

Client Alert

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US Court of Appeals for the Second Circuit Issues Highly Anticipated Decision Regarding Corporate Debt Restructurings

Section 316(b) of the Trust Indenture Act (the “TIA”) states the right of a bondholder to receive payments pursuant to an indenture security cannot be “impaired or affected without the consent of such holder.” Historically, issuers and bondholders have not engaged in extensive litigation based on the argument that Section 316(b) provides a broad restriction protecting bondholders’ substantive right to actually receive such payments. Accordingly, when necessary, issuers and bondholders have been able to pursue out-of-court restructurings of distressed corporate debt that left the legal ability to receive payments intact, even though they had the practical effect of limiting the bondholders’ ability to receive payments — even when the issuers were unable to obtain unanimous bondholder approval for such plans.

This practice was called into question in late 2014 as a result of certain district court cases coming out of the Southern District of New York (see our prior client alert [here](#)). Specifically, in *Marblegate Asset Management, LLC v. Education Management Corp.* certain unsecured bondholders sought an injunction to prevent an out-of-court restructuring of the debt of an education company facing substantial financial difficulties. The proposed plan required the unsecured bondholders to either convert their debt into equity or potentially lose their practical ability to receive principal and interest payments pursuant to their indenture securities. At the district court level, the unsecured creditors were able to successfully argue that the proposed restructuring plan would violate Section 316(b) of the TIA because it had the practical effect of impairing their right to receive payments without their consent to the modification.

On January 17, 2017, a split three-judge panel of the US Court of Appeals for the Second Circuit reversed the district court’s decision in *Marblegate* (see opinion [here](#)). After concluding that the text of Section 316(b) is ambiguous, the two-judge majority analyzed the legislative history and ruled that the TIA prohibits only formal amendments to the “core” payment terms of an indenture security (i.e., the amount of principal and interest owed and the date of maturity) without the consent of the bondholders. The majority opinion concluded that Section 316(b) of the TIA should not be read more broadly to protect the practical ability of bondholders to receive payments pursuant to their indenture securities. The dissenting opinion, however, concluded that Section 316(b) is unambiguous and relied on a plain meaning interpretation to conclude that Section 316(b) should be read broadly and that the district court decision should be affirmed.

Conclusion

We believe the Second Circuit majority opinion restores a level of certainty to issuers and bondholders seeking out-of-court restructuring solutions for distressed corporate debt. Additionally, it puts the Second Circuit (including New York) in alignment with courts of other jurisdictions that have also found that the TIA only requires unanimous consent to amend an indenture’s core payment terms. Nevertheless, the decision is not yet final, as it may be subject to a request for rehearing to the entire Second Circuit or to an appeal to the US Supreme Court. As a result, further developments in this case may merit further attention.

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