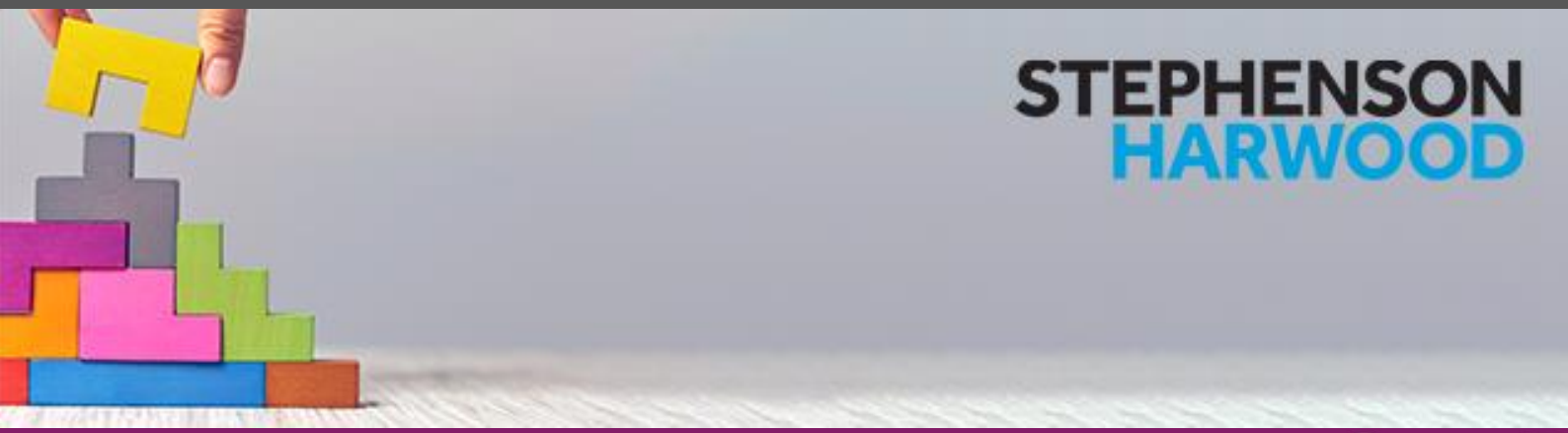

Trustee Basics: Edition 2

The no action clause

The issue

A "no action" clause will appear in almost all English law-governed bond trust deeds.

A no action clause provides that a bondholder (or anyone entitled to payments on the bonds) cannot, initially, proceed directly against the issuer. Instead, the right to bring a cause of action resides with the trustee and it is only if the trustee, having become bound to take action, fails to do so within a reasonable time (with the failure continuing) that a bondholder can then itself proceed directly against the issuer.

The primary purpose of this clause is to protect the issuer from frivolous claims by maverick bondholders.

However, the clause also serves to protect the bondholders as a class because, before taking any action, the trustee will ordinarily ascertain whether or not an action is in the interests of the class of bondholders as a whole (and should not be influenced by the economic interests of a minority).

The current law

The English courts do not look at the no action clause too often. However, as most no action clauses are drafted in very similar terms, those cases which have come to court have been helpful in explaining the scope and interpretation of the clause.

Non-contractual claims are covered if they are, in essence, class claims

The Court of Appeal in *Electrim SA v Vivendi Holdings 1 Corp*[1] confirmed 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.*"[2]

This can include not just claims in contract, but also claims in tort if the object of the claim is to compensate a bondholder for the loss of a contractual right or entitlement under the bonds which it enjoyed by virtue of being a bondholder.

The no action clause will ordinarily relate to proceedings connected to enforcement of the bonds

The case of *Elliott International LP v Law Debenture Trustees Limited*[3] looked at whether opposition proceedings before a French court for the purpose of challenging French insolvency proceedings relating to the issuer fell within the remit of the no action clause in the relevant trust deed.

The court held that they did not and the drafting of the particular no action clause (which adopted the drafting seen in many typical no action clauses) related only to proceedings to enforce the terms of the bonds.

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[1] [2008] EWCA Civ 1178
[2] Collins LJ at 101
[3] [2006] EWHC 3063

In most situations, 24 hours is unlikely to constitute a "reasonable time" for a trustee to fail to act, having become bound to do so

In *Fairhold Securitisation Limited and Another v Clifden (IOM) No.1 Limited and Others*[4] (in which Stephenson Harwood represented the note trustee) the court had to consider the period of time in which the note trustee may consider a noteholder direction before either acting in accordance with it or declining to act. In Fairhold, this question 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 a noteholder to take direct enforcement action under the no action clause.

In Fairhold, Clifden did not persuade the court that it was a noteholder at all. Therefore, Clifden was not entitled to give a noteholder direction to the trustee and the trustee never became bound to act for the purposes of the no action clause. Nonetheless, the court went on to consider what (if a valid direction had been provided by a legitimate noteholder) would constitute a "reasonable" period of time before the note trustee could be viewed (under the terms of the no action clause) as having failed to act.

The facts indicated that Clifden had filed the notice of purported appointment of administrators (e.g. the relevant enforcement action) *before* it had served the purported note direction on the note trustee. Therefore, the judge held that the trustee had not been given a reasonable period of time and, in fact, there had been a negative notice period. He also went on to state "*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*."

Practical tips

- Bondholders will often seek to invoke their rights under the no action clause precisely because the proposed cause of action is not one which the trustee has felt able or willing to undertake. Much will depend on whether the trustee has become "bound" to take action, which is not always easy (or quick) for a trustee to determine. Consequently, whilst seeking directions from the court is unlikely to be the preferred default solution for a trustee, doing so does remain an option in potentially litigious situations. If a trustee can obtain the directions of the court absolving it from taking a specific action, the court may find that the trustee has not become "bound" to take such action in the first place.
- It may be tempting for transaction parties to seek to "hardwire" in specific time limits within which the trustee should act into the drafting of a "no action" clause (rather than relying on the less certain "reasonable time" concept which appears in the drafting of most English law-governed trust deeds). 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. Hardwiring a specific time limit into an English law-governed trust deed would effectively remove the ability for the trustee to adapt to the particular circumstances it faces, which may not be in the interests of its noteholders.
- The Fairhold case, while stopping short of providing any specific guidance on what is a "reasonable" time for the trustee to consider a valid noteholder direction, does suggest that a court is likely to recognise that a trustee will have a number of issues to grapple with, all of which will influence what will be viewed as a reasonable time period. Therefore, while trustees should not sit on their hands when presented with enforcement directions, they should equally not feel "rail roaded" by agitating noteholders.

[4] [2018] 8 WLUK 114

- In complex cross-border transactions (particularly restructurings), transaction parties may wish to bear in mind that if a particular claim cannot be construed as relating to the enforcement of the bonds, litigious options could remain available to bondholders which may not be caught by the "no action" clause.

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