



DECEMBER 2017

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Utility Holdcos See Foreign Demand for Singapore Exchange-Listed Sub Debt Financings

In 2017, the Power and Energy Capital Markets Group at Hunton & Williams advised on several financing transactions involving Chinese institutional investors purchasing subordinated debt securities of U.S. utility holding companies in unregistered “reverse inquiry” transactions with a condition to list the securities on the Singapore Exchange Securities Trading Limited (SGX).

As discussed in the November 2016 *Baseload* issue, we previously advised on several reverse inquiry transactions by Japanese institutional investors purchasing senior debt securities of U.S. utility companies through similar “reverse inquiry” transactions. In those transactions previously discussed, as well as those transactions that are the subject of this article, the offer of securities was effected under Regulation S and Rule 144A of the Securities Act of 1933, as amended.

The “reverse inquiry” transactions that are the subject of this article were further conditioned upon the successful listing of the

securities on the SGX. Listing on an exchange is often a prerequisite for foreign investors because of marketing and compliance reasons (certain financial institutions are prohibited by law from investing in unlisted securities). Additionally, the SGX offers a streamlined process to issuers for listing and ongoing reporting obligations.

Framework of the Transaction

The transaction is similar to a traditional unregistered debt offering via Rule 144A and Regulation S. The issuer engages investment banks who will act as initial purchasers of the offered debt securities. Often, the investment banks will engage their London broker-dealer affiliates, which are geographically closer to the target investor base, in order to execute the transaction. In order to list the securities on the SGX, the issuer will also need to engage a listing agent. The listing agent coordinates and advises the issuer on the listing of the securities on the SGX. The listing agent role is usually served by a local Singapore law firm.

U.S. legal counsels for the issuer and the initial purchasers prepare the purchase agreement, the offering memorandum and term sheet based on documents that are typically used for an unregistered offering. In addition, prior to the launch of the transaction, the listing agent assists the issuer in completing certain pre-approval in-principal (AIP) documents to be submitted to the SGX along with near final drafts of the offering memorandum and term sheet. These pre-AIP documents essentially serve as the issuer's listing application. The SGX reviews these documents (in our experience, within one or two business days) and will provide the issuer with confirmation of its approval in-principal.

Given the time difference between the U.S. and Singapore, pricing of the securities requires extra coordination. See the below chart for a typical timeline of the deal the day before pricing and on the pricing day (PD).

	U.S. Time	Singapore Time
Circulation of Preliminary Offering Memorandum and Draft Term Sheet ("launching" the transaction)	Evening of PD-1	Morning of PD
Pricing Call	6 A.M. of PD	6 P.M. of PD
Finalize Term Sheet	Immediately following the Pricing Call	Immediately following the Pricing Call
Execution of Purchase Agreement	Morning of PD	Evening of PD
Circulation of the Final Offering Memorandum	Afternoon of PD	Morning PD+1

Once the documents are finalized, the listing agent submits the finalized post-AIP documents and the final offering memorandum and term sheet with pricing terms to the SGX. Once the transaction settles through a traditional DTC Fast Automated Securities Transfer or "FAST" closing, the listing agent informs the SGX of the settlement.

Documentation

A typical offering memorandum for these transactions will look very much like any other 144A/Regulation S transaction, with a United States tax section, a Singapore selling legend in the Plan of Distribution section and a section describing applicable transfer restrictions for the securities. In the transactions on which we have advised, each issuer was a "Category 2" issuer under Regulation S, subjecting the securities sold pursuant to Regulation S to a 40 day distribution compliance period. Additionally, similar to registered subordinated debt transactions, the securities are priced at par. Several days prior to launch, the issuer, the initial purchasers and the offshore purchaser will agree

on a coupon rate for the securities, so there is no pricing off of a benchmark treasury rate. The term sheet will also mirror a 144A/Regulation S term sheet, adding a line item indicating that AIP has been received from the SGX. Typically, drafts of the offering memorandum and the term sheet will be shared with the offshore purchaser for review prior to launch of the transaction.

Similarly, the purchase agreement (and associated opinion package) will take the form of a typical 144A/Regulation S agreement and will not differ substantially from the issuer's standard form underwriting agreement with respect to representations and warranties, covenants and closing conditions. Given that the initial purchaser in these transactions was a UK broker-dealer, the purchase agreements included 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 issuer's auditor will prepare pricing and closing comfort letters addressed to the initial purchasers.

Continuing Disclosure Obligations and Costs

Listing on the SGX subjects an issuer to continuing disclosure obligations to the SGX for the life of the securities. The listing agent will provide the issuer with general guidance on the issuer's continuing disclosure obligations.

Listing on the SGX also has some associated costs. There is a listing fee of S\$25,000 (initial listing fee of S\$15,000 and one-time processing fee of S\$10,000) to the SGX (approximately US \$18,000). The issuer must pay professional fees to the listing agent as well. There are no costs to the issuer after the issuance, although the issuer can engage the listing agent to update its continuing disclosure with the SGX if the issuer chooses not to update its disclosures itself.

SEC Approves New Standard Expanding Audit Report



On October 23, 2017, the Securities and Exchange Commission (SEC) approved the Public Company Accounting Oversight Board's (PCAOB) new auditing standard, AS 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*.¹ The PCAOB adopted the new standard on June 1, 2017 with the goal of making the auditor's reports more useful to investors. Although it is considered a significant modification, this plan had been put in motion in 2010 in an effort to require auditors to supply investors with more information.² The biggest change is that the new standard and related amendments expand these reports by requiring that the auditor communicate any critical audit matters (CAM) in the report that arise from the current period's audit of the financial statements or to state that the auditor determined that there is no CAM.³ However, certain investment companies, employee stock and savings plans, emerging growth businesses, and brokers and dealers that report under the Securities Exchange Act of 1934 Rule 17a-5 are not required to report CAM.⁴

¹ Rel. No. 34-81916, Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules on the Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion, and Departures from Unqualified Opinions and Other Reporting Circumstances, and Related Amendments to Auditing Standards (Oct. 23, 2017), available at <http://www.sec.gov/rules/pcaob/2017/34-81916.pdf>.

² Press Release, Public Company Accounting Oversight Board, PCAOB Adopts New Standard to Enhance the Relevance and Usefulness of the Auditor's Report with Additional Information for Investors (June 1, 2007), available at <https://pcaobus.org/News/Releases/Pages/auditors-report-standard-adoption-6-1-17.aspx>.

³ PCAOB Release No. 2017-001 (June 1, 2017).

⁴ *Id.*

CAM is defined as matters communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the financial statements and (2) involve especially challenging, subjective, or complex auditor judgment.

In determining whether a matter involved especially challenging, subjective, or complex auditor judgment, the auditor must take into account certain factors, including, but not limited to:

- the auditor's assessment of the risks of material misstatement, including significant risks;
- the degree of auditor judgment related to areas in the financial statements that involved the application of significant judgment or estimation by management, including estimates with significant measurement uncertainty;
- the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions;
- the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures;
- the nature and extent of audit effort required to address the matter, including the extent of specialized skill or knowledge needed or the nature of consultations outside the engagement team regarding the matter; and
- the nature of audit evidence obtained regarding the matter.⁵

The communication of each CAM should include:

- identifying the CAM;
- describing the principal considerations that led the auditor to determine that the matter is a CAM;
- describing how the CAM was addressed in the audit; and
- referring to the relevant financial statement accounts or disclosures.⁶

In addition to CAM requirements, the new standard also includes several additional improvements to the auditor's report, primarily intended to clarify the auditor's role

⁵ *Id.*

⁶ *Id.*

and responsibilities related to the audit of the financial statements, provide additional information about the auditor, and make the auditor’s report easier to read:

- Auditor tenure—a statement disclosing the year in which the auditor began serving consecutively as auditor;
- Independence—a statement that the auditor is required to be independent;
- Addressee—the auditor’s report will be addressed to the company’s shareholders and board of directors or equivalents (additional addressees are also permitted);
- Enhancements—certain standardized language in the auditor’s report has been changed, including adding the phrase “whether due to error or fraud”, when describing the auditor’s responsibility under PCAOB standards to obtain reasonable assurance about whether the financial statements are free of material misstatements; and
- Standardized form of the auditor’s report—the opinion will appear in the first section of the auditor’s report and section titles have been added to guide the reader.

All provisions other than those related to CAM will take effect for audits of fiscal years ending on or after December 15, 2017.⁷ Provisions related to CAM will take effect for audits of fiscal years ending on or after June 30, 2019, for large accelerated filers, and for fiscal years ending on or after December 15, 2020, for all other companies that the

⁷ *Id.*

requirements apply to.⁸ The SEC hopes that these “phased effective dates for CAMs should facilitate some early-stage analysis through the PCAOB’s Post-Implementation Review (PIR) process, based on the experiences of large accelerated filers.”⁹ After findings are made, the SEC expects that the PCAOB will be open to making any necessary changes to the standards as well as any changes to the effective dates for non-large accelerated filers.¹⁰



⁸ *Id.*

⁹ Public Statement, U.S. Securities and Exchange Commission, Statement on SEC Approval of the PCAOB’s New Auditor’s Reporting Standard (October 23, 2017), available at https://www.sec.gov/news/public-statement/clayton-statement-pcaob-new-auditor-reporting-standard#_ftn2.

¹⁰ *Id.*



New CUSIP?: When a new CUSIP is required in a qualified reopener post A/B Exchange

As a follow-up to the article in April 2017's edition of *Baseload*, "Revised Bond Index Eligibility Puts Renewed Focus on Reopeners," this article discusses strategies for reopenings of securities initially offered pursuant to Rule 144A and Regulation S, where a portion of the securities were not exchanged for registered securities pursuant to an A/B exchange. Attorneys at Hunton & Williams LLP recently represented the initial purchasers in a multi-tranche offering of senior notes, which included the reopening of one series which had been issued in an earlier transaction. The notes of the series being reopened were initially sold only to "qualified institutional buyers" pursuant to Rule 144A and non-U.S. persons outside of the United States pursuant to Regulation S. The majority of Rule 144A notes and the Regulation S notes were exchanged for identical registered notes through an A/B exchange offer, but certain existing holders did not exchange their notes.

The partial exchange of the originally issued notes presented a unique challenge. As discussed in a previous edition of *Baseload*, when reopening a series of securities issued pursuant to Rule 144A and Regulation S where all of the securities have been exchanged, there is not a need to obtain new CUSIPs because the reopened securities can use the existing unregistered CUSIPs (See *Baseload*, June 2013, "Too Late to the Party?: The 144A Reopening Post A/B Exchange"). The issue becomes more complicated when some of the originally issued notes have not been exchanged. As a result,

using the existing CUSIP was not an option because there would be no way to distinguish holders of originally issued notes (which were not exchanged in the A/B exchange offer) from holders of the reopened notes. It was necessary to obtain a temporary CUSIP for the new reopened notes to distinguish them from the originally issued notes held by existing holders and identify the notes which would be eligible for the future A/B exchange.

In the discussed transaction, one holder of Regulation S notes did not exchange its notes in the A/B exchange offer. Thus, only the Regulation S notes required a temporary CUSIP. Therefore, the reopened notes sold pursuant to Rule 144A used the existing CUSIP while the reopened notes sold pursuant to Regulation S had a new CUSIP. The use of an existing CUSIP and a new CUSIP meant that the closing with DTC was completed using two different procedures. The reopened notes using the existing CUSIP settled through the Deposit & Withdrawal at Custodian or "DWAC" program while the reopened notes using a new CUSIP settled through the Fast Automated Securities Transfer or "FAST" program. The use of the FAST program requires that issuers file a new Rule 144A or Regulation S rider, as the case may be, with DTC for the reopened notes with a new CUSIP. The added complication will require coordination among the issuer, initial purchasers and the trustee to ensure all processes are properly followed to permit a smooth closing.



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It is not intended to provide legal advice or legal opinions and must not be relied on as such.

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