Simpson Thacher

Memorandum

Debt-For-Equity Exchanges Developments – FINRA Amendment

January 9, 2025

Debt-For-Equity Exchanges

Debt-for-equity (D4E) exchanges can be part of a structure in a tax-free spin-off transaction. If structured successfully within the confines of commercial, tax, legal and regulatory parameters, D4E exchanges enable a parent company (ParentCo) to complete the spin-off of an entity (SpinCo) on a tax-free basis and de-lever.

A D4E exchange involves several transactions. In general, following the initial distribution of stock representing at least 80% of the voting power of SpinCo stock, ParentCo will hold the remaining SpinCo stock (generally up to 19.9%). Under current IRS guidance, to effect a D4E exchange, ParentCo must have certain "historic debt" (*i.e.*, bank debt or bonds that satisfy certain requirements, including the date of issuance of the debt) that is held (or acquired in the market) by a bank. ParentCo agrees to exchange all or a portion of its remaining SpinCo stock (exchange shares) for such debt at the closing of the equity offering. The bank, as holder of the exchange shares, sells such shares in the equity offering (as the selling securityholder) to the market through the underwriter.[1] At closing of the equity offering, ParentCo is treated as repaying the applicable amount of such debt with the exchange shares.

FINRA Rule 5110 – Current Rule

Pursuant to FINRA Rule 5110 as in effect today, issuer's securities, which are acquired by an underwriter or an affiliate of an underwriter within FINRA's review period[2] are deemed "underwriting compensation."[3] Securities that are deemed underwriting compensation are subject to a 180-day lock-up following the applicable securities offering.[4] Therefore, because exchange shares are deemed underwriting compensation, an underwriter must request exemptive relief to effect a D4E exchange.

[1] In substantially all cases, the selling securityholder is an underwriter in the offering.

[2] Rule 5110(j)(20).

[3] Rule 5110(j)(22).

[4] Rule 5110(e)(1).

FINRA Rule 5110 – Proposed Amendment

As of December 20, 2024, FINRA began publicly seeking comment on proposed amendments to Rule 5110. The applicable proposed amendment would provide relief from exchange shares being deemed underwriting compensation if the exchange shares are part of a bona fide tax-favorable financing transaction and meet the following conditions:

- The affiliated member subsequently offered all of the exchange shares the bank acquired in an offering following the D4E exchange;
- The parties determined the terms of the D4E exchange and the subsequent equity issued through arms' length negotiations based on the market price of the SpinCo equity;
- The affiliated member negotiated customary compensation for an equity public offering; and
- The exchange shares are offered in a firm commitment distribution.

As such, the applicable proposed amendment would codify the exemptive relief that FINRA has granted in connection with D4E exchanges effected to date. The FINRA comment period expires on March 20, 2025.

Simpson Thacher Recent Representative Matters – Debt-For-Equity Exchanges

- In connection with GE's spin-off of GEHC, GE exchanged an aggregate of 90 million shares of GEHC common stock held by GE for loans of GE in 5 separate transactions
- In connection with MDU Resources' spin-off of Knife River, MDU Resources exchanged 6 million shares of Knife River common stock held by MDU Resources for loans of MDU Resources
- In connection with the Atmus Filtration Technologies separation from Cummins, Cummins exchanged 16 million shares of Atmus Filtration Technologies common stock held by Cummins for commercial paper of Cummins in the Atmus IPO
- In connection with Post Holdings' spin-off of BellRing Brands, Post Holdings exchanged an aggregate of 19 million shares of BellRing Brands common stock held by Post Holdings for certain loans of Post Holdings in 2 separate transactions

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