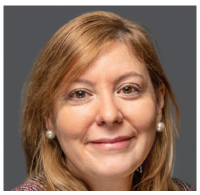
Top 10 Practice Tips: Debt Tender Offers

A Lexis Practice Advisor® Practice Note by Anna Pinedo and Alex Speyer, Mayer Brown LLP



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The following 10 practice points are intended to help you in assisting an issuer with a proposed debt tender offer for cash. Often, issuers of debt securities seek to manage their liabilities through liability management transactions, including debt tender offers for cash. Given the current economic downturn and market volatility resulting from the COVID-19 pandemic, companies with cash on hand may consider repurchasing their outstanding debt for cash. A cash tender offer consists of a public offer by the issuer to purchase all or a portion of the outstanding principal amount of the relevant debt securities from the holders at a specified price, and subject to conditions, set forth in the issuer's offer to purchase.

1. **Consider whether the issuer has enough cash and whether there are more effective liability management alternatives.** Prior to undertaking a debt tender offer for cash, an issuer will need to determine whether it has sufficient cash on hand to effect the repurchases. If an issuer does not have enough cash on hand or views the use of cash to effect a tender offer as an inefficient alternative under the circumstances, the issuer may consider a liability management transaction that does not require deploying cash, such as an exchange offer. In an exchange offer, the issuer offers to exchange new debt or equity securities for certain of its outstanding debt securities. This approach would allow the issuer to achieve a similar result as a debt tender offer by retiring or refinancing outstanding debt securities for non-cash consideration in the form of new securities, thereby obviating the need to deploy cash.
2. **Determine whether the class of debt securities is widely held.** In connection with choosing the appropriate liability management approach, the issuer should consider whether the debt securities are widely held as well as the status (retail versus institutional) and location of the holders. If the debt securities are widely held, privately negotiated or open market purchases may not be efficient for an issuer. In such a situation, a tender offer may be the best way to restructure the issuer's indebtedness. A tender offer allows an issuer to approach or make an offer to all of the holders of a series of its debt securities. Because tender offers do not have to close until specified (and disclosed) conditions are satisfied (including, in some cases, receipt of consents from debt holders to modify the terms of the debt securities that remain outstanding, completion of any necessary financing for the tender offer, and receipt of other necessary consents from third parties), it may be possible to conduct a tender offer and achieve the issuer's objectives.
3. **Consider whether the tender offer rules would apply.** A key consideration in formulating a liability management strategy is the extent to which the Securities and Exchange Commission's (SEC) tender offer rules apply to the contemplated transaction, given that these rules affect the manner in which the transaction must be conducted. The

tender offer rules can apply when a company is offering securities and/or cash for its outstanding securities, and the level of regulation of the offer (in terms of timing and mandated procedural protections) varies depending on the type of security that is the subject of the offer and whether certain conditions necessary for an abbreviated process are satisfied.

An issuer repurchasing its debt securities, either in privately negotiated transactions or in open market purchases, runs the risk that it may inadvertently trigger the SEC's tender offer rules. The term "tender offer" is not specifically defined in statute or in the SEC's regulations. The lack of a specific definition has permitted the SEC and the courts to apply the tender offer rules to a broad range of transactions. Any analysis of whether an offer constitutes a tender offer begins with the often-cited eight-factor test in the *Wellman v. Dickinson* case:

- An active and widespread solicitation of public shareholders for the shares of an issuer.
- A solicitation made for a substantial percentage of the issuer's securities.
- The offer to purchase is made at a premium over the prevailing market price.
- The terms of the offer are firm rather than negotiable.
- The offer is contingent on the tender of a fixed number of shares, often subject to a fixed maximum number to be purchased.
- The offer is open only for a limited period of time.
- The offeree is subjected to pressure to sell his or her security.
- Public announcements of a purchasing program concerning the target issuer precede or accompany a rapid accumulation of large amounts of the target issuer's securities.

These eight factors need not all be present for a transaction to be deemed a tender offer, and the weight given to each element varies based on the facts and circumstances.

Courts have also applied a totality-of-the-circumstances test in determining whether a transaction involves a tender offer that should be subject to the statutory requirements and the SEC's rules. In this context, the courts have examined whether, in the absence of disclosure and procedures required under the tender offer rules, there will be a substantial risk that the offeree lacks the information needed to make an investment decision with respect to the offer. The SEC staff has historically focused on whether a tender offer involves an investment decision on the part of the offeree, particularly where the protections afforded by the tender offer requirements would appear to be necessary based on the nature of the transaction.

For debt repurchases, it is generally possible to structure repurchases in order to avoid the application of these rules. To the extent that an issuer would prefer to avoid the application of the tender offer rules, any repurchase should:

- Be undertaken for a limited amount of securities
- Made to a limited number of holders who are sophisticated
- Not specify a time period or expiration time for the offer
- Be made at prices that are privately and individually negotiated (i.e., the same terms should not be imposed on all offerees) –and–
- Not be conditioned on the issuer having attained a specific principal amount

4. **Determine whether the target class of debt securities is nonconvertible.** The issuer's structuring options also will depend, in part, on the characteristics of the outstanding security. A repurchase or tender for straight debt securities typically will be less complex than a repurchase or tender relating to convertible debt securities. This is because convertible debt securities are treated like equity securities for purposes of the tender offer rules. Specifically, in connection with tenders for convertible debt securities, issuers must comply with the requirements of Rule 13e-4. The obligation to comply with these provisions makes tender offers for convertible or exchangeable debt securities more complicated and time-consuming, and subject the offer to SEC review, which could result in time delays.

In addition, the requirements of Rule 13e-4 result in less flexibility for tenders for convertible or exchangeable debt securities compared to tenders for straight debt securities. A good illustration of this reduced flexibility is that it is not possible for issuers to sweeten the tender offer for convertible or exchangeable debt securities with an early tender premium as would be possible for straight debt securities.

There also may be some accounting issues in connection with repurchasing or tendering for convertible or exchangeable debt securities. While some effects (such as the elimination of the retired debt from the issuer's balance sheet) may be more intuitive, others may not be. Issuers may wish to consult their accountants early in the process. Issuers that intend to restructure their outstanding convertible debt also should consider the effects of such tender on any of their related call spread transactions or share lending agreements.

Finally, under certain circumstances, repurchases of convertible debt securities could be deemed a forced conversion and therefore a distribution of the underlying equity security for purposes of Regulation M. Therefore, it is important to identify early on whether the subject debt securities are convertible debt securities and to structure the tender offer accordingly.

5. **Determine whether the conditions for the abbreviated tender process apply.** In January 2015, the staff of the SEC issued a no-action letter indicating that it would not recommend enforcement action in connection with a tender offer or exchange offer for nonconvertible debt securities that is held open for as few as five business days, to the extent that the offer is conducted in accordance with the following significant conditions (among others):

   - The offer must be structured as an any and all offer, but, may include a minimum tender condition.
   - The offer must be made by the issuer of the debt securities or a parent or a wholly owned subsidiary of the issuer (i.e., third parties tendering for debt securities of an issuer will not be permitted to avail themselves of the shortened tender period).
   - The offer must be open to all record and beneficial holders of the targeted debt securities.
   - The offer must be made solely for cash or other qualified debt securities, which term is defined as securities that are materially identical to the securities that are the subject of the tender offer.
   - The consideration offered in the tender offer must be fixed or based on a benchmark spread (e.g., U.S. Treasury rates, LIBOR, swap rates, or other similar rates).
   - The offer cannot be combined with an exit consent to amend or eliminate covenants or with any other consent solicitation to amend the provisions of the indenture or the debt securities.
   - Holders must be entitled to withdrawal rights until the earlier of the expiration date and, if the offer is extended, the 10th business day following the launch. Holders also must be allowed to withdraw tenders after the 60th business day following the launch if the offer has not been consummated by such time.
   - The offer must permit tenders prior to the expiration time through guaranteed delivery procedures.

   The no-action relief is not available for partial tenders or for tenders or exchanges with exit consents. In addition, the relief is not available:

   - If there exists a default or event of default under the relevant indenture, or under any other indenture or material credit agreement to which the issuer is a party
   - At a time when the issuer is the subject of bankruptcy or insolvency proceedings, or otherwise has commenced activity geared toward accomplishing an out-of-court restructuring or pre-packaged bankruptcy
   - In anticipation of, or in response to, or concurrently with, a change of control or other extraordinary transaction involving the issuer, such as a merger, business combination, or sale of all or substantially all of the issuer's assets
   - 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 of the issuer 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 that would require the furnishing of pro forma financial information with respect to the transaction pursuant to Article 11 of Regulation S-X (whether or not the issuer is an SEC-reporting company)

   Finally, counsel should be aware that any investment grade tender offer that does not qualify for the abbreviated tender offer no-action relief will remain subject to the 10- and 20-day period requirements under the tender offer rules.

6. **Familiarize yourself with the various pricing methodologies that are used for tender offers.** There are several pricing mechanisms that an issuer can use to determine the consideration that it will pay holders to tender their securities. For instance, in order to limit exposure to interest rate fluctuations, issuers may choose real-time fixed spread pricing. Real-time fixed spread pricing permits an issuer/offeror to choose a specific yield spread between the debt being tendered for and a benchmark U.S. Treasury security, which matures at or near the earliest redemption date for such debt security. The purchase price is calculated as the present value of the security subject to the tender offer, discounted at an interest rate equal to the applicable spread. While the actual price to be paid in the tender offer is not fixed at the

commencement of the offer, the formula for determining the price is fixed. The greater the spread, the higher the discount rate, resulting in a lower present value and purchase price.

If an issuer chooses to utilize real-time fixed spread pricing, 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
- 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 manager

7. **Consult with the issuer about retaining a dealer-manager.** Generally, the more complex and significant a restructuring, the more helpful it may be to engage an investment bank as financial adviser. The investment bank will help formulate a plan, locate and identify security holders, structure the transaction, solicit participation, assist with presenting the structure to the various stakeholders, assist with rating agency discussions, and manage the marketing efforts in order to achieve a successful restructuring. Issuers should consider a number of factors, such as the number of debt holders, their sophistication, and whether the issuer has information about, and any contact with, the debt holders.

   The investment bank's role varies in liability management transactions. In a cash tender offer for nonconvertible debt, an issuer may engage an investment bank in an advisory role. In a tender offer for convertible debt securities, which is subject to additional tender offer rules, an issuer may choose to engage an investment bank in an advisory role in order to contact and negotiate the terms with debt holders or to act as an active dealer-manager. In a tender offer coupled with a consent solicitation or a public tender offer for all outstanding debt securities, an issuer usually engages a dealer-manager to manage the entire process. In these transactions, issuers also often use a professional services firm to act as information agent during the process. There are no specific rules regarding compensation preventing issuers from using—and paying—an investment bank to solicit tenders.

8. **Understand the principal negotiating issues arising in connection with the dealer-manager agreement.** The issuer will engage the dealer-manager pursuant to the terms of a dealer-manager agreement. The dealer-manager agreement may be the only agreement between the issuer and the investment bank, or it may supersede an engagement letter relating to the mandate. Usually, the dealer-manager's counsel will prepare the draft agreement, which will detail the dealer-manager's obligations in respect of the transaction and set out the agreement relating to the fees payable to the dealer-manager. The issuer will make representations and warranties to the dealer-manager related to the offer to purchase and other offer materials used in connection with the tender, as well as make representations regarding receipt of all necessary authorizations (if any), corporate approvals, and make other representations comparable to those found in an underwriting agreement. Generally, the dealer-manager agreement will be executed just prior to commencement of the offer. Usually the agreement will require that certain documents, including officers' certificates and legal opinions, be delivered to the dealer-manager at various junctures during the tender offer period.

9. **Familiarize yourself with other securities disclosure requirements applicable to debt tender offers.** Section 14(e) of the Securities Exchange Act is an antifraud provision that establishes the baseline for tender offer regulation. It prohibits an offeror from making any untrue statement of a material fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading. Section 14(e) also prohibits any fraudulent, deceptive, or manipulative acts in connection with a tender offer, and applies to cash tender offers, as well as to exchange offers subject to the tender offer requirements. Prior to undertaking a debt tender offer, an issuer should consider whether it is in possession of any material nonpublic information that must be disclosed, including, but not limited to, the impact of the COVID-19 pandemic on its financial condition or results of operation.

   Under Regulation 14E, an issuer is not required to file any tender offer documents with the SEC, and Regulation 14E does not prescribe any form requirements with respect to offering materials. Any offer to purchase, or other tender offer documentation, is subject, however, to the general antifraud provisions of the Exchange Act, notably Section 10(b), Rule 10b-5, and Section 14(e), and, therefore, may not contain any material misstatement or omission. Some courts have found that Section 14(e) does not impose a scienter requirement (like Rule 10b-5), because, among other things, Section 14(e) prohibits "any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer" in addition to a Rule 10b-5 scienter-based approach that forms part of the first clause in Section 14(e). For example, the Ninth Circuit recently held that Section 14(e) requires only a showing of negligence, without a showing of scienter, to bring a case in connection with alleged misstatements or omissions in connection with a tender offer.

10. **Determine whether there are any tax consequences for holders.** Tax issues can be an important consideration in any liability management transaction. Even with sound tax advice, certain tax consequences are inescapable and must be carefully considered. For instance, corporations with outstanding debt may be subject to tax on cancellation-of-indebtedness (COD) income when all or a portion of such debt has been economically cancelled. COD income can arise in a number of circumstances, including forgiveness of debt by the debt holder, the repurchase of debt by the issuer at a discount, the exchange of one debt instrument of the issuer for another, the modification of debt, and the exchange of debt for equity of the issuer. Additionally, repurchases or exchanges by persons related to the issuer can create COD income. Section 108(a) of the Internal Revenue Code provides a number of exceptions to the inclusion of COD income, including exceptions related to insolvency and bankruptcy.

Related Content

Practice Notes

- Debt Tender Offers
- Debt Tender Offers: Offer to Purchase
- Debt Tender Offers: Letter of Transmittal
- Debt Tender Offers: Legal Opinions and Agent Agreements
- Debt Tender Offer Structuring Considerations
- Debt Securities Restructuring Options

Annotated Forms

- Dealer Manager Agreement (Debt Tender Offer)
- Dealer Manager and Solicitation Agent Agreement (Debt Tender Offer)
- Legal Opinion (Debt Tender Offer) (Offeror's Counsel) (DE Corporation)

Checklists

- U.S. Securities Laws Applicable to Debt Exchange Offers and Cash Tender Offers Chart
- Restructuring Outstanding Debt Securities Chart

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Anna Pinedo is a partner in Mayer Brown's New York office and a member of the Corporate & Securities practice. She concentrates her practice on securities and derivatives. Anna represents issuers, investment banks/financial intermediaries and investors in financing transactions, including public offerings and private placements of equity and debt securities, as well as structured notes and other hybrid and structured products.

She works closely with financial institutions to create and structure innovative financing techniques, including new securities distribution methodologies and financial products. She has particular financing experience in certain industries, including technology, telecommunications, healthcare, financial institutions, REITs and consumer finance. Anna has worked closely with foreign private issuers in their securities offerings in the United States and in the Euro markets. She also works with financial institutions in connection with international offerings of equity and debt securities, equity- and credit-linked notes, and hybrid and structured products, as well as medium term note and other continuous offering programs.

In the derivatives area, Anna counsels a number of major financial institutions acting as dealers and participants in the commodities and derivatives markets. She advises on structuring issues as well as on regulatory issues, including those arising under the Dodd-Frank Act. Her work focuses on foreign exchange, equity and credit derivatives products, and structured derivatives transactions. Anna has experience with a wide range of transactions and structures, including collars, swaps, forward and accelerated repurchases, forward sales, hybrid preferred stock and off-balance sheet structures. She also has advised derivatives dealers regarding their Internet sites and other Internet and electronic signature/delivery issues, as well as on compliance matters.

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