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Liability Management

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Agenda

- Overview of Liability Management and Benefits
- Redemptions
- Open Market Repurchases
- Debt Tender Offers
- Exchange Offers
- Consent Solicitations

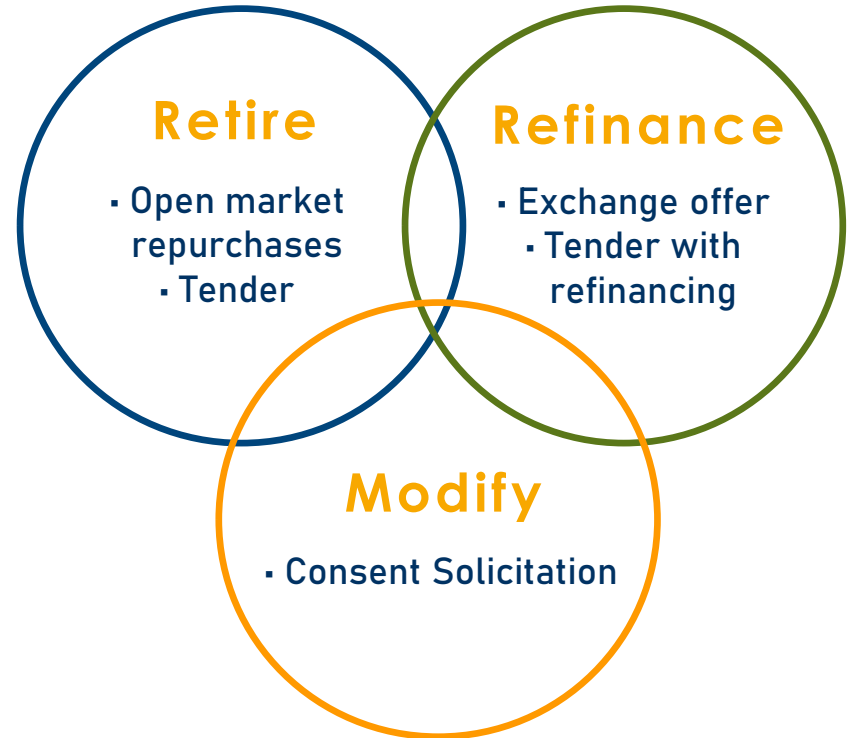


Overview of Liability Management and Benefits



What is liability management?

- Liability management is concerned with helping issuers manage, modify and optimize their outstanding debt portfolio
- The three primary types of liability management transactions focus on retiring, refinancing and/or modifying existing debt instruments



Why is liability management important?

- Perception of issuers supporting their credit curve
- Deleveraging
- Reducing interest expense
- Capture positive economics
- Extending maturities
- Recording of accounting gain
- Potential EPS improvement
- Potential regulatory and ratings benefits
- Increase financing flexibility
- Alternative to more fundamental restructuring or potential bankruptcy
- Capital structure management



How?

Options

Least documentation



Most documentation

Redemptions

Debt tenders

3(a)(9) exchange offers

Debt-for-equity swaps

Repurchases

Private exchange offers

Registered exchange offers

Equity-for-equity exchanges

Least time consuming



Most time consuming

Repurchases for cash

- **Redemptions** – Purchase of outstanding debt securities for cash in accordance with their terms;
- **Repurchases** – Open market or privately negotiated purchases of outstanding debt for cash; and
- **Tender offers** – An offer made to all holders of a series to repurchase outstanding debt securities for cash.

Non-cash alternatives

- Exchange offers, including
 - Private exchange offers (4(a)(2))
 - Section 3(a)(9) exempt exchange offers
 - Registered exchange offers
- One-off exchanges
 - Debt for equity swaps
 - Equity for equity exchanges
- Consent solicitations (although there may be a consent fee)

Choosing among the alternatives

- Will depend upon the issuer's objectives
- Will depend upon the issuer's financial condition:
 - Distressed exchange
 - "Preventive" liability management
 - Opportunistic transactions
- Legal, accounting, ratings, regulatory capital and tax considerations should all be factored into the choice.

Thinking ahead

- Credit/loan facility terms that contain limitations on prepayments
 - May be prohibited
 - May trigger repayment obligations
- Other debt security terms
- Requirement to use proceeds for a particular purpose



Redemptions

Redemptions

- Redeem outstanding debt securities in accordance with their terms, assuming governing documents permit redemption.
 - Certain debt securities may have call protection (not redeemable), or limited call protection (not redeemable for a certain period of time after issuance).
- Other debt instruments may prohibit redemption.
- Indenture usually specifies the procedures.
 - Usually requires notice of not less than 30 nor more than 60 days. Notice should include redemption date, redemption price and specify which, if not all, securities will be redeemed.
 - If not all securities are being redeemed, redemption is usually by lot or pro rata.

Redemptions *(cont'd)*

- Indenture specifies the redemption price.
- For investment grade debt securities:
 - Typically, the redemption price will reflect the holders' yield to maturity on the outstanding debt.
 - Redemption price usually equals the face amount, plus the present value of future interest payments (effectively causing the debt securities to be redeemed at a premium).
- For high yield debt securities:
 - Typically, the redemption price is a fixed percentage (generally, initially par plus half the coupon) declining ratably on an annual basis to par one or two years prior to maturity.

Other considerations

- Issuer must comply with anti-fraud protections under the securities laws.
- Issuers often announce via press release (in connection with providing the notice of redemption) their decision to redeem outstanding debt securities.
 - An issuer should disclose a redemption prior to contacting debtholders if its broader impact on the company's financial condition would be viewed as material.

Fifth Third

- SEC issued a cease and desist order against Fifth Third from committing or causing violations of Reg FD
- Fifth Third issued a redemption notice to a series of trust preferred holders, but did not initially file an 8-K or issue a press release
- Redemption notice was provided by Fifth Third to DTC (as required)
- SEC found Fifth Third failed to consider how its decision to redeem would affect investors in the market for those securities and initially failed to publicly announce the redemption, which the SEC determined was material nonpublic information
- The SEC based its determination of materiality on the trading prices (security was trading at \$26.50, and it was to be redeemed at \$25.00)
- Reminder to issuers to consider public disclosures (in addition to disclosures required by indentures) in the case of issuer tenders, repurchases, redemptions, etc.



Debt Repurchases

Overview

- A repurchase can be affected a number of ways. The issuer may:
 - Negotiate the purchase price directly;
 - Engage a financial intermediary to negotiate and effect open market repurchases;
or
 - Agree with a financial intermediary to repurchase debt securities that the financial intermediary purchases on a principal basis.

Benefits

- Ability to negotiate purchase price allows issuer to take advantage of fluctuating market prices
- Efficient means of refinancing because it requires little preparation, limited or no documentation and modest transaction costs
- Effective if the issuer is seeking to repurchase only small percentage of debt, or if the debt is not widely held

Avoiding the tender offer rules

- An issuer repurchasing its debt securities, whether in privately negotiated transactions or in open market purchases runs the risk that it may inadvertently trigger the tender offer rules.
- The tender offer rules were adopted to ensure that issuer and others conducting tenders for equity securities would be prohibited from engaging in manipulative practices.
- Tender offer is not defined by statute. Courts apply an eight-factor test to determine whether a repurchase is a tender offer:
 1. Active and widespread solicitation of public shareholders for the shares;
 2. Solicitation is made for a substantial percentage of an issuer's stock;
 3. Offer to purchase is made at a premium over the prevailing market price;
 4. Terms of the offer are firm rather than negotiable;
 5. Offer is contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased;
 6. Offer is open only for a limited time;
 7. Offeree is subjected to pressure to sell his stock; and
 8. Public announcement of a purchasing program concerning the target company precedes or accompanies rapid accumulation of large amounts of the stock.

Avoiding the tender offer rules *(cont'd)*

- Repurchase programs should be structured:
 - For a limited amount of securities;
 - To a limited number of holders (preferably sophisticated investors);
 - Over an extended period of time (with no pressure for holders to sell);
 - At prices privately and individually negotiated; and
 - With offers and acceptances independent of one another.

Other considerations

- Private transactions with creditors/debtholders can trigger disclosure obligations under Reg FD.
 - When an issuer discloses any material nonpublic information to market professionals or holders of its securities who may trade on the basis of such information, the issuer must make public disclosure of that information.
- An issuer “testing the waters” may trigger this obligation.
 - May be avoided if the recipients of the information are subject to confidentiality agreements.
 - At what point should an issuer disclose its restructuring activities?
- Issuer should disclose other material nonpublic information (unreleased earnings, potential changes to credit ratings) prior to engaging in repurchases.

Other considerations *(cont'd)*

- Repurchases may trigger Regulation M concerns.
 - Rule 102 makes it unlawful for an issuer to “bid for, purchase, or attempt to induce any person to bid for or purchase, a covered security during the applicable restricted period.”
 - Repurchases of convertible debt may be deemed a “forced conversion” and thus a distribution of the underlying equity security under Regulation M.

Tax considerations

- Repurchase at discount
 - **Issuer:** Generally, cancellation of indebtedness (COD) income equal to adjusted issue price over repurchase price
 - **Holder:** Capital gain, subject to market discount rules, (or loss) to the extent repurchase price is greater (or less) than adjusted basis
- Repurchase at premium
 - **Issuer:** Repurchase premium may be deductible by the issuer as interest expense (Treas. Reg. section 1.163-7(c))
 - Amount in excess of adjusted issue price
 - Section 249: deduction only for a reasonable premium in the case of convertible bonds
 - **Holder:** Capital gain, subject to market discount bond rules

Tax considerations *(cont'd)*

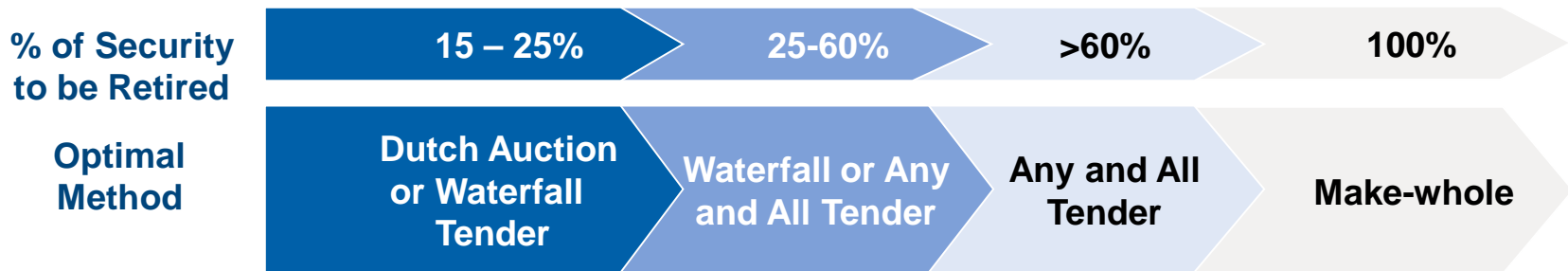
- Related party (50% by value) debt repurchase - COD still realized by debtor
 - Direct purchase by related party
 - “Indirect” purchase where purchaser becomes related
- Exception for debt to be retired within a year
- Deemed issuance to related holder
 - Can create OID – issue price is deemed to be amount paid by related party for the debt
 - No gain or loss to related holder for deemed issuance, but potential for OID



Tender Offers

Overview

- The issuer or a third party makes an offer to purchase the debt for cash
 - The offer may be for “any and all” of the outstanding securities of one or more series or may be for a maximum principal or purchase amount “partial”
 - The price may be fixed, may be at a fixed spread to an identified treasury security or may be based on “Dutch auction” procedures
 - If the offer is for more than one series of securities, the securities may be purchased pursuant to a “waterfall”



Benefits

- Purchase a large amount of securities, typically larger than what is achievable in an open market repurchase program
- Typically able to purchase securities cheaper than redemption/make-whole options
- Able to reach the entire investor base to participate in the offer
- May be combined with a new issue to refinance a series
- May be combined with “exit consents” to amend the underlying indenture, including a covenant “strip” which serves a stick to encourage tender participation

Tenders for convertible debt

- Under the tender offer rules, convertible or exchangeable debt securities are treated like equity securities subject to the rules applicable to equity tender offers (Rule 13e-4).
 - Issuer must file with the SEC a Schedule TO (subject to SEC review).
 - Offer must be made to all holders.
 - “Best price” rule – Consideration paid to any holder for securities tendered must be the highest consideration paid to any other holder for securities tendered.
 - Tender must be announced, usually via *Wall Street Journal* publication.
 - Tender must include withdrawal rights for offer period – securities may be withdrawn after 40 business days from commencement.
 - Issuer may not make any purchases (until ten days after termination of the tender offer) other than through the tender.

Tenders for convertible debt *(cont'd)*

- Things to consider
 - Not possible to “sweeten” the tender offer with an early tender premium.
 - Less flexibility than a tender for straight debt.
 - May have accounting implications.
 - Consider effect on call spread agreements.
 - Tender of convertible debt may be deemed a “forced conversion” and result in a distribution of the underlying equity for Regulation M purposes.

Tenders for straight debt securities

- Tenders for straight debt securities are subject to Regulation 14E, Rules 14e-1, 14e-2 and 14e-3, but not the additional requirements applicable to equity securities.
- A tender offer:
 - May be subject to various conditions to closing, such as receipt of financing or waivers.
 - Must generally be held open for 20 business days
 - Extended for ten days if the amount of securities, provided the amount of securities increase or decreases by more than 2%, and with consideration on if dealer manager's fee increases or decreases.
 - Any extension must be announced via press release the day after scheduled expiration and must indicate the number of securities tendered.
- An issuer may approach all the holders of a series of outstanding debt securities.
- Regulation 14E does not require filing of tender offer documents.

Investment grade v. non-investment grade debt

- Historically, tenders of investment grade debt had been viewed differently by the SEC than those for non-investment grade debt.
- For example, prior to recent no-action letter guidance (available for non-convertible debt, regardless of rating, subject to satisfaction of certain conditions), there were important distinctions between investment grade and non-investment grade:
 - Investment grade debt not subject to the 10- and 20-business day requirements.
 - Issuers of investment grade debt are able to price a tender offer based on a fixed-spread or a real-time fixed-spread over a benchmark security.
- “Hybrids” and trust preferred securities generally considered investment grade debt.

SEC guidance regarding debt tender offers

- The SEC Staff's guidance relating to tender offers for non-convertible debt securities developed through no-action letters and also through more informal interactions
 - Cobbling together no-action letter guidance and reconciling to evolving market practice resulted in some confusion
- In January 2015, the SEC Staff issued no-action letter guidance applicable to tenders for non-convertible debt that provides for an abbreviated process for investment grade and non-investment grade debt provided that the transaction meets certain conditions.
- The 2015 abbreviated tender offer process will not be available in every debt tender or to every issuer. As a result, it remains important to understand the prior rules. Following the issuance of the 2015 no-action letter, both investment grade and non-investment grade tenders, which cannot be conducted in reliance on the relief, will be subject to the prior rules.

Tenders for investment grade debt

- Historically, tenders for non-convertible, investment grade debt were not subject to 20-business day (and 10-business day extension) requirements if:
 - Offers to purchase were made for any and all of the debt securities of a particular series;
 - Offer was open to all record and beneficial holders of the series;
 - Offer was conducted to afford all record and beneficial holders a reasonable opportunity to participate (including expedited dissemination if offer is open for fewer than 10 days); and
 - The tender was not being made in anticipation of, or in response to, other tender offers for the issuer's securities.

Pricing – fixed spread

- Tenders for investment grade debt were priced using a fixed-spread tender.
 - Priced on each day during the offer period by reference to a fixed spread over the then-current yield on a specified benchmark US Treasury security determined as of the date, or a date preceding the date, of tender;
 - The offer provided that information about the benchmark security be reported in a daily newspaper of national circulation; and
 - The offer provided that tendering holders be paid promptly.

Pricing – Real-time fixed-spread

- Tenders for investment grade debt also could be priced using a real-time fixed-spread.
 - Priced by reference to a stated fixed spread over the most current yield on a benchmark US Treasury security determined at the time the holder tenders, rather than by reference to the yield on such benchmark security as of the date, or at the date preceding the date, of tender.
 - The offer must:
 - Clearly indicate the benchmark U.S. Treasury security to be used and must specify the fixed spread;
 - State the nominal purchase price that would have been payable based on the applicable yield of such benchmark security immediately preceding the commencement of the tender;
 - Indicate the reference source to be used to establish the current benchmark yield;
 - Describe the methodology used to calculate the purchase price; and
 - Indicate that the current benchmark yield and the resulting nominal purchase price will be available by calling a toll-free number established by the dealer.

Investment grade v. non-investment grade

Debt pre-abbreviated tenders no-Action relief

- Investment grade debt:
 - Generally, must remain open for 7-10 calendar days;
 - Offer must be extended 5 calendar days for certain modifications to terms;
 - Must be conducted to afford all holders the reasonable opportunity to participate, including dissemination of the offer material on an expedited basis (within two days after commencement);
 - Able to price using a fixed-price spread or a real-time fixed price spread.
- Non-investment grade debt:
 - Must remain open for 20 business days;
 - Offer must be extended 10 business days for certain modifications to terms;
 - Able to use a fixed-price spread that is set two days prior to expiration of the exchange offer.



Abbreviated Tender Offers

Background

- No-action letter was issued on January 23, 2015; C&DIs were issued on November 18, 2016
- SEC Staff will not recommend enforcement action with respect to tender or exchange offers for non-convertible debt securities that are held open for as few as five business days (as opposed to the 20 business days required by Rule 14e-1(a)), with potential extensions of as little as five business days following changes in the offered consideration or three business days following changes in other material terms of the offer
- Letter applies to both investment-grade and non-investment grade debt securities
- Generally, supersedes previously issued no-action letters that had allowed similarly expedited tender or exchange offers only for investment-grade debt securities

Conditions

- In order to rely on the relief, offer must:
 - Be made for any and all securities of a class or series of non-convertible debt;
 - Be made by (i) the issuer of the securities, (ii) a wholly owned subsidiary of the issuer or (iii) a parent company of the issuer;
 - Involve consideration consisting solely of cash or qualified debt securities, or a combination of both
 - “Qualified debt securities” are understood to mean non-convertible debt securities that are (i) identical in all material respects to the targeted debt securities (including as to obligors, collateral, lien priority, covenants and other terms) except for the payment-related dates, redemption provisions and interest rate; (ii) have interest terms payable only in cash; and (iii) a weighted average life to maturity that is longer than that of the targeted debt securities.

Conditions *(cont'd)*

- Not be financed with debt that is senior to the subject securities;
- Be open to all record and beneficial holders of the targeted debt securities, although an exchange offer could be restricted to Qualified Institutional Buyers (as defined in Rule 144A) or non-US persons (within the meaning of Regulation S) so long as other holders of the subject securities have the option to receive cash in an amount equal to the approximate value of the exchange offer consideration;
- Be announced no later than 10:00 a.m., Eastern time, on the first business day of the five business day period, through a widely disseminated press release, which in the case of an offer by an SEC reporting company must also be furnished almost immediately under a Current Report on Form 8-K;
- Permit tenders through guaranteed delivery procedures;
- Use benchmark pricing mechanisms;
- Provide for certain withdrawal rights; and
- Not include early settlement features.

Modifications

- Material changes trigger a requirement to extend the offer period
- Offer period must be extended so that at least five business days remain from and including the announcement of any change in the offered consideration, and at least three business days remain from and including the announcement of any other material change in the offer
- An issuer must notify investors of a material change by a widely disseminated press release, and SEC reporting issuers must file a Form 8-K

Disqualifying events

- 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 securities;
 - 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 to the capital structure of the issuer (e.g., addition of obligors or collateral, increased priority of liens or shortened weighted average life to maturity of such other series); or
 - In connection with a material acquisition or disposition.

Important considerations

- For investment grade debt, prior no-action letters permitted:
 - Tender offers for investment grade debt to remain open for as little as 7 days (now, if the conditions are met, the period can be as short as 5 business days)
 - Issuers to include an early settlement feature (new no-action letter does not allow early settlement)
 - Issuers to deny withdrawal rights (new no-action letter requires withdrawal rights)
 - Consent solicitation could be included in conjunction with the tender offer (abbreviated tender process is not available for an offer that includes an exit consent)
 - Payment in cash (new no-action letter permits cash and/or qualified debt securities)
- In addition, prior no-action letters:
 - Were silent on communication requirements, but the no-action letter specifically requires filing of an 8-K
 - Did not require guaranteed delivery
 - Did not include disqualifying events

Important considerations *(cont'd)*

- General solicitation would be required to be used in connection with satisfying the condition under the no-action letter that the offer be open to all holders of the subject securities
- No “waterfall” or “partial” tenders are permitted in reliance on the no-action letter
- Effectively, for any non-investment grade tender offer that does not qualify for the abbreviated tender relief, then, the tender offer will be subject to the more onerous 20-business day, and 10 business day extension, requirements, and, likely to the dissemination and related requirements of the abbreviated tender no-action letter

Tax considerations

- Generally the same as considerations as repurchases/redemptions
- Treatment of early tender premium?
 - Generally treated as additional consideration for the notes
 - Long-term capital gain to the holder



Exchange Offers

Overview

- The issuer offers investors to exchange a new series of securities for its outstanding securities
- Avoids a trip to the new issue markets / no cash raise required
- Potentially a more efficient means to refinance / extend term
- Typical drivers:
 - Maturity extension (e.g. distressed credit with no access to the new issue market)
 - NPV driven (e.g. refinance notes with lower cost funding)
 - Capital structure driven (e.g. change in obligor)
 - Accounting (e.g. avoid upfront EPS charge in retiring a premium bond)

Refinancing Alternatives

	Exchange Offer	Tender Offer/Redemption with Refinancing
Description	An offer to investors to directly swap their existing notes for new notes	An offer to repurchase existing notes for cash, funded with a new issue
Diagram		
Participation	<p>Holdings must be willing to take the same credit with different duration/coupon</p>	<p>Flexible since holder can participate in the tender, but is not required to buy the new issue (or vice versa)</p>
Accounting Treatment	<p>May be eligible to have the premium paid over book value amortized over the life of the new security (subject to accounting tests)</p>	<p>Upfront accounting charge of premium debt must be recognized upon retirement</p>
New Issue Pricing	<ul style="list-style-type: none"> • Must be set at the launch of the exchange, remain outstanding for 5/20 business days and set without any price talk • May be priced as a concession to “fair” market due to limited investor base 	<ul style="list-style-type: none"> • Determined after price talk • Can be issued in any maturity at any time based on market conditions • Book-building process is the most efficient pricing mechanism
New Issue Execution Risk	<p>None, transaction is self-financing</p>	<p>Can be mitigated by making the tender contingent on the success of the new issue</p>

 = Preferred Alternative

Private exchange offers

- Private exchange offers conducted pursuant to Section 4(a)(2) are subject to limitations:
 - May not constitute a “general solicitation” and must be made only to “sophisticated investors,” usually QIBs.
 - Issuers often pre-certify holders to ensure they meet the sophistication standard.
 - Securities issued will not be freely tradable securities:
 - Holders may request registration rights.
 - Holders may sell under Rule 144 (may be able to tack).

Private exchange offers - process

- A private exchange offer may be conducted on an abbreviated timeline
 - Identify and pre-certify (QIB, accredited investor status) investors;
 - Announce exchange offer;
 - Distribute exchange information (not required to be filed with SEC, not subject to SEC review);
 - Solicit exchanges and/or consents;
 - May engage a dealer-manager to assist.
 - Offer period expires; and
 - Close and announce results of exchange offer.

Section 3(a)(9) exchange offers

- Section 3(a)(9) exempts from the registration requirements “any securities exchanged by the issuer with its existing securityholders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange.”
- Section 3(a)(9) exchange has five requirements:
 - Securities must be of the same issuer
 - SEC will look at the underlying economic reality when examining this issue.
 - SEC provided no-action letter relief for the issuance of a new parent security in exchange for an outstanding parent security that has one or more “upstream” guarantees from the parent’s 100% owned subs
 - No additional consideration from holders
 - The securityholder cannot pay anything of value besides the outstanding security;
 - Rule 149 permits cash payments to effect an equitable adjustment in respect of interest or dividends paid.

Section 3(a)(9) exchange offers *(cont'd)*

- Exchange must be offered exclusively to the issuer’s existing securityholders
 - An issuer may violate this requirement if conducting a simultaneous offering of new securities for cash.
- The issuer must not pay any commission or remunerations for the solicitation of the exchange; and
 - Must consider the relationship between the issuer and the person furnishing the services, the nature of the services performed and the method of compensation.
 - An issuer’s directors, officers and employees may solicit, provided that is not their only role and they receive no bonus for such activities.
 - Activities by third-parties must be “ministerial” or “mechanical.”
- The exchange must be made in good faith and not as a means of avoiding registration.

Section 3(a)(9) exchange offers *(cont'd)*

- Considerations for Section 3(a)(9) exchanges:
 - Securities issued as part of the exchange are subject to the same transfer restrictions as the original securities.
 - Exchange offer may be “integrated” with other securities offerings conducted in close proximity to the exchange.
 - Issuer should apply the SEC’s five-factor integration test in conducting this analysis.

Registered exchange offers

- Registered with the SEC on a Form S-4 registration statement.
 - Must include descriptions of the securities being offered, the terms of the exchange offer, description of the issuer, risk factors, and, if applicable, pro forma financial statements.
 - Commencement may not start until registration statement is declared effective.
 - Rule 162 provides flexibility allowing early commencement provided that no securities are actually exchanged/purchased until the registration statement is effective and the tender has expired.
 - Expanded in December 2008 to apply to exchange offers for straight debt provided the offer has withdrawal rights, if a material change occurs, the information is disseminated in accordance with the tender offer rules and the offer is held open for the minimum periods specified in Rule 13e-4 and Regulation 14D.

Considerations for exchange offers

- Because an exchange offer involves the offering of new securities, participants are subject to liability under Section 11 of the Securities Act.
 - If an issuer engages a financial intermediary to assist with solicitation, it may be subject to statutory underwriter liability and will conduct its own diligence review, and require delivery of comfort letters and legal opinions.
- As with a tender offer, an issuer needs to be mindful of Regulation M's prohibitions on bidding for, or purchasing, its securities when it is engaged in an offer.

Tax considerations

- Same rules apply to a debt-for-debt exchange as an amendment of terms
- “Significant modification” rules
 - A modification is significant only if the legal rights or obligations that are altered and the degree to which they are altered are economically significant
 - Generally, modifications are “significant” if, among other things:
 - The yield changes by the greater of 25 basis points and 5% of the existing yield
 - Scheduled payments are materially deferred
 - Safe harbor equal to the lesser of 5 years or 50% of the original term
 - Modified credit enhancements change payment expectations
 - The nature of the security changes (*e.g.*, from debt to equity [without regard to decline in credit quality] or from recourse to nonrecourse)

Tax considerations *(cont'd)*

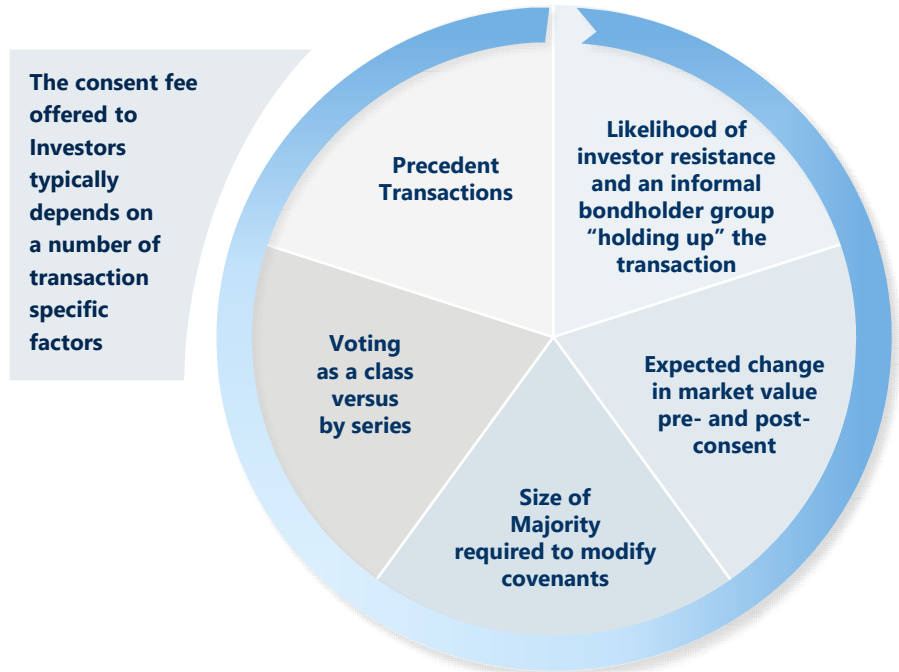
- Consequences to parties
 - Publicly traded?
 - Issuer
 - Potential for COD and OID, exception for issuers in bankruptcy or that are insolvent
 - Corporations that issue obligations with OID as part of their restructuring need to be mindful of potential limitations on the deductibility of this discount
 - Repurchase premium may be deductible by the issuer as interest expense
 - Holder
 - Recapitalization: are the old notes and new notes “securities?”
 - If so, no generally gain or loss
 - If not, generally have gain or loss equal to the difference between the issue price of the new debt and the holder’s basis in the debt instrument, which will usually be a capital gain or loss (except for accrued market discount)



Consent Solicitations

Overview

- Issuer solicits consent to amend the terms of the indenture governing outstanding securities
- Issuer typically offers a consent fee which may depend on how significant the proposed amendments are
- Consent solicitation may be coupled with a tender offer
- May be preceded by negotiation with one or more large holders



Benefits

- Allows issuer to amend restrictive covenants
 - Provide greater operating flexibility under restrictive covenants
 - Permit a potential transaction
 - Incur additional debt
 - Pay dividend
- Modify indenture covenants that restrict or prohibit a restructuring of other debt in order to preserve “going concern” value and avoid bankruptcy.
- Frequently linked with M&A related activity
 - E.g. waive a change of control, amend a reporting requirement, etc.

Consent solicitations

- Must be permitted under the terms of the governing indenture.
- The TIA and most indentures do not permit amendments that reduce principal or interest, amend the maturity date, change the form of payment or make other economic changes unless such amendments are consented to by all holder of the debt securities.
- If the amendments involve a significant change in the nature of the investment, it may be considered an issuance of a “new” security.

Consent solicitations *(cont'd)*

- Concerns
 - Holders may be unwilling to consent to significant modifications because they will still hold the securities afterward.
 - Typically kept open for 10 business days.
- Exit consents are used to change significantly restrictive provisions in connection with a tender or exchange offer.
 - Given by tendering or exchanging holders (who are about to give up their securities) and bind non-tendering or non-exchanging holders.
 - Act as a useful incentive to avoid the “holdout” problem because non-tendering and non-exchanging holders are left with securities that have lost most, if not all, of their protections.
 - An issuer may include a “consent payment” to consenting holders as part of the consideration.
 - Not subject to any legal framework other than contract law principles.

Court cases

Marblegate Asset Management et al. v. Education Management Corp.

- The issuer, Education Management, had bank debt as well as secured notes outstanding, which were guaranteed by the issuer's parent
- Indenture relating to the secured notes provided that the parent guarantee could be released if a majority of the noteholders consented or if the bank creditors released the parent's guarantee of the bank debt
- In an out-of-court restructuring, the issuer and certain of its creditors consented to a release of the parent's guarantee of the issuer's bank debt, foreclosure on the assets of the issuer and its subsidiaries and the foreclosed upon assets would be conveyed by the secured creditor to a new subsidiary that would distribute newly issued debt and equity to the creditors. As part of this restructuring, non-consenting creditors would be left with recourse solely against the issuer and would not receive any debt and equity securities in the restructuring.

Court cases *(cont'd)*

- In 2014, the District Court concluded that the plaintiffs failed to establish a basis for injunctive relief but, in dicta, noted that Section 316 of the Trust Indenture Act was likely violated by the out-of-court restructuring arrangement.
- Section 316 provides that:
 - The right of any holder of any indenture security to receive payment of the principal of and interest on such indenture security, on or after the respective due dates expressed in such indenture security, or institute suit for the enforcement of any such payment on or after such respective dates, shall not be impaired or affected without the consent of such holder....
 - The District Court noted that the section was intended to prevent a holder's core rights from being impaired without that holder's consent. In this case, the restructuring left the noteholders without a source or prospect of recovery

Court cases *(cont'd)*

Meehancombs Global Opportunities Funds, L.P., et al. v. Caesars Entertainment Corp., et al (December 2016)

- The District Court concluded that an out-of-court restructuring that removed certain parent guarantees of obligations issued under two series of notes that was expressly permitted under the terms of the indenture was nonetheless impermissible under Section 316 of the Trust Indenture Act.

Court cases *(cont'd)*

- January 2017, the Second Circuit Court of Appeals overturned the District Court's decision in *Marblegate* holding that Section 316(b) of the TIA was intended to prohibit formal modifications to core payment terms—such as principal amount, interest rate and maturity date—without the consent of all bondholders. In short, Section 316(b) preserved a bondholder's legal right to payment, not the practical ability to receive payment.

Although not expressly stated, it appears that the Second Circuit's decision also tacitly overrules the holding in *Caesars*.

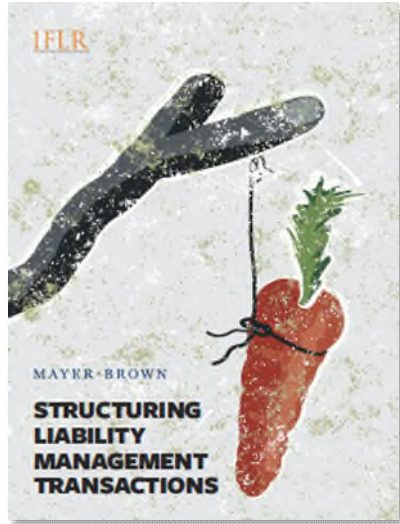
Tax considerations

- Consent solicitations that seek to change “customary accounting or financial covenants” would not, in themselves, be significant modifications
- Tax treatment of consent fees is unclear
 - Tax treatment to holders?
 - Subject to withholding tax if paid to non-US holders?
 - PLR 201105016

Additional resources

IFLR PUBLICATION

[Structuring Liability Management Transactions](#)



Mayer Brown's summary of US legal framework, including guidance in numerous no-action letters applicable to debt repurchases, tender offers and exchange offers. Also presented are some main regulatory and tax considerations.

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