

**PUBLIC**

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RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 95-110-CC  
Goldman, Sachs & Co.  
File No. 132-3

Your letter dated April 24, 1995 seeks our concurrence that a finance subsidiary organized as a business trust under the Delaware Business Trust Act ("DBTA"), 1/ or a similar business trust statute in another state, that issues non-voting preferred trust certificates ("Preferred Trust Certificates") as described in your letter, may rely on the exemption for finance subsidiaries under Rule 3a-5 under the Investment Company Act of 1940 (the "Investment Company Act"). 2/

You state that a finance subsidiary established as a business trust issuing Preferred Trust Certificates, and the related transaction, will comply fully in all respects with Rule 3a-5, except that the transaction will involve the issuance of non-voting Preferred Trust Certificates by a business trust instead of non-voting preferred stock by a corporation. Business trusts are "creatures of contract" in that they are created by a trust instrument under which property is held and administered by a trustee for the benefit of persons who are or may become the beneficiaries of the trust. A Delaware business trust may issue Preferred Trust Certificates having rights, preferences and limitations, including voting rights or the express denial of voting rights, equivalent to those of the preferred stock of a corporation. All of the ownership interests in the business trust will be evidenced by one or more classes of Preferred Trust Certificates and a single class of trust certificates owned by the parent company or a company controlled by the parent. All of the interests in the business trust other than the non-voting Preferred Trust Certificates will be owned by the parent company or a company controlled by the parent company. 3/

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1/ Del. Code, Title 12, §§ 3801 et seq.

2/ Generally, Rule 3a-5 exempts from the definition of investment company a subsidiary that is organized to finance the operations of its parent company or companies controlled by its parent company, provided such companies are not themselves investment companies under Section 3(a) of the Investment Company Act. Under paragraph (b)(1) of Rule 3a-5, "[a] 'finance subsidiary' shall mean any corporation (i) [a]ll of whose securities other than debt securities or non-voting preferred stock . . . are owned by its parent company or a company controlled by its parent company."

3/ You believe that there are several reasons why business trusts were not included in the definition of finance subsidiary in Rule 3a-5. You state that when Rule 3a-5 was adopted in 1984, no parent company, to your knowledge, had  
(continued...)

In the release adopting Rule 3a-5, the Commission stated that it was appropriate to exempt a finance subsidiary from all provisions of the Investment Company Act where neither its structure nor its mode of operation resembles that of an investment company. <sup>4/</sup> The Commission stated that it found this to be the case where the primary purpose of the subsidiary is to finance the business operations of its parent or other subsidiaries of its parent, and where any purchaser of the finance subsidiary's debt instruments ultimately looks to the parent for repayment and not to the finance subsidiary.

You state that, as in the case of a finance subsidiary organized as a corporation, the business trust will be formed for the primary purpose of financing the operations of the parent or its other subsidiaries, and at least 85% of the proceeds from the offering of the Preferred Trust Certificates will be invested in or loaned to the parent or its controlled companies consistent with the requirements of Rule 3a-5. The Preferred Trust Certificates issued by the business trust would (1) be non-voting except for limited circumstances that are effectively the same as those pursuant to which non-voting preferred stockholders in a corporation issuing securities in reliance of Rule 3a-5 would have voting rights; (2) have a liquidation preference that is akin to the liquidation preference of preferred stock; (3) entitle holders to priority for periodic distributions that is akin to the rights of holders of preferred stock; and (4) will benefit from a parent's guarantee in compliance with Rule 3a-5.

Based on the facts and representations in your letter, we would not recommend enforcement action to the Commission if a finance subsidiary organized as a business trust under the DBTA, or a similar business trust statute in another state, that issues

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3/ (...continued)

proposed to use a business trust as a finance subsidiary, so the Commission would not have considered whether to include business trusts within the scope of the rule. In addition, at the time the rule was adopted, finance subsidiaries were commonly established to offer their securities to institutional investors. At that time, some state investment laws applicable to institutional investors were generally more restrictive as to investments in securities issued by non-corporate issuers. The existence of these state law restrictions, therefore, made it less likely that the Commission would have considered whether business trusts should be included in the rule's definition of finance subsidiary.

4/ Investment Company Act Release No. 14275 (Dec. 20, 1984) (adopting Rule 3a-5).

Preferred Trust Certificates as described in your letter, relies on the exemption for finance subsidiaries under Rule 3a-5. 5/ Because this position is based on the facts and representations made in your letter, you should note that any different facts or circumstances might require a different conclusion.



Alison E. Baur  
Senior Counsel

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5/ See also Andrews & Kurth L.L.P. (pub. avail. Apr. 5, 1994) (staff granted no-action relief so that a finance subsidiary organized as a limited partnership could rely on Rule 3a-5); (Lehman Brothers Inc. (pub. avail. Mar. 8, 1994) (staff granted no-action relief so that a finance subsidiary organized as a limited liability company could rely on the rule); Inco Limited (pub. avail. Mar. 4, 1994) (same); Merrill Lynch & Co. (pub. avail. Mar. 2, 1994) (same).

SULLIVAN & CROMWELL

NEW YORK TELEPHONE: (212) 558-4000  
TELEX: 62694 (INTERNATIONAL) 127816 (DOMESTIC)  
CABLE ADDRESS: LADYCOURT, NEW YORK  
FACSIMILE: (212) 558-3588 (125 BROAD STREET)  
(212) 558-3792 (250 PARK AVENUE)

*125 Broad Street, New York 10004-2498*

250 PARK AVENUE, NEW YORK 10177-0021  
1701 PENNSYLVANIA AVE., N.W., WASHINGTON, D.C. 20006-5805  
444 SOUTH FLOWER STREET, LOS ANGELES 90071-2901  
8, PLACE VENDÔME, 75001 PARIS  
ST. OLAVE'S HOUSE, 91 IRONMONGER LANE, LONDON EC2V 8EY  
101 COLLINS STREET, MELBOURNE 3000  
2-1, MARUNOUCHI 1-CHOME, CHIYODA-KU, TOKYO 100  
NINE QUEEN'S ROAD, CENTRAL, HONG KONG

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April 24, 1995

Office of the Chief Counsel,  
Division of Investment Management,  
Securities and Exchange Commission,  
450 Fifth Street, N.W.,  
Washington, D.C. 20549.

Attention: Alison E. Baur, Esq.

Re: Business Trusts as Finance Subsidiaries  
Pursuant to Rule 3a-5

Ladies and Gentlemen:

We are writing on behalf of Goldman, Sachs & Co., in connection with transactions under consideration by their clients, to request confirmation that the staff of the Division of Investment Management (the "Staff") interprets Rule 3a-5 under the Investment Company Act of 1940 to be available for (x) a finance subsidiary established as a business trust under the Delaware Business Trust Act (Dela. Code, Title 12, §§ 3801 et seq.) or a similar business trust statute in another state (y) issuing non-voting preferred trust certificates ("Preferred Trust Certificates"), as further described below.

Under paragraph (b) (1) of Rule 3a-5,

"A 'finance subsidiary' shall mean any corporation  
. . . (i) All of whose securities other than debt

securities or non-voting preferred stock meeting the applicable requirements of paragraphs (a)(1) through (a)(3) or directors' qualifying shares are owned by its parent company or a company controlled by its parent company". (Emphasis added)

The term "corporation" is not defined. By contrast, and as discussed further in Part B below, under paragraph (b)(2) "A 'parent company' shall mean any corporation, partnership or joint venture . . ." (emphasis added) which in turn satisfies certain other conditions. Similarly, the term "preferred stock" is not defined.

In our view, for the reasons discussed further below, construing a business trust to be the equivalent of a corporation, and non-voting Preferred Trust Certificates to be the equivalent of non-voting preferred stock, is consistent with the fundamental purpose of Rule 3a-5 as enunciated in the proposing and adopting releases.\* Our request for interpretive advice is premised on the assumption that the finance subsidiary established as a business trust issuing Preferred Trust Certificates, and the related transaction, will fully comply in all respects with Rule 3a-5, except that the transaction will involve the issuance of non-voting Preferred Trust Certificates by a business trust instead of non-voting preferred stock by a corporation.

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\* Release No. IC-14275 (December 14, 1984) (the "Adopting Release"); Investment Company Act Release No. 12679 (September 22, 1982).

A. Background -- Description of Business Trusts  
and Assumptions

Business trusts are "creatures of contract" in the sense that they are created by a trust instrument under which property is held and administered by a trustee for the benefit of such persons who are or may become the beneficiaries of the trust. Beneficial ownership interests are commonly evidenced by trust certificates. Several states have adopted statutes in recent years pursuant to which beneficial owners of business trusts that conform to the statutes' requirements are entitled to the same limitation of personal liability extended to stockholders of private corporations. One such statute is the Delaware Business Trust Act ("DBTA").

Because the business trust statutes differ somewhat from state to state, and the area will continue to evolve as additional states consider adoption of business trust statutes, it will be helpful to frame our request for interpretive advice based upon the DBTA, as an example. However, the principles involved, and we believe your interpretive position, should be equally applicable to business trusts entitled to limited liability under similar statutes in other states.

The DBTA provides substantial flexibility as to the terms under which a Delaware business trust may be established and operated as well as the terms of the beneficial ownership interests in a Delaware business trust. DBTA § 3801(a) defines a "business trust" to mean:

"an unincorporated business association which (i) is created by a trust agreement under which property is or will be held, managed, administered, controlled, invested, reinvested and/or operated, or business or professional activities for profit are carried on or will be carried on, by a trustee or trustees for the benefit of such person or persons as are or may become entitled to a beneficial interest in the trust property . . . and (ii) files a certificate of trust pursuant to Section 3810 of this Chapter."

DBTA § 3801(b) defines the term "beneficial owner" to mean

"any owner of a beneficial interest in a business trust, the fact of ownership to be determined and evidenced (whether by means of registration, the issuance of certificates, or otherwise) in conformity to the applicable provisions of the governing instrument of the business trust."

Pursuant to DBTA Section § 3803(a), beneficial owners of Delaware business trusts are "entitled to the same limitation of personal liability extended to stockholders of private corporations for profit."

DBTA § 3806(a) provides that the business and affairs of a Delaware business trust shall be managed by or under the direction of its trustees. DBTA § 3806(a) goes on to provide, however, that

"[t]o the extent provided in the governing instrument of a business trust, any person (including a beneficial owner) shall be entitled to direct the trustees in the management of a business trust."

As to the terms of the beneficial ownership interests in a Delaware business trust, DBTA § 3806(b)

provides that a Delaware business trust's governing instrument

"may contain any provision relating to the . . . rights, duties and obligations of the . . . beneficial owners . . . which is not contrary to any provision or requirement of this Chapter and, without limitation:

- (1) may provide for classes, groups or series of . . . beneficial owners, or classes, group or series of beneficial interests, having such relative rights, powers and duties as the governing instrument may provide, and may make provision for the future creation in the manner provided in the governing instrument of additional classes, groups or series of . . . beneficial owners or beneficial interests, having such relative rights, powers and duties as may from time to time be established, including rights, powers and duties senior or subordinate to existing classes, groups or series of . . . beneficial owners or beneficial interests;
- (2) may establish or provide for the establishment of designated series of . . . beneficial owners or beneficial interests having separate rights, powers or duties with respect to specified property or obligations of the business trust or profits and losses associated with specified property or obligations . . . ;
- . . .
- (4) may grant to (or withhold from) all or certain . . . beneficial owners, or a specified class, group or series of . . . beneficial owners, the right to vote, separately or with any or all other classes, groups or series of . . . beneficial owners, on any matter, such voting being on a per

capita, number, financial interest, class,  
group, series or any other basis . . .".

Accordingly, we believe that a Delaware business trust may issue Preferred Trust Certificates having rights, preferences and limitations, including voting rights or the express denial of voting rights, equivalent to those of the preferred stock of a corporation.

Our request for interpretive advice is premised on the assumptions that a business trust relying on Rule 3a-5 would be established as, and have the attributes, set forth below:

(a) The business trust will be established pursuant to a declaration of trust or trust agreement (in either case, the "Trust Agreement" for such business trust) with a bank or trust company, as trustee (the "Trustee"), who is independent from the parent company (the "Parent") that causes the business trust to be established as its financing vehicle.

(b) The ownership interests in the business trust will be evidenced by one or more classes of Preferred Trust Certificates and a single class of trust certificates owned by the Parent or a company controlled by the Parent (in either case, the "Parent Certificate" and, together with the Preferred Trust Certificates, the "Certificates"). Accordingly, all of the interests in the business trust other than the non-voting Preferred Trust Certificates will be owned by the Parent or a company controlled by the Parent.

The Parent Certificate will represent approximately 3% of the aggregate ownership interest in the business trust, with the remaining ownership interest represented by the Preferred Trust Certificates. Both the Preferred Trust Certificates and the Parent Certificate will, on their face, specify the payment entitlements evidenced thereby with respect to distributions of principal and interest or other income on the business trust's assets.

(c) Investors in the Preferred Trust Certificates will have limited liability like that of stockholders in a corporation in reliance on DBTA § 3803(a) or a similar provision in another state's business trust statute.

(d) At least 85% of the proceeds raised by the business trust from issuance of Preferred Trust Certificates will be invested in or loaned to the Parent or companies controlled by the Parent (the securities evidencing such investments or loans collectively, the "Parent Securities").

(e) The Preferred Trust Certificates and the Parent Certificate will receive as distributions on periodic distribution dates specified in the Trust Agreement their pro rata shares of payments received by the business trust on the Parent Securities, except that, in the event of a default or partial payment by the Parent on the Parent Securities, the payment entitlement of the Parent as the holder of the Parent

Certificate will be subordinated to the payment entitlement of the investors as holders of the Preferred Trust Certificates. Similarly, if on liquidation of the business trust\* the proceeds from sale or other liquidation of the business trust's assets were not sufficient to fully satisfy the payment entitlements of the Preferred Trust Certificates and the Parent Certificate with respect to principal, the payment entitlement with respect to principal of the Parent as the holder of the Parent Certificate will be subordinated to the payment entitlement of the investors as holders of the Preferred Trust Certificates. The Trust Agreement will provide that the Trustee is required to distribute to Certificateholders, on the periodic distribution dates specified in the Trust Agreement, amounts received by the Trustee on the Parent Securities.

(f) As a result of the subordination of the Parent Certificate as described in paragraph (e), above, the Preferred Trust Certificates will have a preference, both as to periodic distributions and upon liquidation, over such distributions with respect to any interests in the business trust other than the

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\* Ordinarily the business trust would not be liquidated prior to payment of the Parent Securities at their maturity and distribution of such payment to holders of Preferred Trust Certificates and, on a subordinated basis, the Parent Certificate.

Preferred Trust Certificates that is akin to the preference of preferred stock issued by a corporation.

(g) The Parent will select the initial Trustee and, subject to eligibility requirements specified in the Trust Agreement, will have the right to replace the Trustee unless and until a default on one or more Parent Securities occurs. Thereafter, only holders of the Preferred Trust Certificates will have the right to replace the Trustee. Similarly, any other consensual rights vested by the Trust Agreement in holders of Certificates will be exercised only by the Parent as holder of the Parent Certificate prior to the occurrence of a default under the Parent Securities subject to the Parent being precluded from amending or consenting to any waiver of the terms of the Trust Agreement that would be materially adverse to holders of Preferred Trust Certificates. Accordingly, the Preferred Trust Certificates will be non-voting except for limited circumstances that are effectively the same as those pursuant to which non-voting preferred stockholders in a corporation issuing securities in reliance on Rule 3a-5 would have voting rights.

(h) The Parent will guarantee distribution by the Trustee to holders of the Parent Trust Certificates, in accordance with the terms of the Trust Agreement, of amounts received by the Trustee on the Parent Securities. Such Parent guarantee in favor of holders of Preferred Trust Certificates will be in compliance with Rule 3a-5.

B. Discussion

Based on and subject to the description in Part A, permitting a finance subsidiary established as a business trust and issuing Preferred Trust Certificates to rely on Rule 3a-5 is, in our view, consistent with the basic purposes of Rule 3a-5. The considerations relevant to this view are essentially the same as those bearing on the question of whether a limited liability company issuing non-voting preferred member interests, or a limited partnership issuing non-voting preferred partnership interests, should be permitted to rely on Rule 3a-5. The Staff previously has taken the position that finance subsidiaries organized as limited partnerships or limited liability companies issuing non-voting preferred partner interests or preferred member interests but otherwise complying with the requirements of Rule 3a-5 may rely on the exemption for finance subsidiaries under Rule 3a-5. See Andrews & Kurth L.L.P. (pub. avail. April 5, 1994); Lehman Brothers Inc. (pub. avail. March 8, 1994); Inco Limited (pub. avail. March 4, 1994); and Merrill Lynch & Co. (pub. avail. March 2, 1994).

The basic purposes of Rule 3a-5 are succinctly outlined in the Adopting Release, as follows:

"As stated in the proposing release, the Commission believes that it is appropriate to exempt a finance subsidiary from all provisions of the [1940] Act where neither its structure nor its mode of operation resembles that of an investment company. We have found this to be the case where the primary purpose of the subsidiary is to finance the business operations of its parent or other subsidiaries of its parent which are not

investment companies. We have also found this to be the case where any purchaser of the finance subsidiary's debt instruments ultimately looks to the parent for repayment to the finance subsidiary. The rule, therefore, describes a situation where the finance subsidiary is essentially a conduit for the parent to raise capital for its own business operations or for the business operations of its other subsidiaries."

As in the case of a conventional finance subsidiary in corporate form, the business trusts in the cases we are describing will be formed for the primary purpose of financing the operations of the Parent or its other subsidiaries, and the proceeds of the Preferred Trust Certificates will be on-loaned or invested in securities of the Parent or its controlled companies in compliance with the requirements of Rule 3a-5. A business trust finance subsidiary will be "essentially a conduit for the Parent to raise capital" to the same extent as a conventional corporate finance subsidiary. Holders of Preferred Trust Certificates will have recourse to the guarantor/Parent's credit in the same manner, and to the same extent, as holders of preferred stock of a finance subsidiary established as a corporation. The Preferred Trust Certificates will be non-voting, except for limited voting rights equivalent to the voting rights as described above generally available to holders of otherwise non-voting preferred stock.

We note that, where paragraph (b)(1) specifies that a finance subsidiary will be a corporation, as quoted above, paragraph (b)(2), in contrast, provides "a 'parent

company' shall mean any corporation, partnership or joint venture . . ." (emphasis added) which in turn satisfies certain other conditions. The discussion in Part II.C of the Adopting Release indicates that partnerships and joint ventures were included in the definition of "parent company" in response to the request of commentators on the Rule, as initially proposed, in order that the definition be expansive enough to permit projects with multiple sponsors to rely on the Rule. We have found no indication that the more expansive definition of parent company should be read to imply a deliberately restrictive definition of finance subsidiary.

Although business trusts have existed for many years, long pre-dating the adoption of Rule 3a-5, we do not believe that the existence of business trusts at the time Rule 3a-5 was adopted should be a significant factor in the Staff's consideration of whether Rule 3a-5 may properly be interpreted to permit finance subsidiaries established as business trusts to rely on the Rule. First, and most important, consideration of the eligibility of a business trust as a finance subsidiary was not an issue in 1984 because, at that time, no parent company (at least to our knowledge) had proposed to use a business trust as a finance subsidiary. The reasons for the current interest in using business trusts as finance subsidiaries arise out of the interplay of financial reporting and tax considerations which do not, we believe, implicate the basic purposes of Rule 3a-5. Second, legal investment statutes in some states applicable to certain types of institutional investors have been revised in recent years to broaden such institutional investors' ability to purchase securities issued by business trusts. See, e.g., Sections 1192 and 1192.8 of the

California Insurance Code and Section 653c of the Pennsylvania Insurance Law. When Rule 3a-5 was adopted in 1984, state legal investment laws applicable to institutional investors were generally more restrictive with respect to investments in securities issued by non-corporate issuers than they are today, making it less likely that the eligibility of a business trust as a finance subsidiary was a relevant consideration in 1984. This is relevant because finance subsidiaries established pursuant to exemptive orders prior to the adoption of Rule 3a-5 and in reliance on Rule 3a-5 thereafter were commonly established in connection with the offering of securities targeted to the institutional market (commercial paper, for example). Third, limited partnerships also, of course, were in existence in 1984 and long pre-date the adoption of Rule 3a-5. As indicated above, the Staff nevertheless has taken the position that finance subsidiaries organized as limited partnerships issuing non-voting preferred partner interests but otherwise complying with the requirements of Rule 3a-5 may rely on the exemption for finance subsidiaries under Rule 3a-5.

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We respectfully request your confirmation of our view that Rule 3a-5 may be interpreted to permit a business trust issuing Preferred Trust Certificates to rely on

Office of the Chief Counsel,  
Division of Investment Management

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Rule 3a-5. Should you have any questions, please contact the undersigned at 212-558-3669, John E. Baumgardner, Jr., at 212-558-3866 or Robert S. Risoleo at 212-558-3570.

Very truly yours,

*Mark J. Welshimer*  
Mark J. Welshimer