Litigation Alert

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The Supreme Court of the State of New York Limits the Rights Assignees and Indenture Trustees Have to Commence Actions to Recover with Respect to Notes

In *Cortlandt St. Recovery Corp. v Hellas Telecom*., S.A.R.L., 2014 NY Slip Op 24268 (Sup. Ct., N.Y. County 2014), the Supreme Court of the State of New York ruled on two important issues related to the right to sue for recovery with respect to notes issued under indentures. First, the court held that assignments of a right of collection, but not title to the claims or the note itself, are insufficient as a matter of New York law to confer standing upon an assignee to sue for recovery on a defaulted note. Second, the court held that common indenture provisions do not authorize an indenture trustee to pursue the noteholders' collective fraudulent conveyance claims unless authorized by the registered holders of notes. The court's September 16, 2014 decision will likely impact how distressed debt is traded and enforced.

Background

The court's decision covers four related actions, all of which sought payment of principal and interest on notes issued and guaranteed by Hellas Telecommunications, S.a.r.l. affiliated entities. Three of the actions sought recovery on PIK (payment-in-kind) notes, while the fourth sought recovery on subordinated notes, all of which were in default. Cortlandt Street Recovery Corp., as the "assignee and agent for collection," was a plaintiff in all four actions. Wilmington Trust Co. (WTC), as the indenture trustee, was a plaintiff with Cortlandt in two of the PIK note actions.

Plaintiffs allege that the Hellas entities that issued and guaranteed the PIK notes and the subordinated notes (collectively the "Notes") ceased paying principal and interest on the Notes in 2009, and fraudulently conveyed the proceeds of the note issuances to two private equity firms, Apax Partners, LLP and TPG Capital, L.P., and their principals (collectively, "Apax/TPG").

The court addresses two key standing issues.[1] First, does an "assignee and agent for collection" have standing to sue for recovery of a note? Second, does an indenture authorize an indenture trustee to pursue a noteholder's fraudulent conveyance claims?

Summary of the Court's Opinion

Standing to Seek Repayment

Cortlandt was the "assignee and agent for collection" of a large amount of the PIK notes, but was not a holder of definitive PIK notes issued by Hellas, or a beneficial owner of PIK notes. In order to have standing to sue, a party must have an actual legal stake in the matter being adjudicated. Citing longstanding New York case law, the Cortlandt court explained that in order for an assignee to have an

[1] The merits of the allegations were unexamined, as the Court's focus was solely procedural.

actual legal stake, the assignee must have some title or ownership of the thing being assigned, either the note itself or title to the claims. The indentures at issue (the "Indentures") authorize only a Holder of the Notes or the indenture trustee to maintain an action to recover on the Notes. A "Holder" is defined in the Indentures as "the Person in whose name such Note is registered in the register maintained by the registrar pursuant to the provisions of this Indenture." Under the modern book-entry system of ownership, most noteholders actually hold beneficial interests in a global note issued to Depository Trust Company's (DTC) nominee. In order to become a Holder, the noteholder must cause the issuer to exchange its beneficial interest in the global note for a definitive note registered in the noteholder's name.

Cortlandt did not argue that it was a Holder of the Notes, nor did it claim that the original assignments assigned ownership of the Notes or ownership of the claims. Accordingly, the court determined Cortlandt did not have standing and therefore dismissed Cortlandt as a plaintiff in all four actions.

Cortlandt sought to cure the standing issue in the subordinated notes action by amending the complaint to include addendums to the original assignments. The addendums clarified the subordinated notes assignments by stating that it was the intent of the assignor, SPQR Capital (Cayman) Ltd., to assign "all right, title and interest" to Cortlandt. The court held that while plaintiffs could cure a standing issue by amending a complaint, Cortlandt's efforts to do so were insufficient since SPQR held only book-entry interests and was not a Holder of the subordinated notes.[2] Since it was not a Holder, SPQR itself lacked the authority to sue on the subordinated notes, and the assignment did not convey to Cortlandt any greater rights than those held by SPQR.

On the other hand, the court held that WTC was entitled to summary judgment against the Hellas defendants for principal and interest due under the PIK notes. As indenture trustee, WTC had standing to seek repayment from the issuers and guarantors of the PIK notes. Furthermore, the notes on their face established the obligation to repay, so therefore no extrinsic evidence or trial was required and summary judgment was appropriate.

Standing to Pursue Fraudulent Conveyance Claims

The primary issue with respect to WTC's standing as the indenture trustee was its claims in the second PIK notes action against Apax/TPG for fraudulent conveyance. The court explained that an indenture trustee's authority is defined by the terms of the indenture and is essentially a contract law question. The pertinent portion of the Indenture was section 6.03, which stated, "If an Event of Default occurs and is continuing, the Trustee may pursue any available remedy to collect the payment of principal, premium, if any, and interest on the Notes or to enforce the performance of any provision of the Notes or this Indenture."

[2] After the bankruptcy of the issuer, SPQR requested that its beneficial ownership interests be exchanged for definitive Notes, as permitted under the Indenture, which would have made SPQR a Holder under the Indenture. The issuer's liquidator declined, and instead gave SPQR a letter granting it "individual creditor status" in the liquidation proceeding. The court held that Cortlandt failed to establish that the grant of "individual creditor status" was adequate to override the provisions of the Indenture permitting only Holders to sue.

Finding no New York authority on point, the court relied on a Northern District of Illinois decision which interpreted a similarly drafted indenture. There, the court held that 'any available remedy' "refers only to actions designed to 'collect the principal of, premium, if any, or interest on the Bonds' or to enforce the performance of any provision of the bonds or the Indenture . . . [and] does not give [the trustee] power to protect any and all rights of the bondholders . . . ." *Regions Bank v. Blount Parrish & Co., Inc.,* 2001 WL 726989, *5 (N.D. Ill., June 27, 2001, No. 01-CV-0031, Pallmeyer, J.) As a result, the court determined that because WTC's claims of fraudulent conveyance were not claims brought on the Notes as outlined by section 6.03, but were tort claims against third parties, they were beyond the scope of WTC's authority as the indenture trustee under section 6.03 of the Indenture.

WTC and Cortlandt argued that WTC was directed by a majority of the noteholders to sue Apax/TPG for fraudulent conveyance, and pursuant to sections 6.05 and 6.06 was thus permitted to do so. Section 6.05 of the Indenture provides that "Holders of a majority in aggregate principal amount of the then outstanding Notes may direct the time, method and place of conducting any proceeding for exercising any remedy available to the Trustee or exercising any trust or power conferred on it." Section 6.06 of the Indenture (the "no-action clause") provides that, except to enforce the right to receive payment of principal, premium (if any) or interest when due, "no Holder may pursue any remedy with respect to the Indenture or the Notes" unless certain procedural requirements have been satisfied. Although each indenture is different, the quoted language from sections 6.03, 6.05 and 6.06 of the Indentures is typical of the language found in many modern indentures. The court did not address whether sections 6.05 and 6.06 authorize WTC to bring fraudulent conveyance claims because the court had already determined that Cortlandt and SPQR were not "Holders" and thus could not direct the indenture trustee under section 6.05.

Implications of the Decision

The decision is concerning for several reasons. First, by denying standing to enforce an indenture to beneficial owners of notes, even if they hold an assignment for collection, it will force noteholders to either become "Holders" of definitive notes, enforce their notes through DTC, or rely on the indenture trustee for enforcement, all of which may result in delays and loss of value. If the issuer of the notes ends up in a foreign insolvency proceeding, it may be difficult or impossible for a beneficial owner of notes to compel the liquidator, trustee or administrator to issue notes to enable the beneficial owner to become a registered holder.

Additionally, the decision by the court that, under typical indenture language, a fraudulent conveyance action is not an action that an indenture trustee has standing to bring without authorization from registered holders may eliminate or, at a minimum, complicate the ability of noteholders to pursue a fraudulent conveyance action. Pursuing recovery of transfers made to other parties by the issuer or a guarantor of notes is often a significant source of recovery on defaulted notes. Some courts have held that a fraudulent conveyance action is subject to the no-action clause of an indenture, and that only an indenture trustee may pursue such an action unless the individual noteholders have satisfied the

specified procedural requirements of the no-action clause.[3] Thus, it is common for indenture trustees to bring fraudulent conveyance actions on behalf of noteholders.[4]

Although the Cortlandt decision makes it clear that neither assignees for collection nor beneficial holders are authorized to direct an indenture trustee to bring a fraudulent conveyance action, it does not address whether an indenture trustee, directed by registered holders of notes, would have standing to bring such an action. If indenture trustees never have standing to bring fraudulent conveyance actions, noteholders may have to ultimately pursue the claims themselves, possibly after compliance with no-action clauses, making recovery even more difficult and costly.

[3] *See* Akanthos Capital Management, LLC v. Compucredit Holdings Corp.,734 F.3d 1264 (11th Cir. 2012).

[4] *See* Feldbaum v. McCrory Corp., 1992 Del. Ch. LEXIS 113, at *28.

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