

## Utility Mortgage Indentures: An Update

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Many investor-owned utilities in the United States rely upon a unique form of corporate financing—the open-ended mortgage indenture. Typically, these mortgage indentures create a lien on substantially all of the utility’s real property and equipment, which lien automatically spreads to after-acquired property of the same character. Many of these mortgage indentures were established in the 1920s, 1930s, or 1940s, and are still being used to issue new series of bonds to refinance maturing or redeemed bonds, to finance new construction or operations, or to secure other debt obligations.

Some of these older utility mortgage indentures contain covenants or other provisions that have become cumbersome or unduly restrictive over the years. Morgan Lewis’s Utility Finance Group has helped a number of utility clients amend, restate, or replace their mortgage indentures to change or remove these cumbersome or restrictive provisions. One commonly used method is for the utility to reserve the right to make certain amendments after particular series of bonds have been retired. Another method is for the utility to adopt a refunding or second mortgage indenture that eventually replaces the older mortgage indenture.

However, a better method is for the utility to adopt a modern collateral trust indenture that eventually replaces the older mortgage indenture and accelerates the amendment of the older mortgage indenture. Sometimes a utility will reserve the right to discharge the liens securing its new bonds when certain older bonds have been retired, sometimes referred to as a “fall away” or “fade away” indenture.

Over the last two decades, it has become more common for bond purchasers to demand, and utilities to grant, protection against redemptions for many years, if not for the life of the bonds. This protection has the effect of making it difficult for a utility to make amendments to its mortgage indenture, which are necessary to respond to changing market conditions or the business environment. Accordingly, utilities should think ahead and plan for the future every time they issue no-call or make-whole bonds with a distant maturity date.

The following questions might arise at such a time: Does the utility have the ability to issue bonds up to 70% of the value of its property, plant, and equipment under its mortgage indenture? Does the utility have the flexibility to release property from its mortgage indenture for separate financing (e.g., Department of Energy funding) or for restructuring its utility system (e.g., separation of generation or transmission from distribution)? Is the utility’s mortgage indenture flexible enough to permit desirable merger, securitization, spin-off, or joint venture transactions that may come up? Do other utility mortgage indentures provide greater flexibility, better covenants, or simpler procedures, without

affecting the credit rating on their bonds?

Even if an amendment or new mortgage indenture would not take effect for 20 to 30 years, the sooner that the utility reserves the right to make such amendment or adopts a new collateral trust indenture, the sooner the utility can enjoy the flexibility and other benefits of better covenants and provisions. Sometimes the time of effectiveness can be accelerated with a consent solicitation, an exit consent tender offer, market purchases, or the defeasance of selected series.

The Morgan Lewis Utility Finance Group has helped its utility clients issue bonds, release property, engage in mergers or other restructurings and comply with the covenants under their mortgage indentures (as well as complying with the requirements of the Trust Indenture Act and the federal securities laws) since the 1970s. Recently our team helped one of our utility clients adopt a new mortgage indenture in connection with a corporate restructuring and the successful issuance of \$650 million of bonds under this new mortgage indenture. We also recently helped another utility client replace its 1939 mortgage indenture with a modern collateral trust indenture, a process we started in 2003—two examples of what can be accomplished with a new mortgage indenture.

If you have any questions or would like more information on any of the topics discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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