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VIA E-MAIL: rule-comments@sec.gov

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Amendments to Financial Disclosures about Acquired and Disposed Businesses
File Number S7-05-19

Dear Ms. Countryman:

We are grateful for the opportunity to comment on the release (the "Proposing Release") of the Securities and Exchange Commission's (the "Commission") proposing revisions (the "Proposed Revisions") to the rules governing the disclosure requirements for financial statements and other financial information relating to acquisitions and dispositions of businesses. We believe the Proposing Release takes meaningful and important steps towards rationalizing the disclosure rules and in easing the compliance burden for registrants, while making disclosures about acquired businesses and dispositions more useful to investors. Consequently, we are broadly supportive of the Proposed Revisions. Capitalized terms used and not otherwise defined in this letter have the meanings assigned to them in the Proposing Release.

In response to the Commission's specific requests for comment, we are providing for consideration by the Commission and the staff of the Commission's Division of Corporation Finance (the "Staff") our suggestions for ways in which the Proposed Revisions could be further improved. These suggestions relate to the following areas:

- the determination date and valuation methodology used for the Investment Test,
- the income measure used under the Income Test,
- the proposed requirement to include pro forma adjustments for reasonably estimable synergies in pro forma financial statements, and
- the amount of time registrants have to file pro forma financial statements following the consummation of a significant disposition.

1. Significance Tests—Investment Test

We support the Commission's proposal to revise the Investment Test so that both the numerator and denominator reflect fair values. We offer two suggestions for further enhancements. One relates to the date as of which the registrant's worldwide market value is determined. We propose to use a date that is tied to the date the acquisition is consummated or the date the parties are legally bound to consummate the acquisition. The other suggestion proposes taking into account a registrant's net debt to more accurately measure the value of the entire enterprise and thereby prevent the significance determinations from being skewed by differences in capital structure between the registrant and the target.

a. Determination Date

Pursuant to the current requirements for significance determination, the Investment Test measures the purchase price paid by the registrant as a percentage of the registrant's total assets. As the Commission highlights in the Proposing Release, the purchase price will tend to represent the fair value of the underlying business being acquired, while the carrying value of the registrant's total assets may not fully reflect the registrant's fair value at the time of determination in connection with an acquisition. This mismatch, where present, often overstates the significance of the acquisition to the registrant. The Proposed Revisions address this by replacing the registrant's total assets with the aggregate worldwide market value of its common equity, which will represent the market's view of the fair value of that equity. We are supportive of this change to the Investment Test because we believe it is a more comparable analog to the purchase price of the business being acquired.

The proposed amendments would provide that aggregate worldwide market value of the registrant's voting and non-voting common equity shall be determined as of the last business day of the registrant's most recently completed fiscal year. We believe that the determination date tied to end of a fiscal year can lead to arbitrary results as a registrant's market capitalization may change significantly between the end of its fiscal year and the date of the relevant acquisition. This change can be due to a variety of factors, including more recent earnings information, material developments involving the registrant's business, such as the completion of a significant acquisition, or general stock market trends. As a consequence, a registrant's worldwide market value as of the preceding fiscal year-end is likely to over- or understate the significance of the acquisition on a fair value basis at the time of the acquisition and will most likely not be an accurate measurement of significance.

Measurements for significance purposes that are based on financial statement metrics should be tied to a financial statement period or period-end, but this is not necessary for measurements that are derived from market value. For many registrants their equity trades on a market where an input to determine value is updated every day. We note that in other contexts, the Commission's rules use the market value of a registrant's securities during a certain time period preceding the filing of a registration statement, such as in the case of Form S-3 eligibility or WKSI status. We believe that a similar approach could be employed here. The measurement period for the determination date could be tied to the date of the first confidential submission or the filing of the relevant registration statement or to the date that the registrant enters into a legally binding agreement with respect to the acquisition. The latter would have the benefit of providing greater planning certainty to registrants and would also be consistent with the underlying fair market value concept of the Proposed Revisions. This is because the agreed purchase price will tend to reflect the value of the target at the time the acquisition agreement is signed and the value ascribed to the acquirer should too.

b. Enterprise Value

As currently structured, the Investment Test measures the purchase price paid by the registrant in the acquisition as a percentage of the registrant's total assets. We believe the measures being compared can potentially result in two mismatches. The first relates to a combination of *fair value* (the purchase price) in the numerator with *book values* (total assets) in the denominator. The second is caused by the fact that the numerator is a *net* measure that accounts for liabilities while the denominator is a *gross* measure that does not.

The Proposed Revisions would address the first potential mismatch by replacing the book value of the registrant's total assets in the denominator with the registrant's worldwide market value. As a result, both numerator (purchase price) and denominator (worldwide market value) of the test would be based not on book values but on fair values.

However, the Proposed Revisions would not necessarily eliminate the second potential mismatch. The numerator of the Investment test, both under the existing rules and according to the Proposed Revisions, is the purchase price for the acquisition as determined in accordance with GAAP. Under U.S. GAAP, the purchase price represents the "consideration transferred" within the meaning of Accounting Standards Codification 805 – Business Combinations. This is the consideration delivered to the target's owners for the net assets acquired (gross assets acquired less liabilities assumed). Pre-acquisition debt and other liabilities of the target that are assumed by the acquirer are not considered part of the purchase price. The GAAP purchase price is therefore the consideration paid for the *equity* of the acquired business, which is equal to the *net assets* of that business and therefore accounts for its liabilities. It is a *net* measure of the fair value of the acquired business. The registrant's *total assets*, by contrast, do not reflect its liabilities. They are a *gross* measure of the registrant's book value.

The current Investment Test compares the net assets of the acquired business, measured at fair value, to the total assets of the registrants, measured at book value. Directionally, this mismatch between *net assets* and *total assets* tends to *reduce* the measured significance of the acquisition. This effect is exacerbated when the acquired business has non-operating liabilities, such as debt, which the registrant has to assume and which therefore reduce the purchase price. The corresponding reduction of measured significance is usually more than compensated, however, by the first mismatch between fair value in the numerator and book values in the denominator, which works in the opposite direction.

The Proposed Revisions would lessen the impact of the second mismatch (mixing net and gross measures). This is because the purchase price in the numerator would continue to represent the fair value of the net assets, or equity, of the acquired business, and the denominator would be changed to represent the fair value of the registrant's common equity. As a result, the Investment Test would compare equity values with equity values, or net measures with net measures.

However, the Proposed Revisions have the potential to introduce new anomalies when there are meaningful differences in capital structure between the registrant and the acquired business. We believe the severity of these anomalies will roughly correlate with whether the acquired business is a private company that is delivered by the seller on a cash-free/debt-free basis or is itself a public company with its own debt[1] that the registrant assumes in connection with the acquisition. In the case of a private company target the purchase price will typically represent the entire value of the target business, while in the case of a public company target it will only represent the value of the target's equity net of its debt. But even in acquisitions of public companies differences in leverage levels can skew the significance determination under the Proposed Revisions. If the target has relatively less debt the use of equity value will overstate, and if the target has relatively more debt it will understate, the significance of the target to the registrant.

This potential for anomalous significance results caused by differences in capital structure can be avoided by using enterprise value, which is a capital structure-neutral measure of the fair value of a business. While there are differences in the precise definition of enterprise value depending on the purpose for which it is being used, one basic definition takes the fair value of the equity and then adds total debt and subtracts cash and cash equivalents. Debt less cash and cash equivalents is often referred to as net debt.

If the Commission decides to base the Investment Test on enterprise value rather than equity value, it will need to do that not only in the denominator but also in the numerator. This means that rather than simply using the GAAP purchase price as the numerator, the Investment Test would use as the numerator the sum of the purchase price paid and the amount of net debt assumed. Using enterprise value in the denominator, but the purchase price alone in the denominator, would tend to understate the significance of acquisitions when they involve the assumption of debt.

We believe that enterprise value would more closely calibrate the Investment Test to how investors actually think about the value of a company and the relative significance to it of an acquisition or disposition. Enterprise value has the further benefit that its components (market value of the registrant's common equity, total debt and cash and cash equivalents) are at least as readily available and as objectively determined as the market value of the registrant's common equity alone.

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1 This would include private equity-owned companies and other private companies that have their own debt.

2. Significance Tests—Income Test

We welcome the Commission's proposals to revise the Income Test by adding a revenue component, which we believe will address many circumstances that would otherwise produce anomalous results, as well as to revise the net income component calculation. However, rather than use income or loss from continuing operations after income taxes, we ask the Commission to consider the benefits of instead using, or permitting registrants to use, earnings before interest expense, income taxes, depreciation and amortization ("EBITDA"). We respectfully submit that this would better align the Income Test more closely with the measure that, in our experience, investors are more likely to consider in evaluating the contribution of a proposed acquisition. Furthermore, in many requests for relief to address situations where the existing Income Test produces anomalous results, the Staff has granted relief based on significance calculations referencing EBITDA. By prohibiting adjustments to EBITDA for purposes of this test, the Commission could ensure consistency in the calculation of the measure and comparability across companies.

3. Pro Forma Financial Information—Adjustment Criteria and Presentation Requirements

The Proposed Revisions would replace the existing criteria for pro forma adjustments with a simplified framework based on two categories: (i) "Transaction Accounting Adjustments" that reflect the accounting for the transaction and (ii) "Management's Adjustments" that reflect reasonably estimable synergies and other transaction effects that have occurred or are reasonably expected to occur. The Proposing Release notes that the simplified requirements would provide flexibility to include forward-looking information that gives effect to the synergies and other transaction effects identified by management in determining to consummate or integrate the transaction. While we support the Commission's stated objective to provide more information to investors, we urge the Commission to consider whether requiring reasonably estimable synergies and other forward-looking transaction effects to be reflected in the pro forma adjustments could have the unintended consequence of a chilling effect on disclosure that is otherwise helpful to investors.

Where pro forma financial information is included in an offering document, the company's auditors are normally requested by the underwriters to comment on such information as part of their comfort letter procedures and findings. These procedures include enquiring of management as to the basis of its determination for the pro forma adjustments and as to the compliance of the pro forma financial information as to form with the requirements of Regulation S-X and checking the arithmetic accuracy of the application of those adjustments to the historical amounts. On the basis of these procedures, the auditors typically provide negative assurance regarding such form compliance and application of the pro forma adjustments to the historical amounts.

We believe that requiring the inclusion of reasonably estimable synergies as part of pro forma adjustments could create pressure to understate such adjustments in order to meet such criteria as the auditors may develop and establish to provide requested comfort under the Proposed

Revisions. Moreover, the existing PCAOB standard for the procedures auditors perform to provide comfort on pro forma financial information was prepared under the existing version of Article 11. Its application to Management's Adjustments is unclear and may require rule-making by the PCAOB.

This could result in the preparation of two different synergy estimates: (i) a measure of the synergies and other transaction effects that meets the criteria for disclosure in the pro forma adjustments and that is capable of satisfying the auditor's comfort procedures, and (ii) management's estimate of the actual total expected synergies and other transaction effects that it would prefer to share with investors and the market. Companies may be reluctant to disclose the latter to the extent it is inconsistent with the measure of synergies and other forward-looking effects that is included in public filings and receives the imprimatur of the auditor's comfort process. In this way, the Proposed Revisions could limit the information that is potentially important to investors. Companies that decide to separately disclose synergy estimates that are different from those included in the Management's Adjustments in the pro forma financial statements may incur incremental liability risk resulting from the discrepancy in the numbers and could trigger Staff inquiry as to the basis for the difference. In many cases, companies may not have a choice but be forced to disclose non-auditor approved synergy estimates in merger proxy statements because they were considered as part of the board's decision-making process.

We submit, therefore, that the existing rules already work well. They serve the objective of ensuring a presentation of pro forma information that is reliable and useful to investors, while still eliciting management's good faith and supportable estimates of synergies and other transaction effects in disclosure outside the pro forma adjustments. The mandatory inclusion of such estimates in the pro forma financial statements themselves could have unintended consequences and ultimately reduce the amount of relevant information available to investors or expose companies to incremental liability.

4. Business Dispositions

Items 2.01 and 9.01 of Form 8-K require that registrants file pro forma financial statements within four business days of the consummation of a significant disposition. Unlike pro forma financial statements in connection with acquisitions, which generally require an income statement only for the most recent fiscal year and interim period, a pro forma income statement in connection with a disposition that satisfies the criteria for discontinued operations generally needs to cover the past three fiscal years. We support the Commission's proposal to raise the significance threshold for business dispositions from 10% to 20%, in order to conform the significance tests and threshold for business dispositions to those used for acquired businesses. However, we would ask the Commission to consider extending the deadline for filing of the Form 8-K required upon consummation of a significant disposition.

Compared to the relatively long lead time typical of most acquisitions, a decision to undertake a significant disposition may be made on a relatively short timeline. This is even more likely to be the case for distressed companies or where the disposition does not require any regulatory approvals. The existing four business day filing deadline can result in registrants delaying the consummation of significant disposals until pro forma financial information can be prepared, which could in many instances be a burden on the registrant outweighing the benefit to investors of timely disclosure.

We respectfully submit that extending the deadline for filing pro forma financial information in connection with a significant disposition to 60 days would appropriately balance registrants' compliance burden with the imperative of providing timely disclosure to the market.

We welcome the opportunity to discuss our comments as well as to answer any questions the Commission or the Staff may have in connection with this letter. Any questions about this letter may be directed to Richard Alsop, Harald Halbhuber, Jonathan Handyside or Lona Nallengara of Shearman & Sterling LLP at +1 212 848 4000.

Very truly yours,

Shearman & Sterling LLP