



# BANKRUPTCY CLIENT ALERT

June 28, 2010

Below from the Kutak Rock LLP Bankruptcy Practice Group is a summary of a recent decision of the Second Circuit Court of Appeals addressing the enforceability of non-recourse provisions.

**Non-recourse Financings: *The Bank of New York v. First Millennium, Inc.*,  
2010 WL 2163099 (2d Cir. June 1, 2010)**

The Second Circuit Court of Appeals, in *The Bank of New York v. First Millennium, Inc.*, 2010 WL 2163099 (2d Cir. June 1, 2010), recently declined to enforce a non-recourse provision in an indenture. The ruling effectively provided holders of non-recourse notes issued under an indenture with full recourse to all funds in the related trust estate, including funds that were designated to be paid exclusively to a separate entity holding an interest in the trust.

The transaction at issue was a credit card securitization. In such transaction, credit card receivables were sold to a trust by a bank originator (in this case, NextBank, the failed Internet-only bank), notes were issued by the trust under an indenture to third-party investors, the notes were payable from specified credit card receivables received by the trust, and a “transferor interest” was issued by the trust to the bank originator. The indenture contained a provision limiting the noteholders’ recourse and right to payment to specified credit card revenues received by the trust (the “Non-recourse Provision”) and also provided that the transferor interest held by the bank originator was payable from separate funds in the trust designated as the “transferor interest” funds (the “Transferor Interest Funds”). The indenture also contained a separate “notwithstanding” clause specifying that the notes had an “absolute and unconditional” right to be paid upon the maturity thereof. The transaction experienced significant defaults on the credit cards, resulting in the depletion of all revenues that were designated under the Non-recourse Provision to pay the notes. The only assets remaining in the trust were the Transferor Interest Funds. The notes matured and the noteholders asserted that their recourse should not be limited solely to the funds designed in the Non-recourse Provision, but instead that the notes benefited from the right to be paid from any funds in the trust estate under the indenture, including the Transferor Interest Funds, because the separate “notwithstanding” clause in the indenture provided the notes with the “absolute and unconditional” right to be paid at maturity.

In response, the FDIC, as receiver of the failed bank originator, asserted that the Non-recourse Provision in the indenture limited the noteholders’ recourse solely to the specific revenue source designated in such Non-recourse Provision, that such provision should control and that the right of the noteholders to receive payment was extinguished when the related



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revenues were reduced to zero. The FDIC further asserted that the separate “notwithstanding” clause, on which the noteholders’ argument is based and which specified that the noteholders held an “absolute and unconditional” right to be paid at maturity, was a boilerplate provision that was not intended to control over the Non-recourse Provision in the indenture. Thus, the FDIC asserted that the notes were non-recourse obligations, limited solely to certain funds under the indenture, and held no right to be paid from the separate Transferor Interest Funds in the trust.

The Second Circuit agreed with the noteholders’ interpretation of the indenture and declined to limit recourse on the notes solely to the specific revenues designated in the indenture’s Non-recourse Provision. Instead, the court held that the separate “notwithstanding” clause in the indenture, which specified that the notes have an “absolute and unconditional” right to be paid at maturity, did not limit the noteholders’ recourse upon maturity. Accordingly, the notes had full recourse to and could be paid from any assets in the trust, including the Transferor Interest Funds. The court also noted that the forms of the notes issued under the indenture contained similar “absolute and unconditional” payment language on maturity of the notes and held that the terms of the notes operated independently of the Non-recourse Provision in the indenture. In its holding, the court also rejected the FDIC’s argument that the separate “notwithstanding” clause in the indenture was boilerplate language that was not intended to control over the Non-recourse Provision.

Based on this case, there may be future priority contests in credit card securitizations or similar transactions in which non-recourse noteholders experience losses. However, the case may have a broader application to other non-recourse financings generally. For example, a boilerplate “notwithstanding” clause in an agreement or indenture, which addresses payment of non-recourse obligations, may need to be expressly limited in order to maintain the non-recourse nature of such obligations, as opposed to relying on a general non-recourse provision contained elsewhere in the agreement or indenture. In addition, provisions contained in bonds or notes that are inconsistent with the related indenture may be held to control over the indenture.

Last, this case may also be instructive to indenture trustees who may be required to deal with several parties in a transaction who assert conflicting positions as to the priority of distributions from a single, albeit economically insufficient, trust.

For more information on the material contained in this Bankruptcy Client Alert, contact your regular Kutak Rock representative or any member of our Bankruptcy Practice Group. Listed below is the member of the Bankruptcy Practice Group in our Omaha office who is familiar with the cases summarized in this client alert. For more information on our bankruptcy practice and for recent news and alerts, please visit us at [www.kutakrock.com](http://www.kutakrock.com).



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