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New York's Highest Court Upholds Limited Role of Indenture Trustees

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The New York Court of Appeals in Racepoint Partners, LLC et al. v. JPMorgan Chase Bank, N.A.*, 2010 NY slip op. 0267 (N.Y. 2010), recently reiterated and strengthened its holdings as to the limited obligations of indenture trustees. The Court, in affirming the dismissal of Enron noteholder claims against JPMorgan as indenture trustee, held that the trustee had no obligation to ensure that Enron's filings with the Securities and Exchange Commission ("SEC") were accurate. This decision aligns New York law with the position taken by federal courts as to the proper interpretation of Section 314(a) of the Trust Indenture Act of 1939 ("TIA"), and rejects this latest attempt to impose unbargained-for and onerous obligations upon indenture trustees.*

Pursuant to TIA § 314(a), all TIA-qualified indentures must require obligors to provide the trustee with reports that the obligor is "required to file with the SEC pursuant to Section 13 or 15(d) of the [Securities] Exchange Act." JPMorgan was indenture trustee for holders of notes issued by Enron pursuant to an indenture which contained such a provision (Section 4.02). After it became known that Enron's financial reports were fraudulent and it filed for bankruptcy, plaintiffs (which had acquired approximately $1 billion of such notes) asserted claims against the trustee seeking to make it responsible for losses on the notes.

Plaintiffs argued that Enron, under Indenture § 4.02 and TIA § 314(a), had covenanted to file with the trustee reports that conformed to federal securities law requirements, and had breached this covenant and so defaulted when it filed non-conforming, fraudulent reports. Plaintiffs further asserted that JPMorgan had breached its indenture obligations when it failed to notify noteholders of Enron's defaults, of which JPMorgan allegedly had actual knowledge.

On April 1, 2010, the Court of Appeals upheld the ruling of the intermediate appellate court dismissing plaintiffs' claims. Echoing arguments advanced by the *amicus* brief submitted by the American Bankers Association ("ABA"), the Court noted that "the parties' intent in section 4.02 may be equated with Congressional intent with respect to § 314(a) of the [TIA]." Based on the provision's plain language and legislative

history, the Court determined that Congress had intended to create "a delivery requirement and no more", i.e., a mechanism to timely provide the indenture trustee with certain reports of the obligor's financial situation that must be filed with the SEC. The Court concluded that such provisions "do not create contractual duties on the part of the trustee to assure that the information contained in any report filed is true and accurate. That is simply not the mission or purpose of the trustee or the contract under which it undertakes its duties."

The Court of Appeals noted that its holding "is consistent with the limited, 'ministerial' functions of the indenture trustees" (quoting *AG Capital Funding Partners, L.P. v. State St. Bank & Trust Co.,* 11 N.Y.3d 146, 157 (2008)). It rejected the contrary interpretation advocated by plaintiffs, which "would require indenture trustees to review the substance of SEC filings, so as to reduce the risk of liability, greatly expanding indenture trustees' recognized administrative duties far beyond anything found in the contract." Because Enron did not breach its reporting obligation, the Court did not reach the issue of whether JPMorgan's trustee operations could be imputed with the knowledge of the reports' falsity allegedly held by other parts of the bank.

Racepoint is an important victory for indenture trustees. The appeal had been followed closely by trustees and other members of the financial community because of the Court of Appeals' leading role in interpretation of indentures, many of which are governed by New York law. Importantly, the Court in *Racepoint* declined to follow a 2006 New York state trial court decision concluding that such reporting requirements impose substantive obligations on issuers to provide conforming filings to trustees. Instead, the Court in *Racepoint* opted to follow the decisions of federal courts that have declined to interpret such standard indenture provisions as imposing on companies **contractual** obligations to file accurate reports with the SEC (*see* Pillsbury 1/14/09 bulletin: "8th Circuit Finds No Affirmative Reporting Obligation in Standard Indenture Covenant.").

Had the Court of Appeals sided with the trial court, the burdens on indenture trustees would have likely substantially increased, possibly requiring them to make a factual and legal inquiry into the substantive accuracy of obligors' required financial statements—an inquiry for which trustees are ill-equipped. Moreover, trustees could have been exposed to a wide variety of claims for past and upcoming filings, including allegations that they knew, but failed to provide notice, of such alleged indenture defaults.

Disclosure: Pillsbury Winthrop Shaw Pittman LLP acted as counsel for the American Bankers Association in submitting its *amicus curiae* brief in *Racepoint*. The ABA's members provide more than 90% of the corporate trust services in the United States.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work or the attorneys below.

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