WHEN CAN A BONDHOLDER INSIST ON PROMPT PAYMENT OF PRINCIPAL OR INTEREST: RECENT DEVELOPMENTS UNDER THE TRUST INDENTURE ACT

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Introduction

In December 2014 and January 2015, the United States District Court for the Southern District of New York issued two sets of decisions—*Marblegate Asset Mgmt. v. Educ. Mgmt. Corp.*[1] and MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp.[2]—analyzing a provision of the Trust Indenture Act of 1939 (the "TIA")[3] that has rarely found its way into judicial decisions since the statute's enactment.

Marblegate and *Caesars* each involved a bondholder challenge to an out-of-court restructuring on the grounds that it violated TIA section 316(b), which (among other things) prohibits the impairment of a bondholder's right to receive payment of principal and interest under an indenture

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[1]*Marblegate Asset Management v. Education Management Corp.*, 75 F. Supp. 3d 592, Fed. Sec. L. Rep. (CCH) P 98335 (S.D. N.Y. 2014) [hereinafter, "Marblegate I"]; *Marblegate Asset Management, LLC v. Education Management Corp.*, 111 F. Supp. 3d 542, Fed. Sec. L. Rep. (CCH) P 98553 (S.D. N.Y. 2015) [hereinafter, "Marblegate II" and, together with Marblegate I, "Marblegate"].

[2]*MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.*, 80 F. Supp. 3d 507, Fed. Sec. L. Rep. (CCH) P 98344 (S.D. N.Y. 2015) [hereinafter, "Caesars I"]. *Caesars I* should be read in conjunction with a subsequent decision in the same proceeding, *BOKF, N.A. v. Caesars Entertainment Corp.*, 144 F. Supp. 3d 459 (S.D. N.Y. 2015) [hereinafter, "Caesars II" and, together with Caesars I, "Caesars"].

[3]15 U.S.C.A. §§ 77aaa to 77bbbb [hereinafter cited to as TIA §§ 301–28].

without the bondholder's consent.[4] The two rulings have resurrected questions that have been imbedded in the TIA since its enactment in 1939: (i) what is the scope of the "right . . . to receive payment"; and (ii) when is that right "impaired or affected" without consent?[5] Read narrowly, section 316(b) protects bondholders only against non-consensual changes to the terms of an indenture governing payment of principal and interest, as well as the corresponding right to sue for payment.[6] Read broadly, the provision prevents a bond issuer and majority holders from reaching an agreement (outside of a bankruptcy proceeding) that would force minority non-consenting holders to accept a lesser payment than that provided by the terms of the indenture or force a restructuring of the debt by means of a Chapter 11 reorganization, which poses greater obstacles, uncertainties, and costs.[7]

The handful of prior decisions considering section 316(b) have read it narrowly to prohibit only non-consensual modification of indenture terms directly related to payment of principal and interest. *Marblegate* and *Caesars*, however, propose a much broader reading of this section. Under this emerging line of case law, section 316(b) protects a bondholder's *practical*, not just procedural, right to payment. Accordingly, an out-of-court reorganization that amends an indenture in a way that could jeopardize a bondholder's ability to receive payment may run afoul of section 316(b) even where the key indenture terms related to payment of principal and interest remain intact. This, in turn, can translate into added leverage for minority holders in blocking out-of-court restructurings, and thereby limit or substantially impair the prospects for successful reorganizations outside of the bankruptcy system.

The bigger problem with the new learning from these cases is that, having attempted to draw lines between what is and is not practically permissible under section 316(b), *Marblegate* and *Caesars* have failed to provide any guidance with respect to actions that may be deemed a "practical" impairment of bond payment rights. This article attempts to parse

[4]See TIA § 316.

[5]Marblegate II, 111 F.Supp.3d at 546.

[6]Marblegate II, 111 F.Supp.3d at 546.

[7]Marblegate II, 111 F.Supp.3d at 546.

these new decisions and identify, in light of past precedent and legislative history, what elements of an out-of-court restructurings violate the TIA. Part I discusses the TIA's background. Part II discusses the enactment of the TIA and its complex legislative history. Part III discusses the status of the TIA between 1939 and 2013. Part IV discusses the recent case law interpreting section 316(b) and identifies the potential problems with the reading proposed by this new line of cases.

I. Part I: Background of TIA 316(b)

The TIA, passed in 1939, supplements the Securities Act of 1933[8] with respect to public domestic bond issuances under indentures involving more than $10,000,000 in aggregate principal amount of debt.[9] Among other things, the TIA mandates that certain provisions be included (either expressly or by express reference to the TIA) in an indenture governing debt securities sold in the United States and prohibits (subject to certain exceptions)[10] such sale unless the security has been issued under a TIA-qualified indenture.[11]

Among the TIA's central provisions is section 316(b), which prohibits each security holder's right to receive principal and interest under an indenture from being "impaired or affected"

[8] 15 U.S.C.A. §§ 77a to 77aa.

[9] TIA § 304(a)(9). The TIA is administered by the Securities and Exchange Commission ("SEC"), which has promulgated various regulations for the TIA's interpretation and enforcement.

[10] See infra notes 14–16.

[11] See TIA § 318(c). These terms include requirements regarding the eligibility and appointment of a trustee (TIA § 310), procedures governing trustee claims against an obligor (TIA § 311), information rights of the trustee and bondholders (TIA §§ 312 to 13), the obligor's periodic reporting obligations on matters related to financial status, indenture compliance and status of collateral (TIA § 314), duties of the trustee (TIA § 315), restrictions on amendments to indenture terms governing payment of principal and interest (TIA § 316), and the trustee's standing to recover payment from the obligor upon maturity or default (TIA § 317). See Am. Bankr. Inst., A New Weapon in Mega-Bankruptcy Cases: The Trust Indenture Act, presented at the 2015 Winter Leadership Conference, at 1 n.1 (Dec. 4, 2015) [hereinafter, "ABI Winter Conference"].

without the holder's consent, and preserves the right to institute suits to that end.[12] TIA section 316(b) states—

> Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder, except as to a postponement of an interest payment consented to in paragraph (2) of subsection (a) of this section, and except that such indenture may contain a provision limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of the judgment therein would, under applicable law result in the surrender, impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien.[13]

Section 316(b)'s protections are subject to two express exceptions. The first is the right of a 75% supermajority of the outstanding debt to postpone interest payments for up to three years after the relevant due date.[14] The second prevents a holder from suing on debt if doing so would cause a release of the trustee's lien on collateral securing the indenture obligations.[15] A third, unstated exception to sec-

[12] See TIA § 316.

[13] TIA § 316(b). While most qualified indentures contain language that parallels section 316(b), section 316(b) governs TIA-qualified indentures without regard for any inconsistent of contrary language in the indenture. See George W. Shuster, Jr. The Trust Indenture Act and International Debt Restructurings, 14 ABI L. Rev. 431, 432 (2006). Additionally, if the indenture's language departs from that of section 316(b), the statutory language will override the indenture provisions. TIA § 316(b).

[14] TIA § 316(a)(2) (indenture to be qualified "may contain provisions authorizing the holders of not less than 75 per centum in principal amount of the indenture securities . . . to consent on behalf of the holders of all such indenture securities to the postponement of any interest payment for a period not exceeding three years from its due date.").

[15] Shuster, supra note 13, at 436 (citing 84 Cong. Rec. 9073, 9528 (1939)). This second exception is necessary because in a number of jurisdictions (domestic and international), instituting suit for payment of a secured debt without also bringing a parallel claim to realize on the collateral constitutes a waiver of the security. Shuster, supra note 13, at 436.

tion 316(b) is its inapplicability to reorganizations in bankruptcy proceedings.[16]

The TIA was passed with the legislative purpose of establishing federal statutory standards to govern public trust indentures and to increase judicial oversight over debt reorganizations.[17] In particular, the TIA's legislative history indicates that section 316(b) was intended to protect an individual, retail holder from efforts by institutional investors, usually in coordination with the debt issuer, to restructure all of the issuer's debt.[18] Thus, section 316(b) is a countermajoritarian protection designed to preserve the voice and rights of the minority bondholder.[19] Taken to its extreme, however, this same protection can give individual, minority holders enormous negotiating leverage by enabling them to block an issuer's out-of-court reorganization despite overwhelming majority bondholder support.

[16]Shuster, supra note 13, at 437; see also *In re Bd. of Directors of Telecom Argentina, S.A.*, 528 F.3d 162, 172, 50 Bankr. Ct. Dec. (CRR) 12, Bankr. L. Rep. (CCH) P 81248 (2d Cir. 2008) (Sotomayor, J.) (quoting *In re Delta Air Lines, Inc.*, 370 B.R. 537, 550, 48 Bankr. Ct. Dec. (CRR) 52 (Bankr. S.D. N.Y. 2007), aff'd, 374 B.R. 516 (S.D. N.Y. 2007), aff'd, 309 Fed. Appx. 455 (2d Cir. 2009)). The Bankruptcy Code does not contain any express override of the TIA, except with respect to debt securities issued in connection with a Chapter 11 plan of reorganization that mature no later than one year after the effective date of the plan. See 11 U.S.C.A. § 1145(d). Section 1123 of the Bankruptcy Code, however, provides that a plan of reorganization "shall" contain adequate provisions for the plan's implementation. See 11 U.S.C.A. § 1123(a)(5). This has been interpreted to mean that the Supremacy Clause allows the terms of a plan of reorganization to override inconsistent provisions of contract or state law. See generally *In re Public Service Co. of New Hampshire*, 108 B.R. 854, 19 Bankr. Ct. Dec. (CRR) 1902, 110 Pub. Util. Rep. 4th (PUR) 259 (Bankr. D. N.H. 1989).

[17]See S. Rep. No. 76-248, at 1–2 (1939).

[18]One of the primary sources of legislative history for the TIA is a multi-volume report spearheaded by then-commissioner of the SEC, William O. Douglas. See S.E.C., Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees (Adelaide Rosalia Hasse ed., 1936–1940).

[19]See Shuster, supra note 13, at 433; see also Mark J. Roe, The Voting Prohibition in Bond Workouts, 97 Yale L. J. 232, 251–55 (1987) (discussing section 316(b)'s origins and implications in modern domestic debt restructurings).

Notwithstanding the potential power that section 316(b) may give to minority holders, it is important to recognize that section 316(b) protects only a limited set of rights—the right to collect principal and interest when due and the corresponding right to bring suit for such payment. Thus, while section 316(b) prohibits amendments to indenture provisions governing payment of principal and interest without individual bondholder consent, virtually all other provisions in an indenture are fair game for amendment upon a vote by a specified number of bondholders (often, a simple majority). Thus, section 316(b) represents a balancing of considerations—protecting minority holders on the one hand while not stymying the power of obligors to successfully reorganize out of court, on the other.[20]

II. Part II: Enactment of the Trust Indenture Act ("TIA")

A. *1930's Bankruptcy and Securities Reform*

Key to assessing the competing considerations underlying section 316(b) and their application in today's economic landscape is understanding the political and economic environment in the years leading up to the TIA's enactment.

After the stock market crash in October 1929, Congress began holding hearings and enacting reforms in an effort to restore the public's faith in the capital markets.[21] The first major milestone was the passage of the Securities Act of

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[20]See Shuster, supra note 13, at 440.

[21]S.E.C., The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation, available at http://www.sec.gov/about/whatwedo.shtml (last visited Dec. 29, 2011). A modern analog may be found in the 2008 mortgage-backed securities crisis and resulting stock market panic that led to the enactment of the Dodd Frank Act. See generally, Randall D. Guynn, The Financial Panic of 2008 and Financial Regulatory Reform, Harvard L. Sch. Forum on Corp. Governance and Fin. Reg. (Jan. 15, 2016), available at http://corpgov.law.harvard.edu/.

1933[22] in the peak year of the Great Depression, followed by the Securities Exchange Act of 1934[23] the following year.

Bankruptcy laws were changing as well, developing processes to draw more business reorganizations into the purview of the judicial system. Prior to the 1930's, the Bankruptcy Act of 1898[24] provided only for liquidations and failed to address a method for complex entities (such as railroads) to reorganize within the judicial system.[25] Initial efforts to establish a judicial reorganization procedure began with the judicial creation of "equity receiverships" under section 77B of the Bankruptcy Act of 1898.[26] Beginning in 1933, specific reorganization processes were added to the bankruptcy laws to replace equity receiverships.[27] Thereafter, a large-scale overhaul of the Bankruptcy Act of 1898 resulted in the Bankruptcy Act of 1938, with a plethora of provisions for the reorganization of both entities and individuals within the judicial system.

B. *The SEC Report*

Underlying the expansion and overhaul of the bankruptcy

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[22] 15 U.S.C.A. §§ 77a to 77aa [hereinafter, "Securities Act"].

[23] The Exchange Act governs the secondary trading of securities (stocks, bonds, and debentures) in the United States. 15 U.S.C.A. § 78a to 78ll [hereinafter, "Exchange Act"].

[24] Act of July 1, 1898, ch. 541, 30 Stat. 544, 548, as amended, repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, tit. IV, § 401(a), 92 Stat. 2549, 2682 (1978).

[25] Report to the President on the Bankruptcy Act and Its Administration in the Courts of the United States, Sen. Doc. No. 65, 72d Cong., 1st Sess. 39 (1931) (discussing inadequacy of reorganization provisions in the Bankruptcy Act of 1898 and recommending "voluntary proceedings under which debtors, unable to pay their debts in due course, may have the protection of the court, without being adjudged a bankrupt, for the purpose of composing or extending the maturity of their debts . . . [and] in the case of corporations for the purpose of reorganization.").

[26] Jerome Frank, *Epithetical Jurisprudence and the Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act,* 38 N.Y.U. L.Q. Rev. 317, 329 (1941).

[27] See Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467, 1467–70 (creating § 74 of Bankruptcy Act of 1898); Act of June 7, 1934, ch. 345, 48 Stat. 911, 912–25 (creating § 77B of Bankruptcy Act of 1898); see also *Campbell v. Alleghany Corp.*, 75 F.2d 947 (C.C.A. 4th Cir. 1935) (discussing inadequacy of equity receiverships and existing proceedings for distressed entities).

process through the 1930's was the Congressional intent to encourage (or even require) increased judicial overview of reorganizations, as well as to increase oversight and control over out-of-court reorganizations and workouts, particularly for large public bond issuers.[28] The need for such supervision was frankly expressed in a comprehensive study by the SEC, compiled under the purview of William O. Douglas, who would subsequently become Commissioner and then Chairman of the SEC, and later, an Associate Justice of the United States Supreme Court.[29] The SEC memorialized the study's results and recommendations in a series of eight reports (collectively, the "SEC Report") published in 1936–1940.[30] Part VI of this Report, entitled *Trustees Under Indentures*,

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[28] SEC Report, Part III, Committees for the Holders of Real Estate Bonds 225–26 (1937). For example: (i) bankruptcy trustees became mandatory in cases where debts exceeded $250,000; and (ii) the SEC was required to review plans of reorganization proposed in cases involving debts of over $3 million, for potential impact on public investor interests. See Vincent L. Leibell, Jr., The Chandler Act — Its Effect Upon the Law of Bankruptcy, 9 Fordham L. Rev. 380, 386, 395 (1940).

[29] Section 211 of the Exchange Act authorizes the SEC to study business bankruptcies, reorganizations and protective committees.

[30] See supra note 18. The SEC Report is comprised of eight parts: (I) Strategy and Techniques of Protective and Reorganization Committees (1937); (II) Committees and Conflicts of Interest (1937); (III) Committees for the Holders of Real Estate Bonds (1937); (IV) Committees for the Holders of Municipal and Quasi-Municipal Obligations (1936); (V) Protective Committees and Agencies for Holders of Defaulted Foreign Governmental Bonds (1936); (VI) Trustees Under Indentures (1936); (VII) Management Plans Without Aid of Committees (1938); and (VIII) A Summary of the Law Pertaining to Equity and Bankruptcy Reorganizations and of the Commission's Conclusions and Recommendations (1940). Other legislative guidance may be drawn from the statements of the House of Representatives and the Senate during congressional hearings on the subject of the TIA and its enactment. *See* Shuster, *supra* note 13, at 433. The only other material legislative history available on section 316(b) is a 1958 SEC manual prepared for internal use, which provides in relevant part that—

> In view of the emphasis upon the right to sue for principal and interest in the legislative history of Section 316(b), the staff has acquiesced in the view that it relates solely to a suit on the bonds and does not accord any right to pursue a remedy under the indenture.

S.E.C., Manual on Trust Indenture Act of 1939, 145 (1958).

provided the most significant impetus for the TIA's enactment.[31]

As identified in the SEC Report, out-of-court reorganizations had become a threat to the position of the individual, minority bondholder. First, because individual investors usually had limited information and relatively small holdings, their ability to defend their positions in negotiations of out-of-court reorganizations was limited.[32] Second, obligor's insiders, in concert with large banking houses holding blocks of bonds, had the ability to engineer opaque reorganizations at the expense of minority investors in order to be "reinstated in control of the enterprise" after reorganization and "to thwart all investigation of [their] own alleged misdeeds."[33] The predicament of the minority holder was compounded both by the increasing number of bond issuances and the tendency of corporate entities to draft indentures in "legalese" incomprehensible to many retail holders.[34] The SEC Report also highlighted a fear that indenture provisions allowing majorities to amend payment terms would become standard practice and, without proper constraints, debt reorganizations would take place on that basis without any judicial or administrative supervision.[35] Accordingly, the SEC sought to level the playing field for the individual minority holder, with the goal of restoring public faith in the economy through greater structure, transparency and oversight, and thereby encouraging investment in the U.S. capital markets.

This is not to say that the SEC Report advocated a

[31]Part VI of the SEC Report discusses issues relevant to section 316(b) in three key contexts: (i) protection of minority bondholders (see SEC Report, Part VI, at 61–66); (ii) majority reorganizations (see SEC Report, Part VI, at 143–51); and (iii) debt restructurings (see SEC Report, Part VI, at App'x C, Part B).

[32]See SEC Report, Part IV, at 5 ("The individual security holder is impotent when acting alone and can get together with his fellow security holders only at great labor and expense."). See generally SEC Report, Part IV, at 2–6 (discussing challenges faced by individual minority holders).

[33]See SEC Report, Part IV, at 42 (identifying problems due to reorganizations which are "exclusively in the hands of insiders with conflicting interests to serve.").

[34]See SEC Report, Part IV, at 150.

[35]See SEC Report, Part IV, at 63–64.

wholesale shift in favor of the individual, minority shareholder by requiring unanimous bondholder consent for all aspects of an out-of-court reorganization. Indeed, the SEC acknowledged the hazards that an unfettered unanimity requirement could present to an out-of-court reorganization—entities would be forced to spend their limited resources battling minority holdouts, more often resulting in a foreclosure or liquidation rather than a successful reorganization.[36] The SEC Report—recognizing inherent tension between these policies and the need for oversight over reorganizations on an ongoing basis—concluded that any legislative program designed to protect the interests of investors "must involve an *extension* of the supervisory power of judicial or administrative agencies" and prescribed an active trustee as a remedy for addressing these issues.[37]

C. *Early Versions of the TIA — 1937 & 1938*

Section 316(b) was enacted to address the issues raised in the SEC Report regarding minority bondholders, by mandating the inclusion of certain provisions in all (TIA-qualified) trust indentures.[38] By this statutory mechanism, the SEC was consciously forcing many debt restructurings involving TIA-qualified indebtedness to occur under the supervision of

[36] See SEC Report, Part IV, at 145 ("reorganizers would be faced with the necessity of dealing with a dissenting minority, with the consequences that foreclosure proceedings (and later on, [bankruptcy] proceedings) would be necessary."). This concern about minority holders frustrating the will of majorities was present even before claims trading to obtain blocking positions to a plan of reorganization had become a common strategic practice among hedge funds, beginning in the 1980's. The cases discussed in Part IV of this paper, however, involve battles between hedge funds—likely not the types of entities that Commissioner Douglas had envisioned protecting under the TIA.

[37] See SEC Report, Part I, Strategy and Techniques of Protective and Reorganization Committees 898 (1937).

[38] See Richard L. Epling, Are Rule 23 Class Actions a Viable Alternative to the Bankruptcy Code?, 23 Seton Hall L. Rev. 1555, 1567–68 (1993) [hereinafter, "Epling, Rule 23 Class Actions"]. The TIA also created the requirement that an indenture trustee be appointed for each public bond issue over $10 million in principal amount of debt. See TIA § 302(a)(9). Although an initial draft of TIA section 315(c) imposed fiduciary duties on the indenture trustee, the fiduciary obligation was removed from the statute's final version. See Trust Indentures, Hearings Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce, House of Representatives on H.R. 2191 and H.R. 5220, 76th Cong. 12 (1939).

a bankruptcy court and in accordance with the applicable laws and rules, rather than in an out-of-court setting under rules contracted by the parties on the eve of default.[39]

The predecessor to section 316(b), as proposed in 1937 (the "1937 Bill"),[40] was narrower than the contemporary text and focused largely on the bondholder's right to bring an action for payment of principal and interest. Rather than give *automatic* protection to minority holders, the 1937 Bill merely granted the SEC *authority* to require qualified indentures to contain terms regarding—

> [t]he rights, powers, and remedies of the indenture security holders and the manner in which and conditions upon which such rights, powers and remedies may be exercised, including the right and power of the indenture security holders with respect to . . . bringing action to collect the principal of and interest upon the indenture securities at their respective due dates[.][41]

Introduced in the following year, the TIA of 1938 (the "1938 Bill") largely tracked the 1937 Bill with respect to section 316(b).[42] During testimony in the House on the 1938 Bill, Commissioner Douglas testified that he did not believe the provision would impose a unanimity requirement on most indenture amendments.[43] Rather, he explained that its effect was "merely to prohibit provisions authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for principal . . . [or

[39] Shuster, supra note 13, at 438.

[40] Trust Indenture Act of 1937, S. 2344, 75th Cong. § 7(m)(5) (1st Sess. 1937); see also ABI Winter Conference, at 6–8 (discussing and comparing proposed TIA legislation).

[41] Trust Indenture Act of 1937, S. 2344, 75th Cong. § 7(m)(5) (1st Sess. 1937).

[42] Trust Indenture Act of 1938, H.R. 10292, 75th Cong. § 7(m)(3) (3rd Sess. 1937); see also ABI Winter Conference, at 6–8 (comparing 1937 Bill, 1938 Bill and section 316(b), as enacted).

[43] Trust Indentures: Hearing on H.R. 10292 Before a Subcomm. of the Comm. on Interstate and Foreign Commerce, 75th Cong. 35 (1938); see also S. Rep. No. 75-1619, at 19 (1938). See also Testimony of Edmund Burke, Jr., Asst. Dir. Reorg. Div., SEC, before the ABA, Aims, Purposes and Philosophy of the Barkley Bill (July 25, 1938) (expressing concern that, as drafted, the 1938 Bill would prevent majorities from being able to waive principal and interest defaults, which prohibition would force issuers into bankruptcy).

interest]. In other words, this provision merely restricts the power of the majority to change those particular phases [sic] of the contract."[44]

The final text of section 316(b) reveals two significant distinctions from the prior versions.[45] First, while its predecessors gave the SEC discretion to establish certain mandatory provisions, section 316(b) is automatically incorporated into all TIA-qualified indentures.[46] Second, and perhaps more importantly, the "right to bring an action" in the 1937 and 1938 Bills is augmented with the "right to . . . receive payment" in section 316(b).

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[44]Potentially, Douglas also envisioned a situation where an out-of-court restructuring that is approved by a large majority (e.g., 90–95%) of all holders could proceed notwithstanding the existence of a "stub" issue of holdouts whose payment terms remain unaffected. Indeed, many modern debt-for-debt exchange offers require a minimum threshold (often as high as 95%) for an offer to be effective. Richard L. Epling, Exchange Offers, Defaults, and Insolvency: A Short Primer, 8 Bankr. Dev. J. 31, 37–38 (1991) [hereinafter, "Epling, Exchange Offers"].

[45]Although initial drafts of the 1939 version of the TIA remained largely the same as the 1938 Bill, certain legislators expressed concern about the amount of discretion left with the SEC. Accordingly, the statute was revised and the regulatory powers redrafted as statutory requirements. The TIA has been amended only once since its enactment, and section 316 was unaffected, see Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, 104 Stat. 2713, 2721, though Congress heard testimony on a potential repeal of the TIA in 1995–1996. See infra, note 50 (discussing 1996 proposed amendments).

[46]Qualified indentures are deemed to include certain terms (including that embodied in section 316(b)), which are incorporated by operation of law into the indenture itself. See TIA § 318(c).

1937 & 1938 Bills	**TIA § 316(b) (as enacted)**
SEC may require protection of "the rights, powers, and remedies of the indenture security holders and the manner in which and conditions upon which such rights, powers and remedies may be exercised, including the right and power of the indenture security holders with respect to . . . bringing action to collect the principal of and interest upon the indenture securities at their respective due dates[.]"	"The right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder . . ."

As enacted, section 316(b) prohibits impairment of two separate rights of each individual holder without the holder's consent: (i) the right to receive payment of principal and interest when due; and (ii) the right to sue for past-due principal and interest.[47] Accordingly, "no composition or extension of a public debt securities issue may be effected by a mere majority vote."[48] Yet, for each right granted by section 316(b), there is a corresponding question that courts have been unable to definitively answer—(i) what is the

[47] See Epling, Rule 23 Class Actions, supra note 38, at 1560 ("legislative history of the TIA indicates that the individual consent requirement was intended to require that all restructurings of core terms of public debt securities be subjected to the judicial scrutiny of a bankruptcy court."); see also id. at 1568 n. 36 ("it is clear from the legislative history of the TIA and the writings of William O. Douglas . . . that Section 316(b) was specifically designed to prohibit disenfranchisement of individual bondholders absent judicial scrutiny and that the procedure envisioned was a bankruptcy proceeding.").

[48] See Epling, Exchange Offers, supra note 44, at 32. In his testimony on behalf of the SEC, Assistant Director Burke stated—

> All that the section does is preserve the individual holder's right to bring an action at law to collect his interest and principal in accordance with the terms of his contract, unless he himself has consented to a variation from that contract . . . When an investor buys a bond, he buys a right to get a thousand dollars on a particular date. All that this subsection [316(b)] says is that he shall not be deprived of that individual right without his consent.

scope of the "right . . . to receive payment"; and (ii) when is that right "impaired or affected" without individual consent?

III. Part III: A Dormant Statute — the TIA between 1939 and 2013

Between 1939 and 2013, TIA-specific litigation was sparse, or at least rarely found in reported judicial decisions. This apparent dormancy, together with the changing economic landscape, has fueled arguments for the TIA's repeal (or at least, repeal or substantial amendment of section 316(b)). Obligors and many institutional bondholders and restructuring professionals argue that a bondholder's practical ability to recover payment is protected by other processes which would be preempted by a broad interpretation of section 316(b), for example—(a) contract law and express negotiated indenture provisions; (b) fraudulent conveyance law; and (c) state law judgment enforcement mechanisms (*e.g.*, restrictions on a judgment debtor's asset dispositions and turnover proceedings).[49]

Others argue that the TIA is no longer necessary, either because most holders are sophisticated institutional investors that no longer need the TIA's protection or because market developments have come to demand indenture provisions more stringent than the TIA, thus eclipsing its value.[50] Separately, there remains the persistent concern that section 316(b) gives too much leverage to minority holdouts and leads to failed workouts and unnecessary bankruptcy filings, a result that is both economically inefficient and imposes an increased burden on the already clogged courts.[51] In sum, the argument is that the pendulum has swung from favoring

Trust Indentures: Hearing on H.R. 2191 & H.R. 5220 Before the Subcomm. of the Comm. on Interstate & Foreign Commerce, 76th Cong. 284–85 (1939).

[49]ABI Winter Conference, at 9.

[50]Statement of Congressman Jack Fields, Hearings on H.R. 2131, 104th Cong. (1995). Congress considered reforming the TIA again in the mid-1990's, and heard testimony for its repeal based on arguments that its continued utility was limited. See H.R. Rep. No. 104-622, at 40–41 (1996).

[51]See Epling, Rule 23 Class Actions, supra note 38, at 1558–60, citing Mark J. Roe, The Voting Prohibition in Bond Workouts, 97 Yale L.J. 232 (1987), as advocating for the repeal of TIA section 316(b) for giving too much leverage to holdouts among the bondholder group and leads to failed

judicial oversight over reorganizations to encouraging out-of-court workouts and decreased judicial involvement, and the statute should be amended to reflect this.[52]

This is not to say that the TIA is without its supporters. Many continue to value the TIA for the protection it assures to individual bondholders' bargained-for contractual rights to payment and indeed, it cannot be denied that while the percentage of institutional investors has increased, retail holders remain a significant part of the bond market.[53]

In addition to fueling arguments for repeal, the TIA's dormancy has meant that case law interpreting section 316(b) has remained limited, and little jurisprudence has developed to answer the questions concerning the "right . . . to receive payment" and when that right is "impaired or affected" without consent.[54] To complicate matters further, the

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workouts and unnecessary bankruptcy filings. See also Mark J. Roe, Giving Bondholders a Vote in Debt Restructurings, N.Y. Times (Dec. 14, 2015) (discussing potential ramifications of leverage exercised by minority holdouts to obtain better treatment in workouts to the detriment of reorganizations).

[52]As a practical matter, financial institutions rather than retail holders may be more directly affected by modern out-of-court restructurings, particularly in the context of large issuers. See supra, note __.

[53]Large investment firms continue to manage trillions of retail bond accounts for individual customers. See Inv. Co. Inst., 2015 Investment Company Fact Book, Overview of U.S.-Registered Investment Companies, available at http://www.icifactbook.org/fb_ch1.html (stating that U.S.-registered investment companies managed $18.2 trillion in assets at year-end 2014). The potential impact on individual holders was drawn into focus by the recent economic crises in Detroit and Puerto Rico, where a significant amount of the bonds were held by retail, individual holders. See Michelle Kaske, Puerto Rico Risking Point of No Return With Debt Payment Default, Bloomberg, available at http://www.bloomberg.com (July 30, 2015) (discussing retail distribution of Puerto Rico bonds); Note, Anna M. Rice, Investing in Detroit: Automobiles, Bankruptcy, and the Future of Municipal Bonds, 103 Georgetown L. J. 1335 (2015) (discussing retail distribution of Detroit municipal bonds). However, the practical impact of out-of-court restructurings on retail holders may be primarily in the context municipal bond issuances and Chapter 9 bankruptcies.

[54]There have been some TIA-related developments such as (i) the attempt to use class action to affect out-of-court restructurings and (ii) the use of covenant stripping or otherwise "coercive" types of exit consents in exchange offers has become widely accepted. However, in these cases (and as will be discussed further below), the coercion is limited to covenants

limited case law that has developed has not been always consistent.

A. *UPIC & Co. v. Kinder-Care Learning Centers*

UPIC & Co. v. Kinder-Care Learning Centers was among the first of the modern cases to attempt to confront these questions.[55] In *UPIC*, a subordinated noteholder brought an action to recover unpaid principal and interest, arguing that the indenture's subordination provisions violated TIA section 316(b) by impairing subordinated noteholders' rights to receive payment.[56] The court disagreed and found no violation of the TIA, concluding that the TIA protects only those rights conferred by the indenture.[57] To the extent a holder has agreed to certain treatment under an indenture (*i.e.*, subordination in payment rights upon an event of default), section 316(b) will not override the indenture's provisions to, in effect, give the subordinated noteholder better treatment than what the indenture provides with respect to priority of payment.[58] As for impairment, the court reasoned that subordination provisions establish relative rights as between bondholders of varying seniority and do not impair the subordinated bondholder's right to payment.[59] This statement is undoubtedly correct. Section 316(b) is not, nor was it intended to create, a super-priority right to payment.

B. *Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd.*

Seven years after *UPIC*, section 316(b) was employed again in the S.D.N.Y. District Court, in a challenge to a

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and not to extension or alteration of debt maturities, as prohibited by TIA section 316(b). See generally Epling, Rule 23 Class Actions, supra note 38.

[55] *Upic & Co. v. Kinder-Care Learning Centers, Inc.*, 793 F. Supp. 448, Fed. Sec. L. Rep. (CCH) P 96653 (S.D. N.Y. 1992) [hereinafter, "UPIC"].

[56] UPIC, 793 F. Supp. at 450–51.

[57] UPIC, 793 F. Supp. at 460.

[58] UPIC, 793 F. Supp. at 459–60.

[59] UPIC, 793 F. Supp. at 459 ("[R]ather than serve to diminish or impair the rights of Securityholders as against [the issuer] or function so as to protect [the issuer's] interests, the Subordination Clause serves to protect the relative rights of the holders of Senior Indebtedness as against those of the Securityholders, without impairing the Securityholders' absolute and unconditional right to payment of principal of and interest on the Securities.").

coercive tender offer.[60] In *Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd.*,[61] the bond issuer—Mechala Group Jamaica Ltd. ("Mechala"), a Jamaican holding company for a variety of operating subsidiaries—proposed an out-of-court restructuring via a coercive tender offer made to holders of an aggregate $100 million notes it had issued under a series of indentures. The terms of the tender offer were such that, once a majority of the notes were tendered, the indentures would be stripped of certain financial covenants and Mechala's assets would be transferred to a new entity.[62] A group of minority holders not participating in the tender offer objected to the transaction and filed suit seeking (among other things) preliminary and permanent injunctions against the asset transfer, as well as a declaratory judgment that the tender offer violated the TIA.[63]

The court enjoined the transfer at the preliminary injunction stage, finding the bondholders' claim that the tender of-

[60]For a discussion of coercive tender offers and covenant stripping, see Epling, Rule 23 Class Actions, supra note 38, at 1555 n. 3, explaining that a coercive tender offer is a proposed exchange offer for outstanding debt that is coupled with a consent solicitation asking the bondholders to eliminate certain covenants from the indenture (a practice commonly known as "covenant stripping"). Covenant stripping does not run afoul of section 316(b) because the covenants stripped—typically covenants regarding minimum net worth, asset sales or "equal and ratable" provisions—do not govern the timely payment of principal and interest under the indenture and thus are not subject to the limitations of section 316(b). See Epling, Rule 23 Class Actions, supra note 38, at 1555 n. 3. The practical result is that non-consenting holders are left with greatly weakened credit, even without any amendment to the payment terms in the indenture governing their notes. See Epling, Rule 23 Class Actions, supra note 38, at 1555 n. 3.

[61]*Federated Strategic Income Fund v. Mechala Group Jamaica Ltd.*, Fed. Sec. L. Rep. (CCH) P 90707, 1999 WL 993648 (S.D. N.Y. 1999) [hereinafter, "Mechala"].

[62]Mechala, 1999 WL 993648 at *9–12. Although the asset transfer would have been prohibited under the original terms of the indenture, the bar against a transfer of substantially all of the company's assets was among the covenants stripped from the indenture. Mechala, 1999 WL 993648 at *20–21.

[63]Mechala, 1999 WL 993648 at *12.

fer violated the TIA was likely to succeed on the merits.[64] The court reasoned that the proposed amendments could materially impair or affect a holder's right to sue because non-consenting holders would be left with recovery only against the asset-less defendant or discharged guarantors.[65] If the issuer had proposed a pure covenant stripping exchange offer and did not propose to transfer assets out to another entity, it is not clear that the court would have issued an injunction. However, *Mechala* may be read as the first case to suggest that the TIA protects a practical (not just procedural) right to recovery, and gives bondholders a wider scope of protection than under the *UPIC* line of reasoning.[66]

It may have troubled the court that the asset transfer at issue in *Mechala* was potentially avoidable as a fraudulent conveyance. Accordingly, the bondholders may have been able to obtain substantially the same relief via an ancillary remedy under Rule 18(b) of the Federal Rules of Civil Procedure ("FRCP"), which permits holders to join a fraudulent conveyance claim with a claim for payment of principal and interest.[67] It may be the case that the court's ruling was not necessarily intended to expand the scope of section 316(b)

[64]Mechala, 1999 WL 993648 at *22 ("Plaintiffs have made a sufficient showing that the offer and proposed amendments would constitute an impairment of the right to sue for payment. Consequently, plaintiffs have established a likelihood of success on the merits, i.e. that the offer and proposed amendments may violate the indentures and the Trust Indenture Act by not requiring unanimous consent.").

[65]Mechala, 1999 WL 993648 at *7 ("[i]t is beyond peradventure that when a company takes steps to preclude any recovery by noteholders for payment of principal coupled with the elimination of the guarantors for its debt, that such action . . . constitute[s] an 'impairment' . . . [of] the right to sue for payment.").

[66]It should also be noted that the determination in *Mechala* was made in the context of a preliminary injunction, whereas the *UPIC* ruling was a declaratory judgment. Based on this distinction, *Mechala's* holding may arguably be more limited.

[67]FRCP 18(b) provides—

> A party may join two claims even though one of them is contingent on the disposition of the other; but the court may grant relief only in accordance with the parties' relative substantive rights. In particular, a plaintiff may state a claim for money and a claim to set aside a conveyance that is fraudulent as to that plaintiff, without first obtaining a judgment for the money.

rather to spare bondholders the procedural hurdles of unraveling the transaction as a fraudulent conveyance. Whether this determination reflects wise policy or whether the dissenting bondholders should have been left to their fraudulent conveyance remedy is a highly debatable point.

C. *Magten Asset Mgmt. Corp. v. Northwestern Corp. & YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas*

Mechala was not a turning point for the judicial application of section 316(b), however. In its wake, courts in other jurisdictions continued to hold that section 316(b) protects only a legal (and not practical) right to payment, and that only modifications to an indenture's terms directly related to principal and interest violate the TIA. In 2004, the Bankruptcy Court for the District of Delaware considered a debtor's pre-petition asset transfer in *Magten Asset Mgmt. Corp. v. Northwestern Corp.*[68] The transaction, which did not include a transfer of corresponding liabilities, ultimately led to the debtor's bankruptcy filing.[69] Considering a situation in all material respects analogous to *Mechala*, the court held that the transfer did not violate the TIA because holders retained the procedural right to payment of principal and interest—notwithstanding the fact that their *ability* to recover directly from the obligor was virtually obliterated by the asset transfer.[70] To find otherwise, the court concluded, would be tantamount to giving the bondholders a "guarantee against default."[71]

Finally, in a 2010 decision, *YRC Worldwide Inc. v.*

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[68] *In re Northwestern Corp.*, 313 B.R. 595 (Bankr. D. Del. 2004) [hereinafter, "Northwestern Corp."].

[69] Northwestern Corp., 313 B.R. at 597.

[70] Northwestern Corp., 313 B.R. at 600 ("While the Indenture and the Trust Indenture Act of 1939 do in fact provide that 'the right of any holder of any indenture security to receive payment of the principal of and interest on such security . . . shall not be impaired,' this applies to the holder's *legal* rights and not the holder's *practical* rights to the principal and interest itself.").

[71] Northwestern Corp., 313 B.R. at 600 ("Plaintiffs' legal rights were not impaired . . . there is no guarantee against default."). It is worth noting, however, as in Mechala, the holders may have been able to assert a fraudulent conveyance claim to recover the assets.

Deutsche Bank Trust Co. Americas,[72] the district court held that, while stripping an indenture covenant against the transfer of substantially all of a debtor's assets "might make it more difficult for holders to receive payment directly" from the obligor, removing the provision did not impair a creditor's legal right to receive payment because the TIA made no guarantees regarding a creditor's *practical* rights.[73] The court did not attempt to create its own doctrine of practical impairment of payment rights when interpreting section 316(b).

IV. Part IV: Recent Case law — *Marblegate* and *Caesars*

Most recently, these same issues have re-emerged in two sets of cases in the Southern District of New York. Both *Marblegate* and *Caesars* involved challenges to an out-of-court restructuring on the basis that the obligor under an indenture violated TIA section 316(b) by impairing the noteholders' practical ability to receive payment. The result of these two new decisions is an application of section 316(b) that is arguably broader than ever before. These decisions depart from the literal language of section 316(b) and explore the tension between protecting minority holders on the one hand, and preserving the ability of companies to undergo such consensual out-of-court restructurings, on the other.

A. *Marblegate*

In *Marblegate*, Education Management Corp. ("EDMC"), a for-profit provider of college and graduate education, proposed a coercive tender offer as part of an out-of-court restructuring of its $1.5 million debt, which included guarantees of its subsidiaries' secured debt and unsecured notes.[74] The restructuring was to take place in three steps: (i) the secured lenders would release the parent guarantee, triggering a corresponding release under the notes; (ii) the secured

[72] *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas*, 2010 WL 2680336 (D. Kan. 2010) [hereinafter, "YRC Worldwide"].

[73] *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas*, 2010 WL 2680336, *7 (D. Kan. 2010). As in *Mechala* and *UPIC*, the court did not address whether the individual dissenters could pursue fraudulent conveyance remedies under FRCP 18(b).

[74] Marblegate I, 75 F. Supp. 3d at 597.

lenders would foreclose on substantially all of the assets of EDMC and its subsidiaries; and (iii) the secured lenders would immediately convey the same assets back to a newly formed EDMC subsidiary, which would distribute new debt and equity to consenting creditors.[75] Non-consenting creditors would receive no distributions and would be left with claims only against the issuer (which will be left with only nominal assets).[76] The bondholders were thus presented with a fait accompli resulting from a consensual foreclosure between the debtor's management and equity on the one hand and the senior secured lenders on the other, which is very similar to the kinds of arrangements proposed by the Depression-era bondholder protective committees that are criticized in the SEC Report.[77] However, the creditors on both sides were sophisticated institutions, not retail investors. Although the proposal enjoyed majority creditor support, minority holdouts challenged the transaction as violating TIA section 316(b).[78]

In *Marblegate I*, the court considered the bondholders' request for a preliminary injunction against the intercompany sale. In finding that that the holders would likely succeed on the merits of their TIA claims, the court considered whether the TIA grants to minority bondholders either (i) broad protection against the effects of out-of-court debt restructurings, or alternately (ii) a more narrow protection against a majority-approved amendment of certain core

[75]Marblegate I, 75 F. Supp. 3d at 600–02.

[76]The consequences for holders that refused to participate in the tender offer were plainly stated in an Exchange Offering Circular that EDMC distributed to holders, which explained in no uncertain terms that "Holders who do not tender their Notes in the Exchange Offer will continue to have claims against the Co-Issuers and certain of our subsidiaries that currently guarantee the Notes; however, *substantially all of our assets will have been transferred to New EM Holdings and will not be available to satisfy the claims of such Holders. As a result, we anticipate that such Holders will not receive payment on account of their Notes* . . .". Marblegate I, 75 F. Supp. 3d at 601–02 (emphasis in original).

[77]See supra notes 32–34.

[78]EDMC obtained support for the proposed transaction from over 90% of the unsecured noteholders and 99% of the secured debtholders. Marblegate I, 75 F. Supp. 3d at 601.

terms.[79] Expressly rejecting *Northwestern Corp.* and *YRC Worldwide*, the court chose the broader reading and held that section 316(b) "protects the *ability*, and not merely the formal right, to receive payment[.]"[80] The court explained—

> By defendant's elimination of the guarantors and the simultaneous disposition of all meaningful assets, defendant will effectively eliminate plaintiffs' ability to recover and will remove a holder's "safety net" of a guarantor, which was obviously an investment consideration from the outset. Taken together, these proposed amendments could materially impair or affect a holder's right to sue.[81]

Notwithstanding its finding that the bondholders' arguments would likely succeed on the merits, the court refused to grant the injunction, finding that the other factors—(i) a likelihood of irreparable harm; (ii) that the balance of hardships tips in their favor regardless of the likelihood of success; and (iii) the public interest—did not support injunctive relief.[82]

EDMC ultimately proceeded with the transaction, and the issue was again litigated—this time on the merits.[83] Consistent with its prior finding in *Marblegate I*, the court ruled that the transaction violated the TIA.[84] After an extensive review of the TIA's legislative history, the court interpreted congressional intent as requiring an expansive reading of the protections offered by section 316(b), *i.e.*, to prohibit a transaction that unduly limits a bondholder's practical ability to recover principal and interest (even where key indenture terms regarding payment of principal and interest are untouched).[85] The court explained that permitting the transaction—

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[79] Marblegate I, 75 F. Supp. 3d at 611 ("At issue here is whether the 'right . . . to receive payment' is to be read narrowly, as a legal entitlement to demand payment, or broadly, as a substantive right to actually obtain such payment.").

[80] Marblegate I, 75 F. Supp. 3d at 612 (emphasis in original).

[81] Marblegate I, 75 F. Supp. 3d at 612 (quoting *Mechala*).

[82] Marblegate I, 75 F. Supp. 3d at 616–17.

[83] *Marblegate Asset Management, LLC v. Education Management Corp.*, 111 F. Supp. 3d 542, Fed. Sec. L. Rep. (CCH) P 98553 (S.D. N.Y. 2015).

[84] Marblegate II, 111 F.Supp.3d at 556–557 (internal citations omitted).

[85] Marblegate II, 111 F.Supp.3d at 548.

> would "allow the next cycle of reorganizations [to] take place on a voluntary basis without supervision of any court or administrative agency" . . . so long as the mechanism involves foreclosure and asset sale rather than simple amendment. The Court declines to so enfeeble the Trust Indenture Act[.][86]

Marblegate is currently on appeal in the Second Circuit Court of Appeals.[87]

B. *Caesars*

Several months after the United States District Court for the Southern District of New York issued its decision in *Marblegate II*, it was again faced with section 316(b) in *Caesars*, and again concluded that the TIA protects non-consenting bondholders' practical ability (and not merely the technical right) to receive payment of principal and interest.[88] Caesars Entertainment Corporation ("CEC"), along with its subsidiaries, including Caesars Entertainment Operating Company, Inc. ("CEOC"), were owners and operators of dozens of casinos in the United States.[89] In 2010, CEOC issued $750 million in senior notes due in 2016 and $750 million in senior notes due in 2017.[90] The notes were unsecured, but in each case were backed by a parent guarantee from CEC. In 2014, CEOC and CEC purchased a substantial majority of the notes at par plus accrued interest in exchange for the holders' agreement to: (i) support a future restructuring of CEOC;[91] (ii) release CEC's parent guarantees; and (iii) substantially eliminate the covenant restricting the disposi-

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[86]Marblegate II, 111 F.Supp.3d at 548 (internal citations omitted).

[87]The appeal is docketed as no. 15-2124.

[88]*MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp.*, 80 F. Supp. 3d 507, Fed. Sec. L. Rep. (CCH) P 98344 (S.D. N.Y. 2015).

[89]Caesars, 80 F. Supp. 3d at 510.

[90]Caesars, 80 F. Supp. 3d at 510.

[91]Caesars, 80 F. Supp. 3d at 511. Caesars was acquired in a leveraged buyout by two private equity funds, Apollo Global Management, Inc. and TPG Capital, LP, and the subsequent transactions were designed to transfer assets away from CEOC to affiliates while leaving CEOC saddled with the company debt. Caesars, 80 F. Supp. 3d at 510–11.

tion of "substantially all" of CEOC's assets.[92] Faced with losing the parent guarantee—the only remaining source for payment on the unsecured notes[93]—certain minority bondholders filed suit against CEC, CEOC and certain affiliates (collectively, the "Caesars Defendants"), alleging the transaction (and, specifically, the release of the parent guarantee) was a nonconsensual change to their payment rights in violation of TIA section 316(b) and the terms of the TIA-qualified indentures.[94]

In considering the Caesars Defendants' motion to dismiss, the court rejected the Caesars Defendants' argument that the TIA "protects only a noteholder's *legal* right to receive payment when due," stating that such a narrow reading of the TIA is not mandated by the statutory text.[95] Opting to follow the more expansive reading proposed by *Mechala* and *Marblegate*, the court concluded the bondholders' allegations that the transaction effectively "stripped plaintiffs of the valuable . . . Guarantees leaving them with an empty right to assert a payment default from an insolvent issuer are sufficient to state a claim under section 316(b)."[96] Accordingly, the court permitted the bondholders' section 316(b) claims to stand.[97] Recognizing the commercial implications of the decision, however, it certified the ruling for immediate appeal to the Second Circuit Court of Appeals.[98]

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[92] Caesars, 80 F. Supp. 3d at 511. The covenant was amended to measure future asset sales based on CEOC's assets as of the date of the amendment of the indentures.

[93] Caesars, 80 F. Supp. 3d at 515–16. Due to the amount of CEOC's secured debt, the likelihood of an unsecured creditor's recovery was virtually nonexistent.

[94] Caesars, 80 F. Supp. 3d at 515–16

[95] Caesars, 80 F. Supp. 3d at 519–20.

[96] Caesars, 80 F. Supp. 3d at 517; see also Caesars, 80 F. Supp. 3d at 515, quoting *Marblegate* ("the Court finds . . . unsatisfying the notion that Section 316(b) protects only against formal, explicit modification of the legal right to receive payment, and allows a sufficiently clever issuer to gut the Act's protections through a transaction such as the one at issue here.").

[97] Caesars, 80 F. Supp. 3d at 520.

[98] The Second Circuit Court of Appeals entered an order denying leave to appeal on December 22, 2015. See Order, No. 15-2124 (2nd Cir.).

C. *A Retreat from* Marblegate?

The potential consequences of the broad reading proposed by *Marblegate* and *Caesars* may be to make negotiated out-of-court restructurings more difficult, leaving obligors and creditors to forge through the often more costly and lengthy judicial reorganization process if they cannot obtain unanimous (or near-unanimous) bondholder consent. More troubling is that these cases have posited a broader reading of the TIA, but have failed to provide any real guidance regarding which forms of debt composition are permissible and which are not, though parties drafting new indentures in the future will likely include provisions expressly addressing the releases of third-party guarantees by a simple or super-majority of the holders, and the decisions in *Marblegate* and *Caesars* will recede into legal history.

On January 15, 2015—the same day the S.D.N.Y. District Court issued its ruling in *Caesars*—CEOC and certain of its subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court for the Northern District of Illinois.[99] The bankruptcy filing was an automatic Event of Default under the indentures, triggering CEC's obligations under the parent guarantees.[100] Accordingly, the indenture trustees (BOKF, N.A. and UMB Bank, N.A.) demanded payment from CEC.[101] Pointing to the purported release of the guarantees, CEC asserted that it had no obligation to comply with the payment demand.[102] The trustees filed suit, and the S.D.N.Y. court again faced the question of whether stripping the parent guarantee constituted an impairment under TIA section 316(b).

In denying the trustees' motion for summary judgment, the court held that release of the parent guarantees, standing alone, did not constitute an impermissible impairment under section 316(b). In doing so, the court tried to parse through the new case law to identify guideposts in "determin-

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[99] The cases are pending before the Honorable Judge A. Benjamin Goldgar and are jointly administered under lead case no. 15-01145. As a result of the petition, the action in the S.D.N.Y. District Court was stayed.

[100] Caesars II, 2015 U.S. Dist. LEXIS 113794, *7.

[101] Caesars II, 2015 U.S. Dist. LEXIS 113794, *7.

[102] Caesars II, 2015 U.S. Dist. LEXIS 113794, *7.

[ing] what actions, beyond the detrimental amendment of core terms of an indenture, constitute an impairment under the TIA."[103] The court came away with two bright line rules—

> It is indisputable that if CEOC had unilaterally adjusted the amount of principal or interest it would pay on a note, that would be an impairment under section 316(b). Similarly, renegotiating a debt obligation with a majority of noteholders to the detriment of a nonconsenting minority *under the same indenture* would be an impairment.[104]

This statement leaves many questions unanswered, however. For example, citing *Marblegate*, the court noted that "an impairment *may* also occur where a company restructures debt arising under *other* notes, in the context of an out-of-court reorganization, leaving some noteholders with an unaltered formal right to payment, but no practical ability to receive payment."[105] Likewise, the court acknowledged that the release of a guarantee may in certain circumstances (and in the presence of certain other elements) constitute impairment.[106] But ultimately, the court declined to articulate more legal principles, advocating instead for a fact-specific analysis requiring transactions to be "analyzed as a whole to determine if the overall effect was to achieve a debt restructuring that impaired plaintiffs' right to payment."[107]

And the parade of new decisions continues. In September

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[103] Caesars II, 2015 U.S. Dist. LEXIS 113794 at *28.

[104] Caesars II, 2015 U.S. Dist. LEXIS 113794 at *23–24 (emphasis in original).

[105] Caesars II, 2015 U.S. Dist. LEXIS 113794 at *32 (emphasis added).

[106] Caesars II, 2015 U.S. Dist. LEXIS 113794 at *26 ("the mere release of the Guarantee, standing alone, does not prove an impairment under section 316(b).").

[107] Caesars II, 2015 U.S. Dist. LEXIS 113794 at *35–36. Meanwhile, in CEOC's bankruptcy case, the bankruptcy court faced a similar question after CEOC and its debtor affiliates commenced an adversary proceeding to enjoin the noteholders' actions against CEC in S.D.N.Y. under section 105(a), based on an asserted likelihood that the pending actions would defeat or impair the reorganization and the bankruptcy court's jurisdiction. *In re Caesars Entertainment Operating Co., Inc.*, 533 B.R. 714, 61 Bankr. Ct. Dec. (CRR) 110 (Bankr. N.D. Ill. 2015). The bankruptcy court denied the injunction, based on an application of the Seventh Circuit standard, which permits pending actions to be enjoined where both (i) the estate's claims and the third-party litigation seek recovery from the same assets and (ii) arise out of the same set of facts. Caesars Entertainment,

2015, in *Phoenix Light SF Ltd. v. Bank of N.Y. Mellon*,[108] the United States District Court for the Southern District of New York made it clear that section 316(b) does not create its own independent cause of action to redress alleged trustee negligence. The plaintiffs in *Phoenix Light* were investors in certificates issued by residential mortgage backed securities (RMBS) trusts, and brought suit against the indenture trustee alleging breach of contractual, fiduciary and statutory duties based on the trustee's failure to (among other things) review mortgage files for completeness and ensure that document defects were remedied.[109] The trustee's alleged failures caused plaintiffs to incur significant losses after several loans with document defects ultimately defaulted.[110]

The plaintiffs alleged that their right to receive payment under section 316(b) was rendered effectively meaningless because they were unable "to receive payment in connection with defective mortgage loans for which the trustee failed to take action to correct."[111] The court, however, disagreed and held that section 316(b) only applies to a holder's legal right to receive payment, not the holder's ability to receive payment—

> Although the Court is not unsympathetic to Plaintiffs' argument that BNYM's behavior hampered certificate holders' ability to receive payments to which they were otherwise entitled,

533 B.R. at 730. The court concluded that although the noteholders' litigation sought recovery from the same assets (i.e., CEC's assets), the noteholders' claims arose under the indentures whereas the debtors' claims arose under bankruptcy law. Caesars Entertainment, 533 B.R. at 730–32.

[108] *Phoenix Light SF Ltd. v. Bank of New York Mellon*, 2015 WL 5710645 (S.D. N.Y. 2015) [hereinafter, "Phoenix Light"].

[109] Phoenix Light, 2015 U.S. Dist. LEXIS 131206 at *4–9. The plaintiffs also alleged that the trustees failed to provide notice of breaches by the sellers of the loans held by the trusts, provide accurate monthly reports to certificate holders, and to act prudently following events of default. Phoenix Light, 2015 U.S. Dist. LEXIS 131206 at *4–9.

[110] Phoenix Light, 2015 U.S. Dist. LEXIS 131206 at *8–9.

[111] Phoenix Light, 2015 U.S. Dist. LEXIS 131206 at *29 (citation omitted).

> the text of the statute is clear — Section 316(b) does not provide Plaintiffs a cause of action in this case.[112]

Accordingly, *Phoenix Light* as well as *Caesars II* may be read as placing some outer limits on the broad reading of section 316(b) in *Caesars* and *Marblegate*.

In an attempt to resolve these questions conclusively, in 2015, a rider to a bill was proposed in Congress to amend TIA section 316(b) to narrowly define impairment of the rights to payment. The proposed amendment would have added language to the current text of section 316(b), as follows—

> For purposes of this subsection, the right of a holder of an indenture security to receive payment of the principal of and interest on such indenture security is impaired or affected only when the terms of the indenture governing such indenture security are amended to reduce the specified principal amount or interest rate or to extend the maturity elate of such indenture security.[113]

The amendment was first proposed as a rider to a 2015 highway bill, but was then removed and attached to an omnibus spending bill later the same year. It was ultimately pulled from the spending bill after facing heavy criticism from various scholars and interest groups.[114]

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[112] Phoenix Light, 2015 U.S. Dist. LEXIS 131206 at *30.

[113] See Federal Transportation Bill Could Introduce Retroactive Trust Indenture Act Amendment to Detriment of Current Litigants, Minority Noteholders, available at http://new.reorg-research.com/article/public/MTcyNjg (posted Dec. 1, 2015, 12:25 pm). The amendment was proposed by Sen. Harry Reid (R-Nev.), who ultimately withdrew it from consideration. Matt Jarzemsky, Caesars Takes Aim at Law Aiding Creditors, WallStreet Journal.com (Dec. 6, 2015).

[114] A group of 18 law professors expressed their opposition to the amendment by letter dated December 8, 2015. Shortly thereafter, a similar letter was sent by six asset management companies (BlackRock Inc., DoubleLine Group LP, Oaktree Capital Management LP, Pacific Investment Management Co. LLC, T. Rowe Price Associates and Western Asset Management Co.) on December 14, 2015 expressing the "strongest possible opposition" to the amendment and calling the TIA a "central component" of securities law and criticizing the lack of oversight of the rider. The letter stated that—

> Congress should not amend so crucial a law — particularly in a retroactive fashion — without the benefit of legislative hearings and an opportunity for

Conclusion

The implications of *Marblegate* and *Caesars*, particularly in the Southern District of New York, are potentially significant. These decisions reflect a broad reading of section 316(b) that protects bondholders' practical right to payment of principal and interest, departing from prior case law that adopts a narrower reading of the statute as protecting only the *procedural* right to payment. Accordingly, the legal principle to emerge from *Marblegate* and *Caesars* is that impairment under section 316(b) may be found even where no indenture term governing the payment of principal and interest is affected. Yet, while these cases are clear that section 316(b) protects against something more than just the amendment of these specific indenture terms, exactly what that may be remains far from clear.

The law in the Southern District of New York currently can essentially be distilled down to four key points, as described in *Caesars II*—

1) Amendment of an indenture term relating to principal or interest constitutes an impairment under section 316(b);[115]
2) Renegotiating treatment of a debt obligation with a majority of noteholders to the detriment of a nonconsenting minority *under the same indenture* constitutes an impairment under section 316(b);[116]
3) A restructuring of debt arising under *other* notes that leaves some noteholders with an unaltered formal right to payment, but no practical ability to receive payment, may constitute an impairment (though this result is debatable);[117] and
4) The release of a guarantee, standing alone, does not

public comment. The adverse consequences to the economy and to capital markets could be significant.

[115] Caesars II, 2015 U.S. Dist. LEXIS 113794, *23–24 (emphasis in original).

[116] Caesars II, 2015 U.S. Dist. LEXIS 113794, *23–24 (emphasis in original).

[117] Caesars II, 2015 U.S. Dist. LEXIS 113794, at *32 (emphasis added).

> constitute impairment (though impairment may be found where other circumstances are present).[118]

Thus, while *Marblegate* and *Caesars* suggest that the protections of section 316(b) are broader than previously thought, they do not provide guidance as to how far this expansion may extend. Even the outline proposed by *Caesars II* proves unsatisfying. For example, we know from *Marblegate* that, where an obligor transfers substantially all of its assets in an effort to restructure its debt, thereby leaving non-consenting minority bondholders with recourse only to an asset-stripped entity, such action constitutes an impairment even where provisions regarding payment of principal/interest remain unchanged. But, consider this scenario: A financing vehicle with no assets or operations issues bonds guaranteed by its asset-rich parent, and then proposes a restructuring in which holders would exchange their bonds for that of the parent and a release of the parent's guarantee. Fundamentally, the end result is indistinguishable from *Marblegate*—non-consenting minority bondholders are left with recourse only to an empty shell. Yet, *Caesars II* teaches us that this latter scenario would not violate section 316(b).

The result of these recent decisions certainly will give minority bondholders increased leverage in the context of a proposed out-of-court restructuring. In particular, giving every bondholder a veto right over a broad range of decisions that may be said to "practically" impact the holder's ability to recover principal and interest may lead to such minority holders making unreasonable demands in the hope of a favorable by-out by other investors intent on the restructuring's success.[119] The corollary, of course, is that bond issuers may be increasingly forced to rely on the judicial bankruptcy processes in order to restructure. One consequence of the gamesmanship on both sides of this issue is that drafters of new indentures or indenture amendments may choose Delaware or other non-Second Circuit jurisdictions when drafting choice-of-law clauses.

Finally, it is ironic to note that—notwithstanding the

[118]Caesars II, 2015 U.S. Dist. LEXIS 113794, at *26 ("the mere release of the Guarantee, standing alone, does not prove an impairment under section 316(b).").

[119]See Kenneth N. Klee, How Judges are Skewing Bond Law, Wall Street J. (Nov. 8, 2015).

comprehensive analysis of legislative history undertaken in the *Marblegate* and *Caesars* decisions to determine how narrowly or broadly section 316(b) should be read—the law as it stands may actually have developed contrary to legislative intent in a much more fundamental way. The purpose of the TIA, after all, was to establish a clear framework for indentures, and to make the system more transparent to minority holders. Yet, the case-by-case evaluation that this new case law seems to prescribe runs contrary face of that mandate, leaving issuers, bondholders and the bar to wonder whether section 316(b) has been interpreted so as to render uncertain that which used to be unquestioned.