PROTECTING MA AND PA: BOND WORKOUTS AND THE TRUST INDENTURE ACT IN THE 21ST CENTURY

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Revlon, the well-known cosmetics manufacturer, has labored under a massive debt load since the 1980s, when it was the subject of a classic hostile takeover battle. As with many recent distressed firms, it decided to address its debt not through the Bankruptcy Code and chapter 11, but rather in an "exchange offer." That is, it offered to buy its old bonds back with an offer of new securities. One implication of its decision to proceed this way was that it was able to pay its retail bondholders much less than its institutional bondholders.

The Trust Indenture Act of 1939 was supposed to protect small bondholders from abuse by issuers and their fellow bondholders. Nevertheless, recent exchange offers have become more aggressive than ever. And academic scholarship has argued that the Trust Indenture Act should be repealed because, allegedly, there are very few individual bondholders anymore.

Leaning against this ancient and illustrious literature, I instead argue that today we need the Trust Indenture Act, and Section 316(b) thereof, more than ever. Indeed, I argue for an expansion of the Trust Indenture Act to provide more robust protection for small bondholders, the disappearance of which I submit has been seriously overstated.

I argue that the Trust Indenture Act should be viewed as a floor, from which Securities and Exchange Commission rulemaking can further develop to animate the spirt of the Trust Indenture Act. In particular, by adapting key concepts from equity tender offers—like the "best price" and "all holders" rules—exchange offers can be made more equitable. In addition, I propose a new two-stage process for exchange offers, which exposes tendering bondholders to some chance that their bonds will not be accepted in the tender, and thus they will have to live with a bond modified by the exit consents, which feature so prominently in modern offers.

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INTRODUCTION

Revlon describes itself "as a color authority and beauty trendsetter in the world of color cosmetics and hair care."[1] Most people would probably just call it a makeup or cosmetics company. For corporate lawyers, Revlon is best known for its classic 1980s hostile takeover, which resulted in the creation of the special "Revlon duties" in Delaware.[2] But that hostile takeover and subsequent takeovers of other smaller

1 Press Release, Revlon, Revlon Announces Closing of 5.75% Senior Notes Exchange Offer (Nov. 13, 2020), https://www.revloninc.com/media/2020/11-13-2020-201908154.php [https://perma.cc/D3BM-N28P].

2 Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986). In *Revlon*, the Delaware Supreme Court held that the company's board had breached its duties to shareholders by taking measures to benefit one of two competing bidders who sought control of the target. When *Revlon* applies, the board's fiduciary duty is to maximize current share value through pursuit of the best transaction reasonably available for the shareholders.

companies left the company saddled with a tremendous amount of debt, which has burdened the company ever since.[3]

While it had been struggling with its high debt load for decades, the 2020 COVID-19 pandemic brought a sudden, sharp drop in cosmetic sales.[4] And Revlon had $342.8 million of notes (or bonds)[5] due in early 2021.[6] But it was even worse than that, because under the terms of its loan agreements, if Revlon did not develop a plan to address the maturity of these notes by November 2020, around $1.5 billion of loans would suddenly come due.[7] That is, the loans would mature about ninety days before the bonds unless Revlon had the bonds "under control." As one credit-rating agency explained in summer 2020, "[g]iven the company's very weak financial performance, Moody's does not believe that Revlon has sufficient liquidity to repay the notes or that it has the ability to refinance the notes at this time."[8]

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As a company approaches insolvency—or more vaguely, "financial distress"—American law presents two options for rehabilitation.[9] On the one hand, the firm might file for bankruptcy under chapter 11 of the

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3 Jacob Bernstein, *The Debt King*, N.Y. TIMES (Jan. 11, 2022), https://www.nytimes.com/2022/01/07/style/ron-perelman.html [https://perma.cc/BE33-7TWP].

4 Allison Collins, *Revlon Sales Dipped 20 Percent During Coronavirus Pandemic*, WWD (Mar. 11, 2021, 8:35 AM), https://wwd.com/beauty-industry-news/beauty-features/revlon-sales-dip-2020-coronavirus-pandemic-1234776401-1234776401 [https://perma.cc/QJ65-YZYY].

5 Throughout this Article, I follow modern convention and refer to all corporate debt instruments, save for bank or "syndicated" loans, as "bonds." *Accord* Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 HARV. L. REV. 1821, 1821 n.1 (1992).

6 Jack Hersch, *Revlon to Avoid Bankruptcy with Exchange, Redeems Remaining Bonds at Par*, S&P GLOB.: MKT. INTEL. (Nov. 12, 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/revlon-to-avoid-bankruptcy-with-exchange-redeems-remaining-bonds-at-par-61242105 [https://perma.cc/UW9F-8RZ6].

7 Chedly Louis & John E. Puchalla, *Moody's Says Revlon's Debt Swap Offer Considered to Be a Distressed Exchange*, MOODY'S INVS. SERV. (Aug. 5, 2020), https://www.moodys.com/research/Moodys-says-Revlons-debt-swap-offer-considered-to-be-a—PR_429933 [https://perma.cc/EF4M-XG5G].

8 *Id.*

9 Restructuring or reorganization are the typical terms in the corporate bankruptcy industry. VIRGINIA TORRIE, REINVENTING BANKRUPTCY LAW: A HISTORY OF THE COMPANIES' CREDITORS ARRANGEMENT ACT 6 (2020) ("A restructuring is generally understood to mean rehabilitation of the debtor in the sense that the debtor company will stay in business."). Liquidation presents a third option, but that is not the focus of this Article. *See generally* Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65 (2007).

Bankruptcy Code.[10] Modern chapter 11 presents a variety of "in court" options for restructuring, ranging from traditional reorganization plans, to prepacks (where the plan is approved by creditors before bankruptcy), to 363 sales (where the debtor sells its assets shortly after filing).[11]

Alternatively, a distressed company like Revlon might try to come to a deal with its creditors "out of court"—such deals typically being referred to as "workouts."[12] Here, Section 316(b) of the Trust Indenture Act of 1939 (TIA)[13] comes into play because it prohibits a majority of bondholders from binding their fellow (dissenting) bondholders to a deal that "impair[s] or affect[s]" the latter's rights to receive interest or principal when due.[14] As one Securities and Exchange Commission (SEC) official said when the TIA was pending before Congress,

> If an investor buys a $1,000 bond payable on January 1, 1940, the majority cannot turn it into a $500 bond payable in 1960, without his consent, and without resort to the reorganization machinery now provided by law. There is nothing in this provision, however, which would prevent the majority from waiving its own rights.[15]

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10 *See* Laura N. Coordes, *Bespoke Bankruptcy*, 73 FLA. L. REV. 359, 365 (2021) ("[B]ankruptcy is a federal remedy that allows the debtor to impair contracts and restructure its obligations." (emphasis omitted)).

11 *See* William W. Bratton & David A. Skeel, Jr., *Bankruptcy's New and Old Frontiers*, 166 U. PA. L. REV. 1571, 1572 (2018) ("Today's typical Chapter 11 case looks radically different than did the typical case in the Code's early years."); Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization After* Jevic, 93 WASH. L. REV. 631, 665–66 (2018). 363 sales—which reference Section 363 of the Bankruptcy Code—involve the sale of the debtor's assets to a buyer, leaving the chapter 11 plan process focused on the question of how to distribute the sale proceeds. *See id.* at 668–70, 696–700.

12 *See* Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1341 (2021); *see also* STEPHEN J. LUBBEN, CORPORATE FINANCE ch. 26 (3d ed. 2021) ("At a basic level a workout is simply an agreement between the debtor firm and its creditors.").

13 Trust Indenture Act of 1939, ch. 411, 53 Stat. 1149 (codified at 15 U.S.C. §§ 77aaa–77bbbb). Section 302 of the Act states its purpose, which is to protect "the national public interest and the interest of investors in notes, bonds, debentures, evidences of indebtedness, and certificates of interest or participation therein, which are offered to the public." *Id.* § 302(a) (codified at 15 U.S.C. § 77bbb(a)).

14 *Id.* § 316(b) (codified at 15 U.S.C. § 77ppp(b)); UPIC & Co. v. Kinder-Care Learning Ctrs., Inc., 793 F. Supp. 448, 452 (S.D.N.Y. 1992) ("Section 316(b) expressly prohibits use of an indenture that permits modification by majority securityholder vote of any core term of the indenture, i.e., one affecting a securityholder's right to receive payment of the principal of or interest on the indenture security on the due dates for such payments . . . ."); Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1327–28 (2002).

15 Edmund Burke, Jr., Assistant Dir., Reorganization Div., SEC, Aims, Purposes and Philosophy of the Barkley Bill, Address Before the American Bar Association (July 25, 1938). The Barkley Bill was the name of the TIA before it was finally passed in 1939.

Since direct amendment of a bond contract (known as a bond "indenture")[16] is thus quite arduous—the TIA basically requires unanimous consent[17]—financially embarrassed corporations most often attempt to effectuate a workout by means of an "exchange offer."[18] As the name implies, this is an offer where the debtor-firm attempts to convince bondholders to exchange their bonds for something new, such as a package of securities and perhaps a bit of cash.[19]

These offers are loaded with features to make the new package attractive, while making staying in the old bonds as uncomfortable as possible. The latter must be achieved without running afoul of Section 316(b)—that is, our distressed firm will do everything short of "impairing or affecting" bondholders' rights to receive interest or principal when due.[20] In other words, bondholders' other rights may be impaired or affected without their unanimous consent, just with the consent of a majority of bondholders. And helpfully, from the distressed corporation's perspective, the courts have read the prohibition on impairing or affecting the right to receive principal and interest when due narrowly, such that debtor-companies can do lots of nasty things to bondholders while still complying with the TIA.[21] For example, leaving the company with no assets whatsoever is perfectly fine, so long as the bondholder still has an (ephemeral) contractual right to receive interest and principal from that vacant corporate shell.[22]

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[16] David Javidzad, Note, *Indenture Trustees' Duties Under the Trust Indenture Act in the First, Second, and Third Circuits*, 29 S. CAL. INTERDISC. L.J. 369, 369 (2020) ("A trust indenture is a contract that corporations and governmental entities use to issue securities and borrow money from the general public or large institutional investors. . . . [T]rust indentures typically provide terms and conditions of extending credit, govern activities of security issuers while the securities are outstanding, set forth remedies for security holders in case of issuer default, and contain provisions defining the rights, duties, and obligations of the parties to the agreement." (footnote omitted)).

[17] *See* Cont'l Bank & Tr. Co. of N.Y. v. First Nat'l Petrol. Tr., 67 F. Supp. 859, 872 (D.R.I. 1946) ("The right of the indenture security holder . . . to his interest when due is absolute.").

[18] *See* Howard J. Kashner, *Majority Clauses and Non-Bankruptcy Corporate Reorganizations—Contractual and Statutory Alternatives*, 44 BUS. LAW. 123, 128 (1988) ("[O]utside of bankruptcy, the consent of a holder of public debt governed by such an indenture is always necessary to change the terms of payment of such holder's debt and, a fortiori, to more drastically impair such debt. For this reason, workouts for corporations with public debt either leave such debt intact or seek to deal with it through exchange offers to the debtholders.").

[19] *See* Jill E. Fisch & Caroline M. Gentile, *Vultures or Vanguards?: The Role of Litigation in Sovereign Debt Restructuring*, 53 EMORY L.J. 1043, 1090–91 (2004).

[20] *See* Hal S. Scott, *A Bankruptcy Procedure for Sovereign Debtors?*, 37 INT'L L. 103, 119 (2003).

[21] *See* John C. Coffee, Jr. & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 U. CHI. L. REV. 1207, 1212 (1991).

[22] *See* Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1 (2d Cir. 2017).

Even if the bond could be amended directly, an exchange offer is often desired from the issuer's perspective because it allows differing treatment of the assenters (who receive new securities) and the dissenters (who are left behind in the dissipated vestige of their old securities).

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Revlon embraced this second approach to tackling its financial problems.[23] Specifically, it launched an exchange offer for its $344.8 million of bonds due February 2021, offering for each $1,000 bond tendered either an all-cash option or a combination of cash plus new debt. But the second option was only available to institutional and foreign investors.[24]

American retail holders were only offered the cash option: $275 in cash, plus a $50 "early tender/consent fee" for those tendering before an early tender deadline. Institutional investors, on the other hand, could either take this cash offer or the other option: $250 cash if tendered by the early deadline,[25] plus $145 principal amount of one kind of secured loan, and $217.50 principal amount of another kind of secured loan, for a total of $612.50 for every $1,000 in notes, or .6125 cents on the dollar. Domestic retail bondholders, on the other hand, could at best get .325 cents on the dollar.[26]

As part of the exchange offer, Revlon solicited bondholder consent to eliminate "substantially all of the restrictive covenants and certain events of default" of the senior notes, and notice that the institutional investors were getting secured debt to replace the old unsecured bonds.[27] Retail bondholders were thus faced with the unhappy choice of accepting less return than their fellow bondholders or staying behind in a debt instrument that was stripped of all contractual protections and subordinated in the capital structure. And if these bondholders took too long to think about their options, their return was reduced by $50 per bond.

23 *See* Hersch, *supra* note 6. As this Article was about to be published, Revlon filed a chapter 11 petition: the exchange offer described herein was apparently insufficient to address Revlon's financial problems. *Cosmetics Maker Revlon Files for Bankruptcy in US*, BBC (June 17, 2022), https://www.bbc.com/news/business-61835796 [https://perma.cc/BYQ6-C287].

24 Hersch, *supra* note 6.

25 Two hundred dollars if tendered later. *Id.*

26 *See id.*

27 *Id.*

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Despite the aggressive nature of modern exchange offers, the bulk of academic scholarship argues that Section 316(b) should be repealed to allow for yet more innovation in exchange offers.[28] In the 1980s, citing the "explosive use of junk bonds" and the growth of institutional investors, Professor Mark Roe promoted repeal of Section 316(b).[29] More recently, Professors William Bratton and Adam Levitin, again citing the prevalence of institutional bondholders, have also argued that the prohibition on majority rule is no longer useful and should be repealed.[30] Indeed, the ability of institutional investors to "fend for themselves" has been surfaced as an argument against the prohibition, and the TIA more broadly, since even before the Act was passed by Congress.[31]

As a general matter, this literature argues that bondholders these days are sophisticated investors who can fend for themselves.[32] As such, the universe of workouts and exchange offers should be allowed to expand, thus allowing financially distressed companies a more fulsome way to avoid chapter 11, which is conversely seen as an expensive and dreadful fate to be avoided at all costs.

Against this backdrop, I examine the arguments against Section 316(b)—the prohibition on impairment, or the unanimous consent rule, as I sometimes refer to it—of the TIA. At heart, the argument, at least in

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28 *See* Carlos Berdejó, *Revisiting the Voting Prohibition in Bond Workouts*, 89 TUL. L. REV. 541, 544–45 (2015) ("This long-standing and anachronistic mandatory prohibition on CACs [collective action clauses, or majority vote provisions], which was enacted in the aftermath of the Great Depression, may be quite detrimental to the bond market because it effectively limits the ability of firms to restructure their public debt via workouts and exacerbates the costs of financial distress by unnecessarily forcing issuers into bankruptcy proceedings."); Robert A. Haugen & Lemma W. Senbet, *Bankruptcy and Agency Costs: Their Significance to the Theory of Optimal Capital Structure*, 23 J. FIN. & QUANTITATIVE ANALYSIS 27, 30 (1988).

29 Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 232, 234, 246–48 (1987) ("[T]he prohibition of bondholder votes provides little protection in today's heavily institutionalized bond market.").

30 William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597, 1640, 1646–50 (2018).

31 *E.g.*, Talcott M. Banks, Jr., *Indenture Securities and the Barkley Bill*, 48 YALE L.J. 533, 542 (1939) ("The institutional investor, with adequate research facilities and considerable powers of self-protection, has grown to be a factor of importance.").

32 SARAH PATERSON, CORPORATE REORGANIZATION LAW AND FORCES OF CHANGE 62 (2020) ("The participants in modern leveraged capital structures are sophisticated institutional investors who understand and bargain for the risk of leverage . . . ."); *cf.* Katz v. Oak Indus. Inc., 508 A.2d 873, 879 (Del. Ch. 1986) ("Arrangements among a corporation, the underwriters of its debt, trustees under its indentures and sometimes ultimate investors are typically thoroughly negotiated and massively documented. . . . The terms of the contractual relationship agreed to and not broad concepts such as fairness define the corporation's obligation to its bondholders.").

the more recent decades, has two parts: first, the prohibition thwarts non-bankruptcy debt restructurings, and second, the prohibition was designed to protect a type of bondholder—the "individual bondholder"—that no longer exists.[33] Or stated otherwise, the prohibition or unanimous consent rule is no longer needed, as it is a relic of the New Deal and thwarts useful transactions.

I question both legs of the argument. Namely, I doubt whether the TIA is actually thwarting any useful workouts, and I provide some basic empirical evidence to show that individual bondholders are still quite present in the financial markets. To be sure, the "average" American does not hold individual corporate bonds. But the mythical everywoman (everyman) did not hold individual bonds back in 1939 either.

Today, the standard bond quote from an online brokerage is for twenty-five bonds (or $25,000),[34] and since at least the 1890s, corporate bonds have most often traded in minimum increments of $1,000.[35] A $1,000 bond trade in 1921 would be the approximate equivalent of a $15,000 trade in 2021.[36]

Few "average" Americans, today or then, have that kind of money to invest, and even less have that kind of money to invest solely in a single company.[37] Referring to such investors as "mom and pop" is more than a bit misleading: they are clearly at least upper middle class, but that does

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33 Adam Levitin, *The Examiners: Recalibrate the TIA for Today's Debt Markets*, WALL ST. J. (Sept. 30, 2015, 12:11 PM), https://www.wsj.com/articles/BL-BANKB-21370 [https://perma.cc/B277-GAJU] ("The TIA was originally drafted for a world of ma-and-pa bondholders and portfolio lending by banks. That world is gone.").

34 Default, so the investor can often purchase more or less, subject to various minimums.

35 Corporate bonds (mostly railroad bonds) were routinely sold for $1,000 in the nineteenth century. During World War I, the government sold Liberty Bonds in smaller increments—just as government bonds had been sold in small increments during the Civil War. As a result of the Liberty Bonds' expansion of the pool of bond investors, there was a trend toward issuing bonds in $100 and $500 increments in years between the world wars, but bankers found that selling in small increments was not cost effective. THOMAS CONYNGTON, R.J. BENNETT & PAUL W. PINKERTON, CORPORATION PROCEDURE: LAW, FINANCE, ACCOUNTING 619–29 (1922); JAMES MACDONALD, A FREE NATION DEEP IN DEBT: THE FINANCIAL ROOTS OF DEMOCRACY 396–99 (2003); *see also* W.H. LYON, CAPITALIZATION: A BOOK ON CORPORATION FINANCE 178–79 (1912) ("The ordinary denomination of bonds is $1000. . . . When $500 and $100 denominations are issued at all, they form only part of the entire issue."). The Bureau of Labor Statistics (BLS) only publishes inflation figures going back to 1913, but as of April that year, $500 then would be worth more than $13,600 in 2021, and $100 would be worth about $2,725. *See CPI Inflation Calculator*, U.S. BUREAU OF LAB. STAT., https://www.bls.gov/data/inflation_calculator.htm [https://perma.cc/Q64W-ZSCD].

36 $14,474.15 to be precise, using March data for both years. *See CPI Inflation Calculator*, *supra* note 35.

37 *See* Elizabeth Pollman, *The Supreme Court and the Pro-Business Paradox*, 135 HARV. L. REV. 220, 262–63 (2021).

not mean that such investors are unworthy of protection in a clash with Wall Street titans.[38]

Moreover, through a simple empirical study, we can see that these bondholders are still present in the bond markets. TRACE, FINRA's over-the-counter price reporting service for the fixed income market, shows frequent trades of $100,000 or less. Institutional investors do not trade in such small increments, and the presence of such trades highlights the exaggerated nature of the casual claim that individuals do not buy bonds "anymore."[39]

And while I agree with Bratton and Levitin's observation that an increasingly large part of the bond market is geared toward investors other than domestic individuals—under Rule 144A[40] and Regulation S,[41] bonds are frequently sold to institutions and foreigners, respectively—I am reluctant to conclude that individual investors are not present in these markets.[42] In support of this point, I provide some data on trading in several distressed bonds below the $100,0000 threshold.[43]

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38 According to the Social Security Administration, the average annual wage in the United States in 2020 was $53,383, with the median wage at $34,612, which does not leave much room for $25,000 bond purchases. *See Measures of Central Tendency for Wage Data*, SSA, https://www.ssa.gov/oact/cola/central.html [https://perma.cc/A6S8-FWUK]. The archaic "widows and orphans" is no more helpful. *Cf.* Steven L. Schwarcz, *A Fundamental Inquiry into the Statutory Rulemaking Process of Private Legislatures*, 29 GA. L. REV. 909, 961 n.187 (1995).

39 Hendrik Bessembinder, Chester Spatt & Kumar Venkataraman, *A Survey of the Microstructure of Fixed-Income Markets*, 55 J. FIN. & QUANTITATIVE ANALYSIS 1, 15 (2020) (defining the retail corporate bond market as trades of $100,000 or less and reporting that "[r]etail-size trades . . . account for between 60% and 70% of reported customer transactions, but only 2% of customer trading volume").

40 Rule 144A is a safe harbor exemption from the registration requirements of Section 5 of the Securities Act of 1933 for resales of securities to qualified institutional buyers, who are commonly referred to as "QIBs." Bonds sold under an exemption to the 1933 Act—most often, the "private placement" exemption of Section 4(a)(2)—can be traded amongst institutional investors under Rule 144A. Transactions that are exempt from the 1933 Act are also exempt from compliance with the TIA. 15 U.S.C. § 77ddd. But sometimes these bonds will follow the requirements of the Act, unless it is expected that the bonds will be "144A for life." That is, following the TIA even when not required preserves the option to register under the 1933 Act at a later date. *See* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 468 (2017).

41 A securities offering made by an issuer outside of the United States (in reliance on Regulation S) need not be registered under the Securities Act. Both Rule 144A and Regulation S are discussed further. *See infra* pp. 121–22.

42 *But see* Ellen Carr, *Retail Investors Are Being Squeezed Out of the High-Yield Bond Market*, FIN. TIMES (Sept. 15, 2020), https://www.ft.com/content/5117f3d2-a342-4deb-a3c8-8f0a3d08f801 [https://perma.cc/MRQ8-QZ64].

43 *See infra* Section III.A. And trading data is, if anything, underinclusive, as it does not pick up the "buy and hold" investor who bought in good times and held the investment "all the way down."

On the question of exchange offers, and Section 316(b)'s alleged role in reducing the number of useful out-of-court workouts, I note that exchange offers are more common than ever.[44] Moreover, they are increasingly brutal in their treatment of retail bondholders, who in modern times are frequently excluded from offers, while the exchange offers subordinate their bonds and strip out every covenant that is not protected by Section 316(b). Why we would want to facilitate even more aggressive workouts, through repeal of the slender protection offered by the unanimous consent rule, is rather unclear.

To make the analysis here more concrete, I examine two recent exchange offers. First, Peabody Energy's offer, where domestic individual bondholders were excluded from participation, while their bonds were stripped of covenants and subordinated. And I also look at the Revlon 2020 exchange offer, which, as noted, offered public bondholders $250 in cash, while offering institutional investors $612.50 in cash and senior securities. Bondholders who balked at their treatment were again left behind in old bonds that were stripped of covenants, while the consenting institutional bondholders received new senior secured debt.

There is hardly any evidence here to suggest that many exchange offers are being thwarted. Moreover, I question the notion that there is a substantial cost differential between exchange offers and chapter 11.[45] While it is easy to see what chapter 11 costs, because all is revealed in open court—and plainly the numbers are substantial—nobody really knows what exchange offers cost.[46] The absence of data is too often taken as proof of exchange offer superiority on this front.[47]

Finally, even if there is a small subset of useful exchange offers that are blocked because of Section 316(b), these can easily be consummated through a prepackaged chapter 11 plan that avoids most of the perceived drawbacks of traditional chapter 11 cases. Indeed, short "24-hour"

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44 *See* source cited *infra* note 51 and accompanying text.

45 *Cf.* Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186, 1198 (7th Cir. 1989) ("It is not clear to us that bankruptcy proceedings are more costly than workouts.").

46 *See generally* Stephen J. Lubben, *The Costs of Corporate Bankruptcy: How Little We Know*, *in* RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 275 (Barry E. Adler ed., 2020). Exchange offers probably cost slightly less, as they do not involve preparation of the "court documents" associated with any form of chapter 11. But documentation of the underlying deal involves fundamentally the same work. And many of the bankruptcy filings are standardized, so it is not clear that this difference in cost is substantial. There is also an "apples to oranges" problem, inasmuch as exchange offers restructure specific debt instruments, while a chapter 11 case restructures the entire capital structure. *See id.*

47 That said, transparency (which is, in theory, abundant in chapter 11) is a cost from the debtor-firm's perspective, even if it is not recognized from a societal perspective, and thus may encourage the use of exchange offers despite the out-of-pocket cost.

prepacks have recently been used in several cases, which calls into question the notion that any meaningful number of truly beneficial restructurings are being thwarted by the Act or Section 316 in particular.[48] Indeed, it seems just as likely that the unanimous consent rule mostly thwarts attempts to redistribute value from outsiders to insiders, broadly defined to include those creditors who negotiate the deal with the debtor-firm.

The key sorts of workouts that are barred by the unanimous consent rule are exactly those that no creditor would ever agree to ex ante. Consider, for example, a workout agreement whereby a majority voted to allow the issuer to redeem the bonds for €0.01 per €1,000.[49] Why would a majority agree to such a thing? And even if they did so, should that approval be given any respect? Certainly, the bondholder might just be stubborn, holding out for better treatment than they really deserve, but if the group of "holdouts" exceeds more than a trivial amount, it becomes equally plausible that it is the majority vote that is suspect.[50] The likelihood of collusion between the issuer-debtor and a majority of friendly bondholders is simply too plausible to ignore in these circumstances.

It is this last point that undergirds the basic conclusion of this Article, that Section 316(b)—the unanimous consent rule—is, if anything, too narrow in its scope. But arguing that the unanimous consent rule is presently too narrow is a far cry from suggesting it should be repealed. Instead, I argue that Section 316(b) should remain as the foundation from which other needed policy reforms can grow. I conclude by arguing that several basic rights that are available to equity holders in tender offers should be extended to debt holders as well, to protect small

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48 *See* Andrew Scurria, *Department Store Chain Belk Seeks Chapter 11 for Speedy Restructuring*, WALL ST. J. (Feb. 23, 2021, 8:42 PM), https://www.wsj.com/articles/department-store-chain-belk-seeks-chapter-11-for-speedy-restructuring-11614130933 [https://perma.cc/H457-STUJ] ("Department store chain Belk Inc. filed for bankruptcy protection on Tuesday, commencing an ultra-quick timetable intended to lift the Sycamore Partners-owned company out of chapter 11 within around 24 hours.").

49 *See* Assénagon Asset Mgmt. S.A. v. Irish Bank Resol. Corp. [2012] EWHC 2090 (Ch). The case involved an exchange offer that presented bondholders with the choice between swapping into new debt, with an 80% reduction in principal (a rather extreme "haircut") or having the debt exchanged for a token amount of cash—€0.01 per €1,000 in principal amount. The second prong was facilitated by exit consents given by the bondholders who agreed to the swap in the first prong. For the definition of exit consents, see *infra* text accompanying note 116. The issuer was a bank that had been nationalized by the Irish government during the 2008 financial crisis. The English court concluded that it was not lawful for the majority to facilitate the coercion of a minority by voting for a resolution that expropriated the minority's rights under their bonds for nominal consideration. Note that the second prong of such an exchange offer would undoubtedly violate Section 316(b) of the TIA as it exists today. *See infra* text accompanying note 263.

50 *See* Stephen J. Lubben, *Holdout Panic*, 96 AM. BANKR. L.J. 1 (2022).

bondholders from the increasing coercive nature of modern exchange offers.

This Article has four parts. Part I sketches the available tools for restructuring a distressed company and the legal rules that govern each. Namely, such a firm might file a chapter 11 petition or conduct an exchange offer. The latter is governed by the TIA, including Section 316(b), but the debtor-firm can use exit consents, unequal treatment, and threats of subordination to muscle the exchange through.

Part II then reviews the literature surrounding the TIA, and Section 316(b) in particular. Starting with Professor Roe and covering every major article through Bratton and Levitin, this Part traces the more than thirty-year criticism of the unanimous consent rule. The one notable exception is the late Professor Victor Brudney, who argues not only for the retention of Section 316(b), but also an enhanced duty of good faith amongst bondholders and debtors. Professor Brudney suggests that workouts by troubled companies disadvantage individual bondholders and result in inappropriate sharing of gains of avoiding bankruptcy by debtors and bondholders. This Article is very much in sympathy with the Brudney position.

Part III critiques the academic literature, both quantitatively and qualitatively. Starting with the observation that the small individual bondholder was never the "average" American, I demonstrate that the disappearance of such bondholders has been greatly oversold. Next, the question turns to whether the unanimous consent rule prevents useful workouts, and thus forces overly expensive chapter 11 cases. As noted above, I challenge both aspects of this argument: workouts remain plentiful, and the costs of chapter 11 relative to workouts are likely exaggerated. This Part wraps up by noting the aggressive nature of modern exchange offers, and the continuing need for the protections of Section 316(b).

Part IV develops the idea of Section 316(b) as a floor, from which SEC rulemaking can further develop to animate the spirt of the TIA. In particular, by adapting key concepts from equity tender offers—like the "best price" and "all holders" rules—exchange offers can be made more equitable. In addition, I propose a novel two-step technique to address the central problem with exit consents, when bondholders agree to delete terms of bonds moments before they cease to own those bonds.

Because exit consents are currently given by those who will not experience the consequences of their consent, I propose to change that in a way that will result in more considered consent. Namely, through a two-stage process, I expose tendering bondholders to some chance that their bonds will not be accepted in the tender, and thus they will have to live with the bond as modified by the exit consents.

Ultimately, I conclude that the continued existence of Section 316(b), combined with reforms to address the extremes of modern exchange offers, represent sound policy for a world where retail bondholders are still very much in the market.

I. RESTRUCTURING TOOLS

If a large company is worth saving, American law provides two primary mechanisms for restructuring its debt, each of which are outlined below. One obvious method is under chapter 11 of the Bankruptcy Code, a path which itself could involve a variety of sub-techniques that are also noted. Alternatively, the distressed firm might instead attempt to "workout" its problems with creditors. Most often the mechanism that implements the workout will be an exchange offer.

According to data from Moody's, between 1987 and 2008, about 74% of the total corporate defaults resulted in bankruptcies, while only 16% of defaults were resolved by exchange offers.[51] The mix of restructuring tools has substantially changed in recent years: between 2009 and 2017, about half of corporate defaults triggered bankruptcies while more than 40% were addressed by exchange offers.[52]

According to Moody's, the factors driving the increased use of exchange offers

> include the significant presence of private equity (PE) sponsors as owners of high-yield companies; cost-effectiveness when compared with in-court restructurings that involve many more lawyers and advisers; continued weakening of corporate debt covenants; better overall recovery prospects when compared to bankruptcies; and the incentives for senior bank lenders, who are often in a better position after distressed exchanges are consummated.[53]

As discussed more fully below, all of these factors—with the possible exception of the cost issue—turn on the ability of an exchange offer to restructure particular classes within the capital structure, while chapter 11 typically sweeps more broadly: traditional chapter 11 cases will address the entire capital structure, and even prepacks (discussed below) will at least cover bond debt and equity.[54]

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[51] *The Changing Face of Defaults—Distressed Exchanges and Re-Defaults*, MOODY'S INVS. SERV., Mar. 7, 2018 [hereinafter MOODY'S 2018] (on file with author).

[52] *Id.*

[53] *Id.*

[54] *See* Andrew B. Dawson, *Better Than Bankruptcy?*, 69 RUTGERS U. L. REV. 137, 182 (2016) ("When a large corporation files bankruptcy, it may be expected to impose serious losses on

According to Standard & Poor's (S&P), the "average time spent in bankruptcy for companies that exited before 2020 was over eight months."[55] As will be discussed below, exchange offers, particularly exchange offers conducted under the "private placement" exception to the 1933 Act, can be conducted in about a month.

This means that exchange offers can wrap up much quicker than traditional bankruptcy processes, although as also discussed below, prepacked bankruptcy cases are quite similar to exchange offers in terms of duration.[56] In addition, S&P has noted that exchange offers may offer something of a pretend solution to financial distress:

> Although the appeal of an out-of-court restructuring has increased the number of selective defaults, recidivism is an issue for many of those entities. This raises questions around the efficacy of their out-of-court restructurings.
>
> Based on our data on defaults . . . 208 U.S. and Canadian companies experienced a selective default since 2013. Of these 208 entities, 76 entities (37%) experienced another default either by way of another out-of-court restructuring . . . or a general default or bankruptcy . . . . The odds of these companies experiencing a third default was 22%.[57]

A. *Chapter 11*

A chapter 11 case of any form takes place in federal bankruptcy court under the supervision of a bankruptcy judge. While the Bankruptcy Code is heavily focused on "deal making," the drafters recognized that the traditional corporate law checks on abuse in such deals—shareholder voting and director fiduciary duties—were not apt to operate well in insolvency, where everyone's incentives and interests are scrambled.[58]

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unsecured and non-adjusting creditors: a corporation may have significant tort liabilities, environmental liabilities, and tax liabilities; a corporate bankruptcy may also impose significant losses on communities, which may have invested heavily in the way of local tax credits.").

55 *Default, Transition, and Recovery: Out-of-Court Restructurings May Lead to Repeat Defaults Among Distressed U.S. and Canadian Corporates*, S&P GLOB.: RATINGS (May 11, 2021, 7:06 PM) [hereinafter S&P GLOB. RATINGS], https://www.spglobal.com/ratings/en/research/articles/210511-default-transition-and-recovery-out-of-court-restructurings-may-lead-to-repeat-defaults-among-distressed-u-11939647 [https://perma.cc/K9CE-YWRZ].

56 While a twenty-eight-day notice period is ordinarily required in advance of plan confirmation hearings, *see* FED. R. BANKR. P. 2002(b), 3017(a) & (d), that period can be shortened "for cause" under FED. R. BANKR. P. 9006(c).

57 S&P GLOB. RATINGS, *supra* note 55.

58 *See* Chrystin Ondersma, *Shadow Banking and Financial Distress: The Treatment of "Money-Claims" in Bankruptcy*, 2013 COLUM. BUS. L. REV. 79, 106 (2013) ("Bankruptcy was designed to combat a collective action problem not entirely dissimilar from the run-on-the-bank problem:

Thus, while the debtor can conduct "ordinary course" operations without court oversight, non-ordinary activity is subject to judicial review—although typically under a deferential "business judgment" standard.[59]

Although bankruptcy cases tend to draw upon Delaware corporate law to explain this business judgment standard, it is important to note that bankruptcy arises in a somewhat different context.[60] In bankruptcy, the court is engaged in an ex ante evaluation based on whether the debtor's proposal is substantively reasonable. In Delaware corporate law, the court conducts an ex post evaluation that is based on whether there was adequate process and the merits of the decision are irrelevant. That is, bankruptcy's business judgment test is substantive, while Delaware's is procedural.[61]

As such, it may be that the Delaware case law does not fully translate to the bankruptcy context. But bankruptcy courts and commentators have largely left this point unexplored.[62]

* * *

When drafted in 1978, chapter 11 was primarily designed to foster a negotiation process, after which a reorganization plan would be voted on by creditors and approved (or "confirmed") by the court.[63] But the 1978 Code also included two other provisions that have since provided popular tools when used in conjunction with "normal" chapter 11.

Prepacks have a long, if interrupted, history. Section 77B, enacted in 1934 as the first generally applicable federal corporate reorganization statute, contained a provision for what we would today call a prepackaged reorganization plan: "the plan may be accepted not only before the hearing as to its fairness, but even before the institution of proceedings under Section 77B."[64]

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when a firm faces financial distress, creditors rush to seize cash and collateral from a company, resulting in assets being sold at fire-sale prices, and ultimately, resulting in low returns for creditors overall."); Lindsey Simon, *Chapter 11 Shapeshifters*, 68 ADMIN. L. REV. 233, 236–37 (2016).

59 *See* 11 U.S.C. §§ 363(b), 1101(1), 1107; 3 COLLIER ON BANKRUPTCY ¶ 363.02[4] (Richard Levin & Henry J. Sommer eds., 16th ed. 2020).

60 *See In re* Innkeepers USA Tr., 442 B.R. 227, 231 (Bankr. S.D.N.Y. 2010); 3 COLLIER ON BANKRUPTCY ¶ 363.02[4].

61 *See* Stephen J. Lubben & Alana Darnell, *Delaware's Duty of Care*, 31 DEL. J. CORP. L. 589, 629 (2006).

62 *See, e.g.*, *In re* Latam Airlines Grp. S.A., 620 B.R. 722, 767–70 (Bankr. S.D.N.Y. 2020).

63 David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366, 378 (2020).

64 Joseph L. Weiner, *Corporate Reorganization: Section 77B of the Bankruptcy Act*, 34 COLUM. L. REV. 1173, 1184 (1934). The author notes that the provision was based on the *National Radiator* case, where a form of "prepack" was attempted in a receivership, only to be quashed by the Supreme

The New Dealers did away with "prepacks" for large corporate enterprises in 1938, but they were kept alive in small business cases, and forty years later they came back again with the enactment of the 1978 Code. Section 1125(g) of the Bankruptcy Code provides that "an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law."[65]

By soliciting votes under non-bankruptcy law, in advance of the case being filed, the time actually spent under the oversight of the bankruptcy judge can be greatly reduced.

In recent years, "24-hour" prepacks have become frequent.[66] These one-day cases typically involve restructurings of only the debtor-firm's syndicated loan.[67] More germane for present purposes might be the recent prepackaged case of HighPoint Resources Corporation, which filed a prepack to swap $625 million in unsecured bonds for an equity stake in the reorganized debtor.[68] The HighPoint offer was initially structured as an exchange offer, but when the offer did not receive sufficient support, the debtor proceeded with the same basic deal as a prepack.[69] The case was filed on March 14, 2021, and the plan was

Court (after the enactment of Section 77B), which "used rather unflattering language concerning the plan and its protagonists." *Id.* at 1184–85.

65 11 U.S.C. § 1125(g); *see also id.* § 1126(b) ("[A] holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan . . . .").

66 *See* Daniel Gill, *Federal Watchdog Wants to Put Brakes on High-Speed Bankruptcies*, BLOOMBERG L. (Apr. 5, 2021, 6:01 AM), https://news.bloomberglaw.com/bankruptcy-law/federal-watchdog-wants-to-put-brakes-on-high-speed-bankruptcies [https://perma.cc/9EF9-KFQB].

67 *See A One-Day Ch. 11 Turnaround? Belk Shows It Can Be Done*, KIRKLAND & ELLIS (Mar. 2, 2021), https://www.kirkland.com/news/in-the-news/2021/03/a-one-day-ch-11-turnaround-belk-shows-it-can-be-do [https://perma.cc/KG3X-MHCC]; *see also* Elisabeth de Fontenay, *Do the Securities Laws Matter? The Rise of the Leveraged Loan Market*, 39 J. CORP. L. 725, 747 (2014) ("Notwithstanding their functional convergence with public bonds, corporate loans that are syndicated and traded continue to be treated as non-securities under U.S. law, thereby avoiding all disclosure requirements thereunder.").

68 *See* Peg Brickley, *HighPoint Resources Files for Bankruptcy Ahead of Proposed Merger with Bonanza Creek*, WALL ST. J. (Mar. 15, 2021, 12:59 PM), https://www.wsj.com/articles/highpoint-resources-files-for-bankruptcy-ahead-of-proposed-merger-with-bonanza-creek-11615827585 [https://perma.cc/P4PX-WE22].

69 *HighPoint Resources Commences Voluntary Chapter 11 Proceedings with Votes from More Than 99% of Voting Stakeholders to Accept the Prepackaged Plan*, GLOBENEWSWIRE (Mar. 14, 2021, 10:16 PM), https://www.globenewswire.com/news-release/2021/03/15/2192432/0/en/HighPoint-Resources-Commences-Voluntary-Chapter-11-Proceedings-with-Votes-from-More-Than-99-of-Voting-Stakeholders-to-Accept-the-Prepackaged-Plan.html [https://perma.cc/PMJ5-CJSR].

confirmed on March 18, 2021.[70] Keeping in mind that there is a solicitation process that happens pre-bankruptcy—covered by the same securities laws that are discussed with regard to exchange offers below[71]—modern prepacks thus have about the same duration as exchange offers, while offering the ability to bind all creditors to the deal.[72]

Another way to reduce the disputes that need to be solved within the chapter 11 process is to quickly convert the debtor into a pile of cash.[73] In a 363 sale approach to chapter 11—named after Section 363 of the Code, which authorizes such sales—the debtor sells most of its assets in the early days, thus leaving the plan process to dole out the money.[74] Complex and contentious questions of valuation—both of the debtor and of any securities given under the plan—are avoided, and the operating assets move through the bankruptcy process with considerable speed.[75] The operating company can then proclaim it is "out of bankruptcy," even if "it" remains in chapter 11 as a matter of corporate law.[76]

Voting on plans—whether prepackaged or traditional—are subject to the Code's special two-part voting rule,[77] which overrides both contractual terms and the provisions of the TIA.[78] As will be noted below, exchange offers often have a high vote threshold—80% or more is quite

70 *HighPoint Resources Announces Prepackaged Plan Confirmed by Court*, GLOBENEWSWIRE (Mar. 18, 2021, 5:46 PM), https://www.globenewswire.com/news-release/2021/03/18/2195862/0/en/HighPoint-Resources-Announces-Prepackaged-Plan-Confirmed-By-Court.html [https://perma.cc/9VT5-NMMA].

71 *See infra* Section I.B.

72 And to eliminate existing equity, something that is not possible under state corporate or contract law.

73 *See* Stephen J. Lubben, *No Big Deal: The GM and Chrysler Cases in Context*, 83 AM. BANKR. L.J. 531, 533–36 (2009).

74 *See* Andrew B. Dawson, *Selling Out*, 41 CARDOZO L. REV. 2521, 2533–34 (2020). Doing so can evade important distributional debates that are normally addressed as part of the plan process. *See* Stephanie Ben-Ishai & Stephen J. Lubben, *Sales or Plans: A Comparative Account of the "New" Corporate Reorganization*, 56 MCGILL L.J. 591, 621–22 (2011) (asserting that the risks associated with manipulating the bankruptcy process are now "more extreme in the United States because courts will now allow a section 363 sale to replace a plan in almost every case").

75 *See* Stephanie Ben-Ishai & Stephen J. Lubben, *Involuntary Creditors and Corporate Bankruptcy*, 45 U.B.C. L. REV. 253, 255–56 (2012).

76 All of which illustrates the general abstraction of talking about a firm as a person when assets can easily jump from one corporate box to another.

77 11 U.S.C. § 1126(c) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . .").

78 *See* Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 728–29 (2019); *see also* Thomas S. Green, Comment, *An Analysis of the Advantages of Non-Market Based Approaches for Determining Chapter 11 Cramdown Rates: A Legal and Financial Perspective*, 46 SETON HALL L. REV. 1151, 1156 n.24 (2016).

common. This is driven by a variety of factors, including the debtor's need for financial relief, senior lenders who are unwilling to see substantial payments continue to holdout bondholders, and exchanging bondholders who may require high minimum participation conditions to avoid holdouts from remaining in a senior position (e.g., by retaining bonds that mature earlier than the new debt offered in the exchange).[79] By offering the same basic deal in the form of a prepack, debtor-firms can bind everyone to the exchange, while only needing to obtain support of more than two-thirds in amount of the bonds.[80]

Bondholders and other creditors have no direct vote on a 363 sale itself, although they get to vote on the later plan that distributes the sale proceeds.[81] At the point of the sale, bondholders' primary avenue for "voice" is through the hearings to approve the sale process and then the sale itself. Bondholders can object to the sale process and the sale at those hearings, but the sale will be evaluated using the bankruptcy business judgment standard, meaning that it will be approved if it is mostly reasonable.

More generally, and in contrast to the exchange offers discussed below, any of the chapter 11 approaches will happen in federal court. As such, these procedures will involve some degree of transparency, and thus potential unwanted scrutiny for managers and controlling stakeholders. Nevertheless, when evaluating complaints that exchange offers are made too difficult by the TIA, it bears remembering that prepacks and other chapter 11 tools remain as an alternative.

B. *Workouts and Exchange Offers*

A financially distressed company may attempt to "workout" its problems outside of bankruptcy.[82] In theory, this could take the form of

79 *See* Oscar Couwenberg & Abe de Jong, *It Takes Two to Tango: An Empirical Tale of Distressed Firms and Assisting Banks*, 26 INT'L REV. L. & ECON. 429, 435 (2006) ("[F]irms face a trade-off in choosing between a private restructuring and a formal reorganization, i.e. cost savings associated with a private restructuring, mainly by preventing a destruction of going-concern firm value versus the costs associated with creditors holding out on a restructuring proposal.").

80 There are some additional substantive requirements for prepacks as compared to exchange offers, but many jurisdictions relax the normal chapter 11 requirements for prepackaged cases. *E.g.*, U.S. Bankr. Ct. S.D.N.Y. Local Rule 3018-2: Procedural Guidelines for Prepackaged Chapter 11 Cases.

81 *See* Skeel, *supra* note 63, at 376.

82 An exchange offer only addresses financial creditors and leaves trade creditors and other non-investors untouched. *See* Danielle D'Onfro, *Limited Liability Property*, 39 CARDOZO L. REV. 1365, 1382 (2018) ("Unsecured debt includes not only commercial unsecured debt . . . but also all

a deal to repurchase the outstanding bonds for less than par, but normally a distressed company is short on cash and, in addition, senior credit agreements ("bank loans") typically limit or prohibit repurchases of junior unsecured debt. As a result, often the only viable option outside of bankruptcy for most distressed bond issuers is an exchange offer.

As the name suggests, an exchange offer is an offer to bondholders to swap existing bonds for something new, with the goal of resolving the debtor's financial problems.[83] Thus, bonds might be exchanged for stock or new debt that matures long in the future.

Exchange offers are used because the TIA, and Section 316(b) in particular, blocks direct amendment of the more relevant terms of the bond.[84] That is, the firm in financial distress most often wants to extend the maturity date, reduce the coupon, or even "haircut" bondholders' principal. As discussed in more detail below, these are the precise changes that Section 316(b) prohibits.

Exchanges of public securities are governed by various regulations under the 1933 Securities Act, the 1934 Exchange Act, and the Trust Indenture Act of 1939.[85] Later, this Article will examine the 1934 Act, but here it makes sense to discuss the 1933 Act and the TIA as relevant to exchange offers.

1. The 1933 Act

Because exchange offers, particularly in the context of financial distress, typically involve a debtor-firm issuing new securities (in exchange for the old), those securities are potentially subject to the registration requirements of the 1933 Act.[86] In a registered debt exchange

unfilled contractual obligations and potential judgment creditors."); *cf.* Brook E. Gotberg, *Relational Preferences in Chapter 11 Proceedings*, 71 OKLA. L. REV. 1013, 1026 (2019).

[83] Section I.B draws upon Chapter 2 of STEPHEN J. LUBBEN, THE LAW OF FAILURE: A TOUR THROUGH THE WILDS OF AMERICAN BUSINESS INSOLVENCY LAW (2018).

[84] *See* William W. Bratton, *Bond Covenants and Creditor Protection: Economics and Law, Theory and Practice, Substance and Process*, 7 EUR. BUS. ORG. L. REV. 39, 78–79 (2006) ("A composition can be effected by indirection. Instead of being asked to vote on an amendment of their bond contracts, the bondholders are asked to exchange their bonds for substitute bonds that contain modified terms more favorable to the borrower.").

[85] *See* Hilary J. Allen, *Financial Stability Regulation as Indirect Investor/Consumer Protection Regulation: Implications for Regulatory Mandates and Structure*, 90 TUL. L. REV. 1113, 1116 (2016).

[86] The Securities Act of 1933 requires all offers and sales of securities in the United States to be made under an effective registration statement or an explicit exemption from registration. 1 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 1:17 (2022). Any issuer with at least $10 million in assets and a class of equity securities held by the requisite number of record holders or with an outstanding class of securities listed on a U.S. national securities exchange

offer, an issuer must file a registration statement on Form S-4.[87] Such an exchange offer cannot proceed until the registration statement is declared effective by the SEC. Due to the delay and cost associated with this process, registered exchange offers are rare, especially in the distressed context.

More common is to proceed under one of two exemptions to the 1933 Act. Section 3(a)(9) of the Securities Act provides a security-based exemption for "any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange."[88] If the old bonds were publicly tradable, the new bonds will be as well, a point of contrast with the Section 4(a)(2) offers discussed below.

Notably, this exemption is from the 1933 Act only—any new indenture created as part of the exchange offer will be subject to the qualification requirements of the TIA.[89] Note also that a Section 3(a)(9) offer only works when the corporate entity is the same for both the old and new instruments,[90] and, as the text of the statute indicates, there are limits on payments that can be made in connection with the exchange.[91]

If the debtor-issuer prefers not to comply with the obligations of Section 3(a)(9), an exchange offer could be structured as a private offer

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must also register those securities under the Securities Exchange Act of 1934 and file annual and other reports with the SEC. 2 *id.* § 9:3. Securities registered under the Exchange Act are then subject to the SEC's rules on ownership reporting and tender offers. *Id.* And issuers may also be subject to the SEC's rules on shareholder voting and corporate governance. *Id.* § 9:59.

87 1 A.A. SOMMER, JR., FEDERAL SECURITIES ACT OF 1933 § 7.06 (2021); *see also* Felicia Smith, *Applicability of the Securities Act of 1993 and the Trust Indenture Act of 1939 to Consent Solicitations to Amend Trust Indentures*, 35 HOW. L.J. 343, 348 (1992).

88 15 U.S.C. § 77c(a)(9).

89 Qualification under the TIA is accomplished by filing a Form T-3 with the SEC, which is subject to review by the SEC staff. Unless an indenture for a debt security is qualified under Section 305 of the TIA, which covers registered offerings, or is exempt from qualification under Section 304 (which does not include an exemption for Section 3(a)(9) exchange offers), the sale of a debt security in an exchange offer would violate Section 306 of the TIA. *See infra* note 96 and accompanying text.

90 This rule is a function of the text of the statute, which refers to any security "exchanged by the issuer exclusively with its existing security holders." 1 HAZEN, *supra* note 86, § 4:23. An inability to add additional obligors to the new bonds—as a way of making the new bonds more attractive and discouraging holders remaining in the old bonds—makes the Section 3(a)(9) exchange offer less desirable.

91 In short, the debtor's investment bankers can be paid flat fees, but not "success fees" in connection with a Section 3(a)(9) offer. *See* Compliance and Disclosure Interpretations, Question 125.06, SEC (Apr. 24, 2009). The Seaman no-action letter permits attendance at and participation in meetings with bondholders before the formation of a bondholders committee by a debtor-issuer's financial advisor when the financial advisor's activities are meant to "effect" rather than "promote" an exchange offer. Seaman Furniture Company, Inc., SEC No-Action Letter, 1989 WL 246436 (Oct. 10, 1989).

under Section 4(a)(2).[92] Such an issuer needs to determine that a particular bondholder is a sophisticated investor before making an offer to that holder to avoid a "general solicitation" of investors that could make the offer a public offering and subject to registration. That is, under the securities laws, soliciting sophisticated investors—qualified institutional buyers (QIBs) (within the meaning of Rule 144A under the Securities Act) and accredited investors (within the meaning of Regulation D under the Securities Act)[93]—does not constitute solicitation of the public at large. In addition, in a private placement exchange offer, while the offer of new debt securities is not subject to registration with or review by the SEC, the new securities issued will be "restricted securities" and therefore subject to resale restrictions.

2. The TIA and Section 316(b)

The 1934 Exchange Act instructed the newly formed SEC to conduct a study of corporate restructuring, which until 1933 had been conducted as equity receiverships, largely filed in federal court.[94] As a result of that study—overseen by future Supreme Court Justice William O. Douglas—Congress substantially revised the federal corporate bankruptcy laws in 1938, and then enacted the Trust Indenture Act in 1939.[95] Under the TIA, bonds, unless the subject of an exemption, must be registered under the 1933 Act and be issued under an indenture that meets the requirements of the TIA and that has been qualified with the SEC.[96]

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[92] *See* Ford Lacy & David M. Dolan, *Legal Aspects of Public Debt Restructurings: Exchange Offers, Consent Solicitations and Tender Offers*, 4 DEPAUL BUS. L.J. 49, 51–55 (1991) (contrasting Section 3(a)(9) with Section 4(2)—which later became Section 4(a)(2)).

[93] Although accredited investors might include many retail bondholders—they include people with an annual income exceeding $200,000 ($300,000 for joint income)—in recent years, most exchange offers have been limited to institutional investors who qualify under Rule 144A, or foreign investors under Regulation S. Both are discussed *infra* pp. 121–22.

[94] *See* Stephen J. Lubben, *Fairness and Flexibility: Understanding Corporate Bankruptcy's Arc*, 23 U. PA. J. BUS. L. 132, 161 (2020).

[95] Robert G. Miller, *The Trust Indenture Act of 1939*, 25 CORNELL L.Q. 105, 106 (1939); *accord* Cloyd Laporte, *Changes in Corporate Reorganization Procedure Proposed by the Chandler and Lea Bills*, 51 HARV. L. REV. 672, 674 (1938) ("A third bill, introduced by Senator Barkley, titled the 'Trust Indenture Act of 1937', is a part of the same general plan of legislation." (footnote omitted)); *see also* Percival E. Jackson, *The New Deal Philosophy in Corporate Reorganization*, 4 CORP. REORGANIZATIONS 3 (1937) (discussing the Chandler Bill, which was enacted in 1938 to reform corporate bankruptcy, together with the Barkley Bill, the predecessor of the TIA).

[96] *Overview and Scope—Trust Indenture Act of 1939*, *in* 14 FLETCHER CYC. CORP. § 6828 (2021).

Bond indentures have long been negotiated between the issuer-debtor and the underwriters of those bonds.[97] As a result, bondholders themselves have little input on the terms, save for the indirect influence larger bondholders might have on underwriters.[98] Moreover, most investors, especially retail investors, will rarely see the full indenture before investing in a bond: today, online brokers do not provide them, and the investor has to look for the indenture themselves on the SEC webpage. In prior days, finding the indenture was even more difficult.

It was to address this situation that Congress enacted the TIA. As one leading securities regulation text summarizes:

> The Trust Indenture Act of 1939 was enacted to protect "the national public interest and the interest of investors." The necessity for federal legislation became apparent after years of judicial conflict over the duties of trustees to bondholders and the lack of financial protection afforded even secured bondholders in the chaos that followed the 1929 stock market crash. Exculpatory clauses were included in most indentures and rendered bondholders impotent to hold trustees liable even in those instances in which the trustee's acts or omissions directly resulted in an injury.[99]

"In effect, the TIA would be the investor's silent representative during the drafting of the indenture."[100] As amended in 1990, the TIA perhaps retreats more than a bit from that lofty standard, particularly inasmuch as the statute now permits indenture trustees to operate under conflicts of interest pre-default.[101] Of course, indenture trustees were likely never "trustees" in the true sense of the word, despite what the New

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[97] *See* ROBERT I. LANDAU & ROMANO I. PELUSO, CORPORATE TRUST: ADMINISTRATION AND MANAGEMENT 43–47 (7th ed. 2015).

[98] Brudney, *supra* note 5, at 1829–30 ("The process by which the initial bond contract is negotiated, or the bond itself bought, is not likely to elicit from dispersed individual or institutional investors the informed consent to the bonds' terms—particularly its more arcane protective provisions—that is given by a sole lender." (footnote omitted)); *see also* Royce de R. Barondes, *An Economic Analysis of the Potential for Coercion in Consent Solicitations for Bonds*, 63 FORDHAM L. REV. 749 (1994).

[99] 6 HAZEN, *supra* note 86, § 19:2 (footnotes omitted).

[100] Frederica R. Obrzut, *The Trust Indenture Act of 1939: The Corporate Trustee as Creditor*, 24 UCLA L. REV. 131, 135 (1976).

[101] *See* Trust Indenture Reform Act of 1990, Pub. L. No. 101-550, 104 Stat. 2713. For an overview, see Michael Vincent Campbell, *Implications of the Trust Indenture Reform Act of 1990 Breathing New Life into the Trust Indenture Act of 1939*, 11 ANN. REV. BANKING L. 181, 202–08 (1992). Despite the 1990 update, the statute nevertheless retains its original 1930s era sexism, providing that post-default, the trustee must "use the same degree of care and skill . . . as a prudent man would exercise or use under the circumstances in the conduct of his own affairs." 15 U.S.C. § 77ooo(c).

Dealers may have intended.[102] Nonetheless, the statute provides the baseline for all indentures, including those that are not strictly subject to the TIA.[103]

Most relevant for present purposes, Section 316(b) of the Trust Indenture Act requires that all holders consent to any change in timing or amount of interest and principal payments.[104] Section 316(b) was targeted at reorganizations where insiders, or those affiliated with insiders, would agree to amendments that served their other, non-bondholder, interests.[105] That is, Section 316(b) is as much about bondholders doing wrong by their fellow bondholders as it is about the debtor-creditor relationship.[106]

As one commentator observed less than a decade after enactment of the TIA:

102 *Accord* Elliott Assocs. v. J. Henry Schroder Bank & Tr. Co., 838 F.2d 66, 70 (2d Cir. 1988); *see* Meckel v. Cont'l Res. Co., 758 F.2d 811, 816 (2d Cir. 1985) ("An indenture trustee is not subject to the ordinary trustee's duty of undivided loyalty. Unlike the ordinary trustee, who has historic common-law duties imposed beyond those in the trust agreement, an indenture trustee is more like a stakeholder whose duties and obligations are exclusively defined by the terms of the indenture . . . ."). *But see* LNC Invs. v. First Fid. Bank, Nat'l Ass'n, 935 F. Supp. 1333, 1347 (S.D.N.Y. 1996) (holding that "the TIA does not abrogate an indenture trustee's common-law fiduciary duty of loyalty").

103 *See* James Gadsden, *Annotated Trust Indenture Act*, 67 BUS. LAW. 977, 982–83 (2012) ("Despite the changes in the debt markets and the limitations on the direct application of the TIA, its terms are broadly important since they also are adopted in the drafting of indentures that are not subject to the TIA.").

104 *See* Mark B. Richards, *The Republic of Congo's Debt Restructuring: Are Sovereign Creditors Getting Their Voice Back?*, 73 LAW & CONTEMP. PROBS. 273, 291–92 (2010); Richard A. Stark, *The Trust Indenture Act of 1939 in the Proposed Federal Securities Code*, 32 VAND. L. REV. 527, 540 (1979).

105 *See* William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in a Time of Restructuring*, 1989 DUKE L.J. 92, 116 (1989) ("Antimanagerialists charged that managers and investment bankers dominated workouts and reorganizations, recapitalizing companies at the expense of small bondholders. The Trust Indenture Act responded by mandating that debt contracts governing publicly issued bonds include certain procedural protections, most notably a prohibition against less-than-unanimous waivers of important contract rights." (footnote omitted)); Miller, *supra* note 95, at 116 (arguing that Section 316(b) offers "[i]ncreased protection for minority holders").

106 George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431, 433 (2006).

> [C]ases involving use of majority clauses have disclosed instances where, in securing the vote of security holders, misinformation was supplied or was furnished by biased sources, where votes were cast by those whose interests were adverse to the class being balloted, and where supposedly unbiased fiduciaries participated in the voting and, inadvertently or otherwise, acquired a position adverse to their cestuis, the bondholders.[107]

The legislative record is replete with comments indicating that Congress hoped to force most restructurings into the daylight through federal bankruptcy proceedings.[108] On the other hand, certain comments by then-SEC Commissioner Douglas to the effect that Section 316(b) would not hinder consensual changes to other parts of the indenture allowed the Second Circuit to find that the TIA protected only the specific contractual terms that provide for payment of interest and repayment of principal.[109] Changes to any other aspect of the deal, even if it had the practical effect of making such payments improbable, are fair game in federal court—or at least in the Second Circuit.

But the New York Court of Appeals has conversely held that a foreclosure by the trustee, on behalf of a majority of bondholders, did not override the dissenting noteholder's right to payment or suit. The court based its ruling on the "unanimous consent" provision of the indenture before it, which tracked, as in most indentures, Section 316(b) of the TIA.[110]

The court noted that while the Second Circuit had dealt with a case where the ability to collect still formally existed—even if it was in practice destroyed—in the case before the New York state courts, the trustee and

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107 De Forest Billyou, *Corporate Mortgage Bonds and Majority Clauses*, 57 YALE L.J. 595, 603 (1948) (footnotes omitted). As one Canadian commentator has noted, "Although the US Trust Indenture Act of 1939 prohibited the use of majority provisions [i.e., CACs], these provisions were not used extensively in the United States before then." TORRIE, *supra* note 9, at 8 (emphasis omitted).

108 *See* H.R. REP. NO. 76-1016, at 56 (1939); S. REP. NO. 76-248, at 26–27 (1939); *see also* William W. Bratton & G. Mitu Gulati, *Sovereign Debt Reform and the Best Interest of Creditors*, 57 VAND. L. REV. 1, 53 n.182 (2004) (pointing out that the purpose of Section 316(b) was to discourage out-of-court agreements without judicial supervision); Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE W. RSRV. L. REV. 319, 394 (2013).

109 *See* Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1 (2d Cir. 2017).

110 The clause provided that:

> Notwithstanding any other provision of this Indenture, the right of any Holder to receive payment of principal . . . and interest . . . on a Note . . . or to bring suit for the enforcement of any such payment . . . shall not be impaired or affected without the consent of such Holder.

CNH Diversified Opportunities Master Acct., L.P. v. Cleveland Unlimited, Inc., 160 N.E.3d 667, 668 (N.Y. 2020).

majority bondholders were arguing that the foreclosure ended bondholders' ability to collect further.[111]

There are, of course, countless ways to impair a bondholder's practical ability to be repaid without eliminating its legal right to repayment, so the New York Court of Appeals decision may be easily evaded in future years, especially if that court is unwilling to go further with its analysis.[112]

But bondholders can always reject an exchange offer, and if enough reject, the offer will fail. "Because the distressed bonds continue to be valid contracts until surrendered, holdouts can sue for full payment, upending an issuer's prime motivation for an exchange."[113] For those who are certain that exchange offers are obviously better than chapter 11, holdouts present a serious problem, and indeed much of the academic literature addressed in the following discussion proceeds from that starting point.[114] The reasons for bondholder rejection of an exchange offer are many:

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111 *Id.* at 678.

112 There is an interesting judicial dynamic at play here, given that the Second Circuit presumably provides authoritative interpretations of federal statutes (e.g., the TIA), while most bond indentures contain provisions that track the language of Section 316(b) and are written under New York law, where the Court of Appeals has the last word. *See* Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 355 (2007) ("[N]early all bond indentures and underwriting contracts designate New York law as the governing law.").

113 Keegan S. Drake, Note, *The Fall and Rise of the Exit Consent*, 63 DUKE L.J. 1589, 1591 (2014) (footnotes omitted).

114 *See* Bryant B. Edwards, Jeffrey A. Herbst & Selina K. Hewitt, *Mandatory Class Action Lawsuits as a Restructuring Technique*, 19 PEPP. L. REV. 875, 886 (1992) ("Exchange offers . . . suffer a serious defect. A bondholder who can successfully 'hold out' of an exchange offer by a troubled issuer often stands to reap a windfall at the expense of bondholders who tender in the exchange. The successful holdout, who has made no financial concessions, retains a bond with original payment terms whose prospects for payment, even after the loss or modification of financial covenants, may have improved because of the financial concessions made by bondholders who exchange. The exchange offer, in effect, results in a transfer of value from exchanging to nonexchanging bondholders.").

> Bondholders may believe that the tender price is too low, and therefore wait for a higher price. Creditors may recognize the exchange as merely opportunistic, and therefore, decide to take their chances at normal debt payments, expecting that the company will improve or successfully refinance earlier maturing outstanding debt. However, in today's environment, a creditor may very well believe that it has better chances of receiving superior value via a bankruptcy or reorganization than it would by accepting the [distressed debt exchange (DDE)]. This is particularly true for certain unsuccessful exchanges when investors likely believe that the proposed DDEs are delaying the inevitable, and that it would be better for the company to file sooner rather than drain value through an exchange that does not alter the [debtor's cashflow] profile.[115]

A variety of techniques can be used to inspire participation in the exchange and reduce the number of holdouts. For example, bondholders are often asked to consent to the repeal of all covenants that can be changed by majority rule—typically, this consent is given just before the bondholder swaps into a new security, and as a result, commentators term these "exit consents."[116] Any provision in the indenture that is not the subject of Section 316(b) could potentially be removed by majority vote, leaving the old indenture a shell of its former self.[117] Note that the bondholders who consent upon exiting will not face the consequences of their consent.[118]

Other exchange offers fund an offer for unsecured bonds by means of a secured bank loan or other secured debt.[119] As a result, bondholders who refuse to tender will be subordinated in the capital structure. A similar effect can be obtained by providing new debt that is guaranteed

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115 *Unsuccessful Distressed Debt Exchanges May Lead to Bankruptcy*, FITCHRATINGS (Sept. 28, 2020, 12:00 PM), https://www.fitchratings.com/research/corporate-finance/unsuccessful-distressed-debt-exchanges-may-lead-to-bankruptcy-28-09-2020 [https://perma.cc/Y9JD-6TVZ].

116 Nicholas P. Saggese, Gregg A. Noel & Michael E. Mohr, *A Practitioner's Guide to Exchange Offers and Consent Solicitations*, 24 LOY. L.A. L. REV. 527, 588–89 (1991); *see, e.g.*, Schallitz v. Starrett Corp., 82 N.Y.S.2d 89, 91 (Sup. Ct. 1948).

117 Richard L. Epling, *Are Rule 23 Class Actions a Viable Alternative to the Bankruptcy Code?*, 23 SETON HALL L. REV. 1555, 1555 n.3 (1993).

118 *See* Lee C. Buchheit & G. Mitu Gulati, *Exit Consents in Sovereign Bond Exchanges*, 48 UCLA L. REV. 59, 66 (2000); *see also* Andrew Laurance Bab, Note, *Debt Tender Offer Techniques and the Problem of Coercion*, 91 COLUM. L. REV. 846, 852 (1991) ("Because the issuer may not vote any securities it owns, the indenture can be amended only if the issuer obtains the requisite consents from bondholders immediately before they tender." (footnote omitted)).

119 Many modern syndicated loans have "accordion provisions," which allow the debtor to issue new loans under the existing loan agreement. *Consideration in Using Incremental Facilities to Finance Acquisitions*, DAVIS POLK (Sept. 6, 2019), https://www.davispolk.com/sites/default/files/2019-09-06_considerations_in_using_incremental_facilities_to_finance_acquisitions.pdf [https://perma.cc/487W-L4HV].

by the operating subsidiaries in a corporate group, when the old debt is a mere obligation of the holding company and thus structurally subordinated.[120]

Either the exit consents or subordination approach attempt to make remaining in the old debt instrument uncomfortable. And the two are frequently used simultaneously to increase the discomfort.

Modern exchange offers also offer a variety of side payments to induce—or perchance buy—the consent of bondholders.[121] Consent fees mean that those who tender quickly get paid more, while the debtor-issuer will often pay the legal and other professional expenses of large bondholders who negotiate the deal as part of an "ad hoc" committee. Likewise, unequal treatment of bondholders, particularly as between institutional and individual holders, is quite possible in this context, even though the securities laws would prohibit the same unequal treatment of shareholders.[122]

All of these techniques—exit consents, subordination, and side payments—can make an exchange offer coercive.[123] As the court noted in *Assénagon*:

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120 That is, because the holding company is just a shareholder of the operating companies, creditors of the holding company are subordinate to creditors of the operating companies by virtue of the corporate structure. *See* Saule T. Omarova, *The "Too Big to Fail" Problem*, 103 MINN. L. REV. 2495, 2510 (2019); *cf.* Ilya Beylin, *Designing Regulation for Mobile Financial Markets*, 10 U.C. IRVINE L. REV. 497, 541 (2020).

121 *See* Charles T. Haag & Zachary A. Keller, *Honored in the Breach: Issues in the Regulation of Tender Offers for Debt Securities*, 9 N.Y.U. J.L. & BUS. 199, 246 (2012) ("In this situation, the issuer is both changing the tender offer price on the early tender deadline and paying different security holders different prices in the tender offer.").

122 17 C.F.R. § 240.14d-10 (2019) provides:

> (a) No bidder shall make a tender offer unless:
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> (1) The tender offer is open to all security holders of the class of securities subject to the tender offer; and
>
> (2) The consideration paid to any security holder for securities tendered in the tender offer is the highest consideration paid to any other security holder for securities tendered in the tender offer.

123 Bab, *supra* note 118, at 853 ("On their face, these techniques—particularly the exit consent solicitation—appear to be coercive, in that they effectively deprive bondholders of their capacity to choose between reasonable alternatives. The holder's choice is reduced to that of tendering at a substantial discount to face value, or holding out and being left with a security of potentially minimal value."). As explained in the related context of restructuring support agreements—contracts to bind creditors to a proposed reorganization plan, which also might offer side payments in exchange for early acceptance:

> [E]ven a creditor who does not support the plan is compelled to do so in order to obtain a "full" recovery. If the creditor believes that most creditors will not be bothered to raise objections to the structure, then they too will not risk a fruitless objection that will cost

> The exit consent is, quite simply, a coercive threat which the issuer invites the majority to levy against the minority, nothing more or less. Its only function is the intimidation of a potential minority, based upon the fear of any individual member of the class that, by rejecting the exchange . . . , he (or it) will be left out in the cold.[124]

That is, exit consents and other coercive tools can encourage a bondholder to accept an offer that the holder does not believe is optimal, and even to accept an offer that might not be in the interest of bondholders in general.[125] A lack of bondholder coordination leaves bondholders guessing about their compatriots' intentions, and perhaps leads them to accept an offer they would rather reject. A time limited side payment—often tied to early acceptance of the deal—means that the bondholder has to make a quick decision, further limiting the chances for coordination, if she wants to maximize her recovery in the exchange.[126]

Of course, a bondholder that really wants to hold out can do so. This potentially leaves the debtor company with an annoying "stub" of old debt outstanding, in addition to whatever new securities are issued as part of the exchange offer. Most exchange offers require participation of at least 90% of bondholders.[127] And in some cases, the offer is neither attractive enough, nor punitive enough, to get a sufficient mass of bondholders to participate.

On the other hand, even when exchange offers succeed, they often fail to address the firm's financial distress. The aforementioned 2018 Moody's study found that between 2010 and 2017, a period of relatively light defaults, ninety-two firms experienced financial distress after having

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> some part of their recovery. Through a kind of prisoner's dilemma, it becomes possible to stampede creditors into supporting a plan that many oppose.
>
> The presence of this coercion also makes it difficult to rely on the voting mechanism to signal "good" reorganization plans. In many cases the plan might be supported by sizeable majorities of creditors, but if such support is the price of obtaining a full recovery in the case, courts will receive an unreliable signal about creditors' true sentiments.

Oscar Couwenberg & Stephen J. Lubben, *Private Benefits Without Control? Modern Chapter 11 and the Market for Corporate Control*, 13 BROOK. J. CORP., FIN. & COM. L. 145, 166 (2018) (footnote omitted).

124 Assénagon Asset Mgmt. S.A. v. Irish Bank Resol. Corp. [2012] EWHC 2090 (Ch).

125 *See* Bratton, *supra* note 84, at 80 ("In a real world case where . . . bondholders accept [senior debt in exchange for the old bonds], the [new] security soaks up most of the value of the firm, pushing the value of the holdout bonds well below [the value before or without the exchange]. Absent coordination, the bondholders may be forced to take the bad deal. Note that here the holdout possibility arguably benefits the group as whole.").

126 *See* 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. DEVS. J. 255, 261 (2021).

127 Lacy & Dolan, *supra* note 92, at 58.

previously addressed financial distress at some point since 1987.[128] Of those ninety-two firms, 73% had previously used an exchange offer.

Moreover, in a study of recent energy bankruptcy cases, Moody's found that the worst outcome for bondholders, measured by recoveries, was to not participate in an exchange offer and then hold on to their bonds all the way through the subsequent (second round) bankruptcy process. Moody's advises that bondholders are often best served by a "take the money and run" approach to exchange offers, which further encourages acceptance of substandard offers.[129]

But as will be discussed in Part III, in modern exchange offers, individual bondholders often have no choice but to hold out, as the exchange offer is not even open to them.[130] As a result, modern exchange offers will often disproportionately harm retail bondholders.

II. ACADEMIC UNDERSTANDINGS OF SECTION 316(B)

Professor Roe's 1987 article, noted in the Introduction, was in the vanguard of a literature that largely developed in the early 1990s, when the bill for the prior decade's discovery of junk bonds came due.[131] Roe's article starts with the basic points that undergird this literature generally: workouts are less costly than chapter 11, but holding out makes sense in a workout, and the TIA thwarts the obvious solution to the holdout problem, namely restructuring by majority vote.[132] Roe also surfaces the major debtor countermoves—namely, subordination of the holdouts and use of exit consents to strip bonds of their covenants—but doubts whether they will really work.[133]

After reviewing the reasons why the TIA and Section 316(b) were enacted in 1939, Roe then goes on to argue that "the prohibition's raison d'etre is now gone," because since 1978, the Bankruptcy Code has only required judges to evaluate a reorganization plan's fairness in limited contexts.[134] Namely, while the New Dealers had wanted to prohibit

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128 MOODY'S 2018, *supra* note 51, at 4.

129 *Id.* at 6.

130 *See* Bratton & Levitin, *supra* note 30, at 1641 ("Once the offer goes forward, any mom-and-pop bondholders will not even receive it. They are, in effect, written off as statutory holdouts." (emphasis omitted)).

131 *See* Roe, *supra* note 29, at 232 ("In a future economic recession, some issuers of junk bonds will be forced to seek financial reorganization, similarly, some issuers of investment grade bonds will experience severe reverses and also seek reorganization.").

132 *See id.* at 235–46.

133 *See id.* at 246–48.

134 *Id.* at 255.

private deals in favor of court oversight, court oversight is now greatly reduced, and when combined with the growth of institutional bondholders, Roe concludes that "the voting prohibition is ill-suited to protect bondholders in the 1980's."[135] Bondholders should instead be protected by a loose standard prohibiting fraud and distortion in bond recapitalizations. Importantly for our later discussion, Roe's proposal would only allow majority voting in situations without exit consents or side payments.[136] This last point was often lost on subsequent commentators—especially practitioners—who embraced repeal of Section 316(b) without engaging with the whole of Roe's proposal.

While the BLS concluded that the early 1990s recession lasted just eight months—from July 1990 to March 1991—conditions improved quite slowly afterwards, with unemployment nearing 8% as late as June 1992.[137] As a result, it is perhaps foreseeable that 1991 saw a windfall of articles on the interplay of exchange offers and the TIA.

Many of these were of the aforementioned practitioner sort, addressing key points of practice as the number of exchange offers ramped up.[138] The authors noted the increasing use of exit consents to overcome the problem of Section 316(b)'s prohibition, with one author explaining that "covenant stripping lets the exchange offer proponent do indirectly what it could not do directly: eliminate the control which bondholders may exercise over the company's financial decision-making and business affairs."[139]

In general, the practitioners, as noted above, favored amendment or outright repeal of the section.[140] The main academic contributions at this time were a 1991 article by Professors Coffee and Klein,[141] and a 1992 article by Professor Brudney which many—including most recently Bratton and Levitin—have interpreted as a rejoinder to Roe.[142] Coffee and

135 *Id.* at 258.

136 *See id.* at 270–72.

137 Thomas Nardone, Diane Herz, Earl Mellor & Steven Hipple, *1992: Job Market in the Doldrums*, U.S. BUREAU OF LAB. STATS., MONTHLY LAB. REV. (Feb. 1993), https://www.bls.gov/opub/mlr/1993/02/art1full.pdf [https://perma.cc/336T-NZH2].

138 Kashner, *supra* note 18, like Roe on the academic side, was ahead of the curve here. But key articles in this milieu include Bryant B. Edwards & Jon J. Bancone, *Modifying Debt Securities: The Search for the Elusive "New Security" Doctrine*, 47 BUS. LAW. 571 (1992); Richard L. Epling, *Exchange Offers, Defaults, and Insolvency: A Short Primer*, 8 BANKR. DEVS. J. 15 (1991); Lacy & Dolan, *supra* note 92; and Saggese, Noel & Mohr, *supra* note 116. *See also* Note, *Distress-Contingent Convertible Bonds: A Proposed Solution to the Excess Debt Problem*, 104 HARV. L. REV. 1857 (1991); Bab, *supra* note 118, at 879–81.

139 Epling, *supra* note 138, at 33.

140 *See id.* at 41.

141 Coffee & Klein, *supra* note 21.

142 Brudney, *supra* note 5; *see* Bratton & Levitin, *supra* note 30, at 1625.

Klein built upon a 1990 *New York Law Journal* article by Professor Coffee, in which he argued that a "combined consent solicitation and tender offer is a technique for maximizing coercive pressure."[143] In the law review article, the authors observe that in an exchange offer, a "bondholder must fear both the issuer's threats and its fellow bondholders' opportunism."[144] In particular, they argue that the debtor may proffer an exchange offer to save shareholders, who might be eliminated in a bankruptcy, and the growth of distressed debt investors—which they term "vulture funds"—raises the risk of holdouts within the bondholder class. Thus, it is impossible to know if exit consents and other coercive devices are being used in service of good coercion (to thwart holdouts) or bad coercion (to facilitate equity appropriation).

To overcome this dilemma, the authors argue that exchange offers should proceed in two stages. First, the bondholders should vote on changes to the indenture, and only if those passed should they proceed to decide whether or not to take the offered exchange.[145] Bondholders who vote against the "exit consents" could vote to accept the deal consideration in light of their knowledge that the indenture would be amended. Coffee and Klein suggest that either this form of exchange offer, or a prepackaged bankruptcy, should be the only permitted forms for workouts short of full-blown chapter 11 cases.[146]

They also argue that two Williams Act rules that still today only apply to equity should be expanded to pick up debt tenders offers as well.[147] In particular, they argue that Rule 10b-13 (since redesignated as Rule 14e-5)[148]—which prohibits "side deals" during a pending equity tender offer—should protect bondholders,[149] and likewise they argue that consent fees should be prohibited by expansion of the Act's "best price" rule.[150] As the authors explain:

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143 John C. Coffee, Jr., *Coercive Debt Tender Offers*, N.Y.L.J., July 19, 1990, at 17.

144 Coffee & Klein, *supra* note 21, at 1216.

145 *Id.* at 1243–44.

146 *See id.* at 1243.

147 Coffee & Klein, *supra* note 21, at 1267. The Williams Act is a 1968 amendment to the Securities Exchange Act of 1934 to address the specific issue of tender offers and related takeover issues. The Williams Act added Sections 13(d) and 13(e) (codified at 15 U.S.C. § 78m(d), (e)) and Sections 14(d) and 14(e) (codified at 15 U.S.C. § 78n(d), (e)) to the 1934 Act.

148 17 C.F.R. § 240.14e-5 (2019).

149 Coffee & Klein, *supra* note 21, at 1267. The authors see this rule as protecting the "best price" rule under the Williams Act § 14(d)(7). *See infra* note 285.

150 Coffee & Klein, *supra* note 21, at 1269; *see* 17 C.F.R. § 14d-10(a)(2) (2019).

> Essentially, a bondholder that votes against the proposed indenture amendment receives a lesser total payment for its bonds than does a bondholder that receives the consent fee. When otherwise identical securities receive different prices in the same tender or exchange offer, the "best price" rule should be seen as violated.[151]

Professor Brudney then offers the rare defense of the individual bondholder. Specifically, Professor Brudney begins by comparing the plight of bondholders to a hypothetical single lender, noting that bondholders can be encouraged, with "bribes or threats," to accept a deal that a single lender never would.[152] He also notes that, like side payments and exit consents, subordination of old bondholders to those who agree to the exchange "produces a similar effect."[153] And while he concedes that institutional bondholders could band together, he argues their position is still substantially worse than a sole lender, and thus regulation is justified.[154]

As an initial matter, Professor Brudney urges greater judicial examination of exchange offers: "Difficulties encountered in determining the fairness of a transaction do not justify judicial myopia in examining the coercive or distorting impact on the choices thrust on dispersed debtholders by the strategic behavior of common stockholders."[155]

The key aim of such judicial review is consideration of whether the bondholders had given "informed and undistorted" consent.[156] He recognizes that Coffee and Klein move in a helpful direction, yet he deems it inadequate, inasmuch as the bondholder is still presented with a take-it-or-leave-it offer.[157]

Ultimately, he argues that Section 316(b) must be retained, in addition to judicial consideration of the fairness of a transaction.[158] While he acknowledges that the TIA facilitates holdouts,

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151 Coffee & Klein, *supra* note 21, at 1269.

152 Brudney, *supra* note 5, at 1822.

153 *Id.* at 1834.

154 *Id.* at 1835.

155 *Id.* at 1848.

156 *Id.* at 1849, 1852.

157 *Id.* at 1853–54.

158 *Id.* at 1877 ("To limit the impact of structural tilt in the absence of cohesive bargaining by indisputably loyal bondholders' representatives necessitates the preservation of the bondholders' holdout possibilities embodied in the Trust Indenture Act and an overriding cap of 'fairness' on any adjustment bargain."). Notably, Brudney does not argue for a fiduciary duty to bondholders, but rather an enhanced conception of contractual good faith. *Id.* at 1836–45; *see also* Eileen A. Scallen, *Promises Broken vs. Promises Betrayed: Metaphor, Analogy, and the New Fiduciary Principle*, 1993 U. ILL. L. REV. 897, 953 (1993).

> an institutional bias in favor of bondholders is an appropriately heavy weight on the scales which measure whether it is preferable to risk the limited number of bankruptcies that could be avoided by eliminating a hold-out rule than to add a significant uncertainty to the initial cost of *all* debt by eliminating the buoying-up effect of allowing holdouts.[159]

In short, Professor Brudney offers one of the few modern defenses of Section 316(b), a point I will circle back to at the conclusion of this Part.

Another relevant entry, often overlooked in this literature, comes from Royce de R. Barondes, then a practitioner but since an academic, who presents an argument that in some sense anticipated the analysis the English High Court utilized in *Assénagon*.[160] Namely, he suggests that agreeing to exit consents in advance of an exchange offer effectively puts the bonds in question under the issuer's control, since the issuer then knows the bonds will, in all probability, be exchanged as well, and thus the bonds should not "count" for voting purposes.[161] Barondes ultimately argues that large bondholders should be publicly identified—as with shareholders under the Williams Act—and the voting patterns of those bondholders in exchange offers should also be disclosed.[162]

The literature on exchange offers then continued to develop over the next decade, without necessarily directly engaging with the role played by

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159 Brudney, *supra* note 5, at 1863 (footnote omitted).

160 *See* Assénagon Asset Mgmt. S.A. v. Irish Bank Resol. Corp. [2012] EWHC 2090 (Ch); *see also* 15 U.S.C. § 77ppp (TIA § 316(a)) ("For the purposes of this subsection and paragraph (3) of subsection (d) of section 77ooo of this title, in determining whether the holders of the required principal amount of indenture securities have concurred in any such direction or consent, indenture securities owned by any obligor upon the indenture securities, or by any person directly or indirectly controlling or controlled by or under direct or indirect common control with any such obligor, shall be disregarded, except that for the purposes of determining whether the indenture trustee shall be protected in relying on any such direction or consent, only indenture securities which such trustee knows are so owned shall be so disregarded."). Most indentures also prohibit voting by the issuer more generally.

161 Barondes, *supra* note 98, at 760–62. Notably, Chancellor Allen gave this argument little time in *Katz v. Oak Industries Inc.*, 508 A.2d 873, 881 (Del. Ch. 1986). *Katz* remains the leading American case on exchange offers and exit consents. The prominence of the opinion is somewhat mystifying, as it is not even clear that *Katz* was opining on Delaware law—the vast majority of domestic bond indentures are governed by New York law. *See* Drake, *supra* note 113, at 1593 ("As a Delaware case, *Katz* has merely persuasive authority under New York law. To the extent that *Assénagon* was more persuasive and English law remains ascendant in the realm of finance, the question then arises whether this apparent transatlantic split might actually presage a new unanimity in which *Assénagon* becomes the seminal case on exit consents." (footnotes omitted)).

162 Barondes, *supra* note 98, at 787.

Section 316(b) of the TIA.[163] Nipping on the periphery of this issue, Alan Schwartz suggested that corporations' inability to waive their right to file bankruptcy was a bigger issue than the TIA,[164] while Marcel Kahan, in an article whose title seemed to suggest Section 316(b) would loom large, instead mainly ducked the issue by noting that most indentures include Section 316(b)-style provisions even when they are not subject to the TIA.[165] After the turn of the century, there was a further resurgence of interest in the literature, largely driven by a spate of international and sovereign bond restructurings that raised the question of whether Section 316(b), and unanimous consent requirements more generally, should play any important role in those contexts.[166]

The literature seemed to have run its course as the new century progressed, when two New York district court opinions suddenly reanimated the discourse.[167] The opinions in question ruled that aggressive exchange offers could "impair" the rights protected under Section 316(b), even without directly altering those rights themselves. In one case, the issuer paid off one group of bondholders to "stick it" to another. And in the other case, the debtor essentially conducted an old-fashioned equity receivership, where a collusive mortgage foreclosure was used to leave dissenters with claims against an assetless shell. As one district court judge wrote, a quote which was later used by the second judge, it would be "unsatisfying [to hold] that Section 316(b) protects only against formal, explicit modification of the legal right to receive payment, and allows a sufficiently clever issuer to gut the Act's protections through a transaction such as the one at issue here."[168] The Second Circuit, on the other hand, had no such worries, and restored the

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[163] *See, e.g.*, Richard E. Mendales, *We Can Work It Out: The Interaction of Bankruptcy and Securities Regulation in the Workout Context*, 46 RUTGERS L. REV. 1211 (1994).

[164] *See* Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595, 599 (1993).

[165] *See* Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 608 (1995).

[166] This literature begins with Buchheit & Gulati, *supra* note 118, and includes Shuster, *supra* note 106, as well as Berdejó, *supra* note 28. *See also* Marcel Kahan, *The Relationship Between Individual Rights and Bond Prices: A Comment on* Pricing Collective Action Clauses, 100 B.U. L. REV. 341, 348 (2020).

[167] *See* MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Ent. Corp., 80 F. Supp. 3d 507 (S.D.N.Y. 2015); Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592 (S.D.N.Y. 2014). The cases, and the *Marblegate* appeal, are well summarized in Marcel Kahan, *The Scope of Section 316(b) After* Marblegate, 13 CAP. MKTS. L.J. 136 (2018).

[168] *Marblegate Asset Mgmt.*, 75 F. Supp. 3d at 613; *see also MeehanCombs Glob. Credit Opportunities Funds*, 80 F. Supp. 3d at 515.

TIA to its previous state, holding that Section 316(b) "prohibits only non-consensual amendments to an indenture's core payment terms."[169]

The Second Circuit's opinion was consistent with a slightly earlier district court opinion, in which the court dismissed a complaint alleging that a debt-for-debt exchange offered only to institutional investors and non-U.S. persons violated Section 316(b).[170] According to the court, "Section 316(b) sprang from concerns about majorities abusing minority holders, which did not occur here."[171]

This flurry of judicial activity resulted in a corresponding flurry of academic writing on exchange offers and Section 316(b). These new authors again largely adopted the traditional view that "Congress should repeal § 316(b)."[172]

The most conspicuous example of this second wave literature is the Bratton and Levitin article.[173] Noting that exchange offers have become common post-Lehman, the authors also note that "[c]oercive tactics figure more prominently than ever in the new workouts."[174] The authors make three basic claims: first, that exchange offers succeed far more than the first wave of commentators thought; second, that Section 316(b) does not do much in modern finance; and third, that "bond workouts are more coercive than previously thought in some respects, but also less coercive in others."[175] Based on these three points, the authors argue that Section 316(b) should be repealed and replaced with an intra-creditor fiduciary duty, the roots of which they purport to find in the pre-TIA case law.[176]

Bratton and Levitin argue that exchange offers are more successful now because they are more coercive. They note that more than 80% of all

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169 Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1, 3 (2d Cir. 2017); *see also* Kahan, *supra* note 167, at 140 ("The Second Circuit opinion represents a return to certainty and to literalism.").

170 *See* Waxman v. Cliffs Nat. Res. Inc., 222 F. Supp. 3d 281 (S.D.N.Y. 2016).

171 *Id.* at 291.

172 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, 1241 (2016); *see also* Harald Halbhuber, *Debt Restructurings and the Trust Indenture Act*, 25 AM. BANKR. INST. L. REV. 1 (2017) (arguing for a narrow reading of Section 316(b)); Kirby M. Smith, *Entire Fairness in the Trust Indenture Act*, 85 GEO. WASH. L. REV. ARGUENDO 58 (2017) (arguing for an "entire fairness" standard of review of out-of-court restructurings, in place of the prohibition of Section 316(b)).

173 *See* Bratton & Levitin, *supra* note 30.

174 *Id.* at 1601.

175 *Id.* at 1602.

176 *Id.* at 1603. Although the authors primarily draw on historical cases as the basis for their new fiduciary duty, presumably this duty might also resemble the English approach to majority creditors exemplified by the decision in *Assénagon*, where the court held it was unlawful for the majority bondholders to further the coercion of the minority by voting for a resolution which would destroy the minority's economic rights under their bonds. *See supra* note 49.

recent exchange offers involve exit consents,[177] and more than half involve subordination of old bondholders.[178] Many offers also involve selectively made side payments in exchange for tenders—the authors note that about half of exchange offers involve special treatment for consenters, but they also note the widespread use of restructuring support agreements (RSAs) in connection with bankruptcy restructurings.[179] Others have noted that RSAs can be a way of offering opaque side benefits to parties that sign on to chapter 11 plans, thus suggesting that side payments are foreseeable in bankruptcy too.[180]

Bratton and Levitin also suggest that fewer Americans own bonds today than in 1939 when the TIA was enacted, although they only provide post-war data on bond ownership.[181] More generally, they note the increasing use of Rule 144A by debt issuers—that is, debt that is never registered for public sale—and argue that exchange offers today are more apt to be conducted under Section 4(a)(2) as private placements (and thus limited to institutional investors) instead of Section 3(a)(9), which provides a general exemption for exchanges with existing bondholders, regardless of their sophistication.[182] Moreover, they note the extensive literature on secured creditor control in chapter 11, and thus argue that exchange offers might appeal to unsecured bondholders, given the bondholders' comparative weakness in modern chapter 11.[183] Citing several older studies, they additionally argue that exchange offers also involve lesser direct costs as compared with chapter 11.[184]

In short, they see a world in which the original aims of Section 316(b)—the protection of individual bondholders—is no longer significant, and in which exchange offers are doing good work. As such, they argue for repeal of Section 316(b), although, as noted, they would couple repeal with adoption of a fiduciary duty to fellow bondholders.[185]

These claims are evaluated as part of a broader critique of the literature in Part III of this Article.

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177 Bratton & Levitin, *supra* note 30, at 1638–39.

178 *Id.* at 1639.

179 *Id.*

180 Couwenberg & Lubben, *supra* note 123, at 166; *see also* Skeel, *supra* note 63; Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion—A Response to Skeel*, 130 YALE L.J.F. 335, 346–47 (2020).

181 Bratton & Levitin, *supra* note 30, at 1640. As noted below, data on prewar individual bondholding is quite sparse.

182 *See id.* at 1641–42.

183 *See id.* at 1642–43.

184 *See id.* at 1632.

185 It is unclear in their article how this would work mechanically: the authors suggest a court-created duty, drawing on older case law, which obviously would be difficult for Congress to mandate as part of repeal. *Id.* at 1598, 1665–73.

III. DEFENDING SECTION 316(B) AND THE UNANIMOUS CONSENT RULE

As noted in Part II, much of the scholarship calling for repeal of Section 316(b) rests on the arguments that individual bondholders have left the field, while exchange offers are inherently preferable to chapter 11 cases. That is, bondholders in need of protection are no longer present, so why not make it easier to conduct a helpful exchange offer? In this Part, I question both aspects of this argument.

A. *Individual Bondholders*

Given the growth of mutual funds and other pooled investments, there is little doubt that the percentage of American corporate bonds owned by individuals directly has declined since the 1929 crash, although there is generally a lack of data covering this entire period.[186] We might also worry that the prevalence of individuals invested in high-yield (and thus high-risk) debt is today actually much higher than earlier but obscured by intermediaries like those mutual funds. On the other hand, the bond investor of today, in whatever form, is perhaps more diversified than her counterpart in 1939, inasmuch as a single $1,000 bond today represents less of a commitment to a single debtor-company than the same investment in 1939.[187]

* * *

Individual investors grew as a percentage of the overall population between 1900 and the start of World War I, and during those years some investments were sold on an installment basis to increase participation.[188] In the 1920s, there was a general perception that individual investors flooded the market, in part based on individual investors' experience buying Liberty Bonds during the war.[189] Nevertheless, even in the equity markets, where there is better data, there is some suggestion that

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186 The Federal Reserve data on individual corporate bondholding, which I cite in the upcoming chart, only covers the post-war period.

187 One thousand dollars in 1939 being the equivalent of more than eighteen thousand dollars in 2021. *CPI Inflation Calculator*, *supra* note 35.

188 VINCENT P. CAROSSO, INVESTMENT BANKING IN AMERICA 85, 103–04 (1970).

189 As in the Spanish-American War and the Civil War before it, during World War I, government bonds were sold in smaller increments to encourage purchasing from individual investors. *See* KENNETH D. GARBADE, BIRTH OF A MARKET 41–44, 64–67 (2012).

individuals who invested directly in the markets were a limited part of the population—just as not all women were flappers in the 1920s, those who speculated in stocks and bonds might have been a narrow but noticeable group of Americans.[190]

Moreover, in the debt markets, there are indications that the smallest investors were heavily concentrated in foreign bonds, which were heavily marketed to depositors by banks, and real estate debt.[191] Both suffered extreme losses after the crash, but neither was the main subject of the Trust Indenture Act, which applies to domestic corporate debt.[192] In short, it is unclear how many individuals actually owned corporate bonds in the decade before the crash, and what portion of that group continued to own such bonds well into the Depression.

But if we can draw inferences from the degree of corporate bondholding by financial institutions, it appears that there were not big changes in the market structure between 1920 and 1945.[193] For example, financial institutions (mostly banks and life insurance companies) held about 30% of the outstanding corporate bonds in 1920, and that position was largely stable (give or take a few percent) through the end of World War II.[194]

Immediately after the war, corporate bonds offered returns that paled in comparison with those provided by government savings bonds (for the risk averse individuals) and equities (for the risk seeking).[195] As a result, individuals largely left the corporate bond market for other investments, most of which were not options for institutional investors

190 *See* CAROSSO, *supra* note 188, at 249–50 (noting that "[n]o accurate figures are available for the number of persons owning securities"); *see also* ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 59–60 (rev. ed. 1968) ("[I]n 1929, 73.7 per cent of corporate dividends were received by six hundred thousand persons (597,003) reporting taxable income of $5,000 or more."). Berle and Means ultimately estimate that there were between 4 and 7 million share owners in 1929—quite the range!—when the total population was about 122 million. *Id.* Five thousand dollars in 1929 is about seventy-six thousand dollars in 2021, while the median income in 2020 (the most recent year available) was just over thirty-four thousand dollars. *CPI Inflation Calculator*, *supra* note 35; *Measures of Central Tendency for Wage Data*, *supra* note 38.

191 *See* ARTHUR E. WILMARTH, JR., TAMING THE MEGABANKS: WHY WE NEED A NEW GLASS-STEAGALL ACT 46–69 (2020).

192 *See* CAROSSO, *supra* note 188, at 306 (noting that 20% of foreign bonds defaulted, and "[r]eal estate bonds were the second largest losers").

193 *See* Bruno Biais & Richard Green, *The Microstructure of the Bond Market in the 20th Century*, 33 REV. ECON. DYNAMICS 250 (2019).

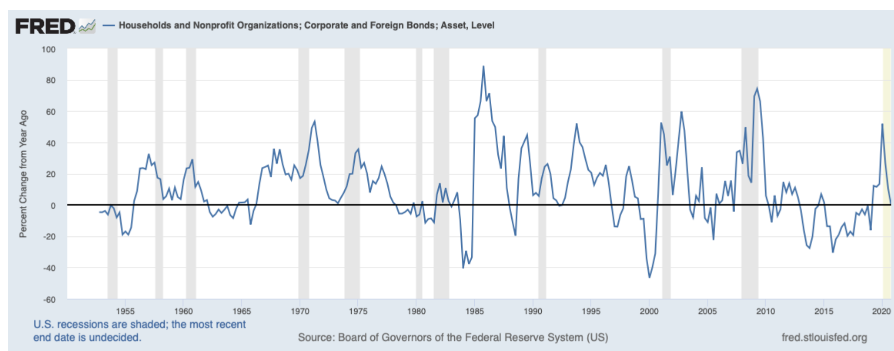
194 *Id.* at 261, fig.5A. During the 1920s, the U.S. Treasury market also became increasingly dominated by institutional investors. GARBADE, *supra* note 189, at 196.

195 *See* Harry G. Guthmann, *The Movement of Debt to Institutions and Its Implications for the Interest Rate*, 5 J. FIN. 70, 72 (1950).

like insurance companies, who thus represented a larger share of the bond market simply by virtue of being the only ones left.

Individual bondholders did not return again until stock prices declined (and interest rates rose) during the late 1960s and into the 1970s.[196] Post-war individual bond ownership peaked at just below 20% of the bond market in the mid-1970s, and reached the teens in the mid-1990s and again during the 2008 financial crisis era. As of 2017, institutional investors held about 94% of the corporate bond market, implying that individuals held the remaining 6%.[197]

The table below shows the percentage change (from the prior year) of individual corporate bond holdings from 1950.[198] As a general matter, the degree of individual debt holding has been quite volatile in the post-war era, tending to rise with declines in the stock market.



But even if individual bondholders only make up about 5% to 10% of the total market today, not only might that change quickly in a coming year—as shown in the graph above—but the dollar values involved are, in any event, still quite substantial, especially given that the U.S. financial

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196 *The Market for Corporate Bonds*, FED. RSRV. BANK N.Y. Q. REV. 27, 27 (1977) ("The market for corporate bonds has undergone a number of major changes over the past fifteen years. Perhaps the most striking has been the increased purchase of corporate bonds by households. During the 1950's and early 1960's, households invested heavily in corporate equities. Then, as the bull market in equities ended in the mid-1960's and interest rates began rising sharply, households increased their corporate bond holdings relative to those of equities.").

197 *See* Ralph S.J. Koijen & Motohiro Yogo, *Understanding the Ownership Structure of Corporate Bonds* 3 (Nat'l Bureau of Econ. Rsch., Working Paper No. 29679, 2022), https://www.nber.org/papers/w29679 [https://perma.cc/8HHB-LZSS] (reporting that "insurers owned 38 percent of corporate bonds, which is higher than 16 percent for pension funds, 10 percent for banks, and 30 percent for mutual funds").

198 *Balance Sheet of Households and Nonprofit Organizations*, FRED ECON. DATA (June 9, 2022), https://fred.stlouisfed.org/series/CFBABSHNO [https://perma.cc/9GWC-5PN6].

markets are vastly bigger now than they were fifty or one hundred years ago.

Moreover, there are clear signs of individuals, or other small traders, present in the market, perhaps to the same relative degree they were in the late 1930s. For example, in 2014, FINRA reported that there were 10.49 million bond trades of $250,000 or less, which it attributed to "a significant increase in retail participation immediately post-crisis."[199]

Current data seems to similarly show the continued presence of retail traders. For example, as of the market close on Friday, April 23, 2021, the second-most traded high-yield bond was an Occidental Petroleum Corporation note due in 2025.[200] During the month before (to, and including, March 25), TRACE reported 173 trades in these notes, 105 of which involved a non-dealer customer as counterparty. Of the latter group of trades, 42 trades involved par values of $100,000 or less, and 54 involved trades of $250,000 or less.[201] As previously noted, trades below either of these thresholds are apt to reflect retail trading, especially when not amongst dealers.

In short, as much as 31% of the total trades in one month—and more than half of the trades, if we exclude trades between dealers—may have been by retail investors in this "junk" bond. The average (median) trade within the broader retail group was $67,648 ($32,500). And twenty-five trades during this month were for $25,000 or less, thirteen of which were for $10,000 or less—with five for $5,000 or less.[202] Trades in these latter groups almost certainly represent retail investors.

Strong evidence of a significant retail presence in one junk bond suggests that the alleged withdrawal of the individual bondholder is overstated. And I find similar results for the month preceding the

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199 BRUCE MIZRACH, FINRA OFF. OF THE CHIEF ECONOMIST, ANALYSIS OF CORPORATE BOND LIQUIDITY 7 (2015), https://www.finra.org/sites/default/files/OCE_researchnote_liquidity_2015_12.pdf [https://perma.cc/593W-9PN9]. The $250,000 threshold is generally adopted for purposes of this Article, although sometimes a more conservative standard of $100,000 is also considered.

200 CUSIP: 674599EB7. The most traded high-yield bond that day was from a Mexican issuer, which is skipped over given the domestic focus of this Article. TRACE data used in this Article comes from *FINRA TRACE Market Aggregate Information*, FINRA, https://finra-markets.morningstar.com/BondCenter/TRACEMarketAggregateStats.jsp [https://perma.cc/8UZG-HSZX], and related web pages.

201 At the other extreme, thirty-six trades involved $1 million or more. For investment grade bond trades over $5 million, or high-yield trades over $1 million, TRACE does not report the actual amount for such trades until six months after the trade. Thus, most of these thirty-six trades are indicated as "1MM+." Stephen J. Lubben, *Oxy Bonds* (May 3, 2021) (on file with author).

202 *Id.*

Peabody and Revlon bonds, which are the subject of the exchange offers examined in Section III.B.

"Peabody Energy, the world's largest coal company, was producing nearly 20% of all U.S. coal by the time it filed for Chapter 11 protection on April 13, 2016."[203] Despite that earlier and somewhat recent chapter 11 reorganization, it continued to experience financial distress, and on December 24, 2020, it announced an exchange offer involving its 6% senior secured notes due March 2022.[204]

Peabody's notes had been issued under Regulation S and Section 4(a)(2), and thus were not formally required to comply with the TIA. Regulation S provides a safe harbor from U.S. registration under the 1933 Act for offshore offers and sales of securities that involve no direct selling efforts in the United States.[205] As noted earlier in this Article, Section 4(a)(2) of the Securities Act provides an exemption for "transactions by an issuer not involving any public offering."[206] A "private placement" under Section 4(a)(2) is frequently used in conjunction with Rule 144A of the Securities Act, which provides an exemption for the resale of privately-placed restricted securities only to certain QIBs that are deemed to be sophisticated investors.[207] In short, "Rule 144A debt" is privately placed with an initial syndicate of investment banks or "initial purchasers," who in turn sell these securities to QIB investors. Sometimes Rule 144A debt is later exchanged into TIA qualified debt, with the exemption used simply to bring the bonds to market quickly, but in the case of Peabody, the debt remained unregistered.[208]

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203 Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 927 (2019).

204 Jack Hersch, *Peabody Energy Announces Exchange Offer for 6% Secured Notes to Extend Maturity*, S&P GLOB.: MKT. INTEL. (Dec. 28, 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/peabody-energy-announces-exchange-offer-for-6-secured-notes-to-extend-maturity-61900963 [https://perma.cc/9SJX-JFUQ].

205 *See* Securities Act Regulation S, 17 C.F.R. §§ 230.901–230.905 (2019).

206 15 U.S.C. § 77d(a)(2).

207 *See* 17 C.F.R. § 230.144A (2019). QIBs include insurance companies, investment companies, certain employee benefit plans, trusts, broker-dealers, and banks that, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the QIB.

208 *See Peabody Announces Exchange Offer and Consent Solicitation Relating to Existing 6.000% Senior Secured Notes Due 2022*, PR NEWSWIRE (Dec. 24, 2020, 11:35 PM) [hereinafter *Peabody Announces Exchange Offer and Consent Solicitation*], https://www.prnewswire.com/news-releases/peabody-announces-exchange-offer-and-consent-solicitation-relating-to-existing-6-000-senior-secured-notes-due-2022--301198481.html [https://perma.cc/KE9C-RMPD]. This is often referred to as "144A for life" debt. Most high-yield debt securities are issued on a 144A basis at least initially. Because a 144A deal is not subject to SEC review, it enables issuers to access the market more quickly, even if the debt is registered later.

There were eighty-five trades in the Regulation S version of these notes in the month before the exchange offer was made public.[209] Thirty-three of these trades involved customers, all but two of which were for $250,000 or less, and indeed the bulk (twenty-nine) were in bonds of $100,000 or less.[210] Of the trades for $250,000 or less, the average trade was for $43,903, and the median was $20,000.[211]

These numbers are especially interesting given that these bonds were (at least in theory) not targeted at domestic retail investors. But it seems entirely probable that debt securities sold under Regulation S could (and in this case did) "flow back" into the United States at some point after they were initially sold to foreign buyers, especially given that the primary resale restriction—Rule 905, under Regulation S—is limited to equity securities. Moreover, if we assume that these notes were "Category 2" securities—debt issued by a reporting United States company[212]—they would have been subject to at most a forty-day holding period abroad, after which U.S. resales could be conducted under the general exemption in Section 4(a)(1) of the 1933 Act.[213]

The Rule 144A version of the same notes traded less frequently during the same time period, and in larger amounts.[214] There were thirty-

209 From November 23 through December 24, 2020. Two cancelled trades are not included in the totals in the text. The two versions of the notes have different CUSIP numbers: U7049LAA6 (Reg S) and 70457LAA2 (144A). Each is reported separately on TRACE. *See* Stephen J. Lubben, *Peabody Bonds* (Apr. 27, 2021) (on file with author).

210 There was only one reported trade of over $1 million. *See id.*

211 *See id.*

212 Rule 903 of Regulation S distinguishes three categories of transactions based on the type of securities being offered and sold, whether the issuer is domestic or foreign, and whether the issuer is a reporting issuer under the Securities Exchange Act of 1934. All Category 2 securities are subject to a forty-day distribution compliance period. 17 C.F.R. § 230.903 (2019). "Distribution compliance period" is defined generally in Rule 902(f) as the period following the offering when any offer or sale of Category 2 securities must be made in compliance with the requirements of Regulation S. That is, after the compliance period has run, Regulation S is no longer applicable. *See id.* § 230.902(f).

213 14A GUY P. LANDER, U.S. SECURITIES LAW FOR INTERNATIONAL FINANCIAL TRANSACTIONS AND CAPITAL MARKETS § 9:39 (2d ed. 2021) ("Offshore offerings by foreign issuers (and offshore debt offerings by domestic issuers) result in purchasers receiving unrestricted securities, and after the distribution compliance period ends, Section 4(a)(1) would be available for routine trading or resale transactions by purchasers of securities in those offerings."). Section 4(a)(1) exempts from registration "transactions by any person other than an issuer, underwriter, or dealer." 15 U.S.C. § 77d(a)(1).

214 *See* Lubben, *supra* note 209. These securities, unlike the Regulation S securities, would be less likely to end up in the hands of domestic retail investors. Moreover, Peabody reported that it had signed a "transaction support agreement" with about 65% of its noteholders under which they agreed to tender into the exchange offer (and thus presumably agreed not to trade their debt in advance of the offer). *See Peabody Announces Exchange Offer and Consent Solicitation*, *supra* note 208. Such an agreement would have been most likely negotiated with large institutional holders of

nine total trades of this version, eighteen with customers.[215] Four of the latter trades were for less than $250,000, but all trades were above $100,000, and thirteen of the customer trades were for more than $1 million.[216] Nevertheless, even four trades with a median of $178,000 is somewhat surprising, given that Rule 144A debt is supposed to be limited to institutional investors.[217]

Similarly, on September 29, 2020, Revlon announced an exchange offer that is also discussed in Section III.B.[218] Its 5.75% senior notes due 2021, the subject of the offer, traded 239 times in the preceding month,[219] and 104 of these were with customers. Eighty-six of the customer trades were for $100,000 or less, and ninety-two customer trades were for $250,000 or less.[220] Of the broader group of potential retail trades (those at $250,000 or less in par value), the average trade was for $40,696, while the median was for $12,500.[221]

The Revlon notes were TIA-qualified debt, so the lower means and medians and higher trading volumes are to be expected. Nonetheless, an average trade of $40,000, and a median of $12,500, is hardly consistent with the notion that individual bondholders have vanished.[222] Indeed, amongst the Revlon trades there are sixty for $25,000 or less—that is, sixty trades in one month that are equal to or less than the default trade in most online brokerage accounts.

In short, retail bondholders are still around. They probably represent a minority of the total bond market, but they may have represented a minority of the total bond market even in the pre-war period. Data on the degree of individual bondholding before the TIA is quite sketchy. Moreover, individual bondholders were never mostly

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the 144A version of the notes, since it would have required reaching out to fewer noteholders to reach the 65% amount.

215 *See* Lubben, *supra* note 209.

216 *See id.*

217 Two of the four smaller trades appear to be related—a dealer bought $181,000 of the bonds from a customer, and shortly thereafter (about fifteen minutes later), a dealer sold the same amount of bonds to a customer for a slightly higher price than the buy trade. *See id.*

218 *See Revlon Announces Commencement of Exchange Offer and Concurrent Consent Solicitation*, BUSINESSWIRE (Sept. 29, 2020, 7:30 AM), https://www.businesswire.com/news/home/20200929005461/en/Revlon-Announces-Commencement-of-Exchange-Offer-and-Concurrent-Consent-Solicitation [https://perma.cc/8A25-LRCV].

219 From August 28 through September 29. CUSIP: 761519BD8. Cancellation and correction entries in TRACE are excluded. *See* Stephen J. Lubben, *Revlon Bonds* (Apr. 28, 2021) (on file with author).

220 Ten trades were for more than $1 million. *See id.*

221 See *id.*

222 And again, note that this is in debt of a plainly distressed firm—presumably retail holders are even more common in higher rated, somewhat more stable, speculative-grade paper.

"moms and pops"—to the extent that term implies either a middle class or "average" American household. The $5,000 trades of the 1940s have become the $25,000 trades of today, but in both cases, the dollar figures were beyond the reach of the average American. The TIA never protected "mom and pop," nor even George F. Babbitt,[223] but rather somebody more like Daisy Buchanan, who has the money to buy individual bonds, but neither the time nor interest to worry about the investment on a day-to-day basis, or to monitor every distressed issuer as it bobs and weaves to avoid a default.[224]

It is those contortions on the eve of default that we turn to next.

B. *The Benefits of Exchange Offers*

As noted, the argument against Section 316(b) is comprised of two parts, each of which supports the other. First, as discussed in Section III.A, it is asserted that there are little to no individual bondholders anymore. And second, critics argue that Section 316(b) precludes useful exchange offers. Given the purported lack of individual bondholders, the repeal of Section 316(b), to unleash further exchange offers, is seen as an easy choice.

But are exchange offers actually "better" than chapter 11 reorganizations? The case for an affirmative answer turns on the assertions that exchange offers are cheaper and, perhaps relatedly, that they result in higher returns for creditors.

Pointing in the other direction, Section III.B highlights the uncertain costs of exchange offers, and to note the disparate treatment of small bondholders in modern exchange offers. Moreover, I observe several points that suggest that exchange offers are being used for reasons that have nothing to do with either cost or creditor recoveries, but rather are indicative of the personal benefits insiders see in exchange offers. In short, the concerns that motivated the Trust Indenture Act are still present, and rather than worry that we have too few exchange offers, I worry that we have too many.

1. The Relative Costs of Exchange Offers

The costs of financial distress are routinely split between direct and indirect costs. The direct costs include professional fees associated with tackling distress, while the indirect costs include the less tangible items

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223 *See* SINCLAIR LEWIS, BABBITT (1922).

224 *See* F. SCOTT FITZGERALD, THE GREAT GATSBY (1925).

like managerial distraction and general business underperformance resulting from the distress. The latter costs are presumed to be much larger than the former, but they are also exceedingly difficult to measure.

Moreover, it would seem that indirect costs are apt to be incurred in any state of financial distress, regardless of what mechanism is used to address the situation, and thus they might be of lesser interest from a policy perspective.[225] As one commentator noted long ago, "[t]here is a common tendency to view bankruptcy as an 'either-or' situation. Either the firm is solvent and there are no costs or the firm is bankrupt and there are costs."[226]

There are several recent empirical studies of chapter 11 direct costs which highlight the substantial amount of professional fees incurred in such cases.[227] But there is a problem contextualizing these studies, given that most other corporate transactions, including exchange offers, are much less transparent with regard to direct costs.[228]

Moreover, while chapter 11 costs are usually reported as all of the direct costs incurred while in chapter 11, out-of-court workout costs are typically measured by the costs of the specific procedure. Thus, while

> it is easy to think that chapter 11 professional fees are all bankruptcy related, in fact all debtors would . . . incur some amount of professional fees even in the absence of financial distress. . . . [And] if most of the supposed costs of chapter 11 are in fact exogenous to the Bankruptcy Code, . . . changes to chapter 11 will be of slight consequence to the overall *ex ante* costs of debt finance. Reductions in the cost of chapter 11 may have only a modest correlation with reductions in the cost of financial distress.[229]

That is, measures of chapter 11 costs likely overstate the "pure" costs of chapter 11 relative to exchange offers, and further, there are few studies of the costs of exchange offers because the costs are often not publicly disclosed.[230]

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225 *See* Gregor Andrade & Steven N. Kaplan, *How Costly Is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed*, 53 J. FINANCE 1443 (1998).

226 Bernell K. Stone, *Bankruptcy Costs: Some Evidence: Discussion*, 32 J. FINANCE 366, 367 (1977).

227 *See, e.g.*, LYNN M. LOPUCKI & JOSEPH W. DOHERTY, PROFESSIONAL FEES IN CORPORATE BANKRUPTCIES: DATA, ANALYSIS, AND EVALUATION 100–07 (2011); Stephen J. Lubben, *What We "Know" About Chapter 11 Cost Is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141 (2012).

228 *See* Lubben, *supra* note 46.

229 Stephen J. Lubben, *The Microeconomics of Chapter 11—Part 1*, 4 INT'L CORP. RESCUE 31, 31–32 (2007) ("About forty percent of the attorneys' fees in a case relate to bankruptcy attorneys, which suggests that as much as sixty percent of the legal costs may be exogenous to chapter 11.").

230 Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 517 (2000) (citing leading studies).

The last point does surface the real cost advantage of exchange offers over chapter 11 cases: exchange offers' relative opacity. Namely, debtor-firm management often resents the transparency of chapter 11, where "a debtor often is said to be 'operating in a fishbowl' during the pendency of its chapter 11 case."[231] Exchange offers may offer no direct cost savings whatsoever and management could still find them "cheaper" because exchange offers will not incur the costs associated with transparency.

Of course, the lack of transparency in receiverships is precisely why the New Dealers wanted to force restructurings into open court, where a judge could oversee the fairness of the process. As described in Section III.A, once we reject the notion that individual bondholders are "gone," one reason for rejecting the New Deal approach to corporate reorganization begins to disappear.

The other reason for rejecting the TIA approach to bonds is that it hinders cheaper, socially beneficial exchange offers. But as just described, nobody really knows how much exchange offers cost, let alone whether they are meaningfully cheaper than something else (most often, chapter 11 cases of some sort). It is conventional wisdom that they are cheaper, but as I have suggested, there could be reasons why management would deem them "cheaper" that have nothing to do with direct or indirect costs. That is, the cost argument could be used as a cover for other factors that are less clearly beneficial to the debtor-firm itself, or society, even while being attractive to managers. In short, the cost argument could be obscuring an agency problem. I return to agency costs below.

2. The True Costs of Modern Exchange Offers

Might exchange offers still be socially beneficial or efficient, even if they are not cheaper than chapter 11 cases? Perhaps, although it is not clear what benefits exchange offers might have that could not be more readily obtained in chapter 11. And recent exchange offer practice should raise concerns that these transactions involve a good deal of appropriation from smaller bondholders.

First, consider the case of Peabody Energy, which, in late December 2020, announced an exchange offer for "any and all of its outstanding 6.000% Senior Secured Notes due 2022."[232] A close reading of the press

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[231] Michelle M. Harner & Jamie Marincic, *Behind Closed Doors: The Influence of Creditors in Business Reorganizations*, 34 SEATTLE U. L. REV. 1155, 1156 (2011); *accord In re* Alterra Healthcare Corp., 353 B.R. 66, 73 (Bankr. D. Del. 2006) ("During a chapter 11 reorganization, a debtor's affairs are an open book and the debtor operates in a fish bowl."); Mendales, *supra* note 163, at 1289 ("A debtor in a Chapter 11 case lives in a fishbowl where creditors have extensive discovery rights.").

[232] *See Peabody Announces Exchange Offer and Consent Solicitation*, *supra* note 208.

release makes clear that the offer was not actually for "any and all" of the notes, because it goes on to explain that:

> The Offering Memorandum and other documents relating to the Exchange Offer and Consent Solicitation will only be distributed to Eligible Holders of Existing Notes who complete and return an eligibility form confirming that they are either (a) a person that is in the United States and is (i) a "Qualified Institutional Buyer" as that term is defined in Rule 144A under the Securities Act of 1933, as amended (the "*Securities Act*"), or (ii) an institutional "accredited investor" (within the meaning of Rule 501(a)(1), (2), (3) or (7) under the Securities Act), or (b) a person that is outside the "United States" and is (i) not a "U.S. person," as those terms are defined in Rule 902 under the Securities Act, and (ii) a "non-U.S. qualified offeree" (as defined in the Offering Memorandum) (such holders, the "*Eligible Holders*").[233]

Since the Offering Memorandum remains hidden, there is no way of knowing the precise definition of some of these terms. But the quoted text certainly suggests that if a retail holder somehow got ahold of some of the notes—and I previously provided some evidence that might have happened, particularly with regard to the Regulation S version—they will not be allowed to participate in the exchange. In essence, they are compelled to become holdouts.

Remaining in the notes had serious consequences for noteholders because it was reported that:

> Peabody is soliciting consents to eliminate "substantially all" of the 6% senior secured notes' restrictive covenants, certain events of default and certain other provisions and to release the collateral securing the notes.[234]

In short, the senior secured notes became "cov light" notes secured by nothing.[235] Along these lines, Peabody reported in January 2021 that:

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[233] *Id.*

[234] Hersch, *supra* note 204.

[235] "Cov light" refers to "covenant light," or a loan agreement with little or no covenants. Post-Lehman, interest rates have been quite low and demand for loans high. As a result, corporate borrowers have used their bargaining power to reduce the requirements—"covenants"—contained in loan agreements. Oscar Couwenberg & Stephen J. Lubben, *Good Old Chapter 11 in a Pre-Insolvency World: The Growth of Global Reorganization Options*, 46 N.C. J. INT'L L. 353, 387 (2021).

> Approximately 13 percent, or $60.3 million, of the 2022 notes did not participate in the exchange offer, leaving those notes as Peabody's only funded debt currently maturing prior to December 2024. Given the level of support for the exchange offer, the amendments to the indenture governing the 2022 notes are now operative. As a result, the 2022 notes are now unsecured and will no longer have the benefit of substantially all of the restrictive covenants. The 2022 notes will continue to bear interest at an annual rate of 6.0 percent and mature in March 2022.[236]

As noted, the debt was not formally subject to the TIA, but it did contain a clause mirroring Section 316(b).[237] That thirteen percent of the old bondholders apparently accepted their fate, including being transformed from secured to unsecured debt, provides some further suggestion that small bondholders were very much present in these notes.

Did the exchange offer comport with the contract? As set forth in the margin, the indenture provided an individual right to "receive payment of principal . . . or interest on its Note."[238] The waiver of a lien is at least one step further than exit consents or subordination and seems to go to the core nature of the original obligation between debtor and creditor. The bondholder lent on a secured basis and the borrower has now converted that into an unsecured obligation.

But the indenture is less than clear on this point, with Section 6.07 opening with "[n]otwithstanding any other provision of this Indenture," but then Section 9.02 allowing for the release of the liens granted under

236 *Peabody Completes Exchange Transaction, Extends Substantial Portion of Near-Term Debt Maturities, Eliminates Net Leverage Ratio, Finalizes Surety Standstill Agreement*, PR NEWSWIRE (Jan. 29, 2021, 2:19 PM), https://www.prnewswire.com/news-releases/peabody-completes-exchange-transaction-extends-substantial-portion-of-near-term-debt-maturities-eliminates-net-leverage-ratio-finalizes-surety-standstill-agreement-301218274.html [https://perma.cc/K4F5-3TJD].

237 Section 6.07, Rights of Holders to Receive Payment, provided:

> Notwithstanding any other provision of this Indenture, the right of any Holder of a Note to receive payment of principal of, premium, if any or interest on its Note on or after the Stated Maturities thereof, or to bring suit for the enforcement of any such payment on or after such dates, shall not be impaired or affected without the consent of that Holder.

Peabody Securities Finance Corporation to Be Merged with and into Peabody Energy Corporation, SEC (Feb. 15, 2017) [hereinafter *Peabody Securities Indenture*], https://www.sec.gov/Archives/edgar/data/1064728/000119312517044977/d348024dex41.htm [https://perma.cc/K4PY-N3MK].

238 *Id.* Section 12.07 of the indenture appears to duplicate the provisions of Section 6.07 quoted above, while extending them beyond the indenture to include the collateral documentation, providing that "[n]othing in this Indenture or the Security Documents will . . . impair, as to the Company and the Holders, the obligation of the Company to pay principal of, premium and interest on the Notes in accordance with their terms or any other obligation of the Company or any other Grantor." *Id.*

the indenture by a two-thirds vote.[239] Most courts would undoubtedly adopt the fiction that an indenture represents a thoughtfully drafted agreement, and decide that the latter provision overrides the former, apart from the unqualified declaration at the outset.[240]

Regardless of how one comes out on the interpretive issue, we might wonder if there is any social utility in this sort of exchange offer. It seems doubtful that this exchange offer was particularly useful to anyone beyond the debtor and perhaps some distressed debt investor who had bought in at a sufficiently low price relative to par. And if an exchange offer can already strip all covenants from an indenture and render secured debt unsecured, what really is to be gained from repealing Section 316(b) beyond even more extreme restructurings?

Then consider the 2020 Revlon exchange offer for its 5.75% senior notes due 2021, noted in the Introduction and Section III.A, which were subject to the TIA.[241] This was actually the second exchange offer Revlon made for these notes: an earlier offer was roundly rejected by bondholders, with only about 5% tendering.[242]

In the revised exchange offer, individual bondholders were offered $275 in cash, and an additional $50 if they tendered within the two weeks of the offer's announcement. Institutional holders, on the other hand, had a choice between the offer made to the individuals or a package of $250 in cash combined with $145 in a term loan and $217.50 in a second lien term loan. Institutional holders were eligible to receive the $50 additional cash payment if they accepted either version of the exchange offer within two weeks.[243] In short, while individual bondholders were offered $275, institutional bondholders, by agreeing to take $25 less in cash, could get $362 in new loans, for a total recovery of more than $600.

The $50 additional consideration for early tenders provides the usual attempt to stampede bondholders into accepting an offer not on the

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239 Specifically, Sections 9.02 and 12.05 read together. *Id.*

240 *See* Elisabeth de Fontenay, *Complete Contracts in Finance*, 2020 WIS. L. REV. 533, 535 (2020) ("Judges tend to believe that sophisticated parties should write lengthy agreements that explicitly provide for the parties' conduct under every contingency, because, in their view, such 'complete' contracts come closer to expressing the parties' entire bargain."); *cf.* William W. Bratton, Jr., *The Interpretation of Contracts Governing Corporate Debt Relationships*, 5 CARDOZO L. REV. 371, 379 (1984).

241 *See Revlon Announces Commencement of Exchange Offer and Concurrent Consent Solicitation*, *supra* note 218.

242 Becky Yerak & Alexander Gladstone, *Revlon Faces Debt Crunch After Bond Exchange Fails*, WALL ST. J. (Sept. 14, 2020, 4:38 PM), https://www.wsj.com/articles/revlon-faces-debt-crunch-after-bond-exchange-fails-11600115925 [https://perma.cc/3WM4-8V2G].

243 *Revlon Announces Commencement of Exchange Offer and Concurrent Consent Solicitation*, *supra* note 218.

merits, but rather based on what they think their fellow bondholders are going to do. The stark split in the recoveries paid to bondholders is something that could never be done in chapter 11, where a chapter 11 plan must "provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest."[244]

"Section 1123(a)(4) embodies the principle that all similarly situated creditors in bankruptcy are entitled to equal treatment."[245] In the Revlon exchange, if we assume that $25 in cash is worth less than $362 in secured term loans, the inequality is plain. What would justify such disparity is not clear.

The exchange offer makes the holdout option unpalatable by eliminating "substantially all of the restrictive covenants and certain events of default provisions from the Indenture"[246] through the use of exit consents. And holdout bondholders would be subordinated by the new term loans. But given the relatively short time until maturity, individual bondholders may have decided that going without covenants for a year and retaining the right to receive the original face amount ($1,000), plus one or two more coupons, was worth more than $275 (or even $325, if we include the early tender premium).[247]

And indeed, Revlon ultimately "blinked," announcing in November 2020 that it would redeem "the remaining $106.8 million in aggregate principal amount of the Notes that did not tender into the Exchange Offer at a price equal to 100% of their aggregate principal amount, together with interest accrued."[248] A bondholder that tendered into the September exchange offer might have had some choice words upon reading about the November move.[249]

Both the Peabody and Revlon exchange offers exhibit the basic fact that these offers, even when operating under Section 316(b) in the case of Revlon, or contractual equivalents in the case of Peabody, are already quite flexible, to the point that they may be used to strip value from smaller bondholders. In Peabody, the retail bondholders—who we must

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244 11 U.S.C. § 1123(a)(4).

245 *In re* Energy Future Holdings Corp., 648 F. App'x 277, 283 (3d Cir. 2016).

246 *Revlon Announces Commencement of Exchange Offer and Concurrent Consent Solicitation*, *supra* note 218.

247 *See id.*

248 *Revlon Announces Closing of 5.75% Senior Notes Exchange Offer*, BUSINESSWIRE (Nov. 13, 2020, 3:19 PM), https://www.businesswire.com/news/home/20201113005674/en/Revlon-Announces-Closing-of-5.75-Senior-Notes-Exchange-Offer [https://perma.cc/SX7S-WMTB].

249 The $236 million in notes accepted the exchange offer, just over the $227 million Revlon needed to remove the covenants. *Id.*

concede came into the notes through the backdoor[250]—were not even engaged. Their bonds were simply gutted, and they were left to face the consequences. Revlon lowballed the retail holders, and although it turned out that they might have been better off ignoring the offer, bondholders should not expect that outcome to be routine.

In short, modern exchange offers are already fostering deals of limited (if any) social utility. Why they should be allowed to become more aggressive, which would presumably involve further appropriation from bondholders and eventually more bondholder-issuer friction, is rather unclear. Nonetheless, this is essentially what the academic literature proposes.[251]

3. Who Really Benefits from Exchange Offers?

It is commonly said that creditors recover more in exchange offers.[252] But as Moody's noted in a recent research report, that is often because researchers assume a full recovery to those classes that are left out of the exchange offer.[253] Thus, "firm-wide recovery rates [are] high among DEs [distressed exchange offers], even though the defaulted debt that was subject to the exchange incurred large losses."[254] The ability of insiders to use exchange offers to target who incurs losses, and who does not, should raise concerns.

Moreover, exchange offers are not used by all distressed businesses equally. In the same study, Moody's found that a firm owned by a private equity fund—regardless of industry—was much more likely to restructure using an exchange offer as compared with firms with traditional equity ownership.[255]

In an even more recent study, Moody's found that 42% of private equity–backed companies utilized exchange offers after defaults, while

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[250] *See supra* note 212 and accompanying text.

[251] As Bratton has conceded in a lecture based on the Bratton and Levitin article, "If 316(b) were repealed and the drafters opted for across-the-board CACs without simultaneously barring exit consents, highly coercive exchange offers along the lines of the British *Assénagon* case could and we think would follow." William W. Bratton, *Collected Lectures and Talks on Corporate Law, Legal Theory, History, Finance, and Governance*, 42 SEATTLE U. L. REV. 755, 880 (2019).

[252] *See, e.g.*, Julian R. Franks & Walter N. Torous, *A Comparison of Financial Recontracting in Distressed Exchanges and Chapter 11 Reorganizations*, 35 J. FIN. ECON. 349, 350 (1994).

[253] *Lessons from More Than a Trillion Dollars in Defaults*, MOODY'S INVS. SERV. (Feb. 22, 2021) [hereinafter MOODY'S 2021A] (on file with author).

[254] *Id.* at 9.

[255] *Id.* at 8–9.

only 29% of "normal" firms used such offers.[256] Conventional debtors were instead more likely to utilize prepacks or traditional chapter 11 cases.

Moody's attributes the greater use of exchange offers by private equity–owned debtors to a desire by the funds to retain "at least some ownership position."[257] S&P reaches a similar conclusion, noting that:

> We believe companies often choose out-of-court restructurings, which are more likely to preserve the equity stake held by private equity owners and their control of the company. Despite the attractions for existing owners, our research shows this incremental approach is frequently insufficient to fix the larger problems facing the company: based on a survey of companies that have experienced a selective default, further defaults occur about 37% of the time.[258]

Moreover, Moody's notes that private equity–owned debtors tend to utilize capital structures that concentrate losses among the bondholders: "Senior unsecured bonds on the balance sheets of PE defaulters recovered 22 cents on a dollar—about half of 41% recovered by their [non-PE] counterparts."[259]

The ability of private equity funds to use exchange offers to retain ownership interest, while at the same time imposing outsized losses on junior creditors, should again raise concerns. Indeed, all of the points made in this Section raise the same basic issues that motivated the passage of the TIA in the 1930s: namely, Wall Street insiders manipulating the restructuring process for their own benefit.

In Part IV, I propose an alternative approach.

IV. ADAPTING THE TIA TO THE 21ST CENTURY

As one commentator recently noted, "Section 316(b) rules out the most straightforward forms of expropriation by allowing individual bondholders to insist on the bonds' initial repayment terms."[260] But as

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256 *Hard Data for Hard Times: Pandemic Edition*, MOODY'S INVS. SERV. 9 (May 18, 2021) (on file with author).

257 MOODY'S 2021A, *supra* note 253, at 8.

258 S&P GLOB. RATINGS, *supra* note 55.

259 MOODY'S 2021A, *supra* note 253, at 7–8 ("The difference in bank debt as the percentage of total debt at default, and its higher recovery rate, has led to the interesting 'optical illusion' where PE-sponsored companies have lower recovery rates for almost each type of debt instrument compared with non-sponsored companies and yet produce substantially similar firm-wide recovery rates.").

260 Buccola, *supra* note 78, at 730.

Part III illustrated, Section 316(b) standing alone is insufficient to block expropriation generally, especially since courts have limited the scope of the Section[261] and rejected attempts to create an equitable "penumbra" around the Section, either through fiduciary duties or by utilizing the implied covenant of good faith.[262]

That Section 316(b) plays a narrow role does not mean it plays no role whatsoever. For example, the exchange offer at issue in *Assénagon Asset Management S.A. v. Irish Bank Resolution Corp.* offered bondholders an 80% haircut, provided they agreed to exit consents that allowed the issuer to redeem all outstanding subordinated notes for €0.01 per €1,000, which it then attempted to do.[263] The "choice" between twenty cents on the Euro, or outright destruction of the bonds' value, is something that no public bondholder would face in the United States so long as Section 316(b) remains in place. Moreover, the fact that most bond indentures contain similar protections—even when, like Peabody's indenture discussed above, not required—strongly suggests that the default term required by the TIA is one that most bondholders want in any event. But Section 316(b) provides even stronger protection to bondholders, in that it avoids the tricky question of whether a "double exit consent" could remove the contractual version of the clause.

That is, could one exit consent remove the requirement that bondholders individually consent to a change of interest, principal, or maturity date, and then another exit consent remove the limitation altogether (now that it is subject to majority rule)? In the Peabody indenture,[264] Section 9.02, which governs bondholder consents to amend the indenture, attempts to address this issue by saying that nothing in Section 9.02 could apply to reduce the "core terms" of the indenture.[265] On the one hand, that clause might simply raise the question of whether a crafty exchange offer now needs a "triple consent," while on the other

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261 *See* Cummings v. Chesapeake Energy Corp., No. CIV-16-00647, 2017 WL 3836112, at *4 (W.D. Okla. Feb. 8, 2017) ("Most courts appear to have construed 316(b) narrowly, protecting only the holder's legal right to receive payments of principal and interest.").

262 *See* Waxman v. Cliffs Nat. Res. Inc., 222 F. Supp. 3d 281, 295–96 (S.D.N.Y. 2016) ("Plaintiffs contend the Exchange Offer violated the implied covenant because non-QIBs could not participate. . . . [T]he Indentures here could have included a provision barring differential treatment of bondholders in exchange offers, but it did not. . . . [T]hat is the end of the claim."); Alexandra Glob. Master Fund, Ltd. v. Ikon Off. Sols., Inc., No. 06 Civ. 5383, 2007 WL 2077153, at *8 (S.D.N.Y. July 20, 2007) ("Because IKON owed no such fiduciary or other analogous duty to its convertible noteholders, it follows that IKON had no duty to disclose its alleged unpublicized intentions to exercise its redemption rights at a date in the future.").

263 Assénagon Asset Mgmt. S.A. v. Irish Bank Resol. Corp. [2012] EWHC 2090 (Ch).

264 *Peabody Securities Indenture*, *supra* note 237.

265 *Id.* § 9.02.

hand, proceeding down that road might finally cause reluctant courts to revitalize the implied covenant of good faith and fair dealing in the corporate finance context, after the clause's decades long slumber. As Professor Brudney argued in the early 1990s, and as previously quoted, "Difficulties encountered in determining the fairness of a transaction do not justify judicial myopia in examining the coercive or distorting impact on the choices thrust on dispersed debtholders by the strategic behavior of common stockholders."[266] A modern coda might add: " . . . in league with distressed debt investors."

In short, just because Section 316(b) is incomplete in its scope does not mean it should be repealed, especially in light of the evidence that the disappearance of the individual bondholder has been greatly exaggerated. I thus join the late Professor Brudney in supporting the retention of Section 316(b), while also suggesting that more needs to be done.

How then might we augment the protections of Section 316(b) to protect against those exchange offers that no bondholder would agree to ex ante—namely, those that involve appropriation of value from a minority of bondholders to benefit insiders or other bondholders?

More than two decades ago, Professors Coffee and Klein proposed that the SEC use its authority under Section 14(e) of the Williams Act[267]—the 1968 amendments made to the Securities Exchange Act of 1934—to beef up the later Act's regulation of tender offers.[268] In particular, they suggested that three concepts, already applicable to equity tender offers, be extended to debt exchange offers.[269]

Moreover, under the TIA, the SEC has the authority to issue rules and regulations as it may deem necessary or appropriate in the public interest, or for the protection of investors to carry out the provisions of

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266 Brudney, *supra* note 5142, at 1848.

267 Pub. L. No. 90-439, 82 Stat. 454 (1968).

268 The Williams Act added two key provisions to the 1934 Act: Section 14(d) applies by its terms only to tender offers for the equity securities of reporting companies, while Section 14(e) applies to all tender offers, including offers for debt securities and securities of non-reporting companies. Section 14(e) prohibits fraudulent, deceptive, and manipulative acts in connection with a tender offer. 15 U.S.C. § 78n(d), (e); *see also* Jayhawk Cap. Mgmt., LLC v. LSB Indus., No. 08-2561, 2012 U.S. Dist. LEXIS 133429, at *41 (D. Kan. Sept. 19, 2012) ("The Williams Act added five sections to the Exchange Act to provide shareholders of the issuing corporation with the necessary time and information to properly consider the offer, ensure that the shareholders were treated fairly, and guarantee that the issuer and bidder were dealing at arm's length.").

269 Coffee & Klein, *supra* note 21, at 1267–69; *accord* Mark L. Berman, *SEC Takeover Regulation Under the Williams Act*, 62 N.Y.U. L. REV. 580, 580 n.3 (1987) ("A rule promulgated pursuant to general rule-making authority need be only 'reasonably related to the purposes of the enabling legislation in order to be sustained.' Thus, because the Williams Act is part of the Exchange Act, SEC rules under the Williams Act need be only reasonably related to the statute's purposes." (quoting Mourning v. Fam. Publ'ns Serv., Inc., 411 U.S. 356, 369 (1973))).

the Act.[270] Consistent with the TIA's limitation of the SEC's role in the pre-issuance phase,[271] it appears that such rules can only be prospective in application, having no effect on already outstanding bonds.[272] As commentators have noted, "the drafters envisioned that investors would be protected by the SEC acting preemptively by requiring protective provisions in indentures, rather than acting after the fact by enforcement and prosecutions."[273] The limitation makes Section 14(e) a more attractive source of potential rulemaking in the exchange offer area, but the authority under the TIA provides a kind of backstop for the Williams Act.

I propose three rules to buttress Section 316(b) for a new era, beginning with one that Coffee and Klein proposed back in 1991.[274] Two are already applicable to equity tender offers, so the change I propose is to extend them to bonds. Doing so will ensure that minority bondholders—including individual retail bondholders—are treated with basic fairness in exchange offers. To the extent that adopting these rules would limit some of today's super aggressive offers, I doubt that is a bad thing. And prepacks remain a valuable tool for quick balance sheet restructurings in the face of extreme holdout problems.

To be sure, most of the points addressed by the rules that follow could also be addressed by the intercreditor duty of good faith proposed by Bratton and Levitin.[275] Putting to one side their recommendation to repeal Section 316(b), such a duty offers greater flexibility than rules could ever offer, and the Bratton-Levitin approach would avoid attempts to game the system with technical compliance with my proposed rules. If their fiduciary duty could work, it would clearly be superior to the rules I propose.

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[270] 15 U.S.C. § 77sss(a) (TIA § 319). A review of the SEC's rules under the TIA suggests the need for some housekeeping—e.g., Rule 7a-6 is entitled "Telegraphic delaying amendments." 17 C.F.R. § 260.7a-6 (2015).

[271] *See* Morris v. Cantor, 390 F. Supp. 817, 821 (S.D.N.Y. 1975); *see also* Zeffiro v. First Pa. Banking & Tr. Co., 623 F.2d 290, 293 (3d Cir. 1980).

[272] In particular, 15 U.S.C. § 77iii(c) (TIA § 309) provides that:

> The making, amendment, or rescission of a rule, regulation, or order under the provisions of this subchapter (except to the extent authorized by subsection (a) of section 77nnn of this title with respect to rules and regulations prescribed pursuant to such subsection) shall not affect the qualification, form, or interpretation of any indenture as to which qualification became effective prior to the making, amendment, or rescission of such rule, regulation, or order.

[273] Gadsden, *supra* note 103, at 1163.

[274] Alternatively, these concepts could be enacted as legislation, but I proceed on the assumption that administrative rulemaking will enable swifter action.

[275] *See* Bratton & Levitin, *supra* note 30.

Of course, the last qualification is at the core of why I propose rules. Bratton and Levitin are unclear if they anticipate their fiduciary duty being codified, or developed as a matter of case law—although they trace its origins to cases like the well-known (if rarely followed) opinion in *Hackettstown National Bank v. D.G. Yuengling Brewing Co.*, where the court held that:

> [I]f the consent was made and the resolution passed by the majority of bondholders, not in the common interest of all, but in the interest of [David] Yuengling, with a view of enabling him, by deferring for five years the payment of interest, to compel the minority bondholders to sell their bonds of such terms as he might dictate, it was a corrupt and unwarranted exercise of the power of the majority.[276]

To the extent Bratton and Levitin urge a revitalized common law duty, they face the basic problem that *Yuengling* predates the *Erie* doctrine,[277] and the Supreme Court has continuously limited the ability of federal courts to engage in common law judging ever since.[278] State courts, in particular New York state courts, might develop Bratton and Levitin's proposed doctrine, although then we get into the question of whether the enactment of the Trust Indenture Act in 1939 superseded the cases the authors rely upon.[279]

More importantly, there is little reason to think that courts will embrace the Bratton and Levitin recommendation. Courts have been extremely reluctant to do anything other than a highly formalistic "plain meaning" analysis in corporate finance cases.[280] Indeed, it is something of

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276 74 F. 110, 113–14 (2d Cir. 1896); *accord* Groseclose v. Merchs. Nat'l Bank & Tr. Co. of Syracuse, 335 N.Y.S.2d 652, 658 (Sup. Ct. 1972). Here, in a case where a majority had voted to waive a default, the court held:

> Owners of a substantial, yet minority, block of bonds are objecting to the treatment they are receiving. . . . [T]he trustee is directed to take action to protect the rights of all the bondholders. Since there are no income, rents or profits, the only other course available to [him] is to foreclose, and [he] is directed to do so.

Id.

277 Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938) (holding that "[t]here is no federal general common law").

278 *See* Rodriguez v. Fed. Deposit Ins., 140 S. Ct. 713, 716 (2020) ("The cases in which federal courts may engage in common lawmaking are few and far between."); *id.* at 717 ("Judicial lawmaking in the form of federal common law plays a necessarily modest role under a Constitution that vests the federal government's 'legislative Powers' in Congress and reserves most other regulatory authority to the States.").

279 *Cf.* William J. Moon, *Delaware's New Competition*, 114 NW. U. L. REV. 1403, 1448 (2020) (reviewing state-created duties to shareholders).

280 Diane Lourdes Dick, *Confronting the Certainty Imperative in Corporate Finance Jurisprudence*, 2011 UTAH L. REV. 1461, 1465–66, n.24 (2011); *see also* Royce de R. Barondes,

a running joke in the author's Corporate Finance class that every finance opinion begins by noting that all contracts contain an implied covenant of good faith and fair dealing,[281] which the court then finds inapplicable to the matter at hand.[282]

In short, there are good reasons to worry that a fiduciary duty approach will not work, as attractive as it is in concept, and thus I proceed to target the principal concerns through SEC rules, which provide stronger underpinnings for reform.

A. *Pay Everyone the Same Price*

Section 14(d)(1) of the Exchange Act (or the Williams Act) requires that all tender offers for equity securities, when those securities are subject to the registration requirements of the Exchange Act, be filed with the SEC and accompanied by the appropriate disclosures.[283] It is conventionally assumed that the limitations in (d)(1)—which applies only to registered equity securities—carry forth to the other subparts of Section 14(d).[284]

Section 14(d)(7) of the Williams Act, the so-called "best-price" provision, provides the following:

> Where any person varies the terms of a tender offer or request or invitation for tenders before the expiration thereof by increasing the consideration offered to holders of such securities, such person shall pay the increased consideration to each security holder whose securities are taken up and paid for pursuant to the tender offer or request or invitation for tenders whether or not such securities have

Vestigial Literalism in the Interpretation of Corporate Financing Instruments, 15 TRANSACTIONS: TENN. J. BUS. L. 239, 288 (2014) ("A number of factors . . . result in courts relying to a lesser extent on the evident purposes of contractual provisions in interpreting corporate financing instruments. . . . One consequence is tedious literalism—hyperliteralism—may reign in interpreting corporate financing instruments."). For key representative opinions, see, for example, Lohnes v. Level 3 Commc'ns, Inc., 272 F.3d 49, 62 (1st Cir. 2001) (warrant); Lorenz v. CSX Corp., 1 F.3d 1406, 1415 (3d Cir. 1993) ("Unless the indenture trustee has deprived the debentureholders of a right or benefit specifically provided to them in the indenture, there is no violation of the implied covenant of good faith and fair dealing."); Metro. Life Ins. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1516–18 (S.D.N.Y. 1989) (bond indenture).

281 *E.g.*, Lehman Bros. Int'l v. AG Fin. Prods., Inc., 38 Misc. 3d 1233(A) (N.Y. Sup. Ct. 2013).

282 *E.g.*, Airborne Health, Inc. v. Squid Soap, LP, 984 A.2d 126, 147 (Del. Ch. 2009).

283 15 U.S.C. § 78n(d)(1).

284 As a matter of statutory interpretation, it is not clear that this is right. For example, paragraph 6 expressly references equity securities, while paragraph 7 only speaks of securities. It could be argued that this difference indicates a difference in congressional intent. *Id.* § 78n(d)(6)–(7).

> been taken up by such person before the variation of the tender offer or request or invitation.[285]

The obvious purpose of this provision is to prevent a tender offeror from discriminating in price among tendering shareholders.[286] Thus, if the offer is initially for $10 per share, but the issuer increases it to $15 per share for some shareholders, all shareholders have to get the new, higher price.

To develop the "best-price rule," the SEC has adopted Rule 14d-10, which provides in pertinent part:

> (a) No bidder shall make a tender offer unless: . . .
>
> (2) The consideration paid to any security holder . . . [pursuant to] the tender offer is the highest consideration paid to any other security holder . . . [during such] tender offer.[287]

To the same end, the SEC has also promulgated a rule prohibiting side deals involving securities subject to a tender offer. Former Rule 10b-13 (now Rule 14e-5)[288] provides in pertinent part:

> (a) No person who makes a cash tender offer or exchange offer for any equity security shall, directly or indirectly, purchase, or make any arrangement to purchase, any such security (or any other security which is immediately convertible into or exchangeable for such security), otherwise than pursuant to such tender offer or exchange offer, from the time such tender offer or exchange offer is publicly announced or otherwise made known by such person to holders of the security to be acquired until the expiration of the period, including any extensions thereof, during which securities tendered pursuant to such tender offer or exchange offer may by the terms of such offer be accepted or rejected.[289]

Exchange offers loaded up with side payments—consent fees or early tender fees being the most common—plainly violate these precepts. The purpose of such side payment is rather plainly to incentivize participation, and indeed to incentivize quick participation that will thwart bondholder coordination. But why should bondholder coordination be discouraged?

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285 *Id.* § 78n(d)(7).

286 *See* 3 HAZEN, *supra* note 86, § 11:21.

287 17 C.F.R. § 240.14d-10(a) (2019).

288 *Id.* § 240.14e-5.

289 *Id.* § 240.10b-13(a).

Moreover, the combined effects of side payments with exit consents, which were addressed in Section I.B.2, make the payments even more malevolent. The bondholder is faced with the choice between taking the side payment, and slightly improving her recovery, or facing the risk of being left behind in a bond transformed into little more than an illiquid "IOU."

A comparatively simply rule, enacted under the SEC's Section 14(e) and TIA powers, could address this issue.[290] Namely, we just need to apply Rules 14d-10 and 10b-13 to the debt securities, and provide that indenture provisions to the contrary are impermissible.

B. *Make the Offer Open to Everyone*

Next consider the problem of offers that are open to some bondholders, but not others. We saw examples of this earlier in this Article, in both the Revlon and Peabody exchange offers. Peabody's offer was closed to individual bondholders, while Revlon offered a choice to institutional investors that was not open to retail investors.[291]

Under the Williams Act, the "all holders rule" provides that a bidder's tender offer must be open to "all security holders of the class of securities subject to the tender offer."[292] The SEC promulgated this rule to ensure "fair and equal treatment of all holders of the class of securities that is the subject of a tender offer."[293] The rule was in response to the Delaware Supreme Court's decision in *Unocal Corp. v. Mesa Petroleum Co.*,[294] where the court upheld the power of a corporation to effect a self-tender for its shares, which excluded shares of a shareholder who was attempting to take over the company.[295] And while, by its terms, the rule

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290 *Cf.* Morey W. McDaniel, *Bondholders and Stockholders*, 13 J. CORP. L. 205, 313 (1988) ("The SEC can assure fair treatment of bondholders in a single stroke with a disclosure rule like rule 13e-3. A public company would have to state whether it reasonably believes a merger, tender offer, spin off, recapitalization or other extraordinary transaction is fair or unfair to any class of the company's securityholders, including bondholders.").

291 *See supra* Section III.B.

292 17 C.F.R. § 240.14d-10(a) (2019) (tender offers by third parties); *id.* § 240.13e-4(f)(8) (tender offers by issuers). The latter is arguably more relevant in the context of exchange offers and provides: "No issuer or affiliate shall make a tender offer unless: . . . The tender offer is open to all security holders of the class of securities subject to the tender offer." *Id.* Rule 13e-4(a)(6) specifies that the term "security holders" means both holders of record and beneficial owners of securities of the class which is the subject of the tender offer. *Id.* § 240.13e-4(6).

293 Amendments to Tender Offer Rules; All-Holders and Best-Price, 51 Fed. Reg. 25873, 25874 (July 17, 1986) (to be codified at 17 C.F.R. pts. 200, 240).

294 493 A.2d 946 (Del. 1985).

295 *Id.* at 949.

does not apply to debt securities, the SEC has recognized the importance of the rule in the bond context by requiring compliance when an issuer wants to undertake a speedy debt tender offer for non-restructuring reasons.[296]

Under the rules for accelerated non-distressed debt tender offers, if the offer is to give unregistered securities to bondholders, holders who are not institutional investors must be given the cash equivalent of the offered securities. Moreover, the issuer may not fund the offer with higher priority debt.

Both seem like sensible rules for exchange offers in general and should be made part of any extension of the all holders rule to bondholders. The requirement that the issuer offer non-accredited investors a comparable recovery avoids the situation where retail bondholders are left with the dregs after an exchange, and the anti-subordination rule addresses an obvious tool of coercion in exchange offers. The all holders rule itself avoids offers that focus on insiders—broadly defined—while leaving the small investors to wait and see if they might get paid.

C. *Considered Exit Consents*

Exit consents are among the most controversial features of modern exchange offers. Indeed, even some scholars who would repeal Section 316(b) would do so only along with enacting a bar on stripping covenants from bonds. For example, Professor Roe concluded that "[s]ince exit consents and a thin residual market can induce a bondholder to consent to an unwanted deal, if there were to be regulatory intervention at all, it should make voting the exclusive mechanism for some classes of recapitalization."[297]

Other commentators, however, argue that exit consents are a vital tool in overcoming "holdout artists."[298] Namely, a particular exchange offer might be undoubtedly beneficial for all, but one bondholder will only agree to accept the offer if paid more than everyone else. In part, this is solved by the best price rule, noted above. And we might also note that

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296 Cahill Gordon & Reindel LLP, SEC No-Action Letter (Jan. 23, 2015), https://www.sec.gov/divisions/corpfin/cf-noaction/2015/abbreviated-offers-debt-securities012315-sec14.pdf [https://perma.cc/4YNU-5S5L]. Notably, this no-action letter also prohibits the use of exit consents in such an accelerated debt tender offer. *Id.* at 2–3. Rule 14e-1(a) requires that all tender offers remain open for at least twenty business days, and the process under the no-action letter represents an exception to that rule. *See* 17 C.F.R. § 240.14e-1(a) (2019).

297 Roe, *supra* note 29, at 272.

298 Daniel P. Herrmann, Note, *An Uneven Exchange? Developing a Fair and Efficient Approach to Exit Consents*, 66 RUTGERS L. REV. 775, 789 (2014).

bankruptcy—including prepacks—remains an option to solve this problem.

But even if we doubt that exit consents provide much value that could not be realized through other means, it should be conceded that the utility of exit consents is an empirical question that is difficult to answer.

The primary concern with such consents is that they are given by tendering security holders that are about to give up their existing debt securities, but not continuing holders of those debt securities. That is, the holders providing the consent are not the ones that will have to live with the consequences of remaining in debt securities with significantly reduced protections.[299]

Removing this aspect of exchange offers would mean that the results of the offer would become more trustworthy. Namely, the consent to the offer would more essentially reflect a vote in favor of the deal.

To facilitate this, I suggest a two-part rule for all distressed exchange offers. First, upon completion of an exchange offer, the issuer must conduct a second, two-week "mini-offer" to the remaining non-tendering bondholders. Then, the issuer must exchange bonds pro rata from the combined pool of bondholders but taking the percentage that tendered into the original offer.

Consider a simple example, where a firm conducts an exchange offer with exit consents that is accepted by 80% of the bondholders. The firm would then conduct the second stage offer. The remaining 20% have two weeks to decide if they want to tender into the offer, and then the debtor exchanges 80% of the total tender.[300]

If we imagine that half of the remaining bondholders opt into the second offer, the total pool of bonds is 90% of the outstanding amount, and the debtor-firm will exchange 80% of the bonds, taking pro rata from each bondholder. In short, those bondholders who agreed to the exit consents in the first round will face some chance of having to "live with"

299 As Davis Polk & Wardwell rather directly put it in 2008, "Because holders willing to accept the new securities in the exchange offer or holders who are tendering in a tender offer would no longer be concerned about the covenants and other protections provided to holders of the old securities, these solicitations can be very successful." *Restructuring Debt Securities: Options and Legal Considerations*, DAVIS POLK & WARDELL 4 (Nov. 17, 2008), https://www.davispolk.com/sites/default/files/files/Publication/46badb97-1f56-4767-9857-692b98bb6cc4/Preview/PublicationAttachment/7f4ca14b-ca18-4d90-8a06-6b77b24206c2/11.17.08.debt.refin.pdf [https://perma.cc/N7VJ-P3PL].

300 It is perhaps likely that once the system was in place for a while, the amount tendered in the first round would decrease, and more would be tendered in the second round, as bondholders would "keep their options open" by shifting to the second round. To the extent this thwarts some offers, if debtor-firms fail to get sufficient "buy in," it might have the healthful benefit of moderating the aggressiveness of modern exchange offers.

the consequences of those exit consents. Presumably, knowing this, they will examine the terms of the exit consents with greater care.[301] And in the process, we limit the use of exit consents to those deals where there is a true holdout problem.

CONCLUSION

The academic (and perhaps practitioner) consensus is that Section 316(b) of the TIA is a historical relic of the New Deal. That conception of the provision assumes that individual bondholders have declined to such a degree that they are best ignored, and that Section 316(b) hinders useful exchange offers. These exchange offers are seen as preferable to formal bankruptcy proceedings.

I have used this Article to raise doubt about both legs of the conventional argument, and to push back against any move to repeal Section 316(b). As we have seen, individual bondholders appear to be present to the same general degree as they have always been—and perhaps to the same extent as they were when the TIA was passed, although solid data on that point is harder to come by.

Moreover, there are good reasons to doubt that exchange offers are cheaper than chapter 11 cases, when measured on an equal footing. And modern exchange offers are often the sources of the very kinds of mischief that the New Dealers sought to prevent.

In the end, not only do I argue against repeal of Section 316(b), but I also suggest ways in which the TIA could be expanded to address the new reality. Of course, this Article only addresses one half of the puzzle: throughout, I have assumed that chapter 11 represents a more transparent, investor-friendly forum. Recent developments in chapter 11 practice call that assumption into question,[302] and I have noted in other work that chapter 11 itself is presently quite hostile to those who are not in the "in crowd."[303] Reforms are vitally needed on both halves of the reorganization equation.

Another approach is to simply dismiss individual bondholders as the regrettable collateral damage of modern finance, who have assumed the risk by investing in highly leveraged firms in the first instance. No

301 If the debtor-firm does not get adequate buy-in after both rounds, it could still retain the option of cancelling the offer, as under current practice. The issuer could also call off the exchange if it failed to receive sufficient tenders in the first round, such that the pro rata exchange would provide insufficient debt relief. The debtor could then proceed with bankruptcy or some other form of restructuring.

302 *See* Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715, 1730–37 (2018).

303 *See* Lubben, *supra* note 50.

doubt many of these bondholders have ignored (or at least failed to notice) the "no lifeguard on duty" signs, but if people keep falling into the pool, perhaps it is time for something more robust than a sign.

And the "assumption of the risk" argument does nothing to address the class of "buy and hold" bondholders who purchased investment-grade debt years ago. A buyout or a wrong turn in the business suddenly renders the company "distressed," and leaves the bondholders floundering in an exchange offer that not only lacks a lifeguard, but in a pool that is now stocked with sharks.

In essence, the modern bond market welcomes individual investors in, only to abuse them on the back end. It is not clear what these investors can do to avoid this fate, other than exit the bond market entirely. If we want to adopt a policy of excluding individual bondholders from the market, we should do that directly. But if we want to continue to facilitate such investments, the time has come to revisit the motivations for the TIA and the role it plays.