HUNTON
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BASELOAD

Current Topics in the Power and Utilities Capital Markets



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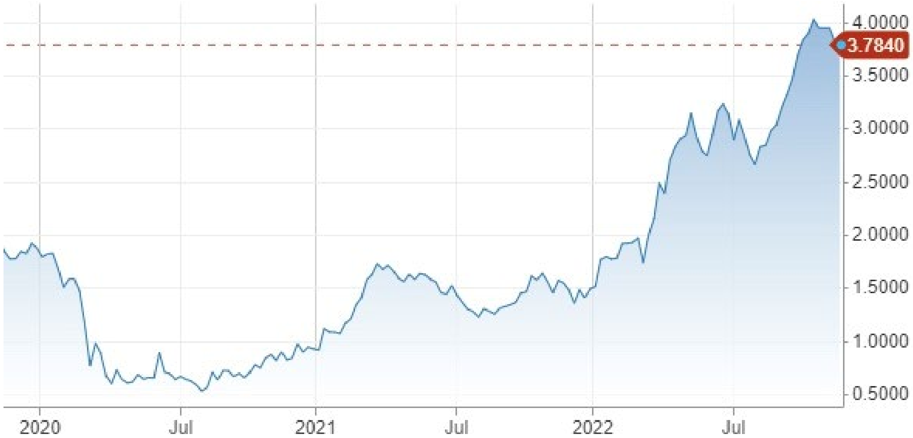
Contents

Liftoff: Power Financing in an Era of Higher Rates

A year or two ago, capital markets professionals were scrambling to figure out how negative interest rates would work.[1] While many were aware that "liftoff" was coming, few expected the increase in interest rates to come so quickly and with such magnitude. Clearly, the financial models that many had been using in recent years have quickly become stale. Below is a chart of the yield on the 10-year United States treasury bond, showing the years 2020 to 2022.[2]



1 See "If a Downturn: Utility Capital Markets in Times of Stress" in the October 2019 issue of Baseload.

2 All interest rate charts courtesy of CNBC.com.

The dramatic increase in rates has impacted all segments of the utility capital markets. And the increase in rates is not only a matter of Treasury yields, but also of credit spreads. In some cases, the new issue credit spreads in the market are some of the highest in the past several decades.

One of the most striking comparisons is between the rates at which utilities (both holding companies (Holdcos) and operating companies (Opcos)) were issuing unsecured debt in 2020 versus 2022. Below is a chart of unsecured coupons of certain Holdcos and Opcos which completed offerings of like tenor in 2020 and in 2022.

Issuer	Tenor	2020	2022
American Electric Power Company	10-Year	2.3%	5.95%
Dominion Energy, Inc.	10-year	3.375%	4.35% / 5.375%
Virginia Electric and Power Company	30-year	2.45%	4.625%
Duke Energy Corporation	5-year	0.9%	4.3% / 5.0%
	10-year	2.45%	4.5%
Baltimore Gas and Electric Company (Exelon)	30-year	2.9%	4.55%
NextEra Energy Capital Holdings, Inc.	10-year	2.25%	5.0%
Public Service Enterprise Group Inc.	5-year	0.8%	5.85%
The Southern Company	10-year	3.7%	5.7%
Alabama Power Company	10-year	1.45%	3.94%
Georgia Power Company	30-year	3.7%	5.125%
WEC Energy Group	3-year	0.55%	5.0%

Moreover, based on our anecdotal review, the rise in interest rates for utility issuers appears to have been more pronounced on the unsecured side. Said another way, the difference in coupons on Opco mortgage bonds in 2020 and 2022 are far less extreme than those in the above chart.

Interest rates have been increasingly impacting the earnings of many utility systems over the past year.[3] One nuance in the regulated utility industry is that Opco issuers often have the opportunity to recover interest expense through rates charged to the utility's customers, subject to PUC review and approval. While this recovery can serve to "cushion" the utility from increasing interest rates, much like pass-through commodity prices, PUCs are likely to focus on such interest costs and related affordability issues, as residential utility bills become more expensive. Further, any regulatory lag for the recovery of interest costs will have a more pronounced effect on utilities' financials given that interest costs have increased exponentially over the past few years.

In preparing this article, Hunton Andrews Kurth had the opportunity to speak with several individuals in the utility industry, including Treasury departments and investment banks. Our goal was to attempt to identify (1) the financing challenges utility systems face in this new interest rate environment and (2) the strategies which are being used, and are expected to be used, to address this new normal.

Board and Regulatory Authority

One practical issue companies are dealing with is existing board authority for debt issuances. Given the frequency with which utilities access the capital markets, boards of directors often give broad discretion to issue debt to management. However, boards often will set caps on the amount of debt that can be issued and on the interest rate on such debt. When financing resolutions were approved by a board of directors months ago, interest rate caps set forth therein have often become stale. We are seeing many utilities avoid this issue by drafting the interest rate caps based on "treasury yield plus a spread" rather than a maximum coupon.

3 Allison Good, *High Interest Rates dent some utilities' short-term earnings growth projections*, MarketWeek, (Nov. 4, 2022).

Board authority aside, most Opcos (as opposed to Holdcos) require a financing order from either a PUC or from FERC. See "Utility Financing Orders: A Quick Guide to the Federal and State Framework" in the November 2021 issue of Baseload. In many instances, Opcos will have an interest rate cap set forth in a PUC financing order and, thus, potentially be subject to the same issue discussed above regarding board authority.

For issuers which require FERC financing authority, the FERC financing orders typically don't set a maximum interest rate. However, FERC generally requires applicants to demonstrate (on a pro forma basis) that their net income will equal or exceed 2X total interest expense. Applicants will often assume a "market" interest rate to calculate their pro forma interest costs for this test. And so current increased interest rates may make it harder for some issuers to pass this 2X coverage test in connection with FERC financing applications.

Capital Structure Debt?

In recent months, issuers are certainly favoring the shorter tenors. Issuers appear to be less concerned with stacking up their balance sheet with shorter-term debt because many have already spent the past several years extending the weighted average maturity of their outstanding debt profile. Moreover, we understand that the rates on the 3-year and 5-year maturity aren't as expensive (on a historical basis) as the shortest end of the curve (12 months, etc.). We should also note that most of the debt issued by utilities in 2022 has been fixed rate. Even in several instances where deals were launched with a floating rate tranche, the floater was often dropped at pricing.

As interest rates and volatility have increased, some utilities have sought to avoid the public capital markets and simply entered into term loans in order to satisfy capital needs. At some point, though, funding banks will naturally run up against their own internal limits to provide capital.

Utilities are getting a significant benefit from tax exempt financing right now. For the past four or five years, many tax exempt deals, whether new money offerings or remarketings of existing debt, have been marketed in a "long term" mode. The rates for long-term tax exempt debt were at all-time lows. But now that interest rates are higher, some expect that more tax exempt deals will go out in daily or weekly modes—the variable rate demand obligation (VRDO) modes. At the same time, utilities will need to be mindful of liquidity in those VRDO modes. Investors can tender bonds for purchase at any time while in a daily or weekly mode. And of late, it's less common for VRDO-mode bonds to be "enhanced" by a letter of credit.

INSIDE SCOOP

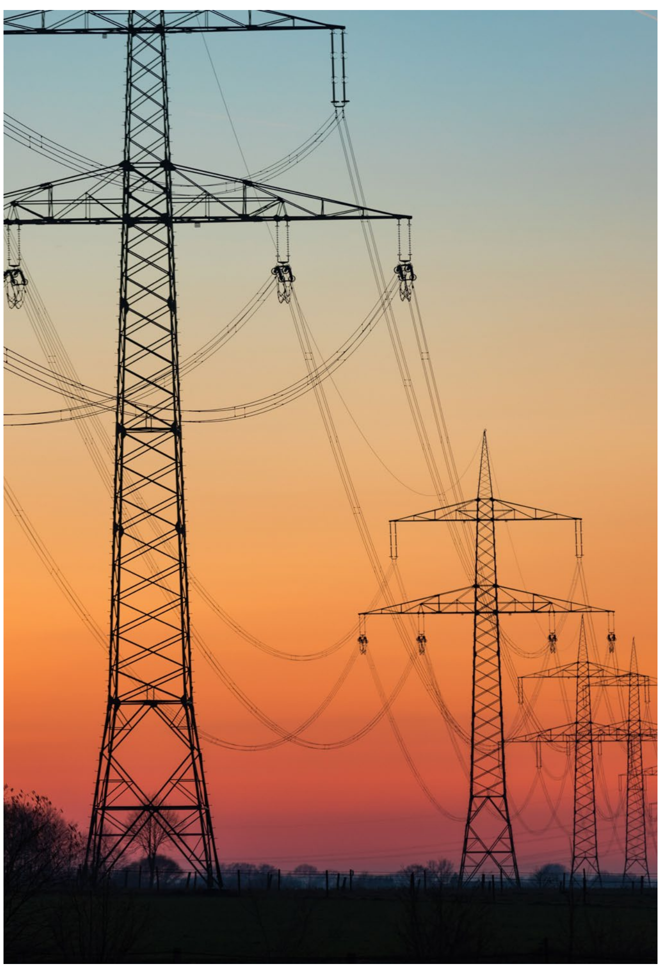
We understand that some utilities compare the rates on "weekly" tax exempt paper with rates available in the commercial paper market (with commercial paper currently yielding significantly higher rates).

Given recent volatility, some issuers may also look to the 4(a)(2) private placement market. In addition to the unfriendly rate environment for issuers, the number of "actionable days" to confidently access the capital markets has decreased demonstrably. Unlike the public debt markets, one advantage of the 4(a)(2) market is the ability to structure "funding" at some date months into the future. So, several utilities have been exploring accessing the 4(a)(2) market

to lock in a rate (albeit at a sub-optimal coupon compared to years past) on an "actionable day" and negotiate for an extended closing/funding to a point in time in the future when the proceeds from the issuance are needed.

Many issuers may also be looking at liability management opportunities in the near future. A lot of the debt which has been issued in the past several years is now trading well below par. So it seems obvious that issuers will likely take advantage of tender offers where it makes sense and also, on a smaller scale, open market purchases.

Finally, utility securitization will likely retain its popularity despite the recent movement in rates. Most state securitization statutes have several statutory tests that must be met in order for the statute to be utilized. A standard requirement of a statute requires an examination and comparison of the cost of traditional debt financing versus a utility securitization. While not all types of costs are optimal candidates for the securitization structure, the difference in credit rating of the standalone utility versus the AAA rating typically afforded a securitization structure almost always ensures interest rate savings.



What about equity?

The higher rates are likely sapping demand from the high-dividend utility stocks. And from the perspective of many utilities, accessing the equity markets isn't very appealing when a stock is 20% off of the most recent highs. To the extent issuers consider follow-on offerings, some in the industry have suggested that equity deals are likely to be structured as "overnight" deals (i.e. a "bought deal" or "block trade"), rather than traditional marketed deals. Given the recent market volatility, issuers would prefer not to be in the market—especially for equity—for any amount of time longer than absolutely necessary.

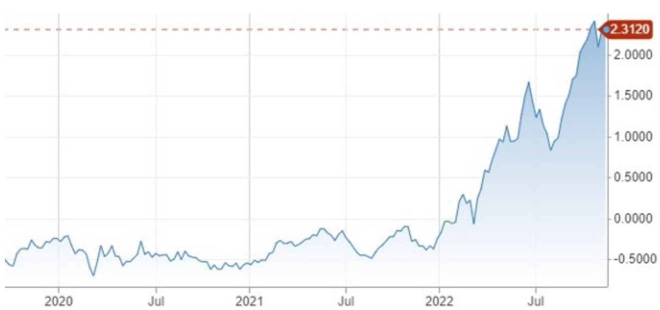
Another continuing trend in this volatile environment is to raise proceeds through asset divestitures as a substitute for accessing the capital markets. In the past 12 months, the following investor-owned utilities have announced sales of the following assets:

- **American Electric Power Company, Inc.** announced sale processes for both Kentucky Power Company and AEP's unregulated contracted renewable assets;
- **Consolidated Edison Inc.** agreed to sell its renewable energy business to German energy company RWE AG for $6.8 billion;
- **Dominion Energy** sold Questar Pipelines to Southwest Gas Holdings Inc. in a transaction valued at $1.975 billion;
- **Duke Energy Corp.** commenced a sale process for its commercial renewable-energy business and agreed to sell a 19.9% interest in its Duke Energy Indiana subsidiary;
- **FirstEnergy Corp.** sold a 19.9% stake in FET, the holding company for FirstEnergy's three regulated transmission subsidiaries, to Brookfield Super-Core Infrastructure Partners for $2.4 billion;
- **NiSource Inc.** announced it would pursue the sale of a 19.9% interest in Northern Indiana Public Service Co.; and
- **Sempra Energy** sold a 10% non-controlling interest in Sempra Infrastructure Partners for $1.73 billion in cash to a subsidiary of the Abu Dhabi Investment Authority.

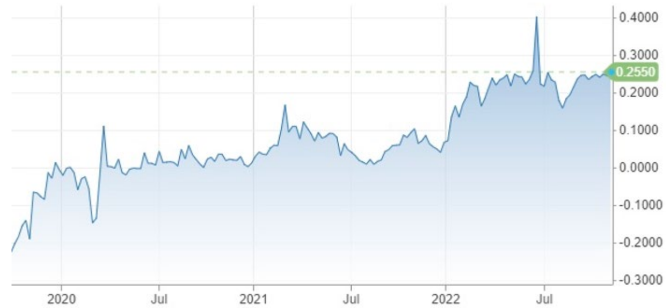
INSIDE SCOOP

We understand that the rating agencies have become wary of many of these assets sales—wherein a system may be selling off, or selling a share in, a highly regarded asset that generates substantial cash flow. To the extent issuers (or rating agencies) sour on the tactic of raising equity through dispositions, we may see an uptick in traditional sales of common stock (or other hybrid securities with equity credit from the rating agencies).[4]

The Treasury departments across the industry are interested in finding any possible strategy to reduce interest costs. To mitigate the increasingly expensive US bond market, many utilities have been exploring foreign denominated debt as a means to exploit the difference in interest rates in the United States versus other countries (e.g. EU, UK, Taiwan and Japan). Below is the yield on the German bund 10-year since 2020. The German bund has experienced a similar 200 basis point run-up in rates over the past year. However, given that the bund started from negative interest rates in 2020 and 2021, the yield remains lower than the yield on a corresponding US Treasury bond.



To the right, is a similar chart for the Japanese 10-year treasury over the past three years. In the case of Japan, the recent rise has been much less dramatic. Again, there was a long period of negative interest yields. But the Japanese 10-year is currently only yielding approximately 0.2% or 0.3%, compared to the United States 10-year yield at approximately 4.2%. One counterbalancing factor, though, is the recent devalutation of the Japanese Yen. In some cases, a cross-border offering into the Japanese market may not provide the size needed to warrant such an offering.



CapEx

A pivotal question in the utility industry is if and when the current interest rate environment curtails utility capital expenditure programs. Most utilities have made "net zero" or similar pledges, promised to close coal and vintage gas plants and increased their projected capital expenditure spend in the transition to renewables. High interest rates, among other issues, are complicating these goals. If the Federal Reserve remains hawkish on rates, it may only be a matter of time before the current higher interest rate environment also begins to impact utility capital expenditure programs. As discussed above, the rapid rise in rates has been a challenge for any existing financial model of the utilities. Internal models for capital expenditures work differently at 5% or 6% for debt borrowing costs than they do at 2% or 3%.

Conclusion

Large balance sheets require constant management. And the run-up in rates over the past two years has presented a number of current and future challenges for the Treasury and Legal teams at utilities across the country. The total impact of the current high interest rate environment on the utility capital markets cannot currently be predicted. Increasing rates have curtailed opportunistic debt refinancings and market volatility has effectively closed the equity market for utilities. Many issuers have avoided the capital markets and focused instead on selling assets in order to raise proceeds. The disposition of such cash flow-generating assets, however, has focused the rating agencies on such strategies. To the extent the Fed remains hawkish, it is unclear how these trends will change in the near term.

4 Darren Sweeney, *Utility executives assess value, risk of ownership stake sales*, S&P Global Market Intelligence (Nov. 22, 2022).

Dealkiller? SEC Comment Letters During a Capital Markets Issuance

Since the adoption of Securities Offering Reform in 2005, the SEC has focused the liability inquiry on the quality of disclosure at the "time of sale" which, according to the SEC, occurs when the investor becomes committed to purchase the security. Events that call into question the quality of the disclosure at the "time of sale" make issuers, bankers and lawyers nervous. One such event that sometimes—but not always—complicates the disclosure analysis in a capital markets transaction is the receipt by the issuer (or affiliate) of a comment letter from the SEC.

SEC comment letters come in a wide variety of forms. A benign SEC comment letter may question an issuer's prior 10-K or 10-Q disclosure but simply request the issuer to revise such disclosure in its future 1934 Act reports. These types of comments letters generally do not impede the timing of a capital markets deal. A less benign SEC comment letter may disagree with an issuer's financial disclosure and request a financial restatement and/or an amendment of a previously filed 10-K or 10-Q. This type of comment letter will stop a capital markets deal dead in its tracks.

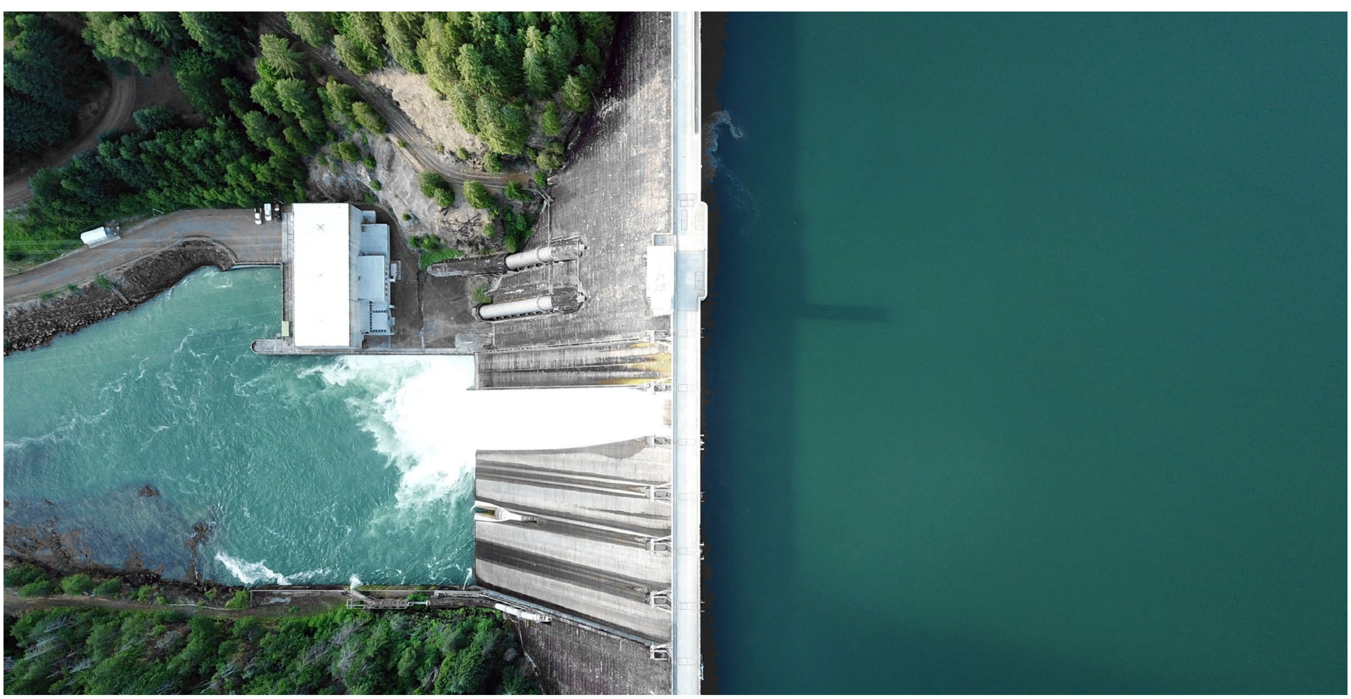
Deal participants are reluctant to issue securities while issuers are in possession of such an ominous SEC comment letter because the SEC is effectively questioning the adequacy of an issuer's existing 1934 Act disclosure. Such disclosure is included or incorporated by reference into the disclosure package which serves as the basis for the investor's investment decision at the "time of sale." So, to avoid pricing securities based on questionable disclosure, the deal is usually pushed until there is agreement with the SEC on such disclosure.

Because the scope and the content of SEC comment letters can vary so widely, there is no standard "off-the-shelf" playbook for dealing with comment letters in the context of capital market offerings. This article will attempt to illustrate various issues and circumstances that we've experienced with different types of comment letters in the context of an impending capital markets transaction.

Background on SEC Comment Letters

The SEC's Division of Corporation Finance (Division) issues comment letters in connection with a review of an issuer's 1934 Act reports (10-Ks, 10-Qs, 8-Ks). These reviews are routine but receipt of a comment letter is relatively random. Although the Sarbanes-Oxley Act of 2002 required the Division to review each reporting company at least once every three years, no issuer can be certain as to whether or when such a review will generate an SEC comment letter.

Historically, comment letters from the SEC were not publicly available. But the SEC began publicly releasing this correspondence in 2005. Comments become part of the public domain once submitted and resolved. Comments and the related responses are posted to the SEC's EDGAR website no earlier than 20 days after the review is completed.



To give context to the frequency and subject matter of SEC comment letters, set forth below is a chart illustrating comment letters received by 1934 Act reporting companies (on 1934 Act reports) in the power and gas utility industry from 2020 to 2022:

	2020	2021	2022
Total[1]	**5**	**13**	**9**
Non-GAAP	4	9	4
MD&A	4	8	8
Climate change	0	1	3
Regulatory accounting	2	2	1
Commitments and Contingencies	1	3	1

Of the publicly available comment letters in the utility sector, as noted in the chart above, most of the comment letters we reviewed in calendar 2022 were either focused on (1) the registrant's use of non-GAAP measures of performance or (2) those topics contained in the SEC's September 2021 Sample Letter to Companies Regarding Climate Change Disclosures.[2]

Timing

The comment letter from the SEC will request a response from the registrant within 10 business days. Generally, issuers should expect a formal response from the SEC roughly 30 days from the date of the issuer's submission. But this response time from the SEC may vary. In their response letter, the SEC may either accept the issuer's answers to the original comment letter and close down the inquiry or disagree/further question the adequacy of the issuer's 1934 Act disclosure.

Furthermore, under the 2005 Securities Offering Reform, large accelerated filers, accelerated filers and well-known seasoned issuers must disclose in their Forms 10-K the substance of any material unresolved SEC staff comments that were issued 180 or more days before the end of the current fiscal year.

First Things First

The first step to take when the registrant has received a comment letter is to make sure it is disseminated to the appropriate parties. SEC comment letters are often sent to the CFO, who may not necessarily be in the loop on the timing of a routine capital markets deal. So, it's of utmost importance that an issuer's internal dissemination process for SEC comment letters be proactive and timely. If there is a capital markets deal pending, the Treasury team, internal accounting/financial reporting, internal legal, external legal and, most importantly, independent auditors should receive the letter immediately.

Another gating item that needs to be analyzed immediately is also pretty straightforward. Namely, which corporate entity is subject to the SEC comment letter? Given that many domestic utility systems have multiple operating companies in addition to a holding company, it's important to determine exactly which registrant or registrants are affected by the comment letter. For example, if the comment letter addresses issues solely with respect to a sister operating company of the potential issuer for the offering, the comment letter may present fewer issues with respect to the upcoming offering. Even if an SEC comment letter impacts only a sister operating company or holding company, however, the issuer may want to alert its underwriters of the receipt of an SEC comment letter in such issuer's utility family. To the extent the issuer's holding company or sister operating company will need to amend its existing 1934 Act documents in relatively close proximity to the capital markets issuance—even though the issuer was not implicated by such comment letter—it may be helpful for the underwriters to be aware of the facts in order to respond to any investor inquiries.

1 Note that amounts in the various categories will not sum to the "Total" amount. Many comment letters were applicable to multiple categories in the chart.

2 Available at https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

If the issuer is subject to an SEC comment letter, the timing and process for notifying underwriters of the upcoming deal and their counsel of the receipt of the comment letter will need to be determined. "Best practices" would certainly be to avoid disclosing the existence of a comment letter for the first time on the diligence call for the deal. If an issuer wants to proceed with an offering after receipt of a comment letter, underwriters' counsel and the bookrunning managers will need time to review, process and discuss the letter. From the banks' perspective, internal counsel will most certainly be brought into the loop. That said, to the extent that the subject matter of the letter is sensitive, issuers can ask to limit distribution of the letter solely to the bookrunners (as opposed to the entire syndicate) and further request that the letter be circulated within each bank on an "as needed" basis. The timing for this process can take up to a day or more—and, depending on the complexity of the issues raised in the letter, may take more time. So, to the extent an issuer receives a comment letter the night before a potential launch, it would behoove all deal participants for this communication to be done rapidly so as to level-set expectations on the timing and advisability of a potential launch. Furthermore, issuers should expect to be asked to discuss the comment letter on the due diligence call prior to launch.

Focus of the Comment Letter

As the table above illustrates, the subject matter of SEC comment letters varies. In the deal context, one of the most important issues is whether the SEC is requesting modifications solely to future filings or requesting modifications to perceived deficiencies in prior filings. Further complicating matters, based on the language in the letter, sometimes it may be unclear whether the SEC is requiring revisions to prior filings or whether the comment letter can be addressed solely in future filings.

If the comment letter requires an issuer to amend disclosure in prior 1934 Act documents, in most cases, the deal should be postponed until after resolution of the comment letter. In the normal course, resolution of an SEC comment letter typically takes up to a few weeks, but may take more time. The reason for postponing the deal centers on the fact that the SEC believes that the issuer's disclosure documents are inadequate.[3] Depending on the questions in the comment letter, certain deal participants may take the position that the requested changes to the disclosure are immaterial to investors or are hyper-technical legal foot-faults.[4] Even if these assertions are credible, the fact of the matter is that, from a liability perspective, it is sub-optimal to price a deal knowing that your issuer's disclosure package will need to be modified per mandate of the SEC.

On the other end of the spectrum, to the extent the SEC has flagged disclosure items to be modified in future filings, deal participants often feel comfortable proceeding with an issuance under these circumstances. Any unusual facts and circumstances will need to be considered, but to the extent the SEC is not requiring amendments of previously filed 1934 Act documents, many deal participants will deem the disclosure package to be adequate and recommend proceeding with the offering. Although the disclosure liability risk is not zero in such a scenario (but is never zero in any circumstance), proceeding with the deal would seem to be reasonable—again, absent any unique facts and circumstances.

3 If the SEC comment letter is commenting on the financial statements and/or notes, the stakes involved in the comment letter can quickly escalate. If the comment letter suggests that there may be errors in prior financial statements, the first step should be a "SAB 99" analysis. "SAB 99" refers to the SEC Staff Accounting Bulletin No. 99, "Materiality." In SAB 99, the staff of the SEC provides guidance on legal and accounting considerations in the interpretation of materiality with respect to financial statement items. See "Errors in Previously Issued Financials? A 'Big P' Problem" in the December 2014 issue of Baseload.

4 For a further discussion of materiality, see "A Big Deal: The Materiality Analysis for Utility Issuers" in the August 2020 issue of Baseload.

Talking to the SEC

The issuer's internal accounting/financial reporting group often will reach out to the SEC individual named in the comment letter (SEC examiner) to discuss the letter and the issuer's proposed responses. Although not required, such communication is certainly helpful when a comment letter is received in close proximity to a deal. SEC examiners will rarely provide resolution to the comment letter in such a call, but the issuer can certainly gauge the SEC examiner's verbal reaction to the proposed responses. Importantly, the issuer can specifically discuss with the SEC examiner whether the issuer's responses can be reflected in future filings or will require amending previously filed 1934 Act documents. This informal insight can be valuable to deal participants in assessing the risk of proceeding with an offering while dealing with an unresolved SEC comment.

Can Disclosure "Fix" an Unresolved Comment Letter

Many times issuers face a scenario where they have received the comment letter and have responded to the SEC prior to launch, but the SEC has not yet responded. To move to a launch, all parties to the deal will need to be reasonably certain that the issuer's response to the comment letter resolves the issues raised by the letters. Depending on the content of the comment letter and response, sometimes deal participants can "get there." Sometimes, however, they can't.

If the comment letter raises issues that are too thorny to predict a favorable response from the SEC, then delaying launch may be necessary. In these scenarios there is often a question as to whether it's possible to "disclose around" the existence of a comment letter. The goal of such an inquiry would be to have the issuer disclose the existence of an unresolved comment letter, warn potential investors that the disclosure may change and then proceed with a capital markets launch (on the assumption that the disclosure has been "cleansed" by alerting investors of the comment letter). In our experience this is rarely a viable option. In most cases, the disclosure of the comment letter rarely accomplishes the task of insulating the issuer and the underwriters from disclosure liability in the context of the capital market deal. Disclosure of a comment letter will generally serve a limited purpose. Investors will be aware of its existence but such disclosure does not remedy potentially inadequate disclosure. Although some may analogize such disclosure to risk factor disclosure, the analysis is not an "apples to apples" comparison. Risk factor disclosure alerts an investor of potential materially adverse issues impacting

an issuer. If such risk factor disclosure, however, is likely resolved within 30 days (i.e., generally the timeframe of resolution of a comment letter), then most issuers (absent unusual circumstances) would opt to postpone the launch until resolution of the disclosure issue. Thus, disclosure of a comment letter does not "fix" an issuer's potentially defective disclosure—it simply alerts the investor that the SEC may require the disclosure package to be modified in the not-too-distant future.[5]

Can Accountants Deliver a Comfort Letter While an SEC Comment Letter is Unresolved

Another interesting scenario arises when the outside accountants are asked to deliver a comfort letter while a comment letter from the SEC is outstanding. Of course, accounting principles and practices are outside the scope of this article. In our experience, however, outside accountants may be reluctant to deliver a comfort letter while a comment letter is outstanding unless certain factors are present, including (i) the topics of the comment letter are clearly routine, (ii) required responses are forward-looking or (iii) the issuer has responded to the comment letter (and the outside accountants agree with response). Each accounting firm (and its national office) likely has internal guidelines and the ability to deliver a comfort letter will undoubtedly be tied to the complexity and focus of the comment letter. Our only practical tip would be to flag the question early because banks are highly unlikely to proceed with a launch unless accountants commit to delivering unqualified comfort letters.

Can Lawyers Give a 10b-5 Letter While an SEC Comment Letter is Unresolved

The ability of issuer's counsel and underwriters' counsel to deliver an unqualified 10b-5 letter will, similar to the comfort letter analysis, depend on the complexity and focus of the SEC comments. If the lawyers have conducted diligence on the SEC comment letter (e.g., calls with the internal accounting/financial reporting, internal/external legal and outside accounting) and the accountants are willing to deliver a comfort letter, often lawyers can deliver the 10b-5 letters.

One fact that can impede the lawyers' ability to deliver their 10b-5 letter is the comfort letter. In an American Bar Association ("ABA") analysis of 10b-5 letters, the ABA stated:

> Because a negative assurance letter is intended to be only one component of underwriters' "due diligence" and is informed by the other components, lawyers may decline to give negative assurance if other customary aspects of underwriters' "due diligence," such as receipt of accountants' comfort letters, are not contemplated. [6]

However, in many, if not most cases, when the outside accountants for the issuer are unable to provide a standard comfort letter, the attorneys working on the deal will similarly be unable to deliver a 10b-5 letter. But as the ABA analysis contemplates, there may still be instances where the attorneys involved may still be able to provide the standard 10b-5 letter at closing.

The Nightmare Scenario

In the unfortunate event that an SEC comment letter is received after launch of the offering but before pricing or closing, the working group will be forced to make a number of critical decisions in a matter of hours or minutes. These issues include whether the comment letter is routine and, therefore, whether the transaction should pause and not price (or, even more difficult, whether trades will need to be broken after a pricing). Delivery of comfort letters and 10b-5 statements will be part of the mix as well. If the transaction has priced and the underwriting agreement has been executed, a bringdown comfort letter and legal opinion (including 10b-5 letters) are required to be delivered at closing. It's unlikely that banks will waive these deliverables or accept qualifications regarding the comment letter. Based on the two sections immediately above, there is a path by which such document can be delivered. But the stars must be aligned in order to close a transaction with these unfortunate facts.

5 Deal participants will further need to consider any potential unfavorable reaction by the SEC to public disclosure of the comment letter prior to its resolution.

6 In "Negative Assurance in Securities Offerings (2008 Revision)" prepared by the Report of the Subcommittee on Securities Law Opinions, Committee on Federal Regulation of Securities, ABA Section of Business Laws, footnote 50.

SEC Provides Temporary Relief: Dark Issuers and 15c2-11

As noted in the October 2022 issue of *Baseload*, the SEC adopted amendments to Rule 15c2-11 (Rule), originally known as the "Penny Stock Quote Rule," which governs the publication or submission of quotations by broker-dealers in a quotation medium other than a national securities exchange.[1] Historically, the Rule applied to the over-the-counter (OTC) equity markets, where holders of securities traded in such market are primarily retail investors, and broker-dealers were required under the rule to review key, basic information about the security.[2] Broadly, the amended Rule added public availability requirements for issuer information. As a result, broker-dealers are effectively prohibited from publishing quotations for an issuer's security when current issuer information is not publicly available.

Through two no-action letters issued in September and December of 2021,[3] the SEC clarified that the Rule applies to other types of OTC securities, including fixed income securities, and specifically identified debt securities issued for resale under Rule 144A as being subject to the Rule. The 2021 no-action letters concerned market participants about many issues, including the January 4, 2023 expiration of relief with respect to debt securities issued pursuant to Rule 144A. In response to input from many capital markets professionals, the SEC issued a third no-action letter on November 30, 2022 (the November 2022 No-Action Letter),[4] which withdrew the compliance timeline established in the prior December 2021 no-action letter. The November 2022 No-Action Letter provides temporary relief expiring January 4, 2025 for market participants to comply with the amended Rule.

The November 2022 No-Action Letter was issued in response to what the SEC described as "indications from industry representatives that they need additional time to complete the operational and systems changes necessary comply with the [Rule]."[5] As a result of such letter, the SEC will not recommend enforcement action for broker-dealers that publish or submit quotations in a quotation medium for fixed income securities if the broker-dealer has determined that the fixed income security or issuer meets certain criteria or there is current and publicly available financial information about the issuer (e.g., (1) has a class of securities listed on a national securities exchange or (2) is subject to the reporting requirements of the 1934 Act and current in such reports). This updated relief will expire on January 4, 2025.

Absent becoming a voluntary filer, following the January 4, 2025 expiration, dark company issuers wishing to continue to access the 144A market to issue fixed income securities (without increased cost as a result of the lack of price quotation on such securities) can consider publishing financial statements to their website to be publicly accessible, including to broker-dealers. Such financial statements would mirror those already prepared and provided to investors or made available at the request of investors pursuant to Rule 144A.

1 Release No. 33-10842; 34-89891; File No. S7-14-19, 17 C.F.R. Parts 230 and 240, The Securities and Exchange Commission, September 16, 2020, available at https://www.sec.gov/rules/final/2020/33-10842.pdf.

2 SIFMA, The Detriment of Rule 15c2-11's Application to Fixed Income Markets (Sep. 12, 2022), *available at* https://www.sifma.org/resources/news/the-detriment-of-rule-15c2-11s-application-to-fixed-income-markets-the-consequences-of-unilateral-rulemaking-without-public-comment/.

3 Securities and Exchange Commission, Letter to Financial Industry Regulatory Authority, Inc., dated September 24, 2021, "Re: Amended Rule 15c2-11 in Relation to Fixed Income Securities," available at https://www.sec.gov/files/rule-15c2-11-fixed-income-securities-092421.pdf and Securities and Exchange Commission, Letter to Financial Industry Regulatory Authority, Inc., dated December 16, 2021, "Re: Amended Rule 15c2-11 in Relation to Fixed Income Securities," available at https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-121621.pdf.

4 Securities and Exchange Commission, Letter to Financial Industry Regulatory Authority, Inc., dated November 30, 2022, "Re: Amended Rule 15c2-11 in Relation to Fixed Income Securities," available at https://www.sec.gov/files/fixed-income-rule-15c2-11-nal-finra-113022.pdf

5 *Id.*

Specifically, Rule 144A(d)(4) requires at the time of resale, a brief statement about the nature of the business of the issuer and "the issuer's most recent balance sheet and [income statements and statements of stockholders' equity], and similar financial statements for such part of the two preceding fiscal years as the issuer has been in operation (the financial statements should be audited to the extent reasonably available)." Financial information is presumed to be "reasonably current" at the time of resale:

- If the balance sheet is of a date less than 16 months before such sale
- If the income statements and statements of stockholders' equity are for the 12 months preceding the date of the balance sheet
- If the balance sheet is dated six months or more before such sale, then interim income statements and statements of stockholders' equity from the date of the balance sheet to a date within six months of the sale will need to be provided

"Publicly available" under the Rule means, among other things, information available on the website of a state or federal agency, an issuer or through an electronic delivery information system that is generally available to the public (not restricted by user name, password, fees or other restraints). Further, absent contradictory guidance (and such guidance would impact the Rule 144A(d)(4) information requirements), such financial statements are generally not required to be audited, however, a lack of audited financial statements would require a broker-dealer "to review unaudited financial statements more closely."[6]

Dark company issuers with existing 144A securities and/or looking to access the 144A markets will still ultimately need to consider the additional costs and risks of making publicly available such information and, if unable or unwilling to make publicly available such information, the potential impacts on trading of their existing 144A securities.[7] While the SEC's November 2022 No-Action Letter is a welcome relief to many, 2025 is right around the corner.

6 Financial Industry Regulatory Authority, Inc., Notice to Members 92-50, Procedures Regarding Securities and Exchange Commission Rule 15c2-11 and Schedule H, Section 4 of the NASD® By-Laws, available at https://www.finra.org/rules-guidance/notices/92-50.

7 See, Healthy Markets Organization, Letter to SEC (Aug. 30, 2022), available at https://healthymarkets.org/wp-content/uploads/2022/08/HMA-ltr-to-SEC-re-15c2-11-8-30-22-2.pdf ("Particularly, the broker-dealers looking to assist investors in trading these securities may widen their spreads, because they may have a less liquid market in trading between brokers.").

Corporate Transactions Partner J.A. Glaccum Joins Houston Office

Prominent corporate transactions attorney **J.A. Glaccum** has joined Hunton Andrews Kurth LLP as a partner in the firm's Houston office.

Glaccum focuses his practice on mergers and acquisitions, divestitures and private equity transactions. In addition to representing companies across a broad range of industries, Glaccum has significant experience in the renewables, power and utilities spaces, including electric utilities, diversified energy companies, nuclear energy companies, independent power producers, fund sponsors and investors.

Glaccum regularly advises public and private companies, private equity firms, infrastructure firms, investment banks and special committees in significant domestic and cross-border transactions, including public and private mergers, leveraged buyouts, spin-offs, reverse Morris Trust transactions, proxy contests, stockholder activism, strategic investments and joint ventures.

He also has a broad corporate practice, with a concentration on securities, corporate finance and governance matters. He has represented clients in public and private capital market transactions, including debt and equity offerings, private equity/sponsor investments and fund formations.

Glaccum earned his law degree from Georgetown University Law Center and is licensed to practice in Texas, Washington, DC and New York. He earned his undergraduate degree from Virginia Military Institute. Prior to attending law school, Glaccum served as a field artillery officer in the United States Army in Korea and in the 82nd Airborne Division.

BASELOAD is prepared from time to time to provide general information about selected power and utilities capital markets developments and issues for attorneys at Hunton Andrews Kurth LLP, and is provided to clients and friends of Hunton Andrews Kurth LLP. It is not intended to provide legal advice or legal opinions and must not be relied on as such. If you have questions related to any of the articles in this issue, please contact any of the below members of the Power and Utilities Capital Markets group at Hunton Andrews Kurth LLP:

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