Liability Management

Key Considerations for Debt Issuers in Asia Pacific

CLIFFORD CHANCE

Introduction

The existence of quantitative easing and a low-interest rate environment have been significant contributors to record volumes of debt issuance by a wide variety of corporate and sovereign issuers in the Asia Pacific (ex-Japan) region in recent years.

However, uncertain conditions in Asian G3 credit markets and prevailing volatility in currency markets (including the end of quantitative easing in the U.S., imminent U.S. federal reserve rate increases and a rapidly appreciating US dollar), coupled with a changing regulatory environment for accessing international debt capital markets in many countries in the region, have the potential to make an active approach to the management of outstanding liabilities, and the rebalancing of corporate balance sheets, increasingly rewarding for many corporate issuers in the region. In addition, companies which have a significant degree of capital markets debt on their balance sheets and facing financial distress as a result of changing economic circumstances may also be forced to reassess their capital structure and engage with creditors (including bondholders) in order stave off or cure impending or existing defaults or insolvency scenarios. Furthermore, and other than an outright bankruptcy or insolvency situation, liability management techniques can also be used by healthy companies to actively mitigate risks where covenants in existing bond conditions are or will come under stress (for example, in the context a leveraged acquisition), and a threat of future breaches exists which could lead to events of default under the terms of the bonds and cross-defaults across an issuer's debt capital structure.

This document describes the main techniques which issuers in the region, who are considering liability management either in the context of an active debt capital restructuring or financial distress situation, might employ. It also highlights some of the legal issues that they and their financial advisors will need to take into account. This document assumes that a liability management exercise will be undertaken in respect of an initial bond issue placed with professional or institutional investors, and does not seek to address issues specific to retail bond markets in the Asia Pacific region.

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1. What is liability management and why undertake a liability management exercise?

The term "liability management" is used to describe a variety of procedures and techniques used by debt capital markets issuers for the purposes of buying back, exchanging or altering the terms of outstanding bonds in order to restructure – or "manage" – their balance sheet liabilities.

These liability management techniques include tender offers (a "public" offer made by an issuer to repurchase all or a portion of its outstanding bonds from investors for cash), exchange offers (an offer made by an issuer to repurchase its outstanding bonds in exchange for new bonds with different terms), consent solicitations (a proposal made by an issuer to its bondholders for amendments to the terms of its existing bonds) or open market repurchases (which are typically privately negotiated and opportunistic repurchases of bonds by an issuer in the open market). Each of these techniques can also be, and frequently are, combined in order to maximise the prospects of success of the principal liability management exercise. For example, an exchange or tender offer is frequently combined with a consent solicitation (in a process known as an "exit consent") which seeks to incentivise bondholders' participation in the overall transaction by requiring their consent to the proposed amendments as part of the tender of bonds pursuant to the tender offer or exchange offer. See *"Liability Management Techniques – Consent Solicitations"*, below.

Undertaking a liability management exercise is an important part of, but not limited to, distressed debt situations. One or more of the liability management techniques outlined above (and described in more detail in this document) can be used by bond issuers in order to:

- *Achieve deleveraging efficiency* – Where outstanding bonds are trading at significant discounts as a result of decreases in secondary market prices, an issuer may be able to optimise its leverage by repurchasing bonds (through a tender offer or open market repurchases) with cash-on-hand and cancelling them at relatively cheap prices. In addition, issuers may consider swapping bonds denominated in one currency for bonds denominated in another currency, where hedging costs and the cost of capital may prove cheaper, and investors are actively seeking exposure to that other currency;
- *Defer near-term maturities* – Where outstanding bonds are maturing in the near-term, issuers can seek to extend their maturity by offering to exchange them for a new series of longer-dated bonds;
- *Avoid stressed covenant testing* – Where existing covenants are, or may come, under pressure as a result of macroeconomic or business-specific circumstances, issuers can seek a waiver or amendment of such covenants through a consent solicitation. In addition, issuers who are anticipating making acquisitions in the near future (which could effectively be prohibited under the terms of existing bond covenants) may look to replace longer term, inflexible capital markets debt with medium term, more flexible bank debt;

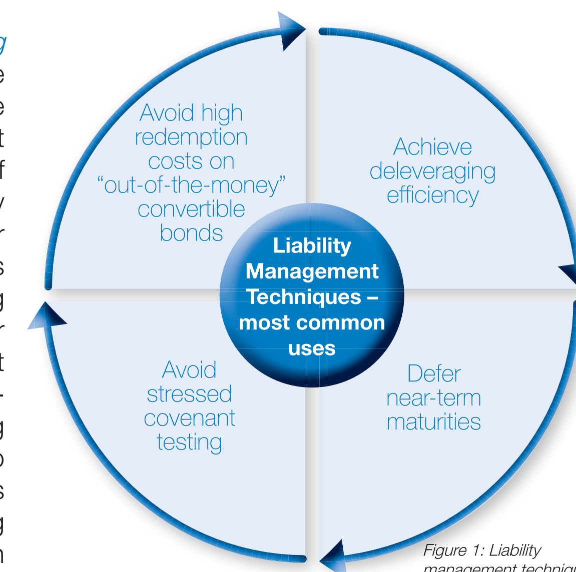

Figure 1: Liability management techniques - most common uses

- *Avoid high redemption costs on "out-of-the-money" convertible bonds* – Where an issuer has convertible bonds outstanding and is facing unexpected redemption costs as a result of bondholders being unlikely to convert their bonds into shares (as the issuer may have expected), issuers may consider an exchange offer of existing convertible bonds for bonds with new terms which will serve to both alleviate their immediate cash flow difficulties and retain the confidence of their investors.

In addition, investors tend to perceive favourably an active approach by issuers to balance sheet liability management, giving them the opportunity to engage directly with issuers to consider restructuring opportunities, gain access to enhanced liquidity in the bonds being traded, avoid a technical default scenario or promote their position in the capital structure of an issuer. As such, an active approach to liability management may have the added benefit of enhancing an issuer's profile in international debt capital markets.

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2. Which laws need to be considered?

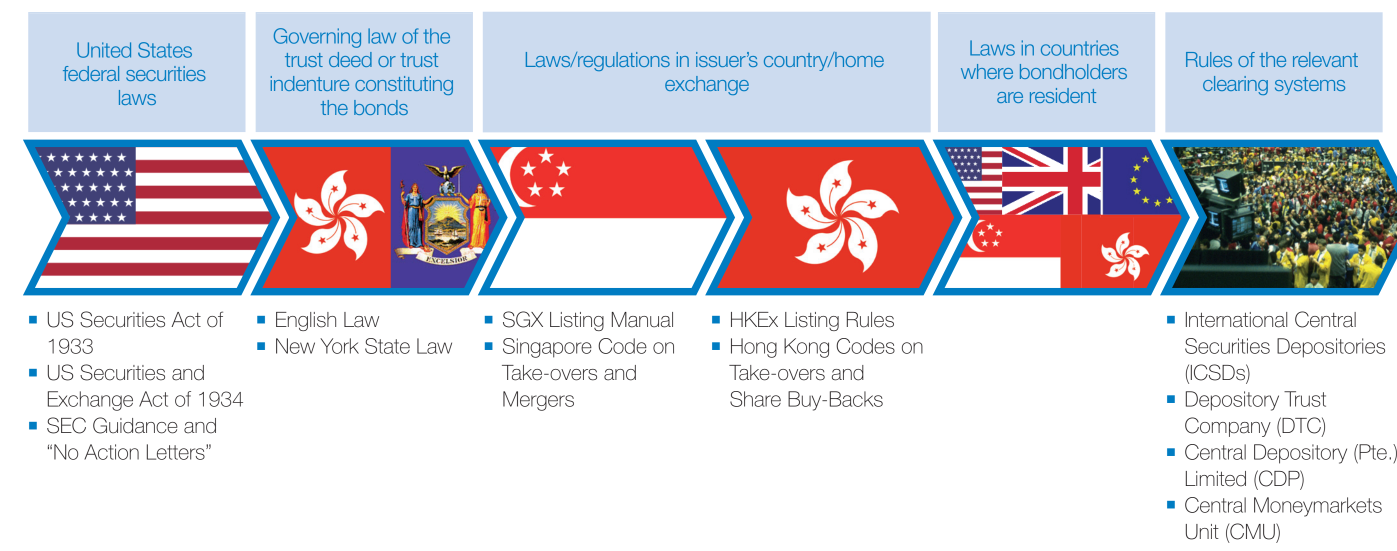

Figure 2: Laws and regulators which needed to be considered in liability management exercises

Any liability management exercise will typically involve the laws of a number of different jurisdictions, depending on the circumstances of each transaction, as follows:

United States federal securities laws

At the outset, it is important for an issuer to try to establish the proportion of its bonds held by U.S. investors. Where the original placement included a resale under Rule 144A of the U.S. Securities Act of 1933 (the **"U.S. Securities Act"**), the answer may be obvious but issuers should understand that, even where the bonds were originally distributed under Regulation S of the U.S. Securities Act, a significant portion of those bonds may have flowed into the U.S. or to U.S. persons in the secondary market following the initial issuance of the bonds.

While it is possible in certain circumstances to avoid the onerous requirements and application of U.S. securities laws by excluding U.S. investors from the proposed liability management exercise, if the proportion of the relevant securities held by U.S. persons is significant (and exclusion of U.S. investors from the offer would likely prejudice the commercial success of the transaction), it will be necessary to comply with certain applicable U.S. rules and U.S. securities laws. In the case of tender offers, these requirements are likely to include minimum time periods for various actions and the so-called anti-fraud provisions of Section 10(b) and Rule 10b-5 of the U.S. Securities and Exchange Act of 1934 (the **"US Exchange Act"**). For example, Rule 14e-1 of the US Exchange Act 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 if there is any change in the percentage of securities being sought, or the consideration to be paid, the offer must be held open for an additional 10 business days from the date the notification of such change is sent to holders. Recognising that bond investors are often sophisticated investors and that the decision as to whether to participate in certain basic kinds of debt tender offers is different from those considerations applicable to equity securities, the staff of the U.S. Securities and Exchange Commission (the **"SEC"**) in 1986 began granting No-Action relief from the 20-day requirement for cash tender offers relating to investment grade debt. In January 2015, the SEC's Division of Corporation Finance issued a "No Action Letter"[1] which has had the effect of creating a category of accelerated tender offers for non-convertible debt securities that can be held open for as little as five business days in certain circumstances. The specific requirements of this new five-day tender offer rule is the subject of a separate Clifford Chance briefing note ("SEC Staff Provides New Guidance for Accelerated Debt Tender Offers"), which may be accessed on the Clifford Chance Financial Markets Toolkit.[2]

Further consideration of relevant U.S. tender offer rules and securities laws is outside the scope of this document but, because of the requirements they impose, if the proportion of the relevant securities held by U.S. persons is not significant their participation is typically excluded.

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Governing law of the trust deed or trust indenture constituting the bonds

Issuers will need to have regard to the governing law of the transaction documents under which their bonds were initially issued. For major cross-border international bond issues, particularly in the Eurodollar bond market, the two most prevalent governing laws are English law (typically governing transactions for bond issues sold to investors outside of the U.S. in reliance on Regulation S) and New York state law (typically governing transactions for bond issues sold to investors where part of the offering includes a placement under Rule 144A). As will become apparent from this document, specific features and nuances of the relevant governing law of the documents constituting the bonds (a trust deed under English law and a trust indenture under New York state law) will need to be taken into account in structuring a liability management exercise, as the same legal regime will likely govern the terms of the liability management exercise. In particular, and as a first step in the structuring of any liability management exercise, a careful analysis of the terms and conditions of the bonds and the provisions of the trust deed, or indenture, constituting the bonds needs to be undertaken to ensure that the structure of the liability management exercise is permitted by the terms of the bonds. This applies, in particular, to consent solicitation exercises, where the trust deed will set out certain thresholds for the passing of ordinary or extraordinary resolutions depending on the term for which an amendment or waiver is sought.

Applicable laws in the issuer's country and the regulations of the exchange on which the bonds are listed

Apart from the federal securities laws of the United States and the governing law of the bond documents, an issuer considering some form of liability management exercise will need to be aware of applicable laws in its own country and the regulations of the stock exchange on which its bonds are admitted to trading. For example, issuers with bonds listed on the Singapore Exchange Securities Trading Limited (the **"SGX"**) are subject to continuing obligations under the SGX Listing Manual, which requires an issuer to disclose immediately to the SGX any information which may have a material effect on the price or value of its debt securities or on an investor's decision whether to trade in such debt securities.[3] In particular, the SGX requires foreign debt securities issuers to announce any redemption or cancellation of the debt securities and any amendments made to the trust deed (or indenture, as the case may be), both of which are likely to form part of any broader liability management exercise. Similar continuing obligations are imposed on issuers with bonds listed on The Stock Exchange of Hong Kong Limited (the **"HKEx"**). Rules 37.44 to 37.53 of the HKEx Listing Rules set out these continuing obligations and, in particular, require an issuer to immediately (after consultation with the HKEx) announce any information which is necessary to avoid a false market in its listed debt securities where, in the view of the HKEx, there is or there is likely to be a false market in its listed debt.[4] Similarly to the SGX, the HKEx Listing Rules also require an issuer to announce as soon as possible aggregate redemptions or cancellations of bonds which exceed 10% (and every subsequent 5% interval) of an issue,[5] and to notify the HKEx in advance of any proposal to replace a trustee for bondholders or to amend the trust deed or the bonds.[6]

In the case of convertible bonds which are admitted to trading on a different stock exchange from that on which the underlying shares are listed, an issuer will also need to take account of the laws of the country of that stock exchange, plus any applicable stock exchange or listing authority rules applicable to its equity. For example, in relation to convertible bonds where the underlying shares (into which the bonds are convertible) are listed on the HKEx, the issuer and its advisers will need to conduct an analysis under the Codes on Take-overs and Share Buy-Backs issued by the Hong Kong Securities and Futures Commission and, where such shares are listed in Singapore, under the Singapore Code on Take-overs and Mergers.

In addition, United Kingdom securities laws, such as the Financial Services and Markets Act 2000, will be relevant if offers are likely to be made in, to or from the United Kingdom.

Laws in countries where bondholders are resident

In the context of an exchange offer or tender offer, an issuer will need to consider applicable laws in countries where bondholders are resident. An issuer and its advisers 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 bonds are held in clearing systems, it is unlikely ever to be possible to ascertain precisely the exact identity of the investor base. It is usual, however, to exclude participation by holders in certain countries where local requirements are relatively onerous (notably the U.S. and Italy[7]) in cases where investors are not sufficiently numerous in those countries as to make the potential benefits of compliance outweigh the costs for some processes.

In the context of consent solicitations, it should be noted that bondholders cannot be excluded from participating in any consent process seeking to amend the terms of bonds which they own. However, as a consent solicitation does not involve the offer or sale of bonds, it does not require registration under the U.S. Securities Act and is otherwise not subject to the anti-fraud provisions of U.S. federal securities laws or similar anti-fraud or market abuse laws in Europe, thereby being of less concern from a securities regulation perspective, and minimising the commercial or practical need to exclude holders in certain jurisdictions. However, care does need to be taken to ensure that any proposed amendments to the terms of the bonds do not "substantially affect" the rights of bondholders, namely, that the amendments may be deemed to constitute the offering of new securities. Generally, this is only the case where the amendments proposed to the terms and conditions of the bonds modify their basic financial and economic terms.[8] In such circumstances, a consent solicitation may be deemed to be an offer of new securities, in which case, securities laws will apply in the same way as they would for any other securities offering. Accordingly, proposals to modify the terms of the bonds should be carefully considered on a case-by-case basis to determine whether they are likely to constitute an offering of new securities.

Rules of the relevant clearing systems

While not strictly speaking a matter of law, consideration also needs to be given to the relevant rules and procedures of the clearing systems through which the bonds to which the liability management exercise relates are cleared.

Typically, bond issues denominated in U.S. dollars are cleared through the International Central Securities Depositories (or "ICSDs", being Euroclear and Clearstream) (in the case of a Regulation S only offering), and the Depository Trust Company, or "DTC" (in the case of a Rule 144A placement), while bond issues denominated in Singapore dollars are usually (but not necessarily) cleared through the SGX's Central Depository (Pte.) Limited, or "CDP", and bond issues denominated in Hong Kong dollars are usually (but not necessarily) cleared through the Hong Kong Monetary Authority's Central Moneymarkets Unit system, or "CMU".

While the clearing system through which the bonds trade and settle is unlikely to have any substantive impact on the structuring considerations for a liability management exercise, it is important to note that different clearing systems will have different processes in supporting the paying and tabulation/exchange agent through the exercise. For example, the principal difference between the ICSDs and local clearing systems like CDP and the CMU is that the ICSDs have systematic processes and electronic platforms which support critical functions in a liability management exercise (such as the voting and blocking of positions in the bonds, reconciliation of votes and/or acceptances in a consent solicitation or tender offer and funds settlement), whilst the locally-based systems do not, meaning that the agents will need to manually support these functions in the course of the exercise. This is important to consider for the purposes of both composing the timetable, and the selection of the tabulation or exchange agent (to ensure they have sufficient experience of the manual support required), for the exercise.

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3. Liability Management Techniques

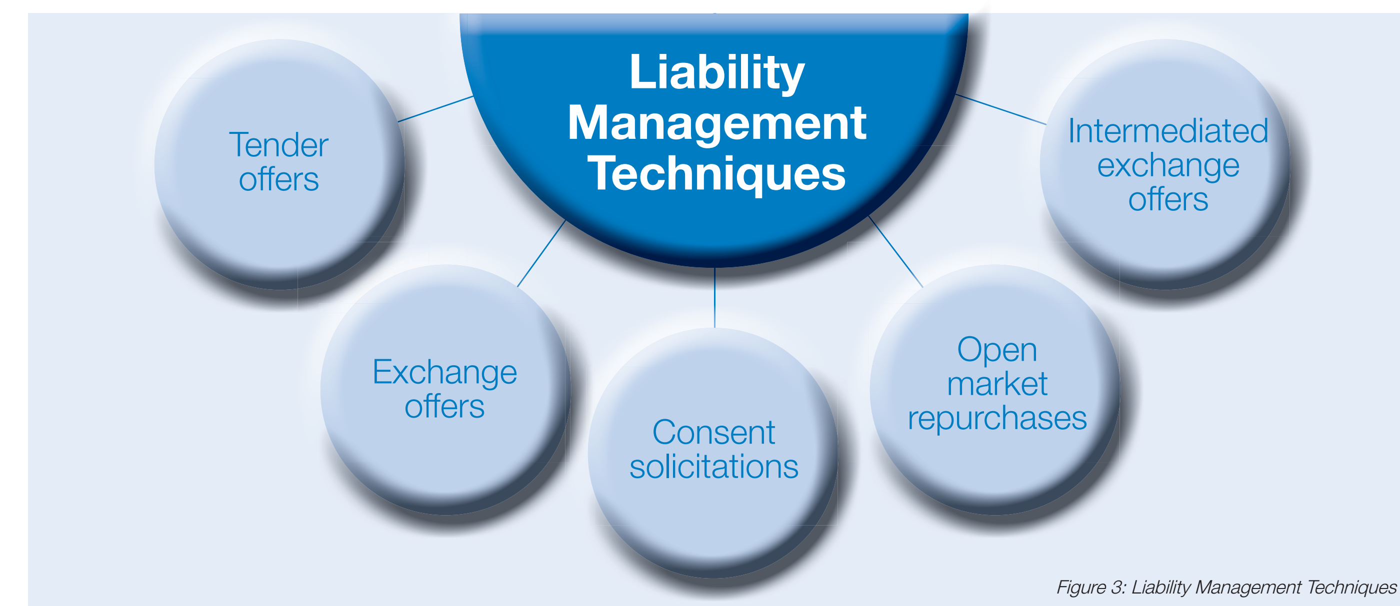

Figure 3: Liability Management Techniques

Tender offers

An issuer with bonds outstanding in the international capital markets may decide to make an offer to purchase its bonds by launching a public offer for the debt. Such an invitation allows an issuer to retire a significant portion of a particular bond issue. Assuming that it is not necessary to comply with the U.S. tender offer rules, there are no rules about the duration of the offer period: as a practical matter, it must be sufficiently long to allow for distribution of materials through the clearing systems and for investors to respond. In many cases, issuers will opt for an offer period of 7-10 business days. Issuers 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 towards close of the offer) which goes some way to transferring the risk of price movements to investors. Alternatively, issuers may look at so-called "modified Dutch Auction techniques" where investors are invited to bid a price (usually within a specified range) at which they would be prepared to sell their bonds. On the basis of those bids the issuer then sets a clearing price (which achieves its goals for the tender) and accepts all the bids which are at or below the clearing price. Bids at the clearing price are accepted pro rata if acceptance in full would result in the issuer purchasing more bonds in aggregate than the overall limit (if any) set by the issuer in the invitation to tender.

An issuer will normally appoint an investment bank with experience in liability management transactions to act as "dealer manager". Usually, a tender offer memorandum or statement will 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 SGX or HKEx, there is no requirement for any approval of the tender offer memorandum or statement by any competent authority. The tender offer may be launched by posting a notice through the clearing systems and, in the case of bonds admitted to trading on the SGX, publishing a simultaneous announcement through the SGXNet portal or, in the case of HKEx listed bonds, on HKExnews. Particular care should be taken to ensure that notices and distributions of offer material comply with applicable laws and stock exchange or listing authority rules, such as the continuing obligations for SGX-listed bonds described above.

Exchange offers

An exchange offer typically involves an offer by the issuer to the holders of outstanding bonds to exchange those bonds for an amount of newly-issued bonds. The offer may be made in respect of all or part (for example, up to a maximum amount) of the outstanding bonds. This technique allows an issuer to extend the maturity of outstanding bonds or effectively amend their terms, whilst at the same time retaining substantially the same investor base (which is familiar with the issuer and its credit profile). The

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economics of the offer (for example, the coupon or covenants applicable to the new bonds) will vary depending on the individual position of the issuer, its objectives in undertaking the exchange offer and the prevailing trading climate.

Unlike a public cash tender offer described above, an exchange offer involves the issue of new bonds and, usually, their listing and admission to trading on a stock exchange. Bearing this in mind, an issuer will need to take particular care to comply with applicable legal and regulatory requirements in the jurisdictions where existing holders are resident as offers of new securities are generally much more heavily regulated than offers to buy existing bonds for cash. Again, it is usual to exclude participation by holders in certain countries where local requirements are relatively onerous (notably the U.S. and Italy) in cases where investors are not sufficiently numerous in those countries as to make the potential benefits of compliance outweigh the costs.

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 and, importantly, contains disclosure on the terms of the new bonds and the issuer. Where the new bonds are to be admitted to trading on a stock exchange such as the SGX, an offering circular (describing the terms of the new bonds, together with the related business, risk and financial disclosures applicable to the issuer) will be appended to the exchange offer memorandum, and will comprise the "offering document" which will be subject to the usual approval by the stock exchange for listing purposes. Given the additional complexity and, in particular, the time required to produce the offering circular, issuers will usually need to allow a significantly longer preparation time prior to launch than would be the case for a public cash tender offer.

Consent solicitations

Issuers may consider launching a consent solicitation whereby a proposal is put to bondholders to consider an amendment to the terms of outstanding bonds. Under a bond issue constituted by an English law trust deed, this may also involve convening a meeting of bondholders to consider and vote on the proposals for amendments. A consent solicitation may be done to avoid a potential breach of a particular covenant, to cure or waive breaches or events of default that have already occurred, or to introduce new terms such as a "call" option allowing the issuer to redeem the bonds prior to their stated maturity at a specified price. The advantage of obtaining the approval of bondholders by an extraordinary resolution is that it binds the entire class of bondholders: in other words, it is possible, provided necessary quorum and voting thresholds are met, to retire an entire series of bonds.

Tender offers and exchange offers may be combined with a bondholder meeting where the holders are invited to consider an extraordinary resolution to give the issuer a right to call the bonds early (often called an "exit consent"). Bondholders who accept the offer also automatically deliver an irrevocable instruction to vote in favour of the extraordinary resolution. Provided the necessary quorum and voting requirements are satisfied, the issuer is then able to redeem the entire series of bonds either for cash or for a combination of cash and new securities.

However, care needs to be exercised to ensure that modifications made to the terms of the existing bonds as part of the exit consent do not impose unfair or punitive outcomes on dissenting or non-participating bondholders (see "Specific legal considerations applicable to liability management exercises – equal treatment of bondholders and oppression of the minority in exit consents", below, for a detailed discussion of these considerations). Where the extraordinary resolution is not passed at a meeting of bondholders, the issuer may decide to accept for redemption that portion of bonds held by holders who have accepted the offer and leave outstanding the remainder of the series. This is a useful technique for an issuer to consider where it is not imperative that an entire class is retired: for example, where the motive for the offer and solicitation is not to remove a "problem" covenant. Where an exchange offer or cash tender offer is combined with a consent solicitation, the notice requirements for a meeting (typically 21 days, as set out in the meeting provisions in the trust deed constituting the bonds) will need to be observed and this will have an impact on the duration of the applicable offer.

Open market repurchases

An issuer may consider repurchasing a modest portion of its outstanding bonds on a case-by-case basis, by taking bids from participants in the secondary market. Alternatively, an issuer may mandate a bank to execute such repurchases on its behalf. This technique allows an issuer to retire a portion of a bond issue in a relatively low-key manner, subject to careful consideration of applicable regulatory issues, particularly in relation to market abuse and insider trading.

Intermediated exchange offers

An intermediated exchange offer is a technique which combines a tender offer with an issue of new bonds. Whilst not commonly used in Asia, intermediated exchange offers have been used successfully in European bond markets in order to achieve exchange accounting treatment, i.e. where existing bonds are trading above their par value, any premium paid for them in a tender can be amortised over the life of the new bonds issued under exchange accounting rules in the issuer's home jurisdiction and under the accounting principles applicable to the preparation of its financial statements. The dealer manager, as offeror, is required to act as the intermediary in order for the exchange to work.

In essence, an intermediated exchange offer is documented and executed as a tender offer with a new bond issue taking place contemporaneously. The dealer manager will take the role of offeror in the tender offer, and pay the purchase price to holders whose bonds are accepted for sale. The tender offer is therefore a third party offer (i.e. not made by the issuer or a member of its group). The purchase price that the offeror pays for the new bonds is financed from the proceeds of the new bond issue.

The documentation is largely the same as that for a tender offer coupled with a new issue, except that the dealer manager will enter into an exchange settlement agreement with the issuer, which will document the agreement between the issuer and the dealer manager for the exchange of the old bonds for new bonds, taking into consideration the differential between the purchase price of the old bonds and the issue price of the new bonds (and fees).

From a risk perspective, it is important to note that the dealer manager will assume credit risk on the old bonds for a period equal to the difference in the time between the settlement of the tender offer and the issuance of the new bonds. Accordingly, it is important that the timing of the settlement of the tender offer and the new issue are aligned as closely as possible.

Care will also need to be exercised to ensure that appropriate exemptions from financial promotion rules and regulations are available, given that the usual exemptions applying to a pure tender offer will not apply (as it is the dealer manager, as intermediary, and not the issuer, who is conducting communications with the issuer's creditors).

In addition, from a practical perspective, the dealer manager will need to assure the clearing systems that it has the issuer's consent to make the offer, otherwise the clearing systems will not permit it to put out the necessary notices to holders. Similarly, the dealer manager is not strictly bound to put out an SGXNet or HKEx announcement about the tender offer. However, given the overall complicity of the issuer in the transaction structure, it would be advisable to do so on the basis that the issuer has knowledge of the tender offer proceeding and has entered into the exchange settlement agreement which will result in the repurchase and cancellation of the bonds. In addition, the intermediated exchange offer, as a whole, is likely to constitute information which may have a material effect on the price or value of the issuer's debt securities or on an investor's decision whether to trade in such debt securities for the purposes of Rule 745 of the SGX Listing Manual, and may fall within the scope of the announcement requirements under Chapter 37 of the HKEx Listing Rules which apply to debt securities. Equally, considerations surrounding material price sensitive information in the context of market abuse and insider trading are also likely to apply.

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4. Specific legal considerations applicable to liability management exercises

Oppression of the minority in exit consents

The decision of the English High Court in the case of *Assenagon Asset Management S.A. and Irish Bank Resolution Corporation Limited (Formerly Anglo Irish Bank Corporation Limited)* [2012] EWHC 2090 (Ch) provides a detailed analysis of the legality of exit consent structures under English law and, in particular, emphasises the position that English courts will not uphold structures that seek to impose unfair or punitive outcomes on dissenting or non-participating bondholders. A detailed analysis of the decision in the *Assenagon* case is the subject of a separate Clifford Chance briefing note ("Liability Management: Exit Consents and Oppression of the Minority", which may be accessed on the Clifford Chance Financial Markets Toolkit[9]), but it is worth summarising the key outcomes thereof insofar as they relate to considerations surrounding the structure of an exit consent:

- Modifications to bond conditions which are prima facie detrimental to bondholders may still be within the modification powers forming part of the bond;
- Bonds that have been acquired by an issuer prior to a meeting (at which such modifications are sought to be effected) may be effectively disenfranchised if the terms of the Bonds so provide;
- However, resolutions passed by the majority of bondholders that seek to impose an unfair price or outcome on holders who do not participate in the tender or exchange may be overturned by the courts;
- Open disclosure of the terms of the proposal for the modifications will not save a resolution that is inherently unfair or oppressive to the minority.

While the facts of the *Assenagon* case reveal a scenario which was overtly oppressive to minority bondholders[10] and therefore relatively easy to assess, other terms proposed for modification may not be as clear-cut, and fall to be carefully considered on a case-by-case basis.

In addition to the common law principles applied to exit consents by the court in *Assenagon*, careful consideration should also be given to the statutory protection afforded to bondholders in different jurisdictions. For example, section 216(b) of the Singapore Companies Act, Chapter 50, provides a statutory remedy to minority bondholders to challenge resolutions in instances where unfair oppression by a majority exists. In the United States, section 316(b) of the U.S. Trust Indenture Act of 1939 effectively prohibits the impairment of a bondholder's right to receive payment of interest and principal without its consent.

Issues of oppression in liability management, and in the context of distressed debt or an insolvency scenario could, depending on the jurisdictions involved, be mitigated through formal court-sanctioned processes such as a scheme of arrangement.[11] Such schemes usually involve a restructuring of all or part of the financial indebtedness of the relevant company, sometimes associated with a related equity restructuring at holding company level, with the existing obligors continuing to conduct the operations of the business. In a successful scheme, the interests of minority dissenting creditors are "crammed down" as a result of the court process, i.e. as long as the requisite voting thresholds for the scheme proposals are obtained, and the approval of the court is granted, claims of minority dissenting secured creditors (such as bondholders) can be compromised without their unanimous consent.[12] As such, a detailed consideration of alternatives should be carried out as part, and at the inception, of a strategic review of any restructuring exercise where concerns such as oppression of the minority might arise.

Voting incentives

It is usual, in the context of consent solicitations, to offer an incentive to holders to vote promptly in connection with the extraordinary resolution. Sometimes the incentive is available for any vote (either for or against) but often the incentive is available only to holders who deliver a vote in favour of the extraordinary resolution on or before a date approximately halfway through the consent process.

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In *Azevedo v Imcopa Importacao and others* [2013] EWCA Civ. 364, the English Court of Appeal considered the legality of such payments in the context of whether they would constitute bribery, and ultimately concluded that such payments would not be unlawful where they are made openly to all bondholders and no bondholders would be prevented from voting.[13] Whilst the decision in *Azevedo* has confirmed that the payment of incentive fees would not invalidate any resolutions taken by a meeting of bondholders, careful consideration needs to be given to the manner in which such fees are structured and paid. In particular:

- It is permissible to provide that incentive fees can be paid only to holders who vote in favour of a resolution; however, it is important to ensure that open disclosure of such fee arrangements is made to all bondholders in the tender offer or exchange offer memorandum forming part of the exercise;
- The offer of consent fees to all bondholders will not necessarily cure or otherwise remove concerns of unfair or oppressive conduct (as described above), and will not by itself lead to a conclusion that the proposals are fair;
- Care should be taken to ensure that any such payments are not routed via the trustee for the bondholders, in order to avoid an argument that the *pari passu* provisions in the trust deed constituting the bonds apply, thereby compelling the trustee to apply the receipt of funds from an issuer in the manner described therein.

In addition, particular care should be taken where a consent solicitation is combined with an exchange offer or tender offer and it is desirable to exclude participation by certain types of investors.

Are buy-backs permitted under existing bond terms?

It is common for bond documentation to contain an express provision permitting the issuer (and any affiliates) to buy back the bonds without restriction. However, it is prudent to check the provisions carefully because, while not common, restrictions on the timing and the manner of buy-backs are not unknown. Also, it is common for bond documentation to specify whether the issuer is obliged to cancel any bonds so purchased or whether it may hold and re-sell any bonds so purchased.

It is also advisable to check whether the rules of the stock exchange or listing authority by which the shares and the bonds are admitted to trading, or applicable laws of the country of that stock exchange or listing authority, provide any restrictions on the timing or manner of buy-backs or offers. For example, Rule 747(1) of the SGX Listing Manual requires an issuer to specifically announce, via SGXNet, any cancellation or redemption of its debt securities.

Similarly, for consent solicitation exercises, and as noted above (see "Which laws need to be considered? – Governing laws of the trust deed or trust indenture constituting the bonds"), a careful analysis of the terms and conditions of the bonds and the provisions of the trust deed, or indenture, constituting the bonds needs to be undertaken to ensure that the issuer and its advisers are familiar with the matters which require bondholder consent for amendment, and the relevant voting thresholds necessary to pass such amendments.

Equal treatment of bondholders

The equal treatment of bondholders is usually provided for in the status covenant included in the terms and conditions of the bonds and, in certain jurisdictions, within the listing rules and continuing obligations applicable to bond issues.

Senior-ranking bond issues will typically include a status (or *pari passu*[14]) covenant which provides that the bonds will rank without any preference among themselves, and at least *pari passu* with all other unsecured and unsubordinated debt of the issuer.

Under English law, the requirement that the bonds rank without preference among themselves has the effect of being a contractual undertaking by the issuer in favour of bondholders that it will treat all bondholders equally, without favouring certain bondholders over others. As such, and as a contractual matter, an issuer may not repay principal to some, but not other, bondholders (unless otherwise provided for in the terms of the bonds) or otherwise agree to modify the terms of a certain proportion of the bonds.

However, whether this covenant is breached in the context of a tender offer or other bond repurchase which seeks to exclude the participation by certain holders (for example, in the U.S.) requires careful analysis: as a matter of English law, the requirement that bonds rank 'without any preference' seems to restrict preferential treatment in respect of all matters relating to the ownership of the bonds, and is not restricted only to the contractual terms of the bonds.[15] It is therefore arguable that an issuer who seeks to exclude the participation of certain bondholders in a tender offer or other bond repurchase exercise is in breach of this covenant where the bond terms do not include an express provision that the issuer (or any of its subsidiaries) may at any time purchase bonds in the open market. Such a buy-back provision is fairly typical in most bond issues governed by English, Singapore or Hong Kong law, however, if no such provision is included, then a partial buy-back may well constitute a breach of the status covenant and the structure of the tender offer should be carefully considered.

From a listing rules perspective, it should also be noted that neither the SGX nor the HKEx has a specific listing rule imposing a requirement for equal treatment similar to that found in the EU Transparency Directive[16] or as imposed by the UK Financial Conduct Authority.[17] However, even if this were the case (and unlike the contractual position above), it is unlikely that a buy-back or tender offer would breach an equality of treatment rule, as this would usually only apply to the contractual rights in the bond terms enforceable against the issuer, as opposed to the separate contract formed by the offer to repurchase. That said, the bond terms should be carefully scrutinised to ensure that there is no provision requiring a tender offer to be made available to all bondholders on equal terms: this would have the effect of being a contractual right enforceable against the issuer, and therefore potentially prevent an issuer from excluding the participation of certain bondholders in the tender offer.

Market abuse

This document assumes that the issuer will be seeking to buy back its bonds for genuine commercial purposes. However, legislative frameworks in certain jurisdictions have led some commentators to suggest that any buy-back of bonds might constitute market abuse.

Even where the issuer's motives are beyond reproach, regulators may regard large trading volumes in illiquid markets as securing the price at an abnormal or artificial level. It is therefore important to ensure that the issuer (and any dealer manager acting on its behalf), like any market participant, executes any market purchases in a way which takes into account the need for the market as a whole to operate fairly and efficiently.

These issues are much less likely to arise in relation to tender offers or exchange offers. The prior announcement of the proposed offer and the fact that investors should have equal access to information on the proposed offer should greatly reduce any risk of disorderly markets or other distortions.

Non-public price sensitive information

Different countries are likely to have different tests as to what constitutes non-public price sensitive information or "inside information" but, generally speaking, it can be regarded as information which would, if made public, be likely to have a significant effect on the price of the bonds (and, in the case of convertible bonds, the underlying shares). For the purposes of this document, it may be helpful to distinguish some different circumstances where information may amount to non-public price sensitive information.

First is the situation where the issuer has information that is unrelated to the proposed buy-back or exchange offer, for example information about potential mergers and acquisitions transactions by the issuer. The issuer is unlikely to be able to make market purchases of its own bonds, or launch a tender offer or exchange offer, where it possesses this type of non-public price sensitive information, unless it is prepared to make that information public before making such purchases or offers.

Second is a situation where the proposed buy-back or exchange would itself have a significant effect on the financial condition of the issuer. In the context of a tender offer or exchange offer in these circumstances, the issuer is likely to have to make effective public disclosure of the material facts concerning the offer and its anticipated impact on or before the launch of the offer. For bonds listed on the SGX, Rule 745 of the SGX Listing Manual would apply in this scenario, and the issuer would be required immediately to disclose to the SGX, via SGXNet, any information which may have a material effect on the price or value of its debt securities or on an investor's decision whether to trade in such debt securities. Hong Kong Listing Rule 37.47 would have a similar effect for bonds listed on the HKEx.

If the issuer starts buying its bonds in the market without making any announcement beforehand (because it does not want to be trading at a disadvantage to other market participants), it is likely reasonably quickly to reach a point where its purchases will force it to make a public announcement, either because

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knowledge of the scale of its purchases will constitute non-public price sensitive information or because the scale of its purchases has been such as to constitute another type of non-public price sensitive information, namely a reduction in the liquidity of the market in the remaining bonds (which would be material to investors' investment decisions). This point is likely to mark the end of the issuer's ability to execute market purchases on comparable terms and, therefore, open market purchases may be less attractive than a tender offer to an issuer wishing to buy back bonds on a significant scale.

Whether the issuer is proposing a tender offer, an exchange offer or a market purchase it will normally be legitimate to delay publication of its intentions, but the issuer must be careful to maintain the confidentiality of its plans and ensure that any disclosure to anyone is only for a legitimate purpose (for example, commercial negotiations with its advisers) and subject to confidentiality undertakings.

Third is a situation where information about the issuer's proposed buy-back would itself have a significant effect on the market for the bonds (or, in the case of convertible bonds, the underlying shares) in the same way as information about a large proposed transaction by any investor. As above, it will normally be legitimate for the issuer to delay publication of its intentions, but the issuer must be careful to maintain the confidentiality of its plans and ensure that any disclosure is only for a legitimate purpose. Also, the fact that the issuer has knowledge of its own intentions to make market purchases and that such information is price sensitive information generally should not preclude the issuer from carrying out those intentions or a dealer from executing the issuer's orders.

Fourth, as noted above, information that the issuer has executed purchases of its own bonds is likely, once a certain volume of purchases has been effected, to be price sensitive in relation to the remaining bonds, because the reduction in the liquidity of the market in the remaining bonds may be material to investors' investment decisions. This is particularly so where (as is usual) the conditions of the bonds require the issuer to cancel purchased bonds.

Prohibited periods

The rules of the stock exchange or listing authority by which the bonds or any underlying shares are admitted to trading, or the applicable laws of the country of that stock exchange or listing authority, may prescribe certain periods during which the issuer is prohibited from dealing in its own securities or only permit it to do so subject to certain conditions. For example, an issuer which has its primary equity listing on the SGX will generally speaking be unable to launch or execute a tender offer or buy-back in various periods leading up to publication of its regular financial reports.

Tax

An issuer buying back bonds for less than the value of the corresponding liability in its balance sheet is likely thereby to generate income which may be liable to tax. However it may be possible, depending upon the circumstances, to avoid such a liability. An issuer contemplating a buy-back of its bonds would be well-advised to take appropriate tax advice at an early stage.

Conclusion

Depending upon the circumstances, liability management exercises can offer significant economic benefits to issuers, both as a form of pro-active balance sheet liability management and in a broader distressed debt or restructuring scenario. However, the variety of different techniques and the potential for various laws and regulatory regimes to impact the process mean that an issuer should not embark upon a liability management exercise without first giving careful consideration to the issues described in this document.

References

[1] Abbreviated Tender or Exchange Offers for Non-Convertible Debt Securities, SEC No Action Letter (23 January 2015).

[2] Clifford Chance Financial Markets Toolkit: http://financialmarketstoolkit.cliffordchance.com

[3] Rule 745, SGX Listing Manual.

[4] Rule 37.47, HKEx Listing Rules.

[5] Rule 37.48, HKEx Listing Rules.

[6] Rule 37.49(a)-(b), HKEx Listing Rules.

[7] However, following a market consultation process in 2012 concerning tender offer regulations, CONSOB (the Italian securities regulator) has approved new secondary regulations which aim to simplify the procedure applicable to tender and exchange offers for debt securities, as well as to reduce the costs and the administrative burden of these transactions and ensure that rules on offers for debt securities are consistent with European practice. This is the subject of a separate Clifford Chance briefing note, "Liability management: green light in Italy", accessible on the Clifford Chance Financial Markets Toolkit: http://financialmarketstoolkit.cliffordchance.com

[8] For example, case law in the United States indicates these basic economic terms to include the rate of interest, the date or schedule for redemption, the payment of the principal amount (and any premium), the right to accelerate upon default the currency and place of payment.

[9] Clifford Chance Financial Markets Toolkit: http://financialmarketstoolkit.cliffordchance.com

[10] In that case, the resolution proposed as part of the exit consent had the effect of including a call option in the bond documentation which would allow Irish Bank, as the issuer, to redeem all bonds not tendered for exchanged for EUR0.001 per EUR1,000 in principal amount of the outstanding bonds.

[11] A scheme of arrangement is typically a court-supervised process (in the United Kingdom, under the Companies Act 2006), which aims to implement an agreement between a debtor and its creditors. Regardless of the jurisdiction of incorporation of the issuer, an English court has jurisdiction to sanction a scheme of arrangement in a company that has a "sufficient connection" to England. A "sufficient connection" is usually established by the "Centre of Main Interests" of the company, or the governing law and jurisdiction clauses in its underlying finance documents. Accordingly, a company incorporated outside of England may be able to use a scheme of arrangement under the English Companies Act 2006 where the terms and conditions of its bonds, and the trust deed constituting its bond issue, is expressed to be governed by English law.

[12] Such a "cram down" scheme distinguishes a scheme of arrangement from a company voluntary arrangement which does not bind secured creditors. Accordingly, where bonds are secured, this alternative may not be commercially or practically feasible.

[13] A detailed analysis of the decision in the Azevedo case is the subject of two separate Clifford Chance briefing notes ("Noteholder Meetings: Paying the Price for Change" and "Consent Fees and Noteholder Meetings", which may be accessed on the Clifford Chance Financial Markets Toolkit: http://financialmarketstoolkit.cliffordchance.com).

[14] Meaning, literally, 'side by side' or 'in equal step'.

[15] See Geoffrey Fuller, The Law and Practice of International Capital Markets, 3rd Ed., at 9.16.

[16] 2004.109/EC, Article 18.1.

[17] Disclosure and Transparency Rules, Rule 6.1.3(2).

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