Foreword

Over the past 15 years, the Committee on Trust Indentures and Indenture Trustees (the "Committee") of the American Bar Association's Business Law Section (the "Section") has published three major pieces in *The Business Lawyer* addressing the statutory and contractual underpinnings of the modern trust indenture: (i) the Revised Model Simplified Indenture, 55 BUS. LAW. 1115 (2000); (ii) the Model Negotiated Covenants and Related Definitions, 61 BUS. LAW. 1439 (2006); and (iii) the Annotated Trust Indenture Act, 67 BUS. LAW. 977 (2012). The Committee and the Section thought it would be useful to lawyers, judges, securities and corporate trust professionals, and government agencies and officials who encounter questions of indenture and Trust Indenture Act ("TIA") interpretation to publish all three pieces as a comprehensive one-book compendium. The Committee and Section are pleased to present such a volume, particularly in light of the limited scholarship, source material, and even legal precedent on trust indentures and the TIA.

While the Committee has not endeavored to rewrite or provide comprehensive updates for the publications, the following commentary and updates dealing with certain major developments are intended to keep the publication of current value to readers.

Revised Model Simplified Indenture

The Revised Model Simplified Indenture ("RMSI") was published in 2000, simplifying and updating the 1983 Model Simplified Indenture (38 BUS. LAW. 741 (1983)), in light of the continuing evolution of indenture practices. The RMSI comprised a complete form of indenture (minus the highly negotiated financial covenants, which were later addressed by the Model Negotiated Covenants and Related Definitions) suitable for a "standard" corporate senior or subordinated debt issuance. Perhaps more significant even than the form indenture provisions, the RMSI was accompanied by extensive Notes, which provide commentary on the RMSI's provisions and discussion of relevant legal authority and practical considerations.

Since its publication, the RMSI has been cited in legal opinions at least a dozen times. Courts have described the RMSI's value as evidence of the

established commercial expectations of practitioners and market participants, and have noted the potential for the RMSI to enhance stability and uniformity in the law. *See, e.g., Quadrant Structured Prods. Co. v. Vertin*, 2013 Del. LEXIS 570, 75–76 (Del. Nov. 7, 2013); *Concord Real Estate CDO 2006-1 v. Bank of Am. N.A.*, 996 A.2d 324, 331 (Del. Ch. 2010). Where litigation has arisen over the meaning and effect of certain indenture provisions, several courts have turned to the RMSI and its Notes for help in interpreting the contested language. In particular, the RMSI has provided insight into the interpretation and application of subordination provisions, particularly the so-called Rule of Explicitness (*see, e.g., HSBC Bank USA v. Bank of New York Mellon Trust Co. (In re Bank of New Eng. Corp.)*, 646 F.3d 90, 98 (1st Cir. 2011)); *Deutsche Bank AG, London Branch v. Metromedia Fiber Network, Inc. (In re Metromedia Fiber Network, Inc.)*, 416 F.3d 136, 140 (2d Cir. 2005)), the scope of no-action clauses (*see, Quadrant Structured Prods. Co., Ltd. v. Vertin*, 23 N.Y.3d 549 (2014)), and the ownership of funds deposited with a paying agent (*Petrohawk Energy Corp. v. Law Debenture Trust Co.*, 2007 U.S. Dist. LEXIS 5803, 16–17 (S.D.N.Y. Jan. 29, 2007).

Model Negotiated Covenants

Having addressed in the RMSI the standard provisions for most TIA-governed debt indentures, the Committee turned to the optional, less standard financial and other covenants often negotiated in such indentures. When originally published in 2006, the Model Negotiated Covenants were designed to provide issuers, underwriters and their respective counsel with a guide to high-yield debt covenant negotiation and interpretation as well as examples of model indenture language. Accordingly, while the Model Negotiated Covenants contain terms that were then and remain now generally common, it is not the case that every term of the Model Negotiated Covenants was then or is now standard or “market.” The authors chose intentionally not to endeavor to provide such a “market” survey, recognizing that market changes and heavy negotiation did not favor absolute standardization of terms. While the years since original publication of the Model Negotiated Covenants may have seen shifting trends in high-yield indentures, the Model Negotiated Covenants continue to serve their original purpose as a guide to drafting concepts for high-yield debt.

One recent legal development bears mention: since the original publication of the Model Negotiated Covenants, a small body of Delaware case law has developed with respect to the “continuing director provision” of the Change of Control covenant (clause (3) of the model definition of “Change of Control”). This provision deems a Change of Control to exist, and triggers a bondholder put right, when the board of directors is no longer composed of a majority of continuing directors or directors “approved” by the continuing directors. The Delaware cases, which concerned Delaware corporations with indentures governed

by New York law, establish that a board of directors is permitted to approve almost any incoming board members, even a dissident stockholder's slate of nominees publicly opposed by the incumbent board in a hostile proxy contest. That is, a typical Change of Control covenant should be read to permit such approval, and such approval does not inherently violate the implied covenant of good faith and fair dealing with the bondholders. Further, these cases demonstrate that the board is obligated to approve the dissident slate—except in the most egregious cases—as not to do so would trigger the change of control put and thereby likely violate the directors' duty of loyalty. The cases suggest that adopting a continuing director provision in a Change of Control covenant without careful consideration by the board (and a record of such consideration) may expose directors to breach of duty of care or loyalty claims given the impact the continuing director provision may have on the free exercise of the stockholder franchise (even though, as practitioners, we observe that boards of directors do not tend to actually analyze their indentures but rather by necessity rely on their counsel). Any form of a continuing director provision which provides that individuals elected to the board by an actual or threatened proxy contest shall not be considered continuing directors, commonly referred to as a "dead hand proxy put," is particularly suspect. While the risk of such claims may be more pronounced for directors of public companies, any successful defense would require directors to establish that they believed in good faith that adopting the provision enabled the corporation to receive an economic benefit—and possibly a unique or extraordinary one at that. Consequently, the continuing director provision may add little protection for the bondholders, and at the cost of inconvenience and litigation exposure for the board of directors, particularly a board of a public Delaware corporation. *See San Antonio Fire & Police Pension Fund v. Amylin Pharmaceuticals, Inc*., 983 A.2d 304 (Del. Ch. May 12, 2009) and *Kallick v. SandRidge Energy, Inc.*, 68 A.3d 242 (Del. Ch. Mar. 8, 2013).

Annotated Trust Indenture Act

Having addressed the provisions of modern corporate indentures, the Committee recognized that they were in many ways offspring of a statute—the Trust Indenture Act of 1939. The Annotated Trust Indenture Act is the most recent of the three publications. The Annotation was intended to serve as a unique "one stop shop" for all issues TIA related.

Case law interpreting the TIA has historically been relatively sparse, and that has not changed since publication of the Annotation. However, certain significant court decisions interpreting the TIA that were released after the publication of the Annotation merit a brief mention here.

One topic on which significant case law developments have recently occurred is the issue of whether residential mortgage-backed securities ("RMBS") are covered by the TIA. For years, corporate trust professionals and lawyers had

operated on the understanding (based in part on guidance from the SEC staff), that such securities were not covered by the TIA, mainly on the basis that such securities are not "debt" securities covered by the TIA but rather are "equity" securities not so covered. However, in *Retirement Board of the Policemen's Annuity and Benefit Fund of the City of Chicago v. The Bank of New York Mellon*, 914 F. Supp. 2d 422 (S.D.N.Y. 2012), *reconsideration denied, interlocutory appeal certified*, 2013 WL 593766 (S.D.N.Y. Feb. 14, 2013), the United States District Court for the Southern District of New York determined that the RMBS securities in that case were "debt" securities covered by the TIA. The decision sent shockwaves through the corporate trust community, not only because such securities had long been assumed to not be covered by the TIA, but also because of the practical implications and problems of applying the TIA to an RMBS structure. The District Court's decision was appealed to the Second Circuit Court of Appeals, and several amicus briefs were filed by industry associations. In *Ret. Bd. of the Policemen's Annuity & Ben. Fund of the City of Chicago v. Bank of New York Mellon*, 775 F.3d 154, 164 (2d Cir. 2014), the Second Circuit reversed the district court's decision, and held that RMBS certificates governed by a pooling and serving agreement are exempt from the TIA because they fall within the exclusion in § 304(a)(2) of the TIA, exempting "any certificate of interest or participation in two or more securities having substantially different rights and privileges."

Another has been litigation applying TIA principles to RMBS and other structured finance transactions. Most such cases involve assertions that the indenture trustee relied upon certificates and opinions in bad faith, or breached obligations pursuant to TIA Section 315(b) to notify indenture securities holders of defaults due to uncured representation and warranty breaches in transfers of assets from which payments on the indenture securities were to be made. One recent structured finance decision (*In Re Medical Capital Securities Litigation*, 2013 WL 1344969 (C.D. Cal. 2013)) cast doubt upon the meaning of 'bad faith,' and that term's proper place in indentures. Although longstanding case law has treated bad faith as equivalent to willful misconduct (*see, e.g., York v. Guaranty Trust Co. of New York*, 143 F. 2nd 503 (2nd Cir. 1944)), the court in *Medical Capital* suggested that bad faith should have been expressly defined in the indenture, and introduced implied concepts beyond willful misconduct such as ignoring "obvious" red flags (obvious with the aid of hindsight available from litigation and results of related law enforcement proceedings).

Recent court decisions have also examined the issue of whether certain non-consensual modifications of noteholders' rights run afoul of the protections embodied in section 316(b) of the TIA. In *Marblegate Asset Management, LLC v. Education Management Corp.*, 2015 WL 3867643 (S.D.N.Y., Jun. 23, 2015), the court held that § 316(b) of the TIA, which prohibits the non-consensual impairment of a holder's right to receive payment under an indenture, protects more than just a noteholder's bare right to sue on its notes, but rather more

robustly encompasses a substantive right to obtain recovery. The court ruled that Education Management LLC, (the issuer of certain bonds) violated section 316(b) of the TIA when it carried out a complex restructuring transaction that divested the issuer of its assets and removed the parent company's guarantee from the bonds, even though this transaction was supported by a majority of the bondholders. The court held that the TIA should be interpreted broadly to prohibit nonconsensual restructurings that have the effect of depriving non-consenting holders of their substantive right to receive payment. Judge Failla noted that "courts should give effect to the purpose of the Act, and not allow minority bondholders to be forced to relinquish claims outside of the formal mechanisms of debt restructuring." Similarly, in *MeehanCombs Global Credit Opportunities Funds, LP v. Caesars Entm't Corp*., No. 14-CV-7091 SAS, 2015 WL 221055 (S.D.N.Y. Jan. 15, 2015), the court held that noteholders stated viable claims against the issuer and its corporate parent where the noteholders alleged that the issuer's divestment of its assets and the release of the parent's guarantee of the notes effected a non-consensual impairment of the noteholders' right to repayment in violation of section 316(b) of the TIA, even though the noteholders' legal right to receive payment from the issuer was not affected. *See also BOKF, N.A. v. Caesars Entm't Corp*., No. 15-CV-1561 SAS, 2015 WL 5076785, at *4 (S.D.N.Y. Aug. 27, 2015) (holding that "in order to prove an impairment under section 316(b), plaintiffs must prove either an amendment to a core term of the debt instrument, or an out-of-court debt reorganization."). As of this writing, there has been continued litigation and even attempts at new legislation around this topic, and so this view of the TIA, or even the language of the TIA itself, may change at any time.

The Committee on Trust Indentures and Indenture Trustees of the American Bar Association Business Law Section[1]

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