

NOTES

CONFLICT OF INTERESTS BETWEEN INDENTURE TRUSTEE AND BONDHOLDERS: AVOIDANCE OF "NO ACTION" CLAUSES PROHIBITING BONDHOLDER SUITS AGAINST THE OBLIGOR*

CORPORATIONS issuing bonds frequently insert "no action" clauses in the underlying indenture agreement with bondholders.¹ Under the "no action" clause, bondholders' rights to sue the corporate debtor are vested in an independent trustee;² bondholders may not sue the corporation unless the

*Rabinowitz v. Kaiser-Frazer Corp.—Misc.—, 111 N.Y.S.2d 539 (Sup. Ct. 1952).

1. Mr. Gerald J. O'Leary, Assistant Director of the Division of Corporate Finance of the S.E.C. stated that "although no attempt has been made to keep a record of [no action clauses] . . . it is a rare indenture which does not include them." Communication to the YALE LAW JOURNAL, Feb. 24, 1953, in Yale Law Library.

2. The "no action" clause has been upheld on the theory that bondholders have by agreement among themselves imposed a condition precedent to the exercise of the right of any individual bondholder to sue. *Dietzel v. Anger*, 8 Cal.2d 373, 376, 65 P.2d 803, 805 (1937). *Contra: In re A. J. Ellis*, 242 Fed. 156, 160 (D.N.J. 1917) (mere right to sue cannot be vested in one who has no legal or equitable interest in claim sued upon). Courts may uphold the clause even where the obligor is trustee, controls the trustee, or is under common control with the trustee, e.g., *Freed v. Marburger*, 353 Mo. 1146, 186 S.W.2d 584, 587-8 (1945). *But cf.*, *Townsend v. Milaca Motors Co.*, 194 Minn. 426, 260 N.W. 525 (1935). The trustee is usually completely independent of the obligor either because of legislative requirements, see text at notes 44, 54, *infra*, or because courts may otherwise be hostile toward the obligor in construing the clause. For general discussion of the theory of "no action" clauses, see STEVENS, *CORPORATIONS* 922-35 (2d ed. 1949); Posner, *The Trustee and the Trust Indenture: A Further Study*, 46 YALE L.J. 737 (1937).

In the absence of specific provisions, "no action" clauses are generally interpreted as prohibiting only actions on the security itself, since the right to sue is essential to negotiability. See, e.g., *Oswianza v. Wengler & Meindel*, 358 Ill. 302, 305, 193 N.E. 123, 124 (1934); *Bullock v. Thermoid Co.*, 114 N.J.L. 205, 176 Atl. 596 (1935); *Miller v. Corvallis Hospital Ass'n*, 182 Ore. 18, 185 P.2d 549 (1947). However, terms on the face of the bonds and in the indenture may prohibit suits by the bondholders even on the matured obligation. Note, 33 MICH. L. REV. 1082 (1935). Since the passage of the Trust Indenture Act of 1939, no restrictions in the indenture are permitted upon the rights of bondholders to sue for their interest and principal when due unless holders of at least seventy-five percent in principal amount of indenture securities consent to a postponement of the due date of the interests payments. TRUST INDENTURE ACT § 316(a) (2), 53 STAT. 1172 (1939), 15 U.S.C. § 77ppp(a) (2) (1946). See LOSS, *SECURITY REGULATIONS* 434-5 (1951); Goodbar, *Bond Trustees as Statutory Trustees*, 28 B.U.L. REV. 399, 418-21 (1948). *But cf.* *Haas v. Palace Hotel Co. of San Francisco*, 101 Cal. App.2d 108, 224 P.2d 783 (1950), *cert. denied*, 342 U.S. 813 (1951). Also see SEN. REP. No. 248, 76th Cong., 1st Sess. 26-7 (1939).

trustee fails to act³ after holders of a specified amount of indenture securities⁴ make written request upon the trustee for action and offer the trustee indemnity for its expenses.⁵ At the same time, the trustee is obligated, at threat of removal or personal liability,⁶ to police the bondholders' interests: the indenture may impose affirmative duties on the trustee such as authentication of the bonds⁷ or recordation of mortgages;⁸ and the trustee is expected to take action on its own initiative as, for example, in obtaining payment for the bondholders where the debtor defaults in interest payments or on the matured obligation.⁹ Purposes of the "no action" clause are manifold. Since the trustee represents the bondholders as a class, whatever steps are taken in dealing with the debtor will presumably be in the interest of all the bondholders.¹⁰ Thus the "no action" clause precludes specious suits instigated by attorneys who hope to receive lucrative fees from a true class action for all bondholders.¹¹ And the debtor corporation is insulated from unwise court action by a few panicky bondholders,¹² or from a possible multiplicity of suits

3. *King v. Finch*, 43 Cal. App.2d 831, 111 P.2d 711 (1941); *Thomason v. Krasa*, 292 Ill. App. 174, 10 N.E.2d 710 (1937). *Cf.* *Holl v. Levin*, 273 Ill. App. 514 (1934); *Pacific States Sav. & Loan Co. v. Hollywood Knickerbocker, Inc.*, 11 Cal. App.2d 56, 52 P.2d 1014 (1935).

4. Section 316(a) (1) of The Trust Indenture Act places a limit of fifty-one percent on the holders in principal amount of indenture securities required to request the trustee to act. 53 STAT. 1172 (1939), 15 U.S.C. § 77ppp (1946). In issues not covered by this Act, there seems to be no limit on the percentage required. *E.g.*, *Goodjon v. United Bond & Bldg. Corp.*, 226 App. Div. 137, 234 N.Y. Supp. 522 (4th Dep't 1929) (75%); *Frobisher v. Tudor Corp.*, 114 N.J. Eq. 470, 168 Atl. 855 (1933) (51%). However, the great majority of these clauses have a 25 percent limit. See cases cited 108 A.L.R. 88 (1937), 174 A.L.R. 436 (1948).

5. See 2 BOGERT, TRUSTS & TRUSTEES § 246 (1953).

6. See text at notes 56, 57 *infra*.

7. Authentication of bonds merely attests to their genuineness but not to the priority or quality of the security. Thus no burden of investigation is placed upon the trustee. *Continental Corp. v. First National Bank of Westfield*, 285 Mass. 419, 189 N.E. 184 (1934). However, trustee is liable for negligent, unauthorized authentication. *Doyle v. Chatham & Phenix National Bank*, 253 N.Y. 369, 171 N.E. 574 (1930).

8. *Benton v. Safe Deposit Bank*, 134 Misc. 727, 236 N.Y. Supp. 36, *aff'd without opinion*, 218 App. Div. 767, 218 N.Y. Supp. 701 (1st Dep't 1926). However, the trustee is not liable for a failure to record unless expressly authorized to do so by the indenture. *Bell v. Title Trust & Guarantee Co.*, 292 Pa. 228, 140 Atl. 900 (1928).

9. *E.g.*, *Driscoll v. Fitch*, 52 F. Supp. 869 (S.D.N.Y. 1943); *Smith v. Guaranty Trust Co.*, 320 Pa. 412, 183 Atl. 47 (1936); *Posner, The Trustee and the Trust Indenture: A Further Study*, 46 YALE L.J. 737, 765-6 (1937).

10. See *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 538, 167 So. 378, 383 (1936).

11. *Home Mortgage Co. v. Ramsey*, 49 F.2d 738, 744 (4th Cir. 1931).

12. *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 539, 167 So. 378, 384 (1936); *Haas v. Palace Hotel Co. of San Francisco*, 101 Cal. App.2d 108, 121, 224 P.2d 783, 790 (1950), *cert. denied*, 342 U.S. 137 (1951); *Note*, 27 COL. L. REV. 443, 579 (1927).

engendered by individual bondholders' actions.¹³ Finally, since responsibility for enforcing the indenture rests with the independent trustee, the need for individual bondholder's vigilance is reduced.

Despite the "no action" clause, courts occasionally permit bondholders to sue the debtor corporation directly without complying with the provisions of the clause. Situations may arise where it is obvious that the trustee, even if requested, will not or cannot represent the bondholders. The trustee may, for example, be acting in bad faith¹⁴ or may be outside the country.¹⁵ In other cases, especially where bonds are negotiable on their face, it may be difficult or even impossible for a bondholder with a legitimate complaint to ascertain, in time, the names and addresses of other present bondholders who might be willing to join in a request for trustee action.¹⁶ In any event, in occasional circumstances, insistence on literal compliance with the "no action"

13. See *Rodman v. Richfield Oil Co.*, 66 F.2d 244, 249 (9th Cir. 1933); *Dietzel v. Anger*, 8 Cal.2d 373, 376, 65 P.2d 803, 805 (1937); *Steffen & Russell, The Negotiability of Corporate Bonds*, 41 YALE L.J. 799, 811 (1932).

14. *E.g.*, *First Trust Co. of Lincoln v. Ricketts*, 75 F.2d 309 (8th Cir. 1934) (bad faith in failing to notify bondholders that obligor had failed and had deced property to trustee); *Brown v. Denver Omnibus & Cab Co.*, 254 Fed. 560 (8th Cir. 1918) (trustee and majority bondholders conspiring against minority); *O'Beirne v. Allegheny & K.R.R.*, 151 N.Y. 372, 45 N.E. 873 (1897) (unreasonable refusal to sue); *Campbell v. Hudson & Manhattan R.R.*, 277 App. Div. 731, 102 N.Y.S.2d 878 (1st Dep't 1951) (trustee's bad faith in abdicating its functions); *Birn v. Childs Co.*, 37 N.Y.S.2d 689 (Sup. Ct. 1942) (bad faith in refusing to sue debtor based on an analogy of a stockholder's derivative action); *Buel v. Baltimore & O.S.W. Ry.*, 24 Misc. 646, 53 N.Y. Supp. 749 (Sup. Ct. 1898) (trustee aiding liens junior to the issue under whose indenture it is trustee); *First National Bank v. Brynwood Land Co.*, 245 Wis. 610, 15 N.W.2d 840 (1944) (trustee owner of majority of bonds and stocks of obligor and was conspiring against the minority).

15. *Ettlinger v. Schumacher*, 142 N.Y. 189, 36 N.E. 1055 (1894) (trustee abroad and probably insane); but *cf.*, *Moore v. Tumwater Paper Mills Co.*, 181 Wash. 45, 42 P.2d 29, *cert. denied*, 296 U.S. 597 (1935) (trustee not licensed in that state and license was a condition precedent to legal action).

Bondholders may also be permitted to bring a direct suit where the trustee cannot take action until requested by the holders of a certain percentage of the securities, and because of the conspiracy or control by a larger group, the minority are unable to meet the condition precedent in order to request action by the trustee. *See, Weir v. Bauer*, 75 Utah 498, 519, 286 Pac. 936, 944 (1930).

16. See *Birn v. Childs Co.*, 37 N.Y.S.2d 689, 696 (Sup. Ct. 1942), in which the court permitted evidence to be introduced that since the bonds were payable to the bearer, it was impossible to locate their owners. The bondholder's plight is increased by "ostrich clauses," under which the trustee can conclusively presume that there has been no default until informed by holders of a specified percentage of bonds. However, bondholders are assisted by § 312 of the Trust Indenture Act which provides that the obligor shall furnish the trustee with the names and addresses of the bondholders at six month intervals or upon the trustee's request. The trustee must afford access to these lists to any three individuals who have been bondholders for more than six months. 53 STAT. 1164 (1939), 15 U.S.C. § 77111 (1946). *See SEN. REP. NO. 248, 76th Cong., 1st Sess. 6, 23 (1939); Loss, op. cit. supra note 2, at 431.*

clause might completely paralyze bondholders whose interests are being harmed. Consequently, courts have sought to protect bondholders by allowing them to sue the corporation directly. In some cases the action against the corporation has been sustained by a strict construction of the indenture agreement in order to limit the coverage of the "no action" clause.¹⁷ But even if the clause is found technically applicable, courts still permit direct suits in the form of a class action in the right of the trustee if the trustee is acting fraudulently or in bad faith,¹⁸ or in some situations when the trustee

17. Where the bonds and the trust agreement were prepared by the issuer, any doubtful language therein is interpreted strictly against the issuer. *Perry v. Darlington Fireproofing Co.*, 76 Ohio App. 101, 63 N.E.2d 222 (1945); *Miller v. Corvallis General Hospital Ass'n*, 182 Ore. 18, 33, 185 P.2d 549, 555 (1947). At least one court has expressed the view that an action to protect the security by way of an injunction is outside the "no action" clause, since the equitable remedy amounts neither to the collection of the bonds nor the enforcement of the securing deed. Also outside the scope of the clauses are suits seeking damage for unlawful diversion or threatened diversion of the mortgaged property or its income, for equitable relief to conserve the security for ultimate redemption of the bonds, to restore the value of impairment to the security, and to remove the trustee for breach of trust. *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 535-6, 167 So. 378, 382-3 (1936). *But cf. Dietzel v. Anger*, 8 Cal.2d 373 377, 65 P.2d 803, 805 (1937) (denying right of bondholders to enforce stockholder's liability).

Moreover, certain terms in the indenture may be unenforceable unless notice is given the bondholders on the face of the bonds as to the restrictive provisions. Two major states, New York and Illinois, frequently permit direct suit by strict requirements of adequate notice to the bondholders on the face of the bonds in regard to restrictions on bondholder rights of action contained in the indenture. *E.g.*, *Oswianzo v. Wengler & Mardell*, 358 Ill. 302, 193 N.E. 123 (1934) (permitting action at law upon the bonds); *Medivin v. 11 West 42nd Street*, 261 App. Div. 721, 27 N.Y.S.2d 551, *appeal denied*, 262 App. Div. 921, 29 N.Y.S.2d 910 (3d Dep't 1941) (action on interest coupons); *Van Wormer v. Two Park Ave. Bldg.*, 65 N.Y.S.2d 529 (Sup. Ct. 1946), *aff'd without opinion*, 271 App. Div. 964, 68 N.Y.S.2d 591 (1st Dep't 1947) (suit on principal obligation arising under plan of reorganization and not under the indenture); *Regan v. Prudence Co.*, 17 N.Y.S.2d 422 (Sup. Ct. 1939) (permitting action against directors of issuer for mismanagement where bonds have matured); *Deutsch v. Gutehoffnungshutte, Aktienverein Fur Bergbau und Huttenbetrieb*, 168 Misc. 872, 6 N.Y.S.2d 319 (Sup. Ct. 1938) (breach of covenant on face of bonds). However, federal and many state courts have liberally used the doctrine of constructive notice to uphold terms in the indenture. *E.g.*, *Dunham v. Omaha & C.B. Street R.R.*, 106 F.2d 1 (2d Cir.), *reversing* 25 F. Supp. 287 (S.D.N.Y. 1938), *cert. denied*, 309 U.S. 661 (1940); *Collier v. E. C. Miller Cedar Lumber Co.*, 13 Wash.2d 201, 124 P.2d 555 (1942). However, federal interpretation and remedies must now conform to those of the states. *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938); *York v. Guaranty Trust Co.*, 326 U.S. 99 (1944).

Individual bondholders may be barred from a suit on the matured obligation by statutes in some jurisdictions which allow only a foreclosure action unless the security has become valueless. This action must be brought by the trustees or by a representative class action. *Haas v. Pacific Hotel Co. of San Francisco*, 101 Cal. App.2d 783, 224 P.2d 783, *cert. denied*, 342 U.S. 137 (1951); *Fitkin v. Century Oil Co.*, 16 F.2d 22 (2d Cir. 1926); also see 27 COL. L. REV. 443, 449 (1927).

18. See note 14 *supra*.

has an "adverse interest," *i.e.*, one that conflicts with its responsibilities under the indenture.¹⁹

Recently, in *Rabinowitz v. Kaiser-Frazer Corp.*,²⁰ a bondholder sued the corporation directly and attempted to circumvent a "no action" clause with the claim that the trustee had an adverse interest. The original issuer of the bonds, Graham-Paige, had agreed to make annual payments of twenty-five percent of its net profits into a sinking fund for the bondholders. To protect the bondholders in the event of a sale of all or a substantial part of Graham-Paige's assets, the indenture required the purchaser of such assets to assume all covenants and to execute an indenture satisfactory to the trustee. Kaiser-Frazer purchased the automotive assets of Graham-Paige and promised to pay the interest on the bonds as it accrued and the debt upon maturity. But the purchaser refused to assume the sinking fund obligation. The trustee, Bank of America, assented to this arrangement, and subsequently made a loan to Kaiser-Frazer. This loan was to be amortized by twenty-five percent of Kaiser-Frazer's net profits. The Graham-Paige indenture agreement contained a "no action" clause, barring bondholder suits against the debtor unless bondholders representing twenty-five percent of the amount of the issue requested the trustee to act and the trustee failed to do so. The owner of \$10,000 worth of bonds representing one-eighth of one percent of the outstanding bonds brought a true class action for all bondholders against Kaiser-Frazer in order to obtain specific performance of the covenant to maintain the sinking fund. Defendant moved to dismiss on grounds that the "no action" clause barred suit and the bondholder's proper remedy, if any, was to proceed for a substitute trustee. The trustee, Bank of America, was not joined as party defendant since it was outside the jurisdiction.²¹

The New York Supreme Court upheld the complaint against Kaiser-Frazer. It pointed out that Bank of America, as trustee, "was charged with the duty of requiring Kaiser-Frazer to assume the sinking fund."²² By virtue of the trustee's loans to Kaiser-Frazer, the trustee had assumed a conflicting status of creditor and, in self-interest because of its creditor status, had assented to Kaiser-Frazer's non-maintenance of the sinking fund. On these facts the court found that it would be futile to request Bank of America to act, and wasteful to insist on a suit for a new trustee. Since the bondholders' interests

19. *Brown v. Denver Omnibus & Cab Co.*, 254 Fed. 560 (8th Cir. 1910) (trustee being paid its debts which are junior to the issue for which it is trustee); *Cochran v. Pittsburgh S. & N.R.R.*, 150 Fed. 682 (C.C.W.D.N.Y. 1907) (trustee both holds bonds and represents bondholders under another issue); *Myers v. American National Bank & Trust Co.*, 277 Ill. App. 378 (1934) (interlocking officers and consenting to payment of junior liens); *Townsend v. Milaca Motors Co.*, 194 Minn. 426, 250 N.W. 525 (1935). For a general discussion see: *Hearings before Subcommittee of Committee On Banking and Currency on S. 477*, 76th Cong., 1st Sess. 180-3 (1939).

20. —Misc.—, 111 N.Y.S.2d 539 (Sup. Ct. 1952).

21. The facts of the case appear *id.* at 540-4.

22. *Id.* at 546.

were impaired, the trustee "incompetent" to act, and the case already before the court, the trustee's adverse interest was held to justify the direct suit against the debtor despite the presence of the "no action" clause.²³ However, the holding as to what constituted the adverse interest of the trustee is not entirely clear. On the one hand, the opinion may be read to indicate that a trustee who is a creditor of the corporate debtor thereby automatically acquires interests that conflict with those of the bondholders.²⁴ Alternatively, the court states that it was Bank of America's consent to non-assumption of the sinking fund, against the background of the loan, that placed it in a position antagonistic to the bondholders' interests.²⁵

In so far as the finding of adverse interest rested solely upon the trustee's creditor status, the *Rabinowitz* holding substantially broadens the adverse interest exception to the operation of the "no action" clause. A trustee's loan to a corporate debtor has never, in itself, justified a direct suit against the corporate debtor.²⁶ Any adverse interest thus created has served to justify the bondholder suit only where the trustee's actions were found unreasonable²⁷ and where the bondholders were in danger of imminent harm.²⁸ Never-

23. *Id.* at 546-7.

24. "[A]s a bank creditor and in its self-interest Bank of America gave its express written consent . . . whereby Kaiser-Frazer . . . did not assume the obligations of the Sinking Fund. . ." *Id.* at 546. But see note 49 *infra*.

25. "[W]hen Bank of America consented to Kaiser-Frazer's declination of assuming any of the provisions of the Indenture, including the sinking fund provisions, it placed itself in a position which was antagonistic to . . . the interests of the debenture holders." *Ibid.*

26. *Shaw v. Railroad Co.*, 100 U.S. 605, 613 (1879) (direct action refused: some trustees owned bonds of the issue represented and another trustee was a general creditor); *Rodman v. Richfield Oil Co.*, 66 F.2d 244, 251 (9th Cir. 1933) (direct action in form of intervention refused: trustee a general creditor). In all other cases where direct action was permitted and the trustee was a creditor of the obligor, factors other than the creditor status apparently influenced the result. See *e.g.*, note 27 *infra*.

27. Where the actions of the trustee were reasonable, even though it was a creditor of the obligor, courts have not permitted direct actions. *Shaw v. Railroad Co.*, 100 U.S. 605 (1879); *Rodman v. Richfield Oil Co.*, 66 F.2d 244 (9th Cir. 1933). In cases where the trustee has been a creditor of the obligor, direct action has been permitted only where there were additional adverse interests or the facts indicated bad faith. *E.g.*, *Brown v. Denver Omnibus & Cab Co.*, 254 Fed. 560 (8th Cir. 1918) (majority bondholders paying off junior debts to trustee and themselves); *Cochran v. Pittsburg S. & N.R.R.*, 150 Fed. 682 (C.C.W.D.N.Y. 1907) (trustee under more than one indenture); *First Wisconsin Nat. Bank v. Brynwood Land Co.*, 245 Wis. 610, 15 N.W.2d 840 (1944) (trustee conspiring with majority bondholders).

None of the cases that the New York Court relies upon deals with the specific problem of the trustee being a creditor of the obligor. One explanation is undoubtedly the paucity of cases dealing with this precise point. Many more cases deal with the issue of the trustee's liability or whether the trustee should receive preferential treatment as a result of its creditor status. However, even here there must be some indication of unreasonable actions or bad faith. *E.g.*, *York v. Guaranty Trust Co.*, 143 F.2d 503 (2d Cir.), *rev'd on other grounds*, 326 U.S. 99 (1944) (trustee's unreasonable delay in not taking action to

theless, despite the fact that neither a trustee loan nor assent to non-maintenance of a sinking fund have ever been considered unreasonable *per se*,²⁹ the New York court made no inquiry—not even a pretense of investigation—into the reasonableness of the trustee's actions. And, presumably, the corporate debtor had no opportunity to invoke the "no action" clause by offering proof that all transactions between the trustee and itself were, at least on their face, reasonable. At the same time, there was no evidence indicating that harm was imminent—ample time seemed available for the bondholders to make appropriate request upon the trustee for action, or to bring suit for a substitute trustee.³⁰

prevent further impairment of the security); *Dunn v. Reading Trust*, 121 F.2d 854 (3d Cir. 1941) (loans in form of interest payments inducing bondholders to believe their security was adequate); *First Trust Co. of Lincoln v. Ricketts*, 75 F.2d 309 (8th Cir. 1934) (trustee, as creditor, purchases property at foreclosure sale instituted by itself as trustee); *Marshall v. Lovell*, 19 F.2d 751 (8th Cir. 1927) (one of the trustees received a secret profit for securing a ratification of an agreement favorable to the obligor); *Marshall & Hsley Bank v. Guarantee Inv. Co.*, 213 Wis. 415, 250 N.W. 862 (1933) (failure to notify bondholders of a default); *Hazzard v. Chase National Bank*, 159 Misc. 57, 287 N.Y. Supp. 541 (Sup. Ct. 1936) (dictum: loans plus accepting substitution of securities of less value as collateral under the indenture). *But cf.* *Anderson v. Pennsylvania Hotel Co.*, 56 F.2d 980 (5th Cir. 1932).

28. See *e.g.*, *Buel v. Baltimore & O.S.W. Ry.*, 24 Misc. 646, 53 N.Y. Supp. 749 (Sup. Ct. 1898) (continuous diversion of net earnings to junior lienors); *Cochran v. Pittsburg S. & N.R.R.*, 150 Fed. 683 (C.C.W.D.N.Y. 1907) (foreclosure imperative remedy and trustee does not foreclose); *First Wisconsin Nat. Bank v. Brynwood Land Co.*, 245 Wis. 610, 15 N.W.2d 840 (1944) (same); *Townsend v. Milaca Motors Co.*, 194 Minn. 426, 260 N.W. 525 (1935) (same). See *York v. Guaranty Trust Co.*, 143 F.2d 503 (2d Cir.), *rev'd on other grounds*, 326 U.S. 99 (1944) (trustee used its position to better its creditor status and took no affirmative steps to protect bondholders).

The danger that a trustee will use its position to better its standing as a creditor has been greatly mitigated by § 311 of the Trust Indenture Act, which prevents a trustee from improving its own creditor position within four months prior to a default in principal or interest under the indenture. If its creditor standing has been improved, the trustee must distribute the proceeds ratably between itself and the bondholders to the extent of the unsecured portion of the bondholders' claim. 53 STAT. 1161 (1939), 15 U.S.C. § 7711k (1946). Minor credit transactions such as discounting notes are exempted by this section. See *Loss, op. cit. supra* note 2, at 430-1; *Hearings before Subcommittee of Committee on Banking and Currency on S. 2344*, 75th Cong., 1st Sess. 61 (1937); SEN. REP. No. 248, 76th Cong., 1st Sess. 23 (1939).

29. Direct action has not been permitted in New York for breach of a covenant to maintain a sinking fund. *E.g.*, *Relmar Holding Co. v. Paramount Public Corp.*, 147 Misc. 824, 263 N.Y. Supp. 776 (Sup. Ct.), *aff'd without opinion*, 237 App. Div. 870, 261 N.Y. Supp. 959 (1st Dep't 1933); *Krause v. Lehigh Valley Coal Co.*, 172 Misc. 2, 14 N.Y.S.2d 206 (Mun. Ct. 1939). See also, *Block v. Mansfield Min. & Smelting Co.*, 23 F. Supp. 700 (E.D.N.Y. 1938); *Goldstein v. Childs Co.*, 264 App. Div. 793, 35 N.Y.S.2d 204 (1st Dep't 1942). *But cf.* *Barnes v. United Steel Workers Corp.*, 11 N.Y.S.2d 161 (Sup. Ct. 1939). Trustee's loans to an obligor are not unreasonable *per se*. See note 27 *supra*.

30. The New York court rested its opinion on cases involving foreclosure actions. However, this is merely another illustration of the imminent harm rationale. Courts in

Conceivably, however, the case may fall into an adverse interest category distinguishable from the cases above. When a trustee is placed in a position in which it must inevitably harm, by any action, one of the interests it represents, courts have applied the adverse interest theory without a showing of unreasonableness or imminent harm. Thus, for example, where a trustee represented several classes of bondholders under different indentures executed by the same obligor, a direct bondholder suit against the debtor was permitted since the trustee could take no action without favoring one class and thereby breaching its obligations to others.³¹ In *Rabinowitz*, the court may have felt the situation was analogous. From the contemporaneousness of the loan and the trustee's assent to non-maintenance of the sinking fund, the court apparently inferred that the assent was part of the bargain in which the loan was obtained.³² And, if the assent were a condition of obtaining the loan, the trustee could not act without injuring either itself or the bondholders. Even here, however, the holding in *Rabinowitz* is an extension of prior case law. Previously, except where the obligor was also trustee,³³ similar applications of the adverse interest theory without a showing of unreasonableness or imminent harm have all concerned a trustee who was trustee for two or more groups whose interests conflicted; but where the conflict was between bondholders and the trustee's own self-interest, courts did not use an adverse interest theory. Rather they permitted evasion of the "no action" clause only upon a showing of bad faith or fraud.³⁴ This latter type of justification for direct suit against the corporate debtor, in contrast to the adverse interest

the "foreclosure" type of action assume that (1) the trustee's interests are sufficiently adverse so that it will not be able to act in the best interests of all the bondholders, and, (2) the *only* remedy which will protect bondholders' interests is foreclosure. Since this is the only remedy, direct action by bondholders is appropriate since it makes no difference who institutes the proceedings. See foreclosure cases cited note 28 *supra*. But even here some courts may insist on the trustee's removal rather than foreclosure. *E.g.*, *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 167 So. 378 (1936).

However, in the instant case there appears to be no foundation for the imminent harm rationale. There is some evidence that at the time that this action was instituted the trustee had ceased to be a creditor of Kaiser-Frazer. *MOODY'S INDUSTRIALS* 1386-8 (1950). Therefore, since the trustee no longer has an adverse interest, an assumption of continuing imminent harm is unwarranted. There is no reason why, if the claims of the bondholders were reasonable, the trustee would not act.

31. *Farmers' Loan & Trust Co. v. Northern Pac. R.R.*, 66 Fed. 169 (E.D. Wis. 1895); *Cochran v. Pittsburg S. & N.R.R.*, 150 Fed. 682 (C.C.W.D.N.Y. 1907); *Myers v. North American National Bank & Trust Co.*, 277 Ill. App. 378 (1934); see *Hearings before Subcommittee of Committee on Banking and Currency on S. 2344*, 75th Cong., 1st Sess. 25-6 (1937).

32. See note 25 *supra*.

33. *E.g.*, *Townsend v. Milaca Motor Co.*, 194 Minn. 423, 260 N.W. 525 (1935). *Cf.* *Fried v. Marburger*, 353 Mo. 1146, 186 S.W.2d 584 (1945).

34. See cases cited note 27 *supra* (trustee a creditor); cases cited note 19 *supra* (other adverse interests).

rationale, dispensed with the prerequisite of imminent harm but required an even more stringent investigation into the reasonableness of the trustee's actions.³⁵

The facts of the *Rabinowitz* case clearly indicate how the New York adverse interest doctrine may now extend to situations in which no factual conflict of interests exists. While it is true that the transactions involved in the decision *may* have created a situation in which the trustee's interest was inimical to those of the bondholders whom it represented,³⁶ whether the conflict of interests did in fact exist can only be determined by examining the circumstances surrounding the transactions. If, for example, Kaiser-Frazer did demand as a condition precedent to its borrowing from the Bank of America instead of elsewhere that the latter, as trustee, assent to non-assumption of the sinking fund, the trustee was indeed in a position where it had to injure either itself or the bondholders it represented.³⁷ But both a loan and the trustee's assent to non-maintenance of the fund may well have been the only conditions on which Kaiser-Frazer would purchase Graham-Paige assets: Graham-Paige was in considerable financial difficulty and the purchaser was in excellent position to dictate many of the terms of sale.³⁸ At the same time there is some evidence, apparently not considered by the court, that the loan and the sale were independent transactions with the loan occurring six months after the sale agreement.³⁹ On either of these theories, the trustee conceivably had interests in almost complete conformity with those of the bond-

35. *Rodman v. Richfield Oil Co.*, 66 F.2d 244 (9th Cir. 1933); *Lauinger v. Carrillo Bldg.*, 41 Cal. App.2d 660, 107 P.2d 287 (1940).

36. The complaint alleged "negligent and wilful misconduct" on the part of the Bank of America. *Rabinowitz v. Kaiser-Frazer Corp.*,—Misc.—, 111 N.Y.S.2d 539, 543 (Sup. Ct. 1952). However, the court did not consider this allegation in its opinion.

37. Of course, Bank of America might have acted solely to obtain Kaiser-Frazer's business on favorable credit terms. But the fact that the loan and the sinking fund were both secured by a percentage of net profits—apparently given some weight by the Court, *id.* at 546—does not necessarily create an adverse interest situation. See note 41 *infra*.

38. In 1945, Graham-Paige's net profits were \$1,030,571, while in 1946, there was a net loss of \$4,364,568. 1946 was Kaiser-Frazer's second year of business and therefore its earning record is not meaningful. *MOODY'S INDUSTRIALS* 3014 (1947). In 1947, however, Kaiser-Frazer's "time charges earned" (ratio of assets to funded debt) was 29.28; the funded debt of Kaiser-Frazer consisted solely of the Graham-Paige debenture. In 1947, Kaiser-Frazer's net profits were \$19,015,678. *Id.* at 1504 (1948). It was not till 1949 that Kaiser-Frazer showed a loss, but its funded debt was still one-half of its assets. *Id.* at 1386-7 (1950).

39. The contract of sale was dated Dec. 12, 1946, the transfer of assets to become effective as of February 10, 1947. 111 N.Y.S.2d 539, 542 (Sup. Ct. 1952). The loan agreement from Bank of America to Kaiser-Frazer was dated June 30, 1947, and it provided for "loans" prior to Oct. 1, 1947 *not to exceed an aggregate* of \$12,000,000. *MOODY'S INDUSTRIALS* 3015 (1947). There is no indication as to whether Kaiser-Frazer borrowed to its permissible maximum; however, the New York Court apparently assumed the entire loan to be a single transaction. 111 N.Y.S.2d 539, 546 (Sup. Ct. 1952).

holders.⁴⁰ In so far as the holding rested upon the trustee's creditor status, and not upon any causal connection between assent to non-maintenance of the fund and the making of the loan, a conflict of interests is clearly absent: there is no evidence that the trustee might gain or lose in any way different from the bondholders were the fund not maintained.⁴¹ While situations might arise in which a trustee's status as creditor does give rise to a conflict of interests, as for example, where trustee and bondholders have liens on identical security and a question of priority is involved,⁴² there seems to be no factual basis for assuming the existence of an adverse interest in all situations where the trustee is a creditor of the obligor.

The *Rabinowitz* doctrine permits a bondholder to circumvent the "no action" clause where a trustee's actions are quite in accord with reasonable business behavior. The extension of loans by a trustee to an obligor is a highly prevalent practice.⁴³ Since the Federal Trust Indenture Act, applicable to all issues over one million dollars, requires a trustee to be a corporation possessing substantial assets,⁴⁴ the trustee function is usually fulfilled by a bank with whom the obligor is accustomed to dealing. This past business relationship, enhanced by the cooperation required between trustee and obligor, encourages a trustee to extend credit—especially distress loans.⁴⁵ Thus if the opinion signifies that the creditor status of the trustee is, in itself, an adverse interest sufficient to justify direct suit, circumvention of the "no action" clause

40. See *Shaw v. Railroad Co.*, 100 U.S. 605 (1879).

41. A conflict in interests does not necessarily exist between the trustee and the bondholders even though they are both secured by percentages of net profit. The bondholders must receive their interest payments before Bank of America will receive part payment on its loan out of net profits. Moreover, unless the earning power of Kaiser-Frazer was thereby jeopardized, the existence of another agreement by Kaiser-Frazer to allocate an additional twenty-five percent of its net profits would not harm the interests of the trustee as creditor. Therefore, there would be no conflict unless a default was pending or actually had occurred. Even here, there might be no conflict of interests depending on such factors as the amount of assets of Kaiser-Frazer, the remaining assets of Graham-Paige, and the priority of liens. Even if the trustee had a prior lien it might be prorated with that of the bondholders. *E.g.*, *Marshall & Ilsley Bank v. Hackett, Hoff, & Thierman*, 213 Wis. 426, 250 N.W. 867 (1933); see note 29 *supra*. *But cf.* *Anderson v. Pennsylvania Hotel Co.*, 56 F.2d 980 (5th Cir. 1932).

42. *E.g.*, *Marshall & Ilsley Bank v. Guarantee Inv. Co.*, 213 Wis. 415, 250 N.W. 862 (1933); *First Trust Co. of Lincoln v. Ricketts*, 75 F.2d 309 (8th Cir. 1934).

43. See Note, 7 U. OF CHI. L. REV. 523 (1940); SEC, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND REORGANIZATION COMMITTEES, pt. VI, 99 (1936), and sources cited note 45 *infra*.

44. Section 310(a)(1) provides that at least one institutional trustee be an American corporation which is subject to governmental supervision or examination with a combined capital of \$150,000 or more. 53 STAT. 1157 (1939), 15 U.S.C. § 77jjj(a)(1) (1946).

45. See *Hearings before Subcommittee of Committee on Banking and Currency on S.2344*, 75th Cong., 1st Sess. 89-92, 119-21, 130, 133-41, 158-9 (1937); *Hearings before Subcommittee of Committee on Banking and Currency on S.477*, 76th Cong., 1st Sess. 86-7, 97, 178-9, 202 (1939).

may then occur not only where there may be no factual conflict of interests, but also on grounds which constitute a normal event in the business world.⁴⁶ At the same time, courts have recognized in the past that assent to breach of an indenture covenant may be quite reasonable.⁴⁷ That the assent and the loan occur together in no way provides a sudden metamorphosis to unreasonable action; depending upon the total factual context, the two events give rise to any number of inferences regarding reasonableness.⁴⁸ Indeed, in the instant case, there is some evidence that the trustee did exact some provision for maintenance of a sinking fund for the bondholders.⁴⁹ Patently, comparing the earning power of Kaiser-Frazer and Graham-Paige, it would have been ludicrous for bondholders to insist on security in the form of twenty-five percent of Kaiser-Frazer's net profits. Perhaps, then, the substitute sinking fund arrangement was quite reasonable. But the court apparently did not consider it. And while the court may have concluded that the trustee's behavior was unreasonable in view of all the circumstances in the case, its failure to make this explicit and the presence of possibly valid business reasons explaining the trustee's behavior create a rationale permitting direct suits where a trustee may exercise eminently sound business judgment.⁵⁰

When a trustee's interests do conflict with those of the bondholders whom it represents, bondholders possess a battery of remedies to protect themselves. Of course, in the first instance, the bondholder who complies with the requisites of the "no action" clause may always police his debtor by direct suit. The

46. Recently, clauses have been inserted into the indenture giving the trustee an express power to lend to the obligor. *E.g.*, *York v. Guaranty Trust Co. of New York*, 143 F.2d 503, 514 (2d Cir.), *rev'd*, 326 U.S. 99 (1944); *Dabney v. Chase Nat. Bank*, 196 F.2d 668, 670 (2d Cir. 1952); *Dudley v. Mealey*, 147 F.2d 268, 272 (2d Cir. 1945). However, as in the *York* case, *supra*, the clause was interpreted strictly as an exculpatory clause. This case involved the liability of the trustee for its negligence and bad faith in not foreclosing. The granting of the loan evidenced bad faith. However, none of these decisions indicate what the effect of these clauses will be on attempts to bring a direct action.

47. See notes 27, 29 *supra*.

48. See text at notes 37-41 *supra*.

49. *Moody's* in 1948 indicates that an agreement existed between Kaiser-Frazer and Graham-Paige whereby the former agreed to reimburse annual sinking fund payments made by Graham-Paige up to \$300,000 pursuant to the indenture. Kaiser-Frazer further agreed to give its unsecured notes for any payments in excess of \$300,000. *MOODY'S INDUSTRIALS* 1505 (1948). This fact was not mentioned in the 1947 edition of *MOODY'S*, nor by the New York Court in its opinion. This arrangement appears to have continued. *Id.* at 2441 (1949); *id.* at 1387 (1950). Also see note 38 *supra*.

50. Loans by a trustee were considered as a possible adverse interest, but were rejected by Congress, in the drafting of the Trust Indenture Act. See *Hearings before Subcommittee of Committee on Banking and Currency on S. 2344*, 75th Cong., 1st Sess. 18-19, 27-8, 55-61 (1937); *Hearings before Subcommittee of Committee on Banking and Currency on S. 477*, 76th Cong., 1st Sess. 152-9, 179-85 (1939); SEN. REP. NO. 248, 76th Cong., 1st Sess. 7, 20-23 (1939); H.R. REP. NO. 1016, 76th Cong., 1st Sess. 34-5, 47-9, 80-4 (1939).

Trust Indenture Act, by providing for periodic reports by the obligor and by the trustee,⁵¹ including the names and addresses of all present bondholders,⁵² greatly facilitates such compliance. Assuming, however, that even with this assistance, compliance is impossible or not timely, other remedies are at the bondholders' command. A bondholder may intervene in an action between trustee and obligor if there is some indication that the trustee may not fairly represent the bondholders.⁵³ Additionally, the Trust Indenture Act makes the mere existence of certain specified adverse interests a ground for an action to remove the trustee.⁵⁴ The action will lie where, for example, the trustee: is a trustee under more than one indenture of the obligor; owns more than a specified percentage of the obligor's securities; has mutual officers or directors with the obligor.⁵⁵ And at common law, especially more recently, existence of any one of an even broader catalog of adverse interests is apparently a ground for removal.⁵⁶ At the same time, should the trustee's adverse interest

51. Section 314(a) provides for periodic reports by the obligor to the trustee. 53 STAT. 1167 (1939), 15 U.S.C. § 77nnn(a) (1946).

Section 313(a) provides for periodic reports to the bondholder by the trustee. 53 STAT. 1165 (1939), 15 U.S.C. § 77mmm(a) (1946).

52. See note 16 *supra*.

53. See *In re Central of Georgia Ry.*, 55 F. Supp. 310 (S.D. Ga. 1944); *Campbell v. Hudson & Manhattan Ry.*, 277 App. Div. 731, 102 N.Y.S.2d 878 (1st Dep't), *aff'd*, 302 N.Y. 902, 100 N.E.2d 183 (1951). *But cf.* *Angevine v. City of Sesser*, 39 F. Supp. 498, 501 (E.D. Ill. 1941) (no absolute right of intervention, and it will not be permitted unless there is sufficient cause); *Central States Life Ins. v. Kopljar Co.*, 80 F.2d 754 (8th Cir. 1935) (no intervention permitted even though intervenor owned almost all the bonds).

54. If the trustee has any of the adverse interests enumerated in § 310(b), note 55 *infra*, it must resign, and upon its failure to do so, any bona fide holder of indenture securities for at least six months may sue for the trustee's removal. 53 STAT. 1158 (1939), 15 U.S.C. § 77jjj(b) (1946). The provisions of § 310(b) have been interpreted as exhaustive by the S.E.C.'s General Counsel. Loss, *op. cit. supra* note 2, at 427-8. The only provision for civil liability in the Trust Indenture Act is for the filing of false documents. Section 323(a), 53 STAT. 1176 (1939), 15 U.S.C. § 77www(a) (1946). Section 309(d) specifically exempts the trustee from liability if the indenture fails to conform with the Act. 53 STAT. 1157 (1939), 15 U.S.C. § 77iii(d) (1946). See Loss, *op. cit. supra* note 2, at 1040-2.

55. The remaining adverse interests proscribed by the Act are: trustee is an underwriter for the obligor; trustee controls or is controlled by the obligor; trustee, through a default, owns more than a specified percentage of the securities of any person who controls the obligor; or trustee has substantial adverse interests in the outside debts of the obligor. The Act also provides for specific exceptions to these generalizations of the proscribed adverse interests, *e.g.*, securities owned as testamentary trustee. 53 STAT. 1158 (1939), 15 U.S.C. § 77jjj(b) (1946). See Loss, *op. cit. supra* note 2, at 426-30; Goodbar, *Bond Trustees as Statutory Trustees*, 28 B.U.L. REV. 399, 418-21 (1948); Note, 7 U. OF CHI. L. REV. 523 (1940); SEN. REP. No. 248, 76th Cong., 1st Sess. 20-21 (1939).

56. More recent dicta in cases where direct action has been denied indicate that the proper remedy is a petition for removal of the trustee. *E.g.*, *Central West Public Service v. Craig*, 70 F.2d 427, 434 (8th Cir. 1934) (foreclosure action); *Florida Nat. Bank of Jacksonville v. Jefferson Standard Life Ins. Co.*, 123 Fla. 525, 542, 167 So. 378, 385

affect his behavior, bondholders may recover from the trustee in suits for damages resulting from fraud, bad faith, or negligence.⁵⁷

Extension of the adverse interest exception to the "no action" clause is totally unnecessary to protect bondholders. Admittedly, in extreme circumstances, alternatives to direct suit against the corporate debtor may be inadequate. A removal suit may not repair actions already undertaken nor a damage suit make all parties whole. Here, however, courts have already gone

(1936) (trustee unjustly refusing to take action on its own initiative occupies a position hostile to minority security holders or conspires against them); *Fried v. Marburger*, 353 Mo. 1146, 1153, 186 S.W.2d 584, 587 (1945) (trustee and obligor same person).

In the past, however, courts have been reluctant to remove a trustee without notice to it and affording it an opportunity to be heard. *E.g.*, *Ettlinger v. Schumacher*, 142 N.Y. 189, 36 N.E. 1055 (1894). Inability to join the trustee because it was outside the jurisdiction may have influenced the court in *Rabinowitz* to entertain the direct action rather than insist on removal. *Rabinowitz v. Kaiser-Frazer*,—Misc.—, 111 N.Y.S.2d 539, 546 (Sup. Ct. 1952). One writer has stated that removal is the "most drastic preventive remedy available . . . [and] should require a greater degree of misconduct than any [other] remedy. . . ." Posner, *supra* note 2, at 777. Moreover, where it is obvious to a court that the remedies necessary to protect the rights of the bondholders, such as foreclosure, will be under judicial supervision, it will consider appointment of a new trustee as a wasteful and unnecessary delay. See note 30 *supra*.

57. Usually an indenture trustee is held to the standards imposed upon an ordinary trustee. *E.g.*, *Birn v. Childs Co.*, 37 N.Y.S.2d 689, 697 (Sup. Ct. 1942); *Palmer, Trusteeship Under the Trust Indenture*, 41 COL. L. REV. 193, 201-7 (1941) (comparison between indenture trustee and family trustee). The liability of the trustee, however, is restricted if it is considered a mere stakeholder under a contract. Then the trustee may not have to assume certain obligations which are ordinarily imposed upon a trustee by operation of law. See, *e.g.*, *Ainsa v. Mercantile Co.*, 174 Cal. 504, 510, 163 Pac. 898, 900 (1917); Posner, *supra* note 2, at 739. At least one commentator contends that the two theories of standards create no difference in fact. 2 BOGART, TRUST AND TRUSTEES §246 (1953).

Trustee was held liable in: *York v. Guaranty Trust Co.*, 143 F.2d 503 (2d Cir.), *rev'd on other grounds*, 326 U.S. 99 (1944) (failure of trustee to use a power conferred on it by the indenture); *Richardson v. Union Mortgage Co.*, 210 Iowa 346, 228 N.W. 103 (1930) (permitting substitution of less valuable securities); *Harvey v. Guaranty Trust Co. of N.Y.*, 134 Misc. 417, 236 N.Y. Supp. 37 (Sup. Ct.), *aff'd without opinion*, 229 App. Div. 774, 242 N.Y. Supp. 920 (1st Dep't 1929) (trustee exceeded scope of his powers). Some courts have held that no right of action exists against a trustee where the plaintiff became a bondholder after the date of the trustee's actions which give rise to its liability. This is based on the theory that no fiduciary relationship could then have been in existence. *Doyle v. Chatham & Phenix National Bank*, 253 N.Y. 369, 171 N.E. 574 (1930). See also *Corbin, The Subsequent Bondholder and the Delinquent Trustee*, 51 COL. L. REV. 813 (1951); Note, 66 HARV. L. REV. 1127 (1953).

The use of exculpatory clauses in the indenture absolving the trustee from negligence, *e.g.*, willful default or specific acts of neglect, discouraged the use of the damage action. See, *e.g.*, *Hazzard v. Chicago National Bank*, 159 Misc. 57, 287 N.Y. Supp. 541 (Sup. Ct. 1936). Posner, *supra* note 2, at 781-90. However, §315(d) of the Trust Indenture Act prohibits the insertion of exculpatory clauses in the indenture except in regard to errors of judgment made by any responsible officer in good faith without negligence, or to actions contrary to the direction of bondholders. 53 STAT. 1171 (1939), 15 U.S.C. §7700o(d) (1946). See SEN. REP. NO. 248, 76th Cong., 1st Sess. 25-6 (1939).

a long way toward safeguarding bondholders: whenever a trustee's actual or impending actions have been unreasonable and bondholders are thereby injured or threatened with harm, direct suits have always been permitted whether upon an adverse interest or any other rationale. But where a trustee with an adverse interest neither threatens nor has done anything unreasonable, or where there is ample time to avoid injury from even unreasonable trustee action, a suit for removal is more than adequate to protect bondholders.⁵⁸ Indeed, if the trustee's interest is really adverse, the removal action may ultimately be brought anyway. Absent pressing circumstances, then, it is difficult to conceive why courts should express solicitude for bondholders to the extent of undermining the objectives of the "no action" clause.⁵⁹

Direct actions, despite "no action" clauses, originated prior to the Trust Indenture Act⁶⁰ and at a time when alternative remedies had not fully developed to protect bondholders. Yet, in the face of more recent developments, the New York court has anomalously broadened the grounds for direct suit to include situations in which a trustee's actions may be reasonable, a trustee's interests not adverse, and bondholders not in danger of imminent harm. Wrong on its reading of precedent, wrong on its rationale, the *Rabinowitz* case is an outdated expression of solicitude for the bondholder.

58. In several cases involving liability of the trustee or attempts to annul the actions of a trustee, suit was brought by a new trustee, indicating that this remedy has been used. *E.g.*, *First Trust Co. of Lincoln v. Ricketts*, 75 F.2d 309 (8th Cir. 1934); *Marshall & Ilsley Bank v. Guarantee Inv. Co.*, 213 Wis. 415, 250 N.W. 862 (1933).

59. See text at notes 36-41, 49 *supra*. There is a possibility, for example, that the holding in the *Rabinowitz* case might result in harm to the Graham-Paige bondholders as a class. Kaiser-Frazer might argue that it assumed that, in case of a sale, the trustee had power to delete any covenants it chose, that the loan was an independent transaction, and that there was no collusion between Kaiser-Frazer and the trustee. The corporation might further argue that if it had been or should now be required to assume the original covenant, instead of the substitute agreement containing such less onerous sinking fund obligations as it apparently later assumed, it would rather rescind the contract. As long as this is a possibility, no matter how tenuous, the majority of bondholders might prefer the existing agreement rather than chance the loss of all benefits from that agreement. Permitting a direct action here ignores the fact that "no action" clauses protect the will of the majority of bondholders rather than the wishes of an individual, no matter how important his financial stake may be to him.

60. Direct actions date back to the 19th century, *Ettlinger v. Schumacher*, 142 N.Y. 189, 36 N.E. 1055 (1894), while the Trust Indenture Act was passed in 1939. 53 STAT. 1149 (1939), 15 U.S.C. § 77aaa (1946).