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LAWRENCE C. BICKFORD

Mr. William E. Toomey
Assistant Chief Counsel
Division of Corporation Finance
Securities and Exchange Commission
500 North Capital Street
Washington, D.C. 20549

Dear Mr. Toomey:

Our firm makes it a practice as part of its executive compensation consulting services to monitor the Staff's responses to no-action and interpretative requests regarding management remuneration, employee stock plans and related matters. Several recent interpretative responses dealing with cash exercises of stock appreciation rights (SARs) appear to take positions which are inconsistent with prior Staff interpretative responses and Release No. 34-18114.

Both of these apparent reversals of prior positions involve what are best described as "tax offset SARs" -- rights which entitle an optionee upon exercise of a stock option to realize, in addition to the option shares, a cash payment equal to the option spread. The intent of these additive payments is to provide funds to offset the income tax incurred upon exercise of the related nonqualified stock option. The purpose of this letter is to request the Staff's clarification regarding the two issues in question:

(1) Does the addition of limited SARs, i.e., rights triggering a payment equal to an option gain in a tender offer or takeover situation, constitute a material amendment as contemplated by the requirements of Rule 16b-3(a)(2) where only tax offset SARs are already attached to the option?

(2) Does the cash settlement of a tax offset SAR which is triggered solely by the exercise of a related stock option require exercise within a Rule 16b-3 window period to gain the exemptive relief provided by the Rule?

The resolution of these two questions would remove the conflicting interpretations presently existing, thus permitting companies to design and operate plans with tax offset SAR elements with more precision and certainty as they pertain to statutory insiders.

- Is adding limited SARs to stock options having tax offset SARs a material plan amendment?

In a response to an interpretative request on behalf of Southland Royalty Company (available November 27, 1981) the Staff's opinion was that a proposed plan amendment permitting "limited rights"(1) to be exercised in lieu of stock options within thirty days following a change of control or shareholder approval of a merger or similar reorganization would not require shareholder approval. Under the instant plan, participants are granted "Units". Each Unit is comprised of an option to purchase one share of stock and a right to a cash payment ("SAR") upon exercise of the option equal to the spread on the option. Unlike the typical SAR, the related option is not cancelled by the exercise of the SAR.(2) Rather, exercise of the SAR triggers the payment (or crediting) of an amount equal to the spread existing when the option is exercised.

The proposed amendment would substitute for the option portion an identical payment equal in amount to the additional payment due from the existing unit or SAR portion. In effect, upon a merger or change of control, a executive would have an SAR attached to his or her option in addition the existing SAR. The result, is that the SAR amount in such a situation would be "equal to twice" the SAR payment available under a normal option exercise.

In Release No. 34-18114 (Q&A #100) the Staff explicitly included increasing the number of SARs which could be available to options under a plan as an example of a plan amendment which materially improves participants' benefits. Under the requirements of Rule 16b-3, of course, any such amendment must have shareholder approval if future plan transactions are to continue to enjoy the exemptive relief afforded by the Rule. In explaining this position, Footnote 141 in the Release stated that an amendment to increase the number of shares covered by SARs, "e.g., 75 percent rather than 50", would require shareholder approval (see Levi Strauss, available February 19, 1980). Southland Royalty appears to us to present a similar situation in that more SARs were being added -- yet, shareholder approval was not required.

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(1) Although this term is not used to describe the rights resulting from the proposed amendment, such rights are clearly tantamount to the "limited rights" discussed in Q&A 100 of Release No. 34-18114.

(2) Release No. 34-18114 defines an SAR as a right attached to the option by which the optionee can receive the gain on the underlying option in lieu of actually exercising the option.

Adding typical SARs, i.e., rights to receive the existing spread on an option in cash and/or stock in lieu of option exercise, has also been deemed a material plan amendment (see Q&A #100) requiring shareholder approval, yet this is precisely what appears to have occurred in the instant case.

Counsel for Southland Royalty noted two prior Staff responses(3) "in which amendments of this character do not require shareholder approval". However, in one, the Champion International situation, tandem SARs were already either available or attached to the options to which limited SARs would be attached.(4) That is, shareholders had already approved the use of SARs and their attendant payments in lieu of option exercises. The Garfinckel, et al letter was a break with past Staff positions, but one which did not concern us at the time, because it was made moot by the Staff's position that the triggering event for the "limited rights" was in the control of officers and directors.

The purpose of limited SARs is, we believe, a legitimate one which places officers on the same footing as non-officers regarding stock options. As counsel for Champion International argued in their request letter regarding the addition of limited SARs that:

> ... an officer or director... risks losing a significant portion of the value... in the event of a tender or exchange offer and, unlike other stockholders, he will not be in a position to obtain the full economic benefit of the offer.

However, the extension of such benefits to officers seemingly does constitute a material increase in benefits to such plan participants relative to their pre-amendment status.

In summary, the Staff has held in prior situations that increases in the number of shares subject to SARs would require shareholder approval. The Southland Royalty response thus appears to represent a significant departure from the materiality concept to which the Staff has adhered previously.

- Does the payment of tax offset SARs require that the related stock option be exercised within a Rule 16b-3(e)(3)(iii) window period?

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(3) Garfinckel, Brooks Brothers, Miller & Rhoads, Inc. (July 20, 1981) and Champion International Corporation (April 13, 1979).

(4) See footnote 142 to Release No. 34-18114.

In a letter to Martin Marietta Corporation (available January 7, 1982), the Staff held that exercises of stock options for which tax offset SAR payments were triggered by option exercises did not have to take place during a Rule 16b-3 window period in order for the safe-harbor of the Rule to apply. Yet, in three prior letters(5) the Staff had taken opposite positions.

In both the Martin Marietta and Peoples Gas situations, counsel argued that the cash payments were not in the control of the receipents because they were the automatic result of an option exercise. The Staff's response to Peoples Gas, unlike that to Martin Marietta, was that officers "must restrict their exercise of stock options and attendant stock appreciation rights to the 10-day period specified in Rule 16b-3(e)(3)(iii) in order to qualify for the safe-harbor provided by Rule 16b-3." The Staff notes that this position was taken based, "in particular" on "the dependence of exercise of the SAR upon exercise of the related stock option."

In the Sears, Roebuck and Cone Mills letters, requesting counsel argued that tax offset payments triggered by option exercises should not be considered SARs subject to Rule 16b-3. Both letters to the Staff noted that if such payments were to be deemed tantamount to SARs they would require exercise of the related options within Rule 16b-3 window periods. The Staff, in reply, held that all of the Rule's requirements regarding cash SARs would have to be met for these companies' tax offset SARs to comply.

In Release 34-18114 (Q&A #128) the Staff stated that the exception to the window period requirement is only available where "the insider has no volition, and the automatic exercise does not provide real opportunity for the misuse of confidential information." Prior to the Martin Marietta letter, the Staff had held that the type of tax offset SAR in question was dependent on the exercise of the related option and thus within the volition of the optionee. The Martin Marietta response takes a totally opposite view by agreeing with counsel that the SAR payment is automatic because it is outside of the control of the optionee. In effect, it appears the Staff is saying that it is totally dependent upon the option exercise, the same rationale used to require option exercises within window periods in the prior responses.

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(5) Cone Mills Corporation, available May 8, 1981, Sears, Roebuck & Co., available April 23, 1979, and Peoples Gas Company, available February 13, 1978.

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Because of the divergent and contradictory positions taken by the Staff regarding tax offset SARs tied to nonqualified stock options, and given their probable future appeal as alternatives to incentive stock options, we respectfully request a letter from the Staff clarifying its positions. Should you or any other member of the Staff have any questions regarding this request, or if additional information is desired, please call me or Cathy Raphael of our firm.

Sincerely,

Lawrence C. Bickford

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LCB:emg

c: Mr. Peter J. Romeo
Mr. Michael R. Kargula