PAGES 1-16
Market Update

PAGES 17-18
Regulatory Updates

PAGES 19-20
Litigation Developments

PAGES 20-22
Restructuring Updates

PAGES 22-25
Other Developments

PAGE 26
Crypto Updates

Cravath Quarterly Review

FINANCE AND CAPITAL MARKETS

Market Update

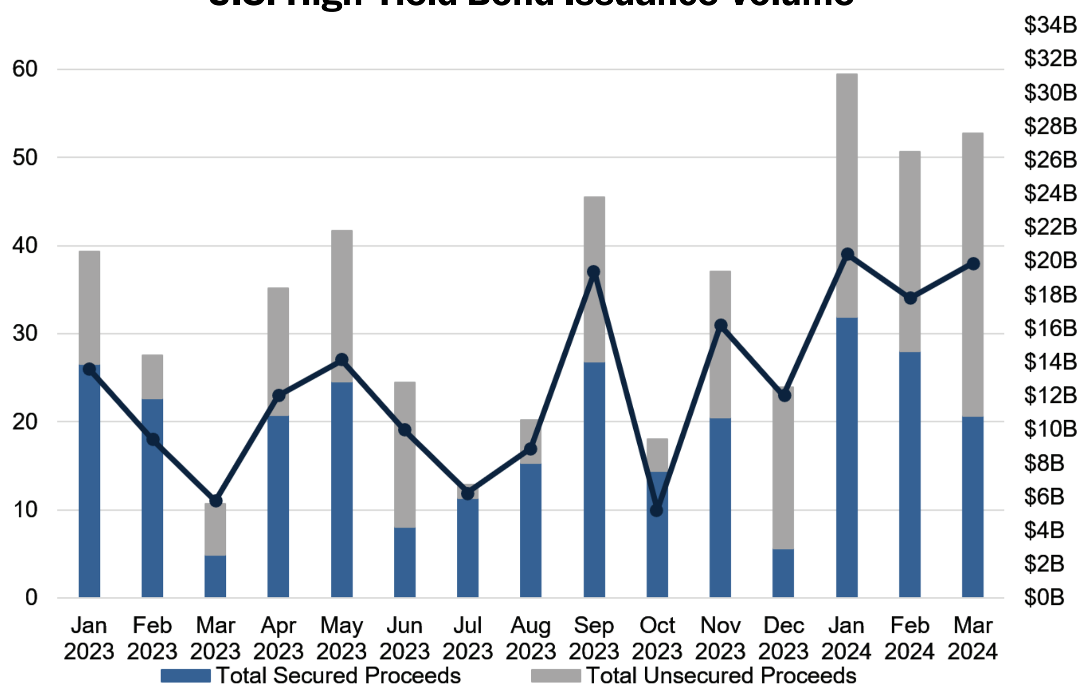
GENERAL TRENDS

U.S. financing activity in the first quarter of 2024 increased considerably compared to the fourth quarter of 2023 and the first quarter of 2023. There was record activity in the U.S. investment-grade bond market, making the first quarter of 2024 the most active first quarter on record. Activity in the U.S. high-yield bond market also increased compared to the fourth quarter of 2023 and the first quarter of 2023. Activity in the U.S. syndicated leveraged loan market (including the leveraged buyout ("LBO") market) increased in the first quarter of 2024 as compared to both the fourth quarter of 2023 and the first quarter of 2023. Activity in the direct lending market slowed down considerably, but continued to outpace the syndicated loan market overall. The number of and total proceeds from U.S. follow-on equity offerings in the first quarter of 2024 increased relative to the fourth quarter of 2024 and the first quarter of 2023. U.S. IPO activity in the first quarter of 2024 increased significantly as compared to the fourth quarter of 2023 and the first quarter of 2023.

BONDS

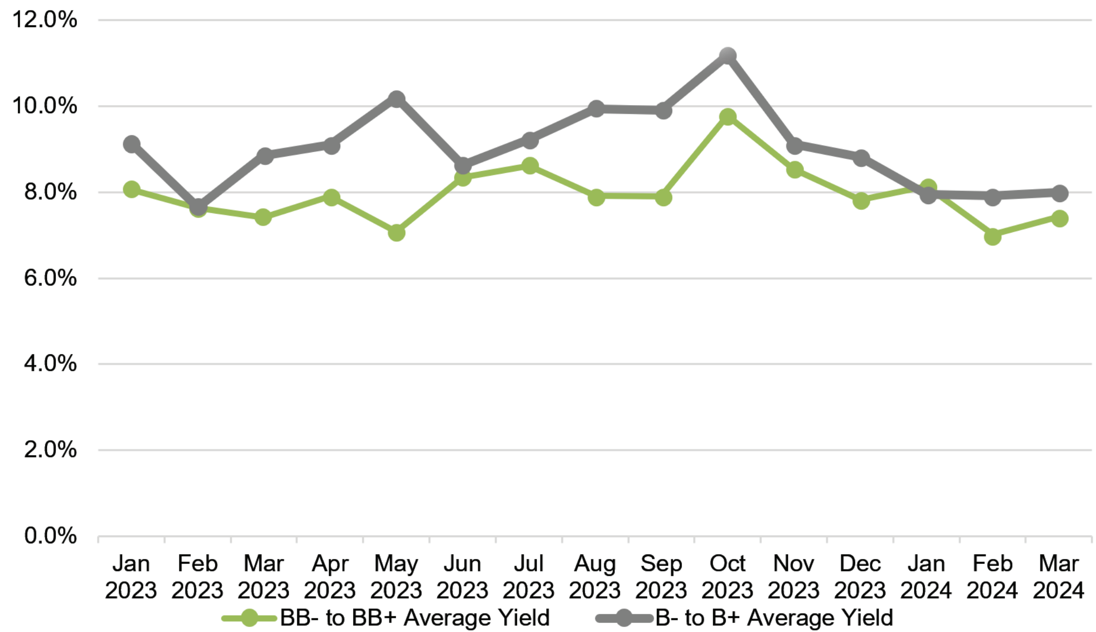
U.S. High-Yield Bonds

Total proceeds from U.S. high-yield bond issuances were $85.2B in the first quarter of 2024, up 106.2% as compared to the fourth quarter of 2023 ($41.3B) and up 109.8% as compared to the first quarter of 2023 ($40.6B). Total proceeds from unsecured bonds were $43.1B in the first quarter of 2024, up 249.3% as compared to $12.3B in the first quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

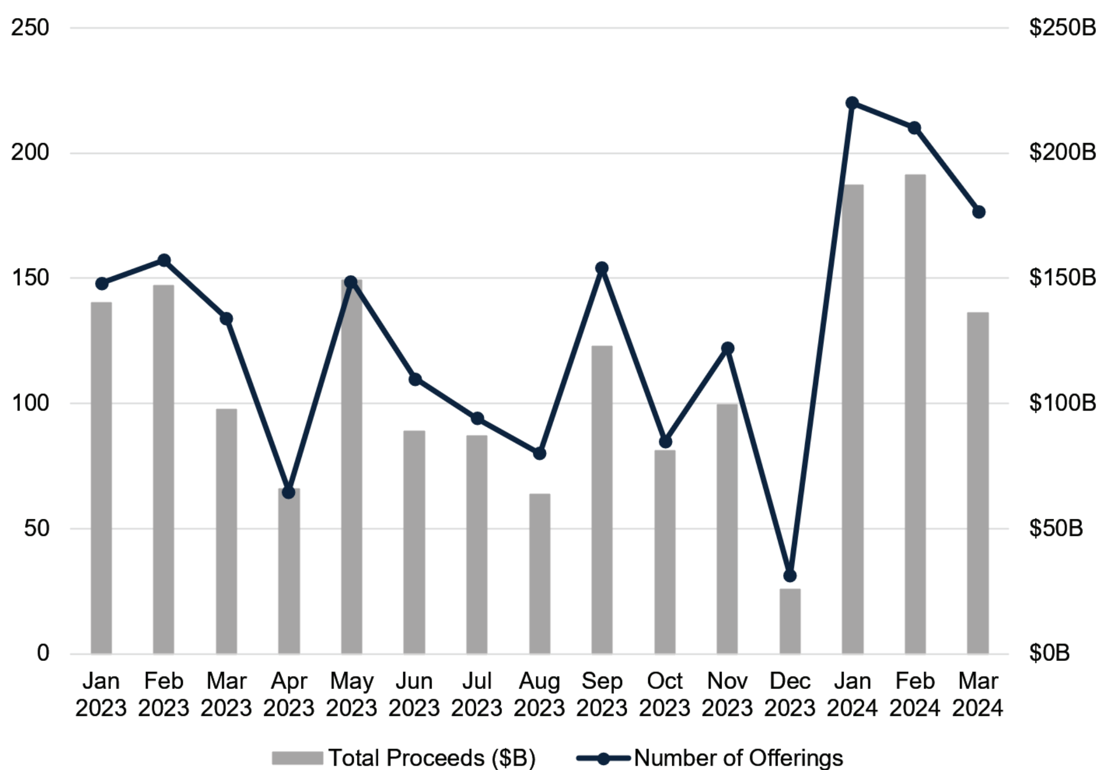
The average initial yield on high-yield notes rated BB- to BB+ issued in the first quarter of 2024 was 7.5%, as compared to 8.7% in the fourth quarter of 2023 and 7.7% in the first quarter of 2023. The average initial yield on high-yield notes rated B- to B+ issued in the first quarter of 2024 was 8.0%, as compared to 9.7% in the fourth quarter of 2023 and 8.5% in the first quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

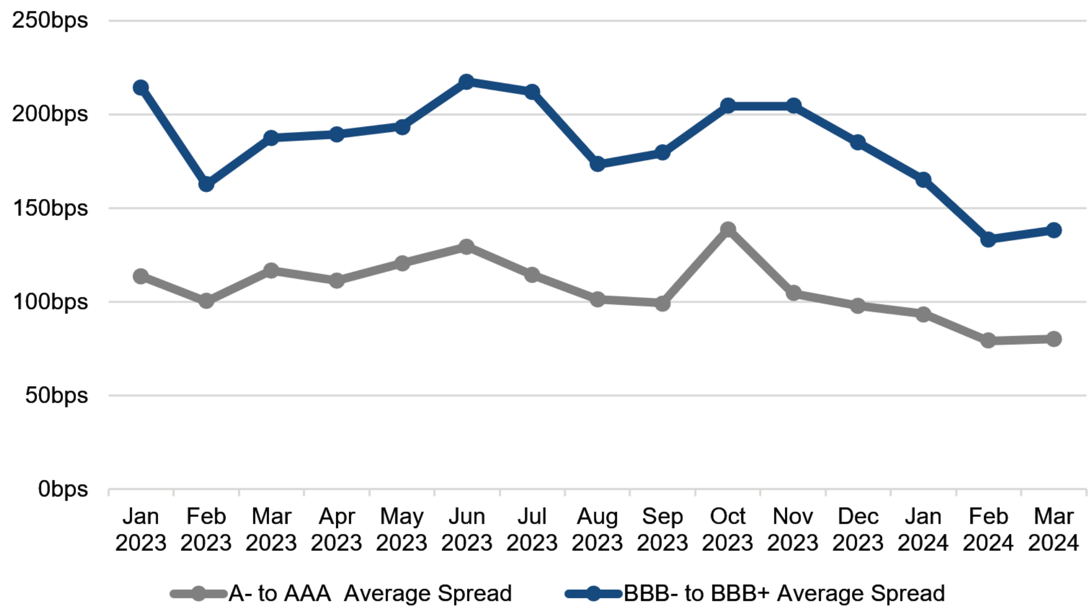
U.S. Investment-Grade Bonds

Total proceeds from U.S. investment-grade issuances were $514.3B in the first quarter of 2024, up 149.6% from $206.1B in the fourth quarter of 2023 and up 33.8% from $384.4B in the first quarter of 2023. Notably, the first quarter of 2024 was the most active first quarter on record for the primary U.S. investment-grade corporate bond market, with sales surpassing the previous record set by the first quarter of 2020.



DATA SOURCE Leveraged Commentary & Data (LCD)

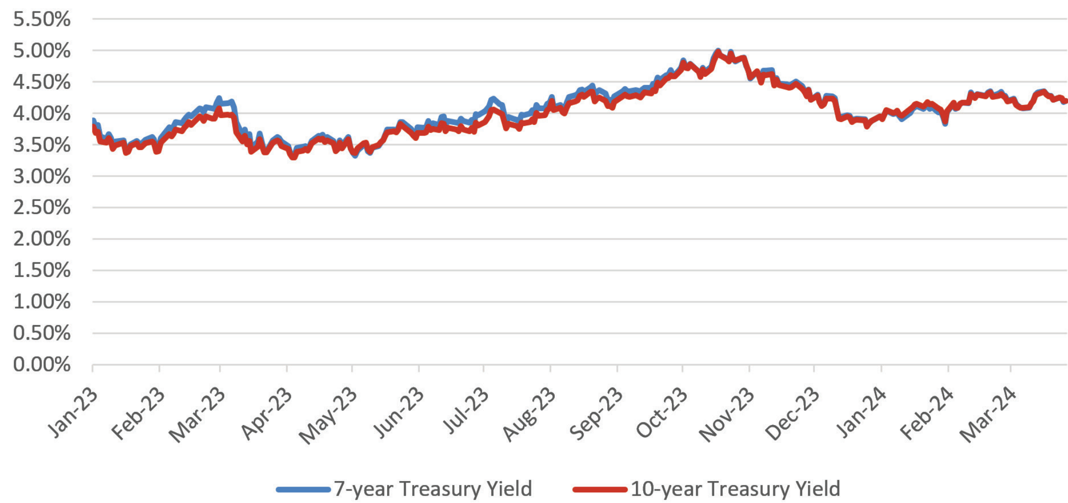
The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated A- to AAA in the first quarter of 2024 decreased 25.8% as compared to the average pricing spread for the fourth quarter of 2023 and decreased 23.5% as compared to the average pricing spread for the first quarter of 2023. The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated BBB- to BBB+ in the first quarter of 2024 decreased 26.5% as compared to the average pricing spread for the fourth quarter of 2023 and decreased 22.7% as compared to the average pricing spread for the first quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

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

Since the Federal Reserve began aggressively increasing interest rates in March 2022, U.S. Treasury yields have significantly increased relative to the historically low rates in 2020. In the first quarter of 2024, the Federal Reserve left interest rates unchanged and generally continued to signal potential rate cuts this year, although expectations for rate cuts during 2024 have since diminished. Both U.S. Treasury 7-year yields and 10-year yields increased 32 bps to 4.2% at the end of the first quarter of 2024, up 8.25% as compared to 3.88% at the end of the fourth quarter of 2023.

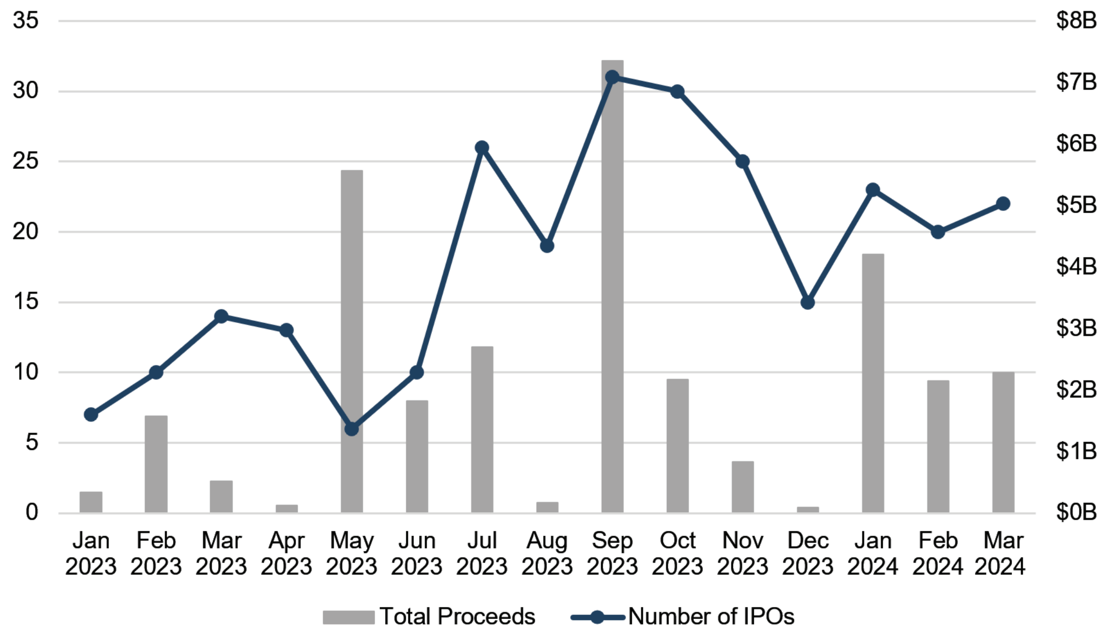


DATA SOURCE U.S. Department of the Treasury

EQUITY

U.S. IPOs

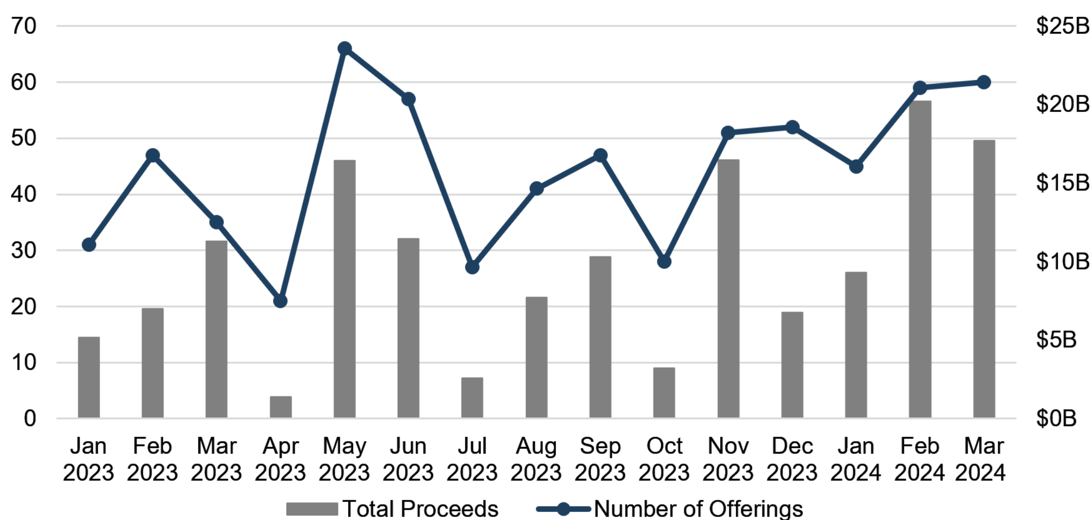
The U.S. IPO market in the first quarter of 2024 was far more active than in the fourth quarter of 2023. The $8.6B in total proceeds from U.S. IPOs (not including SPACs) in the first quarter of 2024 was up 179.9% as compared to $3.1B in total proceeds in the fourth quarter of 2023 and up 290.5% as compared to $2.4B in total proceeds in the first quarter of 2023.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Follow-On Offerings

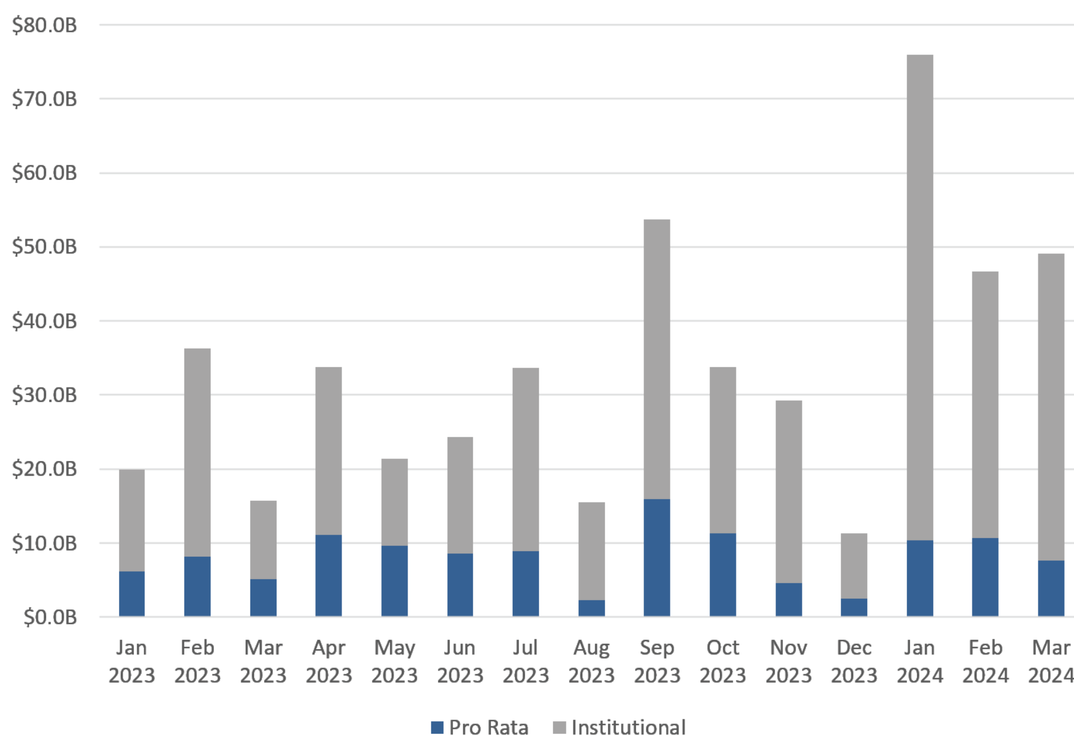
The $47.2B in total proceeds from U.S. follow-on equity offerings in the first quarter of 2024 was up 78.7% as compared to $26.4B in total proceeds in the fourth quarter of 2023 and up 101.5% as compared to $23.4B in total proceeds in the first quarter of 2023.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Syndicated Leveraged Loan Issuances

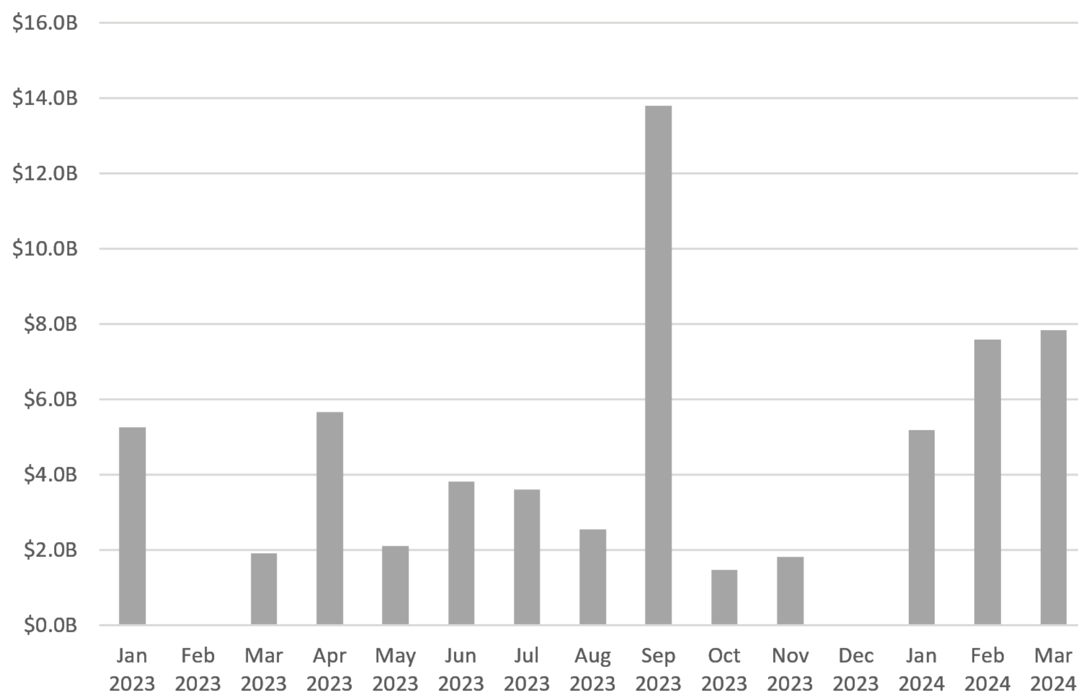
After a relatively slow December, activity in the U.S. syndicated leveraged loan market picked up in the first quarter of 2024, with total volume of $171.8B up 131% as compared to the fourth quarter of 2023 ($74.4B). Both institutional term loans and pro rata loans increased as compared to the previous quarter, up by 155% and 56%, respectively. The trend toward institutional loans making up a larger percentage of total deal volume continued, with institutional loans accounting for 83% of total deal volume in the first quarter of 2024, as compared to 73% in the first quarter of 2023. Total deal volume was also stronger than in the first quarter of 2023, with an increase in total deal volume of 139% as compared to the first quarter of 2023 ($71.9B), driven by institutional loan volume, which was $143.0B in the first quarter of 2024, up 173% as compared to the first quarter of 2023 ($52.4B). Total pro rata loan volume also increased to $28.7B in the first quarter of 2024, up 47% as compared to the first quarter of 2023 ($18.5B).



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Syndicated LBO Loan Volume

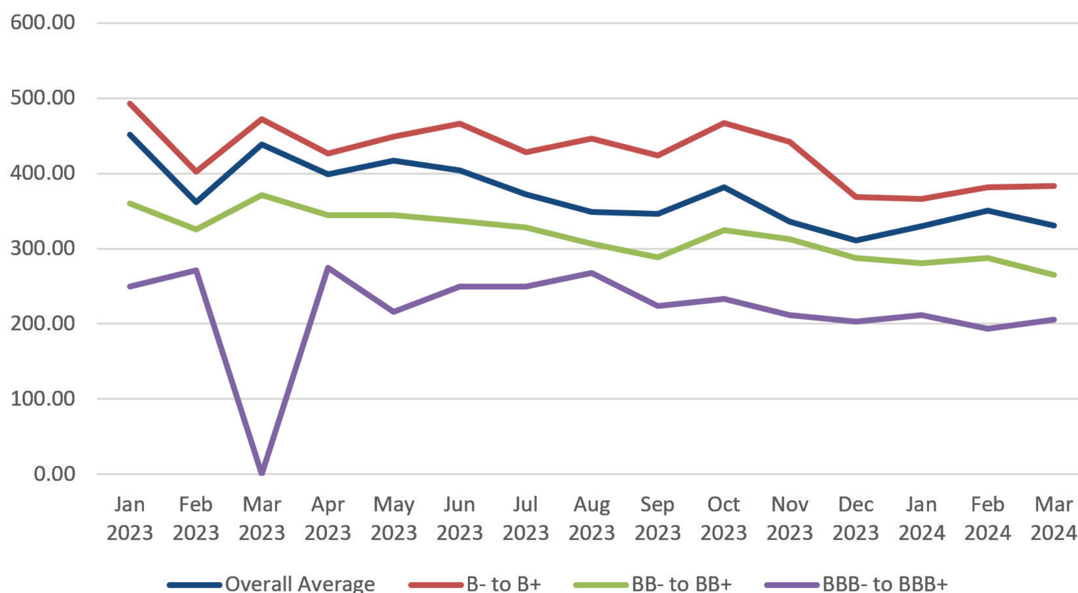
In the first quarter of 2024, there were $20.6B of U.S. syndicated LBO loans issued, which was an increase of 530% as compared to $3.3B in the fourth quarter of 2023 and an increase of 188% as compared to $7.1B in the first quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

Primary Market Syndicated Institutional First-Lien Loan Spreads

Average spreads over benchmark rates on syndicated first lien institutional loans for large corporate leveraged loan transactions were 337 bps in the first quarter of 2024, which is lower than the 380 bps average spread in the trailing 12-month period. Specifically, average spreads over benchmark rates on syndicated first lien institutional loans to borrowers rated (a) B- to B+ were 377 bps in the first quarter of 2024, which is lower than the 440 bps average spread in the trailing 12-month period, (b) BB- to BB+ were 278 bps in the first quarter of 2024, which is lower than the 327 bps average spread in the trailing 12-month period and (c) BBB- to BBB+ were 204 bps in the first quarter of 2024, which is lower than the 239 bps average spread in the trailing 12-month period.

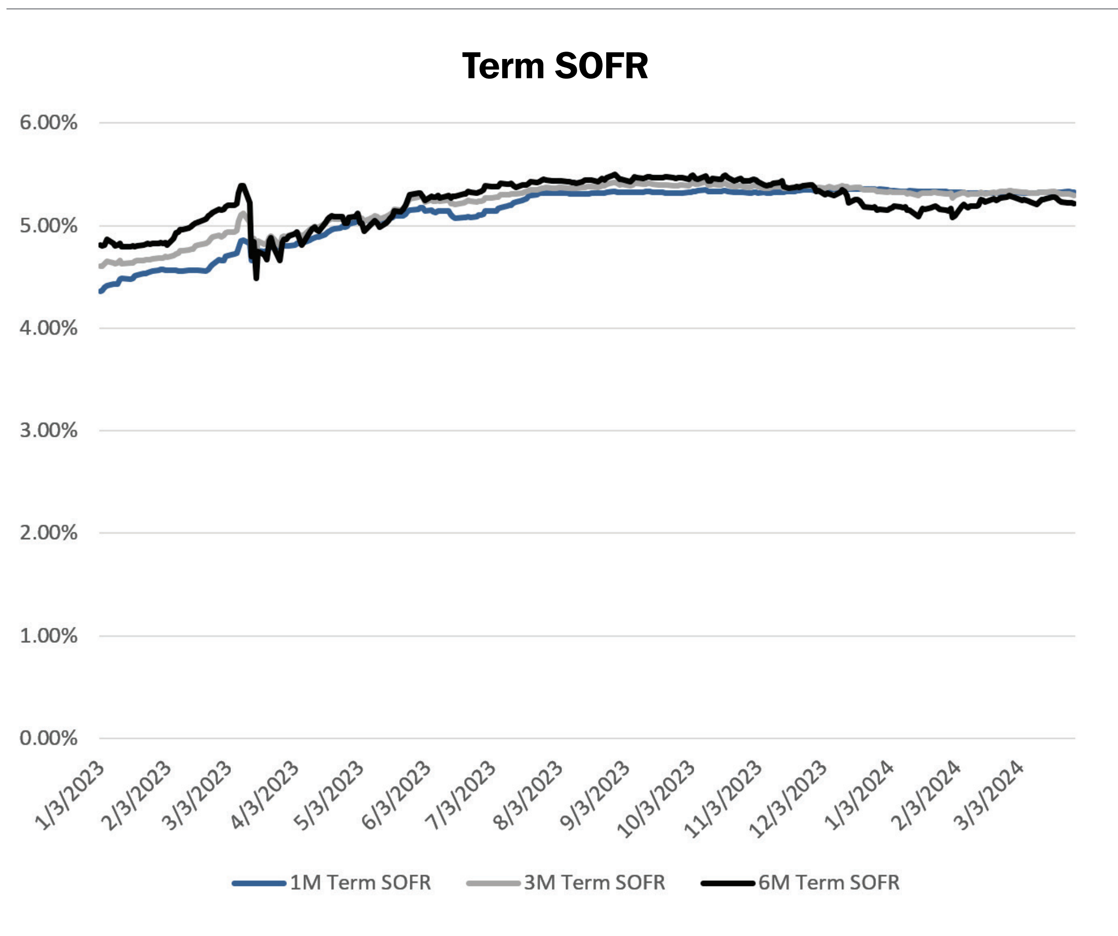


Note: Large corporate borrowers are defined as borrowers with an annual EBITDA of at least $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments.

DATA SOURCE Leveraged Commentary & Data (LCD)

Term SOFR Reference Rate

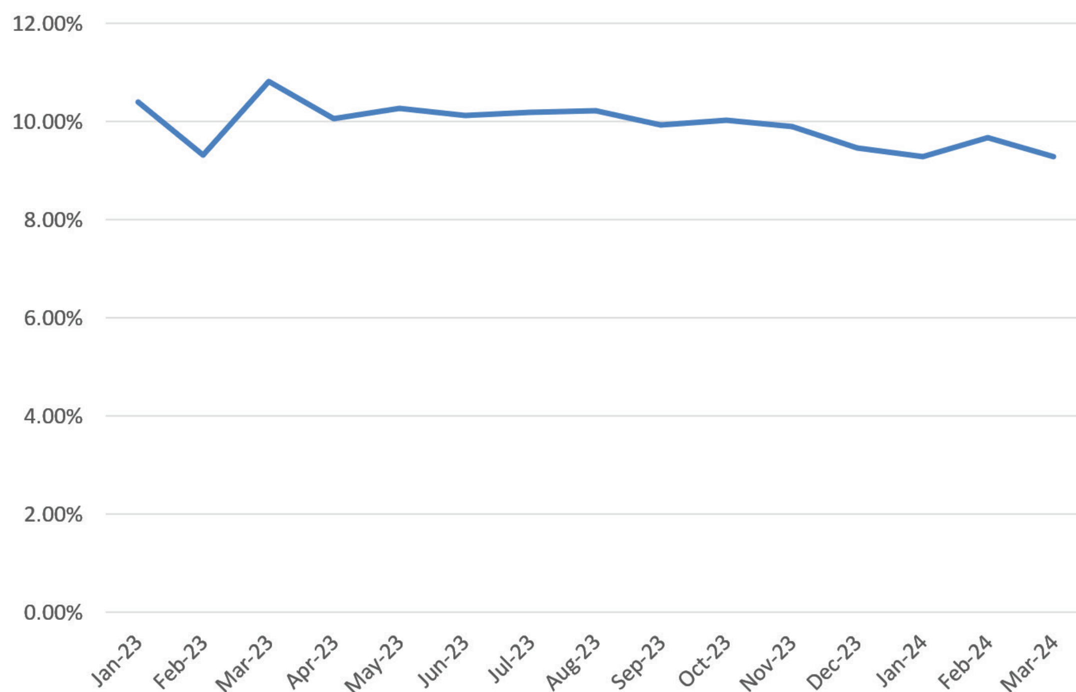
Term SOFR ended the first quarter of 2024 at 5.33%, 5.30% and 5.22% for the one-month, three-month and six-month tenors, respectively, for a decrease of 2 bps, 3 bps and 6 bps, respectively, as compared to the end of the fourth quarter of 2023. The yield curve inversion that began on November 30, 2023 persisted throughout the first quarter of 2024. During the quarter, Term SOFR for the six-month tenor was on average 11 bps lower than the three-month tenor and 12 bps lower than the one-month tenor. However, the yield curve inversion grew less pronounced by the end of the first quarter of 2024. In January, the six-month tenor was on average 16 bps lower than the three-month tenor and 17 bps lower than the one-month tenor, whereas in March, the six-month tenor was on average 8 bps lower than the three-month and one-month tenors.



DATA SOURCE Bloomberg Finance L.P.

Primary Market Syndicated Institutional First-Lien Loan Yields

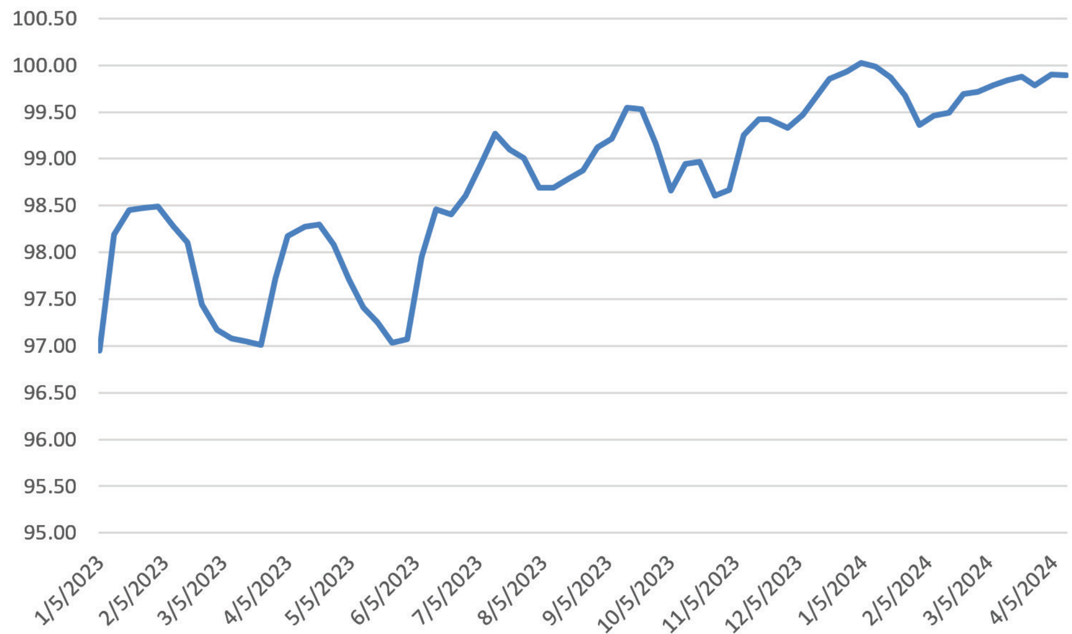
Yields on new-issue syndicated institutional first lien term loans, inclusive of original issue discount, declined slightly in the first quarter of 2024. The average yield of 9.41% in the first quarter of 2024 represented a decrease of 38 bps as compared to the average yield of 9.79% in the fourth quarter of 2023 and a decrease of 71 bps as compared to the average yield of 10.12% in the third quarter of 2023.



SOURCE Leveraged Commentary & Data (LCD)

Secondary Market Pricing

The average bid price of the LCD Flow Name Index as of the end of the first quarter of 2024 increased by 49 bps as compared to the end of the fourth quarter of 2023 and increased by 66 bps as compared to the end of the third quarter of 2023.



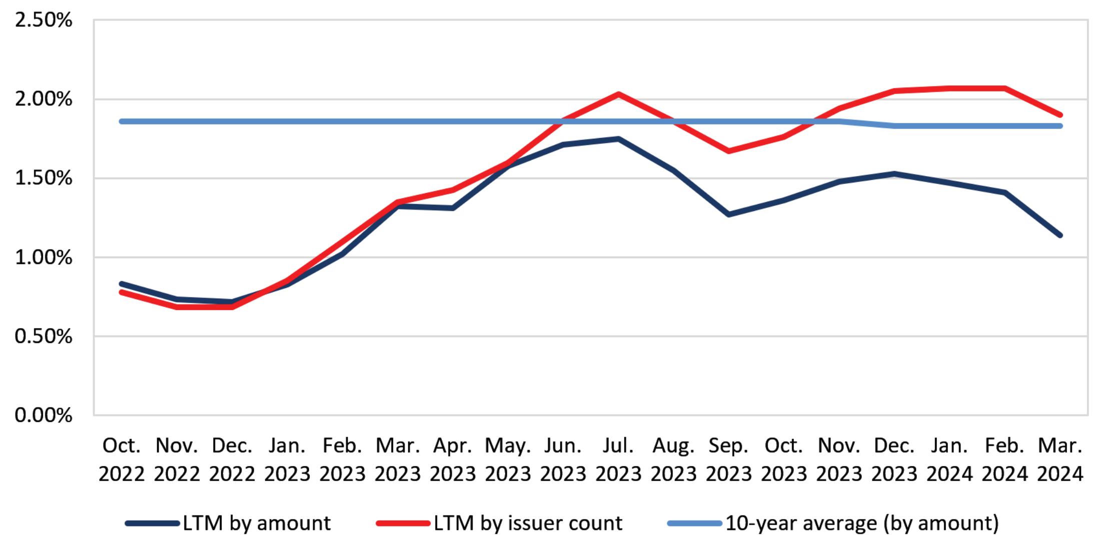
DATA SOURCE Leveraged Commentary & Data (LCD)[1]

1 The LCD Flow Name Index is a composite index of 15 institutional borrower names published on a twice-weekly basis by Leveraged Commentary & Data (LCD).

RESTRUCTURING

U.S. Leveraged Loan Default Rate

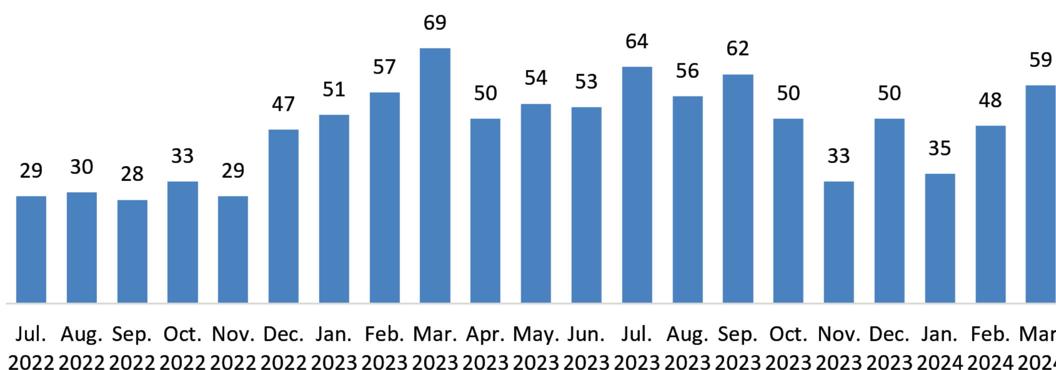
The default rate for U.S. leveraged loans fell in the first quarter of 2024. The default rate of the Morningstar LSTA U.S. Leveraged Loan Index was 1.14% by amount and 1.90% by issuer count for the LTM period ending March 31, 2024, compared to 1.53% by amount and 2.05% by issuer count for the LTM period ending December 31, 2023. The default rate by amount remained below the 10-year average default rate.



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

U.S. Bankruptcy Filings

U.S. bankruptcy filings increased across the first quarter of 2024, with a total of 59 bankruptcy filings in March 2024 compared to 35 and 48 in January and February, respectively. While year-to-date corporate bankruptcies are below the previous year's first quarter total, they are above the first quarter totals from 2021 and 2022. Consumer discretionary and healthcare made up the largest number of bankruptcy filings in the first quarter, with 20 filings in each sector so far this year.



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 New Rules and Amendments Enhancing Investor Protections for SPAC IPOs and de-SPAC Transactions

As previously discussed in the Q4 2023 edition of this newsletter, the Securities and Exchange Commission (the "SEC") recently adopted new rules and amendments aimed at enhancing disclosures and investor protections in initial public offerings ("IPOs") by special purpose acquisition companies ("SPACs") and in subsequent business combination transactions between SPACs and target companies ("de-SPAC transactions"). These rules, adopted on January 24, 2024, reflect the SEC's view that de-SPAC transactions, while structured as M&A transactions, are akin to traditional IPOs, necessitating similar disclosure standards.

For both SPAC IPOs and de-SPAC transactions, the new rules mandate detailed disclosure related to SPAC sponsors, potential conflicts of interest and dilution. SPAC sponsors are required to provide information about their business, their experience in organizing SPACs, their material roles and responsibilities in the SPAC, the amount and price of securities issued to them, their compensation arrangements and any other arrangements they have with the SPAC or its affiliates regarding de-SPAC transactions. The rules also require disclosure of material potential or actual conflicts of interest that SPAC sponsors, SPAC directors or officers and target company directors or officers may have with the interests of unaffiliated security holders of the SPAC. Additionally, disclosures are required with respect to potential sources of dilution, such as shareholder redemptions, sponsor compensation, underwriting fees, warrants, convertible securities and PIPE financings.

The new rules also introduce additional requirements specific to de-SPAC transactions. These include disclosure related to the background, material terms and effects of the transaction; any board determinations regarding the transaction; outside reports materially relating to the transaction; and additional disclosure about the target company. Additionally, target companies must now co-sign registration statements, thereby subjecting them to Section 11 liability for any material misstatements or omissions. The rules require a 20-day minimum dissemination period for prospectuses and proxy and information statements filed for a de-SPAC transaction and a re-determination of smaller reporting company status following the consummation of a de-SPAC transaction. The rules also codify an SEC staff position that a Schedule TO filed in connection with a de-SPAC transaction should contain substantially the same information about a target private operating company that is required under the proxy rules and that a SPAC must comply with the procedural requirements of the tender offer rules when conducting the transaction for which the Schedule TO is filed.

The new rules also impact forward-looking statements and projections in de-SPAC transactions. These include eliminating the safe harbor protections of the Private Securities Litigation Reform Act of 1995 for forward-looking statements in de-SPAC transactions and mandating disclosure of material bases, assumptions and factors underlying projections.

Additionally, the rules include new and amended requirements for shell company business combinations. Under new Rule 145a, such transactions will be deemed sales of securities and thus must be registered under the Securities Act of 1933 (the "Securities Act") or qualify for an exemption thereunder.

These new rules and amendments will take effect on July 1, 2024.

SEC Adopts Climate Disclosure Rules for Public Companies

On March 6, 2024, the SEC adopted climate-related disclosure rules (the "Climate Rules") for public companies. The rules apply to annual reports and registration statements of domestic issuers and most foreign private issuers.

The requirements of the Climate Rules can generally be grouped into five categories, described briefly below:

- *Governance, Strategy and Risk Management Disclosures:* The Climate Rules require a description of climate-related governance at both the board of directors and management levels. The Climate Rules require disclosure of the extent to which climate-related risks have materially impacted or are reasonably likely to materially impact the registrant, including its strategy, results of operations or financial condition in the short term (*i.e.*, in the next 12 months) and in the longer term (*i.e.*, beyond the next 12 months). The Climate Rules also require a description of the registrant's process for identifying, assessing and managing material climate-related risks, including how it identifies whether it has incurred or is reasonably likely to incur a material physical or transition risk and how it decides whether to mitigate, accept or adapt to such risk.
- *Targets and Goals:* Registrants will be required to describe any climate-related target or goal set by the registrant that has materially affected or is reasonably likely to materially affect the registrant's business, results of operations or financial condition, as well as provide annual updates on the progress made toward such target or goal.
- *Scope 1 and 2 Greenhouse Gas ("GHG") Emissions Metrics:* Large accelerated filers and accelerated filers (but not smaller reporting companies or emerging growth companies) are required to disclose their Scope 1 and Scope 2 GHG emissions, if material, with the SEC making clear it intends registrants to apply traditional definitions of materiality used elsewhere in the federal securities laws. Registrants will also need to describe the assumptions and methodology used in preparing their emissions disclosures.
- *Safe Harbor:* The Climate Rules provide a safe harbor under the Private Securities Litigation Reform Act for climate-related disclosures pertaining to transition plans, scenario analyses, the use of internal carbon prices and targets and goals made pursuant to the new disclosure requirements, except for historical facts (which would include, for example, annual updates regarding progress made toward targets or goals or under transition plans).
- *Regulation S-X Financial Statement Disclosures:* The new Article 14 of Regulation S-X requires companies to disclose the aggregate amount of expenditures, losses, capitalized costs and charges, excluding recoveries, incurred as a result of severe weather events and other "natural conditions," such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures and sea level rise, subject to certain minimum thresholds.

Compliance obligations for the Climate Rules will be phased in at different times depending on the requirement and the registrant's filer status. Implementation of the Climate Rules was temporarily stayed by the U.S. Court of Appeals for the Fifth Circuit in a challenge brought by Liberty Energy Inc. The stay was vacated when the SEC's request for a random draw to determine a single forum to consolidate the various challenges to the Climate Rules (which totaled nine proceedings across six appellate courts) was granted and the Liberty Energy Inc. case was transferred to the new, consolidated proceeding before the U.S. Court of Appeals for the Eighth Circuit. On April 4, 2024, the SEC announced that it is staying implementation of the final Climate Rules pending the Eighth Circuit's review.

A full discussion of the Climate Rules can be found in the Cravath Client Memo on the subject.

Litigation Developments

United States District Court Southern District of New York Rules Preliminary Results for a Completed Quarter Are Non-Actionable Forward-Looking Statements

On February 6, 2024, in *In re Lottery.com Securities Litigation*, the United States District Court Southern District of New York ruled that preliminary results for a completed quarter constituted forward-looking statements protected under the bespeaks-caution doctrine. Among other claims, the plaintiffs alleged Section 10(b) and Rule 10b-5 claims of false and misleading statements by the defendant. Section 10(b) of the Exchange Act and SEC Rule 10b-5 prohibit material misstatements or omissions in connection with the purchase or sale of a security. There were a number of challenged statements, but notable among them were statements made by Lottery.com in an October 21, 2021 press release announcing the company's preliminary revenue results for the third quarter, which ended on September 30, 2021. The court held that these statements could not serve as the basis for claims of securities fraud due to the bespeaks-caution doctrine, which states that forward-looking statements accompanied by sufficient cautionary language are not actionable because no reasonable investor could have found the statement materially misleading. While the plaintiffs argued that the preliminary results were not forward-looking statements because they pertained to a quarter that was already completed at the time of the disclosure, the court disagreed. The Second Circuit, in applying the bespeaks-caution doctrine, treats corporate statements of projections as to corporate earnings as forward-looking statements without regard to whether the relevant earnings period has passed. The preliminary results are considered forward-looking statements because their truth cannot be ascertained until some time after they are made. The court noted that just because a quarter has ended does not mean that the quarter's results have been tabulated. The preliminary results are forward-looking statements insofar as they are based on currently available information and preliminary analysis of the unaudited financial results for the quarter, which may be incomplete or provisional, and are predictions of what the company will eventually declare as its financial performance.

Potential Narrowing or Overturn of the Chevron Doctrine Could Impact SEC Rulemaking

The Supreme Court of the United States granted certiorari to hear *Loper Bright Enterprises v. Raimondo* ("*Loper Bright*") in a move that could have broad implications for administrative rules and regulations. In deciding *Loper Bright*, the Supreme Court has the potential to overrule or narrow its landmark decision in *Chevron v. Natural Resources Defense Council* ("*Chevron*"), which has, for the last 40 years, determined the level of deference federal courts afford to interpretations of certain statutes by administrative agencies.

If the Supreme Court were to overrule, or significantly narrow, *Chevron*, the decision could have significant ramifications for the SEC. Historically, the SEC has been given wide latitude in cases involving an analysis of *Chevron*. An overturn could significantly impact rule proposals and the review of challenged rules, such as the upcoming review of the enhanced climate-related disclosure rules and more. Oral argument for *Loper Bright* was heard on January 17, 2024, and a decision is expected from the Supreme Court by late June of 2024.

Kirschner v. JPMorgan Chase Bank, N.A.

On February 20, 2024, the U.S. Supreme Court denied the petition for certiorari filed on December 19, 2023, leaving in place the decision issued by the Second Circuit on August 24, 2023

that syndicated term loans are not "securities" and are therefore not subject to state and federal securities laws and regulations (as previously discussed in the Q3 2023 edition of this newsletter).

Restructuring Updates

Sale of Preference Actions: In re South Coast Supply Co.

On January 22, 2024, in the case of *In re South Coast Supply Co.*, Circuit Judge James L. Dennis of the U.S. Court of Appeals for the Fifth Circuit (the "Fifth Circuit") held that preference claims arising under Section 547 of the Bankruptcy Code are property of the estate that can be sold to a third party pursuant to Section 363 of the Bankruptcy Code.

In 2016, South Coast Supply Company ("South Coast"), an industrial products distributor, began experiencing financial issues. South Coast borrowed $800,000 from its then-CFO Robert Remmert, pursuant to a loan agreement. Over the following two years, South Coast made payments of over $320,000 to Remmert under the loan agreement. On October 17, 2017, after his retirement, Remmert sent a demand letter requesting $405,261.87 to satisfy the loan (lower than the $578,199.04 in principal remaining on the loan). On October 20, 2017, South Coast filed a voluntary chapter 11 petition in the Southern District of Texas.

At the time of its filing, South Coast's only secured creditor was Briar Capital Working Fund Capital, L.L.C. ("Briar Capital"). Five months into South Coast's bankruptcy, it was not generating adequate cash flow to fund the case, so it obtained debtor-in-possession ("DIP") financing from Solstice Capital, LLC ("Solstice"). The order approving the DIP financing specified that Briar Capital would have lien priority over Solstice as to property obtained by South Coast prior to advancement of DIP financing funds and that Solstice would have lien priority on property obtained after that time.

The bankruptcy court subsequently confirmed a chapter 11 plan pursuant to which all South Coast's intangible assets would be sold to Solstice for $500,000, plus an additional $200,000 to satisfy administrative claims. Additionally, the plan provided that Briar Capital would waive its lien with respect to the $700,000 of sale proceeds, in exchange for assignment of preference claims the bankruptcy estate had against Remmert. The plan further provided that Briar Capital would retain all amounts recovered from Remmert, even if those amounts exceeded the value of Briar Capital's claim against the bankruptcy estate.

Following plan confirmation, Briar Capital was substituted as assignee of South Coast in the preference actions brought by the South Coast bankruptcy estate against Remmert. The parties litigated from January 2019 until August 2022, at which time Remmert filed a motion to dismiss, arguing that Briar Capital lacked standing to prosecute the preference action. The District Court for the Southern District of Texas (the "District Court") held for Remmert, holding that since a successful recovery by Briar Capital would not benefit the South Coast bankruptcy estate, Briar Capital lacked standing as a representative of the estate under Section 1123(b)(3)(B) of the Bankruptcy Code.

The decision was appealed to the Fifth Circuit, which reversed the District Court and remanded for further proceedings.

In reaching its holding that preference actions could be prosecuted by an assignee, the Fifth Circuit analyzed sections of the Bankruptcy Code pertaining to the ability of a debtor-in-possession to sell its property and as to what constitutes property of the bankruptcy estate.

Under Section 363(b)(1) of the Bankruptcy Code, a debtor-in-possession, "after notice and a hearing, may use, sell, or lease . . . property of the estate." Thus, the Fifth Circuit reasoned that if

preference claims constitute property of the estate, then they can be sold by a debtor-in-possession pursuant to Section 363(b)(1).

Section 541(a)(1) of the Bankruptcy Code defines property of the estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case." The Fifth Circuit read Section 541(a)(1) broadly to include preference actions because preference actions are "'rights of action created by federal bankruptcy law to avoid a transfer of property' . . . and 'a mechanism in the Bankruptcy Code by which additional property is made available to the estate.'" *(internal citations omitted).* Preference claims also constitute an "interest in property that the estate acquires after commencement of the case" under Section 541(a)(7) because preference actions only become tangible rights once the petition is filed.

In this decision, the Fifth Circuit joined the Eighth and Ninth Circuits in allowing the sale of preference claims. The Fifth Circuit further held that Briar Capital validly purchased the claim and thus had the requisite standing, as there was no additional requirement on purchasers to qualify as "representatives of the estate" to prosecute those claims.

Section 546(e) Safe Harbor: Petr v. BMO Harris Bank N.A.

On March 15, 2024, in the case of *Petr v. BMO Harris Bank N.A.*, a three-judge panel of the U.S. Court of Appeals for the Seventh Circuit held, in an opinion by Circuit Judge Amy J. St. Eve, that the safe harbor under Section 546(e) of the Bankruptcy Code from avoidance actions includes transactions involving private securities that do not implicate the national securities clearance market.

BWGS, LLC was a wholesale distributor of hydroponic and organic garden products with all of its outstanding stock held by an Employee Stock Ownership Plan Trust. Beginning in 2015, BWGS began to experience financial issues. In 2016, Sun Capital Partners VI, L.P. ("Sun Capital") entered into a stock purchase agreement (the "SPA") to acquire 100% of the equity in BWGS for $37 million through a newly created subsidiary called BWGS Intermediate Holding, LLC ("Intermediate Holding"). The stock purchase closed on December 30, 2016, and BWGS thus became a direct, wholly owned subsidiary of Intermediate Holding.

To finance the stock purchase, BMO Harris Bank N.A. ("BMO") made a bridge loan of $25.8 million to Intermediate Holding, with Sun Capital as guarantor. Less than a month later, on January 27, 2017, Sun Capital caused BWGS and Intermediate Holding to enter as joint borrowers into two credit agreements for approximately $25 million. That amount, along with approximately $400,000 of cash on hand at BWGS, was transferred to BMO to pay off the bridge loan. BWGS's financial difficulties continued, eventually leading BWGS's creditors to file an involuntary chapter 7 case against it. An order for relief was then entered by the Bankruptcy Court for the Southern District of Indiana (the "Bankruptcy Court") on April 24, 2019.

The chapter 7 trustee filed a fraudulent transfer action against BMO and Sun Capital, claiming that BWGS's repayment of the bridge loan benefitted Sun Capital and BMO with no consideration to BWGS, making those transfers avoidable under state law and the Bankruptcy Code. BMO and Sun Capital sought to dismiss the action, claiming that the series of transfers were protected transactions under the safe harbor of Section 546(e), which states that "the trustee may not avoid a transfer . . . made by or to (or for the benefit of) a . . . financial institution . . . *in connection with a securities contract*" (emphasis added).

The Bankruptcy Court ruled in favor of the chapter 7 trustee, denying the motion to dismiss. BMO and Sun Capital filed an interlocutory appeal to the United States District Court for the Southern District of Indiana (the "District Court"), which reversed the Bankruptcy Court's

decision and remanded for further proceedings. Subsequently, the chapter 7 trustee appealed to the U.S. Court of Appeals for the Seventh Circuit (the "Seventh Circuit").

In his appeal papers, the chapter 7 trustee argued that the legislative history of Section 546(e) limits its application to transactions that "implicate the system for the clearance and settlement of publicly held securities." In the opinion affirming the District Court's ruling, however, Judge St. Eve of the Seventh Circuit noted that "nothing in the plain language of § 546(e) excludes private contracts," stating that courts construe the term "securities contract" broadly. The court noted that the SPA, bridge loan agreement and Sun Capital's guarantee all constituted such securities contracts as defined in Section 741(7) of the Bankruptcy Code, finding that the SPA constituted "a contract for the purchase . . . of a security," the bridge loan agreement constituted an "extension of credit for the clearance or settlement of securities transactions" and the Sun Capital guarantee constituted a "credit enhancement related to any agreement or transaction . . . including any guarantee . . . to a . . . financial institution . . . in connection with any agreement or transaction referred to in this subparagraph."

Because BWGS's repayment satisfied both Intermediate Holding's obligations under the bridge loan and Sun Capital's obligations under its guarantee, the Seventh Circuit easily found that the transfers were made "in connection with" the securities contracts. The Seventh Circuit further held that Section 546(e)'s safe harbor also preempts any conflicting state law provisions that would otherwise allow these claims to go forward.

The Seventh Circuit's ruling is consistent with decisions in Courts of Appeals for the Third, Fifth, Sixth and Eighth Circuits in finding that the safe harbor of Section 546(e) shields payments made in connection with private securities contracts from fraudulent transfer litigation in bankruptcy, and should be helpful both for sponsors and lenders by clarifying protections available to them in financing the acquisition of stressed private companies.

Other Developments

T+1 Shortened Settlement Cycle for Primary Market Transactions

As an update to the discussion in the Q3 2022 edition of this newsletter, on May 28, 2024, the SEC's amendments to Rule 15c6-1(a) of the Securities Exchange Act (the "Exchange Act") will take effect, shortening the securities clearing and settling process for most broker-dealer securities transactions from two business days after the trade date (T+2) to one business day after the trade date (T+1). Certain categories of securities are exempt from the T+1 requirement. Notably, securities sold pursuant to firm commitment underwritten offerings are exempt from the T+1 requirement if the managing underwriter and the issuer agree to a different settlement cycle.

In light of the impending effective date, the Securities Industry and Financial Markets Association published Primary Market Transactions under the T+1 Shortened Settlement Cycle guidance, which outlines considerations for transactions involving equity securities (including IPOs, restricted securities, margined securities and overnight blocks/bought deals) and fixed income securities under the abbreviated settlement cycle.

District Court Rejects SEC Rules Applying Rule 14(a) "Solicitation" Definition to Proxy Advisory Firms

In 2020, the SEC issued final rules broadening the definition of "soliciting" proxies under Rule 14(a) of the Exchange Act to include

providing proxy-voting advice. Consequently, advisory firms became subject to public filing requirements, other documents and anti-fraud provisions. Institutional Shareholder Services Inc. ("ISS"), one of the largest proxy advisory firms, filed suit against the SEC, challenging its 2020 rule. Though the SEC relaxed some of the 2020 rules in 2022—by eliminating the requirement for proxy firms to simultaneously provide their voting advice to both clients and companies and by removing the obligation to disclose companies' responses to their recommendations to investors—ISS's suit continued. On February 23, 2024, the U.S. District Court for the District of Columbia ruled in favor of ISS in its lawsuit challenging the SEC's 2020 rule, holding that the ordinary meaning of "solicit" at the time of Section 14(a)'s enactment does not reach proxy voting advice for a fee, nor does the Exchange Act's history and purpose support the SEC's interpretation.

Fifth Circuit Scheduled to Rehear a Challenge to Nasdaq's Board Diversity Rule

As discussed in the Q4 2023 edition of this newsletter, in November 2023, attorneys general from 19 states submitted an amicus brief supporting two conservative groups in a case challenging the Nasdaq Stock Market's ("Nasdaq") board diversity rule. The amicus brief urged the Fifth Circuit to hold a rehearing *en banc* after the court denied a petition to review the rule in October 2023, concluding that the SEC's approval of the Nasdaq rule did not violate the Exchange Act and the Administrative Procedure Act.

On February 19, 2024, a majority of the circuit judges in active service on the U.S. Court of Appeals for the Fifth Circuit voted to rehear the case *en banc*. The court has tentatively scheduled oral arguments in the case for the week of May 13 and vacated the October decision upholding the Nasdaq rule. The rule would require companies listed on Nasdaq to disclose board diversity data and, if a board does not have at least one woman and at least one minority member, to provide an explanation for the lack of diverse representation.

SEC's Division of Corporation Finance Updates Disclosure Guidance on Confidential Treatment Requests

The SEC's Division of Corporation Finance issued updates to its guidance on confidential treatment applications submitted pursuant to Rule 406 of the Securities Act and Rule 24b-2 of the Exchange Act. The guidance addresses how companies should file an application objecting to public release of information otherwise required to be filed under the Securities Act and the Exchange Act and what companies should submit in connection therewith. Companies that have previously obtained a confidential treatment order have three options for how to proceed when the order is nearing expiration: apply for an extension, resubmit the exhibit without redactions or transition to Reg S-K Item 601(b)(10)'s rules. Under previous guidance, the procedures for the extension option were determined by whether the order was issued prior to a fixed date (October 15, 2017). The revised guidance introduces a rolling period—extension procedures are determined by whether the order was issued less than three years ago.

Federal District Court Rules the Corporate Transparency Act is Unconstitutional

On March 1, 2024, the U.S. District Court for the Northern District of Alabama granted the plaintiff's motion for summary judgment in National Small Business United, d/b/a the *National Small Business Association, et al. v. Yellen, et al.*, ruling that the Corporate Transparency Act (the "CTA") is unconstitutional because it lacks a sufficient nexus to an enumerated power of Congress and thus exceeds the legislative branch's constitutional limits. The court permanently enjoined enforcement of the CTA against the

National Small Business Association (the "NSBA") and its members.

The ruling in this case has limited applicability: it only prohibits enforcement of the CTA against the plaintiffs—the NSBA and its members. While the NSBA and its members are not required to report beneficial ownership information to FinCEN as a result of this ruling, approximately 40% of NSBA's membership would already have been exempted from reporting regardless of this ruling. Further, it is estimated that the NSBA and its 60,000+ members only account for 0.1%—0.2% of the over 30 million entities FinCEN estimates will be required to file initial beneficial ownership information reports in 2024 (based on the NSBA's membership as of March 1, 2024).

SEC Chair and Commissioners Discuss Accredited Investor Definition in their Remarks Before the Small Business Capital Formation Advisory Committee

The SEC Small Business Capital Formation Advisory Committee (the "SBCF Committee") is a committee that advises and provides recommendations to the SEC on rules, regulations and policy matters relating to small businesses. On February 27, 2024, the SBCF Committee met to discuss potential changes to the accredited investor definition in Regulation D of the Securities Act. Regulation D allows issuers to sell securities in unregistered offerings, and, if relying on Rule 506 exemptions, they may sell to an unlimited number of accredited investors (and a limited number of investors that are not accredited investors).

The SBCF Committee listened to the commissioners' remarks and discussed its own experiences and views regarding the accredited investor definition. It has not yet issued its formal recommendations, though it generally considered 1) not adjusting the income and net worth thresholds for inflation, 2) including educational training for investors and 3) allowing individuals who do not meet the accredited investor thresholds to participate in Regulation D private securities offerings in an amount up to 5% of their income or net worth, whichever is greater.

SEC Investor Advisory Committee Revisits Materiality as a Disclosure Standard

On March 7, 2024, the SEC's Investor Advisory Committee held a panel entitled *Examining the Use of Materiality as a Disclosure Standard—Can the Definition be Improved to Better Serve Investors?* to commemorate the 25th anniversary of Staff Accounting Bulletin 99—Materiality ("SAB 99") and consider whether SAB 99 merited any updates. SAB 99 has been a highly influential codification of the SEC staff's view that misstatements cannot be deemed immaterial only because they do not reach a specific quantitative threshold and that exclusive reliance on quantitative benchmarks is inappropriate and qualitative factors must be considered as well. John White, Cravath Partner and Chair of Cravath's Corporate Governance and Board Advisory Practice, participated on the panel.

Trends Emerge as Early Filers Comply with SEC Cybersecurity Rules

As previously discussed in the Q4 2023 edition of this newsletter, after December 18, 2023, all registrants other than smaller reporting companies were required to begin complying with the SEC's final rules regarding disclosure by public companies, including foreign private issuers, of cybersecurity risk management,

strategy, governance and related incidents. Major themes and best practices emerged, including:

- Most companies reported aligning with frameworks such as the National Institute of Standards and Technology Cybersecurity Framework.
- Many companies highlighted continuous monitoring efforts performed by sophisticated third parties.
- Oversight responsibilities for cybersecurity were frequently integrated into a company's larger enterprise risk management framework, with oversight most frequently delegated to the audit committee.

Double Dip Financing

"Double dip" transactions have become an emerging structure in liability management transactions. A small but growing number of highly leveraged companies have turned to the "double dip" structure to raise debt from new lenders by providing them with enhanced recovery in the event of a bankruptcy as compared to lenders under existing debt facilities, without seeking consent from existing lenders.

The "double dip" structure takes its name from the two secured claims that the transaction establishes on the assets of the existing credit group. Although a "double dip" can take various forms based on the structure of the existing credit group, at its core the first step involves lenders providing a new loan to an affiliate of the borrower that sits outside the existing credit group (for example, an unrestricted subsidiary, a non-guarantor restricted subsidiary or a sister company). The new loan is guaranteed by subsidiaries that guarantee existing debt and is secured by collateral that secures existing debt on a pari passu basis, using capacity under the existing credit facility's debt and liens covenants (the first "dip"). The affiliate then lends the proceeds of the loan to the existing borrower via an intercompany loan, also using pari debt capacity under the existing credit agreement, and the intercompany loan receivable, which is typically guaranteed by the existing credit group, is pledged to secure the new loan (the second "dip"). In certain variants of the "double dip" known as a "pari-plus" structure, in addition to receiving pari guarantees and security, the new loan will benefit from guarantees and collateral of the borrower affiliate that do not benefit existing lenders (including assets of the existing credit group that may have been contributed to the affiliate in a "drop-down" transaction using capacity under the investments covenant in the existing credit agreement). Whether there is potential for a company to engage in a "double dip" transaction depends, among other things, on the availability of capacity under the existing credit agreement's debt, lien and investment covenants.

The "double dip" structure remains untested in court, and opinions differ on how a bankruptcy court would treat the multiple claims created through the structure. In response to "double dip" transactions, the Loan Syndications and Trading Association (LSTA) issued initial guidance in late December 2023 on various considerations in credit agreements to address this type of liability management transaction. Contractual protections and "blocker" language are expected to be developed over the coming months and years as certain lenders seek to shut off borrowers' ability to engage in "double dip" transactions.

Crypto Updates

SEC Approves the Listing and Trading of 11 Exchange-Traded Products Holding Bitcoin

The SEC approved form 19b-4 requests from the Nasdaq Stock Market, CboeBZX Exchange and NYSE Arca to list 11 exchange-traded products ("ETPs") holding bitcoin, and approved the registration statements from the issuers, clearing them to begin trading. While the SEC has rejected approving spot bitcoin ETPs in the past, in this particular instance, the SEC found the issuers demonstrated that there were sufficient other means of preventing fraud and manipulation in this context. Nonetheless, the SEC continues to call for caution. SEC Chair Gary Gensler said in a statement: "While we approved the listing and trading of certain spot bitcoin ETP shares today, we did not approve or endorse bitcoin. Investors should remain cautious about the myriad risks associated with bitcoin and products whose value is tied to crypto."

Cravath, Swaine & Moore LLP

NEW YORK

Two Manhattan West
375 Ninth Avenue
New York, NY 10001
T+1-212-474-1000
F+1-212-474-3700

LONDON

CityPoint
One Ropemaker Street
London EC2Y 9HR
T+44-20-7453-1000
F+44-20-7860-1150

WASHINGTON, D.C.

1601 K Street NW
Washington, D.C. 20006-1682
T+1-202-869-7700
F+1-202-869-7600

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