## Stacey Sutay

Letter of Comment No: — File Reference: 1200-200 Date Received: 3-17-04

----Original Message----

From: Barlow\_James [mailto:Barlow\_James@Allergan.com]

Sent: Wednesday, March 17, 2004 12:15 PM

To: Director - FASB

Cc: Maletta\_Matthew; Darden\_Belinda; Brandt\_Eric

Subject: File Reference 1200-200

## VIA E-MAIL

March 17, 2004

MP&T Director--File Reference 1200-200

Financial Accounting Standards Board

of the Financial Accounting Foundation

401 Merritt 7

P.O. Box 5116

Norwalk, Connecticut 06856-5116

Re: Exposure Draft—Proposed Statement of Financial Accounting Standards, Earnings per Share, an amendment of FASB Statement No. 128 (File Reference 1200-200).

## Dear Director:

Allergan, Inc., a Delaware corporation ("Allergan"), appreciates the opportunity to respond to the Financial Accounting Standards Board (the "Board") regarding the Exposure Draft, Proposed Statement of Financial Accounting Standards, Earnings per Share, an amendment of FASB Statement No. 128 (the "Proposed Statement"). Allergan is a publicly traded, specialty pharmaceutical company listed on the New York Stock Exchange under the symbol "AGN."

Allergan supports the Board's efforts to make financial statements more useful for investors and creditors concurrent with improving the quality of accounting standards. Nevertheless, Allergan is concerned that certain aspects of the Proposed Statement will be counterproductive to investors' and creditors' interests and will likely create, in many instances, less comparability and greater complexity among financial statements. Specifically, Allergan strongly urges the Board to exclude from the Proposed Statement its elimination of the existing provisions of Statement No. 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock. In addition, the proposed amendments to paragraph 29 of Statement No. 128 should be excluded, as should related proposed amendments to paragraph 172 of the Proposed Statement with respect to the option of cash or stock settlements.

The Board's primary reason for adopting the Proposed Statement is to increase the comparability of EPS data on an international basis by converging U.S. accounting standards with the International

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Accounting Standards Board's method of calculating EPS under IAS 33. In this regard, the Proposed Statement expressly contradicts the U.S. Securities and Exchange Commission's (the "SEC") position that accounting principles should not simply be rules-based. Rather, the SEC seeks accounting standards that are objectives-oriented and reflect economic reality. The Proposed Statement is, instead, a "bright-line" rule that does not always reflect economic reality. For example, the following is an excerpt from the notes to consolidated financial statements included in Allergan's 2003 filing on Form 10-K:

"On November 6, 2002, the Company issued zero coupon convertible senior notes due 2022 (Senior Notes) in a private placement with an aggregate principal amount at maturity of \$641.5 million. The Senior Notes, which were issued at a discount of \$141.5 million, are unsecured and accrue interest at 1.25% annually, maturing on November 6, 2022. The Senior Notes are convertible into 11.41 shares of Allergan's common stock for each \$1,000 principal amount at maturity of the Senior Notes, or approximately 7.3 million common shares, if the closing price of Allergan's common stock exceeds certain levels, the credit ratings assigned to the Senior Notes are reduced below specified levels, or the Company calls the Senior Notes for redemption, makes specified distributions to its stockholders or becomes a party to certain consolidation, merger or binding share exchange agreements. Upon conversion, the Company may choose to deliver, in lieu of its common stock, cash or a combination of cash and shares of its common stock. The Company currently intends to settle the accreted value of the Senior Notes in cash. Holders of the Senior Notes may surrender their Senior Notes, in multiples of \$1,000 principal amount at maturity, for conversion into shares of the Company's common stock in a fiscal quarter (and only during such fiscal quarter) if the sale price of the Company's common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than an amount equal to the accreted conversion price per share of the Company's common stock on the last day of the preceding fiscal quarter multiplied by the applicable percentage (as set forth below); provided, however, that in no event shall such amount be less than \$90 per share (subject to adjustment). The initial applicable percentage of the accreted conversion price shall be 125% and shall decline 0.25% every six-month period thereafter to 115% on November 6, 2022. The accreted conversion price per share as of any day will equal the quotient of (i) the accreted value to such day, divided by (ii) the number of shares of the Company's common stock issuable upon the conversion of \$1,000 principal amount at maturity of Senior Notes on such day. As of December 31, 2003, the conversion criteria had not been met. Holders of the Senior Notes may require the Company to purchase the Senior Notes on any one of the following dates at the following prices: \$829.51 per Senior Note on November 6, 2007; \$882.84 per Senior Note on November 6, 2012; and \$939.60 per Senior Note on November 6, 2017. Any Senior Notes purchased by the Company on November 6, 2007 will be paid for in cash. For the November 6, 2012 and November 6, 2017 purchase dates, the Company may choose to pay the purchase price in cash, shares of the Company's common stock, or a combination of cash and shares of the Company's common stock. The Company may not redeem the Senior notes before November 6, 2005, and prior to November 6, 2007 the Company may redeem all or a portion of Senior Notes for cash in an amount equal to their accreted value only if the price of the Company's common stock reaches certain thresholds for a specified period of time. On or after November 6, 2007, the Company may redeem all or a portion of the Senior Notes for cash in an amount equal to their accreted value."

The foregoing convertible debt security has two significant features commonly referred to as "Contingent Conversion" and "Net Share Settlement." The Contingent Conversion feature, which is not addressed in the Proposed Statement, allows the security to become convertible for a limited period of time after certain conversion criteria are met. Thus, the security may be convertible during one fiscal quarter and then not be convertible during the next fiscal quarter (or during any future fiscal quarter).

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The Net Share Settlement feature, which is the subject of this comment letter, allows Allergan the economic option to choose, at a specific time in the future when the conversion criteria are first met, between cash settlement of the accreted value or full share settlement (i.e., the option of settling in either cash or stock). Prior to the conversion criteria being first met, this feature is irrelevant from a computational perspective for reporting diluted EPS. Once the Net Share Settlement effect is actually reflected in the diluted EPS calculation included a Form 10-Q or Form 10-K filing, Allergan cannot change its decision in a future period without having to restate its historical financial statements (i.e., to reflect the fact that the company did not actually choose to settle the accreted value in cash). That is economic reality and exactly what the terms of the convertible debt security require to be reported. The Proposed Statement will override the economic facts and circumstances in this example.

Also, the terms of Allergan's convertible debt security require Allergan to redeem the accreted value of the debt in cash during the period from November 6, 2005 to November 5, 2007, if we call the security for redemption. This means that during the period of time from November 6, 2005 to November 5, 2007, if the conversion criteria have been satisfied during a particular fiscal quarter and Allergan calls the security for redemption, Allergan must pay the accreted value of the security in cash and the balance of any value owed to the security holders in common stock. Again, that is economic reality.

Finally, Allergan has issued several convertible debt securities in the past, and it has reflected the dilutive effect of the conversion of those securities in its calculations of diluted EPS over time according to the security's terms and the effective accounting principles. To my knowledge, Allergan has never settled a convertible debt security by issuing shares of its common stock. This is because the convertible debt securities were not favorable to the security holders at the time of settlement. Accordingly, Allergan has historically reported diluted EPS amounts that do not reflect the economic reality of how the debt security actually settled. The historical reported amounts reflect what might have been able to happen, not what actually happened.

Current reporting practices in this area are well defined by the accounting profession and understood by the users of financial statements, and the Proposed Statement will not improve the quality and clarity surrounding the reporting of the economic substance of these types of convertible debt securities.

If the Board does not agree to eliminate its proposed change as described in my comments above, the Board should, at a minimum, apply the provisions of Proposed Statement prospectively, not retroactively, to contracts entered into on or after December 15, 2003 that contain provisions to settle in either cash or stock. Companies who structured convertible debt securities with these features and properly disclosed their mechanics in their notes to their financial statements should not be penalized. In addition, the financial markets' historical understanding of how these type of convertible debt securities potentially impact a company's diluted EPS calculations should not be disrupted. To the best of my knowledge, the application of the currently existing accounting standards did not result in divergent disclosure or reporting practices in the United States. Retroactive application will likely cause significant confusion among financial statement users who clearly understood the economic substance of these options, and then are told that what they understood the economics to be will no longer be reflected in the actual reported results, even though the contractual provisions still exist.

Also, the great majority of convertible debt securities that contain a Net Share Settlement feature have issuer call and holder put option features built into the contracts which historically have caused a high rate of settlements within the first three to five years from the date of issuance of the convertible debt securities. Because of these call and put options, the majority of the existing securities as of December 15, 2003 will naturally settle and be refinanced with new securities within a relatively short period of time, so any prior accounting principle hangover will be short.

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Finally, the word "restatement" in today's accounting environment, even if properly required by the FASB through an amendment to an existing accounting standard, has a negative connotation and will result in confusion and frustration on the part of financial statement users. Additionally, many public company compensation programs may require revision to deal with any potential backlash or adjustment that might be created by restating prior period reported diluted earnings per share. Therefore, it simply makes more sense to allow company management and the financial markets to deal with this type of accounting standard amendment on a prospective basis with new financial instruments, rather than by requiring history to be restated.

Respectfully,

James F. Barlow

Allergan, Inc.

Vice President, Corporate Controller

(Principal Accounting Officer)