CORONAVIRUS: KEY US AND EEA 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 outstanding bonds such that many of those instruments are now trading below par, some significantly so. Debt buybacks and other liability management options are on the minds of a number of 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 individualised 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 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.

1. Open Market Purchases: An issuer seeking to repurchase a limited portion of its outstanding bonds may do so by soliciting or accepting offers directly 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 small portion of a bond issue in a speedy and low-cost manner. Therefore, buyers seeking to quickly buy a limited amount of bonds may favor private bond buybacks over other alternatives.

2. Tender Offers: An issuer with bonds may alternatively consider making a public offer for all or a substantial 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 recognising 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. 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 uncommon. 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 them at a later date.

- ***Market Abuse Considerations***: Issuers with securities admitted to trading on regulated markets, multilateral trading facilities or organised trading facilities in the EEA may be subject to the Market Abuse Regulation (Regulation (EU) 596/2014). For issuers seeking to buy back their publicly-listed bonds, special attention must be given to whether they are in possession of non-public, price-sensitive information (termed “inside information”). This may be particularly difficult in the context of the current pandemic, as many institutions are yet to have clarity on the longer term effects that restrictive political and economic measures may have on business and operating performance. Issuers seeking to take advantage of pricing dislocations should be careful to be sure that these have not been caused by any lack of clear disclosure to the investor community.

- ***Prohibited Periods***: The rules of the stock exchange or listing authority where bonds (or the Issuer's shares) are admitted to trading 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 some 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. Although the formal concept of closed periods has been abolished by the EU Market Abuse Regulation, European issuers should nevertheless be careful of conducting buybacks too close to periodic financial results, where there is a risk that senior management is in possession of material information that is not yet known to the market.

- ***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 mitigate such a liability. An issuer contemplating a buyback of its bonds would be well-advised to take appropriate tax advice at an early stage.

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