Simpson Thacher

Memorandum

SEC Proposes Changes to Financial Disclosure Requirements That Will Enhance the Ability of Umbrella Partnerships to Issue SEC-Registered Debt

July 26, 2018

On July 24, 2018, the Securities and Exchange Commission proposed significant amendments to its rules designed to simplify and streamline the financial disclosure requirements applicable to registered offerings of debt securities that are guaranteed by related entities.[1] Among these proposals are ones which, if adopted, will enhance the ability of businesses organized as multiple-tier umbrella partnership structures, such as UP-Cs, UPREITs and UP-PTPs, to issue SEC-registered debt securities.

As a general matter, each issuer and guarantor of a registered debt security is treated as registering the offer and sale of a separate security for purposes of the Securities Act of 1933, as amended. Consequently, each issuer and guarantor of a registered debt security would, in the absence of relief, be required to include in the applicable Securities Act registration statement its own audited annual and unaudited interim financial statements as required by Regulation S-X and become subject to ongoing SEC reporting requirements under Section 15(d) of the Exchange Act of 1934, as amended. Rule 3-10 of Regulation S-X provides relief from these rules, however, that allows subsidiary issuers or guarantors to omit financial statements separate from the consolidated financial statements of an SEC-registrant parent company issuer or guarantor. Under its current formulation, however, availability of this Rule 3-10 relief requires, among other conditions, that the subsidiary issuer or guarantor be "100% owned" by the parent company. The rule changes proposed by the SEC would, among other things, replace the condition that a subsidiary issuer or guarantor be 100% owned by the parent company with a condition that it merely be *consolidated* in the parent company's financial statements.

[1] See *Financial Disclosures About Guarantors and Issuers of Guaranteed Securities and Affiliates Whose Securities Collateralize a Registrant's Securities*, Release No. 33-10526; 34-83701; File No. S7-19-18 (July 24, 2018).

In publicly traded umbrella partnership structures, a business is owned by a tax partnership (the "operating partnership" or "OP"), which, in turn, is owned by limited partners, on the one hand, and a listed entity (referred to as a "PubCo"), on the other. Depending on the structure, the PubCo might be treated for federal income tax purposes as a real estate investment trust, a C corporation or a publicly traded partnership. In each case, the PubCo controls the OP as its general partner or managing member and consolidates the results of the OP in its financial statements, but generally does not own 100% of the OP's equity securities as these are also owned by the limited partners of the OP. The OP, as the owner of the business, typically serves as the primary credit support for debt issued by UPREITs, UP-Cs and UP-PTPs, potentially together with its subsidiaries. These entities, however, are currently ineligible for the Rule 3-10 exception because they are not 100% owned by the SEC registrant PubCo. Consequently, companies with umbrella partnership structures have generally avoided issuing debt securities in SEC-registered offerings or, alternatively, have been required to cause the OP itself to become a separate SEC-reporting company in addition to the PubCo, thereby incurring additional cost and expense. If the amendments proposed by the SEC are adopted, the OP in an umbrella partnership structure—as a consolidated subsidiary of the SEC registrant Pubco—would become eligible for the Rule 3-10 exception, thereby enabling the OP to provide credit support for SEC-registered debt without subjecting it to onerous financial reporting requirements.

Click here for additional information regarding the UP-C and other umbrella partnership structures.

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