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## Electronic Road Shows - What to Leave In, What to Leave Out

Some deals in the power and energy capital markets sell easily and quickly. Others need more help. Pre-recorded electronic road show presentations are often used to enhance marketing efforts. Follow-on equity offerings, offerings by issuers faced with unique circumstances and offerings by infrequent issuers will, for example, typically utilize an electronic road show.

In our experience, there is often a lack of consensus among the deal team about the proper contents of the road show slides. Non lawyers view the electronic road show slides as a marketing document, not strictly subject to the Securities and Exchange Commission’s (“SEC”) content rules. Most lawyers will acknowledge the marketing focus of the document, but oftentimes different counsel employ different standards of proper disclosure. The diverging views on the content and treatment of road shows can lead to confusion and frustration. We thought it would be helpful to review the basic legal framework surrounding the use

of an electronic road show and offer some thoughts about what should and what should not be included.<sup>1</sup>

**Basics**

**What It Is**

SEC rules (Rule 433) define a road show as an offer that contains a presentation made by one or more members of the issuer’s management, which includes a discussion of the issuer, the management or the securities being offered. Electronic road shows typically use a PowerPoint format to provide a generic description of the issuer and its financial results, with descriptions of strategy, management and the subject securities also included. As discussed herein, the road show slides will often also contain much more granular statistical information than that contained in the issuer’s 10-K’s and 10-Q’s.

<sup>1</sup> This article covers pre-recorded deal and non-deal road shows in registered and 144A offerings and (for the most part) does not cover issues related to live, in-person road shows or road shows conducted in connection with an IPO.

## Whether to File

Under the 2005 securities offering reform rules, a pre-recorded electronic road show prepared after the registration statement is filed is a permitted free writing prospectus, an “FWP,” subject to certain SEC legending and other requirements.<sup>2</sup> Despite being an FWP<sup>3</sup>, however, a pre-recorded electronic road show (outside of the context of IPOs of common or convertible equity) normally does not need to be filed with the SEC.<sup>4</sup>

## Who Steps Up to the Plate?

A critical initial issue for the deal team is the extent to which the various members of the working group agree to take responsibility for the information contained in the electronic road show slides.

## Issuers

The underwriting agreement contains representations from the issuer to the underwriters or initial purchasers. In these “reps,” issuers routinely cover the information that is contained in the road show slides, with the road show deemed an “issuer free writing prospectus” (defined in Rule 433 as a road show prepared by or on behalf of the issuer).<sup>5</sup> The underwriting agreement will also contain an indemnity section whereby the issuer indemnifies the underwriter for damages related to certain material misstatements or omissions in the offering documents. It is market norm for this indemnity to cover, among other things, any issuer free writing prospectus. The road show slides prepared by the issuer and the deal team are typically specifically identified in the underwriting agreement as falling within this category.

## Lawyers

At closing, counsel will be asked to provide a negative assurance statement (a “10b-5 opinion”) that the disclosure package did not contain any material misstatements or omissions. However, it is very unusual for the attorneys, whether issuer’s (internal or external) or underwriters’ counsel, to cover the road show slides in the lawyers’ 10b-5 opinions delivered at closing.

## Accountants

Similar to the attorneys’ practice with 10b-5 opinions, accountants typically do not provide tick mark comfort on road show financial information. Applicable accounting guidance and the internal guidelines of many accounting firms limit the documents that they will cover in a comfort letter. That said, the point can be a negotiated one. For example, some road show tick mark review is typical in utility legislative or rate reduction bond transactions.

## How Much Is Too Much?

The “old school” rule about road shows cautioned that the only information that could appear in road show slides was information that “was within the four corners of the prospectus.” Prior to the 2005 securities offering reform, the “four corners” typically included the prospectus and the incorporated documents. The rationale for the rule was two-fold. First, because not all investors are privy to the road show, there ought not be any information in the road show that is not also contained in the prospectus (or the incorporated documents). Second, and more importantly, any **material** information that appeared in the road show slides must be included in the prospectus (or the incorporated documents).

Today, most seasoned securities lawyers take a more nuanced view of proper disclosure in road show slides when it comes to information that is not material (especially if it can be derived from public information). But the underlying legal liability principle is still valid. Namely, issuers must not include **material** information in the road show slides that does not appear in the disclosure package available to investors at the time of their investment decision.

Accordingly, an initial task for the deal team (which usually falls to the lawyers) is to confirm whether the material information contained in the draft road show deck is information that is consistent with and currently contained in the disclosure package then being utilized for the transaction. The lawyers’ 10b-5 opinion delivered at closing will, among other things, include their belief that the disclosure package<sup>6</sup> at pricing does not omit any material fact necessary to be included therein.<sup>7</sup> Therefore, information included in the road show slides that is not contained in the disclosure package must be evaluated, first, for materiality and the need to include it in the disclosure package and, second, for consistency of content and presentation with the disclosure package. Deal participants need to be mindful of the prohibition in Rule 433 on information in an FWP, the road show in this case, which conflicts with information in the disclosure package.

<sup>2</sup> A electronic road show that constitutes an FWP should include the legend described in Rule 433 indicating that the issuer has filed a registration statement, that the prospectus for the offering is available on the SEC’s website and that the prospectus can be requested from the issuer or any underwriter or dealer by calling a toll-free number. Regardless of whether the offering is registered, the road show slides should also include a standard list of forward looking statement factors, consistent with an issuer’s 1934 Act reports.

<sup>3</sup> Certain road shows transmitted live, however, are considered “oral communications” under Rule 405 and therefore are not FWPs. Note that for a 144A offering, an electronic road show does not need to follow the distinction between written and oral communications. Section 5 of the 1933 Act does not apply to properly structured private offerings.

<sup>4</sup> See Rule 433(d)(8).

<sup>5</sup> This representation often states that at the “applicable time,” the disclosure package *together with any issuer free writing prospectuses, including electronic road shows*, taken as a whole, does not contain any material misstatements or omissions.

<sup>6</sup> For a typical securities offering, the disclosure package is made up of the preliminary prospectus (including incorporated information) and, in many instances, a term sheet containing the pricing information.

<sup>7</sup> The specific language of Section 12(a)(2) reads, “...an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading...”

If information is not material (especially if it can be derived from public information), most lawyers get comfortable that it may be included in the road show, despite not being contained in the disclosure package. Such information is desirable because it can be used to provide color and context for an issuer. Even if the working group concludes that certain road show information does not need to be in the disclosure package, the information needs to be correct. To the extent there is information in the electronic road show that cannot be verified independently, the underwriters or their counsel may require backup material from the issuer to verify its accuracy and, in so doing, satisfy its legal obligation to perform reasonable due diligence.

It's also important to note, as discussed above, that information in the electronic road show that is not included in the offering document is likely not covered by either the attorneys' 10b-5 opinion to the underwriters or the accountants' comfort letter to the underwriters. Finally, even if information is soft information and arguably not material, most lawyers will evaluate it for puffing issues that could come back to haunt deal participants in a dispute.

### **Guidance**

For equity offerings, the question often arises as to whether earnings guidance should be included in the road show slides. Many utilities and their underwriters choose not to include guidance in equity offering documentation, including within any electronic road show deck. Many prefer to exclude guidance from securities offering materials because of the predictive nature of guidance and risk of liability if earnings prove to be different from the guided amounts. In lieu of including it in the offering materials, many issuers provide guidance through press releases at regularly scheduled intervals (usually the quarterly "earnings releases") or investor slides in connection with industry conferences or non-deal road shows (discussed below). These press releases and investor slides are typically "furnished" and not "filed" with the SEC and, as a result, are not incorporated by reference into securities offering documentation. By excluding guidance from the offering documents, liability surrounding the guidance should be limited to claims under Rule 10b-5. Certain issuers and underwriters will, alternatively, accept the risks of including guidance in the road show slides and underwriters will need to perform the required diligence to verify its accuracy. For a more detailed discussion of guidance considerations in connection with an equity offering, see "Offering Guidance: What to Consider Before Your Next Equity Offering" in the January 2013 issue of *Baseload*.

### **The Deal With Non-Deal Road Shows**

Some issuers conduct non-deal road shows with the investment community. These road shows are designed to update or raise the issuer's profile with the investment community, outside the context of a securities offering. Being outside the offering process provides greater flexibility in the content that can be included. To have this flexibility, care must be taken that any such presentation is not deemed part of a subsequent offering.

The Rule 168 safe harbor under the 1933 Act permits, under certain circumstances, an issuer to conduct a non-deal road show with confidence that the presentation will not be deemed an "offer" under the securities laws. To meet the Rule 168 standard, the issuer must be required to file, and be in compliance with the filing of, its 1934 Act reports and the "timing, manner and form" of the non-deal road show must be consistent with similar past presentations.<sup>8</sup> The availability of Rule 168 is a fact-sensitive analysis and the consistency of the presentation as to timing, manner and form with prior practice must be reviewed with all counsel representing principals in the offering.

Certain non-deal road shows, however, occur without the benefit of Rule 168 and with the possibility, subject to market conditions, of launching a transaction in the near future. Assuming Rule 168 is not available, if a deal is launched on the heels of a non-deal road show, it is possible that the non-deal road show could be construed as an offer of securities (even though the slides make no reference to the upcoming offering).

A non-deal road show done in proximity to a securities offering may constitute a written offer, with the slides deemed an FWP or a prospectus.<sup>9</sup> To avoid this result, counsel should explore the availability of the Rule 168 safe harbor or, alternatively, include the Rule 433 legend<sup>10</sup> and agree that, given the proximity of the non-deal road show to a potential offering, the road show could be deemed an offering of securities.<sup>11</sup> Note that Section 2(a)(3) of the 1933 Act defines the term "offer" expansively to include "every attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value." The SEC has gone on record to state that any publicity that may "contribute to conditioning the public mind or arousing public interest" in an offering can itself constitute an offer.<sup>12</sup>

<sup>8</sup> The issuer would still need to mind anti-fraud considerations. See also Rules 163 and 163A for certain communications made prior to the filing of a registration statement.

<sup>9</sup> If this offer occurs prior to the filing of a registration statement, for any issuer other than a "WKSIs," it would represent an illegal offer under Section 5(c) of the 1933 Act.

<sup>10</sup> See Rule 164 under the 1933 Act which, for certain "eligible issuers," provides cure provisions for the failure to file and failure to include proper legends in an FWP.

<sup>11</sup> Note also that there are additional prospectus delivery requirements in connection with the use of an FWP for issuers that are neither WKSIs nor "seasoned issuers" under the 1933 Act.

<sup>12</sup> See Publication of Information Prior to or After the Effective Date of a Registration Statement, Release No. 33-3844 (October 8, 1957).

To the extent there is concern that the information in the non-deal road show may be considered an offer of securities, the underwriters will likely request a specific representation and indemnity for the information contained therein. Further, the underwriters will seek to ensure that the information contained in the non-deal road show is identical to what will be contained in the deal road show (other than, of course, the slide for the actual terms of the offering) if any, and meet the other standards we have discussed. As long as a deal road show is prepared and is identical to the information in the non-deal road show, the representation and indemnity with respect to the deal road show in the underwriting agreement will provide some comfort as to the information in the non-deal road show. If no deal road show is prepared, as long as the information in the non-deal road show is the information which is ultimately included in the disclosure package for the offering, the information in the non-deal road show will be effectively covered not only by the representations and indemnity by the issuer, but also by the opinions and the accountants' comfort on the disclosure package.

## Principal Legal Framework

### Section 11

For a registered offering, Section 11 of the 1933 Act imposes liability when a registration statement contains a material misstatement or omission.<sup>13</sup> Even though an electronic road show will be considered an FWP, FWPs are not considered part of the registration statement. Even under the unusual circumstance where the issuer opts to, or is required to, file the electronic road show as an FWP, it nonetheless will not be part of the registration statement. Therefore, the electronic road show should not be subject to Section 11 liability. This is an important distinction, as Section 11 imposes strict liability for any material misstatement or omission in the registration statement upon, among others, the issuer, its directors and the underwriters for the offering.

### Section 12(a)(2)

For a registered offering, road shows that are offers of securities are, however, subject to liability under Section 12(a)(2) of the 1933 Act. Section 12(a)(2) provides the buyer of a security with a remedy for material misstatements or omissions<sup>14</sup> made by anyone who offers or sells the security by means of a prospectus (including an FWP) or an oral communication.

### Rule 10b-5

Rule 10b-5 under the 1934 Act deems it unlawful to employ any scheme or device to defraud, to make any material misstatements or omissions<sup>15</sup> or to engage in any acts or

practices that would operate as a fraud or deceit on any person in connection with the purchase or sale of a security. In order to establish a claim under Rule 10b-5, an investor must prove that (1) there was a material misstatement or omission, (2) it was in connection with the purchase or sale of a security and (3) there was "scienter" — defined as the intent or knowledge of manipulation or deception. What is clear is that statements included in, or omitted from, an electronic road show can give rise to liability under Rule 10b-5. Because of the "scienter" requirement, however, a plaintiff's case under Rule 10b-5 is likely more difficult than under Section 12 and certainly more difficult than under Section 11.

### Regulation FD

Regulation FD addresses the selective disclosure of information by issuers.<sup>16</sup> Regulation FD provides that when an issuer discloses material non-public information to certain individuals or entities — generally, securities market professionals, such as stock analysts, or holders of the issuer's securities who may well trade on the basis of the information — the issuer must make public disclosure of that information. There is an exception for information disclosed "in connection with a securities offering registered under the Securities Act." Therefore, while most electronic road shows used in primary registered offerings are not subject to the restrictions of Regulation FD, other road shows are. As such, for electronic road shows conducted before the registration statement is filed, secondary offerings, unregistered offerings or non-deal road shows, the working group will need to confirm that the electronic road show does not contain any material non-public information. Even in the case of a registered offering, issuers may prefer not to avail themselves of the Regulation FD exclusion for registered offerings and first make public any material non-public information to be contained in the electronic road show (or other offering documents).

### Conclusion

The rules and practicalities involved with road shows are complicated. Changes in law and evolving "market norm" practice have added more complexity to the analysis of the proper content and treatment of road show disclosure. Although the marketing benefits of a well-versed road show cannot be denied, deal participants must be mindful that the contents of road shows — both deal and non-deal — are subject to securities laws that, if violated, could cause drastic consequences.

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omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading..."

<sup>13</sup> The specific language of Section 11 reads, "...an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading..."

<sup>14</sup> The specific language of Section 12(a)(2) reads, "...an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading..."

<sup>15</sup> The specific language of Rule 10b-5 reads, "...any untrue statement of a material fact or to

<sup>16</sup> An "issuer" is defined in Regulation FD as one that has a class of securities registered under Section 12 of the 1934 Act or is required to file reports under Section 15(d) of the 1934 Act, subject to certain exceptions.

Note that the definition of "registrant" in Regulation G is very similar to "issuer" in Regulation FD — therefore, pursuant to Regulation G, if the issuer meets such "registrant" definition and is providing any non-GAAP financial measures in the electronic road show, the most comparable GAAP measure and a reconciliation will need to be provided in the road show.

# The Latest in Utility Securitization: 2013 Update

2013 was another interesting year for utility legislative securitizations. The evolution of the financing technique continued as the costs securitized and proposed to be securitized, and the structures of the transactions, included variations from precedent. In contrast to the traditional use of securitization for stranded costs of deregulation and storm recovery costs, in West Virginia and Ohio, new statutes with enlarged categories of costs eligible for securitization were utilized. Special securitization legislation supported the refinancing by the Long Island Power Authority of a substantial portion of its debt capital. Innovative new legislation was passed in Hawaii supporting the issuance of securitization bonds by a governmental entity to fund loans for distributed solar generation. Also, new legislation in Mississippi targeted use of securitization for certain costs of coal gasification and clean coal technology. In the regulatory area, proposed risk retention regulations applicable to asset backed securities were revised to include an exemption for utility legislative securitizations, in recognition of the strength of the structural support and other characteristics of this asset class. These developments are discussed below.

## The Basics

Utility legislative securitizations are the financing of a defined class of costs on an off-credit (to the utility) basis, through the issuance of bonds which are paid by a charge imposed on the utility's retail customers. The entitlement to customer payments in support of the bonds is pursuant to state-specific legislation, which typically includes certain common elements:

- a defined class of costs which may be financed through the bond issuance;
- authorization for the public service commission to identify and quantify the costs and authorize the issuance of the bonds in an irrevocable financing order;
- the imposition through the financing order of a separate non-bypassable charge on the utility's and its successor's customers in amounts necessary to service the bonds;
- a process by which the charges to customers are revised or 'trued-up' to ensure that customer payments are adequate to pay the bonds on a timely basis; and
- a legislative 'pledge' by the state to take no action which would interfere with this process and the payment of the bonds.

In the standard case, the rights established in the financing order are granted to the utility, which sells the rights to a bankruptcy remote special purpose subsidiary which issues the bonds. The net effect of this structure is triple A ratings for the bonds, with lower financing costs than traditional rate base

financing by the utility. The resulting bonds have survived the vicissitudes of utility bankruptcies and recessionary market turmoil.

Enabling legislation generally following this model has been passed in over twenty states and transactions meeting this general description are approaching \$50 billion. The structure was developed in the context of the deregulation of the public utility sector in a number of states, in order to help the utilities finance costs stranded by deregulation. It has since been used in a number of other circumstances, including to help utilities finance the costs of replacing storm damaged assets and for environmental and other investment costs.

## The Ohio And West Virginia Legislation And Transactions

In the spring of 2012, new securitization statutes went into effect in Ohio and West Virginia. There have been three transactions using the new laws: two in the summer of 2013 in Ohio and one in West Virginia in the fall. These statutes are structurally consistent with other utility legislative securitization statutes. Both statutes permit the use of securitization to refinance new categories of specified costs for which recovery from customers by the utilities was previously deferred through capitalization as a regulatory asset. As most, if not all public utilities have such regulatory assets, the transactions may prompt the broadened use of utility legislative securitization from its 'stranded assets' and 'transition costs' roots.

The Ohio securitization law, Section 4928.23 through Section 4928.2318 of the Revised Code of the State of Ohio, (the "[Ohio Securitization Law](#)") permits electric utilities to securitize uncollected 'phase-in costs'. Phase-in costs are defined as costs, including any carrying charges, that were previously authorized by the Public Utilities Commission of Ohio ("PUCO") to be securitized or deferred as regulatory assets. According to a 2011 report prepared by the Ohio Legislative Service Commission, these costs include, among others, costs for fuel, purchased power, compliance with federal emission standards and state renewable-energy benchmarks, economic development and energy efficiency programs.

In June 2013, FirstEnergy Ohio PIRB Special Purpose Trust 2013 issued \$444,922,000 of Pass-Through Trust Certificates representing fractional undivided beneficial interests in phase-in-recovery bonds issued by subsidiaries of Cleveland Electric Illuminating Company, Ohio Edison Company and Toledo Edison Company, all subsidiaries of FirstEnergy Corporation. There were two general categories

of costs recovered as a result of this transaction: deferred fuel costs and deferred purchased power costs. In August 2013, Ohio Phase-In-Recovery Funding LLC issued \$267,408,000 of phase-in-recovery bonds. The transaction replaced a Deferred Asset Recovery Rider under which the sponsor, the Ohio Power Company (“OPCo”) subsidiary of American Electric Power Company, recovered previously deferred distribution costs incurred for consumer education, customer choice implementation, transition plan filing, OPCo’s rate stabilization plan rate cases, distribution line extension charges, certain transfer integration costs, OPCo’s voluntary green power pricing programs and storm costs related to Hurricane Ike. While OPCo had some recovery for traditionally recoverable costs such as transition and storm costs, the majority of the costs recovered by the two Ohio transactions were for general categories of regulatory assets.

The West Virginia legislation, W.Va. Code Section 24-2-4f, as amended, (the “WV Recovery Act”) is the second utility securitization law enacted in West Virginia. The state’s initial utility securitization statute, passed in 2007, permits recovery of environmental control costs. The WV Recovery Act permits a public utility to recover expanded net energy costs (“ENEC”). These costs include historical and projected costs, inclusive of carrying charges of under-recovery balances, adjudicated pursuant to the expanded net energy cost proceedings and authorized for recovery by an order of the Public Service Commission of West Virginia (“WVPSC”).

Appalachian Power Company (“APCo”), a subsidiary of American Electric Power Company, was the sponsor for the November 2013 issuance by Appalachian Consumer Rate Relief Funding LLC of \$380,300,000 of consumer rate relief bonds. The transaction permitted recovery of a portion of APCo’s under-recovered ENEC, principally costs relating to deferred bonus coal payments. The amount to be recovered was established pursuant to a joint stipulation and agreement that was approved by the WVPSC in the summer of 2012.

### **Utility Legislative Securitization Adapted For Long Island Power Authority Refinancing**

In December 2013, utility legislative securitization was used to alleviate debt costs of Long Island’s utility when Utility Debt Securitization Authority (the “UDSA”) issued \$2.085 billion of Restructuring Bonds Series 2013 T (Federally Taxable) and Series 2013 TE (Federally Tax Exempt). The enabling New York legislation, passed in June 2013 and referred to as the LIPA Reform Act (Chapter 173, Laws of New York), was designed to make utility legislative securitization available to the Long Island Power Authority

(“Long Island Authority”), a political subdivision of the state of New York, and its subsidiary, the Long Island Lighting Company (“Lighting”). Lighting, which provides distribution and transmission utility service to the eastern portion of Long Island, New York, retains a heavy debt burden stemming from an investment in the Shoreham nuclear generating station, which never went into service. The Restructuring Bonds proceeds were used to refinance a significant portion of this debt.

The LIPA Reform Act created UDSA as a special purpose political subdivision of New York to issue the bonds. The Act structured entitlements and actions consistent with the utility legislative securitization model. Under the LIPA Reform Act, the Long Island Authority itself is authorized to adopt an irrevocable financing order approving the issuance of the Restructuring Bonds by UDSA, with a further approval by the New York Public Authorities Control Board. Pursuant to the LIPA Reform Act, the financing order issued by the Long Island Authority contained a true-up adjustment mechanism and the various other key elements of the utility legislative securitization structure.

### **Legislation In Hawaii Modifies The Use Of Utility Legislative Securitization**

In June 2013, Hawaii passed legislation for a ‘Green Market Securitization Program’ (“GEMS”) (Chapter 269, Hawaii Revised Statutes), which provides for the on-bill financing of ratepayers’ investment in clean energy technology infrastructure, such as solar panels. The GEMS structure differs from the utility securitization model in a number of ways. In contrast to the prior uses of the structure, the proceeds of the GEMS bonds are not directly or indirectly provided to the utility, but rather they are loaned to customers of the utility. The GEMS bonds are to be issued by a governmental entity and the proceeds deposited in a special fund for the loans, which fund is to be repaid through charges on the bills of customers obtaining the loans. Separately, the GEMS bonds are to be paid through the imposition of a ‘utility-wide non-bypassable surcharge’. In contrast to prior transactions, the charge and transaction are not necessarily utility specific, with the four electric utilities serving the islands imposing a common charge.

No transaction has occurred yet under the GEMS statute and the details of the structure have yet to be worked through or otherwise made explicit. In general, the GEMS bonds are to be issued by the State, acting through the Department of Business, Economic Development, and Tourism. The Department will apply to the public utilities commission for an irrevocable financing order, which would contain

the essential elements of a utility legislative securitization. These elements include a fee or charge to the utilities' customers, effective upon issuance of the bonds, a formulaic adjustment mechanism for the timely payment of the bonds and financing costs, a methodology for allocating the fee among utilities and customer classes, and non-bypassability provisions. Utilities, which are to serve as billing and collection agents, will be parties to the proceedings for the financing order.

### **Mississippi Legislation Enables Securitization Of Prudent Cost Overruns Of Innovative Power Plant**

In February 2013, Mississippi adopted The Mississippi Public Utility Rate Mitigation and Protection Act, House Bill 1134 (the "Mississippi Securitization Law"). The Mississippi Securitization Law makes utility legislative securitization available to finance construction and related costs incurred or expected to be incurred in connection with certain newly constructed base load electric generating facilities that use coal gasification or clean coal technology. The Mississippi Securitization Law limits the qualifying costs that can be recovered through securitization to those costs found to be prudent by the Mississippi Public Service Commission (the "MPSC") and that exceed the previously certified estimate of such costs, up to a maximum of one billion dollars.

The Mississippi Securitization Law was designed specifically to help finance the retail portion of a 582-MW integrated coal gasification combined cycle plant currently under construction in Kemper County, Mississippi (the "Kemper IGCC"). The Kemper IGCC is being built by Mississippi Power Company ("MPC"), a subsidiary of The Southern Company. MPC has announced its intention to use the Mississippi Securitization Law as its form of alternative financing for prudently-incurred Kemper IGCC costs not otherwise recovered in any MPSC rate proceeding. MPC is

expected to file its application for a financing order pursuant to the Mississippi Securitization Law after the Kemper IGCC is placed in service and following completion of the MPSC's final prudence review of costs.

### **Utility Legislative Securitization Exempted From Proposed Risk Retention Rules**

In August 2013, pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, six responsible federal agencies re-proposed rules which would require securitizers to retain not less than 5 percent of the credit risk of any asset being securitized (see Exchange Act Release No. 34-70277 (Aug. 28, 2013)). Consistent with comments filed by authors of this article, among others, the re-proposed rules exempt "certain public utility securitizations". These are defined as securities "...secured by the intangible property right to collect charges for the recovery of specified costs and such other assets, if any, of an issuing entity that is wholly owned, directly or indirectly by an investor owned utility company that is subject to the regulatory authority of a State public utility commission or other appropriate State agency." 'Specified costs' are those identified for recovery by 'specified cost recovery legislation', defined in turn as legislation providing for a financing order pursuant to which the utility acquires an intangible right to impose non-bypassable charges on its transmission and distribution customers, and that contains guarantees that the State does not have the authority to rescind or amend the financing order or revise the costs or reduce or impair the property right, except pursuant to a true-up. Separately and of relevance to securitizations utilizing structures similar to the LIPA Reform Act transaction and the new Hawaii GEMS structure, an exemption is also proposed for asset backed securities issued or guaranteed by any State, or political subdivision or instrumentality thereof that is exempt from registration under the Securities Act of 1933 pursuant to section 3(a)(2) thereof.

# Unlisted Equity Securities: Issuers Beware

The quarterly dividend date for the issuer's preferred stock is approaching. The issuer wires the money for the dividend payment to DTC. But DTC notifies the issuer that DTC refuses to process the dividend payment to holders until the issuer complies with the appropriate FINRA notice requirements. How can this happen?

For most offerings, the FINRA rules and the possibility of a FINRA filing are the concern of the underwriters. FINRA oversees brokerage firms, not issuers. But Rule 10b-17 under the 1934 Act and the companion FINRA Rule 6490 require that issuers with unlisted equity securities notify FINRA of certain events related to those equity securities. Utilities that issue preferred stock or preference stock that is not listed on an exchange should become familiar with these rules given the broad definition of "equity securities."

Rule 10b-17 under the 1934 Act requires any issuer of a class of securities "publicly traded" to provide timely notice to FINRA of certain corporation actions (e.g., record dates of dividends or other distributions of cash or securities, stock splits, rights or subscription offerings).<sup>1</sup> For purposes of Rule 10b-17, the definition of "publicly traded" is construed broadly, including through broker-dealers in the over-the-counter market. The rule exempts securities for which notices are already given in accordance with procedures of a national exchange upon which such security is registered pursuant to Section 12 of the 1933 Act.

FINRA Rule 6490<sup>2</sup> codifies the requirements of Rule 10b-17 for issuers of a class of publicly traded over-the-counter securities<sup>3</sup> by requiring timely notice to FINRA of the corporate actions described above. Upon effectiveness of Rule 6490 in March 2011, issuers and other parties were required to begin using FINRA's new electronic filing system

to provide these notifications.<sup>4</sup> Generally, issuers must provide at least 10 days' notice prior to the record date for the corporate action.

In recognition of FINRA's lack of privity with issuers of over-the-counter securities, Rule 6490 allows FINRA, in its discretion, to announce a "Company-Related Action" when it is contacted by a third party, such as DTC. FINRA also has the authority under Rule 6490 to request information about "Company-Related Actions" from third parties (i.e., DTC). To the extent FINRA determines that an issuer has not complied with the applicable notice requirements, FINRA may request such third party (i.e., DTC) contact the issuer in question regarding the issuer's notice requirements under Rule 10b-17 and, in turn, instruct the issuer to contact FINRA directly to provide notice and complete the requisite form.

Until the issuer complies with the notice requirement of FINRA, FINRA has the ability to instruct DTC to delay processing a transaction (e.g., paying a dividend to equity holders) until FINRA has received the appropriate notice. Further, FINRA has a schedule of payments for the notifications. Timely notifications by an issuer require payment of \$200 to FINRA. Late notifications (after the corporate action date (e.g., record date)) are subject to a \$5,000 payment to FINRA. Finally, although FINRA has no authority to directly regulate issuers, FINRA may refer possible issuer violations of Rule 10b-17 to the SEC for review.

As a result of FINRA's activism in this area, practitioners and investment banks have of late become increasingly focused on Rule 10b-17 and FINRA Rule 6490 compliance. As such, all issuers with unlisted equity, either outstanding or to be issued, must be familiar with this new level of FINRA oversight.

<sup>1</sup> The text of Rule 10b-17 specifically exempts "ordinary interest payment(s) on a debt security" from the requirements of the rule. However, there is no similar exemption for the regular dividend payments on a preferred or preference security.

<sup>2</sup> Release No. 34-62434.

<sup>3</sup> FINRA does not require notices with respect to "Restricted Equity Securities," defined in Rule 6420 as any equity security that meets the definition of "restricted security" as contained in Rule 144(a)(3) under the 1933 Act.

<sup>4</sup> FINRA Rule 6622 requires that all over-the-counter transactions in "OTC Equity Securities" be reported by broker-dealers to FINRA, unless they fall within an express exception. Our understanding is that FINRA is sometimes alerted to Rule 6490 noncompliance when a FINRA broker-dealer member, pursuant to Rule 6622, reports an over-the-counter transaction and FINRA generates an over-the-counter trading symbol for the equity security. The generation of this over-the-counter trading symbol serves as evidence that the security is being traded.



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