CHAPTER 8

The Trust Indenture Act of 1939

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SYNOPSIS

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Summary of This Chapter

The Trust Indenture Act of 1939 (the "Trust Indenture Act")[2] (hereafter referred to as the "Act" or the "TIA") was designed to protect investors who purchase publicly distributed debt securities. The terms used to describe the debt instruments involved include "bond," "note," "debenture," "equipment trust certificate," and "collateral trust bond." The Trust Indenture Act, the terms of which are closely integrated with the Securities Act of 1933 (the "Securities Act"), focuses on the terms of the indenture to achieve investor protection by imposing minimum obligations on trustees and ensuring that trustees have the powers and resources to meet their obligations to investors. *See* § 8.01 *infra.*

The Trust Indenture Act identifies the abuses that led to its adoption in 1939. The final version of the Trust Indenture Act was designed to remedy these perceived abuses and to reflect certain concerns of brokers and businesses. *See* § 8.02 *infra.*

As amended in 1990, the Trust Indenture Act provides that specified substantive provisions concerning the trustee's powers, duties, and qualifications as well as the issuer's

[2] 15 U.S.C.A. §§ 77aaa–77bbbb (2020).

duties are a part of and govern every qualified indenture, whether qualified before or after 1990. The "business provisions" of the indenture are left unregulated. Breaches of the indenture's provisions are enforceable only by the trustee or the bondholders through court proceedings. The statutorily required provisions of the indenture are governed by federal law while the "business provisions" of the instrument are governed by state law. *See* § 8.03 *infra.*

The Trust Indenture Act applies only to debt securities and interests in debt securities. The Commission has excluded interests not represented by a separate physical certificate and interests in which there is no fixed obligation to pay a sum of money from the coverage of the Trust Indenture Act. Only primary distributions require indenture qualification; sales by persons acting as conduits for the issuer, however, are not exempt from the Trust Indenture Act's provisions. The brokers' transaction exemption under the Securities Act is incorporated into the Trust Indenture Act. *See* § 8.04 *infra.*

The Trust Indenture Act generally requires that all securities covered by the Act be issued under an indenture that meets the requirements of the Act. Exemptions are available under the Act that permit an issuer to issue not more than $50 million of debt securities during a twelve-month period without an indenture, or, if the indenture limits the amount of securities that may be outstanding under it at any time to $10 million the indentures' substantive terms need not fully comply with the provisions of the Act. In certain cases, the Commission has required the integration of separate transactions or issues under the exemptive provisions. *See* § 8.05 *infra.*

The Trust Indenture Act provides for the exemption of certain securities. Issuers may apply to the Commission for an order to exempt securities issued under open-end provisions of pre-1939 indentures. The Trust Indenture Act was closely integrated with the Securities Act and, with two exceptions (the exemptions for recapitalizations involving exchanges with existing security holders and judicially and administratively approved reorganizations) the exemptions under Securities Act Section 3 were incorporated into the Trust Indenture Act. Several provisions cover exemptions from the Trust Indenture Act for securities issued in connection with the creation and maintenance of a secondary market in real estate mortgages. Other exemptions from the Trust Indenture Act involve certain foreign government securities, guarantees of exempted securities, issues of limited dollar amounts and bankruptcy related commercial notes. The Commission may grant other exemptions by order or rule, and has done so for certain cross-border offerings of Canadian securities and for certain exchange offers and business combination transactions by foreign private issuers. *See* § 8.06 *infra.*

The Trust Indenture Act also provides for the exemption of debt securities sold in transactions that are also exempt under Securities Act Section 4. Thus, the exemptions for certain private placements, offers and sales to "accredited investors" of up to $10 million, and sales in large dollar amounts of promissory notes secured by certain first lien real estate mortgages are incorporated by the Trust Indenture Act. *See* § 8.07 *infra.*

The Trust Indenture Act specifies the mandatory provisions that are part of every qualified indenture as well as permissible provisions, many of which are included by operation of law unless indenture language to the contrary appears. Other provisions, some of which are standardized and others negotiable, may also be included. Generally, four alternative formats for qualified indentures are available: an indenture that relies upon the automatic incorporation provisions of the Trust Indenture Act; the conventional unified document; the two-part indenture recommended by the American Bar Foundation; and the

Revised Model Simplified Indenture. *See* § 8.08 *infra.*

Filing with the Commission under the Securities Act and the Trust Indenture Act is closely coordinated. Under the Trust Indenture Act, the indenture is deemed qualified when the Securities Act registration statement becomes effective. The issuer of debt securities must file with the Commission: the Securities Act registration statement; Form T-1, the statement of eligibility and qualification of the trustee; and a copy of the indenture with a table of contents. The Securities Act prospectus must contain a description of the debt securities being registered and of the indenture. *See* § 8.09 *infra.*

Supplemental indentures that make changes in the rights of indenture security holders or effect other indenture amendments may be entered into provided they comply with the provisions of the Trust Indenture Act. Shelf registrations of debt securities under Rule 415 present special problems regarding the form of a supplemental indenture when they are needed. Commission rules effective in December 2005 as part of Securities Offering Reform simplified the process by permitting large companies to add new classes of debt securities to shelf registration statements by post-effective amendment. *See* § 8.10 *infra.*

Securities that are exempt from registration under the Securities Act but not under the Trust Indenture Act (certain recapitalizations and reorganizations) require indenture qualification. In such cases, the requirement of indenture qualification generally depends on whether a "sale" has occurred. If no Securities Act registration statement is to be filed, the issuer's application for qualification of the indenture on Form T-3, the trustee's statement of eligibility and qualification on Form T-1, and all other items required for qualification when a Securities Act registration is required must be filed with the Commission. *See* § 8.11 *infra.*

The Trust Indenture Act requires that under every qualified indenture there always be at least one institutional trustee with a combined capital and surplus of at least $150,000. A permissive provision may provide that the trustee's capital and surplus be determined by reference to the trustee's most recently published report of condition. A foreign business entity may act as the institutional trustee only if permitted by Commission order or rule. The Act permits the use of one or more co-trustees, who may be individuals, but the trustees' rights, powers, duties and obligations must be imposed on and carried out by the required institutional trustee, either alone, or jointly with the co-trustees. *See* § 8.12 *infra.*

The obligor and its affiliates may not serve as indenture trustee. Specific post-default conflicts of interest require the resignation or removal of the trustee unless the Commission, in the case of certain defaults not involving non-payment, permits a delay in the obligation to resign. The prohibited conflicts include: dual trusteeships (with some exceptions); prohibited affiliations between the trustee and the obligor or underwriters; beneficial ownership of the trustee's voting securities by the obligor, underwriter, or their affiliates; direct or indirect ownership by the trustee of securities of the obligor and underwriters; and the trustee's being a creditor of the obligor, the trustee's ownership of the obligor's or underwriters' securities in fiduciary capacities; and the trustee's being a creditor of the obligor. *See* § 8.13 *infra.*

Under every qualified indenture, the obligor must furnish to the indenture trustee: bondholder lists; copies of reports required under the Securities Exchange Act of 1934 (the "Exchange Act"); annual certification of compliance with conditions and covenants; evidence of recording the indenture and compliance with any conditions precedent; and certificates of fair value. Permissive provisions obligating the issuer to furnish the trustee

other evidence of compliance with indenture conditions and covenants may also be included in the indenture. *See* § 8.14 *infra.*

The Trust Indenture Act imposes certain duties on the indenture trustee prior to any default by the obligor. The trustee must provide annual reports and periodic reports on certain developments to indenture security holders and to give notice to the security holders of all defaults known to the trustee within ninety days of their occurrence. Unless provided to the contrary in the indenture, the trustee's liability is limited to the performance of the duties specified in the indenture. The trustee, though, must examine certificates and opinions to determine if they comply with the indenture's requirements. A trustee's resignation is effective only upon appointment and acceptance by a successor trustee. *See* § 8.15 *infra.*

Among the servicing functions that must be provided for debt securities, only the duties of the paying agent are regulated by the Trust Indenture Act. The Act requires that each paying agent hold all funds received by it for the payment of principal or interest in trust for the indenture security holders or the indenture trustee and give the trustee notice of any default by an obligor in the payment of principal or interest. *See* § 8.16 *infra.*

The Trust Indenture Act imposes an enhanced duty of care and skill on trustees after default and gives the trustee adequate powers to carry out their duties. The Act grants the trustee the authority, before and after default, to file proofs of claim and other papers in judicial proceedings and to recover judgment in its own name; indentures generally give the trustee other post-default remedial powers not specified in the Act. The Act permits the trustee prior to default to be a direct creditor of the obligor on the indenture securities, but requires the apportionment of amounts collected by the trustee during a specified time. The trustee is also empowered to represent the interest of indenture security holders in bankruptcy proceedings. *See* § 8.17 *infra.*

The Trust Indenture Act provides for direct action to be taken by the indenture security holders to enforce their rights, such as requirements that facilitate communications between bondholders and guarantee the bondholder's right to sue for principal and interest, and permissive provisions that authorize bondholders to postpone interest payments and waive past defaults, direct the trustee in conducting remedial proceedings, and remove the trustee. The Trust Indenture Act permits indentures to include no-action clauses (except to enforce payment of principal or interest) to prevent small numbers of bondholders from acting contrary to the best interests of bondholders in general. *See* § 8.18 *infra.*

The indenture trustee who fails to carry out its obligations under a qualified indenture may be liable to injured bondholders under state law breach of duty claims or a federal private right of action explicitly recognized by the 1990 amendments to the Trust Indenture Act. *See* § 8.19 *infra.*

The Trust Indenture Act creates a private right of action for damages in favor of a person who relies on a materially false or misleading statement in a Trust Indenture Act document. The 1990 amendments to the Trust Indenture Act created some uncertainty as to whether the Commission's enforcement power extends beyond ensuring initial indenture qualification and enforcing prohibitions against false or misleading statements in filings made with the Commission. Willful violations of the Trust Indenture Act, presumably including failure to comply with mandatory obligations imposed by law under the 1990 amendments, may result in criminal prosecution. *See* § 8.20 *infra.*

The Trust Indenture Act does not preempt state jurisdiction provided the state law does

not conflict with federal law. Several states have adopted trust indenture requirements for securities offered or sold in state. *See* § 8.21 *infra.*

§ 8.01 Introduction

The Trust Indenture Act was designed to protect investors who purchase publicly distributed debt securities. The Trust Indenture Act achieves investor protection by imposing minimum obligations on trustees and ensuring that trustees have the powers and resources to meet their obligations.

Debt financing by corporations takes numerous forms. Sometimes funds are borrowed directly from one or a group of banks, or directly from other institutional lenders. At other times funds are borrowed through the sale of debt securities to public investors. The Trust Indenture Act of 1939 governs some aspects of debt financing from public investors.

The terms employed to describe the different debt instruments depend generally upon whether the instruments are long or short term, whether they are issued under an indenture, and whether they are guaranteed, secured by collateral or are unsecured. While the term "bond" is sometimes used to refer to all long-term debt evidenced by securities, "bonds" are, more accurately long-term debt instruments secured by a mortgage on property of the corporate issuer. "Bonds" are to be contrasted with "debentures," which are long-term uncollateralized debt securities. Debenture holders are general unsecured creditors of the issuer.[1]

Within these broad outlines, there are also rather specific subcategories of debt instruments. "Commercial paper," for example, is generally exempt from both Securities Act registration and Trust Indenture Act qualification.[2]

Debt instruments secured by more exotic forms of collateral often are referred to by special titles. For example, "equipment trust certificates" are rather complex debt instruments used to finance the purchase of railroad cars, airplanes, or similar equipment, secured by the equipment whose title has been transferred to a trustee and then leased back or sold under a conditional sale agreement to the railroad, airline, or other borrower.[3] "Collateral trust bonds" are debt securities collateralized by the pledge of other securities, often those of a subsidiary.[4]

In the volatile markets of the 1980s, a number of innovative types of debt securities were created to provide greater flexibility in terms and the ability to come to market rapidly. These included medium term notes, which are offered on a continuous basis or

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[1] *See* Thomas Arthur & Steven B. Kite, 13-3rd C.P.S. (BNA), *Corporate Bond Financing* A-1 to A-2 (1999).

[2] *See* § 3.04 *supra* for discussion of the exemption from Securities Act registration for short-term paper. *See also* § 8.06[3] *infra* for discussion of the exemption from Trust Indenture Act qualification for short-term paper.

[3] *See* 2 L. Loss, J. Seligman, & T. Paredes, *Securities Regulation* § 3(A)(1)(j)(i) (6th ed. 2020), Wolters Kluwer Cheetah [hereinafter, Loss, *Securities Regulation*].

[4] *See* Arthur & Kite, n.2 *supra*, at A-61 (1999).

in multiple tranches, debt securities with variable interest rates, and debt securities denominated in or indexed to foreign currencies.[5] In addition, the securities markets became increasingly internationalized.[6]

The 1990s saw the introduction of structured notes, which are debt securities issued generally by bank holding companies and that, in most cases, do not pay interest. The payment at maturity of a structured note is based on the performance of an underlying "reference asset," which may be an equity index, like the S&P® 500, an equity security, an index of futures contracts or other financial measure. Structured notes may be either registered under the Securities Act, as in the case of structured notes issued by a bank holding company, or exempt from registration, in the case of structured notes issued by a "bank," as that term is defined in Section 3(a)(2) of the Securities Act. Structured notes may also be issued in exempt transactions under Rule 144A under the Securities Act or Section 4(a)(2) of the Securities Act.

The Trust Indenture Act was designed to protect investors who purchase publicly distributed debt securities. The provisions of the Trust Indenture Act are closely integrated with those of the Securities Act. In registered offerings, compliance with the requirements of the Trust Indenture Act is a condition to the Commission's ordering effective a Securities Act registration statement relating to debt securities.[7]

The Trust Indenture Act focuses on the terms of the indenture as the method of achieving investor protection. An indenture is a contract between the issuer of debt securities and a trustee, generally a bank or trust company.[8] Section 303(7) of the Trust Indenture Act defines "indenture" broadly to mean "any mortgage, deed of trust, trust or other indenture or similar instrument or agreement" under which securities are issued, whether or not any property is mortgaged under it.[9]

Historically, the corporate indenture originated as a mortgage of property securing the corporate debtor's obligation on its bonds.[10] The indenture trustee was the mortgagee, holding the mortgage for the benefit of numerous bondholders. The indenture developed into a complex document that largely centralized the enforcement

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[5] *See* Slonaker & Wiltshire, *Innovative Debt Securities*, 20 Rev. of Securities & Commodities Regulation 89 (1987).

[6] *See generally* Symposium, *Globalization of Securities Markets' 90*, 14 Hastings Intl. & Compar. L. Rev. 253-473 (1991). This was recognized by Congress in its enactment of the 1990 Amendments to the Trust Indenture Act. Sec. L. Rep. No 101-155 (1989) 101st Cong., 1st Sess., p. 30.

[7] *See* § 8.09 *infra* for discussion of coordination of filings under the Securities Act and the Trust Indenture Act.

[8] *See generally* R. Landau & R. Peluso, *Corporate Trust Administration and Management* 1943–47 (7th ed. 2015) [hereinafter, Landau & Peluso, *Corporate Trust Administration*].

[9] Where guarantees of securities are to be issued, the guarantee between the trustee and the guarantor is generally considered to be an "indenture." *See* The First Federal Savings Bank (No action Letter, Jan. 16, 1986); First Southern Federal Savings & Loan (No action Letter, Mar. 28, 1983); First Federal Savings and Loan Association, C.C.H. Fed. Sec. L. Rep. ¶ 77,355 (Div. Corp. Fin. 1983); Hawaiian Electric Company, Inc. (Letter, Oct. 11, 1971).

[10] *See* Draper, "A Historical Introduction to the Corporate Mortgage," 2 Rocky Mtn. L. Rev. 71 (1930).

of bondholders' rights in the trustee, even where unsecured debentures were being issued.[11] Courts, however, were in disagreement as to whether the indenture trustee stood in a true fiduciary relationship with bondholders, or was something less than a fiduciary.[12]

The Trust Indenture Act of 1939 was an attempt by Congress to impose minimum obligations on trustees, and to assure that trustees had the powers and resources to meet those obligations. In doing so, Congress created an immensely complex statute. This complexity was for many years a deterrent to the updating of the Act by later sessions of Congress.[13] Changes in the securities markets and in trust institutions since 1939 however finally led to significant statutory revisions.[14] In late 1987, at the urging of the Commission, a number of amendments were introduced in Congress as the Trust Indenture Reform Act of 1987.[15] The proposals in slightly modified form were enacted as Title IV of the Securities Act Amendments of 1990.[16]

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[11] American Bar Foundation, Commentaries on Indentures 4–8 (1971).

[12] *See* Posner, *The Trustee and the Trust Indenture*, 46 Yale L. J. 737 (1937).

[13] *See* Friedman, *Updating the Trust Indenture Act,* 7 U. Mich. J. L. Reform 329 (1974).

[14] A number of revisions were proposed in the American Law Institute's Federal Securities Code, Part XIII (1980). The Code has not been enacted. The principal change which would be effected by it would be that much of what the present Trust Indenture Act requires to be set forth *in extenso* in an indenture would be deemed incorporated without the necessity of setting it forth in each indenture.

[15] *See* Trust Indenture Reform Act of 1987, C.C.H. Fed. Sec. L. Rep. ¶ 84,205.

[16] Pub. L. 101-330, 104 Stat. 2713, 2721 (1990). *See generally* Campbell, Implications of the Trust Indenture Act of 1990 Breathing New Life Into the Trust Indenture Act of 1939, 11 Ann. Rev. of Banking Law 181 (1992).