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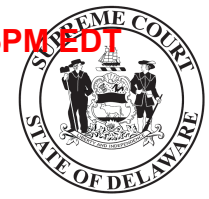

IN THE SUPREME COURT OF THE STATE OF DELAWARE

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 Case Below: Court of Chancery CIVIL ACTION NO. 6990-VCL

APPELLANT'S REPLY MEMORANDUM

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APPELLANT'S REPLY

Appellant replies to five points in Appellees' Answering Supplemental Memorandum.

ARGUMENT

I. THE REPORT CORRECTLY CONSTRUED THE NO-ACTION CLAUSE.

For convenience, we set out the diagram of section 7.06 (A131-32) here:

No holder of any Security

1.0 shall have any right by virtue or by availing of any provision of this Indenture

2.0 to institute any action or proceeding at law or in equity or in bankruptcy or otherwise

3.0 upon or under or with respect to this Indenture, or

4.0 for the appointment of a trustee, receiver, liquidator, custodian or other similar official or for any other remedy hereunder, unless [the holder complies with specified conditions].

Defendants' lead argument is that the Vice Chancellor's construction violates a "rule" against superfluity, because "by virtue" and "by availing of," in subpart 1.0, are repetitive. There are many problems with this argument, but they begin, as the Vice Chancellor did, with the proposition that avoiding tautology where grammatically possible is not an inflexible rule, but a guideline -- one among many -- used by New York courts to reach a "practical interpretation" of

what the parties actually intended. *See Greenwich Capital Fin. Prods., Inc. v. Negrin*, 903 N.Y.S.2d 346, 348 (N.Y. App. Div. 2010).[1] That the superfluity principle is only a guideline is shown in subpart 3.0 of the same sentence. A right of action that arises by virtue or by availing of a provision of an indenture (1.0) must necessarily arise "upon or under or with respect to the Indenture" (3.0). Thus the clause already has superfluous language, whichever party is correct in its construction of subpart 1.0.

But courts do not force "unnatural" constructions that ignore proper grammar and syntax to avoid superfluity. *See Maurice Goldman & Sons, Inc. v. Hanover Ins. Co.*, 80 N.Y.2d 986, 987 (N.Y. 1992). They look to construe the objective intention of the parties, through the natural and grammatical reading of the words they used. *See Greenwich Capital*, 903 N.Y.S.2d at 348; *Maurice Goldman*, 80 N.Y.2d at 987.

Defendants' construction is neither grammatical nor natural. Here again is the phrase, with italics and boldface added to illustrate:

"by **virtue** *or by availing of any provision* **of this Indenture.**"

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[1] The Vice Chancellor concluded that "the compound prepositional phrase 'by virtue of or by availing of' [is] an example of the law's hoary tradition of deploying joint terms, such as 'indemnify and hold harmless,' where technically one term would suffice." Report at 46.

Defendants argue that the word, "virtue," vaults over the italicized words -- sailing by the first appearance of the word, "of," in the process -- to mate with the second "of," which appears in the *second* genitive clause: "of this Indenture." Thus, defendants say, the parties meant, "by virtue of this Indenture, or by availing of any provision of this Indenture."

Had that been what the parties meant to say, they might just as easily have written it. They might even have written it awkwardly, with commas, like this:

"by virtue, or by availing of any provision, of this Indenture."

But they wrote neither. They wrote instead a phrase whose natural reading is that "virtue" (like "availing") will attach to the first "of" it finds, not the second:

By virtue or by availing **of any provision** of this Indenture.

(bold face added). Both "virtue," and "availing" join "of any provision." "Provision" is in turn modified by, "of this Indenture."

In fact, the words "virtue," and "availing" reflect different nuances, *see* SA8-9 (Pl's Opening Br. On Remand at 3-4), but even if they did not, a further problem arises. If "by virtue" modified "of this Indenture," what then?[2] Adding "availing" to "virtue" cannot turn "this Indenture," into "the Securities." The two

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[2] Defendants read "by virtue or by availing" as "the functional equivalent of, and a *substitute for* the alternative phrase 'or the Notes.'" Appellees' Ans. Supp. Memo. at 6 (emphasis in original). This is wishful thinking, not English grammar. *See* discussion, *infra*.

are plainly separate things. They are separately defined terms in the contract, *see* Appellants' Supp. Memo. at 5-6, and separately used in the clause itself ("No holder of any *Security* shall have any right by virtue or by availing of any provision of this *Indenture* . . .") (emphasis added). If defendants were right, the *Feldbaum* and *Lange* clauses barring "any remedy with respect to . . . the Securities" would constitute the kind of "superfluity" they now condemn. "As a matter of plain language," the Vice Chancellor correctly concluded, subpart 1.0 "does not speak to other rights that the holder of a Security may have, such as rights under or by virtue of the Security itself." Report at 11-12.

Defendants' argument that "Indenture" is the "broader term" that "encompasses" the "Securities" could only be correct if a security were a kind of indenture. It isn't. A security evidences a debt obligation; an indenture is a contract between the issuer and a trustee, establishing certain rights and obligations in connection with the issuance of securities. Securities are sometimes issued pursuant to an indenture, but they are never indentures themselves. Reference in the Athilon Indenture to the notes as "delivered under this Indenture," *see* Appellees' Ans. Supp. Memo. at 7, shows that the terms have different meanings.

The Vice Chancellor did not "excise" subpart 2.0, as defendants argue. The phrase, "any action or proceeding at law or in equity or in bankruptcy or

otherwise," merely lists "the types of actions or proceedings that would fall within the clause" if plaintiff asserts a contract claim. Report at 12. Section 1.0 defines the right; subpart 2.0 lists the kinds of proceedings in which the right may not be pursued. The clause may be wordy; it is not superfluous.

Greenwich Financial Services v. Countrywide Financial Corp., No. 650474/2008, slip op. (N.Y. Sup. Ct. Oct. 7, 2010), has no bearing on the question before the Court because the New York Supreme Court did not "define[] the scope" of a "materially identical" no-action clause by looking to subpart 2.0 rather than subpart 1.0. *See* Appellees' Ans. Supp. Memo. at 3-4. Plaintiffs' claim in *Greenwich Financial* arose under the contract, so the court never grappled with whether the first subpart of its no-action clause ("any right by virtue or by availing itself of any provisions of this Agreement:" the equivalent of subpart 1.0) addressed claims arising at common law or by statute. *Id.* at 1, 3, 5.

II. NO NEW YORK STATE COURT DECISION HAS ANSWERED THE QUESTION BEFORE THE COURT.

The Vice Chancellor did not, as defendants suggest, ignore recent authority that "clearly articulated how [New York state courts] would decide this case." *See* Appellees' Ans. Supp. Memo. at 12-13. After carefully examining the cases, he rightly concluded that they do not "shed[] light on the extent to which a New York court would apply the Athilon Clause to bar a claim that did not invoke a provision

of the Indenture." Report at 27. Defendants rely principally on *Walnut Place LLC v. Countrywide Home Loans, Inc. ("Walnut Place I")*, 2012 WL 1138863 (N.Y. Sup. Ct. Mar. 28, 2012), *aff'd*, 948 N.Y.S.2d 580 (N.Y. App. Div. 2012), and *Emmet & Co. v. Catholic Health East*, 951 N.Y.S.2d 846 (N.Y. Sup. Ct. 2012). Neither case is instructive.

In the *Walnut Place* decisions, plaintiffs invoked a provision of the governing contract. The Vice Chancellor concluded that *Walnut Place* says nothing about how a New York court would apply the Athilon no-action clause to claims, like Quadrant's, that do not invoke a provision of the contract. *See* Report at 27. Defendants counter that neither the New York Supreme Court nor the Appellate Division "distinguished the types of claims covered by the no-action clause." Appellees' Ans. Supp. Memo. at 10. There was no reason for them to do so, but in fact the Supreme Court observed that the no-action clause "limits the right of certificateholders to sue for *breach of the PSAs*." *Walnut Place I*, 2012 WL 1138863, at *3 (emphasis added). Breach of the contract was all that was before the trial and appellate courts.

Emmet & Co. is inapposite for the same reason. Bondholders there brought suit for breach of the terms of the indenture governing partial redemptions. 951 N.Y.S.2d at 848. The court construed the no-action clause to "bar[] any

bondholder from bringing suit to *enforce the Indenture* unless certain conditions are met." *Id.* at 849 (emphasis added). It aptly summarized the state of New York law: "[A]ccording to the courts of this state, a party cannot sue to assert its rights *under an indenture* while ignoring the indenture's restriction on its ability to sue." *Id.* at 850 (emphasis added). "Thus, the Indentures' no-action clauses apply to this lawsuit." *Id.* Like the *Walnut Place* decisions, *Emmet & Co.* is silent as to how a New York court would apply the Athilon no-action clause to claims not brought under or to enforce a provision of the Indenture.[3]

The "rule" for which these cases stand is the one articulated in *Emmet & Co.*: no-action clauses apply where a party "assert[s] its rights under an indenture." 951 N.Y.S.2d at 850. The cases do not undermine the broader rule that when parties omit "or the Securities" from the no-action clause, they intend that the clause will not govern the kinds of claims Quadrant has brought. *See* Appellants' Supp. Memo. at 7-12.

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[3] *Emmet & Co.* and *RBC Capital Markets, LLC v. Education Loan Trust IV*, 2011 WL 6152282 (Del. Ch. Dec. 6, 2011) do not rule that a no-action clause applies in all cases except claims for principal and interest. *See* Appellees' Ans. Supp. Memo. at 9. The "legal obligations" referred to in *RBC* were those arising *under terms of the indenture* for rights other than for payment of principal and interest. *See RBC*, 2011 WL 6152282, at *2, *4; *see also* discussion of *RBC* at 10-11 of Appellant's Consolidated Reply Brief. So too in *Emmet & Co.*, 951 N.Y.S.2d at 851-52 (claim that issuer "violated the Indentures' procedures governing partial redemptions."). Neither case speaks to "legal obligations" outside the four corners of an indenture.

III. NEW YORK LAW HAS NOT RECOGNIZED THE POWER OF THE INDENTURE TRUSTEE TO BRING QUADRANT'S CLAIMS.

Van Wezel v. McCord Radiator & Manufacturing Co., 20 N.Y.S.2d 91 (N.Y. City Ct. 1939), does not stand for the proposition that the no-action clause empowers the Indenture Trustee to bring Quadrant's claims. *See* Appellees' Ans. Supp. Memo. at 10-11. The case in fact supports the Vice Chancellor's conclusion that the phrase, "or the Securities," matters. Plaintiff sought to recover the face value of two bonds as damages for the issuer's default of its obligations to pay into a sinking fund. *Van Wezel*, 20 N.Y.S.2d at 93-94. Plaintiff contended that upon an event of default, the trustee could pursue only the remedy of acceleration, and that it sought not to enforce rights under the indenture, but rights enforceable as the holder of a single bond (the sinking fund obligation also appeared on the face of the bonds). *Id.* at 96. The clause at issue barred bondholders from pursuing "any right hereunder *or with respect to the debentures or coupons*." *Id.* at 96 (emphasis added). The court emphasized the breadth of the italicized phrase: "Note the word 'or' immediately following the word 'hereunder'. That 'or' sets actions 'hereunder' off in one category and other actions 'with respect to the debentures' in another category." *Id.* The clause thus applied to plaintiff's claim whether it arose from the indenture or the bond itself. This was why the court characterized the no-action clause as "sweeping." *Id.* at 96-97.

The court concluded that the "trustee has discretion to do what is forbidden to bondholders in order to 'enforce any right' 'with respect to the debentures or coupons.'" *Id.* at 97. In other words, the phrase "or with respect to the debentures or coupons" -- the functional equivalent of the *Feldbaum/Lange* phrase "or the Securities" -- was critical to the court's determination of not just the scope of the clause, but the powers of the trustee. In its final analysis, the court traced the source of the trustee's authority, as a contracting party to the indenture, to bring a claim arising from a provision of the indenture: "[t]he trustee had the right in its discretion to take any legal steps it deemed best for all bondholders when defendant breached obligations under the [indenture] in regard to the sinking fund." *Id.* *Van Wezel* bolsters the Vice Chancellor's conclusion that omission of the phrase "or the Securities" limits the reach of a no-action clause.

Nor does Section 7.08 of the Indenture help Appellees. The section does not create substantive rights; it merely gives those holding a majority of the outstanding securities procedural power to direct the enforcement of rights arising elsewhere, specifically referring to the exercise of "any trust or power conferred on the Trustee *by this Indenture*." *See* Indenture, § 7.08 (A132-33) (emphasis added). The Indenture Trustee's litigation powers arise exclusively from the terms of the Indenture, *id.* § 8.01(a)(i) (A133-34), which grant litigation authority only upon the

occurrence of a defined "Event of Default," *id.* § 7.04 (A131).[4] Nowhere does the Indenture authorize the Indenture Trustee to pursue rights secured to Quadrant by Delaware law by virtue of its status as a holder of the Notes.

Nor does Section 7.02(f) give the Indenture Trustee "standing to assert all claims" under the Indenture or the Securities. *See* Appellees' Ans. Supp. Memo. at 11 n.6 & 22. It provides merely that the Indenture Trustee may enforce rights without actually possessing Securities. Indenture, § 7.02(f) (A130). As the Vice Chancellor observed:

> [C]ontractual provisions may be enforced by the trustee without possession of any such securities. Because the securities, they may be in book form or the securities are with distributor holders. So this seems to me to be just standing to sue of the trustee for contract claims without having to bring the security holders in.

SA136 (H'g Tr., June 12, 2013, 46:7-13).

IV. THE REPORT DOES NOT DISRUPT THE RECEIVERSHIP CASES.

After a thorough examination of *Tang Capital Partners, LP v. Norton*, 2012 WL 3072347 (Del. Ch. July 27, 2012), and its predecessor receivership cases, the Vice Chancellor concluded that the cases are not instructive. They are "limited to statutory receiverships" and do not "speak[] to other contexts, such as the claims in this case." Report at 36. In light of the entire body of no-action clause case law,

[4] For a more thorough discussion of the Indenture Trustee's litigation authority, *see* Appellant's Opening Brief at 14-16.

"the receivership cases should not be relied upon to expand the scope of the Athilon Clause to include claims under the Notes." Report at 47. For the reasons discussed at 15-17 of Appellant's Supplemental Memorandum, *Tang* has no bearing on the outcome here. The older receivership cases do not either.

V. ALLOWING QUADRANT'S CLAIMS TO PROCEED WOULD NOT SUBVERT THE PURPOSE OF THE NO-ACTION CLAUSE.

Defendants assert the "purpose" of no-action clauses[5], but the purpose of any clause depends on the words the parties used. They may use broad language, as in *Feldbaum* and *Lange*, or opt for narrow language, as they did here, and courts will give effect to their choice. Defendants offer no evidence that this suit is unpopular among creditors, nor could they at the motion to dismiss stage. Nor do they show that it lacks merit: whether it has merit is the very point they have striven for two years to avoid. No creditors have joined the defense, and the fact that Quadrant proceeds alone suggests only that smaller holders in a distressed credit are willing to "free ride" the litigation expense. The more disruptive course would be to rewrite a contract in order to impose a court's policy judgment.

The no-action clause provides:

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[5] They call them a prophylaxis against unmeritorious and unpopular suits brought by a single holder, designed to centralize lawsuits whose benefits should properly accrue to the entire noteholder body. *See* Appellees' Ans. Supp. Memo. at 21-24.

> [I]t being understood and intended . . . that no one or more holders of Securities shall have any right in any manner whatever by virtue or by availing of any provisions of this Indenture to affect, disturb or prejudice the rights of any other holder of Securities, or to obtain or seek to obtain priority over or preference to any other such holder or to enforce any right under this Indenture, except in the manner herein provided and for the equal, ratable and common benefit of all holders of Securities.

Indenture, § 7.06 (A132). The stated goal of the provision is to prevent a race to the courthouse between noteholders asserting breaches of the Indenture. With its derivative claims, which are outside the rights under the Indenture, this suit serves that goal, as any recovery will accrue to the equal, ratable, and common benefit of all creditors, just as any recovery with respect to a shareholder derivative claim accrues to the benefit of all stockholders.[6] The construction that defendants advocate would turn the provision upside down by making it impossible for any (or

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[6] Defendants argue that the intent of the drafters was surely to bar all claims (including derivative ones) asserted by a lone creditor. But they never explain why an individual creditor of an insolvent corporation, having acquired derivative standing under *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007), when the equity no longer has value, should not have the same rights to protect the corporate interest as an individual stockholder would have had prior to the point of insolvency. Under *Gheewalla*, creditor standing to bring a derivative claim arises not by virtue of the Indenture, but as a consequence of the creditor having become the residual claimant to the corporation's assets and the primary beneficiary of the fiduciary relationship. By barring the only stakeholders with any economic incentive to monitor and police the actions of corporate fiduciaries from bringing derivative claims, the interpretation urged by defendants would effectively eliminate the most effective constraint on fiduciary misconduct at the point of insolvency -- when arguably that constraint is most important. Such a rule would make no sense as a policy matter. It would be unreasonable to conclude that that is what was intended by the parties to every no-action clause, regardless of the terms of their agreement.

even all) noteholders to bring an action for their collective benefit prior to a contract default.

Part of the rationale espoused by the case law -- that no-action clauses guard against litigation pursued by a lone noteholder against the judgment of the group -- applies where noteholders have agreed to channel actions through the trustee. But where they did not, the pursuit of such claims by a single 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 themselves, or claims belonging to the corporation. Nor does the Indenture grant authority to bring non-contractual claims prior to an express default. It therefore cannot preclude a noteholder from asserting those claims. Had that been the intent, the parties easily could have contracted otherwise.

Parties in Delaware may rely on consistent judicial interpretations of the same language in commercial documents. Section 7.06 is *unlike* the clauses in *Feldbaum, Lange, and Riklis*[7] (each of which held the suit barred), and *like* clauses in *Cruden, Harff, Mann, Continental Illinois* and *Mabon*[8] (each of which held or

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[7] *Feldbaum v. McCrory Corp.*, 1992 WL 119095 (Del. Ch. June 2, 1992); *Lange v. Citibank, N.A.*, 2002 WL 2005728 (Del. Ch. Aug. 13, 2002); *Victor v. Riklis*, 1992 WL 122911 (S.D.N.Y. May 15, 1992).

[8] *Cruden v. Bank of N.Y.*, 1990 WL 131350 (S.D.N.Y. Sept. 4, 1990), *aff'd in part, rev'd in part*, 957 F.2d 961 (2d Cir. 1992); *Harff v. Kerkorian*, 347 A.2d 133 (Del. 1975); *Mann v.*

reasoned that the clause would not bar such a suit). New York state courts construing no-action clauses similar to Section 7.06 have articulated *only* that claims brought to enforce provisions of an indenture are subject to the clause. A ruling in Quadrant's favor would not upset the interpretation New York and Delaware courts have given to any form of no-action clause.

CONCLUSION

For the reasons set out in the Vice Chancellor's carefully-reasoned Report, and Appellant's Supplemental Memorandum and this Reply, this Court should reverse the Order Granting Motion to Dismiss as detailed at 19 of Appellant's Supplemental Memorandum.

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Dated: August 22, 2013

Oppenheimer & Co., 517 A.2d 1056 (Del. 1986); *Cont'l Ill. Nat'l Bank & Trust Co. of Chicago v. Hunt Int'l Res. Corp.*, 1987 WL 55826 (Del. Ch. Feb. 27, 1987); *Mabon, Nugent & Co. v. Texas Am. Energy Corp.*, 1988 WL 5492 (Del. Ch. Jan. 27, 1988).