



# No-action clauses in bond issues upheld

Bond issues usually carry a 'no-action' clause under which only the trustee of the issue may enforce the bonds against the issuer or guarantor on behalf of the bondholders. The bondholders cannot enforce the bonds directly unless the trustee fails to do so in accordance with the terms of the bond documents.

The case of *Elektrim v Vivendi Holdings* confirms the validity of such clauses and clarifies that if a trustee has disclosed all relevant information to the bondholders under the trust deed and bond terms, it will usually not have any further duty to advise bondholders. This briefing explains the background of the case and the effectiveness of no-action clauses in bond issues.

## Background of the case

In the English case of *Elektrim v Vivendi Holdings 1* [2008] EWCA Civ 1178, as part of Vivendi Universal (Vivendi)'s efforts in its dispute with Elektrim over the latter's stake in a Polish telecommunications company, Polska Telefonia Cyfrowa (PTC), Vivendi used a subsidiary, Vivendi Holdings 1 (VH1), to acquire from Everest Capital (Everest) its 8 per cent holding of bonds issued by an Elektrim-established special purpose vehicle (SPV) and guaranteed by Elektrim.

## Claims against the issuer and trustee

As transferee of Everest's rights as bondholder, VH1 then sued Elektrim for fraudulently inducing Everest to buy the bonds and sued the trustee of the bonds for, among other matters:

- accepting 'tainted funds' from Elektrim in payment of the amounts due under the bonds (which were the subject of bankruptcy proceedings instituted by the trustee against Elektrim and Elektrim Finance on behalf of more than 30 per cent of the bondholders) without consulting Everest. The funds were allegedly tainted because they came from a payment by Deutsche Telecom (DT) for Elektrim's shareholding in PTC, which was alleged by Vivendi to be illegal given Vivendi's own claim over those same shares;
- failing to disclose the risks of accepting such tainted funds; and
- failing to exercise adequate due diligence before withdrawing its bankruptcy petition after receipt of

such payment because (as alleged by Vivendi) the trustee did not investigate fully the illegality of the PTC share transfer.

These claims were stated to be claims in tort.

## Effectiveness of no-action clauses

The English Court of Appeal confirmed that the no-action clauses in the bond documentation were effective to prohibit the current proceedings by VH1. Under the relevant clauses, no bondholder could proceed directly against Elektrim or Elektrim Finance to enforce the performance of any of the provisions of the bond documentation unless the trustee became bound to do so and failed to do so within a reasonable time and if such failure was continuing.

The trustee would only be bound to do so if it had been directed by an extraordinary resolution of the bondholders or requested to do so by the holders of at least 30 per cent of the principal amount outstanding of the bonds. In this case, no such resolution had been passed nor had a request been made by bondholders representing the requisite percentage of the outstanding bonds. The court further clarified that even though the claims being brought were in tort (as opposed to contract), the no-action clauses applied equally to them as to contractual claims because the claims being brought were class claims mirroring contractual rights under the bond documentation.

This case therefore highlights the fact that if a no-action clause exists, a bondholder will be able to instruct

the trustee to bring proceedings against the issuer or guarantor only if that bondholder holds the requisite proportion of bonds or is able to garner the support of other bondholders to constitute the requisite proportion.

## Trustee has no fiduciary duty to advise bondholders

In addition, the court held that the trustee 'whose main function is administrative and ministerial' had no fiduciary duty to advise the bondholders of the risks of accepting the funds provided by the issuer to repay the bonds, particularly considering the bondholders were advised by their own legal counsel and given that the trustee had disclosed all relevant information to the bondholders in accordance with the trust deed and the bond terms. The court noted that bondholders are 'expert investors who look after their own interests' who 'may organise bondholders' committees [...] when things go wrong'. Therefore, the case provides comfort to trustees that their duties to bondholders do not include having to advise bondholders either individually or as a class, particularly if those bondholders have separate legal advice.

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