EFiled: Sep 13 2012 04:07PM EDT
Filing ID 46426853
Case Number 338,2012

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, and EBF & ASSOCIATES, LP, Defendants Below/Appellees.	No. 338, 2012 Court below: The Court of Chancery of the State of Delaware, Civil Action No. 6990-VCL

CORRECTED ANSWERING BRIEF OF APPELLEES ATHILON CAPITAL CORP., ATHILON STRUCTURED INVESTMENT ADVISORS LLC, VINCENT VERTIN, MICHAEL SULLIVAN, PATRICK B. GONZALEZ, BRANDON JUNDT AND J. ERIC WAGONER

OF COUNSEL:

QUINN EMANUEL
URQUHART &
SULLIVAN, LLP
Philippe Z. Selendy
Nicholas F. Joseph
Sean P. Baldwin
51 Madison Avenue, 22nd Floor
New York, New York 10010
(212) 849-7000

Dated: September 13, 2012

Philip A. Rovner (#3215)
Jonathan A. Choa (#5319)
POTTER ANDERSON
& CORROON LLP
P.O. Box 951
Wilmington, DE 19899-0951
(302) 984-6000

Attorneys for Defendants Below/Appellees Athilon Capital Corp., Athilon Structured Investment Advisors LLC, Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt and J. Eric Wagoner

TABLE OF CONTENTS

TABLE OF CITATIONS

CASES

STATUTES

RULES

NATURE OF PROCEEDINGS

In the decision under appeal, the Court of Chancery correctly dismissed all claims of Plaintiff Below/Appellant Quadrant Structured Products, Ltd. ("Quadrant") against Defendants Below/Appellees Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt, J. Eric Wagoner (collectively, "the Athilon Board"), Athilon Capital Corp. ("Athilon"), and Athilon Structured Investment Advisors LLC ("ASIA") in a one-page order. This summary dismissal was entirely justified because uniform Delaware and New York authority, unchallenged for at least twenty years, bars all of Quadrant's claims. *Feldbaum v. McCrory Corp.*, 1992 WL 119095, at *8 (Del. Ch. June 2, 1992); *Lange v. Citibank, N.A.*, 2002 WL 2005728, at *7 (Del. Ch. Aug. 13, 2002). As the Court of Chancery held, Quadrant was required to comply with contractual no-action clauses because its claims were common to all noteholders of Athilon. Each of the no-action clauses provides that such claims may be enforced only by the indenture trustee, not an individual noteholder like Quadrant, unless the trustee refuses a properly made demand. Quadrant's admitted failure to make such demand thus requires dismissal of all claims against Athilon, the Athilon Board, and ASIA.

As the well-settled authority cited by the Court of Chancery explains, the primary purpose of no-action clauses is to protect noteholders from unmeritorious and unpopular suits brought by a self-interested individual noteholder—just like Quadrant—and the waste of time and assets that comes with them. Quadrant acquired its notes well after most of the transactions of which it complains took place, and its claims are not supported by a single other noteholder, much less the majority of relevant noteholders required by the no-action clauses.

Nevertheless, Quadrant seeks to evade the contractual limitations it accepted in purchasing its notes by four arguments, none of which is supported by settled Delaware or New York law. The Court of Chancery correctly rejected the three arguments Quadrant presented to it under the authority it cited. That same authority—as well as the plain language of the no-action clauses themselves—refutes Quadrant's fourth argument, made for the first time in this Court and therefore barred by Rule 8 of this Court's rules because it was not fairly presented to the Court of Chancery.

Moreover, the Court of Chancery's dismissal of these claims may be affirmed on a further ground that the Court did not need to reach: Quadrant has failed adequately to plead Athilon's insolvency, the core allegation on which all of its claims depend. The Amended Complaint and the documents incorporated therein make clear that: (1) the value of Athilon's assets is *three times* that of its short-term liabilities, while its long-term debt does not come due for between *twenty-three and thirty-five years*; and (2) Athilon is authorized to amend its operating guidelines—and has in fact done so—to allow it to engage in expanded business activities, which give it, at a minimum, a reasonable prospect of paying off its long-term debt in the *decades* that remain to it before maturity, and of providing a healthy return on its investment to all of its stakeholders, Quadrant included. Providing still further confirmation of Athilon's solvency, just before the Court of Chancery issued its decision, Standard & Poor's upgraded Athilon's issuer credit rating.

Accordingly, the Court of Chancery's dismissal of Quadrant's claims against Athilon, the Athilon Board, and ASIA may be affirmed, *first*, because of Quadrant's failure to comply with the no-action clauses, on which the Court of Chancery rested its decision, and *second,* because of Quadrant's failure adequately to allege Athilon's insolvency, the predicate for all its claims.

SUMMARY OF ARGUMENT

1. Denied. The Court of Chancery correctly dismissed all of Quadrant's claims against Athilon, the Athilon Board, and ASIA for failure to comply with the no-action clauses.

A. Denied. Quadrant's argument that the no-action clauses cannot apply because there has been no contractual default, rendering it impossible for the trustee to bring Quadrant's claims or for Quadrant to comply with the no-action clauses, was correctly rejected by the Court of Chancery. This argument is not only inconsistent with *Feldbaum* and *Lange*, which hold that no-action clauses apply to any claim common to all bondholders, whether based on a contractual default or not, but was also expressly rejected (along with the sole case on which Quadrant relies, which was from Illinois, not Delaware or New York) by *U.S. Bank Nat'l Assoc. v. U.S. Timberlands Klamath Falls, LLC*, 864 A.2d 930, 941 (Del. Ch. 2004) (*"Timberlands II"*) and by the Eleventh Circuit, following *Feldbaum* and *Lange*, in *Akanthos Capital Mgmt., LLC v. Compucredit Hldgs. Corp.*, 677 F.3d 1286, 1293-94, n. 7 (11th Cir. 2012). *See* Section I.C.3.

B. Denied. Quadrant's argument that *Feldbaum* and *Lange* construed substantially different no-action clauses from those at issue here, *first*, was not presented to the court below and is therefore barred by Rule 8 of this court's rules; *second*, is inconsistent with the language of the no-action clauses themselves, whose terms are at least as broad as, if not broader than, the *Feldbaum* and *Lange* clauses; *third*, is inconsistent with *Feldbaum* and *Lange*, and with other authority construing identical clauses and expressly holding that they apply just as broadly as those in *Feldbaum* and *Lange*; and *fourth*, is inconsistent with the private placement memoranda relating to the indentures, on which Quadrant relies heavily in its Amended Complaint, which make clear that the indenture parties intended the clauses at issue to apply at least as broadly as those in *Feldbaum* and *Lange*. *See* Section I.C.4.

2. Denied. The Court of Chancery properly rejected Quadrant's argument that no-action clauses do not apply to derivative claims, because *Feldbaum* and *Lange*, as well as the authorities following them, hold that no-action clauses apply to any claim that affects all

noteholders ratably—or "derivatively"—which the trustee can therefore bring on noteholders' behalf. *See* Section I.C.5.

3. Denied. Quadrant's argument that the Court of Chancery's decision effectively construes the no-action clauses as a blanket waiver by noteholders of all remedies outside the indenture is without merit. No-action clauses do not deprive noteholders of the benefit of *meritorious* claims, but merely require that such claims be brought by the trustee, unless the trustee refuses to do so after a proper demand, in order to protect noteholders against wasteful and self-interested claims like Quadrant's. *See* Section I.C.6.

4. The Court of Chancery's dismissal of the claims against Athilon, the Athilon Board, and ASIA may be affirmed on the further ground that Quadrant failed adequately to plead Athilon's insolvency. Although all of Quadrant's claims depend on Athilon's insolvency, Quadrant's allegations of insolvency are not only conclusory but are also contradicted by other allegations in the Amended Complaint, which make clear that Athilon, at a minimum, has a reasonable prospect of successfully carrying on its business indefinitely for the benefit of all its stakeholders. Because Quadrant has failed to allege either "1) 'a deficiency of assets below liabilities *with no reasonable prospect that the business can be successfully continued in the face thereof*,' or 2) 'an inability to meet maturing obligations as they fall due in the ordinary course of business,'" its claims must be dismissed. *Production Resources Group, LLC. v. NCT Group, Inc.*, 863 A.2d 772, 782 (Del. Ch. 2004) (emphasis added). *See* Section II.C.

STATEMENT OF FACTS[1]

A. Athilon's Business

Since commencing business in 2005, Athilon has been primarily a credit derivative product company ("CDPC"), providing credit protection to counterparties through credit default swaps ("CDS"). A22 (Am. Compl. ¶ 12). In 2008, after the market for uncollateralized derivative transactions collapsed, Athilon's portfolio began to reflect a drop in market value. A29 (¶¶ 41-42). At the end of 2008, Athilon and its wholly owned subsidiary, Athilon Asset Acceptance Corp. ("Athilon Acceptance"), lost their AAA ratings from Moody's, and in the spring of 2009 they lost their Aaa ratings from Standard & Poor's ("S&P"). A30 (¶ 43).

Athilon and Athilon Acceptance have always been able to pay their debts as they fall due in the ordinary course of business. A33 (¶ 60) (Athilon "has more than sufficient assets to meet all of its contingent liabilities on Credit Swaps. ... The risk in its remaining Credit Swaps portfolio is so low that the Company is unlikely to have to pay a Credit Swaps claim."). The maturity date for Athilon's bonds—which account for $600 million of Athilon's liabilities (A28 (¶ 33))—is not until 2035, 2045, 2046 or 2047, depending on the series. A26-27 (¶¶ 22, 26, 29). Accordingly, Athilon does not have to begin repaying the majority of its debt for at least 23 years, and it has 35 years to complete repayment. As of September 30, 2011, Athilon had assets worth three times its meaningful short-term liabilities. B99.[2]

---

[1] Athilon, the Athilon Board, and ASIA do not concede any allegations made in the Amended Complaint, but merely assume Quadrant's well-pleaded allegations to be true for the purposes of Quadrant's appeal.

[2] B99 and B100, Athilon's unaudited September 30, 2011 Consolidated Statement of Financial Condition and Consolidated Statement of Operations, are incorporated by reference into the Amended Complaint at ¶ 56 (A33) and ¶ 87 (A38) respectively.

B. AGHAP's Investment in Athilon

Prior to August 10, 2010, Defendant EBF & Associates, LP ("EBF")[3] purchased a significant stake in various tiers of Athilon's debt, including all of Athilon's junior notes (the "Junior Notes"). A30 (Am. Compl. ¶ 46). The interest on these notes is deferrable—as it is on all of Athilon's long-term debt issuances. A36 (¶ 74).

Subsequently, in August 2010, AGHAP—an entity in which EBF had an indirect interest—acquired control of 100 percent of the equity of AGH, which in turn wholly owned Athilon and ASIA. A30 (¶ 48). All members of the current Athilon Board have been appointed since AGHAP's acquisition. A30 (¶ 49).[4]

---

[3] EBF is not the beneficial owner of any notes or shares of AGH or AGHAP. EBF is an SEC-registered investment adviser that provides investment advice to three limited partnerships which own the equity of AGHAP, and which own various notes issued by Athilon. A fourth limited partnership managed by EBF also owns certain notes issued by Athilon. For the sake of simplicity, this Brief will use "EBF" as shorthand to refer to the ultimate owners of the company.

[4] Quadrant asserts that the Junior Notes and equity are not affected by the transactions it complains of because they are "out of the money," and thus the Athilon Board, at EBF's direction, effectively prefers the Junior Noteholders and equityholders at the expense of the senior noteholders. Br. 9. But this assertion depends on the assumption that EBF only owns Athilon's Junior Notes—an assumption Quadrant has admitted is false. Quadrant conceded in its demand letter, attached to the Amended Complaint, that: "In the aftermath of the 2008 financial crisis, *EBF purchased a significant stake in various tiers of Athilon's debt*, including all of its $50 million Junior Subordinated Deferrable Interest Notes." A62 (emphasis added). Thus, EBF is exposed to at least the same level of risk as other noteholders, including Quadrant, as a result of any transactions entered into by Athilon.

C. ASIA Servicing and Licensing Fees

Pursuant to a long-standing master services agreement entered into on December 17, 2004 (the "Services Agreement"), ASIA provided day-to-day management for Athilon and Athilon Acceptance. A37 (Am. Compl. ¶ 81). The Services Agreement provided for ASIA to be paid a fee. A37 (¶ 82). In 2009, prior to AGHAP's acquisition of Athilon, fees under the Services Agreement amounted to approximately $14 million. A37 (¶ 83). In 2010—the year that AGHAP acquired Athilon (with all the transition costs associated with such an acquisition)—the fees increased to $23.5 million. A38 (¶ 86). In 2011 (after the acquisition had been completed), the fees diminished. A38 (¶ 87). According to Athilon's September 30, 2011 unaudited financial statements (incorporated by reference into the Amended Complaint at ¶ 87 (A38)), for the first nine months of 2011, the fees were $10.7 million (B100)—no higher than the fees paid prior to AGHAP's acquisition.

Athilon and Athilon Acceptance also had a software licensing agreement with ASIA (the "License Agreement"), pursuant to which ASIA received an annual fee. A39 (¶ 93). In 2009, prior to AGHAP's acquisition of Athilon, this fee was $1.25 million, and in 2010, it was $1.5 million. A39 (¶ 94). According to Athilon's September 30, 2011 unaudited financial statements, the fees for the first nine months of 2011 were $937,000 (B100)—again, no higher than the fees paid prior to AGHAP's acquisition.

D. Amendment to the Operating Guidelines

Pursuant to Athilon's Operating Guidelines, the Board is authorized to amend the Operating Guidelines and so expand Athilon's permitted business, as long as it secures the confirmation of Moody's and S&P that such amendment will not adversely affect the company's credit rating. A24 (¶ 18).[5] Pursuant to this authority, the Board amended

---

[5] The Charters of both Athilon and Athilon Acceptance (which are incorporated by reference into the Amended Complaint at ¶¶ 15-16 (A24)) also authorize a simple majority of the Board to engage in activities and make investments not permitted by the Operating Guidelines. B102-03; B119-20. The Operating Guidelines themselves are

Athilon's Operating Guidelines on May 23, 2011, to expand Athilon's permitted eligible investments and allow it to make longer-dated and therefore potentially higher-yielding investments with a view to increasing its assets. A40 (Am. Compl. ¶ 102); B132. As required by the Operating Guidelines, the Board obtained confirmation from Moody's and S&P[6] that this amendment would not result in a downgrade of Athilon's credit rating. *Id.* Quadrant does not allege that Athilon has actually made any higher-risk investments pursuant to this amendment.[7]

E. Quadrant's Purchase of Athilon Notes

In May 2011—nine months after AGHAP acquired Athilon—Quadrant acquired certain of Athilon's Senior Subordinated Deferrable Interest Notes and Subordinated Deferrable Interest Notes. B2 (Compl. ¶ 3). The indentures pursuant to which Quadrant's notes were issued contained the no-action clauses at issue here.[8]

---

not an agreement with noteholders, and in fact are not an agreement with any party.

[6] The S&P ratings confirmation was not incorporated by reference in the Amended Complaint, but Quadrant does not dispute that it was obtained.

[7] Quadrant also refers to Athilon's repositioning of its Auction Rate Securities ("ARS") portfolio in the first quarter of 2011 (A40 (Am. Compl. ¶ 101)) prior to Quadrant's acquisition of Athilon notes. Quadrant alleges that this repositioning involved "the sale of $25 million par amount of ARS and purchase of other securities of similar structure." *Id.* After this "repositioning," Moody's May 23, 2011 ratings confirmation confirmed that Athilon's credit rating was still Ba1 as of that date. B132.

[8] The no-action clauses, Section 7.06 of each indenture, provide: "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

By May 2011, Athilon's 2010 audited financial statements—which disclosed, among other things, the servicing and licensing fees Athilon paid in 2010 (including the increase in fees over the 2009 fees)—were available to noteholders, including any entity purchasing Athilon notes, such as Quadrant.

In July 2011—after the Moody's ratings confirmation was issued—Quadrant acquired more of Athilon's Subordinated Deferrable Interest Notes. B2 (Compl. ¶ 3).

F. Quadrant's Filing of its Original Complaint and of the Amended Complaint

Quadrant filed its original Complaint on October 28, 2011. The Complaint focused primarily on allegations concerning a $50 million payment by Athilon in connection with the termination of a credit default swap. These allegations formed the basis of claims against Athilon, the Athilon Board, EBF, and a John Doe Defendant or Defendants who allegedly received that payment. B3 (Compl. ¶ 12). Reflecting Quadrant's cavalier attitude to this lawsuit, in its Amended Complaint—filed on January 6, 2012, less than three months after its original Complaint—those claims were nowhere to be found, the John Doe Defendants had been removed, and no new substantive allegations had replaced them.

---

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 . . . ." A131; A229.

G. Athilon's Issuer Credit Rating is Upgraded

On April 26, 2012, just before the Court of Chancery issued its decision, S&P upgraded Athilon's issuer credit rating to BB+ from BB. B432.

ARGUMENT

I. THE COURT OF CHANCERY CORRECTLY HELD THAT ALL OF QUADRANT'S CLAIMS ARE BARRED BY THE NO-ACTION CLAUSES

A. Question Presented

Given that all of Quadrant's claims, both direct and derivative, against Athilon, the Athilon Board, and ASIA seek to enforce rights common to all noteholders, and given that Quadrant admits that it failed to comply with any of the requirements of the no-action clauses before bringing suit, did the Court of Chancery correctly hold that the no-action clauses barred all of Quadrant's claims?

B. Standard and Scope of Review

This Court reviews a motion to dismiss *de novo*. *Account v. Hilton Hotels Corp.*, 780 A.2d 245 (Del. 2001) (affirming grant of motion to dismiss). However, under Rule 8 of this Court's rules,"[o]nly questions fairly presented to the trial court may be presented for review." Although the Court may consider questions not presented below "when the interests of justice so require," this exception is "very narrow" (*Russell v. State*, 5 A.3d 622, 628 (Del. 2011) and requires the Court to review for "plain error." *Id.* "Under the plain error standard of review, the error complained of must be so clearly prejudicial to substantial rights as to jeopardize the fairness and integrity of the trial process." *Sivakoff v. Nationwide Mut. Ins. Co.*, 21 A.3d 597, 2011 WL 1877610, at *4 (Del. May 16, 2011) (internal citation omitted).

In reviewing a motion to dismiss, this Court must "accept all well-pleaded factual allegations as true, . . . draw all reasonable inferences in favor of the plaintiff," and affirm dismissal "if the plaintiff would not be entitled to recover under any reasonably conceivable set of circumstances." *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011). The Court "is not . . . required to accept as true conclusory allegations without specific supporting factual allegations." *In re Gen. Motors (Hughes) S'holder Litig.*, 897 A.2d 162, 168 (Del. 2006) (internal citations omitted).

The Court may consider the content of documents that are integral to or are incorporated by reference into the complaint, when the documents "are relevant not to prove the truth of their contents but *only* to determine what the documents stated." *In re Santa Fe Pac. Corp. S'holder Litig.*, 669 A.2d 59, 69-70 (Del. 1995) (emphasis in original). The Court may consider extrinsic documents if, "[w]ithout the ability to consider the document at issue, 'complaints that quoted only selected and misleading portions of such documents could not be dismissed under Rule 12(b)(6) even though they would be doomed to failure.'" *Id.* (internal quotation omitted).

C. Merits of the Argument

1. Quadrant's Failure To Comply With The No-Action Clauses Bars All Of Its Claims, Because These Claims Are Common To All Bondholders

As the Court of Chancery correctly held, all of Quadrant's claims—both direct and derivative—against Athilon, the Athilon Board, and ASIA are barred because Quadrant has failed to satisfy the conditions in the no-action clauses.

Under the authority cited by the Court of Chancery in its opinion, it is settled law in Delaware and New York that no-action clauses like those in the Athilon indentures apply to all claims which are "common to all bondholders." *Feldbaum,* 1992 WL 119095, at *7; *see also Lange*, 2002 WL 2005728, *7. "So long as the suits to be dismissed seek to enforce rights shared ratably by all bondholders, they should be prosecuted by the trustee." *Feldbaum,* 1992 WL 119095, at *7. "[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." *Id.* at *6 (emphasis added); *see also Lange*, 2002 WL 2005728, at *7 (no-action clause applies to claims where "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.").

Quadrant does not dispute that every one of its claims relates to a right that, if held at all, is common to all Athilon noteholders. Br. at 15-16 (Quadrant "asserts rights secured to it by Delaware law *by virtue of its status as a holder of the Notes*. Derivatively, it asserts *claims belonging to Athilon.*") (emphases added). No-action clauses have in fact been held to bar claims for breach of fiduciary duty (*Lange*, 2002 WL 2005728, at *1, **6-7), fraudulent conveyance (*Feldbaum,* 1992 WL 119095, at **7-8), and breach of the implied covenant of good faith and fair dealing (*id.*)—all of which claims are asserted by Quadrant.[9] Thus, every one of Quadrant's claims is subject to the no-action clauses. *Feldbaum*, 1992 WL 119095, at *7.[10]

The no-action clauses require that, before Quadrant, in its status as an Athilon noteholder, can bring suit, (1) it must give the trustee written notice of the alleged "default;" (2) it must obtain the agreement of the holders of at least 50 percent of the relevant notes to ask the Trustee to bring suit; (3) these noteholders must offer the Trustee a "reasonable indemnity;" and (4) the Trustee must refuse to bring the suit in its own name. Quadrant does not dispute that it has failed to comply with any, much less all, of these requirements, nor does it allege circumstances excusing non-compliance. Accordingly, the Court of Chancery correctly dismissed all of Quadrant's claims.

---

[9] *See also Harbinger Capital Partners Master Fund I, Ltd. v. Granite Broad. Corp.*, 906 A.2d 218, 231 n.58 (Del. Ch. 2006) ("no-action clauses may bar fraudulent conveyance claims if their terms are not complied with"); *Victor v. Riklis*, 1992 WL 122911, at *6 (S.D.N.Y. May 15, 1992) (no-action clause barred RICO and fraudulent conveyance claims); *Norte & Co. v. Manor Healthcare Corp.*, 1985 WL 44684, at *6 (Del. Ch. Nov. 21, 1985) (no-action clause barred breach of fiduciary duty claim based on alleged constructive dividend).

[10] In *Feldbaum*, the Court of Chancery applied New York law. *Feldbaum*, 1992 WL 119095, at *9. New York law also applies to Quadrant's claims under the indentures pursuant to Section 13.08 of the indentures. A151; A250. In any event, New York and Delaware law are substantially identical with respect to the application of no-action clauses; indeed, *Feldbaum* cites New York and Delaware law throughout.

2. The No-Action Clauses Are Primarily Designed To Protect Noteholders From Unmeritorious and Unpopular Suits Like Quadrant's

The application of the no-action clauses to bar Quadrant's claims is not only mandated by the settled law applied by the Court of Chancery, but is also wholly consistent with the purpose of such clauses. No-action clauses are primarily designed to protect noteholders from the negative effects of unmeritorious and unpopular suits brought against their collective interest by an individual noteholder like Quadrant. They achieve this purpose by vesting such decisions with the indenture trustee, who acts as a gate-keeper. Quadrant's attempt to bypass this process, if successful, would fatally undermine that purpose and expose Athilon and its noteholders to precisely the harms the no-action clauses were designed to prevent.

The "primary purpose" of no-action clauses is to "make it difficult for individual bondholders to bring suits that are unpopular with their fellow bondholders." *Feldbaum,* 1992 WL 119095, at *5. Such clauses also "protect[] against the risk of strike suits." *Id.* at *6. No-action clauses "protect issuers from the expense involved in defending lawsuits that are either frivolous or otherwise not in the economic interest of the corporation and its creditors." *Id.* Moreover, "[i]n protecting the issuer such clauses protect bondholders. They protect against the exercise of poor judgment by a single bondholder or a small group of bondholders, who might otherwise bring a suit against the issuer that most bondholders would consider not to be in their collective economic interest." *Id.* "The theory is that if the suit is worthwhile, [a significant percent] of the debentureholders would be willing to join in sponsoring it." *Id.*

In the recent decision of *RBC Capital Mkts., LLC, v. Educ. Loan Trust IV*, 2011 WL 6152282 (Del. Ch. Dec. 6, 2011), the Court of Chancery held, following *Feldbaum*, that "[t]he purposes of a no-action clause are to prevent individual holders of notes from bringing unworthy or unpopular actions (i.e., actions which are not approved by the trustee or supported by a majority of the noteholders) against the issuer or the trust, and to ensure that all rights and remedies under the trust indenture are shared equally by all noteholders. . . ." *Id.* at *2. The Court of Chancery noted "the need to preserve the important gate-keeping role served by no-

action clauses," and explained that "[t]he essential purpose of such provisions is to strike the right balance between enabling the effective enforcement of noteholder rights and the avoidance of capital-taxing suits that do not have the support of most noteholders." *Id.* at *5.

No-action clauses also serve the interests of judicial economy by preventing multiple lawsuits from being brought by parties similarly situated with respect to the same wrong. Thus, in *RBC*, the Court of Chancery noted that "[t]he New York courts also view these clauses as beneficial because they 'deter individual debenture holders from bringing independent law suits which are more effectively brought by the indenture trustee.'" *Id.* at *5 (quoting *Feder v. Union Carbide Corp.*, 530 N.Y.S.2d 165, 167 (N.Y. App. Div. 1988)). Similarly, in *Friedman v. Chesapeake and Ohio Ry. Co.*, 261 F. Supp. 728 (S.D.N.Y. 1966), *aff'd*, 395 F.2d 663 (2d Cir. 1968), *cert. denied*, 393 U.S. 1016 (1969), the court held that no-action clauses place "positive limitations on the rights of every bondholder" because "[i]f in a mortgage securing thousands of bonds every bondholder were free to sue at will for himself and for other similarly situated, the resulting harassment would be not only burdensome but intolerable." *Id.* at 729-31.

Thus, there are ample policy grounds for applying no-action clauses like those at issue here to claims which are common to all bondholders. This policy applies with the greatest force to suits like Quadrant's—transparent strike suits brought without the support of *a single other noteholder*, much less the required majority of the relevant noteholders.

3. The No-Action Clauses Apply Whether or Not There Has Been a Contractual Default.

Quadrant attempts to evade the no-action clauses by arguing that the clauses are inapplicable absent a contract default, without which the trustee could not bring Quadrant's claims. Br. 14.[11]

---

[11] Quadrant's assertion that no-action clauses are narrowly construed (Br. 17 n. 65) is irrelevant. As *Feldbaum* and its progeny hold, no-action clauses like those at issue are properly construed to cover any

This is not Delaware or New York law. As the Court of Chancery recognized, *Feldbaum* and the entire line of authority following it hold not only that a trustee *can* bring a claim which is not predicated on a contractual default, but that *only a trustee* can bring such a claim, if it seeks "to enforce rights shared ratably by all bondholders." *Feldbaum*, 1992 WL 119095, at *7. Indeed, *Feldbaum* holds that *precisely because* a claim may be brought on behalf of all noteholders, the trustee can bring such a claim. *Id.* at*8 ("Given the derivative character of these claims, it is clear that they can be prosecuted by the trustees representing the bondholders as a group . . . ."); *see also Lange*, 2002 WL 2005728, at *7 ("Each of the claims that the plaintiffs have asserted are brought on behalf of the Debentureholders as a class and may be asserted by the Indenture Trustee.").

Despite its claim of "confusion" (Br. 18), Quadrant cites no contrary authority from Delaware or New York, which is not surprising, as there is none. The only authority Quadrant can find to support its argument is a single case from Illinois, which has been specifically rejected by the Court of Chancery as inconsistent with *Feldbaum* (and which does not even apply New York or Delaware law).[12] In *Regions Bank v. Blount Parrish & Co., Inc.*, 2001 WL 726989, at *7 (N.D. Ill. June 27, 2001), the court held that the trustee was not entitled to sue because there had been no Event of Default and thus the relevant no-action clauses did not apply. In *U.S. Bank Nat'l Assoc. v. U.S. Timberlands Klamath Falls, LLC* ("*Timberlands II*"), 864 A.2d 930 (Del. Ch. 2004), the Court of Chancery specifically rejected the holding in *Regions Bank*, explaining that, "[w]hile this court is reluctant to interpret the provisions of a trust indenture differently from another court interpreting substantially the same provision, to do otherwise would require the court either to drastically restrict the scope of the no-action clause, as interpreted in prior decision of this court, or render the operation of that clause absurd. Therefore, the

---

claim which is common to all noteholders, whether or not an Event of Default has occurred. *See* the discussion in text.

[12] All of the other cases cited by Quadrant (Br. 14) merely stand for the unremarkable proposition that a trustee's powers arise from the indenture.

court must hold that the Trustee has standing to bring the non-contractual claims." *Id.* at 942.[13]

The Court of Chancery explained that, "[a]s a necessary corollary to holding that the noteholders were unable to bring non-contractual claims, [*Feldbaum*] held that these claims could be brought by the indenture trustee, once demand had properly been made. . . . In light of the clear holding in *Feldbaum*, it is more sensible to read sections 6.3 [trustee's powers] and 6.6 [no-action clause] in concert. *Since section 6.6 requires noteholders seeking to assert non-contractual claims to make demand upon the Trustee, that section must implicitly recognize the power of the Trustee to bring the claims*, in response to a properly made demand even where the Trustee would lack that power under Section 6.3 without a demand." *Id.* at 941-942 (emphasis added).

Quadrant concedes that *Timberlands II* "disagreed in certain respects with *Regions Bank*," but asserts that "[t]he point of disagreement . . . is distinguishable and not relevant here." Br. 15 n. 63. That, as demonstrated by the passages cited above, is false.[14] Quadrant tries to manufacture a distinction on the basis that the *Timberlands II* Court noted

---

[13] *Regions Bank* was also distinguishable on its facts. It involved a claim for fraud in the inducement, which, under *Feldbaum*, would not be subject to the no-action clause in any event because it is not common to all bondholders. *See Feldbaum*, 1992 WL 119095, at *5.

[14] Moreover, while Quadrant notes that *Timberlands II* was vacated and remanded for trial by the Supreme Court, it was vacated on other grounds entirely, and neither the Supreme Court nor this Court has ever expressed any disagreement with the Court's analysis of the no-action clause. As such, *Timberlands II* continues to be a proper statement of Delaware and New York law on this subject. Indeed, various other holdings of *Timberlands II* have been followed by this Court in numerous cases, reflecting its continued authority generally. *See, e.g., Lonergan v. EPE Hldgs. LLC*, 5 A.3d 1008, 1021 (Del. Ch. 2010); *Brinckerhof v. Texas Eastern Prods. Pipeline Co., LLC*, 986 A.2d 370, 390 (Del. Ch. 2010); *Trenwick Amer. Litig. Trust v. Ernst & Young, L.L.P.*, 906 A.2d 168, 195 n. 72 (Del. Ch. 2006); *Khanna v. McMinn*, 2006 WL 1388744, at *30 n. 242 (Del. Ch. May 9, 2006).

that an Event of Default had occurred. But that was not the basis of the Court of Chancery's holding. In *Timberlands II*, just as in this case and *Feldbaum*, the claims at issue were non-contractual and did not arise out of an Event of Default. Thus, the Trustee's authority to bring non-contractual claims in each case depended on the simple fact that the no-action clause applied, not on any Event of Default. Indeed, the *Timberlands II* Court, after noting that an Event of Default had occurred, went on to make clear that, for "valid policy reasons," the same reasoning ought to apply even if there had been no Event of Default. *Id.* at 942, n. 39.[15]

Quadrant's further argument that, because there has been no Event of Default, it cannot comply with the no-action clause (Br. 18), is equally inconsistent with *Feldbaum* and the cases applying it. The no-action clauses in both *Feldbaum* and *Lange* provided that noteholders must give the Trustee notice of an "Event of Default" (*see Feldbaum*, 1992 WL 119095, at *5; *Lange*, 2002 WL 2005728, at *5), but the Court of Chancery nevertheless concluded that the no-action clauses applied and that they could, and indeed, must be complied with.

Quadrant's argument is further inconsistent with the particular language of the no-action clause here, which does not provide that the

---

[15] The Court stated: "In any event, the court notes that valid policy reasons favor the court's interpretation of the interaction between the no-action clause (section 6.6) and the remedies clause (section 6.3). First, . . . no-action clauses deal with the problems of collective action and strike suits by bondholders. These advantages would be greatly reduced if an individual bondholder could avoid the requirements of the no-action clause by bringing a non-contractual claim. Second, interpreting the no-action clause to exclude non-contractual claims would lead to inefficient claim-splitting. The interaction of the no-action clause, which requires a noteholder to demand the trustee bring all contractual claims, and the requirement that the noteholder herself bring the non-contractual claims, would lead to a situation where contractual and non-contractual claims on an indenture would have to be brought by different plaintiffs, possibly in different fora. This is not an efficient use of judicial resources." *Timberlands II*, 864 A.2d at 942 n. 39.

noteholder give "notice of an *Event of Default*," but rather that the noteholder give "notice of *default*." "Default" is sufficiently broad to include non-contractual claims, and in any event cannot be limited to "Event of Default," as that term is defined in the Indenture, assuming there were a meritorious claim.

Moreover, Quadrant's argument was recently rejected by the Eleventh Circuit in *Akanthos Capital Mgmt., LLC v. Compucredit Hldgs. Corp.*, 677 F.3d 1286 (11th Cir. 2012). The Eleventh Circuit held, following *Feldbaum* and *Lange,* that application of the no-action clause at issue was not dependent on an event of default. *Id.* at 1292. "Plaintiffs argue (and the district court found) that because the trustee demand exception contemplates an event of Default, the entire no-action clause only applies to claims predicated on a Default. We do not agree 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).

4. The No-Action Clauses Are At Least As Broad as Those In *Feldbaum* and *Lange*

Quadrant next attempts to evade the application of the no-action clauses by arguing that they are not analogous to those in *Feldbaum* and *Lange.* Br. 16-21. This argument finds no support in the contractual language nor in the caselaw. But, even if it did, Quadrant did not make this argument to the Court of Chancery. Thus, it is barred by Rule 8 of this Court's rules, unless Quadrant can demonstrate "plain error"—that is, that the error Quadrant asserts is "so clearly prejudicial to substantial rights as to jeopardize the fairness and integrity of the trial process." *Sivakoff,* 2011 WL 1877610, at *4 n.10 (internal citation omitted). Far from meeting this stringent standard, Quadrant's argument is without merit.

First, Quadrant's argument is inconsistent with the language of the no-action clauses themselves, whose terms are at least as broad as, if not broader than, those in *Feldbaum* and *Lange*. The *Feldbaum* clause, to which that in *Lange* was virtually identical, provided that "[a] Securityholder may not pursue any remedy with respect to this Indenture or the Securities" without complying with the trustee demand requirement. *Feldbaum,* 1992 WL 119095, at *7. The no-action clauses here go further

and provide that, without such compliance, "[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 [1] at law or [2] in equity or [3] in bankruptcy or [4] otherwise upon or under or with respect to this Indenture, or [5] for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder."

Quadrant's argument that these clauses do not apply to claims with respect to the securities, as opposed to the indentures (Br. 16-21), simply ignores the text of the provision: "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." This clause plainly applies to any right stemming from ownership of Athilon notes—as Quadrant admits, the only right it is attempting to exercise in its claims—because that is a right created by the Indenture itself under Article 2, which allows for the issuance of the notes.

Quadrant's assertion that the language "upon or under or with respect to this Indenture" limits the application of the no-action clause to contractual rights is inconsistent with the rest of the clause. If Quadrant's reading that only contractual rights under the Indenture were covered by the no-action clause were correct, then there would be no rights "at law or in equity or in bankruptcy . . . or for any other remedy hereunder," even though the no-action clauses expressly limit those rights as well. In any event, even if the entire clause were limited to claims "upon or under or with respect to this Indenture," Quadrant's claims would still be covered, because a claim "with respect to" Athilon's notes is, according to ordinary usage, also a claim "with respect to" the indenture pursuant to which the notes were issued.

Second, this conclusion is reinforced by *Feldbaum* and *Lange* themselves, which, contrary to Quadrant's assertion, did not "focus[] on the provision that barred remedies arising from the 'securities'" (Br. 17), but rather treated claims with respect to "the indenture or the securities" as essentially interchangeable and focused instead on the breadth of the phrase "with respect to." *See Feldbaum*, 1992 WL 119095, at *7 ("The clause in question bars all action 'with respect to' the indenture or the securities."); *Lange*, 2002 WL 2005728, at *6 ("the clause in *Feldbaum* was almost identical to [the *Lange* clause], insofar as it governed all

actions 'with respect to' the indenture or the securities."). Moreover, in *Feldbaum*, the Court of Chancery did not engage in a minute parsing of the language of the no-action clause, but based its decision primarily on the strong policy reasons supporting broad application of such clauses. *See, e.g., Feldbaum*, 1992 WL 119095, at *7 ("The policy favoring the channeling of bondholder suits through trustees mandates the dismissal of individual-bondholder actions no matter whom the bondholders sue. So long as the suits to be dismissed seek to enforce rights shared ratably by all bondholders, they should be prosecuted by the trustee.").

The sole case on which Quadrant relies for its purported distinction, *Victor v. Riklis,* 1992 WL 122911 (S.D.N.Y. May 15, 1992) (Br. 19), was pointedly not endorsed by the Court of Chancery. *Victor* was a parallel action to *Feldbaum* but brought by a different plaintiff. In *Victor,* the court distinguished its decision to apply a no-action clause to certain claims from a decision refusing to apply such a clause to similar claims in *Cruden v. Bank of N.Y.*, 957 F.2d 961 (2d Cir. 1992), on the basis that the clause in *Victor* was broader than that in *Cruden.* The Court of Chancery, apparently doubting the merit of this distinction, felt compelled to offer a more compelling one, noting that "even if there had been no difference between the no-action clauses in the two cases, . . . [a]pplication of the no-action clause in *Cruden* still may well have not been appropriate because the trustee in *Cruden* was accused of impropriety. In *Victor*, as here, no such conflict was alleged." *Feldbaum*, 1992 WL 119095, at *7.

Quadrant's further assertion that the decision in *Lange* depended on the fact that "the claims asserted arose not 'with respect to' *the indenture*, but as a result of plaintiffs' status as holders of *the debentures*" (Br. 20) is specifically belied by a recent decision (on which Quadrant itself relies), *Tang Capital Partners, LP v. Norton*, 2012 WL 3072347 (Del. Ch.). *Tang* concerned a no-action clause identical to those at issue here, which the Court of Chancery described as "similar" to the *Feldbaum* clause (*id.* at *6 n. 24), and which it expressly held imposed "restrictions on [plaintiffs'] rights *arising out of their status as note holders.*" *Id.* at *8 n. 41. In other words, contrary to Quadrant's assertion, the Court of

Chancery held that a claim "arising out of [plaintiffs'] status as note holders" was also a claim "with respect to" *the indenture*.[16]

Finally, Quadrant's argument is inconsistent with the private placement memoranda ("PPMs") on which Quadrant relies heavily in the Amended Complaint. Although the no-action clauses are unambiguous, and extrinsic evidence is therefore not necessary to assist in their interpretation, the PPMs nevertheless make crystal clear that the parties to the Athilon indentures intended the no-action clauses to apply to all claims with respect to both the indentures *and* the securities issued pursuant to the indentures, just as the no-action clauses in *Feldbaum* and *Lange* did. Each of the PPMs states that, pursuant to the indenture, "[a] holder may institute a suit against [Athilon] for enforcement of such holder's rights *under the Indenture and the Notes* . . . only if" the requirements of the no-action clause are met. B226; B373.

5. The No-Action Clauses Apply to Derivative Claims

Quadrant also contends that the no-action clause is inapplicable to derivative claims. Br. 22-24. As the Court of Chancery recognized, this is wrong. Derivative claims, by definition, affect all noteholders ratably, and therefore, under *Feldbaum*, *must* be subject to the no-action clauses. *Feldbaum* states this explicitly: "If plaintiffs have been legally injured by the transactions complained of, they are hurt derivatively. They can allege no harm different from that suffered by their fellow bondholders and thus should share any remedy they receive on a *pari passu* basis with other bondholders. Given the derivative character of these claims, it is clear that they can be prosecuted by the trustees representing the bondholders as a group." *Feldbaum*, 1992 WL 119095, at *8.

---

[16] Quadrant's assertion that the court in *Tang* held that "the no-action clause would not bar the derivative claims" for breach of fiduciary duty (Br. 20-21 n. 69) is false. All the court held was that it would allow briefing to go forward on a motion *to dismiss* those claims. *Tang*, 2012 WL 3072347, at *9.

RBC is almost directly on point. There, the Court of Chancery treated plaintiff's claim as derivative (albeit on behalf of a trust, not a corporation) and held that the no-action clause applied: "RBC essentially argues that the payment-of-interest exception [to the no-action clause] should be applied to derivative claims brought to redress injury to the Trust as well as to direct claims brought by the noteholders, so long as the derivative claims allege that the injury to the Trust resulted in a diminution of interest payments made to the noteholders. . . . The New York decisional law addressing analogous situations emphasizes the need to preserve the important gate-keeping role served by no-action clauses, and therefore has required noteholders making derivative claims of the sort advanced by RBC to comply with no-action clauses in trust indentures." *RBC Capital Markets*, 2011 WL 6152282, at *2.

Thus, Quadrant's argument that, in bringing its derivative claims, it is acting "as steward for the Company" and "[i]ts right to protect the Company arises from . . . its mere standing as a creditor," actually proves that the no-action clauses *do* apply to its claims. Br. 24. As *Lange* held, a no-action clause bars breach of fiduciary duty claims brought by debentureholders against the corporation's directors[17] precisely *because* "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." *Lange*, 2002 WL 2005728, at *7 (emphases added). Because Quadrant's standing to bring a derivative claim derives—as Quadrant concedes—from "its mere standing as a creditor," the no-action clauses must apply to this claim, and the claim must be brought by the Trustee.

---

[17] After *North Amer. Catholic Educ. Programming Found., Inc. v. Gheewalla,* 930 A.2d 92, 103 (Del. 2007), if the corporation is insolvent, any such claim can *only* be derivative (since *Gheewalla* held that a creditor can not bring a direct claim against the directors of an insolvent company).

6. The No-Action Clauses Do Not Operate As A "Blanket Waiver Of All Remedies"

Quadrant also attempts to evade the no-action clauses by arguing that the Court of Chancery's decision effectively construes the no-action clauses as a blanket waiver by noteholders of all remedies outside the indenture, undermining this Court's decision in *North Amer. Catholic Educ. Programming Found., Inc. v. Gheewalla,* 930 A.2d 92 (Del. 2007). Br. 25-28. This argument, too, is without merit. No-action clauses are not a waiver of claims at all. They are, instead, merely a limitation on the right to sue. They require that plaintiffs seeking to bring claims common to all noteholders must first obtain the support of a substantial proportion of the relevant noteholders and then make demand of the trustee. As such, they do not bar claims unless they are unmeritorious and unpopular, like Quadrant's. *See Feldbaum*, 1992 WL 119095, at *5 (no-action clauses "need not prevent the prosecution of meritorious suits.").

Moreover, no-action clauses are voluntary. *See Feldbaum,* 1992 WL 119095, at *7 ("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, unless they first comply with the procedures set forth in the clause or their claims are for the payment of past-due amounts."); *Lange*, 2002 WL 2005728, at *7 ("By accepting the Debentures, the plaintiffs agreed that all claims of this sort would be subject to the provisions of [the no-action clause]."). Had Quadrant wished not to be bound by the no-action clauses, it could simply have not purchased Athilon notes. Quadrant's argument, therefore, would require this Court to rewrite contractual terms for a highly sophisticated investor fully capable of protecting itself.[18]

---

[18] In any event, *Gheewalla* did not expand the rights of creditors, as Quadrant contends, but rather limited them, by holding that creditors can bring only a derivative, not direct, claim against an insolvent corporation's directors. *Gheewalla,* 930 A.2d at 103.

II. THE COURT OF CHANCERY'S DISMISSAL OF QUADRANT'S CLAIMS MAY BE AFFIRMED ON THE FURTHER GROUND THAT QUADRANT HAS FAILED ADEQUATELY TO PLEAD ATHILON'S INSOLVENCY

A. Question Presented

May the Court of Chancery's decision to dismiss the claims against Athilon, the Athilon Board, and ASIA be affirmed on the further ground that Quadrant has failed adequately to allege Athilon's insolvency, which is a necessary element of all of Quadrant's claims?[19]

B. Standard and Scope of Review

See Section I.B *supra.*

This Court may affirm the grant of a motion to dismiss on grounds other than those on which the court below relied, as long as those grounds were fairly presented to the court below. *See Unitrin, Inc. v. American General Corp.*, 651 A.2d 1361, 1390 (Del. 1995) ("We recognize that this Court may affirm on the basis of a different rationale than that which was articulated by the trial court. We also recognize that this Court may rule on an issue fairly presented to the trial court, even if it was not addressed by the trial court."); *Telxon Corp. v. Meyerson*, 802 A.2d 257, 262-63 (Del. 2002) (although a particular issue "was not addressed by the trial court in its decision, the issue was fairly presented to that court and is thus properly a subject of appeal.").

C. Merits of the Argument

The Court of Chancery's dismissal of the claims against Athilon, the Athilon Board, and ASIA may be affirmed on the further ground that Quadrant failed adequately to allege Athilon's insolvency. All of Quadrant's claims depend on this allegation. As a creditor of Athilon, Quadrant is entitled to bring its derivative claims against the Athilon Directors only if Athilon is insolvent under Court of Chancery Rule 23.1.

---

[19] This question was raised below (B74-79, B86-89), but was not addressed by the trial court.

Similarly, Quadrant's fraudulent conveyance claims and its other makeweight direct claims are all predicated on Athilon's insolvency.[20] However, Quadrant's allegations of insolvency are not only conclusory, but are also contradicted by the Amended Complaint itself.

The Amended Complaint and documents incorporated therein make clear that, based on Athilon's unaudited September 30, 2011 financial statements: (1) Athilon had assets with a fair saleable value of at least $426 million (A30 (Am. Compl. ¶ 46)); (2) Athilon's long-term debt does not come due for at least *twenty-three* years—while most of it does not come due for *thirty-three to thirty-five* years (A26-27 (¶¶ 22, 26, 29)); (3) the bulk of Athilon's remaining liabilities consist of unrealized losses on credit default swaps on which the risk is, in Quadrant's own words, "so low that the Company is unlikely to have to pay a Credit Swaps claim" (A33 (¶ 60)); and (4) Athilon's shorter-term liabilities—*i.e.*, those it has to pay off in the next *twenty-three years*—amount to only $147 million—approximately *one-third* of the value of its assets. B99.[21]

---

[20] Section 1305(a) and (b) of the Delaware Uniform Fraudulent Transfer Act—the bases for Counts IV, V and VI—require that the defendant be insolvent. Delaware law does not recognize a claim for "constructive dividends" (Count IX) in circumstances such as these; indeed, it is not clear that Delaware recognizes a claim for constructive dividends at all. *See Horbal v. Three Rivers Holdings, Inc.*, 2006 WL 668542, *3 (Del. Ch. March 10, 2006). But, even if such a claim were recognized, it would require allegations of insolvency and excessiveness of the fees paid. 8 Del. C. § 170(a). Civil conspiracy (Count X) requires an underlying tort or statutory wrong. *Ramunno v. Cawley*, 705 A.2d 1029, 1039 (Del. 1998). Because Quadrant's other claims must fail for lack of the required allegation of insolvency, its civil conspiracy claim fails with them.

[21] Moreover, Athilon's financial position is actually stronger than this suggests, for two reasons. *First,* the assets disclosed in Athilon's financial statements do not include approximately $124 million in future premiums due under Athilon's swaps, which are not reported until paid for GAAP purposes. *Second,* the short-term liabilities include $133 million of non-current tax liabilities which will be covered by Athilon's deferred tax

Quadrant nevertheless asserted below that Athilon's insolvency was a question of fact. But there are no disputed facts, as Quadrant has admitted every fact relevant to this inquiry. The only question is whether, on these facts, Athilon can be held to be insolvent. Delaware case-law demonstrates that it cannot.

In *Production Resources,* this Court held:

> To meet the burden to plead insolvency, [plaintiff] must plead facts that show that [defendant] has either: 1) 'a deficiency of assets below liabilities *with no reasonable prospect that the business can be successfully continued in the face thereof*,' or 2) 'an inability to meet maturing obligations as they fall due in the ordinary course of business.'

863 A.2d at 782 (internal citations omitted) (emphasis added). This test was also applied in *N. Amer. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 2006 WL 2588971, at *10 (Del. Ch. Sept. 1, 2006).[22]

Athilon is not insolvent under either prong of this test. Quadrant has not alleged that Athilon has ever been unable to meet its debts as they come due. Moreover, because the value of Athilon's assets (its investments and short-term receivables) is three times that of its shorter-term liabilities, and Athilon has between *twenty-three and thirty-five* years to pay off its long-term debt, it is absurd to suggest that Athilon has "no reasonable prospect of successfully continuing its business in the face of" its liabilities. *Production Resources*, 863 A.2d at 782.

---

asset. However, even leaving these items out of account for the purposes of Athilon's motion to dismiss, Athilon is clearly not insolvent.

[22] On appeal in *Gheewalla*, this Court found it unnecessary to pass on this test. *N. Amer. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 99 n. 20 (Del. 2007). However, in *SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 7 A.3d 973 (Del. Ch. 2010)—a case on which Quadrant relied below (A293)—the Court of Chancery cited to both *Production Resources* and *Gheewalla*, and to no other authorities, for the definition of insolvency. *Id.* at 987.

Quadrant's sole rejoinder below—that Athilon's business is confined by its Charter and Operating Guidelines to the "dead" CDPC business (A297)—is directly contradicted both by Quadrant's allegations in the Amended Complaint and by the documents incorporated therein. *First,* the Amended Complaint concedes that Athilon is able to make "changes to the Operating Guidelines," as long as it obtains "confirmation by the rating agencies." A24 (Am. Compl. ¶ 18). Moreover, Quadrant does not dispute that Athilon *has in fact obtained* such confirmation for changes to its Operating Guidelines allowing it to expand its investments beyond the CDPC business. A40 (¶ 102); B132.

Second, both the Athilon and Athilon Acceptance Charters expressly authorize the companies to engage in activities beyond the CDPC business. Article III of the Athilon Charter authorizes Athilon to engage in the following activities:

> (a) guaranteeing or providing other forms of credit support for the obligations of its subsidiaries, entering into derivative contracts with its subsidiaries *and engaging in additional activities specifically authorized (i) by a majority of the board of directors (including at least one Independent Director),* . . . B102-03 (emphasis added).

Similarly, the Athilon Acceptance Charter authorizes the company to engage in the following activities:

> (a) engaging in transactions judged by the Corporation to be credit default swaps, entering into derivative contracts with its parent *and engaging in additional activities specifically authorized (i) by a majority of the board of directors (including at least one Independent Director)* . . . ;
>
> (b) *investing in investments designated by a majority of the board of directors or permitted by the Operating Guidelines*; . . . B119-120 (emphasis added).

The plain language of these provisions makes clear that the "additional activities" in which both Athilon and Athilon Acceptance may engage are *not* limited to the CDPC business. Article III(a) allows both

corporations *either* to engage in credit default swap ("CDS") activities, without the approval of the Board, *or* to engage in "additional activities"—without limitation—*with* the approval of the Board (including one independent director). Moreover, Article III(b) of the Athilon Acceptance Charter separately and without qualification permits Athilon Acceptance to "invest[ ] in investments designated by a majority of the board."[23]

Third, contrary to Quadrant's allegation that the PPMs restricted Athilon's business to the CDPC business (A52 (Am. Compl. ¶¶ 180-83)), the PPMs in fact said *the exact opposite*.[24] The PPMs expressly state that Athilon may expand its activities beyond the CDPC business, without the consent of noteholders, and that it may even do so without ratings agency confirmation—although Athilon intended, and still intends, to obtain such confirmation. Thus, among other things, each of the PPMs states:

- While our business will initially be limited as described herein under "Business—Operating Guidelines," *we intend to expand the scope of our business* . . . The Operating Guidelines may be amended with Rating Agency Confirmation of such changes, *and without the approval of the holders of the Notes, to permit activities not currently contemplated by the Operating Guidelines.* B206; B309-10 (emphasis added).

- [W]e may seek to amend the Operating Guidelines *to take advantage of new business opportunities.* While any such amendments require Rating Agency Confirmation, *they do not*

---

[23] In addition, Article XVI of both Charters expressly provides that the Board may amend Article III as long as it complies with the provisions of the Operating Guidelines relating to such amendment. B109; B125.

[24] Moreover, the PPMs were issued in 2004 and 2005, over six years before Quadrant purchased its notes. By the time of Quadrant's purchases (the second of which took place in July 2011, after the May 23, 2011 Moody's rating confirmation (B132)), it was clear that Athilon was expanding its business activities and that it had ratings agency approval to do so.

require the approval of the holders of the Notes. We or AAA Corp., with the approval of our respective shareholders (us in the case of AAA Corp.), *may decide to change the Operating Guidelines without the prior review of the Rating Agencies*, in which case each of the Rating Agencies could reduce or withdraw the Triple-A Rating assigned by such Rating Agency. Although we intend to operate in a manner that maintains our Triple-A Ratings, *we are under no obligation to maintain the Triple-A Ratings, or the credit ratings of the Notes, for the benefit of the holders of the Notes.* B220; B324 (emphases added).

- We intend to establish *additional subsidiaries for the conduct of domestic and foreign insurance and reinsurance activities, which may not be successful.* B223; B327 (emphasis added).

- In addition, *AAA Corp. may change or expand the various structural, portfolio and capital constraints, or amend the Operating Guidelines*, upon receipt of Rating Agency Confirmation with respect to such change, expansion or amendment. *No modification of the Operating Guidelines requires the consent of the holders of the Notes.* B239; B342 (emphases added).

Thus, it is clear that Athilon is authorized to amend—and in fact *has amended*—its Operating Guidelines to allow it to expand its investments. Accordingly, given Athilon's substantial assets and low short-term liabilities, it has—at a minimum—a reasonable prospect of successfully continuing its business, of paying off all of its debt, and of generating a healthy return for all of its stakeholders—not just a single self-interested noteholder.

Given these undisputed facts, it should come as no surprise that, just over four months ago, and long after Quadrant made its initial allegations of insolvency, S&P *raised* its issuer credit rating on Athilon. B432.

Accordingly, Athilon is not insolvent under the *Production Resources* test. Because Quadrant has failed to plead Athilon's insolvency sufficiently, and because all of Quadrant's claims are predicated on such

insolvency, this Court may affirm dismissal of Quadrant's Amended Complaint on this alternative ground as well.

CONCLUSION

For the foregoing reasons, the Court should affirm the order below.

OF COUNSEL:

QUINN EMANUEL URQUHART
& SULLIVAN, LLP
Philippe Z. Selendy
Nicholas F. Joseph
Sean P. Baldwin
51 Madison Avenue, 22nd Floor
New York, New York 10010-1601
(212) 849-7000

Dated: September 13, 2012
1074809

POTTER ANDERSON &
CORROON LLP

By: */s/ Philip A. Rovner*
Philip A. Rovner (# 3215)
Jonathan A. Choa (#5319)
Hercules Plaza
P.O. Box 951
Wilmington, DE 19899-0951
(302) 984-6000

Attorneys for Defendants Below/Appellees Athilon Capital Corp., Athilon Structured Investment Advisors LLC, Vincent Vertin, Michael Sullivan, Patrick B. Gonzalez, Brandon Jundt and J. Eric Wagoner

CERTIFICATE OF SERVICE

I hereby certify that on September 13, 2012, a copy of the within document was served electronically by Lexis/Nexis File and Serve on the following attorneys of record:

Lisa A. Schmidt, Esq.
Catherine G. Dearlove, Esq.
Russell C. Silberglied, Esq.
Susan M. Hannigan, Esq.
Richards, Layton & Finger, P.A.
One Rodney Square
920 N. King Street
Wilmington, DE 19801

Collins J. Seitz, Jr., Esq.
Garrett B. Moritz, Esq.
Eric D. Selden, Esq.
Seitz Ross Aronstam & Moritz LLP
100 S. West Street
Suite 400
Wilmington, DE 19801

/s/ Philip A. Rovner
Philip A. Rovner (#3215)