

12-0168-cv(L), 12-0169-cv(CON), 12-0878-cv(CON), 12-0880-cv(CON)*
Franklin Advisers, Inc. v. CDO Plus Master Fund, Ltd.

1
2 **UNITED STATES COURT OF APPEALS**

3
4 **FOR THE SECOND CIRCUIT**

5
6 August Term, 2012

7
8
9 (Argued: March 1, 2013 Decided: August 1, 2013)

10 Docket Nos. 12-0168, 12-0169, 12-0878, 12-0880*

11
12
13 - - - - - X

14
15 THE BANK OF NEW YORK TRUST COMPANY,
16 N.A., AS TRUSTEE,

17
18 Plaintiff,

19
20 - v. -

21
22 FRANKLIN ADVISERS, INC.,

23
24 Defendant-Appellee,

25
26 FRANKLIN CLO II, LTD., FRANKLIN CLO CORP., CHASE MANHATTAN
27 BANK LONDON NOMINEE FOR SEIRA 13, AS NOMINEE, DEUTSCHE BANK
28 SECURITIES INC., AS A NOMINEE, GENSEC IRELAND LIMITED, AS A
29 NOMINEE, HARE & CO., AS NOMINEE, MAC & CO., MASSACHUSETTS
30 MUTUAL LIFE INSURANCE CO., SUN LIFE INSURANCE CO. OF CANADA,
31 AS A NOMINEE, TEMPLETON GLOBAL ADVISORS, LTD., AS A NOMINEE,
32 "JOHN DOE 1," THROUGH "JOHN DOE" 12, THE LAST TWELVE NAMES
33 BEING FICTITIOUS AND UNKNOWN TO PLAINTIFF, THE PERSONS OR
34 PARTIES INTENDED BEING THE BENEFICIAL OWNERS OF THE
35 PREFERRED SHARES, THE SERIES I COMBINATION SECURITY AND THE
36 CLASS C2 NOTES UNDER COMPLAINT,

37
38 Defendants,

39
40 - v. -
41

* Appeals docketed as 12-0168-cv(L) and 12-0169-cv(CON)
were closed by stipulation of the parties on March 8, 2012.

1 CDO PLUS MASTER FUND, LTD., MERRILL LYNCH, PIERCE, FENNER &
2 SMITH INC., AS A NOMINEE,

3
4 Defendants-Appellants.

5
6 - - - - - X
7

8 Before: JACOBS, Chief Judge, POOLER, Circuit
9 Judge, and VITALIANO, District Judge.**

10
11 Merrill Lynch, Pierce, Fenner & Smith Inc., together
12 with CDO Plus Master Fund, Ltd., (collectively, the
13 "Shareholders"), appeal an order of the United States
14 District Court for the Southern District of New York
15 (Marrero, J.) denying their motion for summary judgment and
16 granting partial summary judgment to Franklin Advisers, Inc.
17 ("Franklin"), in a dispute over the payment of a contingent
18 collateral management fee. The Shareholders argue that the
19 district court erred in relying on extrinsic evidence and
20 concluding that Franklin, as collateral manager, was
21 entitled to the contingent fee after the portfolio produced
22 a twelve-percent internal rate of return, according to the
23 terms of the governing indenture. The Shareholders also
24 appeal Franklin's award of attorney's fees and statutory
25 prejudgment interest. For the following reasons, we affirm

** The Honorable Eric N. Vitaliano of the United States District Court for the Eastern District of New York, sitting by designation.

1 the grant of summary judgment and the award of attorney's
2 fees, vacate the award of prejudgment interest, and remand
3 with the instruction to award actual interest on the
4 judgment.

5 JAMES C. MARTIN, Reed Smith LLP,
6 New York, New York (James C.
7 McCarroll and C. Neil Gray, on
8 the brief), for Appellants.
9

10 JONATHAN L. HOCHMAN, Schindler
11 Cohen & Hochman LLP, New York,
12 New York (Matthew A. Katz, on
13 the brief), for Appellee.
14

15 DENNIS JACOBS, Chief Judge:
16

17 This interpleader action was initiated by The Bank of
18 New York Trust Company, N.A. ("BNY"), as Trustee of an
19 investment portfolio of collateralized loan obligations, to
20 resolve a contract dispute between certain shareholders and
21 the manager of that portfolio, Franklin Advisers, Inc.
22 ("Franklin"). In dispute are the terms of the underlying
23 indenture and, specifically, terms governing distribution of
24 a Contingent Collateral Management Fee (the "Contingent Fee"
25 or the "Fee"), which was payable to Franklin only if
26 distributions reached a twelve percent internal rate of
27 return ("IRR"). Franklin claimed the Fee (exceeding \$7
28 million) when the portfolio's return surpassed twelve

1 percent upon an optional redemption voted by the
2 shareholders.

3 On cross-motions for summary judgment, the United
4 States District Court for the Southern District of New York
5 (Marrero, J.) ruled that: (1) the Fee can be paid on an
6 optional redemption; (2) proceeds of an optional redemption
7 should be included in calculating the IRR; and (3) the
8 indenture ("Indenture") is ambiguous as to when the Fee
9 begins to accrue, i.e., whether the fee begins to accrue
10 from the closing date forward, or from the date the
11 portfolio's IRR exceeds twelve percent (an issue the parties
12 resolved by arbitration). On appeal, Merrill Lynch, Pierce,
13 Fenner & Smith Inc. ("Merrill Lynch") and CDO Plus Master
14 Fund, Ltd. ("CDO Plus") (collectively, the "Shareholders")¹
15 argue that each of those rulings was error. They also
16 challenge the court's award of fees and costs, and its award
17 of prejudgment interest at a rate of nine percent pursuant
18 to N.Y. C.P.L.R. § 5001(a). We vacate the award of
19 statutory prejudgment interest and direct that interest be
20 paid only as actually accrued. In all other respects, we
21 affirm.

¹ The term "Shareholders" refers specifically to the Appellants, while "shareholders" refers broadly to all holders of CLO II equity.

I

A. The Transaction

The \$600 million collateral loan obligation from which this dispute arises, titled "CLO II," closed on July 26, 2001. The securities were collateralized by a pool of leveraged commercial loans and then sold to investors who were paid based on cash flow from the underlying loans.

As collateral manager for CLO II, Franklin was responsible for structuring the transaction with the underwriter and for the active management of the portfolio. Merrill Lynch was engaged as underwriter, and two special-purpose investment vehicles were formed as issuer and co-issuer: Franklin CLO II, Ltd. and Franklin CLO Corp. (the "Issuers"). BNY, as Trustee (and stakeholder here), was responsible for collecting principal and interest payments, paying fees and expenses, and then distributing the remaining proceeds to investors.²

On the day of closing, the Trustee and the Issuers executed an Indenture drafted by deal counsel, Cleary Gottlieb Steen & Hamilton LLP ("Cleary"). The same day,

² BNY succeeded Chase Manhattan Bank, the original Trustee, on October 1, 2006.

Franklin and the Issuers executed a Collateral Management Agreement, incorporating all relevant provisions of the Indenture. Merrill Lynch as underwriter sold the CLO II securities to investors on the secondary market. The securities consisted of (1) notes divided into different levels of risk, held by CLO noteholders, and (2) shares of CLO II's equity, held by CLO II shareholders. As portfolio manager, Franklin assembled and maintained CLO II's assets, which, in the main, were leveraged, secured loans made to below-investment-grade borrowers. These loans served as collateral for CLO II's debt obligations to the CLO II noteholders.

B. Provisions in Dispute.

1. The Article 11 "Waterfalls". The Indenture provides that proceeds from the portfolio were to be distributed by BNY according to two sets of detailed payment priorities on defined, quarterly distribution dates. The two payment priorities, set out in Article 11, are called "Waterfalls" because the payments cascade downward to a pool at the bottom for distribution to the shareholders. The first governs distribution of interest proceeds (the "Interest Proceeds Waterfall") and the second governs

1 distribution of principal proceeds derived from obligations
2 paid at maturity or upon liquidation of CLO II (the
3 "Principal Proceeds Waterfall"). The priorities are (1)
4 expenses, (2) noteholders, and (3) shareholders, in that
5 order. Id.

6 2. Franklin's Fees. Franklin was to be paid three
7 types of fees for its work as collateral manager. Two of
8 them were guaranteed and are not at issue here: the Base
9 Collateral Management Fee and the Subordinated Collateral
10 Management Fee.³ The dispute is over the Contingent
11 Collateral Management Fee, a performance-based fee
12 contingent on the shareholders having "received an internal
13 rate of return of 12% per annum . . . on the amount of the
14 initial purchase price of the Preferred Shares for the
15 period from the Closing Date through [the] Distribution
16 Date," JA 79-80,⁴ a precondition designated the "IRR
17 Hurdle." The base calculation of the Fee is approximately
18 equal to 0.25 percent per annum of the value of the
19 collateral and cash in the deal for a given period.

³ The combined guaranteed fees amounted to approximately \$14 million over the life of CLO II.

⁴ "JA" refers to the Joint Appendix; "CA" refers to the Confidential Appendix; "SPA" refers to the Special Appendix; and "SA" refers to the Supplemental Appendix.

1 3. Optional Redemption Provision. CLO II was
2 structured to reach maturity on August 28, 2013. However,
3 Section 9.1(a) of the Indenture provided that, before then,
4 the holders of a majority of the CLO II preferred shares
5 could call for an optional redemption, directing Franklin to
6 sell CLO II's assets, pay its expenses, redeem outstanding
7 notes, and distribute any remaining proceeds to the
8 shareholders.

9 **C. The Redemption Controversy.** In January 2007, a
10 majority of CLO II shareholders called for an optional
11 redemption, to take effect February 28, 2007. On February
12 7, 2007, Franklin auctioned off CLO II's portfolio.

13 It is undisputed that prior to this liquidation
14 Franklin had not achieved the twelve percent rate of return
15 necessary to surmount the IRR Hurdle and earn the Contingent
16 Fee. However, if proceeds on liquidation were included in
17 the calculation, the IRR would have reached 17.7 percent per
18 annum. CDO Plus notified BNY and Franklin of its position
19 that the Fee should be calculated *pre-liquidation* and that
20 Franklin therefore was not entitled to the Fee.⁵

⁵ Franklin points out that CDO Plus has shifted positions. CDO Plus's principal, Don Uderitz, sent a February 2007 email calculating an even *greater* IRR (28.62 percent) but contending that Franklin had waived its

1 Controversy arose when Franklin submitted a claim for a
2 Contingent Fee to BNY, totaling more than \$7 million.⁶

3 Faced with that dispute, BNY asked deal counsel for a
4 formal opinion interpreting the Indenture. Cleary concluded
5 that Franklin was entitled to the Fee. Anticipating
6 litigation between Franklin and the Shareholders, BNY (as
7 Trustee) filed this interpleader action.

8 **D. Procedural History.** At the close of discovery,
9 Franklin and the Shareholders filed cross-motions for
10 summary judgment. The district court ruled that, under the
11 Indenture: (1) a Contingent Fee can be paid upon an optional
12 redemption; and (2) the IRR calculation should include
13 payments made on the redemption date. See Bank of N.Y.
14 Trust, N.A. v. Franklin Advisers, Inc., 674 F. Supp. 2d 458,
15 466-67, 470 (S.D.N.Y. 2009). As to when the Fee accrues,
16 the court found a contractual ambiguity that resisted
17 summary judgment. Id. at 473.

18

entitlement to the Fee by filing an untimely claim. BNY
rejected this untimeliness argument, and CDO Plus has not
pursued the theory here.

⁶ Franklin originally claimed a Fee of \$7,220,205.60,
but this claim increased to \$7,466,654.47 after all interest
payments due on portfolio investments were received.

1 Subject to the Shareholders' reservation of their right
2 to challenge the finding that an ambiguity existed, the
3 parties agreed to arbitrate the following issue: whether
4 "the CLO II indenture should be interpreted to provide that
5 the [Contingent Fee] accrues from the closing date of the
6 transaction or accrues only from the date that the IRR
7 Hurdle is met."⁷ SA 5. In August 2011, following a four-
8 day hearing, the arbitration panel adopted Franklin's
9 position that the Fee accrues from the closing date of the
10 CLO II transaction, even if it is payable only on a
11 distribution date following achievement of a twelve percent
12 IRR.

13 The court confirmed the arbitration award and granted
14 Franklin summary judgment on its claim for attorney's fees.
15 The court also awarded Franklin statutory prejudgment
16 interest at a rate of nine percent pursuant to N.Y. C.P.L.R.
17 § 5001(a). On February 17, 2012, the court entered judgment
18 in Franklin's favor for \$12,763,039.33, consisting of
19 contingent management fees of \$7,466,654.47, attorneys' fees
20 and costs of \$2,064,188.63, and prejudgment interest of
21 \$3,205,196.23.

⁷ Because of how the Contingent Fee is calculated, the accrual date significantly affects the size of the Fee.

II

We review a grant of summary judgment de novo. See Compagnie Financiere de CIC et de L'Union Europeenne v. Merrill Lynch, Pierce, Fenner & Smith Inc., 232 F.3d 153, 157 (2d Cir. 2000). "The question of whether the language of a contract is clear or ambiguous is a question of law to be decided by the court." Id. at 158. If the court determines the operative contract to be ambiguous, it may evaluate the extrinsic evidence as a matter of law. Id. at 159-61.

The Shareholders contend that the district court committed four errors: the first relates to the court's use of extrinsic evidence, and the latter three involve the court's interpretation of certain Fee-related provisions of the Indenture.

III

The Shareholders argue that indentures "are governed by special, market-driven rules of construction" and that "courts are loathe to consider extrinsic evidence of the contracting parties' purported intentions when interpreting indenture provisions." Appellant Br. 21-22. They rely

1 principally on Sharon Steel Corp. v. Chase Manhattan Bank,
2 N.A., 691 F.2d 1039 (2d Cir. 1982).

3 "It is a well-established rule in this Circuit that the
4 'interpretation of Indenture provisions is a matter of basic
5 contract law.'" Jamie Sec. Co. v. The Ltd., Inc., 880 F.2d
6 1572, 1576 (2d Cir. 1989) (quoting Sharon Steel Corp., 691
7 F.2d at 1049) (alterations omitted). The Indenture here is
8 governed by New York law.

9 The district court thoroughly reviewed applicable
10 principles of New York contract law before construing the
11 provisions at issue. See Bank of New York Trust, N.A., 674
12 F. Supp. 2d at 463-64. One such principle is that, if
13 contract terms are ambiguous, "'the court may accept any
14 available extrinsic evidence to ascertain the meaning
15 intended by the parties during the formation of the
16 contract.'" Id. at 463 (quoting British Int'l Ins. Co. v.
17 Seguros La Republica, S.A., 342 F.3d 78, 82 (2d Cir. 2003)).
18 The district court's application of that principle is
19 consistent with Sharon Steel.

20 There, we construed "successor obligor" clauses in
21 indenture agreements between bondholders and a debtor
22 company in liquidation that sought to assign its debt to the

1 purchaser of its assets. Sharon Steel Corp., 691 F.2d at
2 1042-46. We deemed it significant that the indenture
3 clauses at issue were boilerplate. Id. at 1048. Such
4 provisions are given a consistent, uniform interpretation
5 because they “do not depend upon particularized intentions
6 of the parties to an indenture.” Id. “[T]he creation of
7 enduring uncertainties as to the meaning of boilerplate
8 provisions would decrease the value of all debenture issues
9 and greatly impair the efficient working of capital
10 markets.” Id. We therefore construed the terms as a matter
11 of law based on their plain meaning, but also with reference
12 to the purpose the wording was evidently drafted to serve.
13 See id. at 1049-51.

14 The Shareholders argue that Sharon Steel counsels
15 against drawing upon extrinsic evidence to interpret
16 indenture provisions, as the district court did here (to a
17 limited extent⁸). This argument is flawed for several
18 reasons. [1] There is no evidence that the disputed terms
19 in the CLO II Indenture are boilerplate: to all appearances,
20 they were negotiated, tailored to the transaction, and

⁸ As explained in Section V infra, the district court found extrinsic evidence to be dispositive only in determining whether proceeds of an optional redemption should be included in the calculation of the IRR.

1 govern the amount and trigger of a performance fee
2 potentially in the millions. [2] Sharon Steel expressly
3 states that indentures are subject to basic principles of
4 contract law. See supra p. 12. [3] Although the parties
5 failed to produce such evidence, Sharon Steel allowed that
6 "custom or usage might in some circumstances create a fact
7 question as to the interpretation of boilerplate
8 provisions." Id. at 1048. In sum, the district court's use
9 of extrinsic evidence here is consistent with Sharon Steel,
10 as subsequent case law confirms.⁹

11 The Shareholders also invoke the doctrine of contra
12 proferentem as an alternative to extrinsic evidence when the
13 language of the indenture is unclear. See Kaiser Aluminum
14 Corp. v. Matheson, 681 A.2d 392, 398-99 (Del. 1996).
15 However, it does them no good to have ambiguities construed
16 against the drafter, because Franklin did not draft the
17 contract--and did not sign it. The Indenture was drafted by

⁹ See, e.g., Law Debenture Trust Co. of N.Y. v. Maverick Tube Corp., 595 F.3d 458, 466 (2d Cir. 2010) (applying basic principles of New York contract law to indenture provisions and noting that evidence as to "custom and usage is to be considered by the court where necessary"); Bank of N.Y. v. First Millennium, Inc., 598 F. Supp. 2d 550, 556 (S.D.N.Y. 2009) (under New York law, if an indenture is "ambiguous, then the court may accept any available extrinsic evidence to ascertain the meaning intended by the parties").

1 Cleary as deal counsel and was entered into between the
2 Issuers and the Trustee. Contra proferentem is not an
3 available doctrine here.
4

5 IV

6 The Shareholders argue that they were entitled to
7 summary judgment because the Indenture precludes payment of
8 a Contingent Fee upon an optional redemption. They urge
9 that Article 9 of the Indenture, which specifically governs
10 optional redemptions, creates a separate distribution scheme
11 that does *not* provide for a Contingent Fee and that trumps
12 the distribution scheme set out in Article 11.

13 Article 9 pertains to the "Redemption of Notes." JA
14 203-06. Section 9.1, which applies to optional redemptions,
15 contains no reference to any Contingent Fee payment. But
16 Section 9.1(e) is not an alternative payment schedule or
17 "waterfall," as the Shareholders suggest; rather, it adds
18 another step in the waterfall sequence set out in Article
19 11,¹⁰ which is the only comprehensive scheme governing

¹⁰ Section 9.1(e) provides: "After payment of the Notes and the expenses of the Co-Issuers on any Redemption Date, the Trustee shall pay (i) first, to the Class C-2 Redemption Additional Interest and (ii) second to the Preferred Share Paying Agent, for distribution to the Holders of the Preferred Shares as liquidating distributions, all remaining

1 distribution of interest proceeds and principal proceeds
 2 derived from obligations paid at maturity or upon
 3 liquidation of CLO II. On each distribution date, principal
 4 proceeds flow downward to pay, e.g., taxes and
 5 administrative expenses, JA 227 § 11.1(a)(ii)(A), and debt
 6 obligations to noteholders, JA 228 § 11.1(a)(ii)(D)-(H),
 7 until remaining proceeds are tapped for “payment of all due
 8 and unpaid Contingent Collateral Management Fees.” JA 229 §
 9 11.1(a)(ii)(J). The shareholders get the money that pools
 10 at the end. See JA 229 § 11.1(a)(ii)(L). Interest proceeds
 11 follow a similar course. See JA 225 § 11.1(a)(i).

12 Since Article 11 is made “subject to” certain other
 13 provisions in the Indenture, including Article 9,¹¹ the
 14 Shareholders contend that Article 9 controls. But we see no
 15 tension between these two provisions. Article 9 is read
 16 most naturally as supplementing Article 11, not supplanting
 17 it. Thus Article 9 itself states that the notes shall not

proceeds from the sale and/or termination of the Collateral
 and all other funds in the Collection Account.” JA 204 §
 9.1(e).

¹¹ “Notwithstanding any other provision in this
 Indenture, *but subject to the other subsections of this
 Section, Article 9, and Section 13.1*, on or, with respect to
 amounts referred to in Section 11.1(d), before each
 Distribution Date, the Trustee shall” JA 225 §
 11.1(a) (emphasis added).

1 be optionally redeemed unless a financial institution agrees
 2 to pay "all administrative *and other fees and expenses*
 3 *payable under the Priority of Payments* [Article 11] prior to
 4 the payment of the Notes."¹² JA 203 § 9.1(b) (emphasis
 5 added). Article 9's reference to Article 11's Priority of
 6 Payments implies that optional redemptions incorporate the
 7 detailed distribution scheme established in Article 11.

8 The word "fees" does not appear in Section 9.1(e), but
 9 elsewhere in the Indenture the words "fees" and "expenses"
 10 are used interchangeably.¹⁰ Consequently, the reference to
 11 "the expenses of the Co-Issuers on any Redemption Date"
 12 in Section 9.1(e) can be reasonably interpreted to include
 13 fees.

¹² The two provisions work in tandem. Article 11 sets out the priority of payments to take effect on a distribution date; and optional redemptions must fall on a distribution date. See JA 203 § 9.1(a).

¹⁰ For instance, Section 11.1(a)(i)(B) provides for the payment of "accrued and unpaid Administrative Expenses *constituting expenses of the Co-Issuers (other than the Collateral Management Fee but including other amounts payable by the Issuer to the Collateral Manager under the Collateral Management Agreement or this Indenture).*" JA 225, § 11.1(a)(i)(B) (emphasis added). In this provision, "expenses of the Co-Issuers" is a category that *includes* the Contingent Fee (though it just happens to be carved out here).

1 The Shareholders assert that plain meaning analysis
2 requires that we consider only how the two words are used
3 inside Section 9.1(e); but 9.1(e), like all provisions,
4 should be read in light of the whole agreement. See Brooke
5 Group Ltd. v. JCH Syndicate 488, 663 N.E.2d 635, 637 (N.Y.
6 1996) (“[W]hen interpreting a contract, the entire contract
7 must be considered so as to give each part meaning.”). The
8 Shareholders argue that Section 9.1(e) would have no force
9 or effect unless it alters Article 11’s Priority of
10 Payments. See In re OnBank & Trust Co., 688 N.E.2d 245, 247
11 (N.Y. 1997) (“We decline to read the amendment in such a way
12 as to render some of its terms superfluous.”) (citations
13 omitted). However, Section 9.1(e) provides for a specific
14 class of payment called the “Class C-2 Redemption Additional
15 Interest,” to be paid only in the event of an optional
16 redemption, an event that is not treated in Article 11. So
17 construing Articles 9 and 11 together does not sap Section
18 9.1(e) of force and effect.

19 If the Shareholders were right--that Article 11’s
20 Priority of Payments does not apply when shareholders call
21 an optional redemption, and that there can be no Fee in the
22 event of an optional redemption--we would expect the
23 Indenture to contain *some* language to this surprising

1 effect. The Shareholders are arguing for specific and
2 consequential inferences that do not inhere in Section
3 9.1(e) or in the Indenture as a whole.

4 The Shareholders' interpretation is also unworkable.
5 Section 9.1(e) cannot function as a stand-alone distribution
6 scheme and therefore cannot replace Article 11. As
7 discussed, Article 11 channels principal proceeds step-by-
8 step through each class of payment upon a distribution date.
9 It is similarly detailed as to interest proceeds. In
10 contrast, the single sentence of Section 9.1(e), if read in
11 isolation (as the Shareholders urge), leaves to the
12 imagination how classes of noteholders are to be paid, and
13 in what order, and how the portfolio manager is to be paid
14 (in base fees, subordinated fees, or contingent fees), and
15 in what order. Article 9 is therefore no useful substitute
16 for Article 11. The Shareholders' reply brief effectively
17 concedes as much. See Appellant Reply Br. 10 ("[T]he
18 language in Article 9.1(e) referring to 'payment of the
19 Notes and expenses of the Co-Issuers' necessarily implicates
20 aspects of the Article 11 waterfall").

21 Finally, the contract must be read to conform to the
22 parties' reasonable expectations. See Spear, Leeds &
23 Kellogg v. Cent. Life Assurance Co., 85 F.3d 21, 28 (2d Cir.

1 1996). The parties cannot reasonably have intended for
2 shareholders to be able to avoid the Contingent Fee by
3 exercising an *option* to redeem at any time prior to the
4 scheduled maturity date, particularly since poor performance
5 is not the only reason to elect redemption: shareholders
6 might seek redemption to lock in early gains. Moreover,
7 under the Shareholders' view of the Indenture, Article 9
8 would eliminate *all* fees upon an optional redemption,
9 including the subordinated collateral management fee and the
10 base collateral management fee, which are, by definition,
11 guaranteed. See JA 70, 116-17.

12 Accordingly, we conclude that the Indenture allows for
13 the distribution of the Contingent Fee upon an optional
14 redemption.¹¹

¹¹ Franklin offers various kinds of extrinsic evidence, including Franklin's contemporaneous internal and external communications illustrating its expectation that the Fee could be paid upon an optional redemption; communications between BNY, deal counsel, and the Shareholders; the CLO III transaction; the CLO II Model constructed by Merrill; and industry custom and practice. The district court did not find it necessary to consider this evidence given the contract's plain language, and neither do we.

V

Franklin's eligibility for the Fee depends on whether the portfolio's IRR reached the twelve percent threshold, which in turn depends on whether the proceeds of the optional redemption are taken into account.

The Shareholders urge that the waterfall structure in Article 11 renders Franklin's suggested calculation method impossible, because the calculation and payment of the Fee (at Step J of the priority of payments) cannot be based on the funds in the final distribution made at Step L. See JA 229 § 11.1(a)(ii)(J)-(L). As the Shareholders describe it, the funds cannot flow up a waterfall.

The Shareholders are pressing the waterfall analogy much too hard. Article 11 sets forth a payment *distribution* scheme. These calculations of what is to be distributed at each level can of course be made in advance of the actual distribution of the proceeds, and must be. Article 11 confirms that such calculation must take place *prior* to the distribution:

In connection with the application of funds to pay [Contingent Fees] in accordance with [this Article], no more than one Business Day[] after the Due Period ending prior to such Distribution Date, the Collateral Manager shall deliver to the Trustee a calculation of the amount payable on such Distribution Date.

A 229 § 11.1(e). The Collateral Manager could hardly deliver a calculation to the Trustee prior to the distribution date without taking into account proceeds that have not descended any step of the Waterfall--including the final distribution at Step L.

The issue is conclusively resolved by the definition of "Contingent Collateral Management Fee," which contemplates that calculation of the IRR will include proceeds "from the Closing Date through such Distribution Date":

The fee payable for each Interest Accrual Period to the Collateral Manager in arrears on each Distribution Date . . . ; provided, however, that the [CCMF] will be payable on each Distribution Date only to the extent that (i) holders of the Preferred Shares have received an internal rate of return of 12% per annum . . . on the amount of the initial purchase of the Preferred Shares for the period from the Closing Date through such Distribution Date.

JA 79 (emphasis in original). In this context, "through" means "up to and including." 18 Oxford English Dictionary 11 (2d ed. 1989); see also Curlett Family Ltd. P'ship, Ltd. v. Particle Drilling Techs., Inc., 254 F. App'x 320, 324 n.4 (5th Cir. 2007).

We are bound, first and foremost, by the terms' plain meaning. See Laba v. Carey, 277 N.E.2d 641, 644 (N.Y. 1971). The clarity of the contractual language here

1 obviates a need to consider extrinsic evidence.¹² See
2 Rainbow v. Swisher, 527 N.E.2d 258, 259 (N.Y. 1988). The
3 Shareholders actually acknowledge that “proceeds received
4 ‘through’ a given Distribution Date may be counted in
5 determining whether the . . . Shareholders have received a
6 12% IRR on that date.” Appellant Reply Br. 14. Evidently,
7 this concession is made to assist the Shareholders’ argument
8 that Franklin would be entitled to the Fee “only on the *next*
9 Distribution Date,” which, in the context of an optional
10 redemption, never comes. Id. This reading of the Indenture
11 is implausible, to say the least. The Indenture itself thus

¹² At an earlier stage of the litigation, the district court concluded that the Indenture was ambiguous on this point. See Bank of N.Y. Trust, N.A. v. Franklin Advisors, Inc., 522 F. Supp. 2d 632, 637 (S.D.N.Y. 2007). At summary judgment, the court considered extrinsic evidence such as testimony by Rick Caplan, an industry expert, who stated that it was “‘standard in the industry . . . that optional redemption date proceeds are included in calculating whether the equity holders have reached the IRR hurdle rate.’” Bank of N.Y. Trust, N.A. v. Franklin Advisors, Inc., 674 F. Supp. 2d 458, 468 (S.D.N.Y. 2009) (quoting Caplan). Deal counsel Raymond Check confirmed that the calculation of the IRR was intended to account for all returns “through and including” the distribution date, and that this usage and interpretation is common in the industry. Id. at 468-69. The district court observed that the Shareholders failed to produce “any evidence tending to show that the word ‘through’ in the clause at issue is not to be interpreted to include Redemption Date payments” and that “the extrinsic evidence is thus one-sided in favor of Franklin Advisors’ interpretation.” Id. at 470. Because no reasonable jury could find for the Shareholders on this issue, the court therefore granted summary judgment to Franklin. Id.

1 makes plain that calculation of the IRR includes redemption
2 proceeds; we need look no further.

3
4 **VI**

5 Having concluded that a Fee is payable following an
6 optional redemption, and that calculation of the Fee takes
7 into account redemption proceeds, we turn to the issue of
8 accrual: Franklin argues that the Fee began to accrue at the
9 date of closing (July 26, 2001); the Shareholders argue that
10 it did not begin to accrue until the date the portfolio
11 surpassed the IRR Hurdle (February 28, 2007). On this
12 point, the district court found the contract ambiguous and
13 the extrinsic evidence mixed, thus creating a genuine issue
14 of material fact. The parties submitted the issue to an
15 arbitration panel, which concluded that the evidence favored
16 Franklin's position overwhelmingly. We discern no error in
17 the district court's decision.

18 By definition, the Fee is triggered only upon the
19 portfolio reaching an internal rate of return of twelve
20 percent per annum. The Fee is calculated as the "accrued
21 and unpaid Contingent Collateral Management Fee (consisting
22 of the Contingent Collateral Management Fee *accrued for the*
23 *related Interest Accrual Period and any such fee accrued for*

1 *prior Due Periods but not paid on any prior Distribution*
2 *Date)* that is payable on such Distribution Date as described
3 above."¹³ JA 79-80 (emphasis added).

4 Neither argument is compelled by the wording. The
5 provision states that the Contingent Fee includes any fee
6 accrued (but not yet paid) for this or prior periods,
7 without specifying an accrual date. The Shareholders'
8 reading strikes us as unlikely because it would mean that
9 whenever the portfolio manager achieves the stated goal of
10 producing a twelve percent annual IRR, it is entitled to
11 nothing except the potential for a fee, large or small, at
12 some point in the future--subject to the whim of
13 shareholders who may avoid that fee award by taking an
14 optional redemption. Such an incentive fee award creates
15 virtually no incentive at all.

16 Nevertheless, the Indenture contains two seemingly
17 inexplicable features. First, as the Shareholders point
18 out, the Principal Proceeds Waterfall provides for the
19 payment of all "due and unpaid" fees, JA 229 §
20 11.1(a)(ii)(J), while the Interest Proceeds Waterfall

¹³ The Indenture further provides that the Fee shall not exceed forty percent of all interest and principal proceeds available for distribution after the portfolio has reached an IRR of twelve percent. See JA 80.

1 provides for the payment of “(1) the Contingent Collateral
2 Management Fee for such Distribution Date, and then (2) all
3 *accrued and unpaid* Contingent Collateral Management Fees
4 accrued on prior Distribution Dates.” JA 227 §
5 11.1(a)(i)(0) (emphasis added). The distinction (if any)
6 between “due and unpaid” and “accrued and unpaid” is not
7 clear; but, even if the distinction is meaningful, it does
8 not indicate whether accrual begins at closing or upon
9 surmounting the IRR Hurdle.

10 Second, the definition of “Subordinated Collateral
11 Management Fee,” one of two guaranteed fees *not* tied to
12 performance, states that the fee “accrue[s] from the Closing
13 Date whether or not currently payable.” JA 116-17. Since
14 it would have been easy and consistent to include such clear
15 wording in the definition of the Contingent Fee (if that is
16 what the parties intended), the absence lends support to the
17 Shareholders’ argument that the Fee does *not* accrue at
18 closing. However, as the district court observed, the two
19 fees serve distinct purposes and are described in different
20 terms throughout the Indenture. See Bank of N.Y. Trust,
21 N.A. v. Franklin Advisers, Inc., 674 F. Supp. 2d 458, 470-71
22 (S.D.N.Y. 2009).

1 15, 2011) (ECF No. 145). We agree with the Shareholders
2 that this was error.

3 We start with the interpleader statute, N.Y. C.P.L.R. §
4 1006(f), which provides that if a court determines that a
5 claimant in an interpleader action is entitled to interest,
6 the stakeholder "shall be liable to such party for interest
7 to the date of discharge at a rate no greater than the
8 lowest discount rate of the Federal Reserve." N.Y. C.P.L.R.
9 § 1006(f) (McKinney 2013). This statute "provides for an
10 award of interest against a *stakeholder* up to the time of
11 discharge . . . but not against unsuccessful *claimants*."
12 Mfr.'s & Traders Trust Co. v. Reliance Ins. Co., 870 N.E.2d
13 124, 126-27 (N.Y. 2007) (emphasis added). As a result, "the
14 interest award here must be authorized, if at all, by the
15 general interest statute, CPLR 5001(a)." Id. at 127.

16 Section 5001(a) provides for a mandatory award of
17 prejudgment interest in certain actions, including those for
18 breach of contract, but the statute contains an exception
19 for actions at equity:

20 Interest shall be recovered upon a sum awarded
21 because of a breach of performance of a contract,
22 or because of an act or omission depriving or
23 otherwise interfering with title to, or possession
24 or enjoyment of, property, *except that in an action*
25 *of an equitable nature, interest and the rate and*

1 *date from which it shall be computed shall be in*
2 *the court's discretion.*

3
4 N.Y. C.P.L.R. § 5001(a) (McKinney 2013) (emphasis added).

5 Because interpleader actions "are indeed equitable,"
6 Manufacturer's, 870 N.E.2d at 127, the district court erred
7 in concluding that the award was mandated by statute. Cf.
8 United Bank Ltd. v. Cosmic Int'l, Inc., 542 F.2d 868, 878
9 (2d Cir. 1976) (holding that prejudgment interest was
10 required by statute because, while Section 5001
11 "specifically excepts 'action(s) of an equitable nature'
12 from the provision's mandatory scope," the stakeholder did
13 not file an interpleader action).

14 In Manufacturer's, the Court went a step further,
15 holding that the successful claimant was not entitled to
16 statutory prejudgment interest because there was no "sum
17 awarded" against the adverse parties. 870 N.E.2d at 127.
18 Additionally, the Court observed that there had been no
19 finding that the losing claimants breached any contract,
20 interfered unlawfully with the possession or enjoyment of
21 any property, asserted frivolous claims, conducted vexatious
22 litigation, or acted solely to cause delay. Id. at 127-28.
23 As a result, there was no basis for an award of statutory
24 prejudgment interest against them.

1 The Issuer shall indemnify and hold harmless
2 [Franklin] . . . from and against any and all
3 Liabilities, and will reimburse [Franklin] for all
4 reasonable fees and expenses (including reasonable
5 fees and expenses of counsel) . . . as such
6 Expenses are incurred in investigation, preparing,
7 pursuing, or defending any claim, action,
8 proceeding or investigation *with respect to any*
9 *pending or threatened litigation* (collectively, the
10 "Actions"), caused by, or arising out of or in
11 connection with the issuance of the Offered
12 Securities
13

14 JA 321 § 10(b) (emphasis added). Franklin contends that
15 this indemnification provision applies broadly to "any
16 pending or threatened litigation" and has no language
17 restricting it to third-party actions, which is true enough.
18 But neither does it clearly state that the provision applies
19 to third-party claims; and we are wary of the inference that
20 indemnification clauses apply to litigation between the
21 parties in the absence of express wording. See Oscar Gruss
22 & Son, Inc. v. Hollander, 337 F.3d 186, 199 (2d Cir. 2003)
23 ("Promises by one party to indemnify the other for
24 attorneys' fees run against the grain of the accepted policy
25 that parties are responsible for their own attorneys'
26 fees."). In New York, courts "'should not infer a party's
27 intention' to provide counsel fees as damages for a breach
28 of contract 'unless the intention to do so is unmistakably
29 clear' from the language of the contract." Id. (quoting

1 Hooper Assocs., Ltd. v. AGS Computers, Inc., 548 N.E.2d 903,
2 905 (N.Y. 1989)). Where, as here, the contract does not
3 “exclusively or unequivocally refer[] to claims between the
4 parties themselves,” Hooper Assocs., Ltd., 548 N.E.2d at
5 905, we will presume that indemnification extends only to
6 third-party disputes.

7 However, it matters not whether the Agreement covers
8 litigation between the contracting parties because this
9 litigation *is* a third-party dispute. The Agreement was
10 entered into between Franklin and the Issuers. The
11 Shareholders concede (in another context) that they “played
12 no role whatsoever in the execution and drafting of the
13 [Agreement].” Appellant Reply Br. 26. Accordingly, this
14 dispute does not implicate the warning in Oscar Gruss
15 against broadly construing indemnification clauses to cover
16 litigation between contracting parties.

17 Additionally, indemnification clauses (like most other
18 contractual provisions) should be read to implement the
19 parties’ intentions, to the extent possible. See Oscar
20 Gruss & Son, Inc., 337 F.3d at 199. The Agreement here
21 specifically contemplates litigation between management and
22 shareholders. In discussing the limits of Franklin’s
23 responsibilities, Section 10(a) refers to Franklin’s

1 potential liability for mismanaging its investments and
2 providing misleading marketing materials. JA 320 § 10(a).
3 These are fertile areas of litigation with investors, as is
4 management fees. Because the parties' intent is
5 ascertainable from the plain wording of the agreement,
6 indemnification does not offend the rule that "such
7 contracts must be strictly construed to avoid inferring
8 duties that the parties did not intend to create." Id. We
9 therefore affirm the indemnification award.

11 CONCLUSION

12 For the foregoing reasons, we affirm the grant of
13 partial summary judgment to Franklin and the denial of
14 summary judgment to the Shareholders, as well as the award
15 of attorney's fees and costs, but we vacate the award of
16 statutory prejudgment interest and remand with the
17 instruction to award actual interest.