Liability Management During COVID-19: Considerations for Latin American Issuers

COMMENTARY

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IN SHORT

The Situation: Effects from the COVID-19 global pandemic continue to impact adversely the operations and financial results of Latin American issuers.

The Opportunity: In the current environment, Latin American issuers with dollar denominated bonds should consider liability management techniques to restructure or refinance their bonds.

Looking Ahead: Evaluating liability management options requires an issuer-specific analysis. Ultimately, the issuer's underlying financial needs and challenges will determine which type of liability management transaction a company should undertake.

The COVID-19 pandemic continues to impact adversely the global economy and almost every industry. In the current environment, undertaking a liability management exercise to refinance or restructure a Latin American issuer's outstanding debt securities may offer an opportunity to restructure an issuer's balance sheet, improve its financial health, and avoid an insolvency proceeding.

Liability Management Alternatives

Bond Buyback and Cash Tender Offer

A Latin American company considering a bond buyback or cash tender offer should first undertake a realistic analysis of its forecast liquidity and ability to continue operating its business. If cash is available, bond repurchases, from the open market or through privately negotiated purchases, provide a quick and cost-effective liability management alternative. For more information on bond repurchases, please see a previous Jones Day *Commentary*.

If, however, a Latin American issuer wishes to conduct a more organized bond repurchase program, it may consider a cash tender offer. Unlike limited bond repurchases, a tender offer provides an opportunity to retire an entire series of bonds. However, a cash tender offer is more time consuming and requires more cash. Tender offers may also be prohibited under an issuer's other debt instruments, while bond repurchases generally are not.

Consent Solicitation

For an issuer lacking the necessary liquidity to retire debt through bond repurchases or a cash tender offer, a consent solicitation provides an alternative liability management option. A consent solicitation can be used to amend certain terms and conditions of the indenture or other instrument governing an issuer's outstanding bonds. Other than "money" terms (interest, principal, and maturity dates), which generally require 90% or 100% approval of the outstanding principal amount of the debt securities, most indentures permit amendments to other terms (including covenants) with a simple majority or approval by 66⅔% of the outstanding principal amount of the bonds.

A consent solicitation undertaken on a stand-alone basis typically includes a consent fee to incentivize participation. While a stand-alone consent solicitation may not be sufficient on its own to draw the desired bondholder participation, a consent solicitation can be combined with a tender or exchange offer in what is generally referred to as an "exit" consent.

> Before embarking on any of the liability management techniques, a Latin American issuer should carefully review its liquidity position and the terms of its other outstanding debt.

Exchange Offer
An exchange offer may be the best liability management option for a company experiencing distress as a result of the current COVID-19 pandemic. Because an exchange offer is a cashless alternative to a tender offer, it can be more attractive to issuers facing a liquidity crunch. In an exchange offer, a company replaces its outstanding bonds with new bonds or equity or a combination of both (generally with terms more favorable to the issuer) by making an offer to the relevant bondholders of the outstanding debt securities it wants to replace. Exchange offers generally require a minimum acceptance level. Making the new securities more attractive than the old ones is key to the success of an exchange offer.

An exchange offer is typically combined with an "exit" consent solicitation. In an "exit" consent, holders of the old bonds are asked to consent to amendments, waivers, or removals of protective covenants and other terms as a condition of participation in the offer. This process is generally known as "covenant stripping." The holdouts that do not accept the offer will continue to be paid interest and principal under the original terms of the old bonds but they will not have the benefit of the stripped-out protective covenants.

U.S. Securities Law Considerations

Tender Offer Rules
A tender or exchange offer that is made to U.S. bondholders is subject to U.S. tender offer rules. These rules set out procedural requirements that must be satisfied in conducting a cash tender or exchange offer, including keeping the offer open for up to 20 days and extending the offer period if material changes are made to the offer's terms. Some Latin American issuers may choose to exclude U.S. bondholders to avoid these requirements, but this may not be an option if U.S. bondholders hold a significant proportion of the outstanding bonds. Determining the percentage of outstanding bonds held by U.S. bondholders can be difficult if the bonds are held through clearing systems.

The U.S. tender offer rules also include a general antifraud provision prohibiting the making of any untrue statement or any omission of a material fact in connection with the offer. There are no U.S. rules that specifically regulate the content required in materials used for a debt tender.

Exemptions from Registration
Exchange offers are subject to the registration requirements of the U.S. Securities Act of 1933 ("Securities Act") because new securities are offered and issued. Accordingly, it is customary to prepare an offering document and for dealer/managers to conduct due diligence and seek customary legal opinions, disclosure statements, and comfort letters.

The two exemptions most commonly used by Latin American issuers with U.S. bondholders are the "private placement exemption" provided by Section 4(a)(2) of the Securities Act or the "single-issuer exchange offer exemption" provided by Section 3(a)(9). Any new securities issued in a private placement or single-issuer exchange offer may be subject to resale and transfer restrictions.

An exchange offer relying on a private placement exemption is typically structured so U.S. offers and sales are made only to accredited investors. Accordingly, non-accredited investors do not participate in the consent solicitation and are excluded from the offer. They are cashed out instead.

The single-issuer exemption is available only when the initial issuer and the issuer of the new securities are the same and the offer is made to existing bondholders only. Also, the issuer cannot pay a dealer/manager to solicit tenders. The U.S. Securities and Exchange Commission, however, has issued several no-action letters permitting third-parties to perform certain advisory services with respect to the terms and mechanics of the exchange offer, so long as they are not paid a success fee.

Other Considerations

Before embarking on any of the liability management techniques described above, a Latin American issuer should carefully review its liquidity position and the terms of its other outstanding debt. An issuer should also consult its tax and accounting advisors to confirm the tax and accounting treatment of the proposed transaction, as well as its financial advisors to assess market conditions.

An issuer must take into account the applicable securities laws in the jurisdictions where the bondholders are located and comply with any relevant stock exchange or listing authority rules. A Latin American issuer with U.S. bondholders must also consider from the start the applicability of the U.S. tender offer rules and the registration requirements of the Securities Act.

TWO KEY TAKEAWAYS

1. Latin American issuers need to evaluate carefully and implement with their legal and financial advisors the proper liability management tool to restructure successfully their balance sheets, improve their financial health, and avoid an insolvency proceeding.
2. Companies experiencing distress during the current COVID-19 pandemic that act early through a consent solicitation or exchange offer may secure better deals with their bondholders than those who wait until a default is imminent.

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