

Memorandum

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“Section 1145 offers creditors a mechanism for unhindered public resales of securities that have been issued in exchange for creditors’ claims under a Chapter 11 plan of reorganization.”

## Liquidity for Creditors Who Receive New Securities in a Chapter 11 Reorganization: Resales of Plan Securities under Section 1145 of the Bankruptcy Code

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The recent steady drumbeat of Chapter 11 bankruptcy filings is producing an equally persistent corollary: creditors receiving new securities issued by the reorganizing debtor or a related party in full or partial satisfaction of the creditors’ claims. Some of these creditors-cum-investors never planned to receive securities. The paradigmatic example is a creditor that enters into a normal business transaction resulting in an obligation that the debtor company hasn’t yet satisfied when it files for reorganization. Other creditors are presumably willing acquirors of securities; the classic illustration is an investment fund pursuing a post-filing strategy of buying claims on the secondary market.

Whatever a creditor’s route to security holder status, one pressing question always arises: “How and when can we monetize the securities we’re receiving in the claim distribution?”

Section 1145 of the U.S. Bankruptcy Code of 1986 (the “Code”) provides many of the answers. Section 1145 offers creditors a mechanism for unhindered public resales of securities that have been issued in exchange for creditors’ claims under a Chapter 11 plan of reorganization (a “Plan” and, such securities, “Plan Securities”). Understanding the operation and scope of §1145 is therefore crucial for a post-reorganization security holder that wishes to maximize its liquidity options.<sup>2</sup>

This memorandum explores the relevance and availability of §1145 for creditors in the reorganization context. Part I provides an overview of §1145, including the ways it manipulates traditional concepts under the Securities Act of 1933 (the “Securities Act”) to allow enhanced liquidity for creditors who receive Plan Securities. Part II examines potential impediments to a creditor’s use of §1145, and describes how a creditor can try to preserve its §1145 rights or otherwise achieve liquidity for its Plan Securities. Part III considers the relevance of §1145 to creditors of non-publicly traded companies.

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<sup>2</sup> The full text of §1145 is reproduced in Exhibit A. Note that when we refer to “Plan Securities,” we mean securities offered and sold under a Plan in exchange for claims against the debtor. The term does not refer to securities being issued to help finance the debtor’s emergence from Chapter 11, although a Plan also may provide for that.

We refer to our hypothetical creditor and debtor, respectively and unsurprisingly, as “Creditor” and “Debtor.”

## I. WHAT DOES SECTION 1145 DO?

Section 1145 of the Code manipulates in the bankruptcy context certain Securities Act concepts and requirements that normally would apply to the public offering, sale and resale of securities. The effect is that Plan Securities are more easily issued by Debtor and disposed of by Creditor than they otherwise would be.

### Registration Exemption for Debtor’s Issuance of Plan Securities (§1145(a)(1))

If Creditor is to enjoy the liquidity benefits of §1145 in reselling Plan Securities, Creditor must have received the securities from Debtor (or a permitted related entity) in a transaction that itself satisfied §1145. We therefore begin by describing how Debtor offers and issues Plan Securities in compliance with §1145(a)(1).

It is crucial to remember that any offer or sale of a security must be registered under §5 of the Securities Act unless a registration exemption is available. In other words, unless Debtor can claim an exemption from the §5 registration requirement, Debtor will have to register with the SEC its offer and issuance of Plan Securities.<sup>3</sup>

The classic registration exemption for an issuer of new securities is the “private placement” exemption embodied in §4(2) of the Securities Act, which provides that registration is not required for “[t]ransactions by an issuer not involving any public offering.” The problem with §4(2) in the bankruptcy context is that it is frequently unavailable. In particular, the issuance of Plan Securities to a large class of creditors could easily be insufficiently “private” to fit within the §4(2) exemption.

This is where §1145 performs its first alteration of the Securities Act scheme. Section 1145(a)(1) allows Debtor or certain related entities<sup>4</sup> to offer and issue Plan Securities without the need to register the transaction under §5 of the Securities Act. To qualify for the registration exemption, the new securities must be issued by Debtor or a permitted related entity “in exchange for . . . or principally in exchange for” claims against Debtor. There is no limit on the number or value of Plan Securities to be issued, nor on the number of offerees or recipients of the Plan Securities. So, unlike the classic §4(2) registration exemption available for issuers, §1145(a)(1) does not require the issuance of Plan Securities to have “private placement” characteristics—and that makes sense, as §1145(a)(1) is not intended to be the corollary of §4(2) played out in the reorganization context.

### Ensuring that Plan Securities Aren’t “Restricted Securities” (§1145(c))

Section 1145’s second feat of Securities Act manipulation involves the classification of Plan Securities upon their issuance. The Code’s intervention on this point occurs in §1145(c) and has significant liquidity-enhancing results for most creditors who receive Plan Securities.

Rule 144(a)(3) under the Securities Act characterizes as “restricted” any securities that are “acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering.” Restricted securities present potentially significant liquidity problems for their holder. In particular, restricted securities can be resold in the public market only in a transaction registered with the SEC (which depends on the issuer’s willingness to face the burdens of registration) or pursuant to Rule 144 (which imposes a holding period, may entail manner-of-sale and volume limitations and may not be available for

<sup>3</sup> A requirement to register is significant in that it subjects the registrant to a potentially lengthy review process by the SEC staff, typically involves substantial legal and other professional fees and often consumes a great deal of management attention. It is fair to assume that a company in bankruptcy would be particularly burdened by the need to undertake Securities Act registration.

Rule 144(a)(3) under the Securities Act defines “restricted securities” to mean, among other things: (i) securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering; (ii) securities acquired from the issuer that are subject to the resale limitations of Rule 502(d) of Regulation D under the Securities Act; or (iii) securities acquired in a transaction or chain of transactions meeting the requirements of Rule 144A under the Securities Act.

<sup>4</sup> Entities that may issue Plan Securities without registration in reliance on the §1145(a)(1) exemption include not only Debtor, but also (i) an affiliate of Debtor that is participating in a joint Plan with Debtor and (ii) a successor to Debtor.

every issuer or every transaction). Alternatively, restricted securities can be resold in a privately negotiated “§4(1-½)” transaction, but this perpetuates the securities’ restricted status in the buyer’s hands and presumably prompts an attendant pricing haircut.

Since a public offering of securities typically requires Securities Act registration, securities issued without registration are frequently restricted. Creditor therefore might be concerned that Plan Securities issued in reliance on the §1145(a)(1) registration exemption were restricted. If this were the case, Creditor would derive no practical benefit, from a resale perspective, from Debtor having enjoyed the §1145(a)(1) exemption.

The Code resolves this concern by fiat. Section 1145(c) deems an offer or sale of securities in conformity with §1145(a)(1) to be a “public offering” for Securities Act purposes. As a result, Plan Securities that Creditor receives in a §1145(a)(1) offering are unrestricted. As long as Creditor is not an “underwriter” of the Plan Securities (discussed below), Creditor will be able to dispose of Plan Securities freely in the public market in reliance on §4(1) of the Securities Act, the standard resale registration exemption for “transactions by any person other than an issuer, underwriter or dealer.”<sup>5</sup>

### **Narrowing the Definition of “Underwriter” (§1145(b)(1))**

The impact of §1145(c)—declaring that an offer or sale of Plan Securities under §1145(a)(1) is a “public offering,” thereby resulting in the delivery of unrestricted Plan Securities that Creditor can resell freely under §4(1)—is enough for most creditors. That is, a valid §1145(a)(1) issuance entails unimpeded resales for all creditors except those who are “underwriters.” But what happens to creditors who fall into that category?

Section 2(a)(11) of the Securities Act defines an underwriter in relevant part as “any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any

security . . . .” One can well imagine circumstances in which a recipient of Plan Securities might have underwriter status as conceived by §2(a)(11). Many creditors might have no intention regarding Plan Securities other than to resell them promptly. Were these resales to be seen as distributions, and the creditors therefore seen as underwriters, the resales could be conducted only within the confines of Rule 144 or in privately negotiated transactions.

In a two-step process, §1145(b)(1) throws a lifeline to certain creditors who might otherwise be deemed §2(a)(11) underwriters. First, §1145(b)(1) adopts a Code-specific definition of “underwriter,” which is narrower than the traditional Securities Act definition of the term. Second, §1145(b)(1) provides that if a holder of Plan Securities is not an underwriter within the Code-specific definition, it is also not an underwriter for purposes of §2(a)(11).

Section 1145(b)(1) defines “underwriter” to mean, among other things, a person that:

- purchases a claim against, interest in, or claim for an administrative expense in the case concerning, the debtor, if the purchase is with a view to distribution of any security received or to be received in exchange for the claim or interest; or
- is an “issuer,” as defined in §2(a)(11), with respect to such securities (i.e., is an affiliate of the issuer).

The Code’s definition of “underwriter” casts a narrower net than the Securities Act definition. As noted above, a §2(a)(11) underwriter includes any person that purchases securities with a view to a distribution. By contrast, for most holders of Plan Securities, the only way to become an underwriter is to have purchased a claim with a view to distributing the Plan Securities to be issued in exchange for the claim. The mere desire to monetize a claim is not sufficient to make Creditor a §1145 underwriter. Section 1145 subjects to the traditional

<sup>5</sup> Section 4(1) of the Securities Act provides the registration exemption most commonly used by investors who are reselling their securities in the public market (e.g., exchanges, automated inter-dealer quotation systems and over-the-counter). Section 4(1) exempts from the registration requirements of §5 of the Securities Act transactions by persons other than underwriters, issuers or dealers. Section 2(a)(12) of the Securities Act defines a dealer as “any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.” Specific resale provisions apply to dealers under both §4(3) of the Securities Act and §1145(a)(4) of the Code. This memorandum does not address issues related to dealers.

disabilities of a Securities Act underwriter only those creditors that have proactively acquired claims with an intent to distribute the resulting securities.

### **No Underwriter Status for Non-Affiliates Engaging in “Ordinary Trading Transactions” (§1145(b)(1))**

The Code’s final adjustment of the Securities Act scheme is also found in §1145(b)(1). Even if Creditor otherwise falls within the Code’s limited definition of underwriter, Creditor (as long as it is not an affiliate of the issuer) will not be viewed as an underwriter with respect to “ordinary trading transactions” in Plan Securities. We discuss ordinary trading transactions in Part II.

### **Recap**

To sum up: When Debtor’s issuance of securities meets the conditions of §1145(a), Creditor will receive Plan Securities that are unrestricted. This generally means that Creditor, thanks to §1145(b)(1), will be able to resell its Plan Securities freely in reliance on the registration exemption provided by §4(1) under the Securities Act. Section 4(1) will not be available if Creditor is an underwriter; but §1145(b)(1) reduces the risk of underwriter status for non-affiliates of the issuer by (i) limiting the term to a Creditor that acquires claims with a view to distribution of the related securities and (ii) even in that case, providing that a non-affiliate is not an underwriter to the extent it resells securities via ordinary trading transactions. The flow chart attached as [Exhibit B](#) to this memorandum summarizes in visual form the various possibilities involved in the resale of Plan Securities under §1145.

Conversely, Debtor’s failure to satisfy §1145(a) or Creditor’s failure to satisfy §1145(b)(1) will result in Plan Securities having sub-optimal liquidity in Creditor’s hands.<sup>6</sup> We explore in Part II the most likely reasons Creditor might not be able to take advantage of §1145’s liquidity-boosting scheme, and what Creditor can do to protect its liquidity outlook.

## **II. POTENTIAL BARRIERS TO CREDITOR’S USE OF SECTION 1145**

One can generally ascribe the possibility that Creditor will be unable to avail itself of §1145 to either “systemic” or “individual” risk. The latter is more significant for purposes of this memorandum.

### **Systemic (Debtor-Based) Risk**

Systemic risk is the risk that Debtor may be unable to satisfy the two key requirements of §1145(a)(1): that new securities be issued (i) in exchange or principally in exchange for claims against Debtor and (ii) by Debtor or its permitted affiliate or successor.

Whether an issuance of securities satisfies §1145(a)(1) is typically outside Creditor’s control. Creditor likely will rely on Debtor’s conclusion in its Plan disclosure statement and the bankruptcy court’s findings in its Plan confirmation order that any particular issuance is being made in accordance with §1145(a)(1). For the remainder of this memorandum, we assume that any Plan Securities received by Creditor have been validly issued under §1145(a)(1).

### **Individual (Creditor-Based) Risk**

The possibility that Creditor will suffer unfavorable liquidity because it cannot take advantage of §1145(b)(1) is an “individual” risk—whether it arises and the extent of its consequences will depend on Creditor’s particular circumstances. Creditor’s inability to use §1145(b)(1) is likely to stem from Creditor’s status as an underwriter. That status may result either from Creditor’s intentions in acquiring the claim against which securities will be issued under the Plan, or from Creditor’s position as an affiliate of the issuer.

### *Has Creditor Purchased a Claim “With a View to Distribution” of the Resultant Securities?*

Section 1145’s resale liquidity mechanic is premised on the determination that creditors who receive securities in full or partial payment for a claim will not be deemed Securities Act “underwriters” with respect to those securities, and will therefore be able to resell pursuant to

<sup>6</sup> If the issuer’s securities will not be listed and traded on an exchange, automated inter-dealer quotation system or similar trading platform, the value Creditor stands to lose if the full benefits of §1145 are not available is potentially smaller. Part III discusses this situation in more detail.

the registration exemption provided by §4 (1) of the Securities Act. As previously discussed, §1145 seeks to distinguish between creditors who want to sell their securities merely in order to monetize their existing claims and those who have actively acquired claims “with a view to [the] distribution” of the resulting securities.<sup>7</sup>

The full text of §1145(b)(1) is reproduced in Exhibit A to this memorandum, but in short and subject to certain exceptions, an entity is a §1145 underwriter in the following circumstances:

**An Entity is a §1145 Underwriter if It:**

- purchases a claim or interest in a bankruptcy case with a view to distribution of any security received or to be received in exchange for the claim or interest;
- offers to sell securities offered or sold under a Plan on behalf of their holders;
- offers to buy securities offered or sold under a Plan from their holders if the offer to buy is, among other things, made with a view to distribute the securities and under an agreement made in connection with the Plan, the consummation of the Plan or the offer or sale of securities under the Plan; or
- is an “issuer” as defined in §2(a)(11) of the Securities Act.

Focusing on element (A) of the definition (purchasing a claim with a view to distribution of the resulting securities), we consider below three of the many possible factual scenarios that could arise in a reorganization proceeding. Implicit in these scenarios are two key points. The first is that for Creditor to be at risk of underwriter status, it must have actually purchased its bankruptcy claim; a claim arising naturally under an existing Creditor-Debtor relationship carries no risk of conferring underwriter status. The second point is that, in determining whether Creditor is an underwriter due to its purchase of claims, Creditor’s intentions should be tested at the time of acquiring the claim.

**Scenario A.** Creditor is an original creditor; it was owed money by Debtor when Debtor filed for bankruptcy protection and holds a Class X claim related to that debt. Creditor will not be a §1145 underwriter with respect to any securities it receives in payment for its claim because it did not purchase the claim with a view to distribution of the resulting securities. More fundamentally, Creditor did not in fact purchase its claim, which means that one need not even reach the issue of Creditor’s intentions.

**Scenario B.** Creditor believes Debtor’s fortunes will recover following its emergence from bankruptcy. Creditor therefore purchases a Class X claim during Debtor’s reorganization, with the intention of holding the resulting securities for long-term investment or perhaps selling the securities in discrete transactions over time in order to capture the anticipated increase in market value. Creditor will not be a §1145 underwriter in these circumstances. Although Creditor did come to hold securities due to purchasing a preexisting Class X claim, the purchase was not made with a view to distributing the resulting securities.

**Scenario C.** After confirmation of a Plan that provides for holders of Class X claims to receive securities, Creditor purchases a Class X claim with a view to reselling those securities into the market promptly following their issuance. In this case, Creditor likely will be a §1145 underwriter (although it may be able to take advantage of the “ordinary trading transactions” carve-out described below).

If Creditor has purchased claims and is worried that it may be an underwriter under the “purchase-with-a-view-to-distribution” test, what should it do?

First, Creditor should try to determine if it actually would be a §1145 underwriter with respect to the securities in question. It should consider what form of distribution it expects to receive on any claim and document that

<sup>7</sup> Neither the Code nor the Securities Act defines “distribution,” but the term is generally understood to be synonymous with “public offering.” In one early administrative case, for example, the SEC characterized a distribution as “the entire process by which in the course of a public offering a block of securities is dispersed and ultimately comes to rest in the hands of the investing public. [...] It is a process without finite boundaries, and often includes one or more ‘redistributions’ by which portions of the issue are [moved] from speculative buyers [to] permanent investors.” In re Oklahoma-Texas Trust, 2 S.E.C. 764, 769 (1937).

expectation at the time of purchase. If claim distributions will involve securities, Creditor should also consider and document what it plans to do with the securities.

For example, assume Creditor purchases a claim expecting to receive a cash distribution. It later becomes clear that there is not enough value in Debtor's bankruptcy estate to support a distribution only in cash to creditors of that class, so those creditors in fact receive payment in both cash and common stock. It would be hard to argue in these circumstances that Creditor had acquired a claim with a view to distribution of the resulting securities.

If a claim purchaser does determine that it would be a §1145 underwriter under the purchase-with-a-view-to-distribution test, or believes it faces a significant risk of that outcome, its next step should be to explore whether it can obtain sufficient liquidity through the "ordinary trading transactions" carve-out to underwriter status.

*"Ordinary Trading Transactions"—An Escape Hatch for Non-Affiliates that Otherwise would be Underwriters*  
Section 1145(b)(1) restores liquidity to §1145 underwriters in limited circumstances. Notwithstanding the general definition of underwriter in §1145(b)(1), an entity avoids underwriter status to the extent it (i) engages in "ordinary trading transactions" and (ii) is not an issuer (which in this context includes an affiliate of the issuer).

Focusing on the first requirement, §1145 does not define an "ordinary trading transaction." The SEC staff, however, has indicated that an ordinary trading transaction is one that does not involve any of the following activities:

**"Ordinary Trading Transactions" Do Not Involve:**

- concerted action by recipients of Plan Securities in connection with the sale of Plan Securities, or concerted action on behalf of one or more recipients in connection with sales by "distributors;"
- use of informational documents concerning Plan securities prepared or used to assist in the resale of Plan Securities, other than a Plan disclosure statement and documents filed with the SEC pursuant to the Securities Exchange Act of 1934 (e.g., annual and quarterly reports on Forms 10-K and 10-Q); or
- special compensation to brokers and dealers in connection with the sale of Plan Securities designed as a special incentive to resell Plan Securities, other than the compensation that would be paid pursuant to arms-length negotiations between a seller and a broker or dealer, each acting unilaterally, not greater than the compensation that would be paid for a routine similar-sized sale of similar securities of a similar issuer.<sup>8</sup>

The Code's use of the "ordinary trading transaction" concept echoes the distinction §1145 makes between creditors who seek to sell their securities simply to monetize their claims and entities involved in the intentional distribution of securities. The Code is forgiving of non-affiliate entities that would be tagged as §1145 underwriters because they purchased or arguably purchased claims with a view to distribution of the resulting securities, and gives those entities another chance at liquidity so long as their resales do not have the indicia of classic underwriting activity.

*Resale Options for Affiliates of the Issuer*

Element (D) of the §1145(b)(1) underwriter definition states that the "issuer" (as defined in §2(a)(11) of the Securities Act) of the securities being resold is deemed an underwriter.<sup>9</sup>

<sup>8</sup> See, e.g., *Manville Corporation*, SEC No-Action Letter (Aug. 28, 1986); *UNR Industries, Incorporated*, SEC No-Action Letter (July 11, 1989); and *AWS Reorg, Inc.*, SEC No-Action Letter (Oct. 27, 1997). Other transactions may also qualify as ordinary trading transactions based on their particular facts and circumstances. See 8 Collier on Bankruptcy ¶1145.03[3][e], at 1145-37 (Alan N. Resnick and Henry J. Sommer, eds.-in-chief, 15th ed. rev. 2009).

<sup>9</sup> Elements (B) and (C) of the §1145(b)(1) underwriter definition capture, respectively, behavior more closely resembling that of "distributors" and "syndicators," both of which are classic underwriter roles. Creditors that also act as distributors or syndicators will have to separately analyze their resale transactions to determine what registration exemption, if any, is available. This memorandum does not specifically address the provisions of §1145 applicable to distributors and syndicators.

Critically, §2(a)(11) defines “issuer” to include any “person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer”—in other words, an entity typically viewed by the Securities Act as an “affiliate” of the issuer. This status applies regardless of the control person’s activities or intentions with respect to post-reorganization securities. Simply stated, if Creditor is a Securities Act affiliate of Debtor, it is also a §1145 underwriter.

An affiliate’s liquidity options are more limited than those of other §1145 underwriters, since affiliates are not provided liquidity through ordinary trading transactions. An affiliate can resell its Plan Securities under Rule 144’s safe harbor, if and when available, or in an otherwise exempt transaction such as a §4(1-½) private resale. An affiliate reselling under Rule 144 may receive the full market price for its securities, but will be subject to the volume and other applicable limitations of Rule 144.<sup>10</sup> An affiliate reselling under §4(1-½) will not be subject to Rule 144’s limitations, but likely will face a pricing discount, as the purchaser will receive restricted securities that cannot be freely resold into the public market.

What should Creditor do if it is a potential affiliate of the issuer of Plan Securities?

First, Creditor should probe the likelihood that it actually is an affiliate. As with any affiliate analysis under the Securities Act, there is no bright-line test. The legislative history of §1145 suggests that Congress intended any creditor holding at least 10 percent of the issuer’s securities to be a “control person” and therefore an

underwriter<sup>11</sup>; and, as a rule of thumb, securities practitioners often do view 10-percent equity ownership as presumptive evidence of affiliate status. That said, neither the SEC nor the courts have endorsed a particular percentage ownership level or other standard as the definitive criterion in determining affiliate status. Rather, the analysis will hinge on a variety of circumstantial factors, including the investor’s degree of equity ownership, whether the investor has a board seat or is otherwise involved in the issuer’s management, the existence of contractual or other relationships between the investor and the issuer, and the holdings and comparative influence of other equity owners.<sup>12</sup>

Second, Creditor can attempt proactively to avoid affiliate status. There are two main ways to do this. Creditor can reduce its holdings of whatever claims it believes will result in security distributions. Creditor also can limit its interactions with Debtor to activities that should not confer affiliate status (e.g., not seek a seat on the issuer’s board of directors or otherwise become involved in managing the issuer).

Alternatively, Creditor can attempt to negotiate with Debtor for registration rights as part of the Plan. This will not result in avoiding affiliate status, but will improve Creditor’s liquidity position. In many cases, the granting of registration rights involves an affiliate that historically is closely identified with the issuer. Debtor may be less willing to extend registration rights if Creditor is historically a third party who will become a 10-percent shareholder only because it purchased a large number of claims.<sup>13</sup>

<sup>10</sup> Section 1145(c) provides that the offer and sale of securities under §1145(a)(1) constitute a “public offering.” Pursuant to Rule 144(a)(3) under the Securities Act, “restricted securities” are, among other things, “securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering.” Putting the two together, securities offered and sold pursuant to §1145(a)(1) are not restricted securities. Therefore, the holding period requirement of Rule 144 does not apply to resales by a creditor that received the securities pursuant to a plan of reorganization, whether or not the creditor is an affiliate of the issuer. See, e.g., Arrhythmia Research Technology, Inc., SEC No-Action Letter (Nov. 2, 1993); and American First Corporation, SEC No-Action Letter (Sept. 14, 1989). Securities acquired upon the exercise of acquisition rights or convertible instruments acquired pursuant to §1145(a)(2) can also be resold by the receiving creditor without compliance with the Rule 144 holding period. See All American Communications, Inc., SEC No-Action Letter (Oct. 7, 1992).

<sup>11</sup> See 8 Collier on Bankruptcy, supra note 8, ¶1145.03[3][d], at 1145-33; and H.R. Rep. No. 595, 95th Cong., 1st Sess. 238 (1977), reprinted in Collier on Bankruptcy App. Pt. 4(d)(i) (Alan N. Resnick and Henry J. Sommer, eds.-in-chief, 15th ed. rev. 2008).

<sup>12</sup> The affiliate analysis should be based on post-reorganization security ownership. See 8 Collier on Bankruptcy, supra note 8, ¶1145.03[3][d], at 1145-33, 34.

<sup>13</sup> The ongoing reorganization proceedings of W.R. Grace & Co. illustrate the use of registration rights. WR Grace proposes to settle its outstanding asbestos personal injury litigation through, among other consideration, the issuance to a special trust of a warrant to purchase more than 10 million shares of reorganized WR Grace’s common stock. The shares issuable upon exercise of the warrant would represent more than 10% of WR Grace’s outstanding common stock, which raises the possibility that the trust would be an “affiliate” of WR Grace and thus an “underwriter” for purposes of §1145. In order to redress the trust’s resultant liquidity disadvantage, WR Grace proposes to enter into a registration rights agreement with the trust, providing for WR Grace to file a shelf registration statement for the benefit of the trust, covering the resale of the warrant and the warrant shares. See Debtors’ Disclosure Statement for the First Amended Joint Plan of Reorganization under Chapter 11 of the Bankruptcy Code of W.R. Grace & Co., et al., the Official Committee of Asbestos Personal Injury Claimants, the Asbestos PI Future Claimants’ Representative, and the Official Committee of Equity Security Holders Dated as of February 27, 2009, Section 12.3.

Finally, Creditor might simply decide that it is not problematic to be an affiliate of the issuer, whether or not Creditor receives registration rights. For example, Creditor might have long-term investment goals or otherwise wish to maintain significant holdings of the issuer's outstanding equity.

### III. RELEVANCE OF SECTION 1145 TO NON-PUBLICLY TRADED ISSUERS

So far, we have assumed that the issuer of Plan Securities will be a publicly traded company following emergence from bankruptcy. If that will not be the case, however, should Creditor still care about securing the benefits of §1145?

On the one hand, if Plan Securities will not be listed and traded on an exchange, automated inter-dealer quotation system or similar trading platform, a creditor that cannot use §1145 may stand to lose less value than it would if the Plan Securities were publicly traded. For example, in the absence of a public market, a creditor/underwriter may no longer be forced to accept a lower price as a result of reselling in a private transaction rather than over an exchange. That is, all securities may effectively trade through negotiated transactions and buyers may not look for "full" value by purchasing unrestricted securities from a non-affiliate.

On the other hand, the value gap may re-emerge if the issuer decides to become a publicly traded company at some point after the reorganization is completed. In that case, a creditor that (i) has received securities in the manner prescribed in §1145(a)(1) (or (a)(2)), (ii) is not an affiliate of the issuer and (iii) is not otherwise an underwriter with respect to the particular proposed resale will be able to resell freely once public trading begins. A creditor that does not meet these criteria will be forced to resell its securities subject to the restrictions of either Rule 144, if and when available, or pursuant to an exempt transaction that might involve a price discount.

In addition, even in the absence of a public trading market, security holders that are not affiliates or

otherwise §1145 underwriters and do not hold restricted securities have less legal risk under the Securities Act when they resell their securities. In most cases, these resales will be effected in compliance with §5 of the Securities Act without any planning or diligence. In these situations, securities acquired and resold in compliance with §1145 may not provide Creditor with greater liquidity per se, but may benefit Creditor by reducing its risk exposure.

### CONCLUSION

Existing Chapter 11 creditors and entities that are considering purchasing Chapter 11 bankruptcy claims should consider their liquidity options with respect to securities to be received in claim distributions. In particular, they should attempt to address the following questions:

- Does Debtor or a permitted related entity intend to issue securities pursuant to a Plan?
- If so, is the claim held by Creditor part of a class that will receive securities?
- Has Debtor concluded that the offer and sale of the securities to Creditor will meet the requirements of §1145(a)(1) (or (a)(2))?
- When Creditor has received the securities, will Creditor, either through its holdings or its activities, be a §1145 underwriter? In particular, will Creditor be a control person (affiliate) of the issuer?
- If Creditor will be a §1145 underwriter but not a control person (affiliate) of the issuer, can Creditor satisfy its expected liquidity needs by disposing of securities in "ordinary trading transactions?"
- If Creditor will be a §1145 underwriter and/or a control person (affiliate) of the issuer, would Creditor benefit from registration rights? What is the likelihood that the issuer would grant registration rights?
- Will the securities be listed for trading on a public trading platform, either upon issuance or in the foreseeable future?

These questions should be asked as early as possible during Debtor's reorganization proceedings—if not

before the proceedings commence—and should be part of the diligence process if a claim purchase is contemplated. We would be pleased to talk with any Chapter 11 creditor or any investor considering purchasing claims in a Chapter 11 reorganization proceeding about its particular liquidity circumstances.

## QUESTIONS

If you have questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or one of the persons listed below.

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## EXHIBIT A

### **Section 1145. Exemption from securities laws**

**(a)** Except with respect to an entity that is an underwriter as defined in subsection (b) of this section, section 5 of the Securities Act of 1933 and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security do 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;

**(2)** the offer of a security through any warrant, option, right to subscribe, or conversion privilege that was sold in the manner specified in paragraph (1) of this subsection, or the sale of a security upon the exercise of such a warrant, option, right, or privilege;

**(3)** the offer or sale, other than under a plan, of a security of an issuer other than the debtor or an affiliate, if—

**(A)** such security was owned by the debtor on the date of the filing of the petition;

**(B)** the issuer of such security is—

**(i)** required to file reports under section 13 or 15(d) of the Securities Exchange Act of 1934; and

**(ii)** in compliance with the disclosure and reporting provision of such applicable section; and

**(C)** such offer or sale is of securities that do not exceed—

**(i)** during the two-year period immediately following the date of the filing of the petition, four percent of the securities of such class outstanding on such date; and

**(ii)** during any 180-day period following such two-year period, one percent of the securities outstanding at the beginning of such 180-day period; or

**(4)** a transaction by a stockbroker in a security that is executed after a transaction of a kind specified in paragraph (1) or (2) of this subsection in such security and before the expiration of 40 days after the first date on which such security was bona fide offered to the public by the issuer or by or through an underwriter, if such stockbroker provides, at the time of or before such transaction by such stockbroker, a disclosure statement approved under section 1125 of this title, and, if the court orders, information supplementing such disclosure statement.

**(b)**

**(1)** Except as provided in paragraph (2) of this subsection and except with respect to ordinary trading transactions of an entity that is not an issuer, an entity is an underwriter under section 2[(a)] (11) of the Securities Act of 1933, if such entity—

**(A)** purchases a claim against, interest in, or claim for an administrative expense in the case concerning, the debtor, if such purchase is with a view to distribution of any security received or

to be received in exchange for such a claim or interest;

**(B)** offers to sell securities offered or sold under the plan for the holders of such securities;

**(C)** offers to buy securities offered or sold under the plan from the holders of such securities, if such offer to buy is—

**(i)** with a view to distribution of such securities; and

**(ii)** under an agreement made in connection with the plan, with the consummation of the plan, or with the offer or sale of securities under the plan; or

**(D)** is an issuer, as used in such section 2[(a)](11), with respect to such securities.

**(2)** An entity is not an underwriter under section 2[(a)](11) of the Securities Act of 1933 or under paragraph (1) of this subsection with respect to an agreement that provides only for—

**(A)**

**(i)** the matching or combining of fractional interests in securities offered or sold under the plan into whole interests; or

**(ii)** the purchase or sale of such fractional interests from or to entities receiving such fractional interests under the plan; or

**(B)** the purchase or sale for such entities of such fractional or whole interests as are necessary to adjust for any remaining fractional interests after such matching.

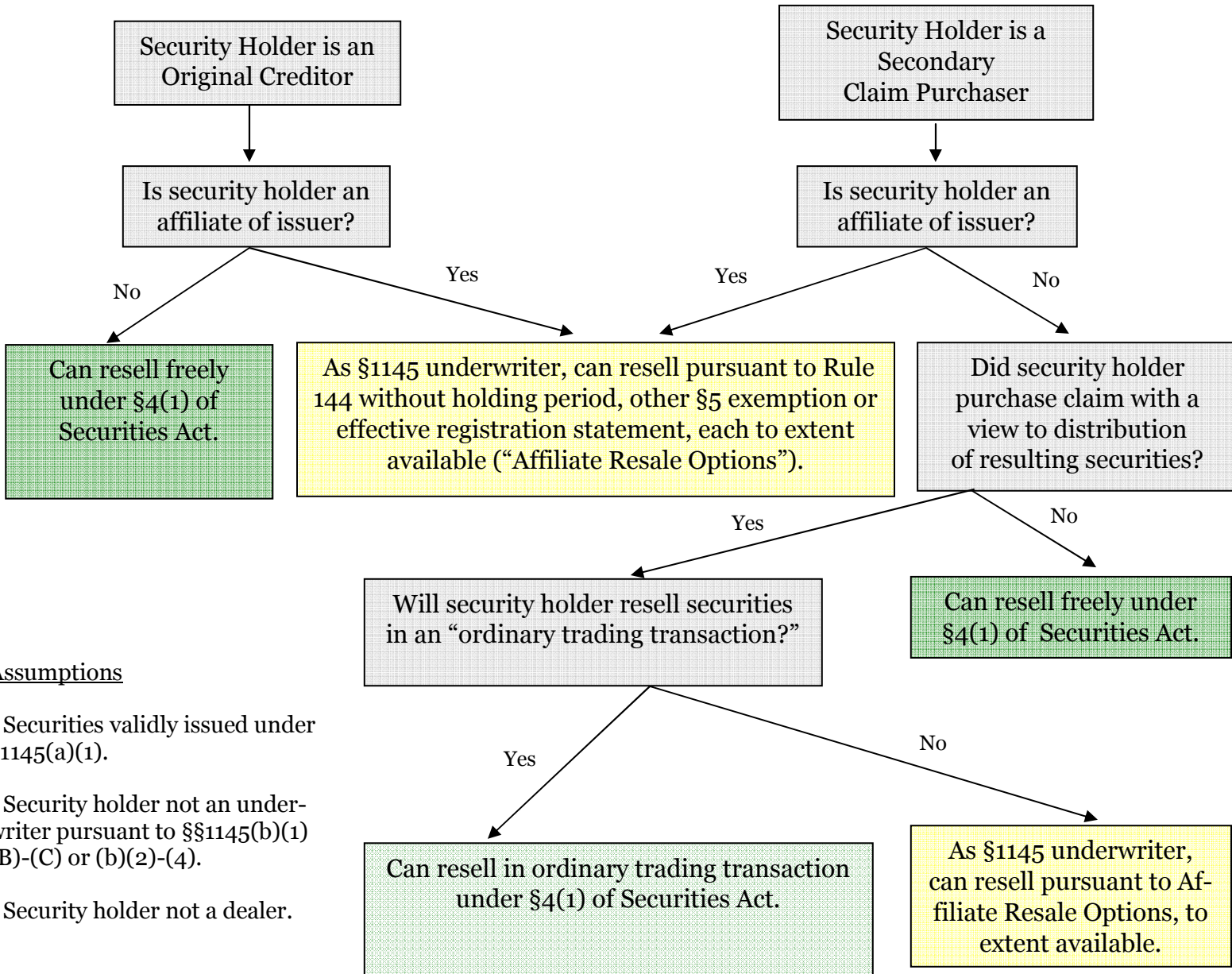
**(3)** An entity other than an entity of the kind specified in paragraph (1) of this subsection is not an underwriter under section 2[(a)](11) of the Securities Act of 1933 with respect to any securities offered or sold to such entity in the manner specified in subsection (a)(1) of this section.

**(c)** 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.

**(d)** The Trust Indenture Act of 1939 does not apply to a note issued under the plan that matures not later than one year after the effective date of the plan.

**EXHIBIT B**

**Security Holders' Resale Options Under Section 1145**



**Assumptions**

- Securities validly issued under §1145(a)(1).
- Security holder not an underwriter pursuant to §§1145(b)(1)(B)-(C) or (b)(2)-(4).
- Security holder not a dealer.