

INDENTURE TRUSTEE FEE POTPOURRI — AN EXPLORATION OF SELECTED ISSUES RELATING TO INDENTURE TRUSTEE FEES AND EXPENSES IN THE BANKRUPTCY CONTEXT

By Jennifer L. Saffer¹

KeyCite®: Cases and other legal materials listed in KeyCite Scope can be researched through West Group's KeyCite service on Westlaw®. Use KeyCite to check citations for form, parallel references, prior and later history, and comprehensive citator information, including citations to other decisions and secondary materials.

I. INTRODUCTION

II. FEES AND EXPENSES OF INDENTURE TRUSTEES UNDER STANDARD INDENTURES

III. THE CONTRACTUAL RELATIONSHIP

IV. SUBJECT MATTER JURISDICTION

I. INTRODUCTION

The duties of an indenture trustee are statutorily mandated by the Trust Indenture Act of 1939 (the "TIA").² When a bankruptcy case occurs, however, the scope of the duties and the rights of the indenture trustee can give rise to complex issues particularly with respect to the payment of the fees and expenses of the indenture trustee, whether from the debtor's estate, by exercise of the indenture trustee's lien rights *vis-à-vis* distributions to the holders of the notes, or otherwise. This article first discusses the provisions of the Revised Model Simpli-

¹Jennifer L. Saffer is a bankruptcy attorney at Jenkins & Gilchrist Parker Chapin LLP, New York, New York. The author thanks Hollace T. Cohen, Esq. of Jenkins & Gilchrist Parker Chapin LLP for her helpful insights and comments in connection with this article, and Sonia S. Shah, a legal assistant at the same firm, for her help in researching and preparing this Article. The author also thanks Richard Lieb, Esq., for his thoughtful questions and comments.

²15 U.S.C. §§ 77aaa, et seq.

fied Indenture³ (the “MSI”) relating to payment of indenture trustee’s fees and expenses, as well as the duties of indenture trustees pursuant to the TIA and the MSI, then addresses some specific issues that may arise in the bankruptcy context in connection with the payment of such fees and expenses, and finally contends that bankruptcy courts lack subject matter jurisdiction where the source of payment of the indenture trustee’s fees and expenses is through the assertion of its contractual lien rights against a noteholder’s distribution.

II. FEES AND EXPENSES OF INDENTURE TRUSTEES UNDER STANDARD INDENTURES⁴

In 1983, the *Business Lawyer* published the Model Simplified Indenture⁵ (the “1983 MSI”) in an attempt to provide a common form for the most standard provisions of indentures and thus reduce the need for significant negotiation of such provisions each time an indenture is required.⁶ “In large part, the 1983 MSI accomplished that objective.”⁷ In 1995, work was begun on a revision of the 1983 MSI. The resulting 1999 Model Simplified Indenture generally updates the 1983 MSI⁸ and adds some provisions that bear on payment of fees and expenses of indenture trustees. The MSI (and nearly all indentures) contain provisions relevant to the payment of indenture trustee fees and expenses.

Section 7.07 of the MSI, entitled “Compensation and Indemnity” provides:

The Company shall pay to the Trustee from time to time reasonable compensation for its services, including for any Agent capacity in which it acts. The Trustee’s compensation shall not be limited by any law on compensation of a trustee of an express trust. The Company shall reimburse the Trustee upon request for all reasonable out-of-pocket expenses incurred by it. Such expenses shall include the reasonable compensation and out-of-pocket expenses of the Trustee’s agents and counsel.

The Company shall indemnify the Trustee against any loss, liability or expense incurred by it including in any Agency capacity in which it acts. The Trustee shall notify the Company promptly of any claim for which it may seek indemnity. The Company shall defend the claim and the Trustee shall cooperate in the defense. The Trustee may have separate counsel and the Company shall pay the reasonable fees and expenses of such counsel. The Company need not pay for any settlement made without its consent, which consent shall not unreasonably be withheld.

The Company need not reimburse any expense or indemnity against any loss or liability incurred by the Trustee through gross negligence, willful misconduct or bad faith.

To secure the Company’s payment obligations in this Section, *the*

³Revised Model Simplified Indenture, published in 55 Bus. Law. 1115 (2000).

⁴The MSI provisions referred to herein are given as examples of provisions typical of those found in indentures.

⁵38 Bus. Law. 741 (1983).

⁶See 55 Bus. Law., *supra*, at 1115.

⁷*Id.*

⁸*Id.*

Trustee shall have a lien prior to the Securities on all money or property held or collected by the Trustee, except that held in trust to pay Principal and interest on particular Securities.

Without prejudice to its rights hereunder, when the Trustee incurs expenses or renders services after an Event of Default specified in Section 6.01(4) or (5) occurs, *the expenses and the compensation for the services are intended to constitute expenses of administration under any Bankruptcy Law.*

(emphasis added).⁹

Section 6.08 of the MSI, “Priorities,” provides in relevant part:

After an Event of Default any money or other property distributable in respect of the Company’s obligations under this Indenture shall be paid in the following order:

First: *to the Trustee (including any predecessor Trustee) for amounts due under Section 7.07;*

Second: to holders of Senior Debt to the extent required by Article 11; . . .

(emphasis added).¹⁰

Section 11.12 of the MSI, “Trustee’s Rights to Compensation, Reimbursement of Expenses and Indemnification” ensures that “The Trustee’s rights to compensation, reimbursement of expenses and indemnification under Sections 6.08 and 7.07 are not subordinated,” even if the rights of holders to payment are subordinated to the rights of holders of senior debt.¹¹

These provisions provide some comfort to the indenture trustee that its fees and expenses will be paid in carrying out its duties, which, in the first instance are statutorily mandated by the TIA,¹² and are set forth in the MSI¹³ and in most indentures.

In the case of a default, the TIA mandates the duties of the indenture trustee:

The indenture trustee shall exercise in case of default (as such term is defined in such indenture) such of the rights and powers vested in it by such indenture, and to use the same care and skill in their exercise, as a prudent man would exercise or use under the circumstances in the conduct of his own affairs.¹⁴

⁹The final paragraph of Section 7.07 did not appear in the 1983 MSI and was added as part of the 1999 revisions. *See* 55 Bus. Law., at 1142 and discussions *infra*.

¹⁰The indenture in an agreement between three parties, the issuer of the securities, the indenture trustee and the noteholders. The noteholders agree by acceptance of their notes to be bound by all of the terms of the indenture.

¹¹With respect to subordination generally under the MSI, *See* Article 11 of MSI published in 55 Bus. Law., *supra*, at 1157-1162.

¹²*See* 15 U.S.C. § 7700o (a) “Duties prior to default,” (b) “Notice of defaults,” (c) “Duties of the trustee in case of default,” (d) “Responsibility of the Trustee,” and (e) “Undertaking for costs.”

¹³MSI, Section 7.01(a), “Duties of Trustee” *See* 55 Bus. Law., at 1139.

¹⁴15 U.S.C. 7700o(c). The MSI provision with respect to the duties of the indenture trustee upon a default is substantially the same as the TIA provision. Section 7.01(a) of

There are a number of ways in which an indenture trustee's fees and expenses can be paid in the context of a bankruptcy case. For example, it can exercise its rights under the indenture to file a proof of claim for payment of its fees and expenses from the debtor. Where the trustee's claim for fees and expenses is unsecured it is unlikely that such claim will be paid in full because full recovery on unsecured claims is rarely 100%. Courts have recognized unsecured claims for fees and expenses based on the contractual provisions of an indenture.¹⁵ "A party's ability to recover for compensation under any contractual agreement is determined by applicable terms of contract subject to Court limitation of reasonableness."¹⁶

Although payment of unsecured claims of the indenture trustee will be made only at the conclusion of the case when distribution is made to all unsecured creditors, an indenture trustee for a secured debt issue may, during the pendency of the bankruptcy case, be able to look to adequate protection payments from use of cash collateral or proceeds from the sale of collateral which secure its claims and the claims of the debt holders and, through exercise of its lien rights with respect to its fees and expenses, receive ongoing payments during the case. This should be permissible regardless of whether the claims of the indenture trustee and the noteholders are oversecured and should not be dependent on Section 506(b) of the Bankruptcy Code because the indenture trustee's payment is received through the enforcement of the lien granted to it by the holders.

An indenture trustee can seek payment of its post-petition fees and expenses as an administrative expense pursuant to Section 503(b)(3)(D) and/or 503(b)(5) of the Bankruptcy Code upon a showing that the indenture trustee has made a "substantial contribution" but this can often be a daunting task.¹⁷ Entitlement to reimbursement of fees and expenses as a substantial contribution "does not depend on, and is inde-

the MSI, entitled "Duties of Trustees" provides: "If an Event of Default has occurred and is continuing, the Trustee shall exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their exercise, as a prudent person would exercise or use under the circumstances in the conduct of its own affairs."

¹⁵See *In re Zenith Laboratories, Inc.*, 119 B.R. 51, 13 U.C.C. Rep. Serv. 2d 905 (Bankr. D. N.J. 1990) (where value of collateral is zero, indenture trustee entitled to payment of fees and expenses under contract as unsecured claim); *In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) ¶ 69005 (2d Cir. 1982).

¹⁶*In re Revere Copper and Brass, Inc.*, 60 B.R. 892, 895 (Bankr. S.D. N.Y. 1986).

¹⁷See, e.g., *Matter of Baldwin-United Corp.*, 79 B.R. 321 (Bankr. S.D. Ohio 1987) (holding, *inter alia*, that one indenture trustee made a substantial contribution to debtor's reorganization and thus was entitled to administrative expense claim for attorneys fees and costs for addressing tax issues in disclosure statement, which court determined benefited all creditors, but that trustee's other involvement in case, primarily with respect to consolidation of debtors' estates, did not constitute a substantial contribution and with respect to another indenture trustee, holding that efforts to mediate disputes in the case and to develop a consensual plan were a substantial contribution, but that its other actions in the case, including representing creditors, was not).

pendent of, any contractual entitlement to reimbursement.”¹⁸ The substantial contribution standard has been interpreted to require that the services of the indenture trustee (and of its attorneys and agents) for which compensation is sought contribute to the estate generally, and not simply aid or enhance the recovery to the indenture trustee’s constituency.¹⁹ Nor is it sufficient for substantial contribution that the indenture trustee fulfilled its statutory duties under the TIA.²⁰

Independent of a showing of substantial contribution under Section 503(b) of the Bankruptcy Code, the final paragraph of Section 7.07 of the MSI, which provides that “when the Trustee incurs expenses or renders services after an Event of Default specified in Section 6.01(4) or (5) occurs, the expenses and compensation for the services rendered are intended to contribute an expense of administration under any Bankruptcy Law,”²¹ may be a basis for payment of such fees and expenses as administrative claims. In this connection, the comments to the MSI notes that, “While the Indenture provisions cannot predetermine the decision of a bankruptcy judge on the question, it is desirable to state the intention of the Company and the Trustee at the time of entry into the Indenture, that compensation due to the Trustee for services rendered and expenses incurred after commencement of a proceeding in bankruptcy shall constitute expenses of administration. . . .”²² This concept makes abundant sense because the indenture trustee for public debt is contractually bound and statutorily required to provide post-petition services consistent with the prudent man standard after the occurrence of an event of default and to continue to do so during the pendency of a bankruptcy case.

Additionally, the indenture trustee can exercise its lien rights against the holders and recover its fees and expenses from the distributions to such holders. In this last scenario, the contractual relationship created by the indenture and the limited subject matter jurisdiction of the bankruptcy courts comes into play.

III. THE CONTRACTUAL RELATIONSHIP

The indenture trustee for both public and private debt acts as the contractual representative for the holders and the indenture trustee’s relationship with the holders is governed by contract, *i.e.*, the indenture. Indeed, “rather than establishing statutory standards (or via SEC

¹⁸*In re Revere Copper and Brass, Inc.*, *supra*, 60 B.R. at 895.

¹⁹*See, e.g., Id.* It is interesting to note that in *Revere*, the indenture trustee waived its contractual right to receive compensation under the indenture from amounts payable to the holders under the plan, since the indenture trustee distributed the entire amount it received under the plan to the holders. 60 B.R. at 895.

²⁰*See Flight Trans. Corp.*, 874 F.2d 576 (8th Cir.1989).

²¹55 Bus. Law., at 1142.

²²55 Bus. Law., at 1215.

regulation, regulatory standards), the TIA establishes *contractual* requirements for judicial enforcement.”²³

The drafters of the MSI recognize the importance of the indenture trustee’s contractual rights as to payment and the lien granted to it by the noteholders, even in cases where the indenture trustee is the trustee for subordinated debt. While the MSI recognizes subordination of junior debt, the notes make clear that while subordination applies to the holders of such debt, it has no effect on the indenture trustee’s contractual entitlement to exercise its lien rights against the distributions on account of the subordinated debt. The notes to Section 11.02 of the MSI recognize the “right of the trustee for the subordinated debt to recover its fees and expenses from the distributions to the subordinated Securityholders prior to passing the distributions up to holders of Senior Debt.”²⁴

The extent and priority of the indenture trustee’s lien under an indenture is discussed in a case decided by the Appellate Division of the New York Supreme Court, *BlueBird Partners, L.P. v. First Fidelity Bank, N.A.*²⁵ In that case, a secured creditor of a bankrupt airline sued present and former trustees for two series of certificates issued under a Secured Equipment Indenture and Lease Agreement (the “Indenture”). The Indenture provided that in the event of default under the Indenture, the trustees’ entitlement to compensation for “all proper charges, expenses or advances” took priority over payment of principal or interest due on the certificates “— in other words, a first priority lien.”²⁶ The plaintiff sought a declaration that the trustees’ liens applied only to surplus funds held by the trustees, *i.e.*, funds in excess of the amounts needed to pay principal and interest on the certificates.²⁷ The Appellate Division relied on the plain meaning of the Indenture provision and concluded that the plaintiff’s assertions were properly rejected by the court below.²⁸

The contractual nature of the relationship created by the indenture is underscored by the District Court’s decision in *In re W.T. Grant Co.*²⁹ In that case, the indenture trustee filed an application with the court seeking to have its fees and expenses paid out of a fund consisting of two percent of the funds promised to the subordinated debentureholders pursuant to a settlement agreement.³⁰ Any portion of the two percent fund not awarded for payment of fees and expenses was to be distributed

²³Roe, Mark J. *Corporate Reorganization and Bankruptcy, Legal and Financial Matters*, p. 460 (Foundation Press) (emphasis in original).

²⁴Note to Section 11.01 of MSI, 55 Bus. Law., at 1216-1217.

²⁵*Bluebird Partners, L.P. v. First Fidelity Bank, N.A., New Jersey*, 248 A.D.2d 219, 671 N.Y.S.2d 7 (1st Dep’t 1998).

²⁶*Id.*, at 224.

²⁷*Id.*

²⁸*Id.*

²⁹*In re W.T. Grant Co.*, 119 B.R. 898 (S.D. N.Y. 1990), *aff’d*, 935 F.2d 1277 (2d Cir. 1991) (Act case).

³⁰*Id.*

to the subordinated debentureholders who had accepted the settlement agreement — none of the funds at issue were to go to the debtors' estates under any circumstances.³¹ The indenture trustee, along with several others who had represented subordinated noteholders in the proceeding, submitted applications to the bankruptcy court for payment of their fees. The bankruptcy court substantially disallowed the application of the indenture trustee (and disallowed entirely the applications of the other applicants). The indenture trustee appealed, contending, *inter alia*, that the bankruptcy judge erroneously evaluated their application under the “benefit to the estate” standard.³²

The indenture trustee argued on appeal that the bankruptcy court's determination that the indenture trustee was entitled to compensation only for services which “clearly benefit the estate and are non-duplicative” was wrong because: (i) the indenture trustee sought fees and expenses pursuant to the *contractual* terms of the indenture, which terms were embodied in the settlement agreement, and (ii) the indenture trustee's fees *were not payable from the bankruptcy estate*, but rather from the settlement fund, the proceeds of which would not under any circumstances inure to the bankruptcy estate.³³ The court explained that under the terms of the indenture (which were required under the TIA), in event of a default under the indenture, the trustee was “*required to exercise the rights and powers vested in it by the indenture. . . . When Grant filed its bankruptcy petition. . . , an ‘Event of Default’ occurred under § 8.01 of the indenture. From that point on, [the indenture trustee] was required to take the steps it took to secure the Subordinated Debentureholders’ recovery and [is] entitled to be compensated for its efforts.*”³⁴ Because the indenture trustee in the *W.T. Grant* case was not seeking fees and expenses from the debtor's estate, but rather from a separate settlement fund belonging to the Subordinated Debentureholders, the “benefit to the estate” standard was not applicable in determining the indenture trustee's entitlement to fees and expenses. While the court in *W.T. Grant* stressed that the fees and expenses of the indenture trustee were to be paid from funds in which the estate did not have an interest, and recognized the indenture trustee's lien rights *vis-à-vis* the holders, the court also stressed the contractual relationship of the parties and explained that the indenture trustee “had a contractual right to be compensated for protecting the interest of the Subordinated Debentureholders. . . .”³⁵

The holding in the *W.T. Grant* case is in keeping with the general principle that where fees are sought pursuant to a contractual right of payment (whether they are fees of an indenture trustee, or otherwise), the relevant contractual provisions determine the propriety and extent

³¹*Id.*, at 900.

³²*Id.*

³³*Id.*

³⁴*Id.*, at 903 (emphasis added).

³⁵*Id.*, at 901.

of the compensation,³⁶ and in stressing that the fees to be paid to the indenture trustee come from distributions to creditors, rather than property of the estate raises questions about what, if any, role the bankruptcy court should have in dealing with indenture trustee fees and expenses when the indenture trustee seeks to exercise its lien rights against distributions to the holders rather than seeking payment from the estate, and indeed whether the bankruptcy courts have subject matter jurisdiction with respect to the fees and expenses of indenture trustees seeking to enforce their lien rights against distributions to holders.

IV. SUBJECT MATTER JURISDICTION

Bankruptcy courts, like all federal courts, are courts of limited jurisdiction and their subject matter jurisdiction is dependent solely on a grant by federal statute. The sole source of bankruptcy jurisdiction is 28 U.S.C. § 1334(b),³⁷ which confers jurisdiction only with respect to proceedings “arising under title 11, or arising in or related to cases under title 11,”³⁸ and 28 U.S.C. § 1334(e), which provides for exclusive jurisdiction “of all property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.”³⁹ As the Supreme Court has explained, the jurisdiction of the bankruptcy courts “is grounded in and limited by” 28 U.S.C. § 1334.⁴⁰

The Supreme court in *Celotex Corp. v. Edwards*,⁴¹ essentially approved the test for “related to” jurisdiction articulated in the seminal case of *Pacor, Inc. v. Higgins*.⁴² Under this test, a matter is “related to” if it could alter the debtors’ rights or in any way affect the administration of the bankruptcy estate.⁴³

³⁶See, e.g., *In re United Merchants and Mfrs., Inc.*, 674 F.2d 134, 6 Collier Bankr. Cas. 2d (MB) 321, Bankr. L. Rep. (CCH) ¶ 69005 (2d Cir. 1982) (recognizing right of unsecured creditor to be paid fees and expenses of its counsel as provided for in loan agreement and holding that the policy of equitable distribution in bankruptcy does not render an unsecured creditor’s otherwise valid contractual claim unenforceable in bankruptcy); *Matter of New York, N. H. & H. R. Co.*, 421 F. Supp. 249, 257-58 (D. Conn. 1976), judgment aff’d, 567 F.2d 166 (2d Cir. 1977), cert. denied sub nom *Zeldes v. Manufacturers Hanover Trust Co.*, 434 U.S. 833, 98 S. Ct. 120, 54 L. Ed. 2d 94 (1977).

³⁷See *Celotex Corp. v. Edwards*, 514 U.S. 300, 115 S. Ct. 1493, 131 L. Ed. 2d 403, 410, 27 Bankr. Ct. Dec. (CRR) 93, 32 Collier Bankr. Cas. 2d (MB) 685, Bankr. L. Rep. (CCH) ¶ 76456, 31 Fed. R. Serv. 3d 355 (1995).

³⁸28 U.S.C. § 1334(b).

³⁹28 U.S.C. § 1334(e).

⁴⁰*Celotex, supra*, 131 L.Ed.2d at 307.

⁴¹*Id.*, n6.

⁴²*Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984).

⁴³“The test for determining whether a civil proceeding is related to bankruptcy is whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.” *Pacor, supra*, 743 F.2d, at 994.

Though a dispute primarily between non-debtor third parties may be “related to” under some circumstances,⁴⁴ the Third Circuit, in *In re The Guild and Gallery Plus, Inc.*,⁴⁵ quoted from the Eleventh Circuit’s decision in *In re Gallucci*, in which the court explained:

*If the action does not involve property of the estate, then not only is it a noncore proceeding, it is an unrelated matter completely beyond the bankruptcy court’s subject matter jurisdiction.*⁴⁶

Hence, when an indenture trustee exercises its lien rights under an indenture and thus seeks to recover its fees and expenses from distributions made to the holders (*i.e.*, property of a third party non-debtor which is outside the estate) the bankruptcy court does not have subject matter jurisdiction with respect to such fees and expenses.

In this connection, the bankruptcy court’s decision in *In re Dickenson Lines, Inc.*⁴⁷ is of interest. In that case, prior to the commencement of the debtor’s bankruptcy, the IRS filed a lien for unpaid withholding taxes against a residence owned by the debtor. Subsequently, (but prior to the commencement of its bankruptcy case) the debtor transferred its interest in the residence pursuant to a quitclaim deed, and the transferee entered into an agreement to sell the residence to another party.⁴⁸

The debtor made a motion in its bankruptcy case to have the IRS lien discharged.⁴⁹ In concluding that it lacked subject matter jurisdiction to determine the validity of the lien, the court explained:

The lien came into existence and attached to the residence pursuant to [26 U.S.C. § 6321] regardless of the pending bankruptcy proceedings, or any provisions contained in Title 11 of the Bankruptcy Code . . . Debtor’s position fails to take into consideration the fact that the *lien is attached to property that is no longer property of the estate . . . the present dispute is between two non-debtors regarding a lien which is attached to non-estate property.*⁵⁰

Likewise, when an indenture trustee exercises its lien rights against distributions to holders, it is exercising such lien rights against property that is no longer property of the estate, and there is no basis for bankruptcy court subject matter jurisdiction.

The Fifth Circuit’s decision in *In re SPM Manufacturing Corpora-*

⁴⁴See, *e.g.*, *In re Best Products Co., Inc.*, 68 F.3d 26, 28 Bankr. Ct. Dec. (CRR) 11, Bankr. L. Rep. (CCH) ¶ 76669 (2d Cir. 1995).

⁴⁵*In re Guild and Gallery Plus, Inc.*, 72 F.3d 1171, 1181, 28 Bankr. Ct. Dec. (CRR) 502, 35 Collier Bankr. Cas. 2d (MB) 70, Bankr. L. Rep. (CCH) ¶ 76738 (3d Cir. 1996).

⁴⁶*In re Gallucci*, 931 F.2d 738, 803, Bankr. L. Rep. (CCH) ¶ 74008 (11th Cir. 1991) (emphasis added); see also *In re Bobroff*, 766 F.2d 797, 803, 13 Bankr. Ct. Dec. (CRR) 502, 12 Collier Bankr. Cas. 2d (MB) 1491, Bankr. L. Rep. (CCH) ¶ 70630 (3d Cir. 1985).

⁴⁷*In re Dickenson Lines, Inc.*, 47 B.R. 653, 12 Collier Bankr. Cas. 2d (MB) 587 (Bankr. D. Minn. 1985).

⁴⁸*Id.*

⁴⁹*Id.* The court noted that when the “debtor transferred the property . . . by quit claim deed, the IRS lien passed with it.”

⁵⁰*Id.*, at 655-656 (emphasis added).

tion⁵¹ is instructive. In that case, a chapter 11 debtor objected to distribution of proceeds following the secured creditor's liquidation of the estate. The district court affirmed the bankruptcy court's order that the secured creditor pay to the estate a certain portion of the proceeds for distribution in accordance with the Bankruptcy Code's priority scheme. The Court of Appeals held that the bankruptcy court lacked authority to compel the secured creditor, which had entered into an agreement with unsecured creditors to share the money it realized from its security, to pay the unsecured creditors' portion of the money to the estate for distribution in accordance with Bankruptcy Code priorities. In so holding the court explained that "the Code does not govern the rights of creditors to transfer or receive nonestate property. . . . Creditors are generally free to do whatever they wish with the bankruptcy dividends they receive. . . ."⁵²

Thus, when an indenture trustee exercises its lien rights it does so against property that has already been distributed under a plan or otherwise (and is not property of the estate), there is no basis or authority for bankruptcy court involvement.⁵³

The district court's decision in *In re Prime Motor Inns, Inc.*⁵⁴ is also instructive in this connection. In that case, letters of credit were issued for the account of Prime Motor Inns and in favor of the indenture trustee in connection with a series of bond issues.⁵⁵ The letters of credit were intended to allow the indenture trustee to draw and pay money owing

⁵¹*In re SPM Mfg. Corp.*, 984 F.2d 1305, 23 Bankr. Ct. Dec. (CRR) 1529, 28 Collier Bankr. Cas. 2d (MB) 451, Bankr. L. Rep. (CCH) ¶ 75090 (1st Cir. 1993).

⁵²984 F.2d, at 1313.

⁵³See *In re Olympia & York Maiden Lane Company LCC*, 1999 Bankr. LEXIS 91 (Bankr. S.D.N.Y. 1999) (holding, *inter alia*, that bankruptcy court lacked subject matter jurisdiction over removed litigation in which the "Debtors do not retain any interest in [the] litigation or any proceeds derived from it"). The bankruptcy court in *Olympia & York* explained that:

debtors estates will not derive any benefit from this litigation. Its outcome will not have any effect on their estates or the administration of these Chapter 11 cases. Thus, we find that this proceeding is not 'related to' a case under title 11 and it must be remanded to the state court pursuant to 28 U.S.C. § 1447(c).

(1999 Bankr. LEXIS 91, *15).

The court further noted that even if the proceeding was somehow "related to," abstention or remand would be proper pursuant to 28 U.S.C. § 1334 or 28 U.S.C. § 1452(b). See also *Matter of Xonics, Inc.*, 813 F.2d 127, 17 Collier Bankr. Cas. 2d (MB) 230, Bankr. L. Rep. (CCH) ¶ 71695 (7th Cir. 1987) (holding bankruptcy court lacked subject matter jurisdiction over a dispute between secured creditors concerning property the estate had abandoned). Compare *In re Best Products Co., Inc.*, 68 F.3d 26, 28 Bankr. Ct. Dec. (CRR) 11, Bankr. L. Rep. (CCH) ¶ 76669 (2d Cir. 1995) (concluding that bankruptcy court had subject matter jurisdiction to enforce, pursuant to Section 510(a), contractual subordination agreement between parties that had filed proofs of claim against the debtor's estate, and noting that "fixing the order of priority of creditor claims against a debtor is an integral and historic bankruptcy function and without this the court would be powerless to rehabilitate a debtor").

⁵⁴*In re Prime Motor Inns, Inc.*, 130 B.R. 610, 22 Bankr. Ct. Dec. (CRR) 1 (S.D. Fla. 1991).

⁵⁵*Id.*, at 611-612.

under the indentures if a default occurred.⁵⁶ Such a default occurred as a result of Prime's commencement of a chapter 11 case.⁵⁷ The issuing banks paid the indenture trustee under the letters of credit, however, before it could distribute the proceeds of the letters of credit to the bondholders, the bankruptcy court granted the debtor's application for a temporary restraining order prohibiting the indenture trustee from distributing the proceeds.⁵⁸ The bankruptcy court subsequently entered an order directing that the letter of credit proceeds be returned to the issuing banks and that the banks reinstate the letters of credit.⁵⁹ The indenture trustee and the issuing bank appealed, contending, *inter alia*, that the bankruptcy court lacked subject matter jurisdiction with respect to the operation and payment of the letters of credit to which the debtor was not a party.⁶⁰ The court held that "the Bankruptcy Court lacked subject matter jurisdiction to enjoin payment or distribution of proceeds under the letter of credit contracts to which the debtors were not parties. 28 U.S.C. §§ 1334 and 157 confer jurisdiction only with regard to contracts or affairs of the Debtors and not to contracts or disputes between the third parties."⁶¹

The court stressed the bondholders' contractual entitlement to payment of the letter of credit proceeds upon a default — the bankruptcy court lacked jurisdiction to interfere with bargained for contractual rights of third parties. "Undoubtedly the Bankruptcy Court believed that the bondholders were not harmed because the letters of credit had been reinstated and Prime was continuing to pay interest. But the bondholders' bargain was to receive payment of all they were owed if there was a bankruptcy filing and to shift to the issuing bank the burden and risk of participating as creditors in the bankruptcy proceeding."⁶²

The indenture creates a contractual relationship between the indenture trustee and the holders. When a distribution has been made to holders and the indenture trustee exercises its contractual lien rights against such distribution, it is exercising bargained for contractual rights against non-estate property *vis-à-vis* non-debtor third parties. This is not "related to" the bankruptcy case under 28 U.S.C. § 1334 and there is no basis for bankruptcy court subject matter jurisdiction.

⁵⁶*Id.*

⁵⁷*Id.*

⁵⁸*Id.*

⁵⁹*Id.*

⁶⁰*Id.*, at 612-613.

⁶¹*Id.*, at 113.

⁶²*Id.*, at 614.

