

CORONAVIRUS: LEVERAGED FINANCE – KEY CONSIDERATIONS IN RESPECT OF DEBT BUYBACKS AND OTHER LIABILITY MANAGEMENT TRANSACTIONS

The Coronavirus (COVID-19) pandemic continues to significantly impact global markets, resulting in price reductions for high yield bonds such that many of those instruments are now trading below par, some significantly so. As mentioned in our "Coronavirus: Leveraged Finance – Immediate Financing Considerations for Financial Sponsors, Underwriters and Debt Investors" briefing, debt buybacks and other liability management options are on the minds of a number of financial sponsors, issuers and investment banks.

The extreme market volatility triggered by the COVID-19 pandemic means that bonds may be trading at a discount. Whether an issuer or related party should consider conducting a bond purchase or repurchase will require an individualized and fact-specific analysis, however, this briefing will set out some general considerations. In particular, we will look at some of the key debt buyback and tender offer considerations for financial sponsors, issuers, management teams and investment banks.

LIABILITY MANAGEMENT OPTIONS

The term "liability management" is used to describe a variety of options and techniques that issuers use to manage their balance sheet liabilities or other parties use to buy outstanding bonds. These options include private buybacks and public offers to repurchase all or a portion of an outstanding issue of bonds for cash. While liability management also includes other techniques such as exchange offers and consent solicitations, we will only address buybacks and tender offers here.

The current market downturn and the global response by governments and central banks have produced a situation where some corporate bonds are trading at prices significantly below their face value, creating a window for issuers and other market players to buy bonds at a discount by way of a private debt buyback or tender offer.

Key issues

- Economic downturn may create a window to buy debt at a discount through bond buybacks or tender offers
- In determining whether to conduct a buyback or tender offer, potential buyers must consider their binding debt agreements, tax implications and applicable securities regulations

1. **Bond Buybacks:** An issuer seeking to repurchase a limited portion of its outstanding bonds may do so by taking bids from participants in the secondary market (likewise, third parties can make open market purchases). Alternatively, it may choose to mandate a bank to execute such repurchases on its behalf and then buy such bonds from that institution. This technique allows an issuer to retire a portion of a bond issue in a speedy and low-cost manner. Therefore, buyers seeking to quickly buy a limited amount of bonds may favour private bond buybacks over other alternatives.

2. **Tender Offers:** An issuer with bonds outstanding in the international capital markets can make an offer to purchase its bonds by launching a public offer for all or part of its outstanding debt (likewise, a third party can undertake a tender offer for bonds). The offer is generally open to all the relevant bondholders, but some holders in certain jurisdictions may be excluded for regulatory reasons. Outside the United States there are a limited number of rules as to how the offer should be conducted or as to how long it must be open. However, in most cases, it involves the preparation of a tender offer memorandum and an agreed period of time for noteholders to respond (often between 5 and 10 business days). Tender offerors must take particular care to ensure that they comply with applicable laws and stock exchange or listing authority rules. Certain key considerations for tender offers that include the United States are addressed below.

Bonds repurchased by the issuer by way of a tender offer or private buyback will typically be cancelled, which will reduce the interest the issuer pays on those bonds. The cancellation of bonds may also result in a potential positive contribution to the issuer's financial results by recognizing the difference between the purchase price (if at a discount) and the par value of such bond.

KEY LEGAL AND REGULATORY CONSIDERATIONS

From a practical standpoint, bond buybacks and tender offers are only viable for purchasers with sufficient cash to buy the bonds. But the ability to consummate these transactions requires careful consideration of key contractual, legal, regulatory and tax issues.

- ***U.S. Tender Offer Rules:*** A tender offer made to U.S. bondholders is subject to the tender offer rules under section 14 of the U.S. Securities Exchange Act of 1934 (the "U.S. Exchange Act") and Regulation 14E promulgated thereunder. These rules provide, among other things, that a tender offer must be held open for up to 20 business days and be further extended in the event that material changes are made to the terms of the offer, except for certain purchases which, subject to conditions, can be completed on an expedited basis (5 business days). While some tender offers exclude U.S. investors in order to avoid these requirements, if the proportion of bonds held by U.S. persons is significant, it may be commercially necessary to comply with the applicable U.S. tender offer rules.
- ***"Creeping" Tender Offers:*** A series of open market bond buybacks that fall short of a full public tender offer may be considered a "creeping" tender offer and be subject to applicable U.S. tender offer rules. Courts generally look to eight different

factors (known as the Wellman test) to determine if a purchase offer is in fact a tender offer. While no factor or combination of factors is dispositive and courts have applied the Wellman test flexibly, there are ways of structuring a debt-buyback to minimize the likelihood that the transaction will be considered a (creeping) tender offer, such as limiting the number of investors and the size of the buyback (generally to less than 20% of total outstanding securities). Nevertheless, a significant degree of judicial discretion is involved and must be recognized in any analysis of whether a purchase offer constitutes a tender offer.

- **Contractual Considerations:** An issuer considering a debt buyback or tender offer should review its debt agreements to determine whether, and under what circumstances, a debt repurchase would constitute a breach of the issuer's covenants. For example, most high yield bond indentures permit voluntary bond repurchases, but the restricted payments covenant may impose limitations on buybacks of subordinated debt, or the relevant loan instruments or intercreditor agreement may limit the extent to which bonds can be repurchased or repaid. Moreover, repurchased and cancelled notes may in some circumstances restrict the ability of an issuer to re-incur the debt, thus reducing its overall debt capacity.
- **Market Abuse Considerations:** Issuers may be subject to the European Union Market Abuse Regulation. For issuers seeking to buy back their publicly-listed bonds, special attention must be given to whether the trade is being made on the basis of non-public, price-sensitive information (“inside information”).
- **Prohibited Periods:** The rules of the stock exchange or listing authority where bonds (or any underlying shares) are admitted to trading, as well as the laws of the country where said stock exchange or listing authority sits, may prescribe certain periods during which the issuer is prohibited from dealing in its own securities or only permit the issuer to do so under certain conditions. In most cases, an issuer will be precluded from launching or executing a tender offer or buyback at certain periods prior to the publication of its regular financial reports.
- **Tax Considerations:** 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 buyback of its bonds would be well-advised to take appropriate tax advice at an early stage.

Our "Coronavirus: Leveraged Finance – Immediate Financing Considerations for Financial Sponsors, Underwriters and Debt Investors" briefing and other Coronavirus (Covid-19) materials can be found here:

https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html

CONTACTS

Americas

Jay Bernstein
Partner

T +1 212 878 8527
E jay.bernstein
@cliffordchance.com

Gary Brooks
Partner

T +1 212 878 8242
E gary.brooks
@cliffordchance.com

Per Chilstrom
Partner

T +1 212 878 2079
E per.chilstrom
@cliffordchance.com

Andrew Epstein
Partner

T +1 212 878 8332
E andrew.epstein
@cliffordchance.com

Jacob Farquharson
Partner

T +1 212 878 3302
E jacob.farquharson
@cliffordchance.com

Larry Medvinsky
Partner

T +1 212 878 8149
E larry.medvinsky
@cliffordchance.com

Jason Myers
Partner

T +1 212 878 8324
E jason.myers
@cliffordchance.com

Anand Saha
Partner

T +1 212 878 8301
E anand.saha
@cliffordchance.com

Hugo Triaca
Partner

T +1 212 878 3222
E hugo.triaca
@cliffordchance.com

Kathleen Werner
Partner

T +1 212 878 8526
E kathleen.werner
@cliffordchance.com

Jon Zonis
Partner

T +1 212 878 3250
E jonathan.zonis
@cliffordchance.com

Patrick Jackson
Counsel

T +55 11 3019 6017
E partrick.jackson
@cliffordchance.com

Lane Feler
Associate

T +1 212 878 8256
E lane.feler
@cliffordchance.com

Rebecca Hoskins
Professional Support
Lawyer

T +1 212 878 3118
E rebecca.hoskins
@cliffordchance.com

Hank Michael
Strategic Advisory
Attorney

T +1 212 878 8225
E hank.michael
@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

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

© Clifford Chance 2020

Clifford Chance US LLP

Abu Dhabi • Amsterdam • Barcelona • Beijing • Brussels • Bucharest • Casablanca • Dubai • Düsseldorf • Frankfurt • Hong Kong • Istanbul • London • Luxembourg • Madrid • Milan • Moscow • Munich • Newcastle • New York • Paris • Perth • Prague • Rome • São Paulo • Seoul • Shanghai • Singapore • Sydney • Tokyo • Warsaw • Washington, D.C.

Clifford Chance has a co-operation agreement with Abuhimed Alsheikh Alhagbani Law Firm in Riyadh.

Clifford Chance has a best friends relationship with Redcliffe Partners in Ukraine.

Asia

Liu Fang
Partner

T +852 2825 8919
E fang.liu
@cliffordchance.com

Johannes Juette
Partner

T +65 6410 2293
E johannes.juette
@cliffordchance.com

Richard Lee
Partner

T +852 2825 8911
E richard.lee
@cliffordchance.com

Alex Lloyd
Foreign Legal
Consultant

T +852 2826 3447
E alex.lloyd
@cliffordchance.com

Jean Thio
Partner

T +65 6506 1956
E jean.thio
@cliffordchance.com

Europe

Alex Bafi
Partner

T +33 1 4405 5267
E alex.bafi
@cliffordchance.com

John Connolly
Partner

T +44 207006 2096
E john.connolly
@cliffordchance.com

Michael Dakin
Partner

T +44 207006 2856
E michael.dakin
@cliffordchance.com

George Hacket
Partner

T +49 69 7199 3103
E george.hacket
@cliffordchance.com

Andrew Kelly
Partner

T +44 20 7006 8552
E andrew.kelly
@cliffordchance.com

Arthur Levi
Counsel

T +44 20 7006 5717
E arthur.levi
@cliffordchance.com

Olivier Plessis
Counsel

T +33 1 4405 5487
E olivier.plessis
@cliffordchance.com

Laura Scaglioni
Counsel

T +39 02 8063 4254
E laura.scaglioni
@cliffordchance.com

Patrick Meson
Senior Associate

T +44 207006 2739
E patrick.meson
@cliffordchance.com