

PUBLIC

8 MAR 1994

RESPONSE OF THE OFFICE OF CHIEF COUNSEL
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 94-114-CC
Lehman Brothers Inc.
File No. 132-3

Your letter dated March 3, 1994 seeks our concurrence that a finance subsidiary organized in the United States as a limited liability company ("LLC") that issues non-voting preferred equity interests ("preferred shares") 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"). 1/

You state that a finance subsidiary established as an LLC issuing preferred shares will comply fully in all respects with Rule 3a-5, except that the transaction will involve the issuance of non-voting preferred shares by an LLC instead of non-voting preferred stock by a corporation. 2/ You state that LLCs, like corporations, are vehicles that provide limited liability to all equity owners, but are more flexible than corporations with respect to, among other things, certain types of financing. You state that an LLC may issue equity interests to members with the same rights with respect to distributions, voting exchanges and conversions, and liquidation rights, as those of common and preferred stock issued by a corporation. You further state that the parent company of the LLC, or a company controlled by the parent company, will own all of the LLC's securities other than the non-voting preferred shares as required by Rule 3a-5(b)(1)(i). 3/

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

1/ 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."

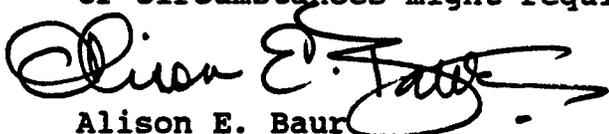
2/ Telephone conversation on March 8, 1994 between Alison Baur and Larry Vranka.

3/ Id.

investment company. 4/ 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 is the case with a finance subsidiary organized as a corporation, the LLC will be formed for the purpose of financing the business operations of its parent or other subsidiaries of its parent, and the proceeds from the sale of preferred shares will be loaned by the LLC to its parent company or companies controlled by the parent company. You further state that, the preferred shares issued by the LLC would (i) entitle holders to priority over certain distributions equivalent to the rights of holders of preferred stock; (ii) have a liquidation preference that is equivalent to the liquidation preference for preferred stock; (iii) 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; (iv) be convertible or exchangeable in compliance with Rule 3a-5 if the terms of the preferred shares provide for conversion and exchange; 5/ and (v) benefit from a parent's guarantee in compliance with Rule 3a-5.

Based on the facts and representations in your letter and telephone conversation, we would not recommend enforcement action to the Commission if a finance subsidiary organized in the United States as an LLC that issues non-voting preferred shares as described in your letter relies on the exemption for finance subsidiaries under Rule 3a-5. 6/ Because this position is based on the facts and representations made in your letter and telephone conversation, you should note that any different facts or circumstances might require a different conclusion.



Alison E. Baur
Attorney

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

5/ Telephone conversation on March 8, 1994 between Alison Baur and Larry Vranka.

6/ See Inco Limited (pub. avail. Mar. 4, 1994); Merrill Lynch & Co. (pub. avail. Mar. 2, 1994).

SIMPSON THACHER & BARTLETT

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SECTION _____

RULE 3a-5

PUBLIC _____

AVAILABILITY 3/8/94

March 3, 1994

**Re: Definition of a Finance Subsidiary Pursuant to
Rule 3a-5 under the Investment Company Act of 1940**

Office of Chief Counsel
Division of Investment Management
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Attention: Alison E. Baur

Dear Ms. Baur:

We are writing on behalf of our client, Lehman Brothers Inc., in connection with a product it is developing and in further reference to discussions we recently had with you concerning the definition of a finance subsidiary under subsection (b) of Rule 3a-5 ("Rule 3a-5") of the Investment Company Act of 1940 (the "1940 Act"). In our view, the issuance of preferred equity interests by a finance subsidiary that is a limited liability company (an "LLC") organized in the United States is analogous to the issuance of non-voting preferred stock by a finance subsidiary that is a corporation. We request that the Staff of the Division of Investment Management (the "Staff") confirm that (i) an LLC would fall within the definition of a finance subsidiary, provided that the requirements specified in clauses (i) and (ii) of Rule 3a-5(b)(1) were met and (ii)

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preferred equity interests issued by an LLC would constitute "non-voting preferred stock" for purposes of Rule 3a-5.

Limited Liability Company as Finance Subsidiary

Rule 3a-5(b) provides that a "parent company" and a "company controlled by the parent company" may be a corporation, partnership or joint venture, but the definition of "finance subsidiary" is limited to any corporation that meets the requirements specified therein. At the time Rule 3a-5 was promulgated, a corporation was generally the only entity that could satisfy clause (i) of Rule 3a-5(b)(1), which states that a finance subsidiary is a corporation "all 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." A partnership or a joint venture generally would not fulfill this requirement because, by definition, they are in most cases owned by two or more common equity owners. Since the promulgation of Rule 3a-5, however, many states have adopted statutes authorizing the organization of limited liability companies, which, like corporations, are vehicles that provide limited liability to all equity owners, but are more flexible than corporations with respect to certain types of financing and other matters. See, e.g., Delaware Limited Liability Company Act (Dela. Code Title 6, §§ 18-101 *et seq.*).

A limited liability company, in our view, can meet the requirements of Rule 3a-5(b)(1). As is the case with a corporation, the parent company of an LLC (or a company controlled by its parent company) can own all of its securities other than debt

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securities or non-voting preferred equity interests as required by clause (i) of Rule 3a-5(b)(1).

The requirements of Rule 3a-5 are intended to ensure that neither the structure nor the mode of operation of any finance subsidiary will resemble that of an investment company, and that the finance subsidiary will act essentially as a conduit for the parent to raise capital for the purpose of financing the business operations of its parent or other subsidiaries of its parent which are not investment companies. We believe that a finance subsidiary that is organized as an LLC rather than as a corporation can be structured to meet all of such requirements, while providing to its parent the greater flexibility afforded by an LLC in raising capital.

Preferred Equity Interests as Non-Voting Preferred Stock

Although an LLC would not issue "stock" to its "stockholders" like a corporation, the flexibility provided by LLC statutes generally permits the issuance of various types of equity "interests" to "members," with terms and provisions like those of common and preferred stocks of any corporate vehicle, i.e., they can be given the same rights with respect to distributions, voting, exchanges and conversions, and liquidation rights. Just as a corporation may issue different classes of stock, an LLC may provide for classes or groups of members having different rights, powers and duties, including rights, powers and duties senior to existing classes and groups of members.

Our client is proposing the use of an LLC that would issue both common equity interests (or "common shares") and preferred equity interests (or "preferred

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shares"). All of the common shares would be owned by the "parent company" of the LLC or a "company controlled by the parent company" (in each case as defined in Rule 3a-5(b)). The LLC would issue and sell its preferred shares to investors. The proceeds from the sale of preferred shares would be loaned by the LLC to its parent company or companies controlled by the parent company for the purpose of financing the operations of such entities. Payments of interest and principal on the loan or loans from the LLC would fund the payment of scheduled distributions and redemption and liquidation distributions on the preferred shares. The obligations of the LLC in respect of the preferred shares would be guaranteed by the parent company pursuant to a guarantee complying with the provisions of Rule 3a-5. The preferred shares would have the following terms, which are equivalent to rights of preferred stock issued by a corporation:

Priority Over Certain Distributions. If distributions have not been made in full on the preferred shares in accordance with their terms (which terms will be determined at the time of the offering of the preferred shares), the LLC will not (i) pay or declare any distributions on any common shares or any other interests of the LLC ranking junior to the preferred shares as to distributions; or (ii) redeem, purchase or otherwise acquire any common shares or any other interests of the LLC ranking junior to the preferred shares as to distributions, until in each case such time as all accumulated arrears of unpaid distributions on the preferred shares have been paid in full.

Liquidation Preference. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the LLC, the holders of the preferred shares at

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the time outstanding will be entitled to receive out of the assets of the LLC available for distribution to members, before any distribution of assets is made to holders of common shares or any other interests of the LLC ranking junior to the preferred shares as regards participation in assets of the LLC, an amount equal to the aggregate of the liquidation preference of the preferred shares and all accumulated arrears of unpaid distributions.

Voting Rights. Holders of the preferred shares will not be entitled to any voting rights, 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.

Conversion and Exchange. If the terms of the preferred shares so provide, the preferred shares will be convertible or exchangeable only for securities issued by the parent company in accordance with the terms of such preferred shares.

For the foregoing reasons, we respectfully request the Staff's confirmation that (i) a finance subsidiary that is organized in the United States as a limited liability company would fall within the definition of a finance subsidiary, provided that the requirements specified in clauses (i) and (ii) of Rule 3a-5(b)(1) of the 1940 Act were met, and (ii) preferred interests in such limited liability company possessing the attributes described above would be characterized as "non-voting preferred stock" for purposes of Rule 3a-5 of the 1940 Act.

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If you have any questions or require any additional information regarding the foregoing request, please call Andrew R. Keller at (212) 455-3577 or Lawrence Vranka, Jr. at (212) 455-7387.

Please acknowledge receipt of this letter by stamping the enclosed copy and returning it in the enclosed self-addressed, stamped envelope.

Very truly yours,

A handwritten signature in cursive script that reads "Simpson Thacher & Bartlett".

SIMPSON THACHER & BARTLETT