STEPHENSON HARWOOD

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Stepping in or over-stepping?

The Court has recently been called upon to consider the validity of the purported appointment of administrators over the issuer of notes by a noteholder purporting to act in the name of the note trustee in *Fairhold Securitisation Limited and Another v Clifden (IOM) No.1 Limited and Others. A number of issues of interest were considered in the judgment including:*

1. the evidence of noteholdings which a note trustee is entitled to require from a noteholder;
2. on the assumption that a valid enforcement direction is given to a note trustee, the period of time in which the note trustee may consider such direction before either acting in accordance with it or declining to act. This was directly relevant to the question of whether the note trustee had, on the facts of the case, become bound to act but failed to do so, thereby entitling the noteholder to take enforcement action; and
3. the nature of the enforcement action which a noteholder would be entitled to take to enforce its rights against the issuer.

Background facts

The case concerned Fairhold Securitisation Limited, a bankruptcy remote vehicle, which issued notes in a principal amount exceeding £440 million (the "Issuer"). GLAS Trust Corporation Limited is the note trustee of the notes (the "Note Trustee") and the qualifying floating charge holder over the Issuer's undertaking, property and assets for the purposes of Schedule B1 to the Insolvency Act 1986.

Clifden (IOM) No.1 Limited ("Clifden") approached the Note Trustee and indicated that it proposed to issue an enforcement direction and appoint administrators over the Issuer. At the time, the terms and conditions of the notes provided that a noteholder direction could be made by holders of at least 25% in aggregate of the principal amount outstanding of the notes. The Note Trustee made repeated requests for evidence of Clifden's noteholding. Some limited documentation was provided but the Note Trustee did not consider it to be satisfactory.

In June 2018, by extraordinary resolutions of the noteholders, the terms and conditions of the notes were amended to provide that a noteholder direction could only be made by holders of at least 50.1% in aggregate of the principal amount outstanding of the notes.

By notice dated 12 July 2018, Clifden purported to appoint administrators over the Issuer under paragraph 14(1) of Schedule B1 to the Insolvency Act 1986 (i.e. by the qualifying floating chargeholder) (the "Notice"); Rizwan Hussain, a director of Clifden having signed a statutory declaration stating that Clifden was acting as agent of the Note Trustee in making the appointments. It was common ground that the Note Trustee had not authorised Clifden to act as its agent.

In giving his judgment, the Judge had regard to a number of important sub-issues in reaching his decision.

Issue 1: Did the Note Trustee make the Appointment?

The appointments were purportedly made pursuant to paragraph 14(1) of Schedule B1 to the Insolvency Act 1986. Pursuant to paragraphs 14 and 18 of the Insolvency Act, this process is only available to the holder of a qualifying floating charge, as defined.

It was common ground between the parties that the Note Trustee was the sole qualifying floating charge holder. It was also common ground between the parties that the Note Trustee did not file the Notice, nor did it take any part in that process. The starting point was therefore that the qualifying floating charge holder did not make the appointments and

that the requirements of the Insolvency Act were not, on their face, met.

Issue 2: Did Clifden have the right to step in to the shoes of the Note Trustee and appoint the administrators itself?

Whilst Clifden accepted that the Note Trustee was the sole holder of a qualifying floating charge and that the Note Trustee had not itself made the appointments, Clifden argued that it had the right to step in to the shoes of the Note Trustee and therefore to make the appointments in the Note Trustee's name.

Clifden relied upon certain provisions of the Trust Deed including that:

- The Note Trustee was not bound to take any proceedings, action or steps or any other action:

  "Unless: *(a) subject to the proviso below, and other than in the case of declaring the notes to be due, it is directed to do so by an extraordinary resolution of the Class A noteholders or the Class B noteholders or in writing by the holders of at least [25%/50.1%] in aggregate of the principal amount outstanding of the Class A notes and the Class B notes then outstanding*" (emphasis added); and

- *"No noteholder shall be entitled to proceed directly against the Issuer or any other party to the Transaction Documents or to enforce the Issuer Security unless the Note Trustee, having become bound to do so, fails to do so within a reasonable period and such failure shall be continuing…*" (emphasis added).

Clifden argued that the effect of these provisions was that there was an implied agency such that where the Note Trustee had become bound to act (i.e. upon receipt of a written direction by the holders of at least [25%/50.1%] in aggregate of the principal amount outstanding of the Class A notes and the Class B notes then outstanding) but did not act, a noteholder was entitled to appoint an administrator as if it were standing in the shoes of the Note Trustee.

The Judge was unpersuaded. The Note Trustee took the Court through various provisions in the Trust Deed and Issuer Deed of Charge, all of which demonstrated that it was the Note Trustee who had the discretion whether to take enforcement action, and nobody else. The Note Trustee argued that the Note Trustee was the only party who had legal title to enforce, as the holder of the qualifying floating charge. The Note Trustee pointed out that there was a separate remedy open to a beneficiary in circumstances where it considered that a trustee had become bound to act, but failed to do so – the beneficiary was entitled to make an application to court for directions requiring the trustee to act or, in relation to its holdings only, seek to enforce its rights, which action could include an application for an administration order pursuant to paragraph 10 of Schedule B1 to the Insolvency Act 1986.

The Judge found that Clifden's argument failed both on the facts and in law. He held that "*In the ordinary course a creditor, which would be the noteholder, could proceed against the borrower, but this right is restricted. When that restriction is removed, they just fall into the position of the ordinary creditor who can proceed directly against the borrower. But that does not mean that they are entitled to do so in the name of the trustee.*"

Issue 3: Did Clifden hold sufficient notes to direct the Note Trustee to act at all?

Clifden asserted that it held 67% of the notes issued by the Issuer. It therefore argued that it was entitled to give a noteholder direction to the Note Trustee.

Clifden's alleged noteholding was said to be broken down as follows:

- £141 million worth of notes that had been purchased in trades with members of the "Ad Hoc Group" (the "**Ad Hoc Notes**"); and
- a second set of notes that were subject to a tender offer made by Clifden in Febraury 2018 and extended thereafters (the "**Tender Offer Notes**").

Clifden alleged that it had entered into trades with a settlement date of 20 February 2018 to acquire the Ad Hoc Notes. Clifden further alleged that, because it had in the meantime launched its tender offer for the notes, regulatory requirements prevented it from making payment on the settlement date. However, by contractual agreement, the settlement date was extended. Clifden failed to produce any evidence supporting its arguments.

In respect of the Tender Offer Notes, Clifden relied on a letter from the tender offer agent, addressed to the Note Trustee. The letter stated that the tender offer agent held "*no less than £40 million of Class A notes irrevocably tendered and held to the order of Clifden for a period no sooner than 28 September 2018*" and went on to state that "*The beneficial owners have appointed Clifden as their duly authorised agent for the purposes of any correspondence and discussions with the Note Trustee*".

The Note Trustee argued that the letter fell short of evidencing any noteholding on Clifden's part. It pointed out that it did no more than say that the beneficial owners authorised Clifden to correspond with the Note Trustee. It did not give Clifden the status of a noteholder. Clifden relied on a further letter from Credit Suisse but this was of no assistance to the Note Trustee as it did not provide any details which would enable the Note Trustee to determine that Clifden was in fact a noteholder.

The Judge agreed with the Note Trustee's approach. The documentation provided to the Note Trustee to evidence Clifden's holding was wholly inadequate. The Judge noted that, at best and if valid, the documents supported a holding of just 10%. In relation to the Ad Hoc Notes, the Judge was "*struck by the lack of documentary support for these substantial trades*."

The Judge held that Clifden had failed to establish that it was in fact a noteholder of any notes. Clifden had therefore failed to demonstrate that it was entitled to give any noteholder direction at all.

Issue 4: Did the Note Trustee have a reasonable period of time to consider the note direction but thereafter fail to act?

Notwithstanding this finding, the Judge went on to consider what the position would have been if Clifden had been a noteholder (with the requisite holdings) and had delivered a noteholder direction to the Note Trustee.

In order to have become entitled to act on its own behalf, Clifden would have had to: (i) serve a written direction on the Note Trustee; (ii) provide an indemnity to the reasonable satisfaction of the Note Trustee; and (iii) allow the Note Trustee a reasonable period of time to consider the note direction but thereafter fail to act.

Remarkably, Clifden's evidence failed to deal with the steps that it took to serve the note direction on the Note Trustee or to file the notice of appointment of administrators with the Court. On the evidence before the Court, however, it appeared that Clifden had in fact filed the notice of appointment of administrators with the Court some hours prior to serving the purported note direction on the Note Trustee (at around 1:30pm on 12 July 2018). Indeed, the Note Trustee only became aware of the purported note direction after it had been emailed a copy of the notice of purported appointment of administrators later that evening. The Judge held that the Note Trustee had clearly not been given a reasonable period of time in which to act; there had in fact been a negative notice period. However, he went on to say that "*the suggestion that the Note Trustee could have any less than 24 hours to consider the direction, to see how they should proceed, to look at the indemnity, well, frankly, the suggestion that it should be any less than 24 hours is unarguable. In fact, 24 hours is unlikely to be long enough for the Note Trustee to weigh up the options, take advice, investigate the indemnity; and, on the facts of this case, investigate whether they were actually dealing within somebody who is entitled to give a direction at all.*"

The Court separately considered whether the purported administrators had given their consent to act. On the evidence, the Judge concluded that they had not.

The Judge made an order declaring the purported administration to be void and of no effect and granted a series of injunctions against Clifden and Mr Hussain in his personal capacity. He commented that Clifden and Mr Hussain's behaviour had amounted to "*an unprincipled asset grab*". Indeed, the Judge was very critical of Clifden and Mr Hussain's approach to the transaction and the proceedings in general. He commented that there was "*a high degree of unreasonableness in [their] behaviour and also [in their] defence of [the] application". Mr Hussain and Clifden's behaviour towards the Note Trustee and the Issuer had "undoubtedly been harrying*".

Clifden has made an application for permission to appeal.

Practical implications

- The Court has re-affirmed that, for the purposes of paragraph 14(1) of Schedule B1 to the Insolvency Act 1986, it is only the holder of the qualifying floating charge that may make the appointment. There is no basis upon which a noteholder is entitled to step into the Note Trustee's shoes and exercise rights on its behalf.
- A Note Trustee is entitled to require evidence reasonably satisfactory to it to establish a noteholder's holding.
- Where a note direction is purportedly given, the Note Trustee is entitled to a reasonable period of time in which to consider it and to take appropriate advice. Although there was a suggestion before the Court that a period of 24 hours might be sufficient for this purpose, the Judge doubted that this was the case. In his view, 24 hours was unlikely to be long enough.
- As was alluded to by the Judge when he referred to the need for the Note Trustee to have time to investigate the indemnity, a trustee's obligation to

- act on directions will almost always (as it was here) be subject to the trustee being indemnified to its satisfaction. The meaning of "indemnified to its satisfaction" has been considered previously by the House of Lords in *Concord Trust v Law Debenture Trust Corporation plc*. Following *Concord Trust*, assuming that the trustee has determined that a particular risk against which it seeks to be indemnified is more than "merely fanciful" and that it is reasonably arguable that the trustee may incur the relevant liability, the trustee is then entitled to an indemnity on a "worst case scenario" basis. It is therefore clear that the very exercise of assessing the adequacy of an indemnity is an involved one and unlikely to be something a trustee will or should ever rush.
- As a practical matter, once a court has agreed that a no-action clause has been triggered, individual bondholders must each then proceed to take relevant enforcement action against the issuer directly. Therefore, one of the key strengths of the trust structure in a bond issue (namely enforcement by the trustee on behalf of its beneficiaries) is lost. The importance of collective action through a trustee was not lost on Collins LJ in the Court of Appeal decision in *Elektrim SA v Vivendi Holdings 1 Corp* who stated that "*The no-action clause should be construed, to the extent reasonably possible, as an effective bar to individual bondholders pursuing, for their own account, what are in substance class claims*". The consequences, both in relation to the issuer and bondholders under a particular trust deed and also in relation to the precedent this could set for the market, of holding a trustee to a short time period within which to act on a direction would certainly never be underestimated by a court. On this basis alone it seems highly unlikely that a bondholder would successfully be able to argue that a trustee became bound to act, and failed to do so, within anything near 24 hours of being given a direction by the requisite percentage of bondholders (often a minority).
- It is also interesting to note that a typical no action clause in a New York law governed trust indenture for a bond issue will commonly provide that a no action clause becomes actionable if the trustee has failed to act on directions within a 60 day "hold" period following the relevant request and offer of indemnity. Although it presumably remains open to a US trustee to act sooner, the drafting provides no particular incentive to do so. However, by not tying the trustee to any particular time period within which to act English law "no action" clauses enable and empower a trustee to adapt to the particular circumstances it faces.
- Finally, this decision confirms the orthodox view that the noteholder's "remedy" in circumstances where a trustee does actually become bound to act but fails to do so, is either to apply to the Court for appropriate directions or to take enforcement action in respect of its noteholding only. A disgruntled noteholder is not entitled to "step in to the shoes" of the trustee and exercise any and all of the rights reserved to it.

Stephenson Harwood acted for the Note Trustee.

Key contacts

Sue Millar
Partner
T: +44 20 7809 2329
E: sue.millar@shlegal.com

Charlotte Drake
Of counsel
T: +44 20 7809 2583
E: charlotte.drake@shlegal.com

STEPHENSON HARWOOD