CLEARY GOTTLIEB

Alert Memo

APRIL 11, 2012

www.clearygottlieb.com

# Adjusting Expectations – New German Bondholder Act not Applicable to All Existing Bonds

Recent court decisions by the District Court of Frankfurt am Main (the "District Court") and the Court of Appeals of Frankfurt am Main (the "Court of Appeals") are forcing market participants to adjust their expectations that the new German Bondholder Act (*Schuldverschreibungsgesetz*, the "2009 Act")[1] can be used to restructure German law-governed bonds issued prior to August 5, 2009.

***Background***

Under German law, and in particular under the German Bondholder Act of 1899 (*Schuldverschreibungsgesetz von 1899*, the "1899 Act") as in force until August 4, 2009, fundamental restructuring measures (such as waivers of principal) could not be resolved by majority vote on the basis of collective action clauses. In this respect, German law was not in line with international standards. This was one of the reasons that lead German issuers to use increasingly non-German laws (particularly English law or New York law) to govern their bonds.

In order to address these perceived shortfalls of German law, the German legislature enacted the 2009 Act, which applies to bonds issued on or after August 5, 2009. The 2009 Act provides issuers of German law-governed bonds with a large degree of flexibility to include collective action clauses in their bonds to aid restructurings. In particular, bondholders may now agree to waivers of principal, reschedulings of debt or debt-equity swap, each by majority vote.

For bonds that had been issued before the 2009 Act became effective, the 2009 Act contains a provision that allows the holders of those bonds to "opt-in" to the 2009 Act. On that basis, most market participants believed that it would be possible to subject existing bonds to the 2009 Act by super-majority vote (75% of the bonds present and voting) and then approve amendments to the terms and conditions of the bonds by majority vote or super-majority vote, as applicable pursuant to the 2009 Act.

Pfleiderer and Q-Cells, two troubled German corporate groups that had issued bonds prior to August 5, 2009, sought to use the "opt in" mechanism to restructure bonds issued by them (in each case through Dutch finance subsidiaries). Certain bondholders that were unhappy with the restructuring proposals filed complaints challenging the bondholder resolutions, thus blocking the restructurings.

---

[1] Reference is made to our related memorandum of August 2009 -- http://www.cgsh.com/reform_of_the_german_bondholder_act/

***The Decisions***

Pfleiderer.[2] In the case brought against Pfleiderer, the Court of Appeals held on March 27, 2012 (published on March 30, 2012) in a non-appealable court order that the 2009 Act does not apply to German law-governed bonds that had been issued by a non-German finance subsidiary of the German parent prior to August 5, 2009. The court based its ruling on a narrow interpretation of the wording of the 2009 Act, as well as the rationale that bondholders must be able to rely on the fact that, in respect of bonds issued by non-German issuers prior to August 5, 2009, rules for majority votes did not exist at the time of issuance.

In other words, since the 1899 Act had not permitted amendments to German law-governed bonds issued by non-German issuers, Pfleiderer bondholders could not validly opt to have the 2009 Act apply to the Pfleiderer bonds. As a consequence of this ruling, Pfleiderer was unable to achieve a consensual restructuring with its bondholders and filed for insolvency on March 28, 2012.

The District Court had also held that the 2009 Act could not apply because the bonds were partially governed by German law and to a limited extent by Dutch law. In the court's view, the 2009 Act requires that the terms and conditions be exclusively governed by German law, and accordingly any split choice of law contained in a bond's terms and conditions would render the 2009 Act inapplicable. The Court of Appeals did not address this argument, and it remains to be seen whether other courts will reach the same conclusion where a German issuer's bonds are governed in part by German law and in part by the law of another jurisdiction.

Q-Cells.[3] In a similar case brought against Q-Cells by certain of its bondholders, the District Court likewise held in an appealable court order that the 2009 Act does not apply to German law-governed bonds issued by non-German issuers prior to August 5, 2009. The decision, which blocked an otherwise consensual restructuring, similarly caused Q-Cells to file for insolvency on April 3, 2012.

***The Consequences***

The Pfleiderer and Q-Cells court decisions call into question the ability of issuers and bondholders to validly "opt in" the application of the 2009 Act by majority vote for bonds issued prior to August 5, 2009. In particular, under these decisions any non-German issuers (including non-German finance subsidiaries issuing bonds for German groups) are excluded from opting in to the 2009 Act, unless the terms and conditions of the bonds already contain a collective action clause.

While the court decisions thus constitute a significant setback for out-of-court restructurings involving bonds issued by non-German issuers prior to August 5, 2009,

---

2 OLG Frankfurt am Main, court order of March 27, 2012, 5 AktG 3/11; LG Frankfurt am Main, court order of October 27, 2011, 3-05 O 60/11.

3 LG Frankfurt am Main, court order of October 27, 2011, 3-05 O 142/11 and others.

the decisions leave open the use of "opt in" resolutions for bonds issued by German issuers. Also, it remains to be seen whether the German legislature will amend the 2009 Act in order to have it specifically apply to bonds issued by non-German issuers prior to August 5, 2009. In any event, notwithstanding these clarifications, the 2009 Act remains a powerful tool for the restructuring of German law-governed bonds issued on or after August 5, 2009.

*

* *

If you have any questions in regard to the issues addressed herein, please feel free to contact Dr. Werner Meier (wmeier@cgsh.com), Michael Kern (mkern@cgsh.com), or Christoph Schauenburg (cschauenburg@cgsh.com) at the Frankfurt office of Cleary Gottlieb or any of our partners and counsel listed under "Germany", "Lawyers in this Practice", under the "Practices" section, "Regions", of our website at http://www.cgsh.com.

CLEARY GOTTLIEB STEEN & HAMILTON LLP

CLEARY GOTTLIEB

# Office Locations

NEW YORK
One Liberty Plaza
New York, NY 10006-1470
T: +1 212 225 2000
F: +1 212 225 3999

WASHINGTON
2000 Pennsylvania Avenue, NW
Washington, DC 20006-1801
T: +1 202 974 1500
F: +1 202 974 1999

PARIS
12, rue de Tilsitt
75008 Paris, France
T: +33 1 40 74 68 00
F: +33 1 40 74 68 88

BRUSSELS
Rue de la Loi 57
1040 Brussels, Belgium
T: +32 2 287 2000
F: +32 2 231 1661

LONDON
City Place House
55 Basinghall Street
London EC2V 5EH, England
T: +44 20 7614 2200
F: +44 20 7600 1698

MOSCOW
Cleary Gottlieb Steen & Hamilton LLC
Paveletskaya Square 2/3
Moscow, Russia 115054
T: +7 495 660 8500
F: +7 495 660 8505

FRANKFURT
Main Tower
Neue Mainzer Strasse 52
60311 Frankfurt am Main, Germany
T: +49 69 97103 0
F: +49 69 97103 199

COLOGNE
Theodor-Heuss-Ring 9
50688 Cologne, Germany
T: +49 221 80040 0
F: +49 221 80040 199

ROME
Piazza di Spagna 15
00187 Rome, Italy
T: +39 06 69 52 21
F: +39 06 69 20 06 65

MILAN
Via San Paolo 7
20121 Milan, Italy
T: +39 02 72 60 81
F: +39 02 86 98 44 40

HONG KONG
Bank of China Tower
One Garden Road
Hong Kong
T: +852 2521 4122
F: +852 2845 9026

BEIJING
Twin Towers – West (23rd Floor)
12 B Jianguomen Wai Da Jie
Chaoyang District
Beijing 100022, China
T: +86 10 5920 1000
F: +86 10 5879 3902

BUENOS AIRES
CGSH International Legal
Services, LLP-
Sucursal Argentina
Avda. Quintana 529, 4to piso
1129 Ciudad Autonoma de Buenos Aires
Argentina
T: +54 11 5556 8900
F: +54 11 5556 8999

SÃO PAULO
Cleary Gottlieb Steen & Hamilton
Consultores em Direito Estrangeiro
Rua Funchal, 418, 13 Andar
São Paulo, SP Brazil 04551-060
T: +55 11 2196 7200
F: +55 11 2196 7299