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WRITER'S DIRECT NUMBER

Via e-mail to: rule-comments@sec.gov

Secretary
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Release No. 33-9929: (File No. S7-20-15): Request for Comment on the Effectiveness of Financial Disclosures About Entities Other Than the Registrant

Ladies and Gentlemen:

We are responding to the Commission's request for comment regarding the financial disclosure requirements in Regulation S-X for certain entities other than a registrant. We regularly advise our clients on matters relating to certain of the questions presented in the request for comment and, with respect to those questions, we offer our perspective together with some specific ideas for the Commission's consideration.

Cahill Gordon & Reindel LLP is an international law firm with a broad corporate practice that includes serving both registrants and financial institutions as underwriters or initial purchasers in connection with securities offerings. Our practice is unique in terms of the number of non-investment grade debt securities offerings we advise on, having represented financial institutions as underwriters or initial purchasers in more than 1 out of every 3 such U.S. offerings in the first nine months of 2015, with a similar relative volume in each of the past 5 years (as reported by *Bloomberg*). We believe our experience with non-investment grade debt securities is particularly relevant in the context of this request for comment because (1) a significant proportion of non-investment grade debt securities are issued in connection with acquisition transactions, implicating Rule 3-05 of Regulation S-X, (2) an overwhelming majority of non-investment grade debt securities (and very few other types of securities) are guaranteed by subsidiaries of the issuer, implicating Rule 3-10 of

Regulation S-X and (3) a significant portion of the debt securities collateralized by stock of subsidiaries that would implicate Rule 3-16 of Regulation S-X are non-investment grade.

Content of the Rule 3-05 Disclosure and Related Requirements

Requests for Comment 2 and 5

We believe that investors find the current Rule 3-05 Financial Statements and associated Pro Forma Information (each term as defined in the request for comment) useful in making investment decisions. However, we also believe that investors could be further benefitted by permitting (but not requiring) registrants to provide a pro forma income statement for the most recently completed four-quarter period (the "**LTM Period**") when the most recent available historical financial statements are not the most recent fiscal year end. As conditions to including an LTM Period pro forma income statement, in addition to the currently required pro forma income statement for the most recent fiscal year and subsequent interim period, a registrant would be required to (1) include a pro forma income statement for the corresponding interim period of the prior fiscal year and (2) include disclosure about how the LTM Period pro formas are calculated.

In our experience, many investors want to see the performance of the combined companies for the LTM Period because it allows them to easily compare the most current information available on an LTM basis to the most recently completed full fiscal year. This can be particularly helpful in highlighting trends in registrant's financial performance and is a common presentation in Rule 144A offering memorandums for sophisticated institutional investors who request this additional disclosure. We note that, as stated in Section 3230.1 of the Financial Reporting Manual of the Division of Corporation Finance (the "**Manual**"), the staff generally does not object to a registrant providing a pro forma income statement for the corresponding prior interim period. If this corresponding prior interim period pro forma income statement is included, then the LTM Period pro forma income statement is either equal or roughly approximate to the mathematical exercise of adding the most recent fiscal year to the current interim period and subtracting the prior year interim period. However, presenting a "true" LTM Period allows investors to view the information they want conveniently, quickly and with confidence that it reflects all appropriate pro forma adjustments over the LTM period.

Tests for Determining Disclosure Required by Rule 3-05 and Related Requirements

Requests for Comment 9 - 13

We frequently see situations where the income test (as defined in Rule 1-02(w) of Regulation S-X) results in the need for Rule 3-05 Financial Statements even though the income test results are significantly disproportionate to the asset and investment tests in that the income test results in substantially more financial statement requirements than the asset or investment tests. In addition to the pure cost to registrants in connection with the preparation of the Rule 3-05 Financial Statements in such situations, registrants also may be disadvantaged in competing for acquisition opportunities where the target does not have audited financial statements. Specifically, we note that the time required to prepare/audit the Rule 3-05 Financial Statements will likely result in a longer time to consummate an acquisition and, as a result, disadvantage a registrant intending to access the capital markets for acquisition financing as compared to those potential buyers who can move faster without such requirements.

A hypothetical example illustrating a common fact pattern is where a registrant with $2 billion of annual revenues, $1 billion of assets and $10 million of income (for purposes of the income test) is in discussions to buy a target with $30 million of annual revenues, $15 million of assets and $6 million of income for a purchase price of $30 million. The target is determined to be insignificant under the assets and investments tests, however the income test would require three years of audited target historical financial statements. In the above hypothetical, as with many real life situations, the income test results may be disproportionate to the assets and investment test results as well as to other pertinent financial metrics for a host of reasons, including unusual or non-recurring items. In actual circumstances similar to the hypothetical above, our experience has been that the usefulness of Rule 3-05 Financial Statements and Pro Forma Information to investors is slight as compared to the associated costs (both in dollars and competitive disadvantage) to registrants.

We propose for consideration adding a revenue element to the current income test such that Rule 3-05 Financial Statements and Pro Forma Information would be required by the test only when both (1) the target is significant under the income test as currently in effect and (2) the target's revenue is at least 20% of the Issuer's revenue over the same measurement period used for the income test. Similarly, we propose to modify the current 40% and 50% significance tests by adding a revenue element such that (1) two years of audited target financial statements (in addition to unaudited interim period financials) would be required when the target is significant at the 40% level for the current income test and 40% for the proposed revenue element and (2) three years of audited target financial statements (in addition to unaudited interim period financials) would be required when the target is significant at the 50% level for the current income test and 50% for the proposed revenue element.

Applying the proposed revenue element to the hypothetical example above would have alleviated the need for the registrant to provide Rule 3-05 Financial Statements or Pro Forma Information.

Based on our experience, we believe supplementing the current income test with the proposed revenue element will reduce the number of anomalous disclosure outcomes currently produced by the current income test alone. When reading the request for comment, we wondered how many of the 60 requests the Staff received in 2014 to consider anomalous disclosure outcomes would have been properly (in the Commission's view) avoided by application of the revenue test.

We think supplementing the current income test with a revenue element is appealing because (1) it would be simple for registrants to test, (2) it continues to promote the highly beneficial certainty, consistent application and fair treatment across all registrants and industries that is a hallmark of the current rules, (3) revenue is a key income statement metric that we believe investors view as a relevant comparison point between an acquiror and target in the context of gauging "significance" in the absolute sense and (4) while it serves as an income statement based "reality check" for one of the existing significance tests, it does not require any fundamental changes to the current significance testing rules.

Some other alternatives to the current income test that might be considered appear to us to raise different potential concerns. For example, one possibility is simply removing the income test; however we can imagine circumstances where an income statement based test is necessary to ensure full and fair disclosure. Another possibility is the purchase price to market capitalization test mentioned in the request for comment; however it is not clear how this could work as a replacement for the income test in a simple and fair manner across all registrants given the large number of registrants without publicly traded equity (we note that this idea seems to have merit as a replacement for the "asset test" for registrants with publicly traded equity). A third possibility is replacing the current income test with a different "bottom line" metric like gross profit, or modifying the current income test by further adjusting income from continuing operations for various accounting items, perhaps creating a new metric like "Adjusted EBITDA" that is a commonly used Non-GAAP financial metric (with adjustments limited to those permitted by Regulation G and Item 10(e)). Although a well devised new "bottom line" metric could reduce anomalous disclosure outcomes, we would caution about added complexity and implementation challenges that could reduce certainty, consistent application and fair treatment across all registrants and industries. A further possibility would be to allow registrants to exercise a greater degree of judgment as referenced in the request for comment; however, the absence of a quantitative income statement test would seem to reduce certainty, consistent application and fair treatment across all registrants and industries.

We recognize that supplementing the income test with a revenue element will not eliminate all disclosure anomalies, and we would continue to encourage issuers to seek guidance from the Staff when appropriate. Our experience tells us that supplementing the current income test with a revenue element would be a simple and straight forward change to the existing rules that would yield a disproportionately large benefit for registrants without any meaningful detriment to investors.

<u>Rule 3-10 of Regulation S-X – Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered</u>

Requests for Comments 35, 36 and 38

Our comments under this heading relate primarily to the fact pattern we see frequently in our practice and that allows for Alternative Disclosures (as defined in the request for comment) contemplated by Rule 3-10(f) of Regulation S-X – a debt security issued by a parent company with multiple subsidiary guarantors that are "100% owned" and provide full and unconditional, joint and several guarantees. In this situation, the parent company issuer frequently has a number of subsidiaries that do not provide guarantees and would be required to provide Consolidating Information (as defined in the request for comment) as a footnote to its financial statements.

In our experience, issuers who have not previously issued guaranteed debt securities struggle to prepare the full Consolidating Information in a timely manner and often balk at the associated cost. As a result, many elect to issue debt securities privately to qualified institutional buyers in accordance with Rule 144A. A typical Rule 144A offering memorandum will disclose revenues, operating income (or a similar metric) when available, assets and liabilities of the issuer/guarantors as a consolidated group and the non-guarantor subsidiaries as a consolidated group. As a general matter, the greater the materiality of the non-guarantor group, the greater the amount of disclosure there will be in a Rule 144A offering memorandum. In our experience, investors find these four key pieces of financial information, together with all of the full consolidated information provided, sufficient to make a well informed investment decision (absent a particularly material group of non-guarantors).

Accordingly, we propose for consideration that the Alternative Disclosure under Rule 3-10(f) of Regulation S-X should be modified such that (1) when the non-guarantor subsidiaries as a consolidated group represent less than X% (perhaps 20% to match the Rule 3-05 significance tests) of each of consolidated revenues, operating income (or similar measure), assets and liabilities, the disclosure requirement should be limited to a statement that the non-guarantors constitute less than X% of each of consolidated revenues, operating income (or similar measure), assets and liabilities, (2) when the non-guarantor subsidiaries as a consolidated group represent less than Y% (perhaps 50%) of each of consolidated revenues, operating income (or similar measure), assets and liabilities, but X% or more of any of such metrics, the disclosure requirement should be an unaudited presentation of these four metrics for the non-guarantor group on a consolidated basis and (3) when the non-guarantor subsidiaries as a consolidated group represent more than Y% of any of consolidated revenues, operating income (or similar measure), assets or liabilities, then the currently required Consolidating Information would remain the standard.

The above proposed disclosure sliding-scale more appropriately matches increasing detail with increasing materiality of the non-guarantor group and therefore better balances the costs to registrants with the benefits of additional disclosure to investors.

<u>Consideration of Current Rule 3-16 Disclosure and Related Requirements</u>

Requests for Comment 46, 49, 50 and 53

While Rule 3-16 Financial Statements (as defined in the request for comment) can be useful to investors in making investment decisions in some cases, in many cases they provide minimal additional value to investors and the time and costs associated with disclosure are therefore unduly burdensome to the registrant. We also are aware of instances where the Rule 3-16 Financial Statement requirements indirectly harmed investors either because registrants scaled back what otherwise would have been the available collateral in order to avoid Rule 3-16 disclosure, resulting in reduced collateral packages for investors and/or registrants have elected to issue the securities in a private placement without any registration rights. Neither of these outcomes benefits investors.

Most of the financings that we see where this rule is implicated are where there is an offering of secured notes that are guaranteed by many of the registrant's subsidiaries and where substantially all the assets of the registrant and the guarantors are pledged as collateral to support the notes and guarantees. As part of this overall credit support package, pledges of stock in (and notes issued by) subsidiaries frequently will be proposed to be included. In these cases, we believe that the disclosures required under Rule 3-10 are already sufficient for investors. Rule 3-16 should be limited so that it only applies in certain situations (i.e., where Rule 3-10 would not be applicable and the Rule 3-16 Financial Statements would be material to an investor's decision).

In looking at the distinction between Rule 3-10 and Rule 3-16, we note that Section 2600.1 of the Manual provides:

> "S-X 3-10 applies only to guarantors (see Section 2500) and does not apply to collateral situations, as the concepts of full, unconditional, and joint and several obligation do not apply to collateralizations. Unlike guarantees, enforcement of collateral provisions would result in the debt holder becoming an equity security holder of the affiliate. Therefore, full audited financial statements of each affiliate whose securities constitute a substantial portion of the collateral of a security that is registered or being registered are required by S-X 3-16."

In the most typical example that we see (i.e., where the stock being pledged is the stock of a guarantor), we believe this rationale for a distinction between guarantees and securities pledges is not applicable. First, the guarantee itself is much more significant to the investor than a pledge of the stock in the guarantor. The guarantee provides the investor with a debt claim at the particular guarantor, while the stock pledge only provides a residual equity claim. As a result, the requirements of Rule 3-10 should be sufficient with respect to the financial statements of that guarantor (even where separate financial statements of the guarantor are not required). Second, in this situation, it is highly unlikely that the debt holder will ever become the holder of the pledged equity security. It is very rare for bondholders to foreclose on collateral outside of a bankruptcy scenario, and even if they did, it would be to sell the collateral to a third party rather than to hold it directly. A purchase of debt securities secured by a guarantor's securities is not akin to making an investment decision with respect to such pledged securities and therefore we do not believe this circumstance calls for financials to be provided. We also believe that, for similar reasons, a pledge of debt securities of a guarantor should not require separate financial statements.

As mentioned above, issuers frequently elect to avoid triggering the Rule 3-16 Financial Statements disclosure by issuing their securities in a private placement without any registration rights. When notes with the guarantee and collateral structure referred to above are issued in a private placement, our experience has been that investors do not request any type of Rule 3-16 information in addition to the summary issuer/guarantor and consolidated non-guarantor information customarily provided, supporting the notion that Rule 3-16 Financial Statements are not particularly useful to investors in this context.

Another situation implicating Rule 3-16 Financial Statements is where the affiliate is not a guarantor and it is (1) a non-subsidiary controlled affiliate of the registrant, (2) a controlling affiliate of the registrant or (3) a subsidiary of the registrant.

In the first two cases, we believe the requirement for Rule 3-16 Financial Statements should be retained. There is no guarantee from these entities, there is no Rule 3-09 overlap and the financial results of these entities are not included as part of the registrant's or any guarantor's financial statements. In the third case (where a subsidiary is not a guarantor), we believe that some requirement as to financial information about such non-guarantor subsidiaries also should be retained. However, since the results of non-guarantor subsidiaries are already included in the registrant's consolidated financial statements (and possibly included in the consolidated financial results of the guarantors), we believe that, instead of current Rule 3-16 Financial Statements, registrants should be required to include financial information of the non-guarantor subsidiaries consistent with Rule 3-10 as if such subsidiary were a guarantor with a full, unconditional and joint and several guarantee.

We also believe there should be some changes to the trigger itself. Currently, the requirement is triggered when the securities of the affiliate being pledged constitute a "substantial portion" of the collateral for the securities being registered. This test compares the value of the pledged securities to the principal amount of the securities being registered. We believe that comparing the value of the pledged securities to the size of the issuance can result in disclosure that is not helpful to investors. We see many situations where a large registrant issues a small amount of securities. This can lead to a situation where the pledged securities are immaterial in size as compared to the assets of the registrant, but the Rule 3-16 Financial Statements are still required. In lieu of that test, we would recommend the requirement be triggered if the value of the pledged securities is at least 20% of the book value of the consolidated assets of the registrant. Alternatively, the test could be based on 20% of the value of the other credit support for the securities being issued (i.e., guarantees and other collateral), without regard to the amount of securities being issued. Lastly, in calculating "value," we believe the "market value" prong should only be applicable if the securities in question are either publicly traded or the fair value of which is otherwise readily available (i.e., the fair value is disclosed in an entity's financial statements).

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Please note that our comments above are intended to be limited to the selected requests for comment expressly addressed herein and we do not intend for any commentary to be implied or inferred beyond the matters expressly addressed.

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We appreciate the opportunity to respond to the Commission's request for comment. Please feel free to contact Doug Horowitz at ([redacted] or Michael Sherman at ([redacted] with any questions about this submission.

Sincerely,

Cahill Gordon & Reindel LLP

Cahill Gordon & Reindel LLP