



## Chesapeake Energy Court Adopts the Narrow View of Section 316(b) of the TIA

On February 8, 2017, the U.S. District Court for the Western District of Oklahoma dismissed the class action lawsuit brought by unsecured bondholders of Chesapeake Energy Corporation (“Chesapeake”), adopting the so-called narrow reading of Section 316(b) of the Trust Indenture Act of 1939 (“TIA”).<sup>1</sup>

In December 2015, Chesapeake launched and closed an exchange offer for its outstanding unsecured bonds for new secured bonds, with a reduced principal amount and an extended maturity and a higher interest rate. The exchange offer was made available only to qualified institutional buyers and non-U.S. persons, so the exchange offer could be made on a private basis. The plaintiffs, who were retail bondholders, asserted that their inability to participate in the exchange offer and the impact of the exchange on the relative security position of the bonds they held caused their bonds to lose value and impaired their ability to collect on the bonds in the future, in violation of Section 316(b) of the TIA and the “no impairment clause” of the indenture, both of which provide that nothing shall impair the bondholders’ right to receive principal and interest on the bonds on or after the due date for such payments.

The court’s decision is notable for two reasons. First, it concluded that the no impairment clause should be given a narrow reading, as a matter of New York state contract law. To get there, the court found that the “no-action” clause of the indenture barred the plaintiffs’ claims and the no impairment clause did not change this result. No-action clauses provide that individual bondholders (such as the plaintiffs, as distinguished from the trustee) may not institute suit under their indentures unless certain conditions are met, including that notice be given to the trustee of a continuing event of default and that holders of at least 25 percent of the outstanding bonds make a written request to the trustee to sue. The court found that the plaintiffs failed to comply with the indenture’s no-action clause and that their failure to allege that any payments were due but unpaid cannot be overridden by the no impairment clause. In this regard, the court adopted a narrow reading of the no impairment clause by concluding that it could bar the application of a no-action clause only if Chesapeake had impaired the bondholders’ legal right to receive principal and interest, rather than their practical ability to collect what they are owed (the so-called broad reading). We are not aware of other court decisions

that have applied state contract law to the “no impairment” language of Section 316(b).

Second, the court adopted the narrow reading of Section 316(b) of the TIA itself, largely based on precedent. The court cited recent rulings adopting this approach, including the Second Circuit in *Marblegate*<sup>2</sup> and the district court in *Cliffs Natural Resources*,<sup>3</sup> as well as Tenth Circuit precedent.<sup>4</sup>

The *Chesapeake* case was one of four lawsuits, along with *Cliffs Natural Resources*, *Vanguard Natural Resources*,<sup>5</sup> and *California Resources*,<sup>6</sup> in which retail bondholders claimed that their inability to participate in a private exchange offer violated Section 316(b). *Cliffs Natural Resources* and *Chesapeake* came out against that claim. It remains to be seen what happens in the *Vanguard Natural Resources* and *California Resources* cases. The former is currently stayed due to the company’s Chapter 11 filing. A motion to dismiss the complaint was filed in the latter on July 8, 2016.

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## Endnotes

- 1 *Cummings v. Chesapeake Energy Corp.*, No. 16-00647 (W.D. Okl. Feb. 8, 2017).
- 2 *Marblegate Asset Mgmt., LLC v. Educ. Mgmt. Fin. Corp.*, 2017 BL 12251 (2d Cir. Jan. 17, 2017), *motion for rehearing filed*, No. 15-02124 (2d Cir. Feb. 8, 2017).
- 3 *Waxman v. Cliffs Natural Resources Inc.*, 2016 BL 406073 (S.D.N.Y. Dec. 6, 2016).
- 4 *Brady v. UBS Fin. Servs., Inc.*, 538 F.3d 1319 (10th Cir. 2008); *YRC Worldwide Inc. v. Deutsche Bank Trust Co. Ams.*, 2010 BL 149963 (D. Kan. July 1, 2010).
- 5 *In re Vanguard Natural Resources Bondholder Litigation*, No. 16-01578 (S.D.N.Y. Mar. 1 2016).
- 6 *Barkau v. California Resources Corp.*, No. 16-02971 (S.D.N.Y. Apr. 21, 2016).

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