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The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the SEC to the Table

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This memo examines broad aspects of the recent controversies and ongoing litigation arising from the Trust Indenture Act's requirement that no bondholder can see his or her payment terms change without the bondholder's own consent. I outline here a path forward for a sensible legal structure governing out-of-bankruptcy restructurings of public bond issues. There are four points to be made:

1. The recent Southern District of New York decisions striking down exit consent transactions are justified under the Trust Indenture Act.[1]
2. The decisions eliminate one difficulty for restructurings: coercive exit consent offers. But they leave in place an equally difficult problem: how to restructure outside of bankruptcy when widespread consent is needed. The court decisions are not the cause of these difficulties; Section 316(b) of the Trust Indenture Act itself is the problem and the courts alone cannot, given § 316(b), solve both problems. That Act clearly but mistakenly bars votes that restructure bond payment terms. In today's

[1] Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., 111 F. Supp. 3d 542, 556 (S.D.N.Y. 2015), *appeal docketed*, No. 15-2124 (2nd Cir. Jul. 2, 2015); MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507, 515–16 (S.D.N.Y. 2015).

institutionalized bond market, there is little reason not to allow uncoerced voting for restructurings.

3. Two important but countervailing degradations of good business decisionmaking are embedded in bond restructurings, both of which emanate from the Trust Indenture Act's voting ban. The first comes from the potential for holdouts (or earnest dissenters) to destroy a good deal that most bondholders sincerely want. But to combat the TIA's voting ban (and sometimes to force an unsound restructuring), issuers use exit consent offers, which can impair bondholders' indenture rights so severely that they reluctantly accept an offer whose terms they dislike. The court decisions eliminate coercive exit consent offers. But they leave in place the first problem: how to restructure outside of bankruptcy when widespread consent is needed. Courts interpreting Section 316(b) cannot reach the best policy result --- which would deal with both distortions --- or even reach an overall good policy result. Other lawmakers need to come to the table.
4. The best result for the bond market is a legal structure that ends both degradations. Legislative solutions are possible and the best legislation would repeal 316(b), with votes on payment terms allowed and with a mechanism to control exit consent transactions coming from legislation or contract. Fallback legislation, recently proposed by the National Bankruptcy Conference and discussed below, could also be warranted. In the absence of wise legislation from Congress, there is another way to construct sensible rules for bond workouts, one that has previously not been

recognized. The Securities and Exchange Commission now has broad authority under Section 304(d) of the Trust Indenture Act (enacted in 1990, not when the Act was passed in 1939) to exempt indentures and transactions from the full force of Section 316(b), "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and purposes fairly intended by [the Act]." Thus the SEC has authority to permit, say, binding bondholder votes on payment terms by a two-thirds dollar majority (mimicking but not replicating the Bankruptcy Code standard), perhaps conditioned on the vote not being forced via an exit consent transaction (definitions will be needed) and not otherwise coerced.

SEC exemptive rule-making thus provides a viable path to facilitate out-of-bankruptcy restructurings of public bond issues going forward. The appellate courts can and should affirm the lower court decisions that the Trust Indenture Act bans exit consent degradation, and the SEC can and should then use its exemptive power to carve out uncoerced votes on payment terms from Section 316(b). After that, uncoerced binding votes would allow sound out-of-court restructurings to bind holdouts, but would not allow exit consent restructurings. Two degradations would be eliminated and sound restructurings could go forward. Win-win.

The next paragraphs expand on these issues.

I. The Holdout Problem

II. The Exit Consent Transaction

I. The Holdout Problem

The Trust Indenture Act, 316(b) states:

. . . Prohibition of Impairment of Holder’s Right to Payment

> (b) 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 . . . shall not be impaired or affected without the consent of such holder . . . . [2]

The fundamental problem that Section 316(b) introduces is that holdouts, depending on how the numbers break, can benefit from a restructuring at the expense of participating bondholders. After a restructuring is completed with some bondholders accepting weaker terms, lower-ranking securities, or a decreased loan amount, the firm can better pay off the nonexchanging bondholders. The following example illustrates:

Firm-to-be-restructured

$150M	$125M	Market value of debt ($200M face value)
	$ 25M	Common stock[3]

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[2] 15 U.S.C. § 77ppp (2012).

[3] The $25 million for stockholders could come from the stockholders’ hold-up value or from the possibility that the firm’s oil prospects give it a .5

Bonds were issued at $200 million when the firm was much healthier. (Think of a shale-oil firm before the collapse of oil prices.) If the firm could be restructured, it would be worth more than its current $150 million. Assume there are five bondholders, each of whom is owed $40 million but each of whose bonds are worth only $25 million. The firm offers to exchange all bonds for stock. The current stockholders have, say, 100 shares of stock and each $40 million face value of bonds is offered 100 shares of new stock. Four bondholders think the deal is worth taking.

One bondholder does not take the deal, either because it hopes to hold out and do better, or because it disagrees and thinks the deal is not good for bondholders. The holdout cannot be bound to the exchange, as § 316(b) precludes a binding vote on payment terms. Moreover, the holdout's nonparticipation will lead the four willing-to-participate bondholders to reconsider, because they would see that if they exchanged, the post-restructuring balance sheet would look like this:

Post-restructuring, if four bondholders accept and one does not

$150M	$ 40M	Nonexchanging bondholder
	$110M	Four exchangers and old stockholding group (each owning one-fifth of the stock)

chance of being worth $250 million and a .5 chance of being worth $50 million. Further examples showing how and when efficiency gains can be large enough that a deal can succeed despite the holdout are in Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232 (1987).

Before the potential exchange, the four willing bondholders had bonds worth $100 million in total. If they exchanged, the nonexchanger could be paid in full and the exchangers would find their $100 million of bonds turned into $88 million of stock. Only if the exchange would increase the firm’s operating value by enough to compensate for the shift in value to the holdout would the exchangers participate without the holdout.[4]

Hence, a deal cannot be made even if a majority of the bondholders prefer one. This is the first underlying problem with Section 316(b). This transaction is not coercive and does not bump into the Trust Indenture Act. But a single holdout can stymie a deal that the issuer and most bondholders consider sound.

II. The Exit Consent Transaction

The prior example is not the only way for an issuer to structure its exchange offer and, since it is one that can readily fail due to the holdout, it is not an attractive structure to the issuer. Prior to the

[4] If all of the bondholders accepted the deal, all would be better off. They’d retain their $25 million in value, plus share in any improved operational capacity due to the firm not being financially stressed anymore. On these numbers, the holdout bondholder, either because it disagrees on the quality of the deal or because it strategically (but unsuccessfully) holds out for more, stymies a deal the four bondholders and the stockholders consider worthwhile. This is the first potential distortion emanating from Section 316(b) --- the failed but worthwhile workout.

Post-restructuring, if all five bondholders accept

$150M + gains	$150M stock	Five exchangers and old stockholders each get $150M/6, or $25M, plus one-sixth of any operational gains

actual exchange, the issuer could ask the bondholders to vote to strip the bond indenture of protective covenants, such as those according the bondholders seniority, security, and sinking fund protections, or limiting the debtor from incurring debt or paying dividends. It can transfer assets from the issuer that would violate a covenant if the bondholders did not delete the covenant. If done outside the context of an exchange offer, such a request would be unremarkable. Bondholders would decide whether the terms offered on net were beneficial or not. If accompanied by a promise of more interest, a payment, or a belief that payment from the weakened firm would be more likely, there’s little reason to second-guess the deal, and § 316(b) would not be in play.

But when the request to strip the bond indenture of protective covenants is tied to an exchange offer, the analytics become more difficult and several Southern District decisions have called § 316(b) into play to invalidate the transaction.

The basic problem with the exit consent exchange offer is that, in principle for all exchanges, and in fact for some exchanges, bondholders could be induced to exchange even though they do not like the terms of the offer. They exchange because they fear being left on the back end without the protective covenants.

Some brief analytics to exemplify: Add to the prior hypothetical that the bond indenture has a debt incurrence covenant that bars the firm from issuing debt senior to the existing bonds and has no subordination covenant. The exit consent offer seeks to strip the indenture of that protection and to add a subordination clause. If the protection is stripped and the subordination permitted, the approving bondholders exchange their old bonds for $75 million of a new senior bond that will mature before the unexchanged bond. The new bonds will hence become senior to the holdout bondholder and will be paid before the holdout's maturity. This company might become insolvent again, because there is a 50% chance that bad results next year will render the firm worth only $75 million operationally. If the firm does deteriorate to $75 million in value, then the exchanging bondholders will take that value and the holdout will get nothing, instead of sharing pro rata out of that $75 million (as it would if there were no exchange).

Post-restructuring, with exit consents

$150M [$75M or 225M]	$75M	Senior debt (face value and financial value) maturing a year earlier than original maturity
	$20M	Real value of old debt (now subordinated), market value is $20M, although face is $40M
	$20M	New stock issued to the four exchanging bondholders
	$35M	Common stock

If the issuer uses this deal structure for the proposed exchange, it can induce the holdout bondholder to consent to change in its payment terms. The holdout has a bond worth $25 million before the exchange. If it holds out, the exchanging bondholders jump ahead in seniority, the covenants are stripped, and the holdout becomes subordinated. On these numbers, its bond is worth $25 million before and $20 million after the exchange. It will reconsider holding out and has the incentive to participate in the deal as long as the exchange offers value of more than $20 million. It will have reason to do so even if it views the deal as leaving the bondholders worse off than without any deal.

The holdout's calculation is not whether the deal is better than what it has before the exchange ($25 million), but whether the deal is better than what value it would have after the exchange ($20 million).

This structure now implicates the Trust Indenture Act's Section 316(b). The bondholder's right to payment is "impaired . . . without the consent of such holder . . . ." Three Southern District judges have now held that exit consent structures like the above run afoul of § 316(b).[5]

Notice something deeper here. The exchanging bondholders had bonds with a financial value of $25 million before the exchange. After the exchange, each bondholder has a package worth $23.75 million (from ¼ of $75 million, which is the value of the new bonds, plus ¼ of $20 million, which is the value of the new stock in exchange package). If each of those four bondholders calculates that it would rather take the exchange and get $23.75 instead of the $20 million that the holdout gets, then they consent to a (slight) degradation of their bond's financial value.

[5] Even before the recent decisions, the Southern District had struck down exit consent transactions as violating § 316(b). Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd., No. 99 CIV 10517 HB, 1999 WL 993648, at *7 (S.D.N.Y. Nov. 2, 1999). The Kansas District Court and the Delaware bankruptcy court held to the contrary, however. YRC Worldwide Inc. v. Deutsche Bank Trust Co. Americas, No. 10-2106-JWL, 2010 WL 2680336, at *1 (D. Kan. July 1, 2010); In re Nw. Corp., 313 B.R. 595, 600 (Bankr. D. Del. 2004). Earlier decisions on the issue are not to be found, as far as I am aware. But because the growth of the junk bond market began in the late 1970s and resulting exit consent transactions to restructure began in earnest in the 1980s, the lack of earlier decisions is unsurprising.

They too may have reason to complain under § 316(b). The issuer's intention to force an exchange is often clear.[6]

The exit consent transactions can engineer yet more complex transactions. In the above example, the asset side of the balance sheet remains intact in the exchange, but the liability side and the protective covenants change. The exiting bondholders could consent to asset transfers out from the debtor, consenting to, say, debt: asset coverage ratio violations. Such transfers were in play in the recent Southern District decisions.[7]

The two-tiered tender offer, which was common in the 1980s, has similar financial properties. In a two-tiered offer, the offeror offered to pay the first 51% of stockholders $100 per share if they tendered to the offeror, and the offeror promised (or threatened) to squeeze out the remaining 49% at $50 per share. Shareholders may well have thought that

[6] E.g., Linklaters, Debt Repurchases and Amendments: U.S. Securities Law Consideration (Oct. 2008), *available at* http://www.linklaters.com/pdfs/Insights/capitalmarkets/DebtTendersClientBriefing.pdf: "As part of tender or exchange offers, issuers often seek 'exit' consents for stripping out restrictive covenants from the terms of the notes. Such consents act as an incentive to participate in the offer because they adversely modify the notes that remain in the hands of holdouts." http://www.linklaters.com/pdfs/Insights/capitalmarkets/DebtTendersClientBriefing.pdf. To the same effect: Cleary Gottlieb, Exit Consents in Restructurings --- Still a Viable Option?, May 1, 2013, http://www.cgsh.com/files/News/5a75efbc-a52d-4199-9e87-d2b2a45a78b4/Presentation/NewsAttachment/484e1d60-193a-410b-b4f9-d2b4ecf14095/Exit%20Consents%20in%20Restructurings%20%E2%80%93%20Still%20a%20Viable%20Option.pdf: "'Covenant-stripping' . . . incentivizes bondholders to participate in the exchange: accepting the new bonds (even though they will usually have a lower face amount than the existing bonds) may be preferable to being 'left behind' in the old bonds, which will cease to have any meaningful covenant protection."

[7] And, hence, one could imagine continued litigation if the decisions are upheld, as some issuers may choose to limit the exit consent arm-twisting to covenant deletions without asset transfers, arguing that their transaction is distinguishable on its facts from those in play in the recent litigation.

the average price should be $90 per share, but fearful of getting $50 on the back-end, they stampeded into the $100/$50 offer and would be coerced into getting less than thought proper in a more studied transaction. The two-tiered distortions provided a major early justification for the poison pill and antitakeover legislation.

III. The Exit Consent Transaction Under the Trust Indenture Act: Formal Legal Rights vs. Practical Rights to Payment

A core statutory interpretive argument that has arisen is that the Trust Indenture Act only protects bondholders from a formal restructuring of their bond’s payment terms but does not protect them from losing practical rights to payment even if the transactional structure forces them to consent to payment terms worse than what they have. The Southern District (but not the Kansas District or the Delaware bankruptcy court) has ruled that the Act protects the real, practical right to payment. Judge Failla in *Marblegate* had the most extensive investigation, carefully examining the text of 316(b) and how it evolved in Congress, showing that the legislation when originally proposed could have been interpreted as only protecting formal rights and not real rights, but that the text of the bills was explicitly amended to reflect a clear purpose of protecting both real and practical rights.[8]

[8] “The legislative history weighs in favor of Plaintiffs' reading of Section 316(b) in two regards. First, the textual changes to what became Section 316(b) over the course of its legislative history demonstrate that the Act's protections were broadened from a mere right to sue into a more substantive right. Second, the purpose of the Act, as expressed consistently throughout the legislative history, was to prevent precisely the nonconsensual majoritarian debt restructuring that occurred here, even if the Act's authors

The court's practical vs. formal standard might be better stated more narrowly than protecting every "practical right" to receive payment, which could be quite broad. Instead, the appropriate standard for the courts to settle on is whether an immediate consequence of a transaction would be to give bondholders no real economic incentive other than to accept a change in payment terms. It's that standard that emanates from Section 316(b): could the bondholders realistically and rationally decide not to participate in the exchange, or must any aware bondholder exchange to protect itself, even if it dislikes the terms of the offer? If that lack of real choice is the result, as it often is under so-called exit consent transactions, then the transaction violates 316(b). In contrast, a free-standing solicitation to amend bond covenants without exit consents would not normally run afoul of Section 316(b). But coupled with an immediate exchange offer, it normally would not get past Section 316(b).

Reversal of the Southern District's decision on appeal due to policy considerations would not be the first time that a fairly clear statute with clear supportive legislative history and strong lower court analysis was not respected if there was a particular preferred market outcome --- which here would be to facilitate out-of-court restructurings that make a bankruptcy filing unnecessary. Courts from time to time find statutory ambiguity and then rule on policy grounds. But if doing so ever is justifiable, doing it under Section 316(b) is particularly inappropriate, because the court cannot obtain a stable,

did not anticipate precisely the mechanisms through which such a restructuring might occur." *Marblegate*, supra note 1, at 554.

appropriate policy result. Even if the appellate court found ambiguities in the statute or its history, which are hard to find, the appropriate policy over-ride available to the courts (in contradistinction to the range available to other lawmakers) is hard to discern. *Either way* the court will have to allow transactional degradation: holdouts who stymie a deal, *or* exit consent transactions that coerce minority bondholders. There's no clear, complete policy result available for the court.

Courts acting alone in interpreting Section 316(b) cannot reach the best, or even an overall good policy result; other lawmakers --- Congress or the SEC --- need to come to the table.

IV. Bringing the SEC to the Table

The setting here is more propitious for good policy resolution than it often is. If the Southern District Trust Indenture Act decisions stand, as statutory fealty should lead to, then the SEC can act to complete the task of handling both distortions (those from holdouts and those from exit consent transactions), because the SEC now has very broad exemptive authority unlike when the TIA was passed in 1939 and even unlike when exit consent first became common in the late 1980s.

Section 304 of the TIA, added in 1990 and not available to the SEC before then, provides:

Exempted Securities and Transactions

> (d) The Commission may, by rules or regulations upon its own motion . . . exempt conditionally or unconditionally any person, . . . indenture, security or transaction, or any class or classes [thereof] from any one or more of the provisions of this title, if

> and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by this title.[9]

The SEC should exempt bond indentures from Section 316(b) if they (1) provide for a binding vote on payment terms approved by two-thirds of the bondholders, without the vote of any conflicted bondholder, and (2) bar coercive transactions such as exit consent exchange offers.[10] Since the overall purpose of the Trust Indenture Act was to protect bondholders, and since the exit consent offers that have grown up in reaction to 316(b)’s vote ban degrade that bondholder protection, an SEC rule-making exemption to allow issuers to package a vote with a ban on

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[9] 15 U.S.C. § 77ddd (2012). The SEC’s rules show it is open for business under § 304(d) for exemptive applications from issuers. 17 C.F.R. § 260.d-7 (SEC instructions on how to apply for a § 304(d) exemption). And it has granted exemptions from § 316(b), under § 304(d). Securities and Exchange Commission, Order Granting Application for Exemption: Petroleos Mexicanos and the Pemex Project Funding Master Trust, Trust Indenture Act. Release No. 2,430, 2004 WL 2347881 (Oct. 13, 2004), *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/pemex101304.pdf.

[10] Allowing a vote will in and of itself cut issuers’ incentives to use exit consent transactions. Issuers today have reason to resist banning exit consent transactions because, without the possibility of a vote, the paths to an out-of-bankruptcy restructuring of a public bond issue are limited. But with a clean vote allowed, the issuer has less need for an exit consent transaction because the vote will often be easier. More issuers would willingly forgo exit-consents via a contractual restriction in the indenture and some issuers, even if permitted to use them, will find the vote just as good or better and voluntarily choose the vote over the coercive transaction.

Exit consents could be evaluated under contractual good faith standards and under indenture provisions barring the issuer from voting a treasury bond (i.e., a bond that it sold and then bought back). Because the bondholder in an exit consent transaction has no continuing economic interest in the bond, the bond could be seen as de facto being voted by the issuer, which the indenture typically bars. The leading American decision did not accept that view. Katz v. Oak Indus., 508 A. 2d 873 (Del. Ch. 1986) (Allen, J.). A British court recently and prominently held to the contrary, explicitly criticizing *Oak Industries*. Assénagon Asset Mgmt. S.A. v. Irish Bank Resolution Corp., [2012] EWHC (Ch) 2090 (Eng.).

coercive deals is well within the Trust Indenture Act's policy parameters.[11]

Much of this can be done by rule-making with prospective impact, so that companies contemplating a bond issue could have pre-approved terms to consider using.[12]

V. Legislation

This judicial-regulatory framework would put the right legal overlay on bond workouts going forward for newly issued bonds and would do so without Congress having to act. Holdouts could no longer stymie out-of-court restructurings, and issuers could not coerce minority

[11] The SEC has separate authority under Section 14 of 1934 Act, which prohibits "any fraudulent, deceptive or manipulative acts or practices, in connection with any tender offer," which would include exchange offers of publicly-issued debt. But the Section 14 authority is not as broad as the exemptive authority under § 304(d). A two-tiered tender offer for a target company's stock is designed to manipulate stockholders into participating in a transaction that they disapprove of, just as an exit consent proposal is designed to manipulate bondholders into consenting. But the Supreme Court ruled that to run afoul of Section 14, the act needed to have a material omission or misstatement. Coercion is not enough. Schreiber v. Burlington Northern, Inc., 472 U.S. 1, 12 (1985). However, the SEC's exemptive authority under Section 304 is much broader than its Section 14 authority, extending beyond deceptive practices to permit exemptions that are in the public interest.

Moreover, exit consents work effectively without deception, so there's little basis for bondholders to turn to Section 14. Indeed, to coerce the bondholders into tendering, issuers have reason *to emphasize and not hide* the bondholder's poor position if it holds out. Hence, deception is not integral to the exit consent offer.

In contrast to the exit consent transaction for bondholders, the corporate analogue for stockholders --- the two-tiered tender offer --- cannot today readily go forward for a firm with a poison pill, which Delaware and other states have validated.

[12] In some restructurings, the covenants themselves are important to change to make the restructuring viable --- arm-twisting to change payment terms is not the only motivation for votes to alter covenants. If the vote on covenants is combined with a vote on changed payment terms, each bondholder can ordinarily decide whether the deal is overall good enough; no coercion need be involved and, hence, such combined votes should pose little problem.

bondholders with exit consent deals. Future bond issues' restructurings would be well-governed.

But what about bonds already in the market? Because we usually prefer not to go retroactive with new substantive rules, the holdout problem could persist for bonds already issued. Perhaps this is not a large problem: over time the current bonds would mature and be retired, replaced with new bonds with modernized restructuring terms.

Three possibilities could handle the holdout problem for current bonds, if this were seen as a necessary problem to solve. First, Congress could go retroactive after all, if it thought that's what the bond market today wants. I do not recommend such a solution. Proponents of exit consent transactions reportedly proposed quasi-retroactive legislation to validate exit consent transactions struck down by lower courts.[13] The proposal, which for a time was reported to have a good chance of passage, not only had retroactive qualities that are usually avoided (and that plausibly worked against its passage) but went substantively in the wrong direction from the analysis here: instead of permitting binding bondholder votes and limiting exit consent

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[13] Matt Jaremsky, *Caesars Takes Aim at Law Aiding Creditors*, WALL ST. J. (Dec. 6, 2015), http://www.wsj.com/articles/caesars-takes-aim-at-law-aiding-creditors-1449445319; Liz Moyer, *Wall Street's Debt Restructuring Fight Heads to Washington*, N.Y. TIMES: DEALBOOK (Dec. 7, 2015), http://www.nytimes.com/2015/12/08/business/dealbook/wall-streets-debt-restructuring-fight-heads-to-washington.html; Liz Moyer, *Law Professors Ask Congress to Delay Changes in Debt Law*, N.Y. TIMES: DEALBOOK (Dec. 8, 2015), http://www.nytimes.com/2015/12/09/business/dealbook/law-professors-ask-congress-to-delay-changes-in-debt-law.html; Liz Moyer, *Under Fire, Debt Restructuring Amendment Is Pulled*, N.Y. TIMES: DEALBOOK (Dec. 15, 2015), http://www.nytimes.com/2015/12/16/business/dealbook/under-fire-debt-restructuring-amendment-is-pulled.html.

distortions, the legislation would have continued to ban votes (and, hence, holdout distortions) but freely permit exit consent transactions.

Second, the SEC could facilitate exchange offers that put in the new terms (yes on votes; no on exit consents), as long as no restructuring under the new terms occurred for, say, two years. Such a proposal would not be without some retroactive tone, but it would be modest.

Third, one could amend the Bankruptcy Code to facilitate a quick bondholder restructuring.

The National Bankruptcy Conference has prominently proposed adding a new chapter 16 to the Bankruptcy Code, which would allow binding votes on payment terms in a short, rapid alternative to chapter 11.[14] If the anti-exit-consent judicial rulings stand, the legislative proposal would complete the termination of the two distortive consequences of Section 316(b) going forward. The judicial rulings would end the exit consent distortion, and the NBC's new chapter 16 would end the holdout problem. It would do so by making a bankruptcy Section 1126 vote even more viable than it is now. This combination would soundly resolve and reduce the two distortions.

[14] Richard Levin, National Bankruptcy Conference Proposed Amendments to Bankruptcy Code to Facilitate Restructuring of Bond and Credit Agreement, Harvard Law School Bankruptcy Roundtable, Feb. 9, 2015, http://blogs.harvard.edu/bankruptcyroundtable/2016/02/09/national-bankruptcy-conference-proposed-amendments-to-bankruptcy-code-to-facilitate-restructuring-of-bond-and-credit-agreement-debt/. The full proposal and transmission letter to Congress are at http://newnbc.wpengine.com/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

The statute, while a big step forward in important circumstances, would be incomplete, however: the issuer would have to declare bankruptcy, which some do not wish to declare. There's also a philosophical issue, in that the statute could be seen as effectively telling bondholders that they *cannot* contract to have a voting ban. That is, such a statute would say that *even if* bondholders preferred the voting ban of 316(b) (which some bondholders could want anyway), then they cannot have the ban, because it can be overridden by a vote at any time for an issuer willing to take advantage of new chapter 16.[15]

The issue is a philosophical one in that if one interprets the proposed chapter 16 as merely bringing forward the Code's basic voting features, then chapter 16 is basic bankruptcy, which always overrides contract. But if we view the proposed chapter 16 as just a targeted contract right for bondholders (because nothing else would be affected in a chapter 16), then it is de facto doing just what William O. Douglas, the SEC's Chair in 1939, and Congress did to bondholders in 1939 via the Trust Indenture Act, namely, telling bondholders what their

[15] Why might they want to bar voting on payment terms anyway? They might mistrust the issuer or other bondholders, seeing the vote ban as their best protection. Traditional bank syndications allowed each bank to decide on whether to accept changes in payment terms.

But major market evidence goes the other way. Voting clauses were common before the Trust Indenture Act. See Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939); Aladdin Hotel Co. v. Bloom, 200 F.2d 627 (8th Cir. 1953). In Britain, whose financial system most resembles America's, publicly-issued bonds are often restructured via a vote; Britain does not have an equivalent to Section 316(b). See *Assénagon*, supra note 10. Preferred stock, which has financial terms similar to risky bond issues, almost always uses a vote, despite that the preferred stock issues are free to use any recapitalization structure they'd like. And private deals often handle the holdout/exit-consent problem without a vote, but designate syndicate leaders who can agree to change payment terms on behalf of all the creditors in the deal.

contract rights must be and barring them from deciding for themselves. Since the chapter 16 result is in my view much closer to the right package that most bondholders and issuers would negotiate toward, it is a better set of nonnegotiable rights than is now in the Trust Indenture Act. But that point is debatable.

VI. Conclusion

The Southern District's decisions, both from the past year and 1999,[16] are consistent with the Trust Indenture Act's purpose and history when they have struck down exit consent restructurings. There's a basis for a plain meaning interpretation of bars to indenture clauses that impair a bondholders right to payment. But even if plain meaning does not handle the question of whether that payment right protection is only formal rather than real, Judge Failla's precise review of the legislative history should preclude an alternative outcome.

Courts on occasion invoke policy trumps for statutory construction, but this is an exceedingly poor place to consider doing so. The Trust Indenture Act induces two distortions in bond restructuring decisionmaking. It can induce holdouts that stymie a deal, and it can induce exit consent coercions that twist bondholder arms into taking a deal that some and, conceivably, many bondholders dislike but take anyway for fear of being on the back-end of a deal with protective covenants stripped from the indenture. The courts alone cannot solve both problems via a policy-oriented trump.

[16] See *Mechala*, supra note 5. I am aware of no earlier decisions, but since exit consents were not as far as I know used until the late 1980s, that absence is unsurprising.

The best policy solution is to bar exit consent transactions (as similar two-tiered tender offers cannot go forward in takeovers) and to allow bondholders to vote to restructure their bonds' payment terms. The courts, with the Trust Indenture Act in hand, can ban the first. The SEC can then under appropriate conditions allow for the vote, using its broad exemptive authority.