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MNPI and NDAs: The Alphabet Soup of Getting Restricted

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Investors wanting to equip and position themselves to negotiate a debtor's restructuring may temporarily relinquish their ability to buy and sell securities in exchange for access to material nonpublic information ("MNPI"). This delicate balance between the need for investment liquidity and the desire for informational transparency often leads to increasingly fierce negotiation between a company and its creditors over the terms of a confidentiality or non-disclosure agreement (the "NDA").

When a company is ready to negotiate a restructuring of its public debt, it will typically direct its attorneys to negotiate an NDA with holders of substantial indebtedness. An NDA will typically require the creditor to acknowledge that it may receive MNPI. In accordance with federal securities laws, the receipt of MNPI immediately "restricts" the ability of the creditor to trade unless the creditor has executed a "big boy" letter with its counterparty. While a "big boy" puts the buyer on notice of the creditor/seller's possession of MNPI, many sellers will refrain from trading with "big boy" letters because the efficacy of the "big boy" remains uncertain, subjecting the seller to potential civil and criminal liability notwithstanding their execution.

In addition to these trading restrictions, the NDA also will impose contractual restrictions on the ability of the creditor to share or discuss confidential information or MNPI with parties who have not executed a confidentiality agreement with the company. Some NDAs include a "standstill" provision prohibiting any discussions with other creditors or parties in interest for a certain term, whether those parties execute a similar NDA with the company or not.

Indeed, if the company wishes to accelerate negotiations to achieve resolution of impending liquidity challenges, an NDA may very well facilitate, rather than impede, dialogue among its key stakeholders. Investors will want all these contractual restrictions to terminate on the same date as the trading restrictions (i.e., the date upon which the company "blows out" or "cleanses" the MNPI; see further discussion below) to avoid the undesirable scenario where the investor can trade again for purposes of federal securities laws, but still remains subject to the contractual prohibitions in the NDA.

MNPI can range from a transaction proposal or term sheet to more detailed nonpublic financial and operational information, such as cash flow projections. Even mere knowledge of the existence of nonpublic restructuring discussions and negotiations between the company and certain creditors may constitute MNPI. The level of informational visibility the investor wants will often determine the length of the restrictions in the NDA. For the investor to become "unrestricted" after its receipt of MNPI, the MNPI must either become (i) immaterial/stale or (ii) public. Accordingly, investors will require the company to publicly disclose the MNPI at the earliest possible cleansing or "blow out" date through a press release or SEC filing. The company will then weigh these considerations against its own external disclosure timeline (i.e., a company may not wish to preview year-end numbers before it files its Form 10-K) and the reality that it must try to accommodate the liquidity concerns of its largest creditors if it wishes to achieve a consensual deal with their participation and imprimatur. Regardless, if the investor determines the company has failed to sufficiently cleanse all MNPI, after prompt written notice to the company, the investor frequently has the self-help remedy entitling it to disclose the information on its own.

Some investors try to avoid these issues altogether by retaining a financial advisor or law firm to get "restricted" on its behalf. The advisor, however, cannot reveal the nonpublic content to the investor until the investor is willing to be restricted. Thus, the investors effectively allow their advisors to negotiate for them to some extent until the investors are willing to restrict themselves and complete the deal. This strategy also affords the investors more time to trade and accumulate their position.

Investors at hedge funds or financial institutions having one department that trades debt for itself or clients and another department that holds debt for their own proprietary accounts may erect internal information barriers or trading walls to enable the department trading debt for clients to continue to do so, while the other department is restricted and negotiates a restructuring. These entities often designate one or a small number of individuals as "restricted personnel" with access to MNPI while nondesignated employees on the other side of the wall continue to trade the company's securities. The erection of walls must be done with much care. Large institutions, of necessity, must know and understand their total exposure to each credit for risk and financial reporting purposes. The individuals who know this information are effectively operating above the walls and looking down at each department, creating a situation of walls without ceilings. These individuals must be identified in advance and instructed not to share any information they learn with people trading or holding the debt for which there is an NDA.

Most importantly, investors must understand that the determination of what constitutes MNPI remains an inherently subjective one. Accordingly, investors must always evaluate the aforementioned considerations in consultation with internal compliance officers and experienced securities law counsel before trading.

Read http://www.distressed-debt-investing.com/2013/02/advanced-distressed-debt-lesson-mnpi.html.

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