Feature

KEY POINTS

- The relevant agreement was governed by New York law and applying New York law principles (which are reflected in equivalent English law principles) the court gave "control" a "businessman's interpretation".
- "Control" did not mean being a 51% noteholder and for there to be *de facto* control it would need to come from the issuer's side of the line and be pervasive.
- The claim was brought in the Financial List and is an interesting example of a speedy resolution of a valuable and important dispute.

Authors Stephen Moverley Smith QC and Oliver Assersohn

Debt, power and keeping your vote: the meaning of "control" in disenfranchisement provisions

The article discusses the recent case of *Citibank v Oceanwood Opportunities Master Fund & Ors* [2018] EWHC 448 in which it was held that a majority noteholder did not have "control" of the issuer following a default and so was not prevented by the disenfranchisement provisions in the relevant documentation from being able to give directions to the Security Agent and Note Trustee. The article is likely to be of interest to participants in leveraged finance transactions and to lawyers for parties involved in similar disputes.

INTRODUCTION

The article summarises and comments on the judgment of Mr Justice Mann in *Citibank v (1) Oceanwood Opportunities Master Fund (2) Foxhill Capital Partners LLC (3) Foxhill Opportunity Fund L.P* [2018] EWHC 448 (8 March 2018) (the judgment).

The documentation relevant to the dispute was interpreted in accordance with commercial expectation and the judgment sets out various parameters likely to be of relevance in future cases (although we note that the judgment also stressed the importance of context and did not purport to provide an exhaustive definition of control). Where questions of *de facto* control arise, the analysis will inevitably remain fact sensitive.

THE FACTS

The parties

Citibank NA (Citibank) was Security Agent and Note Trustee under financing arrangements for Norske Skog Group, the Norwegian based producer of publication paper.

Citibank brought the claim under Pt 8 for directions whether or not it should (or was entitled to) follow directions by the first defendant (Oceanwood) which was the majority holder of the loan notes in question. Oceanwood's position had been challenged by the second and third defendants (together Foxhill) who held a minority interest in the loan notes.

The main underlying agreements

There were three main relevant transactional documents (all dated 24 February 2015):

- **The Indenture:** The issuer was a company within the Norske Skog Group called Norske Skog AS (NSAS) and the notes governed by the Indenture were 11.75% Senior Secured Notes due in 2019 in an aggregate principal amount of €290m. Section 2.09 contained the words crucial to the case namely that Notes owned by the "Issuer" (ie NSAS), "Guarantor" or by "any Person" "… directly or indirectly controlling or controlled by or under direct or indirect common control with the Issuer or any Guarantor, will be considered as though not outstanding…". Oceanwood and Foxhill were holders of notes within that provision. The Indenture was subject to New York Law.
- **The Intercreditor Agreement (ICA):** The ICA regulated the activities and interests of the Senior Secured Noteholders and their relationship with Citibank as Security Agent. As Security Agent Citibank formally exercised all enforcement powers for the noteholders, but it did so potentially subject to direction from a majority under the terms of the ICA. The ICA was subject to English law.
- **The share pledge agreement:** The agreement was between Norske Skog Group company as pledgor (one above NSAS in the chain of holding companies) and Citibank as pledgee, acting as Security Agent under the loan documentation. The pledgor charged the shares in NSAS with the liabilities under the various debt documents, including the Indenture. The share pledge agreement was subject to Norwegian law.

Oceanwood as noteholder and bidder for NSAS

In June 2017, the top companies in the group launched restructuring negotiations. In the same month, the group missed an interest payment but the negotiating noteholders (including Oceanwood) agreed to postpone the acceleration event which that default had led to (this agreement was extended until 23 August 2017).

On 24 August 2017, there was an EGM of the parent company and a chairman appointed who was perceived by the negotiating noteholders to favour the rights of shareholders over creditors and therefore seen as a risk to the interests of creditors

(such as Oceanwood). The other directors were also replaced. In response, the majority of noteholders (including Oceanwood) directed Citibank to use powers under the share pledge agreement to replace the Chairman and the Board of the group's parent company.

The restructuring negotiations failed and Oceanwood acquired the negotiating noteholder's interests giving it a majority of over 51%. Oceanwood withdrew support for a consensual debt restructuring and took steps to bid in the sale of the group.

Citibank was proposing to take the necessary enforcement action to pursue and complete the sale but needed to know if Oceanwood was entitled to make up part of the group of noteholders giving directions for that purpose. The matter was urgent because there were concerns the business could not survive if there was uncertainty or delay in the sale process.

PROCEDURAL BACKGROUND

Citibank issued the claim on 4 January 2018 and joined Foxhill because Foxhill was one of those questioning Oceanwood's rights. Oceanwood and Foxhill were made representatives for the respective sides of the argument.

The claim was brought in the Financial List and directions given to procure a speedy trial because otherwise the dispute was said to be likely to imperil a sale of secured assets and thus imperil the survival of the Norske Skog group business.

Citibank issued the claim in England on the basis that the dispute was one arising under the ICA. Foxhill disputed jurisdiction because the Indenture was subject to New York law and contained a New York jurisdiction clause.

From a procedural perspective, it was possible that both the jurisdiction and the substantive dispute would be determined together. In the event, Mr Justice Mann determined that jurisdiction would be decided first and judgment was handed down on that issue on Tuesday 20 February 2018 [2018] EWHC 305 (Ch) with the trial of the substantive matter to start on the following Monday (26 February 2018). Foxhill expressed some uncertainty that it would participate and was concerned that by doing so it could be said to have submitted to the jurisdiction. The judgment notes that Foxhill were "… offered safeguards against the point being taken against it …". (para 6).

On Thursday 22 February 2018 Foxhill indicated that it would not participate in the trial despite being a representative defendant. Mr Justice Mann raised the question of how the absence of Foxhill might affect the usefulness of any decision and the appropriateness of a trial taking place and so Citibank (which had intended to be neutral) took on a role in arguing the point at the trial *via* its junior counsel.

THE SUBSTANTIVE DISPUTE

Mr Justice Mann commented at para 36 of the judgment that:

> "It appears that one of Foxhill's major concerns, if not its only real concern, is that Oceanwood is taking unfair advantage of its position to procure a sale process in which it can then participate in an unfairly advantageous manner, but that is not the issue raised in these proceedings. The question or questions in these proceedings turn on whether Oceanwood's wishes or directions can or should be taken into account by Citibank and this turns on whether Oceanwood 'controls' NSAS as the Norske Issuer (or other companies) for the purposes of section 2.09."

Foxhill's case rested on two bases. First, that Oceanwood controlled NSAS by virtue of its 51% holding of the debt. Second, on the facts and looking at what actually happened, Oceanwood had *de facto* control.

Principles of construction as found in the judgment

The construction of s 2.09 arose in respect of the Indenture which was governed by New York law. Oceanwood and Foxhill put in a statement of principles of New York law and each adduced expert evidence. There was little difference between the parties and the relevant principles are set out at para 42 of the judgment. Mr Justice Mann stated that "… most of the principles are entirely familiar to common law lawyers in this jurisdiction, which is not surprising …" (para 42) and that the principles were all "… reflected in equivalent English law principles…" (para 43).

Control by virtue of 51% holding of the debt

Foxhill's argument was essentially that:

- Citibank could vote the shares;
- Citibank had to act on the instructions of the majority of noteholders;
- Oceanwood had the majority;
- Oceanwood could therefore direct Citibank; and so
- Oceanwood controlled NSAS as the issuer.

Mr Justice Mann rejected the argument for a number of reasons but primarily because it would in his view have led to an absurd conclusion which made no commercial sense. As was stated at para 56 of the judgment:

> "The short answer to Foxhill's case is that the control referred to in section 2.09 does not include the consequences of the working out of the arrangements in the loan documentation and which arise under the documentation itself. That is not really control at all. It is really a right to provide how the Security Agent should realise a security, and in that context and for that purpose (if voting becomes relevant) how to vote some shares. The 'control' referred to in clause 2.09 must be control arising other than under the loan documentation."

Whatever else control might mean it could not mean being a 51% noteholder. A documentary scheme which allowed for a majority noteholder could not sensibly be operated on the footing that becoming a majority cost the noteholder its vote (see para 59 of the judgment).

Mr Justice Mann observed that in chasing down the meaning of "acceleration event" (and thereby uncovering a further

example of absurdity arising from Foxhill's construction) it was necessary to undertake "… a difficult journey through definitions within definitions within definitions in the agreements – there are 42 pages of definitions in the ICA and 33 pages in the Indenture – and then into substantive provisions and back again …" (see para 55 of the judgment).

De facto control

Mr Justice Mann stated that:

> "… For what it is worth it seems to me… right not to rule out all species of de facto (non-equity based) control …" (para 44).

The judgment noted that the question becomes, in any given case, whether the circumstances demonstrate a sufficient degree of control of the right nature so as to fall within s 2.09.

Foxhill relied on a number of reasons in support of its contention that Oceanwood had *de facto* control (these are summarised at para 37 of the judgment and included (for example) that Oceanwood used the powers under the ICA to require Citibank to replace the Board).

The court reviewed the meaning of "control" by reference to a number of US authorities and their use of "control" in different contexts. Mr Justice Mann emphasised that context is "all-important" (see paras 77, 80, 83-84). The crucial section is at paras 85-87:

> "… What I consider to emerge from the Indenture in its commercial context is as follows. Section 2.09 clearly covers control in a shareholder sense. That is likely to be the prime target. Its context indicates that its first purpose (so far as control by an Issuer is concerned) is to prevent an Issuer acquiring promoting its own interests and standing in the way of creditors by acquiring notes and voting them. The section then implicitly recognises that the same conduct will be equally undesirable if carried out by someone who controls the Issuer. Such a person is on the Issuer's side of the Issuer/Noteholder divide and is in the same opposing interest *vis-à-vis* the Noteholders. The paradigm of such a person is a controlling shareholder.
>
> Short of shareholding there may be other instances of control which still exist and fall to be treated as activity on the Issuer side of the line – perhaps a contractual right to control, or a shadow controller who for all practical purposes can control the Issuer without actually having a direct or indirect shareholding. I do not see why those people, who in reality fall to be treated as the Issuer, should not be seen to have control even without a shareholding. They should be treated as being on the same side of the line. In these cases whether a degree of influence is sufficient to amount to control is a question of fact and degree and no clear dividing lines can be specified which will provide a test applicable to all circumstances.
>
> A useful touchstone is probably the word 'pervasive' (to borrow a word from Mr Smith's bankruptcy authority). It is a useful word to encapsulate the degree of control required because it distinguishes areas of limited control from the sort of serious case which the preceding paragraph of this judgment anticipates. It does, of course, itself introduce questions of fact and degree, but it does at least connote the extent to which there has to be exercisable influence, and to that extent I would agree with it. One can easily imagine cases where there is some control over a part of the affairs of a company but where one would not say the 'controller' controls the company …"

The court rejected the contention that "controlling" should be given a wide definition as it would appear to a laymen. The word had to be given a businessman's interpretation, in accordance with New York law principles. The judgment does not profess to give a clear answer as to what "control" is (see para 90) but "… assists in helping to form a view as to what it is not …" (see para 90).

On the particular facts of the case, the court held that Oceanwood did not have control in the sense of coming from the issuer side of the line and being pervasive. Everything that Oceanwood did was in its interests as creditor and to further its interests as creditor under the very documentation which included the "control" provision. The replacement Board was not appointed with the expectation that it would do whatever the appointer told it. The court considered the other factors relied on in this particular case and found that Oceanwood did not have and did not exercise *de facto* control over any company in the Norske group for the purposes of s 2.09.

POST-SCRIPT

A NSAS press release of 4 May 2018 stated that Oceanwood had entered into a sale and purchase agreement to buy NSAS' entire issued share capital. The acquisition is subject to various antitrust and regulatory approvals. The Chairman of the Board stated that the acquisition:

> "… concludes almost two years of relentless efforts and engagement to address the Norske Skog Group's excessively levered capital structure. Oceanwood's decision to acquire a majority position in the secured bond and subsequently the decision to initiate a sales process proved to be the key to resolving the stalemate that was threatening the future of the operating business … ."

The sales proceeds are to be distributed by Citibank in accordance with the ICA.

COMMENTARY ON THE JUDGMENT

The case is an example of the swift resolution of disputes available in the Financial List. Even allowing for the challenge to jurisdiction and a requirement for expert evidence on foreign law, judgment was handed down approximately two months after issue and allowed for the sale of the secured assets.

The judgment will be relevant to the construction of other leveraged finance documents in its analysis of commercial common-sense in this context and in

Biog box
Stephen Moverley Smith QC and Oliver Assersohn practise from XXIV Old Buildings, Lincoln's Inn, London. Email: stephen.moverley.smith@xxiv.co.uk and oliver.assersohn@xxiv.co.uk

particular on the interpretation of "control". The judgment clearly states that "control" cannot simply mean a 51% noteholder (see para 59 of the judgment) and sets out useful parameters for a *de facto* assessment.

It remains the case that there is legitimate scope for argument as to the meaning of "control" in disenfranchisement provisions because:

- a comprehensive definition of control was not needed to resolve the case and the judgment repeatedly stressed the importance of context;
- the acceptance that a *de facto* analysis is relevant to an assessment of "control" will inevitably introduce a fact sensitive element to future cases which has potential to create uncertainty. For example, on different facts it is possible to envisage a scenario where (unlike in this case) it could be argued that a board was acting in the best interests of those responsible for their appointment and not the best interests of the company; and
- if English law had applied there are arguments that the tension between the meaning of language and retrospectively applying a notion of commercial common sense have not been entirely settled (see eg Lord Sumption's 2017 Harris Society Annual Lecture).

In terms of wider significance, it is entirely possible that parties will cite the authoritative and persuasive judgment in other contexts where "control" is relevant (eg Schemes of Arrangement under the Companies Act (2006)). Parties that do so risk facing the obvious counter-argument that the judgment stressed that context was key and mostly rejected examples of the use of the word "control" in different contexts when applying New York law.

Stepping back from the detail, the debt structure was critical to the business of the Norske Skog Group and yet construing aspects of the relevant documentation was something even the court found involved a difficult journey. There is a strong case for simplification of the contractual matrix so that the operation of the structure is clear from the outset and where (as here) a term has acquired special meaning that that is clearly spelled out. The judgment could be a useful weapon in the armoury of lawyers who seek contractual transparency and simplicity. ■

Further Reading:

- Hong Kong in the spotlight: the new "significant controllers" regime (2018) 4 JIBFL 251.
- LexisNexis Loan Ranger blog: Can a majority noteholder have "control" over the issuer so as to preclude it from giving direction to the agent?