

RIGHTS OFFERINGS

S. 1145(a)(1) discusses the exemption from securities registration of securities issued in connection with a bankruptcy POR. These include securities issued "when the offer or sale under a plan of a security of the debtor is ... (A) in exchange for a claim against ... the debtor or (B) principally in such exchange and partly for cash or property". The bulk of the legal analysis rests on the principal/partly test and turns specifically on the valuation ascribed to the recovery on creditor claims.

"The SEC historically has interpreted the definition of 'principally in such exchange' to accommodate bona fide exchanges, as long as the value of the securities being issued exceeds the value of the claims. Yet, the SEC has been unwilling to recognize even a de minimis exception if it appears that a debtor may be using the Section 1145 exemption as a pretext for an unregistered financing."

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"In contrast, the SEC historically has enforced registration requirements in cases in which a cash infusion exceeds the value being exchanged, no matter how insignificant the cash portion may be."

- Wendell H. Adair Jr. and Brett Lawrence (Stroock & Stroock & Lavan LLP), "Rights Offerings: Raising Cash Without Registering Securities", **The Journal of Corporate Renewal**, October 2004, 1-2

The note from Stroock alludes to no-action letters from the SEC in two cases: *Jet Florida Sys., Inc.* and *Bennett Petroleum Corp.*

Essentially, the test appears to be as follows: creditors can purchase an additional 75% of securities when compared to the amount that they receive as standalone consideration for their claims without triggering a requirement to register the rights under the "principally/partly" test.

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Consider the following case study:

Facts:

Unsecured Claims Pool	234.0	
Creditor A's Claim	23.4	
Creditor A's Pro Rata Share - Unsecured	10.0%	
Post-reorg Equity Pre-Rights Value	118.0	
Consideration for Unsecured		Elect either 50% of post-reorg pre-rights equity or \$43.13m in cash
Rights Offering		2 parts: \$30m senior secured convertible note + \$10m new common
Rights Subscribed Before Oversubscription	5.0	Pro Rata amount of Rights actually subscribed

Rights Offering Oversubscription:

To participate in the rights offering, creditors have to subscribe for their full pro rata portions of common stock **and** the oversubscription enabled creditors to subscribe for up to 2x their pro rata shares of common still unclaimed after the initial rights offering.

Oversubscription only applied to the common stock portion of the rights offering

Only half of the pool of unsubscribed common is available for the oversubscription

Outcome for Creditor A:

Standalone Unsecured Recovery	5.9
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Pre-oversubscription Rights Offering:

Pro Rata Portion of New Notes	3.0
Pro Rata Portion of New Common	1.0
Total Pro Rata Rights Value	4.0
Test: Is this less than 75% of the Standalone	Yes

Oversubscription:

Maximum Oversubscription Available	2.5
Creditor A Max Election - Oversubscription	20.0%
Creditor A Max Election - Oversubscription	0.5
Total Rights Including Oversubscription	4.5
Test: Is this less than 75% of the Standalone	No

