

SEC Regulations Committee
October 11, 2007 - Joint Meeting with SEC Staff
SEC Offices – Washington DC

Discussion Document D

Topic: Application of Rules 3-10 and 3-16 of Regulation S-X to Automatic Shelf Registration Statements

Background: Company X is a calendar year-end, well-known seasoned issuer with a reporting obligation under Section 13(a) of the Exchange Act. In order to be in a position to respond quickly to market conditions, Company X has determined to file an automatic shelf registration statement on Form S-3 to register the offer and sale by one of its subsidiaries (Subsidiary A) of an unspecified amount of debt securities. Subsidiary A (an operating subsidiary) is not otherwise an SEC registrant.

The prospectus that is included in the Form S-3 states that the debt securities being registered may be guaranteed by Company X and some, but not all, of Company X's direct and indirect subsidiaries. These subsidiaries are listed as additional registrants in the automatic shelf registration statement. Subsidiary A and all of the named guarantor subsidiaries are 100% owned, the guarantees will be full and unconditional and joint and several. The non-guarantors are more than minor.

Although a number of subsidiaries will be named in the registration statement as guarantors, the debt issued by Subsidiary A may ultimately be guaranteed by less than all of the named subsidiary guarantors. The final list of guarantors will be named in a prospectus supplement at the time of a takedown.

Question 1: Rule 3-10(a) of Regulation S-X states:

“Every issuer of a registered security that is guaranteed and every guarantor of a registered security must file the financial statements required for a registrant by Regulation S-X.”

What financial statements must be included or incorporated by reference in the automatic shelf registration statement at the time it is filed (i.e., at the effective date)?

View A: Because the actual composition of the group of subsidiary guarantors that will guarantee a particular security may not be known when the automatic shelf registration statement is filed, Subsidiary A and the guarantor subsidiaries are not required to provide financial statements in the automatic registration statement at the time it is filed.

Subsidiary A and the guarantor subsidiaries would, however, be required to provide the required financial statements prior to the actual sale of any guaranteed debt securities (i.e., in a shelf takedown). The financial statements provided at the time of the takedown should comply with Regulation S-X (e.g., Rule 3-10(d)) and may be provided by filing a post-effective amendment to the registration statement, by filing them in an Exchange Act report that is incorporated by reference in the registration statement or by providing them in a prospectus supplement.

Supporters of View A note that it is broadly consistent with the guidance provided in Question 25 of the DCF Staff's November 30, 2005 *Securities Offering Reform Questions and Answers*. The staff's answer to Question 25 indicated that for purposes of complying with Rule 3-10(g) of Regulation S-X, the test would not be made until an actual sale of a security takes place.

Supporters of View A do not believe that compliance with Rule 3-10 before the time that any guaranteed securities are actually sold would provide much in the way of meaningful and incremental investor protection. However, it would clearly result in additional costs to the issuer(s). Supporters of View A also believe that the same answer would apply even if the shelf registration statement were not an “automatic” shelf registration statement.

View B: The debt being registered is a security to be offered and sold by Subsidiary A. The guarantees of that debt by Company X and by the guarantor subsidiaries are also securities that are being registered. Therefore, the automatic shelf registration statement must include (or incorporate by reference) financial statements of the issuer (Subsidiary A) and each of the guarantors unless they are otherwise exempt from this requirement. Additionally, upon filing the automatic shelf registration statement, Subsidiary A and all of the guarantor subsidiaries will attract a reporting obligation under Section 15(d) the Exchange Act unless otherwise exempt from this requirement.

The only exemption available to Subsidiary A and the guarantor subsidiaries listed in the automatic shelf registration statement from the requirements of the Securities Act to provide financial statements in the automatic shelf registration statement would be to comply with Rule 3-10(d) of Regulation S-X. Compliance with Rule 3-10(d) would require that Company X’s financial statements included or incorporated by reference in the automatic shelf registration statements include the condensed consolidating financial information specified by Rule 3-10(d)(4). This is true even though Subsidiary A has no current plans to issue the debt securities and even though the group of subsidiary guarantors may ultimately change. Compliance with Rule 3-10(d)(4) should continue in Company X’s future periodic reports as well. This will provide Subsidiary A and the guarantor subsidiaries with an exemption from Exchange Act reporting through Exchange Act Rule 12h-5(a). At the time of an actual sale of guaranteed securities, Company X should evaluate its compliance with Rule 3-10 and should provide any additional financial statement disclosures that would be necessary (e.g., an alternative set of condensed consolidating financial information if not all of the subsidiary guarantors listed in the automatic shelf registration statement guarantee the debt to be issued).

Committee Recommendation: The Committee favors View A as a more practical approach that is consistent with investor protection. The Committee does not believe investors need financial information about potential subsidiary issuers or guarantors for securities that have not yet been offered for sale. However, absent relief, it appears to the Committee that the literal application of existing SEC rules and regulations would require Rule 3-10 information upon the initial filing of a shelf registration statement, consistent with View B.

SEC Staff Position: The Staff takes View B and notes that the answer would be the same even if the shelf registration statement was not an automatic shelf registration statement. When the registration statement becomes effective, the subsidiary issuer/guarantors become registrants and have separate Exchange Act reporting obligations unless they are otherwise exempt. This is true even though securities are not yet issued under the registration statement. In order to qualify for an exemption from Exchange Act reporting under Rule 12h-5, the subsidiary issuer/guarantors would need to be permitted to omit financial statements by Rule 3-10. That omission is conditioned on the parent company providing the financial information (e.g., condensed consolidated financial information) specified by Rule 3-10(b)-(f), as applicable.

The Staff also stated that a post-effective amendment and information required by Rule 3-10 would be required if, after the effective date, a pre-existing subsidiary (or a newly formed entity into which pre-existing assets were transferred) is added as a guarantor.

Additional Background: Company X’s automatic shelf registration statement also will register the offer and sale by Company X of an unspecified amount of non-convertible senior debt that will

be collateralized by the stock (held by Company X) of Company X's domestic subsidiaries (including Subsidiary A).

Question 2: Rule 3-16 of Regulation S-X states that securities constitute a "substantial portion of the collateral" for any class of securities registered or being registered if the greatest of (i) the aggregate principal amount, (ii) par value or (iii) book value of the securities as carried by the registrant, or (iv) the market value of such securities equals 20% or more of the principal amount of the secured class of securities. How should Company X perform this analysis in connection with the automatic shelf registration statement being filed?

View A: Because the amount of collateralized securities to be issued is not known at the time that the automatic shelf registration statement is filed, Company X need not comply with Rule 3-16 at that time. This is also the case if Company X files a Form 10-K after the time that the automatic shelf registration is filed but before an actual sale of collateralized debt. At the time of a specific sale of collateralized debt, Company X must perform the Rule 3-16 analysis. Any financial statements required by Rule 3-16 at the time of the takedown may be provided by filing a post-effective amendment to the registration statement, by filing them in an Exchange Act report that is incorporated by reference into the registration statement or by providing them in a prospectus supplement.

Supporters of View A do not believe that compliance with Rule 3-16 before the time that any collateralized securities are actually sold would provide much in the way of meaningful and incremental investor protection. However, it would clearly result in additional costs to the issuer(s). Additionally, supporters of View A note that it is broadly consistent with the guidance provided in Question 25 of the DCF Staff's November 30, 2005 *Securities Offering Reform Questions and Answers*. The staff's answer to Question 25 indicated that for purposes of complying with Rule 3-10(g) of Regulation S-X, the test would not be made until an actual sale of a security takes place. Supporters of View A believe that the same answer would hold even if the registration statement were for a specified amount of securities (e.g., registering the offer and sale of up to \$500 million of collateralized debt).

View B: Because Company X cannot determine to exclude any of the entities from the 3-16 analysis, it should presume that they will be required and should provide financial statements pursuant to Rule 3-16 in the automatic shelf registration statement as well as any subsequently filed Form 10-Ks. At the time that Company X sells collateralized debt, it should perform the Rule 3-16 test based on the principal amount of the securities sold and may stop providing Rule 3-16 financial statements for any subsidiaries that don't meet the test at the time that the securities are sold.

Committee Recommendation: The Committee supports View A.

SEC Staff Position: The Staff takes View A and notes that a distinguishing feature between Questions 1 and 2 is that in Question 1, the subsidiary issuer/guarantors are separate registrants under the Securities Act of 1933. In Question 2 the subsidiaries are not separate registrants.