Exit Consents Unlawful Under English Law

30 July 2012

On 27 July 2012, the Chancery Division of the English High Court upheld a challenge to the legality of an exit consent on the basis that it was oppressive towards the minority bondholders and at variance with the purposes for which majorities in a class are given power to bind minorities. The court also upheld a separate claim that the use of the exit consent in issue was caught by a prohibition in the applicable trust deed against the issuer voting bonds beneficially held by it or for its own account.

The court's judgment, delivered by Mr. Justice Briggs, is the first judicial pronouncement on the legality of exit consents under English law and, unless overturned on appeal, casts doubt on the effectiveness of exit consents to restructure debt. The impact of the decision is likely to be significant given the widespread use of exit consents in debt restructurings.

The Exchange Offer and Exit Consent

The claimant, Assénagon Asset Management S.A., purchased €17 million of subordinated notes issued by Anglo Irish Bank Corporation Limited between September 2009 and April 2010. The subordinated notes had been trading at less than 50% of their face value at the time and were due to mature in 2017.

Following the nationalisation of Anglo Irish in January 2009 and subsequent capital infusions from the Irish government over the course of 2009 and 2010, the Irish government proposed to restructure Anglo Irish's debt to impose losses upon subordinated bondholders. In October 2010, Anglo Irish launched an exchange offer, pursuant to which subordinated noteholders were invited to exchange their bonds for new senior notes (for every €1 of subordinated notes, noteholders would receive 20 cents of new senior notes) *provided* that they also voted in favour of a resolution which, if passed by more than 75% of voting noteholders, would allow Anglo Irish to redeem all of the outstanding subordinated notes for a nominal amount (equal to €0.01 per €1,000 in principal amount).[1]

The exchange offer was successful. Approximately 92% of the subordinated noteholders by value agreed to exchange their notes and voted in favour of the resolution at a bondholder's meeting in November 2010. Anglo Irish subsequently exercised its newly acquired right to redeem the remaining subordinated notes and the claimant, which had not exchanged its subordinated notes and had not voted in favour of the resolution, received €170 for its €17 million face value of notes.

Assénagon's Claim

In April 2011, Assénagon sought a declaration that the November 2010 resolution was invalid on three grounds. First, it was submitted that the resolution was beyond the power of the majority noteholders, as it conferred upon Anglo Irish a power to expropriate the subordinated notes for a nominal sum. Second, it was submitted that the noteholders who voted in favour of the resolution held their notes beneficially, or for the account of Anglo Irish and therefore those votes should have been disregarded pursuant to the disentitlement provision under the trust deed. Finally, it was submitted that the resolution constituted an abuse of power of the majority as it conferred no benefit upon the noteholders as a class and was both

[1] While indentures issued in the United States are generally subject to the Trust Indenture Act, which requires a 100% vote to reduce the principal amount of debt, English law does not impose a similar requirement.

oppressive and unfair against the minority who had not agreed to participate in the exchange offer and vote in favour of the resolution.

The High Court's Judgment

Briggs J rejected the claimant's first ground on the basis that the trust deed, taken as a whole, contemplated that a majority could effectively bind the minority as to a forfeiture of the rights conferred by the notes, by cancelling either or both of the principal and minimum interest payable thereunder.

The second ground was upheld by Briggs J who determined that at the time of the bondholder meeting in November 2010, which was held after the results of the exchange offer had been announced but before settlement, Anglo Irish had a beneficial interest in the notes held by the relevant majority because such notes were the subject of a specifically enforceable contract for sale by exchange. As a result, these notes fell within the prohibition in the relevant trust indenture aimed at preventing the voting of notes in Anglo Irish's interests rather than in the interests of the noteholders as a class.

Despite finding in favour of the claimant on the second ground, which was sufficient to grant the declaration sought, Briggs J also addressed the third ground as it raised a "question of wide importance within the bond market." Having characterised the resolution as a negative inducement to deter noteholders from refusing the proffered exchange, Briggs J concluded that it was not lawful for the majority to aid the coercion of a minority by voting for a resolution which expropriates the minority's rights under their bonds for nominal consideration.

In so holding, Briggs J declined to follow cases applying New York law, most notably, ***Katz v Oak Industries Inc.***, which have concluded that voting of securities by majority noteholders pursant to exit consents do not run afoul of provisions that prohibit the issuer from voting treasury securities, and that exit consents are not an abuse of power or unduly coercive in light of the ability of all holders to participate in the exit consent offer.

Comment

The *Anglo Irish* decision casts doubt on the legality under English law of any form of exit consent that imposes less favourable consequences upon those who decline to participate in any associated exchange offer, even if such exit consent does not lead to a complete expropriation of the relevant securities as occurred in the *Anglo Irish* case.

The outcome of the judgment is surprising, in view of the fact that the bondholders, including the claimant, were sophisticated investors, the inducement to participate in the exchange offer was offered to all holders, and the consequence of not doing so was clearly communicated to the holders in the exchange offer memorandum.

In the United States, exit consents are commonly used debt restructuring tools and have survived judicial challenge by minority bondholders on several occasions. As the High Court's decision has thrown into doubt the legality of exit consents under English law, unless (and until) the judgment is overturned on appeal, issuers should strongly consider adopting New York law as the exclusive governing law of their debt instruments (and imposing exclusive U.S. jurisdiction) in order to preserve the flexibility to use exit consents as a possible restructuring tool in the future.

- **See** *Assénagon Asset Management S.A. v. Irish Bank Resolution Corporation Limited (Formerly Anglo Irish Bank Corporation Limited)* [2012] EWHC 2090 (Ch).

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