Linklaters

An in-depth study into liability management transactions: Session 5 – U.S. Law Considerations in Liability Management

June 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:

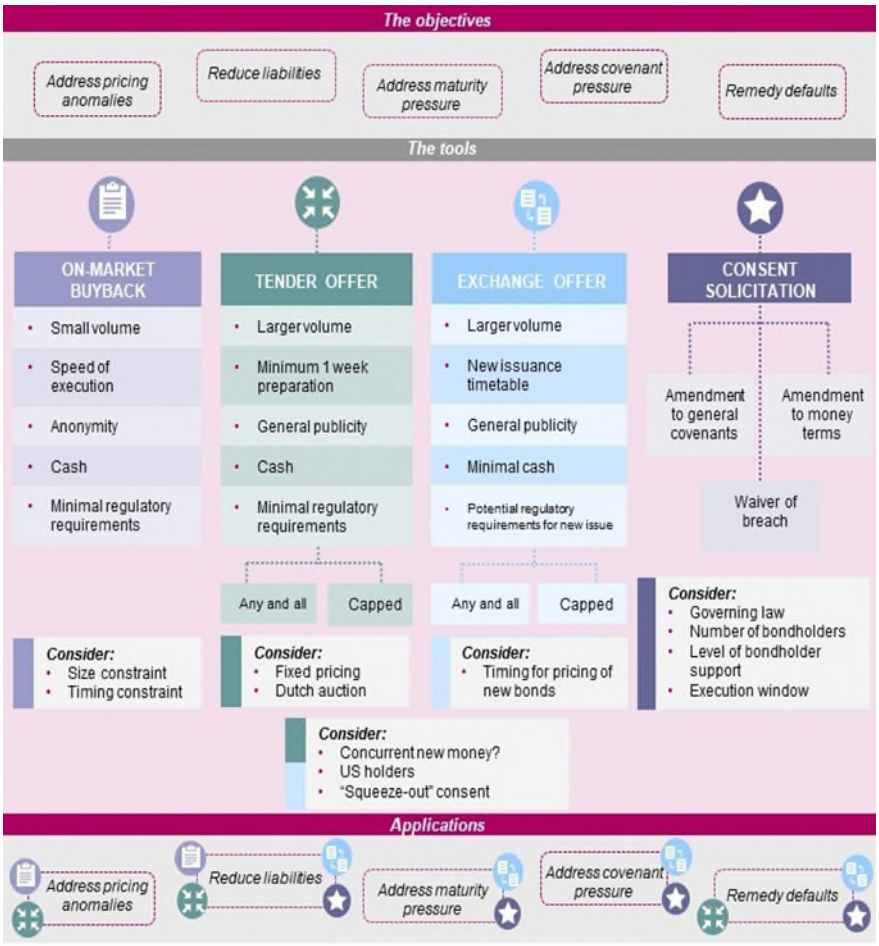
- Can we undertake a third party tender offer or exchange offer?
- How do we locate bondholders?
- Can we speak to bondholders prior to launch and undertake pre-sounding? What can and can't we say?
- Can the issuer continue to buy back bonds in the open market ahead of launch of a tender offer?
- **When 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 5 that was held on 26 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 5, we cover a range of common U.S. law issues that impact liability management transactions, including:

- how to exclude U.S. holders;
- U.S. law considerations for exchange offers;
- the "new security" doctrine in consent solicitations;
- process and thresholds in NY law governed bond instruments; and
- common issues in U.S. "abbreviated tender offer" structures.

General Overview of U.S. Law Considerations

The wide range of liability management transactions that we have covered in the preceding four sessions implicate different aspects of U.S. law. These U.S. law issues can be generally categorized under four major concerns:

- Laws regulating "tender offers". In the bond context, the key consideration is that if a tender offer is subject to U.S. rules, it would be subject to the 20-business day minimum tender offer period, and related timing considerations.
- Laws regulating the "offer and sale" of any security. Any offer or sale of a security to U.S. purchasers must be registered under the U.S. Securities Act, unless an exemption is available. In order to qualify for an exemption from the U.S. Securities Act, the transaction must be documented and structured to satisfy the applicable requirements. These concerns can arrive in the context of an exchange offer, as well as consent solicitations that rise to the level of an offering of a "new security".
- Laws relating to disclosure. An offer and sale of a security under U.S. law requires the preparation of a disclosure document that meets certain minimum standards as to providing all material information to the investor. In a tender offer context, even without an offer of a security, there are still concerns about so-called 10b-5 liability, and ensuring that offerees have access to all material information relevant to the tender offer itself.
- U.S. laws relating to application and interpretation of the relevant contracts and agreements. In particular, many bond transactions in Asia are governed by NY law documentation. NY law indentures have a particular approach to amendments and waivers that are different in key respects from English law trust deeds, which should be taken into account.

Excluding U.S. Holders vs Avoiding U.S. Jurisdictional Means

We often speak of "excluding U.S. holders," but that is not correct.

The concept of "U.S. holders" in the Regulation S offering context is not relevant to tender offers. In order to avoid the application of U.S. tender offer rules, we want to avoid U.S. jurisdictional means, i.e., avoiding communications and transactions that are made into or through mechanisms in the U.S. This means not simply excluding participation by holders in the U.S., but also:

- No dissemination of materials to, contact with or solicitation of holders in the U.S. (even if reverse-inquiry);
- Restrictive language in the offer documents;
- Representations (or deemed representations) from holders that they are not in the U.S.; and

- Publicity restrictions.

This is generally not problematic for issuers that originally issued the bonds pursuant to Regulation S, and the bonds are cleared and settled through Euroclear/Clearstream. In those cases, the tender offer materials would only be distributed outside the U.S., and with the applicable restrictive language and deemed representations, there should be no reason for the tender offer to be made through U.S. jurisdictional means.

However, for Asian issuers that have issued bonds on a Rule 144A basis, this may present a challenge as the holdings by U.S. holders may be significant and the bonds are likely to clear and settle through DTC. In these situations, there are additional procedures that will likely be necessary to avoid U.S. jurisdictional means:

- Tender offer materials are only disseminated through the "Reg S" tranche through Euroclear and Clearstream and not DTC (and no dissemination to holders in the U.S. even if on a reverse-inquiry basis);
- Participating holders will need to confirm (or be deemed to confirm) they are not in the U.S.;
- Any notices required to be provided to bondholders through DTC are made only after the tender offer period has expired; and
- Include restrictive language in the tender offer memorandum.

U.S. tender offer rules would not apply in a consent solicitation context, unless it is a "squeeze out" or "exit consent" transaction that combines a tender offer and consent. A stand-alone consent solicitation can normally be made to all holders, including those in the U.S. However, if the consent involves an amendment to a fundamental economic term, that may be deemed an offering of a new security and documented and structured as an offering. This "new security" doctrine is discussed later in this Session 5.

U.S. Law Considerations for Exchange Offers

From a U.S. law analytical point of view, an exchange offer is a tender offer and an issuance of new bonds. Therefore, the exchange offer will need to comply with the above-discussed tender offer considerations, and also include preparation of disclosure and selling restrictions as in a normal offering.

For exchange offers structured to avoid U.S. jurisdictional means, this means that the new bonds will need to be issued as a Regulation S offering, and exclude participation by U.S. offerees.

For exchange offers structured to include U.S. holders, the new bonds will normally be issued to qualified institutional buyers (the "QIBs"). QIB status of offerees in the U.S. would need to be pre-certified through representation letters/certifications prior to delivery of offering materials. Offering materials will need to be prepared to "Rule 144A" standards.

Since exchange offers to U.S. holders will necessarily require use of U.S. jurisdictional means, and subject to U.S. tender offer rules, a better

alternative from a timing perspective may be for issuers to structure an exchange offer as an “abbreviated tender offer”, as more fully described later in this Session 5.

“New Security” Doctrine

Generally speaking, an amendment to the terms of a bond is not considered an “offer or sale” of a security that would fall under the U.S. Securities Act’s requirements for manner of sale or disclosure. However, an amendment to the terms of a bond that affects “fundamental economics” of a bond may be deemed to be the offer and sale of a new security because the bondholder will be making a new investment decision as to the old bonds.

Therefore, any consent solicitation that affects any of the following terms should be carefully considered:

- extension of maturity;
- reduction of payable amounts of principal or interest;
- modification of redemption premium;
- modification of place or currency of payment; and/or
- modification of default rights.

Generally, a modification to the terms of a covenant would not be considered a new security.

If a consent solicitation involved an amendment to terms that rises to the level of a new security, it would be subject to all of the considerations normally involved in an offering of bonds, i.e., preparation of proper disclosure in an offering memorandum, implementation of selling restrictions, etc. In practice, an issuer would not go ahead with such a consent.

NY Law Thresholds and Process for Consent Solicitations

Indentures of debt securities issued pursuant to Rule 144A and Regulation S will not need to be qualified under the Trust Indenture Act of 1939. Therefore, requirements for amendments of terms of such debt securities are contractual in nature.

A New York law governed indenture of such debt securities usually provides for three types of amendments: (i) technical amendments for changes that would not be materially adverse to the bondholders and thus would not require prior consent from the bondholders, (ii) amendments of certain fundamental terms that would require consent from all holders or near unanimity; and (iii) other amendments which would normally require consent from holders representing more than 50% of the principal amount of the outstanding bonds.

The terms that are subject to the unanimity requirement usually include (but not limited to): (i) changing the maturity of the bonds, (ii) reducing the principal amount of, or rate of interest on, the bonds, (iii) changing the currency of the bonds, (iv) reducing the principal amount of bonds the holders of which must consent to an amendment or waiver, (v) impairing the

right to institute suit for the enforcement of any payment on or after the relevant due date; (vi) releasing any guarantor from its obligations under any guarantee provided to the bonds, or releasing collateral granted for the benefit of the holders, unless such release is otherwise permitted under the indenture and (vii) making any change in the amendment and waiver provisions.

A unanimous consent for such amendments is very difficult to obtain. Therefore, if an issuer seeks to amend such terms, it may be better to engage in other liability management such as a concurrent "exit" tender offer or an exchange offer for new securities to effectively modify the relevant terms.

The process for consent solicitations under New York law governed indentures is usually carried out in the form of electronic or written consent. This is in contrast with the practice under English law governed documents, under which the issuer is usually able to convene a bondholder meeting in order to pass a resolution for a proposed amendment. The English law governed documents usually provide for a quorum for such meetings and the required thresholds of votes cast at such meetings to pass a resolution, and even lower thresholds for the quorum at adjourned meetings.

Abbreviated Tender Offers (ATOs)

In 2015, the U.S. Securities Exchange Commission, the primary regulator over the U.S. securities market, issued a "no-action letter" which effectively created a new framework for issuers to reduce the 20-business day minimum offer period to a 5-business day offering period.

Key requirements to qualify for the ATO regime are:

- **Non-convertible debt securities** – the offer can only be for non-convertible debt; it can include multiple series or classes of debt
- **Offer not by a third party** – offer should only come from the issuer of the bonds or a parent, guarantor or subsidiary
- **Any-and-all offer** – the offer must be made to all holders, and must purchase any-and-all, i.e., cannot cap the amount accepted or only accept tenders from certain holders
- **Cash or "qualified debt securities"** – accepting holders must be paid consideration in cash or "qualified debt securities" (i.e., an exchange offer for new bonds that have essentially the same terms as the old bonds, also interest only payable in cash and tenor must have a longer life to maturity than the old bonds)
- **Fixed or benchmark pricing** - tender offer pricing much be fixed, or based on spread-to-benchmark-rate announced at the start of the tender
- **No consents** – an ATO cannot be combined with a consent solicitation, i.e., no exit consents
- **No senior debt to finance** – an ATO cannot be financed with the proceeds of more senior debt than the old bonds; debt is considered

senior if it has additional obligors/guarantors/collateral, shorter weighted average life to maturity, or otherwise senior in right of payment

There are certain features or facts that may disqualify a tender offer from the ATO treatment:

- **Events of default** - the issuer is in default under a material credit agreement or indenture;
- **Insolvency** – the issuer is subject to bankruptcy proceedings or is in discussions with creditors;
- **Change of control** – the tender offer is made in anticipation of, or response to, a change of control or other extraordinary transaction involving the issuer (e.g., a merger);
- **Other tenders** – the tender offer is made in anticipation of or in response to other tender offers for the issuer's securities;
- **Changes to capital structure** – the tender offer is made concurrently with a tender offer by the issuer for another series of the issuer's securities such that it would add obligors, guarantors or collateral or shorten the weighted average life to maturity of the other series;
- **Material acquisitions / dispositions** – The offer is commenced within 10 business days after the public announcement or consummation of a material acquisition or sale that would require furnishing pro forma financial information under SEC rules.

There are also certain complications which will need to be carefully considered to avoid disqualification from the U.S. ATO rules:

- **Offer timing based on U.S. time zone and certain announcement requirements** – the tender offer timeline will need to take certain U.S. EST time zone considerations into account. For example, the offer must remain open until 5pm U.S. EST on the 5th U.S. business day of the offer. In addition, where consideration or pricing is not determined at launch of the tender or exchange offer, the final interest rate or spread must be announced by 9am U.S. EST on the business day prior to expiration of the offer, and exact amount of consideration or interest rate must be announced by 2pm U.S. EST on the expiration date. This may be different from non-U.S. tender offers where final pricing is not announced until after expiration of the tender offer.
- **Financing conditions** – ATO can be conditioned on obtaining necessary financing (for example the issuance of new bonds), as long as the condition is not subject to the issuer's discretion and is clearly disclosed.
- **Waterfall structure** – it is possible to make an ATO for multiple series of bonds, which are prioritized in order of payment, as long as this is clearly disclosed. However, the offeror will need to carefully consider any financing conditions and how those would impact termination of offer for

specific series. In addition, the U.S. ATO regime does not favour “picking and choosing” across series.

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