

# Noteholder Meetings: Paying the Price for Change?

In a recent decision, the English court has confirmed that payments offered to holders of debt securities in return for their consent to amendments to the terms of the notes are not bribes or illegal where they are made openly to all noteholders and no noteholders are prevented from voting. Payments only to those noteholders who vote in favour of a resolution are permissible and do not breach the requirement to treat note holders as a class and distribute any payments *pari passu*.

## Consent Fees and Noteholder Meetings

The unreported decision of the High Court in *Azevedo v Imcopa Importacao and others* earlier this week has provided some welcome clarification on the ability to pay consent fees in connection with noteholder meetings and given a reassuring approval of existing market practice.

### Background

It has for some time been a common practice in connection with English law noteholder meetings that consent fees are offered to noteholders in order to incentivise them to deliver voting instructions and to approve proposals to modify the terms and conditions of outstanding debt securities. In English law liability management transactions, there has always been a residual uncertainty as to whether consent fees that are only made available to holders

who vote in favour of the modifications are in fact permissible.

Although this has long been the practice in US transactions, under English law there remained some uncertainty that such arrangements could be open to challenge on the basis that they offended against principles of equal treatment or the equitable doctrine that modification powers must be exercised "*in the interest of the class of holders as a whole*".

In the *Azevedo* decision, the English Court has for the first time affirmed this practice as being permissible under English law, and given some clear guidelines as to basis for its decision.

### Facts of the Case

One of the defendants in the *Azevedo* case had issued bonds in the form of loan notes, constituted by a trust deed, and which had been purchased by the claimant. The original issuer was later substituted by another defendant as

## Key issues

- Court upholds payment of consent fees in connection with Noteholder Meetings
- Fees can be paid only to holders who vote in favour of a resolution
- Open disclosure of fee arrangements required

issuer of the notes. A restructuring plan was subsequently formulated, and three proposals in the form of consent solicitations were sent to all the noteholders, asking for their consent to an amendment to the terms of the notes in return for a consent fee payment.

The claimant only consented to the first two amendments but not the third. The claimant received the payments to which it was entitled for having voted on the first two proposals, but all three proposals were in fact approved by the requisite majority of noteholders.

The amendments to the loan notes were part of a wider restructuring of Imcopa Importacao that was subsequently approved by the Brazilian courts. Once the Brazilian court approval had been obtained, and the third set of proposals were implemented, the claimant then tried to argue that the defendants were in repudiatory breach of the loan note purchase contract on the grounds that the consent fee payments were unlawful. The claimant asked the Court to award them repayment of the sums lent under the notes, plus damages for breach of contract.

## Issues

Amongst other arguments, the claimant suggested that because the offer of a consent payment was a bribe it should therefore be illegal and invalidate the votes in their favour, and that it furthermore amounted to different treatment of those noteholders that had consented and those that had not consented, which was contrary to the obligation to treat noteholders as a class and distribute any payments *pari passu*.

## The Court's Decision

Following the reasoning in *Goodfellow v Nelson Line (Liverpool) Ltd* and *British American Nickel Corp Ltd v MJ O'Brien Ltd* Mr Justice Hamblen concluded that consent fee payments were not bribes when made openly and where no noteholders were prevented from exercising their voting rights.

Although there was no previous English authority on the point, the judge did acknowledge that US Courts had previously held that consent solicitations involving fee payments were a commonly used means of debt restructuring. The judge was particularly influenced by a Delaware case of *Kass v Eastern Airlines Inc* which drew a distinction between consent fees that

are offered openly and private arrangements that are not fully disclosed. In the judge's view this reasoning was consistent with the English authorities mentioned above.

The key factors behind the judge's decision to allow the fee payments in *Azevedo* were:

- the consent fees had been openly and repeatedly disclosed in documents that were made available to all noteholders
- the fees were payable to all noteholders voting in favour;
- There was nothing in the trust deed or the notes that could be construed as in any way preventing the payment; and
- each noteholder was entitled and free to vote as he wished.

The Court also confirmed that the payments were not inconsistent with the *pari passu* requirements in the status provisions of the loan notes.

The Court was also influenced by the fact that the claimant had voted in favour of (and received) the first two fee payments, and in the Court's view, the claimant was therefore implicitly acknowledging that the payments were lawful. All three resolutions had been passed by a substantial majority, and each consent solicitation was part of a wider restructuring approved by the Brazilian courts.

## Comment

The Court's decision in *Azevedo* represents welcome support for what has become an increasingly common market practice of only paying consent fees to those who support an Issuer's proposals. It also helps to provide some guidance as to the criteria which will be

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relevant to determining whether consent fee arrangements will be upheld under English law.

The Court did not however have to consider whether any particular limits should be imposed on the size of any such consent fees however, nor did it express any misgivings as to the nature

of the underlying proposals which had been sanctioned by the Brazilian Court. As a result, care should still be taken in circumstances where resolutions or modifications are proposed which are clearly detrimental to a holder's rights, (e.g. compulsory redemption or squeeze out provisions), as the payment of a consent fee would not necessarily remove any concerns as to the fairness of the underlying proposals.

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