IN THE SUPREME COURT OF THE STATE OF DELAWARE

QUADRANT STRUCTURED PRODUCTS COMPANY, 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: The Court of Chancery of the State of Delaware, C.A. No. 6990-VCL

APPELLANT'S OPENING BRIEF

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NATURE OF PROCEEDINGS

This is an appeal from a two-paragraph "Order Granting Motion to Dismiss," dated June 5, 2012, of the Court of Chancery, dismissing the Amended Complaint of Plaintiff Below/Appellant Quadrant Structured Products Company, Ltd. ("Plaintiff" or "Quadrant") against Defendants Below/Appellees, Athilon Capital Corp. ("Athilon" or the "Company"), its officers and directors, EBF & Associates, LP ("EBF"), and Athilon Structured Investment Advisors LLC ("ASIA") (collectively, "Defendants"). The Court of Chancery ruled that the claims alleged are barred by no-action clauses in trust indentures, although the terms of the clauses plainly do not reach the claims at issue.

Athilon is an unusual Delaware corporation. It is insolvent. Limitations in its corporate charter and the peculiarities of its failed business make recovery from its insolvency impossible. Yet because most of its debt is long-term debt, Athilon's inevitable liquidation can be delayed, leaving insiders with many years to raid Athilon's cash and deplete what should remain for creditors.

In October 2011, Quadrant commenced a derivative action against Athilon's directors and others. On behalf of Athilon, as well as individually, Quadrant, as creditor of the insolvent Athilon, sought to recover assets that have already been misappropriated by insiders and to enjoin further destruction of Athilon's residual value. Quadrant also asserted direct fraudulent transfer and other claims against EBF, the partnership that effectively controls Athilon, and ASIA, an EBF affiliate. Quadrant filed the Amended Complaint in January 2012. On June 5, 2012, prior to oral argument, the Court of Chancery granted the Defendants' motions to dismiss on the single ground that the "no-action clauses" barred suit, citing two Court of Chancery decisions and providing no other support for its ruling. On June 20, 2012, Quadrant filed its notice of appeal.

The narrow issue presented by this appeal -- whether a no-action clause in a trust indenture bars noteholders from pursuing all rights of action against or on behalf of the obligor, even causes of action plainly outside the terms of the no-action clause itself -- is one of first impression in this Court.

SUMMARY OF ARGUMENT

1. The Court of Chancery erred when it dismissed the Amended Complaint for "failure to comply with the no-action clauses."

A. The Court of Chancery improperly relied on decisions barring bondholders from bringing individual collection remedies when they have contractually agreed that such remedies may be brought only by an indenture trustee. Here there was no contract that permitted the indenture trustees to pursue the claims alleged in the Amended Complaint, because the claims neither allege nor depend upon a contract default. With no such contract default present, the indenture trustee has no power to pursue the claims brought. "Compliance" with the no-action clauses by an Athilon noteholder ("Noteholder") was not only unnecessary, it was literally impossible. *See* Section I.C.1.a.

B. The Court of Chancery also erroneously relied on previous decisions that it described as directly analogous. Those decisions construed substantially different contracts. The clauses at issue here apply only to claims that arise from the governing indenture itself. Unlike the clauses in previous cases, they do not refer to claims that arise from the underlying securities themselves. *See* Section I.C.1.b.

2. The Court of Chancery also erred in holding that the no-action clauses barred the derivative counts asserted in the Amended Complaint. The very nature of derivative claims -- which are claims of the issuer, brought by Quadrant on the issuer's behalf -- renders the no-action clauses inapplicable, for the indentures give the indenture trustees no rights to pursue claims *of* the issuer. *See* Section II.C.

3. The Court of Chancery further erred by effectively construing the procedural mechanism of the no-action clauses as a blanket waiver by Quadrant of all remedies outside the trust indenture. Imposing such a waiver by judicial fiat misconceived the law of waiver, misunderstood the function of an indenture trustee, and upended traditional lending relationships. If upheld, the imposition of this waiver will embolden corporate fiduciaries to ignore their fiduciary duties and exploit insolvent Delaware corporations, with what amounts to immunity from suit. *See* Section III.C.

STATEMENT OF FACTS

A. Formation And Limited Business Purpose Of Athilon.

Athilon is a credit derivative product company ("CDPC"), created to provide credit protection to large financial institutions in the form of "credit swaps" -- that is, contracts in which the CDPC promises that it will make one (or more) defined payment(s) 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.[1] In private placement memoranda and public material directed to prospective creditors, Athilon detailed the tightly controlled, limited nature of its business, designed so the CDPC's risk of having to pay on credit swaps would be remote.[2] In each private placement memorandum, Athilon explained: "We are a holding company for, and guarantee the obligations of, [Athilon Asset Acceptance Corp. ("Athilon Acceptance")], our wholly owned-subsidiary. [Athilon Acceptance] is a limited purpose company that provides credit protection from the risk of loss on only highly-rated financial obligations . . . primarily consisting of portfolios of financial obligations or CDOs. [Athilon Acceptance] provides this protection in the form of credit swaps . . . ."[3]

The charters of Athilon and Athilon Acceptance limit their corporate operations to the CDPC business and expressly require adherence to a set of operating guidelines,[4] which are critical to the limited purpose for which Athilon and Athilon Acceptance were

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[1] A22 (Am. Compl. ¶ 12). Because the Court of Chancery granted a motion to dismiss in a case in which the only record was the Amended Complaint, the allegations of the Amended Complaint must be taken as true. *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Hldgs. LLC*, 27 A.3d 531, 536 (Del. 2011). The factual recitation in this brief summarizes pertinent allegations.

[2] A40, A51-52 (¶¶ 99-100, 176-90).

[3] A51 (¶ 180 (emphasis added)).

[4] A23 (¶¶ 14-16).

formed.[5] The operating guidelines contain structural, portfolio, leverage, and operating constraints. They require Athilon to invest in conservative securities of short duration and high credit quality, and require that its portfolio be sufficient to cover all liabilities, including credit swap payment obligations and principal and interest on Athilon's debt obligations.[6] Ratings agencies required Athilon and Athilon Acceptance to adopt and follow the operating guidelines, and to seek the approval of those agencies for modifications.[7]

The operating guidelines require that when "Suspension Events" relating to (among other things) capital shortfalls, leverage ratios, or insolvency are not cured, Athilon and Athilon Acceptance must enter "runoff" mode.[8] "Runoff" mode, an insurance industry concept, operates to protect the creditors who provided debt capital. In runoff mode, neither Athilon nor Athilon Acceptance may issue new credit swaps.[9] Athilon continues to collect premiums on existing credit swaps. If Athilon has to pay out on any credit swap (which, in light of the credit quality of the remaining insureds, is unlikely), that obligation is paid. In time, the credit swaps (which are limited in duration) "run off," and at that point Athilon is liquidated.

B. Capitalization Of Athilon.

Athilon was formed in 2004 with $100 million of equity.[10] It raised $600 million of debt, issuing $350 million in senior subordinated notes, $200 million in three series of subordinated notes, and $50 million in junior notes (the "Junior Notes") (collectively, the "Notes").[11] The senior subordinated notes rank first in priority, followed by the subordinated notes, and the Junior Notes, which are held by EBF.[12]

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[5] A24 (Am. Compl. ¶ 18).
[6] A24-25 (¶ 20).
[7] A24 (¶¶ 18-19).
[8] A24-25 (¶ 20).
[9] A24-25 (¶ 20).
[10] A25-26 (¶ 21).
[11] A26-28 (¶¶ 22-31).
[12] A25-26, A28 (¶¶ 21, 32).

Each class of notes is subordinate to Athilon's credit swap obligations.[13] Interest payments on each series of notes are deferrable for up to five years at Athilon's option.[14] Quadrant holds certain of the senior subordinated notes and the subordinated notes.[15]

C. Athilon's Failed Business.

The operating guidelines were designed to ensure that credit swaps would be issued only on contracts that were unlikely to trigger a payment obligation under the swaps.[16] The rating agencies gave Athilon and Athilon Acceptance "AAA/Aaa" counterparty credit and investment grade debt ratings based in part on the strict underwriting and investment limits contained in the operating guidelines.[17] Because of the highly controlled nature of the business and the remote risk presented by Athilon's credit swaps and investments, the market initially accepted this business model.[18] The ratings and Athilon's adherence to strict operating guidelines permitted it to undertake over $50 billion in nominal, contingent risk, with approximately $700 million in capital.[19]

By 2008, Athilon was in distress. Notwithstanding its operating guidelines, it had previously entered into two risky credit swaps (referencing residential mortgage-backed securities, rather than corporate-based collateralized debt obligations).[20] Athilon then suffered an irrevocable setback in the international financial crisis of 2008.[21] Its business premise utterly failed after the Lehman Brothers collapse in September, 2008, because financial institutions would no longer enter

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[13] A25-26 (Am. Compl. ¶ 21).
[14] A26-28 (¶¶ 22, 26, 31).
[15] A21 (¶ 3).
[16] A28 (¶ 34).
[17] A29 (¶ 40).
[18] A29 (¶ 39).
[19] A29 (¶ 37, 38).
[20] A29 (¶ 41).
[21] A29-30 (¶ 42).

into credit swap contracts with any entity (including all existing CDPCs) that would not post collateral -- as Athilon lacked the ability to do.[22]

Without sufficient capital, Athilon and Athilon Acceptance officially lost their AAA/Aaa ratings at the end of 2008, and by August, 2010 no longer had any investment grade debt or counterparty credit ratings.[23] This, and Athilon's capital deficiencies, put Athilon and Athilon Acceptance into permanent "runoff mode" under the operating guidelines.[24] Insolvent, and limited by its governing documents to an industry (leveraged provision of credit protection in the form of Credit Swaps) that was no longer viable, Athilon had no possibility of generating profit for its shareholders, or even of fully repaying its junior levels of debt.[25]

D. The EBF Takeover.

Following the collapse of Athilon's business, the prices and ratings of its debt securities fell precipitously.[26] EBF purchased the Junior Notes at significant discounts to their face value[27] and, in August, 2010, used a special-purpose vehicle, AGH Acquisition Partners, LLC, to acquire 100 percent of Athilon's equity.[28] EBF installed the current board, which is controlled by EBF, to exercise effective control over Athilon through its domination and control of its director-designees.[29]

E. Athilon's Financial Condition And Runoff.

The Amended Complaint alleges that Athilon is insolvent: it carries $600 million of outstanding institutional debt, assets with fair

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[22] A29-30 (Am. Compl. ¶ 42).
[23] A30 (¶ 43).
[24] A30, A34 (¶¶ 44, 63, 64).
[25] A30 (¶¶ 41-42).
[26] A30 (¶ 45).
[27] A30 (¶ 46).
[28] A30 (¶ 48).
[29] A30-31 (¶ 49).

saleable value of only approximately $426 million,[30] and a stated GAAP shareholder's equity at negative $660 million as of September 30, 2011.[31] It has sub-investment grade debt and issuer credit ratings.[32]

By early 2009, the enterprise had sustained several "Suspension Events" under the operating guidelines.[33] The operating guidelines provide the Athilon entities a period of time to cure the Suspension Events to avoid a permanent runoff.[34] Unable to cure the deficiencies, they formally entered permanent runoff mode, where they remain today.[35] Neither Athilon nor Athilon Acceptance has any prospect of returning to normal operations as a CDPC, because the CDPC industry has collapsed, and each is precluded from engaging in any other business under its operating guidelines.[36]

However, among Athilon's current powers is the right to defer the payment of interest on some or all of the Notes.[37] Deferral helps fiduciaries husband resources until all credit swap obligations roll off, so that resources may then be distributed to stakeholders in the order of their priority. Runoff also requires that Athilon and Athilon Acceptance preserve capital, reduce expenses, and reduce risk for the benefit of credit swap counterparties and residual stakeholders.[38] Today, Athilon is simply a legacy portfolio of credit swaps whose beneficiaries will continue to pay premiums until the last swap matures in 2014 or soon thereafter.[39] Its assets, which consist simply of securities,[40] are inadequate to meet Athilon's obligations to its Noteholders.[41] Because

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[30] A32-33 (Am. Compl. ¶ 56).
[31] A32-33 (¶ 56).
[32] A33 (¶ 57).
[33] A34 (¶ 63).
[34] A24-25, A34 (¶¶ 20, 63).
[35] A34 (¶¶ 63-64).
[36] A33 (¶¶ 58, 59).
[37] A36 (¶ 73).
[38] A34 (¶ 65).
[39] A33 (¶ 59).
[40] A34 (¶ 62).
[41] A33-34 (¶ 61).

Athilon is insolvent, prohibited from engaging in new business ventures, and restricted to a business that has since collapsed, there is no plausible scenario for a return to solvency.[42] Thus, when Athilon's last credit swap expires in or about 2014, the only faithful course for its directors will be to distribute assets to stakeholders in the order of their priority.[43]

F. EBF Enriches Itself At The Expense Of Athilon And Its Stakeholders, Awaiting The Expiration Of Athilon's Last Credit Swap To Commence A New Venture.

A faithful fiduciary would today be deferring interest payments and husbanding assets, in runoff, for later distribution to stakeholders.[44] Instead, EBF has exploited its equity control to loot Athilon.[45] With the Athilon board at its disposal, EBF has caused interest to be paid to itself rather than lawfully deferred to the inevitable liquidation (in which those junior securities would receive no return).[46] EBF has funneled to its subsidiaries service fees that vastly exceed market rates.[47] It rejected an offer to replace an insider "management contract" that would have saved Athilon millions of dollars.[48] EBF's control of Athilon allows it to exploit the trove of its assets for the years before the stated final maturities of Athilon's funded debt.[49] If unchecked by a court, this conduct might continue for decades.[50]

The Defendants' strategy goes further than merely bleeding Athilon through inappropriate fees and interest payments. The long-term plan is to use Athilon's available capital to start a new business -- a riskier venture never contemplated by Athilon's governing documents,

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[42] A34-35 (Am. Compl. ¶ 66).
[43] A35 (¶ 67).
[44] A36-37 (¶¶ 72-79).
[45] A36 (¶ 72).
[46] A36-37 (¶¶ 72-79).
[47] A37-39 (¶¶ 80-98).
[48] A38-39 (¶¶ 89-92).
[49] A31 (¶ 50).
[50] A31 (¶ 50).

operating guidelines, investors, or the Company itself at the time it raised the original, low-covenant debt capital.[51] This investment strategy imposes risk on higher-priority debt tranches that would otherwise receive payment in a liquidation, but no risk upon EBF, which, in light of Athilon's insolvency, holds junior debt and equity securities not entitled to a recovery. EBF has nothing to lose.[52]

In short, the Amended Complaint alleges that the stewards of the house are gambling with house money. This gambling, risk-free to themselves, imposes all of the risk on debt holders senior in the capital structure. As debt-holders, Quadrant and other creditors can never receive the reward of an equity return, and thus never receive any benefit from EBF's gaming.[53] However, without judicial relief, these debt holders will bear all of the risk of loss occasioned by the gaming strategy.

G. Quadrant Initiates Suit In The Court Of Chancery.

In accordance with Delaware law and Rule 23.1 of the Rules of the Court of Chancery, on July 8, 2011, Quadrant made demand upon the Athilon board.[54] Quadrant demanded that the board and Athilon officers take certain immediate remedial action for the benefit of Athilon and provide adequate assurances that they would protect the interests of Athilon in the future.[55] Athilon and the board rejected the demand in bad faith, without explanation or written response.[56]

Because the board refused to pursue remedial action, in October 2011, Quadrant commenced a derivative action on behalf of Athilon against each member of its board, for damages and appropriate injunctive relief.[57] Quadrant also asserted, among other things, direct

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[51] A37-38, A40-41 (Am. Compl. ¶¶ 80-88, 101-06).
[52] A41 (¶ 106).
[53] A41 (¶¶ 106-07).
[54] A41-42, A61-68 (¶ 109; Am. Compl. Ex. 1).
[55] A41-42, A61 (¶ 109; Am. Compl. Ex. 1).
[56] A44 (¶¶ 121-25).
[57] A45, A57-59 (¶ 127; Am. Compl. Prayers for Relief).

claims including fraudulent transfer claims against EBF, the partnership that effectively controls Athilon, and ASIA, an EBF-affiliate. [58] Quadrant filed the Amended Complaint in January 2012.

H. The Indentures Governing The Notes Held By Quadrant.

Because the Court of Chancery dismissed the Amended Complaint on the single ground that the no-action clauses in the operative indentures bar the suit, the language of the indentures warrants careful review. The analysis below focuses on the Indenture for the Subordinated Deferrable Interest Notes, Series A and B, dated December 21, 2004 (the "Indenture"), whose "no action" clause is, in material respects, identical to the clause in a related indenture.[59]

The Indenture establishes an "Indenture Trustee," whose "duties and obligations" are "determined solely by the express provisions of this Indenture." Section 8.01(a)(i). Those duties depend on the existence or nonexistence of "Events of Default," which are defined in Article 7. "[P]rior to the occurrence of an Event of Default" the Indenture Trustee "undertakes to perform such duties and only such duties as are specifically set forth in this Indenture." Section 8.01. Upon an Event of Default, its authority remains similarly bound: "In case an Event of Default has occurred (which has not been cured or waived), the Trustee shall exercise such of the rights and powers vested in it by this Indenture[.]" Section 8.01. Those "rights and powers" are delegated to the Indenture Trustee in Article 7, the title of which is descriptive: "Remedies of the Trustee and Securityholders on Event of Default." Broadly speaking, "Events of Default" occur upon failure to pay interest or repay principal, and from covenant breaches by the issuer. Section 7.01. (Insolvency, standing alone, is not an Event of Default.)

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[58] A20-21, A48-50 (Am. Compl. ¶¶ 2, 155-168).

[59] A131-32 (Section 7.06, Dec. 21, 2004 Indenture). The material provisions of the Indenture for the Senior Subordinated Notes, dated as of July 26, 2005, the only other operative indenture, are identical. A229-30 (Section 7.06, July 26, 2005 Indenture).

Section 7.04 gives the Indenture Trustee authority to initiate litigation "for the specific enforcement of any covenant or agreement contained in this Indenture or in aid of the exercise of any power granted in this Indenture or to enforce any other legal or equitable right vested in the Trustee by this Indenture or by law," but only "[i]n case an Event of Default in respect of a series of Securities has occurred." In short, under Article 8, the Indenture Trustee has only the authority expressly given by the Indenture, and Article 7 limits its litigation authority to suits against the issuer brought in cases of a defined Event of Default.

Section 7.06 contains the no-action clause. It provides, in relevant part:

> 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 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 . . . .

Section 7.06 (emphasis added). By its terms, then, the no-action clause governs noteholder suits that arise "by virtue or by availing of any provision" of the Indenture, or "upon or under or with respect to" the Indenture, or for other remedies "hereunder" -- *i.e.,* under the Indenture. A noteholder may not bring such actions unless it first gives "written notice of default" and otherwise meets the defined conditions. Section

7.06 thus governs only those suits that (a) arise upon, under or with respect to *the Indenture*, and (b) involve a defined contract default.

ARGUMENT

I. THE COURT OF CHANCERY ERRED IN DISMISSING THE AMENDED COMPLAINT FOR FAILURE TO COMPLY WITH THE NO-ACTION CLAUSES

A. Question Presented.

Did the Court of Chancery err when it dismissed the Amended Complaint based on the existence of a no-action clause, where the indenture trustee had authority only with respect to claims arising from an "event of default" under the indenture, and the claims in the Amended Complaint did not involve any such "event of default?"[60]

B. Standard And Scope Of Review.

This Court "reviews a motion to dismiss *de novo* and examines whether the trial court erred as a matter of law in formulating or applying legal principles." *Stayton v. Clariant Corp.*, 10 A.3d 597, 600-01 (Del. 2010) (footnote omitted) (reversing grant of motion to dismiss).

C. Merits Of The Argument.

As a clear and unambiguous contract governed by New York law, *see* Indenture § 13.08, the Indenture must be enforced according to the plain meaning of its terms. *Greenfield v. Philles Records, Inc.*, 780 N.E.2d 166, 170 (N.Y. 2002) ("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.") (internal citation and quotations omitted); *Lobacz v. Lobacz*, 897 N.Y.S.2d 516, 517 (N.Y. App. Div. 2010); *Hillman v. Hillman*, 910 A.2d 262, 270 (Del. Ch. 2006).

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[60] A286-89.

1. Because There Has Been No "Event of Default," The Indenture Trustee Has No Authority To Bring Any Of The Claims Asserted By Quadrant.

a. The Contracts In This Case Do Not Delegate To The Indenture Trustee Any Authority To Bring The Claims At Issue.

The Indenture establishes the Indenture Trustee, whose litigation powers arise exclusively from the terms of the Indenture. Indenture §8.01(a)(i); *see Navarro Sav. Ass'n v. Lee*, 446 U.S. 458, 464-65 (1980) (powers of indenture trustee derive from instruments creating the trust relationship); *Meckel v. Cont'l Res. Co.*, 758 F.2d 811, 816 (2d Cir. 1985) (indenture trustee is "more like a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture agreement"); *U.S. Bank, Nat'l Ass'n v. U.S. Timberlands Klamath Falls, L.L.C. ("Timberlands I")*, 2004 WL 1699057, at *2, *3, *5 & n.38 (Del. Ch. July 29, 2004) (same).[61]

The Indenture delegates to the Indenture Trustee the authority to bring litigation claims only upon the occurrence of a defined "Event of Default." Indenture §7.04. Nowhere does it confer upon the Indenture Trustee the power to bring claims that are not based on an Event of Default under the Indenture. Such contract limitations bind an indenture trustee. In *Timberlands I*, the court dismissed an indenture trustee's claims for fraudulent conveyance and breach of fiduciary duty, ruling that "because there has not been an Event of Default under the Indenture, the Trustee lacks standing to assert the claims." 2004 WL 1699057, at *2. The court rejected the trustee's argument that it had a broader power to protect noteholders, concluding that "the powers of the Trustee are defined by and limited by the terms of the Indenture. The power of the

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[61] *Timberlands I* noted commentary in *Revised Model Simplified Indenture*, 55 BUS. LAW 1115 (2000), that "the law is well established that prior to an event of default, the trustee's duties are limited to those explicitly set forth in the indenture." 2004 WL 1699057, at *5 n.38.

Trustee to sue the Issuer . . . is contingent on the occurrence of an Event of Default." *Id.* at *3. Other courts have similarly confined the authority of a trustee to those powers expressly delegated in the indenture. For example, in *Regions Bank v. Blount Parrish & Co.*, 2001 WL 726989, at *3-5 (N.D. Ill. June 27, 2001), an indenture trustee was denied even *post-default* authority to assert fraud and other claims, notwithstanding language in the indenture giving it the right to pursue "any available remedy" to collect payment or enforce the agreements. 2001 WL 726989, at *3-6.[62] The court observed that the pre- and post-default duties of the trustee were limited to rights of action specifically authorized by the indenture, which did not include tort actions personal to bondholders. *Id.* at *5.[63] As the court in *Premier Bank* put it, "[t]he non-exclusion of other remedies already belonging to the trustee does not create an assignment of additional remedies belonging to the bondholders." 114 F. Supp. 2d at 881-82.

In short, where claims arise not from an "Event of Default," but from other rights that are personal to a Noteholder, the Indenture Trustee had no power to bring them. It follows that the no-action clause does not apply to the Amended Complaint, for section 7.06 applies only to a "right by virtue or by availing of any provision of this Indenture . . . or otherwise upon or under or with respect to this Indenture, or [for various forms of relief] *hereunder*" (emphasis added). Quadrant brings no claims under the Indenture. It asserts rights secured to it by Delaware

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[62] *See also Premier Bank v. Tierney*, 114 F. Supp. 2d 877, 881 (W.D. Mo. 2000) (indenture conferred no right upon indenture trustee to pursue separate tort actions); *Cont'l Bank, N.A. v. Caton*, 1990 WL 129452, at *5 (D. Kan. Aug. 6, 1990); *United Bank of Ariz. v. Sun Mesa Corp.*, 119 F.R.D. 430, 431-32 (D. Ariz. 1988).

[63] While *U.S. Bank Nat'l Assoc. v. U.S. Timberlands Klamath Falls ("Timberlands II")*, 864 A.2d 930, 937 (Del. Ch. 2004), disagreed in certain respects with *Regions Bank*, this Court vacated *Timberlands II* in its entirety, remanding to the Court of Chancery for a trial, without addressing the merits of the opinion. *U.S. Timberlands Klamath Falls, L.L.C. v. U.S. Nat. Ass'n*, 875 A.2d 632 (Del. 2005) (TABLE). The point of disagreement between *Timberlands II* and *Regions Bank* is distinguishable and not relevant here.

law by virtue of its status as a holder of the Notes. Derivatively, it asserts claims belonging to Athilon. *See* A45-48 (Am. Compl. Counts I-III) (claims for corporate waste committed by the directors, breaches of fiduciary obligations owed to Athilon and its stakeholders, and the aiding and abetting thereof by EBF). It asserts direct counts as well, but not for payment of the Notes. *See* A49-57 (Am. Compl. Counts IV-X) (damages and injunctive relief sought under the Delaware Fraudulent Transfer Act and for breach of the implied covenant of good faith and fair dealing, intentional interference with contractual relations, constructive dividends in violation of the General Corporation Law, and civil conspiracy). None of these claims arises from an "Event of Default" under the Indenture. While default under the Indenture is inevitable in the future, that contractual default is not anticipated for many years. Because Quadrant neither alleges that an Event of Default has occurred, nor seeks relief in respect of such a default, the no-action clause does not bar its claims.

b. The Authorities Cited By The Court of Chancery Do Not Warrant Dismissal In This Case.

The Court of Chancery rested on two decisions that barred direct noteholder claims that involved substantially different allegations. *Feldbaum v. McCroy Corp.*, 1992 WL 119095 (Del. Ch. June 1, 1992), is readily distinguishable. Its no-action clause applied not only to rights arising under its indenture, but also to "any remedy with respect to . . . the Securities." *Id.* at *5. Moreover, as the Court of Chancery noted at the outset of its discussion, *plaintiffs alleged that defaults under the indenture had occurred. Id.* at *2. In this contract default scenario, the court held that the no-action clause's reference to rights arising from the securities applied to direct claims *against* an issuer, so long as "the trustee is capable of satisfying its obligations." 1992 WL 119095, at *6.[64] The court applied the clause to bar creditor claims arising under state law for fraudulent conveyance, breaches of the implied covenant of good faith and fair dealing, and common law fraud. *Id.* at *5. The court observed that no-action clauses "delegat[e] the right to bring a suit

[64] The case involved suits from three separate creditor factions.

enforcing rights of bondholders to the trustee[.]" *Id.* at *6. Rejecting the argument that the no-action clause did not apply, the court focused on the provision that barred remedies arising from the "securities." Its narrow holding would apply only to clauses of that character and ancillary state-law claims that arise after defaults occur.[65]

The rationale espoused by *Feldbaum* -- that the no-action clause guards against litigation pursued by a lone noteholder against the judgment of the group -- applies where noteholders have agreed to channel collection actions through the trustee. But where, as here, the noteholders did not assign to the trustee authority to bring claims based on the rights at issue, the pursuit of such rights by a lone noteholder offends no one's agreement or expectation. In this case, the Indenture confers no power on the Trustee to bring claims arising from the securities -- here, the Notes -- themselves. Nor does it give rights to bring litigation prior to an "Event of Default." Thus the Amended Complaint pleads no claims that the Indenture Trustee is capable of satisfying. *Feldbaum* is not on point.

The only other authority upon which the Court of Chancery relied, *Lange v. Citibank, N.A.*, 2002 WL 2005728 (Del. Ch. Aug. 13, 2002), simply followed the reasoning in *Feldbaum,* again holding that a no-action clause barred a noteholder from pursuing fraudulent conveyance claims under state law. The no-action clause in *Lange* mirrored the one in *Feldbaum*, barring suits "with respect to this Indenture *or the Securities*" unless the noteholder first sought trustee enforcement. *Lange*, 2002 WL 2005728, at *5 (emphasis added). Like *Feldbaum, Lange* was a post-default case, and the subtext in both decisions suggests that the court viewed the litigation efforts as an end-run around the agreed methodology for pursuing remedies on default. The Vice Chancellor concluded that "[b]y accepting the Debentures, the plaintiffs agreed that all claims of this type would be subject to the provisions of [the no-action clause]." *Id.* at *7. Under the facts of

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[65] No-action clauses are narrowly construed. *Cruden v. Bank of N.Y.*, 957 F.2d 961, 968 (2d Cir. 1992); *Metro. W. Asset Mgmt., LLC v. Magnus Funding, Ltd.*, 2004 WL 1444868, at *5 (S.D.N.Y. June 25, 2004).

Lange, the court was not confronted with the *non sequitur Feldbaum* created here: how a trustee could be "capable of satisfying" claims that arise outside a contract, when its delegated authority depends on a contract default.[66]

A serious problem arises when the ruling in *Feldbaum* is applied to substantially different indenture trust provisions. If a creditor can be deprived of rights on the theory that those rights have been delegated to a trustee, then it must be crystal clear that the rights have in fact been delegated to the trustee and can be enforced by it. As the former Chancellor noted, only those claims that the trustee "is capable of satisfying" must be channeled through the no-action clause. The Chancellor may have inferred a delegation in the indenture before him, with its reference to "remed[ies] with respect to . . . the Securities." However, no such language is present here.

Feldbaum and *Lange* continue to sow confusion, particularly in the non-default area, as recent decisions from another jurisdiction show. In *Akanthos Capital Management, LLC v. CompuCredit Holdings Corp.*, a district court, reading an indenture under plain rules of construction, correctly ruled that because the no-action clause at issue made "no provision for non-default claims," it did not bar plaintiff's fraudulent transfer claims. 770 F. Supp. 2d 1315, 1328 (N.D. Ga. 2011) ("Because no default has yet occurred, it is difficult to fathom how the noteholders could pursue their UFTA claim while also complying with the no-action clause."). The Eleventh Circuit reversed. Citing sweeping language in *Feldbaum* and *Lange*, the court observed that "a standard no-action clause vests in the trustee all of the securityholders' rights to bring suit, making the trustee the only path to a remedy[.]" *Akanthos Capital Mgmt., LLC v. CompuCredit Hldgs. Corp.*, 677 F.3d 1286, 1294 (11th Cir. 2012). The court simply rejected the argument that because the no-action clause at issue there contemplated an event of default, it must apply only to claims asserted on or after a default. *Id.* at 1289, n.3, 1293 n.7. In a Delphic attempt at explanation, the court stated that "the scope of an *exception* to a rule should necessarily define the scope of the rule itself." *Id.* at 1293, n.7 (emphasis in original).

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[66] The issuer in *Lange* had in fact defaulted. *Id.* at *3.

The fundamental point is that contract decisions depend on contract language. The no-action clauses in *Feldbaum*, *Lange*, and *Akanthos* were broader than the one at issue here. Each barred a noteholder from pursuing *any remedy* with respect to the operative indenture *or the Securities* unless the noteholder met the defined conditions. *Feldbaum*, 1992 WL 119095, at *5; *Lange*, 2002 WL 2005728, at *5; *Akanthos*, 677 F.3d at 1292 (emphasis added). By contrast, Section 7.06 of the Indenture does not refer to the securities. It provides that Noteholders shall not 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*[,]" and bars other remedies "hereunder," unless certain conditions are met.[67]

This distinction matters. In *Victor v. Riklis*, 1992 WL 122911 (S.D.N.Y. May 15, 1992), the court concluded that a no-action clause that bars claims "with respect to the Indenture or the Securities" broadens its scope:

> 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. *See Cruden v. Bank of New York*, [1990 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶95,466 at 97,416 (S.D.N.Y. 1990) (stating that plaintiff's RICO and fraud claims were not subject to any "restrictive provisions" of the indentures). *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. The Vice Chancellor observed in *Lange* that "what is determinative" of whether a claim is subject to the no-

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[67] A131-32.

action clause is whether "the claim is one with respect to the Indenture or the Debentures themselves." *Lange*, 2002 WL 2005728, at *7. He concluded that "[e]ach of the claims pled in the amended complaint clearly satisfies that test" -- fraudulent transfer and breach of fiduciary duty claims -- because plaintiffs' "ability to press those claims depends entirely on [plaintiffs'] ownership of the Debentures[.]" *Id.* The court thus acknowledged that the claims asserted arose not "with respect to" *the indenture*, but as a result of plaintiffs' status as holders of *the debentures*.

In short, it is the Indenture in this case that controls, not the construction courts have placed on other indentures containing different language.[68] The powers of the Indenture Trustee must be expressly given. Section 7.06 of the Indenture does not bar claims that relate to "the Notes"; it applies only to claims that arise "by virtue" or "by availing of" a provision of the Indenture.[69] Because none of Quadrant's

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[68] An indenture is a contract. *See In re BankAtlantic Bancorp, Inc. Litig.*, 39 A.3d 824, 837 (Del. 2012). It would be nonsensical to argue that a contract between A and B must be construed in the same manner that a court previously construed a contract between C and D, when the contracts contain different terms.

[69] Late last month, the Court of Chancery concluded that a no-action clause barred a claim for the appointment of a receiver where, as here, the no-action clause specifically addressed actions for receivers. *See Tang Capital P'rs LP v. Norton*, 2012 WL 3072347 (Del. Ch. July 27, 2012). No receivership has been sought here. Moreover, In *Tang Capital P'rs*, plaintiffs first sought a temporary restraining order, in part on the basis of breach of fiduciary duty claims, to enjoin alleged wrongdoing by Savient's board. *Id.* at *2. The Vice Chancellor denied preliminary relief not because the no-action clause barred the fiduciary duty claims, but for plaintiffs' failure to allege colorable claims. *Id.* at *7. In dismissing the receivership claim last month, the Vice Chancellor rejected plaintiffs' contention that dismissal would leave plaintiffs with no recourse in the face of serious mischief by the company's board. *Id.* at *7-8. The Vice Chancellor observed that even though he had earlier denied plaintiffs' motion for preliminary relief, colorable breach of fiduciary duty claims would give plaintiffs recourse outside the

direct and derivative claims arises from the Indenture, *Feldbaum* and *Lange* are not on point. The Court's dismissal of Quadrant's claims distorts the plain language of the no-action clause and is inconsistent with the Indenture Trustee's powers as delegated in the Indenture.[70]

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receivership claim. *Id.* In other words, the no-action clause would not bar the derivative counts. Because the fiduciary duty claims remained subject to defendants' Rule 12(b)(6) motion to dismiss, upon dismissing the receivership claim for failure to comply with the no-action clause, the Vice Chancellor ordered briefing on the fiduciary claims to proceed. *Id.* at *8-9.

[70] Even assuming, *arguendo*, that the Indenture Trustee has the authority to bring Quadrant's claims, the Indenture nowhere delegates such authority *exclusively* to the Indenture Trustee.

II. THE NO-ACTION CLAUSE DOES NOT APPLY TO DERIVATIVE CLAIMS

A. Question Presented.

Did the Court of Chancery err in holding that a no-action clause in a trust indenture bars a noteholder of an insolvent issuer from pursuing, derivatively, claims *of* the issuer, where the indenture trustee has been delegated no authority to assert claims *of* the issuer?[71]

B. Standard and Scope of Review.

See Section I.B, *supra* at 13.

C. Merits of the Argument.

1. The No-Action Clause Does Not Apply To Derivative Claims.

The Indenture's no-action clause cannot bar the suit for a more fundamental reason that neither the Defendants, the Court of Chancery, nor any of the prior decisions has addressed. The Indenture grants to the Indenture Trustee power only to prosecute claims *against* the issuer; that is, it may assert *against* Athilon a breach of its contract. The Indenture nowhere authorizes the Indenture Trustee to bring suit on *behalf of* Athilon. Yet this action is in large part a derivative action, in which Quadrant seeks to bring suit on behalf of Athilon, to protect it from self-interested misconduct by its fiduciaries.

The derivative plaintiff typically is a shareholder, seeking to remedy harm to the enterprise, but when a corporation is insolvent, the class with standing to protect that enterprise expands to include creditors. *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101-02 (Del. 2007). Below, Defendants cited to no decision holding that a no-action clause barred a creditor from pursuing a *derivative* action, and Quadrant is aware of none. For example, neither *Lange* nor *Feldbaum* held that a no-action clause bars *derivative* claims.

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[71] A290-92.

The clause at issue in *Lange* barred "breach of fiduciary duty" claims, but the only such claim in the case was a *direct* assertion of such a claim by the creditor plaintiff against a corporate fiduciary.[72] "To the extent that [the issuer] was insolvent," the court wrote, "its directors may have owed fiduciary duties *to the Debentureholders as a class*, and such duties may be enforced in an action by the Indenture Trustee." *Lange*, 2002 WL 2005728, at *7 (emphasis added). The creditors in *Lange* argued that the "directors [of the issuer] owed *them* fiduciary duties," *id.* at *5 (emphasis added), that is, owed those duties *directly to the plaintiff debentureholders*. As *Lange* considered only a direct claim, it is not authority for dismissal of the derivative counts here.

Nor is *Feldbaum*.[73] It considered direct claims for fraudulent conveyance and other wrongs. While the Chancellor observed that creditors in fraudulent conveyance claims "are hurt derivatively,"[74] his use of the adverb refers not to derivative actions in the procedural sense,[75] but to the fact that all creditors suffer a ratable (although personal) harm when their obligor fraudulently conveys property outside its estate in violation of the Delaware statute. It must be the case that the claims were direct, not derivative, because derivative claims are claims of Athilon, and as a matter of law, outside of title 11 of the United States Code, fraudulent transfer claims do *not* belong to Athilon.[76]

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[72] In 2002, the notion that insolvency might create, in creditors, a *direct* right of action against corporate fiduciaries was in full swing. *Gheewalla* had not yet been decided. In *Lange*, the court was addressing this direct claim. It did not reach whether a direct claim could lie, but determined that the no-action clause precluded the creditor from bringing it.

[73] *Akanthos* was not a derivative case either. Like *Feldbaum*, on which the Eleventh Circuit leaned heavily, *Akanthos* involved direct claims (for fraudulent conveyance), not derivative claims.

[74] *Feldbaum*, 1992 WL 119095, at *8.

[75] *See Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031 (Del. 2004).

[76] *See* 6 *Del. C.* § 1307; *Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 199 (Del. Ch. 2006), *aff'd sub nom.*

Often a bondholder group will elect to negotiate over defaults, and courts have frequently observed that no-action clauses help guard against unpopular "suit[s] *against* the issuer."[77] However, no decision holds that such clauses have any bearing on suits *of* the issuer, which by definition seek to benefit the issuer, for the benefit of all of its stakeholders. As a creditor, Quadrant has standing to, and now seeks to act as steward for Athilon. Its right to protect Athilon derivatively arises not from the Indenture, or even any personal right of action, but from its mere standing as a creditor of the insolvent Athilon. *See Gheewalla*, 930 A.2d at 101-02.

In bringing a derivative claim under Rule 23.1, a shareholder need not have any personal "right of action." Its mere status as shareholder gives it standing to seek to protect the corporate interest. Nothing in *Gheewalla* suggests that the rule should be different where the derivative plaintiff is a bondholder and the corporation is insolvent. It has standing to prosecute a derivative action not because it has a claim in default and entitled to immediate payment, but because its mere status as a creditor gives it standing to protect the corporate interest. Hence the whole question of whether that same creditor is barred by a no-action clause from pursuing collection remedies against the corporation is irrelevant to the question whether it may proceed derivatively to protect the corporation. Because nothing in the Indenture delegates this right to the Indenture Trustee, and nothing in the Indenture takes it from a Noteholder, the no-action clause is not applicable to the derivative counts. In short, because this is in large part a derivative action, the decisions in *Feldbaum* and *Lange* are off point.

So far as Quadrant has been able to determine, no court has ever read a no-action clause to bar derivative claims. It was plain error to have done so here.

Trenwick Am. Litig. Trust v. Billett, 931 A.2d 438 (Del. 2007) ("the creditors of Trenwick America would have had direct standing to prosecute [a fraudulent transfer] action").

[77] *Feldbaum*, 1992 WL 119095, at *6.

III. THE COURT SHOULD NOT CONSTRUE NO-ACTION CLAUSES AS A WAIVER OF REMEDIES OUTSIDE OF THE INDENTURE

A. Question Presented.

Did the Court of Chancery err in holding that a no-action clause in a trust indenture bars a noteholder from pursuing claims that do not arise from an "event of default" as defined in the indenture, where nothing in the indenture waives, limits, or assigns the noteholder's right to bring such claims?[78]

B. Standard and Scope of Review.

See Section I.B, *supra* at 13.

C. Merits of the Argument.

Below, the Defendants appear to have asserted, as a fall-back to the "delegation" theory, a theory of waiver, arguing that if the Indenture did not delegate to the Indenture Trustee the power to pursue the rights of action, those rights were waived. Under this theory, the Indenture itself would operate to release (not merely channel through a trustee) a range of personal Noteholder rights that spring from the law of fiduciary duty, fraudulent transfer, securities, and other sources of law not requiring note default as a prerequisite.

The waiver theory again illustrates the danger of reading *Feldbaum* too broadly. It might theoretically be possible to read the language of the *Feldbaum* no-action clause, which bars the pursuit of "any remedy with respect to . . . the Securities," as a waiver of all remedies of the holder of the security, even those that cannot be pursued by an indenture trustee. This reading strains against the law of waiver, for courts generally insist that waiver of a right be express. *See DiRienzo v. Steel P'rs Hldgs., L.P.*, 2009 WL 4652944, at *4-5 (Del. Ch. Dec. 8, 2009); *Estate of Anglin ex rel. Dwyer v. Estate of Kelley ex rel. Kelley*, 705 N.Y.S.2d 769, 772 (N.Y. App. Div. 2000) ("The intent to waive

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[78] A289-90.

must be unmistakably manifested, and is not to be inferred from a doubtful or equivocal act.") (internal quotations and citation omitted).[79] Waiver must be knowing and voluntary, and must not be presumed. *Wimbledon Fund LP–Absolute Return Fund Series v. SV Special Situations Fund LP*, 2010 WL 2368637, at *4 (Del. Ch. June 14, 2010), *rev'd on other grounds*, --- A.3d ----, 2011 WL 3689009 (Del. 2011) (TABLE) (waiver "must be unequivocal" and is "the voluntary and intentional relinquishment of a known right . . . and implies knowledge of all material facts, and intent to waive") (internal quotations and citation omitted); *see, e.g.*, *Gilbert Frank Corp. v. Fed. Ins. Co.*, 520 N.E.2d 512, 514 (N.Y. 1988) ("Waiver is an intentional relinquishment of a known right and should not be lightly presumed.").

But not even that strained reading can be applied to the very different no-action clause at issue here. Section 7.06 does not bar the pursuit of rights arising from the Notes. It confers on the Indenture Trustee no such rights, and contains no other language from which one can infer an intent to waive non-default rights. Nothing in its text suggests that the procedural mechanism of the no-action clause was intended as a waiver by the noteholder of state-law creditor remedies. Because the Indenture cannot support a ruling premised on waiver, then absent express delegation of a right to the Indenture Trustee, Quadrant did not waive extra-contractual rights, and retains the power to pursue them.

The result below misapprehends the nature of an indenture trustee's function. An indenture trustee collects and pays money to lenders. It takes instruction from the group, and either makes, or carries out practical, collective judgments as to when to sue and when to bargain. Indenture trustees bring actions to collect debts from issuers; not actions to *protect* issuers. To be sure, it remains open to the institutional lending community to evolve. In the future, it is theoretically possible that bondholders may delegate to an indenture

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[79] An implied waiver of a right may be found only where there is "a clear, unequivocal, and decisive act of the party demonstrating relinquishment of the right." *DiRienzo*, 2009 WL 4652944, at *4 (internal quotation and citation omitted).

trustee exclusive power to pursue derivative rights, even absent events of default, and issuers may consent to such delegations. The Indenture at issue in this case does not accomplish this radical change in lending relationships, however. Only the Court of Chancery's order did that.

Few, if any creditors would sign an indenture if they understood it to constitute a blanket waiver of unenumerated rights. An outright bar -- through a waiver theory -- of traditional creditor remedies also enables mischief by corporate management and other corporate fiduciaries beyond the power of stakeholders to remedy. The lower court's reading would allow such fiduciaries to escape judicial scrutiny for faithless conduct such as the conduct at issue here. Such an extraordinary waiver of a noteholder's rights would have far-reaching and detrimental consequences for corporations and their stakeholders. It ought not to be judicially imposed.

The issue presented by this appeal is significant to more than the stakeholders of Athilon. It is one of first impression, for this Court has never construed a no-action clause in the post-*Gheewalla* era. In a practical sense, the order below undermines *Gheewalla*'s ruling that creditors of an insolvent corporation have standing to bring derivative claims to protect the corporation from breaches of fiduciary duties. 930 A.2d at 101-02. Because *some* form of a no-action clause is a standard feature of the trust arrangements that underlie issuances of public debt, the Order's remarkable -- and unprecedented -- interpretation of the no-action clause would bar any institutional creditor from pursuing the remedy *Gheewalla* promised. Few trade creditors have the resources to bring derivative actions to protect corporations. Thus *Gheewalla* may lose practical meaning unless this Court reverses.

In this particular case, affirmance would leave Athilon open to years of looting, devastating its real stakeholders who would have no ability to protect themselves until the occurrence of an event of default. In proceedings below, Defendants stated that they could place the Company's assets at risk for a generation before the Company has to begin repayment of its debt obligations.[80] While fiduciary breaches

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[80] A289-90.

abound already, it is possible that no "Event of Default," as defined by the Indenture will occur for decades. If nothing limits Appellees except the maturity of long-dated notes, decades of plunder, speculation and immunity from judicial review could lie ahead.

In short, affirming the decision below would remove the pen from the hand of contracting parties, and judicially impose -- upon whatever contracts they write -- broad waivers of state-created creditor rights, including the right to protect an insolvent obligor. It would leave no one to protect stakeholders in insolvencies that do not yet present contract defaults, and would largely immunize boards of directors against the consequences of self-interested exploitation of distressed Delaware corporations.

CONCLUSION

The Court should reverse the Order below.

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Dated: August 3, 2012