

Bond Case Briefs

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BONDS - NEW YORK

FMS Bonds, Inc. v. Bank of New York Mellon

United States District Court, S.D. New York - July 28, 2016 - Slip Copy - 2016 WL 4059155

Around 1994, the former General Motors Corporation ("GM") sought to build a sewage disposal facility in Warren, Ohio, and negotiated with the County of Trumbull, Ohio (the "Issuer") regarding the issuance of a series of industrial revenue bonds (the "Bonds") in order to finance the project.

On July 1, 1994, the Issuer and GM entered into a written agreement pursuant to which the Issuer would loan GM proceeds to fund the construction project (the "Loan Agreement"). The proceeds loaned under the Loan Agreement were generated by the offering and sale of the Bonds in the aggregate principal amount of \$2.75 million. The Bonds were issued pursuant to a written Indenture of Trust (the "Indenture"), as executed between the Issuer and an Indenture Trustee (the "Trustee"), Dai-ichi Kango Trust Company of New York ("DKT"). In 1999, DKT was succeeded as Trustee by JPMorgan Chase Bank ("JPMC"). Seven years later, on October 1, 2006, the predecessor to Defendant BNY Mellon would succeed JPMC as Trustee.

Plaintiffs are bondholders owning 92.73% of the Bonds issued, which they acquired in October 2009. They allege that the Loan Agreement and the Indenture "contain frequent reference to the other and were intended to be read together," and that, together, those two agreements "required GM to repay with periodic interest the \$2,750,000 aggregate amount of the Bonds to the Trustee" on behalf of the Issuer and, ultimately, the bondholders.

On January 1, 1999, GM and Delphi Automotive Systems LLC ("Delphi") entered into a written agreement (the "1999 Agreement") under which Delphi assumed GM's obligations to make payments under the Bonds to the Trustee. The 1999 Agreement purported to assign the Loan Agreement in full to Delphi, but the Trustee was not a party to the 1999 Agreement, and Plaintiffs allege that the Trustee never consented to such an assignment, and that neither GM nor Delphi sought to comply with the provision of the Loan Agreement requiring the Trustee to consent to any assignment. Nevertheless, Plaintiffs allege that, upon learning of the 1999 Agreement, the Trustee should have known that it was an "intended third-party beneficiary" of the 1999 Agreement. Critically, upon execution of the 1999 Agreement, Delphi honored its payment obligations to the Trustee for at least the next ten years.

Delphi filed a petition for relief under Chapter 11 of the Bankruptcy Code in 2005. The bar date for creditors to file a proof of claim in the Delphi Bankruptcy was July 31, 2006 (the "Delphi Bar Date"). The Delphi Bankruptcy concluded in August 2009. The Trustee did not file a proof of claim in the bankruptcy case, timely or otherwise. In August 2008, Delphi entered into a Master Restructuring Agreement with GM (the "Delphi-GM MRA"), pursuant to which Delphi "agreed to perform certain of its existing contractual obligations to GM, including paying GM's obligations to the Trustee in respect of the Bonds." The Delphi-GM MRA contained an express "no third-party beneficiary" provision, however, and in any event, Delphi and GM entered into a subsequent agreement pursuant to which Delphi's obligations to GM were resolved and extinguished.

GM filed a petition for relief under Chapter 11 of the Bankruptcy Code in June 2009 (the "GM

Bankruptcy”). The bar date for creditors to file a proof of claim in the GM Bankruptcy was November 30, 2009 (the “GM Bar Date”). The Trustee did not file a proof of claim with respect to the Bonds, and GM’s obligations to the Trustee under the Bonds were not scheduled as GM obligations in GM’s bankruptcy filings.

But the Trustee contended that the Bonds were not listed because, by that point, they were a direct obligation of Delphi’s—indeed, as the Trustee notes, Delphi made an interest payment to the Trustee on July 1, 2009, a payment that, had GM attempted to make it, would have been precluded by the automatic stay then in place due to the GM Bankruptcy.

On July 8, 2009, the Bankruptcy Court approved an Asset Sale Plan (the “New GM Plan”). Neither the New GM Plan nor any other order from the Bankruptcy Court required the new GM to assume any obligation as to the Trustee in respect of the Bonds. At the closing of the GM bankruptcy case, GM’s obligations in respect of the Bonds were discharged and the Bonds thereby rendered worthless.

On January 2, 2010, Delphi failed to make an interest payment due on the Bonds and informed the Trustee that Delphi would not make any further the interest payment because Delphi was obligated “only to the extent that General Motors Corporation is obligated to make such payments,” and since the GM Bankruptcy discharged all obligations GM owed to the Trustee, Delphi no longer had to pay on an underlying GM obligation that no longer existed.

Pursuant to section 8.4 of the Indenture, Plaintiffs executed a Direction & Indemnity Agreement (the “D&I Agreement”) on November 17, 2011. The D&I Agreement instructed the Trustee to seek an order from the Delphi Bankruptcy Court authorizing the Trustee to commence an action against Delphi seeking the outstanding principal and interest due under the Bonds, or in the alternative, if such relief was denied, to file late proofs of claim in the Delphi Bankruptcy (the “Instruction”). Further, pursuant to sections 9.1(l) and (o) of the Indenture, Plaintiffs agreed to indemnify the Trustee “on demand” for any losses, liabilities, costs, and expenses related to the Trustee’s compliance with the Instruction. The indemnity provision specifically covered breaches of fiduciary duty “as a result of relying upon and complying with the Instruction,” but did not cover losses resulting from the Trustee’s “gross negligence or willful misconduct.”

On November 15, 2010, Delphi moved the Bankruptcy Court that adjudicated the Delphi Bankruptcy to enjoin the Trustee from taking any action against Delphi regarding payment on the Bonds. On December 10, 2010, the Bankruptcy Court ruled in Delphi’s favor and enjoined the Trustee from seeking payment from Delphi without prior authorization of the Bankruptcy Court.

Plaintiffs filed this suit against the Trustee on November 30, 2015, ultimately alleging three causes of action: (1) breach of contract (the Indenture) for failure to file a timely proof of claim in the GM Bankruptcy, (2) breach of contract (the Indenture) for failure to file a timely proof of claim in the Delphi Bankruptcy, and (3) breach of fiduciary duty for seeking further indemnification in order to rectify the Trustee’s own mistakes and negligence. Trustee moved to dismiss.

The District Court held that:

- General issues of material fact existed as to whether the Trustee acted prudently in failing to file a timely proof of claim in the GM Bankruptcy, precluding summary judgment;
- Plaintiffs’ breach of contract cause of action for failure to file a timely proof of claim in the Delphi Bankruptcy was time-barred, as the cause of action accrued on the Delphi Bar Date, more than six years prior to this action;
- General issues of material fact existed as to whether the Trustee breached its fiduciary duty by

seeking further indemnification in order to rectify the Trustee's own mistakes and negligence (notwithstanding the the indemnification provision of the D&I Agreement), precluding summary judgment; and

- Plaintiffs could pursue punitive damages, but only as to the breach of fiduciary duty for seeking further indemnification in order to rectify the Trustee's own mistakes and negligence claim.