



Client Alert



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Responding to the SEC Comment Letter

Each year the staff of the Division of Corporation Finance (the "Staff") of the Securities and Exchange Commission ("SEC") issues approximately 2,200 comment letters on the registration statements and reports filed under the Securities Act of 1933 and the Securities Exchange Act of 1934. Responding to these comment letters absorbs a tremendous amount of the time and resources of management teams, their counsel and the auditors. Below are some practical considerations for making the process as efficient as possible.

Be prepared before the letter arrives. We can't predict exactly when the company will receive a comment letter. But we can anticipate certain patterns.

Any time the company files a registration statement there is a possibility it will receive a comment letter, but some registration statements are more likely than others to trigger one. Forms S-8 almost never prompt a comment letter. Probably less than 50% of resale Forms S-3 will receive one. Automatic shelf registration statements will go effective immediately and thus there will be no comment letter before effectiveness, and our experience has been that seldom does a comment letter arrive after effectiveness. On the other end of the spectrum, the SEC has a policy of always commenting on registration statements for initial public offerings. Other registrations statements on Forms S-1 and S-11 frequently receive a comment letter, with a pattern that is hard to summarize succinctly, but the following factors usually come into play: the time elapsed since the last time the company experienced a comment letter process; a history of the company's past issues raised in comments; the complexity of the offering and the disclosure; the industry of the company; and the SEC's current focus on certain issues.

For 1934 Act filings, the SEC has a policy (imposed by the Sarbanes-Oxley Act) of reviewing each company's periodic reports no less frequently than once every three years. As a result, if the company has not received any comments for a period that is approaching three years, watch out! Section 408 of Sarbanes-Oxley also specifies factors the SEC is to consider when scheduling reviews, including market capitalization, financial restatements, volatility of the company's stock price, and the P/E ratio. In addition to these scheduled reviews, the SEC will conduct some targeted reviews. Certain types of filings tend to trigger these reviews, for instance, Forms 8-K reporting a change in auditors, a resignation of a director, or a material acquisition, and any filing

that reports a financial statement restatement.

While waiting for the next comment letter, I generally advise companies to consider the following preparedness steps: monitor SEC guidance on disclosure issues; monitor accounting pronouncements that may impact the company's financial statements; maintain a file of documentation for significant disclosure matters; prepare memoranda to document significant events and changes in disclosure and accounting policies; review comment letters for other companies in the same industry; periodically review the company's previous comment letters and compare them to current filings to make sure that the company continues to comply with agreements made or requirements imposed in connection with prior resolutions of issues. Management also should be aware that the Staff may and probably will review other company communications, such as press releases, investor relations pages, management speeches and conference presentations, and compare them to the information in the company's SEC reports. The company should monitor those other communications for consistency with its SEC reporting.

Assembling the team to compile the response. You want to be sure to have the appropriate personnel engaged in the response effort. This team should include the people who have primary responsibility for preparing the SEC disclosure documents under review. Be sure to include personnel from legal, accounting, and corporate governance, as appropriate, depending on the nature of the issues raised in the comment letter. The company should also involve outside counsel and the auditors. The Staff tends to have certain preferred approaches to various accounting and disclosure issues which are not readily apparent from reading the statute and the rules. Experienced SEC counsel and auditors will be sensitive to such issues and can guide the company through the comment process more efficiently. Sometimes the comment process leads to the need to amend a filing, and this will frequently require the consent of the auditors, so having them engaged early will avoid delays later in the process. In addition, to the extent you are negotiating with the Staff regarding accounting methods, the auditors must concur in the proposed method.

Divide and conquer but remain well coordinated. Assign primary responsibility for the response to each comment or group of comments (for instance, all the comments on MD&A may be assigned as a group). However, to the extent multiple persons are working on the responses, there will need to be careful coordination throughout the process to maintain consistency in approach and style (see discussion below). There should also be one designated person to oversee and coordinate all the responses.

Ask the Staff for additional time. The comment letter will typically include a deadline to respond. We usually see a time frame of 10 days for 1934 act reports. The Staff will usually grant reasonable requests for additional time. We typically ask for a few (3 to 5) additional days for a comment letter that does not appear to have any controversial or overly complex issues. For those that do, we try to come up with a reasonable estimate of the amount of time that will be required to deal with the issue and ask for that.

Do not hesitate to ask for clarification. If you are uncertain about what information the Staff is seeking or otherwise do not fully understand the comment, place a call to the Staff person identified in the letter

and ask for additional explanation. The Staff does not mind such inquiries and indeed encourages them. When contacting the Staff, it usually is best to make the initial contact to the most junior legal or accounting professional, referred to as the “examiner,” depending on whether the comment in question is a legal or accounting comment. The examiner will work within the Staff to involve a more senior person as needed. It is best to try to avoid “going over the head” of the examiner because that will generally irritate the Staff. The comment letter will indicate the names and telephone numbers of the first line legal and accounting examiners and of their immediate supervisors. Occasionally, if there is a severe time pressure and you cannot contact the examiner, you may need to contact the supervisor.

Maintain objectivity. Management teams can sometimes become defensive when receiving comments on their work. We advise them to remain objective and to not interpret comments as an attack on the quality of the work. Expressing anger towards the Staff is rarely productive. It also helps to be aware that the initial comments represent the beginning point for the Staff’s inquiries, and the Staff is usually open to well-reasoned counterpoints.

Assume that the text of your responses may end up in your SEC reports. High among the reasons to be careful in your response is the possibility that you may have to add part or all of your response into the next SEC report. To bolster the existing public disclosure, management teams frequently will respond with additional background material or explanations. The Staff frequently will tell the company to add this material into future filings. You may be living with that language for a long time.

Remember that all comment letters and responses will become public on EDGAR. Usually about 20 business days after the comment process has run its course, the SEC will post all the correspondence on EDGAR. Your battles with the Staff will become publicly accessible. Choose your words wisely.

Carefully think through all the implications of your responses. In the rush to dismiss a particular concern of the Staff, it is easy to forget additional ramifications from the response. For instance, once you assert that the company is following a certain accounting treatment, it may be difficult to change it later. In addition, once you agree to make a change to your disclosure, it may be awkward to reverse that agreement.

Maintain consistency in your answers. As the comment process unfolds across several items of correspondence, it is important to maintain a consistent approach on each comment or issue. If you change the justification or reasoning behind your accounting and other disclosure positions, you may lose credibility with the Staff. Also make sure there is consistency among the various responses within the same comment letter. For instance your approach to the accounting treatment and footnote disclosure in the financial statements may affect what you are required to disclose in MD&A. If you assert that an item is material to your financial statements, but say you don’t think it is required to be discussed in MD&A, the Staff may challenge the apparent inconsistency.

Watch out for the fishing expedition. Sometimes the Staff will ask some open ended questions which will

seem innocuous. Watch out! You may receive subsequent comments which involve significant changes to your financial statements or other disclosure if the Staff doesn't like your answer. A good example is a comment about your segment disclosure. The comment may ask how you determined which segments to report. If the Staff doesn't agree with your analysis they may ask you to revise your financial statements to reflect additional segments. Also be careful about any comments about revenue recognition and non-GAAP financial measures. These are tricky areas and once you take a position as to the company's approach it may be difficult to change it.

Consider which comments may require an amendment to your previously filed report as opposed to merely requiring enhanced disclosure in future reports. In some comments the Staff may suggest that you will need to amend the report to provide the additional disclosure requested by the Staff. However, the Staff may be open to an argument that the issue is not sufficiently material to cause the report to be materially misleading, in which case the company may request that the Staff forego requiring a current amendment and allow the company to wait to provide the additional disclosure in the next periodic report to be filed. The company should be prepared to provide a principled analysis of the effect of the proposed change on the overall disclosure to investors. It is also helpful to offer sample disclosure to be provided in the next report. Be mindful that once you have agreed to make a change in future filings, the Staff may insist on an amendment to your past filings. In some comments the Staff may actually state that the disclosure needs to be provided later. In most such instances, the Staff will request the sample disclosure.

Prepare a response that is persuasive, clear and concise. Draft each response to present clearly the company's position on the pertinent issue in a way that will persuade the Staff that it is the correct position. Be sure to cite applicable authoritative accounting pronouncements and SEC guidance. Explain how the company's approach serves to satisfy the SEC's requirements while providing good disclosure to investors. Avoid conclusory or argumentative statements. If the company's major argument is that the technical application of the rule will place too large of a burden on the company, explain how the company is burdened and how the alternative provided by the company will provide adequate disclosure for investors (and be prepared for the possibility that you will lose this argument).

The response letter should include the "Tandy" language. The Staff requests companies to represent in writing that they will not use the SEC's comment process as a defense in any securities related litigation against them. This request is known as a "Tandy" letter. The representation must come from the company and not outside counsel, so if the response letter is signed by outside counsel, the company will need to submit a separate letter or exhibit.

Ask for confidential treatment of sensitive materials. SEC Rule 200.83 allows companies to maintain confidentiality for certain materials provided to the SEC in the comment process. That rule requires the filer to submit its response letter using two separate documents -- a response to the comment letter without the confidential information, and a separate paper document including the confidential information. Absent a confidentiality request under this rule, all materials provided to the Staff will be subject to disclosure to

any party upon a Freedom of Information Act (“FOIA”) request. Unlike requests for confidential treatment of exhibits under Rule 406 and Rule 24b-2, under Rule 83 the company does not have to provide a justification for confidential treatment until a FOIA request is made by another party to the SEC for copies of the confidential material. The confidential treatment under Rule 83 expires after 10 years unless the company files a request to renew it.

The initial correspondence to the SEC transmitting the materials must indicate that the company is invoking Rule 83. The confidential material should be kept in a separate document from the response letter to the Staff, and the company should be careful not to provide significant portions of the confidential documents in the text of the response letter. The company must mark each page with “Confidential Treatment Requested by [name]” and an identifying number and code, such as Bates-stamped number. The words “FOIA Confidential Treatment Request” must appear on the top of the first page of the request. The submitter must include his or her name, address, and telephone number and inform the FOIA Office of any change of address, telephone number, or representation. A written request must be given to the Staff and a copy of the request, but not the confidential information, should be faxed to the FOIA Office or mailed to the FOIA Office. The current address and fax number can be found on the SEC’s web site. The request must be submitted on paper, even if the requester is an electronic filer. The request can be included in the response letter as long as the company provides a hard copy of the response letter to the Staff.

Consider requesting a return of supporting materials. The company can request the return of supplemental materials submitted with the response letter, under Rule 418(b) or Rule 12b-4. This is another way to avoid publication of sensitive material. The supplemental materials should be submitted in hard copy (not filed on EDGAR), and the company’s request should accompany the submission. The SEC will honor the request if it determines that the return of the materials is consistent with investor protection and the provisions of the FOIA.

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