FINAL REGULATIONS
ON
QUALIFIED REOPENINGS OF DEBT ISSUANCES

SIMPSON THACHER & BARTLETT LLP

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On January 12, 2001 the Internal Revenue Service (the "IRS") issued final regulations regarding the treatment of qualified debt reopenings (the "Final Regulations"). The Final Regulations address when a subsequent issuance of debt obligations will be considered part of the same issue as the original debt issuance. When debt is considered part of the same issuance it can use the same CUSIP number, creating a fungible debt offering. The Final Regulations adopt, with certain modifications, the proposed regulations issued on November 5, 1999 (the "Proposed Regulations").

As described further below, the Final Regulations provide that:

- Non-publicly traded debt will be considered part of the same issue as long as it is issued within 13 days of the original debt issuance.

- Publicly traded debt will be considered part of the same issue if it is either: (1) issued within 6 months of the original debt issuance and satisfies a new single yield test (rather than the two-part yield test set forth in the Proposed Regulations); or (2) issued with only a de minimis amount of original issue discount, regardless of the amount of time that has passed since the original debt issuance.

BACKGROUND

If market interest rates have risen since an original debt issuance, a subsequent issuance of debt instruments with identical terms will generally price at a discount to the face amount. When this discount is more than a de minimis amount (generally 25 basis point per year), the additional securities will either have market discount or original issue discount, depending upon whether the additional securities are treated as part of the same "issue" as the original securities.

If the additional securities are treated as part of the same issue, they will have market discount. In contrast, if the additional securities are not treated as part of the same issue, they will have original issue discount. Unlike market discount, original issue discount is accrued into a holder's income currently and the issuer is required to report this accrued amount to the IRS. To comply with its reporting obligation, the issuer must be able to distinguish the additional debt instruments from the original debt instruments (which were not issued with original issue discount). Thus, the additional debt instruments will have to be given a new CUSIP number and the two issuances will not be fungible.

Under the prior effective Treasury regulations (still applicable to reopenings prior to March 13, 2001), two or more debt instruments are part of the same "issue" if they have the same payment and credit terms and are sold "reasonably close in time" either pursuant to a common plan or as part of a single transaction or series of related transactions. Neither the prior regulations nor existing case law provided any guidance as to when an additional issuance was reasonably close in time, and this lack of guidance created uncertainty for debt reopenings.

QUALIFIED REOPENINGS UNDER THE FINAL REGULATIONS

The Final Regulations, like the Proposed Regulations, replace the reasonably close in time standard with a bright-line rule of 13 days. The purpose of the modification is to require that all additional issuances made more than 13 days after the original issuance satisfy the qualified reopening rules in order to avoid treatment as a new issue. Because the qualified reopening rules apply only to debt that is publicly traded, any debt that is not publicly traded is covered only by this 13 day bright-line rule.

A reopening is a qualified reopening if: (1) the original debt instruments are publicly traded; (2) the issue date of the additional debt instruments (treated as if they were a separate issue) is not more than 6 months after the issue date of the original debt instruments; and (3) on the earlier of the announcement date or the pricing date of the additional debt instruments, the yield of the original debt instruments (based on fair market value) is not more than 110 percent of the yield (or, in certain circumstances, the coupon rate) of the original debt instruments on their issue date. For purposes of this test, the announcement date is the later of 7 days before the pricing date of the additional debt instruments or the date on which the issuer's intent to reopen a security is publicly announced.

In addition, the Final Regulations clarify that a reopening is also a qualified reopening if the original debt instruments are publicly traded and the additional debt instruments are issued with no more than a de minimis amount of original issue discount. No time restrictions are included in this test. As a result, the de minimis test is not limited to the 6 month period after the issue date of the original debt instruments.

A qualified reopening, however, does not include a reopening of tax-exempt obligations or contingent payment debt instruments.

CONSEQUENCES TO ISSUER

The Final Regulations, like the Proposed Regulations, provide special rules for the issuer's treatment of debt instruments comprising an issue when there is a qualified reopening. Under these rules, the issuer is required to adjust the aggregate adjusted issue prices of all its debt instruments in the issue (both original and additional) based on the difference between the amounts paid by the holders to acquire the additional debt instruments in the qualified reopening and the adjusted issue price of the original debt instruments. The issuer then recomputes the yield of the debt instruments as of the reopening date and uses this redetermined yield to calculate its accruals of interest expense over the remaining term of the debt instruments.

CONSEQUENCES TO HOLDER

As stated above, if the issuance of the additional securities constitutes a qualified reopening, the additional securities will have the same issue price as the original securities. Any non-de minimis difference between the face amount of the additional securities and the holder's purchase price for such additional securities will constitute market discount, rather than original issue discount as would be the case if the additional securities were treated as a different issuance. Unlike original issue discount, which a holder must accrue into income currently on a constant yield basis over the term of the debt obligation, market discount is generally not required to be included in a holder's income until the debt obligation is retired or sold.

EFFECTIVE DATE

The Final Regulations for qualified reopenings (other than for certain Treasury reopenings) apply to debt instruments that are part of a reopening where the reopening date is on or after March 13, 2001.

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If you have any questions regarding the application of the regulations, please contact John Creed (212-455-3485), John Curran (212-455-3582), Paige Melendres (212-455-2244), or Karen Sakanashi (011-852-2514-7655) in our Hong Kong office, or any other member of the tax department.

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