

Custody chains and restructuring

Sarah Paterson

Assistant Professor in Law, LSE

Wider research framework

- Wider research focuses on extent to which protections afforded to junior bondholders equivalent to those offered by US bankruptcy law need to be in place in order for foreign issuers to access US high yield bond markets
- Argues that UK legal environment is currently far less hospitable for junior bondholders than US but nonetheless rapid increase in UK issuers accessing US high yield market pursuant to a Rule 144A offering
- Concludes that equivalent protections do not need to be in place *ex ante*
- Argues that if significant numbers of US investors purchase New York law governed debt issued by UK issuers will drive convergence *ex post* – cf JC Coffee and B Cheffin’s work on corporate governance structures in accessing equity markets

Implications for law and practice for intermediated securities

- Convergence in law and/or practice driven by market forces (rather than the other way around) has implications for law and/or practice for intermediated securities

Bondholder communication

- Well-documented challenges exist in organising lenders for the purposes of restructuring negotiations
- Challenges are magnified where debt raised in debt capital markets
 - Institution identified in the Clearing System's account unlikely to be the ultimate investor
 - Although bondholders may organise amongst themselves and come forward to negotiate, may not represent a proportion of the issue sufficient to ensure that terms agreed in principle can be achieved formally
 - Issuer may therefore be negotiating "in the dark"
 - Holders may be concerned to maintain freedom to trade and not to receive inside information
- These challenges are heightened when investors are dispersed across jurisdictions
- Pressure for convergence in practice and shorter custody chains?

Voting and representation

- Bonds may be issued with
 - A fiscal agent whose role is largely limited to making payments to bondholders (generally an agent of the issuer except in an English law governed trust deed with respect to payments held for bondholders)
 - A trustee who acts as agent for the bondholders; notoriously conservative about their mandate but more active than fiscal agent

Voting and representation: US

- In US, role of trustee developed as a result of large public debt offerings by railroads
- New Deal reforms
 - Neutering the power of Wall Street banks to coordinate restructurings
 - Steering restructurings towards the courts
- Trust Indenture Act 1939
 - Section 316(b) a bondholder's debt may not be reduced or its term extended without the bondholder's consent

Voting and representation: US

- Chapter 11 plan where less than unanimous bondholder consent
 - Beneficial creditors vote on a plan
 - Where bonds are issued through clearing system and held through custody chains, the ultimate beneficial owner of the bond votes on the plan
 - Likely to be further reinforced by provisions in the trust indenture which will expressly provide that the trustee will not vote on any plan of reorganisation or similar agreement

Voting and representation: UK

- Trustee of an English law governed trust deed is more likely to regard itself, as the party with the legal title, as the creditor for the purposes of the reorganisation
- Has already given rise to challenges in domestic context
 - Requirement for vote by majority in number where restructuring implemented using a scheme of arrangement

Voting and representation: UK

- “Marconi” solution
 - Exchange of dematerialised holdings in global note for definitive bonds
 - Unpopular in market – time consuming and expensive
- Contingent creditor analysis
 - Used in a number of cases (Castle Holdco 4 Limited [2009] EWHC 3919 (Ch), In the matter of Gallery Capital SA and in the matter of Gallery Media Group Limited [2010] WL 4777509 and Co-operative Bank plc [2013] EWHC 4072 (Ch))
 - In all cases terms and conditions contained right for creditors to call for definitive notes in certain circumstances
- Position where no right to call for definitive notes?
 - Inconsistencies which could arise where issuer has both English law and New York law governed debt
 - Requirement for English and US proceedings to assure recognition
 - Pressure on English courts to adopt a consistent approach

Conclusion

- Suggested that if significant numbers of US investors purchase New York law governed high yield bonds issued by UK issuers, pressure *ex post* for:
 - Simplification in holding structures
 - Substantive harmonisation of law on approaches to voting and representation
- Draft Working Paper ‘Does Insolvency Law Matter? Convergence in Junior Bondholder Protection in the US and the UK’ available at <http://ssrn.com/abstract=2409589>