



## A Note Trustee's discretion to agree modifications

### The issue

A Note Trustee will usually be given a limited power to agree modifications to the terms of the Trust Deed or the terms and conditions of the Notes, without seeking the consent of the Noteholders.

This limited power will ordinarily extend only to modifications:

- of a **"formal, minor or technical nature"**;
- to correct a **manifest error**; or
- where the Note Trustee is of the opinion that the modification is not materially prejudicial to the interests of the Noteholders. Any such power to determine no material prejudice will often be further limited so that it is not capable of extending to the modification of important commercial terms which require a higher quorum at meetings of Noteholders (entrenched terms which are commonly referred to as "Reserved Matters" or "Basic Terms Modifications" in the Trust Deed).

If the Note Trustee is not able or willing to exercise this power, it will be necessary for the Noteholders to pass a resolution approving the modification. Under the terms of the Note Trust Deed this will usually require the convening of a Noteholder meeting to consider and vote on the modification, or the passing of a written resolution (if the Trust Deed provides for this – some older Trust Deeds may not and, where they do, the thresholds tend to be high).

Achieving Noteholder consent to a modification tends to be an expensive and time-consuming process. Consequently, it will be tempting for an Issuer to seek to persuade a Note Trustee that a modification it wishes to make fits with the categories above. However, to ensure it will not be held liable for acting outside the authority conferred by the Trust

Deed, a Note Trustee must be satisfied that any consent it gives is firmly within the four corners of its discretionary power.

### The current law

[What constitutes a modification of a "formal, minor or technical nature"?](#)

It is difficult to point to any hard and fast rules on exactly what is meant by these terms. One view<sup>1</sup>, which seems to us to be sound and sensible, is as follows:

- A **formal** modification is a modification which does not change the substantive legal effect of a document.
- A **minor** modification is a modification which may change the substantive legal effect of a document, but only in such a way that its effect on the rights of the parties is unimportant.
- It is not altogether clear how a **technical** modification differs from a formal or a minor modification, but arguably could include (for example) modification of a reference to a data source or a technical term (such as a statutory provision which has been modified or superseded).

[When can an amendment be made to correct a "manifest error"?](#)

A manifest error is one which is so obviously wrong to the reader, applying reason, that there is no room for a credible argument to the contrary.

Judicial reference is often made to the definition of manifest error given by Lord Lindley<sup>2</sup>: "oversights

<sup>1</sup> Fuller: The Law & Practice of Capital Markets (3rd Edition)

<sup>2</sup> Lindley & Banks on Partnership, 18th edition (2002)

and blunders so obvious as to admit of no difference of opinion". Recently, the judge in [Flowgroup Plc v Co-operative Energy Limited](#)<sup>3</sup> (while applying the phrase in a slightly different context) agreed that a manifest error must be more than just a wrong answer, it must be a "howler".

It is, however, important to note that a manifest error does not always have to be immediately obvious. For complex transactions it might be necessary to do some detailed analysis to ascertain whether there is indeed a manifest error in the relevant document. However, the test will then be if, when that analysis has been done, the error is sufficiently obvious as to count as a "manifest error". It is now also generally accepted that:

- it is possible to take account of related (and substantially contemporaneous) documents (and not just the document containing the potential manifest error) to form a view over whether there is indeed a manifest error; and
- any solution to "fix" a manifest error should also be obvious.

Some Trust Deeds now include the ability for a Note Trustee to agree a modification which, in its opinion, is to correct a "proven error" (or similar drafting). It seems to us that it would be reasonable for a Note Trustee to apply similar considerations to those set out above when forming its opinion as to whether there is a "proven error".

#### When can a Trustee determine that a modification is not materially prejudicial to the interests of Noteholders?

Often it will not be straightforward for a Note Trustee to form the opinion that a proposed modification is not materially prejudicial to the interests of the Noteholders. The Note Trustee will need to consider the following:

- *Whose interests should it consider?* The starting point should always be that the Note Trustee should consider the interests of the holders as a class (and not consider the position of any particular Noteholder or group of Noteholders). However, a careful check of the transaction documents will be essential. It is not always a straightforward matter for the Trustee to determine whose interests it needs to consider. Depending on the type of transaction and the drafting of the particular transaction documents, the Trust Deed could dictate that the interests of only certain classes of Noteholder (such as the

most senior class) should be considered by the Trustee in certain circumstances.

- *What is the nature of the proposed discretion?* If the Note Trustee's power to determine no material prejudice has been limited so that it does not apply to reserved matters or basic terms modifications (which will usually be the case), it will be important to assess the nature of the modification.
- *What is meant by "material prejudice in this context?"* It is generally considered that "material" prejudice in this context means prejudice that is more than de minimis. A Note Trustee is also likely to need to consider potential (as well as actual) prejudice when it is exercising this discretion, which can bring in a broad range of potential considerations. This contrasts with the Note Trustee certifying material prejudice in relation to certain events of default, when the Note Trustee needs to confirm that the relevant event has caused actual (and not potential) material prejudice.

#### Practical tips

1. The Note Trustee is not under any obligation to exercise its discretion to modify – it is a power. Furthermore, under most Trust Deeds, the Note Trustee will usually be entitled to decline to take any form of action unless it is indemnified (or, if the Trust Deed provides for it, secured or pre-funded) to its satisfaction.
2. The circumstances in which a modification counts as being of a "formal, minor or technical nature" or to correct a "manifest error" are likely to be relatively rare.
3. Note Trustees will not ordinarily wish to confirm the absence of material prejudice without expert advice on which they can rely without liability. For example, under most Trust Deeds a Note Trustee can usually rely (without liability for doing so) on:
  - expert legal, financial, or other professional advice; and
  - certificates issued by one or more directors of an Issuer, confirming certain factual matters.
4. Where an Issuer is seeking to persuade a Note Trustee to exercise its discretion, it may present the Note Trustee with a so-called "Consent Letter". Among other things, this may:

<sup>3</sup> [2021] EWHC 344 (Comm)

- explain the background for the request;
- provide an analysis of why the Trustee should be able to exercise a discretion (by reference to facts, not opinions, which are confirmed by those providing the Consent Letter to be accurate and complete);
- signpost provisions of the Trust Deed which the Note Trustee should reference (including those which empower the Note Trustee to exercise a discretion); and
- confirm that no Event of Default has occurred or will arise as a result of the consent being given.

It is very important for a Note Trustee to ensure that any Consent Letter is drafted such that it plugs into the protections available to the Note Trustee under the Trust Deed. So, if the Trust Deed provides that the Trustee can rely on a certificate as to matters of fact or expediency signed by two directors of the Issuer, the Consent Letter should take that form and contain that information. However, if there are legal or financial issues to consider, a Note Trustee will probably also wish to seek its own advice.

5. Trustees have sometimes looked to use so-called "negative consent" procedures. Under a negative consent process the Note Trustee informs the Noteholders that it is intending to exercise its discretion, unless the Noteholders provide objections to the Note Trustee within a particular timeframe. While this might be useful to indicate to the Note Trustee any strong Noteholder feeling about certain changes, the Trust Deed will not usually provide for this type of process. Further, under English contract law, silence does not constitute acceptance. Therefore, the Note Trustee will not be fully protected when relying on such a process and it must still always form its own fully considered opinion when exercising a discretion.
6. While a Trustee can rely on various protective provisions in the Trust Deed and this can be informed by relevant and appropriate advice and confirmations of fact, it will still have to form its own view when exercising a discretion and document the decision process it has gone through.

It remains possible for the Trustee to seek the assistance of the court where there are mistakes or ambiguities in trust documents and the Note Trustee is concerned about its own liability in agreeing or pursuing a particular course of action. Depending on the issue to be resolved and the attitude of the relevant parties, this would ordinarily be dealt with by way of a construction hearing or rectification of the Trust Deed. As with many court-based processes, these tend to be time-consuming and expensive.

7. It will always remain open to an Issuer to seek Noteholder consent to a proposed modification via the normal mechanisms in the Trust Deed (e.g., a resolution passed by the appropriate majority at a quorate meeting of holders, or, if the Trust Deed provides for it, a written resolution).

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