Marblegate and the Trust Indenture Act of 1939 in the Second Circuit: What Happened? What Consequences?

1. The statute at issue: Section 316(a) of the Trust Indenture Act of **1939**
    a. "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 . . . [circumstances not relevant]."
    b. Statute's fit with New Deal thinking on reorganization: bondholders should not be displaced without either (1) their own freely given consent or (2) a judicial determination as to fairness according to priority.
        i. Douglas, Fortas, Frank: writings, speeches, etc. LA Lumber; Chapter X
        ii. Explanation then: a private deal would be infected by insider control and could not be trusted. Cf. Roe, Three Ages of Bankruptcy.
2. The *Marblegate* litigation
    a. The facts, with a "death trap" quality to the deal.
    b. Question to decide: does 316(b) protect real, practical rights or just the formal right not to be subject to a collective action clause in the bond indenture that could affect payment terms?
    c. Cases had been mixed, with an earlier SDNY case, Mechala, saying the former and other decisions saying the latter. No appellate resolution.
    d. The lower court in *Marblegate*: protects practical, real rights of the bondholders. Legislative history shows drafting changes moving from formality to real rights protection.
    e. On appeal: Second Circuit says statute's text is ambiguous, looks to legislative history and concludes 316(b) protects formal rights not to be subject to a collective action clause, and no more
        i. In addition, hard to draw a line on what practical rights should be protected.
        ii. Dissent: text of statute is clear. The statute gives bondholders the right to be free from being impaired. This deal impaired the bondholders. Hence, *Marblegate* deal violated 316(b).
        iii. I'll add textual argument not considered by either the majority or the dissent.
    f. Likely stability of the Second Circuit holding, pending motion for a rehearing.
3. Deal consequences
    a. Return to status quo ante.
    b. Negatives of status quo ante: out-of-court restructurings harder to do (because cannot use a vote) than they need to be.
        i. Cf. similar instruments that aren't regulated. Some voluntarily forgo a vote; many do not. Cf. the change-over in the sovereign debt market in recent years from 316(b)-like clauses to collective action.

c. Further negatives: to get an out-of-bankruptcy restructuring to work without a binding vote, the company and their advisors often go for exit consent transactions, whose operative mechanism is a "death trap" effort to coerce.
    i. That is, to twist the arms of reluctant bondholders into consenting to the restructuring of their bond's payment terms, the deal often has to offer participants something extra, like a partial bump up in seniority or security or a shortening of maturity, along with a stripping of nonpayment covenants for the bondholders who do not exit.
    ii. Two negative features of these kinds of bumps up: (1) the deal doesn't often stabilize the firm's capital structure enough and (2) the tactics are coercive.

4. Better policy result:
    a. Repeal 316(b), allow a bondholder vote
        i. An unrestricted vote has negatives, however, such as conflicts of interest, exit consent coercion
        ii. Bond indenture could control many of these. Bankruptcy Code § 1126 makes an effort toward such control.
        iii. Possible better policy result could be conditional repeal: i.e., vote allowed, if and only if the indenture bars x, y, and z, the relevant coercive, conflicted downsides.
        iv. Probably low demand for change.
            1. No motivated player as there was for legislative change in the *Caesars* bankruptcy.
            2. Most bond issues don't default.
            3. Repeal would presumably be forward-looking for new bond issues, not for indentures already in place. Hence, no immediate payoff to anyone.
    b. SEC exemptive authority: none when statute enacted. Now exists, post-1990.
        i. Alternative avenue for reaching better policy result.
        ii. But SEC has a big agenda nowadays. TIA issues are not high on the agenda.
        iii. Note SEC reaction to Fidelity's application for rule-making under tender offer section of securities laws to control exit consent transactions to reduce/end their "death trap" quality.
        iv. Cf. securities rules protections for shareholders in tenders that don't apply to offers to debt-holders.