*Business Reorganization/Legislation*

# Public Securities and the Bankruptcy Plan Process: What Not to Do


**Dan Besikof, Moderator**
*Loeb & Loeb LLP; New York*

**Jasmine Ball**
*Debevoise & Plimpton LLP; New York*

**Patricia Casimates**
*FINRA (formerly NASDAQ); Washington, D.C.*

**Peter Finkel**
*Wilmington Trust; Minneapolis*

**Mark F. Hebbeln**
*Foley & Lardner LLP; Chicago*

**Jane Sullivan**
*Epiq Systems, Inc.; New York*

# Public Securities and the Bankruptcy Plan Process: What Not to Do

ABI 2016 Annual Spring Meeting

16 April 2016

Debevoise & Plimpton

## Panelists

- Shane G. Ramsey, Moderator – Kilpatrick Townsend & Stockton LLP
- Jasmine Ball – Debevoise & Plimpton LLP
- Patricia Casimates – Financial Industry Regulatory Authority
- Peter Finkel – Wilmington Trust
- Mark F. Hebbeln – Foley & Lardner LLP
- Jane Sullivan – Epiq Systems, Inc.

## The Intersection of the Bankruptcy Code and the Federal Securities Laws

- "[T]he Bankruptcy Code and the Securities Acts create two distinct regulatory schemes." – *In re* Enron Corp., 341 B.R. 141, 159 (Bankr. S.D.N.Y. 2006)
  - Judge Gonzalez noted that these two regulatory schemes do not necessarily have to be harmonized



## The Intersection of the Bankruptcy Code and the Federal Securities Laws

- These two regulatory schemes often intersect when dealing with distressed companies
  - Potential liabilities under securities laws
  - Disclosure Statements and adequate information
  - Solicitation of votes under a Chapter 11 plan of reorganization (a "POR")
  - Conversions of debt to common stock as part of a POR
  - Tradability of common stock issued as part of a POR

# Legal Background



## Disclosure and Solicitation Requirements

- What are the disclosure and solicitation requirements with respect to a POR?
- Sections 1125 and 1126 of the Bankruptcy Code govern postpetition disclosure and solicitation and acceptance of votes.
  - Section 1125 relates to postpetition disclosure and solicitation
  - Section 1126 relates to acceptance of plan votes
- Without Section 1125, a bankruptcy court would be required to ensure that a full proxy statement or prospectus was provided in accordance with securities.

## Section 1125(a)(1) – "Adequate Information"

- Section 1125(a)(1) of the Bankruptcy Code provides that "adequate information" is:

  "of a kind, and in sufficient detail, as far as is **reasonably practicable** in light of the nature and history of the debtor and the condition of the debtor's books and records, … that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan, … and in determining whether a disclosure statement provides adequate information, **the court shall consider** the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information" [emphasis added]



## Section 1125(b) – Timing and Information Requirements

- Section 1125(b) provides:

  "An acceptance or rejection of a plan may not be solicited **after** the **commencement of the case** under this title from a holder of a claim or interest …**unless, at the time of or before such solicitation**, there is transmitted to such holder the plan or a summary of the plan, and a **written disclosure statement** approved, after notice and a hearing by the court as **containing adequate information**. …" [emphasis added]

- Section 1125(d) provides additional guidance:

  "Whether a disclosure statement required under subsection (b) of this section contains adequate information is not governed by any otherwise applicable nonbankruptcy law, rule or regulation … ."

## Section 1125(e) – Safe Harbor Provision

- Section 1125(e) provides:

  "A person that solicits acceptance or rejection of a plan, **in good faith and in compliance with the applicable provisions of this title**, or that participates, in good faith and in compliance with the applicable provisions of this title, in the offer, issuance, sale, or purchase of a security, offered or sold under the plan … is not liable, on account of such solicitation or participation, for violation of any applicable law, rule, or regulation governing solicitation of or acceptance or rejection of a plan or the offer, issuance, sale, or purchase of securities." [emphasis added]

- Section 1125(e) was intended to replace the more stringent fraud requirement under the securities laws (which include potential fraud claims related to honest, open, good faith omissions to state material facts)



## *Century Glove, Inc. v. First American Bank*

- Section 1125 is not an antifraud device
  - "Once adequate information has been provided a creditor, § 1125(b) does not limit communication between creditors. It is not an antifraud device." *See Century Glove, Inc. v. First American Bank*, 860 F.2d 94, 101 (3d Cir. 1988).
- Section 1125 does not provide blanket protection
  - If a party's actions are not "solicitations", pre-disclosure communications may be subject to the stricter requirements of the securities laws. *See Century Glove,* 860 F.2d at 102.
    - » The meaning of "solicitation" under § 1125(b) is determined by case law.

## Disclosure and Solicitation – Questions to Ask

- Can the action being taken be viewed as a "solicitation"?
- Are the solicitations being made in "good faith"?
- Was "adequate information" provided?
- Does the disclosure and solicitation comply with the timing requirements set forth in the Bankruptcy Code?
- Do we comply with Section 1125(e)?
  - Loss of the safe harbor requires compliance with the registration requirements under Section 5 of the Securities Act
    - » Failure to comply with Section 5 could result in civil and criminal liability
  - Loss of the safe harbor could expose parties to Rule 10b-5 fraud claims



## Securities Issued Under a Plan of Reorganization

- Is the common stock issued pursuant to a Chapter 11 POR freely tradable without registration under Section 5 of the Securities Act?

## Section 5 of the Securities Act – Registration Requirements

- Sales (including resales) and offers of securities must be registered with the SEC unless there is an exemption
- Section 5 of the Securities Act requires that each transaction be evaluated separately, so an exemption for an initial sale does not mean a future resale is exempt
- Without an exemption, Section 5 of the Securities Act would require registration for BOTH:
  - the initial issuance and distribution of securities under the POR; and
  - the resale by holders of claims and interests of securities issued to such holders under a POR



## Section 1145 of the Bankruptcy Code

- Section 1145 of the Bankruptcy Code provides (generally):
  - Exemption from registration (§1145(a))
  - Adjustment of the "underwriter" definition (§1145(b))
  - An offer/sale in compliance with Section 1145(a) is deemed to be a public offer (§1145(c))
  - The TIA does not apply to notes issued under the POR that mature within 1 year of the effective date of the POR (§1145(d))

## Section 1145(a) – Exemption from Registration

- Under Section 1145(a), Section 5 of the Securities Act does not apply to:

  "(1) the offer or sale **under a plan** of a security of the debtor, of an affiliate participating in a joint plan with the debtor, or of a successor to the debtor under the plan –

  (A) **in exchange for** a claim against, an interest in, or a claim for an administrative expense in the case concerning, the debtor or such affiliate; or

  (B) **principally** in such exchange and partly for cash or property;" [emphasis added]



## Section 1145(a)(1) – "Principally" Test

- Section 1145(a)(1)(B) requires that the securities issued be "principally" to satisfy claims, interests or administrative expense claims and only "partly for cash or property"
  - Offerings to raise new capital are not eligible for Section 1145(a)(1)

- The issuance of securities by a debtor (or certain other entities), if principally in exchange for claims, interests, or administrative expense claims is exempt from the Section 5 registration requirements under the Securities Act

## Section 1145(b) – Definition of "Underwriter"

- Section 1145(b)(1) modifies the Securities Act restrictions on resale of securities issued under a POR by modifying the definition of "underwriter"
- Were claims acquired with a "view to distribution" of securities issued under a POR?
  - Look at intent at the time the claims or interests were acquired
  - A fact-intensive inquiry of the particular transaction at the time of acquisition of the claims/interests



## Section 1145(c) – Deemed Public Offering

- Section 1145(c) provides:

  "An offer or sale of securities of the kind and in the manner specified under subsection (a)(1) of this section is deemed to be a public offering."

- What does this mean?
  - The issuance of securities under a POR in accordance with Section 1145(a)(1) is NOT a private placement
  - Such securities would NOT be
    - » subject to private placement restrictions upon resale
    - » resticted securities for the purposes of Rule 144
    - » subject to registration prior to resale by recipients of such securities (provided that such recipients are not a bankruptcy underwriter, an affiliate or a dealer)

## Potential Liability Under Securities Laws Related to Sale of Securities Issued Under a POR

- Section 1145 provides exemptions from the registration requirements under Section 5 of the Securities Act
  - Recipients of securities issued pursuant to a POR (other than certain parties set forth in Section 1145) should be able to resell such securities without registration
  - Debtors have the ability to issue securities without the expense or delay of a registration process under the securities laws
- Section 1145 does NOT provide exemptions from the antifraud provisions under securities laws
  - Generally, the restrictions on sale or purchase of securities while in possession of material nonpublic information (MNPI) is still applicable



## Registration and Trading Limitations – Questions to Ask

- Does Section 1145(a) of the Bankruptcy Code apply?
  - Is the security being offered pursuant to a POR?
  - Is the security being offered "principally" in exchange for claims or interests?
  - Is the security being offered security of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or of a successor to the debtor?
- Are you an "underwriter" as defined in Section 1145(b)?
- Do you have MNPI?

**ABI PANEL - TALKING POINTS:**

**PATRICIA CASIMATES (FINRA) AND JANE SULLIVAN (EPIQ)**

**Background**

- Two types of security holders:
    - Registered – owns directly
    - Beneficial – owns in "Street name" through a bank or broker
- Two types of transactions – including for distributions:
    - Record date
    - Surrender
- Relevant Filings
    - Chapter 11
    - Chapter 7
    - Chapter 15

**FINRA Specifics [P Casimates]**

FINRA Rule 6490:

Codifies the requirements of SEA Rule 10b-17:

- Requires issuers of securities to provide notice of corporate actions to the exchange and in the case of non-exchange listed securities, notice is given to FINRA
- Notice must be given 10 calendar days prior to record date, or
- If such 10 day advance notice is not practical, on or before the record date and in no event later than the effective date of the corporate action
- Clarifies FINRA regulatory authority to:
    - Administers Corporate Actions and Dividend Announcements for OTC Equity Securities
    - Charge fees and late penalties for corporate action notifications

- Request documents & information to support the corporate action
- Deny processing of a corporate action under certain conditions

- Reviews and processes documents related to announcements for:
  - SEA Rule 10b-17 Actions ("SEA Rule 10b-17 Actions")
  - Splits
  - Dividends
  - Other Company-Related Actions ("Other Company-Related Actions") to facilitate the orderly trading and settlement of OTC securities
  - Name change
  - Symbol change

- Coordinates announcements
  - Issuers or their designated representative
  - ADR banks
  - Transfer Agents
    - Maintain lists of registered holders – usually individuals, if any
  - DTC (The Depository Trust Company) – U.S. Depository
    - Holds most Stock – typically 80% or more
    - Generally 100% of a bond issue

  - Other entities:
    - Main non-U.S. depositories: Euroclear and Clearstream – "ICSDs" International Clearing Securities Depository

  - Lists available to issuer:
    - Registered holders,
    - DTC participants (banks and brokers that are direct participants), and
    - Non-Objecting Beneficial Owners ("NOBOs") who consent to disclosure

**Record Date vs. Surrender Events**

- Can have one OR the other

- Overview of "Record Date" transaction
    - Record Date – ONLY look to record date records
    - Record date requires at least 10 days advanced notice of record date to FINRA in compliance with SEC Rule 10b-17
    - DO NOT make record date the confirmation date or other date that cannot be known in advance
    - Does not permit a customized result or treatment to be linked to a particular holder
        - Cannot have treatment election be part of a record date plan vote;
        - Record date holder makes election and then sells – but no one knows to whom, so election is unusable
    - Trading continues after the record date passes
        - Continued trading can cause major problems
        - Implied due-bill with every trade thereafter
    - Future distributions must be to NEW RECORD DATES - not the initial record date
    - If securities are cancelled, additional steps must be taken to:
        - Stop trading by notifying FINRA, and
        - Remove positions from DTC
    - Record Date distributions are ideal when security is not cancelled:
        - Dividend or interest payment;
        - Plan treatment to non-cancelled security (e.g., for retained security or guarantee payment)
    - FINRA may set ex-date before or after distribution, depending on size of payment:
        - For distributions less than 25% of trade price, ex-date is two days prior to record date
        - For distribution 25% or greater, ex-date is first business day after payment date.

- Overview of "Surrender" process
    - Action via delivery or surrender of securities
    - NO RECORD DATE should apply
    - Registered holders (if any) submit certificate, unless surrender is deemed
    - For Street name securities, a surrender event is handled in one of two ways:
        - "Voluntary" – for specific treatment elections or other events where treatment is chosen or needs to be claimed individually; or
        - "Mandatory" – for automatic full exchange of old for new (such as a Plan distribution)
            - Removes securities from DTC for cancellation;
            - DTC can create "escrow" positions for potential future distributions
    - Mandatory exchange is simplest way to make distributions to security holders
    - Distributions typically flow through the depository system, unless non-eligible
        - Cash or DTC-eligible securities can flow through DTC;
        - Non-DTC eligible treatment needs to be handled specially, but "exchange" concept can still work
    - Plan should call for *surrender* or *exchange* of securities
    - Carve our securities from definition of "Distribution Record Date"
    - May need specific language for each type of holder or claim, and not a confusing blend
    - SPECIAL: when shares are cancelled but receiving no distribution
    - Plan may say shares are cancelled, but this is NOT automatic.
    - FINRA must be notified in advance (as discussed above)

**Balloting [J Sullivan – brief overview]**

- Balloting is usually a record date event

- Rights offerings are also usually record date driven
- Treatment elections by security holders is an exception (more later)
- All instructions must be processed through the banks and brokers, or their agent (nominees)
    - Even if holders are known, voting should still be done via the nominees
- Treatment elections should not be done via the ballot, since trading will continue after the voting record date
- Instead there should be a mechanism for holders to literally submit (surrender) the bonds of any holders wishing to receive the alternative treatment
- Treatment elections may be done contemporaneously with voting or after Plan confirmation
    - With almost no exceptions, no record date should apply
    - Possible exception: buy out for small positions (to prevent fraud)
    - Ideally, utilize DTC's Automated Tender Offer Program to segregate bonds of electing holders
    - Other options are more difficult

# ABI SPRING MEETING

**Public Securities and the Bankruptcy Plan Process: What Not to Do**

**Saturday, April 16, 2016**

**11:15 am – 12:30 pm**

**Peter Finkel & Mark Hebbeln**

## I. SOLICITATION OF VOTES ON A CHAPTER 11 PLAN

### a. General Principles

#### i. *In re Tenn-Fla Partners*, No. 92-27624-B (MJN), 1993 WL 151346, at *1 (Bankr. W.D. Tenn. Apr. 29, 1993)

"Obviously [Rule 3017(e)] indicates that there is a great deal of discretion given to the trial court about procedures and adequacy of those procedures. It does clearly provide that the court may enter such orders as the court deems appropriate."

#### ii. *In re Amster Yard Associates*, Bankr. S.D.N.Y. 1997, 214 B.R. 122 (Bankr. S.D.N.Y. 1997)

"Since proposed Chapter 11 plan impaired unsecured creditors who were entitled to vote, proponent had to obtain approval of disclosure statement, transmit approved disclosure statement and plan or plan summary to each claim holder, and give each holder reasonable amount of time to examine these documents and decide how to vote."

### b. How Much Time Needed To Solicit Bondholders?

#### i. Fed. R. Bankr. P. 3017(e)

"(e) Transmission to beneficial holders of securities

At the hearing held pursuant to subdivision (a) of this rule, the court shall consider the procedures for transmitting the documents and information required by subdivision (d) of this rule to beneficial holders of stock, bonds, debentures, notes, and other securities, determine the adequacy of the procedures, and enter any orders the court deems appropriate."

#### ii. 5 Norton Bankr. L. & Prac. 3d § 97:28

"The length of time given to creditors and equity holders to accept a reorganization plan is not specified in the Bankruptcy Code or the Bankruptcy Rules. The federal securities law permits an exchange offer to expire 20 business days after it is commenced, absent any material changes to the terms of the offer. However, Bankruptcy Rule 2002(b) provides that all creditors shall have at least 28 days to consider a disclosure statement. . . . a 28-day period may be considered the minimum

reasonable time period to be afforded to creditors and equity holders to accept a reorganization plan."

**iii. *In re Southland Corp*., 124 B.R. 211, 227 (Bankr. N.D. Tex. 1991)**

"The Court finds that there were only eight (8) business days allowed for the transmission of the materials by brokers to their customers (beneficial owners) and for the original receipt, analysis and vote by the actual owners of the claims or stock. … The Court finds that an unreasonably short time was prescribed for the votes to accept or reject. … The time allowed for voting in this case was unreasonably short; the votes are not to be deemed acceptances, and all votes are invalidated."

**iv. *In re Pioneer Fin. Corp*., 246 B.R. 626, 635 (Bankr. D. Nev. 2000)**

"Thus, a pre-petition solicitation process is invalid where there is no evidence that the solicitation has been sent to beneficial bondholders, and no showing has been made that record holders have been authorized by beneficial holders to vote on their behalf, *See City of Colorado Springs Spring Creek Gen. Improvement Dist*., 177 B.R. 684, 691 (Bankr. D. Colo. 1995)(confirmation denied where debtor failed to show that disclosure had been provided to all beneficial holders in a pre-petition solicitation); *In re Southland*, 124 B.R. 211 (Bankr. N.D. Tex. 1991)(court required re-vote in prepackaged Chapter 11 case because it was unclear whether ballots had been cast by beneficial owners or record holders)."

## II. INDENTURE TRUSTEE-BONDHOLDER COMMUNICATIONS

### a. Notices to Holders

#### *i. Relevant Indenture Provisions*

Notice of Events of Default.

If a Default occurs and is continuing and if it is known to the Trustee, the Trustee shall mail or otherwise deliver in accordance with the procedure of DTC to Holders of Notes a notice of the Default within 90 days after it occurs. Except in the case of a Default relating to the payment of principal of or premium, if any, or interest (including Additional Interest, if any) on any Note, the Trustee may withhold from the Holders notice of any continuing Default if and so long as a committee of its Responsible Officers in good faith determines that withholding the notice is in the interests of the Holders of the Notes. The Trustee shall not be deemed to know of any Default unless a Responsible Officer of the Trustee has actual knowledge thereof or unless written notice of any event which is such a Default is received by the Trustee at the Corporate Trust Office of the Trustee.

Reports by Trustee to Holders of the Notes.

Within 60 days after each May 15, beginning with the May 15 following the date of this Indenture, and for so long as Notes remain outstanding, the Trustee shall mail to

the Holders of the Notes a brief report dated as of such reporting date that complies with Trust Indenture Act Section 313(a) (but if no event described in Trust Indenture Act Section 313(a) has occurred within the twelve months preceding the reporting date, no report need be transmitted). The Trustee also shall comply with Trust Indenture Act Section 313(b)(2). The Trustee shall also transmit by mail all reports as required by Trust Indenture Act Section 313(c). A copy of each report at the time of its mailing to the Holders of Notes shall be mailed to the Issuer and filed with the SEC and each stock exchange on which the Notes are listed in accordance with Trust Indenture Act Section 313(d). The Issuer shall promptly notify the Trustee when the Notes are listed on any stock exchange.

***ii. When/How Often?***

1. Commencement of Case
    a. Case Venue/Number
    b. Chapter 11 Filing = Event of Default
    c. First Day Motions – Summary of Material Orders
    d. Second Day Hearing – Summary of Material Motions/Objection Deadlines
    e. DIP Financing/Cash Collateral
2. Major Settlements
    a. Delta Case
        i. Indenture Trustee issues 16 notices to bondholders informing them of negotiations with Delta over bonds and inviting them to join unofficial committee
        ii. 60% in principal amount of bondholders direct Indenture Trustee to enter into settlement
        iii. Indenture Trustee sends notice of settlement to bondholders
        iv. Minority holders object to settlement
        v. Bankruptcy Court: approves settlement, plan goes effective, distributions made
        vi. District Court: appeal is equitably moot; indenture trustee has authority to exercise remedies and agree to settlements that bind bondholders
        vii. Third Circuit: affirms District Court
3. Approval of Disclosure Statement
    a. Description of Plan Treatment of Creditors, Including Noteholders
    b. Voting Mechanics/Deadlines
4. Confirmation of Plan
    a. Notice of Effective Date
5. Distributions
    a. Amount/Amount Per $1,000

***iii. What To Say***

1. Summary of Pleadings
2. Trustee Taking a Position?
3. Deadline to Object
4. Hearing Date/Time

## III. UPDATE ON TRUST INDENTURE ACT LITIGATION

**a. Background**

***i. Trust Indenture Act Section 316(b)***

(b) Notwithstanding any other provision of the indenture to be qualified, 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, except as to a postponement of an interest payment consented to as provided in paragraph (2) of subsection (a), and except that such indenture may contain provisions limiting or denying the right of any such holder to institute any such suit, if and to the extent that the institution or prosecution thereof or the entry of judgment therein would, under applicable law, result in the surrender, impairment, waiver, or loss of the lien of such indenture upon any property subject to such lien.

**b. Caesars**

i. ***SDNY/Delaware Actions***

1. Actions by Indenture Trustees and Noteholders against Caesars Entertainment Corporation (CEC) to enforce guarantees of $7 billion of notes issued by Caesars Entertainment Operating Company and guaranteed by CEC
2. Allegations:
    a. CEC:
        i. Guarantees were released pursuant to terms of indenture even without the consent of each holder of the notes
        ii. Section 316(b) of the TIA protects only the "legal right" to receive payment when due
    b. Indenture Trustees/Noteholders
        i. Release of guarantees violated Section 316(b)
        ii. Section 316(b) protects more than just bare legal right to payment
    c. SDNY:
        i. "When a company take steps to preclude any recovery by noteholders for payment of principal coupled with the elimination of the guarantors for its debt, . . . such action . . . constitute[s] an 'impairment' . . ."

***ii. Request for Section 105 Injunction***

1. CEOC requests that Bankruptcy Court enjoin the SNDY and Delaware actions under Section 105 of the Bankruptcy Code, arguing that such actions will thwart its restructuring efforts, which it claims depend on a substantial contribution from CEC in settlement of certain claims CEOC has against CEC
2. Bankruptcy Court:
    a. For litigation against a non-debtor to be enjoined, it must arise out of the same acts of the non-debtor that gave rights to disputes in the bankruptcy proceeding
    b. Here, litigation by CEOC against CEC relate to alleged fraudulent conveyances, while the Indenture Trustee/Noteholder litigations against CEC arise from CEC's alleged repudiation of the guarantees that it issued
    c. Thus, Bankruptcy Court refuses to enter injunction
3. District Court: Affirms
4. Seventh Circuit:
    a. Nothing in Section 105 authorizes the limitation on the powers of a bankruptcy judge urged by the Indenture Trustees/Noteholders
    b. Section 105 grants "extensive equitable powers that bankruptcy courts need in order to be able to perform their statutory duties"
    c. Issue: Whether the injunction is likely to enhance the prospects for a successful resolution of the disputes attending the bankruptcy. If so, the injunction would be appropriate.
    d. Remands case for further proceedings consistent with the opinion.