

May 14, 2000

Kathryn A. Oberly
Vice Chair and
General Counsel

Office of the Chief Accountant
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D. C. 20549

OFFICE OF
CHIEF ACCOUNTANT
MAY 16 PM 4:06
S.E.C.

Re: Ernst & Young/Cap Gemini Transaction

Ladies and Gentlemen:

We hereby request that the Staff of the Securities and Exchange Commission advise that, based upon and subject to the matters referred to herein, it will not recommend that the Securities and Exchange Commission take enforcement action against Ernst & Young LLP, Ernst & Young U.S. LLP or any of their respective subsidiaries (collectively, "EYUS"), or any other firms not owned by EYUS but conducting audit activities outside the United States for SEC registrants under the name "Ernst & Young" or derivations thereof (collectively, "EYI" and, together with EYUS, "EY"), asserting that EY is not "independent" based upon the attribution to EY of the activities of Cap Gemini, S.A. ("Cap Gemini") following the completion of the transaction described below.

Legal Analysis

The federal securities laws require that financial statements filed with the Commission by public companies, investment companies, broker-dealers, public utilities, investment advisers and others be certified (audited) by independent public accountants.¹ The federal securities laws also authorize the Commission to define "accounting, technical and trade" terms used in the federal securities laws.²

The Commission has adopted Rule 2-01 of Regulation S-X, which provides, in part, that the "Commission will not recognize any certified public accountant or public accountant who is not in fact independent."³ Rule 2-01(b) provides that an accountant will not be considered independent of a company in which "he, his firm, or a member of his firm had

1 See, e.g., 15 U.S.C. 77aa(25), (26), 15 U.S.C. 781, 78q, and 78m, 15 U.S.C. 79e(b), 79j, 79n, 15 U.S.C. 80a-8, 80a-29, 15 U.S.C. 80b-3(c)(1).
2 See 15 U.S.C. 77s(a), 15 U.S.C. 78c(b), 15 U.S.C. 79t(a), and 15 U.S.C. 80a-37(a).
3 17 C.F.R. 210.2-01 (1996)

... any direct financial interest or any material indirect financial interest.” Rule 2-01 further provides that:

In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.⁴

The Commission’s interpretations of Rule 2-01 are collected in Section 600 of the Codification of Financial Reporting Policies (“Codification”), entitled “Matters Relating to Independent Accountants.”⁵ Section 602.01 of the Codification states that a materiality standard is used when assessing indirect financial interests because “some latitude for judgment is necessary in order to avoid undue hardship and expense to registrants and to accounting firms having a widespread accounting practice” In addition, Section 602.02.c of the Codification restricts the independent accountant from performing “bookkeeping and related professional services” that might cause a “mutuality of interest” to develop between the auditor and its client. Finally, Section 602.02.g of the Codification addresses business relationships -- such as joint ventures, limited partnership agreements, and investments -- that may impair an auditor’s independence. That section provides, in part, that:

Direct and material indirect business relationships . . . with a client . . . will adversely affect the accountant’s independence with respect to that client. Such a mutuality or identity of interests with the client would cause the accountant to lose the appearance of objectivity and impartiality in the performance of his audit because the advancement of his interest would, to some extent, be dependent upon the client.

E&Y desires to obtain assurance that, to the extent Cap Gemini provides certain consulting services for, enters into business relationships with, and/or makes investments in E&Y audit clients, E&Y’s independence will not be deemed impaired pursuant to Rule 2-01 and Sections 602.01, 602.02.c, 602.02g, or other provisions of the Commission’s independence rules.

E&Y believes that, under the conditions detailed in this letter, it would not have a “mutuality of interest” or a “direct or material indirect business relationship” with, or a

⁴ *Id.*

⁵ Financial Reporting Codification, Section 600-Matters Relating to Independent Accountants, reprinted in SEC Accounting Rules (CCH) ¶ 3,851, at 3,781.

“direct financial interest or material indirect financial interest” in any of its audit clients that are also clients of or enter into business relationships with Cap Gemini, or in which Cap Gemini invests. This conclusion is based on the conditions detailed in this letter, which will, among other things: 1) limit at the outset and within five years end E&Y’s equity interest in Cap Gemini; 2) impose limitations on Cap Gemini’s use of the E&Y name; 3) require a strict separation of E&Y and Cap Gemini’s corporate governance; 4) forbid any revenue sharing between E&Y and Cap Gemini; 5) forbid any joint marketing agreements between E&Y and Cap Gemini; and 6) restrict any shared services between E&Y and Cap Gemini.

Factual Background

Pursuant to the Master Agreement, dated February 28, 2000 (the "Master Agreement"), and other agreements specified therein (the "Ancillary Agreements" and, together with the Master Agreement, the "Agreements"), certain of the EY firms have agreed to sell their respective Consulting Businesses, as defined in the Master Agreement (collectively, "EY Consulting"),⁶ to Cap Gemini in exchange for up to 43.5 million Cap Gemini common shares plus Eu. 375 million in cash. Cap Gemini common shares are traded in the public securities markets in France, but are not presently traded in the U.S. securities markets. A portion of the Cap Gemini common shares issuable in the transaction will be held by certain of the EY firms participating in the transaction or their partners or other equity owners; the remainder of those shares will be held by former EY partners or employees who as of the closing will become employees of Cap Gemini or its subsidiaries. Other key terms of the proposed transaction are:

1. For five years, EY will not compete with Cap Gemini by engaging in or holding itself out as engaged in the Consulting Business (as defined in footnote 6 of this letter) being transferred to Cap Gemini.
2. After consummation of the sale, there will be no corporate governance, management or direct or indirect financial ties between EY and Cap Gemini (other than EY's ownership of Cap Gemini common stock and certain rights and restrictions arising under a global shareholders agreement (the "Shareholders Agreement") to be entered into at the

⁶ The Master Agreement defines the "Consulting Business" as "the consulting and related businesses as conducted at any time during the two years prior to the closing and/or as of the Closing by the [EYUS] Partners designated as "CS Partners" on Schedule 1.1-1 [to the Master Agreement], as supplemented as of the Closing Date pursuant to Schedule 7.24 [of the Master Agreement], and other Transferred Employees."

closing of the transaction in substantially the form attached to the Master Agreement).⁷

3. The 43.5 million shares of Cap Gemini common stock (subject to adjustments as provided in the Master Agreement) to be received by EY in the transaction will represent approximately 36% of Cap Gemini's issued and outstanding common stock as of the close of the transaction, calculated on a fully diluted basis. Not less than 25% of those shares will be sold within several days after the closing in an underwritten public offering in France pursuant to an underwriting agreement with globally recognized underwriting/financial advisory firms to be entered into as a condition to the closing (the "Initial Monetization"). None of the lead managers for the underwriting syndicate for the Initial Monetization is an EY audit client. As a result, giving effect to the sale of Cap Gemini shares to be sold in the Initial Monetization, the EY audit/tax firms and/or their partners/owners will own less than 20% of the outstanding common stock, calculated either on a primary or fully diluted basis.⁸

Conditions to No-Action Confirmation

We request that, subject to compliance with the following conditions, the SEC Staff not recommend enforcement action to the Commission based on the attribution to EY of the activities of Cap Gemini following completion of the Cap Gemini transaction under the following conditions:

1. EY will own no Cap Gemini common stock within five years of the closing date (subject to the limited exception specified below in this paragraph). EYUS will own no more than 15 percent of Cap Gemini's outstanding common stock immediately following the closing. The EY

⁷ Under the Shareholders Agreement, EYUS has the right to designate a person for election to Cap Gemini's Supervisory Board (essentially the equivalent of a board of directors of a U.S. corporation) so long as EY owns over 10% of Cap Gemini's common shares. Prior to the closing, EY will irrevocably waive that right with the result that, while Cap Gemini may at its option propose a former EY partner or other person (other than a current EY partner or employee or former partner or employee with continuing financial ties to EY other than under post-retirement benefit plans available to broad categories of former personnel) for election to the Supervisory Board, EY will have no contractual or other right to require Cap Gemini to do so.

⁸ The exact number of Cap Gemini shares issued in the transaction is not presently determinable because it will depend upon whether Cap Gemini decides to acquire all of the Consulting Businesses of all EY firms. However, as indicated below, any changes will be immaterial, and in all events in no event will the shares owned by EY be over 20% of Cap Gemini's total outstanding shares (whether calculated on a primary or fully diluted basis). The number of shares issued to EYUS will represent approximately 70% of the total number of shares issued to EY in the transaction.

firms in the aggregate will not own more than 20 percent of Cap Gemini stock immediately following the closing (giving effect to the Initial Monetization and shares transferred to former partners and consulting partners and former employees). EY entities other than EYUS may retain the stock they receive in the transaction for such additional period (believed to be two years plus one day, but in all events not longer than three additional years after the five-year period), provided that (i) those entities document to the reasonable satisfaction of the Staff the substantial tax advantage that they believe necessitates the longer retention periods, (ii) EYUS has no beneficial interest in any such retained shares, (iii) the retained shares in total are less than 2.5% of Cap Gemini's outstanding common stock, and (iv) no EY partner or executive serves on Cap Gemini's Supervisory Board during the additional period. Of the E&Y firms that have entered into divestiture agreements with Cap Gemini to date, the exception in the immediately preceding sentence might apply only to the E&Y firm in Germany.

The calculation of the percentage of Cap Gemini common stock owned by EY at any particular time will be based on the percentage of outstanding Cap Gemini common stock owned by EY and/or its partners, employees and pension funds for active partners at that time. Shares covered by the Initial Monetization or owned by former consulting partners or retired partners with no continuing role or financial interest (other than through a fully funded retirement plan) in EY will be deemed not to be owned by EY for the purposes of this letter.

2. Cap Gemini will be entitled to use a variant of the "Ernst & Young" name and logo (e.g., "Cap Gemini/Ernst & Young Consulting") for a transitional period of four years, as long as:
 - (i) All publications, letterhead and stationery, name plates, office signage, business cards and similar materials clearly designate the former consulting practice of EY as being wholly owned by Cap Gemini; and
 - (ii) EY does not represent in any publication, advertisement, press release, name plates, office signage, business cards or other similar material that it is the same firm, or controls, manages, governs or is affiliated with Cap Gemini, Cap Gemini's "consulting" business or any other affiliate, subsidiary or division of Cap Gemini.

3. Cap Gemini and EY will maintain separate corporate governance, management and financial structures and interests including: separate boards of directors (including no contractual right to representation on Cap Gemini's Supervisory Board and no service on the Cap Gemini Supervisory Board by any then-active EY partner or employee or former partner or employee with continuing financial ties to EY other than under post-retirement benefit plans available to broad categories of former personnel), executives, employees, capital, credit lines or facilities, client bases, governing documents, operating policies, financial operations and financial and accounting policies. Cap Gemini and EY will not exert financial or other influence over the other party's corporate governance, management and financial structures or interests (except that, subject to the limitations specified above as to Cap Gemini's Supervisory Board, EY may exercise its voting rights in respect of its Cap Gemini common stock and as to the monetization and other provisions in the Shareholders Agreement).
4. After closing, EY will not accrue, pay to or receive from Cap Gemini any royalty, interest, dividend or other payment, whether or not tied to the performance of what is currently EY Consulting, except for dividends payable to all Cap Gemini shareholders and payments required to be made under the Agreements (e.g., working capital true-up, indemnity, etc.), which payments are described in Annex A hereto. Accordingly, EY and Cap Gemini will not share profits or revenue from consulting or any other engagements or agreements.
5. EY and Cap Gemini may, but will be under no obligation to, refer clients to one another. EY and Cap Gemini may not pay referral fees or other compensation for such referrals to each other nor to any subsidiary, affiliate, employee or agent of the other entity. EY and Cap Gemini may not enter into any co- or joint marketing, advertising or similar agreements or arrangements inconsistent with the foregoing conditions or which do not clearly state that EY and Cap Gemini are separate firms.
6. EY may enter into "shared/transitional services" agreements for internal accounting and information services, office facilities and other services specified in the Transitional/Shared Services Agreement attached and schedules annexed to the Master Agreement as Exhibit D. The principal terms for the shared services agreements are set forth in the Services Agreement and schedules annexed thereto. Shared services agreements will have varying terms (six months to three years, except for facilities

management services which will continue for the term of the associated lease, and services related to the Center for Business Knowledge). Services and facilities identified in the definitive documents and certain other assets, such as EY's Center for Business Knowledge,⁹ will be provided or shared in accordance with the Shared Services Agreement so long as (i) the former EY Consulting is physically separate from EY's other businesses and (ii) charges for such use are determined at arm's length (defined as cost, the basis historically used by EY to allocate expenses to its Consulting Business) and appropriate provision is made so that confidential information (including information maintained in the Center for Business Knowledge) is not communicated between EY and Cap Gemini. Under the Transitional/Shared Services Agreement, EY will not be receiving services from Cap Gemini and the pricing provisions of the Transitional/Shared Services Agreement will not generate a profit for EY. Cap Gemini will lease office space, other than as a sublessee or assignee of EY, for the former EY Consulting not later than the dates that existing leases expire as to space now shared by EY consulting and other EY businesses. Until such relocations are made, EY and Cap Gemini will have separate and distinct office signage and their offices will be clearly distinguishable from one another although they may share certain common facilities. The term for the provision of such services will in no event be longer than three years after the Closing (except for the CBK and facility services as aforesaid).

7. EY will consent to periodic reviews by Commission Staff or an independent party designated by the Commission or its staff to ascertain that EY is complying with the conditions herein provided.
8. In accordance with the Master Agreement, at closing, EY will cease engaging in the Consulting Business (as defined in footnote 6 of this letter), and during the period between five and ten years after the closing may not use the name "Ernst & Young" in the Consulting Business. Notwithstanding the previous sentence, EY may after five years provide

⁹ EYUS' Center for Business Knowledge ("CBK") is a facility located in Cleveland, Ohio, which operates, in essence, as an electronic library and has rapid information/content research capabilities. Under the Shared Services Agreement, as of the closing, the information primarily relating to the Consulting Business will be separated and made available only to Cap Gemini; provisions will be made so that the other content is not separately accessible by Cap Gemini personnel. While the term of the agreement relating to the CBK extends, by its terms, for three years, it is possible that Cap Gemini would have a right to use the CBK for a longer period of time in order to access content that it develops itself after the closing but stores in the CBK (subject in all events to the separate access protocols prohibiting EY personnel from accessing Cap Gemini's information and vice-versa).

the services sold to Cap Gemini if a Commission rule permits EY to provide those services or the Commission has not within five years promulgated any rule that would prohibit EY from providing those services.

9. As indicated above, not less than 25% of the Cap Gemini common shares issuable to EY in the transaction will be sold in the Initial Monetization. Up to an additional 25% of such shares will also be included in the Initial Monetization if market conditions permit. If not, a portion of the next 25% of the shares not sold in the Initial Monetization will be converted into cash at the closing and/or sold in a second underwritten public offering expected to be completed on or before April 1, 2001, or as promptly as practicable thereafter. The balance of the Cap Gemini common shares will be sold in additional underwritten public offerings to be completed on or about the closing anniversary dates specified below:

<u>Anniversary</u>	<u>% To Be Sold¹⁰</u>
Second	20%
Fourth	20%
Fifth	10%

Certain Confirmations

In connection with its request herein, EYUS hereby confirms to the Staff that:

1. After closing, EY will continue to be subject to the independence requirements of the securities laws and the SEC's independence rules and interpretations issued thereunder to the same extent as it was so subject prior to the closing.
2. EY hereby represents to the SEC Staff that it agrees to the above conditions and that it has furnished a copy of this letter (and will furnish any final agreement on this subject) to Cap Gemini. Cap Gemini will expressly acknowledge that it has been furnished a copy of this letter. EY further represents to the Staff that it is not aware of any provisions of the

¹⁰ This is the monetization schedule for EYUS. The schedule for the rest of the EY firms may vary slightly, but will still result in the sale of all shares by the fifth anniversary except in the limited circumstances noted in Paragraph 1 on Pages 4-5 of this letter.

Master Agreement or any agreement or instrument referred to therein that is inconsistent with this no-action letter in any material respect.

3. EYUS has furnished the Staff a copy of the penultimate draft of the Master Agreement and Ancillary Agreements (including without limitation the schedules, exhibits and annexes thereto) and hereby represents to the Staff that the final executed versions of such documents will not differ in any respect material to the matters referred to in this letter from the drafts so furnished.

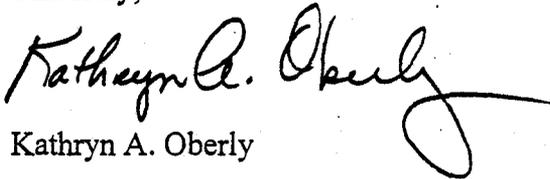
Confirmation Requested

Based upon the following representations and subject to compliance with the foregoing conditions, we hereby request that the Staff of the Securities and Exchange Commission advise that if an EY audit client is also a client of, enters into a business relationship with, or is invested in by Cap Gemini, the Office of the Chief Accountant will not assert, on any of those grounds, that EY's independence from that audit client has been impaired.

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If for any reason you do not concur with the views expressed in this letter, we respectfully request an opportunity to discuss this matter with the Staff prior to any written response to our letter. If you have any questions or need any additional information concerning the foregoing, please do not hesitate to call me at 212-773-2500 or Robert A. Profusek of Jones, Day, Reavis & Pogue, EYUS' outside counsel in this matter, at 212-326-3800.

Sincerely,



Kathryn A. Oberly

copy to: Robert A. Profusek, Esquire
Jones, Day, Reavis & Pogue

Richard A. Pollack, Esquire
Sullivan & Cromwell

POSSIBLE PAYMENTS UNDER
THE MASTER AGREEMENT

Master Agreement
(Section 2.9)

Customary closing net working capital provision to the extent that EYUS' Consulting Business' Closing Date net working capital is higher or lower than \$250 million, the excess or lower amount will be paid by Cap Gemini or EYUS, as the case may be

Master Agreement
(Section 10.3)

Customary cross-indemnity provisions for breaches of representations, warranties and covenants (subject to a \$100 million basket as to breaches of representations and warranties)

Master Agreement
(Section 9.3)

Cap Gemini to pay one half of the underwriting commissions on the first Eu. 172/share for Cap Gemini shares included in the Initial Monetization (but not on any shares sold in excess of 25% of the total number of shares included in the Initial Monetization)

Master Agreement
(Schedule 7.12(a))

Liquidated damages equal to 2.893 million Cap Gemini shares in the event of a merger with a "Big 5" firm that has not separated from its consulting business

Master Agreement
(Schedule 7.23)

EYUS to reimburse Cap Gemini for (1) up to \$37.5 million of costs incurred to separate EYUS' Consulting Business from EY LLP and (2) a total of \$60 million over three years for other separation and integration expenses