# 15-2124

In The

## United States Court of Appeals

For The Second Circuit

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

*Plaintiffs-Counter-Defendants-Appellees,*

*v.*

EDUCATION MANAGEMENT FINANCE CORP.
AND EDUCATION MANAGEMENT LLC,

*Defendants-Appellants,*

EDUCATION MANAGEMENT CORP.,

*Defendant-Counterclaimant-Appellant,*

*and*

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

*Intervenor-Appellant.*

*On Appeal from the United States District Court*
*for the Southern District of New York*

# BRIEF OF THE LOAN SYNDICATIONS AND TRADING ASSOCIATION AND THE CHAMBER OF COMMERCE OF THE UNITED STATES AS *AMICI CURIAE* IN SUPPORT OF NEITHER PARTY

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# CORPORATE DISCLOSURE STATEMENT

Pursuant to Federal Rules of Appellate Procedure 29(c)(1) and 26.1, Amicus Curiae Loan Syndications and Trading Association ("LSTA") hereby discloses that it is a not-for-profit trade association with no parent corporation or publicly traded stock. No publicly held company has 10% or greater ownership in the LSTA.

Pursuant to Federal Rules of Appellate Procedure 29(c)(1) and 26.1, the Chamber of Commerce of the United States of America ("Chamber") hereby discloses that it is a non-profit, tax-exempt organization incorporated in the District of Columbia. The Chamber has no parent corporation, and no publicly held company has 10% or greater ownership in the Chamber.

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## STATEMENT OF INTEREST OF *AMICI CURIAE*

The Loan Syndications and Trading Association ("LSTA") and the Chamber of Commerce of the United States ("Chamber") respectfully submit this amicus brief to offer their perspective on the issues presented by this case.[1]

The LSTA is a not-for-profit trade association that represents a broad and diverse membership involved in the origination, syndication, and trading of commercial loans. Its mission is to promote a fair, orderly, efficient, and growing corporate loan market and to provide leadership in advancing and balancing the interests of all market participants.

The LSTA's interest in this case arises out of the significance of the question presented to companies' ability to restructure corporate debt in an efficient and sensible manner, which is critical to a robust and smoothly functioning market in commercial debt. Because of its role in the corporate debt market, the LSTA is well-positioned to provide market participants' perspective on the issue at hand. Indeed, the LSTA frequently appears as *amicus curiae* in cases raising issues of importance to the corporate debt market, and courts have often looked to its views.

[1] Pursuant to Fed. R. App. P. 29(c)(5), *amici* certify that no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money intended to fund the preparation or submission of the brief; and no person or entity other than *amici* or their members contributed money intended to fund the preparation or submission of the brief. All parties have consented to the filing of this brief.

*See In re DBSD N. Am., Inc.*, 634 F.3d 79, 105 (2d Cir. 2010); *In re Enron Corp.*, 379 B.R. 425, 430 (S.D.N.Y. 2007); *In re Phila. Newspapers, LLC*, 422 B.R. 553, 555 n.5 (Bankr. E.D. Pa. 2010) (all citing LSTA amicus briefs).

The Chamber of Commerce of the United States of America is the world's largest business federation. It represents 300,000 direct members and indirectly represents the interests of more than 3 million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files amicus curiae briefs in cases that raise issues of concern to the nation's business community.

*Amici* submit this brief not to take sides in the dispute between the parties, but to offer this Court their perspective on the purpose and proper interpretation of the bondholder protection provisions of the Trust Indenture Act ("TIA"). However the Court resolves this particular appeal, *amici* strongly urge the Court to reject an unduly expansive reading of those provisions, which would threaten the orderly operation of the financial markets.

## SUMMARY OF ARGUMENT

Section 316(b) of the Trust Indenture Act provides that "the right of any holder of any indenture security to receive payment of the principal and interest on such indenture security ... shall not be impaired or affected without the consent of such holder." 15 U.S.C. § 77ppp(b). Multiple courts have held that section 316(b) protects minority bondholders against alteration of their *legal* right to payment under the indenture without their consent. *See, e.g.*, *In re Northwestern Corp.*, 313 B.R. 595, 600 (Bankr D. Del. 2004); *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Ams.*, No. 10-2106, 2010 WL 2680336, at *7 (D. Kan. July 1, 2010); *see also* George W. Shuster Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 Am. Bankr. Inst. L. Rev. 431, 434 (2006).[2]

The district court did not follow these authorities. Instead, it embraced a far broader interpretation of section 316(b), reading the statute to bar any action that would hinder bondholders' "*practical*" ability to receive payment. *Marblegate Asset Mgmt., LLC* v. *Educ. Mgmt. Corp.*, No. 14 Civ. 8584, __ F. Supp. 3d __, 2015 WL 3867643, at *4 (S.D.N.Y. June 23, 2015) (emphasis in original). This reading casts aside the settled understanding of section 316(b) in favor of a

[2] *Amici* do not address, and does not believe this Court is required to decide in this case, the precise contours of what constitutes a "legal right" to payment. The district court here found that the restructuring at issue left the dissenting bondholders' legal rights unimpaired. This Court may therefore simply rule that when bondholder's legal rights are unaffected, section 316(b) does not apply.

limitless one that risks doing real harm to the corporate loan market. It wrongly broadens a carefully sculpted, narrow provision protecting individual bondholders' basic legal rights from modification without their consent to a prohibition on routine out-of-court majority-supported restructurings in which a minority bondholder believes the restructuring might cause it to recover less on its investment. And it causes the TIA to usurp other areas of law that, unlike the TIA, *are* designed to protect bondholders' economic interests in disputes involving the substance of a corporate borrower's business dealings.

Moreover, the district court identified no coherent limiting principle that might cabin its reasoning. Under the district court's interpretation of the TIA, courts would routinely be required to scrutinize the "fairness" of everyday business transactions in the name of bondholder protection. Such a surprising, indeed revolutionary, rule would invalidate a host of provisions that are commonly included in financing documents—provisions that serve important and valuable purposes.

The district court's reading of section 316(b) is far from harmless. It casts aside freely and fairly negotiated provisions commonplace in modern indentures. And, by enabling individual dissenting creditors to block—or "hold up" in return for payment—beneficial restructurings to which most creditors have agreed, it risks driving companies that might otherwise have restructured their debt successfully out of court into bankruptcy or foreclosure. Nothing in the TIA or its legislative history supports such an interpretation. This Court should make clear that the district court's reading of the TIA is erroneous, and that section 316(b) exists to protect bondholders' legal right to payment, rather than their "practical" ability to collect.

## ARGUMENT

### I. THE TRUST INDENTURE ACT PROTECTS A BONDHOLDER'S LEGAL RIGHT TO PAYMENT

The district court correctly identified the core issue in this case: "Is [section 316(b) of the TIA] a broad protection against nonconsensual debt restructurings, or a narrow protection against majority amendment of certain 'core terms'?" *Marblegate I*, 75 F. Supp. 3d at 610. The district court concluded, wrongly, that the former interpretation was correct. This case concerns a restructuring that, as the district court itself found, did not modify any creditor's legal right to payment. *Marblegate II*, 2015 WL 3867643, at *2 ("[T]he Intercompany Sale would not formally alter the dissenting Noteholders' right to payment on their Notes"). Applying its "broad" interpretation of section 316, the district court nonetheless mistakenly found that the TIA prohibited the restructuring. *Id.* at 4.

Education Management[3] was effectively deprived of the ability to pursue a chapter 11 bankruptcy by the provision of federal law that makes an entity that has filed for bankruptcy ineligible for funds under Title IV of the Higher Education Act. *See* 20 U.S.C. § 1002(a)(4)(A). Accordingly, the Company instead attempted an out-of-court restructuring of its debt. *Marblegate II*, 2015 WL 3867643, at *1. It negotiated a deal with a majority of its creditors containing provisions designed to encourage participation in the restructuring. *Id.* at *2. First, Education Management's secured lenders would release its parent corporation, Education Management Corporation ("EDMC"), from EDMC's guarantee of the secured loans. That would cause a simultaneous release of EDMC's guarantee of the unsecured notes at issue in this case. *Id.* Second, the secured lenders would foreclose on the assets of the issuers of the notes and sell them to a new subsidiary of EDMC. *Id.* Finally, the Company would distribute new debt and equity to all creditors participating in the restructuring. Noteholders could choose not to participate, in which case they would retain their legal claims for payment against the note issuers. Since those entities would no longer have assets, however, the district court "anticipate[d]" that claims against the issuers would remain unpaid. *Id.* Notwithstanding its conclusion that the rights of dissenting noteholders were

[3] "Education Management" and the "Company" refer to the three defendants-appellants.

not "formally alter[ed]," the district court held that the restructuring was impermissible under section 316(b) because the noteholders' "*practical*" ability to be repaid was impaired. *Id.* at *4 (emphasis in original). This interpretation contravenes both the TIA's text and its purpose.

The TIA was designed to safeguard the rights of investors faced with trustees who either failed to maintain their disinterested status or lacked the power to represent bondholder interests adequately. *See generally* TIA § 302, 15 U.S.C. § 77bbb. It protects investors by regulating the terms of indentures. Certain provisions are automatically deemed to be a part of every indenture qualified under the TIA, regardless of the actual language of the instrument. *See* TIA § 316, 15 U.S.C. § 77ppp. Among those provisions is section 316(b), which provides in relevant part that:

> Notwithstanding any other provision of the indenture ... 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 ... .

15 U.S.C. § 77ppp(b). Thus, as long as a non-unanimous modification of an indenture leaves intact dissenting holders' "right … to receive payment of the principal … and interest," the modification does not run afoul of section 316(b).

At the outset, the district court's reading of the "right" protected by section 316(b)—as including not only legal entitlement to payment but also the practical ability to collect—cannot be reconciled with the ordinary understanding of a "right" to payment. A "right" to payment has never been understood to provide an assurance that a lender will in fact be paid; lenders, including bondholders, charge interest in part to compensate for the risk that the borrower will lack the assets to repay them, and vary the interest rate depending on their assessment of that risk. *See* Richard Hynes & Eric Posner, *The Law and Economics of Consumer Finance*, 4 Am. K. & Econ. Rev. 168, 170 (2002) ("In a competitive market the interest rate will reflect the time value of money, inflation, and the risk of default."); Jinkook Lee and Jeanne M. Hogarth, *The Price of Money: Consumers' Understanding of APRs and Contract Interest Rates*, 18 J. Pub. Pol'y & Mktg. 66, 66 (1999) ("[T]he price of a loan is a function of its risk.").

In addition, the broader statutory context refutes a reading of section 316(b) as prohibiting acts that merely frustrate minority bondholders' practical ability to receive payment. Provisions in a statute must be "place[d] in context, interpreting the statute as a symmetrical and coherent regulatory scheme and fitting all parts into a harmonious whole." *NRDC v. Abraham*, 355 F.3d 179, 195 (2d Cir. 2004) (internal quotations omitted). As read by the district court, section 316(b) would be entirely unlike any other provision in the TIA.

As the district court itself notes, *Marblegate II*, 2015 WL 3867643, at *5—the TIA achieves its goal of investor protection in two ways. First, the TIA regulates the procedures governing the issuance of corporate debt, setting standards for the eligibility of trustees, TIA § 310, prescribing the manner in which they are to carry out their duties, TIA § 315, and requiring trustees and issuers to provide bondholders certain information, TIA §§ 313, 314. Second, in some strictly limited circumstances, including in section 316(b), the TIA regulates the specific terms that must be part of any covered indenture. But the TIA does not regulate the substance of corporate transactions. While the parties may bargain for provisions in indentures that permit or prohibit particular transactions, the TIA itself contains no such provisions. Rather, it accomplishes its investor-protection goal in certain specific and limited ways—setting forth specific minimum standards for trustee conduct, requiring the provision of information to holders, and prescribing the manner in which holders may take certain actions under an indenture. Against that backdrop, it would be strikingly anomalous to read the TIA implicitly to grant courts open-ended authority to prohibit corporate transactions that impair a bondholder's practical ability to recover.

The TIA's purpose and legislative history reinforce this conclusion. Section 316 is not addressed in detail in the legislative history, but such history as there is clearly supports a narrow reading of the provision. Testifying before a subcommittee of the House Committee on Interstate and Foreign Commerce, Edmund Burke Jr., later SEC commissioner and one of the principal drafters of the TIA, offered a defense of section 316(b) against contemporary critics:

> This subsection seems to have drawn considerable fire. Yet it is safe to say that it is in 90 percent or more of the forty billions of indentures now outstanding. .... *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 .... 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. As a matter of fact, he cannot be deprived of that right unless indenture specifically so provides. .... There is every reason why this subsection should be in practically every indenture, as in fact it is. In the absence of such a provision, the bonds themselves would be rendered nonnegotiable under the laws of many States.

*Trust Indentures: Hearings on H.R. 2191 and H.R. 5220 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 76th Cong. 284-85 (1939) (statement of Edmund Burke Jr., Assistant Director, Reorganization Division of the SEC) (emphasis added).[4] In other words, section 316(b) preserves the

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[4] The relevant portion of section 316(b) of the bill discussed before the subcommittee is identical to the text of section 316(b) as enacted. *See Trust Indentures: Hearings on H.R. 2191 and H.R. 5220 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 76th Cong. 31 (1939) (Exhibit H.R. 5220); *cf.* TIA § 316(b), 53 Stat. 1149, 1173 (1939). In 1990, Congress adopted the current form of section 316(b), which clarifies that the provision is deemed

bondholder's *legal right* to sue for payment, not its *practical ability* to receive payment. The House and Senate reports are less specific, stating that section 316(b) exists to prevent the nonconsensual "impair[ment]" of an indenture security holder's "right" to receive principal and interest, but they clarify that "[t]his prohibition does not prevent the majority from binding dissenters by *other* changes in the indenture"—many of which could impair a bondholder's practical ability to recover—"or by a waiver of other defaults." H.R. Rep. No. 76-1016, at 56 (1939); S. Rep. No. 76-248, at 27 (1939) (emphasis added).[5]

The district court noted all of these signals in the legislative history, but ultimately concluded that the "broader worries" expressed at various points by the

included in any qualified indenture. Securities Amendment Acts of 1990, § 415(4), 104 Stat. 2713, 2731 (1990).

[5] Further support is found in the testimony of then-SEC commissioner William Douglas before the same committee, discussing a predecessor to section 316(b). Commissioner Douglas explained that "[t]he effect of this exception is merely to prohibit provisions authorizing ... 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* ... In other words, this provision merely restricts the power of the majority to change *those particular phases* of the contract." *Trust Indentures: Hearing on H.R. 10292 Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce*, 75th Cong. 35 (1938) (statement of William O. Douglas, Comm'r, SEC) (emphasis added). He testified that "[u]ntil comparatively recently," it was "perfectly standard" to find such provisions in indentures. *Id.* Significantly, Commissioner Douglas' testimony emphasized the types of *indenture provisions* that section 316(b) would preclude; it contains no suggestion that section 316(b) would bar particular corporate actions or transactions.

SEC and Congress justified a more expansive reading of section 316(b). *Marblegate II*, 2015 WL 3867643, at *12. The court relied in particular on statements in the House and Senate Reports that the TIA prevents "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans." *Id.*; *see also* H.R. Rep. No. 76-1016, at 56 (1939); S. Rep. No. 76-248, at 26 (1939).[6] While increasing judicial scrutiny of debt-readjustment plans may have been among the goals of the TIA's drafters, this broad and highly general statement of purpose cannot overcome the substantial evidence indicating that section 316(b) was not meant to reach every situation in which the "fairness" of a debt-readjustment plan might questioned, but is instead addressed only to disputes surrounding the legal right to payment. The district court erred when it concluded that "giv[ing] effect to the purpose of the Act," *Marblegate II*, 2015 WL 3867643, at *12, required setting aside the concrete limitations of the text, context, and history to pursue broader policy goals.

[6] This solicitude for the fairness of out-of-court restructurings seems grounded in a continuing concern of Commissioner Douglas and the SEC more broadly that bondholders were being treacherously dealt with by other players in the corporate debt market possessing very different interests from their own. *See, e.g.*, *Regulation of Sale of Securities: Hearing on S. 2344 Before a Subcomm. of the S. Comm. on Banking and Currency*, 75th Cong. 24 (1937) (statement of William O. Douglas, Comm'r, SEC) ("To the extent that the indenture is the product of the borrower, the underwriter or the trustee, only their respective interests are reflected therein."); *id.* at 28 ("[T]he underwriter may have reasons for concealing defaults when it would be to the best interests of the security holders to proceed forthwith to foreclosure, receivership, or bankruptcy.").

In short, the correct interpretation of section 316(b) is that it protects bondholders' *legal* right to payment, not their practical ability to recover from the issuer. *See, e.g.*, Shuster, 14 Am. Bankr. Inst. L. Rev. at 434 ("The amount and timing of principal and interest due on an individual's bond may not be changed without the consent of the individual bondholder, but virtually any other provision of an indenture may be changed by the vote of a group of bondholders (often a simple majority)."). That was the understanding of the provision when it was enacted. *See* Edmund Burke Jr. Assistant Director, Reorganization Division, SEC, *Aims, Purposes and Philosophy of the Barkley Bill*, Address to the Sixty-First Annual Meeting of the ABA, at 11 (July 25, 1938) ("In other words, the effect of this prohibition will be to limit ... the control of the majority ... If an investor buys a $1,000 bond payable as of January 1, 1940, the majority cannot turn it into a $500 bond payable in 1960."). And other than the one outlier decision the district court relied on, that is how courts have consistently understood section 316(b) ever since. *See, e.g., In re Northwestern Corp.*, 313 B.R. at 600 (section 316(b) "applies to the holder's *legal* rights and not the holder's *practical* rights") (emphasis in original); *In re Bd. of Dirs. of Multicanal S.A.*, 307 B.R. 384, 389 (Bankr. S.D.N.Y. 2004) ("Section 316(b) ... declares that … the right of any holder to institute suit for principal or interest on the holder's bonds or debentures cannot be impaired without consent."); *YRC Worldwide Inc.*, 2010 WL 2680336, at *7;

*but see Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd.*, No. 99 Civ. 10517, 1999 WL 993648, at *7 (S.D.N.Y. Nov. 2, 1999) (concluding that the TIA bars transactions that prevent noteholders from recovering payment "as a practical matter"). This Court should reaffirm that understanding.

## II. OTHER LEGAL REMEDIES, NOT THE TIA, PROTECT AGAINST TRANSACTIONS THAT IMPAIR CREDITORS' PRACTICAL ABILITY TO RECOVER

Reaffirming the traditional understanding of section 316(b) does not leave bondholders unprotected from attempts to deprive them of the practical ability to receive payment on their claims. To the contrary, long-established remedies other than the TIA protect individual bondholders from corporate transactions that improperly impair their practical ability to recover. The Court should not lightly conclude that Congress intended, in enacting the TIA, effectively to override each of these other legal remedies that are specifically aimed at protecting creditors' ability to collect payment.

Both Congress and the states (through statutory and common law) have developed specific rules and remedies to address improper conduct by corporate actors that might prevent a company from paying its creditors. For example, a transfer of assets that leaves a company unable to pay its debts, while providing less than reasonably equivalent value to the company for the assets transferred, may be avoidable under state law as a fraudulent conveyance. *See* Uniform Fraudulent Transfer Act §§ 4-5. Indeed, fraudulent conveyance law is routinely invoked as a remedy for transactions involving the transfer of a company's value to the apparent detriment of creditors. *See, e.g.*, *In re Tribune Co. Fraudulent Conveyance Litig.*, 499 B.R. 310, 310 (S.D.N.Y. 2013) (describing fraudulent conveyance litigation in Tribune case resulting from leveraged buyout). Bankruptcy law both incorporates and supplements state-law prohibitions on fraudulent conveyances, 11 U.S.C. §§ 544(b), 548, and also provides that transactions that prefer one creditor over another in the period immediately prior to a bankruptcy filing may be unwound, *id.* § 547.

Perhaps most significantly, bondholders in today's corporate bond markets typically protect themselves with detailed and robust covenants governing the conduct required of both issuer and trustee. "Protective covenants are a[n] ... important set of bondholder rights. Designed to protect the bondholders' entitlement to receive payments from the company ... [t]he most common types of protective covenants in publicly issued bonds are debt restrictions, dividend restrictions, asset sale restrictions, investment restrictions, restrictions on mergers, restrictions on liens and sale/leasebacks, and restrictions on transactions with affiliates." Marcel Kahan, *Rethinking Corporate Bonds: The Trade-Off Between Individual and Collective Rights*, 77 N.Y.U.L. Rev. 1040, 1045 (2002). For example, restrictions on the incurrence of additional indebtedness commonly protect existing creditors from the risk that new debt could dilute their recovery on their claims in the event of insolvency. The ABA has published a detailed set of model negotiated covenants for inclusion in high-yield bonds. William J. Whelan III, Comm. on Trust Indentures and Indenture Trustees, ABA Section of Business Law, *Model Negotiated Covenants and Related Definitions*, 61 Bus. Law. 1439 (2006). Today's high-volume and highly efficient bond markets are more than capable of assessing the legal protections written into any given indenture and pricing bonds accordingly. Mark E. Van Der Wiede, *Against Fiduciary Duties to Corporate Stakeholders*, 21 Del. J. Corp. L. 27, 48 (1996) ("[M]any legal terms in bond indentures are priced by the market.").

Likewise, all contracts—including indentures—provide a baseline level of protection for the expectations of contracting parties through the implied covenant of good faith and fair dealing. *See, e.g.*, *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986) (implying a covenant of good faith and fair dealing into an indenture to cover conduct where "[it is] clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of ... had they thought to negotiate with respect to that matter").

Absent evidence that contracts are generally failing bondholders as a means of protecting their investment, this Court should not read the TIA to supplant these specifically negotiated bargains reached at arm's length between sophisticated parties.

To be sure, these creditor protections cannot ensure that a bondholder will recover on its investment. But that does not mean that this Court should read the TIA to provide a new substantive guarantee against frustration of a bondholder's expectation of payment. In many situations, the law's expectation is simply that bondholders will treat the possibility of nonpayment as a business risk. For example, bondholders were historically denied the protection of fiduciary duties because, compared to stockholders, they were thought to be adequately protected by their priority claim, before stockholders, on the firm's assets. David M.W. Harvey, *Bondholders' Rights and the Case for a Fiduciary Duty*, 65 St John's L. Rev. 1023, 1032-33 (2012). Thus, if a bondholder's ability to recover on its claim is impaired because directors failed to exercise due care in the management of company assets, the bondholder may have no recourse. Likewise, if the value of a company's assets diminishes, so that a secured creditor's claim exceeds the value of the company and no recovery is left for unsecured bondholders, the law generally views that outcome as a risk the bondholder assumed by investing. Indeed, that is precisely why unsecured bond debt typically carries a higher interest rate than senior secured debt. The law does not protect bondholders' practical ability to recover payment in general, but only in certain situations, such as where an insolvent issuer improperly disposes of its assets for less than fair value.

Section 316(b) of the TIA, properly read, addresses one particular situation in which bondholders are thought to require protection. Section 316(b) prevents a majority of bondholders from colluding with an issuer to amend the indenture to provide less favorable payment terms to the non-consenting minority. Congress judged this particular type of scheme, in which a minority bondholder is deprived of its legal right to the full payment for which it originally contracted, to be one from which bondholders required protection. But its judgment in this respect should not be extended to provide bondholders special protection from any transaction that might practically impair their ability to be repaid on their claims—that is simply the risk that bondholders assume when they buy bonds.

## III. NO LIMITING PRINCIPLE CABINS THE DISTRICT COURT'S READING OF THE TIA

The decision below articulates no coherent limiting principle to cabin the rule it announced. The district court objected to the restructuring here because it "gave dissenting bondholders a Hobson's choice," *Marblegate II*, 2015 WL 3867643, at *13, "deprive[d] "dissenting bondholders of assets against which to recover," *id.* at 4, and "risk[ed] the elimination of their practical ability to recover," *Marblegate I*, 75 F. Supp. 3d at 595. But these conditions could be alleged to be present in a wide range of circumstances. If a company agrees, for example, to issue substantial new debt to fund a risky investment, existing bondholders may fear that the new debt service payments required will ultimately render the company practically unable to make payments to existing creditors. Significant management or director turnover, strategic acquisitions or spin-offs, or changes in a company's business plan could all be characterized as events practically impairing a bondholder's ability to receive payment. As described above, the law's traditional answer to these concerns is to address them through the specific covenants that creditors negotiate or through laws restraining an insolvent company's ability to dispose of its assets in a way that hinders creditors. Nothing in the district court's analysis or reasoning, however, would exclude such disputes from the scope of the TIA.

While the district court asserted that its construction of the TIA would not open the door to claims asking courts to determine "whether a proposed investment in a new widget factory is likely to erode an issuer's financial stability and thus negatively affect a bondholder's ability to receive payment," *Marblegate I*, 75 F. Supp. 3d at 613, it offered no administrable principle that would bar such claims.

The district court held that, in view of the legislative history of the TIA, it could restrict its prohibition on "[p]ractical . . . modifications" of indentures to situations where "such modifications effect an involuntary debt restructuring." *Marblegate I*, 75 F. Supp. 3d at 614; *cf.* H.R. Rep. No. 76-1016, at 56 (1939);

S. Rep. No. 76-248, at 26 (1939) ("Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this prohibition."). But the term "involuntary debt restructuring" is nowhere defined and could encompass any number of potential transactions.

More fundamentally, nothing in the text of section 316(b)—or any other part of the TIA—provides any foundation for such a rule. Section 316(b) provides simply that the "right of any holder" to payment of principal and interest "shall not be impaired or affected," without limiting its scope to involuntary debt restructurings. That is entirely consistent with a reading of section 316(b) as a narrow provision prohibiting the modification of certain core terms of an indenture without the consent of all holders—and entirely inconsistent with reading section 316(b) to grant courts a wide-ranging power to invalidate corporate transactions based on their perceived practical effect on the company's ability to repay its bondholders.

## IV. THE DISTRICT COURT'S READING OF THE TIA WILL HAVE HARMFUL CONSEQUENCES FOR THE CORPORATE LOAN MARKET

The foremost concern of both the LSTA and the Chamber is that the rule adopted by the district court, if left undisturbed, will have harmful consequences for the corporate loan market. That market is enormous—the corporate bond market is over $8 trillion in size, and the market for senior loans itself totals $1.5

trillion.[7] All participants in the corporate debt markets, including secured creditors, depend on certain and predictable outcomes.

Both secured and unsecured corporate debt is widely traded, and disruption within the corporate debt markets could have substantial downstream consequences for the broader economy. Indeed, industry participants have already commented on the probability that the district court's decision will destabilize that market.[8] Rather than countenance such harm, this Court should reject the district court's reading of section 316(b).

First, the district court's decision invalidates provisions, such as those in the indenture at issue in this case, under which a senior creditor's release of a parent

[7] *See* Securities Industry and Financial Markets Association ("SIFMA"), *US Bond Market Issuance and Outstanding*, http://www.sifma.org/uploadedFiles/ Research/ Statistics/StatisticsFiles/CM-US-Bond-Market-SIFMA.xls?n=53437; SIFMA, *US Corporate Bond Issuance*, http://www.sifma.org/WorkArea/ DownloadAsset.aspx? id=8589942781.

[8] *See, e.g.*, Jasmine Ball et al., Client Update, Debevoise & Plimpton LLP, *Expansive Trust Indenture Act Interpretation May Negatively Affect Bond Restructurings*, Jan. 28, 2015, *available at* http://www.debevoise.com/~/media/ files/client%20updates/expansivetrustindentureactinterpretationmaynegativelyaffectbondrestructurings.pdf; Alert Memorandum, Cleary Gottlieb, *S.D.N.Y. District Court Holds Trust Indenture Act Limits Ability of Issuer To Restructure Bonds of Dissenting Bondholders Outside of Bankruptcy*, June 30, 2015, http://www.cgsh.com/files/News/e38b9161-904e-49e5-8593-752bf7029cf3/ Presentation/NewsAttachment/1e920495-a096-42f8-9ccb-774be82d5687/ Alert%20Memo%20(PDF%20Version)%202015-48.pdf ("[O]ut of court restructurings may become more contentious, expensive and difficult to negotiate to a final global resolution.").

guarantor will automatically operate to release a junior bondholder's parent guarantee. These provisions are commonplace in high-yield corporate debt indentures. *See* Amended Expert Report of James Gadsden ¶ 32, *Marblegate Asset Mgmt, LLC v. Education Mgmt Corp.*, No. 14-cv-08584 (S.D.N.Y. Nov. 12, 2014) ("Gadsden Rep.) (finding that "provisions such as [guarantee releases of this kind] are common, appearing with some modifications in 33 out of the 52 indentures (63%) in the survey."). Nor are such terms limited to the indenture context. *Id.* ¶ 31 n.14 (citing ABA Model First Lien/Second Lien Intercreditor Agreement § 1.10, containing a similar term).

These provisions serve a critically important purpose—protecting a senior creditor's structural priority. Unless a secured creditor knows that, upon release of a guarantee of its debt by a parent company, guarantees of all junior debt will likewise be released, the secured creditor cannot effectuate such a release while still preserving its senior position over unsecured holders. *Cf.* Gadsden Report ¶ 31 (describing purpose of guarantee release provisions in Education Management indenture). In many cases, the inclusion of such provisions may well be critical to the senior creditor's decision to permit the borrower to incur additional indebtedness that is otherwise prohibited by the terms of the senior secured loan. Moreover, noteholders are compensated for the greater risks associated with such provisions through the higher rates of interest typically paid on unsecured junior debt.

The district court's decision, however, effectively nullifies such provisions. Even assuming that the district court's decision could be limited to "involuntary debt-restructurings," many if not all of the situations in which a secured creditor will seek to release a guarantee could be characterized as a "debt restructuring." And it is undeniable that release of a guarantee will have some "practical effect" on the ability of a bondholder to receive payment on its loans. Applying the logic of the district court's decision, therefore, in virtually any case in which they might be invoked, such terms will fall afoul of section 316(b).

Second, the district court's decision, if left to stand, will have a destabilizing effect because it effectively invalidates provisions requiring the cooperation of issuers if a secured creditor forecloses on its collateral. Credit agreements often provide that in the event of a default, the debtor must cooperate with a secured lender in foreclosing on the lender's collateral. These provisions serve an important purpose. They maximize value in cases of distress by permitting a secured creditor to assert its rights in an orderly and efficient manner, thus leading to a "friendly" sale of the issuer's business as a going concern, rather than requiring that the assets be sold off in bits and pieces.[9]

Such a value-maximizing foreclosure sale, however, is extremely difficult without the borrower's cooperation. *Id.* The district court's decision appears to prohibit requiring such cooperation unless every bondholder consents to the foreclosure, because a foreclosure would undoubtedly, as a practical matter, affect unsecured bondholders' ability to recover. *Cf. Marblegate I*, 75 Supp. 3d at 615; *see also id.* at 615 (describing proper role of secured creditor guarantee provision as being limited to "genuinely adversarial attempt[s] to safeguard some recovery" for secured creditors). This limitation—which has no basis in the text of the TIA—will harm secured creditors by depriving them of what may be the most efficient way for them to assert their rights.

If the TIA is read to bar such commonplace provisions, the effect will be one of two things: either companies will be required to pay additional "hold up value" to dissenting minority holders in order to effectuate an out-of-court restructuring, or more companies will simply be pushed into bankruptcy. That outcome would cause significant harm.

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[9] *See* Nicholas F. Kajon, Friendly Foreclosure Sales vs. Other Chapter 11 Alternatives, Law 360, Sept. 23, 2010, *available at* http://www.law360.com/articles/195841/friendly-foreclosure-sales-vs-other-ch-11-alternatives.

Although chapter 11 provides an appropriate forum for restructuring many distressed enterprises, because it imposes significant direct and indirect costs, many companies seek to avoid chapter 11 and instead pursue out-of-court restructurings. *See* Stuart C. Gilson, *Coming Through in a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping To Revive the U.S. Economy*, 24 J. Applied Corp. Fin. 23, 26 (2012) (describing costs of bankruptcy). An out-of-court restructuring may be more efficient, involve lower professional fees and reputational costs, and provide a borrower with greater flexibility than a chapter 11 case. Courts interpreting the Bankruptcy Code have consistently recognized the benefits staying out of court might provide to both debtors and creditors. *See In re Colonial Ford, Inc.*, 24 B.R. 1014, 1022 (Bankr. D. Utah 1982) (describing "benefits which debtors in general may derive from out-of-court workouts"); *In re Cheeks*, 167 B.R. 817, 819 (Bankr. D.S.C. 1994) (noting "public policy in favor of encouraging out of court restructuring and settlements"); *In re TWA*, 261 B.R. 103, 117 n.4 (Bankr. D. Del. 2001) (same); *In re Genco Shipping & Trading*, 509 B.R. 455, 462 (Bankr. S.D.N.Y. 2014) (same).

Rather than recognizing this long-established public policy, the district court viewed out-of-court restructurings with suspicion. *Marblegate II*, 2015 WL 3867643, at *13. But nothing in modern bankruptcy policy, or the way courts interpret today's Bankruptcy Code, supports such a view. To the contrary, out-of-court restructurings—like any consensual resolution of a dispute that would otherwise require protracted and expensive litigation and the extensive consumption of limited judicial resources—should be encouraged. Acknowledging that debtors and creditors may be able to restructure a company's finances more efficiently outside of chapter 11 does not "enfeeble" the TIA, *id.*, but merely recognizes its proper scope, as a regulation of core payment terms of indentures.

## CONCLUSION

For the foregoing reasons, the district court's erroneous construction of section 316(b) of the Trust Indenture Act should be rejected.

Respectfully submitted,

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## CERTIFICATE OF COMPLIANCE

Pursuant to Federal Rules of Appellate Procedure 29 and 32, the undersigned hereby certifies that this brief complies with the type-volume limitations of Federal Rules of Appellate Procedure 29(d) and 32(a)(7)(B)(i):

1. Exclusive of the exempted portions of the brief, as provided in Federal Rule of Appellate Procedure 32(a)(7)(B), the brief contains 6074 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Word 2010 in 14 point Times New Roman font. As permitted by Federal Rule of Appellate Procedure 32(a)(7)(C), the undersigned has relied upon the word count feature of this word processing system in preparing this certificate.

/s/ Danielle Spinelli

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