The Importance of Being Bound: Bondholders' Vote and Workouts in the U.S. and in Italy

by

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ABSTRACT: *When companies face financial distress, it may be advantageous for all parties involved to restructure bond loans and to renegotiate the deal, for example, by converting the bonds into shares. Some legal systems do not allow the majority of bondholders to vote on the proposed agreement and, by doing so, to bind the dissenting minority. Recent controversies and litigation in the U.S. have reignited the debate on the limits of this regime. This paper analyzes the drawbacks of the prohibitive approach, with particular regard to the judicial cases and the business practices of two major legal systems (the U.S. and Italy), argues that a rule that allows bondholders' vote on out-of-court restructurings represents a much preferable option and suggests the solutions which, in the absence of such a rule, may be currently adopted.*

INTRODUCTION

Two recent American law cases, *Marblegate* and *Caesars*,[1] have refired the smoldering debate about the propriety of nonjudicial or nonbankruptcy law restructuring of bond issues.[2] In 2015, the U.S. District Court for the Southern District of New York reaffirmed that coercive exit consent transactions that force bondholders into questionable restructurings are prohibited by § 316(b) of the Trust Indenture Act of 1939 ("TIA"). After *Marblegate*

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[1]Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., 111 F. Supp. 3d 542 (S.D.N.Y. 2015); MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507 (S.D.N.Y. 2015); *see also* BOKF, N.A. v. Caesars Entm't Corp., Nos. 15-cv-1561 (SAS) & 15-cv-4634 (SAS), 2015 WL 5076785 (S.D.N.Y. Aug. 27, 2015). The decisions will be analyzed in depth *infra* section II.C.

[2]The first contribution to the debate may be found in Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232 (1987).

and *Caesars* followed a series of proposals attempting to reform those parts of the Act that effectively prevented nearly every out-of-court workout. Then, in January of 2017, the U.S. Court of Appeals for the Second Circuit adopted a narrow interpretation, holding that § 316(b) only prohibits formal non-consensual modifications of an indenture's core payment terms.[3]

The district courts' interpretation, though broad, more coherently aligns with the text, the legislative history, and the purpose of the TIA. Section 316(b) provides that the individual right of each bondholder to receive payment of the principal of and interest on her indenture security on the due dates cannot (with a few minor exceptions) be impaired without the bondholder's consent. This section was enacted to protect bondholders from insiders' abuses by giving individual bondholders each the power to veto proposed modifications to their bonds' terms and conditions in an out-of-court restructuring. This "protection" often precludes even fair renegotiation agreements between the issuer and the bondholders because a majority vote is not enough to give their approval. Modification of bond provisions by majority vote is also prohibited or discouraged in other countries, though, in recent years, some foreign jurisdictions adopted a more permissive approach.

The article analyzes the desirability of adopting a regulatory approach that permits bond modifications to be approved by a majority of the bondholders and that bind those holders who dissent.[4] Midterm modifications of debt are often required to avoid insolvency and turn around a corporation's affairs. Because it is often impossible or impractical to obtain unanimous consent—the individual consent of each and every bondholder, embracing a majority rule structure furthers the possibility of reaching an agreement. This paper asks whether the different regulatory approaches to consent strike a reasonable balance between the issuer's needs and interests and the investors' protection and how the applicable regime should be shaped. We compare various international legal systems and conclude that: (*i*) governments should adopt rules that allow a majority bondholders' vote to accept out-of-bankruptcy restructurings of bond issues; (*ii*) if the TIA cannot be changed in the United States, the Securities and Exchange Commission's power to grant exemptions could authorize transactions and agreements otherwise banned; and (*iii*) in Italy (and other civil law jurisdictions), the contract or indenture binding the issuer and the bondholders may provide for modification of core terms of the loan by a majority vote at a bondholders' meeting.

Part I considers why allowing a binding vote of the bondholders in work-

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

[4] The conversion of bonds into shares has traditionally been regarded by legislators and legal doctrine as a modification affecting the fundamental conditions of the bond loan as has the renunciation of the repayment of part of the principal or the payment of interest. Conversion is more than a mere amendment of the terms because a conversion causes the original loan agreement to be replaced with another.

outs is so important along with the rationales for prohibiting or allowing this opportunity. Part II focuses on the U.S. legal system, discusses the statutory provision that bans majority rule, how the jurisprudence and the business practices have evolved, and recent proposals for reform. Part III considers the Italian system, its rules and business practices, and how to overcome its limits. Part IV suggests an alternate rule and interim solutions to the problem while awaiting statutory reform.

I. AMENDING CORE TERMS OF THE BOND: THE INDIVIDUAL VETO POWER V. THE MAJORITY VOTE

In "The Importance of Being Earnest", Oscar Wilde describes the irrevocable desire of a young lady to be engaged to a man named Ernest, because of the assonance between the male name ("Ernest") and the quality of being serious ("earnest"), as if a name could grant his own virtues. Bonds "bind" their issuer and their purchasers or holders, but does that "binding" require each bondholder to be granted veto power over the bonds' modification? Just as Ernest may not actually *be* earnest, a bondholder's individual veto power does not guarantee that her best interests are actually protected. Indeed just the opposite may be the case.

During the twentieth century, the law protected the interests of bondholders by guaranteeing that fundamental characteristics of the debt they held could not be impaired without each holder's individual consent (the "Individual Veto" or "Unanimity" rule). This Part questions whether this model remains relevant light of the evolution of capital markets and sea changes in the sophistication, expertise, and broad dispersal of bondholders. These changes warrant considering protecting holders' rights by allowing them the ability to accept bond modifications by majority vote (the "Majority Vote" rule), provided that vote is free, informed, and unaffected by conflicts of interest.

A. THE NEED FOR RENEGOTIATION IN BOND ISSUES

The duration of the issuer-holder contractual relationship requires establishing mechanisms, agreed at the time of the issue, that facilitate renegotiating the terms of the debt so that the issuer and the holders can address the issuer's changing financial position or other conditions. Often, amending the original agreement may be desirable in order to prevent default. Default and insolvency costs may sometimes be unavoidable when there are no prospects of recovery for the company.[5] Even so, before bankruptcy, the bondholders

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[5]There is a large body of literature about the effective magnitude of bankruptcy costs. Direct costs include expenses for lawyers, advisors, accountants and other professionals. Indirect costs are essentially related to a series of opportunity costs. *See* EDWARD I. ALTMAN & EDITH HOTCHKISS, CORPORATE

can play a key role in helping the company to recover and defend their investment by renegotiating the terms of the debt.[6] When the company is dealing with financial difficulties, only a renegotiation of the terms of the debt can prevent the risk of bankruptcy.[7] Not only defaulting companies need restructuring.[8] Companies in good standing may find renegotiation advisable to accommodate further capital expansion needed to expand into new markets, for example. It may be well worth an issuer's offer of a future interest rate increase in exchange for the holders agreeing to reschedule the due date for payment or relieve guarantors of the debt.[9]

In either case, the renegotiation of the originally agreed terms implies an

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FINANCIAL DISTRESS AND BANKRUPTCY: PREDICT AND AVOID BANKRUPTCY, ANALYZE AND INVEST IN DISTRESSED DEBT 93-94 (3d ed. 2006).

On the one hand, the studies about direct costs show that small firms may be unable to survive the reorganization process, due to the excessive fees involved compared with their assets. *See* Jerold B. Warner, *Bankruptcy Costs: Some Evidence*, 32 J. FIN. 337 (1977); Edward I. Altman, *A Further Empirical* Investigation of the Bankruptcy Cost Question, 39 J. FIN. 1067 (1984); Brian L. Betker, *The Administrative Costs of Debt Restructurings: Some Recent Evidence*, 26 FIN. MGMT. 56 (1997); Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509 (2000).

On the other hand, the research shows that the indirect costs of financial distress are significant. *See* Altman, *supra*; Gregor Andrade & Steven N. Kaplan, *How Costly is Financial (not Economic) Distress? Evidence From Highly Leveraged Transactions That Became Distressed*, 53 J. FIN. 1443 (1998); Tim C. Opler & Sheridan Titman, *Financial Distress and Corporate Performance*, 49 J. FIN. 1015 (1994). With particular regard to the Italian scenario, see Marco Bisogno & Roberto De Luca, *Indirect Costs of Bankruptcy: Evidence From Italian SMEs*, 2 J. ACCT. FIN. 20 (2012).

[6]Some studies compare direct costs of a formal bankruptcy to an out-of-court restructuring, revealing that costs are significantly lower in a successful restructuring without entering a chapter 11 case. *See* Stuart C. Gilson, John Kose & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315 (1990); Stuart C. Gilson, *Managing Default: Some Evidence on how Firms Choose Between Workouts and Chapter 11*, *in* CORPORATE BANKRUPTCY. ECONOMIC AND LEGAL PERSPECTIVES 308 (Jagdeep S. Bhandari & Lawrence A. Weiss eds., 1996). *But see* Gilson, *supra*, at 315 (arguing that bankruptcy also provides certain benefits that offset at least part of this costs difference, e.g. the possibility to issue prepetition debt). *See* also Elizabeth Tashjian, Ronald C. Lease & John J. McConnell, *An Empirical Analysis of Prepackaged Bankruptcies*, 40 J. FIN. ECON. 135 (1996); Betker, *supra* note 5 (examining the administrative costs for a sample of exchange offers, prepackaged bankruptcies and traditional chapter 11 cases and finding that prepackaged bankruptcies costs are lower than in traditional chapter 11 filings and similar to exchange offers costs). Nevertheless, it cannot be excluded that the inability to recapitalize outside of bankruptcy has a great cost.

[7]The process of revising debt obligations in order to avoid distress can be called "workout", "composition", "restructuring", and "recapitalization". It can involve lowering of the interest rate, forgiving a payment default, waiving prepayments, amending covenants, exchanging bonds for less onerous securities. *See* WILLIAM W. BRATTON, CORPORATE FINANCE: CASES AND MATERIALS 341 (6th ed. 2008).

[8]Such perspective is consistent with the genesis of the earliest forms of organizations of bondholders, whether they arose spontaneously or on a legal basis, which often consist of occasional organizations established upon economic crisis of the issuer. For an overview on the origin of the organizations of bondholders see JEAN ESCARRA, TRAITÉ THÉORIQUE ET PRATIQUE DE L'ORGANISATION DES OBLIGATAIRES (GROUPMENT ET REPRÉSENTATION) (1922).

[9]One might also imagine the opportunities for the issuer to make a prepayment or, conversely, to reach the natural maturity of the loan in spite of the occurrence of the conditions that would guarantee to the bondholders the right to early repayment.

increased need for protection of the bondholders. An issuer might, for example, propose to convert the debt into equity to liberate itself from an excessively costly obligation and propose unfair or unsupported treatment to the bondholders as part of that effort.[10] Bondholders desperate to preserve some chance of recovery might fall prey to these proposals. This is the major reason why policymakers in many different countries address this concern with specific and prohibitive rules.

B. Comparing the Individual Veto and Majority Vote Models

Most jurisdictions follow one of two rules for regulating the ability of an issuer to avoid insolvency or accommodate changing capital needs by renegotiating the debt. One requires the creditors' unanimous consent ("unanimity rule") while the other permits certain modifications to be approved upon a majority vote of the bondholders ("majority rule").[11]

1. *Unanimity and the "Holdout Problem"*

In several countries, and notably, the United States, unanimous bondholder consent to a modification of payment terms is required. Thus, all of the bondholders must support the proposed renegotiation, otherwise the restructuring will not be approved. Because obtaining unanimity is so difficult, even the mere consideration of a proposed restructure may be rendered impractical.

This approach creates a menu of disadvantages. A single bondholder, who may even be a competitor of the company, can frustrate the efforts to reach an agreement. An issuer may have great difficulty and expense in-

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[10]*See* Victor Brudney, *Corporate Bondholders and Debtor Opportunism: In Bad Times and Good*, 105 Harv. L. Rev. 1821, 1862 (1992). Furthermore, fear of receiving misleading information from the company makes the bondholders reluctant to accept the proposed restructuring and can lead to the failure of the deal (mutual mistrust problem). For instance, the mutual mistrust problem exists because bondholders do not know whether the information about the current financial situation of the company is reliable or not. *See* Roe, *supra* note 2, at 238 n.15 (observing that a renegotiation plan which involves the offer of stock for debt can reduce this risk, because "[b]ondholders might mistakenly exchange undervalued bonds, but the exchange would be for similarly undervalued stocks"). Despite the implications of the mutual mistrust problem, it can be noticed that, even if the company is not truly insolvent, from the point of view of bondholders, possessing stocks instead of debt is not exactly the same. First, only the distribution of dividends to stockholders is possible and the amount is variable, while bondholders are normally entitled to receive periodic interest. Secondly, stockholders risk their capital and they may be subordinated to other future creditors, while bondholders as creditors are more protected. Finally, it seems that, from a bondholder's perspective, a change of bonds for shares could be justified only in particular cases, for example when it represents an unavoidable and more favorable alternative to bankruptcy.

[11]The way in which bondholders express their consent can vary depending on different legal systems: while typically in civil law systems it could be expressed through the meeting of the bondholders, in common law systems there are generally no statutory provisions on the topic, even if the trustee and the issuer may provide lists of bondholders who left their names to the issuer for this purpose. *See* Trust Indenture Act of 1939 § 312, 15 U.S. C. § 77lll (2012).

curred in giving notice to all bondholders and collecting evidence of their consent. The company may lack the necessary financial resources and may not even know who some of the bondholders are or where they can be reached. These circumstances effectively preclude bondholders and the company reaching an advantageous agreement.[12] Faced with holdouts, an issuer might propose to renegotiate, but agree that only the consenting bondholders would be affected by the restructure terms while dissenters would be granted the full repayment of their investment.[13]

While that approach might give bondholders the broadest freedom of choice, whether it actually works is another matter. With little or no incentive to opt for the less-favorable treatment, what rational holder would opt for a future possibility (and not certainty) of being repaid instead of the sure and immediate reimbursement?[14] Moreover, should enough bondholders refuse the offer, the restructuring plan would fail.[15]

2. *Majority Vote*

In the second model, the agreed-to restructuring terms are submitted to the bondholders for a vote. The decision of the majority binds the minority. In a system free from distortions like conflicts of interest,[16] this approach

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[12]For an in-depth analysis of the reasons for holdouts and bargaining failures see Roe, *supra* note 2, at 237-39, where the Author underlines that even a renegotiation with a single creditor may fail because of disparate expectations, mutual mistrust and strategic action.

[13]Nevertheless, in order to consider this system plausible from an economic perspective, it seems necessary to add that a minimum threshold of consenting bondholders would be required for the success of the restructuring. It is obvious that, if the company could potentially repay in full all the (holdout) bondholders, a restructuring plan would not be necessary.

[14]According to A. Schwartz, this could happen only in cases of "greedy offers", when the proposed workout awards the company a larger share of the firm and the creditors a smaller share than the bankruptcy order of distribution would imply. In contrast, the Author argues that the holdout problem does not exist when the company proposes a "successful offer", a workout offer that is conditioned on unanimous acceptance and reorganizes the firm in the same priority order that would have been followed in bankruptcy. *See* Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595, 597-598 (1993). However, the Author does not consider the practical difficulties to reach unanimity, especially in case of dispersed bondholders (high costs, time, bondholders unreachable, etc.).

[15]The circumstance that bondholders who do not exchange their bonds for stock will be enriched at the expenses of those who do exchange, since they allow the company to integrally reimburse the holdouts, has been described as the "buoying-up effect". *See* Roe, *supra* note 2, at 237-39; *see* also Marcel Kahan, *Rethinking Corporate Bonds: The Trade-off between Individual and Collective Rights*, 77 N.Y.U.L. REV. 1040, 1055-1056 (2002).

[16]For example, it is clear that the exclusion from the vote of bondholders with a conflict of interest must be assured. Moreover, bondholders have to be clearly informed about the subject matter of the vote and their vote must be free, without any direct or indirect coercion. *See* Zohar Goshen, *Controlling Strategic Voting: Property Rule or Liability Rule?*, 70 S. CAL. L. REV. 741, 746 (1997) (affirming the superiority of a simple majority rule, provided that each individual votes in accordance with her personal assessment of the utility of the transaction for the group ("sincere voting") and not in line with the assessment of other voters ("strategic voting") or with the utility of the deal for herself ("voting in conflict of interests")); *see* also Zohar Goshen, *Voting (Insincerely) in Corporate Law*, 2 THEORETICAL INQ. L. 815, 815-16 (2001).

should be beneficial.[17] Bondholders would be stripped of their incentive to hold out.[18] Instead, they could freely evaluate if the proposed plan really is a better option, compared with the perspective of a bankruptcy.

Likewise, a solvent issuer could seek a change of terms to gain a capital or other competitive advantage. For instance, the issuer might desire to make an investment that will cash flow in five years. It may ask the bondholders to renounce their coupon interest due for the next three years, offering in return an increased interest return when the investment becomes profitable. Though each bondholder has an incentive to refuse in order to receive their current interest without betting on the successful outcome of the deal, a potential holdout bondholder loses some leverage. Even if that holder dissents (and loses), he or she would benefit from the acceptance by the other bondholders by reaping the positive outcome of the proposed investment, issuer's increased net worth, and the rise in market value of the bonds. If a majority of the holders rejects the debt's renegotiation, the issuer's investment plans may be frustrated, but all holders will have had an equal say in the outcome. Even in the absence of an imminent risk of bankruptcy of the issuer, the majority vote model still represents the desirable approach.

C. Bondholders Voting Rights in Workouts. A Comparative View

Basic principles of contract law allow for changing the terms of a loan with the consent of the debtor and its creditors. However, what is really relevant for the parties is making it possible to reach an agreement between the company and the bondholders as a group, even when some bondholders dissent. Generally, amendments to ancillary conditions of the bond loan, such as a temporary postponement of the payment of interest, are not affected by unanimity rules. In some jurisdictions, the majority of bondholders may adopt a decision that is binding on the dissenting minority, but not about amendments to the core terms of the debt or converting it to equity. There, applicable rules vary among countries.[19] Examples of these approaches will be examined in the following paragraphs.

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[17]For a different point of view see Brudney, *supra* note 10, at 1858 (highlighting, in contrast, that, when bankruptcy is not imminent, the right to holdout may raise the price of a proposed refunding and then the average price that all bondholders will receive).

[18]*See* Robert A. Haugen & Lemma W. Senbet, *Bankruptcy and Agency Costs: Their Significance to the Theory of Optimal Capital Structure*, 23 J. Fin. and Quantitative Analysis 27, 30 (1988). According to the Authors, bond indentures could provide that a plan, approved by the board, is submitted to the debtholders and, if a majority approves it, all debtholders are bound. As an alternative, bond indentures could give the bond trustee the right to accept or reject offers on behalf of all the bondholders.

[19]*See* Philip Wood, International Loans, Bonds and Securities Regulation. Law and Practice of International Finance 175 (1995).

1. *Unanimity Jurisdictions*

a. Unanimity as a Mandatory Rule

The United States has embraced a very restrictive approach since the enactment of the Trust Indenture Act of 1939 (Trust Indenture Act or TIA).[20] Under U.S. law, almost every amendment of the indenture involving payment terms requires the unanimous consent of the bondholders, though a 75% majority of the bondholders (measured by principal amount) may authorize a postponement of an interest payment up to three years from its due date.[21]

Argentinian law provides that the bondholders may agree to modify terms of the debt with the majorities required for extraordinary meetings of the *sociedad anônima*. Core terms modifications require unanimity.[22] Ecuador law contains similar provisions permitting certain terms modifications to be approved by a two-thirds vote, but retains the unanimity requirement for modifications to interest rates, the term and form of capital or interest repayment, and guarantees or modalities of payments, as provided in the contract.[23]

b. Unanimity as a Default Rule

Germany and Chile are among the countries that have adopted the unanimity principle as a "default" rule. In other words, while unanimity is the rule, the issuer and the holders can agree to other decision-making provisions. The German Bond Act,[24] enacted in 2009, provides as a general rule that the amendment of the terms and conditions of a bond issue requires an agreement between the issuer and every single bondholder. However, the indenture may grant holders the right to adopt majority resolutions on amendments such as consenting to the conversion of the bonds into shares or other financial instruments so long as all bondholders are treated alike.[25]

Under revised Article 125 of Chile's Securities Market Law,[26] the bondholders may, in a meeting, authorize their representative to negotiate and conclude an agreement with the issuer modifying the terms of the loan. That modification can be approved by a vote of two-thirds, except where a differ-

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[20]Pub. L. No. 76-253, 53 Stat. 1149 (codified as amended at 15 U.S.C. §§ 77aaa-77bbbb (2012)).

[21]Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp(b) (2012).

[22]Law No. 19550 art. 354, Apr. 25, 1972, 22409 B.O. 11 (Arg.).

[23]Ley de Mercado de Valores, art. 168 (Ecuador).

[24]Gesetz über Schuldverschreibungen aus Gesamtemissionen-Schuldverschreibungsgesetz [SchVg] [Bond Act], Jul. 31, 2009, BGBL. I at 2512, last amended by Gesetz [G] of December 22, 2020, BGBL. I at 3256 (Ger.), http://www.gesetze-im-internet.de/schvg/BJNR251210009.html; *see* Jason Grant Allen, *More than a Matter of Trust: the German Debt Securities Act 2009 in International Perspective*, 7 CAP. MKT'S L. J. 55 (2011).

[25]*See* § 4, § 5(1), § 5(3) n. 5 and § 5(2). Such amendment is part of a non-exhaustive catalogue of terms that may be altered only by a 75% qualified majority. *See* § 5(4).

[26]Law No. 18.405, Octubre 21, 1981, DIARIO OFICIAL [D.O.] (Chile). Art. 125 has been amended in 2007 by art. 6, n. 8, Law No. 20.190, Junio 5, 2007 DIARIO OFICIAL [D.O.].

ent percentage is provided by other laws, or a higher percentage is mandated by the indenture. An indenture amendment changing the interest rate or payments, the amount and maturity of the debt, or the guarantees, may only be agreed to upon the consent of no less than 75% of the amount of the outstanding bonds. If the indenture does not contemplate a specific percentage, a unanimous vote is required.

In the "default rule" jurisdictions, contracting parties generally decide to adopt an indenture clause allowing a qualified majority of bondholders to authorize amendments to the core terms of the loan, often selecting 75% as the qualifying majority required.[27]

2. *Legal Systems Adopting Majority Vote*

Consensual restructuring of bond debt is allowed under English law, where trust deeds frequently give a majority of holders the power to modify bond terms.[28] The power to bind the minority, however, is subject to certain limits, an important one being that the majority's actions must benefit the class as a whole.[29]

A case involving an exit consent transaction established general principles in the matter.[30] In *Assénagon*,[31] noteholders were offered in exchange for their unsecured subordinated notes, new unsubordinated notes of lower value. Participating holders were asked to consent to a resolution agreeing to accept redemption of their remaining notes for € 0.01 per € 1000 of existing principal at a noteholders' meeting convened for this purpose. Even though the court recognized that the trust deed allowed a supermajority to bind the minority to an abrogation of all the rights of noteholders, it found the proposed resolution both oppressive and unfairly prejudicial to minority and therefore unlawful because it was designed to substantially destroy the value

[27]*See* Carlos Berdejó, *Revisiting the Voting Prohibition in Bond Workouts*, 89 TUL. L. REV. 541, 563-64 (2015).

[28]*See* Olswang LLP, *Restructuring Bonds: Legal Issues Under English Law*, *in* THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: CORPORATE RECOVERY & INSOLVENCY 2015, at 6 (9th ed. 2015).

[29]English courts often recall a decision of the Privy Council on appeal from Canada: *British America Nickel Corp'n v MJ O'Brien Ltd* [1927] AC 369. In this case involving mortgage bonds being exchanged for income bonds, the court affirmed that "[t]here is, however, a restriction on such powers, when conferred on a majority of a special class in order to enable that majority to bind a minority. They must be exercised subject to a general principle, which is applicable to all authorities conferred on majorities of classes enabling them to bind minorities; namely, that the power given must be exercised for the purpose of benefiting the class as a whole, and not merely individual members only. Subject to this the power may be unrestricted."

[30]The exit consent is a technique used to persuade bondholders to exchange their bonds for new securities on different terms. At the same time, exchanging holders commit themselves to vote for a resolution amending the terms of the existing bonds in an unfavorable way. As a consequence, holders who fail to offer their securities for exchange risk the devaluation of their bonds. A deeper analysis of the exit consent technique and its legitimacy under U.S law will be developed in section II.D.

[31]Assénagon Asset Mgmt. S.A. v. Irish Bank Resolution Corp. Ltd. (formerly Anglo Irish Bank Corp. Ltd.) [2012] EWHC 2090 (Ch).

of the notes.[32] The majority power to bind must be exercised in good faith and in the best interests of the class of holders as a whole.[33]

Similarly permissive legislation can be found in Spain, though with some restrictions. Art. 425 of the Spanish Corporate Enterprises Act[34] provides that agreements made in the bondholders' general assembly must be adopted by absolute majority of the issued bonds' value, but amendments to the terms of repayment of the nominal value, conversion, or exchange of the bonds require a favorable vote of two-thirds of the outstanding bonds. In Portugal the bondholders may vote to amend the terms of the obligation in a meeting, though the majority requirements vary.[35] In Luxembourg, the bondholders may modify or waive specific collateral, postpone interest payment dates, agree to reduce the interest rate or change the conditions of payment, extend or suspend the amortization period, agree to the conversion of the bond debt to the company's equity, and agree to the substitution of bonds by shares or bonds of other companies.[36] Similar rules are provided by Belgian law, which gives the bondholders analogous modification rights upon a majority vote of the outstanding bonds.[37]

In Switzerland, the community of bondholders is authorized to take all measures required to safeguard their collective interests, in particular as regards any financial difficulties encountered by the borrower.[38] A two-thirds majority of the bonds outstanding is required to approve a variety of measures, including the full or partial conversion of bonds into shares.[39]

France takes a hybrid approach. Some types of amendments or modifications may be authorized by a two-thirds majority.[40] These rights have three

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[32]The court concluded that the exit consent is a "coercive threat which the issuer invites the majority to levy against the minority, nothing more or less. Its only function is the intimidation of a potential minority, based upon the fear of any individual member of the class that, by rejecting the exchange and voting against the resolution, he (or it) will be left out in the cold." *Id.* at 84.

[33]*Id.* at 6. Another recent case is Azevedo and another v. Imcopa Importação, Exportação E Indústria De Oleos Ltda and others [2013] EWCA Civ 364. In *Azevedo*, the issue was the legitimacy under English law of the "consent solicitation", a process where a company aims to solicit and procure votes in support of a financial restructuring proposal by offering and making cash payments to those noteholders who vote in favor of the proposal. In this case the court found that there was not a preordained discrimination between a majority and a minority, since the payment was available to all members of the class and it held that the transaction was not inconsistent with English company law.

[34]Corporate Enterprises Act art. 425, as amended by art. 45.11 of Law 5/2015 (B.O.E. 2010,1) (Spain).

[35]Código das Sociedades Comerciais, art. 355/7 (Port.).

[36]Loi du 10 août 1915, last amended by Loi du 10 août 2016, in the coordinated and reorganized version resulting from Règlement grand-ducal du 5 décembre 2017, art. 470-13 (Lux.).

[37]CODE DES SOCIÉTÉS [C. Soc.] art. 7:162 (Belg.) with reference to *société anonyme; see also id.* art. 5:108 (with reference to *société à responsabilité limitée*).

[38]Obligationenrecht [OR]; Code des Obligations [CO], Codice delle obbligazioni [CO] Mar 30, 1911, RS 220, art. 1164 C, par. 1.

[39]*Id.* art. 1170 D.

[40]Including any proposal relating to total or partial abandonment of the guarantees conferred on the

limitations. The bondholders may not vote to increase the financial burdens on bondholders, nor can a majority vote establish or ratify the inequitable treatment of bondholders within a particular class, or agree to the conversion of bonds into shares.[41] That part of an indenture providing to the contrary is void. As debt-to-equity conversion is often a key concession in in a debt restructuring, the French regime may be considered more prohibitive.

In Peru, the General Law of Corporations grants a majority of bondholders similar powers to accept a proposed agreement with the issuer. An absolute majority of the bonds in circulation is required to approve the resolution.[42] Brazilian law[43] provides that the deed of issue shall state the quorum required to approve amendments to the conditions of the debentures, which shall not be less than one-half of the debentures in circulation. In contrast the trustee lacks the power to agree to amend conditions of the issue.

By comparison, Italian law is less permissive. Like many other civil law jurisdictions, Italian law establishes an organization of bondholders. In this context, a bondholders' meeting is entitled to resolve matters of common interest for the holders, including modifying the conditions of the bond, but only upon the approval of a supermajority of the bondholders.[44] Excluded from that is the power to amend some core terms of the loan not specified in the rule, precluding bondholders' voting on those issues.[45]

3. *Judicially Supervised Restructuring: Brief Overview.*

Many jurisdictions provide for nonbankruptcy law judicial bond restructurings. These procedures are not specifically tailored to bond debt, but are available to all creditors in order to restructure debt. Formal restructuring assures increased protection to bondholders, granting them court oversight over a renegotiation. At the same time, such a process may be more expensive and less efficient than a bondholders' vote in a nonjudicial setting. If the issuer is already in deep crisis, additional time and expense may weigh on the likely success of a renegotiated deal. Though these proceedings may not be

bondholders, to reschedule the due date for payment of interest or to change to the mechanisms governing redemption or the interest rate. *See* CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L 228-65, section 1 (Fr.).

[41]*Id.* art. L 228-68.

[42]*See* Arts. 322, n. 2, and 323, Ley No. 26887, Diciembre 5, 1997 [Ley General de Sociedades] [General Law of Corporations], DIARIO OFICIAL [D.O.] de 9.12.1997 (Peru), http://www.leyes.congreso.gob.pe/Documentos/Leyes/26887.pdf.

[43]Art. 71, par. 5, Lei No. 6.404, de 15 de Dezembro de 1976, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] de 17.12.1976 (Braz.); *see also id.* art. 70 (pertaining to trustee's powers).

[44]*See* art. 2415, section 1, n. 2 Codice civile [C.c.] (It.).

[45]The U.S. and Italian legal systems will be analyzed in depth in the following parts. *See infra* Parts II, III.

optimal, it is useful to mention several examples of judicially supervised restructuring processes.

In the United Kingdom, bonds may be renegotiated in a statutory "scheme of arrangement." Part 26 of the Companies Act provides for a company and any class of its creditors to reach a compromise or arrangement which must be accepted by a majority in number holding 75% of the debt held by the creditors or a class of creditors who must be present and voting at the meeting.[46] The court has broad powers at two stages of the process. First, after the company applies for an arrangement, the court orders the meeting of the creditors to be summoned in such manner as it directs. Second, after the meeting and vote, the court sanctions the scheme of arrangement, making it binding on all creditors or classes. In "sanctioning" the scheme of arrangement, the court must determine whether the proposed scheme is such that an honest and intelligent member of the class concerned, acting in respect of his interest, might reasonably approve of it.[47]

Royal Decree-Law 4/2014 added an additional provision four to the Spanish Act on Insolvency.[48] This provides that some terms of a refinancing agreement that is signed by creditors representing at least 60% of the financial liabilities may bind the dissenting creditors upon judicial approval. Such terms can include moratoria not exceeding five years or conversion of the debt to participation loans during the same term. More aggressive changes to the terms of the debt require that 75% of the creditors sign the agreement. These include moratoria longer than five years, write-down of principal, conversion of debt to other forms of securities, and the assignment of assets or rights in lieu of payment. If a conversion of debt to equity is proposed, dissenting creditors may choose between conversion and a write-down equivalent to the amount of the face value of the shares or stakes, and where appropriate, the relevant issue or undertaking premium. If the creditors do not accept the conversion, they are understood to have opted for the write-down.

In Italy, debt restructuring agreements are governed by Article 182-*bis* of the Bankruptcy Law.[49] Such an agreement may be entered into by the debtor and at least 60% of its creditors, and provides for terms and conditions freely negotiated between the parties involved. It is mainly regarded as

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[46]Companies Act, (2006), Part 26 (Eng.). In addition, see the new Part 26A restructuring scheme, added by Corporate Insolvency and Governance Act, (2020).

[47]Re Dorman, Long & Co Ltd; Re South Durham Steel and Iron Co Ltd [1933] All ER Rep 460.

[48]Act on Insolvency (B.O.E. 2003, 22) (Spain).

[49]Regio Decreto 16 marzo 1942, n. 267, G.U. Apr. 6, 1942, n. 81, last amended by Decreto Legge 18 aprile 2019 n. 32, G.U. Apr. 18, 2019 n. 92 (It.). Note that the Bankruptcy Law will be repealed by the new Code of Crisis and Insolvency (Decreto Legislativo 12 gennaio 2019 n. 14, G.U. Feb. 14, 2019 n. 6/ L), which comes into force on September 1, 2021. Then, the debt restructuring agreements will be governed by art. 57, Code of Crisis and Insolvency.

a private agreement carried out outside formal procedures,[50] although it requires a limited involvement of the bankruptcy court, which has to approve the agreement. Such an agreement, with few exceptions, only binds those creditors who have entered into it. Dissenting creditors must be paid in full. An independent expert must assess the feasibility of the agreement to grant the payment of all the credits.[51] An alternative is the restructuring plan,[52] the main effect of which is that the agreement is sheltered from claw-back actions in a subsequent bankruptcy filing. This second procedure is not supervised by the court, although the plan must be validated by an expert. Like the debt restructuring agreement, the restructuring plan is not binding on creditors who do not sign it.

D. Sovereign Debt Restructuring—Collective Action Clauses

Sovereign bonds issued on the international markets represent one of the major sources of private funding to countries. Issuing sovereign bonds is similar to issuing corporate bonds. Bonds are issued all over the world and pools of international banks play various roles in their placements, implicating the laws of the countries where they are issued and placed.[53] The choice of law applicable to a sovereign bond obligation is commonly specified in the indenture. Often issuers specify English or New York state law. When bonds are issued by European countries, the governing law is either that of the issuing state or of England. Austria, Hungary, Italy, Poland, and Sweden have issued bonds under New York state law.[54]

The choice of the governing law is important when restructuring the debt.[55] Bond issues under English law may be modified upon the consent of a qualified majority of bondholders. Bond debt governed by U.S. law requires

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[50]Composition with creditors (*concordato preventivo*) or bankruptcy.

[51]A study shows that the implementation of such agreements is very limited in the practice of the business. From 2006 (year of introduction) to 2014, only 675 debt restructuring agreements have been implemented in a total of 896,779 insolvency procedures. *See* Valter Conca, Alessandro Danovi & Luca Riva, *Dieci anni di accordi di ristrutturazione dei debiti ex art. 182-bis L.F. Un'analisi empirica nei principali Tribunali italiani* (May 12, 2015), http://www.sdabocconi.it/it/eventi/2015/05/dieci-anni-accordi-ristrutturazione-dei-debiti-ex-art-182-bis-lf.

[52]*See* art. 62, section 3, lett. d) Bankruptcy Law (It.). The restructuring plans will be governed by art. 56, Code of Crisis and Insolvency (It.).

[53]Mauro Megliani, Sovereign Debt: Genesis-Restructuring-Litigation 205-206 (2015).

[54]Udaibir S. Das, Michael G. Papaioannou & Christoph Trebesch, *Sovereign Debt Restructurings 1950-2010: Literature Survey, Data, and Stylized Facts* 41-43 (IMF Working Paper No. 12/203, August 2012), https://www.imf.org/external/pubs/ft/wp/2012/wp12203.pdf.

[55]To be precise, there are various techniques to restructure sovereign bonds: the cooperative approach, which consists of formal or informal negotiations, the exit consent, and the unilateral offer. *See* Megliani, *supra* note 53, at 368.

unanimous consent to modify the obligation.[56] Given the TIA's ban of the Majority rule in nearly all situations, this is not surprising. However, such a clause is neither mandatory, nor the only alternative, because the TIA's bar on majority action clauses doesn't apply to sovereign bond issues.[57]

Unanimity action clauses make large scale restructuring of sovereign debt practically impossible. The difficulties in reaching bondholders are even greater in the context of sovereign debt, when bonds are held by dispersed international holders. Moreover, a reorganization process under the procedure and majority required by chapter 11 is not a viable path for sovereign debt.[58]

Collective action clauses (CACs)[59] provide a solution to global financial crises that affect sovereign debt markets. CACs allow a supermajority of bondholders to accept a deal on behalf of the entire group.[60] Consequently, replacing unanimity provisions with majority rule provisions is an emerging trend.[61] In 2002, the G-10 Working Group on Contractual Clauses was formed to promote the development of suitable contractual provisions for sovereign debt to facilitate workouts. The Working Group recommended "the inclusion of a majority amendment clause permitting amendments of payment terms with the approval of a supermajority of bondholders."[62] In 2005, the European Commission included the CACs in bond loans issued according

[56]Lee C. Buchheit & G. Mitu Gulati, *Sovereign Bonds and the Collective Will*, 51 EMORY L.J. 1317, 1325-29 (2002).

[57]Section 304 of the Trust Indenture Act exempts from its coverage "any note, bond, debenture, or evidence of indebtedness issued or guaranteed by a foreign government or by a subdivision, department, municipality, agency, or instrumentality thereof" (Trust Indenture Act of 1939 § 304 (a)(6), 15 U.S.C. § 77ddd(a)(6) (2012)).

[58]*See* Buchheit & Gulati, *supra* note 56, at 1344 (observing that "in a negotiated sovereign debt restructuring (unlike a corporate reorganization under chapter 11), all similarly-situated creditors do not vote as a class, and thus soliciting the "collective will" of creditors in a sovereign context really means seeking action by separate creditor groups under separate debt instruments").

[59]"Collective action clauses" refers to other provisions besides majority action clauses. For example, "collective representation clauses" establish a creditor committee or other representative arrangement for bondholders. "Majority enforcement clauses" (or "initiation clauses") allow 25% of bondholders to approve any acceleration of debt, at the same time permitting that 50% of bondholders may rescind any such acceleration. "Engagement clauses" provide early and regular interaction of the issuer with the bondholders, and define the process of restructuring. *See* Robert B. Ahdieh, *Between Mandate and Market: Contract Transition in the Shadow of the International Order*, 53 EMORY L.J. 691, 699 n.15 (2004).

[60]*See* Elena Carletti, Paolo Colla & Mitu Gulati, *Evaluating the 2013 Euro CAC Experiment* 2-3 (May 20, 2016), http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=6294&context=faculty_scholarship.

[61]There is much literature on collective action clauses and sovereign debt. More recently see Michael Bradley & Mitu Gulati, *Collective Action Clauses for the Eurozone*, 18 REV. FIN. 2045, (2014); Christian Hofmann, *Sovereign-Debt Restructuring in Europe Under the New Model Collective Action Clauses*, 49 TEX. INT'L L.J. 385 (2014). According to Steven L. Schwarcz, *A Minimalist Approach to State "Bankruptcy"*, 59 UCLA L. REV. 322, 330, 330 n.40 (2011), however, few States adopt this kind of clauses.

[62]GROUP OF TEN, REPORT OF THE G-10 WORKING GROUP ON CONTRACTUAL CLAUSES 3 (2002), http://www.bis.org/publ/gten08.pdf.

to the European Medium-Term Note program.[63] In 2012, CACs became mandatory in all new European Union government securities having maturity dates beyond one year and issued on or after January 1, 2013.[64] Finally, in February 2012, common terms of reference for the CACs were introduced.[65] These terms allow the terms and conditions of the bonds in relation to reserved matters, to be modified with the consent of the issuer and the affirmative vote of holders of not less than 75% of the aggregate principal amount of the outstanding bonds represented at a duly called meeting of bondholders or a written resolution executed by the holders of not less than 66 2/3% of the aggregate principal amount of the bonds then outstanding.[66]

Initially, five emerging market sovereign issuers implemented the abovementioned approach. They have issued bonds in the international market specifying that New York law governs and including CACs.[67] Other countries followed, issuing new obligations that expressly provide that amendments to the terms of the loan require the consent of a qualified majority of bondholders.[68] Greece enacted a statute implementing CACs in Greek sovereign debt issues.[69]

The widespread use of CACs in sovereign debt indentures reduces the impact of the choice of the governing law on the restructuring process. It also reflects a willingness to facilitate renegotiation and workouts that has

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[63]Communication from the Commission to the Council 2005/331, *Review of the Facility Providing Medium-Term Financial Assistance to Member States under Article 119 of the Treaty* (2005), http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0331:FIN:EN:PDF.

[64]According to art. 12 § 3 of the Treaty Establishing the European Stability Mechanism, Feb. 2, 2012, T/ESM 2012, http://www.european-council.europa.eu/media/582311/05-ESM2.en12.pdf.

[65]Sub-Committee on EU Sovereign Debt Markets, Economic and Financial Committee [EFC], *Common Terms of Reference* (Feb. 17, 2012), http://europa.eu/efc/sub_committee/pdf/cac_-_text_model_cac.pdf.

[66]Common Terms of Reference § 2.1. Reserved matters include change of the date on which any amount is payable on the bonds, and reduction of any amount, including any overdue amount, payable on the bonds. *Id.* § 1 (h).

[67]The five countries are Kazakhstan (1997), Lebanon (1997, 1999), Qatar (1999, 2000), Bulgaria and Egypt (2001). *See* Mark Giugiatti & Anthony Richards, *The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers*, 35 GEO. J. INT'L L. 815, 820-21 (2004).

[68]Among others, Mexico, Uruguay, Brazil, Korea, South Africa, Belize, Italy, Turkey (2003); Argentina (2005), Ghana and Gabon (2007). *See* Das, Papaioannou & Trebesch, *supra* note 54, at 44; MEGLIANI, *supra* note 53, at 359.

[69]The Greek legislature passed a law that introduced retroactively a CAC, allowing the restructuring of the existing bonds with the consent of a qualified majority, based on a quorum of votes representing 50% of face value and the consent of two-thirds of the face-value taking part in the vote allowed. Art. 1 § 4 Nomos (2012: 4050) ΕΦΗΜΕΠΙΣ ΤΗΣ ΚΥΒΕΡΝΗΣΕΩΣ [Rules of amendment of titles issued or guaranteed by the Hellenic Republic with the Bondholder's agreement], ΤΗΣ ΕΛΛΗΝΙΚΗΣ ΔΗΜΟΚΡΑΤΙΑΣ 2012, A:5 (Greece); *see* Jeromin Zettelmeyer, Christoph Trebesch & Mitu Gulati, *The Greek Debt Restructuring: An Autopsy* 11 (Peterson Inst. for Int'l Econ., Working Paper No. 13-8, 2013), https://piie.com/publications/wp/wp13-8.pdf; *see also* MEGLIANI, *supra* note 53, at 371 (arguing that, in contrast with the usual pattern of CACs included by contractual agreement, Greece amended *ex imperio* the terms of the loan).

been promoted by recent legislation concerning sovereign debt and corporate bonds.[70]

E. The Reasons for the Unanimity Approach and Its Obsolescence.

If the majority rule option seems to be optimal, why do some legal systems instead require holder unanimity to make core term modifications? There are three main reasons: the protection of bondholders, the general principles of contract law, and the negotiability of bonds. The perceived need for bondholder protection is historical: policymakers established the rule in a time when individual bondholders were essentially common people, not professional investors, and their interests were not sufficiently protected by disclosure rules.[71] Lawmakers and regulators feared that companies would use their superior institutional knowledge as leverage against "widows and orphans" and wanted to assure individual holders that a judge would evaluate any proposed restructuring plan during a bankruptcy case. In this paternalistic view, bankruptcy was seen not as a costly procedure to avoid, but on the contrary, as a desirable result.[72] Another reason for not allowing majority bondholder rule, particularly in civil law systems, is the shared understanding that bonds are like any other contract which can only be modified by the agreement of all parties individually.[73] Negotiability provides a third justification for the unanimity requirement.[74] Even before jurisdictions began to

[70]For an overview of the use of the CACs in sovereign bonds, see IMF, Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts (Sep. 17, 2015), http://www.imf.org/external/np/pp/eng/2015/091715.pdf.

[71]*See* U.S. Sec. & Exch. Comm'n, Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part II: Committees and Conflicts of Interest 1 (1937); *see*, also, William O. Douglas, *Protective Committees*, *in* Democracy and Finance 199 (James Allen ed., 1940) (affirming that "the average investor does not possess the training, the experience, or the skill" demanded by problems in reorganizations).

[72]*See infra*, section II.B.

[73]Regarding the U.S. legal system, see Claude D. Rohwer-Anthony M. Skrocki, Contracts in a Nutshell 326 (7th ed., 2010) (affirming that contract modification, like formation, needs mutual assent); Gabriel Reilly-Bates & Daniel R. Saeedi, *Modification of Contracts*, in Contract Law, Analyzing and Drafting 373 (Karen F. Botterud ed., 2015).

Therefore, allowing the modification of the terms of the loan by a majority vote represents a substantial departure from the overarching principles of contract law. Such a rule operates in favor of the corporation that, otherwise, would find it extremely costly to collect the consent of each and every bondholder should it have wished to adjust the conditions of the loan to its changed economic situation. *See* Luca Autuori, *Commentary to artt. 2415-2420 C.c.*, *in* Obbligazioni. Bilancio. Artt. 2410-2435-bis C.c. Commentario alla Riforma delle Società 203, 206 (Mario Notari & Luigi A. Bianchi eds., 2006); *see also* Nicoletta Ciocca, Gli Strumenti Finanziari Obbligazionari 100 (2012) (examining other foreign experiences and highlighting that every amendment to the original issuing rules is exceptional regarding the consensual principle).

[74]*See* De Forest Billyou, *Corporate Mortgage Bonds and Majority Clauses*, 57 Yale L.J. 595, 596-97 (1948); Robert Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 Colum. L. Rev. 901, 927, n.93 (1927).

prohibit majority clauses, contract provisions allowing for the modification of the principal and interest by vote were not much used in the U.S. Under the Negotiable Instrument Law, to be negotiable, an instrument must include "*an unconditional promise or order to pay a sum certain in money . . .[and] be payable on demand, or at a fixed or determinable future time*".[75] In the light of this provision, the New York Stock Exchange had been reluctant to list bonds subject to majority clauses enabling amendments to principal or interest. Major bond issuers, followed by smaller issuers, were deterred from adopting such provisions.[76]

Do these justifications still apply? No. Today the bondholder protection rationale is resolved by the rules and regulations that bar conflicts of interest[77] and impose duties of good faith and fair dealing on the parties.[78] These go a long way toward preventing insiders' abuses. The provision of providing supermajority requirements would add a further layer of protection.[79] There is no correlation between the protection of the individual bondholder and that holder retaining an individual veto power, especially when a common and binding decision that best treats the interests of the bondholders as a body might serve that holder better in the long run. Moreover, because the marketplace and its regulation have both evolved, bondholders are likely to be better-informed investors, not necessarily individuals, who are professional investors. Expansive and aggressively enforced disclosure regulations insure extensive disclosure to investors.[80]

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[75]UNIF. NEGOTIABLE INSTRUMENTS ACT § 1(2)-(3) (1896), 3B U.L.A. app. I at 507 (1992).

[76]*See* Billyou, *supra* note 74, at 597; Buchheit & Gulati, *supra* note 56, at 1326.

[77]For example, by limiting or excluding the voting rights of bondholders who are, at the same time, shareholders of the company in case of conflict of interest.

[78]The abuse of majority rule in the Italian legal system refers to cases in which there is a conflict solely among shareholders, that does not affect the company. In such cases, the principles of good faith and fair dealing apply, causing the invalidity of a resolution of the shareholders' meeting which, although formally regular, aimed to benefit some shareholders to the detriment of others; see Cass., October 26, 1995, n. 11151, in *Giur. Comm.*, 1996, II, 329, the leading case on the subject. Also, implied duties of good faith among bondholders are recognized in common law, see the American case Hackettstown Nat'l Bank v. D.G. Yuenglin Brewing Co., 74 F. 110 (2d Cir. 1896) and the English case Assénagon Asset Mgmt. S.A. v. Irish Bank Resolution Corp. Ltd. (formerly Anglo Irish Bank Corp. Ltd.) [2012] EWHC 2090 (Ch).

[79]The need for a higher percentage of the absolute majority of bondholders to approve amendments to the core terms of the loan may act as a disincentive to gain the control of the bond issue with the only aim to destroy it, since the relevant costs would hardly be recovered upon completion of the restructuring.

[80]*See* Roe, *supra* note 2, at 259 (reporting data showing that, in the mid 80s, ninety percent of the U.S. bond market was institutional); Marcel Kahan, *The Qualified Case Against Mandatory Terms in Bonds*, 89 NW. U. L. REV. 565, 583 (1995) (confirming that institutional investors dominate the market for corporate bonds and individual investors have a small role) and, more recently, Adam Levitin, *The Examiners: Recalibrate the TIA for Today's Debt Markets*, WALL ST. J. (Sept. 30, 2015, 12:11 p.m.), http://blogs.wsj.com/bankruptcy/2015/09/30/the-examiners-recalibrate-the-tia-for-todays-debt-markets/ (highlighting that the U.S. prohibition was originally drafted for a world of "Ma and Pa" bondholders and portfolio lending by banks, while debt securities are now almost entirely an institutional market); William W. Bratton, Jr. & Adam J. Levitin, *The New Bond Workouts* 47 (U of Penn, Inst for Law & Econ

The contract law rationale for unanimity, that contracts can be modified only with the consent of all the parties involved, ignores the fact that, typically, bondholders of a particular issue or class share the same legal position and status that can be advocated by them as a group through a representative. This justifies rules by which bondholders are not merely treated as individuals, but rather as a single creditor. In addition, bond debt is part of the issuer's financial structure. In company law, many issues are decided by majorities of shareholders or directors, meaning that the majority principle is fundamental to corporate law and allows the company to rapidly and efficiently operate. Even in jurisdictions where unanimity is the rule, majorities and supermajorities can make minor changes to the loan contract. Thus, there is no valid reason to not consider using the majority, or supermajority vote to considering and approving a proposed renegotiation of the debt in a way that affects what all the bondholders may expect to receive.

Contract law principles can also be honored by the including of a specific clause in the indenture providing for various matters to be decided by majority vote. Unfortunately, this option would only be viable in jurisdictions that do not ban bondholder majority rule concerning core terms modifications of the debt.

Finally, negotiability concerns could be addressed by the enactment of different rules for bonds that are listed and those that are not. Listed bonds must be negotiable while unlisted issues that do not actively "trade" on markets may not need to be "negotiable" in a commercial law sense. Moreover, bond modification rules may be more properly considered market rules, rather than rules of organization relating to the company law. National company law, in other words, should only regulate the process of issuing bonds through mandatory provisions, but should not extend to regulating the prohibitions, responsibilities and decisions of creditors.[81] Where the law of the nation of issue also regulates these aspects, it should not for that reason alone preclude the application of a different market rule concerning bondholder decision-making.

Research Paper No. 17-9, European Corporate Governance Institute (ECGI)-Law Working Paper No. 356/2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2909186 (showing that in 2015 the percentage of bonds held by households amounts to 11%).

Concerning France, see MAURICE COZIAN-ALAIN VIANDIER-FLORENCE DEBOISSY, DROIT DES SOCIÉTÉS, 513 (26th ed. 2013) (observing that the typical bondholder has changed after the establishment of the organisation of bondholders (« *la masse* ») in 1935, often being an institutional investor (*«investisseur institutionnel»*, such as *SICAV, fonds commun de placement, compagnie d'assurances. . .*) sufficiently armed to defend directly and individually its rights, without needing to form coalitions with other bondholders). Regarding the Italian bond market, see *infra* section III.A.

[81]*See* Mario Notari, *La raccolta dei mezzi finanziari nella s.r.l.*, *in* LA RIFORMA DEL DIRITTO SOCIETARIO DIECI ANNI DOPO, PER I QUARANT'ANNI DI GIURISPRUDENZA COMMERCIALE, MILANO 13-14 GIUGNO 2014 117-18 (2015).

Denying bondholders the ability to vote on core term modifications is outmoded and should be avoided. Even among the countries in which this ban exists, there are many exceptions. In the upcoming parts, we examine two major legal systems in which the vote of bondholders on a modification of the core terms of the loan is not allowed, highlighting the (often harmful) workarounds this prohibition causes.

II. WORKOUTS IN THE U.S.

A. BACKGROUND: BRIEF OVERVIEW OF BOND ISSUES IN THE U.S.

In the U.S. system, a bond issue is governed by the provisions of a trust indenture,[82] a contract entered into between a company issuing bonds or debentures[83] and a trustee for the holders of the bonds or debentures, delineating the rights of both the holders and the issuer.[84] It is composed of two parts, one that describes the obligations and restrictions on the issuer, and another one that contains the provisions related to the rights of bondholders on default of the conditions previously set forth and disciplines the relationship between the indenture trustee and the bondholders. The trust indenture also regulates the procedure of amendment of the indenture and the protection of any conversion privilege.[85]

When bonds are offered or sold to the public in interstate commerce, they must be issued under an indenture that complies with the TIA.[86] The TIA was enacted in 1939 as an amendment to the Securities Act[87] after a study about corporate reorganization by the Securities and Exchange Commission (SEC).[88] The TIA was primarily intended to: *i)* provide full and fair disclosure throughout the life of securities; *ii)* provide means to assure such contin-

[82]To be more precise, in corporate practice, there is a distinction between loan agreement and trust indenture. Loan agreements are contracts entered into between a corporation issuing long-term notes and the holders, which usually involve issues with a small number of lenders. On the contrary, trust indentures favor the borrowing of small amounts of money from a large number of lenders on the same conditions by channeling administration and enforcement through a single party, the indenture trustee. *See* William W. Bratton, Jr., *The Interpretation of Contracts Governing Corporate Debt Relationships*, 5 CARDOZO L. REV. 371, 371 n.1 (1984).

[83]In the U.S. system there is a sharp difference between bonds and debentures: while the former are secured long-term notes, the latter are unsecured. Still, for the purpose of this study, is not necessary to focus on this distinction.

[84]*See* Bratton, Jr., *supra* note 82, at 371 n.1; UPIC & T Co. v. Kinder-Care Learning Ctrs., Inc., 793 F. Supp. 448 (S.D.N.Y. 1992).

[85]*See* THOMAS LEE HAZEN, SECURITIES REGULATION 428 (2011).

[86]*See* GUY P. LANDER, U.S. SECURITIES LAW FOR INTERNATIONAL FINANCIAL TRANSACTIONS AND CAPITAL MARKETS 4-59 (2d ed. 2013).

[87]The Securities Act constitutes Title I; Title II is the ineffective Corporation of Foreign Bondholders Act and the Trust Indenture Act is Title III of the statute.

[88]*See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES (1936-40). At the time at which the Securities Exchange Act of 1934 was enacted, Congress directed the SEC

uing disclosure to the securities holders and allow them to get together for the protection of their own interests; and *iii)* assure that the security holders would have the services of a disinterested indenture trustee that conformed to high standards of conduct.[89] According to the legislative history, these objectives were to be accomplished by establishing statutory standards to which trust indentures should have conformed. In 1954 and, again in 1990, the above-mentioned Act was amended with the principal purpose to modernize it. One of the most relevant effects of the 1990 amendment was that it simplified conformity with the requirements of §§ 310-317, by providing that these sections are direct statutory commands imposed on any indenture qualified under the Act.[90] As a consequence, a review of indentures to assure compliance with these rules is no longer necessary.[91] At the same time, the 1990 legislation granted the SEC broad exemption authority concerning any provision of the Trust Indenture Act, in order to provide flexibility in administration and adaptability to future developments.[92]

Even when bond issue is not subject to the TIA, it is regulated by an indenture with terms that are freely negotiated. The American Bar Association provides a standard model of indenture, which is widely adopted.[93] In the next paragraph, the mandatory provision of § 316(b) of the TIA will be specifically examined, since it contains a prohibition on the majority vote to modifications of the core terms of the loan agreement in bond workouts.[94]

B. Section 316(b) of the TIA: Content and Legislative History

Section 316(b) of the TIA contains a prohibition on impairment of the right of the holders to payment, expressed in the following terms:

> Notwithstanding any other provision of the indenture to be qualified, 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

to conduct such investigation and to submit a report with its conclusions by January 3, 1936. *See* 4 Louis Loss, Joel Seligman & Troy Paredes, Fundamentals of Securities Regulation 2 (6th ed. 2011).

[89] S. Rep. No. 76-248, at 1-2 (1939); H.R. Rep. No. 76-1016, at 25 (1939).

[90] Trust Indenture Act § 318 (c), 15 U.S.C. § 77rrr (c) (2012).

[91] *See* Loss, Seligman & Paredes, *supra* note 88, at 50-51.

[92] S. Rep. No. 101-155, at 29-30 (1989).

[93] American Bar Association, *Revised Model Simplified Indenture*, 55 Bus. Law. 1115 (2000). The first version of the model is the *Model Simplified Indenture*, 38 Bus. Law. 741 (1983).

[94] A similar prohibition is provided by § 6.07 of the *Revised Model Simplified Indenture, supra* note 93.

> of such holder, except as to a postponement of an interest payment consented to as provided in paragraph (2) of subsection (a) of this section,[95] and except that such indenture may contain provisions limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of judgment therein would, under applicable law, result in the surrender, impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien.[96]

The provision establishes a rule protecting the fundamental right of the bondholders to receive principal and interest on the debt both from a substantive and a procedural point of view, with two moderate exceptions. First, the subsection requires the individual consent of each bondholder for any action that would impair or affect the holder's substantive right to receive principal and interest in the due date. Likewise, each individual bondholder's consent is required to affect the right to sue on the bond for its payment.[97] This provision neutralizes "no action clauses" that grant rights to enforce the provisions of the indenture only to a certain percentage of bondholders or that entitle the trustee to bring a suit in the interest of bondholders.[98]

This expression of the unanimity rule has two exceptions. The first exception allows a 75% supermajority of the principal amount of the bonds to postpone an interest payment up to three years from its due date. The second one permits the indenture to place limits on an individual bondholder instituting a suit that would cause the impairment or the loss of the lien of the indenture upon a property.

In understand § 316(b), it is necessary to examine its legislative history and the debate surrounding its enactment.[99] Enacted in 1939, the TIA was a

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[95]*See* 15 U.S.C. § 77ppp(a)(2) (an indenture to be qualified "*may contain provisions authorizing the holders of not less than 75 per centum in principal amount of the indenture securities or if expressly specified in such indenture, of any series of securities at the time outstanding to consent on behalf of the holders of all such indenture securities to the postponement of any interest payment for a period not exceeding three years from its due date.*" (emphasis added)).

[96]15 U.S.C. § 77ppp(b).

[97]"Bondholders had absolute right to bring action to recover past-due interest, regardless of whether action was regarded as one under their notes or under the indenture, pursuant to statutorily required exception to 'No Action' clause in indenture authorizing suits to recover past-due principal and interest. Trust Indenture Act of 1939, § 316(b), as amended, 15 U.S.C.A. § 77ppp(b)." *In re* Envirodyne Indus., Inc., 174 B.R. 986, 996 (Bankr. N.D. Ill. 1994) (Westlaw headnote 9); *see also* George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431,435 (2006).

[98]MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507, 513-514 (S.D.N.Y. 2015).

[99]For a deep analysis of the legislative history of § 316(b) of the TIA, see Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp., 111 F. Supp. 3d 542, 547-553 (S.D.N.Y. 2015).

Depression-era federal statute aiming to fill the lack of bond indentures. Section 316(b)'s first versions evolved into its current form. Initially, the individual consent of each bondholder was not expressly required in order to modify the holder's right to obtain the principal and the interest. Instead, individual consent was only necessary to sue, notwithstanding any limitations imposed by "no action" clauses.

The 1937 version of the TIA[100], the 1938 version,[101] and the initial 1939 version[102] focused on the right of the holders to bring an action and would

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[100] The indenture to be qualified shall contain such provisions as the Commission shall deem necessary or appropriate in the public interest or for the protection of investors in respect of the following matters-[*omissis*] (5) The rights, powers, and remedies of the *indenture* security holders and the manner in which and conditions upon which such rights, powers and remedies may be exercised, including the right and power of the *indenture* security holders with respect to accountings by the indenture trustee, bringing action to collect the principal of and interest upon the *indenture* securities at their respective due dates, and calling and holding meetings of the *indenture* security holders and taking action at such meetings.

Trust Indenture Act of 1937, S. 2344, 75th Cong. § 7(m)(5) (1st Sess. 1937), *Regulation of Sale of Securities: Hearing on S. 2344 Before a Subcomm. of the Comm. on Banking and Currency*, 75th Cong. 12 (1937).

[101] The indenture to be qualified shall contain provisions which the Commission deems adequate, having due regard to the public interest and the interest of investors, with respect to the following matters-[*omissis*] (3) The rights, powers, and remedies of the indenture security holders and the manner in which and conditions upon which such rights, powers, and remedies may be exercised, including the rights, powers, and remedies of the indenture security holders with respect to (A) accountings by the indenture trustee, (B) bringing action to collect the principal of and interest upon the indenture securities upon their respective due dates, and (C) calling and holding meetings of the indenture security holders and taking action at such meetings. The indenture to be qualified may contain provisions authorizing the holders of not less than a majority in principal amount of the indenture securities at the time outstanding to consent to the postponement of any interest payment for a period not exceeding one year from its due date, or to the waiver of any default and its consequences, except a default in the payment of the principal of any indenture security upon the date of maturity specified therein, and except that a default in the payment of interest shall not be waived unless payment of all arrears of interest not so postponed shall have been made or provided for. [*omissis*]

Trust Indenture Act of 1938, H.R. 10292, 75th Cong. § 7(m)(3) (3rd Sess.1937), *Trust Indentures: Hearings on H.R. 10292 Before the Committee on Interstate and Foreign Commerce*, 75th Cong. 12-13 (1938).

[102] The indenture to be qualified shall contain provisions which the Commission deems adequate, having due regard to the public interest and the interest of investors, with respect to the rights, powers, and remedies of the indenture security holders and the manner in which and conditions upon which such rights, powers, and remedies, may be exercised, including the rights, powers, and remedies of the indenture security holders with respect to—

(a) accountings by the indenture trustee,

(b) bringing action to collect the principal of and interest upon the indenture securities upon their respective due dates and

(c) calling and holding meetings of the indenture security holders and taking action at such meetings. [*omissis*]

Trust Indenture Act of 1939, S. 477, 76th Cong. § 314(b) (1st Sess.1939), *Trust Indenture Act: Hearing*

have conferred on the SEC the regulatory authority to require indenture provisions governing that. During the 1939 Senate hearings, the text was changed by creating the substantive right of each bondholder to receive payment of principal and interest and to protect that right from being impaired without the holder's consent. Rather than granting the SEC discretionary power to regulate such provisions in indentures, the prohibition of such provisions was mandated by statute.[103]

The purpose of the subsection can be found in the 1936 SEC Report[104] which preceded the introduction of the TIA and in the speeches of the Report's author, future Supreme Court Justice William O. Douglas, and in the House and Senate Hearings.[105] An analysis of these documents reveals § 316(b) was enacted to protect bondholders from opportunistic behavior by insiders and quasi-insiders who might seek the destruction of bond issues in the interest of insiders themselves.[106] This fear probably originated from cases in which a majority of insider bondholders attempted to defraud minority, non-insider holders, based on a provision included in the trust indenture allowing a majority-approved modification of the minority's rights.[107]

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on S. 477 Before the Subcomm. on Securities and Exchange of the Comm. on Banking and Currency, 76th Cong. 14 (1939).

[103]The indenture to be qualified shall provide that, notwithstanding any other provision thereof, 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, except as to a postponement of an interest payment consented to as provided in subsection (a).

Trust Indenture Act of 1939, H.R. 5220, 76th Cong. § 316(b) (1st Sess.1939), *Trust Indentures: Hearings on H.R. 2191 and H.R. 5220 Before a Subcomm. of the Comm. On Interstate and Foreign Commerce*, 76th Cong. 31 (1939).

[104]U.S. SEC. & EXCH. COMM'N, *supra* note 88.

[105]Many issues touched upon in these documents would be relevant for this purpose, but, in short, only few significant passages will be quoted in this article.

[106]*See* Roe, *supra* note 2, at 251-52; UPIC & T Co. v. Kinder-Care Learning Ctrs., Inc., 793 F. Supp. 448, 452-53 (S.D.N.Y. 1992); MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507, 512 (S.D.N.Y. 2015); *see also* Bank of New York v. First Millennium, Inc., 607 F.3d 905, 917 (2d Cir. 2010); *In re* Board of Directors of Multicanal S.A., 307 B.R. 384, 388, 391-92 (Bankr. S.D.N.Y. 2004).

The Commission especially focuses on the conflict of interests of the protective committee dominated and controlled by the management. *See* U.S. SEC. & EXCH. COMM'N, *supra* note 71, at 162-63; *see also* DOUGLAS, *supra* note 71, at 203-14.

[107]In *Hackettstown Nat'l Bank v. D.G. Yuengling Brewing Co.*, 74 F. 110 (2d Cir. 1896), the court, based on the lack of good faith-which is imposed by community of interest - and referring to several cases decided by the English courts, argued that "a vote at a meeting of bondholders, sanctioning a modification of the rights of the bondholders, passed by the corrupt majority for the purpose of effectuating such a collusive consent, is not within the power contemplated by the provision in the trust deed". Therefore, it must be highlighted that, even in the absence of a specific prohibition of indenture clauses allowing the majority of bondholders to bind the minority on a modification of the core terms of bond issue, the court actually granted protection to minority bondholders, properly interpreting and applying such a clause in

In the SEC Report, the Commission focused on the provision contained in older indentures that allowed the reorganization by contract through an action taken at the bondholders' meeting or merely providing that the assent of a certain percentage of bondholders was adequate to change the terms of the bonds.[108] The SEC evaluated the arguments in favor of the utility and value of such provisions, but concluded that "if these provisions come into vogue and no controls are set up over them, the next cycle of reorganizations will take place on a voluntary basis without supervision of any court or administrative agency."[109] The SEC Report underscored the lack of or poor quality of information provided to individual bondholders in advance of these meetings as well as the bondholders' inability to properly interpret whatever information they received.[110]

Douglas expressed this point of view on several occasions,[111] in particular during House hearings held on April 25, 1938, when he referred to the impossibility amending an indenture resulting from the bill's requirement of the unanimous consent of the bondholders. According to Douglas, amendments were not precluded other than in cases where a majority could force a dissenting bondholder to accept a reduction or deferment of her claim. He also clarified that "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this exception."[112] This position was incorporated into the House and Senate reports on the 1939 Act.[113] Finally,

good faith. Another relevant case subject to the rules existing in the pre-TIA era is *Aladdin Hotel Co v. Bloom*, 200 F.2d 627 (8th Cir. 1953) (although the case was decided in 1953, it refers to bonds issued in 1938 and, hence, not governed by the TIA). In this case, on the contrary, the court established that the modification was made in strict compliance with the trust deed and it did not find "substantial evidence warranting a finding of bad faith, fraud, corruption or conspiracy" of the owners of the majority of the bonds, who were at the same time the owners of a majority of the stock of the company.

[108]U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART VI: TRUSTEES UNDER INDENTURES 143-151 (1936).

[109]*Id.* at 150. The SEC analysis, ultimately, does not seem to suggest the introduction of a strict prohibition of such clauses. In fact, the Commission noticed that these clauses gave rise to abuse and problems, at the same time admitting that they may solve some of the reorganization difficulties. Moreover, in its conclusion the SEC announces that it will defer its proposals about "control and supervision over these indenture provisions".

[110]U.S. SEC. & EXCH. COMM'N, *supra* note 71, at 1. According to DOUGLAS, *supra* note 71, at 199, "the average investor does not possess the training, the experience, or the skill" demanded by problems in reorganizations.

[111]See Justice Douglas's opinion in *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106 (1939). *See* Roe, *supra* note 2, at 253.

[112]*Trust Indentures: Hearings on H.R. 10292*, *supra* note 101, at 35 (testimony of William O. Douglas, Chair, Securities and Exchange commission)). It must be underlined that Douglas referred to the text of the rule contained in section 7(m)(3) of the 1938 Trust Indenture Act, see *supra* note 101. Almost the same words were used in the statement of E. Burke Jr., Assistant Director, Reorganization Division of the Securities and Exchange Commission with reference to § 316(b) of the final version of the Trust Indenture Act. *Trust Indentures: Hearings on H.R. 2191 and H.R. 5220*, *supra* note 103, at 219.

[113]"Under subsection (b), the indenture must provide that, except as to an interest postponement so

Edmund Burke, Assistant Director of the Reorganization Division of the SEC, explained that, when an investor buys a bond, he buys the right to get a certain amount at the due date and § 316(b) states that "he shall not be deprived of that individual right without his consent."[114]

Our brief examination of the legislative history and debate about § 316(b) shows that its initial purpose was to ensure that bondholders had the procedural right to sue for the principal and interest of their debt without the limitations of no action clauses. The later introduction of the substantive right to receive payment grew out of deep suspicions about the fairness of private restructurings. Past experiences had showed how private restructurings, approved by majority vote, failed to protect the rights of individual bondholders. As a consequence, the aim of the Congress in enacting the rule was to protect bondholders and to lead hapless individual holders away from the treacherous shallows of out-of-court restructurings and into the safe waters of bankruptcy proceedings.[115] Bankruptcy was viewed as an ideal place to evaluate a restructuring plan controlled by judges and federal bankruptcy courts. This paternalistic protection effectively banned out-of-court restructurings without distinguishing between agreements that potentially favor the parties and restructurings that are unfavorable. The *Marblegate* cases called this reading into question.[116]

C. THE INTERPRETATION OF § 316(B) IN THE JURISPRUDENCE

Over the past eighty years, many courts have interpreted and applied § 316(b) many times. The courts have taken two different approaches.[117]

consented to, the right of any indenture security holder to receive his principal when due and to bring suit therefore may not be impaired without his consent. Evasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by this prohibition. Until comparatively recently, a prohibition of this sort was perfectly standard in note and bond indentures. In many states it is necessary in order to preserve the negotiability of the notes or bonds; in others it is necessary if the notes or bonds are to be legal investments for insurance companies, savings banks and the like. This prohibition does not prevent the majority from binding dissenters by other changes in the indenture or by a waiver of other defaults, and the majority may of course consent to alterations of its own rights" H.R. REP. NO. 76-1016, at 56 (1939); S. REP. NO. 76-248, at 26-27 (1939).

[114]*Trust Indentures: Hearings on H.R. 2191 and H.R. 5220*, *supra* note 103, at 285 (statement of E. Burke Jr., Assistant Director, Reorganization Division of the Securities and Exchange Commission). He also points out that if the majority of the bondholders accept a postponement of their interest they are allowed to do so and such action will be binding on them.

[115]*See also* Brady v. UBS Financial Services, Inc., 538 F.3d 1319, 1325 (10th Cir. 2008) ("[i]n practice, the provision tends to force recapitalizations into bankruptcy court because of the difficulty of completing a consensual workout.").

[116]See *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 846 F.3d 1 (2d Cir. 2017), which will be examined in depth *infra* section II.C.

[117]*See* Michael Riela, *Don't Forget About Trust Indenture Act When Restructuring Public Debt Securities Out of Court*, 34 AM. BANKR. INST. J. 18, 85 (2015).

Some courts have adopted a narrow interpretation of the subsection, reading it as only protecting a bondholder's procedural right to bring an action and safeguarding only the holder's actual interest. Other courts have opted for a broader interpretation of the prohibition, reading the subsection as protecting individual bondholders from any potential harm to their rights.

An example of the narrow view is found in *UPIC*,[118] where the court recognized the bondholder's procedural right to sue the issuer for payment of principal and interest under bond.[119] At the same time, it held that the subordination clause of an indenture is fully enforceable against the bondholders, since it serves to protect the rights of the senior creditors without impairing the bondholders' absolute and unconditional right to payment under the securities. Another narrow interpretation case is *Magten*,[120] where the issuer of the securities transferred its assets to its insolvent parent company, which assumed the obligations of the subsidiary under the indenture. The court concluded that § 316(b) "applies to the holder's *legal* rights and not the holder's *practical* rights to the principal and interest itself" [emphasis in original].[121] Thus, the transfer was not an action barred by the TIA.

The court in *YRC* reached a similar conclusion.[122] In that case, the issuer proposed a restructuring that offered to exchange the holders' notes for the issuer's stock, requiring consent to a deletion of two sections of the indenture.[123] One section obligated the issuer to repurchase the securities on any of three purchase dates and the other barred the issuer from merging or transferring substantially all its assets to another entity without the transferee assuming its obligations under the notes and indentures. The court found that § 316(b) required that the clause deleting the repurchase provisions could not be deleted by other than unanimous consent of the holders.[124] Relying on the *Magten* decision, the court found that removing the merger or transfer bar made collecting from the issuer or its transferee more difficult, but that it did not impair the holders.

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[118]UPIC & T Co. v. Kinder-Care Learning Ctrs., Inc., 793 F. Supp. 448 (S.D.N.Y. 1992).

[119]In this case, the issuer was obliged to repurchase the notes for their outstanding principal amount. Moreover, the indenture contained a provision requiring 60 days' notice of default to trustee in order to pursue a remedy, which the court considered not applicable to actions for principal and interest brought under § 316(b) of the TIA.

[120]Magten Asset Mgmt. Corp. v. Nw. Corp. (*In re* Nw. Corp.), 313 B.R. 595 (Bankr. D. Del. 2004).

[121]*Id.* at 600.

[122]YRC Worldwide Inc. v. Deutsche Bank Tr. Co. Ams., No. 10-2016-JWL, 2010 WL 2680336 (D. Kan. July 1, 2010).

[123]The issuer obtained the consent of holders of more than 90% of each set of notes, but not the unanimous consent potentially required by § 316(b) of the TIA.

[124]In the view of the court, in fact, the fixed purchase dates of the indenture's section dates represented the "due dates" on which the holders have the right to receive payment of the principal pursuant to § 316(b) of the TIA.

A broader approach to § 316(b) has begun to gain traction.[125] The first case to take this view was *Mechala*,[126] which deals with a cash tender offer for the issuer's notes as a part of a planned reorganization.[127] The proposal, along with several indenture amendments, would be accepted if a majority of holders accepted the offer.[128] In particular, the subsidiaries' guarantee of the notes would be released and the issuer stripped of its assets. The court enjoined the issuer from consummating the tender offer, holding that the planned operation would have eliminated the ability of the issuer to recover in violation of the TIA because of the asset transfer and because it removed the holders' "safety net" of a guarantor. According to the court, the proposed amendments could have materially impaired or affected the right to sue of a holder.

Fourteen years later, in the *Marblegate* case,[129] EDMC, a provider of student loans, was experiencing financial distress, so it proposed a restructuring plan-negotiated with a creditors' committee-to security holders. EDMC could not filed for bankruptcy, since it would have lost its eligibility to receive federal funds received as an education institution.[130] Consequentially, an out-of-court restructuring was its only viable alternative.

EDMC proposed two paths. First, it offered to convert its debt into a smaller amount of debt and equity.[131] Over 90% of the unsecured notes and 99% of the secured debt accepted.[132] EDMC's alternate path involved UCC foreclosure sale of all the assets to its secured creditors who would, in turn

[125]The perspective of different experts on the consequences of the recent decisions has been published by the *Wall Street Journal*. *See* Jenny Choi, *WSJ The Examiners— Trust Indenture Act*, HARV. L. SCH. BANKR. ROUNDTABLE (Oct. 6, 2015), http://blogs.harvard.edu/bankruptcyroundtable/2015/10/06/wsj-the-examiners-trust-indenture-act [http://perma.cc/R4KP-4HCM] (introducing the roundtable posts).

[126]Federated Strategic Income Fund v. Mechala Grp. Jam. Ltd., No 99 CIV 10517 HB, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999).

[127]The opinion reports that the issuer Mechala was owned by a family that also owned 23% of the total amount of the notes.

[128]This kind of operation, which will be analyzed in the following paragraph, is very common.

[129]Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592, 617 (S.D.N.Y. 2014).

[130]In fact, the issuer EDMC is a for-profit provider of college and graduate education, which benefited from federal students aid programs made under Title IV of the Higher Education Act of 1965, 20 U.S.C. §§ 1070-1099. A higher education institution loses its status and its eligibility for Title IV funds if it, or a controlling affiliate, files for bankruptcy or has an order for relief in bankruptcy filed against it. *See* 20 U.S.C. § 1002(a)(4)(A); Conditions of Institutional Eligibility, 34 C.F.R. § 600.7(a)(2).

[131]EDMC offered to repay to security holders a minimal part of the loan and to exchange the main part with secured terms loans and preferred convertible stock, while the unsecured noteholders would have received equity convertible into EDMC's stock.

[132]It is interesting to note that only the plaintiffs refused the proposal, but there were some remaining holders of the notes, along with the roughly 1% of the secured debt not to have consented who are represented to be as-yet-unidentified. This circumstance demonstrates the practical impossibility to reach unanimity on a proposal on an out-of-court restructuring, because of holders who do not actively participate in the vote.

release its guarantees of the subsidiary's debts.[133] When EDMC did not receive unanimous consent to the exchange offer, it consented to foreclosure sale of assets to its subsidiary. The dissenting holders argued that the structure of the sale and releases would impair their payment rights under the indenture in violation of § 316(b). They requested the issue of a preliminary injunction in order to block the restructuring. Although it denied the motion for a preliminary injunction,[134] the court held that "the Trust Indenture Act simply does not allow the company to precipitate a debt reorganization outside the bankruptcy process to effectively eliminate the rights of nonconsenting bondholders."[135]

EDMC consented to the sale, resulting in further actions being brought by its debt holders. In the second *Marblegate* case, and after a thorough examination of the text, history and purpose of the rule, the court adopted a broad interpretation of § 316(b). The court held that TIA's protections go beyond simply protecting holders from being forced to accept indenture amendments. Because the TIA protects the right of the individual to receive principal and interest, its reach is broad enough to prevent a majority's forcing the dissenting minority bondholders to renounce to their claims outside of bankruptcy restructuring, whether the claim elimination is directly requested or circuitously pursued.[136]

The Second Circuit reversed, adopting the view that § 316(b)'s terms and legislative history show that it was designed to protect bondholders from being forced to acquiesce in formal amendments to an indenture's core payment terms and indenture provisions. Section 316(b) does not, however, ban other forms of reorganization like foreclosures. Therefore, because the intercompany transfer did not formally amend any terms of the indenture, it did not fall under § 316(b)'s proscription.[137]

The Second Circuit also examined the legislative history of § 316(b) and concluded that the drafters of the TIA were well-aware of foreclosure-based reorganizations like the one implemented in the Intercompany Sale. Foreclosures, were a frequent means of reorganization in the 1930's and the SEC

[133]The Exchange Offering Circular clearly stated that holdout unsecured noteholders would have continued to have their claims; however, because of the transfer to a new entity of all the assets, they would have not been satisfied with the payment on account of their notes. Exchange Offering Circular, at 3. On the other hand, nonconsenting secured creditors would have received debt in the new entity, but such debt would have become junior to that of consenting secured creditors.

[134]Because plaintiffs failed to demonstrate a likelihood of irreparable harm, that the balance of equities favored injunctive relief or the public interest of the injunction.

[135]Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592, 617 (S.D.N.Y. 2014).

[136]*See id.* at 556. It is remarkable that, at the same time, the court expressly recognized the potentially troubling implications of the Trust Indenture Act for holdouts and its obsolescence in the context of modern bankruptcy.

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

Report mentions them in various sections. Throughout the history related to the scope of § 316(b), there are only references to debt restructurings using CACs, suggesting that Congress did not mean to prohibit foreclosure-based reorganizations.[138] In particular, the court referred to Douglas' testimony, which is narrowly limited to CACs and formal amendments to core payment terms. Similarly, his additional testimony about the prevention of the evasion of judicial scrutiny refers literally only to "debt-readjustment plans", a technique of voluntary reorganization distinct from foreclosure-based reorganizations.[139] The Second Circuit's opinion also stated that notwithstanding § 316(b), a restructure through foreclosure might still be challenged under state law theories of successor liability or fraudulent conveyance.[140]

A careful reading of the SEC Report, however, casts doubt on the court of appeals' interpretation of it. The court ignores three fundamental points. First, the SEC Report focuses almost exclusively on judicial foreclosures that were subject to judicial supervision and review.[141] Second, the SEC Report noted that restructure by foreclosure was not as frequent once bankruptcy restructuring became available.[142] Third, the SEC Report observed that nonjudicial foreclosures were a matter of state law existing in a limited number of states, but noted that restructuring using nonjudicial foreclosure still presented problems.[143] In sum, the SEC Report did not challenge foreclo-

[138]Conversely, the dissenting judge pointed out that an opposite conclusion may be reached even only relying on the plain language of the rule. According to his view, the use of the word "right", as well as of the broad phrase "impaired or affected", makes clear that the right of the bondholders to receive payment can be diminished also without altering the payment terms of the indenture. As a consequence, the prohibition in § 316(b) is not limited to mere amendments of the indenture: an out-of-court debt restructuring violates the TIA when it is designed to eliminate a nonconsenting noteholder's ability to receive payment, and when it leaves bondholders no choice but to accept a modification of the terms of their bonds.

[139]*See supra* note 112 and accompanying text.

[140]A similar conclusion has been reached by Harald Halbhuber, *Debt Restructuring and the Trust Indenture Act*, 25 AM. BANKR. INST. L. REV. 1 (2017). *See also* Bratton, Jr. & Levitin, *supra* note 80, at 59-64.

[141]*See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART VIII: A SUMMARY OF THE LAW PERTAINING TO EQUITY AND BANKRUPTCY REORGANIZATIONS AND OF THE COMMISSION'S CONCLUSIONS AND RECOMMENDATIONS 13 (1940); see also infra note 144.

[142]*See* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART I: STRATEGY AND TECHNIQUES OF PROTECTIVE AND REORGANIZATION COMMITTEES 895 (1937) (noting that with increasing use of section 77 and 77B of the Bankruptcy Act foreclosures become of less importance for reorganization purposes, but they will continue to be relevant only in state court proceedings).

[143]*See* U.S. SEC. & EXCH. COMM'N, *supra* note 141, at 14 n.20, 345, 350-55 (concluding that, in the light of the lack of judicial review of the plan in reorganization cases, foreclosures under power of sale must be regarded as less desirable than judicial foreclosures); *see also* U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART III: COMMITTEES FOR THE HOLDERS OF REAL ESTATE BONDS 220 (1936) (holding that the minorities' need for a trustee who protects their interest

sures specifically because of their scarce practical relevance in respect to the problems it was facing: foreclosures at that time were mainly judicial, so they were already coherent with the purpose of the Commission.[144] Other types of foreclosures, which constituted an exception, were not an impending problem at that time, although the SEC Report disclosed their criticalities.

In this context, Douglas' testimony concerns only the issue of unlawful provisions of the indenture in response to a criticism directed exclusively toward the impossibility to amend the indenture.[145] Also, it is more than plausible that Douglas's concern about "evasion of judicial scrutiny" is limited to voluntary restructuring because foreclosures usually already involved the supervision of a judge.

Whether or not Congress specifically intended to include or exclude restructuring by foreclosure from the scope of § 316(b), its language is broad and should be read in the light of Congress's and SEC's concerns about issuers gaining unfair advantages over bondholders in unsupervised workouts. The rule could be properly read as prohibiting out-of-court restructurings including of the kind dealt with in the *Marblegate* cases.[146]

In the *Caesars* case,[147] the court considered an attempt by the debtor to relieve its parent company of payment guaranties without the unanimous consent of the noteholders which would have negatively affected the dissenting holders' ability collect payment. After two private equity funds acquired the companies in a leveraged buyout, the parent was to transfer its assets affiliates and place the holding company in bankruptcy. If the majority of the noteholders consented to waiving the guaranties, the surviving company

becomes particularly acute in those cases in which the plan of reorganization or the bid price in the foreclosure sale are not subject to the scrutiny of a court).

[144]See U.S. SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES, PART III: COMMITTEES FOR THE HOLDERS OF REAL ESTATE BONDS, *supra* note 143, at 227-28: with reference to indenture clauses allowing changes with the agreement of 75 percent of the bondholders, the SEC noticed that "[b]y virtue of their voluntary features, the expenses and delay of *foreclosure or other court proceedings* are to be avoided". Also, Mr. Nath's testimony before the SEC reported that "[t]here would be no court supervision contemplated, and *if anybody thought court supervision was necessary*, 77B would always be available or *foreclosures might be available*" *Id.* (emphasis added).

[145]*See* MARK J. ROE & FREDERICK TUNG, BANKRUPTCY AND CORPORATE REORGANIZATION: LEGAL AND FINANCIAL MATERIALS 28-29 (4h ed. Supp. 2017) (challenging the court's reading of the legislative history based on a correct interpretation of Douglas's testimony, the purpose of the rule, and the contemporaneous views of the Washington bankruptcy establishment).

[146]For a different point of view see Marcel Kahan, *The Scope of section 316(b) After Marblegate*, 13 CAP. MKTS. L.J. 136, 140, 146 (2018) (concluding that the decision of the Second Circuit was correct in confining the scope of § 316(b) to formal amendments to core payment terms, representing a return to certainty and to literalism).

[147]MeehanCombs Glob. Credit Opportunities Funds, LP v. Caesars Entm't Corp., 80 F. Supp. 3d 507 (S.D.N.Y. 2015).

would buy their notes back.[148] The dissenting noteholders were not offered that opportunity. The court found that the release of the guarantees was "an impermissible out-of-court debt restructuring achieved through collective action", representing "exactly what TIA section 316(b) is designed to prevent."[149] In a later decision in the *Caesars* case, the court elaborated that to demonstrate an impairment of collection rights under § 316(b), a holder must show either that a core term has been amended or an out-of-court restructure attempted and the existence of the impairment evaluated as of the date that payment becomes due.[150]

Courts continue to debate the scope of § 316(b). The district courts' decisions in *Marblegate* and *Caesars*, in particular, lean in the direction of protecting minority bondholders from any majority attempt to burden their rights.[151] Those courts examined the original purpose of the legislation and recognized that § 316(b) protects a holder's substantive right to actually obtain payment. Therefore, any workout that involves binding nonconsenting shareholders to something less than full payment—even potentially—violates the rule.[152] That effectively prevents successful reorganizations.[153] The Second Circuit's opinion in *Marblegate* favors a limited application of the prohibition in apparently contrast to Congress's original purpose. This may be viewed as a reaction to the practical reality that a majority-imposed restruc-

[148]The amount offered to favored noteholders (corresponding to the purchase price paid for the notes par plus accrued interest and transactional fees and costs) was particularly high, representing "an extraordinary one hundred percent premium over market". *See id* at 511.

[149]*See id* at 516. The case was followed by another decision *MeehanCombs Glob. Credit Opportunities Master Fund, LP v. Caesars Entm't Corp.*, No. 14-cv-7091, 2015 WL 9478240, (S.D.N.Y., Dec. 29, 2015) on actions brought for the enforcement of the guarantee obligations. In this case the court did not address the issue whether the transaction described in the text violated the TIA, because there was a genuine dispute as to whether such guarantees had been already released in a preceding transaction.

[150]BOKF, N.A. v. Caesars Entm.t Corp., Nos. 15-cv-1561 (SAS) & 15-cv-4634 (SAS), 2015 WL 5076785 (S.D.N.Y. Aug. 27, 2015). In this case the court noticed that, at that stage, there was a genuine dispute as to whether the challenged guarantee transactions were an out-of-court reorganization.

[151]However, the existence of opposite precedents may lead to forum shopping, with plaintiffs trying to sue in the Southern District of New York. *See* Jason Harbour & Matthew Mannering, *Recent Decisions Concerning the Trust Indenture Act Underline the Limits on Out-of-Court Restructurings*, 132 BANKING L. J. 249, 254 (2015). Also, companies may be deterred from registering their bonds with the SEC to avoid the applicability of the Trust Indenture Act. *See* Sharon Levine, *The Examiners: Rulings May Deter Companies from Registering Bonds*, WALL ST. J. (Sept. 29, 2015, 3:38 p.m.), http://blogs.wsj.com/bankruptcy/2015/09/29/the-examiners-rulings-may-deter-companies-from-registering-bonds/.

[152]The judicial standard currently adopted would be better implemented with a more narrowly defined standard, aiming to verify whether the proposed transaction would give bondholders no real economic incentive other than to accept a change in payment terms. In other words, "[i]f that lack of real choice is the result, then the transaction violates section 316 (b)." *See* Mark J. Roe, *The Trust Indenture Act of 1939 in Congress and the Courts in 2016: Bringing the SEC to the Table*, 129 HARV. L. REV. F. 360, 370 (2016).

[153]The same court that adopts a broad interpretation of § 316(b) is aware of the negative consequences related to the holdouts problem. *See* Marblegate Asset Mgmt. v. Educ. Mgmt. Corp., 75 F. Supp. 3d 592, 616-617 (S.D.N.Y. 2014).

ture may be impossible, even where nearly every (but not every) party agrees. This leaves the dissenting minority without effective and readily accessible protection against possible abuses. Though it is possible to distinguish the *Caesars* cases on their facts, their holdings appear to have been overruled by the court of appeals' opinion in *Marblegate.*

D. SOME ALTERNATIVES TO OUT-OF-COURT RESTRUCTURINGS: EXIT CONSENTS

Though § 316(b) requires the consent of each bondholder to restructure a debt outside bankruptcy, some other options may remain. They include "exit consents," the prepackaged bankruptcy petitions, and SEC exemptions.[154] These alternatives vary: one is aggressive if not coercive, one is neutral,[155] and one is compliant with law and desirable, at least until § 316(b) can be reformed.

Many of the cases discussed above involve a widely used business practice, the "exit consent."[156] Bondholders are asked to consent to modifications just as they leave the indenture behind (in exchange for payment or other consideration).[157] In its basic form, bondholders receive an the "exit exchange offer", an exchange of their old bonds for new ones issued by an affiliate in a lesser amount.[158] The exiting bondholders agree to vote in favor of the amendment of non-core terms of the indenture (e.g. waiving of guaranties or removing protective covenants),[159] which makes the bonds more difficult to enforce and therefore less valuable.[160] As a result, the value of the unre-

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[154]Another option is the repurchase of a sufficient amount of the bonds, either in market or via private transactions, so that the issuer can pay the remaining bonds on maturity. *See* John C. Coffee, Jr. & William A. Klein, *Bondholder Coercion: The Problem of Constrained Choice in Debt Tender Offers and Recapitalizations*, 58 U. CHI. L. REV. 1207, 1209 (1991). This alternative will not be analyzed in this research, since it does not address critical legal issues and also because it does not seem to be often practical for a company which faces financial difficulties.

[155]Although it probably requires more time and huge costs if compared to a vote of the majority of bondholders binding the minority.

[156]New data about exchange offers made by distressed issuers are provided by Bratton, Jr. & Levitin, *supra* note 80, at 43-46. The research shows the current widespread use of exit consents and coercion (in particular, consent solicitations stripping covenants from the old bonds accompanied 82.6% of the offers included in the sample).

[157]*See* MARK J. ROE & FREDERICK TUNG, BANKRUPTCY AND CORPORATE REORGANIZATION: LEGAL AND FINANCIAL MATERIALS 485 (4h ed. 2016); Coffee, Jr. & Klein, *supra* note 154, at 1224; *see also* Jonathan C. Lipson, *Governance in the Breach: Controlling Creditor Opportunism*, 84 S. CAL. L. REV. 1035, 1055 (2011); Robert Gertner & David Scharfstein, *A Theory of Workouts and the Effects of Reorganization Law*, 46 J. FIN. 1189, 1200 (1991) (arguing that an exchange is profitable only if the debt is exchanged for cash or for debt that has higher priority than the original debt).

[158]Bondholders may also be offered the opportunity merely to sell their bonds, as was the case in *Caesars.*

[159]It is also possible to add a subordination clause, so that bondholders who accept the offer exchange their old debt for a new senior debt.

[160]It must be recalled that, in wider terms, not all majority votes on amendments of the indenture are

deemed dramatically decreases.[161] Naturally, this disincentivizes the holdouts. So, even if the value of the offer does not appear adequate, reluctant bondholders still have strong incentives to accept in order not to be left with worthless or hard-to-enforce paper.[162] This shows how the prohibition contained in § 316(b) distorts market incentives and potentially works against the interests of the same bondholders that the subsection was designed to protect.[163] The exit consent model is extremely coercive, because it forces bondholders to accept an offer without the opportunity to evaluate its feasibility.[164] If the offer is tendered as to only a certain amount of the issue, holders may rush to be the ones who actually accept the offer.[165] This precludes the majority of bondholders from exercising the role that they would have played voting in an out-of-court restructuring: freely evaluating the viability of the proposed restructuring plan while negotiating the best terms.

The hazard to holders is similar to that inherent in a two-tiered tender offer that precedes a merger.[166] In these schemes, often used in the 1980s, the bidder tenders payment to a majority of the shareholders for their share, gaining control, and then tenders less to remaining minority. Many states'

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strictly prohibited by § 316(b) of the TIA: "[u]nder subsection (b), the indenture must provide that, except as to an interest postponement so consented to, the right of any indenture security holder to receive his principal when due and to bring suit therefore may not be impaired without his consent. (*omissis*) This prohibition does not prevent the majority from binding dissenters by other changes in the indenture or by a waiver of other defaults, and the majority may of course consent to alterations of its own rights." H.R. REP. NO. 76-1016, at 56 (1939); S. REP. NO. 76-248, at 26-27 (1939).

[161]The major risk for individual bondholders is to remain at the "back-end" of the deal. In fact, as sophisticated investors may easily calculate the value of incentives, it is more likely that they would be pushed into the exchange offer, as stated by Mark J. Roe, Professor, Bankruptcy Course Class at the Harvard Law School (Nov. 23, 2015).

[162]From a hypothetical point of view, all the bondholders could refuse a disadvantageous offer, so that it would fail. Regardless, individually, the fear of each bondholder in holding bonds without value, after the success of the offer, pushes the holder to accept the offer.

[163]"Thus Douglas's no-vote rule facilitated one serious distortion—the holdout who can kill a good deal—and then, in reaction, deal makers invented a countervailing distortion: the coercive exit consent exchange offer to twist or break the arms of dissenting bondholders". Mark J. Roe, *Giving Bondholders a Vote in Debt Restructuring*, N.Y. TIMES, (Dec. 14, 2015), http://www.nytimes.com/2015/12/15/business/dealbook/giving-bondholders-a-voice-in-debt-restructuring.html?_r=0.

[164]For an opposite point of view, see Kahan, *supra* note 146, at 146, who argues that "[b]ecause, in the US, the core payment terms cannot be amended by majority consent, the potential scope of "coercion" through exit consents is limited". The Author, however, seems to undervalue that it is precisely the impossibility of modifying the core terms of the indenture on the basis of a majority vote (pursuant to § 316(b) of the TIA) that leads to the use of the exit consent technique and that a similar mechanism, potentially, may reach results in certain cases very similar to the substantial zeroing of the value of the bonds, through the removal of protective covenants, the stripping of the guarantees etc.

[165]*See* Coffee, Jr. & Klein, *supra* note 154, at 1265.

[166]*See* Mark Roe, *The Examiners: End the Trust Indenture Act's Bondholder Voting Ban*, WALL ST. J. (Sept. 29, 2015, 11:04 a.m.), http://blogs.wsj.com/bankruptcy/2015/09/29/the-examiners-end-the-trust-indenture-acts-bondholder-voting-ban/.

corporation laws have evolved to thwart the use of that mechanism.[167] The lower court *Marblegate* decisions operated to ban exit consents through a broader interpretation of § 316(b).[168] With the Second Circuit's reversal of those decisions, exit consents remain an available means for working around § 316(b), at least in that circuit.[169]

"Prepackaged" bankruptcy petitions are another means to obtaining majority bondholder acceptance of a proposed reorganization that will bind all of the bondholders if the debtor's plan is confirmed.[170] According to § 1126(b) of the Bankruptcy Code,[171] the holder of a claim who had already accepted or rejected a plan before the commencement of the reorganization case is bound by that acceptance or rejection, provided that the debtor has given all of the claim- and interest holders adequate disclosure.[172] A class accepts the plan when it has been accepted by creditors holding at least two-thirds in amount

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[167]Even if courts have ruled that this technique is not illegal *per se*, its existence was the origin of reforms in many state laws to guarantee equal treatment for all shareholders. In particular, according to the position of the Delaware Supreme court, boards are allowed to adopt defensive measures deterring takeovers, in order to neutralize the coercion imposed by the two-tiered tender offer. Moreover, market forces operated through adoption of fair price provisions as well as redemption rights in corporate charters. *See* PATRICK A. GAUGHAN, MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS 264-265 (6th ed. 2015); *see also* ROE & TUNG, *supra* note 157, at 495. On the regulation of tender offers on the federal level (Williams Act) and the differences between equity and debt securities see also Coffee & Klein, *supra* note 154, at 1264-71. *See also* Bratton, Jr. & Levitin, *supra* note 80, at 46 (showing that in many cases issuers took advantage of William Act exclusion of debt exchanges from the operation of the all-holders rule to offer better terms for acceptances received by an early tender date).

[168]See previous paragraph. In *Katz v. Oak Indus. Inc.*, 508 A.2d 873, (Del. Ch. 1986), the court ruled the legitimacy of an exit consent, although in this case, surprisingly, the plaintiff omitted to invoke § 316(b) of the TIA in order to contest the transaction.

[169]*See* Edward B. Rock, 163 U. PA. L. REV. 2019, 2048 (2015) (observing that exit consents are one response to the inflexibility of Trust Indenture Act).

[170]*See* ROE & TUNG, *supra* note 157, at 496; *see also* Roe, *supra* note 2, at 243, 243 n.34; BRATTON, *supra* note 7, at 359; John J. McConnell & Henri Servaes, *The Economics of Prepackaged Bankruptcy*, *in* CORPORATE BANKRUPTCY. ECONOMIC AND LEGAL PERSPECTIVES, *supra* note 6, at 322-26.

[171]This rule refers to the most common form of bankruptcy: reorganization (chapter 11 of Bankruptcy Code). The aim of this procedure is to allow the firm to continue its activity, after restructuring the debt and reallocating equity. Under U.S. law, there is another form of bankruptcy: liquidation (chapter 7 of Bankruptcy Code). It requires the sale of the firm and the distribution of the cash among creditors.

[172] (b) For the purposes of subsections (c) and (d) of this section, a holder of a claim or interest that has accepted or rejected the plan before the commencement of the case under this title is deemed to have accepted or rejected such plan, as the case may be, if—

(1) the solicitation of such acceptance or rejection was in compliance with any applicable nonbankruptcy law, rule, or regulation governing the adequacy of disclosure in connection with such solicitation; or

(2) if there is not any such law, rule, or regulation, such acceptance or rejection was solicited after disclosure to such holder of adequate information, as defined in section 1125(a) of this title.

11 U.S.C. § 1126(b) (2012).

and more than one-half in number of the allowed claims voted.[173] That vote binds the holdouts concerning the plan proposed in the context of a reorganization so long as it meets the other confirmation requirements of chapter 11.[174] Of course, this model is a court-supervised restructuring. Still, it accelerates the procedure, and, at least theoretically, reduces expense. It also represents an inconsistency between out-of-court and in-court restructuring practices, at least in the United States, allowing an issuer to accomplish in bankruptcy that it could not accomplish out of court because of § 316(b).[175]

Another possible means of working around the § 316(b) prohibition is in the TIA itself.[176] In the 1990 amendments,[177] Congress added a provision that grants the SEC the power to carve out broad exemptions from the TIA when doing so would be in the public interest and consistent with protecting the interests of investors while serving the purpose of the Act.[178] So, the SEC could exempt any person, registration statement, indenture, security or transaction from § 316(b) even imposing specific conditions. Presumably, it could allow an indenture to include a clause authorizing a majority vote on core amendments of the loan,[179] or also authorize a transaction involving a renegotiation agreement subject to such a vote, perhaps even in the absence of a preexisting ad hoc indenture clause. Broader use of the exemption pow-

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[173] (c) A class of claims has accepted a plan if such plan has been accepted by creditors, other than any entity designated under subsection (e) of this section, that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors, other than any entity designated under subsection (e) of this section, that have accepted or rejected such plan.

11 U.S.C. § 1126(c) (2012).

[174]*See also* Gertner & Scharfstein, *supra* note 157, at 1211-12 (affirming that the chapter 11 voting procedure permits to internalize the effects of the investment decision and also to bypass the holdout problem, enhancing investment efficiency. However, the Authors highlight that voting procedures for exchange offers by the firm are prohibited by the TIA).

[175]Moreover, pursuant to the reform of bankruptcy legislation of 1978, the judge has the power to evaluate the restructuring plan applying a fair and equitable standard only if the requirement of the consent of a supermajority of creditors is not met (11 U.S.C. §§ 1126(c), 1129(a)(8)(A), 1129(b)(1) (2012)). *See* Roe, *supra* note 2, at 255, 255 n.72.

[176]For this relief, see Roe, *supra* note 166. More recently, see also Roe, *supra* note 152, at 362.

[177]"The Commission may, by rules or regulations upon its own motion, or by order on application by an interested person, exempt conditionally or unconditionally any person, registration statement, indenture, security or transaction, or any class or classes of persons, registration statements, indentures, securities, or transactions, from any one or more of the provisions of this subchapter, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by this subchapter". Trust Indenture Act of 1939 § 304 (d), 15 U.S.C. § 77ddd(d) (2012) (amended on Nov. 15, 1990, Pub.L. 101-550, Title IV, § 403).

[178]As an example, see Securities and Exchange Commission, Order Granting Application for Exemption: Petroleos Mexicanos and the Pemex Project Funding Master Trust, Trust Indenture Act Release No. 2430, 2044 WL 2347881 (Oct. 13, 2004), https://www.sec.gov/divisions/corpfin/cf-noaction/pemex101304.pdf.

[179]For instance, it may have been useful in the case of EDMC, because of the unavailability of the bankruptcy for higher education institutions.

ers would afford necessary flexibility and would meet the original aim of the Commission expressed in the 1930's report: protecting securities holders by granting them administrative control on bond restructurings.

Notwithstanding the existence of these alternatives, the preferable solution still remains the amendment of § 316(b), in order to adapt it to the current needs of bondholders in the present day. We propose a possible amendment below and consider the most recent attempt to do so. Given that empirical analysis suggests that exit consents enjoy growing popularity in the 21st century, bondholders need the ability to approve out-of-court restructurings by majority vote.

1. *Exit Consents in Bond Indentures: An Empirical Analysis*

Now that exit consents are widely used and sometimes litigated, however, issuers should consider whether to expressly allow or prohibit them in bond indentures.[180] A review of a sample consisting of indentures subject to the 144A Registration exception—which need not be qualified under the TIA—shows that most indentures expressly permit exit consents.[181] Yet it also appears that there is widespread use of provisions that replicate § 316(b) in bond indentures. In other words, the adoption of indenture provisions that allow exit consents confirms the need to provide for an alternative option when acceptance of workout proposals by majority vote is barred by law or clauses that replicate § 316(b). In this case exit consents remain one of the few mechanisms allowing an out-of-bankruptcy restructuring of the bond issue.[182] New data have been examined in order to test this conclusion.

The research had two aims: (*i*) to investigate whether bond indentures contain explicit provisions regarding exit consents or not and (*ii*) to analyze whether such provisions, if existent, tend to allow or disallow exit con-

[180]It is interesting how the Second Circuit, incidentally, notes that "of course, sophisticated creditors, like Marblegate, can insist on credit agreements that forbid transactions like the Intercompany Sale." Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp., 846 F.3d 1 (2d Cir. 2017), at 16.

[181]*See* Bratton, Jr. & Levitin, *supra* note 80, at 80-84. The Rule 144A exemption from registration for the securities offered in the exchange is an exemption requiring that only "qualified institutional buyers" be solicited. Contracts governing bonds issued under the Rule 144A exemption are not subject to the TIA.

[182]For a different interpretation of such data, see *id.* at 82-83. The Authors of the research hypothesize that, from the perspective of the issuer, the interest in allowing exit consents arises primarily when the issuer of an unredeemable bond seeks to pay down early. On the opposite side, bondholders want to keep their holdout privilege, at the same time giving the issuer the possibility of an out-of-court restructuring. The Authors finally underline that the Southern District decisions in *Caesars* and *Marblegate* did not provoke a shift to CACs, deducing that there is no latent demand for collective action. Another explanation, however, may be found. First, it must be borne in mind that § 316(b) of the TIA has been qualified as a mandatory rule and it has also been included in the *Revised Model Simplified Indenture. See supra* note 93. These circumstances may lead the drafters to the incorporation of such rule in every indenture, whether subject to the TIA or not, since it is deemed to realize the best interest for the parties involved. Moreover, the issuer may consider convenient to accept a UAC in exchange for the express authorization of exit consents.

sents.[183] Table 1 shows the results of the research about the general sample (A), Table 2 refers to the specific sample of the bond indentures relating to newly issued bonds (B).

Table 1—All Documents

Sample A	**Number**	%
No provision	100	84%
Explicit provision	19	16%
allowing exit consents	17	
disallowing exit consents	2	
Total	**119**	**100%**

Table 2—Newly Issued Bond Indentures

Sample B	**Number**	%
No provision	39	74%
Explicit provision	14	26%
allowing exit consents	14	
disallowing exit consents	0	
Total	**53**	**100%**

Despite slight differences among the results, we observed the same tendencies in the two samples. First, specific provisions about exit consents are not very common in bond indentures. The vast majority (84% in Sample A and 74% in Sample B) omit exit consent clauses. Second, when the parties do explicitly refer to exit consents in bond indentures, the clauses authorize

[183]The sample has been retrieved through the SEC electronic database Full-Text Search (available at https://searchwww.sec.gov/EDGARFSClient/). In particular, the sample has been collected from EDGAR's Form 8-K Files pursuant to a search for text based on the following key words: "trust indenture act" AND "indenture" AND "notes" AND "trustee" AND "amendment" AND "consent" AND "majority" AND "EX-4.1" NOT "144A". The search took place in August 2020. The filter on filing date has been added with starting date 01/01/2020 and ending date 06/30/2020. A total of 129 results were found, although some of them were duplicates and, therefore, excluded from the sample. The final sample includes 119 documents. It must be underlined that 53 of them may be properly qualified as bond indentures relating to newly issued bonds, while the remaining part of the sample includes documents such as supplemental indentures, officer's certificates establishing the terms of notes and other kinds of agreements. However, both samples-the general one (A) as well as the specific sample including only the 53 bond indentures relating to newly issued bonds (B)-were considered relevant for the purpose of the research, due to their suitability to include provisions regarding exit consents.

them.[184] In Sample A, 17 of the 19 documents sanctioned exit consents and only two barred them. In Sample B, each of the 14 bond indentures contained provisions expressly authorizing exit consents.

These findings support our previous observation about the role of exit consents today. Given the existence of § 316(b), issuers perceive a need to preserve a means of restructuring bond indentures outside of bankruptcy court. Provisions expressly authorizing issuers to resort to such coercive methods are infrequent, perhaps because they discourage potential investors from purchasing bonds or simply because, after the Second Circuit decision in *Marblegate*, they are no longer necessary. Only in a few cases do bond indentures explicitly clarify the issuer's position about exit consents, and, in those cases, they are permitted.[185] In one of the even fewer cases that ban exit consents, the issuer may offer consideration as an inducement to the holders to consent, but those payments must also be offered to nonconsenting holders.[186] This tends to show that issuers continue to seek the flexibility to restructure bond debt.

Institutional investors hold the market power to influence the terms of the indentures in their favor. Still, they may not oppose exit consent provisions because they can cooperate and protect themselves, thus neutralizing the coercive effects of exit consent clauses.[187] Individual investors, on the other hand, hold less such market power and likely are not involved in negoti-

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[184]The provision legitimizing exit consents is usually included in the clauses concerning amendments of the bond indenture that can be adopted with the consent of holders or the entering into supplemental indentures. In its largest version such provision clarifies that (non-core) amendments to bond indentures require the consent of the majority of the bondholders "including, without limitation, consents obtained in connection with a repurchase of, or tender or exchange offer for, the Notes." On the contrary, provisions disallowing exit consents may be formulated as follows: "[a]ny consent given [. . .] by a Holder of a 2020 Bond that has transferred or has agreed to transfer its 2020 Bond to the Company, any Subsidiary of the Company or any Affiliate of the Company in connection with such consent shall be void and of no force or effect except solely as to such Holder, and any amendments effected or waivers granted or to be effected or granted that would not have been or would not be so effected or granted but for such consent (and the consents of all other Holders of 2020 Bonds that were acquired under the same or similar conditions) shall be void and of no force or effect except solely as to such Holder."

[185]One of the indentures allows exit consents and consent solicitation, provided the solicitation is made to all holders. The provision is the following: "The Company and the Trustee may amend or supplement this Indenture with the consent (including consents obtained in connection with a tender offer or exchange offer for the Securities or a solicitation of consents in respect of the Securities, *provided* that in each case such offer or solicitation is made to all Holders of then-outstanding Securities) of the Holders of at least a majority in principal amount of the then-outstanding Securities."

[186]Such provision clarifies that "The Company will not, directly or indirectly, pay or cause to be paid any remuneration [. . .] to any holder of Notes as consideration for or as an inducement to the entering into by such holder of any waiver or amendment of any of the terms and provisions hereof [. . .] unless such remuneration is concurrently paid [. . .] on the same terms, ratably to each holder of Notes then outstanding even if such holder did not consent to such waiver or amendment."

[187]*See* Kahan, *supra* note 80, at 618 (although focusing on coercive structures in consent solicitations, affirming that coercion works only when bondholders are dispersed; as a consequence, there is no need for a mandatory prohibition of coercive structures).

ating indenture terms. The data supports our conclusion that, as long as § 316(b) remains the law, exit consents will continue to be of use to issuers.

E. PROPOSALS FOR REFORM

In the recent past, many scholars argued that a change of the voting prohibition provided for by § 316(b) of the TIA is needed. Professor Roe has proposed that Congress amend the TIA, repealing this subsection and replacing it with provisions that sanction the use of a majority rule. The proposed new rule would grant a two-thirds majority of the holders the power to bind all the holders to a renegotiation agreement so long as no insiders were permitted to vote and that an independent fiduciary review the documents and disclosures and inform the holders accordingly.[188] Such a rule might solve the holdout problem while at the same time addressing the conflict of interest and disclosure issues that led to the introduction § 316(b).[189]

Professor Levitin has argued that the TIA goes too far, if it is interpreted to prohibit impairments to credit enhancements like guaranties, but not far enough if courts are excluding most asset-backed securities from its ambit. It should be updated in order to reflect the real conditions of modern financial markets.[190]

More recently, Congress has had opportunities to amend § 316(b).[191]

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[188]*See* Roe, *supra* note 2, at 270-71; *see also* Howard J. Kashner, *Majority Clauses and Non-Bankruptcy Corporate Reorganizations—Contractual and Statutory Alternatives*, 44 BUS. LAW. 123, 131 (1988).

[189]*But see* Brudney, *supra* note 10, at 1877 (arguing that the preservation of the bondholders' holdout possibilities embodied in the TIA is necessary, in order to contrast debtor strategic behavior. Rules could be fashioned to encourage bondholder cohesiveness, allowing them to act as a sole lender in the bargaining process). From another perspective, Alan Schwartz concludes that a majority-rule contract clause could ameliorate the holdout problem, even if he thinks that successful workouts terms, which grant each creditor more than she would obtain in bankruptcy, are a preferred solution. As a consequence, should majority-rule clauses be allowed, they would probably not be used. Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J. OF L. & ECON. 595, 630 (1993); *see also* Claire Finkelstein, *Financial Distress as a Noncooperative Game: A Proposal for Overcoming Obstacles to Private Workouts*, 102 YALE L.J. 2205, 2224, 2227 (1993) (arguing that a majority of bondholders could bind a minority only to the extent that the latter receive some protection from an independent third party, such as a judicial supervision. As a consequence, according to the Author, a preferable solution would be a unanimous consent clause, incorporated into the debt contract).

[190]Adam Levitin, *The Examiners: Recalibrate the TIA for Today's Debt Markets*, WALL ST. J. (Sept. 30, 2015, 12:11 p.m.), http://blogs.wsj.com/bankruptcy/2015/09/30/the-examiners-recalibrate-the-tia-for-todays-debt-markets/.

[191]The text of the amendment provided that it would have been retroactively applied and to any action that at the date of the enactment of the Act had not resulted in a final non-appealable judgment. The proposed amendment circulated on November 25, 2015. It seems that it was inserted into a federal transportation bill, which would have been signed by the President, but it did not appear in the final text. *See* Reorg Research, *Potential TIA Amendment Excluded From Congressional Committee Report on Agreed Federal Transportation Bill* (Jan. 12, 2015, 16:45 p.m.), http://new.reorg-research.com/article/public/MTcyODI=; *see also* Max Frumes, Angelo Thalassinos & Sarah Gefter, *The Mysterious Shelved Amendment to the Transportation Bill That Would Divide Billionaires*, FORBES (Dec. 4, 2015, 11:00 a.m.),

One such "clarifying amendment"[192] would have provided for an extremely narrow interpretation of the text of § 316(b) that limited the applicability of the prohibition of a binding majority vote to modifications that reduce the principal amount of the debt or the interest rate, or that extend the maturity date of the security.[193] Only in cases where indenture provisions preclude the holder from commencing an action for payment would the right to sue be deemed impaired. At the time, the amendment was a matter of discussion among scholars,[194] almost all of whom opposed the proposed reform and wrote a letter to Congress expressing their opposition.[195] Their principle concern was the lack of legislative hearings and opportunity for public comment that proceeded the amendment effort.[196] The amendment of § 316(b) never became law.

Most recently, the National Bankruptcy Conference[197] proposed the in-

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http://www.forbes.com/sites/maxfrumes/2015/12/04/the-mysterious-shelved-amendment-to-the-transportation-bill-that-would-divide-billionaires/.

[192]Pursuant to the proposed amendment, the following should have been inserted at the end of subsection (b): "For purposes of this subsection, the right of a holder of an indenture security to receive payment of the principal of and interest on such indenture security is impaired or affected only when the terms of the indenture governing such indenture security are amended to reduce the specified principal amount or interest rate or to extend the maturity date of such indenture security. The right of a holder of an indenture security to institute suit to enforce payment of the principal of and interest on such indenture security is impaired or affected only when the indenture governing such indenture security contains (or is amended to contain) provisions preventing the holder from commencing an action at law or in equity to enforce payment. Nothing in this subsection shall be construed as requiring the consent of all holders of an indenture security to any amendment to an indenture or to any action, including, without limitation, an action undertaken by an obligor except as specifically provided in this subsection". The text of the amendment is available at http://www.politico.com/f/?id=00000151-5bae-d412-a37d-fffe41e70000.

[193]This version of the amendment did not appear in the Highway Bill that Congress approved on December 4th, 2015. *See* H.R. 22, 114th Cong. (2015-2016). Then another version of the amendment was added to the Omnibus Appropriation Legislation. *See* H.R. 2029, 114th Cong. (2015-2016). The relevant modification with respect to the earlier version was that the new version made changes retroactive to Dec. 1, while the first one applied retroactivity to any restructuring not approved and completed in court. *See* Liz Moyer, *Wall Street's Debt Restructuring Fight Heads to Washington*, N.Y. TIMES: DEALBOOK (Dec. 7, 2015), http://www.nytimes.com/2015/12/08/business/dealbook/wall-streets-debt-restructuring-fight-heads-to-washington.html?_r=0.

[194]See the opinion of Professor Roe quoted by Frumes, Thalassinos & Gefter, *supra* note 191. *See also* Adam Levitin, *Private Equity's Private Bill to Amend the Trust Indenture Act*, CREDIT SLIPS (December 7, 2015, 11:06 a.m.), http://www.creditslips.org/creditslips/2015/12/private-equitys-private-bill-to-amend-the-trust-indenture-act.html.

[195]Letter from Douglas G. Baird. Professor of Law, University of Chicago Law School et al. to Mitch McConnell, Majority Leader, U.S. Senate et al. (Dec. 8, 2015), http://corpgov.law.harvard.edu/wp-content/uploads/2015/12/Trust-Indenture-Act-Scholars-Letter.pdf.

[196]For a different perspective, see the opinion of Kenneth N. Klee, Professor emeritus at the University of California, quoted by Liz Moyer, *Law Professors Ask Congress to Delay Changes in Debt Law*, N.Y. TIMES: DEALBOOK (Dec. 8, 2015), http://www.nytimes.com/2015/12/09/business/dealbook/law-professors-ask-congress-to-delay-changes-in-debt-law.html?_r=0.

[197]The National Bankruptcy Conference (NBC) is formed by leading bankruptcy scholars and practitioners in the field of bankruptcy law, whose primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.

troduction of a new Chapter 16 of the Bankruptcy Code to facilitate bankruptcy court supervision of bond restructurings.[198] The NBC proposed a summary proceeding preserving to the debtor the right to file a plan modifying the rights of one or more classes of claims for debt incurred under a bond indenture or a loan agreement. At least two-thirds of all of the claims in the class would be required to accept the plan. The court's role would be limited to determining whether to approve the proposed amendments and make it binding on the dissenters. The objective of the NBC proposal was to provide for debt restructuring without unanimous consent. The proposed proceeding is similar to those existing in other developed countries[199] and would be more streamlined and less expensive than a prepackaged chapter 11 case.

III. WORKOUTS IN ITALY

A. Background: Brief Overview of Bond Issues in Italy

In the Euro area, where capital markets are generally small and firms basically rely on bank financing, bonds represent only about 10% of firm's financial liabilities, a small percentage compared with 40% in the U.S. Nonetheless, during times of recent economic crisis, when bank lending to Italian firms diminished, the legislature introduced new rules aiming to promote the issuing of bonds by unlisted firms.[200] Most investors holding Italian corporate bonds are banks or non-residents; the percentage of bonds held by Italian households is very low.[201]

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[198]The full text of the proposal is available at http://newnbc.wpengine.com/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

[199]*See supra* section I.C.3.

[200]Matteo Accornero, Paolo Finaldi Russo, Giovanni Guazzarotti & Valentina Nigro, *First-time Corporate Bond Issuers in Italy*, Bank of Italy Occasional Paper No. 269, 8-10 (2015), https://www.bancaditalia.it/pubblicazioni/qef/2015-0269/QEF_269.pdf (reporting that the number of Italian corporate bonds issues from 2002 to 2013 was, on average, about 160 per year and annual gross issues averaged 25 billion). During the economic crisis, there was an increase of placements for large firms, mostly in the international market. On the contrary, small and medium size enterprises reduced volume and number of placements and resorted almost exclusively to the domestic market. *Id.*

[201]In 2015, the total stocks of corporate bonds (excluding bonds issued by banks and including only bonds issued by firms and other financial intermediaries) amounted to € 317,718.49 million in nominal value. A huge part of them is held by banks and non-residents (about 36.35 and 56.48% respectively). Another 5.70% of stocks of bonds is held by insurance companies. A small part of stocks of bonds is in the portfolio of social security institutions (about 0.14%) or held by Italian investment funds (about 0.94%). Corporate bonds in the Bank of Italy's portfolio are about 0.02% of the total amount (repos not included). Only the remaining 0.33% of stocks of corporate bonds (amounting to € 1,076.68 million) are held by households, firms and other sectors. However, the percentage of bonds held by different groups of investors vary considerably when examining bonds issued by banks. In this case, the stocks of bonds held by households, firms and other sectors represent about 30% of the total amount. This is based on data from Bank of Italy, available at Bank of Italy, Mercato Finanziario No. 31/2016 9 (Table 2 [TDEE0060]) (2016), http://www.bancaditalia.it/pubblicazioni/mercato-finanziario/2016-mercato-finanziario/suppl_31_16.pdf; Bank of Italy, Statistical database). Also, research on Italian house-

The issuance of bonds ("obbligazioni")[202] in Italy is mainly subject to the provisions of the Civil Code (in particular, by arts. 2410-2420-*ter*)[203] and the provisions of the contract between the issuer and the bondholders. Under Italian law, the directors of the company are given the power to issue bonds unless otherwise provided by law or the company's specific bylaws. The Civil Code establishes precise monetary limits on the issuing of bonds, providing that a company may not issue bearer or registered bonds in an amount that shall exceeding twice the amount of the share capital, the legal reserve, and available reserves according to the most recent approved balance sheet.[204] This maximum amount includes the liabilities of the company on guaranties of other companies' securities it has given, including foreign entities. It also provides a set of rules governing the guarantees that secure the bonds.[205] The parties cannot contract out of these rules.

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holds' financial wealth shows that, among its components, the main part is represented by equity, shares and investment units, followed by currency and deposits and finally by bonds (37, 24 and 18% respectively in 2005). *See* Giorgio Albareto, Raffaello Bronzini, Diego Caprara, Amanda Carmignani & Andrea Venturini, *The Real and Financial Wealth of Italian Households by Region*, *in* HOUSEHOLD WEALTH IN ITALY 57, 63 (2008), http://www.bancaditalia.it/pubblicazioni/altri-atti-convegni/2007-ricchezza-famiglie-ita/Household_Wealth_Italy.pdf. For an overview of the bond market in Italy see also BANK OF ITALY, FINANCIAL STABILITY REPORT No. 1/2016, 26-27 (2016), https://www.bancaditalia.it/pubblicazioni/rapporto-stabilita/2016-1/en-FSR-1-2016.pdf?language_id=1; with particular regard to *private placement*, see Nicola Branzoli & Giovanni Guazzarotti, *Il mercato dei private placement per il finanziamento delle imprese* [The Private Placement Market for Firm Debt Financing], BANK OF ITALY OCCASIONAL PAPERS No. 262, 14-15 (2015), https://www.bancaditalia.it/pubblicazioni/qef/2015-0262/QEF_262.pdf?language_id=1.

[202]The difference between bonds and debentures, existing in the U.S. scenario and based on the circumstance that the former is secured on some assets, is not mentioned in Italian Civil Code. *See supra* note 83.

[203]*See* ALESSANDRO DE NICOLA & MARCO CARONE, ITALIAN COMPANY LAW 79-83 (2014). When issued by listed corporations, bonds may also be subject to a set of specific rules that will not be specifically examined by this research.

It should be noted, however, that Decreto Legge 22 giugno 2012, n. 83, G.U. Giu. 26, 2012, n. 147, converted into law, with amendments, by Legge 7 agosto 2012, n. 134, G.U. Ago. 11, 2012, n. 187, introduced significant changes to the civil and tax law regime applicable to debt securities, known as minibonds, such as financial bills and bonds, issued by unlisted companies other than banks and micro-enterprises. In particular, the reform has abolished the limits on the tax deduction of passive interests for the issuer, as well as the maximum value of the securities that can be placed, provided that securities are traded on a regulated market or held by professional investors. From the first issue in November 2012 to the end of 2015 there have been 179 placements of minibonds for a total of € 7,191 billion. *See* Osservatorio Mini-Bond, *Il Report Italiano sui Mini-Bond*, 37 (2016), http://www.osservatoriominibond.it/portal/minibond/document (considering securities with a maturity up to 36 months, issued by both listed and unlisted corporations under the new rules and not traded in markets open to retail investors).

[204]However, there are some cases in which such limit may be exceeded. The most relevant cases are the following: the bonds issued in excess are reserved for subscription by professional investors, safe for their liability in case of subsequent circulation among acquirers who are not professional investors; the bonds are secured by a first degree mortgage on real estate property owned by the company; the bonds are listed on regulated markets or they give the right to acquire or subscribe shares; authorization given by the governmental authority, due to the existence of specific reasons based on national economy.

[205]In particular, guarantees must be mentioned in the bond certificate. *See* art. 2414, section 1, n. 5

Art. 2411 of the Italian Civil Code provides that the right of the holders to obtain the reimbursement of capital and the payment of interest may be, partially or wholly, subordinated to the satisfaction of the rights of other creditors of the company. It also sets out that only maturity and amount of interest may vary and be related to the performance of the company itself. The repayment of the capital is viewed as an indispensable element of the bond and must be in principle assured.[206] The contract between the issuer and the bondholders is considered an obligation of the firm, because it sets the terms of a collective loan that is divided in standard units. The contract contains standard clauses and by signing it, the bondholders become subject to the application of the majority principle and to the consequent abatement of their individual rights.[207]

The set of rules specifically related to the organization of bondholders, provided by arts. 2415-2418 of the Italian Civil Code, will be discussed in the following section.

B. The Organization of Bondholders

To protect bondholders and to facilitate needed modifications of the original terms of the debt, Italian law establishes two bodies, the common representative and the meeting of bondholders.[208] The so called "organization of bondholders" protects bondholders' common interests. These legal rules date back to the original 1942 Civil Code and have remained substantially unchanged even after the 2003 Italian Company Law reform. Only minor modifications were introduced in the following years.[209]

The common representative need not be a bondholder and may be an

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Codice civile [C.c.]. Moreover, the resolution on the issuance of bonds secured by guarantees must designate a public notary, who will perform the formalities needed for the creation of the same guarantees. Lastly, the guarantees can be created in favor of bondholders, as well as in favor of a representative, who will be entitled to act on behalf of the holders to enforce all the substantial and procedural rights related to them. *See* art. 2414-*bis* Codice civile [C.c.].

[206] *See ex multis*, Andrea Bartalena, *Le nuove obbligazioni* [*The New Bonds*], BANCA BORSA TIT. CRED. 543, 548 (2005); Mario Notari, *Gli strumenti finanziari partecipativi: punti fermi e problemi aperti negli orientamenti interpretativi del notariato milanese* [*Participatory financial instruments: fixed points and open problems in the interpretation of the Milanese notary*], RIV. SOC. [REV. CO.] 1134, 1137 (2018) (specifying that the bonds give the right to the repayment of the capital or, in any case, to the payment of a sum of money, which constitutes a debt of the issuer and a credit of the bondholder).

[207] *See* Gianvito Giannelli, *Il Contratto e i Prestiti Obbligazionari*, *in* I CONTRATTI PER L'IMPRESA 337, 337-338, 340 (Gregorio Gitti, Marisaria Maugeri & Mario Notari eds., 2012).

[208] 10 Gian Franco Campobasso, *Obbligazioni di Società*, *in* DIGESTO, DISC. PRIV., SEZ. COMM. 280, 293 (1994).

[209] Since 1920s, Cesare Vivante observed that the commonality of the interests of bondholders would have required in Italy, as well as in other European countries, the creation of an association, with a general meeting of the holders resolving by a majority vote. The Author noticed that often an agreement with the company made in time, the concession of a delay of the payment of principal or interest could avoid the ruin of bankruptcy, to the mutual advantage of both. *See* 2 CESARE VIVANTE, TRATTATO DI DIRITTO COMMERCIALE. LE SOCIETÀ COMMERCIALI 341 (5th ed.1928).

individual or an investment services or trust company.[210] The common representative is appointed during the meeting of the bondholders.[211] Under art. 2418 of the Italian Civil Code, the common representative is in charge of implementing the resolutions made at the bondholders meeting for the protection of their common interests in dealing with the company. The common representative is also bondholders' legal representative in proceedings such as the composition with creditors (*concordato preventivo*) or bankruptcy.

According to art. 2415 of the Italian Civil Code, at the meeting of bondholders, the following may be resolved: the appointment and revocation of the common representative; the amendments of the conditions of the loan; the proposal for the controlled administration and composition with creditors; the creation of a fund for the expenses needed to protect the common interest and the related statements of accounts; and other matters of common interest for the bondholders.[212] The meeting may be convened by the directors or by the representative of the bondholders when they consider it necessary or when requested by bondholders who hold at least one-twentieth of the issued and outstanding securities.

The Italian Civil Code does not provide a specific regulation for the meeting of bondholders other than by reference to the Civil Code's provisions concerning extraordinary meetings of shareholders.[213] The favorable vote of the bondholders holding half of the issued and outstanding bonds is required for a resolution to modify loan terms to be valid under art. 2415, section 1, n. 2, even in second call.[214]

The company cannot participate in any resolution concerning any bonds that it may own,[215] removing a potential conflict of interest. This rule does not expressly refer to other types of potential or actual conflict of interest, such as the shareholder holding the majority of the bonds. Nevertheless, it is

[210]The directors, the statutory auditors, the employees of the issuing company and those who are in a position of ineligibility or forfeiture of office cannot be appointed as common representative. *See* art. 2417, section 1 Codice civile [C.c.].

[211]Art. 2417, section 1 Codice civile [C.c.]. The common representative stays in office for a period no longer than three financial years and can be re-appointed. If not appointed by the meeting of the bondholders, she must be appointed by the court upon request of either one or more bondholders or the directors of the company.

[212]According to art. 2416 Codice civile [C.c.], the resolutions passed by the meeting may be challenged under the same rules governing the challenge of resolutions of the meeting of the shareholders.

[213]Therefore, the majority needed to pass a resolution ("quorum") may vary, based, on the one hand, on the applicability of the discipline related to listed or unlisted companies and, on the other hand, on the circumstance that the resolution is taken on the first or in further meetings. Carmelo Raimondo & Marco Pagani, *New Italian Rules for High-Yield Bonds*, INT'L FIN. L. REV. (2013) (providing a description of all the cases).

[214]*See id.* (affirming that this majority is applicable only when the rules related to unlisted companies are applicable).

[215]Art. 2415, section 4 Codice civile [C.c.].

a general principle of both legal doctrine and caselaw that conflicts of interest regarding the resolutions of a meeting are disfavored by Italian company law. This general principle can also be applied to the meeting of the bondholders.[216] In the event the resolution may be potentially damaging to bondholders, the resolution may be challenged if majority support for it could not have been achieved without the vote of the holder in a conflict of interest.[217] Finally, pursuant to art. 2419 of the Italian Civil Code, the provisions above described do not preclude any individual action by bondholders, with the only exception of those incompatible with decisions made by the meeting of bondholders.

In the following paragraph, we examine specific resolutions of the meeting of bondholders to assess whether and to what extent amendments of the core terms of the loan by a majority vote are allowed in Italy. A comparison of the Italian and U.S. models follows.

C. The Amendments of the Terms of the Bond Loan, the Statutory Rule and its Interpretation

As mentioned above, art. 2415 of the Italian Civil Code lists the matters the meeting of bondholders may decide. This list includes "amendments of the terms of the loan."[218] The Report on the Italian Civil Code reflects the legislative intent that a majority of the bondholders are permitted to approve substantial modifications to the original loan agreement, the interest rate, payment and prepayment, and the guaranties provided at the time of the issuance. The Report underlines that this provision represents an advantage for bondholders because the prompt modification of loan conditions may be the most effective way to grant noteholders satisfaction of their claims.[219]

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[216]*See* Giancarlo Frè, *Commentary to art. 2415 C.c.*, *in* SOCIETÀ PER AZIONI. ARTT. 2325-2461 C.C. COMMENTARIO DEL CODICE CIVILE 608, 614 (Antonio Scialoja & Giuseppe Branca eds., 5th ed. 1982). *See also* Campobasso, *supra* note 208, at 294 (pointing out that it cannot be automatically affirmed that being a controlling shareholder and at the same time, a bondholder, represents a situation of conflict of interest).

[217]Legal scholars argue that it is very difficult to prove the potential damage. In a recent decision, the plaintiff, holder of 49% of the bonds issued by a company, challenged the resolution of the meeting of the bondholders passed with the vote of the bondholder holding 51% of the bonds, who, at the same time, indirectly had the control of the issuer. In particular, the resolution approved the proposal of a composition with creditors (*concordato preventivo*), while, according to the plaintiff, a bankruptcy proceeding would have been preferable. The court rejected the case, highlighting that the plaintiff was required to have proved not only the conflict of interest of the majority bondholder and that her vote was decisive for the resolution being approved, but also the damage for creditors. In other words, it must be given evidence of the circumstance that the majority vote is unequivocally aiming to infringe the rights of the minority bondholders and to put the majority holder in an advantageous position. *See* Trib. Milano, 12 febbraio 2014, http://www.giurisprudenzadelleimprese.it/wordpress/wp-content/uploads/2014/02/20140214_RG629-20141.pdf.

[218]*See* art. 2415, section 1, n. 2 Codice civile [C.c.] ("sulle modificazioni delle condizioni del prestito").

[219]Relazione al Codice civile [Report on the Italian Civil Code], n. 987 (also clarifying that the appli-

Nevertheless, because the expression "amendments of the term of the loan" is generic, and because of the fear of possible abuses, two alternative and quite restrictive interpretations concerning which amendments are allowed have been made.[220]

According to a position that dates back to the origin of the rule, in order to identify the permissible modifications, a distinction must be made between main and accessory terms of the loan (*modalità essenziali* and *modalità accessorie*).[221] While amendments to the former could not be approved by majority vote, amendments to the latter could be made by a resolution passed at the meeting of bondholders. In any case, there is no agreement on the ways in which terms of the loan could be deemed as "main" or, alternatively, "accessory". Basically, amendments to accessory terms include a change of the date of reimbursement of the loan, a reduction in the interest rate, and the withdrawal of part of the guarantees. In contrast, amendments to the main terms imply releasing the issuer from part of its debt (i.e. providing for the repayment of less than the nominal value of the bonds) and, as to of convertible bonds, waiving the right to convert bonds into shares.

A more recent perspective rejects the distinction between main and accessory terms and focuses on different criteria in identifying which changes can be approved with a majority vote.[222] Viewed in this perspective, the meeting of bondholders does not wield unlimited authority, but may vote to amend the terms of the loan if the common interest of bondholders justifies that position, subject to the principle of equality of treatment. Those modifications may not change the structural characteristics of the bond loan, typically an interest-bearing loan divided into shares, nor can the meeting agree to a shift from one type of bond to another.

Thus, the meeting of the bondholders may pass resolutions concerning such matters as an extension of the duration of the loan, a reduction in the interest rate, and a temporary suspension of interest payments. In contrast, the majority of the bondholders can not directly or indirectly impose a principal reduction upon the minority. Nor can the meeting of the bondholders

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cation of the rules of the extraordinary meeting of shareholders sufficiently prevents resolutions that do not respond to the real interest of all bondholders, also considering the provision of the right to challenge the resolutions of the meeting of bondholders).

[220]For a synthesis of the positions, see MARCELLA SARALE, LE SOCIETÀ PER AZIONI-OBBLIGAZIONI 367 (2000).

[221]From this perspective, although spanning a range of opinions, see Aldo Formiggini, *Diritti individuali degli azionisti privilegiati e degli obbligazionisti* [*Individual Rights of Preferred Stockholders and Bondholders*], RIVISTA TRIMESTRALE DI DIRITTO E PROCEDURA CIVILE [REV. TRIM. DR. PROC. CIV.] 103, 127 (1952); ALESSANDRO GRAZIANI, Diritto delle società, 425 (5th ed. 1963).

[222]5 Gian Franco Campobasso, *Le obbligazioni, in* CONTROLLI. OBBLIGAZIONI. TRATTATO DELLE SOCIETÀ PER AZIONI 379, 497 (G. E. Colombo & G. B. Portale eds., 1988); Frè, *supra* note 216, at 610-11.

approve a forced conversion of the bonds into shares or a definitive abolition of the right to receive payment of interest.

These rules relate only to amendments affecting the original loan. A new loan secured by guaranties or liens on the company's assets does not require the approval of the meeting of the bondholders, even though it may have general impact on all of the creditors, bondholders included.

These restrictive interpretations are questionable. In interpreting what "amendments of the terms of the loan" means, courts should merely consider whether an amendment occurs when a bond debt, with its typical financial instruments—bonds—remains in place after changes are adopted. Bonds exist as long as they retain their essential characteristic: the reimbursement of the principal. Partial or complete forgiveness of interest, partial payment of the principal, or shifting types of bonds should all be "amendments of the terms of the loan" because, even after such changes, the bonds are still viable.

The meeting of the bondholders may not pass resolutions approving restructures that will result in waiving of the reimbursement of capital or converting the bonds to shares. In either case, the bonds will no longer be viable.

D. Differences Between the Italian and the U.S. Approach

Three main differences between the Italian and American law's approach to bond modification can be identified. The first relates to general modifications of terms and conditions of the loan by bondholder meeting resolution. In Italy, art. 2415, section 1, n. 2 of the Italian Civil Code as it is currently interpreted permits this, except where the modification affects the bond's core terms. American law maintains a similar rule, although it can only be inferred by the reference to the prohibitive language of § 316(b) of the TIA.[223] What is different is the two countries' definition of "core terms." The Italian law is much less restrictive because it allows extensions of the loan's duration of the loan, reductions in the interest rate, and a temporary suspension of the interest payment to be approved by majority vote. Not so in the U.S. where § 316(b) explicitly provides that modifications involving "payment of the principal of and interest on such indenture security, on or after the respective due dates" require the consent of each holder.[224] Moreo-

[223]As William O. Douglas himself said, referring to the rule incorporated in § 316(b) of the TIA, "the bill does place a check or control over the majority forcing on the minorities a debt-readjustment plan. It does go that far; but it does not prohibit any other restriction or appropriate amendments of the indenture by the consent of the parties." This prohibition "*does not prevent the majority from binding the dissenters by other changes in the indenture* or by waiving defaults and the majority may, of course, consent to the alteration of its own rights" (emphasis added). *Trust Indentures: Hearings on H.R. 10292*, *supra* note 101, at 36 (testimony of William O. Douglas, Chair, Securities and Exchange Commission).

[224]Regarding the procedural right to institute a suit, the two legal systems are even more similar, both granting individual bondholders the possibility to sue for enforcement of their rights. *See* art. 2419 Codice

ver, a limited amendment, such as an interest postponement, is possible only to the extent that a supermajority consents to delay the payment, and only for a period not longer than three years.[225]

Italian law grants the meeting of bondholders the authority by operation of law to amend the non-core terms of the loan by a majority vote,[226] even if a specific clause permitting that is not set out in the contract. In the U.S. model, as contemplated by § 316(a)(2) of the TIA, the contract must contain a provision allowing a majority consisting of at least the 75% in principal amount of indenture securities to amend the indenture to modify the debt.[227]

Although the Italian rule does not allow the majority of bondholders to bind the minority on a modification of the core terms of the loan and other renegotiation agreements, such as the conversion of the bonds into shares, it does not provide an express prohibition regarding such a vote that is analogous to § 316(b).

E. Some Alternatives to Out-of-court Restructurings

Because Italian law does not allow the meeting of the bondholders to fundamentally change the characteristics of the debt by a majority vote, other viable alternatives to out-of-court restructurings are needed. In the past, foreign companies, mostly controlled by Italian companies, were established to issue the debt. That resulted in the debt being governed by the law of a different country, usually Great Britain. Possible restructuring proposals were subject to the noteholders meeting, whose procedure and requisite majority were provided for in the trust deed.[228] This option, while still viable, presents several drawbacks. First, it may be cost prohibitive for many companies. And, it may yield less investor protection than that accorded to in-

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civile [C.c.], provided that it does not concern a matter of resolution of the meeting of the bondholders; Trust Indenture Act of 1939 § 316(b), 15 U.S.C. § 77ppp(b) (2012).

[225]Section 316(a)(2) provides that the indenture "may contain provisions authorizing the holders of not less than 75 per centum in principal amount of the indenture securities or if expressly specified in such indenture, of any series of securities at the time outstanding to consent on behalf of the holders of all such indenture securities to the postponement of any interest payment for a period not exceeding three years from its due date."

In order to prevent possible conflicts of interest, it is also specified below that "in determining whether the holders of the required principal amount of indenture securities have concurred in any such [. . .] consent, indenture securities owned by any obligor upon the indenture securities, or by any person directly or indirectly controlling or controlled by or under direct or indirect common control with any such obligor, shall be disregarded [. . .]" *Id.*

[226]As mentioned above, the percentage of bondholders required in order to reach the majority in Italy may vary depending on whether it is a listed or unlisted company and the circumstance of whether or not it is a first or further meeting. *See supra* note 213.

[227]Trust Indenture Act of 1939 § 316(a)(2), 15 U.S.C. § 77ppp(a)(2) (2012).

[228]*See* Matteo Zaccagnini, *Alcune Osservazioni in Tema di Ristrutturazioni di Prestiti Obbligazionari Emessi da Società Quotate Italiane*, *in* Crisi d'Impresa e Ristrutturazioni. Percorsi tra Banca e Mercato 199, 207, 207 n.15 (Ferdinando Bruno & Andrea Rozzi eds., 2010).

vestors by Italian law. Especially after the financial collapses of some Italian enterprises that had abused similar techniques during the early 2000s, individual investors could be skeptical toward investing in foreign bonds, making them less attractive.

The contracting parties could choose the law governing the issue by agreement.[229] An Italian company could issue bonds subject to a different nation's laws, with the purpose of applying the broader foreign provisions related to resolutions of the meeting of the bondholders.[230] However, whether the organization of the bondholders must be conducted under the nation's law designated in the agreement or by the law of the country of the issuer is debatable.[231] The choice of law made by the parties might not affect the applicability of certain provisions of Italian law that cannot be altered by agreement. The choice of law option shares some of the other drawbacks mentioned above and may not be a viable solution to the problem within the Italian legal framework.

Finally, although it has yet to be examined in Italian jurisprudence or legal scholarship, it is doubtful that a coercive mechanism like exit consent would comply with Italian law,[232] not least because of the principle of equal treatment among bondholders,[233] the potential relevance of conflicts of interests in the meeting of bondholders, and the existence of duties of good faith and fair dealing among the issuer and the bondholders, as well as inside the group of bondholders.[234]

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[229]Pursuant to Article 3 of Regulation (EC) No 593/2008 of the European parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations ("Rome I"), 2008 O.J. (L 176) 6.

[230]*See* Autuori, *supra* note 73, at 249.

[231]*See* Anna Gardella, *Commentary to art. 1, V, Regolamento CE n. 593/2008 del Parlamento europeo e del Consiglio del 17 giugno 2008 sulla legge applicabile alle obbligazioni contrattuali («Roma I»)* [*Commentary to art. 1, V, Regulation (EC) No 593/2008 of the European parliament and of the Council of 17 June 2008 on the Law Applicable to Contractual Obligations («Rome I»)*], NUOVE LEGGI CIV. COMM. [NEW L. CIV. COMMENT.] 577, 582 (Francesco Salerno & e Pietro Franzina eds., 2009).

[232]*See* Danilo Semeghini, *Ristrutturazioni del debito e offerte coercitive nella prassi anglo-americana* [*Debt Restructurings and Coercive Offers in the Anglo-American Practice*], NUOVO DIR. SOC. [NEW CO. L.] 26, 50-51 (2013) (identifying possible limits to the use of coercive offers in the Italian context in compatibility with the principle of equal treatment among bondholders and in overcoming the correct procedures provided for the meeting ("*metodo collegiale*")).

[233]Pursuant to art. 92, section 1 D. Lgs. 24 febbraio 1998, n. 58, G.U. Mar. 26, 1998 n. 71 ("TUF"): "[l]isted issuers and listed issuers with Italy as their home Member State shall guarantee the same treatment and with identical terms and conditions to all holders of the listed financial instruments". The same principle of equal treatment among bondholders also applies with reference to non-listed companies. *See supra* section III.C.

[234]*See* Francesca Prenestini, *La "vendita del voto" nell'assemblea degli obbligazionisti* [*Vote-buying in the meeting of bondholders*], GIUR. COMM. [COM. JURIS.] 890 (2019) (arguing the legitimacy of consent payments by the issuer to those bondholders voting in favour of amendments to the terms of the bond loan under Italian law, provided that bondholders' vote is unaffected by conflict of interests-given the lack of a potential damage for them-, and equality of treatment of all bondholders is ensured).

F. A PROPOSED SOLUTION

Since a majority vote that binds a minority of the bondholders regarding radical restructuring measures is not permitted under Italian law and the alternatives discussed above are not satisfactorily viable, a further option must be considered. May the parties include a provision allowing such a vote in the contract governing the loan?

Some authors have explored the legitimacy of including such a provision in the bylaws, enlarging the matters that the meeting of bondholders may resolve.[235] Whether such a provision overcomes the legal rule is doubtful, particularly concerning authorizing the meeting of bondholders to pass a resolution by majority vote upon major amendments or the conversion of bonds. Notwithstanding their peculiar connection with the company, as well as the provision of their own organization, the position of bondholders as creditors is different from, and in conflict with that of shareholders. The debtor-creditor relationship between the company and bondholders is a creature of contract. While corporate bylaws can sketch the boundaries of the company's authority to contract, they cannot unilaterally govern the relationship between the company and its creditors.

Unlike the U.S., Italian law does not contain an analog to § 316(b) of the TIA. In the absence of a statutory prohibition, as well as in the light of the principle of contractual freedom, the parties could affirm in their agreement that the meeting of bondholders be granted the authority to vote upon an amendment to a core term of the loan.[236] A series of arguments support this view.

Most of the rules related to the organization of bondholders are not mandatory, unlike the provisions concerning the limits related to the issuance of bonds or to the authority to decide the issuance.[237] Although the organization of bondholders must be established, most of the legal provisions regarding its functioning can be altered by the parties' agreement because they almost exclusively deal with their contractual relationship. In the case of issuing bonds, the primary interests in play are those of the company and the

[235]*See* Raffaele D'Ambrosio, *Commentary to art. 2415 C.c.*, *in* CODICE COMMENTATO DELLE SOCIETÀ 794, 795 (Guido Bonfante, Diego Corapi, Giuseppe Marziale, Renato Rordorf & Vincenzo Salafia eds., 2d ed., 2007); Alessandra Costa, *Commentary to art. 2415 C.c.*, *in* CODICE COMMENTATO DELLE S.P.A. 1070, 1073 (Giuseppe Fauceglia, & Giorgio Schiano di Pepe eds., 2007) (although not specifically related to an amendment of the core terms of the loan).

[236]*See* Autuori, *supra* note 73, at 220 (admitting that the conditions of the issue could enlarge the matters of resolution of the bondholders, at least as to the possibility of renouncing to part of the principal, as well as to the payment of the (future or accrued) interest and, with some doubts, to resolve upon the conversion of the bonds into shares).

[237]In fact, as mentioned above, when the contract is subject to a foreign law, the Italian rules about the organization of the bondholders, with some exceptions, may not be applied. *See* Autuori, *supra* note 73, at 251-52.

bondholders. In sum, the statutory rules are supplementary terms, implied whenever the contract is silent.[238]

Amendments to the core terms of the loan, along with restructuring provisions, whether approved by each bondholder or by a majority, align well with basic contract law principles. If a clause permitting the majority vote is set out in the original contract, we assume that provision was negotiated for, known to, and accepted by all of the parties. Therefore, because the bondholders have already agreed to give the majority the renegotiating authority and even the power to extinguish the debt, they have already consented to rule by majority.[239]

Significant innovations that have taken place in the area of insolvency law and the evolution of business practice in the same sector have not triggered similar innovations in company law relating to the organization of bondholders. The various forms of debt restructuring, including the attribution of shares to creditors, the exchange of bonds with other financial instruments, the reduction of capital, and the alteration of other terms are legal and legitimate. These approaches are contemplated in the rules governing compositions with creditors.[240] Legitimate ways to prevent or contain a company's financial crises include adopting measures that would be proper during a composition with creditors. As insolvency law evolves toward decreasing judicial review,[241] the costs of formal insolvency proceedings increase,[242] and as bondholders have increasingly become sophisticated institutional investors or shareholders of the issuer, more efficient means of private bond resolutions should be found. Today's bond investors are fully capable of fending for themselves even out of court.[243]

Lastly, if the raison d'être of the organization of bondholders is to prepare instruments aimed at more effective bondholder protection and at facilitating,

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[238]From a similar perspective, see Giannelli, *supra* note 207, at 355 (arguing that the contract could contain provisions regarding the organization of the group, for instance providing the operating rules of the meeting of bondholders and of the common representative, concerning those aspects which are not governed by the law or when the law only sets some limits).

[239]Similarly, see CIOCCA, *supra* note 73, at 105 (arguing that the conditions of the issue could give the meeting of the bondholders the authority to decide upon amendments of the terms of the loan, since this provision would be accepted by each bondholder when she acquires the financial instruments. At the same time, the Author underlines that such amendments must comply with the principal of equal treatment among bondholders, as well as be based on the interest in the restructuring of the debt not only on behalf of the issuer, but also of the bondholders).

[240]*See* art. 160, section 1, lett. a) Bankruptcy Law (It.). The matter will be governed by art. 85, section 3, lett. a) Code of Crisis and Insolvency (It.).

[241]*See* Roberto Sacchi, *Dai soci di minoranza ai creditori di minoranza* [*From minority shareholders to minority creditors*] FALL. [BANKR.] 1063 (2009) (affirming that the protection of minority creditors, in the past entrusted to more penetrating powers of intervention of the judge, must now be guaranteed through a judicial control on the level of information offered to the creditors and the regularity of their vote).

[242]*See supra* note 5 and accompanying text.

[243]*See supra* note 201 and accompanying text.

where necessary, amendments to the original conditions of the loan also in the interest of the issuer,[244] it is clear that a conventional extension of the matters of resolution of the meeting appears fully consistent with the purposes pursued by the legislature.

The ability of the bondholders to agree to the conversion of bonds into shares or other financial instruments must also be considered.[245] In that event, the bondholders' decision modifies the essential nature of the contractual relationship between the holders and the issuer by rendering the holders shareholders. Even so, there are other arguments in favor of granting the meeting of bondholders this authority that may be inferred from the Italian legal system.

Italian law provides for bonds to be convertible,[246] granting their holders the right to convert them into shares of the company (*obbligazioni convertibili*). The nature of bonds is notionally fully compatible with their conversion into shares, at least where this possibility is contemplated ab initio by contract and conferred as a right attributed to the individual bondholder. In certain cases, the decision to convert bonds into shares belongs to the issuer or is given to a third party or tied to an external event (*obbligazioni convertende*).[247] If strangers can be given this power, why not bondholders by a majority vote? The Italian Civil Code does not expressly prohibit a majority vote on the conversion of bonds into shares in contrast to, for instance, French law.[248] The French legal system explicitly excludes the authority of the meeting of bondholders to resolve upon the conversion of the bonds into shares.[249] The absence of such a ban in Italian law suggests that voting on the conversion of the bonds into shares may be contracted for by the parties.

Having proposed to provide a clause allowing a binding vote of the meeting of bondholders in workouts in the contract, what should that clause contain?[250] The clause should provide for supermajority voting upon amendments in the core terms of the loan and the conversion of the bonds

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[244]*See* Campobasso, *supra*, note 208, at 293.

[245]*See* Autuori, *supra* note 73, at 221-22.

[246]*See* art. 2420-*bis* Codice civile [C.c.] (It.).

[247]*See* Andrea Giannelli, *Obbligazioni convertibili, convertende e a conversione sintetica* [*Convertible, "convertende" and synthetic conversion bonds*], RIV. SOC. [REV. CO.] 689, 692-93 (2016).

[248]According to CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L 228-65, section 1 (Fr.), "[l]'assemblée générale délibère sur toutes mesures ayant pour objet d'assurer la défense des obligataires et l'exécution du contrat d'emprunt ainsi que sur toute proposition tendant à la modification du contrat [. . .]".

[249]Pursuant to CODE DE COMMERCE [C. COM.] [COMMERCIAL CODE] art. L 228-68, section 1 (Fr.), "[l]es assemblées ne peuvent ni accroître les charges des obligataires ni établir un traitement inégal entre les obligataires d'une même masse. Elles ne peuvent décider la conversion des obligations en actions, sous réserve des dispositions de l'article L. 228-106. Toute disposition contraire est réputée non écrite."

[250]In the absence of a legal framework and limits imposed by the law, the risk may be that such clauses could be, in practice, unilaterally provided by the issuer, omitting mechanisms of protection for the bond-

into shares. It is reasonable to provide flexibility, because the parties could not exhaustively identify in advance all the possible types of amendments that might occur. In any case, such a provision should assure that the authority of the meeting of bondholders to amend the terms of the loan by a majority vote only occurs when certain events like the financial distress of the issuer occur. In addition, the amendments should be subject to the requirement of equal treatment and the common interest of bondholders.

Protection and information must also be provided the bondholders. Each bondholder, before acquiring the bonds, should be able to know and understand the clause. A common representative, perhaps an investment service or a trust company, should be in charge of evaluating the restructuring agreement and providing bondholders with all the necessary information before the vote. Lastly, the reference to legislative rules and principles concerning the meeting of the shareholders should be sufficient to address the risk of conflicts of interest and should grant bondholders the chance to challenge the resolution via judicial action.

CONCLUSION

Issuers facing financial difficulties need bondholders to be able to consider and approve restructure deals that modify the core terms of the debt so that holdouts do not thwart the process. As the analysis of two different legal systems in which such vote is not permitted shows, the same fears of the risk of abuses by the majority and the lack of information of the bondholders characterized the U.S. and Italy's approach to bondholder voting in the last century. History shows that the ban not only does not prevent these abuses, but that the attempts to work around the ban may lead to greater abuse. The prohibitive approach has failed to protect individual bondholders and exposed them to harmful practices like exit consent in the U.S. It also causes companies' higher costs and makes issues less attractive for investors. These rules also impede the possibility of companies to recover, resulting in negative repercussions for all of the stakeholders.

Abuses by insiders could be avoided by prohibiting their votes. As for lack of information, nowadays, financial market regulation grants full disclosure to investors. Today's bond investors are not necessarily individuals nor are they unsophisticated. Most are sophisticated professional or institutional investors. Trustees or common representatives could supply supplementary information.

From a policy point of view, allowing the majority to bind the minority on a vote upon the amendments to the core terms of the loan and other

holders. Then, the optimal solution would be a legal rule regarding the matter, requiring mandatory limits to the content of the clause.

restructuring measures such as the conversion of bonds into shares would be optimal. The evolution of the law, particularly in the field of the sovereign debt supports this. In recent years, these clauses have frequently been included in the context of issues of sovereign debt. Also, in Germany and Chile, where unanimous vote has become a default rule, contracting parties often choose to include majority action clauses in bond indentures. This trend seems to demonstrate that, when parties are free to negotiate the best conditions for debt issues, they might consider it convenient to formulate a clause allowing the majority to vote and to bind a minority on the core amendments of the debts.[251] Making out-of-court restructuring more practical would serve the additional need for workouts posed by the ongoing COVID-19 pandemic and the financial distress it has caused in many sectors.[252]

For now, two different solutions might be implemented in the U.S. and Italy. Until § 316(b) can be reformed, the SEC could exercise its authority to grant exemptions to the ban. In the latter, Italian law can be interpreted to enlarge the list of matters upon which the meeting of bondholders may resolve in the bond contract. The contract could also include authority for the meeting to vote upon an amendment to the core terms of the loan and other measures, not qualified as mere amendments of the loan, such as the conversion of bonds into shares.

Whatever solution is adopted, the best mechanism for the protection of the bondholder has shifted from the guarantee of an individual veto power to being bound by a free, informed, and non-conflicted majority vote.

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[251] *See* Roe & Tung, *supra* note 157, at 496-97.

[252] *See* Yan Liu, José Garrido, and Chanda DeLong, *Private Debt Resolution Measures in the Wake of the Pandemic*, 3, 5 (IMF COVID-19 Special Series, May 27, 2020), https://www.imf.org/~/media/Files/Publications/covid19-special-notes/en-special-series-on-covid-19-private-debt-resolution-measures-in-the-wake-of-the-pandemic.ashx?la=en; The World Bank Group, *COVID-19 Outbreak: Implications on Corporate and Individual Insolvency*, 4 (COVID-19 Notes Finance Series, Apr. 13, 2020), http://pubdocs.worldbank.org/en/912121588018942884/COVID-19-Outbreak-Implications-on-Corporate-and-Individual-Insolvency.pdf.