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What makes the UK so attractive for high yield bond restructurings?

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Restructuring & Insolvency analysis: Many European jurisdictions are developing procedures that they hope will rival those of the UK. However, Richard Nevins, senior partner in Cadwalader, Wickersham & Taft's financial restructuring department (London), says the UK will likely remain the jurisdiction of choice for bond restructuring.

What has been the situation in the high yield bond markets over recent years?

Since the collapse of Lehman and the onset of the Eurozone crisis there has been a significant rise in the use of high yield bond debt as a means of financing in the UK, Europe and beyond. In the first half of 2014 EUR 75bn of high yield debt has been issued in Europe (EUR 75bn was issued in the whole of 2013) compared to approximately EUR 25m in each of 2006 and 2007. Much of this new debt has been incurred to refinance maturing bank debt as the high yield bond market supplants Europe's weakened banking sector as the finance source of choice for the continent's debtors. This has allowed the 'wall of maturities' (when leveraged buyout deals entered into at the height of the 2004-07 cycle mature) which many predicted will lead to the next financial crisis, to be pushed back to later in this decade (approximately EUR 120bn of high yield debt comes due in 2018).

The attraction of bond over bank debt for Europe's debtors, struggling in stagnating economies, is obvious. Bond indentures contain only incurrence covenants and not the financial maintenance covenants typically seen in loan agreements. In addition, the terms and structure of bond issuances tend not to be negotiated as vigorously as bank debt (if at all). Issuers have taken advantage of liquidity in the high yield market caused by investors chasing yield in a low interest rate environment to replace relatively restrictive bank debt with looser termed bond debt.

In light of this growth in the high yield market, bondholders have become more sophisticated in the way they deal with restructuring situations. The development of senior secured notes (as opposed to the subordinated notes typically seen years ago) has allowed bondholders to get to the negotiating table in more restructuring situations and has led to an increase in the number of noteholder-led restructurings such as ATU and CEDC.

How do the European restructuring options for high yield bonds compare to those in in the US?

The principal difference between bond restructuring in Europe and the US is that in the US, Chapter 11 offers a court supervised debtor in possession forum based on a number of precedents in which a restructuring can be negotiated and implemented. No European jurisdiction yet offers a mature, tested restructuring statute that allows for this, despite countries like Germany, Spain, Italy and France attempting to develop insolvency regimes that compare to Chapter 11.

In Europe the majority of successful restructurings are negotiated consensually and out of court (using ad hoc waivers and standstills to ensure that the debtor remains stable throughout the process) and

implemented using the laws of an available jurisdiction that allows for the most efficient implementation that binds all creditors into the agreed outcome (while protecting directors from any liability).

The use of Luxembourg and Dutch finance companies as the note issuer in many European high yield structures, and the availability of forum shopping provided by the EU Insolvency Regulation (EC) 1346/2000, permits a significant amount of flexibility in this. Centre of main interest (COMI) shifting (in one form or another) to implement European restructurings has become the norm. As a result the UK is the jurisdiction of choice for the implementation of European restructuring transactions. In the form of the scheme of arrangement and pre-packaged administration sale the UK provides a 'transaction friendly' regime that allows all creditors to be bound into a single outcome. The English courts are keen to give effect to the commercial intention of the parties to the restructuring and this has proved attractive to debtors and creditors alike. This is not to say that other jurisdictions are not used if the UK is unavailable or unsuitable. In fact, a number of recent European bond restructurings (eg Truvo, CEDC and Lyondell Basel) have used Chapter 11 proceedings in the US as an implementation tool.

Are we likely to see more European-based restructurings involving high yield bonds taking place in the UK?

The short answer is yes. While a number of European jurisdictions are developing rescue procedures that they hope will rival those of the UK it is likely that the UK will remain the jurisdiction of choice for bond restructuring for the foreseeable future. The English courts provide a regime based on well-established precedent of which most bond investors (particularly those based in London and New York) have a good understanding. New European laws, not unsurprisingly, have experienced some teething problems when used. The concordato preventivo process in Italy for SEAT Pagine Gialle S.p.A has been on-going for 19 months with little public communication between the company and bondholders and one only needs to look at the reticence for bondholders in Codere to file for concorso to appreciate that despite the recent law changes in Spain bondholders would still prefer to implement transactions in the UK.

The ruling in the scheme of arrangement of Apcoa (*Apcoa Parking (UK) Ltd & others* [2014] EWHC 997 (Ch), [2014] All ER (D) 49 (Apr)), in which the English courts accepted jurisdiction where the governing law of the debt restructured had been changed from German to English law (thus establishing the required 'sufficient connection' for the purposes of the Companies Act 2006) will only expand the availability of the English courts as a forum for implementing the restructurings of Europe's debtors.

At the first signs of financial distress of the issuer company, what steps should UK bondholders take in the UK to protect their position?

We would always suggest that bondholders organise themselves as soon as possible when an issuer is in financial distress. One of the primary disadvantages facing bondholders relative to bank syndicates in a distressed situation is the fragmented nature of a bondholder constituency. Distressed issuers often attempt to use this fact to their advantage when their bonds are trading at a discount to par, launching distressed tender or exchange offers at discounted prices, structured so that bondholders are penalised for non-acceptance. While core economic amendments of NY law high yield notes typically require 90% or unanimous bondholder consent (giving bondholders safety in resisting a coercive tender offer), other amendments (such as stripping all covenants and/or many events of default) only require 50% consent and will make a bond significantly less attractive to hold.

On this basis, bondholders are well served to organise and engage with the debtor early, highlighting that directors' duties are now owed to creditors. This should go some way to ensuring that they play a proactive role in any solution to the debtor's distress and are not presented with a transaction that pits bondholders against each other for scarce value creating a 'prisoners' dilemma' situation.

Richard Nevins specialises in complex UK and European financial restructurings and special situation creditor-debtor engagements and investments, and has advised both debtors and creditors on many significant deleveragings, equitisations and negotiated refinancings over the last decade. He is well versed in relevant insolvency laws in multiple European jurisdictions, having closed restructurings in the UK, France, Italy, Germany, Spain, Portugal, Russia, Sweden, Poland and the Netherlands, is experienced in deal

implementation via cross-border US Chapter 11 proceedings and English schemes of arrangement, and is expert in NY law high yield bonds.

Interviewed by Kate Beaumont.

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