Eleventh Circuit Rules "No-Action" Clause Bars Noteholders' Fraudulent-Transfer Claims

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In *Akanthos Capital Mgmt., LLC v. CompuCredit Holdings Corp.*, 677 F.3d 1286 (11th Cir. 2012), the U.S. Court of Appeals for the Eleventh Circuit reversed a district-court decision and dismissed claims brought by noteholders under Georgia's Uniform Fraudulent Transfers Act ("UFTA") to avoid allegedly fraudulent transfers made by the issuing company. The primary issue confronting the Eleventh Circuit involved the circumstances under which a "no-action" clause in a bond indenture precludes noteholders from taking legal action against a debt issuer. In enforcing the terms of the no-action clause to bar noteholders from bringing UFTA claims, the Eleventh Circuit refused to deviate from legal precedent that generally discourages efforts to circumvent the provisions of a contract and refused to alter the terms of an agreement in cases not involving an indenture trustee's demonstrated conflict of interest.

What Is a No-Action Clause?

When companies issue notes or bonds, an "indenture" is sometimes created to govern the terms of the debt instrument. The indenture stipulates the terms of the contract between bondholders and the issuer company, including the time period of repayment and the rate of interest. A "no-action" clause is a common provision in an indenture. The clause establishes when and how creditors can take legal action against the issuer. No-action clauses guard against superfluous suits by an individual bondholder or a small bondholder group that may not share the interests of other bondholders. Most important, these clauses commonly require bondholders to seek action through an intermediary—usually an indenture trustee.

Some bondholder suits fall outside the scope of the no-action clause altogether, whereas others satisfy certain limited exceptions. Exceptions vary among indentures, although most indentures share a core set of prerequisites to bondholder action, which may include: (i) nonpayment of principal or interest; (ii) a minimum threshold of bondholders who collectively seek a remedy (usually 25 percent or more); and (iii) failure by the indenture trustee to take action. The indenture trustee's conflict of interest may also serve as justification for bondholders to take action. Outside of these exceptions, bondholders are generally obligated to take collective action through the indenture trustee.

Akanthos Capital

CompuCredit Holdings Corporation ("CompuCredit") is a financial-services provider operating in the subprime-lending market. In 2005, CompuCredit issued approximately $387 million in convertible notes, $230 million of which were scheduled to be repurchased in May 2012 in accordance with the terms of the indenture. Akanthos Capital Mgmt., LLC, and certain other hedge funds (the "noteholders") hold a majority of the principal amount of the notes.

The no-action clause in the indenture, which is governed by New York law, provides in relevant part as follows:

> A Securityholder may not pursue any remedy with respect to this Indenture or the Securities, except in case of a Default due to the non-payment of the principal amount of the Securities, any accrued and unpaid Interest, any accrued and unpaid Contingent Interest, if any, or any accrued and unpaid Liquidated Damages, if any, unless:
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> (a) the Holder gives to the Trustee written notice stating that a Default is continuing;

(b) the Holders of at least 25% in aggregate principal amount of the Securities at the time outstanding make a written request to the Trustee to pursue the remedy;

(c) such Holder or Holders offer reasonable security or indemnity to the Trustee against any costs, liability or expense;

(d) the Trustee does not comply with the request within 60 days after receipt of such notice and offer of security or indemnity; and

(e) the Holders of a majority in aggregate principal amount of the Securities at the time outstanding do not give the Trustee a direction inconsistent with the request during such 60-day period.

In November 2009, CompuCredit publicly reported that it would likely be unable to honor its repurchase obligation under the indenture, due to poor financial performance and substantially decreased asset value. CompuCredit further announced that it planned to spin off the company's profitable microloan business (its only profitable division). The following month, the company announced its intention to pay a cash dividend of $24 million—the first dividend CompuCredit had ever paid—to its shareholders in less than 60 days.

In December 2009, the noteholders sued CompuCredit and its officers, directors, and principal shareholders in federal district court in Georgia, alleging that CompuCredit's payment of the dividend violated Georgia's UFTA as a transfer made with the intent to hinder, delay, or defraud creditors. The noteholders argued, among other things, that CompuCredit's financial reporting artificially depressed the market value of the notes (as well as the repurchase price) and that the company's plan to spin off its profitable microloan business to benefit insiders would reduce CompuCredit's ability to pay the notes. All of the defendants moved to dismiss the complaint.

The District Court's Decision

The district court denied the defendants' motion to dismiss. The court explained that the no-action clause in the indenture did not preclude the noteholders' suit under the UFTA because: (i) the noteholders asserted "extra-contractual" claims exempt from the no-action clause; (ii) the noteholders collectively held a majority of the notes; and (ii) CompuCredit made it impossible to comply with the 60-day notice requirement by announcing that it would pay a dividend to shareholders less than 60 days prior to the payment. Under these circumstances, the court concluded, the noteholders did not have to rely, as a prerequisite to taking action, on the exceptions expressly delineated in the no-action clause.

In April 2011, the district court certified the following question to the Eleventh Circuit as part of an interlocutory appeal of its ruling: "Under New York Law, may noteholders sue under Georgia's Uniform Fraudulent Transfer Act where the noteholders have not complied with the conditions precedent to filing suit specified in the 'no-action clause' in the trust indentures governing the notes?"

The Eleventh Circuit's Ruling

A three-judge panel of the Eleventh Circuit reversed. In doing so, the court of appeals rejected the "extra-contractual" fraudulent-transfer-claim exception relied on by the district court, concluding that the noteholders relinquished to the indenture trustee their right to sue upon agreeing to be bound by the contract. Citing *Feldbaum v. McCrory Corp.*, 1992 WL 119095 (Del. Ch. June 2, 1992), the Eleventh Circuit explained that the no-action clause bars all actions regarding the indenture or the notes, subject only to the exceptions set forth therein. In addition, the court wrote, "Courts applying New York law have consistently held . . . that no-action clauses bar fraudulent conveyance claims." Because the noteholders did not argue that there was

any trustee conflict of interest (an exception that has been recognized by New York courts), the Eleventh Circuit explained, there is no reason to deviate from the consistent legal framework applied to indentures.

The Eleventh Circuit also rejected the noteholders' claim that their actions were legitimate because they held a majority of the principal amount of the notes. Acknowledging that no-action clauses are meant to protect against suits brought by a handful of investors, the court was not convinced that the noteholders' majority-ownership interest alleviates the clear-exception requirements of the indenture. Instead, the Eleventh Circuit concluded, the best way to interpret the indenture is by reviewing its clear, unambiguous language, which does not authorize noteholder action solely on the basis of majority ownership.

The Eleventh Circuit did not consider the timing of the dividend announcement and payment relevant. Although a notice of less than 60 days prevented the noteholders from relying on the trustee-demand exception, the court explained, the dividend payment complied with the terms of the trust indenture, which required only 20 days' notice of a dividend payment.

Case Implications

No-action clauses are a common feature of indentures and other agreements governing debt instruments. In *Akanthos Capital*, the Eleventh Circuit determined that such clauses "must be given a consistent, uniform interpretation" to preclude noteholder suits that fall outside the express terms of the delineated exceptions. The ruling demonstrates that investors would be well advised to review indentures and other governing agreements carefully, recognizing that courts'

broad interpretation of the scope of no-action clauses may restrict their individual efforts to pursue causes of action against the issuer.