WHITE & CASE

# **Insight:** Financial Restruturing & Insolvency

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# Bond Consent Solicitation Payments

## Court of Appeal Upholds Judgment in *Azevedo & Another v Imcopa*

In summer 2012, two important judgments were handed down on cases relating to bond consent solicitations. Although the consent solicitation techniques proposed by the debtor companies in each case were markedly different, at issue in both cases was how companies, which are seeking to amend their bond terms, can lawfully incentivise their bondholders to vote in favour of proposed amendments to the relevant bonds. Given the continuing need for many companies with bonds in their capital structure to amend those bonds as a result of the ongoing 'Great Recession', and in light of increased levels of bond issuances in recent years, the two judgments and a recent Court of Appeal decision will be viewed with great interest by debtors and creditors alike.  Many bonds issued by international companies and foreign sovereigns are governed by English law and these judgments are therefore likely to have world-wide ramifications.

On 22 April 2013 the Court of Appeal upheld the judgment of Hamblen J in *Azevedo and Another v Importacao, Exportaacao E Industria De Oleos Ltda and others* [2012] EWHC 1849 (Comm).  The decision also confirmed that an appeal against the High Court's judgment in the second consent solicitation case, *Assenagon Asset Management S.A. v Irish Bank Resolution Corporation (formerly Anglo Irish Bank Corporation Ltd)* [2012] EWHC 2090 (Ch), will not be pursued.  The High Court judgment in *Assenagon* therefore remains good law.

In *Azevedo*, Hamblen J found that it is lawful for a company to offer the 'carrot' of an additional payment to bondholders who vote in favour of an amendment where that additional payment is not made to those that do not vote or vote against the proposal.  The claimants' arguments that (i) a class of noteholders must be treated on a *pari passu* basis; and (ii) consent payments made only to those Noteholders who vote in favour of an amendment should be characterised as an unlawful "bribe", were each dismissed at first instance and on appeal to the Court of Appeal.


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## *Pari Passu* Treatment

Lloyd LJ acknowledged that the requirement for *pari passu* treatment of all members of a class (in this case, the noteholders) is a basic principle of English insolvency law. However, given that the present case did not involve insolvency law, Lloyd LJ considered that the principle could only be invoked by reference to the terms of the relevant note documents. He noted that the underlying trust deed required that any moneys received by the Trustee be held on trust in payment of amounts owing in respect of the notes *pari passu* and rateably. However, on the facts, the terms of the consent solicitation were such that the funds required to make the consent payments were not at any stage held by the Trustee and so Lloyd LJ held that there was "no other valid basis … for the argument that the relevant funds had to be applied *pari passu* as between all the noteholders".

## Validity of Consent Payments

Lloyd LJ also considered the argument that the consent payments in question, which were only made to those noteholders who voted in favour of the resolution, were invalid under English law. However, after an analysis of the relevant authorities, Lloyd LJ confirmed that there was nothing which prevented the making of the consent payments to those that voted in favour of the amendments to the bonds:

*"I would hold that it is not inconsistent with English company law, or with the documents governing the Notes in the present case, for the Issuer to offer a consent payment to Noteholders who vote in favour of a resolution proposed for their consideration as a class, where the payment is available for all members of that class, and provided that the basis of the payment is made clear in the documents related to the resolution, the meeting and the vote, as was the case here."*

## *Assenagon*

In contrast, the consents sought by Anglo Irish Bank in 2009 and 2010 in connection with a number of distressed exchange offers, were successfully challenged in the High Court by *Assenagon*. These exchange offers differed from the *Azevedo* consent solicitations in that Anglo Irish Bank's bondholders were invited to exchange their bonds for cash and/or new securities, and bondholders who accepted the exchange were required to vote in favour of a resolution which would have allowed Anglo Irish Bank to call the bonds of investors who did not participate in the exchange, for a nominal consideration.

In *Assenagon*, Briggs J held that "this form of coercion is in my judgement entirely at variance with the purpose for which majorities in a class are given power to bind minorities" and added that "oppression of a minority is of the essence of exit consent of this kind, and it is precisely that at which the principles restraining the abusive exercise of powers to bind minorities are aimed".

In contrast, the Noteholders in *Azevedo* were asked to consent to certain amendments to their bonds and the claimants' case did not include any allegation of oppressiveness, unfairness or bad faith in relation to the consent solicitation.

While the differences between *Assenagon* and *Azevedo* are acknowledged, it is a shame that the Court of Appeal was not able to hear the two cases side by side, as two key factors in *Assenagon* were also present in the amendment proposed by Imcopa, namely:

(i) the offer was available to the entire class of bondholders; and

(ii) the adverse treatment of those who did not accept the offer was transparent.

In *Assenagon*, Briggs J reported that counsel for Anglo Irish Bank had argued there was no principled basis distinguishing *Assenagon* from *Azevedo*. The solicitations in each case had, however, markedly different economic effects: in *Azevedo* a non-consenting holder would lose the benefit of an inducement to vote in favour of the proposal, whilst in *Assenagon* the non-consenting holder stood to lose everything and hence the Anglo Irish Bank consent solicitation technique was considerably more coercive in nature.

Apart from the key commercial differences between *Assenagon* and *Azevedo*, there were a number of technical differences. In particular, the exchange offer at issue in *Assenagon* was structured such that Anglo Irish Bank acquired a specifically enforceable promise to acquire the relevant bonds before the vote. As a consequence, Anglo Irish Bank had a beneficial interest in those bonds. The trust deed which bound Anglo Irish Bank specifically prohibited the Bank from voting any bonds which it held for itself, and it was held that votes cast in respect of bonds which had been tendered for exchange were therefore invalid. This was sufficient for the judge to side with Assenagon. Briggs J also distinguished the *Assenagon* case from the *Azevedo* case on the following grounds:

(i) the resolutions to postpone the interest payments in *Azevedo* were the substance of that which the Issuer wished to achieve, whereas in *Assenagon* the substance of the Bank's plan was to substitute new notes for existing notes;

(ii) the Issuer in *Azevedo* proferred the inducement whereas in *Assenagon* it is the noteholders which wield the negative inducement (i.e. the call option resolution);

(iii) the *Azevedo* proposal was "plainly capable of being beneficial to noteholders". Mr Justice Briggs went on to explain "[in the *Assenagon* case] the Resolution was designed in substance to destroy rather than enhance the value of the notes and was, on its own of no conceivable benefit to the Noteholders"; and

(iv) the claimants in *Azevedo* did not claim minority oppression but only bribery.

Given that any future exchange offer processes will no doubt be structured to avoid falling foul of any such voting restriction in bond documentation, of more likely relevance for future cases was Briggs J's conclusion that the solicitation would have, in any case, failed owing to the actual and/or threatened oppression of the minority of bondholders who did not participate in the exchange.

## Conclusion

There was a strong market reaction to the *Assenagon* judgment. Attempts in recent years by minority creditors to protect themselves from votes of the majority have usually failed. By contrast, a small inducement to vote in favour of consent solicitations or so called 'early bird' fees are relatively common practice in the UK capital markets and the *Azevedo* case, now confirmed by the Court of Appeal, may well be seen by market participants as nothing more than endorsing a practice which is fairly widespread. The heavily coercive nature of the Anglo Irish Bank approach (mirrored in practice by certain other Irish banks) is not seen as standard commercial practice given the nature of the technique that allowed expropriation of the bonds of dissenting bondholders for virtually no consideration.

It is interesting to speculate how the English judiciary would react to another type of coercive technique, often seen in US restructurings, where exiting bondholders who accept an offer are required to strip the bonds they leave behind of key protective covenants. These so called 'exit consent' or 'covenant stripping' techniques could potentially fall foul of the minority oppression arguments which Briggs J found persuasive in *Assenagon*. Given such uncertainty, at least until a scenario equivalent to *Assenagon* is considered by the appellate courts in England, it may be that companies decide not to risk the challenge of a disgruntled bondholder on minority oppression grounds and instead of 'covenant stripping' may prefer to implement a restructuring of their bonds either by the 'carrot' of a consent payment or alternatively seek to use a more formal restructuring technique, such as a UK scheme of arrangement.