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Not Your Father's Debt Restructuring: Overview of Recent Developments in Restructuring Convertible Debt

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Public companies that wish to pursue restructurings of outstanding debt must address a number of legal and business issues prior to launching any restructuring. This is particularly true for restructurings of convertible debt, which can be more complicated to structure and complete than restructurings of non-convertible debt, in part because convertible debt is treated as an equity security for purposes of the U.S. tender offer rules and the possible need for stockholder approval for issuances of new equity or convertible debt in excess of certain thresholds under stock exchange rules. Issuers engaging in exchange offers and other convertible debt restructurings must pay close attention to various Securities and Exchange Commission ("**SEC**") rules and regulations, including registration requirements and exemptions, tender offer rules and proxy rules.[2] Planning a restructuring without careful consideration of these rules and recent developments may result in a proposed restructuring that cannot be completed or carries significant risk of delay in launching or completing the restructuring.

At the outset of any proposed restructuring involving convertible debt, certain fundamental structuring questions should be addressed. These questions are summarized below. Please note this is a summary, and for a more detailed discussion of the issues raised in this article and a detailed discussion of some of the legal, practical and logistical issues raised in many exchange offers, please click here or contact John Utzschneider, Gitte Blanchet or your regular Bingham contact.

Question 1: How many holders will the issuer need to participate in the exchange in order for it to be successful?

At the outset, the issuer and its advisors should consider the goals of the proposed debt restructuring, including the amount of debt sought to be exchanged. Knowing these goals is important because it will frame much of the analysis with respect to subsequent questions such as application of the tender offer rules. As part of this initial analysis, the issuer should also determine to the extent possible the ownership of its outstanding convertible debt. This can be done by engaging a proxy advisory/consent solicitation firm that should be able to determine ownership based on its search processes. In addition to determining the number of holders, it is also useful to determine whether there are any ownership concentrations that would allow an individual or group of bondholders to block the exchange offer and to better inform the issuer about the type of investor holding the convertible debt.

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[2] We note that at the 2011 SEC Speaks conference, on February 4 - 5, 2011, Michele Anderson, Chief of the SEC's Office of Mergers and Acquisitions stated that the SEC would be providing additional guidance in 2011 with respect to issuer debt tender offers. While she emphasized this would be guidance with respect to tender offers for straight debt securities as opposed to convertible debt, some of the Staff's new guidance may be relevant to convertible debt tender offers as well.

Question 2: How much time does the issuer have to complete a restructuring, and how long could the proposed restructuring take?

The issuer should determine whether it has any outside dates by which it must complete a restructuring. This outside date could be based on the need to complete a restructuring as a condition to completing a new money financing, or the need to address an upcoming interest payment or a looming event of default. The issuer should then compare the anticipated timeline for the proposed restructuring. For example, if the issuer has a deadline 45 days out, a proposed restructuring in the form of a registered exchange offer, which could take 3-4 months, will not work. In this situation, the issuer must address the deadline event or choose a more streamlined restructuring transaction, such as a privately negotiated exchange for a smaller amount of outstanding debt. In addition, the issuer should look at its proposed timeline and determine whether it can provide the requisite financial information (such as audited financials) when required in its SEC filings over the course of the proposed restructuring.

Question 3. Is the transaction a tender offer?

Because convertible debt is considered to be an equity security under the tender offer rules, exchange offers for convertible debt and offers to purchase convertible debt for cash may be subject to the same tender offer rules applicable to tender offers for common stock.[3] If a convertible debt exchange offer by an issuer is determined to be a tender offer, it will be subject to the provisions of Rule 13e-4[4] promulgated pursuant to the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), including the following requirements:

- the tender offer must remain open for a minimum period of 20 business days and at least ten business days from the date notice is given of any change in the percentage of the class of securities being sought, the consideration offered or the dealer's solicitation fee;[5]
- bondholders must be permitted to withdraw securities tendered in the tender offer at any time during the period when the tender offer remains open and, if tendered securities have not yet been accepted for payment, after the expiration of 40 business days from the commencement of the tender offer;[6]
- if the tender offer is for less than all of the outstanding securities, in the event that more securities are tendered than the issuer is willing to accept, the issuer must accept the securities on a *pro rata* basis;[7]
- the tender offer must also be open to all bondholders of the class of securities subject to the tender offer (sometimes referred to as the "**all holders rule**");[8] and

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[3] Although this article deals primarily with exchange offers, we note that any proposed acquisition of convertible debt for cash should also be analyzed to determine whether it is a tender offer. An exchange offer for non-convertible debt, if determined to be a tender offer, is also subject to a few of the basic tender offer rules contained in Regulation 14E, including the 20 business day requirement. Because most of the rules described above do not apply to exchange offers for non-convertible debt, issuers have much more flexibility in structuring the exchange offer.

[4] See 17 C.F.R. § 240.3a11-1 (2010).

[5] 17 C.F.R. § 240.13e-4(f)(1) (2010).

[6] 17 C.F.R. § 240.13e-4(f)(2) (2010) .

[7] 17 C.F.R. § 240.13e-4(f)(3) (2010).

[8] 17 C.F.R. § 240.13-e4(f)(8)(i) (2010). The SEC has, however, indicated that a tender offer may be made for fewer than all outstanding securities, but all bondholders must be eligible to accept the offer if they choose. See Amendments to Tender Offer Rules: All-Holder and Best-Price, Exchange Act Release No. 34-23421, (July 17, 1986). The all-holders rule does not prohibit the issuer from excluding bondholders in any jurisdiction where the tender offer is prohibited by administrative or judicial action after the issuer has made a good faith effort to comply with the applicable statute. See 17 C.F.R. § 240.13e-4(f)(9) (2010).

- the consideration paid to any bondholder for securities tendered in a tender offer must be the highest consideration paid to any other bondholder for securities tendered in the tender offer (sometimes referred to as the "**best price rule**").[9]

The tender offer rules also contain antifraud provisions prohibiting issuers from, in connection with a tender offer, employing any device or scheme to defraud a person, making any false statements of material fact or omission of a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading or engaging in any act or practice that operates or would operate as a fraud or deceit on any person.[10]

Prior to finalizing the structure of the proposed exchange offer, an issuer must determine whether its proposed exchange offer will constitute a tender offer. The term "tender offer" is not defined in the Exchange Act. However, in *Wellman v. Dickinson*,[11] the court proposed a test consisting of the following eight factors: (i) active and widespread solicitation; (ii) solicitation of the holders of a substantial percentage of the securities; (iii) the offer is made at a premium over the prevailing market price; (iv) the terms of the offer are firm and not negotiable; (v) the offer is contingent on the tender of a fixed number of securities and may be subject to a maximum number of securities to be purchased; (vi) the offer is open for a limited period of time; (vii) the offerees are pressured to sell their securities; and (viii) whether the announcement of a purchasing program precedes or accompanies rapid accumulations of the issuer's securities.[12] All eight factors need not be present and the weight of the various factors will be considered in determining whether a tender offer exists.[13] Not all courts apply the *Wellman* test. In *Hanson Trust PLC v. SCM Corporation*,[14] the court stated that the true test of the existence of a tender offer is whether there appears to be a likelihood that there will be "a substantial risk that solicitees will lack information needed to make a carefully considered appraisal of the proposal put before them," unless the tender offer rules are followed.[15] Some courts have also declined to find that an offer was a tender offer when the offerees are sophisticated.[16]

If an issuer is proposing one or more exchange offers limited to institutional investors, the exchange offer may not give rise to a tender offer even though the issuer may be seeking to exchange a significant portion of the securities outstanding. Privately negotiated exchanges are sometimes appropriate when an issuer wants to exchange a portion of a series of securities that is concentrated among a few holders. Issuers should discuss with their advisors the rules-of-thumb for determining whether a privately negotiated exchange or series of exchanges will be deemed to constitute a tender offer. For an example of a transaction structured as a series of exchange offers that were not treated as a tender offer but exchanged approximately 80% of the issuer's debt of that series, refer to Pier 1 Imports Inc.'s 2009 privately negotiated debt exchanges.[17]

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[9] 17 C.F.R. § 240.13e-4(f)(8)(ii) (2010).

[10] See 17 C.F.R. § 240.14e-1- § 240.14f-1(2010).

[11] *Wellman v. Dickinson*, 475 F. Supp 783 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983) (cited with approval in Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers, Exchange Act Release No. 34-43069 64 FR 46581 (July 24, 2000).

[12] See *Wellman v. Dickinson*, 475 F. Supp 783 (S.D.N.Y. 1979), aff'd, 682 F.2d 355 (2d Cir. 1982), *cert. denied*, 460 U.S. 1069 (1983). The eighth factor, rapid accumulation following a public announcement, was first articulated in *S-G Securities, Inc. v. Fuqua Inv. Co.,* 466 F. Supp. 1114 (D. Mass. 1978).

[13] See Commission Guidance on Mini-Tender Offers and Limited Partnership Tender Offers, Exchange Act Release No. 34-43069 64 (July 24, 2000).

[14] *Hanson Trust PLC v. SCM Corporation*, 774 F.2d 47 (2d Cir. 1985).

[15] *Id.*

[16] See *In re General Motors Class E Stock Buyout Securities Litigation*, 694 F. Supp. 1119 (D. Del. 1988).

[17] See Pier 1 Imports Inc., Current Report (Form 8-K) (July 31, 2009), SEC Comment Letter, dated October 28, 2009, *available at* http://www.sec.gov/Archives/edgar/data/278130/000000000009060764/filename1.pdf, and Pier 1 Imports Inc., SEC Response Letter, dated November 12, 2009, *available at* http://www.sec.gov/Archives/edgar/data/278130/000110465909064497/filename1.htm

Question 4: Will the transaction have to be registered with the SEC under the Securities Act?

Unless the restructuring involves the purchase of debt solely for cash, the end result of the exchange offer will be the issuance of a new security, and therefore an issuer must either find an exemption from the registration requirements of the Securities Act of 1933, as amended (the "**Securities Act**"), or file a registration statement with the SEC to register the issuance of the securities to be issued in the exchange offer. Common exemptions include: Section 4(2) of the of the Securities Act, which provides an exemption for transactions not involving any public offering; Section 3(a)(9) of the Securities Act, which provides an exemption for an offer to exchange existing securities for new securities that is made by the "same issuer"; and Section 1145 of the Bankruptcy Code, which provides that the registration requirements of the Securities Act do not apply to the offer or sale of securities pursuant to a plan of reorganization.[18] Issuers should discuss the intricacies and requirements of these exemptions from registration with their advisors.

Question 5: Can the issuer discuss the proposed exchange offer with bondholders and can bondholders sign lock-ups?

In order to increase the likelihood of an exchange offer's success, an issuer may desire to engage in negotiations with bondholders and possibly have bondholders enter into lock-up agreements whereby the holders agree to tender their securities in the exchange offer and agree to any indenture consent being solicited. If the issuer is contemplating a registered exchange offer, the issuer must be careful not to run afoul of the so-called "gun jumping" prohibitions under the Securities Act with respect to such pre-commencement communications. Gun jumping occurs when an "offer" is made prior to the filing of a registration statement under the Securities Act or "sales" are made prior to the effectiveness of the registration statement.[19] The SEC interprets the word "offer" very broadly; accordingly, the issuer and its advisors should be careful in their pre-launch communications with bondholders to avoid violating the registration requirements of the Securities Act.

Rules 165 and 166 promulgated under the Securities Act provide exemptions from the gun jumping prohibitions in connection with certain communications between an issuer and holders of its securities. Combined, Rules 165 and 166 allow an issuer to communicate with its bondholders prior to launching an exchange offer in order to assess their receptiveness to various terms and potentially to discuss with certain bondholders the possibility of entering into lock-up agreements. In addition, an issuer may attempt to get one or more of its bondholders to enter into lock-up agreements ahead of launching an exchange offer to increase the certainty of a successful outcome, which in turn may encourage other bondholders to tender in the offer. If the exchange offer is structured as a non-registered exchange offer under Section 4(2)/Regulation D or Section 3(a)(9), there is no prohibition on the issuer entering into lock-up agreements with bondholders. However, in the context of a registered exchange offer, an issuer must ensure that entering into a lock-up agreement with bondholders does not constitute gun jumping or otherwise violate securities laws. The issuer and its advisors should review the SEC's Compliance and Disclosure Interpretation 139.29 (issued in August 2010) ("**CDI 139.29**"). In CDI 139.29 the SEC states that the execution of a lock-up agreement with a bondholder prior to filing a registration statement in connection with a registered debt exchange offer may constitute a contract under the Securities Act, which would cause an offer and sale of the issuer's securities to be made to the locked-up holders prior to the exchange offer being made to other bondholders; however, the Staff stated that it will not object to

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[18] See 11 U.S.C. 1145 (2006).

[19] See, e.g., *SEC v. Arvida Corp.*, 169 F. Supp. 211 (S.D.N.Y. 1958) and Guidelines for the Release of Information by Issuers Whose Securities are in Registration, Securities Act Release No. 33-5180 (August 20, 1971).

the registration of subsequent offers and sales pursuant to an exchange offer when lock-up agreements have been signed as long as the following conditions are met: (i) the lock-up agreements are only signed by accredited investors; (ii) the persons signing the lock-up agreements own less than 100% of the outstanding principal amount of the relevant series of notes; (iii) the issuer will make a tender offer to all holders of the relevant series of notes; and (iv) all bondholders eligible to participate in the exchange offer are offered the same amount and form of consideration.[20] C&D Technologies, Inc.'s fall 2010 convertible debt exchange offer provides some real-world lessons in using CDI 139.29.[21]

Question 6: Will the issuer need stockholder approval for the exchange offer?

It is not unusual in convertible debt exchange offers for issuers to offer more shares as part of the exchange (or new convertible debt with more shares issuable on conversion) than are issuable under the outstanding convertible debt. Prior to commencement of the exchange offer, the issuer must determine whether it has sufficient authorized shares to issue all the shares that could be issued in the exchange offer or upon conversion of the new convertible debt. If the issuer does not have sufficient authorized shares, it will need to obtain stockholder approval to amend its charter to increase the number of authorized shares. The issuer must also review the corporate law of its jurisdiction of incorporation to determine the vote necessary to increase its authorized shares. In order to increase the likelihood of obtaining stockholder approval, the issuer will need to work closely with its proxy advisor to ensure that the proposal to increase the authorized shares is treated as a discretionary proposal for purposes of the rules governing proxy voting by brokers so that brokers will be authorized to vote on the proposal even without instructions from their client.[22] Issuers should also review the current proxy voting guidelines published by ISS, a subsidiary of MSCI Inc., to determine whether the requested increase in authorized shares falls within ISS' guidelines for share increases. Additionally, if the issuer is listed on Nasdaq and NYSE, stockholder approval may be required under Nasdaq Marketplace Rule 5635 or NYSE Rule 312.03.

Question 7: Should the issuer consider a prepackaged bankruptcy as part of the process?

Holdout bondholders often raise serious issues in exchange offers. The holdout problem arises when bondholders have a preference (either real or asserted as a negotiating strategy) for retaining the existing securities. One or more bondholders may decide not to tender in the exchange offer hoping that a sufficient number of other bondholders tender so that the exchange offer is successful, decreasing the odds that the issuer pursues a restructuring in bankruptcy. A restructuring in bankruptcy can eliminate the holdout problem because, if the requisite votes are obtained, the reorganization will bind all bondholders of that class. Accordingly, depending on the terms of the exchange offer and the level of participation necessary for the successful completion of the exchange offer, the level of participation necessary to approve a bankruptcy plan may be lower, and issuers may want to consider a prepackaged or prearranged bankruptcy plan alternative. Another potential route for an issuer is to combine an out-of-court exchange offer with a prepackaged bankruptcy. In such a situation, the issuer would offer to exchange existing securities for new securities at the same time it solicits acceptances of a prepackaged Chapter 11 reorganization plan. If an issuer desires to pursue a combination exchange offer/prepack, the issuer should evaluate separately whether the exchange offer and the prepack must be registered under the Securities Act or if there is an available exemption from registration. If the issuer can't identify an

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[20] See *id.*

[21] See C&D Technologies SEC Response Letters dated November 9, 2010 and November 23, 2010 *available at* http://www.sec.gov/Archives/edgar/data/808064/000119312510253526/filename11.htm and http://www.sec.gov/Archives/edgar/data/808064/000119312510267569/filename11.htm.

[22] See NYSE Rule 452.

available exemption for the pre-bankruptcy filing solicitation of votes, the issuer will need to consider whether to register the offering with the SEC or move to another approach such as a pre-arranged bankruptcy.

Conclusion

As suggested by the introduction to this article, planning is everything when considering a restructuring of convertible debt. Issuers should involve counsel early in the process to assist them in making sure the proposed debt restructuring can be structured in a manner that both maximizes the chances of a successful outcome and complies with applicable securities laws and stock exchange requirements. With advanced planning and careful execution, issuers can utilize convertible debt exchange offers as an effective way to reduce interest payments and lengthen the maturities of outstanding debt.

As noted in the introduction, this is only a summary discussion. For a more detailed discussion of the issues raised in this article and a detailed discussion of some of the legal, practical and logistical issues raised in many exchange offers, please click here or contact John Utzschneider, Gitte Blanchet or your regular Bingham contact.