Second Circuit Court of Appeals Overturns *Marblegate*

January 17, 2017

Decision restores certainty to out-of-court debt restructurings

In a surprising 2014 decision, the District Court for the Southern District of New York held that the Trust Indenture Act of 1939 (TIA) was violated by a debtor's restructuring transaction that was permitted under, and involved no amendment to, the relevant indenture. In *Marblegate Asset Management* v. *Education Management Corp.,* which we discussed in an **earlier memo**, the district court interpreted Section 316(b) of the TIA to impose substantive limitations on out-of-court restructurings that harm bondholders' *practical ability to receive* payment – not just their *legal right* to payment – unless all bondholders consent. A few weeks later another district judge in the Southern District issued a similar decision in *Meehancombs Global Credit Opportunities Funds, LP* v. *Caesars Entertainment Corp.*, holding that a majority amendment to strip parent guarantees similarly deprived bondholders of their practical ability to recover payment, and thus required unanimity. More recently, in December 2016, a third district judge in the Southern District declined to extend the *Marblegate* and *Caesars* precedents, and held in *Waxman v. Cliffs Natural Resources Inc.* that an exchange offer, in the absence of any majority action through consent and in the absence of any asset stripping or guarantee releases, would not fit within the earlier decisions or implicate the TIA, as we discussed in a **recent memo**.

Today, in a long-anticipated decision, the Second Circuit Court of Appeals overturned *Marblegate*. And, although silent on covenant and guarantee stripping, we believe the *Marblegate* decision tacitly overrules *Caesars*. To the relief of any company seeking to restructure its debt outside of bankruptcy, it appears that the *Marblegate* and *Caesars* era has come to a close.

Although the Second Circuit agreed with the district court that the text of Section 316(b) is ambiguous, the appellate court concluded after reviewing the legislative history and contemporaneous SEC authority that Section 316(b) was intended to prohibit formal modifications to core payment terms – such as principal amount, interest rate and maturity date – without the consent of all bondholders, but did not "go further by banning other well-known forms of reorganization like foreclosures." The Second Circuit emphasized that its holding "will not leave dissenting bondholders at the mercy of bondholder majorities," and said that by preserving a holder's legal right (if not practical ability) to receive payment, the holder was free to pursue other remedies under federal or state law, relying on such theories as successor liability and fraudulent conveyance.

The plaintiffs will have the ability to seek a rehearing in the Second Circuit, and could eventually try to mount an appeal to the U.S. Supreme Court. But for now, if the opinion is not disturbed, it is binding law in all federal courts in New York, Connecticut and Vermont, and is likely to be viewed as persuasive authority by other federal courts around the country.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Bruce K. Dallas	**650 752 2022**	**bruce.dallas@davispolk.com**
Joseph A. Hall	**212 450 4565**	**joseph.hall@davispolk.com**
Sophia Hudson	**212 450 4762**	**sophia.hudson@davispolk.com**
Marshall S. Huebner	**212 450 4099**	**marshall.huebner@davispolk.com**
Michael Kaplan	**212 450 4111**	**michael.kaplan@davispolk.com**
John B. Meade	**212 450 4077**	**john.meade@davispolk.com**
Brian M. Resnick	**212 450 4213**	**brian.resnick@davispolk.com**
Byron B. Rooney	**212 450 4658**	**byron.rooney@davispolk.com**
Shane Tintle	**212 450 4526**	**shane.tintle@davispolk.com**
Richard D. Truesdell, Jr.	**212 450 4674**	**richard.truesdell@davispolk.com**