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Dismissal of $6.4 Billion Lawsuit Serves as a Reminder to Debt Security Holders to Obtain Depositary Proxies Before Pursuing Litigation

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A surprising recent decision by a New York federal judge, *UMB Bank, N.A. v. Bristol-Myers Squibb Company*, No. 21-CV-4897 (S.D.N.Y. Sept. 30, 2024), is a stark reminder to holders of debt securities of the pitfalls of commencing litigation against an issuer without meticulously following the procedures required by the governing documents. It is also a reminder to issuers to explore procedural defenses they may have when facing holder enforcement actions.

Judge Jesse Furman of the Southern District of New York dismissed a $6.4 billion lawsuit against issuer Bristol-Myers Squibb because the plaintiff, UMB Bank, had not been properly appointed as the trustee for the securities and therefore lacked standing to sue on behalf of the directing holders. The agreement at issue pertained to contingent value rights but had provisions typical of a bond indenture, including vesting in a trustee authority to sue the issuer in the event of a default. A majority of holders alleged the company violated the agreement, and they sought to replace the existing trustee with UMB Bank, which they believed would be better suited to pursue litigation. But the court held that the replacement was ineffective.

The source of the defect was the so-called "indirect holding system," which was devised to facilitate settling of securities transactions. Rather than creating a certificated security for each investor, issuers create a single "global security" that is held by (and registered in the name of) a depositary institution or its nominee. An end-investor owns a "book-entry interest"—a place on the depositary's ledger that indicates its ultimate beneficial entitlement to payment. This system was designed to reduce paperwork in connection with trading, but it has grown to have meaningful effects on litigation rights. This is because indentures and similar agreements vest authority to take various actions only in "Holders"—the registered owners of the securities, which usually means the depositary or its nominee—and not in beneficial owners with only book-entry interests. To have the same rights as "Holders," beneficial owners must either convert their interests into certificated securities or (more commonly) obtain proxies authorizing them to exercise the registered owner's rights. (This issue arises in the context of indentures and similar instruments; most credit agreements, by contrast, do not implicate the indirect holding system.)

In *UMB Bank*, the indenture-like agreement specified that the trustee could be replaced only by a majority vote of "Holders," and the investors seeking to sue did not obtain depositary proxies before attempting to install the new trustee. This meant that UMB Bank was not duly appointed, and Judge Furman dismissed the suit based on the plaintiff's lack of standing, even though the case had been ongoing for three years.

In some contexts, a standing issue like this can be cured after the fact. When beneficial owners sue for payment on a note, they can avoid dismissal by obtaining a proxy from the registered owner after litigation

has begun. The unexpected twist in *UMB Bank* was that an after-the-fact attempt to "reconfirm" the replacement trustee after the beneficial owners obtained depositary proxies was held to be insufficient to cure the standing problem. Judge Furman concluded that the improperly appointed trustee had no economic interest (direct or indirect) in the outcome, and that this presented a jurisdictional problem that could not be overcome after litigation was commenced. Nor did Judge Furman accept that the issuer ratified the replacement trustee through its conduct. Despite the issuer's litigating the case for years without raising the issue, Judge Furman found insufficient evidence that the company intentionally relinquished its contractual right to insist on a proper trustee appointment. In the end, however, Judge Furman dismissed the case without prejudice to the refiling of a new lawsuit by a duly appointed trustee, at which time, he said, he would "likely pick up where this case left off in terms of motion practice, discovery, and the like."

The beneficial owners in *UMB Bank* therefore may be able to save their litigation after some additional cost and delay. But the case is an important warning to holders of indenture securities: carefully check the governing documents to determine which rights are reserved for "Holders" as distinct from beneficial owners. Be especially wary of language found in some indentures saying that beneficial owners "shall have no rights" with respect to the global security, and that the depositary shall be considered the "sole owner" of the global security for all purposes. In some circumstances, the indirect holding system may not have a practical effect, such as when beneficial owners ask a properly appointed trustee to act and the trustee agrees to follow their direction. Such a process usually can be accomplished with certifications of beneficial ownership. But in other circumstances, the difference between registered owners and beneficial owners may matter, such as when commencing a lawsuit for payment, sending a notice of acceleration or default, or (as *UMB Bank* teaches) seeking to replace the trustee. Beneficial owners would be well advised to consider obtaining proxies in advance. So, too, should they factor into their litigation strategies the additional effort and time that process will take.

Bond issuers likewise should consider the effect of the indirect holding system when confronted with the possibility of holder enforcement. For example, if an issuer receives a notice of default or acceleration—or, for that matter, if it is served with a lawsuit—it can demand proof that the investors behind the action have received a proxy from the depositary or otherwise have obtained the status of "Holders." This can act as an additional barrier to litigation.

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