THE RESOURCE FOR BANKRUPTCY, COLLECTIONS AND DEBT RECOVERY

debt³

Vol. 21 • Issue No. 5
September/October 2006

ANNUAL SOFTWARE BUYERS GUIDE

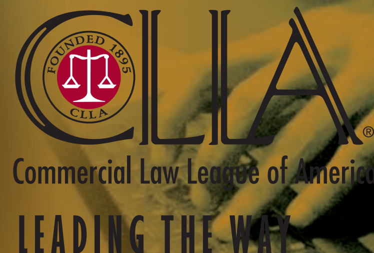
IN THIS ISSUE

Rights Offerings in Corporate Reorganizations

Privacy Issues in Debt Collection between Canada and the USA

Garnishment affidavits must contain new and precise language—or penalties could result

Where Have All the Cases Gone?



contents

Vol. 21 • Issue No. 5
September/October 2006

REMINDER:
Please pay National Membership Dues

Debt³ (ISSN 0888-8000) is published bi-monthly by the Commercial Law League of America®, 70 E. Lake Street, Suite 630, Chicago, IL 60601; (312) 781-2000. POSTMASTER: Send address changes to *Debt³* 70 E. Lake Street, Suite 630, Chicago, IL 60601. Periodicals postage paid at Chicago, Illinois and additional mailing office.

Copyright ©2006 by the Commercial Law League of America®. Permission to reprint materials in *Debt³* may be granted on written request to the Editor at the Commercial Law League offices.

The views and conclusions expressed in articles are those of the authors and are not necessarily those of the Editorial Board, or of the Commercial Law League of America®; nor should any advertisement be considered an endorsement of the product or service involved.

The price of an annual subscription to members of the Commercial Law League of America® ($18.00) is included in their dues. Annual subscription to others is $65.00 per year in the U.S. and Canada, $70.00 elsewhere. Single copy price is $15.00. Write the Commercial Law League of America®, 70 E. Lake Street, Suite 630, Chicago, IL 60601; (312) 781-2000.

small claims **8** #1 Pet Peeve is Put on Hold
Credit Manager's Index for August indicates Momentum
Strategies for Leadership • Did You Know? •
Speaking of Manners, What about E-mail? •
Flexibility Top Desire

features **10** Annual Software Buyers Guide
18 Rights Offerings Take on a New Role as the Centerpiece in Corporate Reorganizations
20 Privacy Issues in Debt Collection between Canada and the USA

league views **5** President's Page by Sidney S. Friedman
44 Viewpoint by David Watson

marketing **24** Marketing in a Technical Revolution

leadership **27** The Secret to Leadership Hasn't Changed—Communicate

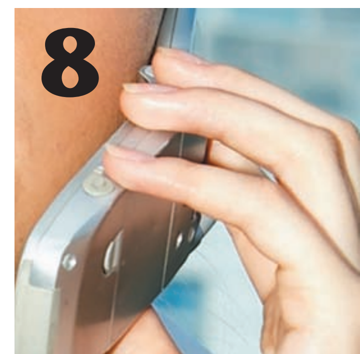
practice aid **28** Court Decision Makes it Imperative Garnishment Affidavits Contain New and Precise Language—Or Penalties Could Result

lifestyle **32** What's So New About New York

convention highlights **34** Memorial Address • Convention Report •

league business **38** Eastern Region Scholarship Notice • 2006 Roster and Dues Deadline •
member news **39** Among Our Members • Newly Admitted Members • Member Benefits • Post Office Report

heard & overheard **41** Where Have All the Cases Gone?



CLLA
Commercial Law League of America
LEADING THE WAY

Rights Offerings Take on a New Role as the Centerpiece in Corporate Reorganizations

by Lee E. Buchwald[1] and Nicholas F. Kajon[2]

[1]Lee E. Buchwald is the founder and President of Buchwald Capital Advisors LLC in New York City, an investment banking firm specializing in financial reorganizations. Mr. Buchwald, a twenty-five year veteran investment banker, provides financial advisory, trustee and expert testimony services. Prior to founding Buchwald Capital Advisors, Mr. Buchwald was an executive at Rothschild Inc., Salomon Brothers and Chanin Capital Partners.

[2]Nicholas F. Kajon is a Shareholder at Stevens & Lee, P.C., a professional services firm with 180 lawyers and 40 business and consulting professionals located in 15 offices throughout the Mid-Atlantic region. Mr. Kajon is a member of the Bankruptcy and Corporate Restructuring Group practicing in the New York office.

Introduction to Rights Offerings

A rights offering is a mechanism that companies can use to raise equity capital. A right is similar to a warrant. It gives the holder the right, but not the obligation, to purchase securities from the company at a set price on or before an expiration date. Rights, however, typically are exercisable for a much shorter period of time than warrants. Rights usually expire within a month, while warrants may expire in two to five years. In some cases, rights are transferable and could be bought and sold prior to the expiration date.

Basic Economics of Rights Offerings

In order for rights offerings to accomplish their intended purpose, they must be priced at a discount to the estimated fully-diluted, post-exercise value of the company's stock. A fairly typical 20% discount, for example, would mean that the rights holder could purchase stock for $8.00 per share that has a projected value of $10.00 per share. The other critical component of a rights offering is the backstop. The backstop is similar to an underwriter and agrees in advance to purchase all shares with respect to those rights that are not exercised. The backstop can be a major financial institution, creditors or investors. In addition to whatever inherent value there might be in the investment, the backstop usually earns a handsome fee for providing the assurance that the company will raise the required equity financing.

Years ago, rights offerings were not frequently a critical component in Chapter 11 reorganizations. When utilized, a typical scenario would be giving equity holders, who would otherwise be wiped out, an opportunity to reinvest at a discount or possibly sell their rights for a modest return. In addition, rights offerings have been used as a mechanism for permitting equity holders to participate in the post-reorganized enterprise on the grounds that the rights would not be offered on account of old stock but in consideration of new value, thus presumably complying with the so-called new value corollary to the absolute priority rule.[3] Nevertheless, the Supreme Court, while declining to determine whether a new value corollary existed, held in LaSalle that plans providing junior interest holders with exclusive opportunities free from competition and without benefit of market valuation may not be crammed down on dissenting classes.[4] Moreover, rights offerings with large discounts may fail to satisfy the requirement of the new value corollary that the value given is proportionate to the value received. While securities issued under a plan of reorganization are exempt from registration under the Securities Act of 1933 and similar state laws,[5] many companies choose to register their post-reorganization securities to enhance the underlying value.

Current Developments

Recently, rights offerings have re-emerged as a primary source of exit financing. Owens Corning will be raising $2.2 billion through a rights offering to bondholders and certain other creditors. J.P. Morgan Securities will earn a $100 million fee for backstopping the offering. Similarly, USG Corporation is raising $1.8 billion through a rights offering to stockholders. Berkshire Hathaway, USG's largest stockholder, agreed to backstop the offering for a $67 million fee. J.L. French Automotive Castings raised $130 million of exit financing through a rights offering backstopped by second lien lenders. Silicon Graphics Corp. is planning to raise $50 million in exit financing through a rights offering backstopped by noteholders.

There are a number of reasons why rights offerings are in vogue:

1. Rising interest rates make floating rate bank financing riskier for companies emerging from bankruptcy, prompting a desire to decrease leverage and increase equity financing.

2. Investors want to avoid the pain of Chapter 22s and 33s, many of which were caused by companies exiting Chapter 11 with an inadequate amount of equity capital relative to post-reorganization indebtedness.

3. Over the past three to five years, the market for distressed securities has been awash in capital. Investors have had a difficult time achieving adequate returns merely through the purchase of defaulted debt securities as the competition for these opportunities have run prices up. Large rights offerings represent a relatively new way to bolster returns on distressed investments.

4. The prevalence of claims trading and hedge fund participation in the market for distressed securities frequently results in debt concentrated in the hands of relatively few sophisticated investors. These investors are willing to take equity risks and are interested in procuring sizable positions in restructured companies.

5. Rights offerings are designed to give the holder a "guaranteed" short-term profit due to the discount offered from the expected trading value.

6. The backstop can earn sizable fees with very little risk.

For more information on these issues, contact Lee E. Buchwald at (212) 297-6168 or **lbuchwald@buchwaldcapital.com** or Nicholas F. Kajon at **nfk@stevenslee.com** or (212) 537-0403.

© 2006 Lee E. Buchwald and Nicholas F. Kajon. This publication is intended as a general guide only. It does not constitute legal advice of Stevens & Lee, P.C. or any member of the firm with respect to the legal issues described. The opinions expressed herein are those of the authors, and not necessarily those of their respective firms. It is recommended that readers not rely on this general guide in structuring transactions in which they are involved, but that professional advice be sought.

[3] 11 U.S.C. § 1129(b)(2)(B) (requiring that for a plan to be crammed down on a dissenting class of unsecured claims, no holder of a junior class receive or retain any property on account of such junior claim or equity interest).

[4] *Bank of America National Trust and Savings Association v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999).

[5] 11 U.S.C. § 1145.

For more information on these issues, contact **Lee E. Buchwald** at (212) 297-6168or **lbuchwald@buchwaldcapital.com**

For more information on how these issues may affect your rights, contact **Nicholas F. Kajon** at **nfk@stevenslee.com** or 212-537-0403. Stevens & Lee, P.C. is a professional services firm with 180 lawyers and 40 business and consulting professionals located in 15 offices throughout the Mid-Atlantic region. You can find more information about Stevens & Lee, P.C. at **www.stevenslee.com**.