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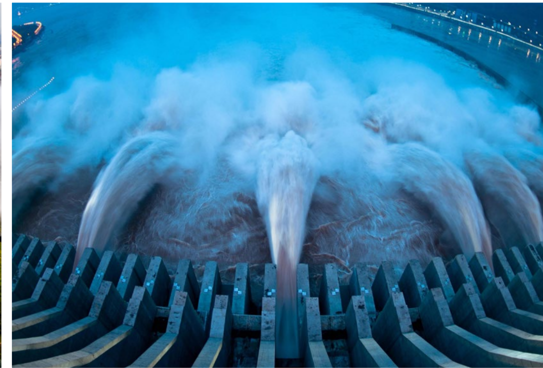
Current Topics in the Power and Utilities Capital Markets



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TRAFFIC IN CONVERTIBLES: NEW TREND IN UTILITY CAPITAL MARKETS

Converts—a debt instrument that is convertible (or exchangeable) into shares of the issuer or another entity—have come to the fore in the utility capital markets. One explanation for this trend is the recent runup in interest rates. See "Liftoff: Power Financing in an Era of Higher Rates" in the December 2022 issue of Baseload. Typically, the coupons on convertible debt are significantly lower than straight debt. The coupon rates on converts are lower than on plain vanilla debt because investors in the convert have exposure to equity upside if the issuer's share price reaches an agreed-upon threshold. Below is a chart of the convertibles that have come to market in the regulated utility space since December 2022.[1]

1 Ramakrishnan, Shankar, *Analysis: Some highly rated US companies take unusual funding route as rates rise*, Reuters (Feb. 27, 2023); Shah, Jill, *Blue-Chip Companies Eye Convertible Bond Sales To Cut Costs*, Bloomberg Law News (Apr. 26, 2023).

Company	Closing Date	Principal Amount*	Greenshoe Option	Convertible or Exchangeable	Conversion Premium	Settlement	Hedge	Maturity	Redemption
NextEra Energy Partners, LP	Dec 12, 2022	$500mm	No	Convertible	20%	Net Share (Flexible Remainder)	Capped Call	June 15, 2026	None
PPL Corporation	Feb 24, 2023	$1bb	Yes	Exchangeable	22.50%	Net Share (Flexible Remainder)	None	Mar 15, 2028	Provisional call on or after Mar 20, 2026
The Southern Company	Feb 28, 2023	$1.725bb	Yes	Convertible	30%	Net Share (Flexible Remainder)	None	Dec 15, 2025	None
Alliant Energy Corporation	March 2, 2023	$575mm	Yes	Convertible	25%	Net Share (Flexible Remainder)	None	Mar 15, 2026	None
Duke Energy Corporation	April 6, 2023	$1.725bb	Yes	Convertible	25%	Net Share (Flexible Remainder)	None	April 15, 2026	None
FirstEnergy Corp.	May 4, 2023	$1.5bb	Yes	Convertible	20%	Net Share (Flexible Remainder)	None	May 1, 2026	None
CMS Energy Corporation	May 5, 2023	$800mm	Yes	Convertible	20%	Net Share (Flexible Remainder)	None	May 1, 2028	Provisional call on or after May 6, 2026
American Water Capital Corp.	June 29, 2023	$1.035bb	Yes	Exchangeable	22.50%	Net Share (Flexible Remainder)	None	June 15, 2026	None
CenterPoint Energy, Inc.	August 4, 2023	$1bb	Yes	Convertible	25%	Net Share (Flexible Remainder)	None	Aug 15, 2026	None

*(including any shoe)

Convertible note offerings can be conducted as registered offerings but, more commonly, as unregistered private offerings under Rule 144A under the Securities Act of 1933, as amended (1933 Act). Most issuers seeking to repurchase shares of common stock at the time of their convertible note offering will offer their notes under Rule 144A in order to avoid regulatory issues under Regulation M. Relying on Rule 144A also minimizes delay in the event the issuer does not have an effective shelf registration statement on file with the SEC and the issuer is not a well-known seasoned issuer (WKSI).[2]

Note that, unlike "mandatory convertibles" (either convertible preferred or equity units), convertible debt does not receive equity credit for the issuer by the credit rating agencies.

2 Note also that Rule 144A requires that the conversion price of the convertible notes be at least 10% above the market value of the underlying shares. But as is clear from the table above, the market generally supports premiums in excess of 10% over the market price of the underlying shares and so this is not usually an issue.

Convertible, Exchangeable and 3(a)(9)

As indicated in the table above, two of the recent offerings were conducted on an "exchangeable" basis, rather than as "convertible offerings". The distinction is largely academic.

In the case where the debt security is issued by a finance subsidiary, the finance subsidiary debt is deemed to be "exchangeable" into the common stock of the parent company. The more interesting question, at least for the lawyers, is what exemption is available for the equity security that is issued upon conversion (or exchange) of the debt security. In the most straightforward example, the issuer's debt is convertible into the issuer's equity. At the time of the issuance of the equity to the holder of a convertible instrument, the issuer may rely on Section 3(a)(9) of the 1933 Act so as to avoid registration of the sale of the equity. Section 3(a)(9) provides, in part, that no registration of the sale of the equity security is required as the equity security is,"…[a] security exchanged by the issuer with its existing security holders exclusively where no commission or other remuneration is paid or given directly or indirectly for soliciting such exchange".

In the case where the debt security is issued with either a downstream guarantee (i.e., from a parent company guarantor) or an upstream guarantee (i.e., from a subsidiary guarantor), the analysis for the issuance of the equity becomes a bit more nuanced. However, in a series of no-action letters, the SEC has provided some comfort that even where the convertible debt security contains a guarantee, 3(a)(9) should in most cases still be available for the subsequent conversion (or exchange).[3]

Timing and Settlement of the Convert

None of the transactions listed in the table above, with the exception of the NextEra Energy Partners, LP transaction, are convertible at the outset. In each case, for a certain initial period of the convertible, the conversion may be exercised by the holder only upon satisfaction of certain conditions (which usually include a specified trading price of the common stock, or a specified trading price of the convert itself, or certain other corporate events). Further, for the longer dated converts listed above, PPL Corporation and CMS Energy Corporation, the exercise by the issuer of a redemption right also gives rise to a holder's right to convert its notes.

For a convert, settlement options with respect to the consideration to be provided upon conversion may include:

- settlement of the conversion option in shares of common stock ("full physical settlement");
- settlement of the conversion option in cash ("cash-convertible"); or
- settlement of the original principal amount in cash and any conversion premium in shares of common stock ("net-share settlement").

An issuer may also retain the option to settle in cash, shares or a combination of the two ("flexible settlement"). As made clear from the table above, all of the transactions included a similar settlement method for the conversion, which we have described as "Net Share" settlement with a flexible remainder (also referred to as "Instrument C"). Issuers pay cash up to the aggregate principal amount of the notes to be converted or exchanged and pay or deliver, as the case may be, cash, shares of common stock or a combination of cash and shares of common stock, at the issuer's election, in respect of the remainder.

3 For convertible securities issued by a finance subsidiary and guaranteed by the finance subsidiary's parent that are exchangeable for a parent security. See, e.g., The Warnaco Group, Inc. (August 7, 1998) and Echo Bay Mines, Ltd. (May 18, 1998). For "upstream guarantees", see Section 3(a)(9) Upstream Guarantees (January 12, 2010). Note, however, that the January 12, 2010 no-action letter regarding exchanges of securities with an "upstream" guarantee from a subsidiary notes that the subsidiary guarantors are "100% owned" subsidiaries. To the extent the subsidiary guarantee is provided by a subsidiary which is not 100% owned, Section 3(a)(9) may not be available and the issuer may need to put in place a resale shelf registration statement in order to register the offering of equity securities.

Derivative Overlays

In connection with a convert, the issuer also has the option of a derivative overlay. These are sometimes styled as a "bond hedge and warrant". In this structure, issuer buys a call option, or "bond hedge," that has the same strike price as the convertible note. And separately the issuer sells a higher strike price call option, or "warrant".

Another option is a "capped call". In a capped call, the issuer purchases a call option that has the same strike price as the convertible note. However, the option's payout stops, or is capped, at a higher strike price.[4] Interestingly, only the NextEra Energy Partners, LP transaction listed in the table above included a derivative overlay. In the instance of NextEra Energy Partners, LP there was a capped call.

Board Authorization

Convertible note offerings require approval of an issuer's board of directors.

- If the issuer is a Delaware corporation, under Delaware law, the board of directors may delegate final approval of the pricing terms of a convertible note offering to a pricing committee of the board. However, in the event that the board delegates the final approval to a pricing committee of the board, issuers should take care to ensure that the delegation resolution contains the parameters required by Sections 152 and 153 of the Delaware General Corporation Law (DGCL).[5] Issuers that are not incorporated in Delaware should similarly review their state corporation laws to determine what level of delegation is permitted.
- Counsel should also review the resolutions authorizing the offering to make sure (1) any proposed greenshoe is authorized, (2) any new standalone indenture for the convertible debt is authorized, (3) reservation of the shares of common stock issuable upon conversion (or exchange) of the convert is authorized and (4) that any derivative overlay for the convert is both contemplated and authorized (should it be utilized).

No Conflicts, Including with Existing Credit Agreements

At the outset, any issuer contemplating a convert will need to review its outstanding agreements in order to make certain that the convertible debt will not conflict with any existing contract or arrangement. In particular, the issuer and counsel should review the events of default in existing credit agreements, indentures and any private placement note purchase agreements in order to get comfortable that the language in any cross default/cross acceleration provision would not be triggered by the convertible debt, including the conversion feature itself. Specifically, certain issuers with cross default provisions in their credit agreements that contemplate an "event" or "condition" which causes indebtedness to become payable prior to its maturity (rather than cross default provisions merely contemplating a default/failure) have amended such language to clarify that a holder converting a convertible note prior to maturity does not constitute such an "event" or "condition".

Ratings Letters

In many investment grade debt offerings, an issuer will get verbal confirmations prior to launch from the respective ratings agencies that the security will receive a particular rating at closing. And usually this satisfies most Debt Capital Markets desks in order to be comfortable describing a rating (whether in a Bloomberg announcement or in a pricing term sheet) as the "Expected Rating" on the security. For converts, the practice we have observed has been a little different. First of all, on many convertible debt transactions for smaller, non-investment grade issuers, there are no ratings obtained on the convertible debt in connection with the transaction. However, on these recent convert offerings for investment-grade utilities, there has been increased discussion among the deal teams about exactly what is

4 One potential implication of the new 1% excise tax for stock buybacks that was introduced in the Inflation Reduction Act is on the accompanying call transaction for a convertible offering—either a capped call or bond hedge and warrant. These call transactions can be closed out via physical settlement, cash settlement or net share settlement. A call transaction that is settled by delivery of shares of common stock (i.e., physical settlement or net share settlement) appears to be subject to the excise tax. The 1% excise tax would be levied against the fair market value of the shares of common stock delivered to the issuer upon settlement of the call transaction. However, under an applicable netting rule, the value of the settled shares may be offset for purposes of the excise tax by the value of shares issued upon conversion of the notes (or any other issuance of the issuer's stock), provided that the conversion (or other issuance) occurs within the same tax year as the settlement of the call transaction. If settlement of the call transaction and the note conversion (or other issuance) do not occur within the same tax year, then no netting would be permitted and the excise tax would apply to the full value of the shares delivered in the call transaction. Absent additional guidance from the IRS, there is some question whether a cash settlement of the call transaction would be treated as the economic equivalent of a stock redemption for these purposes that is also subject to the excise tax (or whether the netting rule would apply). IRS guidance is expected to further define and clarify the scope of the new excise tax. However, the timing for release of that guidance currently remains uncertain.

5 In our experience, boards delegate authority to a subcommittee thereof to approve the specific pricing terms of the convertible note. We are aware of some practitioners that have considered whether issuers could forego a pricing committee and delegate approval of the ultimate pricing terms to management. Such a delegation, however, would be subject to the parameters required under Sections 152 and 153 of the DGCL. In particular, the board would need to pay special attention to authority for the maximum number of shares issuable upon conversion (including as a result of any "make-whole" fundamental change event). Calculating a precise number of shares is not possible until the actual pricing of the convertible instrument as such number is dependent on a number of factors, including the conversion premium. Accordingly, board authority for the transaction at the outset setting a cap on the number of shares would need to be flexible enough to accommodate a wide-range of pricing scenarios while also satisfying the requirements under the DGCL to determine the adequacy of the consideration received. Certain boards may be uncomfortable with such an expansive delegation of authority.

needed at launch to satisfy expectations of the ratings for purposes of marketing. In our experience, and unlike investment-grade plain vanilla debt, it's more likely that the Converts desks at the investment banks will want ratings letters in hand prior to launch.

Accounting Treatment

A US accounting rule had required that companies issuing convertibles add in a hypothetical interest expense on the bond, adding to the cost of issuance. That rule was eliminated last year. The FASB voted unanimously to proceed with a simplified model for convertible debt accounting and has provided a final Accounting Standards Update, Debt—Debt with Conversion and Other Options (Subtopic 470-20) to formalize the change. The effective date was for filers with fiscal years beginning after December 15, 2021.

Reg M

As described above, offering the convertible securities pursuant to Rule 144A allows more flexibility under Regulation M. While there is an "excepted security" under Regulation M for certain non-convertible debt securities (which had been available for non-convertible debt securities which were "investment grade", but has recently been amended to replace "investment grade" with a standard of creditworthiness), such exception is obviously not available for convertible securities. There is, however, an "excepted transaction" exemption under Regulation M for distributions of securities eligible for resale under Rule 144A of the 1933 Act solely to persons that are or are reasonably believed to be "qualified institutional buyers" or "QIBs".

Stock Exchange Considerations

Shareholder Approval

Both NYSE and Nasdaq listing rules require shareholder approvals with respect to certain transactions. Rule 312.03(c) of the NYSE Listed Company Manual requires shareholder approval prior to the issuance of common stock, or securities convertible into or exercisable for common stock, if:

- the common stock has, or will have upon issuance, voting power equal to or in excess of 20% of the voting power outstanding before the issuance of such stock; or
- the number of shares of common stock to be issued is, or will be upon issuance, equal to or in excess of 20% of the number of shares of common stock outstanding before the transaction.

Luckily (in this case) the NYSE also has exemptions for (1) "any public offering for cash," and (2) non-public offering issuances so long as the issuance is made for cash and at least at the "minimum price."[6]

Nasdaq Listing Rule 5635 requires shareholder approval for certain types of transactions, including issuances that may exceed 20% of the pre-transaction total shares outstanding or voting power that are priced at less than the "minimum price".[7]

For most convertible debt offerings, the offering will fall into the respective exceptions described above under the NYSE and Nasdaq for offerings of securities at a price that equals or exceeds the applicable "minimum price". Convertible bonds of utilities listed in the table above are optionally convertible by the investor and have an embedded "conversion premium." The conversion premium is the amount by which the conversion price exceeds the market price of the stock at the time of pricing the convertible bond. Given this premium, the conversion price will be higher than the market value (i.e. the "minimum price") of a share of common stock.[8]

6 "Minimum Price" for NYSE purposes is defined as the lower of: (i) the official closing price of issuer's common stock immediately before the execution of the transaction agreement and (ii) the average official closing price of issuer's common stock during the five days immediately preceding the transaction agreement.

7 "Minimum Price" for NASDAQ purposes is the lower of: (i) the Nasdaq Official Closing Price ("NOCP")(as reflected on Nasdaq.com); or (ii) the average NOCP of the common stock (as reflected on Nasdaq.com) for the five business days immediately preceding the signing of the binding agreement.

8 Until 2015, the NYSE and Nasdaq both took the position that this exception was available only for notes settled using full physical settlement (i.e., where the issuer settled the conversion entirely in shares) and was not available in the case of net-share settlement or flexible settlement. Both NYSE and Nasdaq changed their position on this topic in 2015, and now net-share or flexibly settled convertible notes may take advantage of this exception.

Timely Alert/Material News Policy

In our experience, most convert launches are announced after market close. Note that pursuant to Section 202.06 of the NYSE Listed Company Manual, listed companies are prohibited from publishing material news after the official closing time for the NYSE's trading session until the earlier of 4:05 p.m. ET or the publication of the official closing price of the company's security. The issuer will need to send an e-mail to NYSEalert@nyse.com, attaching a copy of the launch press release and providing the anticipated time of pricing. In such cases where the transaction is announced after market close, the issuer will not need to call the NYSE in advance, however.

The Nasdaq has a similar material news policy. Except in unusual circumstances, a Nasdaq-listed company is required to make prompt disclosure to the public through any Regulation FD compliant method (or combination of methods) of disclosure of any material information that would reasonably be expected to affect the value of its securities or influence investors' decisions. See Nasdaq Rule 5250(b)(1). The issuer shall also, prior to the release of the information, provide notice of such disclosure to Nasdaq's MarketWatch Department (through the electronic disclosure submission system available at www.nasdaq.net, except in emergency situations) at least ten minutes prior to public announcement if the information involves any of the events set forth in IM-5250-1 and the public release of the material information is made between 7:00 a.m. to 8:00 p.m. (Note that IM-5250-1 includes both "(f)…public or private sales of additional securities" and "(h) Any event requiring the filing of a Form 8-K.")

Taxes

When structured correctly, a convertible bond should be treated, for tax purposes, as debt. Accordingly, interest paid on the bond should be deductible to the issuer (subject to business interest deduction limitations of Code Section 163(j)). Similarly, interest paid on the bonds is taxable to the holders. Notably, interest that is accrued but not paid (a feature common in convertible bond issuances) will still generate annual taxable income/deduction under the "original issue discount" rules of the tax code. Under those circumstances, any "deemed" taxable interest will create tax basis for the holder which will serve to offset the eventual later cash payment of the interest at maturity or conversion.

Generally, conversion of a convertible bond into equity of the issuer does not result in a taxable event for the issuer or the holder. The holder of the bond will own the converted equity with a carryover tax basis from the bond (including any basis from "deemed" interest payments). The holding period for the converted equity will be treated as beginning when the debt was issued (in other words, the holder "tacks" on the earlier bond holding period). To the extent the bond has accrued interest at the time of conversion, which has not been previously taxed to the holder, such interest will be treated as paid to the holder, generating income for the holder and a deduction for the issuer as well as additional tax basis in the holder's converted equity.

Conclusion

With higher rates seemingly here to stay for some time, we expect this trend—investment grade utilities issuing convertible debt—to continue for some time. Stay tuned in the second half of 2023 to see which other issuers decide to do the same.

EXCHANGING EXCHANGES: PRACTICAL AND LEGAL CONSIDERATIONS

One recent trend among utility holding company issuers is to voluntarily delist shares of their common stock from the New York Stock Exchange (NYSE) and relist the shares on The Nasdaq Stock Market (Nasdaq). Recent examples of this trend are: Xcel Energy Inc. in December 2017, Exelon Corporation in September 2019, American Electric Power Company, Inc. in September 2020 and Evergy, Inc. in December 2022. Given the emergence of this trend, we thought it might be helpful to review some of the legal and practical considerations of a move to Nasdaq.

Reasons for a Move and Preliminary Considerations

As with any corporate decision, there are a multitude of reasons why an issuer would switch stock exchanges. Issuers have noted that several reasons for their switch to Nasdaq were the (1) lower continuing listing fees, (2) more flexible continuing listing standards and (3) integrated technological platform at Nasdaq.

Before making the decision to switch stock exchanges an issuer should undertake a review of its material agreements to ensure that such documents do not contain any restrictions with respect to moving to a different stock exchange. Notable agreements to review would be the issuer's:

- credit agreements;
- indentures;
- debt instruments;
- employee benefit plans (particularly involving plans with respect to issuing common stock on a going forward basis); and
- stock plans and any other agreement involving the issuer's common stock.

Additionally, the issuer should review and update its corporate governance documents to comply with any requirements of the new stock exchange. For example, issuers switching to Nasdaq should be aware of the diversity rules required of a listed company's board of directors, among other corporate governance requirements. If any of the issuer's corporate governance documents need to be updated, the issuer should build in enough lead time before the stock exchange switch to accomplish such changes. The issuer should also update its D&O questionnaires on a going forward basis to reflect the requirements of the new stock exchange.

Making the Move

Once the decision has been made to make the move to the new stock exchange, the issuer will need to take steps required under the NYSE's continuing listing rules and Rule 12d2 of the Securities Exchange Act of 1934, as amended (1934 Act). The below timeline outlines the necessary steps to finalize the move from NYSE to Nasdaq:

Timing	Event
10 Calendar Days before submitting final Listing Application to Nasdaq	Submit draft Listing Application to Nasdaq, including: » Corporate Governance Certification Form » Listing Agreement » Logo Submission Form » Draft press release announcing de-listing from the NYSE and listing on Nasdaq
7 Calendar Days before submitting final Listing Application to Nasdaq	Obtain pre-approval from Nasdaq concerning the draft Nasdaq Listing Application.
At least 10 Calendar Days before De-Listing of Common Stock	Send final, executed Listing Application to Nasdaq, including (a) Corporate Governance Certification Form, (b) Listing Agreement, and (c) Logo Submission Form.
	Send notice to the NYSE regarding (i) de-listing of the issuer's common stock from the NYSE noting the specific date on when NYSE is to suspend trading and (ii) listing it on Nasdaq, reflecting the exact date when trading will begin. Additionally, send the NYSE a Secretary's Certificate certifying the Board resolutions authorizing the transfer to Nasdaq, as required by NYSE Listing Company Manual Section 806.02. [The issuer may need to interface with their NYSE representative to ensure a smooth transition and answer any questions the NYSE may have.]
	Issue press release regarding the transfer of listing from the NYSE to Nasdaq. The press release must be posted on the issuer's website and remain available until, at least, the NYSE delisting on Form 25 has become effective. See Rule 12d2-2(c)(2)(iii) of the 1934 Act.
	File the Form 8-K (Item 3.01) with the Securities and Exchange Commission (SEC) regarding (i) de-listing the issuer's common stock from NYSE and (ii) listing it on Nasdaq. Also, if necessary, include Item 5.03 regarding any amendments to the issuer's Certificate of Incorporation or Bylaws (to be effective upon listing on Nasdaq).
10th Calendar Day after notice was provided to NYSE	File the Form 8-A with the SEC via EDGAR to register the issuer's common stock on Nasdaq under Section 12(b) of 1934 Act. The Form 8-A is to be filed with the SEC after the market closes on the last day the issuer's common stock is listed on the NYSE. This must be at least 10 days after notice was provided to NYSE.
	File Form 25 with the SEC via EDGAR to voluntarily withdrawal its common stock from the NYSE. The Form 25 will become effective 10 days after it is filed with the SEC. The Form 25 is to be filed with the SEC (i) after the market closes on the last day the issuer's common stock is listed on the NYSE and (ii) after the Form 8-A is filed with the SEC on EDGAR to register the issuer's common stock on Nasdaq under Section 12(b) of the 1934 Act.
	Nasdaq to certify registration of the issuer's common stock on Nasdaq. Certification filed by Nasdaq with the SEC via EDGAR(i) after the market closes on the last day the issuer's common stock is listed on the NYSE, (ii) after the Form 8-A is filed with the SEC on EDGAR to register the issuer's common stock on Nasdaq under Section 12(b) of the 1934 Act, and (iii) after the Form 25 is filed with the SEC via EDGAR to voluntarily withdraw the issuer's common stock from the NYSE.
Trading Day (Next scheduled trading day)	The issuer's common stock begins trading on Nasdaq.

After the move to Nasdaq has been completed, the issuer should keep in mind that it will need to update the "Name of Each Exchange on Which Registered" section on the cover of its next 1934 Act filing on Form 8-K, Form 10-Q or Form 10-K.

DOE LOANS AND UTILITY SECURED DEBT

In May 2023, the US Department of Energy's (DOE) Loan Programs Office (LPO) issued updated Program Guidance (Program Guidance) for the Title 17 Clean Energy Financing Program (Program) and an interim final rule (Interim Final Rule) amending the regulations applicable to the Program.[1] The Program, which was originally conceived in the Energy Policy Act of 2005 and has been periodically expanded and refined since, enables DOE, acting through LPO, to guarantee third party loans made in support of a variety of qualifying energy-related projects.[2] Most recently, the Inflation Reduction Act of 2022 (IRA) increased LPO's aggregate loan authority, appropriated funds to support issuing new loans across several LPO programs and enabled a new "Energy Infrastructure Reinvestment Financing" mechanism (EIRF), described in further detail below.[3] Under the expanded Program, LPO has been authorized to disburse and administer guarantees for loans to a broad set of clean energy, decarbonization and energy infrastructure reinvestment projects with an aggregate principal amount of over $300 billion.

The Program offers loan guarantees for energy projects qualifying under one of the four following categories:

- **Innovative Energy:** Projects that deploy "New or Significantly Improved Technology" that is technically proven but not widely commercialized in the United States;
- **Innovative Supply Chain:** Projects that either (a) employ "New or Significantly Improved Technology" in the manufacturing process for a qualifying clean energy technology or (b) manufacture a qualifying New or Significantly Improved Technology;
- **State Energy Financing Institutions (SEFI):** Projects that support the deployment of a qualifying clean energy technology and receive meaningful financial support or credit enhancements from a state agency or financing authority. SEFI projects are not required to employ "New or Significantly Improved Technology"; and
- **EIRF:** Projects that (a) retool, repower, repurpose, or replace Energy Infrastructure (facilities used for electric generation or transmission, or facilities used for fossil fuel-related production, processing, and delivery) that has ceased operations or (b) enable operating Energy Infrastructure to avoid, reduce, utilize, or sequester air pollutants or emissions of greenhouse gases. EIRF projects are not required to employ "New or Significantly Improved Technology". EIRF is described in further detail here.

One of the Program's stated goals is to serve as a "Bridge to Bankability" for projects that otherwise might have difficulty attracting commercial loans. A project receiving a loan guarantee under the Program should have reduced interest expense when compared with commercial loans without such a guarantee, is likely to benefit from relatively favorable terms and conditions and should have a better chance demonstrating its viability in debt and equity markets for subsequent iterations.

1 Loan Guarantees for Clean Energy Projects, 88 Fed. Reg. 34419 (May 30, 2023) (amending 10 C.F.R. § 609).

2 Public Law 109–58, title XVII (2005), as amended; 42 U.S.C. 16511 et seq.

3 Public Law 117–169 (2022).

In order for a project to qualify, certain key Program requirements must be met. First, the underlying loan benefiting from a loan guarantee under the Program (Guaranteed Obligations) generally must be senior in both payment and lien priority to other financing, though the Interim Final Rule contemplates that the LPO may permit the Guaranteed Obligations to share a pari passu lien with other financing in LPO's discretion.[4] Note, however, that this restriction does not apply to additional financial support that might be provided by a SEFI, thus permitting such SEFI financial support to be in the form of mezzanine loans or even grants, among others. Secondly, the borrower benefiting from a loan guarantee under the Program must pledge sufficient collateral to secure the repayment of the Guaranteed Obligations as determined by LPO.[5] However, such collateral may include assets that are unrelated to the qualifying project, and the DOE has previously suggested that "a more modest pledge of assets" may be all that is required for a corporate balance sheet lending structure involving a creditworthy sponsor.[6] Indeed, the DOE confirms that secured corporate lending is an acceptable transaction structure in the new Program Guidance. Finally, the project must satisfy various other Program requirements, discussed in further detail here.

Utilities evaluating the eligibility of their projects for loan guarantees under the Program should pay close attention to the senior secured financing requirements discussed above. Utility mortgage bonds are often secured by a pledge of substantially all of the utility's assets. These mortgages create a first priority lien (subject only to certain permitted liens) on substantially all of the utility's real property and equipment and the lien automatically spreads to after-acquired property of the same character. Therefore, obtaining a lien release under the mortgage on the assets subject to the DOE loan to enable the pledging of such assets as collateral for DOE may present challenges, particularly for utilities where issuance capacity is already constrained, as further discussed below

Another option, when the borrower already has an existing mortgage on its assets, would be to issue a collateral mortgage bond as a new series of mortgage bonds to secure the DOE loan. Issuers with secured operating company bank facilities or senior debt collateralized by a mortgage bond as a result of a negative pledge may be already familiar with this structure. Such collateral mortgage bond would have a face amount and maturity corresponding to the terms of the DOE loan then outstanding and would be held by DOE as collateral for the guaranteed obligations. As a result of holding the collateral mortgage bond, DOE would rank equally in right of payment with the issuer's existing or future bondholders under the mortgage and DOE's rights and remedies (e.g., acceleration in event of default) would be subject to the requirements included in the mortgage for any bondholder. Utility mortgages are effectively limited in the amount of debt that may be issued under the mortgage based (among other things) on the value of property subject to the lien of the mortgage. For a modern utility mortgage, a typical threshold is that additional debt under the mortgage not exceed seventy percent (70%) of the balance of the cost or the fair value (whichever shall be less) of property available to support a further issuance under the mortgage. We note, however, that many of the DOE loan programs are large projects and so an issuer may already be running up against incurrence limitations set forth in the mortgage on further debt issuances.

While loan guarantees issued under the Program can enable projects that would face difficulty in obtaining acceptable debt financing without such support, prospective borrowers should pay close attention to the recently released restrictions and requirements applicable to the Program. Further, utility issuers will need to examine the security package requirements of any DOE loan and determine how best to navigate the requirements. For those utilities with existing secured debt, the DOE loan requirements will likely require significant structuring considerations.

4 88 Fed. Reg. at 34433 (10 C.F.R. § 609.8(b)(9))

5 88 Fed. Reg. at 34432 (10 C.F.R. § 609.8(b)(7))

6 Loan Guarantees for Projects That Employ Innovative Technologies, 74 Fed. Reg. at 63546 (Dec. 4, 2009) (amending 10 C.F.R. § 609).

RECENT CLIENT ALERTS AND PUBLICATIONS

Over the past year, Hunton lawyers have authored client alerts and blog posts covering a range of topics relevant to the power and utilities capital markets industry:

FERC'S Order No. 2023 Aims at Improving and Expediting the Generator Interconnection Process, August 4, 2023

SEC Adopts Final Public Company Cybersecurity Disclosure Rules, July 27, 2003

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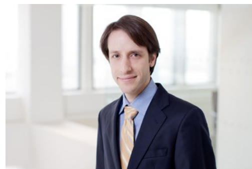

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