DTEK: Has the English High Court Provided Another Option for Restructuring New York Law Bonds?

In *Re DTEK Finance BV*,[1] the English High Court decided that a change in the governing law of bonds from New York to English law, established a sufficient connection with the English jurisdiction for it to sanction the bonds' restructuring via a UK scheme of arrangement.

Background

DTEK Finance B.V. (DTEK), a Netherlands company, is part of a privately owned corporate group that operates an energy business in the Ukraine. DTEK was the finance company in the group and would raise funds on the capital markets before distributing them to the rest of the group.

The high yield bonds that were restructured in this case were issued in 2010 and comprised US$200 million of unsecured 9.5 percent senior notes, governed by New York law, that were due to mature in April 2015.

Recent destabilization in the region and currency devaluation had adversely affected the group's financial position and DTEK lacked funds to pay the amounts due on maturity.

Schemes of Arrangement

A "scheme" is a formal arrangement between a company and its creditors and/or members or shareholders that can bind dissenting creditors as long as the statutory majorities vote in favor and the English Court approves it. Depending on what rights the relevant creditors have, and how the proposed terms of the scheme would affect them, they may be split into classes for voting purposes.

Schemes follow a procedure under the UK Companies Act rather than the Insolvency Act. This means that a company need not be insolvent in order to propose a scheme and so schemes carry less stigma than ordinary insolvency proceedings.

Schemes are very flexible. They can be used to vary creditors' rights under contracts so as to impose debt write-downs, effect debt for equity swaps, and alter interest rates or maturity dates. Also, there are no specified provisions that a scheme must include.

Restructuring Plan

DTEK wished to extend the maturity of the 2015 notes, and so launched an exchange offer and consent solicitation under which DTEK would acquire and cancel the existing notes, with noteholders receiving new 2018 notes for 80 percent of the par value of the old notes, plus 20 percent in cash by way of incentive.

The consent solicitation invited the noteholders to agree a change of governing law to English law with the express intention that this would enable a scheme to be sanctioned if the exchange threshold was not achieved. It was also structured so that noteholders that supported the exchange offer would be treated as having

approved the proposed scheme, which was launched at the same time.

The exchange offer threshold under the terms of the 2015 notes' indenture was 98 percent. This threshold was not met, as only 91.1 percent of noteholders ultimately agreed to the offer. Therefore DTEK had to attempt to restructure the notes via its contingency plan of effecting a scheme.

Jurisdiction: "Sufficient Connection"

In order for a scheme of arrangement proposed by non-UK companies to be sanctioned by the English Court, the company proposing it must have a "sufficient connection" to the English jurisdiction.

In previous cases, a sufficient connection has been found on a variety of evidential grounds, for example: assets being situated in England or business being carried on there; the relevant company having moved its center of main interests to England; and liabilities being owed to creditors based in England or under agreements governed by English law.

The key aspect of the *DTEK* case is that the English Court was being asked to accept jurisdiction on the basis that, by the time the matter came before it at the sanction hearing (the final stage in the scheme process), the governing law clause in the notes had been changed from New York law to English law. Therefore, when considering whether it had jurisdiction to sanction the scheme, the court had to form a view as to whether the governing law of the 2015 notes had been changed to English law through the consent solicitation.

Was the Change in Governing Law Effective?

The 2015 notes' indenture was silent as to what consent level is required for a change in governing law (as is the case generally with indentures used in European high yield issuances).

DTEK argued that a simple majority was required to change the governing law of the notes and their indenture from New York law to English law. This was argued before the English court applying New York contract construction law, with expert evidence on the law being provided by former US Bankruptcy Judge Peck.

A hedge fund claiming to hold beneficial interest in some of the notes had argued before the sanction hearing that the change of governing law required consent greater than 90 percent, on the basis that this was a change that would "impair or affect" noteholders' rights to bring enforcement proceedings.

Initially, more than 88 percent of noteholders consented to the change in governing law and accepted the exchange offer. By the eve of the sanction hearing, 91.1 percent of noteholders had agreed. The effect of this was twofold: firstly, it meant that more than 90 percent of noteholders had agreed to the change in governing law (and so the crux of the opposing noteholders' challenge fell away); and secondly, the threshold majorities required for approval of a scheme had been achieved. Because of this, the question of what percentage of noteholders need to consent to a change in governing law remains open to argument in a future case.

Decision

The Judge hearing the case, Mrs. Justice Rose, ruled that the fact that the 2015 notes were, following the consent solicitation and by the time of the sanction hearing, governed by English law, was sufficient of itself to give the High Court jurisdiction to sanction the scheme to effect the exchange of notes. Mrs. Justice Rose also decided that the connection was not made less sufficient because of timing or manner of change of governing law.

On the facts, there were other bases on which the court was satisfied it would have jurisdiction: the Opco guarantees were governed by English law; DTEK in fact held some assets in the United

Kingdom; and DTEK was found to have shifted its COMI from the Netherlands to the United Kingdom.

Implications of the Decision

The key legal point to emerge from the case is that even though the change in governing law was clearly planned and effected in order to forum shop—i.e., to pass the English Court's jurisdiction test for a scheme—this was not a problem on the facts.

In terms of its practical application, this case shows that European- and US-based issuers of US law-governed bonds may be able to use an English scheme of arrangement to restructure bonds where only 75 percent by value and a majority in number of noteholders are supportive of the relevant issuer's proposal.

Issuers and their advisers may now need to look more closely at the drafting of consent thresholds for changes in notes' governing law and consider even dealing explicitly with the point.

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Endnotes

[1] [2015] EWHC 1164 (Ch)