Insight: Financial Restructuring & Insolvency

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DTEK Scheme sanctioned on the basis of a change of governing law of New York law bonds

On 27 April 2015, the English High Court sanctioned a scheme of arrangement (the "**Scheme**") for the US$200 million 9.5% senior notes due 2015 (the "**2015 Notes**") issued by DTEK Finance B.V. (the "**Issuer**"), a Dutch finance subsidiary of the Ukraine's largest privately owned energy group ("**DTEK**"). The Scheme was approved by 91.1% of noteholders.

DTEK joins a growing number of foreign companies, among them New World Resources and Invitel, to use an English law scheme of arrangement as a way of restructuring New York law governed high yield notes. This is in part because amendments to key economic terms typically require 90% in principal amount support under the instrument constituting the notes, making a consensual solution often unachievable, particularly when the notes are widely held.

Previously, foreign companies have shifted their centre of main interest ("**COMI**") to create sufficient connection with England. DTEK, following closely in the footsteps of APCOA (see our **Insight** from December 2014), has become the first European issuer of high yield notes in the European high yield market to change the governing law of a New York law governed indenture to English law in order to avail itself of the flexibility of an English law scheme of arrangement. This has opened up yet another avenue for foreign companies with New York law governed notes to successfully restructure their outstanding indebtedness.

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Background

With over 120,000 employees, DTEK is the largest power company in the Ukraine. Over recent years, its operations have been adversely affected by the challenging political and macro-economic conditions in the Ukraine, including the significant devaluation of the Ukrainian hryvnia and the military conflict in the Eastern Ukraine, where a large part of its assets are located. As a consequence, DTEK did not have the funds to repay its noteholders in full on 28 April 2015 when the 2015 Notes were due to mature. After an unsuccessful exchange offer in March 2015, DTEK had little choice but to use a cram down mechanism in order to restructure the debt.

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Sufficient Connection

Before APCOA, the market had speculated whether it would be possible to create sufficient connection off the back of a change in governing law. Since APCOA, the market has focused on whether it would be possible to do the same in relation to New York law governed indentures.

Facing a looming maturity and a significant amount of uncertainty as to whether such an amendment would work – both from a commercial perspective and as a matter of New York law – DTEK opted to both change the governing law of the 2015 Notes and shift the COMI of the Issuer from the Netherlands to the UK. Whilst ultimately both elements were used to demonstrate sufficient connection, DTEK represents another step forward for foreign companies and confirms once again that, provided the contractual provisions have been complied with, the English courts will have jurisdiction to compromise rights under what are now English law governed documents.

Sufficient Connection

The English court has jurisdiction to sanction a scheme for a foreign company if it is satisfied that the company has a sufficient connection with the English jurisdiction. Typically, as seen in *Re Magyar Telecom* [2013] EWHC 3800 (Ch) and *Re Zlomrex International Finance* [2013] EWHC 4605 (Ch), this is established by shifting a company's centre of main interest to the UK or where the rights that are being compromised are under English law governed finance documents, as seen in *Re PrimaCom* [2012] EWHC 164 (Ch) and *Re Rodenstock* [2011] EWHC 1104 (Ch).

Majority Consent?

The terms of the 2015 Notes indenture – consistent with most, if not all, indentures used in European high yield notes issues – was silent as to what consent level was required for a change of governing law. In this case, DTEK relied both on a plain language interpretation of the indenture based on New York canons of contract construction and on robust expert evidence given by the former US bankruptcy judge, Judge Peck, who presided over many of the Lehman cases, to support its view that this amendment could be effected on simple majority consent.

As in APCOA, DTEK made it explicit to noteholders that it was seeking to change the governing law of the 2015 Notes in order to create the sufficient connection needed to establish jurisdiction for a scheme. Ultimately, noteholders representing 91.1% in aggregate principal amount of the notes then outstanding voted in favour of the change in governing law. However, the change of governing law was actually effected based on votes of noteholders representing 88.58% in aggregate principal amount of the notes then outstanding.

A dissenting noteholder sought to challenge the Scheme, claiming that the change of governing law was made in violation of the terms of the 2015 Notes indenture. The noteholder argued that such an amendment required the consent of holders of 90% of the 2015 Notes because it would "impair or affect" the right of noteholders to bring proceedings for the enforcement of the right to be repaid. This challenge was subsequently withdrawn shortly before the Scheme sanction hearing. Had the noteholder not withdrawn its challenge, this would have become a question of whether, under New York law, a change of the governing law merely modifies rather than impairs or affects the law that would apply to enforcement proceedings.

Conclusion

The DTEK restructuring demonstrates the flexibility of English law schemes of arrangement as a robust tool to rescue companies in financial distress. High yield restructurings will inevitably continue, as issuers struggle to cope with the burdens placed on them as economic and geopolitical conditions continue to evolve and, in many cases, as more complex capital structures are implemented. By confirming that a change in governing law works, APCOA and DTEK have made schemes more accessible to foreign companies and reaffirmed why they are the international restructuring tool of choice.

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