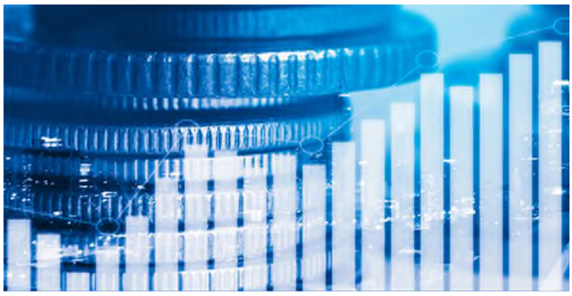
Linklaters

An in-depth study into liability management transactions: Session 4 – Consent Solicitations



May 2020

Our five part liability management webinar series – your questions answered

With the recent increase in liability management activity in Asia, we are pleased to present our five part webinar series which will aim to provide you with an in-depth study into liability management transactions. In this series, we will cover a range of topics including a number of commercial and legal questions frequently asked by bankers and issuers on liability management transactions – for example:

> Can we undertake a third party tender offer or exchange offer?

> How do we locate bondholders?

> Can we speak to bondholders prior to launch and undertake pre-sounding? What can and can't we say?

> Can the issuer continue to buy back bonds in the open market ahead of launch of a tender offer?

> **When and why would an issuer want to undertake** (a) a tender and exchange, **(b) a tender and consent or (c) an exchange and consent?**

> Can we secure "anchor" bondholder support ahead of launching a tender offer, exchange offer or consent solicitation?

> Can we exclude U.S. bondholders even where the existing bonds are cleared through DTC?

> **What happens when a disgruntled bondholder challenges the tender offer, exchange offer or consent solicitation shortly after launch?**

> **What is the difference between an exchange offer and extending the maturity date of existing bonds?**

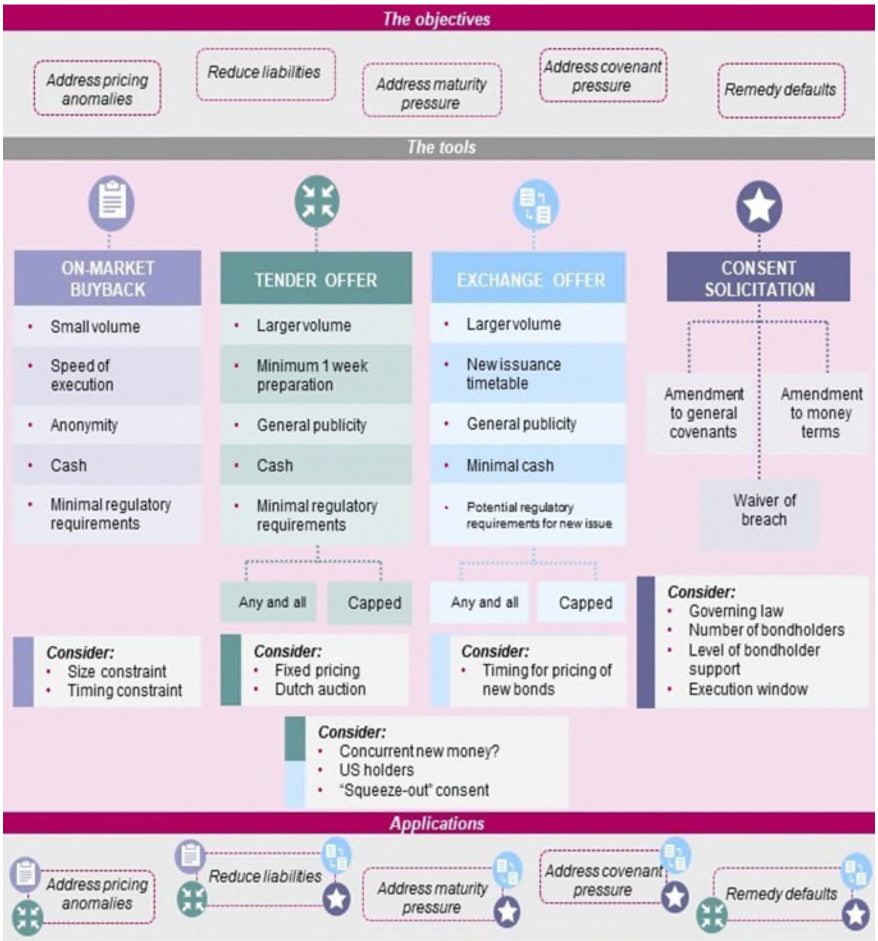
> What happens if the issuer's financials will be published during the offer period?

Ranked No. 1 for Managers' Legal Counsel (*Debtwire 2019 APAC (ex-Japan) USD High Yield Bonds League Table*)

Ranked No. 1 for Issuer's Legal Counsel (*Bloomberg 2019 Asia (ex-Japan) Issuer G3 Currency Bonds League Table*)

Ranked No. 1 for Managers' Legal Counsel (*Bloomberg 2019 Asia (ex-Japan) Issuer G3 Currency Bonds League Table*)

The road map below illustrates some of the key areas which we will be exploring in our five part webinar series.



This client note is a follow-up to Session 4 that was held on 19 May 2020 for our debt capital markets clients.

We hope you find our webinar series and corresponding client notes useful. As always, we encourage you to get in touch with us and speak to your usual Linklaters' contacts if you have any questions.

Introduction

In this Session 4, we provide an in-depth discussion on consent solicitations, including:

> The reasons for conducting consent solicitations;

> "Squeeze out" consents, what they are, how they work and issues to look out for; and

> The challenges associated with bondholder committees and holdouts.

Session 4 and this client note will examine consent solicitations from the perspective of English law governed bonds, although we will touch upon the position for New York law governed bonds in certain sections.

In this series, we have focussed primarily on liability management conducted outside of the United States although our fifth and final webinar and client note will examine U.S. issues on liability management transactions.

What is a consent solicitation?

A consent solicitation is an approach by an issuer or guarantor to request the consent of bondholders to amend the terms and conditions of one or more series of existing bonds. It can take various forms such as a written resolution, an electronic consent, a bondholder meeting or, in the context of New York law governed bonds, a "rolling" consent, each of which will be explored in greater detail below.

A consent solicitation would be appropriate where the issuer is keen to undertake an exercise that has the potential to bind the full principal amount outstanding of one or more series of existing bonds.

Why undertake a consent solicitation?

Reasons for undertaking consent solicitation

We have identified below three main categories of consent solicitations based on the underlying economic and commercial drivers behind each exercise. These are set out in the table below together with the voting thresholds and timing considerations that typically apply in order to pass a resolution proposed through the consent solicitation.

Pursuant to a…	CONSENT SOLICITATION*: Amendment to general covenants / Waiver of breach	Amendment to money terms or substitution or exchange of the bonds or amendment to voting terms	Effectiveness	Timing
BONDHOLDERS' MEETING (ENGLISH LAW)	**Quorum:** A quorum of 33.3% or 50% of principal amount outstanding (for initial meeting) and no minimum proportion (for adjourned meeting) **Voting threshold:** In order to pass the extraordinary resolution, at least 75% of votes cast at the meeting must be in favour of the resolution	**Quorum:** A quorum of 66.6% or 75% of principal amount outstanding (for initial meeting) and 25% of principal amount outstanding (for adjourned meeting) **Voting threshold:** In order to pass the extraordinary resolution, at least 75% of votes cast at the meeting must be in favour of the resolution	Once the resolution is passed at a meeting	At least 21 calendar days (for initial meeting) At least 14 calendar days (and no more than 42 calendar days) (for adjourned meeting)
WRITTEN RESOLUTION OR ELECTRONIC CONSENT (ENGLISH LAW)	**Quorum:** No quorum **Voting threshold:** In order to pass the written resolution or electronic consent, at least 90% of principal amount outstanding must vote in favour of the resolution	**Quorum:** No quorum **Voting threshold:** In order to pass the written resolution or electronic consent, at least 90% of principal amount outstanding must vote in favour of the resolution	**Written resolution:** once the written resolution is executed **Electronic consent:** the relevant date for submission of electronic consents	**Written resolution:** no fixed duration **Electronic consent:** at least 10 calendar days
ROLLING CONSENT (NEW YORK LAW)	**Quorum:** No quorum **Voting threshold:** In order to pass the consent, at least 50% of principal amount outstanding must vote in favour of the resolution	**Quorum:** No quorum **Voting threshold:** In order to pass the consent, at least 90% or 100% of principal amount outstanding must vote in favour of the resolution	As soon as requisite consents are obtained	No fixed duration

**the thresholds and timing provided above are indicative only and subject to the provisions set out in the underlying documentation of the existing bonds*

Consent solicitations versus tender offers and exchange offers

The key difference between a consent solicitation on the one hand, and a tender offer or exchange offer on the other hand, is that the latter mechanisms are purely voluntary – investors can choose whether they wish to participate or not in the liability management exercise. In contrast, a consent solicitation allows the votes of the majority to bind the minority, so that even those bondholders who did not wish to participate in the consent solicitation or those who voted against the resolution proposed as part of the consent solicitation would be bound by the resolution should the relevant voting thresholds be met. This also means that under a consent solicitation, an issuer cannot disenfranchise bondholders from voting, unlike a tender offer or an exchange offer which can be offered to only certain holders due to jurisdictional restrictions (for example, excluding holders based in the United States).

Another key feature of consent solicitations, in comparison to tender offers and exchange offers, is that the terms of the existing bonds will contain provisions which regulate the timing, structure and conduct of any consent solicitation exercise. Consequently, issuers will generally have less flexibility – for example:

- the terms of the existing bonds may prescribe certain procedural requirements (including minimum notice periods) for convening and holding a bondholders' meeting;
- the terms of the existing bonds may prescribe certain procedural requirements for the casting of votes by bondholders;
- the terms of the existing bonds may prescribe certain quorum and/or voting thresholds for passing a resolution; and
- there may be restrictions on what amendments can be made to the terms of the consent solicitation.

Consent solicitations as a means of refinancing existing bonds

An issuer wishing to refinance existing bonds which are nearing maturity may have to decide whether to undertake a consent solicitation (to extend the maturity date of the existing bonds or to provide for the redemption of the existing bonds for new bonds with a later maturity date) or an exchange offer (to exchange the existing bonds for new bonds with a later maturity date). Some of the key considerations to bear in mind would include:

- an incentive would need to be provided by the issuer in a consent solicitation, such as a consent fee (for which it should ensure it has sufficient cash) or a modification to the terms of the bonds which is favourable to bondholders;
- an exchange offer may require additional regulatory approvals (e.g. registration with the National Development and Reform Commission in Mainland China or the approval of the offering or listing document from the relevant securities regulator or stock exchange), which, depending on the specific fact pattern, may not be required for a consent solicitation. A consent solicitation, however, can give rise to other structural complexities, such as the application of the new security doctrine (which will be examined in our next webinar) and the Markets in Financial Instruments Directive (commonly known as MiFID II), particularly in the context of retail bondholders;
- the issuer may only need to achieve a partial refinancing, so an exchange offer could provide the issuer with more certainty that at least some of the existing bonds can be refinanced. Conversely an exchange offer alone is unlikely to provide 100% participation and so if the issuer needs a full refinancing, then a consent solicitation would be required (either alone or combined with an exchange offer (see "Squeeze Outs" below)); and
- the issuer may be able to execute an exchange offer more quickly (particularly if it is issuing the new bonds off a medium term note programme) compared to the timing required for convening a bondholders' meeting.

Squeeze outs

What is a squeeze out?

A consent solicitation may be combined with an exchange offer or a tender offer if the intention is to sweep up all remaining outstanding bonds not repurchased or exchanged in the concurrent tender offer or exchange offer in order to achieve 100% take-up (commonly referred to as a "squeeze out"). Generally speaking under a squeeze out, a bondholder who accepts the tender offer or exchange offer is automatically deemed to vote in favour of an extraordinary resolution to amend the terms and conditions of the existing bonds – such amendments could be to (i) in the case of English law governed bonds, insert a new call option or an early maturity date which would allow the issuer to redeem all the existing bonds (in exchange for cash or new bonds) or (ii) in the case of New York law governed bonds, where to include a redemption provision would require the support of between 90% to 100% of bondholders, undertake a "covenant strip" of the existing bonds.

Issues to consider when undertaking a squeeze out

In any English law squeeze out scenario, where an issuer is effectively implementing amendments to the terms of the existing bonds via majority consent, parties should consider whether what is being proposed may be challenged by the dissenting minority creditors under the principles outlined in the *Redwood*[1] and *Assénagon*[2] cases. One of the key principles from these two cases is the prevention of the exercise of voting rights by a majority where the proposed action would be abuse or amount to a "fraud on the minority", because either:

> the majority appear, in exercising their voting rights, not to be acting in good faith, as the proposed amendments to the existing bonds are clearly vindictive, unfair or oppressive, or the effect of the resolution is discriminatory (giving the majority a benefit that is being denied to the minority) and so suggests that the majority are not acting *bona fide* for the benefit of the class as a whole; or

> the majority are receiving an undisclosed payment as an incentive to pass the relevant resolution.

In order to put some of these points into context, we have set out below some of the key questions to bear in mind when structuring a squeeze out:

> If consenting bondholders are conferred an additional payment or incentive in return for supporting the resolution which is not available to non-consenting bondholders (such as a consent fee, a better redemption price or a more favourable exchange ratio), how material is this additional payment or incentive?

> How much does a dissenting bondholder stand to lose by not approving the consent? What redemption price or exchange ratio would a

[1] *Redwood Master Fund Ltd v TD Bank Europe Ltd [2002] EWHC 2703*

[2] *Assénagon Asset Management S.A. v Irish Bank Resolution Corporation Limited (Formerly Anglo Irish Bank Corporation Limited) [2012] EWHC 2090 (Ch)*

dissenting bondholder receive relative to that received by a consenting bondholder?

> When will the issuer announce its acceptance of existing bonds offered under the concurrent tender offer or exchange offer? Any announcement of acceptance should not occur prior to the extraordinary resolution being either approved or rejected in the consent solicitation, otherwise, the validity of the votes could be challenged on the basis that the beneficial interest in such tendered or exchanged bonds had already been transferred from the original bondholders to the issuer, rendering the votes invalid and the resolution void.

> What is the underlying commercial rationale for the squeeze out? Could there be said to be a coercion of a minority which effectively expropriates the minority’s rights under the existing bonds for a nominal amount of consideration?

> Is the consent solicitation within the powers of the trust deed/fiscal agency agreement for the existing bonds? If the consent is for an amendment which is not contemplated under the documentation for the existing bonds, then this could render the resolution void.

Further issues to consider from case studies

Pricing and structural features

Once an issuer has decided to undertake a consent solicitation exercise, it will need to consider how it wishes to structure and price the transaction. Some common questions for issuers to consider at the outset are set out below:

> Will there be an early bird deadline and early bird consent fee?

> If multiple series of existing bonds are involved, can we use multi-series aggregation so that only one bondholder meeting is needed? If not, could or should the consent solicitations be made inter-conditional?

> Can a “written consent” option (in addition to calling a bondholders’ meeting) be built into the structure in order to allow the issuer to pass the resolution more quickly should the higher 90% voting threshold be met?

> If the issuer is under time pressure to push through the amendments, will there be sufficient time for an adjourned meeting? What other options might the issuer have in this scenario?

> In a squeeze out scenario where holders of existing bonds who don’t participate in the “voluntary” exercise still need to receive new bonds or shares under the consent solicitation, how will you go about dealing with retail holders or U.S. holders who receive new bonds or shares?

Incentive payments

An issuer may often wonder if it is possible to offer a group of bondholders an additional incentive for participating in the consent solicitation and supporting the resolution. The answer is not always straight forward but a few key points are worth bearing in mind:

- The fundamental principle remains that all bondholders should be treated equally and fairly. This means that if an additional incentive is being offered, it should be offered to all bondholders (even if not all bondholders choose to accept it). An additional incentive that is only available to selected bondholders could cast doubt on the validity of any votes cast by such bondholders and trigger some of the concerns from *Redwood* and *Assénagon* outlined above. For example, are such selected bondholders voting with the same economic interests as the remaining bondholders? What is the materiality of this inducement? In voting for the resolution, are such bondholders acting *bona fide* for the benefit of the class of bondholders as a whole?
- The above principles could still be relevant even where the additional incentive was being provided by a third party (for example, a major shareholder of the issuer) rather than by the issuer itself. Again, what is the underlying reason for the payment of this additional incentive by the third party? Is it to induce certain bondholders to vote in favour of the resolution, such that these selected bondholders are acting with a different set of economic interests in mind?
- Transparency is key. All incentives and other consent fees (and any conditions on their payment) should be clearly disclosed in the consent solicitation memorandum.
- It is possible that an issuer may wish to "pre-sound" the terms of a consent solicitation with a selected group of bondholders prior to launch and negotiate and agree the indicative terms of any consent fee. While there is nothing objectionable *per se* with agreeing the indicative terms of a consent fee up front with a selected group of bondholders, such consent fee should be offered to all bondholders once the consent solicitation is launched. In addition, any pre-sounding should be done bearing in mind some of the principles around pre-sounding discussed in our Session 2 webinar.

Bondholder committees and holdouts

The formation of *ad hoc* bondholder committees in the context of a consent solicitation presents two main issues – firstly, the possibility that an organised and unified group of bondholders can look to "pick holes" into the structure of the consent solicitation and challenge its legality, and secondly, the ability of the bondholder committee to build a blocking stake to prevent the resolution from passing. It can often be difficult to ascertain how many bondholders are in the committee, whether a key "spokesperson" or leader of the bondholder committee has been appointed and whether the committee's views are representative of other non-committee bondholders.

Having said that, the formation of *ad hoc* bondholder committees can also present certain advantages, particularly in the context of a bond restructuring proposal. For example, if the proposal has been agreed with the committee up front, and therefore has block support, the relevant resolutions are more likely to be passed, and the meeting is considerably more likely to be quorate. If the bondholders in the committee have the same economic interest as other bondholders, their views are likely to be representative and they are therefore able to make an important and helpful contribution to the process.

In certain cases, the bondholder committee members may even decide to formalise the committee by passing a resolution to establish a negotiating mandate for the committee, releasing members of the committee from liability, delegating decision making powers to committee members or allowing it to fulfil some of the roles that would otherwise have been carried out by the trustee.

Stay tuned: 26 May 2020 - our fifth and final webinar session on U.S. issues on liability management transactions

We welcome you to join us for our next session on U.S. issues on liability management transactions where we will take an in-depth look into:

- structuring liability management transactions to fall outside of the U.S. tender offer rules;
- U.S. securities laws considerations for exchange offers;
- the new security doctrine in consent solicitations; and
- comparison of consent solicitations under English law trust deeds versus New York law indentures.

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