Emory Bankruptcy Developments Journal

Volume 37 | Issue 2

4-26-2021

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Recommended Citation

Tobias Wetlitzky, *Water Under the Bridge? A Look at the Proposal for a New Chapter 16 of the Bankruptcy Code from a Comparative Law Perspective*, 37 Emory Bankr. Dev. J. 255 (2021).

Available at: https://scholarlycommons.law.emory.edu/ebdj/vol37/iss2/1

WATER UNDER THE BRIDGE? A LOOK AT THE PROPOSAL FOR A NEW CHAPTER 16 OF THE BANKRUPTCY CODE FROM A COMPARATIVE LAW PERSPECTIVE

Tobias Wetlitzky[*]

ABSTRACT

In light of the ongoing COVID-19 pandemic, bankruptcy law will play a crucial role in addressing the consequences of the global economic shutdown. Many large corporations in the U.S. will need to undergo chapter 11 bankruptcy proceedings or may attempt to reorganize their financial debt in an out-of-court workout. However, section 316(b) of the Trust Indenture Act of 1939 has long been blamed for making out-of-court restructurings practically impossible, because it requires unanimous approval from bondholders. In 2014, the National Bankruptcy Conference presented a solution for the inefficiencies in bond workouts by proposing a streamlined debt reorganization procedure for borrowed money in a new chapter 16 of the Bankruptcy Code. This Article argues that now is time to take a new look at the 2014 proposal from a comparative law perspective. Considering the legal situation in England and Wales as well as Germany, the Article outlines a proposal for a modern workout mechanism for bond debt.

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INTRODUCTION

The ongoing COVID-19 pandemic and the restrictions many countries have imposed in an effort to halt the spread of the virus had significant effects on economies around the globe. In the United States, the economy shrank at an unprecedented rate in the first half of the year,[1] and weekly unemployment filings hit record highs.[2] Despite the ray of hope in the form of quickly developed vaccines, a new surge in coronavirus cases slowed down economic recovery by the end of the year 2020.[3] In line with expectations,[4] a wave of companies experienced financial distress and chose to undergo a corporate reorganization under chapter 11 of the Bankruptcy Code to restructure their outstanding debt.[5] Other companies avoided bankruptcy by contractually restructuring their bond debt ("workouts").[6] However, this illuminated a well-known problem in the world of corporate distress: because an out-of-court restructuring requires the cooperation of nearly all lenders, companies frequently do not succeed in their

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[1] Ben Casselman, *A Collapse That Wiped Out 5 Years of Growth, with No Bounce in Sight,* N.Y. TIMES (July 30, 2020), https://www.nytimes.com/2020/07/30/business/economy/q2-gdp-coronavirus-economy.html.

[2] Lucy Bayly, *Around 1.2 Million People Filed for Unemployment Benefits for the First Time Last Week,* NBC NEWS (Aug. 6, 2020), https://www.nbcnews.com/business/business-news/around-1-1-million-people-filed-unemployment-benefits-first-time-n1235990.

[3] Martha C. White, *U.S. Economy Gains Just 245,000 Jobs in Final Report of 2020 as Recovery Stalls with COVID Surging,* NBC NEWS (Dec. 4, 2020), https://www.nbcnews.com/business/economy/u-s-economy-gains-just-245-000-jobs-final-report-n1249983.

[4] Mary Williams Walsh, *A Tidal Wave of Bankruptcies Is Coming*, N.Y. TIMES (June 18, 2020), https://www.nytimes.com/2020/06/18/business/corporate-bankruptcy-coronavirus.html.

[5] Becky Yerak, *Commercial Chapter 11 Filings Rose 29% Last Year, While Personal Bankruptcies Dived,* WALL ST. J. (Jan. 5, 2021), https://www.wsj.com/articles/commercial-chapter-11-filings-rose-29-last-year-while-personal-bankruptcies-dived-11609886730 (although a steep decline in personal bankruptcy filings "kept overall U.S. filings at their lowest level since 1986", commercial chapter 11 filings were up 29% compared to last year's numbers); Ben Winck, *US Chapter 11 Bankruptcies Surged to a Decade-High in the 3rd Quarter as Stimulus Dried Up*, BUS. INSIDER (Nov. 18, 2020), https://www.businessinsider.com/us-bankruptcies-q3-decade-high-stimulus-expired-coronavirus-resurgence-recession-2020-11?r=DE&IR=T (the number of chapter 11 bankruptcies hit their highest level since 2010 in the third quarter of 2020); *see also* Jialan Wang et al., *Bankruptcy and the COVID-19 Crisis* 1–28 (Harv. Bus. Sch. Working Paper No. 21-041, 2020), https://www.hbs.edu/faculty/Publication%20Files/21-041_a9e75f26-6e50-4eb7-84d8-89da3614a6f9.pdf (observing the surprising pattern of consumer bankruptcies not tracking the business cycle and unemployment rates, offering "financial, physical, and technological barriers to accessing the [bankruptcy] court system" as a possible explanation).

[6] *See, e.g.*, Gillian Tan & Eliza Ronalds-Hannon, *Mall Landlord CBL Turns to Moelis, Weil for Restructuring,* BLOOMBERG LAW (Apr. 28, 2020), https://www.bloomberglaw.com/product/blaw/document/X4V83SE8000000?criteria_id=ea3f4221faea09ab5303e90b09e215f3&searchGuid=d75af648-6ff7-44a3-9c27-22bc45bc0882; Gillian Tan, *California Fitness Chain Explores Options to Ease Debt After Virus Shuts Gyms,* BLOOMBERG (Oct. 1, 2020), https://www.bloomberg.com/news/articles/2020-09-30/in-shape-explores-options-to-ease-debt-after-virus-shuts-gyms.

restructuring attempts.[7] Often, they are then only left with the option of entering a lengthy and expensive chapter 11 proceeding.

Back in 2014, the National Bankruptcy Conference ("NBC")—an organization composed of about sixty leading bankruptcy judges, professors, and practitioners—developed a solution to the inefficiencies in out-of-court restructurings.[8] The NBC envisaged a streamlined procedure "for a workout involving only borrowed money and court supervision of the process to protect the minority while reducing the expense and complexity of using chapter 11's pre-packaged plan process."[9] However, the proposal never became legislative reality, and it appears there are no plans to implement it in the near future. More than five years after its initial presentation, this Article assesses whether the proposal fits into the world of modern corporate distress and whether it could add value to the bankruptcy law framework. It will conclude that the NBC identified important issues with today's bond debt workouts, but that they are more efficiently addressed in a modern workout mechanism outside of the Bankruptcy Code that draws from other jurisdictions' experience. This Article proceeds in Part I with an overview of the current framework for bond debt workouts and the judicial upheavals that coincided with the NBC's reform proposal. In Part II, this Article discusses whether—in light of current market practice—there is a need for a codified restructuring mechanism. Part III addresses common reform discussions and—from a comparative law perspective—outlines a proposal for a modern workout mechanism for bond debt. The final Part concludes.

I. THE CURRENT FRAMEWORK FOR BOND DEBT WORKOUTS

When a company finds itself in financial distress despite a viable business model, it will attempt to restructure the right-hand side of its balance sheet. The restructuring of financial obligations can be achieved under chapter 11 of the Code or by an out-of-court workout.[10] The latter is a contractual agreement

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7 *See, e.g.*, Andrew Scurria, *Envision Healthcare Lenders Object to Debt Exchange,* WALL ST. J. (Apr. 20, 2020), https://www.wsj.com/articles/envision-healthcare-lenders-object-to-debt-exchange-11587420536; Alexander Gladstone, *California Resources Tries to Restructure $4.9 Billion of Debt,* WALL ST. J. (Mar. 18, 2020), https://www.wsj.com/articles/california-resources-tries-to-restructure-4-9-billion-of-debt-11584552392.

8 Letter from Richard Levin, Chair, Nat'l Bankr. Conf., to Reps. Marino and Johnson and Sens. Grassley and Leahey (Dec. 18, 2015), http://nbconf.org/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

9 *Id.*

10 William W. Bratton & Adam J. Levitin, *The New Bond Workouts,* 166 U. PA. L. REV. 1597, 1604 (2018) ("[R]estructuring can take place in bankruptcy court, under Chapter 11 of the Bankruptcy Code. Alternatively, the restructuring can take place out of court in what is known as a workout.") (internal quotations omitted).

between the company in distress and its creditors in which the parties modify outstanding debt.[11] Ideally, the workout would constitute a faster and cheaper option for the debtor than a chapter 11 proceeding and would provide creditors with a greater amount than they would expect through bankruptcy.[12] This Section first presents the common hurdles to implementing a successful workout and upheavals in relevant case law. Second, this Section details the NBC's reform efforts and describes the current state of bond debt workouts.

A. *The Trust Indenture Act and Its Effects on Workouts*

The Trust Indenture Act of 1939 ("TIA") contains strict requirements for bond workouts and has long been blamed for making out-of-court restructurings practically impossible.[13] In particular, TIA section 316(b) requires the debtor to obtain unanimous consent from creditors in order to modify "the right . . . to receive payment of the principal of and interest on" the bond.[14] Whereas creditors are grouped into classes in chapter 11 bankruptcy proceedings, every single creditor needs to consent to the proposed bond term modifications for the workout.[15] This is because the TIA is meant to prevent out-of-court restructuring measures being forced on minority bondholders.[16] It prohibits bond terms from providing for majority decisions ("collective-action clauses"), unless the bond

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[11] Richard E. Mendales, *We Can Work It Out: The Interaction of Bankruptcy and Securities Regulation in the Workout Context,* 46 RUTGERS L. REV. 1213, 1220 (1994) (explaining that this process often starts well before the debtor's actual inability to meet its obligations, potentially triggered by the debtor falling below certain liquidity measures or a general breakdown of creditor confidence).

[12] Ginny Y. Chung, Comment, *Taxing Times Ahead: The Impact of the Cottage Savings Regulations on Debtors and Creditors in Workouts*, 12 BANKR. DEV. J. 245, 250 (1995) (noting that workout negotiations are relatively inexpensive, expedient, and allow management to continue operating the business without judicial interference); Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595, 601–03 (1993) (showing that, if creditors act rationally, they have an incentive to accept a proposed workout plans because the payoff for creditors in a workout scenario exceeds the bankruptcy payoff).

[13] *See, e.g.*, Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 270 (1987) (discussing restrictions imposed on out-of-court restructurings by the TIA); Howard J. Kashner, *Majority Clauses and Non-Bankruptcy Corporate Reorganizations—Contractual and Statutory Alternatives,* 44 BUS. LAW. 123, 124 (1988) (discussing "TIA's formidable barrier to any non-bankruptcy reorganization of a corporation having such public debt"); George W. Shuster, *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431, 442 (2006).

[14] 15 U.S.C.A. § 77ppp(b) (West).

[15] *See* 11 U.S.C. § 1123(a) (2019) (mandating a plan of reorganization, which designates classes of claims and specify the treatment of any class of claims); 7 COLLIER ON BANKRUPTCY ¶ 1122.03 (16th ed. 2020) (outlining that a bankruptcy plan will generally classify nonpriority prepetition unsecured claims, priority claims, secured claims, and equity interests distinctly and in their own groups).

[16] Shuster, *supra* note 13, at 437 (explaining that Congress sought to prevent issuers from circumventing or "contract[ing]-around" the bankruptcy provisions by agreeing with a simple majority of its bondholders on a reduction or reorganization of its bond debt).

is issued under an exemption of the SEC registration requirements.[17] Thus, a single dissenting bondholder can prevent the successful implementation of a bond term modification by refusing its consent or initiating enforcement actions while the workout is under negotiation.[18]

Alternatively, a debtor can ask bondholders to exchange their existing bonds for new ones that contain scaled-down terms with lighter financial obligations for the debtor.[19] This process is called an "exchange offer" and does not require all creditors to participate in order to take effect.[20] However, a number of issues with the potential to impede a successful workout arise in connection with exchange offers. First, if only some of the bondholders accept the exchange offer, non-consenting creditors may have better chances of getting paid because of the creditor's overall improved financial situation.[21] This incentivizes the latter to stick with the more favorable original bond terms ("free riders").[22] Second, if the exchange offer is conditioned on a tender threshold, minority bondholders could strategically demand extra compensation before committing to accept the offer ("holdouts").[23] In light of this, bondholders who would otherwise be willing to participate may refuse to make concessions if costs and benefits of the workout are unequally distributed.[24]

On the other hand, it is not uncommon for issuers to implement equally distorting techniques: issuers frequently connect their exchange offer with a request to strip the old bond of protective covenants ("exit consents").[25] The

[17] Vincent S. J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 732 (2019) (explaining that one such exemption is section 506 of Regulation D, which allows for private placements upon the satisfaction of certain conditions, but that it is not typically used in note offerings).

[18] Jennifer Payne, *The Role of the Court in Debt Restructuring,* 77 CAMBRIDGE L.J. 124, 127 (2018).

[19] William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors,* 57 VAND. L. REV. 1, 21 (2004).

[20] Harold B. Groendyke, Note, *A Renewed Need for Collective Action: The Trust Indenture Act of 1939 and Out-of-Court Restructurings*, 94 TEX. L. REV. 1239, 1244 (2016) (noting that exchange offers often provide for a debt-to-equity swap, in which creditors hand over bonds and receive common stock in return. This process can produce clear benefits for both sides: the issuer in distress can save cash by stopping bond payments and the bondholders exchange bad debt for the possibility of profiting from the delivered company's future success).

[21] Mark J. Roe, Commentary, *The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the SEC to the Table*, 129 HARV. L. REV. F. 360, 363 (2016) (showing that the nonexchangers' desire to receive full payment may even stymie the deal if the remaining bondholders only consider it worthwhile on the condition that all bondholders cooperate).

[22] *See, e.g.*, Sanford J. Grossman & Oliver D. Hart, *Takeover Bids, the Free-Rider Problem, and the Theory of the Corporation*, 11 BELL J. ECON. 42, 43–44 (1980) (noting generally that among a multitude of shareholders, some will be tempted to free ride on the efforts of other investors to improve the firm).

[23] Bratton & Levitin, *supra* note 10, at 1607.

[24] 1 COLLIER BUS. WORKOUT GUIDE ⁋ 5.13 (2020).

[25] Roe, *supra* note 21, at 363 (noting that this process typically concerns protective covenants "such as

modification of business covenants that do not affect core payment rights is often subject to a majority or supermajority vote as provided for in the bond terms.[26] In case a majority of bondholders decided to accept the exchange offer, they also agree to the modifications and thereby substantially decrease the old bond's attractiveness.[27] Facing this scenario, a bondholder could decide to take the exchange offer than being stuck with the old, stripped-down bond.[28] Moreover, issuers may strategically offer higher compensation for earlier tender acceptance and set a short tender period to make it more difficult for bondholders to coordinate.[29]

Over the past decades, dissenting bondholders were only able to challenge an exchange offer with exit consents by invoking a breach of the implied contractual duty of good faith and fair dealing.[30] However, issuers were in the clear as long as they adhered to the standard set out in the leading case on exit consents; in *Katz*, bondholders were presented with the choice of tendering their bonds for significantly less than their face value or being left with bonds that would be stripped of protective covenants in case most other bondholders accepted the exchange offer.[31] Even though Chancellor Allen recognized that any "rational bondholder [was] 'forced' to tender and consent,"[32] he held that exit consents survive judicial scrutiny as long as the issuer's behavior is not "wrongfully coercive."[33] The relevant threshold is whether the original parties to the contract would have agreed to the exit consent's conditions had they foreseen them at the time of contract conclusion.[34] Shortly thereafter, Chancellor Allen applied the test to an exchange offer providing extra compensation for each bond tendered in *Kass*.[35] The court held that such consent solicitation

those according the bondholders seniority, security, and sinking fund protections, or those limiting the debtor from incurring debt, paying dividends, or transferring assets.").

26 1 COLLIER BUS. WORKOUT GUIDE ¶ 2.04 (2020).

27 Roe, *supra* note 21, at 366 (showing that, in a possible future insolvency of the issuer, the exchanging bondholders may be able to recover at least some value whereas the holdouts would be left with nothing due to the previously stripped protective covenants).

28 Bratton & Levitin, *supra* note 10, at 1609 (explaining the bondholders' distorted choice: while exchange offers are already inherently coercive due to the reduced liquidity of the old bonds if a significant number of bondholders accepts the exchange, exit consents add an extra threat because bondholders considering to refuse the offer face the prospective of being left with an old bond with diminished rights).

29 Bratton & Levitin, *supra* note 10, at 1610 (noting that some issuers even exclude some bondholders from the set of offerees altogether).

30 Keegan S. Drake, Note, *The Fall and Rise of the Exit Consent*, 63 DUKE L.J. 1589, 1592 (2014).

31 *Id.* at 1602 (citing Katz v. Oak Indus. Inc., 508 A.2d 873, 878 (Del. Ch. 1986)).

32 *Id.*

33 *Id.* (citing *Katz*, 508 A.2d at 880).

34 *Id.*

35 *Id.* at 1604 (citing Kass v. E. Air Lines, Inc., 1986 Del. Ch. LEXIS, at *486 (Del. Ch. Nov. 14, 1986)).

measures fell within the expectations of the parties to the contract as long as the same offer was made to all bondholders.[36]

The test developed in *Katz* provides bondholders with a potentially powerful argument. However, this holds true only if they can identify an express provision in the indenture that nobody could believe the contracting parties would have allowed to be rendered meaningless by the challenged conduct.[37] Absent exceptional circumstances, courts proved to be reluctant to invalidate exchange offers based on a breach of the implied contractual duty of good faith and fair dealing.[38] Thus, for decades, the only feasible out-of-court bond restructuring solution was highly susceptible to distortions both from the issuers' and the bondholders' sides.[39]

B. *The Shock: Southern District of New York's Broad Interpretation*

A triad of decisions by the District Court for the Southern District of New York expanded the scope of TIA section 316(b) in 2014 and 2015, threatening to make workouts more difficult to implement.[40] In *Marblegate I*, EDMC, a for-profit education company, proposed to restructure $1.305 billion in secured debt and $217 million in unsecured notes (issued by EDMC's operating subsidiary)

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36 *Id.*

37 John C. Coffee & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 U. CHI. L. REV. 1207, 1259 (1991).

38 1 COLLIER BUS. WORKOUT GUIDE ⁋ 5.12 (2020); *see, e.g.*, Caplan v. Unimax Holdings Corp., 591 N.Y.S.2d 28, 29 (N.Y. App. Div. 1992) (holding that there is no "cause of action for breach of an implied covenant of good faith and fair dealing" where plaintiffs received all the promised benefits under the indenture); *In re* Loral Space & Commc'ns Consol. Litig., No. 2808-VCS, 2008 Del. Ch. LEXIS, at *136 (Del. Ch. Sept. 19, 2008) (holding that an issuer does not breach its duty of good faith and fair dealing even when it offers bondholders uneven consideration for their participation in the workout, if the parties actually considered the question in the negotiation process but ultimately incorporated no restriction on such consent solicitation measures); *see also* Kirby M. Smith, *Entire Fairness in the Trust Indenture Act*, 85 GEO. WASH. L. REV. ARGUENDO 58, 60 (2017) (arguing that courts, when assessing out-of-court restructurings, should apply the "entire fairness standard of review", which Delaware courts have constructed as a standard to balance competing concerns in the context of controlling shareholder mergers. However, it does not appear as if courts followed this proposal.).

39 Bratton & Levitin, *supra* note 10, at 1600 (noting that holdout bondholders and coercive tactics by issuers constitute an intrinsic problem for exchange offers, because "[f]ew of the process protections accorded by corporate and securities law to stockholders receiving tender and exchange offers apply to bond exchanges[]" and, in contrast to a bankruptcy proceedings, there is "no judicial oversight of the restructuring process.").

40 *See* Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592, 612–14 (S.D.N.Y. 2014) [hereinafter Marblegate I]; MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Ent. Corp., 80 F. Supp. 3d 507, 516 (S.D.N.Y. 2015) [hereinafter Caesars I]; BOKF, N.A. v. Caesars Ent. Corp., 144 F. Supp. 3d 459, 473 (S.D.N.Y. 2015) [hereinafter Caesars II]; *see also* Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd., 99 CIV 10517, 1999 U.S. Dist. LEXIS 16996, at *20–22 (S.D.N.Y. Nov. 2, 1999) (the court first applied a broader interpretation of TIA Section 316(b) and on which it relied when rendering the 2014 and 2015 decisions).

by an out-of-court exchange offer.[41] If all creditors consented, the offer provided secured creditors with a recovery rate of roughly 55% and, through disbursement of equity convertible into EDMC's common stock, noteholders with a recovery rate of roughly 33%.[42] Because Marblegate, a hedge fund, refused consent, EDMC resorted to a backup plan: the secured lenders lifted EDMC's parent guarantee, foreclosed on the subsidiary's assets, and transferred the assets to a newly formed subsidiary of EDMC.[43] While the new subsidiary distributed debt and equity to the consenting creditors, the dissenting noteholder was left with no more than its claims against the subsidiary that had been stripped of its assets.[44]

The holdout sought a temporary restraining order and preliminary injunction to prevent the restructuring.[45] The district court denied the motion because it found that Marblegate had not demonstrated a likelihood of imminent and irreparable harm.[46] However, it clarified that because TIA section 316(b) contains a "broad protection against nonconsensual debt restructurings," Marblegate had demonstrated a likelihood of success on the merits.[47] The district court recognized that the text of TIA section 316(b) "lends itself to multiple interpretations" and thus resorted to an analysis of the legislative history.[48] It took the position that TIA section 316(b) was intended to "force bond restructurings into bankruptcy where unanimous consent could not be obtained."[49] Therefore, it concluded that practical modifications of indentures "impair or affect" a bondholder's right to receive payment in violation of the TIA when they effect an involuntary debt restructuring.[50]

A few weeks later, a different judge in the Southern District of New York took a similar stance: in *Caesars I* and *Caesars II*, the parent company of the bond's issuer redeemed bonds in full for a group of 51% of the bondholders while collecting exit consents that lifted the parent guarantee, leaving the minority bondholders with worthless claims against the issuer.[51] The court held

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41 *Marblegate I*, 75 F. Supp. 3d at 597.

42 Jason W. Harbour & Shannon E. Daily, Marblegate*: Second Circuit Limits TIA Prohibition to Altering Legal Right to Payment*, AM. BANKR. INST. J., Mar. 2017, at 2.

43 *Marblegate I*, 75 F. Supp. 3d at 601.

44 Bratton & Levitin, *supra* note 10, at 1652 (as a result, the consenting creditors carried out the same deal the holdout hedge fund had earlier rejected, but this time it had no say in the matter and could not intervene).

45 *Marblegate I*, 75 F. Supp. 3d at 602.

46 *See id.* at 605–10.

47 *Id.* at 610–11.

48 *Id.* at 611.

49 *Id.* at 614.

50 *Id.*

51 *See* Caesars I, 80 F. Supp. 3d 507, 509 (S.D.N.Y. 2015); Caesars II, 144 F. Supp. 3d 459, 462–64 (S.D.N.Y. 2015).

in both cases that TIA section 316(b) not only applies to formal modifications of the legal right to receive payment; instead, it prohibits parties from lifting parent guaranties to the detriment of dissenting bondholders because this impairs their practical ability to recover payment.[52]

When the district court addressed the merits of the *Marblegate* case, it reaffirmed its previous conclusion on the broad interpretation of TIA section 316(b) and held that the provision's specific purpose was to prevent a "nonconsensual majoritarian debt restructuring . . . even if the Act's authors did not anticipate precisely the mechanisms through which such a restructuring might occur."[53] Because the restructuring only gave bondholders the choice between taking the common stock or taking nothing, it violated the rights of minority bondholders under TIA section 316(b).[54]

C. The Proposal: A New Chapter 16 of the Bankruptcy Code

Long before the controversial decisions in the Southern District of New York, the NBC started a project to rethink and modernize chapter 11 of the Code.[55] One of their proposals was the creation of a new chapter 16 of the Code to "facilitate court supervision of bond restructurings."[56] The NBC approved the proposal at its 2014 Annual Meeting.[57] The proposal attempts to "preserv[e] both the flexibility of chapter 11's collective action and supermajority voting rules for a workout involving only borrowed money and court supervision of the process to protect the minority while reducing the expense and complexity of using chapter 11's pre-packaged plan process."[58] It would apply only to the restructuring of debt for borrowed money under loan agreements and allows "a debtor seeking to modify a class of debt without unanimous consent" to restructure its debt without the costs and burdens of a typical chapter 11 case.[59]

In particular, the filing of a chapter 16 case would not trigger most of the provisions and restrictions ordinarily associated with a bankruptcy proceeding:

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52 *Caesars I*, 80 F. Supp. 3d at 509; *Caesars II*, 144 F. Supp. 3d at 472–73.

53 Marblegate II, 111 F. Supp. 3d 542, 554 (S.D.N.Y. 2015).

54 *Id.* at 556.

55 *See* Levin, *supra* note 8 (noting that the NBC first initiated the project in 2009 "to examine how chapter 11 could be modernized to accommodate substantial changes in finance, economics, and law since it was first adopted in 1978.").

56 Levin, *supra* note 8.

57 *See* NAT'L BANKR. CONF., REPORT OF THE NATIONAL BANKRUPTCY CONFERENCE: PROPOSAL FOR A NEW CHAPTER FOR RESTRUCTURING BOND AND CREDIT AGREEMENT DEBT (CHAPTER 16), at 1–2 (2014) [hereinafter 2014 NBC Report]; Levin, *supra* note 8.

58 Levin, *supra* note 8.

59 2014 NBC Report, *supra* note 57, at 10.

there would be no estate, automatic stay, avoiding powers, judicial supervision of the management, nor a creditors' committee.[60] Only the debtor could file a chapter 16 case and any involuntary filing of bankruptcy proceedings under chapter 7 or 11 by a bondholder impaired under the plan or an indenture trustee of the impaired bonds would be held in abeyance for 90 days or until the chapter 16 case is resolved.[61] *Ipso facto* clauses triggered by a chapter 16 filing would be unenforceable, allowing the creditor to operate in the ordinary course without being subject to enforcement actions by other creditors.[62] If a supermajority of bondholders (either two-thirds or three-fourths) in the affected classes accepted the plan, the bankruptcy court would assess whether the plan provides the same treatment for all creditors in each class and satisfies the "best interest" test pursuant to Code section 1129(a)(7).[63] Upon confirmation, the plan would become binding between the debtor and the affected classes of creditors.[64]

The NBC's proposal focused on addressing the holdout problem that arises in out-of-court bond restructurings by providing the debtor with a streamlined, court-supervised bankruptcy procedure.[65] It attempts to strike a balance by protecting minority bondholders while not requiring unanimity when it comes to bondholders' resolutions.[66] In light of the Southern District of New York's broad interpretation of TIA section 316(b)—which had the potential to prevent all workouts that affected a creditor's practical ability to receive payment—the NBC repeated and highlighted its call for a reform in 2015.[67]

[60] 2014 NBC Report, *supra* note 57, at 7 (codifying this in proposed section 1601 of the Code); *see* NAT'L BANKR. CONF., REPORT OF THE NATIONAL BANKRUPTCY CONFERENCE: STATUTORY DRAFT OF PROPOSAL FOR A NEW CHAPTER FOR RESTRUCTURING BOND AND CREDIT AGREEMENT DEBT (CHAPTER 16), at 2 (2015) [hereinafter 2015 NBC Report]; Levin, *supra* note 8.

[61] 2014 NBC Report, *supra* note 57, at 6–7 (codifying this in proposed sections 1627, 1628, and 1641 of the Code, and providing that the 90-day period can be prolonged for cause); Levin, *supra* note 8.

[62] 2014 NBC Report, *supra* note 57, at 7 (codifying this in proposed sections 1624 and 1625 of the Code).

[63] 2014 NBC Report, *supra* note 57, at 8–9 (codifying this in proposed sections 1643–1649 of the Code); Levin, *supra* note 8.

[64] 2014 NBC Report, *supra* note 57, at 10 (codifying this in proposed section 1650); Levin, *supra* note 8.

[65] 2014 NBC Report, *supra* note 57, at 2; Levin, *supra* note 8.

[66] Levin, *supra* note 8 (stating that "Chapter 16 proposes a middle ground, preserving both the flexibility of chapter 11's collective action and super-majority voting rules for a workout involving only borrowed money and court supervision of the process to protect the minority while reducing the expense and complexity of using chapter 11's prepackaged plan process."); *see also* Roe, *supra* note 21, at 374–75 (noting that the proposed chapter 16 would end the holdout problem and its results would, in his view, closely resemble the package that most bondholders and issuers would negotiate toward.).

[67] *See* 2015 NBC Report, *supra* note 60, at 1–2.

D. The Correction: Court of Appeals for the Second Circuit's Revision

In early 2017, a divided panel in the Court of Appeals for the Second Circuit revised *Marblegate II* by holding that TIA section 316(b) only bars non-consensual modifications of core payment terms.[68] While the court agreed with the district court's finding that the phrase "right . . . to receive payment" is ambiguous, it reached a different conclusion as to the provision's legislative history: the drafters were "well aware of the range of possible forms of reorganization available to issuers" but decided to exclusively address "formal amendments and indenture provisions like collective-action and no-action clauses."[69] The court noted that "no other provision in the TIA purports to regulate an issuer's business transactions," which would be the likely effect of the district court's broad interpretation.[70]

The district court's approach would require an assessment of whether the challenged transaction was designed to eliminate a non-consenting bondholder's ability to collect payment.[71] The Second Circuit explained that deciding cases "based on the 'relationship of particular borrowers and lenders' or the 'particularized intentions of the parties to an indenture'" undermines its objective of a uniform interpretation of trust indentures.[72] It further noted that minority bondholders have options to protect themselves in situations like these: they can prohibit the transfer of substantial assets in their credit agreements or resort to state and federal law remedies, such as successor liability or fraudulent transfer avoidance.[73] Therefore, the court concluded that EDMC's exchange offer did not violate TIA section 316(b) because it did not modify any core payment terms and did not prevent Marblegate from exercising its legal right to sue and collect on its bonds.[74]

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[68] Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1, 3 (2d Cir. 2017) [hereinafter Marblegate III].

[69] *Id.* at 9.

[70] *Id.* at 8.

[71] *Id.* at 15.

[72] *Id.* (quoting Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039, 1048 (2d Cir. 1982)).

[73] *See id.* at 16; *see also* Harald Halbhuber, *Debt Restructurings and the Trust Indenture Act,* 25 AM. BANKR. INST. L. REV. 1, 4 (2017) (stating that, while the TIA was specifically enacted to curb the use of indentures which included provisions forcing dissenting bondholders to accept equity as consideration in a restructuring, all workouts "are subject to scrutiny under fraudulent conveyance and other laws protecting creditors generally, just as they would have been in the 1930s" before the TIA came into force.).

[74] *Marblegate III*, 846 F.3d at 17.

E. The Present: A New Normal?

Marblegate I and *II* and the uncertainties associated with the decisions initially caused considerable turmoil in the financial restructuring industry.[75] After its revision, market practice quickly returned to its previous state.[76] Even though *Marblegate III* left a few questions on the distinction between core and non-core payment terms unanswered, market participants can presently rely on the narrow interpretation of TIA section 316(b) and execute exchange offers.[77]

However, this also means that workouts by way of exchange offer are still subject to the previously described distortions, both from the issuers' and the creditors' sides. The next Section of this Article thus addresses the question of whether a reform of the current restructuring mechanism for bond debt is still necessary and desirable.

II. NEED FOR A CODIFIED RESTRUCTURING MECHANISM FOR BOND DEBT

Under the current framework for bond debt workouts, individual bondholders can hold out and demand additional payment in return for accepting the exchange offer or profit from a debtor's improved financial situation after

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75 Lisa M. Schwietzer, Kara A. Hailey & Matthew L. Rappoport, *S.D.N.Y. District Court Holds Trust Indenture Acts Limits Ability of Issuer to Restructure Bonds of Dissenting Bondholders Outside of Bankruptcy*, 11 PRATT'S J. BANKR. L. 317, 321 (2015) (claiming that the court's interpretation of TIA Section 316(b) in *Marblegate II* "could embolden holdout bondholders to force—or threaten to force—companies that might otherwise pursue out-of-court restructurings into expensive Chapter 11 proceedings"); *see also* Bratton & Levitin, *supra* note 10, at 1601 (stating that the impact of *Marblegate I and II* "was the biggest jolt to the normally staid world of bond contracting since the leveraged takeovers and buyouts of the 1980s.").

76 *See* Reorg Research, Inc., *Panel Recap: Out-of-Court Restructurings After Marblegate: Trust Indenture Act Section 316(b) and Beyond* (Apr. 3, 2017), http://blogs.harvard.edu/bankruptcyroundtable/files/2017/04/Reorg_Research_-_2017-04-03_18-57-14_-_Panel_Recap-_Out-of-Court_Restructurings_After_Marblegate-_Trust_Indenture_Act_Section_316b_and_Beyond.pdf (providing a recap of a panel discussion on out-of-court restructurings after *Marblegate III*, in which Mr. Byron B. Rooney noted that the previous market practice of issuers' being able to extensively restructure their debt obligations as long as the bondholders' legal right to repayment is not interrupted had experienced a revival after the Second Circuit's decision.).

77 *See* Bratton & Levitin, *supra* note 10, at 1654–55. However, a recent decision by the New York Court of Appeals has the potential to reignite uncertainty in the corporate debt market. *See* CNH Diversified Opportunities Master Acct., LP v. Cleveland Unlimited, Inc., No. 42, 2020 N.Y. LEXIS 2514, at *1 (N.Y. Oct. 22, 2020) (holding that the minority bondholders' right to sue for payment on the notes survived the indenture trustee's strict foreclosure and purported note cancellation—undertaken at the direction of the majority bondholders—because the action impaired their "right to receive payment" and thus violated an indenture provision substantively identical to TIA Section 316(b)). In the 5–4 decision, both the majority and the dissent claimed to be consistent with *Marblegate III* but came to opposing conclusions based on their respective understanding of the underlying principles and the circumstances of the case in front of them. *Id.* at *21, *41. The extent to which *CNH* will have an impact on the rights and strategies of issuers and bondholders remains to be seen and depends on how the markets and other courts will deal with the decision.

other creditors made concessions.[78] On the other hand, issuers can incentivize a majority of bondholders to accept an exchange offer and strip the remaining bondholders from their contractual protections by way of exit consents.[79] In light of these distortions, it is worth analyzing whether the bond workout system is a broken one in need of amendments.

A. Can the Market Find Ways to Successfully Implement Bond Workouts?

It has been held as the conventional wisdom for decades that TIA section 316(b) makes workouts dysfunctional by prohibiting majority decisions when it comes to the amendment of payment terms.[80] However, evidence from the years after the 2008 financial crisis suggests that workouts are now a viable restructuring option for distressed borrowers; because of the lack of financing in the Great Recession, companies in distress increasingly turned towards exchange offers to restructure their debt instead of filing for bankruptcy.[81] Compared to pre-financial crisis levels, a significantly larger percentage of exchange offers successfully closed, albeit often in connection with increased coercion through exit consents, vote buying, and rewards for earlier tenders.[82]

One reason for this is that modern restructurings are often largely controlled by dominant secured creditors.[83] They typically grant debtor-in-possession loans and gain control over the reorganization process through detailed covenants in the loan agreement, providing for the loan's termination in case the debtor does not follow the previously agreed-upon reorganization structure.[84] In the

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78 *See supra* notes 21–24 and the accompanying text.

79 *See supra* notes 25–29 and the accompanying text.

80 *See, e.g.*, Sris Chatterjee, Upinder S. Dhillon & Gabriel G. Ramirez, *Coercive Tender and Exchange Offers in Distressed High-Yield Debt Restructurings: An Empirical Analysis*, 38 J. FIN. ECON. 333, 339–40 (1995) (presenting results from a study of forty-six exchange announcements in the time period between 1989 and 1992); *see also* Christopher James, *Bank Debt Restructurings and the Composition of Exchange Offers in Financial Distress*, 51 J. FIN. 711, 716–18 (1996) (studying 68 exchange offers in the time period between 1980 and 1990).

81 Bratton & Levitin, *supra* note 10, at 1634 (noting that reorganization in a chapter 11 proceeding typically requires financing in the form of debtor-in-possession loans, but the market for these loans collapsed during the credit crunch of—a time period in which demand for reorganization financing spiked).

82 Bratton & Levitin, *supra* note 10, at 1638–39 (showing that, in the time period from 2010 to 2016, out of a sample of forty-six exchange offers made by distressed issuers, 87.5% of the offers closed. However, 82.6% of the offers in the sample included consent solicitation provisions stripping covenants from the old bonds, far exceeding the share of exit consents in earlier studies.).

83 *Cf.* DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 230–31 (Foundation Press 6th ed. 2014) (calling the secured creditor in modern bankruptcies "the 800-pound gorilla in the room", who controls the process because the debtor is not able to obtain alternative financing and effectively dictates the decision to file a chapter 11 petition, because it "wants to use the bankruptcy forum to sell its collateral rather than exercise its foreclosure rights under state law.").

84 *Id.* at 231.

negotiation process prior to the implementation of the restructuring, an issuer and a secured creditor can easily agree on an out-of-court workout.[85] Notably, out-of-court exchange offers typically entail lower administrative costs than a lengthy chapter 11 proceeding.[86] If the unsecured bondholders decided to refuse the exchange offer, the secured creditor could instead pursue a quick going-concern sale in a pre-packaged bankruptcy proceeding.[87] In light of this, unsecured bondholders may prefer to accept an exchange offer than risk a more costly bankruptcy proceeding that could leave the debtor with no assets (and their claims worthless).[88] Provided that one does not consider secured creditors in corporate reorganization to be excessively powerful, the current situation can be seen as an efficient solution to a decades-old problem.[89] If more exchange offers successfully close despite TIA section 316(b), one could argue that there is no need for legislative action.[90]

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[85] *See* Bratton & Levitin, *supra* note 10, at 1645.

[86] Bratton & Levitin, *supra* note 10, at 1630–31 (citing Edward I. Altman & Brenda Karlin, *The Re-Emergence of Distressed Exchanges in Corporate Restructurings*, 5 J. CREDIT RISK 43, 49–50 (2009) (showing that bondholder recovery rates in exchange offers are significantly higher than in other restructuring measures)); EDITH S. HOTCHKISS ET AL., *Bankruptcy and the Resolution of Financial Distress*, in 2 HANDBOOK OF CORPORATE FINANCE: EMPIRICAL CORPORATE FINANCE 235, 251 (B. Espen Eckbo ed., 2008) (suggesting that direct restructuring costs are substantially lower for an out-of-court restructuring than for a court-supervised bankruptcy)).

[87] *See* AM. BANKR. INST., COMMISSION TO STUDY THE REFORM OF CHAPTER 11: 2012–2014 FINAL REPORT AND RECOMMENDATIONS 83–87 (2014) (outlining the concerns as to the premature sale of substantial assets under section 363 of the Code).

[88] Bratton & Levitin, *supra* note 10, at 1644 (explaining that financial creditors may accept a flawed workout if it "provides a significant reduction in bankruptcy costs and averts the possibility of a settlement skewed to the interests of the secured class.").

[89] *See* LOAN SYNDICATIONS & TRADING ASS'N, THE TROUBLE WITH UNNEEDED BANKRUPTCY REFORM: THE LSTA'S RESPONSE TO THE ABI CHAPTER 11 COMMISSION REPORT 48–52 (2015) (arguing that "bankruptcy sales can and do realize as much value for all stakeholders as a traditional reorganization.").

[90] Players in the bond market, for instance, seem to have come to terms with the return to the status quo after *Marblegate III*. Some industry representatives of the consequences of the Southern District of New York's interpretation of TIA section 316(b) for successfully implementing workouts, some industry representatives even tried to incorporate a clause amending the Trust Indenture Act into an (unenacted) spending bill. *See* Matt Jarzemsky, *Caesars Takes Aim at Law Aiding Creditors*, WALL ST. J. (Dec. 6, 2015), https://www.wsj.com/articles/caesars-takes-aim-at-law-aiding-creditors-1449445319. After the Second Circuit's revision, however, these efforts came to a sudden halt. *Cf.* Reorg Research, Inc., *Panel Recap: Out-of-Court Restructurings After Marblegate: Trust Indenture Act Section 316(b) and Beyond* (Apr. 3, 2017), http://blogs.harvard.edu/bankruptcyroundtable/files/2017/04/Reorg_Research_-_2017-04-03_18-57-14_-_Panel_Recap-_Out-of-Court_Restructurings_After_Marblegate-_Trust_Indenture_Act_Section_316b_and_Beyond.pdf (providing a recap of a panel discussion on out-of-court restructurings after *Marblegate III*, in which Professor Roe noted that the pressure for change to the TIA was unlikely to persist after the Second Circuit's decision). However, the New York Court of Appeal's recent *CNH* decision clearly shows that, absent a comprehensive regime regulating out-of-court workouts, there is a possibility of courts reigniting uncertainty in the corporate debt market despite *Marblegate III*. *See* CNH Diversified Opportunities Master Acct., LP v. Cleveland Unlimited, Inc., No. 42, 2020 N.Y. LEXIS 2514, at *14–43 (N.Y. Oct. 22, 2020) (where both the majority and the dissent claimed to be consistent with *Marblegate III* but arrived at diametrically opposed conclusions when applying the principles to

B. *A Codified Bond Workout Framework Offers Legal Certainty*

However, the mere fact that issuers found ways to successfully close exchange offers and minimize the impact of TIA section 316(b) by partnering with secured creditors does not mean that the process is flawless.[91] It is still prone to distortions from the issuers' and the bondholders' sides and can lead to results that are heavily skewed in favor of one or the other.

To have an adequate economic effect, exchange offers often require participation of at least 90–95% of the existing bondholders.[92] Any bondholder that does not participate effectively counts as a "no" and it may be difficult to even locate the required number of bondholders.[93] Even if the issuer is able to approach all bondholders, it must decide between making a coercive exchange offer to ensure wide participation or allowing holdouts to potentially stymie the deal.[94] This constitutes an unbalanced and inefficient bargaining situation; instead of being able to negotiate a joint solution, bondholders are left with either taking what is on the table or sticking with their (often worthless) bonds.[95] On the other hand, individual bondholders should not have the power to torpedo a workout that an overwhelming majority of bondholders would agree to. Even though exchange offers rarely reach the threshold of "wrongfully coercive"—the threshold required for a successful legal interception[96]—holdouts can challenge an exchange offer in court and demand compensation in return for not further delaying the workout's implementation.[97] In a regime that allows for binding decisions to be taken by a supermajority of all bondholders but at the

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the case at hand).

[91] Bratton & Levitin, *supra* note 10, at 1646–47 (arguing that the facts of the *Marblegate* and *Caesars* cases "cast an unflattering light on the distortionary tactics that drive the new restructuring," requiring a revised approach that prevents some of the coercive tactics common in today's workouts). For a detailed analysis of their proposal *see infra* notes 120–125 and the accompanying text.

[92] 1 COLLIER BUS. WORKOUT GUIDE § 2.04 (2020). Exchange offers are meant to reduce the leverage of individual security holders by permitting "each existing security holder to make an independent determination concerning the merits of the restructuring"; this advantage, however, may be rendered moot if bondholders know that the economics of the restructuring require near 100% participation, opening the door for holdouts and free riders. *Id.*

[93] See Mendales, *supra* note 11, at 1228–29 (noting that obtaining consent from the required amount of bondholders is "one of the most difficult tasks for the proponents of a typical exchange offer" and that the "task of obtaining a supermajority is far more difficult than one of simple persuasion").

[94] 1 COLLIER BUS. WORKOUT GUIDE § 5.13 (2020) (arguing that a company in distress considering an exchange offer with exit consents "should carefully review its strategy and existing debt documents" because creditors facing the possibility of their protective covenants being stripped by exit consents may choose to challenge the coercive exchange offer in court).

[95] *See supra* notes 25–29 and the accompanying text.

[96] *See supra* Part I.A.

[97] *See* 1 COLLIER BUS.WORKOUT GUIDE § 5.13 (2020).

same time bars coercive techniques, the uncertainties and distortions noted above could be ameliorated.[98] Bondholders could freely decide on whether the proposed amendments constitute a promising bedrock for the restructuring, and issuers do not have to worry about minority bondholders impeding the process.[99]

Skeptics of a codified bond workout framework now point to the option of a pre-packaged chapter 11 bankruptcy,[100] which does provide for binding majority decisions within each class of creditors[101] and the possibility to confirm a restructuring plan despite the consent of an impaired class ("cramdown").[102] In a pre-packaged bankruptcy, a distressed company approaches its creditors to negotiate a reorganization plan prior to the filing under chapter 11.[103] Especially for an over-leveraged holding company that exclusively or predominantly holds financial debt, this may constitute the kind of balanced regime necessary for a quick and cost-efficient turnaround.[104] In reality, however, an issuer's financial and operating activities may not be separated, which requires the issuer to simultaneously negotiate not only with bondholders, but also banks and trade creditors.[105] Moreover, chapter 11 entails comprehensive disclosure requirements, and the negative publicity of entering bankruptcy may complicate the debtor's relations with suppliers, customers, and employees.[106] While pre-

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98 *See* Buccola, *supra* note 17, at 746–48 (proposing a "stripped-down bankruptcy regime" which could structurally look similar to the proposed chapter 16 with the advantage of allowing supermajorities to compromise on their claims and thereby reducing holdout incentives but at the same time preventing the debtor to "unfairly single out dissenters").

99 For a proposed design of a workout mechanism which allows for swift restructurings through supermajority decisions but limits coercive measures *see infra* Part III.B.

100 *See, e.g.*, 2014 NBC Report, *supra* note 57, at 10 (explaining that one NBC member "questioned the need for a special Bankruptcy Code provision" in the discussions leading up to the reform proposal, because given the availability of pre-packaged plans a streamlined bankruptcy "proceeding really would not add very much in the way of greater speed, efficiency or economy").

101 *See* 11 U.S.C. § 1126(c) (2019) (pursuant to which a plan can be confirmed if, in each class, the class members who accepted the plan represent at least two-thirds in amount and more than one-half in number of the allowed claims held by those who voted on the plan).

102 *See id.* § 1129(b) (pursuant to which at least one impaired class must have accepted the plan and the plan may not "discriminate unfairly" against and must be "fair and equitable" to the dissenting class).

103 1 COLLIER BUS. WORKOUT GUIDE § 6.01 (2020).

104 *See id.* § 6.04.

105 *Id.* (noting that even though negotiations with impaired classes are not legally required, a distressed company will usually negotiate with all holders of the principal obligations it attempts to restructure in order to achieve swift results by ensuring consent when the plan is put to a vote); *see* Stephen J. Lubben, *What We "Know" About Chapter 11 Cost Is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141, 150 (2012) (suggesting that the disregard for the costs associated with the negotiation process may have contributed to the conventional wisdom among scholars and bankruptcy practitioners that pre-packaged bankruptcies are significantly cheaper than regular chapter 11 cases).

106 1 COLLIER BUS. WORKOUT GUIDE § 6.04 (2020) (highlighting that suppliers may refuse to extend credit terms, customers may be reluctant to place long-term orders if they cannot be certain about their fulfillment, and employees may seek alternative employment).

packaged bankruptcies decreases the amount of time the company spends in bankruptcy,[107] the debtor nevertheless requires court approval for transactions out of the ordinary course during the proceeding.[108] Considering these procedural burdens, it is not entirely surprising that empirical evidence suggests that pre-packaged bankruptcies are not cheaper than traditional chapter 11 cases.[109] A regime exclusively tailored to bond debt, which allows for confidential negotiation and acceptance through a supermajority while safeguarding minority bondholders' interests, would constitute a more efficient reorganization mechanism for a broader set of debtors.

In similarly dynamic situations with a variety of competing interests, Congress has taken action to impose rules and standard. For example, the Williams Act facilitates takeover attempts but grants stockholders the benefits of a prohibition of vote-buying and protections against coercive actions.[110] In a traditional chapter 11 bankruptcy, the Code attempts to balance "the rights of the individual against the rights of the group, the rights of the debtor against the rights of its creditors."[111] Nothing remotely comparable exists for issuers and bondholders; a system that ensures no individual player's interests are prejudiced does not exist in the context of an out-of-court workout.[112]

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[107] Foteini Teloni, *Chapter 11 Duration, Pre-Planned Cases, and Refiling Rates: An Empirical Analysis in the Post-BAPCPA Era*, 23 AM. BANKR. INST. L. REV. 571, 586–87 (2015) (showing that among companies with more than $100 million in assets that both filed for and exited chapter 11 between 1997 and 2014, those who used pre-packaged bankruptcies spent considerably less time in bankruptcy than the other companies in the dataset).

[108] *See* 11 U.S.C. 363(b)(1) (2019) (pursuant to which a trustee may only use, sell, or lease property of the estate other than in the ordinary course of business "after notice and a hearing").

[109] Lubben, *supra* note 105, at 178–79 (showing that—based on a dataset of all 2004 major bankruptcy cases—pre-packaged cases were not cheaper than traditional chapter 11 cases if one accounted for at least some of the cases' pre-bankruptcy costs). Thus, pre-packaged bankruptcies appear to merely shift costs into the pre-bankruptcy period, but do not lead to a significant overall cost reduction.

[110] Bratton & Levitin, *supra* note 10, at 1619–20 (outlining that the Williams Act requires persons making a tender offer to hold it open for at least twenty business days, 17 C.F.R. § 240.14e-1 (2008), submit the tender offer to all holders, *id.* §§ 240.13e-4(f)(8)(i), 240.14d-10(a)(1), and pay all tenders the highest consideration on offer. *Id.* §§ 240.13e-4(f)(8)(ii), 240.14d-10(a)(2)).

[111] Shuster, *supra* note 13, at 440. Shuster further notes that this legal scheme creates "an advanced degree of comfort that the individual bondholder's rights will not be unduly prejudiced" and that—in contrast to out-of-court workouts—a judge will hear any concerns that individual bondholders may have. Shuster, *supra* note 13, at 440.

[112] *Cf.* Royce de R. Barondes, *An Economic Analysis of the Potential for Coercion in Consent Solicitations for Bonds*, 63 FORDHAM L. REV. 749, 764 (1994). Even though the Williams Act generally applies to any tender offer and could include debt exchange offers, "the requirements that an offer be made to all holders, that the highest consideration paid in the tender offer be paid to all holders who tender and that partial offers be prorated generally would not apply to debt tender offers, as those provisions relate only to tender offers for equity securities." *Id.*

A codified framework for bond workouts could combine three objectives by carefully balancing the interests of debtors, creditors, and the public. First, a minimal regime that is exclusively focused on the restructuring of debt for borrowed money under loan agreements could facilitate faster and less costly workouts. Second, the regime could prevent holdouts from torpedoing a deal by allowing creditors to make decisions by supermajority. Third, bondholders could enjoy adequate protection against coercive techniques through a prohibition of exit consents and vote-buying and through limited court supervision. Even though the Second Circuit struck down the overly broad interpretation of TIA section 316(b) in *Marblegate III,* it has not (and could not have) addressed the underlying issues of out-of-court workouts described above.[113] Therefore, there is need for legislative action to create a more balanced system that ultimately leads to more efficient corporate reorganizations.

III. Proposed Design of the Workout Mechanism

Since the NBC submitted its proposal to Congress, it has not attracted substantial attention among lawmakers or scholars. Especially after *Marblegate III,* the enthusiasm to reform bond workouts seems to have faded. This largely follows the fact pattern of legislative inaction despite continued calls for reform prior to the District Court for the Southern District of New York's decisions.[114] Given that there is a need to address the obstacles in the process of achieving efficient and value-maximizing workouts, however, it is worth considering what form legislative action should take.

A. Repeal of TIA Section 316(b)?

Since TIA section 316(b) has been identified as the main source complicating bond workouts, a comparatively easy solution could be to repeal the provision. There are a number of bankruptcy scholars who advocate for a repeal with varying grades of market actor autonomy. For example, Professor

113 In *Marblegate III,* the Second Circuit only addressed the question of how broadly the unanimous consent requirement of TIA section 316(b) is to be understood. *See* Marblegate III, 846 F.3d 1, 6 (2d Cir. 2017). In contrast, the question in front of the court was not whether coercive measures in out-of-court restructurings could and should be curbed through judicial intervention. *See* Bratton & Levitin, *supra* note 10, at 1651 (noting that while the Southern District of New York's decisions showed a clear intention of establishing a constructive regime of judicial policing of workouts, the Second Circuit stayed silent on the measure and strictly stuck to an analysis of the provision's legislative history).

114 *See* Reorg Research, Inc., *Panel Recap: Out-of-Court Restructurings After Marblegate: Trust Indenture Act Section 316(b) and Beyond* (Apr. 3, 2017), http://blogs.harvard.edu/bankruptcyroundtable/files/2017/04/Reorg_Research_-_2017-04-03_18-57-14_-_Panel_Recap-_Out-of-Court_Restructurings_After_Marblegate-_Trust_Indenture_Act_Section_316b_and_Beyond.pdf.

Marcel Kahan argues that bondholders—who are almost exclusively institutional investors—can protect themselves by analyzing standardized bond terms in advance and demanding adequate compensation for unfavorable terms.[115] He concludes that TIA section 316(b) should be repealed and no other mandatory terms for bonds should be adopted.[116]

On the other hand, Professor Mark Roe has long advocated for the Securities and Exchange Commission to absorb some of the effects of a repeal. His approach is based on the proposition that a repeal carries a high risk of distortions because there is no guarantee that issuers will succeed in including collective-action clauses.[117] Alternatively, if they do, coercive side payments to preferred creditors can be expected.[118] Professor Roe thus proposes for the SEC to use its powers under TIA section 304(d)[119] to allow issuers to provide for a binding vote on payment terms by a two-thirds majority of bondholders, but only if they contractually bar coercive consent facilitation techniques, such as exchange offers with exit consents.[120]

Professors Bratton and Levitin take a middle ground position: they favor an outright repeal of TIA section 316(b), with the modes of restructuring and voting

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[115] Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U.L. REV. 565, 572–87 (1995) (in particular noting that no significant informational inefficiencies exist in the market for newly issued bonds and that "studies of informational efficiency in the bond market establish that at least some legal terms are priced").

[116] *Id.* at 622 (while recognizing that coercive structures play a role in bondholder consent solicitations, he relies on empirical evidence suggesting that such structures do not actually hurt bondholders and concludes that the issue should "be left to contractual resolution and that no mandatory prohibition should be imposed").

[117] *See* Roe, *supra* note 13, at 272–77 (noting that issuers will resist the incorporation of collective-action clauses because of the negative signaling effects regarding a possible future decline in the firm's financial health and agency costs due to managers, knowing well that collective-action clauses will facilitate a future workout, possibly taking less care in preventing exactly this scenario).

[118] *See* Roe, *supra* note 13, at 272–77.

[119] TIA section 304(d) provides that:

> 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 subchapter, 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.

15 U.S.C.A. § 77ddd (West).

[120] Roe, *supra* note 21, at 372 (noting that, due to the amendment of TIA Section 304 in 1990, the SEC now has considerably broader exemptive authority). He proposes that the SEC should exempt bond indentures from TIA 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." Roe, *supra* note 21, at 372.

rules left to the determination of the drafters of bond contracts.[121] However, they recognize that—when given a blank slate—issuers may no longer use exit consents to facilitate necessary workouts but as instruments of pure coercion.[122] Thus, they complement their approach with the revival of a doctrine developed by courts in the nineteenth century: the intercreditor duty of good faith.[123] The duty "would operate as a default while explicit process rulemaking would be left to the drafters."[124] If need be, bondholders could raise claims against the issuer or other bondholders and ask a court to police opportunistic or coercive behavior.[125]

Relying on issuers and bondholders to come to a balanced solution in the bond terms appears to be an unrealistic concept. Because the deals are underwritten, bondholders are not even present at the negotiation stage.[126] The underwriters only have an incentive to serve the interests of the initial investors.[127] On the secondary market, bond terms are non-negotiable: buyers merely have the option to invest in an issued bond or look for an alternative that suits their interest. Thus, if the issuer's financial situation deteriorates, the original bond terms may not allow an issuer to restructure by way of a supermajority decision or, in case of a collective-action clause, may not provide minority bondholders with sufficient protection because the underwriters did not have their interests in mind when negotiating the bond terms.

Calling for the SEC's oversight is not an adequate solution to this problem as it is limited to one specific point in time; in other words, the SEC would grant an exemption from TIA section 316(b) at the time of the issuance of the bond only if the bond terms appear to be fairly balanced. However, it could not

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121 Bratton & Levitin, *supra* note 10, at 1602 (adding that while they "do not know what contracting equilibrium would obtain in the wake of repeal," they think that it is an issue best left to the market).

122 Bratton & Levitin, *supra* note 10, at 1665.

123 Bratton & Levitin, *supra* note 10, at 1665–70 (explaining that courts held majority creditors subject to a requirement of good faith and a prohibition on collusion with the debtor). The enactment of the TIA, however, shifted a substantial portion of restructuring activity into bankruptcy and the bond market shifted to mostly institutional investors with more efficient means to safeguard their interests, eventually causing intercreditor duties to slip out of the collective memory. Bratton & Levitin, *supra* note 10, at 1665–70.

124 Bratton & Levitin, *supra* note 10, at 1671.

125 Bratton & Levitin, *supra* note 10, at 1671–72 (suggesting that the intercreditor duty "could be read to imply a categorical prohibition of exit consents" if the indenture does not explicitly permit the use of consent solicitation measures).

126 Bratton & Levitin, *supra* note 10, at 1665 (explaining that bondholders' interests are represented only by the underwriters' counsel, but that the "underwriters' interests are limited to the initial marketability of the bonds and do not perfectly align with those of the bondholders").

127 Groendyke, *supra* note 20, at 1258 (explaining that initial institutional investors may not assign significant value to provisions regulating out-of-court restructurings since many of them expect to sell their holdings long before the issuer ever enters a situation of financial distress).

intervene in a situation of financial distress, even though the bond terms now fail to appropriately reflect the interests of issuer and bondholders. Lastly, resolving cases based on the intercreditor duty of good faith may lead to beneficial results in individual cases, but highly depends on courts' interpretation of the doctrine. The best example of its application to exchange offers stems not from United States but English case law. In *Assénagon Asset Management*, the High Court of Justice applied the intercreditor duty and held that "the exit consent is, quite simply, a coercive threat," its only function being "the intimidation of a potential minority."[128] While it is possible that some United States courts would consider *Assénagon Asset Management* as persuasive authority when it comes to the assessment of coercive exit consents, it seems unlikely that they will collectively move away from the long-established principles under *Katz* and *Kass*.[129] With forum shopping already being a controversial issue in corporate bankruptcy law, a uniform approach to workouts is preferable. Therefore, the repeal of TIA section 316(b) does not adequately address the issues that arise in out-of-court bond restructurings.

B. Creating a New Chapter 16 in the Bankruptcy Code?

The NBC presents its proposal for a new chapter 16 of the Bankruptcy Code as a "streamlined, judicial procedure for restructuring TIA-governed indentures" and to address the holdout problem.[130] A stripped-down bankruptcy regime could indeed serve as a mechanism to efficiently reorganize distressed companies where holdout incentives could otherwise hinder the process.[131] While the proposed chapter 16 solves the holdout problem, it does not itself address the distortion of exit consents.[132] An issuer would still be free to make an exchange offer, promising the majority bondholders a reward for stripping the old bond off its bondholder protections. Moreover, although the proposed chapter 16 of the Code does not require a full-fledged bankruptcy proceeding, having to publicly file a bankruptcy case may have a deterring effect on companies.[133] The stigma of bankruptcy could cause business partners to avoid

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128 Assénagon Asset Mgmt. S.A. v. Irish Bank Resolution Corp., [2012] EWHC (Ch) 2090 [85] (Eng.).

129 Drake, *supra* note 30, at 1620 (arguing that "*Assénago*n does not mark the exit consent's death knell, but rather its outer limit" and that it "could fit easily with *Kass* among the progeny of *Katz*.").

130 2015 NBC Report, *supra* note 60, at 1.

131 Buccola, *supra* note 17, at 748.

132 Roe, *supra* note 21, at 375. Roe further notes that enshrining supermajority decisions in the proposed chapter 16 of the Code would effectively override bondholders and issuers ability to agree on a voting ban if they wanted to, thus doing the same as TIA section 316(b): "telling bondholders what their contract rights must be and barring them from deciding for themselves." Roe, *supra* note 21, at 375.

133 Roe, *supra* note 21, at 375.

the company in distress, even though the typical bankruptcy effects—such as the automatic stay—do not apply in the proposed chapter 16.

The NBC noted in its proposal that it took inspiration from other jurisdictions, allowing "debtors to restructure bank or bond debt with judicial oversight without having to initiate broader insolvency proceedings."[134] This Article takes a closer look at two of them: the scheme of arrangement in England and Wales, Part 26 of the Companies Act, and in Germany, the *Schuldverschreibungsgesetz* ("German Debt Securities Act"). This comparative law approach informs an alternative proposal to reforming the current restructuring mechanism for bond debt. Namely, Congress should amend the TIA, allowing for supermajority decisions while barring exit consents and vote buying and providing for limited court supervision.

1. *The Scheme of Arrangement in England and Wales*

In England and Wales, Part 26 of the Companies Act provides for a flexible restructuring tool known as a "scheme of arrangement."[135] It is not an insolvency proceeding and the debtor does not enjoy the benefits of a statutory moratorium on creditors' claims.[136] A scheme of arrangement allows complex and highly leveraged companies to restructure their balance sheets while continuing to pay trade creditors and preserve business relationships.[137]

The successful implementation of a scheme of arrangement requires a three-step process. First, the company in distress presents the proposed scheme and its effects on creditors and shareholders to the court and, upon its approval, summons the creditors and shareholders to attend meetings of the relevant classes.[138] Second, creditors and shareholders meet in classes to debate and vote on the scheme.[139] Each class must approve the scheme by a majority in number that is representing at least three-fourths in value.[140] Thus, while the majority of creditors or shareholders in each class can cramdown a scheme, it is not possible for a class of senior creditors to cramdown a scheme on junior classes of

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[134] 2014 NBC Report, *supra* note 57, at 4.

[135] Jennifer Payne, *Cross-Border Schemes of Arrangement and Forum Shopping,* 14 EUROPEAN BUS. ORG. L. REV. 563, 565 (2013).

[136] 2 COLLIER INT'L BUS. INSOLVENCY GUIDE ¶ 21.05(a) (2020).

[137] *Id.* ¶ 21.05.

[138] David S. Stevenson, *Grab the Fire Extinguisher: Comparing UK Schemes of Arrangement to U.S. Corporate Bankruptcy After* Jevic, 68 CLEV. ST. L. REV. 73, 91 (2019).

[139] *See* Sovereign Life Assurance Co. v. Dodd [1892] 2 QB 573, 583 (defining classes as those "whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.").

[140] 2 COLLIER INT'L BUS. INSOLVENCY GUIDE ¶ 21.05 (2020).

creditors and shareholders.[141] Third, to become effective, the court must sanction the scheme. This step is not a mere rubber-stamping of the approved scheme; the court assesses the overall fairness and reasonableness and may refuse the scheme if it finds that the majority has not voted in the interests of the entire class or even that of third parties.[142]

The scheme of arrangement provides a comparatively quick mechanism to deleverage companies in distress, without having to initiate insolvency proceedings. Allowing managers to avoid the stigma of insolvency may incentivize them to seek restructuring at an earlier point in time. Moreover, the requirement of court sanctioning ensures a balancing of the interests of the company, its creditors and shareholders. Today's popularity of schemes of arrangement as a restructuring tool is largely based on the courts' pragmatic and reasonable approach after the financial crisis.[143]

2. Bond Workouts under the German Debt Securities Act

After a period of 110 years of legislative stagnation, Germany updated its regulation of bondholder organization and representation in 2009.[144] The German Debt Securities Act applies to all bonds issued under German law, regardless of the issuer's place of incorporation or the bond's place of listing.[145] Much like TIA section 316(b), the previous law required unanimous creditor approval for amendments to core terms and conditions of a bond.[146] In contrast, the 2009 Act now allows bond terms to provide for majority decisions when it comes to the amendment of all terms and conditions, including the interest rate, maturity, and principle.[147] While incidental decisions can be made by simple

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141 Payne, *supra* note 18, at 130. Professor Payne further notes that while a cramdown of entire classes is not possible using a scheme alone, a *de facto* cramdown can be achieved by twinning a scheme of arrangement with another insolvency mechanism available under English and Welsh law, the "administration". Payne, *supra* note 18, at 130.

142 Jennifer Payne, *Schemes of Arrangement, Takeovers and Minority Shareholders Protection*, 11 J. CORP. L. STUD. 67, 95 (2011).

143 Payne, *supra* note 135, at 567.

144 Jason G. Allen, *More Than a Matter of Trust: The German Debt Securities Act 2009 in International Perspective,* 7 CAP. MKTS. L.J. 55, 60 (2012).

145 *See* Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, last amended by Gesetz [G], June 23, 2017 BGBL I at 1693, § 1 (Ger.).

146 Carlos Berdejo, *Revisiting the Voting Prohibition in Bond Workouts*, 89 TUL. L. REV. 541, 558–59 (2015).

147 Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 5(1), (3) (Ger.).

majority, at least three-fourths of the bondholders present and voting must accept changes to core terms.[148]

The German Debt Securities Act, just like the act it replaced, contains an express prohibition on buying votes.[149] It is thus likely that exchange offers with exit consents would be considered inadmissible under German law and issuers never tried to implement them as a restructuring measure.[150] Amendments that are agreed-upon by the required majority bind all bondholders, including dissenters.[151] The German Debt Securities Act does not provide for direct judicial supervision of bondholders' resolutions. It merely allows dissenters to challenge a resolution in court for breach of law or the bond terms and conditions.[152] While the right to challenge provides protection for minority bondholders, it can be used by holdouts as a threat to delay the reorganization unless they receive a reward to drop the suit.[153] To counter this, practitioners proposed limiting dissenting bondholders' rights to monetary compensation in case a court later considers the bondholders' resolution to violate law or bond terms and conditions, but allowing the time-sensitive workout to proceed despite opposition from individual bondholders.[154]

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148 Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 5(4) (Ger.).

149 Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 6(2), (3) (Ger.); Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 23(3), (4) (Ger.). Votes cast in violation of the prohibition are void and the act constitutes a misdemeanor.

150 Stephan Balthasar, *Unternehmenssanierungen nach dem Schuldverschreibungsgesetz und der Restrukturierungsrichtlinie: eine kritische Analyse*, 183 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT [ZHR], no. 6, 2019, at 662, 674.

151 Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 5(2) (Ger.).

152 *See* Schuldverschreibungsgesetz [SchVG] [Debt Securities Act], July 31, 2009, BGBL I at 1693, § 20 (Ger.).

153 Reinhard Bork, *Debt Restructuring in Germany*, 2018 EUROPEAN CO. FIN. L. REV. 503, 505–06 (2018) (explaining that even though the issuer may petition a court of appeal to unfreeze the reorganization blocked by the dissenting bondholder's challenge, the process will still result in a delay of several months. Especially in urgent restructurings, issuers will typically not have the financial runway to wait for the court of appeal's decision and pay off the holdout.).

154 Christoph H. Seibt & Lars Westpfahl, *Auf dem Weg zu einem „Neuen Sanierungsgesellschaftsrecht"? Ergebnisse einer Experten-Umfrage*, 34 ZEITSCHRIFT FÜR WIRTSCHAFTSRECHT [ZIP], no. 49, 2013, at 2333, 2337 (presenting a survey among insolvency administrators, lawyers, restructuring advisors, and scholars, in which three-quarters of the participants welcomed a system that would grant monetary compensation to dissenting bondholders affected by a resolution violating the law or the bond terms and conditions.).

3. *Reform Proposal: A Modern Workout Mechanism in the Trust Indenture Act*

By envisaging a court-supervised, streamlined bankruptcy proceeding, the NBC closely modeled its proposal after the scheme of arrangement in England and Wales.[155] However, a mechanism that requires coordination with creditors and involves court supervision already exists in the United States in form of a pre-packaged chapter 11 proceeding.[156] Much like a scheme of arrangement, a pre-packaged bankruptcy allows for binding majority decisions within each class of creditors and a court sanctioning through the "best interest" test.[157] A United States scheme of arrangement could possibly ameliorate some of the prevalent issues with pre-packaged bankruptcies specifically regarding bond debt.[158] It is questionable, though, whether it would be worth the legislative effort to create a new chapter of the Code if it turns out to be very similar to an existing procedure. Moreover, the proposal does not bar coercive techniques such as exit consents. Thus, while issuers would enjoy the benefit of supermajority decisions, they could still attempt to impose less favorable terms on bondholders by offering scaled-down bonds and collecting exit consents from a simple majority of bondholders.

The purpose of a workout is to keep the company out of bankruptcy. Instead of creating a new chapter of the Code, it thus appears consequential to amend the piece of legislation that causes the most troubles in bond workouts: TIA section 316(b). Drawing from the German Debt Securities Act while making sure not to repeat some of the legislative mistakes, Congress could create a balanced workout mechanism.[159] The proposed reform of the TIA builds on four core elements.

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155 2014 NBC Report, *supra* note 57, at 4–6 (outlining the core features of a scheme of arrangement pursuant to the Companies Act 2006). The NBC's proposal closely follows the regulation in England and Wales in several important aspects: just like the scheme of arrangement, the proposed chapter 16 does not contain a moratorium on creditor action in the form of an automatic stay. Both the scheme of arrangement and the proposed chapter 16 contain an element of court supervision in order to ensure protection of affected creditors. Neither the Companies Act (Section 899) or the proposed 11 U.S.C. § 1649 allow for cramdown but require a supermajority in each class of creditors. 2014 NBC Report, *supra* note 57, at 7. The NBC also considered recent legislative changes in Spain, allowing a company to cram down extensive debt modifications with the consent of at least 75% of the total outstanding debt, and other jurisdictions such as France, Italy, and Chile, permitting indentures to provide for a majority or supermajority vote on the modification of core terms without court review. However, the NBC ultimately decided to adopt a streamlined court-sanctioned process based on the model of the scheme of arrangement in England and Wales. 2014 NBC Report, *supra* note 57, at 6.

156 *See* 11 U.S.C. §§ 1126(c), 1129(b) (2019); 1 COLLIER BUS. WORKOUT GUIDE § 6.01 (2020); *id.* § 6.04.

157 1 COLLIER BUS. WORKOUT GUIDE § 6.05 (2020).

158 *See supra* Part II.B.

159 The 2009 German Debt Securities Act is far from a perfect act of legislation: practitioners frequently criticize that the act does not provide sufficiently clear rules on how to execute a debt-to-equity swap without

First, the amended TIA should permit the modification of core payment terms by supermajority if the bond terms and conditions contain a collective-action clause.[160] While the NBC did not specify whether it preferred a two-thirds or three-fourths threshold, the latter strikes a balance between the interests of issuer and bondholders.[161] Persuading 75% of the bondholders to agree to the proposed modifications requires the issuer to make an offer that the overwhelming majority of bondholders considers helpful in implementing a successful workout. At the same time, unlike the current requirement of a unanimous vote, the threshold does not give excessive power to holdouts. After all, the experiences with the German Debt Securities Act show that collective-action clauses facilitate bond workouts by eliminating the threat of individual holdouts torpedoing a deal.[162]

Second, Congress should include a provision in the amended TIA which has the same effect as the vote buying prohibition in the German Debt Securities Act. It is likely that the permission of supermajority decisions alone would lead to a significant decrease in coercive measures such as exchange offers with exit consents. Modifications through collective-action clauses grant the issuer a viable option of implementing a successful workout, rendering more complicated and controversial exchange offers superfluous. However, to grant greater protection to minority bondholders, exchange offers with exit consents

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possible corporate and tax liabilities and that it is not possible to combine multiple bonds in one proceeding and one overall vote, *see* Seibt & Westpfahl, *supra* note 154, at 2338; Balthasar, *supra* note 150, at 670. However, the experiences with the German Debt Securities Act can still serve as valuable input in the process of developing a balanced regime for out-of-court workouts, adopting some and amending other basic features and underlying ideas of the act.

[160] This would allow issuers and bondholders to agree on a provision that suits their needs, leaving room for both unanimous-action clauses and collective-action clauses. *See generally* Roe, *supra* note 21, at 375 (appearing to criticize the binding supermajority vote in the proposed chapter 16 of the Code, arguing that it is a "philosophical issue" whether legislators should impose a nonnegotiable set of rights on issuers and bondholders.).

[161] 2014 NBC Report, *supra* note 57, at 8.

[162] *See* Balthasar, *supra* note 150 at 668–69 (noting that debt restructurings under the 2009 Debt Securities Act significantly increased to around seventy per year from their previous level of around seventeen per year under the old law). Some recent examples include the restructuring of the agribusiness Amatheon Agri Holding N.V., in which holders of the €125 million bond approved a debt-to-equity swap, *Amatheon Agri Holding N.V.: Shareholders Approve Debt to Equity Swap*, DGAP (June 24, 2019), https://www.dgap.de/dgap/News/corporate/amatheo-n-agri-holding-shareholders-approve-debt-equity-swap/?newsID=1163369, and the corporate reorganization of the energy company RWE AG, where 16 bonds needed to be taken over by its then-subsidiary Innogy SE. *See Supervisory Board Approves Reorganisation of RWE*, RWE (Aug. 10, 2015), https://www.group.rwe/en/investor-relations/news-and-ad-hoc-announcements/news/archive-ir-announcements/2015/Supervisory-Board-approves-reorganisation-of-RWE. The process required approval from the respective bondholders and passed with the requisite majorities under the German Debt Securities Act. *See* Christiane Mühe, *Änderungen von Anleihebedingungen–Herausforderungen und praktische Erfahrungen bei der Durchführung von Gläubigerabstimmungen*, 2017 ZEITSCHRIFT FÜR BANK- UND KAPITALMARKTRECHT [BKR], no. 1, 2017, at 50.

should be barred. This could be achieved through measures such as prohibiting vote buying or requiring bond term modifications and exchange offers to be unbundled. The amended TIA would then ensure that bondholders can freely weigh the costs and benefits of agreeing to the proposed workout conditions, without facing coercive consent facilitation measures designed to render any other alternative economically unviable.

Third, the amended TIA should not allow individual bondholders to delay the workout by challenging it in court. Because the German Debt Securities Act allows dissenters to file an action for annulment of the bondholders' resolution, issuers and bondholders cannot safely execute the workout until the lawsuit is resolved. As time is precious when it comes to workouts, the issuer often yields to the pressure and pays the holdout off. Of course, minority bondholders need to be able to successfully challenge unlawful bond term modifications. However, limiting the available remedies to monetary compensation instead of annulment constitutes a sufficient level of protection. The issuer will be able to implement the changes despite the existence of a challenge and will have to pay damages in case a court later determines that the modification infringed upon the law or the bond terms and conditions.

Fourth, in order to achieve efficient workouts, the amended TIA should allow for the uniform restructuring of all the issuer's bond issues. Currently, neither the German Debt Securities Act nor the TIA provide for a workout mechanism that allows the issuer to bind the bondholders of all its bond issues in one proceeding.[163] Instead, the issuer needs to negotiate workouts with the respective groups of bondholders and risks facing conflicting results. The amended TIA could permit the incorporation of joint decision clauses in the bond terms pursuant to which the proposed amendments become binding on the bondholders, even if only a simple majority of the holders of the respective bond issue agreed to it. This would be the case if a supermajority of the creditors from all bond issues agreed to the workout, allowing for a uniform restructuring of the entirety of the issuer's financial debt.[164]

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[163] *Cf.* Theodor Baums, *Weitere Reform des Schuldverschreibungsrechts!*, 177 ZEITSCHRIFT FÜR DAS GESAMTE HANDELS- UND WIRTSCHAFTSRECHT [ZHR], no. 6, 2013, at 807–11 (noting that the 2009 Trust Indenture Act only allows to call for parallel creditors' meetings and the option to condition the vote on one bond on the outcome of the votes on the remaining bond issues, potentially incentivizing holdouts and leading to a gridlock).

[164] For example, this is the case in Switzerland. The Swiss Code of Obligation allows multiple bond issues to be restructured by way of joint decisions, where the proposed amendments to the bond terms become binding on all bondholders if persons representing at least two-thirds of the bond capital consent and at least a majority of holders of each bond issue consent. *Cf.* OBLIGATIONENRECHT [OR], CODE DES OBLIGATIONS [CO], CODICE DELLE OBLIGAZIONI [CO] [Code of Obligations] Mar. 30, 1911, SR 220, RS 220, art. 1171 (Switz.). The

The outlined reform proposal would amend one of the major hurdles to successful workouts, TIA section 316(b), by creating a mechanism designed to balance the interests of issuers and bondholders. It draws from the experience with the German Debt Securities Act and ameliorates some of its shortcomings. The proposed amended TIA allows issuers and bondholders to confidentially and swiftly negotiate and implement a workout, without the repercussions of a public process that requires court approval. The parties involved can rely on a codified bond workout mechanism, without the uncertainty of whether a court will consider a challenged exchange offer to be "wrongfully coercive."[165] Even though such challenges are seldomly successful, the possibility of a case similar to *Assénagon Asset Management* in the United States cannot be precluded. Thus, while issuers are currently able to often successfully close exchange offers,[166] it is equally in their interest to create a codified workout regime. The prohibition of exit consents is balanced out by other characteristics of the proposal, such as the permission of collective-action clauses and the limitation to monetary compensation for dissenters.

CONCLUSION

Amid the economic turmoil caused by the COVID-19 pandemic, it is time to rethink the framework under which companies can restructure their financial debt obligations. Ideally, such a framework should provide companies and bondholders with an efficient mechanism that saves time, money, and ultimately jobs by allowing for the implementation of a successful workout. The assessment of the current framework for bond debt workouts shows that such a mechanism does not exist today. Workouts by exchange offer are prone to distortions from the issuers' and bondholders' sides. Thus, the NBC's proposal for a chapter 16 of the Code is by no means water under the bridge. It identified persistent issues that arise in connection with bond workouts and proposed a carefully drafted piece of legislation. However, what can be achieved through the proposed chapter 16 proceeding is in many aspects already possible in a pre-packaged chapter 11 bankruptcy. Moreover, the proposal does not address exchange offers with coercive consent facilitation measures.

Congress should draw from other jurisdictions' experiences and create a modern workout mechanism that specifically addresses the common problems

mechanism essentially works like a collective-action clause for issuers with multiple bond issues; it eliminates the possibility of creditors from one bond issue jeopardizing the overall financial restructuring of the issuer to the detriment of the creditors from all other bond issues.

165 *See supra* Part I.A.

166 *See supra* Part II.A.

of out-of-court restructurings. The proposal outlined in this Article combines three objectives. First, a codified regime specifically tailored towards the restructuring of bond debt allows for cost- and time-efficient workouts. Second, it grants issuers a viable chance of successfully executing a workout by allowing bondholders to pass resolutions by supermajority. Third, it safeguards minority bondholders' interests by barring coercive consent facilitation techniques such as vote buying and exit consents.