Marblegate Decision Overturned by the Second Circuit Court of Appeals

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Section 316(b) of the Trust Indenture Act of 1939 ("TIA") provides that, subject to certain exceptions, the right of a holder of an indenture security to receive principal and interest payments, or to institute suit to enforce such payments after they become due, shall not be impaired or affected without such holder’s consent. Market participants had long viewed Section 316(b) of the TIA as a “boilerplate” provision, contained or incorporated by reference in most high yield indentures, that protected only a bondholder’s right to bring suit to enforce payment obligations.

However, in Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp. ("Marblegate"), the United States District Court for the Southern District of New York expanded the interpretation of Section 316(b) of the TIA to also prohibit transactions that result in an impairment of a non-consenting bondholder’s practical ability to receive payments, not just its legal right to receive payments, even where the transaction does not specifically modify any of the indenture’s payment terms. Accordingly, the ability to consummate a transaction either expressly permitted by an indenture or consented to by holders of the requisite amount of outstanding bonds that could impair (whether or not materially) the ability of an issuer to make payments became the subject of a great deal of uncertainty. This uncertainty had a significant adverse impact on the debt capital markets as new issuers began pursuing “144A for life” transactions over offerings that would require a TIA qualified indenture, even if such a transaction involved a higher interest rate or less effective execution, and many out-of-court restructurings that would have been beneficial to issuers and creditors of distressed credits were not pursued or had to be effected through costly and time-consuming bankruptcy proceedings to avoid the litigation risk of this new broad interpretation of the TIA.

On January 17, 2017, the United States Court of Appeals for the Second Circuit reversed Marblegate and ruled that only non-consensual amendments to an indenture’s core payment terms (i.e., changes to interest rate, principal amount and maturity effected without the consent of each bondholder) violate Section 316(b) of the TIA, bringing increased clarity with respect to the ability to effect permitted consensual amendments to indenture provisions and out-of-court restructurings involving bonds. The Second Circuit decision effectively narrows the interpretation of Section 316(b) to be consistent with pre-Marblegate practice and also is substantially consistent with the “white paper” agreed to by more than 25 major law firms, including Paul Hastings, in April 2016, which was intended to allow law firms to render necessary legal opinions in connection with indenture amendments and out-of-court restructurings of solvent issuers.
The Second Circuit did not expressly address the impact of its holding on the decision of the United States District Court for the Southern District of New York in BOKF, N.A. v. Caesars Entertainment Corp. (“Caesars”) which involved a bond issuer modifying covenants and stripping guarantees in a manner permitted by the underlying TIA governed indenture. The Second Circuit did, however, refer to that decision in a footnote, characterizing Caesars as adopting the District Court’s Marblegate interpretation of Section 316(b), but sending to the fact finder the question of whether the overall effect of the transactions at issue was a debt restructuring or a series of routine corporate transactions. In any event, if the Second Circuit’s decision stands, it would seem reasonable to conclude that such decision implicitly overrules Caesars. The Caesars decision concluded that Section 316(b) protects a bondholder’s practical ability, as well as the legal right, to receive payment when due, that impairment could be proven either by amendment to a core term or an out-of-court debt reorganization, that transactions must be analyzed as a whole to determine their overall effect on prospects for recovery, and that alleged impairment must be evaluated not necessarily at the time of amendment but as of the date that payment becomes due. Those conclusions seem plainly inconsistent with the fundamental holding in the Second Circuit reversal of Marblegate, which absent rehearing en banc or reversal on further appeal, is the law in the Second Circuit.

It should be noted that the Second Circuit’s majority opinion was accompanied by a dissent. The dissenting judge would have upheld Marblegate, writing that an out-of-court debt restructuring impairs or affects a non-consenting bondholder’s right to receive payment when it is designed to eliminate a non-consenting bondholder’s ability to receive payment, and when it leaves bondholders no choice but to accept a modification of the terms of their bonds.

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