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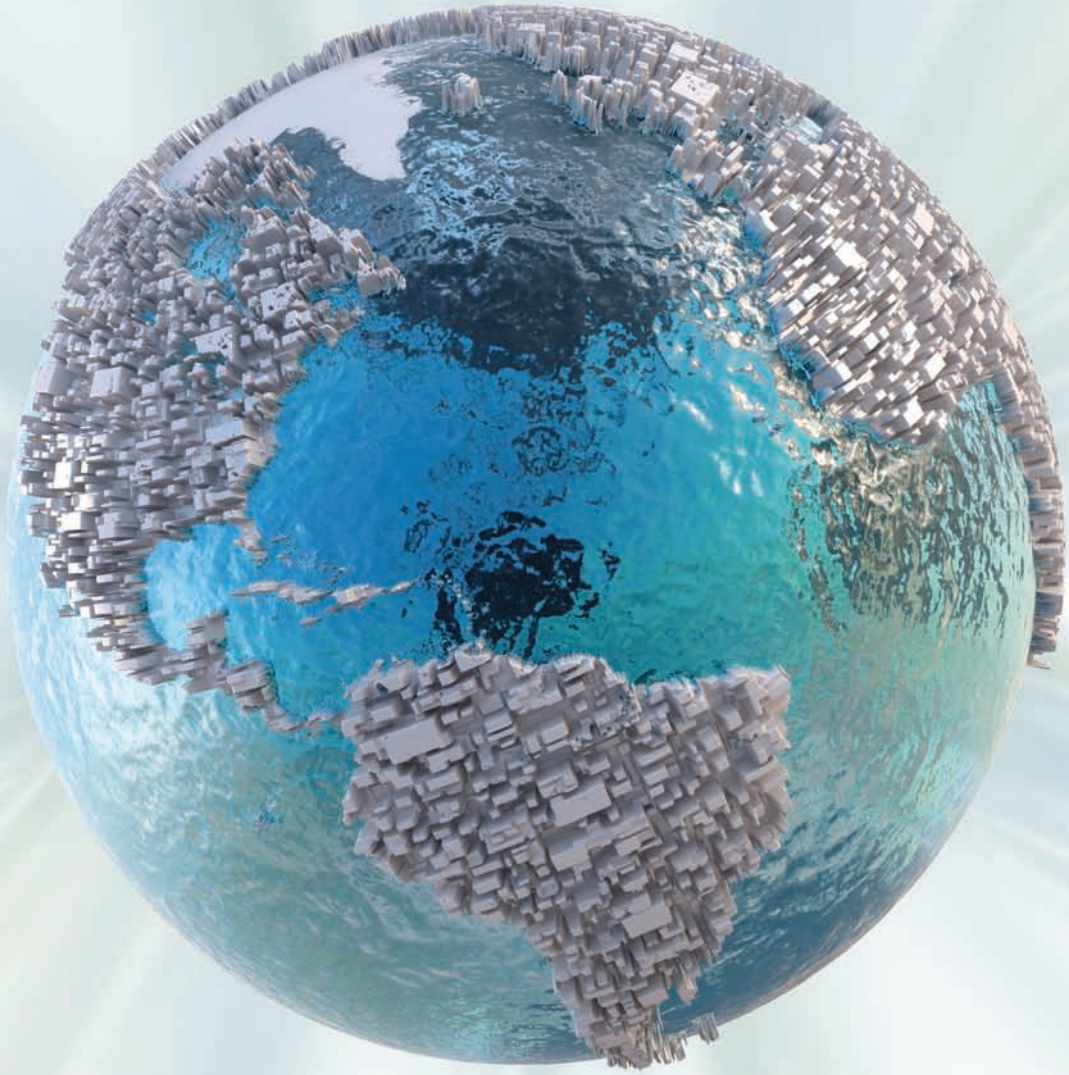

Building the new world

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Drafting under scrutiny

Bond documentation has failed to keep pace with changing bondholder meeting practices. Draftsmen should take note of these common discrepancies

Few of us can claim to have extensive experience of bondholder meetings. At times, when a bond is issued and the requisite documentation drafted, insufficient attention is paid to the possibility of a bondholder meeting being held. There is a good reason for this – bondholder meetings aren't a regular occurrence for a lawyer.

Although a bondholder meeting may be called to consider any matter affecting holder interests, in practice a meeting is usually convened only in a debt restructuring context. This, of course, is not always the key consideration for the team structuring, arranging and drafting a bond issuance. However, in a world in which the terminology of restructuring, insolvency and bondholder activism has become familiar to all, bondholder meetings are growing in frequency. This means that the provisions governing these meetings are increasingly relevant, and subject to increased scrutiny.

Recent English case law has cast some doubt over a narrow interpretation of bondholder meeting provisions. In *Assénagon Asset Management SA v Irish Bank Resolution Corporation Ltd [2012] EWHC 2290*, the validity of an exit consent was challenged by a minority holder. The court held that bondholder meeting provisions should not be considered in isolation, but instead should be interpreted along with the trust deed as a whole. This broader, more purposive approach means that ambiguous or confusing terms in a bondholder meeting provision schedule should be read in conjunction with all of the bond documentation, and also in the context of the transaction. This follows case law guidance on contractual interpretation, and should serve as helpful guidance for those tasked with interpreting bondholder meeting provisions, where the drafting isn't clear. The case highlights the importance of clear drafting to reflect both commercial intent and practical reality.

Unfortunately, while market practice has changed over the years from the issuance of definitive bearer bonds, to bonds held via a clearing system, bond documentation, and in particular bondholder meeting provisions, has often failed to keep pace with changes in practice. This means that documents often include redundant language. Certain provisions which no longer follow market practice are ambiguous, or at best simply superfluous. It makes it timely to consider new practices in bondholder voting mechanisms.

Provisions or practice?

Publication of notice

Bond documents usually contain a requirement to publish the meeting notice on the relevant stock exchange website (if the bonds are listed) or through the relevant clearing system (should the bonds be held in global form, as is the case for most bonds issued today). Publication of notices by such means is either free, or is carried out in return for a nominal amount. Importantly, the notice can usually be published within 24 hours of delivery by the issuer – helpful when a transaction is running to a tight timeframe.

Since most bond investors hold their bonds in electronic form, and choose electronic rather than print news sources, the value of publication in a newspaper is limited. Such publication is comparatively expensive, and the newspaper may require that the final form of the notice is delivered several days before publication.

In some cases, where the bonds are to be listed on a stock exchange whose rules require the publication of the notice in a newspaper, then the draftsman's hands are tied – newspaper publication should be specified. The newspaper is usually specified in the terms and conditions – most commonly a newspaper circulated nationally in the jurisdiction where the issuer is incorporated, or an international financial newspaper such as the Financial Times.

Other bond documents may state that (subject to no definitive bonds being issued) newspaper publication is not required, provided that the notice is posted on the relevant stock exchange or clearing system website, or alternatively, that newspaper publication is only applicable if the relevant stock exchange rules so require. Many exchanges, including the London Stock Exchange, no longer require newspaper publication if a notice is published on its website.

However, newspaper publication continues to be a requirement for certain issuances, even if the bonds are listed, and there is no stock exchange requirement for newspaper publication, and bonds are held in a clearing system. In such instances, the continued inclusion of such a requirement is anachronistic.

Clarity of purpose

Most meeting provision schedules specify that the business of the meeting should be set out in the notice. However, the level of detail required may be unclear – for example, references may be made to setting out the 'nature of the business to be considered' or simply 'the agenda'.

At a practical level, it is in the interests of both the issuer and the holders that the holders are provided with clear and full information in the notice. Issuers may also wish to consider establishing a website or web pages where holders can obtain further information as to meeting mechanics and process – this may be particularly helpful in a restructuring scenario. The provision of such information will reduce the volume of holder queries once the notice has been published, and means that holders or their proxies attend the meeting fully informed, ensuring that the process runs smoothly. Given that a bondholder meeting is very scripted and procedural, it isn't usually the appropriate forum for a holder or proxy to

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ask detailed questions as to the nature of the resolution.

Where a decision is to be made by way of extraordinary resolution, it is good practice to either set out the resolution in full, or to include a full explanation as to the implications of the extraordinary resolution in the event that it is passed. Fortunately, many meeting provisions include this requirement. Where not expressly set out, the party issuing the meeting notice should be mindful of the benefits of providing such information. Likewise, draftsmen should consider the use of this wording. Where a matter is to be decided by ordinary resolution, the implications of the resolution being passed are likely to be of lesser significance. In such instances, the party issuing the notice should have the scope to include in the notice such information as it deems to be sufficient. However, the reality is that most bondholder meetings are convened to consider matters that will have a material effect on the rights of holders – and so, in practice, inclusion of a full resolution or explanation should be the norm.

> **Today, a 21-day notice period seems excessive – a 14 day, or even 10 day notice period would be more appropriate**

Notice period

Many English law bond documents contain a 21-day notice period. Today, 21 days seems excessive – a 14 day, or even 10 day notice period would be more appropriate. A shorter notice period is of particular help in the context of a debt restructuring, where the form of the resolution may not be finalised until late in the process. Once the notice is published (usually with the resolution set out therein), the resolution for consideration at the meeting is final – and so the shorter the time period between finalising the resolution and holding the meeting, the better.

Attendees and quorum

Bondholder meeting provisions often specify that the quorum requirement must be met by the presence of one or two attendees, being either a holder or proxy, and representing a certain percentage of the aggregate outstanding principal amount of bonds.

Attendance by the holder Some bond documents do not have a clear definition of bondholder or holder. Other documents include a definition, but the holder is defined as the physical holder of the bonds. In a market where many bonds are issued in the form of a bearer bond in global form, it is the common depository who is the physical holder of the bonds, as custodian for the clearing system. The common depository is not an agent of the holders, and they will not typically wish to act on behalf of the holders with respect to bondholder meetings. Similarly, note or bond may be defined in the plural, without reference to the holder of an individual note or bond. A strict interpretation of the definition often results in the global bond being the bond or note, rather than each individual bond held by the beneficial holders.

Drafting should make it clear that the holder is the person shown in the records of the relevant clearing system as holder of a particular principal amount of the bonds, and that (other than with respect to the payment of principal or interest), the holder of the relevant global bond should not be deemed to be the holder. Certain law firms made this change to their standard form in recent years, and it would be encouraging to see others follow suit.

How many attendees? Under certain circumstances, a quorum requirement of two attendees is appropriate, and in other situations, a one attendee requirement would be preferable.

For example, where a single block voting instruction has been issued with respect to votes both for and against the resolution, two proxies should be appointed. At the meeting, one proxy will complete a voting card with respect to the votes for the resolution, the other will complete a voting card with votes against.

In other scenarios, a quorum requirement of two attendees can lead to problems. A single holder may hold the entire outstanding principal amount, so any meeting would be inquorate, even though all bonds are represented. This situation can be addressed by instructing the single holder to nominate two attendees, or to pass a written resolution in place of hosting a meeting (if permitted by the provisions). Another solution is to amend the agency agreement or trust deed. Such documents usually allow the issuer to amend or modify where such amendment or modification is of a technical nature, and does not prejudice the interests of the holders. In practice this amendment or modification can be documented by way of a side letter, to be signed by the fiscal agent or trustee. However, while there are such practical solutions to the problem, it would be helpful to consider the possible eventualities when drafting.

A common drafting solution is to set a quorum requirement of two attendees, with a one attendee carve-out. Such a carve-out then applies should there be a single holder of all outstanding bonds. However, problems remain with this approach, in particular if an issuance is not widely held. For example, a holder may hold 90% of the bonds, and a minority holder may hold the remaining 10%. The minority holder could ensure that a meeting is not quorate by not attending. A quorum requirement of one would be preferable, with a two attendee carve-out where a block voting instruction is issued with votes both for and against.

Other attendees The drafting is often unclear as to whether other parties (such as legal advisors) may attend along with the relevant holder or proxy, which can lead to problems if the attendee arrives with advisors expecting that they are to be admitted to the meeting. This should be clearly set out in the provisions, and in the notice. It would also be helpful to establish the forms of identification that are acceptable in order to grant such admittance.

Show of hands

The default method of voting is often specified as being by way of a show of hands. On a show of hands, each proxy or holder has one vote. This is rarely practicable. For example one holder may attend representing 75% of the outstanding principal amount, and another holder representing 25% of the outstanding principal amount. If the 75% holder voted in favour of the resolution, and the 25% holder against, the result on a show of hands would be 50/50, which isn't representative of the actual holdings. Further, in the event of a 50/50 result, the provisions may specify that the chairman has a casting vote. In many cases, the chairman is appointed in writing by the issuer – often the issuer's legal counsel is chosen. This means that, in theory at least, the vote could be swung in the interests of

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the issuer. There have been instances where holders, fearful that a vote would be carried out by show of hands, with the issuer's counsel potentially having the casting vote, have attended the relevant meeting in person to keep an eye on proceedings – although their presence would not prevent the chairman from exercising that casting vote.

Fortunately, most meeting provisions allow for the chairman to demand a vote by way of poll instead, or have a carve-out for an automatic poll where there is only one voting party. Demanding a vote by way of poll may be at the discretion of the chairman, and so it may be argued that the risks outlined above remain – the chairman could still direct a vote by show of hands, and possibly exercise a casting vote. In practice, common sense prevails – voting almost always takes place by poll. The show of hands wording is another anachronism, and has limited value in today's market.

Deposit of bonds

Meeting provisions commonly present a holder with two options to attend (whether in person or in proxy) and vote at a bondholder meeting. Some will choose to attend in person or by proxy by means of voting certificate, this being a document presented at the meeting as proof of entitlement to attend and vote. Others may request that the votes attributable to his bonds are included in a block voting instruction, this being a document nominating a proxy to vote on behalf of one or more holders.

Provisions often state that to obtain a voting certificate or to attribute bonds to a block voting instruction, a holder must deposit bonds with the paying agent at least 48 hours before the meeting. In a world of clearing system holdings, this is rarely appropriate. In practice, the holder (or the holder's clearing system member) will instruct the clearing system to block his bonds. The paying agent will be notified, and will then either issue the voting certificate or include the bonds in the block voting instruction. Encouragingly, many bondholder meeting provision schedules at least contemplate that bonds may be held in a clearing system. Good drafting practice would be to ensure that provisions reflect practice – but unfortunately that isn't always the case.

Changes in clearing system practice

Clearing system practices have and will continue to change over time, and good drafting will seek to accommodate this. For example, it should be made clear that references to the deposit of bonds should be construed in accordance with the standard practices of the relevant clearing system.

Another helpful provision permits the trustee or agent to prescribe such additional provisions, or amend existing provisions, as it sees fit in order to reflect the practices of the relevant clearing systems. Notice of any alternative or additional provisions can then be given to the holders in the notice of meeting. There is a danger of being too prescriptive in the meeting provisions – such wording allows a great deal of flexibility.

A third way?

The restructuring of Greek private sector debt in 2012 affected multiple series of bonds, either issued or guaranteed by the Hellenic Republic. Given the number of affected bonds, an additional voting mechanism was introduced in an effort to streamline the process. In addition to the usual voting certificate or block voting instruction options, holders with a clearing system account were also able to participate by means of a 'participation instruction'. Having received a standard form participation instruction via the clearing system, holders choosing this method submitted a completed version through the clearing system to the paying agent – irrevocably instructing the paying agent to appoint two employees of the tabulation agent to vote either for, or against the resolution. Submission of a participation instruction resulted in the relevant bonds being blocked. Those holding bonds through a third party's clearing system account were able to instruct such third party to submit an instruction on its behalf.

The distinction between the participation instruction and the block voting instruction approach is subtle. In each case, holders' bonds are blocked, and then a proxy is appointed by way of electronic instruction. However, under the participation instruction approach, the proxy is a tabulation agent, acting in such capacity in respect of all series of bonds subject to the restructuring – the proxy function is centralised. The holder benefits from a simple process – by submitting the form, the bonds are automatically blocked and the proxy appointed. The issuer benefits from improved visibility, and control over process. In the lead-up to the meeting, the tabulation agent can monitor the percentages voting for or against the resolution – meaning that the issuer (where all or most votes are cast by way of participation instruction) can anticipate the meeting result.

Such an approach may only be suitable under certain circumstances. Even where meetings are held in respect of several series of bonds, the preparatory work involved in a participation instruction approach would rarely be practicable. The Greek transaction required special arrangements with the relevant clearing systems to ensure that systems were in place for participation instruction submission, and the delivery of the participation instructions to the paying agent and tabulation agent. However, these voting mechanics do have their place in large sovereign restructuring transactions, where meetings may be called in respect of multiple series. This is likely to be a voting method that we will see more of in the future – and it should be a consideration both for draftsmen, and advisors to distressed sovereigns.

Looking forward

Bond documentation does not always reflect market practice, particularly in relation to bondholder meetings. With bondholder rights under increased scrutiny, the provisions for the holding of meetings are of great importance. Draftsmen should be mindful of market practice, and consider whether the forms that are used in new issuances contain redundant or ambiguous language. In the absence of clear language, caution is urged in interpretation.

By Matthew Czyzyk of Cleary Gottlieb Steen & Hamilton in London

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