CRAVATH, SWAINE & MOORE LLP

WORLDWIDE PLAZA
825 EIGHTH AVENUE
NEW YORK, NY 10019-7475

TELEPHONE: (212) 474-1000
FACSIMILE: (212) 474-3700

CITYPOINT
ONE ROPEMAKER STREET
LONDON EC2Y 9HR
TELEPHONE: 44-20-7453-1000
FACSIMILE: 44-20-7860-1150

WRITER'S DIRECT DIAL NUMBER

(212) 474-1620

THOMAS R. BROME
ROBERT D. JOFFE
ALLEN FINKELSON
RONALD S. ROLFE
PAUL C. SAUNDERS
DOUGLAS D. BROADWATER
ALAN C. STEPHENSON
MAX R. SHULMAN
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JOHN E. BEERBOWER
EVAN R. CHESLER
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MICHAEL L. SCHLER
KRIS F. HEINZELMAN
B. ROBBINS KIESSLING
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RORY O. MILLSON
FRANCIS P. BARRON
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SARKIS JEBEJIAN
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ERIC W. HILFERS
GEORGE F. SCHOEN
ERIK R. TAVZEL

SPECIAL COUNSEL
SAMUEL C. BUTLER
GEORGE J. GILLESPIE, III
THOMAS D. BARR

OF COUNSEL
ROBERT ROSENMAN
CHRISTINE BESHAR

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File Number S7-06-03

Dear Ms. Morris:

I am submitting this letter in response to the Commission's request for public comment on the proposed extension of the implementation of Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") for non-accelerated filers and newly public companies.[1] Section 404 has been identified as among the most challenging and demanding of the reforms enacted by Sarbanes-Oxley. Recognizing the significant challenges imposed by compliance with Section 404, the Commission and its staff have rightly shown a sensitivity in implementing Section 404 that has led to several delays in applicable compliance dates and various other forms of relief for differently situated issuers. Although, as stated below, I support the proposal to extend the implementation of Section 404 with respect to non-accelerated filers, the primary purpose of this letter is emphatically to support the Commission's proposal to provide a transition period for compliance with Section 404's requirements by newly public companies. While I view the further extension for non-accelerated filers as a natural outgrowth of the "growing pains" associated with Rule 404, for the reasons described below, I believe that the proposed transition period for newly public companies is critical to providing newly public companies with sufficient time to implement the requirements of Rule 404 effectively and efficiently.

I. Proposed Extension for Non-Accelerated Filers

The steps outlined by the Commission and the Public Company Accounting Oversight Board ("PCAOB") on May 17, 2006 represent a laudable response to the well-documented burdens and complexities associated with the implementation of

[1] Release No. 33-8731 (Aug. 9, 2006) (the "Proposing Release").

Section 404.[2] The steps outlined on that date, particularly potential Commission guidance on management's assessment of internal control over financial reporting ("ICFR") and proposed modifications to Auditing Standard No. 2 ("AS 2"), in my view, hold the promise of increased efficiency both in terms of company time and auditor costs. In order for the potential benefit of these initiatives to have their maximum effect, it is appropriate for the Commission to further extend the implementation of Section 404 with respect to non-accelerated filers.

It is my view that sequentially implementing the requirements of Section 404(a) and Section 404(b) is a sensible approach. The sequential approach will permit management of non-accelerated filers to perform their own Section 404(a) assessment of ICFR in lieu of being required to conduct this assessment at the same time as they are assisting their auditors in conducting the audit required by Section 404(b). Although an issuer will undoubtedly want to have significant auditor involvement during the year for which only management's assessment is required, the burden of the Section 404 implementation process should be alleviated to some extent, and the cost will in any event be spread over two years rather than being concentrated in one.

If Commission guidance on management's assessment and revisions to AS 2 are not completed promptly, I would urge the Commission to consider a further extension of implementation of Section 404 for non-accelerated filers. This will allow smaller companies to benefit from the experience of accelerated filers in complying with the new guidance and audit standard. Even assuming prompt Commission guidance regarding management's assessment of ICFR, it seems unlikely that such guidance could be provided in time for management of accelerated filers with calendar year ends to incorporate this guidance into their assessments for the year ending December 31, 2006. If this is the case, under the existing extension proposal, non-accelerated filers would be part of the first "class" of issuers required to incorporate this guidance into their management's assessment. Similarly, non-accelerated filers should not be included in the first "class" of issuers whose ICFR audits are conducted in accordance with revised AS 2. I think it would be more sensible to permit non-accelerated filers to benefit from the experience of accelerated filers in implementing any Commission guidance on management's assessment and audit firms in implementing revised AS 2 by extending implementation of Section 404(a) and 404(b) for non-accelerated filers—whether sequentially or at the same time—until a significant number of accelerated filers have completed an assessment that incorporates such guidance and have been subject to an audit conducted in accordance with revised AS 2.

For the reasons stated in the Proposing Release, if the Commission adopts a sequential implementation of Section 404(a) and 404(b), I believe that the

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[2] See SEC Press Release 2006-75 (May 17, 2006), "SEC Announces Next Steps for Sarbanes-Oxley Implementation" and PCAOB Press Release (May 17, 2006), "Board Announces Four-Point Plan to Improve Implementation of Internal Control Reporting Requirements."

management's report on ICFR of a non-accelerated filer (or a foreign private issuer that is an accelerated filer but not a large accelerated filer) should be deemed "furnished" rather than "filed" during the first year of the company's compliance with Section 404(a). The risk of an overly conservative assessment by management or allegations made with hindsight following the first audit regarding the quality of management's review strongly militates in favor of permitting these reports to be "furnished."

II. Proposed Transition Period for Compliance with Section 404 by Newly Public Companies

As described below, I believe that providing a transition period for newly public companies[3] to comply with Section 404 is of critical importance. A transition period will:

- result in equal treatment of all newly public companies;
- minimize the need for companies to make the substantial investment in time and expense to prepare for Section 404 compliance prior to becoming a public company;
- separate the initial public offering process from the Section 404 process, thereby enhancing Section 404 efforts; and
- minimize the risk that the timing of an initial public offering is influenced by the timing of Section 404 implementation.

In order to be effective and meaningful, compliance with Section 404 requires a company to invest substantial time and resources over an extended period of time. For instance, many auditors and consultants continue to advise that most companies need a full twelve months of preparation time before their first Section 404 reports are due. The required evaluations, although they are "as of" year-end, require testing and other work for a period of multiple months prior to that assessment date. The Commission's various actions to delay the implementation of Section 404 for different issuers have reflected this reality. Because no company is an accelerated filer with respect to its first required annual report on Form 10-K, newly public companies have received the benefit of the Commission's prior extensions of the implementation of Section 404 for non-accelerated filers. Assuming the Commission adopts the further extension of the implementation of Section 404 for non-accelerated filers contemplated by the Proposing Release, newly public companies will benefit from that extension as well.

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[3] The term newly public companies includes all companies that complete an initial public offering—whether by a "traditional" IPO of equity securities or by registering an exchange offer for debt securities that were initially issued in a Rule 144A or other unregistered transaction.

However, following final implementation of Section 404 for non-accelerated filers, a company intending to go public would face the stark and rather dire choice of having to begin preparations for Section 404, at considerable cost, prior to the time the company is public or having to accept an almost certain inability to comply meaningfully with the requirements of Section 404. For example, assuming Section 404 is fully implemented for non-accelerated filers for years ending after December 15, 2008, a calendar-year company that completes its initial public offering in October 2008 will either need to have made substantial progress toward compliance with Section 404 before that time or will face severe and possibly insurmountable difficulties in including the required Section 404 reports with its first 10-K filing due in March 2009. Section 404 does not, and is not intended to, apply to private companies. Under the existing rules, however, private companies planning to become public companies would effectively be required to bear considerable costs, both monetary and otherwise, due to the requirements of Section 404. These costs would need to be incurred prior to a company becoming public or even knowing for certain that it will become public. The proposed transition period will substantially alleviate these consequences by providing companies with a minimum period of time after they become public to comply with the requirements of Section 404.

When analyzing the costs and benefits of its initial rulemaking under Section 404, the Commission noted that it was allowing an extended period of time for public companies to comply with the new rules. In that regard, it noted that

> A longer transition period will help to alleviate the immediate impact of any costs and burdens imposed on companies. A longer transition period may even help to reduce costs as companies will have additional time to develop best practices, long-term processes and efficiencies in preparing management reports. Also, a longer transition period will expand the period of availability of outside professionals that some companies may wish to retain as they prepare to comply with the new requirements.[4]

Commission Chairman Christopher Cox reaffirmed this sentiment just last month by emphasizing that the proposed rule modifications will provide "further relief for smaller companies and most foreign issuers" and will "allow time for the Commission and the PCAOB to redesign Section 404 implementation in a way that is efficient and cost effective for investors."[5] The Commission's analysis applies all the more in the situation of a newly public company. Unless the Commission provides an equitable

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[4] Release No. 33-8238 (June 5, 2003), Section V.B.

[5] SEC Press Release 2006-136 (Aug. 9, 2006), "SEC Offers Further Relief from Section 404 Compliance for Smaller Public Companies and Many Foreign Private Issuers."

transition period, these companies will not enjoy any of the potentially reduced costs and increased benefits that the Commission's continued refinements to Section 404 have afforded—and are expected to continue to afford—other companies.

I believe the Commission greatly increases the chances that newly public companies will be able to meet the high standards inherent in Section 404 if it affords them the time they will need to prepare for full compliance. As the Commission understands, the offering period for an initial public offering is a demanding time for companies, which may be relatively small and young and already strapped for personnel and cash. It is unrealistic to expect companies in such a situation to put in place the necessary systems and processes for full compliance with Section 404. It would be a far better system that allowed a company to put its best foot forward for its offering process and then turn, with its best foot again available, to the challenges of complying with Section 404.

Without the proposed transition period there is a very real, and unfortunate, possibility that there will be a lower quality of Section 404 compliance and the Commission will be stymied, with regard to this subset of companies at least, in its admirable goal of providing better reliability of financial statements and financial reporting. Neither investors nor newly public companies want this result, and it is in the public interest generally for the Commission to take reasonable steps that would help prevent it. John W. White, Director of the Division of Corporation Finance, recently explained that "[q]uality financial reporting is a critical cornerstone to our capital markets, and investors are entitled to rely upon it. Section 404 has a key role to play in enhancing the reliability of public companies' financial statements."[6] The proposed transition period for newly public companies would improve the quality of Section 404 compliance by giving those companies more time to comply with the requirements.

Absent a transition period for newly public companies, we also face the very real prospect that there will be unintended, and significant, effects on the business and capital-raising decisions that companies must make. For example, prior to the most recent extension of the Section 404 implementation date for non-accelerated filers, those of us in the private bar who are active in representing underwriters and issuers during initial public offerings heard credible stories of issuers that were considering allowing Section 404 to dictate the timing of their offerings by delaying their initial public offering until after the end of their fiscal year in order to "buy" an additional twelve months to comply with Section 404. Similarly, an exchange offer might be delayed following a Rule 144A debt offering in order to provide the issuer with more time to comply with Section 404 once it becomes a public company (as will happen when it exchanges the Rule 144A securities with registered ones). Rather than being able to respond solely to the conditions of the market and their own business, these companies are finding their capital-raising decisions and timing to be driven by regulatory forces that seem almost

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[6] SEC Press Release 2006-112 (July 11, 2006), "SEC Moves Forward on Sarbanes-Oxley 404 Improvements."

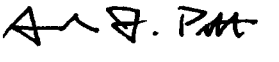
capricious in this regard. At the margin, these companies may elect to pursue a non-U.S. listing rather than a U.S. listing. I believe this consequence was unintended by Sarbanes-Oxley and the Commission, and I submit that it is unfortunate and should be avoided if possible.

In the Proposing Release, the Commission solicits comments on whether it should adopt a transition period only for companies that become public in the third or fourth quarter of their fiscal year. I do not believe that the Commission should adopt this alternative transition structure. To do so, in my view, would merely introduce another arbitrary date (between the last day of the second fiscal quarter and the first day of the third fiscal quarter) into the initial public offering planning process.

* * *

In closing, let me state my appreciation and support for the Commission's efforts to implement Section 404 as sensibly as possible and to understand the consequences and ramifications of Section 404 for public companies, our capital markets and investors alike. I believe that the proposals to extend the Section 404 compliance dates for non-accelerated filers as well as the proposed transition period for compliance with Section 404 by newly public companies are indicative of the Commission's hard-working efforts to implement these rules fairly and thoughtfully and should be adopted promptly.

Respectfully submitted,



Andrew J. Pitts

Nancy M. Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090