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VIEWPOINT

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Rights Offerings Roadmap For Chapter 11

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Rights offerings—the issuing of new securities to current investors—have emerged as a key component in a number of Chapter 11 cases in recent years. They became increasingly common in the wake of the financial crisis as a means for companies to obtain exit financing for their emergence from Chapter 11 when traditional financing options were limited.

Today, they remain popular within the corporate bankruptcy arena as a mechanism for distressed investors to gain a greater share of equity within a reorganized company. As rights offerings have far-reaching implications for all major creditors in a Chapter 11 case, it's critical for debtors to lay the administrative framework for them to proceed efficiently and effectively.

Companies of all sizes and industries in the current market have used rights offerings as a vehicle to restructure their balance sheets. Rights offerings have played a significant role in Chapter 11 cases such as Six Flags Inc., Tronox Inc., Aleris International Inc., Vertis Holdings Inc., Cooper-Standard Holdings Inc., and Movie Gallery Inc., among others. Distressed investors leverage them as both a defensive and offensive strategy. They may participate in a rights offering as a shield to protect their existing investments, while simultaneously increasing their positions within the capital structure by acquiring a larger stake in the company. These competing creditor interests combined with the greater complexity of corporate debt in today's market requires debtors to plan ahead for a smoothly administered rights offering.

At first glance, the administrative execution of rights offerings may seem a straightforward process. In fact, the subscription process can be complicated and must be approached with methodical planning from the time the debtor confirms that it will take place. Debtors and their professionals need to map out every stage of these transactions to ensure that no detail is overlooked and the most efficient administrative strategy is employed for the needs of the case.

Specifically, there are several key criteria that debtors should consider to determine the best course for their successful administration. Debtors must determine eligibility requirements for participation in the rights offering, the type of security to be issued and whether rights are transferrable to another party. Debtors must also decide whether an oversubscription privilege—which gives investors the opportunity to acquire

additional securities beyond the initial offer—will be included in the process. Most rights offerings will involve a backstop purchaser, which is an entity or consortium that commits to buy any remaining, unsubscribed securities that originate from an offering. This provides assurance to the debtor that all of the newly issued securities or shares will be subscribed for and allows the company to reach its financing goals.

In some cases, the backstop purchaser may also request a guaranteed proration of shares to ensure that it will be able to acquire a minimum amount of new securities if there is a greater demand than anticipated from participating holders. All of these factors must be considered in advance to ensure an efficient and effective outcome.

Eligibility plays a pivotal role in the rights-offering planning process. In the current restructuring environment, debtors have become increasingly selective in determining who will be included and whether certain holders will be given priority or privileges based upon the goals and interests of the involved creditor constituencies. When holders of publicly traded securities are deemed eligible, debtors must plan ahead for the additional procedures needed to communicate with these constituencies.

For instance, holders of publicly traded securities within a company undergoing Chapter 11 can only be reached through designated intermediaries and channels, such as the Depository Trust Company (DTC) or brokers and dealers, depending on whether they hold the securities directly as a registered holder or through a nominee as a “street name” holder. This chain of communication with public securities holders must be managed carefully as part of the rights offering to ensure the efficient flow of information to and from eligible holders.

When public securities holders are involved, debtors also must take additional steps in the prescreening and accreditation process necessary to confirm eligibility. The process is more complicated with public securities holders because the company must work with the nominees to obtain the necessary certification and eligibility of the holder. There are several variations of how this can be handled within a Chapter 11 case depending on the type of holders that are involved and the needs of the case. The most important consideration for public securities holders is to determine if the communication with holders must travel through the DTC or outside of it in order to reach the appropriate parties.

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The importance of the administrative procedures and processes at the foundation of the case shouldn't be underestimated, as they will allow for seamless communication through the appropriate channels regardless of how the rights offering is structured. Each rights offering scenario requires specialized planning to ensure that all the case developments are administered in the proper sequence with the necessary communication between all parties. Noticing, solicitation and disbursements cannot proceed unless the proper channels are in place to reach and communicate with the participating public securities holders. Without the transparent and accurate administration of each of these phases of the rights offering, the successful outcome of a Chapter 11 company may be jeopardized.

In today's Chapter 11 environment, rights offerings can present challenges from both a substantive and administrative standpoint. Having a well-planned administrative strategy from the start enables the debtor and its professionals to navigate both planned and unexpected obstacles along the way. With the proper administrative and procedural framework in place, debtors will be able to steer the case towards a smoothly administered outcome in whatever direction it takes.

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