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Client Alert

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Restructuring High Yield Bonds: Getting Ready for the Next Phase of the Cycle

The Big Picture

High yield bonds have been a significant source of financing for both corporations and leveraged acquisitions. Approximately half of all corporate borrowers are currently rated below investment grade, and approximately $1 trillion of outstanding debt is rated below investment grade.[1] With the global credit crunch casting a dark pall over any security that bears any semblance of risk, high yield interest rates have skyrocketed and the volume of new issuances has shrunk dramatically.

Meanwhile, the widely publicized economic slowdown has put pressure on the performance of many issuers. There has been a substantial increase in the percentage of high yield bonds trading at distressed levels[2] and in the number of formerly investment-grade issuers who have seen their bonds downgraded to "junk" status. With nearly $100 billion of high yield bonds maturing over the next few years, we expect to see a significant increase in high yield defaults in 2008 and beyond.[3]

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Refinancing options are severely limited in the current debt market. Many issuers of high yield bonds will therefore be forced to restructure their outstanding bonds (*e.g.*, reduce cash interest expense, defer near-term maturities or eliminate or modify covenants in old bonds that restrict or prohibit a restructuring of other debt) in order to preserve the going concern value of their businesses and avoid bankruptcy. This *Client Alert* will examine in some depth two of the most useful tools available to issuers of high yield bonds seeking to restructure their debt—exchange offers and "prepackaged" plans of reorganization. We will also briefly discuss "prenegotiated" plans of reorganization. Debt repurchase programs are covered in another one of our *Client Alerts* entitled *Navigating Debt Repurchases—Issues and Answers*.[4]

There are several characteristics of high yield bonds that will present challenges in any comprehensive debt restructuring, including the anonymity of their potentially numerous holders, their long no-call periods and the requirement that each affected holder consent to amendments to payment terms. With the increasing presence of hedge funds in the high yield market since the last downturn, issuers seeking to restructure their bonds should expect to confront a more organized and specialized class of investors. And, of course, any attempt to restructure high yield bonds will generally require the consent of the senior lenders under the issuer's credit agreement (which, in many cases, will need to be amended concurrently

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with the bond restructuring), and agreements governing other debt may also need to be amended in connection with any restructuring transaction. These challenges often lead issuers to retain specialized advisors to assist in any restructuring effort. All major commercial and investment banks have "Liability Management" teams that specialize in debt restructurings. These bankers can be very helpful in brokering a deal between a troubled high yield issuer and its creditors.

Exchange Offers: The Most Viable Non-Bankruptcy Alternative

In ordinary circumstances, issuers have a number of alternatives for restructuring their outstanding high yield bonds. These alternatives include cash tender offers, debt repurchases, optional redemptions, satisfaction and discharge and defeasance.However, in a distressed situation, issuers often find that none of these alternatives is realistic because each requires a significant amount of cash—the one commodity that is in short supply for many distressed issuers.[5] In addition to an issuer's cash shortfall, most senior credit agreements prohibit repurchases of junior debt ahead of its scheduled maturity. As a result, the only viable option outside of bankruptcy for many distressed issuers is an exchange offer, typically coupled with an exit consent that strips most protective covenants from any non-exchanged bonds.

What is an Exchange Offer and How Does it Work?

An exchange offer is an offer by an issuer to repurchase its (or one of its affiliate's) outstanding bonds in exchange for new bonds with different terms, which may include reductions in principal, different interest rates or reduced cash interest burdens, extended maturity dates and tighter covenants to reflect the issuer's weaker operating performance. Issuers may also seek to reduce their debt burden by exchanging their outstanding bonds for equity securities or for a combination of a reduced principal amount of new bonds and an equity component.

There are three primary types of exchange offers: registered exchange offers, Section 3(a)(9) exchange offers and private exchange offers. We will discuss the pros and cons of each of these three choices in the sections that follow, but first let's review a few basic points that are common to all exchange offers.

Exchange Offers are Securities Offerings. All exchange offers are offerings of securities. As a result, they must be registered unless they qualify for a particular exemption from the registration requirements of the US securities laws. In addition, the disclosure documents used in exchange offers can create liability for the issuer and others under the anti-fraud provisions of the US securities laws, including Section 11 of the Securities Act (in the case of registered exchange offers) and Rule 10b-5 under the Exchange Act (in the case of all exchange offers).

The Carrot-and-Stick Approach. Issuers seeking to restructure their bonds will create incentives to entice existing bondholders to participate in the exchange offer and disincentives for them to remain in the old bonds. The incentives may include new bonds with a higher interest rate, additional guarantees or collateral, and the new bonds may rank contractually, effectively or structurally senior to the old bonds. Bondholders—usually through a committee—will assess these proposed terms against retaining the payment terms of their old bonds in light of the issuer's prospects, with a close eye on terms being agreed to by other creditors. Disincentives to remaining in the old bonds include the looming

threat of a bankruptcy filing and an exit consent that strips the old bonds of most of their protective covenants.

The Holdout Problem. Only bondholders who agree to exchange their old bonds for new bonds benefit from (or are bound by, depending on your perspective) the terms of the new bonds. Bondholders who do not participate in the exchange are known as "holdouts," and the holdout issue is often the Achilles' heel of exchange offers, as discussed below.

The 20 Business Day Rule. Because all exchange offers are considered to be tender offers, they are all subject to the US tender offer rules. The principal requirement of the tender offer rules applicable to exchange offers targeting non-convertible debt securities is that the exchange offer must be kept open for 20 business days. In addition, certain amendments to the terms of an ongoing exchange offer may require the exchange offer to be extended for up to 10 additional business days.[6] Exchange offers targeted at holders of convertible debt securities are subject to a thicket of additional tender offer rules, as convertible debt is considered to be an equity security under the US tender offer rules. The equity tender offer rules are not addressed in this *Client Alert*.

Registered Exchange Offers

In a registered exchange offer, an issuer prepares and files an exchange offer prospectus in a registration statement on Form S-4 with the SEC. The registration statement must include information concerning the terms of the exchange offer (including *pro forma* financial information showing the effect of the exchange offer on the issuer, often showing a range of outcomes based on different acceptance levels) and a description of the issuer, its business and the risks associated with accepting and declining the exchange offer. Registered exchange offers are typically used where the debt is widely distributed, but are otherwise not the first choice for issuers because they generally take longer to complete. The following table sets forth the principal advantages and disadvantages of a registered exchange offer.

Registered Exchange Offer	
Advantages	Disadvantages
• Useful in situations where the debt is widely distributed • New bonds freely transferable • Issuer may use (and pay) bankers to solicit exchanges • All bondholders may participate in the exchange offer • Can use a different issuer for some or all of the new bonds and any equity	• Timing—may be subject to SEC review and comment before the 20 business day offer can be commenced[7] • Section 11 securities law liability on content of registration statement • More costly than unregistered deal • Holdout issue

Section 3(a)(9) Exchange Offers

Section 3(a)(9) of the Securities Act exempts from registration under the Securities Act ". . . any security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange." The Section 3(a)(9) exemption generally has four major requirements:

- No payment may be made by the issuer for solicitation services in connection with the exchange offer;
- The old bonds and the new bonds and any equity offered in the exchange must be issued by the same issuer;
- Bondholders may not be required to contribute cash or any other property, other than the old bonds, in exchange for the new bonds (although the issuer may offer a mix of cash and new bonds/new equity in the exchange);[8] and
- The exchange offer may only be made to existing bondholders.

The restriction on payment for the solicitation of exchanges does not limit solicitation itself, but does prevent an issuer from paying or otherwise compensating for soliciting activities. It is this requirement that most significantly limits the utility of a Section 3(a)(9) exchange offer. Depending on the complexity of the restructuring proposal and the likelihood of bondholders forming a committee,[9] an issuer may determine that it needs to retain a paid solicitation agent in order to complete the exchange offer successfully, in which case a Section 3(a)(9) exchange offer would not be a viable option.

While there is no definitive list of permitted and prohibited solicitation activities, there are a number of SEC no-action letters that provide guidance. Generally, an issuer's directors, officers and other employees may undertake soliciting activities so long as they are not specially compensated for such activities. As a safeguard, these activities should be only incidental to their regular duties.[10] In addition, interpretive guidance indicates that an issuer may hire investor relations or proxy solicitation firms as information agents to perform ministerial tasks, such as notifying bondholders of the details of the exchange offer, confirming bondholder contact details and ascertaining that they have received all requisite materials and reminding bondholders of approaching deadlines. However, such agents may not inform security holders of management's recommendation with respect to the offer.[11]

In addition, the SEC has provided guidance on the role that bankers can play in a Section 3(a)(9) exchange offer and how they may be compensated.[12] In general, a bank:

- Cannot make any recommendation regarding the exchange offer to bondholders or their advisors;
- Cannot make any solicitation (direct or indirect) of exchanges or consents;
- Can only provide bondholders with information that was included in communications sent directly by the issuer;
- May provide a fairness opinion; and
- May have discussions or negotiations with legal and financial representatives of bondholder committees.[13]

In order not to run afoul of the prohibition on payment for solicitation services, bankers are generally paid a fixed advisory fee in Section 3(a)(9) exchange offers, rather than a fee that is contingent upon the success of the exchange offer.

Disclosure in a Section 3(a)(9) exchange offer is generally comparable to the disclosure that would be included in a prospectus for a registered exchange offer. The following table sets forth the principal advantages and disadvantages of a Section 3(a)(9) exchange offer.

3(a)(9) Exchange Offer	
Advantages	Disadvantages
• Quick (no registration or SEC review required) • Less expensive than a registered exchange offer • Section 11 does not apply (although Rule 10b-5 does apply) • Exemption applies regardless of number or sophistication of holders	• New bonds will be "restricted securities" if the old bonds were "restricted"; bondholders may require registration rights[14] • Prohibition on payment for solicitation services • Requirement that new bonds and any equity be issued by the same issuer as the old bonds • Holdout issue

Private Exchange Offers

Section 4(2) of the Securities Act exempts from the registration requirements of the Securities Act all securities issued in "[t]ransactions by an issuer not involving any public offering." Regulation D is the safe harbor promulgated pursuant to Section 4(2). These provisions are most commonly thought of as the basis for private placements, but they are equally applicable to exchange offers.

Although Section 4(2) and Regulation D do not prohibit an offering to unsophisticated holders if certain requirements are met, in practice most Section 4(2) exchange offers are made only to "qualified institutional buyers" (QIBs) and non-US investors.[15] In order to ensure that a private exchange offer is not made to any ineligible offerees, the issuer will first send an inquiry letter to all outstanding bondholders seeking confirmation of their status. Only those bondholders who have certified their status as QIBs (either through such letter or an existing "QIB letter" held by the bank assisting the issuer) or non-US persons will receive the actual offering memorandum for the exchange offer. In most situations, close to 100 percent of an issuer's high yield bonds are held by QIBs or by offshore investors, so this procedure does not typically limit, to any meaningful extent, the pool of investors eligible to participate in a private exchange offer.

Disclosure in a private exchange offer is generally comparable to the disclosure that would be included in a prospectus for a registered exchange offer. The table at the bottom of this page sets forth the principal advantages and disadvantages of a private exchange offer.

Private Exchange Offer	
Advantages	Disadvantages
• Quick (no registration or SEC review required) • Less expensive than a registered exchange offer • Issuer may use (and pay) bankers to solicit exchanges • Section 11 does not apply (although Rule 10b-5 does apply) • Can use a different issuer for some or all of the new bonds and any equity	• New bonds will be "restricted securities"; bondholders may require registration rights • Generally limits offer to QIBs and non-US investors • Holdout issue

Why Use an Exit Consent and How Far Can it Go?

In connection with an exchange offer, issuers will usually request that holders who tender their bonds for exchange also consent to amendments to the indenture under which the original bonds were issued. These consents—known as "exit consents"—are distinguished from ordinary consent solicitations in that they are given by exchanging bondholders on their way out the door and not as an ongoing holder of the old bonds. Because exit consents are binding on all holders (including those that do not exchange), they have the effect of penalizing holdouts who continue to hold the old bonds by effectively stripping the old bonds of most of their protective covenants and events of default. This penalty is intended to incentivize bondholders to participate in the exchange offer. In other words, the exit consent is the "stick" in the carrot-and-stick approach to restructuring.

To date, exit consents have been viewed by the US courts as permissible contract amendments governed only by basic contract law principles.[16] Importantly, however, under Section 316(b) of the Trust Indenture Act of 1939 and the express terms of most indentures, exit consents cannot amend the maturity date, reduce principal or interest, change the form of payment (such as substituting in-kind payments for cash payments) or make other economic changes to the terms of the bonds held by non-exchanging holders.[17] As a result, holders unwilling to agree to new payment terms can "hold out" and retain their old bonds with the same payment terms (albeit without other covenant protections).[18]

The Holdout Problem

The "holdout" bondholders who do not participate in the exchange offer retain their old bonds with the same payment terms, often leaving them (even when the protective covenants are stripped from the old bonds) in a position to get paid earlier, and perhaps more, than a holder of the new bonds. The result is a transfer of value from exchanging to non-exchanging bondholders.

High minimum exchange conditions (90 percent plus) are common in exchange offers in part because they are demanded by the bondholders who do participate, as they want to limit the amount of holdouts that can benefit from the actions taken by the exchanging bondholders.[19] These high thresholds are also insisted on by distressed issuers, who need imminent and substantial relief from impending maturities and high cash interest burdens, and by senior lenders who are usually being asked for some kind of concession and are unwilling to see substantial cash payments continue to the holdouts. Even with the elimination of covenant protections for the old bonds through "exit consents,"[20] and notwithstanding the "incentives" that may be built into the terms of the new bonds as described above, many exchange offers fail because of this need for a high minimum exchange condition. The holdout problem is exacerbated where the issuer seeks to restructure multiple tranches of debt and the senior bondholders (who are usually offered the most valuable new securities in an exchange) condition their exchange on high minimums from junior classes of bondholders (who may be offered only nominal recoveries).

Bankruptcy Alternatives for Distressed Issuers

Distressed issuers have a number of alternatives within bankruptcy, including a traditional Chapter 11 filing, a "prepackaged" plan of reorganization under Chapter 11 (also known as a "prepack"), a combination of an exchange offer and a prepack, and a "prenegotiated" plan of reorganization.

How Prepacks Work

Prepacks are a viable solution to the holdout problem encountered in exchange offers. The magic of prepacks is found in Section 1126(c) of the Bankruptcy Code. That section provides that a plan of reorganization that alters the payment terms of a particular class of claims need only be approved by two-thirds in amount and more than half in number of the claims in that class that actually turn out to vote on the plan. So long as these minimum voting thresholds are met for a given issuance of bonds, all dissenters and holdouts are bound by the terms of the plan of reorganization. Section 1126(c) of the Bankruptcy Code overrides the Trust Indenture Act's requirement that each affected holder consent to an amendment that affects payment terms.

In a prepack, the issuer solicits all the necessary creditor approvals to confirm a Chapter 11 plan of reorganization *before* filing a Chapter 11 petition. In other words, the issuer packages up the bankruptcy plan *prior* to filing for bankruptcy so that the bankruptcy court will approve (and implement) the plan within a matter of weeks after the initial bankruptcy petition is filed. Hence the term "prepackaged." Using this technology, an issuer can avail itself of the magic of Section 1126(c) of the Bankruptcy Code without all the fuss of a protracted bankruptcy process. For this reason, prepacks became very popular among over-leveraged issuers in this phase of the last credit cycle. Solicitations of creditor approvals in a prepack must comply both with applicable bankruptcy laws and non-bankruptcy rules and regulations (primarily the US federal and state securities laws).

The following table sets forth the principal advantages and disadvantages of a prepack.

Prepacks	
Advantages	Disadvantages
• Quicker, cheaper and less disruptive than a traditional Chapter 11 proceeding • Eliminates holdout issue • Securities issued pursuant to plan are freely tradable[21]	• May be more expensive and more disruptive to issuer than non-bankruptcy alternatives • Requires two-thirds in amount and 50.1 percent in number of claims actually voting to consent • Bankruptcy stigma may be unacceptable to management

A further advantage of a prepack is the ability to amend the payment terms of certain classes of claims even if they *do not* approve the plan of reorganization, pursuant to a process known as "cram down." Section 1129(b) of the Bankruptcy Code (which also overrides the Trust Indenture Act) provides that a negative vote by junior creditors cannot block consummation of the plan if the plan is approved by at least one class of senior claims that is being "impaired" in the plan (*i.e.*, is giving up some of its rights) and the junior creditors are getting at least what they would get under a Chapter 7 liquidation (which in most cases is nothing). As a result, a comprehensive restructuring may be possible using the tools available in the Bankruptcy Code with a much lower minimum participation requirement than would be necessary outside of bankruptcy.

The Real Deal: Combined Exchange Offer/Prepackaged Bankruptcy Plan

By combining the features of an exchange offer and a prepack, an issuer can have the best of both worlds. In a combined exchange offer and prepack, the issuer simultaneously solicits exchanges of old bonds for new bonds and acceptances of a "prepackaged" Chapter 11 reorganization plan. In other words, a vote for the exchange offer is a vote for the backup prepackaged plan.

The issuer conditions the exchange offer on a high level of acceptances (*e.g.*, 90 percent or more) so as to minimize the holdout problem. If the issuer receives more than 90 percent, the exchange offer is completed outside of bankruptcy. If the issuer receives less than 90 percent in the exchange offer but more than two-thirds in amount and a majority in number of the claims voting, then the prepack is accepted and the issuer proceeds with obtaining bankruptcy court approval of the prepack. If neither the exchange offer nor the prepack is successful, the issuer will likely end up making a traditional Chapter 11 filing in bankruptcy court. The benefit of combining the exchange offer and prepack is that it provides the potential holdout bondholder with an incentive (avoiding a "free fall" bankruptcy) to participate in the exchange offer, as the recovery in a traditional Chapter 11 bankruptcy may be less favorable than the consideration offered in the exchange/prepack.

The Prenegotiated Plan: The Shortest Distance Between Two Points?

A "prenegotiated" plan of reorganization is like a prepack without the wrapping paper and the bow. In a prenegotiated plan, the issuer determines, based on conversations with its key creditors, that a particular plan of reorganization will be acceptable to them. The issuer typically secures "lock-up agreements" or "letter of intent" style agreements with key creditors promising to vote in favor of a particular plan should the issuer propose it within a designated timeframe. Based on this understanding, the issuer will file for bankruptcy and immediately ask the bankruptcy court to approve solicitation materials so that the formal plan approval process may commence immediately. The issuer may even have finalized the solicitation materials prior to filing the bankruptcy petition. In other words, a prenegotiated plan is like a prepack except that the vote to approve the plan is conducted in accordance with the Bankruptcy Code under the auspices of the court rather than outside of bankruptcy under the auspices of the securities laws (as is the case with prepacks).

An issuer can typically consummate its prenegotiated plan within two months following the commencement of the Chapter 11 case—a substantially abbreviated timeline compared to a traditional "free fall" bankruptcy.

Bankruptcy Risk Factors: What Can Go Wrong

Exacerbated Liquidity Issues Upon Announcement of Restructuring

An announcement of a restructuring, including a prepack or a prenegotiated plan, may adversely affect an issuer's operations, in particular its relationships with trade creditors, suppliers or customers. If these entities cease to provide normal trade credit to the issuer or modify or limit their business with the issuer, the issuer will likely have significant liquidity issues. A reduction in liquidity increases the likelihood that the issuer will be forced to file for Chapter 11 before completing the solicitation of acceptances of a prepack or negotiations with its creditors.

Will the Court Confirm the Plan?

Because most of the structuring in a prepack or prenegotiated plan is done outside the auspices of the bankruptcy court, there is less certainty than in a traditional Chapter 11 case that the court will accept all components of the plan. Unlike a traditional Chapter 11 case, a bankruptcy court is asked to confirm the plan in substantially the form presented, or deny confirmation of the plan, without the opportunity to express its concerns or views as to the various features of the plan. There are a number of issues (voting mechanics, classification of claims, valuation and feasibility of the prepack, to name a few) that objecting creditors can raise as a challenge to a prepack. Although the track record of prepacks withstanding these objections is strong, there is always the possibility of an unpleasant surprise in a bankruptcy proceeding.

Disclosure Issues

Exchange offers and prepacks are conducted pursuant to, and must comply with, US federal and state securities laws. Moreover, all discussions with bondholders that rise to the level of an "offer" of new bonds must either be registered, be exempt from the registration requirements of the Securities Act by virtue of Section 3(a)(9) or qualify as a bona fide private offer. The exchange offer and prepack solicitation documents need to be prepared with an eye toward Rule 10b-5 and good disclosure practices. In addition, private negotiations with creditors can trigger disclosure or other obligations under Regulation FD, in particular where discussions are conducted with one or more bondholder or lender groups to "test the waters" with respect to a particular restructuring plan in advance of a public announcement. Issuers facing the choices described in this *Client Alert* will likely also be updating the "Liquidity and Capital Resources" discussion in their Exchange Act filings.

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This *Client Alert* examines a few of the restructuring alternatives available to issuers of high yield bonds. However, there are a wide variety and combination of alternatives available to issuers, depending on their capital structure and their liquidity position. These restructuring alternatives involve a complex web of regulations and issues, including US federal and state securities laws, the provisions of the Trust Indenture Act, FINRA rules and regulations, corporate law issues, tax considerations, general debtor and creditor issues and applicable bankruptcy rules. In addition, practices that are acceptable and sufficient under US federal securities laws may not be adequate in a bankruptcy context. Financial restructurings require extensive legal analysis and guidance and, as always, advance planning by issuers will help to avoid unexpected consequences.

Endnotes

[1] *See* Caroline Salas, "Junk Bond Losses Top $35 Billion, JP Morgan Sees More," Bloomberg.com, March 25, 2008. Debt is considered investment grade if it is rated "BBB-" or higher by Standard & Poor's and "Baa3" or higher by Moody's.

[2] High yield bonds are considered "distressed" when they are trading at a yield that is more than 1,000 basis points over comparable option-adjusted US treasuries.

[3] Patrick Hosking, "Experts Predict Rises in Junk Bond Defaults," *TimesOnline*, March 22, 2008.

[4] For more information on debt repurchases, *see* Latham & Watkins' *Client Alert 687, Navigating Debt Repurchases—Issues and Answers*, released March 31, 2008, which is available at: www.lw.com.

[5] Consent solicitations (whereby issuers solicit amendments to existing indentures) do not necessarily require significant cash outlays and are often useful to amend overly restrictive incurrence covenants. However, any attempt to revise key payment terms such as maturity, interest rate or type of interest paid (*e.g.*, converting cash interest to pay-in-kind) may be considered the offer and sale of a "new security" under SEC interpretations, which would be treated as an exchange offer for securities law purposes and require the issuer to comply with securities laws applicable to new issuances. *See* Bryant B. Edwards and Jon J. Bancone, "Modifying Debt Securities: The Search for the Elusive 'New Security' Doctrine," 47 BUS. LAW. 571 (1992).

[6] Regulation 14E under the Exchange Act applies to tender offers for debt securities. Rule 14e-1(a) requires that all tender offers remain open for at least 20 business days. Rule 14e-1(b) requires that a tender offer remain open for at least 10 business days following any change in the offer price or amount of bonds sought. In the context of equity securities, the SEC has indicated that there may be other circumstances, such as a material change in the offer's terms or the waiver of a material condition to the offer, that would require that a tender offer remain open for at least five business days from disclosure of the event. *See Interpretive Release Relating to Tender Offer Rules*, Exchange Act Release No. 34-24296 (April 3, 1987). By analogy, bond issuers may wish to consider whether to extend an exchange offer for a period of less than 10 business days following a change less material than price or amount sought.

[7] Rule 162 of the Securities Act permits issuers to commence (for Rule 14e-1 purposes) registered exchange offers for *equity* securities upon the filing of a registration statement rather than waiting until the effectiveness of the registration statement, but does not help issuers commencing registered exchange offers for non-convertible debt securities.

[8] Subject to a limited exception for equitable adjustments in respect of dividends or interest permitted by Rule 149 under the Securities Act, Section 3(a)(9) prohibits an issuer from requiring holders to contribute any property (including cash) other than the old bonds in a Section 3(a)(9) exchange, but there is no restriction on what an issuer may offer to its holders. Furthermore, Rule 150 under the Securities Act permits an issuer to make payments to existing holders in connection with an exchange of new bonds for old bonds (when such payments are part of the terms of the offer) without losing the benefit of Section 3(a)(9).

[9] Committees can form a unified front which increases the chances that the exchange offer will be successfully completed without the need for a widespread solicitation. However, committees can cause problems as well, in particular where they are made up of both recent (debt raider or vulture fund) purchasers and long-term holders of the bonds. Disagreements among committee members can delay or prevent completion of a restructuring.

[10] *See*, for example, the *El Paso Natural Gas Co.* (March 11, 1971) no-action letter relating to an issuer's ability to use its directors, officers and employees for solicitation soliciting activities. Other interpretive letters set forth a variety of circumstances to be considered.

[11] *See*, for example, the *Chris-Craft, Industries, Inc.* (September 8, 1972) no-action letter relating to the requirement that the solicitation activities be limited to regular duties. Other interpretive letters set forth a variety of circumstances to be considered.

[12] *See*, for example, the *Seaman Furniture Company, Inc.* (September 29, 1989), *International Controls Corporation* (August 6, 1990) and *Calton Incorporated* (September 30, 1991) no-action letters, which seemed to obviate the standard set forth in the *Dean Witter & Co., Inc.* (November 21, 1974) no-action letter.

[13] The *Seaman* no-action letter referenced in note 12 above sanctions attendance at and participation in meetings with bondholders prior to the formation of a bondholders committee by an issuer's paid financial advisor.

[14] Generally speaking, when old bonds are exchanged for new bonds in a Section 3(a)(9) exchange offer, the new bonds retain the "restricted" or "unrestricted" character of the old bonds. For example, if the old bonds were publicly tradable, the new bonds will be as well. In the case of restricted bonds, holders should be able to "tack" the holding period pursuant to Rule 144(d)(3)(ii).

[15] A "qualified institutional buyer" is defined in Rule 144A(a) of the Securities Act. Although Regulation D would allow "accredited investors" to participate in a private exchange offer, there may be "blue sky" law issues in some states if not all of the offerees are QIBs. Because of these state law complexities, many issuers elect to limit private exchange offers to QIBs. Offshore exchange offers would be structured to comply with the requirements of Regulation S.

[16] A leading case upholding exit consents is *Katz v. Oak Industries*, 508 A.2d 873 (Del. Ch. 1986).

[17] Section 316(b) of the Trust Indenture Act of 1939 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 to 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 . . ."

[18] Current rules permit an issuer to secure a bondholder's agreement to exchange prior to the launch of an exchange offer, but these lock-up agreements must be structured to avoid violations of the Securities Act and the tender offer rules. In addition, the terms of a lock-up agreement must be carefully crafted to preserve the ability of locked-up bondholders to serve on creditor committees or take other actions in a bankruptcy.

[19] The market tolerates a "stub" amount of old bonds, generally 10 percent or less of the outstanding issue.

[20] In addition to holding bonds with no meaningful covenant protection following successful completion of an exchange offer and exit consent, stub bondholders are also faced with a limited public float (which can hamper the liquidity and, consequently, the market price, of their old bonds).

[21] Securities issued in a bankruptcy proceeding typically are exempt from the registration requirements of the Securities Act by virtue of Section 1145 of the Bankruptcy Code and Section 3(a)(10) of the Securities Act.

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