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

APL-2019-0031
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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

This case raises crucial issues regarding the rights of corporate bondholders to collect principal and interest on their notes—rights protected by statute and, for bond issues not subject to the federal securities laws, by standardized contractual provisions found in virtually every trust indenture issued since the adoption of the Trust Indenture Act in 1939.

Appellants, the Minority Noteholders, hold $5 million in senior secured notes issued by Respondent Cleveland Unlimited, Inc., a former telecommunications company that operated in Ohio. In December 2010, Cleveland Unlimited defaulted on its obligation to pay principal and interest due on the notes. After unsuccessful negotiations concerning a voluntary restructuring, the Company and a majority group of noteholders implemented a debt-for-equity exchange that by its terms purported to: (i) "cancel" and "terminate" the Company's obligation to pay further interest and principal due on its notes; and (ii) substitute for the notes shares of company stock. All noteholders—whether they consented to the exchange or not—were forced to participate in this debt-for-equity exchange.

The legal question presented by this case is whether Respondents were permitted to "cancel" and "terminate" the Minority Noteholders' payment rights

without their consent. As the unambiguous language of the controlling (New York-law-governed) trust indenture makes plain, they were not.

Section 6.07 of the Indenture states that:

> Notwithstanding any other provision of the Indenture, the right of any Holder to receive payment of principal of, premium, if any, and interest and Additional Interest, if any, on a Note, on or after the due dates expressed in such Note, or to bring suit for the enforcement of any such payment on or after such respective date, shall not be impaired or affected without the consent of such holder.

(A-233-A-234, § 6.07 (emphasis added).) That text should have been the end of the lower courts' analysis. Yet both the trial court and the Appellate Division declined to apply Section 6.07's plain terms, making two errors in the process.

First, rather than apply Section 6.07 as written, the Appellate Division and the trial court found that the Indenture permitted the involuntary termination of the Minority Noteholders' right to payment based on a misapplication of the Second Circuit's decision in *Marblegate Asset Management v. Education Management Finance Corp.*, 846 F.3d 1 (2d Cir. 2017). In *Marblegate*, the Second Circuit was asked to interpret Section 316(b) of the Trust Indenture Act of 1939, which Congress passed in order to curb rampant abuses of minority bondholders by bond issuers and majority groups of bondholders. Although *Marblegate* concerned the interpretation of a federal statute, the language of Section 316(b) is substantively

identical to Section 6.07, and thus likewise prohibits the non-consensual impairment of a noteholder's payment rights.

The issue in *Marblegate* was whether Section 316(b) had been violated when a company that had issued a series of notes removed all assets from the entity obligated to pay principal and interest on the notes. Doing so effectively rendered the issuer judgment-proof but did not disturb the noteholders' legal right to payment of the principal and interest due on the notes. Because the noteholders' legal right to repayment remained intact, the Second Circuit held that the TIA had not been violated.

Here, in contrast, Cleveland Unlimited never moved any assets; instead, Respondents purported to "terminate" Cleveland Unlimited's obligation to pay principal and interest by operation of a debt-for-equity exchange that was agreed to by some but not all noteholders. This case, in other words, presents the opposite of the scenario that played out in *Marblegate* and therefore should yield the opposite conclusion: the debt-for-equity exchange violated Section 6.07 because it impaired the Minority Noteholders' legal right to payment of interest and principal.

The error from which both decisions below suffer rests on the same misconception—namely, that *Marblegate* stands for the principle that the TIA is violated only when a transaction involves a "formal amendment" of the indenture. Under this reading of *Marblegate*, an issuer could circumvent its legal obligations

and terminate a noteholder's legal right to payment of principal and interest so long as no "formal amendment" of the indenture occurred as part of the process. As detailed below, the lower courts' interpretation is based on a single, out-of-context sentence from the Second Circuit's opinion, and conflicts both with key portions of the Second Circuit's own analysis and the plain text of Section 316(b).

Second, the lower courts incorrectly found that, even if Respondents' actions were contrary to Section 6.07, they were nonetheless permissible under other sections of the Indenture and the accompanying Security Agreement that gave the Trustee various remedies in the event of a default. To be sure, the Indenture and Security Agreement granted the Trustee significant powers in the event Cleveland Unlimited defaulted on the notes. But the lower courts failed to appreciate that in exercising those remedies, Respondents and the Trustee were prohibited from impairing the Minority Noteholders' payment rights without their consent. This result is compelled by the plain text of Section 6.07, which, by its own terms, applies "notwithstanding any other provision of the Indenture." The Security Agreement likewise provides that the Trustee's actions are "subject to" the terms of the Indenture. Accordingly, even though the Trustee was authorized to take sweeping actions under the Indenture, it could not impinge on the Minority Noteholders' payment rights without the consent of the affected holders. Yet that is exactly what Respondents and the Trustee purported to do here.

If not corrected by this Court, the errors made by the trial court and the Appellate Division will substantially weaken the rights of corporate bondholders, cast doubt over New York's well-settled rules of contractual interpretation, and (last but not least) create a needless conflict between New York and federal law. For these reasons and those set forth below, this Court should reverse the Appellate Division's decision.

QUESTIONS PRESENTED

1. Where an indenture provides that noteholders' right to the payment of principal and interest may not be "impaired or affected" without their consent, may the issuer and a majority group of noteholders direct the indenture trustee to terminate the payment rights of all noteholders so long as such termination does not involve a formal amendment of the indenture?

2. Where an indenture expressly protects a minority noteholder's right to payment "notwithstanding any other provision of the indenture," and where the "actions of the collateral trustee" pursuant to a related security agreement are "subject to the provisions of the indenture," may a bond issuer, trustee, and majority of noteholders rely on conflicting provisions of the indenture and security agreement to terminate the minority noteholder's payment rights?

* * *

Both the Appellate Division and the trial court decision it affirmed incorrectly concluded that the answers to both of the above questions should be "yes."

STATEMENT OF JURISDICTION

This Court has jurisdiction over this appeal pursuant to CPLR § 5602(a)(1)(i) and 22 NYCRR § 500.22. The underlying action originated in the Supreme Court, and the Appellate Division's decision finally determined the action and was not appealable as a matter of right. On February 14, 2019, this Court granted permission to appeal. The issues raised in this appeal were raised before the Supreme Court and the Appellate Division. (A-84, A-1774-A-1776.)

STATEMENT OF FACTS

A. Cleveland Unlimited's Issuance of the Notes

Until its liquidation in 2014, Respondent Cleveland Unlimited, Inc. ("Cleveland Unlimited" or the "Company") operated a small regional wireless telecommunications business in Ohio. (A-161; A-602 at 13-19; A-630 at 1-7; A-639, ¶ 1.) On December 15, 2005, Cleveland Unlimited issued $150 million of "senior, secured" debt (the "Notes"). The Notes had a five-year maturity and required Cleveland Unlimited to pay interest to the noteholders on a quarterly basis until the maturity date, December 15, 2010, at which point the Notes would mature and Cleveland Unlimited would be obligated to repay to the noteholders the full amount of the principal it had borrowed. (A-208-A-209, § 4.01; A-309-A-310.) Both the Indenture and the Notes provided that principal and interest would be paid in U.S. dollars. (A-208-A-209, § 4.01; A-271-A-272.)

The Notes were "senior, secured" debt, which ensured that the noteholders were not subordinate to Cleveland Unlimited's other creditors and granted the Trustee a security interest in (or lien on) Cleveland Unlimited's assets. (A-214; § 4.09(3); A-270; A-373-A-374, § 2.1; A-391, § 9.1.) Nineteen of Cleveland Unlimited's subsidiaries and affiliates (the "Guarantors") fully, unconditionally, and irrevocably guaranteed payment on the Notes. (A-132-A-133, ¶¶ 12-30; A-147-A-148, ¶¶ 12-30; A-180, § 1.01; A-252-A-253, § 10.01; A-643-A-644, ¶ 17.)

Appellants (the "Minority Noteholders") purchased a total of $5 million principal amount of the Notes in April 2010 in the secondary market at a price of 98.5 percent of face value, and received interest payments as scheduled on or about June 15 and September 15, 2010. (A-135, ¶¶ 40, 42; A-610 at 2-22; A-632 at 3-11.)

B. The Indenture's Core Payment Terms

The Notes were issued pursuant to an indenture (the "Indenture"), dated December 15, 2005, by and among Cleveland Unlimited, the Guarantors, and U.S. Bank National Association ("U.S. Bank") as Indenture Trustee for the Notes.[1] (A-161; A-639, ¶ 1.)

[1] The parties also executed a Collateral Trust Agreement, with U.S. Bank functioning as the Collateral Trustee, and a separate Security Agreement. (A-323; A-360.) U.S. Bank, in its role as Indenture Trustee and Collateral Trustee, is referred to herein as the "Trustee."

Section 6.07 of the Indenture provided that a noteholder's rights (i) to payment of principal and interest and (ii) to sue to enforce that right could not "impaired" or "affected" without its consent:

> Notwithstanding any other provision of the Indenture, the right of any Holder to receive payment of principal of, premium, if any, and interest and Additional Interest, if any, on a Note, on or after the due dates expressed in such Note, or to bring suit for the enforcement of any such payment on or after such respective date, shall not be impaired or affected without the consent of such holder.

(A-233-A-234, § 6.07.) The language of Section 6.07 parallels Section 316(b) of the Trust Indenture Act of 1939 (the "TIA"), which provides:

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

15 U.S.C. § 77ppp(b). The Indenture also incorporated any provision of the TIA that was required to be included in a qualified indenture.[2] (A-255, § 11.01.) This included Section 316(b).[3] (A-162.)

C. The Limitations Imposed by Section 6.07

The Indenture and related agreements gave the Trustee the ability to take certain actions for the benefit of the noteholders. For example, Section 9.1 of the Security Agreement states that, if the Company defaults on its payment obligations, "the Collateral Trustee may . . . (iv) Take possession of the Collateral or any part thereof." (A-391-A-393, § 9.1.) Section 6.03 of the Indenture likewise says that, in the event of a default, the Trustee "may pursue any available remedy by proceeding at law or in equity to collect the payment of, premium, if any, or interest or Additional Interest, if any, on the Notes." (A-232, § 6.03.)

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[2] A "qualified" indenture is one that governs securities that have been registered with the SEC. 15 U.S.C. § 77iii(a).

[3] In addition to incorporating Section 316(b) of the TIA and including Section 6.07 as a contractual provision, the Indenture and the Notes included other sections intended to ensure that an individual noteholder's right to the payment of principal and interest could not be compromised without that noteholder's consent. For example, Section 9.02 of the Indenture and Section 13 of the Form of Note prohibited, without unanimous approval of all noteholders, any amendment or waiver that would "reduce the principal of or change the fixed maturity of any Note," "reduce the rate of or change the time for payment of interest on any Note," or "make any Note payable in money other than stated in the Notes" (i.e., U.S. dollars). (A-249-A-251, § 9.02; A-275-A-277, § 13.)

Notably, the Indenture and related documents constrained the power of the Trustee—and the power of the noteholders themselves[4]—to compromise any individual noteholder's right to payment. To that end, numerous provisions underscored that the Trustee's power to act was subject to the constraints imposed by the Indenture. (A-396-A-397 (Security Agreement § 11.1(a)) ("The actions of the Collateral Trustee hereunder are subject to the provisions of the Indenture."); A-391-A-393 (Security Agreement § 9.1) ("Subject to the provisions of this Agreement and applicable law, [the Trustee may] exercise all the rights and remedies of a secured party on default under the UCC[.]"). And Section 6.07, in turn, provided that each noteholder's right to receive payment was inviolable and would be immune from encroachment, "notwithstanding any other provision of th[e] Indenture." (A-233-A-234, § 6.07.)

D. Cleveland Unlimited's Default on the Notes on the Maturity Date

On December 15, 2010, Cleveland Unlimited defaulted on its obligation to pay the principal owed on the Notes. (A-138, ¶ 53; A-152, ¶ 53; A-476, ¶ B.) Prior to its default, the Company entered into discussions with its noteholders, including the Minority Noteholders. (A-138, ¶ 57; A-152, ¶ 57.) The parties

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[4] Section 6.05 of the Indenture allows "the 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 trust or power conferred on the Trustee or the Collateral Trustee, as the case may be, or exercising any trust or power conferred on the Trustee or the Collateral Trustee, as the case may be, including, without limitation, any remedies provided for in Section 6.03." (A-233, § 6.05.)

executed a short-term agreement (the "Forbearance Agreement") under which the noteholders agreed to temporarily refrain from exercising rights and remedies while the parties considered potential restructuring transactions. (A-476.) Cleveland Unlimited and the Guarantors "ratif[ied] and confirm[ed] their Payment Obligations, liabilities and agreements under the Indenture Documents, and the liens and security interests created thereby." (A-481, § 5.)

During the forbearance period, counsel for a majority of the noteholders (the "Majority Noteholders") proposed a transaction pursuant to which each noteholder would give up all legal rights under the Notes and instead would become equity holders. (A-532, §§ 2.1, 2.2.) However, after reviewing confidential financial information made available by the Company, the Minority Noteholders determined that Cleveland Unlimited's financial prospects were extremely precarious and declined to give up the protections provided to each noteholder under the Indenture and Security Agreement. (A-611-A-616.) Instead, the Minority Noteholders favored the filing of a Chapter 11 bankruptcy pursuant to which the noteholders (as senior, secured creditors) would be paid prior to the Company's other creditors, believing a bankruptcy would best maximize value for the noteholders and protect their interests. (A-619-A-622.) Alternatively, the Minority Noteholders advised the Company that they would agree to allow the other noteholders to exchange their Notes for shares and would stay on as debtholders in a manner that would

give the Company a runway to improve its financial condition. (A-617-A-618.)

The parties failed during the forbearance period to consummate a consensual financial restructuring or other such accommodation. (A-633-A-634.) Accordingly, when the forbearance period ended and Cleveland Unlimited still failed to repay the principal and accrued and unpaid interest, the Minority Noteholders retained all of the rights they had before the Forbearance Agreement, including the right to receive payment of principal and interest and to bring suit to enforce that right.

E. Cleveland Unlimited's Purported Termination of the Minority Noteholders' Core Payment Rights

On June 1, 2011, counsel for the Majority Noteholders announced that the Majority Noteholders would proceed with an alternative transaction under a specific section of Article 9 of the U.C.C., which is entitled, "Acceptance of Collateral in Full or Partial Satisfaction of Obligation." N.Y. U.C.C. § 9-620. In this type of transaction, a secured creditor is permitted, but is not required, to accept collateral in complete satisfaction of the debt, without a foreclosure sale or other market test. *See* N.Y. U.C.C. §§ 9-620 to 9-622. Thus, in the transaction proposed by the Majority Noteholders (the "Debt-for-Equity Exchange"), the noteholders would receive the collateral pledged by Cleveland Unlimited's direct parent (CUI Holdings, LLC), which was 100 percent of the equity of Cleveland Unlimited.

The parties frequently referred to the Debt-for-Equity Exchange as a "strict foreclosure." This term is a misnomer that can lead to confusion. The relevant sections of the U.C.C. do not use the words "strict foreclosure" (or even the term "foreclosure," for that matter) and the mechanics of the Debt-for-Equity Exchange do not resemble those of a traditional foreclosure action. *See* N.Y. U.C.C. §§ 9-620 to 9-622.

Counsel for the Majority Noteholders (Allan Brilliant of Dechert LLP, who now represents Respondents) sent an email to the noteholders on June 1, 2011, discussing the efforts of the Majority Noteholders and Cleveland Unlimited to move forward with the Debt-for-Equity Exchange. (A-546.) In his email, Mr. Brilliant asserted that the Debt-for-Equity Exchange did not require consent from each impaired noteholder, a tacit recognition that Section 6.07 was a problem for Cleveland Unlimited:

> As you know we have been working with the Indenture Trustee on an alternative transaction, a strict foreclosure under the Uniform Commercial Code, that would enable us to maintain the structure of the consensual deal – without the $35 million of new debt – <u>without requiring consent from all of the bondholders</u>.

(*Id.*) (emphasis added).

The Minority Noteholders previously were unaware of the planned transaction; however, promptly after receiving this email, counsel for the Minority Noteholders delivered a letter to the Company and the Trustee stating that the

Minority Noteholders "do not join in or in any way consent to the proposed transaction." (A-558.) The letter informed the Company and the Trustee that, if they proceeded with the Debt-for-Equity Exchange without the Minority Noteholders' consent, Cleveland Unlimited "will continue to owe principal, premium, if any, interest, and Additional Interest, if any, to [the Minority Noteholders] after a closing of the proposed transaction." (*Id.*) The Minority Noteholders further stated that they "expressly reserve their rights to pursue any and all remedies against the Company, the Guarantors, the Indenture Trustee, and all other parties[,]" including for payment of principal and interest. (*Id.*)

Notwithstanding the plain language of the Notes, the Indenture, and the TIA—as well as the objection lodged by the Minority Noteholders—Cleveland Unlimited, its affiliated entities, the Majority Noteholders, and the Trustee proceeded with the Debt-for-Equity Exchange. (A-569-A-583.) As the first step in the Debt-for-Equity Exchange, representatives of the Majority Noteholders instructed the Trustee to, among other things, enter into a Strict Foreclosure Agreement and Joint Instructions to Escrow Agent (the "Strict Foreclosure Agreement"), dated September 8, 2011. (A-559-A-568.)

Pursuant to the terms of the Strict Foreclosure Agreement, Cleveland Unlimited's parent company transferred its 100 percent equity stake in the Company to the Trustee for the benefit of the Noteholders. (A-570-A-571, § 2.)

Cleveland Unlimited then issued approximately 96.7% of its shares to CUI Acquisition Corp., a corporation owned by the Majority Noteholders. (A-141, ¶ 73; A-155, ¶ 73.) The remaining approximate 3.3% of shares were purportedly "transferred" to the non-participating noteholders, including the Minority Noteholders. (A-141, ¶ 73; A-155, ¶ 73.) The Minority Noteholders never agreed to accept equity in lieu of cash; however, Respondents delivered physical certificates representing Cleveland Unlimited shares, in the names of each of the Minority Noteholders, to the Minority Noteholders' brokers and custodians, which shares were automatically placed in their respective accounts. (A-809-A-813.) On the same day that it signed the Strict Foreclosure Agreement, the Trustee sent a Notice to all noteholders purporting to advise them that all rights to repayment under the Notes were extinguished:

> [B]y operation of law as a result of the strict foreclosure, the indebtedness evidenced by the Notes shall be deemed <u>paid and cancelled</u> and with limited exceptions, the obligations of the Company under the Indenture <u>shall be terminated</u>. The rights of the holders will be limited to receiving their pro rata share of the aforementioned distribution and no further distributions will be made to Holders on account of the Notes.

(A-585.) (emphasis added).

F. The Majority Noteholders Disadvantage the Minority Noteholders

Despite the Respondents' current position that all noteholders received the same consideration and that the Minority Noteholders were equivalent

shareholders, they did not treat the Minority Noteholders in an equivalent manner. For example, the Respondents made distributions to the Majority Noteholders on behalf of their "equity" positions but have not made any distributions to the Minority Noteholders. (A-596 at 13-25; A-597 at 1-20; A-603 at 1-12.) In addition, after liquidating the Company's assets in 2014 and 2015, the Respondents paid $34 million plus 10 percent interest to certain of the Majority Noteholders who had been invited to make a senior secured loan to Cleveland Unlimited immediately following the Debt-for-Equity Exchange. (A-593 at 9-18; A-604 at 1-13; A-605 at 21-24; A-628 at 2-25; A-629 at 1-9.) The Minority Noteholders were never offered the opportunity to participate in this deal, even though it substantially increased the return earned by the Majority Noteholders on their initial investment. (A-594 at 3-11.)

G. This Action and the Trial Court's Decision

Left with no other option to enforce their legal rights, the Minority Noteholders brought this action against Cleveland Unlimited and the Guarantors for payment on the Notes. (A-129-A-144.) On March 22, 2017, both sides moved for summary judgment. (A-67-A-68; A-920-A-922.) In a decision and order dated January 11, 2018, Justice Saliann Scarpulla denied the Minority Noteholders' motion for summary judgment and granted summary judgment in favor of Respondents. (A-8-A-25; A-26-A-43.) The trial court reasoned "that there was a

collective design to this transaction, and the Collateral Trustee was to act for all of the noteholders in the event of the issuer's default, upon the direction of a majority of noteholders." (A-19.) As a result of this "collective design," the trial court found that "the Collateral Trustee's pursuit of the out-of-court debt restructuring here at the direction of the Majority Noteholders was authorized under the parties' agreements." (*Id.*) Despite the plain language Section 6.07, and its statement that it required each noteholder to consent "notwithstanding any other provision of the Indenture," the trial court nevertheless found that Section 6.07 did not conflict or otherwise "unravel the collective design of this transaction or trump the other provisions in the Collateral Trust or the Security Agreement. (A-21.)

Seemingly inconsistent with its own decision, the trial court noted that "Plaintiffs retain the legal right to obtain payment by suing Cleveland Unlimited as the issuer of the original notes." (A-24.) Of course, that is exactly what the Minority Noteholders are doing with this lawsuit. By granting summary judgment to Cleveland Unlimited and the Guarantors, the trial court abrogated that legal right.

H. The Appellate Division's Decision

The Appellate Division affirmed the trial court's ruling on the ground that there was no conflict between Section 6.07 of the Indenture and the provisions relied upon by the Respondents. The Appellate Division held that:

> Section 6.07 of the Indenture, which sets forth that the holder's right to payment of principal and interest on the note, or to bring an enforcement suit, "shall not be impaired or affected without the consent of such Holder," does not supersede the numerous default remedy provisions of the Agreements, nor does it conflict with them.

(A-1775.)

Like the trial court, the Appellate Division found that Section 316(b) of the TIA—which Section 6.07 parallels—"prohibits only non-consensual amendments to an indenture's core payment terms." (*Id.*) The Appellate Division based this finding on the Second Circuit's decision in *Marblegate*, concluding (incorrectly) that the Second Circuit had read Section 316(b) to prohibit only a narrow set of "formal amendments" to indentures under the amendments procedure within the Indenture itself and otherwise (notwithstanding its plain text to the contrary) does not proscribe actions that "impair" or "affect" a noteholder's legal right to payment.

The Minority Noteholders thereafter filed a timely motion for leave to appeal to this Court, explaining that the First Department's decision was not only wrong on the law and wrong on the facts but would also create havoc in the bond markets where a substantial majority of debt documents are governed by New York law. On February 14, 2019, this Court granted the Minority Noteholders' motion.

STANDARD OF REVIEW

The standard of review of a decision granting summary judgment on a breach of contract action is *de novo*. *Duane Reade, Inc. v. Cardtronics, LP*, 54 A.D.3d 137, 140 (1st Dep't 2008).

ARGUMENT

I. THE DEBT-FOR-EQUITY EXCHANGE IMPAIRED OR AFFECTED THE MINORITY NOTEHOLDERS' RIGHT TO PAYMENT OF PRINCIPAL AND INTEREST ON THEIR NOTES

A. Governing Legal Principles

"[U]nder New York law[,] interpretation of indenture provisions is a matter of basic contract law." *Quadrant Structured Prod. Co. v. Vertin*, 23 N.Y.3d 549, 559 (2014). New York courts therefore "construe an indenture subject to the rule that 'a written agreement that is complete, clear and unambiguous on its face must be enforced according to the plain meaning of its terms.'" *Cortlandt Street Recovery Corp. v. Bonderman*, 31 N.Y.3d 30, 39 (2018) (quoting *Quadrant*, 23 N.Y.3d at 559-60). "It is well established that when reviewing a contract, particular words should be considered, not as if isolated from the context, but in the light of the obligation as a whole and the intention of the parties manifested thereby." *Kolbe v. Tibbetts*, 22 N.Y.3d 344, 353 (2013).

To ascertain the parties' intention, "it is common practice for the courts of this State to refer to the dictionary to determine the plain and ordinary meaning of

words to a contract." *Mazzola v. Cnty. of Suffolk*, 143 A.D.2d 734, 735 (2d Dep't 1988) (internal citation omitted); *see also Ragins v. Hospitals Ins. Co.*, 22 N.Y.3d 1019, 1022 (2013) (using dictionary to determine plain meaning of term not defined in contract).

B. The Plain Language of Section 6.07 Is Dispositive

The plain language of the Indenture provides that the Minority Noteholders' right to receive payment of principal and interest cannot be impaired or affected without their consent. Section 6.07 of the Indenture states:

> Notwithstanding any other provision of this Indenture, the right of any Holder to receive payment of principal of, premium, if any, and interest and Additional Interest, if any, on a Note, on or after the respective due dates expressed in such Note, or to bring suit for the enforcement of any such payment on or after such respect dates, shall not be impaired or affected without the consent of such Holder.

(A-233-A-234, § 6.07.) (emphasis added).

The ordinary meaning of a "right" is "[s]omething that is due to a person by just claim, legal guarantee, or moral principle," or "[a] legally enforceable claim that another will do or will not do a given act." Black's Law Dictionary (8th ed.

2004).[5] The "right" to which Section 6.07 refers is the "right of any Holder to receive payment of principal and interest." Thus, Section 6.07 addresses each noteholder's legally enforceable claim to payment of principal and interest on the Notes.

The ordinary meaning of "impair" is "to diminish the value of" (Black's Law Dictionary (8th ed. 2004)) or "to diminish in strength, value, quantity, or quality." American Heritage Dictionary (Second College Ed. 1982); *accord* 5 Oxford English Dictionary 72 (1933) (defining "impair" as "[t]o make worse, less valuable, or weaker; to lessen injuriously; to damage, injure"); Webster's New International Dictionary of the English Language 1246 (2d ed. 1934) ("To make worse; to diminish in quantity, value, excellence, or strength; to deteriorate; damage; as, to impair health"); *see also Humana Inc. v. Forsyth*, 525 U.S. 299, 301, (1999) ("The dictionary defines 'impair' as to weaken, make worse, lessen in power, diminish, relax, or otherwise affect in an injurious manner."). The ordinary meaning of "affect" is "to produce an effect on; to influence in some way." Black's Law Dictionary (8th ed. 2004); *accord* 1 Oxford English Dictionary 152 (1933) (defining

[5] This definition has been substantively unchanged since the time of the TIA's enactment, when the *Oxford English Dictionary* defined it as a "[j]ustifiable claim, on legal or moral grounds, to have or obtain something, or to act in a certain way," 8 Oxford English Dictionary 670 (1933), and *Webster's New International Dictionary* defined it as "[t]hat to which one has a just claim; a power or privilege to which one is entitled upon principles of morality, religion, law, or the like," Webster's New International Dictionary of the English Language 2147 (2d ed. 1934).

"affect" as "[t]o make a material impression on; to act upon, influence, move, touch, or have an effect on"); Webster's New International Dictionary of the English Language 42 (2d ed. 1934) ("to act, or produce an effect, upon").

In this matter, Respondents cannot reasonably dispute that the Debt-for-Equity Exchange both "impaired" and "affected" the Minority Noteholders' legal "right" to payment according to the above definitions. Indeed, the Trustee's notice advised all noteholders that their Notes were "cancelled" and Cleveland Unlimited's obligations under the Indenture were "terminated." In other words, the Trustee's notice purported to extinguish and nullify the Minority's Noteholders' legal right to payment in its entirety—an action both more definitive and harmful than merely "weakening" or "diminishing" the right to payment, or otherwise making the right "worse." For this reason, Section 6.07 necessarily prohibits the Respondents' actions in this case. By way of comparison, the plaintiff in *Marblegate* argued (unsuccessfully) that the mere movement of the note issuer's assets should be treated as an "impairment" of the noteholder's "right" to collect principal and interest. In this matter, where Respondents purported to "terminate" the Minority Noteholders' legal entitlement to further payment, there can be no question that the Minority Noteholders' "rights" were "impaired" within the meaning of Section 6.07.

Rather than give effect to the plain and unambiguous terms of the Indenture, the Appellate Division instead relied on a misreading of *Marblegate* (discussed below) to hold that Section 6.07 "prohibits only non-consensual amendments to an indenture's core payment terms." (A-1775.)[6] Yet nothing in the plain language of Section 6.07 limits the prohibition on impairing or affecting the "right ... to receive payment" to "formal amendments" of the Indenture. Rather, the Indenture's use of the expansive phrase "impaired or affected" makes clear that Section 6.07 is not limited in its scope to mere amendments.[7]

Moreover, Section 9.02 of the Indenture—not Section 6.07—addresses amendments to the Indenture that require unanimous consent. Reading Section 6.07 as addressing only formal amendments would make Section 6.07 entirely duplicative of Section 9.02 because both provisions would address only amendments of the Indenture. Such an interpretation would violate New York's

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[6] The trial court likewise found that Section 6.07 concerned only amendments to the Indenture. (A-23.)

[7] To be sure, in *Marblegate* the Second Circuit concluded that Section 316(b) was ambiguous on the question presented there—*i.e.*, does Section 316(b) prohibit only interference with a noteholder's legal right to payment or does it also proscribe acts that interfere with the noteholder's practical ability to recover on its notes. It is hornbook law that "[c]lauses can, of course, be ambiguous in one context and not another." *Cont'l Cas. Co. v. Rapid-Am. Corp.*, 80 N.Y.2d 640, 652 (1993). And, as discussed at length in Section I.C, *infra*, the context and issues presented in this case—*i.e.*, whether an indenture provision that parallels the language of Section 316(b) prohibits a Trustee and majority noteholders from "cancel[ing]" and "terminat[ing]" a minority noteholder's right to payment—are materially different from those in *Marblegate*. Given that material difference, *Marblegate*'s conclusion, while correct on the facts and issues presented there, is inapposite here.

rule against rendering contract provisions "superfluous." *See Givati v. Air Techniques, Inc.*, 960 N.Y.S.2d 196 (2d Dep't 2013) (internal citations omitted) ("[A] court should not read a contract so as to render any term, phrase, or provision meaningless or superfluous[.]").

C. The Lower Courts Misapplied the Second Circuit's Decision in *Marblegate,* Which Confirms that the Minority Noteholders' Legal Right to Payment May Not Be Impaired Without Their Consent

The lower courts' finding that Section 6.07 did not prohibit the cancellation of the Minority Noteholders' payment rights was based in large part on a misunderstanding and misapplication of the Second Circuit's decision in *Marblegate*. *Marblegate* addressed a related—but fundamentally different—legal question than is at issue here; specifically, whether Section 316(b) of the TIA is violated when a bond issuer removes all assets from the company obliged to pay out on the notes, but leaves intact the plaintiff noteholder's legal right to collect principal and interest from that now-penniless issuer. The Second Circuit held that the subject transaction did not violate the TIA, based on its finding that although the TIA protects a noteholder's "legal right" to payment, it does not protect the noteholder's "practical ability" to recover. As stated by the Second Circuit:

> [W]e hold that Section 316(b) of the TIA does not prohibit the Intercompany Sale in this case. The transaction did not amend any terms of the Indenture. Nor did it prevent any dissenting bondholders from initiating suit to collect payments due on the dates specified by the Indenture.

> Marblegate retains its legal right to obtain payment by suing the EDM Issuer, among others.

Marblegate, 846 F.3d at 17 (emphasis added).

Here, the lower courts ignored the substance of *Marblegate*'s holding and instead—based on a single sentence of the decision taken out of context—decided that the TIA (and, thus, Section 6.07) is violated only when the disputed transaction involves a "formal amendment" to the underlying indenture. For the reasons discussed below—each of which is addressed in the following subsections—this reading of *Marblegate* is incorrect:

First, *Marblegate* involved fundamentally different facts. As noted above, the *Marblegate* transaction effectively stripped the bond issuer of all its assets, but left the plaintiff noteholder's legal right to payment from that (now-penniless) company intact. The Debt-for-Equity Exchange involved in this matter presents the opposite scenario—*i.e.*, it did not remove any assets from Cleveland Unlimited, but it purported to terminate the Minority Noteholders' right to collect principal and interest from the Company.

Second, *Marblegate* involved a different legal issue. Unlike here, the Second Circuit was asked whether the TIA permits actions that leave a noteholder's "legal right" to payment undisturbed but negatively impact the noteholder's "practical ability" to collect payment. This case, in contrast, does not involve any impairment of the Minority Noteholders' "practical ability" to collect

(because Cleveland Unlimited retained all of its assets). Rather, it involves a direct and clear impairment of the Minority Noteholders' "legal right" to payment, which the Debt-for-Equity Exchange purported to cancel.

Third, the lower courts' interpretation of *Marblegate* conflicts with key portions of the Second Circuit's analysis and the plain language of the TIA. According to the lower courts, *Marblegate* stands for the proposition that the TIA is violated only when there is a formal amendment to the indenture. But the Second Circuit made clear in *Marblegate* that the TIA in fact does prohibit actions that do not involve an indenture amendment. *See* Section I.B.2, *infra*; *Marblegate*, 846 F.3d at 7 (holding that the TIA prohibits the application of "collective action clauses" in indentures that would otherwise permit non-unanimous changes to core payment terms).

Fourth, and finally, Respondents' argument that the Debt-for-Equity Exchange is permitted because the Second Circuit purportedly held that Section 316(b) permits "foreclosures" is incorrect. As previously noted, the Debt-for-Equity Exchange was in no material way similar to a traditional foreclosure, and the Second Circuit did not at any point consider whether a so-called "strict foreclosure" violated Section 316(b). What the Second Circuit did consider—and hold—was that Section 316(b) prohibits the termination of a bondholder's legal right to payment without consent.

For all of the following reasons, the lower courts' application of *Marblegate* in this case was incorrect.

1. *Marblegate* Involved Fundamentally Different Facts

Marblegate involved a transaction that was, in its material respects, distinguishable from the one at issue here. The dispute arose when Education Management Corporation ("EDMC") attempted to restructure its debts based on the inability of its subsidiaries, Education Management LLC and Education Management Finance Corporation (together, the "EDM Issuer"), to make payments on: (i) $1.3 billion of secured bank debt issued under a 2010 credit agreement; and (ii) approximately $217 million of outstanding unsecured notes that it had issued pursuant to an indenture qualified under the TIA. *Marblegate*, 846 F.3d at 3. The bank debt gave EDMC's secured lenders broad rights to proceed against the collateral securing those loans, which included virtually all of EDMC's assets. The notes, in contrast, were not supported by security interests, but earned a significantly higher rate of interest (20%) based on the increased risk of those securities, and were also guaranteed by EDMC, as parent to EDM Issuer. *Id.*

In September 2014, EDMC and an ad hoc steering committee of its lenders agreed to a comprehensive restructuring of EDM Issuer's payment obligations that, by EDMC's own admission, was intended to "incentivize" a majority of EDMC's

secured and unsecured lenders to consent to the proposed transaction. The key steps of the restructuring included the following:

- First, EDMC's bank lenders agreed to foreclose upon (*i.e.*, seize) substantially all of the assets of EDM Issuer, and then sell those assets to a newly organized subsidiary of EDMC. *Id.* at 4. This transaction (called the "Intercompany Sale") effectively transferred all of EDM Issuer's assets to a new company ("Newco"), leaving EDM Issuer with nothing of value. *Id.*
- Second, the secured lenders agreed to release EDMC from its parent guarantee on the secured debt, which in turn resulted in the automatic release of the parent guarantee covering EDMC's unsecured debt (*i.e.*, the notes). Upon the release of the guarantee of the notes, the noteholders would be able to demand repayment only from EDM Issuer (which, as a result of the Intercompany Sale, had no assets).
- Third, EDMC initiated an exchange of the notes previously issued by EDM Issuer for new notes and securities issued by Newco. Important here, if an unsecured noteholder refused to participate in the exchange, it would keep its notes against EDM Issuer, and thus technically would continue to have a <u>legal</u> right to demand principal and interest from the original issuer of the notes. But because EDM

> Issuer's assets had been transferred to an affiliate, EDM Issuer as a practical matter would have no ability to make any payments to the noteholders—it was judgment-proof. *Id*.

In short, the *Marblegate* restructuring removed all assets from the company obliged to pay out on the notes, but left intact the noteholders' legal right to collect principal and interest from that company. The transaction at issue in this case, on the other hand, left Cleveland Unlimited with all of its assets, but purported to terminate the Minority Noteholders' payment rights. The lower courts ignored these critical differences, as well as the impact those differences had on the legal issue addressed by the Second Circuit.

2. *Marblegate* Involved a Different Legal Issue

The *Marblegate* plaintiffs filed suit against EDMC and EDM Issuer, seeking a declaratory judgment that the proposed transaction violated the plaintiffs' rights under Section 316(b) of the TIA. *Id.* at 5. After a trial on the merits, the district court ruled in favor of the plaintiffs, and EDMC appealed to the Second Circuit.

The plaintiff in *Marblegate* argued before the Second Circuit that, "although the <u>contractual terms</u> governing Marblegate's Notes had not changed, its <u>practical ability</u> to receive payment would be completely eliminated by virtue of the [restructuring], to which it did not consent." *Marblegate,* 846 F.3d at 5 (emphasis added). The Second Circuit described the issue on appeal as follows:

> The core disagreement in this case is whether the phrase "right . . . to receive payment" forecloses more than formal amendments to payment terms that eliminate the right to sue for payments. . . . On the one hand, 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. . . . On the other hand, adding that such a right cannot be "impaired or affected" suggest[s] that it cannot be diminished, relaxed, or "otherwise affected" in an injurious manner.

Marblegate, 846 F.3d at 6-7 (citations omitted) (emphasis in original).

The Second Circuit ultimately rejected the *Marblegate* plaintiff's arguments, finding that Section 316(b) prohibits only "non-consensual amendments of core payment terms (that is, the amount of principal and interest owed, and the date of maturity)." *Id.* at 7. Central to the Second Circuit's decision was its observation that the sponsors of the TIA were principally concerned with actions taken by issuers and majority noteholder groups to limit the contractual rights of minority noteholders, rather than their practical ability to recover.

In explaining its ruling, the court noted that Congress specifically intended to limit the use of "collective action clauses"—indenture provisions that allowed a majority of noteholders to alter an indenture's payment terms. *Id*. at 9-10. During Congressional hearings regarding the TIA, William O. Douglas, then the Chairman of the SEC and an expert on corporate reorganizations, testified that if Section 316(b) were enacted into law, majority groups of noteholders would no longer be

able 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. In other words, this provision merely restricts the power of the majority to change those particular phases of the contract."[8] 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).

The Second Circuit also observed that, even though noteholders' "practical ability" to recover principal and interest was not protected by the TIA, objecting noteholders still had claims and remedies they could pursue in any suit against a defaulting issuer. *Marblegate*, 846 F.3d at 16. The court specifically noted that, "[b]y preserving the legal right to receive payment, we permit creditors to pursue available State and federal law remedies." *Id*.

As with the relevant facts, the legal issues raised by *Marblegate* and this case are fundamentally different: *Marblegate* addressed whether the TIA is violated where a noteholder's practical ability to collect has been impaired, while this case asks whether the TIA (and Section 6.07) is violated where a noteholder's

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8 The Second Circuit also based its decision on the fact that the "practical effects" reading of "impaired or affected" advocated by the plaintiff "would transform a single provision of the TIA into a broad prohibition on any conduct that could influence the value of a note or a bondholder's practical ability to collect payment." *Marblegate*, 846 F.3d at 7.

legal right to payment has been impaired. Although the lower courts found otherwise, *Marblegate* supports the Minority Noteholders' position in this matter, because it held that the TIA is intended to protect a noteholder's "legal right" to receive principal and interest.[9] The Minority Noteholders are not relying on the loss of a "practical ability" to recover from Respondents as their theory of impairment. (A-23.) Rather, the Minority Noteholders object to the purported termination of their "legal right" to payment of principal and interest—and to obtain a judgment against Respondents, as issuer and guarantors of the Notes—exactly what Section 6.07 is meant to protect.

[9] *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.").

As the chart below demonstrates, the factual and legal differences between this case and *Marblegate* are both patent and determinative of the outcome here.

<u>Key Differences Between *Marblegate* and This Case</u>

	<u>Marblegate</u>	**<u>This Case</u>**
What happened to the note issuer's assets?	Issuer's assets transferred to a newly created affiliate, leaving the issuer with no funds available to pay noteholders.	Cleveland Unlimited retained all of its assets and thus remained capable of paying its noteholders.
What happened to the noteholders' <u>legal</u> right to principal and interest?	The noteholders retained their legal right to principal and interest.	The noteholders' legal right to principal and interest was "cancelled" and "terminated" pursuant to the Debt-for-Equity Exchange.
What is the legal issue presented?	Is TIA section 316(b) violated where a noteholder retains its "legal right" to payment but no longer has the "practical ability" to collect on its notes?	Is Section 6.07 of the Indenture (which parallels TIA section 316(b)) violated where a noteholder's legal right to principal and interest is "terminated"?
What is the applicable holding?	The Second Circuit ruled that the TIA protects only a noteholder's "legal right" to payment, but not its "practical ability" to collect.	The lower courts, based on a misreading of *Marblegate*, ruled that Section 6.07 of the Indenture permits the termination of a noteholder's legal right to payment so long as that termination is effectuated through a means other than the "formal amendment" of the Indenture.

3. The Lower Courts' Application of *Marblegate* Conflicts with Both the Second Circuit's Analysis and the TIA

In addition to ignoring the factual and legal distinctions between this case and *Marblegate*, the lower courts erred by focusing myopically on whether the challenged transaction here included an actual amendment to the Indenture under, evidently, the indenture amendment provisions set forth in Article Nine of the Indenture. (A-249-A-251, §§ 9.01, 9.02.) In its decision below, for example, the First Department cited *Marblegate* in support of its finding that "Section 6.07 of the Indenture, which tracks the language of section 316(b) of the Trust Indenture Act of 1939 (15 USC §§ 77ppp[b]) prohibits only non-consensual amendments to an indenture's core payment terms." (A-1775.) (citations omitted); *see also* (A-24.) (trial court opinion finding that *Marblegate* did not support the Minority Noteholders "because the foreclosure transaction at issue here did not amend any terms of the Indenture").

The lower courts' rulings are founded on an overly literal reading of the phrase "formal amendment" that conflicts with key elements of the Second Circuit's decision and the language of the TIA itself. Again, *Marblegate* addressed whether Section 316(b)'s prohibition on activities that "impair" or "affect" a noteholder's legal right to payment extend beyond *de jure* invasions of that legal right to proscribe conduct that make it *de facto* impossible for a noteholder to vindicate that right.

Below, the Respondents advocated an interpretation of *Marblegate* where the only alteration to a noteholders' legal rights that mattered for the purposes of the TIA was one effectuated by an amendment to the Indenture accomplished under the provision of the Indenture that speaks to "amendments" (*i.e.*, Article Nine). Of course, that is not the language used in *Marblegate*, which held that amendments to the Noteholders' "payment terms" are what Section 316(b) prohibits.

Respondents' argument cannot be reconciled with the Second Circuit's decision. As already explained, the actual—and, indeed, the only—issue before the Second Circuit was whether Section 316(b) prohibited conduct that had the practical effect of limiting a noteholder's ability to receive payment. In other words, if an issuer is stripped of its assets but remains liable on the notes, does that result in a TIA violation? Accordingly, the Second Circuit's *obiter dictum* about what <u>other</u> sorts of actions might or might not be covered by the TIA forms no part of that court's holding (and would not be binding on this Court in any event). *See Global Reinsurance Corp. of Am. v. Century Indemnity 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); *Knight-Ridder Broadcasting, Inc. v. Greenberg*, 70 N.Y.2d 151, 160 n.6 (1987) ("It is basic that principles of law are

not established by what was said, but by what was decided, and what was said is not evidence of what was decided, unless it relates directly to the question presented for decision.") (internal citation and quotation marks omitted).

Applying "formal amendment" in its most literal sense—*i.e.*, a document entitled "Amendment to Indenture"—puts that portion of the *Marblegate* decision in direct conflict with other portions of the Second Circuit's analysis. The Second Circuit made clear that one of the chief evils to be remedied through enactment of Section 316(b) was the use of collective action clauses by majority interest-holders to change payment terms. Collective action clauses "authorize a majority of bondholders to approve changes to payment terms and forces those changes on all bondholders." *Marblegate*, 846 F.3d at 7. So, in a case where an indenture contained such a clause, a majority of noteholders could—outside the formal process for amending the Indenture—direct the Trustee to reduce the amount of principal and/or interest due under the Notes. *See id.* at 10-11.

Section 316(b)'s ban on such clauses is doubly relevant here. For one thing, when the Majority Noteholders directed the Trustee to engage in the Debt-for-Equity Exchange, they used Section 6.05 (which allows a majority of noteholders to direct the Trustee's actions) as a "collective action" clause, because—under the Appellate Division's reading of *Marblegate*—the Majority Noteholders could use

that provision to effect a *de jure* termination of the minority holders' payment rights.

Marblegate's focus on collective action clauses is also relevant because such clauses cannot be characterized as "formal amendments" to an Indenture—they are, instead, part of the Indenture's original text. Nor, as explained above, are actions of majority noteholders taken pursuant to such clauses "formal amendments" to the indenture; indeed, the great utility of those clauses (to the majority) is that they afford the majority a streamlined way to effect any change to payment terms they prefer, without any need for a formal amendment of the indenture.

In support of its ultimate holding, the Second Circuit stressed that "Marblegate retains its legal right to obtain payment by suing the EDM Issuer, among others." *Id.* at 17. It identified the additional steps Marblegate could take given that it held that legal right, such as pursuing theories of successor liability or fraudulent conveyance. *Id.* at 16. This portion of the Second Circuit's decision would be meaningless if the legal right to payment could be terminated simply by changing the form of the transaction through something other than an amendment.

These passages underscore the fact that in discussing a "formal amendment of the indenture's payment terms," the Second Circuit did not mean to confine Section 316(b)'s scope only to formal amendments <u>of the indenture</u>. The use of

the phrase "formal amendment of the indenture's payment terms" was a convenient (although underinclusive) way of distinguishing (i) actions that would formally alter the noteholder's legal rights, from (ii) actions that (as in *Marblegate*) left those rights intact but destroyed any practical chance of getting paid. This reading is consistent with *Marblegate*'s core holding: Section 316(b) was designed to protect legal rights—not to operate as a guaranty of actual payment.

The fact that the "formal amendment" language was not intended to operate as a binding legal limitation on the scope of Section 316(b) also is obvious from the text and purpose of Section 316(b). That statute provides in unequivocal terms that "the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security . . . shall not be impaired or affected without the consent of such holder." 15 U.S.C. § 77ppp(b) (emphasis added). If Congress had intended to restrict the effect of this provision to changes wrought by formal amendments, it certainly could have done so—*e.g.*, by providing that the "provisions of the indenture creating or defining the noteholder's legal right to payment shall not be amended or deleted without the consent of such holder." But the actual text of Section 316(b) is not so limited, a fact that belies Respondents' argument on this issue.

Notably, the testimony of Chairman Douglas and the SEC reports that accompanied the TIA as it made its way through Congress make clear that the

overarching goal of Section 316(b) was to prevent majority interest-holders from stripping minority holders of their right to payment. 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) (goal of Section 316(b) was to strip majority noteholders of the ability 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"); *id.* ("In other words, this provision merely restricts the power of the majority to change those particular phases of the contract."). Yet, if *Marblegate* bore the meaning ascribed to it by Respondents, a majority of noteholders would be free to terminate a minority holder's right to payment so long as the majority avoids executing any document entitled "Amendment to Indenture." That would be an absurd outcome and thus cannot possibly have been the meaning assigned to the statute by Congress. *See, e.g., People v. Santi*, 3 N.Y.3d 243, 242 (2004) ("[C]ourts normally accord statutes their plain meaning, but will not blindly apply the words of a statute to arrive at an unreasonable or absurd result.") (internal citation and quotation marks omitted). *Doctors Council v. N.Y.C. Employees' Retirement Sys*., 71 N.Y.2d 669, 675 (1988) (stating that a statute should not be interpreted in a manner that "would cause an

anachronistic or absurd result contrary to the contextual purpose of the enactment”).

A formal-amendments-only reading of Section 316(b) also conflicts irreconcilably with the Second Circuit’s emphatic assurances that its ruling would not “leave dissenting bondholders at the mercy of bondholder majorities”—an assurance that would have rung hollow if a majority of noteholders could negate the minority’s right to payment whenever the majority pleased, provided it could do so without resorting to a formal amendment to the indenture. *Marblegate*, 846 F.3d at 16. Instead, the Second Circuit underscored that its decision would protect minority holders’ rights to “initiat[e] suit to collect payments due on the dates specified in the Indenture,” and pursue related “State and federal law remedies.” *Id*. This portion of the *Marblegate* opinion necessarily refutes Respondents’ suggestion that they should be allowed to extinguish the Minority Noteholders’ legal right to payment so long as they do so without formally amending the Indenture. Put differently, if Respondents were somehow correct that the TIA is not triggered without an amendment to the Indenture (and to be clear, they are not), the Debt-for-Equity Exchange should be deemed to constitute such an amendment, on the grounds that it eviscerated legal rights that the parties had previously agreed to uphold. To find otherwise would result in a “form over substance” application of the law that is contrary to the jurisprudence of this Court. *Cf. Plotch v.*

Citibank, N.A., 27 N.Y.3d 477, 483 (2016) (finding an agreement qualified as a "first mortgage of record" because "[t]o hold otherwise places form over substance"); *E. Midtown Plaza Hous. Co. v. Cuomo*, 20 N.Y.3d 161, 171 (2012) (rejecting argument distinguishing privatization plans "since it elevates form over substance.").

The upshot of all of the foregoing is that: (i) Section 316(b) cannot be read as meaning anything other than what its plain text says: a noteholder's right to payment of interest and principal cannot be impaired or affected without its consent; and (ii) *Marblegate* holds nothing more than that diminishing or eliminating a noteholder's practical ability to obtain payment is not an "impair[ment]" or "[e]ffect" within the meaning of Section 316(b). In light of the foregoing, this Court should reverse the Appellate Division and make clear that Section 6.07 (like Section 316(b)) prohibits the termination of a noteholder's legal right to payment, regardless of whether such termination is effected through an actual amendment to the indenture.

4. Respondents' Foreclosure Argument Is Without Merit

Respondents have previously argued that under *Marblegate*, any transaction styled as a "foreclosure"—including the Debt-for-Equity Exchange effected here, which they denominated as a "strict foreclosure"—cannot result in a violation of the TIA. This argument fails.

Some clarification of the relevant terminology is warranted. The term foreclosure generally refers to the historically common event in which a senior secured creditor would exercise its rights to seize collateral—often to the detriment of junior creditors who, once the collateral was foreclosed upon, would be left in possession of a legal right to payment but no practical prospect of having that right fulfilled. As *Marblegate* explained:

> Particularly compelling is the [1940 SEC] Report's discussion of the role of junior creditors in foreclosure-based reorganizations. In characterizing the choice faced by junior creditors when deciding whether to participate in foreclosure-based reorganizations, the 1940 SEC Report noted that "the participation in the plan given to junior creditors was the product of practical reasons, not legal compulsion." And in comparison to dissenting secured creditors entitled to a pro rata distribution of foreclosure proceeds, the 1940 SEC Report noted that if junior creditors "refused participation in the plan, they were thrown back to participation in such of the debtor's assets as to which senior creditors could lay no prior claims," which was "at best nominal."

Id. at 13 (emphasis added) (citing Securities and Exchange Comm'n, Report on the Study and Investigation of the Work, Activities, Personnel, and Functions of Protective and Reorganization Committees, Pt. 8 (1940)).

The foregoing passage makes clear that the Second Circuit was considering foreclosures that push junior creditors to participate through "practical reasons, not legal compulsion." *Id*. Indeed, the passage notes that junior creditors that refused

to participate in the transaction would still retain their rights against the issuer and any remaining assets that it might hold. The Second Circuit held that transactions of this sort—*i.e.*, foreclosures—did not violate the TIA because they affected only the junior creditor's practical ability to collect, not their legal right to pursue the issuer.

The transaction at issue in *Marblegate* was arguably within the scope of the type of transactions anticipated by the drafters of Section 316(b). As discussed above, the foreclosure conducted by the bank lenders in *Marblegate* involved: (i) the seizure of all assets held by EDM Issuer, and (ii) the sale (*i.e.*, movement) of those assets to Newco, which was not a contractual obligor on any of EDMC's debts. This left the non-consenting junior creditor (Marblegate) with no practical ability to collect against the issuer because the issuer did not have any assets.

Perhaps in an effort to avoid close scrutiny of the substance of their transaction, Respondents here have consistently sought to label the Debt-for-Equity Exchange as a "strict foreclosure." Although even the Minority Noteholders have occasionally adopted that colloquial terminology, it is a deceptive misnomer that has no legal significance. The transaction effected here bore none of the hallmarks of a traditional foreclosure. Here, unlike in *Marblegate*, the issuer (Cleveland Unlimited) remained intact with all of its operating assets. Also unlike *Marblegate*, where the plaintiff's legal rights remained intact, the Debt-for-Equity

Exchange purported to terminate the Minority Noteholders' right to recover principal and interest.

Critically, the Second Circuit had no reason to consider whether a so-called "strict foreclosure"—*i.e.*, a transaction that purports to terminate minority holders' legal right to further payment and legal right to sue the issuer—was permissible under the TIA. For that reason, Respondents are wrong when they suggest that anything called a "foreclosure" is by definition permissible under *Marblegate* and the TIA (and, thus, Section 6.07 of the Indenture). What matters under *Marblegate* is whether the Minority Noteholders retain the "legal right to obtain payment by suing the [Cleveland Unlimited] Issuer." *Id.* at 17. Because the Debt-for-Equity Exchange purported to extinguish those rights (and did not result in any transfer of the issuer's assets), Cleveland Unlimited cannot rely on that transaction to avoid paying the Minority Holders the principal and interest owed on their Notes.

Finally, Respondents at various points below made a related argument that, if they had been unable to execute the strict foreclosure following Cleveland Unlimited's default, the Company would have been forced to declare bankruptcy. Implicit in this argument is the suggestion that bankruptcy is a result to be avoided at all costs. This is incorrect, especially in the context of this case. Because the Noteholders held senior secured notes, a bankruptcy filing would have allowed them to recover all available assets from Cleveland Unlimited prior to the payment

of any of the Company's unsecured lenders. *See Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973, 979 (2017) ("Secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts."); *In re Midway Airlines, Inc.*, 383 F.3d 663, 669 (7th Cir. 2004) ("Secured claims are paid (or the collateral returned) before any distribution is made to priority claimants or to unsecured general creditors."). In this matter, where Cleveland Unlimited went into liquidation only a few years following the Debt-for-Equity Exchange, it remains an open question whether the Majority Noteholders were correct to give up their liens in exchange for equity.

For all of the foregoing reasons, Respondents are incorrect that any transaction termed a "foreclosure" necessarily passes muster under *Marblegate*. Where a company wishes to avoid bankruptcy through an out-of-court restructuring, it must ensure that the transaction does not impair noteholders' legal rights to payment (as EDMC and the ad hoc steering committee of lenders successfully did in *Marblegate*).

II. SECTION 6.07 OF THE INDENTURE CONTROLS OVER ANY CONFLICTING PROVISION

By its express terms, Section 6.07 applies "notwithstanding any other provision of th[e] Indenture" and thus overrides any conflicting provision of the Indenture. In addition, the provisions of the Security Agreement cannot serve as a basis to impair or affect the Minority Noteholders' right to receive payment under

the Indenture because the Security Agreement provides that "[t]he actions of the Collateral Trustee hereunder are subject to the provisions of the Indenture." (A-396-A-397, § 11.1(a) (emphasis added).) Thus, the lower courts erred in holding that other provisions of the documents sanction the Debt-for-Equity Exchange.

A. New York Law Recognizes and Enforces "Notwithstanding any Other Provision" Clauses Like the Clause that Appears in Section 6.07 of the Indenture

The plain language of the Indenture unequivocally provides that the Minority Noteholders' right to payment of principal and interest cannot be taken away without their consent. Section 6.07 of the Indenture states:

> Notwithstanding any other provision of this Indenture, the right of any Holder to receive payment of principal of, premium, if any, and interest and Additional Interest, if any, on a Note, on or after the respective due dates expressed in such Note, or to bring suit for the enforcement of any such payment on or after such respect dates, shall not be impaired or affected without the consent of such Holder.

(A-233-A-234, § 6.07.) (emphasis added).

New York law makes clear that a contract clause containing the phrase "notwithstanding any other provision" will override any conflicting provision in the contract. *Beardslee v. Inflection Energy, LLC*, 25 N.Y.3d 150, 158 (2015) (citing *Bank of N.Y. v. First Millennium, Inc.*, 607 F.3d 905, 918 (2d Cir. 2010) (affirming summary judgment; reasoning that the phrase "notwithstanding any other provision" in the indenture clause trumped a similar conflicting provision));

see also Int'l Multifoods Corp. v. Commercial Union Ins. Co., 309 F.3d 76, 90 (2d Cir. 2002) (affirming summary judgment because the clause "notwithstanding anything herein contained to the contrary" overrode other inconsistent provisions).

Here, Section 6.07 conflicted with numerous other portions of the Indenture. The most obvious conflict is with the two sections that the lower courts cited as authorizing the Debt-for-Equity Exchange: Section 6.03 (which allows the Trustee to "pursue any available remedy" in the event of a default) and Section 6.05 (which allow a majority in interest to "direct the time, method, and place" for exercising "any . . . power conferred on the Trustee . . . , including . . . , any remedies provided for in Section 6.03). (A-17.) Whereas these two provisions purportedly authorized the Trustee to invalidate the Minority Noteholders' legal right to payment without their consent, Section 6.07 expressly prohibited such an act in the absence of noteholder consent. Given this conflict, the clear law of this state is that the section containing the "notwithstanding any other provision" language—*i.e.*, Section 6.07—controls.

B. The Minority Noteholders' Right to Receive Payment Takes Precedence Over Any Conflicting Provisions of the Security Agreement

In addition to Section 6.07's "notwithstanding language," the lower courts also failed to apply language in the Security Agreement making clear that, even though the Collateral Trustee had authority to take a broad set of actions under the

Security Agreement, those actions could not impair or affect the Minority Noteholders' right to receive payment of principal and interest. The parties agreed in the Security Agreement that "[t]he actions of the Collateral Trustee hereunder are subject to the provisions of the Indenture." (A-396-A-397, § 11.1(a).) Under this provision, the Collateral Trustee's authority to effectuate remedies (or take any other action) is necessarily limited by Section 6.07 of the Indenture. *E.g., Englestein v. Mintz*, 345 Ill. 48, 61 (1931) ("The words 'subject to,' used in their ordinary sense, mean 'subordinate to,' 'subservient to' or 'limited by.'"); *Michelin Tires (Canada) Ltd. v. First Nat. Bank of Bos.*, 666 F.2d 673, 677 (1st Cir. 1981) (same); *R.A. Mackie & Co., L.P. v. Petrocorp Inc.*, 329 F. Supp. 2d 477, 505 (S.D.N.Y. 2004) (same). For this reason, any actions taken by the Trustee under the Security Agreement, including the Debt-for-Equity Exchange, were not authorized if they impaired or otherwise affected the Minority Noteholders' legal right to receive principal and interest; under Section 6.07, that legal right to receive payment is sacrosanct. In finding that the provision of the Security Agreement allowing the Trustee to pursue U.C.C. remedies somehow trumped Section 6.07 of the Indenture, the lower courts ignored this express and unambiguous provision.

It should be emphasized that, in this context, the fact that the Debt-for-Equity Exchange may have complied with the terms of U.C.C. is irrelevant. Under New York law, parties to a contract may agree to contractual terms that limit or

otherwise vary the provisions of the U.C.C. N.Y. U.C.C. § 1-302(a) ("Except as otherwise provided in subsection (b) or elsewhere in this act, the effect of provisions of this act may be varied by agreement."). Here, because the parties agreed that the Minority Noteholders' right to receive principal and interest could not be impaired or affected without their consent, the Debt-for-Equity Exchange effectuated by the Company and the Trustee could not have had the legal effect of terminating those rights.

C. Application of the Plain Meaning of Section 6.07 Does Not Make the Trustee's Remedies Meaningless

The lower courts also erred in finding that the application of Section 6.07 would render "meaningless" the various remedies provided to the Trustee following an Event of Default. (A-21.) The provisions of the Indenture and Security Agreement gave the Collateral Trustee expansive powers. For example, under Section 6.03 of the Indenture, the Trustee is empowered to "pursue any available remedy by proceeding at law or equity" to collect principal or interest or to enforce the Notes' terms. (A-232, § 6.03.). Similarly, under Section 9.1 of the Security Agreement, "the Collateral Trustee may . . . (iv) Take possession of the Collateral or any part thereof . . . [and] (viii) Subject to the provisions of this Agreement and applicable law, exercise all the rights and remedies of a secured party on default under the UCC[.]" (A-391-A-393, § 9.1.)

Of course, the most obvious example of a remedy available to the Trustee is an ordinary foreclosure upon the Company's assets under the U.C.C. and the monetization of those assets through a sale. *See* N.Y. U.C.C. § 9-610 (providing for disposition of collateral after default). It then would have distributed the net cash to noteholders on a pro-rata basis. *See* N.Y. U.C.C. § 9-615(a) (addressing application of proceeds). The Company and the Guarantors would have remained liable for any deficiency. *See* N.Y. U.C.C. § 9-615(d)(2) (providing that obligor is liable for any deficiency). This action would have provided cash to the noteholders, as permitted by the Indenture, and likewise would have left in place the noteholders' right to receive principal and interest as to any deficiency amount.

The Trustee was also empowered to bring suit against the Company and Guarantors, obtain a judgment, and pursue other means of satisfying that judgment, such as garnishing any unencumbered cash. In addition, the Trustee could seek to recover any improper payments made by the Company through New York's fraudulent transfer laws. *See* N.Y. Debt. & Cred. Law § 270 *et seq.*; *see also Cortland Street Recovery*, 31 N.Y.3d at 40 (holding that the phrase "any available remedy" included all remedies available at law and in equity, based on any viable theory of recovery, including suits against third parties). Again, the noteholders would receive cash and the right to receive the remaining amount would remain in place.

The only arrow removed from the Trustee's quiver by the application of Section 6.07 of the Indenture is the Trustee's ability to impair the noteholders' payment rights without their consent. Based on the foregoing, the trial court was incorrect when it suggested that the preservation of the Minority Noteholders' payment rights would undermine all of the powers and remedies granted to the Trustee.

D. The Lower Courts Incorrectly Applied this Court's Decision in *Beal Savings Bank v. Sommer*

In declining to apply Section 6.07 based on the supposed threat it posed to "collective design of [the bond issue] transaction," the lower courts specifically relied on this Court's decision in *Beal Savings Bank v. Sommer*, 8 N.Y.3d 318 (2007). (A-19.) In so doing, they overlooked the fact that in this matter (unlike in *Beal*) there is a specific non-impairment provision (Section 6.07) that protects the Minority Noteholders' individual right to receive and sue for payments of principal and interest owed on the Note.

The dispute in *Beal* arose when 36 of 37 lenders in a bank syndicate agreed that entering into a settlement was a better option than attempting to recover all of the amounts owed under the credit agreement. *Id*. The one lender that refused to consent to the settlement moved to file suit on its own behalf, and the rest of the lenders sought to force the dissenting lender to comply with the deal struck by the majority. On appeal, this Court was asked to determine whether the one non-

consenting lender could sue for breach of contract "contrary to the will of the other 36 lenders to forbear from taking action." *Id*. at 320-21. The Court found that the non-consenting lender could not act contrary to the settlement agreed to by the other members of the syndicate.

Both the context and controlling legal documents in *Beal* were materially different than those at issue here. First, as to context, *Beal* concerned a bank loan, not a bond indenture. *Id.* at 320. As this Court will appreciate, the bank loan market is inherently different from the bond market. The Indenture at issue here, like nearly every other indenture in the bond market, specifically provides that each holder under all circumstances retains its right to receive—and to sue for—payment of principal and interest and incorporates the parallel provisions from the TIA. Credit agreements generally—and the one in *Beal* specifically—lack a non-impairment provision akin to Section 6.07 and do not incorporate the parallel provision of the TIA.

Second, the controlling agreements in *Beal* also are materially different than those at issue here. In *Beal*, the credit agreement included no provision specifying the rights of an individual creditor to proceed contrary to the majority. As a result, this Court was forced to look to other relevant clauses in an effort to ascertain what the parties intended:

> 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.

Id. at 326. This Court's analysis of other provisions in the credit agreement and related agreements led it "to conclude that the agreements have an unequivocal collective design." *Id*. Given the absence of any explicit individual right to sue in the agreement and the court's construction of other provisions of those documents, the *Beal* court concluded that the parties had not intended to create an individual right of action. *Id.* at 328.

Here, Section 6.07 of the Indenture explicitly answers the question that the documents in *Beal* did not—a noteholder's right to payment of principal and interest cannot be impaired or affected without its consent, and it may take individual action to enforce those rights, notwithstanding any other provision in the Indenture. Accordingly, because Section 6.07 of the Indenture bars the termination of the Minority Noteholders' payment rights, *Beal* in no way supports the lower courts' decisions.

CONCLUSION

For the reasons set forth above, 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 enter summary judgment for Plaintiffs-Appellants.

Dated: April 12, 2019

Respectfully submitted,

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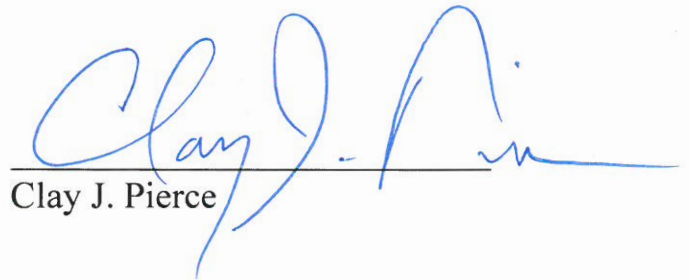

Clay J. Pierce