Feature

KEY POINTS

- Hybrid financing structures involving New York law governed notes and English law governed intercreditor agreements are now commonplace in the European market. Unlike in the US, where Chapter 11 almost always provides a feasible method of non-consensual debt restructurings, in Europe, out-of-court restructurings are often the most effective and value maximising path. Senior in-the-money creditors will often rely on share-pledge enforcements combined with comprehensive releases of claims and guarantees in favour of out-of-the-money mezzanine, junior, or intercompany creditors under the English law intercreditor agreement.
- In *CNH v Cleveland*, the New York Court of Appeals (the highest court in the state) reached a decision that may undermine the ability of majority creditors to pursue an out-of-court transaction premised on these mechanisms. It held that wording in the indenture tracking s 316(b) of the Trust Indenture Act – which states that "notwithstanding" any other indenture provision, the right of a holder to "receive payment" on its notes or to "institute suit for the enforcement" of payment "shall not be impaired" without the consent of the holder – overrides any other provision of the indenture. This arguably calls into question the viability of transactions involving releases of claims of, or guarantees issued in favour of, non-assenting creditors.

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CNH v Cleveland: impact of Court of Appeals decision on out-of-court European high yield restructurings

In 2020, a US court determined that minority noteholders' rights to receive principal and interest on their notes survived a "strict foreclosure" and cancellation of notes, undertaken by the indenture trustee at the direction of a majority of noteholders. In this article, we consider the potential effect of that decision on out-of-court, majority-led share pledge enforcements, which are a key debt-restructuring tool in the European market.

INTRODUCTION

The Court of Appeals' decision in *CNH Diversified Opportunities Master Account, LP v Cleveland Unlimited, Inc*, 2020 WL 6163305 (NY Oct. 22, 2020) represents a significant development in the area of law concerning when minority holders of a New York law governed note issuance have the right to hold up an out-of-court, majority-approved debt restructuring of a note issuer.

CASE SUMMARY

In December 2005, Cleveland Unlimited Inc. (CUI) issued $150m of senior secured, five-year term, high yield notes under a New York law indenture. The notes were guaranteed by various subsidiaries of CUI. At the time of issuance, CUI, the guarantors and the trustee also signed a separate collateral trust agreement and a security agreement. Remedies in the event of default were set out in the indenture and the additional documents, and the trustee was authorised to take action, including exercising remedies available under the Uniform Commercial Code (such as foreclosure), at the direction of a majority of noteholders.

When CUI ultimately defaulted, it entered into a forbearance agreement under which CUI's parent company provided an additional parent guarantee and pledged 100% of its shareholding in CUI to secure the notes. When no consensual solution was reached, holders of 97% of the notes directed the trustee to conduct a strict foreclosure on the CUI equity, under which the notes were equitised and cancelled. The minority noteholders, despite the purported cancellation of their notes in exchange for equity, brought claims to recover their principal and interest against the issuer and the guarantors.

A divided New York Court of Appeals, in a 4-3 decision, ruled in favour of the minority noteholders. The court focused on boilerplate indenture language derived from s 316(b) of the Trust Indenture Act and typically incorporated into non-TIA qualified indentures as well. That provision states that "notwithstanding" any other indenture provision, the right of a holder to "receive payment" on its notes or to "institute suit for the enforcement" of payment "shall not be impaired" without the consent of the holder. In *Marblegate Asset Management, LLC v Education Management Finance Corp*, 846 F.3d 1 (2d Cir. 2017), a seminal 2017 case successfully litigated by one of the authors, the Second Circuit held that this language has a narrow and specialised meaning: it prohibits only "non-consensual amendments to an indenture's core payment terms" (those stating how much is owed and when) and does not forbid transactions that do not amend these terms and do not prevent dissenting noteholders from initiating suit to collect payment on the notes when due. In other words, the provision protects the formal *legal* right to receive payment, but not the *practical* ability to realise a recovery. Thus, in *Marblegate*, s 316(b) was held not to bar a foreclosure by secured lenders that removed all the issuer's assets, automatically released a parent guarantee in accordance with the indenture but left the payment terms of the notes unchanged.

In *CNH v Cleveland*, however, the court ruled that the "notwithstanding" language of s 316(b) overrode any other provision of the indenture, including provisions in which related documentation – such as the collateral trust agreement and the security agreement – were expressly referenced. The court ruled that the minority holders that did not assent to the strict foreclosure transaction could not be stripped

Biog box

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of their rights to sue on the now-cancelled notes, and instead were permitted to obtain judgment for the full amount of their notes from the issuer and guarantors, which had been substantially de-leveraged following the equitisation of the majority's notes.

EUROPEAN OUT OF COURT RESTRUCTURINGS AND INTERCREDITOR RELEASES

Hybrid financing structures involving New York law governed notes and English law governed intercreditor agreements are now commonplace in the European market. In this structure, the notes themselves are issued under a New York law indenture to which the issuer, any guarantors, and the trustee are parties. The issuer's equity often serves as collateral for the notes under a share pledge executed by the parent company.

European indentures are not typically TIA qualified; however, many contain TIA wording or some close derivation, including the non-impairment language of s 316(b). The indenture also typically contains express provisions setting out the noteholders' consent to the intercreditor agreement, although these provisions do not expressly override the TIA wording. The intercreditor agreement, governed by English law, is not typically signed directly by noteholders; rather, the indenture trustee and the security trustee are parties to this agreement and the noteholders' advance consent is considered to be given via the indenture itself. A global note, which evidences the debt, also typically contains a specific agreement for the parties to abide by the terms of the indenture and in some cases may also specifically reference additional documents like the intercreditor agreement.

If a non-consensual restructuring becomes necessary, senior in-the-money creditors will often instruct the security trustee to enforce on the share pledge. This enforcement usually results in the issuer's shares or other collateral being transferred to a third-party buyer or a new vehicle controlled by the senior creditors. In order to ensure that the senior creditors have exclusive rights to the collateral, undiluted by interests of the junior out-of-the-money creditors, it is essential to release any claims – including based on guarantees – of those creditors that would have recourse to the collateral. The English law intercreditor agreement typically contains detailed provisions to effectuate this release and grants the security trustee the powers to unilaterally deliver the release.

ANALYSIS AND CONCLUSION

The court's ruling in *CNH v Cleveland* may embolden hold-out creditors in out-of-court restructurings. The ruling goes further than *Marblegate*'s interpretation of s 316(b) in significant respects. First, the court held that the non-impairment language in indentures bars not only formal amendments of indentures, but also an exercise of remedies by the trustee that has the effect of eliminating non-consenting holders' legal rights to receive payment or bring a collection suit. In the US, where foreclosures are not frequently used to effectuate restructurings, this aspect of the *Cleveland Unlimited* ruling may have limited consequences. But it could give rise to serious concerns about the efficacy of European share-pledge enforcements.

Second, the court's ruling precluded reliance on other indenture provisions or related documents to argue that noteholders gave advance consent to the challenged transaction. The indenture, as well as the collateral trust agreement, contained numerous terms that authorised the indenture trustee to exercise remedies, including by conducting foreclosures, at the direction of a noteholder majority in default scenarios. Under the logic of *Marblegate*, these other contractual terms might have been dispositive, pointing to the conclusion that there was no s 316(b) issue: following the indenture as written, without amending it, honours the holders' rights to receive payment and sue for enforcement; it does not impair those rights. Nevertheless, the Court of Appeals in *CNH v Cleveland* held that the language of s 316(b) overrode whatever authority the trustee had to effectuate the strict foreclosure under these other contractual terms, since it applied "notwithstanding" any other indenture provision. The Court of Appeals also held that the noteholders had not given advance consent to the challenged transaction through the collateral trust agreement, since the noteholders had not actually signed that document – rather, much like how the intercreditor agreement in a European hybrid structure works, as described above, the consent to the terms of the separate agreement was provided in the indenture itself. The "notwithstanding" clause of s 316(b) therefore was held to override the noteholders' purported consent to foreclosures in the separate collateral trust agreement, too. A vigorous dissent, which would have enforced the plain contractual terms of the indenture and the related documents rather than interpreting them as being in conflict with and trumping each other, warned that the court's ruling "needlessly injects uncertainty into a multi-trillion-dollar corporate debt market".

Any reading of s 316(b) must be understood against the backdrop of the legislative history, which is outlined in detail in *Marblegate*. As set out in that case, the purpose of s 316(b) was to prevent indentures from containing clauses that allow noteholder majorities to force minorities to accept the results of out-of-court debt-readjustment plans. In the US, Chapter 11 provides an answer to whatever uncertainties may surround an out-of-court restructuring process: an issuer or its creditors can commence a bankruptcy case and benefit from the Bankruptcy Code's drag-along and cram-down features to force non-assenting creditors to abide by the terms of a plan. In Europe, there are no complete solutions. While alternatives such as the new English restructuring plan may provide answers to those looking for junior cram-down mechanisms, share pledge enforcements and related intercreditor releases will likely continue to be attractive restructuring tools for senior creditors. But those creditors now will need to consider the effect of *CNH v Cleveland* carefully as they structure their plans. ■

Further Reading:

- Indented: recent court decisions on New York law-governed indentures and their impact (2019) 4 JIBFL 245.
- High-yield bonds: an introduction to material covenants and terms (2014) 4 JIBFL 242.
- LexisPSL: Restructuring & Insolvency: Getting into bed with bondholders (2012) 4 CRI 120.