To be Argued by:
JAMES H. MILLAR
(Time Requested: 30 Minutes)

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Court of Appeals

of the

State of New York

CNH DIVERSIFIED OPPORTUNITIES MASTER ACCOUNT, L.P., AQR DELTA MASTER ACCOUNT, L.P., AQR DELTA SAPPHIRE FUND, L.P. and AQR FUNDS—AQR DIVERSIFIED ARBITRAGE FUND,

Plaintiffs-Appellants,

– against –

CLEVELAND UNLIMITED, INC., CLEVELAND UNLIMITED AWS, INC., f/k/a Triad AWS, Inc., CLEVELAND UNLIMITED LICENSE SUB, LLC, CLEVELAND PCS REALTY, LLC, CSM WIRELESS, LLC, CSM COLUMBUS (OH) OPERATING SUB, LLC, CSM INDIANAPOLIS OPERATING SUB, LLC, CSM COLUMBUS (IN) OPERATING SUB, LLC, CSM NEW CASTLE OPERATING SUB, LLC, CSM CANTON OPERATING SUB, LLC, CSM YOUNGSTOWN OPERATING SUB, LLC, CSM CLEVELAND OPERATING SUB, LLC, CSM COLUMBUS (OH) LICENSE SUB, LLC, CSM INDIANAPOLIS LICENSE SUB, LLC, CSM COLUMBUS (IN) LICENSE SUB, LLC, CSM NEW CASTLE LICENSE SUB, LLC, CSM CANTON LICENSE SUB, LLC, CSM YOUNGSTOWN LICENSE SUB, LLC, CSM CLEVELAND LICENSE SUB, LLC and CUI HOLDINGS, LLC,

Defendants-Respondents.

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PRELIMINARY STATEMENT

Respondents' brief is a study in misdirection, throwing argument after argument at the wall in an effort to distract this Court from Section 6.07 of the Indenture or to convince the Court that it should be deemed to mean something other than what it actually says. Respondents' efforts are futile. They concede, as they must, that the disputed Debt-for-Equity Exchange purported to "cancel" the Minority Noteholders' payment rights on their Notes, even though Section 6.07 prohibited any party from "impair[ing]" any noteholder's right to receive principal and interest without their express consent. Try as they may, Respondents simply cannot reconcile their actions with the plain language of this provision, which applies "notwithstanding any other provision of th[e] Indenture."

Respondents' counterarguments—that this is a case about indenture trustee powers (an argument made for the first time in the history of this case), invocation of a so-called "prevailing interpretation" of the TIA, a tortured reading of the Second Circuit's decision in *Marblegate*, cherry-picking quotations from the TIA's legislative history, and, when all else fails, a naked appeal to policy considerations—are all irrelevant in light of Section 6.07's clear text and, in any event, are wrong even on their own terms. This Court should reverse.

That conclusion is not changed by Respondents' contention that the Indenture has a "collective design;" that argument misreads this Court's cases and

ignores that, unlike the "collective design" decisions Respondents cite, the Indenture contains clear text that squarely answers the issue before the Court. Also meritless is Respondents' claim that a damages trial is necessary; the Indenture promises payment, in cash, of a specified sum of money. That sum of money is incontestable and apparent on the face of the record. No trial is required.

This Court has long held that when the text of a contract is clear, a reviewing court should ignore extra-contractual evidence and decide the case based on that text. This case—in particular, Respondents' brief—aptly demonstrates the wisdom of that rule. For the reasons set forth below and in the Minority Noteholders' opening brief, the Court should reverse the decision of the Appellate Division and remand with instructions to grant summary judgment to the Minority Noteholders.

ARGUMENT

I. THE INDENTURE'S PLAIN LANGUAGE CONTROLS—AND COMPELS REVERSAL OF THE APPELLATE DIVISION

It is "a fundamental tenet of contract law" that when a contract "'is complete, clear and unambiguous on its face,'" it "'must be enforced according to the plain meaning of its terms,' without reference to extrinsic materials outside the four corners of the document." *Goldman v. White Plains Ctr. for Nursing Care, LLC*, 11 N.Y.3d 173, 176 (2008) (quoting *Greenfield v. Philles Records*, 98

N.Y.2d 562, 569 (2002)).[1] As the Minority Noteholders demonstrated in their opening brief, the Indenture's terms are unambiguous, and therefore should be enforced as written. Section 6.07 states that, "[n]otwithstanding any other provision of the Indenture, the right of any Holder to receive payment of principal of . . . and interest . . . on a Note, on or after the due dates expressed in such Note . . . shall not be impaired or affected without the consent of such holder." (A-233-A-234, § 6.07.) The Debt-for-Equity Exchange effected by Cleveland Unlimited, the Trustee, and the Majority Noteholders purported to "cance[l]" the referenced notes without making the required principal and interest payments and to "terminat[e]" the Indenture and therewith the obligation to pay principal and interest on the Note—all without the Minority Noteholders' consent. (A-585.) That transaction was as straightforward a violation of Section 6.07 as one can contemplate.

In response, Respondents argue that the Debt-for-Equity Exchange is permissible because it was authorized by provisions of the Indenture <u>other than</u> Section 6.07. *See* Resp. Br. at 16 (claiming that Indenture Sections 6.03 and 12.08

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[1] As this Court has underscored, fidelity to a contract's written terms is particularly critical for commercial contracts such as those at issue here. *See 159 MP Corp. v. Redbridge Bedford, LLC*, --- N.Y. ---, No. 26, 2019 WL 1995526, at *3 (May 7, 2019) ("In keeping with New York's status as the preeminent commercial center in the United States, if not the world, our courts have long deemed the enforcement of commercial contracts according to the terms adopted by the parties to be a pillar of the common law.").

"authorized the trustee to exercise the UCC strict foreclosure remedy").[2] The text refutes this suggestion. As quoted above, Section 6.07's payment guarantee applies "notwithstanding any other provision of th[e] Indenture," and, as this Court has emphasized, provisions containing a "notwithstanding" clause trump any conflicting provisions. *Beardslee v. Inflection Energy, LLC*, 25 N.Y.3d 150, 158 (2015). Under the Indenture's plain terms, the noteholders' right to receive principal and interest could not be "impaired," regardless of what other actions the Trustee was permitted to pursue.

Respondents also argue that Section 6.07 was not intended to apply to actions taken pursuant to authority conferred on the Trustee by the accompanying Security Agreement and Collateral Trust Agreement. *See, e.g.,* Resp. Br. at 62. Respondents are wrong on both the law and the facts. On the law, it has been a textbook principle of contract interpretation in this state for nearly 150 years that when multiple "instruments . . . [are] executed at the same time, relating to the same subject-matter, [they] must be construed together as if they constituted but one instrument." *Meriden Britannia Co. v. Zingsen*, 48 N.Y. 247, 251 (1872); *Rogers v. Smith*, 47 N.Y. 324, 327 (1872); *accord Nau v. Vulcan Rail & Constr.*

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[2] Respondents cite this Court's decision in *Cortlandt St. Recovery Corp. v. Bonderman*, 31 N.Y.3d 30, 40 (2018), for the proposition that the language in Section 6.03 unambiguously authorized "a trustee to pursue any lawful means of enforcing a noteholders' rights." The case is inapposite because it involved no conflict with an indenture provision that, like Section 6.07, applied "notwithstanding any other provision of th[e] Indenture."

Co., 286 N.Y. 188, 197, 36 N.E.2d 106, 110 (1941) ("All three instruments were executed at substantially the same time, related to the same subject-matter, were contemporaneous writings and must be read together as one."). Respondents thus err in asking the Court to wrench the Collateral Trust and Security Agreements from their proper context.

The contracts themselves also belie Respondents' argument. The Security Agreement expressly states that the "actions of the Collateral Trustee hereunder are subject to the provisions of the Indenture and the Collateral Trust Agreement." (A-396-A-397, § 11.1(a).) Had the drafters wanted to exempt the Trustee from Section 6.07's restrictions, the Security Agreement would not include this language. Similarly, while the Collateral Trust Agreement authorizes the Trustee to "otherwise exercise or enforce the rights and remedies of a secured party . . . with respect to the Collateral," the Trustee does so "under the Security Documents."[3] (A-332, Collateral Trust Agreement, § 3.1(a)(4) (authorizing the Trustee to "enforce the rights and remedies of a secured party . . . with respect to the Collateral under the Security Documents")) (emphasis added). Because the term "Security Documents" is defined to include the Security Agreement, the Trustee's actions under the Collateral Agreement are (like its actions under the

[3] In quoting the relevant provision of the Collateral Trust Agreement, Respondents conveniently omitted the words "under the Security Agreement."

Security Agreement), under Section 11.1 of the Security Agreement, "subject to the provisions of the Indenture." (A-396-A-397, § 11.1(a).) Again, had the drafters wanted to exempt the Trustee from Section 6.07's restrictions, they would not have included this language in the Collateral Trust Agreement.

Faced with these insurmountable textual barriers, Respondents deride the textual analysis this Court requires as overly "literalist,"[4] and instead ask the Court to adopt a construction that is divorced from the text and which Respondents have concocted based on a grab-bag of extrinsic sources. Respondents' extra-contractual authorities should not even be considered in light of Section 6.07's clear text. In any event, and as discussed immediately below, they fail to support the reading Respondents would engraft onto Section 6.07.

II. RESPONDENTS' ARGUMENTS FOR AN INTERPRETATION OF SECTION 6.07 CONTRARY TO THE INDENTURE'S PLAIN LANGUAGE ARE ALL WITHOUT MERIT

A. Section 6.07 Applies to Acts of the Trustee, Particularly Where (As Here) the Trustee's Actions Were Dictated and Directed by Majority Noteholders

Respondents argue at various points that the Debt-for-Equity Exchange should be deemed exempt from both Section 6.07 of the Indenture and Section 316(b) of the TIA because it was conducted by the Trustee pursuant to the post-default powers granted by the Indenture, the Security Agreement, and the

[4] Resp. Br. at 24.

Collateral Trust Agreement. Resp. Br. at 26. According to Respondents, both Section 6.07 and Section 316(b) restrict only "majority action" clauses that otherwise would permit a majority of noteholders to modify the Indenture's core payment terms. "Trustee remedies," they argue, "do not present this danger" because "[t]hey activate only following an event of default." Resp. Br. at 5.

This argument cannot be squared with the record on appeal or the text of the Indenture. In terms of the record, the Debt-for-Equity Exchange occurred only because the Majority Noteholders directed the Trustee to cancel the Notes and instead distribute company stock to the noteholders. (A-561, ¶ 8; A-562, ¶ 10.) As Respondents acknowledged below,[5] the Majority Noteholders purported to direct the actions of the Trustee based on a classic "majority action" clause included in the Indenture—Section 6.05—which allowed "Holders of a majority in principal amount of the outstanding Notes [to] direct the time, method, and place of conducting any proceeding for exercising any remedy available to the Trustee or the Collateral Trustee." (A-560, ¶ 5) (emphasis added). Notwithstanding the fact that this direction was impermissible under the Indenture because their chosen remedy was unavailable due to Section 6.07, there is no evidence in the record that the Trustee ever exercised its "independent judgment" in proceeding with the

[5] *See* Resp. Appellate Division Br., at 14 (stating that both Section 6.05 (quoted above) and the express terms of the Note permitted "Holders of a majority in principal amount of the Notes outstanding to direct the Trustee in its exercise of any trust or power") (internal citation omitted).

Debt-for-Equity Exchange. Thus, based on the undisputed record, this case is very much about "majority control"—a fact Respondents acknowledge when they (repeatedly) note that the Debt-for-Equity Exchange was supported by 96% of the Noteholders. Resp. Br. at 1, 12.

Even if the Trustee had acted independently (it did not), Section 6.07 includes no carve-out for actions taken by the Trustee, and implying such a carve-out would directly conflict with the obvious intent of Section 6.07's "notwithstanding" clause—*i.e.*, to have its payment right supersede all other provisions of the Indenture. Although Respondents suggest at one point that Section 6.07 applies only prior to an event of default, that is clearly not the case. Resp. Br. at 26, 30-31. Section 6.07 expressly protects a noteholder's right to sue for principal and interest—something that would occur <u>only</u> after a default on the issuer's payment obligations. (A-233-A-234, § 6.07 (protecting "the right of any Holder . . . to bring suit for the enforcement of any such payment on or after such respective [due] date").)

Respondents admit in their brief that Section 6.07 was intended to prevent "collusive agreement[s]" whereby a majority of noteholders were allowed "to favor themselves at the minority's expense." Resp. Br. at 4-5. Although Respondents now suggest otherwise, the Debt-for-Equity Exchange was exactly that kind of transaction, enabling the Majority Noteholders to secure not only their

preferred investment structure (equity) but also the chance to make a senior secured loan to Cleveland Unlimited ($34 million at 10% interest) immediately following the Debt-for-Equity Exchange (A-628 at 2-25; A-629 at 1-9). As such, the fact that the Debt-for-Equity Exchange required the Trustee to take some action in no way exempts the transaction from Section 6.07's protection of the Minority Noteholders' payment rights.

B. Respondents' Formal-Amendments-Only Reading of Section 6.07 and TIA Section 316(b) Has No Support in the Law.

1. Respondents Fail to Demonstrate a "Prevailing Interpretation" of Section 316(b) as Prohibiting Only Formal Amendments to an Indenture's Text.

Stymied by the plain text of Section 6.07, *see* Section I, *supra*, Respondents argue that that text cannot mean what it says on its face, because courts and commentators alike have believed for generations that it means something else—*i.e.*, that Section 316(b) of the TIA permits changes to core payment terms so long as those changes are not effected via formal amendments of the indenture's literal text. Resp. Br. at 3-4, 26-28, 52. This supposed "prevailing interpretation" is a gross mischaracterization and this Court should reject it accordingly.

None of Respondents' cases hold that Section 316(b) is limited to formal amendments of the indenture.[6] If anything, Respondents' authorities cut against

[6] Given the significance of the Second Circuit's *Marblegate* decision to these issues, it is discussed in Section I.A.2, immediately below.

their position. Take, for instance, their invocation of the ABA's Annotated Trust Indenture Act. Resp. Br. at 18-19. Rather than opine that Section 316(b) prohibits only formal amendments (as Respondents say it does), the ABA's assessment is that Congress sought to use Section 316(b) to prevent a wide range of "'majority actions,'" including "waiv[ing] interest or principal payments on the bonds," which would operate "to the detriment of bondholders but to the benefit of the company and its insider equity holders." Am. Bar Ass'n, *Annotated Trust Indenture Act*, 67 Bus. Law. 979, 1146 (2012). Of course, a "waive[r] [of] interest or principal payments" would not qualify as a formal amendment of the indenture; it would simply be a decision—supposedly on behalf of all noteholders—to forgo receipt of interest or principal. If, as Respondents' own sources suggest, such waivers are prohibited by Section 316(b), then Section 316(b) cannot be read as barring only formal amendments' to indentures' text.[7]

In other instances, Respondents reimagine the language of the cases they cite. Consider, in this regard, *Bank of N.Y. v. First Millennium, Inc.*, 607 F.3d 905 (2d Cir. 2010), a case in which the Second Circuit, applying New York law, refused to consider the history and purpose of Section 316(b) because the text of a bond indenture's "notwithstanding" clause was plain. *Id.* at 917 ("We decline to

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[7] Respondents' authorities also undercut their narrow (and anti-bankruptcy) view of Section 316(b). *See* Section II.C.1, *infra*.

disregard the plain language of the indenture provision on account of its similarity to a provision of the TIA."). The court's only (oblique) reference to Section 316(b)'s purpose was in its description of the appellant's attempt to invoke that purpose, describing it as "protect[ing] minority bondholders by prohibiting majority bondholders from collusively agreeing to modify the bond's payment terms." *Id*. A passing reference of this sort cannot bear the weight that Respondents place on it. In any event, Respondents are wrong even on their own terms, because a prohibition on changing "payment terms" (*i.e.*, how, when, or how much payment will be made) is not the same thing as a prohibition only against formal amendments to the text of an indenture's payment provisions. The former prohibits a change in substance without regard to the mechanism by which that change is achieved, whereas the latter concerns only a single mechanism for effecting that change. Nothing in *First Millennium* (or any of Respondents' other authorities) supports that false equivalence. *See* Resp. Br. at 18-20.[8]

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[8] In a similar vein is Section 39:4 of the *Business Workouts Manual*, which Respondents cite at page 19 of their brief. As Respondents note, that treatise states that "Section 316(b) was historically considered to be limited to modifying the 'core' terms of an indenture related to repayment rights." Matthew W. Kavanaugh and Randye B. Soref, *Business Workouts Manual* § 39:4 (2018). Again here, however, Respondents shear the statement from its context. The paragraph that preceded the quoted language concerned two cases that had evaluated whether majority-initiated removal of various non-payment-related covenants from an indenture violated Section 316(b). For that reason, the Manual's authors had no reason to distinguish between formal amendments and other modifications of payment rights. Instead, they were focused on whether Section 316(b) should be read to prohibit changes to indenture provisions that affected a noteholder's ability to obtain payment, without altering in any way its legal right to receive that payment. *Id.*

Respondents also seek support for their view in the legislative history surrounding the TIA's enactment and—in the process—invite the Court to engage in what has been appropriately characterized as "an exercise in 'looking over a crowd and picking out your friends.'" *Exxon Mobil Corp. v. Allapattah Serv., Inc.*, 545 U.S. 546, 568 (2005) (citing Patricia M. Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 Iowa L.Rev. 195, 214 (1983)).

Such is the case here, where Respondents have plucked a handful of statistics and collateral observations from the TIA's voluminous legislative history and proffered them as proof positive of their construction of the TIA. *See* Resp. Br. at 28-29 (citing legislative history sources for the propositions, *inter alia*, that at the time of the TIA's enactment, "trustees were empowered to accelerate" issuers' payment obligations and that "76% of indentures gave trustees the power to sue for all amounts due").

If such an exercise in legislative archaeology were appropriate (and it is not, given the clarity of the indenture's text, *see* Section I.A, *supra*), it would be notable that the historical record contains at least as many passages that contradict Respondents' view of Section 316(b). The House Report, for example, emphatically pronounced that under Section 316(b), "the right of any indenture security holder to receive his principal and interest when due and to bring suit

therefor may not be impaired without his consent." H.R. Rep. No. 76-1016, at 56 (1939). And SEC Chairman Douglas likewise testified that "[t]he effect of [Section 316(b)] is merely to prohibit provisions authorizing such a majority to force a non-assenting security holder to accept a reduction or postponement of his claim for principal, or a reduction of his claim for interest or a postponement thereof for more than 1 year." Trust Indentures, Hearings Before a Subcomm. of the H. Comm. on Interstate and Foreign Commerce, House of Representatives on H.R. 10292, 75th Cong. 35 (1938) (statement of William O. Douglas, Commissioner, SEC) (emphasis deleted)).[9]

Finally, Respondents' suggestion of a longstanding consensus view that Section 316(b) is limited to formal amendments cannot be squared even with the procedural history of this case, in which a group of prominent law professors filed an *amicus* brief noting that, since the TIA's enactment, an "individual bondholder's right to seek repayment of principal with interest has been a stable feature of the corporate bond market" and describing the lower courts' approval of a majority's "ability to effectively terminate the individual repayment right" of

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[9] *See also, e.g.*, Trust Indentures, Hearings Before a Subcomm. Of the H. Comm. On Interstate and Foreign Commerce, House of Representatives on H.R. 2191 and H.R. 5220, 76th Cong. 35 (1939) (statement of Edmund Burke, Jr., Assistant Director, Reorganization Division, SEC) ("[A]ll that the section [316(b)] does is preserve the individual holder's right to bring an action at law to collect his interest and principal in accordance with the terms of his contract, unless he has himself consented to a variation from that contract." (emphasis deleted)).

minority noteholders as a potential "evolution in th[os]e rules." Law Professors' Amicus Br. at 1. If Respondents' reading of the TIA truly were as universally accepted as they say, it is unlikely that so many disinterested experts would describe the decisions below as a possible "evolution" in the law.

In sum, all Respondents can point to in support of their supposed "prevailing interpretation" is a potpourri of authorities that refute their substantive analysis of the TIA (*e.g.*, the Annotated Trust Indenture Act), reject the analytical framework they propose for construing the indenture (*e.g.*, *First Millennium*), or constitute isolated, cherry-picked statements lifted from literally thousands of pages of legislative history. Their arguments, in short, are wrong on their own terms and are irrelevant in any event, given the clarity of the contractual text.

2. *Marblegate* Does Not Support Respondents' Formal-Amendments-Only Reading of Section 316(b)

Wholly aside from the amalgam of other sources discussed above, Respondents also argue that *Marblegate* confirms their view that Section 316(b) prohibits only formal amendments to an indenture's text. Resp. Br. at 40-43. This is so, they argue, because the Second Circuit more than once used the word "amendment" (or similar terminology) when describing the reach of Section 316(b). *Id*. at 42 & n.9. As the Minority Noteholders have already pointed out, however, those statements were irrelevant to the Second Circuit's analysis and thus rank as nothing more than dicta. Minority Noteholders Br. at 37-38; *Global Reins.*

Corp. of Am. v. Century Indem. Co., 30 N.Y.3d 508, 517 (2017) ("[T]he Court's holding comprises only those statements of law which address issues which were presented to the [Court] for determination.") (internal citation and quotation marks omitted).

The "formal amendments" question was simply not at issue in *Marblegate*; instead, the only dispute between the parties was whether Section 316(b) protects (1) only a noteholder's legal right to receive payment and interest; or (2) the noteholder's practical ability to recover payment. *See Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp*., 846 F.3d 1, 6-7 (2d Cir. 2017) ("Congress's use of the term 'right' to describe what it sought to protect from non-consensual amendment suggests a concern with the legally enforceable obligation to pay that is contained in the Indenture, not with a creditor's practical ability to collect on payments. . . ." (emphasis added)); *id*. at 2 (explaining the district court's holding that because the recapitalization plan "stripped the non-consenting noteholders . . . of their practical ability to collect payment on notes," the plan violated Section 316(b) (emphasis added)); *id*. at 7 (surveying the problems created by a reading of Section 316(b) that prohibited any action that affected, however slightly, a noteholder's practical ability to collect on its debt); *id*. at 12 (citing legislative history for the proposition that "other [i.e., non-payment-related] changes in the indenture or by a waiver of other defaults . . . might impair a bondholder's

practical ability to recover payment without violating Section 316(b)" (emphasis added)).

Incredibly, Respondents argue that *Marblegate* "provides no support for a distinction between a permissible impairment of a noteholder's 'practical ability' to receive payment, on the one hand, and an impermissible impairment of its 'legal right' to do so, on the other." Resp. Br. at 46. The passages quoted above belie this suggestion. What is more, the "legal right" vs. "practical ability" framing was adopted not only in the Second Circuit in *Marblegate* but also in the district court proceedings in that case, as well as in at least one other contemporaneous district court decision that immediately preceded *Marblegate*. *See BOKF, N.A. v. Caesars Entmt. Corp.*, 144 F. Supp. 3d 459, 467 (S.D.N.Y. 2015), *abrogated by Marblegate*, 846 F.3d 1 ("[S]ection 316(b) protects a noteholder's practical ability, as well as the legal right, to receive payment when due."); *id.* at 477 ("[T]hree courts in this district have concluded that section 316(b) protects noteholders' practical right to payment." (citing, *inter alia*, *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 75 F. Supp. 3d 592, 611-15 (S.D.N.Y. 2014))).

Furthermore, *Marblegate* has been read by at least one other court as clearly involving the "legal right" vs. "practical ability" dichotomy. *See Cummings v. Chesapeake Energy Corp.*, No. 16-00647, 2017 WL 3836112, at *5 (W.D. Ok. Feb. 8, 2017) ("In *Marblegate*, the Court concluded that as long as a bondholder

retains the 'legal right to obtain payment by suing . . . ,' the holder cannot 'invoke Section 316(b) to retain an "absolute and unconditional" right to payment of its notes.' It rejected the broader reading of § 316(b) that the district court had adopted and retained the focus on a bondholder's legal rights, as opposed to factors which might affect[] the holder's practical right to collect." (emphasis added)).[10]

Put simply, *Marblegate* addressed the scope of the right that Section 316(b) protects (legal right vs. practical ability). It did not—and, indeed, had no reason to—address whether Section 316(b)'s protections are limited to changes effected via particular procedural mechanisms (formal amendments vs. majority instructions to a trustee vs. majority-directed waiver of interest or principal payments). Respondents cannot use *Marblegate* to evade the Indenture's plain text.

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[10] Multiple commentators agree. *See, e.g.*, Jason W. Harbour and Shannon E. Daily, Marblegate: *Second Circuit Limits TIA Prohibition to Altering Legal Right to Payment*, 36-MAR Am. Bankr. Inst. J. 12, 12 (2017) (explaining that *Marblegate* "allow[s] financially distressed companies to pursue out-of-court restructurings that impair its bondholders' practical ability to receive future payments as long as the legal right to receive payment remains unaltered"); Kirby M. Smith, *Entire Fairness in the Trust Indenture Act*, 85 Geo. Wash. L. Rev. Arguendo 58, 67-68 (2017) ("As demonstrated by [*Marblegate*], minority creditors can protect themselves by bringing suit under the [TIA]—a right that, because of the [TIA], cannot be taken away by a majority-favored out-of-bankruptcy restructuring."); Ettore A. Santucci, *The Second Circuit's* Marblegate *Decision and Third Party Legal Opinions in Debt Restructurings*, 2017-NOV Bus. L. Today 1, 2 (2017) ("The Second Circuit held that section 316(b) protects only bondholders' formal legal right to the payment of principal and interest and not their practical ability to collect principal and interest.").

C. Respondents' Policy and Factual Arguments Are Both Incorrect and Irrelevant

1. Respondents' Purported Aversion to Bankruptcy Is Contrary to the Applicable Law and Without Factual Basis

Respondents contend that, if Section 316(b) of the TIA (and thus, Section 6.07 of the Indenture) were to prohibit out-of-court restructurings that are not 100% consensual, then distressed issuers would be forced into bankruptcy proceedings. Resp. Br. at 50-52. But judicial review of those restructurings is precisely the intent of that provision. The House Report on Section 316(b) states, "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this prohibition." S. Rep. No. 248, 76th Cong., 1st Sess. 26 (1939); H.R. Rep. 1016, 76th Cong., 1st Sess. 56 (1939). Multiple federal cases confirm this fact. *See Brady v. UBS Fin. Servs., Inc.*, 538 F.3d 1319, 1325 (10th Cir. 2008) ("[Section] 316(b) was designed to provide judicial scrutiny of debt readjustment plans to ensure their equity. In practice, the provision tends to force recapitalizations into bankruptcy court because of the difficulty of completing a consensual workout.") (citations omitted); *UPIC & Co. v. Kinder-Care Learning Centers, Inc.*, 793 F. Supp. 448, 453 (S.D.N.Y. 1992) ("The [SEC] was undoubtedly aware that requiring unanimity in bondholder voting—rather than mere majority action—would frustrate consensual workouts and help induce bankruptcy. And convinced that insiders or quasi-insiders would damage

bondholders, the Commission welcomed the prospect.") (citation omitted); George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 Am. Bankr. Inst. L. Rev. 431, 438 (2006) ("The [SEC], in promoting the TIA, was consciously forcing debt restructurings involving TIA-qualified indebtedness to occur in bankruptcy court under the applicable laws and rules, rather than in an out-of-court setting under rules contracted by the parties.") (footnote omitted).

Respondents' argument is also based on a false factual premise—namely, that bankruptcy is cumbersome, lengthy, expensive, and deleterious to a company's ability to continue to operate as a going concern. *See* Resp. Br. at 50-52. In fact, it is well understood—as explained by Respondents' preferred source—that "[o]ne common restructuring strategy is to propose an exchange offer and, if the appropriate consents are not achieved by a certain date, the distressed company files a prepackaged chapter 11 filing that utilizes special provisions of the Bankruptcy Code to override the indenture's consent thresholds and 'drag along' nonconsenting bondholders." *See Business Workouts Manual* § 39:2.

2. Enforcing Section 6.07 According to Its Plain Terms Is Not Unreasonable

Respondents contend that the Minority Noteholders' "literalist interpretation would put Section 6.07 into conflict with the Bankruptcy Code." Resp. Br. at 21. That is plainly incorrect. The Bankruptcy Code is a federal statute—one not at issue in this case—that trumps inconsistent provisions of a given creditor's

contract with the debtor as well as Section 316(b) of the TIA in exchange for other protections in the restructuring process. *See, e.g., In re Bd. of Dirs. of Telecom Argentina, S.A.*, 528 F.3d 162, 172 (2d Cir. 2008).

Respondents also wrongly suggest that enforcing Section 6.07 according to its plain language would thwart a trustee's ability to accelerate payments of principal and interest after an event of default. Resp. Br. at 21-22. That argument, however, improperly conflates the timing of a payment, on the one hand, with the right to payment, on the other. Section 316(b) concerns the right to receive principal and interest "on or after the respective due dates expressed in such indenture security." 15 U.S.C. § 77ppp(b). The plain language looks to the indenture to determine when a payment is due. A timing mechanism in an indenture that moves the due date earlier in time is recognized as simply the means by which one calculates "the due dates expressed in [the] indenture." *See UPIC & Co.*, 793 F. Supp. at 455 (holding that principal that comes due after the triggering of an early repurchase right falls within a "due date expressed in the Security").[11]

In re Delta Air Lines, Inc. does not help Respondents. In that case, certain noteholders complained about a settlement that the collateral trustee reached with Delta Airlines, a debtor in a chapter 11 case, under a lease that Delta had rejected

[11] Moreover, the Tenth Circuit has found that acceleration does not extinguish a noteholder's right to sue based on the original "Stated Maturity" set forth in the indenture. *Brady*, 538 F.3d at 1325-26.

in bankruptcy. *In re Delta Air Lines, Inc.*, 370 B.R. 537, 540-41 (Bankr. S.D.N.Y.), *aff'd*, 374 B.R. 516 (S.D.N.Y. 2007), *aff'd*, 309 F. App'x 455 (2d Cir. 2009). Of critical importance, the notes in that case were not issued or guaranteed by Delta, but rather were issued on a non-recourse basis by the Kenton County Airport Board ("KCAB"). *Id.* at 541. As collateral, KCAB assigned to the collateral trustee the right to receive rents due under KCAB's lease with Delta Airlines. *Id.* at 540. The individual noteholders, however, had no standing to make claims directly against Delta—taking action against collateral was the province of the trustee. *Id.* at 542.

The noteholders argued that the collateral trustee's settlement impaired their right to payment. *Id.* at 546. In the first instance, of course, the noteholders had no standing to make claims for payment directly against Delta, the lessee. *Id.* at 542. Here, of course, the Minority Noteholders are not pursuing claims against a third party whose payments operate as collateral for their notes; instead, they are proceeding directly against the issuer and its guarantors—facts that render *Delta*'s discussion of the role of the collateral trustee inapposite here.

In addition, the bankruptcy court made abundantly clear that the settlement was part of a Chapter 11 reorganization, which trumped any rights that might exist by way of contract. *Id.* at 546 ("The Bankruptcy Code, which overrides private agreements, grants Delta the right to reject the Lease and terminate future

payments under the Lease to KCAB, which will terminate payments under the Indenture to the Bondholders.").

Respondents also misplace their reliance on *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1281 (9th Cir. 1992). The documents in that case used different language that merely gave the bondholders standing to sue for payment without the need to first obtain consent from the trustee. *Id*. Unlike here, however, that language did not preserve a right to payment of principal and interest for each individual bondholder and thus did not "take away from [the trustee] the power to settle or compromise Bondholders' claims." *Id.*

3. The Availability of Other Remedies Is Irrelevant

Respondents raise various other legal actions that they contend the Minority Noteholders should have pursued, such as suing the trustee, filing an involuntary bankruptcy, and bringing a fraudulent transfer action. Resp. Br. at 54-55. This is misdirection. The Minority Noteholders were under no obligation to pursue any other potential remedies and, more important, the existence of any additional remedies does not excuse or in any way alter Cleveland Unlimited's primary obligation on the Notes.

4. Respondents' Arguments Concerning the "Value Maximizing" Advantages of the Transaction Are Both Irrelevant and Incorrect

Respondents claim that "the strict foreclosure delivered more value than any other available remedy, and more than a bankruptcy." Resp. Br. at 1. Not only is

there nothing in the record to support that statement, but Respondents' brief demonstrates that it is false: Cleveland Unlimited's business failed. Resp. Br. at 52. It is preposterous to claim that handing out shares in a collapsing business "delivered more value than any other available remedy."

In any event, it does not matter whether the transaction maximized value—the Indenture did not permit it, and there is no "value maximization" exception to either Section 6.07 or TIA Section 316(b).

Finally, Respondents distort the Minority Noteholders' argument when they complain that the Minority Noteholders "did not identify any alternative by which to obtain payment on their Notes" and are insisting on "a 100% recovery on their Notes[,]to be funded, not by CUI (which could not pay), but by their fellow noteholders." Resp. Br. at 2. First, the Minority Noteholders did propose alternatives (although they were not obligated to do so). (A-617-A-622.) Next, the Minority Noteholders are not claiming that other noteholders must pay Cleveland Unlimited's debt. Rather, the Minority Noteholders are simply seeking a judgment against Respondents as obligors on the unpaid Notes.

It bears repeating that the Majority Noteholders consented to give up their debt in exchange for equity to make a play for economic upside. That gambit failed. They cannot now complain about the Minority Noteholders having

payment priority, Resp. Br. at 53-54, given that the Majority Noteholders engineered a transaction to voluntarily move down the capital structure.

III. RESPONDENTS' "COLLECTIVE DESIGN" ARGUMENT FAILS

Although Respondents attempt to deemphasize the "collective design" theory that provided the basis for the lower courts' decisions, they nevertheless continue to misrepresent this Court's holding in *Beal Savings Bank v. Sommer*, 8 N.Y.3d 318 (2007).

The core difference between *Beal* and this case is that the Minority Noteholders are relying on a non-impairment provision in the Indenture that protects the right to receive and sue for payments of principal and interest owed on the Note. This Court expressly acknowledged that no such provision existed in *Beal*:

> Here, of course, neither the Credit Agreement nor the Keep-Well contains an explicit provision stating that a Lender may—or may not—take individual action in the event of default, and thus we are compelled to look to other specific clauses and the agreements as a whole to ascertain the parties' intent.

Beal, 8 N.Y.3d at 326. The lack of such a provision led this Court to analyze other provisions in the parties' agreements and "to conclude that the agreements have an unequivocal collective design." *Id*. Tellingly, Respondents do not even mention this language from *Beal*. Instead, they point to various parts of *Beal*'s Keep-Well that they contend contain "language stronger than Section 6.07 here." Resp. Br. at

60 (emphasis in original). None of these provisions, however, "stat[es] that a Lender may—or may not—take individual action in the event of default." *Beal*, 8 N.Y.3d at 326. That is the key distinction on which *Beal* turned and what led the Court to look to the "collective design" of the agreements. Section 6.07 forecloses that result here. The "collective design" rationale of *Beal* is inapposite, and the lower courts erred when they relied upon it.

IV. THE GUARANTORS REMAIN LIABLE FOR CLEVELAND UNLIMITED'S BREACH

Respondents argue that, even if the Debt-for-Equity Exchange violated the Indenture, Respondent CUI Holdings, LLC, one of Cleveland Unlimited's Guarantors, "must be dismissed because it was released." Resp. Br. at 63. This argument fails. Because Cleveland Unlimited breached its contractual obligations to the Minority Noteholders (by never paying them what they were owed on their Notes), its Guarantors—including CUI Holdings—remain liable for that obligation.

Under New York law, a party in default of its contractual obligations cannot enforce any subsequent release of its guarantee that it received at a time when it remained in material breach of that obligation. *Peconic Surgical Group PC v. Cervone*, 930 N.Y.S.2d 175, 2011 WL 2347613, at *3 (N.Y. Sup. Ct. Suffolk Cnty. June 1, 2011) ("A party to a contract who fails to perform a material obligation of the contract is not in court with clean hands and may not seek the aid of a court of

equity in the protection of alleged rights arising out of or connected with the contract."); *accord Michael I. Weintraub, M.D., P.C. v. Schwartz*, 516 N.Y.S.2d 946, 948-49 (2d Dep't 1987) ("[a]ssuming the plaintiffs have breached their own obligations under the contract, they would be precluded from seeking to enforce against the defendant even the reasonable portion of the restrictive covenant").

By failing to make payments after Cleveland Unlimited's default, CUI Holdings and the other Guarantors were in breach of their guarantee obligations at the time of the Debt-for-Equity Exchange. Accordingly, they are precluded from relying on Section 10.02 of the Indenture to claim they are released from their guarantee obligations. *See, e.g.*, *Lassiter v. Topeka United School Dist. No. 501*, 347 F. Supp. 2d 1033, 1041-43 (D. Kan. 2004) (release unenforceable if defendant committed a material breach of the agreement).

V. RESPONDENTS' SET-OFF DEFENSE IS MERITLESS; NO TRIAL ON DAMAGES IS NECESSARY

The terms of the Indenture and Note required Cleveland Unlimited to pay the Minority Noteholders in cash, and the amounts due on the Note are the contractual damages the Minority Noteholders are seeking in this collection action. There are no factual disputes on these points, and thus no trial on damages is necessary.

Respondents do not dispute that: (i) the Indenture and Note required that the Minority Noteholders be paid in cash and did not provide for any alternate

payment medium (including stock); and (ii) Respondents failed to comply with that requirement when they purported to give the Minority Noteholders stock rather than cash. Accordingly, the Minority Noteholders are entitled to contractual damages—*i.e.*, damages sufficient to "restore the injured party to the position he would have had if the contract had been fully performed." *HYMF, Inc. v. Highland Capital Mgmt., L.P.*, No. 601027/2009, 2012 WL 1071401, at *11 (N.Y. Sup. Ct. N.Y. Cnty. Mar. 23, 2012) (emphasis added) (citing *Brushton–Moira Cent. School Dist. v. Fred H. Thomas Assocs., P.C.*, 91 N.Y.2d 256, 262 (1998)). If Respondents had attempted to pay Cleveland Unlimited's noteholders in used refrigerators—and the noteholders rejected that form of payment—Respondents surely would not argue that the value of the refrigerators be deducted from any damages award. But that is the absurd result that Respondents' argument leads to when they suggest that shares of stock fulfill a contractual provision that explicitly required payment in cash.

The Minority Noteholders immediately and expressly objected to the Debt-for-Equity Exchange at the time Respondents proposed it. (A-558.) Although Respondents make much of an email in which a representative of the Minority Noteholders identified them as "holders of the equity," that email was nothing more than a request for information. (A-1661, A-1698-99.) It is certainly not an "acceptance" of the stock, which was made obvious when the Minority

Noteholders shortly thereafter filed suit for payment of the Notes in cash and said they would return the shares to Respondents.[12]

The fact that Respondents foisted stock certificates upon the Minority Noteholders is meaningless. The comments to the relevant section of New York's U.C.C. state that "[a] debtor's voluntary surrender of collateral to a secured party and the secured party's acceptance of possession of the collateral does not, of itself, necessarily raise an implication that the secured party intends or is proposing to accept the collateral in satisfaction of the secured obligation under this section."). N.Y. U.C.C. § 9-620 cmt. 5; *see also Kapor v. RJC Investment, Inc*., 434 P.3d 869, 876 (Mont. 2019) (noting that debtor cannot use purported conveyance of collateral to "bar a deficiency judgment when the creditor never agreed to acceptance in satisfaction of the debt").[13]

From the outset, the Minority Noteholders have made clear that they would not accept shares of Cleveland Unlimited in exchange for the extinguishment of their contractual right to payment. And they have repeatedly told Respondents that they would return the shares as soon as they were paid the principal and interest

12 Respondents certainly never treated the Minority Noteholders as equity holders on par with the Majority Noteholders. For example, Respondents never made distributions to the Minority Noteholders on behalf of their "equity" positions as they did for the majority. (A-596 at 13-25; A-597 at 1-20; A-603 at 1-12.)

13 N.Y. U.C.C. § 9-620(b) requires that any acceptance by a secured creditor be in writing. The Minority Noteholders, of course, never provided any acceptance in writing.

due on the Note. The Minority Noteholders are entitled to the payments they are owed, in the medium prescribed by the parties' contract, and Respondents cannot escape their payment obligation by transferring another asset to the Minority Noteholders. There is no reason to hold a trial on damages.

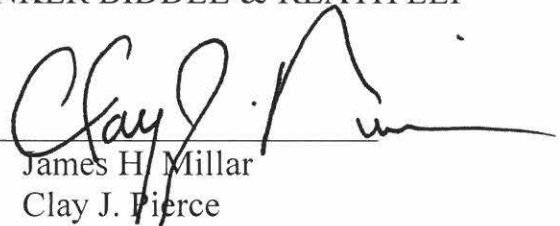
CONCLUSION

For the reasons set forth above and in their opening brief, Plaintiffs-Appellants CNH Diversified Opportunities Master Account L.P., AQR Delta Master Account, L.P., AQR Delta Sapphire Fund, L.P., and AQR Funds—AQR Diversified Arbitrage Fund respectfully request that the Court reverse the Appellate Division's decision affirming the trial court's grant of summary judgment to Defendants-Respondents and direct that summary judgment be entered for Plaintiffs-Appellants.

Dated: July 25, 2019

Respectfully submitted,

DRINKER BIDDLE & REATH LLP

By: 

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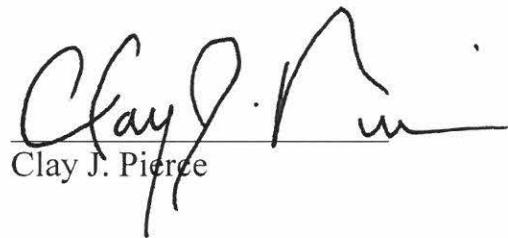

Clay J. Pierce