

Delaware Supreme Court Affirms Indenture Limitations on Suits Among Noteholders

On May 22, 2014, the Delaware Supreme Court, applying New York law, affirmed the dismissal of an action brought by Plaintiff noteholders against other noteholders under an indenture for approving amendments with which Plaintiffs disagreed.

I. Background and Procedural History

Marisco Superholdco, LLC (the “Company”) issued notes under an indenture in December 2007. As part of a financial restructuring in 2010, a majority of the Company’s noteholders approved amendments to the indenture. Plaintiffs brought suit in the Court of Chancery, claiming that they were injured by the approved amendments to the indenture. They based their suit on Section 6.06 of the indenture, titled “Limitation on Suits”, which stated as follows:

“A Holder may pursue a remedy with respect to this Indenture or the Notes only if:

- (1) Such Holder has previously given the Trustee notice that an event of Default is continuing;
- (2) Holders of at least 25% in aggregate principal amount of the then outstanding Notes have requested the Trustee to pursue the remedy;
- (3) Such Holders have offered the Trustee reasonable security or indemnity against any loss, liability, or expense;
- (4) The Trustee has not complied with such request within 60 days after the receipt of the request and the offer of security or indemnity; and
- (5) Holders of a majority in aggregate principal amount of the then outstanding Notes have not given the Trustee a direction inconsistent with such request within such 60-day period.

A holder of a Note may not use this Indenture to prejudice the rights of another Holder of a Note or to obtain a preference or priority over another Holder of a Note.”¹

Plaintiffs’ claim was based on the argument that the last sentence of Section 6.06 should be interpreted to mean that “a noteholder [who] votes to approve amendments to the [i]ndenture that are injurious to a dissenting noteholder...has breached [its] contractual duties...under the [i]ndenture and must pay damages to the dissenting noteholder.”²

The defendants moved to dismiss the claims under Rule 12(b)(6) and the Court of Chancery granted that motion stating that “Section 6.06 could not reasonably be read to provide [Plaintiffs] with a basis to sue [the

¹ *Caspian Alpha Long Credit Fund, L.P. v GS Mezzanine Partners 2006, L.P.*, No. 472, 2013, slip op. at 2 (Del. May 22, 2014) [hereinafter “Slip Op.”]. available at <http://courts.delaware.gov/opinions/download.aspx?ID=205990>.

² *Id.* at 3.

Defendants] for voting to approve amendments to the [i]ndenture.”³ Plaintiffs appealed to the Delaware Supreme Court. The Delaware Supreme Court affirmed the dismissal of Plaintiffs’ claims.⁴

II. The Court’s Decision

The Court stated that, when a court is deciding a motion to dismiss under Rule 12(b)(6), it must accept all well-pled allegations of fact as true as well as draw reasonable inferences in the plaintiff’s favor. However, there is no requirement to accept “every strained interpretation proposed by the plaintiff.”⁵ A court may dismiss a claim based on contract interpretation where “the defendant’s interpretation is the *only* reasonable construction as a matter of law.”⁶

New York law requires that, when interpreting a contract, the court must read the contract as a whole and “give to each clause its intended purpose in the promotion of the primary and dominant purpose of the contract.”⁷ The Court further focused on when a contract can be found to be ambiguous. The test for ambiguity requires that “the terms of the contract could suggest more than one meaning when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business.”⁸ The Court noted that Delaware courts and the State of New York are in agreement that commercial contracts that use standard language should be given a consistent meaning for the purpose of interpretation. To that end, courts may consider commercial usage and model contracts, such as the Model Debenture Indenture Provisions adopted by the Corporate Debt Financing Project of the American Bar Association, in order to produce more uniform decisions.

In this case, the Court found Plaintiffs’ interpretation of the contract to be an unreasonable one. When the language of the indenture is read in full context, the Court stated it was clear that the last sentence of Section 6.06 is referring to noteholders acting in a representative capacity as a fiduciary for all noteholders, rather than referring to a noteholder simply exercising its voting rights as a noteholder, and not actually exercising any fiduciary authority. The Court agreed with the Court of Chancery that Section 6.06 was not meant to be a broad provision that would subject noteholders to potential liability for voting to approve amendments where there is not unanimous support. The Court further supports this interpretation with a comparison to the commentary to the Model Indenture, which also contradicted Plaintiffs’ reading of Section 6.06. The Model Indenture commentaries are consistent with the interpretation that “the last sentence of Section 6.06 is related to that section’s status as a no-action clause and does not create a wide-ranging contractual basis for suit against noteholders who support [i]ndenture amendments that other noteholders do not favor.”⁹ Moreover, the Court of Chancery referred to other sections of the indenture that “specifically permitted the amendments at issue in this case to be approved by a majority of the noteholders and did not require a unanimous consent.”¹⁰ The Court noted that to read Section 6.06 as interpreted by Plaintiffs would not only be unreasonable, but would also unsettle the marketplace by granting a

³ *Id.* at 1.

⁴ *Id.*

⁵ *Id.* at 2.

⁶ *Vanderbilt Income & Growth Assocs., LLC v. Arvida/JMB Managers, Inc.*, 691 A.2d 609, 613 (Del. 1996) (internal citations omitted) (emphasis in original); *VLIW Tech., LLC v. Hewlett-Packard Co.*, 840 A.2d 606, 615 (Del. 2003).

⁷ *Empire Properties Corp. v. Mfrs. Trust Co.*, 43 N.E.2d 25, 28 (N.Y. 1942).

⁸ *Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp.*, 595 F.3d 458, 466 (2d Cir. 2010) (internal citations omitted).

⁹ *Slip. Op.* at 5.

¹⁰ *Id.* at 6.

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never-before-seen power to dissenting noteholders and place all noteholders at risk simply for voting in their self-interest.¹¹ Therefore, the Court affirmed the lower court's decision to dismiss Plaintiffs' claims.

III. Significance

This decision affirms that courts should give commercial contracts a consistent and predictable meaning.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com; John Schuster at 212.701.3323 or jschuster@cahill.com.

¹¹ *Id.* at 6-7.