

SUMMARY OF TESTIMONY:
HEARING ON PRESERVING PARTNERSHIP CAPITALISM
THROUGH STOCK OPTIONS FOR AMERICA’S WORKFORCE

Dilution is the Real Cost of Employee Stock Options

- “In the last six months, I have surveyed in face-to-face meetings over 50 of our largest investors, and I’ve asked them that specific question: who bears the cost of the options that are outstanding? Is it the company or is it the shareholders? One hundred percent of them recognized that this is a cost that is borne by the shareholders. It’s not an expense of the company. No assets of the company are being used. And that cost comes in the form of dilution.”

*Testimony of Dennis Powell, Chief Financial Officer, Cisco Systems, at 25.**

- “The granting of options would be immediately reflected in EPS, acknowledging that a transaction has occurred. It is a cost that is a shareholder cost, not an operating cost. Every company will recognize the impact of diluted option grants upon award, without respect to vesting schedules, allowing greater comparability of financial statements from company to company. Net income will not be distorted by an option expense....Financial reporting for options will be much clearer, understandable and reflect the true substance of the transaction.”

Testimony of Sandra Wijnberg, Chief Financial Officer, Marsh & McLennan, at 35.

- “We’re not proponents of expensing options. We are proponents of expressing the potential dilution when the options are actually issued to an employee.”

Wijnberg Testimony, at 51.

- “So the proposed expensing is precisely wrong, because it ignores all of the benefits associated from using stock options.”

Testimony of Professor William Sahlman, Harvard Business School, at 42.

* All pages numbers refer to the Hearing Transcript.

- “It is not a current expense. The proposals would drive a further wedge between potential free cashflow and current income.”

Sahlman Testimony, at 53.

Mandatory Expensing Will Make Financial Statements Inaccurate and Unreliable

- “My belief is that expensing would make [our financial statements] less accurate, significantly less accurate, and harder to even understand. If you take an example of, say, the year 2000, when we issued stock options at Intel, Black-Scholes would have said expense \$2.5 billion over the next few years. Those options likely will never be exercised, so I would have a \$2.5 billion expense for cash that never outflows, for a transaction that never happened.”

Testimony of Andy Bryant, Chief Financial Officer, Intel, at 27.

- “It’s less accurate and less transparent. It’s big numbers; it’s a material difference; it’s not small numbers.”

Bryant Testimony, at 28.

- “...in 2001, the Black-Scholes valuation of the options Cisco granted to all of its employee based were valued at \$3 billion. Today, if you valued those under the same Black-Scholes model, they would be worth \$200 million, less than ten percent. I’ve got to say that within that period, one of those numbers cannot be right, and they’re certainly not reliable.”

Powell Testimony, at 88.

- “So I think it’s not just trying to get a more accurate model or adjusting for some of the things that don’t happen, like vesting or whatever. It’s about a fundamental misrepresentation of the future....So it moves the income statement and the balance sheet further from the economic truth, not closer.”

Sahlman Testimony, at 42-43.

- “I just want to point out that the Association of Finance Professionals does not believe that expensing options is the right approach. I’d also like to

point out that the models that are talked about will not yield an output or a valuation that is reliable. It will distort the financial statements and make them less reliable, less transparent, and we believe that it is not the right approach.”

Testimony of James Haddad, Association of Finance Professionals, at 46.

- “I think what you’re doing is a little misleading. There are estimates out there. There is no question that we make estimates, but I buy the inventory or I buy the small company or whatever it is, so we know the cash, we true it up at the end, and we get it generally right, and no one is perfect, and we certify that it’s materially accurate. If I sign that certification based on expensing stock options from the year 2000, I today – I’d have to say I’m lying, they’re not true. You cannot get within a half a billion dollars doing Black-Scholes, within half a billion of the right numbers.”

Bryant Testimony, at 85-86.

- “One of the key differences between what Mr. Herz was reciting in terms of all those estimates that are in the financial statements and what has been proposed with respect to expensing stock options, is that all of those other estimates get trued up in reality over time. And what has been proposed today, I think, by the FASB, has absolutely no true-up mechanism to reality. So...you have absolutely no way of ever recapturing a bad estimate of these stock options.”

Wijnberg Testimony, at 88-89.

- “I will guarantee you that the CEOs that sign their books that they’re now required to do, saying the accuracy of their earnings, the one thing they know that isn’t accurate is the value they put on those options. It just cannot be. And the Black-Scholes method was determined for options that were immediately tradable, at that moment. Stock options aren’t tradable for as much as five years. It is an unknowable thing.”

Barksdale Testimony, 24.

- “The Black-Scholes method clearly does not work...and I think everybody here readily recognizes that.”

Testimony of Grace Hinchman, Financial Executives International, at 63.

Mandatory Expensing Will Harm Rank-and-File Employees

- “...there is a lot of preliminary evidence suggesting that expensing will concentrate options among the top executives and hurt the chance of employee ownership for the middle and working classes and the employees of technology companies.”

Written Testimony of Professor Douglas Kruse, Rutgers University, May 8, 2003.

- “...the expectation of stock option expensing appears to be resulting in a protection of and enhancement of the concentration of the stock option phenomenon in the hands of the highest executives.”

Supplemental Written Testimony of Joseph Blasi, May 8, 2003.

- “...stock option expensing may have the unintended economic consequence of rolling back partnership capitalism on a much wider scale in the United States.”

Blasi Supplemental Testimony.

- “The risk is that we create partnership capitalism for the top and destroy it for the rest of the country. There’s a risk that the average American citizen, middle class and working class workers, will have their broad-based employee ownership and profit sharing extinguished.”

Blasi Testimony, at 67.

- “So we don’t understand why in the interest of corporate reform and reducing executive greed, we should have the unintended consequence of encouraging companies to respond by concentrating the percent of incentive and stock option pie at the top.”

Blasi Testimony, at 69.

- “Any solution that does not protect the working people of our country from becoming entangled in the maze of rules and regulations will be unacceptable.”

Statement of Senator Mike Enzi, at 8.

Mandatory Expensing Will Harm the Economy

- “...it makes it very difficult for me just to sit back and say, well, I’m going to let unelected people make decisions that can have such a harmful impact on the people, enterprises, and innovations of this country.”

Statement of Senator George Allen, at 92-93.

- “...big businesses grew from small businesses. Options have been a primary tool for attracting talent to a firm with little cash. We do not want a solution at the expense of small business.”

Enzi Statement, at 8.

- “The FASB process didn’t adequately consider alternatives to expensing, in my opinion, and, again, if it’s finalized, the rule will hurt the economy, reduce the ability of companies to retain and attract skilled workers.”

Statement of Senator Barbara Boxer, at 14.

- “I don’t think the economics are good, and I don’t think the policy is any good.”

Testimony of Jim Barksdale, at 24.

- “I don’t think that there could be a worse time in America’s economic history to adopt such a policy [expensing].”

Testimony of John Doerr, at 54.

- “This is a big competitiveness issue....[T]he innovation economy is where we’re going to get the growth in jobs and the economic prosperity and therefore economic security for Americans....[T]he use of broad-based employee stock ownership, which I content will disappear if expensing is mandated, the use of broad-based employee ownership delivers higher returns to the share owners of the companies who use them, produces higher productivity, higher returns on equity, higher returns on assets, counting the effect on dilution.”

Doerr Testimony at 55.

- “And if these options are expensed, mandated to be expensed by FASB, and even perhaps by the international accounting standards board affecting European countries, we should be mindful of the fact that entrepreneurs in Taiwan, entrepreneurs in Singapore that are trying to create the buyopolis, entrepreneurs in China won’t just do software development there – won’t just do software work or sequencing some genes there – they will not create companies there. And they’ll list them on those markets, and America will be weaker.”

Doerr Testimony at 55.

- “If we get rid of that company ownership option in the United States, it’s going to have a humongous impact on the American economy.”

Testimony of Tom Scholl, at 61.

- “...the NASDAQ view [is] that expensing options could have long-term negative effects on stock prices, raise the cost of capital and reduce economic growth.”

Testimony of Dan Crowley, the NASDAQ Stock Exchange, at 64.

Mandatory Expensing Will Not Constrain Executive Pay

- “The question we are concerned about is what would be the consequences for middle class and working class citizens of possible stock option expensing, and what the policy responses to this. First, I think it’s important to realize that a false hope that expensing will control runaway overall executive pay is something that we have to confront. The lesson of history is clear. We did a fifty-year analysis of the Conference Board’s executive compensation reports. We found that whenever regulatory agencies or the government or the accounting profession changed certain treatment of executive compensation, top executives figured out another way to take rent out of those companies. They just moved the chairs, rearranged the chairs.”

Blasi Testimony, at 66.

Broad-Based Employee Stock Option Plans Benefit Rank-and-File Workers

- “This is not a high-tech issue. At Staples, we give stock options to over 5,000 associates a year....I think one of our great advantages as a nation is the owner attitude that we create amongst our employees by giving stock options to them....It would be a tremendous loss to...competitiveness...to force the expensing of stock options.”

Testimony of Tom Stemberg, Chairman, Staples, at 39-40.

- “There is quite a bit of evidence that broad-based equity participation...is linked to better company performance and employee attitudes.”

Kruse Testimony.

- “I’ve seen the effect of options on working people, and broad-based employee stock options are a great motivator, particularly when you’re a small company, you haven’t got any cash and you want to get people involved in it, and that gets them excited and makes them work 18 hours a day, seven days a week.”

Barksdale Testimony, at 23.

The FASB’s Process is Fundamentally Flawed

- “...even the process for setting accounting standards, the FASB approach, which began by assuming that there was a problem, may, in the end, produce a solution that may or may not be workable or necessary.”

Enzi Statement, at 8.

- “I think process is very important. Actually, at Intel, we approached the FASB Board and asked if we should have a conversation. They told us no; that our comments weren’t welcome, and that they plan to have this done by January. And that came from the FASB Board, and we ought to stay out of the way. That came from a FASB Board member.”

Bryant Testimony, at 33.

- “What I’m a little disappointed in at this point in time is the appearance that everything has been decided already. I really thought there was some

flexibility, and I've been defending you on that flexibility, and it sounds like the rule is written and ready to be put out, which kind of takes away from any need for us to do anything like this and I really think takes away from FASB as well."

Enzi Statement, at 44.

- "If there's a process but you've determined the end result, then there isn't a process."

Enzi Statement, at 45.

- "That's like saying I've decided before you come into the courtroom, you're guilty and we're just going to discuss whether we hang you or use the guillotine. It really is. That's not an impartial jury."

Barksdale Testimony, at 76-77.

- "It seems, Bob, that you're defending a decision that you say you haven't made yet."

Powell Testimony, at 78.

- "I've got to say that when people have talked to me about this expensing thing, I wasn't nearly as concerned about it as I have become during this panel. As I said at the outset, I have been one of the big defenders of the independence of FASB, but concerns that I've read in the paper before, which have been emphasized by you today, give me some real concern over that independence aspect and about preconceptions going into doing things....As you said, there are a number of ways that we can watch. I'll be doing those, because, as I say, I have more concerns now than when I came into the meeting."

Enzi Statement, at 95.