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GLOBAL PUBLIC COMPANY ACADEMY

RECENT DEVELOPMENTS IN DEBT AND EQUITY OFFERINGS 2021

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Agenda

- Debt and equity capital markets in 2020
- Sustainable financing (ESG-related debt issuance)
- Direct listings, ESG, recent SEC SPAC developments
- Floating rate/SOFR and mandatory converts/equity units

Debt Capital Markets in 2020

- Q1 marked by volatility
- Global debt issuance topped $10 trillion for the first time (25,000 offerings)
  - $4.8 trillion from investment grade corporate debt
  - $500 billion from high-yield debt
  - Over $200 billion from green bonds
- The Fed's response to Covid-19 led to massive supply in March 2020
  - Fed's Secondary Market Corporate Credit Facility led to a record amount of bonds issued the week of March 23, 2020
  - Fed expanded eligible assets to include high-yield bonds that had recently fallen from investment grade, as well as certain ETFs

Equity Markets in 2020

- US IPO volume more than doubled in 2020 to 494
  - $174B raised (150% increase over 2019)
- SPACs represented about half of all US IPOs in 2020
- Leading sectors:
  - Finance
  - Health Technology
  - Technology Services
- Globally, IPO proceeds reached a record high of $268B ($208B in 2019)
- Record 862 follow-on equity offerings in 2020 raised $257.23B
- Direct listings: two more companies in 2020
  - Palantir Technologies and Asana

Sustainable Financing

- Common product types
  - Green bonds – proceeds allocated to fund or offset the cost of green projects (e.g., green building, renewable energy, pollution prevention)
  - Social bonds – proceeds allocated to fund social projects (e.g., affordable housing, expansion of basic services)
  - Sustainability bonds – proceeds allocated to fund a combination of both green and social projects
  - Sustainability-linked bonds – coupon, maturity, or repayment amount tied to the issuer's ability to achieve specified sustainability-related performance metrics (e.g., emission or waste reduction)

Sustainability-linked Bonds

- Focused on incorporating measurable, forward-looking sustainability key performance indicators (KPIs) and sustainable performance targets (SPTs)
  - KPI and SPT examples include emission or waste reduction, increasing the use of renewable energy or recycled materials in production
- Ear-marked for general corporate purposes, unlike traditional green bonds
- Unrestricted use of proceeds offers a big advantage for issuers still interested in attracting ESG-focused investors
  - Alternative for issuers for whom identifying an “Eligible Green Project” may not be feasible
- Similar Use of Proceeds disclosure issues to green bonds
  - What are the KPIs or SPTs?
  - “Penalty” for missing KPI or SPT targets?
  - How will the issuer report its progress?

Sustainable Debt Disclosures

- Risk Factors
  - No legal, regulatory, or market definition or standard of what is a "green," "social," or "sustainable" project
- Use of Proceeds
  - Used towards an "Eligible Green Project" (or similar term defined in the prospectus)
    - Can also have an amount equal to the net proceeds of the offering allocated exclusively towards an eligible project
  - Reporting the allocation of funds to the specific eligible project(s), typically reported on the issuer's website
  - Adherence to voluntary guidelines is common, but not universal
    - E.g., the Green Bond Principles, created by the International Capital Market Association (ICMA)

Direct Listings

- Not a novel concept, but evolving paths and structures
- NYSE direct listing rules approved by SEC in December 2020
- Nasdaq has proposed rules which have not yet been approved, but pattern NYSE rules in most respects
- New rules permit issuers to raise capital as part of primary direct floor listing
- To date, direct listings conducted by large, cutting-edge companies (eg, Spotify, Slack, Palantir, Roblox) and have been secondary direct floor listings
- Recent ML&B article on topic: https://www.morganlewis.com/pubs/2021/01/sec-approves-nyse-rules-allowing-companies-to-raise-money-in-registered-direct-offerings

Direct Floor Listings – General

- Shares are registered for sale under Securities Act of 1933 of Form S-1 (or F-1)
- Issuer applies for listing of securities on exchange
- Listing must meet certain size/price parameters
- Issuer must meet various eligibility requirments
- No underwriters
- Price set on first day of trading through reference price/market dynamics
- Pros: More egalitarian process, less onerous lock-ups, avoid underwriter leakage
- Cons: Potential lack of liquidity, unpredictability in market, difficult to generate interest

Primary Direct Floor Listings

- Significant development in that issuer itself would be able to raise capital
- Transaction must meet certain size requirements
  - Issuer must sell at least $100 million of shares, or a lesser amount that when combined with other shares sold in initial offering (ie, by shareholders) exceeds $250 million
- Listing company must satisfy NYSE eligibility requirements
  - Quantitative and qualitative/governance
- Nasdaq expected to have similar rules/requirements
- Extent of market adoption remains to be seen

ESG Developments

- SEC has made clear this is a priority
- Satyman Khanna newly appointed Senior Policy Advisor for Climate and ESG
- On March 4, 2021, SEC announced the creation of a Climate and ESG Task Force in the Division of Enforcement
- Likely move to unified disclosure standard
  - Eventual use of single global ESG reporting framework
- "Going forward, I believe SEC policy on ESG disclosures will need to be both adaptive and innovative. We can and should continue to adapt existing rules and standards to the realities of climate risk, for example, and the fact that investors increasingly are asking for ESG information to help them make informed investment and voting decisions. We will also need to be open to and supportive of innovation – in both institutions and policies on the content, format and process for developing ESG disclosures." *John Coates, Acting Director, Division of Corporation Finance, March 11, 2021*
- Growing priority for ISS, Glass Lewis, institutional investors, others

SPAC Developments

- High and growing levels of SPAC activity through 2020 and into 2021
  - Approximately $170 billion of SPAC M&A transactions in Q1 2021 – exceeded all of 2020
  - Represented approximately 30% of overall M&A volume
  - Approximately 400 public SPACs looking for deals
- SEC has long had concerns regarding certain elements of SPAC transactions
- April 2021 "SEC Staff Statement on Accounting and Reporting Considerations for Warrants Issued by SPACs"
  - Generally, suggests that SPAC warrants should be classified as liabilities rather than equity
- Could require restatement of financial statements
- Could create more certainty/roadmap for SPACs – longer-term positive?
- June 2021 -- ML&B GPCA Session on SPACs: https://www.morganlewis.com/events/2021/06/going-public-through-a-spac-current-issues-for-spac-sponsors-and-private-companies-2021

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EQUITY UNITS

Uptick in popularity as a form of equity-linked financing, particularly for utility issuers.

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What is an equity unit?

- An equity unit transaction is a mandatory convertible product (typically in a stated amount of $50) and initially issued in the form of a corporate unit consisting of:
  - a purchase contract issued by the issuer and
  - a fractional undivided beneficial ownership interest in a $1,000 principal amount debt security of the issuer (both senior and subordinated debt securities have been issued as components of equity units).
- This is the “classic” form of equity unit although there are different variations of this product, particularly ones that use a different “host” security as a component of the equity unit.

What is a purchase contract?

- Each purchase contract obligates a holder of equity units to purchase from the issuer common stock of the issuer (subject to anti-dilution adjustments) on the purchase contract settlement date, which date is typically three years in the future.
- The obligation to purchase common stock is secured by the underlying debt security—the investor is not required to pay any additional money.
- The number of shares an investor receives is determined pursuant to a formula set at the time of pricing that depends on the market price of the common stock immediately before the purchase contract settlement date, subject to a maximum settlement rate and a minimum settlement rate.

What is a remarketing?

- The debt security component of the issuer is required to be remarketed prior to the purchase contract settlement date.
- The remarketing typically occurs, at a time selected by the issuer, during the six-month period prior to the purchase contract settlement date.
- If a successful remarketing occurs other than immediately before the purchase contract settlement date, the proceeds from the remarketing are invested in a treasury portfolio that matures on or prior to the purchase contract settlement date.
- The proceeds from a successful remarketing (or the proceeds from the maturing treasury portfolio) will be used to satisfy the obligation to purchase common stock pursuant to the purchase contracts.
- Following a successful remarketing, the interest rate on the debt security will be reset.

What are the payments on an equity unit?

- The yield payable on an equity unit consists of
  - interest on the debt security and
  - contract adjustment payments.
- Interest on the debt security will accrue at an annual rate and typically will be paid quarterly until a successful remarketing occurs.
- "Contract adjustment payments" will also be paid periodically with respect to the underlying purchase contract.
  - Contract adjustment payments are typically subordinated.

Why are equity units attractive?

- Equity units generate cash proceeds and lock in a share price of a common stock offering today while largely avoiding common stock dilution until the purchase contract settlement date.
- Issuers receive equity credit from the rating agencies.
- Payments of interest on debt component of equity units are tax-deductible

What is IRS Rev. Rul. 2003-97?

- The IRS issued a revenue ruling in 2003 which provides that interest on a debt security in an equity unit is deductible if the four critical factors are satisfied.
- It is critical for a corporate lawyer to understand the four "critical factors" set forth in the revenue ruling as much of the complexity of the equity unit product relates to these factors.
- The four critical factors (from IRS Rev. Rul. 2003-97) are:
  - Critical Factor I. The holder has the unrestricted legal right to convert the Purchase-Contract/Note unit into a Purchase-Contract/Strip unit or to settle the Purchase Contract with separate cash and retain the Note, and the holder is not economically compelled to keep the unit unseparated.
  - Critical Factor II. The Purchase Contract provides that, in the event of X's bankruptcy, the Purchase Contract will terminate and the associated Note or Strip will be released to the holder; and, on the Issue Date, X reasonably believes, based on advice from counsel, that the provision would be enforceable in bankruptcy and would result in the holder of a Purchase-Contract/Note unit being treated as a creditor in the bankruptcy proceeding.
  - Critical Factor III. The period the Notes will remain outstanding after a remarketing is significant, both absolutely and relative to the total term of the Notes. For purposes of this factor, Notes are considered to remain outstanding only during the period when they are not subject to redemption at the option of the issuer.
  - Critical Factor IV. On the Issue Date, it is substantially certain that a remarketing of the Notes will succeed. For purposes of this factor, a remarketing of the Notes is not substantially certain to succeed if the Reset Rate is capped.

FLOATING RATE DEBT SECURITIES

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Background

- In 2017, the UK Financial Conduct Authority announced that it would cease publication of the London Interbank Offered Rate (LIBOR) index at the end of 2021.
- In November 2020, the ICE Benchmark Administration, the administrator of LIBOR, announced that publication of most forms of LIBOR was extended to June 30, 2023.
- There are trillions of dollars of loans, bonds, derivatives and other financial contracts that are based on LIBOR.

ARRC Fallback Language

- In April 2019, the Alternative Reference Rates Committee (“ARRC”), a group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York, released its final “fallback language” recommendations for US dollar-denominated floating rate notes if LIBOR was not longer available.
- The ARRC’s guidance contained sample language with a waterfall of specific successor rates.
- The initial successor rate is expected to be the secured overnight financing rate (“SOFR”) published daily by the Federal Reserve Bank of New York. The initial priority in the waterfall is “Term SOFR,” which is expected to be the forward-looking term rate based on SOFR, followed by the “Compounded SOFR,” which is a compounded average of daily SOFRs if Term SOFR does not exist.
- Since SOFR differs from LIBOR, the ARRC guidance provides that adjustments will be necessary for instruments originally priced using LIBOR.
- In particular, the ARRC’s guidance provides that certain adjustments may be made to the rate, including applying a spread thereto, or modifying the business day convention, interest determination dates and related provisions and definitions, to make such alternative reference rate comparable to the initial LIBOR rate.
- In our experience, the ARRC fallback language has been included as a term of new issuances of LIBOR floating rate securities, with few relatively few deviations from the sample language, since it was released in 2019.

New Money Deals Using SOFR

- Issuers have become increasingly comfortable using “SOFR” to issuer floating rate debt since the beginning of the year.
  - Large banks had started issuing SOFR floating rate debt before then.
  - Notable deals in 2021 include Enbridge Inc., Verizon Communications Inc. and NextEra Energy Capital Holdings, Inc.
- The new deals have been done using “compounded SOFR”.
  - Although the ARRC fallback language contemplated that “term SOFR” would be the first fallback rate, term SOFR is not yet available.
- Compounded SOFR is calculated by compounding the daily SOFR rate, which is typically calculated over the course of a period ending two business days prior to the interest payment date, and then adding the transaction-specific applicable spread to determine the interest due.

New York Legislation

- On April 6, 2021, the NY LIBOR Legislation (Senate Bill 297B/Assembly Bill 164B) was signed into law.
  - The NY LIBOR Legislation generally tracks the legislation proposed by the ARRC.
  - The law provides a statutory remedy for so-called "tough legacy contracts," i.e., contracts that reference U.S. dollar-denominated LIBOR as a benchmark interest rate but do not include effective fallback provisions in the event LIBOR is no longer published or is no longer representative, and that will remain in existence beyond June 30, 2023 in the case of the overnight, 1 month, 3 month, 6 month and 12 month tenors, or beyond December 31, 2021 in the case of the 1 week and 2 month tenors.
- Under this law, if a contract governed by New York law
  - references LIBOR as a benchmark interest rate and
  - does not contain benchmark fallback provisions, or contains benchmark fallback provisions that would cause the benchmark rate to fall back to a rate that would continue to be based on LIBOR,

  then on the date LIBOR permanently ceases to be published, or is announced to no longer be representative, LIBOR will be deemed by operation of law to be replaced by the "recommended benchmark replacement."
- This law provides that the "recommended benchmark replacement" shall be based on SOFR and shall have been selected or recommended by the Federal Reserve Board, the Federal Reserve Bank of New York or the ARRC (each a "relevant recommending body") for the applicable type of contract, security or instrument. The recommended benchmark replacement will include any applicable spread adjustment and any conforming changes selected or recommended a relevant recommending body.

Q&A

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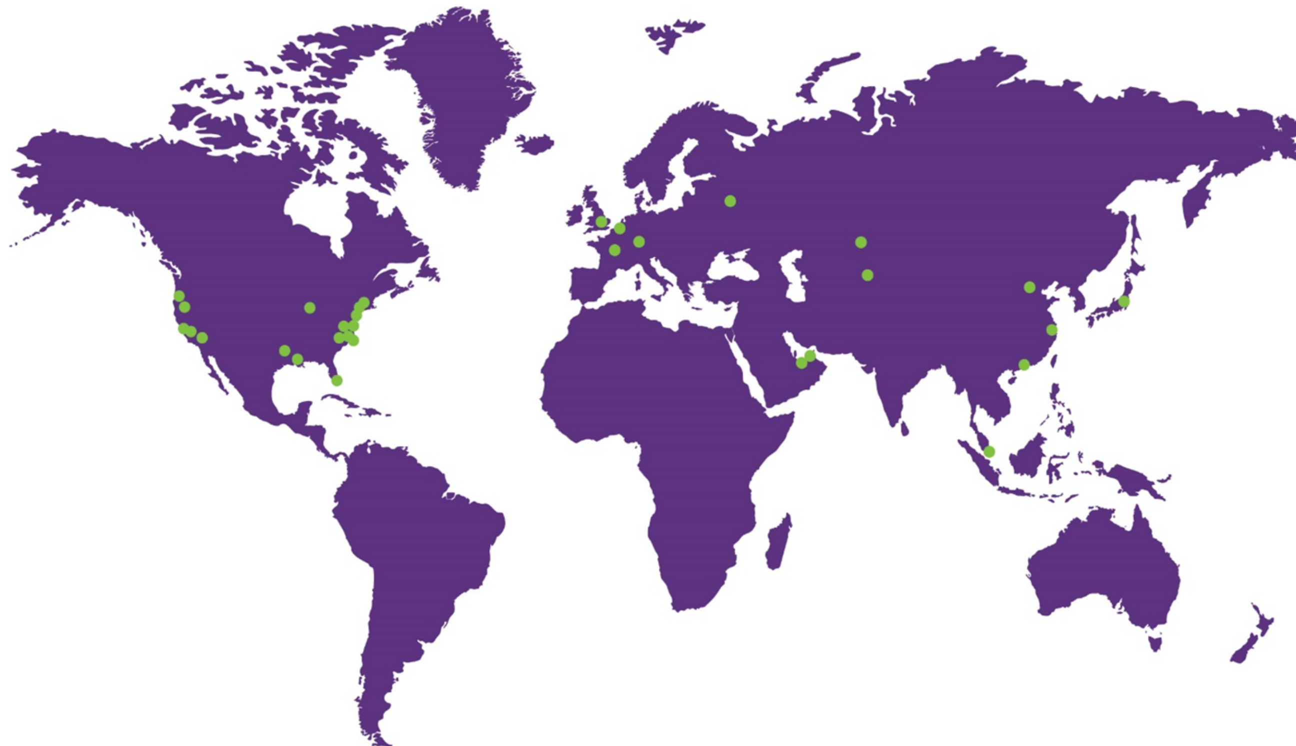

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