News Bulletin

June 5, 2009

Section 3(a)(9) Exchange Offers

Many issuers are now focused on liability management transactions as part of a new and increased effort to restructure and strengthen their balance sheets in light of the recent financial crisis. Financial institutions also are engaging in liability management transactions in order to meet Tier 1 and other capital requirements. In addition, debtors and creditors recently have been more receptive to pursuing voluntary, out-of-court restructurings as an alternative to bankruptcy. Liability management is attractive for many issuers as there are a wide array of transactions and restructuring options available for issuers, including redemptions, repurchases, debt tenders, private exchange offers, Section 3(a)(9) exchange offers, registered exchange offers, debt for equity swaps, equity for equity exchanges, and consent solicitations.[1]

Background

In an exchange offer, the issuer offers to exchange new debt or equity securities for its outstanding debt or equity securities. An exchange offer often is used as an alternative to a cash tender offer if an issuer does not have or want to use its available cash resources to repurchase outstanding debt or equity securities. For distressed companies, an exchange offer may be the best non-bankruptcy restructuring option. An exchange offer enables an issuer to, among other things:

- reduce interest payments or cash interest expense (by exchanging debt securities with a high rate for a lower rate);
- reduce the principal amount of outstanding debt (in the case of a debt-equity swap);
- manage the maturity dates of outstanding debt (by exchanging debt securities that are coming due for debt securities with an extended maturity);
- modify the terms of securities (for example, interest payment dates, conversion ratios and redemption provisions); and
- reduce or eliminate onerous covenants (if coupled with an exit consent).

An issuer may need to comply with the tender offer rules in connection with an exchange offer, depending on the facts and circumstances.[2] Because an exchange offer also involves the offer of new securities, it must comply with,

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[1] For more information regarding liability management, see our client alert entitled "Liability Management: Is Now the Time to Rebalance Your Balance Sheet?" (Mar. 5, 2009) [hereinafter, Liability Management Client Alert], *available at* http://www.mofo.com/news/updates/files/090305DebtRepurchases.pdf.

[2] This client alert does not discuss the tender offer rules. For more information regarding the tender offer rules, see Liability Management Client Alert, *supra* note 1.

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or satisfy an exemption from, the registration requirements of the Securities Act.[3] An issuer may rely on the private placement exemption provided under Section 4(2) of the Securities Act or the exemption provided by Section 3(a)(9) of the Securities Act. In addition, an exemption pursuant to Regulation S for offers and sales to non-U.S. persons may be available on a stand-alone basis or combined with other applicable exemptions from registration. An issuer also must be mindful of Regulation M's prohibitions on bidding for, or purchasing, its securities when it is engaged in an exchange offer.[4]

Section 3(a)(9) exchange offers present a number of advantages compared to other types of exchange offers and restructuring options, including the following:

- can be completed quickly, as there is no registration required and, therefore, no SEC Staff review (however, if the exchange offer is subject to the tender offer rules, then it is likely that the Schedule TO would be reviewed);[5]
- are flexible (an issuer can retire an entire series or class of debt securities);
- do not require cash on hand (there are only minimal costs);
- there is no Section 11 liability with regard to an offer to exchange, as there is no registration statement required;
- can be paired with a consent solicitation;
- the limitations on OID tax deductions for certain high-yield obligations issued during 2009 have been suspended; and
- often can be accomplished largely tax-free for debt holders.

However, Section 3(a)(9) exchange offers also have a number of disadvantages compared to other exchange offers and restructuring options, including the following:

- the new securities issued in the exchange offer may be "restricted," depending on the status of the securities surrendered for exchange;
- there is a limited ability to engage and compensate an investment bank or other third parties in connection with the exchange offer;
- there may be holdout issues;
- the exchange offer may be integrated with other offers done in close proximity;
- if the exchange offer is subject to the tender offer rules, the offer must be made to all existing security holders; and
- if the exchange offer is subject to the tender offer rules, all investors of the same class must be paid the same price.

This client alert provides (1) a general overview of the requirements under Section 3(a)(9), (2) guidance regarding permissible and impermissible activities and fees with respect to solicitation, and (3) a discussion of other important considerations.

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[3] For this reason, the documentation for an exchange offer (including the offer to exchange) must be more detailed than that for a cash tender offer; for example, the offering materials must describe the terms of the new securities.

[4] If the securities being exchanged are debt securities convertible into equity securities, under certain circumstances, repurchases of the convertible debt securities could be deemed a forced conversion and, therefore, a "distribution" of the underlying equity securities for Regulation M purposes.

[5] When debt securities are offered, an indenture may need to be qualified under the Trust Indenture Act and the Form T-3 filed for the purpose of qualifying the indenture may be subject to SEC Staff review.

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Requirements under Section 3(a)(9)

Section 3(a)(9) of the Securities Act applies to "any securities 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."[6] The exemption from registration provided by Section 3(a)(9) is a transactional exemption only. This means that the new securities issued are subject to the same restrictions on transferability, if any, of the old securities, and any subsequent transfer of the newly issued securities will require registration or another exemption from registration.[7] For example, if the old securities were issued without registration in a Section 4(2) private placement and then were exchanged by a holder for new securities, the holder could only sell or transfer the new securities without registration pursuant to Rule 144, pursuant to Section 4(1), or, with respect to securities held by affiliates, in a Section 4(1-1/2) private placement.

The four main requirements of Section 3(a)(9) are as follows:

- *Same issuer*. The issuer of the old securities being surrendered is the same as the issuer trying to effectuate an exchange of the new securities.
- *No additional consideration from the security holder*. The security holder must not be asked to part with anything of value besides the outstanding securities.
- *Offer only to existing security holders*. The exchange must be offered exclusively to the issuer's existing security holders.
- *No remuneration for the solicitation*. The issuer must not pay any commission or remuneration for the solicitation of the exchange.

In addition, as a general matter and similar to other exempt offerings, any exchange offer under Section 3(a)(9) must be made in good faith and not as part of a plan to avoid the registration requirements of the Securities Act.

Same issuer

Section 3(a)(9) exempts any securities exchanged by the issuer with its security holders. This means that the new securities being issued and the securities that are being surrendered must originate from a single issuer. Although this concept seems relatively straight forward, there are a number of scenarios that can complicate the identity of issuer analysis. In fact, over the years, the SEC Staff has granted no-action relief in response to facts and circumstances that do not fit neatly within the "single issuer" requirement. For example, in *Echo Bay Resources Inc.*, the SEC Staff granted no-action relief under Section 3(a)(9) for an exchange of guaranteed debt securities of a finance subsidiary for the securities of the parent-issuer guarantor.[8] The incoming letter in *Echo Bay Resources* emphasized the economic reality of the transaction, including the relationship between the parent issuer and the subsidiary, noting that the subsidiary was established by the parent-issuer to issue securities and finance the activities of the parent-issuer and the subsidiary had minimal assets and liabilities that were tied to the issuance of securities.[9] However, it should be noted that the SEC Staff takes the view that there is no identity of issuer between a subsidiary and its parent where the subsidiary had outstanding a class of debentures guaranteed by its

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[6] The exemption does not apply with respect to a security exchanged under Chapter 11 of the U.S. Bankruptcy Code. Other exemptions, such as Section 1145 of the U.S. Bankruptcy Code, may apply with respect to securities exchanged pursuant to a plan of reorganization.
[7] *See, e.g.*, SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections (#Question 125.08) (Nov. 26, 2008), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm.
[8] *See* SEC No-Action Letter, Echo Bay Resources Inc. (May 18, 1998).
[9] The incoming letter stated: "In economic reality, it is the [parent issuer's] financial position and business prospects and the value of the [parent issuer's] securities to be issued … that will be of interest to investors in making their investment decisions."

parent and the subsidiary proposed to offer a new debenture that would not be guaranteed by its parent in exchange for the guaranteed debenture.[10]

In *Suntrust Banks, Inc.*, the SEC Staff provided no-action relief in connection with the "same issuer" requirement under Section 3(a)(9), in a situation where the trust preferred trust securities of an existing trust and the substantially similar trust preferred securities of a newly formed trust were deemed to constitute securities of their parent, given that the trusts had limited purposes and the obligations of the trusts were guaranteed under back-up arrangements between the parent and the trusts.[11]

Further, In *Grupo TMM, S.A. de C.V.*, an issuer transferred its common stock to a trust in order to facilitate the exchange of old securities for new ones.[12] The issue in the no-action request was whether the issuance by the trust, which was ostensibly a different issuer, would preclude the issuer from relying on the Section 3(a)(9) exemption. The SEC Staff, without agreeing with counsel's analysis (and noting "policy considerations") provided no-action relief from Securities Act registration requirements. The incoming letter noted that the trust was a special purpose entity established for the sole purpose of allowing investors to obtain the economic right in a security and the trust did not engage in any activities unrelated to this purpose and has no independent financial or economic activity. More significantly, the SEC Staff's approach, along with the approach taken in *Echo Bay Resources Inc.*, *Suntrust Banks, Inc.* and similar no-action letters, indicates that the SEC will often focus on the underlying economic reality of the exchange for the purposes of the identity of issuer analysis.[13]

Consistent with these precedents, issuers have relied on Section 3(a)(9) to exchange common or preferred stock for trust preferred securities. For example, on June 3, 2009, KeyCorp announced an offer to exchange, in reliance on Section 3(a)(9), its common shares for any and all trust preferred securities of KeyCorp Capital I, KeyCorp Capital II, KeyCorp Capital III and KeyCorp Capital IV,[14] and on June 30, 2005, Foster Wheeler Ltd. announced an offer to exchange, in reliance on Section 3(a)(9), its common shares for all outstanding shares of its 9.00% trust preferred securities.[15]

Another frequent concern with the identity of an issuer arises when, through a merger, acquisition or other transaction, an issuer has unconditionally assumed the obligations of the securities of another issuer. The SEC Staff is of the view that the Section 3(a)(9) exemption is available for the exchange of the securities of one issuer for the debt securities of another issuer when the obligations on those debt securities have been fully and unconditionally assumed by the issuer of the new security.[16]

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[10] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections (Question 125.05) (Nov. 26, 2008), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm. In this circumstance, the SEC Staff views the guarantee and the debenture as separate securities, thus the exchange of the old parent guarantee for the subsidiary's new debenture would not involve and exchange between the same issuer, even though the exchange of the primary security is exempt from registration.
[11] See SEC No-Action Letter, Suntrust Banks, Inc. (July 16, 1999).
[12] *See* SEC No-Action Letter, Grupo TMM, S.A. de C.V. (June 27, 2002).
[13] There are a number of other no-action letters and additional SEC materials that provide additional guidance regarding the Section 3(a)(9) requirements. *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections, *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm, SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Rules, *available at* http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm, and SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Trust Indenture Act of 1939, available at http://www.sec.gov/divisions/corpfin/guidance/tiainterp.htm.
[14] *See* Press Release, "KeyCorp Commences Separate Exchange Offers for $503,530,000 of Its Series A Preferred Stock and for $797,647,000 Trust Preferred Securities of Four Affiliated Trusts" (June 3, 2009), *available at* http://finance.yahoo.com/news/KeyCorp-Commences-Separate-prnews-15424331.html?.v=1.
[15] *See* Press Release, "Foster Wheeler Launches New Equity-for-Debt Exchange" (June 30, 2005), *available at* http://phx.corporate-ir.net/phoenix.zhtml?c=80422&p=irol-newsArticle&ID=725266&highlight=.
[16] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections (Question 125.02) (Nov. 26, 2008).

No additional consideration from the security holder

Under Section 3(a)(9), the consideration that security holders exchange must consist only of the old securities. However, there are two limited exceptions to this requirement. First, under Rule 150 under the Securities Act, an issuer can make payments to its security holders "in connection with an exchange of securities for outstanding securities, when such payments are part of the terms of the offer of the exchange." The SEC Staff has provided no-action relief where these payments included cash or a cash equivalent[17] and even when paid by an affiliate of the issuer.[18] Second, under Rule 149 under the Securities Act, a security holder can make any cash payments that may be necessary "to effect an equitable adjustment, in respect of dividends or interest paid or payable on the securities involved in the exchange, as between such security holder and other security holders of the same class accepting the offer of exchange." For example, an equitable adjustment may be necessary when, due to the timing of interest payments and sales between security holders, one security holder receives the benefit of an interest payment due to another security holder. In this case, the issuer can require the unjustly enriched security holder to reimburse the issuer for the extra interest payment. In addition, an issuer can also require the security holders to waive the right to receive an interest payment or other consideration accruing from a security.[19]

Offer only to existing security holders

Any exchange offer conducted in reliance on Section 3(a)(9) may be made only to existing security holders. Although this requirement also appears straight forward, it may not be satisfied if an issuer is conducting an offering of new securities for cash at the same time as the exchange offer. In this case, the issuer must take care to keep the two offerings separate and avoid their "integration," which would require the registration of the combined offerings or the application of another exemption from registration. The determination regarding integration is fact specific, and the issuer must apply the SEC's five-factor test.[20]

Further, if any part of the issue in the same transaction as the exchange is sold for cash, or intended to be sold for cash, or provided to creditors (as opposed to security holders), even if those portions of the transaction are exempt pursuant to another exemption or are registered, then Section 3(a)(9) would not be available.[21]

There is no requirement, however, that a Section 3(a)(9) offering be made to all members of a given class of security holders (assuming that tender offer rules do not apply to the transaction). As a result, an issuer may choose to rely on Section 3(a)(9) to exchange with securities with one or a limited group of investors.

No remuneration for solicitation

Section 3(a)(9) expressly prohibits an issuer from paying a person or entity a commission or other remuneration either directly or indirectly for soliciting the exchange. When determining what activity and/or commission or other remuneration is permissible under Section 3(a)(9), an issuer or a third party involved in the exchange should consider the following factors:

- the relationship between the issuer and the person or entity furnishing the services;
- the nature of the services performed; and

[17] *See* The News Corporation Limited, SEC No-Action Letter (May 15, 1992) and International Controls Corp., SEC No-Action Letter (Aug. 6, 1990).
[18] *See* Carolina Wholesale Florists, Inc., SEC No-Action Letter (Aug. 17, 1976).
[19] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections (#Question 125.04) (Nov. 26, 2008), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm.
[20] The five-factor test requires that an issuer consider: (1) whether the offerings are part of a single plan of financing; (2) whether the offerings involve issuances of the same class of securities; (3) whether the offerings are made at or about the same time; (4) whether the same type of consideration is received; and (5) whether the offerings are made for the same general purposes. *See* SEC Release No. 33-4552 (Nov. 6, 1962).
[21] *See* Release No. 33-2029 (Aug. 8, 1939).

- the method of compensation for the services.

Issuer's activities

As a general rule, an issuer may solicit holders of target securities without jeopardizing the use of the Section 3(a)(9) exemption. An issuer soliciting holders of target securities should adhere to the following guidelines:

- the personnel chosen to contact the security holders, which may include the issuer's directors, officers, and key employees (the "corporate solicitors"), should have significant responsibilities with the issuer other than the solicitation of the exchange and should not be hired for the purpose of soliciting the exchange;
- no special bonus, commission, fee, or any other type of remuneration should be paid to the corporate solicitors for their solicitation activities, which means they should be paid no more than their regular salary; and
- the corporate solicitors should attend to their regular duties, with their solicitation efforts only being additional assignments.[22]

Third party activities

An issuer also may engage third parties, such as financial advisers, investment banks, and investor relations firms, to assist in the exchange offer, subject to certain limitations. Whether an issuer should engage a third party for assisting with an exchange offer and the services that the third party will provide depends on the issuer's particular situation and the type of transaction contemplated. Generally, the more complex and significant a restructuring (for example, a restructuring for a distressed company), the more helpful it may be for an issuer to engage a financial intermediary, such as an investment bank. The type of transaction will dictate an investment bank's role (including any limitations on its activities), which ranges from merely an advisory role to responsibilities as an agent or principal. However, an issuer merely interested in taking advantage of declining secondary market prices for debt securities also may benefit from engaging an investment bank to locate, contact, and negotiate with security holders to retire (or exchange) their securities on favorable terms. In either case, an investment bank, which typically has a "liability management," "restructuring," or "workout" team specializing in debt restructurings, will help create a restructuring plan, structure the transaction, solicit participation, and manage the marketing efforts to achieve a successful restructuring. Some important factors to consider in determining whether to engage a third party include the number of security holders and their organization and sophistication and whether the issuer has information about, or any contact with, its security holders.

Impermissible activities. Services may be provided by persons or entities other than the issuer in a Section 3(a)(9) exchange, subject to the following limitations:

- cannot make any recommendation regarding the exchange to any security holder, or to any adviser or other representative of any such security holder; [23]
- when communicating with security holders, can provide only that information which is included in the various communications sent by the issuer to the security holders; and
- should limit its activities to performing functionary services or administrative assistance in the distribution of exchange materials and providing information about the mechanics of the exchange.

If any security holder or any adviser or other representative to any security holder asks for a third party's opinion on an investment-related attribute of the exchange, the third party should direct the holder of the target securities to contact the appropriate officer or employee of the issuer. The third party may respond to questions from

[22] *See* SEC No-Action Letter, URS Corporation (May 8, 1975).
[23] *See* SEC No-Action Letter, Dean Witter & Co., Inc. (Nov. 21, 1974). *See also* SEC No-Action Letter, Stokley-Van Camp, Inc. (Mar. 31, 1983).

security holders regarding substantive elements of the exchange that are addressed in the exchange materials by directing the security holder to the pertinent portion of the exchange materials; however, the third party must not convey management's views or recommendations on the exchange, even if those views or recommendations or both are contained in the exchange materials.

Permissible activities. Permissible activities can be grouped into two broad categories: (1) advice to the issuer with respect to the terms and mechanics of the exchange; and (2) services that are administrative, ministerial, or mechanical in nature in furtherance of the exchange.[24] Any services not deemed administrative, ministerial, or mechanical must be ancillary to the effective mechanical operation of the process of formulating a restructuring proposal.[25]

For example, in *Seaman Furniture Co., Inc.*, the SEC granted no-action letter relief in connection with a proposed exchange offer for which the issuer hired investment bankers from Merrill Lynch to act as its financial advisers.[26] The issuer characterized the services and activities provided by its financial advisers as follows:

> Since their engagement by the Company in July 1989, the investment bankers from Merrill Lynch Capital Markets who have acted as the Company's financial advisors have performed the following services for the Company: (1) performed financial analyses; (2) assisted the Company in formulating a restructuring proposal; (3) advised the Company with respect to the terms of the new securities to be issued in connection with the restructuring and the new capital structure of the Company; (4) participated in meetings between representatives of the Company, on the one hand, and the banks, on the other hand; (5) participated in meetings between representatives of the Company, on the one hand, and the legal and financial advisors to the Committee, on the other hand; and (6) conversed by telephone with representatives of the banks and the legal and financial advisors to the Committee. Merrill Lynch Capital Markets will not: (1) be named as a dealer manager of the Exchange Offer; (2) deliver a fairness opinion with respect to the Exchange Offer; or (3) communicate directly with any holder of Existing Sub Debt with respect to substantive matters relating to the restructuring or the Exchange Offer. The Company understands that during the aforementioned telephone conversations and meetings its financial advisors have: (1) outlined the current status of negotiations between the Company and the other creditors of the Company; (2) discussed the Company's financial statements and projections; (3) presented the Company's current proposals with respect to the terms of the Exchange Offer and the restructuring to the banks and the legal and financial advisors to the Committee; and (4) received and discussed the counterproposals of the banks and the legal and financial advisors to the Committee and relayed such counterproposals to the Company. We understand that the Company's financial advisors have not (1) expressed to the banks or the legal or financial advisors to the Committee their views as to (a) the fairness of the proposed restructuring or the Exchange Offer or (b) the value of the securities to be issued in connection with the Exchange Offer or (2) made any recommendation to the banks or the legal and financial advisors to the Committee with respect to the restructuring or the Exchange Offer.[27]

The argument made by the issuer that such services and activities were permitted under Section 3(a)(9) was that there was no direct contact between the issuer's financial advisers and any debt holder with respect to substantive matters relating to the exchange offer.[28] In addition, the issuer stated that the activities of the issuer's financial advisers constituted activities "effecting" rather than "promoting" an exchange because (1) the exchange offer had not been made, (2) the issuer's financial advisers had not and would not make any recommendation to the debt

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[24] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Securities Act Sections (#Question 125.03) (Nov. 26, 2008), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm, and
[25] *See* SEC No-Action Letter, Seaman Furniture Co., Inc. (Oct. 10, 1989). An issuer also needs to be particularly mindful of those third parties, such as investor relations firms, that communicate with security holders. Hiring a firm to communicate with security holders could be construed as payment for solicitation. The SEC, however, allows investor relations firms to participate in exchange offers in a limited capacity.
[26] *See id.*
[27] *See id.*
[28] *See id.*

holders or their advisers with respect to the proposed exchange offer, and (3) it is customary for an issuer involved in a complex financial transaction to engage an investment banker to act as an intermediary among the parties to a negotiation, especially when the other parties are professional legal and financial advisers.[29]

A financial advisor may advise the issuer with respect to virtually all aspects of developing and executing the exchange. The SEC has taken a no-action position with respect to each of the following advisory services:[30]

- performance of financial analysis for the issuer;
- formulation or assistance in the formulation of a restructuring proposal for the issuer's approval;
- advice on the issuer's capital structure following the restructuring;
- advice on the timing and organization of the restructuring proposal;
- advice on the proposed terms and mechanical procedures for the exchange;
- advice on the proposed terms of the new securities;
- assistance in the preparation of the various exchange materials to be sent by the issuer to the security holders;
- advice to employees of the issuer on the procedures to be used in conversations with security holders concerning the exchange;
- engaging in pre-launch discussions or negotiations with legal and financial representatives of debt holder committees; and
- providing a fairness opinion regarding the exchange.[31]

A third party can engage in administrative, ministerial, or mechanical services designed to convey the information in the exchange materials to security holders. These activities can be divided into two groups: (1) those in which the third party merely services as a functionary in disseminating information; and (2) those in which the third party communicates directly with security holders or their advisers or other representatives. However, the latter group of services should be conducted with great care.

The SEC Staff has acknowledged in no-action letters that third parties may provide each of the following functionary services in disseminating information to security holders:[32]

- obtain a list of the issuer's security holders from the issuer, and confirm the accuracy of the addresses of the security holders;
- mail or otherwise assist in the distribution of exchange materials;
- maintain records on the exchange;
- be named as a financial intermediary in the exchange materials;

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[29] *See id.*
[30] *See, e.g.,* SEC No-Action Letter, Seaman Furniture Co., Inc. (Oct. 10, 1989); SEC No-Action Letter, Mortgage Investors of Washington (Sept. 8, 1980); SEC No-Action Letter, Hamilton Brothers Petroleum Corp. (Aug. 14, 1978); SEC No-Action Letter, Valhi, Inc. (Sept. 15, 1976); and SEC No-Action Letter, Dean Witter & Co., Inc. (Jan. 22, 1975).
[31] An issuer is permitted to hire an investment bank to render a fairness opinion on the terms of the exchange; however, if the investment bank also is acting as a dealer-manager and conducting solicitation activities, the SEC has held that obtaining a fairness opinion would violate Section 3(a)(9). *See* SEC Division of Corporation Finance, *Compliance and Disclosure Interpretations*: Securities Act Sections (#Question 125.07) (Nov. 26, 2008), *available at* http://www.sec.gov/divisions/corpfin/guidance/sasinterp.htm.
[32] *See, e.g.*, SEC No-Action Letter, Mortgage Investors of Washington (Sept. 8, 1980); SEC No-Action Letter, Barnett Winston Investment Trust (Oct. 11, 1977); and SEC No-Action Letter, Dominion Mortgage & Realty Trust (Apr. 3, 1975).

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- contact nominees holding target securities and ascertain the number of the exchange materials needed by each brokerage house for transmittal to beneficial holders;
- deliver sufficient quantities of the exchange materials to brokerage houses, trust officers, other banks, and other nominees for distribution to beneficial holders of the target securities; and
- mail duplicate copies of exchange materials to security holders who appear to have lost or mislaid those originally sent to them.

The issuer may rely on a third party, such as an investor relations firm or other sales force or an information agent, to inform security holders of the exchange offer.[33] A third party can contact security holders directly for the following administrative, mechanical, or ministerial purposes, subject in all instances to the requirement that no solicitation take place as a result of any such contacts:[34]

- to determine whether the security holders received the exchange materials;
- to determine whether the security holders understand the procedures for participating in the exchange (for example, expiration dates and to whom to forward documents);
- to answer questions or resolve any confusion about the procedures for participating in the exchange;
- to contact back-office personnel of nominees who hold securities for the benefit of others to make sure that they promptly forward exchange materials to the nominees;
- to urge back-office personnel to check with the beneficial holders of the target securities about whether such holders have received the exchange materials, understand procedurally how to participate in the exchange, and are generally aware of the relevant dates and deadlines;
- to determine whether the security holders intend to participate in the exchange and to communicate their responses to the issuer;
- to remind the security holders of all appropriate deadlines; and
- to respond to the questions of security holders that do not concern the mechanical aspects of the exchange by directing the security holders to the relevant portions of the exchange materials.

Fees paid to third parties

Section 3(a)(9) does not specify the types of fees that third parties can receive in an exchange. However, the SEC Staff has indicated through various no-action letters that a financial adviser may receive a fixed fee for its services, not contingent upon the success of the exchange, plus reasonable expenses related to the exchange. A fixed fee arrangement eliminates one factor which might otherwise support the inference that the financial adviser had an incentive to engage in a solicitation of security holders. Therefore, whenever paid third parties are contacting security holders within permissible guidelines, it is advisable that their fees be a fixed amount not tied to the success of the exchange. Nevertheless, determining whether a paid solicitation has occurred is a fact-specific analysis that will turn on the facts present in a particular transaction. Note that this determination is not necessarily based upon the method of payment of fees to the third party. In addition, if the issuer relies on an investor relations firm, sales force, information agent or others to inform security holders of the exchange, then the issuer can only pay a fee on a flat, per-contact basis to that financial intermediary.[35]

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[33] Relying on an investment bank in this instance may be efficient as the firm that initially sold the securities may be in the best position to contact its former customers.
[34] *See supra* note 27.
[35] This second requirement applies to any of the issuer's agents who contact the security holders, and not only to dedicated sales departments.

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Redemption standby agreement

A redemption standby agreement between an issuer and an investment bank can be combined with an exchange of securities under Section 3(a)(9). An issuer engages an investment bank as a standby purchaser when it plans to force the conversion of convertible debentures (or other similar instruments) by calling the debentures for redemption but would like to protect itself from having to make substantial cash outlays in the event that the issuer's stock price declines in the period between the redemption notice and the redemption date and the holders elect for redemption.

A standby agreement between an issuer and an investment bank is similar to an underwriting agreement for a primary distribution of securities. The investment bank agrees, for a fee, to purchase at a price slightly above the redemption price all of the debt securities that are offered to it before the redemption date, and then to convert those debt securities into common stock. The issuer can rely on Section 3(a)(9) to exempt the exchange of its common stock for the debt securities acquired by the investment bank.[36]

Open market purchases

An investment bank also can itself effect open market purchases of an issuer's securities as a principal and then later exchange those securities with the issuer for new securities in reliance on Section 3(a)(9). However, all of the conditions under Section 3(a)(9) must be satisfied, which means that the investment bank cannot receive any commission or remuneration in connection with the open market purchases.

Other considerations

Involvement of affiliates

In some circumstances, affiliates of an issuer may seek to exchange the issuer's debt or equity securities. This may occur on the corporate level, such as when a parent exchanges securities of its subsidiaries or when subsidiaries exchange securities of their parent or other subsidiaries, or if officers, directors or significant shareholders seek to exchange the issuer's securities. In these instances, the "affiliates" would generally be considered insiders of the issuer and subject to the same disclosure obligations as the issuer. In many circumstances, the involvement of an affiliate may preclude reliance on the Section 3(a)(9) exemption for an exchange offer.

Qualification under the Trust Indenture Act

Exchange offers of debt securities that are exempt from registration under Sections 3(a)(9) are not exempt from qualification under the Trust Indenture Act.[37] Unless an indenture for a debt security is qualified under Section 305 of the Trust Indenture Act, which covers registered offerings, or is exempt from qualification under Section 304 (which does not include an exemption for Section 3(a)(9) exchange offers), the sale of a debt security pursuant to a Section 3(a)(9) exchange would generally violate Section 306 of the Trust Indenture Act unless an application for qualification of the related indenture has been filed with the SEC.[38] Qualification under the Trust Indenture Act is accomplished by filing a Form T-3 with the SEC, which is subject to review by the SEC Staff. The

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[36] *See* SEC No-Action Letter, TransTechnology Corp. (Feb. 23, 1983); SEC No-Action Letter, Foster Wheeler Corp. (July 2, 1973); SEC No-Action Letter, Kewanee Oil Co. (Feb. 5, 1973); and SEC No-Action Letter, Squibb Corp. (June 23, 1971).

[37] *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Trust Indenture Act of 1939 (Question 101.05) (Mar. 30, 2007), *available at* http://www.sec.gov/divisions/corpfin/guidance/tiainterp.htm. See also SEC No Action Letter, Mississippi Chemical Corp. (Nov. 25, 1988) and SEC No Action Letter, Mississippi Chemical Corp. (June 23, 1989).

[38] Section 306 of the Trust Indenture Act does not apply to exchange offers that are exempt under Section 3(a)(9) where the offering does not exceed $5 million and Section 304(a)(8) and Rule 4a-1 under the Trust Indenture Act otherwise are available. See SEC Division of Corporation Finance, Compliance and Disclosure Interpretations: Trust Indenture Act of 1939 (Interpretation 207.01) (Mar. 30, 2007), *available at* http://www.sec.gov/divisions/corpfin/guidance/tiainterp.htm.

solicitation of the exchange offer may not commence until the Form T-3 is filed, and no sales may be made until the Form T-3 is declared effective by the SEC Staff.

Securities exchange requirements

The securities exchanges, including the New York Stock Exchange ("NYSE"), the Nasdaq Stock Market ("Nasdaq") and the NYSE Alternext US ("NYSE Amex"), require shareholder approval for the issuance of equity securities by listed issuers in various situations.[39] Each exchange also applies these shareholder approval provisions to offerings of securities that are convertible into, or in the case of the NYSE and Nasdaq, exchangeable for, common stock, such as convertible debt. For example, the requirement for shareholder approval for issuances of common stock in an amount more than 20% of the current outstanding common stock, at a price below the greater of book or market value, has resulted in many Section 3(a)(9) exchange offers structured with a price floor for the common stock, a volume weighted average price ("VWAP") or a maximum amount of common stock issued just below the appropriate threshold. An issuer also must carefully review the securities exchange rules if the security to be exchanged is either actual equity or convertible or exchangeable debt, or if the exchange offer cannot be categorized as a "public offering." In addition, the securities exchanges require shareholder approval when an issuance will result in a "change of control" of the issuer.[40]

Tax considerations[41]

An issuer that exchanges new debt for old debt in an exchange offer will recognize ordinary cancellation of indebtedness ("COD") income to the extent the adjusted issue price of the old debt exceeds the issue price of the new debt. A modification of existing debt, as part of an exchange offer, also will be treated as an exchange of existing debt for new debt if the modification is "significant." Generally, modifications are significant if, among other things, (1) the yield changes by the greater of 25 basis points or 5% of the existing yield, (2) scheduled payments are materially deferred, (3) modified credit enhancements change payment expectations, or (4) the nature of the security changes (for example, from debt to equity or from recourse to nonrecourse).

Assuming the exchange or modification constituted a recapitalization, the exchange or modification generally should not result in gain or loss to the debt holder. However, depending on the terms of the new debt relative to the old debt, certain tax consequences could follow. For example, if the principal amount of the new debt exceeded that of the old debt, the holder could recognize gain equal to the fair market value of the excess. Exchanges and modifications also can create OID or, conversely, an amortizable premium, due to differences in the issue price of the new debt and the stated redemption price at maturity.[42]

Under the American Recovery and Reinvestment Act of 2009, issuers often will be able to elect to defer any COD income recognized during exchanges in 2009 and 2010. In addition, the limitations on OID deductions for certain high-yield obligations ("AHYDOs") issued in exchanges during 2009 have been suspended. Taken together, the deferral of COD income and the suspension of limitations applicable to AHYDOs can create significant tax benefits for debt exchanges occurring this year.

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[39] *See, e.g.,* Nasdaq Marketplace Rule 5635(a)-(f), and related publicly available interpretive guidance; NYSE Issuer Manual Sections 312.00 – 312.07; and NYSE Amex Company Guide Sections 710-713.
[40] *See* Nasdaq Rule 5635(b); NYSE Rule 312.03(d); and NYSE Amex Company Guide Section 713(b).
[41] For a more detailed discussion of the tax considerations in connection with exchange offers, see our client alert entitled "Tax Provisions of the Stimulus Bill" (Feb. 17, 2009), *available at* http://www.mofo.com/news/updates/files/CMGTaxStimulus.pdf, and our legal update entitled "Temporary Deferral of Cancellation-of-Indebtedness Income Under the Recovery and Reinvestment Act of 2009" (Feb. 2009), *available at* http://www.mofo.com/news/updates/files/15268.html.
[42] In each case, particular attention must be paid to terms of art including "issue price," the meaning of which may vary depending on a number of factors. For example, if existing debt is publicly traded, the "issue price" of new debt issued (or constructively issued, in the case of a modification) in exchange for existing debt is deemed the current market price. Given current economic conditions, debt exchanges or modifications will often result in COD income because the market prices of many existing debt securities are steeply discounted from their adjusted issue prices.

Liability considerations

Restructuring transactions, including exchange offers, involve the purchase and sale of securities. Therefore, these transactions are subject to the general antifraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5 under the Exchange Act. Section 10(b) provides an implied cause of action covering all transactions in securities and all persons who use any manipulative or deceptive devices in connection with the purchase or sale of any securities. Rule 10b-5 covers substantially the same ground as Section 10(b) and prohibits, among other things, the making of any untrue statement of a material fact or the omission of a material fact necessary to make the statements made not misleading. Under Rule 10b-5, the issuer, its directors, officers and employees, and its agents, including third parties retained by the issuer, may be held liable. Exchange offers may also be subject to Section 14(e) of the Exchange Act, which, in addition to specific procedural requirements, contains prohibitions regarding material misstatements and omissions similar to those in Section 10(b) and Rule 10b-5.

Contacts

Capital Markets and Corporate

Ze'-ev Eiger
(212) 468-8222
zeiger@mofo.com

Nilene Evans
(212) 468-8088
nevans@mofo.com

David Lynn
(202) 887-1563
dlynn@mofo.com

Brandon Parris
(415) 268-6617
bparris@mofo.com

Anna Pinedo
(212) 468-8179
apinedo@mofo.com

Jim Tanenbaum
(212) 468-8163
jtanenbaum@mofo.com

Tax

Stephen Feldman
(212) 336-8470
sfeldman@mofo.com

Thomas A. Humphreys
(212) 468-8006
thumphreys@mofo.com

Shane Shelley
(858) 720-5169
sshelley@mofo.com

If you would like to receive a copy of our Liability Management Handbook, please email Christie Adams at cadams@mofo.com.

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