Letter of Comment No: 39

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January 21, 2003

Dear Sir or Madam:

I am writing today to urge you not to recommend mandatory expensing of stock options.

I believe strongly that this action will depress U.S. stock prices, raise the cost of capital

and reduce U.S. economic growth rates to European levels. Equally important, it will

undermine entrepreneurship and innovation for which the U.S. is the envy of the world.

First, expensing stock options sounds innocent enough but, if implemented, it would have

devastating effect on the stock-option plans of millions of employees. If employee stock

options were treated as an "expense" on the income statement, financial statements would

decrease in reliability, transparency and comparability.

Financial statements are already intricate and sometimes difficult to understand. Adding a

non-cash expense derived from estimates of option value to financial statements, in many

cases, would distort them and increase investor confusion and mistrust.

Second, expensing stock options would severely handicap companies' recruiting efforts,

especially among California's highly competitive biotech and high-tech industries, where

stock options are a major tool for attracting and retaining top talent.

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Over the years, IDEC has been able to attract and retain top managerial talent through employee stock options, and those employees have contributed to increased earnings and higher stock prices. I'm certain if expensing stock options is mandated attracting and retaining key personnel will become increasingly difficult in the biotechnology industry.

Third, the issue of expensing stock options has been championed by politicians and pundits as a panacea for preventing corporate fraud and misconduct in the aftermath of the Enron debacle. These misguided social engineers believe that Enron's accounting of employee stock options was a major contributor to the energy giant's collapse. Nothing could be further from the truth.

Enron's financial statements fully and accurately disclosed stock options granted to its employees. Don't misunderstand me; I'm not defending Enron.

Enron's failure and apparent fraud were in giving inaccurate, incomplete and untimely information to shareholders and securities markets. But using Enron's collapse to hoist a new tax on the backs of the most innovative and productive workforce in the world is a sham and shameless. The ultimate effects of this action could cause an unforeseen devastating effect on our future economy.

Under current accounting and tax rules, expensing stock options is unnecessary. The Financial Accounting Standards Board (FASB) regulation 123, introduced in October

1995, already requires companies to report in detail the impact of stock options in the footnotes to their financial statements.

Fourth, expensing stock options would set a new and dangerous precedent for companies, employees and investors. Stock options that are exercised would be calculated *twice* against earnings, not once. Earnings, which have already been diluted by increasing the number of shares outstanding, would be charged a second time by the value of the options.

What's wrong with this? Accurately expensing options is rather like herding cats; it's impossible to do. First, when a company grants stock options to employees, money is not exchanged. Employees are simply granted the right to buy the company's stock at some indeterminate date in the future.

There is no definite value to the option during the grant period, so it's impossible to accurately deduct it from a company's earnings. Secondly, employees may never exercise their options. How come?

They may leave the company before vesting in the option plan, or the market price of the underlying shares may drop substantially below the grant price of the option and never be exercised by employees.

In a nutshell, expensing stock options would require companies to deduct phantom

expenses against real earnings, whether stock options are exercised or not.

Reading various schemes for expensing stock options reminds me, oddly enough, of Sen.

George McGovern. In 1988 the former Senator and Presidential candidate opened a hotel

and restaurant in Connecticut, only to see it go bankrupt.

Several years later McGovern confessed in the Wall Street Journal, "I . . . wish that

during the years I was in public office, I had had this firsthand experience about the

difficulties businesspeople face every day. It would have made me a better U.S. senator."

One wishes that more politicians and pundits had a similar business experience as well as

greater awareness of the hopes and dreams of American workers - 10 million of whom

were granted stock options last year. Perhaps then they would realize that expensing stock

options is the surest way to idle one of major engines driving innovation and

entrepreneurialism in the U.S. - employee stock options.

Sincerely,

William H. Rastetter

Chairman and CEO

**IDEC Pharmaceuticals Corporation** 

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