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Attys, SEC Slog Long Road To Debt Tender Offer Reform

By **Stephanie Russell-Kraft**

Law360, New York (February 04, 2015, 6:01 PM ET) -- When New York-based private equity shop The Blackstone Group LP first made an offer to bondholders in its leveraged buyout of Equity Office Properties Trust, it was the day after Christmas in 2006. The creditors, caught off guard by what they saw as a blatant undervaluation of their securities, rejected the bid.

The offer, which was far below fair value for longer-dated bonds, also came far too suddenly, leaving creditors little time to make decisions over the holiday week, according to David Knutson, who represented one of the creditors at the time.

Blackstone and Equity Office had attempted to divide and conquer the bondholders, looking to pay full price for short bonds and shortchange longer-duration bondholders, according to David Knutson, who represented one of the creditors at the time. By launching the transaction over the holiday break, the dealers also made it extremely difficult for investors to gather information, review documents and collaborate, he said.

“They used a couple of different tactics to get people to participate in some less-than-favorable economics,” Knutson said.

But the bondholders didn’t push over easily. Together, they negotiated with Blackstone and ended up netting over $150 million more than the private equity firm had initially offered when they finally accepted a new bid on Feb. 8, 2007.

The deal was a “watershed moment” for the group, according to Knutson, who is now a senior research analyst at Legal & General Investment Management America.

In the months that followed, leaders from the negotiation joined together with other institutional investors to form a lobby group known as the Credit Roundtable. Their goal was to strengthen bondholder covenant protections and regulate corporate actions in order to prevent what had happened with Blackstone from happening again.

At that time, the SEC’s rulebook for bond tender offers was incredibly thin. First written in 1934, the rules were most recently updated in 1986, when the agency shortened the offer period for debt securities with an investment-grade rating from a minimum of 20 days to seven to 10 calendar days.

But those calendar days included weekends and holidays, and an offer sent out at 11:59 p.m. on a Monday night would still count as an offer made that day, even if creditors didn't actually get the memo until Wednesday. To make matters worse, custodians typically required early deadlines — before the end of a tender offer window — to guarantee the creditors' transactions, according to Knutson.

"The deadline really wasn't the deadline of the transaction," he said. "It turned out to be earlier."

And there were problems for issuer counsel, too, as they were left to contend with the SEC staff on an individual basis to find out what would or wouldn't be accepted later on. They were starting to get frustrated by the lack of clarity from the SEC when it came to offers that didn't fit the existing mold.

"You end up with a market where people have had different conversations with different people at the SEC and then take different positions," said Michael Kaplan, a co-head of Davis Polk & Wardwell LLP's global capital markets group who has joined the effort to update the SEC's tender offer rules.

Once formed, the Credit Roundtable immediately got to work pressuring the SEC for a guidance update. But the agency, caught up in what was to become the greatest financial crisis since the Great Depression, didn't answer.

The group tried again in 2010, this time enlisting Paul Weiss Rifkind Wharton & Garrison LLP partner Larry Wee to help draft a set of talking points to address the problems in the agency's tender offer regime and propose potential fixes. Wee, who had experience representing both bondholders and issuers, was also eager to address what he saw as an ongoing informational imbalance.

"If you think about it, the issuer always knows when it wants to do a tender offer. They know, right? And the banks know," he said. "But the bondholders don't know until a press release goes out."

The SEC granted the Credit Roundtable's request for a meeting, but reform efforts stalled again, as the agency was caught up in the wake of Dodd-Frank Act reform, according to Knutson and Wee.

"It didn't pick up again until 2012, when we became aware of an effort by issuer counsel to update prior guidance around corporate actions," Knutson said.

Jim Clark of Cahill Gordon & Reindel was one of those attorneys. After years of lobbying the commission for written guidance on debt tender offers, Clark had already become well known among the SEC staff. The lack of a clear framework on what kinds of tender offers were kosher often made him wary of giving legal opinions, he said, and he urged the commission to update its guidance.

After seven years of lobbying, the SEC finally obliged.

"When you have enough people over a number of years calling you — and I was one of them — saying you really need to put out some written guidance on this, I think they finally said, 'Enough's enough, we're going to finally do something about it,'" Clark said.

At an April meeting in the SEC's Washington, D.C., headquarters, the agency, led by Office of Mergers and Acquisitions chief Michele Anderson, gathered a large conference room full of nearly 60 attorneys, investment banks and representatives from the Credit Roundtable, including Knutson, Wee, Kaplan and Clark.

“I went into that meeting thinking absolutely nothing would happen,” Clark said. “I was shocked about how people fairly quickly came on the same page with a lot of basic concepts that would let you restructure these rules.”

By the end of the day, compromise was within reach. Clark took the lead on drafting a proposal, but the SEC warned him that no reform would be approved without the blessing of the Credit Roundtable.

“Their mandate is investor protection, and they’re not going to provide relief if the Credit Roundtable that’s been involved says, ‘We’re the investors, and we think this is not helpful to us,’” said Kaplan.

In the months that followed, Clark spent hours hashing out his proposal with Wee and the other conference participants. During that time, several attorneys threatened to quit the project.

“Trying to get all these people on the same page was almost impossible, but we somehow managed it,” said Clark. “And we proposed a very, very comprehensive — I would call revolutionary — change in the way that debt tender offers would work.”

But the group’s first proposal went too far for the SEC staff, according to Clark. A provision to reduce all debt tender offers to a clearly defined 10-day window was scrapped, and Wee and Clark doubled down on a proposed framework for a straightforward five-business-day tender offer.

The release needed to be consistent and clear, so that all parties could read the same playbook, according to Wee.

“There were times when I had to talk to the Credit Roundtable and say, you know, in all fairness, the issuers have a point on this one,” Wee said. “Or on this one, we can’t really ask for it because the standard isn’t specific enough so that I, as issuer’s counsel, would be able to give an opinion about it.”

“Much to Jim’s credit, he was able to herd all of the cats on his side,” he added. Wee also praised Anderson and SEC counsel David Orlic and Daniel Duchovny for their pragmatism and flexibility during the negotiations. Anderson could not be reached for comment on this story.

After months of negotiation, Clark and the others had laid out a framework for five-business-day debt tender offers meeting certain criteria. They sent the SEC a detailed letter explaining the new scheme and asked the commission for its blessing. At the end of January, the SEC issued a no-action letter approving the idea.

Under the terms of the letter, issuers must give creditors five full business days to consider their offers, and the announcement must be made immediately and electronically available — via press release or hyperlink — before 10 a.m. on the first business day.

Unlike the SEC’s previous framework, the new offer type applies to both high-yield and investment-grade securities and permits issuers to make exchange offers as a means of refinancing existing debt by swapping out it out for new debt.

Those provisions could be a game changer for high-yield issuers, according to Clark.

“If you have a bond at 10 percent, and you can issue new bonds at 5 percent, and every day that 10 percent bond stays outstanding, you are paying double interest,” he said. “When you multiply those amounts by hundreds and hundreds of millions of dollars, it actually adds up to a lot of money. So my phones are ringing off the hook from high-yield issuers saying this is awesome."

Knutson also praised the new tender offer framework, albeit for different reasons.

"The most important thing in my mind is the improvement of transparency," he said. "So when a transaction is launched, I'll have an 8-K or 6-K [form]. I'll have links to offering documents. It modernized the dissemination of information and made the transactions more transparent."

The new tender offer guidance doesn't apply to deals involving solicitations or other considerations, a provision that made it past both investors and issuers.

"The rule of thumb is that if it feels like a straightforward refinancing, then it should be a five-business-day tender offer," said Wee. "If it doesn't feel like a straightforward refinancing, if it feels like the issuer is trying to get the investors to do something they don't want to do, there are structural changes, anything like that shouldn't be a five-business-day tender offer."

Issuers now have their sights set on the next round of updates: clarifying the rules for all tender offers. Clark, who had his fill of negotiations over the past year, is handing off the reins to Kaplan. But the group formed at the April SEC meeting will mostly stick together.

"The part we're working on now is to codify existing practice," said Kaplan. "It would be nice to make the the rules more clear for everyone."

In the meantime, David Knutson is relieved knowing that the Blackstone deal, if offered today, would have a more clearly defined time window.

Under the past framework, the game was too easy for companies looking to extract value from creditors and give it to equity holders, Knutson said.

"You'd be pitching business, and if your competitor would come up with a slightly craftier mousetrap then he would win the business," he explained. "It was just this evolving rule, and by putting out a bright-line test, you level the playing field."

--Editing by Kat Laskowski and Kelly Duncan.
