ALERT

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Ziggo: Another Definitional Split in the Credit Default Swap Market

A recent decision reminds credit swap market participants that thorough knowledge of the documentation and definitions relating to a particular credit default swap is critical.

On January 21, 2019, the Credit Derivatives Determinations Committee for Europe ("DC") convened to decide whether a Successor should be named for credit default swaps ("CDS") referencing Ziggo, a Netherlands-based broadband cable operator. The answer: It depends on which definitions apply. The DC determined that Ziggo Bond Company B.V. ("Ziggo Company") became a Successor with respect to CDS that incorporated the 2014 ISDA Credit Derivatives Definitions ("2014 Definitions") but not with respect to CDS that incorporated the 2003 ISDA Credit Derivatives Definitions, as supplemented by the July 2009 Supplement ("2003 Definitions").

The decision under the 2014 Definitions was based on the DC's finding that Ziggo Company became a Universal Successor to Bond Finance B.V. ("Ziggo Finance") when it assumed all of that entity's debt in March 2018. Under Section 2.2(c) of the 2014 Definitions, an entity can be a Successor if "either (A) the related Succession Date occurs on or after the Successor Backstop Date [90 calendar days before the Successor question was posed to the DC] or (B) such entity is a Universal Successor." The 2003 Definitions do not contain the concept of a Universal Successor. The DC determined there was no Successor for Ziggo Finance under those definitions because the March 2018 Succession Event occurred prior to the October 2018 Successor Backdrop Date.

The result of this split is that Ziggo Finance CDS referencing the 2003 Definitions are effectively orphaned, while Ziggo Finance CDS referencing the 2014 Definitions now cite the debt of Ziggo Company. Additionally, if any CDS market participant sold Ziggo Finance credit protection based on the 2014 Definitions and bought Ziggo Finance credit protection based on the 2003 Definitions, that party is now left completely unhedged.

Though rare, divergent outcomes like this are not unprecedented in the CDS markets. In December 2015, the same DC decided that a Bankruptcy Credit Event had occurred under the 2003 Definitions but not the 2014 Definitions, with respect to Spanish renewable energy company Abengoa S.A., because of the relocation of a single word ("similar") in the definitions. Like Abengoa, the Ziggo situation should serve as a reminder that in the world of CDS, knowledge of the documentation is of utmost importance. As the CDS industry is once again considering overhauling its definitions, it will need to be mindful of the basis risks (and opportunities) that its efforts may produce.

George J. Cahill
New York

Locke R. McMurray
New York

Jayant W. Tambe
New York

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