Cravath Quarterly Review

FINANCE AND CAPITAL MARKETS

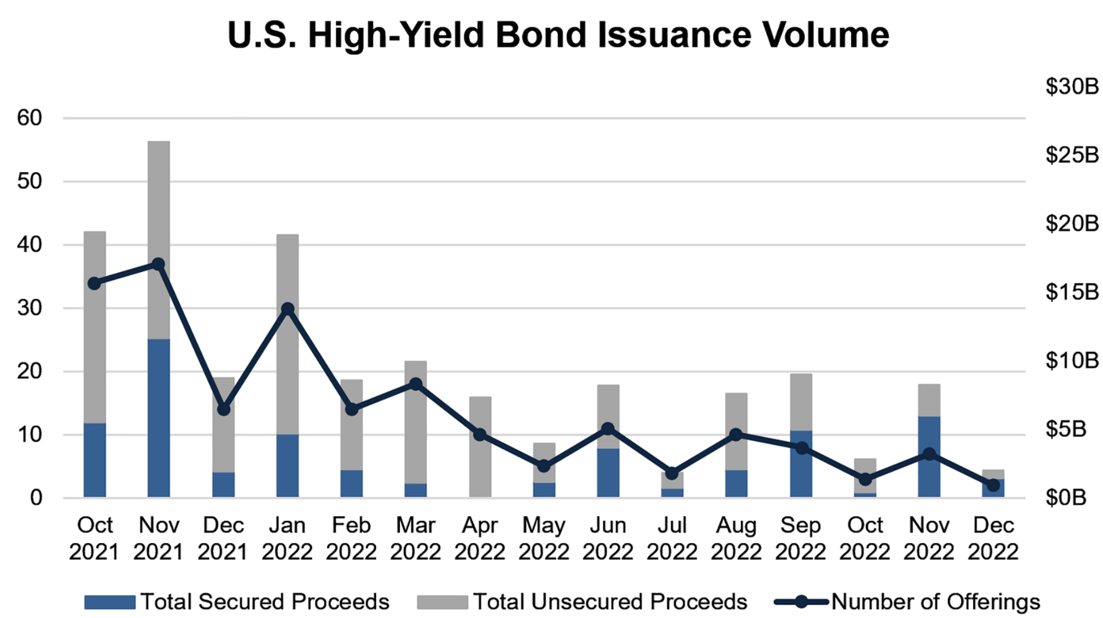
01

Market Update

BONDS

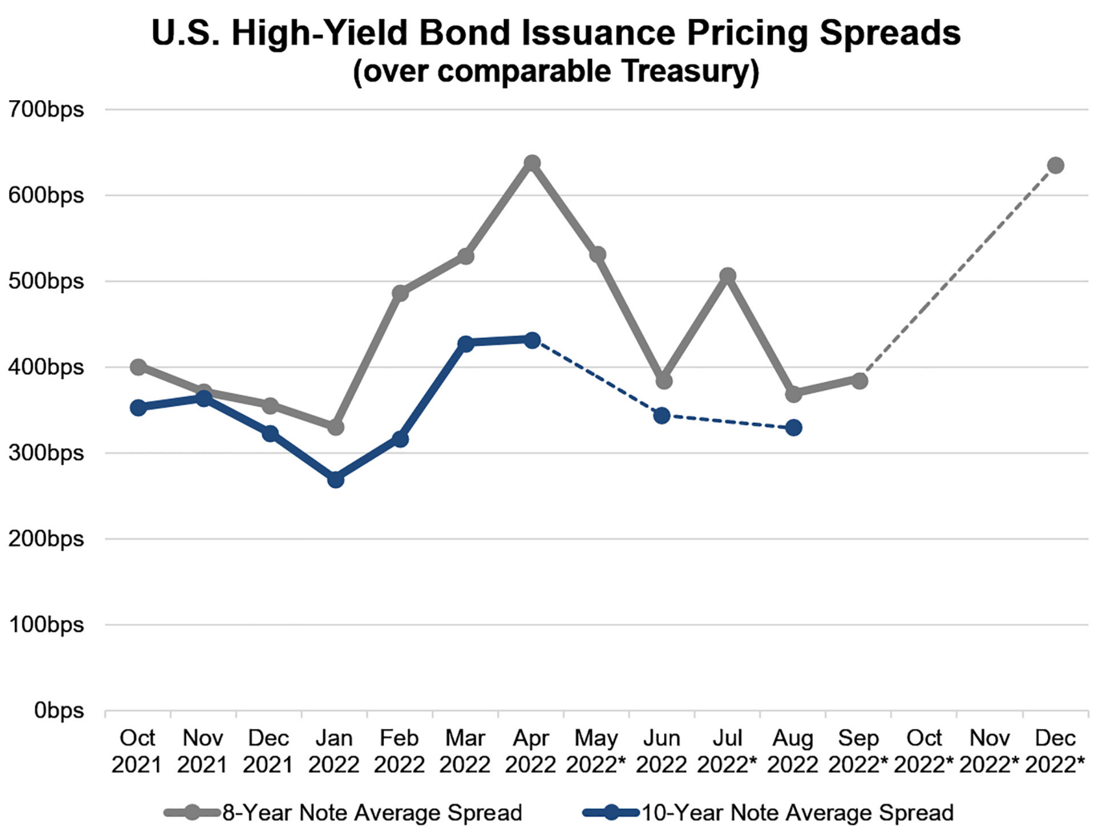
U.S. High-Yield Bonds

The pace of U.S. high-yield bond issuances continued to decline in the fourth quarter of 2022, extending the downward trend that began in the fourth quarter of 2021. The $13B in proceeds from issuances for the fourth quarter of 2022 was down 29% as compared to the third quarter of 2022 ($18B) and 76% as compared to the fourth quarter of 2021 ($54B). The $89B in total proceeds from issuances in 2022 was approximately 77% lower than the all-time annual high of $392B set in 2021, and the lowest annual total since 2008.



DATA SOURCE Leveraged Commentary & Data (LCD)

There were no high-yield 10-year notes issued in the fourth quarter of 2022, and the only high-yield 8-year notes issued in the fourth quarter of 2022 were issued in December 2022. The average pricing spread (measured over the comparable Treasury) on high-yield 8-year notes issued in December 2022 was approximately 51% higher than the average spread in the third quarter of 2022. Overall, average pricing spreads (measured over the comparable Treasury) on high-yield 8-year notes for 2022 was up 25% as compared to 2021 and average pricing spreads (measured over the comparable Treasury) on high-yield 10-year notes was up 17% on the same comparison. Higher spreads over the comparable Treasury combined with higher Treasury yields resulted in significant all-in widening of high-yield bond yields in 2022, with the effective yield on the ICE BofA US High Yield Index increasing from 4.35% at the end of 2021 to 8.87% at the end of 2022.

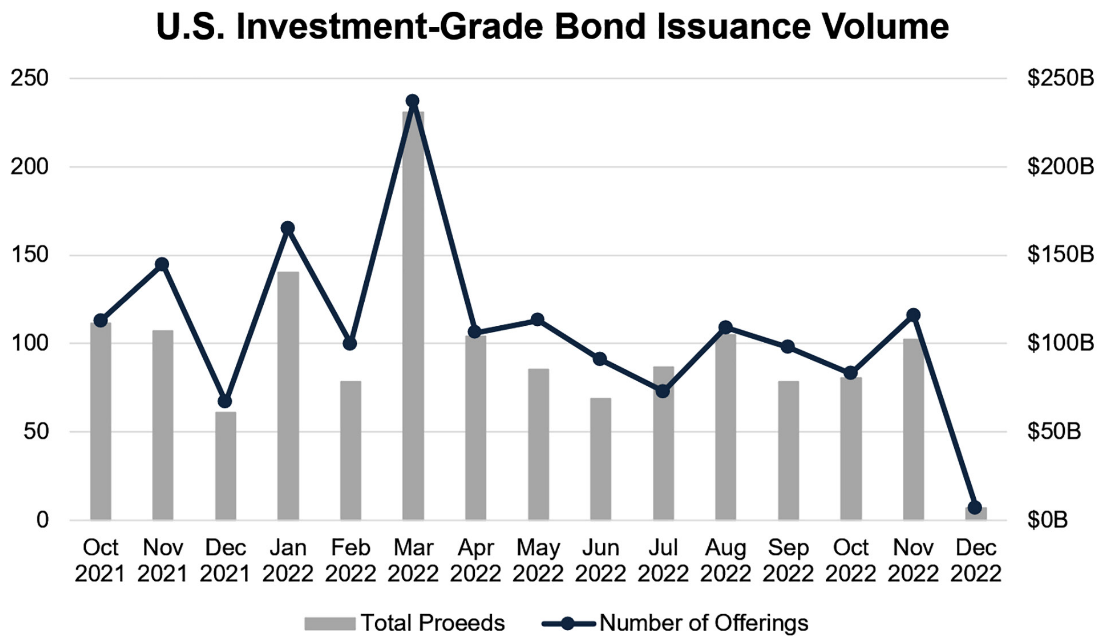


* No high-yield bonds with a 10-year maturity were issued in May, July, September, October, November or December 2022. No high-yield bonds with an 8-year maturity were issued in October or November 2022.

DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Investment-Grade Bonds

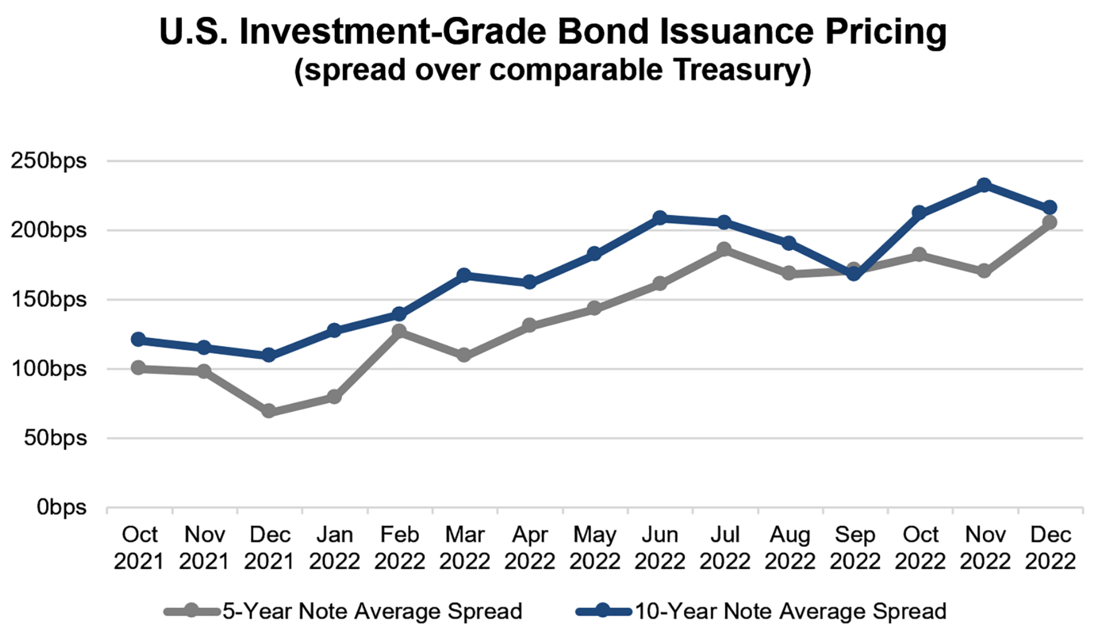
Total proceeds from U.S. investment-grade issuances were $191B in the fourth quarter of 2022, down 30% as compared to the third quarter of 2022 ($270B) and 32% from the fourth quarter of 2021 ($279B). The $1,169B in total proceeds from issuances in 2022 was down 15% as compared to 2021 ($1,372B). The $7.25B in proceeds from issuances in December 2022 was the lowest monthly total since 2008.



DATA SOURCE Leveraged Commentary & Data (LCD)

Pricing spreads (measured over the comparable Treasury) on U.S. investment-grade bond issuances in the fourth quarter increased over the prior quarter, with an overall increase on the 5-year note average spread of 6% as compared to the average for the third quarter of 2022. Pricing spreads on 10-year notes (measured over the comparable Treasury) in the fourth quarter of 2022 saw an increase of 17% as compared to the average spread in the third quarter of 2022.

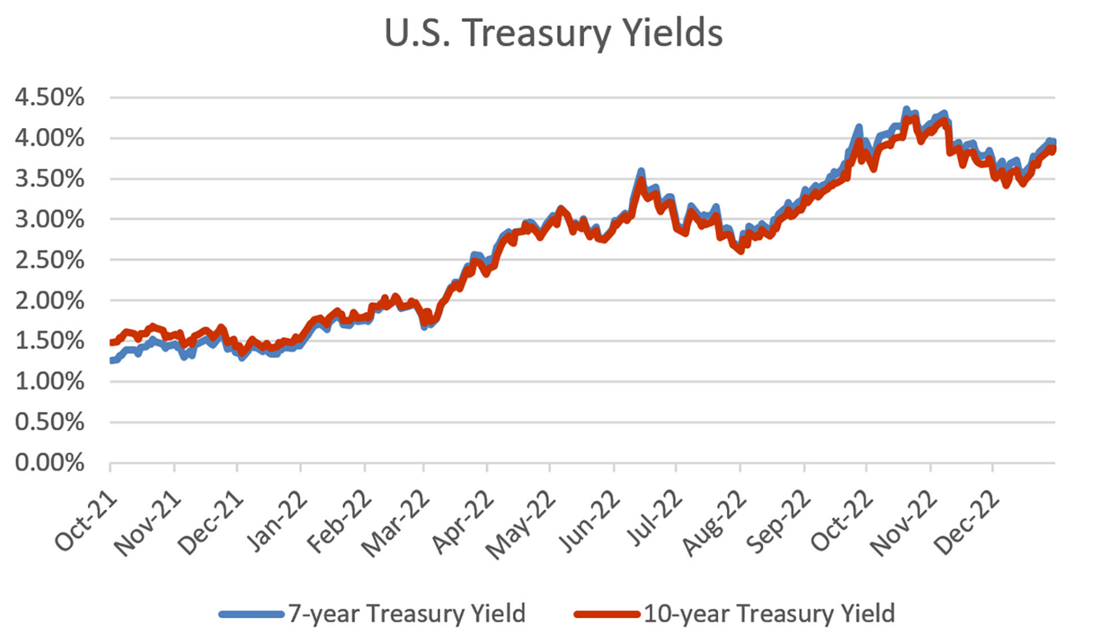
Overall, pricing spreads (measured over the comparable Treasury) on U.S. investment-grade bond issuances in 2022 were significantly higher than in 2021, with an overall increase on the 5-year note average spread of 75% over the average spread for 2021. Pricing on 10-year notes in 2022 saw a similar but slightly less significant increase of 65% as compared to the average spread in 2021.



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Treasury 7-year and 10-year Yields

U.S. Treasury 7-year and 10-year rates fluctuated over the course of the fourth quarter of 2022, but ended the quarter roughly equivalent to rates at the end of the third quarter of 2022. The 7-year rate ended the fourth quarter at 3.96%, a decrease of 1 bp compared with the end of the third quarter of 2022, and the 10-year rate ended the fourth quarter at 3.88%, an increase of 5 bps compared to the end of the third quarter of 2022. However, U.S. Treasury 7-year and 10-year rates increased significantly over the course of 2022, with the 7-year rate up 252 basis points and the 10-year rate up 236 basis points at the end of 2022 as compared to the end of 2021.

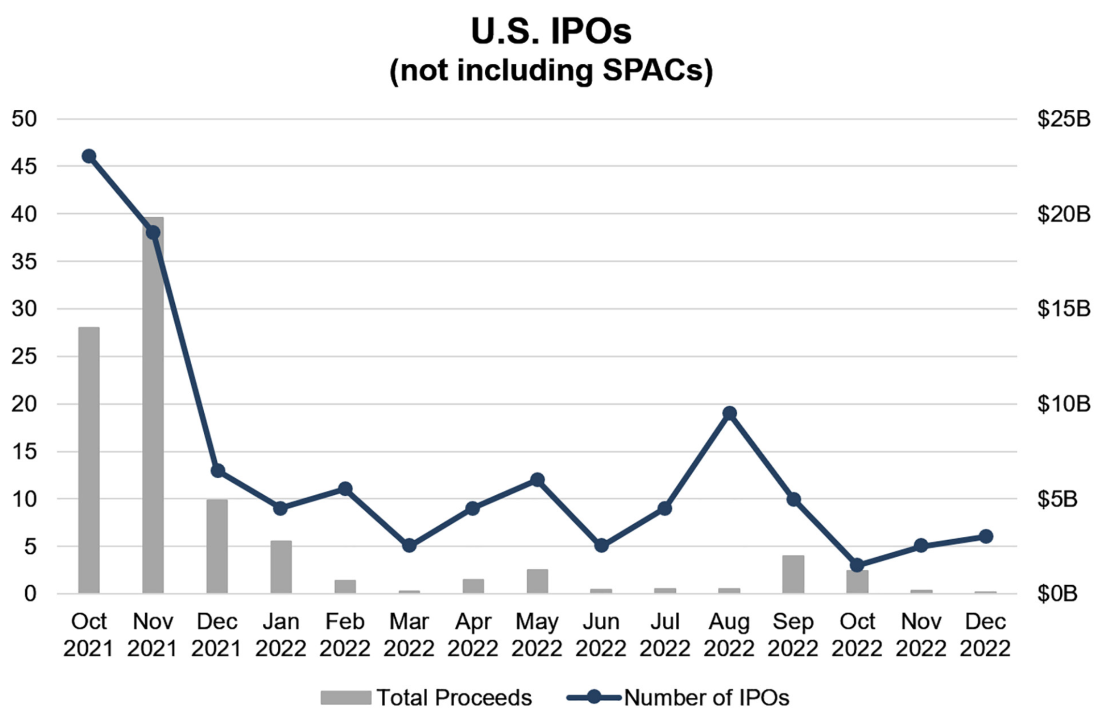


DATA SOURCE Bloomberg Finance L.P.

EQUITY

U.S. IPOs

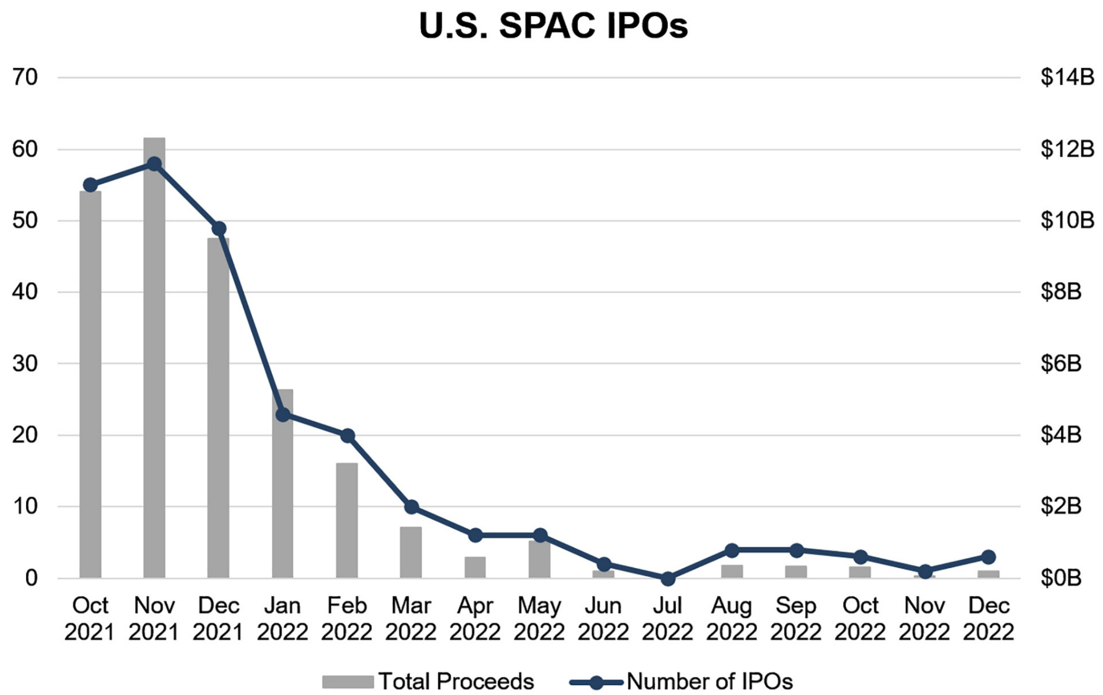
The U.S. IPO market (not including SPACs) in 2022 remained far less active compared to the record-setting levels seen in 2021, driven by volatile market conditions and macroeconomic and geopolitical considerations. The $9.9B of total proceeds from U.S. IPOs (not including SPACs) for 2022 was the lowest annual total in two decades, and was approximately 94.1% lower than the of $167.7B of total proceeds in 2021. The $1.5B of total proceeds from U.S. IPOs (not including SPACs) for the fourth quarter of 2022 was down 42.7% as compared to the third quarter of 2022 ($2.6B) and down 96.2% as compared to the fourth quarter of 2021 ($28.7B).



DATA SOURCE Refinitiv, an LSEG Business

U.S. SPACs

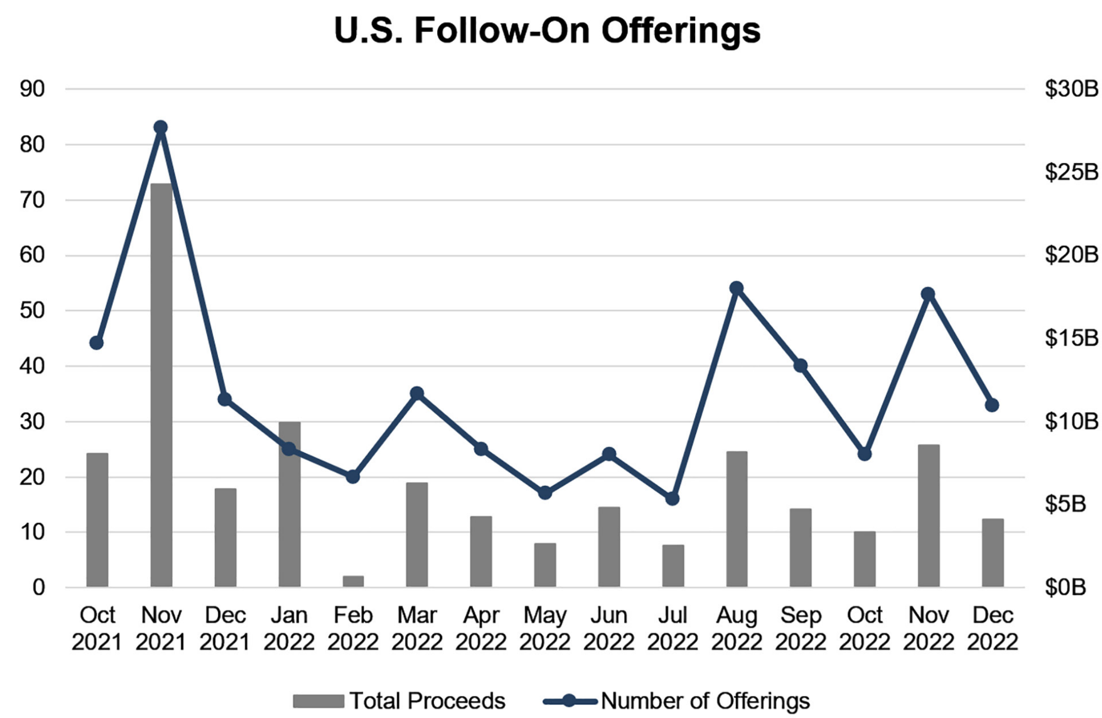
The U.S. SPAC market saw decreased activity over the course of 2022, and remains far less active as compared to 2021 levels. The $12.9B of total proceeds from U.S. SPAC IPOs for 2022 was down 91.8% as compared to 2021 ($156.2B), driven by, among other things, (i) the regulatory landscape, (ii) underperformance of de-SPAC companies, (iii) high redemption rates in connection with business combinations, which make de-SPACs harder to consummate and (iv) an increase in the risk-free rate of return.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Follow-On Offerings

The $16.0B in proceeds from U.S. follow-on equity offerings for the fourth quarter of 2022 was up 4.1% as compared to the third quarter of 2022 ($15.4B) and down 58.1% as compared to the fourth quarter of 2021 ($38.3B). Total proceeds from U.S. follow-on equity offerings in 2022 were $60.1B, down 71.9% from 2021 ($214.2B).

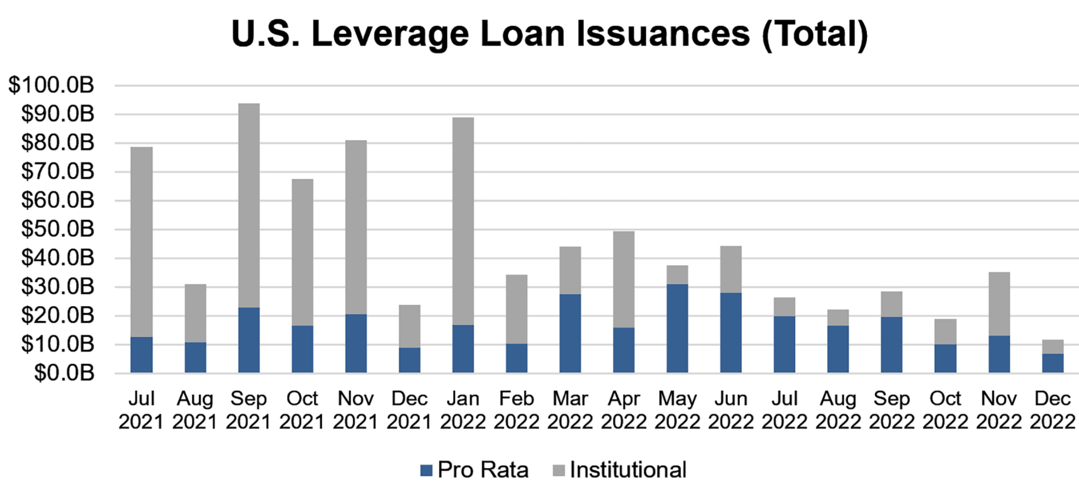


DATA SOURCE Refinitiv, an LSEG Business

LOANS

U.S. Leveraged Loan Issuances

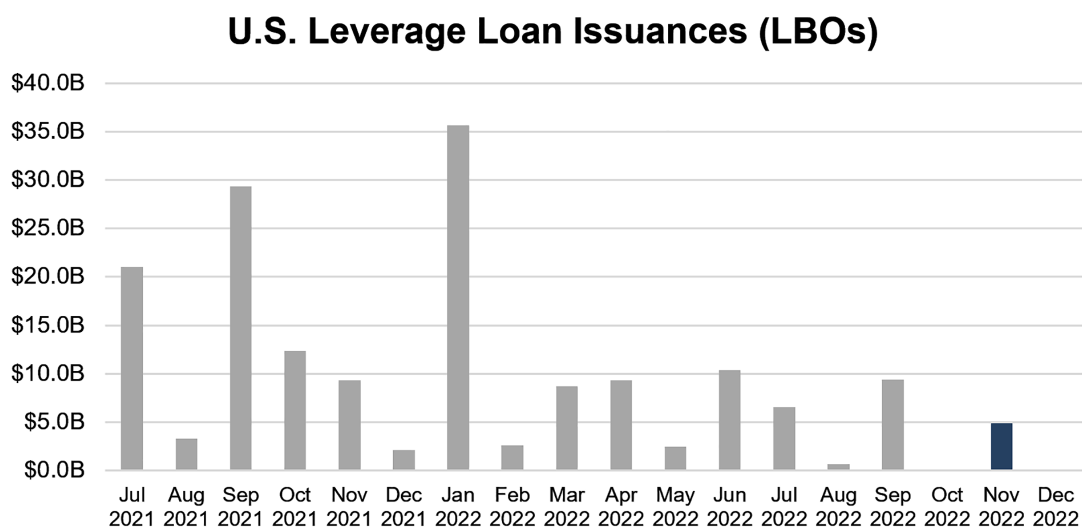
Activity in the U.S. leveraged loan market continued to slow in the fourth quarter of 2022, with total volume down 15% as compared to the third quarter of 2022 (and down 62% as compared to the fourth quarter of 2021). Institutional term loan volume was $35.7B in the fourth quarter of 2022, up 69% compared to the third quarter of 2022 (but down 72% as compared to the fourth quarter of 2021). Pro rata loan volume was $30.5B in the fourth quarter of 2022, down 46% compared to the third quarter of 2022 (and down 34% as compared to the fourth quarter of 2021). The share of pro rata loan volume decreased to 46% of total loan volume in the fourth quarter of 2022, down from 73% in the third quarter of 2022 (but up from 27% in the fourth quarter of 2021). The middle market institutional term loan market was especially weak—as of January 24, 2023, LCD reported no middle market first lien institutional loans issued in the third and fourth quarters of 2022.



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. LBO Loan Volume

In the fourth quarter of 2022, there were $4.9B of U.S. LBO loans issued, as compared to $16.5B in the third quarter of 2022 (and down from $23.8B in the fourth quarter of 2021). As of January 24, 2023, LCD reported no U.S. LBO loans issued in October 2022 and December 2022.

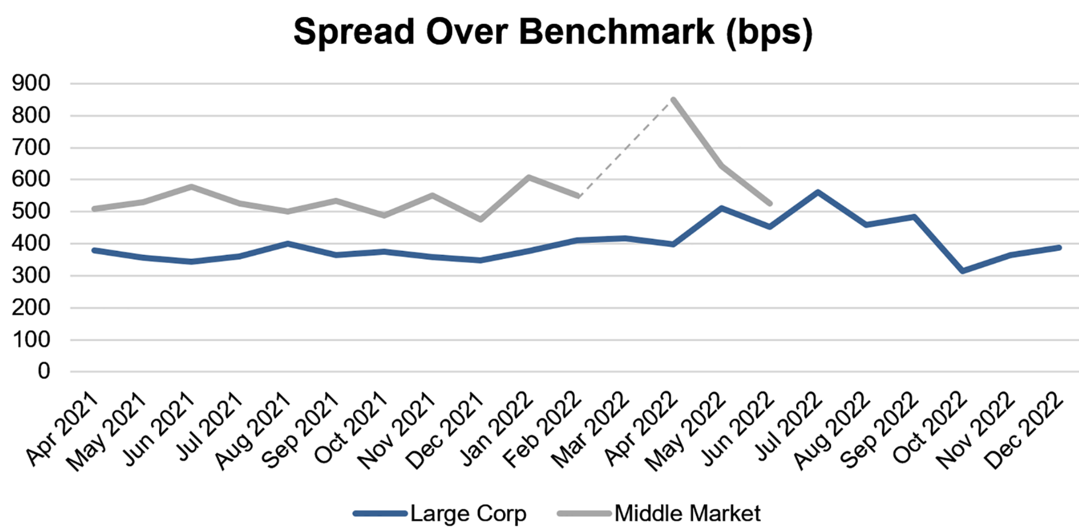


DATA SOURCE Leveraged Commentary & Data (LCD)

- In this challenging environment of rising interest rates and severely depressed levels of market activity, leveraged buyouts completed via private credit continued to outpace transactions completed via syndicated loans. Through December 8, 2022, only one LBO loan had been issued in the syndicated loan market in the fourth quarter of 2022, as opposed to 46 in the private credit market, according to LCD.
- Certain sponsors continued to finance acquisitions without third-party debt in the fourth quarter of 2022. Given the challenging financing environment, rather than borrow at unattractive pricing/terms, some private equity firms opted to use equity, and look to raise debt whenever financing markets improve. For instance, Thoma Bravo, Francisco Partners and Sunstone Partners all announced acquisitions in the fourth quarter of 2022 that were financed without third-party debt.

Primary Market Institutional First-Lien Loan Spreads

Average spreads over benchmark rates on first lien institutional loans for large corporate leveraged loan transactions were 354 bps in the fourth quarter of 2022, 38 bps tighter than the 392 bps average spread in the trailing twelve month period.

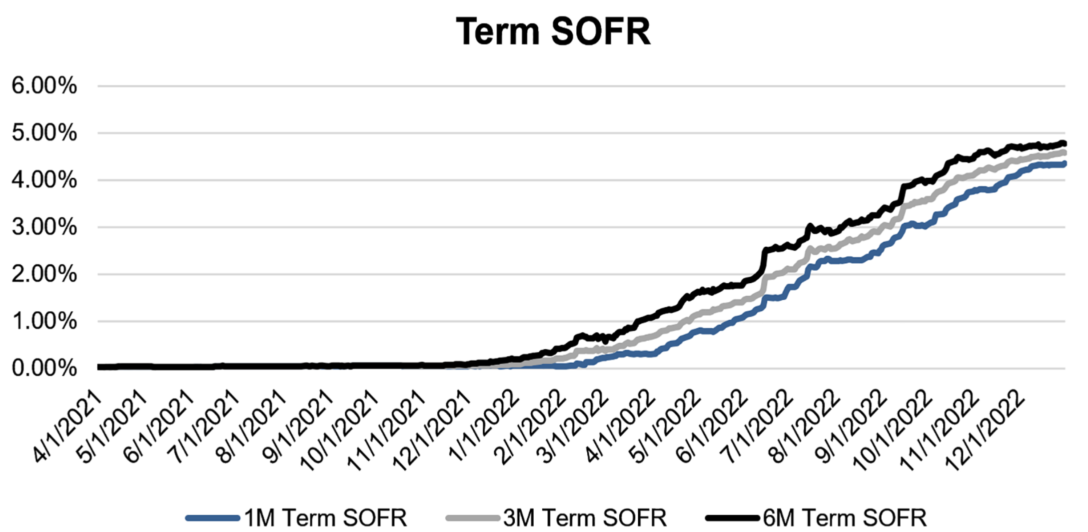


Note: Middle market is defined as borrowers with an annual EBITDA of less than $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments. As of January 24, 2023, LCD reported no middle market first lien institutional loans in March 2022 or in the third and fourth quarters of 2022.

DATA SOURCE Leveraged Commentary & Data (LCD)

Term SOFR Reference Rate

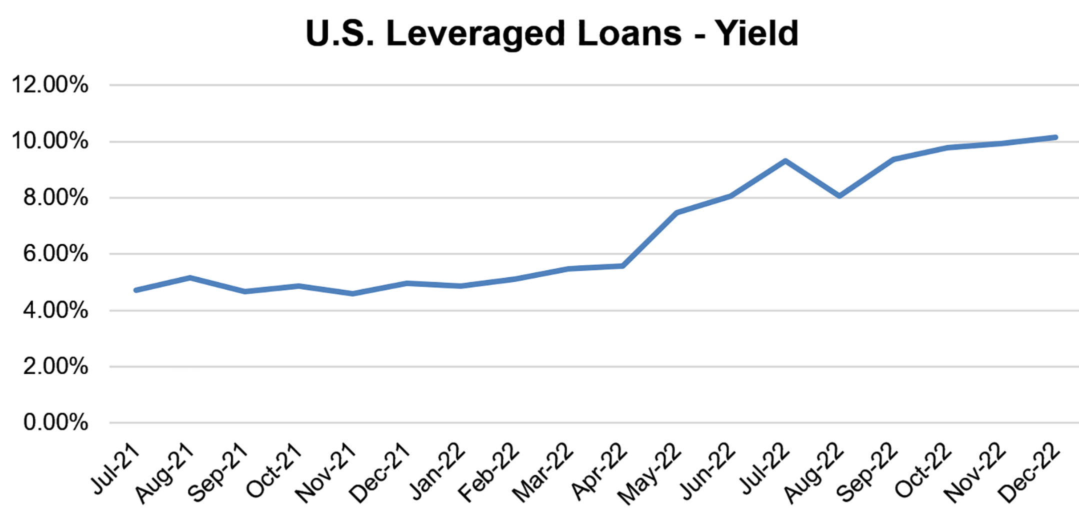
While spreads over benchmark tightened in the fourth quarter of 2022, benchmark rates increased. Term SOFR ended the fourth quarter of 2022 at 4.36%, 4.59% and 4.78% for the one-month, three-month and six-month tenors, respectively, for an increase of 132 bps, 99 bps and 79 bps, respectively, compared with the end of the third quarter of 2022.



SOURCE Bloomberg Finance L.P.

Primary Market Institutional First-Lien Loan Yields

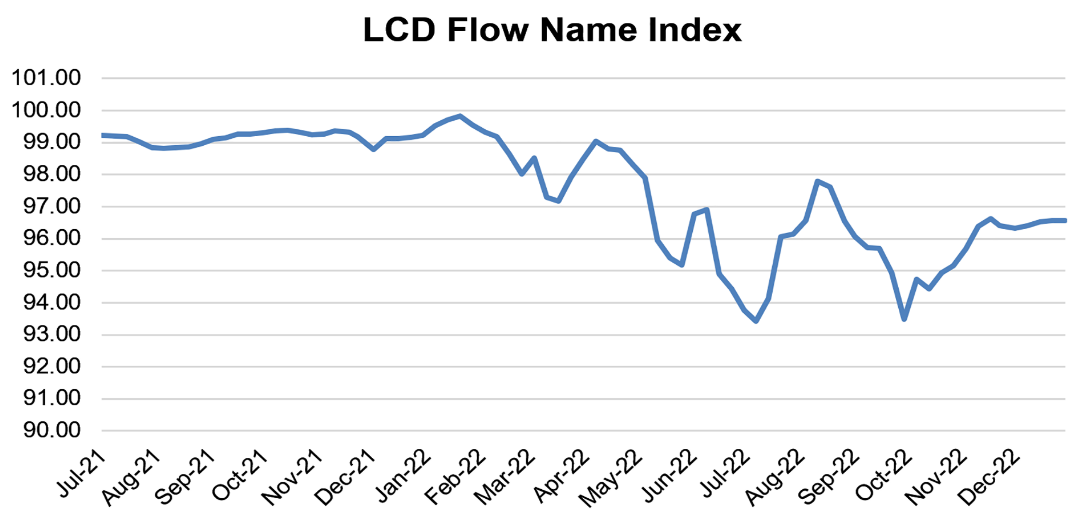
Yields on new-issue institutional first lien term loans continued to rise in the fourth quarter of 2022, with the average yield rising above 9.8% in October 2022 for an increase of approximately 492 bps year-over-year. The average yield remained above 9.9% in November 2022 and December 2022 for an increase of approximately 532 bps and 519 bps year-over-year, respectively.



DATA SOURCE Leveraged Commentary & Data (LCD)

Secondary Market Pricing

The average bid price of the LCD Flow Name Index increased in the fourth quarter of 2022 as compared to the third quarter of 2022 but decreased as compared to the end of 2021, with a decrease of over 267 bps year-over-year.

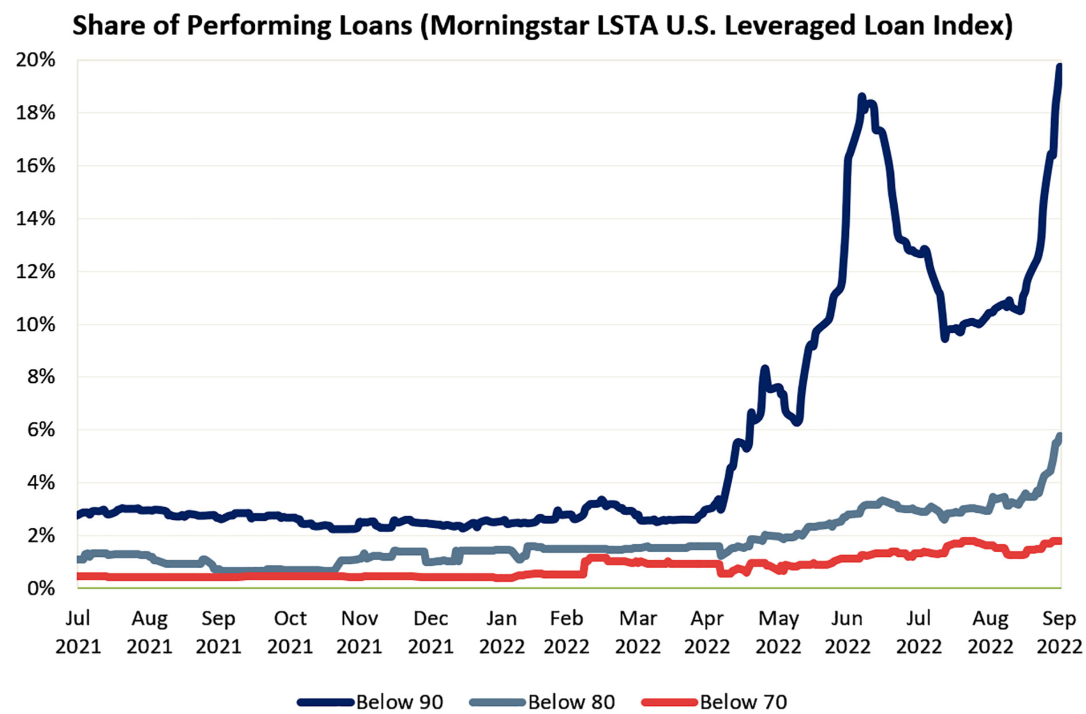


DATA SOURCE Leveraged Commentary & Data (LCD)[1]

1 The LCD Flow Name Index is a composite index of fifteen institutional borrower names published on a twice-weekly basis by Leveraged Commentary & Data (LCD).

Share of Performing Loans

The percentage of loans in the Morningstar LSTA U.S. Leveraged Loan Index priced below 90 cents on the dollar dipped before rising dramatically at the end of the third quarter, increasing from 16.19% at the end of the second quarter to 19.74% at the end of the third quarter. The percentage of loans priced below 80 cents on the dollar more than doubled, from 2.81% at the end of the second quarter to 5.79% at the end of the third quarter.

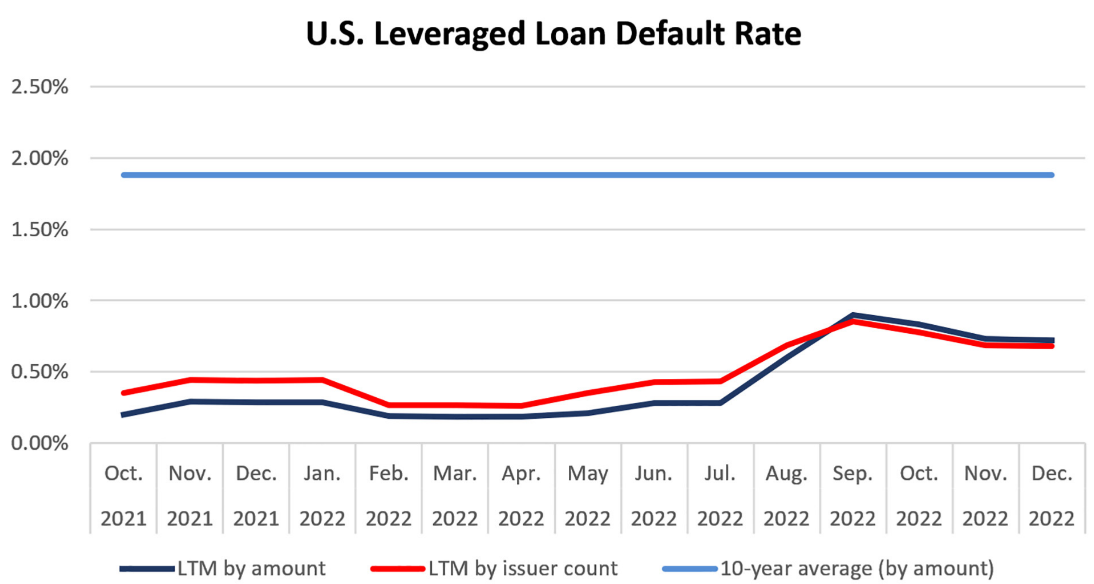


SOURCE Leveraged Commentary & Data (LCD); Morningstar LSTA U.S. Leveraged Loan Index

RESTRUCTURING

U.S. Leveraged Loan Default Rate

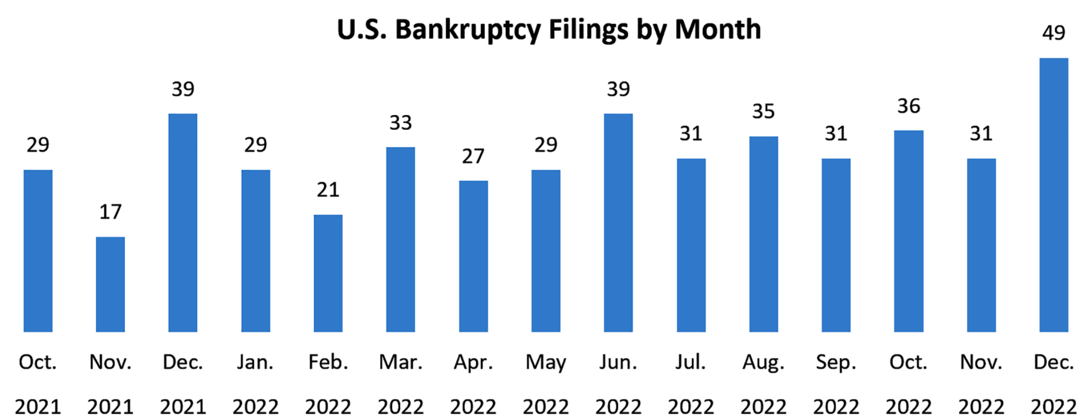
The default rate for U.S. leveraged loans decreased slightly in the fourth quarter. The default rate ended the year at 0.72% by amount and 0.68% by issuer count for the LTM period ending December 31, 2022, compared to 0.90% by amount and 0.85% by issuer count for the LTM period ending September 30, 2022.



DATA SOURCE Leveraged Commentary & Data (LCD); Morningstar LSTA U.S. Leveraged Loan Index

U.S. Bankruptcy Filings

The number of U.S. bankruptcy filings remained relatively stable through most of the fourth quarter, but saw a significant increase in December. The industrials, consumer discretionary and healthcare sectors had the most filings in 2022.



Note: Bankruptcy filing data limited to public companies or private companies with public debt where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to $2 million, or private companies where either assets or liabilities at the time of the bankruptcy filing are greater than or equal to $10 million.

DATA SOURCE S&P Global Market Intelligence

Regulatory Updates

SEC Adopts Amendments to Rule 10b5-1 and Adds Insider Trading-Related Disclosures

On December 14, 2022, the SEC adopted final rules to amend Rule 10b5-1 and provide additional conditions to reliance on the affirmative defense provided by that rule to violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. The final rules also impose new disclosure requirements on public companies to (1) describe and file their insider trading policies, (2) provide additional narrative and tabular disclosure about compensatory incentive awards in certain situations and (3) disclose information about the use of Rule 10b5-1 plans and other trading arrangements by officers and directors on a quarterly basis. Lastly, the final rules add a mandatory check box to Forms 4 and 5 to require reporting insiders to indicate whether the transaction is pursuant to a plan intended to satisfy the Rule 10b5-1 affirmative defense and mandate the disclosure of bona fide gifts of securities to be reported on Form 4. The amendments to Rule 10b5-1 will be effective on February 27, 2023. The new Item 408 of Regulation S-K which requires disclosure of insider trading policies and the new Item 402(x) of Regulation S-K which requires disclosure related to compensatory incentive awards are effective in the first filing that covers the first full fiscal period that begins on or after April 1, 2023 for companies other than smaller reporting companies. In practice, this means that for companies with calendar year end, disclosure about insiders' use of Rule 10b5-1 plans and other trading arrangements will be required in the Form 10-Q filed for the second quarter of 2023 and disclosure of insider trading policies and compensatory incentive awards will be required in the Form 10-K covering fiscal year 2023 and the 2024 proxy statement, in each case to be filed in 2024. Section 16 reporting persons must disclose the bona fide gifts of securities on Form 4 for gifts made on or after February 27, 2023. The disclosure requirement upon Section 16 reporting persons to check a box indicating if the transaction is related to a 10b5-1 trading plan is effective for Forms 4 or 5 filed on or after April 1, 2023.

For further discussion of these amendments, see our memo published on December 20, 2022.

SEC Provides Additional Compliance and Disclosure Interpretations for Non-GAAP Financial Measures

On December 13, 2022, the SEC Division of Corporation Finance updated its compliance and disclosure interpretations ("CDIs") for Non-GAAP Financial Measures by amending CDI questions 100.01, 100.04 and 102.10(a) and providing new CDI questions 100.05, 100.06, 102.10(b) and 102.10(c).

- CDI Question 100.01 clarifies that presenting a non-GAAP performance measure that excludes normal, recurring, cash operating expenses necessary to operate an issuer's business is an example of an adjustment, that although not explicitly prohibited, could result in a non-GAAP measure that is misleading.
- CDI Question 100.04 notes that a non-GAAP measure can violate Rule 100(b) of Regulation G if the recognition and measurement principles used to calculate the measure are inconsistent with GAAP, and provides examples of such misleading presentations.
- CDI Question 100.05 provides that a non-GAAP measure can be misleading if any adjustment made to it or the GAAP measure is not labeled or described.

- CDI Question 100.06 states that a non-GAAP measure can violate Rule 100(b) of Regulation G and be misleading, even if it includes extensive, detailed disclosure about the nature and effect of each adjustment made to the most directly comparable GAAP measure.
- CDI Question 102.10(a) is amended to provide new examples of disclosure where a non-GAAP measure would be more prominent than the most directly comparable GAAP measure, which would violate Item 10(e)(1)(i)(A) of Regulation S-K which requires an issuer that presents a non-GAAP measure to present the most directly comparable GAAP measure with equal or greater prominence.
- CDI Question 120.10(b) offers examples of disclosures that would cause the non-GAAP reconciliation to be more prominent than the most directly comparable GAAP measure, which would violate Item 10(e)(1)(i)(A) of Regulation S-K.
- CDI Question 120.10(c) explains that the SEC staff will consider an income statement that is comprised of non-GAAP measures and includes most or all line items and subtotals typically found in a GAAP income statement to be a non-GAAP income statement.

These CDIs generally reflect positions taken by the Division of Corporation Finance in recent comment letters, meetings and speeches, though the new CDIs (particularly CDI questions 100.01 and 100.06) may have a significant effect on the ability for some registrants to make non-GAAP adjustments in the same manner they have previously.

Excise Tax on Stock Buybacks

On December 27, 2022, the IRS released Notice 2023-2 providing interim guidance on the application of the new 1% excise tax on stock buybacks imposed by the Inflation Reduction Act.

The 1% excise tax applies to stock repurchases by publicly traded U.S. corporations occurring after December 31, 2022. The excise tax is equal to 1% of the fair market value of any stock repurchased by the corporation (or an affiliate) during the taxable year, net of any issuances by the corporation during the same year. There are certain exceptions, including (i) repurchases that are part of a reorganization, (ii) where the total value of the stock repurchased during a taxable year does not exceed $1 million and (iii) to the extent the repurchases are treated as a dividend.

Notice 2023-2 provides helpful clarification as to the application of the excise tax. On the one hand, the notice clarifies that certain common M&A transactions will generally not result in an excise tax liability. For instance, stock repurchased as part of tax-free reorganizations, spin-offs and split-offs are not included in the excise tax base, although the inclusion of cash consideration in these transactions may trigger tax. Similarly, distributions in a complete liquidation of a corporation (such as a SPAC) are exempt from the excise tax, as are any other distributions by that corporation in the year of liquidation.

On the other hand, Notice 2023-2 confirms that many common M&A transactions will present excise-tax sensitivities. For instance, the payment of cash deal consideration will be treated as a redemption for excise tax purposes to the extent it is funded with debt at the target level (*i.e.*, an LBO structure). Similarly, there is no exemption for redemptions of preferred stock (even if those redemptions are pursuant to the preferred stock's terms).

Taxpayers may rely on the guidance in Notice 2023-2 until Treasury issues forthcoming proposed regulations.

Litigation Developments

Supreme Court Grants Review of Slack Direct Listing Case

On December 13, 2022, the Supreme Court of the United States agreed to hear an appeal of a decision by the United States Court of Appeals for the Ninth Circuit in *Slack Technologies, LLC v. Pirani*. The case addresses the question of who has standing to sue under Sections 11 and 12(a)(2) of the Securities Act of 1933, as amended (the "Securities Act"). Section 11 of the Securities Act allows investors to bring claims based on false or misleading statements in a registration statement and Section 12(a)(2) of the Securities Act allows investors to bring claims based on false or misleading statements in a prospectus or oral communication. Historically, courts have required that plaintiffs show that the security purchased was issued under, and directly traceable to, the particular registration statement in question to bring a Section 11 claim. Similarly, to bring a claim under Section 12(a)(2), courts have historically required plaintiffs to show that the security in question was purchased "by means of a prospectus or oral communication" from a statutory seller who either directly passed title to or actively solicited a sale of the security.

Slack Technologies, Inc. ("Slack") went public on the New York Stock Exchange in 2019 through a direct listing. In the direct listing, a certain number of shares were registered under the registration statement filed by Slack and sold on the exchange at the same time unregistered shares were sold on the exchange by existing shareholders as permitted by SEC Rule 144. Applying long-standing "tracing" doctrine to Slack's direct listing could arguably mean that no plaintiff could have standing to sue under Section 11 or 12(a)(2) of the Securities Act, because it would be impossible to show that the purchased shares were issued under an allegedly misleading registration statement or purchased by means of an allegedly misleading prospectus.

As discussed in the Q3 2021 edition of this newsletter, the district court's decision in the case, which found that shareholders who purchased shares of Slack following Slack's direct listing had standing under the Securities Act to file suit under Section 11 for statements made in Slack's registration statement for the direct listing, was affirmed by the Ninth Circuit in September 2021. Slack petitioned for certiorari, arguing that every other court of appeals to consider the question has held, under the "tracing" doctrine mentioned above, that plaintiffs bringing claims under Sections 11 and 12(a)(2) of the Securities Act must prove that the securities purchased were issued under an allegedly misleading registration statement. The Supreme Court granted certiorari on December 13, 2022 to resolve the split in authority created by the Ninth Circuit's decision.

Delman v. GigAcquisitions3, LLC, et al.

On January 4, 2023, the Delaware Court of Chancery denied a motion to dismiss relating to claims against GigCapital3, Inc., a Delaware SPAC ("GigCapital3"), and GigAcquisitions3, LLC, GigCapital3's sponsor (the "Sponsor"), which alleged that GigCapital3's directors and the Sponsor breached their fiduciary duties in connection with a de-SPAC transaction by depriving public stockholders of information necessary to decide whether to redeem their shares or to invest in the combined company.

GigCapital3's definitive proxy statement for the de-SPAC transaction (the "Proxy") with Lightning eMotors Inc. ("Lightning"), filed on March 22, 2021, contained financial projections prepared by Lightning's management that forecast dramatic growth over the next five years. On May 17, 2021, after the de-SPAC transaction was consummated, the combined company reduced its 2021 revenue guidance, decreasing its projected revenue by 12.7% compared to the financial projections contained in the Proxy.

In denying the motion to dismiss, the court noted that (1) disclosure in GigCapital3's prospectus of the facts creating a conflict of interest for the defendants did not foreclose fiduciary duty claims the plaintiffs may have under Delaware law on the basis of those facts and (2) it is reasonably conceivable that, in connection with the de-SPAC transaction, the defendants breached their fiduciary duty of disclosure under Delaware law (derived from the duties of care and loyalty), by failing to disclose information necessary for the plaintiff to decide whether to redeem or to invest in the combined company. The court also noted that the Proxy was misleading because it did not accurately disclose the net cash per share to be invested in GigCapital3's target, and also provided "lofty projections" of the target that "were not counterbalanced by impartial information" showing what stockholders "could realistically expect from the combined company".

Restructuring Updates

Fraudulent Transfer Litigation: In re Tops Holding II Corporation

On October 12, 2022, Bankruptcy Judge Robert D. Drain of the Southern District of New York, issued the final opinion of his judicial career in the bankruptcy cases of supermarket chain Tops Holdings II Corporation ("Tops") and its affiliated debtors. In his ruling, Judge Drain declined to dismiss an adversary proceeding initiated by the Tops post-confirmation litigation trustee against certain private equity investors ("PE Investors") seeking avoidance of four dividend payments totaling $375 million as constructive and actual fraudulent transfers and damages for breach of fiduciary duties.

As background, in 2007, the PE Investors purchased Tops for $300 million, using $200 million of debt and $100 million of equity. Following this acquisition, Tops paid four dividends totaling $375 million to the PE Investors in 2009, 2010, 2012 and 2013, all funded with senior secured debt. It is alleged that at the time these dividends were paid, the PE Investors relied on solvency opinions they knew or should have known underestimated liabilities (particularly Tops's substantial contingent pension-related liabilities) and overestimated the business's value. After allegedly paying out more than the business's full equity value in the form of dividends, the PE Investors sold the business to management for a relatively small amount in December 2013. In 2018, the company filed for bankruptcy and in the same year confirmed a plan of reorganization that left substantial creditor losses and created a litigation trust to try to get some of those losses back from the PE Investors and former directors.

The first notable aspect of Judge Drain's opinion is that he did not dismiss causes of action for constructive fraudulent conveyance relating to dividends paid out in 2009 and 2010, despite the fact that such claims are facially time-barred by the then-applicable six-year lookback period under New York fraudulent transfer law. Since Tops did not file for bankruptcy until February 2018, presumably any transfers occurring before February 2012 should have been safe from litigation. Unfortunately for the PE Investors, that is not how the court ruled. Rather, looking to Section 544(b) of the Bankruptcy Code, the court found that the litigation trustee is permitted to step into the shoes of any creditor with an allowable unsecured claim and avoid any claim avoidable by that creditor. Judge Drain held that since the IRS was a creditor of Tops, and since the U.S. Government is not subject to state statutes of limitation under the doctrine of *nullum tempus occurrit regi*, the six-year statute of limitations is not applicable to the litigation trustee when it steps into the shoes of the IRS, and therefore its claims relating to the 2009 and 2010 dividends were not time-barred. Though perhaps a surprising result to some, Judge Drain's analysis is consistent with a substantial majority of bankruptcy courts that have examined this issue.

The second notable aspect of Judge Drain's opinion is that he rejected arguments by the PE Investors that because they were paid out as part of an integrated transaction with issuances of senior secured notes, the dividends were safe harbored from fraudulent transfer litigation by Section 546(e) of the Bankruptcy Code, which provides a safe harbor for qualifying transactions, including "settlement payments" under "securities contracts", made by qualifying entities, including "financial institutions" (which term includes customers of financial institutions when the financial institution is acting as agent or custodian in connection with the securities contract in question). Judge Drain referred to the Supreme Court's decision in *Merit Management Group, LP v. FTI Consulting* in his explanation as to why the dividends were not "settlement payments", explaining that the Section 546(e) analysis should focus on the specific overarching transaction the trustee aims to avoid, and not at component parts that might be safe harbored. Because the dividends in isolation were not settlement payments, they are not safe harbored, notwithstanding their payment in connection with notes issuance transactions that did involve settlement payments. He also declined to find that the PE Investors or Tops were "financial institutions" qualified to use the Section 546(e) safe harbor, due to the fact that there was apparently no documented paying agent or custodianship agreement with the banks transferring the money from the secured lenders to Tops and the PE Investors, and such documented arrangements had been in existence in other recent cases extending the Section 546(e) safe harbor to customers of financial institutions.

Judge Drain's opinion serves as a valuable reminder that dividend recapitalization transactions may be subject to later attack if a bankruptcy occurs, even if solvency opinions are obtained in connection with the transaction, and that state law statutes of limitations might not provide as much protection as they appear (given that the IRS will almost always be a creditor of operating businesses). Additionally, to the extent the Section 546(e) safe harbor may be applicable to a transaction, it is important to ensure that agency and custody relationships with banks are adequately documented to increase the likelihood that the transaction parties will be treated as "financial institutions" for the purpose of the safe harbor.

Ownership of Crypto Accounts: In re Celsius Network LLC

On January 4, 2023, Bankruptcy Judge Martin Glenn of the Southern District of New York held in the chapter 11 cases of Celsius Network LLC and its affiliated debtors that as a general matter, funds deposited in "Earn" accounts on Celsius's crypto platform are property of the bankruptcy estate and are not customer property. Judge Glenn's decision was applicable only to Earn accounts, and not "custody" or "withhold" accounts, which were stipulated by the main parties in interest to be customer property and not property of the bankruptcy estate (subject to the bankruptcy estate's preference claims stemming from transfers to those accounts from Earn accounts). As of July 10, 2022 (shortly before Celsius filed for bankruptcy), customers had approximately 600,000 accounts in Celsius's Earn program, which accounts collectively held cryptocurrency assets with a market value of $4.2 billion. Customers who deposited assets in the Earn program earned high rates of interest, and Celsius was able to pay this interest for a time by investing these assets, primarily by loaning them to third parties.

In order to deposit assets in Earn accounts, customers were required to agree to "clickwrap" terms of use, and in order to access their Earn accounts, had to agree to new terms of use every time they changed. These terms of use unambiguously stated that all assets deposited in the Earn program were property of Celsius and not of the customer. Judge Glenn held that the clickwrap terms of use were enforceable as a matter of New York law, and he found that over 99% of Earn customers had agreed to them. For that reason, he held that assets in Earn accounts are property of the bankruptcy estate, subject to individualized contract formation defenses any account holder may have.

At the beginning of the current crypto downturn, there was significant concern and speculation that depositors on crypto platforms would be treated as general unsecured creditors in future bankruptcy cases. At least in this case where there were clear terms of use supporting that treatment, that has become a reality. It will be interesting to see how courts deal with situations where the terms involved are more ambiguous, or where such terms unambiguously state that the assets belong to customers, but the debtor has commingled customer assets with other assets.

Crypto Updates

SEC Releases Sample Letter on Recent Developments in Crypto Asset Markets

In light of ongoing bankruptcies and financial risks that have plagued crypto asset market participants and caused distress in the crypto asset markets, on December 8, 2022, the SEC's Division of Corporation Finance released an illustrative letter containing sample comments that it may issue to companies who are directly or indirectly impacted by such events. For example, the Division of Corporation Finance has asked, if applicable, for companies to disclose:

- significant crypto market asset developments that are material to an issuer's business, financial condition and results of operation and share price, including any impact that can be attributed to the price volatility of crypto assets;
- how bankruptcies of any crypto asset market participants have impacted or may impact, directly or indirectly, the issuer's business, financial condition, customers and counterparties, including if any material assets may fail to be recovered, or be lost or misappropriated as a result of bankruptcies;
- any exposures, direct or indirect, to other companies, customers, custodians or other crypto asset market participants who are in the midst of a bankruptcy, have experienced excessive or suspended redemptions of crypto assets, have unaccounted crypto assets or have experienced material corporate compliance failures;
- steps taken to safeguard the issuer's customers' crypto assets, including any policies or procedures to prevent self-dealing, conflicts of interests and commingling of assets and any changes made to such policies or procedures in light of the current crypto asset environment;
- any excessive redemptions or withdrawals of crypto assets, including any related suspensions, and its potential impact on the issuer's financial condition and liquidity;
- whether crypto assets serve as collateral for loans, margins, rehypothecations or similar activities that the issuer or its affiliates are a party to and if so, the identity and quantity of the crypto assets used in the arrangement, as well as the nature of the relationship with the other parties and any encumbrances on the collateral;
- whether crypto assets that have been issued serve as collateral for another person's or entity's loans, margins, rehypothecations or similar activities and if so, whether the current crypto asset environment has impacted the value of the collateral and its potential impact

on the issuer's financial condition and liquidity; and

- risk factors as a result of the current crypto asset environment, such as material risks arising from:
    - excessive or suspended redemptions or withdrawals of crypto assets;
    - reputational harm, including how the issuer's business is perceived by customers, counterparties and regulators;
    - unauthorized or impermissible customer access to products and services outside jurisdictions in which the issuer has obtained the requisite government licenses and authorizations;
    - regulatory developments, including material pending crypto asset regulation and legislation that may have a material impact on the issuer's business financial condition and results of operation;
    - any assertion of jurisdiction by regulators and government entities over the issuer's crypto assets and markets;
    - failing to safeguard the issuer's, its affiliates' or its customers' crypto assets, including the impact of any ineffective policy or procedure to prevent self-dealing, conflicts of interests and commingling of assets;
    - gaps that the issuer's board of directors or management has identified in the risk management of crypto assets;
    - using crypto assets as collateral, either by the issuer or others; and
    - depreciation in the issuer's stock price, loss in customer demand for products and services, equity and debt financing, increased losses or impairments of the issuer's investments or assets, legal proceedings and government investigations against the issuer or its affiliates and price volatility of crypto assets.

SEC v. LBRY, Inc.

On November 7, 2022, the U.S. District Court for the District of New Hampshire granted summary judgment in favor of the SEC in its enforcement action against New Hampshire-based LBRY, Inc. Specifically, the District Court found that LBRY's offer and sale of its cryptotokens (LBRY Credits or "LBC") constituted an unregistered securities offering, and, as a result, a violation of Section 5 of the Securities Act.

LBRY had contended that LBC constituted a utility token rather than a security because it facilitated Web3 video and image sharing without the need for a centralized provider such as YouTube. LBC rewarded "miners" on the LBRY network and could be spent to publish media onto the LBRY blockchain, purchase paywall content, and "tip" creators, amongst other uses. Despite recognizing these uses of the token, the District Court stated that there is no contradiction between a token having some consumptive utility and such token also constituting a security, for example, by virtue of its speculative characteristics. The District Court focused on (i) a number of statements made by LBRY to potential investors, including emails and other correspondence, that would lead those investors to reasonably expect that the LBC token would grow in value due to the ongoing efforts of the LBRY team, and (ii) the "objective economic realities" of the transaction over its form. The District Court's decision draws further contours as to how courts may interpret what constitutes a "promoter or third party" under the test for evaluating investment contract securities developed in *SEC v. W.J. Howey Co.* and its progeny. Specifically, the LBRY court held that when token creators retain a significant stake in their issued and outstanding tokens, potential purchasers might reasonably purchase such tokens thinking that those creators will exert efforts to benefit that retained stake.

For further discussion of this case, see our memo published on November 17, 2022.

Chapter 11 Activity

The fourth quarter of 2022 saw a deepening level of distress in the crypto space, driven by a general decline in crypto asset values and contagion stemming from the rapid collapse of FTX, which went from being the third-largest crypto asset exchange in the world, with a valuation in excess of $30 billion, to bankruptcy and criminal fraud charges in a matter of weeks. Due to FTX's prominent role in crypto markets, its rapid demise has caused difficulties for several crypto exchanges, lending platforms, traders and investment funds that have assets locked on the site. Additionally, the collapse of FTX placed downward pressure on the value of cryptocurrencies by shaking institutional and retail confidence in crypto intermediaries, further affecting businesses dependent on high crypto asset prices and trading volumes to remain viable.

Notable crypto-related chapter 11 filings with a direct link to FTX's downfall include: BlockFi Inc., a crypto exchange that had substantial funds locked on FTX US that was forced to stop withdrawals on November 10, 2022 (one day before FTX's chapter 11 filing) and file for chapter 11 protection itself on November 28, 2022; and Genesis Global Capital, LLC ("GGC"), a large crypto platform that stopped withdrawals by depositors participating in its crypto lending and borrowing service on November 16, 2022 (shortly after announcing that it had $175 million of funds locked on FTX), and which filed for chapter 11 protection on January 19, 2023. GGC is also the largest creditor of Three Arrows Capital, with a claim of $1.2 billion against the now-insolvent crypto hedge fund, whose collapse in June 2022 set off an earlier wave of crypto-related bankruptcies.

Other Developments

SEC Requiring Inflation Disclosure

Over the past year, the SEC staff has issued comment letters to public companies urging them to provide additional information in their SEC filings on the impact of inflation on their business. These comment letters were issued as part of the SEC staff's filing review process and have required companies receiving the letters to more extensively disclose the impact of inflation on results of operations, sales, profits, capital expenditures, maintenance and other financial metrics, as well as general business goals and pricing strategies. Likewise, in a September 2022 conference, SEC Acting Chief Accountant Paul Munter stressed the need for banks to take inflationary pressures into account when preparing financial statements, in accordance with FASB ASC Topic 255, Changing Prices.

U.S. Treasury Proposes Releasing More Data on Treasuries Trading

On November 16, 2022, Nellie Liang, the Treasury Department's undersecretary for domestic finance, announced a proposal to enhance public reporting of Treasuries trading data as part of broader efforts by the Treasury Department to strengthen the resilience of the Treasury market. Specifically, the Treasury Department is proposing providing transaction-level data for benchmark, on-the-run securities (*i.e.*, the most recently issued Treasury bonds of a particular maturity), which are the most widely traded Treasury bonds. Although the Treasury

Department has not specified when the new trading data will start being released, Ms. Liang said in her remarks that the release will occur gradually "and in a calibrated way" over the coming months.

SEC Extends Implementation Deadline for Rule 15c2-11 by Two Years

On November 30, 2022, the SEC issued a no-action letter delaying the implementation of the amended Rule 15c2-11 for certain fixed income securities and asset-backed securities until January 4, 2025 (the "November 2022 Letter"). Rule 15c2-11, as amended in 2020, requires that current financial and other information about issuers of securities be publicly available for broker-dealers to quote those securities. Initially, the amended rule was to take effect in September 2021. In response to concerns from issuers and broker-dealers, the SEC issued a no-action letter in December 2021 setting out a phased approach to implementation of the rule, with the first phase to expire on January 4, 2023. The November 2022 Letter states that SEC staff will not recommend enforcement action related to the amended Rule 15c2-11 for the relevant securities for an additional two years, until January 4, 2025.

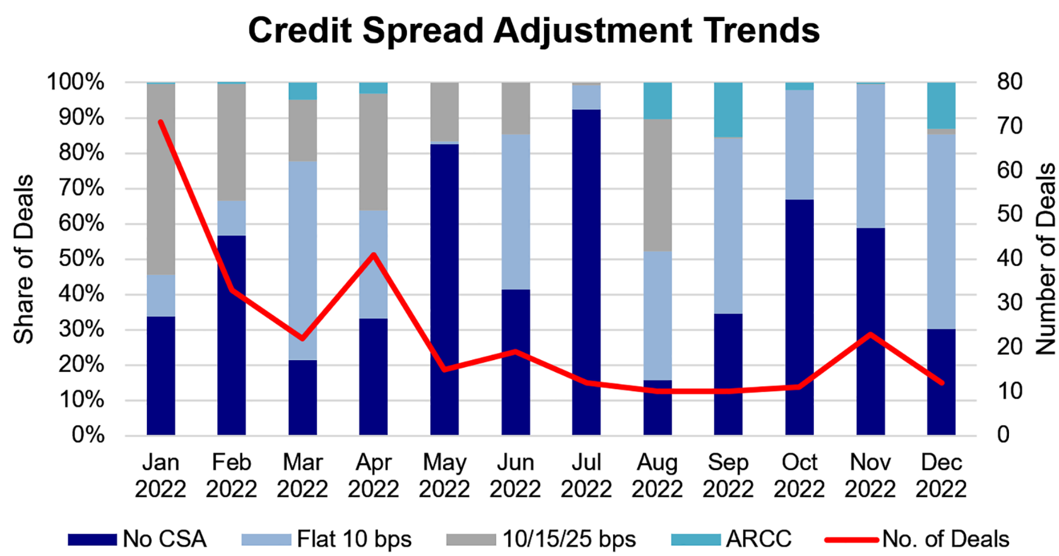
LIBOR Updates

FINAL LIBOR TRANSITION RULE:

On December 16, 2022, the Federal Reserve Board (the "Board") adopted its final rule implementing the Adjustable Interest Rate ("LIBOR") Act by identifying benchmark rates based on SOFR to replace overnight, one-month, three-month, six-month and 12-month LIBOR in contracts subject to the LIBOR Act. These contracts include U.S. contracts that do not mature before LIBOR ceases to be published on June 30, 2023 and that lack adequate fallback provisions that would replace LIBOR with a replacement benchmark rate. The final rule codified safe harbor protections for selection or use of SOFR as a replacement benchmark. The Board also confirmed that LIBOR contracts containing fallback provisions that identify a benchmark replacement are outside of the scope of the LIBOR Act. The final rule will be effective 30 days after publication in the Federal Register.

CREDIT SPREAD ADJUSTMENTS:

Credit spread adjustments ("CSAs"), which are designed to account for the fact that SOFR, as a secured risk-free rate, is generally lower than LIBOR, continue to be a topic of discussion and negotiation between borrowers and arrangers in the fourth quarter of 2022. According to data from Leveraged Commentary & Data (through December 31, 2022), a majority of institutional deals on a dollar-weighted basis in the fourth quarter of 2022 had no CSA (57.9%), an increase as compared to the second quarter (41.2%) and the third quarter (47.2%). With respect to amendments to existing agreements to implement SOFR, Bloomberg recently reported that institutional investors have begun organizing to reject SOFR implementation without ARRC-recommended CSAs, which are 11.448/26.161/42.826 basis points for one-, three- and six-month Term SOFR.



DATA SOURCE Leveraged Commentary & Data (LCD). Deal share calculated on a dollar-weighted basis.

SYNTHETIC LIBOR:

On November 23, 2022, the UK's Financial Conduct Authority (FCA) opened a consultation on its proposal to require "synthetic" dollar-denominated LIBOR for one-, three- and six-month tenors to continue to be published after the June 30, 2023 phase-out until September 30, 2024 for use in certain legacy LIBOR contracts. The FCA's proposal contemplates that synthetic dollar-denominated LIBOR would be based on Term SOFR plus the ARRC-recommended CSAs of 11.448/26.161/42.826 basis points for one , three- and six-month Term SOFR. For older loan agreements with no fallback language, the proposed synthetic LIBOR would benefit borrowers who otherwise would have shifted to the higher prime rate. It would not affect more recent loan agreements with fallback language including a "non-representative" trigger (*i.e.*, a fallback trigger in the event that LIBOR is no longer "representative"). It would affect loan agreements with fallback language without a non-representative trigger. Even still, borrowers that have the ability to opt into SOFR with CSAs determined by reference to market practice (as opposed to being hardwired to the ARRC-recommended CSAs) or have the "amendment approach" to LIBOR replacement may benefit from exercising the early opt-in or amendment process as market practice has trended to lower CSAs than those recommended by ARRC (see above). Borrowers without a non-representative prong and with early opt-in mechanics that are limited to ARRC-recommended CSAs may benefit from a "wait and see" approach, delaying implementation of Term SOFR until they are able to amend or refinance with market-standard CSAs. The dollar-denominated LIBOR consultation closed on January 6, 2023 and the FCA plans to announce its decision on the proposal in the first half of 2023.

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