Entire Fairness in the Trust Indenture Act

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ABSTRACT

Recently, the Trust Indenture Act of 1939 has reappeared in out-of-court restructuring litigation. This piece of New Deal legislation was intended to prevent coercive restructurings whereby savvy institutional players took advantage of unknowledgeable or unengaged noteholders. Until recently, the Act was uncontested, but recent out-of-bankruptcy restructurings have resurrected it. These cases have implications for future restructurings, as courts continue to parse the legislative text and history to arrive at a workable solution. This Essay argues that a workable solution is already here: Delaware's entire fairness standard. By importing the tenets of Delaware's entire fairness review into Trust Indenture Act litigation, courts can navigate new terrain with a reliable map with which both courts and market participants are familiar. As such, this Essay proceeds first by recounting the history of the Act, with particular emphasis on Congress's requirement of "judicial scrutiny of the fairness of debt-readjustment plans." Against this backdrop, the Essay then compares the standard debt-readjustment process with controlling shareholder mergers. In both cases, a dominant majority could abuse its control to the disadvantage of minority investors. In the latter case, Delaware corporate law has developed a set of judicial review standards to protect minority shareholders while not foreclosing beneficial transactions. Delaware's solution, the entire fairness standard, has served shareholders in good stead. While courts must reckon with the statutory language of the Trust Indenture Act, the intent of Congress is clear: to ensure judicial scrutiny of out-of-court restructurings. As such, this Essay concludes by arguing for an application of entire fairness review to cases involving alleged violations of the Act. Courts would be wise to adopt such a standard because it serves the purpose of the Act and provides socially optimal protection against coercive deals while allowing socially beneficial restructurings.

INTRODUCTION

The Trust Indenture Act[1] aims to protect minority noteholders from abuse by an unscrupulous majority.[2] Most notably, § 316(b) of the Act prohibits any "impairment of [a] holder's right to payment" without the holder's consent.[3] But what is "impairment" of the "right to payment"? That question emerged within the past few years in the proposed out-of-bankruptcy restructuring of Education Management Corporation ("EMC")

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1 Trust Indenture Act of 1939, 15 U.S.C. §§ 77aaa–77bbbb (2012).

2 *See id.* § 77bbb.

3 *Id.* § 77ppp(b).

in the *Marblegate* litigation. EMC could not seek bankruptcy protection because "[d]eclaring bankruptcy would have rendered [EMC] ineligible for [federal] funds, depriving it of nearly 80% of its revenue."[4] As such, it pursued an out-of-bankruptcy restructuring,[5] which transferred all of EMC's assets to a new entity such that the assets would "not be available to satisfy the claims of [dissenting Noteholders]."[6] Dissenting noteholders brought claims under the Trust Indenture Act, and the district court held that EMC's restructuring violated the Act because the out-of-bankruptcy restructuring removed dissenting noteholders' "substantive right to receive [payment]."[7] Since a decision was handed down in *Marblegate I* in 2014, "a number of actions have been filed challenging out of court restructurings under [the Act]."[8]

Despite increasing claims, courts are conflicted on how expansively to interpret the Act's "right to payment" language. This conflict increases the costs and uncertainty of out-of-bankruptcy restructurings, which can be quicker and cheaper than formal bankruptcy proceedings. Administrative costs in bankruptcies can reach 7.5% of the liquidating value of a firm's assets, and the average bankruptcy takes over two years to complete, adding to the psychic cost of bankruptcy.[9] An out-of-bankruptcy process is likely cheaper and quicker than bankruptcy, saving administrative costs for both creditors and debtors.

Unfortunately, the Act provides no guidance for courts concerning these more favorable out-of-bankruptcy restructurings. For example, consider a restructuring that provides new notes to holders that consent to removing the security package associated with the older notes, thus leaving nonconsenting noteholders with limited recovery. Such a restructuring may run afoul of the Act. And in one recent and notable attempt to provide a

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4 Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Corp. (*Marblegate II*), 111 F. Supp. 3d 542, 543 (S.D.N.Y. 2015), *vacated and remanded sub nom.* Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp. (*Marblegate III*), 846 F.3d 1 (2d Cir. 2017).

5 Throughout this Essay, the terms "out-of-bankruptcy" and "out-of-court" restructuring are used interchangeably. Both terms serve to connote a restructuring that is completed outside of formal bankruptcy proceedings under Title 11 of the U.S. Code.

6 *Marblegate II*, 111 F. Supp. 3d at 544 (alteration in original) (quoting Marblegate Asset Mgmt. v. Educ. Mgmt. Corp. (*Marblegate I*), 75 F. Supp. 3d 592, 602 (S.D.N.Y. 2014)).

7 *Id.* at 555 (emphasis omitted); *see infra* note 60.

8 Miranda S. Schiller & Agustina Berro, *Court Rejects § 316(b) Claims in* Cliffs Natural Resources, WEIL BANKR. BLOG (Dec. 8, 2016), https://business-finance-restructuring.weil.com/out-of-court-restructuring/court-rejects-§316b-claims-cliffs-natural-resources/ (stressing that despite the rise in the number of claims post-*Marblegate*, noteholders have rarely asserted the Act until recently).

9 *See* Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization*, 61 J. FIN. 1253, 1254, 1270 (2006).

way out of this chasm, Professor Mark Roe has called on the Securities and Exchange Commission ("SEC") to "use its exemptive power to carve out uncoerced votes on payment terms from section 316(b)."[10] His plea to the SEC stems from his belief that "no judicial interpretation can construct a stable, appropriate policy framework for the bond market because the [Act] unwisely disrupts sensible, out-of-court distressed company restructurings, as well as coercive ones."[11] Despite Professor Roe's lack of confidence in the judicial system, this Essay proposes a way forward.

The issues facing minority noteholders in out-of-court restructurings are similar to those of minority shareholders in controlling shareholder mergers. In both instances, there is a compelling need to protect the minority from abuse and disingenuous dealing. But, at the same time, there is a need for the court to ensure that holdout problems do not prevent a socially-valuable deal from emerging. In the context of controlling shareholder mergers, Delaware courts have constructed a standard to balance these competing concerns. The entire fairness standard of review places a burden on the controller to show that both the process and the price were fair.[12] That is, the controller must demonstrate that the outcome of its process was substantively fair. In effect, Delaware forces the controller to walk a tightrope to ensure that the minority is not hoodwinked, but if the controller successfully navigates this tightrope act, the minority's rights are considered vindicated.

This standard has been in place for at least thirty years and has been proven pliable enough for courts to employ.[13] Although the players involved in, and the process of, an out-of-bankruptcy restructuring are slightly different, the courts must navigate the same balance between competing concerns. Because the entire fairness standard has been a useful and administrable tool in the context of controlling shareholder mergers, this Essay proposes that courts follow Delaware's lead and adapt a modified version of the entire fairness standard to evaluate out-of-bankruptcy restructurings. To reach this conclusion, this Essay proceeds in three parts. First, this Essay briefly reviews the history of the Act, with a particular focus on its drafters' concern that the prohibitions embedded in the Act prevent the "[e]vasion of judicial scrutiny of the fairness of debt-

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10 Mark J. Roe, Commentary, *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, 362 (2016).

11 *Id.* at 361.

12 *See* Weinberger v. UOP, Inc., 457 A.2d 701, 711 (Del. 1983) (establishing that the entire fairness standard governs freezeout mergers and outlining "[t]he concept of fairness" as having "two basic aspects: fair dealing and fair price").

13 *See infra* Section III.A.

readjustment plans."[14] In search of an apt standard of judicial scrutiny, this Essay next considers the conceptual and economic concerns with out-of-bankruptcy restructurings and compares them to controlling shareholder mergers. Despite their modest differences, this Essay shows that both transactions present similar concerns. Finally, leveraging the work of Delaware's court system, this Essay briefly summarizes Delaware law as it relates to controlling shareholder mergers before recommending the adoption of the same standard for debt-readjustment plans. What emerges is a standard that courts and market participants are familiar with, and that is easily administered by courts.

I. A BRIEF HISTORY OF THE TRUST INDENTURE ACT OF 1939

Enacted in the wake of the Great Depression, the Trust Indenture Act was the brainchild of the then SEC chairman William O. Douglas.[15] Douglas and his contemporaries at the SEC worried that insiders or majority creditors would harm minority noteholders. Their solution was simple: require a judge to scrutinize restructuring transactions.[16] Douglas believed that the right to payment was absolute, and could be modified only by the noteholders' consent. This principle is embedded in one of Douglas's first decisions on the Court, *Case v. Los Angeles Lumber Products Co.*[17] In *L.A. Lumber*, Douglas held that each creditor must consent for a restructuring plan to be "fair and equitable."[18] Otherwise, the plan must fail.

Similar logic is ported into the Act: the payment terms or the maturity of the indenture cannot be impaired without the consent of the noteholder. The statutory language appears clear:

> [T]he right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be

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14 S. REP. NO. 75-1619, at 19 (1938); *see also Marblegate II*, 111 F. Supp. 3d 542, 546–54 (S.D.N.Y. 2015) (discussing the history of the Act), *vacated and remanded*, *Marblegate III*, 846 F.3d 1 (2d Cir. 2017).

15 *Marblegate II*, 111 F. Supp. 3d at 547 (noting that "[t]he primary author of the 1936 SEC Report was William O. Douglas"); Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 234 (1987) (calling Douglas "the principal architect of the [§ 316] prohibition" in the Act); *see also* 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, at III (1936).

16 Roe, *supra* note 15, at 234.

17 308 U.S. 106 (1939).

18 *Id.* at 114 ("All those interested in the estate are entitled to the court's protection.").

impaired or affected without the consent of such holder.[19]

But the statute's apparent clarity muddles the issues that arise and the context in which the Act was passed. For instance, what does it mean to impair or affect the right to receive payment? Does a mere technical impairment suffice or should courts construe the right broadly to encompass any activity a company engages in that may affect the ability to repay the debt?[20] And, of course, what is the limiting principle on the expansive interpretation? Surely, several management missteps led to the destruction of Lehman Brothers, but it seems ludicrous to think that noteholders would have a claim under the Act against Lehman (or its management) because it impaired their right to payment by mismanaging its liquidity, stockpiling overvalued mortgage backed securities, or any number of other missteps.

This dispute is at the heart of recent litigation concerning the Act. And, as the *Marblegate I* court noted, legislative history provides a way out of this dichotomy.[21] To illuminate this struggle, this Section first presents a brief history of the Act and highlights modern developments that may cut against a rigid interpretation of the Act. Most importantly, the Act's history and historical context surrounding its enactment demonstrate that Congress sought to require judicial scrutiny before a noteholder's rights were impaired. Next, this Section observes the confusion in the courts over what exactly § 316 of the Act means. Though only a handful of cases have grappled with the meaning of § 316 in the context of out-of-bankruptcy restructurings, the confusion stymies corporate restructurings outside of bankruptcy.

A. The History and Purpose of the Act

The history of the Act begins with a 1936 report by the SEC.[22] The SEC was studying "the work, activities, personnel, and functions of protective and reorganization committees," and naturally such a study included a report on the role of the indenture trustee within the reorganization process.[23] The report discusses the problem of contractual arrangements in bonds, which allow the majority to restructure the instrument without consent of the minority.[24] While noting the challenges

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19 15 U.S.C. § 77ppp(b) (2012).

20 *See Marblegate II*, 111 F. Supp. 3d at 546 (recognizing that the Act can be interpreted to cover a narrow or broad swath of corporate activity).

21 *Marblegate I*, 75 F. Supp. 3d 592, 613 (S.D.N.Y. 2014) ("[A] way out of this dichotomy is provided by the legislative history.").

22 *See Marblegate II*, 111 F. Supp. 3d at 547–48.

23 SEC. & EXCH. COMM'N, *supra* note 15, at III.

24 *See id.* at 143–44.

faced by a minority as a result of these contractual terms, the report acknowledges the "practical impossibility" of obtaining 100 percent of the investors to effectuate a restructuring.[25] "Acknowledging these competing concerns, the SEC deferred to a future report a full analysis and recommendations . . . ."[26] But it is unknown if that report was ever issued.[27]

The 1936 report led to the introduction of the Trust Indenture Act in 1937.[28] While the precise language of the Act, and § 316 specifically, morphed over time, the concerns of the SEC and Congress remained the same.[29] Throughout the revision process, from 1937 to 1939, the purpose behind § 316 endured: to ensure that restructurings were subject to judicial scrutiny.[30] Both the Senate and House reports accompanying the Act noted that the general goal of § 316 was to prevent the "[e]vasion of judicial scrutiny of the fairness of the debt-readjustment plans."[31] Moreover, Douglas testified to Congress that § 316 prohibited a majority from changing terms related to principal and interest payments, but did *not* "prohibit any other restriction."[32] Douglas echoed the language of the Senate and House committee reports, noting that "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by [§ 316]."[33] Specific terms could not be changed, but an out-of-bankruptcy restructuring was still possible, subject to judicial scrutiny.

The historical context in which the Act was passed further supports this interpretation of § 316. At the time of the Act's enactment, companies could restructure through bankruptcy or equity.[34] In equity, creditors would conduct a foreclosure-based reorganization whereby the secured creditors foreclosed on the assets of the company and sold them, effectuating a restructuring through this process.[35] In most states, these foreclosure-based

25 *Id.* at 145.

26 *Marblegate II*, 111 F. Supp. 3d at 548 (citing SEC. & EXCH. COMM'N, *supra* note 15, at 150).

27 *See id.*

28 *See id.* at 547.

29 *See id.* at 552.

30 *See id.* at 547–54 (summarizing the Act's legislative history).

31 H.R. REP. NO. 76-1016, at 56 (1939); S. REP. NO. 75-1619, at 19 (1938).

32 *Marblegate II*, 111 F. Supp. 3d at 550 (quoting *Trust Indentures: Hearings on H.R. 10,292 Before the H. Subcomm. of the Comm. on Interstate & Foreign Commerce*, 75th Cong. 36 (1938) (statement of William O. Douglas, Comm'r, Sec. & Exch. Comm'n)).

33 *Id.* at 549 (quoting *Trust Indentures*, *supra* note 32, at 35 (statement of William O. Douglas)).

34 *See* Harald Halbhuber, *Debt Restructurings and the Trust Indenture Act*, 25 AM. BANKR. INST. L. REV. 1, 9 (2017).

35 *See id.* at 10.

reorganizations "required a judicial decree" to be effectuated.[36] Traditionally, a dissenting creditor would be paid the liquidation value in cash; however, the SEC observed that "[s]ome indentures were including provisions that permitted a majority of bondholders to force a dissenting minority to accept equity as consideration in a restructuring and effectively cut off" any potential claim the minority would have against the creditor, including "fraudulent conveyance claims."[37] Section 316 remedied this by mandating a right to seek judicial scrutiny—the Act did not mean to force companies to use bankruptcy as the only means of restructuring, but instead it merely afforded the minority the opportunity for judicial scrutiny if bankruptcy was not sought.[38] The 1933 and 1934 amendments to the Bankruptcy Act did make bankruptcy a more favorable course of action for most restructurings.[39] But even after the passage of the Bankruptcy Act, the SEC "assume[d] that reorganization through foreclosure was still available."[40]

Several commentators have noted that the Act may kill any hope of restructuring out of bankruptcy.[41] The Act's legislative history and historical context rebut that presumption. The 1978 amendments to the Bankruptcy Code abandoned Douglas's ideal, suggested by his opinion in *L.A. Lumber*, that each and every creditor had a fundamental right to payment, unless he consented.[42] Despite the legislative history, courts continue to differ on the breadth of the rights embedded in the Act. All that is clear from the history of the Act is that Congress wanted to ensure that out-of-bankruptcy restructurings were entitled to judicial scrutiny. In the context of bankruptcy, § 1126 of the Bankruptcy Code provides that, under the guidance of a bankruptcy judge, two-thirds of creditors are required to confirm a bankruptcy plan,[43] therefore allowing the expansive interpretation of the Act to be voided under the judicial scrutiny of a bankruptcy judge. However, the question of what level of judicial scrutiny is warranted by out-of-bankruptcy restructurings remains unanswered.

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36 *Id.*

37 *Id.* at 4.

38 *See id.* at 3.

39 *Id.* at 21–22.

40 *Id.* at 22.

41 *See, e.g.*, Jonathan C. Lipson, *Governance in the Breach: Controlling Creditor Opportunism*, 84 S. CAL. L. REV. 1035, 1054 (2011); Roe, *supra* note 15, at 234.

42 CORPORATE BANKRUPTCY: ECONOMIC AND LEGAL PERSPECTIVES 424–25 (Jagdeep S. Bhandari & Lawrence A. Weiss, eds., 1996).

43 11 U.S.C. § 1126(c)–(d) (2012). Note that, in the bankruptcy context, the classes of creditors do not need to be only creditors invested in the same note—the court may combine creditors with like claims into the same class. *See id.* § 1122. In out-of-bankruptcy restructurings, that is not the case.

B. Confusion in the Courts: Application of the Act

In interpreting the Act, courts have split over whether the Act "protects only the legal right to demand payment [or the] substantive right to receive it."[44] As mentioned above, this line of inquiry has key limits. Any misguided act of the debtor inherently impairs the substantive right to payment. However, the mere maintenance of a legal right permits restructuring in all but name only—a nefarious majority could strip away any means of repayment while still providing the minority with a *legal right* to repayment.

A handful of courts define the Act's limits in terms of *legal* rights—that is, the right to sue for enforcement without concern for whether the debtor is judgment proof. For instance, in *In re Board of Directors of Multicanal S.A.*,[45] the court noted that the Act protects investors "against impairment through the mechanism of a collective action clause."[46] Further, the court held that a "foreign insolvency proceeding[]" can impair the rights of noteholders.[47] While the court in *Multicanal* did not explicitly make this point, the court found that the Act's requirements are lifted when a restructuring is subject to judicial scrutiny.[48] The court acknowledged that § 316 "expressly prohibits use of an indenture that permits modification by majority security holder vote of any core term of the indenture,"[49] but it further noted that because the Act prohibits only majority or collective action clauses, it "does not create rights against impairment of contractual obligations."[50] In line with the legislative history, the Act prevents restructurings from escaping judicial scrutiny. In this case, although judicial scrutiny was provided by proceedings under Argentinian law,[51] the restructuring was nonetheless subjected to scrutiny.

Multicanal is an outlier in terms of the depth of analysis conducted on the Act. Most courts that have limited the Act's reach to legal rights have done so by briskly stating that § 316 "applies to the holder's *legal* rights and not the holder's *practical* rights to the principal and interest itself."[52]

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44 *Marblegate II*, 111 F. Supp. 3d 542, 546 (S.D.N.Y. 2015).

45 307 B.R. 384 (Bankr. S.D.N.Y. 2004).

46 *Id.* at 389. Collective action clauses "permit [the issuer] to amend the terms of the bonds and to bind dissenting bondholders if a sufficient number of bondholders . . . agree." NML Capital, Ltd. v. Republic of Argentina, 699 F.3d 246, 253 (2d Cir. 2012).

47 *See Multicanal*, 307 B.R. at 393.

48 *See id.* at 391.

49 *Id.* at 389 (quoting UPIC & Co. v. Kinder-Care Learning Ctrs., Inc., 793 F. Supp. 448, 452 (S.D.N.Y. 1992)).

50 *Id.*

51 *See id.* at 386.

52 *See, e.g.*, *In re* Nw. Corp., 313 B.R. 595, 600 (Bankr. D. Del. 2004).

This is correct as far as it goes—the Act is concerned about a legal right to have a restructuring subjected to judicial scrutiny absent unanimous consent. Such courts have limited their analysis to asking if there is a legal right to enter court, but are not concerned with substantive rights to repayment. Essentially, these courts ensure the creditor's right to enter court but do not prohibit the majority from stripping away the creditor's remedy. But the Act was intended to provide each investor with a right to sue to ensure that out-of-bankruptcy restructurings are subjected to judicial scrutiny; without subjecting the restructuring to judicial scrutiny, these courts fail to substantiate that legal right. A right without a remedy is worthless.

Countering this narrow interpretation, other courts have read the Act expansively. *Federated Strategic Income Fund v. Mechala Group Jamaica Ltd.*[53] dealt with a complex restructuring whereby the debtor tendered for certain notes and once a requisite number of holders tendered certain valuable guarantees would be released.[54] A nonconsenting debtor brought suit under the Act, and the court validated his claim. Summarizing the restructuring, the court stated, "defendant's elimination of the guarantors and the simultaneous disposition of all meaningful assets . . . will effectively eliminate plaintiffs' ability to recover and will remove a holder's 'safety net' of a guarantor."[55] The court was swift in concluding that plaintiffs "made a sufficient showing that the offer and proposed amendments would constitute an impairment of the right to sue for payment" and thus violate the Act: "It is beyond peradventure that when a company takes steps to preclude any recovery by noteholders for payment of principal coupled with the elimination of the guarantors for its debt, that such action does not constitute an 'impairment' or 'affect' the right to sue for payment."[56]

Other courts have similarly interpreted the Act expansively whereby a restructuring that is valid under the indenture is held to violate the Act.[57] The *Marblegate II* court noted that "[t]he restructuring . . . did not directly amend any term explicitly governing any individual bondholder's right to receive payment."[58] But the court nonetheless found the out-of-bankruptcy restructuring violated the Act because "the restructuring gave dissenting

53 No. 95 CIV 10517 HB, 1999 WL 993648 (S.D.N.Y. Nov. 2, 1999).

54 *Id.* at *1–2.

55 *Id.* at *7.

56 *Id.*

57 *See, e.g.*, BOKF, N.A. v. Caesars Entm't Corp., 144 F. Supp. 3d 459, 470 (S.D.N.Y. 2015).

58 *Marblegate II*, 111 F. Supp. 3d. 542, 556 (S.D.N.Y. 2015), *vacated and remanded*, *Marblegate III*, 846 F.3d 1 (2d Cir. 2017).

bondholders a Hobson's choice" that practically eliminated the dissenting bondholders' ability to receive payment.[59]

Unlike the courts construing the Act as only a legal right, the expansive interpretation adopted by many courts goes too far. The Act does *not* protect against impairment, but impairment must be predicated on judicial scrutiny. Surprisingly, the *Marblegate II* court explicitly notes that "[i]n arriving at its decision, [it did] not opine on the wisdom or fairness" of the proposed restructuring.[60] Ironically, this is what the Act requires: a legal right granted to every individual noteholder that ensures out-of-bankruptcy restructurings will receive judicial scrutiny. Next, this Essay turns to the mechanisms by which judicial scrutiny can be assured through the existing legal rights of the Act.

C. *Out of Bankruptcy Judicial Scrutiny of Restructuring Plans*

Some have argued that, outside of bankruptcy, § 316 imposes a unanimity rule on any out-of-bankruptcy restructurings.[61] Moreover, hints of such a heavy burden are sprinkled in the legislative history of the Act.[62] However, in passing the Act, Congress sought to close a loophole that allowed a majority of debtors to force a minority to accept a restructuring *and* eliminate the minority's rights (especially their independent right to sue) under the indenture.[63] More importantly, Congress sought to subject out-of-bankruptcy restructurings to judicial scrutiny. To ensure that any out-of-bankruptcy restructuring received judicial scrutiny, however, Congress provided a belt-and-suspenders approach.

Crucially, § 316 specifically protects minority investors from forfeiting their rights to sue for enforcement under the Act.[64] As demonstrated by

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[59] *Id.*

[60] *Id.* In 2017, the Second Circuit vacated the district court opinion. *See Marblegate III*, 846 F.3d at 2. The Second Circuit determined that the restructuring at issue in *Marblegate* did not violate the Act. After reviewing the text and legislative history, the court determined "that Congress sought to prohibit formal modifications to indentures without the consent of all bondholders, but did not intend to go further by banning other well-known forms of reorganization like foreclosures." *Id.* at 13–14. However, as argued in this Essay, the Second Circuit's holding quickly passes over a key piece of recurring legislative history—that the Act was meant to ensure the judicial scrutiny of debt-readjustment plans. The Second Circuit holds that indenture terms must be modified to violate the Act, but such a reading undermines the spirit of the Act. And, as the dissent noted, the majority read out of the text of the statute key words, such as "impair" and "affect" to the point that the text of the statute is no longer given its more natural reading. *Id.* at 18–20 (Straub, J., dissenting).

[61] *See* Roe, *supra* note 15, at 234.

[62] *See, e.g.*, *Marblegate II*, 111 F. Supp. 3d at 551 (quoting Edmund Burke, a drafter of the Act, as saying that "the [Act] will . . . force issuers into bankruptcy").

[63] Halbhuber, *supra* note 34, at 4.

[64] 15 U.S.C. § 77ppp(b) (2012) ("[T]he right of any holder of any indenture security

Marblegate II, minority creditors can protect themselves by bringing suit under the Act—a right that, because of the Act, cannot be taken away by a majority-favored out-of-bankruptcy restructuring. However, in the event that minority investors are asleep at the wheel, the indenture trustee can seek judicial scrutiny for out-of-bankruptcy restructurings that violate the Act. Because a nonconsenting minority cannot be forced to relinquish title to the indenture, the company will technically default on the indenture the next time interest is due, allowing the trustee to bring suit.[65] The Act also prohibits relieving the trustee from liability for acts of negligence.[66] As such, when an individual investor does not bring suit, the trustee has an incentive to bring a claim under the Act.

Therefore, unless all investors consent to the out-of-bankruptcy restructuring, in which case no noteholders of the original indenture remain, either a member of the minority or the trustee can bring suit and subject the out-of-bankruptcy restructuring to judicial scrutiny. The question is, what type of judicial scrutiny should accompany such suits? The remainder of this Essay attempts to provide courts with a clear path forward.

II. DEBT-READJUSTMENT PLANS AND CONTROLLING SHAREHOLDER MERGERS

Impairment of the payment obligations of an indenture cannot proceed without judicial scrutiny—that is clear from the history of the Act. While most observers believe that judicial scrutiny must take place within bankruptcy,[67] the Act is not clear. Bankruptcy is costly, and debtors attempting to circumvent the expense of bankruptcy may turn to out-of-bankruptcy restructurings.[68] Most assume that the Act, while not preventing

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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.").

65 15 U.S.C. § 77qqq(a)(1) provides:

> The indenture trustee shall be authorized . . . in the case of a default in payment of the principal of any indenture security, when and as the same shall become due and payable, or in the case of a default in payment of the interest on any such security, when and as the same shall become due and payable and the continuance of such default for such period as may be prescribed in such indenture, to recover judgment, in its own name and as trustee of an express trust, against the obligor upon the indenture securities for the whole amount of such principal and interest remaining unpaid.

See also BOKF, N.A. v. Caesars Entm't Corp., 144 F. Supp. 3d 459, 462 (S.D.N.Y. 2015).

66 15 U.S.C. § 77ooo(d); *see also* YRC Worldwide Inc. v. Deutsche Bank Tr. Co., No. 10-2106-JWL, 2010 WL 2680336, at *4 (D. Kan. July 1, 2010).

67 *See* Harold B. Groendyke, Note, *A Renewed Need for Collective Action: The Trust Indenture Act of 1939 and Out-of-Court Restructurings*, 94 TEX. L. REV. 1239, 1243 (2016).

68 *See id.* at 1240 (noting that out-of-bankruptcy "workouts provide a relatively quick

out-of-bankruptcy restructurings, creates a severe holdout problem—any minority debtholder can prevent a restructuring because its right to payment cannot be impaired without its consent under § 316 of the Act.[69] However, as the history shows, a right to payment can be impaired if subject to judicial scrutiny. The Act was not meant to prevent out-of-bankruptcy restructurings, but merely to provide the minority creditors with a right to ask the court to review the transaction.

Removing the holdout problem that most commentators focus on, the key concern (and the key concern of Congress) is the ability of a majority of bondholders to take advantage of the minority.[70] The same issue, of course, exists in other corporate transactions—most notably, controlling shareholder mergers whereby the majority shareholder purchases the entire firm.[71] In such mergers, the controller's ability to dictate the terms could harm the minority investors. Courts take a holistic approach to evaluating the majority's actions under the entire fairness standard of review. This Section sketches the economics of out-of-court bankruptcy and controlling shareholder mergers. Through looking at the economics of the two transactions, it becomes clear that the economic structures of each are similar. As such, the courts' solution to the potential abuse in the controlling shareholder merger scenario can, and should, be ported into the evaluation of out-of-court restructurings under the Act.

A. The Economic Structure of Debt-Readjustment Plans

While most academics have assumed that each bondholder must accept an out-of-bankruptcy restructuring to be valid, the history of the Act cuts against this. If the restructuring is subject to judicial scrutiny, then the Act's requirements are satisfied. Additionally, most commentators have noted that the existence of the Act creates a holdout problem,[72] which occurs when those who do not consent "hold out" to extract all gains that, in an arms-length negotiation, should be divided between the two parties. Essentially, a holdout problem exists when the legal structure creates a situation whereby an individual gains more from not agreeing than he or she would from agreeing, even if, in the aggregate, the gains from agreeing would be greater for everyone.[73] This problem is created by the traditional view that the Act requires all noteholders to consent; however, the problem that Congress attempted to remedy by passing the Act was not the holdout

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and inexpensive solution" to a company's debt-overhang problem).

69 *See id.* at 1260.

70 *Id.* at 1242.

71 *See id.* at 1240.

72 *See, e.g.*, Roe, *supra* note 10, at 363–65.

73 *See id.* at 364–65.

problem. Rather, Congress required subjecting debt-restructuring plans to judicial scrutiny because of another problem: the ability for the majority to coerce a transaction at the expense of the minority.[74] It is to that problem that this Essay now turns.

Prior to the passage of the Act, insiders or sophisticated lenders restructured debt in ways that were favorable to them. For example, in *Allan v. Moline Plow Co.*,[75] a majority forced a restructuring on minority noteholders. The noteholders could sue for default only if the indenture trustee refused to sue after twenty-five percent of noteholders had petitioned it to sue.[76] Because over ninety percent of noteholders consented to the issuance, the minority holder had no legal remedy to prevent the restructuring—the nonconsenting noteholder was either forced to accept the restructuring or lose the ability to collect on the notes.[77]

The *Allan* case is indicative of what the Act was attempting to remedy. Without the Act's protections, minority shareholders could face a coercive prisoner's dilemma. For instance, the creditor could propose a restructuring by which consenting noteholders receive new notes, with a stronger security package and a face value of seventy-five percent of the current value of their notes. Nonconsenting noteholders will be left with their original notes, but no security package. In essence, then, they will be left with nothing. However, the company will need a majority of the noteholders to agree to the restructuring in order for the existing noteholders security package to become worthless. If noteholders could collude, they would not consent; however, fearing others will defect and consent to the restructuring, they will all consent even though refusing to do so would be in their best interest. This same prisoner's dilemma could be played out with a majority noteholder pushing an adverse restructuring to benefit its other positions (for example, debt that is senior to the noteholders' debt).[78] Regardless, in the absence of protection, minority

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[74] *See supra* Section I.A.

[75] 14 F.2d 912 (8th Cir. 1926).

[76] *Id.* at 913.

[77] *Id.* at 914, 917. This case is used as an example in the SEC's 1936 report. *See* SEC. & EXCH. COMM'N, *supra* note 15, at 62.

[78] In fact, a controlling noteholder's proposal may be more coercive. If a plurality noteholder controlled forty percent, then the ability to defect and not consent is riskier because, to complete the restructuring, only another ten percent of noteholders need to consent. Moreover, there would be no dilemma if the controlling noteholder held more than fifty percent of the notes—the only individuals who would not consent would be those who did not know a controller existed. Of course, if the controller acquired a position without notice, this could be very destructive—noteholders may attempt to collude and reject the position only to give the controller a more valuable stake. Regardless of the scenario, the structure sketched above presents ample opportunities for sharp dealings and advantage

noteholders can be coerced into accepting a restructuring by virtue of the fact that the alternative (being wiped out) is worse.

A proposed debt-readjustment plan can be modeled using the prisoner's dilemma. Assume two noteholders, Noteholder 1 and Noteholder 2, each hold a note that has a face value of $100. The debtor is in distress, and the note is currently worth $80. An out-of-bankruptcy restructuring is proposed that would lower the interest rate and extend the maturity of the debt. If all noteholders consent, they will have a restructured note worth $80. If a noteholder does not consent, he will be left with a note that, effectively, has no value. In contrast, the noteholder that did consent has a note worth $90 because the value that would have gone to the nonconsenting noteholder goes to all the other noteholders.

Figure 1 presents this hypothetical scenario in a game theoretical manner. Regardless of the strategy or choice of Noteholder 1, Noteholder 2 should *always* consent, and vice versa.[79]

Figure 1. Debt Readjustment Plans as a Prisoner's Dilemma

		Noteholder 1	
		Consent	**No Consent**
Noteholder 2	**Consent**	$80 $80	$0 $90
	No Consent	$90 $0	$80 $80

This game holds in the absence of a controlling majority because the creditor can act as a controller in these circumstances. In fact, the creditor is best positioned and most similar to the classic case of a controlling shareholder—the creditor is more informed and has the option of bankruptcy at its disposal. As such, it can propose, without the presence of a controlling majority, a coercive out-of-bankruptcy restructuring whereby

taking.

79 Both this game theoretical analysis and the analysis below are incomplete. As others have pointed out, the ability to purchase votes (through purchasing the instruments at issue) or having economic interests without votes (in the context of derivative ownership) may change the number of equilibria present in the game. For the purposes of this Essay, this discussion contemplates a binary one-shot game, which mirrors how courts have discussed these situations despite their rich theoretical and practical complexity. *See generally* Jordan M. Barry et al., *On Derivatives Markets and Social Welfare: A Theory of Empty Voting and Hidden Ownership*, 99 Va. L. Rev. 1103 (2013); Alessandra Casella et al., *Competitive Equilibrium in Markets for Votes*, 120 J. Pol. Econ. 593 (2012).

noteholders will find it in their best interest, quite unfortunately, to *always* consent.

The Act attempts to solve this problem—it is easy for a noteholder to not consent because their right to payment cannot be impaired. Of course, as others have pointed out, this creates significant holdout problems.[80] In a fair and equitable restructuring proposal, a petulant noteholder can always insist on more and, under a broad interpretation of the Act, the noteholder is free to do so (and force the debtor into bankruptcy). However, the holdout problem is predicated on an expansive reading of the Act untethered to its historic roots.[81] The right against impairment is *not* absolute; rather, the impairment can proceed subject to judicial scrutiny. Courts must draw lines to determine what an impairment is. The historical record indicates that Congress was not worried about impairment per se but instead worried about the coercive prisoner's dilemma described above. A noncoercive, fair, and equitable restructuring, subject to judicial scrutiny, should suffice to allow impairment. What level of judicial scrutiny courts should adopt when asked to assess the validity of a Trust Indenture Act claim remains unclear. The same type of economic issues are at play in controlling shareholder freezeouts.

B. The Economic Structure of Controlling Shareholder Freezeouts

Under Delaware law, consummating a merger requires the consent of the board and the approval of a majority of shareholders.[82] When a controlling shareholder owns the majority of the shares, the controller can force a sale by control of the board or through a tender offer. Through control of the process, a controller can force a transaction—the minority can be forced to sell or tender their shares. There are controls in place because "non-controlling shareholders will not automatically participate in any value increase as a result of the freeze-out."[83] Delaware courts subject these transactions to entire fairness because "in a merger between the corporation and its controlling stockholder—even one negotiated by disinterested, independent directors—no court could be certain whether the transaction terms fully approximate what truly independent parties would have achieved in an arm's length negotiation."[84]

When a controlling shareholder offers to purchase the company in a

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80 *See supra* notes 72–73 and accompanying text.

81 *See supra* Section I.A.

82 DEL. CODE ANN. tit. 8, § 251(a)–(c) (2011).

83 Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Controlling Shareholders*, 152 U. PA. L. REV. 785, 804 (2003).

84 Citron v. E.I. Du Pont de Nemours & Co., 584 A.2d 490, 502 (Del. Ch. 1990).

tender offer, a prisoner's dilemma-like situation, similar to the one presented above in the context of out-of-bankruptcy restructurings, exists.[85] A controlling shareholder may offer less than adequate consideration for the minority's shares. While the slim consideration may warrant not tendering,

> a non-tendering shareholder individually faces an uncertain fate. That stockholder could be one of the few who holds out, leaving herself in an even more thinly traded stock with little hope of liquidity and subject to a § 253 merger at a lower price or at the same price but at a later (and, given the time value of money, a less valuable) time.[86]

Tender offers do not represent true prisoner's dilemmas. For example, imagine that a controlling shareholder proposes a tender offer for the minority's shares at a price that is $5 less than what the shareholder believes the long-run value of the company is.[87] However, if you do not tender, you will be left with a highly illiquid minority claim that will be valued at $10 less than the long-run value of the company. Figure 2 shows that, if a shareholder knows that others plan to not tender, then that shareholder will not tender. This game has two Nash equilibria[88] (both shareholders tender or both shareholders do not tender), but tendering may be the more likely outcome because of high coordination costs and investor risk aversion.[89]

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85 *See In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 441–42 (Del. Ch. 2002) ("[S]ome view tender offers as creating a prisoner's dilemma—distorting choice and creating incentives for stockholders to tender into offers that they believe are inadequate in order to avoid a worse fate.").

86 *Id.* at 442.

87 A nonconsenting holder *always* has the appraisal remedy—that is, a nonconsenting holder can ask the court to appraise the shares and the acquirer will pay the value appraised by the court. DEL. CODE ANN. tit. 8, § 262 (2011). Despite this method, the appraisal remedy is imprecise and relies on courts accurately valuing the shares, a task at which they are not especially adept. *See* Anthony J. Casey & Julia Simon-Kerr, *A Simple Theory of Complex Valuation*, 113 MICH. L. REV. 1175, 1177 (2015) ("[I]t has become routine for courts to eschew expertise and valuations grounded in research and mathematical models in favor of the middle ground.").

88 "A set of strategies is a Nash equilibrium if no player has an incentive to deviate from her strategy given that the other players do not deviate." Ian Ayres, *Playing Games with the Law*, 42 STAN. L. REV. 1291, 1297 (1990).

89 If the investor were risk-neutral and knew that there was a fifty percent chance the other investor would either tender or not tender, then the investor would prefer to not tender because the expected value of a no-tender strategy is equal to a tender strategy. However, if the investor is at all risk-averse, then tendering becomes the favored strategy.

Figure 2. Controlling Shareholder Tender Offer Nash Equilibrium

		Shareholder 1	
		Tender	**No Tender**
Shareholder 2	**Tender**	-\$5 -\$5	-\$10 -\$5
	No Tender	-\$5 -\$10	\$0 \$0

While tender offers do not represent a true prisoner's dilemma, the same concerns that were present in the out-of-bankruptcy restructuring scenario exist here. Moreover, when discussing tenders, Delaware courts have suggested that they may represent a prisoner's dilemma, suggesting that the coordination costs and risk aversion concerns likely make the No Tender/No Tender scenario unlikely.[90] Further, in practice, over eighty percent of tender offers are successful.[91] These forces suggest that, in fact, a tender offer presents the same opportunity for coercion that an out-of-bankruptcy restructuring does.

C. *The Likeness of Debt-Readjustment Plans and Freezeouts*

The notable difference between out-of-bankruptcy restructurings and controlling shareholder mergers belies their similarities. In both scenarios, a dominant force can coerce a dispersed group to consent to an unattractive transaction by dint of their power. A prisoner's dilemma-like scenario exists in both, and thinking about minority protections is key to allowing investors to invest knowing these situations may emerge.[92] Of course, legal rules to protect investors will inherently be overinclusive and underinclusive.[93] And, where sophisticated controllers are involved, any legal rules will merely provide controllers with the tools for coercive

90 *See In re Pure Res.*, 808 A.2d at 441–42.

91 DONALD M. DEPAMPHILIS, MERGERS, ACQUISITIONS, AND OTHER RESTRUCTURING ACTIVITIES: AN INTEGRATED APPROACH TO PROCESS, TOOLS, CASES, AND SOLUTIONS 102 n.44 (8th ed. 2015).

92 When initially investing, in either equity or debt, a minority investor does not know, ex ante, if a controller will emerge—a former minority shareholder through transactions on the market can become a controller. If an investor was not protected from these coercive transactions, the return required by investors would be higher to compensate investors for this risk.

93 *See* Louis Kaplow, *Rules versus Standards: An Economic Analysis*, 42 Duke L.J. 557, 586 (1992) (noting the predominant view that "rules tend to be over- and underinclusive relative to standards").

action.[94] Alternatively, the legal rule will be so overinclusive that it will deter many socially valuable deals.[95]

More importantly, absent a protective legal scheme, both scenarios otherwise present prisoner's dilemma-like scenarios: the minority will consent to the out-of-bankruptcy restructuring or the merger because it will be in its best interest to do so. Of course, there are notable differences between the two. The out-of-bankruptcy restructuring presents a true prisoner's dilemma while the tender offer does not (though the coercive scenario is the likely Nash equilibrium). But a majority equityholder tendering for shares may have more power to effect a restructuring than majority noteholders. Majority equityholders likely control the board, whereas a majority noteholder may still need to work with the corporation to effectuate a restructuring. So while there is a true prisoner's dilemma in the out-of-bankruptcy restructuring, the increased power to effectuate a coercive transaction in the tender offer makes tendering the predominant outcome.

Ultimately, both scenarios present the same unique concern: coercive transactions that harm minority investors. Protecting these minority investors via a rule will inherently be overinclusive and underinclusive. For controlling shareholder mergers, Delaware has created a standard—entire fairness review—to protect minorities from a potentially coercive transaction. The next Section reviews the application of that standard before applying the entire fairness standard to out-of-bankruptcy restructurings.

III. THE ENTIRE FAIRNESS STANDARD OF REVIEW IN THE TRUST INDENTURE ACT

Despite their differences, the economic structure and incentives at play in debt-readjustment plans and controlling shareholder mergers are strikingly similar. Most importantly, both provide opportunities for majorities to extract all value for themselves, at the expense of the minority. These types of situations raise obvious problems. They increase the cost of (or decrease the benefits from) dispersed ownership, encourage subterfuge in ownership structures, require inefficient monitoring by minority owners or holders, and raise the cost of capital. As such, when the majority "labors under actual conflicts of interest" Delaware subjects majority-controlled transactions to entire fairness—"Delaware's most onerous standard."[96]

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94 *See* Cass R. Sunstein, *Problem with Rules*, 83 CAL. L. REV. 953, 991–96 (1995).

95 *Cf.* Kaplow, *supra* note 93, at 591.

96 *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 44 (Del. Ch. 2013).

Over the last thirty years, the entire fairness standard has evolved, and exceptions to the standard have increased.[97] However, the standard remains a key tool for protecting minority shareholders against the threat of a coercive majority. Importantly, the standard does not rely on the subjective view of those involved in the transaction. "Rather, the transaction itself must be objectively fair, independent of the board's beliefs."[98] Moreover, it remains the standard by which controlling shareholder mergers are judged—"a [transaction] with a controlling stockholder [will] always be subject to the entire fairness standard."[99] In the context of tender offers, these transactions are viewed under the *Solomon* standard,[100] but this standard is modified to capture the essence of the entire fairness standard.[101] In essence, the entire fairness standard is used to review controlling shareholder mergers, and this Part proceeds with that essence in mind.

A. The Entire Fairness Standard and Its Application

At the heart of the entire fairness is the idea that "[a] fair process usually results in a fair price."[102] The test is flexible and recognizes "the reality that '[t]he value of a corporation is not a point on a line, but a range of reasonable values.'"[103] As such, the fairness or robustness of the process informs the court's determination of fair price. The Delaware Supreme Court articulated the entire fairness standard in *Weinberger v. UOP, Inc.*[104]:

> The concept of fairness has two basic aspects: fair dealing and

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97 *See, e.g.*, *In re* MFW S'holders Litig., 67 A.3d 496, 500, 534, 536 (Del. Ch. 2013) (holding that "a going private merger conditioned upfront by the controlling stockholder on approval by *both* a properly empowered, independent committee and an informed, uncoerced majority-of-the-minority vote" is subject to the business judgment rule, *not* the entire fairness standard).

98 *In re Trados*, 73 A.3d at 44 (quoting Gesoff v. IIC Indus., Inc., 902 A.2d 1130, 1145 (Del. Ch. 2006)).

99 *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 616 (Del. Ch. 2005) (citing Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1116–17 (Del. 1994)).

100 *See* Solomon v. Pathe Commc'ns Corp., 672 A.2d 35, 39 (Del. 1996) (describing a standard that "do[es] not impose any right of the shareholders to receive a particular price" in an uncoercive tender offer).

101 *See In re* Pure Res., Inc., S'holders Litig., 808 A.2d 421, 424 (Del. Ch. 2002) (noting that a controlling shareholder tender offer "is subject, as a general matter, to the *Solomon* standards," but noting the concerns that resulted in the use of the entire fairness standard "should be accommodated within the *Solomon* form of review").

102 Am.'s Mining Corp. v. Theriault, 51 A.3d 1213, 1244 (Del. 2012).

103 *In re* Orchard Enters., Inc. Stockholder Litig., 88 A.3d 1, 30 (Del. Ch. 2014) (quoting Cede & Co. v. Technicolor, Inc., No. Civ. A. 7129, 2003 WL 23700218, at *2 (Del. Ch. Dec. 31, 2003), *aff'd in part, rev'd in part on other grounds*, 884 A.2d 26 (Del. 2005)).

104 457 A.2d 701 (Del. 1983).

> fair price. The former embraces questions of when the transaction was timed, how it was initiated, structured, negotiated, disclosed to the directors, and how the approvals of the directors and the stockholders were obtained. The latter aspect of fairness relates to the economic and financial considerations of the proposed merger, including all relevant factors: assets, market value, earnings, future prospects, and any other elements that affect the intrinsic or inherent value of a company's stock. However, the test for fairness is not a bifurcated one as between fair dealing and price. All aspects of the issue must be examined as a whole since the question is one of entire fairness. However, in a non-fraudulent transaction we recognize that price may be the preponderant consideration outweighing other features of the merger.[105]

Basically, entire fairness aims to approximate what "a reasonable seller, under all of the circumstances, would regard as within the range of fair value; one that such a seller could reasonably accept."[106]

The holistic process described by *Weinberger* has been modified over time by the Delaware courts. Certain procedural structures shift the burden of proof to the plaintiff, and some onerous processes result in Delaware applying the favorable business judgment rule.[107] Delaware's common law has worked through these permutations over the last thirty-five years to provide increasing clarity to the market about what procedures are presumptively fair. The clarity provided by these permutations have caused entire fairness to go from a standard to a quasi rule—the courts have given shareholders enough guidance about the process necessary to be presumptively valid such that few cases end up being reviewed under entire fairness. This same clarifying process could also work in applying the doctrine of entire fairness to out-of-court restructurings. However, because of the differences between controlling shareholder mergers and out-of-bankruptcy restructurings, it is not necessary to document the particulars here. Rather, the focus is on how the Delaware courts generally employ entire fairness.

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105 *Id.* at 711 (citation omitted).

106 Cinerama, Inc. v. Technicolor, Inc., 663 A.2d 1134, 1143 (Del. Ch. 1994).

107 *See* Kahn v. M&F Worldwide Corp., 88 A.3d 635, 644 (Del. 2014) ("[B]usiness judgment is the standard of review that should govern mergers between a controlling stockholder and its corporate subsidiary, where the merger is conditioned *ab initio* upon both the approval of an independent, adequately-empowered Special Committee that fulfills its duty of care; and the uncoerced, informed vote of a majority of the minority stockholders."); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117–18 (Del. 1994) (holding that the burden of proving entire fairness shifts from the defendant to the plaintiff when an independent special committee with real bargaining power is convened to negotiate with the controller).

Although entire fairness review is not a bifurcated process, Delaware courts traditionally look to process first. A key consideration for the courts is how the process evolved, and the controller's level of control of the process. An independent committee with full power to reject a controller's proposal may be the gold standard—it provides the minority with clear protection.[108] While some of the minority may disagree with the outcome from the process, it helps support an inference that the process (which ultimately determines price) is fair. With regards to independence, information will also be key.[109] An independent committee can still be bamboozled if they are not fully informed. Providing them with full information and the tools to assess that information (such as a respectable banker and lawyer) aid the negotiation process and remove the perception of control. The transaction starts to look "fair."[110] Moreover, the controller could agree to give the entire minority a voice in the process by conditioning the merger on an affirmative vote of the majority of the minority. This reduces coercion (if they do not vote, a transaction will *not* be consummated) and puts the minority's stamp of approval on an independent and arm's-length transaction.[111] This process will not be perfect—and the price arrived at will never satisfy every minority shareholder—but the closer to an arm's-length transaction the process appears, the more likely Delaware courts are to deem the process fair.

Unlike process, there is no guide for what a fair price looks like. Fortunately, the courts do not preoccupy themselves with perfect accuracy when determining entire fairness. They are, however, focused on the reasonableness of the price—they ask whether the price that emerges fits within what would reasonably be expected from an arm's-length transaction.[112] However, process can inform (and help verify) price. Those

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108 *Lynch*, 638 A.2d at 1117–18 (noting that for an independent committee to have value, and effect a shift in the burden of proving entire fairness from the defendant to the plaintiff, the majority shareholders cannot control the process and the independent committee must have real bargaining power).

109 *See* Leo E. Strine, Jr., *Documenting the Deal: How Quality Control and Candor Can Improve Boardroom Decision-Making and Reduce the Litigation Target Zone*, 70 BUS. LAW. 679, 687 (2015) ("For the impartial directors to check managerial self-interest in such a debatable situation, they also need good information and advice.").

110 *See In re* S. Peru Copper Corp. S'holder Derivative Litig., 52 A.3d 761, 797–809 (Del. Ch. 2011) (noting that the Special Committee's advisors were affiliated with the controller and the committee was not independent because the analysis by the advisor did not provide the committee with thorough information and valuation of the transaction).

111 Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983) (acknowledging that when a controlling shareholder merger "has been approved by an informed vote of a majority of the minority shareholders" the burden of proving entire fairness shifts from the defendant to the plaintiff).

112 Kahn v. Tremont Corp., 694 A.2d 422, 431 (Del. 1997) ("The price element [of

negotiating are concerned about price, and their process can help inform the court about what was reasonable. For example, if the initial range of share prices was between $10 and $20, and through an independent process, the ultimate price ended up at $15, that may look fair (especially if the process was independent). On the contrary, if the price arrived at was $10.50, a court may be suspicious, especially if the process was less than perfect.

In many ways, process is more important than price when assessing entire fairness. It is easier to verify if the process was fair and independent, and Delaware courts rely on the process to generate a fair price. If the process was fair, more often than not, the price will be fair as well. This same dichotomy exists when negotiating out-of-bankruptcy restructurings. Ultimately, investors care about the price they receive, but valuing the notes (and, by proxy, the company) is difficult. As such, a fair and inclusive process will generally indicate that the consideration advanced in an out-of-bankruptcy restructuring is fair.

B. Modifying the Entire Fairness Standard for Application to the Act

Entire fairness is a flexible, equitable standard that provides courts with a framework to apply judicial scrutiny to transactions that often attract coercive behavior by controllers. While the global focus of entire fairness is ultimately a determination about process and price, process concerns can provide strong indicia that the entire transaction was fair.

Processes similar to those that bring a transaction closer to fairness in the controlling shareholder context are at play in out-of-bankruptcy restructurings. For example, in *Federated Strategic Income Fund*, after the distressed company, Mechala, sought strategic advice from an investment bank, an informal creditors committee was formed.[113] That committee "retained its own legal advisor . . . as well as its own financial advisor."[114] Through the committee's negotiation with the creditor, it was able to raise the amount offered to noteholders from thirty-five cents on the dollar to over forty-five cents on the dollar.[115] Of course, there was a dispute about valuation among creditors within the committee. Federated Strategic Income Fund "believe[d] that if the [forty-five cent] tender offer did not proceed, then further negotiations with Mechala may eventually yield a

entire fairness review] relates to the economic and financial considerations relied upon when valuing the proposed purchase including: assets, market values, future prospects, earnings, and other factors which effect the intrinsic value of the transaction.").

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

114 *Id.*

115 *Id.* at *1, 3.

higher and 'more realistic'" result.[116] These disagreements are expected, but the Fund's estimate that they could obtain a tender offer in the sixty to seventy-five cents on the dollar range was not based on a formal analysis; instead, it was "merely . . . 'a very subjective calculation in a forced situation.'"[117]

There were moderately coercive elements at play in *Federated Strategic Income Fund*. For instance, those who consented to the tender would be paid a two-million-dollar consent fee on a pro rata basis.[118] Moreover, those who did not consent to the tender offer were left with valueless notes. As part of the tender offer, the guarantees and assets that secured the notes were eliminated, which "effectively eliminate[d]" the nonconsenting noteholders' ability to recover.[119] Despite the relatively fair process, this coercive aspect of the transaction makes the out-of-bankruptcy restructuring entirely *un*fair. However, *Federated Strategic Income Fund* provides insight into what could make such an out-of-bankruptcy restructuring fair and pass muster under a modified entire fairness standard. If, for example, the same proposal was made to noteholders, but nonconsenting noteholders were also given the modified note (worth forty-five cents on the dollar), this transaction may approach entire fairness. Despite the modest incentive to tender (the two million dollars that each consenting noteholder gets pro rata for consenting), the process and price look entirely fair. It was a process in which an independent and contentious creditor committee negotiated with the creditor to its advantage (a twenty-eight percent increase in the value creditors received), and the consent of more than fifty percent of the creditors was required to effectuate the transaction.[120]

Because of the size of the creditors committee, the requisite number of consenting noteholders was obtained prior to launching the tender. Such an action may lead to accusations of coercive behavior, and rightfully so. However, the creditors committee could modify its behavior, and commit to tendering based on what the majority of the non-committee member creditors do. That is, if a majority of the minority creditors (those not on the creditors committee) vote to tender, then the majority will also tender; but if not, then no tender will take place. This creates a situation whereby

116 *Id.* at *5.

117 *Id.* (quoting Transcript of Oral Argument at 16, *Federated Strategic Income Fund*, No. 99 CIV 10517 HB).

118 *Id.* at *3. With seventy-seven percent of noteholders agreeing to a tender, this resulted in a 3.456 cent on the dollar payment to consenting noteholders. *Id.*

119 *Id.* at *7.

120 Consent of more than fifty percent of creditors was necessary because a majority was required to lift the guarantees and the security package per the indenture. *See id.* at *1.

the creditors committee can act independently to negotiate what it believes is a fair deal, but receives a check by independent creditors. If both agree that this is a fair deal, the restructuring looks entirely fair and should pass muster under the Act. Moreover, these types of tender offers are subject to federal disclosure laws, and minority investors should therefore be fully informed about the transaction if the requisite notice is provided.[121]

Similar to the emergence of presumptively fair processes under Delaware common law, as out-of-bankruptcy restructurings are subjected to judicial scrutiny, courts will wrestle with the appropriate process that should presumptively lead to a fair restructuring. The focus, similar to Delaware's focus in entire fairness cases, should be on independence in the negotiation process, the sophistication of the parties to the negotiation (and the sophistication of their advisors), the give-and-take in the negotiation, and the approval process as an independent check on the negotiation. The more independent the process is, the more likely a court should be to find that the out-of-court restructuring is valid. A clouded process may force the court to wade into price, but it should do so skeptically because of the imperfections in valuation process, even when judicially supervised.[122] Applying judicial scrutiny to out-of-bankruptcy restructurings, through the lens of entire fairness, ensures an independent process, which should proxy a fair price. Moreover, the bankruptcy bar supports this type of process—one that affords judicial scrutiny to the restructuring of a specific debt instrument.[123] Ultimately, this application fulfills Congress's purpose in passing the Act: that "[e]vasion of judicial scrutiny of the fairness of debt-readjustment plans is prevented by [§ 316]."[124]

CONCLUSION

In passing the Trust Indenture Act of 1939, Congress sought to protect minority noteholders by requiring judicial scrutiny prior to the impairment of their rights under the indenture. As recent cases show, the question of what level of judicial scrutiny debt-readjustment plans warrant remains unanswered. This Essay points to a solution in the entire fairness standard

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121 *See* 17 C.F.R. § 240.13e-4(b)–(c) (2016) (requiring the dissemination of information in the context of debt tender offers).

122 *See* Casey & Simon-Kerr, *supra* note 87, at 1178–80.

123 *See* NAT'L BANKR. CONF., PROPOSAL FOR A NEW CHAPTER FOR RESTRUCTURING BOND AND CREDIT AGREEMENT DEBT ch. 16 (2014), http://nbconf.org/wp-content/uploads/2015/07/Proposed-Amendments-to-Bankruptcy-Code-to-Facilitate-Restructuring-of-Bond-and-Credit-Agreement-Debt.pdf.

124 *Marblegate II*, 111 F. Supp. 3d 542, 550–51 (S.D.N.Y. 2015) (quoting *Trust Indentures: Hearings on H.R. 10,292 Before the H. Subcomm. of the Comm. on Interstate & Foreign Commerce*, 75th Cong. 36 (1938) (statement of William O. Douglas, Chairman, Sec. & Exch. Comm'n)), *vacated and remanded*, *Marblegate III*, 846 F.3d 1 (2d Cir. 2017).

adopted by Delaware courts to evaluate controlling shareholder mergers. Because of the economic similarities at issue in debt-readjustment plans and controlling shareholder mergers, the entire fairness standard is a readily adoptable and adaptable level of judicial scrutiny that is known to judges, lawyers, and the market. Its adoption to debt-readjustment plans that may run afoul of the Act provides participants with a readily available tool for policing these bargains. Entire fairness emerges as a clear standard by which courts can assess such restructurings. Adopting the entire fairness standard would produce socially optimal protection against coercive deals while allowing socially beneficial restructurings.