HUNTON & WILLIAMS

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Current Topics in the Power and Energy Capital Markets

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Contents

Consolidation, Gas Assets and Canadian Acquisitions Drive Power and Energy Capital Markets

In the past several years, the Power and Energy Capital Markets group at Hunton & Williams has seen a pronounced increase in M&A activity in the electric utility industry. Three themes have been particularly notable of late:

(1) consolidation among utilities,

(2) the acquisition of gas assets by electric utilities; and

(3) the acquisition by Canadian utilities of U.S. companies.

All of this activity has led to a significant increase in mergers and acquisitions-related financing activity in the industry. Over the past 18 months, our capital markets group alone has been involved in approximately $30 billion worth of financings in order to fund these purchases. This note will briefly review these three trends, including the companies and particular types of financing of each.

Consolidation Among Electric Utilities

Slowing electricity demand is causing many utilities to look beyond their service territories for growth and operational efficiency through scale. M&A activity in the electric utility industry has been on a tear in recent years.

On May 29, 2016, Great Plains Energy Incorporated (Great Plains) and Westar Energy, Inc. (Westar) entered an agreement whereby Great Plains agreed to acquire Westar in a combined cash and stock transaction. The transaction is valued at $12.2 billion, including $8.6 billion in total stock and cash consideration to be received by Westar's shareholders and the assumption of $3.6 billion in Westar's debt. In October 2016, Great Plains issued 52.6 million shares of common stock and 15 million depositary shares to finance a portion of the cash consideration of the acquisition.

On June 23, 2014, Wisconsin Energy Corp. (WEC) and Integrys Energy Group, Inc. (Integrys) announced that they had entered into a definition agreement for WEC to acquire Integrys. The transaction was valued at $9.1 billion. In June 2015, WEC issued three series of notes with a total aggregate principal amount of $1.2 billion. The proceeds were used to fund the cash portion of the consideration for the merger. WEC also assumed the outstanding debt of Integrys.

Exelon Corporation (Exelon) and Pepco Holdings, Inc. (Pepco) announced on April 30, 2014 that they had entered into a definitive agreement to combine. In June 2014, Exelon sold over $2 billion of common stock pursuant to an equity forward. In the same month, Exelon sold $1.15 billion principal amount of equity units to fund the Pepco acquisition. Finally, in June 2015, Exelon sold $4.2 billion aggregate principal amount of notes, in five different series. Three of the series contained a Special Mandatory Redemption provision at 101% in the event that the merger was not consummated.[1] The two companies announced the completion of the merger on March 23, 2016. The announcement followed the approval of the merger by the Public Service Commission of the District of Columbia.

Utility Acquisitions of Gas Assets

In addition to utilities acquiring other utilities in order to achieve scale, we have also seen a number of transactions wherein utilities are acquiring gas assets (midstream and distribution assets rather than exploration and production). In many cases this is viewed as a diversification play in order to help offset waning electricity demand for an existing utility.

On September 26, 2016, DTE Energy Company (DTE) announced it had agreed to purchase $1.3 billion in midstream natural gas assets from M3 Midstream LLC and Vega Energy Partners, boosting its presence in the Appalachian basin. On October 5, 2016, DTE issued and sold 13,500,000 equity units, initially consisting of corporate units, for an aggregate stated amount of $675 million. Also on October 5, 2016, DTE issued and sold $400,000,000 aggregate principal amount of 3-year senior notes and $600,000,000 aggregate principal amount of 10-

[1] Exelon Corporation, Form 424(b)(2) (June 10, 2015), *available at* https://www.sec.gov/Archives/edgar/data/1109357/000119312515218993/d937171d424b2.htm.

year senior notes. Proceeds from the offerings were used for the purchase.

On April 20, 2016, a Consolidated Edison, Inc. (Con Edison) subsidiary entered into a contribution agreement pursuant to which it agreed to purchase, for $975 million (subject to closing adjustments), a 50 percent equity interest in a new entity, Stagecoach Gas Services LLC, to which a Crestwood Equity Partners LP (Crestwood) subsidiary agreed to contribute 100 percent of the equity interests in certain gas pipeline and storage companies. In May 2016, Consolidated Edison, Inc. sold 10,200,000 shares of common shares of Con Edison. Also in May 2016, Con Edison sold $500 million aggregate principal amount of debentures due 2021. Total proceeds from the two offerings totaled approximately $1.2 billion. Con Edison used a portion of the net proceeds to subsequently fund the purchase of the equity interest in the gas pipeline and storage joint venture.

On January 31, 2016, Dominion Resources Inc. (Dominion) and Questar Corporation (Questar) entered into an agreement whereby Dominion agreed to acquire Questar. Questar is a Rockies-based integrated natural gas company. On August 9, Dominion sold an aggregate principal amount of $1.3 billion of senior notes. On August 15, Dominion sold 25,000,000 equity units with total net proceeds of approximately $1.4 billion. In both cases, the transactions were used to fund a portion of the purchase price of the acquisition. Under the terms of the merger agreement, as of market close on September 16, 2016, each Questar share was canceled and Questar shareholders received $25.00 per share of common stock – or about $4.4 billion. Dominion also assumed approximately $1.5 billion of Questar's outstanding debt.

On October 26, 2015, Duke Energy Corporation (Duke) and Piedmont Natural Gas Company, Inc. (Piedmont) entered into an agreement whereby Duke agreed to acquire Piedmont for $4.9 billion in cash. Duke issued 9.25 million shares of common stock to finance a portion of the acquisition. On October 3, 2016, having received all necessary shareholder and regulatory approvals, Duke completed its acquisition of Piedmont. The transaction was valued at $6.7 billion.

The Southern Company (Southern) and AGL Resources Inc. (AGL) announced on August 24, 2015 that they had entered into an agreement to combine the two companies in an all-cash transaction. In May 2016, Southern sold 18,300,000 shares of common stock to underwriters at a price of $48.60 per share, resulting in $889,380,000 of proceeds to Southern. Also in May 2015, Southern issued $8.5 billion aggregate principal amount of senior notes to fund the acquisition. It is believed to be the largest utility bond offering in history. The offering consisted of seven different series, six of which contained both a "Special Mandatory Redemption" and "Special Optional Redemption" in the event that the merger was not consummated. At closing of the transaction on July 1, 2016, AGL became a wholly-owned subsidiary of Southern.

Also, on July 10, 2016, Southern announced a natural gas pipeline venture with Kinder Morgan, Inc. through Southern's acquisition of a 50% interest in Southern Natural Gas Company, L.L.C. (SNG). SNG owns a 7,600 mile pipeline system connecting natural gas supply basins in Texas, Louisiana, Mississippi, Alabama and the Gulf of Mexico to markets in Louisiana, Mississippi, Alabama, Florida, Georgia, South Carolina and Tennessee. In August 2016, Southern sold 32,500,000 shares of common stock at a price of $49.30 per share, which resulted in $1,602,250,000 of proceeds. On September 13, 2016, Southern Company Gas Capital Corporation, the finance subsidiary of

Southern Company Gas, closed on two series of senior notes with an aggregate principal amount of $900 million. A portion of the net proceeds of the senior notes was used to repay funds that Southern lent to Southern Company Gas in order to complete the acquisition.

Canadian Purchases

The purchase of American utilities by Canadian companies has occurred despite the weakening of the loonie. In January 2013, the currencies were evenly valued. Today, the Canadian dollar is valued at approximately $0.75 US. But even though the lower Canadian dollar makes these deals pricier for Canadian firms, they should get an earnings boost in the longer term when they convert the cash flows from their new U.S. subsidiaries into Canadian dollars.

On February 9, 2016, Fortis Inc. (Fortis) and ITC Holdings Corp. (ITC) entered into an agreement and plan of merger whereby Fortis agreed to acquire ITC. The acquisition was valued at approximately $11.3 billion, including approximately $6.9 billion in Fortis common shares and cash and the assumption of approximately $4.4 billion of ITC's debt. On September 29, 2016, Fortis announced that it had commenced an offering of two series of notes in a combined aggregate principal amount of US$2.0 billion in order to finance a portion of the cash consideration for the acquisition. The notes were only offered to qualified institutional buyers in the United States pursuant to Rule 144A under the U.S. Securities Act of 1933, as amended (Securities Act), and outside the United States pursuant to Regulation S under the Securities Act. The acquisition closed on October 14, 2016.

Also on February 9, 2016, Algonquin Power & Utilities Corp. (Algonquin) and Empire District Electric Co. (Empire) entered into a merger agreement whereby Algonquin will acquire Empire. Under the terms of the all-cash transaction, which is expected to close in the first quarter of 2017, Empire shareholders will be entitled to $34 per share, representing a 21% premium to the closing share price on February 8, 2016. On the date Algonquin announced the deal, it also announced the C$1 billion sale of convertible debentures pursuant to a bought deal. According to Algonquin's public filings, a future debt financing of approximately US $0.6 billion will also be required.

On September 4, 2015, Emera Inc. (Emera) and TECO Energy, Inc. (TECO) entered into an agreement whereby Emera agreed to acquire TECO. The all-cash transaction was valued at $10.4 billion. In order to finance the transaction, on June 16, 2016, Emera US Finance LP completed a private offering of $3.25 billion of senior notes. On the same day, Emera Incorporated completed a $1.25 billion offering of fixed-to-floating subordinated notes. The subordinated notes were sold pursuant to an F-10 registration statement under the Multijurisdictional Disclosure System (MJDS). MJDS allows eligible Canadian issuers to make a registered offering in the United States using a prospectus prepared and reviewed in Canada. On July 1, 2016, Emera completed the acquisition of all outstanding shares of TECO for approximately $6.5 billion.

Conclusion

Combined, these three themes have been drivers of a healthy pace for capital markets activity in the sector over the past several years. As for utility M&A generally, in a November 10 article in Energy Finance Daily,[2] Dan Testa reported that many executives at the Edison Electric Institute's financial conference this year did not believe that the recent level of utility M&A activity would continue. The price multiples of acquired utilities are certainly one factor. The federal and state level regulatory hurdles are another. Time will tell if the pace of consolidation is now truly on the decline, or if the current pace of consolidation will continue for the years to come.

[2] Dan Testa, *At EEI conference, utility CEOs take a more critical view of M&A*, Energy Finance Daily, Nov. 10, 2016.

Utilities See Japanese Demand for Reverse Inquiry Debt Financings

Over the past year, we have seen an increase in the number of Japanese institutional investors purchasing debt securities of U.S. utility companies in unregistered "reverse inquiry" transactions. Recent transactions included private offerings by three different utility issuers: a $300 million senior notes sale in August 2015, a $350 million senior notes sale in April 2016 and a $290 million sale of senior notes in September 2016.

In a debt reverse inquiry, a particular investor or small group of investors (or an investment bank acting on behalf of such investor or investors) reaches out to an issuer to express interest in purchasing a certain amount of the issuer's debt securities. Often, the investor is interested in a product similar to what the issuer has already sold in recent transactions, but prefers the flexibility of a reverse inquiry transaction rather than waiting until the issuer is in the market again. A reverse inquiry transaction offers flexibility to the investor in terms of overall timeline (including closing date), purchase price and offering terms. The advantages to the issuer are also significant. Assuming the transaction is done on an unregistered basis, an issuer does not have to prepare and file prospectus supplements or a free writing prospectus with the SEC, saves on filing costs with the SEC and could also save on the cost of obtaining letters from the rating agencies if not requested by the investor.

On these recent deals, the investor's purchase of the issuer's debt securities was effected on a private placement basis. They relied, at least in part, on Regulation S, which exempts offers and sales of securities that occur outside of the United States from the registration requirements of Section 5 of the Securities Act of 1933, as amended (Securities Act). All three transactions cited above relied initially on Regulation S for the sale to the United Kingdom bank acting as the initial purchaser and initial resale to the investor in Japan. The deals were also structured to permit sales to "Qualified Institutional Buyers" as defined in Rule 144A under the Securities Act.

The offering memorandums for the deals look very much like any other 144A/Regulation S transaction, with both a tax section and a section describing the transfer restrictions applicable to the debt. In these recent deals, the issuer was a “Category 2” issuer under Regulation S.[1] As such, the “distribution compliance period” under Regulation S was 40 days. The debt could not be offered or sold within the United States or to, or for the account or benefit of, U.S. persons as part of their distribution or otherwise until 40 days after the late of the date of the commencement of the offering and the date of the original issuance, except in accordance with Regulation S or Rule 144A or any other available exemption from registration.

In the utility deals in which we have participated, the sole foreign offering legend including in the Plan of Distribution is a Japanese legend. Also, given that a UK investment bank was acting as the initial purchaser of the securities, an EEA prospective directive legend is typically included on the cover of the offering memorandum.

The purchase agreement will also look very much like a typical 144A/Regulation S agreement. Similarly, the issuer’s covenant package does not vary greatly from a typical Rule 144A/Regulation S offering. Issuers will covenant to furnish to holders upon request the information required under Rule 144A(d)(4) of the Securities Act and refrain from soliciting any offer to buy or offer to sell the securities through general solicitation or a public offering (including any other security that could be integrated with the current transaction).

Given that the initial purchaser in each of the three deals mentioned above was a UK bank, the purchase agreement in each case also added a provision whereby the issuer acknowledged that the obligations of the initial purchaser were subject to the “bail-in powers” under Directive 2014/59/EU (the BRRD). The BRRD is part of a series of EU banking reforms made in response to the financial crisis and establishes a framework for the resolution of failing financial institutions. The BRRD gives regulators a range of tools to do this, including bail-in powers to write-down and/or convert into equity certain liabilities of failing institutions.

Typically, issuer’s and initial purchaser’s counsel will prepare a draft preliminary offering memorandum, term sheet and purchase agreement to be sent to the offshore purchaser for review in the days prior to pricing the deal. At the same time, the issuer’s accountants will prepare a comfort letter for delivery at pricing. Once the purchaser agrees on terms, including the spread from the benchmark treasury and the commission paid to the initial purchaser, the parties will agree on a date to price the transaction, where there will be a short pricing call to set the benchmark treasury yield. Counsel will finalize the term sheet, offering memorandum and purchase agreement that day and the initial purchaser and the issuer will execute the purchase agreement. Given the continued low, and often negative, yields in the Japanese market, we believe this financing trend will continue in the near future.

[1] Category 2 transactions include offerings of:

- Equity securities of a reporting foreign issuer;
- Debt securities of a reporting U.S. or foreign issuer; and
- Debt securities of a non-reporting foreign issuer.

Popularity of Green Bonds Continues

"Green bonds" are issued to raise funds for new and existing projects with "environmentally sustainable" benefits. Their market presence has continued in 2016. A record $41 billion in green bonds was raised in 2015, according to data compiled by Bloomberg.[1] HSBC Holdings Plc predicts $55 billion to $80 billion of green bonds will be issued around the world in 2016, an increase of 32 percent to 91 percent from 2015's level. The total outstanding amount will reach $133 billion to $158 billion by the end of 2016, according to the report.[2]

From the issuer's perspective, a green bond can both (i) result in the diversification of its investor base, and (ii) contribute to "green" investor relations and corporate responsibility initiatives. There are also incentives for buyers of the bonds. Although bonds are normally sold at similar prices to equivalent non-green bonds, they often trade more strongly in secondary markets as the market attracts 'buy-and-hold' investors.[3]

The green bond principles, the first set of principles for verifying the credentials of green bonds, were launched by the International Capital Markets Association (ICMA) in 2014. In June 2016, the ICMA published an updated edition of the green bond principles.[4] The green bond principles have four primary components: (1) Use of Proceeds, (2) Process for Project Evaluation and Selection, (3) Management of Proceeds and (4) Reporting.[5] As there is no standard definition of what constitutes a "green bond", the Use of Proceeds section of a typical green bond prospectus normally informs potential investors of the principal green aspects of the transaction. Typically the use of proceeds, reporting and any second party opinions do not form part of the terms and conditions of the green bond and do not create specific contractual obligations. However, they typically form part of the disclosure documents or are referred to in the disclosure documents. The green bond principles also detail certain types of potential third party review: (1) consultant review, (2) verification, (3) certification, and (4) rating.

In November 2015, Southern Power Company issued two series of notes for a total offering of $1 billion. The use of proceeds was the financing of, or investments in, solar and wind power generation facilities located in the United States.[6] In March 2016, Georgia Power Company issued $325 million of green bonds. The proceeds were to be used for investments in (a) solar power generation facilities located in the State of Georgia or elsewhere in the United States or (b) electric vehicle charging infrastructure located in the United States.[7] In

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1 Jessica Shankleman, *Green Bond Market Will Grow to $158 Billion in 2016, HSBC Says*, Wall St. J., Jan. 26, 2016.

2 *Id.*

3 Gavin Jackson, *Green bond market faces growing pains*, The Financial Times, June 8, 2016.

4 ICMA, Voluntary Process Guidelines for Issuing Green Bonds (June 16, 2016), *available at* http://www.icmagroup.org/Regulatory-Policy-and-Market-Practice/green-bonds/green-bond-principles/

5 *Id.*

6 Southern Power Company, Form 8-K (Nov. 12, 2015), *available at* https://www.sec.gov/Archives/edgar/data/1160661/000116066115000041/sopower2015c-d8k11x15.htm.

7 Georgia Power Company, Form 8-K (Mar. 2, 2016), *available at* https://www.sec.gov/Archives/edgar/data/41091/000004109116000033/ga8k2016a2016b.htm.

June 2016, Southern Power Company issued €1.1 billion of bonds. (See the July 2016 Baseload for "*Euro-Denominated Bonds: A Quick Guide for US Utility Issuers*") The proceeds, as with their 2015 offering, were to be used for investments in solar and wind generation.[8] Also in June 2016, Westar Energy Inc. sold $350 million of bonds, the proceeds of which were used to finance investments in wind energy.[9] In November 2016, Southern Power issued an additional $900 million of green bonds.[10]

All of these transactions employed the issuer's independent accountants to verify the use of proceeds as outlined in the offering document. However, in these utility green bond offerings, we have not seen examples of the other types of third party review outlined in the green bond principles: consultant review, certification against an external green assessment standard or rating by a qualified third party. In March 2016, Moody's Investors Service, Inc. (Moody's) published a new methodology for a green bonds assessment. This presumably conforms to the "rating" category of potential third party review discussed in the green bond principles. Moody's green bonds assessment (GBA), which ranges from GB1 for excellent to GB5 for poor, is designed to help investors determine if green bond proceeds are being used to achieve "positive environmental outcomes."[11] The Upper Mohawk Valley Regional Water Finance Authority received a green bond assessment of GB1 for $8.78 million of water system revenue bonds in August from Moody's – this was the first GBA the rating agency has issued in the U.S.[12] It remains to be seen whether separate "green" ratings, apart from credit ratings for the issuance, will become more common for utility green bonds.

[8] Southern Power Company, Form 8-K (June 13, 2016), available at https://www.sec.gov/Archives/edgar/data/1160661/000116066116000057/sopo8k2016ab.htm.

[9] Westar Energy, Inc., Form 424(b)(2) (June 13, 2016), *available at* https://www.sec.gov/Archives/edgar/data/54507/000119312516621993/d207455d424b2.htm.

[10] Southern Power Company, Form 8-K (Nov. 10, 2016) *available at* https://www.sec.gov/Archives/edgar/data/1160661/000116066116000079/sopo2016d-ef8xk.htm.

[11] Lynn Hume, *Moody's Issues First Muni Green Bond Assessment in U.S.*, The Bond Buyer, Aug. 10, 2016.

[12] *Id.*

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