

LIABILITY MANAGEMENT TRANSACTIONS FOR HIGH-YIELD NOTES

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Securities and Capital Markets Practice Group Webinar

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PAUL
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LIABILITY MANAGEMENT OVERVIEW

- Transactions designed to restructure debt securities
- Includes:
 - Open market purchases or privately negotiated transactions
 - Tender offers—offers to purchase for cash
 - Exchange offers—offers to exchange notes for other securities or obligations; it is a form of tender offer
 - Consent solicitations—solicitation of consents to amend terms of notes, either on a stand-alone basis or in conjunction with a tender offer or exchange offer
- Tender offers are mainly designed to “capture the discount” of the notes when they are trading below par
- Exchange offers can also be used to “capture the discount,” extend maturities or alter the capital structure in an out-of-court restructuring

CONSIDERATIONS FOR OPEN MARKET PURCHASES

- Open market purchases may be subject to the Williams Act and other related regulations regarding tender offers
 - Material non-public information (MNPI) Considerations
 - Consider whether purchaser and other participants may have MNPI
 - Blackout periods
 - 10b5-1 trading plan
 - Non-disclosure agreements, wall cross procedures and “Big Boy” letters
 - Debt held by the issuer or an affiliate of the borrower/issuer is often subject to limitations on voting (including for waiver and consent purposes)
 - Extensive repurchases of notes/bonds should be structured to avoid being considered a “creeping” tender offer, which implicates additional regulatory and documentary requirements
 - If a potential tender offer to all holders is contemplated, plan carefully to avoid integration with the tender offer
 - Bankruptcy Considerations

TENDER OFFER OVERVIEW

- Why undertake a tender offer?
 - To refinance notes that are not currently callable (if no “make-whole” during non-call period)
 - To de-lever by repurchasing notes below the applicable call price
- Parties involved in a tender offer are:
 - The issuer (or a third party, such as a sponsor or affiliate making the offer)
 - The investment banks acting as dealer managers
 - Information and tender agent (e.g., DF King; Global Bondholder; InnisFree; etc.)
 - Depositary (i.e., DTC)
- No SEC filing required, but subject to the tender offer rules:
 - Must remain open for at least 20 business days from commencement, except in certain circumstances
 - Must remain open for at least 10 business days following a change in certain terms
- Not an offering of securities, but still subject to antifraud provisions of the securities laws.

EXCHANGE OFFER OVERVIEW

- Why undertake an exchange offer?
 - To refinance debt that is not currently callable
 - To extend maturity profile of the issuer, or amend other pricing terms or “sacred” rights that would require unanimous consent to amend
 - To “capture the discount” of notes trading below par in order to reduce aggregate principal amount of indebtedness
 - To reorganize the capital structure, by, for instance, offering secured notes in exchange for unsecured notes while maintaining a relatively consistent interest rate profile
 - Option for issuers with less cash (compared to a tender offer)
- Parties involved in an exchange offer are:
 - The issuer
 - The investment banks acting as dealer-managers
 - Information and exchange agent (e.g., DF King; Global Bondholder; InnisFree; etc.)
 - Depositary (i.e., DTC)
 - Auditors for the issuer
 - Trustee and collateral agent (if secured notes) for the existing notes
 - Trustee and collateral agent (if secured notes) for the new notes

CONSENT SOLICITATIONS/EXIT CONSENTS

- Issuers may solicit consents to approve amendments to terms of existing notes, either as a stand-alone transaction or in conjunction with a tender offer or exchange offer:
 - In a stand-alone consent solicitation, this usually is accomplished through payment of a consent fee, which ranges from 20 basis points to 50 basis points; pricing depends on scope and nature of proposed amendments
 - There is no securities law or rule requiring that consent fees be provided to all participating holders; however, there is often a provision of the indenture requiring any fee be paid to any participating holder
- Consent thresholds for amendments:
 - Most negative covenants: typically majority
 - Asset Sale and Change of Control covenants are typically a majority unless an asset sale or change of control offer has been triggered (at which point typically becomes a “sacred” right)
 - Collateral release: typically 66 2/3% (occasionally 75% or 90%)
 - Economic terms and other “sacred” rights (principal, maturity): 100%
 - Indentures typically provide that notes held by the issuer or its affiliates are not considered outstanding for purposes of calculating consent thresholds
- “Stripping the covenants” through exit consents in a tender or exchange offer:
 - Issuer concurrently solicits the consent of tendering/exchanging noteholders to the modification or elimination of existing debt covenants, and the acceptance of the tendered/exchanged debt is often conditioned upon obtaining requisite consent
 - Designed to induce holders to accept the tender or exchange offer because any benefit of nonparticipation is often outweighed by the loss from retaining notes stripped of desired covenants

- Long-standing history of courts viewing the ability to “strip covenants” and release collateral to be permissible even if coercive, so long as permitted under the indenture and notes
- Several years ago, in connection with several cases involving covenant strips in exit consents, a court in New York held that exit consents violated the Trust Indenture Act of 1939 (TIA), but was subsequently overruled
 - In *Marblegate and Caesars*, the U.S. District Court for the Southern District of New York held that the relevant exit consent in each case violated Section 316(b) of the TIA, reasoning that Section 316(b) prohibits not only impairment of a dissenting bondholder’s formal right to payment, but also “practical impairment” of such right.
 - In January 2017, in a 2–1 decision, the Second Circuit reversed the district court’s ruling in *Marblegate*
- Section 316(b) of the TIA prohibits only non-consensual amendments to an indenture’s core payment terms
- *Marblegate* approached as somewhat of an aberration, and exit consents are generally still considered permitted under the terms of customary indentures, so long as parties are not doing something fraudulent in connection with the process
 - Trustee requires an officers’ certificate and opinion from issuer’s counsel that amendment is in compliance with the indenture

SECURITIES LAWS CONSIDERATIONS FOR EXCHANGE OFFERS

- Exchange offers involve the offering of securities as regulated by the Securities Act of 1933 and so new securities must be registered absent a registration exemption.
- Two main exemptions relied upon in context of exchange offers to avoid registration:
 - Section 4(a)(2)
 - Exchange offers typically limited to qualified institutional buyers (QIBs) and non-US persons
 - Essentially follows the framework for a Rule 144A/Reg. S offering
 - Drawback: if there are any holders who do not fit into these categories, may be limiting potential tenders for “retail investors”
 - Approximately 90% of recent high-yield notes are “private-for-life” and therefore do not have a retail component
 - New notes are not freely tradeable, and consideration needs to be given to investor base (e.g., will they demand registration rights on new notes?)
 - Section 3(a)(9)
 - Exempts from registration any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange
 - “No commission or remuneration” provision means bankers are prohibited from soliciting exchanges and receiving success fees
- TIA applicable if existing notes were registered, which is not customary any longer (Note: Most private-for-life indentures expressly opt out of TIA).

CONSIDERATIONS FOR OFFERS BY SPONSORS AND AFFILIATES ⁹

- Tender offers for notes can also be made by sponsors or affiliates of the issuer, and sponsors or affiliates can also conduct open-market purchases
- Sponsors and affiliates will be subject to the same regulatory requirements as if the issuer itself were conducting the offer
 - Rule 10b-5
 - Tender offer rules
 - Antifraud
- MNPI
 - The purchaser should consider whether it possesses MNPI about the notes or the issuer, such as unreleased recent operating results
 - U.S. securities laws may require disclosure or result in liability for those who purchase debt securities while in possession of such information
- Consideration should be given to the business purpose of the affiliate or sponsor repurchase, and applicable provisions of the indenture
 - Most indentures provide that notes held by affiliates of the issuer are deemed not to be outstanding for purposes of calculating consent thresholds and voting

APPLICABLE REGULATIONS AND EXCHANGE OFFER LIABILITY

- Exchange offers are considered tender offers under the Federal securities laws.
- Therefore, under the tender offer rules, the offer must remain open for at least 20 business days, except tender offers satisfying certain conditions (i.e., abbreviated debt tender offers).
- Offer must remain open for at least 10 business days following certain amendments to the terms:
 - Change in percentage of securities being sought
 - Change in tender price or dealer manager fee
- Other amendments to offer terms may require extensions of offer period by at least five business days.
- No SEC filing required, but still subject to applicable regulations relating to the private offering of securities and to antifraud rules applicable to all tender offers.
- Issuers and dealer managers may be subject to Rule 10b-5 liability.

- ***Offer to Purchase (Tender Offer)***
 - Contains brief summary of business of the issuer, including risk factors specific to the tender offer
 - Contains descriptions of the covenants being stripped, if concurrent consent solicitation
 - Contains a description of the mechanics and process to follow to tender existing notes
 - Can incorporate information by reference to existing reports
- ***Offering Memorandum (Exchange Offer)***
 - Contains business and financial information about the issuer, including risk factors, MD&A and audited financial statements
 - Contains descriptions of the new notes being offered and a comparison of the rights of the new notes against the existing notes
 - Contains a description of the mechanics and process to follow to tender existing notes
 - Offering memorandum can incorporate information by reference to existing reports
- ***Eligibility Letter (Exchange Offer)***
 - Letter that holders must complete, certifying their eligibility as a QIB or non-US person in order to participate
- ***Letter of Transmittal/ATOP Message***
 - The document or process by which holders tender their existing notes in the offer
 - Letter of Transmittal is not necessary, if all notes are held through DTC
- ***Information and Tender/Exchange Agent Agreement***
 - Agreement between issuer and the information and tender/exchange agent

KEY DOCUMENTS FOR TENDER OR EXCHANGE OFFERS (CONT'D)¹²

- ***Dealer Manager Agreement***

- Agreement between issuer and investment banks executed at launch of the offer
- Bank fees: fees for banks structured to take into account success of transaction; usually structured as a fixed percentage per existing notes tendered
 - 10-50 bps of the principal amount of existing notes tendered or exchanged
- Contains reps and warranties, indemnities and conditions similar to a purchase agreement

- ***Comfort Letter (Exchange Offer)***

- Letter from the issuer's auditors that helps establish a due diligence defense by expertizing portions of the offering memorandum and documents incorporated by reference
- Typically delivered at launch and at each settlement date

- ***Legal Opinions***

- Opinions from counsel to the issuer and the dealer managers regarding corporate status of the issuer, validity of the new notes (if applicable) and securities law compliance
- Typically delivered at launch and at each settlement date

- ***Press Releases***

- Press release by the Issuer at launch of the offer, early settlement, final settlement and any extension (if applicable)

- ***Support Agreement***

- Sometimes there is a "support agreement" with an ad hoc committee of noteholders negotiated and signed prior to launch of exchange offer (deal is already done for their support of the offer)

PROCESS FOR TENDER OR EXCHANGE OFFERS

Time Frame	Steps
<i>Prior to Launch (days to several weeks)</i>	<ul style="list-style-type: none"> • Identify holders—information agent to lead this process • Due diligence—same as for a 144A/Reg. S high-yield offering (exchange offer only) • Prepare offering memorandum/offer to purchase, eligibility letter and, if necessary, letter of transmittal • Negotiate dealer manager agreement, comfort letter (exchange offer only) and opinions
<i>Launch (T+0)</i>	<ul style="list-style-type: none"> • Execute dealer manager agreement • Comfort letter (exchange offer only) and opinions delivered • Launch press release issued
<i>Early participation date (T+10)</i>	<ul style="list-style-type: none"> • Last day for holders to tender and receive early participation premium • Coincides with withdrawal deadline • Press release of early participation results issued next business day
<i>Expiration Date (T+20)</i>	<ul style="list-style-type: none"> • Press release of offer results issued next business day
<i>Final settlement date (T+22)</i>	

Note: Days referenced are business days

- **Stand-alone Consent Solicitations**
 - No minimum time requirement under securities laws; generally, 10 days
 - Usually extended three to five days, following material modification of consent solicitation

- General structuring considerations: consensual vs. coercive transactions
 - Up-tier transactions (e.g., exchanging junior debt for more senior debt in the capital structure)
 - Amendments and waivers (e.g., waiver of defaults and/or maturity extensions)
 - Drop-down financings: unrestricted subsidiary/non-guarantor restricted subsidiary transactions with asset transfers and new money financings
 - Priming new money debt investments (e.g., investment of new secured debt to prime existing secured/unsecured debt)
 - Primary covenant issues:
 - Investment/restricted payment capacity for non-guarantor and/or unrestricted subsidiaries
 - Debt capacity for non-guarantor restricted subsidiaries
 - Asset sale vs. restricted payment capacity for asset drop-down transactions
 - Flexibility to refinance junior debt with more senior/senior secured debt

- Early Participation Premium
 - Premium given to tendering holders who tender on or before the 10th business day of the offer (referred to as the early participation date)
 - Customarily, approximately 5% of the principal amount of the notes subject to the offer
- Fixed Price vs. Fixed Spread vs. Modified Dutch Auction Pricing
 - Modified Dutch auction pricing allows competitive pricing by which holders specify an exchange ratio within a specified range
- Withdrawal Date
 - Customarily, withdrawals permitted through early participation date
- Early Settlement Date
 - Customary provision allowing for settlement of the offer following the early participation date

DIFFERENT STRUCTURES FOR EXCHANGE OFFERS

- Debt-for-Debt
 - Extension of maturities
 - Amendments to covenants
 - Amendments to collateral
- Debt-for-Debt *plus* “Equity Kicker”
 - Debt exchange for debt, plus some type of equity (e.g., warrants)
 - Stock exchange shareholder approval rights for equity issuance, if public company
 - “Equity Kicker” often 5-15% of equity at a penny strike price
- Debt-for-Equity
 - Full “out-of-court” restructuring through exchange offer or “pre-pack” bankruptcy, where existing debt takes virtually all equity except some “tip” to existing management and/or equity
 - Confirm enough authorized stock under the company’s charter
 - Stock exchange shareholder approval rights for equity issuance, if public company
 - Change-in-control provisions in existing agreements

RESPONSES TO THE HOLDOUT PROBLEM

Because participation is voluntary, tender and exchange offers must be structured to account for holdouts.

Carrots	Sticks
Greater market value	Risk of bankruptcy
Greater interest rate	In an exchange offer, non-exchanging holders may own notes that are junior to those held by the exchanging holders
Shorter maturities	Exit consents, leaving no covenant protection for existing notes
Senior or secured position	Limited liquidity for holdouts following the offer
More restrictive covenants	
Early participation premium and consent fees for tendering in first 10 days of offer	
“Equity Kicker” as part of consideration for exchange	

NO ACTION RELIEF: FIVE BUSINESS DAY TENDERS

- In January 2015, the SEC gave no-action relief for offers of non-convertible debt securities where the tender offer satisfies various criteria set forth therein:
 - Shortens the 20-business day period for which a tender offer must be open to five business days
 - Shortens the 10-business day period requirement for changes in consideration offered to five business days, and for any other material changes to the terms to three business days
- Criteria for five-day tender/exchange offer are:
 - Offer must be for any and all of a class or series of non-convertible notes
 - Be made by the issuer of the notes, a wholly owned subsidiary of the issuer or the parent of the issuer
 - Be open to all holders of the notes
 - Be made for cash and/or qualified debt securities (i.e., non-convertible notes that (i) are identical in all material respects to the targeted notes except for the payment-related dates, redemption provisions and interest rate; (ii) have interest terms payable only in cash and (iii) have a weighted average life to maturity that is longer than that of the targeted debt securities)
 - Not be financed with debt that is senior to the notes
 - Have a guaranteed delivery feature
 - Be announced no later than 10 a.m. ET on the first business day of the five-business day period through a widely disseminated press release
 - Provide for certain withdrawal rights
 - Use benchmark pricing mechanisms
 - Not include an early settlement feature

- The abbreviated tender offer process is not available if the offer is made:
 - In connection with a consent solicitation to amend the documents governing the subject notes
 - If there is a default or event of default under any of the issuer's material debt agreements
 - If the issuer is the subject of bankruptcy or insolvency proceedings or has commenced an out-of-court restructuring or a pre-packaged bankruptcy process
 - In anticipation of or in response to, or concurrently with, a change of control, merger or other extraordinary transaction involving the issuer
 - In anticipation of or in response to a competing tender offer
 - Concurrently with a tender offer for any other series of the issuer's securities made by the issuer or certain affiliates, if the effect of such offer would result in a change in the capital structure of the issuer
 - In connection with a material acquisition or disposition

3(a)(9) EXCHANGE OFFERS

- **Exchange offer by the issuer without a formal dealer manager or solicitation agent pursuant to Section 3(a)(9) of the Securities Act**
- **Requirements:**
 - The issuer of the old securities must be the same as the issuer trying to exchange for the new securities.
 - *exception can be made if the new issuer has unconditionally assumed all of the old issuer's obligations*
 - The holders must not be asked to part with anything of value besides the outstanding securities.
 - *Issuer can pay security holders extra amounts to participate in exchange, and security holders may pay amounts to effect an equitable adjustment of with regard to other tendering holders*
 - Exchange can only be offer to the current holders of the issuer's securities.
 - The issuer cannot pay any commission or remuneration to any party for soliciting the exchange (bankers are prohibited from soliciting exchanges and receiving success fees).

3(a)(9) EXCHANGE OFFERS (CONT'D)

- **Advantages:**

- Limited documentation compared to other exchange offers (no dealer manager agreement or registration statement required, minimal opinions required)
- Bank or other third party may act as a financial advisor to the issuer
- Comfort letter not required
- No Section 11 liability
- Does not require cash on hand
- Can be accomplished relatively quickly in comparison to registered exchange offers

- **Disadvantages:**

- Cannot hire banks or brokers to solicit tenders or make recommendations to holders
- May face holdout issues from existing holders, with lowered ability to interact with holders
- If subject to tender offer rules, offer must be made to all existing security holders and all investors of the same class must be paid the same price

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