("The use of trustees to take and hold the mortgaged property as security for the benefit of the bondholders affords a device for unified action which otherwise would be impossible, especially since the holders of the bonds are numerous and of changing identity."). Over time, a true corporate mortgage that recorded a lien on real property "was found to be awkward if not impossible for many types of corporate borrowers," and it was "dispensable in many cases if adequate contractual protections were included in the debt instrument or the related indenture." *Commentaries, supra* note 3 at 6. "The solution was to take the corporate mortgage indenture form, delete the conveyancing and other provisions relating to the collateral, and insert covenants designed to protect the debentureholders.... Other provisions of an administrative nature remained much the same in a debenture instrument as those in a mortgage indenture." *Id.* at 7. The result was the now-familiar bond/indenture structure at issue in this case.

Because of the distinction between debt instruments and security instruments, New York courts held that if the bond did not contain language making it subject to the indenture or sufficiently incorporating the terms of the indenture by reference, then the creditor could sue freely on the bond.[4] More importantly for present purposes, New York courts held that even if the language of the bond sufficiently referenced the terms of the indenture, a no-action clause in the indenture that only referred to the indenture would not limit a creditor from suing on the bond.[5]

For example, in *General Investment Co. v. Interborough Rapid Transit Co.,* 200 A.D. 794, 193 N.Y.S. 903 (1922), *aff'd,* 235 N.Y. 133, 139 N.E. 216 (1923), the plaintiff sought to recover on five promissory notes. Each of the notes referred to an indenture for the holder's rights. The issuer invoked the no-action clause in the indenture, which stated: "No holder of any note hereby secured shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of this indenture, or for the execution of any trust hereof, or for the appointment of a receiver, or for any other remedy hereunder...." *Id.* at 905. The court held that the no-action clause

> merely denied the holders of the notes "any right to institute any suit, action or proceeding in equity or at law for *the enforcement of this indenture.*" ... But the action at bar is not to affect, disturb, or prejudice the lien of the collateral indenture or to enforce any right thereunder. The action is solely for the purpose of recovering on defendant's primary obligation to pay said moneys, with interest.... The remedies are entirely separate and distinct.... [T]he present action is not barred by the clause in question, as the action is not to enforce the indenture or any rights thereunder, or to secure any remedy or relief therein provided.... Said clause relates solely to the enforcement of the collateral security for the payment of said notes, and in no manner affects the action upon the notes themselves.

***18** *Id.* at 909 (emphasis in original) (citation omitted). By contrast, if the note sufficiently referenced the terms of the indenture *and* the no-action clause encompassed the rights of holders under the bonds, then the no-action clause applied to a suit on the bonds.[6] Courts applying New York law adhere to these rules today.[7]

Since the adoption of the Trust Indenture Act, it has rarely been necessary for holders of a covered issue to litigate whether they could assert a direct right to recover past due payments of principal or interest notwithstanding the language of a no-action clause. Bondholders instead have attempted to assert other types of direct claims. A series of illustrative decisions have construed no-action clauses in indentures governed by New York law to determine whether the bondholder claims could proceed.

The first major decision was *Cruden,* where holders of debentures sought to assert fraud and civil RICO claims. The no-action clauses in the governing indenture provided that unless its procedural requirements were followed, the holders did not have

> any right by virtue or by availing of any provision of this Indenture to institute any action or proceedings at law or in equity or in bankruptcy or otherwise, upon or under or with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder....

Cruden II, 957 F.2d at 967 (emphasis omitted). The district court held that the no-action clause did *not* bar the fraud and RICO claims: "Plaintiffs' other claims are not made under the Indenture, such as the RICO and fraud claims. The Court finds that plaintiffs do have standing to bring suit on these claims as well, any restrictive provision of the Indentures being inapplicable to these claims." *Cruden v. Bank of N.Y.,* 1990 WL 131350, at *12 (S.D.N.Y. Sept. 4, 1990) ("*Cruden I* "), *aff'd in part, rev'd in part, Cruden II,* 957 F.2d 961 (2d Cir.1992). The district court then dismissed the fraud and RICO claims under statutes of limitations. *Id.* at *16, *18. On appeal, without commenting on the no-action clause analysis, the United States Court of Appeals for the Second Circuit reversed the limitations-based dismissal of the RICO claims and remanded the case for trial. *See* 957 F.2d at 974, 978. By directing the case to go forward, the Second Circuit indicated that it accepted the district court's interpretation of the no-action clause, which otherwise would have barred the claims.

The next significant decision was *Victor v. Riklis,* 1992 WL 122911 (S.D.N.Y. May 15, 1992), where debentureholders argued that *Cruden I* permitted them to bring fraud and RICO claims. The district court distinguished *Cruden I* because the no-action clauses in the two cases differed. The *Cruden I* clause only referred to the indenture, but the *Victor* clause added the phrase "or the Securities." The *Victor* court held that the difference was dispositive:

> ***19** Victor relies on the district court's decision in *Cruden,* which held that a debentureholder's RICO and fraud claims were not barred by a no-action provision. *Cruden* is distinguishable from this case, however, because that no-action clause was not as broad as the one contained in the E–II indentures....
>
> Accordingly, we find that the E–II indenture's reference to actions with respect to the securities as well as the indenture itself broadens the scope of the no-action clause to include Victor's RICO and fraud claims.

1992 WL 122911, at *6 n. 7 (citations omitted).

Perhaps the most influential decision for no-action clause jurisprudence was *Feldbaum,* in which Chancellor Allen applied New York law. Bondholders whose securities were governed by the same indentures considered in *Victor v. Riklis* contended that a restructuring (i) breached the implied covenant of good faith and fair dealing in the indentures, (ii) violated New York's prohibition against fraudulent transfers, and (iii) was the product of fraudulent misrepresentations. *See Feldbaum,* 1992 WL 119095, at *2–3. The defendants moved to dismiss, arguing that the no-action clause barred the claims. As Quadrant argued originally in this case, the *Feldbaum* plaintiffs asserted that the no-action clause applied only to claims for breach of express indenture provisions. Chancellor Allen disagreed:

> Given the purposes for which no-action clauses are designed, I cannot accept plaintiffs' position. No principled reason or factual particularity of this case is advanced that would justify this view. In my opinion, no matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for recovery of past due interest or [principal], is subject to the terms of a no-action clause of this type.

Id. at *6. Chancellor Allen later explained that the trustee would not be "capable of satisfying its obligations" if the suit alleged misconduct by the trustee. Absent such circumstances, "courts systematically conclude that, in consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all bondholders, and thus can be prosecuted by the trustee...." *Id.* at *7.

Turning to the claims before him, Chancellor Allen held that the no-action clause governed the plaintiffs' implied covenant claims and the fraudulent conveyance claims. The harms those claims sought to address affected all bondholders proportionately, so it was up to the trustee to prosecute the claims on behalf of all bondholders. *Id.* at *7–8. The Chancellor reached the same conclusion about the fraud claims to the extent the complaint alleged that the bondholders were deprived of an opportunity to seek injunctive relief against the restructuring. *Id.* at *9. Such an injunction would have been sought on behalf of and inured to the benefit of all bondholders, making it relief that only the trustee could seek. To the extent the complaint alleged fraud that deprived the bondholders of an opportunity to sell their bonds in the market, the Chancellor held that the no-action clause would not apply. In *Feldbaum,* however, the alleged fraud consisted of the defendants' failure to disclose that the restructuring violated the indentures. The fraud claim therefore constituted an effort "to transmute a contract claim litigable only by the indenture trustee into an individual fraud claim." *Id.* at *10. Chancellor Allen refused to credit this stratagem and dismissed the fraud claim as well. In substance, *Feldbaum* held that a no-action clause would apply to any remedy sought on behalf of all bondholders, but given the expansive language of the *Feldbaum* clause, that reading was entirely appropriate.

***20** In *Lange,* another decision by this Court interpreting New York law, Chancellor Strine, then-Vice Chancellor, relied on *Feldbaum* when confronted with an identical no-action clause. *Lange,* 2002 WL 2005728, at *5–6. The plaintiff debentureholders contested the leveraged buyout of an allegedly insolvent issuer, contending that the defendants breached their fiduciary duties, effected fraudulent transfers, and aided and abetted the primary violations. *Id.* at *5. Chancellor Strine held that the no-action clause barred the claims.

> Per *Feldbaum,* the particular nature of a claim that is asserted on behalf of the Debentureholders as a class is not determinative of the applicability of [the no-action clause]; what is determinative is whether the claim is one with respect to the Indenture or the Debentures themselves. Each of the claims pled in the amended complaint clearly satisfies that test, as the Debentureholders' ability to press those claims depends entirely on their ownership of the Debentures and the adverse effect that certain actions have allegedly had on each Debentureholder, *pro rata* to her ownership of those securities.

Id. at *7. Because each of the claims could be asserted by the trustee, the plaintiffs could not proceed without complying with the no-action clause.

Two more recent decisions followed *Feldbaum* and *Lange.* In the *Wherehouse Entertainment* litigation, the issuing corporation failed to redeem outstanding debentures at a premium after the occurrence of an event that the plaintiffs contended triggered the redemption obligation. The plaintiffs asserted claims for breach of contract, breach of the implied covenant of good faith and fair dealing, tortious interference with contract, and fraudulent conveyance. *See McMahan & Co. v. Wherehouse Entm't, Inc.,* 859 F.Supp. 743, 745–46 (S.D.N.Y.1994), *aff'd in part, rev'd in part,* 65 F.3d 1044 (2d Cir.1995). Like the *Feldbaum/Lange* clause, the *Wherehouse Entertainment* clause barred the debentureholders from seeking "any remedy with respect to [the] Indenture or the Securities" unless they first complied with its terms. *Id.* at 747. The court held that the state law claims sought a remedy with respect to the securities and dismissed the claims. *Id.* at 747–48.

Similarly in the *Akanthos* litigation, bondholders argued that certain transactions engaged in by the issuing corporation constituted illegal fraudulent transfers. *See Akanthos Capital Mgmt., LLC v. CompuCredit Hldgs. Corp.,* 677 F.3d 1286 (11th Cir.2012). Like the *Feldbaum/Lange* clause, the *Akanthos* clause stated that noteholders " 'may not pursue any remedy with respect to the Indenture or the Securities' " without first complying with the requirements of the clause. *Id.* at 1289. The United States Court of Appeals for the Eleventh Circuit held that the clause applied, finding it "clear that Plaintiffs' suit relates to the trust indentures or the securities." *Id.* at 1293. In reaching this conclusion, the court relied on and quoted extensively from *Feldbaum* and *Lange.*

***21** Consistent with the pre-TIA decisions, the foregoing authorities indicate that the effect of a no-action clause depends on its language. In *Cruden,* where the no-action clause paralleled the Athilon Clause and applied only to attempts to assert rights grounded in the indenture, the district court permitted the plaintiffs to assert claims arising from their status as noteholders, and the Court of Appeals implicitly agreed with this analysis. The other decisions all involved much broader no-action clauses like those in *Feldbaum* and *Lange,* and the courts consistently applied those expansive no-action clauses in accordance with their terms.

For their part, the defendants rely on two inapposite cases: *Walnut Place LLC v. Countrywide Home Loans, Inc.,* 96 A.D.3d 684, 948 N.Y.S.2d 580 (2012), and *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.,* No. 650474/2008, 2010 WL 9525799 (N.Y.Sup.Ct. Oct. 7, 2010). In both cases, the defendants issued certificates, analogous to notes, pursuant to pooling and service agreements ("PSAs"), analogous to an indenture. Holders of certificates alleged that the defendants breached representations and warranties in the PSAs. Both decisions held that the no-action clauses in the PSAs barred the claims. Neither decision addressed an attempt by certificate holders to invoke rights that did not depend on the PSAs. Both cases are comparable to an attempt by noteholders to assert a claim for breach of the indenture, which is a claim to which a no-action clause necessarily applies. *See* Foster, *supra* note 1, at n.3 ("Where the individual bondholder, in order to make out a cause of action, must rely upon some violation by the debtor of the terms of the trust indenture or like instrument securing the bond, then, rather plainly, the bondholder cannot maintain his action unless he has met such restrictive conditions as are imposed by the trust indenture in respect of actions by individual bondholders."). Subpart 3.0 of the Athilon Clause explicitly bars such a claim. Neither *Walnut Place* nor *Greenwich Financial* sheds light on the extent to which a New York court would apply the Athilon Clause to bar a claim that did not invoke a provision of the Indenture.

C. Other Instructive Delaware Precedents

In *Feldbaum* and *Lange,* this Court interpreted expansive no-action clauses that were governed New York law. In other decisions, the Delaware Supreme Court and this Court have commented on narrower clauses and suggested that bondholders could bring claims that fell outside of the language of the clause. Unfortunately, these decisions have not made clear whether the indentures in question were governed by New York law. I discuss them for three reasons. First, they represent the only extant indications of the Delaware Supreme Court's views; second, given the prevalence of New York law in this area, some of the indentures may have been governed by New York law despite the absence of any reference in the opinion; and third, this Court has observed that there are no pertinent distinctions between New York law and Delaware law in this area. *See Tang Capital P'rs, LP v. Norton,* 2012 WL 3072347, at *4 & n. 15 (Del.Ch. July 27, 2012) (interpreting no-action clause in indenture with New York choice of law provision; noting that "[n]either party has cited and I am not aware of any case law indicating that the principles of contract interpretation under New York law, so far as relevant to this case, differ materially from those under Delaware law"); *Elliott Assocs., L.P. v. Bio–Response, Inc.,* 1989 WL 55070, at *3 n. 1 (Del.Ch. May 23, 1989) (interpreting no-action clause in indenture with New York choice of law provision; remarking that "there has been no showing that the law of New York differs from that of Delaware with respect to any of the matters at issue here" and concluding that "it appears to be of no consequence which authorities are relied upon").

***22** This line of Delaware decisions begins with *Harff v. Kerkorian,* 324 A.2d 215 (Del.Ch.1974) (*"Harff I "*), *aff'd in part, rev'd in part,* 347 A.2d 133 (Del.1975) (*"Harff II "*). There, holders of debentures claimed that they had been harmed by the declaration of an allegedly improper dividend, and they sued both derivatively and directly for breach of fiduciary duty. Chancellor Quillen dismissed their derivative claims for lack of standing. *Id.* at 220. The defendants argued that to the extent the same claims could be framed as direct causes of action, they were barred by a no-action clause in the related indenture, which provided that "[n]o holder of any Debenture shall have any right by virtue of or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect this Indenture...." *Id.* at 221 n. 5. Although the opinion did not quote the entire clause, the foregoing portion resembles the Athilon Clause.

In ruling on the debentureholders' class claims, Chancellor Quillen noted that "[t]he authorities cited by plaintiffs for the proposition that creditors can maintain an action against management for violation of rights which exist independently of the Indenture Agreement all involved either fraud or insolvency." *Id.* at 221. The Chancellor observed that the plaintiffs had not alleged that the corporation was insolvent, asserted any violation of a Delaware statute, or pled that the dividend amounted to fraud. *Id.* He concluded that "no fiduciary duties existed as between the parties and that the rights of the convertible debenture holders ... are confined to the terms of the Indenture Agreement." *Id.* at 222. In light of this holding, the Chancellor held that "[t]he effect of the 'no-action clause' ... need not be determined." *Id.*

On appeal, the Delaware Supreme Court affirmed the dismissal of the derivative claim, but reversed the dismissal of the direct claims. *Harff II,* 347 A.2d at 134. The Delaware Supreme Court held that the plaintiffs had pled adequately that the dividend amounted to fraud. *Id.* The Delaware Supreme Court accepted the plaintiffs' contention that "this 'tort claim is wholly unrelated to and unaffected by any contract rights that the plaintiffs may have under the Indenture Agreement.' " *Id.* The high court held that that "judgment in favor of the defendants in the class action is reversed and the cause remanded for trial of the issue of fraud." *Id.* As in *Cruden II,* the appellate decision did not comment on the no-action clause analysis.

Harff II implies that the Delaware Supreme Court believed a no-action clause with the same scope as the Athilon Clause would not bar the noteholders' individual claims for damages under a theory of fraud. In *Continental Illinois,* Justice Jacobs, then a Vice Chancellor, read *Harff II* in this fashion: "By recognizing that the debenture holders were entitled to proceed on a claim of fraud independent of the terms and limitations of the Indenture, the Supreme Court in *Harff* implicitly ruled that the no-action clause of the indenture would not bar an action for fraud." *Cont'l Ill. Nat'l Bank & Trust Co. of Chi. v. Hunt Int'l Res. Corp.,* 1987 WL 55826, at *5 (Del.Ch. Feb. 27, 1987); *see also Simons v. Cogan,* 549 A.2d 300, 303 (Del.1988) ("this Court permitted the class action in *Harff* to proceed because plaintiffs had brought themselves within the fraud exception").

***23** In *Mann v. Oppenheimer,* Justice Walsh, then Vice Chancellor, reached the same conclusion about *Harff. See Mann v. Oppenheimer & Co.,* 1985 WL 11555 (Del.Ch. Apr. 4, 1985), *rev'd on other grounds,* 517 A.2d 1056 (Del.1986). The plaintiffs in *Mann* owned subordinated debentures and challenged an exchange offer on grounds of fraud. The defendants relied on a no-action clause which stated, "no holder of any Debenture may institute any action to enforce any remedy under the Indenture unless the Trustee declines or fails to exercise its powers or to institute such action...." *Id.* at *3. The plaintiffs argued that the no-action clause only restricted "suits brought 'under or upon' the indenture." *Id.* Citing *Harff I,* Justice Walsh stated: "There is merit in plaintiffs' position. Even though this dispute may implicate the terms of the Indenture, the allegations of fraud and Federal security law violations are sufficient to support an independent action. Thus, the plaintiffs need not have given notice to the Trustee prior to bringing suit." *Id.* (citation omitted). Justice Walsh nevertheless granted summary judgment in favor of the defendants. *Id.* On appeal, the Delaware Supreme Court reversed and remanded so that the noteholder plaintiffs could take discovery on the common law fraud claims before the court addressed the defendants' motion for summary judgment. *See Mann v. Oppenheimer & Co.,* 517 A.2d 1056, 1060–61 (Del.1986). Although the Delaware Supreme Court did not explicitly address the no-action clause, its ruling was consistent with Justice Walsh's interpretation and inconsistent with the contrary position that the no-action clause barred the claims as a matter of law. *See Cont'l Ill.,* 1987 WL 55826, at *5 (interpreting *Mann* in this fashion).

Justice Berger, then Vice Chancellor, employed a similar analysis in *Mabon, Nugent & Co. v. Texas American Energy Corp.,* 1988 WL 5492 (Del.Ch. Jan. 27, 1988). The holders of debentures sued the issuer and its parent for breach of the indenture and for fraud, contending that the defendants misrepresented that the parent would assume the indenture. The defendants relied on a no-action clause. Although the language of the clause was not quoted in the opinion, Justice Berger described it as requiring that notice be given to the trustee and other procedural requirements met "before instituting any action for the enforcement of any remedy under the indenture." *Id.* at *2. Justice Berger held that the no-action clause only applied to the breach of contract claim: "Plaintiffs' remaining claims are not contractual and, therefore, the restrictions in the Indenture do not apply." *Id.* at *3 (citing *Cont'l Illinois,* 1987 WL 55826).

It bears noting that in *Lange,* Chancellor Strine declined to read the *Harff* cases as expressing any view on the scope of a no-action clause. 2002 WL 2005728, at *7 n. 21. On the merits, Chancellor Strine had held that the broad no-action clause at issue in *Lange* barred the noteholders claims for breach of fiduciary duty. *Id.* at *7. In a footnote, he observed that some earlier cases suggested that claims for breach of fiduciary duty could fall outside a no-action clause, citing *Continental Illinois,* and he traced "[m]ost of this confusion" to *Harff II.* He then asked,

> ***24** [D]id the *Harff* case hold that a no-action clause could not bar a bondholder suit alleging fraud or that the issuer was insolvent? The answer to that question is no. In *Harff,* the Court of Chancery expressly avoided any ruling on the scope of applicability of the no-action clause, and the Supreme Court never addressed it any discernible, articulated way.

2002 WL 2005728, at *7 n. 21. Notably, the *Lange* footnote framed the operative question as whether a no-action clause could bar a breach of fiduciary duty claim, not whether the specific language of the no-action clause at issue in *Harff* barred the claim. As in the current case, the parties may not have focused at the trial court level on the specific wording of the two clauses, and the *Lange* decision did not parse the narrower no-action clause in *Harff* or contrast it with the broader no-action clause in *Lange.*

Taken together, the *Harff* cases and subsequent decisions indicate that the Athilon Clause applies only to claims under the Indenture and does not extend to claims that rely on other sources of law. The limited reading that these cases give to narrow no-action clauses parallels the approach taken by the authorities that explicitly apply New York law.

D. Authoritative Commentary

Although New York law directs that indenture provisions be interpreted using standard principles of contract interpretation, "[c]ourts strive to give indenture provisions a consistent and uniform meaning because uniformity in interpretation is important to the efficiency of capital markets." *Concord Real Estate CDO 2006–1, Ltd. v. Bank of Am. N.A.,* 996 A.2d 324, 331 (Del.Ch.2010) (internal quotation marks omitted), *aff'd,* 15 A.3d 216 (Del.2011) (TABLE). Experienced drafters deploy settled language:

> The preparation of an instrument of security intended to provide with artistic completeness for the ramifications of the modern corporate entity imposes upon its author the obligation to use wording that is well defined among those engaged in the interpretation of such indentures. To depart from well understood verbiage is to invite criticism and possibly to plunge the investor into the field of the unknown.

Bond Issues at 4.

"Courts enhance stability and uniformity of interpretation by looking to the multi-decade efforts of leading practitioners to develop model indenture provisions." *Concord Real Estate,* 996 A.2d at 331. These efforts began with the *Commentaries* in 1971 and continued with subsequent updates. *See, e.g., Revised Model Simplified Indenture,* 55 Bus. Law. 1115 (2000); *Model Simplified Indenture,* 38 Bus. Law. 741 (1983); *Mortgage Bond Indenture Form,* 36 Bus. Law. 1917 (1981).

The *Commentaries* "provide powerful evidence of the established commercial expectations of practitioners and market participants." *Concord Real Estate,* 996 A.2d at 331. "Where a standard term is the product of an explicit standard-setting process such as the model bond indenture or the model simplified indenture, commentaries of the standard-setting organization should be accorded authoritative weight." Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "The Economics of Boilerplate"),* 83 Va. L. Rev. 713, 765 (1997) (footnote omitted). The Delaware Supreme Court and other courts "have looked to the [*Commentaries*] as 'an aid to drafting and construction' of common indenture language." *Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp.,* 29 A.3d 225, 241 (Del.2011); *see Kaiser Aluminum Corp. v. Matheson,* 681 A.2d 392, 396–97 (Del.1996) (relying on *Commentaries* and subsequent versions of the model indenture).

***25** The *Commentaries* contain a model no-action clause that resembles the Athilon Clause:

> No holder of any Debenture or coupon shall have any right to institute any proceeding, judicial or otherwise, with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless [the holder complies with the conditions in the clause].

Commentaries, supra note 3, § 5–7 at 232. Unlike the Athilon Clause, the *Commentaries'* model clause does not contain language similar to subpart 1.0 that explicitly addresses the source of the rights that a holder may invoke. It does, however, contain language similar to subparts 3.0 and 4.0 addressing the types of proceedings governed by the clause, *viz.,* those "with respect to this Indenture" or which seek "the appointment of a receiver or trustee, or for any other remedy hereunder." Notably, the model clause does not refer to proceedings "with respect to the Debentures," and the *Commentaries* stress this point: "Note that this limitation is only on suits under the indenture." *Id.* at 233. Reinforcing this observation, the *Commentaries* describe as a "curious case" a decision which held that a "holder of coupons for overdue interest on mortgage bonds issued under an indenture containing a provision similar to the [model no-action clause] could not maintain a suit on such coupons." *Id.* at 233 n.22 (referencing *Bartol v. Gottlieb–Bauernschmidt–Straus Brewing Co.,* 129 Md. 32, 98 A. 286 (1916)). The implication is that the plain language of the model no-action clause only applies to suits under the indenture or that seek specified remedies, but not to other suits, such as actions or proceedings that do not rely on the indenture and seek other remedies.

More recent authority confirms this interpretation. In 2000, the Ad Hoc Committee for Revision of the 1983 Modified Simplified Indenture, working under the aegis of the Committee on Developments in Business Financing of the American Bar Association's Section of Business Law and assisted by members of the Committee on Trust Indentures and Indenture Trustees and the Business Bankruptcy Committee's Subcommittee on Trust Indentures, produced a Revised Model Simplified Indenture. *See Revised Model Simplified Indenture,* 55 Bus. Law. 1115 (2000); *see also Bank of N.Y.,* 29 A.3d at 242 (relying on the Revised Model Simplified Indenture and commentary). Its model no-action clause resembles the *Feldbaum/Lange* clause: "A Securityholder may pursue a remedy with respect to this Indenture or the Securities only if [the holder complies with the terms of the clause]." *Revised Model Simplified Indenture,* 55 Bus. Law. 1115, 1137–38 (2000).

Like the *Feldbaum/Lange* clause, the model clause applies to any efforts by a Securityholder to "pursue a remedy with respect to this Indenture or the Securities." Yet notwithstanding the broad language, the commentary to the provision states:

> ***26** The clause applies, however, only to suits brought to enforce contract rights under the Indenture or the Securities, not to suits asserting rights arising under other laws.
>
> Note that the introductory language requiring compliance prior to pursuing a remedy "with respect to this Indenture *or the Securities* " indicates merely that claims to enforce the contractual terms of the Securities (which may include rights incorporated from the Indenture) are likewise subject to the no-action clause (subject to the exclusion noted in the preceding paragraph).

Id. at 1191–92 (emphasis in original) (citations omitted). Thus, according to authoritative commentators, even a clause like the *Feldbaum/Lange* clause should not extend beyond contract rights. For purposes of the issue presented by the Remand Order, this commentary confirms that the Athilon Clause should receive a narrow reading.

E. The Statutory Receivership Cases

There is one line of cases that cuts against the preceding authorities and favors equating the Athilon Clause with the *Feldbaum/Lange* clause. When considering bondholders' petitions for a statutory receivership, judicial decisions have given a broad construction to no-action clauses paralleling the Athilon Clause. The defendants rely on *Tang,* which they say holds that the Athilon Clause must apply to any attempt by a noteholder to bring an action on a debt instrument. I read *Tang* and its predecessor cases as limited to statutory receiverships and not as speaking to other contexts, such as the claims in this case.

In *Tang,* noteholders petitioned for a statutory receivership under Section 291 of the Delaware General Corporation Law based on their status as creditors. *See* 8 *Del. C.* § 291 ("Whenever a corporation shall be insolvent, the Court of Chancery, on the application of any creditor or stockholder thereof, may, at any time, appoint 1 or more persons to be receivers of and for the corporation...."). Like the Athilon Clause, the no-action clause in *Tang* provided that

> no Holder of any Note shall have any right by virtue or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture, or for the appointment of a receiver, trustee, liquidator, custodian or other similar official, or for any other remedy hereunder [without meeting specified conditions]....

Tang, 2012 WL 3072347, at *3 (emphasis omitted). The noteholders argued that the no-action clause did not apply because they were not invoking a "right by virtue or by availing of any provision of this Indenture." The defendants responded that the no-action clause applied because the phrase " 'by virtue of or by availing of any provision [of this Indenture]' should be construed to bar actions that arise out of any rights or status conferred on the Note holders by the Indenture." *Id.* at *5. Vice Chancellor Glasscock commented that he "read the [no-action clause] as the Defendants do" and stated that he agreed that the phrase " 'by virtue of the Indenture' indicates coverage of such causes of action available to a plaintiff by virtue of its status as a Note holder." *Id.*

***27** In support of their right to pursue a statutory receivership notwithstanding the no-action clause, the plaintiffs relied on *Noble v. European Mortgage & Investment Corp.,* 165 A. 157 (Del.Ch.1933). Vice

Chancellor Glasscock declined to follow *Noble* and relied instead on *Elliott Associates,* in which Justice Berger, then Vice Chancellor, distinguished the earlier *Noble* decision. To understand this line of authority, it is helpful to start with *Noble* and work forward.

Noble was one of two opinions addressing whether a no-action clause applied to a claim for a statutory receiver that Chancellor Josiah O. Wolcott issued within a five month period. In *Noble,* Chancellor Wolcott considered whether a bondholder could obtain a statutory receivership in light of a no-action clause that applied to "any action or proceeding at law or in equity upon or in respect of this indenture, or for the execution of any trust or power hereof, or for any other remedy under or upon this indenture." 165 A. at 158 (internal quotation marks omitted). The issuer had defaulted on its interest payments, and the holders of the coupons sued for the overdue payments and for the appointment of a statutory receiver. Chancellor Wolcott noted that the petition for a statutory receiver did not seek a remedy "under or upon this indenture" and that no-action clauses were "strictly construed." *Id.* at 159. The coupon holders were therefore "as much entitled to file a receivership bill under the statute as is any other creditor." *Id.*

Shortly thereafter, in *Tietjen v. United Post Offices Corp.,* 167 A. 846 (Del.Ch.1933), Chancellor Wolcott considered a similar petition for a statutory receivership. The *Tietjen* no-action clause applied to "any suit, action or proceeding at law or in equity for the foreclosure of this indenture, or for the appointment of a receiver, or for any other remedy hereunder...." *Id.* at 847. The petitioner relied on *Noble,* but Chancellor Wolcott observed that "[w]hat clearly distinguishes the pending case from the *Noble* Case is this—that here the indenture in Section 1 of Article Seven expressly denies to any bondholder the right to sue for the appointment of a receiver unless the required request has been made of the trustees...." *Id.* In response to the petitioner's argument that the no-action clause applied only to "the appointment of a receiver ... hereunder," *viz.* under the terms of the indenture, Chancellor Wolcott explained that the no-action clause extended to any remedy that the trustee could obtain under the indenture, and that the language of the indenture demonstrated that the trustee could seek a statutory receiver:

> It is suggested by the complainant that the only sort of receiver which the prohibition referred to can be taken to contemplate is a receiver of the property under the indenture, and that inasmuch as the pending bill seeks a general receiver for the corporation and not of the property alone, the prohibition is not applicable. The answer to that suggestion I think is plain, for it is to be observed that the request and refusal are conditions precedent not only to the bondholders' right to sue for a receiver but as well to the bondholders' right to enforce any power or remedy given to the trustees. Now among those powers which are given to the trustees is the one found in Section 5 of the same Article Seven, which is that in case any one of the defaults occurs under Section 2 (which defaults accelerate the maturity of the bonds) the trustees are "entitled as of right, without notice, to the appointment of a receiver ... of each and every [of] the rights and properties of the corporation, with power to operate and continue the business of the corporation, and with all other rights and powers of receivers in equity." This language clearly shows that the sort of receiver which the bondholders are forbidden to seek without satisfying the conditions precedent, is not of the limited type which operates only in a custodial capacity over the mortgaged property.

***28** *Id.* at 847–48. Because the type of statutory receiver that the bondholders sought was one that the trustee could obtain under the indenture, Chancellor Wolcott dismissed the petition. *Id.* at 848.

Tietjen reached the same result as two contemporaneous New York decisions. *See Greene v. N.Y. United Hotels,* 236 A.D. 647, 260 N.Y.S. 405 (1932), *aff'd,* 204 Ind. 311, 183 N.E. 798 (1933); *Ernst v. Film Prod. Co.,* 148 Misc. 62, 264 N.Y.S. 227 (Sup.Ct.1933). In *Greene,* the no-action clause provided that

> [i]n order to promote and protect the equal and ratable rights of every holder of the Debentures and to avoid multiplicity of suits, all the Debentures shall be subject to the condition that no holder of any Debenture or coupon appertaining thereto shall have any right to institute any action, at law or in equity, under or growing out of any provision of this Indenture, or for the enforcement thereof, [without meeting its conditions].

260 N.Y.S. at 406. A single bondholder sought the appointment of a receiver because of the corporation's failure to pay interest coupons when due. The appellate court affirmed the dismissal of the petition on two grounds. First, the complaint did not plead compliance with the no-action clause, and the court stated without analysis that "[t]he plaintiff as a bondholder holds his securities subject to the condition of this underlying trust

agreement and can maintain an action only upon the conditions specified in the trust agreement." *Id.* at 407. The court did not discuss whether the plaintiff had instituted an action "under or growing out of any provision of this indenture, or for the enforcement thereof." Second, the complaint requested a receiver but did not describe what the receiver would do. *Id.* The court held that the appointment of a receiver "is provisional" and "never ... the ultimate object of the action," hence the complaint was "fundamentally defective." *Id.* I suspect that under current pleading standards, it would be reasonable to infer that the petitioner wanted the receiver to cause the company to pay the interest on the past-due coupons. *See Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC,* 27 A.3d 531, 536 (Del.2011) (adopting "reasonable conceivability" as pleading standard in Delaware state court).

Ernst involved the same indenture litigated in *Relmar Holding Co. v. Paramount Publix Corp.,* 147 Misc. 824, 263 N.Y.S. 776 (Sup.Ct.1932), *aff'd,* 237 A.D. 870, 261 N.Y.S. 959 (1933). The no-action clause provided:

> In order to promote and protect the equal ratable right of every holder of the bonds and to avoid multiplicity of suits, all the bonds shall be subject to the condition that all rights of action thereon, or in respect thereof, or on or in respect of the coupons thereto appertaining, are vested exclusively in the trustee under this indenture, and that no holder of any bond or coupon appertaining thereto shall have any right to institute any action, at law or in equity, upon the bonds or any of the appurtenant coupons, or growing out of any provision thereof, or of this indenture, or for the enforcement of this indenture [without complying with its conditions].

***29** *Relmar,* 263 N.Y.S. at 777–78 (Sup.Ct.1932). In *Relmar,* plaintiff bondholders contended that the issuance of a new series of bonds by one of Paramount's wholly owned subsidiaries violated the terms of the indenture, and the court had little difficulty holding that the no-action clause applied. *Id.*

In *Ernst,* the plaintiffs sought the appointment of a receiver on the grounds that the same issuance constituted a fraudulent conveyance. 264 N.Y.S. at 228. This time, the plaintiffs contended that they were not suing under the indenture but rather as creditors under the New York Debtor and Creditor Law. *Id.* The court held that the no-action clause applied to this claim as well:

> What [the plaintiffs] seek is a receiver *in a representative action* to set aside a transfer as fraudulent. The nature of their action shows that they are presuming to speak for all the bondholders and not for themselves alone. They are attempting to protect their rights under the indenture, but to be permitted to do so they must not contravene its terms.... As soon as the plaintiffs presumed to speak for all other bondholders, they necessarily brought in the collateral indenture, their right to do which is challenged as a question of fact.

Id. at 229. The court seemingly could have reached the same result simply by citing the plain language of the no-action clause, which encompassed not only rights of action under the indenture but also rights under the bonds.

The outcomes in *Tietjen, Greene,* and *Ernst* reflected the rule at the time in most jurisdictions. *See* Smith, *supra* note 1 (collecting cases). By contrast, contemporaneous decisions from the New Jersey Court of Chancery held that no-action clauses must be interpreted strictly such that when a clause referred to a right of action by virtue of the indenture or a remedy under its terms, it did not bar a suit for a statutory receiver. *See Jennings v. Studebaker Corp.,* 112 N.J. Eq. 591, 165 A. 631 (N.J.Ch.1933); *Tachna v. Pressed Steel Car Co.,* 112 N.J. Eq. 174, 163 A. 806 (N.J.Ch.1933), *rev'd on other grounds,* 112 N.J. Eq. 411, 164 A. 413 (E. & A.1933); *Reinhardt v. Interstate Tele. Co.,* 71 N.J. Eq. 70, 63 A. 1097 (N.J.Ch.1906). This did not mean that a New Jersey court would grant the petition for a statutory receiver, only that the no-action clause did not bar consideration of the petition on the merits. *See Jennings,* 165 A. at 633–34 (denying petition).

Against this backdrop, Justice Berger decided *Elliott Associates.* The plaintiffs held debentures and sought the appointment of a receiver for the issuer, Bio–Response, Inc under Section 291. They also claimed that Bio–Response had committed fraud and violated the implied covenant of good faith and fair dealing. *Elliott Assocs.,* 1989 WL 55070, at *1, *4. Citing *Harff I* and *II,* Justice Berger noted that "debenture holders may be able to seek relief outside of the indenture where there are 'special circumstances which affect the rights of the debenture holders as creditors of the corporation, e.g., fraud, insolvency, or a violation of a statute....' " *Id.* at *4. But Justice Berger held that (i) the complaint did not sufficiently allege fraud and (ii) the implied covenant of good faith and fair dealing did not give the plaintiffs any rights other than those found in the indenture. *Id.*

***30** This left the claim for a receiver, which Justice Berger held was barred by the no-action clause. Like the Athilon Clause and the provision in *Tang,* the no-action clause at issue in *Elliott Associates* stated:

> No Holder of any Security shall have any right by virtue of or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder unless such Holder previously [complies with specified conditions].

Id. at *6. Justice Berger held that "[u]nlike the relevant clause in *Noble,* there is nothing in this Indenture reserving to plaintiffs the right to commence an action, 'so long as the procedure they adopt is not under the [I]ndenture' " and that "as in *Tietjen,* Debenture holders are expressly denied the right to bring an action for the appointment of a receiver without first following the specified procedure...." *Id.* at *7.

In *Tang,* Vice Chancellor Glasscock followed *Elliott Associates* on grounds of *stare decisis.* He noted that "[t]he language of the indenture's no-action clause in *Elliott* was nearly identical to that [in *Tang*]." 2012 WL 3072347, at *6. He therefore relied on *Elliott Associates* as "directly on point" and "not credibly refuted." *Id.*

In my view, the defendants are correct to point out the tension between the rulings in the Delaware statutory receivership cases and the plain language of the no-action clauses at issue. After excising the inapplicable language, the relevant portions of the *Tang* and *Elliott Associates* clauses stated: "No Holder of any Security shall have any right by virtue of or by availing of any provision of this Indenture to institute any action or proceeding ... for the appointment of a receiver or trustee, or for any other remedy hereunder." The predicate requirement for triggering the clause was that the holder invoke a right "by virtue of or by availing of any provision of this Indenture." The plaintiffs, however, were not asserting any right "by virtue of or by availing of any provision of this Indenture," but rather under Section 291. Consistent with the New Jersey authorities, it would seem that the no-action clause would not apply to a petition for receivership that did not rely on the indenture. *Tietjen,* however, held that the reference to a receivership was sufficient to reach the opposite conclusion, creating a conceptual disconnect.

Elliott Associates relied on *Tietjen,* focused on the reference to "the appointment of a receiver" in the no-action clause, and did not dilate on the apparent limitation of the clause to claims "by virtue of or by availing of any provision of this Indenture." 1989 WL 55070, at *6. *Tang* reasoned through the conceptual disconnect and bridged the divide by holding that a suit "by virtue of or by availing of any provision of this Indenture" was the equivalent of a suit under the notes. To reach this result, the *Tang* court adopted the defendants' position that if the two prepositional phrases "by virtue of" and "by availing of" did not mean different things, then one would be rendered surplusage, an outcome contrary to standard principles of contract interpretation. 2012 WL 3072347, at *5. *Tang* gave meaning to both by interpreting the phrase "by availing of any provision of this Indenture" to refer to claims under the indenture itself while interpreting "by virtue of ... this Indenture" to encompass claims under the notes. *Id.*

***31** As demonstrated by this authorities discussed in this opinion, some no-action clauses refer to claims under "the Indenture" while others refer to claims under "the Indenture or the Notes." The *Tang* approach eliminates any distinction between the two usages by transforming a no-action clause like the Athilon Clause into the functional equivalent of the following provision, in which the italicized language reflects alterations:

> No Holder of any Note shall have any right by virtue of or by availing of any provision of this Indenture *or the Notes* to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture *or the Notes,* or for the appointment of a receiver, trustee, liquidator, custodian or other similar official, or for any other remedy hereunder *or under the Notes.*

If applied to a no-action clause that already included the italicized references, the reasoning in *Tang* would render them meaningless because the phrase "by virtue of ... the Indenture" takes care of note-based claims. The no-surplusage rule thus contradicts itself: by not treating the phrase "by virtue of ... the Indenture" as surplusage, the phrase "or the Notes" becomes surplusage.

Under *Cruden II, Victor v. Riklis,* and pre-TIA decisions, including the phrase "or the Notes" changes the scope of the no-action clause. These authorities indicate that if one of the two phrases is redundant, it is "by virtue of." It consequently seems preferable to regard the compound prepositional phrase "by virtue of" or by availing of as an example of the law's hoary tradition of deploying joint terms, such as "indemnify and hold harmless," where technically one term would suffice. *See, e.g., Majkowski v. Am. Imaging Mgmt. Servs., LLC,* 913 A.2d 572, 588 (Del.Ch.2006) (declining to give separate meaning to the phrase "hold harmless"; noting that "[t]he terms 'indemnify' and 'hold harmless' have a long history of joint use throughout the lexicon of Anglo–American legal practice"). *See generally* Bryan A. Garner, *The Redbook: A Manual on Legal Style* § 11.2 at 192 (2d ed. 2006) ("The doublet and triplet phrasing common in Middle English still survives in legal writing, especially contracts, wills, and trusts. That's probably the worst possible soil for it to grow in because those who interpret legal writing are impelled to strain for distinctions so that no word is rendered surplusage. Yet that is exactly all but one word ... is [in these phrases]."). Under this reading, the Athilon Clause would not encompass a petition for a statutory receivership, which is not to say that a no-action clause could not be drafted to reach such a petition. The *Feldbaum/Lange* clause would bar a statutory receivership action, because through such an action a "Securityholder" would be pursuing a "remedy with respect to this Indenture or the Securities."

The Complaint does not seek a statutory receivership, so for purposes of the issue raised by the Remand Order, this Court is not required to follow the decisions in *Tietjen, Elliott Associates,* and *Tang* on grounds of *stare decisis.* Rather, the tension between these opinions and other decisions suggests that the receivership cases should not be relied upon to expand the scope of the Athilon Clause to include claims under the Notes.

F. Applying The Athilon Clause To Quadrant's Claims

***32** The foregoing review of cases and authorities indicates that each noteholder claim must be measured against the particular language of the no-action clause in question. In this case, the Athilon Clause applies to Counts VII and VIII in their entirety and to Count X to the extent it alleges a conspiracy to engage in the wrongs alleged in Counts VII and VIII. Otherwise, the Athilon Clause does not apply to the Complaint.

1. Count I: Breach Of Fiduciary Duty

In Count I of the Complaint, Quadrant asserts a derivative claim on behalf of Athilon against the individual defendants for breach of fiduciary duty. In *Feldbaum* and *Lange,* this Court held that the no-action clause at issue in those cases barred similar claims for breach of fiduciary duty. *See Feldbaum,* 1992 WL 119095, at *6–8; *Lange,* 2002 WL 2005728, at *7. Based on the arguments previously made at the trial level, *Lange* and *Feldbaum* were "directly on point." Dismissal Order ¶ 1.

The Athilon Clause, however, only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Count I, Quadrant relies on its status as a creditor under the Notes, its allegation that Athilon is insolvent, and the doctrine of creditor standing articulated by the Delaware Supreme Court in *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla,* 930 A.2d 92, 101–02 (Del.2007). Quadrant does not rely on any provision of the Indenture. It therefore appears, based on the argument Quadrant made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling and that the plain language of the Athilon Clause does not extend to a *Gheewalla* claim.

Levy v. Paramount Publix Corp., 149 Misc. 129, 266 N.Y.S. 271 (Sup.Ct.1933), *aff'd,* 241 A.D. 711, 269 N.Y.S.2d 997 (1934), a case cited in *Lange,* does not compel a different result. The *Levy* decision construed the same no-action clause addressed in *Relmar* and *Ernst,* quoted above. The no-action clause expressly encompassed rights of action on the bonds, "or in respect thereof," and barred any holder of the bonds from instituting any action "upon the Bonds ... or growing out of any provision thereof." *Levy,* 266 N.Y.S. at 273. Like the no-action clause in *Lange,* the no-action clause in *Levy* was not limited to rights under the indenture. Moreover, the court in *Levy* does not appear to have relied on the no-action clause to dispose of the breach of fiduciary duty claim, which failed on other grounds. *Id.* at 273–76. *Levy* reinforces the principle that the plain language of the no-action clause controls.

2. Count II: Aiding and Abetting A Breach Of Fiduciary Duty

In Count II of the Complaint, Quadrant asserts a derivative claim on behalf of Athilon for aiding and abetting the breaches of fiduciary duty alleged in Count I. In *Feldbaum,* this Court held that a no-action clause "applies equally to claims against non-issuer defendants as to claims against issuers." 1992 WL 119095, at *7. With that additional analytical step, the analysis of Count I applies equally to Count II, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

3. Count III: Permanent Injunction Based On Breach of Duty

***33** In Count III of the Complaint, Quadrant seeks a permanent injunction barring the individual defendants from causing Athilon to make interest payments on the Junior Notes or to pay the service and license fees identified in Count I. For purposes of the Athilon Clause, the analysis is the same as Count I, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

4. Counts IV And V: Fraudulent Conveyance

In Counts IV and V, Quadrant challenges the payment of interest on the Junior Notes and the service and license fees paid to EBF and ASIA as fraudulent transfers. In *Lange* and *Feldbaum,* this Court held that the no-action clause at issue in those cases barred similar claims for fraudulent transfer. *See Feldbaum,* 1992 WL 119095, at *6–8; *Lange,* 2002 WL 2005728, at *7. Based on the arguments previously made at the trial level, *Lange* and *Feldbaum* seemed "directly on point." Dismissal Order ¶ 1.

The Athilon Clause only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Counts IV and V, Quadrant relies on its status as a creditor under the Notes, its allegation that Athilon is insolvent, and provisions of the DFTA. *See* 6 *Del. C.* §§ 1304(a)(1), 1305(b). Quadrant does not rely on any provision of the Indenture. It therefore appears, based on the argument Quadrant made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling.

Lange and *Feldbaum* cited New York cases for the proposition that no-action clauses can bar fraudulent transfer claims. Clearly this is so, but whether it is true in a particular case depends on the specific language of the clause. *Feldbaum* relied on the *Ernst* case, and *Lange* relied on both *Levy* and *Ernst. See Feldbaum,* 1992 WL 119095, at *6; *Lange,* 2002 WL 2005728, at *7 n. 19. As discussed, the no-action clause in *Levy* and *Ernst* explicitly included rights of action on the bonds, "or in respect thereof," and barred any holder of the bonds from instituting any action "upon the Bonds ... or growing out of any provision thereof." *Levy,* 266 N.Y.S. at 273. The *Lange* decision also relied on *Victor v. Riklis* and *Wherehouse Entertainment. See Lange,* 2002 WL 2005728, at *7 n. 18. As discussed, both decisions interpreted a no-action clause identical to the *Feldbaum/Lange* clause, which barred the debentureholders from seeking "any remedy with respect to [the] Indenture or the Securities" unless they first complied with its terms. Each ruling turned on the broad scope of the no-action clause at issue. None stands for the proposition that every no-action clause, however worded, necessarily bars fraudulent transfer claims.

5. Count VI: Permanent Injunction Based On Fraudulent Conveyance

Count VI seeks a permanent injunction under the DFTA against continuing payments of interest on the Junior Notes and service and license fees to EBF and ASIA. For purposes of the Athilon Clause, the analysis is the same as Counts IV and V, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

6. Count VII: Implied Covenant Of Good Faith And Fair Dealing

***34** Count VII contends that by taking the actions detailed in Count I and elsewhere in the Complaint, Athilon breached the implied covenant of good faith and fair dealing that inheres in the Indenture. In *Feldbaum,* this Court held that the no-action clause at issue barred a claim for breach of the implied covenant. *See Feldbaum,* 1992 WL 119095, at *6. The Dismissal Order relied on *Feldbaum.* Neither the argument debuted by Quadrant on appeal, nor the authorities considered on remand suggest a different result.

"New York law recognizes an implied duty of good faith and fair dealing as part of its contract law." *Rossdeutscher v. Viacom, Inc.,* 768 A.2d 8, 20 (Del.2001). The implied obligation encompasses "any promises which a reasonable person in the position of the promisee would be justified in understanding were included." *Dalton v. Educ. Testing Serv.,* 87 N.Y.2d 384, 639 N.Y.S.2d 977, 663 N.E.2d 289, 291 (1995). The resulting contract term is "implicit in the agreement as a whole." *Rowe v. Great Atl. & Pac. Tea Co.,* 46 N.Y.2d 62, 412 N.Y.S.2d 827, 385 N.E.2d 566, 570 (1978). "A breach of the implied covenant is a breach of contract." *Rossdeutscher,* 768 A.2d at 20.

By invoking the implied covenant, Quadrant sued to enforce an implied term of the Indenture. Count VII of the Complaint even references the Indenture. The Athilon Clause applies to any action or proceeding "upon or under or with respect to this Indenture." Dkt. 32 Ex. A. at 51. Quadrant's failure to comply with the Athilon Clause is fatal to its implied covenant claim. *Simons,* 549 A.2d at 305.

7. Count VIII: Tortious Interference With The Implied Covenant

Count VIII contends that EBF tortiously interfered with Athilon's obligations under the implied covenant of good faith and fair dealing that inheres in the Indenture. Such a claim on its face asserts a right "by virtue or by availing of any provision of [the] Indenture" and constitutes an action "upon or under or with respect to [the] Indenture." It is therefore covered by plain language of the Athilon Clause.

Two New York cases support this result. In *RJ Capital,* the United States District Court for the Southern District of New York interpreted a no-action clause which provided that "[n]o Holder of any Note shall have any right to institute any Proceedings, judicial or otherwise, with respect to his Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder [without complying with its terms]." *RJ Capital,* 2011 WL 3251554, at *5. Elsewhere, the indenture made the rights of noteholders to sue for principal and interest "subject to the provisions of [the no-action clause]," and the noteholders did not argue that the TIA overrode this provision. *Id.* at *6 n. 6 (emphasis omitted). The noteholders contended that the collateral manager for the debt securities tortiously interfered with the terms of the indenture by issuing inaccurate reports that the issuer then used to calculate the payments of principal and interest required by the indenture. The court held that the no-action clause barred the claim for tortious interference, but also dismissed the claim on the merits. *Id.* at *7, *14. Similarly in *Emmet & Co. v. Catholic Health East,* 37 Misc.3d 854, 951 N.Y.S.2d 846 (Sup.Ct.2012), the court held that a no-action clause applied to a claim for tortious interference with rights under an indenture, although the court did not quote the language of the clause. *Id.* at 849–50 (applying New York law because of lack of conflict with the law of the jurisdictions chosen under the indentures).

8. Count IX: Constructive Dividends In Violation Of Delaware Law

***35** Count IX asserts that Athilon paid constructive dividends in violation of Delaware law and seeks to recover those payments from the individual defendants. Under the reasoning of *Feldbaum* and *Lange,* such a claim should be barred. *See Feldbaum,* 1992 WL 119095, at *6 ("[N]o matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for the recovery of past due interest or [principal], is subject to the terms of a no-action clause of this type."); *accord Lange,* 2002 WL 2005728, at *7 (quoting *Feldbaum*).

Unlike the *Feldbaum/Lange* clause, the Athilon Clause only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Count IX, Quadrant relies on its status as a creditor under the Notes and Sections 170, 173, and 174 of the Delaware General Corporation Law. *See* 8 *Del. C.* §§ 170, 173, 174. The Athilon Clause does not reach such a claim. *See Regan v. Prudence Co.,* 17 N.Y.S.2d 422, 425 (Sup.Ct.1939) (holding that no-action clause did not apply to a suit for to recover dividends under New York's Stock Corporation Law).

The defendants cite *Norte & Co. v. Manor Healthcare Corp.,* 1985 WL 44684 (Del.Ch. Nov. 21, 1985), as standing for the proposition that a no-action clause applies to a claim alleging constructive dividends, but the *Norte* plaintiffs contended that defendants paid "constructive dividend in violation of various provisions in the trust indentures." *Id.* at *5. By relying on provisions of the trust indentures, the *Norte* plaintiffs brought the claim within the scope of the no-action clause in that case. Had Quadrant made a similar argument here, then the Athilon Clause would apply.

Count IX does not allege constructive dividends that violated the Indenture; rather, it alleges constructive dividends that violated the General Corporation Law. It therefore appears, based on the argument Quadrant made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling.

9. Count X: Civil Conspiracy

Count X asserts a claim for civil conspiracy against EBF and ASIA for actions taken in concert with the individual defendants. In *Feldbaum,* this Court held that a no-action clause "applies equally to claims against non-issuer defendants as against issuers." 1992 WL 119095, at *7. Count X seeks to impose secondary liability on other defendants for conspiring in the primary wrongs detailed in other counts of the Complaint. In my view, the Athilon Clause should apply to Count X to the same degree as it applies to the primary wrongs. As a practical matter, this means that the Athilon Clause bars the plaintiffs' ability to recover against secondary actors for conspiring to commit the wrongs alleged in Counts VII and VIII. Otherwise the Athilon Clause does not apply.

III. CONCLUSION

***36** As directed by the Remand Order, this opinion has analyzed the significance under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon indentures. The analysis has included a discussion of decisions by New York courts and other courts applying New York law. This opinion has not addressed other arguments about the Athilon Clause that Quadrant raised on appeal but which were not the subject of the Remand Order.

It appears that as a matter of New York law, the differences between the Athilon Clause and the *Feldbaum/Lange* clause are significant. Based on the analysis presented, the Athilon Clause does not apply to Counts I through VI and IX of the Complaint, or to Count X to the extent it seeks to impose liability on secondary actors for violations of the other counts. The clause applies to Counts VII and VIII of the Complaint, subject to the outcome of Quadrant's other arguments on appeal.

Footnotes

* Sitting by designation pursuant to art. IV, § 12 of the Delaware Constitution and Delaware Supreme Court Rules 2 and 4(a) to constitute the quorum required.

1 EBF disputes that it is the ultimate parent of Athilon.

2 N.Y. COMP.CODES R. & REGS., tit. 22 § 500.27(a) (2013).

3 The facts are drawn from the allegations of the complaint filed in the Court of Chancery.

4 Athilon and its subsidiary are referred to collectively as "Athilon." Credit swaps are contracts in which a credit derivative product company, such as Athilon, promises to make one or more defined payments should a specified degree of losses be sustained on a reference portfolio, as a result of defaults or other "credit events" by one or more designated obligors during a specified (typically, multi-year) period of time.

5 Generally, a Suspension Event involves, *inter alia,* capital shortfalls, leverage ratios, or insolvency.

6 Report on Remand, Exhibit C, at p. 5.

7 Count VII claimed that Athilon breached the Indenture's implied covenant of good faith and fair dealing, and Count VIII asserted that EBF had tortiously interfered with Athilon's obligations under the Indenture. Count X charged EBF and ASIA with civil conspiracy for actions taken in concert with the individual defendants.

8 Italics added.

9 Italics added.

10 Exhibit C to this Certificate, at 54–55.

11 *Gen. Inv. Co. v. Interborough Rapid Transit Co.,* 200 A.D. 794, 193 N.Y.S. 903 (1922) *aff'd,* 235 N.Y. 133, 139 N.E. 216 (1923), which was decided before the adoption of the Trust Indenture Act, addressed whether a no-action clause with no reference to "the Securities" precluded a security holder's action to collect outstanding principal and interest due under the securities.

1 *Quadrant v. Vertin,* C.A. 6990–VCL, slip op. (Del. Ch. June 5, 2012) (Laster, V.C.).

2 *Id.*

3 *Id.*

4 2002 Del. Ch. LEXIS 101, 2002 WL 2005728 (Del.Ch. Aug. 13, 2002).

5 1992 Del. Ch. LEXIS 113, 1992 WL 119095 (Del.Ch. June 1, 1992).

6 *Account v. Hilton Hotels Corp.,* 780 A.2d 245, 248 (Del.2001).

7 *Feldbaum,* 1992 WL 119095, at *5, *7–8.

8 *Id.* (italics added).

9 *Id.* at *3.

10 2002 WL 2005728, at *6.

11 *Id.* at *5–6 (italics added).

12 App. to Appellant's Op. Br. at A–229 (emphasis added) (§ 7.06 of the Indenture).

13 *Id.*

14 Both *Lange* and *Feldbaum* cited federal and New York cases concerning the interpretation of no-action clauses in contracts and indentures governed by New York law. In this case, the Court of Chancery order did not cite, or discuss the applicability of those decisions or any other New York cases decided after *Feldbaum* and *Lange.*

1 *See, e.g., McClelland v. Norfolk S. R.R. Co.,* 110 N.Y. 469, 18 N.E. 237, 241 (1888); *Rothschild v. Rio Grande W. Ry. Co.,* 32 N.Y.S. 37, 39–40 (Sup.Ct.1895). Two American Law Report annotations collect and summarize no-action clause cases, including numerous New York decisions. *See* C.T. Foster, *Validity, construction, and application of express restrictions on right of action by individual holder of one or more of a series of corporate bonds or other obligations,* 174 A.L.R. 435 (1948 & Supp.) (including updates through current day); P.V. Smith, *Validity, construction, and application of express restrictions on right of action by individual holder of one or more of a series of corporate bonds or other obligations,* 108 A.L.R. 88 (1937 & Supp.) (including updates through 1948).

2 *McMahan & Co. v. Wherehouse Entm't, Inc.,* 65 F.3d 1044, 1050 (2d Cir.1995); *accord Cruden v. Bank of N.Y.,* 957 F.2d 961, 968 (2d Cir.1992) ("*Cruden II* "); *Metro W. Asset Mgmt., LLC v. Magnus Funding, Ltd.,* 2004 WL 1444868, at *5 (S.D.N.Y. June 25, 2004); *UPIC & Co. v. Kinder–Care Learning Ctrs., Inc.,* 793 F.Supp. 448, 454 (S.D.N.Y.1992); *see also Revised Model Simplified Indenture,* 55 Bus. Law. 1115, 1191 (2000) ("No action clauses are strictly construed against the issuer.").

3 The issue rarely arises today, because Section 316(b) of the TIA establishes that the holder of a note governed by the act has an absolute and unconditional right to sue on the note for past due payments of principal and interest. *See* 15 U.S.C. § 77ppp(b). Since the passage of the TIA, even those indentures not covered by the act typically contain language paralleling Section 316(b). *See generally* American Bar Association, *Commentaries on Model Debenture Indenture Provisions 1965, Model Debenture Indenture Provisions All Registered Issues 1967, and Certain Negotiable Provisions* 233–34 (1971) [hereinafter *Commentaries*]; Churchill Rodgers, *The Corporate Trust Indenture Project,* 20 Bus. Law. 551, 563, 565–66 (1965).

4 *See, e.g., Enoch v. Brandon,* 249 N.Y. 263, 164 N.E. 45, 47 (1928) (holding that references in bond to aspects of indenture "all

have to do with the trust mortgage. They refer to the rights conferred by it upon the bondholders and limit and explain those rights. They are so linked together as to indicate that the obligor was speaking solely of the security."); *Cunningham v. Pressed Steel Car Co.,* 238 A.D. 624, 265 N.Y.S. 256, 259 (1933) ("We do not find that the reference to the indenture constitutes a bar to the maintenance of this action [on the bonds]."), *aff'd,* 263 N.Y. 671, 189 N.E. 750 (1934); *Lubin v. Pressed Steel Car Co.,* 146 Misc. 462, 263 N.Y.S. 433, 436–37 (City Ct.1933) (holding that where bonds referred generally to the indenture for the "rights of the holders of said bonds," language was not sufficiently specific to make no-action clause in indenture applicable to bonds (internal quotation marks omitted)); *Berman v. Consol. Nev.–Utah Corp.,* 132 Misc. 462, 230 N.Y.S. 421, 424 (Sup.Ct.1928) (holding that reference in bond to indenture was insufficient to make bond subject to no-action clause found in indenture); *Brown v. Mich. R.R. Co.,* 124 Misc. 630, 207 N.Y.S. 630, 631 (City Ct.1924) ("There is nothing on the face of the bond to show that there is any provision in the mortgage preventing the owner of any bond from maintaining an action at law for the money when the same becomes due."); *see also Marlor v. Tex. & Pac. Ry. Co.,* 19 F. 867, 868 (C.C.S.D.N.Y.1884) (applying New York law; finding "nothing in the language of the mortgage to qualify the promise of the bond" and noting that "[w]hether [a bondholder's] interest can be collected through a foreclosure of the mortgage is a different inquiry, and not relevant now [to the suit on the bond]"), *aff'd,* 123 U.S. 687, 8 S.Ct. 311, 31 L.Ed. 303 (1887).

Other jurisdictions reached the same result. *See, e.g., Kimber v. Gunnell Gold Mining & Milling Co.,* 126 F. 137, 138 (8th Cir.1903) ("A mortgage ... does not, in the absence of an express stipulation or of a statute to that effect, constitute any defense to an action at law against the mortgagor by each of the creditors upon the bonds or primary obligations thus secured."); *Manning v. Norfolk S. Ry. Co.,* 29 F. 838, 839 (C.C.E.D.Va.1887) ("The common-law right of suing to judgment upon a written obligation admitted to be valid is of too high a character to be taken away by implications, especially if these are drawn from instruments other than that which is given in direct and positive acknowledgement of the debt."); *Mendelson v. Realty Morg. Corp.,* 257 Mich. 442, 241 N.W. 154, 154 (1932) ("[I]t is a fact, recognized alike by business and the law, that a bond and its securing mortgage have different functions, are governed by different legal principles, and, for some purposes at least, are separate contracts."); *Reitz v. Pontiac Realty Co.,* 316 Mo. 1257, 293 S.W. 382, 385 (1927) ("The [no-action] provisions of the mortgage ... deal with remedies provided for in the mortgage, and have no reference to respondent's right of action [on the bonds] at common law."); *Putnam v. Pittsburgh Rys. Co.,* 330 Pa. 210, 199 A. 211, 212 (1938) ("The right of the individual owner of bonds to sue thereon is not affected by provisions of the mortgage securing them unless such provisions exclude the right in express terms or by necessary implication."); *Phila. & Balt. Cent. R.R. Co. v. Johnson,* 54 Pa. 127, 129 (1867) (holding that in an action not "upon the mortgage" but for default in payment on the bonds, a "limitation" in the mortgage was "irrelevant"). *See generally* Leonard A. Jones, *A Treatise on the Law of Corporate Bonds and Mortgages* § 196a (3d ed. 1907) ("A provision restraining proceedings for foreclosure on the part of individual bondholders until after a requisition made upon trustees by a certain proportion of the bondholders and a refusal to comply therewith is valid and obligatory upon the individual bondholders *as respects the enforcement of the security.*" (emphasis added)).

5 *See, e.g., Hibbs v. Brown,* 190 N.Y. 167, 173, 82 N.E. 1108 (1907) ("[T]he clauses [of the indenture] ... only relate to and control procedure under the trust indenture itself for the purpose of enforcing payment of coupons and do not for any other purposes work or permit a postponement of the time of payment of the coupons or prevent a bondholder from enforcing his ordinary and general remedies at law for the collection of such obligations."); *Barnes v. United Steel Works Corp.,* 11 N.Y.S.2d 161, 163 (Sup.Ct.1939) (accepting that bond sufficiently incorporated terms of indenture but holding that no-action clause did not apply to suit on the bond when it only addressed suits under the indenture); *Deutsch v. Gutehoffnungshutte,* 168 Misc. 872, 6 N.Y.S.2d 319, 322 (Sup.Ct.1938) (holding that no-action clause in the indenture "relates solely to the enforcement of collateral security for the repayment of the bonds and in no way affects the action on the bonds themselves").

6 *See, e.g., Lidgerwood v. Hale & Kilburn Corp.,* 47 F.2d 318, 320 (S.D.N.Y.1930) (applying New York law; finding that note sufficiently incorporated terms of indenture and that no-action clause in indenture barred suit on the notes after maturity where it applied to "the enforcement of any of the covenants or agreements herein or in the Notes contained" (internal quotation marks omitted)); *Friedman v. Am.–Nat'l Co.,* 172 Misc. 1044, 16 N.Y.S.2d 887, 887 (Sup.Ct.1939) (holding that debenture sufficiently incorporated indenture and that no-action clause governed suit for principal due where clause stated that "[a]ll rights of action on this debenture and the annexed interest coupons, except as otherwise provided by said agreement, are vested in said trustee, and the enforcement thereof is governed by the provisions of said trust agreement" (internal quotation marks omitted)); *Rudick v. Ulster & Del. R.R.,* 147 Misc. 637, 263 N.Y.S. 498, 500 (1928) (holding that bonds sufficiently incorporated by reference the no-action clause in the indenture and that "the language thereof plainly states that no holder shall have the right to institute any action at law or in equity for the collection of the principal or interest [absent compliance with its conditions]"); 1 *Mortgages and Mortgage Foreclosure in N.Y.* § 4:8 (2012) ("If in fact appropriate notice is given to the bondholder in his bond, provisions restricting and limiting the rights of bondholders to sue and enforce their obligations may be legally imposed, depending upon the wording of the instrument."); Posner, *supra,* at 775 (noting before the passage of the TIA that "the bondholder's power to sue at law on his matured bond, as well as upon his matured interest coupons, is at times nullified by references to the indenture made in the bond. In such cases, the reference clauses must be explicit....").

7 *See RJ Capital, S.A. v. Lexington Capital Funding III, Ltd.,* 2011 WL 3251554, at *6 n. 7 (S.D.N.Y. July 28, 2011) (applying plain language of no-action clause that extended to suits for payment of interest or principal on the bonds where plaintiffs did not argue that the TIA overrode the provision); *In re Envirodyne Indus., Inc.,* 174 B.R. 986, 994 (Bankr.N.D.Ill.1994) (interpreting no-action

clause governed by New York law; holding that action to recover past due interest is a claim "under the Notes" and not governed by the no-action clause, which applied to claims "under the Indenture").

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UNPUBLISHED OPINION. CHECK COURT RULES BEFORE CITING.

Court of Chancery of Delaware

Quadrant Structured Products Company, Ltd., Individually and Derivatively on Behalf of Athilon Capital Corp., Plaintiff,
v.
Vincent **Vertin**, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner, Athilon Capital Corp., Athilon **Structured** Investment Advisors LLC, and EBF & Associates, LP, Defendants.

C.A. No. 6990–VCL | Submitted: March 22, 2013 | Decided: June 20, 2013

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REPORT PURSUANT TO DELAWARE SUPREME COURT RULE 19(c)

LASTER, Vice Chancellor.

***1** Plaintiff **Quadrant Structured Products** Company, Ltd. ("**Quadrant**") owns notes issued by defendant Athilon Capital Corp. ("Athilon"). Before filing this lawsuit, **Quadrant** did not comply with the no-action clauses in the indentures governing its notes. The defendants moved to dismiss on that basis, and **Quadrant** responded with arguments that this Court rejected in *Feldbaum v. McCrory Corp.*, 1992 WL 119095 (Del. Ch. June 1, 1992), and *Lange v. Citibank, N.A.*, 2002 WL 2005728 (Del. Ch. Aug. 13, 2002). At the time, **Quadrant** did not distinguish the language of the Athilon no-action clause from the clause at issue in *Feldbaum* and *Lange*. I granted the motion, observing that *Feldbaum* and *Lange* were "directly on point."

On appeal, **Quadrant** argued that the Athilon clause differs critically from the *FeldbaumlLange* clause because the former refers only to claims under the indenture, but the latter referred to both the indenture and the notes. By order dated February 12, 2013, the Delaware Supreme Court directed me "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses."

For the reasons set forth herein, **Quadrant** has persuaded me that the language of the Athilon no-action clause distinguishes this case from *Feldbaum* and *Lange*. Had **Quadrant** previously made this argument, I would have relied on the no-action clause to dismiss only Counts VII–VIII and part of Count X, and then reached the defendants' other grounds for dismissing the remaining counts.

I. FACTUAL BACKGROUND

The facts are drawn from **Quadrant's** verified amended complaint (the "Complaint" or "CC") and the documents it incorporates by reference, including (i) an indenture dated as of December 21, 2004, between Athilon and Deutsche Bank Trust Company Americas, as Trustee, governing the Subordinated Deferrable Interest Notes, Series A and B, and (ii) an indenture dated as of July 26, 2005, between Athilon and The Bank of New York, as Trustee, governing the Senior Subordinated Deferrable Interest Notes, Series A, B, C and D. For present purposes, the indentures are substantively identical, so I refer to them singly as the "Indenture." Quotations are from the 2004 indenture.

A. Athilon's Corporate Structure And Business Model
Athilon is a Delaware corporation with its principal place of business in New York, New York. Athilon and its wholly owned subsidiary, Athilon Asset Acceptance Corp. (jointly, the "Companies"), were formed in 2004 to sell credit default swaps to financial institutions. Through its subsidiary, Athilon wrote credit default swaps covering senior tranches of collateralized debt obligations. At the parent level, Athilon guaranteed the swaps.

Athilon was financed originally with $100 million of equity capital. It raised another $600 million of debt capital, comprising $350 million in senior subordinated notes, $200 million in subordinated notes, and $50 million in junior notes (collectively, the "Notes"). The Notes are long-term obligations that will mature, depending upon the series, in 2035, 2045, or 2047. Interest payments on the Notes are deferrable for up to five years at Athilon's option. All of the Notes rank in priority below Athilon's credit default swap obligations.

***2** The Companies' organizational documents limit their permissible lines of business to selling credit default swaps and require compliance with strict operating guidelines. The Companies only can invest in high quality securities of short duration, and their portfolios must be sufficient at all times to cover any credit default swaps and the Notes. The guidelines mandate that if a "Suspension Event" occurs and remains uncured, then the Companies must enter "runoff" mode. When in that status, the Companies cannot write new business and must pay off existing credit default swaps as they mature.

B. The Business Model Fails.
Before the financial crisis of 2008, market participants discounted the risks faced by credit derivative **product** companies, enabling Athilon to underwrite over $50 billion in nominal credit default risk. Measured against its $700 million in committed capital, Athilon operated with a vertiginous leverage ratio of 71:1. Measured against Athilon's equity, Athilon's leverage ratio was a stratospheric 506:1. At that level, a 0.2% loss on the collateralized debt obligations covered by Athilon's credit default swaps would wipe out its equity cushion and render Athilon insolvent, at least on paper. The rating agencies gave the Companies "AAA/Aaa" debt ratings and investment grade counterparty credit ratings.

In 2008, the Companies found themselves in distress, and they lost their AAA/Aaa ratings at the end of that year. By early 2009, the Companies had sustained several Suspension Events. In 2010, Athilon unwound two credit default swaps at a cost of $370 million, more than three times its equity capital. By August, the Companies no longer held any investment grade debt or counterparty credit ratings. Under the operating guidelines, the Companies entered permanent runoff mode.

C. The EBF Takeover
With Athilon in distress, the trading prices of its debt securities fell precipitously. EBF & Associates, LP ("EBF") seized the opportunity to purchase a large position in the riskiest tranche of Notes (the "Junior Notes") at a significant discount. In August 2010, EBF acquired 100% of Athilon's equity. EBF installed the current board of directors, which the Complaint alleges is dominated and controlled by EBF. In May 2011, nine months after EBF took control, **Quadrant** acquired its position in the Notes.

Quadrant alleges that Athilon is insolvent. Excluding its outstanding credit default swaps, Athilon continues to carry $600 million of debt, but its assets allegedly have a fair market value of only $426 million. As of September 30, 2011, Athilon's shareholder's equity, measured according to GAAP, stood at negative $660 million. The Complaint alleges that Athilon has no prospect of returning to solvency because it can only sell credit default swaps, and the market for that business has collapsed.

Quadrant argues that under the circumstances, a properly motivated board of directors would preserve Athilon's value for orderly liquidation in 2014, when the last credit default swap expires. The EBF designees on the Athilon board, by contrast, are pursuing strategies designed to benefit EBF and its affiliates. They have caused Athilon to continue paying interest on the Junior Notes, notwithstanding the right to defer those payments and the fact that the Junior Notes would receive nothing in an orderly liquidation. They also agreed to pay Athilon **Structured** Investment Advisors LLC ("ASIA"), an EBF affiliate, above-market service fees to manage Athilon's day-to-day operations. Together, the EBF designees and ASIA have embarked on a high-risk investment strategy, contrary to the terms of Athilon's governing documents, that amounts to a "heads EBF wins, tails everyone else loses" bet. If the high-risk investments succeed, then the underwater Junior Notes and equity will benefit. If the investments fail, then the more senior tranches of Notes will bear the loss.

D. The Quadrant Complaint
***3** In October 2011, **Quadrant** filed suit against Athilon,

its officers and directors, EBF, and ASIA. As amended, the Complaint contained ten counts:

•Count I asserted a derivative claim on behalf of Athilon against the individual defendants for breaching their fiduciary duties by (i) continuing to pay interest on the Junior Notes; (ii) paying above-market service and license fees to EBF; (iii) departing from an appropriately conservative capital investment strategy; and (iv) causing Athilon to violate its organizational documents and operating guidelines.

•Count II asserted a derivative claim against EBF for aiding and abetting the breaches of fiduciary duty alleged in Count I.

•Count III sought a permanent injunction barring the individual defendants from causing Athilon to pay the interest and fees identified in Count I.

•Counts IV and V challenged the payment of interest and fees under the Delaware Fraudulent Transfer Act ("DFTA").

•Count VI sought a permanent injunction under the DFTA against the continuing payment of interest and fees.

•Count VII contended that by taking the actions detailed in Count I and elsewhere in the complaint, Athilon breached the implied covenant of good faith and fair dealing that inheres in the Indenture.

•Count VIII asserted that EBF had tortiously interfered with Athilon's obligations under the Indenture.

•Count IX asserted that Athilon paid constructive dividends in violation of Delaware law and sought to recover those payments from the individual defendants.

•Count X asserted a claim for civil conspiracy against EBF and ASIA for actions taken in concert with the individual defendants.

Quadrant brought Counts I–III derivatively in its capacity as a creditor of an insolvent corporation. **Quadrant** brought Counts IV–VIII directly in its capacity as a creditor. **Quadrant** brought Counts DC and X both directly and derivatively. In Counts I–VI and IX, **Quadrant** relied solely on its status as a holder of the Notes. In Counts VII and VIII, **Quadrant** relied on the Indenture. In seeking to impose secondary liability under Count X, **Quadrant** relied on the Notes and the Indenture to the same degree as the related primary counts.

The defendants moved to dismiss the Complaint on a variety of substantive and procedural grounds. In their lead argument, the defendants invoked the no-action clause in the Indenture, which states:

Limitations on Suits by Securityholder. No holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless such holder previously shall have given to the Trustee written notice of default in respect of the series of Securities held by such Securityholder and of the continuance thereof, as hereinbefore provided, and unless also the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding shall have made written request upon the Trustee to institute such action or proceedings in its own name as trustee hereunder and shall have offered to the Trustee such reasonable indemnity as it may require against the costs, expenses and liabilities to be incurred therein or thereby and the Trustee for 60 days after its receipt of such notice, request and offer of indemnity shall have failed to institute any such action or proceedings and no direction inconsistent with such written request shall have been given to the Trustee pursuant to Section 7.08 hereof within such 60 days....

***4** Dkt. 32 Ex. A. § 7.06 at 51–52 (the "Athilon Clause"). **Quadrant** admittedly did not comply with the Athilon Clause before filing suit. Relying on *Feldbaum, Lange,* and their progeny, the defendants pointed out that no-action clauses have resulted in pleadings-stage dismissals of precisely the types of claims that **Quadrant** asserted.

To avoid the Athilon Clause, **Quadrant** argued that it governs "only those suits that arise from a default" and not other types of claims. Ans. Br. at 10. **Quadrant** also argued that to enforce the Athilon Clause "would operate to ban (not merely channel through a particular plaintiff) a range of personal noteholder claims that spring from the law of fiduciary duties, fraudulent transfer, securities, and other sources of law, none of which requires a note default as a prerequisite to suit," thereby converting the Athilon Clause into a covert release of claims and leaving noteholders without a remedy. *Id.* at 13. **Quadrant** likewise contended that the Athilon Clause applied only to suits *against* the issuer and not to derivative actions brought by creditors on the issuer's behalf. *Id.* at 15. In its only response to *Feldbaum,* **Quadrant** asserted that under that decision, a no-action clause would bar a noteholder suit only "so long as 'the trustee is capable of satisfying its obligations.' " *Id.* at 10 (quoting *Feldbaum,* 1992 WL 119095, at *6). According to **Quadrant**, the trustee could not fulfill its obligations because the trustee only could sue following an "Event of Default," and no "Event of Default" had yet occurred. *Id.* at 10–11. **Quadrant** did not contend that the language of the Athilon Clause differed meaningfully from the language of the clause at issue in *Feldbaum* and *Lange.*

After reviewing the briefing and the authorities cited by the parties, I concluded that *Feldbaum* and *Lange* addressed the points **Quadrant** had raised. By order dated June 5, 2012, I dismissed the action with prejudice, observing that *Feldbaum* and *Lange* were "directly on point." Dkt. 60 (the "Dismissal Order").

E. The Appeal

Quadrant appealed. Before the Delaware Supreme Court, **Quadrant** reiterated the arguments rejected in *Feldbaum* and *Lange,* noting that both were Court of Chancery decisions and that the issues presented questions of first impression for the high court. *See* Appellant's Op. Br. at 1. **Quadrant** also argued for the first time that *Feldbaum* and *Lange* "construed substantially different contracts" and that the Athilon Clause applied "only to claims that arise from the governing indenture itself." *Id.* at 2. In support of this new contention, **Quadrant** observed that the *Feldbaum/Lange* clause "applied not only to rights under its indenture, but also to 'any remedy with respect to ... the Securities.' " *Id.* at 16–17 (quoting *Feldbaum,* 1992 WL 119095, at *5–6; citing *Lange,* 2002 WL 2005728, at *5). **Quadrant** also relied on *Victor v. Riklis,* 1992 WL 122911 (S.D.N.Y. May 15, 1992), as giving dispositive meaning to the absence of the phrase "or the Securities." Appellant's Op. Br. at 19–20. **Quadrant** had not cited *Victor* before this Court.

By order dated February 12, 2013, the Delaware Supreme Court determined that "the current record is insufficient for appellate review." ***Quadrant Structured*** *Prods. Co. v.* ***Vertin,*** No. 388, 2012, ¶ 1 (Del. Feb. 12, 2013) (the "Remand Order"). The Delaware Supreme Court explained that "[o]n appeal, **Quadrant** claims that *Lange* and *Feldbaum* are not controlling, because the no-action indenture clause in those cases were [sic] critically different from the no-action clause in the Athilon indenture at issue here." *Id.* ¶ 4. The high court observed that the no-action clauses in both *Lange* and *Feldbaum* provided that "[a] Securityholder may not pursue a remedy with respect to this Indenture *or the Securities* " without satisfying the conditions set forth in the clause. *Id.* ¶ 5 (quoting *Feldbaum,* 1992 WL 119095, at *5 (emphasis in original)), ¶ 6 (quoting *Lange,* 2002 WL 2005728, at *5 (emphasis in original)). The Delaware Supreme Court observed that the Athilon Clause "is worded differently from the indentures at issue in *Lange* and *Feldbaum* " and that "[u]nlike the no-action clauses in *Lange* and *Feldbaum,* the no-action clause in the Athilon Indenture does not contain the phrase 'or the Securities.' " *Id.* ¶ 7. The Delaware Supreme Court remanded the case to this Court with instructions "to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon indentures." *Id.* ¶ 9. The Remand Order stressed that "[t]he analysis should include a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here." *Id.* The Remand Order did not instruct this Court to address any of the other arguments raised by **Quadrant** on appeal. Pursuant to Supreme Court Rule 19(c), the Delaware Supreme Court retained jurisdiction to consider the implications of this Court's report.

II. LEGAL ANALYSIS

*5 In accordance with the Remand Order, this opinion first considers the plain language of the Athilon Clause and the *Feldbaum/Lange* clause. It then reviews (i) authorities that have construed no-action clauses under New York law, (ii) other instructive Delaware precedents, and (iii) authoritative commentary. Because the linguistic distinction that **Quadrant** raised on appeal appears to have analytical heft, the opinion concludes by applying the language of the Athilon Clause to the ten counts in the Complaint.

A. The Plain Language Of The Clauses

"[U]nder New York law interpretation of indenture provisions is a matter of basic contract law." *U.S. Bank Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C.,* 2004 WL 1699057, at *2 (Del. Ch. July 29, 2004) (internal quotation marks omitted). "The best evidence of what parties to a written agreement intend is what they say in their writing. Thus, a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms." *Greenfield v. Philles Records, Inc.,* 98 N.Y.2d 562, 750 N.Y.S.2d 565, 780 N.E.2d 166, 170 (N.Y.2002) (citation and internal quotation marks omitted).

For purposes of plain language analysis, the Athilon Clause can be parsed a follows:

> No holder of any Security
>
> 1.0 shall have any right by virtue or by availing of any provision of this Indenture
>
> 2.0. to institute any action or proceeding at law or in equity or in bankruptcy or otherwise
>
> 3.0 upon or under or with respect to this Indenture, or
>
> 4.0 for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder,
>
> unless [the holder complies with specified conditions].

See Dkt. 32 Ex. A. § 7.06 at 51–52. The *FeldbaumlLange* clause used different language: "A Securityholder may not pursue any remedy with respect to this Indenture or the Securities unless [the Securityholder complies with specified conditions]." *Feldbaum,* 1992 WL 119095, at *5; *accord Lange,* 2002 WL 2005728, at *5 ("A Securityholder may not pursue a remedy with respect to this Indenture or the Securities unless [the Securityholder complies with specified conditions]."). The operative question posed by the Remand Order is whether subparts 1.0 through 4.0 of the Athilon Clause give it a different scope than the simpler language of the *FeldbaumlLange* clause.

Subpart 1.0 of the Athilon Clause defines the sources of rights governed by the clause. Under this subpart, no "holder of any Security shall have any right by virtue or by availing of any provision of this Indenture." As a matter of plain language, the Athilon Clause does not speak to other rights that the holder of a Security may have, such as rights under or by virtue of the Security itself. It likewise does not address rights that might exist under the common law, state statutes, or federal statutory schemes like civil RICO or the federal securities laws. The *FeldbaumlLange* clause does not contain language resembling subpart 1.0 and is not limited to any subset of potential rights. It applies to any right that any Securityholder might have, regardless of its source, to the extent the Securityholder invokes it to "pursue any remedy with respect to this Indenture or the Securities." In this respect, the Athilon Clause is narrower than the *FeldbaumlLange* clause.

Subpart 2.0 of the Athilon Clause identifies the types of actions or proceedings that would fall within the clause if the "holder of any Security" asserted a right "by virtue or by availing of any provision of this Indenture." This aspect of the Athilon Clause encompasses "any action or proceeding at law or in equity or in bankruptcy or otherwise" that falls within the scope of the clause. The *Feldbaum/Lange* clause does not contain language resembling subpart 2.0. Just as the *FeldbaumlLange* clause is not limited to any subset of potential rights, it is not limited to any particular type of action or proceeding. It rather applies to any action or proceeding that any Securityholder might bring to the extent the Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Along this dimension, given the broad language of the Athilon Clause, the two provisions appear equivalent.

***6** Subparts 3.0 and 4.0 of the Athilon Clause impose additional limitations on its scope. As noted, under subparts 1.0 and 2.0, the Athilon Clause extends to any "action or proceeding" in which the plaintiff asserts a "right by virtue or by availing of any provision of this Indenture." Under subparts 3.0 and 4.0, the "action or proceeding" also must be one in which the plaintiff (i) sues "upon or with respect to this Indenture" (3.0) or (ii) seeks as a remedy "the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder" (4.0). As a matter of plain language, the Athilon Clause only applies to actions or proceedings involving certain types of claims (those "upon or under or with respect to this Indenture") or those seeking certain types of remedies ("the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder"). The plain language of the term "hereunder" refers to the Indenture, which appears in both the immediately preceding subpart (3.0) and in the first subpart (1.0). The *FeldbaumlLange* clause does not contain any language limiting the types of claims a Securityholder might bring, nor does it call out specific remedies. Rather, it applies broadly to any action or proceeding to the extent that a Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Here too, the Athilon Clause is narrower than the *Feldbaum/Lange* clause.

As a matter of plain language, the differences between the Athilon Clause and the *Feldbaum/Lange* clause appear significant. The Athilon Clause applies only when the holder of a Security asserts "any right by virtue or by availing of any provision of this Indenture" and only to an "action or proceeding" in which the holder sues "upon or under or with respect to this Indenture," seeks a particular remedy available under the Indenture, or otherwise seeks "appointment of a trustee, receiver, liquidator, custodian or other similar official." The *FeldbaumlLange* clause applies broadly to any action or proceeding that any Securityholder might bring to the extent that the Securityholder "seeks to pursue any remedy with respect to this Indenture or the Securities." Under the *Feldbaum/Lange* clause, it does not matter what source of rights the Securityholder invokes or the nature of the claim that the Securityholder asserts.

B. Cases Addressing Athilon Clauses Under New York Law

The Remand Order calls for "a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here." Remand Order ¶ 9. New York courts have been interpreting no-action clauses for over one hundred years.[1] Under New York law, no-action clauses are "strictly construed." New York decisions indicate that the specific language of the no-action clause matters and that a no-action clause will not encompass causes of action, theories, or remedies that do not fall within its terms.

Before the adoption of the Trust Indenture Act of 1939 (the "TIA"), New York courts frequently considered whether a no-action clause in an indenture could restrict a bondholder from seeking to recover on the bond for past due payments of principal and interest.[3] New York courts consistently held that absent contractual language to the contrary, the holder of a debt instrument enjoyed creditors' rights derived from the debt instrument (whether labeled "bonds," "notes," or "debentures") distinct from the trustee's rights against the underlying collateral derived from the security instrument (whether labeled an "indenture," "mortgage," or "deed of trust"). As in the current case, the no-action clause almost invariably appeared in the security instrument and not in the debt instrument.

*7 Anyone who has purchased a home using traditional bank financing will recognize the distinction between a debt instrument and the security instrument: the borrower signs a debt instrument in the form of a promissory note reflecting the debt, and the borrower separately executes a mortgage that secures the debt by creating a lien against the home. *See* 1 *Mortgages and Mortgage Foreclosure in N.Y.* § 4:8 (2012) ("[A] corporation bond is a promise to pay, exactly as is the mortgage bond signed by the individual homeowner; the mortgage securing it is a securing lien on designated property in exactly the manner of the mortgaged homestead."). If the borrower defaults, the bank can proceed *in rem* by foreclosing on the mortgage, sue the borrower *in personam* on the promissory note, or both. *See,* e.g., *Manley v. MAS Assocs., LLC,* 968 A.2d 492 (Del.2009) (TABLE) (dual *in personam* and *in rem* proceeding); *Wells Fargo Bank, N.A. v. Williford,* 2011 WL 5822630, at *3 (Del.Super.Nov. 17, 2011) (*in rem* proceeding); Louis S. Posner, *TheTrustee and the Trust Indenture: A Further Study,* 46 Yale L.J. 737, 768 (1937) ("[B]onds and mortgages, though evidencing but one debt, nevertheless constitute two distinct promises giving rise to two separate causes of action, [such that] the trustee, whose legal relations are held confined to the mortgage, has no enforceable rights at law on the indebtedness").

Nineteenth century lawyers used the traditional real estate mortgage as a model when their corporate clients needed to raise long-term debt to fund major infrastructure projects like canals and railroads. *See Commentaries, supra* note 3 at 4. "The adaptation of the traditional real estate mortgage to this purpose was a work of marvelous ingenuity and a development of the greatest significance in the economic growth of the United States." *Id.* at 5. A further practical problem for publicly traded debt was the need to

> afford bondholders the benefits of a mortgage lien on the assets and yet provide in an orderly fashion for a multiplicity of bondholders holding ... securities, subject to change of ownership through trading in the bonds. The answer was found in the conveyance of the real estate and other mortgageable assets of the corporation to a trustee for the benefit of all bondholders.

Id.; *see* 1 Ralph A. McClelland & Frederick S. Fisher, Jr., *The Law of Corporate Mortgage Bond Issues In Conjunction With A Typical Indenture Of Mortgage And Deed Of Trust Securing Bonds 2* (1937) [hereinafter *Bond Issues*] ("The use of trustees to take and hold the mortgaged property as security for the benefit of the bondholders affords a device for unified action which otherwise would be impossible, especially since the holders of the bonds are numerous and of changing identity."). Over time, a true corporate mortgage that recorded a lien on real property "was found to be awkward if not impossible for many types of corporate borrowers," and it was "dispensable in many cases if adequate contractual protections were included in the debt instrument or the related indenture." *Commentaries, supra* note 3 at 6. "The solution was to take the corporate mortgage indenture form, delete the conveyancing and other provisions relating to the collateral, and insert covenants designed to protect the debentureholders.... Other provisions of an administrative nature remained much the same in a debenture instrument as those in a mortgage indenture." *Id.* at 7. The result was the now-familiar bond/indenture **structure** at issue in this case.

Because of the distinction between debt instruments and security instruments, New York courts held that if the bond did not contain language making it subject to the indenture or sufficiently incorporating the terms of the indenture by reference, then the creditor could sue freely on the bond.[4] More importantly for present purposes, New York courts held that even if the language of the bond sufficiently referenced the terms of the indenture, a no-action clause in the indenture that only referred to the indenture would not limit a creditor from suing on the bond.[5]

***8** For example, in *General Investment Co. v. Interborough Rapid Transit Co.,* 200 A.D. 794, 193 N.Y.S. 903 (App.Div.1922), *affd,*235 N.Y. 133, 139 N.E. 216 (N.Y.1923), the plaintiff sought to recover on five promissory notes. Each of the notes referred to an indenture for the holder's rights. The issuer invoked the no-action clause in the indenture, which stated: "No holder of any note hereby secured shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of this indenture, or for the execution of any trust hereof, or for the appointment of a receiver, or for any other remedy hereunder...." *Id.* at 905. The court held that the no-action clause

> merely denied the holders of the notes "any right to institute any suit, action or proceeding in equity or at law for *the enforcement of this indenture.*" ... But the action at bar is not to affect, disturb, or prejudice the lien of the collateral indenture or to enforce any right thereunder. The action is solely for the purpose of recovering on defendant's primary obligation to pay said moneys, with interest.... The remedies are entirely separate and distinct.... [T]he present action is not barred by the clause in question, as the action is not to enforce the indenture or any rights thereunder, or to secure any remedy or relief therein provided.... Said clause relates solely to the enforcement of the collateral security for the payment of said notes, and in no manner affects the action upon the notes themselves.

Id. at 909 (emphasis in original) (citation omitted). By contrast, if the note sufficiently referenced the terms of the indenture *and* the no-action clause encompassed the rights of holders under the bonds, then the no-action clause applied to a suit on the bonds.[6] Courts applying New York law adhere to these rules today.[7]

***9** Since the adoption of the Trust Indenture Act, it has rarely been necessary for holders of a covered issue to litigate whether they could assert a direct right to recover past due payments of principal or interest notwithstanding the language of a no-action clause. Bondholders instead have attempted to assert other types of direct claims. A series of illustrative decisions have construed no-action clauses in indentures governed by New York law to determine whether the bondholder claims could proceed.

The first major decision was *Cruden,* where holders of debentures sought to assert fraud and civil RICO claims. The no-action clauses in the governing indenture provided that unless its procedural requirements were followed, the holders did not have

> any right by virtue or by availing of any provision of this Indenture to institute any action or proceedings at law or in equity or in bankruptcy or otherwise, upon or under or with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder....

*Cruden II,*957 F.2d at 967 (emphasis omitted). The district court held that the no-action clause did *not* bar the fraud and RICO claims: "Plaintiffs' other claims are not made under the Indenture, such as the RICO and fraud claims. The Court finds that plaintiffs do have standing to bring suit on these claims as well, any restrictive provision of the Indentures being inapplicable to these claims." *Cruden v. Bank of N.Y.,* 1990 WL 131350, at *12 (S.D.N.Y. Sept. 4, 1990) ("*Cruden I* "), *aff'd in part, rev'd in part, Cruden II,* 957 F.2d 961 (2d Cir.1992). The district court then dismissed the fraud and RICO claims under statutes of limitations. *Id.* at *16, *18. On appeal, without commenting on the no-action clause analysis, the United States Court of Appeals for the Second Circuit reversed the limitations-based dismissal of the RICO claims and remanded the case for trial. *See* 957 F.2d at 974, 978. By directing the case to go forward, the Second Circuit indicated that it accepted the district court's interpretation of the no-action clause, which otherwise would have barred the claims.

The next significant decision was *Victor v. Riklis,* 1992 WL 122911 (S.D.N.Y. May 15, 1992), where debentureholders argued that *Cruden I* permitted them to bring fraud and RICO claims. The district court distinguished *Cruden I* because the no-action clauses in the two cases differed. The *Cruden I* clause only referred to the indenture, but the *Victor* clause added the phrase "or the Securities." The *Victor* court held that the difference was dispositive;

> Victor relies on the district court's decision in *Cruden,* which held that a debentureholder's RICO and fraud claims were not barred by a no-action provision. *Cruden* is distinguishable from this case, however, because that no-action clause was not as broad as the one contained in the E–II indentures.... Accordingly, we find that the E–II indenture's reference to actions with respect to the securities as well as the indenture itself broadens the scope of the no-action clause to include Victor's RICO and fraud claims.

1992 WL 122911, at *6 n.7 (citations omitted).

Perhaps the most influential decision for no-action clause jurisprudence was *Feldbaum,* in which Chancellor Allen applied New York law. Bondholders whose securities were governed by the same indentures considered in *Victor v. Riklis* contended that a restructuring (i) breached the implied covenant of good faith and fair dealing in the indentures, (ii) violated New York's prohibition against fraudulent transfers, and (iii) was the **product** of fraudulent misrepresentations. *SeeFeldbaum,* 1992 WL 119095, at *2–3. The defendants moved to dismiss, arguing that the no-action clause barred the claims. As **Quadrant** argued originally in this case, the *Feldbaum* plaintiffs asserted that the no-action clause applied only to claims for breach of express indenture provisions. Chancellor Allen disagreed:

> ***10** Given the purposes for which no-action clauses are designed, I cannot accept plaintiffs' position. No principled reason or factual particularity of this case is advanced that would justify this view. In my opinion, no matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for recovery of past due interest or [principal], is subject to the terms of a no-action clause of this type.

*Id.*at *6. Chancellor Allen later explained that the trustee would not be "capable of satisfying its obligations" if the suit alleged misconduct by the trustee. Absent such circumstances, "courts systematically conclude that, in consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all bondholders, and thus can be prosecuted by the trustee...." *Id.* at *7.

Turning to the claims before him, Chancellor Allen held that the no-action clause governed the plaintiffs' implied covenant claims and the fraudulent conveyance claims. The harms those claims sought to address affected all bondholders proportionately, so it was up to the trustee to prosecute the claims on behalf of all bondholders. *Id.* at *7–8. The Chancellor reached the same conclusion about the fraud claims to the extent the complaint alleged that the bondholders were deprived of an opportunity to seek injunctive relief against the restructuring. *Id.* at *9. Such an injunction would have been sought on behalf of and inured to the benefit of all bondholders, making it relief that only the trustee could seek. To the extent the complaint alleged fraud that deprived the bondholders of an opportunity to sell their bonds in the market, the Chancellor held that the no-action clause would not apply. In *Feldbaum,* however, the alleged fraud consisted of the defendants' failure to disclose that the restructuring violated the indentures. The fraud claim therefore constituted an effort "to transmute a contract claim litigable only by the indenture trustee into an individual fraud claim." *Id.* at *10. Chancellor Allen refused to credit this stratagem and dismissed the fraud claim as well. In substance, *Feldbaum* held that a no-action clause would apply to any remedy sought on behalf of all bondholders, but given the expansive language of the *Feldbaum* clause, that reading was entirely appropriate.

In *Lange,* another decision by this Court interpreting New York law, Chancellor Strine, then-Vice Chancellor, relied on *Feldbaum* when confronted with an identical no-action clause. *Lange,* 2002 WL 2005728, at *5–6. The plaintiff debentureholders contested the leveraged buyout of an allegedly insolvent issuer, contending that the defendants breached their fiduciary duties, effected fraudulent transfers, and aided and abetted the primary violations. *Id.* at *5. Chancellor Strine held that the no-action clause barred the claims.

> Per *Feldbaum,* the particular nature of a claim that is asserted on behalf of the Debentureholders as a class is not determinative of the

> applicability of [the no-action clause]; what is determinative is whether the claim is one with respect to the Indenture or the Debentures themselves. Each of the claims pled in the amended complaint clearly satisfies that test, as the Debentureholders' ability to press those claims depends entirely on their ownership of the Debentures and the adverse effect that certain actions have allegedly had on each Debentureholder, *pro rata* to her ownership of those securities.

***11** *Id.*at *7. Because each of the claims could be asserted by the trustee, the plaintiffs could not proceed without complying with the no-action clause.

Two more recent decisions followed *Feldbaum* and *Lange.* In the *Wherehouse Entertainment* litigation, the issuing corporation failed to redeem outstanding debentures at a premium after the occurrence of an event that the plaintiffs contended triggered the redemption obligation. The plaintiffs asserted claims for breach of contract, breach of the implied covenant of good faith and fair dealing, tortious interference with contract, and fraudulent conveyance. *See*McMahan & Co. v. Wherehouse Entm't, Inc., 859 F.Supp. 743, 745–46 (S.D.N.Y.1994), *aff'd in part, rev'd in part,*65 F.3d 1044 (2d Cir.1995). Like the *FeldbaumlLange* clause, the *Wherehouse Entertainment* clause barred the debentureholders from seeking "any remedy with respect to [the] Indenture or the Securities" unless they first complied with its terms. *Id.* at 747. The court held that the state law claims sought a remedy with respect to the securities and dismissed the claims. *Id.* at 747–48.

Similarly in the *Akanthos* litigation, bondholders argued that certain transactions engaged in by the issuing corporation constituted illegal fraudulent transfers. *SeeAkanthos Capital Mgmt., LLC v. CompuCredit Hldgs. Corp.,* 677 F.3d 1286 (11th Cir.2012). Like the *Feldbaum/Lange* clause, the *Akanthos* clause stated that noteholders " 'may not pursue any remedy with respect to the Indenture or the Securities' " without first complying with the requirements of the clause. *Id.* at 1289. The United States Court of Appeals for the Eleventh Circuit held that the clause applied, finding it "clear that Plaintiffs' suit relates to the trust indentures or the securities." *Id.* at 1293. In reaching this conclusion, the court relied on and quoted extensively from *Feldbaum* and *Lange.*

Consistent with the pre-TIA decisions, the foregoing authorities indicate that the effect of a no-action clause depends on its language. In *Cruden,* where the no-action clause paralleled the Athilon Clause and applied only to attempts to assert rights grounded in the indenture, the district court permitted the plaintiffs to assert claims arising from their status as noteholders, and the Court of Appeals implicitly agreed with this analysis. The other decisions all involved much broader no-action clauses like those in *Feldbaum* and *Lange,* and the courts consistently applied those expansive no-action clauses in accordance with their terms.

For their part, the defendants rely on two inapposite cases: *Walnut Place LLC v.Countrywide Home Loans, Inc.,* 96 A.D.3d 684, 948 N.Y.S.2d 580 (App.Div.2012), and *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.*, No. 650474/2008, 2010 WL 9525799 (N.Y.Sup.Ct. Oct. 7, 2010). In both cases, the defendants issued certificates, analogous to notes, pursuant to pooling and service agreements ("PSAs"), analogous to an indenture. Holders of certificates alleged that the defendants breached representations and warranties in the PSAs. Both decisions held that the no-action clauses in the PSAs barred the claims. Neither decision addressed an attempt by certificate holders to invoke rights that did not depend on the PSAs. Both cases are comparable to an attempt by noteholders to assert a claim for breach of the indenture, which is a claim to which a no-action clause necessarily applies. *See* Foster, *supra* note 1, at n.3 ("Where the individual bondholder, in order to make out a cause of action, must rely upon some violation by the debtor of the terms of the trust indenture or like instrument securing the bond, then, rather plainly, the bondholder cannot maintain his action unless he has met such restrictive conditions as are imposed by the trust indenture in respect of actions by individual bondholders."). Subpart 3.0 of the Athilon Clause explicitly bars such a claim. Neither *Walnut Place* nor *Greenwich Financial* sheds light on the extent to which a New York court would apply the Athilon Clause to bar a claim that did not invoke a provision of the Indenture.

C. Other Instructive Delaware Precedents

***12** In *Feldbaum* and *Lange,* this Court interpreted expansive no-action clauses that were governed New York law. In other decisions, the Delaware Supreme Court and this Court have commented on narrower clauses and suggested that bondholders could bring claims that fell outside of the language of the clause. Unfortunately, these decisions have not made clear whether the indentures in question were governed by New York law. I discuss them for three reasons. First, they represent the only extant indications of the Delaware Supreme Court's views; second, given the prevalence of New York law in this area, some of the indentures may have been governed by New York law despite the absence of any reference in the opinion; and third, this Court has observed that there are no pertinent distinctions between New York law and Delaware law in this area. *SeeTang Capital P'rs, LP v. Norton,* 2012 WL 3072347, at *4 & n.15 (Del. Ch. July 27, 2012) (interpreting no-action clause in indenture with New York choice of law provision; noting that "[n]either party has cited and I am not aware of any case law indicating that the principles of contract interpretation under New York law, so far as relevant to this case, differ materially from those under Delaware law"); *Elliott Assocs., L.P. v. Bio–Response, Inc.,* 1989 WL 55070, at *3 n.1 (Del. Ch. May 23, 1989) (interpreting no-action clause in indenture with New York choice of law provision; remarking that "there has been no showing that the law of New York differs from that of Delaware with respect to any of the matters at issue here" and concluding that "it appears to be of no consequence which authorities are relied upon").

This line of Delaware decisions begins with *Harff v. Kerkorian,* 324 A.2d 215 (Del. Ch.1974) ("*Harff I* "), *aff'd in part, rev'd in part,*347 A.2d 133 (Del.1975) ("*Harff II* "). There, holders of debentures claimed that they had been harmed by the declaration of an allegedly improper dividend, and they sued both derivatively and directly for breach of fiduciary duty. Chancellor Quillen dismissed their derivative claims for lack of standing. *Id.* at 220. The defendants argued that to the extent the same claims could be framed as direct causes of action, they were barred by a no-action clause in the related indenture, which provided that "[n]o holder of any Debenture shall have any right by virtue of or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect this Indenture...." *Id.* at 221 n.5. Although the opinion did not quote the entire clause, the foregoing portion resembles the Athilon Clause.

In ruling on the debentureholders' class claims, Chancellor Quillen noted that "[t]he authorities cited by plaintiffs for the proposition that creditors can maintain an action against management for violation of rights which exist independently of the Indenture Agreement all involved either fraud or insolvency." *Id.* at 221. The Chancellor observed that the plaintiffs had not alleged that the corporation was insolvent, asserted any violation of a Delaware statute, or pled that the dividend amounted to fraud. *Id.* He concluded that "no fiduciary duties existed as between the parties and that the rights of the convertible debenture holders ... are confined to the terms of the Indenture Agreement." *Id.* at 222. In light of this holding, the Chancellor held that "[t]he effect of the 'no-action clause'... need not be determined." *Id.*

On appeal, the Delaware Supreme Court affirmed the dismissal of the derivative claim, but reversed the dismissal of the direct claims. *Harff II,* 347 A.2d at 134. The Delaware Supreme Court held that the plaintiffs had pled adequately that the dividend amounted to fraud. *Id.* The Delaware Supreme Court accepted the plaintiffs' contention that "this 'tort claim is wholly unrelated to and unaffected by any contract rights that the plaintiffs may have under the Indenture Agreement.' " *Id.* The high court held that that "judgment in favor of the defendants in the class action is reversed and the cause remanded for trial of the issue of fraud." *Id.* As in *Cruden II,* the appellate decision did not comment on the no-action clause analysis.

HarffII implies that the Delaware Supreme Court believed a no-action clause with the same scope as the Athilon Clause would not bar the noteholders' individual claims for damages under a theory of fraud. In *Continental Illinois,* Justice Jacobs, then a Vice Chancellor, read *Harff II* in this fashion: "By recognizing that the debenture holders were entitled to proceed on a claim of fraud independent of the terms and limitations of the Indenture, the Supreme Court in *Harff* implicitly ruled that the no-action clause of the indenture would not bar an action for fraud." *Cont'lIll. Nat'l Bank & Trust Co. of Chi. v. Hunt Int'l Res. Corp.,* 1987 WL 55826, at *5 (Del. Ch. Feb. 27, 1987); *see alsoSimons v. Cogan,* 549 A.2d 300, 303 (Del.1988) ("this Court permitted the class action in *Harff* to proceed because plaintiffs had brought themselves within the fraud exception").

***13** In *Mann v. Oppenheimer,* Justice Walsh, then Vice Chancellor, reached the same conclusion about *Harff. See*Mann v. Oppenheimer & Co., 1985 WL 11555 (Del. Ch. Apr. 4, 1985), *rev'd on other grounds,*517 A.2d 1056 (Del.1986). The plaintiffs in *Mann* owned subordinated debentures and challenged an exchange offer on grounds of fraud. The defendants relied on a no-action clause which stated, "no holder of any Debenture may institute any action to enforce any remedy under the Indenture unless the Trustee declines or fails to exercise its powers or to institute such action...." *Id.* at *3. The plaintiffs argued that the no-action clause only restricted "suits brought 'under or upon' the indenture." *Id.* Citing *Harff I,* Justice Walsh stated: "There is merit in plaintiffs' position. Even though this dispute may implicate the terms of the Indenture, the allegations of fraud and

Federal security law violations are sufficient to support an independent action. Thus, the plaintiffs need not have given notice to the Trustee prior to bringing suit." *Id.* (citation omitted). Justice Walsh nevertheless granted summary judgment in favor of the defendants. *Id.* On appeal, the Delaware Supreme Court reversed and remanded so that the noteholder plaintiffs could take discovery on the common law fraud claims before the court addressed the defendants' motion for summary judgment. *See*Mann v. Oppenheimer & Co., 517 A.2d 1056, 1060–61 (Del.1986). Although the Delaware Supreme Court did not explicitly address the no-action clause, its ruling was consistent with Justice Walsh's interpretation and inconsistent with the contrary position that the no-action clause barred the claims as a matter of law. *See Cont'l Ill.,*1987 WL 55826, at *5 (interpreting *Mann* in this fashion).

Justice Berger, then Vice Chancellor, employed a similar analysis in *Mabon, Nugent & Co. v. Texas American Energy Corp.,* 1988 WL 5492 (Del. Ch. Jan. 27, 1988). The holders of debentures sued the issuer and its parent for breach of the indenture and for fraud, contending that the defendants misrepresented that the parent would assume the indenture. The defendants relied on a no-action clause. Although the language of the clause was not quoted in the opinion, Justice Berger described it as requiring that notice be given to the trustee and other procedural requirements met "before instituting any action for the enforcement of any remedy under the indenture." *Id.* at *2. Justice Berger held that the no-action clause only applied to the breach of contract claim: "Plaintiffs' remaining claims are not contractual and, therefore, the restrictions in the Indenture do not apply." *Id.* at *3 (citing *Cont'l Illinois,*1987 WL 55826).

It bears noting that in *Lange,* Chancellor Strine declined to read the *Harff* cases as expressing any view on the scope of a no-action clause. 2002 WL 2005728, at *7 n.21. On the merits, Chancellor Strine had held that the broad no-action clause at issue in *Lange* barred the noteholders claims for breach of fiduciary duty. Id. at *7. In a footnote, he observed that some earlier cases suggested that claims for breach of fiduciary duty could fall outside a no-action clause, citing *Continental Illinois,* and he traced "[m]ost of this confusion" to *Harff II.* He then asked,

> [D]id the *Harff* case hold that a no-action clause could not bar a bondholder suit alleging fraud or that the issuer was insolvent? The answer to that question is no. In *Harff,* the Court of Chancery expressly avoided any ruling on the scope of applicability of the no-action clause, and the Supreme Court never addressed it any discernible, articulated way.

2002WL 2005728, at *7 n.21. Notably, the *Lange* footnote framed the operative question as whether a no-action clause could bar a breach of fiduciary duty claim, not whether the specific language of the no-action clause at issue in *Harff* barred the claim. As in the current case, the parties may not have focused at the trial court level on the specific wording of the two clauses, and the *Lange* decision did not parse the narrower no-action clause in *Harff* or contrast it with the broader no-action clause in *Lange.*

Taken together, the *Harff* cases and subsequent decisions indicate that the Athilon Clause applies only to claims under the Indenture and does not extend to claims that rely on other sources of law. The limited reading that these cases give to narrow no-action clauses parallels the approach taken by the authorities that explicitly apply New York law.

D. Authoritative Commentary

***14** Although New York law directs that indenture provisions be interpreted using standard principles of contract interpretation, "[c]ourts strive to give indenture provisions a consistent and uniform meaning because uniformity in interpretation is important to the efficiency of capital markets." *Concord Real Estate CDO 2006–1, Ltd. v. Bank of Am.N.A.,* 996 A.2d 324, 331 (Del. Ch.2010) (internal quotation marks omitted), *aff'd,*15 A.3d216 (Del.2011) (TABLE). Experienced drafters deploy settled language:

> The preparation of an instrument of security intended to provide with artistic completeness for the ramifications of the modern corporate entity imposes upon its author the obligation to use wording that is well defined among those engaged in the interpretation of such indentures. To depart from well understood verbiage is to invite criticism and possibly to plunge the investor into the field of the unknown.

Bond Issues at 4.

"Courts enhance stability and uniformity of interpretation by looking to the multi-decade efforts of leading practitioners to develop model indenture provisions." *Concord Real Estate,* 996 A.2d at 331. These efforts began with the *Commentaries* in 1971 and continued with subsequent updates. *See, e.g.,Revised Model Simplified Indenture,* 55 Bus. Law. 1115 (2000); *Model Simplified Indenture,* 38 Bus. Law. 741 (1983); *Mortgage Bond Indenture Form,* 36 Bus. Law.1917 (1981).

The *Commentaries* "provide powerful evidence of the established commercial expectations of practitioners and market participants." *Concord Real Estate,* 996 A.2d at 331. "Where a standard term is the **product** of an explicit standard-setting process such as the model bond indenture or the model simplified indenture, commentaries of the standard-setting organization should be accorded authoritative weight." Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (or "TheEconomics of Boilerplate* "), 83 Va. L.Rev. 713, 765 (1997) (footnote omitted). The Delaware Supreme Court and other courts "have looked to the *[Commentaries]* as 'an aid to drafting and construction' of common indenture language." *Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp,* 29 A.3d 225, 241 (Del.2011); *see Kaiser Aluminum Corp. v. Matheson,* 681 A.2d 392, 396–97 (Del.1996) (relying on *Commentaries* and subsequent versions of the model indenture).

The *Commentaries* contain a model no-action clause that resembles the Athilon Clause:

> No holder of any Debenture or coupon shall have any right to institute any proceeding, judicial or otherwise, with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder, unless [the holder complies with the conditions in the clause].

Commentaries, supra note 3, § 5–7 at 232. Unlike the Athilon Clause, the *Commentaries* ' model clause does not contain language similar to subpart 1.0 that explicitly addresses the source of the rights that a holder may invoke. It does, however, contain language similar to subparts 3.0 and 4.0 addressing the types of proceedings governed by the clause, *viz.,* those "with respect to this Indenture" or which seek "the appointment of a receiver or trustee, or for any other remedy hereunder." Notably, the model clause does not refer to proceedings "with respect to the Debentures," and the *Commentaries* stress this point: "Note that this limitation is only on suits under the indenture." *Id.* at 233. Reinforcing this observation, the *Commentaries* describe as a "curious case" a decision which held that a "holder of coupons for overdue interest on mortgage bonds issued under an indenture containing a provision similar to the [model no-action clause] could not maintain a suit on such coupons." *Id.* at 233 n.22 (referencing *Bartol v. Gottlieb–Bauernschmidt–Straus Brewing Co.,* 129 Md. 32, 98 A. 286 (Md.1916)). The implication is that the plain language of the model no-action clause only applies to suits under the indenture or that seek specified remedies, but not to other suits, such as actions or proceedings that do not rely on the indenture and seek other remedies.

***15** More recent authority confirms this interpretation. In 2000, the Ad Hoc Committee for Revision of the 1983 Modified Simplified Indenture, working under the aegis of the Committee on Developments in Business Financing of the American Bar Association's Section of Business Law and assisted by members of the Committee on Trust Indentures and Indenture Trustees and the Business Bankruptcy Committee's Subcommittee on Trust Indentures, produced a Revised Model Simplified Indenture. *SeeRevised Model Simplified Indenture,* 55 Bus. Law. 1115 (2000); *see alsoBank of N.Y.,* 29 A.3d at 242 (relying on the Revised Model Simplified Indenture and commentary). Its model no-action clause resembles the *Feldbaum/Lange* clause: "A Securityholder may pursue a remedy with respect to this Indenture or the Securities only if [the holder complies with the terms of the clause]." *Revised Model Simplified Indenture,* 55 Bus. Law. 1115, 1137–38(2000).

Like the *Feldbaum/Lange* clause, the model clause applies to any efforts by a Securityholder to "pursue a remedy with respect to this Indenture or the Securities." Yet notwithstanding the broad language, the commentary to the provision states:

> The clause applies, however, only to suits brought to enforce contract rights under the Indenture or the Securities, not to suits asserting rights arising under other laws.
>
> Note that the introductory language requiring compliance prior to pursuing a remedy "with respect to this Indenture *or the Securities* " indicates merely that claims to enforce the contractual terms of the Securities (which may include rights incorporated from the Indenture) are likewise subject to the no-action clause (subject to the exclusion noted in the preceding paragraph).

*Id.*at 1191–92 (emphasis in original) (citations omitted).

Thus, according to authoritative commentators, even a clause like the *Feldbaum/Lange* clause should not extend beyond contract rights. For purposes of the issue presented by the Remand Order, this commentary confirms that the Athilon Clause should receive a narrow reading.

E. The Statutory Receivership Cases
There is one line of cases that cuts against the preceding authorities and favors equating the Athilon Clause with the *Feldbaum/Lange* clause. When considering bondholders' petitions for a statutory receivership, judicial decisions have given a broad construction to no-action clauses paralleling the Athilon Clause. The defendants rely on *Tang,* which they say holds that the Athilon Clause must apply to any attempt by a noteholder to bring an action on a debt instrument. I read *Tang* and its predecessor cases as limited to statutory receiverships and not as speaking to other contexts, such as the claims in this case.

In *Tang,* noteholders petitioned for a statutory receivership under Section 291 of the Delaware General Corporation Law based on their status as creditors. *See*8 *Del. C.* § 291 ("Whenever a corporation shall be insolvent, the Court of Chancery, on the application of any creditor or stockholder thereof, may, at any time, appoint 1 or more persons to be receivers of and for the corporation...."). Like the Athilon Clause, the no-action clause in *Tang* provided that

> no Holder of any Note shall have any right by virtue or by availing of any provision of this Indenture to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture, or for the appointment of a receiver, trustee, liquidator, custodian or other similar official, or for any other remedy hereunder [without meeting specified conditions]....

*Tang,*2012 WL 3072347, at *3 (emphasis omitted). The noteholders argued that the no-action clause did not apply because they were not invoking a "right by virtue or by availing of any provision of this Indenture." The defendants responded that the no-action clause applied because the phrase " 'by virtue of or by availing of any provision [of this Indenture]' should be construed to bar actions that arise out of any rights or status conferred on the Note holders by the Indenture." *Id.* at *5. Vice Chancellor Glasscock commented that he "read the [no-action clause] as the Defendants do" and stated that he agreed that the phrase " 'by virtue of the Indenture' indicates coverage of such causes of action available to a plaintiff by virtue of its status as a Note holder." *Id.*

***16** In support of their right to pursue a statutory receivership notwithstanding the no-action clause, the plaintiffs relied on *Noble v. European Mortgage & Investment Corp.,* 165 A. 157 (Del.1933). Vice Chancellor Glasscock declined to follow *Noble* and relied instead on *Elliott Associates,* in which Justice Berger, then Vice Chancellor, distinguished the earlier *Noble* decision. To understand this line of authority, it is helpful to start with *Noble* and work forward.

Noble was one of two opinions addressing whether a no-action clause applied to a claim for a statutory receiver that Chancellor Josiah O. Wolcott issued within a five month period. In *Noble,* Chancellor Wolcott considered whether a bondholder could obtain a statutory receivership in light of a no-action clause that applied to "any action or proceeding at law or in equity upon or in respect of this indenture, or for the execution of any trust or power hereof, or for any other remedy under or upon this indenture." 165 A. at 158 (internal quotation marks omitted). The issuer had defaulted on its interest payments, and the holders of the coupons sued for the overdue payments and for the appointment of a statutory receiver. Chancellor Wolcott noted that the petition for a statutory receiver did not seek a remedy "under or upon this indenture" and that no-action clauses were "strictly construed." *Id.* at 159. The coupon holders were therefore "as much entitled to file a receivership bill under the statute as is any other creditor." *Id.*

Shortly thereafter, in *Tietjen v. United Post Office Corp.,* 167 A. 846 (Del. Ch. 1933), Chancellor Wolcott considered a similar petition for a statutory receivership. The *Tietjen* no-action clause applied to "any suit, action or proceeding at law or in equity for the foreclosure of this indenture, or for the appointment of a receiver, or for any other remedy hereunder...." *Id.* at 847. The petitioner relied on *Noble,* but Chancellor Wolcott observed that "[w]hat clearly distinguishes the pending case from the *Noble* Case is this—that here the indenture in Section 1 of Article Seven expressly denies to any bondholder the right to sue for the appointment of a receiver unless the required request has been made of the trustees...." *Id.* In response to the petitioner's argument that the no-action clause applied only to "the appointment of a receiver ... hereunder," *viz.* under the terms of the indenture, Chancellor Wolcott explained that the no-action clause extended to any remedy that the trustee could obtain under the indenture, and that the language of the indenture demonstrated that the trustee could seek a statutory receiver:

> It is suggested by the complainant that the only sort of receiver which the prohibition referred to can be taken to contemplate is a receiver of the property under the indenture, and that inasmuch as the pending bill seeks a general receiver for the corporation and not of the property alone, the prohibition is not applicable. The answer to that suggestion I think is plain, for it is to be observed that the request and refusal are conditions precedent not only to the bondholders' right to sue for a receiver but as well to the bondholders' right to enforce any power or remedy given to the trustees. Now among those powers which are given to the trustees is the one found in Section 5 of the same Article Seven, which is that in case any one of the defaults occurs under Section 2 (which defaults accelerate the maturity of the bonds) the trustees are "entitled as of right, without notice, to the appointment of a receiver ... of each and every [of] the rights and properties of the corporation, with power to operate and continue the business of the corporation, and with all other rights and powers of receivers in equity." This language clearly shows that the sort of receiver which the bondholders are forbidden to seek without satisfying the conditions precedent, is not of the limited type which operates only in a custodial capacity over the mortgaged property.

***17** *Id.*at 847–48. Because the type of statutory receiver that the bondholders sought was one that the trustee could obtain under the indenture, Chancellor Wolcott dismissed the petition. *Id.* at 848.

Tietjen reached the same result as two contemporaneous New York decisions. *SeeGreene v. N.Y. United Hotels,* 236 A.D. 647, 260 N.Y.S. 405 (App.Div.1932), *aff'd,*204 Ind. 311, 183 N.E. 798 (N.Y.1933); *Ernst v. Film Prod. Co.,* 148 Misc. 62, 264 N.Y.S. 227 (Sup.Ct.1933). In *Greene,* the no-action clause provided that

> [i]n order to promote and protect the equal and ratable rights of every holder of the Debentures and to avoid multiplicity of suits, all the Debentures shall be subject to the condition that no holder of any Debenture or coupon appertaining thereto shall have any right to institute any action, at law or in equity, under or growing out of any provision of this Indenture, or for the enforcement thereof, [without meeting its conditions].

260 N.Y.S. at 406. A single bondholder sought the appointment of a receiver because of the corporation's failure to pay interest coupons when due. The appellate court affirmed the dismissal of the petition on two grounds. First, the complaint did not plead compliance with the no-action clause, and the court stated without analysis that "[t]he plaintiff as a bondholder holds his securities subject to the condition of this underlying trust agreement and can maintain an action only upon the conditions specified in the trust agreement." *Id.* at 407. The court did not discuss whether the plaintiff had instituted an action "under or growing out of any provision of this indenture, or for the enforcement thereof." Second, the complaint requested a receiver but did not describe what the receiver would do. *Id.* The court held that the appointment of a receiver "is provisional" and "never ... the ultimate object of the action," hence the complaint was "fundamentally defective." *Id.* I suspect that under current pleading standards, it would be reasonable to infer that the petitioner wanted the receiver to cause the company to pay the interest on the past-due coupons. *See Cent. Mortg. Co. v. Morgan Stanley Mortg.Capital Hldgs. LLC,* 27 A.3d 531, 536 (Del.2011) (adopting "reasonable conceivability" as pleading standard in Delaware state court).

Ernst involved the same indenture litigated in *Relmar Holding Co. v. Paramount Public Corp.,* 147 Misc. 824, 263 N.Y.S. 776 (Sup.Ct.1932), *aff'd,* 237 A.D. 870, 261 N.Y.S. 959 (App.Div.1933). The no-action clause provided:

> In order to promote and protect the equal ratable right of every holder of the bonds and to avoid multiplicity of suits, all the bonds shall be subject to the condition that all rights of action thereon, or in respect thereof, or on or in respect of the coupons thereto appertaining, are vested exclusively in the trustee under this indenture, and that no holder of any bond or coupon appertaining thereto shall have any right to institute any action, at law or in equity, upon the bonds or any of the appurtenant coupons, or growing out of any provision thereof, or of this indenture, or for the enforcement of this indenture [without complying

> with its conditions].

*Relmar,*263 N.Y.S. at 777–78 (Sup.Ct.1932). In *Relmar,* plaintiff bondholders contended that the issuance of a new series of bonds by one of Paramount's wholly owned subsidiaries violated the terms of the indenture, and the court had little difficulty holding that the no-action clause applied. *Id.*

***18** In *Ernst,* the plaintiffs sought the appointment of a receiver on the grounds that the same issuance constituted a fraudulent conveyance. 264 N.Y.S. at 228. This time, the plaintiffs contended that they were not suing under the indenture but rather as creditors under the New York Debtor and Creditor Law. *Id.* ‰The court held that the no-action clause applied to this claim as well:

> What [the plaintiffs] seek is a receiver *in a representative action* to set aside a transfer as fraudulent. The nature of their action shows that they are presuming to speak for all the bondholders and not for themselves alone. They are attempting to protect their rights under the indenture, but to be permitted to do so they must not contravene its terms.... As soon as the plaintiffs presumed to speak for all other bondholders, they necessarily brought in the collateral indenture, their right to do which is challenged as a question of fact.

*Id.*at 229. The court seemingly could have reached the same result simply by citing the plain language of the no-action clause, which encompassed not only rights of action under the indenture but also rights under the bonds.

The outcomes in *Tietjen, Greene,* and *Ernst* reflected the rule at the time in most jurisdictions. *See* Smith, *supra* note 1 (collecting cases). By contrast, contemporaneous decisions from the New Jersey Court of Chancery held that no-action clauses must be interpreted strictly such that when a clause referred to a right of action by virtue of the indenture or a remedy under its terms, it did not bar a suit for a statutory receiver. *SeeJennings v. Studebaker Corp.,* 112 N.J. Eq. 591, 165 A. 631 (NJ. Ch.1933); *Tachna v. Pressed Steel Car Co.,* 112 N.J. Eq. 174, 163 A. 806 (N.J. Ch.1933), *rev'd on other grounds,*112 N.J. Eq. 411, 164 A. 413 (N.J.1933); *Reinhardt v. Interstate Tele. Co.,* 71 N.J. Eq. 70, 63 A. 1097 (NJ. Ch.1906). This did not mean that a New Jersey court would grant the petition for a statutory receiver, only that the no-action clause did not bar consideration of the petition on the merits. *SeeJennings,* 165 A. at 633–34 (denying petition).

Against this backdrop, Justice Berger decided *Elliott Associates.* The plaintiffs held debentures and sought the appointment of a receiver for the issuer, Bio–Response, Inc under Section 291. They also claimed that Bio–Response had committed fraud and violated the implied covenant of good faith and fair dealing. *Elliott Assocs.,* 1989 WL 55070 at *1, *4. Citing *Harff I* and *II,* Justice Berger noted that "debenture holders may be able to seek relief outside of the indenture where there are 'special circumstances which affect the rights of the debenture holders as creditors of the corporation, e.g., fraud, insolvency, or a violation of a statute....' " *Id* at *4. But Justice Berger held that (i) the complaint did not sufficiently allege fraud and (ii) the implied covenant of good faith and fair dealing did not give the plaintiffs any rights other than those found in the indenture. *Id.*

This left the claim for a receiver, which Justice Berger held was barred by the no-action clause. Like the Athilon Clause and the provision in *Tang,* the no-action clause at issue in *Elliott Associates* stated:

> No Holder of any Security shall have any right by virtue of or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder unless such Holder previously [complies with specified conditions].

***19** *Id.*at *6. Justice Berger held that "[u]nlike the relevant clause in *Noble,* there is nothing in this Indenture reserving to plaintiffs the right to commence an action, 'so long as the procedure they adopt is not under the [I]ndenture' " and that "as in *Tietjen,* Debenture holders are expressly denied the right to bring an action for the appointment of a receiver without first following the specified procedure...." *Id.* at *7.

In *Tang,* Vice Chancellor Glasscock followed *Elliott Associates* on grounds of *stare decisis.* He noted that "[t]he language of the indenture's no-action clause in *Elliott* was nearly identical to that [in *Tang*]." 2012 WL 3072347, at *6. He therefore relied on *Elliott Associates* as "directly on point" and "not credibly refuted." *Id.*

In my view, the defendants are correct to point out the tension between the rulings in the Delaware statutory receivership cases and the plain language of the no-action clauses at issue. After excising the inapplicable language, the relevant portions of the *Tang* and *Elliott Associates* clauses stated: "No Holder of any Security shall have any right by virtue of or by availing of any provision of this Indenture to institute any action or proceeding ... for the appointment of a receiver or trustee, or for any other remedy hereunder." The predicate requirement for triggering the clause was that the holder invoke a right "by virtue of or by availing of any provision of this Indenture." The plaintiffs, however, were not asserting any right "by virtue of or by availing of any provision of this Indenture," but rather under Section 291. Consistent with the New Jersey authorities, it would seem that the no-action clause would not apply to a petition for receivership that did not rely on the indenture. *Tietjen,* however, held that the reference to a receivership was sufficient to reach the opposite conclusion, creating a conceptual disconnect.

Elliott Associates relied on *Tietjen,* focused on the reference to "the appointment of a receiver" in the no-action clause, and did not dilate on the apparent limitation of the clause to claims "by virtue of or by availing of any provision of this Indenture." 1989 WL 55070, at *6. *Tang* reasoned through the conceptual disconnect and bridged the divide by holding that a suit "by virtue of or by availing of any provision of this Indenture" was the equivalent of a suit under the notes. To reach this result, the *Tang* court adopted the defendants' position that if the two prepositional phrases "by virtue of" and "by availing of" did not mean different things, then one would be rendered surplusage, an outcome contrary to standard principles of contract interpretation. 2012 WL 3072347, at *5. *Tang* gave meaning to both by interpreting the phrase "by availing of any provision of this Indenture" to refer to claims under the indenture itself while interpreting "by virtue of ... this Indenture" to encompass claims under the notes. *Id.*

As demonstrated by this authorities discussed in this opinion, some no-action clauses refer to claims under "the Indenture" while others refer to claims under "the Indenture or the Notes." The *Tang* approach eliminates any distinction between the two usages by transforming a no-action clause like the Athilon Clause into the functional equivalent of the following provision, in which the italicized language reflects alterations:

> No Holder of any Note shall have any right by virtue of or by availing of any provision of this Indenture *or the Notes* to institute any suit, action or proceeding in equity or at law upon or under or with respect to this Indenture *or the Notes,* or for the appointment of a receiver, trustee, liquidator, custodian or other similar official, or for any other remedy hereunder *or under the Notes.*

***20** If applied to a no-action clause that already included the italicized references, the reasoning in *Tang* would render them meaningless because the phrase "by virtue of ... the Indenture" takes care of note-based claims. The no-surplusage rule thus contradicts itself: by not treating the phrase "by virtue of ... the Indenture" as surplusage, the phrase "or the Notes" becomes surplusage.

Under *Cruden II, Victor v. Riklis,* and pre-TIA decisions, including the phrase "or the Notes" changes the scope of the no-action clause. These authorities indicate that if one of the two phrases is redundant, it is "by virtue of." It consequently seems preferable to regard the compound prepositional phrase "by virtue of" or by availing of as an example of the law's hoary tradition of deploying joint terms, such as "indemnify and hold harmless," where technically one term would suffice. *See, e.g.,Majkowski v. Am. Imaging Mgmt. Servs., LLC,* 913 A.2d 572, 588 (Del. Ch.2006) (declining to give separate meaning to the phrase "hold harmless"; noting that "[t]he terms 'indemnify' and 'hold harmless' have a long history of joint use throughout the lexicon of Anglo–American legal practice"). *See generally* Bryan A. Garner, *The Redbook: A Manual on Legal Style* § 11.2 at 192 (2d ed. 2006) ("The doublet and triplet phrasing common in Middle English still survives in legal writing, especially contracts, wills, and trusts. That's probably the worst possible soil for it to grow in because those who interpret legal writing are impelled to strain for distinctions so that no word is rendered surplusage. Yet that is exactly all but one word ... is [in these phrases]."). Under this reading, the Athilon Clause would not encompass a petition for a statutory receivership, which is not to say that a no-action clause could not be drafted to reach such a petition. The *Feldbaum/Lange* clause would bar a statutory receivership action, because through such an action a "Securityholder" would be pursuing a "remedy with respect to this Indenture or the Securities."

The Complaint does not seek a statutory receivership, so for purposes of the issue raised by the Remand Order, this Court is not required to follow the decisions in *Tietjen, Elliott Associates,* and *Tang* on grounds of *stare decisis.* Rather, the tension between these opinions and other decisions suggests that the receivership cases should not be relied upon to expand the scope of the Athilon Clause to include claims under the Notes.

F. Applying The Athilon Clause To Quadrant's Claims

The foregoing review of cases and authorities indicates that each noteholder claim must be measured against the particular language of the no-action clause in question. In this case, the Athilon Clause applies to Counts VII and VIII in their entirety and to Count X to the extent it alleges a conspiracy to engage in the wrongs alleged in Counts VII and VIII. Otherwise, the Athilon Clause does not apply to the Complaint.

1. Count I: Breach Of Fiduciary Duty

In Count I of the Complaint, **Quadrant** asserts a derivative claim on behalf of Athilon against the individual defendants for breach of fiduciary duty. In *Feldbaum* and *Lange,* this Court held that the no-action clause at issue in those cases barred similar claims for breach of fiduciary duty. *See Feldbaum,*1992 WL 119095, at *6–8; *Lange,* 2002 WL 2005728, at *7. Based on the arguments previously made at the trial level, *Lange* and *Feldbaum* were "directly on point." Dismissal Order ¶ 1.

***21** The Athilon Clause, however, only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Count I, **Quadrant** relies on its status as a creditor under the Notes, its allegation that Athilon is insolvent, and the doctrine of creditor standing articulated by the Delaware Supreme Court in *North American Catholic Education Programming Foundation, Inc. v. Gheewalla,* 930 A.2d 92, 101–02 (Del.2007). **Quadrant** does not rely on any provision of the Indenture. It therefore appears, based on the argument **Quadrant** made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling and that the plain language of the Athilon Clause does not extend to a *Gheewalla* claim.

Levy v. Paramount Publix Corp., 149 Misc. 129, 266 N.Y.S. 271 (Sup.Ct.1933), *aff'd,*269 N.Y.S.2d 997 (App.Div.1934), a case cited in *Lange,* does not compel a different result. The *Levy* decision construed the same no-action clause addressed in *Relmar* and *Ernst,* quoted above. The no-action clause expressly encompassed rights of action on the bonds, "or in respect thereof," and barred any holder of the bonds from instituting any action "upon the Bonds ... or growing out of any provision thereof." *Levy,* 266 N.Y.S. at 273. Like the no-action clause in *Lange,* the no-action clause in *Levy* was not limited to rights under the indenture. Moreover, the court in *Levy* does not appear to have relied on the no-action clause to dispose of the breach of fiduciary duty claim, which failed on other grounds. *Id.* at 273–76. *Levy* reinforces the principle that the plain language of the no-action clause controls.

2. Count II: Aiding and Abetting A Breach Of Fiduciary Duty

In Count II of the Complaint, **Quadrant** asserts a derivative claim on behalf of Athilon for aiding and abetting the breaches of fiduciary duty alleged in Count I. In *Feldbaum,* this Court held that a no-action clause "applies equally to claims against non-issuer defendants as to claims against issuers." 1992 WL 119095, at *7. With that additional analytical step, the analysis of Count I applies equally to Count II, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

3. Count III: Permanent Injunction Based On Breach of Duty

In Count III of the Complaint, **Quadrant** seeks a permanent injunction barring the individual defendants from causing Athilon to make interest payments on the Junior Notes or to pay the service and license fees identified in Count I. For purposes of the Athilon Clause, the analysis is the same as Count I, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

4. Counts IV And V: Fraudulent Conveyance

In Counts IV and V, **Quadrant** challenges the payment of interest on the Junior Notes and the service and license fees paid to EBF and ASIA as fraudulent transfers. In *Lange* and *Feldbaum,* this Court held that the no-action clause at issue in those cases barred similar claims for fraudulent transfer. *See Feldbaum,*1992 WL 119095, at *6–8; *Lange,* 2002 WL 2005728, at *7. Based on the arguments previously made at the trial level, *Lange* and *Feldbaum* seemed "directly on point." Dismissal Order ¶ 1.

The Athilon Clause only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Counts IV and V, **Quadrant** relies on its status as a creditor under the Notes, its allegation that Athilon is insolvent, and provisions of the DFTA. *See*6 *Del C.* §§ 1304(a)(1), 1305(b). **Quadrant** does not rely on any provision of the Indenture. It therefore appears, based on the argument **Quadrant** made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling.

***22** *Lange* and *Feldbaum* cited New York cases for the proposition that no-action clauses can bar fraudulent transfer claims. Clearly this is so, but whether it is true in a particular case depends on the specific language of the clause. *Feldbaum* relied on the *Ernst* case, and *Lange* relied on both *Levy* and *Ernst. See Feldbaum,*1992 WL 119095, at *6; *Lange,* 2002 WL 2005728, at *7 n.19. As discussed, the no-action clause in *Levy* and *Ernst* explicitly included rights of action on the bonds, "or in respect thereof," and barred any holder of the bonds from instituting any action "upon the Bonds ... or growing out of any provision thereof." *Levy,* 266 N.Y.S. at 273. The *Lange* decision also relied on *Victor v. Riklis* and *Wherehouse Entertainment. See Lange,*2002 WL 2005728, at *7 n.18. As discussed, both decisions interpreted a no-action clause identical to the *Feldbaum/Lange* clause, which barred the debentureholders from seeking "any remedy with respect to [the] Indenture or the Securities" unless they first complied with its terms. Each ruling turned on the broad scope of the no-action clause at issue. None stands for the proposition that every no-action clause, however worded, necessarily bars fraudulent transfer claims.

5. Count VI: Permanent Injunction Based On Fraudulent Conveyance

Count VI seeks a permanent injunction under the DFTA against continuing payments of interest on the Junior Notes and service and license fees to EBF and ASIA. For purposes of the Athilon Clause, the analysis is the same as Counts IV and V, both as to the initial ruling in the Dismissal Order and for purposes of the Remand Order.

6. Count VII: Implied Covenant Of Good Faith And Fair Dealing

Count VII contends that by taking the actions detailed in Count I and elsewhere in the Complaint, Athilon breached the implied covenant of good faith and fair dealing that inheres in the Indenture. In *Feldbaum,* this Court held that the no-action clause at issue barred a claim for breach of the implied covenant. *See Feldbaum,*1992 WL 119095, at *6. The Dismissal Order relied on *Feldbaum.* Neither the argument debuted by **Quadrant** on appeal, nor the authorities considered on remand suggest a different result.

"New York law recognizes an implied duty of good faith and fair dealing as part of its contract law." *Rossdeutscher v. Viacom, Inc.,* 768 A.2d 8, 20 (Del.2001). The implied obligation encompasses "any promises which a reasonable person in the position of the promisee would be justified in understanding were included." *Dalton v. Educ. Testing Serv.,* 87 N.Y.2d 384, 639 N.Y.S.2d 977, 663 N.E.2d 289, 291 (N.Y.1995). The resulting contract term is "implicit in the agreement as a whole." *Rowe v. Great Atl. & Pac. Tea Co.,* 46 N.Y.2d 62, 412 N.Y.S.2d 827, 385 N.E.2d 566, 570 (N.Y.1978). "A breach of the implied covenant is a breach of contract" *Rossdeutcher,* 768 A.2d at 20.

By invoking the implied covenant, **Quadrant** sued to enforce an implied term of the Indenture. Count VII of the Complaint even references the Indenture. The Athilon Clause applies to any action or proceeding "upon or under or with respect to this Indenture." Dkt. 32 Ex. A. at 51. **Quadrant's** failure to comply with the Athilon Clause is fatal to its implied covenant claim. *Simons,* 549 A.2d at 305.

7. Count VIII: Tortious Interference With The Implied Covenant

Count VIII contends that EBF tortiously interfered with Athilon's obligations under the implied covenant of good faith and fair dealing that inheres in the Indenture. Such a claim on its face asserts a right "by virtue or by availing of any provision of [the] Indenture" and constitutes an action "upon or under or with respect to [the] Indenture." It is therefore covered by plain language of the Athilon Clause.

Two New York cases support this result. In *RJ Capital,* the United States District Court for the Southern District of New York interpreted a no-action clause which provided that "[n]o Holder of any Note shall have any right to institute any Proceedings, judicial or otherwise, with respect to his Indenture, or for the appointment of a receiver or trustee, or for any other remedy hereunder [without complying with its terms]." *RJ Capital,* 2011 WL 3251554, at *5. Elsewhere, the indenture made the rights of noteholders to sue for principal and interest "subject to the provisions of [the no-action clause]," and the noteholders did not argue that the TIA overrode this provision. *Id.* at *6 n.6 (emphasis omitted). The noteholders contended that the collateral manager for the debt securities tortiously interfered with the terms of the indenture by issuing inaccurate reports that the issuer then used to calculate the payments of principal and interest required by the indenture. The court held that the no-action clause barred the claim for tortious interference, but also dismissed the claim on the merits. *Id.* at *7, * 14. Similarly in Emmet & Co. v. Catholic Health East, 37 Misc.3d 854, 951 N.Y.S.2d 846 (Sup.Ct.2012), the court held that a no-action clause applied to a claim for tortious interference with rights under an indenture, although the court did not quote the language of the clause. *Id.* at 849–50 (applying New York law because of lack of conflict with the law of the jurisdictions chosen under the indentures).

8. Count IX: Constructive Dividends In Violation Of Delaware Law

***23** Count IX asserts that Athilon paid constructive dividends in violation of Delaware law and seeks to recover those payments from the individual defendants. Under the reasoning of *Feldbaum* and *Lange,* such a claim should be barred. *See Feldbaum,* 199 WL 119095, at *6 ("[N]o matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for the recovery of past due interest or [principal], is subject to the terms of a no-action clause of this type."); *accordLange,* 2002 WL 2005728, at *7 (quoting *Feldbaum*).2

Unlike the *Feldbaum/Lange* clause, the Athilon Clause only extends to actions or proceedings where a noteholder claims a right "by virtue or by availing of any provision of this Indenture." In Count IX, **Quadrant** relies on its status as a creditor under the Notes and Sections 170, 173, and 174 of the Delaware General Corporation Law. *See*8 *Del. C.* §§ 170, 173, 174. The Athilon Clause does not reach such a claim. *SeeRegan v. Prudence Co.,* 17 N.Y.S.2d 422, 425 (Sup.Ct.1939) (holding that no-action clause did not apply to a suit for to recover dividends under New York's Stock Corporation Law).

The defendants cite Norte & Co. v. Manor Healthcare Corp., 1985 WL 44684 (Del. Ch. Nov. 21, 1985), as standing for the proposition that a no-action clause applies to a claim alleging constructive dividends, but the *Norte* plaintiffs contended that defendants paid "constructive dividend in violation of various provisions in the trust indentures." *Id.* at *5. By relying on provisions of the trust indentures, the *Norte* plaintiffs brought the claim within the scope of the no-action clause in that case. Had **Quadrant** made a similar argument here, then the Athilon Clause would apply.

Count IX does not allege constructive dividends that violated the Indenture; rather, it alleges constructive dividends that violated the General Corporation Law. It therefore appears, based on the argument **Quadrant** made on appeal and the authorities considered on remand, that *Lange* and *Feldbaum* are not controlling.

9. Count X: Civil Conspiracy

Count X asserts a claim for civil conspiracy against EBF and ASIA for actions taken in concert with the individual defendants. In *Feldbaum,* this Court held that a no-action clause "applies equally to claims against non-issuer defendants as against issuers." 1992 WL 119095, at *7. Count X seeks to impose secondary liability on other defendants for conspiring in the primary wrongs detailed in other counts of the Complaint. In my view, the Athilon Clause should apply to Count X to the same degree as it applies to the primary wrongs. As a practical matter, this means that the Athilon Clause bars the plaintiffs' ability to recover against secondary actors for conspiring to commit the wrongs alleged in Counts VII and VIII. Otherwise the Athilon Clause does not apply.

III. CONCLUSION

As directed by the Remand Order, this opinion has analyzed the significance under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon indentures. The analysis has included a discussion of decisions by New York courts and other courts applying New York law. This opinion has not addressed other arguments about the Athilon Clause that **Quadrant** raised on appeal but which were not the subject of the Remand Order.

It appears that as a matter of New York law, the differences between the Athilon Clause and the *Feldbaum/Lange* clause are significant. Based on the analysis presented, the Athilon Clause does not apply to Counts I through VI and IX of the Complaint, or to Count X to the extent it seeks to impose liability on secondary actors for violations of the other counts. The clause applies to Counts VII and VIII of the Complaint, subject to the outcome of **Quadrant's** other arguments on appeal.

Footnotes

1 *See, e.g.,McClelland v. Norfolk S. R.R. Co.,* 18 N.E. 237, 241 (N.Y.1888); *Rothschild v. Rio Grand W. Ry. Co.,* 32 N.Y.S. 37, 39–40 (Sup.Ct.1895). Two American Law Report annotations collect and summarize no-action clause cases, including numerous New York decisions. *See* C.T. Foster, *Validity, construction, and application of express restrictions on right of action by individual holder of one or more of a series of corporate bonds or other obligations,* 174 A.L.R. 435 (1948 & Supp.) (including updates through current day); P.V. Smith, *Validity, construction, and application of express restrictions on right of action by individual holder of one or more of a series of corporate bonds or other obligations,* 108 A.L.R. 88 (1937 & Supp.) (including updates through 1948).

2 McMahan & Co. v. Wherehouse Entm't, Inc., 65 F.3d 1044, 1050 (2d Cir.1995); *accordCruden v. Bank of N.Y.,* 957 F.2d 961, 968 (2d Cir.1992) ("*Cruden II* "); *Metro W. Asset Mgmt., LLC v. Magnus Funding, Ltd.,* 2004 WL 1444868, at *5 (S.D.N.Y. June 25, 2004); UPIC & Co. v. Kinder–Care Learning Ctrs., Inc., 793 F.Supp. 448, 454 (S.D.N.Y.1992); *see alsoRevised Model Simplified Indenture,* 55 Bus. Law. 1115, 1191 (2000) ("No action clauses are strictly construed against the issuer.").

3 The issue rarely arises today, because Section 316(b) of the TIA establishes that the holder of a note governed by the act has an absolute and unconditional right to sue on the note for past due payments of principal and interest. *See*15 U.S.C. § 77ppp(b). Since the passage of the TIA, even those indentures not covered by the act typically contain language paralleling Section 316(b). *See generally* American Bar Association, *Commentaries on Model Debenture Indenture Provisions 1965, Model Debenture Indenture Provisions All Registered Issues 1967, and Certain Negotiable Provisions* 233–34 (1971) [hereinafter *Commentaries*]; Churchill Rodgers, *The Corporate Trust Indenture Project,* 20 Bus. Law. 551, 563, 565–66 (1965).

4 *See, e.g.,Enoch v. Brandon,* 249 N.Y. 263, 164 N.E. 45, 47 (N.Y.1928) (holding that references in bond to aspects of indenture "all have to do with the trust mortgage. They refer to the rights conferred by it upon the bondholders and limit and explain those rights. They are so linked together as to indicate that the obligor was speaking solely of the security."); *Cunningham v. Pressed Steel Car Co.,*238 A.D. 624, 265 N.Y.S. 256, 259 (App.Div.1933) ("We do not find that the reference to the indenture constitutes a bar to the maintenance of this action [on the bonds]."), *aff'd,*263 N.Y. 671, 189 N.E. 750 (N.Y.1934); *Lubin v. Pressed Steel Car Co.,*146 Misc. 462, 263 N.Y.S. 433, 436–37 (City Ct.1933) (holding that where bonds referred generally to the indenture for the "rights of the holders of said bonds," language was not sufficiently specific to make no-action clause in indenture applicable to bonds (internal quotation marks omitted)); *Berman v. Consol. Nev.-Utah Corp.,* 132 Misc. 462, 230 N.Y.S. 421, 424 (Sup.Ct.1928) (holding that reference in bond to indenture was insufficient to make bond subject to no-action clause found in indenture); *Brown v. Mich. R.R. Co.,* 124 Misc. 630, 207 N.Y.S. 630, 631 (City Ct.1924) ("There is nothing on the face of the bond to show that there is any provision in the mortgage preventing the owner of any bond from maintaining an action at law for the money when the same becomes due."); *see alsoMarlor v. Tex. & Pac. Ry. Co.,* 19 F. 867, 868 (C.C.S.D.N.Y.1884) (applying New York law; finding "nothing in the language of the mortgage to qualify the promise of the bond" and noting that "[w]hether [a bondholder's] interest can be collected through a foreclosure of the mortgage is a different inquiry, and not relevant now [to the suit on the bond]"), *aff'd,*123 U.S. 687, 8 S.Ct. 311, 31 L.Ed. 303 (1887).

Other jurisdictions reached the same result. *See, e.g.,Kimber v. Gunnell Gold Mining & Milling Co.,* 126 F. 137, 138 (8th Cir.1903) ("A mortgage ... does not, in the absence of an express stipulation or of a statute to that effect, constitute any defense to an action at law against the mortgagor by each of the creditors upon the bonds or primary obligations thus secured."); *Manning v. Norfolk S. Ry. Co.,* 29 F. 838, 839 (C.C.E.D.Va.1887) ("The common-law right of suing to judgment upon a written obligation admitted to be valid is of too high a character to be taken away by implications, especially if these are drawn from instruments other than that which is given in direct and positive acknowledgement of the debt."); *Mendelson v. Realty Morg. Corp.,* 241 N.W. 154, 154 (Mich.1932) ("[I]t is a fact, recognized alike by business and the law, that a bond and its securing mortgage have different functions, are governed by different legal principles, and, for some purposes at least, are separate contracts."); *Reitz v. Pontiac Realty Co.,* 293 S.W. 382, 385 (Mo.1927) ("The [no-action] provisions of the mortgage ... deal with remedies provided for in the mortgage, and have no reference to respondent's right of action [on the bonds] at common law."); *Putnam v. Pittsburgh Rys. Co.,* 199 A. 211, 212 (Pa.1938) ("The right of the individual owner of bonds to sue thereon is not affected by provisions of the mortgage securing them unless such provisions exclude the right in express terms or by necessary implication."); *Phila. &Balt. Cent. R.R. Co. v. Johnson,* 54 Pa. 127, 129 (1867) (holding that in an action not "upon the mortgage" but for default in payment on the bonds, a "limitation" in the mortgage was "irrelevant"). *See generally* Leonard A. Jones, *A Treatise on the Law of Corporate Bonds and Mortgages* § 196a (3d ed. 1907) ("A provision restraining proceedings for foreclosure on the part of individual bondholders until after a requisition made upon trustees by a certain proportion of the bondholders and a refusal to comply therewith is valid and obligatory upon the individual bondholders *as respects the enforcement of the security.*" (emphasis added)).

5 *See, e.g.,Hibbs v. Brown,* 190 N.Y. 167, 173, 82 N.E. 1108 (1907) ("[T]he clauses [of the indenture] ... only relate to and control procedure under the trust indenture itself for the purpose of enforcing payment of coupons and do not for any other purposes work or permit a postponement of the time of payment of the coupons or prevent a bondholder from enforcing his ordinary and general remedies at law for the collection of such obligations."); *Barnes v. United Steel Works Corp.,* 11 N.Y.S.2d 161, 163 (Sup.Ct.1939) (accepting that bond sufficiently incorporated terms of indenture but holding that no-action clause did not apply to suit on the bond

when it only addressed suits under the indenture); *Deutsch v. Gutehoffnungshutte,* 168 Misc. 872, 6 N.Y.S.2d 319, 322 (Sup.Ct.1938) (holding that no-action clause in the indenture "relates solely to the enforcement of collateral security for the repayment of the bonds and in no way affects the action on the bonds themselves").

6 *See, e.g., Lidgerwood v. Hale & Kilburn Corp.,* 47 F.2d 318, 320 (S.D.N.Y.1930) (applying New York law; finding that note sufficiently incorporated terms of indenture and that no-action clause in indenture barred suit on the notes after maturity where it applied to "the enforcement of any of the covenants or agreements herein or in the Notes contained" (internal quotation marks omitted)); *Friedman v. Am.-Nat'l Co.,* 172 Misc. 1044, 16 N.Y.S.2d 887, 887 (Sup.Ct.1939) (holding that debenture sufficiently incorporated indenture and that no-action clause governed suit for principal due where clause stated that "[a]ll rights of action on this debenture and the annexed interest coupons, except as otherwise provided by said agreement, are vested in said trustee, and the enforcement thereof is governed by the provisions of said trust agreement" (internal quotation marks omitted)); *Rudick v. Ulster & Del. R.R.,* 147 Misc. 637, 263 N.Y.S. 498, 500 (1928) (holding that bonds sufficiently incorporated by reference the no-action clause in the indenture and that "the language thereof plainly states that no holder shall have the right to institute any action at law or in equity for the collection of the principal or interest [absent compliance with its conditions]"); 1 *Mortgages and Mortgage Foreclosure in N.Y.* § 4:8 (2012) ("If in fact appropriate notice is given to the bondholder in his bond, provisions restricting and limiting the rights of bondholders to sue and enforce their obligations may be legally imposed, depending upon the wording of the instrument."); Posner, *supra,* at 775 (noting before the passage of the TIA that "the bondholder's power to sue at law on his matured bond, as well as upon his matured interest coupons, is at times nullified by references to the indenture made in the bond. In such cases, the reference clauses must be explicit....").

7 *SeeRJ Capital, S.A. v. Lexington Capital Funding III, Ltd.,* 2011 WL 3251554, at *6 n.7 (S.D.N.Y. July 28, 2011) (applying plain language of no-action clause that extended to suits for payment of interest or principal on the bonds where plaintiffs did not argue that the TIA overrode the provision); *In re Envirodyne Indus., Inc.,* 174 B.R. 986, 994 (N.D.Ill.1994) (interpreting no-action clause governed by New York law; holding that action to recover past due interest is a claim "under the Notes" and not governed by the no-action clause, which applied to claims "under the Indenture").

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Supreme Court of Delaware.

QUADRANT STRUCTURED PRODUCTS CO., LTD., Individually and Derivatively on behalf of Athilon Capital Corp., Plaintiff Below, Appellant,
v.
Vincent **VERTIN**, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner, Athilon Capital Corp., Athilon **Structured** Investment Advisors LLC, EBF & Associates, LP, Defendants Below, Appellees.

No. 338, 2012. | Submitted: Feb. 5, 2013. | Decided: Feb. 12, 2013.

Synopsis
Background: Holder of debt securities brought action against defendants. The Court of Chancery dismissed. Plaintiff appealed.

Holding: The Supreme Court, Jack B. Jacobs, J., held that remand was required for issuance of opinion analyzing the significance, if any, under New York law of the differences between the no-action clauses in precedent applying New York law and indenture in instant case.

Remanded.

West Headnotes (1)

[1] **Appeal and Error**
Ordering New Trial, and Directing Further Proceedings in Lower Court

Remand was required for the court of chancery to issue an opinion analyzing the significance, if any, under New York law of the differences between the no-action clauses in precedent applying New York law and indenture governing securities that plaintiff held.

Cases that cite this headnote

Court Below: Court of Chancery of the State of Delaware, C.A. No. 6990 VCL.

Before STEELE, Chief Justice, HOLLAND, BERGER, JACOBS and RIDGELY, Justices, constituting the Court en Banc.

ORDER

JACK B. JACOBS, Justice.

***1** This 12th day of February 2013, upon consideration of the briefs of the parties, and their contentions in oral argument, it appears to the Court that:

1. **Quadrant Structured Products** Co., Ltd., the plaintiff-below ("**Quadrant**"), appeals from a Court of Chancery order granting a motion to dismiss by the defendants, who are Athilon Capital Corp. ("Athilon"), Athilon's officers and directors, EBF & Associates, LP ("EBF"), and Athilon **Structured** Investment Advisors LLC ("ASIA") (collectively, "defendants"). We conclude that the current record is insufficient for appellate review. Accordingly, the case must be remanded to the Court of Chancery to issue an opinion stating its reasons for concluding that **Quadrant's** claims are barred by the no-action clause in the indenture governing the Athilon securities that **Quadrant** holds.

2. In October 2011, **Quadrant**, a holder of Athilon debt securities, brought this action asserting claims against Athilon and its officers and directors, and against EBF (a partnership that indirectly controls Athilon) and ASIA (an EBF affiliate that manages Athilon on a day-to-day basis). On June 5, 2012, based solely on the parties' briefs, the Court of Chancery granted the defendants' motion to

dismiss **Quadrant's** Amended Complaint.[1]

3. The order dismissing the Amended Complaint consists of two short paragraphs which conclude that dismissal was warranted "in light of the plaintiff's failure to comply with the no-action clauses in the indentures governing the debt instruments that the plaintiff holds."[2] The order cited, as "directly on point,"[3] two Court of Chancery opinions decided under New York law, *Lange v. Citibank, N.A.*[4] and *Feldbaum v. McCrory Corp.*[5] No reasons were stated to support the conclusion that those cases were directly on point. This appeal followed.

4. This Court reviews *de novo* a trial court's grant of a motion to dismiss.[6] On appeal, **Quadrant** claims that *Lange* and *Feldbaum* are not controlling, because the no-action indenture clause in those cases were critically different from the no action clause in the Athilon indenture at issue here ("Athilon Indenture"). Therefore, **Quadrant** argues, by concluding that the Athilon no-action clause barred this lawsuit, the Court of Chancery erred as a matter of law.

5. In *Feldbaum,* the Court of Chancery, applying New York law, held that a no-action clause in an indenture constituted a waiver by the bondholder-plaintiffs of their right to prosecute an action against the debtor-defendants without first satisfying the conditions prescribed by the no-action clause.[7] The *Feldbaum* indenture provided that "[a] Security-holder may not pursue any remedy with respect to this Indenture *or the Securities* " unless certain conditions were first satisfied.[8] Because the bondholder-plaintiffs had not complied with those conditions, the court dismissed the claims covered by the indenture's no-action clause.[9]

***2** 6. In *Lange,* the Court of Chancery granted the defendants' motion for judgment on the pleadings, similarly because the plaintiffs, a group of debenture holders, had failed to comply with a no-action clause in the applicable indenture, which also was governed by New York law.[10] The no-action clause, which contained language identical to that in *Feldbaum,* provided that "[a] Security-holder may not pursue a remedy with respect to this Indenture *or the Securities* " unless the debenture holder first satisfied certain conditions.[11]

7. In this case, the Athilon Indenture, which is also governed by New York law, is worded differently from the indentures at issue in *Lange* and *Feldbaum.* The Athilon Indenture provides that "[n]o holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise *upon or under or with respect to this Indenture,* " unless certain conditions are first satisfied.[12] Unlike the no-action clauses in *Lange* and *Feldbaum,* the no-action clause in the Athilon Indenture does not contain the phrase "or the Securities."[13] The absence of that phrase, **Quadrant** argues, critically distinguishes *Lange* and *Feldbaum* and renders them noncontrolling. That argument presents a litigable issue that merits analysis by the Court of Chancery in the first instance.

8. The Court of Chancery order of dismissal did not address the differences between the respective no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture. Presumably the court found those differences to be not legally significant, but the order does not explain why. Nor does the order cite to, or discuss, applicable New York case law that would support the court's implicit view that the New York courts would find those differences legally insignificant.[14] For these reasons, and at this juncture, the record does not adequately lend itself to informed appellate review.

9. Accordingly, we remand this action to the Court of Chancery to issue an opinion analyzing the significance (if any) under New York law of the differences between the no-action clauses in the *Lange* and *Feldbaum* indentures and the Athilon Indenture. The analysis should include a discussion of decisions by New York courts, and other courts applying New York law, that bear on the issue presented here.

NOW, THEREFORE, IT IS ORDERED that the judgment of the Court of Chancery is **REMANDED** for further proceedings in accordance with this Order. Jurisdiction is retained.

Footnotes

1 ***Quadrant** v. Vertin,* C.A. 6990VCL, slip op. (Del. Ch. June 5, 2012) (Laster, V.C.).

2 *Id.*

3 *Id.*

4 2002 Del. Ch. LEXIS 101, 2002 WL 2005728 (Del. Ch. Aug. 13, 2002).

5 1992 Del. Ch. LEXIS 113, 1992 WL 119095 (Del. Ch. June 1, 1992).

6 *Account v. Hilton Hotels Corp.,* 780 A.2d 245, 248 (Del.2001).

7 *Feldbaum,* 1992 WL 119095, at *5, *78.

8 *Id.* (italics added).

9 *Id.* at *3.

10 2002 WL 2005728, at *6.

11 *Id.* at *56 (italics added).

12 App. to Appellant's Op. Br. at A229 (emphasis added) (§ 7.06 of the Indenture).

13 *Id.*

14 Both *Lange* and *Feldbaum* cited federal and New York cases concerning the interpretation of no-action clauses in contracts and indentures governed by New York law. In this case, the Court of Chancery order did not cite, or discuss the applicability of those decisions or any other New York cases decided after *Feldbaum* and *Lange.*

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