Feature

KEY POINTS

- Courts and Trustees both see "noteholders" as the persons named in the records of the clearing system. Gaining control will mean formally acquiring Notes, or the consent of those who hold them.
- Attempts to gain control of an MBS need to comply with the terms of its particular Trust Deed and Conditions, which therefore need to be carefully considered.
- Although the defendants failed, there are useful pointers in this case for how others might succeed.

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How not to snaffle a CMBS: *BMF6 v Greencoat*

In *BMF6 v Greencoat Investment Ltd* Mr Justice Zacaroli granted declarations and injunctions preventing the defendants seizing control and selling the assets of a securitisation structure. Nicola Rushton QC considers why, and what lessons can be learnt from why the defendants failed.

The story in *Business Mortgage Finance 6 Plc v Greencoat Investment Limited and others* [2019] EWHC 2128 (Ch) was essentially one of a bunch of corporate buccaneers failing to gain control of a commercial mortgage backed securitisation (CMBS) structure so as to sell off its assets. It could be said their methods were so high-handed as to be farcical. Mr Justice Zacaroli had no difficulty in granting a series of declarations and injunctions to bar them from boarding the good ship BMF6, most of which counsel for the buccaneering defendants felt unable to oppose. But the case nevertheless raises interesting questions around how those who might want to gain control of such a structure could go about doing so more effectively.

In summary, the key points of interest were:

- The terms of the particular Trust Deed and Master Conditions are critical in defining what can be done and how, on issues such as: appointing additional trustees, removing the Trustee, voting rights, declaring an event of default and the like.
- The judge made a clear finding that "Instrumentholders" was limited to the named account holders recorded in the books of the clearing systems (here Euroclear and Clearstream). Even though the definition was extended to include "beneficial owners", this did not mean it extended to those with more remote beneficial interests. While this conclusion depended on the terms of the particular Trust Deed, the judge gave significant weight to the impracticality of allowing a wider definition. Unless limited to those recorded in the clearing systems, it would be very difficult to identify who were noteholders. This will be true of MBS structures generally and has important implications for the formality of the steps which will have to be taken to acquire Notes (or the consent of existing noteholders).
- An "event of default", necessary to trigger redemption of notes or appointment of a receiver, must be a genuine event of default within the meaning of the Master Conditions. It does not mean whatever you want it to mean, Humpty Dumpty-style.
- Any steps relating to the corporate entity itself (here BMF6), such as appointing or removing directors, must be done in accordance with the Articles of Association of that company. They cannot be removed or appointed by a receiver under the Deed of Charge.
- The judge left open the question of whether the noteholders, or a class thereof, could pass an effective Written Resolution requiring the Trustee to appoint additional trustees. On the case before him:
  - they were not noteholders; and
  - they did not have the required majority.

None of this suggests a determined person could not gain control of an MBS by controlling a sufficiently high proportion of Notes, or at least A-class notes. However, the Trustee is obliged to act in accordance with the Trust Deed and Conditions. This may include considering the interests of all the noteholders including junior ones, so in practice senior noteholders may have to make consent payments to more junior ones.

Mr Justice Zacaroli gave a restricted definition to "Instrumentholder". This had a knock-on effect on many of the other steps the defendants had purported to take. The Notes were held in global form, no definitive notes having been issued. This meant the Trustee was the only actual holder of any Notes, as common depository for the global note. The definition of Instrumentholder extended to cover "holders of the beneficial interests" in the Notes. However, the judge accepted that this was intended to address precisely the situation where the Note was held in global form. The Trust Deed gave the Trustee power to determine entitlement to a Note and permitted it to take into account information held by or available to the clearing system in making that decision. The practical and legal effect of this was that the securitisation documents did not envisage any such enquiry going any further back than the person recorded as the holder of an account in the books of Euroclear or Clearstream. The judge said there were strong, practical reasons why this should be so: the ultimate beneficiaries might be wholly unknown to the clearing system or the account holders, possibly behind a chain of intermediaries. It would be impractical for the Trustee to enquire any further than the position statement from the clearing system.

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The first defendant, Greencoat Investments Ltd (GIL) had issued a tender offer to noteholders, inviting them to tender Notes for purchase by GIL. However, settlement had not occurred and until it did, the original noteholders retained their voting rights. Nor had payment in accordance with the offer been made by GIL. Although a large number of notes had been blocked and held to GIL's order by the clearing systems, whatever beneficial interest GIL had acquired, the judge held it was not an "Instrumentholder" within the extended definition in the Trust Deed. In any event GIL had not acquired an interest in at least 75% of all the A class Notes, only of the A1 (sterling denominated) Notes.

While there may be variations in the terms in which noteholders are defined in other securitisations, it is unlikely that any definition will extend to beneficial owners which it is difficult for the Trustee to identify. Of course, sellers of notes may agree to vote in accordance with the buyer's instructions before formal settlement, but query what incentive they might have before they had been paid. Here GIL was attempting to acquire voting rights without paying for the Notes or formally acquiring interests through the clearing systems. What it means is that any party seeking to gain control of a securitisation by controlling Notes should take the steps necessary to be recognised as a noteholder, in accordance with the securitisation documents.

Compliance with the terms of the Trust Deed and Conditions was also relevant to the question of whether the noteholders could direct the Trustee to certify that an Event of Default had occurred. This was intended to trigger further steps including appointing a receiver under the Deed of Charge and/or an administrator and redeeming the Notes. It does not appear the judge had any issue in principle with Noteholders passing a Written Resolution requiring the Trustee to make a certification or to appoint administrators. The real problem (in addition to the defendants' lack of standing as noteholders) was that there had in fact been no Event of Default within the meaning of the securitisation documents. Although the defendants produced evidence supposedly showing that BMF6 was balance sheet insolvent, and although the junior noteholders had not been paid all the interest due for at least 4 years, there had been no non-payment of the A class notes. By the terms of the securitisation documents, this meant that an Event of Default had not occurred. The purported direction was therefore invalid – unless the Trustee had grounds for certifying there had been an event which was materially prejudicial to the interests of the noteholders of any class, which it did not. The defendants had also failed to indemnify the Trustee to its satisfaction for taking any such step.

Such issues will depend on the specific wording of the Trust Deed. Where the securitisation is non-performing and the attempt to direct the Trustee is part of a restructuring, a requirement that there has been an Event of Default will not pose a problem. However, the judge's approach does make it more difficult for a would-be predator to manufacture a "default" with the intention of collapsing the securitisation and selling off the assets, as appears to have been the intention here.

The judge left open the question of whether, on the terms of the Trust Deed, a 75% majority of noteholders (or of A Class noteholders) could pass a Written Resolution directing the Trustee to appoint additional trustees. He was not prepared to give a ruling on a hypothetical which clearly had the potential of encouraging further action by the defendants. But in principle it would seem such a resolution could be passed, so long as the conditions for doing so were satisfied.

In this context it should be noted that the judge also held that the defendants' attempt to remove the Trustee was invalid: one of many reasons he gave was that the Trust Deed required there to be at least one Trust Corporation. This is another indication that any attempt to gain control of a securitisation by, among other things, replacing the Trustee, must comply with such practical formalities.

Finally, the judge rejected the purported removal and replacement of the directors of BMF6 by the (purported) receiver. Quite apart from the fact the receiver himself had not been properly appointed, any removal and replacement of directors had to be done in accordance with the Articles of Association of the company itself. Ordinary company law applied. The receiver could not just do this by diktat. This may seem obvious, but with all the emphasis on the securitisation documentation, one should not forget that changes to the company and its directors need to be carried out in accordance with the company documents and company law. In a genuine insolvency situation, it will not be necessary to replace the directors, only to appoint a receiver or administrator. However, if the aim is to gain control rather than to restructure or deleverage, there will be this additional issue of gaining control of the shares and of the company itself.

Overall therefore, while superficially this is not a decision to encourage buccaneers, its main message is that such attempts need to be done by the book to have a decent chance of succeeding. ■

Further Reading:

- X-class loan notes and avoiding moral hazard (2017) 4 JIBFL 222.
- The consequences of an Issuer in a CMBS having its own rights of action (2015) 1 JIBFL 22.
- LexisPSL: Banking & Finance: Practice Note: Key parties, documents and terms of a commercial mortgage-backed securities transaction.