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TRUST MORTGAGES -- CONSTRUCTION OF NO-ACTION CLAUSE

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TRUST MORTGAGES — CONSTRUCTION OF NO-ACTION CLAUSE — Plaintiff, a trustee under a trust indenture securing two issues of defendant company's bonds, sought to recover a partial summary judgment for interest, premiums, and principal on the series of bonds then due. Defendant company conceded that the sums claimed were overdue and unpaid, but contended that the real right of action on the bonds was vested in the bondholders. The bonds on their face made a reference to the trust indenture for a description of the rights of the holders. The bonds further contained a stipulation that, except as otherwise provided for in the trust indenture, all rights of action on the bonds were "vested exclusively in the trustee." The trust indenture contained a provision that no action was to be maintained by the bondholders unless certain conditions were complied with. *Held*, the bonds gave sufficient notice that all rights of action were vested in the trustee. The trust indenture, to which adequate reference was made, explicitly provided that defendant was to be liable in suits by the trustees on the bonds, and that the bondholders might sue only under certain limited circumstances. *Central Hanover Bank & Trust Co. v. Siemens & Halske Aktiengesellschaft*, (D. C. N. Y. 1936) 15 F. Supp. 927.

In the absence of "no-action" clauses [1] and provisions conferring additional powers on the trustee,[2] the principle that not more than one party shall have a

[1] The provision involved in the principal case, set out in 15 F. Supp. 927 at 928, is typical of the usual restrictive clause. Paraphrased, that clause provided no bondholder might commence suit to collect on any bond unless he had given written notice of default and had tendered adequate security to the trustee against expenses of suit, and unless also a majority of the bondholders had requested the trustees to take action and the trustee had "declined or failed to take such action."

[2] The indenture in the instant case provided that on default the trustee may sue at law to enforce payment of the bonds, and that on commencement of any suit "to

right to sue on any single cause of action governs the judicial apportionment of remedies.[3] Whereas the bondholders as obligees have all the rights of action on the bonds,[4] the trustee sues on the indenture for the protection of the cestuis' interest in the security.[5] The desirability of altering this situation has led to the inclusion of specific restrictive provisions in the trust indenture coupled with a reference in the bonds giving operative effect thereto.[6] The first issue concerns the adequacy of the reference as a notice of the restrictive provisions set out in the indenture. It appears upon careful inspection that whereas the federal courts have sustained exceedingly indefinite language as sufficient notice,[7] explicit references have been deemed insufficient in the states which follow the view set out in the decisions of the lower courts of New York.[8] The basis for this split of authority is the fundamental difference in legal philosophy with respect to the way these courts look upon the inevitable conflict between minority and majority bondholders. Reasons [9] such as the destruction of negotiability have been advanced for strictly construing these "no-action" clauses.[10] But the real rationale is that the courts will not sacrifice the individual bondholder's inter-

obtain judgment for the principal and interest on the bonds," or for both, the defendants would consent to entry of judgment for principal, premium, interest, cost, expenses and compensation of the trustee, "and for such other relief as the Trustee may be entitled to hereunder."

[3] See 27 COL. L. REV. 443 at 444 (1927).

[4] See Fitkin v. Century Oil Co., (C. C. A. 2d, 1926) 16 F. (2d) 22 at 24: "Suits must be in the hands of the real parties in interest. The only exception to this rule is where a trustee of an express trust may maintain an action in his own name on behalf of the beneficiaries. . . . A trustee under a mortgage comes within this exception as to the security but not as to the bonds or notes, for they are not payable to the trustee." Also see Mackay v. Randolph Macon Coal Co., (C. C. A. 8th, 1910) 178 F. 881; and In re A. J. Ellis, Inc., (D. C. N. J. 1917) 242 F. 156, to the same effect.

[5] See note 4, supra.

[6] See 27 COL. L. REV. 443 at 447 (1927).

[7] See 33 MICH. L. REV. 604 at 607 (1935). See St. Louis-Carterville Coal Co. v. Southern Coal and Mining Co., 194 Mo. App. 598, 186 S. W. 1152 (1916).

[8] See the reference provision in Brown v. Michigan Ry., 124 Misc. 630, 207 N. Y. S. 630 (1924). Also, see Oswianza v. Wengler and Mandell, 358 Ill. 302, 193 N. E. 123 (1935). In 2 JONES, BONDS AND BOND SECURITIES, 4th ed., § 811 (1935), it is pointed out that the cases may be reconsidered according to the language used in the incorporation clause.

[9] (1) There is a feeling on the part of the courts that the corporation is misleading the bondholders by first putting in an absolute unqualified promise and then following with the incorporation clause, which they feel must escape the bondholders' attention. See Brown v. Michigan Ry., 124 Misc. 630, 207 N. Y. S. 630 (1924).

(2) It is suggested in 83 UNIV. PA. L. REV. 679 at 680 (1935) that the depression was a factor that led courts to grasp at straws in their attempts to aid suits by bona fide holders.

[10] See 2 JONES, BONDS AND BOND SECURITIES, 4th ed., § 676 et seq. (1935); 33 MICH. L. REV. 604 at 606 (1935); 33 MICH. L. REV. 1082 at 1084 (1935) contains a complete list of incorporation by reference clauses. Also see 41 YALE L. J. 312 at 313 (1931) which suggests that there is legislation in various states which makes all corporate bonds negotiable regardless of the Negotiable Instruments Law.

ests to the benefit of the common security. On the other hand, the majority of courts [11] stress the necessity of protecting the group from capricious actions on the part of ill-advised individual bondholders.[12] It is highly expedient in this day of widely scattered holdings of corporate securities that the bondholders be represented by the trustees.[13] The second issue of this case lies in the construction to be placed on the indenture provisions restricting action on the part of the bondholders.[14] The court in the principal case decided the effect, not of these restrictive provisions on the bondholders' rights, but of the indenture provisions on the trustees' rights. The court feels that the rights of the trustee may be additional to rights of the bondholder.[15] But in the event the apportionment doctrine [16] is too firmly entrenched by previous decisions, rights of bondholders and trustees must be held mutually exclusive. As a result of such a rule, the same issues arise in construing the effect of these "no-action" clauses as did in connection with the incorporation provisions.[17] Those reasons of policy and

[11] Federal cases that have adopted this rule are Home Mtg. Co. v. Ramsey, (C. C. A. 4th, 1931) 49 F. (2d) 738; Harvey v. Illinois Power & Light Corp., (D. C. Ill. 1933) 3 F. Supp. 489; Craig v. Consolidated Cement Corp., (C. C. A. 10th, 1934) 69 F. (2d) 613; Allan v. Moline Plow Co., (C. C. A. 8th, 1926) 14 F. (2d) 912; Crosthwaite v. Moline Plow Co., (D. C. N. Y. 1924) 298 F. 466. Courts in other jurisdictions that have adopted this rule are St. Louis-Carterville Coal Co. v. Southern Coal & Mining Co., 194 Mo. App. 598, 186 S. W. 1152 (1916); State v. Comer, 176 Wash. 257, 28 P. (2d) 1027 (1934); Moody v. Pacific S. S. Co., 174 Wash. 256, 24 P. (2d) 609 (1933); Thayer v. South Side Foundry & Machine Works, 112 W. Va. 134, 163 S. E. 821 (1932). *Contra*: Some of the New York cases are Nievel Realty Corp. v. Prudence Bonds Corp., 151 Misc. 737, 271 N. Y. S. 209 (1934); Cunningham v. Pressed Steel Car Co., 238 App. Div. 624, 265 N. Y. S. 256 (1933); Berman v. Consolidated Nevada-Utah Corp., 132 Misc. 462, 230 N. Y. S. 421 (1928). Courts in other jurisdictions that have adopted the New York rule are: Thorpe v. Mindeman, 123 Wis. 149, 101 N. W. 417 (1884); Guilford v. Minneapolis, S. Ste. M. & A. R. R., 48 Minn. 560, 51 N. W. 658 (1892); Paepcke v. Paine, 253 Mich. 636, 235 N. W. 871 (1931); Sturgis Nat. Bank v. Harris Trust & Savings Bank, 351 Ill. 465, 184 N. E. 589 (1933); Pflueger v. Broadway Trust & Savings Bank, 351 Ill. 170, 184 N. E. 318 (1932).

[12] See TRACY, CORPORATE FORECLOSURES, RECEIVERSHIPS AND REORGANIZATIONS, § 6 (1929); 2 JONES, BONDS AND BOND SECURITIES, § 811 (1935); 1 QUINDRY, BONDS AND BONDHOLDERS, § 137 (1934). In the event that the circumstances in favor of intervention are unusually strong, no court will refuse to allow a bondholder to intervene, regardless of the language of the provisions.

[13] See TRACY, CORPORATE FORECLOSURES, RECEIVERSHIPS AND REORGANIZATIONS, § 6 (1929); 41 YALE L. J. 312 (1931).

[14] See 33 MICH. L. REV. 604 at 608 et seq. (1935); 27 COL. L. REV. 579 at 580 et seq. (1927). Recognizing the wisdom of such provisions, the courts have generally upheld these provisions. However, many provisions whose language is not as explicit have been limited in scope to actions on the security only. See Fleming v. Fairmont & M. R. R., 72 W. Va. 835, 79 S. E. 826 (1913); Brown v. Michigan R. R., 124 Misc. 630, 207 N. Y. S. 630 (1924).

[15] See In re United Cigar Stores Co., (C. C. A. 2d, 1934) 68 F. (2d) 895; In re International Match Corp., (D. C. N. Y. 1932) 3 F. Supp. 445.

[16] See note 3, supra.

[17] See note 12, supra.

fairness presented in construing the reference clause as adequate notice demand that these "no-action" provisions be given binding effect.

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