Cash Debt Tender Offers: A Valuable Restructuring Tool

Eliezer M. Helfgott

Foreign companies in need of financing have in the past often looked to the U.S. public debt markets as a source of inexpensive long term capital. During this period of low interest rates and with the expansion and globalization of the European and other world markets, many foreign companies are in fact now seeking to refinance their indebtedness and update and adjust their capital structure. Unfortunately, the ability to amend the terms of such indebtedness or to refinance does not rest with a single lender or syndicate of lenders. As U.S. public debt securities are one of the most permanent financing alternatives available, they are also one of the most difficult to refinance. Making a tender offer for outstanding U.S. public debt securities, however, can be used to overcome many of these difficulties. A debt tender offer can be a valuable tool for taking advantage of the current conditions and can give companies desiring to restructure the flexibility to do so.

This article will discuss the various options, rules and other features relating to a tender offer for non-convertible debt securities using cash as consideration (Cash Debt Tender Offer).[1]

Qualifying as a Cash Debt Tender Offer

The preliminary question that must be addressed before commencing purchases of debt securities is whether such purchases must be qualified as a tender offer. Unfortunately, the term "tender offer" is not defined in the Securities Exchange Act of 1934. However, in *Wellman v. Dickinson*,[2] the SEC proposed an eight factor test which has become the generally accepted guidelines for determining whether a tender offer has been made. The eight factors that would suggest that a tender offer is being made are: (1) active and widespread solicitation of public securityholders; (2) solicitation of the holders of a substantial percentage of the issuer's securities; (3) an offer to purchase made at a premium over the prevailing market price; (4) an offer containing terms which are firm, rather than negotiable; (5) an offer contingent on the tender of a fixed number of securities, often subject to a fixed maximum number to be purchased; (6) an offer open only for a limited period of time; (7) offerees being pressured to sell their securities; and (8) whether the public announcement of a purchasing program concerning the target precedes or accompanies rapid accumulations of large amounts of the target's securities. Not all factors would need to be present in any case, and the weight accorded to each factor would be determined in each case.[3]

Consequently, by avoiding some of the *Wellman* factors listed above an issuer can avoid the characterization of its purchases as a tender offer. For example, open market purchases or privately negotiated purchases that are independent of one another, separately negotiated and priced with no advance announcement of an intention to make such purchases would not constitute a tender offer. On the other hand, the existence of many of the *Wellman* factors when making cash purchases of debt securities may require that such purchases be characterized as a Cash Debt Tender Offer.

Pricing a Cash Debt Tender Offer

There are two methodologies for pricing Cash Debt Tender Offers. A "fixed price," where a specified price is fixed at the outset of the tender offer period, is the simplest and most straightforward method. A holder knows exactly what the amount is being offered. However, the disadvantage to an issuer of a fixed price tender offer is that interest rates may fluctuate during the tender offer period. Consequently, the fixed price set at the beginning of the tender offer period may turn out to be too high or too low based on the direction of the interest rate movement resulting in either overpayment or undersubscription.

An alternative to a fixed price tender offer is a "fixed spread" tender offer. In a fixed spread tender offer, the price to be paid for the securities being sought is calculated based on a fixed number of basis

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[1] Tender offers using securities as consideration, or exchange offers, may be subject to registration requirements of the Securities Act of 1933 and are beyond the scope of this article.

[2] *Wellman v. Dickinson*, 475 F. Supp. 783 (S.D.N.Y. 1979), *aff'd*, 682 F.2d 355 (2d Cir. 1982).

[3] *Id.* at 823-24.

points over the then current yield of a specified U.S. Treasury. A fixed spread tender offer has the advantage of reducing the interest rate risk to both the issuer and the holders who tender.

Within the fixed spread pricing methodology there are a number of different pricing variations that could further reduce the interest rate risk. The tender offer could be structured so that the yield is measured for all holders a specified number of days prior to the expiration of the tender offer period. On such price determination date, the price would be set based on a fixed spread over the then current yield on the specified benchmark security as reported by a designated reporting service. Holders would have the opportunity to calculate the hypothetical price to be paid per security over the course of the tender offer period and the issuer would announce the final price on the price determination date. To further reduce interest rate risk, a fixed spread tender offer could also be structured so that the price to be paid to each purchaser would be calculated separately based on the current yield on the date of or date preceding such holder's tender (daily fixed spread pricing) or even at the exact time of such tender (continuous fixed spread pricing). Using these structures, each holder tendering securities would receive a different price.

A disadvantage to the fixed spread pricing methodology is that the price is based on a complex formula to determine the present value of a benchmark security based on a constantly changing yield. Furthermore, depending on the type of fixed spread pricing used, the actual price is set at the time a tender is made or shortly before the expiration of the tender offer period. Thus, holders are afforded little time to properly assess the tender offer price. To address this concern, some issuers have set a minimum price so that holders will at least be aware of the lowest dollar amount being offered for their securities.

If an issuer intends to purchase less than all of the outstanding securities of a class or series, a "Dutch auction" or a "modified Dutch auction" structure may also be used. In a pure Dutch auction, an issuer invites holders to tender their securities at prices specified by the holders. The issuer then proceeds to purchase securities, starting with those tendered at the lowest price and continuing with those tendered at increasing prices, until it has accepted all the securities it desires, purchasing the securities at the varying prices at which they were tendered. In a modified Dutch auction, the holders tender securities at a price within a preset price range. The issuer pays the single lowest price within that range that will enable it to purchase the amount of securities sought in the tender offer to each holder that has tendered their securities at or below such set price. These structures have the added advantage to an issuer of not paying more than the amount at which the holders are willing to sell.

Laws Governing a Cash Debt Tender Offer

The rules regulating Cash Debt Tender Offers are fairly sparse. The forms and filings mandated for domestic equity tender offers are not applicable to Cash Debt Tender Offers. No SEC filings are required and the rules for domestic equity tender offers, such as the requirement that all holders receive the same consideration for their securities, are not applicable. As such, daily and continuous fixed spread pricing (in the case of investment grade debt securities[4]) as well as the Dutch auction structures discussed above (where each holder receives different consideration for their securities) are permitted.

Basic antifraud rules such as Rule 10b-5 do, however, still apply. Consequently, while no detailed information needs to be provided to holders other than the most basic terms of the tender offer, such as the price to be paid, the number of securities being sought and the expiration date of the offer, in order to avoid any potential Rule 10b-5 claims, accepted practice has become to provide or incorporate by reference additional information about the offer and the issuer in an offer to purchase document.

In addition, Regulation 14E, applicable to any foreign or domestic tender offer, including Cash Debt Tender Offers, requires, among other things, that an offer be kept open for a minimum of 20 business days and for least 10 business days following any increase or decrease in the percentage of the class of securities being sought or the consideration offered.

Notwithstanding Regulation 14E, in a series of no-action letters, the SEC relaxed certain time period restrictions for tender offers for investment grade debt securities.[5] Subsequently, the SEC has also orally granted similar no-action relief for tender offers for

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[4] Salomon Brothers Inc., SEC No-Action Letter, [1990-1991 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 79,643 (Oct. 1, 1990); Goldman, Sachs & Co., SEC No-Action Letter, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,833 (Dec. 3, 1993).

[5] *See* Salomon Brothers Inc., SEC No-Action Letter, WSB File No. 031786015 (Mar. 12, 1986); Shearson Lehman Brothers Inc., SEC No-Action Letter, WSB File No. 120886025 (Dec. 3, 1986); Merrill Lynch Pierce Fenner & Smith Inc., SEC No-Action Letter, WSB File No. 070786011 (July 2, 1986); Kidder, Peabody & Co. Inc., SEC No-Action Letter, WSB File No. 052786024 (May 5, 1986).

certain non-investment grade debt securities which are widely followed and trade in established markets based on their yield in relation to benchmark U.S. Treasury securities of similar maturities. As part of this no-action relief, the SEC permitted the use of the fixed spread pricing methodology discussed above without complying with the rule requiring the extension of a tender offer for 10 business days following the adjustment or setting of a price to be paid for the securities being sought.[6] The SEC also granted no-action relief for investment grade debt securities by only requiring a tender offer to remain open for as little as 7-10 days instead of the 20 business days required by the rules.[7] Without the reduced interest rate risk offered by the fixed spread pricing methodology, the SEC feared that many issuers would have to forego the tender offer route and use other strategies to refinance. As a result individual non-institutional investors would not be afforded the opportunity to receive a repurchase premium.[8] Furthermore, since Cash Debt Tender Offers usually offer only modest premiums and many issuers as part of a refinancing effort wish to effect such refinancing during short interest rate windows of opportunity, the SEC concluded that participation by individual non-institutional investors would not materially increase if the offer were kept open for the full 20 business days.[9]

While, as noted above, the SEC has reduced certain minimum time periods, it has set certain conditions when conducting a fixed spread tender offer to preserve the integrity of the repurchase process. Generally speaking, a fixed spread cash tender offer for non-convertible debt securities is permissible if: (i) the offer is open to all record and beneficial holders of that class or series of debt; (ii) the offer identifies the specific benchmark Treasury security to be used in calculating the purchase price and the daily newspaper of national circulation to be used as a source of daily yield data (and the specific quotation service in a continuous fixed spread offering); (iii) the offer discloses the fixed spread to be added to the yield on the benchmark Treasury security; (iv) the offer describes the assumptions and methodology to be used to calculate the purchase price; (v) the offer discloses the nominal fixed price based under the applicable reference yield prevailing immediately preceding the commencement of the offer; (vi) in the case of an offer for non-investment grade debt securities, the nominal price is set prior to the second day preceding the expiration of the offer; (vii) the offer is conducted in a manner designed to afford all record and beneficial holders of that class or series of debt a reasonable opportunity to participate in the tender offer; (viii) the offeror pays promptly for tendered securities after such securities are accepted for payment; and (ix) the offer is not made in anticipation of or in response to other tender offers for the issuer's securities.[10]

Conclusion

A foreign or domestic company wishing to refinance or restructure its outstanding U.S. public debt can benefit from undertaking a Cash Debt Tender Offer. A Cash Debt Tender Offer has the advantage of speed, efficiency and little regulation. It can be used to bypass the constraints resulting from the fact that U.S. public debt is generally widely held and can be structured to reduce interest rate risk as much as possible. Accordingly, a Cash Debt Tender Offer should be viewed as a valuable tool for adjusting or updating the capital structure of a company to fit its then current needs.

Eliezer M. Helfgott *is counsel at Friedman Kaplan Seiler & Adelman LLP in New York.*

[6] *Id.*

[7] Goldman, Sachs & Co., SEC No-Action Letter, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,833 (Dec. 3, 1993).

[8] *See* Salomon Brothers Inc., SEC No-Action Letter, WSB File No. 031786015 (Mar. 12, 1986); Shearson Lehman Brothers Inc., SEC No-Action Letter, WSB File No. 120886025 (Dec. 3, 1986); Merrill Lynch Pierce Fenner & Smith Inc., SEC No-Action Letter, WSB File No. 070786011 (July 2, 1986); Kidder, Peabody & Co. Inc., SEC No-Action Letter, WSB File No. 052786024 (May 5, 1986).

[9] *Id.*

[10] Goldman, Sachs & Co., SEC No-Action Letter, [1993-1994 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 76,833 (Dec. 3, 1993).