Cravath Finance and Capital Markets Newsletter

Volume 1 | Issue 1

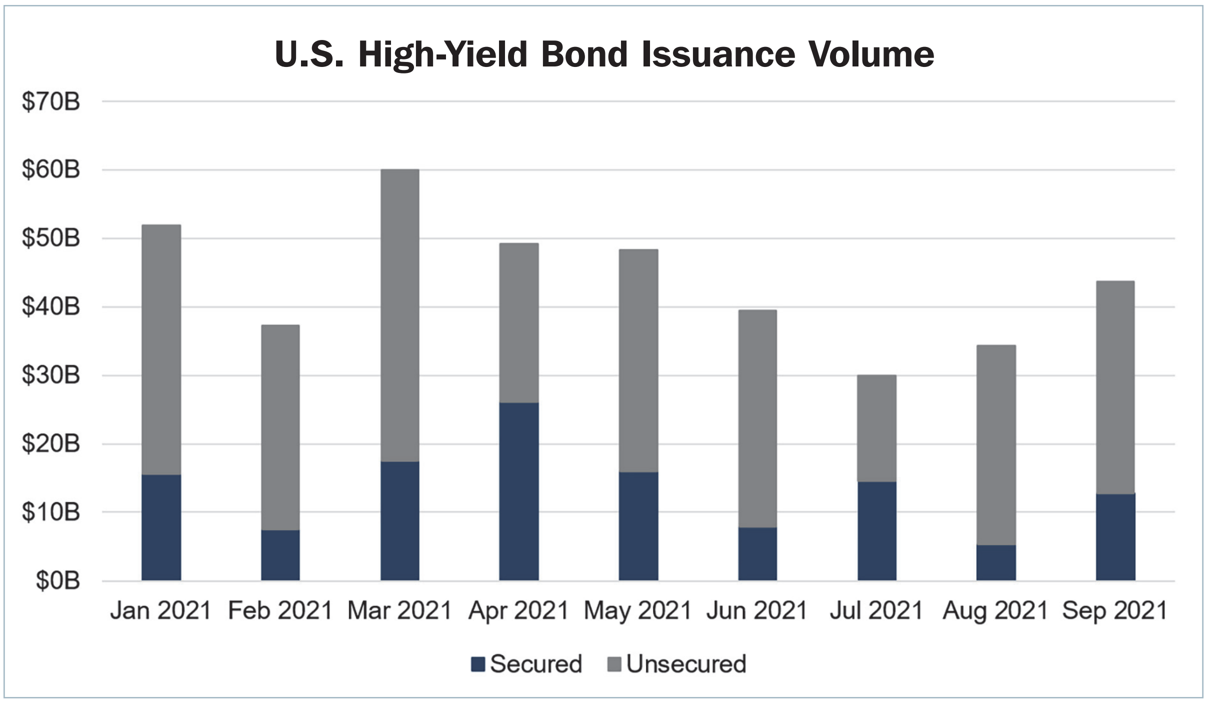
Q3 2021

Market Update

BONDS

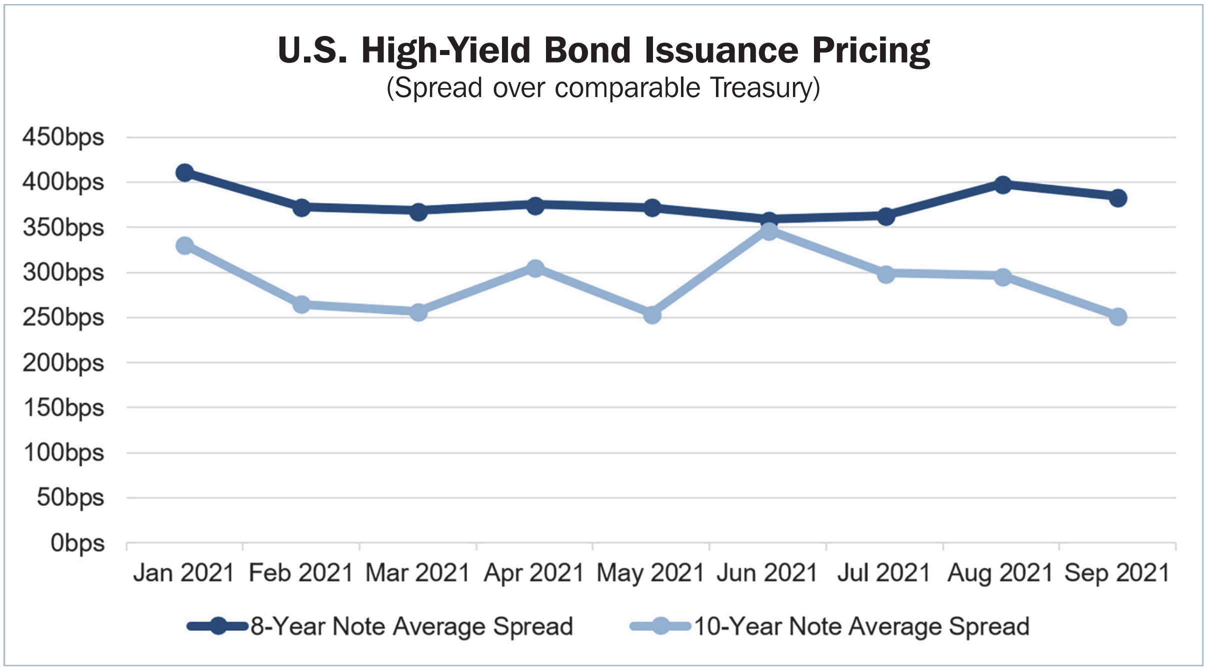
U.S. High-Yield Bonds

The U.S. high-yield bond market remains historically busy. Total proceeds from high-yield issuances were $394B in the first three quarters of 2021, up 16% as compared to the first three quarters of 2020. The $108B in proceeds from issuances for the third quarter of 2021 was down 21% as compared to the second quarter of 2021 ($137B).



Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

The historic volume in U.S. high-yield bond issuance has coincided with a favorable pricing environment for issuers. However, recent concerns over inflation may signal an upswing in pricing across sectors. Overall, pricing (measured by spread over the comparable Treasury) on high-yield 8-Year Notes for the first three quarters of 2021 was down 21.0% as compared to the first three quarters of 2020, and pricing on high-yield 10-Year Notes was down 18.2% on the same comparison.

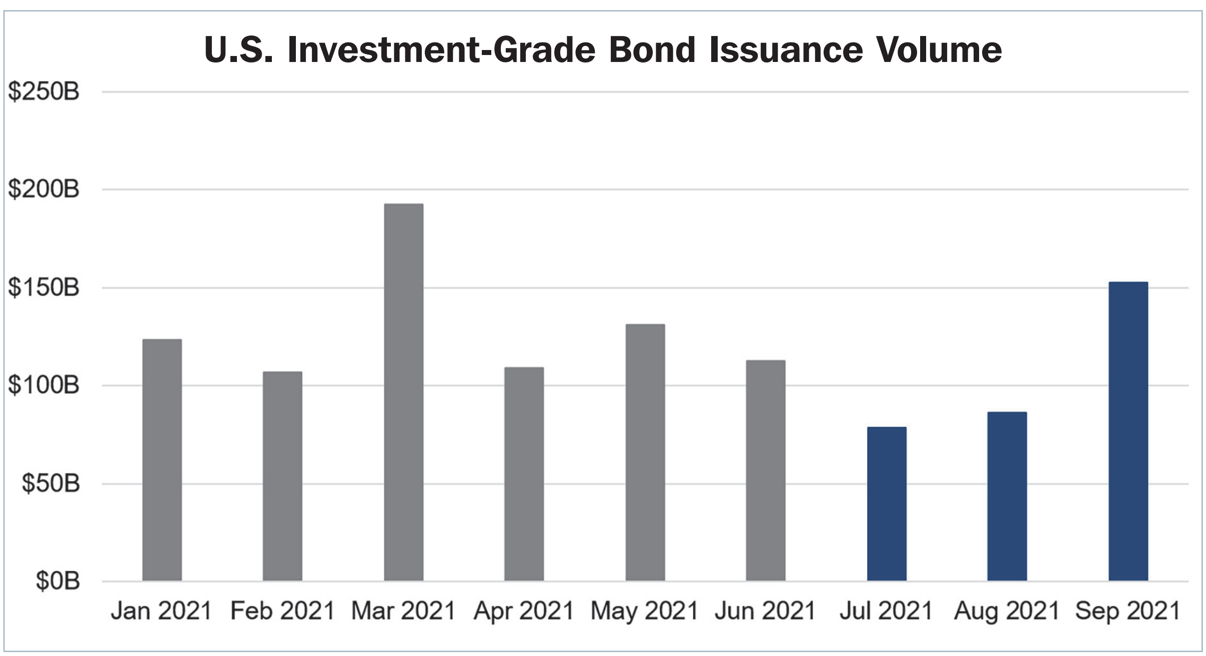


Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Note: Averages are dollar-weighted based on reported spreads.

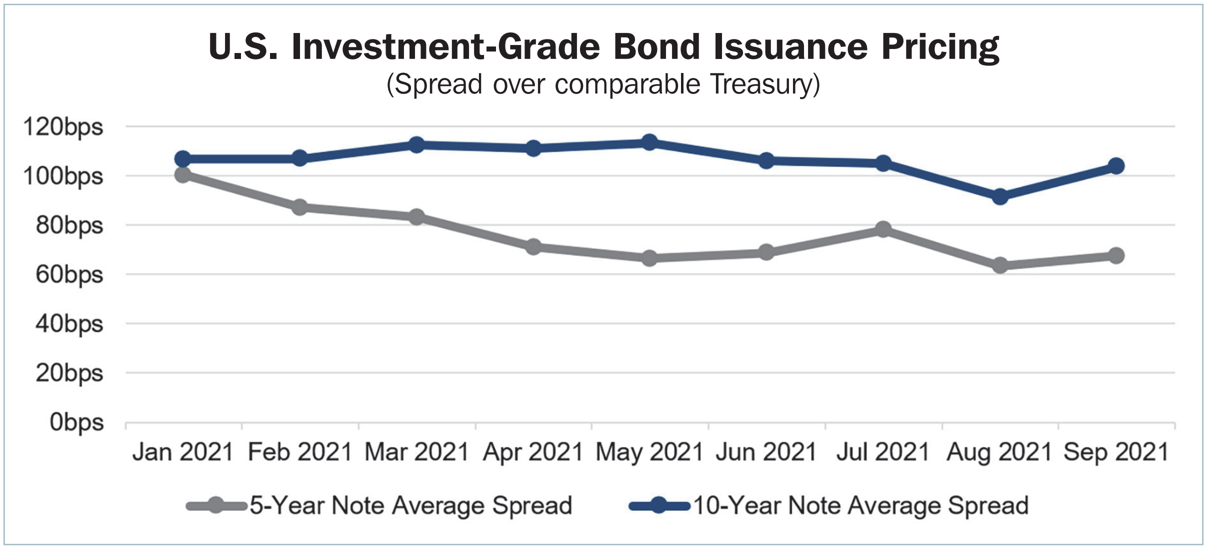
U.S. Investment-Grade Bonds

Total proceeds from investment-grade issuances were $1,092B in the first three quarters of 2021, down 27% as compared to the first three quarters of 2020, which was an historically busy year. The $317B in proceeds from issuances for the third quarter of 2021 was down 20% as compared to the second quarter of 2021 ($353B).



Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Pricing (measured by spread over the comparable Treasury) on U.S. investment-grade bond issuances in the first three quarters of 2021 was significantly lower than the same period last year, with an overall average decline on the 5-Year Note average spread of 63.4% over the average for the first three quarters of 2020. Pricing on 10-Year Notes over the first three quarters of 2021 has seen a similar but less dramatic decline of 47.2% on average over pricing over the same period in 2020.



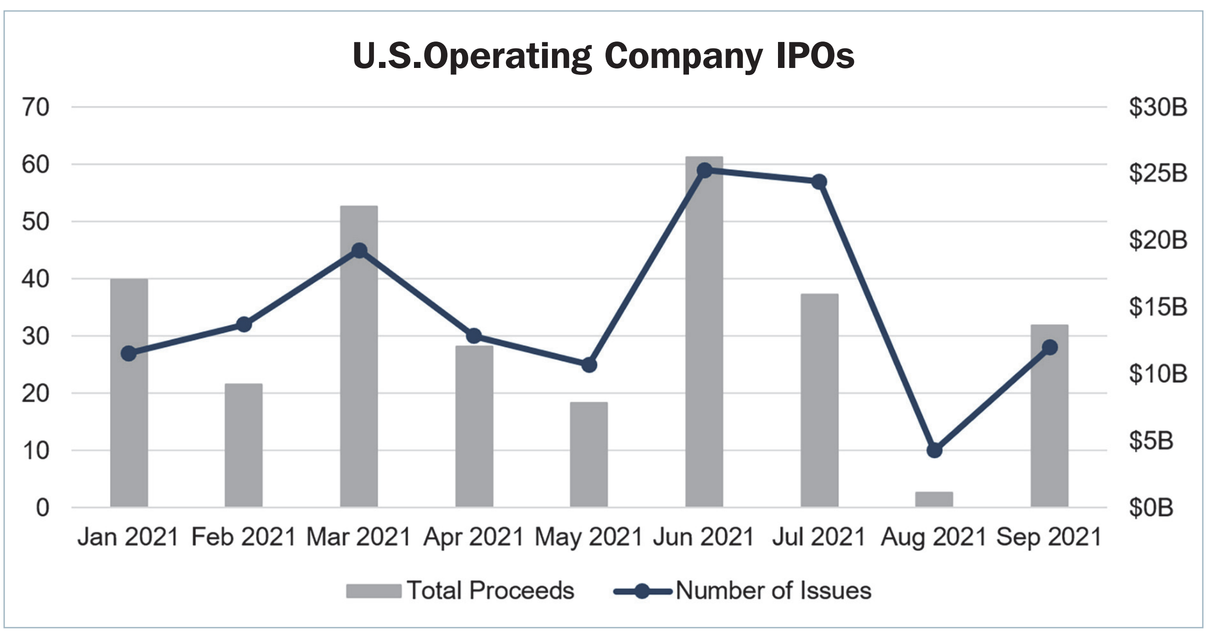
Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Note: Averages are dollar-weighted based on reported spreads.

EQUITY

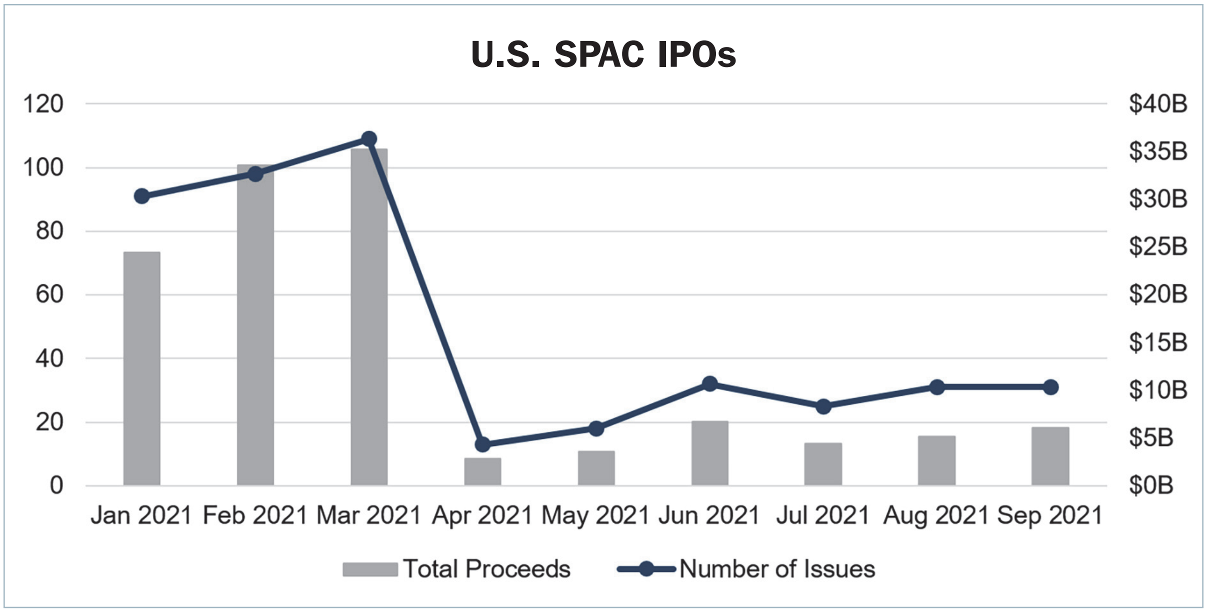
U.S. IPOs

The traditional U.S. IPO market was less active in the third quarter of 2021 than both of the first two quarters of 2021. The $30.7B of total proceeds from U.S. IPOs for the third quarter of 2021 was down 33% as compared to the record-setting second quarter of 2021 ($46.1B).



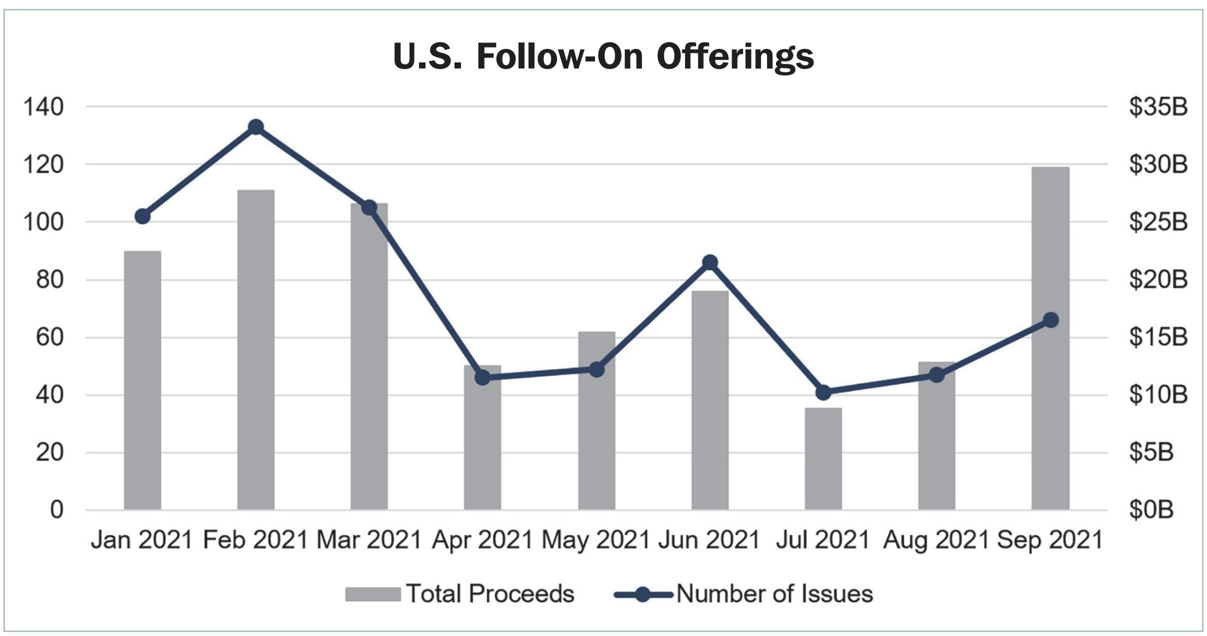
Data Source: Refinitiv, An LSEG Business

U.S. SPACs
The U.S. SPAC market remains far less active as compared to 2020 or the first quarter of 2021. The $15.7B of total proceeds from SPAC issuances for the third quarter of 2021 was up 19% as compared to the second quarter of 2021 ($13.2B) but was down 83% as compared to the first quarter of 2021 ($93.2B), driven by, among other things, accounting and regulatory uncertainty and trading levels at or below initial issue prices in the secondary markets.



Data Source: Refinitiv, An LSEG Business

U.S. Follow-On Offerings
The $51.3B in proceeds from U.S. follow-on equity offerings for the third quarter of 2021 was up 9% as compared to the second quarter of 2021 ($46.9B) but down 33% as compared to the first quarter of 2021 ($76.6B).

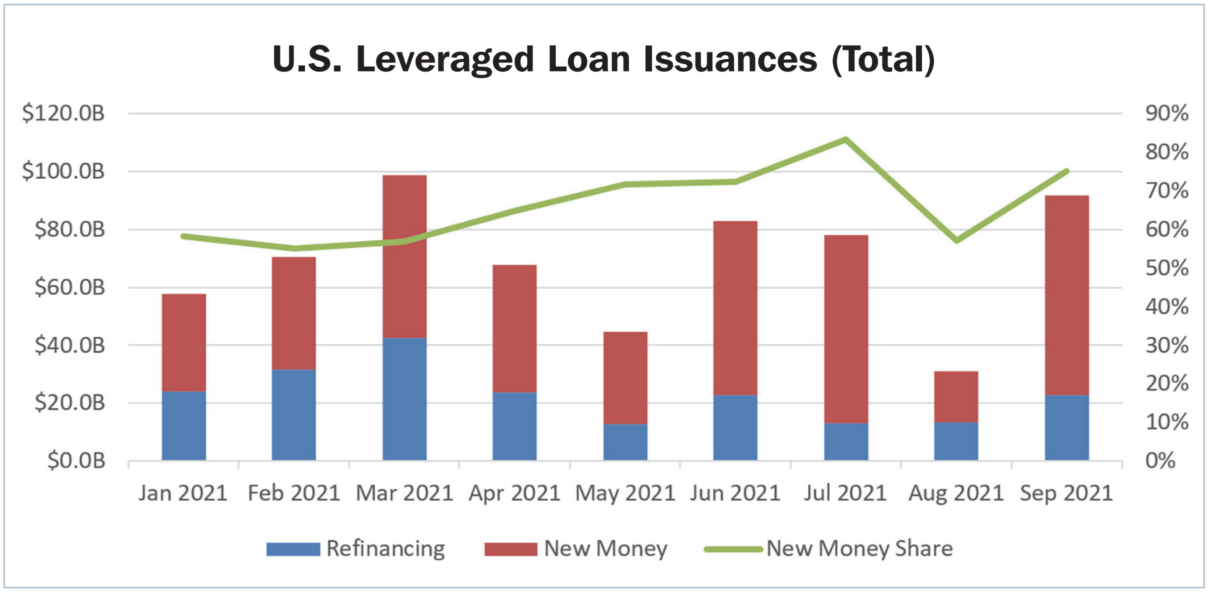


Data Source: Refinitiv, An LSEG Business

LOANS

U.S. Leveraged Loan Issuances

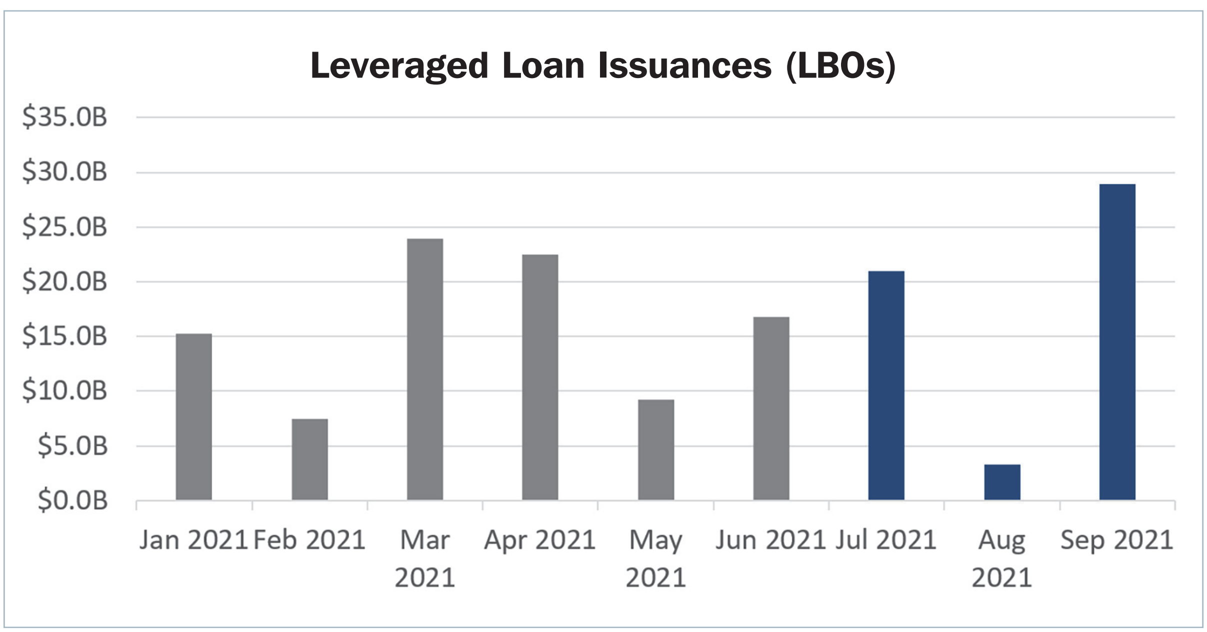
The U.S. leveraged loan market picked up in September after a slower August, with new money volume leading the way. New money volume was $68.9B in September and $151.7B in the third quarter of 2021, bringing totals for the first nine months of 2021 to $623.3B, up 108% as compared to the first nine months of 2020. Refinancing activity was $22.8B in September, bringing the third quarter total to $49.2B, down from $59.4B in the second quarter.



Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

U.S. LBO Loan Volume

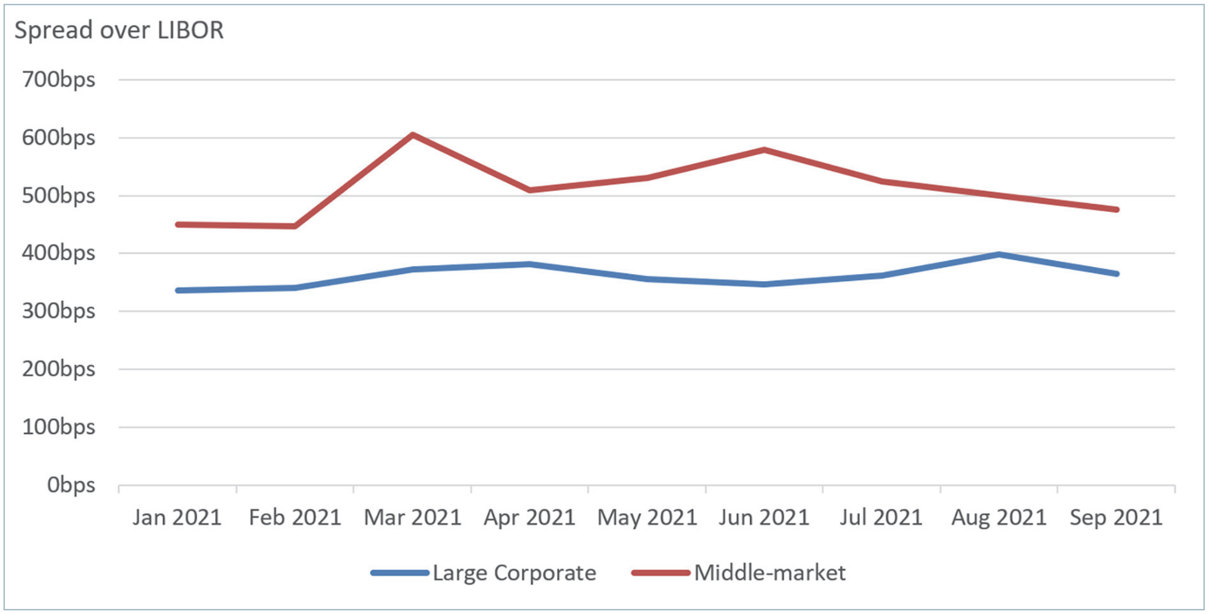
The U.S. LBO loan market was busy at historic levels in the third quarter of 2021. There were over $53B in principal amount of U.S. LBO loans issued in the third quarter of 2021, the highest quarterly level since 2008. For the first three quarters of 2021, LBO loan volume totaled $148.6B in principal amount, up 287% as compared to the first three quarters of 2020.



Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Primary Market Institutional First-Lien Loan Spreads

Average LIBOR spreads on first lien institutional loans for large corporate leveraged loan transactions were 367 bps in the third quarter of 2021, 15 bps wider than the 352 bps average over the first and second quarters of 2021. Middle market spreads were 500 bps in the third quarter of 2021, 17 bps tighter than the 517 bps average over the first and second quarters of 2021.

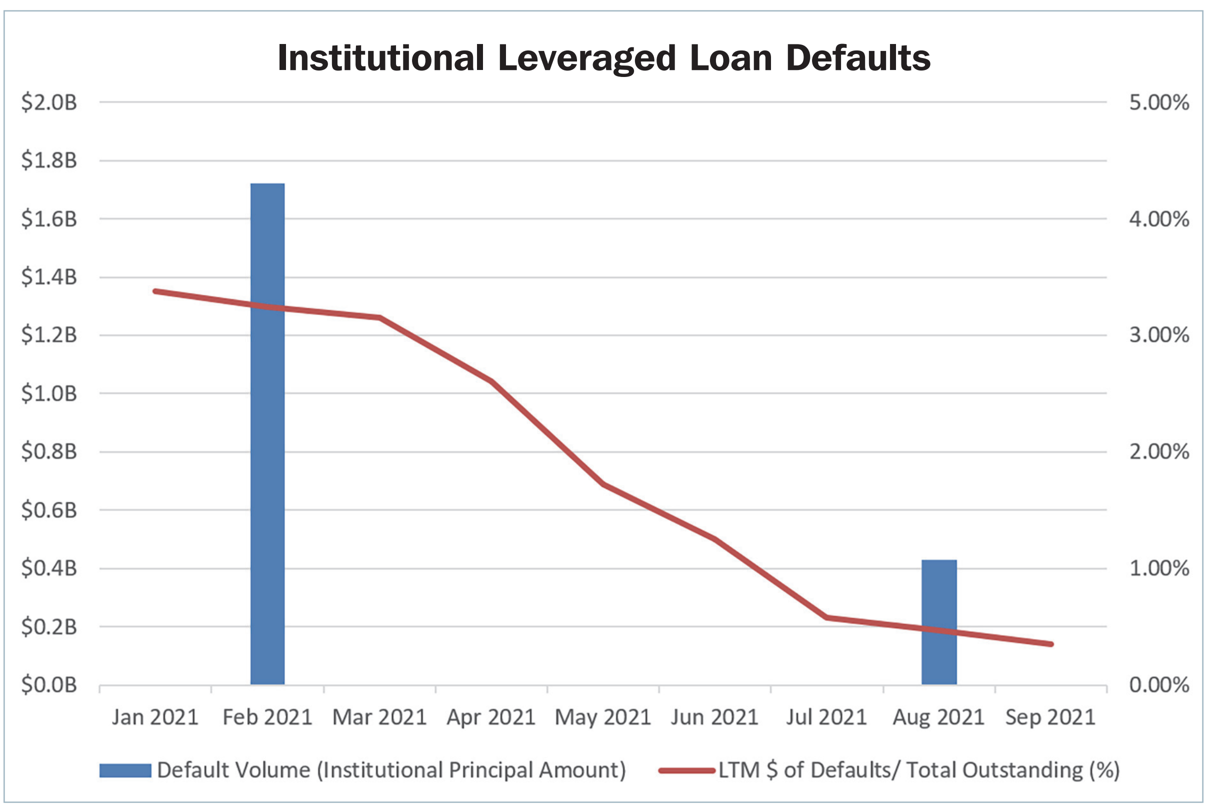


Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Note: Middle market is defined as borrowers with an annual EBITDA of less than $50mm. Averages are dollar-weighted based on reported spreads.

U.S. Institutional Leveraged Loan Defaults

There continue to be very few U.S. institutional leveraged loan defaults. With no institutional loan defaults in September, the principal amount of U.S. institutional leveraged loans that have defaulted in 2021 totaled $2.1B through the first three quarters of 2021, down 96% as compared to the first three quarters of 2020.



Data Source: Leveraged Commentary & Data (LCD), an offering of S&P Global Market Intelligence

Legal Developments

CASE LAW

Q3 2021 featured notable decisions addressing (i) NYSE Direct Listings and Section 11 Standing and (ii) a lawsuit challenging an "uptiering" transaction.

1. *Pirani v. Slack Technologies, Inc.*

On September 20, 2021, the U.S. Court of Appeals for the Ninth Circuit affirmed the district court's decision in *Pirani v. Slack Technologies, Inc.*, finding that shareholders who purchased shares of Slack Technologies, Inc. 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. In the 2-1 opinion, the court determined that because the "shares could not be purchased without the issuance of Slack's registration statement", plaintiffs had standing to sue under Section 11 even though the plaintiffs could not show that the purchased shares were registered under that particular registration statement.

Section 11 of the Securities Act makes issuers strictly liable for registration statements containing "an untrue statement of a material fact" or omission of "a material fact required" to keep the statements from being misleading. Unlike liability under Section 10(b) of the Securities Act, which requires that the defendant act with intent to deceive, manipulate or defraud, Section 11 confers liability for any material misstatements or omissions in a registration statement. Courts have historically required that plaintiffs show that the security purchased was issued under and directly traceable to the particular registration statement in question. Because such tracing is often logistically impossible after otherwise identical shares that weren't included in the registration statement at issue begin trading, courts have generally rejected Section 11 claims made by subsequent purchasers.

In 2018, the New York Stock Exchange (NYSE) implemented a rule allowing companies to go public through a Selling Shareholder Direct Floor Listing rather than a traditional initial public offering. 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 Section 11 standing doctrine to Slack's direct listing could arguably mean that no plaintiff could have standing to sue under Section 11, because it would be impossible to show that the shares at issue were registered.

The Ninth Circuit focused instead on whether the shares could have been purchased if not for the registration statement in determining Section 11 standing. Under the Ninth Circuit's reasoning, "the same registration statement [made] it possible to sell both registered and unregistered shares to the public" and therefore Section 11 standing was warranted.

When NYSE implemented the new rules around direct listing, many speculated that plaintiffs seeking to file suit under Section 11 or Section 12 would face a significant hurdle on the standing issue. With this ruling, the Ninth Circuit showed that courts may allow for flexibility on this issue to keep open the potential for liability. Slack has indicated intent to petition the court for rehearing or rehearing en banc.

2. *Audax Credit Opp. v. TMK Hawk Parent, Corp.*

On August 16, 2021, a New York State Supreme Court judge denied a motion to dismiss in a claim brought by minority lenders who were primed in a restructuring transaction undertaken by TriMark USA, LLC, finding that, among other things, an amended "no-action" provision in TriMark's credit agreement was unenforceable with respect to the transaction.

In September 2020, restaurant supplier TriMark, whose business had been battered by the COVID-19 pandemic, agreed with certain participating lenders under its first lien credit facilities to amend the credit agreement to permit the establishment of two tranches of priming debt. The participating lenders agreed to strip covenants and make other amendments to the credit agreement, including to subordinate the existing debt and to broaden the agreement's "no-action" clause in an attempt to limit suits from the non-participating lenders. The non-participating lenders – which were not given the opportunity to participate in the priming transaction – went from being lenders in a

$569 million first-lien facility to being effectively third-lien lenders behind $427.5 million in super-senior tranches. They brought suit against TriMark, its private equity sponsors, Centerbridge and Blackstone, and the participating lenders on a variety of grounds. The defendants filed a motion to dismiss.

The court rejected the defendants' argument that the amended credit agreement's "no-action" provision should block the plaintiffs' suit, finding that such provision is unenforceable and inapplicable to the claims asserted by the plaintiffs.

The amended credit agreement's "no-action" clause purported to preclude lenders from asserting <u>any</u> causes of action against the borrower and other lenders, whereas the unamended clause only purported to restrict suits to realize upon the collateral or to enforce any guaranty.

While stating that "no-action" clauses are generally enforceable, the court reasoned in this case that the amended clause was not enforceable because it did not reflect an "ex ante agreement to sacrifice certain individual rights for the 'salutary purpose' of benefitting the venture as a whole"; instead, it was deployed specifically in connection with the priming transaction as an attempted "preemptive self-pardon".

This ruling indicates that courts may be receptive to primed lenders' claims challenging uptiering transactions – even where the underlying credit agreement does not contain a "Serta" provision (named for another uptiering example) including a priming transaction as one of the "sacred rights", requiring the consent of all affected lenders – by taking a practical view of the effect of the transaction as a whole and its effect on lenders' rights.

REGULATORY UPDATES

SPAC Deal Spurs SEC Enforcement Action

The SEC has previously signaled its focus on the regulatory requirements around special purpose acquisition companies (SPACs) amid the proliferation of SPAC transactions in the last several years. In its first major enforcement action of the SPAC boom, on July 13, 2021, the SEC announced charges against a SPAC, the SPAC's CEO, its sponsor, the SPAC's target and the target's CEO for making misleading claims to investors. According to SEC Chair Gary Gensler, "[t]his case illustrates risks inherent to SPAC transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors".

The SPAC transaction at issue involves the planned merger between Stable Road Acquisition Corp., a SPAC, and Momentus, Inc., a commercial space company offering in-space infrastructure services. Stable Road's IPO in November 2019 gave it an 18-month window in which to combine with another business before public shareholders would have the right to redeem their shares. Stable Road announced the merger with Momentus in October of 2020 and simultaneously raised $175 million in PIPE (private investment in public equity) funding in exchange for shares in the eventual merged company. Before the merger's anticipated closing in August 2021, the SEC brought its enforcement action, alleging that Momentus and its CEO committed fraud by claiming to investors that the company's proprietary propulsion technology had been successful in live tests in space and by mispresenting national security concerns around the company's CEO, which would undermine its ability obtain necessary clearances.

Though Stable Road had engaged a space tech consulting firm to conduct due diligence on its behalf, the claim regarding successful live testing was not sufficiently investigated, according to the SEC. Stable Road also allegedly failed to investigate or disclose risk factors connected to the CEO of Momentus, including a government requirement that he divest from a similar company and an export license denial by the Commerce Department. Both Stable Road's SEC disclosures and investor materials included Momentus's alleged material misstatements around successful space testing and omissions of concerns regarding the clearance and licensure risks related to the CEO.

Stable Road consented to an order stating violations under Section 17(a)(2) and 17(a)(3) of the Securities Act, Section 13(a) and 14(a) of the Exchange Act and Rules 12b-20, 13a-11 and 14a-9 thereunder, without admitting or denying the SEC's findings. Stable Road's sponsor, its CEO and the target company consented to similar orders, and Stable Road and the target company agreed to pay penalties of $1 million and $7 million, respectively. Litigation continues against the target company's CEO, against whom the SEC filed a complaint in the U.S. District Court for the District of Columbia. The SEC also ordered that Stable Road and Momentus allow PIPE investors to terminate their subscription agreements, while the sponsor agreed to forfeit 250,000 founder shares that it would have been entitled to upon shareholder approval of the merger.

This enforcement action shows the SEC's effort to drive SPACs and their sponsors to play a more active due diligence and gatekeeping role in selecting target companies for combination, and to not merely rely on the target's representations. Chair Gensler said that the action will help better align the incentives of SPAC transaction parties with those of investors. In the future, SPACs should expect the SEC to carefully scrutinize disclosure filings and other public statements to determine whether the SPAC has conducted an appropriate due diligence investigation on any potential target.

Rule 10b5-1 Plans

On September 9, 2021, the SEC's Investor Advisory Committee (IAC) adopted the Investor as Owner subcommittee's recommendations on rules around Rule 10b5-1 plans. Under the recommendations, the IAC is advising that the SEC require a "cooling off" period of at least four months between the adoption or modification of a Rule 10b5-1 plan and the execution of the first trade under the newly adopted or newly modified plan. The committee also recommended prohibiting overlapping plans so that a single person or entity may not have more than one Rule 10b5-1 plan at a time. The IAC also adopted various recommendations regarding plan reporting and disclosure, including advising the SEC to (i) require electronic submission of Form 144; (ii) require enhanced public disclosure of Rule 10b5-1 plans, including proxy statement disclosure of the number of shares covered under Rule 10b5-1 plans by each named executive officer and of the total number of shares covered under "corporate" Rule 10b5-1 plans, as well as timely disclosure on Form 8-K of the adoption, modification or cancellation of Rule 10b5-1 plans and the number of shares covered; (iii) enhance disclosure of Rule 10b5-1 trades, including certain modifications to Form 4; and (iv) ensure that all companies with any securities listed on U.S. exchanges (which would include foreign private issuers) are subject to Form 4 reporting requirements. The recommendations are generally consistent with prior public statements made by Chair Gensler on the topic of potential reforms to Rule 10b5-1 plans. The IAC also clarified in their session that their recommendations applied to Rule 10b5-1 plans entered into by individual insiders rather than company stock repurchase plans structured to comply with the Rule 10b5-1 safe harbor.

Form 8-K Trading Gap

In July 2021, the 8-K Trading Gap Act, which originally passed in the House in January 2020 but did not advance in the Senate, was reintroduced in the House and Senate. Under the proposed legislation, the SEC would be required to issue rules that prohibit officers and directors of reporting companies from trading securities in anticipation of a current report on Form 8-K. Under such rules, reporting companies would be required to establish and maintain policies, controls and procedures that are reasonably designed to prohibit their executive officers and directors from purchasing, selling or otherwise transferring any equity security of the issuer, directly or indirectly, during a certain time period before a Form 8-K is filed. With respect to an event described in sections 1 through 6 of Form 8-K (*i.e.*, disclosures regarding the registrant's business and operations, financial information, securities and trading markets, matters related to accountants and financial statements, corporate governance and management, and asset-backed securities), the prohibition would apply to the period between the date of the event and the date on which the issuer files or furnishes the related Form 8-K. With respect to an event described in section 7 or 8 of Form 8-K (*i.e.*, disclosures pursuant to Regulation FD and other events), the prohibition would apply between the date on which the issuer determines that the issuer will disclose the event and the date on which the issuer files or furnishes the related Form 8-K. Certain transactions, such as transactions that occur automatically or are made pursuant to an advance election, would be exempt from the requirements.

Cryptoassets

Cryptoasset issues have been an increasing focus of bank and market regulators and global standard setting organizations in 2021, with particular urgency in the second half of the year. The primary global standard setter for prudential standards for banks, the Basel Committee on Banking Supervision, kicked off efforts in earnest with a consultation on the prudential treatment of cryptoasset exposures in June 2021. In the United States, the President's Working Group on Financial Markets announced in July 2021 that staff are preparing a report on stablecoins, which should be released by the end of the year. The Federal Reserve Board is also preparing its own white paper, anticipated to be released in the fall of 2021, that will cover a range of digital-asset issues including issues related to stablecoins, other cryptoassets and central bank digital currencies. An interagency "sprint" team of U.S. bank regulators is coordinating on policy-making on digital asset and related issues, and this group expects to communicate to the public some of its work before year-end. Enforcement efforts by market regulators are ramping up as well. In October 2021, the Commodity Futures Trading Commission announced charges against Tether Holdings Limited and affiliates for making untrue or misleading statements and omissions of material fact regarding whether it held sufficient U.S. dollar reserves to fully back its stablecoin. In that enforcement action, the CFTC asserted that the Tether stablecoin is a commodity under the Commodity Exchange Act. Lastly, the SEC has taken an expansive view of its jurisdictional authority – Chair Gensler stated in an August 2021 speech that the SEC will take its "authorities as far as they go" over digital asset issues. We expect further acceleration of activity in this space, with the potential for Congress to wade into the debate to help clarify jurisdictional boundaries across the various agencies.

NYSE Aligns Related Party Transaction Thresholds with SEC Disclosure Requirements

On April 2, 2021, NYSE made amendments to several sections of the NYSE Listed Company Manual concerning shareholder and independent approval requirements for related party transactions. The changes to Section 314.00 of the Listed Company Manual, regarding independent approval of related party transactions, required that the listed company's audit committee or another independent body of the board of directors "conduct a reasonable prior review and oversight of all related party transactions" for "potential conflicts of interest" and prohibited such transactions if determined to be inconsistent with the interests of the company and its shareholders.

The April amendment raised concerns among NYSE-listed companies because it defined "related party transactions" without regard to the transaction value threshold of $120,000 of Item 404 of Regulation S-K and the materiality thresholds of Form 20-F, Item 7.B, respectively, as applicable. Companies were faced with two separate standards for related party transactions, one for disclosure and the other for review and approval.

On August 19, 2021, NYSE filed a rule proposal to take immediate effect in August 2021 in order to align the review and approval requirements for related party transactions with existing SEC disclosure regulations, including the materiality thresholds. According to the proposed amendment, the April 2 amendments had "unintended consequences" and created a "significant compliance burden". The exchange said that it believes that review of large numbers of immaterial transactions was not an effective use of independent directors' time.

Pursuant to the August rule change, listed companies will only need to identify and submit for prior review transactions that meet the applicable disclosure threshold under Item 404 of Regulation S-K or Form 20-F Item 7-B.

Other Developments

Activity relating to the replacement of the London interbank offered rate (LIBOR) as a benchmark rate continued apace in the third quarter of 2021 in the syndicated lending market. In particular, multicurrency facilities were and continue to be a focus for amendments to implement new benchmarks, as we approach the December 31, 2021 date for the cessation of (i) all Euro LIBOR settings; (ii) subject to "synthetic" settings for certain tenors for certain legacy contracts, all GBP and Yen LIBOR settings; (iii) all Swiss franc LIBOR settings; and (iv) the 1-week and 2-month U.S. Dollar LIBOR settings.

Of particular note were the following developments:

- On July 29, 2021, the Alternative Reference Rates Committee (ARRC) formally recommended the adoption of the CME Group's forward-looking Secured Overnight Financing Rate term rates (Term SOFR). In ARRC's press release, Governor Randal K. Quarles of the Federal Reserve Board said that all firms "should be moving to meet [the Federal Reserve Board's] supervisory guidance advising them to end new use of LIBOR this year".

- Also on July 29, 2021, the U.S. House Financial Services Committee progressed the Adjustable Interest Rate (LIBOR) Act of 2021 to the House, following the passage of a similar New York State statute that came into effect on April 6, 2021 (Senate Bill S297B). If passed and signed into law, the Adjustable Interest Rate (LIBOR) Act would provide for a SOFR-based replacement rate for certain financial contracts that do not contain sufficient fallback language.

- On September 29, 2021, the Financial Conduct Authority (FCA) announced that it will require the publishing of "synthetic" 1-, 3- and 6-month GBP and yen LIBOR settings for the duration of 2022 for certain legacy contracts that will be specified before the end of the year.

- Shortly after the end of the third quarter, on October 5, 2021, at a speech before the Structured Finance Association Conference, Governor Quarles reiterated his call to banks to speed up the transition away from LIBOR, and noted that in his view, "new" use of LIBOR after 2021 would include any agreement that creates additional LIBOR exposure for a supervised institution or extends the term of an existing LIBOR contract.

- There remain alternatives to Term SOFR as replacements to LIBOR, including the Bloomberg Short-Term Bank Yield Index (BSBY). This benchmark, however, continues to be disfavored by regulators. In particular, on September 20, 2021, SEC Chair Gensler endorsed the ARRC's recommendation of SOFR-based LIBOR replacement rates, and specifically criticized BSBY, noting that it suffers from the "same flaws as LIBOR".

The FCA has previously announced that the overnight, 1-month, 3-month, 6-month and 12-month U.S. Dollar LIBOR settings will continue to be provided until June 30, 2023 for legacy contracts.