

## V. Finance, Mergers, and Acquisitions

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### A. INTRODUCTION

The second half of 2017 and early 2018 were marked by revisions to reporting and disclosure policies by various regulatory bodies. The Securities and Exchange Commission (SEC) continued to pursue a variety of disclosure reform and simplification initiatives under the Fixing America’s Surface Transportation Act (FAST Act). Additionally, companies had to adapt to a new Public Company Accounting Oversight Board (PCAOB) reporting standard, the planned phasing out of the London Interbank Offered Rate (LIBOR), and updates to the New York Stock Exchange’s (NYSE) material news policy.

### B. PCAOB ADOPTS AUDITOR REPORTING STANDARD

On June 1, 2017, the PCAOB adopted a new auditing standard, AS 3101, *The Auditor’s Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*, to enhance the relevance and usefulness of the auditor’s report by providing additional information to investors.<sup>1</sup> The new standard and re-

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1. 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, 2017), *available at* <https://pcaobus.org/News/Releases/Pages/auditors-report-standard-adoption-6-1-17.aspx>.

lated amendments require auditors to include a discussion of critical audit matters in their report accompanying audited financial statements.

The project to enhance the auditor's reporting model began in 2010 with PCAOB staff outreach to various stakeholders.<sup>2</sup> In June 2011, the PCAOB issued a Concept Release to seek public comment on potential changes to the auditor's reporting model.<sup>3</sup>

The new standard requires the auditor to communicate in its report any critical audit matters arising from the current period's audit of the financial statements or to state that the auditor determined that there are no critical audit matters.<sup>4</sup> A critical audit matter is defined as a matter communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the financial statements and (2) involved especially challenging, subjective, or complex auditor judgment.

In determining whether a matter involves especially challenging, subjective, or complex auditor judgment, the auditor must take into account, alone or in combination, certain factors, including, but not limited to: (1) the auditor's assessment of the risks of material misstatement, including significant risks; (2) 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; (3) the nature and timing of significant unusual transactions and the extent of audit effort and judgment related to these transactions; (4) the degree of auditor subjectivity in applying audit procedures to address the matter or in evaluating the results of those procedures; (5) 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 (6) the nature of audit evidence obtained regarding the matter.<sup>5</sup>

The communication of each critical audit matter should include: (1) identification of the critical audit matter; (2) a description of the principal considerations that led the auditor to determine that the matter is a critical audit matter; (3) a description of how the critical audit matter was addressed in the audit; and (4) reference to the relevant financial statement accounts or disclosures.<sup>6</sup>

The new standard requires that for each matter arising from the audit of the financial statements that (1) was communicated or required to be communicated to the audit committee, and (2) relates to accounts or disclosures that are material to the financial statements, the auditor document whether or not the matter was determined to be a critical audit matter (i.e., involved especially challenging, subjective, or complex auditor judgment) and the basis for such determination.

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2. *Id.*

3. PCAOB Release No. 2011-003 (June 1, 2011).

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

5. *Id.*

6. *Id.*

The final version of the standard also includes a number of additions to the auditor's report, primarily intended to clarify the auditor's role 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 is to 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 that 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 critical audit matters took effect for audits of fiscal years ending on or after December 15, 2017.<sup>7</sup> Provisions related to critical audit matters will take effect for audits for 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 to which the requirements apply.<sup>8</sup>

### C. THE DEMISE OF LIBOR

In July 2017, Andrew Bailey, head of the U.K. Financial Conduct Authority (FCA), announced that the FCA would begin phasing out the LIBOR interest rate benchmark by the end of 2021, citing a lack of meaningful data to sustain the benchmark rate, which underpins, among other things, mortgages, corporate debt securities, and interest rate derivatives contracts.<sup>9</sup>

LIBOR, which first appeared in the 1980s, is calculated daily by surveying banks on their estimated borrowing costs from one another in five currencies across seven time periods. It was previously overseen by the British Bankers' Association until a rate-rigging scandal uncovered in 2012 led to the ICE Benchmark Administration (IBA), a subsidiary of Intercontinental Exchange, Inc., taking control over the administration of the benchmark in 2014. With IBA as ad-

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7. *Id.* at 4.

8. *Id.*

9. Max Colchester, *Scandal-Hit Libor to Be Phased Out*, WALL ST. J., July 27, 2017.

ministrator, LIBOR underwent a series of reforms meant to more closely tie submissions and rates to actual transactions in order to ensure that the rate represents market conditions. Given that change, it became increasingly difficult to measure a market that was not sufficiently active.<sup>10</sup>

The decision to abandon the benchmark rate has prompted discussion among a variety of market participants regarding viable replacements for LIBOR and how to interpret existing documentation based on LIBOR that does not provide for other alternatives. In August 2017, the Federal Reserve requested public comment on three proposed reference rates based on the interest rate on overnight loans collateralized by U.S. Treasuries that could serve as a replacement for U.S. Dollar LIBOR. These rates would provide a benchmark for overnight borrowing costs, principally in the “repo” market.<sup>11</sup> In the United Kingdom, the Bank of England is in the process of reforming the Sterling Overnight Index Average rate, which measures overnight borrowing costs in the sterling unsecured markets and might serve as a viable alternative to British pound sterling (GBP) LIBOR.<sup>12</sup> Both the U.S. and U.K. alternatives are backward looking, observed rates, however, unlike the forward looking LIBOR rate.<sup>13</sup>

A transition to alternative benchmarks also has a significant impact on existing documentation for floating rate debt securities, interest rate swaps, and credit agreements. It remains uncertain how existing contracts using LIBOR will be amended and which benchmark will replace LIBOR. Corporate debt issuers will have to consider how to amend floating rate indentures and whether bondholder consent will be required for such amendments, particularly if multiple benchmark rates replace LIBOR. Additionally, loan documentation will have to be evaluated by lenders and borrowers to determine whether amendments are necessary.<sup>14</sup>

## D. SECURITIZATION UPDATE

### 1. Public Service Company of New Hampshire

On June 15, 2017, Public Service Company of New Hampshire (PSNH) filed a petition for a financing order with the New Hampshire Public Utilities Commission (NHPUC).<sup>15</sup> PSNH is requesting that the NHPUC permit PSNH to use securitiza-

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10. *Id.*

11. Repo and reverse repo transactions are formally purchases but function as short-term collateralized loans. One party buys a financial asset from another, who promises to buy it back at a higher price, often the next day; the markup is equivalent to the interest rate on the loan. *See* Liz McCormick & Stephen Spratt, *The Repo Market*, BLOOMBERG QUICKTAKE (Feb. 23, 2017), available at <https://www.bloomberg.com/quicktake/the-repo-market>.

12. Gabriel T. Rubin & Katy Burne, *Fed Seeks Comment on Three Proposed Borrowing Benchmarks*, WALL ST. J., Aug. 24, 2017.

13. Luca Casiraghi, Luca Morreale & Silla Brush, *Libor's Uncertain Succession Triggers \$350 Trillion Headache*, BLOOMBERG, July 27, 2017.

14. *Id.*

15. New Hampshire Public Utilities Commission, Petition for Findings of Fact and Issuance of a Financing Order, Case No. DE 17-096 (June 15, 2017), available at <https://www.puc.nh.gov/Regulatory/Docketbk/2017/17-096.html>.

tion to recover certain stranded costs associated with the divestiture of its generation assets. The sale is part of a comprehensive 2015 settlement agreement between PSNH and the State of New Hampshire that is aimed at completing deregulation of the electric utility industry in New Hampshire and stabilizing rates.<sup>16</sup>

On January 30, 2018, the NHPUC issued a final financing order approving securitization of an amount of stranded costs up to \$690 million for recovery from PSNH's ratepayers.<sup>17</sup> PSNH completed the sale of its generation assets on January 10, 2018.<sup>18</sup> A registration statement has been filed with the SEC, and, when complete, the transaction will be the third offering of rate reduction bonds in which PSNH is the sponsor.

## 2. Fair Hydro Plan (Ontario)

On June 1, 2017, the legislature of the Province of Ontario, Canada, passed the Fair Hydro Act. Under the Act and related regulations, electricity bills for residential customers will be reduced by an average of 25 percent.<sup>19</sup> The reduction represents an initiative whereby recovery of clean energy costs incurred by utilities in Ontario from customers will be spread over thirty years through a reduction of the Global Adjustment charge. The Global Adjustment charge was established by the Ontario government in 2005 to cover the cost of providing adequate generating capacity and conservation programs. The Act contemplates that Ontario Power Generation will sponsor a series of transactions to refinance clean energy costs through the issuance of debt to be serviced through adjustments to customers' future electricity bills; such adjustments will be known as the Clean Energy Adjustment charge.<sup>20</sup> The first of these transactions was completed at the end of 2017. Pursuant to the Act, the Clean Energy Adjustment charge is expected to be added to customers' bills beginning in 2021.

## E. SEC PROPOSALS UNDER THE FAST ACT

On October 11, 2017, the SEC proposed changes to Regulation S-K to simplify and reduce the disclosure requirements for public companies, investment advisors, and investment companies. These proposed amendments would imple-

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16. Press Release, Eversource Energy, Sale Process of Eversource's N.H. Electric Generation Units Launched (Feb. 28, 2017), available at <https://www.eversource.com/Content/docs/default-source/Investors/nh-generation-sale-news-release.pdf?sfvrsn=0>.

17. New Hampshire Public Utilities Commission, Order Granting Petition Case No. DE 17-096 (Jan. 30, 2018), available at <https://www.puc.nh.gov/Regulatory/Docketbk/2017/17-096.html>.

18. Associated Press, *Eversource Power Plant Sale Completed*, U.S. NEWS & WORLD REP., Jan. 11, 2018.

19. Press Release, Ministry of Energy, Ontario Passes Legislation to Lower Electricity Bills by 25 Per Cent (May 31, 2017), available at <https://news.ontario.ca/mei/en/2017/05/ontario-passes-legislation-to-lower-electricity-bills-by-25-per-cent.html>.

20. Press Release, Ontario Energy Board, The Fair Hydro Act, 2017 (June 15, 2017), available at <https://www.oeb.ca/newsroom/2017/fair-hydro-act-2017>.

ment the mandate under the FAST Act.<sup>21</sup> The FAST Act was enacted in December 2015 and directs that the SEC review the disclosure requirements of Regulation S-K and modernize and simplify its requirements. Section 72002 of the FAST Act required the SEC to “further scale or eliminate requirements . . . to reduce the burden on emerging growth companies, accelerated filers, smaller reporting companies, and other smaller issuers, while still providing all material information to investors.”<sup>22</sup> In response, the SEC staff published a report in November 2016 with various recommendations.<sup>23</sup> Although not all of the recommendations were accepted, the SEC’s October 2017 proposed amendments were largely premised on that report. A few of the key proposed amendments are:

*Item 102—Description of physical property.* Currently, Item 102 requires a company to disclose its “principal plants, mines and other materially important physical properties.” In response to concerns of immaterial disclosures, the SEC proposed an amendment to Item 102 that would require a company’s description of its physical property only if the properties are considered material to the company.<sup>24</sup>

*Item 303—Management’s discussion and analysis.* Item 303(a) mandates registrants to discuss their “financial condition, changes in financial condition, and results of operations” to “enhance a reader’s understanding of [the registrant’s] financial condition, changes in financial condition, and results of operations.” The discussion generally focuses on a period-to-period comparison from the company’s three most recent fiscal years. The proposed amendment to Item 303 would grant flexibility when discussing historical periods to reduce the period-to-period comparison to the two most recent fiscal years. Registrants would be allowed to eliminate the comparison involving the earliest year in situations where “(i) the discussion is not material to an understanding of the company’s financial condition, changes in financial condition, and results of operations, and (ii) the registrant has filed its prior year Form 10-K on EDGAR containing management’s discussion and analysis of the earliest of the three years included in the financial statements of the current filing.”<sup>25</sup>

*Item 405—Section 16 compliance.* The SEC proposed to eliminate the requirement for directors, officers, and ten percent shareholders to furnish copies of

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21. Release No. 33-10425, Securities and Exchange Commission, FAST Act Modernization and Simplification of Regulation S-K (Oct. 11, 2017), available at <https://www.sec.gov/rules/proposed/2017/33-10425.pdf>.

22. H.R. 22 (Dec. 4, 2015), Pub. L. No. 114-94.

23. Securities and Exchange Commission, Report on Modernization and Simplification of Regulation S-K (Nov. 23, 2016), available at <https://www.sec.gov/reportspubs/sec-fast-act-report-2016.pdf>.

24. Release No. 33-10425, Securities and Exchange Commission, FAST Act Modernization and Simplification of Regulation S-K (Oct. 11, 2017), available at <https://www.sec.gov/rules/proposed/2017/33-10425.pdf>.

25. *Id.*

reports mandated by Section 16(a) of the Securities Exchange Act of 1934, as amended (1934 Act) to their companies. Under this section, directors, officers, and 10 percent shareholders are required to provide copies to the registrant of beneficial ownership reports filed under Section 16. Given the availability of these reports on EDGAR, the SEC believes physical delivery is no longer necessary. Currently, many companies include a heading and disclosure in their annual report on Form 10-K and their proxy statements regarding any timely reporting failure by their reporting persons. The SEC proposed eliminating both the heading and accompanying disclosure if the company has no delinquencies to report. In addition, the proposal includes changing the heading to “Delinquent Section 16(a) Reports” and deleting the check box on the cover of the Form 10-K that relates to Item 405 disclosures.<sup>26</sup>

*Item 601—Exhibit requirements.* Proposals related to Item 601 would permit the omission of confidential information from material contract exhibits if “such information is both (i) not material and (ii) competitively harmful if publicly disclosed, even where the registrant has not submitted a confidential treatment request.” If adopted, this would change the current process that requires a registrant to give the SEC an unredacted copy of each exhibit and request confidentiality. Under the proposals, exhibits would continue to be reviewed and the SEC staff would continue to assess the appropriateness of redactions. Registrants will need to mark the exhibit index specifying which sections of the exhibit have been omitted and include a statement that indicates that information from the marked exhibit has been omitted.<sup>27</sup>

The SEC allowed a period for public comment on these proposed amendments, which ended on January 2, 2018.

## F. NYSE UPDATES ITS MATERIAL NEWS POLICY

On December 4, 2017, the SEC approved<sup>28</sup> a proposal by the NYSE to amend Section 202.06 of the NYSE Listed Company Manual to prohibit listed companies from issuing material news after the closing of trading on the NYSE until the earlier of (1) the publication of the official NYSE closing price of the company’s quoted security or (2) five minutes after the official closing time for the

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26. *Id.*

27. *Id.*

28. Release No. 34-82180, Securities and Exchange Commission, Notice of Filing of Amendment No. 1 and Order Granting Accelerated Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Amend Section 202.06 of the NYSE Listed Company Manual to Prohibit Listed Companies from Issuing Material News After the Official Closing Time for the Exchange’s Trading Session Until the Earlier of Publication of Such Company’s Official Closing Price on the Exchange or Five Minutes After the Official Closing Time (Nov. 30, 2017), available at <https://www.sec.gov/rules/sro/nyse/nysearchive/nysearchive2017.htm>.

NYSE trading session (generally, 4:00 p.m. Eastern Time).<sup>29</sup> The rule change provides an exception when a company is publicly disclosing material information to cure an unintentional disclosure under Regulation FD.<sup>30</sup>

The amendment is designed to alleviate confusion caused by price discrepancies between the NYSE closing price and trading prices on other venues after the NYSE official closing time and before the posting of the NYSE closing price.<sup>31</sup> When a listed company releases material news immediately after the official NYSE closing time but before the company's official closing price is published, there can be a material difference in the NYSE official closing price and any price realized during that interlude for a trade executed in another market, potentially leading to investor confusion.<sup>32</sup>

Notwithstanding the rule change and although closing prices are almost always published within five minutes of the official closing time, the NYSE continues to include advisory text in Section 202.06 asking listed companies to avoid issuing material news until the earlier of (1) publication of the company's official closing price or (2) fifteen minutes after the NYSE's official closing time.<sup>33</sup>

#### **G. ELLIOTT MANAGEMENT CORP. LEADS EQUITY INVESTMENT IN FIRSTENERGY CORP.**

On January 22, 2018, FirstEnergy Corp. announced an approximate \$2.5 billion equity infusion through the issuance of \$1.62 billion in mandatory convertible preferred equity and \$850 million common equity to a consortium of affiliates of Elliott Management Corporation, Bluescape Energy Partners LLC, Zimmer Partners LP, and GIC Private Limited. The preferred equity has an initial conversion price of \$27.42 per share and will receive dividends payable on FirstEnergy common stock on an as-converted basis and be non-voting, except in limited circumstances. The common equity was issued to Zimmer at a price of \$28.22 per share.<sup>34</sup>

FirstEnergy has faced numerous financial difficulties since its acquisition of Allegheny Energy Inc. in 2011, where it acquired a number of coal-fired generation plants and took on \$3.8 billion of Allegheny debt.<sup>35</sup> Additionally, the Midwestern utility previously announced plans to exit the unregulated competitive

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29. Memo, New York Stock Exchange, Material News Issued Immediately After NYSE Closing Time, *available at* [https://www.nyse.com/publicdocs/nyse/regulation/nyse/Material\\_News\\_Issued\\_Immediately\\_After\\_NYSE\\_Closing\\_Time\\_20171207.pdf](https://www.nyse.com/publicdocs/nyse/regulation/nyse/Material_News_Issued_Immediately_After_NYSE_Closing_Time_20171207.pdf).

30. *Id.*

31. *Id.*

32. *Id.*

33. *Id.*

34. See FirstEnergy Corp., Forms 8-K (Jan. 22, 2018), *available at* <https://www.sec.gov/Archives/edgar/data/1031296/000103129618000006/a8-kdated01222018xpressrel.htm> and <https://www.sec.gov/Archives/edgar/data/1031296/000162828018000519/a8-kdated01222018eqdocs.htm>.

35. See Liam Denning, *Elliott Is Doing Pretty Nicely in the Power Business*, BLOOMBERG, Jan. 22, 2018, *available at* <https://www.bloomberg.com/gadfly/articles/2018-01-22/elliott-firstenergy-stake-doing-pretty-well-in-power>; Michael J. de la Merced, *In \$4.7 Billion Deal, FirstEnergy of Ohio Is*

energy business, selling 1,600 megawatts (MW) of merchant generation in January 2017 and noting on a November 2016 earnings call that FirstEnergy Solutions Corporation, its competitive subsidiary, was under strategic review and could be forced to file for bankruptcy.<sup>36</sup> FirstEnergy Solutions has \$500 million of debt maturities in 2018<sup>37</sup> and over \$3.7 billion of total debt, while one analyst assessed the total value of its assets at only \$1.3 billion.<sup>38</sup>

As part of the equity investment, FirstEnergy established a five-member independent restructuring working group (with three company designees and the remaining two of the five seats going to C. John Wilder and Tony Horton), which will be tasked with planning FirstEnergy's exit strategy from its competitive energy business and transforming the company into a "fully regulated utility."<sup>39</sup> Wilder, chairman of Bluescape, and Horton, CFO of Energy Futures Holdings Corporation, both have experience in turning around troubled utilities. Wilder was a part of a similar advisory committee when Elliott made a significant equity investment in NRG Energy, Inc. in 2017, which announced several months later that it would sell a number of NRG's assets, including at least 50 percent of its stake in NRG Yield Inc., a renewable financing subsidiary, and revert to being primarily a wholesale and retail electricity business in Texas.<sup>40</sup>

The net proceeds from the equity issuance were used to reduce debt at the FirstEnergy holding company level under various loan agreements by \$1.45 billion and contribute \$750 million to its pension fund, as well as for general corporate purposes.<sup>41</sup> In a press release, FirstEnergy noted that the investment positions FirstEnergy for additional investments across its utility subsidiaries, including grid modernization in Ohio and infrastructure improvement in New Jersey.<sup>42</sup>

On April 1, 2018, FirstEnergy announced that its nuclear and coal power plant units filed for bankruptcy court protection as the company looks to restructure, sell

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to *Buy a Pennsylvania Utility*, N.Y. TIMES, Feb. 11, 2010, available at <http://www.nytimes.com/2010/02/12/business/energy-environment/12energy.html?dbk>.

36. Darren Sweeney, *FirstEnergy CFO says new investors '100% in support' of company strategy*, SNL FINANCIAL, Jan. 24, 2018, available at <https://www.snl.com/web/client?auth=inherit#news/article?Id=43282184&KeyProductLinkType=2>.

37. *Id.*

38. Denning, *supra* note 35.

39. FirstEnergy Corp., Press Release, *FirstEnergy Announces Transformational \$2.5 Billion Equity Investment* (Jan. 22, 2018), available at [https://www.firstenergycorp.com/newsroom/news\\_articles/firstenergy-announces-transformational--2-5-billion-equity-inves.html](https://www.firstenergycorp.com/newsroom/news_articles/firstenergy-announces-transformational--2-5-billion-equity-inves.html).

40. See Denning, *supra* note 35; Liam Denning, *NRG Ditches the Old and Embraces . . . the Old*, BLOOMBERG, July 12, 2017, available at <https://www.bloomberg.com/gadfly/articles/2017-07-12/nrg-energy-asset-sale-plan-embracing-the-old>.

41. FirstEnergy Corp., Form 8-K (Jan. 22, 2018), available at <https://www.sec.gov/Archives/edgar/data/1031296/000103129618000010/a8-kdated01252018.htm>.

42. Press Release, FirstEnergy Corp., *FirstEnergy Announces Transformational \$2.5 Billion Equity Investment* (Jan. 22, 2018), available at [https://www.firstenergycorp.com/newsroom/news\\_articles/firstenergy-announces-transformational--2-5-billion-equity-inves.html](https://www.firstenergycorp.com/newsroom/news_articles/firstenergy-announces-transformational--2-5-billion-equity-inves.html).

assets, and win government support to cope with competitors using lower-cost natural gas.<sup>43</sup> The filing was made by FirstEnergy Solutions and FirstEnergy Nuclear Operating Co.<sup>44</sup> The companies said they have over \$550 million in cash and “sufficient liquidity to continue normal operations” while restructuring.<sup>45</sup>

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43. *FirstEnergy nuclear, coal plant units file for bankruptcy protection*, REUTERS, Apr. 1, 2018, available at <https://www.reuters.com/article/us-firstenergy-bankruptcy/firstenergy-nuclear-coal-plant-units-file-for-bankruptcy-protection-idUSKCN1H81GX>.

44. *Id.*

45. *Id.*