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The Scope of Section 316(b) after Marblegate

By

Marcel Kahan*

Abstract

Section 316(b) of the Trust Indenture Act provides that right of any to receive payment of the principal and interest may not be impaired or affected without the holder’s consent. This article analyzes the recent case law on whether corporate restructurings that impair the practical ability of bondholders to obtain payment on their bonds violate Section 316(b) of the Trust Indenture Act. After concluding that the Court of Appeals for the Second Circuit was correct in confining the scope of Section 316(b) to formal amendments to core payment terms, the article turns to an issue left open by Marblegate: whether formal amendments that release a guarantor or that expand the conditions in which a guarantor is automatically released are within the scope of Section 316(b) and thus require the consent of each affected holder. Based both on the literal wording of Section 316(b) and, as far as parent-guarantors are concerned, on its economic function, Section 316(b) should be held to require the consent of each affected holder for an amendment releasing a guarantor from its obligations under the guarantee. By contrast, applying Section 316(b) to subsidiary guarantors does neither much harm nor much good since indentures leave companies with significant scope to eviscerate the economic benefit of subsidiary guarantees.

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Introduction

In the United States, corporate bond indentures – the agreements that contain most of the terms of corporate bonds – typically run 50 to 100 pages. While most of the provisions in these indentures can be freely varied by the parties, a few are prescribed by the federal Trust Indenture Act of 1934 (TIA). One of the most notable, and most litigated, of these provisions derives from Section 316(b) of the TIA and provides:

[t]he right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder.¹

Section 316(b) has two separate elements. The first relates to the right of bondholders to sue the company; the second to the right to receive payment of the principal of and interest on the security on or after the respective due dates. This second element had generally been understood to prohibit amendments to the core payments terms by majority bondholder consent.²

Typically, indentures contain a section – in the article on Defaults and Remedies – that rephrases, with slight variations to make it comport to the rest of the indenture, the wording of Section 316(b). Even agreements not subject to the TIA, such as sovereign bonds, sometimes use bond indentures subject to the act as a template and follow its language.³ In addition, however, indentures contain a separate section – in the article on Amendments – on the terms that cannot be amended with the consent of holders of a majority (or supermajority) in principal amount of outstanding bonds. This section virtually universally provides that amendments that reduce the interest or principal amount due on a security or that change the time of payment of interest or the stated maturity of the security require the consent of each affected holder of the security.

As to the core of the second element, the prohibition of amendments to the payment terms by majority consent, it thus seems that Section 316(b) pushes at an open door. Rather than forcing bonds to include a provision that otherwise would be absent, bonds contain a separate amendment section that, in effect, duplicates the indenture section implementing Section 316(b) and expressly (albeit using different phraseology) provides that amendments of the main payment terms by majority consent are not permitted.⁴

I. Mechala, Caesars and Marblegate

² See, e.g., Mark J. Roe, The Voting Prohibition in Bond Workouts, 97 Yale L.J. 232 (1987) (“Fifty years ago, Congress prohibited all binding bondholder votes that would modify any core term—principal amount, interest rate, and maturity date—of a bond indenture.”)
The case law interpreting the second element of Section 316(b) has, until recently, been sparse. The most notable opinion was Federated Strategic Income Fund v. Mechala Grp. Jamaica Ltd.,\(^5\) an unreported decision by a federal District Court for the Southern District of New York from 1999. *Mechala* involved a Jamaican company in financial distress. After negotiations, a group of creditors agreed to accept a tender offer pursuant to which they would sell their bonds for less than 50 cents on a dollar and would consent to amendments stripping the indenture from most protective covenants and eliminating subsidiary guarantees. The amendments were to be followed by a sale of 99.9% of the stock of Mechala’s subsidiaries to a company controlled by Joseph Matalon, whose family owned Mechala. Once this restructuring was completed, Mechala’s only asset would have been a nominal amount of cash and a 0.1% stake in its former subsidiaries. Bondholders who did not tender their bonds would retain their legal right to payment from Mechala; but that right would have been rendered worthless.

The court in *Mechala* held that the amendments together with the asset transfers “impaired” the holders’ right to receive payment. As the court reasoned:

Taken together, these proposed amendments could materially impair or affect a holder’s right to sue. A holder who chooses to sue for payment at the date of maturity will no longer, *as a practical matter*, be able to seek recourse from either the assetless defendant or from the discharged guarantors. It is beyond peradventure that when a company takes steps to preclude any recovery by noteholders for payment of principal coupled with the elimination of the guarantors for its debt, that such action does not constitute an “impairment” or “affect” the right to sue for payment.”\(^6\)

*Mechala* attracted little attention and, for 15 years, no following. This may be somewhat surprising as *Mechala’s* reasoning was sweeping. To be sure, the amendments at issue in *Mechala* and the restructuring enabled by them eliminated the practical ability to seek recourse from Mechala. Yet Section 316(b) requires the consent of each holder for any impairments of a right, not just for highly material ones. It is thus understood that even immaterial amendments to the core payment terms – such as a change in the maturity date by a single day – would require unanimous bondholder consent. But this would then seem to imply that any amendment that impairs or affects the practical ability to obtain payment likewise requires unanimous consent, even if the amendment does not eliminate the practical ability to obtain payment.

Then, in 2014 to 2015, the arguments made by the *Mechala* court were taken up in two sets of District Court opinions, involving restructuring of the debts of Caesars Entertainment Operating Co. (CEOC) and Education Management LLC (EMLLC), respectively. CEOC had issued bonds guaranteed by its parent, Caesars Entertainment Corp. (CEC). CEC then undertook various transactions designed to have this guarantee released. In May 2014, CEC sold a 5% stake in CEOC (the “May Transaction”). The indenture for at least some of CEOC’s bonds provided that the guarantee would automatically terminate when CEOC ceases to be a wholly-owned subsidiary of CEC. CEC thus claimed that the May Transaction resulted in the release from its guarantee.\(^7\) CEC further asserted that the guarantees were released under a separate indenture clause that

\(^{5}\) 1999 WL 993648 (S.D.N.Y. 1999).

\(^{6}\) Id. at *7 (emphasis added).

provided for a release when CEC was released from all of its other guarantees on “Existing Indebtedness.” Finally, in August, holders of certain notes (the “August Transaction Notes”) granted “exit consents” to indenture amendments that purported to remove guarantees and modified another covenants and immediately prior to selling their notes to CEOC. A few months later, in January 2015, CEOC filed for bankruptcy and various parties demanded payment from CEC under the guarantees.

In the opinion, Meehancombs Global Credit Opportunities Funds, LP v. Caesars Entertainment Corp. (Caesars I), the court refused to dismiss a suit brought by holders of the August Transaction Notes who had not consented to the amendments and not sold their notes to CEOC. The court, following Mechala, rejected the argument “that Section 316(b) protects only the against formal, explicit modifications of the legal right to receive payment.” Rather, because the “removal of the Guarantees through the August 2014 Transactions [allegedly was] an impermissible out-of-court restructuring achieved through collective consent,” the complaint could not be dismissed.

A second opinion, Caesars II, addressed claims by the trustee for bonds containing a guarantee allegedly released through the May 2014 Transactions. In refusing to grant CEC’s motion for summary judgment, the court clarified that “either an amendment to a core term of the debt instrument or an out-of-court debt reorganization” can constitute an impairment under Section 316(b), but did not decide whether the transactions at issue amounted to an out-of-court debt reorganization.

Notably, Caesars II went beyond Mechala or Caesars I in that it applied Section 316(b) in a context not involving any amendment to an indenture by majority consent. At the same time, it contained a limiting principle: unless there is an amendment to a core term, only an out-of-court debt reorganization – and not any other transaction that affects the practical ability to obtain payment – constitutes an impairment.

The Marblegate litigation proceeded contemporaneously with the Caesars’ litigation and the first opinion, Marblegate I, was released just two weeks prior to Caesars I. Education Management LLC (EMLLC) had negotiated an out-of-bankruptcy restructuring with holders of its secured and unsecured debt. Like those of CEOC, the debts of EMLLC were guaranteed by a parent company, Education Management Corporation (EMDC). To pressure any unsecured holdout creditors to participate to the restructuring, the terms of the restructuring provided that, unless all creditors participated, the secured creditors would release EMDC’s parent guarantee, exercise their right to foreclose on EMMLC’s assets, and sell these assets to a newly-

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8 Id.
9 Id.
10 80 F.Supp.3d 507.
11 Id. at 514.
12 Id. at 516.
13 Id. at 468.
15 An out-of-bankruptcy restructing was advantageous because, if EDLLC and EMDC field for bankruptcy, they would become ineligible for Title IV funding from the Department of Education. Id. at 595-596.
formed subsidiary of EMDC. That new subsidiary would then distribute debt and equity securities to participating creditors. Under a clause similar to the one at issue in *Caesars II*, the release of the guarantee of the secured debt would automatically trigger a release of the guarantee of the unsecured debt. With EMLLC left without assets and the EMDC guarantee gone, unsecured holdout creditors would receive nothing.16

Unsecured holdout creditors argued that the restructuring violated Section 316(b) of the Trust Indenture Act. In *Marblegate I*, the court refused to grant a preliminary injunction to stop the restructuring, arguing that even though the unsecured creditors were likely to succeed on the merits, they had an adequate remedy at law. In *Marblegate II*,17 following a trial, the court held that the restructuring violated the rights of the unsecured holdout creditors under Section 316(b).

*Marblegate II* contained an elaborate analysis of the legislative history of and the textual changes to the TIA.18 Based on these sources, the court concluded that Section 316(b) could be violated without a formal amendment to the payment terms. Rather, a nonconsensual majoritarian out-of-court debt restructuring could also violate Section 316(b).19

The district courts’ opinions in *Marblegate II* and *Caesars II* raised substantial concern. According to two leading commentators, *Marblegate* disrupted practice assumptions going back three-quarters of a century, made bond counsel more reluctant to issue opinion letters on the enforceability of trust indentures, and led to efforts to get Congress to retroactively overrule the court’s opinion.20

One issue posed by the opinions is how far they extended. If even a transaction that involves no majority amendment of any indenture term can run afoul of Section 316(b) – as held in both *Marblegate II* and *Caesars II* – then many transactions unilaterally undertaken by the company could arguably “impair” or “affect” the right to payment. To be sure, both case confined the scope of Section 316(b), when no formal amendment is involved, to an out-of-court reorganization or debt restructuring. However, neither opinion make clear when a transaction qualifies as an out-of-court reorganization or debt restructuring. Moreover, the literal wording of Section 316(b) – its use of the terms “impair” or “affect” – would suggest that, once a right to payment is involved, even a small change in the right would require the consent of each affected holder.

On appeal, the Second Circuit, in a 2-1 opinion, overruled the district court in *Marblegate.*21 Based on its reading of the legislative history, the Second Circuit concluded that the Section 316(b) only limits the type of amendments that can be adopted through majority bondholder consent.22 The Marblegate transaction thus clearly lies outside the scope of Section

16 Id. at 601.
18 Id. at 546-555.
19 Id. at 546, 556-557.
22 See id. at *9 (“the relevant portions of the TIA’s legislative history exclusively addressed formal amendments and indenture provisions like collective–action and no–action clauses.”); id. at *16 (“The transaction did not amend any terms of the Indenture.
316(b). Moreover, in dicta, the court suggested that even with respect to formal amendments, Section 316(b) applies only to amendments of the core payment terms. Thus, we are back to where we were pre-Mechala: Section 316(b) only bars formal, majoritarian amendments to core payment terms.

The Second Circuit opinion represents a return to certainty and to literalism. By confining the scope of Section 316(b) to formal amendments of core payment terms, the questions of what constitutes an out-of-court reorganization or debt restructuring – terms not found in Section 316 – and when an out-of-court reorganization or debt restructuring is significant enough to impair the practical ability to receive payment become moot. Furthermore, the opinion moots the question of why other actions – such as amendments to non-core payment terms or unilateral company actions that are not out-of-court reorganizations or debt restructurings – cannot also impair the practical ability to receive payment.

On all of these fronts, the Second Circuit opinion is a step in the right direction. Although the majority opinion drew a vigorous dissent by Judge Straub, it establishes a binding precedent for the Second Circuit. And given the prominence of the Second Circuit in commercial disputes in general and bondholder disputes in particular, it is likely that courts in other circuits will follow its lead.

As noted, the Marblegate contains ample reference to the legislative history of Section 316(b) and directly address the issue of how the statutory provision should be interpreted. The case law, however, probably applies with similar force to bond indentures that are not subject to the TIA, but nevertheless include Section 316(b)-type language. Although the terms of these indentures should be construed in accordance with the principles of contractual, not statutory, interpretation, the parties to the contract, in copying the statutory language, most likely intended and understood that this language in their contracts would be construed to have the same meaning as the equivalent statutory language.

II. Section 316(b) and Guarantees

The Marblegate opinion also does not resolve another important issue: do the core payment terms that cannot be amended by majority consent include the right to receive payment from a guarantor – and hence do amendments eliminating a guarantee require the consent of each affected holder.24

23 See, e.g., id. at *16 (“Limiting Section 316(b) to formal indenture amendments to core payment rights will not leave dissenting bondholders at the mercy of bondholder majorities.”) (emphasis added).
That the Circuit Court’s opinion did not address this issue is not surprising: the transactions at bar in the appeal involved no formal amendment to a guarantee. More surprisingly, however, the courts Mechala and in Caesars I did not address this issue even though the transactions at bar in these cases involved amendments that purported to result in a release of a guarantee. Given that these courts concluded that the amendments violated Section 316(b) because they impaired the practical ability to obtain payment, one may have thought that they would have at least considered the straight literal argument: that Section 316(b) bars the impairment of the formal right to receive payment; that a release from a payment obligation impairs the formal right to payment; that just as the bondholders have a formal right to payment from the principal obligor, they also have a formal right to payment from a guarantor; and that nothing in Section 316(b) confines the right to payment that cannot be “impaired” to the right to receive payment from the principal obligor.

Including a formal amendment to the legal right to payment from a guarantor in the scope of Section 316(b) would result in only a limited and clearly delineated expansion of the provision. An amendment that purported to provide for a release of a guarantor or to relax the conditions for a release – as appears to have been the case in Mechala and in Caesars I – would be deemed to impair or affect the right of payment from the guarantor and would require the consent of each affected holder. In contrast, a release granted pursuant to provisions contained in the indenture when the bonds were issued – as in Caesars I and in Marblegate – would be valid. In this respect, the release of a guarantor would be treated equivalently to a release of the principal obligor: many indentures provide that a principal obligor can be released upon the sale of all or substantially all assets and no one suggests that such a release is inconsistent with Section 316(b).

The literal case for including the right of payment from a guarantor in the right “to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security,” is strong. But such inclusion also makes economic sense, at least with respect to parent-guarantors. Consider the economic effect of a Note issued by XYZ Corp. with a guarantee by its parent ABC Inc. (or, for that matter, by any company other than an XYZ subsidiary): as a result of the parent guarantee, the assets of ABC become directly, and the assets of any ABC subsidiary that is not XYZ or a subsidiary of XYZ become indirectly, available to satisfy the Note. Without the guarantee, only the assets of XYZ (and, indirectly, of XYZ subsidiaries) would be so available. A priori, either asset pool – ABC’s and XYZ’s – may be more important. Thus, if Section 316(b) protects minority bondholders against an amendment releasing XYZ from its payment obligations – as it does – it should also protect them against a release of ABC from its payment obligations.  

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25 In Caesars II, CEC argued that its parent guarantee was not intended to provide credit support, but merely to facilitate financial reporting. 144 F.Supp.3d at 469-70; Regulation S-X, Rule 3-10(b) and (c) (parent guarantee may eliminate need to provide separate financial statements for wholly-owned subsidiary-issuer). But the notion that parent guarantees (merely) intended to facilitate financial reporting should be treated differently from guarantees (also) intended to provide credit support smacks of hypocrisy. The presumable reason why an issuer-subsidiary is not required to file separate financial reports if there is a full and unconditional parent guarantee is that the parent provides and will continue to provide credit support and therefore that the
Assuming, then, that a rule like Section 316(b) that requires unanimous consent for an amendment releasing XYZ from its obligation is justified, there is no reason why an amendment releasing ABC from its obligations should be treated differently. To the contrary, if ABC could be released from the guarantee by an amendment, Section 316(b) could be effectively eviscerated by having the nominal issuer of the bonds that cannot be released – XYZ in our example – hold only minimal assets and supplying the economically material support for the debt through an ABC guarantee. Economically, such a structure would be virtually equivalent to bonds issued by ABC where ABC could be released from its payment obligations through an amendment approved merely by majority consent – a structure incompatible with Section 316(b).

In sum, as to parent guarantees, both the literal language of Section 316(b) and the economic function of the guarantee strongly support interpreting Section 316(b) to encompass the right to receive payment from a parent-guarantor.

As to subsidiary guarantees, however, the economics are different. Unlike parent guarantees, subsidiary guarantees do not make a new pool of assets available to creditors. Rather, if XYZ’s Notes enjoyed a guarantee by XYZ subsidiary Sub Corp., the Noteholders would gain direct – as opposed to merely indirect – recourse to these assets. Put differently, a Sub guarantee affects the relative priority among creditors in the XYZ enterprise. Without a guarantee, the Notes would be structurally subordinate to Sub creditors (to the extent of Sub assets) and structurally at par with XYZ creditors whose debts are not guaranteed. With a guarantee, the Notes would be structurally at par with Sub creditors and structurally senior (to the extent of Sub assets) to XYZ creditors whose debts are not guaranteed.

But modifying structural seniority – the effect of a subsidiary guarantee – is different from obtaining recourse to a new asset pool. For one, there are multiple other factors that bear on the relative seniority of the Notes and that can be manipulated to undo any benefits obtained through the guarantee. The benefits obtained from becoming structurally senior to creditors of XYZ that do not enjoy a Sub guarantee can be eliminated in several ways: by having Sub transfer its assets to XYZ or a subsidiary of XYZ that has not provided a guarantee; by having Sub merge with XYZ; by granting other XYZ creditors a Sub guarantee; or by repaying the other creditors of XYZ or repurchasing their debt. Likewise, the benefits obtained from becoming structurally par to other creditors of Sub can be eliminated by repaying the other creditors of Sub or repurchasing their debt; having Sub transfer its assets to a subsidiary and having that subsidiary provide a guarantee to such creditors; or securing such creditors with a lien on Sub assets. To be sure, other covenants can and do restrict such actions. However, if Section 316(b) encompasses only amendments to the formal right to payment, such other covenants can be modified with majority creditor consent. Thus, even if Section 316(b) would preclude a majoritarian amendment to release a subsidiary guarantor, the effective protections offered by such guarantee depend on other covenants that can be eliminated by the issuer once other covenants are stripped with majority creditor consent.  

26 financial statements of the issuer-subsidiary are not material from the perspective of a creditor enjoying the guarantee.

26 The effective protections offered by a parent guarantee can, of course, also be reduced. Specifically, a parent – ABC in our example – can transfer assets to its shareholders (or to a holding company) via dividends or share repurchases, thereby reducing the pool of assets
The contractual structure of bonds with parent or subsidiary guarantees largely accords with this analysis. For this article, I collected a sample of 50 bonds issued in 2017 under an indenture that contained provisions on guarantees. Of these bonds, 36 provided for subsidiary guarantees, four provided for parent guarantees, and ten provided for both parent and subsidiary guarantees. Of the 46 bonds with subsidiary (or parent and subsidiary) guarantees, 29 provided that a release of any subsidiary from guarantee required the consent of each affected holder. Assuming that these provisions are interpreted to encompass not just an explicit release but also an amendment to the indenture provisions governing an automatic release — as is likely, but not certain — they have the same import as reading Section 316(b) to encompass guarantees.

The other bonds with subsidiary guarantees offered lesser or no protection. Eight of the indentures governing these bonds provided that the release of a “Significant Subsidiary” or an amendment to the guarantee provisions that had a materially adverse effect required the consent of each affected holder; three contained various other restrictions on amendments; and six provided no express restrictions (beyond the general restriction that such amendment may impair the right to payment on the due dates provided in the securities).

However, even in the bonds with strong formal protections against a release through a majoritarian amendment, the substantive protection offered by the guarantee would be eliminated through the automatic release provisions. In all but two of these bonds, the subsidiary was automatically released upon a sale of the subsidiary.27 Thus, if the issuer sells a subsidiary guarantor and either keeps the proceeds in its own treasury or invests them in a subsidiary that is not a guarantor, the creditors would effectively lose the benefits of the guarantee.

Notably, the indentures governing 38 of the 46 bonds with subsidiary guarantees required, in general or some circumstances, additional guarantees by newly-formed subsidiaries. Such covenants, like the initial guarantee itself, are designed to assure that bondholders do not available to make payment under the guarantee. To the extent covenants, such as restricted payments and affiliate transactions provisions, limits such transfers, these covenants could also be removed by majority consent. Importantly, however, non-contractual legal rights by creditors limit the ability to engage in such asset transfers. In particular, fraudulent conveyance law would provide the ability to set aside for the benefit of creditors any asset transfer without fair consideration — which would include dividend payments and payments to repurchase one’s shares — if at the time or as a result the transferee corporation was insolvent or was left with unreasonably small capital. Non-contractual legal rights would also restrain the ability to reduce the protections offered by a subsidiary guarantee through asset transfers without fair consideration. But because there are many other ways to reduce the protections afforded by a subsidiary guarantee — including through the repayment on other debt, through the grant of a lien to secured other debt for fair consideration, or through asset transfers to a subsidiary — fraudulent conveyance law would leave much greater scope for reducing the protections offered by a subsidiary guarantee.

In addition, of bonds with subsidiary guarantees, 33 provided for an automatic release when a subsidiary is designated as unrestricted and 32 provided for an automatic release when all or certain other guarantees by the subsidiary are discharged (a provision similar to the one at issue in Marblegate). Many indentures also provided for a release if a subsidiary-guarantor sells all or substantially all assets.
become structurally subordinated to subsidiary creditors. However, in all of these bonds, this covenant could be eliminated by a majority amendment. This, even if the indenture does not permit a release of a guarantor by majority amendment, the same practical result could be achieved by (i) an amendment eliminating the covenant requiring additional guarantees, (ii) a sale of the subsidiary-guarantor (or, if a sale does not result in an automatic release, an upstreaming of the subsidiary guarantor’s assets) and (iii) the transfer of the sale proceeds into an newly-formed subsidiary.

In other words, subsidiary guarantees are generally an element of a broader scheme to give bondholders greater structural priority and the elements needed to make the scheme effective can be changed with majority consent. Interpreting Section 316(b) to encompass guarantees would thus offer some additional formal rights with respect to subsidiary guarantees – in those bonds that do not contain strong protections – by no meaningful substantive protection. It would do little good – but it would also do little harm.

Among the fourteen bonds with parent guarantees, the indentures for seven did not permit a release by majority amendment. One additional indenture provided, in the guarantee article, that no amendment would affect the guarantee – a provisions what could be interpreted to prohibit a release via amendment. The other indentures contained no significant restrictions on a release through a majoritarian amendment (again, beyond the general restriction that such amendment may impair the right to payment on the due dates provided in the securities). Generally, an automatic release of a parent guarantor was provided only upon the parent’s transfer of all or substantially all of its assets and the assumption of the guarantee by the transferee – provisions equivalent to those applicable to the issuer itself.

That a majority of bond indentures contain strong contractual protections against a release of the guarantor through a majoritarian amendment and that the provisions for automatic release of a parent-guarantor generally match those for an automatic release of the principal obligor indicates that the formal right to payment from a guarantor enjoys a status similar to the formal right of payment against the primary obligor. For parent guarantees, interpreting Section 316(b) to encompass guarantees would offer not just additional formal rights with respect to those bonds that do not contain strong protections, but these additional formal rights would provide substantive protections for minority bondholders. Interpreting Section 316(b) to encompass parent guarantees would thus be consistent with the economic importance of parent guarantees and the typical contractual provisions on automatic release, the literal

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28 In several indentures, any amendment with an adverse effect on the guarantee required the consent of each affected holder. Although this restriction on amendments could arguably also encompasses the covenant regarding future subsidiary guarantors, a more natural interpretation is that it applies only to guarantees in effect at the time of the proposed amendments.

29 Alternatively, this provision could be interpreted to provide only that a regular indenture amendment would not affect the validity of the guarantee. Moreover, because this provision is contained in a separate indenture section, and because that section is not listed among the section that cannot be amended without consent of each affected holder, it may be possible to first modify the section providing that no amendment affects the validity of the guarantee and then amend the indenture to provide for a release of the guarantor.
wording of Section 316(b), and the purpose of Section 316(b) to prescribe limits on the ability of modify key payment provisions by majoritarian amendments.

III. A Short Note on English Law

The techniques and exit consent and consent payments, which involve discrimination among consenting and non-consenting bondholders are well accepted under U.S. law. Discrimination in the treatment of bondholders who accept an exchange offer with exit consents or a consent payment for an indenture amendment and those who do not can be coercive: bondholders may be “coerced” to accept an proposal that offers little value because they fear that, if sufficient other holders accept, they will receive even lower value. By contrast, English law has been more skeptical of exit consents. In Assenagon Asset Management SA v Irish Bank Resolution Corp Ltd (Assenagon), for example, the court held that exit consents to an amendment could not be used to permit the issuer to redeem non-participating bonds for a small percentage of their face value.

US and English exit consents, however, differ greatly in their broader context. In the US context, both under Section 316 of the Trust Indenture Act and under the contractual amendment provisions, the amendments at issue in Assenagon would have required unanimous bondholder consent. Because, in the US, the core payment terms cannot be amended by majority consent, the potential scope of “coercion” through exit consents is limited. Within these constraints, exit consents have by now be used for over 30 years and, despite the theoretical potential for coercion, bond indentures still do not contain provisions prohibiting coercively structured exit consents and empirical evidence suggests that bondholders are not harmed by these transactions. In bonds issued under English law, by contrast, where payment terms can be amended if the requisite percentage of bondholders consents and the amendment binds a

32 See Liu, supra note 24 (comparing validity of exit consents under US and UK law).
33 [2012] EWHC 2090 (Ch), [2012] WLR(D) 243.
34 Marcel Kahan & Bruce Tuckman, Do Bondholders Lose from Junk Bond Covenant Changes?, 66 Journal of Business 499 (1993) (finding evidence that bond prices increase when companies make coercively structured offers and suggesting that this price increase is due to bondholdings being sufficiently concentrated to enable bondholders to protect themselves against adverse offers).
dissenting minority,\textsuperscript{35} it may make more sense to police the process in which consents can be obtained – as the court did in \textit{Assenagon}.\textsuperscript{36}

In a sense, therefore, the protections afforded to minority bondholders under Section 316(b) and under the contractual amendment provisions in the US and the protections afforded to minority bondholders under \textit{Assenagon} under English law are substitutes. Given Section 316(b) and the contractual amendment provisions in the US, further protection against coercively structured exit consents seems neither needed nor desired. Perhaps the reverse is true for bonds issued under English law: if the amendment process is effectively policed, protection in the form of unanimous consent provisions may not be needed or desired.

Conclusion

The opinion by the Court of Appeals for the Second Circuit in \textit{Marblegate} restored greater certainty to the scope of Section 316(b) by confining it to formal amendments of core payment terms. Yet, neither the Second Circuit opinion nor prior cases have addressed an important issue: can a bond indenture be amended with the consent of holders of a majority of bonds to release a guarantor from its obligations under the guarantee. Both the literal wording of Section 316(b) – by its reference to a right of payment and its apparent agnosticism as to the entity that has the corresponding obligation to pay – and the economic function of parent guarantees suggest that a release of a guarantor by amendment would violate Section 316(b). By contrast, the economic function of subsidiary guarantees – to enhance the structural seniority of the guaranteed debt – and the overall covenant structure would not warrant a requirement that any amendment that releases a subsidiary guarantor from its guarantee obligation receive unanimous consent. But as such a requirement would not be effective, it would do neither much harm nor much good.

\begin{itemize}
\item \textsuperscript{35} Assenagon at *15, 17-18 (providing for “Extraordinary Resolution” that sanctioned a reduction or cancellation of principal with approval of 3/4 of persons voting at a meeting attended by holders of 2/3 of the nominal amount of notes); id. at *49 (“There are however no statutory safeguards against abuse of power by a majority of the 2017 Noteholders in the present context.”)
\item \textsuperscript{36} See Edward B. Rock, \textit{Corporate Law Doctrine and the Legacy of American Legal Realism}, 163 University of Pennsylvania Law Review. 2019, 2045 (arguing that the constraints on amendments imposed by the Trust Indenture Act justify the more permissive approach to exit consents under US, compared to English, law) (2015).
\end{itemize}