

Companies Plant Seeds For Green Convertible Bonds

By **Tom Zanki**

Law360 (August 14, 2020, 1:50 PM EDT) -- The booming global market for green bonds, whereby companies borrow money and earmark proceeds for environmentally friendly purposes, is now expanding to include hybrid bonds that can convert from debt into equity.

Before 2020, only two green convertible bonds were issued, according to Dealogic. But at least five U.S. and European companies since May have issued green convertible bonds, which have features resembling ordinary bonds except that investors may convert these securities into stock.

Capital markets lawyers expect these hybrid securities to grow along with the larger green bond market, aided by investor demand plus the desire of companies to tout their environmental credentials. In Europe, there is also legal pressure under the European Union's pending Taxonomy Regulation, which will require larger issuers to set performance thresholds and increase disclosures explaining the extent to which their activities are considered "sustainable."

"It's the direction of travel of the entire investor universe, particularly the debt financing universe and especially in Europe where there is concerted effort from EU institutions as well as in individual countries," said White & Case LLP partner Richard Pogrel.

White & Case advised underwrites for French renewable energy company Neoen's first European convertible bond in June, which raised €170 million (\$201 million).

The United States doesn't have similar legislation as the EU. On a regulatory front, the U.S. Securities and Exchange Commission has resisted requiring increased disclosure regarding companies' environmental, social and governance, or ESG, policies as some commissioners say they would rather trust the market than impose "prescriptive requirements" on issuers.

"The political climate in the United States is much less homogeneous," said Shearman & Sterling LLP partner Antonia Stolper. "While in Europe, the EU collectively and the U.K. are very committed to getting carbon-neutral."

Despite regulatory inconsistency worldwide, global interest in environmentally related capital raising continues to expand. Green bonds raised a record \$258 billion in 2019, according to the Climate Bonds Initiative, a 51% increase from 2018 levels. Nearly half of those proceeds, or 45%, were raised in Europe while Asia and North America followed at 25% and 23% respectively.

The vast majority of green financing is raised through conventional bonds. Google parent Alphabet Inc. on Monday priced a \$10 billion bond offering that includes \$5.75 billion dedicated to "sustainability" projects, which the company's prospectus says will be geared toward things like construction of environmentally friendly buildings and energy-efficient renovations.

Green bonds lack a concise legal definition, so investors are relying on the company's word that it will abide by its stated intention for spending proceeds as outlined in offering documents.

The same holds true for green convertible bonds, which is a nascent market compared to standard bonds, albeit a growing one. Lawyers say it's not surprising to see environmentally focused convertible bonds surface given the yearslong boom in green financing.

"It's certainly a logical development," Mayer Brown LLP partner Paul Forrester said.

Convertible bonds differ from standard bonds in that a company sells debt upfront but investors can convert their holdings into stock after a certain period of time if shares hit a specific price.

This flexibility can appeal to investors who want the relative safety of bonds, while reserving the future right to assume more risk and convert into stock if they decide market conditions are favorable. Convertible bonds also tend to pay lower interest rates than standard bonds to offset the added benefit of being changeable into stock, which can reduce expenses for the issuer.

Convertible bonds represent a smaller market compared with the traditional bond and equity markets. Such bonds can fill a niche during volatile times when investors are less certain about stock prices. The U.S. convertible bonds market **rocketed this spring**, partly aided by uncertainty stemming from the pandemic as investors and issuers sought more flexible securities.

"There are certain issuers who are well suited to convertible bonds because anytime you have a stock that has more upside or greater potential for volatility, the option becomes more valuable," Shearman & Sterling partner Richard Alsop said.

The recent uptick of U.S. issuers selling green convertible bonds includes companies focused on renewable energy. San Jose, California-based Bloom Energy Corp., advised by Latham & Watkins LLP, on Thursday priced a \$200 million upsized green convertible bond, while Maxeon Solar Technologies Ltd. priced an upsized \$185 million green convertible bond in July. Hydrogen fuel cell company Plug Power Inc. raised \$200 million through a similar instrument in May.

Beyond the U.S., real estate companies are also finding green convertible bonds useful. Hong-Kong based Link Real Estate Investment Trust raised HK\$4 billion (\$516.8 million) last year to fund future and existing green projects.

Lawyers anticipate the movement toward green convertible bonds will accelerate, at least among companies for whom this capital-raising tool makes sense. Such bonds may also lure investors wishing to dedicate more of their portfolio to green investments.

"The market is there," Forrester said. "There are clearly investors who are looking for a little more spread and are willing to take a little more risk. This would be an appropriate instrument for them."

Pogrel noted that convertible bond investors often consist mostly of hedge funds seeking to capitalize on arbitrage opportunities, or short-term fluctuations. But he is also seeing more long-term investors drawn to green convertible bonds, which could indicate staying power.

"It's a natural evolution of the sustainable finance market from bonds to convertible bonds," Pogrel said. "But it is also developing in tandem with higher levels of long-only investors participating in many convertible bond offerings."

"This is not a one-off," Pogrel added. "There is undoubtedly going to be more green convertibles."

--Editing by Rebecca Flanagan and Marygrace Murphy.