Pre-Marketing: Risks and Considerations Relating to Bespoke Securitization Transactions

NOVEMBER 28, 2022

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I. INTRODUCTION

The current volatility in financial markets has caused an increase in interest in pre-marketing certain bespoke securitization transactions, including esoteric, real estate-based, whole business, music royalty and digital infrastructure transactions.

Pre-marketing generally refers to the sharing of certain materials with a select group of prospective investors under non-disclosure agreements, prior to the formal launch of the broader marketing process.

While pre-marketing can be an appealing option in uncertain market conditions, pre-marketing also presents increased risk and related challenges for placement agents, initial purchasers and issuers alike.

This client alert will present issues specifically focused on deal-specific pre-marketing, rather than "non-deal" marketing that regularly occurs at industry conferences, general investor update presentations and similar events and occurrences.

II. PRE-MARKETING MATERIALS: AN OVERVIEW

Pre-marketing materials may include, the following:

A. *Term Sheet* — often called the "Summary of the Offering" or the "box" section of the Preliminary Offering Memorandum.

B. *'Pink' Offering Memorandum* — an 'advance' version of the full Preliminary Offering Memorandum, subject to change in the 'Red' Preliminary Offering Memorandum finalized at launch.

C. *Preliminary Investor Presentation* — an 'advance' version of the Investor Presentation ordinarily shared with investors at the time of launch.

D. *Appraisals, stratification tables, financial information and other transaction-specific information* — can include various additional transaction or company-specific data or specific information requested by certain investors.

III. WHY CONSIDER PRE-MARKETING?

Given the uncertainty and volatility of current market conditions, pre-marketing allows for testing of a transaction with a smaller group of prospective anchor investors, prior to committing to a broad-marketing process. This can be particularly useful for both new prospective investors and new issuers, or with respect to asset classes with which prospective investors have less familiarity. Pre-marketing also gives certain prospective investors the opportunity to provide feedback on the proposed terms prior to launch, allowing the parties to address structural points at an early stage.

IV. RISKS AND CONSIDERATIONS

There is an inherent tension between the perceived advantages of pre-marketing and the necessity of protecting issuers, placement agents and initial purchasers from incurring additional liability. Some of the key considerations in attempting to navigate the risks of such a strategy are as follows.

Non-Disclosure Agreements

Any pre-marketing materials generally should be provided to prospective investors confidentially pursuant to non-disclosure agreements. Deal teams should take care to note and consider timing to negotiate such non-disclosure agreements with prospective investors and issuers, such that pre-marketing materials can be circulated when the deal team deems it most effective.

Entering into non-disclosure agreements aims to protects issuers, placement agents and initial purchasers from liability under Rule 10b-5 and Reg FD, as described below.

A. Rule 10b-5 Liability

Rule 10b-5 of the Securities and Exchange Act of 1934 protects against misleading disclosure and makes it illegal to “make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading in connection with the purchase or sale of any security.” While pre-marketing materials are generally superseded by the offering memoranda provided to investors generally, Rule 10b-5 may still pertain to pre-marketing materials. As such, issuers should take care to prevent misstatements in pre-marketing materials and highlight material differences between pre-marketing materials and offering memoranda so that prospective investors do not rely on preliminary presentations.

B. Regulation Fair Disclosure (Public Companies)

The U.S. Securities and Exchange Commission (SEC) Regulation Fair Disclosure (Reg FD) prohibits publicly traded companies from selectively disclosing material non-public information (MNPI) regarding such company or its securities to certain persons. As a result, if a public issuer discloses MNPI in pre-marketing under a non-disclosure agreement, the issuer must also publicly disclose or “cleanse” this information prior to releasing prospective investors from the restrictions of their non-disclosure agreement. Issuers should take special care to determine what constitutes MNPI in connection with the specific offering, taking into account whether information is material to the broader public company or is only material to the securitization, which may only comprise a small portion of the overall company, as this may ease the burden of cleansing requirements.

Indemnification

It is generally market practice for issuers to indemnify placement agents and initial purchasers for all marketing materials along with offering memoranda and other pre-marketing materials shared with prospective investors. It is important to contemplate risk allocation and explicitly agree to the scope of indemnification coverage upfront to avoid disagreement regarding coverage once materials have already been distributed.

The indemnification provisions of the note purchase agreement will typically cover pre-marketing materials (and marketing materials). Representations and warranties are generally included to the effect that the pre-marketing and marketing materials did not contain untrue statements of material fact or omit to state material facts necessary to be not misleading. A schedule of materials to be indemnified should be socialized between an initial purchaser and issuer to allow adequate time for their review and confirmation that each item is as agreed. However, because pre-marketing occurs prior to signing the note purchase agreement, an initial purchaser's engagement letter often provides blanket indemnification and agreement on whether an item or pre-marketing materials will be indemnified for.

Version Control

Incremental pre-marketing risk to issuers, placement agents and initial purchasers can be lessened by limiting how much pre-marketing material is shared in the first place (e.g., sharing a Term Sheet introduces relatively less risk than distributing a full Pink Offering Memorandum) and by minimizing the amount of time between the release of pre-marketing materials and the formal launch versions of such materials. Often investors provide investor-favorable comments through feedback in the pre-marketing process. To the extent that terms become more company-favorable between pre-marketing and broader marketing, care should be taken to highlight such changes to mitigate any claims that investors relied upon pre-marketing materials and misunderstood the final terms. It is important to always provide disclaimers with any materials shared including carefully disclaiming that changes may occur between pre-marketing and final launch versions of the offering materials, and that the final launch versions of offering materials supersede any previously provided information. The use of such disclaimers, however, does not automatically insulate issuers, placement agents and initial purchasers from potential investor claims in the future.

Legal Due Diligence

Conducting appropriate diligence further mitigates the risk of having to provide additional or corrective disclosure prior to the broader launch of the transaction. To mitigate the risk most effectively, initial purchasers should significantly advance their legal due diligence and hold initial due diligence calls with the company to confirm no material red flags that would be important to investors or otherwise require significant supplement to or restatement of the offering materials.

Financial Due Diligence

Financial diligence is equally important in pre-marketing risk mitigation. All information to be disclosed in the pre-marketing materials should be reviewed and materially agreed among the issuer, accountants, initial purchaser and third-party diligence provider to support and verify financial data. While the most conservative approach would be to tie out any such financial information and have it covered by a letter from a third-party diligence provider outlining their "agreed-upon procedures" or a comfort letter from the issuer's auditor, as applicable, parties may be comfortable in some circumstances to agree to a lower standard of signoff for pre-marketing purposes, with full comfort and procedures being provided prior to formal launch, to the extent that material changes between pre-marketing and formal launch are not likely to occur. Similar to indemnification for pre-marketing materials, issuers,

placement agents and/or initial purchasers should agree to such standard in advance to avoid delays in distributing pre-marketing materials at the desired time.

V. CONCLUSION

Largely as a result of recent market conditions, we have seen increased interest in pre-marketing in the bespoke securitization space. While investors may push to receive certain materials on a pre-marketing basis under a compressed timeline, it is critical for issuers, placement agents and initial purchasers to understand and manage the risks and liabilities inherent in providing such information.

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