



German Federal Court of Justice Clarifies “Opt-in” Rules Under the German Bonds Act

On September 15, 2014, the German Federal Court of Justice (*Bundesgerichtshof*) published a landmark decision¹ clarifying that holders of bonds issued prior to August 5, 2009, under the old German Bonds Act of 1899 may opt in to, and take advantage of the benefits of, the provisions of the new German Bonds Act of 2009.

Background

For the first time, the German Federal Court was called upon to construe the meaning of the new German Bonds Act of 2009 (the “2009 Bonds Act”). The German Federal Court took the opportunity to answer questions of high practical importance for restructurings, such as whether holders of bonds issued prior to August 5, 2009, by German or foreign issuers could take advantage of the benefits of the 2009 Bonds Act, including the ability to amend the terms of the bond if approved by a majority of bondholders.

Section 24 para. 2 of the 2009 Bonds Act states that the holders of bonds issued prior to the 2009 Bonds Act coming into force (August 5, 2009) may pass—with the approval of the issuer—a resolution to have their bonds governed by the 2009 Bonds Act instead of the old Bonds Act of 1899 (the “1899 Bonds Act”),

i.e., to opt in to the new rules. Such an opt-in significantly increases the options for amending the terms and conditions of a bond by a majority vote of the bondholders. Under the 1899 Bonds Act, it was possible to extend the term of bonds only for up to three years or to relieve the issuer from paying interest. By contrast, the 2009 Bonds Act also permits the waiver of principal amounts, the implementation of debt-for-equity swaps, and other structural changes to bonds that are common in bond restructurings in international markets. Such an opt-in resolution requires, among others, approval by a qualified majority of 75 percent of the bondholders by amount present at a bondholders meeting.

Notwithstanding the wording of Section 24 of the 2009 Bonds Act, the Frankfurt Court of Appeals held in 2012² that, based on the principle of “*pacta sunt servanda*” (“agreements must be kept”), the holders of bonds issued prior to August 5, 2009, to which the 1899 Bonds Act was not applicable, could not pass an opt-in resolution unless: (i) the bondholders unanimously consented; or (ii) the terms and conditions of the bond instrument already included a majority voting clause, and a majority of bondholders approved the opt-in resolution.

Since in practice most German bonds issued prior to 2009 did not have majority voting or other collective action clauses, the 2012 decision of the Frankfurt Court of Appeals meant that a restructuring of pre-2009 bonds was generally impossible. In addition, the Frankfurt Court of Appeals held that only bonds falling within the application of the 1899 Bonds Act could be subject to an opt-in resolution. As the 1899 Bonds Act was applicable only to bonds issued by an issuer domiciled in Germany under German law, all bonds issued by foreign issuers (including foreign subsidiaries of German companies or special-purpose companies that issued bonds under German law) prior to August 5, 2009, were, according to the Frankfurt Court of Appeals, excluded from the benefits of the 2009 Bonds Act. As a consequence, some German bond restructurings failed (the most prominent ones involving Pfleiderer AG and Q-Cells SE).

In addition, German legal professionals had expressed uncertainty concerning whether the 1899 Bonds Act (and thus the ability to opt in to the 2009 Bonds Act) would apply to other types of securities, such as hybrid financial instruments (e.g., participation rights (*Genussscheine*)).³

The Decision of the German Federal Court of Justice

In its decision, the German Federal Court of Justice explicitly overruled the reasoning of the Frankfurt Court of Appeals and clarified a number of open questions.

In the case at hand, a company had, under the regime of the 1899 Bonds Act, issued registered convertible participation rights (*Wandelgenussscheine*) in the form of bonds. Upon the original maturity date, one bondholder requested repayment of the principal amount of its bonds. The issuer rejected the repayment demand, arguing that the other bondholders had passed a written resolution opting in to the 2009 Bonds Act and extending the maturity date of the bonds by four years.

On appeal, the Frankfurt Court of Appeals⁴ held that the extension of the maturity date of the bonds could not have been validly approved because the bondholders were not permitted to opt in to the 2009 Bonds Act, and the terms and conditions of the original bonds did not allow for any amendment with the approval of a mere majority of the bondholders.

The German Federal Court of Justice expressly ruled that the holders of any bond issuance under German law prior to August 5, 2009, may pass an opt-in resolution with the approval of a qualified majority of 75 percent of the bondholders, whether or not the bonds in question are governed by the 1899 Bonds Act or are subject to a majority collective action clause. The German Federal Court of Justice based its decision on the broad wording of Section 24 of the 2009 Bonds Act and its underlying legislative intent. The court held that the German legislature's intent in approving the opt-in provision was to create greater flexibility regarding the scope of collective action clauses for corporate bonds, particularly in cases where a majority of bondholders favor a restructuring (as distinguished from an insolvency proceeding), even with respect to bonds issued prior to enactment of the 2009 Bonds Act.

According to the German Federal Court of Justice, the general permissibility of such an opt-in does not violate the general principle of *pacta sunt servanda*. In addition, the court reasoned, application of the 2009 Bonds Act to bonds issued prior to the law's enactment does not constitute a violation of existing bondholder rights given that the legislature may provide for retroactive effect of a law under certain circumstances. The court explained that existing bondholder rights were not being altered retroactively because any changes to the terms of an old bond could occur only during the original term of the bond prior to the repayment date. Any such amendment by majority vote during the original term of the bonds, the court concluded, is justified under the German constitution because the legislative goal of promoting more flexible bond restructurings in the interests of a majority of bondholders outweighs the interests of the minority bondholders.

Finally, even though the German Federal Court of Justice confirmed the general validity of opt-in resolutions passed by majority bondholder vote, the court rejected the issuer's argument that the bonds were validly amended because the intended amendment of the terms and conditions provided for different treatment of holders of the same class of bonds. Such argument is incompatible with the legislative concept of equal treatment of all bondholders within the same class. The court clarified that the invalidity of resolutions violating the principle of equal treatment without such resolutions being formally contested (*Anfechtung*) was not explicitly stated in the

2009 Bonds Act, but it was one of the underlying concepts in the 2009 legislative reform of the law governing bonds.

Important Take-Aways for the Restructuring Practice

The decision of the Federal Court of Justice is expected to promote successful restructurings of bonds issued under the 1899 Bonds Act, thereby minimizing the risk of insolvency for the bond issuer and allowing it to overcome financial difficulties.

The ruling's key concepts for bond restructuring practitioners include:

- The opt-in mechanism is available for all bonds issued under the 1899 Bonds Act that are subject to German law, irrespective of where the issuer is domiciled.
- The opt-in rules also apply to certificated participation rights (*Genussscheine*) and to registered bonds as well as all other bonds that are subject to German law (except for *Pfandbriefe* and for German federal, state, or municipal bonds).
- The opt-in mechanism even applies to bonds issued under the 1899 Bonds Act that are not subject to a majority or collective action clause.
- An opt-in resolution as well as follow-on resolutions regarding specific amendments of the terms and conditions can be passed at a single bondholders meeting.
- Amendments to the terms and conditions of a bond are invalid if the changes treat bondholders of the same class differently, irrespective of whether bondholders formally challenge the validity of the resolution implementing the amendments.

In summary, the recent decision of the Federal Court of Justice is a big step forward toward more flexible restructuring of companies that have issued as yet unredeemed bonds under the 1899 Bonds Act.

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Endnotes

- 1 *Bundesgerichtshof*, judgment of July 1, 2014—II ZR 381/13 (*Immovest*).
- 2 OLG Frankfurt, decision of March 27, 2012—5 AktG 3/11, in: NZG 2012, p. 593 (*Pfleiderer*).
- 3 OLG Frankfurt, decision of April 28, 2006—20 W 158/06, in: ZIP 2006, p. 1388, denied the applicability of the 1899 Bonds Act for *Genussscheine*; in contrast, OLG Schleswig, decision of December 10, 2013—2 W 82/13, in: ZIP 2014, p. 221, confirmed the applicability of the 2009 Bonds Act for *Genussscheine*.
- 4 OLG Frankfurt, judgment of March 15, 2013—24 U 97/12 (not published).