

NORWEGIAN BOND MARKET - SUPREME COURT REACHES PRACTICAL COMMERCIAL SOLUTION TO UNUSUAL LEGAL ISSUE

On 7 April 2010, the Norwegian Supreme Court overruled the Borgarting Court of Appeal's decision and decided in favour of Norsk Tillitsmann ASA (NTM) in a verdict concerning the legal capacity of NTM as trustee in the Norwegian bond market. After several court decisions, a fast-track legislative process and about one year in a legal vacuum, NTM is now back where everybody thought it was one year ago.

NTM had, after its establishment in 1993, become the predominant trustee in the Norwegian bond market. According to its own statements, it manages a portfolio of approximately 1,700 bond loans at a combined value exceeding 750 billion NOKs. The Norwegian bond market has traditionally been characterized as a low risk market, but during the last decade a market for high-yield bonds has been established, particularly in the offshore sector.

One such bond, issued by Thule Drilling ASA, was at the heart of the unexpected legal issue which arose in the NorInvest case. NorInvest Ltd., a company incorporated in the Virgin Islands and one of the main shareholders of Thule, guaranteed an equity issue in 2008 which was never finalized. In March 2009, NTM submitted an arrest petition for the amount guaranteed by NorInvest. NorInvest opposed the petition, arguing, to everybody else's surprise, that NTM could not legally represent the bondholders.

The point of law in question was the basic principle under Norwegian procedural law that a party to a legal action must have sufficient legal interest in the action - the background, of course, being that a court verdict shall have legal effect upon the right parties. Applied to debt recovery actions, this principle implies that a claim must be submitted by the *de facto* creditor in its own name and not by a representative. The question in the NorInvest case was therefore whether the fact that NTM was the trustee for the bondholders, and thus in legal terms their representative, under the circumstances gave NTM the required legal interest in the action.

NorInvest won both in the court of first instance and in the Court of Appeal, the main reasoning being that the real creditors were the bondholders and not NTM. NTM could not represent the bondholders as long as they remained anonymous. The rulings were in line with the above general rule, from which the courts of lower instance dared not deviate. Anonymity of bondholders under Norwegian bond loans thus raised issues when mandatory legal principles were applied to the agreement structures.

Understandably, these decisions sent a shock wave in the direction

of NTM and the investors, provoking great frustration and astonishment. The decision of the Court of Appeal, which was appealed to the Supreme Court by NTM, was a source of great concern, not least to those bondholders faced with extensive enforcement challenges due to the standard provision of the loan agreement prohibiting individual bondholders from enforcing the bond on their own. Awaiting the Supreme Court's decision, issuers, bondholders and evidently NTM itself, also expressed considerable concern about how to create a workable system for new bonds, especially since none of the parties to new agreements wished to significantly alter the inherently legitimate prohibition against single-enforcing bondholders.

Following the decision of the Borgarting Court of Appeal, NTM quickly requested the relevant government authorities to draw up new legislation permitting NTM to represent bondholders in legal proceedings. The authorities initiated a fast-track legislative process, and the Ministry of Finance issued a white paper on 25 November 2009 proposing a new statute. During the hearing, the proposal met with almost no opposition.

However, the legislative process should now prove unnecessary because the Supreme Court reached a unanimous decision in favour of NTM in its verdict of 7 April 2010. The decision is based firstly on the undisputed and obvious need for enforceability of bond loans. It was further founded on statements given during the white paper hearing. It appears that the judges of the Supreme Court were of the opinion that the necessity for a workable solution was more important than the argument for deviating from the main rule of law. As the first-voting judge stated, it is particularly necessary to take into consideration the agreements between the parties when such are founded on standard agreements which the financial and commercial community as a whole consider suitable for the situation at hand. As opposed to courts of lower instance, it is the Supreme Court's privilege to develop the rule of law. In the verdict of 7 April, the Supreme Court applied the privilege to create an important exception to what was understood to be a set procedural rule.

So, is the issue of the legal capacity of Norwegian bond trustees solved once and for all? It is directly stated in the verdict that the decision is not confined to NTM's legal capacity, but would apply similarly to other companies acting as trustees based on a corresponding system of agreements. Considering that a trustee's position is largely unregulated in Norwegian law, it may be assumed that most agreements founded on similar principles will be accepted by Norwegian courts in the future. However, bearing in mind the fact that NTM is almost the only bond arranger in Norway, debtors and particularly creditors should exercise caution before creating and entering into agreements which considerably deviate from the system created by NTM.

It is not clear whether the above legislative process will be concluded. In our opinion, it seems unlikely. It also remains to be seen whether or not it is a good idea to implement legislation covering a fragment of the bond system based on a fast-track legislative process alone.

Several of the institutions invited to comment on the legislative process, including the Ministry of Trade and Industry, pointed out the need to regulate not only the legal capacity of the bond trustee, but also other aspects of a trustee's position. It is not unlikely that the Ministry of Finance will stop the present legislative process, and instead initiate a broader procedure under which the aim will be to regulate further aspects of the bond market.

For the time being, however, the Norwegian bond market remains a legal area unregulated by statutory legislation, thus leaving the parties with the task of creating workable solutions. As a result of the Supreme Court's ruling, this practice may be upheld. It may in any case be considered encouraging for players represented in the Norwegian commercial market that both the Supreme Court and the Norwegian Government seem to have honoured solutions currently in place between the parties.

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