

TEPOEL LECTURE: BOND TRUSTEES AND THE RISING CHALLENGE OF ACTIVIST INVESTORS

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I. INTRODUCTION

A bond indenture is the contract controlling the relationship between investors in corporate bonds and the issuer of those bonds. Large financial institutions, such as U.S. Bank, Bank of NY Mellon, and Deutsche Bank, typically administer the governance of bond indentures on behalf of the investors; in that role, they are called indenture trustees or, more colloquially, bond trustees.

A. BONDHOLDERS AND SHAREHOLDERS

Bondholders, therefore, are the primary beneficiaries of indenture governance, just as shareholders are the primary beneficiaries of corporate governance. As beneficiaries, though, bondholders and shareholders have much different expectations. Indenture governance and corporate governance have evolved differently to meet those different expectations.

For example, because bondholders are only entitled to—and thus, only expect to receive—principal and accrued interest on their bonds, indenture governance has evolved to protect that recovery.¹ In contrast, because shareholders, as residual claimants of the firm, are entitled to (and thus expect to receive) the firm’s surplus value, corporate governance has evolved to increase that value.²

Most people would consider corporate governance as much more important than indenture governance. In part, that is because corporations and stock markets are highly visible to the average person. Also, a corporate manager’s job—to try to increase shareholder value—involves more judgment and discretion, and thus can be more

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1. See Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. L. 559, 561 (2003).

2. See *id.*

interesting (and more desirable of scholarly study), than an indenture trustee's job of merely protecting bondholder recovery.

Still, indenture governance is critically important. Domestically and worldwide, the amounts invested in bonds dwarfs the amounts invested in stock. Recent data show, for example, that global bond issuance is almost thirty times greater than global equity issuance.³

B. INDENTURE TRUSTEE DUTIES

Historically, an indenture trustee's governance duties turn on whether the trustee is acting pre-default or post-default.

1. *Post-Default Duties*

Once an indenture defaults—in the worst case, because the issuer has failed to pay its bonds—the law requires the indenture trustee to act on behalf of the bondholders as would a prudent person in similar circumstances regarding its own affairs.⁴

Many post-default decisions—such as whether to accelerate the maturity of the bonds or to liquidate collateral—involve difficult judgment calls.⁵ These decisions are made more difficult by what I have called a “protection gap”: when things go wrong, investors often blame parties with deep pockets, especially indenture trustees, for failing to protect them.⁶

Post-default indenture governance becomes even more complicated when the bondholders themselves have conflicting interests caused, for example, by conflicting payment priorities or conflicting sources of payment.⁷ The indenture trustee then also faces the difficult task of trying to understand and balance the respective obligations owed to conflicting classes, sometimes called “tranches,” of investors—which involves what some have called “tranche warfare.”

3. See, e.g., SIFMA, SIFMA FACT BOOK 45-46 (2018), <https://www.sifma.org/wp-content/uploads/2017/08/US-Fact-Book-2018-SIFMA.pdf> (showing that, in 2017, global long-term bond issuance was \$21,099.7 billion versus global equity issuance of only \$720.7 billion).

4. See, e.g., Trust Indenture Act of 1939 § 315(c), 15 U.S.C. § 7700o(c) (2018) (“The indenture trustee shall exercise in case of default . . . the same degree of care and skill . . . as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.”).

5. See Steven L. Schwarcz & Gregory M. Sergi, *Bond Defaults and the Dilemma of the Indenture Trustee*, 59 ALA. L. REV. 1037, 1040 (2008) (“Indenture trustees for defaulted bonds . . . face the conundrum that they are required to act prudently but lack clear guidance on what prudence means.”).

6. Steven L. Schwarcz, *The Roberta Mitchell Lecture: Structuring Responsibility in Securitization Transactions*, 40 CAP. U. L. REV. 803, 804 (2012).

7. See generally Steven L. Schwarcz, *Fiduciaries with Conflicting Obligations*, 94 MINN. L. REV. 1867 (2010).

Notwithstanding its complexities, post-default indenture governance is informed by case law. And perhaps *because of* its complexities, post-default indenture governance is also informed by legal scholarship.

2. *Pre-Default Duties*

In contrast, pre-default indenture governance is not yet well-informed by either case law or legal scholarship. The paucity of guidance reflects that, absent a default, bond investors were relatively passive. The rising challenge of activist investors is now changing that. Thus, it is critical to understand what an indenture trustee's pre-default duties should be.

For example, activist investors—which include hedge funds and so-called “vulture” funds—are buying bonds of troubled companies, at deep discounts. As bondholders, they then make demands on indenture trustees. They also sue indenture trustees for losses on their bonds.

Indenture trustees must know how to respond. My goal is to try to provide a framework for guiding an indenture trustee's response.

To start, let us consider the history of an indenture trustee's pre-default duties.

II. BACKGROUND

A. THE TIA HISTORICAL RECORD

The history of enactment of the Trust Indenture Act of 1939 (“TIA”)⁸ provides a valuable record of the original debate over indenture trustee's pre-default responsibilities. Congress enacted the TIA in order to restore investor confidence in the bond markets following the stock-market crash of 1929 and the Great Depression.

The TIA currently requires the appointment of an indenture trustee for bondholders in most public bond issuances over \$10 million.⁹ The indenture trustee's basic role, according to the TIA, is to help solve the collective action problem that bondholders individually may be unable to coordinate their actions with other bondholders.¹⁰

The 1929 report of the Securities and Exchange Commission (“SEC”) that led to enactment of the TIA criticized the passive, or

8. 15 U.S.C. §§ 77aaa–77bbb (2018).

9. Trust Indenture Act of 1939, 15 U.S.C. § 77ddd(a)(9) (2018).

10. See 15 U.S.C. § 77bbb(a)(1) (stating that the TIA was enacted because “individual action by [investors] . . . is rendered impracticable by reason of the disproportionate expense,” “concerted action by [investors] in their common interest . . . is impeded by reason of the wide dispersion of [investors] through many States,” and relevant information may not be available to all investors).

“ministerial,” pre-default role generally taken at that time by indenture trustees.¹¹ The SEC recommended that a post-default “prudent man” standard should apply to indenture trustee performance both pre- and post-default,¹² and that indenture trustees should be required to actively monitor actions of a bond issuer.¹³ Almost a decade later when the TIA was enacted, however, the pre-default ministerial role had become widely accepted in market practice and was codified into the TIA.¹⁴

B. BOND MARKET CHANGES

The indenture trustee’s pre-default duties have not been seriously re-examined since 1939, but the bond market has changed dramatically. Institutional investors now dominate, holding over 80% of corporate and foreign bonds.¹⁵ There are few retail investors. Institutional investors face less of a collective action problem than retail investors.

Whether or not due to bond-market changes, there are conflicting views today of the indenture trustee’s pre-default role. The dominant view by far reflects the ministerial role that was codified in the TIA: that indenture trustees have no pre-default fiduciary duties to bondholders. Rather, their indenture-governance duties are ministerial and limited to the specific terms of the indenture.¹⁶ These duties typically include administrative tasks such as mailing notices or selecting bonds for redemption or delivering certificates, preparing and transmitting reports, and forwarding notices.

Since the 2007 to 2008 financial crisis (the “financial crisis”), however, some investors argue that indenture trustees—especially indenture trustees of securitized bond issues—should have some pre-default fiduciary duties. Understanding this requires an understanding of the categories of bond issues.

11. SEC. & EXCH. COMM’N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL, AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART VI—TRUSTEES UNDER INDENTURES 110 (1936).

12. Wilber G. Katz, *Responsibility of Trustees Under the Federal Trust Indenture Act of 1939*, 26 A.B.A. J. 290, 291 (1940).

13. Stewart M. Robertson, *Debenture Holders and the Indenture Trustee: Controlling Managerial Discretion in the Solvent Enterprise*, 11 HARV. J.L. & PUB. POL’Y 461, 472-73 (1988).

14. 15 U.S.C. § 7700o(a)(1).

15. BD. OF GOVERNORS OF THE FED. RESERVE SYS., FINANCIAL ACCOUNT OF THE UNITED STATES: FLOW OF FUNDS, BALANCE SHEETS, AND INTEGRATED MACROECONOMIC ACCOUNTS: SECOND QUARTER 2015 122 (2015).

16. See, e.g., Trust Indenture Act of 1939, 15 U.S.C. § 7700o(a)(1) (2018); *Elliott Assocs. v. J. Henry Schroder Bank & Tr. Co.*, 838 F.2d 66, 68-71 (2d Cir. 1988).

C. THE CATEGORIES OF BOND ISSUES

In unsecured bond issues, which dominate bond issuance, the indenture trustee acts for the benefit of investors whose right to payment is based on a contract claim against the issuer. This is little different from how an “agent bank” acts for a syndicate of unsecured bank lenders. In secured bond issues, the indenture trustee acts that same way and, usually, also as a collateral agent for the investors.

In securitized bond issues,¹⁷ the indenture trustee acts for the benefit of investors whose right to payment is limited to collections on specified financial assets, such as mortgage loans.¹⁸

Even prior to the financial crisis, credit-rating agencies debated whether indenture trustees of securitized bond issues have greater duties than indenture trustees of other types of bond issues.¹⁹ During the financial crisis, some practitioners also observed expectations that indenture trustees of securitized bond issues may have higher pre-default duties than indenture trustees of other bond issues.²⁰

Whether or not inspired by these precedents, I have seen several complaints in recent lawsuits alleging that, pre-default, an indenture trustee of a securitized bond issue should “police the deal” for, or otherwise protect, the investors.²¹ To date, however, courts have not

17. The indenture in a securitized bond issue is often designated a pooling and servicing agreement, or “PSA.” In my experience, the relevant provisions concerning the trustee of a securitized bond issue are identical whether it uses an indenture or a PSA. Also, some securitized bond issues, even though involving a public offering, have been interpreted to be outside the scope of the TIA. *See* *Ret. Bd. of Police v. Bank of N.Y. Mellon*, 775 F.3d 154, 164 (2d Cir. 2014) (holding that certain pass-through mortgage-backed securities were exempt from the TIA under § 304(a)(2) because they were “certificate[s] of interest or participation in two or more securities having substantially different rights and privileges,” namely, the numerous mortgage loans held by each trust”). My normative analysis of securitized bond issues is not dependent on whether such bond issues are subject to the TIA.

18. Steven L. Schwarcz, *What is Securitization? And for What Purpose?*, 85 S. CAL. L. REV. 1283, 1295-98 (2012).

19. *Compare* MOODY’S GLOBAL CREDIT RESEARCH, MOODY RE-EXAMINES TRUSTEE’S ROLES IN ABS AND MBS 3-4 (2003) (suggesting that indenture trustees in MBS transactions have an affirmative duty to investigate likely servicer defaults and to be proactive participants) *with* *Fitch: Seller/Servicer Risk Trumps Trustee’s Role In U.S. ABS Transactions*, BUS. WIRE (Feb. 24, 2003), <https://www.businesswire.com/news/home/20030224005501/en/Fitch-SellerServicer-Risk-Trumps-Trustees-Role-U.S.> (stating that such “unrealistic reliance on [indenture] trustees” in MBS and other securitization transactions not only “misses the mark” but also “increases the risk to investors by potentially masking other more important considerations” such as the quality of servicer performance).

20. *See, e.g.*, Christopher J. Brady, Marla Chernof Cohen, & Harold L. Kaplan, *The Role of the Trustee in Securitization Transactions*, ch. 9, at 9-3, in *SECURITIZATION OF FINANCIAL ASSETS* (Jason H.P. Kravitt ed., 3d ed. Supp. 2013).

21. *See, e.g.*, Complaint at 2-3, *Commerzbank AG v. Bank of New York Mellon*, No. 1:15-cv-10029 (S.D.N.Y. Dec. 23, 2015) (contending that prior to an Event of Default, a trustee for a securitized bond issue is required to police the deal for investors).

ruled that indenture trustees have greater duties in securitized bond issues.

III. ANALYZING PRE-DEFAULT DUTIES

To analyze what pre-default duties an indenture trustee should have, consider the possible normative frameworks for legally imposing duties in a business context. There are two potentially overlapping frameworks: to correct market failures and to maximize efficiency.

A. CORRECTING MARKET FAILURES

The fundamental normative justification for financial regulation is to correct market failures. The primary justification for regulating the duties of a trustee pre-default, therefore, should be to correct pre-default market failures.

When the TIA originally was enacted in 1939, many of the bondholders for whom indenture trustees acted were retail investors. Without an indenture trustee acting for them, they were unable to adequately protect themselves because of a collective action problem—which is a type of market failure. Today, institutional investors dominate the bond markets, greatly reducing that collective action problem.

But the rise of activist investors and the emergence of securitized bond issues have created other market failures. The rise of activist investors has created a possible agency failure: activist investors do not necessarily act for the benefit of the other investors. The emergence of securitized bond issues has created a possible information failure: some securitized bond issues are so complex that investors do not always fully understand them.²²

I do not see why indenture trustees should, or even how they could, correct the agency failure. Activist investors are responsible for that failure. Future indentures should be drafted to try to limit the ability of those investors to cause such failure.

Nonetheless, indenture trustees should not want to exacerbate that failure. When requested to take an action, for example, an indenture trustee may wish to consider whether that action could create or worsen a conflict of interest among investors. If so, it should have the right to refuse to take that action—provided that refusal violates neither the indenture nor formal investor directions.

Nor do I see why indenture trustees should, or how they could, correct the information failure. Securitizations can be extremely com-

22. Steven L. Schwarcz, *Securitization and Post-Crisis Financial Regulation*, 102 CORNELL L. REV. ONLINE 115, 131 (2016).

plex. It can take around forty pages to describe the underlying financial assets, and around thirty pages to describe how cash flows from those assets are allocated.²³ Large securitizations may be even more complex, including multiple types of underlying financial assets and multiple tranches of bonds.

There is no evidence, though, that indenture trustees could correct that information failure. Indenture trustees receive relatively tiny fees, and the trust departments of financial institutions normally engage in only relatively ministerial tasks.²⁴ Indenture trustees rarely even negotiate the terms of the indentures. Instead, they are usually presented the transaction documents at the last minute and asked to sign with little to no opportunity to make changes.²⁵

In contrast, the institutional investors in securitized bond issues, including the activist investors, are highly sophisticated. In the Rule 144A-exempt transactions that characterize many securitized bond issues, the investors must be qualified institutional buyers (“QIBs”): the highest SEC ranking of investor sophistication and size. Indenture trustees could not understand complex securitized bond issues better than those investors.²⁶

B. MAXIMIZING EFFICIENCY

Another normative justification for financial regulation is maximizing efficiency. In theory, correcting market failures should make private markets work efficiently.

In practice, though, maximizing efficiency requires avoiding any duplication of efforts. The pre-default duties of indenture trustees are usually limited to straightforward administrative tasks. Indenture trustees should not be performing additional pre-default roles that duplicate what other parties are doing.

Also, if future indentures require indenture trustees to perform additional pre-default roles, they would then want to be further compensated. Payment of that compensation would reduce the value of the trust estate for bondholders.

23. Andra C. Ghent et. al., *Complexity in Structured Finance* 14 (Nov. 2, 2017) (unpublished draft), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2325835.

24. AM. BANKERS ASS'N, *CORPORATE TRUST COMMITTEE, THE TRUSTEE'S ROLE IN ASSET-BACKED SECURITIES* 3 (2010).

25. *Id.* at 4.

26. *Cf.* Press Release, Dep't of the Treasury, Remarks by Counselor to the Secretary for Housing Finance Policy Dr. Michael Stegman Before the Structured Finance Industry Group 1st Annual Private Label Symposium (Nov. 12, 2014), <https://www.treasury.gov/press-center/press-releases/Pages/jl2694.aspx> (concluding that the “core competency of [indenture] trustees is in carrying out administrative functions, not in forensic activities that require subjectivity and judgment, which is ultimately what a fiduciary must exercise”).

The current equilibrium of small trustee fees and (except when the trustee is formally directed by investors, as I will later discuss) ministerial pre-default duties represents the current market practice for balancing costs and benefits. Market practice provides a presumption of efficiency.

C. ARTICULATING A NORMATIVE RULE

This analysis suggests the following rule. Pre-default, an indenture trustee should only have the duties specified in the indenture. An indenture trustee also should have the right to refuse to take an action that could create or exacerbate a conflict of interest among investors, provided that refusal violates neither the indenture nor formal investor directions.

This rule could result in a pre-default protection gap if the indenture fails to assign any specific party to enforce pre-default remedies. For example, some securitization indentures fail to assign a party to enforce certain remedies for breaches of representations and warranties regarding purchased financial assets.

If such a protection gap arises, the bondholders typically could protect themselves, such as by marshalling the requisite voting rights (and providing adequate indemnification of costs) to contractually direct the indenture trustee or the servicer to enforce those remedies. Sometimes, bondholders might be unable to marshal the requisite voting rights to protect themselves; but courts have refused to infer implied covenants to protect sophisticated bondholders.²⁷

IV. APPLYING THE PROPOSED PRE-DEFAULT NORMATIVE RULE

Next, let us apply the rule for determining an indenture trustee's pre-default duties to the types of issues that may arise in lawsuits.

A. TAKING ENFORCEMENT AND OTHER REMEDIAL ACTIONS

Even prior to a formal default, one or more investors may demand that the indenture trustee take some enforcement or other remedial action to try to correct a perceived problem. Compliance with that demand could be expensive; indenture trustees normally are entitled to reimbursement of their enforcement costs from the trust estate, which would reduce the value of that estate for investors generally. Taking

27. *Cf. Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504 (S.D.N.Y. 1989) (refusing to find an implied covenant protecting investors where the bond indenture lacked that protection).

remedial action could, therefore, create a conflict if it would disproportionately benefit only certain investors.

For example, activist investors may purchase “underwater” subordinated (junior) bonds at pennies on the dollar. Those investors may then demand that the indenture trustee take an expensive enforcement action, with relatively little chance of success—but a high recovery if successful.

If the issuer is solvent enough to pay the senior bonds, then taking that enforcement action would be unlikely to benefit the senior investors. It could hurt them, though, if the cost of a failed enforcement action reduces the issuer’s ability to pay the senior bonds.

The activist investors, nonetheless, would want the indenture trustee to take that enforcement action. Absent that action, their subordinated bonds are worth little—so they would lose little if the action is unsuccessful. But taking the action gives them a small chance of being paid in full.

Absent formal investor directions, an indenture trustee should have the right to refuse to take that action. In case of doubt, an indenture trustee could seek—or could request the investors demanding the action to arrange for—formal investor directions. An indenture typically allows investors with at least 25-50% of voting rights to direct the indenture trustee to act, and to indemnify the indenture trustee for the cost of taking the action.²⁸

B. INVESTIGATING “RED FLAGS” AND OTHER SUSPICIOUS OCCURRENCES

Investors may become aware of so-called red flags or other suspicious occurrences in a bond issue (such as an unusual number of mortgage-loan defaults), even prior to a formal default. One or more investors may then demand that the indenture trustee investigate the event. Compliance with that demand could be costly, reducing the value of the estate for investors generally.

The indenture trustee’s engagement in such an investigation could, therefore, create a conflict if it would disproportionately benefit only certain investors. For example, an investor in subordinated bonds who might benefit from an expensive investigation would have an incentive to direct the indenture trustee to make that investigation

28. See, e.g., Adam J. Levitin, *The Paper Chase: Securitization, Foreclosure, and the Uncertainty of Mortgage Title*, 63 DUKE L. J. 637, 709 (2013) (observing that a typical indenture allows holders of more than 25% principal amount of bonds to control trustee actions). The TIA requires indentures to authorize at least majority bondholders to direct the trustee’s exercise of power. Trust Indenture Act of 1939, 15 U.S.C. § 77ppp(a)(1) (2018).

if the costs of an unsuccessful investigation are disproportionately borne by investors in more senior bonds. Absent formal investor directions, an indenture trustee should have the right to refuse to make that investigation.

Even absent an investor demand, investors sometimes use the indenture trustee's failure to investigate a red flag or other suspicious occurrence as a basis for a later claim against the indenture trustee as a deep pocket. Although indentures typically absolve trustees from liability unless they act negligently or with willful misconduct, investors sometimes argue that a trustee's failure to make the investigation constitutes negligence. Reading an indenture as a consistent whole, however, the more specific governing text would appear to be the standard provision that the trustee "undertakes to perform . . . only such duties as are specifically set forth" in the indenture and has no duty to investigate any "facts or matters" unless appropriately requested by investors to do so. An omission cannot be negligent if there is no duty to act.

C. MONITORING AND SUPERVISING SERVICERS (AND OTHER PARTIES)

In securitized bond issues, the bondholders are dependent on collections on the purchased financial assets. Invariably, therefore, these transactions require a party, usually called a servicer (or sometimes, collection agent), to service those financial assets and collect payment thereon.²⁹ In litigation filed following the financial crisis, which caused widespread defaults on residential mortgage loans, some investors argued that indenture trustees in mortgage-backed securities transactions should have monitored or supervised the performance of the mortgage-loan servicer.³⁰

An indenture could specifically require the indenture trustee to supervise the servicer or assure that the servicer complies with the indenture. However, more typically in my experience, indentures provide that the indenture trustee has no duty to monitor or supervise the servicer. Instead, the servicer itself typically attests periodically to its own compliance, and the indenture trustee is entitled to rely on the truth and accuracy of that attestation.³¹

29. The servicer normally is required to act in the "best interests" of the investors. Steven L. Schwarcz, *Protecting Financial Markets: Lessons from the Subprime Mortgage Meltdown*, 93 MINN. L. REV. 373, 392 (2008).

30. See, e.g., *Ellington Credit Fund, Ltd. v. Select Portfolio Servicing, Inc.*, 837 F. Supp. 2d 162, 178 (S.D.N.Y. 2011) (alleging that trustee of securitization breached its duty for insufficient supervision of servicer).

31. Sometimes an experienced master servicer may be appointed to supervise the servicer's performance.

Absent clear indenture language, should the indenture trustee have a pre-default duty to monitor or supervise the servicer? I think not. Imposing a monitoring or servicing requirement would be duplicative and expensive—and thus inefficient. Furthermore, most indenture trustees are not equipped or compensated to monitor or supervise the servicer's performance, which typically involves collecting payments on the financial assets, communicating with borrowers, addressing borrower delinquencies and bankruptcies, working out loan modifications or other borrower difficulties, foreclosing on properties, maintaining foreclosed homes, and selling real-estate-owned properties after foreclosure.

D. MONITORING FOR FORMAL DEFAULTS

Investors sometimes claim that an indenture trustee should have a pre-default duty to monitor for the existence of a formal default, sometimes termed an "Event of Default." Such a default could trigger the post-default heightened "prudent person" duty. Some practitioners have likewise suggested that indenture trustees for securitized bond issues might have this pre-default monitoring duty.³² Indentures normally provide, however, that notwithstanding the actual existence of a formal default, the indenture trustee's post-default heightened duty is not triggered until a responsible officer of the indenture trustee has "actual knowledge" or, if the indenture provides, written notice of that formal default.

Consistent with that indenture language, I do not believe that an indenture trustee should have a pre-default monitoring duty. Requiring such a duty would require the indenture trustee to constantly investigate all events that might trigger the default. That would be expensive and time consuming—and thus, inefficient—with investors bearing the cost.

Requiring such a duty also could expose the indenture trustee to indeterminate liability if it failed, even for reasons beyond its control, to become aware of a default. Uncertainty of the standard by which their performance would be judged would discourage financial institutions from acting as indenture trustees, or at least motivate them to charge higher fees to compensate for the risk.

Investors sometimes may notify the indenture trustee that a default has occurred, without clearly showing the existence of the default. What should be the duty of an indenture trustee regarding an

32. Brady et al., *supra* note 20, at 9-7 (discussing the additional sophistication and specialization needed for such a trustee "to achieve an appropriate awareness of possible weakening financial condition of an issuer or servicer or to determine early amortization events").

alleged, but unproved (or possibly disputed), default—such as an allegation based solely on news media, that the servicer is acting improperly?

The answer should take into account and attempt to balance common-sense, practical considerations. That could include the indenture trustee having conversations with the servicer about its performance, communicating the results of those conversations to the investors, and seeking, or requesting the investors to obtain, formal investor directions.

V. RESOLVING AMBIGUITIES

Any normative rules for determining an indenture trustee's pre-default duties inevitably will face ambiguities. Consider how an indenture trustee could try to resolve ambiguities.

A. OBTAIN LEGAL OPINION

An indenture trustee could try to obtain a legal opinion to resolve ambiguities. Section 8.01 of most indentures, entitled "Duties and Responsibility of the Trustee," usually allows indenture trustees acting in good faith to "conclusively rely" on opinions that conform to the indenture's requirements.³³

Furthermore, § 8.02 of most indentures, entitled "Certain Rights of the Trustee," usually allows indenture trustees to consult with counsel and to rely on "the written advice" or "an opinion" of counsel as "full and complete authorization and protection for any action taken, suffered or omitted by it in good faith and in accordance with such advice or opinion."³⁴

B. OBTAIN INVESTOR DIRECTIONS

An indenture trustee also could attempt to resolve ambiguities by trying to obtain formal investor directions, as mentioned.³⁵ If the indenture trustee receives those directions, it should be justified in following them.

C. SEEK JUDICIAL GUIDANCE

In more difficult or sensitive cases, an indenture trustee could seek judicial guidance. Two basic types of judicial procedures—interpleader and declaratory judgment actions—may be appropriate.

33. See, e.g., NAT'L ASS'N OF BOND LAWYERS, MODEL FORM OF TRUST INDENTURE § 8.01(a)(2).

34. *Id.* § 8.02(d).

35. See *supra* note 28 and accompanying text.

Interpleader is a procedure whereby a party with property subject to competing claims may compel the parties asserting those claims to litigate their dispute in a single proceeding.³⁶

An indenture trustee also might request a declaratory judgment to have a court determine its rights prior to taking action that may expose it to liability. Unlike interpleader, however, a declaratory judgment action requires the existence of an “actual controversy.”³⁷

D. EXERCISE COMMON SENSE

Lacking other guidance, an indenture trustee ultimately should rely on common sense. For example, regardless of what the indenture trustee’s duty otherwise should be, the occurrence of a suspicious event should not trigger a duty to investigate occurrences and events that are unrelated to that event. Such an extraneous investigation could significantly reduce trust assets without commensurately benefitting the investors.

Similarly, absent formal investor directions, an indenture trustee should not generally take an action that would be expensive but unlikely to lead to a net favorable outcome—such as investigating whether a bankrupt or clearly insolvent party had breached one or more of its representations and warranties. Even if the indenture trustee could prove such a breach, a damage claim against that party may be unrecoverable.

36. CYCLOPEDIA OF FEDERAL PROCEDURE § 22:1 (3d ed. 2005).

37. Robert J. Coughlin et al., *Rule 22 to Resolve a Catch-22: Defensive Maneuvers for Corporate Trustees Faced with Conflicting Claims*, in NEW DEVELOPMENTS IN SECURITIZATION 2008 777, 783 (2008).