

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

RBC CAPITAL MARKETS, LLC,)
)
 Plaintiff,)
)
 v.) Civil Action No. 6297-CS
)
 EDUCATION LOAN TRUST IV and)
 U.S. EDUCATION LOAN TRUST IV, LLC,)
)
 Defendants.)

MEMORANDUM OPINION

Date Submitted: September 9, 2011

Date Decided: December 6, 2011

Donald J. Wolfe, Jr., Esquire, Matthew E. Fischer, Esquire, POTTER ANDERSON & CORROON LLP, Wilmington, Delaware; Alan J. Stone, Esquire, Patrick Marecki, Esquire, MILBANK, TWEED, HADLEY & McCLOY LLP, New York, New York, *Attorneys for Plaintiff.*

Kurt F. Gwynne, Esquire, Brian M. Rostocki, Esquire, REED SMITH LLP, Wilmington, Delaware, *Attorneys for Defendant The Bank of New York Mellon, as Indenture Trustee for Defendant Education Loan Trust IV.*

Daniel B. Rath, Esquire, Rebecca L. Butcher, Esquire, LANDIS RATH & COBB LLP, Wilmington, Delaware, *Attorneys for Defendant U.S. Education Loan Trust IV, LLC.*

STRINE, Chancellor.

I. Introduction

This is a suit by a holder of auction rate notes issued under an Indenture of Trust dated March 1, 2006 (the “Indenture”) and certain “Supplemental Indentures” thereto, against the issuer of the notes, U.S. Education Loan Trust IV, LLC (the “Issuer”) and the trust, Education Loan Trust IV (the “Trust,” and together with the Issuer, “Education Loan Trust”).¹ The plaintiff, RBC Capital Markets, LLC (“RBC”), claims that the Issuer caused the Trust to pay “millions of dollars in excessive fees” to the Issuer and an affiliate of the Issuer in breach of limits on those fees set forth in the Supplemental Indentures.² These unauthorized payments allegedly reduced the amount of interest payments made to RBC and the other auction rate noteholders by negatively affecting an input to the contractual formula for the interest rate paid on their notes.

RBC contends that, because Education Loan Trust’s breach of the Indenture and the Supplemental Indentures allegedly had the indirect effect of reducing the interest paid to the noteholders, it is entitled to sue Education Loan Trust under a statutorily-mandated section of the Indenture that gives any noteholder an “absolute and unconditional” right to receive payment of the principal and interest on its notes and to “institute suit for the enforcement of any such payment” if Education Loan Trust fails to make principal or interest payments when due.³ In response, Education Loan Trust argues that this section does not apply to RBC’s claims, and that RBC’s suit is barred by the Indenture’s “no-

¹ For economy of expression, I refer to the Issuer and the Trust collectively as “Education Loan Trust” throughout this opinion except where it is necessary to identify them independently.

² Compl. ¶ 1.

³ *Id.* ¶ 58.

action” clause, a standard provision that imposes certain requirements on the noteholders before they can bring a lawsuit under the Indenture, including making demand on the indenture trustee (the “Trustee”).

In considering this question under New York law, which governs the Indenture, I conclude that the no-action clause applies to RBC’s claims. RBC has an unconditional right to sue for interest payments on its notes that have not been made as due. But, RBC does not allege that it did not receive interest payments on its auction rate notes on time, or that that the interest rate formula applicable to the notes was not applied as written. RBC’s claim therefore is not that Education Loan Trust breached the terms of the Indenture addressing the right of noteholders like RBC to timely interest payments calculated in accordance with the terms of the Indenture and the Supplemental Indentures. Rather, RBC argues that Education Loan Trust breached the Indenture by causing the Trust to make fee payments in excess of the limits imposed by the Supplemental Indentures. These excessive payments had the result, RBC contends, of negatively affecting an input to the formula in the Supplemental Indentures used to calculate the interest rate on the auction rate notes, and causing lower interest payments to be made to the noteholders than would have been the case had the Trust only paid the appropriate level of fees.

RBC attempts to avoid the strictures of the no-action clause by seeking to conflate its actual claim of breach – which is that Education Loan Trust violated the Indenture by causing the Trust to pay out excessive fees – with one of the harms supposedly caused by that breach – which is that the interest rate paid on the auction rate notes was depressed

and therefore RBC received lower interest payments than it otherwise would have received. Such an end run around the limitations imposed by the no-action clause is contrary to the purposes of no-action clauses as recognized by courts under New York law and by learned commentators. The 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. RBC essentially argues that the payment-of-interest exception 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. But there are *many* wrongful breaches of a trust indenture that could directly injure the trust holding the notes and thereby have an indirect effect on the interest rate paid on notes issued under that indenture. 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. In doing so, these decisions highlight the important role that no-action clauses play in ensuring that lawsuits affecting noteholders and issuers are only brought if there is substantial support from the noteholders as a class, and in ensuring that such lawsuits are prosecuted in the best interest of all noteholders. When a noteholder must premise its claim for payment of interest on proving a breach of

provisions of the trust indenture not directly addressing the schedule or amount of interest payments due, it must comply with the no-action clause. Otherwise, the narrow payment-of-interest exception would undermine the important policy interest served by no-action clauses. Because RBC has not pled that it has met any of the conditions precedent to suit required by the no-action clause, I dismiss all of RBC's claims.

II. Factual Background

These are the facts as drawn from the complaint, its attachments, and the documents that it incorporates. Because this case presents a discrete legal question, I attempt to distill the facts down to their essence.

RBC is a holder and beneficial owner of approximately 15% of the notes outstanding under the Indenture. Specifically, RBC holds Series 2006-1 and Series 2006-2 auction rate notes. The management of these two series, and the interest rate calculations applicable to the notes in each series, are governed by the Supplemental Indentures, which are dated March 1, 2006, and September 1, 2006.⁴

The interest rate paid on each series of auction rate notes issued under the Indenture was set by auctions held every 28 days. At these auctions, investors would submit bids for the notes, which were ranked based on the interest rate offered and the amount of notes to be purchased, from the lowest minimum bid rate to the highest minimum bid rate. Orders for the auction rate notes were then filled, starting with the lowest bid submitted, until all of the available notes were sold. Investors could bid to sell, hold, or buy more auction rate notes. In the event that there were not enough buy

⁴ The relevant terms of each Supplemental Indenture are identical.

orders to satisfy the sell orders, the auction would fail. The calculation of the interest rate to be paid on the notes depended on the results of the auction, but under all circumstances the interest rate was capped by the lesser of a “Maximum Rate” or a “Net Loan Rate,” both of which were determined according to formulas contained in the Supplemental Indentures.⁵

On March 18, 2011, RBC brought this action, alleging that, at the direction of the Issuer, the Trust paid out “Operating Fees” and “Administration Fees” in excess of explicit limitations set forth in § 7(a) of each of the Supplemental Indentures.⁶ Because the Net Loan Rate, which in certain circumstances could determine the interest rate payable on a series of auction rate notes, was calculated based on a formula that requires deducting certain fees paid by the Trust, RBC claims that the payment of unauthorized and excessive fees resulted in an improperly low Net Loan Rate, and therefore that improperly low interest payments were made to the holders of auction rate notes.⁷ RBC claims that these violations of the Indenture and the Supplemental Indentures gave rise to RBC’s unconditional right to sue for payment of unpaid interest on its notes under the

⁵ Compl. ¶ 18.

⁶ *Id.* ¶¶ 36, 41.

⁷ Under the Supplemental Indentures, the Net Loan Rate for any interest period equals “(a) the sum of all interest payments and Special Allowance Payments made with respect to Financed FFELP Loans during the preceding calendar quarter, less (b) all consolidation loan rebate fees, Note Fees, Servicing Fees and Administration Fees during the preceding calendar quarter, divided by (c) the average daily principal balance of Financed FFELP Loans for the preceding calendar quarter.” Def. Letter to the Court (Sept. 7, 2011) Ex. 1 at Sched. A, §1.01, Ex. 2 at Sched. A §1.01 (emphasis added). The Financed FFELP Loans are the student loans that back the auction rate notes issued under the Indenture.

payment-of-interest exception in § 6.09 of the Indenture.⁸ RBC's complaint contains three counts: accounting, unjust enrichment, and breach of contract.⁹ The Issuer and the Trust have each filed a motion to dismiss RBC's claims under Court of Chancery Rule 12(b)(6).

III. The Relevant Provisions Of The Indenture

The resolution of this dispute turns on whether RBC's claims are subject to the requirements imposed by § 6.08 of the Indenture (the no-action clause), or whether RBC is exempt from such requirements under § 6.09 of the Indenture (the payment-of-interest exception). Section 6.08 provides, in relevant part:

[N]o holder of any Note...shall have any right to institute any suit, action or proceeding in equity or at law for the enforcement of this Indenture or... any other remedy hereunder unless (a) an Event of Default shall have occurred and be continuing, (b) the Acting Beneficiaries Upon Default shall have made written request to the Trustee with respect thereto, (c) such Beneficiary or Beneficiaries shall have offered to the Trustee indemnity..., (d) the Trustee shall have thereafter failed for a period of [60] days after the receipt of the request and indemnification or refused...to institute such action, suit or proceeding in its own name and (e) no direction inconsistent with such written request shall have been given to the Trustee during such [60]-day period by the Holders of not less than a majority in aggregate Principal Amount of the Notes then Outstanding...; it being understood and intended that no one or more Holders of the Notes...shall have any right in any manner whatsoever to affect, disturb or prejudice the lien of this Indenture by his, her, its or their action or to enforce any right hereunder

⁸ Compl. ¶¶ 55-58. Although RBC asserts that an overpayment of Operating Fees reduced the interest payments on the auction rate notes, the Operating Fees are actually not part of the Net Loan Rate calculation set forth in the Supplemental Indentures. *See supra* note 7. Thus, RBC's claim that the Trust paid out Operating Fees in excess of contractual limitations is unrelated to a claim that RBC did not receive additional interest payments to which it was entitled.

⁹ RBC seeks an accounting to determine whether the Trust is being administered properly and what, if any, additional interest is owed to RBC and the other holders of auction rate notes as a result of Education Loan Trust's alleged misconduct. Education Loan Trust has raised the issue of whether an accounting is a remedy or a cause of action. I find it unnecessary to reach this question because § 6.08 of the Indenture warrants dismissal of RBC's entire complaint.

except in the manner herein provided, and that all proceedings at law or in equity shall be instituted, had and maintained in the manner herein provided and for the benefit of the Holders of all Outstanding Notes...; provided, however, that, notwithstanding the foregoing provisions of this Section 6.08, the Acting Beneficiaries Upon Default may institute any such suit, action or proceeding in their own names for the benefit of the Holders of all Outstanding Notes....¹⁰

The “Acting Beneficiaries Upon Default” are defined in the Indenture as a majority of the noteholders.¹¹ In other words, no minority holder of notes can sue for any remedy under the Indenture unless it first complies with certain pre-conditions, including making a demand on the Trustee. RBC does not allege that it has met any of these requirements. Instead, RBC contends that its claims fall within the purview of § 6.09, which reads as follows:

Notwithstanding any other provision in this Indenture, the Holder of any Note shall have the right, which is absolute and unconditional, to receive payment of the principal of, premium, if any, and interest on such Note in accordance with the terms thereof and hereof and, upon occurrence of an Event of Default with respect thereto, to institute suit for the enforcement of any such payment....¹²

The relevant Event of Default that triggers a cause of action under § 6.09 of the Indenture is a “default in the due and punctual payment of any interest on any Senior Note for five Business Days.”¹³

¹⁰ Rostocki Aff. Ex. 1 (Indenture of Trust (March 1, 2006)) (the “Indenture”) § 6.08.

¹¹ *Id.* § 1.01.

¹² *Id.* § 6.09.

¹³ *Id.* § 6.01(a); *see also* Compl. ¶¶ 55, 57.

IV. Legal Analysis

A. Standard Of Review

When considering a motion to dismiss, I must accept all well-pled factual allegations in the complaint as true, accept even vague allegations in the complaint as “well-pleaded” if they give the defendants notice of the claim, draw all reasonable inferences in favor of the plaintiff, and deny the motion unless the plaintiff could not recover under any “reasonably conceivable” set of circumstances susceptible of proof.¹⁴ I am not, however, required to accept conclusory allegations as true.¹⁵

B. RBC’s Claims Are Subject To The No-Action Clause And Do Not Survive A Motion To Dismiss

This case presents a pure legal question: whether a claim that interest payments made on the auction rate notes during a certain time period were too low is a direct claim governed by the Indenture’s payment-of-interest exception if the claim depends on first proving that Education Loan Trust breached the Indenture because the Trust paid out fees that were in excess of specific contractual limitations. For reasons explained more fully below, I find that if a noteholder plaintiff must prove an independent contractual breach, such as the one that RBC must prove here, in order to show that the interest payments made to it were lower than they should have been, the no-action clause applies to the plaintiff’s claims.

¹⁴ *Cent. Mortg. Co. v. Morgan Stanley Mortg. Capital Holdings LLC*, 27 A.3d 531, 536 (Del. 2011).

¹⁵ *Price v. E.I. DuPont de Nemours & Co.*, 26 A.3d 162, 166 (Del. 2011); *Gantler v. Stephens*, 965 A.2d 695, 704 (Del. 2009); *In re Gen. Motors (Hughes) S’holder Litig.*, 897 A.2d 162, 168 (Del. 2006).

Here, RBC has not alleged that the terms of the Indenture requiring periodic interest payments were directly breached, or that the interest rate formula for the auction rate notes was not applied as set forth in the Supplemental Indentures. In other words, it cannot show that there has been a “default in the due and punctual payment”¹⁶ of interest on its notes by pointing solely to the provisions of the Indenture and the Supplemental Indentures addressing what and under what formula interest was to be paid. RBC in fact admits that it received timely interest payments. Rather, RBC has pled that Education Loan Trust breached the Indenture and thus impoverished the Trust itself, and that RBC suffered a harm incidental to, rather than as a direct result of, that breach.

No-action clauses such as § 6.08 of the Indenture are “a standard feature of indenture agreements which require compliance by bondholders to prevent dismissal of their suit.”¹⁷ The 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.¹⁸ The New York

¹⁶ Indenture § 6.01(a).

¹⁷ *In re Cendant Corp. Securities Litig.*, 2005 WL 3500037, at *9 (D.N.J. Dec. 21, 2005) (applying New York law); *see also McMahan & Co. v. Warehouse Entm’t, Inc.*, 65 F.3d 1044, 1050 (2d Cir. 1995); *Howe v. Bank of New York Mellon*, 783 F. Supp. 2d 466, 473 (S.D.N.Y. 2011); *UPIC & Co. v. Kinder-Care Learning Ctrs., Inc.*, 793 F. Supp. 448, 454 (S.D.N.Y. 1992); *Simons v. Cogan*, 542 A.2d 785, 793 (Del. Ch. 1987) (applying New York law); *see generally Revised Model Simplified Indenture*, 55 BUS. LAW. 1115, 1137-38 (2000) [hereinafter *Model Indenture*] (including a no-action clause in model indenture agreement).

¹⁸ *See Friedman v. Chesapeake and Ohio Ry. Co.*, 261 F. Supp. 728, 729-31 (S.D.N.Y. 1966), *aff’d*, 395 F.2d 663 (2d Cir. 1968), *cert. denied*, 393 U.S. 1016 (1969) (citing the 8th Circuit’s decision in *Quirke v. St. Louis-San Francisco Ry. Co.*, 277 F.2d 705, 709 (8th Cir. 1960), *cert. denied*, 363 U.S. 845 (1960), for the proposition that a no-action clause places “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 others similarly situated, the resulting harassment and litigation would be not only burdensome but intolerable.”); *Meyer v.*

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.”¹⁹ No-action clauses effect these related purposes “by delegating the right to bring a suit enforcing rights of bondholders to the trustee, or to the holders of a substantial amount of bonds, and by delegating to the trustee the right to prosecute such a suit in the first instance.”²⁰ In addition, no-action clauses ensure that any remedy attained by noteholders for a violation of the trust indenture will be shared equally.²¹

New York courts have found that no-action clauses apply to both contractual and non-contractual claims.²² In *Feldbaum v. McCrory Corp.*, former Chancellor Allen dealt

Lowry & Co., Inc., et al., 19 N.Y.S.2d 835, 836 (N.Y. Sup. Ct. 1940) (“[C]lauses limiting the right of action by any bondholder...usually have good sense behind them, in that they are designed to prevent trumped-up and capricious suits.”); *see generally* American Bar Foundation, *Commentaries on Model Debenture Indenture Provisions* 232 (1971) [hereinafter *Commentaries*] (explaining that the “major purpose” of a no-action clause is “to deter individual debentureholders from bringing independent lawsuits for unworthy or unjustifiable reasons”).

¹⁹ *Feder v. Union Carbide Corp.*, 530 N.Y.S.2d 165, 167 (N.Y. App. Div. 1988).

²⁰ *Feldbaum v. McCrory Corp.*, 1992 Del. Ch. LEXIS 113, at *21 (Del. Ch. June 2, 1992) (quoting the *Commentaries*).

²¹ *Commentaries*, *supra* note 18, at 232 (“An additional purpose [of no-action clauses] is the expression of the principle of law that would otherwise be implied that all rights and remedies of the indenture are for the equal and ratable benefit of all the holders.”).

²² *See, e.g., Friedman*, 261 F. Supp. at 729-31 (holding that no-action clause barred contract claim for breach of indenture provisions requiring sinking fund payments, payment of back interest upon any distribution of dividends, and payment of principal upon breach of indenture); *RJ Capital, S.A. v. Lexington Capital Funding III, Ltd.*, 2011 WL 3251554, at *7 (S.D.N.Y. July 28, 2011) (finding that no-action clause barred suit against issuer and collateral manager alleging misapplication of the Indenture’s priority-of-payment provisions); *Bank of N.Y. v. Battery Park City Auth.*, 675 N.Y.S.2d 860, 860 (N.Y. App. Div. 1998) (holding that no-action clause barred suits by former bondholders for wrongful redemption); *Feder*, 530 N.Y.S.2d at 166 (holding that no-action clause barred contract claim for breach of indenture provision requiring the adjustment of terms for conversion to common stock); *Sutter v. Hudson Coal Co.*, 21 N.Y.S.2d 40 (N.Y. App. Div. 1940) (dismissing contract claim for breach of sinking fund obligations created by indenture); *Meyer*, 19 N.Y.S.2d at 836-37 (finding that no-action clause barred suit alleging failure of managers of premises covered by bond issue trust indenture to account properly); *Levy v. Paramount Publix Corp.*, 266 N.Y.S. 271, 275 (N.Y. Sup. Ct. 1933), *aff’d*, 269 N.Y.S.2d 997

with no-action clauses contained in indentures governed by New York law, and distilled his understanding of New York law well and thusly: “no matter what legal theory a plaintiff advances, if the trustee is capable of satisfying its obligations, then any claim that can be enforced by the trustee on behalf of all bonds, other than a claim for the recovery of past due interest or [principal] is subject to the terms of a no-action clause....”²³ As a result, counsel for RBC conceded at oral argument that if RBC’s claims do not fall within the exception provided by § 6.09 of the Indenture, they are all barred by § 6.08.²⁴

The payment-of-interest exception relied on by RBC is mandated by the Trust Indenture Act, which requires that a holder of notes issued under a trust indenture have the right to sue directly to collect interest and principal when due.²⁵ Specifically, § 316(b) of the Trust Indenture Act provides:

Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit

(N.Y. App. Div. 1934) (dismissing breach of fiduciary duty claims against issuer’s directors in connection with issuer’s alleged fraudulent conveyance for failure to comply with no-action clause); *see also Lange v. Citibank, N.A.*, 2002 WL 2005728, at *7 (Del. Ch. Aug. 13, 2002) (finding that no-action clause barred fraudulent conveyance claims) (applying New York law); *Feldbaum*, 1992 Del. Ch. LEXIS 113, at *28-33 (finding that no-action clause barred fraudulent conveyance claims, claims for breach of the implied covenant of good faith and fair dealing, and claims that fraudulent misrepresentations induced bondholders not to seek to enjoin transaction) (applying New York law).

²³ *Feldbaum*, 1992 Del. Ch. LEXIS 113, at *22.

²⁴ *RBC Capital Markets, LLC v. Education Loan Trust IV*, C.A. No. 6297 at 40 (Del. Ch. Aug. 31, 2011) (TRANSCRIPT) (“Q. What about this – are you arguing that the unjust enrichment or the accounting claims should be treated differently? A. We think they’re either subject to 6.08 or they’re not...”).

²⁵ *See Cruden v. Bank of New York*, 957 F.2d 961, 968 (2d Cir. 1992).

for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder....²⁶

Thus, provisions such as § 6.09 of the Indenture are statutorily mandated and appear in all trust indentures.²⁷

In my view, § 6.09 cannot reasonably be read to apply to RBC's claims. Section 6.09 provides a limited exception to the Indenture's no-action clause that allows a noteholder to sue directly when that noteholder has not received a payment of principal or interest when due. RBC does not allege a violation of any specific term of the Indenture or Supplemental Indentures that deals with the timing of interest payments or the amount of interest payments made, in the sense that Education Loan Trust failed to make an interest payment when due or tampered with or failed to apply the required interest rate formula.²⁸ The violations alleged by RBC did not affect the occurrence of interest

²⁶ 15 U.S.C. § 77ppp(b). Federal courts have explained that the enactment of § 316(b) can be attributed to the SEC's concern about "the motivation of insiders and quasi-insiders to destroy a bond issue through insider control, and the generally poor information about a prospective reorganization available to individual dispersed bondholders." *UPIC & Co. v. Kinder-Care Learning Ctrs., Inc.*, 793 F. Supp. 448, 452-53 (S.D.N.Y. 1992). Section 316(b) addressed this concern by making it difficult for a distressed firm to successfully complete a consensual workout and thereby forcing contractual recapitalizations to be brought under the jurisdiction of the bankruptcy courts. See Senate Comm. on Banking and Currency, Trust Indenture Act of 1939: Report to Accompany S. 2065, S. Rep. No. 248, 76th Cong., 1st Sess. 26 (1939) (stating that the "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans is [intended to be] prevented by [§ 316(b)'s] prohibition."). The *Commentaries* describe the purpose of the development of payment-of-interest exceptions to no-action clauses as ensuring "the negotiability of the debentures by making certain that the promise to pay contained therein was unconditional." *Commentaries*, *supra* note 18, at 234.

²⁷ See *Model Indenture*, *supra* note 17, at 1193; *Commentaries*, *supra* note 18, at 234.

²⁸ Cf. *Bank of New York v. Battery Park City Auth.*, 675 N.Y.S.2d 860, 860 (N.Y. App. Div. 1998) (finding that the plaintiffs could not sue under a no-action clause's "express authorization of actions for unpaid interest" because "they [were] not seeking to recover past due interest as such, but rather the higher interest they could have expected to receive were it not for [an] allegedly wrongful redemption.").

payments, but rather directly injured the Trust itself and therefore indirectly affected an input to the calculation of the interest rate.²⁹ Here, RBC alleges that the Issuer injured the Trust by causing the Trust to pay out excessive fees. As a result, RBC's claim that it received improperly low interest payments depends in the first instance on and is derivative of a claim belonging to the Trust itself. The most obvious remedy for that breach would be a recovery against the Issuer for excessive fees, which would then be paid back into the Trust. That is a classic derivative action recovery – it would go to the Trust in the first instance. Presumably, the return of these funds would benefit all noteholders by eventually increasing their returns in some way. But that would be a secondary consequence of redressing in the first instance the impoverishment of the Trust by the excess payment of fees.³⁰ Because the remedy sought by RBC is derivative of proving an independent wrong, rather than a direct violation of the provisions of the Indenture addressing when and what interest is due, RBC must follow the procedures mandated by the no-action clause.³¹

²⁹ See *Schallitz v. Starrett Corp.*, 82 N.Y.S.2d 89, 91 (N.Y. Sup. Ct. 1948) (holding that a waiver, executed by a majority noteholder, of defaults resulting from adoption of an executive compensation plan in violation of the indenture, did not violate the Trust Indenture Act because § 316 of the Trust Indenture Act “forbids postponement only of interest actually due and payable by the terms of the indenture security and does not prohibit the incidental effect upon income interest caused by diminution in dividends from other sources.”).

³⁰ In other words, it is by no means certain that a court would remedy any payment of excess fees by allocating those overages to prior periods. One could imagine other remedies, such as requiring a payment of damages plus interest to the Trust, which the Trust would then be obliged to apply to the benefit of the noteholders ratably as of that time. Indeed, precisely because the alleged violation and its remedy affect all noteholders, the application of the no-action clause is necessary in order to ensure that its purposes of ensuring that litigation benefits the holders of notes as a class are served.

³¹ See *Feldbaum*, 1992 WL 119095, at *8 (where plaintiff bondholders are “hurt derivatively,” they “can allege no harm different from that suffered by their fellow bondholders and thus

The *Feder* case decided by the New York Appellate Division, Second Department, and the *Lange* case decided by this court (applying New York law) provide useful analogues to the issue presented by this action. In *Feder v. Union Carbide Corp.*,³² holders of convertible debentures sued to recover damages allegedly caused by the issuer's failure to adjust the conversion ratio of their debentures to common stock in accordance with the terms of the indentures.³³ The New York Appellate Division affirmed the trial court's decision to grant defendants' motion to dismiss because the plaintiffs had not complied with the no-action clause in the indenture under which the debentures were issued.³⁴ Importantly, the court found that an exception to the no-action clause in the indenture allowing the debentureholders to sue directly for the enforcement of their "right to convert" the debenture to common stock did not apply where the "alleged breach would not prevent the debenture holders from exercising their right to

should share any remedy they receive on a *pari passu* basis with other bondholders."); compare *General Inv. Co. v. Interborough Rapid Transit Co.*, 193 N.Y.S. 903 (N.Y. App. Div. 1922). In *Interborough*, a case that pre-dated the Trust Indenture Act, the New York Appellate Division, First Department, found that a no-action clause in a collateral indenture did not prevent an action brought by a plaintiff noteholder to recover unpaid principal and interest on promissory notes issued under that indenture. *Id.* at 909. The court reasoned that the plaintiff's action was "not brought under the collateral agreement or to enforce any possible rights of the plaintiff by virtue thereof" and that the action was rather "purely one to recover upon the primary indebtedness represented by defendant's...promissory notes." *Id.* at 908. The court distinguished between the defendant's "primary obligation" to pay principal and interest on the notes and actions brought to enforce rights under the collateral indenture, noting that the remedies for the two different kinds of actions were "entirely separate and distinct." *Id.* at 909. Although the indenture at issue in *Interborough* did not contain an exception to the no-action clause for the enforcement of principal and interest payments as modern indenture agreements are required to do, the court's reasoning sheds light on the distinction between direct claims made for principal and interest payments and derivative claims brought under an indenture that are properly subject to the approval of a majority of the noteholders and/or the indenture trustee.

³² 530 N.Y.S.2d 165 (N.Y. App. Div. 1988).

³³ *Id.* at 166.

³⁴ *Id.*

convert, but would affect the price at which the conversion was executed.”³⁵ In other words, the court held that the exception to the no-action clause was inapplicable to a claim which involved proving that the conversion right was affected derivatively by another wrong.³⁶ Here, analogous to *Feder*, the remedy sought by RBC is not directly premised on a violation of the provisions of the Indenture addressing when and what interest is due, but rather derivative of proving an independent wrong that involves alleged violations of other provisions contained in the Supplemental Indentures.

In *Lange v. Citibank, N.A.*,³⁷ holders of debentures alleged that the subsidiaries of the company that provided the revenue for the repayment of their debentures had been sold for less than fair value.³⁸ As a result, the debentureholders did not receive cash interest payments on their debentures when such payments were due.³⁹ The debentureholders sued, contending that the sales of the subsidiaries were fraudulent

³⁵ *Id.*

³⁶ An exception to no-action clauses for the enforcement of conversion rights, unlike the exception for enforcement of principal and interest payments, is not mandated by the Trust Indenture Act, but does appear in the American Bar Association’s model indenture. *See Model Indenture, supra* note 17, at 1193 (noting that “actions to enforce conversion rights [] are expressly exempted from the obligation to comply with [the model no-action clause].”). Such an exception is generally recognized to be a standard provision. *See* 6A FLETCHER CYC. CORP. § 2695 (2011) (“The refusal of the corporation to make the conversion at the demand of a bondholder creates in the bondholder’s favor a right of action that does not affect the other bondholders as a class, but it is a right that he or she may assert without the necessity of resorting to the trustee as an intermediary.”). The purposes of the exception for conversion rights seem analogous to those of the principal and interest exception.

³⁷ 2002 WL 2005728 (Del. Ch. Aug. 13, 2002).

³⁸ *Id.* at *1.

³⁹ *Id.* at *3. The indenture in *Lange* specifically provided that the debentures were subordinate to certain other debt and that, in the event that the senior debt was in default, the debentureholders could not demand any principal or interest payments. *Id.* at *2.

conveyances and resulted from breaches of fiduciary duties.⁴⁰ The crux of the debentureholders' argument was that, had the subsidiaries not been sold for an allegedly unfair price, there would have been proceeds that would have resulted in principal and interest payments to them. In *Lange*, as in the present case, the plaintiff attacked transactions that had a derivative effect on principal and interest payments and sought to sue directly to recover what principal and interest they believed should have been paid to them. This court applied New York law and dismissed the debentureholders' complaint because they did not follow the procedures set forth in the trust indenture's no-action clause, holding that "[e]ach 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."⁴¹

Breaches of fiduciary duty or contract under a trust indenture that injure the trust directly can have the indirect effect of diminishing – or in *Lange*'s case, eliminating altogether – principal and interest payments due to holders of notes. But this does not mean that such breaches should automatically give rise to a cause of action under the exception to no-action clauses for enforcement of principal and interest payments. If a predicate to recovery is proving a breach of legal obligations under a trust indenture other than those directly addressing the payment of principal and interest, the proper course of action is to apply the requirements of the no-action clause to those claims. Otherwise, any breach that has the effect of injuring the trust directly and thereby arguably reducing,

⁴⁰ *Id.* at *1.

⁴¹ *Id.* at *6.

delaying, or eliminating a principal and interest payment under a trust indenture would be an individual action even though the breach affected the trust as a whole, and the narrow exception to no-action clauses mandated by the Trust Indenture Act would corrode away the general rule,⁴² a result at odds with New York law.⁴³

Thus, I find that § 6.09 does not apply to RBC's claims, and RBC's claims are properly within the purview of § 6.08. Because RBC has not pled that it has complied with any of the pre-conditions to suit set forth in the no-action clause, RBC's complaint must be dismissed.

V. Conclusion

For the foregoing reasons, the Issuer's and the Trust's motions to dismiss are GRANTED. IT IS SO ORDERED.

⁴² Cf. *Feder v. Union Carbide Corp.*, 530 N.Y.S.2d 165 (N.Y. App. Div. 1988) (explaining that the exception providing a direct cause of action to debentureholders for enforcement of their "right to convert" the debenture to common stock "must not be construed to render the [no-action clause] ineffective.").

⁴³ I note that as a Delaware judge applying the law of a respected sister state, I should be chary about innovating, as RBC would have me do. See *Viking Pump, Inc. v. Century Indem. Co.*, 2009 WL 3297559, at *25 n.144 (Del. Ch. Oct. 14, 2009) (noting that, "[u]nder principles of comity," Delaware courts applying New York law are under a "duty to respect [their] sister state...by applying its law in the manner most faithful to their understanding of how the New York Court of Appeals would."). If litigants want innovative common law, they should address their claims to the courts of the state whose law applies. My duty here is to show comity and respect by carefully and cautiously applying New York law. Our courts should never serve or be seen to serve as a way to bypass the precedent of the courts of the sovereign whose law governs the case. And lest I be perceived as ignoring this issue, RBC's briefs and my own independent research have revealed no basis to conclude that New York's approach to interpretation is inconsistent with any federal policy purpose served by the establishment of the principal and interest exception under § 316(b) of the Trust Indenture Act.