

The background of the slide is a dark green grid with various financial data elements. At the top, there are currency codes: ITL, DEM, BEF, FRF, MGF, RUS, followed by percentage changes like +0.16, -0.01%, +0.04, -0.01%. Below these are JPY, EUR, CHF, GBR, SEK, CAD. Further down, RMY 18.68 - 0.7% and DTR 31.48 - 0.0% are visible. The bottom right shows a bar chart with green bars of varying heights. The overall theme is global finance and capital markets.

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GLOBAL PUBLIC COMPANY ACADEMY

DEBT OFFERINGS IN THE CAPITAL MARKETS

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OVERVIEW

Basic Concepts

Debt Offerings

Indentures, the Trust Indenture Act and Trustees

SEC Registration

Rule 144A

Types of Debt Instruments Commonly Offered

Other Types of Debt Instruments

Boilerplate

The Basics

- **Debt**
- **Debt vs. Equity**
- **Capital Markets vs. Commercial Loan Transactions**

Debt Offerings

- **SEC Registered**
- **Rule 144A**
- **Rule 4(a)(2) Private Placements**

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INDENTURES, THE TRUST INDENTURE ACT AND TRUSTEES

Indentures and Forms

- **ABA – Revised Model Simplified Indenture**
 - Model Negotiated Covenants
 - Annotated Trust Indenture Act
- **American Bar Foundation – Model Debenture Indenture, with Commentary (1971)**
- **ABF Model Mortgage Bond Indenture Form (1981) – for certain secured transactions**
- **Indentures for Recent Offerings**

Trust Indenture Act, or TIA

- **Imposes minimum standards for indentures**
- **Requires certain provisions to be included**
- **1990 amendments (Trust Indenture Reform Act, or TIRA) provide for automatic inclusion of mandatory provisions without necessity of reciting them in the indenture.**
 - However, Regulation S-K (Item 601) still requires a “reconciliation and tie-sheet”
- **Requires a disinterested trustee**
- **Provides substantive regulation (not limited to disclosure requirements)**

TIA Key Provisions

- **TIA Section 305**

- Requires debt securities being registered under the Securities Act of 1933, or 33 Act, and issued in public offerings, to be issued under an indenture qualified under the Trust Indenture Act (TIA Section 305(b))
- Requires a 33 Act registration statement for the registration of such a security to contain specified disclosures (TIA Section 305(a))

- **TIA Section 309 provides that an indenture under which a security is to be issued will be deemed to have been qualified when a 33 Act registration statement becomes effective with respect to such security**
- **TIA broadly defines “Indenture” to encompass both secured and unsecured instruments under which debt securities are outstanding or to be issued**

TIA Key Provisions (*cont'd*)

TIA Section 310 – Trustee Eligibility and Disqualification

- Requirement for an “Institutional Trustee”
 - Corporate entity (could be foreign) authorized to exercise corporate trust powers and subject to supervision or examination by a governmental authority
 - Combined capital and surplus not less than \$150,000
 - Trustee prepares Form T-1 which is filed by the issuer as an exhibit to its 33 Act registration statement. SEC Staff may issue a refusal order preventing the registration statement from becoming effective if it determines that the trustee fails to meet eligibility requirements.
- Disqualification in the event of a “conflicting interest”
 - If indenture securities are in default, and
 - One of the conditions set forth in Section 310(b)(iii) is satisfied (for instance, the trustee is trustee under more than one indenture of the obligor), then
 - Trustee must either eliminate the conflicting interest or resign

TIA Key Provisions (*cont'd*)

Reports by Obligor; Evidence of Compliance with Indenture – TIA Section 314

- Periodic Reports
- Annual Compliance Certificate
- Compliance with conditions precedent
- Fair value
- Recitals in certificates and opinions - “four sillies”

Duties of Trustee – TIA Section 315

- Prior to default, Trustee may conclusively rely, as to truth of statements and correctness of opinions, in absence of bad faith, upon certificates and opinions conforming to indenture requirements
- Trustee must provide to security holders notice of defaults known to it within 90 days after the occurrence thereof
- Trustee has duty to exercise same degree of care and skill as a prudent man would exercise in the conduct of his own affairs in case of default

Disclosure Requirements – TIA and S-K

TIA Section 305 – Requires the 33 Act registration statement to contain an analysis of Indenture provisions with respect to:

- What constitutes a default, and withholding of notice to security holders of a default
- Authentication and delivery of indenture securities and application of proceeds
- Release and/or substitution of property subject to lien of the indenture
- Satisfaction and discharge of the indenture
- Evidence required to be furnished to the trustee as to compliance with conditions and covenants of the indenture

TIA Forms T-1, T-2, T-3, T-6

SEC Registration

- **33 Act registration is required when the “private placement” exemption is not available**
- **Standalone Registration**
- **Shelf Registration**
 - Rule 415 allows for “continuous or delayed” offerings
 - Issuer must be “eligible” to use Form S-3 for primary sales
 - WKSI Form S-3ASR
- **Subsidiary Registrants – S-3 eligibility and ability to piggyback on parent WKSI S-3ASR**

SEC – Registration - Shelf Takedown Procedure

“Launch”

- Preliminary Prospectus Supplement
- Press Release

“Pricing”

- Pricing Term Sheet
- Underwriting Agreement
- Comfort Letter
- Press Release
- Final Prospectus Supplement

“Closing”

- Indenture/Indenture Supplement/Notes
- Closing Deliverables
- Press Release
- Form 8-K (underwriting agreement, legal opinion and indenture supplement creating series)

Disclosure Requirements

- **S-K Item 202(b) requires a description of the terms of debt securities including a brief outline and description of the following:**
 - Maturity, interest, conversion, redemption, amortization, sinking fund or retirement
 - Any lien, including priority and underlying property
 - Any subordination of debt securities
 - Any restrictions on the incurrence of additional debt
 - Basis upon which secured debt is to be issued
 - Events of default
 - Trustee and any material relationship with the issuer and affiliates
- **Hybrid securities may implicate other provisions of Item 202**

Rule 144A Offerings

- **Rule 144A**
- **“QIBs”**
- **Rule 144A Offerings**
- **Registration Rights vs. Rule 144A For Life**

Rules 144A Offerings – Exchange Offers

- **Registration Rights Agreement (timing and penalties)**
- **Registered Exchange on Form S-4**
- **Practice Developed through “No Action” Letters**

Types of Debt Instruments Commonly Offered – Investment Grade

- **Ratings**
 - BBB- or better (S&P)
 - Baa3 or better (Moody's)
- **Limited Covenant Package**
 - Restrictions on Secured Debt
 - Change of Control
- **Unsecured/No Guarantees**

Types of Debt Instruments Commonly Offered – High Yield Debt

- **Rating below Investment Grade**
- **Significant “Incurrence-Based” Covenants, restricting:**
 - Debt
 - Restricted Payments
 - Contractual Restrictions on Cash Flow
 - Liens
 - Transactions with Affiliates
 - Asset Sales
 - Change of Control
- **Often Guaranteed and/or Secured**

Types of Debt Instruments Commonly Offered – Convertible Debt

- **Convertible into Common Stock**
- **No Significant Covenants, but Complex Mechanics**
- **Contingent Convertibility**
- **Physical Settlement vs. Net Settlement**
- **Stock Exchange Issues (20% rule)**
- **Hedging Strategies**

Special Issues with Guarantees/Security

- **Guarantees and Regulation S-X Rule 3-10**
- **Security and Regulation S-X Rule 3-16**

Mortgage Indentures and Other Secured Debt

- **Commonly used in public utility industry**
- **Mortgage Indenture provides for issuance of secured debt, with**
 - Issuances of debt instruments, or bonds, plus
 - A lien on specified assets
- **Recorded as a real estate mortgage**
- **Often open-ended, allowing additional debt to be secured ratably with existing debt**
- **Property may be released upon meeting certain conditions**

Why Secured Debt?

Pricing/Rating advantages:

- May be more highly rated than unsecured debt with a “negative pledge”
- May provide better “pricing” (lower interest rate)

Bankruptcy treatment:

- Secured debt is generally given priority in a bankruptcy as to collateral
- Often bondholders will be entitled to payments during the bankruptcy if the collateral is worth more than the bonds

Mortgage Indenture Basics

- **Open-ended to permit additional debt issuances secured on a *pari passu* basis with existing debt**
- **Covers “after-acquired property” of the type described by the mortgage and acquired by issuer after the initial debt issuance**
 - Lien “spreads” to new property
 - Unless mortgage includes “anti-spreading” provisions
- **Provides for release of property once certain conditions are met**

Mortgages Indenture Basics (*cont'd*)

- **What property is covered?**

- Property owned by issuer, for example, in the public utility context, property usually used in operation of its utility business – e.g., plants, equipment, real property
- Commonly mortgage identifies “Excepted Property” – generally those types of property that are not suitable to long-term security or where subjecting them to the lien of the mortgage might create challenges for the issuer in daily management of the business
- Examples of “Excepted Property” in the public utility context:
 - cash, securities
 - merchandise, equipment, or supplies held for sale in the ordinary course of business, fuel consumable in operation of business, energy or gas produced for sale
 - timber, rolling stock, vehicles, aircraft, mineral rights
 - accounts receivable, contracts, general intangibles

- **Subject to permitted liens (often called “excepted encumbrances”) – e.g., workmen’s liens, tax liens, and liens existing at the date of execution of the indenture**

Mortgage Indenture Basics (*cont'd*)

- **Releases and issuances are limited by provisions designed to preserve collateral for outstanding bonds**
- **Issuance tests for new bonds:**
 - Property “Additions”
 - Retired bonds
 - Cash
- **Covenants:**
 - Maintenance of mortgaged property, insurance and lien
 - Maintenance of franchises and licenses to do business
 - Typically no financial covenants other than, in older mortgages, an earnings coverage test at issuance, generally requiring earnings at least 2x annual interest requirements for bonds issued under the mortgage

Secured Debt

- **Additional TIA provisions are relevant in the secured debt context regarding value of collateral and protection of security interest, including provisions regarding:**
 - Appraisal of collateral; determination of fair value (TIA Section 314(c) and (d))
 - Issuances
 - Releases
 - Monitoring perfection of liens/recording (TIA Section 314(b))
- **Disclosure requirements (S-K Item 202(b)(2) and (5))**
 - Description of lien
 - Basis for issuance
 - Disclosure relating to available bondable property
- **Model – American Bar Foundation Mortgage Bond Indenture Form**

Junior Subordinated Debt - Hybrids

- **Considered debt for tax purposes but receive equity credit from rating agencies**
- **Very long term – 60 or more years**
- **Deeply subordinated**
- **Interest deferral rights coupled with dividend blocker**
- **Redeemable at par after 5 years (retail), 10 years (institutional)**
- **Interest rates, fixed period followed by floating (institutional)**

Green Bonds

- **Use of Proceeds – Finance Eligible Green Expenditures**
- **Eligible Green Expenditures – Renewable energy, energy efficiency, virtually any expenditures that promote sustainability**
- **Reporting – Periodic updates on issuer's website regarding allocation of proceeds to Eligible Green Expenditures with issuer attestation and independent accountant attestation of use of proceeds**
- **General credit of issuer rather than revenue or project based, same pricing as other *pari passu* debt of issuer**
- **Used by issuers to highlight green assets/business and diversify investor base (Environmental, Social and Governance investors)**

Notes used as Qualified Replacement Property

- **Sold to investors seeking to acquire “qualified replacement property” – deferring gains upon sales of investor’s “qualified securities” under Section 1042 of Internal Revenue Code**
- **Qualified replacement property is a security issued by domestic operating company that did not have “passive investment income” in excess of 25% of gross revenues and did not issue the qualified securities**
- **Issuer states belief that it qualified as domestic operating corporation and meets passive income test for prior fiscal year**
- **Securities may be very long term, up to 50 years, with very low interest rate**
- **No call for 40 years but investors have put right starting after one year**

Listed Debt Securities

- **Long-term (generally 50+ years) debt securities listed on NYSE**
- **Allow issuer access to retail market, which benefits issuers frequently drawing from institutional market**
- **Typically issued in \$25 denominations**
- **Generally 5-year no call period followed by par call to maturity**
- **Underwriting commissions significantly higher than institutional sales (typically 3.15% v. 0.65%)**
- **NYSE lists debt securities with preferred stock ticker symbols**
- **Listing process involves short-form subsequent listing application (relies on existing equity listing) and additional fees**
- **NYSE listing requires SEC Securities Exchange Act of 1934 filing to register series on Form 8-A**

Reopeners

- **Issuer reserves right to “reopen” series of debt securities after initial sale**
- **Example language**
 - The mortgage permits us to issue an unlimited amount of bonds from time to time in one or more series, so long as we meet issuance tests set forth in the mortgage. All bonds of any one series need not be issued at the same time, and a series may be reopened for issuances of additional bonds of such series. Thus, we may, from time to time, without notice to or the consent of the existing holders of the bonds, create and issue further bonds having the same terms and conditions as the bonds offered hereby in all respects, except for the issue date, price to public and, if applicable, the initial interest payment on such bonds. Additional bonds issued in this manner will be consolidated with, and will form a single series with, the previously outstanding bonds of such series.
- **Allows issuer to sell aggregate principal amounts below \$300 million while still accessing institutional investors required to limit investments to index eligible securities**
- **Prevents negotiation of terms such as covenants in connection with sale of securities**
- **Typically sold at discount or premium depending upon market movement since first issuance of the series**
- **If sold at a discount, requires “original issue discount” analysis**
- **Disclosure generally includes section explaining certain tax consequences of the “qualified reopening”**

Don't forget the boilerplate

- **Corporate existence**
- **Merger or Sales of All or Substantially all the Property/Discharge**
- **Amendment provisions – pre-consents to mortgage amendments**

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