The Swiss Perspective on Cross-Border Restructuring of (High Yield) Bonds

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In cross-border restructurings of (high yield) bonds, issuers more frequently seek to apply foreign statutory laws and schemes that could ease restructuring by way of forcing certain non-consenting noteholders to accept the amended terms. From the perspective of Swiss issuers and guarantors, cross-border restructurings raise critical Swiss law questions and require a thorough legal analysis.

Key takeaways:

- **Notes issuers in need of a restructuring of their debt tend to look into foreign restructuring schemes that provide for low noteholder consent thresholds**
- **For example, the English law scheme of arrangement under part 26 of the Companies Act 2006 provides for a 75% threshold**
- **There is some uncertainty with respect to the recognition of such schemes in Swiss courts**
- **Careful legal analysis is required in case of note issuances by affiliates/special purposes vehicles that are guaranteed/secured by Swiss companies**

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1. Finding an Alternative Path for a Bond Restructuring

The terms of high yield bonds are usually governed by the laws of the State of New York. In the event an issuer wishes to amend material terms of the issued notes (e.g., maturity date or interest), such standard bond documentation typically requires the (close to) unanimous consent of the noteholders. Also, a voluntary exchange offer under which the issuer is issuing new notes in exchange for the existing notes will be subject to a similar acceptance rate in case the new notes provide for less attractive terms than the existing notes form a noteholder's point of view.

For obvious reasons such (close to) unanimous consent is often not achievable. Issuers in need of a restructuring of their debt, e.g., in case the approaching repayment is at risk due to financial distress, therefore, may have to look into restructuring schemes available under foreign laws.

Recently, various companies restructured their debt by way of an English law scheme of arrangement under part 26 of the Companies Act 2006 (the "English Scheme"), sometimes combined with a voluntary exchange offer. The English Scheme then may serve as backup in case the voluntary exchange acceptance thresholds are not met.

As opposed to the (close to) unanimous consent requirement under the usual New York law governed high yield bond documentation, or the usual acceptance levels of voluntary exchange offers, the English Scheme only requires 75 percent of noteholders by value and a majority in number to consent. Once sanctioned by the English court, the English Scheme is then binding on all creditors, whether they were present, or voted for or against it.

In addition to this relatively low threshold requirement, the English courts have shown their willingness to accept jurisdiction, also in cases where there was initially no link to England, as can be seen in the example of the DTEK restructuring case (see Section 2 below). Even when the connection to England is established simply as a consequence of forum shopping, it is possible that issuers benefit from a scheme of arrangement to restructure their bonds where only 75 percent by value and a majority in number of the noteholders were supportive of the issuers' restructuring proposal.

2. Example: The DTEK Restructuring Case

The DTEK Group is the largest privately owned energy business in Ukraine, employing more than 120'000 people. The military conflict in Ukraine in 2014/15, and the resulting devaluation of the Ukrainian hryvnia, significantly impacted DTEK's business. Consequently, DTEK faced the prospect of failing to redeem its outstanding USD 200 million 9.5 percent Senior Notes (the "2015 Notes") on their maturity date in 2015.

The issuer of the 2015 Notes – a Dutch group company of DTEK – initiated a dual track process to cancel the 2015 Notes and all guarantees thereunder, and issue new notes (on substantially the same terms but with a maturity date in 2018) by seeking the noteholders' consent to:

1. a voluntary exchange (requiring tenders from 98% of the noteholders); or

2. in case the 98% tender threshold was not achieved (i.e., as a fall-back), (a) amend the governing law from New York to English law; and (b) an English Scheme (requiring a lower threshold).

As only 88.6% of the noteholders offered their consent, the 98% tender threshold for the exchange offer was not met, and DTEK decided to proceed in amending the governing law from New York to English law, (requiring the consent of more than 50%, which they had) and the English Scheme, (requiring the consent of more than 75% in value and 50% in numbers of noteholders – present and voting – which they also had).

The DTEK-case was described as groundbreaking because the English court held, for the first time, that simply changing the governing law of the 2015 Notes from New York to English law created a "sufficient connection" to England for the English court to sanction the English Scheme. This was despite the fact that from the outset it had been explained to the noteholders that the change in governing law from New York to English law was primarily aimed at establishing the English court's jurisdiction to sanction the English Scheme. In previous decisions, a "sufficient connection" had to be established by means such as moving the center of main interest to England ("COMI-Shift").

Following DTEK, legal commentators expected issuers around the world to use the case as a precedent and basis for restructuring their (high yield) bonds in the future (as opposed to the restructuring of loan debt as the Loan Market Association (LMA) did in 2012 by revising its leveraged finance standard by recommending a governing law change to require all-lender consent).

3. Implications and Swiss Law Aspects

With expected high yield bond maturities of USD 361 billion in Europe and USD 394 billion in the US in 2018/19 (source: Bloomberg), it seems likely that more restructurings are on the way. Some of those involve note issuances that are guaranteed by Swiss companies. If so, the question becomes relevant whether the respective foreign law governed restructuring, as for example the English Scheme, would be recognized in Switzerland (causing enforcement actions under the existing notes against the Swiss guarantor to be effectively blocked).

In general, the recognition of foreign decisions in Switzerland is governed by the Swiss Federal Private International Law Act (PILA), according to which international treaties are reserved, in particular the Lugano Convention of 2007. The Lugano Convention and its signatories, being essentially Switzerland and the EU member states, provide for mutual recognition of decisions, subject to exceptional cases (e.g., public policy). The scope of application of the Lugano Convention is, however, limited in particular for two reasons:

- First, the Lugano Convention applies to civil and commercial law matters, and governs issues of jurisdiction as well as recognition and enforcement of foreign judgments. In particular, however, the Lugano Convention does not apply to bankruptcy proceedings, proceedings relating to the winding-up of insolvent companies or other analogous

proceedings.

- Secondly, the Lugano Convention only applies to decisions which qualify as a judgment in the sense of the Lugano Convention.

Therefore, foreign law schemes based on insolvency laws are unlikely to fall under the Lugano Convention. Even for the English Scheme that is under the Companies Act (as opposed to the Insolvency Act), there is no final clarity if the scheme falls under the scope of the Lugano Convention and whether it constitutes a "decision" in the sense of the Convention. As there is no guidance from courts in Switzerland, and relevant court judgments with respect to the recognition and enforcement of the English Scheme in other European courts are divided, the relevant facts of each case needs careful analysis.

The above analysis on the Lugano Convention is of great importance because there is currently no international treaty in place under which a Swiss court would be obliged to recognize and enforce an English court's decision sanctioning a scheme of arrangement under English law.

If analyzed under the PILA the recognition is questionable, in particular because it cannot be excluded that Swiss courts could qualify the scheme of arrangement – even though it is governed by the English Companies Act – as an insolvency and debt restructuring proceedings. Foreign courts' decisions on such insolvency proceedings are recognized in Switzerland, amongst others, if such a decision has been rendered at the place of incorporation of the debtor. Because the issuers of (high yield) bonds are typically special purpose vehicles incorporated in the Netherlands, Luxembourg etc. and the court decision is rendered in England, this requirement would not be met.

4. Brexit and other Swiss relevant Aspects

Also, in the mid-term, it should not be forgotten that the UK's vote in favor of Brexit has led to further uncertainties on the future regime of applicable international treaties. In particular, the Lugano Convention applies to the UK by virtue of its membership in the EU. Following Brexit, of course the UK could become a party to the Lugano Convention considering that the Lugano Convention is open for accession to non-EU member states, but this would require that either (i) the UK becomes an EFTA member; or (ii) all existing member states of the Lugano Convention unanimously agree to the accession (see the Pestalozzi Legal Update "Brexit – Implications for Business between Swiss and UK Companies").

On the other hand, Brexit could also become an opportunity in this particular respect if the UK manages to achieve in its Brexit-related treaty negotiations that the English Scheme is subject to mutual recognition.

Finally, the Swiss uncertainties with respect to the recognition of foreign restructuring schemes may be counterbalanced by the fact that, once an issuer and its group are in financial difficulties, mandatory Swiss law financial assistance limitations may anyway cause the Swiss guarantors guarantee or security to be of minor relevance only. If the structure is up or cross-stream, (i.e., the Swiss guarantor is not a direct or indirect parent company of the SPV/notes issuer) then the value of the guarantee is limited to the freely distributable reserves

of such Swiss guarantor and, needless to say, such freely distributable reserves are most likely to be inexistent in case of financial distress of a group.

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