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# Dentons DCM Quick Guide to Cash Tender Offers

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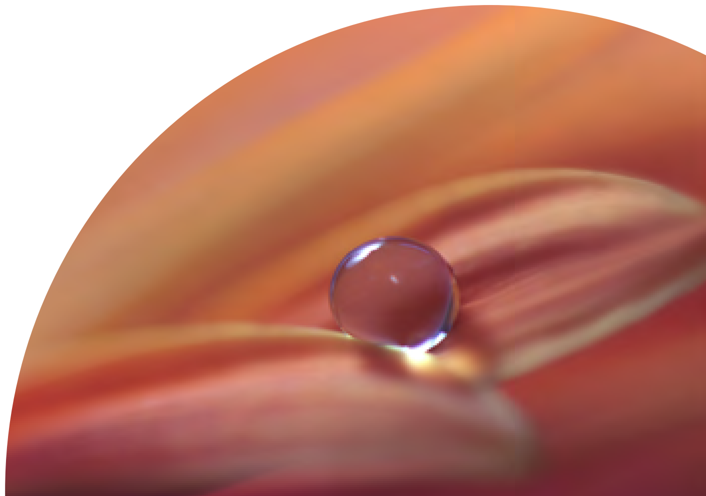
This note is a quick guide to cash tender offers for an issuer wishing to repurchase its bonds by means of a cash tender offer for debt securities (a **Tender Offer**). A Tender Offer is actually an "invitation to treat" under English law, by which an issuer (or someone acting on the issuer's behalf), indicates that if the issuer's bondholders are prepared to offer certain bonds for repurchase, the issuer is willing to consider accepting that offer on the terms set out in a tender offer memorandum. Therefore, pursuant to English contract law, it is the bondholders' submission of their bonds and tender instructions pursuant to the terms of the tender offer memorandum that forms the "offer" under contract law, which is then "accepted" by the issuer, creating a binding contract.

For an outline of other liability management alternatives that may be available, please see our Quick Guide to Liability Management Alternatives.



### Why carry out a Tender Offer?

There could be a number of reasons why an issuer would wish to carry out a Tender Offer, including to:

- use up excess liquidity or to demonstrate to the market that the issuer is confident that it has sufficient access to liquidity;
- take advantage of secondary market bond prices below par and generate a profit in doing so;[1]
- manage interest costs or (in the case of a bank) net interest margin;
- manage FX risk and reporting volatility by reducing exposure to bond liabilities in currencies other than the issuer's reporting/functional currency;
- (when compared to open market repurchases) retire significant proportions of an issuer's outstanding bonds in a short time frame and so manage deleveraging effectively;
- facilitate investment by existing investors in a new bond issue (which will provide a new issue premium) by releasing cash back to the existing investors and reducing their aggregate credit exposure to the issuer;
- manage future execution risk on a new issue by refinancing early rather than within the last year up to maturity of the bonds;
- repay before long-dated bonds become current liabilities on the balance sheet;
- lower the issuer's outstanding exposure to an existing bond issue where there is a pending problem or risk relating to that bond issue and where a consent solicitation would be impractical;
- strengthen or support its long-term debt ratings position as a result of one or more of the above factors; or
- provide holders with an opportunity to sell their bonds back to the issuer where macro-economic or issuer-specific events have changed the economic value of holdings in the bonds.

### Does an issuer have the money?

A Tender Offer will use some of an issuer's available liquidity, and so an issuer must have available cash (or the means to raise new cash – for example, by way of a simultaneous new bond issue (a "new financing condition"), although this may not be commercially attractive in an increasing interest rate environment). Limits can be placed on the maximum amount the issuer will spend on the Tender Offer (a "maximum acceptance cap") if the issuer is not planning to retire as much as possible of an outstanding series of bonds. Features such as a maximum acceptance cap and a new financing condition that the Tender Offer is conditional upon a simultaneous bond issue raising a certain minimum amount, can ensure that an issuer has the available cash to fund the Tender Offer, even if investors tender more bonds than originally anticipated.

It should also be remembered that an issuer retains the flexibility, at its sole and absolute discretion, to amend or even pull the Tender Offer entirely if the issuer's circumstances change during the period that the Tender Offer is open and the issuer decides that it is no longer willing or able to proceed with the Tender Offer and the repurchase of the bonds. There are investor relations and reputational considerations to be borne in mind if an issuer exercises this discretion, but investors are accustomed to seeing conditional offers (for example, with a new financing condition).

If preservation of cash is an issuer's priority, a Tender Offer may not be the best option, and other liability management techniques such as an Exchange Offer could be considered. For more information on Exchange Offers, please see our Quick Guide to Liability Management Alternatives.

1. In particular, if an issuer has losses in the relevant year, it would be able to offset the profits from a Tender Offer and cancellation of bonds below par against those losses to avoid tax charges arising from the profit on the Tender Offer and cancellation. An issuer should consider with their accounting teams the range of accounting impacts on its balance sheet and profit and loss statement which may arise from a Tender Offer.

**What proportion of outstanding bonds does the issuer want to acquire and are the outstanding bonds widely held?**

- How widely held is the series of bonds being targeted for purchase?
  - Widely held – Tender Offer will likely be more effective than other liability management alternatives; or
  - Narrowly held – consider privately negotiated purchases (i.e. open market repurchase/bilateral bond buyback).
- Tender Offers are more appropriate for purchases of a significant proportion of outstanding bonds (smaller, discrete bond purchases may be able to be achieved through open market repurchases).
- If multiple series are being targeted, Tender Offers are likely to be more appropriate and would allow targeting multiple series on an "any and all" or "prioritised waterfall" basis. This would create efficiencies by targeting multiple series for purchase within one process and pursuant to one document (i.e. one Tender Offer memorandum). A maximum acceptance cap is often used in such a situation to control the overall quantum of the Tender Offer and to create some competitive tension between investors in different series.

**When can an issuer launch a Tender Offer and how long does the issuer have to hold it open for?**

- A Tender Offer cannot be launched when the issuer is in possession of "inside information" for the purposes of the UK or EU Market Abuse Regulations (as applicable) or material non-public information in a US context.
- Holders often wait until near to the end of the offer period before tendering in order to reduce their market risk. The length of time for which the Tender Offer is held open is significant.
- The length of time for which a Tender Offer is held open also needs to take into account that instructions to holders will need time to filter through the Clearing System participants and custodian chain to the beneficial owners (and the beneficial owners' instructions will have to make their way back up the chain). If the bonds are held by sophisticated institutional investors who can respond promptly, then this is unlikely to be an issue. However, if the bonds are more diversely held or held by retail, the speed of response to the Tender Offer via the Clearing System participants and custodians does need to be considered.
- *If the Tender Offer is not targeting US persons*: while there is no minimum offer period in the UK, Tender Offers are usually held open for at least five business days. Tender Offers targeting low denomination and/or certificated securities may need to be held open for longer to accommodate the time needed for retail investors to tender.
- *If the Tender Offer is targeting US persons*:[2]
  - Full tender process requires the Tender Offer to be open for 20 business days from the date the offer is first sent to holders and, in addition, if there is a change in consideration or the percentage of securities being sought (subject to a 2% *de minimis* exception), the Tender Offer must remain open for at least 10 business days following the change (Rule 14e-1 of the Securities Exchange Act of 1934), or open for at least five business days following any other material change.
  - It is possible to undertake an abbreviated tender process in certain situations. This requires the Tender Offer to be open for five business days and to remain open for five business days following a change in consideration or three business days following any other change. An abbreviated US Tender Offer must, among other requirements (see the SEC's 2015 no action letter):

2. This article is primarily discussing Tender Offers for non-convertible bonds and non-AT1 bonds (that may be converted into equity upon a future trigger event). Additional complexities arise in the context of Tender Offers for such convertible or potentially convertible bonds, especially if US holders are involved.

- be an "any and all" offer;
- be made by the issuer or parent/subsidiary of the issuer only (no third party tenders);
- be open to all holders;
- be solely for cash or "qualified debt securities"[3] (securities that are materially identical to the securities which are the subject of the Tender Offer save for maturity date, interest payment and record dates, redemption provisions and interest, with interest payable in cash only);
- be for a fixed or benchmark-spread-based consideration;
- permit holders to withdraw prior to the earlier of the expiration date or the 10th business day after launch;
- not be financed with new debt that is senior to the bonds being tendered;
- not be combined with an exit consent or consent solicitation to amend terms of the bond being tendered; and
- not be used if:
  - the bonds being tendered are currently subject to an event of default, a change of control or other extraordinary transaction such as a merger;
  - there is a competing tender offer; or
  - the issuer is subject to a material acquisition or disposal.

**What are the usual pricing alternatives for a Tender Offer?**

Various alternatives exist as to how a Tender Offer is priced, including:

- *Fixed price:*
  - The price is fixed at the outset of the Tender Offer.
  - Best for price certainty and simplicity if the bond has a non-volatile price and the issuer is not concerned about market movements during the offer period impacting the success of the Tender Offer.
  - This may be more appropriate for a bond near maturity which may price close to par and be less volatile in response to market conditions.
- *Fixed spread:*
  - The issuer selects a discount rate being a specific spread above either: (a) the yield to maturity on a benchmark treasury security (for example, a US Treasury, UK Gilt or German Bund, depending on the currency of the bonds) with a remaining tenor as close as possible to the maturity or next call date of the bonds to be tendered; or (b) an interpolated mid-swap rate.
  - The price paid for the bonds will reflect a net present value calculation of the future scheduled bond payments using the selected discount rate.
  - In a European Tender Offer, the purchase price is then typically determined following the end of the offer period based on the resulting yield. In a US Tender Offer that is not conducted on an abbreviated basis, an "early bird" premium (see below) may also be a feature.
  - Unless the bond is towards the end of its life, market movements reflected in movements in the benchmark security or mid-swap rate (as applicable) may materially impact the pricing of the Tender Offer due to the net present value calculation.
  - Best for simplicity on fixed-rate bond Tender Offers, while still providing for market movement, with the pricing usually determined at the end of the offer period.
  - The Fixed Spread pricing mechanism provides a degree of protection for all parties against interest rate fluctuation during the period in which the Tender Offer is open.

3. Minimum tender conditions may be included to allow for the minimum denomination of qualified debt securities being exchanged into.

- *Unmodified Dutch auction* (not permitted for any US Tender Offers):
  - The issuer indicates a pricing range and holders submit bids indicating the lowest price within that range that they will accept. The issuer accepts or rejects each holder at the price the holder submitted.
  - Best for introducing competitive tension as to pricing between bondholders and letting the "market" set the price of the Tender Offer. Given this competitive tension between bondholders, an Unmodified Dutch auction is generally not perceived as a bondholder-friendly pricing option.
- *Modified Dutch auction* (not permitted for US abbreviated Tender Offers):
  - The issuer indicates a pricing range and holders submit bids indicating the lowest price within that range that they will accept. The issuer selects one "clearing price" and all bonds submitted by holders under and up to that clearing price are accepted for tender (proration may be applied if more offers are received than the maximum acceptance amount set by the issuer) at the clearing price.
  - Best for letting the "market" set the price of the Tender Offer while preserving equality between tendering holders and complying with the rules applicable to a US Tender Offer. This method may therefore be preferred for bonds that still have a substantial period until maturity.
- *"Early bird" premiums*
  - Uncommon in European Tender Offers and US abbreviated Tender Offers, due to the generally shorter offer period compared to US Tender Offers.
  - More common in full 20 business day US Tender Offers. An early bird premium may be offered to any holders who tender their bonds in the first 10 business days of the Tender Offer. As a holder tendering after this is receiving a decreased consideration, for US Tender Offers there must be 10 business days from the end of the entitlement to the early bird premium to the end of the US Tender Offer.

In all pricing alternatives, scaling/proration is permitted on Tender Offers with a maximum acceptance cap if there is excess demand for the Tender Offer from holders. However, a capped Tender Offer is not permitted for an abbreviated US Tender Offer, which must be available on an "any and all" basis.

The reason a modified Dutch auction is permitted for a US Tender Offer (although not a US abbreviated Tender Offer), but an unmodified Dutch auction is not so permitted, is that under Rule 13e-4 of the Securities Act of 1934 all holders accepted for tender must be paid the highest consideration paid to any other holder whose securities are accepted. The differential prices paid in an unmodified Dutch auction would not meet this requirement.

In considering whether to launch a Tender Offer, an issuer will also have to be aware of how their bond investors would expect to be treated if, for example, the issuer has a "live" call option (the current ability to call the bonds at a set call price in the terms and conditions). Investor expectations as to the pricing of any Tender Offer would likely be framed by reference to any prevailing call option price then available to the issuer under the terms of the bonds.

Finally, whatever pricing method an issuer chooses, the tax and accounting impacts of the price paid for the bonds compared to the par value of the bonds should be considered, along with whether the bonds will be cancelled (as is usually the case) or held in treasury. A purchase of bonds by the issuer at a discount to par will likely result in a taxable profit for the issuer unless the issuer can set off the profit against its other losses.

**Who are the parties that will be involved in a Tender Offer?**

- An investment bank (or banks) acting as Dealer Manager(s) appointed by the issuer to advise on structural features of the Tender Offer including the method of pricing (although the choice of pricing method is ultimately a decision for the issuer), manage the process and engage with holders on behalf of the issuer, answer bondholder queries regarding the structure and raise awareness of the Tender Offer through their network;
- Tender Agent appointed by the issuer to manage the communication with holders on behalf of the issuer in relation to the practicalities of the Tender Offer (e.g. access to Tender Offer documentation and delivery of instructions);
- Dealer Manager(s) Legal Counsel; and
- Issuer Legal Counsel.

Other parties, such as tax advisers or auditors, may also be involved depending on the complexity of the transaction.

**Documentation**

Although variation may be seen deal-to-deal, a Tender Offer usually involves:

- Engagement Letter with Dealer Manager(s) (if required by the relevant Dealer Manager(s));
- Dealer Manager(s) Agreement;
- Tender Agency Agreement or Engagement Letter;
- Tender Offer Memorandum[4];
- Legal Opinion (addressed to Dealer Manager(s)) at launch;
- Corporate Authorisations of the issuer;
- Announcements (including via any relevant Stock Exchange, Bloomberg, through the clearing systems, and via a Regulatory Information Service, as applicable):
    - Launch;
    - Pricing and/or Cap (where relevant);
    - Satisfaction of any conditions to the Tender Offer; and
    - Results;
- Instructions to the Agents and ICSDs to mark down the global notes to reflect the cancellation of bonds repurchased pursuant to the Tender Offer; and
- Notice to the Stock Exchange on which the bonds are listed, relating to the cancellation of bonds repurchased pursuant to the Tender Offer.

4. In the event that the Tender Offer Memorandum contains financial information (which would be unusual), an auditor's comfort letter on such financial information would also be required.

**What impact might a Tender Offer have on future bondholder relations?**

This will be very bespoke to an issuer and the reasons for the Tender Offer. A Tender Offer provides all bondholders, including those that are engaged with and favourably inclined to the issuer, the option to exit the bonds. An investor's decision to participate in a Tender Offer is entirely voluntary and while the issuer can offer incentives to participate, investors are not forced or coerced into participation.

Investors who do not tender their bonds will continue to receive interest payments until maturity, however those investors should ensure they are aware of any changes that are introduced to the terms of the bonds if the Tender Offer is paired with an "exit consent", where the tendering bondholders are also asked to consent to changes to the bond terms. If the issuer is considering other liability management exercises in the future, it may be harder to motivate the "rump" of bondholders who elected not to participate in the Tender Offer (or who were simply not sufficiently engaged to consider participating). For this reason it is always worth an issuer considering whether there are any changes to the terms of their bond that they wish to introduce pursuant to an exit consent alongside a Tender Offer. Please see our Quick Guide to Liability Management Alternatives for a summary of key considerations on an exit consent.

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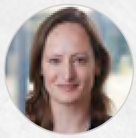

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This note is written in the context of cash tender offers in relation to DCM bond issues in the European market, where such bonds were issued under an exemption to the registration requirements of the US Securities Act of 1933 (as amended), on either a Regulation S or a Rule 144A/Regulation S basis. It is a high-level overview of a complex topic, intended to provide a general overview of the issues. Prior to taking any specific actions, the particular factual circumstances of an individual liability management exercise and issuer should be considered and specific legal advice sought.



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