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Cravath Quarterly Review

FINANCE AND CAPITAL MARKETS

Market Update

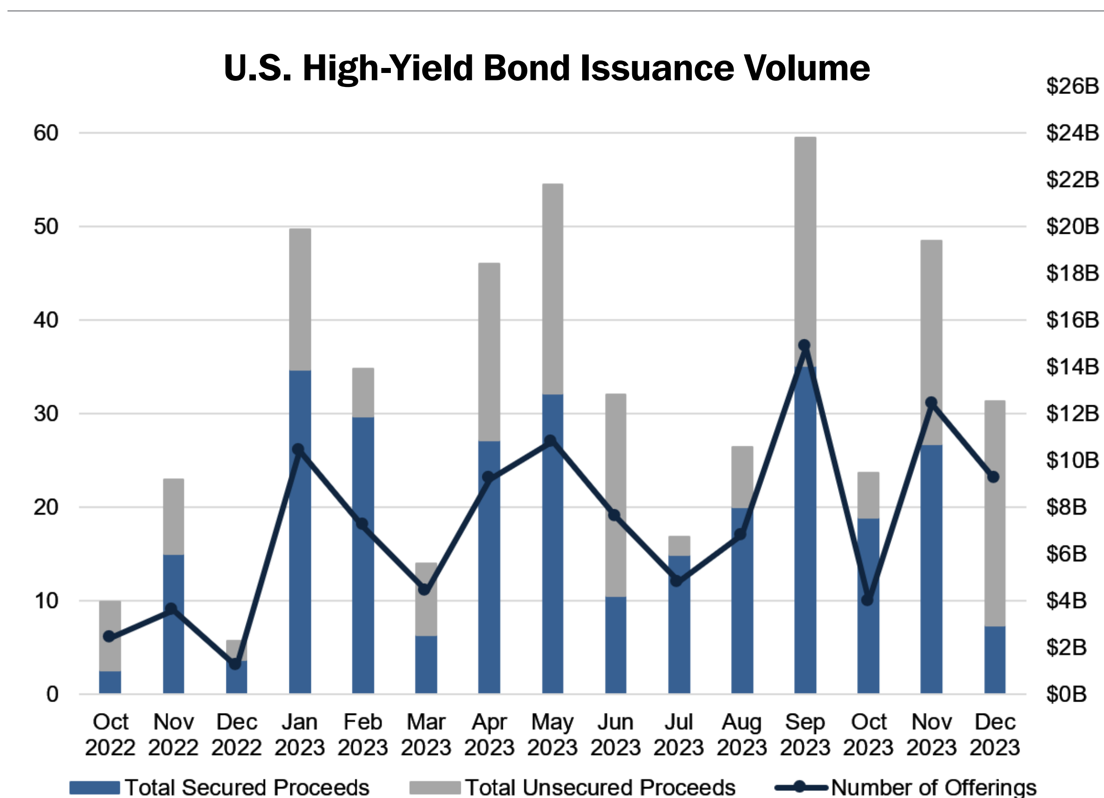
GENERAL TRENDS

U.S. financing activity in the fourth quarter of 2023 generally decreased compared to the third quarter of 2023, but remained elevated from the levels seen in the fourth quarter of 2022. Activity in the U.S. investment-grade bond market declined relative to the third quarter of 2023, but was slightly higher than the fourth quarter of 2022. Activity in the U.S. high-yield bond market was similar to the third quarter of 2023, but increased significantly as compared to the fourth quarter of 2022. Activity in the U.S. syndicated leveraged loan market (including the leveraged buyout ("LBO") market) decreased considerably in the fourth quarter of 2023 as compared to the third quarter of 2023, but remained stronger than the fourth quarter of 2022. Activity in the direct lending market continued to outpace the syndicated loan market overall. The number of and total proceeds from U.S. follow-on equity offerings in the fourth quarter of 2023 increased relative to the third quarter of 2023 and the fourth quarter of 2022. U.S. IPO activity in the fourth quarter of 2023 declined considerably as compared to the third quarter of 2023, but was higher than the fourth quarter of 2022. However, many companies have publicly filed registration statements and/or announced plans for IPOs, leading to an expected increase in U.S. IPO activity in 2024.

BONDS

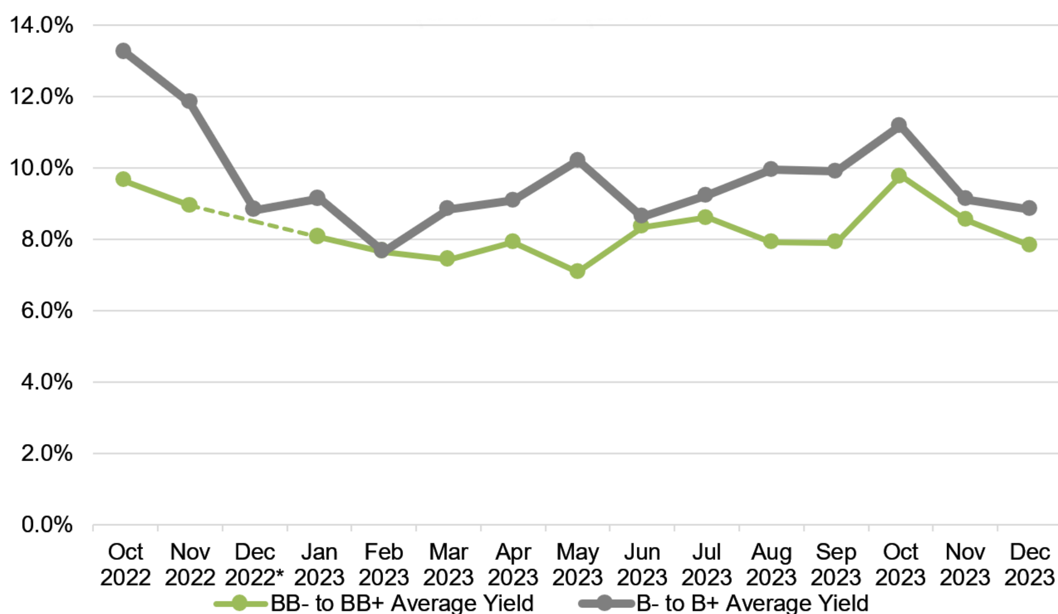
U.S. High-Yield Bonds

Total proceeds from U.S. high-yield bond issuances were $41.3B in the fourth quarter of 2023, up 0.5% as compared to the third quarter of 2023 ($41.1B) and up 168.5% as compared to the fourth quarter of 2022 ($15.4B). Total proceeds from unsecured bonds were $20.1B in the fourth quarter of 2023, up 192.2% as compared to $6.9B in the fourth quarter of 2022. On a year-over-year basis, the $176.1B in total proceeds from issuances in 2023 increased 72.2% from the $102.3B in total proceeds from issuances in 2022.



DATA SOURCE Leveraged Commentary & Data (LCD)

The average initial yield on high-yield notes rated BB- to BB+ issued in the fourth quarter of 2023 was 8.7%, as compared to 8.1% in the third quarter of 2023 and 9.3% in the fourth quarter of 2022. The average initial yield on high-yield notes rated B- to B+ issued in the fourth quarter of 2023 was 9.7%, roughly equivalent to the third quarter of 2023 and lower than the average initial yield of 11.3% in the fourth quarter of 2022. However, yields have seemingly begun to decline in more recent weeks, due to strong macroeconomic conditions and an expectation for rate cuts in the U.S. On a year-over-year basis, the average initial yield on high-yield notes rated BB- to BB+ issued in 2023 was up 18.4% as compared to 2022 and the average initial yield on high-yield notes rated B- to B+ issued in 2023 was up 2.1% as compared to 2022.

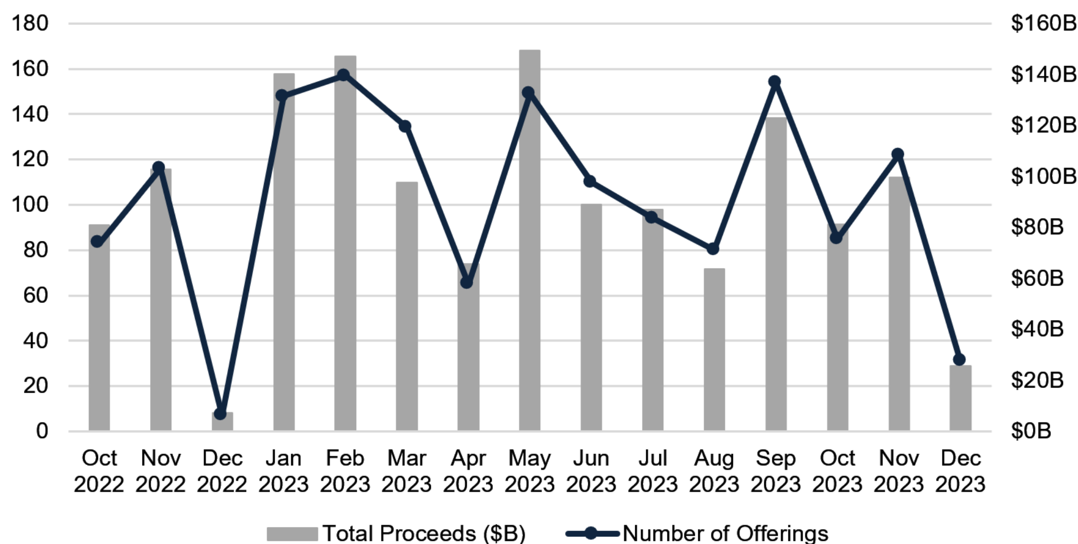


* No high-yield notes rated BB- to BB+ were issued in December 2022.

DATA SOURCE Leveraged Commentary & Data (LCD)

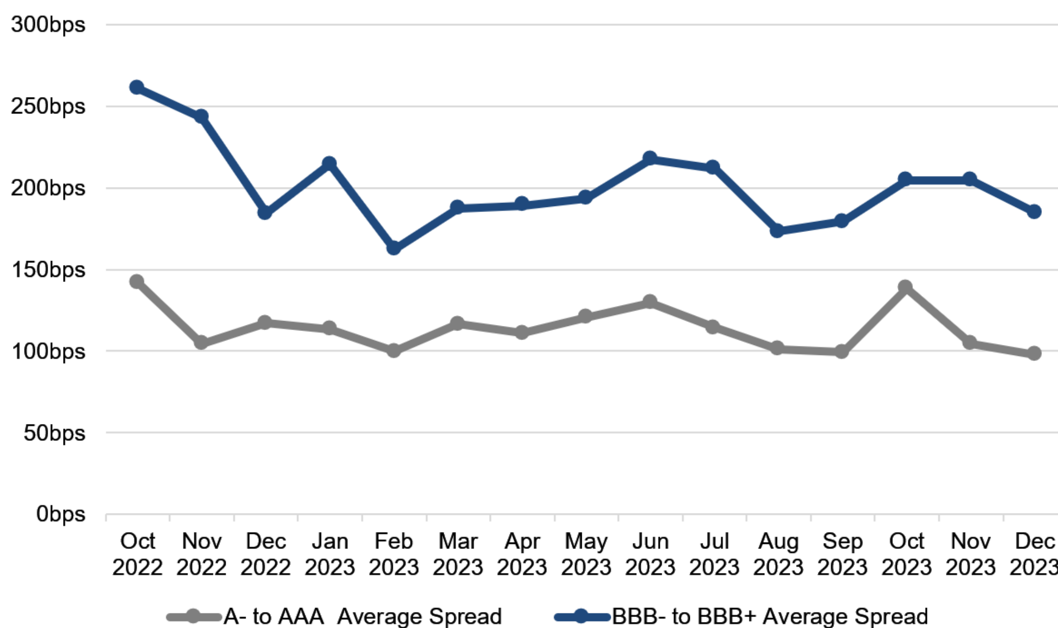
U.S. Investment-Grade Bonds

Total proceeds from U.S. investment-grade issuances were $206.1B in the fourth quarter of 2023, down 24.6% from $273.3B in the third quarter of 2023 and up 8.1% from $190.6B in the fourth quarter of 2022. On a year-over-year basis, the $1,167.6B in total proceeds from issuances in 2023 was on par with the $1,169.1B in total proceeds from issuances in 2022.



DATA SOURCE Leveraged Commentary & Data (LCD)

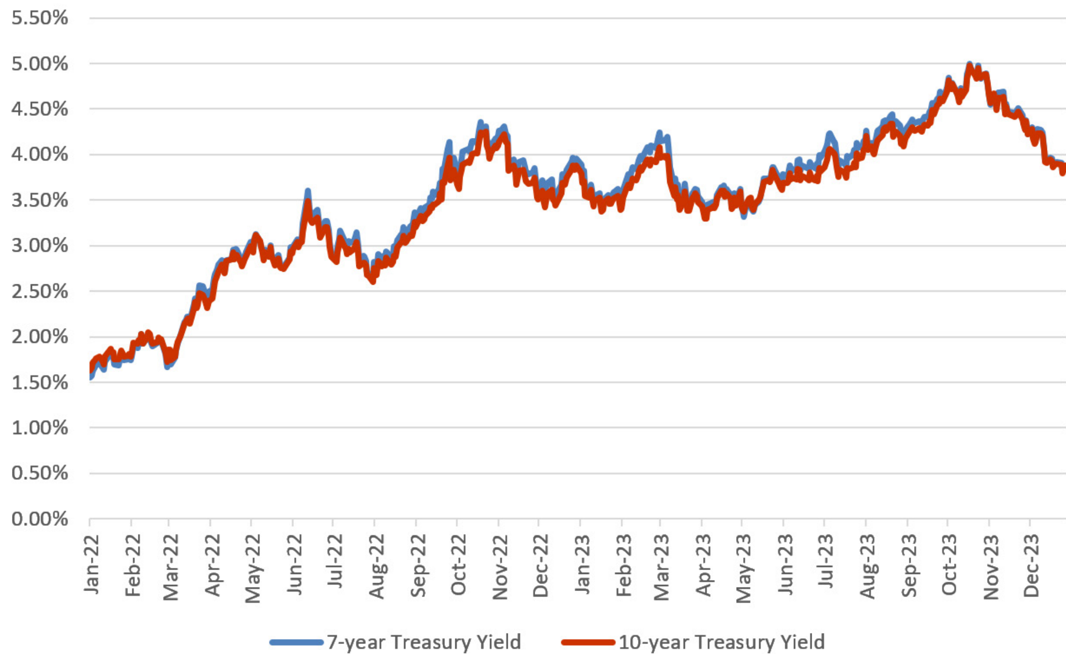
The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated A- to AAA in the fourth quarter of 2023 increased 8.2% as compared to the average pricing spread for the third quarter of 2023 and decreased 6.3% as compared to the average pricing spread for the fourth quarter of 2022. The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated BBB- to BBB+ in the fourth quarter of 2023 increased 5.1% as compared to the average pricing spread for the third quarter of 2023 and decreased 13.8% as compared to the average pricing spread for the fourth quarter of 2022. On a year-over-year basis, average pricing spreads (measured over the comparable Treasury) on U.S. investment-grade bond issuances in 2023 were similar to 2022, with an overall increase of 2.6% for notes rated A- to AAA and decrease of 3.8% for notes rated BBB- to BBB+.



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 fourth quarter of 2023, the Federal Reserve left interest rates unchanged and signaled potential rate cuts in 2024. U.S. Treasury 7-year yields decreased 73 bps to 3.88% at the end of the fourth quarter of 2023, down 15.8% as compared to 4.61% at the end of the third quarter of 2023. U.S. Treasury 10-year yields decreased 71 bps to 3.88% at the end of the fourth quarter of 2023, down 15.5% as compared to 4.59% at the end of the third quarter of 2023. This decrease brought U.S. Treasury yields back in line with levels seen at the end of the fourth quarter of 2022 at 3.96% for 7-year yields and 3.88% for 10-year yields.

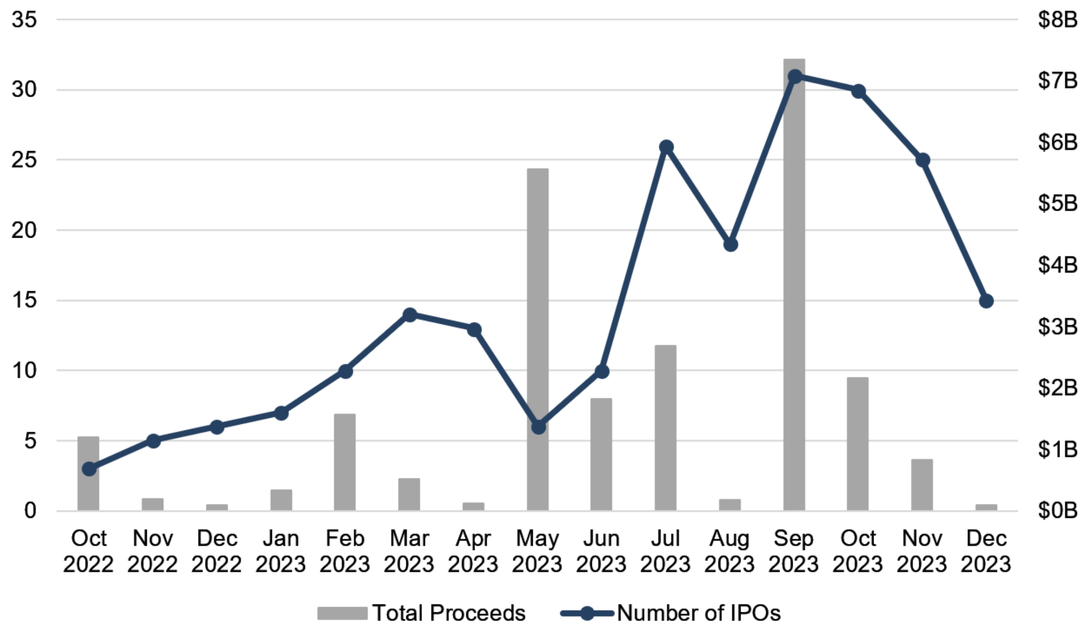


DATA SOURCE U.S. Department of the Treasury

EQUITY

U.S. IPOs

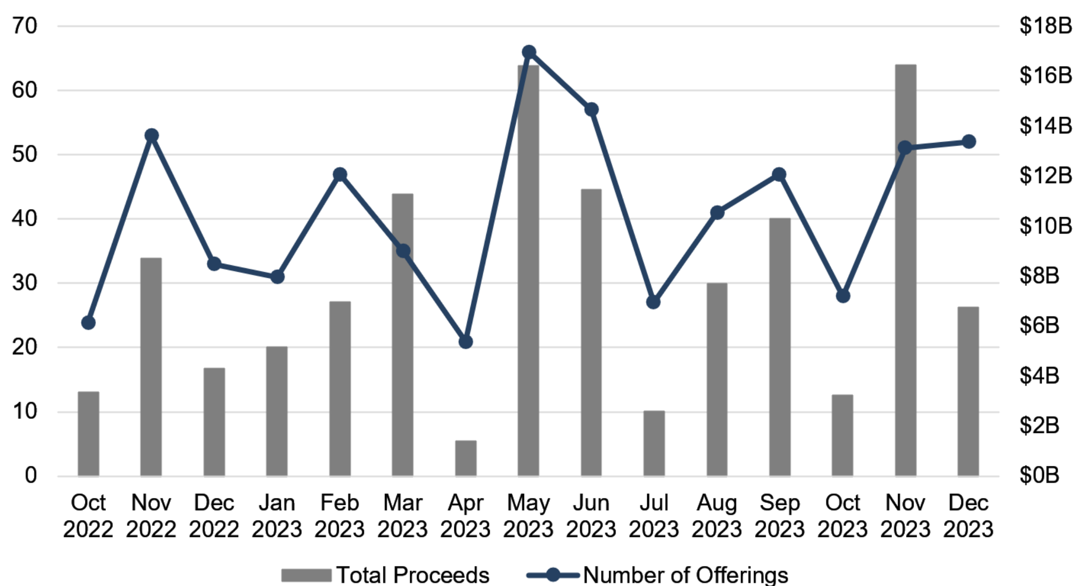
The U.S. IPO market in the fourth quarter of 2023 remained far less active compared to the record-setting levels seen in 2021 and slowed considerably compared to the third quarter of 2023. The $3.1B in total proceeds from U.S. IPOs (not including SPACs) in the fourth quarter of 2023 was down 69.8% as compared to $10.2B in total proceeds in the third quarter of 2023 (partially driven by the $4.9B in total proceeds from Arm's IPO in the third quarter of 2023) and up 108.51% as compared to $1.5B in total proceeds in the fourth quarter of 2022. On a year-over-year basis, the $23.2B in total proceeds from U.S. IPOs (not including SPACs) in 2023 was 134.7% higher than the $9.9B in total proceeds in 2022 and 86.2% lower than the $167.7B in total proceeds in 2021.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Follow-On Offerings

The $26.4B in total proceeds from U.S. follow-on equity offerings in the fourth quarter of 2023 was up 28.4% as compared to $20.6B in total proceeds in the third quarter of 2023 and up 61.6% as compared to $16.4B in total proceeds in the fourth quarter of 2022. On a year-over-year basis, total proceeds from U.S. follow-on equity offerings were $99.7B in 2023, up 64.9% as compared to $60.4B in total proceeds in 2022.

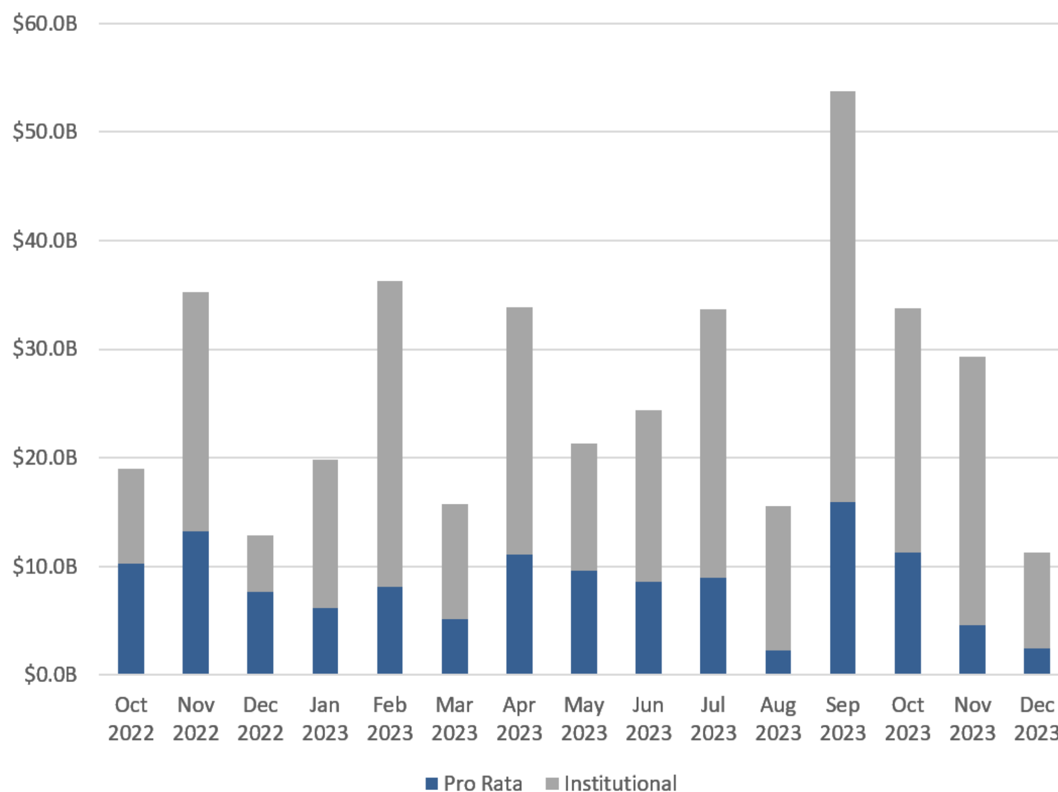


DATA SOURCE Refinitiv, an LSEG Business

U.S. Syndicated Leveraged Loan Issuances

After a relatively busy September, activity in the U.S. syndicated leveraged loan market slowed in the fourth quarter of 2023, with total volume down by 28% as compared to the third quarter of 2023. The decrease was distributed evenly between institutional term loans and pro rata loans, which respectively decreased by 32% and 26% as compared to the third quarter of 2023. However, deal volume remained stronger than last year, with an increase in total deal volume of 11% as compared to the fourth quarter of 2022 driven by institutional loan volume, which was $56.0B in the fourth quarter of 2023, up 56% as compared to the fourth quarter of 2022. By contrast, total pro rata loan volume decreased to $18.4B in the fourth quarter of 2023, down 41% as compared to the fourth quarter of 2022.

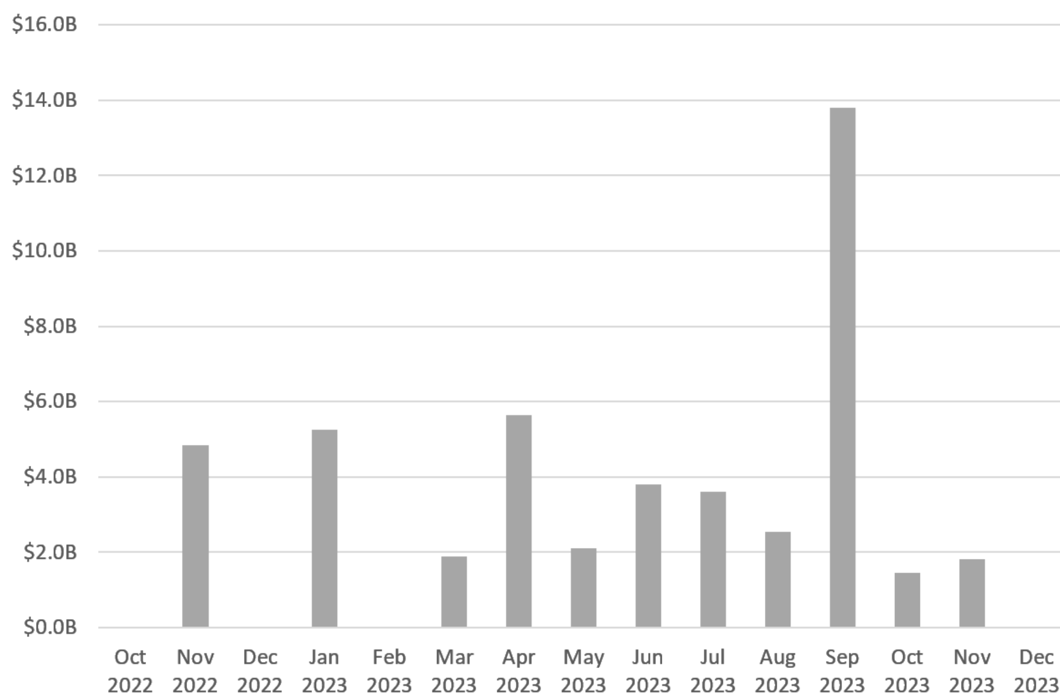
U.S. Syndicated Leveraged Loan Issuances (Total)



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Syndicated LBO Loan Volume

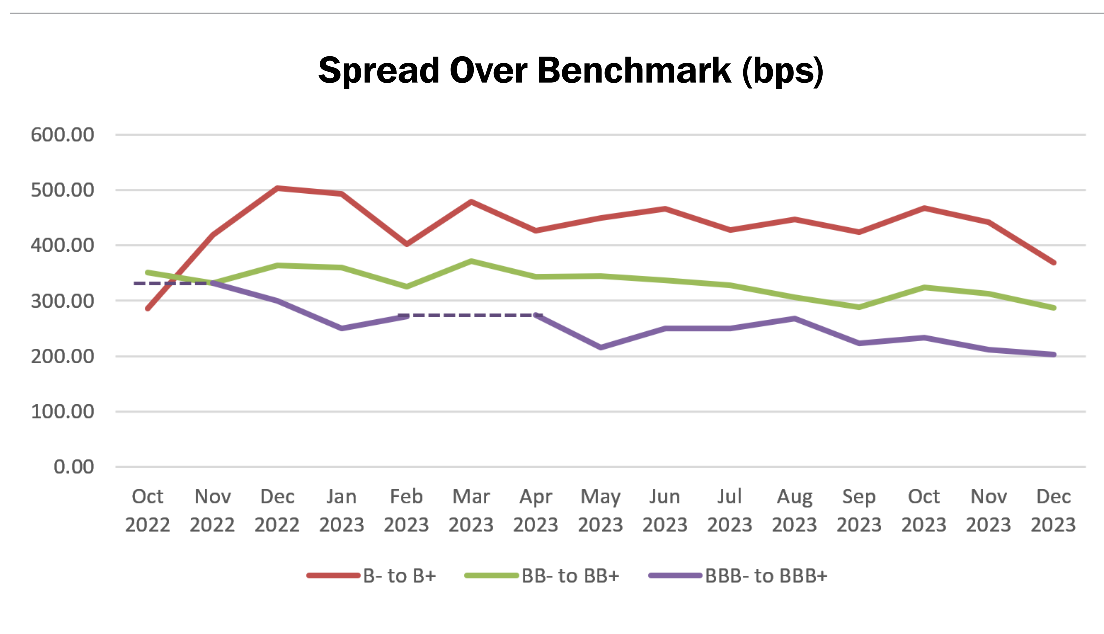
In the fourth quarter of 2023, there were $3.3B of U.S. syndicated LBO loans issued, which was a decrease of 84% as compared to $19.9B in the third quarter of 2023 and a decrease of 33% as compared to $4.9B in the fourth quarter of 2022. As of January 25, 2024, LCD reported no U.S. LBO loans issued in December 2023 in the U.S. syndicated leveraged loan market.



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 343 bps in the fourth quarter of 2023, which is lower than the 385 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 426 bps in the fourth quarter of 2023, which is lower than the 435 bps average spread in the trailing 12-month period, (b) BB- to BB+ were 308 bps in the fourth quarter of 2023, which is lower than the 339 bps average spread in the trailing 12-month period and (c) BBB- to BBB+ were 216 bps in the fourth quarter of 2023, which is lower than the 264 bps average spread in the trailing 12-month period.

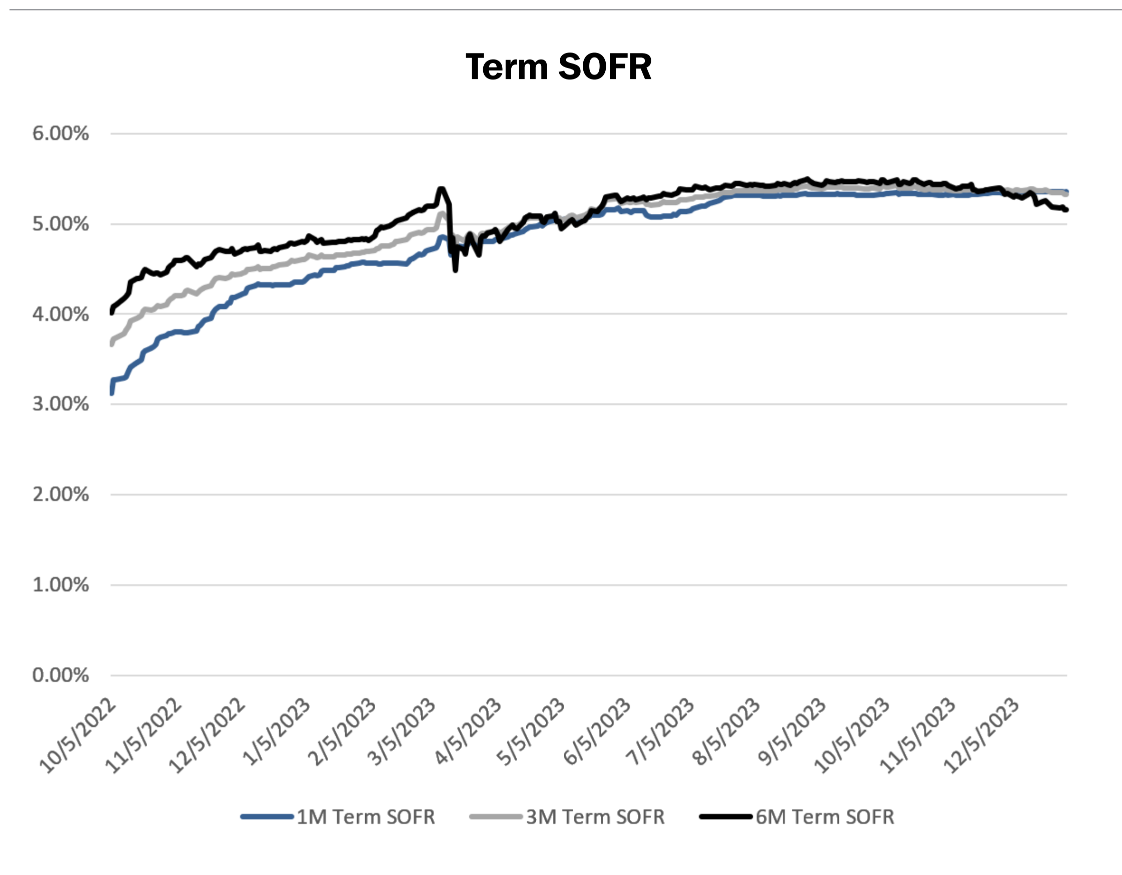


Note: Large corporate borrowers are defined as borrowers with an annual EBITDA of at least $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments.

DATA SOURCE Leveraged Commentary & Data (LCD)

Term SOFR Reference Rate

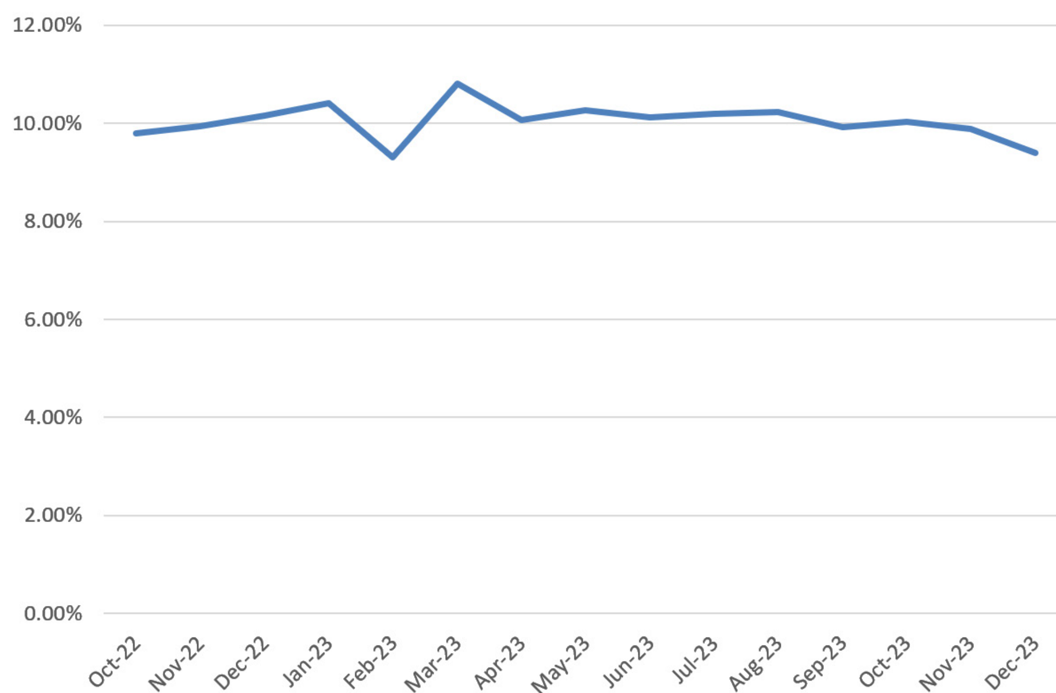
Term SOFR ended the fourth quarter of 2023 at 5.35%, 5.33% and 5.16% for the one-month, three-month and six-month tenors, respectively, for an increase of 4 bps and a decrease of 6 bps and 31 bps, respectively, as compared to the end of the third quarter of 2023. Notably, on November 30, 2023, Term SOFR for the six-month tenor dropped below the Term SOFR for both the one-month and three-month tenors. The yield curve inversion persisted through the remainder of the fourth quarter of 2023 and grew more pronounced following the Federal Reserve's policy statement on December 13 indicating that it sees lower borrowing costs in 2024; the six-month tenor was on average 4 bps lower than the one-month tenor from December 1 through December 13 and was on average 14 bps lower than the one-month tenor from December 14 through the end of the month.



DATA SOURCE Bloomberg Finance L.P.

Primary Market Syndicated Institutional First-Lien Loan Yields

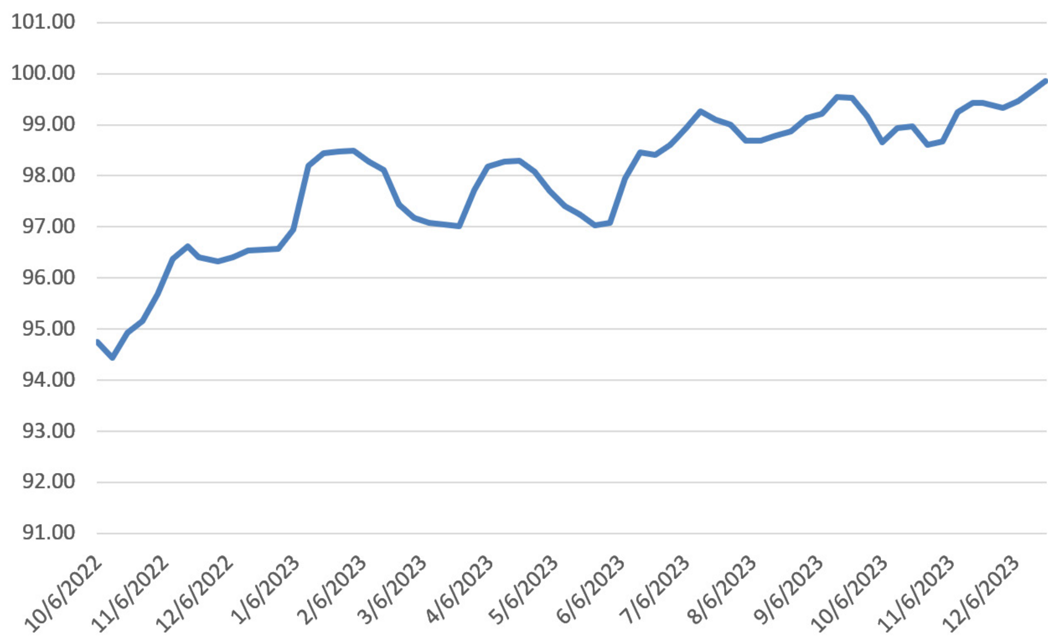
Yields on new-issue syndicated institutional first-lien term loans, inclusive of original issue discount, declined slightly in the fourth quarter of 2023. The average yield of 9.77% in the fourth quarter of 2023 represented a decrease of 35 bps as compared to the average yield of 10.12% in the third quarter of 2023 and a decrease of 38 bps as compared to the average yield of 10.15% in the second 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 fourth quarter of 2023 increased by 18 bps as compared to the end of the third quarter of 2023 and increased by 334 bps as compared to the end of the fourth quarter of 2022.



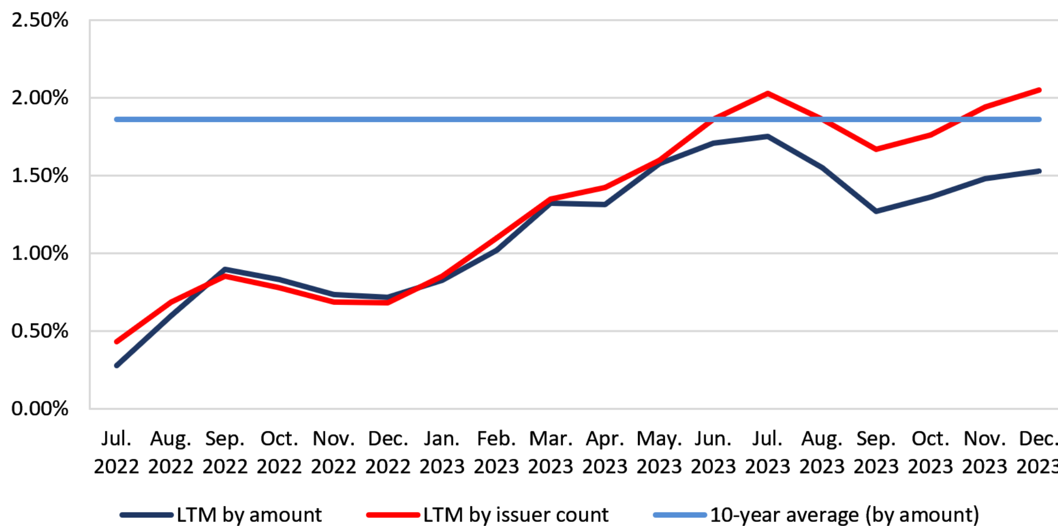
DATA SOURCE Leveraged Commentary & Data (LCD)[1]

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).

RESTRUCTURING

U.S. Leveraged Loan Default Rate

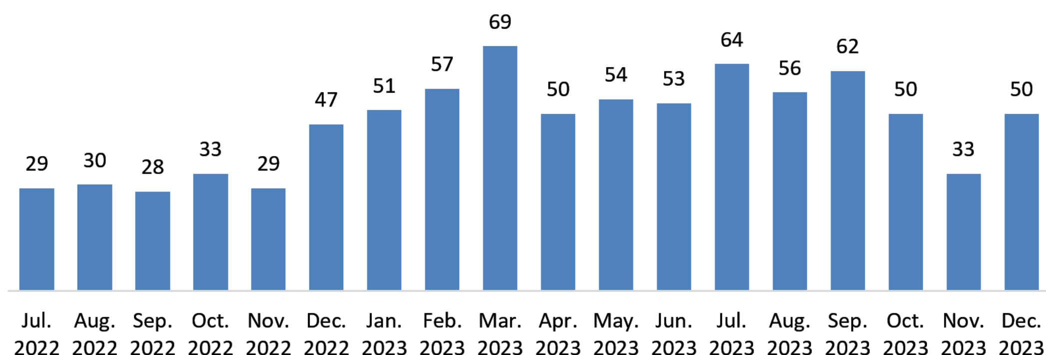
The default rate for U.S. leveraged loans increased throughout the fourth quarter of 2023. The default rate of the Morningstar LSTA US Leveraged Loan Index was 1.53% by amount and 2.05% by issuer count for the LTM period ending December 31, 2023, compared to 1.27% by amount and 1.67% by issuer count for the LTM period ending September 30, 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

While the number of U.S. bankruptcy filings slowed slightly in the fourth quarter of 2023, the year ended with the most filings of any year since 2010. Consumer discretionary, healthcare and industrials set the pace for bankruptcies in 2023, with 82 bankruptcy filings for consumer discretionary companies, 81 filings for healthcare companies and 80 filings for industrials.



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 the Rules Governing Beneficial Ownership Reporting

On October 10, 2023, the Securities and Exchange Commission (the "SEC" or the "Commission") adopted rule amendments (the "Beneficial Ownership Amendments") governing beneficial ownership reporting under Sections 13(d) and 13(g) of the Securities Exchange Act of 1934 (the "Exchange Act"). The Beneficial Ownership Amendments were proposed in order to promote greater visibility into the ownership shares of public companies by requiring market participants to provide more timely information on their positions. In summary, the Beneficial Ownership Amendments:

- shorten the deadlines for initial filings and amendments to Schedules 13D and 13G beneficial ownership reports;
- require that the filings be made using a structured, (XML-based) machine-readable data language;
- clarify the application of Section 13(d) and Section 13(g) of the Exchange Act to certain derivative securities; and
- provide guidance on the application of the existing statutory language to the circumstances under which two or more persons may be deemed to have formed a "group" subject to beneficial ownership reporting obligations.

Additional information about the Beneficial Ownership Amendments can be found in the Cravath Client Memo on the subject.

SEC Cybersecurity Rules Go into Effect

After December 18, 2023, all U.S. public companies, including foreign private issuers (but excluding smaller reporting companies, which have until June 15, 2024), must begin complying with the SEC's final rules regarding disclosure of cybersecurity risk management, strategy, governance and related incidents. As a reminder, the rules require: (i) current reporting of cybersecurity incidents determined to be material; and (ii) annual reporting of companies' processes to identify, assess and manage cybersecurity risks, as well as management's role in assessing and managing, and the board's role in overseeing, such risks. A full discussion of the new rules can be found in the Cravath Client Memo on the subject.

DOJ and SEC Provide Guidance on Cybersecurity Disclosure Delays

Pursuant to the SEC's cybersecurity reporting rules, companies may request to delay otherwise required disclosure if the U.S. Attorney General determines that public disclosure of the incident poses a substantial threat to public safety or national security.

On December 12, 2023, the Department of Justice (the "DOJ") released guidelines outlining the process by which the U.S. Attorney General will determine disclosure delay requests. Most notably, the DOJ clarified that the primary inquiry is whether the public disclosure (and not the underlying cybersecurity incident) poses a threat to public safety and national security. The guidelines noted that companies typically will be able to disclose material information related to a cybersecurity incident at a level of generality without providing compromising details. However, under certain circumstances, such disclosure could still pose a threat to public safety and national security. If the U.S. Attorney General determines that a disclosure delay is merited, the company will have an additional 30 days for disclosure, and in certain cases the U.S. Attorney General may grant subsequent periods of delay if the risk to public safety and national security continues to exist.

On December 14, 2023, the SEC published four Compliance and Disclosure Interpretations ("CDIs") relating to the public safety and national security exception to cybersecurity reporting. For more information, the CDIs are available here.

- CDI Question 104B.01 provides that registrants must file the Item 1.05 Form 8-K within four business days of determining a cyber incident to be material, unless the U.S. Attorney General notifies the SEC in writing of its determination that public disclosure of the incident threatens public safety or national security before the Form 8-K due date.
- CDI Question 104B.02 notes that registrants must file the Item 1.05 Form 8-K within four business days following the expiration of a permitted delay period (or any extension thereof).
- CDI Question 104B.03 clarifies that if the U.S. Attorney General determines, during a permitted delay period, that disclosure of the incident no longer threatens public safety or national security and notifies the SEC and the registrant of its new determination, the registrant must file the Item 1.05 Form 8-K within four business days of receiving such notification.
- CDI Question 104B.04 explains that Item 1.05 does not preclude registrants from consulting with the DOJ, the FBI or any other federal government agencies regarding a cybersecurity incident at any time, including before materiality is determined, and such consultation alone would not render an incident material.

SEC Brings Enforcement Action on Cybersecurity Practices and Disclosures

In October 2023, the SEC initiated an enforcement action against SolarWinds Corporation ("SolarWinds") and its chief information security officer, Timothy G. Brown, alleging they defrauded investors and failed to disclose known cybersecurity risks. In December 2020, SolarWinds announced that it was the target of a two-year-long cyberattack and that its custom IT systems were compromised. This announcement caused SolarWinds's stock price to drop approximately 25 percent in two days and approximately 35 percent in the next two weeks.

The SEC allegations focus on SolarWinds only disclosing generic risks related to its cybersecurity practices and failed to disclose specific risks related to the ongoing cyberattack. Of note, the SEC also charged Brown with personal liability, alleging that Brown had knowledge of SolarWinds' cybersecurity vulnerabilities and inadequate public disclosures but failed to take corrective actions. The complaint seeks permanent injunctive relief, disgorgement of profits and civil penalties from the company and a bar from acting as director or officer of other companies against Brown.

SEC Exempts Rule 144A Fixed-Income Securities from Rule 15c2-11 Disclosures

On October 30, 2023, the SEC issued an order exempting Rule 144A fixed-income securities from disclosure requirements under the newly expanded Rule 15c2-11 for brokers and dealers. Rule 15c2-11 generally imposes information and recordkeeping requirements on brokers and dealers publishing quotations for securities. As discussed in the Q4 2022 edition of this newsletter, in September 2020, the SEC amended Rule 15c2-11 of the Exchange Act to require brokers and dealers to keep records of certain publicly available information about the issuer and its security before they can begin quoting that security. The amendment was adopted with the aim of providing greater transparency to investors. Following the adoption of this amendment, various market participants petitioned the SEC to exempt Rule 144A fixed-income securities from Rule 15c2-11 (as

discussed in the Q3 2023 edition of this newsletter), arguing the rule is not suited to the fixed-income market and may harm corporate issuers' ability to raise capital for projects funded by Rule 144A bonds. The SEC granted this exemption, reasoning that investors in Rule 144A fixed-income securities are assumed to be sophisticated and capable of researching public information about the issuer on their own.

SEC Adopts New Short Sale Disclosure Rule

On October 13, 2023, the SEC adopted Rule 13f-2 of the Exchange Act to promote transparency by increasing the public availability of short sale data. Rule 13f-2 will require institutional investment managers that meet certain reporting thresholds to report certain equity security short position and short activity data on Form SHO. The SEC will, on a slightly delayed basis, publish this data, aggregated by security (thus protecting the confidentiality of the reporting managers).

The SEC also amended the National Market System Plan governing the consolidated audit trail ("CAT NMS Plan") to require that each consolidated audit trail ("CAT") reporting firm report to the CAT whether it is claiming the bona fide market making exception in Rule 203(b)(2)(iii) of Regulation SHO in connection with a short sale. The amendment will supplement short sale data provided to the SEC in Form SHO, thus filling a current information gap, the SEC argues.

Rule 13f-2, Form SHO, and the amendment to the CAT NMS Plan became effective on January 2, 2024 (the "SSDR effective date"). The compliance date for Rule 13f-2 and Form SHO will be 12 months after the SSDR effective date, and the SEC will begin publishing the aggregated data three months after that compliance date. The compliance date for the amendment to the CAT NMS Plan will be 18 months after the SSDR effective date.

SEC Adopts New Rule 10c-1a Requiring Securities Loan Reporting

On October 13, 2023, the SEC adopted Rule 10c-1a under the Exchange Act, which requires any covered person to provide certain information on covered securities loans to a registered national securities association ("RNSA"). Such required information includes, among other information, the name of the issuer, amount of securities loaned, rates and fees of the loan and the type of collateral. A covered person includes (a) any person that agrees to a covered securities loan on behalf of a lender, (b) any person that agrees to a covered securities loan as the lender when an intermediary is not used and (c) a broker or dealer for fully paid or excess margin securities. A covered securities loan is a transaction in which one person lends a reportable security (a security for which information is already reported or required to be reported to specified existing reporting regimes or their later replacements) to another person, subject to certain exclusions.

Rule 10c-1a became effective on January 2, 2024 (the "Rule 10c-1a effective date"). The final rule's compliance dates require that: (1) an RNSA proposes rules pursuant to Rule 10c-1a(f) within four months of the Rule 10c-1a effective date, (2) the proposed RNSA rules are effective no later than 12 months after the Rule 10c-1a effective date, (3) covered persons report Rule 10c-1a information to an RNSA starting on the first business day 24 months after the Rule 10c-1a effective date (the "reporting date") and (4) RNSAs publicly report Rule 10c-1a information within 90 calendar days of the reporting date.

SEC Adopts Rules and Amendments for SPAC IPOs and De-SPAC Transactions

On January 24, 2024, the SEC adopted new rules and amendments to regulate initial public offerings by special purpose acquisition

companies ("SPAC IPOs") and subsequent business combinations between SPACs and target companies ("de-SPAC transactions"). The final rules were adopted to provide additional investor protections through enhanced disclosure requirements and increased liability, which will likely further reduce the already declining number of SPAC IPOs and de-SPAC transactions. Additional information on the final rules can be found in the Cravath Client Memo on the subject.

Litigation Developments

Kirschner v. JPMorgan Chase Bank, N.A.

As discussed in the Q3 2023 edition of this newsletter, the Second Circuit issued a unanimous decision upholding the district court's ruling that syndicated term loans are not "securities" and are therefore not subject to state and federal securities laws and regulations. On December 19, 2023, the plaintiff, as trustee of the Millennium Lender Claim Trust, filed a petition for certiorari for review of the Second Circuit's decision by the U.S. Supreme Court. As of publication, the U.S. Supreme Court has yet to accept certiorari.

Fifth Circuit Vacates the SEC's New Share Repurchase Disclosure Modernization Rule

On May 3, 2023, the SEC adopted final rules which add or update a number of disclosure requirements relating to an issuer's repurchase of its registered equity securities. On October 31, 2023, the U.S. Court of Appeals for the Fifth Circuit ("Fifth Circuit") issued an opinion in *Chamber of Commerce of the USA v. SEC*, granting a petition for review of the Share Repurchase Disclosure Modernization Rule. The Fifth Circuit held that the "SEC acted arbitrarily and capriciously . . . when it failed to respond to petitioners' comments and failed to conduct a proper cost-benefit analysis," thereby violating the Administrative Procedure Act ("APA"). The ruling gave the Commission 30 days to correct defects within the rule.

On November 22, 2023, the SEC issued an order staying the Share Repurchase Disclosure Modernization Rule pending further SEC action. On December 1, 2023, the SEC's Office of General Counsel submitted a letter to the Fifth Circuit communicating that the SEC was unable to correct defects within the Share Repurchase Disclosure Modernization rule by the November 30, 2023 deadline. On December 19, 2023, the Fifth Circuit issued an order vacating the Share Repurchase Modernization Rule. In light of the new rule being vacated, registrants are reminded that the prior rules regarding disclosure of share repurchases, which were rescinded by the SEC as part of adopting the new rules, are now back in effect.

Restructuring Updates

Application of Section 546(e) Safe Harbor: In re Nine West LBO Sec. Litig.

On November 27, 2023, in the case of *In re Nine West LBO Sec. Litig.*, Circuit Judges Chin, Sullivan and Bianco of the U.S. Court of Appeals for the Second Circuit affirmed the district court's ruling that the safe harbor in section 546(e) of the Bankruptcy Code provides protection from claw-back/avoidance claims for transfers made in connection with a securities contract (which includes a merger agreement in a public company M&A deal) when a financial institution is acting as an agent of the target company. However, the court held that there is no safe harbor for individual transfers that did not use a paying agent, even if those transfers are part of a broader transaction with the financial institution serving as paying agent in other aspects.

The case arose from actions taken in connection with the acquisition of the Jones Group by Sycamore Partners through a leveraged buy-out

in 2014. As part of the LBO, Jones Group merged into a subsidiary of Sycamore, which survived as Nine West.

To complete the acquisition, consideration was paid through three separate transfers:

1. Nine West deposited approximately $1.101 billion with Wells Fargo, which, pursuant to the paying agent agreement, distributed checks or wire transfers to the Jones Group book-entry shareholders in exchange for their shares (the "DTC Transfers");
2. Nine West deposited approximately $4 million with Wells Fargo, which, pursuant to a paying agent agreement, distributed checks or wire transfers to Jones Group paper stock-holding shareholders in exchange for their shares (the "Certificate Transfers"); and
3. Nine West paid $78 million to Jones Group's directors, officers, and employee shareholders through Jones Group's payroll program (the "Payroll Transfers").

On April 6, 2018, Nine West and several affiliate debtors filed a chapter 11 petition in the United States Bankruptcy Court for the Southern District of New York. On February 27, 2019, the Bankruptcy Court confirmed Nine West's plan of reorganization.

Following confirmation of Nine West's plan of reorganization, a litigation trustee representing unsecured creditors and an indenture trustee representing noteholders sought recovery from the Company's directors and officers, pleading various claims, including fraudulent transfer claims. In 2020, Judge Rakoff of the U.S. District Court for S.D.N.Y. dismissed the fraudulent transfer claims, holding that the LBO payments were protected pursuant to section 546(e) of the Bankruptcy Code. This decision was appealed to the Second Circuit.

Section 546(e) of the Bankruptcy Code provides a safe harbor against the avoidance of settlement payments made by or to (or for the benefit of) a financial institution in connection with a securities contract. In 2018, the Supreme Court clarified the scope of the safe harbor in the case of *Merit Management Group, LP v. FTI Consulting, Inc.*, holding that it is not sufficient for a financial institution to be a "mere conduit" in a securities transfer, but instead, it must be a "qualifying entity" for a transaction to benefit from the safe harbor protection. The Court noted that section 101(22)(A) of the Bankruptcy Code defines a qualifying "financial institution" to include not only banks, but also a customer of a bank when the bank is acting as agent or custodian for a customer in connection with a securities contract, meaning that the customers of a bank are considered "financial institutions" for purposes of the safe harbor in section 546(e).

Rather than looking at the transactions arising out of the merger agreement as a whole, the Second Circuit examined the definition of "financial institution" in section 101(22)(A) and the application of the safe harbor to the Nine West LBO on a transfer-by-transfer basis, on the grounds that "financial institution" includes bank customers only in transactions where the bank is acting as their agent but not, as the defendants argued, in any transaction related to a securities contract so long as the bank acted as their agent at one point in connection with that contract. The court determined that Wells Fargo acted as Nine West's agent in the Certificate Transfers and DTC Transfers, giving Nine West "financial institution" status, and therefore safe harbor protection, with respect to those transfers. The Payroll Transfers were not made by Wells Fargo acting as agent for Nine West, so Nine West was not a qualifying participant in this transfer and the safe harbor did not apply. After the court's decision, Nine West applied for a stay of mandate with plans to petition for certiorari on the grounds that there is a substantial question for the Supreme Court to clarify regarding the interpretation of 101(22)(A) and definition of financial institution that was at issue in *Merit Management*.

The implication of this decision is that safe harbor protection does not insulate every transfer made in settlement of a securities or M&A transaction from attack as a fraudulent transfer. Rather, each transfer will be examined individually. Parties involved in securities transactions and LBOs should consider payment flows and determine whether they can be implemented in a way that increases the likelihood of safe harbor protection by utilizing the services of a financial institution to effect all payments to the greatest extent practicable.

Involuntary Petitions: In re TV Azteca, S.A.B. de C.V.

On November 20, 2023, in the case of *In re: TV Azteca, S.A.B. de C.V.*, Judge Lisa G. Beckerman of the U.S. Bankruptcy Court for the Southern District of New York ruled that a creditor cannot file an involuntary petition when a portion of the creditor's claim is subject to a bona fide dispute, even if part of its claim is undisputed.

In 2017, TV Azteca, a mass media and television company incorporated and headquartered in Mexico, issued $400 million unsecured notes due 2024. The debtor stopped making interest payments in 2021, and in May 2022, the indenture trustee sent a notice of acceleration to the debtor on behalf of the noteholders, claiming an event of default and accelerating repayment of the obligations due under the indenture and the notes.

On August 26, 2022, the indenture trustee brought suit in federal district court in New York against TV Azteca, seeking recovery of the remaining principal, interest and other amounts due, including a $16.5 million redemption premium. TV Azteca argued in that case that no redemption premium was due because there had been no voluntary prepayments of the notes. In July of 2022, TV Azteca also initiated a suit in Mexico against the noteholders and the indenture trustee and obtained an injunction prohibiting collection on the notes.

On March 20, 2023, certain holders of the notes filed involuntary chapter 11 petitions against TV Azteca and its guarantor subsidiaries in the United States Bankruptcy Court for the Southern District of New York. In support of their petition, the filing noteholders claimed the debts for the principal and interest of the notes but did not claim the disputed $16.5 million in redemption premium (which had been asserted by the indenture trustee in the earlier state court action). TV Azteca, as alleged debtor, filed a motion to dismiss the involuntary petition, citing among other things Section 303(b)(1) of the Bankruptcy Code, which requires involuntary cases to be brought by "three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability *or the subject of a bona fide dispute as to liability or amount*" (emphasis added).

On November 20, 2023, and after unsuccessful mediation between the filing noteholders and TV Azteca, Judge Beckerman found that the portion of the filing noteholders' claims arising from the redemption premium was subject to a bona fide dispute and that they were therefore not permitted to file an involuntary petition against TV Azteca and the chapter 11 cases should be dismissed. In other words, the court held that if part of a claim is legitimately disputed, that renders the whole claim invalid as the basis for initiating an involuntary bankruptcy case. Even though the noteholders did not claim the redemption premium in their involuntary petition, Judge Beckerman reasoned that the court could not "blithely ignore the District Court Action when . . . the proofs of claim that would be filed in these Chapter 11 cases by the Indenture Trustee as a fiduciary on behalf of all of the holders of the Notes will include a redemption premium." As a result, even if certain petitioning noteholders attempted to disclaim their entitlement to a redemption premium to preclude dismissal, they could not do so where other creditors could seek the disputed amount pursuant to the same documents and transaction.

Judge Beckerman's decision is consistent with case law in the First, Fifth and Ninth Circuits and most bankruptcy courts that have considered the subject, and this highlights the limitations noteholders and lenders face in filing an involuntary petition against a recalcitrant debtor. If there is any chance that the noteholders might seek an involuntary filing at any point during a restructuring process, they should not formally assert claims that could be legitimately disputed down the road, as those disputed claims could give the debtor a basis to get out of an involuntary bankruptcy proceeding.

Other Developments

Provision in NDAA Rescinding Section 16 Exemption for Foreign Private Issuers Dies in Conference

As discussed in the Q3 2023 edition of this newsletter, the Senate approved the National Defense Authorization Act for Fiscal Year 2024 ("NDAA") with a provision that would rescind the Section 16 exemption for foreign private issuers. This bill was previously passed in the House of Representatives without the Section 16 provision and was therefore sent to a conference committee to address any differences between the House and Senate bills. On December 13, 2023, the Senate and House armed services committees completed conference on the NDAA and the Section 16 provision was dropped in the conference report.

Attorneys General Back Lawsuit To Overturn Nasdaq Diversity Rule

On November 19, 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 urges 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 diversity rule did not violate the Exchange Act and the APA. The amicus brief argues that the diversity rule violates the equal protection clause of the Constitution by interfering with corporate board composition and imposing a quota in favor of women and minorities. It further contends that the SEC lacks statutory authority to regulate corporate boards generally. If effective, 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 Settles $25 Million Enforcement Action on Accounting Control Violations

On November 14, 2023, the SEC announced a settlement with Charter Communications ("Charter") with respect to charges challenging the company's stock buyback rules authorized under its Rule 10b5-1 trading plans. The SEC alleges that Charter did not qualify for the Rule 10b5-1 affirmative defense because there is an "accordion" provision under the plans that allowed the company to increase the amount of stock buyback if it conducted debt offerings with buybacks as a permitted use of proceeds. To qualify for the Rule 10b5-1 affirmative defense, a trading plan must not allow the holder to influence its subsequent transactions. The SEC maintains that, since the company had control over the issuance of debt offerings, it also had control over the amount of stock buyback under the trading plan and thereby failed to establish the affirmative defense under Rule 10b5-1.

Instead of bringing charges for insider trading, however, the SEC charged Charter with violations of internal accounting controls under Exchange Act Section 13(b)(2)(B), which requires companies to implement accounting controls that ensure "access to assets is permitted only in

accordance with management's general or specific authorization" and does not require the SEC to prove scienter. The SEC argues that the authorization by Charter's board of directors with respect to the trading plans was for Rule 10b5-1 compliant plans, that Charter traded under non-compliant plans, and that Charter's internal accounting controls were not reasonably designed to analyze whether the "accordion" provisions complied with Rule 10b5-1 and therefore were made in accordance with management's general or specific authorization. In response, Charter agreed to settle the enforcement action for $25 million in civil penalty without admitting or denying the allegations.

SEC Adopts Amended NYSE Minimum Price Rule

As discussed in the Q3 2023 edition of this newsletter, the New York Stock Exchange ("NYSE") proposed an amendment to allow listed companies to issue shares to passive shareholders below the "Minimum Price". Following the public comment period and an amendment to the original proposal to clarify certain definitions and provide additional reasoning for the rule change, the SEC approved NYSE's proposal on December 26, 2023. For more information, the amended rule is available here.

SEC Announces Enforcement Results for Fiscal Year 2023

On November 14, 2023, the Commission filed 784 enforcement actions, representing an increase of 3% over the previous year. The 784 enforcement actions included:

- 501 original, or "stand-alone," enforcement actions, which represented an 8% increase over the prior year;
- 162 "follow-on" administrative proceedings that sought to bar or suspend individuals from certain functions in the securities markets; and
- 121 actions targeting issuers who were allegedly delinquent in making required SEC filings.

The Commission also obtained orders totaling almost $5 billion in financial remedies with $3.369 billion in disgorgement and prejudgment interest and $1.580 billion in civil penalties. Both the disgorgement and civil penalties ordered were the second-highest amounts in SEC history, behind only fiscal year 2022. The Commission also distributed over $900 million to harmed investors for the second consecutive year. The report highlights the Commission's focus on rewarding self-reporting and cooperation while prioritizing the protection of whistleblowers.

Decline in Sustainability-Linked Loans

U.S. issuances of sustainability-linked loans, which offer borrowers a spread discount or penalty triggered by their performance against environmental, social or governance goals, declined by 80% in 2023 compared to 2022, according to data compiled by Bloomberg. This decline follows a surge of growth in 2020 and 2021, with global issuances of sustainability-linked loans peaking in 2021 at more than $500B. While both the EMEA and APAC regions saw decreases in issuances in 2023 compared to the previous year, the Americas saw the most significant decrease.

As of the end of 2023, the size of the global sustainability-linked loan market was approximately $1.5T, of which about $187B will come due in 2024, according to Bloomberg's estimates.

Crypto Updates

Binance Enters into $4.3 Billion Plea Deal with the DOJ

Binance Holdings Ltd. ("Binance") was investigated by the DOJ for violations of the Bank Secrecy Act ("BSA"), failure to register as a money transmitting business and violations of the International Emergency Economic Powers Act ("IEEPA").

The greatest share of Binance's customers came from the United States, and as a result of serving U.S. customers, the DOJ claimed that Binance was required to register as a money services business with the Financial Crimes Enforcement Network ("FinCEN") and implement an effective anti-money laundering ("AML") program. Binance failed to register as a money transmitter, implement core AML controls (such as know-your-customer protocols or systematically monitoring transactions) and file any suspicious activity reports with FinCEN.

U.S. sanctions laws prohibit U.S. customers from trading with customers in comprehensively sanctioned jurisdictions, such as Iran. The DOJ claimed that Binance knew that it had a significant number of both U.S. customers and customers from comprehensively sanctioned jurisdictions and that its matching engine would necessarily match these customers, facilitating transactions in violation of the IEEPA and that the company failed to implement controls to prevent U.S. customers from conducting transactions with customers in sanctioned jurisdictions, causing over $898 million in trades between U.S. and Iranian customers between January 2018 and May 2022.

On November 21, 2023, Binance pled guilty and agreed to pay over $4.3 billion to resolve the DoJ's claims, over $2.5 billion of that sum being a forfeiture and over $1.8 billion being the total financial penalty. As part of the DOJ plea agreement, Binance also agreed to retain an independent compliance monitor for three years and to improve their AML and sanctions compliance programs. Separately, Binance has reached resolutions with FinCEN, the Office of Foreign Assets Control and the U.S. Commodity Futures Trading Commission, and the DOJ will credit approximately $1.8 billion toward those agreements. Binance's founder and CEO, Changpeng Zhao, plead guilty to failing to maintain an effective AML program in violation of the BSA (and agreed to pay $50 million for this violation) and resigned as CEO.

As discussed in the Q2 2023 edition of this newsletter, the SEC has also filed suit against Binance in the U.S. District Court for the District of Columbia alleging that Binance and Zhao misappropriated customer funds, engaged in manipulative trading, illegally traded in cryptocurrencies that are securities and operated the platform as a broker, exchange and clearing agency without registering any of these functions with the SEC. That matter was not resolved by Binance's and Zhao's pleas to the DOJ's claims and is still pending.

SDNY Grants Partial Summary Judgment to Terraform Labs

On December 28, 2023, the U.S. District Court for the Southern District of New York ("SDNY") issued an order on motion for summary judgment in *SEC v. Terraform Labs Pte. Ltd.* The case involved an SEC enforcement action against defendants Terraform Labs ("Terraform") and its founder, Do Hyeong Kwon, for engaging in alleged unregistered securities offerings of crypto assets, unregistered transactions of security-based swaps and fraudulent schemes involving misrepresentations to investors.

The court granted partial summary judgment in favor of the SEC on the unregistered offerings of securities claim. As discussed in the Q3 2023 edition of this newsletter, SDNY Judge Jed Rakoff denied Terraform's motion to dismiss in July 2023, holding that the SEC asserted a plausible claim that sales of Terraform's crypto assets are securities offerings. On summary judgment, the court concluded that the relevant Terraform crypto assets are securities as a matter of law which defendants offered and sold without registration with the SEC in violation of Sections 5(a) and 5(c) of the Securities Act. The court's analysis hinged on the third prong of the *Howey* test from *SEC v. W.J. Howey Co.*, which provides the definition of a security. Under the *Howey* test, the sale of certain assets is considered a sale of a security if it is an (i) investment of money in (ii) a common enterprise with (iii) an expectation of profits derived from the managerial efforts of a third party. Judge Rakoff held that there is no genuine dispute that investors had an expectation of profit from the promotional efforts of Terraform, citing public communications made by Terraform and Kwon in interviews, tweets and presentations, which promised high rates of returns for investments in the relevant crypto assets.

The court granted partial summary judgment in favor of the defendants on the security-based swaps claim and denied the parties' cross-motion for summary judgment on the fraud claims. On the security-based swaps, Judge Rakoff held as a matter of law that defendants did not offer or effect security-based swap transactions because the relevant assets do not meet the statutory definition of a security-based swap. On the fraud claims, the court found genuine disputes of material facts and held that the question of materiality of the defendants' alleged misrepresentations must be decided by a jury. A jury trial for the remaining fraud claims is scheduled to begin on January 29, 2024.

UPDATES ON INTEREST RATE BENCHMARKS

BSBY Cessation and ARRC Closing

On November 15, 2023, Bloomberg Index Services Limited ("BISL") announced the future termination of the publication of the Bloomberg Short-Term Bank Yield Index ("BSBY") and all tenors of BSBY to be effective on November 15, 2024. BSBY has been published since March 2021 as part of the transition away from LIBOR to alternative reference rates, and was previously considered a potential benchmark replacement for LIBOR before the Alternative Reference Rates Committee ("ARRC") formally recommended the adoption of Term SOFR for U.S. dollar transactions on July 29, 2021. BISL cited BSBY's current limited usage and the unlikelihood of significant future growth in usage as determining factors for its decision.

Further, on November 30, 2023, ARRC released its closing report with reflections on the transition from LIBOR and announced the conclusion of the committee itself. The closing report emphasized three areas that it believes firms should focus on going forward in order to preserve the more robust system of reference rates achieved by ARRC: (a) active review of any reference rates that firms may consider using to ensure that they are sufficiently robust and fit for purpose, (b) the importance of appropriate fallback language for any contractual use of reference rates and (c) maintaining an appropriate balance between use of SOFR and Term SOFR. Following the wind-down of ARRC, the Federal Reserve Bank of New York announced that it will launch a new sponsored group in 2024 to focus on promoting the integrity, efficiency and resiliency in use of reference rates across financial markets to build on the legacy of ARRC's work.

CDOR Transition

On December 16, 2021, the Canadian Alternative Reference Rate working group ("CARR"), established by the Canadian government in March 2018 to guide benchmark reform efforts in Canada, recommended that Refinitiv Benchmark Services Limited ("RBSL"), the benchmark administrator of the Canadian Dollar Offered Rate ("CDOR"), should cease the calculation and publication of all tenors of CDOR. This decision was driven by CARR's doubts regarding CDOR's future robustness as similarly experienced with LIBOR. Following this recommendation, on May 16, 2022, RSBL announced that the calculation and publication of all tenors of CDOR will permanently cease after June 28, 2024.

As part of the transition away from CDOR, two new rates have been introduced: (a) daily compounded Canadian Overnight Repo Rate ("CORRA"), which is an overnight risk-free rate measured by the cost of overnight general collateral funding in Canadian dollars using Government of Canada treasury bills and bonds as collateral and administrated by the Bank of Canada, and (b) Term CORRA, which is a forward-looking risk-free rate available in one-month and three-month tenors calculated using transactions, executable bids and offers of one-month and three-month CORRA futures traded on the Montreal Exchange and administrated by CanDeal Benchmark Administration Services Inc.

On July 27, 2023, CARR published further recommendations for the transition and provided a milestone date of November 1, 2023, after which no new agreements should reference CDOR.

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