REVERSEinquiries

Consent Solicitations: Challenging Orthodoxies

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If an issuer wants to amend the terms of an outstanding security or the indenture governing the security, it must comply with the provisions of the indenture governing supplemental indentures. For certain minor or ministerial amendments, bondholder consent is typically not required. For more significant amendments, including amendments to affirmative or negative covenants, the consent of a majority or two-thirds of bondholders is typically required under the applicable indenture. If the amendment relates to a core term, such as the interest rate, interest amount, the amount of principal or payment dates, the supplemental indenture requirement normally reads:

> "no such supplemental indenture shall, *without the consent of the Holder of each Outstanding Security affected* thereby, change the stated maturity of the principal of, or any installment of principal of or interest on, any Security, or reduce the principal amount thereof or the rate of, interest thereon …." (Emphasis added.)

Requiring the consent of each affected holder for certain payment provisions of the security is based on Section 316(b) of the Trust Indenture Act of 1939 ("TIA") (Prohibition of Impairment of Holder's Right to Payment), which reads in part:

> "Notwithstanding any other provision of the indenture to be qualified, the right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or to institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected *without the consent of such holder* …." (Emphasis added.)

The requirement for the consent of each holder affected by an amendment has often been read by practitioners to require the unanimous consent of the holders of the series of securities to agree to the amendment in order for the amendment to be effective. A recent article in an industry publication suggests that the "100% consent required" reading of the supplemental indenture provision is not shared by all. The article was in response to a letter from The Credit Roundtable to Waste Management, Inc., suggesting that a consent solicitation could be used to delay a redemption date for multiple series of securities.[1] The article highlighted the supplemental indenture requirements in the Waste Management, Inc. indenture, almost exactly like the indenture language quoted above, and made the argument that if less than all of the security holders consented to the change in the redemption date, the non-consenting holders

[1] The Credit Roundtable letter is available at: https://bit.ly/2OHqCWd.

would not be affected by the amendment – their securities would be redeemed under the original terms. The rationale that only consenting holders would be affected by a proposed amendment, with non-consenting holders not affected and thus not required to consent under the amendment provisions, has support in the learning around Section 316(b) of the TIA. Section 316(b) is a "collective action clause" designed to protect security holders from the tyranny of a majority of security holders who might, for some reason (such as during a bankruptcy workout), use their majority status to modify a core term of the indenture, such as an interest or payment provision.[2]

The legislative history of Section 316(b) is enlightening with respect to whether unanimous consent is required to alter a note holder's right to receive interest and principal when due. The District Court of Rhode Island cited this legislative history of Section 316(b) in 1946:

> "Under subsection (b), the indenture must provide that, except as to an interest postponement consented to as provided in subsection (a), the right of any indenture security holder to receive his principal and interest when due and to bring suit therefore may not be impaired *without his consent*...This provision does not prevent the majority from binding dissenters by other changes in the indenture or by a waiver of defaults, and the majority may of course consent to alterations of its own rights."[3] (Emphasis added.)

However, no cases were found litigating this point in the context of a consent solicitation.

How these supplemental indenture provisions are read may become important to issuers with outstanding U.S. dollar LIBOR floating rate securities. Most "legacy" LIBOR floating rate securities issued prior to 2018 will, once LIBOR ceases to be published, default into fixed rate securities. That change may or may not be detrimental to security holders and/or issuers. Issuers wishing to resolve this potential problem may want to consult counsel as to whether a consent solicitation to amend the interest rate provisions of legacy LIBOR floating rate securities is a potential solution. If so, even without unanimous consent, the securities of at least the consenting holders could be moved into a new floating rate basis (e.g., the ARRC recommended secured overnight financing rate [SOFR]) while the securities of the non-consenting holders would remain in their unamended, fixed rate status. If this were feasible, there would nonetheless be a significant number of practical challenges to overcome. For example, the one series of notes would have to subsequently be represented by two different CUSIPs, with each corresponding to a new series having different rates, but with both CUSIPs voting together as a single series.

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[2] See UPIC & Co. v. Kinder-Care Learning Ctrs., Inc., 793 F.Supp 448, 452 (S.D.N.Y. 1992).

[3] Cont'l Bank & Trust Co. of N.Y. v. First Nat. Petroleum Trust, 67 F.Supp. 859, 872 (D.R.I. 1946) (quoting the report of the Committee of Interstate and Foreign Commerce of the House of Representatives on the Trust Indenture Bill of 1939, June 30, 1939, House of Representatives Report No. 1016, 76th Congress, 1st Session, D. Analysis by Sections, at p. 56).