ROPES & GRAY

ALERT

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Second *Marblegate* Decision Finds for Bondholders Using the Trust Indenture Act to Block an Out-of-court Restructuring

Twin rulings by the District Court for the Southern District of New York, the first of which was issued in December 2014 and the second issued on June 23rd of this year, have created great uncertainty in the bond market regarding whether, when and to what extent Section 316(b) of the Trust Indenture Act (the "**TIA**") may now be used by minority bondholders to block out-of-court restructurings, notwithstanding that a particular restructuring is consistent with the provisions of the relevant indenture. In the cases, the Court first stated and then ruled that the out-of-court restructuring to be carried out by Education Management Corp. ("**EDMC**"), which would have converted the interests of bondholder Marblegate Asset Management ("**Marblegate**") from a $14m debt investment into a $5m stock ownership was impermissible under the TIA. The basis for this was Section 316(b) of the TIA, which states that: "*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*." While Section 316(b) has conventionally been understood to guarantee noteholders a legal right to receive principal and interest (i.e. the right to sue to enforce the right to be repaid), the Court's *Marblegate* decisions indicate that the TIA may in certain circumstances be used to block restructurings in which a noteholder is compelled by the majority to accept certain terms, notwithstanding the terms of the underlying debt instrument itself. As a consequence of *Marblegate*, issuers and noteholders are now looking for greater certainty in their transactions and trying to understand which parties may have which avenues of recourse available to them in the event of a restructuring.

Towards the end of the second decision, the Court acknowledged the "*potentially troubling implications of the Trust Indenture Act in rewarding holdouts*." The increased leverage for holdout noteholders created by *Marblegate* is only one of several implications now creating consternation among issuers and debt investors as well as those who represent them. Another one is the opacity of when the Court's holding may apply- neither of the *Marblegate* decisions defines the term 'restructuring' nor provides parameters for what types of transactions may be categorized as such and thereby may become vulnerable under Section 316(b). Noteholders who are party to an indenture with clear amendment provisions must now consider the potential for obscurities and complexities around those provisions in the face of an issuer's restructuring. For notes and bonds that are publicly filed with the Securities and Exchange Commission, and therefore fall under the auspices of the TIA, without more case law available, it seems that the uncertainty created by *Marblegate* will have to be tolerated. However, for debt issuances under Rule 144A that are 'private-for-life', one answer may be to revise the relevant indenture to eliminate the issues raised by Section 316(b) in order to avoid ambiguities about what that language might mean in the context of a restructuring.

If you have any questions about this Alert, please contact your usual Ropes & Gray attorney.