

# Liability Management in Russia

## Introduction

Over the last several years, Russian companies and banks have tapped the international capital markets for billions of U.S. dollars through Eurobond issuances. With plenty of new money available in the market, liability management exercises were relatively rare. The current economic downturn, steep falls in oil prices and the exchange rate, alongside Russian borrowers' restricted international market access due to ongoing sanctions, have resulted in increased interest in liability management transactions for Russian companies.

The current financial environment has placed a strain on certain credits and some borrowers may need to consider consent solicitations, possibly combined with other techniques, where covenants under existing borrowing facilities have been tested. Borrowers also continue to need to manage their debt maturity profiles, which can include looking to try to push out maturities through the use of exchange offers. In addition, Russian debt is trading at lower levels, providing attractive purchasing opportunities for borrowers with available liquidity, and those borrowers might be willing to repurchase their debt through tender offers.

This briefing addresses some of the legal, regulatory and taxation questions which Russian Eurobond issuers need to consider in the context of (1) tender offers, (2) exchange offers or (3) consent solicitations with respect to Loan Participation Notes ("LPNs") (a structure where the notes are issued by an orphan special purpose vehicle or third party bank (the "**LPN Issuer**") and the issue proceeds on-lent to a Russian company (the "**Borrower**"). Although this briefing offers a brief commentary on certain Russian taxation matters, it does not purport to provide advice on Russian taxation issues. Before proceeding, borrowers should consider carefully with their tax and accounting advisers the taxation and accounting consequences of a particular liability management exercise.

## Tender Offers

In the context of a tender offer, one of the Borrower, the LPN Issuer or a third party makes an offer to purchase LPNs (including those held by investors in Russia, subject to compliance with certain limitations) during a specified period. Unlike an exchange offer, a tender offer is not accompanied by the issue of new securities and, for this reason, is easier to structure and may be executed more quickly. This technique offers a Borrower the opportunity to retire a significant volume of LPNs of a particular issue.

Assuming it is not necessary to comply with U.S. tender offer regulations, there are no rules about the duration of the offer period: it should be sufficiently long to allow for distribution of materials through the clearing systems and for investors to respond. In many cases, Borrowers will opt for an offer period of 7-10 business days. Borrowers may choose to price the tender on a fixed basis at the outset (which has the benefit of simplicity) or opt for a spread over a reference rate (priced close to the settlement date of the

offer) which goes some way to transferring the risk of price movements to investors. Alternatively, Borrowers may consider the "modified Dutch auction" technique, whereby investors are invited to offer a price (usually within a specified range) at which they would be prepared to sell their LPNs: the Borrower then sets a clearing price and accepts those bids made at or below the clearing price.

In an auction structure, the Borrower will usually specify a target size for the transaction, encouraging investors to submit low offers in order to maximise their chances of having their bonds repurchased. Because the target size is capable of affecting the prices at which investors offer their bonds for sale, care needs to be taken when exercising any discretion to increase or decrease this target level in order to avoid behaviour that might be viewed as market abuse.

### Relevant Rules

A Borrower will normally appoint an investment bank with experience in liability management transactions to act as "dealer manager". Usually, a tender offer memorandum will

## Key issues

- Introduction
- Tender Offers
- Exchange Offers
- Consent Solicitation
- Legal, Regulatory and Tax Issues

be produced, describing the terms of the offer, the applicable restrictions on participation and the means by which a beneficial owner of bonds may accept the offer. In respect of bonds which are admitted to trading on the regulated market in the UK, Ireland or Luxembourg, there is no requirement for pre-vetting of the tender offer memorandum by the applicable regulator. Particular care should be taken to ensure compliance with the listing rules in any other jurisdiction where the bonds may be listed. The tender offer may be launched by posting a notice through the clearing systems and, in the case of bonds admitted to trading in the UK, via RNS or, in the case of Ireland or Luxembourg, by publication on the website of the relevant stock exchange. Bearing in mind concerns about financial promotion and jurisdictional risk (described below), particular care should be taken by the legal team to ensure that notices and the distribution of offer materials comply with applicable law.

#### *Jurisdictional Risk*

Apart from English law (assuming this is the governing law of the bonds) and the laws of the Russian Federation, it will be important to consider any applicable restrictions in the jurisdiction of the LPN Issuer and in jurisdictions where bondholders are resident. A Borrower, advised by the dealer manager, may have a fair idea of the location of significant holdings and may decide to initiate a holders' search to try to provide more clarity. Given that most international Eurobonds are held in global form in clearing systems, it is unlikely ever to be possible to ascertain precisely the identity of the investor base. It is usual, however, to exclude participation by holders in certain jurisdictions (notably the U.S.) where local requirements are sufficiently onerous as to make compliance difficult. The dealer manager and other intermediaries, notably the tender agent, will usually take care to ensure that the tender offer memorandum is not made available to these excluded holders, and will not solicit their participation in the transaction.

#### *Cancellation of LPNs and Reduction of Loan*

Russian LPNs would typically contain a provision which allows the Borrower and its subsidiaries to purchase and cancel outstanding LPNs. Upon surrender of the LPNs to the LPN Issuer for cancellation, the relative portion of the outstanding loan between the Borrower and the LPN Issuer is deemed to have been redeemed without any need for an actual flow of funds (but note our observations with respect to Russian taxation below).

## Exchange Offers

In the context of an exchange offer, typically the issuer of the new LPNs makes an offer to the holders of the existing LPNs to exchange their notes for new notes, which may carry a different rate of interest and/or maturity date. Unlike a public cash tender offer described above, an exchange offer includes the issue of new securities and, usually, their admission to trading either on a regulated or an unregulated market. Bearing this in mind, a Borrower will wish to take particular care to ensure compliance with applicable legal and regulatory requirements in the jurisdiction where existing holders are resident. Again, it is usual to exclude participation by U.S. holders (where the original issue was distributed under Regulation S and the U.S. holding is not thought to be significant).

Documentation for an exchange offer typically includes a dealer manager agreement (appointing an investment bank as dealer manager) and an exchange offer memorandum which describes the terms of the offer, any relevant incentives (for example, an "early bird payment") and, importantly, contains disclosure on the terms of the new securities and the Borrower. Where the new securities are to be admitted to trading on a regulated market in the EEA or offered to the public in the EEA, the exchange offer memorandum will comprise the "prospectus" and will be subject to the usual pre-vetting by the applicable regulator. Given the additional complexity, Borrowers will usually need to allow for a significantly longer lead-in time prior to launch than would be the case for a public cash tender offer.

#### *Settlement Mechanics*

An LPN exchange offer raises a number of Russian tax and accounting issues which need to be considered carefully by Borrowers and their advisers prior to launch and which will be heavily dependent on the particular structure employed (see the brief outline below under "*Legal, Regulatory and Tax Issues*"). Borrowers may choose to structure the offer and settlement mechanics as follows:

- eligible investors present the existing LPNs to the LPN Issuer for exchange into new LPNs without an accompanying cash payment;
- at the same time, the LPN Issuer agrees to sell the tendered LPNs to the Borrower or one of its subsidiaries;
- following the expiry of the exchange offer, the LPN Issuer issues the new LPNs (accepting the existing

LPNs in lieu of payment) and sells the existing LPNs to the Borrower or one of its subsidiaries;

- the proceeds from the sale of the existing LPNs are used by the LPN Issuer for the purposes of making a new loan to the Borrower; and
- the Borrower or its subsidiary presents the existing LPNs to the LPN Issuer for cancellation and reduction of the relevant proportion of the original loan (thus completing the exchange offer).

### Consent Solicitation

Borrowers may need to consider launching consent solicitation exercises to put a proposal to investors to consider an amendment to the terms of the existing LPNs (and usually the existing LPN loan). This may be done to avoid a potential breach of a particular covenant, or to improve the regulatory capital treatment of the existing subordinated LPN loan, or to introduce a "call" option, allowing the LPN Issuer to redeem the LPNs at a specified price (the LPN loan being reduced at the same time) prior to their stated maturity. The advantage of a bondholder meeting is that it binds the holders of the entire series; in other words, it is possible, provided the necessary quorum and voting thresholds are met, to retire or amend an entire series of LPNs.

Borrowers launching a consent solicitation may appoint an investment bank (to act as a consent coordinator or proposal agent) to deal with the noteholders. Also, a consent solicitation would generally require close interaction with the trustee and their counsel and it is, therefore, important that the trustee is notified of the Borrower's intention to seek the noteholders' consent as early in the process as possible.

Any meeting of holders will usually need to be convened by the LPN Issuer: the Borrower may arrange for the distribution of the consent solicitation memorandum but the notice of meeting must come from the LPN Issuer (or the consent coordinator/proposal agent on the LPN Issuer's behalf). Consent solicitations are likely to require an extraordinary resolution that is passed by either a two-thirds or three-quarters vote of the noteholders present at the meeting. Generally, investors appoint a bank as their proxy to vote in connection with the extraordinary resolution (rather than electing to vote in person). As a consequence, large meetings of investors are rare and the meeting can generally be organised relatively inexpensively.

Particular care should be taken where the proposed amendments will affect material payment terms or the

identity of obligors, as these changes may be sufficiently fundamental that the amended bonds would be viewed as a "new security" for English and/or U.S. securities law purposes. The right to vote is a contractual term of the existing securities, and so it is not usually possible to exclude holders from voting on the relevant amendments. There is, therefore, a risk that the Borrower is considered to be "offering" a new security to existing holders, with the result that offering restrictions and disclosure requirements will need to be considered in each relevant jurisdiction, in the same manner as for a primary offering.

### Legal, Regulatory and Tax Issues

As noted above, a number of legal, regulatory and tax issues (including, but not limited to, those discussed below) may arise in the context of Russian liability management exercises and it would therefore be advisable to discuss the proposed structure and its implications with the Borrower's counsel, auditors and tax advisers before the commencement of the relevant exercise.

#### U.S. Legal Issues

At the outset, it is important for a Borrower to try to establish the volume of the bonds held by U.S. investors. Where the original placement included a resale under Rule 144A, the answer may be obvious, but Borrowers should understand that, even where the bonds were originally distributed under Regulation S of the U.S. Securities Act of 1933, a significant portion of those bonds may have flowed into the U.S. or to U.S. persons. If the volume of the relevant securities held by U.S. persons is significant (say, more than 10 per cent.), and it is not possible to execute the transaction without their participation, it will be necessary to comply with U.S. tender offer rules (unless an exemption is available).

Rule 14e-1 of the Securities Exchange Act of 1934 requires that any tender offer be held open for not less than 20 business days from the date the offer is first sent to holders and then held open for an additional 10 business day period from the date any change in the consideration to be paid or the percentage of securities being sought is sent to holders. However, in January 2015, the Securities Exchange Commission issued guidance in the form of a No-Action Letter permitting a debt tender offer to be held open for only 5 business days if certain requirements and conditions are met. These are discussed in our briefing [http://www.cliffordchance.com/briefings/2015/02/sec\\_staff\\_providesnewguidanceforaccelerate.html](http://www.cliffordchance.com/briefings/2015/02/sec_staff_providesnewguidanceforaccelerate.html).

**EU Legal Issues**

It is important for Borrowers to be aware of any regulatory issues pursuant to the Market Abuse Directive. Borrowers with securities admitted to trading on a regulated market have an ongoing obligation to disclose any "inside information" affecting the Issuer and those securities, and before commencing any liability management exercise it will be important to ensure that the relevant entity is fully compliant with these continuing obligations. In light of the detailed legislative framework which determines whether or not information is "inside information" for these purposes, this sort of assessment is best conducted on a case-by-case basis. If information is identified which should be disclosed to investors, this can be included in public announcements either prior to, or at the time of, launching the transaction. It is also important to note that any liability management transaction may itself constitute "inside information" for these purposes, and therefore information relating to any potential transaction should be carefully controlled by the Borrower and its advisers.

**Russian Legal Issues***Corporate Approvals*

Borrowers need to consider whether the acquisition of LPNs from the noteholders (as part of either a tender offer or an exchange offer) requires approval by the company's board of directors or shareholders as a "major transaction" (that is, a transaction with a value of 25 per cent. or more of the balance sheet value of the company's assets as of the last reporting date).

Where a tender offer or an exchange offer involves a related party or an affiliate, Borrowers should also consider whether the contractual arrangements would constitute an "interested party transaction" for the Borrower and, as such, require a vote of the majority disinterested or disinterested non-executive directors (depending on the number of shareholders in the company) or the majority vote of disinterested shareholders.

Borrowers should also consider any additional corporate approval requirements (such as approvals at the Management Board level) that may be set out in the Borrower's charter.

*Securities Market Law Issues*

Consent solicitations and tender offers do not normally involve an offer of securities to Russian investors and therefore no Russian securities market related legal issues

should arise. However, in the context of an exchange offer, Borrowers must comply with the requirements of the Securities Market Law, which imposes a number of restrictions in respect of the offering and distribution of foreign securities into Russia. Borrowers may wish either to exclude the Russian holders of LPNs from the exchange offer invitation or structure the offer in a way that would not breach the requirements of the Securities Market Law.

*Equity-Related Issues*

In circumstances where a liability management transaction includes an equity element (i.e. accompanied by an offering of shares/ADRs/GDRs or convertible or exchangeable bonds), transaction parties should consider the Russian law issues that may arise in the context of such an offering, including the Russian Central Bank's consent required for ADR/GDR programmes, issues relating to the transfer/delivery of Russian shares or ADRs/GDRs to the noteholders, and compliance by the noteholders with Russian law securities holding prior approval/post-notification/disclosure requirements as well as mandatory tender offer requirements.

*Regulatory Issues*

Borrowers that are banks may also want to consider the regulatory implications of liability management exercises. In particular:

- when purchasing the LPNs, Russian banks need to ensure that they comply with the "N6 ratio" that limits the bank's exposure to a single borrower or a group of related borrowers;
- when purchasing the LPNs, Russian banks should also consider the impact of the relevant transaction on their capital. In particular, investment by a Russian bank in the LPNs issued to finance a subordinated loan to such Russian bank, would reduce its capital accordingly.

**Russian Tax Issues**

As discussed above, there are certain Russian tax issues that a Borrower may wish to consider when structuring liability management exercises.

One of the tax concerns a Borrower may need to consider relates to the question of whether the cancellation of the outstanding loan in connection with the surrender of the LPNs to the LPN Issuer without actual repayment of the loan in cash would constitute forgiveness of the Borrower's debt by the Issuer and consequently result in a crystallisation of taxable income in the hands of the

Borrower in an amount equal to that of the extinguished portion of the loan. The Borrower may also need to consider whether the costs incurred by the Borrower in connection with purchasing the outstanding LPNs would be deductible for taxation purposes. Although this may, in principle, be achieved, the answer will ultimately depend on the exact wording of the loan agreement and the trust deed, and the Borrower will need to look at each particular transaction on a case-by-case basis. It is worth mentioning that while the LPN documentation would typically allow the Borrower to choose an entity of the Borrower's group that would surrender the LPNs for cancellation/redemption, from a Russian tax perspective it is unlikely that any costs incurred in connection with repurchase of the LPNs would be tax deductible for the Borrower if the outstanding LPNs are presented for redemption to the LPN Issuer by the Borrower's subsidiary/affiliate rather than by the Borrower itself.

Also, as Russian accounting practices are in some respects more rigorous than those in Western Europe and North America, the surrender and cancellation of LPNs to the LPN Issuer may need to be formalised by way of a surrender and cancellation agreement setting out the aggregate notional amount of LPNs to be surrendered and cancelled and the corresponding amount of the loan to be extinguished.

If, instead of surrendering the LPNs to the LPN Issuer, the Borrower decides to purchase the outstanding LPNs and

hold them to maturity, income received by the Borrower on such LPNs in the form of interest and premium (if any) at redemption will form part of the Borrower's taxable income. If LPNs are purchased by the Borrower, there may be a concern that the purchase price, or portion thereof, paid by the Borrower to the LPN holders may be subject to Russian withholding tax at the rate of 20 per cent. and, therefore, both the Borrower and the LPN holders may want to consider their withholding tax position in connection with the purchase of the LPNs. This issue may potentially be dealt with by structuring the purchase of the outstanding LPNs through an affiliate of the Borrower located outside Russia for Russian tax purposes and in an otherwise appropriate jurisdiction that would purchase the LPNs without triggering any Russian tax issues, subject to the Borrower's ability to fund such affiliate in a tax-efficient way. Those LPNs could be held offshore until maturity.

Finally, in the context of consent solicitations, borrowers are often expected to pay an inducement fee and Russian borrowers need to consider and structure that payment carefully to make sure that it is tax deductible and will not give rise to Russian withholding tax issues (as may be the case, for instance, where a direct payment of an inducement fee is made to a noteholder located in a jurisdiction that does not have a double tax treaty with Russia).

## Authors



**Stewart Dunlop**  
Partner

E: [stewart.dunlop@cliffordchance.com](mailto:stewart.dunlop@cliffordchance.com)



**Robert Trefny**  
Partner

E: [robert.trefny@cliffordchance.com](mailto:robert.trefny@cliffordchance.com)



**Tamer Amara**  
Partner

E: [tamer.amara@cliffordchance.com](mailto:tamer.amara@cliffordchance.com)



**Alexander Anichkin**  
Partner

E: [alexander.anichkin@cliffordchance.com](mailto:alexander.anichkin@cliffordchance.com)



**Evgeny Soloviev**  
Counsel

E: [evgeny.soloviev@cliffordchance.com](mailto:evgeny.soloviev@cliffordchance.com)



**Paul Deakins**  
Senior Associate

E: [paul.deakins@cliffordchance.com](mailto:paul.deakins@cliffordchance.com)



**Dmitry Tolkachev**  
Senior Associate

E: [dmitry.tolkachev@cliffordchance.com](mailto:dmitry.tolkachev@cliffordchance.com)



**Arthur Levi**  
Senior Associate

E: [arthur.levi@cliffordchance.com](mailto:arthur.levi@cliffordchance.com)



This publication does not necessarily deal with every important topic or cover every aspect of the topics with which it deals. It is not designed to provide legal or other advice.

[www.cliffordchance.com](http://www.cliffordchance.com)

Clifford Chance, Ul. Gasheka 6, 125047 Moscow, Russia  
© Clifford Chance 2015  
Clifford Chance CIS Limited

---

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Casablanca ■ Doha ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Istanbul ■ Jakarta\* ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh ■ Rome ■ São Paulo ■ Seoul ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

\*Linda Widyati & Partners in association with Clifford Chance.