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COMMENTARY

Securities Law Considerations in Cross-Border Restructurings

Non-U.S. companies in the process of restructuring debt that includes one or more series of U.S. bonds must ensure that their restructuring plan and any securities issued as part of such plan comply with the requirements of U.S. securities law, in particular the registration requirements of the U.S. Securities Act of 1933 ("Securities Act").

This *Commentary* discusses the registration requirements under the Securities Act along with the more common exemptions relied upon when new unregistered securities are issued as part of a restructuring plan. A less frequently used exemption, Section 3(a)(10) of the Securities Act, and a proposed course to satisfy the requirements of this exemption, are also explained.

U.S. Securities Law Considerations

It is fairly common for a company seeking to restructure its U.S. bonds to replace the existing bond with a new bond (normally through an exchange offer) or with new stock in the company. However, because the restructuring plan involves the offering of new securities, it must either comply with the registration requirements of Section 5 of the Securities Act or satisfy the requirements of an exemption from registration.

Section 5 requires an issuer to register with the U.S. Securities and Exchange Commission ("SEC") all offers and sales of its securities, unless the security to be issued is exempt from registration pursuant to Section 3 of the Securities Act, or the transaction is structured to satisfy the requirements of certain transactional exemptions available under Section 4 of the Securities Act or the rules promulgated under such Act. The registration process can be both time-consuming and costly, and it is often inconsistent with the fundamental objective of putting into place an efficient restructuring that does little or nothing to impair the value of the underlying business.

There are exemptions available for issuing securities in a cross-border restructuring without submitting to the SEC registration process. In this context, the most commonly used exemptions are the private placement exemption (provided by Section 4(a)(2) of the Securities Act) and the single-issuer exchange offer exemption (provided by Section 3(a)(9) of the Securities Act).[1]

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The Private Placement Exemption—Section 4(a)(2)

Known as the "private placement" exemption, Section 4(a)(2) exempts transactions that do not involve a public offering or distribution. A second requirement of this exemption is that there cannot be any "general solicitation or advertising" in connection with the issuance of the new securities, which then results in the imposition of restrictions on publicity and public communications during the offering.[2]

In addition, under the private placement exemption, the new securities are "restricted securities" (as defined in Rule 144(a)(3) under the Securities Act) so they are subject to limits pertaining to transfer and resale.

Restructuring plans relying on the Section 4(a)(2) exemption are generally structured so offers and sales in the United States are made only to "accredited investors" as defined in Rule 501(a) of Regulation D of the Securities Act, with a concurrent offering outside the United States pursuant to Regulation S.[3] Customarily, nonaccredited investors are excluded from the offer of new securities and instead are cashed out. Although it is legally possible to offer and sell securities to nonaccredited U.S. holders, including them triggers additional disclosure requirements that are quite onerous and make the process more costly and time-consuming. In addition, the number of nonaccredited investors who can participate in a private placement is limited to no more than 35, making compliance with the exemption difficult, if not impossible, in cases where the securities to be offered would be widely held.

The Single-Issuer Exchange Offer Exemption—Section 3(a)(9)

Section 3(a)(9) of the Securities Act exempts securities exchanged by an issuer with its existing security holders. The exemption is available only when the initial issuer and the issuer of the new securities are the same entity and the offer is made only to existing security holders. In addition, the issuer cannot pay any "commission or other remuneration … for soliciting such exchange."[4]

A Section 3(a)(9) exchange offer provides various advantages for issuers in a restructuring: (i) it can be completed quickly in the absence of registration or SEC review; (ii) unlike repurchases or tender offers, it does not require cash; and (iii) if all holders participate, it presents an opportunity for retiring an entire series or class of debt securities, without concern about nonaccredited holders.

However, the "no payment of commission or remuneration" requirement significantly limits the availability of the exemption because it is very typical for a company that is undergoing a restructuring to retain the services of a financial advisor, with the advisor customarily being compensated based on the success of the offering. If the exchange offer is subject to the U.S. tender offer rules, another set of requirements must be complied with, thus making, in some instances, the exchange offer a less attractive option for the issuer. As in Section 4(a)(2) private placements, the new securities issued in a Section 3(a)(9) exchange offer, depending on the nature of the issuer's existing securities, may be subject to resale and transfer restrictions.

The "Fairness Hearing" Exchange Exemption—Section 3(a)(10)

A third and less frequently used option is the "fairness hearing" exchange exemption provided by Section 3(a)(10) of the Securities Act. Section 3(a)(10) can provide more flexibility to non-U.S. debtors than other exemptions because it can be used in cases where securities are widely held and financial advisors can be compensated.

Section 3(a)(10) provides an exemption for offers and sales of new securities to be exchanged by an issuer for other securities—not cash—if the terms of the exchange have been approved after a fairness hearing by a U.S. or foreign court, or by a U.S. governmental entity expressly authorized by statute to grant such approval. This exemption is available without registration with, or review by, the SEC, and the exchanged securities are freely tradable unless the seller is an affiliate of the issuer.

In a 2008 Staff Legal Bulletin, the SEC explained that, among other findings, "fairness" requires that the court conclude that the "exchange is fair to the security holders participating in the exchange" and that the terms and conditions are procedurally and substantively fair.[5] In addition, adequate notice

and a right to attend the hearing must be provided to everyone to whom the securities would be issued in the proposed exchange.[6] The court must also be advised before the hearing that the issuer will rely on the exemption. The SEC also clarified that any court may approve the fairness of the offer, including a foreign court.[7]

Moreover, bankruptcy courts in the United States have opined that a U.S. bankruptcy court has jurisdiction to pass on the fairness requirement necessary to satisfy the Section 3(a)(10) exemption. In *In re Board of Directors of Multicanal S.A.*, Case No. 04-10280 (ALG), Judge Allan Gropper of the United States Bankruptcy Court for the Southern District of New York determined that an Argentine company that had completed a restructuring of U.S. bonds under Argentine insolvency law could rely on the U.S. bankruptcy courts to conduct the "fairness hearing" required for the Section 3(a)(10) exemption. The court, under former section 304 of the U.S. Bankruptcy Code, had already recognized the Argentine restructuring plan, its *acuerdo preventivo extrajudicial* ("APE").[8] The question remaining for the court was whether it (the U.S. bankruptcy court) or the court in Argentina with jurisdiction over the APE had jurisdiction to hold the fairness hearing required under Section 3(a)(10).

The court explained that the authority "to order other appropriate relief" was granted expressly under Section 304(b)(3) of the United States Bankruptcy Code.[9] The court emphasized that the evaluation of fairness was predicated on the exchange and not on the conditions underlying the reorganization plan.[10] Additionally, Section 3(a)(10) refers to "any court," and Section 4(2) (now 4(a)(2))—the statute from which Section 3(a)(10) was derived—expressly included "courts of reorganization."[11]

Conclusion

While Sections 4(a)(2) and 3(a)(9) remain the most common avenues used in a restructuring to issue new securities without registration with the SEC, companies seeking to restructure their U.S. bonds should not overlook Section 3(a)(10) as a viable exemption if the bond issuance in question is widely held or if the company has agreed to pay a financial advisor or investment bank based on the success of the exchange offer.

Given the broad discretionary nature of both U.S. bankruptcy courts and the fairness requirement of Section 3(a)(10), non-U.S. companies could utilize Chapter 15 of the U.S. Bankruptcy Code as an avenue to give effect to their foreign insolvency proceeding and, more importantly for the purpose of this *Commentary*, to serve as the venue for the required fairness hearing.

Lawyer Contacts

For further information, please contact your principal Firm representative or one of the lawyers listed below. General email messages may be sent using our "Contact Us" form, which can be found at www.jonesday.com.

Pedro A. Jimenez
Miami / New York
+1.305.714.9701 / +1.212.326.3776
pjimenez@jonesday.com

Marie Elena Angulo
Miami / London
+1.305.714.9705 / +44.20.7039.5246
mangulo@jonesday.com

S. Wade Angus
New York / São Paulo
+1.212.326.3755 / +55.11.3018.3914
swangus@jonesday.com

Marcello Hallake
São Paulo / New York
+55.11.3018.3933 / +1.212.901.7058
mhallake@jonesday.com

Jessica Mendoza
Miami
+1.305.714.9720
jmendoza@jonesday.com

Endnotes

1 Exchange offers under Section 3(a)(9) may be subject to the U.S. tender offer rules depending on the facts and circumstances. This *Commentary* does not examine the U.S. tender offer rules.

2 On July 10, 2013 the SEC adopted final rules under Section 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act") removing the ban against general solicitation and general advertising in private offerings made to accredited investors only in reliance on Rule 506(c) of Regulation D under the Securities Act, another available private placement exemption. Regulation D requires that an issuer relying on Rule 506(c) take reasonable steps to verify that all purchasers are accredited investors, file a Form D with the SEC, and appoint an agent for service of process in the United States. Because of these additional requirements, some non-U.S. issuers have opted to structure their offerings under Section 4(a)(2) and be subject to the ban on general advertising and solicitation.

3 Offers to bondholders outside the United States are generally undertaken concurrently and are structured to comply with Regulation S under the Securities Act, which provides a safe harbor exemption from registration for offshore offers and sales to investors located outside the United States.

4 To qualify for the exemption, the existing security holders must not be asked to provide additional consideration.

5 Staff Legal Bulletin No. 3A (CF), June 18, 2008.

6 *Id*.

7 *Id.*

8 11 U.S.C. § 304 of the U.S. Bankruptcy Code was repealed and replaced with Chapter 15 of the U.S. Bankruptcy Code.

9 *In re Bd. of Dirs. of Multicanal S.A.*, 340 B.R. 154, 165 (2006).

10 *Id.*

11 *Id*. at 166.

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