15-2124-cv(L)

15-2141-cv(CON)

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

MARBLEGATE ASSET MANAGEMENT, LLC,
MARBLEGATE SPECIAL OPPORTUNITIES MASTER FUND, L.P.,

Plaintiffs-Counter-Defendants-Appellees,

v.

EDUCATION MANAGEMENT FINANCE CORP., EDUCATION MANAGEMENT, LLC,

Defendants-Appellants,

(Caption Continued on the Reverse)

On Appeal from the United States District Court
for the Southern District of New York (New York City)

BRIEF FOR EDUCATION MANAGEMENT APPELLANTS

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EDUCATION MANAGEMENT CORPORATION,

Defendant-Counter-Claimant-Appellant,

STEERING COMMITTEE FOR THE AD HOC COMMITTEE OF
TERM LOAN LENDERS OF EDUCATION MANAGEMENT, LLC,

Intervenor-Appellant.

CORPORATE DISCLOSURE STATEMENT

In accordance with Federal Rule of Appellate Procedure 26.1(a), defendant-counterclaimant-appellant Education Management Corporation states that there is no publicly held corporation that owns 10% or more of its stock.

Defendant-appellant Education Management LLC is a subsidiary of Education Management Corporation.

Defendant-appellant Education Management Finance Corp. is a subsidiary of Education Management Corporation.

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PRELIMINARY STATEMENT

On this appeal, the Court is asked to correct an error of law on an issue of first impression that has divided lower courts and generated substantial uncertainty in the world of corporate debt.

Section 316(b) of the Trust Indenture Act (the "TIA") provides that "*the right* of any holder of any indenture security to receive payment" when due "shall not be impaired or affected without the consent of such holder." 15 U.S.C. § 77ppp(b) (emphasis added). Based on this language, multiple courts have held that section 316(b) protects a "holder's *legal* rights" to payment as established in the indenture, as opposed to the holder's "*practical*" ability to recover payment. *Magten Asset Mgmt. Corp.* v. *Nw. Corp. (In re Nw. Corp.)*, 313 B.R. 595, 600 (Bankr. D. Del. 2004) (emphasis in original). The TIA thus ensures that, absent a noteholder's consent, the issuer will "remain obligated" to honor the bond's payment terms; but it does not protect "against the issuing company's default or its ability to meet its obligations." *YRC Worldwide Inc.* v. *Deutsche Bank Trust Co. Am.*, 2010 WL 2680336, at *7-8 (D. Kan. July 1, 2010).

In the decision on appeal, the United States District Court for the Southern District of New York (Failla, J.) disagreed with these authorities and instead followed an earlier decision from the Southern District, which held that the TIA prohibits actions that, "*as a practical matter*," prevent a noteholder from "be[ing] able to seek recourse" when its notes are due. *Federated Strategic Income Fund* v. *Mechala Grp. Jamaica Ltd.*, 1999 WL 993648, at *7 (S.D.N.Y. Nov. 2, 1999) (emphasis added). Drawing on *Mechala*, the district court concluded that an out-of-court restructuring violates the TIA if it "deprives dissenting bondholders of assets against which to recover," even if it does not "formally alter the dissenting Noteholders' right to payment on their Notes." *Marblegate Asset Mgmt., LLC* v. *Educ. Mgmt. Corp.*, __ F. Supp. 3d __, 2015 WL 3867643, at *2, *4 (S.D.N.Y. June 23, 2015) ("*Marblegate II*"); *accord Marblegate Asset Mgmt.* v. *Educ. Mgmt. Corp.*, 75 F. Supp. 3d 592, 611-15 (S.D.N.Y. Dec. 30, 2014) ("*Marblegate I*").

The district court erred in its interpretation of section 316(b) and, as a result, it erred in applying the statute to this case. There is no dispute as to the relevant facts: Education Management, an education company, was facing severe financial difficulties but, as a result of its dependence on federal funding, was not in a position to file for bankruptcy. Secured lenders holding close to $1.3 billion in claims thus agreed to exchange much of their debt for equity. Unsecured noteholders were offered two options: they too could exchange their debt for equity, or they could retain their notes. If any noteholders chose the latter option, however, secured lenders would exercise their contractual rights to foreclose upon the issuers' assets and release a guarantee of the notes by the issuers' parent company. All noteholders had agreed in the indenture that the secured lenders could exercise those rights.

The challenged transactions do *not* contravene section 316(b). They do not "modify any indenture term explicitly governing the right to receive interest or principal on a certain date" (*Marblegate II*, 2015 WL 3867643, at *3), and they do not prevent noteholders "from asserting a legal claim to payment" against the issuers (*Marblegate I*, 75 F. Supp. 3d at 612). At most, the challenged transactions merely affected plaintiffs' "*practical ability* to recover their principal and remaining interest payments." *Id*. at 595 (emphasis added).

Section 316(b), however, does not address a noteholder's "practical ability" to collect payment, whether in a "restructuring" or otherwise. Rather, as demonstrated by the statute's language and history, section 316(b) shields the legal entitlement to payment of an agreed amount on an agreed date, and thereby "prohibit[s] majority bondholders from collusively agreeing to *modify the bond's payment terms*." *Bank of New York* v. *First Millennium, Inc.*, 607 F.3d 905, 917 (2d Cir. 2010) (emphasis added). But the statute does nothing more. A noteholder's "practical ability" to collect is governed by *other* indenture provisions and *other* bodies of law — which, in contrast to the district court's gloss on the TIA, provide clear and predictable rules to govern transactions that may impact noteholder recoveries.

In light of the district court's error in interpreting section 316(b), its decision should be reversed. Yet even under the district court's flawed interpretation, there still was no violation in this case because, at bottom, the challenged transactions did not cause injury to the plaintiffs. As shown by the undisputed evidence, when plaintiffs brought this lawsuit, their ability to collect was *already* impaired as a result of the company's financial problems, with the company's assets insufficient to satisfy its senior secured debt. Even if the statute regulates the "practical" effects of corporate transactions, it does not guarantee 100% cash recoveries to noteholders whose claims were impaired *before* the transactions occurred. The district court's judgment should be reversed on that independent basis as well.

JURISDICTIONAL STATEMENT

The complaint alleges violations of the Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa-77bbbb, and section 6.07 of the indenture governing the notes purchased by plaintiffs-appellees. The district court had subject matter jurisdiction under 15 U.S.C. §§ 77vvv(b) and 77v(a), and 28 U.S.C. §§ 1331 and 1367(a).

The district court issued an opinion and order on June 23, 2015; final judgment was entered by the district court on June 25, 2015. Defendants-appellants and intervenor-appellant filed timely notices of appeal on July 2, 2015. This Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF THE ISSUES PRESENTED

1. Does section 316(b) of the TIA, which prohibits impairment of the "right" to receive payment, preclude out-of-court restructuring transactions that may affect a noteholder's practical ability to recover but do not modify the payment terms of the indenture security?

2. Did the district court err when it concluded that Education Management's restructuring transactions would violate section 316(b) of the TIA, even though non-participating noteholders: (a) retained their legal claims against the issuers for payment at maturity; and (b) agreed in the indenture that the parent company's guarantee of those unsecured claims would be automatically released if secured lenders released the parent company's guarantee of their secured claims?

3. Did the district court err when it concluded that Education Management's restructuring transactions would impair even plaintiffs' ability to recover on their notes, where it was undisputed that: (a) plaintiffs' recovery was

already impaired as a result of Education Management's financial condition; and (b) plaintiffs stood to receive more by participating in the transactions than if the transactions failed?

STATEMENT OF THE CASE

A. Education Management's financial difficulties

Education Management[1] provides college and graduate education through campus-based and online instruction. A1793 (¶ 3). When this lawsuit began, the Company had approximately $1.5 billion of debt, consisting of $1.3 billion in secured loans and $217 million in unsecured notes. A1753 (¶ 3). The notes were issued by Education Management Finance Corp. and Education Management LLC and guaranteed by the parent company, Education Management Corporation ("EDMC"). An indenture dated March 5, 2013, governs the notes (A1033), which carry a cash interest rate of *15%* per year (A1175) and an effective interest rate (accounting for premiums and other features) of nearly *20%* per year (A288).

[1] Throughout this brief, "Education Management" and the "Company" refer to the three defendants-appellants: Education Management Corporation, Education Management LLC, and Education Management Finance Corp. "Marblegate" refers to the two plaintiffs-appellees: Marblegate Asset Management LLC and Marblegate Special Opportunities Master Fund, L.P.

By the time of this lawsuit, Education Management's debt burden had become unsustainable. As a result of various factors, Education Management and similar companies experienced declining enrollment and results. A1800 (¶¶ 26-27); A1757 (¶¶ 13-14). By June 2014, the Company faced liquidity problems that threatened its ability to meet its obligations to secured lenders. A1758 (¶¶ 17-18).

B. The debt-for-equity exchange

In contrast to most companies with too much debt, Education Management could not look to bankruptcy as a practical method of reorganizing. A1459 (128:5-7). Under Title IV of the Higher Education Act, a bankruptcy filing strips a school of eligibility to receive federal student-aid funds. 20 U.S.C. § 1002(a)(4)(A); A1463 (142:20-143:2); A1759 (¶ 21). Loss of Title IV funding, which accounts for most of the Company's revenue, would have destroyed the value of Education Management. A1463 (142:12-15); A1759 (¶ 21). The Company and its creditors therefore had to find solutions outside of bankruptcy court.

After months of intense negotiations, Education Management and the vast majority of its creditors reached an agreement in August 2014. A1759-1760 (¶ 22). To avoid near-term default and a going-concern qualification from the Company's auditors, holders of most of the Company's secured and unsecured debt agreed to accept the payment of interest in kind (rather than in cash) through fiscal year 2015. A1758 (¶¶ 17-18); A1760 (¶ 23). In addition, secured lenders agreed to amend the Credit Agreement to extend an impending maturity and eliminate covenants. A1760 (¶ 23); *see* A484 (Amendment Agreement). As consideration for these and other "significant concessions," secured lenders received a guarantee from EDMC, the parent company. *Marblegate I*, 75 F. Supp. 3d at 616; A1760 (¶ 23).

Beyond these near-term arrangements, Education Management and most of its creditors also entered into a Restructuring Support Agreement (the "RSA"), which contemplated a broad balance-sheet restructuring that would reduce the Company's debt from $1.5 billion to $400 million. A988-999. That debt reduction would be achieved by having creditors, including unsecured noteholders, voluntarily exchange their debt claims for equity. A1761-1762 (¶¶ 25-26).

The Company's secured lenders made substantial compromises under the RSA. They agreed that approximately $1.155 billion of secured debt would be exchanged for $400 million of new term loans, plus preferred stock convertible into approximately 77% of EDMC's common stock. A988-989; A1761-1762 (¶ 25). In addition, even though their secured debt would not be repaid in full, the secured lenders agreed that unsecured noteholders could exchange their notes for preferred stock convertible into approximately 19% of EDMC's common stock, plus warrants for more equity. A989-991; A1761-1762 (¶ 25).

The RSA received broad support. By the time this suit was filed, creditors holding 98% of the Company's total debt — including more than 90% of the unsecured notes — agreed to the deal. A1763 (¶ 28).

C. The foreclosure sale and release of the parent guarantee

The Credit Agreement provided that, if any secured lender or unsecured noteholder did not agree to the exchange, an event of default would occur, in which case the Company and its secured lenders would take steps to protect the lenders' collateral. *First*, the Company was obligated to cooperate in implementing a transaction whereby the collateral agent for the secured lenders would exercise its rights to foreclose on the issuers' assets and sell those assets to a new subsidiary of EDMC (the "Intercompany Sale"). A1296 (§ 5.16); A1322 (§ 8.1(b)); A967 (§ 4.05); A1764-1765 (¶¶ 32-33). This sale to an EDMC subsidiary — with EDMC remaining as the ultimate parent and a party to agreements with regulators — was designed to avoid regulatory issues that could have affected accreditation and funding. A1463 (143:3-13); A1471 (173:16-174:12); A1502 (297:10-23).

Second, it was contemplated that the secured lenders would release EDMC (the parent) of its guarantee of their secured debt, which, under the indenture, would have the effect of releasing EDMC from its guarantee of the unsecured notes as well. A1765 (¶ 34); A1783-1784 (¶ 7); A1161 (§ 10.06). In addition, although not necessary in light of the guarantee-release by secured lenders, a majority of noteholders separately agreed to release the parent guarantee upon completion of the debt exchange. A1027-1028 (§ 2(e)(iii)).

There is no dispute that these transactions had "valid contractual bases." *Marblegate I*, 75 F. Supp. 3d at 610. With respect to the foreclosure, the Credit Agreement provided that secured lenders had the right to effectuate "the Intercompany Sale . . . by means of the exercise of remedies under Article 9 of the [Uniform Commercial Code]." A1325 (§ 8.2(b)); *Marblegate I*, 75 F. Supp. 3d at 610 ("[T]he foreclosure . . . is a valid exercise of the secured creditors' rights under UCC Article 9."). In addition, the indenture for the unsecured notes carved out "foreclosures on assets" from the list of prohibited "Asset Sales" (A1040-1041, A1122-1125 (§§ 1.01, 4.10)), and the offering circular for the notes warned that secured lenders could "foreclose on the pledged assets to the exclusion of holders of the" unsecured notes (A844).

With respect to the parent guarantee, the Credit Agreement authorized holders of more than 50% of the secured debt to release a guarantee of secured obligations. A1331 (§ 9.8(a)). The indenture, in turn, explicitly provided in section 10.06 that upon "the release or discharge of the guarantee" of the Company's *secured* debt, EDMC would "be automatically and unconditionally released and discharged" from its guarantee of the *unsecured* notes, as long as EDMC delivered an officer's certificate and opinion of counsel stating that the "conditions precedent provided for in this Indenture relating to such transaction have been complied with." A1161 (§§ 10.06(a)(ii), 10.06(b)). The indenture separately provided that — whereas the consent of each noteholder would be required to reduce the principal or interest owed by the issuers, change the maturity dates, or release the guarantees of "Significant Subsidiaries" — a guarantee from the parent company could be "waived with the consent of the Holders of a majority in principal amount of the then outstanding Notes." A1155-1156 (§ 9.02).

The terms permitting release of the parent guarantee are consistent with the origin of that guarantee. As set forth in the offering memorandum for the notes, the parent guarantee was provided to noteholders "solely for the purpose of allowing the Issuers to satisfy their reporting obligations" on a consolidated basis (as permitted by SEC rules), and with the explicit understanding of all noteholders that they "*should not assign any value to this guarantee*." A817 (emphasis added); A1755-1756 (¶¶ 10-11). The offering memorandum also made clear that the noteholders' "right to receive payments . . . is effectively junior to those lenders who have a security interest in [the issuers'] assets," and that secured lenders "have the discretion to release the guarantors under the senior secured credit agreement in a variety of circumstances, which will cause those guarantors to be released from their guarantees of the New Notes." A844, A845.

The foreclosure sale and release of the parent guarantee made the Company's exchange offer attractive to noteholders. Indeed, the Company disclosed its expectation that non-participating noteholders, although continuing "to have claims against the Co-Issuers," would "not receive payment on account of their Notes, including then accrued and unpaid interest, from and after the date the Proposed Restructuring is consummated." A52.

The proposed transactions, however, did not compel anyone to exchange their debt for equity. Noteholders had the option to retain their notes, without modification of the amount owed or maturity date, along with all associated creditor remedies under state law.

D. The holdouts

Marblegate is a hedge fund that buys claims against distressed companies. It bought unsecured notes issued by Education Management with an approximate face value of $14 million. A1770-1771, A1774-1775 (¶¶ 3, 15). Unlike virtually all other creditors, Marblegate refused to participate in the Company's debt-for-equity exchange. Along with another noteholder that has since agreed to participate in the exchange, Marblegate brought this lawsuit on October 28, 2014, and moved for a preliminary injunction.

Marblegate pursued its holdout strategy despite the fact that, absent a successful restructuring, it stood to receive little or nothing on account of its notes. The undisputed facts at trial showed that, without a restructuring, noteholders would have received, at most, two more interest payments. A1508 (321:1-324:3). The undisputed facts, including the only valuation offered into evidence, also established that Education Management's enterprise value was far below its $1.3 billion in secured debt. *Marblegate I*, 75 F. Supp. 3d at 599; A1509 (327:10-22).

Accordingly, before the restructuring, Marblegate's ability to recover on its notes was severely limited; its recovery was contingent on the Company's other creditors compromising their claims. As conceded by Marblegate's expert witness, Marblegate would have recovered more by exchanging its notes for equity, as other creditors agreed to do, than if the restructuring failed. A1510 (329:14-330:24).

E. The preliminary injunction decision

The district court held a hearing on plaintiffs' preliminary injunction motion on November 18 and 19, 2014. The court issued an opinion and order (amended as of December 30, 2014) denying the motion on the grounds that the plaintiffs had failed to demonstrate irreparable harm, lack of an adequate legal remedy, a balance of hardships in their favor, or that the public interest warranted an injunction. *Marblegate I*, 75 F. Supp. 3d at 605-10.

In the same opinion, the district court also determined that plaintiffs were likely to succeed on a claim under the TIA. The court stated that section 316(b) "lends itself to multiple interpretations," and recognized a split in authority. *Id.* at 611-13. In particular, the court acknowledged that two cases, *Northwestern Corp.* and *YRC Worldwide*, "suggest that Plaintiffs have no claim," because the transactions would not prevent plaintiffs "from asserting a legal claim to payment" for the full amounts owed. *Id*. at 612. The court, however, sided with *Mechala* — a prior decision from the Southern District — which held that the TIA "protects the *ability*" of noteholders to receive payment. *Id*. (emphasis in original).

The Court also concluded that the legislative history of the TIA, as opposed to the statutory text, provides a "limiting principle" applicable to the rule in *Mechala*. *Id*. at 614. In particular, the court held that where the payment terms of an indenture are not explicitly modified, section 316(b) is violated when the transactions at issue, as a practical matter, "effect an involuntary debt restructuring." *Id.*

F. The district court's final decision

On January 5, 2015, the foreclosure sale was completed and secured lenders released EDMC's guarantee of the secured debt. The Company's debt was reduced to $400 million. The Company, however, did not take steps required to complete the release of EDMC's guarantee of the unsecured notes. In particular, EDMC did not deliver an officer's certificate and opinion of counsel to the indenture trustee. Instead, EDMC filed a counterclaim against Marblegate, seeking a declaration that it was permitted to complete the release of the parent guarantee. A2209-2225. The Company also continued paying interest to Marblegate. A2197-2198.

The parties agreed that the record on the preliminary injunction motion would be adopted as the record for purposes of trial, subject to limited additions. A2239-2242. On June 23, 2015, the district court issued its final decision. After further review of legislative history, the court concluded that the challenged transactions, and in particular the release of the EDMC guarantee, would violate the TIA. *Marblegate II*, 2015 WL 3867643 at *11-13. The court issued a declaration that EDMC "shall guarantee any past and future payments of principal and interest to Marblegate on their respective due dates under the March 5, 2013 Indenture." *Id*. at *14. As a result, pending the outcome of this appeal, Marblegate has a guarantee from a significantly de-levered company. It is also the only noteholder that did not exchange its debt for equity, and it continues to receive more than $2 million per year in interest on its high-yield notes.

STANDARD OF REVIEW

The relevant facts are "not in dispute." *Marblegate I*, 75 F. Supp. 3d at 595 n.1. This appeal raises a question of how to interpret the TIA and apply the statute to the undisputed facts. Those issues are reviewed *de novo*. *E.g.*, *United States* v. *Gravel*, 645 F.3d 549, 551 (2d Cir. 2011); *Finkel* v. *Romanowicz*, 577 F.3d 79, 84 (2d Cir. 2009).

SUMMARY OF ARGUMENT

The district court's judgment should be reversed. By its terms, section 316(b) of the TIA prohibits non-consensual impairment of a noteholder's legal *right* to receive payment; the statute does not address transactions that affect a noteholder's *ability* to collect. The statute, accordingly, only prevents modification of core payment terms — namely, those establishing how much is owed and when. This interpretation has been adopted by numerous courts, is consistent with statements of this Court, and is supported by the statute's legislative history. Point I, *infra*.

Under the correct interpretation of section 316(b), the challenged transactions are lawful in all respects. Those transactions do not modify the core payment terms of the indenture. Marblegate, moreover, agreed in the indenture that the Company and its secured lenders could undertake those transactions. Point II, *infra*.

Even if section 316(b) protects a noteholder's ability to collect, the judgment should be reversed. Plaintiffs' ability to collect was impaired as a result of the Company's financial problems, not the challenged transactions. Point III, *infra*.

ARGUMENT

I. THE DISTRICT COURT ERRED IN HOLDING THAT THE TRUST INDENTURE ACT PROTECTS A NOTEHOLDER'S PRACTICAL ABILITY TO RECOVER PAYMENT.

A. Section 316(b) of the TIA protects noteholders against modification of an indenture's core payment terms: the amount owed and the due dates.

Section 316(b) has traditionally been understood, including by this Court, to "prohibit[] majority bondholders from collusively agreeing to modify the bond's payment terms." *Bank of New York* v. *First Millennium, Inc.*, 607 F.3d 905, 917 (2d Cir. 2010). Those payment terms, or "core terms," are those that "affect[] a securityholder's right to receive payment of the principal of or interest on the indenture security on the due dates for such payments." *UPIC & Co.* v. *Kinder-Care Learning Ctrs., Inc.*, 793 F. Supp. 448, 452 (S.D.N.Y. 1992); *see also* ABA Section of Bus. Law, Comm. on Trust Indentures and Indenture Trustees, *Annotated Trust Indenture Act*, 67 Bus. Law. 979, 1146 (Aug. 2012) (section 316(b) prohibits "an indenture from allowing 'majority actions' to modify core terms of the indenture such as the payment of principal or interest").

The district court's novel interpretation of section 316(b) — under which the statute protects against "practical" impairment of the ability to recover in the context of an out-of-court "debt restructuring" (*Marblegate I*, 75 F. Supp. 3d at 614) — departs from this understanding, and it lacks support in either the statutory language or the legislative history of section 316(b).

1. By its terms, section 316(b) protects only the legal "right" to receive payment at maturity.

The TIA regulates "the terms on which debt securities may be sold in the public markets." *Annotated Trust Indenture Act*, 67 Bus. Law. at 980. It provides that specific indenture provisions are deemed to form "a part of and govern" covered indentures, "whether or not physically contained therein." 15 U.S.C. § 77rrr.

The terms of section 316 are among those that are automatically incorporated into indentures. *See id.* Section 316(b) provides as follows:

> 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 as provided in paragraph (2) of subsection (a) of this section, and except that such indenture may contain provisions 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 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.

15 U.S.C. § 77ppp(b) (emphasis added).

The district court, with virtually no analysis of the statute's language or structure, concluded that "the text of Section 316(b) lends itself to multiple interpretations," and resorted to legislative history. *Marblegate I*, 75 F. Supp. 3d at 611. The statute itself, however, cannot be so easily discarded: On its face, the statutory text is unambiguous in protecting only the "right" of a noteholder to receive payment when due and to sue for enforcement of such payment.

"Statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose." *United States* v. *Kozeny*, 541 F.3d 166, 171 (2d Cir. 2008) (internal quotation marks omitted). Here, the statute addresses the "right" to receive payment at maturity and, correspondingly, the "right" to sue if payment is not made. The "ordinary meaning" of the word *right* is a "legally enforceable claim of one person against another, that the other shall do a given act, or shall not do a given act." *Dennis* v. *Higgins*, 498 U.S. 439, 447 & n.7 (1991) (quoting Black's Law Dictionary 1324 (6th ed. 1990)). It is "[a] legal, equitable, or moral entitlement to . . . something." Oxford English Dictionary (3d ed. 2010).[2]

By its terms, then, section 316(b) protects a noteholder's "entitlement" to payment at maturity. On the most basic level, the statute prevents a majority of noteholders from modifying an indenture to alter the amount owed or the date on which it must be paid, and from stripping noteholders of standing to sue for payment

[2] Dictionaries predating the TIA offer similar definitions. *See, e.g.*, Bouvier's Law Dictionary 1072 (William Edward Baldwin ed., 1934) ("A well-founded claim"); 8 W.A. Craigie & Henry Bradley, A New English Dictionary on Historical Principles 670 (Sir James A.H. Murray ed., 1914) ("Justifiable claim, on legal or moral grounds, to have or obtain something"; "A legal, equitable, or moral title or claim to the possession of property or authority, the enjoyment of privileges or immunities").

upon maturity. The statute, however, does not provide protection against default or a guarantee that a lawsuit for payment will succeed. Moreover, contrary to the district court's ruling, the statute does not subject "restructuring" transactions to any different standard than other transactions.

The statute's focus on legal entitlements is reaffirmed by its structure. *See U.S. Nat'l Bank of Ore.* v. *Indep. Ins. Agents of Am., Inc.*, 508 U.S. 439, 455 (1993) (statutory construction "must account for a statute's full text, language as well as punctuation, structure, and subject matter"). Section 316 begins, in subsection (a), by defining the authority that can be conferred on noteholder majorities: Subsection (a)(1) permits indenture provisions authorizing majorities to direct the time, method, and place of instituting suit for any remedy under the indenture, and also to consent on behalf of all noteholders to waive a default and its consequences. 15 U.S.C. § 77ppp(a)(1). Subsection (a)(2) permits indenture provisions authorizing holders of 75% of an issuance to consent "on behalf of the holders . . . to the postponement of any interest payment" for up to three years. *Id.* § 77ppp(a)(2).

Subsection (b) — the provision invoked by Marblegate here — mandates exceptions to subsection (a). As an exception to the power of majorities to direct the enforcement of remedies, subsection (b) ensures that each individual holder retains the authority to "institute suit" for payment at maturity, unless the lawsuit would threaten the validity of a lien granted to noteholders. And as an exception to the rule that majorities and super-majorities can consent to waive defaults, subsection (b) provides that a majority cannot change the amounts owed or due dates of an indenture security, other than one particular kind of change: namely, postponement of interest for up to three years as approved by 75% of holders (in accordance with subsection (a)(2)). *Id.* § 77ppp(b).

Thus, analyzed as a whole, section 316 allocates power between majorities and individual holders concerning the alteration of legal claims, through waiver or postponement, and the enforcement of those claims in court. But it makes no mention of conduct by issuers, whether undertaken as part of a "restructuring" or otherwise, that affect the *outcome* of an individual holder's efforts to collect.

Consistent with the language and structure of the statute, numerous decisions have held that section 316(b) protects "the holder's *legal* rights and not the holder's *practical* rights to the principal and interest itself." *Magten Asset Mgmt. Corp.* v. *Nw. Corp. (In re Nw. Corp.)*, 313 B.R. 595, 600 (Bankr. D. Del. 2004) (emphasis in original). In *Northwestern Corp.*, noteholders challenged a transfer by a corporation that "relegated [them] to the bottom of the heap of [the corporation's] creditors," and "in essence left them with little at the end of the day." *Id.* at 599. The court rejected the claim that the noteholders' consent was required, reasoning that their "legal rights were not impaired" and the TIA does not provide a "guarantee against default." *Id*. at 600; *accord Brady* v. *UBS Fin. Servs., Inc.*, 538 F.3d 1319, 1326 n.9 (10th Cir. 2008) (quoting and citing *Nw. Corp.* with approval).[3]

In *YRC Worldwide Inc.* v. *Deutsche Bank Trust Co. Americas*, 2010 WL 2680336 (D. Kan. July 1, 2010), the district court adopted the same text-based approach. There, an indenture trustee argued that section 316(b) required unanimous consent to remove an indenture provision that prohibited the issuer from disposing of its assets to a non-obligor, because noteholders would "be denied direct recourse" against the issuer. *Id.* at *7. The court disagreed, concluding that the removal of the covenant did not impair "the holders' *legal rights*" because the issuer would "remain obligated under the notes and indentures if such a transfer did occur."

[3] *See also* Debevoise & Plimpton, *Expansive Trust Indenture Act Interpretation May Negatively Affect Bond Restructurings*, at 3 & n.5 (Jan. 28, 2015) ("[A]s generally understood, the TIA only protects a legal right to *seek* payment by protecting each holder against amendments of certain 'core terms' not implicated in [*Marblegate*]." (emphasis in original; citing *Nw. Corp.* with approval)), *available at* http://www.debevoise.com/~/media/files/client%20updates/expansivetrustindentureactinterpretationmaynegativelyaffectbondrestructurings.pdf.

Id. (emphasis added). The court explained that "TIA § 316(b) does not provide a guarantee against the issuing company's default or its ability to meet its obligations," and so does not preclude transactions that make it "more difficult for holders to receive payment." *Id.*; *see also Schallitz* v. *Starrett Corp.*, 82 N.Y.S.2d 89, 91 (N.Y. Sup. Ct. 1948) (unanimous consent not required for covenant waivers that reduced sources of recovery: section 316(b) "forbids postponement only of interest actually due and payable by the terms of the indenture security").

Although this Court has not addressed the precise questions presented here, its commentary on section 316(b) is consistent with the approach adopted by these other courts. In *Bank of New York* v. *First Millennium, Inc.*, the Court characterized section 316(b) only as protecting against "modif[ication]" by majority of a "bond's payment terms." 607 F.3d 905, 917 (2d Cir. 2010). In the same decision, the Court made clear that a noteholder's "right" to receive payment may itself be conditioned in the indenture, and that enforcing such conditions does not violate the TIA. En route to holding that an indenture provision granting noteholders an "*absolute and unconditional*" right to "receive payment" controlled over a provision that limited the noteholders' recourse to specified assets, the Court rejected an argument that the grant of an "absolute and unconditional" payment right was "boilerplate" derived from the TIA. *Id*. at 916-17. According to the Court, that contractual language went *beyond* section 316(b), because "[n]othing in Section 316(b), or the TIA in general, requires that bondholders be afforded 'absolute and unconditional' rights to payment." *Id.* at 917.

The district court's decision in *UPIC & Co.* v. *Kinder-Care Learning Centers, Inc.*, 793 F. Supp. 448 (S.D.N.Y. 1992), likewise confirms that, as long as a bond's payment terms are not modified after the fact by a majority, section 316(b) does not limit the power of indenture parties to impose conditions on payment. In that case, an indenture provided that if the issuer's secured indebtedness was in default, any debt repayments would be applied to the secured debt before the unsecured notes. In rejecting a challenge under section 316(b), the court agreed that the noteholders' "right to demand payment of principal and interest" for purposes of section 316(b) "cannot be divorced from the provisions of the Indenture and the [notes] which *define the scope of that right*." *Id.* at 457 (emphasis added); *see also McMahan & Co.* v. *Wherehouse Entm't, Inc.*, 859 F. Supp. 743, 748 (S.D.N.Y. 1994) (rejecting section 316(b) claim where condition to payment right had not occurred; statute applies only "when the right to payment becomes absolute and unconditional"), *aff'd in part and rev'd on other grounds*, 65 F.3d 1044 (2d Cir. 1995).

The limited scope of section 316(b) is further confirmed by cases construing indenture "no action" clauses, which provide that — subject to the protections of section 316(b) — individual holders may not exercise remedies absent action by the indenture trustee. *See, e.g.*, A1139-1140 (Indenture § 6.06; example of no-action clause). These cases establish that where a claimed wrong has only the *practical* effect of making a borrower less capable of making debt payments, and does not alter a core payment term, section 316(b) is not implicated.

For example, in *RBC Capital Markets, LLC* v. *Education Loan Trust IV*, 2011 WL 6152282 (Del. Ch. Dec. 6, 2011), the Delaware Chancery Court dismissed a noteholder action claiming that unauthorized payments by the issuer had reduced the amounts available to noteholders. Chancellor Strine concluded that section 316(b) of the TIA did not apply, and that the no-action clause barred the suit, because the plaintiff did "not allege a violation of any specific term of the Indenture . . . that deals with the *timing* of interest payments or the *amount* of interest payments made." *Id.* at *5 (emphasis added); *see also, e.g.*, *Feldbaum* v. *McCrory Corp.*, 1992 WL 119095, at *1-2 (Del. Ch. June 2, 1992) (claims alleging that "restructuring transactions" had "increased the risk of default" barred by no-action clause).

In the decision on appeal, the court below disagreed with or disregarded all of these precedents, and instead followed an isolated decision from the Southern District: *Federated Strategic Income Fund* v. *Mechala Group Jamaica Ltd.*, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999). In that decision, Judge Baer read into section 316(b) a prohibition on transactions that, "as a practical matter," prevent a noteholder from "be[ing] able to seek recourse" when its notes are due. *Id*. at *7. The court below "side[d]" with *Mechala* over later decisions, while imposing an extra-statutory "limiting principle" on the *Mechala* approach — namely, that it applies only in the context of an out-of-court "debt restructuring." *Marblegate I*, 75 F. Supp. 3d at 612, 614-15.[4]

Mechala, however, is neither persuasive nor on point. The decision contains limited analysis of the statutory text, and it does not cite any authority to support its broad gloss on the statute. *Mechala*, moreover, addressed an indenture provision

[4] In a separate case, Judge Scheindlin has since agreed with *Mechala* and the court below that, in the context of a "restructuring," section 316(b) "protects a noteholder's practical ability, as well as the legal right, to receive payment when due." *BOKF, N.A.* v. *Caesars Entm't Corp.*, 2015 WL 5076785 (S.D.N.Y. Aug. 27, 2015). Judge Scheindlin, however, recognized a "brewing" split in authority and certified her decision for appeal. *Id.* at *13 & n.95; *see also MeehanCombs Global Credit Opps. Funds, LP* v. *Caesars Entm't Corp.*, 80 F. Supp. 3d 507, 515-16 (S.D.N.Y. 2015).

granting an "absolute and unconditional" right to receive payment (*id*. at *5 n.5), which — as explained by this Court in *Bank of New York* — provides *more* protection than section 316(b) of the TIA (607 F.3d at 916-17). Notably, in another case where bondholders bargained for an "absolute and unconditional" right to receive payment, Judge Baer held that the revocation of an issuer's sovereign immunity waiver without unanimous consent did *not* impair that right. *Greylock Global Opp. Master Fund Ltd.* v. *Province of Mendoza*, 2005 WL 289723, at *4-5 (S.D.N.Y. Feb. 8, 2005), *aff'd*, 162 F. App'x 85, 87 (2d Cir. 2006) (summary order) (concluding that the indenture did not "preclude the bondholders from executing an amendment that might — in some practical sense — affect a bondholder's ability to recover payment"). While Judge Baer sought to distinguish *Mechala* on the ground that the transactions there had a greater effect on plaintiffs' "ability to recover debt . . . upon maturity" (2005 WL 289723, at *5 & n.4), there is no principled basis to distinguish among transactions based on their practical effects, and the statute provides no guidance to the courts on how to do so.

In addition, unlike this case, *Mechala* did not involve an exercise by secured lenders of their contractual and state-law rights. In *Mechala*, noteholders were asked to amend their indenture, by majority action, to facilitate transactions that would reduce their recoveries while other creditors were paid "in full." 1999 WL 993648, at *5. Here, as discussed further in Part II, the Company's secured lenders significantly reduced their own claims and exercised powers that all noteholders explicitly allocated to them in the governing indenture.

2. The legislative history confirms that the statute addresses only changes by majority to the amount owed or the due dates.

The district court determined that it "must turn to legislative history" to interpret section 316(b), forgoing any sustained analysis of the statute itself. *Marblegate I*, 75 F. Supp. 3d at 611. The legislative history, however, also does not support the expansive interpretation adopted below; instead, consistent with the statutory text, it shows that the TIA was intended to protect against majority modification of an indenture's core payment terms — but no more.

The legislative history shows that, from the outset, proponents of the statute had two specific concerns: *First*, they were concerned about indenture provisions that would allow a majority of noteholders to deprive other noteholders of the power to sue on their notes; and *second*, they were concerned about indenture provisions that would permit a majority of noteholders to modify payment terms by waiving or postponing an issuer's obligations. The same proponents, however, rejected suggestions that the statute would do more than address those specific concerns.

<u>The 1936 SEC report</u>

The TIA, including section 316(b), was the handiwork of the Securities and Exchange Commission. A primary impetus for the legislation was the agency's Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees. *See* 15 U.S.C. § 77bbb; A2297 (Statement of Congressman Cole); A3341.

Part VI of the report, entitled "Trustees under Indentures," discussed majority control under indentures. The SEC first addressed "no-action" provisions that deprived bondholders of the right to sue on their notes absent majority approval. The agency explained that, "[u]nder certain indentures it may be that [minority bondholders] cannot even bring suit to collect the money which the issuer owes them on their securities." A3375 (p. 62).

Later in Part VI, the SEC addressed indenture provisions permitting majorities to modify or waive an issuer's payment obligations. The agency noted that an increasing number of indentures provided that 75% of the holders could "release the trust indenture and discharge the obligation of the bonds, in return for cash or securities," thus reducing the amount owed to all holders. A3415 (p. 143); *see also* A3417-3418 (pp. 147-48) (example of majority-control provision).

The report went on to explain that, in the absence of these majority-control provisions, the "release or amendment of the indenture could not be obtained without consent of all of the bondholders or without the aid of a foreclosure or bankruptcy court." A3416 (p. 144). To illustrate this point, the report cited *Hollister* v. *Stewart*, 111 N.Y. 644 (1889), a case in which a majority of bondholders sought to substitute an existing mortgage with new mortgages at a reduced interest rate, and to "waive all existing defaults." *Id.* at 658. The court held that a creditor that had not assented to the exchange retained its claim for the original amount, because "the other parties to the contract could not vary its terms." *Id.*; *see* A3416 (pp. 144-45).

The 1938 bill and congressional proceedings

In its foundational report, therefore, the SEC addressed two distinct kinds of majority-control provisions: those that deprived noteholders of the right to sue, and those that permitted a majority of noteholders to waive payment defaults and make binding modifications to the payment terms of a contract. Both kinds of provisions were addressed in the TIA.

The 1938 version of the bill, in section 7(m)(3), limited majority control over the right to sue by providing that an indenture must contain provisions protecting "the rights, powers, and remedies of the indenture security holders with respect to . . . bringing action to collect the principal of and interest upon the indenture securities upon their respective due dates." A2347-2348.

Section 7(m)(3) of the 1938 bill separately addressed the SEC's concern about majority action to extinguish or reduce an issuer's debt obligations. It provided that an indenture could include provisions authorizing a majority to postpone interest payments by up to one year, and to waive an issuer's defaults, "*except a default in the payment of the principal* of any indenture security *upon the date of maturity specified therein*." A2347-2348 (emphasis added).

The "main proponent" of the TIA, SEC Chairman William O. Douglas (A2297), commented on this "exception" when testifying before Congress in April 1938. In defending the provision from criticism, Douglas explained:

> The effect of this exception is 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 a reduction of his claim for interest or a postponement thereof for more than 1 year. In other words, *this provision merely restricts the power of the majority to change those particular phases of the contract*.

A2370 (emphasis added). Chairman Douglas went on to elaborate on the rationale for restricting majority-control provisions that permit changes to core payment terms: "Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this exception." A2370. This statement — which carried over into the final House and Senate reports on the statute (A3274; A3337-3338) — echoed the 1936 SEC report, in which the agency recognized that majority-control provisions attempted to accomplish what otherwise could be achieved only in bankruptcy: "vary" the terms of the issuer's payment obligation without the consent of all noteholders. A3416 (p. 145) (quoting *Hollister*, 111 N.Y. 644).

<u>The 1939 bill and congressional proceedings</u>

The proposed statutory language of section 7(m)(3) remained in the bill until March of 1939, when Congressman Cole introduced a revised version. A2668.[5] In the revised bill, the relevant language was moved to section 316, and was broken up into two parts: subsection (a), which would permit postponement of interest payments by majority, but only for a short specified period, and subsection (b),

[5] In an interim version, what had been section 7(m)(3) was moved to section 314. *See* A2680-2681; A2447.

which would protect the right to receive payment of principal and interest (subject to subsection (a)) and to institute suit for enforcement. A2697-2698.

Section 316(b), however, was not intended to differ in scope from the version on which Chairman Douglas had commented. Rather, as Congressman Cole stated, the requirements of the original bill were "converted into specific statutory requirements," such that the "requirements of the [new] bill will be satisfied by the inclusion in the indenture of provisions in the precise language of the statute." A2668. In other words, while the 1938 bill vested the SEC with authority to review indenture language, the revised bill mandated specific language for indentures. But the goals of the statute did not change. At congressional hearings in April 1939, Douglas's prior testimony was "incorporated" at the request of the SEC. A2703.

Testimony from the SEC's representative at the 1939 hearings, Edmund Burke Jr., reaffirms the limited scope of section 316(b). Burke, who acted as one of the SEC's main spokesmen (*see* A2889; A2478; A3031), responded to the "considerable fire" that had been directed at section 316(b), explaining:

> 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 has himself consented to a variation from that contract.

A2951-2952. To accomplish this, Burke continued, the statute protects the amount and maturity date of a noteholder's claim: "When an investor buys a bond, he buys a right to get a thousand dollars on a particular date. *All that this subsection says* is that he shall not be deprived of that individual right without his consent." A2951-2952 (emphasis added). Burke thus confirmed again that section 316(b), as enacted, only protects the legal "right" to sue and to receive payment of an agreed amount on a particular date. As Burke stated, that is "[a]ll that the section does."

3. The district court's flawed analysis of the legislative history

After reviewing the legislative history, the district court concluded that section 316(b) prohibits not just majority modification of an indenture's core payment terms, but also out-of-court debt "reorganizations" that impair the ability of noteholders to collect. *Marblegate II*, 2015 WL 3867643, at *5, *11-13. Aside from lacking any basis in the statutory text, this conclusion was based on several critical flaws in the court's analysis of the legislative history.

The district court first erred in focusing on what it characterized as "textual changes" to the statute. *Id.* at *11. Although the court recognized that "the legislative history does not reveal a specific intent to strengthen the protections of Section 316(b)" between early versions of the bill and the final version, the court nonetheless concluded that the bill underwent a "significant" expansion in scope. *Id*. In particular, the court stated that, whereas an early version protected only the right of a bondholder to "bring[] action to collect" principal and interest, the final version added an "entirely separate" right to receive payment at maturity. *Id*.

That is not correct. Section 316(b), as enacted in 1939, did *not* add an "entirely separate right." *Id*. As demonstrated above, section 7(m)(3) of the 1938 bill specifically provided that a majority could only postpone interest payments for one year and could *not* waive "a default in the payment of the principal." A2347-2348. Chairman Douglas testified that the purpose of this "exception" was to ensure that a majority could not "change" the "particular phases of the contract" establishing payment amounts and due dates. A2370. From early on, therefore, the statute protected noteholders from majority-control provisions that would *either* curtail the power to sue *or* modify the indenture's payment terms.

The district court also went astray in its use of legislative history to divine the "purpose" of section 316(b). *Marblegate II*, 2015 WL 3867643, at *12. Quoting Douglas's testimony, the court stated that section 316(b) was meant to prevent an "undesirable result: allowing 'a majority to force a non-assenting security holder to accept a reduction or postponement of his claim.'" *Id*. From this, the court inferred that section 316(b) does not just preclude "straightforward amendment" to an indenture's payment terms. *Id.*

Read in full, however, Chairman Douglas's testimony supports the precise conclusion that the district court rejected. In the sentence in which Douglas spoke of "forc[ing]" a minority holder to accept a reduction or postponement of its claim, he made clear that he was referring to majority-control provisions — *i.e.*, "provisions authorizing" majorities to amend an indenture's payment terms, thereby modifying the legal entitlements of all holders. A2370. By contrast, he made no reference to commercial pressure resulting from, or the "practical" effects of, an issuer's conduct. Rather, in the next sentence, Douglas stated that "[i]n other words," section 316(b) "merely restricts the power of the majority to change those particular phases of the contract" establishing the amount owed and the due dates. *Id.*

Douglas, therefore, was explicitly concerned with "provisions" authorizing *legally binding* alterations of contractual payment terms — the types of alterations commonly effectuated in a bankruptcy proceeding. This concern harkened back to the SEC report, which likewise focused on provisions authorizing a majority to effectuate a "readjustment of the indebtedness" under an indenture, after which minority holders would be "*bound* to accept in lieu of [their] outstanding bonds new, modified, or substitute securities." A3417-3418 (pp. 147-48) (quoting majority-control provision; emphasis added).

B. A noteholder's ability to recover is protected by other indenture provisions and other bodies of law.

The district court's analysis of section 316(b) was also flawed insofar as it ignored the broader legal context in which the TIA operates. Without regard to the TIA, noteholders have a variety of well-defined rights and remedies to protect their *ability* to get paid. The TIA is not needed to serve that function and, in any event, it does not provide the courts with any workable rules to apply in doing so.

1. Contractual protections of the ability to recover

As set forth in the expert report of James Gadsden — which was admitted into evidence and never contested by plaintiffs — parties to indentures negotiate "restrictive covenants" aimed at protecting noteholders from actions that could lead to default. A1714-1715 (¶ 18), A1723-1724 (¶¶ 38-41). For example, many indentures have provisions restricting debtors from paying dividends to shareholders, incurring additional indebtedness, or selling assets. A1723-1724 (¶¶ 39-40). As Gadsden explained, "[t]he function of these covenants is to limit an issuer's ability to engage in activities . . . which could affect the ability of the issuer to make payments on the notes." A1714-1715 (¶ 18).

As Gadsden further explained, these covenants are "separate from the provisions of the indenture requiring payment of principal and interest and protecting that right to payment." A1723 (¶ 38). Also, "[a]s a matter of standard market practice," restrictive covenants are subject to amendment by majority. A1724 (¶ 41). The reason for this majority rule is that issuers and noteholders need "flexibility to permit transactions that most noteholders conclude are beneficial, including in situations where the issuer is in distress." A1724 (¶ 41).

As demonstrated by the Gadsden report, sophisticated participants in the bond market rely on *express* negotiated provisions — not section 316(b) — to protect their economic ability to collect. A1710 (¶ 4). But under the district court's decision, section 316(b) *implicitly* protects each noteholder's ability to receive payment in the context of a restructuring.

In contrast to the court below, other courts in this Circuit have found indenture-based claims "especially troublesome" where, as here, the indenture "could easily have been drafted to incorporate expressly the terms the Plaintiffs now urge th[e] court to imply." *Hartford Fire Ins. Co.* v. *Federated Dep't Stores, Inc.*, 723 F. Supp. 976, 992 (S.D.N.Y. 1989). Judge Walker's decision in *Metropolitan Life Insurance Co.* v. *RJR Nabisco, Inc.*, 716 F. Supp. 1504 (S.D.N.Y. 1989), is instructive. In that case, bondholders argued that an issuer violated the implied covenant of good faith and fair dealing when it incurred substantial new debt, thus reducing the likelihood that "the company would remain able to make interest payments and repay principal." *Id.* at 1517, 1520 (internal quotation marks omitted). Judge Walker rejected the claim. Emphasizing that protections of the ability to get paid must be expressly bargained for, Judge Walker agreed that:

> Short of bankruptcy, *the debt security holder can do nothing to protect himself against actions of the borrower which jeopardize its ability to pay the debt unless he . . . establishes his rights through contractual provisions set forth in the debt agreement or indenture*.

Id. at 1518 (quoting Am. Bar Found., *Commentaries on Indentures* 1-2 (1971) (emphasis added by Judge Walker)).[6]

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[6] *See also Sharon Steel Corp.* v. *Chase Manhattan Bank, N.A.*, 691 F.2d 1039, 1049 (2d Cir. 1982) (citing the *Commentaries* for the same proposition and for the proposition that "[t]here is no governing body of statutory or common law that protects the holder of unsecured debt securities against harmful acts by the debtor except in the most extreme situations"); *Geren* v. *Quantum Chem. Corp.*, 832 F. Supp. 728, 732-33 (S.D.N.Y. 1993) (Leval, J.) (rejecting implied-covenant challenge to dividend payment that did not alter "the explicit right to receive periodic interest payments and the repayment of principal").

The benefits of allowing the parties themselves to determine what an issuer can and cannot do are manifest. As Gadsden testified, sophisticated parties are able to negotiate clear, predictable rules to protect noteholders' ability to collect. A1723-1724 (¶¶ 38-41). To the extent noteholders agree to looser covenants and a higher risk of default, they can adjust their economic terms — as they did here by negotiating for a nearly *20%* yield. By contrast, the district court's gloss on the statute puts the onus on market participants and fact-finders to assess the "practical" effects of transactions and whether a "restructuring" has occurred. These indeterminate criteria introduce significant uncertainty into a market where predictability is paramount. *See generally Sharon Steel Corp.*, 691 F.2d at 1048 (stressing the importance of "uniform" application of "standard" indenture provisions and avoiding the "uncertainties" created "if interpretation of boilerplate [indenture] provisions were submitted to juries").

2. Legal protections of the ability to recover

The law provides additional protections to noteholders without regard to the parties' contract. Indeed, an entire body of law — the law of fraudulent conveyances — exists to address actions by debtors "trying to avoid paying their debts." *Grupo Mexicano de Desarrollo S.A.* v. *Alliance Bond Fund, Inc.*, 527 U.S.

308, 322 (1999).[7] State law also recognizes post-judgment remedies that facilitate debt collection by creditors, including restraining a judgment debtor's disposition of property and collecting debts from certain transferees. *See, e.g.*, N.Y. C.P.L.R. §§ 5222, 5229 (restraining notices); *id.* § 5225(b) (payment by transferees).

If the district court's interpretation of the TIA were correct, section 316(b) would usurp the function of these legal doctrines. But unlike those bodies of law — which have been carefully developed by statute and case law in every U.S. jurisdiction — section 316(b) provides no specific guidance on when the "ability" to collect should be protected or when defenses should be recognized.

Nor does the statute give direction as to how a protection of noteholders' "ability" to collect should interact with the rights of secured lenders under Article 9 of the Uniform Commercial Code. In a related context — a case involving a

[7] Under New York's fraudulent conveyance statute, a creditor can set aside transfers that are intended to "hinder, delay, or defraud" creditors or that are made without "fair consideration" while the debtor is insolvent. N.Y. Debt. & Cred. Law §§ 273, 276. The Uniform Fraudulent Transfer Act, which has been adopted by most other jurisdictions, affords similar rights and remedies to creditors. *See* UFTA §§ 4, 5, 7 (U.L.A. 1984). At the same time, state legislatures have provided transferees with defenses, including by limiting liability where the transferee gave value in good faith (*e.g.*, *id*. § 8(d)) and by shielding transfers that result from a secured lender's exercise of state-law foreclosure rights (*see id.* § 8(e)).

Bankruptcy Code provision authorizing a trustee to avoid fraudulent transfers for the benefit of creditors — the Supreme Court declared that foreclosure law and fraudulent conveyance law are the "two pillars of debtor-creditor jurisprudence," and declined to construe a federal statute "to disrupt the ancient harmony" of those bodies of law by expanding the power to challenge foreclosure sales. *BFP* v. *Resolution Trust Corp.*, 511 U.S. 531, 543-44 (1994). The Court held that to displace "traditional state regulation" of foreclosure sales, "the federal statutory purpose must be 'clear and manifest.'" *Id*. at 544 (quoting *English* v. *Gen. Elec. Co.*, 496 U.S. 72, 79 (1990)).

"[A]bsent clearer textual guidance" (*id*. at 543), this Court should not infer that Congress intended the TIA to be used as yet another tool to regulate conduct affecting creditor recoveries — especially one that would deprive secured lenders of the benefits of a "valid exercise of [their] rights under UCC Article 9" (*Marblegate I*, 75 F. Supp. 3d at 610).

C. Interpreting the TIA to prohibit only modification of core payment terms does not "enfeeble" the statute.

1. Protecting legal claims ensures that noteholders retain their state-law rights and remedies.

The district court stated that a broad judicial gloss on section 316(b) is necessary to prevent the statute from being "enfeeble[d]." *Marblegate II*, 2015 WL 3867643, at *13. This concern about "enfeebling" the statute is not well-founded.

The protection of the legal "right" to payment at maturity is in itself highly significant. By protecting that right, section 316(b) ensures not only that noteholders maintain a claim for payment at maturity, but also that they retain the power to exercise associated rights and remedies under state law. As noted, fraudulent conveyance law provides broad powers to a "creditor" — *i.e.*, a "person who has a claim," meaning a "right to payment" (UFTA § 1(3)-(4); N.Y. Debt & Cred. Law § 270), while post-judgment remedy statutes confer various rights on a "judgment creditor" (*see generally, e.g.*, *McCahey* v. *L.P. Investors*, 774 F.2d 543 (2d Cir. 1985) (discussing New York's statutes)). State law also provides means for holders of legal claims to sue third parties when they believe their ability to collect has been compromised. For example, "the creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties." *N. Am. Catholic Educ. Programming Found., Inc.* v. *Gheewalla*, 930 A.2d 92, 101 (Del. 2007).

Accordingly, regardless of whether an issuer has assets to meet its obligations, a noteholder that has a "right to receive payment" from that issuer retains substantial powers and benefits. If noteholder majorities were able to reduce or postpone the claims of other holders, they could deprive the minority holders of their creditor remedies under state law. The prohibition against impairment of the "right" to receive payment does not have to be expanded to have teeth.

2. The district court's concern about encouraging out-of-court restructurings was misplaced.

For much the same reason, the district court had no sound basis for its concern that, absent an expansive reading of section 316(b), "the next cycle of reorganizations will take place on a voluntary basis without supervision of any court or administrative agency" (*Marblegate II*, 2015 WL 3867643, at *12, *13 (quoting 1936 SEC report)).

Precisely because legal claims to payment are protected by the TIA, a restructuring that takes place outside of bankruptcy remains subject to attack by dissenters, including on fraudulent conveyance theories. By contrast, the bankruptcy process can *bind* creditors to a plan of reorganization — and discharge their legal claims (11 U.S.C. §§ 524, 1141(d)) — even if they do not consent to its terms.[8]

Education Management and its creditors were driven to seek an out-of-court solution for unique reasons. As the district court observed, it is "the unusual role played by Title IV's funding requirements for for-profit education institutions" that "removes bankruptcy as a viable option" for Education Management. *Marblegate I*, 75 F. Supp. 2d at 617. But the presence of this "unusual" issue in one case does not mean that market participants will forgo the significant protections of the Bankruptcy Code in other cases.

The district court's expansive interpretation of the TIA not only is unnecessary to protect in-court restructurings, but also casts a shadow over out-of-court resolutions that Congress and the courts have otherwise *encouraged*. As this Court has explained, there is a "strong bankruptcy policy in favor of the speedy, inexpensive, negotiated resolution of disputes, that is an out-of-court or

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[8] Under the Bankruptcy Code, a class of creditors can approve a chapter 11 plan upon a vote by only one-half of the class by number and holders of two-thirds of the claims in that class by amount. 11 U.S.C. § 1126(c). Once a plan is confirmed, dissenters cannot challenge transactions occurring under the plan. *See* 11 U.S.C. § 1141(a) ("[T]he provisions of a confirmed plan may bind . . . any creditor . . . whether or not the claim . . . of such creditor . . . is impaired under the plan.").

common law composition." *LTV Corp.* v. *Valley Fid. Bank & Trust Co. (In re Chateaugay Corp.),* 961 F.2d 378, 382 (2d Cir. 1992); *accord, e.g., Tex. Commerce Bank, N.A.* v. *Light (In re Pengo Indus., Inc.),* 962 F.2d 543, 549 (5th Cir. 1992).

Consistent with this "strong" policy, this Court has held that "[i]n the absence of *unambiguous* statutory guidance, we will not attribute to Congress an intent to place a stumbling block in front of debtors seeking to avoid bankruptcy with the cooperation of their creditors." *Chateaugay*, 961 F.2d at 383 (emphasis added). A federal statute thus should not be interpreted to "create[] a disincentive for creditors to cooperate with a troubled debtor," such as by encouraging "holdouts who refuse to cooperate." *Id.* at 382. Section 316(b), therefore, should not be interpreted to empower holdouts such as Marblegate to challenge out-of-court workouts.

3. An expansive reading of the TIA is not needed to give effect to the statute's disjunctive terms.

The district court also suggested that, absent an expansive interpretation of section 316(b), the "right to receive payment" would be "repetitive" of the right to "institute suit," in which case the disjunctive "or" in the statute would be "disregarded." *Marblegate II*, 2015 WL 3867643, at *11.

As discussed above, however, there is a well-recognized distinction between these two separate rights. *Supra* Points I.A.2, I.A.3. Protection of the right to "institute suit" is necessary to limit the effect of no-action clauses, so as to avoid procedural barriers to lawsuits by individual holders to collect principal and interest. By contrast, protection of the "right to receive payment" is necessary to prevent a majority from reducing the amount owed to other holders, thus depriving minority holders of a valid claim on which to sue. *See UPIC*, 793 F. Supp. at 456-57 (distinguishing between "'procedural' right to commence an action for nonpayment" and the "noteholder's right to payment").

Accordingly, the "right to receive payment" already has a meaning beyond the right to "institute suit." Under the correct reading of the statute, the disjunctive "or" has full effect.

II. THE TRUST INDENTURE ACT, PROPERLY INTERPRETED, DID NOT PRECLUDE EDUCATION MANAGEMENT'S RESTRUCTURING TRANSACTIONS.

The result reached by the district court depends on a reading of the TIA under which the statute protects *more* than the legal right to payment as defined in the indenture. By contrast, "[t]he language and logic of the *Northwestern Corp.* and *YRC Worldwide* decisions" — which interpret the statute to protect only against modification of the indenture's payment terms — "would suggest that Plaintiffs have no claim" under the TIA. *Marblegate I*, 75 F. Supp. 3d at 612.

When section 316(b) is properly interpreted, the inescapable conclusion is that Education Management's restructuring does not contravene the statute. Plaintiffs have challenged two components of the restructuring: the Intercompany Sale and the release of the parent company EDMC's guarantee of the unsecured notes. Both transactions had "valid contractual bases" (*Marblegate I*, 75 F. Supp. 3d at 610), and neither transaction "modif[ied] any indenture term explicitly governing the right to receive interest or principal on a certain date." *Marblegate II*, 2015 WL 3867643, at *3; *see also id.* at *13.

The transactions, therefore, do not violate section 316(b) of the TIA. The Intercompany Sale, which occurred following the denial of injunctive relief, involved a foreclosure by secured lenders and sale of the foreclosed assets to a new Education Management affiliate. It did not alter the indenture's payment terms. After the sale, Marblegate had the same legal entitlement to be paid principal and interest in the amounts and on the dates agreed by the parties, and all state-law rights and remedies associated with that entitlement. As the district court concluded, "the Intercompany Sale would not formally alter the dissenting Noteholders' right to payment on their Notes." *Marblegate II*, 2015 WL 3867643, at *2.

Release of the parent guarantee also would not impair the right to receive payment for which Marblegate bargained, as it would not involve modification of the indenture's core payment terms. The amount owed to Marblegate would not change, nor would the due dates. Rather, the parent guarantee would be released by operation of the plain terms of the parties' indenture.

As summarized above, the majority of the Company's secured lenders determined, in connection with the exchange, to release EDMC from its guarantee of the secured debt. A1765 (¶ 34); A1783-1784 (¶ 7). Under the indenture, that release should have resulted in the release of the parent guarantee of the notes. Section 10.06 of the indenture provides that — as soon as the Company delivers an officer's certificate and opinion of counsel stating that the "conditions precedent" for the guarantee release have occurred (which the Company has not done only because of the district court's decision) — the parent guarantee "shall be automatically and unconditionally released and discharged" upon "the release or discharge of the guarantee by such Guarantor of the Senior Credit Facilities." A1161.

Such indenture provisions are entirely standard in the market, and their purpose is to "preserve[] the priority of the rights of the holders of the secured debt over unsecured debt." A1720-1721 (¶¶ 31-33). Indeed, the offering memorandum for the notes specifically warned investors like Marblegate that the notes were effectively "junior" to the Company's secured debt (A844), that the parent guarantee of the notes could be released at the secured lenders' discretion (A845), and that noteholders should not assign *any value* to the parent guarantee (A887).[9]

The district court acknowledged that the guarantee-release provisions in the indenture could be "invoked" without violating the TIA. *Marblegate I*, 75 F. Supp. 3d at 615-16. Nonetheless, the court held that they could not be invoked *in this case*, because the release would occur in the context of a "debt reorganization" that, according to the court, would impair the ability of dissenting holders to collect on their claims. *Id.* at 616.

This ruling was completely novel. As explained in one comment: "The TIA has been in effect for more than 75 years, and we are not aware of any precedent for reading Section 316(b) of the TIA to bar issuers from implementing actions

[9] Not only did the Company's secured lenders release the parent guarantee of the notes, but a majority of noteholders did so as well in the context of the exchange offer. A1028 (§ 2(e)(iii)). Although not necessary to address in light of the secured-lender release, the majority release was also consistent with the indenture, under which guarantees from entities other than Significant Subsidiaries may be "waived with the consent of the Holders of a majority in principal amount of the then outstanding Notes." A1155-1156 (§ 9.02).

permitted by the indenture that reduce the likelihood of payment of the notes without unanimous creditor consent."[10] What is more, prior to the decision below, no court had read a distinction between "debt reorganizations" and other transactions into section 316(b). Such a distinction can be located nowhere in the text of section 316(b) or any other provision of the TIA.

The decision not only was unprecedented, but also was at odds with authority from this Circuit. As the district court in *UPIC* explained, a noteholder's right to payment under section 316(b) "cannot be divorced from the provisions of the Indenture and the [notes] which *define the scope of that right*." 793 F. Supp. at 457 (emphasis added). Section 316(b) thus does not prevent enforcement of contractual provisions that condition the payment of unsecured creditors on the payment of secured lenders. *Id.* at 460; *see also Bank of New York*, 607 F.3d at 917 ("Nothing in Section 316(b), or the TIA in general, requires that bondholders be afforded 'absolute and unconditional' rights to payment.").

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[10] Davis Polk & Wardwell LLP, *SDNY Issues Novel Opinion Holding that Out-of-Court Restructurings May Violate Noteholder Rights Under the Trust Indenture Act* (Feb. 3, 2015), *available at* https://blogs.law.harvard.edu/bankruptcyroundtable/2015/02/03/sdny-issues-novel-opinion-holding-that-out-of-court-restructurings-may-violate-noteholder-rights-under-the-trust-indenture-act/.

The district court, accordingly, had no sound basis to prevent the Company and its secured lenders from relying on expressly-negotiated indenture provisions permitting the release of unsecured guarantees. As in *UPIC*, the parties' agreement to prioritize secured over unsecured debt should be respected and Marblegate, a sophisticated hedge fund, should not be relieved of its contractual commitments.

III. THE TRUST INDENTURE ACT, EVEN AS INTERPRETED BY THE DISTRICT COURT, DID NOT PRECLUDE EDUCATION MANAGEMENT'S RESTRUCTURING TRANSACTIONS.

The evidence below was undisputed that without a restructuring, Marblegate's ability to collect on its notes was virtually nil: as the district court found, the notes stood behind more than $1.3 billion in secured debt, which the Company could not satisfy. Marblegate's ultimate recovery in the absence of a restructuring would have been limited to one or two more interest payments at most, with no recovery of principal. *Marblegate I*, 75 F. Supp. 3d at 599.

By contrast, in the restructuring, participating noteholders were offered a recovery in the form of new equity. Based on undisputed evidence of the Company's enterprise value, and as calculated by Marblegate's own expert witness, that equity would be equivalent to a recovery for noteholders of approximately 33% of their debt claims (and up to 58% on some assumptions) — more than the value of a couple of interest payments. A2115 (¶ 4) (opining that mid-point recovery for noteholders in transaction was $71 million on $217 million note issuance). Marblegate, therefore, would have been better off exchanging its debt than preventing the restructuring from occurring. *See* A1510 (Tr. 329:14-330:24); *Marblegate I*, 75 F. Supp. 3d at 599.

The challenged transactions, therefore, did not "impair" Marblegate's recoveries, nor did they "disinherit" Marblegate. *Id*. at *615. Where Marblegate's notes already had minimal value, and that value would only *increase* through Marblegate's participation in the restructuring, it cannot be said that the transactions caused harm to Marblegate at all. Any diminution of Marblegate's ability to recover was the result of the Company's financial distress — the product of business and economic factors that preceded, and were not caused by, the transactions at issue. A1757 (¶¶ 13, 14).

The district court's conclusion that Marblegate's right to receive payment was impaired by the challenged transactions — because the transactions "deprive[d] dissenting bondholders of assets against which to recover" (*Marblegate II*, 2015 WL 3867643, at *4) — yields a perverse result. Under the district court's reasoning, a noteholder that *already* lacks a prospect for recovery can use the TIA not to protect against impairment but to *improve* its position. If the district court's decision is affirmed, Marblegate will have catapulted from the position of an unsecured creditor with a near-worthless claim to the *only* financial creditor, secured or unsecured, that may receive full payment at maturity of the original amounts owed. While unsecured noteholders agreed to be "effectively junior to those lenders who have a security interest in [the Company's] assets" (A844), Marblegate will have subverted this priority scheme, obtaining a windfall recovery at the expense of the Company's secured lenders and other noteholders. Indeed, as a result of the district court's decision, Marblegate has already obtained an outsized recovery compared to other creditors: The Company has paid millions in interest to Marblegate since this suit was commenced, and is continuing to pay interest during this appeal.

Even if the TIA were not limited to protecting against modification of core payment terms, nothing in the statute compels federal courts to intervene on behalf of holdouts whose claims are *already* impaired and whose recovery is contingent on the very transactions that they resist. As this Court has recognized, a federal statute should not be interpreted to grant a "windfall" to "holdouts who refuse to cooperate" in an out-of-court workout. *Chateaugay*, 961 F.2d at 382. The TIA, indeed, states explicitly that a plaintiff suing for damages under the statute may not recover "a total amount in excess of his actual damages on account of the act complained of." 15 U.S.C. § 77www. Regardless of the relief sought by Marblegate in this case, a judgment placing it in a *better* position than it would have occupied had there been no restructuring contravenes the TIA's clearly-expressed policy of remedying only actual injury caused by a violation of the statute. *See, e.g.*, *LNC Invs., Inc.* v. *First Fid. Bank*, 1997 WL 528283, at *34 (S.D.N.Y. Aug. 27, 1997) (plaintiffs "entitled to recover only their out-of-pocket losses" caused by TIA violation). The district court's decision should be reversed on that independent ground as well.

CONCLUSION

For the reasons set forth herein, the judgment of the district court should be reversed and judgment should be entered for defendants-appellants.

Dated: September 9, 2015

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CERTIFICATE OF COMPLIANCE WITH RULE 32(A)

I hereby certify that:

1. This brief complies with the type-volume limitations of Federal Rule of Appellate Procedure 32(a)(7)(B), because this brief contains 12,044 words, excluding the parts of the brief exempted by Federal Rule of Appellate Procedure 32(a)(7)(B)(iii).

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Dated: September 9, 2015

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