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FINANCIAL STATEMENTS AND PERIODIC
REPORTS FOR RELATED ISSUERS AND
GUARANTORS OF REGISTERED SECURITIES

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Introduction

In August 2000, the SEC published Release No. 33-7878 (the “Release”), which promulgated financial reporting rules for related issuers and guarantors of guaranteed debt and debt-like securities. These rules codify, in large part, the positions the Staff had developed through Staff Accounting Bulletin (“SAB”) No. 53, later interpretations of SAB 53 and the registration statement review process. The new reporting rules reflect:

- amendments to Rule 3-10 of Regulation S-X, which address the financial statements and information required of related issuers and guarantors of guaranteed securities;
- new Rule 3-16 of Regulation S-X, which addresses the financial statements required of affiliates whose securities collateralize a registered issuance;
- new Rule 12h-5, which exempts subsidiary issuers and subsidiary guarantors of guaranteed securities from periodic reporting obligations under the Securities Exchange Act of 1934 (the “Exchange Act”); and
- the rescission of SAB 53.

Issuers of guaranteed securities and guarantors may still request no-action letters from the Division of Corporation Finance if the Release does not address their situation. The principles of the Release will be applied to such requests.

Rule 3-10 will require, generally, the inclusion of *condensed consolidating financial information* as a condition to omitting the separate financial statements of a subsidiary issuer or subsidiary guarantor. Under SAB 53, a subsidiary issuer or subsidiary guarantor was permitted to include *summarized financial information*. In the Release, the SEC stated that condensed consolidating information clearly distinguishes the assets, liabilities, revenues, expenses and cash flows of the entities that are legally obligated under the indenture from those that are not. In addition, for some time prior to the adoption of the Release, through interpretive requests and the review and comment process, the Staff had required condensed consolidating financial information in all situations excepts those specifically addressed by SAB 53.

The new rules generally are effective for registration statements and post effective amendments filed on or after September 25, 2000.

This memorandum addresses which financial statements and information to prepare in the case of a registered offering guaranteed by one or more entities within a corporate structure.

Background

Guarantees of securities are securities themselves for the purposes of the Securities Act of 1933 (the “Securities Act”). As a result, the Securities Act requires the offering of both the guaranteed security and the guarantee to be either registered or exempt from registration. Any Securities Act registration statement must include disclosure of both financial and non-financial information about the issuer of the guaranteed security as well as any guarantors. In addition, Securities Act registration causes both the issuer and the guarantors to become subject to Section 15(d) of the Exchange Act which, in turn, requires all Securities Act

registrants to file Exchange Act periodic reports for at least the fiscal year during which the related Securities Act registration statement became effective.

There are circumstances where full Securities Act and Exchange Act disclosure by both the issuer and the guarantors may not be useful to an investment decision and, therefore, may not be necessary. In 1983, the Staff addressed this issue in SAB 53, which described the approach the Staff would take in its review of registration statements for offerings of securities issued by a subsidiary that are guaranteed by the parent company of that subsidiary and offerings of securities issued by a parent company that are guaranteed by a subsidiary of that company. Since the publication of SAB 53, however, the Staff has had to respond to interpretive requests that involve new and complex transaction structures. Rule 3-10, as amended, now identifies which financial statements and information must be included in Securities Act registration statements, Exchange Act registration statements and Exchange Act periodic reports for guarantors.

There are three situations in which no separate financial information or condensed consolidating financial information will be required, so long as the parent company financial statements include specified narrative disclosure. These situations arise when:

- the subsidiary issuer is a finance subsidiary and the parent company is the only guarantor of the securities;
- the parent company of the subsidiary issuer has no independent assets or operations, the parent company guarantees the securities, no subsidiary of the parent company guarantees the securities and any subsidiaries of the parent company other than the issuer are minor; or
- the parent company issuer has no independent assets or operations and all of the parent company's subsidiaries, other than minor subsidiaries, guarantee the securities.

Rule 3-10

The amendments to paragraph (a) of Rule 3-10 restate the general rule that all issuers or guarantors of registered securities must include separate financial statements as required by Regulation S-X. The SEC adopted new paragraphs (b) through (f) of Rule 3-10 to provide exceptions to the general rule and permit condensed consolidating financial information in registration statements and parent company periodic reports when:

- a finance subsidiary issues securities that its parent company guarantees;
- an operating subsidiary issues securities that its parent company guarantees;
- a subsidiary issues securities that its parent company and one or more other subsidiaries of its parent company guarantee;
- a parent company issues securities that one of its subsidiaries guarantees; or
- a parent company issues securities that more than one of its subsidiaries guarantees.

Only one of these five situations can apply to any particular offering and the subsequent Exchange Act reporting. With respect to these five situations, the following two-part analysis determines whether modified financial information may be provided for subsidiary issuers and subsidiary guarantors.

- Is the subsidiary issuer or subsidiary guarantor 100% owned by its parent company?
- Are the guarantees full and unconditional?

If the answer to *both* questions is yes, condensed consolidating financial information is allowed. If the answer to *either* question is no, condensed consolidating financial information is not allowed. The discussion of amended Rule 3-10 that follows below *assumes both that the subsidiary is 100% owned by its parent company and that the guarantee is full and unconditional*. In addition, the modified financial information permitted by paragraphs (b) through (f) of Rule 3-10 is available only for guaranteed debt and debt-like securities under which the issuer has a contractual obligation to pay a fixed sum at a fixed time and, in cases in which the obligation to make such payments is cumulative, a set amount of interest must be paid.¹

The SEC also adopted three other new paragraphs to Rule 3-10. Paragraph (g) provides the financial statement requirements for recently acquired subsidiary issuers and subsidiary guarantors. Paragraph (h) defines the following terms for purposes of Rule 3-10:

- “100% owned”
- “full and unconditional” (a guarantee can be full and unconditional even if it has a fraudulent conveyance savings clause or different subordination terms than the guaranteed securities; but is not full and unconditional if not operative until some time after default)
- “annual report”
- “quarterly report”
- “no independent assets or operations”
- “minor”
- “finance subsidiary”
- “operating subsidiary”

Paragraph (i) provides instructions for preparing the condensed consolidating financial information required by paragraphs (c) through (f) of Rule 3-10.

Finance subsidiary issuer of securities guaranteed by its parent company only

As adopted, paragraph (b) of Rule 3-10 codifies SAB 53’s treatment of finance subsidiaries and provides that subsidiary issuers would not be required to include any financial information if:

¹ The Release also discusses the applicability of Rule 3-10 to preferred and trust preferred securities.

- the subsidiary is a finance subsidiary;
- the parent company of the subsidiary issuer guarantees the securities;
- no other subsidiary of the parent company guarantees the securities;
- the parent company's financial statements are filed for the periods specified by Rules 3-01 and 3-02 of Regulation S-X; and
- the parent company's financial statements include a footnote stating that the issuer is a 100%-owned finance subsidiary of the parent company and the parent company has fully and unconditionally guaranteed the securities.

If a subsidiary issuer satisfies the requirements of paragraph (b) but for the fact that it co-issued the securities, jointly and severally, with its parent company, the parent company may present its financial information with respect to the subsidiary as paragraph (b) permits.

Operating subsidiary issuer of securities guaranteed by its parent company only

SAB 53 permitted a parent company's financial statement footnotes to include summarized financial information regarding an operating subsidiary issuer. Consistent with the SEC's view that condensed consolidating financial information is more appropriate, the SEC adopted paragraph (c) of Rule 3-10 to provide that these issuers need not include separate financial statements if:

- the parent company guarantees the securities;
- no other subsidiary of the parent company guarantees the securities;
- the parent company's financial statements are filed for the periods specified by Rules 3-01 and 3-02 of Regulation S-X; and
- the parent company's financial statement footnotes include condensed consolidating financial information for the same periods with a separate column for the parent company, the subsidiary issuer, any other subsidiaries of the parent on a combined basis, consolidating adjustments and the total consolidated amounts.

Condensed consolidating financial information may be omitted if:

- the parent company has no independent assets or operations;
- any subsidiaries other than the subsidiary issuer are minor; and
- the parent company's financial statements include a footnote stating that the parent company has no independent assets or operations, the guarantee is full and unconditional and any subsidiaries other than the subsidiary issuer are minor.

In addition, a separate column for other subsidiaries is not required when the parent company has independent assets or operations, but the other subsidiaries are minor.

Subsidiary issuer of securities guaranteed by its parent company and one or more other subsidiaries of that parent company

Largely in line with the Staff's position regarding the structure in which a subsidiary issues securities and both its parent company and one or more other subsidiaries of that parent company are guarantors, the SEC adopted paragraph (d) of Rule 3-10 to provide that these subsidiary issuers and subsidiary guarantors need not include separate financial statements if:

- the guarantees are joint and several;
- the parent company's financial statements are filed for the periods specified by Rules 3-01 and 3-02 of Regulation S-X; and
- the parent company's financial statement footnotes include condensed consolidating financial information for the same periods with a separate column for the parent company, the subsidiary issuer, the guarantor subsidiaries on a combined basis, any other subsidiaries on a combined basis, consolidating adjustments and the total consolidated amounts.

Paragraph (d) applies in the same manner regardless of whether the issuer is a finance subsidiary or an operating subsidiary. A separate column for other subsidiaries is not required when those other subsidiaries are minor.

If a subsidiary issuer satisfies the requirements of paragraph (d) but for the fact that it co-issued the securities, jointly and severally, with its parent company, the parent company may present its financial information with respect to the subsidiaries as paragraph (d) permits.

If there is one subsidiary guarantor and that subsidiary's guarantee is not joint and several with the parent company's guarantee, or there is more than one subsidiary guarantor and any of the subsidiary guarantees is not joint and several with the guarantees of the parent company and the other subsidiaries, the condensed consolidating financial information should include a separate column for each subsidiary guarantor whose guarantee is not joint and several.

In the event that a parent company has no independent assets or operations, the subsidiary issuer is a finance company and all of the parent company's other subsidiaries guarantee the securities on a full and unconditional and joint and several basis, the consolidated financial statements, when combined with the required narrative information, will constitute sufficient financial information disclosure for the purpose of Rule 3-10(d).

Single subsidiary guarantor of securities issued by its parent company

Paragraph (e) of Rule 3-10 codifies the Staff's positions regarding the structure in which a parent company issues securities and one of its subsidiaries guarantees those securities and provides that the subsidiary guarantor need not include separate financial statements if:

- no other subsidiary of that parent company guarantees the securities;
- the parent company's financial statements are filed for the periods specified by Rules 3-01 and 3-02 of Regulation S-X; and
- the parent company's financial statement footnotes include condensed consolidating financial information for the same periods with a separate column for the parent company, the subsidiary guarantor, any other subsidiaries of the parent on a combined basis, consolidating adjustments and the total consolidated amounts.

Paragraph (e) applies in the same manner regardless of whether the subsidiary guarantor is a finance subsidiary or an operating subsidiary.

Condensed consolidating financial information may be omitted if:

- the parent company has no independent assets or operations;
- any subsidiaries other than the guarantor are minor; and
- the parent company's financial statements include a footnote stating that the parent company has no independent assets or operations, the guarantee is full and unconditional and any non-guarantor subsidiaries are minor.

A separate column for other subsidiaries is not required when the parent company has independent assets or operations, but the other subsidiaries are minor.

Paragraph (e) of Rule 3-10 does not apply if the subsidiary co-issued the securities, jointly and severally, with its parent company. Instead, if the subsidiary is a finance subsidiary, paragraph (b) would apply and if the subsidiary is an operating subsidiary, paragraph (c) would apply.

Multiple subsidiary guarantors of securities issued by their parent company

Paragraph (f) of Rule 3-10 codifies the Staff's position regarding the structure in which a parent company issues securities and more than one of its subsidiaries guarantees the securities and provides that the subsidiary guarantors need not include separate financial statements if:

- the guarantees are joint and several;
- the parent company's financial statements are filed for the periods specified by Rules 3-01 and 3-02 of Regulation S-X; and
- the parent company's financial statement footnotes include condensed consolidating financial information for the same periods with a separate column for the parent company, the subsidiary guarantors on a combined basis, any other subsidiaries on a combined basis, consolidating adjustments and the total consolidated amounts.

Condensed consolidating financial information may be omitted if:

- the parent company has no independent assets or operations;
- any subsidiaries other than the subsidiary guarantors are minor; and
- the parent company's financial statements include a footnote stating that the parent company has no independent assets or operations, the guarantees are full and unconditional and joint and several, and any non-guarantor subsidiaries are minor.

A separate column for other subsidiaries is not required when the parent company has independent assets or operations, but the other subsidiaries are minor.

If any of the subsidiary guarantees is not joint and several with the guarantees of the other subsidiaries, the condensed consolidating financial information must include a separate column for each subsidiary guarantor whose guarantee is not joint and several.

Recently acquired subsidiary issuers and guarantors

Recently acquired subsidiary issuers and subsidiary guarantors generally are not included in the consolidated results of the parent company for all periods. Thus, condensed consolidating financial information does not effectively present all material financial information to investors.

Paragraph (g) of Rule 3-10 addresses this issue by requiring, notwithstanding the exemptions of Rule 3-10, pre-acquisition financial statements for any recently acquired subsidiary issuer or subsidiary guarantor:

- that has not been included in the audited consolidated results of its parent company for at least nine months of the most recent fiscal year; and
- whose net book value or purchase price, whichever is greater, is 20% or more of the principal amount of the securities being registered.

Paragraph (g) requires pre-acquisition financial statements in Securities Act registration statements only. Those financial statements are not required in Exchange Act periodic reports.

Instructions for preparing condensed consolidating financial information

Rule 3-10 contains a series of instructions for preparing the financial information required for the exemptions provided by Rule 3-10. Generally, the information will be presented in columnar form for each category of parent and subsidiary as issuer, guarantor and non-guarantor. The instructions state, for example, that:

- the information should follow the guidance of S-X Rule 10-01
- the information should be audited for the same periods as the parent's financial statements; information prepared other than in US GAAP should be

reconciled to US GAAP to the extent necessary to evaluate the sufficiency of the guarantees

- a separate column should be provided for each subsidiary issuer or subsidiary guarantor that is not 100% owned, whose guarantee is not full and unconditional or whose guarantees are not joint and several with the guarantees of other subsidiaries (subsidiary guarantors may combine financial information in one column if the guarantees are joint and several)
- a separate column should be provided by legal jurisdiction if differences in laws affect enforceability of the guarantees
- restrictions on the ability of a parent or guarantor to obtain funds by loan or dividend from a subsidiary should be disclosed

Rule 3-16

Prior to the adoption of the Release, the financial statement requirements for affiliates whose securities collateralize registered securities were combined with the requirements for guarantors in Rule 3-10. With the restructuring of Rule 3-10, the SEC adopted new Rule 3-16 to relocate the financial statement requirements for affiliates whose securities collateralize registered securities.

Consistent with the Staff's past approach, collateralizing affiliates will continue not to incur Exchange Act reporting requirements. In addition, unlike subsidiary issuers and subsidiary guarantors, collateralizing affiliates are not registrants. Therefore, financial statements of collateralizing affiliates are not required in quarterly reports of the issuer of the collateralized security.

Exchange Act Reporting Requirements

Prior to the adoption of the Release, subsidiary issuers or subsidiary guarantors that were not required to include separate financial statements in their Securities Act registration statements would request no-action relief from the Exchange Act reporting requirements. In order to reduce significantly the need for these requests, the SEC adopted new Rule 12h-5 to provide certainty regarding the availability of an exemption from Exchange Act reporting.

Rule 12h-5 exempts from Exchange Act reporting:

- subsidiary issuers or subsidiary guarantors permitted to omit financial statements by paragraphs (b) through (f) of Rule 3-10; and
- recently acquired subsidiary issuers or subsidiary guarantors that would be permitted to omit financial statements by paragraphs (b) through (f) of Rule 3-10, but are required to provide pre-acquisition financial statements under paragraph (g) of such rule.

The parent company periodic reports must still include the modified financial information permitted by paragraphs (b) through (f) of Rule 3-10 for as long as the subject securities are outstanding. The parent company's periodic reports need not, however, provide

the non-financial disclosure required by the periodic report form for the subsidiary, unless the securities laws otherwise require the parent company to provide information about the subsidiary. In addition, in the case of recently acquired subsidiary issuers or subsidiary guarantors, Exchange Act reporting is not required when financial statements are provided under Rule 3-10 solely because the subsidiary was recently acquired.

Foreign Parent Companies

Foreign parent companies reporting on Form 20-F

If a parent company reports on Form 20-F and is not required to file quarterly reports under the Exchange Act, Rule 3-10 would not require that parent company to file more frequent information regarding its domestic subsidiary issuers and domestic subsidiary guarantors.

Foreign parent companies reporting on Form 40-F

When a Canadian parent company and one or more of its subsidiaries register an offering of guaranteed securities under the MJDS system, in most instances the parent company and its subsidiaries incur reporting obligations under Section 15(d). When a subsidiary issuer or subsidiary guarantor is also eligible to register its security under the MJDS, the financial statements that would appear in the registration statement and in any annual report on Form 40-F filed by the Canadian parent company would not be affected by Rule 3-10. The disclosure would be in accordance with Canadian disclosure standards. When a subsidiary issuer or subsidiary guarantor is not eligible to register its security under the MJDS, the financial statements of the parent company included in the Securities Act registration statement and any Exchange Act registration statement or annual report must comply with Rule 3-10.

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This memorandum is intended solely for general informational purposes and should not be construed as, or used as a substitute for, legal advice with respect to specific transactions, since such advice requires an evaluation of precise factual circumstances. U.S. counsel should be consulted as to all questions that arise with respect to the laws, rules, regulations and other legal requirements discussed herein. For further information concerning the subject matter of this memorandum, please contact any member of the Paul Weiss Securities Group, including:

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