

ACT  
SECTION 3(b)(1)  
RULE 3a-5  
PUBLIC LIABILITY 3/17/97

**PUBLIC**

FEB 21 1997

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 96-614  
KDSM, Inc. and Sinclair Capital  
File No. 132-3

Based on the facts and representations in your letter, and without necessarily agreeing with your legal analysis, we would not recommend enforcement action to the Commission if KDSM, Inc. ("KDSM"), an indirect wholly owned subsidiary of Sinclair Broadcast Group, Inc. ("Sinclair Broadcast"), does not register as an investment company, in reliance on either section 3(b)(1) of the Investment Company Act of 1940 ("Investment Company Act"), or rule 3a-5 under that Act. This position is based particularly on your opinion that KDSM would not be an investment company because either (i) KDSM would be primarily engaged directly or through wholly owned subsidiaries in a business or businesses other than investing, reinvesting, owning, holding, or trading in securities, or (ii) if KDSM is deemed to be primarily engaged in owning or holding securities due to its financing activities, its primary purpose would be to finance the operations of Sinclair Broadcast and KDSM would meet all the requirements of rule 3a-5.

In addition, based on the facts and representations in your letter, and without necessarily agreeing with your legal analysis, we would not recommend enforcement action to the Commission if Sinclair Capital, a wholly owned subsidiary of KDSM, does not register as an investment company in reliance on rule 3a-5 under the Investment Company Act. This position is based particularly on your opinion that Sinclair Capital would meet all the requirements of rule 3a-5.

You should note that any different facts or representations might require a different conclusion with respect to each of your questions.

Your request for confidential treatment under 17 C.F.R. § 200.81(b) has been granted until the earlier of 120 days from the date of this letter or the date of any disclosure of the facts sufficient to reveal the essence of the no-action request or this response. Please inform this office if this information is made public in any fashion prior to the expiration of the 120-day period.

*Rochelle Kauffman Plesset*

Rochelle Kauffman Plesset  
Senior Counsel

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**CONFIDENTIAL TREATMENT REQUESTED  
BY KDSM AND SINCLAIR CAPITAL  
PURSUANT TO 17 C.F.R. § 200.81**

February 21, 1997

*BY MESSENGER*

Jack W. Murphy, Esq.  
Chief Counsel  
Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

**Re: KDSM, Inc. and Sinclair Capital Under Investment Company Act Rule 3a-5**

Dear Mr. Murphy:

On behalf of KDSM, Inc. ("KDSM"), a Maryland corporation, and Sinclair Capital, a Delaware business trust, and based on the facts described below, we request a statement by the staff of the Division of Investment Management (the "Staff") of the Securities and Exchange Commission (the "Commission") that the Staff will not recommend enforcement action to the Commission if KDSM and Sinclair Capital do not register as investment companies.

KDSM is an operating company that also will function as a finance subsidiary of its parent company, Sinclair Broadcast Group, Inc. ("Sinclair Broadcast"). As discussed in greater detail below, we believe that KDSM will not be an investment company because it either (i) will be excepted by section 3(b)(1) of the Investment Company Act ("Company Act") because it will be engaged primarily, directly or through wholly-owned subsidiaries, in a business or businesses other than that of investing, reinvesting, owning, holding, or trading in securities or, alternatively, (ii) will be exempted by rule 3a-5 under the Company Act as a finance subsidiary

that complies with the rule's requirements including, in particular, those in subparagraph (a)(5) concerning the use of offering or borrowing proceeds.

Sinclair Capital is a wholly-owned subsidiary of KDSM that, unlike KDSM, will engage in no business other than its activities relating to its status as a finance company. Sinclair Capital will issue preferred securities to investors that will be guaranteed by its ultimate parent, Sinclair Broadcast. As further discussed below, we believe that Sinclair Capital will be exempted by rule 3a-5 under the Company Act as a finance subsidiary that complies with the rule's requirements including, in particular, those in subparagraph (a)(2) concerning the parent company guarantee.

## I. Background

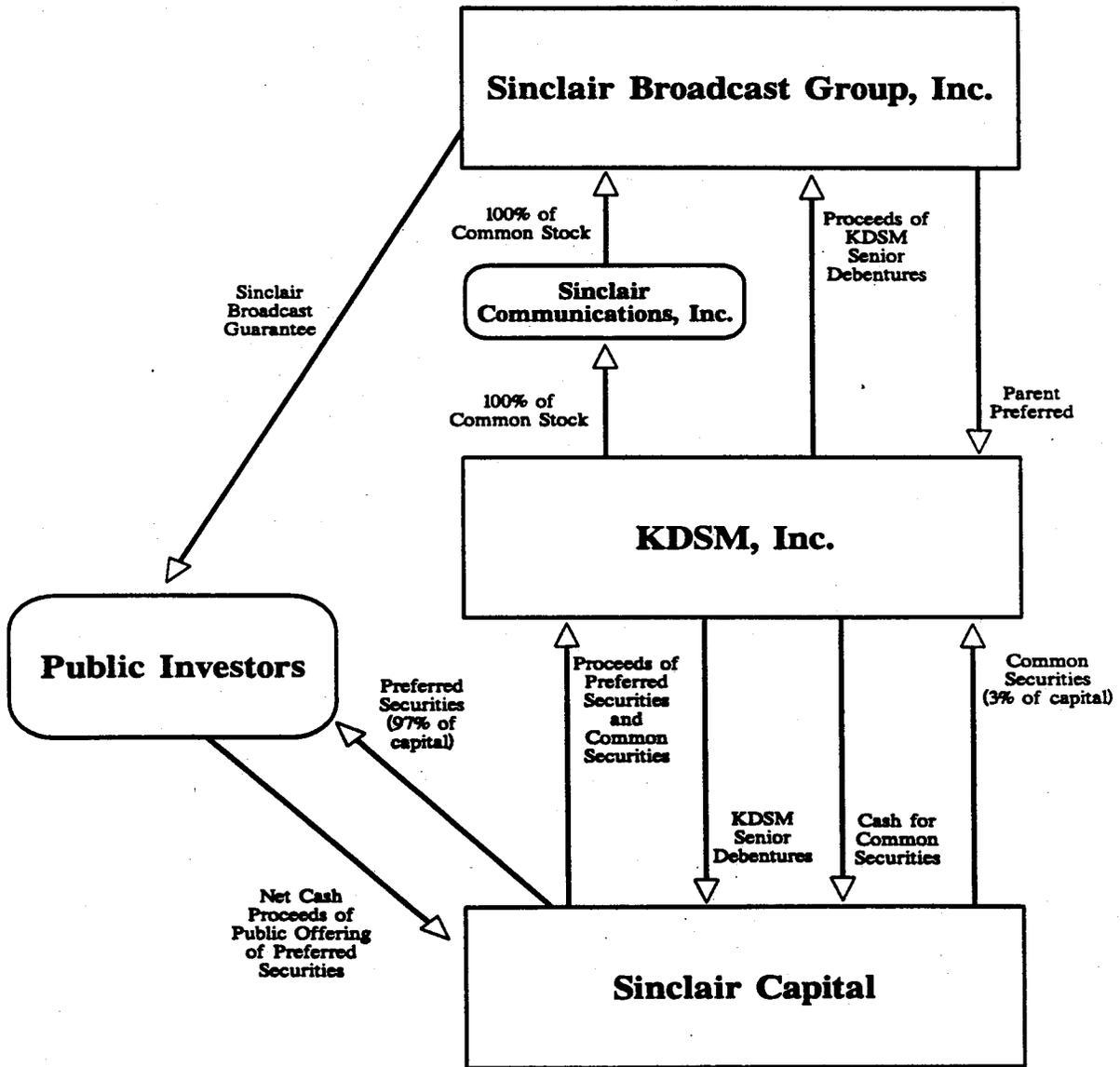
### A. General Structure

KDSM owns all of the common securities of Sinclair Capital. KDSM is an indirectly wholly owned subsidiary of Sinclair Broadcast, a Maryland corporation. Sinclair Broadcast is a broadcasting company that owns or provides programming services to television and radio stations. KDSM owns, or will own, together with its wholly owned subsidiaries, in addition to all of the voting securities of Sinclair Capital, the assets and operations of KDSM-TV in Des Moines, Iowa. These other assets are expected to have an estimated current value of approximately \$50 million.

Sinclair Broadcast formed Sinclair Capital for the sole purpose of providing financing for the operations of Sinclair Broadcast via an offering of Sinclair Capital preferred securities (the "Public Preferred"). Sinclair Capital will sell to investors Public Preferred and will use the net proceeds to purchase senior debentures from KDSM (the "KDSM Debentures"). All expenses of Sinclair Capital will be paid by KDSM. Although the amount of Public Preferred to be sold is still subject to final determination, for purposes of this letter, we have assumed that the Public Preferred will have a liquidation preference totaling \$200 million. KDSM will, in turn, use the proceeds from the sale of the KDSM Debentures to purchase preferred stock issued by Sinclair Broadcast (the "Parent Preferred"). Sinclair Broadcast will issue a guarantee for the benefit of the Public Preferred holders (the "Sinclair Broadcast Guarantee") that, as discussed below, is modeled on guarantees permitted by the Staff in prior interpretive and no-action letters. Sinclair Capital will own no assets other than the KDSM Debentures.

Sinclair Broadcast elected this three-tiered structure to comply with certain restrictions in the indentures relating to prior debt obligations and in light of tax considerations. In particular, Sinclair Broadcast, and its subsidiaries generally, are restricted under the terms of its indentures from issuing additional debt but may, under certain circumstances, issue preferred stock. Despite the indenture restrictions, Sinclair Broadcast is permitted to designate certain subsidiaries as "unrestricted subsidiaries" that may issue their own debt. Sinclair Broadcast will designate KDSM as an unrestricted subsidiary. Sinclair Broadcast and KDSM are members of the same consolidated group for federal income tax purposes. As a result, Sinclair Broadcast will be, in effect, entitled to an income tax deduction for interest paid on debt issued by KDSM

to non-group members. Sinclair Capital will be a grantor trust for federal income tax purposes. Sinclair Capital will not be a member of the consolidated group for federal income tax purposes because only entities that are taxable as corporations may be members of a consolidated tax group. Accordingly, KDSM can issue debt securities to Sinclair Capital and obtain a deduction for the interest, effectively enabling Sinclair Broadcast to obtain interest deductions without violating the terms of its indentures. For your convenience, a structural diagram of the proposed transaction is provided below:



**B. Terms of the Sinclair Capital Preferred Shares**

Sinclair Capital will sell Public Preferred shares to investors. Although the amount of Public Preferred to be sold is still subject to final determination, for purposes of this letter, we have assumed that it will have a liquidation preference totaling \$200 million. Depending on market conditions at the time of the offering, Sinclair Capital may sell a greater or lesser number of shares of Public Preferred. The distribution preference rate is likewise yet to be determined. Sinclair Capital will use cash received from payments on the KDSM Debentures to make distributions on the Public Preferred, and Sinclair Capital will be unable to declare distributions or redeem the Public Preferred in the absence of such payments.

Sinclair Capital must redeem the Public Preferred for cash at the liquidation preference plus accumulated and unpaid distributions at the end of 12 years unless it does not have sufficient funds to do so due to a default by KDSM on its obligation to repay the KDSM Debentures at maturity. Similarly, Sinclair Capital must redeem the Public Preferred if KDSM redeems the KDSM Debentures prior to maturity. If an event of default on the KDSM Debentures occurs, the holders of at least 25% in aggregate liquidation value of the Public Preferred will have the right to direct the trustees of Sinclair Capital to declare the principal of and interest on the KDSM Debentures immediately due and payable.

If Sinclair Broadcast (or one or more of its subsidiaries which collectively own directly or indirectly 50% or more of the company's consolidated assets) becomes bankrupt or insolvent or is dissolved or liquidated, Sinclair Capital, at the option of the holders of a majority in aggregate liquidation value of its Public Preferred, may be dissolved and liquidated. In addition, Sinclair Capital will liquidate and dissolve upon the expiration of its term in 2015 if it has not previously liquidated and dissolved. Upon an event of default of the Public Preferred, the holders of a majority in aggregate liquidation preference of the Public Preferred will have the right to elect new trustees of Sinclair Capital.<sup>1/</sup>

**C. Terms of the Sinclair Broadcast Guarantee**

Sinclair Broadcast will unconditionally guarantee, on a junior subordinated basis, the payment in full under the Public Preferred of:

- (a) any accrued and unpaid distributions on the Public Preferred that have been theretofore declared on the Public Preferred from funds of Sinclair Capital legally available therefor in accordance with the Sinclair Capital trust agreement;

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<sup>1/</sup> Events of default on the Public Preferred include the failure of Sinclair Capital to make distributions for any period for which KDSM pays interest on the KDSM Debentures and any event of default on the KDSM Debentures.

(b) the redemption price payable with respect to any Public Preferred called for redemption by Sinclair Capital from funds legally available therefor in accordance with the terms of the Sinclair Capital trust agreement; and

(c) upon a voluntary or involuntary dissolution, winding-up or termination of Sinclair Capital (other than in connection with a redemption of all of the Public Preferred), the payment of an amount if, when, and to the extent holders of the Public Preferred are lawfully entitled to payment thereof from Sinclair Broadcast equal to the lesser of (i) the full liquidation preference plus accumulated and unpaid dividends to which the holders of the Public Preferred are lawfully entitled, and (ii) the amount of Sinclair Capital's legally available assets remaining after satisfaction of all claims of other parties which, as a matter of law, are prior to those of the holders of the Public Preferred.

The Sinclair Broadcast Guarantee will be unsecured and is expected to be subordinate to most or all other liabilities of Sinclair Broadcast. Under the terms of the Guarantee, any holder of Public Preferred may institute a legal proceeding directly against Sinclair Broadcast to enforce its rights under the Sinclair Broadcast Guarantee without first instituting a legal proceeding against Sinclair Capital or any other person or entity.

#### D. Terms of the KDSM Debentures

KDSM will sell Sinclair Capital the KDSM Debentures for roughly \$200 million, assuming Sinclair Capital sells 2 million shares of the Public Preferred. The KDSM Debentures will have an aggregate principal amount equal to the purchase price and an interest rate equal to the distribution rate on the Public Preferred. They will mature in 2008 and will be secured by a pledge of the Parent Preferred. The ability of KDSM to make payments on its debentures depends primarily on its receipt of dividends on the Parent Preferred. In addition, because KDSM owns KDSM-TV, it may be able to finance payments on its debentures through the cash flow generated by the operations of KDSM-TV in the event insufficient dividends are received.

KDSM may redeem the KDSM Debentures for cash at the liquidation value plus accumulated interest and a specified premium any time after five years from issuance or upon a "Tax Event" or an "Investment Company Act Event."<sup>2/</sup> In addition, if a Tax Event occurs, KDSM can cause Sinclair Capital to dissolve and distribute the KDSM Debentures provided that this option can only be exercised if Sinclair Broadcast is able, at the time of such an event, to

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<sup>2/</sup> A Tax Event is defined, among other things, to include certain clarifications or changes in tax law involving unexpected taxation of the activities of KDSM or Sinclair Capital or that would cause Sinclair Broadcast on a consolidated basis to lose its tax deduction for interest on the KDSM Debentures. An Investment Company Act Event is defined as a change or clarification of law that would cause Sinclair Capital or KDSM to be considered an investment company under Section 3 of the Company Act.

fully and unconditionally guarantee the KDSM Senior Debentures on a junior subordinated basis effective at the time of the distribution of KDSM Debentures. Sinclair Broadcast could not provide such a guarantee as of the date of the offering because of restrictions in its existing debt agreements. Prior to three years after issuance, KDSM may also redeem up to 50% of the KDSM Debentures with the proceeds of a redemption of the Parent Preferred for cash at the liquidation value plus accrued interest and a specified premium.

KDSM will covenant that it will not, nor will it permit any of its subsidiaries to, incur or guarantee or otherwise in any manner become directly or indirectly liable for any indebtedness, except that KDSM may incur indebtedness if the debt to annual operating cash flow ratio of KDSM and its subsidiaries at the time such indebtedness is incurred (after giving pro forma effect thereto), is 4 to 1 or less. In addition, and notwithstanding the ratio, KDSM will not be restricted from issuing the KDSM Debentures, trade debt in the ordinary course of business, and debt for working capital purposes not to exceed \$5 million.

#### E. Terms of the Parent Preferred

The Parent Preferred will have a distribution rate that will be up to one percentage point higher than the interest rate of the KDSM Debentures and a liquidation preference equal to the principal amount of the KDSM Debentures. Sinclair Broadcast will have the option to repay the Parent Preferred in the same circumstances and at the same redemption prices as KDSM will have the option to redeem the KDSM Debentures.

The Parent Preferred will have a stated maturity of approximately 12 years and will be mandatorily redeemable on its maturity date. The holders of a majority in aggregate liquidation value of the outstanding Parent Preferred will have the right to cause Sinclair Broadcast to increase the size of its board of directors by two members and will have the right to elect the two new directors upon Sinclair Broadcast's failure to: (a) pay dividends during four consecutive quarters; (b) make and consummate a change of control offer upon the occurrence of a change of control in certain circumstances; (c) discharge any redemption obligation with respect to the Parent Preferred; or (d) meet its covenants on the Parent Preferred.

#### II. Analysis

Rule 3a-5 was adopted after the Commission granted many exemptive applications that allowed operating companies to raise capital through finance subsidiaries. The Commission recognized that a variety of tax and other regulatory reasons often caused companies to seek to raise capital through wholly-owned subsidiaries rather than doing so directly. *Exemption from All Provisions of the Investment Company Act of 1940 for Certain Finance Subsidiaries of United States and Foreign Private Issuers*, SEC Release No. IC-12679, 1982 WL 35650, \*1 (Sept. 22, 1982) ("Proposing Release"). While these finance subsidiaries may meet the technical definition of investment company under Section 3(a)(3) of the Company Act, the Commission recognized that they "were not engaging in the kind of business the [Company] Act was intended to regulate." *Id.* at \*1-\*2.

The primary intent of the Commission in developing Rule 3a-5 was to exempt appropriate subsidiaries from counterproductive regulation while assuring that "neither the structure nor mode of operation of a qualifying finance subsidiary resembles that of an investment company." *Exemption From the Definition of Investment Company for Certain Finance Subsidiaries of United States and Foreign Private Issuers*, SEC Release No. IC-14275, 1984 WL 52669, \*3 (December 14, 1984) ("Adopting Release"). According to the Commission:

We have found this to be the case where the primary purpose of the subsidiary is to finance the business operations of its parent or other subsidiaries of its parent which are not investment companies. We have also found this to be the case where any purchaser of the finance subsidiary's debt instruments ultimately looks to the parent for repayment and not to the finance subsidiary. The rule, therefore, describes a situation where the finance subsidiary is essentially a conduit for the parent to raise capital for its own business operations or for the business operations of its other subsidiaries.

*Id.*

To assure that qualifying financing subsidiaries are of this nature, the Commission imposed six limitations on their activities in paragraph (a) of Rule 3a-5. In summary, these are:

(1) Any debt of the finance subsidiary issued to or held by the public must be unconditionally guaranteed by the parent;

(2) any non-voting preferred stock of the finance subsidiary issued to or held by the public must be unconditionally guaranteed by the parent;

(3) the terms of the parent's guarantee must allow the public holders to institute legal proceedings directly against the parent to enforce the guarantee without first proceeding against the finance subsidiary;

(4) any securities issued by the finance subsidiary that are convertible or exchangeable must be convertible or exchangeable only for securities issued by the parent or for debt or non-voting preferred of the finance subsidiary meeting the above requirements;

(5) the finance subsidiary must invest in or loan to its parent or a company controlled by its parent at least 85% of the proceeds from offerings of the finance subsidiary's debt or non-voting preferred securities, or any other borrowings, as soon as practicable, but in any event within six months after receipt; and

(6) the finance subsidiary must own, hold or trade in only Government securities, securities of the parent company or a company controlled by the parent, or debt securities which are exempted from the provisions of the Securities Act of 1933 (Securities Act") by Section 3(a)(3) of that Act.

**CONFIDENTIAL TREATMENT REQUESTED  
BY KDSM AND SINCLAIR CAPITAL  
PURSUANT TO 17 C.F.R. § 200.81**

KDSM has been structured to satisfy the requirements of paragraph (a) of Rule 3a-5. KDSM will not issue any preferred stock or debt to the public, eliminating the need for any guarantee that otherwise might be required under subparagraphs (a)(1), (a)(2), and (a)(3).<sup>3/</sup> Because securities issued by KDSM will not be convertible or exchangeable, subparagraph (a)(4) is inapplicable (and any voluntary dissolution of KDSM in which KDSM Debentures are distributed is conditioned on such debentures being guaranteed by Sinclair Broadcast). KDSM will own, hold or trade in only Government securities, securities of Sinclair Broadcast or a company controlled by Sinclair Broadcast, or debt securities which are exempted from the provisions of the Securities Act by Section 3(a)(3) of that Act as required by subparagraph (a)(6). As discussed in greater detail below, we believe that KDSM will comply with the remaining provisions of Rule 3a-5, including the use of proceeds requirement of subparagraph (a)(5) and the definition of finance subsidiary in paragraph (b).

We also believe that Sinclair Capital meets the requirements of paragraph (a). Sinclair Capital will not issue any debt to the public, eliminating any need to comply with subparagraph (a)(1). Sinclair Broadcast will, as discussed below, issue an unconditional guarantee of the Public Preferred structured to comply with the Staff's interpretations of subparagraph (a)(2). The Sinclair Broadcast Guarantee will give the Public Preferred holders the right to proceed directly against Sinclair Broadcast to enforce the terms of the guarantee without first proceeding against Sinclair Capital, thus complying with subparagraph (a)(3). Neither the Public Preferred nor any other security issued by Sinclair Capital will be convertible or exchangeable into any other security, thus rendering the requirements of subparagraph (a)(4) inapplicable, as discussed below. Sinclair Capital will invest substantially all of the net offering proceeds in KDSM, a company controlled by Sinclair Broadcast, as soon as practicable, but in any event within six months after receipt, thereby satisfying the requirements of subparagraph (a)(5). Finally, Sinclair Capital will own, hold or trade in only Government securities, securities of Sinclair Broadcast or a company controlled by Sinclair Broadcast, or debt securities which are exempted from the provisions of the Securities Act Section 3(a)(3) in compliance with subparagraph (a)(6).

In our view, KDSM and Sinclair Capital are able to comply with the requirements of Rule 3a-5 because they are engaged in the type of financing activities that the Commission envisioned when it promulgated Rule 3a-5. Just as the Commission intended, both entities are structured to

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<sup>3/</sup> See *PSEG Capital Corp.*, SEC No-Action Letter, 1988 WL 234525 (July 13, 1988) (private placement of non-guaranteed debt securities permitted by the Staff in light of the fact that Rule 3a-5 only requires the guarantee of securities "issued to or held by the public"); see also *Societe Generale and SGA Society Generale Acceptance N.V.*, SEC No-Action Letter, 1992 WL 75606 (Feb. 14, 1992) and *MEC Finance USA, Inc.*, SEC No-Action Letter, 1991 WL 243175 (Oct. 25, 1991) (securities sold in public offerings to persons outside the United States are not "issued to or held by the public" for purposes of Rule 3a-5 and accordingly need not be guaranteed by the parent company).

raise capital for their ultimate parent because of business and tax considerations. Specific issues associated with KDSM and Sinclair Capital are discussed below.

**A. KDSM, the Definition of Finance Subsidiary, and the "Primary Purpose" Test**

As a preliminary matter, an entity seeking to rely on Rule 3a-5 must fall within the definition of finance subsidiary provided in subparagraph (b)(1). That subparagraph provides that a finance subsidiary means any company:<sup>4/</sup>

(i) all of whose securities other than debt or preferred stock meeting the requirements of subparagraphs (a)(1) through (a)(3) or directors' qualifying shares are owned by its parent company or a company controlled by its parent company; and

(ii) the primary purpose of which is to finance the business operations of its parent company or companies controlled by its parent company.

These requirements serve to insure that the finance subsidiary is a conduit through which the parent raises capital. Adopting Release at \*6.

KDSM will comply with subparagraph (b)(1)(i) both initially and for so long as it relies on Rule 3a-5. Initially, KDSM will issue securities only to Sinclair Broadcast and Sinclair Capital. Sinclair Broadcast meets the definition of "parent company" as it is a corporation, which is not an investment company under Section 3(a), or is excepted or exempted from that definition pursuant to Section 3(b) or the rules under Section 3(a), and which is organized under the laws of Maryland. The KDSM Debentures issued by KDSM to Sinclair Capital will not be publicly offered, and thus subparagraphs (a)(1) through (a)(3) will be inapplicable. If KDSM issues additional securities, whether debt or equity, such securities will be limited to those permitted by paragraph (b) for so long as KDSM relies on Rule 3a-5.

The only substantial question about whether KDSM falls within the definition of finance subsidiary relates to the primary purpose requirement of subparagraph (b)(1)(ii). As noted previously, KDSM owns and will continue to own assets other than its interest in Sinclair Capital and the Parent Preferred. We believe that such operations will be subsidiary to its primary purpose of financing the operations of Sinclair Broadcast, and accordingly that KDSM meets the definition of finance subsidiary.

Neither Rule 3a-5, nor the releases accompanying its proposal and adoption, define primary purpose. The Proposing Release made clear that the reason for the primary purpose test

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<sup>4/</sup> While subparagraph (b)(1) uses the term "corporation," in several no-action letters the Staff has allowed Delaware business trusts to rely on Rule 3a-5. See *Lehman Brothers, Inc.*, SEC No-Action Letter, 1995 WL 329629 (May 26, 1995); *Goldman, Sachs & Co.*, SEC No-Action Letter, 1995 WL 271721 (April 27, 1995).

was to "ensure that the exemption does not provide a vehicle through which some other type of investment company warranting regulation might evade the [Company] Act." Proposing Release at \*4. In response to comments that were critical of the primary purpose requirement, the Adopting Release made it clear that a finance subsidiary can hold other assets not invested with the parent and still qualify:

The Commission has decided to retain the primary purpose test in the final rule; to do otherwise would be inconsistent with the rule's underlying rationale. If a subsidiary were to be engaged primarily in non-financing activities, it could not be considered a conduit for the parent to raise capital. In addition, the Commission notes that **the primary purpose test by no means prevents a finance subsidiary from engaging in non-financing activities so long as its primary purpose is to engage in financing activities.**

Adopting Release at \*6 (emphasis added).

While the Commission has not yet expanded upon this explanation, in similar contexts, in determining the business in which a company is "primarily engaged," the staff has used the manner in which the assets of a company are deployed as the predominant factor. "In various contexts, the term 'primarily engaged' in a business has been taken to mean that at least 55% of a company's assets are employed in, and 55% of a company's income is derived from, that business." *Exemption from the Investment Company Act of 1940 for the Offer and Sale of Securities by Foreign Banks and Foreign Insurance Companies and Related Entities*, SEC Release No. IC-17682, 1990 WL 321555, \*17 n.33 (Aug. 17, 1990); *see also Econo Lodges of America, Inc.*, SEC No-Action Letter, 1989 WL 246651 (Dec. 22, 1989) (agreeing that the requestor qualified for a Section 3(c)(5)(C) exception where 55% of the company's assets were invested in qualifying assets and the company planned to lend 85% of the proceeds of a public offering to its parent).

In our view, the primary purpose of KDSM is to finance the operations of Sinclair Broadcast. The substantial majority of its assets will be used to engage in financing activities. KDSM will purchase Parent Preferred with the offering proceeds from the sale of the KDSM Debentures. KDSM also will own the operations of KDSM-TV which are expected to have a current value of approximately \$50 million. Although the precise offering proceeds may vary depending upon market conditions, under any scenario well over 55% of KDSM assets would be used directly in KDSM's financing activities upon completion of the offering. KDSM's remaining assets will indirectly facilitate these financing activities. We note in particular that KDSM must retain operating assets *because of* its financing activities, and not due to any attempt to evade the purposes of the Act or become a *de facto* investment company. Sinclair Broadcast has been advised that it could not replace KDSM with a finance subsidiary owning no substantial assets other than the Parent Preferred and retain its ability to deduct interest paid on the KDSM Debentures.

We acknowledge, however, that it may be possible to view KDSM as primarily engaged in a non-investment business due to the fact that the day by day activities of its officers and employees primarily relate to its broadcast business, it is known as a broadcast station operator, and may continue to operate its broadcast station after any financing activities are terminated. If KDSM fails to meet the "primary purpose" test of subparagraph (b)(1)(ii) because it is deemed to be primarily engaged in its broadcasting business, we are of the opinion that it would be excluded from the definition of investment company pursuant to Section 3(b)(1) of the Company Act. Section 3(b)(1) excepts companies that meet the *prima facie* definition of investment company in Section 3(a)(3) but that, directly or through wholly-owned subsidiaries, are engaged primarily in a business or businesses other than investing, reinvesting, owning, holding or trading in securities. Although KDSM expects to hold a broadcast license in a wholly-owned subsidiary, it has no other subsidiaries. Accordingly, we are of the opinion that KDSM is not an investment company because it either (i) is primarily engaged directly or through wholly-owned subsidiaries in a business or businesses other than investing, reinvesting, owning, holding, or trading in securities or, (ii) if KDSM is deemed to be primarily engaged in owning or holding securities due to its financing activities, its "primary purpose" would be to engage in financing activities and, subject to the staff's concurrence with our views concerning subparagraph (a)(5) as discussed below, it complies with the remaining provisions of Rule 3a-5.

#### B. Additional Borrowings by KDSM

To avoid any question about KDSM's status as an investment company, we seek the Staff's concurrence that KDSM would be in compliance with subparagraph (a)(5) assuming that it meets the definition of finance subsidiary. Subparagraph (a)(5) requires that a financing subsidiary invest in or loan to its "parent company" or a "company controlled by the parent company" at least 85% of the proceeds of an offering of debt, non-voting preferred securities, or other borrowings as soon as practicable and in any event within six months after receipt of the proceeds. According to the Adopting Release, in the absence of such a requirement, "the finance subsidiary could act as a *de facto* investment company for an indefinite period." Adopting Release at \*7.

KDSM will invest all of the net offering proceeds in Sinclair Broadcast simultaneously with their receipt, thereby complying with subparagraph (a)(5) initially. KDSM, however, would be both a finance subsidiary and an operating company. KDSM thus has retained the right to issue additional debt to finance its operations, although such rights are substantially restricted under the terms of the KDSM Debentures. As discussed above, in addition to issuing the KDSM Debentures, KDSM can incur trade debt in the ordinary course of business, debt for working capital purposes not to exceed \$5 million, and additional indebtedness only if the debt to operating cash flow ratio of KDSM when such indebtedness is incurred, after giving *pro forma* effect thereto, is 4 to 1 or less. We believe that KDSM's right to incur additional debt offends neither the policy nor the letter of the Rule.

As a matter of policy, the reason for preserving KDSM's right to incur additional indebtedness is to help assure that its operating business can function. KDSM will not incur additional debt for investment purposes. Rather, as the owner and operator of an existing television station, KDSM has and will continue to have financial obligations and needs that relate to its continued management of the television station. The concern expressed in the Adopting Release -- that a finance subsidiary that retained offering proceeds might function as a *de facto* investment company -- simply is not present.

As far as the letter of the rule is concerned, we believe that the ability to incur additional debt also is consistent with subparagraph (a)(5). KDSM will agree that it will invest in or loan to Sinclair Broadcast or companies other than itself that are controlled by Sinclair Broadcast at least 85% of the *cumulative proceeds* of all issued and outstanding debt securities or non-voting preferred stock or any other debt (collectively, "financings") as soon as is practicable, but in any event within six months after receipt of any cash pursuant to a financing. Thus, if KDSM raises \$200 million through KDSM Debentures and owns Parent Preferred for which it has paid \$200 million and which has not been redeemed, it could raise approximately \$35 million of additional debt or non-voting preferred and use the proceeds to finance its operations (\$200 million is slightly more than 85% of \$235 million).

We would like to emphasize that KDSM will not use the ability to raise additional debt or offering proceeds for securities investment purposes. KDSM will continue to comply with subparagraph (a)(6) of the rule, which will prevent it from owning securities other than Government securities, securities issued by Sinclair Broadcast or companies controlled by Sinclair Broadcast, or debt securities exempted by section 3(a)(3) under the Securities Act. Moreover, KDSM will use any debt or offering proceeds, other than those that are promptly forwarded to Sinclair Broadcast or companies controlled by Sinclair Broadcast, solely to finance its broadcast operations (or such other non-securities investment business or businesses in which it may be engaged in the future).

Given the limitations on KDSM's investment activities, interpreting the 85% requirement on a cumulative, rather than an offering-by-offering, basis is consistent with the primary purpose requirement of subparagraph (b)(1) as well as subparagraph (a)(5)'s intent to ensure that a finance subsidiary does not become a *de facto* investment company. So long as all of the outstanding principal amount of debt and preferred stock is included in the calculation, at all times the vast majority of the outstanding financing activity of KDSM will be directly tied to financing the activities of Sinclair Broadcast and its other controlled companies. In addition, the limitations on the purposes for which KDSM can retain additional debt provides further assurance that it will not be used as a device to evade the policies underlying, and provisions of, the Company Act.

C. The Public Preferred and Rule 3a-5(a)(2)

Unlike KDSM, Sinclair Capital will issue securities -- the Public Preferred -- to the public.<sup>5/</sup> As non-voting preferred stock, such securities are subject to subparagraph (a)(2), which provides that:

Any non-voting preferred stock of the finance subsidiary issued to or held by the public is unconditionally guaranteed by the parent company as to payment of dividends, payment of the liquidation preference in the event of liquidation, and payments to be made under a sinking fund, if a sinking fund is to be provided (except that the guarantee may be subordinated in right of payment to other debt of the parent company).

The Staff first interpreted the requirements of subparagraph (a)(2) in *Cleary, Gottlieb, Steen & Hamilton*, SEC No-Action Letter 1985 WL 57328 (Dec. 23 1985). *Cleary, Gottlieb, Steen & Hamilton* ("Cleary") and the Staff considered whether a parent could provide a guarantee of the financing subsidiary's preferred stock sufficient to comply with subparagraph (a)(2) without causing the financing subsidiary preferred to be recharacterized as debt for federal income tax purposes. Cleary noted that one possible interpretation of the guarantee requirement of subparagraph (a)(2) would be to require that the parent guarantee the *declaration* of dividends on preferred stock and the *existence* of a certain amount of assets legally available for distribution. Cleary argued that such an interpretation was unnecessary, and would have the effect of causing a holder of finance subsidiary preferred stock to have greater rights than a holder of comparable parent preferred. The Staff agreed, and stated that such an interpretation would be "inconsistent with the intent of the rule" and that the proper interpretation of subparagraph (a)(2) was to require that the parent guarantee the *payment of dividends that have been properly declared* and the *distribution of assets that are legally available*. Thus, the response stated that "[w]e interpret rule 3a-5(a)(2) under the 1940 Act to require the parent of a financing subsidiary:

1) to unconditionally guarantee the payment of dividends on the subsidiary's non-voting preferred stock, which have been properly declared by the subsidiary's board of directors; and

2) in the event of a liquidation, to unconditionally guarantee the payment of the lesser of

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<sup>5/</sup> Initially, the Public Preferred may be offered in a non-public offering exempted from the registration requirements of the Securities Act by Section 4(2) of that Act or the rules and regulations thereunder. Because Sinclair Capital expects to grant registration rights to holders of the Public Preferred even if these securities initially are offered privately, it is treating such securities as if they were publicly issued *ab initio* for purposes of the guarantee requirement.

- i) the full liquidation preference plus accumulated and unpaid dividends to which the preferred stockholders are lawfully entitled, or
- ii) the amount of the subsidiary's assets remaining after satisfaction of other parties having claims which, as a matter of law, are prior to those of the preferred stockholders."

*Cleary* at \*3.

*Cleary* presented the guarantee issue on a purely policy basis, without identifying or describing any particular proposal. The Staff subsequently was asked to consider subparagraph (a)(2) in a specific fact setting in *Chieftain Int'l Funding Corp.*, SEC No-Action Letter, 1992 WL 335318 (Nov. 3, 1992). Like the current proposal, *Chieftain* involved a multi-tiered structure. *Chieftain International Funding Corp.* ("Funding Corp.") was a wholly-owned subsidiary of *Chieftain International (U.S.), Inc.* ("Chieftain U.S.") which was in turn a wholly-owned subsidiary of *Chieftain International, Inc.* ("Chieftain Canada"). Funding Corp. intended to issue preferred stock to the public and loan the proceeds to or invest them in *Chieftain Canada* or its subsidiaries for use in business operations. The preferred would be convertible into shares of *Chieftain Canada* common stock at the option of the holders at any time. *Chieftain Canada* planned to unconditionally guarantee on a subordinated basis:

(i) the payment of dividends, when, as and if properly declared by Funding Corp.'s Board of Directors, out of funds legally available therefor;

(ii) in the event of liquidation, the payment of an amount if, when and to the extent holders of Preferred Stock are lawfully entitled to payment thereof from Funding Corp. equal to the lesser of (a) the full liquidation preference plus accumulated and unpaid dividends to which the holders of Preferred Stock are lawfully entitled and (b) the amount of Funding Corp.'s assets remaining after satisfaction of all claims of other parties which, as a matter of law, are prior to those of the holders of Preferred Stock; [and]

(iii) in the event of redemption, the payment of the redemption price . . . if, when and to the extent holders of Preferred Stock are lawfully entitled to payment thereof from Funding Corp.

The Sinclair Broadcast Guarantee is modeled on and substantially identical to the guarantees in *Cleary* and *Chieftain*. All three guarantees guarantee the payment of dividends lawfully declared. Specifically, Sinclair Broadcast will guarantee the payment of any accrued and unpaid distributions on the Public Preferred that have been theretofore declared on the Public Preferred from funds of Sinclair Capital legally available therefor in accordance with the Sinclair Capital trust agreement. In *Cleary* the Staff approved a parent guarantee of "the payment of dividends on the subsidiary's non-voting preferred stock, which have been properly declared by the subsidiary's board of directors." *Cleary* at \*3. *Chieftain* proposed to guarantee

"the payment of dividends, when, as and if properly declared by Funding Corp.'s Board of Directors, out of funds legally available therefor." *Chieftain* at \*2.

All three guarantees guarantee upon liquidation the lesser of the liquidation preference plus accumulated and unpaid dividends, and assets remaining after prior claims are paid. Specifically, Sinclair Broadcast will guarantee upon liquidation the payment of the lesser of: (i) the full liquidation preference plus accumulated and unpaid dividends to which the holders of the Public Preferred are lawfully entitled; and (ii) the amount of Sinclair Capital's legally available assets remaining after satisfaction of all claims of other parties which, as a matter of law, are prior to those of the holders of the Public Preferred. In *Cleary* the Staff approved the guarantee upon liquidation of "the payment of the lesser of i) the full liquidation preference plus accumulated and unpaid dividends to which the preferred stockholders are lawfully entitled, or ii) the amount of the subsidiary's assets remaining after satisfaction of other parties having claims which, as a matter of law, are prior to those of the preferred stockholders." *Cleary* at \*3. *Chieftain* proposed to guarantee upon liquidation the payment of "an amount if, when and to the extent holders of Preferred Stock are lawfully entitled to payment thereof from Funding Corp. equal to the lesser of (a) the full liquidation preference plus accumulated and unpaid dividends to which the holders of Preferred Stock are lawfully entitled and (b) the amount of Funding Corp.'s assets remaining after satisfaction of all claims of other parties which, as a matter of law, are prior to those of the holders of Preferred Stock." *Chieftain* at \*2.

Lastly, all three guarantees allow the public holders to institute legal proceedings directly against the parent without first proceeding against the finance subsidiary. In our view, the Sinclair Broadcast Guarantee meets the Staff's interpretation of Rule 3a-5 set out in *Cleary* and applied in *Chieftain*.

We believe that one aspect of the guarantee that was not expressly discussed in *Cleary* and *Chieftain* merits discussion: the meaning of the statement that the parent will guarantee payment of "the amount of the subsidiary's" lawfully available assets remaining after satisfaction of claims if this "amount" is less than the full liquidation preference plus accumulated and unpaid dividends. In particular, we believe that the guarantee of the "amount of the subsidiary's assets" does not require that the parent deliver the *cash equivalent value* of these assets, but rather take direct responsibility for ensuring that the subsidiary promptly deliver to the holders of its preferred securities *any assets held by the subsidiary that lawfully can be distributed*. Any requirement that the parent guarantee the delivery of the cash equivalent value of the assets of a finance subsidiary would, in effect, amount to a requirement that the parent guarantee "the existence of a certain amount of assets legally available for distribution" that the Staff in *Cleary* stated was inconsistent with the intent of Rule 3a-5. In this regard, we note that Sinclair Broadcast may be precluded from promising to deliver the cash equivalent value of any liquidation preference under the terms of its current indentures.

As discussed in Part I.B., above, Sinclair Capital may be liquidated and dissolved in the absence of a redemption of the Public Preferred for their full liquidation preference plus

accumulated and undistributed dividends if: (i) a majority in interest of the holders of the Public Preferred so elect after Sinclair Broadcast becomes bankrupt, insolvent, dissolves, or liquidates; (ii) a Tax Event occurs and KDSM Debentures are the sole asset distributed and are fully and unconditionally guaranteed by Sinclair Broadcast on a junior subordinated basis effective at the time of the distribution, or (iii) in the year 2015 if Sinclair Capital has not previously liquidated and dissolved (which could occur only if the KDSM Debentures were in default). It is impossible to predict with complete certainty what assets would be owned by -- and therefore available for distribution from -- Sinclair Capital in the event of a liquidation (other than one involving a distribution of the guaranteed KDSM Debentures) without a prior redemption of the Public Preferred for cash. However, such assets could include KDSM Debentures or, in some cases, any rights or other assets that Sinclair Capital gained as holder of KDSM Debentures. We believe that the parent's guarantee that it will cause the finance subsidiary promptly to distribute any assets remaining after resolution and satisfaction of prior claims without requiring that legal action be brought against or demand be made of the finance subsidiary fully satisfies subparagraph (a)(2) with respect to (i) and (iii), above.<sup>6/</sup>

Although not directly discussed in *Cleary* and *Chieftain*, our interpretation is consistent with many other transactions that relied on those letters. Moreover, a contrary interpretation would severely disrupt the ability of finance subsidiaries to issue preferred stock by requiring precisely the type of collection guarantee that was rejected by the Staff. For example, in *Ford Motor Company Capital Trust I*, SEC No-Action Letter, 1996 WL 435548 (Aug. 2, 1996), Ford Motor Company ("Ford") and Ford Motor Company Capital Trust I (the "Trust") sought an exemption from the periodic reporting requirements of Sections 13 and 15(d) of the Exchange Act. While Ford and the Trust did not seek assurance concerning Rule 3a-5, the transaction relied on the rule (*Ford* at \*2) and is representative of transactions that comport to the *Cleary* and *Chieftain* positions.<sup>7/</sup> As described in the requesting letter, "[t]he Preferred Securities Guarantee constitutes a guarantee of payment and not of collection." *Ford* at \*9. The no-action request subsequently described how the guarantee would function. First, the request noted that

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<sup>6/</sup> As noted previously, any voluntary determination to dissolve and liquidate KDSM Debentures is conditioned upon the existence of a full and unconditional guarantee of such debentures, thus eliminating any concern that a voluntary liquidation would be used as a mechanism to evade a guarantee.

<sup>7/</sup> *Ford* is substantially identical to a large number of similar letters under the Exchange Act. Like *Ford*, each letter states that the guarantee is one of "payment and not of collection," and makes it clear that non-cash assets might be distributed upon a liquidation of the finance subsidiary without any cash payment of a liquidation preference or its equivalent. See, e.g., *Salomon Inc.*, SEC No-Action Letter, 1997 WL 47183 (Feb. 5, 1997); *Texas Utilities Electric Co.*, SEC No-Action Letter, 1997 WL 29323 (Jan. 24, 1997); *Commonwealth Edison Co.* SEC No-Action Letter, 1996 WL 183332 (Apr. 16, 1996); *Time Warner Inc.*, SEC No-Action Letter, 1996 WL 149073 (Apr. 1, 1996).

liquidation could occur at the maturity or early redemption of the parent's debt securities held by the Trust, which would enable the Trust to make corresponding payments on its preferred securities. Second, if the Trust was liquidated without repayment of the parent debt, the debt securities held by the Trust would be distributed to the holders of Trust preferred. *Ford at \*15*. Like Ford, we believe that Sinclair Broadcast's guarantee that any assets actually owned by Sinclair Capital will be delivered in the event of a liquidation fully complies with subparagraph (a)(2).

We also would like to emphasize that this interpretation is consistent with the underlying purposes of rule 3a-5, which seeks to put the holder of securities issued by a finance subsidiary in substantially the same position as if the holder held parent securities directly. In this regard, we note that although debt and preferred securities often are regarded as being functionally equivalent, there are certain distinctions between such securities that are material to the nature of the parent's guarantee. If a holder of debt securities is not paid principal or interest when due, the holder can bring a direct suit to enforce its right to an immediate cash payment. Accordingly, a holder of debt securities issued by a finance subsidiary will be in substantially the same position as a holder of parent debt only if the holder similarly can require the parent to make a cash payment upon a default.

In contrast, a holder of preferred securities issued without a sinking fund has no specific right to any payment upon the stated maturity of the securities. Rather, a holder of preferred securities simply would be entitled to the payment of any liquidation preference plus any accumulated and unpaid dividends before any payment could be made to the holders of the issuer's common securities, and might enjoy certain voting rights. Thus, a direct holder of preferred securities would not have any right to sue for an immediate cash payment upon stated maturity. Of course, this does not mean that an issuer does not have a substantial incentive to make timely and full payments on its preferred. Just as if it had not used a finance subsidiary structure, Sinclair Broadcast will be unable to make distributions to its common holders after the maturity of the Parent Preferred pending payment of any liquidation preference and accumulated distributions relating to the Parent Preferred.

Finally, *Chieftain* involved one element in addition to a *Cleary*-type guarantee that we believe is not germane but which we discuss because *Chieftain* is the only no-action letter that addresses subparagraph (a)(2) in the context of a specific structure. In *Chieftain*, Funding Corp.'s preferred shares were to be convertible into Chieftain Canada common stock at any time at the option of the holders. For that reason, Chieftain Canada stated that it would guarantee performance of Funding Corp.'s obligation to deliver the proper number of shares of its common stock to the holders of Funding Corp.'s preferred shares. In the case of Sinclair Capital, the Public Preferred will not be convertible or exchangeable for securities of any other entity.<sup>8/</sup>

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<sup>8/</sup> Of course, securities issued by KDSM might, or might not, be among the assets distributed to holders of Public Preferred if Sinclair Capital is liquidated and the Public Preferred

In our view, the convertibility provision was discussed in *Chieftain* because it was part of the particular transaction at issue and not because of any requirement that preferred stock issued by a finance subsidiary be convertible into the securities of its parent company. First and foremost, *Cleary* made no mention of such a convertibility feature. Second, subparagraph (a)(4) makes clear that such convertibility is permitted, but not required, providing simply that any securities issued by a finance subsidiary that are convertible or exchangeable be convertible or exchangeable only for securities issued by the parent or for debt or non-voting preferred of the finance subsidiary.<sup>2/</sup> Although not specifically sanctioned by the staff, we note that many other transactions have been effected in reliance on *Cleary* without a convertibility feature.

We believe that the discussion of convertibility in *Chieftain* simply reflects the requestor's attempt to assure the Staff that its securities would comply with subparagraph (a)(2) and that the three-tiered structure would not interfere with the holder's ability to receive target securities. Because *Chieftain* is the only application of the *Cleary* position to a specific transaction, however, we seek confirmation that the Staff will not recommend enforcement action if the Public Preferred is not convertible into securities of Sinclair Broadcast.

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We believe that neither Sinclair Capital nor KDSM is the type of entity that Congress intended to regulate under the Company Act. Each entity is primarily engaged in the *bona fide* financing of the operations of Sinclair Broadcast and its controlled companies, and the holders of the Public Preferred are able to look to the Sinclair Broadcast Guarantee to assure that they

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has not been redeemed for cash in accordance with its terms. Such a liquidating distribution of assets, under the limited circumstances described in this letter, does not constitute an convertibility or exchange feature covered by subparagraph (a)(4). A holder of Public Preferred does not have any right to cause the Public Preferred to be exchanged or converted into another security, and any receipt of KDSM Debentures would merely constitute the ordinary distribution of Sinclair Capital's assets upon its cessation. In addition, even if the ability to effect a voluntary dissolution and distribution of KDSM Debentures upon a Tax Event were viewed as the functional equivalent of convertibility, a voluntary distribution would satisfy subparagraph (a)(4) because the KDSM Debentures would be fully and unconditionally guaranteed.

<sup>2/</sup> In this regard, we note that the Staff stated that it approved the *Chieftain* structure "in particular" because the proposed guarantee conformed to the Staff's "interpretation" of subparagraph (a)(2). *Chieftain* at \*2. The Staff's only mention of the convertibility feature was in its discussion of the deal terms.

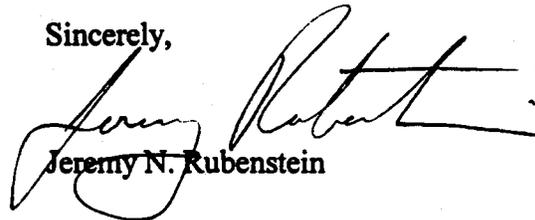
Jack W. Murphy, Esq.  
February 21, 1997  
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**CONFIDENTIAL TREATMENT REQUESTED  
BY KDSM AND SINCLAIR CAPITAL  
PURSUANT TO 17 C.F.R. § 200.81**

receive payment. On the basis of the foregoing, we request a statement that the Staff will not recommend enforcement action to the Commission if KDSM and Sinclair Capital do not register as investment companies.

Please contact Jeremy N. Rubenstein at 202-663-6159 or John C. Nagel at 202-663-6134 if you need additional information or if you would like to discuss these matters further.

Sincerely,



Jeremy N. Rubenstein