691 F.2d 1039

United States Court of Appeals,

Second Circuit.

SHARON STEEL CORPORATION, Plaintiff-

v.

The CHASE MANHATTAN BANK, N.A.

**Opinion**

RALPH K. WINTER, Circuit Judge:

This is an appeal by Sharon Steel Corp. (“Sharon”) and UV Industries, Inc. (“UV”), trustees of the UV Liquidating Trust (collectively the “UV Defendants”) from grants of a directed verdict and summary judgment by the United States District Court for the Southern District of New York (Henry F. Werker, *Judge*) in favor of the Trustees of certain UV indentures (“Indenture Trustees”) and intervening holders of debentures issued pursuant to certain of those indentures (“Debentureholders”).

BACKGROUND

1. *The Indentures*

Between 1965 and 1977, UV issued debt instruments pursuant to five separate indentures, the salient terms of which we briefly summarize.

The debentures, notes and guaranties are general obligations of UV. Each instrument contains clauses permitting redemption by UV prior to the maturity date, in exchange for payment of a fixed redemption price (which includes principal, accrued interest and a redemption premium) and clauses allowing acceleration as a non-exclusive remedy in case of a default.[3](#co_footnote_B00331982143989_1) Each contains a “successor obligor” provision allowing UV to assign its debt to a corporate successor which purchases “all or substantially all” of UV’s assets. If the debt is not assigned to such a purchaser, UV must pay off the debt. While the successor obligor clauses vary in language, the parties agree that the differences are not relevant to the outcome of this case.

2. *The Liquidation of UV*

During 1977 and 1978, UV operated three separate lines of business. One line, electrical equipment and components, was carried on by Federal Pacific Electric Company (“Federal”). In 1978, Federal generated 60% of UV’s operating revenue and 81% of its operating profits. It constituted 44% of the book value of UV’s assets and 53% of operating assets. UV also owned and operated oil and gas properties, producing 2% of its operating revenue and 6% of operating profits. These were 5% of book value assets and 6% of operating assets. UV also was involved in copper and brass fabrication, through Mueller Brass, and metals mining, which together produced 13% of profits, 38% of revenue and constituted 34% of book value assets and 41% of operating assets. In addition to these operating assets, UV had cash or other liquid assets amounting to 17% of book value assets.

On December 19, 1978, UV’s Board of Directors announced a plan to sell Federal. On January 19, 1979, the UV Board announced its intention to liquidate UV, subject to shareholder approval. On February 20, 1979, UV distributed proxy materials, recommending approval of (i) the sale of Federal for $345,000,000 to a subsidiary of Reliance Electric Company and (ii) a Plan of Liquidation and Dissolution to sell the remaining assets of UV over a 12-month period. The proceeds of these sales and the liquid assets were to be distributed to shareholders. The liquidation plan required “that at all times there be retained an amount of cash and other assets which the [UV Board of Directors] deems necessary to pay, or provide for the payment of, all of the liabilities, claims and other obligations ...” of UV. The proxy statement also provided that, if the sale of Federal and the liquidation plan were approved, UV would effect an initial liquidating distribution of $18 per share to its common stockholders.

On March 26, 1979, UV’s shareholders approved the sale of Federal and the liquidation plan. The following day, UV filed its Statement of Intent to Dissolve with the Secretary of State of Maine, its state of incorporation. On March 29, the sale of Federal to the Reliance Electric subsidiary for $345 million in cash was consummated. On April 9, UV announced an $18 per share initial liquidating distribution to take place on Monday, April 30.

The Indenture Trustees were aware that UV contemplated making an $18 per share liquidating distribution since at least February 20, 1979 (the date the proxy materials were distributed).[10](#co_footnote_B010101982143989_1) On April 26, the Trustees met with UV officers and directors and collectively demanded that UV pay off all the debentures within 30 days or, alternatively, that UV establish a trust fund of $180 million to secure the debt.

The outcome of this meeting was an “Agreement for Treatment of Certain Obligations of UV Industries, Inc.,” dated April 27, 1979, between UV and the Indenture Trustees (“April Document”). Under the April Document, UV agreed, *inter alia,* to set aside a cash fund of $155 million to secure its public debt and to present a proposal for the satisfaction and discharge of that debt to the Indenture Trustees within 90 days. The Indenture Trustees agreed not to seek an injunction against the payment of the $18 per share liquidating distribution. The April Document provided that all obligations thereunder would terminate upon the payment of UV’s public debt or upon UV’s abandonment of the plan of liquidation.

On July 23, 1979, UV announced that it had entered into an agreement for the sale of most of its oil and gas properties to Tenneco Oil Company for $135 million cash. The deal was consummated as of October 2, 1979 and resulted in a net gain of $105 million to UV.

3. *The Sale to Sharon Steel*

In November, 1979, Sharon proposed to buy UV’s remaining assets. Another company, Reliance Group (unrelated to Reliance Electric), had made a similar offer. After a brief bidding contest, UV and Sharon entered into an “Agreement for Purchase of Assets” and an “Instrument of Assumption of Liabilities” on November 26, 1979. Under the purchase agreement, Sharon purchased all of the assets owned by UV on November 26 (*i.e.,* Mueller Brass, UV’s mining properties and $322 million in cash or the equivalent) for $518 million ($411 million of Sharon subordinated debentures due in 2000-then valued at 86% or $353,460,000-plus $107 million in cash). Under the assumption agreement, Sharon assumed all of UV’s liabilities, including the public debt issued under the indentures. UV thereupon announced that it had no further obligations under the indentures or lease guaranties, based upon the successor obligor clauses.

On December 6, 1979, in an attempt to formalize its position as successor obligor, Sharon delivered to the Indenture Trustees supplemental indentures executed by UV and Sharon. The Indenture Trustees refused to sign. Similarly, Sharon delivered an assumption of the lease guaranties to both Chase and Union Planters but those Indenture Trustees also refused to sign.

DISCUSSION

1. *The Successor Obligor Clauses*

Sharon Steel argues that Judge Werker erred in not submitting to the jury issues going to the meaning of the successor obligor clauses. We disagree.

Successor obligor clauses are “boilerplate” or contractual provisions which are standard in a certain genre of contracts. Successor obligor clauses are thus found in virtually all indentures. Such boilerplate must be distinguished from contractual provisions which are peculiar to a particular indenture and must be given a consistent, uniform interpretation. As the American Bar Foundation *Commentaries on Indentures* (1971) (“*Commentaries* ”) state:

Since there is seldom any difference in the intended meaning [boilerplate] provisions are susceptible of standardized expression. The use of standardized language can result in a better and quicker understanding of those provisions and a substantial saving of time not only for the draftsman but also for the parties and all others who must comply with or refer to the indenture, including governmental bodies whose approval or authorization of the issuance of the securities is required by law.

*Id.*

Boilerplate provisions are thus not the consequence of the relationship of particular borrowers and lenders and do not depend upon particularized intentions of the parties to an indenture. There are no adjudicative facts relating to the parties to the litigation for a jury to find and the meaning of boilerplate provisions is, therefore, a matter of law rather than fact.

Moreover, uniformity in interpretation is important to the efficiency of capital markets. As the Fifth Circuit has stated:

A large degree of uniformity in the language of debenture indentures is essential to the effective functioning of the financial markets: uniformity of the indentures that govern competing debenture issues is what makes it possible meaningfully to compare one debenture issue with another, focusing only on the business provisions of the issue (such as the interest rate, the maturity date, the redemption and sinking fund provisions in the conversion rate) and the economic conditions of the issuer, without being misled by peculiarities in the underlying instruments.

[*Broad v. Rockwell International Corp.,* 642 F.2d 929, 943 (5th Cir.)](http://www.westlaw.com/Link/Document/FullText?findType=Y&serNum=1981114220&pubNum=350&originatingDoc=Icd12bfc2931311d993e6d35cc61aab4a&refType=RP&fi=co_pp_sp_350_943&originationContext=document&vr=3.0&rs=cblt1.0&transitionType=DocumentItem&contextData=(sc.Default)#co_pp_sp_350_943), *cert. denied,* [454 U.S. 965, 102 S.Ct. 506, 70 L.Ed.2d 380 (1981)](http://www.westlaw.com/Link/Document/FullText?findType=Y&serNum=1981243305&pubNum=708&originatingDoc=Icd12bfc2931311d993e6d35cc61aab4a&refType=RP&originationContext=document&vr=3.0&rs=cblt1.0&transitionType=DocumentItem&contextData=(sc.Default)). Whereas participants in the capital market can adjust their affairs according to a uniform interpretation, whether it be correct or not as an initial proposition, the creation of enduring uncertainties as to the meaning of boilerplate provisions would decrease the value of all debenture issues and greatly impair the efficient working of capital markets. Such uncertainties would vastly increase the risks and, therefore, the costs of borrowing with no offsetting benefits either in the capital market or in the administration of justice. Just such uncertainties would be created if interpretation of boilerplate provisions were submitted to juries sitting in every judicial district in the nation.

Sharon also argues that Judge Werker erred in rejecting evidence of custom and usage and practical construction as to the meaning of the successor obligor clauses. While custom or usage might in some circumstances create a fact question as to the interpretation of boilerplate provisions, the evidence actually offered by Sharon simply did not tend to prove a relevant custom or usage. Sharon’s experts both conceded that so far as the meaning of successor obligor clauses and the language “all or substantially all” are concerned, the UV/Sharon transaction was unique. Their testimony was thus limited to use of such clauses and such language in very different contexts. Because context is of obvious and critical importance to the use of particular language, the testimony offered did not tend to prove or disprove a material fact.

Sharon’s proffer of evidence as to practical construction also fails. At best, it amounted to a few statements over a two-week period by Indenture Trustees or Debentureholders implying that a purchaser such as Sharon might become a successor obligor. Sharon’s offer of proof falls woefully short of the kind of mutual understanding over a period of time which is necessary for practical construction to become relevant to interpretation. Particularly where boilerplate is concerned, a more deliberate and enduring course of conduct is necessary to utilize practical construction.

We turn now to the meaning of the successor obligor clauses. Interpretation of indenture provisions is a matter of basic contract law. As the *Commentaries* at 2 state:

The second fundamental characteristic of long term debt financing is that the rights of holders of the debt securities are largely a matter of contract. There is no governing body of statutory or common law that protects the holder of unsecured debt securities against harmful acts by the debtor except in the most extreme situations ... [T]he debt securityholder can do nothing to protect himself against actions of the borrower which jeopardize its ability to pay the debt unless he ... establishes his rights through contractual provisions set forth in the ... indenture.

Contract language is thus the starting point in the search for meaning and Sharon argues strenuously that the language of the successor obligor clauses clearly permits its assumption of UV’s public debt. Sharon’s argument is a masterpiece of simplicity: on November 26, 1979, it bought everything UV owned; therefore, the transaction was a “sale” of “all” UV’s “assets.” In Sharon’s view, the contention of the Indenture Trustees and Debentureholders that proceeds from earlier sales in a predetermined plan of piecemeal liquidation may not be counted in determining whether a later sale involves “all assets” must be rejected because it imports a meaning not evident in the language.

Sharon’s literalist approach simply proves too much. If proceeds from earlier piecemeal sales are “assets,” then UV continued to own “all” its “assets” even after the Sharon transaction since the proceeds of that transaction, including the $107 million cash for cash “sale,” went into the UV treasury. If the language is to be given the “literal” meaning attributed to it by Sharon, therefore, UV’s “assets” were not “sold” on November 26 and the ensuing liquidation requires the redemption of the debentures by UV. Sharon’s literal approach is thus self-defeating.

Sharon argues that the sole purpose of successor obligor clauses is to leave the borrower free to merge, liquidate or to sell its assets in order to enter a wholly new business free of public debt and that they are not intended to offer any protection to lenders. On their face, however, they seem designed to protect lenders as well by assuring a degree of continuity of assets. Thus, a borrower which sells all its assets does not have an option to continue holding the debt. It must either assign the debt or pay it off. As the *Commentaries* state at 290:

The decision to invest in the debt obligations of a corporation is based on the repayment potential of a business enterprise possessing specific financial characteristics. The ability of the enterprise to produce earnings often depends on particular assets which it owns. Obviously, if the enterprise is changed through consolidation with or merged into another corporation or through disposition of assets, the financial characteristics and repayment potential on which the lender relied may be altered adversely.

The single reported decision construing a successor obligor clause, [*B. S. F. Company v. Philadelphia National Bank,* 42 Del.Ch. 106, 204 A.2d 746 (1964)](http://www.westlaw.com/Link/Document/FullText?findType=Y&serNum=1964133115&pubNum=162&originatingDoc=Icd12bfc2931311d993e6d35cc61aab4a&refType=RP&originationContext=document&vr=3.0&rs=cblt1.0&transitionType=DocumentItem&contextData=(sc.Default)), clearly held that one purpose of the clause was to insure that the principal operating assets of a borrower are available for satisfaction of the debt.

Sharon seeks to rebut such inferences by arguing that a number of transactions which seriously dilute the assets of a company are perfectly permissible under such clauses. For example, UV might merge with, or sell its assets to, a company which has a miniscule equity base and is debt heavy. They argue from these examples that the successor obligor clause was not intended to protect borrowers from the kind of transaction in which UV and Sharon engaged.

We disagree. In fact, a substantial degree of protection against diluting transactions exists for the lender. Lenders can rely, for example, on the self-interest of equityholders for protection against mergers which result in a firm with a substantially greater danger of insolvency. So far as the sale of assets to such a firm is concerned, that can occur but substantial protection exists even there since the more debt heavy the purchaser, the less likely it is that the seller’s equityholders would accept anything but cash for the assets. A sale to a truly crippled firm is thus unlikely given the self-interest of the equityholders. After a sale, moreover, the lenders would continue to have the protection of the original assets. In both mergers and sales, complete protection against an increase in the borrower’s risk is not available in the absence of more specific restrictions, but the self-interest of equityholders imposes a real and substantial limit to that increase in risk. The failure of successor obligor clauses to provide even more protection hardly permits an inference that they are designed solely for the benefit of borrowers.

Sharon poses hypotheticals closer to home in the hope of demonstrating that successor obligor clauses protect only borrowers: *e.g.,* a transaction involving a sale of Federal and the oil and gas properties in the regular course of UV’s business followed by an $18 per share distribution to shareholders after which the assets are sold to Sharon and Sharon assumes the indenture obligations. To the extent that a decision to sell off some properties is not part of an overall scheme to liquidate and is made in the regular course of business it is considerably different from a plan of piecemeal liquidation, whether or not followed by independent and subsequent decisions to sell off the rest. A sale in the absence of a plan to liquidate is undertaken because the directors expect the sale to strengthen the corporation as a going concern. A plan of liquidation, however, may be undertaken solely because of the financial needs and opportunities or the tax status of the major shareholders. In the latter case, relatively quick sales may be at low prices or may break up profitable asset combinations, thus drastically increasing the lender’s risks if the last sale assigns the public debt. In this case, for example, tax considerations compelled completion of the liquidation within 12 months. The fact that piecemeal sales in the regular course of business are permitted thus does not demonstrate that successor obligor clauses apply to piecemeal liquidations, allowing the buyer last in time to assume the entire public debt.

We hold, therefore, that protection for borrowers as well as for lenders may be fairly inferred from the nature of successor obligor clauses. The former are enabled to sell entire businesses and liquidate, to consolidate or merge with another corporation, or to liquidate their operating assets and enter a new field free of the public debt. Lenders, on the other hand, are assured a degree of continuity of assets.

Where contractual language seems designed to protect the interests of both parties and where conflicting interpretations are argued, the contract should be construed to sacrifice the principal interests of each party as little as possible. An interpretation which sacrifices a major interest of one of the parties while furthering only a marginal interest of the other should be rejected in favor of an interpretation which sacrifices marginal interests of both parties in order to protect their major concerns.

Of the contending positions, we believe that of the Indenture Trustees and Debentureholders best accommodates the principal interests of corporate borrowers and their lenders. Even if the UV/Sharon transaction is held not to be covered by the successor obligor clauses, borrowers are free to merge, consolidate or dispose of the operating assets of the business. Accepting Sharon’s position, however, would severely impair the interests of lenders. Sharon’s view would allow a borrowing corporation to engage in a piecemeal sale of assets, with concurrent liquidating dividends to that point at which the asset restrictions of an indenture prohibited further distribution. A sale of “all or substantially all” of the remaining assets could then be consummated, a new debtor substituted, and the liquidation of the borrower completed. The assignment of the public debt might thus be accomplished, even though the last sale might be nothing more than a cash for cash transaction in which the buyer purchases the public indebtedness. The UV/Sharon transaction is not so extreme, but the sale price paid by Sharon did include a cash for cash exchange of $107 million. Twenty-three percent of the sale price was, in fact, an exchange of dollars for dollars. Such a transaction diminishes the protection for lenders in order to facilitate deals with little functional significance other than substituting a new debtor in order to profit on a debenture’s low interest rate. We hold, therefore, that boilerplate successor obligor clauses do not permit assignment of the public debt to another party in the course of a liquidation unless “all or substantially all” of the assets of the company at the time the plan of liquidation is determined upon are transferred to a single purchaser.

The application of this rule to the present case is not difficult. The plan of liquidation was approved by UV’s shareholders on March 26, 1978. Since the Indenture Trustees make no claim as to an earlier time, *e.g.,* the date of the Board recommendation, we accept March 26 as the appropriate reference date. The question then is whether “all or substantially all” of the assets held by UV on that date were transferred to Sharon. That is easily answered. The assets owned by UV on March 26 and later transferred to Sharon were Mueller Brass, certain metals mining property, and substantial amounts of cash and other liquid assets. UV’s Form 10-K and Sharon’s Form S-7 state that Mueller Brass and the metals mining properties were responsible for only 38% of UV’s 1978 operating revenues and 13% of its operating profits. They constitute 41% of the book value of UV’s operating properties. When the cash and other liquid assets are added, the transaction still involved only 51% of the book value of UV’s total assets.

Since we do not regard the question in this case as even close, we need not determine how the substantiality of corporate assets is to be measured, what percentage meets the “all or substantially all” test or what role a jury might play in determining those issues. Even when the liquid assets (other than proceeds from the sale of Federal **\*1052** and the oil and gas properties) are aggregated with the operating properties, the transfer to Sharon accounted for only 51% of the total book value of UV’s assets. In no sense, therefore, are they “all or substantially all” of those assets. The successor obligor clauses are, therefore, not applicable. UV is thus in default on the indentures and the debentures are due and payable. For that reason, we need not reach the question whether the April Document was breached by UV.

 

3. *The Redemption Premium*

Judge Werker held that the redemption premium under the indentures need not be paid by UV. His reasoning was essentially that UV defaulted under the indenture agreement and that the default provisions provide for acceleration rather than a redemption premium. We do not agree. The acceleration provisions of the indentures are explicitly permissive and not exclusive of other remedies. We see no bar, therefore, to the Indenture Trustees seeking specific performance of the redemption provisions where the debtor causes the debentures to become due and payable by its voluntary actions.

This is not a case in which a debtor finds itself unable to make required payments. The default here stemmed from the plan of voluntary liquidation approved on March 26, 1979, followed by the unsuccessful attempt to invoke the successor obligor clauses. The purpose of a redemption premium is to put a price upon the voluntary satisfaction of a debt before the date of maturity. While such premiums may seem largely irrelevant for commercial purposes in times of high interest rates, they nevertheless are part of the contract and would apply in a voluntary liquidation which included plans for payment and satisfaction of the public debt. We believe it undermines the plain purpose of the redemption provisions to allow a liquidating debtor to avoid their terms simply by failing to take the steps necessary to redeem the debentures, thereby creating a default. We hold, therefore, that the redemption premium must be paid.

5. *Attorney’s Fees*

Judge Werker granted attorney’s fees and expenses to the Debentureholders to be recovered out of the common fund secured for the class they have represented. The Debentureholders argue that Sharon Steel should be made to pay those fees and expenses. Noting that the debentures specifically provide for payment of attorney’s fees and expenses only for litigation brought by the Indenture Trustees, we affirm this ruling on Judge Werker’s opinion.

CONCLUSION

We affirm Judge Werker’s dismissal of Sharon’s amended complaint and award of judgment to the Indenture Trustees and Debentureholders on their claim that the debentures are due and payable. We reverse his dismissal of the claim for payment of the redemption premium and his award of the interest earned on the $155 million fund. We affirm his granting of attorney’s fees and expenses to the Debentureholders out of the judgment recovered. The Indenture Trustees shall be awarded their full costs. The Debentureholders shall be awarded one-half their costs.