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Drafting Indenture 'No-Action' Clauses under New York Law

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DRAFTING INDENTURE ‘NO-ACTION’ CLAUSES UNDER NEW YORK LAW

WILLIAM N. LAY*

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I. INTRODUCTION

When issuing corporate debt instruments, issuers routinely place restrictive clauses in bond indentures that limit the ability of debtholders’ ability to sue the issuer.¹ These restrictive

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¹ *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp.*, 677 F.3d 1286, 1298 (11th Cir. 2012) (noting that a no action clause is a “standard provision present in many trust indentures.”).

provisions are called “no action” clauses.² A well-drafted no-action clause protects an issuer from frivolous or unwarranted lawsuits by preventing individual or small groups of debtholders from bringing suits that are specious or unwelcome by the majority of the debtholders.³ However, since no action clauses may preclude claims from debtholders with legitimate grievances, from bringing their claims in court, legal challenges to no action clauses frequently arise.⁴ Consequently, thoughtful, precedent-informed drafting is essential when drafting a no action clause for a bond indenture.

While courts in the vast majority of jurisdictions agree that no action clauses are generally enforceable, disputes concerning the scope and interpretation of no action clauses are common.⁵ The objective of this Article is to outline the general background and mechanics of a no action clause, draw the reader’s attention to recent case law that may affect a court’s interpretation of a no action clause,

² *Id.*

³ *Conflict of Interests Between Indenture Trustee and Bondholders: Avoidance of “No Action” Clauses Prohibiting Bondholder Suits against the Obligor*, 62 YALE L.J. 1097, 1098-99 (1953) (“[T]he ‘no action’ clause precludes specious suits instigated by attorneys who hope to receive lucrative fees from a true class action for all [debt]holders. And the debtor corporation is insulated from unwise court action by a few panicky [debt]holders, or from a possible multiplicity of suits engendered by individual [debt]holders’ actions.”) (internal citations omitted); *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 538 (1936).

⁴ *Id.* at 1099-1100 (“[I]n occasional circumstances, insistence on literal compliance with the “no action” clause might completely paralyze [debt]holders whose interests are being harmed.”).

⁵ 14 N.Y. JUR. 2D BUSINESS RELATIONSHIPS § 336 (2015) (“Reasonable restrictions on the right of action of an individual holder of corporate bonds or other obligations, either in respect of the obligation or the security or both, have generally been upheld as valid.”); *Quadrant Structured Products Co. v. Vertin*, 23 N.Y.3d 549, 565 (2014) (“Defendants are correct that generally a no-action clause prevents minority securityholders from pursuing litigation against the issuer, in favor of a single action initiated by a Trustee upon request of a majority of the securityholders”); *Dietzel v. Anger*, 8 Cal. 2d 373, 376 (1937) (“The great majority of the cases hold the restrictive provision valid on the theory that the [debt]holders have, by agreement among themselves, imposed a condition precedent to the exercise of the right of any one of them to sue individually.”)..

and, finally, to make drafting recommendations to the reader. This Article will focus on the application and interpretation of no action clauses under New York law, since New York law governs the vast majority of corporate debt indentures.⁶ In particular, this Article will analyze issues addressed in the New York Court of Appeals' decision in *Quadrant Structured Products Co. v. Vertin* (hereafter "*Quadrant*")⁷ and the 11th Circuit's decision in *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp* (hereafter "*Akanthos*").⁸

This Article will proceed in four parts. Part II will explain the general background, development, and mechanics of a no action clause. In particular, Part I will explain the general standards of interpretation and exceptions to no action clauses that have been recognized in New York courts. Next, Part III will introduce and detail recent decisions construing New York law that involve the enforceability of a no action clause. Specifically, Part III will explain how the New York Court of Appeals' decision in *Quadrant* increases the probability that a New York court will decline to enforce a no action clause under certain conditions. Finally, Part IV will outline lessons learned from *Quadrant* and *Akanthos* can help a drafter maximize the probability that New York courts will enforce a no action clause in their indenture. The Article will conclude with a summation at Part V.

⁶ REAL ESTATE INVESTMENT TRUSTS § 12:136 (2015) ("... most corporate indentures and many loan documents are governed by New York law and are to be litigated in New York courts . . ."). Many indentures that are drafted in other states will contain a choice-of-law provision that specifies that New York Law will govern the indenture. See *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp.*, 677 F.3d 1286, 1289 (11th Cir. 2012) ("The trust indentures have a choice-of-law provision specifying that New York law governs the agreement.").

⁷ *Quadrant Structured Prod.'s Co. v. Vertin*, 23 N.Y.3d 549 (2014).

⁸ *Akanthos Capital Mgmt., LLC*, 677 F.3d at 1292. In this case, the 11th Circuit interpreted New York law.

II. GENERAL BACKGROUND AND MECHANICS OF A NO ACTION CLAUSE

A. BACKGROUND

A no action clause limits the ability of individual or small groups of debtholders to sue issuers by vesting the debtholder's right to sue in a third party, the trustee.⁹ The third party trustee effectively holds legal title to the securities.¹⁰ No action clauses for debt instruments are found in the indenture, which is a written agreement between the parties that sets forth, among other things, the obligations of the issuer, the debtholder's rights and remedies in the event the issuer defaults, as well as the responsibilities of the trustee.¹¹ For actions within the scope of the no action clause, it is the trustee, not the debtholder(s), who must bring suit.¹² No action clauses can make bringing suit against an issuer an expensive and time-consuming endeavor.¹³

No action clauses have been regularly upheld and enforced in the vast majority of jurisdictions, including New York.¹⁴ The

⁹ *Conflict of Interests Between Indenture Trustee and Bondholders: Avoidance of "No Action" Clauses Prohibiting Bondholder Suits against the Obligor*, 62 YALE L.J. 1097, 1098-99 (1953) ("Under the 'no action' clause, [debt]holders' rights to sue the corporate debtor are vested in an independent trustee . . .").

¹⁰ *Quadrant Structured Prod.'s Co.*, 23 N.Y. at 555 (noting that an indenture is "a written agreement that bestows legal title of the securities in a single Trustee . . .") (citing George G. Bogert & George T. Bogert, *THE LAW OF TRUSTS AND TRUSTEES* § 250 at 280 (2d ed. rev. 1992)).

¹¹ *Quadrant Structured Prod.'s Co.*, 23 N.Y.3d at 555.

¹² *Rabinowitz v. Kaiser-Frazer Corp.*, 111 N.Y.S.2d 539, 545 (N.Y. Sup. Ct. 1952) ("[O]rdinarily a request upon a trustee to take action must be made by the holders of the prescribed percentage of bonds before a class action may be instituted by a [debt]holder."). Exceptions to this are discussed *infra*.

¹³ James Gadsden, *Indenture "No-Action" Clauses Bar Independent Claims by Securityholders*, 130 BANKING L.J. 226, 228 (2013).

¹⁴ 14 N.Y. JUR. 2D BUSINESS RELATIONSHIPS § 336 (2015) ("Reasonable restrictions on the right of action of an individual holder of corporate bonds . . . have generally been upheld as valid."); *Dietzel v. Anger*, 8 Cal. 2d 373, 376 (1937) ("The great majority of the cases hold the restrictive provision

common rationale cited by courts in enforcing no action clauses is that debtholders, in effect, impose the restrictions on themselves.¹⁵ Parties to an issuance of debt have the opportunity to review a no action clause before executing the indenture, giving debtholders ample opportunity to object or renegotiate the clause if they see fit.¹⁶ In the same way, subsequent purchasers may review the indenture and no action clause before buying bonds. However, scholarship suggests that debtholders rarely do so.¹⁷

No action clauses have a long history of litigation, despite the presence of a substantial amount of case law supporting their general enforceability. In fact, litigation over the interpretation and enforcement of no action clauses has occurred for over 70 years, particularly since the seminal case of *Birn v. Childs Co.* was decided in New York in 1942.¹⁸ Cases such as *Birn* and *Rabinowitz v. Kaiser-Frazer Corp.* provide an early glimpse into the way New York courts interpret no action clauses.¹⁹ The general principles of

valid on the theory that the [debt]holders have, by agreement among themselves, imposed a condition precedent to the exercise of the right of any one of them to sue individually.”).

¹⁵ *Dietzel v. Anger*, 8 Cal. 2d 373, 376 (1937) (“The great majority of the cases hold the restrictive provision valid on the theory that the [debt]holders have, by agreement among themselves, imposed a condition precedent to the exercise of the right of any one of them to sue individually.”).

¹⁶ *Feldbaum v. McCrory Corp.*, No. CIV. A. 11866, 1992 WL 119095, at *7 (Del. Ch. June 2, 1992) (“[I]n consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all [debt]holders, 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.”).

¹⁷ Efrat Lev, Adv., *The Indenture Trustee: Does It Really Protect Bondholders?*, 8 U. MIAMI BUS. L. REV. 47, 49 (1999) (“Unfortunately, [debt]holders are usually unaware of the existence of the indenture, let alone its specific provisions.”).

¹⁸ *Birn v. Childs Co.*, 37 N.Y.S.2d 689 (N.Y. Sup. Ct. 1942). While this case is a seminal case, it is not the earliest. Some disputes concerning issues related to no action clauses date back to the 19th Century. See *Farmers' Loan & Trust Co. v. N. Pac. R. Co.*, 66 F. 169, 170 (C.C.E.D. Wis. 1895) (noting issues with trustee conflicts of interest).

¹⁹ See generally *Birn*, 37 N.Y.S.2d at 689; *Rabinowitz v. Kaiser-Frazer Corp.*, 111 N.Y.S.2d at 539.

law introduced in *Birn* and *Rabinowitz* are alive and well today.²⁰ In addition, *Rabinowitz* and *Birn* established common law exceptions to the general rule that trustees, rather than debtholders, must bring suit under causes of action that fall within the scope of the no action clause.

I. GENERAL INTERPRETATION OF NO ACTION CLAUSES

As a general rule, aA trust indenture is a contract, which means that the interpretation and construction of a no action clause contained in an indenture is a matter of basic contract law.²¹ A no action clause that is complete, clear and unambiguous on its face will be enforced according to the plain meaning of its terms.²² Therefore, when reading interpreting a no action clause, a court will “give effect to the precise words and language used.”²³

It is well settled that no action clauses will be strictly construed, and thus read narrowly, and narrowly read by New York courts.²⁴ In addition, New York courts’ commonly apply the maxim *expressio unius est exclusio alterius* may apply while interpreting no action clauses.²⁵ Under this theory, where a no action clause

²⁰ The precedent of *Birn* and *Rabinowitz* concerning trustee-related exceptions for unreasonable refusal to sue and conflicts of interest are still valid under modern New York law. See *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp.*, 677 F.3d 1286, 1294 (11th Cir. 2012) (“Although courts applying New York law have found no-action clauses applicable as a general rule, they have been willing to abrogate that rule under one consistently acknowledged exception: when the trustee, by reason of conflict of interest or unjustifiable unwillingness, cannot properly pursue a remedy for trust beneficiaries.”).

²¹ *Quadrant Structured Products Co. v. Vertin*, 23 N.Y.3d 549, 559 (2014) (citing *Sharon Steel Corp. v. Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1049 (2d Cir. 1982)); see also Thomas Lee Hazen, *THE LAW OF SECURITIES REGULATION* § 19.1, at 467 (6th ed.) (referring to indenture as a contract).

²² *Quadrant Structured Prod.’s Co.*, 23 N.Y.3d at 559-60.

²³ *Id.* at 60.

²⁴ *Id.*

²⁵ *Id.*; *MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm’t Corp.*, 80 F. Supp. 3d 507, 518 (S.D.N.Y. 2015).

expressly describes a particular cause of action, thing, or person to which it shall apply, a court will draw an irrefutable inference that what is omitted or not included was intended to be omitted and excluded.²⁶

II. EXCEPTIONS TO NO ACTION CLAUSES

Under certain some circumstances, no action clauses are unenforceable and inoperative regardless of the language used or conditions contained in the clause.²⁷ In particular, there are two trustee-related exceptions that will render a no action clause unenforceable: (1) unreasonable refusal by the trustee to bring suit,²⁸ and (2) conflict of interest of the trustee.²⁹

First, a no action clause is unenforceable where a trustee unreasonably refuses to sue the issuer.³⁰ This exception can be studied by analyzing *Birn*. In *Birn*, the plaintiffs owned debt securities issued by Childs Co.³¹ Pursuant to the indenture that governed the plaintiff's securities, debtholders brought suit seeking to require the issuer, Childs Co., to comply with the terms of a bond indenture requiring the Childs Co. was required to payment certain of funds to a sinking fund.³² The plaintiffs alleged that, at some point, Childs Co. defaulted on this obligation by not making the payments.³³ Pursuant to a no action clause found in the debt indenture, the debtholders plaintiffs in *Birn* provided the trustee, Empire Trust Company, with adequate notice of default and requested that the trustee bring suit.³⁴ However, the trustee refused

²⁶ *Calenzo v. Shah*, 976 N.Y.S.2d 555, 558 (2013) (describing the general effect of *expressio unius est exclusio alterius*).

²⁷ See generally *Birn v. Childs Co.*, 37 N.Y.S.2d at 689; *Rabinowitz v. Kaiser-Frazer Corp.*, 111 N.Y.S.2d at 546.

²⁸ *Birn*, 37 N.Y.S.2d at 689.

²⁹ *Rabinowitz*, 111 N.Y.S.2d at 546.

³⁰ *Birn*, 37 N.Y.S.2d at 697.

³¹ *Id.* at 689.

³² *Id.* at 696 (“Plaintiff gave the trustee written notice of what she claimed and I have found to be a completed event of default, viz., failure to comply with the sinking fund provision.”).

³³ *Id.*

³⁴ *Id.*

to sue, insisting that no default had occurred.³⁵ The *Birn* court found for the plaintiff, holding that a debtholder may bypass the trustee and sue the issuer directly where: (1) the trustee, after receiving proper notice and opportunity to bring suit, refuses to sue, and (2) the trustee's refusal to bring suit is unreasonable.³⁶ Therefore, a trustee's unreasonable refusal to bring suit will render a no-action clause unenforceable, and the plaintiffs may sue the issuer directly.

Second, a no action clause is unenforceable where the trustee has a conflict of interest, as demonstrated in *Rabinowitz*. In *Rabinowitz*, debtholders, once again, sued the issuer to enforce a sinking fund provision in the bond indenture.³⁷ The issuer moved to dismiss, claiming that the plaintiffs had not satisfied the conditions precedent to suit under the indenture's no action clause.³⁸ While the *Rabinowitz* Court concluded that the plaintiffs did not satisfy the conditions of the no action clause, the court held that the clause was inoperative³⁹ because the trustee, Bank of America, had created a conflict of interest by loaning money to the issuer after the indenture was executed.⁴⁰ The *Rabinowitz* Court definitively stated, "[a]A trustee cannot be permitted to assume a position inconsistent with or in opposition to his trust. His duty is single, and he cannot serve two masters with antagonistic interests."⁴¹ Consequently, *Rabinowitz* holds that a conflict of interest between a trustee and an issuer can render a no action clause unenforceable.⁴²

In sum, a no action clause, while strictly construed, will be interpreted under the basic tenants of contract law. Specifically, New

³⁵ *Id.*

³⁶ *Id.* at 697 ("Equity also allows other beneficiaries to sue upon causes of action vested in their trustees when the trustee unreasonably refuses to sue.").

³⁷ *Rabinowitz*, 111 N.Y.S.2d at 542("It is this failure of [issuer] to have assumed the obligations of the sinking fund and to have paid 25% of its annual profits into such fund which presents the crux of this case . . .").

³⁸ *Id.* at 540.

³⁹ *Id.* at 547 ("[I]t is my view that the 'no action' clause involved in the case at bar is inoperative and inapplicable.").

⁴⁰ *Id.* at 546.

⁴¹ *Id.*

⁴² *Id.* at 547.

York courts will attempt to give effect to the plain language of the clause, while also incorporating the maxim of *expressio unius est exclusio alterius*. While the general enforceability of no action clauses is not widely disputed, drafters should be mindful that there are two trustee-related exceptions that will render no action clauses unenforceable: (1) unreasonable refusal on the part of the trustee to bring suit when requested, and (2) trustee conflicts of interest.

B. MECHANICS OF A NO ACTION CLAUSE

A conventional no action clause prevents debtholder(s) from bringing suit directly against an issuer, unless: (1) the type of action the issuer wants to bring falls outside the scope of the no action clause, (2) the debtholder(s) plaintiffs satisfy conditions set out in the no action clause,⁴³ or (3) a common law trustee-related exception applies, such as conflict of interest.⁴⁴ To understand the mechanics of a no action clause, it is best to analyze one. A typical no action clause looks like this:

Limitation on Suits. A Securityholder may pursue a remedy with respect to this Indenture or the Securities only if:

- (1) the Holder gives to the Trustee notice of a continuing Event of Default;
- (2) the Holders of at least 25% in principal amount of the Securities make a request to the Trustee to pursue the remedy;

⁴³ Gadsen, *supra* note 137, at 1097-98 (“[B]ondholders may not sue the corporation unless the trustee fails to act after holders of a specified amount of indenture securities make written request upon the trustee for action and offer the trustee indemnity for its expenses.”) (internal citations omitted). These two conditions in particular are commonly found in no-action clauses.

⁴⁴ Rabinowitz, 111 N.Y.S.2d at 545 (“ . . . an individual [debt]holder has the right to bring a class action to protect his interests . . . whenever the Indenture Trustee has acted in such a manner as to put itself in a position where it cannot faithfully and competently discharge its duty as a fiduciary.”).

- (3) such Holder or Holders offer to the Trustee indemnity satisfactory to the Trustee against any loss, liability or expense;
- (4) the Trustee does not comply with the request within 60 days after receipt of the request and the offer of indemnity; and
- (5) during such 60-day period the Holders of a majority in principal amount of the Securities do not give the Trustee a direction inconsistent with the request.⁴⁵

I. SCOPE OF THE CLAUSE

When analyzing the sample no action clause, one should take particular notice of the scope of the clause. This particular no action clause applies to suits arising both under the indenture *and* the underlying securities. This is significant, as *Quadrant* held that if the no action clause fails to does explicitly state that the no action clause is applicable to suits arising from the underlying securities, the maxim of *expressio unius est exclusio alterius* will apply and limit the scope of a no action clause to actions arising under the indenture.⁴⁶ This would exclude causes of action arising under the underlying securities. This will be discussed in more detail *infra* at Part II and Part III. In addition, the sample clause states that it applies to “Securityholders.” In defining the parties to whom the indenture applies, despite this, drafters should be cautious, as New York law sometimes permits non-parties to an indenture—such as directors or officers—to assert and enforce a no action clause.⁴⁷

II. CONDITIONS OF THE CLAUSE

The conditions debtholder(s) are required to meet to bring suit under the sample no action clause are common. First, the clause

⁴⁵ Gadsden, *supra* note 132, at 1228.

⁴⁶ *Quadrant Structured Prod.’s Co.*, 23 N.Y.3d at 552 (“[W]e conclude that a trust indenture’s ‘no-action’ clause that specifically precludes enforcement of contractual claims arising under the indenture, but omits reference to ‘the Securities,’ does not bar a securityholder’s independent common-law or statutory claims.”).

⁴⁷ *Akanthos Capital Mgmt., LLC*, 677 F.3d at 1292 (“A number of courts applying New York law . . . have held that non-party defendants may still assert the no-action clause.”).

requires the debtholder to give the trustee notice of the default. In addition to notice, the debtholder(s) must give the trustee 60 days to sue before bringing suit themselves. This gives the trustee time to evaluate the claim and determine whether the conditions of the no action clause have been satisfied and the claim is legitimate.

Perhaps the most notable and, for debtholders, pesky condition contained in the sample no action clause is the requirement that the debtholder(s) who is petitioning the trustee to bring suit must be joined by the holders of at least 25% of the bondssecurities. This condition is standard and the figure of 25% is customary and regularly enforced.⁴⁸ This condition can be difficult and time consuming for debtholder(s) to satisfy. However, the Trust Indenture Act (the “TIA”) helps small debtholder(s) comply with these types of conditions, as the TIA requires issuers to furnish trustees with a list of all debtholders’ names and addresses.⁴⁹ This disclosure facilitates communication between debtholders and the trustee and enables small debtholders to find and petition other debtholders to request the trustee to bring suit in order to comply with the conditions of the no action clause.

The final conditions in the sample no action clause simply require aggrieved debtholders to offer an indemnity and respect a 60-day holding period where the trustee can analyze the actions of the debtholders to see if the majority of debtholders undertake direction inconsistent with the aggrieved debtholder’s request. While the conditions in the sample no action clause are typical; individual, negotiated no action clauses may be different. Therefore, drafters should compare their no action clause with precedent in order to understand the way any changes from precedent could affect a court’s interpretation of their clause. Having discussed the general background and mechanics of no actions clauses, the next step involves understanding case law that affects the general application and interpretation of no action clauses.

⁴⁸ Gadsden, *supra* note 132, at 1228 (“The 25% figure is standard.”).

⁴⁹ 15 U.S.C. § 7711l (1990) (“Each obligor upon the indenture securities shall furnish or cause to be furnished . . . all information in the possession or control of such obligor, or of any of its paying agents, as to the names and addresses of the indenture security holders.”).

III. THE IMPACT OF *QUADRANT* AND *AKANTHOS*

While drafting no action clauses under New York law, drafters may find it helpful to analyze past court decisions that have interpreted no action clauses when making drafting decisions. Having already explained the general rules of interpretation for no action clauses, this Part will focus on lessons that can be learned by analyzing recent court decisions interpreting that interpret no action clauses under New York law. This section will focus on a crucial lesson found in *Quadrant*, as well as important precedent established in the 11th Circuit's decision in *Akanthos*.

A. *QUADRANT*

In *Quadrant*, the New York Court of Appeals provided guidance concerning the scope of no action clauses.⁵⁰ The facts are relatively simple. Athilon Capital Corp (“Athilon”) is a company that, along with a wholly owned subsidiary, sold credit derivatives products, such as credit default swaps.⁵¹ To finance its business, Athlon raised over \$600 million by issuing three classes of notes: (1) \$350 million in senior subordinated notes, (2) \$200 million in three different series of subordinated notes, and (3) \$50 million in junior notes.⁵² Quadrant Structured Products Company, Ltd. (“Quadrant”), the plaintiff, owned several classes of the subordinated notes, including some senior subordinated notes.⁵³ A third company, EBF & Associates, L.P. (“EBP”) acquired Athilon in 2010, owned the junior notes, and controlled Athilon's bBoard of dDirectors.⁵⁴ The notes issued by Athilon were accompanied by indentures containing no action clauses, which were governed by New York law.⁵⁵

Quadrant brought suit in Delaware against Athilon, Athilon's officers and directors, EBF, and others, alleging breaches of fiduciary duty and fraudulent transfer claims and seeking damages and

⁵⁰ *Quadrant Structured Prod.'s Co.*, 23 N.Y.3d at 553.

⁵¹ *Id.*

⁵² *Id.* at 554.

⁵³ *Id.* at 554-55.

⁵⁴ *Id.* at 553.

⁵⁵ *Id.* at 556-57.

injunctive relief.⁵⁶ Quadrant claimed that Athilon's bBoard of directors, which is controlled by EBP, "failed to preserve Athilon's value in anticipation of liquidation in 2014" and breached its fiduciary duty by making payments on its junior notes, to the detriment of the senior subordinated securities, such as those owned by Quadrant.⁵⁷

In response, the defendant's moved to dismiss the lawsuit on the grounds that Quadrant's suit was barred by the debt indenture's no action clause.⁵⁸ The indenture's no action clause provided that:

No holder of any Security shall have any right by virtue or by availing of any provision of this Indenture to institute any action or proceeding at law or in equity or in bankruptcy or otherwise upon or under or with respect to this Indenture⁵⁹

In addition, the indenture required that "the holders of not less than 50% of the aggregate principal amount of the relevant series of Securities at the time Outstanding" make request to the trustee to bring suit.⁶⁰ This is in contrast to the standard figure of 25%.⁶¹

The Delaware Chancery Court agreed with the defendants and dismissed Quadrant's lawsuit, holding that the no action clause barred the plaintiff's claims.⁶² However, on appeal, Quadrant argued, for the first time, that the no action clause contained in Athilon's indentures was inapplicable since the clause applied only to claims arising out of the indenture and therefore could not bar common-law or statutory claims arising under the securities.⁶³ This defense arose from the fact that the language of the no action clause stated that it applied to claims arising under the indenture, rather than claims arising under the indenture *or the Securities*, as was the case

⁵⁶ *Id.* at 556.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 556-57.

⁶⁰ *Id.* at 557.

⁶¹ Gadsden, *supra* note 132, at 1228 ("The 25% figure is standard.").

⁶² Quadrant Structured Prod.'s Co., 23 N.Y.3d at 557.

⁶³ *Id.* at 558.

in past precedent.⁶⁴ The Delaware Supreme Court remanded the case back to the Delaware Chancery Court with instructions that the Chancery Court issue an opinion analyzing the significance (if any) under New York law of the differences between [the precedent clause and Athilon's clause].⁶⁵ The report concluded that the no action clause was limited in scope and only applied to "actions or proceedings where a securityholder claims a right by virtue or by availing of any provision of the *indenture*."⁶⁶ The Delaware Supreme Court then certified two questions at issue to the New York Court of Appeals.⁶⁷

First, the New York Court of Appeals held that "a no-action clause which by its language applies to rights and remedies under the provisions of the indenture agreement, *but makes no mention of individual suits on the securities*, does not preclude enforcement of a debtholder's independent common-law or statutory rights."⁶⁸ In coming to this conclusion, the *Quadrant* Court reasoned that the no action clause at issue, "with its specific limit on the enforcement of indenture contract rights," was in contrast to more standard no action clauses that also cover securities-based claims.⁶⁹ Furthermore, the court cited the maxim of *expressio unius est exclusio alterius* as supporting its conclusion.⁷⁰ The defendants attempted to argue that "references to the indenture should be interpreted to include the securities, and that to do otherwise will upset the parties' expectations." However, the court dismissed this argument as unconvincing and unsupported by precedent and the plain language of the clause/indenture.⁷¹

The *Quadrant* Court makes it clear that any language in a no action clause that states that the clause shall apply or not apply to

⁶⁴ *Id.* at 558-59.

⁶⁵ *Id.* at 558.

⁶⁶ *Id.* (emphasis added).

⁶⁷ *Id.* at 558-59.

⁶⁸ *Id.* at 559 (emphasis added).

⁶⁹ *Id.* at 561.

⁷⁰ *Id.* at 560.

⁷¹ *Id.* at 565.

certain claims will be strictly enforced and narrowly construed.⁷² In addition, under the precedent established by this decision, if a drafter wants a no action clause to apply to claims arising from the underlying securities, in addition to those arising under an indenture, the clause must explicitly say so.⁷³ Further drafting tips and suggestions from this precedent are addressed *infra* at Part III.

B. *AKANTHOS*

In *Akanthos*, the 11th Circuit Court of Appeals, interpreting New York law, provided clarity concerning *who* may invoke the protections of a no action clause.⁷⁴ The plaintiffs in *Akanthos* owned convertible notes issued by the defendant, CompuCredit Holdings Corp.⁷⁵ In 2009, the plaintiffs sued the defendant in the Federal District Court for the Northern District of Georgia, alleging violations of Georgia's Uniform Fraudulent Transfers Act.⁷⁶ The defendant moved to dismiss, claiming the lawsuit was barred by a no action clause contained in the notes' indenture.⁷⁷ The federal district court held that the no action clause was inapplicable to the claims brought by the plaintiffs, thus defeating the defendant's motion to dismiss.⁷⁸ On interlocutory appeal, the 11th Circuit reversed the district court, holding that the no action clause was operative and barred the plaintiff noteholders from bringing suit.⁷⁹

Before the 11th Circuit, the plaintiffs argued that the no action clause in the indenture was inapplicable because the parties seeking to enforce the no action clause, officers and directors of the defendant, were not parties to the indenture.⁸⁰ This argument centers

⁷² *Id.* at 559-60.

⁷³ *Id.*

⁷⁴ *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp.*, 677 F.3d 1286, 1292 (11th Cir. 2012).

⁷⁵ *Id.* at 1288.

⁷⁶ *Id.* at 1289.

⁷⁷ *Id.*

⁷⁸ *Id.* at 1288.

⁷⁹ *Id.*

⁸⁰ *Id.* at 1292 (“Plaintiffs also argue that the applicability of the no-action clause cannot properly be asserted by persons-such as Officers and Directors-who are not parties to the indentures containing that clause.”).

on the scope of a no action clause.⁸¹ Can defendants who are not parties to an indenture invoke the protection of a no action clause? In answering this question, the 11th Circuit held that “non-party defendants may still assert [a] no-action clause.”⁸² In reaching this decision, the *Akanthos* Court cited numerous opinions by New York courts that allowed non-parties to an indenture to invoke the protections of a no action clause.⁸³ The court reasoned that noteholders effectively waive their right to sue when they execute a no action clause and that this waiver “applies equally to claims against non-issuer defendants as to claims against issuers.”⁸⁴ This is particularly true with no action clauses that “explicitly make their scope depend on the nature of the claims brought, not on the identity of the defendant.”⁸⁵ Accordingly, the 11th Circuit overruled the district court’s holding and enforced the no action clause.⁸⁶

Akanthos teaches drafters, and potential plaintiffs, a crucial lesson concerning the scope of no action clauses; defendants who are not parties to the underlying indenture may, depending on the language of the clause, be entitled to can enforce no action clauses. This can be a problem for plaintiff noteholders, since *Akanthos*

⁸¹ *Id.* (noting that an issue contested one of the contested issues was the applicability of the no action clause).

⁸² *Id.*

⁸³ *Id.*; see *Peak Partners, LP v. Republic Bank*, 191 F. App’x 118, 126–27 (3d Cir. 2006) (applying New York law) (finding no-action clause applicable despite plaintiff’s argument that defendant was not a party to the trust indenture); *Sterling Fed. Bank, F.S.B. v. DLJ Mortg. Capital, Inc.*, 2010 WL 3324705, at *7 (N.D. Ill. Aug.20, 2010) (applying New York law) (holding that no-action clause barred plaintiff from bringing suit against mortgage-servicer defendant who was not party to the trust indenture).

⁸⁴ *Id.* (citing *Feldbaum v. McCrory Corp.*, 1992 WL 119095, at *8 (Del.Ch. June 2, 1992) (applying New York law) (finding that “in consenting to no-action clauses by purchasing bonds, plaintiffs waive their rights to bring claims that are common to all debtholders,” and that waiver “applies equally to claims against non-issuer defendants as to claims against issuers.”)).

⁸⁵ *Id.* (citing *Feldbaum*, 1992 WL 119095, at *7 (applying New York law)).

⁸⁶ *Id.* at 1298 (“[W]e REVERSE and REMAND for dismissal of Plaintiffs’ claims.”).

broadens the scope of parties protected by a no action clause.⁸⁷ However, *Akanthos* also suggests a solution to this problem. If a noteholder or issuer wants to limit the number of parties who can be allowed to enforce a no action clause, *Akanthos* suggests that inserting language explicitly limiting the parties who may enforce a no action clause may be effective.⁸⁸ This solution is hinted in the court's citation of *Feldbaum*, where the court states that the general rule of allowing non-parties to an indenture to enforce a no action clause is especially applicable where clauses "explicitly make their scope depend on the nature of the claims brought, not on the identity of the defendant."⁸⁹ This suggests that where a no action clause expressly makes the scope of the no action clause dependent on the *identity* of the defendant, as well as the nature of the claim, then a court will be less likely to allow non-parties to an indenture to enforce a no action clause. This approach is also consistent with a basic tenants of contracts; enforcing the plain meaning of a clause.

Quadrant and *Akanthos* provide drafters, potential plaintiffs and defendants with guidance concerning how New York courts will interpret a no action clause. The most important lesson drafters can take away from these cases is that specificity and precision in drafting will play a crucial role in the application and effectiveness of a no action clause. Using the precedent set in *Quadrant* and *Akanthos*, along with analyzing the basic rules of interpretation for no action clauses discussed *supra* in Part I, we may now move forward to Part III, which will make suggestions to drafters.

IV. ANALYSIS AND RECOMMENDATIONS

After discussing and analyzing the general rules of interpretation for no action clauses, as well as the precedent of

⁸⁷ *Id.* at 1292 (noting that non parties to an indenture can enforce a no action clause under New York law).

⁸⁸ *Id.* (noting that the general rule allowing non-parties to an indenture to enforce a no action clause is especially applicable where the clause "explicitly make their scope depend on the nature of the claims brought, not on the identity of the defendant.").

⁸⁹ *Id.*

Quadrant and *Akanthos*, it is clear that no action clauses, while generally enforceable, will be strictly and narrowly construed.⁹⁰ Therefore when drafting, counsel to an issuer can maximize the likelihood that their no action clause will be enforced in New York by following a few simple suggestions.

A. BE CAREFUL WHEN SELECTING A TRUSTEE

To begin, one should practitioners should counsel clients to be careful when selecting a trustee.⁹¹ The malfeasance or nonfeasance of a trustee can render well drafted no action clauses unenforceable.⁹² In particular, since trustee conflicts of interest may render a no-action clause inapplicable, clients should undertake due diligence on the trustee to make sure that no potential conflicts of interests arise after the execution of the indenture.⁹³ It is notable that *Rabinowitz* deals with a conflict of interest that arose *after* the execution of the indenture, so conflicts that *precede* an indenture may possibly be resolved by waiver or other means.⁹⁴

Avoiding trustee conflicts of interest is undoubtedly advantageous for an issuer.⁹⁵ For example, if the defendant in *Rabinowitz* had realized that receiving a loan from the trustee, Bank of America, would invalidate their no action clause, the defendant could have either sought financing from another source, or appointed another trustee, or sought a waiver.⁹⁶ If the defendant had taken these actions, the no action clause in *Rabinowitz* would have likely

⁹⁰ *Quadrant Structured Prod.'s Co.*, 23 N.Y.3d at 560.

⁹¹ See generally *infra* notes 92–97 and accompanying text.

⁹² See generally *Birn v. Childs Co.*, 37 N.Y.S.2d 689 ; *Rabinowitz v. Kaiser-Frazer Corp.*, 111 N.Y.S.2d at 539.

⁹³ *Rabinowitz*, 111 N.Y.S.2d at 546.

⁹⁴ *Id.* (“*Subsequent to the date of the Indenture*, Bank of America made several loans to both Kaiser-Frazer and Graham-Paige which were enmeshed with the sale of the automotive assets of the latter to Kaiser-Frazer. The nature of these transactions was such as to create a conflict in the interests of Bank of America as trustee and Bank of America as a creditor of both Graham-Paige and Kaiser-Frazer.”) (emphasis added).

⁹⁵ *Id.* If there was were no conflict of interest, the no action clause would have barred the plaintiff’s lawsuit. Therefore, avoiding conflicts of interest can be advantageous to issues.

⁹⁶ *Id.*

been enforced and the plaintiff's lawsuit dismissed.⁹⁷ Therefore, drafters should urge their client to use caution when selecting a trustee and establish safeguards to prevent trustee conflicts of interest from arising.

In addition to taking steps to ensure that trustee conflicts of interest do not invalidate their no action clause, counsel should also make sure that trustees are aware of their duties and are competent to execute them. For example, under the model no action clause in Part I(b), if the trustee fails to take action within 60 days, a debtholder may bypass the trustee and sue directly, provided all the other conditions are satisfied.⁹⁸ This means that inactivity or nonfeasance by the trustee can make it easier for disgruntled debtholders to sue. In addition, it is well established that the malfeasance of a trustee can invalidate a no action clause where a trustee unreasonably refuses to sue an issuer.⁹⁹ While this issue should rarely cause a problem, since most appointed trustees are large financial institutions, such as Bank of America, counsel would be wise to vet potential trustees for competency, as well as conflicts of interest.

B. DRAFT NO ACTION CLAUSES WITH SPECIFICITY AND PRECISION

After carefully selecting a trustee, counsel should be careful to draft their no action clause with specificity and precision. *Quadrant* and *Akanthos* are two examples of cases where a no action clause *could* have been effective, but was not, due to the language the drafter chose to use.¹⁰⁰ When it comes to no action clauses, details matter, particularly since courts will “give effect to the precise words and language used” in a no action clause.¹⁰¹ For example, in *Quadrant*, if the drafter of Athlon's no action clause had simply

⁹⁷ See generally *id.* (The *Rabinowitz* Court cites no other reason, aside from conflict of interest, for declining to enforce the no action clause).

⁹⁸ See Model No Action Clause at Part I(b).

⁹⁹ *Birn*, 37 N.Y.S.2d at 697 (“Equity also allows other beneficiaries to sue upon causes of action vested in their trustees when the trustee unreasonably refuses to sue.”).

¹⁰⁰ See generally *Quadrant Structured Prod.'s Co.*, 23 N.Y.3d at 560; *Akanthos Capital Mgmt., LLC*, 677 F.3d at 1292.

¹⁰¹ *Quadrant Structured Prod.'s Co.*, 23 N.Y.3d at 560.

stated that the no action clause prohibited any action “upon or under or with respect to this Indenture *or the Securities*,” then Quadrant’s lawsuit may have been dismissed.¹⁰² This is particularly true since the maxim of *expressio unius est exclusio alterius*, a factor the court relied upon when reaching its conclusion, would not have applied had the drafter included “the Securities” in the clause. *Quadrant* is a shining example of how good, precedent-informed drafting can make or break a no action clause. Indeed, it is arguable that, in light of the *Quadrant* decision, one should always include the “Securities” in the scope of a no action clause, unless there is a particular justification for its omission.

Further reinforcing the idea that precise drafting is critical, the *Akanthos* decision suggests that anyone may enforce a no action clause unless the clause says otherwise.¹⁰³ From the perspective of debtholders’ counsel, it would be wise, if possible, to negotiate limits on parties who can enforce a no action clause. This would make it easier to sue non-parties to the indenture. If the indenture in *Akanthos*, via express language, only permitted parties to the indenture to enforce the no action clause, then it is likely that the *Akanthos* Court would have held that the no action clause at issue was inapplicable and the lawsuit against the directors and officers of the issuer, non-parties to the indenture, could have continued.¹⁰⁴ However, from a trustee and issuer’s perspective, it may benefit issuers to allow anyone to enforce the clause, since that interpretation would extend protection to not just the issuer, but also its officers and directors.¹⁰⁵

All in all, while no action clauses are strictly construed and narrowly read, New York courts have made it clear that they will enforce the plain meaning of the terms used in a no action clause, giving effect to the precise words and language used.¹⁰⁶ Specific, precedent-informed drafting could have changed the outcomes of

¹⁰² *Id.* at 556-57.

¹⁰³ *Akanthos Capital Mgmt., LLC*, 677 F.3d at 1292 (noting that the general rule allowing non-parties to an indenture to enforce a no action clause is especially applicable where the clause “explicitly make their scope depend on the nature of the claims brought, not on the identity of the defendant.”).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ *Quadrant Structured Prod.’s Co.*, 23 N.Y.3d at 560.

Quadrant and *Akanthos*, so counsel should always consider precedent and the particular risks/needs of their client before drafting a no action clause.

C. BE MINDFUL OF SCOPE

Drafters should always be cognizant of the scope of a no action clause's scope. It is easy to simply copy and paste a form no action clause from a precedent transaction, but good drafters should always evaluate the scope of the sample clause before inserting it into their indenture. As mentioned *supra*, be mindful of whether the clause applies only to actions arising under the indenture, or whether the clause also forbids lawsuits arising from the underlying securities. Issuers' counsel will likely desire for the scope of the no action clause to be as broad as possible, while debtholders may undoubtedly want desire a narrower clause. Finally, remember that the maxim of *expressio unius est exclusio alterius* applies when considering the scope of no action clauses, particularly, in terms of parties who can enforce the clause and in terms of claims that fall under the clause's protection.¹⁰⁷ While this maxim applies, terms that are omitted from a no action clause will be assumed to be intentional omissions, as was the case in *Quadrant*.¹⁰⁸

D. EVALUATE THE CONDITIONS OF THE NO ACTION CLAUSE

Finally, the conditions of a no action clause are of paramount concern when drafting a no action clause. Ideally, the conditions will be strict enough to prevent specious lawsuits from a small number of debtholders, but lenient enough to allow a substantial number of debtholders to sue for legitimate grievances.¹⁰⁹ The most important

¹⁰⁷ *Id.*

¹⁰⁸ *Id.* ("Even where there is ambiguity, if parties to a contract omit terms—particularly, terms that are readily found in other, similar contracts—the inescapable conclusion is that the parties intended the omission. The maxim *expressio unius est exclusio alterius*, as used in the interpretation of contracts, supports precisely this conclusion.")

¹⁰⁹ *Conflict of Interests Between Indenture Trustee and Debtholders: Avoidance of "No Action" Clauses Prohibiting Debtholder Suits against the Obligor*, 62 YALE L.J. 1097, 1098-99 (1953) ("[T]he 'no action' clause precludes specious suits instigated by attorneys who hope to receive lucrative fees from a true class action for all debtholders. And the debtor

condition set by issuers is the requisite number of debtholders who must petition the trustee to sue. As mentioned *supra*, a condition that requires holders of 25% of all outstanding bonds or notes to request a trustee to sue is standard and often enforced.¹¹⁰

However, the indenture in *Quadrant* set a much higher standard, requiring that “holders of not less than 50% of the aggregate principal amount of the relevant series of Securities” petition the trustee.¹¹¹ While the figure of 25% is standard, *Quadrant* suggests that issuer’s counsel has some leeway in setting this condition, since the *Quadrant* court didn’t invalidate the clause due to the 50% figure.¹¹² Indeed, increasing the number from 25% to 50% makes it more difficult for debtholders to sue, which makes increasing the figure attractive for issuers. For safety’s sake, however, conservative issuers should stick with the 25% requirement since 25% is standard and there is always a risk that a court may invalidate a no action clause that contains draconian with too harsh of conditions as void on public policy grounds.¹¹³

Finally, drafters should make sure that trustees have sufficient time to review claims and petitions to sue in order to faithfully execute their duties as a trustee. To this end, a condition, such as the example provided *supra* in the model no action clause that allows debtholders to bypass the trustee only after 60 days of inaction on the part of the trustee is recommended. This condition gives the trustee sufficient time to review the claim and evaluate its legitimacy. Therefore, sticking with this condition and 60-day time frame, as noted in the model no action clause in Part I, is advisable.

V. CONCLUSION

In conclusion, no action clauses can be a powerful tool for issuers. The no action clause prevents specious and frivolous

corporation is insulated from unwise court action by a few panicky debtholders, or from a possible multiplicity of suits engendered by individual debtholders’ actions.”) (internal citations omitted).

¹¹⁰ Gadsden, *supra* note 132, at 1228 (“The 25% figure is standard.”).

¹¹¹ *Quadrant Structured Prod.’s Co.*, 23 N.Y.3d at 557.

¹¹² *Id.*

¹¹³ Gadsden, *supra* note 132, at 1228.

lawsuits by small debtholders, yet allows a substantial number of debtholders with legitimate grievances to litigate their claims. Furthermore, the no action clause prevents a small number of debtholders from suing the company where the suit is antagonistic to the majority of debtholders. In drafting no action clauses, counsel should vet potential trustees for conflicts of interest and competence and compare precedent clauses with the particular needs of their transaction. Most importantly, counsel should always draft with specificity and precision, since New York courts will enforce the plain meaning of a no action clause. By learning from the precedent of cases such as *Quadrant* and *Akanthos*, as well as considering the scope and conditions of their particular clause, drafters can maximize the probability that New York courts will enforce their indenture's no action clause.