

Chancery Ruling Limits National Collegiate Founder Clout

By **Jeff Montgomery**

Law360 (August 27, 2020, 9:17 PM EDT) -- In a milestone opinion on control of the troubled National Collegiate Student Loan investment trusts, a Delaware vice chancellor found on Thursday that a private equity founder has no current beneficial interest in and little current control over what began as a \$15 billion fleet of collateralized student loans.

Vice Chancellor Joseph R. Slights III, in a 191-page decision, clarified some of the rights and duties of the different players surrounding the 800,000-student-loan enterprise, and declared as a matter of first impression that the founder and ultimate owners — mainly interests of Donald Uderitz's Vantage Capital Group — owe fiduciary duties to indenture trustees who manage the loans.

The decisions emerged from a motion for judgment on pleadings, resolving many but not all of the more than 140 requests for rulings brought by different parties to the National Collegiate enterprise and the litigation it has fueled.

Battles involving trustees, loan servicers, administrators, Uderitz, unpaid lawyers and students claiming they were wrongly sued by National Collegiate for unproven claims to unpaid debts have sprawled across the country in both state and federal courts in recent years. Uderitz, who founded the collateralized student loan venture, escalated the battle in 2016 with an attempt to install a new loan servicer, after claiming that audits had turned up problems under the existing servicer, the Pennsylvania Higher Education Assistance Agency, and concerns over alleged mismanagement and billions in lost loan value.

The disputes, the vice chancellor said, have left the trusts in "a state of near paralysis," with outside parties unable to determine who controls and can make commitments.

"While I have addressed the discreet questions of law that have been submitted for decision, this opinion will not resolve all of the parties' disputes," the vice chancellor cautioned in a footnote. "I trust this opinion is a valuable first step toward bringing clarity to the parties as they sort through broader aspects of their disagreements regarding the trusts' governance and operations."

The vice chancellor's decision was released eight days after the Third Circuit Court of Appeals sent back to the U.S. district court in Delaware a finding that the owners failed to secure needed noteholder approval for the retention of a new loan servicer during the dispute with the Pennsylvania Higher Education Assistance Agency.

The trusts are bundles of student loans used as collateral for notes, with the collateral and debts governed by indentures drawn up under New York law. A squad of trustees, servicers and administrators was formed to service the loans and assure payment on notes, with loan payments financing debt repayment and administrative costs.

Tensions soon emerged. Uderitz's "owner" interests sought support for claims to control over an owner trustee, Wilmington Trust, which was squeezed by conflicting demands from an indenture trustee, other administrators and servicers, and first-in-line noteholders. Other litigation alleged billions in lost value due to mismanaged loan records.

Among the biggest steps Thursday was a finding that New York law, which governs a linchpin indenture agreement, does not prohibit an absolute assignment of trust collateral to the indenture parties, along with a security interest in the collateral, until the notes are paid.

"This leads to the inescapable conclusion, based on the plain language of the indenture, that the trusts currently have no beneficial interest in the student loans that serve as collateral for the notes," the vice chancellor found.

Although the owners have no direct or indirect right to receive proceeds from loans until noteholders are fully paid, Vice Chancellor Slight found that the owners still have obligations and a financial interest in assuring that the loans continue to be serviced and paid.

In another finding of first impression, the vice chancellor said that "to the extent they use their rights to direct the owner trustee (and, in turn, the trusts), as a matter of fiduciary duty, the owners cannot use the trusts' legal title to the student loans to self-deal at the expense of the student loans' beneficial owners."

Drawn into the suit were issues over rights to direct the trusts, owner trustee expenses eligible for payment, the limits of noteholder authority to enforce trust documents and the extent to which owners can direct the trusts.

Vice Chancellor Slight observed one real-world consequence of confusion and ambiguity: the Delaware district court's invalidation of a \$22 million agreement between the trusts and the Consumer Financial Protection Bureau to settle thousands of borrower complaints about collection and record-keeping practices.

"Specifically, the court determined that the proposed consent judgment effecting the settlement was executed on behalf of the trusts by a party who lacked authority to bind the trusts," the vice chancellor said.

Attorneys for the owners and owner trustee did not immediately respond to requests for comment.

In a statement released late Thursday, Michael A. Hanin of Kasowitz Benson Torres LLP, counsel to the noteholders, said the court's decision "confirms that when securitized assets are assigned to an indenture trustee, those assets must be managed for the benefit of noteholders and cannot be exploited for personal gain by residual equity holders or anyone else."

Hanin noted the other decisions by the district court and Third Circuit favorable to the noteholders, and

said the ruling "marks another important step towards resolving the disputes that have plagued these trusts — and threatened the basic assumptions on which participants in the trillion dollar securitization market rely — for many years."

Erik Haas of Patterson Belknap Webb & Tyler LLP, counsel to Ambac Assurance Corporation, which provides financial guarantee insurance for some trust securities, said that Vice Chancellor Slight's decision "correctly aligns the legal rights with economic interests in the securitizations, which is vital to ensuring the continued viability of these important structured finance transactions."

Haas said the decision has received significant attention in the structured finance industry and will have a material impact on securitization transactions, which provide liquidity for part of the financial sector.

"Vice Chancellor Slight's decision goes a long way to resolving the myriad disputed issues" involving economic interests and rights in securitization transactions, Haas said, noting that it was a "significant victory for stakeholders in the securitizations at issue, as well as the financial community as a whole."

A national structured finance group warned in late 2017 that the Consumer Financial Protection Bureau agreement with the trusts, later invalidated by the district court, could rattle and destabilize the securitization industry because it would have signaled "to the investing public that indentures are no longer binding,"

The trusts' owners are represented by Garrett B. Moritz, Benjamin Z. Grossberg and S. Reiko Rogozen of Ross Aronstam & Moritz LLP.

Wilmington Trust is represented by Jason C. Jowers, Stephen B. Brauerman, Elizabeth A. Powers and Brett M. McCartney of Bayard PA.

The noteholders are represented by Catherine A. Gaul of Ashby & Geddes PA and Michael Hanin and Uri Itkin of Kasowitz Benson Torres LLP.

The Pennsylvania Higher Education Assistance Agency is represented by Stacey A. Scrivani of Stevens & Lee PC.

Ambac Assurance Corp. is represented by Melissa N. Donimirski and Kurt M. Heyman of Heyman Enerio Gattuso & Hirzel LLP and Erik Haas, Joshua Kipnees, George A. LoBiondo, Jared Buszin, Peter Shakro, Devon Hercher and Jonah Wacholder of Patterson Belknap Webb & Tyler LLP.

GSS Data Services Inc. is represented by Rebecca L. Butcher and Jennifer L. Cree of Landis Rath & Cobb LLP and John P. Doherty and William Hao of Alston & Bird LLP.

U.S. Bank NA is represented by John W. Shaw and Jeff Castellano of Shaw Keller LLP and Matthew A. Martel, Joseph B. Sconyers, Keith M. Kollmeyer and Anthony M. Masero of Jones Day.

Turnstile Capital Management LLC is represented by Kevin G. Abrams and J. Peter Shindel Jr. of Abrams & Bayliss LLP.

Transworld Systems Inc. is represented by Daniel A. O'Brien of Venable LLP.

The other trusts are represented by Kimberly A. Evans and Rebecca A. Musarra of Grant & Eisenhofer PA.

The case is National Collegiate Student Loan Master Trust et al. v. Pennsylvania Higher Education Assistance Agency et al., case number 12111, in the Court of Chancery of the State of Delaware.

--Editing by Bruce Goldman.