

SEC Regulations Committee
July 10, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document B

Topic: When Rule 3-05 Financial Statements Must be Provided in Registration Statements Covering Secondary Offerings

Background: In Release 33-7355, the SEC amended Rule 3-05 to make the timetable for providing acquired business financial statements for acquisitions below the 50% significance level in registration statements generally consistent with the timetable for providing them in Form 8-K (i.e., they are generally due 75 days after the acquisition is completed). However, for acquisitions above the 50% significance level, the acquired business financial statements continue to be required in registration statements when the acquisition becomes probable. This discussion document addresses the timetable for providing acquired business financial statements in registration statements when (a) the significance of the acquisition exceeds 50% and (b) the registration statement covers a secondary offering (or other offering that is not of a capital raising nature). Specifically, are Rule 3-05 financial statements required when the greater than 50% significant acquisition becomes probable or 75 days after it is completed?

Release 33-7355 addresses this question. It appears to provide an exception to the general requirement to provide financial statements for acquisitions that are more than 50% significant as soon as they become probable if the offering is a secondary offering. It states (underlining added):

The amendments adopted today will eliminate in most circumstances the requirement to include in Securities Act registration statements audited financial statements for probable business acquisitions or for business acquisitions that were consummated 74 or fewer days before a registered offering of securities. (footnote reference omitted) Although the proposed rules would have permitted omission of those financial statements in all circumstances other than offerings by “blank check companies,” (footnote reference omitted) the rules as adopted provide that financial statements of probable and recently consummated business acquisitions will continue to be required in registration statements of any issuer if the acquisition would be significant above the 50% level using the tests that have been previously established. (footnote reference omitted) As was permitted prior to today's amendments, registered offerings that are not primarily of a capital raising nature and certain private placements may go forward without financial statements of an acquired business, regardless of its significance, until 75 days following the acquisition. (footnote reference omitted)

Guidance in the 2000 edition of the Staff Training Manual seems to support the view that there is an exception to the general requirement if the offering is a secondary offering.

Topic Two.I.A.1 states:

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| Registration Statements and Proxies | a) If less than 50% significant, financial statements of a business acquired or likely to be acquired need not be included unless the registration statement is declared effective (or proxy is mailed) 75 days or more after the acquisition is consummated. Refer to I.D and I.E for tests of significance. This rule does not apply to “blank check” issuers. |
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- b) If 50% or greater significant financial statements of a recent or probable acquisition are required.
- c) Certain types of offerings may proceed even if the acquisition exceeds the 50% level (conversions, warrants or rights, Drips, benefit plans, secondary offerings, sales pursuant to Rule 144). [Instruction 1 to Item 7 of Form 8-K.]

Topic Two.I.F.4 states (underlining added):

4. Issues arising from '33 and '34 Act Integration

a) Acquiree financial statements and certain offerings

During the 75 day period for providing financial statements of acquirees in Form 8-K, registration statements will be declared effective even if financial statements of >50% significant acquirees are not provided only in the case of secondary offerings, securities underlying outstanding convertible securities or warrants or rights, and reinvestment and employee benefit plans. Prior to declaring these registration statements effective, however, the staff should consider the need to obtain assurance from the issuer that the required financial statements will be timely filed.

Interpretation S21 from the Telephone Interpretations Manual appears to conflict with this. It states (italics added):

Instruction 2 to Item 7 of Form 8-K states that during the pendency of the 60 day extension of Item 7(a)(4), registration statements will not be declared effective and offerings should not be made pursuant to existing registration statements. A clause in Instruction 2 beginning provided indicates that certain types of offerings are not affected by "this restriction". *"This restriction" refers to making offerings pursuant to effective registration statements, but does not refer to making registration statements or post-effective amendments effective.*

Instruction 2 referred to in S21 no longer exists. The remaining instruction to Item 9.01 of Form 8-K states (underlining added):

During the period after a registrant has reported a business combination pursuant to Item 2.01 of this form, until the date on which the financial statements specified by this Item 9.01 must be filed, the registrant will be deemed current for purposes of its reporting obligations under Section 13(a) or 15(d) of the Exchange Act. With respect to filings under the Securities Act, however, registration statements will not be declared effective and post-effective amendments to registrations statements will not be declared effective unless financial statements meeting the requirements of Rule 3-05 of Regulation S-X are provided. In addition, offerings should not be made pursuant to effective registration statements, or pursuant to Rules 505 and 506 of Regulation D where any purchasers are not accredited investors under Rule 501(a) of that Regulation, until the audited financial statements required by Rule 3-05 of Regulation S-X are filed; provided, however, that the following offerings or sales of securities may proceed notwithstanding that financial statements of the acquired business have not been filed:

- (a) offerings or sales of securities upon the conversion of outstanding convertible securities or upon the exercise of outstanding warrants or rights;
- (b) dividend or interest reinvestment plans;
- (c) employee benefit plans;
- (d) transactions involving secondary offerings; or
- (e) sales of securities pursuant to Rule 144.

In a recent situation, the SEC staff took the position that (as indicated in Interpretation S21) the guidance in Release 33-7355 and the instruction to Item 9.01 of Form 8-K means that in the case of a secondary offering (and the other types of offerings listed in the instruction) there is no exception to the general requirement to provide financial statements for acquisitions that are more than 50% significant as soon as they become probable. Rather, the guidance and instruction simply mean that an offering pursuant to an effective registration statement does not have to be suspended and the registrant does not have to evaluate whether there has been a fundamental change and whether acquired business financial statements need to be provided. This position took the registrant by surprise, since (1) the language in Release 33-7355 and the Staff Training Manual seems to clearly say the financial statements need not be provided, (2) the SEC staff routinely waives the requirement (for registration statements filed both before and after the 75 day period) when a registrant cannot provide the financial statements and asks for relief and (3) the registrant viewed the determination as to whether a fundamental change has occurred to be its responsibility (as discussed in Topic I.F.4.b)(2) of the Staff Training Manual), rather than something that is dictated by rule or SEC staff interpretation.

Issue/Question: Is a registration statement covering a secondary offering required to include Rule 3-05 financial statements when a greater than 50% significant acquisition becomes probable before the registration statement can become effective?

View A: No. Pursuant to Release 33-7355, and supported by the language in the Staff Training Manual and the instruction to Item 9.01 of Form 8-K, secondary offerings of securities may proceed notwithstanding that financial statements of the greater than 50% significant business acquisition (probable or completed) have not been filed.

View B: Yes. The guidance in Release 33-7355, the Staff Training Manual, and the instruction to Item 9.01 of Form 8-K only apply to existing effective registration statements. All new registration statements should provide the Rule 3-05 financial statements of a probable or completed acquisition of a greater than 50% significant business.

Committee Recommendation: The Committee supports View A. The Committee recommends the SEC staff consider revising Interpretation S21 in the Telephone Interpretations Manual to clarify this view.

SEC Staff Response: The staff supports View B and noted that View B applies to both new registration statements and post-effective amendments. The SEC staff expects to revise the Staff Training Manual to reflect this position.