

Bond Case Briefs

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INDENTURE TRUSTEES - SOUTH DAKOTA

Water Works Board of City of Birmingham v. U.S. Bank National Association

United States District Court, D. South Dakota, Southern Division - July 17, 2018 - Slip Copy - 2018 WL 3448347

Plaintiffs purchased \$25 million in bonds. Those bonds were part of a scheme involving a series of sham Native American tribal bonds sold to unsuspecting investors, with the profits redirected to a group of criminal conspirators. U.S. Bank served as Trustee under an Indenture Agreement

Plaintiffs' sued U.S. Bank, alleging breach of contract, breach of the implied covenant of good faith and fair dealing, and negligence. U.S. Bank moved to dismiss.

As to its breach of contract claim, Plaintiffs alleged that U.S. Bank breached its obligations under the Indenture Agreement by failing to disburse the proceeds to the proper person, failing to require proper written instructions from the Issuer, failing to investigate material deficiencies and inconsistencies in the documents, failing to value or cause to be valued the Annuity Investment, and failing to notify the Issuer of breaches of the indenture agreement and potential fraud.

The Court found that a factual question remained as to whether U.S. Bank had indeed carried out its obligations under the Indenture Agreement in good faith.

As to Plaintiff's action for breach of the implied covenant of good faith and fair dealing, the Court found that South Dakota law imposed no restriction on a party's freedom to contract over the implied covenant of good faith and fair dealing. As the parties did in fact contract over such an obligation in the the Indenture Agreements, the Court dismissed Plaintiffs' claim for breach of implied covenant of good faith and fair dealing.

Finally, Plaintiffs alleged that U.S. Bank was negligent in sending the proceeds to a sham entity; failing to ensure the instructions were genuine, signed by the right party, and reasonable and appropriate under the circumstances; failing to conduct an investigation; failing to value the Annuity investment, and failing to notify the Issuer and the Plaintiffs of breaches of the indenture agreement and the possibility of fraud.

"Plaintiffs in this case cite primarily to case law from the state of New York for support in asserting that 'indenture trustees owe note holders an extracontractual duty to perform basic, nondiscretionary, ministerial functions redressable in tort if such a duty is breached.' The caselaw demonstrates that the distinction between an ordinary trustee and an indenture trustee is an important one. 'The leading authorities make clear that, unlike those of an ordinary trustee, the duties of an indenture trustee are generally defined by and limited to the terms of the indenture.'"

"Under New York common law, however, two additional duties are imposed upon an indenture trustee: 1) the duty to avoid conflicts of interest; and 2) the duty to perform basic, nondiscretionary, ministerial duties. However, these Indenture Agreements are not governed by New York common law. They are governed by South Dakota law."

“The Parties have not cited any South Dakota case law providing for additional common law duties for indenture trustees, specifically.”

“Plaintiffs have not yet offered any facts suggesting that the work of an indenture trustee is similar to that of lawyers, veterinarians, doctors, accountants, and architects—professions where South Dakota courts have found an independent duty. However, the Indenture Agreements themselves provide that U.S. Bank as Trustee ‘shall not be answerable for the exercise of any discretion or power under this Indenture or under any Supplemental Indenture, nor for anything whatever in connection with the trust, *except only its own willful misconduct or negligence.*’ Doc. 150-3 at 41 (emphasis added). Although “ ‘this carve-out language’ ... by itself, does not excuse [Plaintiffs] from identifying an independent duty,” see *GSA Home Equity Trust*, 133 F. Supp. 3d at 1224, at this early stage of litigation, the Court does not have enough evidence before it to establish what would be expected of Defendant in the industry, nor what representations were made by Defendant regarding its expertise in this area prior to entering into the Indenture Agreements. Where discovery has not yet been completed and where the Indenture Agreement itself allows for liability in the case of willful misconduct or negligence, the Court cannot say as a matter of law that no independent legal duty exists in this case. Therefore, the Plaintiffs have presented enough plausible facts for their cause of action for negligence to survive this motion to dismiss.”