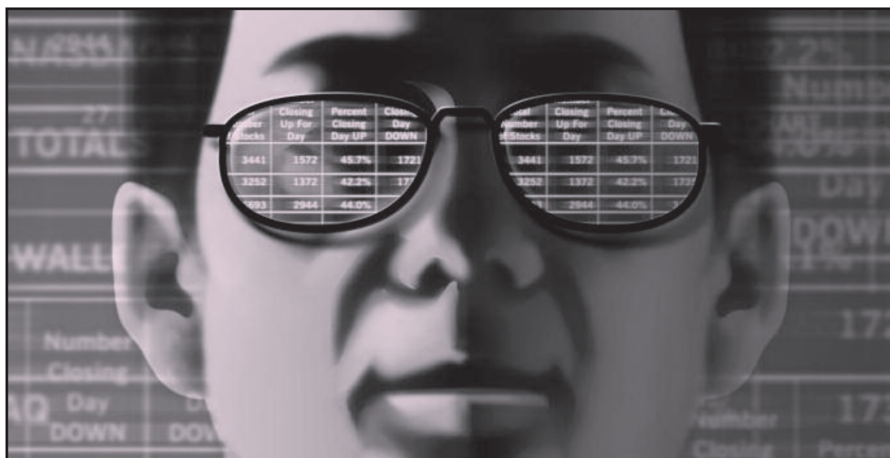
ABA SECTION OF PUBLIC UTILITY, COMMUNICATIONS AND TRANSPORTATION LAW

infrastructure

Vol. 46, No. 4, Summer 2007



"St. Mark": A cautionary tale for general counsel Part 1

By Peter V. Fazio Jr.

Editor's note: The author presented this article at the Section's program at the 2007 American Bar Association Annual Meeting in August 2007. Part 2 of the article will be published in the Fall 2007 issue of Infrastructure. *The attachments referenced in the article are posted on the Section's Web site at www.abanet.org/pubutil/publications/.*

This article focuses on the Conrad Black trial and particularly the lessons it offers for general counsel of publicly held U.S. corporations following Enron. These lessons relate to the actions of one of the defendants, Mark Kipnis, the corporate counsel in Chicago. Part 1 summarizes the complex background of the case. Part 2, to be published in the next issue of this newsletter, provides details on the corporation, the general counsel, and the ensuing litigation of the case.

Peter V. Fazio Jr.

Background

The essence of the trial charges relate to what we old-fashioned corporate lawyers would refer to as the taking of a corporate opportunity by officers and directors of the

(continued on page 8)

Fazio is acting general counsel, NiSource Inc. and Special Partner, Schiff Hardin LLP, Chicago, Illinois.
The author gratefully acknowledges the assistance of Tiffany Redding, Washington University School of Law, summer associate, and for assistance with access to documents filed in the case and other facts submitted into evidence, the Kipnis defense team at Schiff Hardin, Ronald S. Safer, Patricia Brown Holmes, Matthew B. Mock, Erika L. Csicsila, Jamal Sadat Muhammad, Elizabeth A. Blackwood, Kelly M. Warner, and Art Mitzel Jr.
Fazio can be reached at pfazio@schiffhardin.com.

INSIDE

- *Section chair's column p. 2*
- *Editor's note p. 2*
- *Hybrid securities: An increasingly popular financing tool p. 3*
- *Section of Public Utility, Communications and Transportation Law: 2007 – 2008 Leadership p. 6*

infrastructure

Vol. 46, No. 4

ISSN: 1097-251X

Infrastructure is produced quarterly by ABA Publishing for the ABA Section of Public Utility, Communications and Transportation Law.

©2007 by the American Bar Association. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of the publisher. To request reprints, go to www.abanet.org/policy/reprints.html.

Articles and reports reflect the views of the individual authors and do not necessarily represent the position of the American Bar Association; the Section of Public Utility, Communications and Transportation Law; or the chair of the Newsletter Committee.

Readers are encouraged to send news, views, requests or suggestions.

Send e-mail to: pubutil@abanet.org

Chair, Newsletter Committee
Linda L. Randell
linda.randell@uinet.com

Committee members
Richard D. Cudahy
David R. Hardy
Carrie J. Hightman
J.P. Shotwell
Casey Wren

Section director
Susan Koz
American Bar Association
Chicago

ABA Publishing
Jane Harper-Alport
Editor

Amanda Draper
Designer

LexisNexis is the primary corporate sponsor of the Section of Public Utility, Communications and Transportation Law.

Chair's column

By William T. Torgerson

Once again our stellar *Infrastructure* editor, Linda Randell, has produced a fascinating issue. The Section's thanks go to Linda, who never missed a beat while going through a significant career transition. Those of us who are "in-house" welcome Linda to our ranks and hope the transition hasn't been too shocking!

Our two articles this quarter include part 1 of a cautionary tale and an exploration of the world of hybrid securities.

The cautionary tale comes from former Section Chair Peter Fazio, who chronicles the travails of a newly minted general counsel who found himself the subject of criminal prosecution in the Conrad Black case. Peter presented the paper during our CLE event at the ABA's annual meeting in San Francisco. Its lessons are profound and worthy of careful study, especially by anyone who might find himself or herself exposed to the darker corners in the world of corporate governance.

On a brighter note, James Barresi and Aaron Seamon explore the world of hybrid securities, something of great importance to capital-intensive infrastructure industries. Their review gives hope that we may be closing in on the "perfect" security—i.e., equity for good equity purposes and debt for good debt purposes, all in one security. I would be more enthused about this were it not for the tendency I have perceived in recent years of rating agencies, congresses, and the IRS to upset such things just when they are hitting their stride. More troublesome still is the apparent erosion, at least in some political policy circles, of the concept that changes to the laws and regulations in this area should be prospective only. There is hope, however, that the need for stability and certainty will prevail and transactions will be judged according to the precepts that were in place at their inception.

Editor's note

By Linda L. Randell

At the Section's program at the ABA annual meeting in August, the information offered was truly continuing legal education. Peter Fazio held the group in rapt attention while discussing a new general counsel who, it appears, was a good lawyer and a good person but ultimately found himself convicted by a jury of unlawful conduct. Mr. Fazio's paper, which formed the basis of his CLE presentation, is being published in *Infrastructure* (part 1 in this issue, and part 2 in our next issue).

The article will provide food for thought, regardless of whether you are in-house counsel or outside counsel. Unfortunately, though, those unable to attend the program missed the opportunity to ask Mr. Fazio questions about the issues raised by the indictment, the trial, and the jury verdict.

The Barresi-Seamon article on hybrid securities describes a financing vehicle that could be the best of both worlds.

This issue also includes a list of the Section's committees, committee chairs, and vice chairs. If you would like to start participating in Section activities, including working on the committee reports that are posted on the Web site, let us know. And, send me your thoughts for future articles. E-mail me at linda.randell@uinet.com.

Hybrid securities: An increasingly popular financing tool

By James J. Barresi and Aaron A. Seamon

Over the past two years, the volume of hybrid securities issued in the United States has increased dramatically. Between January 2006 and June 2007, approximately $75 billion of tax-deductible hybrid securities were issued in the United States, with approximately $68 billion of that amount issued in the last 12 months.[1] Most of these hybrid securities have been issued by regulated and ratings-conscious businesses in the banking, insurance, and energy industries. However, corporations in a broad variety of industries have begun to issue hybrid securities with greater frequency. Many issuers have used hybrid securities in a creative and cost-effective manner to optimize their capital structure. Some commentators on corporate finance have described hybrid securities as "holy grail" instruments that offer much of the financial flexibility and capital benefits of equity and, at the same time, many attributes of debt, such as non-dilution of equity and tax-deductible interest payments.[2] Issuers have successfully used hybrid securities to fund stock repurchases,[3] debt redemptions, and acquisitions; to satisfy regulatory capital requirements (to the extent applicable); and for other corporate purposes, all without compromising their credit ratings or otherwise diluting existing equity holders.

James J. Barresi

Aaron A. Seamon

This article provides a brief overview of hybrid securities, their key terms, the market for hybrid securities, and the benefits such securities can provide when added to a company's capital structure.

Barresi is a partner and Seamon is a senior associate with the law firm of Squire, Sanders & Dempsey L.L.P. In the past two years, Barresi and Seamon have advised corporations in more than 20 issuances of hybrid securities. They may be contacted at jbarresi@ssd.com and aseamon@ssd.com.

Hybrid securities overview

Hybrid securities contain characteristics of both debt and equity. Many are specifically designed to take advantage of differences in the manner in which taxing authorities, rating agencies, and certain regulators characterize debt and equity. In other words, many hybrid securities are structured to qualify as debt for tax purposes, receive substantial equity credit from rating agencies, and satisfy regulatory capital requirements applicable to companies in certain industries. Hybrid securities typically rank junior to unsecured debt and senior to common stock in a company's capital structure.

Hybrid securities have played an important role in corporate finance for decades or longer, having historically included certain types of preferred stock and convertible debt as well as traditional trust preferred and REIT preferred securities. However, in years preceding 2005, hybrid securities that constituted debt for tax purposes were also typically treated as debt by rating agencies. However, in 2005, Moody's Investors Service ("Moody's") paved the way for a new generation of hybrid securities by revising its methodology for analyzing and rating hybrid securities.[4] Moody's revised ratings methodology created an opportunity to structure hybrid securities to receive substantial equity credit

for rating agency purposes while still qualifying as debt for tax purposes. By the end of 2005, some leading investment banks had structured new hybrid securities that satisfied Moody's revised ratings criteria as well as the ratings criteria of other major rating agencies.

Overview of rating agency and tax framework for assessing hybrid securities

While the guidelines adopted by major rating agencies for rating hybrid securities differ in various substantive respects, they have many similarities.[5] In general, rating agencies carefully analyze certain terms of hybrid securities, such as (i) term to maturity, (ii) call options, (iii) conversion options, (iv) interest deferral provisions and (v) priority of claims with respect to distributions and liquidation. Rating agencies score hybrid securities based on the strength of such terms relative to the terms of common stock, which typically include no maturity date, no payment default, and subordination to all creditors and preferred stockholders. In contrast, debt securities typically have a reasonably short stated maturity date, accelerate in the event of a payment default, and have priority over all equity holders with respect to distributions and upon liquidation. Accordingly, debt securities, and even traditional hybrid securities treated as debt for tax purposes, typically do not provide the level of financial flexibility and loss-absorption or "cushion" that rating agencies demand in order to grant substantial equity credit.

Hybrid securities are heavily structured to obtain equity credit and debt status.

Of course, a natural tension exists between the terms necessary to achieve significant equity credit from rating agencies and debt status for tax purposes. This tension is complicated by the fact that legal authority distinguishing debt from equity for tax purposes is not based upon a bright line test, but rather is determined by the entirety of the facts and circumstances surrounding the terms of the particular instrument. Characteristics relevant to this analysis, none of which are independently outcome-determinative, include**,** among others, (i) the presence or absence of a fixed maturity date, (ii) the length of time until the maturity date, (iii) the presence or absence of a determinable interest rate, (iv) the expected source and likelihood of repayment, (v) the adequacy of the issuer's capitalization, and (vi) the credit rating of the security in question.[6] Each of these characteristics requires its own analysis, which may also be complicated. For example, in determining whether an instrument has a reasonable fixed maturity date, courts have considered the nature and stability of the issuer's industry, the history of the issuer, including the length of time it has been in business, and the likelihood that it will continue to be in business when the instrument matures.[7]

While there are distinctions in the scope of equity credit granted by the various rating agencies to a particular hybrid security, there is a direct correlation between the scope of equity credit provided by the agencies and the scope of the equity-like features the instrument contains.[8] Over time, as hybrid securities inch closer to maturity, for example, the equity credit granted by rating agencies will amortize and, eventually, disappear.

Key features of the new generation of hybrids

In light of the discussion above, it should not be surprising that many new hybrid securities must be heavily structured to obtain substantial equity credit from rating agencies while simultaneously achieving debt status for tax purposes. For example, and as described in more detail below, most new hybrid securities have very long final maturities, contain substantial interest deferral provisions, are subordinated to other debt for borrowed money (but not preferred equity) of the issuer, and contain other provisions designed to provide the issuer with substantial financial flexibility and loss-absorption typically associated with equity while, at the same time, preserving indicia of debt. Discussions with rating agencies, underwriters, and, if applicable, regulators, regarding equity credit and market demand frequently lead to revisions to the structure of a particular offering. Such revisions are often implemented quickly and have the potential to affect the tax analysis and treatment of the instrument.

Perpetual or long dated maturity. Rating agencies will not provide (or continue to provide) substantial equity credit to instruments that do not have a long remaining life to maturity. As such, most enhanced hybrid securities have final maturity dates of 50 years or more from the date of issuance. Some hybrid securities have final maturities of up to 80 years. Maturities of such length, in concert with other factors, can jeopardize the debt status of hybrid securities. In an effort to support the tax analysis, some structures have used scheduled maturities (i.e., dates ranging from 30 to 50 years after issuance on which new securities with similar characteristics are to be issued, if possible, for the

purpose of repaying or redeeming the initial hybrid securities). Likewise, in an effort to support the tax analysis and delay any amortization or expiration of rating agency credit, some structures permit the issuer to extend the term of the hybrid securities at a date well into the future, assuming the issuer satisfies certain criteria at that time (e.g., investment grade credit ratings).

Deep subordination. As noted above, all new hybrid securities are very deeply subordinated. Subordinating such instruments to virtually all other indebtedness for borrowed money of the issuer, including other subordinated indebtedness and traditional trust preferred securities, helps to provide an equity-like cushion for other, more senior debt holders of the issuer, as required by the rating agencies.

Extended interest deferral periods. Recent enhanced hybrid securities have been structured to permit, or even require in certain circumstances, the issuer to defer interest payments for up to 10 years, without being subject to an event of default that triggers acceleration of principal. Such deferred interest payments typically accumulate and bear interest, which is very helpful in connection with classifying the instruments as debt for tax purposes. Deferring interest payments, however, will also normally trigger provisions that prohibit distributions or dividends on instruments that are equal or subordinate to the hybrid securities in liquidation preference (commonly referred to as "dividend stopper" provisions). Additionally, many hybrid securities contain limited interest forgiveness provisions in the context of insolvency, which further bolsters the financial flexibility and equity-like features of the security for rating agency purposes, but can put some pressure on the tax analysis, depending on the precise nature of such interest forgiveness provisions.

Alternative payment mechanism. Another variant on prior hybrid security structures is to require interest payments that have been deferred for a substantial period of time to be made from the proceeds of the issuance of certain "qualified replacement securities." Qualified replacement securities typically include only a short list of securities with very high equity content.

Replacement capital covenant. One of the more novel developments in hybrid structures is Moody's requirement that the issuer issue a "replacement capital covenant," pursuant to which the issuer agrees, for the benefit of holders of more senior debt, not to redeem or repurchase the hybrid security, except out of the proceeds of a new issuance of securities containing the same or better equity characteristics. The replacement capital covenant is viewed by Moody's as a tool to preserve loss-absorption by ensuring that a deeply subordinated and flexible instrument will remain a component of the issuer's capital structure for a long period of time (and not be redeemed at the whim of the issuer). The replacement capital covenant is a complex document that issuers must carefully evaluate and understand, as this covenant will have a long-term impact upon the issuer's overall capital planning.

Principal benefits of issuing hybrid securities

Issuers in a broad range of industries have improved their capital structure in the past two years through the issuance of hybrid securities. In light of the rating agencies' relatively new approach to rating hybrid securities, issuers can receive substantial equity credit for certain types of hybrid securities that constitute debt for tax purposes. This has enabled many issuers to lower their overall cost of capital by using the proceeds of hybrid securities to fund very large share repurchases and dividends, acquisitions, and other large expenditures (e.g., pension obligations) with tax-deductible debt. Other issuers have simply used hybrid securities to retire traditional hybrid securities, such as trust preferred securities and surplus notes, upon the expiration of any no-call period applicable to such instruments. Importantly, hybrid securities allow issuers to achieve these objectives without compromising their credit ratings or otherwise diluting existing equity holders.

Market access/acceptance

As noted above, the market for hybrid securities has been very strong over the past two years. The substantial majority of deals in which the authors have been involved have been oversubscribed and/or upsized and closed on favorable pricing terms. Many commentators have noted that one reason for the strong demand is that yields on fixed income instruments have been relatively low and hybrid securities offer an opportunity to increase yield by up to 50 or, in some cases, 100 basis points over the senior debt of the issuer. Investors may take comfort from the fact that issuers of hybrid securities tend to be companies that consistently tap the capital markets and are highly focused on maintaining high credit ratings. Such issuers may be viewed as both strong credits and willing to do whatever is possible to avoid deferring interest payments (and triggering the dividend stopper provision, described above). In any event, given the volume and success of hybrid offerings in the past two years, the instruments are no longer viewed as an exotic or unknown asset class.

Conclusion

While the use of securities with both debt and equity-like features is a familiar concept, relatively recent innovations in hybrid securities have provided extraordinary benefits to many issuers. Unregulated corporations, in addition to banks, insurance companies, and energy companies, have begun to issue hybrid securities with

(continued on page 11)

Section of Public Utility, Communications and Transportation Law: 2007 – 2008 Leadership

Who Does What in the Section

Officers

Chair	William T. Torgerson, Washington, D.C.
Chair-elect	T. Michael Payne, Bedminster, N.J.
Vice-chair	Walter Demond, Austin, Tex.
Immediate past chair	James F. Mauzé, St. Louis, Mo.
Section delegates	David R. Poe, Washington, D.C.
	Samuel H. Porter, Columbus, Ohio
Secretary	George A. Avery, Chevy Chase, Md.
Budget officer	Jon C. Wood, San Antonio, Tex.

Council

Terms ending 2008	Carrie Hightman, Chicago, Ill.
	Nancy Loftin, Phoenix, Ariz.
	Robert Schwentker, Raleigh, N.C.
	J.P. Shotwell, Washington, D.C.
Terms ending 2009	Daniel R. Conway, Columbus, Ohio
	Peter V. Lacouture, Providence, R.I.
	Johanna O'Loughlin, Pittsburgh, Pa.
	John C. Peirce, Washington, D.C.
Terms ending 2010	Robert L. Brubaker, Columbus, Ohio
	Laura Douglas, Louisville, Ky.
	Brian O'Neill, Washington, D.C.
	Linda Stein, Washington, D.C.

Administrative Committees

Annual Report

Chair	Peter V. Lacouture, Providence, R.I.
Vice-chairs	David M. Sweet, Washington, D.C.
	Wallace F. Tillman, Arlington, Va.

Long Range Planning

Chair	Samuel H. Porter, Columbus, Ohio
Vice chairs	John J. Burke, Butte, Mont.
	Gerald A. Connell, Alexandria, Va.
	Frank J. Costello, Washington, D.C.
	Walter Demond, Austin, Tex.
	M. Douglas Dunn, New York, N.Y.
	William E. Graham Jr., Raleigh, N.C.
	Barrett K. Hawks, Atlanta, Ga.
	Ronald D. Jones, Lakeville, Conn.
	William J. LeBuhn, Devon, Pa.
	James F. Mauzé, St. Louis, Mo.
	David R. Poe, Washington, D.C.
	Wallace F. Tillman, Arlington, Va.

Meetings

Chair	Thomas Gadsden, Philadelphia, Pa.
Vice-chairs	Walter McFarland Beale, Jr., Birmingham, Ala.
	John Beardsworth, Richmond, Va.
	Peter V. Fazio Jr., Chicago, Ill.
	David R. Poe, Washington, D.C.
	Samuel H. Porter, Columbus, Ohio
	Wallace F. Tillman, Arlington, Va.

Membership

Chair	Patricia Dondanville, Chicago, Ill.
Vice-chairs	Ernest J. Ierardi, Pittsford, N.Y.
	William Robinson III, Covington, Ky.
	Mark S. Tibberts, New York, N.Y.

Newsletter

Chair	Linda L. Randell, New Haven, Conn.
Vice-chairs	Richard D. Cudahy, Chicago, Ill.
	David R. Hardy, New York, N.Y.
	Carrie J. Hightman, Chicago, Ill.
	James P. Scott Shotwell, Washington, D.C.
	Casey Wren, Austin, Tex.

Nominating

Chair	Gerald A. Connell, Alexandria, Va.
Vice chairs	Ray S. Bolze, Washington, D.C.
	Jerome F. Donohoe, Chicago, Ill.
	David R. Poe, Washington, D.C.
	Wallace F. Tillman, Arlington, Va.

Programs & CLE Meetings

Chair	Gordon Kaiser, Cleveland, Ohio
Vice-chairs	Daniel Brenner, Washington, D.C.
	Walter Demond, Austin, Tex.
	Floyd L. Norton IV, Washington, D.C.
	Brian O'Neill, Washington, D.C.
	Charles A. Patrizia, Washington, D.C.
	T. Michael Payne, Bedminster, N.J.
	John C. Peirce, Washington, D.C.
	Robert B. Pringle, San Francisco, Calif.
	Linda Randell, New Haven, Conn.
	William T. Torgerson, Washington, D.C.
	Louis P. Warchot, Washington, D.C.
	Dena E. Wiggins, Washington, D.C.

Web site

Chair	John C. Peirce, Washington, D.C.
Vice-chair	Jonathan Wilson, Atlanta, Ga.

Writing Competition

Chair	Daniel R. Conway, Columbus, Ohio
Vice-chairs	Linda Stein, Washington, D.C.
	Robert B. Williams, New York, N.Y.
	Jonathan B. Wilson, Atlanta, Ga.
Senior advisors	Richard D. Cudahy, Chicago, Ill.
	Samuel H. Porter, Columbus, Ohio

Industry Committees

Aviation

Chair	Peter B. Kenney Jr., St. Paul, Minn.
Vice-chairs	Malcolm Benge, Washington, D.C.
	Frank J. Costello, Washington, D.C.

Cable Television

Chair	Daniel Brenner, Washington, D.C.
Vice-chairs	Thomas Nathan, Philadelphia, Pa.
	David R. Poe, Washington, D.C.

Communications

Chair	Daniel R. Conway, Columbus, Ohio
Vice-chairs	James D. Ellis, San Antonio, Tex.
	Brian Fitzgerald, Albany, N.Y.
	Richard D. Gary, Richmond, Va.
	Thomas Gerke, Overland, Kans.
	Carrie J. Hightman, Chicago, Ill.
	Theodore Livingston, Chicago, Ill.
	James F. Mauzé, St. Louis, Mo.
	T. Michael Payne, Bedminster, N.J.
	Caroline N. Watson, Columbia, S.C.

Electricity

Chair	Clark E. Downs, Washington, D.C.
Vice-chairs	James H. Bailey, Washington, D.C.
	Richard W. Blackburn, Wolfeboro, N.H.
	J.A. Bouknight, Jr., Washington, D.C.
	John J. Burke, Butte, Mont.
	Edward H. Comer, Washington, D.C.
	Mark Crosswhite, Birmingham, Ala.
	Richard D. Cudahy, Chicago, Ill.
	Laura Douglas, Louisville, Ky.
	Kenneth B. Driver, Washington, D.C.
	N. Beth Emery, San Antonio, Tex.
	G. Edison Holland, Atlanta, Ga.
	Ernest J. Ierardi, Pittsford, N.Y.
	Rodger A. Kershner, Detroit, Mich.
	Arthur E. Korkosz, Akron, Ohio
	Peter V. Lacouture, Providence, R.I.
	Nancy C. Loftin, Phoenix, Ariz.
	Robert M. Lyford, Little Rock, Ark.
	William Massey, Washington, D.C.
	John R. MacArthur, Raleigh, N.C.
	John McMahon, Pearl River, N.Y.
	Randall E. Mehrberg, Chicago, Ill.
	Ferd C. Meyer Jr., Bigfork, Mont.
	Rodney O. Mundy, Birmingham, Ala.
	Bruce Nakamura, Honolulu, Hi.
	David Poole, Dallas, Tex.
	Linda L. Randell, New Haven, Conn.
	Robert B. Schwentker, Raleigh, N.C.
	J.P. Shotwell, Washington, D.C.
	Robert D. Sloan, New Orleans, La.
	Patricia T. Smith, Columbia, S.C.
	S. Kinnie Smith Jr., Jackson, Mich.
	Wallace F. Tillman, Arlington, Va.
	William T. Torgerson, Washington, D.C.
	B. Keith Trent, Charlotte, N.C.
	Casey Wren, Austin, Tex.

Gas

Chair	Brian O'Neill, Washington, D.C.
Vice-Chair	William P. Boswell, Pittsburgh, Pa.
	James F. Bowe Jr., Washington, D.C.
	Paul K. Connolly Jr., Washington, D.C.
	Mark Darrell, Ladue, Mo.
	Katherine B. Edwards, Alexandria, Va.
	Robert Fleishman, Washington, D.C.
	Francis P. Mood, Columbia, S.C.
	David J. Muchow, Arlington, Va.
	Johanna O'Loughlin, Pittsburgh, Pa.
	Russ M. Strobel, Naperville, Ill.
	David M. Sweet, Washington, D.C.
	Michael R. Waller, Houston, Tex.

Internet Industry

Chair	Jonathan B. Wilson, Atlanta, Ga.
Vice-chair	C. Celeste Creswell, Atlanta, Ga.

Maritime

Chair	John J. Reilly, New York, N.Y.
Vice-chairs	Thomas Mills, Washington, D.C.
	Charles A. Patrizia, Washington, D.C.

Nuclear Energy

Chair	James H. Miller III, Atlanta, Ga.
Vice-chairs	M. Stanford Blanton, Birmingham, Ala.
	George L. Edgar, Washington, D.C.
	Joseph M. Farley, Birmingham, Ala.
	Gerald Garfield, Hartford, Conn.
	Jay Guiterrez, Washington, D.C.
	Nicholas S. Reynolds, Washington, D.C.
	Jon Wood, San Antonio, Tex.

Oil Pipelines

Chair	Steven H. Brose, Washington, D.C.
Vice-chairs	Eugene R. Elrod, Washington, D.C.
	Elisabeth R. Myers, Washington, D.C.
	Dena E. Wiggins, Washington, D.C.

Railroads

Cochairs	Linda Stein, Washington, D.C.
	Louis P. Warchot, Washington, D.C.
Vice-chairs	Jerome F. Donohoe, Chicago, Ill.
	Ferd C. Meyer Jr., Bigfork, Mont.
	Jeffrey Moreland, Fort Worth, Tex.

Water

Chair	Thomas P. Gadsden, Philadelphia, Pa.
Vice-chairs	Laura Douglas, Louisville, Ky.
	Richard D. Gary, Richmond, Va.
	William J. LeBuhn, Devon, Pa.
	Linda Randell, New Haven, Conn.

Practice Committees

ADR

Chair	Barrett K. Hawks, Atlanta, Ga.
Vice-chairs	George A. Avery, Chevy Chase, Md.
	John Bingham, Birmingham, Ala.
	James F. Mauzé, St. Louis, Mo.
	Ferd C. Meyer Jr., Bigfork, Mont.
	Samuel H. Porter, Columbus, Ohio
	Linda Stein, Washington, D.C.
	Thomas J. Stipanowich, Mailibu, Calif.

Antitrust

Chair	Robert B. Pringle, San Francisco, Calif.
Vice-chairs	S. Eason Balch, Birmingham, Ala.
	Ray S. Bolze, Washington, D.C.
	Gerald A. Connell, Alexandria, Va.
	Richard D. Cudahy, Chicago, Ill.
	Michael D. McNeeley, Washington, D.C.
	Floyd L. Norton IV, Washington, D.C.
	John C. Peirce, Washington, D.C.
	Linda L. Randell, New Haven, Conn.
	Michael R. Waller, Houston, Tex.

Corporate Governance

Chair	Jeffrey Cross, Columbus, Ohio
Vice-chairs	Richard W. Blackburn, Wolfeboro, N.H.
	Walter Demond, Austin, Tex.
	Peter V. Fazio Jr., Chicago, Ill.
	Gordon S. Kaiser, Cleveland, Ohio
	Rodger A. Kershner, Detroit, Mich.
	Nancy C. Loftin, Phoenix, Ariz.
	Michael Madigan, Washington, D.C.
	David Powers, Hong Kong
	William T. Torgerson, Washington, D.C.
	Bruce Worthington, San Francisco, Calif.

Environmental

Chair	Robert L. Brubaker, Columbus, Ohio
Vice-chairs	Kristy A. Niehaus Bulleit, Washington, D.C
	Charles A. Patrizia, Washington, D.C.
	R. Edwin Selover, Newark, N.J.
	Tom Skinner, Chicago, Ill.

Infrastructure Finance, Mergers and Acquisitions

Chair	Walter McFarland Beale Jr., Birmingham, Ala.
Vice-chairs	William T. Baker Jr., New York, N.Y.
	John J. Beardsworth Jr., Richmond, Va.
	Jeffrey Cross, Columbus, Ohio
	Patricia Dondanville, Chicago, Ill.
	Emmett Ellis IV, New York, N.Y.
	Michael Fitzpatrick, New York, N.Y.
	Robert J. Grey, Allentown, Pa.
	David R. Hardy, New York, N.Y.
	Barrett K. Hawks, Atlanta, Ga.
	Safal Joshi, Dallas, Tex.
	Gordon S. Kaiser, Cleveland, Ohio
	William S. Lamb, New York, N.Y.
	Bruce Peterson, Detroit, Mich.
	David Powers, Hong Kong
	J. Anthony Terrell, New York, N.Y.
	Dynda Thomas, Cleveland, Ohio
	Robert B. Williams, New York, N.Y.
	Bruce R. Worthington, San Francisco, Calif.

Infrastructure Security

Chair	Robert B. Schwentker, Raleigh, N.C.
Vice-chairs	William P. Boswell, Pittsburgh, Pa.
	Peter V. Fazio Jr., Chicago, Ill.
	Thomas P. Gadsden, Philadelphia, Pa.
	John Reilly, New York, N.Y.
	R. Edwin Selover, Newark, N.J.
	Louis P. Warchot, Washington, D.C.

Labor

Chair	Paul J. Ondrasik, Washington, D.C.
Vice-chairs	Robert A. Dufek, Washington, D.C.
	John Ring, Washington, D.C.
	Larry Steward, Detroit, Mich.

Taxation & Accounting

Chair	David R. Hardy, New York, N.Y.
Vice-chairs	Charles A. Mannix, Eureka, Mo.
	Dale L. Ponikvar, New York, N.Y.
	Martha Groves Pugh, Washington, D.C.
	Theodore J. Vogel, Jackson, Mich.
	Andrew Zakupowsky, Washington, D.C.

If you would like to join a committee, please call the Section office at 312/988-6238 or e-mail pubutil@abanet.org.

"St. Mark": A cautionary tale for general counsel Part 1

continued from page 1

corporation, namely the diversion of non-competition payments from the corporation to officers and a controlling shareholder. In that context the actions complained of also were the underpinning of a civil suit in the Delaware Chancery Court in 2004[1] that resulted in the overturning of an attempt by Black to frustrate the efforts of independent directors to reverse his actions to take control of and sell the company before the company recouped the payments.

In the post-Enron environment in which we now live, the United States Attorney for the Northern District of Illinois in Chicago, where Conrad Black's principal United States newspaper, the *Chicago Sun-Times*, is located, chose to characterize defendants' actions as theft and prosecute them as part of a fraudulent scheme under the mail and wire fraud statutes rather than as violations of Sarbanes/Oxley or the securities laws.

Hollinger International. Hollinger International ("International") was a Delaware corporation with its principal office located in Chicago, Illinois. It was a holding company that was publicly traded on the New York Stock Exchange. Through its operating subsidiaries, International owned and published newspapers around the world, including the *Chicago Sun-Times,* the *Daily Telegraph* in the United Kingdom, the *National Post* in Toronto, the *Jerusalem Post* in Israel, and numerous community newspapers in the United States and Canada. The corporate structure of which it was a part was very complex. As a result, the Audit Committee of International, which consisted of three independent directors, functioned as International's independent committee for purposes of reviewing and approving the fairness of transactions between International and its controlling shareholders, officers, and directors in related-party transactions.

Conrad Black and David Radler, his principal associate in the newspaper business, by all accounts were brilliant businessmen. They assembled a media empire similar to the one controlled by Rupert Murdoch today. In the course of acquiring the many businesses that constituted that empire over the years, their search for capital resulted in a highly convoluted corporate structure. It was privately controlled, but dipped into the public market at two different levels. It employed varying classes of stock that, in some cases, separated economic and voting interests in a way that allowed private entities to exercise more voting control than their economic investment otherwise would entitle them to, analogous to the situation of the Bancroft family and the *Wall Street Journal* about which we have heard so much lately as Rupert Murdoch successfully added that paper to his empire. A number of these corporations also used similar names, which makes the story difficult to follow.

The principal elements were that International owned the *Chicago Sun-Times* and most of the assets that were sold in a way that produced non-competition payments that served as the basis for the charges. International was, in turn, controlled by Hollinger, Inc. (referred to as "Inc."), a Canadian publicly held company, which in turn was controlled by Ravelston, a Canadian privately held company that, among other things, provided the services of the defendants other than Kipnis to International under a management services agreement, a related-party transaction between Ravelston and International. Ravelston in turn was controlled by Black and his principal associates, including Radler.

Corporate responsibilites. Black acted as chairman and CEO, focusing on strategy and the bigger issues, and delegated to Radler responsibility for day-to-day operations of the empire. Radler was a no-nonsense operating executive who managed with what might be termed a "military style." Jerry Minkkinen, executive director of the Chicago Newspaper Guild, was quoted in the *Chicago Reader* of July 13, 2007, as saying he particularly admired Kipnis for conducting himself honorably while representing Radler. "It's hard for anyone to imagine the circumstances under which people worked on the management side under the Radler regime," Minkkinen said. "He would brook no dissension or compromise from his minions. Radler was clearly the driving force in all those negotiations." Asked if he ever wondered why Kipnis didn't quit, he replied, "Yeah, quite frankly. It had to be a very, very difficult environment." Atkinson and Boultbee, the other principal associates of Black and Radler, who participated in the ownership of Ravelston, had overall responsibility for the legal and financial matters of the empire, respectively. Kipnis, who was hired as corporate counsel for International in Chicago, considered Atkinson his legal boss and Radler his business boss. Black, Radler, Atkinson, and Boultbee operated the empire mostly from offices in Canada, although Radler spent a good deal of time in Chicago, where the corporation maintained an apartment for his use.

Non-competition payments served as the basis for the charges.

Ownership interest. To illustrate the leverage Conrad Black employed in this structure, it is interesting to note that he had an indirect ownership interest in Inc. of approximately 51 percent, and by virtue of that ownership he had an indirect ownership in International of approximately 15 percent. Despite having only a minority ownership in International, he was able to maintain voting control over International through Inc.'s ownership of Class B Common stock, which carried disproportionate (10 to 1) voting rights. The result of all this was that every $100 transferred out of International into Inc. would effectively cost Black $15 but give him $51. Similarly, every $100 that was transferred out of International and into Ravelston would cost Black $15 but give him $65. Thus the government's position was that Black was able to exert both his management position and voting control at International to transfer money to himself and his principal associates and away from International's public shareholders at a very low cost, considering his minority stake in International.

Sales transactions. The empire was effectively put together by the mid-nineties. In the late nineties a strategic decision was reached to sell a significant portion of the United States community newspaper assets, a decision resulting largely because of the Internet boom and decreasing reliance on newspapers as a source of news. The sales began in 1998 with the disposition of a publication called *American Trucker* and several other smaller publications to Intertec Publishing Company for approximately $75 million. From early 1999 through late 2000, virtually all of International's United States community newspapers, except for those in the Chicago metropolitan area, were sold to a variety of purchasers for an aggregate consideration of approximately $679 million. In 2000 International sold several hundred Canadian newspapers, an Internet investment called Canada.com, and a 50 percent interest in the *National Post* to CanWest Global Communications Corp. for approximately $2.1 billion.[2]

In 1996 a tax court in Canada held that, under the facts of the particular case, non-competition fees were not taxable under Canadian tax law. In December 1999 a Canadian federal court of appeal affirmed this decision. These court decisions created a potential tax benefit for Canadian taxpayers who legitimately received non-competition payments. All of the defendants but Kipnis were Canadian taxpayers.

In most of the transactions involving sales by International, the agreements included a non-competition provision whereby International promised not to acquire or establish a newspaper within a certain geographic distance from the newspapers it sold for a certain period of time after the sale. These were usual provisions because newspaper purchasers buy not just the trade name of the newspaper but also its subscriber

and advertiser bases. Purchasers often request the seller's agreement not to return to the same area for a short period of time to operate a rival newspaper. For commercial and tax purposes, it is not unusual for the buyer and seller to allocate a portion of the sales proceeds to the seller's non-competition agreement. The buyer, however, typically does not pay additional consideration for a separate agreement that prohibits the seller's affiliates and officers from personally competing with the buyer. However, in the CanWest transaction the buyer insisted on extending the non-competition covenants to Black and Radler, the principal architects of the media empire. Since this led to a personal obligation on the part of Black and Radler it was thought appropriate to apportion a part of the compensation for the non-competition covenants to the two individuals who were personally bound.

These facts apparently focused the attention of the Canadian defendants on the possibility of transferring substantial sums of money to themselves as individuals under circumstances where the receipt of those sums would not be taxable under Canadian law. The prospect of receiving substantial amounts of money tax-free appears to have been irresistible to Black and Radler, who then felt it necessary or appropriate to include their other long-time associates, Atkinson and Boultbee, in the scheme.

Non-compete covenantors. Starting in 1999, Black, Boultbee, and Radler decided that in connection with all future sales of International's U.S. community newspapers, Inc. would be included as a non-compete covenantor as a matter of course and would receive 25 percent of the proceeds allocated to a non-competition agreement in each transaction. This came to be known as the "template" and provisions to effect this objective were inserted into the draft purchase and sale agreement sent to prospective bidders as the assets were effectively auctioned off. The decision to initiate the template diverted 25 percent of the proceeds allocated to International's non-competition agreement regardless of whether the buyer requested or valued Inc.'s agreement not to compete. The inclusion of Inc. as a beneficiary also made each of these sales related-party transactions that required approval by International's Audit Committee.

In the summer of 2000, the Canadian defendants decided that, with respect to anticipated transactions with Forum, Paxton, and Community Newspaper Holdings, Inc. II (CNHI II), they would insert themselves as individual non-compete covenantors and would direct a portion of the proceeds of each of these transactions to themselves as bonus compensation. The decision to characterize these payments as "non-competition" payments as opposed to bonus compensation was motivated by a desire to receive favorable tax treatment in Canada. These payments were to be above and beyond the funds allocated to the non-competition agreement in the transaction by the parties, which would continue to be divided between International and Inc. pursuant to the template.

A pattern having been established, ways were found to allocate the "appropriate" amount of the sales proceeds to Inc. and the Canadian individuals even in cases where the underlying documents had inadvertently been drafted without non-competition provisions.

The end result of all of this was that in sales generating an aggregate consideration of over $600 million, Inc. received non-competition payments aggregating $16.6 million, Black $19.1 million, Radler $19.1 million, Boultbee $1.9 million, and Atkinson $1.9 million. In addition Ravelston received $26.4 million.

Kipnis received no non-competition payments. He received one bonus of $100,000 and a second bonus of $50,000 relating to his work on various transactions, but was acquitted of the counts that related to those transactions.

Kipnis was the only inside corporate lawyer at publicly held International.

Corporate counsel. Mark Kipnis was the only inside corporate lawyer at publicly held International. The management of International, the other officers of International with whom he interacted on a daily basis to carry out his duties, were not employees of International. They were all employed by Ravelston, which compensated them. Ravelston provided their services to International under the terms of the management services agreement mentioned above. Under the terms of that agreement, International and Ravelston were supposed to meet at least annually to determine whether Ravelston would continue to provide these services and at what fee. The fee was to be determined through negotiations between Ravelston and the Audit Committee of International. The agreement also provided that Ravelston would provide the details of any conflict of interest involving Ravelston's performance of its management services to the secretary of International, Kipnis, who in turn was to present all material facts concerning all related-party transactions to International's Audit Committee for its review and approval.

Black chose high profile individuals to be the "independent" directors of International. They included James Thompson, a former governor of Illinois and U.S. Attorney for the Northern District of Illinois, Marie-Josée Kravis, the wife of Henry Kravis, the well-known financier, and Richard Burt, a former ambassador. They

constituted International's Audit Committee, which was chaired by Thompson.

It is not contested that if they had knowingly approved the payment of the non-competition amounts to the Canadian defendants there would have been no civil or criminal offense.

The entire situation was further complicated by the arrogant attitude and extravagant lifestyle of Conrad Black, which was partially financed by International. This resulted in additional counts that are not covered in this article, but of which Black was acquitted.

It's relatively easy to summarize these matters in the abstract but you can't truly appreciate the issues or the enormity of the impact of a criminal prosecution on an individual unless you get into some of the details. For that reason I have set out below excerpts from the opening and closing arguments on behalf of Mr. Kipnis [see Part 2 of this article], and I have attached significant detail from the superseding information in an attempt to indicate the extent of the government's case [see Attachment B, posted at www.abanet.org/pubutil/publications/]. Although this, in a way, gives you both sides of the story, I have not attempted to evenly balance them because that would have been impossible given the complexity of the facts underlying the charges.

[*Part 2 of this article will be published in the Fall 2007 issue of* Infrastructure.]

Endnotes

1. Black v. Hollinger Int'l., 844 A.2d 1022 (Del. Ch.), *aff'd*, 872 A.2d 559 (Del. 2005).

2. The numbers used in this article relate to the transactions that were the basis for this criminal prosecution. The same approach was used in other significant transactions not involved in this case.

Hybrid securities: An increasingly popular financing tool

continued from page 5

greater frequency for the purpose of optimizing their capital structure and lowering their cost of capital without compromising their credit ratings or diluting equity holders. Many leading underwriters and other market experts predict that hybrid securities will continue to be issued with increasing frequency in coming years. Nonetheless, hybrid securities remain complex, heavily structured instruments that require careful and thoughtful analysis and execution.

Endnotes

1. Source: Credit Suisse Securities (USA) LLC.

2. *See, e.g.*, *Guide to Hybrid Securities—Part 1: Overview of Hybrid Securities—in Association with Fitch Ratings,* GT NEWS, June 27, 2006, available at www.gtnews.com/feature/138_1.cfm; Richard Beales, *Banks Hope to Cash In on Rush into Hybrid Securities*, THE FINANCIAL TIMES (London, England), Feb. 6, 2006, available at www.ft.com/cms/s/0/e22d70f2-9674-11da-a5ba-0000779e2340.html.

3. One popular use for capital raised by issuing hybrid securities is funding accelerated share repurchase programs, or ASRs.

4. *See* MOODY'S INVESTORS SERVICE, *Refinements to Moody's Tool Kit: Evolutionary Not Revolutionary!* A Product of the New Instruments Standing Committee, Feb. 2005, #91696. *See also* STANDARD & POOR'S, *Corporate Criteria—Equity Credit: What It Is, and How You Get It; Factoring Future Equity into Ratings; Tax Deductible Preferred and Other Hybrids*; *Streamlining Hierarchy for Hybrid Securities and Modified Hybrid Hierarchy*, June 2006, available at www2.standardandpoors.com/spf/pdf/fixedincome/corporateratings_2006.pdf; FITCH RATINGS, *Equity Credit for Hybrids and Other Capital Securities*, Sept. 2006; and A.M. BEST, *Equity Credit for Hybrid Securities*, Apr. 2005, available at www.ambest.com/ratings/methodology/hybridsecurities.pdf.

5. This article provides a brief and general overview of certain portions of relevant rating agency guidelines.

6. *See* Roth Steel Tube Co. v. Comm'r, 800 F.2d 625 (6th Cir. 1986), and Nassau Lens Co., Inc. v. Comm'r, 308 F.2d 39 (1962), for a discussion of factors considered for purposes of determining whether a particular instrument constitutes debt or equity.

7. *See* Monon R.R. v. Comm'r, 55 T.C. 345 (1970), *acq.* 1973-2 C.B. 3; I.R.S. Priv. Ltr. Rul. 199910046 (Nov. 16, 1998).

8. For example, Moody's will award a hybrid security a specified percentage of equity credit based upon where the equity features of the security fall on Moody's debt/equity continuum, which consists of five categories or baskets, including (i) Basket A (0 percent equity and 100 percent debt); (ii) Basket B (25 percent equity and 75 percent debt); (iii) Basket C (50 percent each of equity and debt); (iv) Basket D (75 percent equity and 25 percent debt); and (v) Basket E (100 percent equity and 0 percent debt). New hybrid securities that qualify as debt for tax purposes are almost always classified as Basket C or D instruments.

infrastructure

Section of Public Utility, Communications and Transportation Law
American Bar Association
321 N. Clark Street
Chicago, IL 60610

Nonprofit Organization
U.S. Postage
PAID
American Bar Association

JOIN A COMMITTEE — ONLINE!

Now is a great time to join a Section committee online at www.abanet.org/pubutil/committee.html

Take advantage of committee membership and have access to the semiannual committee reports available on the Web site, committee teleconferences, and more.

Section Industry Committees:

Aviation
Cable Television
Communications
Electricity
Gas
Internet
Maritime
Motor Carriers
Nuclear Energy
Oil Pipelines
Railroads
Water

Section Practice Committees:

Alternative Dispute Resolution
Antitrust
Corporate Governance
Environmental
Infrastructure Finance, Mergers and Acquisitions
Infrastructure Security
Labor
Taxation & Accounting