Debt Repurchases and Amendments: U.S. Securities Law Considerations

Until the current dislocation of the financial markets, issuers engaged in tender and exchange offers with respect to their debt securities in order to refinance at lower cost of borrowing and decrease cash interest expense. These options remain available to companies whose bonds are trading below par because of market (rather than operational or general economic) factors and who have access to cash. However, in the face of a slowing global economy and closed capital markets, companies are rediscovering the advantages of the same liability management tools as protection against covenant breaches and refinancing risk.

Following on our client note in which we summarised potential issues under the Market Abuse Directive that may arise in connection with open market repurchases, we set out below certain considerations that arise under the U.S. Securities Exchange Act of 1934 (the “Exchange Act”) and the U.S. Securities Act of 1933 (the “Securities Act”) in connection with (i) open market repurchases, (ii) tender offers, (iii) exchange offers and (iv) consent solicitations relating to debt securities held by U.S. persons. We assume for the purposes of this note that the issuer of the notes is a foreign private issuer¹ for purposes of U.S. federal securities laws and that the notes are non-convertible² and not registered or listed on an exchange in the United States.³

Open Market Repurchases

Issuers with notes trading at stressed levels often wish to purchase such notes in order to retire them at a discount. An open market purchase or series of negotiated transactions may be the most straightforward approach to repurchasing debt as the U.S. federal securities regulation distinguishes between accumulations of securities and tender offers which are subject to the tender offer provisions of Section 14 of the Exchange Act and the regulations thereunder.

Application of the U.S. tender offer rules

The term “tender offer” is not defined in the Exchange Act or rules adopted by the U.S. Securities and Exchange Commission (the “SEC”), but the SEC has developed a list of eight factors for determining whether an open market purchase programme or series of negotiated purchases extended to U.S. holders by use of U.S. jurisdictional means (e.g., the U.S. mail, wire services, the Internet, etc.) is a tender offer subject to Section 14 of the Exchange Act. The factors are:

(i) active and widespread solicitation of public securityholders;
(ii) solicitation for a substantial percentage of the target's outstanding securities;
(iii) an offer price representing a premium over prevailing market price;
(iv) firm rather than negotiable terms;

¹ “Foreign private issuer” is defined in Rule 3b-4 under the Exchange Act as any foreign issuer other than a foreign government, except an issuer meeting the following conditions: (i) more than 50 per cent. of the issuer’s securities are owned directly or indirectly by U.S. residents; and (ii) a majority of the issuer’s executive officers or directors are U.S. citizens or residents, or more than 50 per cent. of the issuer’s assets are located in the United States, or the issuer’s business is administered principally in the United States.

² Only tender offers for equity securities are subject to Section 14(d)(1) of the Exchange Act and Rule 14d-1 thereunder. Convertible debt is considered to be an equity security under Section 3(a)(11) of the Exchange Act. Consequently, tender offers for convertible debt should comply with both Regulation 14D and Regulation 14E of the Exchange Act.

³ Where the tender or exchange offer and any related consent solicitation is for equity securities (including debt securities convertible into equity securities) registered under Section 12 of the Exchange Act, the issuer has to consider the requirements of Rule 13e-4, the “going private” Rule 13e-3 and the proxy rules set forth in Regulation 14A.
(v) solicitation contingent on a minimum amount of securities or subject to a fixed maximum;

(vi) an offer open for a limited period of time;

(vii) pressure on public securityholders to sell; and

(viii) public announcements preceding or accompanying purchases.

Whether open market or negotiated purchases constitute a “creeping”, or de facto, tender offer will be a facts-and-circumstances determination, and there is always some risk that large accumulations will be challenged as a tender offer, subject to applicable rules in the United States.

**Potential consequences of making a “creeping” or “de facto” tender offer**

If a series of open market or negotiated purchases is deemed to constitute a de facto tender offer and the applicable U.S. rules have not been complied with, the issuer may be subject to suits or challenges from investors who have not been able to sell their securities in such open market purchases, particularly after the price of the securities has fallen. In addition, if a formal tender offer is launched in close proximity to an open market purchase, holders objecting to coercive terms or exit consent provisions in the formal tender offer may challenge the open market purchases and argue that such open market purchases should have been conducted pursuant to the terms of the tender offer. Any such challenges could impact the viability and timing of a successful tender offer or buy-back programme.

**Structuring open market purchases to avoid application of the U.S. tender offer rules**

To minimise the risk that U.S. tender offer rules will be deemed to apply to open market or negotiated purchases, such purchases should be conducted through a dealer manager with liability management capability and knowledge of the ownership profile for the outstanding notes. If only a portion of the issue is to be reacquired, the objective should be to obtain that amount from the smallest number of institutional holders in order to avoid the appearance of a general solicitation. Noteholders should be contacted on a selective basis and the sales force at the securities firm conducting the purchases should apply no pressure on the holders of the notes, set no time limit on the holder to make a decision and be prepared to negotiate the purchase price subject to the issuer’s approval.

**Cash Tender Offers**

If the open market purchases cannot be structured to avoid the U.S. tender offer rules or if the issuer seeks to repurchase the whole class of notes, the offer will be subject to the tender offer provisions of Regulation 14E under the Exchange Act.

**Minimum tender offer period**

Rule 14e-1(a) of Regulation 14E requires that all tender offers must be held open for at least 20 business days from the date the offer is first published or sent to securityholders. Pursuant to Rule 14e-1(b), if there has been a change in the number of securities sought or in the offer price, the tender offer must remain open for at least 10 business days from the date that notice of such change is first published or sent to securityholders.

In the case of issuer tender offers for non-convertible, investment-grade debt securities, the SEC has provided no-action relief from the 20- and 10-business day requirements so long as the debt tender offer satisfies certain conditions, which vary depending on whether the debt tender offer is for a fixed price, a fixed spread, a real-time fixed spread or a continuously priced fixed spread. In no event may an offer be open for less than seven calendar days.
Pricing options

There are various methods by which the purchase price for debt securities can be determined. In respect of investment grade debt, the SEC staff has approved (in addition to a fixed price), fixed price spread, real-time fixed price spread and continuously priced fixed spread options, provided that the issuer meets certain requirements (which vary depending on the pricing option used), such as tendering for all debt of a particular class or series, opening the tender to all record and beneficial holders of that class and making certain disclosures with respect to the methodology used to calculate the price. Fixed spread cash tender offers for non-investment grade debt securities are considered by the SEC staff on a case-by-case basis.4

Dutch auctions

Rules also allow debt tender offers by way of a “dutch auction”, or by “modified dutch auction”. Issuers using dutch auctions for debt tender offers are not required to disclose the minimum and maximum prices to be paid in the tender. The SEC staff has, however, required at least one such issuer to revise a tender offer to include a price range where the original tender offer did not.

“Early-bird” specials

U.S. tender offer rules also permit an issuer to offer dual settlements, whereby noteholders are given the option to tender early in exchange for an early participation payment in addition to the purchase price of tendered debt.

Regardless of pricing mechanism used, “prompt payment” provisions of Exchange Act Rule 14e-1(c) apply to all tender offers. Since 1995, the SEC staff has taken the view that “prompt payment” under that rule requires payment no later than three business days after the tender offer concludes.

Complying with antifraud provisions

Tender offers for debt are subject to certain basic antifraud provisions, including Section 14(e) of the Exchange Act, Regulation 14E and Rule 10b-5 under the Exchange Act (“Rule 10b-5”). Section 14(e) is a broadly worded antifraud provision that prohibits any person, in connection with a tender offer, from making any false or misleading statements, as well as from engaging in any fraudulent, deceptive or manipulative act. Rule 14e-3 of Regulation 14E prohibits any person in possession of material information relating to a tender offer which that person knows or has reason to know has been acquired from specified sources to trade in the securities subject to such tender offer unless the information and its sources are publicly disclosed by a press release or otherwise.

In addition to the antifraud provisions of Section 14(e) and Rule 14e-3, the issuer, and possibly its financial adviser, would have potential liability for any material misstatements or omissions in connection with the offer pursuant to Rule 10b-5. Where new securities are used as consideration,4

4 In general, the SEC staff has granted informal no-action relief upon receiving the following assurances:
   • The date for fixing the actual tender offer price must be no later than the second business day prior to the expiration of the tender offer;
   • At least two firms make a market in the high yield securities;
   • There is some minimum level of trading activity in the subject bonds and the bonds trade generally on a spread to Treasuries basis;
   • The period for consenting to exit amendments and receiving the consent fee end at least five business days prior to the expiration of the tender offer period; and
   • In the case of tender offers coupled with an exit amendment, assurances that there will not be a material adverse change in the trading price of the bonds that were not tendered and accepted in the tender offer.
the issuer will also have liability exposure under the Securities Act, including Section 11 (for a registered offering) and Section 12.

As a result, an issuer will often voluntarily disclose information relating to itself and/or the tender offer. For instance, the issuer may issue a press release concerning itself and the offer.

**Avoiding the application of the U.S. tender offer rules**

**“Tier I” exemption**

An offer may qualify for the “Tier I” exemption from the tender offer rules if the issuer and its advisers can establish that 10% or less of the notes are held by U.S. resident holders. This exemption requires a “look through” of clearing systems, banks, brokers and other nominees to the beneficial owners, which can be difficult and time consuming. Perhaps most importantly, holders of notes held in bearer form may be presumed to be outside the United States unless the issuer “knows or has reason to know that these securities are held by U.S. residents”.

The SEC released on 19 September 2008 certain amendments to the Tier I exemption, including, among other changes, permitting the offeror to calculate U.S. ownership as of any date no more than 60 days before, and no more than 30 days after, the public announcement of the transaction rather than as of the date that is 30 days prior to the publication of the offer document as currently required. Where the offeror cannot conduct the look-through analysis within the 90-day period, the SEC will permit the use of a date not more than 120 days before the public announcement. Further, the revised rules no longer require that individual holders of more than 10% of the subject securities be excluded from the calculation of U.S. ownership. These amendments will be effective from 8 December 2008.

In practice, it can be difficult for an issuer to establish that 10% or less of its notes are held by U.S. residents, which has limited issuers’ ability to rely on the Tier I exemption when making a debt tender offer. Nonetheless, U.S. beneficial ownership remains a factor to consider when seeking to avoid U.S. jurisdiction.

**Avoiding U.S. jurisdiction**

An issuer that does not want to comply with the U.S. tender offer rules, and which does not qualify for the Tier I exemption, may seek to avoid the application of the U.S. tender offer rules by avoiding the use of U.S. jurisdictional means. It should be noted that U.S. securities laws do not prescribe a method for avoiding U.S. jurisdictional means, and certain such attempts have been the subject of litigation. The SEC has, however, provided informal guidance in this area, which it reiterated most recently in connection with the amendments to the cross-border tender offer rules of September 2008 discussed above. Pursuant to that guidance, an offeror must do more than simply purport to exclude U.S. securityholders from the transaction by the use of legends and disclaimers. Rather, the offeror must also implement adequate measures reasonably designed to guard against purchases from and, in the case of an exchange offer, sales of securities to, U.S. securityholders.

Practically speaking, this would mean the offer document could not be sent into the United States and forms of acceptance could not be received from the United States, thus precluding the participation of all U.S.-based persons, whether beneficial owners of the securities or registered owners, such as custodians. To ensure that U.S. jurisdictional means are not implicated, the issuer would need to implement appropriate procedures, including, among others:

1. adding language to the offer document and other offering materials requesting that nominees, custodians, etc. not forward the materials to anyone in the United States;

---

(ii) not permitting participation in the offer by anyone in the United States, and refusing to acknowledge any acceptance where the form of acceptance indicates that it has been sent from the United States; and

(iii) restricting certain publicity, including not having any road shows in the United States and only distributing press releases outside the United States (with appropriate legends).

**Exchange Offers**

Where an issuer wishes to modify certain terms of its notes but finds it impracticable to obtain noteholder consent from each noteholder affected, it may choose to offer new notes with the desired terms in exchange for the outstanding notes.

*Minimum exchange offer period*

Rule 14e-1 of Regulation 14E applies to all exchange offers. The timing and prompt payment requirements discussed above in connection with cash tender offers are applicable to exchange offers as well.

*Avoiding U.S. registration*

To the extent new notes are used as consideration for the offer, such securities would either have to be registered with the SEC under the Securities Act or qualify for an exemption from registration. Registration could be accomplished on a Form F-4, but this would be a difficult, time-consuming and expensive process. Regulation S under the Securities Act would provide an exemption for new notes outside the United States so long as there are no “directed selling efforts” for the new notes in the United States. With respect to any U.S. holders, there are several alternatives.

**Section 3(a)(9)**

Section 3(a)(9) of the Securities Act provides an exemption from registration where certain requirements are satisfied, including, among others, that (i) the issuer not pay its financial adviser or others a fee to solicit U.S. holders and (ii) the existing notes that are the subject of the tender offer and the new notes offered be issued by the same issuer.

The analysis of whether any fees paid to a financial adviser constitute a solicitation fee in violation of Section 3(a)(9) is highly fact specific. Activities that would render the Section 3(a)(9) exemption unavailable include, for example, payment of a “success fee” or other fee based on the outcome of the offer, as would any actions taken by the financial adviser that could be viewed as a recommendation for holders to participate in the offer. The SEC has, however, decided not to take enforcement action where an issuer paid its financial advisers for a fairness opinion on the proposed exchange as well as when such financial advisers subsequently participated in discussions with noteholders but as part of “effecting” rather than “promoting” the exchange.

Issuers seeking to rely on Section 3(a)(9) for exchanges of guaranteed notes must pay particular attention to the requirement that tendered notes and new notes be from the same issuer, since under the Securities Act, the guarantor of a note would also be considered an issuer. The SEC has interpreted strictly this requirement for the availability of the exemption.

**U.S. private placement**

If the offer was not generally extended into the United States, the issuer could offer new notes to U.S. holders who are “accredited investors” and/or “qualified institutional buyers” (“QIBs”) as defined in the Securities Act on a private placement basis. In order to comply with the private placement exemption, the issuer must ensure that no “general solicitation” or “general advertising” regarding the offer is conducted in the United States. Accordingly, the exchange offer documents should be sent only to
those U.S. holders with whom the issuer has a pre-existing relationship and that the issuer reasonably believes are accredited investors or QIBs. To participate in the offer, noteholders would be required to certify either that they are outside the United States or that they are accredited investors or QIBs and agree to observe certain resale restrictions.

**Tier I exemption**

If the offer qualifies for the Tier I exemption discussed above, the new notes would be exempt from registration pursuant to Rule 802 under the Securities Act. The use of the Tier I exemption would require the issuer to furnish the offer document to the SEC on Form CB and appoint a U.S. agent for service of process by filing Form F-X with the SEC.

**Avoiding the use of U.S. jurisdictional means**

If the offer is not extended into the United States in the manner discussed above, U.S. holders would not receive any new notes. Rather, any new notes to which they were entitled could be sold on their behalf and the proceeds paid to them.

Note that state securities laws (so-called “blue sky laws”) may also be implicated, even if the offer is exempt under U.S. federal securities laws.

**Complying with antifraud provisions**

The issuer and its financial adviser should be aware of potential liability under Rule 10b-5 for material misstatements or omissions in connection with the offer of the new notes in the United States or to U.S. holders, including in the offer document. The remedy for a U.S. holder would be rescission or, if the U.S. holder had already sold its securities, damages equivalent to the decrease in the price of the new notes prior to such sale.

**Consent Solicitations**

As part of tender or exchange offers, issuers often seek “exit” consents for stripping out restrictive covenants from the terms of the notes. Such consents act as an incentive to participate in the offer because they adversely modify the notes that remain in the hands of holdouts. Alternatively, issuers may conduct stand-alone consent solicitations to modify terms that do not require unanimous consent from noteholders for amendment.

**Potential U.S. registration requirements**

Whether an issuer is conducting a consent solicitation simultaneously with a tender offer or on a stand-alone basis, it will need to consider whether the proposed modification of the terms of the note are so substantial that, in essence, such consent solicitation could be deemed an offering of a new security in exchange for the old security, thereby triggering registration requirements under the Securities Act if an exemption from registration cannot be relied upon. Where an issuer seeking consent proceeds without registration or an exemption under the Securities Act and the modification sought is later deemed to constitute a new security (and hence illegally distributed), the distribution may be subject to rescission under Section 12 of the Securities Act and the issuer to antifraud liability under Exchange Act Section 10(b) and Rule 10b-5. Case law and SEC no-action letters suggest that a new security could only be deemed to result from consent solicitations in respect of terms that can only be amended with unanimous noteholder consent.

**Effect of exit consent on minimum tender offer period**

In the case of investment grade, non-convertible notes, the relief from the minimum tender offer period requirements discussed above is not available where such tender offer includes a consent solicitation for covenant waivers or indenture amendments, i.e. the tender offer must be kept open for a minimum
20 business days. However, a fixed spread pricing mechanism may be used in this instance without violating the 10-business day requirement of Rule 14e-1(b) with respect to modifications of pricing.

If a consent solicitation offers a separate consent payment, such consent payment may be considered part of the tender offer consideration even if the consent is solicited separately and independently from the tender. As a result, any increase or decrease in the consent payment will be subject to the 10-business day extension requirement of Rule 14e-1.

**Validity of exit consents**

U.S. courts have upheld exit consents. However, such cases have been in the context of tender or exchange offers for all securities of a particular class. It is possible that an exit consent in a dutch auction may be vulnerable to a legal challenge because, in a partial tender offer, even tendering noteholders may be forced to continue to hold the amended security.

**Key Differences between Rules Applicable to Debt and Equity Tender Offers**

Although not specifically referenced in the Exchange Act, the SEC has confirmed that the proration, withdrawal, “best price” and other provisions set forth in subsections (1) through (8) of Section 14(d) of the Exchange Act are only applicable to tender offers conducted pursuant to Regulation 14D. They do not apply to tender offers governed solely by Regulation 14E, which include debt tender offers. As a result, the issuer may (i) purchase notes on a “first come, first served” basis to encourage noteholders to tender their securities quickly after the commencement of a tender offer, (ii) offer limited or no withdrawal rights, thus limiting the ability of holdouts to persuade tendering noteholders to reconsider their decision and withdraw and (iii) conduct dutch auctions and modified dutch auctions as well as include early-bird specials and thereby avoid paying to all noteholders the highest consideration paid to any one of them or open the offer to all noteholders of the same class.

* * * * *

This note is intended to provide a brief overview of the U.S. federal securities law issues related to debt tender and exchange offers. The specific facts and circumstances of individual transactions will require detailed examination to assess the applicability of the U.S. tender offer rules. Please address any queries to your regular Linklaters contact or any of the partners listed below.
<table>
<thead>
<tr>
<th>Office</th>
<th>Tel No.</th>
<th>Contact</th>
<th>E-mail Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>London</td>
<td>+44 20 7456 2000</td>
<td>David Ludwick</td>
<td><a href="mailto:david.ludwick@linklaters.com">david.ludwick@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jason Manketo</td>
<td><a href="mailto:jason.manketo@linklaters.com">jason.manketo@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Alexander Naidenov</td>
<td><a href="mailto:alexander.naidenov@linklaters.com">alexander.naidenov@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tom O'Neill</td>
<td><a href="mailto:tom.oneill@linklaters.com">tom.oneill@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cecil Quillen</td>
<td><a href="mailto:cecil.quillen@linklaters.com">cecil.quillen@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Brigid Rentoul</td>
<td><a href="mailto:brigid.rentoul@linklaters.com">brigid.rentoul@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jennifer Schneck</td>
<td><a href="mailto:jennifer.schneck@linklaters.com">jennifer.schneck@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Patrick Sheil</td>
<td><a href="mailto:patrick.sheil@linklaters.com">patrick.sheil@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Pam Shores</td>
<td><a href="mailto:pam.shores@linklaters.com">pam.shores@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tom Shropshire</td>
<td><a href="mailto:tom.shropshire@linklaters.com">tom.shropshire@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Steve Thierbach</td>
<td><a href="mailto:steve.thierbach@linklaters.com">steve.thierbach@linklaters.com</a></td>
</tr>
<tr>
<td>New York</td>
<td>+1 212 903 9000</td>
<td>Joshua Berick</td>
<td><a href="mailto:joshua.berick@linklaters.com">joshua.berick@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jeff Cohen</td>
<td><a href="mailto:jeff.cohen@linklaters.com">jeff.cohen@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ray Fisher</td>
<td><a href="mailto:raymond.fisher@linklaters.com">raymond.fisher@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Edward Fleischman</td>
<td><a href="mailto:edward.fleischman@linklaters.com">edward.fleischman@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jon Gray</td>
<td><a href="mailto:jon.gray@linklaters.com">jon.gray@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Scott Sonnenblick</td>
<td><a href="mailto:scott.sonnenblick@linklaters.com">scott.sonnenblick@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Larry Vranka</td>
<td><a href="mailto:larry.vranka@linklaters.com">larry.vranka@linklaters.com</a></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>+852 2842 4888</td>
<td>Hyung Ahn</td>
<td><a href="mailto:hyung.ahn@linklaters.com">hyung.ahn@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sang Lee</td>
<td><a href="mailto:sang.lee@linklaters.com">sang.lee@linklaters.com</a></td>
</tr>
<tr>
<td>Frankfurt</td>
<td>+49 69 71 003 258</td>
<td>Mark Devlin</td>
<td><a href="mailto:mark.devlin@linklaters.com">mark.devlin@linklaters.com</a></td>
</tr>
<tr>
<td>Milan/Rome</td>
<td>+39 02 88 393 5216 (Milan)</td>
<td>Luigi Sensi</td>
<td><a href="mailto:luigi.sensi@linklaters.com">luigi.sensi@linklaters.com</a></td>
</tr>
<tr>
<td></td>
<td>+39 06 367 12 239 (Rome)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paris</td>
<td>+33 1 56 43 58 42</td>
<td>Luis Roth</td>
<td><a href="mailto:luis.roth@linklaters.com">luis.roth@linklaters.com</a></td>
</tr>
<tr>
<td>Singapore</td>
<td>+65 6890 7377</td>
<td>Arun Balasubramanian</td>
<td><a href="mailto:arun.balasubramanian@linklaters.com">arun.balasubramanian@linklaters.com</a></td>
</tr>
</tbody>
</table>

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.