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Restructuring Alternatives for Latin American and Caribbean Companies with US Dollar-Denominated Bond Debt

Lack of liquidity, devalued currencies, historically high interest rates and declining revenues amidst the global credit crisis have made it extremely difficult for companies to service their debt. We review several restructuring alternatives for companies in Latin America and the Caribbean with US Dollar-denominated bond debt.

Restructuring Alternatives for Latin American and Caribbean Companies with US Dollar-Denominated Bond Debt

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The current international credit crisis has made it extremely difficult for many companies in Latin America and the Caribbean to refinance and, in some cases, service their debt. This has resulted in serious financial challenges for companies throughout the region.

Except for the most creditworthy borrowers, banks are generally unwilling to lend, and investors in the capital markets are unwilling to increase their exposure, to companies in the region. Consequently there is currently little or no liquidity for many companies seeking to refinance their maturing bank and bond debt, especially for those companies rated below investment grade. For companies that are able to access financing, interest rates are at historically high levels, reflecting the perception of increased risk associated with extending credit to companies in the region. In addition, the recent devaluation of important local currencies, including the Mexican Peso and the *Real*, has made it much more difficult for many companies in the region with US dollar-denominated debt to meet their interest and any amortization payments, increasing the possibility of default. Finally, the global economic recession is adversely affecting most businesses throughout the region, resulting in declining revenues and increased difficulty in complying with financial covenants in loans and bonds.

In these market conditions, companies in the region with US dollar-denominated debt (which includes, in addition to loans and bonds, liabilities arising under derivative contracts) are actively reviewing their restructuring options. This memorandum provides an overview of the principal restructuring alternatives for companies in the region with capital market debt outstanding, in order to assist such companies and their financial advisers in evaluating the merits of the various restructuring alternatives (which are typically characterized as “liability management transactions”).

Covenant Relief – Consent Solicitation

For Latin American and Caribbean companies that are only experiencing temporary liquidity problems, as opposed to a more serious degree of financial distress, one restructuring alternative is to seek amendments to, or waivers from compliance with, the restrictive covenants contained in the indenture (or fiscal agency agreement) that set forth the terms of the company's bonds.

A consent solicitation is a transaction to modify or remove some or all of the covenants in a bond issue. There are two types of consent solicitation: a stand alone consent and an exit consent. A stand alone consent solicitation amends or removes certain covenants, while an exit consent solicitation is only used in conjunction with a tender offer or exchange offer (each, as described below), and eliminates all of the restrictive covenants, leaving non-tendering bondholders with a bond that is merely a promissory note. These are two very different transactions with different objectives, different investor dynamics and, consequently, different pricing.

The ability to waive or amend covenants is prescribed by the indenture itself, which will discuss the requirements for adopting amendments or supplemental indentures with the consent of holders. Bondholder consent to amendments to non-core provisions of an indenture, and the terms of the bonds issued thereunder (including covenants and events of default), usually requires the consent of holders representing 50 percent or more of the face value of the outstanding bonds governed by the indenture. Amendments to any core term, such as changes to redemption provisions, principal amount, interest rate and maturity date, however, will require the consent of *all* holders. In consent solicitations involving changes to core terms, the success of a restructuring will depend on the number of bondholders who consent to the requested changes, as non-consenting holders (or "holdouts") will not be bound by the changes to the core terms. In either case, bondholders generally consent only if they are paid a fee by the issuer for doing so.

Consent solicitations will not generally require any filing with the US Securities and Exchange Commission (SEC), as essentially they are communications between the company and the existing holders of its securities.

Tender Offer

For Latin American and Caribbean companies that have access to financing or existing cash, a second debt restructuring alternative is to repurchase the company's bonds for cash at a discount. For companies whose bonds are trading at a significant discount from their face value, repurchasing the bonds through a tender offer (or an open market purchase, discussed below) can be a very effective means of reducing indebtedness, provided financing or cash is available.

A tender offer, in contrast to an open market purchase, allows the company to purchase some or all of one or more outstanding bond issues in an orderly process. Depending on the circumstances of the transaction, tender offers are frequently conducted with a concurrent exit consent solicitation that eliminates all of the non-economic covenants, leaving non-tendering bondholders with a bond that is essentially a promissory note. The use of the exit consent solicitation is customary practice and is intended to achieve a high degree of bondholder participation.

The price paid to bondholders in a tender offer is determined in one of three ways:

- Using a fixed price that will not change over the term of the offer;
- Using a fixed spread to a pre-determined US Treasury issue, where the price is determined once only and paid to all holders. This price will vary with Treasury yields until it is set, generally 10 business days (in the case of non-investment grade bonds) and two business days (in the case of investment grade bonds) before the expiration date of the offer; or
- A Modified Dutch Auction, described below.

When conducting a tender offer, issuers must comply with certain rules governing tender offers in the United States under the Securities Exchange Act of 1934 (the "Exchange Act"), including: Section 14(e) (which broadly proscribes offers made on the basis of misleading or incomplete information) and Rule 14e-1 (which requires that offerors hold tender offers open for 20 business days and comply with certain other obligations); Rule 14e-2 (which requires an issuer to state (i) whether it recommends that securityholders accept or reject the offer, (ii) that it expresses no opinion with respect to the offer or (iii) that it is unable to take a position with respect to the offer); and Rule 14e-3 (which prohibits persons other than the offeror from engaging in transactions in the securities that are the subject of the tender offer on the basis of material non-public information that was acquired from the offeror or an agent of the offeror).

The SEC staff has indicated in several no-action letters that self-tenders by issuers for their debt securities may be kept open for fewer than 20 business days where certain conditions are met (including that the debt securities not be convertible into equity securities, that the debt securities be rated investment grade, that the tender offer is for any and all of the bonds of the same series, that the offer consideration consist of cash and, if the offer is open for fewer than 10 calendar days, that the offer be disseminated on an "expedited basis"). No SEC filing or registration statement is required for debt tender offers. However, if the company is an SEC-reporting company, it will be required to report the results of its tender offer in its next quarterly report on Form 6-K (to the extent it files a Form 6-K) or in its annual report on Form 20-F, and in its accompanying financial statements.

In addition to US securities law considerations, most companies in the region will need to consider tender offer restrictions that may be imposed by local authorities or the stock exchanges on which their securities may be listed. In particular, securities commissions in a company's home jurisdiction often impose disclosure and other requirements on tender offers

for any security of a public company, and such requirements should be reviewed with local counsel.

Modified Dutch Auction

Dutch Auctions, also known as reverse auctions, are another way of pricing a tender offer. They can be conducted using either a range of prices or a range of spreads that are used to determine the price. Bondholders select the price within the range at which they want to tender their bonds. There are two types of reverse auction:

- A pure Dutch Auction
- A Modified Dutch Auction.

With a pure Dutch Auction, if their bonds are accepted for purchase, investors will be paid their requested price. With the Modified Dutch Auction, the issuer determines a clearing price at which it can repurchase the targeted amount of debt. This one price is then paid to all investors whose bonds are accepted for purchase. Pure Dutch Auctions are rarely employed.

The attraction of an auction is that the pricing burden is shifted from the issuer to the investor. The investor is now a price-maker rather than a price-taker in the tender offer situation. Modified Dutch Auctions are most effective when an issuer seeks to repurchase less than all of its outstanding securities. The theory of the auction is that anonymity, competition among participants, price discovery and the uncertainty of participation or exclusion leads to more efficient pricing than with a more traditionally priced tender offer.

Exchange Offer

A third restructuring alternative — and the one that is most heavily favored by Latin American and Caribbean companies in today's market — is an exchange offer. An exchange offer is an offering by the issuer to exchange a new debt security for an existing debt security. It can be conducted with or without an "exit" consent solicitation, as described above. If a like principal amount of new debt is issued, the offer will only be extended to the existing holders of bonds as of a previously determined date, often referred to as the "record date." If the amount of new bonds to be offered is larger in amount than the original issue, the excess over the original amount can be offered to the existing holders of record (i.e., reflecting a differential exchange ratio that values the old bonds over face value) and, if the issuer seeks new investors, it can conduct an integrated offering of additional amounts of new bonds for cash or other consideration.

Exchange offers, which are a form of tender offer, must remain open for a minimum period of 20 business days. They also require that issuers comply with certain of the SEC's rules governing tender offers, including Section 14(e) and Rule 14e-1, Rule 14e-2 and Rule 14e-3 under the Exchange Act.

The exchange offer is unique among the list of restructuring alternatives in that it may require a filing by the issuer with the SEC if the new bonds are to be registered with the SEC. The filing of a registration statement with the SEC on Form F-4 will be necessary. The SEC may choose to review the Form F-4 filing, and this possibility should be discussed with US counsel in determining timing and other considerations. However, if the exchange offer is for bonds that were issued in a private placement (sometimes referred to as "Rule 144A bonds"), the issuer could issue the replacement bonds pursuant to a private placement that avoids the necessity for any SEC registration. Finally, new bonds issued in an exchange offer may qualify for the exchange offer exemption under Section 3(a)(9) of the Securities Act of 1933 (the "Securities Act"), which provides issuers with an exemption from registration for securities issued to their existing securityholders so long as no compensation is paid to a financial adviser or other agent for soliciting the exchange, and so long as no additional consideration is received from existing securityholders.

In an exchange offer that is exempt under Section 3(a)(9) of the Securities Act, the indenture must still be qualified under the Trust Indenture Act of 1939, which requires a filing with the SEC. An issuer should discuss the availability of a private placement or the Section 3(a)(9) exemption with its US counsel.

While exchange offers are reasonably efficient transactions, they have one practical drawback relating to investors commonly known as "holdouts." Holdout investors refuse to tender their bonds in an exchange offer because they assume, often correctly, that if the transaction is completed their "old bonds" will become more valuable because the issuer's balance sheet will have been improved.

When the holdout group becomes sizable — representing 10 percent or more of the bonds outstanding — the holdouts may be able to thwart the exchange offer, because issuers are reluctant to complete exchanges if a large block of old bond debt will remain outstanding post-exchange. Latin American and Caribbean companies that are considering exchange offers may confront the holdout problem, which in their cases will be exacerbated by the fact that a number of bonds issued by companies in the region include global bonds whose owners are difficult to identify, and with whom it may be difficult to communicate.

Open Market Purchase of Bonds

A fourth restructuring alternative involves the opportunistic repurchase of bonds in the secondary market by an issuer, typically at a significant discount from the par value of the bonds. Depending upon the extent of the discount, such open market purchases can be very effective for achieving debt reduction.[1] The issuer appoints a repurchase agent, who purchases bonds discreetly from holders within issuer-specified spread, price and size limits. This is conducted as a low-profile activity in which the identity of the ultimate buyer, the issuer, is not disclosed. If it becomes known that the issuer is buying its own bonds, it is likely that the price will rise as a result.

A program of open market purchases usually involve neither any public announcement of the issuer's actions nor any filings with the SEC. A foreign issuer that is an SEC-reporting company will simply reflect the results of its activities in its quarterly report on Form 6-K (to the extent it files a Form 6-K) or in its annual report on Form 20-F, and in its accompanying financial statements. The requirement to disclose their activities means that issuers that are SEC-reporting companies can essentially maintain anonymity for one quarter.

Issuers must be careful not to engage in open market purchases while in possession of material non-public information, because doing so would subject the issuer to sanctions for engaging in insider trading. In addition, a potential disclosure issue is created where an open market purchase program is conducted after an issuer has decided to conduct a tender offer for its remaining bonds after acquiring a certain amount of its outstanding bonds. This is so because bondholders who sell their bonds at a price below the tender offer price may argue that they were misled by the issuer, and could assert a claim against the issuer seeking damages under the anti-fraud provisions of the Exchange Act.

In addition, a company that engages in an open market purchase program needs to take care that its purchases are not deemed to constitute a tender offer, which requires compliance with Section 14(e) of the Exchange Act and with Rules 14e-1, 14e-2 and 14e-3 under the Exchange Act. The US courts have specified the factors that comprise a tender offer (including active and widespread solicitation of holders, a solicitation for a substantial percentage of an issuer's bonds, the inclusion of an offering premium, firm and fixed terms, conditioning the offer on tender of a minimum amount of bonds and the use of pressure tactics and public announcements), although not all of these factors need to be present for an open market purchase solicitation to be characterized as a tender offer. Companies considering open market purchases should consult with their financial and US legal advisers in advance to structure a program that removes any significant risk of characterization as a tender offer under the Exchange Act.

In addition to SEC-reporting requirements, issuers that are SEC-reporting companies will also need to meet the reporting requirements of the stock exchanges on which the securities are listed. In the case of securities listed on the New York Stock Exchange (NYSE), for example, Rule 204.33 of the NYSE Listed Company Manual requires that an issuer notify the NYSE about a repurchase of its own securities within 10 days after the close of the fiscal quarter in which it occurs. This notification requirement may be met by submission to the NYSE of a copy of the issuer's quarterly report on Form 6-K (to the extent it files a Form 6-K) if it is available within the 10 days following the end of the fiscal quarter in which the repurchase occurred.

Open market purchases do *not* facilitate covenant amendments, and in fact can impede them. This might happen because, by purchasing its own bonds, the issuer will be precluded from voting those bonds in any consent solicitation. This preclusion reduces the pool of votes and effectively concentrates control of the consent in fewer hands, leading to a higher degree of bondholder leverage than was previously the case. If a consent solicitation is contemplated,

careful consideration should be given to whether it is beneficial to buy "cheap" bonds in the open market in advance of the transaction.

Bondholder Identification

All of these restructuring alternatives require identification of bondholders, which is a challenge. In general, it is easier to identify US institutional bondholders than to identify bondholders in the Euromarket. Most bonds held by US investors are in registered form, and are held in book-entry form through the Depository Trust Company (DTC). Companies contemplating a restructuring of their bonds will generally engage an "information agent," who will undertake to identify an issuer's bondholders.

At the request of an issuer, DTC will provide a list of its securities held in book-entry form. This list is then researched by the information agent, who distills the information and will collate a list of the underlying beneficial owners — the institutions that actually own the securities. This work forms the basis of the strategy, pricing and solicitation effort by investment banks working to effect the amendment or repurchase or exchange the security.

Unfortunately, outside the United States transparency is much more limited. The DTC's sister organizations in Europe, Euroclear and Clearstream have a policy of preserving the anonymity of their holders and will not provide the same information that DTC does in the United States. The inability to identify investors in bond issues distributed outside the United States is compounded by the fact that many non-global securities are issued in bearer, as opposed to book-entry, format.

As a result of these factors, considerable reliance may have to be placed on the trading records of the investment bank that acted as lead manager for the offering.

Endnote

[1] It is a common occurrence for family shareholders, directly or through friendly intermediaries, to purchase the issuer's bonds through negotiated open market purchases, for subsequent resale to the issuer or retention until maturity. These persons may qualify as "affiliates" of the issuer under the terms of the indenture or fiscal agency agreement, who are therefore disqualified from voting those bonds.

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