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Client Alert

Latham & Watkins
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Navigating Bond Repurchases in Europe and the United Kingdom

The new year has not seen much improvement in the state of the debt markets, especially in Europe, but issuers of bonds may take advantage of one aspect of this gloomy market. Many high yield bonds are trading at substantial discounts to par, providing an opportunity for issuers to repurchase their bonds in the open market or in privately negotiated transactions at favourable prices. Such an opportunity allows issuers to de-leverage and reduce future refinancing risk. Before embarking on either a formal bond repurchase program, or purchasing bonds on the open market or in privately negotiated transactions, issuers should be aware of a variety of legal issues and potential pitfalls that need to be considered in advance. Particular attention must be paid to legal and regulatory issues which can vary from jurisdiction to jurisdiction.

In the discussion that follows, we will first address issues that should be considered in every bond repurchase transaction. We then separately discuss some of the jurisdictional issues raised by the United Kingdom, Germany, France, Italy, Ireland and Luxembourg.

Our goal is to provide some general answers that may be useful in planning bond repurchases. However, you should consult counsel about the facts specific to your circumstances before commencing, and during the course of, any bond repurchases.

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Are there any contractual restrictions that apply?

First and foremost, the governing instrument of the bonds in question must allow for the repurchase of the bonds. It would be unlikely for a typical indenture or trust deed to prohibit repurchases of bonds issued under that instrument. However other financial agreements may limit an issuer's ability to repurchase the bonds.

Senior credit facilities and other agreements governing the relationship between an issuer's creditors must be carefully examined for potential restrictions on an issuer's ability to repurchase its bonds. In many instances, the credit agreement may well prohibit repurchasing other debt, even *pari passu*, unsecured debt, absent pre-negotiated baskets usable for this purpose. Moreover, repurchases of subordinated debt are likely to constitute "Restricted Payments" under bond indentures governing senior debt securities. In that case, a waiver or consent must be obtained to allow for the repurchase, but this process would be potentially time consuming and costly.

In addition, if an issuer is looking to borrow funds for the bond repurchase, it must consider whether the borrowing covenants under its indentures and credit facilities prohibit that borrowing. There may also be restrictions on the use of the issuer's cash under other contractual documentation.

Will public disclosure of the purchases be required?

An issuer must consider whether, at the time of any debt repurchase, it possesses "material non-public information" under US securities laws, the EU Market Abuse Directive, the regulatory protections of other relevant jurisdictions and the rules of the relevant securities exchange on which the bonds are listed, if any. Certain specific regulatory requirements are detailed under the Jurisdictional Snapshots that follow, and issuers should consult US securities counsel for advice with respect to US securities laws, in particular Rule 10b-5 under the Securities Exchange Act of 1934.

Under the EU Market Abuse Directive, dealings based on inside information are prohibited. "Inside information" is generally non-public information of a "precise nature" relating directly or indirectly to a company or its securities that would, if public, be likely to have a "significant effect" on the price of the securities. An issuer contemplating a bond repurchase program or open market purchases will need to consider, prior to implementing such a program or making any repurchases, if it is in possession of "inside information." It is therefore important for an issuer to consider unreleased earnings and financial results, any unannounced merger or asset sale, the impact of the bond repurchase on the financial condition of the issuer, and the impact of the bond repurchase on the trading market for those securities. Making these judgments often requires determinations of materiality, so issuers should work with counsel to make appropriate judgments regarding undisclosed facts and upcoming events[1].

In addition, in every bond repurchase program or determination to make significant open market purchases, the question arises whether the fact that the issuer is preparing to do so is itself material, non-public information that should be disclosed in advance of the program or purchases. If the total "float" of a particular series of bonds will not be materially reduced through issuer repurchases or retirements, we believe that an announcement prior to such purchases will rarely be required unless the impact of the repurchases on the issuer's financial condition or results will be material to bondholders and is being selectively disclosed in the process of making repurchases[2]. In some cases, however, the impact of any planned repurchases or program on the float or the trading market for the subject bonds may be independently material and in those cases a prior announcement may be advisable.

Once open market purchases have been made, issuers should consider how and when the existence of such repurchases should be disclosed. Under the EU Market Abuse Directive, issuers should consider whether at the time of the repurchase and after each repurchase, if the information regarding the repurchase was made public, it would have a significant effect on the price of the bonds. If an issuer fails to make an announcement when required, it could be restricted in its ability to make future repurchases.

It is important to point out that the safe harbour available under the EU Market Abuse Directive for the repurchase of shares under a program within certain parameters does not apply to debt repurchases. Those parameters (for example, the announcement of repurchases and the price and limits on repurchase amounts) are good guidelines, however, for structuring the process for bond repurchases.

For information about specific requirements in certain jurisdictions, see the Jurisdictional Snapshots that follow.

How can an issuer plan ahead for disclosure?

We often advise clients to plan ahead for these events by including a statement of intention in a regular periodic report. For example, in the Liquidity and Capital Resources section of the OFR or MD&A included in a periodic report, issuers can include the following statement (tailored, of course, to line up with the issuer's actual situation):

"We may from time to time seek to retire or purchase our outstanding debt through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. The amounts involved may be material."

Even with such disclosure in a periodic report, if that report is not widely disseminated, it may not meet the jurisdictional standards for public disclosure.

Will these purchases trigger application of applicable tender offer rules?

A significant percentage of bond issuances over the last five years, particularly high yield bonds, have been marketed in the United States pursuant to the re-sale exemption found in Rule 144A under the Securities Act of 1933, so significant amounts of some issuances may be held through US accounts. As a result, and in light of the fact that many jurisdictions have tender offer rules that are or may be applicable to debt securities, issuers planning bond repurchases should take care to design that program such that it does not constitute a tender offer, either in the United States or elsewhere. It is beyond the scope of this Client Alert to examine the pitfalls in each significant jurisdiction, but we are of the view that adhering to guidance designed to avoid a tender offer as developed by United States case law provides a good framework for a bond repurchase program.

A debt tender offer in the United States is a publicly made offer to bondholders to tender their bonds for sale at a specified price subject to specified conditions over a fixed period of time. However, the technical definition of "tender offer" has been generally defined by case law in the United States. The first set of principles was developed in *Wellman v. Dickinson*[3], where the court discussed eight factors that are characteristic of a tender offer:

- Were the offers to purchase or the solicitation of offers to sell disseminated in a widespread manner?
- Did the price offered represent a premium in excess of the current market price of the securities being sought?
- Did the offers fail to provide for a meaningful opportunity to negotiate the price and terms?
- Did the solicitation involve a substantial percentage of the securities?
- Was the offer contingent on a minimum principal amount of bonds being tendered (and/or a maximum principal amount of bonds being purchased)?
- Was the offer open for only a limited period of time?
- Were the recipients of the offer under pressure to respond to the offer?
- Were public announcements of the acquisition program followed by a rapid accumulation of large amounts of the company's bonds?[4]

This factors-based test was distinguished in *Hanson Trust PLC v. SMC Corporation*[5], in which the court held that five privately negotiated purchases and one open-market purchase of a corporation's common stock totalling 25 percent of the outstanding common stock of such corporation did not constitute a tender offer[6]. The court reasoned that:

- The purchaser was in contact with only six of 22,800 stockholders.

- The selling stockholders were all highly sophisticated.
- There was no pressure to sell by conduct that the tender offer rules were designed to prevent.
- There was no active or widespread advance publicity or public solicitation.
- No significant premium was paid (the price paid was less than 1.5 percent over the market price).
- No minimum number of shares or percentage of common stock was required for the purchases.
- There was no time limit during which the purchaser made the subject purchases.

The aforementioned court decisions were made based on the purchases of equity securities. To our knowledge, no US court has ever directly addressed the question of what constitutes a tender offer in the context of debt securities. Given the nature of debt securities and the sophisticated nature of most bondholders, we believe that more flexibility should be granted to issuers seeking to repurchase their debt securities than for equity securities, where the purpose or result of the latter type of offer may be to change the control of the issuer.

Based on the principles enunciated in Wellman and Hanson, we believe that purchases of bonds solely through ordinary open market transactions and over an extended period of time do not implicate the tender offer rules[7]. However, in other circumstances, including where repurchases will include active solicitations or negotiations to purchase bonds, we recommend that companies and their affiliates consider the following factors in designing and implementing their bond repurchases:

- *Timing*. The repurchases should be made over a meaningful period of time. The longer the period, the better. There should be no set time-period or deadline.
- *Number of Solicited Sellers*. Solicitations should be made to a limited number of potential sellers. The fewer number of holders contacted, the greater the probability that the offers to purchase will not be considered a tender offer.
- *Variable Prices and Terms.* Negotiated purchases from multiple sellers should be at different prices and on different terms. The greater the variation in price and terms, the greater the probability that the offers will not be considered a tender offer.
- *Nature of Sellers.* Privately negotiated purchases of securities from sophisticated institutional investors generally should not be deemed to constitute a tender offer, even if a significant percentage of the outstanding bonds is acquired.
- *Character of Offer to Purchase.* The purchaser should refrain from applying pressure to potential sellers to sell their bonds, such as "take it or leave it" offers, offers conditioned on other purchases or offers open for very short periods before being rescinded.

For a more thorough consideration of particular facts and circumstances, please discuss with counsel.

Can an issuer vote the bonds it repurchases?

Issuers should not pursue bond repurchases with the purpose of gaining voting control over bonds in anticipation of an upcoming consent solicitation. Virtually all indentures and trust deeds provide that bonds held by the issuer or its affiliates will be treated as not outstanding for purposes of determining whether requisite consents have been obtained. As a result, bonds held by an issuer after being repurchased on the open market will not typically affect the outcome of a consent solicitation to the issuer's advantage. In fact, by reducing the number of bonds deemed outstanding for purposes of a consent, a bond repurchase could have the undesired side-effect of concentrating ownership in the hands of fewer bondholders, providing them with extra leverage in a consent solicitation or restructuring.

Jurisdictional Snapshots

United Kingdom

Repurchase of Straight Bonds. For any straight bonds listed on the London Stock Exchange, Rule 6.1.3. of the Disclosure and Transparency Rules obliges issuers to give all holders of their debt securities ranking *pari passu* equal treatment in respect of the rights attaching to those debt securities.

In the context of a straight bond repurchase there are two primary ways of complying with this rule. If the issuer repurchases in the open market all bondholders are understood to have the same opportunity to sell into that market. Alternatively, the issuer can conduct a tender offer that is open to all bondholders. It is important to note that certain strategies described under "Will These Purchases Trigger a Tender Offer?" above that are used to avoid a tender offer under the US rules are, under most circumstances, at odds with the UK requirement to treat all bondholders equally. The current interpretation of the UK equal treatment rule would prohibit incentivizing only some of the bondholders to tender their bonds. However, the issuer is permitted to offer an early, more beneficial tender price as part of its tender offer, provided that it is made available to all bondholders wishing to tender their bonds by the early tender deadline.

Because UK tender offer rules conflict to a degree with US tender offer rules, issuers may opt to exclude US holders from participating in a tender offer conducted in accordance with UK tender offer rules. Conflicting rules in other jurisdictions may result in the exclusion of holders from those jurisdictions as well.

Taxation. A UK company acquiring its own debt, or a company acquiring the debt of a connected UK company, at a discount will generally give rise to taxable income for the UK debtor equal to the difference between the par value of the debt and the acquisition price. While it was previously possible to avoid a tax charge by using a newly-incorporated affiliate company to repurchase the debt, this exemption in the Corporation Tax Act 2009 has since been limited by provisions contained in the Finance Act 2010 such that an exemption to the general rule for straight repurchases now exists only where: (i) the repurchase is made on arm's length terms; (ii) there has been a change of ownership (as defined in section 719 of the Corporation Tax Act 2010) of the issuer in the 12 months before, or 60 days after, the repurchase; (iii) it is reasonable to assume that, but for the change in ownership, the issuer would be subject to insolvency arrangements within the 12 months following such change in ownership; and (iv) it is reasonable to assume that, but for the change in ownership, the repurchase would not have been made. As a result, the exception is intended to only apply to repurchases that are undertaken as part of genuine corporate rescues. Moreover, even if these conditions are met, any future cancellation of the debt by the new holder will result in the issuer being taxed on the previously untaxed discount.

France

A very large proportion of high yield bonds issued by French issuers in recent years are governed by New York law and were sold mostly outside of France. As such, and in accordance with Article L. 228-90 of the French Commercial Code, the French rules applicable to straight bonds (*obligations*) have a limited impact on high yield bonds issued by French issuers. In particular, the French Commercial Code provisions relating to the *masse des obligataires* and its representative are not applicable to most high yield bonds issued by French issuers. In addition, most high yield bonds issued by French issuers are listed on an unregulated market outside of France (generally in Luxembourg or Ireland), so French listing rules do not apply. As a consequence, French rules generally do not have a material impact on repurchase transactions of most high yields bonds issued by French issuers.

For straight bonds listed on a regulated market or an organized multilateral trading facility in France, a certain number of disclosure rules would be applicable in case of a repurchase of bonds. In particular, if the issuer acquires more than 10 percent of the bonds on or off market in one or more transactions, it must publicly disclose the fact that such purchases have been made within four trading days. While the notification thresholds continue to apply, in 2010 the French market authority (the *Autorité des marchés financiers* or AMF) suppressed all public offer obligations with respect to straight listed bonds (only applicable today to convertible bonds). An orderly acquisition procedure is available to issuers on a voluntary basis only, which would consist of the implementation of a centralized facility or procedures (such as those that would typically be used in connection with a tender offer), enabling the issuer to offer all holders the opportunity to sell or exchange some or all of the bonds and ensuring equal treatment of all holders.

Germany

Equal Treatment of Bondholders. For any bonds of an issuer for which the home member state is Germany, the German Securities Trading Act (implementing the EU Transparency Directive) provides for an obligation on the issuer to treat all holders of a class of securities equally. This applies to debt as well as equity securities and irrespective of the law governing the securities. In the context of a bond repurchase there are two main ways to comply with this rule. If the issuer purchases in the open market all bondholders are understood to have the same opportunity to sell into that market. Alternatively, the issuer can conduct the repurchase offer that is open to all bondholders. It is important to note that certain strategies described above used to avoid a tender offer under the US rules may be at odds with the German requirement to treat all bondholders equally. In a similar vein the current understanding and interpretation of the German equal treatment rule would prohibit incentivizing certain, but not all, bondholders to tender into the offer by adding additional consideration. An exception where such "sweetening the deal" would be permissible is an incentive for an early tender as long as it is open to all bondholders. For bonds governed by German law, it is not possible for a majority of bondholders to accept a repurchase offer of an issuer with binding effect on all bondholders.

Because German tender offer rules conflict to a degree with US tender offer rules, issuers may opt to exclude US holders from participating in a tender offer conducted in accordance with German tender offer rules. Conflicting rules in other jurisdictions may result in the exclusion of holders from those jurisdictions as well.

Public Disclosure Requirements. Unlike in the context of equity securities there is little regulation or case law about publicity required in the context of repurchases of bonds in the open market. Germany has implemented the EU Market Abuse Directive and as outlined above, while the safe harbours provided thereunder are not directly applicable to debt securities, their prerequisites can provide guidance for issuers about the types of information the market may expect and the timing of their disclosure, although a more restrictive approach can be warranted in the specific situation. You should consult with counsel on how to address these issues in the context of a specific transaction.

Tax Consequences. If the issuer repurchases bonds at less than their nominal value, German tax law assumes a profit of the issuer in the amount of the difference between the book value and the amount paid (including transaction cost). The repurchase of the debt through an affiliated German or foreign entity may avoid this tax burden. However, if such affiliate is a German one, it may generate a taxable profit when the debt is subsequently paid back in total. This may differ in other jurisdictions. A subsequent waiver by the acquiring affiliate on the other hand, may result in a tax burden at the level of the issuer. When determining the cash

available for a repurchase, the potential tax liability that might be triggered by such profits (depending, of course, on the overall earnings of the issuer) needs to be taken into account.

Italy

Background on Italian rules on cash tender offers. In Italy, unlike other EU Member States, cash tender offers for debt securities are governed by specific rules different from those applicable to public offers according to the Prospectus Directive (Directive EC/2003/71).

As a result, Italian tender offer rules apply, whether or not the securities are listed in Italy, to cash tender offers extended into Italy to more than 99 Italian holders residing or domiciled in Italy where the total aggregate value of the offering is more than €2.5 million in a 12-month period. With these two conditions, the launch of cash tender offers must be disclosed to the Italian Financial Regulator (CONSOB) and the public, and the offering is subject to CONSOB approval of an offering document.

New tender offer rules for debt securities. To fill the competitive market and regulatory gap with other European Countries and ensure equal treatment of bondholders, on April 5, 2011, CONSOB approved several amendments to the rules on cash tender offers in Italy. The new regime has made it more appealing for an issuer to repurchase its bonds as it is now more difficult to trigger the Italian tender offer rules by making selective debt repurchases or even where an offer to purchase is extended more generally to existing bondholders. Under the new rules and CONSOB interpretation, cash tender offers involving debt securities (i) which are addressed exclusively to qualified investors or (ii) having a minimum denomination of at least €50,000 (to be calculated by adding the nominal value of each security sold by each investor in any offer) launched by the issuer of such securities or an affiliate are, in each case, exempt from the Italian tender offer rules. In addition, consent solicitations and amendment and waiver requests are no longer subject to the Italian tender offer rules.

For additional information on the April 5, 2011 amendments, please see our *Client Alert* No. 1230 dated 6 September 2011 entitled "Recent Changes to CONSOB Rules on Cash Tender Offers and Exchange Offers for Debt Securities Extended into Italy."

Ireland

Rules that were once in place for bonds listed on the Irish Stock Exchange (the ISE) requiring a notification to the Company Announcements Office for repurchases reaching certain thresholds have been revoked with respect to straight debt securities. Instead, the ISE now incorporates the disclosure requirements of the EU Market Abuse Directive and the equal treatment provisions of the EU Transparency Directive. As a result, the considerations discussed above regarding the impact of any repurchases on the price of the bonds, the materiality of the fact that bond repurchases will be made and whether open market purchases provide for equal treatment of bondholders will apply to all bonds listed on the ISE. Latham & Watkins does not practice Irish law. We advise issuers to consult with Irish counsel and the exchange to confirm that repurchases are implemented in a manner which does not violate the applicable rules.

Luxembourg

As is the case with the ISE, there are no longer specific rules for the repurchase of bonds listed on the Luxembourg Stock Exchange (LuxSE). Rule 904 of the Rules and Regulations of the LuxSE provides that issuers must communicate as early as possible to the LuxSE any information which, on the date of its publication, is likely to influence the price of the listed bonds, which reflects the implementation of the EU Market Abuse Directive. Rule 902 of the Rules and Regulations requires the issuer to ensure equal treatment of all holders of bonds issued within the same issue, reflecting the implementation of the EU Transparency Directive.

As a result, the considerations discussed above regarding the impact of any repurchases on the price of the bonds, the materiality of the fact that bond repurchases will be made and whether open market purchases provide for equal treatment of bondholders will apply to all bonds listed on the LuxSE. Latham & Watkins does not practice Luxembourg law. We advise issuers to consult with Luxembourg counsel and the Exchange to confirm that repurchases are implemented in a manner which does not violate the applicable rules.

Endnotes

[1] A special sub-class of the pre-commencement disclosure issues may arise depending on what the issuer's plans may be with respect to the balance of the bonds that remain outstanding. This Client Alert assumes that the opportunistic acquisition of bonds at favourable prices is the only objective being pursued. However, some companies may consider implementing an open market bond repurchase program as a first stage in an integrated plan to retire the entire issue — for example, by launching a tender offer (presumably at a higher price) for the bonds not purchased on the open market or in privately negotiated transactions. Similarly, a company may contemplate repurchasing bonds more cheaply immediately prior to exercising optional redemption rights at a fixed but higher price. In either case, disclosure questions about the issuer's plans will need to be addressed.

[2] The percentage reduction in the float of any given bond issue that is material will need to be considered in light of all prevailing facts and circumstances. An issuer who purchases bonds "at the market" in small amounts over time may never be telegraphing its intention to substantially reduce the overall float to any individual seller. In general, a bondholder who sells in a repurchase program will not be concerned about the size of the float after the sale and will therefore not have a claim that it would not have sold at the agreed price had it known of the pending float reduction.

[3] Wellman v. Dickinson, 475 F. Supp. 783, 823-824 (S.D.N.Y. 1979).

[4] This last factor was first enunciated in S-G Securities, Inc. v. Fugua Inv. Co., 466 F. Supp. 1114 (D. Mass. 1978).

[5] Hanson Trust PLC v. SMC Corporation, 774 F. 2d 47 (2d Cir. NY 1985).

[6] All of the subject purchases were made on the same day that the purchaser terminated a conventional tender offer. The court held that the subject purchases did not constitute part of the conventional tender offer because the purchaser: (i) clearly terminated the conventional tender offer; (ii) did not decide to engage in private purchases before terminating the conventional tender offer; and (iii) reserved the right to purchase securities after the termination of the conventional tender offer in the original offer to purchase it filed with the Securities and Exchange Commission.

[7] A hiatus should be taken between bond repurchases on the open market and the launch of a conventional tender offer to avoid integrating the open market repurchases and the subsequent tender offer as well as to avoid potential claims that the open-market repurchases were part of a "creeping" tender offer.

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