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The DTEK Restructuring – The Final Chapter

The court's sanction of DTEK's latest scheme includes novel references to its outstanding bank debt and helpfully rules on the controversial 'domicile test'.

The DTEK group recently implemented a long-term restructuring of its unsecured New York law-governed notes consisting of its US$750 million 7.875% senior notes due 2018, as well as its US$160 million 10.375% senior notes due 2018 (the Notes and holders of the Notes, the Noteholders) using an English law scheme of arrangement (the 'long term restructuring' or LTR Scheme). DTEK subsequently entered into an override agreement with a vast majority of its bank lenders, signaling the completion of a holistic restructuring. Despite the fact the bond deal preceded the bank deal, and creditors had different objectives and sensitivities, a number of unique features were used which allowed DTEK to successfully complete the restructuring to the satisfaction of both creditor groups.

Key Points:

- As part of the overall deal, existing bank lenders could elect to swap part of their bank debt into new restructured notes up to a maximum aggregate amount of US$300 million. This innovative option proved important to negotiations because it meant that bank lenders could elect to be treated as a Noteholder (assuming this treatment suited their risk and commercial appetite) for the purposes of the restructuring. The option demonstrated DTEK's commitment to treating its bank lenders and Noteholders equitably, by giving bank lenders the opportunity to become Noteholders.

- The LTR Scheme was implemented three months prior to finalization of the bank deal in which a "modification provision" authorized the ad hoc committee of Noteholders to amend the new restructured notes documentation (on behalf of the Noteholders) if DTEK's negotiations with its bank lenders resulted in the banks receiving additional benefits beyond what was given to the Noteholders under the LTR Scheme. This modification provision further guaranteed equitable treatment of DTEK's creditors.

- The court ruled on what percentage of creditors need to be domiciled in the UK to satisfy Article 8(1) of the EU Recast Judgments Regulation (the Recast Regulation), confirming earlier precedents that the gateway is opened by a single noteholder being domiciled in England and Wales, with the Expediency Test (as defined below) not requiring more than one noteholder to establish the Court's jurisdiction.

Background

DTEK, advised by Latham & Watkins, is the largest privately owned energy business in Ukraine and operates across the coal mining, power generation, and electricity distribution and sales segments. Since

2014, the deteriorating financial environment in Ukraine has significantly and negatively impacted DTEK's business. This adverse impact has already led DTEK to turn to the English courts twice to approve schemes of arrangement: first, in Spring 2015 to extend the maturity of its 2015 Notes (in what turned out to be a ground-breaking case as the first time a bond's governing law was changed to effect an independent path to English jurisdiction) and subsequently a year later, through a standstill scheme to allow DTEK to continue negotiations with its Noteholders and bank lenders. Please refer below for further color on these earlier schemes.

The LTR Scheme

On 18 November 2016, DTEK agreed on the terms of a restructuring of the Notes with an ad hoc committee of Noteholders; the LTR Scheme was launched to implement those terms. The scheme cancelled the Notes and replaced them with 10.75% senior PIK toggle notes due 2024, in a total aggregate principal amount of US$1.275 billion (the New Notes). At the creditors' meeting, convened by Newey J on 2 December 2016, the Noteholders present and voting (by proxy), representing an overwhelming 88.98% of the total outstanding Notes, unanimously approved the LTR Scheme. On 21 December 2016, Norris J sanctioned the LTR Scheme.

Swapping Bank into Bond Debt

A crucial and unique element of the Notes' restructuring, and in parallel with DTEK's negotiations with its bank lenders, was the creation of optionality to swap bank debt into New Notes up to a total aggregate amount of US$300 million. If the total amount tendered to be swapped exceeded US$300 million, such amounts would be exchanged on a pro rata basis. Therefore, if bank lenders had the risk appetite and commercial impetus, they could become Noteholders for the purposes of the restructuring.

As a practical matter, this option also reduced the number of major players in the bank lender group (as they became Noteholders) and the total aggregate quantum of outstanding bank debt, thereby creating a positive dynamic for the continuation of negotiations in DTEK's restructuring of its bank debt.

Upon the issuance of the New Notes on 29 December 2016, US$300 million of the New Notes, an amount sufficient to cover all bank debt tendered and conditionally accepted for exchange, were delivered into escrow to be held pending the completion of the exchange offer. Upon the satisfaction of the conditions attached to the exchange offer, the escrowed notes are to be delivered to tendering holders. This structure ensured that the bank exchange offer did not delay the issuance of the New Notes in any way.

Equitable Treatment

DTEK sought to ensure fair and equitable treatment between the Noteholders and banks throughout the process, so that the restructuring as a whole did not provide materially better terms to one set of creditors over the other. As negotiations for the bank restructuring were still ongoing at the time of the Noteholder deal in November 2016, the LTR Scheme included a "modification provision" to ensure that the banks could continue their negotiations without being constrained by the Noteholder deal. Such a modification provision worked by allowing the ad hoc steering committee of Noteholders to amend the New Notes documentation (on behalf of the Noteholders) if DTEK's negotiations with the banks resulted in them receiving certain additional benefits beyond what was given to the Noteholders under the LTR Scheme. The feature was included in the LTR Scheme documentation and drawn to the attention of the judge, and thereby had judicial blessing. Many sizeable capital structures, and especially those with bilateral facilities, could potentially benefit from this feature as it introduces a high degree of flexibility into the negotiations.

The Previous Schemes

2015 Scheme

Given the impending maturity of its outstanding US$500 million 9.5% Senior Notes in April 2015 DTEK Finance B.V. (as issuer of these Original Notes) embarked on a twin-tracked exchange offer/consent solicitation and English law scheme of arrangement (the 2015 Scheme). The Original Notes were cancelled and new notes were issued by DTEK Finance plc (an English company) with an extended maturity of March 2018 (the 2015 Notes). Although DTEK took steps to change the COMI of the issuer of the Original Notes from the Netherlands to England (successfully, it turned out), DTEK adopted a "belt and braces" approach. It set out to achieve a connection to the English courts by way of a change of governing law and jurisdiction from New York to English law.[1] With the court accepting such a change of governing law as an effective and independent path to jurisdiction in respect of high yield notes, the 2015 Scheme was ground breaking and paved the way for non-English high yield bond issuers to avail themselves of the flexible English scheme restructuring tool.[1]

Standstill Scheme

To give DTEK breathing room in which to progress negotiations, on 26 April 2016 DTEK implemented a standstill of the US$750 million 7.875% Senior Notes due 4 April 2018 and the 2015 Notes through a second English scheme. The standstill was in force until 28 October 2016.

Jurisdiction

As the issuer of the Notes, DTEK Finance plc, is a company incorporated in, and with a center of main interests (COMI) in England and Wales, the English court had no trouble in finding jurisdiction to sanction the LTR Scheme.

There is however, ongoing debate as to whether the Recast Regulation applies to an English scheme, and in particular its "domicile rule," which is the principle that any person domiciled in the EU must be "sued" in the courts of that Member State (Chapter II).[1]

To avoid resolving this debate, the English courts have assumed the Recast Regulation *does* apply, and have turned to the question of whether the facts of the case support one of the exceptions to the domicile rule applying and giving it jurisdiction. DTEK relied on Article 8(1) (the Expediency Test) arguing that the English court had jurisdiction because 1) at least one Noteholder (in its capacity as a "defendant") was domiciled in England and Wales, 2) at least one was domiciled in the EU, and 3) all the Noteholders' claims were so closely connected that for the sake of expediency the court should hear and determine them together to avoid the risk of irreconcilable judgments resulting from separate proceedings.

Norris J, presiding over the sanction hearing, was convinced that the gateway to Article 8 is opened by a single noteholder being domiciled in England and Wales (thereby favoring the *Re Metinvest BV* [2016] EWHC 79 (Ch) approach[2] and countering the stance of Snowden J, who initiated this debate in the *Van Gansewinkel*[3] case). Norris J stated that the Expediency Test should not focus on "materiality," *i.e.* a sufficient number of defendants domiciled in the UK, but should rather focus on and evaluate the risk of irreconcilable judgments, especially in other European countries. Therefore, *all* creditors need to be bound for a scheme to be effective and Norris J was not inclined to analyze the precise percentage of noteholders that are domiciled in the UK, the EU or elsewhere. Norris J also relied on the expectation of the Noteholders that a compromise of the Notes would be considered by an English court, given that the Notes' issuer is English. No doubt the fact that 83% of the Noteholders entered into a lock-up to support the LTR Scheme, through which they also submitted

to the jurisdiction of the English court, contributed to this conclusion.

A final comment on the Notes: as they were governed by New York law, DTEK also filed a petition for the recognition of the LTR Scheme sanction order under Chapter 15 of the US Bankruptcy Code. Recognition was duly granted by Judge Sean Lane on 17 January 2017.

Bank Restructuring

Following consensual negotiations between DTEK and its bank lenders, an override agreement on 29 March 2017 implemented a restructuring of the vast majority of DTEK's banks. In particular, the maturity of the overridden facilities was extended to 30 June 2023, which now enables DTEK to meet its debt service obligations going forward and develop its operations in an improving Ukrainian economic climate.

Conclusion

Ultimately, the DTEK transaction, including its novel bank-bond swap and modification provision, is another clear demonstration of how an English scheme is a powerful and flexible restructuring tool, and one which allows for deals to be effected as part of wider, and often very complex capital structure adjustments which strive to recognise the varying criteria of stakeholders. Finally, the LTR Scheme judgment will serve as a useful precedent on the domicile rule, with the focus helpfully shifted away from the difficult notion of materiality and onto the more practical question of how best to avoid irreconcilable judgments.

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Endnotes

[1] See *Re Primacom Holding GmbH* [2013] BCC 201 (Hildyard J) at [8]-[17], *Re Magyar Telecom BV* [2014] BCC 488 (David Richards J) at [31] and *Re Van Gansewinkel Groep NV* [2015] EWHC 2151 (Ch) (Snowden J).

[2] *See* also Warren J in *Re Hibu Group Ltd* [2016] EWHC 1921 (Ch), and Asplin J in *Re CBR Fashion GmbH,* 5 August 2016

[3] [2015] EWHC 2151 (Ch) (Snowden J).