WHITE & CASE

Insight: Financial Restructuring & Insolvency

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Magyar Telecom B.V. – the Restructuring of a High Yield Bond via an English Law Scheme of Arrangement

On 12 December 2013, our client, Magyar Telecom B.V. (the "**Company**"), a Dutch holding company of the Invitel group of companies (the "**Group**") and one of the leading telecommunication services providers in Hungary, completed the restructuring of its €345 million 9.5% Senior Secured Notes due 2016 (the "**Notes**").

There has been a considerable increase in New York law governed high yield debt issuance in Europe and the emerging markets over the past few years and currently the default rate remains at historic lows. If the default rate returns to, or exceeds, historic norms then debtors and bondholders will need to find a way to restructure those bonds that have not proved to be sustainable. This client alert briefly describes the background to the Magyar Telecom transaction, examines the commercial parameters of the restructuring, explains how the transaction was implemented and contemplates the significance of the transaction for future restructurings.

The Background

The environment for telecommunication services providers in Hungary is highly competitive. In recent years competition has increased as new market entrants pushed providers to invest significant resources to upgrade their networks, while pricing has fallen. At the same time, Hungary's economy has struggled since the financial crisis in 2008 with low GDP growth and persistently elevated unemployment levels. In addition, the Hungarian government imposed a number of extraordinary tax measures against large corporates in sectors such as telecommunications, all of which severely reduced the Group's cash flow generation and caused liquidity issues. In early 2013, these pressures culminated in a decision made by the Group and its owner, Mid Europa Partners, to find a holistic solution via a deep restructuring of the Notes.

The Commercial Agreement

Following protracted negotiations, the Group signed a restructuring agreement on 15 July 2013 which eventually attracted the support of just over 70% of the noteholders.

The key elements of the commercial deal were:

- All Notes were cancelled and new notes (the "**New Notes**") with an aggregate principal value of €155 million were to be issued to the noteholders;

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- All third party noteholders could participate in a modified reverse Dutch auction (the "**Cash Option**") in which they could elect to sell a pro rata portion of their New Notes. The Cash Option was funded by an injection of €15 million by Mid Europa Partners (the sale resulted in the eventual bond debt of the Group to third party creditors being reduced to approximately €140 million);
- Noteholders received a pro rata portion of equity in a newly created vehicle (the "**Equityco**") which would own 49% of the Group;
- Mid Europa Partners subscribed for €10 million of New Notes and €15 million of additional equity which was used to fund the Cash Option; and
- The New Notes and the shares of EquityCo were stapled together into Units and listed on the Euro MTF market of the Luxembourg Stock Exchange, where they only trade as Units (i.e. it is not possible to buy and sell the New Notes or the EquityCo shares separately).

It is worth highlighting that the stapling is a fairly novel aspect of the structuring of the transaction. Key stakeholders felt that the stapling feature meant that the interests of the holders of the equity and the debt would be more closely aligned. It took considerable work with the clearing systems, the listing authority and the custodians to ensure the stapling could be achieved.

Implementation

As with every restructuring, the starting point was to look for a local process which could be used. The Netherlands-incorporated Company issued the Notes and whilst there is a process similar to a scheme in the Netherlands, called a Dutch Akkoord, this process works only for non-secured debt whereas the Company's Notes were secured. To avoid negative PR and practical difficulties that would result from an insolvency process in Hungary or a Chapter 11 proceedings in the US, the Company chose the Scheme – which is a process under the UK Companies' Act and not an insolvency process. The Company ran the Scheme concurrently with an exchange solicitation but in the end the transaction was implemented via the Scheme.

The Scheme is an English court supervised process where strict procedures need to be complied with, including the need for an initial convening court hearing (the "**Convening Hearing**"), a vote of the creditors in a meeting and finally a sanction court hearing (the "**Sanction Hearing**"). To achieve the statutory threshold the Company needed the support of 75% by value and a majority in number of the noteholders present and voting at the meeting. Eventually, a vast majority of the noteholders representing almost 90% in value supported the Scheme.

One of the key implementation requirements was that the Scheme needed to release not only the debt of the Company, but the related guarantees by Group members in favour of the noteholders. In recent years, English judges have determined that a scheme is able to effect such releases otherwise the purpose of the scheme would be defeated as creditors might seek to proceed against the operating companies which have invariably issued guarantees in favour of the noteholders. It was also important that the New York courts recognised the third party releases, which is discussed below.

Jurisdiction – the Scheme

The UK Court has jurisdiction to sanction a scheme in relation to a "company" which is defined as "any company liable to be wound up under the Insolvency Act 1986". Sections 220 and 221 (1) of the Insolvency Act 1986 give the Court the power to wind up a foreign company. The Court can therefore sanction a scheme in relation to a foreign company where there is a sufficient connection to the English jurisdiction to justify the Court sanctioning a scheme.

In recent years, a number of debt restructurings of non-English incorporated companies had been accomplished where such a scheme was based on English governing law of the underlying finance documents (see for example Re Rodenstock [2012] BCC 459; Re PrimaCom (No. 2) [2013] BCC 219; and Re Nef Telecom BV [2012] EWHC 2944 (Ch)). As the Notes were New York law governed, however, this simple route was not available to the Company and 'sufficient connection' had to be established by the means of shifting its Centre of Main Interest ("**COMI**") to the UK.

The COMI Shift

COMI is referred to in the EC Regulation on Insolvency Proceedings (1346/2000/EC) (Insolvency Regulation) which came into force on 31 March 2002. The significance of COMI is that within the European Union (except Denmark), a company must file for insolvency in its jurisdiction of incorporation unless its COMI is within another member state. Recent European Court of Justice judgments (Re Eurofood IFSC Ltd [2006] Ch 508 and Interedil Srl (In Liquidation) v Fallimento Interedil Srl [2012] BCC 851 at [47] to [53]) demonstrate that the presumption that a company must file in the jurisdiction of its registered office may be rebutted where, from the viewpoint of third parties, the place in which a company's central administration is located, is not the same as that of its registered office. The shifting of the COMI from one jurisdiction to another has now become an established tool of restructuring and the Company embarked on a number of measures (such as opening of a UK office, notices to creditors, negotiation meetings with creditors in London, appointment of UK based directors) to ensure that the Company's COMI shifted from the Netherlands to the UK. At the Convening Hearing, Mr Justice Arnold was satisfied that the COMI of the Company was indeed in the UK.

In addition, at the Convening Hearing the Company disclosed to the court that the COMI was recently shifted and how this was effected. The identification of a company's COMI is an exercise to be undertaken at the time of the request to open proceedings and, so long as the COMI migration has a sufficient degree of permanence, the sufficient connection test should be satisfied. Further, the Company argued that there was nothing improper about a debtor company moving its COMI to the UK for the purposes of opening insolvency proceedings in this jurisdiction where the reason for so doing is to advance the interests of its creditors.

Other Jurisdictional Issues

As Mr Justice Richards pointed out in his judgement at the Sanction Hearing ([2013] EWHC 3800 (Ch)), the court will not generally make any order which has no substantial effect and, before the court will sanction a scheme, it will need to be satisfied that the scheme will achieve its purpose (Sompo Japan Insurance Inc v Transfercom Ltd [2007] EWHC 146 (Ch), Re Rodenstock GmbH at [73]-[77]).

Accordingly, detailed expert evidence of US law was laid before the Court that it was likely that the US Courts would recognise and give effect to the Scheme, notwithstanding that it alters and replaces rights governed by New York law. Similarly, expert evidence was given that the courts of the Netherlands would recognise and give effect to the Scheme, as would the courts of Hungary where some of the guaranteeing companies and secured assets were located.

The US Chapter 15 Order

The Company successfully sought an order from the US Bankruptcy Court recognising the Scheme as a 'foreign main proceeding' and permanently enjoining the noteholders from commencing proceedings under the cancelled Notes. Whilst this is not the first case we are aware of where a US Bankruptcy court has issued a Chapter 15 Order in respect of a foreign plan that compromises New York governed notes, it is the first case where US Bankruptcy court considered whether the release of the guarantees effected by a UK scheme was appropriate given that non-consensual third party releases of non-debtor guarantors have not been routinely approved in Chapter 11 cases. In making his ruling, Judge Lane pointed out that the Scheme under consideration could not function without such a release, otherwise disgruntled noteholders could simply sue the operating companies who have given guarantees under the Notes. Judge Lane referred to recent precedents (Metcalfe & Mansfield Alternative Investments 421 B.R. 685 (Bankr. S.D.N.Y. 2010) and In re Sino-Forest Corp., 2013 WL 6154114 (Bankr. S.D.N.Y. Nov. 25, 2013)) where similar third party releases were features of Canadian court approved insolvency plans for which enforcement relief was sought in a US Chapter 15 case. Judge Glenn in the Metcalfe case stated that 'the correct inquiry was not whether the scheme would have been approved in a Chapter 11 case, but rather whether the foreign order should be enforced in the United States'. Relying on those precedents and his findings that the English proceedings in respect of the Scheme were fair and sufficiently protective of creditors' best interests, Judge Lane felt able to issue the requisite order, having determined it was not manifestly contrary to US public policy to do so.

Conclusions

Magyar Telecom BV's successful path through the complex cross border jurisdictional thicket can only be welcomed given the support of the vast majority of the noteholders and the possible insolvency, which would have resulted had its restructuring not been successful. Whilst some of the features of the restructuring were not novel, for example the use of a scheme to compromise notes and the COMI shift to achieve the requisite jurisdictional nexus, judges on both sides of the Atlantic issued a number of helpful judgements which will assist future companies in a similar predicament.

Key Points

- The Magyar Telecom transaction is a model of how to compromise a New York law note issued by a non-English incorporated company using an English law scheme of arrangement (the "**Scheme**");
- The Scheme was recognised in the US by an order under Chapter 15 of the US Bankruptcy Code (the "**US Chapter 15**");
- The other relevant jurisdictions (the Netherlands, Hungary and the United States) did not provide an attractive alternative to the Scheme for the implementation of the transaction;
- The Scheme effected releases of claims against third parties such as related guarantees by Group members in favour of the noteholders;
- The Magyar Telecom transaction demonstrated that New York courts now respect non-consensual releases of claims against third parties effected through an English scheme even though New York courts do not routinely allow these in domestic cases;
- The restructuring also demonstrated how flexible schemes can be as the transaction included unusual commercial features such as stapling of debt and equity or debt buyback through modified reverse Dutch auction; and
- A number of judgments were issued both as part of the Scheme process and the US Chapter 15 which will smooth the path for similar future restructurings.

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