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Cravath Quarterly Review

FINANCE AND CAPITAL MARKETS

Market Update

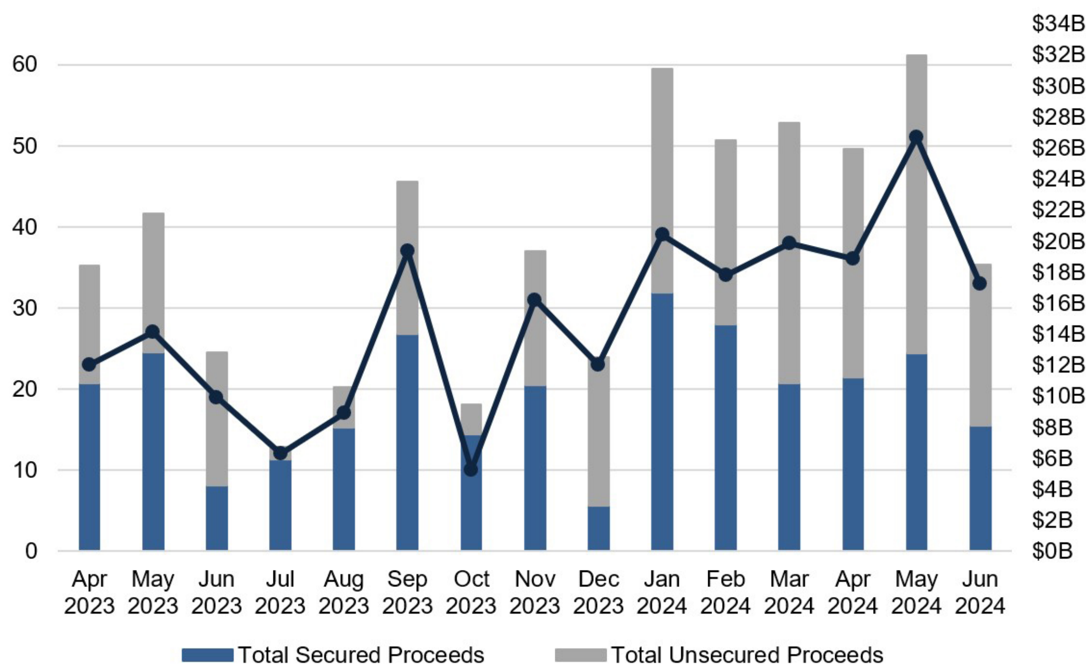
GENERAL TRENDS

U.S. financing activity in the second quarter of 2024 generally decreased compared to the first quarter of 2024, but generally remained elevated from the levels seen in the second quarter of 2023. Activity in the U.S. investment-grade bond market declined relative to the first quarter of 2024, but was slightly higher than the second quarter of 2023. Activity in the U.S. high-yield bond market also declined relative to the first quarter of 2024, but was significantly higher than the second quarter of 2023. Activity in the total U.S. syndicated leveraged loan market increased in the second quarter of 2024 as compared to both the first quarter of 2024 and the second quarter of 2023, while activity in the leveraged buyout ("LBO") market decreased as compared to the first quarter of 2024, but was higher than the second quarter of 2023. The number of and total proceeds from U.S. follow-on equity offerings in the second quarter of 2024 decreased relative to the first quarter of 2024 and the second quarter of 2023. U.S. IPO activity in the first quarter of 2024 increased significantly as compared to the first quarter of 2024 and the second quarter of 2023.

BONDS

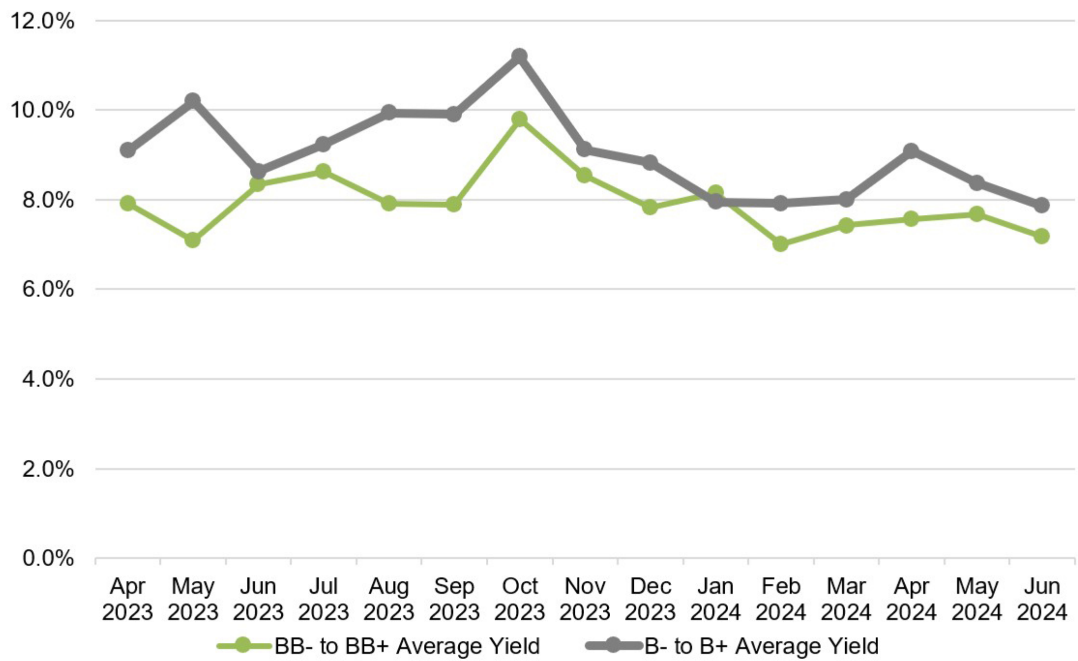
U.S. High-Yield Bonds

Total proceeds from U.S. high-yield bond issuances were $76.4B in the second quarter of 2024, down 10.3% as compared to the first quarter of 2024 ($85.2B) and up 44.2% as compared to the second quarter of 2023 ($53.0B). Total proceeds from unsecured bonds were $44.3B in the second quarter of 2024, up 76.7% as compared to $25.1B in the second quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

The average initial yield on high-yield notes rated BB- to BB+ issued in the second quarter of 2024 was 7.5%, unchanged from the first quarter of 2024 and decreased from 7.8% in the second quarter of 2023. The average initial yield on high-yield notes rated B- to B+ issued in the second quarter of 2024 was 8.4%, as compared to 8.0% in the first quarter of 2024 and 9.3% in the second quarter of 2023.

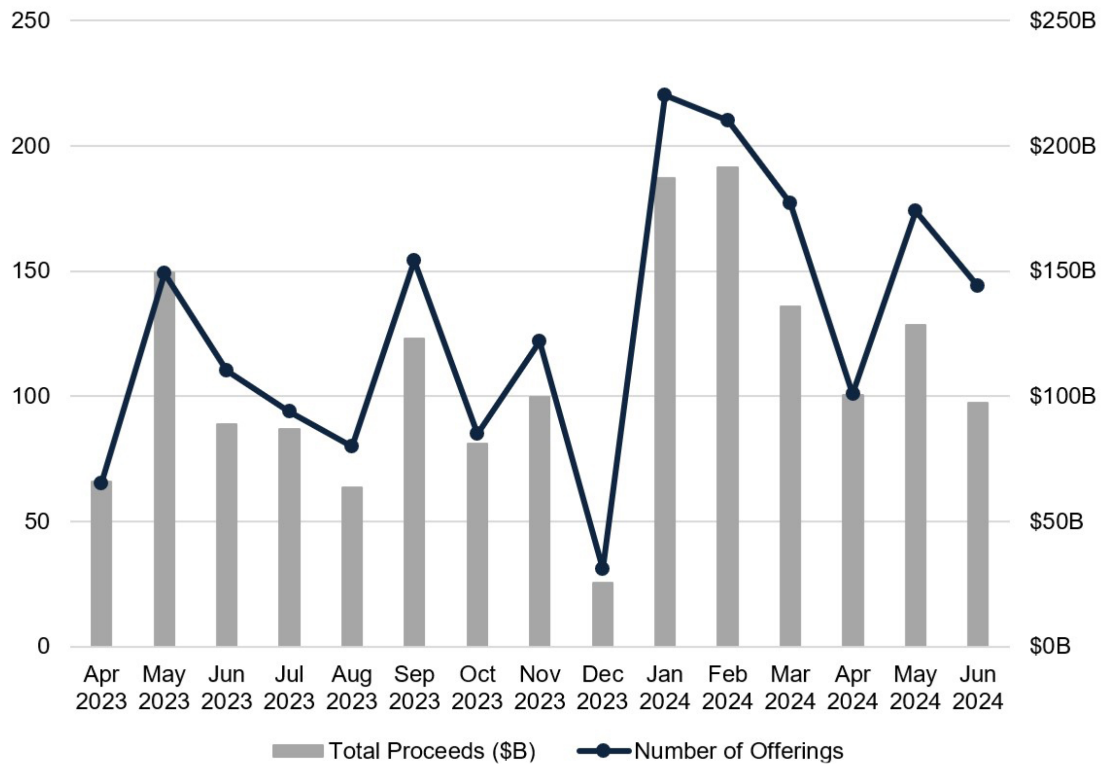


DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Investment-Grade Bonds

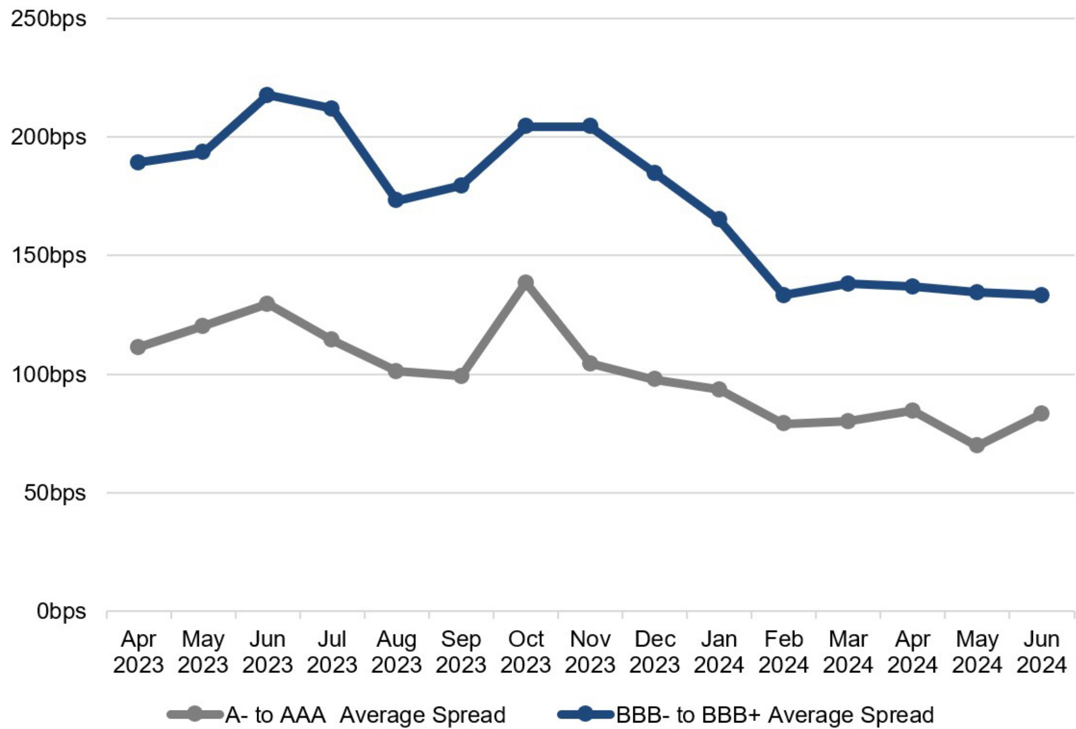
Total proceeds from U.S. investment-grade issuances were $326.1B in the second quarter of 2024, down 36.6% from $514.3B in the first quarter of 2024 and up 7.3% from $303.8B in the second quarter of 2023.

The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated A- to AAA in the second quarter of 2024 decreased 5.9% as compared to the average pricing spread for the first quarter of 2024 and decreased 34.2% as



DATA SOURCE Leveraged Commentary & Data (LCD)

compared to the average pricing spread for the second quarter of 2023. The average pricing spread (measured over the comparable Treasury) on U.S. issuances of investment-grade notes rated BBB- to BBB+ in the second quarter of 2024 decreased 7.2% as compared to the average pricing spread for the first quarter of 2024 and decreased 32.6% as compared to the average pricing spread for the second quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

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

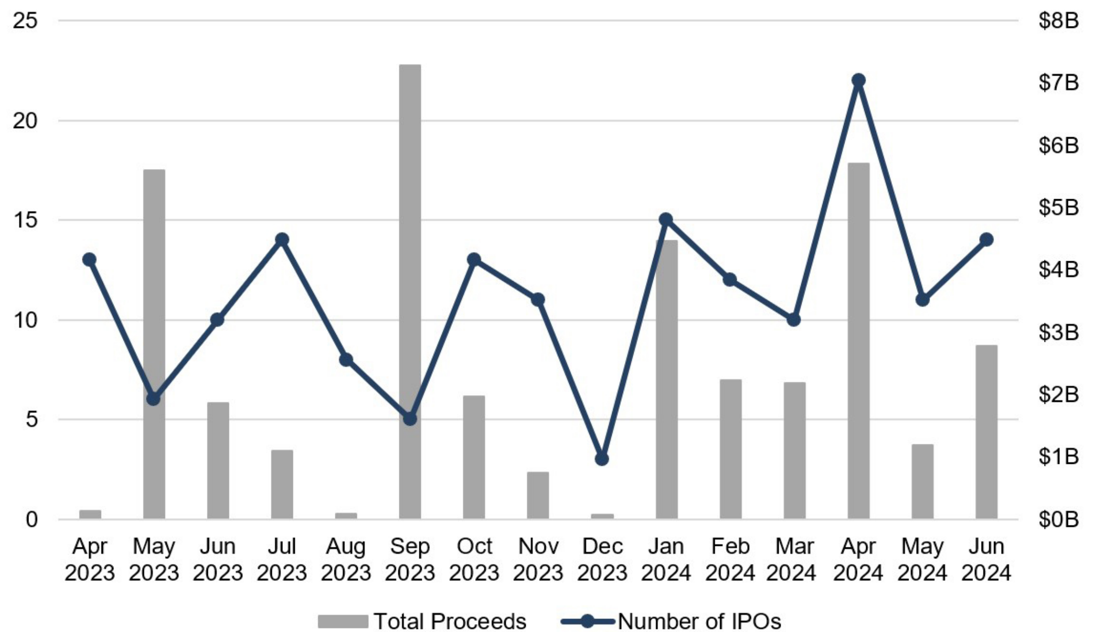
Since the Federal Reserve began aggressively increasing interest rates in March 2022, U.S. Treasury yields have significantly increased relative to the historically low rates in 2020. In the second quarter of 2024, the Federal Reserve left interest rates unchanged and generally continued to signal potential rate cuts in 2024. U.S. Treasury 7-year yields increased 13 bps to 4.33% at the end of the second quarter of 2024, up 3.10% as compared to 4.20% at the end of the first quarter of 2024. U.S. Treasury 10-year yields increased 16 bps to 4.36% at the end of the second quarter of 2024, up 3.81% as compared to 4.20% at the end of the first quarter of 2024.

DATA SOURCE U.S. Department of the Treasury

EQUITY

U.S. IPOs

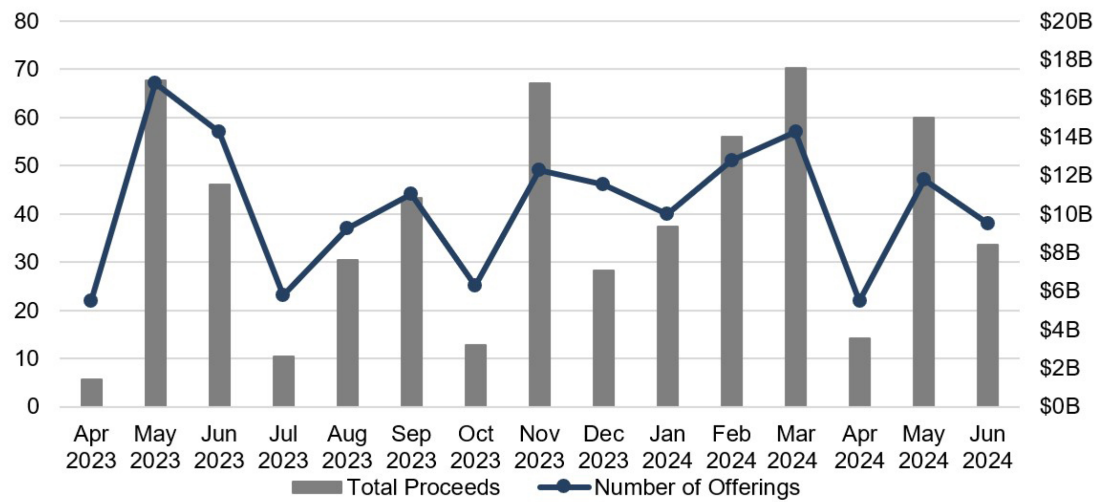
The U.S. IPO market in the second quarter of 2024 continued the increase in activity we observed in the first quarter of 2024. The $9.7B in total proceeds from U.S. IPOs (not including SPACs) in the second quarter of 2024 was up 9.0% as compared to $8.9B in total proceeds in the first quarter of 2024 and up 27.5% as compared to $7.6B in total proceeds in the second quarter of 2023.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Follow-On Offerings

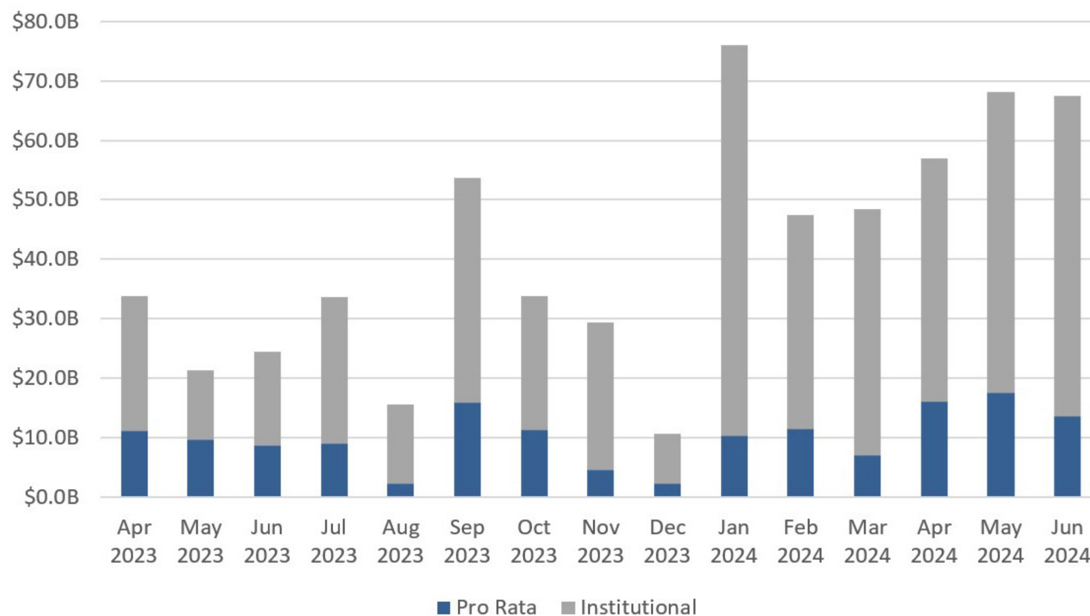
The $26.9B in total proceeds from U.S. follow-on equity offerings in the second quarter of 2024 was down 34.2% as compared to $40.9B in total proceeds in the first quarter of 2024 and down 9.9% as compared to $29.9B in total proceeds in the second quarter of 2023.



DATA SOURCE Refinitiv, an LSEG Business

U.S. Syndicated Leveraged Loan Issuances

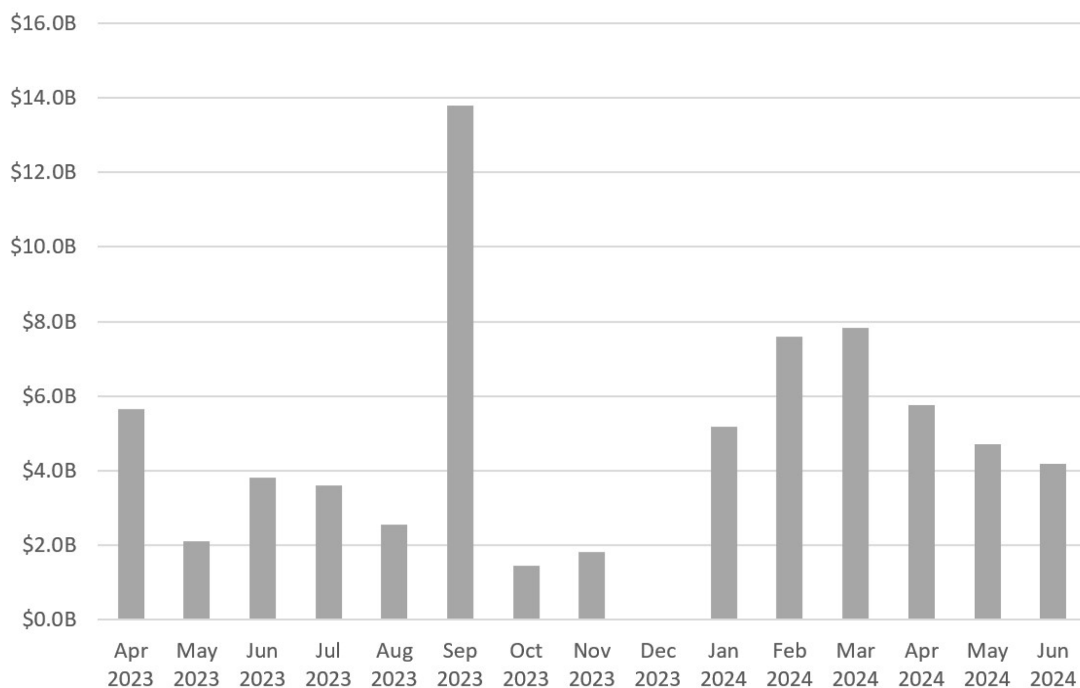
Activity in the U.S. syndicated leveraged loan market increased in the second quarter of 2024, with total volume of $192.6B, up 12% as compared to the first quarter of 2024 ($171.9B). Pro rata loan volume increased by 64% as compared to the previous quarter, whereas institutional loan volume increased by 2% as compared to the previous quarter. Institutional loans continued to make up a larger percentage of total deal volume than in the recent past, accounting for 75% of total deal volume in the second quarter of 2024, as compared to 63% in the second quarter of 2023. Total deal volume in the second quarter was also stronger than last year, with an increase in total deal volume of 142% as compared to the second quarter of 2023 ($79.5B), driven by institutional loan volume, which was $145.4B in the second quarter of 2024, up 190% as compared to the second quarter of 2023 ($50.1B). Total pro rata loan volume also increased to $47.2B in the second quarter of 2024, up 61% as compared to the second quarter of 2023 ($29.4B).



DATA SOURCE Leveraged Commentary & Data (LCD)

U.S. Syndicated LBO Loan Volume

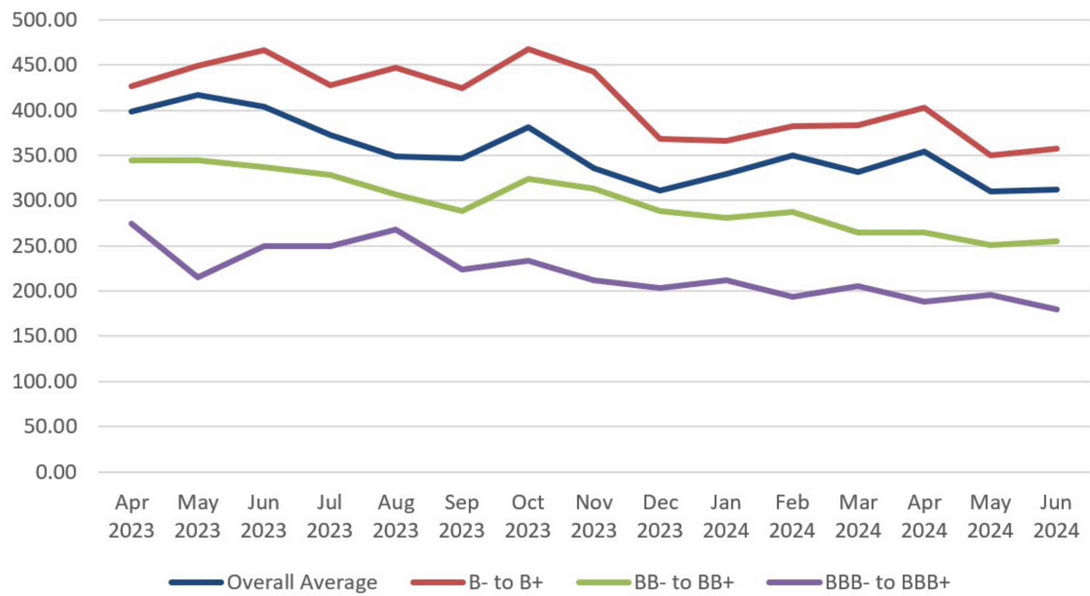
In the second quarter of 2024, there were $14.7B of U.S. syndicated LBO loans issued, which was a decrease of 29% as compared to $20.6B in the first quarter of 2024 and an increase of 27% as compared to $11.6B in the second quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

Primary Market Syndicated Institutional First-Lien Loan Spreads

Average spreads over benchmark rates on syndicated first lien institutional loans for large corporate leveraged loan transactions were 326 bps in the second quarter of 2024, which is lower than the 360 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 370 bps in the second quarter of 2024, which is lower than the 421 bps average spread in the trailing 12-month period, (b) BB- to BB+ were 257 bps in the second quarter of 2024, which is lower than the 309 bps average spread in the trailing 12-month period, and (c) BBB- to BBB+ were 187 bps in the second quarter of 2024, which is lower than the 224 bps average spread in the trailing 12-month period.

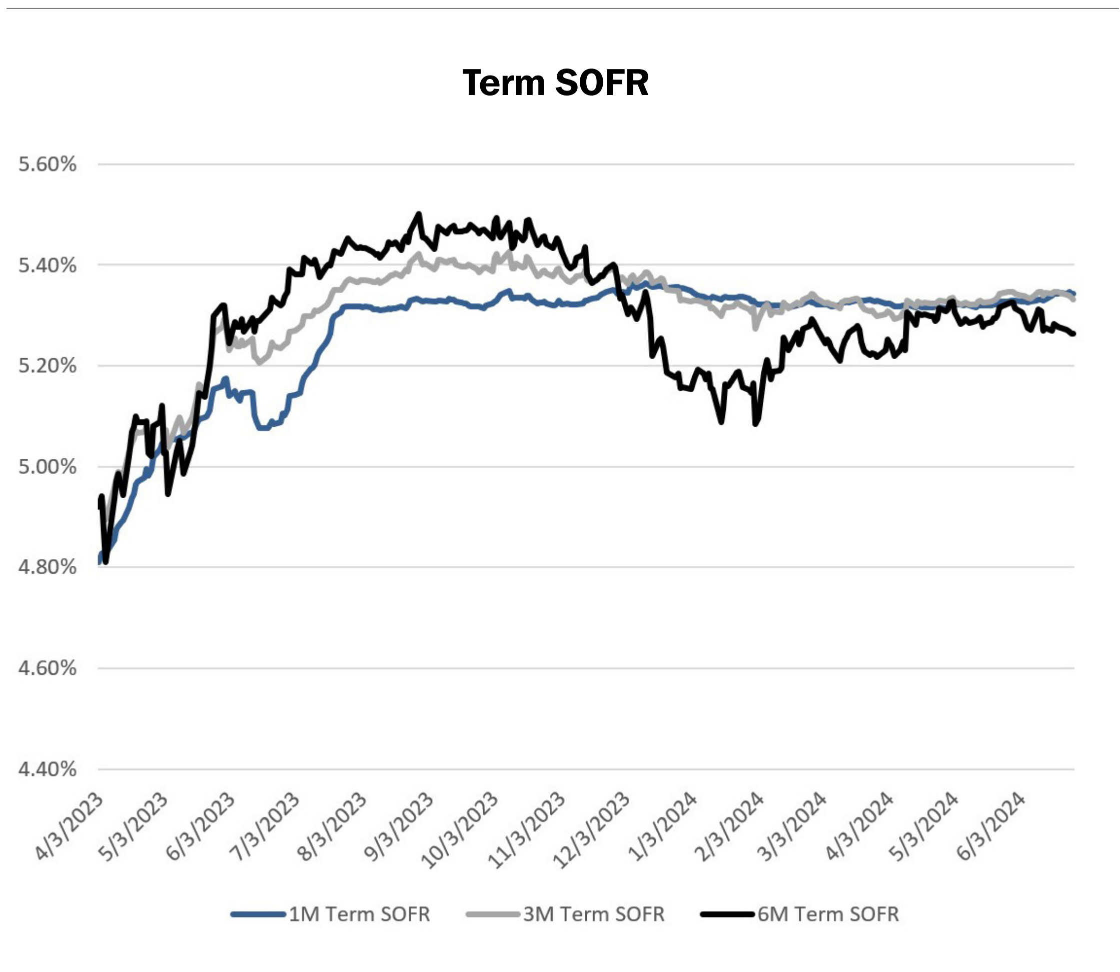


Note: Large corporate borrowers are defined as borrowers with an annual EBITDA of at least $50mm. Average spreads are dollar-weighted based on reported spreads, and do not reflect credit spread adjustments.

DATA SOURCE Leveraged Commentary & Data (LCD)

Term SOFR Reference Rate

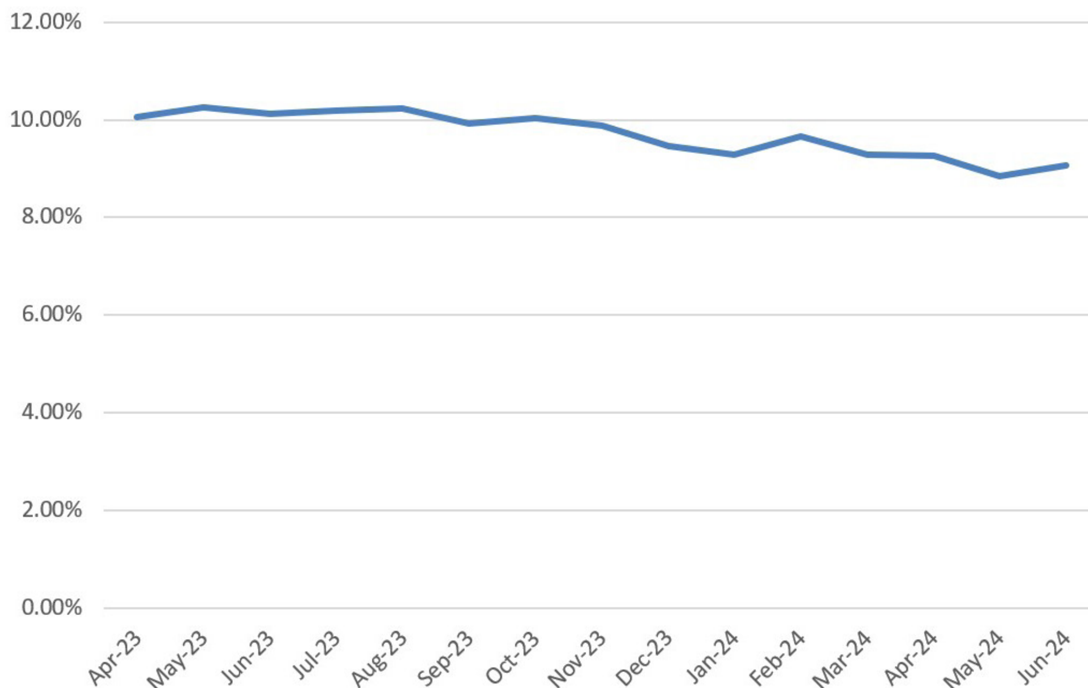
Term SOFR ended the second quarter of 2024 at 5.35%, 5.35% and 5.33% for the one-month, three-month and six-month tenors, respectively. Term SOFR for the one-month and three-month tenors was flat as compared to the end of the first quarter of 2024, while Term SOFR for the six-month tenor increased by 4 bps as compared to the end of the first quarter of 2024. The yield curve inversion that began on November 30, 2023 persisted throughout the second quarter of 2024, aside from the first two days of May, during which Term SOFR for the six-month tenor was 1 bp higher than Term SOFR for the one-month and three-month tenors. This brief reversion of the yield curve correlated to the Federal Reserve's interest rate announcement on May 1, 2024. The yield curve inversion was less pronounced than in the first quarter of 2024. During the quarter, Term SOFR for the six-month tenor was on average 4 bps lower than the three-month tenor and the one-month tenor, as compared to 12 bps lower than the three-month tenor and the one-month tenor in the first quarter of 2024.



DATA SOURCE Bloomberg Finance L.P.

Primary Market Syndicated Institutional First-Lien Loan Yields

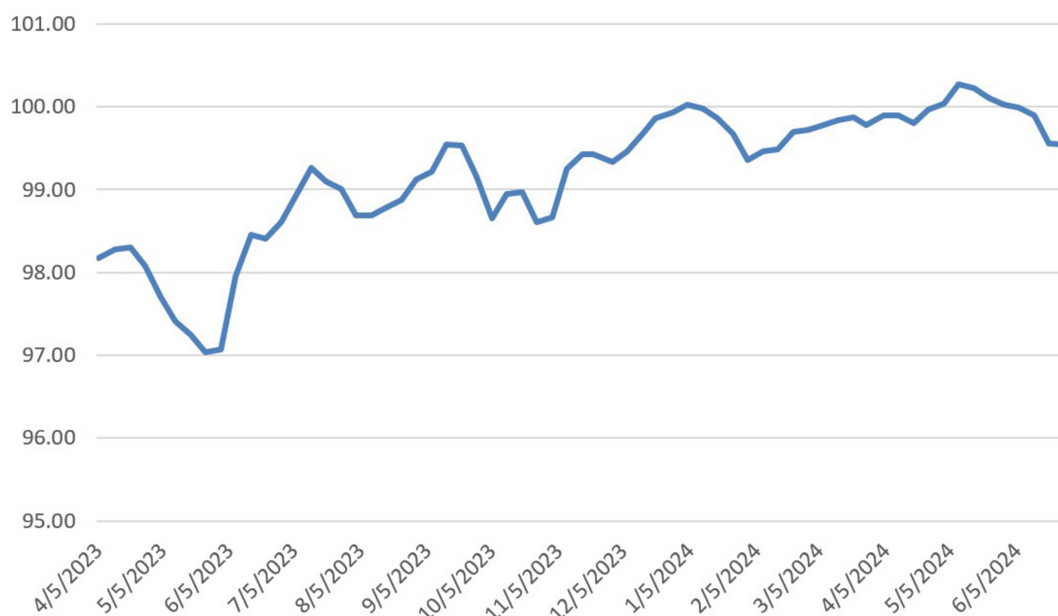
Yields on new-issue syndicated institutional first lien term loans, inclusive of original issue discount, declined in the second quarter of 2024. The average yield of 9.05% in the second quarter of 2024 represented a decrease of 36 bps as compared to the average yield of 9.41% in the first quarter of 2024 and a decrease of 74 bps as compared to the average yield of 9.79% in the fourth quarter of 2023.



DATA SOURCE Leveraged Commentary & Data (LCD)

Secondary Market Pricing

The average bid price of the LCD Flow Name Index as of the end of the second quarter of 2024 increased by 21 bps as compared to the end of the first quarter of 2024 and increased by 69 bps as compared to the end of the fourth quarter of 2023.



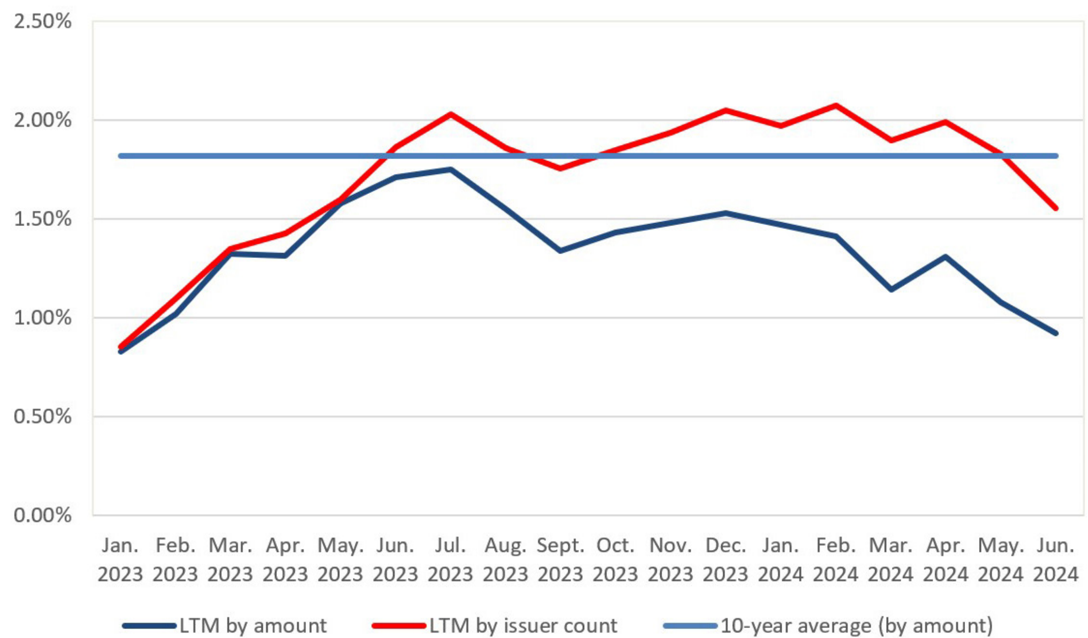
DATA SOURCE Leveraged Commentary & Data (LCD)[1]

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

RESTRUCTURING

U.S. Leveraged Loan Default Rate

The default rate for U.S. leveraged loans fell throughout the second quarter of 2024. The default rate of the Morningstar LSTA U.S. Leveraged Loan Index was 0.92% by amount and 1.55% by issuer count for the LTM period ending June 30, 2024, compared to 1.14% by amount and 1.90% by issuer count for the LTM period ending March 31, 2024. The default rate by amount remained below the 10-year average default rate.

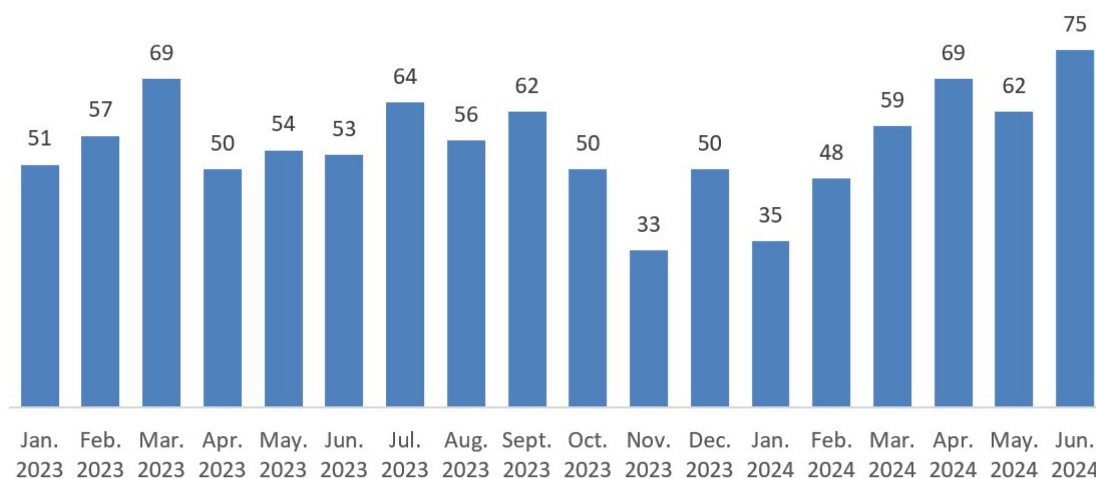


DATA SOURCE PitchBook | Leveraged Commentary & Data (LCD); Morningstar LSTA U.S. Leveraged Loan Index

U.S. Bankruptcy Filings

U.S. bankruptcy filings increased across the second quarter of 2024, with a total of 75 bankruptcy filings in June 2024 compared to 69 and 62 in April and May, respectively. Corporate bankruptcy filings have surged during this quarter, marking the highest totals since at least the middle of 2020.

Consumer discretionary, healthcare and industrials have continued to set the pace for bankruptcies in 2024, with 16 consumer discretionary bankruptcy filings in June compared to seven bankruptcies in the healthcare sector and nine bankruptcies in 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

Final Rules Enhancing Investor Protections for SPAC IPOs and de-SPAC Transactions Go Into Effect

As previously discussed in the Q1 2024 edition of this newsletter, the Securities and Exchange Commission's (the "SEC") new rules for special-purpose acquisition companies ("SPACs") and subsequent business combination transactions between SPACs and target companies (called "de-SPAC transactions") took effect on July 1, 2024, enhancing oversight of SPAC deals, although in a more limited scope than initially proposed. These regulations are designed to provide investor protections similar to those in traditional initial public offerings. Additional information on the final rules can be found in the Q1 2024 edition of this newsletter and the Cravath Client Memo on the subject.

Implementation of Basel III Endgame Stalls

Basel III originated in the wake of the Great Financial Crisis but has recently reemerged following bank failures in 2023. As the crisis was unfolding in 2008, international central bankers agreed upon a series of reforms to bank regulation which came to be known as Basel III. Banks are now subject to a set of detailed capital requirements based upon bank size, activity and type. Banks once again came under increased regulatory scrutiny following the collapses of Signature Bank, First Republic Bank and Silicon Valley Bank in March 2023, as discussed in the Q1 2023 edition of this newsletter. The Basel III Endgame proposal is the latest iteration of these reforms.

On March 6, 2024, Federal Reserve Chair Jerome Powell indicated to lawmakers that the previously announced plans to increase bank capital requirements ("Basel III Endgame") would be scaled back. The proposed regulations would have increased the amount of capital required on balance sheets of U.S. banks with $100 billion or more of total assets by an aggregate 16% to create a larger capital buffer against bank insolvency. The announcement prompted extensive opposition in comments from lobbying groups, academics and industry executives, many of whom questioned the proposed capital requirement increases for larger U.S. banks, citing their resilience during the COVID-19 pandemic and the regional banking crisis last spring.

The comments also presented concerns about whether the regulations at issue simply serve to channel risks into more opaque portions of the financial system and reduce availability of bank lending. The emergence of direct lenders as a prominent source of debt financing, themselves not subject to capital requirements, may have factored into the Fed's calculus. Banks, for their part, are finding creative ways to work within existing regulations to obtain yield, such as making senior loans to nonbank financial intermediaries, holding highly rated securitized assets and engaging in synthetic risk transfers. Regulators are expected to issue a revised plan in the coming months, which will likely propose less onerous changes to U.S. bank capital requirements.

Litigation Developments

Supreme Court Strikes Down Chevron Deference

On June 28, 2024, the Supreme Court of the United States, in a 6-3 decision in *Loper Bright Enterprises v. Raimondo* ("Loper") and its related case, *Relentless v. Department of Commerce*, overturned the longstanding precedent set by *Chevron USA v. Natural Resources Defense Council* ("*Chevron*") since 1984.

Chevron established a two-part test to determine when courts should give deference to an executive agency's interpretation of a statute. At step one, courts assess whether Congress "has directly spoken to the precise issue at question." If Congress's intent is clear, both the court and the agency must adhere to it and courts will reject any agency interpretation inconsistent with congressional intent. However, if the statute is silent or ambiguous on the matter, courts proceed to step two, where they evaluate whether the agency's interpretation is based on "a permissible construction of the statute." If so, the court defers to such agency interpretation even if it is not the interpretation the court would have made.

The *Loper* majority opinion, written by Chief Justice John Roberts, overturning *Chevron*, asserting that the doctrine had proven "fundamentally misguided." Roberts emphasized the need for courts to independently assess whether agencies act within their statutory authority, contending that *Chevron* restricts judicial evaluation rather than promoting it. He also argued that, over time, *Chevron* has proved unworkable (because there is no meaningful definition of the statutory ambiguity courts are meant to identify at step one) and unreliable (because of the Court's frequent adjustments to *Chevron* throughout the years).

Justice Elena Kagan authored the dissent, arguing that *Chevron* has become crucial to modern governance, supporting a range of regulatory efforts such as environmental protection, food safety, drug regulation, and financial market integrity. She cautioned that overturning *Chevron* would disrupt the legal system, casting doubt on established statutory interpretations and endangering longstanding interests of affected parties.

The *Loper* ruling is expected to have widespread implications for agency rulemaking across industries. Prior rulings upholding agency interpretations of statutes that relied on *Chevron* step two may no longer be entitled to precedential deference if the decision did not conclude as to the relevant statute's meaning. As it relates to the SEC, the loss of *Chevron* deference is poised to immediately influence ongoing cases challenging major new SEC rules, including the Eighth Circuit litigation challenging the SEC's enhanced climate disclosure rules. Without *Chevron* deference, the SEC's ability to defend its interpretation of its regulatory powers under federal securities laws may face increased scrutiny and potential limitations.

United States v. Peizer Results in First Criminal Insider Trading Conviction Based on Trades Placed Pursuant to a Rule 10b5-1 Trading Plan

On June 21, 2024, a federal jury in California convicted former Ontrak, Inc. ("*Ontrak*") CEO and Chairman of the Board of Directors Terren S. Peizer of insider trading based on his use of SEC Rule 10b5-1 trading plans in a landmark case. The decision marks the first insider trading conviction based on a Rule 10b5-1 trading plan and demonstrates the SEC's heightened scrutiny of corporate insiders and trading plans.

Rule 10b5-1 plans are typically used by corporate insiders as an affirmative defense against insider trading charges, provided that the plan satisfies applicable criteria (including being established in good faith and at a time when the insider does not possess material non-public information ("MNPI")). As alleged by the Department of Justice and SEC, Peizer adopted the first plan in May 2021 after Peizer acquired information that Cigna, Ontrak's largest customer, had raised reservations about maintaining its contract with Ontrak and the second plan in August 2021 after Ontrak's chief negotiator for the contract informed Peizer that the contract would likely be terminated. In both instances, Peizer possessed MNPI when he entered into the plans and made false representations in plan certifications.

Moreover, Peizer declined to choose a trading plan offered by a broker dealer which would have mandated a "cooling-off period" and instead chose another broker-dealer's plan which would allow him to immediately start trading. Peizer took these actions before the February 27, 2023 amendments to Rule 10b5-1 cooling off periods. Peizer was convicted of one count of engaging in a securities fraud scheme and two counts of securities fraud for insider trading.

Supreme Court Rules Omissions Under Item 303 of Regulation S-K Must Render an Affirmative Statement Misleading for a Viable Section 10(b) or Rule 10b-5 Claim

Item 303 requires companies to disclose material "known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations" in the Management, Discussion and Analysis section of registration statements, annual and quarterly reports, and certain other filings. On April 12, 2024, in *Macquarie Infrastructure Corp. v. Moab Partners, L.P.* ("*Moab*"), the Supreme Court of the United States resolved a circuit split and unanimously ruled that securities fraud claims under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 cannot be based solely on an allegation that an issuer has omitted information required by Item 303 of Regulation S-K.

In reaching its decision, the Court contrasted Rule 10b-5(b) with Section 11 of the Securities Act, which explicitly prohibits omissions of material facts necessary to make statements not misleading. The Court noted that while Section 11 prohibits "pure omissions" if there is a duty to disclose, Section 10(b) and Rule 10b-5 only prohibit "half-truths." The Court concluded that interpreting Section 10(b) and Rule 10b-5 to cover pure omissions would make Section 11 redundant. Therefore, while claims based on pure omissions of Item 303 information from a registration statement can still be made under Section 11 if adequately pled, to support a Section 10(b) or Rule 10b-5 claim, plaintiffs must demonstrate that omission of Item 303 information renders other affirmative statements misleading.

Incora Non-Pro-Rata Uptier Transaction Struck Down in Court

On July 10, 2024, Judge Marvin Isgur of the U.S. Bankruptcy Court for the Southern District of Texas held in *In re Wesco Aircraft Holdings, Inc.* that a 2022 non-pro-rata secured uptier exchange transaction (the "Uptier Exchange") by aerospace parts supplier Westco Aircraft Holdings Inc. ("Incora") unlawfully stripped collateral rights from senior secured noteholders in connection with a $250 million rescue financing, following which Incora filed for bankruptcy. The ruling has garnered the attention of distressed debt investors, who have increasingly been engaging in creative transaction structures that allow companies to raise capital in exchange for granting new financing sources enhanced recovery over other creditors.

In March 2022, Incora pursued a liability management transaction involving its senior secured notes due 2026 (the "2026 Notes"). Incora first amended the 2026 Notes indenture, with simple majority approval from noteholders Silver Point and Pimco, to authorize the issuance of $250 million of 2026 Notes (the "Phantom Notes") to them. The Phantom Notes issuance gave Silver Point and Pimco the two-thirds majority necessary to further amend the 2026 Notes indenture to release the liens on Incora's assets (without the consent of dissenting noteholders) and effect the Uptier Exchange. As a result of the transaction, the trading price of the 2026 Notes fell from around 84 cents on the dollar to close to 60 cents on the dollar.

The key point of dispute was whether the series of transactions "had the effect" of stripping the liens, which required the consent of two-thirds of the noteholders under the 2026 Notes indenture. The non-participating noteholders argued that the initial amendment, the Phantom Notes issuance and the Uptier Exchange were a single, integrated transaction (as evidenced by the fact it all took place on the same day) that was designed to transfer value to participating noteholders and therefore each of the steps required a two-thirds vote. Incora and the favored noteholders countered that these were separate transactions and therefore the initial amendment and the issuance of the Phantom Notes, with a simple majority vote, were permitted under the 2026 Notes indenture.

Judge Isgur held that the $250 million in Phantom Notes only made sense in the context of stripping the non-participating noteholders of their liens, as Silver Point and Pimco would have never issued $250 million in *pari passu* debt without the attendant benefits to their own position as existing creditors, and therefore the Uptier Exchange and related transactions violated the terms of the 2026 Notes indenture. Judge Isgur made clear, however, that this ruling is limited to an interpretation of Incora's transaction documents and does not challenge the legality of uptier transactions generally.

Restructuring Updates

NON-CONSENSUAL THIRD-PARTY RELEASES: *HARRINGTON V. PURDUE PHARMA L.P.*

On June 27, 2024, in the case of *Harrington v. Purdue Pharma L. P.*, the Supreme Court of the United States held, in a 5-4 majority opinion written by Justice Gorsuch, that non-consensual third-party releases are categorically impermissible in chapter 11 bankruptcy plans.

Purdue Pharma L. P. ("Purdue") began marketing and manufacturing OxyContin in the 1990s. Due to the rise in opioid-related addictions, Purdue's practices came under intense public scrutiny. An affiliate of Purdue signed a plea agreement with the United States in 2007 in order to settle false marketing and faulty medical reimbursement claims.

Beginning in 2007, Purdue increased distributions to the Sackler family from 15% to nearly 70% of its annual revenue, resulting in approximately $11 billion being distributed to the Sackler family. These distributions, which represented roughly 75% of Purdue's assets, were further diverted to overseas trusts and family-owned companies.

By 2019, Purdue faced thousands of lawsuits brought by opioid addicts and their estates asserting various federal and state claims. Purdue filed a voluntary chapter 11 petition in the Bankruptcy Court for the Southern District of New York in 2019 under pressure from these claims. As part of Purdue's heavily negotiated chapter 11 plan, the Sackler family initially agreed to contribute $4.325 billion to the bankruptcy estate in exchange for the non-consensual release of and permanent injunction against all opioid-related present and future claims brought by any claimant against various non-debtor individuals and entities related to the Sackler family. Over 95% of voting creditors supported the plan.

The bankruptcy court confirmed the plan, including the non-consensual release of the Sackler family by creditors. On appeal, the district court vacated the decision. The district court's decision was then appealed to the Court of Appeals for the Second Circuit. While the appeal was pending, the Sackler family agreed to contribute an additional $1.175 to $1.675 billion in exchange for the withdrawal of certain objections to the plan by various governmental entities. A divided panel of the Second Circuit reversed the district court and

reinstated the bankruptcy court's order approving the plan of reorganization. This decision was appealed to the Supreme Court of the United States.

In the majority opinion, Justice Gorsuch offered three reasons the Bankruptcy Code does not allow for the discharge of claims "brought by non-debtors against other non-debtors, all without the consent of those affected." First, he analyzed the text of section 1123(b) of the Bankruptcy Code, which enumerates five categories and a catchall provision that describe the types of allowable provisions in a chapter 11 plan. He quickly rejected the first five categories as a plausible statutory basis for non-debtor releases and turned to the catchall provision to determine whether "any other appropriate provision not inconsistent with the applicable provisions of this title" could warrant inclusion of non-consensual third-party releases in a bankruptcy plan.

Justice Gorsuch interpreted this provision "in light of its surrounding context . . . to embrace only objects similar in nature to the specific examples preceding it." Noting that each of the five categories concerned the rights and responsibilities of the debtor, Justice Gorsuch found that the catchall provision does not contemplate the power to grant non-consensual releases of non-debtors.

Second, Justice Gorsuch explained that the Bankruptcy Code allows discharges for debtors because they "place substantially all of their assets on the table." Because the Sackler family did not volunteer substantially all their assets for distribution to creditors, Justice Gorsuch found such a discharge to the Sackler family inappropriate. Even though section 524(g) of the Bankruptcy Code authorizes non-consensual non-debtor releases specifically in asbestos cases, Justice Gorsuch viewed this narrow exception as further evidence that non-debtor releases are disallowed in other contexts.

Third, Justice Gorsuch looked to the historical purpose of the Bankruptcy Code, noting that bankruptcy discharges had traditionally been reserved only for the debtor, and concluded that allowing such non-debtor releases would run contrary to hundreds of years of bankruptcy tradition.

After clarifying that its decision did not impact the viability of *consensual* third-party releases (which may provide for a release of non-debtors by creditors who opt in or forbear from opting out of a release), the Supreme Court reversed the Second Circuit and remanded the case for further proceedings.

The Supreme Court's decision in *Purdue* will have far-reaching impact on bankruptcy practice and outcomes in bankruptcy cases. The prospect of non-consensual, third-party releases could previously be used to induce contributions from insiders, insurers and other parties in interest to bankruptcy estates, particularly in mass-tort cases like *Purdue*. The *Purdue* decision may also affect other forms of permanent injunctive relief provided by bankruptcy courts for the benefit of non-debtors, such as exculpation of estate fiduciaries for actions taken in connection with a chapter 11 case.

Other Developments

Conviction in First-Of-Its-Kind Case Supports the SEC's "Shadow Trading" Theory of Insider Trading Liability

"Shadow trading" is an insider trading theory of liability based on trading securities of a company based on MNPI about another company. *SEC v. Matthew Panuwat* (which was previously discussed in the Q1 2022 edition of this newsletter) is the first case to find a plaintiff liable for insider trading under this shadow trading theory.

Defendant Matthew Panuwat, formerly Senior Director of Business Development at Medivation Inc. ("*Medivation*"), was closely involved in discussions about a potential merger. Shortly after he received a confidential email from Medivation's CEO announcing an imminent acquisition by Pfizer, Inc. and prior to public announcement of this information, Panuwat purchased out-of-the-money options to acquire stock of a competitor, Incyte Corp., at a significant premium. After the acquisition was announced two days later, the stock prices of both Medivation and Incyte Corp., along with other competitors, rose significantly, earning Panuwat approximately $107,066 from his call options.

The SEC filed a complaint against Panuwat in the U.S. District Court for the Northern District of California, alleging that his actions constituted insider trading in violation of Section 10(b) of the Exchange Act and Rule 10b-5. The SEC argued that Panuwat had a duty to keep MNPI about Medivation confidential and to refrain from trading on this information due to three factors: (1) Medivation's insider trading policy (which prohibited profiting from trading the securities of other companies based on Medivation MNPI), (2) a confidentiality requirement not to use information learned during his employment, unless for the benefit of Medivation and (3) a common law duty of trust and confidence. The jury delivered a verdict in favor of the SEC.

The New York Stock Exchange Proposes Rule Giving the Exchange Discretion to Delist Companies That Change Their Primary Business Focus

The New York Stock Exchange ("NYSE") proposed an amendment to Section 802.01D of the NYSE Listed Company Manual regarding its discretionary authority to delist certain companies. The proposed amendment would allow the NYSE to, in its sole discretion, commence immediate suspension and delisting proceedings for a listed company that "changed its primary business focus to a new area of business that is substantially different from the business it was engaged in at the time of its original listing or which was immaterial to its operations at the time of its original listing." If the NYSE became aware of such a change in business, it would assess the company's suitability for continued listing in light of such change, focusing on the qualitative aspects of suitability without applying any of the quantitative standards for initial listing.

The proposal acknowledges that delisting a company under this rule would be "an extraordinary action" and states that the NYSE "anticipates seldom relying on this new discretionary authority, and only after thorough analysis of all relevant facts and circumstances."

In proposing the rule, the NYSE cited concerns about protecting investors who acquired stock of a company prior to its change in primary business focus and who may not have acquired the stock had they been aware of the company's imminent business focus change. The NYSE also mentioned past instances where companies had suffered "significant downward price movement" subsequent to a change in business focus, resulting in significant losses to investors.

District Court Rules That Archegos Shareholders Failed to Establish the Fundamental Elements of Insider Trading

On April 1, 2024, the U.S. District Court for the Southern District of New York ruled on seven securities class actions stemming from the collapse of investment firm Archegos Capital Management, LP ("Archegos") in March 2021. Archegos manipulated the stock of seven issuers through margin accounts and derivative contracts with certain financial institutions, amassing controlling, non-public positions that inflated stock prices. As stock prices fell in March 2021, Archegos was facing substantial losses and its

collapse was imminent. Archegos disclosed its situation to its largest counterparties in an after-market phone call, asking them to enter a standstill. Instead, before the news was made public, the financial institutions declared Archegos to be in default and sold their stakes to mitigate losses, further depressing share prices.

Shareholders from these companies sued the financial institutions on two theories. First, they argued that Archegos' significant stake in the companies made it a corporate insider, and that Archegos provided confidential information to the banks. Plaintiffs alleged that the banks avoided losses by using inside information about Archegos' scheme. Alternatively, under a misappropriation theory of insider trading, the shareholders claimed the banks breached their fiduciary duty to Archegos by using Archegos' information for their benefit.

U.S. District Judge Jed Rakoff ruled that the shareholders failed to establish the essential elements of insider trading. Regarding the shareholders' first argument, the complaint did not adequately allege that the financial institutions traded based on confidential information or that their trades breached any fiduciary duty. Judge Rakoff explained that the classic "tipper" model of insider trading did not apply in this case, as Archegos was not aware of insider information from the companies. Even if the fund's positions were considered confidential information, Judge Rakoff noted that this information did not belong to the companies. Therefore, Archegos breached no duty in disclosing it, and the banks were not prohibited from trading based on this disclosure. Regarding the shareholders' second, alternative argument, Judge Rakoff held that the banks did not misappropriate Archegos' information because Archegos shared the information with multiple counterparties, the information was not considered confidential and the financial institutions did not deceive Archegos about their plans to trade based on the disclosure.

Supreme Court Grants Certiorari in Facebook, Inc. v. Amalgamated Bank to Determine Scope of Corporate Risk Disclosure Requirements

On June 10, 2024, the Supreme Court of the United States granted certiorari to hear *Facebook, Inc. v. Amalgated Bank*, a decision that may have broad implications for securities fraud claims based on corporate risk disclosures. Previously, a divided Ninth Circuit Court of Appeals panel of judges reversed the lower court's dismissal of the plaintiff's complaint and held that Facebook could be held liable under Section 10(b) of the Exchange Act and Rule 10b-5 for risk disclosures in its 2016 Form 10-K identifying security breaches and improper third-party data access as risk factors that "could harm" its business. On the basis that, at the time these disclosures were made, Facebook knew that political consulting firm Cambridge Analytica had already improperly accessed and used Facebook users' personal data, the Ninth Circuit found Facebook liable because they represented a risk that had already materialized as merely hypothetical.

On appeal to the Supreme Court, Facebook argues there was no evidence that these security breaches posed any ongoing or future business harm. The central issue is whether a company's failure to disclose a risk that had already materialized, but did not pose a known risk of ongoing or future business harm, could be deemed "false or misleading" and thus actionable under Section 10(b) of the Exchange Act and Rule 10b-5. The case is currently scheduled to be heard by the Supreme Court during its 2024-2025 term.

Rise of Asset-Based Financing in the Private-Credit Market

In 2023, limited availability of syndicated loans contributed to a shift away from syndicated transactions toward direct lender loans, with direct loans refinancing about $20 billion in syndicated loans over the course of the year. These dynamics have shifted in 2024—as of the end of the second quarter of 2024, broadly syndicated transactions have refinanced more than $16 billion of direct loans. As investors have returned to the syndicated market, there has been corresponding pressure on direct lenders for better terms in the private credit market.

Spurred by heightened competition between the syndicated and private credit markets, private lenders are seeking to protect their returns by exploring a wider variety of lending transactions. Asset-based financing in particular has been generating excitement amongst private-credit funds. For example, Atalaya Capital Management LP ("Atalaya"), an alternative investment firm, raised approximately $1 billion at the end of May for a fund focused on investments in asset-based deals, including consumer credit card receivables and auto loans. Blue Owl Capital Inc. announced on July 16 that it had entered into a definitive agreement to acquire Atalaya and cited Atalaya's status as an "early pioneer in private asset-based finance" in the announcement.

While the strategy remains relatively new to institutional investors, investors increasingly view asset-based loans as an attractive investment in the current economic environment. Such loans may provide greater protection against downside risk, as lenders can recover the value of the underlying assets, and serve as a hedge against inflation, provided that the growth of the underlying asset value keeps pace with inflation. However, such benefits depend, among other things, on sufficient on-going due diligence regarding the value of the underlying assets and robust protection against senior liens on the underlying collateral.

Crypto Updates

Unanimous Jury Verdict Holds Terraform and Kwon Liable to Pay $4.5 billion in Fraud Verdict

As discussed in the Q4 2023 edition of this newsletter, the SEC brought enforcement action against *Terraform* Labs PTE, Ltd. ("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. On December 28, 2023, the U.S. District Court for the Southern District of New York (a) granted partial summary judgment in favor of the SEC on the unregistered offerings of securities claim, (b) granted partial summary judgment in favor of the defendants on the security-based swaps claim and (c) remanded to a jury to resolve genuine disputes of material facts on the fraud claims. Additional information about the reasoning behind the court's December 2023 ruling can be found in the Q4 2023 edition of this newsletter.

In April 2024, a nine-day jury trial on the remanded fraud claims revealed that Terraform misled investors about their blockchain technology and the stability of their crypto asset, UST, which collapsed in May 2022, leading to significant market losses. On April 5, 2024, a unanimous jury found Terraform and Kwon guilty of securities fraud, leading to a settlement with the SEC.

As part of the settlement, Terraform will pay approximately $3.6 billion in disgorgement, approximately $467 million in prejudgment interest, and a $420 million civil penalty. It will cease crypto asset securities sales, wind down operations and distribute its remaining assets to investor victims and creditors through a liquidation plan to be approved by the court in its separate Chapter 11 bankruptcy case. Kwon will pay $110 million in disgorgement and approximately $14.3 million in prejudgment interest on a joint and several basis with Terraform, as well as an $80 million civil penalty. Both defendants consented to a permanent injunction against future violations of the registration and fraud provisions they violated.

President Biden Vetoes House Joint Resolution That Would Have Repealed the SEC's Crypto Accounting Guidance

SEC Staff Accounting Bulletin 121 was published on March 31, 2022 and requires financial institutions and other custodians holding digital assets such as cryptocurrencies for their platform users to account for such assets as liabilities on their balance sheets. Both chambers of Congress passed resolutions in May 2024 overruling this guidance using the Congressional Review Act. Lawmakers who passed the resolutions argued the SEC's guidance imposes a cost-prohibitive capital requirement on custodians thereby harming consumers by discouraging well-regulated entities from safeguarding consumers' crypto assets.

On May 31, 2024, President Joe Biden vetoed the House of Representatives resolution, thereby keeping the SEC guidance in effect.

In explaining his decision to veto the resolution, President Biden stated that the resolution would "inappropriately constrain" the SEC's ability to address future issues and risk "undercutting the SEC's broader authorities regarding accounting practices." Subsequently, on July 11, 2024, the House of Representatives held a vote to re-consider the resolution, but the vote failed to meet the necessary two-thirds majority to override the President's veto.

District Court Dismisses Claims That Secondary Crypto Asset Transactions Are Investment Contracts in Binance SEC Crypto Case, But Rules That the Majority of the SEC's Case Will Move Forward

As discussed in the Q4 2023 edition of this newsletter, the SEC filed suit against Binance Holdings Ltd. ("*Binance*") in the U.S. District Court for the District of Columbia alleging that Binance and founder and CEO, Changpeng 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.

One of the SEC's key arguments is that certain crypto coins fall within the definition of "securities" pursuant to Section 2 of the Securities Act because they are "investment contracts." On June 28, 2024, U.S. District Judge Amy Berman Jackson issued an order denying a motion to dismiss as to 12 of 13 claims brought in the SEC's complaint (though some were narrowed by the court) and finding that a "contractual arrangement" is not necessary for an investment contract to exist. Judge Jackson

dismissed the claim alleging that secondary sales of Binance's BNB token by third parties are investment contracts, using reasoning that closely tracked that of last year's *SEC v. Ripple* ("*Ripple*") decision from the Southern District of New York, which held that secondary sales of Ripple's XRP token on public exchanges were not securities sales. Judge Jackson also dismissed a claim regarding Binance's stablecoin, BUSD, on the grounds that there was no showing of the "expectation of profit" necessary to meet the test for an investment contract under *SEC v. W.J. Howey Co.* because "the alleged defining feature of the 'stablecoin' was that its value would remain constant."

The order adds to the growing body of caselaw regarding cryptocurrency enforcement and highlights the ongoing complexity and evolving nature of the task. While the court allowed the majority of the SEC's claims to pass the motion to dismiss stage, it followed the previous *Ripple* decision in deciding that secondary crypto asset transactions are not investment contracts, casting doubt on the SEC's authority to regulate secondary transactions on crypto exchanges.

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