

3M CO
Form 424B2
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Registration No. 333-176082

Prospectus Supplement to Prospectus dated August 5, 2011.

\$3,000,000,000

3M Company

Medium-Term Notes, Series F

3M may offer from time to time medium-term notes, series F. The final terms of each note will be included in a pricing supplement. 3M will receive between \$2,996,250,000 and \$2,977,500,000 of the proceeds from the sale of the notes, before expenses and after paying the agents discounts and commissions of between \$3,750,000 and \$22,500,000. The following terms may apply to the notes.

- Mature nine months or longer
- Fixed or floating interest rate, zero-coupon or issued with original issue discount; a floating interest rate may be based on:
- Commercial paper rate
- Prime rate
- CD rate
- Federal funds rate
- LIBOR

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- EURIBOR
- Treasury rate
- CMT rate
- 11th district cost of funds rate
- Any other rate specified by us in a pricing supplement
- Any combination of rates specified in a pricing supplement
- Amount of principal or interest may be determined by reference to an index or formula
- Book-entry form only
- May be subject to redemption by us or repurchase at the option of the Holder
- Not amortized or subject to a sinking fund
- Interest paid on fixed rate notes semi-annually
- Interest paid on floating rate notes monthly, quarterly, semi-annually or annually
- Minimum denominations of \$2,000 and integral multiples of \$1,000 in excess thereof
- Fully registered form
- May be foreign currency or composite currency denominated
- Same day settlement and payment in immediately available funds

Investing in the notes involves certain risks. See Risk Factors on page S-28.

We do not plan to list the notes for trading on any securities exchange.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

We may sell the notes directly or through one or more agents or dealers, including the agents listed below. The agents are not required to sell any specific number or amount of the notes. They will use their reasonable best efforts to sell the notes offered. No commission will be payable on sales that we make directly. There is no established trading market for the notes and there can be no assurance that a secondary market for the notes will develop.

Goldman, Sachs & Co.

Barclays Capital

BofA Merrill Lynch

Citigroup

Deutsche Bank Securities

J.P. Morgan

Morgan Stanley

UBS Investment Bank

Prospectus Supplement dated September 2, 2011.

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ABOUT THIS PROSPECTUS SUPPLEMENT

You should read this prospectus supplement along with the accompanying prospectus and your pricing supplement. These documents contain information you should consider when making your investment decision. You should rely on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus and your pricing supplement. We have not, and the agents have not, authorized anyone else to provide you with different or additional information. If anyone provides you with different or inconsistent information, you should not rely on it.

This prospectus supplement, the accompanying prospectus and your pricing supplement do not constitute an offer to sell or a solicitation of an offer to buy any securities other than the notes. This prospectus supplement, the accompanying prospectus and the applicable pricing supplement do not constitute an offer to sell or a solicitation of an offer to buy such notes in any circumstances in which such offer or solicitation is unlawful.

Information in this prospectus supplement, the accompanying prospectus or your pricing supplement may change after the date on the front of the applicable document. You should not interpret the delivery of this prospectus supplement, the accompanying prospectus or your pricing supplement or the sale of the notes, as an indication that there has been no change in our affairs since those dates.

DESCRIPTION OF NOTES WE MAY OFFER

*Please note that in this section entitled **Description of Notes We May Offer**, references to **3M**, **we**, **our** and **us** mean 3M Company, unless the context indicates otherwise. Also, in this section, references to **Holders** mean those who own notes registered in their own names, on the books that we or the Trustee maintain for this purpose, and not those who own beneficial interests in notes registered in street name or in notes issued in book-entry form through The Depository Trust Company. Owners of beneficial interests in the notes should read the subsection entitled **Legal Ownership of Notes**. Certain defined terms used throughout this prospectus supplement are in quotation marks and bold print where they are first defined.*

**Information About Our Medium-Term
Note Program**

The Notes Will Be Issued Under the Indenture

As required by U.S. federal law for all bonds and notes of companies that are publicly offered, the notes are governed by a document called the indenture. The indenture dated November 17, 2000, as the same may be amended and supplemented, is a contract between us and The Bank of New York Mellon Trust Company, N.A., which acts as trustee. The trustee has two main roles:

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- First, the trustee can enforce your rights against us if we default. There are limitations on the extent to which the trustee acts on your behalf, which we describe in the accompanying prospectus under Debt Securities Events of Default ; and
- Second, the trustee performs administrative duties for us, such as sending you interest payments and notices.

We May Issue Other Series of Debt Securities

The indenture permits us to issue different series of debt securities from time to time. The series F medium-term notes will be a single, distinct series of debt securities. We may, however, issue notes in such amounts, at such times and on such terms as we wish. The notes may differ from one another, and from other series, in their terms. We may create and issue additional notes with the same terms as previous issuances of Series F medium-term notes, so that the additional notes will be considered as part of the same issuance as the earlier notes.

This section summarizes the material terms that will apply generally to the notes as a series and adds to, and to the extent inconsistent therewith replaces, the description of the general terms and provisions of the debt

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securities contained in the accompanying prospectus. Each particular note will have financial and other terms specific to it, and the specific terms of each note will be described in a pricing supplement. Those terms may vary from the terms described here. As you read this section, therefore, please remember that the specific terms of your note as described in your pricing supplement will supplement and, if applicable, may modify or replace the general terms described in this section. The statements we make in this section may not apply to your note.

When we refer to the notes , the series F medium-term notes or these notes , we mean our medium-term notes, series F. When we refer to a series of debt securities , we mean a series, such as the notes, issued under the indenture. When we refer to your pricing supplement , we mean the pricing supplement describing the specific terms of the note you purchase.

Amounts That We May Issue

The indenture does not limit the aggregate amount of debt securities that we may issue, nor does it limit the number of series or the aggregate amount of any particular series. We have initially authorized the issuance of series F medium-term notes in such amounts as will not result in the notes having an aggregate initial offering price greater than \$3,000,000,000, or an equivalent amount in any other currency or currency unit. We may, however, increase this authorized amount at any time without your consent. The indenture and the notes do not limit our ability to incur other indebtedness or to issue other securities. Also, we are not subject to financial or similar restrictions by the terms of the notes, except as described under Debt Securities Restrictions on Secured Funded Debt and Restrictions on Sale and Lease-Back Transactions in the accompanying prospectus.

How the Notes Rank Against Other Debt

The series F medium-term notes will not be secured by any of our property or assets or any of our subsidiaries' property or assets. Thus, by owning a note, you are one of our unsecured creditors.

The notes will not be subordinated to any of our other debt obligations. This means that, in a bankruptcy or liquidation proceeding against us, the notes would rank equally in right of payment with all of our other unsecured and unsubordinated debt.

This Section is Only a Summary

The indenture and its associated documents, including your note, contain the full legal text of the matters described in this section, the accompanying prospectus and your pricing supplement. The indenture and the notes are governed by New York law. A copy of the indenture has been filed with the SEC. See About this Prospectus and Where You Can Find Additional Information in the accompanying prospectus for information on how to obtain a copy.

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This section, the accompanying prospectus and your pricing supplement summarize all the material terms of the indenture and your note. They do not, however, describe every aspect of the indenture and your note. For example, in this section, the accompanying prospectus and your pricing supplement, we use terms that have been given special meaning in the indenture, but we describe the meaning of only the more important of those terms.

Features Common to All Notes

Stated Maturity and Maturity

The day on which the principal amount of your note is scheduled to become due is called the stated maturity of the principal and is specified in your pricing supplement. The principal may become due sooner, by reason of redemption, repayment or acceleration after a default. The day on which the principal actually becomes due, whether at the stated maturity or earlier, is called the maturity of the principal .

We also use the terms stated maturity and maturity to refer to the dates when other payments become due. For example, we may refer to a regular interest payment date when an installment of interest is scheduled to

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become due as the stated maturity of that installment. When we refer to the stated maturity or the maturity of a note without specifying a particular payment, we mean the stated maturity or maturity of the principal, as the case may be.

Any issue proceeds of notes that have a maturity of less than one year and that are accepted by us in the United Kingdom or whose issue otherwise constitutes a contravention of Section 19 of the Financial Services and Markets Act 2000 (the FSMA) will be issued to a limited class of professional investors and shall have a minimum denomination of £100,000 or greater (or its equivalent in other currencies).

Currency of Notes

Amounts that become due and payable on your note will be payable in a currency, composite currency, basket of currencies or currency unit or units specified in your pricing supplement. We refer to this currency, composite currency, basket of currencies or currency unit or units as a specified currency . The specified currency for your note will be U.S. dollars, unless your pricing supplement states otherwise. Some notes may have different specified currencies for principal and interest.

You will have to pay for your notes by delivering the requisite amount of the specified currency for the principal to the agent that we name in your pricing supplement, unless other arrangements have been made between you and us or you and that agent. We will make payments on your notes in the specified currency, except as described below in Payment Mechanics .

Types of Notes

We will issue the following three types of notes:

- **Fixed Rate Notes.** A note of this type will bear interest at a fixed rate described in the applicable pricing supplement. This type includes zero coupon notes, which bear no interest and are instead issued at a price lower than the principal amount.
- **Floating Rate Notes.** A note of this type will bear interest at rates that are determined by reference to an interest rate formula. In some cases, the rates may also be adjusted by adding or subtracting a spread or multiplying by a spread multiplier and may be subject to a minimum rate or a maximum rate. The various interest rate formulas and these other features are described below in Interest Rates Floating Rate Notes . If your note is a floating rate note, the formula and any adjustments that apply to the interest rate will be specified in your pricing supplement.
- **Indexed Notes.** A note of this type provides that the principal amount payable at its maturity, and/or the amount of interest payable on an interest payment date, will be determined by reference to a current exchange rate, a composite currency, commodity price or other financial or non-financial indices described in the applicable pricing supplement. If you are a Holder of an indexed note, you may

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receive a principal amount at maturity that is greater than or less than the face amount of your note depending upon the value of the applicable index at maturity. That value may fluctuate over time. If you purchase an indexed note, your pricing supplement will include information about the relevant index, how amounts that are to become payable will be determined by reference to that index, risks of indexed note investment that are not associated with an investment in other types of notes, any applicable foreign currency risks and certain risks and additional tax considerations associated with that indexed note. For a description of certain risks associated with indexed notes, see Risk Factors Risks Associated with Indexed Notes and Risk Factors Foreign Currency Risks below.

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Original Issue Discount Notes

A fixed rate note, a floating rate note or an indexed note may be an original issue discount note. A note of this type is issued at a price lower than its principal amount and provides that, upon redemption, repayment or acceleration of its maturity, an amount less than its principal amount will be payable. A note issued at a discount to its principal may, for U.S. federal income tax purposes, be considered an original issue discount note, regardless of the amount payable upon redemption, repayment or acceleration of maturity. See *Certain U.S. Federal Income Tax Considerations U.S. Holders Original Issue Discount* below for a brief description of the U.S. federal income tax consequences of owning an original issue discount note.

Information in the Pricing Supplement

Your pricing supplement will describe one or more of the following terms of your note:

- the stated maturity;
- the specified currency or currencies for principal and interest, if not U.S. dollars;
- the price at which we originally issue your note, expressed as a percentage of the principal amount, and the original issue date;
- whether your note is a fixed rate note, a floating rate note or an indexed note and also whether it is an original issue discount note;
- if your note is a fixed rate note, the yearly rate at which your note will bear interest, if any, and the interest payment dates, if different from those set forth below under *Interest Rates Fixed Rate Notes* ;
- if your note is a floating rate note, the interest rate basis, which may be one of the nine base rates described in *Interest Rates Floating Rate Notes* below; any applicable index currency or maturity, spread or spread multiplier or initial, maximum or minimum rate; the interest reset, determination, calculation and payment dates; and the calculation agent, all of which we describe under *Interest Rates Floating Rate Notes* below;

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- if your note is an original issue discount note, the yield to maturity and any additional provisions relating to this feature of the note;
- if your note is an indexed note, the principal amount, if any, we will pay you at maturity, the amount of interest, if any, we will pay you on an interest payment date or the formula we will use to calculate these amounts, if any;
- whether your note may be redeemed at our option or repaid at the Holder's option prior to the stated maturity and, if so, other relevant terms such as the redemption commencement date, repayment date(s), redemption price(s) and redemption period(s), all of which we describe under "Redemption and Repayment" below;
- whether we will issue or make available your note in non-book-entry form; and
- any other terms of your note that are not inconsistent with the provisions of the indenture, which other terms could be different from those described in this prospectus supplement.

Your pricing supplement will summarize specific financial and other terms of your note, while this prospectus supplement describes terms that apply generally to the notes as a series and the accompanying prospectus describes the general terms and provisions of the debt securities issued under the indenture. Consequently, the terms described in your pricing supplement will supplement those described in this prospectus supplement and the terms

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described in this prospectus supplement will supplement those described in the accompanying prospectus. In the event that the terms described in these documents are inconsistent, the terms described in the document that is dated later will be controlling. The terms used in your pricing supplement have the meanings described in this prospectus supplement and the accompanying prospectus, unless otherwise specified.

Legal Ownership of Notes

We refer to those who have notes registered in their own names, on the books that we or the trustee maintain for this purpose, as the Holders of those notes. These persons are the legal holders of the notes. We refer to those who, indirectly through others, own beneficial interests in notes that are not registered in their own names as indirect holders of those notes. As we discuss below, indirect holders are not legal holders, and investors in notes issued in book-entry form or in street name will be indirect holders.

Book-Entry Holders

We will issue each note in book-entry form only, unless we specify otherwise in the applicable pricing supplement. This means notes will be represented by one or more global notes registered in the name of a financial institution that holds them as depository on behalf of other financial institutions that participate in the depository's book-entry system. These participating institutions, in turn, hold beneficial interests in the notes on behalf of themselves or their customers.

Under the indenture, only the person in whose name a note is registered is recognized as the Holder of that note. Consequently, for notes issued in global form, we will recognize only the depository as the Holder of the notes and we will make all payments on the notes to the depository. The depository passes along the payments it receives to its participants, which in turn pass the payments along to their customers who are the beneficial owners. The depository and its participants do so under agreements they have made with one another or with their customers; they are not obligated to do so under the terms of the notes.

As a result, investors will not own notes directly. Instead, they will own beneficial interests in a global note, through a bank, broker or other financial institution that participates in the depository's book-entry system or holds an interest through a participant. As long as the notes are issued in global form, investors will be indirect holders, and not Holders, of the notes.

Street Name Holders

In the future we may terminate a global note or issue notes initially in non-global form. In these cases, investors may choose to hold their notes in their own names or in street name . Notes held by an investor in street name would be registered in the name of a bank, broker or other financial institution that the investor chooses, and the investor would hold only a beneficial interest in those notes through an account he or she maintains at that institution.

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For notes held in street name, we will recognize only the intermediary banks, brokers and other financial institutions in whose names the notes are registered as the Holders of those notes and we will make all payments on those notes to them. These institutions pass along the payments they receive to their customers who are the beneficial owners, but only because they agree to do so in their customer agreements or because they are legally required to do so. Investors who hold notes in street name will be indirect holders, not Holders, of those notes.

Legal Holders

Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, run only to the Holders of the notes. We do not have obligations to investors who hold beneficial interests in global notes, in street name or by any other indirect means. This will be the case whether an investor chooses to be an indirect holder of a note or has no choice because we are issuing the notes only in global form.

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For example, once we make a payment or give a notice to the Holder, we have no further responsibility for that payment or notice even if that Holder is required, under agreements with depository participants or customers or by law, to pass it along to the indirect holders but does not do so. Similarly, if we want to obtain the approval of the Holders for any purpose e.g., to amend the indenture or to relieve us of the consequences of a default or of our obligation to comply with a particular provision of the indenture we would seek the approval only from the Holders, and not the indirect holders, of the notes. Whether and how the Holders contact the indirect holders is up to the Holders.

When we refer to you, we mean those who invest in the notes being offered by this prospectus supplement and accompanying prospectus, whether they are the Holders or only indirect holders of those notes. When we refer to your notes, we mean the notes in which you hold a direct or indirect interest.

Special Considerations for Indirect Holders

If you hold notes through a bank, broker or other financial institution, either in book-entry form or in street name, you should check with your own institution to find out:

- how it handles securities payments and notices;
- whether it imposes fees or charges;
- how it would handle a request for the Holders' consent, if ever required;
- whether and how you can instruct it to send you notes registered in your own name so you can be a Holder, if that is permitted in the future;
- how it would exercise rights under the notes if there were a default or other event triggering the need for Holders to act to protect their interests; and
- if the notes are in book-entry form, how the depository's rules and procedures will affect these matters.

What Is a Global Note?

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We will issue each note in book-entry form only, unless we specify otherwise in the applicable pricing supplement. Each note issued in book-entry form will be represented by a global note that we deposit with and register in the name of a financial institution or its nominee, that we select. The financial institution that we select for this purpose is called the depository. Unless we specify otherwise in the applicable pricing supplement, The Depository Trust Company, New York, New York, or DTC, will be the depository for all notes issued in book-entry form. See Information About The Depository Trust Company below.

A global note may represent one or any other number of individual notes. All notes represented by the same global note will have the same terms.

A global note may not be transferred to or registered in the name of anyone other than the depository or its nominee, unless special termination situations arise. We describe those situations below under Special Situations When a Global Note Will Be Terminated. As a result of these arrangements, the depository, or its nominee, will be the sole registered owner and Holder of all notes represented by a global note, and investors will be permitted to own only beneficial interests in a global note. Beneficial interests must be held by means of an account with a broker, bank or other financial institution that in turn has an account with the depository or with another institution that does. Thus, an investor whose note is represented by a global note will not be a Holder of the note, but only an indirect holder of a beneficial interest in the global note.

If the pricing supplement for a particular note indicates that the note will be issued in global form only, then the note will be represented by a global note at all times unless and until the global note is terminated. We

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describe the situations in which this can occur below under *Special Situations When a Global Note Will Be Terminated* . If termination occurs, we may issue the notes through another book-entry clearing system or decide that the notes may no longer be held through any book-entry clearing system.

Special Considerations for Global Notes

As an indirect holder, an investor's rights relating to a global note will be governed by the account rules of the investor's financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a Holder of notes and instead deal only with the depositary that holds the global note.

If notes are issued only in the form of a global note, an investor should be aware of the following:

- An investor cannot cause the notes to be registered in his or her own name, and cannot obtain non-global certificates for his or her interest in the notes, except in the special situations we describe below;
- An investor will be an indirect holder and must look to his or her own bank or broker for payments on the notes and protection of his or her legal rights relating to the notes, as we describe under *Legal Ownership of Notes* above;
- An investor may not be able to sell interests in the notes to some insurance companies and other institutions that are required by law to own their securities in non-book-entry form;
- An investor may not be able to pledge his or her interest in a global note in circumstances where certificates representing the notes must be delivered to the lender or other beneficiary of the pledge in order for the pledge to be effective;
- The depositary's policies, which may change from time to time, will govern payments, transfers, exchanges, notices and other matters relating to an investor's interest in a global note. We and the trustee have no responsibility for any aspect of the depositary's policies or actions or for its records of ownership interests in a global note. We and the trustee also do not supervise the depositary in any way;
- The depositary will require that those who purchase and sell interests in a global note within its book-entry system use immediately available funds and your broker or bank may require you to do so as well; and

- Financial institutions that participate in the depository's book-entry system, and through which an investor holds its interest in the global notes, may also have their own policies affecting payments, transfers, exchanges, notices and other matters relating to the notes. There may be more than one financial intermediary in the chain of ownership for an investor. We do not monitor and are not responsible for the actions of any of those intermediaries.

Special Situations When a Global Note Will Be Terminated

In a few special situations described below, a global note will be terminated and interests in it will be exchanged for certificates in a non-global form representing the notes it represented. After that exchange, the choice of whether to hold the notes directly or in street name will be up to the investor. Investors must consult their own banks or brokers to find out how to have their interests in a global note transferred on termination to their own names, so that they will be Holders. We have described the rights of Holders and street name investors above under **Legal Ownership of Notes**.

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The special situations for termination of a global note are as follows:

- if the depository notifies us that it is unwilling or unable to continue as depository for that global note or if the depository ceases to be a clearing agency registered under the Securities Exchange Act of 1934 and a successor depository is not appointed by us within 90 days of receiving such notice or becoming aware of such ineligibility;
- if we notify the trustee that we wish to terminate that global note; or
- if an event of default has occurred with regard to notes represented by that global note and has not been cured or waived; we discuss defaults in the accompanying prospectus under **Debt Securities** **Events of Default** .

If a global note is terminated, only the depository, and not we or the trustee, is responsible for deciding the names of the institutions in whose names the notes represented by the global note will be registered and, therefore, who will be the Holders of those notes.

Information About The Depository Trust Company

DTC has provided the following information to us. DTC is:

- a limited-purpose trust company organized under the laws of the State of New York;
- a banking organization within the meaning of the New York Banking Law;
- a member of the Federal Reserve System;
- a clearing corporation within the meaning of the New York Uniform Commercial Code; and
- a clearing agency registered under the Securities Exchange Act of 1934.

Information About Euroclear and Clearstream

The following is based on information furnished by Clearstream or Euroclear, as the case may be:

If we so specify in the applicable pricing supplement, investors in the notes may elect to hold beneficial interests in global notes through either Clearstream Banking, *société anonyme* (Clearstream), or Euroclear Bank S.A./N.V. (Euroclear), as participants in DTC.

Clearstream and Euroclear hold interests on behalf of their participating organizations through customers' securities accounts in Clearstream's and Euroclear's names on the books of their respective depositaries, which hold those interests in customers' securities accounts in the depositaries' names on the books of DTC. At the present time, Citibank, N.A. acts as U.S. depository for Clearstream and JPMorgan Chase Bank, N.A. acts as U.S. depository for Euroclear (the U.S. Depositaries). Notes offered and/or sold to investors in the European Economic Area will only be offered or sold in minimum denominations of \$2,000 and integral multiples of \$1,000 in excess thereof.

Clearstream holds securities for its participating organizations (Clearstream Participants) and facilitates the clearance and settlement of securities transactions between Clearstream Participants through electronic book-entry changes in accounts of Clearstream Participants, thereby eliminating the need for physical movement of certificates. Clearstream provides to Clearstream Participants, among other things, services for safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing. Clearstream interfaces with domestic markets in several countries.

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Clearstream is registered as a bank in Luxembourg, and as such is subject to regulation by the Commission de Surveillance du Secteur Financier, and the Banque Centrale du Luxembourg, which supervise and oversee the activities of Luxembourg banks. Clearstream Participants are world-wide financial institutions including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations, and may include the agents (as defined herein) or their affiliates. Indirect access to Clearstream is available to other institutions that clear through or maintain a custodial relationship with a Clearstream Participant. Clearstream has established an electronic bridge with Euroclear as the operator of the Euroclear System (the Euroclear Operator) in Brussels to facilitate settlement of trades between Clearstream and the Euroclear Operator.

Distributions with respect to the notes held beneficially through Clearstream will be credited to cash accounts of Clearstream Participants in accordance with its rules and procedures, to the extent received by the U.S. Depository for Clearstream.

Euroclear holds securities and book-entry interests in securities for participating organizations (Euroclear Participants) and facilitates the clearance and settlement of securities transactions between Euroclear Participants, and between Euroclear Participants and participants of certain other securities intermediaries through electronic book-entry changes in accounts of such participants or other securities intermediaries.

Euroclear provides Euroclear Participants, among other things, with safekeeping, administration, clearance and settlement, securities lending and borrowing, and related services. Euroclear Participants are investment banks, securities brokers and dealers, banks, central banks, supranationals, custodians, investment managers, corporations, trust companies and certain other organizations, and may include the agents or their affiliates. Non-participants in Euroclear may hold and transfer beneficial interests in a global note through accounts with a Euroclear Participant or any other securities intermediary that holds a book-entry interest in a global note through one or more securities intermediaries standing between such other securities intermediary and Euroclear.

Securities clearance accounts and cash accounts with the Euroclear Operator are governed by the Terms and Conditions Governing Use of Euroclear and the related Operating Procedures of the Euroclear System, and applicable Belgian law (collectively, the Terms and Conditions). The Terms and Conditions govern transfers of securities and cash within Euroclear, withdrawals of securities and cash from Euroclear and receipts of payments with respect to securities in Euroclear. All securities in Euroclear are held on a fungible basis without attribution of specific certificates to specific securities clearance accounts. The Euroclear Operator acts under the Terms and Conditions only on behalf of Euroclear Participants, and has no record of or relationship with persons holding through Euroclear Participants.

Distributions with respect to notes held beneficially through Euroclear will be credited to the cash accounts of Euroclear Participants in accordance with the Terms and Conditions, to the extent received by the U.S. Depository for Euroclear.

Transfers between Euroclear Participants and Clearstream Participants will be effected in the ordinary way in accordance with their respective rules and operating procedures.

Subject to compliance with the transfer restrictions applicable to the global notes described herein, cross-market transfers between DTC's participating organizations (DTC Participants), on the one hand, and Euroclear Participants or Clearstream Participants, on the other hand, will be effected through DTC in accordance with DTC's rules on behalf of Euroclear or Clearstream, as the case may be, by its U.S. Depository; however, such cross-market transactions will require delivery of instructions to Euroclear or Clearstream, as the case may be, by the counterparty in such system in accordance with the rules and procedures and within the established deadlines (European time) of such system.

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Euroclear or Clearstream, as the case may be, will, if the transaction meets its settlement requirements, deliver instructions to its U.S. Depositary to take action to effect final settlement on its behalf by delivering or receiving interests in the global note in DTC, and making or receiving payment in accordance with normal procedures for same-day fund settlement applicable to DTC. Euroclear Participants and Clearstream Participants may not deliver instructions directly to their respective U.S. Depositaries.

Due to time zone differences, the securities accounts of a Euroclear Participant or Clearstream Participant purchasing an interest in a global note from a DTC Participant in DTC will be credited, and any such crediting will

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be reported to the relevant Euroclear Participant or Clearstream Participant, during the securities settlement processing day (which must be a business day for Euroclear or Clearstream) immediately following the settlement date of DTC. Cash received in Euroclear or Clearstream as a result of sales of interests in a global note by or through a Euroclear Participant or Clearstream Participant to a DTC Participant will be received with value on the settlement date of DTC but will be available in the relevant Euroclear or Clearstream cash account only as of the business day for Euroclear or Clearstream following DTC's settlement date.

The information in this section concerning Euroclear and Clearstream and their book-entry systems has been obtained from sources that we believe to be reliable, but we take no responsibility for the accuracy of that information.

Although Euroclear and Clearstream have agreed to the foregoing procedures to facilitate transfers of interests in the global notes among Euroclear Participants and Clearstream Participants, they are under no obligation to perform or to continue to perform such procedures, and such procedures may be discontinued at any time. None of 3M, any of the agents or the trustee will have any responsibility for the performance by Euroclear or Clearstream or their respective participants of their respective obligations under the rules and procedures governing their operations.

Interest Rates

This subsection describes the different kinds of interest rates that may apply to your note, if it bears interest.

Fixed Rate Notes

Each fixed rate note, except any zero coupon note, will bear interest from its original issue date or from the most recent date to which interest on the note has been paid or made available for payment. Interest will accrue on the principal of a fixed rate note at the fixed yearly rate stated in the applicable pricing supplement, until the principal is paid or made available for payment. Unless otherwise specified in the applicable pricing supplement, interest on a fixed rate note will be payable semi-annually each May 15 and November 15, which will be the interest payment dates for a fixed rate note, and at maturity. Each payment of interest due on an interest payment date or the date of maturity will include interest accrued from and including the last date to which interest has been paid, or made available for payment, or from the issue date if none has been paid, or made available for payment, to but excluding the interest payment date or the date of maturity. If, however, an interest payment date or the maturity date of a fixed rate note falls on a day that is not a business day, we will make the required payment of principal, premium, if any, and/or interest on the next succeeding business day, and no additional interest will accrue with respect to the payment made on that next succeeding business day. We will compute interest on fixed rate notes on the basis of a 360-day year of twelve 30-day months. We will pay interest on each interest payment date and at maturity as described below under **Payment Mechanics**. If the original issue date of a note is between a regular record date and the corresponding interest payment date, the initial interest payment will be made to the holder of record on the next interest payment date after the next regular record date.

Floating Rate Notes

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*In this subsection, we use several specialized terms relating to the manner in which floating interest rates are calculated. These terms appear in **bold, italicized** type the first time they appear, and we define these terms in *Special Rate Calculation Terms* at the end of this subsection.*

Also, please remember that the specific terms of your note as described in your pricing supplement will supplement and, if applicable, may modify or replace the general terms regarding the floating rates of interest described in this subsection. The statements we make in this subsection may not apply to your note.

Each floating rate note will bear interest from its original issue date or from the most recent date to which interest on the note has been paid or made available for payment. Interest will accrue on the principal of a floating rate note at the yearly rate determined pursuant to the interest rate formula stated in the applicable pricing

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supplement, until the principal is paid or made available for payment. We will pay interest on each interest payment date and at maturity as described below under **Payment Mechanics** .

Base Rates. We currently expect to issue floating rate notes that bear interest at rates based on one or more of the following base rates:

- commercial paper rate;
- prime rate;
- CD rate;
- federal funds rate;
- LIBOR;
- EURIBOR;
- treasury rate;
- CMT rate; and/or
- 11th district rate.

We describe each of these base rates in further detail below in this subsection. If you purchase a floating rate note, your pricing supplement will specify the type of base rate that applies to your note.

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Initial Base Rate. For any floating rate note, the base rate in effect from the original issue date to the first interest reset date will be the initial base rate . We will specify the initial base rate in the applicable pricing supplement.

Spread or Spread Multiplier. In some cases, the base rate for a floating rate note may be adjusted:

- by adding or subtracting a specified number of basis points, called the spread , with one basis point being 0.01%; or
- by multiplying the base rate by a specified percentage, called the spread multiplier .

If you purchase a floating rate note, your pricing supplement will specify whether a spread or spread multiplier will apply to your note and, if so, the amount of the spread or spread multiplier.

Maximum and Minimum Rates. The actual interest rate, after being adjusted by the spread or spread multiplier, may also be subject to either or both of the following limits:

- a maximum rate , which is a specified upper limit that the actual interest rate in effect at any time may not exceed;
and/or
- a minimum rate , which is a specified lower limit that the actual interest rate in effect at any time may not fall below.

If you purchase a floating rate note, your pricing supplement will specify whether a maximum rate and/or minimum rate will apply to your note and, if so, what those rates are.

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Whether or not a maximum rate applies, the interest rate on a floating rate note will in no event be higher than the maximum rate permitted by New York law, as it may be modified by U.S. law of general application. Under current New York law, the maximum rate of interest, with some exceptions, for any loan in an amount less than \$250,000 is 16% and for any loan in the amount of \$250,000 or more but less than \$2,500,000 is 25% per year on a simple interest basis. These limits do not apply to loans of \$2,500,000 or more. The indenture is, and any notes issued under the indenture will be, governed by New York law.

The rest of this subsection describes how the interest rate and the interest payment dates will be determined, and how interest will be calculated, on a floating rate note.

Interest Reset Dates. The rate of interest on a floating rate note will be reset, by the calculation agent described below, daily, weekly, monthly, quarterly, semi-annually or annually. The date on which the interest rate resets and the reset rate becomes effective is called the interest reset date. Except as otherwise specified in the applicable pricing supplement, the interest reset date will be as follows:

- for floating rate notes that reset daily, each *business day*;

- for floating rate notes that reset weekly and are not treasury rate notes, the Wednesday of each week;

- for treasury rate notes that reset weekly, the Tuesday of each week;

- for floating rate notes that reset monthly, the third Wednesday of each month;

- for floating rate notes that reset quarterly, the third Wednesday of March, June, September and December of each year;

- for floating rate notes that reset semi-annually, the third Wednesday of each of two months of each year as specified in the applicable pricing supplement; and

- for floating rate notes that reset annually, the third Wednesday of one month of each year as specified in the applicable pricing supplement.

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For a floating rate note, the interest rate in effect on any particular day will be the interest rate determined with respect to the latest interest reset date that occurs on or before that day. There are several exceptions, however, to the reset provisions described above.

The base rate in effect from the original issue date to the first interest reset date will be the initial base rate. For floating rate notes that reset daily or weekly, the base rate in effect for each day following the second business day before an interest payment date to, but excluding, the interest payment date, and for each day following the second business day before the maturity to, but excluding, the maturity, will be the base rate in effect on that second business day.

If any interest reset date for a floating rate note would otherwise be a day that is not a business day, the interest reset date will be postponed to the next day that is a business day. For a LIBOR or EURIBOR note, however, if that business day is in the next succeeding calendar month, the interest reset date will be the immediately preceding business day.

Interest Determination Dates. The interest rate that takes effect on an interest reset date will be determined by the calculation agent by reference to a particular date called an interest determination date. Except as otherwise specified in the applicable pricing supplement:

- For all floating rate notes other than LIBOR notes, EURIBOR notes, treasury rate notes and 11th district rate notes, the interest determination date relating to a particular interest reset date will be the second business day before the interest reset date.

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- For LIBOR notes, the interest determination date relating to a particular interest reset date will be the second **London business day** preceding the interest reset date, unless the **index currency** is pounds sterling, in which case the interest determination date will be the interest reset date. We refer to an interest determination date for a LIBOR note as a LIBOR interest determination date .
- For EURIBOR notes, the interest determination date relating to a particular interest reset date will be the second **TARGET business day** preceding the interest reset date. We refer to an interest determination date for a EURIBOR note as a EURIBOR interest determination date .
- For treasury rate notes, the interest determination date relating to a particular interest reset date, which we refer to as a treasury interest determination date , will be the day of the week in which the interest reset date falls on which treasury bills i.e., direct obligations of the U.S. government would normally be auctioned. Treasury bills are usually sold at auction on the Monday of each week, unless that day is a legal holiday, in which case the auction is usually held on the following Tuesday, except that the auction may be held on the preceding Friday. If as the result of a legal holiday an auction is held on the preceding Friday, that Friday will be the treasury interest determination date relating to the interest reset date occurring in the next succeeding week.
- For 11th district rate notes, the interest determination date relating to a particular interest reset date will be the last working day, in the first calendar month before that interest reset date, on which the Federal Home Loan Bank of San Francisco publishes the monthly average cost of funds paid by member institutions of the Eleventh Federal Home Loan Bank District for the second calendar month before that interest reset date. We refer to an interest determination date for an 11th district rate note as an 11th district interest determination date .

Interest Calculation Dates. As described above, the interest rate that takes effect on a particular interest reset date will be determined by reference to the corresponding interest determination date. Except for LIBOR notes and EURIBOR notes, however, the determination of the rate will actually be made on a day no later than the corresponding interest calculation date. The interest calculation date will be the earlier of the following:

- the tenth calendar day after the interest determination date or, if that tenth calendar day is not a business day, the next succeeding business day; and
- the business day immediately preceding the interest payment date or the maturity, whichever is the day on which the next payment of interest will be due.

The calculation agent need not wait until the relevant interest calculation date to determine the interest rate if the rate information it needs to make the determination is available from the relevant sources sooner.

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Interest Payment Dates. The interest payment dates for a floating rate note will depend on when the interest rate is reset and, unless we specify otherwise in the applicable pricing supplement, will be as follows:

- for floating rate notes that reset daily, weekly or monthly, the third Wednesday of each month or the third Wednesday of March, June, September and December of each year, as specified in the applicable pricing supplement;
- for floating rate notes that reset quarterly, the third Wednesday of March, June, September and December of each year;
- for floating rate notes that reset semi-annually, the third Wednesday of the two months of each year specified in the applicable pricing supplement;
- for floating rate notes that reset annually, the third Wednesday of the month specified in the applicable pricing supplement; and

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- at maturity.

Regardless of these rules, if a note is originally issued after the regular record date and before the date that would otherwise be the first interest payment date, the first interest payment date will be the date that would otherwise be the second interest payment date. We have defined the term regular record date below under Payment Mechanics Regular Record Dates for Interest .

In addition, the following special provision will apply to a floating rate note with regard to any interest payment date other than one that falls on the maturity. If the interest payment date would otherwise fall on a day that is not a business day, then the interest payment date will be the next day that is a business day. However, if the floating rate note is a LIBOR note or a EURIBOR note and the next business day falls in the next calendar month, then the interest payment date will be advanced to the next preceding day that is a business day. In all cases, an interest payment date that falls on the maturity will be made on the next succeeding business day, but interest on that payment will not accrue after the maturity.

Calculation of Interest. Calculations relating to floating rate notes will be made by the calculation agent. Unless the applicable pricing supplement states otherwise, the calculation agent for any issue of floating rate notes will be The Bank of New York Mellon Trust Company, N.A. We may appoint a different institution to serve as calculation agent from time to time after the original issue date of the note without your consent and without notifying you of the change.

For each floating rate note, the calculation agent will determine, on the corresponding interest calculation or determination date, as applicable, the interest rate that takes effect on each interest reset date. In addition, the calculation agent will calculate the amount of interest that has accrued during each interest period i.e., the period from and including the original issue date, or the last date to which interest has been paid or made available for payment, to but excluding the payment date. For each interest period, the calculation agent will calculate the amount of accrued interest by multiplying the face amount of the floating rate note by an accrued interest factor for the interest period. This factor will equal the sum of the interest factors calculated for each day during the interest period. The interest factor for each day will be expressed as a decimal and will be calculated by dividing the interest rate, also expressed as a decimal, applicable to that day:

- by 360, in the case of commercial paper rate notes, prime rate notes, LIBOR notes, EURIBOR notes, CD rate notes, federal funds rate notes and 11th district rate notes; or
- by the actual number of days in the year, in the case of treasury rate notes and CMT rate notes.

Upon the request of the Holder of any floating rate note, the calculation agent will provide for that note the interest rate then in effect and, if determined, the interest rate that will become effective on the next interest reset date. The calculation agent's determination of any interest rate, and its calculation of the amount of interest for any interest period, will be final and binding in the absence of manifest error.

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All percentages resulting from any calculation relating to a note will be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point (e.g., 9.876541% (or.09876541) being rounded down to 9.87654% (or.0987654) and 9.876545% (or.09876545) being rounded up to 9.87655% (or.0987655)). All amounts used in or resulting from any calculation relating to a floating rate note will be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, or to the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, with one-half cent or one-half of a corresponding hundredth of a unit or more being rounded upward.

In determining the base rate that applies to a floating rate note during a particular interest period, the calculation agent may obtain rate quotes from various banks or dealers active in the relevant market, as described in the following subsections. Those reference banks and dealers may include the calculation agent itself and its affiliates, as well as any agent and its affiliates.

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Commercial Paper Rate Notes

If you purchase a commercial paper rate note, your note will bear interest at a base rate equal to the commercial paper rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The commercial paper rate will be the *money market yield* of the rate, for the relevant interest determination date, for commercial paper having the *index maturity* specified in your pricing supplement, as published in H.15(519) under the heading *Commercial Paper Nonfinancial* . If the commercial paper rate cannot be determined as described above, the following procedures will apply.

- If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the commercial paper rate will be the rate, for the relevant interest determination date, for commercial paper having the index maturity specified in your pricing supplement, as published in *H.15 daily update* or any other recognized electronic source used for displaying that rate, under the heading *Commercial paper Nonfinancial* .
- If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the commercial paper rate will be the money market yield of the arithmetic mean of the following offered rates for U.S. dollar commercial paper that has the relevant index maturity and is placed for an industrial issuer whose bond rating is *AA* , or the equivalent, from a nationally recognized rating agency: the rates offered as of 11:00 A.M., New York City time, on the relevant interest determination date, by three leading U.S. dollar commercial paper dealers in New York City selected by the calculation agent.
- If fewer than three dealers selected by the calculation agent are quoting as described in the prior paragraph, the commercial paper rate for the new interest period will be the commercial paper rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

Prime Rate Notes

If you purchase a prime rate note, your note will bear interest at a base rate equal to the prime rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The prime rate will be the rate, for the relevant interest determination date, published in H.15(519) under the heading *Bank prime loan* . If the prime rate cannot be determined as described above, the following procedures will apply.

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- If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the prime rate will be the rate, for the relevant interest determination date, as published in H.15 daily update or another recognized electronic source used for the purpose of displaying that rate, under the heading "Bank prime loan".

- If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), then the prime rate will be the arithmetic mean of the following rates as they appear on the **Reuters page USPRIME1**: the rate of interest publicly announced by each bank appearing on that page as that bank's prime rate or base lending rate, as of 11:00 A.M., New York City time, on the relevant interest determination date.

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- If fewer than four of these rates appear on the Reuters page USPRIME1, the prime rate will be the arithmetic mean of the prime rates or base lending rates, as of the close of business on the relevant interest determination date, of three major banks in New York City selected by the calculation agent. For this purpose, the calculation agent will use rates quoted on the basis of the actual number of days in the year divided by a 360-day year.

- If fewer than three banks selected by the calculation agent are quoting as described in the prior paragraph, the prime rate for the new interest period will be the prime rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

CD Rate Notes

If you purchase a CD rate note, your note will bear interest at a base rate equal to the CD rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The CD rate will be the rate, on the relevant interest determination date, for negotiable U.S. dollar certificates of deposit having the index maturity specified in your pricing supplement, as published in H.15(519) under the heading CDs (secondary market) . If the CD rate cannot be determined in this manner, the following procedures will apply.

- If the rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the CD rate will be the rate, for the relevant interest determination date, described above as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading CDs (secondary market) .

- If the rate described in the prior paragraph does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the CD rate will be the arithmetic mean of the following secondary market offered rates for negotiable U.S. dollar certificates of deposit of major U.S. money center banks with a remaining maturity closest to the specified index maturity, and in a representative amount: the rates offered as of 10:00 A.M., New York City time, on the relevant interest determination date, by three leading nonbank dealers in negotiable U.S. dollar certificates of deposit in New York City, as selected by the calculation agent.

- If fewer than three dealers selected by the calculation agent are quoting as described in the prior paragraph, the CD rate in effect for the new interest period will be the CD rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

Federal Funds Rate Notes

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If you purchase a federal funds rate note, your note will bear interest at a base rate equal to the federal funds rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The federal funds rate will be the rate for U.S. dollar federal funds on the relevant interest determination date, as published in H.15 (519) opposite the heading Federal funds (effective) , as that rate is displayed on

Reuters page FEDFUNDS1 under the heading EFFECT. If the federal funds rate cannot be determined in this manner, the following procedures will apply.

- If the rate described above is not displayed on Reuters page FEDFUNDS1 at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and

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the rate is available from that source at that time), then the federal funds rate, for the relevant interest determination date, will be the rate described above as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading Federal funds (effective) .

- If the rate described in the prior paragraph is not displayed on Reuters page FEDFUNDS1 and does not appear in H.15(519), H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the federal funds rate will be the arithmetic mean of the rates for the last transaction in overnight, U.S. dollar federal funds arranged, before 9:00 A.M., New York City time, on the relevant interest determination date, by three leading brokers of U.S. dollar federal funds transactions in New York City selected by the calculation agent.
- If fewer than three brokers selected by the calculation agent are quoting as described in the prior paragraph, the federal funds rate in effect for the new interest period will be the federal funds rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

LIBOR Notes

If you purchase a LIBOR note, your note will bear interest at a base rate equal to the London interbank offered rate for deposits in U.S. dollars or any other index currency, which is referred to as LIBOR , as specified in your pricing supplement. In addition, the applicable LIBOR base rate will be adjusted by the spread or spread multiplier, if any, specified in your pricing supplement. LIBOR will be determined in the following manner:

- LIBOR will be the offered rate appearing on the **designated LIBOR page**, as of 11:00 A.M., London time, on the relevant LIBOR interest determination date, for deposits of the relevant index currency having the relevant index maturity beginning on the relevant interest reset date. Your pricing supplement will indicate the index currency and the index maturity that apply to your LIBOR note.
- If no rate appears on the designated LIBOR page, then LIBOR will be determined on the basis of the rates, at approximately 11:00 A.M., London time, on the relevant LIBOR interest determination date, at which deposits of the following kind are offered to prime banks in the London interbank market by four major banks in that market selected by the calculation agent: deposits of the index currency having the relevant index maturity, beginning on the relevant interest reset date, and in a **representative amount**. The calculation agent will request the principal London office of each of these banks to provide a quotation of its rate. If at least two quotations are provided, LIBOR for the relevant LIBOR interest determination date will be the arithmetic mean of the quotations.
- If fewer than two quotations are provided as described in the prior paragraph, LIBOR for the relevant LIBOR interest determination date will be the arithmetic mean of the rates for loans of the following kind to leading European banks quoted, at approximately 11:00 A.M., in the **principal financial center**, on that LIBOR interest determination date, by three major banks in that financial center selected by the calculation agent: loans of the index currency having the relevant index maturity, beginning on the relevant interest reset date, and in a representative amount.

- If fewer than three banks selected by the calculation agent are quoting as described in the prior paragraph, LIBOR for the new interest period will be LIBOR in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

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EURIBOR Notes

If you purchase a EURIBOR note, your note will bear interest at a base rate equal to the interest rate for deposits in euros designated as EURIBOR and sponsored jointly by the European Banking Federation and ACI the Financial Market Association (or any company established by the joint sponsors for purposes of compiling and publishing that rate). In addition, the EURIBOR base rate will be adjusted by the spread or spread multiplier, if any, specified in your pricing supplement. EURIBOR will be determined in the following manner:

- EURIBOR will be the offered rate for deposits in euros having the index maturity specified in your pricing supplement, beginning on the relevant interest reset date, as that rate appears on Reuters page EURIBOR01 as of 11:00 A.M., Brussels time, on the relevant EURIBOR interest determination date.
- If the rate described above does not appear on Reuters page EURIBOR01, EURIBOR will be determined on the basis of the rates, at approximately 11:00 A.M., Brussels time, on the relevant EURIBOR interest determination date, at which deposits of the following kind are offered to prime banks in the Euro-zone interbank market by the principal ***Euro-zone*** office of each of four major banks in that market selected by the calculation agent: euro deposits having the relevant index maturity, beginning on the relevant interest reset date, and in a representative amount. The calculation agent will request the principal Euro-zone office of each of these banks to provide a quotation of its rate. If at least two quotations are provided, EURIBOR for the relevant EURIBOR interest determination date will be the arithmetic mean of the quotations.
- If fewer than two quotations are provided as described in the prior paragraph, EURIBOR for the relevant EURIBOR interest determination date will be the arithmetic mean of the rates for loans of the following kind to leading Euro-zone banks quoted, at approximately 11:00 A.M., Brussels time on that EURIBOR interest determination date, by three major banks in the Euro-zone selected by the calculation agent: loans of euros having the relevant index maturity, beginning on the relevant interest reset date, and in a representative amount.
- If fewer than three banks selected by the calculation agent are quoting as described in the prior paragraph, EURIBOR for the new interest period will be EURIBOR in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

Treasury Rate Notes

If you purchase a treasury rate note, your note will bear interest at a base rate equal to the treasury rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The treasury rate will be the rate for the auction, on the relevant treasury interest determination date, of treasury bills having the index maturity specified in your pricing supplement, as that rate appears on Reuters page USAUCTION10 or USAUCTION11 under the heading INVEST

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RATE . If the treasury rate cannot be determined in this manner, the following procedures will apply.

- If the rate described above does not appear on either page at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), the treasury rate will be the ***bond equivalent yield*** of the rate, for the relevant interest determination date, for the type of treasury bill described above, as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading U.S. government securities/Treasury bills/Auction high .
- If the rate described in the prior paragraph does not appear in H.15 daily update or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at

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that time), the treasury rate will be the bond equivalent yield of the auction rate, for the relevant treasury interest determination date and for treasury bills of the kind described above, as announced by the U.S. Department of the Treasury.

- If the auction rate described in the prior paragraph is not so announced by 3:00 P.M., New York City time, on the relevant interest calculation date, or if no such auction is held for the relevant week, then the treasury rate will be the bond equivalent yield of the rate, for the relevant treasury interest determination date and for treasury bills having a remaining maturity closest to the specified index maturity, as published in H.15(519) under the heading U.S. government securities/Treasury bills/secondary market .
- If the rate described in the prior paragraph does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), then the treasury rate will be the rate, for the relevant treasury interest determination date and for treasury bills having a remaining maturity closest to the specified index maturity, as published in H.15 daily update, or another recognized electronic source used for displaying that rate, under the heading U.S. government securities/Treasury bills/secondary market .
- If the rate described in the prior paragraph does not appear in H.15 daily update, H.15(519) or another recognized electronic source at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from one of those sources at that time), the treasury rate will be the bond equivalent yield of the arithmetic mean of the following secondary market bid rates for the issue of treasury bills with a remaining maturity closest to the specified index maturity: the rates bid as of approximately 3:30 P.M., New York City time, on the relevant treasury interest determination date, by three primary U.S. government securities dealers in New York City selected by the calculation agent.
- If fewer than three dealers selected by the calculation agent are quoting as described in the prior paragraph, the treasury rate in effect for the new interest period will be the treasury rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

CMT Rate Notes

If you purchase a CMT rate note, your note will bear interest at a base rate equal to the CMT rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The CMT rate will be the following rate displayed on the *designated CMT Reuters page* under the heading . . . Treasury Constant Maturities. . . for the *designated CMT index maturity*:

- if the designated CMT Reuters page is Reuters page FRBCMT, the rate for the relevant interest determination date; or

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- if the designated CMT Reuters page is Reuters page FEDCMT, the weekly or monthly average, as specified in your pricing supplement, for the week that ends immediately before the week in which the relevant interest determination date falls, or for the month that ends immediately before the month in which the relevant interest determination date falls, as applicable.

If the CMT rate cannot be determined in this manner, the following procedures will apply.

- If the applicable rate described above is not displayed on the relevant designated CMT Reuters page at 3:00 P.M., New York City time, on the relevant interest calculation date (unless the calculation is made earlier and the rate is available from that source at that time), then the CMT rate will be the applicable treasury constant maturity rate described above i.e., for the

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designated CMT index maturity and for either the relevant interest determination date or the weekly or monthly average, as applicable as published in H.15(519) opposite the caption Treasury constant maturities .

- If the designated CMT Reuters screen page is FRBCMT and the applicable rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest determination date, unless the calculation is made earlier and the rate is available from one of those sources at that time, then the CMT rate will be the treasury constant maturity rate, or other U.S. treasury rate, for the designated CMT index maturity and with reference to the relevant interest determination date, that:

- is published by the Board of Governors of the Federal Reserve System, or the U.S. Department of the Treasury; and

- is determined by the calculation agent to be comparable to the applicable rate formerly displayed on the designated CMT Reuters screen page and published in H.15(519).

- If the designated CMT Reuters screen page is FEDCMT and the applicable rate described above does not appear in H.15(519) at 3:00 P.M., New York City time, on the relevant interest determination date, unless the calculation is made earlier and the rate is available from one of those sources at that time, then the CMT rate will be the treasury constant maturity rate, or other U.S. treasury rate, for the one-week or one-month rate, as applicable, for the designated CMT index maturity and with reference to the relevant interest determination date, that is otherwise announced by the Federal Reserve Bank of New York for the week or month, as applicable, immediately preceding that interest determination date.

- If the designated CMT Reuters screen page is FRBCMT and the rate described in the second preceding paragraph does not appear at 3:00 P.M., New York City time, on the relevant interest determination date, unless the calculation is made earlier and the rate is available from one of those sources at that time, then the CMT rate will be the yield to maturity of the arithmetic mean of the following secondary market offered rates for the most recently issued treasury notes having an original maturity of approximately the designated CMT index maturity and a remaining term to maturity of not less than the designated CMT index maturity minus one year, and in a representative amount: the offered rates, as of approximately 3:30 P.M., New York City time, on the relevant interest determination date, of three primary U.S. government securities dealers in New York City selected by the calculation agent. In selecting these offered rates, the calculation agent will request quotations from five of these primary dealers and will disregard the highest quotation or, if there is equality, one of the highest and the lowest quotation or, if there is equality, one of the lowest. If fewer than five but more than two such offered rates are provided, the CMT rate will be based on the arithmetic mean of the bid prices provided, and neither the highest nor lowest of such quotations will be eliminated. Treasury notes are direct, non-callable, fixed rate obligations of the U.S. government.

- If the designated CMT Reuters screen page is FEDCMT and the Federal Reserve Bank of New York does not publish a one-week or one-month rate, as applicable, for U.S. Treasury securities on the relevant interest determination date, unless the calculation is made earlier and the rate is available from one of those sources at that time, then the CMT rate will be the yield to maturity of the arithmetic mean of the following secondary market offered rates for the most recently issued treasury notes having an original maturity of approximately the designated CMT index maturity and a remaining term to maturity of not less than the designated CMT index maturity minus one year, and in a representative amount: the offered rates, as of approximately 3:30 P.M., New York City time, on the relevant interest determination date, of three primary U.S. government securities dealers in New York City selected by the calculation agent. In selecting these offered rates, the calculation agent will request quotations from five of these primary dealers and will disregard the

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highest quotation or, if there is equality, one of the highest and the lowest quotation or, if there is equality, one of the lowest. If fewer than five but more than two such offered rates are provided, the CMT rate will be based on the arithmetic mean of the bid prices provided, and neither the highest nor lowest of such quotations will be eliminated.

- If the calculation agent is unable to obtain three quotations of the kind described in the prior paragraph, the CMT rate will be the yield to maturity of the arithmetic mean of the following secondary market offered rates for treasury notes with an original maturity longer than the designated CMT index maturity, with a remaining term to maturity closest to the designated CMT index maturity and in a representative amount: the offered rates, as of approximately 3:30 P.M., New York City time, on the relevant interest determination date, of three primary U.S. government securities dealers in New York City selected by the calculation agent. In selecting these offered rates, the calculation agent will request quotations from five of these primary dealers and will disregard the highest quotation or, if there is equality, one of the highest and the lowest quotation or, if there is equality, one of the lowest. If two treasury notes with an original maturity longer than the designated CMT index maturity have remaining terms to maturity that are equally close to the designated CMT index maturity, the calculation agent will obtain quotations for the treasury note with the shorter remaining term to maturity.
- If fewer than five but more than two of these primary dealers are quoting as described in each of the prior two paragraphs, then the CMT rate for the relevant interest determination date will be based on the arithmetic mean of the offered rates so obtained, and neither the highest nor the lowest of those quotations will be disregarded.
- If two or fewer primary dealers selected by the calculation agent are quoting as described in the prior paragraph, the CMT rate in effect for the new interest period will be the CMT rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

11th District Rate Notes

If you purchase an 11th district rate note, your note will bear interest at a base rate equal to the 11th district rate and adjusted by the spread or spread multiplier, if any, specified in your pricing supplement.

The 11th district rate will be the rate equal to the monthly weighted average cost of funds for the calendar month immediately before the month in which the relevant 11th district interest determination date falls, as displayed on Reuters page COFI/ARMS under the heading 11th Dist COFI as of 11:00 A.M., San Francisco time, on that date. If the 11th district rate cannot be determined in this manner, the following procedures will apply.

- If the rate described above does not appear on Reuters page COFI/ARMS on the relevant 11th district interest determination date, then the 11th district rate for that date will be the monthly weighted average cost of funds paid by institutions that are members of the Eleventh Federal Home Loan Bank District for the calendar month immediately before the month in which the relevant 11th district interest determination date falls, as most recently announced by the Federal Home Loan Bank of San Francisco as that cost of funds.

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- If the Federal Home Loan Bank of San Francisco fails to announce the cost of funds described in the prior paragraph on or before the relevant 11th district interest determination date, the 11th district rate in effect for the new interest period will be the 11th district rate in effect for the prior interest period. If the initial base rate has been in effect for the prior interest period, however, it will remain in effect for the new interest period.

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Special Rate Calculation Term

In the subsection entitled Interest Rates , we use several terms that have special meanings relevant to calculating floating interest rates. We describe these terms as follows:

The term *bond equivalent yield* means a yield expressed as a percentage and calculated in accordance with the following formula:

$$\text{bond equivalent yield} = \frac{D \times N}{360 (D \times M)} \times 100$$

where

- D means the annual rate for treasury bills quoted on a bank discount basis and expressed as a decimal;
- N means 365 or 366, as the case may be; and
- M means the actual number of days in the applicable interest reset period.

The term *business day* means, for any note, a day that meets all the following applicable requirements:

- for all notes, is a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in New York City generally are authorized or obligated by law, regulation or executive order to close;
- if the note is a LIBOR note, is also a London business day;
- if the note has a specified currency other than U.S. dollars or euros, is also a day on which banking institutions are not authorized or obligated by law, regulation or executive order to close in the principal financial center of the country issuing the specified currency;

- if the note is a EURIBOR note or has a specified currency of euros, or is a LIBOR note for which the index currency is euros, is also a **TARGET** business day; and
- for all notes, and solely with respect to any payment or other action to be made or taken at any place of payment designated by us outside New York City, is a Monday, Tuesday, Wednesday, Thursday or Friday that is not a day on which banking institutions in such place of payment generally are authorized or obligated by law, regulation or executive order to close.

The term **designated CMT index maturity** means the index maturity for a CMT rate note and will be the original period to maturity of a U.S. treasury security specified in the applicable pricing supplement. If no such original maturity period is so specified, the designated CMT index maturity will be 2 years.

The term **designated CMT Reuters page** means the Reuters page specified in the applicable pricing supplement that displays treasury constant maturities as reported in H.15(519). If no Reuters page is so specified, then the applicable page will be Reuters page FEDCMT. If Reuters page FEDCMT applies but the applicable pricing supplement does not specify whether the weekly or monthly average applies, the weekly average will apply.

The term **designated LIBOR page** means the display on the Reuters 3000 Xtra Service, or any successor service, on the LIBOR01 page or LIBOR02 page, as specified in the applicable pricing supplement, or any replacement page or pages on which London interbank rates of major banks for the relevant index currency are displayed.

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The term **Euro-zone** means, at any time, the region comprised of the member states of the European Economic and Monetary Union that, as of that time, have adopted a single currency in accordance with the Treaty on European Union of February 1992.

H.15(519) means the weekly statistical release entitled "Statistical Release H.15(519) Selected Interest Rates", or any successor publication, published by the Board of Governors of the Federal Reserve System.

H.15 daily update means the daily update of H.15(519) available through the worldwide-web site of the Board of Governors of the Federal Reserve System, at:

<http://www.federalreserve.gov/releases/h15/update/h15supd.htm>,

or any successor site or publication.

The term **index currency** means, with respect to a LIBOR note, the currency specified as such in the applicable pricing supplement. The index currency may be U.S. dollars or any other currency, and will be U.S. dollars unless another currency is specified in the applicable pricing supplement.

The term **index maturity** means, with respect to a floating rate note, the period to maturity of the instrument or obligation on which the interest rate formula is based, as specified in the applicable pricing supplement.

London business day means any day on which dealings in the relevant index currency are transacted in the London interbank market.

The term **money market yield** means a yield expressed as a percentage and calculated in accordance with the following formula:

$$\text{money market yield} = \frac{D \times 360}{360 (D \times M)} \times 100$$

where

- D means the annual rate for commercial paper quoted on a bank discount basis and expressed as a decimal; and

- **M** means the actual number of days in the relevant interest reset period.

The term **principal financial center** means (i) the capital city of the country issuing the specified currency or (ii) the capital city of the country to which the index currency, if applicable, relates, except, in each case, that with respect to U.S. dollars, Australian dollars, Canadian dollars, Euros, South African rand and Swiss francs, the **Principal Financial Center** shall be The City of New York, Sydney, Toronto, London, Johannesburg and Zurich, respectively.

The term **representative amount** means an amount that, in the calculation agent's judgment, is representative of a single transaction in the relevant market at the relevant time.

Reuters page means the display on the Reuters 3000 Xtra Service, or any successor service, on the page or pages specified in this prospectus supplement or the applicable pricing supplement, or any replacement page or pages on that service.

Reuters page USPRIME1 means the display on the Reuters 3000 Xtra Service, or any successor service, on the **USPRIME1** page, or any replacement page or pages on which prime rates or base lending rates of major U.S. banks are displayed.

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The term **TARGET business day** means any day on which the Trans-European Automated Real-Time Gross Settlement Express Transfer (TARGET) System, or any successor system, is open for business.

If, when we use the terms designated CMT Reuters page, H.15(519), H.15 daily update, Reuters page FEDFUNDS1, Reuters page USAUCTION10, Reuters page USAUCTION11 or Reuters page COFI/ARMS we refer to a particular heading or headings on any of those pages, those references include any successor or replacement heading or headings as determined by the calculation agent.

Redemption and Repayment

Unless otherwise indicated in your pricing supplement, your note will not be entitled to the benefit of any sinking fund that is, we will not deposit money on a regular basis into any separate custodial account to repay your notes. In addition, we will not be entitled to redeem your note before its stated maturity unless your pricing supplement specifies a redemption commencement date. You will not be entitled to require us to buy your note from you, before its stated maturity, unless your pricing supplement specifies one or more repayment dates.

If your pricing supplement specifies a redemption commencement date or a repayment date, it will also specify one or more redemption prices or repayment prices, which will be expressed as a percentage of the principal amount of your note. It may also specify one or more redemption periods during which the redemption prices relating to a redemption of notes during those periods will apply.

If your pricing supplement specifies a redemption commencement date, your note will be redeemable at our option at any time on or after that date unless otherwise indicated in your pricing supplement. If we redeem your note, we will do so at the specified redemption price, together with interest accrued to the redemption date. If different prices are specified for different redemption periods, the price we pay will be the price that applies to the redemption period during which your note is redeemed.

If your pricing supplement specifies a repayment date, your note will be repayable at your option on the specified repayment date at the specified repayment price, together with interest accrued to the repayment date. In the event that we exercise an option to redeem any note, we will give to the trustee and the Holder written notice of the principal amount of the note to be redeemed, not less than 30 days nor more than 60 days before the applicable redemption date. We will give the notice in the manner described below in Notices .

If a note represented by a global note is subject to repayment at the Holder's option, the depositary or its nominee, as the Holder, will be the only person that can exercise the right to repayment. Any indirect holders who own beneficial interests in the global note and wish to exercise a repayment right must give proper and timely instructions to their banks or brokers through which they hold their interests, requesting that they notify the depositary to exercise the repayment right on their behalf. Different firms have different deadlines for accepting instructions from their customers, and you should take care to act promptly enough to ensure that your request is given effect by the depositary before the applicable deadline for exercise.

Street name and other indirect holders should contact their banks or brokers for information about how to exercise a repayment right in a timely manner.

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If any notes are redeemable and we redeem less than all those notes, we may block the transfer or exchange of those notes during the period beginning 15 days before the day we mail the notice of redemption and ending on the day of that mailing, in order to freeze the list of Holders to prepare the mailing. We may also refuse to register transfers of or exchange any note selected for redemption, except that we will continue to permit transfers and exchanges of the unredeemed portion of any note being partially redeemed.

In the event that the option of the Holder to elect repayment as described above is deemed to be a tender offer within the meaning of Rule 14e-1 under the Securities Exchange Act of 1934, we will comply with Rule 14e-1 as then in effect to the extent applicable.

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We or our affiliates may purchase notes from investors who are willing to sell from time to time, either in the open market at prevailing prices or in private transactions at negotiated prices. Notes that we or they purchase may, at our discretion, be held, resold or cancelled.

Payment Mechanics

Who Receives Payment?

If interest is due on a note on an interest payment date, we will pay the interest to the person or entity in whose name the note is registered at the close of business on the regular record date relating to the interest payment date. If interest is due at maturity but on a day that is not an interest payment date, we will pay the interest to the person or entity entitled to receive the principal of the note. If principal or another amount besides interest is due on a note at maturity, we will pay the amount to the Holder of the note against surrender of the note at a proper place of payment or, in the case of a global note, in accordance with the applicable policies of the depository.

Regular Record Dates for Interest

Unless we specify otherwise in the applicable pricing supplement, the regular record date relating to an interest payment date for any fixed rate note will be the May 1 or November 1 next preceding that interest payment date, and for any floating rate note will be the 15th calendar day before that interest payment date, in each case whether or not the record date is a business day. For the purpose of determining the Holder at the close of business on a regular record date when business is not being conducted, the close of business will mean 5:00 P.M., New York City time, on that day.

How We Will Make Payments Due in U.S. Dollars

We will follow the practice described in this subsection when paying amounts due in U.S. dollars. Payments of amounts due in other currencies will be made as described in the next subsection.

Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depository as in effect from time to time. Under those policies, we will pay directly to the depository, or its nominee, and not to any indirect holders who own beneficial interests in the global note. An indirect holder's right to receive those payments will be governed by the rules and practices of the depository and its participants, as described above under [What Is a Global Note?](#)

Payments on Non-Global Notes. We will make payments on a note in non-global form as follows. We will pay interest that is due on an interest payment date by check mailed on the interest payment date to the Holder at his or her address shown on the trustee's records as of the close of business on the regular record date. We will make all other payments by check at the paying agent described below, against surrender of the

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note. All payments by check will be made in next-day funds i.e., funds that become available on the day after the check is cashed.

Alternatively, if a non-global note has a face amount of at least \$1,000,000 and the Holder asks us to do so, we will pay any amount that becomes due on the note by wire transfer of immediately available funds to an account at a bank in New York City, on the due date. To request wire payment, the Holder must give the paying agent appropriate wire transfer instructions at least ten days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person or entity who is the Holder on the relevant regular record date. In the case of any other payment, payment will be made only after the note is surrendered to the paying agent. Any wire instructions, once properly given, will remain in effect unless and until new instructions are given in the manner described above.

Book-entry and other indirect holders should consult their banks or brokers for information on how they will receive payments on their notes or how we will make payments due in other currencies.

We will follow the practice described in this subsection when paying amounts that are due in a specified currency other than U.S. dollars.

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Payments on Global Notes. We will make payments on a global note in accordance with the applicable policies of the depositary as in effect from time to time. We understand that these policies, as currently in effect at DTC, are as follows.

Unless otherwise indicated in your pricing supplement, if you are an indirect holder of global notes denominated in a specified currency other than U.S. dollars and if you elect to receive payments in that other currency, you must notify the participant through which your interest in the global note is held of your election:

- on or before the applicable regular record date, in the case of a payment of interest, or
- on or before the 16th day prior to stated maturity, or any redemption or repayment date, in the case of payment of principal or any premium.

You may elect to receive all or only a portion of any interest, principal or premium payment in a specified currency other than U.S. dollars.

Your participant must, in turn, notify DTC of your election on or before the third DTC business day after that regular record date, in the case of a payment of interest, and on or before the 12th DTC business day prior to stated maturity, or on the redemption or repayment date if your note is redeemed or repaid earlier, in the case of a payment of principal or any premium.

DTC, in turn, will notify the paying agent of your election in accordance with DTC's procedures.

If complete instructions are received by the participant and forwarded by the participant to DTC, and by DTC to the paying agent, on or before the dates noted above, the paying agent, in accordance with DTC's instructions, will make the payments to you or your participant by wire transfer of immediately available funds to an account maintained by the payee with a bank located in the country issuing the specified currency or in another jurisdiction acceptable to us and the paying agent.

If the foregoing steps are not properly completed, we expect DTC to inform the paying agent that payment is to be made in U.S. dollars. In that case, we or our agent will convert the payment to U.S. dollars in the manner described below under *Conversion to U.S. Dollars*. We expect that we or our agent will then make the payment in U.S. dollars to DTC, and that DTC in turn will pass it along to its participants.

Indirect holders of a global note denominated in a currency other than U.S. dollars should consult their banks or brokers for information on how to request payment in the specified currency.

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Payments on Non-Global Notes. Except as described in the last paragraph under this heading, we will make payments on notes in non-global form in the applicable specified currency. We will make these payments by wire transfer of immediately available funds to any account that is maintained in the applicable specified currency at a bank designated by the Holder and is acceptable to us and the trustee. To designate an account for wire payment, the Holder must give the paying agent appropriate wire instructions at least ten days before the requested wire payment is due. In the case of any interest payment due on an interest payment date, the instructions must be given by the person or entity who is the Holder on the regular record date. In the case of any other payment, the payment will be made only after the note is surrendered to the paying agent. Any instructions, once properly given, will remain in effect unless and until new instructions are properly given in the manner described above.

If a Holder fails to give instructions as described above, we will notify the Holder at the address in the trustee's records and will make the payment within five business days after the Holder provides appropriate instructions. Any late payment made in these circumstances will be treated under the indenture as if made on the due date, and no interest will accrue on the late payment from the due date to the date paid.

Although a payment on a note in non-global form may be due in a specified currency other than U.S. dollars, we will make the payment in U.S. dollars if the Holder asks us to do so. To request U.S. dollar payment, the Holder must provide appropriate written notice to the trustee at least ten days before the next due date

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for which payment in U.S. dollars is requested. In the case of any interest payment due on an interest payment date, the request must be made by the person or entity who is the Holder on the regular record date. Any request, once properly made, will remain in effect unless and until revoked by notice properly given in the manner described above.

Book-entry and other indirect holders of a note with a specified currency other than U.S. dollars should contact their banks or brokers for information about how to receive payments in the specified currency or in U.S. dollars.

Conversion to U.S. Dollars. When we are asked by a Holder to make payments in U.S. dollars of an amount due in another currency, either on a global note or a non-global note as described above, we will determine the U.S. dollar amount the Holder receives as follows. The exchange rate agent described below will request currency bid quotations expressed in U.S. dollars from three or, if three are not available, then two, recognized foreign exchange dealers in New York City, any of which may be the exchange rate agent, as of 11:00 A.M., New York City time, on the second business day before the payment date. Currency bid quotations will be requested on an aggregate basis, for all Holders of notes and other debt securities, if any, requesting U.S. dollar payments of amounts due on the same date in the same specified currency. The U.S. dollar amount the Holder receives will be based on the highest acceptable currency bid quotation received by the exchange rate agent. If the exchange rate agent determines that at least two acceptable currency bid quotations are not available on that second business day, the payment will be made in the specified currency.

To be acceptable, a quotation must be given as of 11:00 A.M., New York City time, on the second business day before the due date and the quoting dealer must commit to execute a contract at the quotation. If some or all of the relevant notes are LIBOR notes or EURIBOR notes, the second preceding business day will be determined for this purpose as if none of those notes were LIBOR notes or EURIBOR notes.

A Holder that requests payment in U.S. dollars will bear all associated currency exchange costs, which will be deducted from the payment.

When the Specified Currency Is Not Available. If we are obligated to make any payment in a specified currency other than U.S. dollars, and the specified currency or any successor currency is not available to us due to circumstances beyond our control such as the imposition of exchange controls or a disruption in the currency markets we will be entitled to satisfy our obligation to make the payment in that specified currency by making the payment in U.S. dollars, on the basis of the most recently available exchange rate.

For a specified currency other than U.S. dollars, the exchange rate will be the noon buying rate for cable transfers of the specified currency in New York City as quoted by the Federal Reserve Bank of New York on the then-most recent day on which that bank has quoted that rate.

The foregoing will apply to any note, whether in global or non-global form, and to any payment, including a payment at maturity. Any payment made under the circumstances and in a manner described above will not result in a default under any note or the indenture.

Exchange Rate Agent. If we issue a note in a specified currency other than U.S. dollars, we will appoint a financial institution to act as the exchange rate agent and will name the institution initially appointed when the note is originally issued in the applicable pricing supplement. We may change the exchange rate agent from time to time after the original issue date of the note without your consent and without notifying you of

the change.

All determinations made by the exchange rate agent will be at its sole discretion unless we state in the applicable pricing supplement that any determination is subject to our approval. In the absence of manifest error, those determinations will be conclusive for all purposes and binding on you and us, without any liability on the part of the exchange rate agent.

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Payment When Offices Are Closed

If any payment is due on a note on a day that is not a business day, we will make the payment on the next day that is a business day, and no additional interest on such payment will accrue with respect to the payment made on the next succeeding business day. However, if the interest payment date on a floating rate note, other than any interest payment date that falls on the maturity, would otherwise fall on a day that is not a business day, then the interest payment date will be the next day that is a business day. If the floating rate note is a LIBOR note or a EURIBOR note and the next business day falls in the next calendar month, then the interest payment date will be advanced to the next preceding day that is a business day.

Payments postponed to the next business day in these situations will be treated under the indenture as if they were made on the original due date. Postponements of this kind will not result in a default under any note or the indenture. The term business day has a special meaning, which we describe above under *Special Rate Calculation Terms*.

Paying Agent

We may appoint one or more financial institutions to act as our paying agents, at whose designated offices notes in non-global entry form may be surrendered for payment at their maturity. We call each of those offices a *paying agent*. We may add, replace or terminate paying agents from time to time. We may also choose to act as our own paying agent. Initially, we have appointed the trustee, at its corporate trust office in New York City, as the paying agent. We will notify you of changes in the paying agents.

Unclaimed Payments

Regardless of who acts as paying agent, all money paid by us to a paying agent that remains unclaimed at the end of two years after the amount is due to a Holder will be repaid to us. After that two-year period, the Holder may look only to us for payment and not to the trustee, any other paying agent or anyone else.

Notices

Notices to be given to Holders of a global note will be given only to the depositary, in accordance with its applicable policies as in effect from time to time. Notices to be given to Holders of notes not in global form will be sent by mail to the respective addresses of the Holders as they appear in the trustee's records, and will be deemed given when mailed. Neither the failure to give any notice to a particular Holder, nor any defect in a notice given to a particular Holder, will affect the sufficiency of any notice given to another Holder.

Book-entry and other indirect holders should consult their banks or brokers for information on how they will receive notices.

RISK FACTORS

Your investment in the notes is subject to certain risks. This prospectus supplement does not describe all of the risks of an investment in the notes, whether arising because the return on the notes is linked to one or more interest rates or currency indices or formulas or because the notes are denominated in a currency other than U.S. dollars. You should consult your own financial and legal advisors about the risks entailed by an investment in the notes and the suitability of your investment in the notes in light of your particular circumstances. Before investing in the notes, you should consider carefully, among other factors, the matters described below. In addition, you should review the Risk Factors and

Cautionary Note Concerning Factors That May Affect Future Results sections of 3M's Annual Report on Form 10-K for the fiscal year ended December 31, 2010, the Risk Factors and Cautionary Note Concerning Factors That May Affect Future Results sections of 3M's Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2011 and June 30, 2011 and the Risk Factors and Cautionary Note Concerning Factors That May Affect Future Results sections of any future report filed by 3M with the Securities and Exchange Commission, all of which are incorporated by reference herein. See Where You

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Can Find Additional Information and Incorporation of Certain Documents By Reference in the accompanying prospectus.

Risks Associated with Indexed Notes

The following is a brief summary of certain considerations which prospective purchasers of indexed notes should take into account. Additional risks and tax considerations will be set forth in the applicable pricing supplement.

Due to the manner in which the principal amount due at maturity on an indexed note is determined, holders of indexed notes may lose a portion or all of their investment in indexed notes depending upon the value at maturity of the applicable index. Similarly, holders of indexed notes may lose a major portion or all of the interest due on an interest payment date depending upon the value of the applicable index on any interest payment date. Indices based upon foreign currencies, composite currencies, commodities or other financial or non-financial indicators can be quite volatile in nature.

Indexed notes are speculative in nature and involve a high degree of risk, including the risk that the principal amount payable at maturity may be zero and that on one or more interest payment dates the interest rate may be zero percent. Prospective purchasers should therefore be prepared to sustain a total loss of the principal of the indexed notes and to receive no interest thereon. Indexed notes are not an appropriate investment for investors who are not sophisticated with respect to foreign currency transactions, commodity prices and commodity and financial or non-financial indices.

Prospective purchasers are encouraged to review the applicable pricing supplement for additional risks associated with the specific issuance of indexed notes. See also Foreign Currency Risks below.

Foreign Currency Risks

General

Exchange Rates and Exchange Controls

An investment in notes that are denominated in other than U.S. dollars entails significant risks that are not associated with a similar investment in a security denominated in U.S. dollars. Such risks include, without limitation,

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- the possibility of significant changes in rates of exchange between the U.S. dollar and the various foreign currencies or composite currencies, and
- the possibility of the imposition or modification of foreign exchange controls by either the U.S. or foreign governments.

Such risks depend on economic and political events over which we have no control. In recent years, rates of exchange between the U.S. dollar and certain foreign currencies have been highly volatile and such volatility may be expected in the future. Fluctuations in any particular exchange rate that have occurred in the past are not necessarily indicative, however, of fluctuations in the rate that may occur during the term of any note. Depreciation of a specified currency other than U.S. dollars against the U.S. dollar would result in a decrease in the effective yield of such note below its coupon rate, and in certain circumstances could result in a loss to the investor on a U.S. dollar basis.

Governments have imposed from time to time, and may in the future impose, exchange controls which could affect exchange rates as well as the availability of a specified foreign currency at a note's maturity. Even if there are no actual exchange controls, it is possible that the specified currency for any particular note will not be available at such note's maturity. In that event, we will repay in U.S. dollars on the basis of the most recently available exchange rate.

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This prospectus supplement and the attached prospectus and any applicable pricing supplement do not describe all the risks of an investment in the notes denominated in other than U.S. dollars. Prospective investors should consult their own financial and legal advisors as to the risks entailed by an investment in the notes denominated in other than U.S. dollars. Notes denominated in other than U.S. dollars are not an appropriate investment for investors who are unsophisticated with respect to foreign currency transactions.

Currently, there are limited facilities in the United States for conversion of U.S. dollars into foreign currencies, and vice versa. In addition, banks offer limited non-U.S. dollar denominated checking or saving account facilities in the United States. Accordingly, unless otherwise specified in the applicable pricing supplement, payments on notes made in a specified currency other than U.S. dollars may be made from an account with a bank located in the country issuing the specified currency.

Unless otherwise specified in the applicable pricing supplement, notes denominated in other than U.S. dollars will not be sold in, or to residents of, the country issuing the specified currency in which particular notes are denominated. The information set forth in this prospectus supplement is directed to prospective purchasers who are residents of the United States, and we disclaim any responsibility to advise prospective purchasers who are residents of countries other than the United States with respect to any matters that may affect the purchase, holding or receipt of payments of principal of and interest on the notes. Such persons should consult their own financial and legal advisors with regard to such matters.

Governing Law and Judgments

The notes will be governed by and construed in accordance with the laws of the State of New York. If an action based on the notes were commenced in a court in the United States, it is likely that such court would grant judgment relating to the notes only in U.S. dollars. It is not clear, however, whether, in granting such judgment, the rate of conversion into U.S. dollars would be determined with reference to the date of default, the date judgment is rendered or some other date. New York statutory law provides, however, that a court shall render a judgment in a foreign currency of the underlying obligation and that the judgment shall be converted into U.S. dollars at the rate of exchange prevailing on the date of the entry of the judgment.

Exchange Rate and Controls for Specified Currencies

With respect to any note denominated in other than U.S. dollars, a pricing supplement including a currency supplement with respect to the applicable specified currency (which supplement shall include information with respect to applicable current foreign exchange controls, if any) and the relevant historical exchange rates for the specified currency shall constitute a part of this prospectus supplement. Such information concerning exchange rates is furnished as a matter of information only and should not be regarded as indicative of the range of or trends in fluctuations in currency exchange rates that may occur in the future.

CERTAIN U.S. FEDERAL INCOME TAX CONSIDERATIONS

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This section describes the material U.S. federal income tax consequences of owning the series F medium-term notes and is the opinion of Lauri B. Ink, Senior Tax Counsel to 3M Company. It applies to you only if you hold your notes as capital assets for tax purposes. This section does not apply to you if you are a holder subject to special rules, such as:

- a dealer in securities or currencies;
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings;
- a bank;
- a life insurance company;

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- a tax-exempt organization;
- a person that holds notes that are a hedge or that are hedged against interest rate or currency risks;
- a person that holds notes as part of a straddle or conversion transaction for tax purposes; or
- a person whose functional currency for tax purposes is not the U.S. dollar.

This section deals only with notes that are due to mature 30 years or less from the date on which they are issued. The U.S. federal income tax consequences of owning notes that are due to mature more than 30 years from their date of issue will be discussed in any applicable pricing supplement. This section is based on the Internal Revenue Code of 1986 (the Code), its legislative history, existing and proposed regulations under the Code, and published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

Please consult your own tax advisor concerning the consequences of owning these notes in your particular circumstances under the Code and the laws of any other taxing jurisdiction.

U.S. Holders

This subsection describes the tax consequences to a U.S. holder. You are a U.S. holder if you are a beneficial owner of a note and you are:

- a citizen or resident of the United States;
- a domestic corporation (including an entity treated as a corporation for U.S. federal income tax purposes);
- an estate whose income is subject to U.S. federal income tax regardless of its source; or

- a trust if a U.S. court can exercise primary supervision over the trust's administration and one or more U.S. persons are authorized to control all substantial decisions of the trust.

If a partnership (including for this purpose any entity treated as a partnership for U.S. federal income tax purposes) is the beneficial owner of any note, the treatment of a partner in that partnership will generally depend upon the status of such partner and the activities of such partnership.

If you are not a U.S. holder, this subsection does not apply to you and you should refer to U.S. Alien Holders below.

Payments of Interest

Except as described below in the case of interest on a discount note that is not qualified stated interest, each as defined below under Original Issue Discount General, you will be taxed on any interest on your note, whether payable in U.S. dollars or a foreign currency, including a composite currency or basket of currencies other than U.S. dollars, as ordinary income at the time you receive the interest or it accrues, depending on your regular method of accounting for tax purposes.

Cash Basis Taxpayers. If you are a taxpayer that uses the cash receipts and disbursements method of accounting for tax purposes and you receive an interest payment that is denominated in, or determined by reference to, a foreign currency, you must recognize income equal to the U.S. dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars.

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Accrual Basis Taxpayers. If you are a taxpayer that uses an accrual method of accounting for tax purposes, you may determine the amount of income that you recognize with respect to an interest payment denominated in, or determined by reference to, a foreign currency by using one of two methods. Under the first method, you will determine the amount of income accrued based on the average exchange rate in effect during the interest accrual period or, with respect to an accrual period that spans two taxable years, that part of the period within the taxable year.

If you elect the second method, you would determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year. Additionally, under this second method, if you receive a payment of interest within five business days of the last day of your accrual period or taxable year, you may instead translate the interest accrued into U.S. dollars at the exchange rate in effect on the day that you actually receive the interest payment. If you elect the second method, it will apply to all debt instruments that you hold at the beginning of the first taxable year to which the election applies and to all debt instruments that you subsequently acquire. You may not revoke this election without the consent of the Internal Revenue Service (the IRS).

When you actually receive an interest payment, including a payment attributable to accrued but unpaid interest upon the sale or retirement of your note, denominated in, or determined by reference to, a foreign currency for which you accrued an amount of income, you will recognize ordinary income or loss measured by the difference, if any, between the exchange rate that you used to accrue interest income and the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars. However, you may not treat this ordinary income gain or loss as an adjustment to the interest income you receive.

Original Issue Discount

General. If you own a note, other than a note with a term of one year or less (a short-term note), it will be treated as a discount note issued at an original issue discount if the amount by which the note's stated redemption price at maturity exceeds its issue price is more than a de minimis amount. Generally, a note's issue price will be the first price at which a substantial amount of notes included in the issue of which the note is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. A note's stated redemption price at maturity is the total of all payments provided by the note that are not payments of qualified stated interest. Generally, an interest payment on a note is qualified stated interest if it is one of a series of stated interest payments on a note that are unconditionally payable at least annually at a single fixed rate, with certain exceptions for lower rates paid during some periods, applied to the outstanding principal amount of the note. There are special rules for variable rate notes that are discussed below under Variable Rate Notes .

In general, your note is not a discount note if the amount by which its stated redemption price at maturity exceeds its issue price is less than the de minimis amount of 1/4 of 1% of its stated redemption price at maturity multiplied by the number of complete years to its maturity. Your note will have de minimis original issue discount if the amount of the excess is less than the de minimis amount. If your note has de minimis original issue discount, you must include the de minimis amount in income as stated principal payments are made on the note, unless you make the election described below under Election to Treat All Interest as Original Issue Discount . You can determine the includible amount with respect to each such payment by multiplying the total amount of your note's de minimis original issue discount by a fraction equal to:

- the amount of the principal payment made divided by

- the stated principal amount of the note.

Generally, if your discount note matures more than one year from its date of issue, you must include original issue discount (OID) in income before you receive cash attributable to that income. The amount of OID that you must include in income is calculated using a constant-yield method, and generally you will include increasingly greater amounts of OID in income over the life of your note. More specifically, you can calculate the

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amount of accrued OID that you must include in income by adding the daily portions of OID with respect to your discount note for each day during the taxable year or portion of the taxable year that you hold your discount note. You can determine the daily portion by allocating to each day in any accrual period a pro rata portion of the OID allocable to that accrual period. You may select an accrual period of any length with respect to your note and you may vary the length of each accrual period over the term of your note. However, no accrual period may be longer than one year and each scheduled payment of interest or principal on the note must occur on either the first or final day of an accrual period.

You can determine the amount of OID allocable to an accrual period by:

- multiplying your discount note's adjusted issue price at the beginning of the accrual period by your note's yield to maturity; and then
- subtracting from this figure the sum of the payments of qualified stated interest on your note allocable to the accrual period.

You must determine the note's yield to maturity on the basis of compounding at the close of each accrual period and adjusting for the length of each accrual period. Further, you can determine your discount note's adjusted issue price at the beginning of any accrual period by:

- adding your note's issue price and any accrued OID for each prior accrual period; and then
- subtracting any payments previously made on your note that were not qualified stated interest payments.

If an interval between payments of qualified stated interest on your note contains more than one accrual period, then, when you determine the amount of OID allocable to an accrual period, you must allocate the amount of qualified stated interest payable at the end of the interval, including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval, pro rata to each accrual period in the interval based on their relative lengths. In addition, you must increase the adjusted issue price at the beginning of each accrual period in the interval by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but that is not payable until the end of the interval. You may compute the amount of OID allocable to an initial short accrual period by using any reasonable method if all other accrual periods, other than a final short accrual period, are of equal length.

The amount of OID allocable to the final accrual period is equal to the difference between:

- the amount payable at the maturity of your note, other than any payment of qualified stated interest; and

- your note's adjusted issue price as of the beginning of the final accrual period.

Acquisition Premium. If you purchase your note for an amount that is less than or equal to the sum of all amounts, other than qualified stated interest, payable on your note after the purchase date but is greater than the amount of your note's adjusted issue price, as determined above under General, the excess is acquisition premium. If you do not make the election described below under Election to Treat All Interest as Original Issue Discount, then you must reduce the daily portions of OID by an amount equal to:

- the excess of your adjusted basis in the note immediately after purchase

over

- the adjusted issue price of the note

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divided by:

- the excess of the sum of all amounts payable (other than qualified stated interest) on the note after the purchase date over
- the note's adjusted issue price.

Market Discount. Your note, other than a short-term note, will be a market discount note if:

- you purchase your note for less than its issue price as determined above under General ; and
- the note's stated redemption price at maturity or, in the case of a discount note, the note's revised issue price, exceeds the price you paid for your note by at least 1/4 of 1% of your note's stated redemption price at maturity or revised issue price, respectively, multiplied by the number of complete years to the note's maturity. To determine the revised issue price of your note for these purposes, you generally add any OID that has accrued on your note to its issue price.

If your note's stated redemption price at maturity or, in the case of a discount note, its revised issue price, does not exceed the price you paid for the note by 1/4 of 1% multiplied by the number of complete years to the note's maturity, the excess constitutes de minimis market discount, and the rules discussed below are not applicable to you.

You must treat any gain you recognize on the maturity or disposition of your market discount note as ordinary income to the extent of the accrued market discount on your note. Alternatively, you may elect to include market discount in income currently over the life of your note. If you make this election, it will apply to all debt instruments with market discount that you acquire on or after the first day of the first taxable year to which the election applies. You may not revoke this election without the consent of the IRS. If you own a market discount note and do not make this election, you will generally be required to defer deductions for interest on borrowings allocable to your note in an amount not exceeding the accrued market discount on your note until the maturity or disposition of your note.

You will accrue market discount on your market discount note on a straight-line basis unless you elect to accrue market discount using a constant-yield method. If you make this election, it will apply only to the note with respect to which it is made and you may not revoke it.

Pre-Issuance Accrued Interest. An election may be made to decrease the issue price of your note by the amount of pre-issuance accrued interest if:

- a portion of the initial purchase price of your note is attributable to pre-issuance accrued interest;
- the first stated interest payment on your note is to be made within one year of your note's issue date; and
- the payment will equal or exceed the amount of pre-issuance accrued interest.

If this election is made, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on your note.

Notes Subject to Contingencies Including Optional Redemption. Your note is subject to a contingency if it provides for an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies, other than a remote or incidental contingency, whether such contingency relates to payments of interest or of principal. In such a case, you must determine the yield and maturity of your note by assuming that the payments will be made according to the payment schedule most likely to occur if:

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- the timing and amounts of the payments that comprise each payment schedule are known as of the issue date; and
- one of such schedules is significantly more likely than not to occur.

If there is no single payment schedule that is significantly more likely than not to occur, other than because of a mandatory sinking fund, you must include income on your note in accordance with the general rules that govern contingent payment obligations. These rules will be discussed in the applicable pricing supplement.

Notwithstanding the general rules for determining yield and maturity, if your note is subject to contingencies, and either you or we have an unconditional option or options that, if exercised, would require payments to be made on the note under an alternative payment schedule or schedules, then in the case of an option or options of ours, we will be deemed to exercise or not exercise an option or combination of options in the manner that minimizes the yield on your note and, in the case of an option or options that you hold, you will be deemed to exercise or not exercise an option or combination of options in the manner that maximizes the yield on your note. If both you and we hold options described in the preceding sentence, those rules will apply to each option in the order in which they may be exercised. You may determine the yield on your note for the purposes of those calculations by using any date on which your note may be redeemed or repurchased as the maturity date and the amount payable on the date that you chose in accordance with the terms of your note as the principal amount payable at maturity.

If a contingency, including the exercise of an option, actually occurs or does not occur contrary to an assumption made according to the above rules then, except to the extent that a portion of your note is repaid as a result of this change in circumstances and solely to determine the amount and accrual of OID, you must redetermine the yield and maturity of your note by treating your note as having been retired and reissued on the date of the change in circumstances for an amount equal to your note's adjusted issue price on that date.

Election to Treat All Interest as Original Issue Discount. You may elect to include in gross income all interest that accrues on your note using the constant-yield method described above under *General*, with the modifications described below. For purposes of this election, interest will include stated interest, OID, de minimis original issue discount, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium, described below under *Notes Purchased at a Premium*, or acquisition premium.

If you make this election for your note, then, when you apply the constant-yield method:

- the issue price of your note will equal your cost;
- the issue date of your note will be the date you acquired it; and

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- no payments on your note will be treated as payments of qualified stated interest.

Generally, this election will apply only to the note for which you make it; however, if the note for which this election is made has amortizable bond premium, you will be deemed to have made an election to apply amortizable bond premium against interest for all debt instruments with amortizable bond premium, other than debt instruments the interest on which is excludible from gross income, that you hold as of the beginning of the taxable year to which the election applies or any taxable year thereafter. Additionally, if you make this election for a market discount note, you will be treated as having made the election discussed above under `Market Discount` to include market discount in income currently over the life of all debt instruments that you currently hold or later acquire. You may not revoke any election to apply the constant-yield method to all interest on ; MARGIN-LEFT: 0px; TEXT-INDENT: 0px; MARGIN-RIGHT: 0px; FONT-FAMILY: Times New Roman">

\$		2,048,565
\$		732,512
\$		1,069,947
Weighted average shares outstanding - basic		
		30,642,187
		17,147,268
		36,425,094
		17,147,268
Effect of dilutive securities:		
Convertible notes *		
		2,724,521
		-
		-
		-
Options granted		
		733,927
		-
		571,906
		-

Weighted average shares outstanding - diluted

34,100,635

17,147,268

36,997,000

17,147,268

(Loss) Earnings per share – basic *

\$ (0.01)

)
\$ 0.12

\$ 0.02

\$ 0.06

(Loss) Earnings per share - diluted

\$ (0.01)

)
\$ 0.12

\$ 0.02

\$ 0.06

* These securities are anti-dilutive, therefore, basic and diluted loss per share are the same.

* Interest expense on convertible note issued on April 29, 2008 has been added back to net income for the computation of diluted earnings per share.

Foreign Currency Translation and Comprehensive Income (Loss)

The Company’s functional currency is the Renminbi (“RMB”). For financial reporting purposes, RMB has been translated into United States dollars (“USD”) as the reporting currency. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the reporting period. Translation adjustments arising from the use of different exchange rates from period to period are included as a component of stockholders' equity as “Accumulated other comprehensive income”.

Gains and losses resulting from foreign currency transactions are included in income. There has been no significant fluctuation in the exchange rate for the conversion of RMB to USD after the balance sheet date.

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The Company uses SFAS 130 “Reporting Comprehensive Income”. Comprehensive income is comprised of net income and all changes to the statements of stockholders’ equity, except those due to investments by stockholders, changes in paid-in capital and distributions to stockholders.

Segment Reporting

SFAS No. 131, “Disclosures about Segments of an Enterprise and Related Information” requires use of the “management approach” model for segment reporting. The management approach model is based on the way a company’s management organizes segments within the company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure, or any other manner in which management disaggregates a company. SFAS 131 has no effect on the Company’s financial statements as substantially all of the Company’s operations are conducted in one industry segment. All of the Company’s assets are located in the PRC.

New Accounting Pronouncements

Accounting for Financial Guarantee Insurance Contracts

In May 2008, the FASB issued SFAS No. 163, “Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60.” The scope of this Statement is limited to financial guarantee insurance (and reinsurance) contracts, as described in this Statement, issued by enterprises included within the scope of Statement 60. Accordingly, this Statement does not apply to financial guarantee contracts issued by enterprises excluded from the scope of Statement 60 or to some insurance contracts that seem similar to financial guarantee insurance contracts issued by insurance enterprises (such as mortgage guaranty insurance or credit insurance on trade receivables). This Statement also does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of FASB Statement No. 133, “Accounting for Derivative Instruments and Hedging Activities.” This Statement will not have an impact on the Company’s financial statements.

The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles.” This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (“GAAP”) in the United States. This Statement will not have an impact on the Company’s financial statements.

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133 (“SFAS 133”). This Statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. Based on current conditions, the Company does not expect the adoption of SFAS 161 to have a significant impact on its results of operations or financial position.

Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51” (“SFAS 160”). SFAS 160 establishes new accounting and reporting standards for the

noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Based on current conditions, the Company does not expect the adoption of SFAS 160 to have a significant impact on its results of operations or financial position.

Business Combinations

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), "Business Combinations" ("SFAS 141R"). SFAS 141R will significantly change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141R will change the accounting treatment for certain specific items, including:

- Acquisition costs will be generally expensed as incurred;
- Noncontrolling interests (formerly known as "minority interests" - see SFAS 160 discussion above) will be valued at fair value at the acquisition date;
- Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for non-acquired contingencies;
- In-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS 141R also includes a substantial number of new disclosure requirements. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, since we are a calendar year-end company, we will continue to record and disclose business combinations following existing GAAP until January 1, 2009. We expect SFAS 141R will have an impact on accounting for business combinations once adopted but the effect is dependent upon acquisitions at that time.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132R

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132R" ("SFAS 158"), which requires employers to recognize the underfunded or overfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through accumulated other comprehensive income. Additionally, SFAS 158 requires employers to measure the funded status of a plan as of the date of its year-end statement of financial position. The new reporting requirements and related new footnote disclosure rules of SFAS 158 are effective for fiscal years ending after December 15, 2006. We adopted the provisions of SFAS 158 for the year end 2006, and the effect of recognizing the funded status in accumulated other comprehensive income was not significant. The new measurement date requirement applies for fiscal years ending after December 15, 2008.

3. RESTRICTED CASH

Restricted cash consisted of cash in the bank of approximately \$440,000 (RMB 3,000,000) to secure a three-month bank acceptance that the Company issued to its vendor, and cash in another bank of approximately \$403,000 (RMB

2,750,000) to secure the execution of a project contract that the Company entered into with its customer during the quarter ended September 30, 2008.

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4. NET INVESTMENT IN SALES-TYPE LEASES

Under sales-type leases, TCH leased TRT systems to Xingtai and Zhangzhi with terms of five years and thirteen years, respectively. The components of the net investment in sales-type leases as of September 30, 2008 and December 31, 2007 are as follows:

	September 30, 2008	December 31, 2007
Total future minimum lease payments receivables	\$ 26,396,799	27,162,928
Less: unearned interest income	(17,503,279)	(18,147,167)
Net investment in sales - type leases	\$ 8,893,520	9,015,761
Current portion	\$ 1,201,748	1,081,981
Noncurrent portion	\$ 7,691,772	7,933,780

As of September 30, 2008, the future minimum rentals to be received on non-cancelable sales type leases are as follows:

Years ending September 30,		
2009	\$	3,429,954
2010		3,272,807
2011		3,272,807
2012		2,293,312
2013		1,803,564
Thereafter		12,324,355
	\$	26,396,799

5. PREPAID EQUIPMENT RENT FOR OPERATING LEASES

On April 10, 2008, the Company leased energy recycling power generation equipment for operating under a one-year, non-cancellable lease for the amount of approximately \$4,455,000 (RMB 31,000,000). At the end of this one-year lease term, the Company has the right to renew the lease for another four-year term at an aggregate price of approximately \$10,940,000 (RMB 75,000,000) with a separate agreement. The lease payment of approximately \$4,455,000 has been paid in full.

On the same day, the Company entered into a leasing agreement with a lessee to lease out the above power generation equipment under a one-year, non-cancellable lease for the lease payment of approximately \$583,000 (RMB 4,000,000) per month with the option to renew. The lessee will pay a lower monthly lease payment of approximately \$486,000 (RMB 3,333,000) under the circumstance that the Company renews the lease of the equipment from the ultimate lessor after one year.

On May 21, 2008, the Company leased energy recycling power generation equipment from the same lessor for operating under a one-year, non-cancellable lease for the amount of approximately \$6,560,000 (RMB 45,000,000). At the end of the one-year lease term, the Company has the right to renew the lease for another four-year term at an aggregate price of approximately \$17,500,000 (RMB 120,000,000) with a separate agreement. The lease payment of approximately \$6,560,000 has been paid in full.

On the same day, the Company entered into a leasing agreement with the same lessee to lease out the above power generation equipment under a one-year, non-cancellable lease for the lease payment of approximately \$887,000 (RMB 5,850,000) per month with the option to renew. The lessee will pay a lower monthly lease payment of approximately

\$729,000 (RMB 5,000,000) if the Company renews the lease of the equipment from the ultimate lessor after one year.

6. INVENTORY

Inventory consisted of two equipment systems that will be used for TRT projects in the amount of \$10,560,282 and \$9,870,315 at September 30, 2008 and December 31, 2007, respectively.

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7. ADVANCE FOR EQUIPMENT

Advance for equipment represented advance payment of approximately \$2,640,701 (RMB 18,000,000) to an independent contractor for constructing a power generation system and purchase of the equipment that will be used for the construction. At September 30, 2008, this project has not commenced construction yet. Upon completion of the construction, the Company will sell the power that is generated from this system to certain customers or lease out the whole system for rental income (See Note 20).

8. CONSTRUCTION IN PROGRESS

Construction in progress represented the amount paid to an independent contractor for constructing another power generation system for the total amount of approximately \$10,046,935 (RMB 68,500,000). The construction project commenced in March 2008, and will take about 11 months to complete. Upon completion, the Company will sell the power that is generated from this system to predetermined customers (See Note 20).

9. TAX PAYABLE

Tax payable consisted of the following at September 30, 2008 and December 31, 2007:

	September 30, 2008	December 31, 2007
Income tax payable	\$ 1,198,015	\$ 491,835
Business tax payable	86,902	41,126
Other taxes payable	10,080	1,561
	\$ 1,294,997	\$ 534,522

10. ACCRUED LIABILITIES AND OTHER PAYABLES

Accrued liabilities and other payables consisted of the following at September 30, 2008 and December 31, 2007:

	September 30, 2008	December 31, 2007
Other payables	\$ 3,230,777	\$ 2,274,805
Employee welfare payable	240,124	228,923
Accrued expenses	114,733	61,998
Total	\$ 3,585,634	\$ 2,565,726

At, September 30, 2008, other payable mainly consisted of employee training and social insurance payable of approximately \$152,000, consulting and legal expenses paid by a third party on behalf of the Company, which will be repaid by the Company in the amount of approximately \$370,000, a payable to Yingfeng for the cost of obtaining the ownership of two TRT projects that were previously owned by Yingfeng of approximately \$1,681,000 (RMB 11,460,257), and leasing deposits received from the lessee for leasing the power generation equipments of approximately \$1,027,000 (RMB 7,000,000).

11. ADVANCE FROM MANAGEMENT

Advance from management represented the balances due to a director for unsecured advances in 2007, which are interest free and repayable in the next twelve months. This advance was repaid as of September 30, 2008.

12. MINORITY INTEREST

Minority interest represented a 20% equity interest in Huaxin. Huaxin was incorporated in November 2, 2007, and engages in a similar business to TCH. At September 30, 2008 and December 31, 2007, minority interest was \$16,219 and \$15,080, respectively.

13. DISCONTINUED OPERATIONS

Since January 2007, the Company has gradually phased out and substantially scaled down most of its business of mobile phone distribution and provision of pager and mobile phone value-added information services. In the first and second quarters of 2007, the Company did not engage in any substantial transactions or activity in connection with these businesses. On May 10, 2007, the Company ceased and discontinued these businesses. Accordingly, the results of the discontinued operations have been segregated from continuing operations. The discontinued operations had an income of \$28,457 for the nine months ended September 30, 2007. The income represented the write down of deferred revenue generated from the provision of pager value-added information services.

14. INCOME TAX

Effective January 1, 2008, the PRC government implemented a new corporate income tax law with a new maximum corporate income tax rate of 25%. The Company is governed by the Income Tax Law of the PRC concerning privately-run enterprises, which are generally subject to tax at a statutory rate of 25% (33% prior to 2008) on income reported in the statutory financial statements after appropriate tax adjustments.

The Company's subsidiaries generated substantially all of its net income from its PRC operation. Shanghai TCH's effective income tax rates for 2008 and 2007 are 18% and 15%, respectively. Xi'an TCH's effective income tax rate for 2008 is 25%. Shanghai TCH and its subsidiaries Xi'an TCH and Xingtai Huaxin filed separate income tax returns.

There is no income tax for companies domiciled in the Cayman Islands. Accordingly, the Company's consolidated financial statements do not present any income tax provisions related to Cayman Islands tax jurisdiction where Sifang Holding is domiciled. The parent company, China Recycling Energy Co., Ltd., is taxed in the US and has a net operating loss for the nine and three months ended September 30, 2008. A 100% valuation allowance has been established due to the uncertainty of its realization.

For the nine and three months ended September 30, 2008 and 2007, the Company's effective income tax rate differs from the US statutory rate because of the effect of the tax holiday, effect of tax on loss on nontaxable jurisdiction and valuation allowance.

15. CONVERTIBLE NOTES PAYABLE

On November 16, 2007, the Company entered into a Stock and Notes Purchase Agreement ("Purchase Agreement") with Carlyle Asia Growth Partners III, L.P. ("CAGP") and CAGP III Co. Investment, L.P. (together with CAGP, the "Investors"). Under the terms of the Purchase Agreement, the Company sold to the Investors a 10% Secured Convertible Promissory Note in the principal amount of \$5,000,000 (the "First Note"). Additionally, the Purchase Agreement provides for two subsequent transactions to be effected by the Company and the Investors, which include (i) the issuance by the Company and subscription by the Investors of a total of 4,066,706 shares of common stock of Company, at the price of \$1.23 per share for an aggregate purchase price of approximately \$5,000,000, and (ii) the issuance and sale by the Company to the Investors of a 5% Secured Convertible Promissory Note in the principal amount of \$15,000,000 (the foregoing transactions, together with sale and purchase of the First Note, are hereinafter referred to as the "Offering"). The subsequent transactions are contingent upon the satisfaction of certain conditions specified in the Purchase Agreement, including entry into specified energy and recycling project contracts and the purchase of certain energy recycling systems.

The First Note bears interest at 10% per annum and matures on November 16, 2009. The principal face amount of the First Note, together with any interest thereon, convert, at the option of the holders at any time on or prior to maturity, into shares of the Company's common stock at an initial conversion price of \$1.23 per share (subject to anti-dilution adjustments). The First Note is subject to mandatory conversion upon the consummation of the aforementioned

issuance and subscription of shares of the Company's common stock under the Purchase Agreement. As more fully described in the First Note, the obligations of the Company under the First Note shall rank senior to all other debt of the Company.

As collateral for the First Note, the President and a major shareholder of the Company pledged 9,653,471 shares of the Company's common stock held by him to secure the First Note.

The First Note was considered to have an embedded beneficial conversion feature because the conversion price was less than the quoted market price at the time of the issuance. Accordingly, the beneficial conversion feature of \$5,000,000 was recorded separately as unamortized beneficial conversion feature based on the intrinsic value method. The First Note is recorded in the balance sheet at face value less the unamortized beneficial conversion feature. The terms for the First Note were amended on April 29, 2008 and the First Note was repaid in full on June 25, 2008, as described below.

On April 29, 2008, the Company entered into an Amendment to the Purchase Agreement with the investors. Under the terms of the Amendment, (i) the Company issued and the Investor subscribed for a total of 4,066,706 shares of common stock of the Company, at the price of \$1.23 per share for an aggregate purchase price of \$5,002,048, as originally contemplated under the Agreement; (ii) the Investors converted the principal amount under the First Note (and waived any accrued interest thereon) into 4,065,040 shares of common stock of the Company at the conversion price per share of \$1.23, pursuant to the terms and conditions of the First Note issued under the Agreement; (iii) the Company issued and sold to the Investors a new 5% Secured Convertible Promissory Note in the principal amount of \$5,000,000 to the Investors (the "Second Note" and collectively with the First Note, the "Notes"); and (iv) the Company granted to the Investors an option to purchase a 5% Secured Convertible Promissory Note in the principal amount of \$10,000,000, exercisable by the Investors at any time within nine (9) months following the date of the closing of the transactions contemplated by the Amendment (the "Option Note").

The Second Note bears interest at 5% per annum and matures on April 29, 2011. The principal face amount of the Second Note, together with any interest thereon, convert, at the option of the holders at any time on or after March 30, 2010 (or such earlier date if the audited consolidated financial statements of the Company for the fiscal year ending December 31, 2009 are available prior to March 30, 2010) and prior to maturity, into shares of the Company's common stock at an initial conversion price that is tied to the after-tax net profits of the Company for the fiscal year ending December 31, 2009, as described in the Second Note. The Second Note is subject to mandatory conversion upon the listing of the Company's common stock on the National Association of Securities Dealers Automated Quotations main-board, the New York Stock Exchange or the American Stock Exchange. As more fully described in the Second Note, the obligations of the Company under the Second Note shall rank senior to all other debt of the Company.

The Second Note and the Option Note are both secured by a security interest granted to the Investors pursuant to the Share Pledge Agreement.

The Second Note was not considered to have an embedded beneficial conversion feature, nor included in the computation of diluted earnings per share because the conversion price and convertible shares are contingent upon future net profits, and anti-dilutive for these shares due to the Company's net loss for the nine months ended September 30, 2008.

On June 25, 2008, the Company and the Investors entered into a Rescission and Subscription Agreement to rescind the conversion of the First Note and the issuance of conversion shares of Common Stock at the Second Closing pursuant to Amendment to Stock and Notes Purchase Agreement dated on April 29, 2008. The Company and the Investors rescinded the conversion of the principal amount (\$5,000,000) under the First Note into 4,065,040 shares of Common Stock, and the Investors waived accrued interest on the First Note. Accordingly, the interest expense which had accrued on the note has been recorded as a decrease on interest expense for the period. At the Rescission and Subscription Closing, the Company repaid in full the First Note and issued to the Investors, 4,065,040 shares of Common Stock at the price of \$1.23 per share for an aggregate purchase price of \$5,000,000.

16. STOCK-BASED COMPENSATION PLAN

On November 13, 2007, the Company approved the 2007 Non-statutory Stock Option Plan, which was later amended and restated in August 2008 (the "2007 Plan"), and granted stock options with an aggregate amount of 3,000,000 shares of the stock at \$1.23 per share to acquire the Company's common stock at par value \$0.001 to twenty (20) managerial and non-managerial employees under the 2007 Plan.

The vesting terms of options granted under the 2007 Plan is subject to the Non-Statutory Stock Option Agreements for managerial and non-managerial employees. For managerial employees, no more than 15% of the total stock options shall vest and become exercisable on the six month anniversary of the grant date. An additional 15% and 50% of the

total stock options shall vest and become exercisable on the first and second year anniversary of the grant date, respectively. The remaining 20% of the total stock options shall vest and become exercisable on the third year anniversary of the grant date. For non-managerial employees, no more than 30% of the total stock options shall vest and become exercisable in the first year anniversary of the grant date. An additional 50% of the total stock options shall vest and become exercisable in the second year anniversary of the grant date. The remaining 20% of the total stock options shall vest and become exercisable on the third year anniversary of the grant date. Each stock option shall become vested and exercisable over a period of no longer than five years from the grant date.

Based on the fair value method under SFAS No. 123 (Revised) "Share Based Payment" ("SFAS 123(R)"), the fair value of each stock option granted is estimated on the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option pricing model has assumptions for risk free interest rates, dividends, stock volatility and expected life of an option grant. The risk free interest rate is based upon market yields for United States Treasury debt securities at a maturity near the term remaining on the option. Dividend rates are based on the Company's dividend history. The stock volatility factor is based on the historical volatility of the Company's stock price. The expected life of an option grant is based on management's estimate as no options have been exercised in the Plan to date. The fair value of each option grant to employees is calculated by the Black-Scholes method and is recognized as compensation expense over the vesting period of each stock option award. For stock options issued, the fair value was estimated at the date of grant using the following range of assumptions:

The options vest over a period of three years and have a life of 5 years, volatility of 100%, risk free interest rate of 3.76%, and dividend yield of 0%. No estimate of forfeitures was made as the Company has a short history of granting options.

Effective June 25, 2008, the Company cancelled all vested shares and accepted optionees' forfeiture of any unvested shares underlying the currently outstanding options.

On August 4, 2008, the Company granted stock options to acquire an aggregate amount of 3,000,000 shares of the Company's common stock, par value \$0.001, at \$0.80 per share to 17 employees under the 2007 Plan. The options vest over a period of three years and have a life of 5 years, volatility of 100%, risk free interest rate of 2.76%, and dividend yield of 0%. No estimate of forfeitures was made as the Company has a short history of granting options.

The following table summarizes activity for employees in the Company's Plan for the nine months ended September 30, 2008:

	Number of Shares	Average Exercise Price per Share	Weighed Average Remaining Contractual Term in Years
Outstanding at December 31, 2006	-		
Granted	3,000,000	\$ 1.23	5.00
Exercised	-		
Forfeited	-		
Outstanding at December 31, 2007	3,000,000	\$ 1.23	4.87
Exercisable at December 31, 2007	-		
Granted	-		
Exercised	-		
Forfeited	-		
Outstanding at March 31, 2008	3,000,000	\$ 1.23	4.62
Exercisable at March 31, 2008	-		
Granted	-		
Exercised	-		
Cancelled vested shares	450,000		
Forfeited unvested shares	2,550,000		
Outstanding at June 30, 2008	-	\$ -	-
Exercisable at June 30, 2008	-		
Granted	3,000,000	\$ 0.80	5.00
Exercised	-		

Forfeited	-		
Outstanding at September 30, 2008	3,000,000	\$	0.80
Exercisable at September 30, 2008	-		4.84

The Company recorded \$728,316 of compensation expense for employee stock options during the nine months ended September 30, 2008, of which, \$632,444 was for the options cancelled on June 25, 2008.

The weighted-average grant date fair value of stock options granted to employees for the nine months ended September 30, 2008 was \$0.80 per share. The Company recorded \$95,872 of compensation expense for employee stock options during the quarter ended September 30, 2008. There were no options exercised during the nine months ended September 30, 2008.

17. SHAREHOLDERS' EQUITY

On April 29, 2008, the Company issued and the Investor subscribed for a total of 4,066,706 shares of common stock of the Company, at the price of \$1.23 per share for an aggregate purchase price of \$5,002,048 under the Purchase Agreement.

On June 25, 2008, the Company and the Investors entered into a Rescission and Subscription Agreement to rescind the conversion of the First Note and the issuance of conversion shares of Common Stock pursuant to Amendment to Stock and Notes Purchase Agreement dated on April 29, 2008. The Company and the Investors rescinded the conversion of the principal amount (\$5,000,000) under the First Note into 4,065,040 shares of Common Stock and repaid the First Note in full. At the Rescission and Subscription Closing, the Company issued to the Investors, 4,065,040 shares of Common Stock at the price of \$1.23 per share for an aggregate purchase price of \$5,000,000.

The Company issued 3,278,259 shares of its Common Stock to one of the Company's shareholders who paid \$4,032,258 cash to the Company during the quarter ended June 30, 2008. This purchase was part of an investment agreement by the shareholder entered into in November 2007 to purchase the shares at \$1.23 per share.

18. STATUTORY RESERVES

Pursuant to the new corporate law of the PRC effective January 1, 2006, the Company is now only required to maintain one statutory reserve by appropriating from its after-tax profit before declaration or payment of dividends. The statutory reserve represents restricted retained earnings.

Surplus Reserve Fund

The Company is required to transfer 10% of its net income, as determined under PRC accounting rules and regulations, to a statutory surplus reserve fund until such reserve balance reaches 50% of the Company's registered capital.

The surplus reserve fund is non-distributable other than during liquidation and can be used to fund previous years' losses, if any, and may be utilized for business expansion or converted into share capital by issuing new shares to existing shareholders in proportion to their shareholdings or by increasing the par value of the shares currently held by them, provided that the remaining reserve balance after such issuance is not less than 25% of the registered capital.

Common Welfare Fund

The common welfare fund is a voluntary fund that the Company can elect to transfer 5% to 10% of its net income to this fund. This fund can only be utilized on capital items for the collective benefit of the Company's employees, such as construction of dormitories, cafeteria facilities, and other staff welfare facilities. This fund is non-distributable other than upon liquidation.

19. CONTINGENCIES

The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the North America and Western Europe. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

The Company's sales, purchases and expenses transactions are denominated in RMB and all of the Company's assets and liabilities are also denominated in RMB. The RMB is not freely convertible into foreign currencies under the current law. In China, foreign exchange transactions are required by law to be transacted only by authorized financial institutions. Remittances in currencies other than RMB may require certain supporting documentation in order to affect the remittance.

20. COMMITMENTS

Zhangzhi Steel New blast furnace TRT Power Generator Project

On November 11, 2007, the Company entered a Project General Contractor agreement with an independent contactor under contemplation to construct a 1080 cubic meter blast furnace for the third phase of Zhangzhi TRT project which was originally signed on June 22, 2006. The total contract price is approximately \$4,375,000 (RMB 30,000,000); the Company has paid approximately \$2,625,000 (RMB 18,000,000) for the purchase of equipment. This project is expected to produce 45,000,000 KW/h annual energy output upon completion.

Shenwei Cement Pure Low Temperature Waste Heat Power Generator Project

In November 2007, the Company signed a cooperative agreement with Shenwei Group for a Cement Waste Heat Power Generator Project. The Company will build two sets of 12MW pure low temp cement waste heat power generator systems for its two 2500 tons per day cement manufacturing lines in Jin Yang and a 5,000 tons per day cement manufacturing line in Tong Chuan. During the first quarter of 2008, the Company finished the equipment bidding process, selecting the equipment, and commenced construction of the systems. Total investment will be approximately \$12,593,000 (93 million RMB) with estimated annual power generated capacity of 180 million KWH once the two systems are put into operation. The Company will use the BOT (build, operate, transfer) model to build and operate the systems. The operation period will be 5 years. During the operation period, Shenwei Group will pay the Company the monthly electricity fee based on the actual power generated by the systems at 0.4116 RMB per KWH as agreed.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Note Regarding Forward-Looking Statements

This quarterly report on Form 10-Q and other reports filed by the Company from time to time with the Securities and Exchange Commission (collectively the "Filings") contain or may contain forward-looking statements and information that are based upon beliefs of, and information currently available to, Company's management as well as estimates and assumptions made by Company's management. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. When used in the filings, the words "anticipate", "believe", "estimate", "expect", "future", "intend", "plan", or the negative of these terms and similar expressions as they relate to Company or Company's management identify forward-looking statements. Such statements reflect the current view of Company with respect to future events and are subject to risks, uncertainties, assumptions, and other factors (including the risks contained in the section of operations and results of operations, and any businesses that Company may acquire. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended, or planned.

Although Company believes that the expectations reflected in the forward-looking statements are reasonable, Company cannot guarantee future results, levels of activity, performance, or achievements. Except as required by applicable law, including the securities laws of the United States, the Company does not intend to update any of the forward-looking statements to conform these statements to actual results. Readers are urged to carefully review and consider the various disclosures made throughout the entirety of this quarterly report, which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations, and prospects.

Our financial statements are prepared in US Dollars and in accordance with accounting principles generally accepted in the United States. See "Foreign Currency Translation and Comprehensive Income (Loss)" below for information concerning the exchange rates at which Renminbi ("RMB") were translated into US Dollars ("USD") at various pertinent dates and for pertinent periods.

OVERVIEW OF BUSINESS BACKGROUND

China Recycling Energy Corporation (the "Company" or "CREG") (formerly China Digital Wireless, Inc.) was incorporated on May 8, 1980, under the laws of the State of Colorado. On September 6, 2001, the Company re-domiciled its state of incorporation from Colorado to Nevada. The Company, through its subsidiary Shanghai TCH Data Technology Co., Ltd. ("TCH"), is doing the business of selling and leasing energy saving equipment. The businesses of mobile phone distribution and provision of pager and mobile phone value-added information services were discontinued in 2007. On March 8, 2007, the Company changed its name to "China Recycling Energy Corporation".

On June 23, 2004, the Company entered into a stock exchange agreement with Sifang Holdings Co. Ltd. ("Sifang Holdings") and certain shareholders. Pursuant to the stock exchange agreement, the Company issued 13,782,636 shares of its common stock in exchange for a 100% equity interest in Sifang Holdings, making Sifang Holdings a wholly owned subsidiary of the Company. Sifang Holdings was established under the laws of the Cayman Islands on February 9, 2004 for the purpose of holding a 100% equity interest in Shanghai TCH Data Technology Co., Ltd. ("TCH"). TCH was established as a foreign investment enterprise in Shanghai under the laws of the People's Republic of China (the "PRC") on May 25, 2004. Since January 2007, the Company has gradually phased out and substantially scaled down most of its business of mobile phone distribution and provision of pager and mobile phone value-added information services. In the first and second quarters of 2007, the Company did not engage in any substantial transactions or activity in connection with these businesses. On May 10, 2007, the Company ceased and discontinued

the businesses related to mobile phones and pagers. These businesses are reflected in continuing operations for all periods presented based on the criteria for discontinued operations prescribed by Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”.

On February 1, 2007, the Company’s subsidiary, TCH entered into two TRT Project Joint-Operation Agreements (“Joint-Operation Agreement”) with Xi’an Yingfeng Science and Technology Co., Ltd. (“Yingfeng”). Yingfeng is a joint stock company registered in Xi’an, Shaanxi Province, the PRC, and engages in the business of designing, installing, and operating TRT systems and sales of other renewable energy products. TRT is an electricity generating system that utilizes the exhaust pressure and heat produced in the blast furnace of a steel mill to generate electricity. In October 2007, the Company terminated the Joint-Operation Agreement with Yingfeng and became fully entitled to the rights, titles, benefits and interests in the TRT Projects.

On September 21, 2007, the Company's subsidiary, TCH changed its name to "Shanghai TCH Energy Technology Co., Ltd."

During the second quarter of 2008, the Company leased two energy recycling power generation equipment systems under one-year, non-cancellable leases with the rents paid in full; at the same time, the Company leased this equipment out for higher rental income under one-year, non-cancellable leases.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported net sales and expenses during the reporting periods. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates on historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

While our significant accounting policies are more fully described in Note 2 to our consolidated financial statements, we believe that the following accounting policies are the most critical to aid you in fully understanding and evaluating this management discussion and analysis.

Basis of presentation

These accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America ("US GAAP") and pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for annual financial statements.

Basis of consolidation

The consolidated financial statements include the accounts of CREG and, its subsidiaries, Sifang Holdings, TCH, and TCH's newly incorporated subsidiaries Xi'an TCH and Huaxin. Xi'an TCH and Huaxin engage in the same business as TCH. Substantially all of the Company's revenues are derived from the operations of TCH and its subsidiaries, which represent substantially all of the Company's consolidated assets and liabilities. All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of estimates

In preparing these consolidated financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities in the balance sheets and revenues and expenses during the year reported. Actual results may differ from these estimates.

Accounts receivable and concentration of credit risk

Accounts receivable are recorded at the invoiced amounts and do not bear interest. The Company extends unsecured credit to its customers in the ordinary course of business but mitigates the associated risks by performing credit checks and actively pursuing past due accounts. An allowance for doubtful accounts is established and determined based on managements' assessment of known requirements, aging of receivables, payment history, the customer's current credit worthiness and the economic environment.

Financial instruments that potentially subject the Company to credit risk consist primarily of accounts receivable and other receivables. The Company does not require collateral or other security to support these receivables. The Company conducts periodic reviews of its clients' financial condition and customer payment practices to minimize collection risk on accounts receivable.

The operations of the Company are located in the PRC. Accordingly, the Company's business, financial condition, and results of operations may be influenced by the political, economic, and legal environments in the PRC, as well as by the general state of the PRC economy.

Inventory

Inventory is valued at the lower of cost or market. Cost of work in progress and finished goods comprises direct material cost, direct production cost and an allocated portion of production overheads.

Property and Equipment

Property and equipment are stated at cost, net of accumulated depreciation. Expenditures for maintenance and repairs are expensed as incurred; additions, renewals and betterments are capitalized. When property and equipment are retired or otherwise disposed of, the related cost and accumulated depreciation are removed from the respective accounts, and any gain or loss is included in operations. Depreciation of property and equipment is provided using the straight-line method over the estimated lives ranging from 5 to 20 years as follows:

Building	20 years
Vehicle	2 - 5 years
Office and Other Equipment	2 - 5 years
Software	2 - 3 years

Sales-type leasing and related revenue recognition

The Company invests and leases TRT systems to Xingtai and Zhangzhi. The Company will transfer all benefits, risks and ownership of the TRT systems to Xingtai and Zhangzhi at the end of each lease term. The Company's investment in these projects is recorded as sales-type leases in accordance with SFAS No. 13, "Accounting for Leases" and its various amendments and interpretations. The sales and cost of goods sold is recognized at the point of sale. The investment in sales-type leases consists of the sum of the total minimum lease payments receivable less unearned interest income. Unearned interest income is amortized to income over the lease term as to produce a constant periodic rate of return on the net investment in the lease.

Foreign Currency Translation and Comprehensive Income (Loss)

The Company's functional currency is the Renminbi ("RMB"). For financial reporting purposes, RMB has been translated into United States dollars ("USD") as the reporting currency. Assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Revenues and expenses are translated at the average rate of exchange prevailing during the reporting period. Translation adjustments arising from the use of different exchange rates from period to period are included as a component of stockholders' equity as "Accumulated other comprehensive income". Gains and losses resulting from foreign currency transactions are included in income. There has been no significant fluctuation in exchange rate for the conversion of RMB to USD after the balance sheet date.

The Company uses SFAS 130 "Reporting Comprehensive Income". Comprehensive income is comprised of net income and all changes to the statements of stockholders' equity, except those due to investments by stockholders, changes in paid-in capital and distributions to stockholders.

NEW ACCOUNTING PRONOUNCEMENTS**Accounting for Financial Guarantee Insurance Contracts**

In May 2008, the FASB issued SFAS No. 163, "Accounting for Financial Guarantee Insurance Contracts, an interpretation of FASB Statement No. 60." The scope of this Statement is limited to financial guarantee insurance (and reinsurance) contracts, as described in this Statement, issued by enterprises included within the scope of Statement 60. Accordingly, this Statement does not apply to financial guarantee contracts issued by enterprises excluded from the

scope of Statement 60 or to some insurance contracts that seem similar to financial guarantee insurance contracts issued by insurance enterprises (such as mortgage guaranty insurance or credit insurance on trade receivables). This Statement also does not apply to financial guarantee insurance contracts that are derivative instruments included within the scope of FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement will not have an impact on the Company's financial statements.

The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the FASB issued SFAS No. 162, “The Hierarchy of Generally Accepted Accounting Principles.” This Statement identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with US GAAP. This Statement will not have an impact on the Company’s financial statements.

Disclosures about Derivative Instruments and Hedging Activities

In March 2008, the FASB issued SFAS No. 161, “Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133” (“SFAS 133”). This Statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (i) how and why an entity uses derivative instruments, (ii) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (iii) how derivative instruments and related hedged items affect an entity’s financial position, financial performance, and cash flows. Based on current conditions, the Company does not expect the adoption of SFAS 161 to have a significant impact on its results of operations or financial position.

Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51

In December 2007, the FASB issued SFAS No. 160, “Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51” (“SFAS 160”). SFAS 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent’s equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. SFAS 160 clarifies that changes in a parent’s ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Based on current conditions, the Company does not expect the adoption of SFAS 160 to have a significant impact on its results of operations or financial position.

Business Combinations

In December 2007, the FASB issued SFAS No. 141 (Revised 2007), “Business Combinations” (“SFAS 141R”). SFAS 141R will significantly change the accounting for business combinations. Under SFAS 141R, an acquiring entity will be required to recognize all the assets acquired and liabilities assumed in a transaction at the acquisition-date fair value with limited exceptions. SFAS 141R will change the accounting treatment for certain specific items, including:

- Acquisition costs will be generally expensed as incurred;
- Noncontrolling interests (formerly known as “minority interests” - see SFAS 160 discussion above) will be valued at fair value at the acquisition date;
- Acquired contingent liabilities will be recorded at fair value at the acquisition date and subsequently measured at either the higher of such amount or the amount determined under existing guidance for

non-acquired contingencies;

- In-process research and development will be recorded at fair value as an indefinite-lived intangible asset at the acquisition date;
- Restructuring costs associated with a business combination will be generally expensed subsequent to the acquisition date; and
- Changes in deferred tax asset valuation allowances and income tax uncertainties after the acquisition date generally will affect income tax expense.

SFAS 141R also includes a substantial number of new disclosure requirements. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is prohibited. Accordingly, since we are a calendar year-end company we will continue to record and disclose business combinations following existing GAAP until January 1, 2009. We expect SFAS 141R will have an impact on accounting for business combinations once adopted but the effect is dependent upon acquisitions at that time.

Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132R

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132R" ("SFAS 158"), which requires employers to recognize the underfunded or overfunded status of a defined benefit postretirement plan as an asset or liability in its statement of financial position and to recognize changes in the funded status in the year in which the changes occur through accumulated other comprehensive income. Additionally, SFAS 158 requires employers to measure the funded status of a plan as of the date of its year-end statement of financial position. The new reporting requirements and related new footnote disclosure rules of SFAS 158 are effective for fiscal years ending after December 15, 2006. We adopted the provisions of SFAS 158 for the year end 2006, and the effect of recognizing the funded status in accumulated other comprehensive income was not significant. The new measurement date requirement applies for fiscal years ending after December 15, 2008.

RESULTS OF OPERATIONS

Comparison of Nine Months Ended September 30, 2008 and September 30, 2007

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales:

Nine Months Ended September 30	2008		2007	
	\$	% of Sales	\$	% of Sales
Sales	6,876,223	100%	9,075,999	
Sales of products	-	-	9,075,999	100%
Rental income	6,876,223	100%	-	-
Cost of sales	(4,810,011)	70%	(6,981,537)	77%
Cost of products	-	-	(6,981,537)	77%
Rental expense	(4,810,011)	70%	-	-
Gross profit	2,066,212	30%	2,094,462	23%
Interest income on sales-type lease	1,716,544	25%	473,075	5%
Total operating income	3,782,756	55%	2,567,537	28%
Total Operating expenses	(2,142,728)	31%	(358,726)	4%
Income from operation	1,690,028	24%	2,208,811	24%
Total non-operating income (expenses)	(1,316,551)	19%	210,346	2.3%
Income (loss) before income tax	323,477	5%	2,419,157	27%
Income tax expense	(796,458)	11.6%	(399,049)	4.4%
Minority interest	(83)	-	-	-
Income from operations of discontinued component	-	-	28,457	0.3%
Net income (loss)	(473,064)	(6.9)%	2,048,565	23%

SALES. Net sales for the nine months ended September 30, 2008 were \$6.88 million while our net sales for the nine months ended September 30, 2007 were approximately \$9.08 million, a decrease in revenues of \$2.2 million. The decrease was due to changing of our business type during 2007. We discontinued our mobile phone business and commenced the selling, manufacturing and construction of energy saving systems during 2007. We sell our systems through sales-type leasing. Sales and cost of sales are recorded at the time of leasing; the interest income from the sales-type leasing is our major revenue source in addition to the sales revenue. We sold two TRT systems through sales-type leasing during the nine months ended September 30, 2007, while we had interest income of \$1.7 million from sales-type leasing and rental income of \$6.88 million from leasing out two power generating systems for the same period of 2008.

COST OF SALES. Cost of sales for the nine months ended September 30, 2008 was \$4.81 million while our cost of sales for the same period of 2007 was approximately \$6.98 million, a decrease of \$2.17 million. The decrease in cost of sales is attributed to changing our business type from a mobile phone business to manufacturing, selling, constructing and leasing the energy saving systems in 2007. We leased two power generating systems under one-year, non-cancellable leases with options to renew at a favorable price during the nine months ended September 30, 2008. We paid the lease payments in full and leased the equipment out for higher monthly rental income under one-year, non-cancellable lease.

GROSS PROFIT. Gross profit was \$2.07 million for the nine months ended September 30, 2008 as compared to \$2.09 million for the same period of 2007, representing gross margins of approximately 30% and 23% for the nine months ended September 30, 2008 and 2007, respectively. The increase in our gross profit was mainly due to a decreased cost of sales derived from changing our business type from a mobile phone business to manufacturing, selling, constructing and leasing the energy saving systems during 2007. We sold two TRT systems through sales-type leasing with gross profit recognized during the nine months ended September 30, 2007, while we had interest income from sales-type leasing and rental income for the same period of 2008.

OPERATING INCOME. Operating income was \$3.78 million for the nine months ended September 30, 2008 while our operating income for the same period of 2007 was \$2.57 million, an increase of \$1.21 million. The growth in operating income was mainly due to (i) changing of our business type and (ii) commencing selling and leasing our energy saving systems through sales-type leasing. Two TRT systems sold since the inception of sales-type leases in 2007 now generate additional interest income. Interest income on sales-type lease over the nine months ended September 30, 2008 was \$1.72 million, an approximately \$1.25 million increase from \$473,000 for the same period of 2007.

OPERATING EXPENSES. Operating expenses consisted of selling, general and administrative expenses totaling approximately \$2.14 million for the nine months ended September 30, 2008 as compared to \$0.36 million for the same period of 2007, an increase of approximately \$1.78 million or 494%. This increase was mainly due to the compensation expense of approximately \$730,000 related to the fair value of the stock options to employees, and increased payroll, marketing and traveling expense due to the expansion of our business.

NET INCOME (LOSS). Our net income (loss) for the nine months ended September 30, 2008 was \$(473,064) as compared to \$2,048,565 net income for the same period of 2007, a decrease of \$2.52 million. This decrease in net income was mainly due to interest expense on our amortized beneficial conversion feature for the convertible note of approximately \$1,250,000 and compensation expense of the fair value of stock options of \$730,000 for nine months ended September 30, 2008. The convertible note that was issued on November 16, 2007 was repaid on June 25, 2008 and all the vested and non-vested options that were granted on November 13, 2007 were cancelled on June 25, 2008, but reissued on August 4, 2008.

Comparison of Three Months Ended September 30, 2008 and September 30, 2007

The following table sets forth the results of our operations for the periods indicated as a percentage of net sales:

Three Months Ended September 30	2008		2007	
	\$	% of Sales	\$	% of Sales
Sales	4,259,807	100%	4,294,836	100%
Sales of products	-	-	4,294,836	100%
Rental income	4,259,807	100%	-	-
Cost of sales	(2,977,402)	70%	(3,303,719)	77%
Cost of products	-	-	(3,303,719)	77%
Rental expense	(2,977,402)	70%	-	-
Gross profit	1,282,405	30%	991,117	23%
Interest income on sales-type lease	576,817	13.5%	274,689	6.4%
Total operating income	1,859,222	44%	1,265,806	29.5%
Total Operating expenses	(638,949)	15%	(15,183)	0.35%
Income (loss) from operation	1,220,273	29%	1,250,623	29%
Total non-operating income (expenses)	(59,774)	1.4%	1,428	0.03%
Income (loss) before income tax	1,160,499	27%	1,252,051	29%
Income tax expense	(427,960)	10%	(187,456)	4.36%

Minority interest	(27)	-%	-	-%
Income from operations of discontinued component	-	-	5,352	0.12%
Net income (loss)	732,512	17%	1,069,947	25%

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SALES. Net sales for the quarter ended September 30, 2008 were \$4.26 million while our net sales for the quarter ended September 30, 2007, were \$4.29 million, a decrease in revenues of \$35,029. The decrease was due to changing our business type during 2007. We discontinued our mobile phone business and commenced selling, manufacturing and construction of energy saving systems during 2007. We sell our systems through sales-type leasing. Sales and cost of sales are recorded at the time of leasing; the interest income from the sales-type leasing is our major revenue source in addition to the sales revenue. We sold one TRT system through sales-type leasing during the quarter ended September 30, 2007 which brought us both gross sales and interest income for the third quarter of 2007, while we had interest income from sales-type leasing and rental income from operating lease during the third quarter ended September 30, 2008.

COST OF SALES. Cost of sales for the quarter ended September 30, 2008 was \$2.98 million while our cost of sales for the quarter ended September 30, 2007 was \$3.3 million, a decrease of \$0.32 million. The decrease in cost of sales is attributed to changing our business type from a mobile phone business to manufacturing, selling, constructing and leasing the energy saving systems in 2007. We leased two power generating systems under one-year, non-cancellable leases with options to renew at favorable prices, we paid the lease payments in full and lease them out for higher monthly rental income under one-year, non-cancellable leases. The cost of sales for the nine months ended September 30, 2008 was only the amortization of the prepaid leasing expense while the cost of sales was only the cost of manufacturing and selling a TRT system through the sales-type leasing for the same period of 2007.

GROSS PROFIT. Gross profit was \$1.28 million for the quarter ended September 30, 2008 as compared to \$0.99 million gross profit for the quarter ended September 30, 2007, representing gross margins of approximately 30% and 23% for the third quarter ended 2008 and 2007, respectively. The increase in our gross profit was mainly due to changing our business type from a mobile phone business to manufacturing, selling, constructing and leasing the energy saving systems in 2007. We sold one TRT system through sales-type leasing during the third quarter of 2007, which resulted in a lower gross profit, while we had rental income from operating leasing with higher gross profit margin for the same period of 2008.

OPERATING INCOME. Operating income was \$1.86 million for the three months ended September 30, 2008, while our operating income for the same period of 2007 was \$1.27 million, an increase of \$0.59 million. The growth in operating income was mainly due to the increase of \$290,000 in gross profit and the increase of \$300,000 in interest income on sales-type lease over the same three months ended September 30 between 2008 and 2007.

OPERATING EXPENSES. Operating expenses consisted of selling, general and administrative expenses totaling approximately \$638,949 for the quarter ended September 30, 2008 as compared to \$15,183 for the quarter ended September 30, 2007, an increase of approximately \$623,766 or 4108%. This increase was mainly due to increased payroll, marketing, traveling and consulting expenses associated with expanding our business by getting more leasing and project contracts as well as amortized compensation expenses for employee stock options.

NET INCOME (LOSS). Our net income (loss) for the quarter ended September 30, 2008 was \$732,512 as compared to \$1,069,947 net income for the quarter ended September 30, 2007, a decrease of \$337,435. This decrease in net income was mainly due to interest expense on our convertible note of approximately \$105,000, compensation expenses of \$95,872 for employee stock options and increased operating expense due to expansion of our business.

LIQUIDITY AND CAPITAL RESOURCES

Nine months ended September 30, 2008 as compared to nine months ended September 30, 2007

As of September 30, 2008, the Company had cash and cash equivalents of approximately \$1,705,940. At September 30, 2008, other current assets consisted of approximately \$19.5 million and current liabilities consisted of approximately \$11.5 million, working capital amounted to \$9.68 million at September 30, 2008. The ratio of current

assets to current liabilities was 1.84:1 at the nine months ended September 30, 2008.

The following is a summary of cash provided by or used in each of the indicated types of activities during nine months ended September 30, 2008 and 2007:

	2008	2007
Cash provided by (used in):		
Operating Activities	\$ (3,721,969)	\$ (302,825)
Investing Activities	(10,924,213)	-
Financing Activities	14,387,174	48,015

Net cash flow used in operating activities was \$3.72 million during the nine months ended September 30, 2008, as compared to \$0.3 million in same period of 2007. The increase in net cash used in operating activities was mainly due to the net loss for the period, decrease in accounts payable, and prepaid equipment rents.

Net cash flow used in investing activities was \$10.9 million for the nine months ended September 30, 2008, as compared to no net cash used in investing activities for the nine months ended September 30, 2007. The increase of net cash flow used in investing activities was mainly due to the acquisition of equipment of \$113,906 and payment for construction in progress of approximately \$9.99 million for constructing a power generating system. We will use the BOT (build, operate, transfer) model to build and operate a system and charge the user of this system monthly electricity fees based on the actual power generated by the systems.

Net cash flow provided by financing activities was \$14.39 million for the nine months ended September 30, 2008 as compared to net cash provided by financing activities of \$48,015 for the nine months ended September 30, 2007. The increase of net cash flow provided by financing activities was mainly due to the issuance of common stock to an accredited investor for \$5 million, issuance of a convertible note to the same investor for \$5 million, and issuance of common stock to one of our major shareholders for \$4,032,258.

We believe we have sufficient cash to continue our current business throughout September of 2009 due to increased sales, interest revenue and rental income from operating activity.

We do not believe that inflation had a significant negative impact on our results of operations during 2008.

Off-Balance Sheet Arrangements

We have not entered into any other financial guarantees or other commitments to guarantee the payment obligations of any third parties. We have not entered into any derivative contracts that are indexed to our shares and classified as stockholder's equity or that are not reflected in our consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

Contractual Obligations

Restricted Cash in Bank

During the quarter ended September 30, 2008, we issued a bank acceptance to our vendor in the amount of approximately \$440,000 (RMB 3,000,000); the bank acceptance has a term of three months. We deposited the same amount of cash in the bank to secure the payment of this bank acceptance.

In September of 2008, we entered into a contract to install a 7-Megawatt capacity electricity-generation system for a world-class nickel-iron manufacturing company. We deposited approximately \$403,000 (RMB 2,750,000) into the bank to secure the execution of this contract.

Convertible Notes Payable

On November 16, 2007, the Company entered into a Stock and Notes Purchase Agreement ("Purchase Agreement") with Carlyle Asia Growth Partners III, L.P. ("CAGP") and CAGP III Co. Investment, L.P. (together with CAGP, the "Investors"). Under the terms of the Purchase Agreement, the Company sold to the Investors a 10% Secured Convertible Promissory Note in the principal amount of \$5,000,000 (the "First Note"). Additionally, the Purchase Agreement

provides for two subsequent transactions to be effected by the Company and the Investors, which include (i) the issuance by the Company and subscription by the Investors of a total of 4,066,706 shares of common stock of Company, at the price of \$1.23 per share for an aggregate purchase price of approximately \$5,000,000, and (ii) the issuance and sale by the Company to the Investors of a 5% Secured Convertible Promissory Note in the principal amount of \$15,000,000 (the foregoing transactions, together with sale and purchase of the First Note, are hereinafter referred to as the "Offering"). The subsequent transactions are contingent upon the satisfaction of certain conditions specified in the Purchase Agreement, including entry into specified energy and recycling project contracts and the purchase of certain energy recycling systems.

The First Note bears interest at 10% per annum and matures on November 16, 2009. The principal face amount of the First Note, together with any interest thereon, convert, at the option of the holders at any time on or prior to maturity, into shares of the Company's common stock at an initial conversion price of \$1.23 per share (subject to anti-dilution adjustments). The First Note is subject to mandatory conversion upon the consummation of the aforementioned issuance and subscription of shares of the Company's common stock under the Purchase Agreement. As more fully described in the First Note, the obligations of the Company under the First Note shall rank senior to all other debt of the Company.

As collateral for the First Note, the President and a major shareholder of the Company pledged 9,653,471 shares of the Company's common stock held by him to secure the First Note.

The First Note was considered to have an embedded beneficial conversion feature because the conversion price was less than the quoted market price at the time of the issuance. Accordingly, the beneficial conversion feature of \$5,000,000 was recorded separately as unamortized beneficial conversion feature based on the intrinsic value method. The First Note is recorded in the balance sheet at face value less the unamortized beneficial conversion feature. The terms for the First Note were amended on April 29, 2008 and the First Note was repaid in full on June 25, 2008, as described below.

On April 29, 2008, the Company entered into an Amendment to the Purchase Agreement with the investors. Under the terms of the Amendment, (i) the Company issued and the Investor subscribed for a total of 4,066,706 shares of common stock of the Company, at the price of \$1.23 per share for an aggregate purchase price of \$5,002,048, as originally contemplated under the Agreement; (ii) the Investors converted the principal amount under the First Note (and waived any accrued interest thereon) into 4,065,040 shares of common stock of the Company at the conversion price per share of \$1.23, pursuant to the terms and conditions of the First Note issued under the Agreement; (iii) the Company issued and sold to the Investors a new 5% Secured Convertible Promissory Note in the principal amount of \$5,000,000 to the Investors (the "Second Note" and collectively with the First Note, the "Notes"); and (iv) the Company granted to the Investors an option to purchase a 5% Secured Convertible Promissory Note in the principal amount of \$10,000,000, exercisable by the Investors at any time within nine (9) months following the date of the closing of the transactions contemplated by the Amendment (the "Option Note").

The Second Note bears interest at 5% per annum and matures on April 29, 2011. The principal face amount of the Second Note, together with any interest thereon, convert, at the option of the holders at any time on or after March 30, 2010 (or such earlier date if the audited consolidated financial statements of the Company for the fiscal year ending December 31, 2009 are available prior to March 30, 2010) and prior to maturity, into shares of the Company's common stock at an initial conversion price that is tied to the after-tax net profits of the Company for the fiscal year ending December 31, 2009, as described in the Second Note. The Second Note is subject to mandatory conversion upon the listing of the Company's common stock on the National Association of Securities Dealers Automated Quotations main-board, the New York Stock Exchange or the American Stock Exchange. As more fully described in the Second Note, the obligations of the Company under the Second Note shall rank senior to all other debt of the Company.

The Second Note and the Option Note are both secured by a security interest granted to the Investors pursuant to the Share Pledge Agreement.

The Second Note was not considered to have an embedded beneficial conversion feature, nor included in the computation of diluted earnings per share because the conversion price and convertible shares are contingent upon future net profits, and anti-dilutive for these shares due to the Company's net loss for the nine months ended September 30, 2008.

On June 25, 2008, the Company and the Investors entered into a Rescission and Subscription Agreement to rescind the conversion of the First Note and the issuance of conversion shares of Common Stock at the Second Closing pursuant to Amendment to Stock and Notes Purchase Agreement dated on April 29, 2008. The Company and the Investors rescinded the conversion of the principal amount (\$5,000,000) under the First Note into 4,065,040 shares of Common Stock, and the Investors waived accrued interest on the First Note. Accordingly, the interest expense which had accrued on the note has been recorded as a decrease on interest expense for the period. At the Rescission and Subscription Closing, the Company repaid in full the First Note and issued to the Investors, 4,065,040 shares of Common Stock at the price of \$1.23 per share for an aggregate purchase price of \$5,000,000.

Zhangzhi Steel New blast furnace TRT Power Generator Project

On November 11, 2007, the Company entered a Project General Contractor agreement with an independent contractor to construct a 1080 cubic meter blast furnace for the third phase of the Zhangzhi TRT project which was originally signed on June 22, 2006. The total contract price is approximately \$4,375,000 (RMB 30,000,000); the Company has paid approximately \$2,625,000 (RMB 18,000,000) for the purchase of the equipment. This project is expected to produce 45,000,000 KW/h annual energy output upon completion.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

Prior to the conclusion of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13(a)-14(c). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective in timely alerting them to information relating to us (including our consolidated subsidiaries) required to be included in our periodic SEC filings.

Changes in internal control over financial reporting

Management has previously disclosed in the Company's Form 10-KSB for the fiscal year ended December 31, 2007, that the Company's internal control over financial reporting was subject to certain material weaknesses and set forth the Company's planned steps to address these weaknesses. During the nine-month period ended September 30, 2008, the Company made the following changes in its internal controls over financial reporting that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting:

- Reorganized the accounting and finance department and hired additional accounting and operations personnel with adequate experience, skills and knowledge relating to complex, non-routine transactions;
 - Engaged a new accounting firm that has experience working with U.S. public companies;
- Hired a Certified Public Accountant with expertise in U.S. accounting principles to prepare the Company's annual report and quarterly reports;
- Established a complete management system based upon the Company's internal accounting process to ensure that internal control over financial reporting is effective;
 - Established an internal audit system with a senior accountant serving as the Company's internal auditor; and
- Made amendments to the Company's accounting system and working process (including internal audit and material transaction review and verification process) to strengthen the timeliness and efficiency of the Company's internal controls.
- Retained an outside consultant to provide the company with independent internal control risk consulting services related to the company's Sarbanes-Oxley Section 404 compliance efforts.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The Company is not currently involved in any material pending legal proceedings.

Item 1A. Risk Factors

Not applicable.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit

Number Description

- | | |
|------|--|
| 10.1 | Form of Nonstatutory Stock Option Agreement - Manager Employee under the China Recycling Energy Corporation 2007 Nonstatutory Stock Option Plan (incorporated by reference to Exhibit 10.1 to China Recycling Energy Corporation's Current Report on Form 8-K filed August 8, 2008). |
| 10.2 | Form of Nonstatutory Stock Option Agreement - Non-Manager Employee under the China Recycling Energy Corporation 2007 Nonstatutory Stock Option Plan (incorporated by reference to Exhibit 10.2 to China Recycling Energy Corporation's Current Report on Form 8-K filed August 8, 2008). |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a).* |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a).* |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.* |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.* |

* Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CHINA RECYCLING ENERGY CORPORATION
(Registrant)

Date: November 6, 2008

/s/ Guangyu Wu
Guangyu Wu
Chief Executive Officer

Date: November 6, 2008

/s/ Xinyu Peng
Xinyu Peng
Chief Financial Officer

EXHIBIT INDEX

Exhibit Number	Description
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10.2	Form of Nonstatutory Stock Option Agreement - Non-Manager Employee under the China Recycling Energy Corporation 2007 Nonstatutory Stock Option Plan (incorporated by reference to Exhibit 10.2 to China Recycling Energy Corporation's Current Report on Form 8-K filed August 8, 2008).
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a).*
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a).*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350.*
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350.*

* Filed herewith.
