



CLIENT MEMORANDUM

Restructuring Public Debt – An Overview of the Legal Framework

January 21, 2009

INTRODUCTION

The credit markets and the broader economy have recently been mired in a period of nearly unprecedented turmoil. Due to the credit crunch, financing and refinancing options have been severely limited for more than a year. Furthermore, the increase in volatility in the markets and the decrease in investors' appetite for risk has caused the outstanding debt of many companies to trade at levels below par. As a result, many companies with public debt have sought or are seeking to restructure all or a portion of their debt, either to rectify looming debt service issues or to take advantage of the disrupted markets to delever.

Simpson Thacher has been involved in numerous debt restructuring transactions in recent months. This memorandum provides an overview of the legal framework that is applicable to transactions involving the restructuring of debt securities, based on our recent experience. We note that the

memorandum focuses on voluntary, out-of-bankruptcy restructurings. We also note that each company's situation is different and will require a detailed analysis of its capital structure and financing documents. Accordingly, we urge you to contact your relationship partner should you wish to discuss how the matters covered in this memorandum might apply to your company.

EXECUTIVE SUMMARY

This memorandum discusses the methods by which a company can restructure its outstanding debt securities. The choice of which approach to employ will depend on a variety of factors, including, among others, the availability of cash, the scope of the restructuring, the desired timing of the transactions and the restrictions contained in the documents governing the company's debt. Often, consents will be required under certain of the financing documents if a particular structure is chosen (for example, the relevant financing documents

may permit an exchange offer to be considered a "permitted refinancing," whereas a cash tender offer may constitute a prohibited restricted payment). The company must also be cognizant of the various constituencies within the company's capital structure and how each will react to the restructuring initiative.

Debt securities are repurchased or restructured in a variety of different ways:

- **Privately Negotiated or Open-Market Purchases:**

Privately negotiated or open-market purchases may be appropriate when an issuer is seeking to repurchase a relatively small percentage of the outstanding series of debt securities or when the securities are concentrated among a few holders. Privately negotiated or open-market purchases must be structured so that they will not constitute tender offers under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Debt retirements conducted as privately negotiated or open-market purchases may be attractive because they can commonly be completed quickly and little or no documentation is required. Companies also retain greater flexibility in terms of the pricing of repurchases than in tender and exchange offers.

- **Cash Tender Offers:** In lieu of privately negotiated or open-market purchases targeting a limited number of investors, a company may approach all holders of one or more series of its debt securities in a tender offer and offer to purchase all or a portion of such securities, either on the basis of fixed prices or, in certain circumstances, on the basis of prices determined by reference to fixed spreads over benchmark Treasury securities. If the securities to be purchased are widely held and the company has decided to use cash as consideration, a tender offer may be the most effective method of executing a repurchase. Tender offers may be coupled with consent solicitations to eliminate

covenants or events of default with respect to securities that are the subject of the tender offer but which are not tendered by investors. The risk of loss of contractual protections presented by the consent solicitation can present an additional incentive for holders to participate in the transaction.

Cash tender offers will be subject to tender offer rules under the Exchange Act including the requirements that the offer generally remain open for at least 20 business days and that at least 10 business days elapse between (i) notice of any change in the price to be paid in the offer or the amount of securities sought and (ii) the expiration of the tender offer.¹ Cash tender offers for equity securities, including convertible or exchangeable debt securities, are subject to significant additional regulatory requirements under the Exchange Act and commonly require filings to be made with the Securities and Exchange Commission.

- **Exchange Offers:** Exchange offers may be appropriate for companies that wish to restructure existing debt obligations but do not have sufficient liquidity to finance privately negotiated or open-market purchases or cash tender offers. The same Exchange Act rules applicable to cash tender offers will apply to exchange offers, including heightened regulatory requirements where the securities sought in the exchange offer are equity securities such as convertible or exchangeable debt securities. In addition, the securities offered in an exchange offer will also be subject to the requirements of the Securities Act of 1933, as amended (the "Securities

¹ The duration of a cash tender offer for straight debt securities rated investment grade may be shortened in certain circumstances. See *infra* note 6.

Act”), unless the securities offered are exempt from registration (by virtue of Section 3(a)(9) of the Securities Act) or the exchange offer is exempt as a private offering (by virtue of conducting the offering as a private placement to a limited number of accredited investors or “qualified institutional buyers” within the meaning of Rule 144A under the Securities Act).²

- **Consent Solicitations:** In lieu of repurchasing outstanding debt obligations, companies may also effect a restructuring by amending the terms of existing debt obligations through a consent solicitation. Consent solicitations may enable a company to relax covenants or events of default either in respect of a particular contemplated transaction or permanently. As noted above, consent solicitations may also be conducted in tandem with tender offers or exchange offers, with companies obtaining “exit consents” from holders to amend or waive certain undesirable provisions in the agreement governing the securities subject to the tender or exchange offers.

In addition to issues arising from the application of the securities laws (including prospective liability under Rule 10b-5 in relation to transactions that involve the purchase and/or sale of securities), restructuring of a company’s outstanding debt may also raise significant tax, bankruptcy and accounting issues.

PRIVATELY NEGOTIATED AND OPEN-MARKET PURCHASES

If the company has sufficient cash on hand or available on short notice, privately negotiated or open-market purchases may be attractive methods of repurchasing outstanding debt securities because such repurchases can ordinarily be commenced, and commonly completed, very quickly. Companies also retain greater flexibility in terms of pricing as compared with tender and exchange offers where the same consideration is offered to all investors targeted in

the transaction. It is important, however, to conduct such purchases in a manner that will ensure that they do not constitute tender offers.

The Exchange Act and the rules promulgated thereunder do not contain a bright-line definition of what constitutes a tender offer. However, an eight-factor test³ formulated by certain courts provides a guideline to be used in determining whether a transaction constitutes a tender offer. The analysis is intensely fact-driven. The eight factors have not been viewed by courts or practitioners as having equal importance in all cases and no single factor is necessarily viewed as being dispositive in any given transaction. It is common to consider limitations on the number of holders who may be approached as part of a program to effect privately negotiated or open-market repurchases, as well as to consider limiting the percentage of the outstanding securities to be repurchased, although the manner in which the repurchases are conducted is usually regarded as more critical to the analysis than any specific numerical limitations. Because the determination of whether a particular repurchase program is likely to constitute a tender offer is nuanced, it is important to consult with counsel before implementing any such program. Failure to comply with the tender offer rules, if applicable, may result in an enforcement action by the SEC and/or claims by investors.

In addition, any privately negotiated or open-market purchase of debt securities will constitute a “purchase” of

² Exchange offers for equity securities such as convertible or exchangeable debt securities generally may not be structured as private offerings because the tender offer rules under the Exchange Act require that offers for equity securities be made to all holders and hence it is generally not possible to limit the offer to just accredited investors or qualified institutional buyers.

³ The eight factors are: (1) whether there is active and widespread solicitation of public holders of the securities; (2) whether the solicitation is for a substantial percentage of the securities involved; (3) whether the offer to purchase is at a premium over the current market value of the securities; (4) whether there is an absence of negotiation; (5) whether the offer is conditioned on a minimum number of securities tendered; (6) whether the offer is open for a limited time; (7) whether the holder is under pressure to sell; and (8) whether publicity is followed by rapid accumulation of the securities.

a security for the purposes of the Exchange Act antifraud provisions, including Rule 10b-5. Accordingly, because an issuer may be considered to be the ultimate insider with respect to its own securities, it is important that issuers refrain from privately negotiated or open-market purchases during periods when there may be information material to debt investors which has yet to be publicly disseminated. Furthermore, consideration should be given as to whether the company's intention to use cash resources to repurchase outstanding debt securities is itself material, particularly where a company has not previously indicated that it may seek to repurchase its outstanding debt from time to time. It should be noted that affiliates of the issuer would be considered insiders under the antifraud rules and would be obligated to disclose, or to cause the issuer to disclose, any material non-public information about the issuer prior to trading in the subject securities. Otherwise, affiliates should consider whether they should abstain from trading.⁴

One of the drawbacks of privately negotiated or open-market purchases is that such repurchases may need to be tailored in light of tender offer considerations and, as a result, it may be difficult to accumulate a large amount of the targeted securities. In addition, it is frequently very difficult to combine privately negotiated or open-market repurchases with the solicitation of consents as at least a majority of the outstanding securities will be required to effect the amendment (a significant threshold for privately negotiated and open-market purchases) and, in the case of high yield debt securities, many indentures include a covenant that requires each holder to be offered consideration for a consent solicitation. Also, timing of the solicitation of consents is critical in the context of privately negotiated and open-market purchases because the purchased securities will cease to be outstanding for the purposes of the consent solicitation once purchased by the issuer and any consents previously obtained would commonly become invalid at such time if the consented action has not already been effected. Consequently, if the object of the transaction is to retire all or substantially all of a series of debt securities and/or to eliminate or amend the restrictive covenants or other provisions contained in the underlying indenture through an exit consent process, it will be appropriate to consider other methods of

repurchasing the securities in lieu of privately negotiated or open-market purchases.

CASH TENDER OFFERS

A tender offer allows the company to approach all holders of a series of its debt securities with an offer to purchase. Tender offers (or exchange offers, if the offered consideration is to include new securities) are frequently necessary or appropriate where all or a substantial percentage of an issue of debt securities is sought to be purchased and/or the holdings of such debt securities are widely dispersed. Because tender offers can be launched subject to specified conditions, a tender offer may be a preferable buyback structure when the advisability of a repurchase depends on other factors, such as the receipt of financing sufficient to fund the repayment or the adoption of amendments to debt instruments. As noted above, tender offers and exchange offers may be coupled with consent solicitations⁵ that, if successful, may facilitate the accomplishment of the offer and reduce the issuer's continuing compliance obligations with respect to any of the relevant debt securities that are not tendered and remain outstanding following the completion of the offer. Different rules are applicable depending on whether the tender offer is for straight debt securities or debt securities with equity features (*e.g.*, convertible or exchangeable notes).

Straight Debt Securities

The principal tender offer regulations that apply to straight debt tender offers are Regulation 14E and Rules 14e-1, 14e-2 and 14e-3 of the Exchange Act. Unlike the case of tender offers for debt securities with equity features or a registered exchange offer, the rules do not specify any form requirements for the tender offer documentation and do not require any

⁴ There are a variety of other factors that may require consideration in connection with repurchases by affiliates of an issuer's outstanding debt securities, including whether the purchases could be challenged as constituting an inappropriate diversion of a corporate opportunity where the issuer itself might otherwise purchase its own securities, whether the purchased securities, in the hands of the affiliate, might be subject to equitable subordination in a bankruptcy and whether the securities in the hands of the affiliate could be voted in connection with any future consent solicitation.

⁵ See "Consent Solicitations" below.

filing of tender offer documentation with the SEC. It is critical, however, that the offer to purchase and other tender offer documentation not contain any material misstatements or omissions because the general antifraud provisions of the Exchange Act, including Rule 10b-5, will apply to purchases made pursuant to tender offers.

- **Tender Offer Period:** A tender offer subject to Rule 14e-1 generally must be held open for at least 20 business days from the date on which the tender offer is commenced.⁶ For the purposes of determining the applicable minimum tender offer period, the date on which the tender offer is commenced (*i.e.*, the date on which the tender offer documents are first sent to the holders of the subject securities) is counted as the first business day of the tender offer period. The tender offer must remain open for at least 10 business days from the date on which there is a change in (1) the percentage of securities being sought (to the extent that the change exceeds two percent of the original amount sought), (2) the consideration offered or (3) any dealer's soliciting fee. Although not specified in the face of the rules, the staff of the SEC has also taken the position that tender offers subject only to Regulation 14E must remain open for a minimum period, generally five business days, following any other material changes to the offer or waiver of material conditions.⁷
- **Withdrawal Rights:** Regulation 14E does not require any withdrawal rights be provided for tender offers for straight debt although it is standard market practice to afford holders withdrawal rights, which rights might expire after an initial period, commonly the first 10 business days, where the tender offer is made concurrently with a consent solicitation or where the tender offer includes an early tender premium for noteholders who tender their straight debt securities early in the tender offer. If a material change occurs during the tender

offer or a material condition is waived after withdrawal rights have terminated, consideration should be given to whether withdrawal rights must be reinstated for holders who had previously tendered their securities.

- **Extension:** Any extension of a tender offer's duration must be made by press release or other public announcement by 9:00 a.m., Eastern Standard Time, on the business day next succeeding the previously scheduled expiration date of the tender offer. Any press release extending a tender offer must include disclosure of the approximate number of securities tendered to date.

Debt Securities with Equity Features

A tender offer by a company that has a class of equity securities registered under the Exchange Act or that is otherwise a reporting company under the Exchange Act, for debt securities with equity features (*e.g.*, convertible or exchangeable notes) must also satisfy the requirements of Rule 13e-4 of the Exchange Act.⁸ Since Regulation 14E applies to all tender offers, the tender offer regulatory

⁶ Pursuant to certain no action letters issued by the staff of the SEC, issuer cash tender offers for any and all of a class of straight debt securities that is rated investment grade may be conducted in a period of 7 to 10 calendar days if appropriate measures are taken to expedite the dissemination of the offer to investors. *See, e.g.*, *Salomon Brothers Inc.*, SEC No-Action Letter, WSB File No. 031786015 (Mar. 12, 1986) and *Goldman, Sachs & Co.*, SEC No-Action Letter, WSB File No. 033186024 (Mar. 26, 1986).

⁷ *See* Regulation of Takeovers and Security Holder Communications, Exchange Act Release No. 34-42055 (Oct. 22, 1999), available at <http://www.sec.gov/rules/final/33-7760.htm>. *See also* "Exchange Offers" below.

⁸ A tender offer for convertible or exchangeable debt securities may also be subject to the "going private" rule, Rule 13e-3 under the Exchange Act, if the tender offer is likely to cause the series of securities to be held by less than 300 holders (commonly not an issue as such securities frequently are held by less than 300 holders before a tender offer commences) or to cause such securities, if listed on a national securities exchange, to be delisted (commonly not an issue as convertible and exchangeable debt securities, other than certain mandatory convertible or exchangeable securities, are infrequently listed on national securities exchanges) and there is no available exemption from Rule 13e-3. In the event that Rule 13e-3 is applicable, the tender offer documentation will need to contain significant additional information responding to the elevated disclosure requirements imposed by Rule 13e-3.

requirements discussed above (*e.g.*, the minimum 20 business day offering period) also apply to tender offers for debt securities with equity features. The following additional requirements, among others, are applicable to tender offers subject to Rule 13e-4.

- **Form and Filing Requirements:** Rule 13e-4 requires the company to file a Schedule TO with the SEC on the day that a tender offer subject to such rule is commenced. Schedule TO requires that certain specific disclosures be included in the tender offer documentation distributed to investors and/or in the Schedule TO itself. If there are any material changes in the information contained in the Schedule TO, an amendment to the Schedule TO must be promptly filed. Furthermore, all written communications relating to the tender offer must be filed with the SEC. Schedule TO filings are commonly reviewed by the staff of the SEC and comments are frequently made that require revisions to the information contained in the Schedule TO or, less commonly, the tender offer documentation itself. The review by the SEC commences after the Schedule TO is filed with the SEC and any comments are likely to be received within approximately 10 days of the commencement of a tender offer.
- **Commencement:** Rule 13e-4 sets forth particular requirements for the commencement of a tender offer for equity securities. In contrast to tender offers for straight debt securities, it is common to prepare and publish a tombstone advertisement in a newspaper with national circulation in order to comply with the commencement formalities set forth in Rule 13e-4.
- **Withdrawal Rights:** A company making a tender offer subject to Rule 13e-4 must permit securities tendered to be withdrawn at any time during the

period the tender offer remains open. Furthermore, tendered securities are permitted to be withdrawn, if not yet accepted for payment, after the expiration of 40 business days from the commencement of the tender offer.

- **All Holders and Best Price Rules:** Generally, tender offers subject to Rule 13e-4 must be open to all security holders. Furthermore, the consideration paid to any holder pursuant to the tender offer must generally be the highest consideration paid to any holder pursuant to the tender offer.
- **Purchases Outside of the Tender Offer:** Rule 13e-4(f)(6) expressly prohibits purchases by the issuer or any affiliate of any of the securities that are the subject of the tender offer, or any securities of the same class or series or any right to purchase such securities, other than pursuant to the tender offer, for a period of 10 business days after the completion of the tender offer. This "cooling off" requirement is in addition to the prohibition contained in Rule 14e-5 which, subject to certain exceptions, prohibits any "covered person" from directly or indirectly purchasing, or arranging for the purchase of, any securities that are the subject of the tender offer (or any securities that are immediately convertible or exchangeable for subject securities), from the time of first public announcement of a tender offer until its expiration, other than pursuant to the tender offer. Rule 14e-5 defines "covered persons" to include the offeror and its affiliates and the offeror's dealer manager and its affiliates.

Consequences - Differing Structuring Options

In the absence of the more particularized requirements of Rule 13e-4, companies seeking to restructure their debt obligations will have more flexibility in structuring a tender offer for straight debt than for debt securities that include equity features.

One example of greater flexibility available to companies in structuring tender offers for straight debt securities is the possibility of structuring the offer with an "early tender premium" feature. For tender offers structured with an early tender premium, tendering holders who tender early during the tender offer, typically in the first 10 business days, are eligible to receive the "total consideration" which includes an early tender premium, commonly expressed as a specific dollar amount per \$1,000 principal amount of tendered securities.⁹ Holders who tender after the early tender date would be eligible to receive a lower price equal to the total consideration less the early tender premium. It is possible to structure a tender offer for straight debt on this basis because the "best price" rule applicable to tender offers for equity securities does not apply to offers for straight debt securities. This structure can be appealing to companies because it creates an incentive for holders to tender in the first 10 business days of the offer, thereby affording earlier visibility as to the likely success of a tender offer (and the related consent solicitation, if any), which may facilitate other corporate transactions including completion of a financing transaction to fund the tender offer.

The absence of specific disclosure and documentation requirements, as well as the absence of required filings with the SEC, also enables tender offers for straight debt securities to be documented and completed with greater speed and lower cost than is commonly the case with tender offers for debt securities with equity features.

EXCHANGE OFFERS

In circumstances where a company does not have sufficient available funds (or an ability to raise sufficient funds in a timely fashion) to offer cash as the sole consideration for the purchase of debt securities, a company may be able to restructure its outstanding debt by offering to exchange the outstanding securities for equity securities or new debt obligations. The total consideration offered in an exchange offer may also be structured to include cash in addition to the exchange securities.

In addition to having to satisfy the relevant Exchange Act rules that are applicable to tender offers,¹⁰ an exchange

offer must also satisfy the registration requirements under the Securities Act, unless there is an available exemption from registration. Because an exchange offer represents an offering of securities, the offering documentation will include more detailed disclosure, including descriptions of the offered securities, as compared with the offering documentation used in connection with a cash tender offer. Furthermore, because participants in the exchange offer may have statutory underwriters' liability in relation to the exchange offer, it is common for parties to conduct due diligence and for legal opinions and auditors' comfort letters to be delivered to the dealer manager for the exchange offer. The more extensive documentation and related due diligence typically results in exchange offers requiring significantly greater time to execute than cash tender offers. Whether an exchange offer is conducted as a registered offering, with the attendant prospect of SEC review, or in reliance upon an exemption from registration will also have a significant impact on the timing for the transaction.

Exemptions from Registration under Securities Act

There are two primary exemptions from the Securities Act registration requirements that may be utilized in an exchange offer. The first exemption, under Section 3(a)(9) of the Securities Act, is unique to offers made by an issuer to exchange its outstanding securities with new securities issued by such issuer. The second exemption is predicated on the exchange offer being conducted as a private placement under Section 4(2) of the Securities Act.

Section 3(a)(9). Section 3(a)(9) is an exemption that covers only the exchange offer. Any resales of the exchange securities received must be made pursuant to an independent exemption. If the original securities were subject to transfer restrictions at the time of the exchange, then the exchange securities received in the exchange offer will have the same restrictions as the original securities.

⁹ Withdrawal rights are often provided in the beginning of the tender offer period, with such rights structured to expire after the early tender date, namely after the tenth business day.

¹⁰ See "Cash Tender Offers" above.

On the other hand, if the original securities were freely transferable at the time of exchange, for example because the securities were registered pursuant to a back-end registration rights agreement or the original securities are freely transferable pursuant to Rule 144, then the exchange securities will be freely tradable by non-affiliates.

The availability of the Section 3(a)(9) exemption is subject to the following conditions:

- **Same Issuer:** The original securities and the exchange securities must be issued by the same issuer.
- **Exclusively with Security Holders:** An exchange offer under Section 3(a)(9) must be limited exclusively to the company's existing security holders. Care must be taken to ensure that a separate offering of securities for cash is not integrated with an exchange offer under Section 3(a)(9), which might destroy the Section 3(a)(9) exemption.
- **No Remuneration or Commissions:** In order to use the exemption provided by Section 3(a)(9), a company may not pay, directly or indirectly, any compensation in relation to the solicitation of the exchange. In general, officers, directors and employees of the company may solicit holders if such persons were not hired for the purpose of soliciting holders, have other duties to which they continue to attend and are not paid additional compensation for such activities. The SEC has also interpreted this exemption to permit the use of investment banks as financial advisers under limited circumstances where such firms do not solicit investors. As this condition has historically received close scrutiny by the SEC, special care must be taken in the analysis.

In the case of many exchange offers, even where the "issuer identity" and "investor identity" conditions are satisfied, companies frequently conclude that it is not possible to proceed in reliance upon Section 3(a)(9) because it is necessary for the company to engage a recognized financial institution to serve as dealer manager to solicit

participation in the offer by investors. This is especially the case where the rationale for the exchange offer and/or the terms of the exchange securities must be explained to investors and/or where the dealer manager's imprimatur on the transaction may be valuable. In such circumstances, a company will likely find that it needs to engage the services of a dealer manager which will be paid to solicit tenders by investors into the exchange offer which will preclude reliance upon Section 3(a)(9).

Private Placement Exchange Offer. If the requirements of Section 3(a)(9) cannot be satisfied, but a significant amount of the targeted straight debt securities is held by qualified institutional buyers and/or accredited investors, it may be possible for a company to structure its exchange offer as a private placement exchange offer pursuant to Section 4(2) of the Securities Act.¹¹ An exchange offer made under Section 4(2) must be structured to ensure that it does not constitute a "public offering." These private placements cannot include any "general solicitation" of prospective investors and must be limited to sophisticated investors, such as qualified institutional buyers or accredited investors. In order to ensure that the offerees are suitable to participate in a private exchange offer, it is typically necessary for the issuer to implement pre-qualification procedures to ensure that the participating holders are qualified institutional buyers or accredited investors, through the use of "pathfinder" or "seeker" letters or other methods. Since certain holders will not be eligible to participate in a private placement exchange offer, care

¹¹ If the securities targeted for exchange are debt securities with equity features, it is often impossible to structure the exchange offer, assuming that the exchange offer constitutes a "tender offer," as a private placement because the "all holders" rule requires that the offer be made available to all securityholders, regardless of whether they are entities eligible to participate without restriction in private placements such as "accredited investors", as defined in Regulation D, or "qualified institutional buyers", as defined in Rule 144A. One circumstance in which an exchange offer for convertible or exchangeable securities might be conducted on a private placement basis would be where all of the convertible or exchangeable securities were sold in reliance upon Rule 144A and are subject to permanent transfer restrictions requiring that the securities be held only by qualified institutional buyers. In such circumstances, it may be possible to structure the exchange offer as a private placement because all of the holders of the securities should be qualified institutional buyers.

must be taken in analyzing whether such an exchange would be permitted under the company's financing documents. For example, if the exchange offer is coupled with a consent solicitation, an indenture containing a "payments for consent" covenant may preclude the company from pursuing a private placement exchange offer coupled with exit consents (unless the consent payments or other consent consideration is ultimately paid to all holders).

Registered Exchange Offers

If the exchange securities to be issued pursuant to the exchange offer do not qualify for an exemption under the Securities Act, the company can conduct the exchange offer on a registered basis by filing a registration statement on Form S-4 or, in the case of foreign private issuers, Form F-4. It is important to note that registration statements on Form S-4 or Form F-4 will not be effective upon filing, regardless of whether the issuer is a "well known seasoned issuer" or "WKSI", in contrast to Form S-3 or Form F-3 registration statements filed by such issuers. The determination of whether the SEC staff will review a filing and the process of responding to any staff comments can significantly protract the execution timing for a registered exchange offer.

Straight Debt. In the case of registered exchange offers for straight debt securities, the company must prepare and file a registration statement on Form S-4 or Form F-4, as the case may be. The registration statement must be declared effective by the SEC prior to commencing the exchange offer unless the company avails itself of the "early commencement" rules.¹² In order to use the early commencement rules in an exchange offer for straight debt, the company must (1) provide withdrawal rights to the same extent as would be required if the exchange offer were subject to the requirements of Exchange Act Rule 13e-4 or Regulation 14D and (2) if a material change occurs in the information published, sent or given to security holders, the bidder must disseminate revised materials as required under Exchange Act Rules 13e-4(e)(3) and 14d-4(d) and must hold the offer open with withdrawal rights for the minimum time periods specified in those rules.

As such, a company using the early commencement option in an exchange offer for straight debt will lose some of its flexibility in structuring the transaction.¹³ See "Exchange Offers – Registered Exchange Offers – Early Commencement" below for more information.

Debt with Equity Features. A company choosing to conduct a registered exchange offer for convertible or exchangeable debt securities will be subject to the same registration process applicable to a registered exchange offer for non-convertible debt securities. However, the one significant difference is that such an exchange offer would also be subject to the requirements of Rule 13e-4 (as described above in "Cash Tender Offers – Debt Securities with Equity Features"). An exchange offer for convertible or exchangeable debt securities can benefit from the early commencement rules available in Rule 13e-4 of the Exchange Act and Rule 162 of the Securities Act (so long as it does not also constitute a "going private" transaction).

Early Commencement. Under the early commencement procedures, an exchange offer may be launched with a preliminary prospectus and the 20 business day offering period may be commenced while the SEC staff is still reviewing the registration statement. However, the

¹² Rule 162 of the Securities Act was amended in December 2008 to permit the early commencement of exchange offers subject only to Regulation 14E. The newly expanded early commencement rules still do not apply to "going private" transactions subject to Rule 13e-3 of the Exchange Act. See Commission Guidance and Revisions to the Cross Border Tender Offer, Exchange Offer, Rights Offerings, and Business Combination Rules and Beneficial Ownership Reporting Rules for Certain Foreign Institutions, Exchange Act Release No. 34-58597 (Sept. 19, 2008), available at <http://www.sec.gov/rules/final/2008/33-8957.pdf>. See also SEC Adopts Amendments to Cross-Border Tender Offer, Exchange Offer and Business Combination Rules and Beneficial Ownership Reporting Rules (Oct. 3, 2008), available at <http://www.simpsonthacher.com/content/publications/pub753.pdf>, for a discussion on the SEC's release.

¹³ For example, an exchange offer for straight debt securities utilizing the early commencement option cannot be structured to have an early tender date on which withdrawal rights expire. An exchange offer for straight debt securities that is not commenced early may still provide no (or limited) withdrawal rights to the holders of the subject securities.

exchange offer may not be consummated until the registration statement has been declared effective by the SEC, which may result in the need to extend the exchange offer period. It is frequently prudent, if the registration statement is being reviewed by the SEC staff, to defer the commencement of the exchange offer until the receipt and resolution of any significant SEC comments in order to diminish the risk that the SEC staff requires the recirculation to securityholders of an amended and supplemented offering document containing revisions to the prospectus required by the SEC staff. As a result, despite the fact that the SEC has committed to granting expedited review for exchange offers, a registered exchange offer utilizing the early commencement procedures will still require more time to document and complete than an unregistered exchange offer or a cash tender offer.

CONSENT SOLICITATIONS

In connection with cash tender offers and exchange offers, the company may also solicit consents to amend or waive certain restrictive provisions contained in the instruments governing the debt securities subject to such tender or exchange offers. In such instances, the tendering security holders are commonly required to consent to the requested amendments as part of the tender of securities pursuant to the tender offer or exchange offer. If the requisite amount of outstanding debt securities, as specified in the relevant indenture, is tendered in the tender or exchange offer, the company will be able to amend the terms of the indenture. Commonly, a portion of the total consideration offered in an offer coupled with a consent solicitation is characterized as a consent payment. Such consent payment is only available to securityholders who tender on or prior to the consent deadline, which is commonly a date 10 business days after the commencement of the offer and consent solicitation. Withdrawal rights usually terminate on the consent payment deadline as well.¹⁴

These amendments or waivers obtained in consent solicitations coupled with a tender or exchange offer generally will not affect the tendering holders since they will either receive cash or exchange securities upon the

consummation of the offer and the effectiveness of the amendments and waivers is typically subject to the condition that the tendered securities have been accepted for payment or exchange pursuant to the offer. However, if the requisite consents are obtained and the indenture is amended, non-tendering holders will be bound by the changes. As a result, exit consents, if properly used, can be a powerful inducement to participate in a tender or exchange offer.

A company may also seek to amend the terms of its debt instruments by conducting a consent solicitation that is not executed concurrently with a tender offer or exchange offer. Typically the amendments or waivers sought in such circumstances are more limited than the amendments or waivers that may be sought in a consent solicitation conducted in tandem with a tender or exchange offer because the consenting holders will remain subject to the terms of the indenture as amended or waived. Hence, the investors will be more reluctant to agree to sweeping changes. Free-standing consent solicitations are frequently open for a minimum period of 10 business days although a supplemental indenture giving effect to the amendments or waivers sought may be executed and delivered as soon as the requisite consents from securityholders are obtained.

A company that intends to solicit consents, either concurrently with a tender offer or exchange offer, or as a separate consent solicitation, must consult counsel to carefully analyze the provisions it desires to amend. Under the terms of some indentures, certain provisions cannot be amended without the consent of each affected holder, whereas other provisions can be amended by majority approval. Furthermore, if the provisions of the outstanding securities are amended to such a degree that there would be a significant change in the nature of the investment to

¹⁴ As noted above under the caption "Cash Tender Offers—Debt Securities with Equity Features," withdrawal rights in an offer subject to Rule 13e-4 must extend through the expiration date of such offer. Holders of the subject securities in an exchange offer for straight debt that is commenced early must also be accorded with withdrawal rights until the expiration date.

the remaining holders, the remaining securities may be deemed a "new security" which would then require that the new securities be registered under the Securities Act or be subject to an exemption from registration.

LIABILITY

The general antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder apply to "the purchase and sale of any security." Consequently, these antifraud provisions apply to privately negotiated and open-market purchases, tender offers and exchange offers, whether registered or not. Under Rule 10b-5, an issuer and its directors, officers, employees or agents may be liable for disseminating false or misleading material information or withholding or omitting material information.

In addition, registered exchange offers will be subject to Securities Act liability, in addition to Exchange Act liability. Therefore, in addition to liability under Section 10(b) and Rule 10b-5 of the Exchange Act, liability under Section 11 (relating to registration statements) and Section 12 (relating to prospectuses and oral communications) of the Securities Act must also be considered.

Dealer managers are not exposed to the statutory liability of "underwriters" under the federal securities laws in connection with cash tender offers, but will commonly be regarded as statutory "underwriters" in connection with solicitations in connection with exchange offers because the dealer manager may be regarded as a distribution participant by virtue of their activities soliciting participation by investors in the offering of securities. Dealer managers in exchange offers typically conduct due diligence commensurate to the review of an underwriter in a securities offering, including the receipt of comfort letters from the company's independent auditors and legal opinions and negative assurance statements from legal counsel.

Restructuring transactions also frequently require consideration of issues arising from the application of Regulation FD. Subject to certain exceptions, under

Regulation FD, whenever an issuer, or person acting on an issuer's behalf, intentionally discloses material non-public information to securities market professionals or holders of the issuer's securities who may trade on the basis of the information, the issuer must make simultaneous public disclosure of that information. If the issuer unintentionally discloses material information, it must "promptly" make public disclosure of such information.

In the context of restructuring transactions, it is frequently necessary to consult or negotiate with securityholders before formally commencing the transaction. In such circumstances, consideration must be given as to whether the information to be conveyed to the securityholders requires that the securityholders be bound by some form of confidentiality agreement in order to ensure Regulation FD compliance. In the context of privately negotiated or open-market purchases, tender offers and exchange offers and consent solicitations that are made without formal filings with the SEC, consideration must likewise be given as to whether information must be disclosed in a press release or Form 8-K filing to ensure that securityholders who are not included in the transaction are presented with any previously non-public material information being shared with participating securityholders, which information may include the occurrence of the proposed transaction itself.

TAX, BANKRUPTCY AND ACCOUNTING MATTERS

There are significant tax, bankruptcy and accounting considerations that typically arise in connection with the debt restructuring transactions discussed above. These issues must be analyzed prior to engaging in any debt restructuring.

- **Cancellation of Indebtedness:** If the debt being restructured is cancelled in exchange for an amount less than its adjusted issue price, the company may have to recognize cancellation of indebtedness income, typically the difference between the principal amount of debt repurchased and the

repurchase price, unless certain exemptions apply. Cancellation of indebtedness income may also be applicable if a person related to the company engages in such a transaction.

- **AHYDO and Loss of Interest Deduction:** In general, the interest deduction on payment-in-kind notes and high-yield original issue discount ("OID") debt instruments with maturities in excess of five years would be deferred until such interest was actually paid in cash. Furthermore, interest paid on yields in excess of 600 basis points over the applicable federal rate would be deemed to be a non-deductible dividend. Since debt instruments offered in exchange offers frequently reflect enhanced interest rates to attract the interest of investors, a company's ability to issue new high-yield OID debt instruments or modify an old high-yield OID debt instrument while at the same time obtaining or continuing current interest deductions on such instruments is curtailed by the applicable tax rules.
- **Limitation on Net Operating Loss Carryforwards:** If equity securities are offered in exchange for debt securities, an analysis must be conducted to determine whether an ownership change under Section 382 of the Internal Revenue Code of 1986 would occur, limiting the company's future use of net operating loss carryovers after the occurrence of such change.
- **Creation of New OID and Disallowance in Bankruptcy:** Typically, upon the bankruptcy of a debtor, unamortized OID becomes a disallowed claim in bankruptcy courts. The question arises whether new OID would be created in an exchange offer where the outstanding securities are surrendered for new securities with a lower face amount. Courts have held that "face value"

exchanges—an exchange where the outstanding debt securities are substituted with new debt securities with the same principal amount—do not generate disallowable OID.¹⁵ Although the first such court, in dictum, also suggested that "fair value" exchanges—*i.e.* transactions where the outstanding debt securities are exchanged for new securities with a reduced principal amount—might be treated differently from "face value" exchanges and result in OID (the difference between the face amount of the new security and its trading price), most practitioners do not believe the idea withstands analysis. There are no cases directly on point regarding the issue of "fair-value" exchange.

- **Substantial Modification of Debt versus Distressed Debt Treatment:** In an exchange offer, the company should perform an analysis as to whether the transaction would be treated as a substantial modification of debt or receive distressed debt treatment. If there is a substantial doubt as to the company's ability to continue as a going concern, the company may not be able to account for the transaction as a substantial modification of debt. Under the substantial modifications of debt treatment, the company would be able to recognize a gain on the extinguishment of the debt securities upon the consummation of the transaction and record the new debt at fair value. The difference between the fair value and the principal amount of the new instrument will be expensed over the term of the new instrument as interest and added to the balance sheet. If the transaction is not accounted for as substantial modifications of debt, the company

¹⁵ See *In re Chateaugay Corp.*, 961 F.2d 378, 381-382 (2d. Cir. 1992); *In re Pengo Industries, Inc.*, 962 F.2d 543 (5th Cir. 1992).

would have to record the new debt at par value plus all applicable interest payments as a liability on its balance sheet. The difference between the principal amount of the exchanged debt and the recorded value of the new instrument will be recorded as a gain or loss, as the case may be. This liability will be reduced over the term of the new instrument and, as such, the company would not record interest expense related to the new debt in future periods.

This memorandum is for general information purposes and should not be regarded as legal advice. If we can be of assistance regarding the matters discussed in this memorandum, please contact your relationship partner or any member of our Corporate Department, including those listed on the following page:

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The names and office locations of all of our partners, as well as memoranda regarding recent legal developments, can be obtained from our website, www.simpsonthacher.com.

This memorandum was not intended or written to be used, and cannot be used, for the purpose of avoiding tax-related penalties under Federal, State or local tax laws.

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