Letter of Comment No: 2489 File Reference: 1102-100



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Bruce L. Claflin
President/Chief Executive Officer

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Director of Major Projects Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

> Re: File Reference No. 1102-100, Proposed Statement of Financial Accounting Standards, Share-Based Payment, an amendment of FASB Statements No. 123 and 95

## Dear Sir or Madam:

3Com believes that equity participation is an important motivator for companies that require an entrepreneurial approach to their business, markets and customers. We strongly believe that shareholder value can be maximized by promoting employee equity participation. We are not alone in this belief. Many companies, especially growing technology companies, have adopted broad-based equity incentive programs to allow employees to share in the success of their employers. Because the implementation of the above-referenced proposal could lead to significant non-cash expenses appearing on a company's income statement, companies that seek to reward employees for increasing shareholder value with equity compensation awards will be at a disadvantage in the eyes of investors. In addition, we believe implementation of the proposed standard will degrade the quality of earnings statements further promoting the use of pro forma reporting as a way to clarify earnings statements.

The above proposal requires that the fair value of stock options awarded to employees be expensed, at the time the stock options are granted, using an appropriate valuation technique that takes into consideration various factors, including (at a minimum) the exercise price of the option, the expected term of the option, the current price of the underlying share, the expected volatility of the underlying share price, the expected dividends on the underlying share, and the risk-free interest rate. It has been widely discussed, and is generally accepted, that the Black-Scholes valuation method, when applied to employee stock options, produces wide-ranging, and therefore often misleading results because employee stock options are unique instruments that are subject to various restrictions, are contingent on continued employment and often have terms of up to ten years.

The method suggested by FASB has little, if any, relationship to the actual expense that a company incurs when granting employee stock options. To the contrary, companies receive a benefit. When an option is exercised, a company receives cash equal to the exercise price, which is typically equal to the fair market value of the underlying stock on the date the option was granted. In addition, the proposal would require companies to incur an expense for options that may never be exercised. For example, over the past two years we have had more than 50 million stock options cancelled or expire worthless to the recipient. These are options which under the proposed rules would have had to have been expensed.

In the proposal, it is noted that approximately 500 public companies have voluntarily adopted or announced their intention to adopt the fair-value-based method. While many companies have indicated their intent to voluntarily comply, it is far from universal. There remains a strong and vocal resistance based on the belief that the proposed "cure" for less than fulsome disclosure in fact makes the problem worse. The use of a formula to determine the amount to expense associated with employee stock options produces nothing more than pro forma estimates. Interestingly, pro forma accounting is discouraged in almost all other contexts. Footnotes have long been used to explain the impact of complex transactions. Footnote disclosure of detailed information about employee stock options provides investors with the tools necessary to make their own determinations about the cost associated with those awards.

Proposals that would require companies to expense stock options have been released periodically for several years. Each of these proposals has been rejected because there is no accurate, objective method for valuing employee stock options. It has been suggested that if companies are forced to include these expenses in their financial statements, companies will put their energies into developing better models. This is something FASB has been trying to do for years without great success.

We support the Board's goal of providing investors with expanded information about employee stock options, however, the Board's recently released proposal would not achieve this objective. Investors are looking for comprehensive information about employee stock options to allow them to make their own determination about the impact of those options on a company's financial performance. TechNet, a network of CEO's that promotes the growth of the technology industry and the economy, has proposed guidelines for the disclosure of expanded employee stock option information. TechNet has suggested that companies provide shareholders with information about stock options in their quarterly SEC filings, including detailed information about:

- · employee and executive option grants;
- year-to-date option activity, as well as option activity for the last fiscal year; and
- information comparing exercise price to current market prices, and the related intrinsic value as of the reporting date.

## 3COM

3Com, like many other companies, has adopted many of TechNet's proposals and currently provides detailed information about stock option activity in its quarterly reports filed with the SEC, including the number of options granted and outstanding, the effect of those options on our earnings per share, the remaining options available for grant under our stock option plans, and the exercise prices of our outstanding options. The availability of this detailed information provides investors with the information necessary to make informed investment decisions.

For the above reasons, I urge you to reconsider adopting the proposal and support initiatives proposed by TechNet and others which call for comprehensive disclosure of detailed information about employee stock options, which would allow investors to make their own determination about the impact of employee stock options on a company's financial performance.

Sincerely,

President and Chief Executive Officer