Cravath Quarterly Review
Finance and Capital Markets

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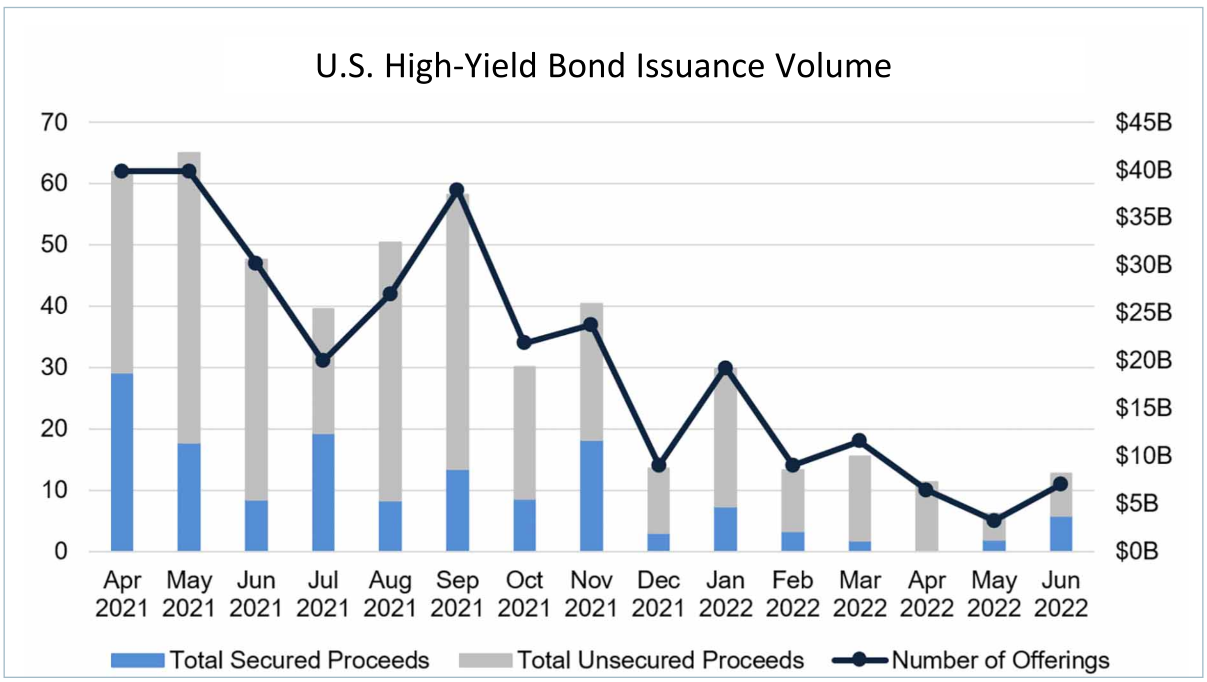
Market Update

BONDS

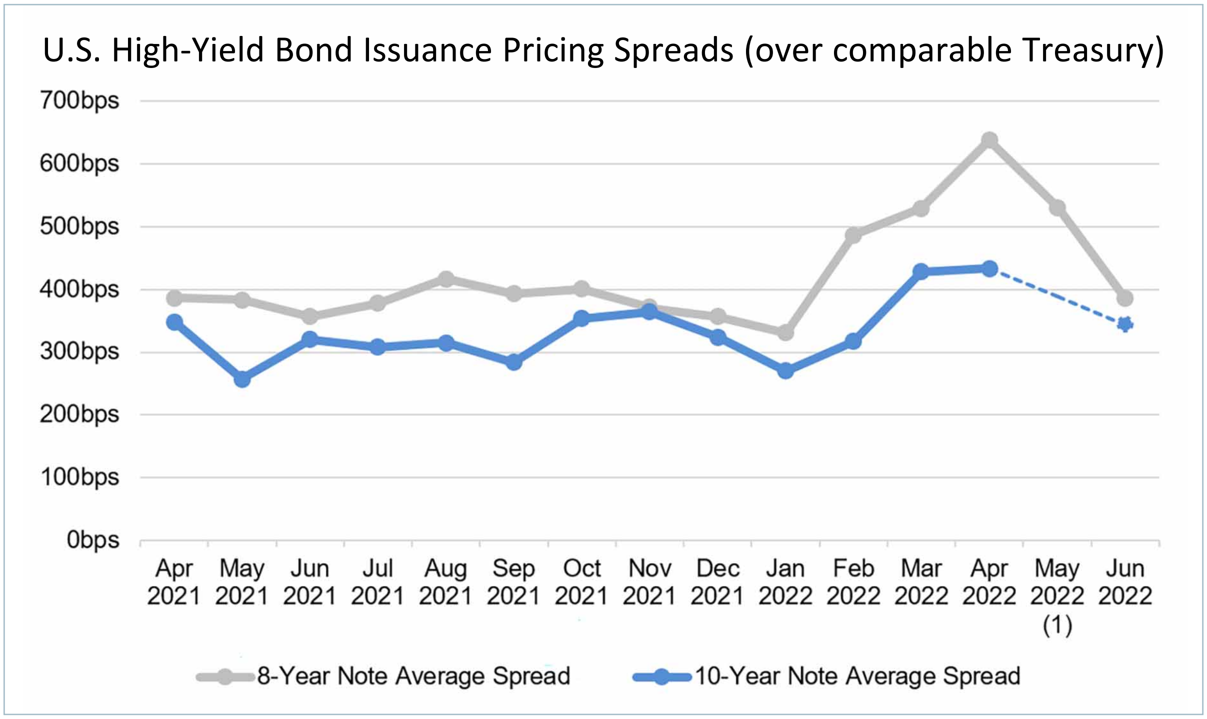
U.S. High-Yield Bonds

The pace of U.S. high-yield bond issuances declined in the second quarter of 2022, continuing the downward trend that began in the fourth quarter of 2021. The $19B in proceeds from issuances for the second quarter of 2022 was down 48% as compared to the first quarter of 2022 ($38B) and 81% from the second quarter of 2021 ($112B), representing the lowest quarterly total since the fourth quarter of 2018. During the second quarter of 2022, lower trading prices for high-yield bonds in the secondary market created attractive repurchase opportunities for issuers with ample liquidity.



Data Source: Leveraged Commentary & Data (LCD)

After an initial increase in April, pricing spreads (measured over the comparable Treasury) for high-yield bond issuances decreased in May and June of 2022 for 8-year maturities. For 10-year maturities, April saw a small increase in pricing spreads (measured over the comparable Treasury), no high-yield bonds with a 10-year maturity were issued in May, and pricing spreads declined in June. Average pricing spreads on high-yield 8-year and 10-year notes in the second quarter of 2022 were approximately 15% higher than in the first quarter of 2022.

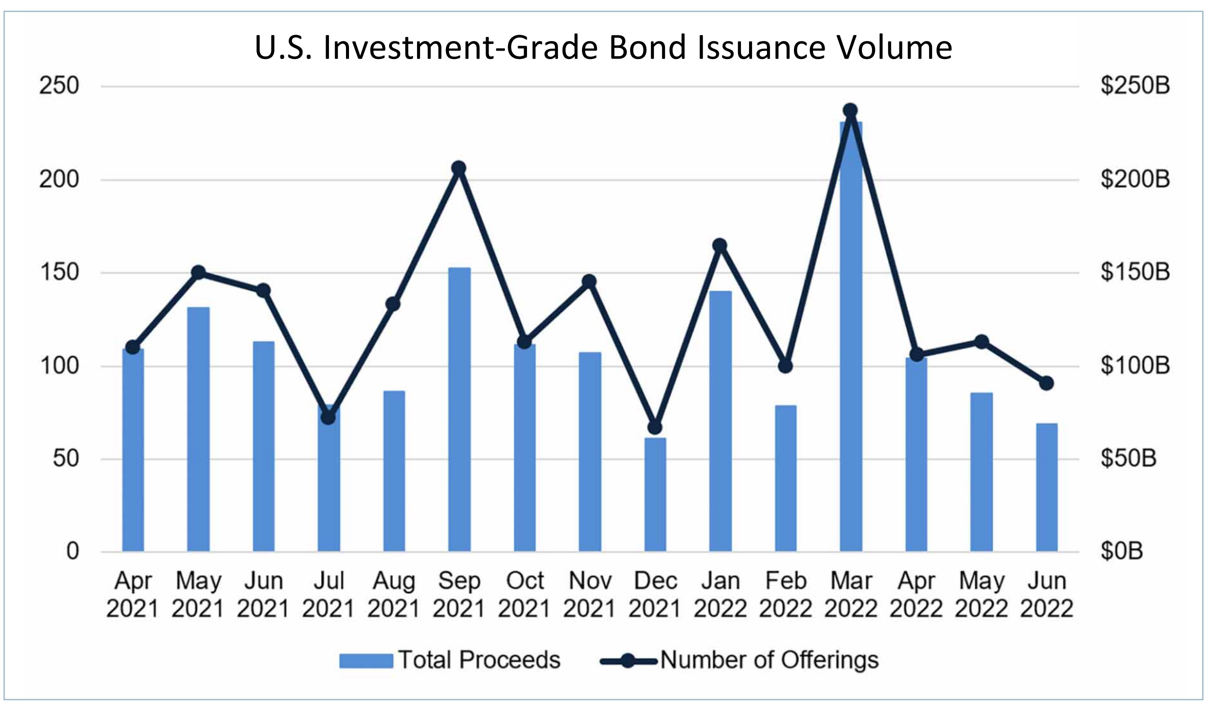


(1) No high-yield bonds with a 10-year maturity were issued in May 2022.

Data Source: Leveraged Commentary & Data (LCD)

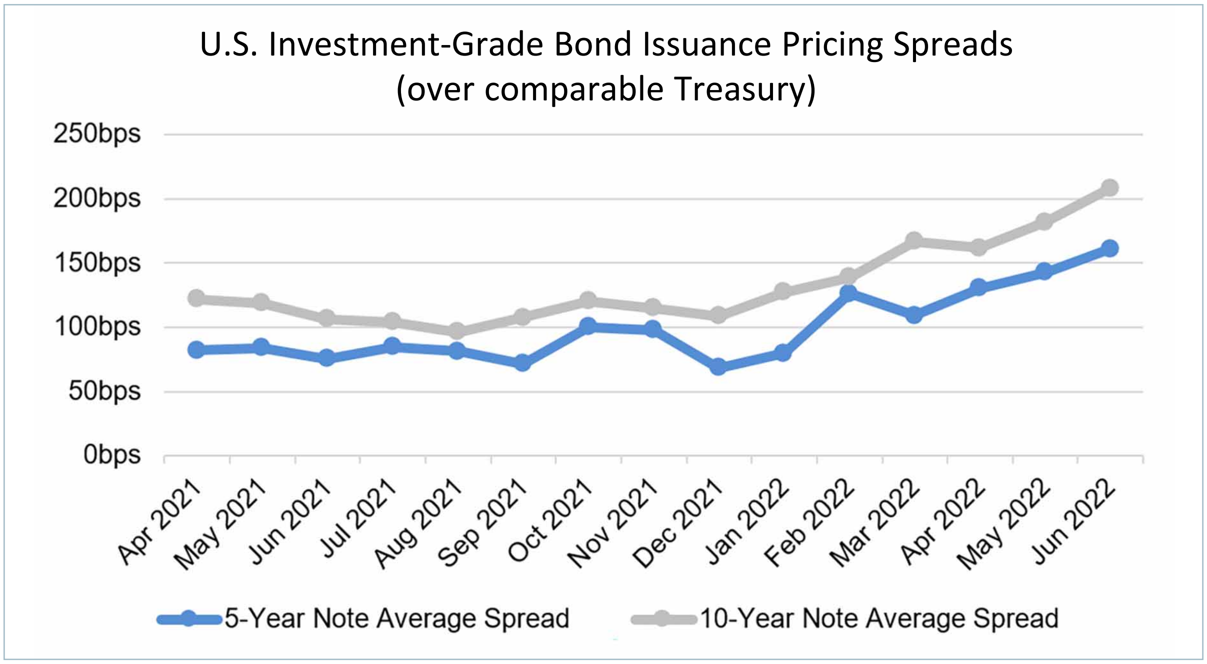
U.S. Investment-Grade Bonds

Total proceeds from U.S. investment-grade issuances were $259B in the second quarter of 2022, down 42% as compared to the first quarter of 2022 ($449B) and 36% from the second quarter of 2021 ($353B).



Data Source: Leveraged Commentary & Data (LCD)

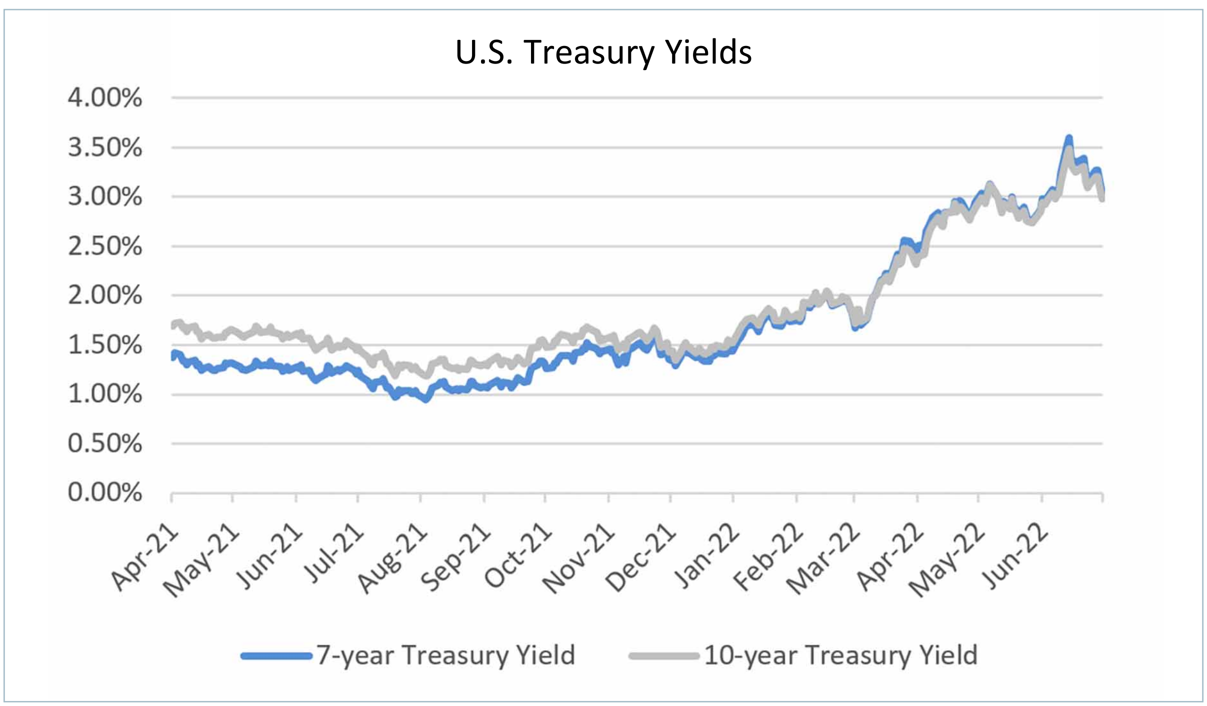
Pricing spreads (measured over the comparable Treasury) on U.S. investment grade bond issuances in the second quarter increased over the prior quarter, with an overall increase on the 5-year note average spread of 38% as compared to the average for the first quarter of 2022. Pricing spreads on 10-year notes in the second quarter of 2022 saw an increase of 27% as compared to the average spread in the first quarter of 2022.



Data Source: Leveraged Commentary & Data (LCD)

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

U.S. Treasury 7-year and 10-year rates ended the second quarter of 2022 at 3.04% and 2.98%, respectively, for an increase of 64 bps and 66 bps, respectively, compared with the end of the first quarter of 2022.

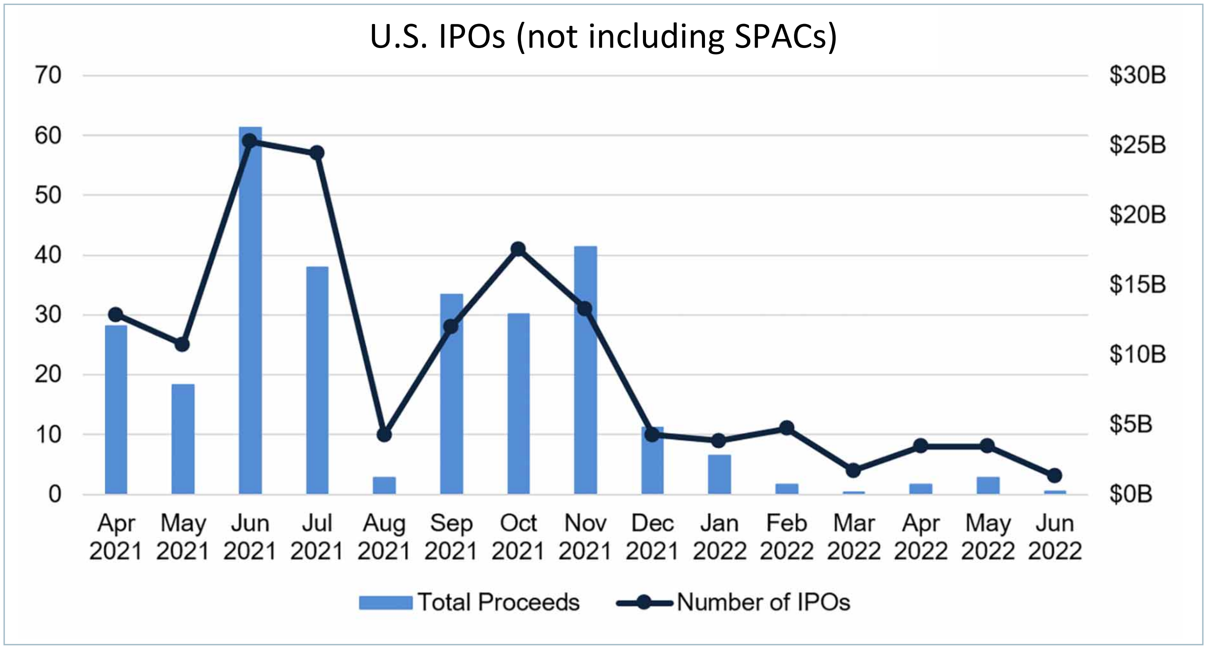


Data Source: Bloomberg Finance L.P.

EQUITY

U.S. IPOs

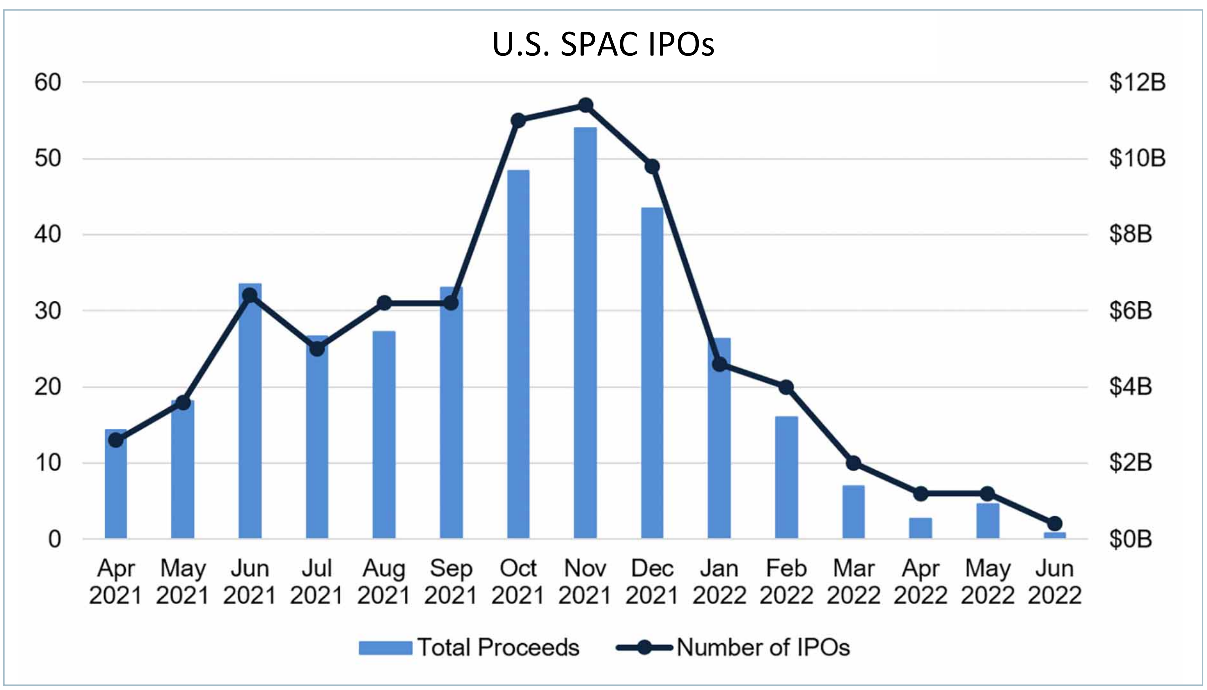
The U.S. IPO market (not including SPACs) saw a continued decrease in activity in the second quarter of 2022 compared to the record-setting levels seen in 2021, driven by volatile market conditions and stock market declines. The $2.1B of total proceeds from U.S. IPOs (not including SPACs) for the second quarter of 2022 was down 42.9% as compared to the first quarter of 2022 ($3.6B) and 95.5% as compared to the second quarter of 2021 ($46.2B).



Data Source: Refinitiv, an LSEG Business

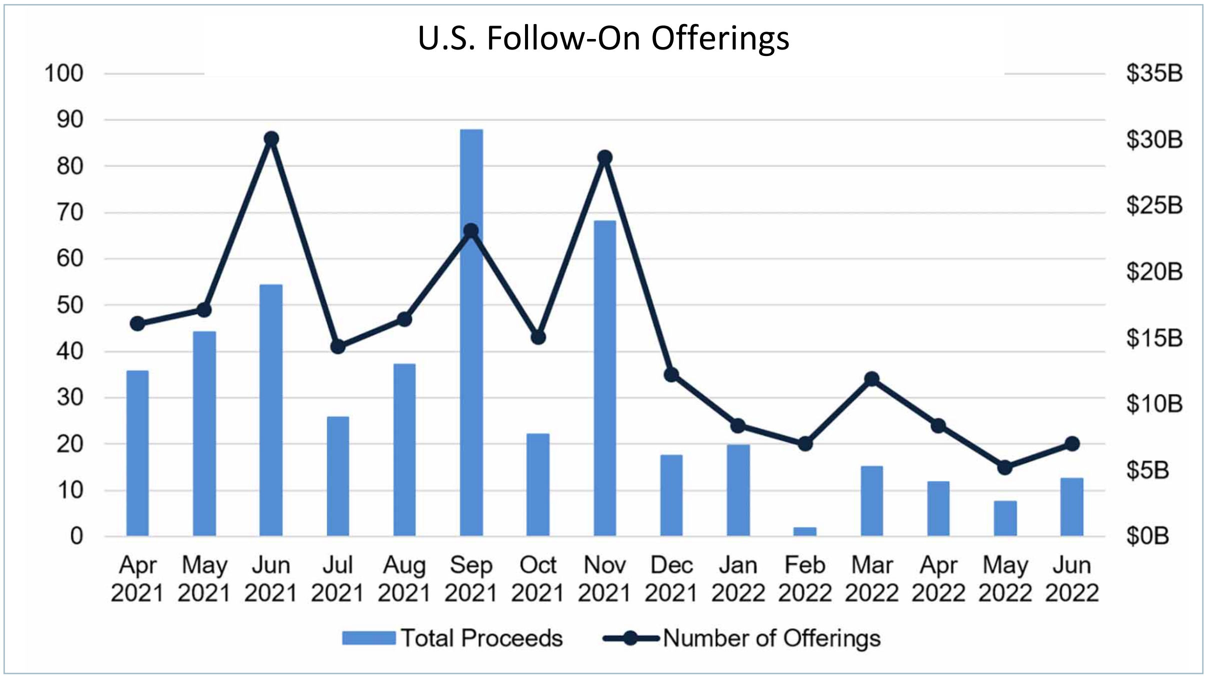
U.S. SPACs

The U.S. SPAC market saw a continued decrease in activity in the second quarter of 2022, and remains far less active as compared to the boom that ended with the first quarter of 2021. The $1.6B of total proceeds from U.S. SPAC IPOs for the second quarter of 2022 was down 83.4% as compared to the first quarter of 2022 ($9.9B) and was down 87.6% as compared to the second quarter of 2021 ($13.2B), driven by, among other things, regulatory uncertainty, trading levels of U.S. SPAC IPOs at or below initial issue prices in the secondary markets and declining market appetite in connection with a rise in market volatility.



Data Source: Refinitiv, an LSEG Business

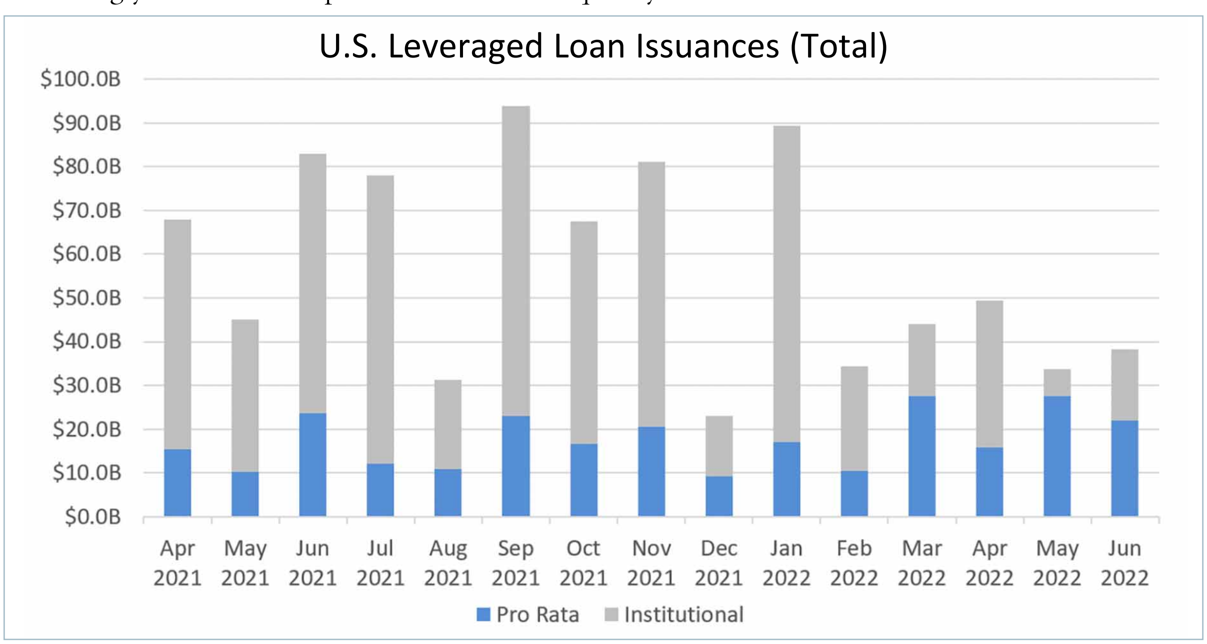
U.S. Follow-On Offerings
The $11.1B in proceeds from U.S. follow-on equity offerings for the second quarter of 2022 was down 13.2% as compared to the first quarter of 2022 ($12.8B) and down 76.3% as compared to the second quarter of 2021 ($46.9B).



Data Source: Refinitiv, an LSEG Business

LOANS

U.S. Leveraged Loan Issuances
Activity in the U.S. leveraged loan market slowed in the second quarter of 2022 as compared to the first quarter of 2022, with total volume down 28% (and down 38% as compared to the second quarter of 2021). Institutional term loan volume was $56.0B in the second quarter of 2022, down 50% compared to the first quarter of 2022 (and down 62% as compared to the second quarter of 2021). Pro rata loan volume was $65.3B in the second quarter of 2022, up 18% compared to the first quarter of 2022 (and up 33% as compared to the second quarter of 2021). The share of pro rata loan volume increased to 54% of total loan volume in the second quarter of 2022, up from 33% in the first quarter of 2022 (and 25% in the second quarter of 2021). As the institutional market slowed dramatically and yields for new institutional loan issuances increased, borrowers increasingly looked to the pro rata market for liquidity.

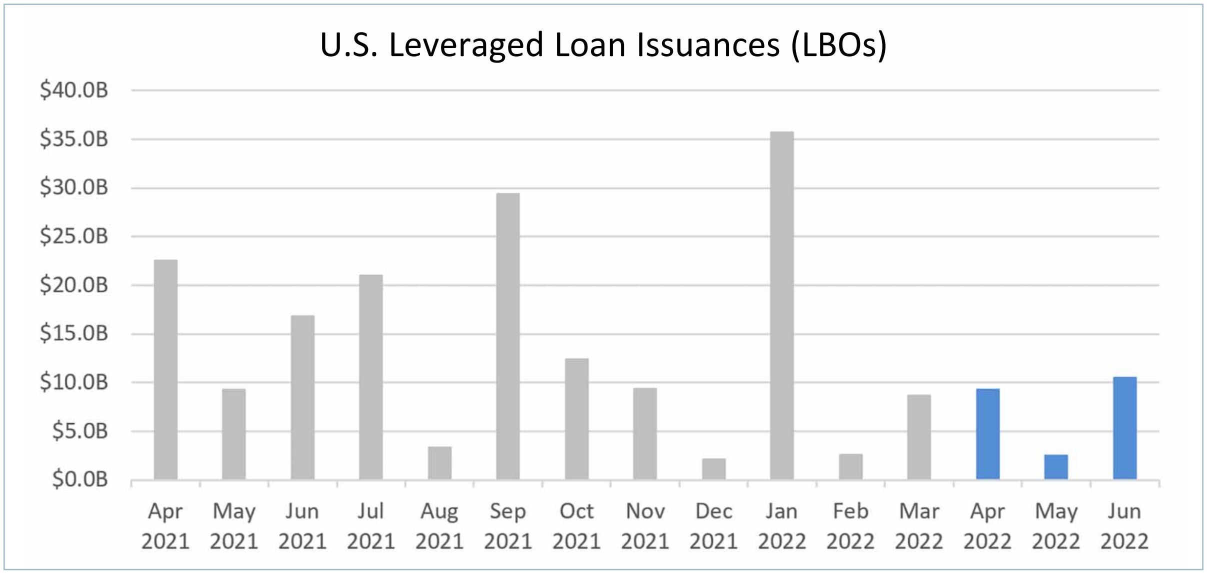


Data Source: Leveraged Commentary & Data (LCD)

US LBO Overall Volume

The U.S. LBO loan market has not yet recovered from the sharp drop in volume in February 2022 with the onset of hostilities in Ukraine and related market turmoil. In the second quarter of 2022, there were $22.2B of U.S. LBO loans issued, as compared to $47.0B in the first quarter of 2022 (and $48.6B in the second quarter of 2021).

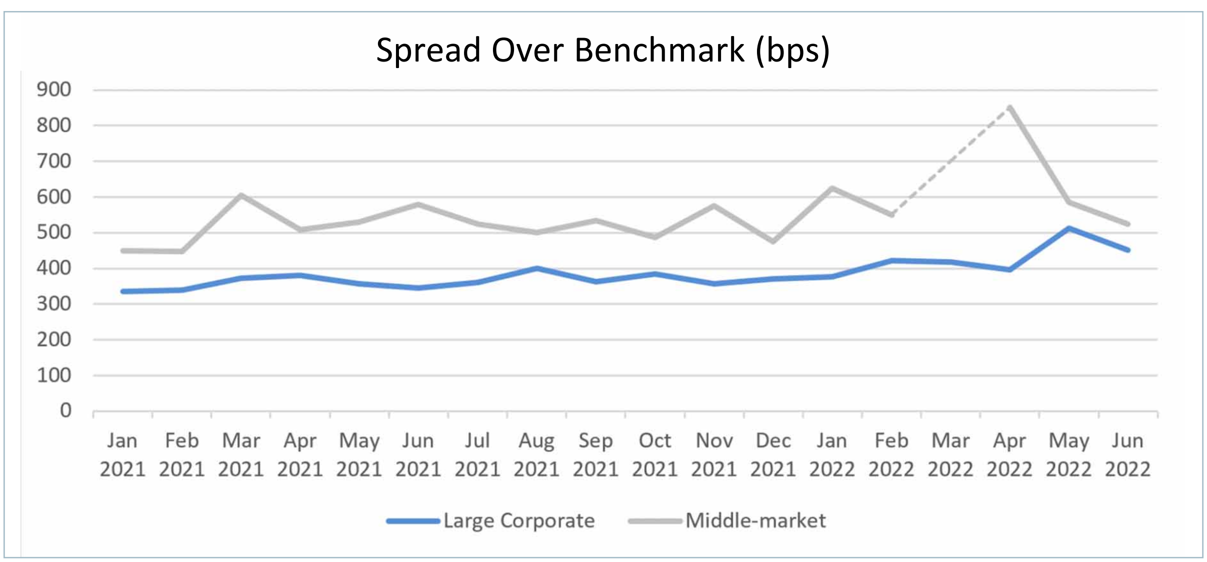
Notably, despite the market turmoil there have been a number of large LBO loans made by direct lenders in 2022, including approximately $5B in connection with the acquisition of Zendesk Inc., $3.7B in connection with the acquisition of Datto and $2.5B in connection with the acquisition of Anaplan Inc.



Data Source: Leveraged Commentary & Data (LCD)

Primary Market Institutional First-Lien Loan Spreads

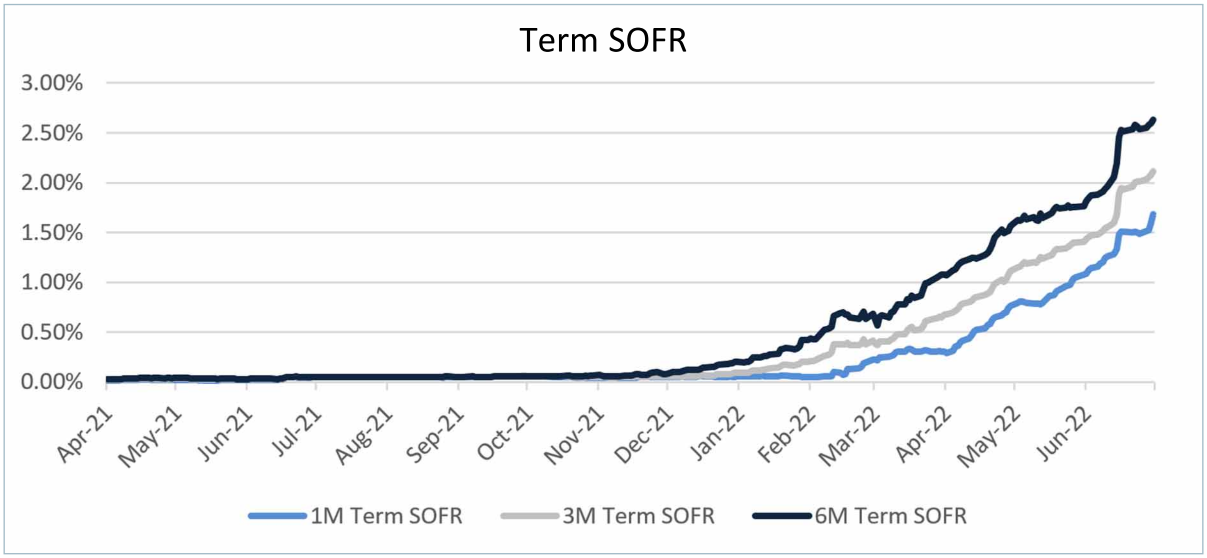
Average spreads over benchmark rates on first lien institutional loans for large corporate leveraged loan transactions were 424 bps in the second quarter of 2022, 62 bps wider than the 363 bps average spread in the trailing twelve month period. Middle market average spread was 608 bps in the second quarter of 2022, 76 bps wider than the 532 bps average spread in the trailing twelve month period.



Data Source: Leveraged Commentary & Data (LCD)

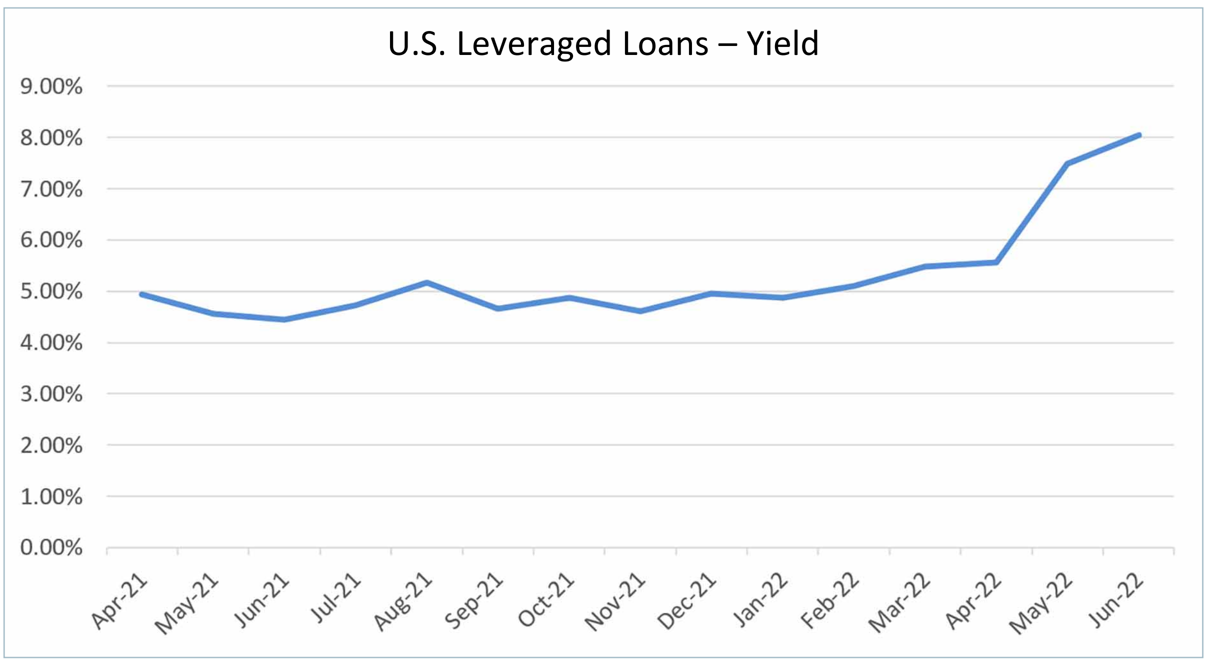
Note: Middle market is defined as borrowers with an annual EBITDA of less than $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments. As of July 11, 2022, LCD reported no middle market first lien institutional loans for March 2022.

Term SOFR Reference Rate
At the same time as spreads over benchmark have widened, benchmark rates have also increased. Term SOFR ended the second quarter of 2022, at 1.69%, 2.12% and 2.63% for the 1-month, 3-month and 6-month tenors, respectively, for an increase of 138 bps, 144 bps and 155 bps, respectively, compared with the end of the first quarter of 2022.



Source: Bloomberg Finance L.P.

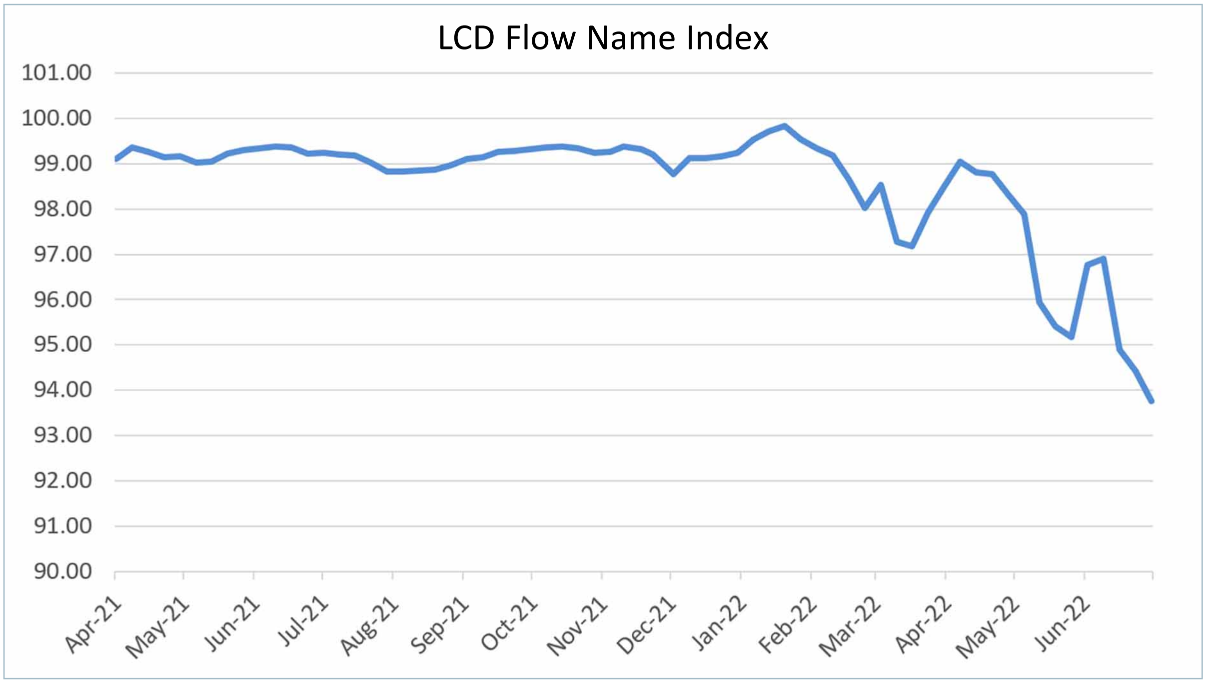
Primary Market Institutional First-Lien Loan Yields
New issue prices for institutional first lien term loans fell in the second quarter of 2022, with the average yield rising above 8.0% in June 2022 for an increase of approximately 360 bps year over year.



Data Source: Leveraged Commentary & Data (LCD)

Secondary Market Pricing

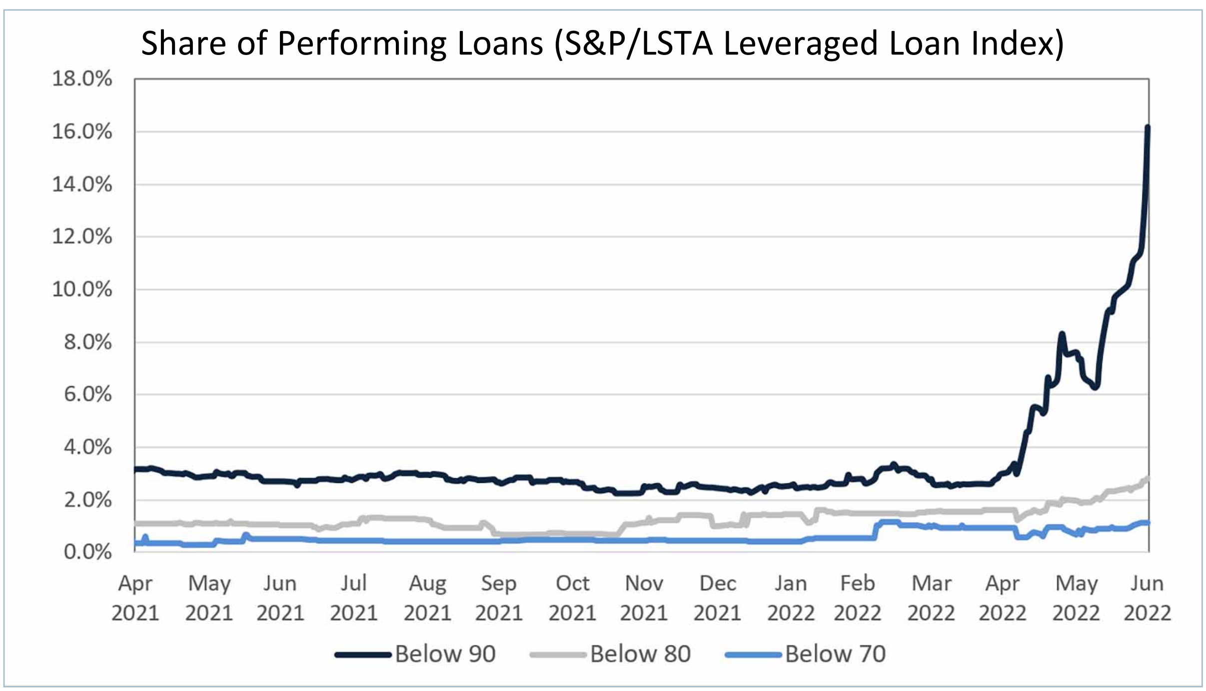
Similarly, the average bid price of the LCD Flow Name Index[1] continued to slide in the second quarter of 2022, crossing the 94.0 threshold at the end of June 2022 for a decrease of over 540 bps year over year.



Data Source: Leveraged Commentary & Data (LCD)

Share of Performing Loans

The percentage of loans in the S&P/LSTA Leveraged Loan Index priced below 90 cents on the dollar jumped significantly this quarter, rising from 2.78% at the end of the first quarter to 16.19% at the end of the second quarter. These lower trading prices seen in the secondary market create attractive repurchase opportunities for borrowers with ample liquidity.



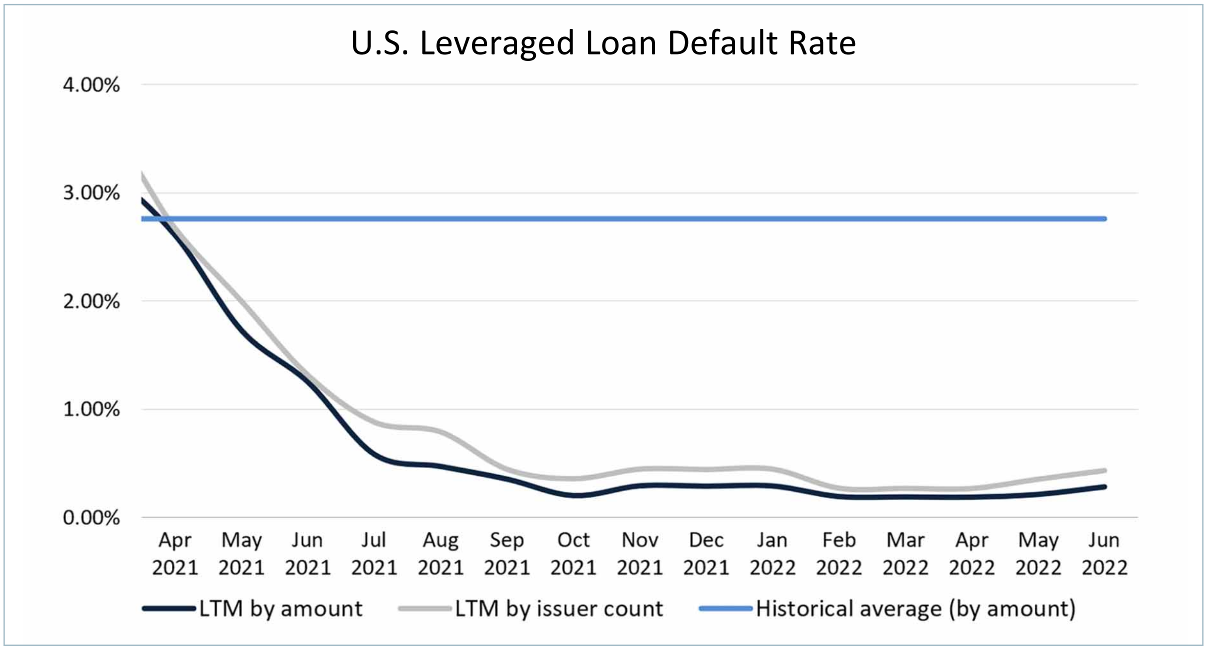
Source: Leveraged Commentary & Data (LCD); S&P/LSTA Leveraged Loan Index

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

RESTRUCTURING

U.S. Leveraged Loan Default Rates

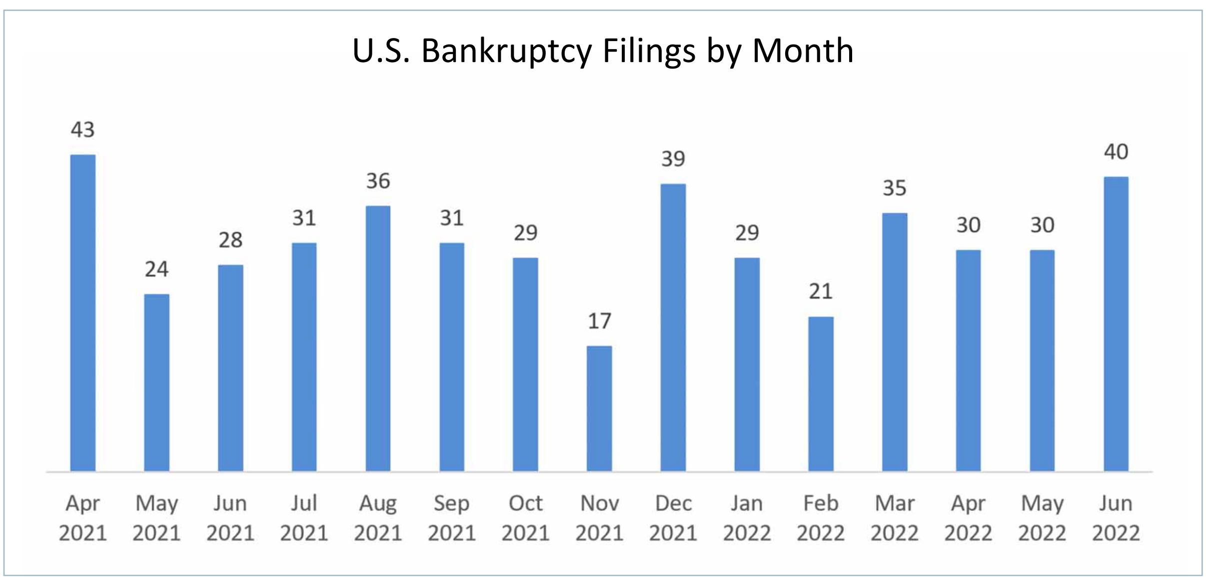
The default rate for U.S. leveraged loans remained low but rose slightly at the end of the second quarter. The default rate ended the quarter at 0.28% by amount and 0.43% by issuer count for the LTM period ending June 30, 2022, compared to 0.19% by amount and 0.27% by issuer count for the LTM period ending March 31, 2022—still far lower than the default rate for the LTM period ending June 30, 2021, which was 1.25% by amount and 1.31% by issuer count.



Data Source: Leveraged Commentary & Data (LCD); S&P/LSTA Leveraged Loan Index

U.S. Bankruptcy Filings

U.S. bankruptcy filings rose slightly in the second quarter, with the consumer discretionary, industrials and healthcare sectors having the most filings in 2022 year-to-date.



Data Source: S&P Global Market Intelligence

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.

Regulatory Updates

Comment Period Extended for Landmark Rules to Enhance and Standardize Climate-Related Disclosures

On May 9, 2022, the SEC extended the comment period for its long-awaited rules to enhance and standardize climate-related disclosures for public companies. The rules, originally proposed on March 21, 2022, include significant and detailed line-item disclosures in a number of climate-related areas, such as: (i) climate risk identification, management and governance; (ii) requirements to report Scope 1 and Scope 2 emissions, and if material or if included in an emissions target, Scope 3 emissions; (iii) mandatory third-party attestation over Scope 1 and Scope 2 emissions; (iv) requirements to report GHG emission reduction targets, if any, and related information about targets and goals; and (v) new requirements under Regulation S-X requiring climate-specific disclosures in a new note to registrants' audited financial statements. The comment period closed on June 17, 2022. Ultimately, more than 14,000 comments were submitted to the SEC, including by a number of companies, academics, trade and industry associations, former SEC Chairs and Commissioners and other constituencies.

Comment Period Reopened for Rules on Clawbacks of Erroneously Awarded Compensation

On June 8, 2022, the SEC reopened the comment period for the second time for its proposal to implement provisions of Section 954 of the Dodd-Frank Act, which would require the national securities exchanges and national securities associations to create listing standards that would require registrants to establish a non-discretionary clawback policy for erroneously awarded compensation and disclose such policy. The rules were initially proposed in July 2015. The comment period was previously reopened on October 14, 2021, and the comment period closed on November 22, 2021. The second reopened comment period closed on July 14, 2022.

Comment Period Reopened for Rules on Private Fund Proposals

On May 9, 2022, the SEC reopened the comment period on the proposed regulation of private fund advisers intended to enhance private fund investor protection. The rules would expand compliance obligations for all investment advisers for private funds, including exempt reporting advisers, foreign private advisers and other advisers not required to register with the SEC. Many of the comments received by the SEC involved concerns regarding the scope of the regulation, the effective standard of care for investment advisers under the rules and the potential negative consequences for sophisticated investors that enhanced disclosure may cause. The comment period closed on June 13, 2022.

SEC Proposes Enhancements to Fund and Adviser Disclosures on ESG

On May 25, 2022, the SEC continued its focus on Environmental, Social and Governance ("ESG") disclosures by proposing amendments to rules and disclosure forms that would require funds and investment advisers to specify their ESG practices. Specifically, the proposed rule will require the disclosure of ESG strategies in fund prospectuses, annual reports and advisor brochures; the implementation of layered, tabular disclosure for ESG funds so that investors can compare ESG funds against each other; and the disclosure of greenhouse gas emissions associated with environmentally focused funds' portfolio investments. The proposed rule will cover registered investment companies, business development companies, registered investment advisers and some unregistered advisers. Simultaneously, the SEC proposed a rule to modernize the Investment Company Act "Names Rule" by requiring a greater number of funds to follow the "80 percent investment policy", which mandates registered investment companies with names suggesting a particular investment area of focus to adopt a policy where 80 percent of their assets are invested in that area of focus. The proposed rule would cover funds with names suggesting the investments are focused on ESG factors. The comment period on both proposed rules will close on August 16, 2022.

SEC Amends Electronic Filing Requirements

On June 2, 2022, the SEC adopted amendments to Regulation S-T to mandate the electronic filing and submission of a number of documents, including reports on Form 144, reports on Form 6-K, "glossy" annual reports, notices of exempt solicitation and annual reports for employee benefit plans on Form 11-K, among others. The amendments also require the use of Inline XBRL for filing of financial statements and accompanying notes to the financial statements required in the annual reports for employee benefit plans on Form 11-K. Most of the amendments will go into effect January 11, 2023, but the requirement to submit Form 11-K with Inline XBRL will not go into effect until July 11, 2025.

Litigation Developments

Jarkesy v. Securities and Exchange Commission
On May 18, 2022, the Fifth Circuit Court of Appeals held that the SEC's use of administrative hearings was unconstitutional. First, the court held the SEC's administrative hearings violated the Seventh Amendment, which guarantees a right to a jury trial. Courts have traditionally held that "private rights" protected at common law must be heard by a jury, while "public rights" can be decided without a jury. The Fifth Circuit noted that because SEC enforcement actions seek civil penalties, they are similar to common law suits which are afforded a right to a jury trial. Second, the court found Congress improperly delegated its legislative power to the SEC and to have failed to provide an "intelligible principle" for choosing whether to use juries or administrative law judges ("ALJs") to adjudicate violations of securities laws. Third, the court determined the SEC violated the Take Care Clause of Article II of the Constitution with its statutory restrictions on the President's ability to remove SEC ALJs. The decision may make it more likely that the SEC will elect to bring its enforcement actions in federal court rather than in administrative hearings before ALJs.

Securities and Exchange Commission Enforcement v. Vale S.A.
On April 28, 2022, the SEC charged Vale S.A. ("Vale") with the violation of antifraud and reporting provisions of the securities laws under Sections 10(b) and 13(a) of the Securities Exchange Act of 1934 and Section 17(a) of the Securities Act of 1933 for false or misleading disclosures regarding the safety of its dams prior to the collapse of the Brumadinho dam in 2019. Vale is a publicly traded Brazilian mining company with ADRs listed on NYSE (VALE) and one of the world's largest producers of iron ore. The complaint alleges that Vale misled investors regarding the safety of the dam through its ESG disclosures. In particular, the SEC alleges that Vale knew the Brumadinho dam did not meet internationally recognized standards for dam safety while Vale's public sustainability reports and filings stated that the company complied with the "strictest international practices" in dam safety and that all dams were certified to be in stable condition. The SEC filed suit in the United States District Court for the Eastern District of New York. This lawsuit marks the first ESG-related enforcement from the SEC since the creation of the Climate and ESG Task Force in March 2021.

Restructuring Update

Crypto in Bankruptcy
Many cryptoasset companies have recently shown signs of distress or filed for bankruptcy, leaving investors and commentators to wonder how cryptoassets would be treated in a bankruptcy case. The many unanswered questions relevant to the treatment of such assets in bankruptcy include whether a cryptoasset would have priority as "customer property" or whether customers would simply have a general unsecured claim against the debtor.

Cravath partners Paul Zumbro and David Portilla have authored an a Viewpoint piece in The Wall Street Journal's Pro Bankruptcy platform entitled "How Congress Can Minimize the Cryptopocalypse"that provides a potential solution to the uncertainty, recommending that Congress act quickly to protect markets and investors by adopting a liquidation framework specific to cryptoasset intermediaries and exchanges, with distribution priority given to customer property, based on the special frameworks already in place for the liquidation of stockbrokers and commodity brokers. This approach would provide much needed stability in the cryptoasset markets, which are currently experiencing disruption and loss of investor confidence due to uncertainty regarding the potential treatment of customer cryptoassets in an intermediary's or exchange's bankruptcy.

DISTRESSED M&A

Stream TV Networks, Inc. v. SeeCubic, Inc.
On June 15, 2022, the Supreme Court of Delaware reversed a decision of the Court of Chancery that held that there is an "insolvency exception" to the general requirement for shareholder approval of a sale of all or substantially all of a corporation's assets.

Section 271 of the Delaware General Corporation Law ("DGCL") provides that any sale, lease or exchange of all or substantially all of a corporation's assets must be approved by a majority of shareholders entitled to vote. However, Vice Chancellor Laster held in the Court of Chancery that an exception to this requirement had developed in the common law—and survives today—which allows an insolvent corporation that is not yet in bankruptcy to sell all or substantially all of its assets with only the approval of the board of directors (and not the shareholders). (Note that Section 303 of the DGCL explicitly provides that a corporation in a federal bankruptcy proceeding may carry out any order of the bankruptcy court, including asset sales, without approval by its board *or* shareholders—typically during bankruptcy the board continues to approve material transactions before they are presented to the bankruptcy court for approval, but no action by shareholders is sought or obtained.)

The Supreme Court of Delaware disagreed, holding that, even if there had been an insolvency exception to the shareholder approval requirement in the past, that exception did not survive the enactment of Section 64(a) of the DGCL (the statutory predecessor to Section 271) in 1917.

While the Supreme Court of Delaware found that the private foreclosure transaction at issue required a shareholder vote under the *corporate charter*, which required a shareholder vote for "a sale, lease *or other disposition* of all or substantially all of the assets" of the corporation, it declined to answer whether *Section 271* generally requires a shareholder vote to approve a private foreclosure transaction as a "sale, lease *or exchange*". Therefore, it remains somewhat of an open question whether a corporation must receive shareholder approval before entering into a private foreclosure transaction in which it relinquishes all or substantially all of its property to a secured creditor in exchange for extinguishment of indebtedness—but the strong implication from the Supreme Court of Delaware is that Section 271 requires shareholder approval in that circumstance.

MOAC Mall Holdings LLC v. Transform Holdco LLC (In re Sears Holdings Corp.)
On June 27, 2022, the United States Supreme Court granted *certiorari* in an appeal of an order approving the assumption and assignment of a lease in the *Sears* bankruptcy case. At issue in the appeal is the effect of section 363(m) of the Bankruptcy Code. Section 363(m) provides that the reversal or modification on appeal of an authorization to sell or lease property to a good-faith purchaser does not affect the validity of that sale or lease, unless the authorization, sale or lease was stayed pending appeal.

The Courts of Appeal are currently split on whether section 363(m) operates as a *per se* bar on any appeal from an order approving a sale or lease of property to a good-faith purchaser. The Second and Fifth Circuits have held that any appeal from a sale order—or even any order that is "integral" to a sale order—is barred by section 363(m), except for an appeal on the issue of whether the purchaser acquired the property in good faith. The Third, Sixth, Seventh, Ninth and Tenth Circuits have held that a sale order may be appealed (beyond the issue of good faith), as long as the appellate court is able to fashion a remedy that will not affect the validity of the sale.

While section 363(m) does include an exception where the authorization, sale or lease is stayed pending appeal, such stays are rarely obtained, as the court will often require the posting of a bond as a condition to granting the stay. For large transactions, the amount of the bond may be prohibitively expensive, and many potential appellants have likely decided against seeking a stay due to the bonding requirement. Courts are also reluctant to grant stays due to the importance of finality of bankruptcy court sale orders in order to encourage bidding in bankruptcy court auctions.

Section 363(m) is a manifestation of that fundamental bankruptcy policy of finality, which provides all parties-in-interest with certainty in often fragile situations and, in turn, maximizes the value of the estate for the benefit of all creditors. The Supreme Court's decision will be closely watched, as it will determine the extent to which parties may rely on a sale order as final, which may have significant consequences for the willingness of potential purchasers to enter into transactions with bankrupt entities.

DISTRESSED FINANCING

Bayside Capital Inc. v. TPC Group Inc. (In re TPC Group Inc.)
LCM XXII Ltd. v. Serta Simmons Bedding, LLC
Litigation continues in cases involving out-of-court priming transactions, with two significant opinions arising out of "uptiering"-style transactions issued so far this year.

On July 6, 2022, Bankruptcy Judge Craig T. Goldblatt of the District of Delaware issued an opinion in *Bayside Capital Inc. v. TPC Group Inc. (In re TPC Group Inc.)*, which focused on a requirement to obtain consent from all affected noteholders in order to make any change to the provisions of an indenture (and the related intercreditor agreement) "dealing with the application of proceeds of Collateral that would adversely affect the Holders".

Through a series of transactions, one group of noteholders (constituting the requisite majority) amended the indenture to subject it to a new intercreditor agreement, which resulted in subordination of the original noteholders to a new tranche of senior notes. The objecting minority noteholders argued that the amendments required the consent of all affected noteholders, as the subordination effectively resulted in a change to the application of proceeds of collateral.

Judge Goldblatt found that the amendments were permitted by the indenture, as the provision requiring all proceeds of collateral to be shared ratably among noteholders—which he found was the only provision "dealing with the application of proceeds of Collateral"—was left unchanged. The court rejected the argument of the objecting noteholders, finding that the lack of an express anti-subordination clause meant that the provision requiring ratable distribution only applies "to distributions *within* a class, and [does] not prohibit subordination of an entire class to another, different class".

The *TPC Group* opinion echoes another opinion issued by District Judge Katherine Polk Failla of the Southern District of New York on March 29, 2022, in *LCM XXII Ltd. v. Serta Simmons Bedding, LLC*. In evaluating an uptiering transaction challenged on similar grounds, Judge Failla examined a provision in a credit agreement that provided that the waterfall that applies upon an event of default was "subject in all respects to the provisions of each applicable Intercreditor Agreement". The court found that nothing in the applicable transaction documents prohibited lenders from executing a new intercreditor agreement containing a waterfall that gave priority to new debt over existing first-lien debt, and, by the plain terms of the credit agreement, the waterfall under the new intercreditor agreement supplanted the existing waterfall under the credit agreement.

While the *Serta* and *TPC* opinions both relied on a strict reading of the contractual text to permit the transactions at issue, the *Serta* court did allow one claim to proceed based on the "spirit" of the contract—a claim for breach of the implied covenant of good faith and fair dealing. Judge Failla found that the plaintiffs' allegations that their expressly bargained-for first-lien priority rights were subverted due to private negotiations with select lenders were sufficient for that claim to survive a motion to dismiss. By contrast, Judge Goldblatt found that, while the transactions at issue in *TPC* "may have violated . . . the 'all for one, one for all' spirit of a syndicated loan, . . . [t]here is nothing in the law that requires holders of syndicated debt to behave as Musketeers. To the extent such holders want to be protected against self-interested actions by borrowers and other holders, they must include such protections in the terms of their agreements."

Other Developments

Convertible Debt Issuances Decrease as Returns Decline

The increase in popularity of convertible bonds in 2020 and 2021 is now in sharp decline, with relatively few bond issuances to date in 2022 and many convertible bonds trading well below face value. The $10.2B in proceeds from issuances in the U.S. market through June 30, 2022 represent a decline of 83% in the first six months of 2022 as compared to the same period in 2021, per data from Refinitiv. One potential explanation for this decline is the stock performance of the types of high-growth technology companies that were prime candidates for convertible bond issuance in the last several years. The Fed's decision to raise interest rates is also contributing to the decrease in trading level for these types of bonds, depressing prices and deterring potential issuers from entering the convertible bond market.

SEC Personnel Update

On May 3, 2022, the SEC announced that it will double the size of the recently renamed Crypto Assets and Cyber Unit (previously the Cyber Unit) within the Division of Enforcement. The Crypto Assets and Cyber Unit will now consist of 50 SEC staff. Chair Gensler noted that "[b]y nearly doubling the size of this key unit, the SEC will be better equipped to police wrongdoing in the crypto markets while continuing to identify disclosure and controls issues with respect to cybersecurity".