In a recently published decision, the New York Court of Appeals, New York’s highest state court, held that an indenture trustee is not liable to noteholders for inaccuracies in SEC reports of the notes’ issuer. Racepoint Partners, LLC v. JPMorgan Chase Bank, N.A., (2010).

In Racepoint Partners, Enron, as the issuer of a series of notes, entered into an indenture agreement with Chase Manhattan Bank, naming Chase as the indenture trustee for the holders of certain Enron Notes. Section 4.02 of the indenture agreement provided that Enron was to submit copies of all SEC filings and annual reports to Chase within 15 days after they are filed with the SEC. Specifically, Enron agreed:

> [T]o file with the Trustee [i.e. Chase], within 15 days after it files the same with the [Securities and Exchange Commission], copies of its annual reports and of the information, documents and other reports . . . which the Company [i.e. Enron] is required to file with the SEC pursuant to Section 13 or 15 (d) of the [Securities] Exchange Act. Delivery of such reports, information and documents to the Trustee is for informational purposes only and the Trustee’s receipt of such information shall not constitute constructive notice of any information contained therein or determinable from information contained therein, including the Issuer’s compliance with any of its covenants hereunder (as to which the Trustee is entitled to rely exclusively on Officers’ Certificates). The issuer also shall comply with any other provisions of Trust Indenture Act Section 314(a).

Failure to comply with that clause in the indenture agreement amounted to a default by the breaching party.

The instant litigation came about as a result of Enron’s accounting fraud scandal. Plaintiffs Racepoint Partners LLC and Willow Capital-IL L.L.C. had purchased approximately $1 billion of Enron notes. When the value of the notes plummeted, the plaintiff noteholders filed suit against Chase, as trustee, on the grounds that Enron defaulted under the indenture agreement (by submitting fraudulent SEC filings) and that Chase, with knowledge of the default, was liable for damages suffered as a result of Enron’s breach of the indenture (i.e. the filing of false information with the SEC).

Chase moved to dismiss the noteholders’ claims and the trial court denied its motion. The Appellate Division reversed and the Court of Appeals affirmed the reversal, resulting in the dismissal of the noteholders’ claims.

In dismissing the noteholders’ claims, the Court of Appeals focused on the fact that the indenture agreement’s requirement that Enron produce its SEC filings to Chase as trustee was a statutorily mandated provision pursuant to § 314(a) of the Trust Indenture Act of 1939. The Court held that provisions such as that contained in the Enron/Chase indenture agreement requiring that SEC reports be delivered to the trustee, “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.” The Court recognized that if plaintiffs could hold the trustee responsible in this instance, indenture trustees would be required to review the substance of SEC filings, which would greatly expand the indenture trustee’s...
administrative duties far beyond anything found in the indenture. Chase, therefore, had no liability to the noteholders for misstatements in Enron’s SEC filings.

This decision insulates indenture trustees from any duty to review or confirm the statements in any SEC filings by an issuer. While such a proposition may have seemed obvious based on the language of section 4.02 of the indenture, the plaintiffs’ claims in this case did initially survive a motion to dismiss — raising some doubt as to the potential liability of an indenture trustee. In the end, consistent with the traditional view of the duties of an indenture trustee prior to an event of default, the Court reaffirmed the “limited, ‘ministerial’ functions of indenture trustees.”

Endnote

1 Plaintiffs here were secondary holders of the notes but, as noted by the Court, were vested with the claims and demands of the primary holders.

About the Authors

Donna Burnett is a partner at Locke Lord and is the head of a six-member section of attorneys who represent corporate trustees and practice full time in corporate trust law in both tax exempt and taxable securities offerings. This section of dedicated attorneys is relatively unique among U.S. law firms. In addition, Donna Burnett represents participants in securities and structured finance transactions, including issuance (taxable and tax-exempt) as well as workouts and defaults on such transactions. Ms. Burnett has worked with a number of municipalities, energy companies, monoline insurers, trustee banks, custodians, servicers, collateral administrators, letter of credit banks and purchasers or holders to help issue (including structuring with special purpose vehicles) secure debt (including collateralized debt obligations) and securities such as mortgage and other asset back certificates and to help pursue remedies and liquidate assets following default.

Joseph N. Froehlich is a partner in Locke Lord’s New York office. He represents indenture trustees in litigation matters, including interpleader actions, in state and federal court. Additionally, he has experience in representing clients in complex commercial, business litigation and bankruptcy both in New York and throughout the country. Mr. Froehlich has extensive experience representing financial institutions, educational institutions and insurance companies in every step of the litigation process.

Casey B. Howard is a senior litigation associate in Locke Lord’s New York office working predominantly in the areas of bankruptcy, indenture trustee litigation and other complex commercial litigation. Mr. Howard represents indenture trustees in litigation matters in New York’s state, federal and bankruptcy courts. Mr. Howard also has experience in labor, reinsurance and maritime law.