

# Corporate Trust Alert

Keeping you connected with legal developments in Corporate Trust law

JUNE 25, 2003

## Moody's Downgrades RJR to Junk - Triggers Trapping Event in Many Tobacco Securitization Deals

As you may have seen in the news, Moody's has cut R.J. Reynolds ratings to junk status.

In mid-June 2003, the rating agency, Moody's Investors Service, downgraded the long-term debt of R.J. Reynolds Tobacco Holdings Inc. to below investment grade status. Moody's cut RJR's senior guaranteed unsecured debt rating to Ba1 from Baa2 and its unguaranteed unsecured indebtedness to Ba2 from Baa3.

In many tobacco settlement securitization transactions such an event is a Downgrade Trapping Event.<sup>1</sup> Usually the determination of a downgrade trapping event is made as of any deposit date, and only relates to an original participating manufacturer (as that term is defined in the Master Settlement Agreement) with a market share (as defined in the MSA) of 7% or more in the calendar year preceding such deposit date. RJR's was over 22% in 2002.

After the occurrence of a trapping event, many indentures require the corporate trustee to deposit into the Trapping Account, the lesser of the Trapping Amount or the amount necessary to make the amount therein equal the Trapping Requirement. The trapping requirement to be met for a downgrade is usually 25% of the total principal outstanding and usually has to be held until 1 year after the downgrade event terminates (i.e. RJR debt is returns to being rated investment grade). The trapping amount is usually defined as the cash deposited with the corporate trustee in excess of what is needed to make the rated debt service payments on the bonds. Of course, all of these terms would be subject to negotiation, so they may differ slightly from one transaction to another. Accordingly, corporate trustees should consult the applicable governing documents before proceeding.

The issuer may have a continuing disclosure requirement to inform the corporate trustee of rating changes. The corporate trustee also may have an obligation to report to the Rating Agency and holders that a Trapping Event has occurred and is continuing and what the Trapping Requirement, if any, is as of a particular distribution date.

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<sup>1</sup> Generally speaking, securitizations with so-called "turbo" bonds do not have these trapping events.

So, if you have tobacco settlement securitization transactions in your corporate trust portfolio, you need to check the governing documents for guidance in light of this recent event. If you have any questions regarding these matters, please feel free to call Laura Wheeler at 415-984-8417 or anyone in the Nixon Peabody Corporate Trust Group.<sup>2</sup>

The foregoing summary is provided by Nixon Peabody for education and informational purposes only. It is not a full analysis of the matter summarized and is not intended and should not be construed as legal advice. This publication may be considered advertising under applicable laws.

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<sup>2</sup> Just a reminder that Nixon Peabody has extensive experience in tobacco-related securitization transactions, not only as counsel to the indenture trustee, but also as either issuer's counsel or underwriter/disclosure counsel in structuring and documenting and/or preparing the disclosure for such transactions.

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