REVISITING GOOD FAITH AND FAIR DEALING CHALLENGES BY NON-PARTICIPATING HOLDERS TO INDENTURE AMENDMENTS EFFECTUATED THROUGH USE OF EXIT CONSENTS

By James H. Millar[*]

Introduction

Whether as part of out-of-court restructurings brought on by financial distress or more ordinary corporate-finance transactions, issuers of notes under an indenture often effectuate exchange offers to swap one series of debt for another or some other security. The exchange might provide debt that sits higher up the capital structure, offer better credit support, or furnish other benefits (including a cash component) to incentivize the noteholders to participate in the exchange. Other times, the company might induce voluntary participation in an exchange by describing the downside, such as a bankruptcy filing, if sufficient holders don't participate.

At times, the issuer will require that those holders that exchange their notes give their consent to an amendment to the existing indenture essentially the instant before they turn in their notes—the so-called "exit consent." An exit consent might amend the indenture to strip covenants—for example, covenants that require the issuer to satisfy certain financial metrics—diminishing the rights of those that continue to hold the old notes. Holders that might not otherwise want to exchange their notes into the new security or other such consideration might feel "coerced" because if they do not exchange, they will be left in a weaker position given the indenture amendments.

An interesting issue arises when a company requires exchanging noteholders to provide exit consents, but the company does not make the offer available to all holders. For

[*]James H. Millar is a partner in the Corporate Restructuring group of Drinker Biddle & Reath LLP, resident in the New York office.

example, assume an issuer engages in a private transaction whereby it repurchases 51% of its notes for cash from a group of favored holders. Relying on the amendment provision of the indenture (which in this hypothetical requires only a simple majority), the issuer uses exit consents from those holders to cause an amendment to the indenture that significantly diminishes the trading price of the notes that were not exchanged. Those favored holders that participated in the transaction likely received a premium-to-market price for their notes in the exchange, while those that did not have the opportunity to participate suffered the downside.

The question then becomes, if the indenture does not speak to whether or not those exit consents are valid—and many indentures do not provide one way or the other—is the transaction permissible? The case law is scant, as the only court to consider this issue is the Delaware Court of Chancery in *Katz v. Oak Industries*.[1] Relying on the implied covenant of good faith and fair dealing under New York law, that court stated (some would say in *dicta*) that exit consents in an exchange offer were permissible so long as every holder had the opportunity to participate to obtain the same financial benefit.[2] No other reported opinion has been found that addresses precisely this issue of exit consents in an exchange offer.

That said, some cases have considered the issue of whether an issuer could pay some of its holders to consent to an amendment, with the notable difference that those that consent would continue to hold notes under the as-amended indenture as opposed to participate in an exchange offer that provides them with a new security or cash. These cases likewise apply the New York implied covenant of good faith and fair dealing to unpack the parameters of whether and under what circumstances payments-for-consent are permissible.[3] These cases are instructive for the exit consent

[1] *Katz v. Oak Industries Inc.*, 508 A.2d 873 (Del. Ch. 1986).

[2] Katz, 508 A.2d at 881.

[3] See *Kass v. Eastern Air Lines, Inc.*, 12 Del. J. Corp. L. 1074, 1986 WL 13008 (Del. Ch. 1986); *Drage v. Santa Fe Pacific Corp.*, 1995 WL 396370 (Ohio Ct. App. 8th Dist. Cuyahoga County 1995); Pisik v. BCI Holdings Corp., Index No. 14593/87 (N.Y. Sup. Ct. June 21, 1987); *In re Loral Space and Communications Inc.*, 34 Del. J. Corp. L. 670, 2008 WL 4293781 (Del. Ch. 2008).

situation because they focus on the critical issue: unequal treatment of similarly situated noteholders.

This article provides a review of *Katz v. Oak Industries*[4] and its first cousin, *Kass v. Eastern Air Lines*,[5] both decided in 1986 by Chancellor Allen of the Delaware Court of Chancery. Since then, a few courts have discussed the payments-for-consent issue and some closely related topics. Through analyzing those cases, some views can be drawn concerning the limitations and vitality of a challenge to exit consents based on the legal theory set forth in *Katz v. Oak Industries*.

The Implied Covenant of Good Faith and Fair Dealing

New York law provides that all contracts contain an implied covenant of good faith and fair dealing that prohibits a party to a contract from doing anything to "destroy or injure the right of another party to receive the benefits of the contract."[6] The implied duty of good faith and fair dealing applies when a party to a contract acts in a way that is intended to deprive the other party of the fruits of the contract.[7] "To breach the implied covenant, the party must act in a way that is inconsistent with the justified expectations of the other party."[8]

While the case law is somewhat sparse, courts applying New York law have stated that to comply with the implied covenant of good faith and fair dealing, an issuer soliciting exit consents or otherwise paying for consent to an amendment must offer the transaction to **all** noteholders if those that reject the offer are to lose rights. Two Delaware Court of Chancery cases from 1986 make this point (yet hold that it

[4] See *Katz v. Oak Industries Inc.*, 508 A.2d 873 (Del. Ch. 1986).

[5] See *Kass v. Eastern Air Lines, Inc.*, 12 Del. J. Corp. L. 1074, 1986 WL 13008 (Del. Ch. 1986).

[6] See *Chase Manhattan Bank, N.A. v. Keystone Distributors Inc.*, 873 F. Supp. 808, 815 (S.D. N.Y. 1994).

[7] See *Dalton v. Educational Testing Service*, 87 N.Y.2d 384, 639 N.Y.S.2d 977, 663 N.E.2d 289, 291 (1995).

[8] See *Rus, Inc. v. Bay Industries, Inc.*, 322 F. Supp. 2d 302, 315 (S.D. N.Y. 2003).

doesn't apply to the facts at issue).[9] Other cases provide variations on the theme.[10]

The Delaware Cases — *Katz v. Oak Industries* and *Kass v. Eastern Airlines*

In *Katz v. Oak Industries*, Chancellor Allen of the Delaware Court of Chancery considered whether to enjoin an exchange offer and consent solicitation based on a claim of breach of the duty of good faith and fair dealing.[11] The company, Oak Industries, suffered from severe financial distress.[12] As part of its efforts at reorganization, Oak Industries entered into a stock purchase agreement whereby another company would buy stock of Oak Industries for cash.[13] As a condition to the purchaser's obligation, the agreement provided that 85% of the aggregate principal amount of Oak Industries' notes shall tender and accept an exchange offer that would reduce the debt overhang.[14]

The company thus extended certain exchange offers to each class of its notes.[15] As part of the offers, Oak Industries included the condition, in addition to a minimum tender requirement, that any holders that tender their notes consent to an amendment to the relevant indenture.[16] Those amendments would remove financial covenants and other protections that benefited the noteholders, thereby resulting in

---

[9] See *Katz v. Oak Industries Inc.*, 508 A.2d 873 (Del. Ch. 1986); *Kass v. Eastern Air Lines, Inc.*, 12 Del. J. Corp. L. 1074, 1986 WL 13008 (Del. Ch. 1986).

[10] See *Drage v. Santa Fe Pacific Corp.*, 1995 WL 396370 (Ohio Ct. App. 8th Dist. Cuyahoga County 1995); Pisik v. BCI Holdings Corp., Index No. 14593/87 (N.Y. Sup. Ct. June 21, 1987); *Whitebox Convertible Arbitrage Partners, L.P. v. World Airways, Inc.*, 2006 WL 358270 (N.D. Ga. 2006); *In re Loral Space and Communications Inc.*, 34 Del. J. Corp. L. 670, 2008 WL 4293781 (Del. Ch. 2008).

[11] See *Katz v. Oak Industries Inc.*, 508 A.2d 873 (Del. Ch. 1986).

[12] Oak Industries, 508 A.2d at 875.

[13] Oak Industries, 508 A.2d at 876.

[14] Oak Industries, 508 A.2d at 876.

[15] Oak Industries, 508 A.2d at 876.

[16] Oak Industries, 508 A.2d at 877.

adverse consequences for any holders that chose not to tender their notes.[17]

The plaintiff-noteholder complained that this presented a "rigged vote," whereby holders who exchanged—and thus had no interest going forward in the terms of the indenture—were required to vote to eliminate protective provisions for others who chose not to exchange.[18] The rational noteholder, argued the plaintiff, would be "forced" to tender its bonds, or else face holding a security with no financial covenants and no ready market.[19] The plaintiff contended that linking the offer with the exit consent constituted a breach of the duty of good faith and fair dealing.[20] It pointed to certain indenture provisions that allegedly were inconsistent with the structure of the transaction: (i) a provision that required a stated percentage of noteholders to consent to a modification of the indenture; and (ii) a provision that prevented the company from voting notes that it held.[21]

The court began by setting forth the relevant inquiry: "[I]s it clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter[?]"[22] The court then examined each of the provisions raised by plaintiffs to see if it could infer that, had the contracting parties actually negotiated on this point, they would have expressly agreed to prohibit linking the exit consent with the exchange of the notes.[23]

---

[17] Oak Industries, 508 A.2d at 877.

[18] Oak Industries, 508 A.2d at 878.

[19] Oak Industries, 508 A.2d at 878.

[20] Oak Industries, 508 A.2d at 878.

[21] Oak Industries, 508 A.2d at 880–82. The plaintiff also asserted that the transaction was, essentially, a redemption that violated the redemption provision that set a price whereby Oak Industries could force holders to submit their notes. The court rejected this argument. Katz, 508 A.2d at 880–82.

[22] Oak Industries, 508 A.2d at 880.

[23] Oak Industries, 508 A.2d at 880.

The court looked first at the provision requiring a majority vote to amend the indenture.[24] The court concluded that there was nothing in the indenture that prohibited offering inducement to vote "yes," at least where "the inducement is offered on the same terms to each holder of an affected security."[25] So long as everyone has the opportunity to obtain the financial benefit, finding that a payment for a "yes" vote violated the implied covenant of good faith and fair dealing would be "wholly inconsistent with the strictly commercial nature of the relationship."[26]

Next, the court considered the provision prohibiting Oak Industries from voting notes that it holds.[27] The purpose of that provision, the court found, was to prevent the company from voting as a bondholder for amendments that favored the company to the detriment of the noteholders.[28] The court reasoned:

> But the linking of the exchange offer and the consent solicitation does not involve the risk that bondholder interests will be affected by a vote involving anyone with a financial interest in the subject of the vote other than a bondholder's interest. That the consent is to be given concurrently with the transfer of the bond to the issuer does not in any sense create the kind of conflict of interest that the indenture's prohibition on voting treasury securities contemplates. Not only will the proposed consents be granted or withheld only by those with a financial interest to maximize the return on their investment in Oak's bonds, **but the incentive to consent is equally available to all members of each class of bondholders.** Thus the "vote" implied by the consent solicitation is not affected in any sense by those with a financial conflict of interest.[29]

Of critical importance, the court determined that the covenant of good faith and fair dealing underlying the indenture provisions at issue was not violated so long as the offer was made to all noteholders. The court focused on the underlying economics given that notes involve fundamentally a commercial transaction. Thus, the inquiry became effectively

---

[24] Oak Industries, 508 A.2d at 881.

[25] Oak Industries, 508 A.2d at 881.

[26] Oak Industries, 508 A.2d at 881.

[27] Oak Industries, 508 A.2d at 881.

[28] Oak Industries, 508 A.2d at 881.

[29] Oak Industries, 508 A.2d at 881.

whether every noteholder had the opportunity to make the investment decision to sell its right to consent to the proposed transaction. While the court did not issue the injunction, one is left with the strong impression that it might well have come out the other way if every holder did not have the opportunity to participate.

In *Kass v. Eastern Air Lines*, Chancellor Allen of the Delaware Court of Chancery several months later again had to consider the contours of the implied covenant of good faith and fair dealing in the context of indenture amendments.[30] In that case, Eastern sought to merge with a subsidiary of Texas Air Corporation through a transaction that contemplated payment of a dividend by the merged entity to its sole shareholder.[31] The indentures for the outstanding notes, however, prohibited payment of the proposed dividend.[32]

To get around this issue, the company sought to amend the indentures to relax the financial covenants that prohibited the dividend.[33] The company recognized that the proposed amendment would offer no benefit to the noteholders and thus they would have little incentive to agree to it.[34] Thus, to induce consents, Eastern offered to pay a fee (in either cash or airline tickets) to those holders that agreed.[35]

Certain noteholders sought a temporary restraining order, claiming that the fee must be paid to all the noteholders no matter how they voted on the amendment.[36] They argued that the fee-for-consent offer offended certain basic, if unstated, understandings of the amendment provisions of the indenture.[37] While the amendment provisions required a two-thirds vote to amend the indenture, the plaintiffs asserted that it could not have been contemplated that the issuer could

---

[30] See *Kass v. Eastern Air Lines, Inc.*, 12 Del. J. Corp. L. 1074, 1986 WL 13008 (Del. Ch. 1986).

[31] Eastern Air Lines, 1986 WL 13008 at *1.

[32] Eastern Air Lines, 1986 WL 13008 at *1.

[33] Eastern Air Lines, 1986 WL 13008 at *1.

[34] Eastern Air Lines, 1986 WL 13008 at *1.

[35] Eastern Air Lines, 1986 WL 13008 at *1.

[36] Eastern Air Lines, 1986 WL 13008 at *1–*2.

[37] Eastern Air Lines, 1986 WL 13008 at *5.

pay a fee to those that agreed to consent to an amendment but not those that declined to consent.[38]

The court initially noted that the case was difficult to evaluate without a developed factual record (which was not available at the TRO stage).[39] That said, the court stated that the plaintiff could obtain a TRO—even without a developed factual record—if Eastern had "not made its offer to all bondholders on the same terms, but had [] privately paid money to sufficient holders to carry the election."[40] Such a transaction would have been so inconsistent with the concept of voting implied by the amendment provision of the indenture that it would violate the reasonable expectations of the contracting parties.[41] Because Eastern did make the offer to all holders, the court did not grant the TRO.[42]

Of critical importance, the Delaware Court of Chancery's analysis in these two cases presumes that the amendment provision of the indenture requires (without explicitly stating) that, if a company is going to offer payment for a "yes" vote, the company must make that offer to all holders. In other words, the parties expressly agreed that a supermajority affirmative vote could amend an indenture. The parties must necessarily have assumed that, before the indenture could be amended to adversely affect holders that chose not to consent to the amendment, those dissenters must have had the chance to take the deal and obtain the same financial result. Otherwise, one might imagine, the amendment to the indenture should be enforceable by or against only those that provided consent.

Notes about Other Cases

Oak Industries and *Eastern Air Lines*[43] remain the two primary cases in this arena. Given that the cases are over 30-years old—and indeed, in each of them, the court rejected ef-

[38] Eastern Air Lines, 1986 WL 13008 at *5.

[39] Eastern Air Lines, 1986 WL 13008 at *5.

[40] Eastern Air Lines, 1986 WL 13008 at *5.

[41] Eastern Air Lines, 1986 WL 13008 at *5.

[42] Eastern Air Lines, 1986 WL 13008 at *5.

[43] The author chooses to use the names of the company at issue for each case, rather than denominating them *Katz* and *Kass* from the named plaintiffs. As it turns out, the plaintiffs in each case were pursuing class ac-

forts to enjoin a transaction based on the claims of a breach of the covenant of good faith and fair dealing—one has to consider whether the proposition enunciated in those cases would hold sway with a court today. Citations to *Oak Industries* and *Eastern Air Lines* by other courts provide some clues to how courts might think about these issues.

In *Drage v. Sante Fe Pacific Corp.*, the Court of Appeals of Ohio introduced, perhaps inadvertently, a meaningful limitation to the right of noteholders to demand that an offer to pay for an amendment be made equally available to all holders.[44] In that case, the company sought to amend its indenture to permit a spin-off of its real estate subsidiary.[45] As an inducement for noteholders to consent, the company offered $10 for each $1,000 of principal amount to holders who consented to the amendment until the requisite amount of consents were received.[46] The plaintiff-bondholder brought a putative class action case, which the trial court dismissed for failure to comply with the "no-action clause" in the indenture.[47]

On appeal, the Court of Appeals of Ohio affirmed the trial court in an opinion that focused primarily on the analysis of the no-action clause.[48] That court, however, offered an alternate holding, stating that under the authority of *Oak Industries* and *Eastern Air Lines*, the plaintiff's action must be dismissed given that New York law permits payment for consents to an amendment to an indenture.[49] As to that statement of New York law, the case did not break new ground.

Of critical importance, however, are the terms of the offer of payment for consent: the company agreed to pay the $10 fee per $1,000 principal amount only to "those holders who consented to the amendment up to and until the time that the requisite amount of consents were received to permit the

---

tions and, perhaps not so surprisingly, the plaintiff Moise Katz was also listed as a plaintiff in the case brought by Philip Kass.

[44] See *Drage v. Santa Fe Pacific Corp.*, 1995 WL 396370 (Ohio Ct. App. 8th Dist. Cuyahoga County 1995).

[45] Drage, 1995 WL 396370 at *1.

[46] Drage, 1995 WL 396370 at *1.

[47] Drage, 1995 WL 396370 at *1–*3.

[48] Drage, 1995 WL 396370 at *3–*7.

[49] Drage, 1995 WL 396370 at *6–*7.

amendment to the trust indenture."[50] Thus, if a noteholder consented after the company had already received the requisite majority, that consenting noteholder, while bound to the amendment, would not receive the cash payment.[51]

This detail is significant. The Ohio appellate court has thus recognized that noteholders are treated fairly so long as the **offer** is made to all holders, even though all holders cannot accept the offer. In addition, the court did not impose any requirement that, assuming that more than the requisite majority accepted the offer, the company pay the fee *pro rata* over all accepting holders. Rather, the court blessed acceptances based on speed of response—i.e., those that tender their consent first get the fee, while those that tender after the threshold is reached do not.

As noted, this portion of the opinion provided an alternate holding to affirm the trial court and, as such, the issue did not receive any discussion beyond restating and at times quoting the discussions from *Oak Industries* and *Eastern Air Lines*.[52] Indeed, the issue was not decided by the trial court and was not identified by the plaintiff-appellant as a point of error.[53] Thus, the Ohio court may not have fully vetted its analysis and perhaps did not necessarily appreciate the limitation that it was imprinting on the existing precedent. In that regard, it is not a certainty that other courts will follow.

Perhaps of greater import, the thrust of the Delaware cases could fairly be understood as setting forth a requirement that all holders have access to equal treatment as an economic matter, given the commercial nature of the relationship between issuer and noteholder. In *Santa Fe Pacific Corporation*, the holders were treated equally only insofar as each of them (presumably) got to start the race for the consent fee at the time the offer was made. Under the terms of the offer, however, it was impossible for each holder to obtain equal treatment given that, even if everyone consented to the amendment, the first responders would get the fee and the latter responders would not. Rather than an investment choice, that discrepancy turns on timing and perhaps mechan-

[50] Drage, 1995 WL 396370 at *1.

[51] Drage, 1995 WL 396370 at *1.

[52] See Drage, 1995 WL 396370 at *6–*7.

[53] Drage, 1995 WL 396370 at *2–*3.

ics of tendering consent. If one accepts the proposition from the Delaware cases that certain indenture provisions require that deals be offered to all noteholders, nothing in those provisions suggests that speed of response as contemplated by *Santa Fe Pacific Corporation* satisfies the underlying concerns.

Two other cases bear mention. The first, *Pisik v. BCI Holdings Corp.*, is an unreported case (even in electronic fashion) from the Supreme Court of the State of New York.[54] That opinion, like *Eastern Air Lines*, rejected an application to enjoin a payments-for-consent transaction to amend an indenture.[55] It is noteworthy because the New York court cites with approval the decisions of Vice Chancellor Allen in *Oak Industries* and *Eastern Air Lines*, supporting the notion that those cases present correct statements of New York law that would be applied by New York courts.

Of more recent vintage, *Whitebox Convertible Arbitrage Partners v. World Airways* is interesting because, among other reasons, the noteholder prevailed in resisting a motion for summary judgment, although the case does not concern exit consents or indenture amendments.[56] In that case, the company needed to restructure some of its outstanding bond debt so that it could obtain federal loan guarantees.[57] After an unsuccessful public exchange offer, the company announced a private agreement with certain select noteholders whereby those favored holders would exchange their notes for a combination of new notes and cash.[58] After that deal closed, all other holders would be redeemed for cash pursuant to the existing redemption provisions in the indenture.[59] The plaintiff-noteholders sued, complaining that their exclusion

---

[54] Pisik v. BCI Holdings Corp., Index No. 14593/87 (N.Y. Sup. Ct. June 21, 1987).

[55] See Pisik, slip op. at 1–3.

[56] See *Whitebox Convertible Arbitrage Partners, L.P. v. World Airways, Inc.*, 2006 WL 358270 (N.D. Ga. 2006).

[57] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *1.

[58] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[59] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

from the more favorable exchange violated the contractual duty of good faith and fair dealing.[60]

The court recognized that the indenture required that, for a **partial** redemption, the notes to be redeemed must be selected by lot, *pro rata*, or by such other method deemed fair and appropriate by the indenture trustee.[61] The company claimed it met this obligation because, after it completed the private transaction, it paid the plaintiff-noteholders the redemption price provided by the indenture.[62] In addition, the company argued that the provisions for a partial redemption—that is, the provisions that required a selection by lot or *pro rata*—did not apply because the company redeemed all the outstanding notes at the time.[63]

The court, however, went beyond the express terms of the indenture by turning to New York law on good faith and fair dealing.[64] It found that the company manipulated the process by conducting in essence one partial redemption—*i.e.*, the private transaction with the preferred noteholders—followed by another partial redemption whereby it redeemed the non-favored noteholders at the price set forth in the indenture.[65] The critical fact was that the company treated one group of noteholders more favorably.[66]

Although this case did not concern exit consents or indenture amendments, it is still instructive. As with *Oak Industries* and *Eastern Air Lines*, the *World Airways* court took the view that the covenant of good faith and fair dealing as applied to indentures prevents the issuer from giving a subset of noteholders better treatment without making that treatment available to all holders. While the indenture provision at issue was different—that is, the *World Airways* court was concerned with the redemption provision as opposed to the indenture amendment provision—the substantive requirement that all noteholders have the opportunity to take the

[60] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[61] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[62] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[63] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[64] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *2.

[65] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *3.

[66] Whitebox Convertible Arbitrage Partners, 2006 WL 358270 at *3.

deal remained the command of the covenant of good faith and fair dealing under New York law. In addition, *World Airways* demonstrates that a plaintiff-noteholder can indeed prevail under this analysis.

Specific Indenture Covenants

As Chancellor Allen recognized in *Oak Industries*, the critical question with regard to the implied covenant of good faith and fair dealing is whether the parties who negotiated the express terms of the contract would have included a prohibition against conduct at issue had they negotiated on that point.[67] That of course means that the implied covenant of good faith and fair dealing disappears in any situation where the indenture addresses the issue at hand. And indeed, specific indenture provisions concerning payments-for-consent do exist and appear fairly regularly. A common example from a 2012 indenture is as follows:

> Section 4.18 NO INDUCEMENTS.
>
> The Company shall not, and the Company shall not permit any of its Subsidiaries, either directly or indirectly, to pay (or cause to be paid) any consideration, whether by way of interest, fee or otherwise, to any Holder for or as an inducement to any consent, waiver, amendment or supplement of any terms or provisions of this Indenture or the Notes, unless such consideration is offered to be paid (or agreed to be paid) to all Holders which so consent, waive or agree to amend or supplement in the time frame set forth on solicitation documents relating to such consent, waiver, agreement or supplement.[68]

When such a provision is found in the indenture, it answers the question about whether the company must offer the transaction to all holders. But what about the situation where the indenture is silent, but the parties did in fact consider the issues during negotiations? A relatively recent case addresses that situation.

In *In re Loral Space and Communications Inc.*, Vice Chancellor Strine (now the Chief Justice of the Delaware Supreme Court) had to determine whether a payments-for-consent transaction that was offered only to the largest holder

---

[67] See *Katz v. Oak Industries Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986).

[68] Hornbeck Offshore Servs, Inc., Current Report (Form 8-K, EX-4.2.) (March 21, 2012).

violated the covenant of good faith and fair dealing.[69] In that case, when it emerged from bankruptcy in 2005, the company issued notes under an indenture, which imposed certain limitations on the company's operations and future financial transactions.[70] The notes were also callable at a premium four years later (in 2009), but could be callable sooner with the consent of the holders of 33% of the outstanding amount of the notes.[71]

From the time of issuance, a single large holder owned 45% of the notes (as well as some equity), and thus could by itself provide the requisite consent to an early redemption.[72] Indeed, this precise fact was set forth in the company's bankruptcy disclosure statement.[73] The disclosure statement also made clear that the large holder had other interests in the company that differed from those of the other noteholders.[74]

As part of a subsequent transaction that would provide the single large holder with benefits on account of other equity interests, it agreed to an early redemption of the notes.[75] Certain smaller noteholders brought suit claiming a violation of the covenant of good faith and fair dealing because the single large holder received a benefit (through its equity holdings) not available to the other holders.[76] While the indenture did not contain any covenant against unequal payments for consent, the plaintiff-noteholders contended that New York law implied such a covenant as a "bedrock principle of the bond markets."[77]

The company responded to this argument by showing that the original publicly filed draft of the indenture contained a payments-for-consent covenant that required all holders to

---

[69] See *In re Loral Space and Communications Inc.*, 34 Del. J. Corp. L. 670, 2008 WL 4293781 (Del. Ch. 2008).

[70] Loral Space, 2008 WL 4293781 at *33.

[71] Loral Space, 2008 WL 4293781 at *33.

[72] Loral Space, 2008 WL 4293781 at *33.

[73] Loral Space, 2008 WL 4293781 at *33.

[74] Loral Space, 2008 WL 4293781 at *33.

[75] Loral Space, 2008 WL 4293781 at *34, *37.

[76] Loral Space, 2008 WL 4293781 at *34, *37.

[77] Loral Space, 2008 WL 4293781 at *34.

receive the same treatment.[78] That provision (as demonstrated by a publicly filed blackline version) was deleted before the document became final.[79] As the court found after an evidentiary presentation, the case did not present the circumstance where the parties had failed to address a possibility in negotiations for which the court had to fill the gap nor did it present the circumstance where the parties negotiated to a draw.[80] Rather, the parties expressly considered the issue—and the smaller noteholders lost.[81] They could not then ask the court to imply a provision into the agreement that they demanded in negotiations but did not obtain.[82]

While *Loral* presents an interesting situation, one would expect it to be the rare exception. *Loral* involved a company emerging from bankruptcy with the actual stakeholders negotiating over the deal documents. The provision that required the consent of only 33% of the holders to permit an early redemption is without question atypical on its face, and even more so when one considers that all parties knew at the time of negotiations that a large holder would exist.

That situation stands in stark contrast to more typical bond issuances, where the beneficial noteholders usually have no input on the negotiations, as that function would be performed by the underwriter.[83] Unlike *Loral*, it seems just as likely as not—and perhaps more so—that the issue of unequal-payments-for-consent simply never came up in negotiations. While *Loral* recognizes the existence of payment-for-consent covenants in some indentures and one model indenture,[84] the ABA form indenture and its Model Negotiated Covenants and

---

[78]Loral Space, 2008 WL 4293781 at *35.

[79]Loral Space, 2008 WL 4293781 at *35.

[80]Loral Space, 2008 WL 4293781 at *35.

[81]Loral Space, 2008 WL 4293781 at *35.

[82]Loral Space, 2008 WL 4293781 at *35.

[83]See, e.g., *Metropolitan Life Ins. Co. v. RJR Nabisco, Inc.*, 716 F. Supp. 1504, 1509 (S.D. N.Y. 1989) ("[I]ndentures are often not the product of face-to-face negotiations between the ultimate holders and the issuing company. What remains equally true, however, is that underwriters ordinarily negotiate the terms of the indentures with the issuers. Since the underwriters must then sell or place the bonds, they necessarily negotiate in part with the interests of the buyers in mind.").

[84]See Loral, 2008 WL 4293781, at *36.

Related Definitions contain no such model provision.[85] Rather, the ABA provision recognizes that state laws might require equal treatment of holders for consent solicitations.[86]

Comments on Current Status

When considering a question of the implied covenant of good faith and fair dealing with regard to a bond indenture, the critical question concerns whether the parties would have proscribed the transaction in question if they had thought to negotiate over the issue. In 1986, when Chancellor Allen wrote *Oak Industries* and *Eastern Air Lines*, the court's view necessarily was that all noteholders should have the opportunity to obtain the same treatment. They had all made the equivalent commercial decision to buy into the notes, and they should likewise have the same commercial decision to exit or vary that arrangement.

That general proposition has held up well over the years. The relatively recent case of *Loral*, however, introduces some doubt. Given that some indentures now have express provisions that insist upon equal treatment, is the absence of such a provision a license to provide unequal treatment?

In the *Loral* situation, it is clear that the absence of the equal-pay-for-amendment provision was expressly part of the negotiation, and thus one need not look to the implied covenant of good faith and fair dealing. But should the simple fact that some indentures address the issue mean that others lose the protection of the implied covenant in situations where it might otherwise apply? In other words, just because (i) the question could be answered by negotiations and drafting, and (ii) other parties in other situations did indeed perform those tasks, does the plaintiff in a given action lose the ability to assert the implied covenant that might otherwise be appropriate in its circumstance?

---

[85] See generally ABA Revised Model Simplified Indenture, 55 Bus. Law. 1115 (2000); Model Negotiated Covenants and Related Definitions, 61 Bus. Law. 1439 (2006). In a passing reference, the comments to the ABA document suggest that any prohibition against exit consents could be included in the sections on outstanding and treasury securities in Article 2. ABA Revised Model Simplified Indenture, 55 Bus. Law. at 1180. As the above example of a "No Inducements" covenant demonstrates, however, the practice is put any such limitation in the negative covenants sections set forth in Article 4.

[86] ABA Revised Model Simplified Indenture, 55 Bus. Law. at 1205.

If one goes down that road, the implied covenant of good faith and fair dealing in the indenture context necessarily has a time limit on it. Once a court or commentator has sufficiently identified an issue to put the world on notice, noteholders would not be able to claim the benefit of the implied covenant. That would lead to less certainty in the law, not more, as to when and under what circumstances a noteholder could successfully challenge a company transaction.

Perhaps the better approach would be for the New York courts to address the issues explicitly as a matter of New York law. Given that indentures memorialize investment decisions common across all holders, the New York courts could reasonably reach the view that attempts by the company in cahoots with large holders to favor some holders at the expense of others should be discouraged. Indeed, perhaps the more sensible approach is for indentures to specifically provide for situations when unequal treatment of the minority is permitted. In this regard, rather than be faced with after-issuance attempts by the company to skirt equal treatment, all investors will know upon issuance which circumstances would lead to such a result.