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November 15, 2002

Securities and Exchange Commission
Office of Chief Counsel
Division of Corporation Finance
Judiciary Plaza
Washington, D.C. 20549

Public Avail. Date: 12/21/01 0122200215
Act Section Rule
1934 14(a) 14a-8

Subject: Stockholder Proposal of Donald S. Parry

Ladies and Gentlemen:

Pursuant to Rule 14a-8(j) under the Securities Exchange Act of 1934, I am enclosing six copies of this letter together with a proposal and statement in support thereof (collectively, the "Proposal"), attached as Exhibit A hereto, which Proposal was submitted by Donald S. Parry (the "Proponent"), which Proponent is acting on behalf of himself and multiple co-filers, to the International Business Machines Corporation (the "Company" or "IBM").

The Proposal asks that "the Board of Directors adopt a policy that executive compensation will be determined in the future without regard to any pension fund money that accounting rules may require to treat as income, so that the compensation of senior executives will more closely reflect their performances in managing the business." IBM believes that the Proposal may properly be omitted from IBM's proxy materials being prepared for our 2002 annual meeting of stockholders (the "2002 Annual Meeting") for the reasons discussed below. To the extent that the reasons for omission stated in this letter are based on matters of law, these reasons are the opinion of the undersigned as an attorney licensed and admitted to practice in the State of New York.

THE PROPOSAL AS WELL AS THE STATEMENT OF SUPPORT SHOULD BE OMITTED FROM THE COMPANY'S PROXY MATERIALS UNDER RULES 14a-8(i)(3) AND 14a-9, AS VAGUE AND INDEFINITE AS WELL AS MATERIALLY FALSE AND MISLEADING TO THE COMPANY'S SHAREHOLDERS AS WELL AS THE COMPANY.

Rule 14a-8(i)(3) permits the omission of proposals and associated supporting statements that are contrary to the Commission's proxy rules, including Rule 14a-9, which in turn, prohibits false or misleading statements in proxy materials. Rule 14a-9(a) provides that no proxy solicitation shall be made containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading. Note (b) to Rule 14a-9 goes on to provide that material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation, may also be misleading within the meaning of such Rule.

Following our review of the Proposal, the Company believes that the entire Proposal as well as the associated "Statement of Support" should be omitted pursuant to Rules 14a-9 and 14a-8(i)(3) because substantial portions of such Proposal and its "Statement of Support" are materially false and misleading,

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and others are so inherently vague and indefinite as to be subject to a host of varying interpretations by both shareholders and the Company.

1. The Proposal itself is subject to exclusion as vague and indefinite, as it lacks specificity and is subject to a variety of potential interpretations by both the Company and any putative stockholder asked to vote intelligently thereon.

The text of the Proposal itself seeks for executive compensation to be determined without regard to "any pension fund money" that "accounting rules" may require the company to treat as "income" so that compensation will more closely reflect the executives' performance in "managing the business." There are a number of ways to interpret this sentence. We first question what the Proponent means by "any pension fund money." What does "any pension fund money" mean? Each year, the Company reports on its retirement plans in the Notes to our Consolidated Financial Statements. In Note V to the 2000 financial statements, the Company provides a table entitled "(INCOME)/COST OF PENSION PLANS," which includes a three year comparison of cost and income items associated with both our U.S. pension plan as well as our non-U.S. plans. None of the items in this table is specifically labeled "pension fund money." (See Exhibit B; page 86) Under Statement of Financial Accounting Standard ("SFAS") No. 87 and SFAS No. 132, IBM is required to report in the Consolidated Statement of Earnings costs or income associated with both the Company's defined benefit ("DB") plans as well as its defined contribution ("DC") plans. DB plans are generally understood to be traditional pension plans where participants accrue benefits over time. DC plans, such as IBM's 401(k) plan, provide additional post-retirement benefits to participating employees, with a portion of employee contributions matched by the employer in accordance with the terms of the DC plan. Both DB and DC plans (as well as other benefits such as post-retirement medical coverage) are all properly considered in calculating a company's total costs for its post-retirement obligations.

The Proponent would have the Company determine executive compensation without regard to "any pension fund money." Yet the amounts cited by the Proponent in the supporting statement do not support the words of the Proposal, as such amounts appear to focus only on the DB plans. The Proposal and the Statement of Support cannot be reconciled and are therefore fatally flawed. In fact, and as noted above, both DC and DB costs or income, as applicable, must be recognized in the Consolidated Statement of Earnings under the "accounting rules" the Proponent references. As such, under one reading of the Proposal, stockholders should properly consider "any pension fund money" as including both IBM's DB and DC plans. Yet, the amounts cited by the Proponent in the Statement of Support, in addition to addressing only the DB costs and conflicting with the words of the Proposal itself, are otherwise erroneous and misleading.¹ If, on the other hand, "any pension fund money" is not supposed to include both the DB and DC, should we only consider one or the other?

Further, the Proposal addresses "income" but does not mention pension "costs"? Should they be considered? What combination of DB plan income, DB plan costs, DC plan income, and DC plan costs does the Proponent want the Company to disregard (or consider) in making the compensation calculation? The Proposal refers simply to "any pension fund money that accounting rules may require the company to treat as income." There is nothing in the Proposal to suggest that "any pension fund money" include both the income as well as the costs associated therewith, nor specifying whether such calculations should be associated with Company's DB, DC plans, or both.

¹ The dollar amounts later cited by the Proponent in Paragraph 3 of the "Statement of Support" are in any event materially false and misleading under Rule 14a-9, because the Proponent impermissibly subtracted a pre-tax amount from an after-tax amount, in order to come up with an incorrect result and an improper conclusion as to what IBM's net profit would have been without the "pension income." See discussion in Section 2(c) of this letter, *infra*, which discusses this problem together with the other defects in Paragraph 3 of the Proponent's Statement of Support.

We are further confused over the use of the term "income" in this Proposal. Should income be viewed on a gross or a net basis? Perhaps more to the point in this case, specifically because of the dollar amounts misapplied by the Proponent in Paragraph 3 of the Statement of Support, we wonder whether the term "income" should be considered on an *after-tax* or on a *pre-tax* basis? In this connection, it is important to keep in mind that Paragraph 3 of the Statement of Support utilizes an *after-tax* profit amount, but impermissibly subtracts from it a *pre-tax* amount for pension income, which amount was evidently extrapolated from Note V. (See Section 2(c) of this letter, *infra*, for further discussion of this irregularity.)

Finally, we wonder whether the term "income" should be seen and treated as income in accordance with GAAP (which includes negative income or "losses"), or should "income" be considered literally and therefore disregarded for purposes of the executive compensation calculation only if it is a positive amount on a bottom-line basis? Unfortunately, the Proposal does not address this or other important considerations. Even if we can first: (i) understand the definition the Proponent wants for "income," and then further (ii) assume *arguendo* that there was such "pension fund money" ("income") in a given year, how would the Company address these situations in other years where there is no plan "income" or in situations where there are both plan "losses" and/or actual Plan deficit balances? The Proposal is also silent on these points. Finally, if annual plan expenses and losses are in fact to be considered (rather than disregarded), how should they be factored into the executive compensation calculations? Should these losses be deducted? The Proposal is again silent on this important question.

Indeed, if the Proposal would have the Company determine executive compensation "without regard" to "any pension fund money" that accounting rules may require the company to treat as "income," following study of the Proposal and "Statement of Support," one reading of the Proposal would have the Company consider (in the calculation) certain items if these items were not required to be treated as "income" and disregard other items (in the calculation) if these items fit within the Proponent's definition of "income." The Proposal does not provide any answers on how the Company is to interpret its words, and stockholders should certainly not be made to speculate upon it.

In addition, one reading of the Proposal (See description of "Statement of Support" Paragraph 3, *infra*) could suggest that the Company, like the Proponent, actually ignore certain DC cost items.² In addition to being inconsistent with GAAP, more notably this reading of the Proposal also seems to suggest that the Company treat the DC costs/income in a manner which is inconsistent with the Company's DB costs/income. Is this the intent of the Proposal? Should the Company treat its DB and DC income and costs differently? Clearly it is confusing as well as inconsistent with the very words of the Proposal. Moreover, that same third paragraph of the Statement of Support is itself materially false and misleading to the extent it ignores \$443 million of the Company's DC plan costs in recognizing the impact of all Company retirement plans on the Company's Consolidated Statement of Earnings. Why were those DC amounts ignored? Because they were costs and therefore unfavorable to Proponent's position? Clearly, these costs must be properly be considered under GAAP; the "accounting rules" the Proponent cites, and

² As is also subsequently noted under the Company's discussion of the third paragraph of the Proponent's Statement of Support, the Proponent appears to have totally ignored \$443 million of the Company's defined contribution plan costs in his analysis of the impact of the retirement plans on the company's income. Ignoring costs is, of course, improper under GAAP. Moreover, such an omission, being *material* and counter to GAAP, also serves to cast further doubt upon the integrity of the Proposal itself. See text accompanying footnote 4, *infra*, TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) (the test for materiality is whether there is a substantial likelihood that a reasonable shareholder would consider an omitted fact to be of significance in deciding how to vote). The net impact in 2000 of all of the retirement plans which were properly recognized in the Consolidated Statement of Earnings, included both DB and DC plans, amounted to \$728 million. See Note V to IBM 2000 Annual Report at page 85. Furthermore, the Proponent also ignored all Non-Pension Postretirement benefits and the \$401 million of costs relating thereto. Once this \$401 million is considered, the total retirement related income, including post retirement medical coverage, amounted to \$327 million. All of this is clearly pointed out in the *first* paragraph of Note V to the Company's 2000 Annual Report, and is further expanded upon in Note W to such Report. (See Exhibit B at page 85 and 88).

which rules the Company must follow. Given the Proponent's utter failure in such Paragraph to consider or otherwise discuss the impact of the DC plan costs, which costs are in and of themselves quite material to an understanding of the Company's retirement plans in any given year, we believe that such inability or unwillingness to consider such DC costs makes the Proposal's oblique reference to consider "any pension fund money" in the text of the Proposal hopelessly vague and indefinite as well as materially false and misleading.

There are yet other problems with the Proposal. In addition to the U.S. DB plan, the Company has many other plans outside the U.S. Each retirement plan may have reportable income as well as a surplus in a given year, losses in other years (with a net surplus balance notwithstanding a loss in a given year), or an actual net deficit balance in such Plan, generally resulting either from a single Plan year loss or cumulative losses accruing over a period of years. Each situation is specifically distinct, with potentially different consequences in the calculations the Proponent would have us make attendant thereto. None of this is even considered or addressed in any way in the Proposal. The Proposal seeks to modify the Company's executive compensation calculations with respect to how "income" is to be treated, yet utterly fails to address what is meant by "income" as well as how the Company should address costs, Plan losses and deficit situations at any level. Clearly, if a proposal is to be properly considered for a stockholder vote, let alone implemented, both the Company, as well as its stockholders, would need to be able to understand what the ramifications of that proposal would entail in these situations. Yet, the instant Proposal, being over simplistic, provides no assistance whatsoever in its interpretation.

The Proposal is also silent as to whether and how the Company should treat *increasing* net Plan deficit positions in the Company's executive compensation calculations. Should executives be held accountable for these deficits? Or, if there remained a net Plan deficit in a given year notwithstanding the generation of some income, should the Company still be "required" to eliminate that "income" from consideration in the executive compensation calculations? Would the Proponent like the net-out concept to be applied only in years where there is a pension plan "surplus"? Is the Proponent aware that other situations may well exist where there is no surplus? Clearly, the Company has no way of knowing the answers to these questions, as the Proposal fails to address any of these situations. Neither the Company nor its stockholders should have to speculate on how this Proposal should be interpreted.

The Company also disagrees with the false suggestion that income from the Company's pension plans should be segregated from income from "managing the business," as if the two are altogether distinct from each other. Although the Company's top executives are not involved in making day-to-day management decisions for the pension plans, it is improper to suggest that "managing a business" does not include, at a *macro* level, overall executive responsibility and accountability for the Company's total profit and loss, which profits and losses necessarily include those generated by the Company's pension plans. In sum, IBM's top executives are judged not only by their marketing efforts on behalf of the Company, but also by their ability to manage all aspects of cost and expense, including, among others, those related to compensation and benefits.

Finally, the Proponent has also utterly ignored the fact, also clearly pointed out in Note V as well as Note W to the Company's 2000 Annual Report, that IBM also incurred an additional \$401 million of costs for nonpension postretirement benefits in 2000. Such benefits include medical, dental and life insurance for U.S. retirees and eligible dependents. Once these costs are properly considered, the total retirement-related income in 2000, including such the nonpension postretirement benefits, amounted to only \$327 million. \$327 million is materially less than the \$1.17 billion the Proponent has cited and misapplied in his analysis. Although the Proponent may certainly wish to "*cherry pick*" only those items favorable to his position, it is critical, under Rules 14a-8(i)(3) and 14a-9 that he do so in a manner which does not improperly distort the true facts, which facts have been set out in the Company's annual report.

Under TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976) and its progeny, the test for materiality in the context of proxy statement omissions or misstatements is whether there is a substantial likelihood that a reasonable shareholder would consider the omitted or misstated fact to be of significance in

deciding how to vote. Given the facts here, we believe it clear that the disclosure of the omitted facts above would be viewed by the reasonable stockholder as having significantly altered the "total mix" of the information actually made available in the defective Proposal. Once the variety of other omissions and misstatements in the Proposal are considered, we believe the materiality standard in Northway is more than satisfied. Indeed, to salvage the instant Proposal, it would have to be substantially rewritten. And, since such an exercise is well beyond the scope contemplated by the staff in permitting clarifications under Rule 14a-8(i)(3) and Rule 14a-9, the entire Proposal should properly be excluded under such Rules.

In short, while the Proposal, on its face, may sound simple enough, it raises far more questions than it answers. Determining the correct amount of compensation to be earned in a given year and paid to the executives utilizing a formulaic methodology is critically dependent upon the existence of clear and crisp criteria for the proper application of such formulas. The Company believes it is wholly improper and misleading to inject uncertainties into any such calculations, as this Proponent would have the Company do through the instant Proposal. A stockholder's use of vague or undefined terminology simply cannot form the basis of a valid stockholder proposal under Rule 14a-8(i)(3) and its predecessor, Rule 14a-8(c)(3), and since the instant Proposal is hopelessly vague and indefinite, it would be inappropriate to rewrite the entire Proposal. Therefore, the entire Proposal should be omitted under Rule 14a-8(i)(3), as neither the Company and its stockholders should not be made to speculate over how to address these various scenarios.

Both the staff as well as the courts have rejected, under Rule 14a-8(i)(3) and its predecessor rule, Rule 14a-8(c)(3), as well as Rule 14a-9, similar proposals, which although sounding simple enough on their face, had the potential to be vague and indefinite as well as false and misleading to stockholders. As such, these proposals were properly eliminated from further consideration. For example, in Joseph Schlitz Brewing Company (March 21, 1977), the staff was asked to examine a resolution seeking for the registrant to adopt a corporate policy that the registrant not allow its advertisements to appear in television programs containing "*excessive and gratuitous violence*." The staff concurred that the proposal could be excluded under former Rule 14a-8(c)(3). After recognizing that the determination of what constitutes "*excessive and gratuitous violence*" is a highly subjective matter, the staff wrote that

such a determination, and any resultant action by the Company would have to be made without guidance from the proposal, and consequently, in possible contravention of the intentions of the shareholders who voted on the proposal. That is, the action requested by the proposal is so inherently vague and indefinite that the shareholders voting on the proposal would not be able to determine with any reasonable certainty exactly what actions or measures the Company would take in the event the proposal was implemented. Consequently, we believe that the proposal may be misleading, in that any action ultimately taken by the Company upon the implementation of the proposal could be quite different from the type of action envisioned by the shareholders at the time their votes were cast.

The Schlitz ruling rings particularly true here. The Proponent's casual use of the terms "any pension fund money" and "income" is subject to a variety of readings in a complex area subject to detailed accounting rules and regulations, such as SFAS 87 and 132. The Company submits that its stockholders, no matter how sophisticated, are no more able than those in Schlitz, to interpret a Proposal such as the instant one, which, as described above, misstates certain items, omits other important information, and fails to provide crisp direction, either to the Company or stockholders as to how it should be interpreted under a variety of different real-life plan scenarios. Since the entire Proposal falls woefully short of anticipating and/or providing guidance as to its interpretation under such scenarios, it should, *ipso facto*, be declared defective on its face, and excluded forthright from further consideration under Rule 14a-8(i)(3), utilizing the Schlitz rationale. Other more recent letters have reached the same conclusion. See also IDACORP (September 10, 2001) (proposal seeking to amend company's charter to provide for recall of Board of Directors, setting forth particulars and procedures for such recall, properly excluded by staff as vague and indefinite under Rule 14a-8(i)(3)); Sensar Corporation (July 17, 2001) (upholding as vague and indefinite under Rule 14a-8(i)(3) the exclusion by the staff of a proposal evidencing displeasure over matters relating

to stock option grants to management); H.J. Heinz Company (May 25, 2001) and McDonalds Corporation (March 13, 2001)(proposal seeking for the registrant to commit to "full implementation" of certain accountability standards and a program to monitor compliance with these standards ruled to be fully excludable under Rule 14a-8(i)(3) as vague and indefinite); cf. Qwest Communications International Inc. (March 2, 2001)(staff concurred that portions of a proposal and its supporting statement relating to the determination of future awards of performance-based compensation for top executive officers using a measure of net income from operations that did not include accounting rule income, particularly pension credits resulting from increases in the pension fund surplus could properly be omitted as materially false and misleading under Rule 14a-9).

2. **The "Statement of Support" provides no information to supplement or clarify the defects in the Proposal itself, and further confuses matters by itself setting forth a host of additional statements which are both vague and indefinite as well as false and misleading.**

As noted above, the Proposal itself is woefully inadequate, as it fails to address a variety of real-life situations likely to occur in connection with "any pension plan money," including how to interpret such term as well as the "income" and costs associated with the Company's various retirement plans in net surplus and deficit positions. Moreover, there is nothing in the "Statement of Support" providing any other information which would serve to elucidate how certain items garbled in, or missing from, the Proposal itself might be interpreted. Not only does the instant "Statement of Support" fail to provide the Company with any better understanding of how the Company could go about implementing the Proposal under these various scenarios, the Statement of Support actually goes on to compound the confusion by injecting a variety of new statements which, in and of themselves, are vague and indefinite as well as false and misleading under Rules 14a-8(i)(3) and 14a-9.

a. Paragraph 1 of the Statement of Support

Rather than aiding in an understanding of the Proposal, as a supporting statement normally should do, the instant Statement of Support serves to further confuse under Rule 14a-8(i)(3). For example, the Company believes the first paragraph of the Statement of Support is false and misleading, as there simply is no factual basis for the statement that IBM "distorts the principle of pay for performance" to the extent it bases executive compensation on pension income. IBM executives are in fact fully accountable for, and earn their incentive compensation based upon, the Company's results, as determined under generally accepted accounting principles (GAAP). Moreover, the Company is not "distorting" anything by basing its compensation arrangements on income properly determined and reported under GAAP. Indeed, since bottom line accountability is the hallmark of "pay for performance," we believe it is wholly false and misleading for the Proposal to suggest that IBM is distorting this concept by basing executive compensation on income determined under GAAP rather than under the vague and confusing model now suggested by the Proponent.

Moreover, the Company finds false and misleading the Proponent's attempt in this first paragraph: (i) to single out IBM and its treatment of pension income under the "accounting rules," and (ii) to claim the structure of our executive compensation programs may be distorted. The design of IBM's executive compensation programs are in fact "state of the art" models of pay for performance, with the structure of such plans having been recommended to the Company by independent expert consultants who deal regularly with such plans and who also work with a variety of other public and private corporations on incentive compensation arrangements. In addition, there is nothing unique about basing incentive compensation calculations on the Company's net income (which includes the pension income the Proponent now complains about). Indeed, any intimation that IBM is somehow operating differently from other companies in this arena is not well taken. While the Proponent may be opposed to *how much* the Company pays out to its executives, as evidenced in the third and fourth paragraphs of the "Statement of Support", we believe it is disingenuous for the Proponent to suggest "distortions" in *how* we compensate our executives (through the structure of the underlying compensation plans).

Moreover, "performance-based" terms for both the Company's annual incentive as well as the long-term performance incentive programs were specifically approved by IBM stockholders at the 1995 and 1999 annual meetings. In connection with the deductibility of compensation under Section 162(m) of the Internal Revenue Code, the Company specifically noted in our 1999 proxy statement that:

the Compensation Committee will not have the flexibility to pay a covered executive more than the incentive amount indicated by [the] formula. The Compensation Committee will have the flexibility to reduce this amount in its complete discretion. (1999 Proxy Statement at page 27).

The Company therefore rejects any intimation that executive compensation is not performance-based. Given all of the foregoing, the first paragraph of the Statement of Support should be omitted in its entirety as false and misleading under Rules 14a-8(i)(3) and 14a-9.

b. Paragraphs 2, 4 and 6 of the Statement of Support

Each of the second, fourth and sixth paragraphs of the "Statement of Support" when read together, are replete with a host of statements which are both vague as well as misleading under Rules 14a-9 and 14a-8(i)(3). Specifically, these paragraphs falsely imply, among other things, that IBM, *in order to raise the amount of income in the pension plan so that the executive compensation payouts could also be raised:*

- (i) created a cash balance plan;
- (ii) wrongfully withheld "retiree cost of living adjustments from 1989 to 2001" and
- (iii) engages in the practice of "earnings management."

Uninformed readers of these three paragraphs could well believe, *falsely*, that the Company manipulates the pension plan, including its structure, investments and payouts, all for the financial benefit of the Company's executives. Nothing can be further from the truth. See Note (b) to Rule 14a-9, *supra*.

In the first place, contrary to the Proposal's suggestion, the Company's cash balance pension plan was implemented in order to allow the Company to stay competitive in the marketplace and to attract and retain the industry's most talented people. Second, the old pension plan has always made all payments due and owing to its existing retirees in a timely manner. Contrary to the Proposal's suggestion, there were, in fact, absolutely no "cost of living adjustments" even payable to retirees under the pension plan during the period in question. Therefore, given this fact, it is both false and misleading to suggest that IBM "withheld" any such amounts from its retirees.³ Furthermore, it is equally false and misleading for the Proposal to suggest that the Company is involved in earnings management, or that the Company's senior executives manage the pension fund's day-to-day investments for their own advantage. Rather, such investments are made by independent investment managers, who act as fiduciaries strictly in accordance with the terms of the Employment Retirement Income Security Act of 1974 (ERISA). For the same reason, the Company utterly rejects the intimation in the final paragraph of the Statement of Support that the Company undertook various steps in order "to increase the compensation of senior executives by millions of dollars." In addition to the fact that the Company acts strictly in accordance with applicable laws, rules and regulations, the actual executive compensation criteria for the Company's senior executives are determined -- not by the Company's senior executives themselves -- but by capable individuals who are completely independent of management -- in this case, members of the Executive Compensation and Management Resources Committee of the Board of Directors. As described in our proxy statement:

³ This allegation also is indicative of a personal grievance of the Proponent, an IBM retiree, who suggested as part of his Proposal last year that IBM retirees be given an increase in their pensions. In fact, the Company provided an increase to retirees

"[t]he Executive Compensation and Management Resources Committee has responsibility for administering and approving all elements of compensation for elected corporate officers and certain other senior management positions.... Members of this committee are outside directors who are not officers or employees of IBM or its subsidiaries and are not eligible to participate in any of the plans or programs that the committee administers. In the opinion of the Board, these directors are independent of management and free of any relationship that would interfere with their exercise of independent judgment as members of this committee." (IBM 2001 Proxy Statement at page 10).

In this same vein, the Company strongly objects to the Proposal's use of the term "given" in the first and second sentence of the fourth paragraph of the Statement of Support. IBM executives were not "given" either their "cash bonus awards" or their long-term incentive payments. Rather, to the extent such executives received payouts under such categories, those executives earned such payments in accordance with the terms of the applicable plans--all as described in the Company's proxy statement.

The Company also objects to the Proponent's selective use of facts, as evidenced in last sentence in the second paragraph, relating to the increase in the expected rate of return on pension assets and the "growth of pension income that was credited to IBM under the accounting rules." There are a number of actuarial assumptions utilized in order to determine costs and benefit obligations for the principal pension plans. Depending on the assumptions made, income may decrease or increase. These assumptions include the discount rate, the expected return on plan assets and the rate of compensation increase. (See Exhibit B at page 87 -- *Table of Weighted-Average Actuarial Assumptions* as of December 31, 2000, 1999 and 1998). Under current accounting rules, the expected rate of return on plan assets represents the Company's long term view of investment returns, not just the current year. Adjustments are effected in full compliance with generally accepted accounting principles ("GAAP") and SFAS 87 and 132. Moreover, the change was fully supported by historical investment performance. While the Proponent appears to be focusing on the 1999 to 2000 expected return on plan assets change from 9.5% to 10%, he utterly ignores other assumptions in the same table, such as the rate of compensation increase, which was flat last year, but which increased from 5% to 6% between 1998 and 1999. It is noteworthy that such an increase in the compensation has exactly the opposite effect on the costs of the pension plans. It *increases* the cost and *reduces* any gain. Since no acknowledgment or explanation whatsoever was made of any of these other factors, which factors are important and which have a net positive or negative effect on the GAAP pension income as reported from year to year, the entire sentence should be viewed as woefully incomplete as well as potentially materially misleading to any reasonable stockholder actually interested in understanding the implications of the Proposal and voting intelligently thereon. The sentence should therefore be omitted in its entirety.

For these reasons, we believe the host of defects -- including both omissions and misstatements -- are simply not subject to any ready cure under Rules 14a-8(i)(3) and 14a-9. Since each of the second, fourth and sixth paragraphs of the Statement of Support contain a variety of material omissions as well as false and misleading statements, each of these three paragraphs should be omitted in *their entirety* under such Rules.

c. Paragraph 3 of the Statement of Support

The third paragraph of the Statement of Support is also materially false and misleading within the meaning of Rules 14a-8(i)(3) and 14a-9. In the first place, the Proponent incorrectly compares the "record after-tax profit of \$8.1 billion" with \$1.17 billion from the Company's defined benefit plans. Unfortunately, the \$1.17 billion is a pre-tax amount. In colloquial terms, the Proponent is improperly comparing apples and oranges. It is therefore entirely incorrect -- as well as materially false and misleading -- for the Proponent to compare the two amounts, and then to subtract the pre-tax amount of \$1.17 billion from the \$8.1 billion of net income after tax, in order to come up with the incorrect conclusion that "IBM's reported net profit would have fallen from the prior year to just \$6.9 billion." For this reason alone, the entire third paragraph should be omitted as materially false and misleading under Rule 14a-9.

In addition, and irrespective of the improper calculation, the discussion in such paragraph fails to consider that IBM *must also* report, under SFAS 87 and SFAS 132, the costs associated with its *defined contribution* plans in its financial reporting as well as its *defined benefit* plans. Retirement Plan reporting under SFAS 87 and 132 includes reporting related to both the income/cost associated with the Company's defined benefit plans as well as the income/cost associated with the Company's defined contribution plans. In formulating the Proposal, the Proponent appears to have reviewed Note V to the Company's 2000 Annual Report, but focused solely upon the *defined benefit* plan numbers in crafting the Statement of Support. However, in so doing, the Proponent totally ignored the very real and substantial costs associated with the Company's *defined contribution* plans. Why were these costs ignored? The Proposal clearly states that the executive compensation be determined without regard to "any pension fund money" that accounting rules may require the company to treat as income. With this being the case, does the Proponent also want the Company to ignore these costs in making the Executive Compensation calculations? Or does the Proponent want these costs to be considered in order to reduce the amount of profits subject to these calculations? The dollar amount of such *defined contribution* plan costs, \$443 million, is quite real and significant. Under GAAP, these costs must also be properly recognized in the Company's Consolidated Statement of Earnings. More importantly, for purposes of this Proposal, the Proponent should also recognize that such costs serve to materially reduce the overall effect of the retirement plans on the Company's earnings. Since the Proponent utterly ignores this \$443 million in the discussion, and since these defined contribution plan costs are quite material to an understanding to the impact of all retirement plan income/costs that must be recognized in the Company's Consolidated Statement of Earnings, the Company believes that the Proponent's omission of this \$443 million causes the entire third paragraph of the Statement of Support (as well as the text of the Proposal, supra) to be materially false and misleading.⁴

Furthermore, as was also noted earlier, the Proponent has also utterly ignored the fact, which was also clearly pointed out in Note V as well as Note W to the Company's 2000 Annual Report, that IBM also incurred an additional \$401 million of costs for nonpension postretirement benefits in 2000. We believe this amount is also material. Once all of these costs are properly considered, the total retirement-related income in 2000, including the nonpension postretirement benefits, amounted to only \$327 million. As noted earlier, \$327 million is materially less than the \$1.17 billion the Proponent has cited in his Proposal.

We continue to believe that it is wholly improper under Rules 14a-8(i)(3) and 14a-9 for a proposal to: (1) misstate certain items, (2) "cherry pick" from other items favorable to the Proponent's position, and (3) utterly ignore other items which are unfavorable to the Proponent's position, but which are quite material to a full understanding of the issues raised in the Proposal. This is the situation we face here. As a result of the multiple problems we have outlined, the Company believes this entire third paragraph should be omitted under Rules 14a-8(i)(3) and 14a-9.

d. Paragraph 5 of the Statement of Support

Paragraph 5 of the Statement of Support is also materially false and misleading. For the reasons set forth earlier, in connection with the first paragraph of the Statement of Support, the Company renews its same objection to the premise of the Proposal that the Company is somehow distorting the principle of pay for performance through these calculations. It is not. In addition, since the Company already views such compensation as performance-based, and since IBM stockholders have approved the terms of the

⁴ In addition to being materially false and misleading under Rules 14a-9 and 14a-8(i)(3), this oversight also casts substantial doubt over the integrity of the Proposal itself, which makes reference to "any pension fund money that accounting rules may require the company to treat as income." (sic) It is axiomatic that "any pension fund money" should properly include both defined benefit pension plan money as well as defined contribution pension plan money. See Note V to the Company's Annual Report, supra. See also text accompanying footnote 2, supra.

programs under which incentive compensation is paid to senior executives (see discussion in 2(a), supra), the entire fifth paragraph of the Statement of Support is also redundant and should be eliminated.

Given all of the multiple infirmities, in both the Proposal as well as the Statement of Support, the Company submits, after having carefully studied the submission, including each of its component parts, that it is both vague and indefinite as well as woefully false and misleading. Clearly, neither the IBM stockholders nor the Company should have to wonder how this Proposal ought to be interpreted, let alone implemented. Over the years, there have been many situations in which the staff has granted no-action relief to registrants with proposals which were similarly infirm. In this connection, the Commission has found that proposals may be excluded where they are

so inherently vague and indefinite that neither the shareholders voting on the proposal, nor the Company in implementing the proposal (if adopted), would be able to determine with any reasonable certainty exactly what actions or measures the proposal requires. See Philadelphia Electric Company (July 30, 1992).

The staff's response above applies with full force to the instant Proposal. In Wendy's International, Incorporated (February 6, 1990), the staff excluded under former Rule 14a-8(c)(3) a proposal seeking to "eliminate all anti-takeover measures previously adopted and refrain from adopting any in the future." The staff noted that the proposal, if implemented, would require the Company to determine what constitutes an anti-takeover measure, and that such a determination would have to be made without guidance from the proposal, and would be subject to differing interpretations by shareholders voting on the proposal and the Company if the proposal were implemented. The staff therefore determined that the Proposal could be misleading because any action ultimately taken by the company upon implementation could be significantly different from the actions envisioned by shareholders voting on the Proposal. See also Comshare, Incorporated (August 23, 2000) (second proposal asking for Comshare not to "discriminat[e] among directors based upon when or how they were elected" and "try to avoid defining change of control based upon officers or directors as of some fixed date," properly excluded by registrant as vague and indefinite); see also IDACORP, supra; H.J. Heinz Company, supra.

The courts have supported such a view, quoting the Commission's rationale:

it appears to us that the proposal, as drafted and submitted to the company, is so vague and indefinite as to make it impossible for either the board of directors or the stockholders at large to comprehend precisely what the proposal would entail. Dyer v. Securities and Exchange Commission, 287 F. 2d 773, 781 (8th Cir. 1961).

In the case of NYC Employees' Retirement System v. Brunswick Corp., 789 F. Supp. 144, 146 (S.D.N.Y. 1992), the court stated:

the Proposal as drafted lacks the clarity required of a proper shareholder proposal. Shareholders are entitled to know precisely the breadth of the proposal on which they are asked to vote.

The rationale employed in both Dyer and Brunswick should apply in full force to the instant Proposal.

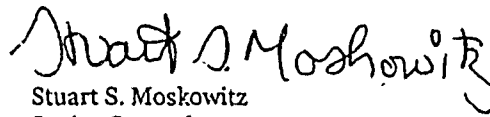
Similarly, in Eastman Kodak Company (February 8, 1991), the registrant was also faced with a proposal which, like the instant one, was hopelessly vague and indefinite. There, the proponent urged that the registrant not provide or make available its products, services, or other resources to any government or entity doing business with or in any country which demonstrated its anti-Americanism and threat to U.S. national security by voting in the United Nations more than 80 percent of the time during the last five years against the position of the United States. Upon review of that proposal, the staff concurred that it simply could not stand, noting specifically "the absence of any specificity as to what constitutes the Company making its resources 'available' to a prohibited entity or as to what constitutes an 'entity doing

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business with' an anti-American company." Given the fact that the instant Proposal suffers from multiple infirmities similar to those noted in the above staff letters and court cases cited above, the Company hereby submits that the instant Proposal and Statement of Support should also be omitted *in its entirety* under Rules 14a-8(i)(3) and 14a-9. The Company therefore respectfully requests that no enforcement action be recommended to the Commission if the Company excludes the *entire submission* on the basis of Rules 14a-8(i)(3) and 14a-9.

In summary, for the reasons and on the basis of the authorities cited above, IBM respectfully requests your advice that the Division will not recommend any enforcement action to the Commission if the Proposal is omitted from IBM's proxy materials for the 2002 Annual Meeting. We are sending the Proponent and each co-filer a copy of this submission, thus advising them of our intent to exclude the Proposal from the proxy materials for the 2002 Annual Meeting. We respectfully request to be copied on any response that may be made to the Commission. If you have any questions relating to this submission, please do not hesitate to contact the undersigned at (914) 499-6148. Thank you for your attention and interest in this matter.

Very truly yours,



Stuart S. Moskowitz
Senior Counsel

with copies to: Mr. Donald S. Parry
1178 Wood Duck Hollow
Jacksonville, FL 32259-2932
and the co-filers to the Proposal

IBM Stockholder Proposal on Executive Compensation.

Resolved: The Stockholders request that the Board of Directors adopt a policy that executive compensation will be determined in the future without regard to any pension fund money that accounting rules may require the company to treat as income, so that the compensation of senior executives will more closely reflect their performances in managing the business.

Statement of Support

Accounting rules require IBM to treat a portion of certain pension fund surpluses as income even though no pension fund money is transferred to the company. To the extent IBM bases executive compensation on such pension income, it distorts the principle of pay for performance.

At the end of 2000, IBM's defined benefit pension plans had a total surplus of \$10.7 billion in excess of benefit obligations. The surplus arose, in part, from stock market gains, the 1999 creation of a cash balance pension plan that cut the projected retirement pay of many employees, and the withholding of retiree cost of living adjustments from 1989 to 2001. An increase in the expected rate of return on pension assets also contributed to the growth of pension income that was credited to IBM under the accounting rules.

IBM reported "record after-tax profit of \$8.1 billion" for 2000. But "net periodic pension income" from the company's defined benefit plans accounted for \$1.17 billion of that total. Without that \$1.17 billion in "pension income" IBM's reported net profit would have fallen from the prior year to just \$6.9 billion.

Despite this fact, IBM's five top executives were given \$11.67 million in cash bonus awards "for the year's performance." They were given an additional \$12.87 million under the Long Term Incentive program based largely on IBM reaching predetermined income targets. It therefore appears that the compensation of these executives was strongly influenced by the "pension income" that permitted IBM to report a "record after-tax profit" for 2000.

We believe compensation ought to be based on performance. It should not be distorted by "pension income" because that source of reported income does not reflect the operational performance of the Company, money actually received by the Company, or the performance of executives.

A related concern, according to a Wall Street Journal report, is the possibility "that companies can use pension accounting to manage their earnings by changing assumptions to boost the amount of pension income that can be factored into operating income." The possibility of earnings management is increased when changes in assumptions, or cuts in retirement benefits, have the potential to increase the compensation of senior executives by millions of dollars.

ES 91595

CHAIRMANOFFICE

From: JRS1RON@aol.com
Sent: Thursday, November 22, 2001 10:30 PM
To: chairmanoffice@sec.gov
Cc: stuartmoskowitz@us.ibm.com
Subject: IBM Stockholders Proposal of Donal M Parry

This note is intended for the SEC Office of Chief Counsel & is in response to the 11/15/01 letter from IBM Senior Counsel Stuart Moskowitz. Mr. Moskowitz's 11 page letter asks that the proposal be omitted from the proxy materials for the 2002 Annual Meeting. He states that the proposal is "vague and indefinite as well as materially false and misleading". He then goes on with 11 pages of legalistic BS as justification. As an IBM stockholder I strongly disagree that the proposal is vague and indefinite. The proposal is simple and direct, with the intent of basing executive compensation on the current operational results. They currently are factoring in increases in the pension funds in the formulas to determine executive compensation. Although I try to wade through the 11 pages, I was frustrated by the obvious "smokescreen" he was attempting. The proposal refers to pension fund money and the rebuttal attempts to muddy the water with arguments regarding the nonpension postretirement benefit costs. These referenced costs have nothing at all to do with the pension funds and is an obvious diversion. In reviewing the letter I saw no justification for the allegations of being false and misleading. In summary the proposal has merit, and is clear enough that some of those highly rewarded executives could implement it to meet the intent of the proposal. I believe the proposal is in the best interest of IBM stockholders, and they should get a chance to evaluate and vote on it.

Donald S. Parry
1178 Wood Duck Hollow
Jacksonville, Fl., 32259-2932
December 5, 2001

01 DEC -6 PM 11:50

Office of the Chief Counsel, Division of Corporate Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

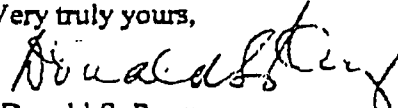
Subject: Reply to IBM's November 15, 2001 letter concerning my Stockholder Proposal on Executive Compensation.

Dear Members of the Office of the Chief Counsel, Division of Corporate Finance,

I received a copy of IBM's letter dated November 15, 2001. The letter states that the stockholder proposal I submitted "may properly be omitted from IBM's proxy materials".

I am sending this letter to advise you that I will be sending a detailed response in the near future. Please do not make any decision until you have had a chance to read and consider my reply. Thank you.

Very truly yours,



Donald S. Parry

cc: Stuart S. Moskowitz

Frederick B. Wade
ATTORNEY AT LAW

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FAX (608) 255-3353

SUITE 740
122 WEST WASHINGTON AVENUE
MADISON, WISCONSIN 53703 .

Phone (608) 255-5111

December 14, 2001

Office of Chief Counsel
Division of Corporation Finance
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: IBM Request for a No-Action Letter Concerning
Stockholder Proposal of Donald S. Parry

Ladies and Gentlemen:

I. Introduction

I am sending this letter in response to the claim of International Business Machines ("IBM" or the "company") that the stockholder proposal of Donald S. Parry "may properly be omitted from IBM's proxy materials." With the possible exception of a mathematical computation in paragraph 3 of the Statement of Support, we submit that the Proposal and the Statement of Support are precise, clearly stated and accurate as submitted.

II. The Proposal

A. Background

The Proposal seeks to change IBM's current practice of including "net periodic pension income" in the after-tax net income and earnings-per-share numbers that the Company uses as criteria for the making of executive compensation decisions. As explained below, this practice has led the company to compensate its top executives for the year 2000 as if they contributed to the production of \$1.17 billion in pre-tax "pension income" through their efforts in managing the business, when in fact their performance in managing the business had nothing to do with the production of that income.

In this context, the company's 2001 proxy statement contains an explicit representation on page 13 that the executive "compensation program" is partially "tied both to annual and long-term financial performance." Two pages later it states that "IBM achieved . . . record after-tax profit of 8.1 billion, and earnings improvement of 19%, year-to-year . . . to a record \$4.44 per share," as if those financial "results" are an accurate measure of "IBM's business performance" for the year 2000.

Then, on the apparent assumption that "such financial measures as net income . . . [and] earnings-per-share" are in fact accurate measures of "IBM's business performance," the Chairman and Chief Executive Officer was given an annual bonus award of \$8,000,000, an increase of \$800,000 over the prior year, on the premise that his bonus was "earned for the year's performance." (emphasis added, pp. 13, 14, 16). In addition, the proxy materials state that he "also earned a payout from the 1998-2000 long-term incentive program award [valued at \$3.58 million] based on the Company's cumulative financial results over the three-year period," with most of the weight given to "earnings-per-share." (emphasis added, pp. 15-16).

Despite the assertions that the Chairman "earned" his bonus and "earned" his long-term incentive award, it is a fact that \$1.17 billion of IBM's total pre-tax income of \$11.5 billion, or more than 10 per cent of that total, was derived from "net periodic pension income" from the Company's defined benefit pension funds (DB funds). In other words, more than 10 per cent of IBM's pre-tax income was derived from a source that had nothing to do with the performance, efforts or operational actions of the company's senior executives.

B. The Text of the Proposal

The Proposal is carefully designed to prevent senior executives from being compensated in the future for the production of "pension income" that they did not contribute to earning by their efforts in managing business. It requests:

"that the Board of Directors adopt a policy that executive compensation will be determined in the future without regard to any pension fund money that accounting rules may require the company to treat as income, so that the compensation of senior executives will more closely reflect their performances in managing the business."

Under the circumstances set out above, the proposal is precise, clearly stated and accurate as it stands. For example, given IBM's current practice of including "pension income" in the after-tax net income and earnings-per-share numbers that the company uses as measures of executive performance, the proposal plainly calls for subtracting that "pension income" from those after-tax numbers at the point that they are factored into executive compensation decisions.

The reference to "pension fund money that accounting rules may require the company to treat as income" makes clear that the Proposal contemplates the same computations under the accounting rules that IBM actually used to determine the amounts of "net periodic pension income" that it reported from various defined benefit plans for the year 2000. These are the same amounts that IBM reported to investors on pages 57 and 86 of its annual report.

The word "any" is used in recognition of the fact that IBM has more than one defined benefit plan that is now producing income under the accounting rules. For the year 2000, IBM reported "net periodic pension income" in the table on page 86 of its annual report of \$824 million from its "U.S. Plan," and \$347 million from various "Non-U.S. Plans." Under these circumstances, the use of the word "any" reflects the fact that the net income from all of these plans must be added together to determine the total amount of "pension income" for the year 2000, which was not derived from "IBM's business performance." And when these numbers are added together, as IBM did on page 57 of the annual report, it is evident that IBM had a total of \$1.17 billion in pre-tax "net periodic pension income" for 2000 as a result of "cost and expense reductions" related to its DB pension funds.

III. Response to the Company's Arguments

A. Response to Arguments Concerning the Proposal and Paragraphs 1 and 5 of the Statement of Support

Most of the Company's arguments stem from a refusal to accept the proponent's premise that a change in policy is needed to prevent the compensation of senior executives, as if they had contributed to the production of pension income by their efforts in managing the business, when in fact they did not. For example, the company lawyer makes an incredible claim, in view of the facts set forth in the preceding paragraphs, that "there is simply no factual basis for the statement that IBM 'distorts the principle of pay for performance' to the extent it bases executive compensation on pension income." (p. 6).

This argument is plainly indefensible. IBM executives were compensated as if their efforts in managing the business during the year 2000 contributed to the production of 100 per cent of IBM's after-tax net income, when it is evident that those efforts contributed to producing less than 90 per cent of the company's pre-tax net income of \$11.5 billion.

The company lawyer goes on to claim that the Proposal and Statement of Support are false and misleading, on the theory that the costs of defined contribution plans (DC plans) and certain other nonpension post retirement benefits "are all properly considered in calculating a company's total costs for its post-retirement obligations." (p. 2). But the calculation of the total post-retirement costs is not the issue. The issue is IBM's current practice of compensating executives, as if they had contributed to the production of pension income by their efforts in managing the business, when in fact they did not.

In this context, it is important to understand that the DB funds, DC plans, and other post-retirement plans are all forms of deferred compensation that are normally accounted for as a cost of operations. These costs must normally be offset by profits from business operations, which are under the direction and control of senior executives, if the company is to report any net profit.

It is not normal for pension funds and post-retirement plans to generate income that can be used to offset the costs of operations, and thereby make it appear that the amount of income from operations is higher than the amount that those business operations actually earned. Under these circumstances, there is nothing false or misleading about the proposition that "net periodic pension income" ought to be subtracted from the criteria that IBM uses to make decisions about the compensation of its executives. While IBM may be required to include that pension fund "income" in its consolidated net earnings for purposes of financial reporting, it does not necessarily follow that the company ought to compensate its senior executives, as if they had contributed to producing that income by their individual efforts in managing business operations, when in fact they did not do so.

The company lawyer also attempts to confuse the issue by asking a number of questions about how DC plans might be treated under the proposal. But the DC plans are clearly outside the scope of the proposal.

The Proposal is expressly limited, by its terms, to the Company's practice of treating "pension fund . . . income" for purposes of executive compensation as if it were ordinary income from operations. In contrast, the assets of a DC plan are held in individual accounts rather than a single "fund." Moreover, it is my understanding that a DC plan cannot produce any income that would ever be added to the earnings statement. And, whether this understanding is always true or not, the table on page 86 of the annual report makes clear that the Proposal does not affect DC plans, because they did not generate any income for the year 2000, and are not likely to generate any income for the foreseeable future.

As for the costs of DC plans, those are normal and customary costs of operations. Since the proposal is concerned with the abnormal phenomenon of "income" that is derived from a source other than the operations that are under the direction and control of IBM's executives, it would clearly be inappropriate to subtract the costs of DC plans from the pension income that the company derived from its DB plans in 2000. That would mask and conceal the true amount of reported pre-tax income that did not result from

the efforts of senior executives. Accordingly, there is nothing false or misleading about either the Proposal, or the Statement of Support, as a result of the fact that DC plans are outside the scope of the proposal. The Proposal is clearly limited, by its express terms, to the kind of "pension income" from the DB funds that IBM identified and reported for the year 2000 on pages 57 and 86 of its annual report.

The company lawyer also attempts to confuse the issue by claiming that the costs of "nonpension postretirement benefits . . . are properly considered." (p. 4). But as noted above, the proposal is plainly limited by its terms to the unusual phenomenon of "pension fund . . . income," which has been used in the making of executive compensation decisions, as if it were ordinary income from operations. As in the case of the DC plans, it would therefore be inappropriate to subtract the costs of those nonpension benefits from the "net periodic pension income" that IBM reported, because that would mask the amount of reported pre-tax "income" that the company's senior executives did not contribute to producing through their personal efforts in managing the business. Thus, as in the case of the DC plans, there is nothing false or misleading about either the Proposal, or the Statement of Support, as a result of the fact that nonpension post retirement plans are outside the scope of the proposal.

The company lawyer also attempts to confuse the issue by asking rhetorical questions like "what is meant by income?" (p. 4). In asking such questions, he utterly ignores the fact that the proposal concerns "any pension fund money that accounting rules may require the company to treat as income." (emphasis added). As with the question just cited, the answers to his questions lie in the applicable accounting rules that are specified in the proposal.

Finally, the company lawyer disputes use of the term "pension fund money" on the ground that there is no item in the table on page 86 of the annual report that "is specifically labeled "pension fund money." (p. 2). First, as a matter of usage, it would have been redundant to speak of "any pension fund income that the accounting rules may require the company to treat as income." (emphasis added). More importantly, the American Heritage Dictionary (Second

College Edition) defines "money" as "assets and property considered in terms of monetary value." Therefore, as used in the proposal, "pension fund money" clearly means the monetary value of any assets or property owned by the company's DB pension funds "that accounting rules may require the company to treat as income." For the year 2000, that monetary value is the \$1.17 billion total of "net periodic pension income" that IBM reported to investors on pages 57 and 86 of its annual report.

B. Response to the Arguments Concerning
Paragraph 3 of the Statement of Support

The company lawyer contends that it was false and misleading "to subtract the pre-tax amount of \$1.17 billion from the \$8.1 billion of net income after tax" in paragraph 3 of the Statement of Support, in order to calculate the impact of IBM's "pension income" on the after-tax net income that the Company reported. In this context, RIA's Analysis of Federal Taxes: Income, states that the earnings of a qualified retirement plan "are tax-exempt -- permitting a tax-free buildup of the funds." (See Exhibit A, par. H-5101). Moreover, because the assets of IBM's defined benefit plans are held in trust for the benefit of the beneficiaries, it is clear that IBM did not actually receive any of the "pension income" that it reported as part of its consolidated statement of earnings.

Under these circumstances, it appears that no tax was actually due on the \$1.17 billion in pre-tax "pension income" that IBM reported. From this perspective, it was not unreasonable for the proponent to subtract the \$1.17 billion figure from IBM's "record after-tax profit of \$8.1 billion," in order to determine what the after-tax profit would have been without the fortuitous addition of that pre-tax "pension income" to the earnings statement.

However, in preparing this letter, I have contacted a number of attorneys and accountants in private practice, at the University of Wisconsin School of Business, and in various government agencies in an attempt to determine whether all of the \$1.17 billion in pre-tax pension income would have flowed through to the bottom line of the earnings statement, as the proponent assumed. Although I have not been able to obtain a definitive answer to this highly

esoteric accounting question, it may be that the company lawyer has a point. While it appears that IBM was not actually required to pay any taxes on the \$1.17 billion in pension income that it reported, it has been suggested to me that GAAP may have required IBM to create a "deferred tax liability" to account for the fact that its income for earnings statement purposes was higher than its income for tax purposes. It has also been suggested that, if such a "deferred tax liability" was created for financial reporting purposes, the \$1.17 billion in pension income would not have flowed through to the bottom line without some reduction to account for the amount of the "deferred tax liability" involved.

A definitive resolution of this esoteric issue is not necessary in the present context, because the proponent is prepared to modify the paragraph to eliminate any doubt about its accuracy. Three proposed alternatives are set forth below with additions noted in bold type, and deletions set off with brackets.

The first alternative would make two deletions to eliminate the specific computation of how much the company's "reported net profit would have fallen" in 2000, as well as the last three words of the second sentence:

"IBM reported "record after-tax profit of \$8.1 billion" for 2000. But "net periodic pension income from the company's defined benefit plans accounted for \$1.17 billion [of that total]. Without that \$1.17 billion in "pension income" IBM's reported net profit would have fallen from the prior year [to just \$6.9 billion].

The second alternative would go a step further by adding "pre-tax" before each reference to "pension income" in order to highlight the distinction between pre-tax and after-tax income:

"IBM reported "record after-tax profit of \$8.1 billion" for 2000. But **pre-tax** "net periodic pension income from the company's defined benefit plans accounted for \$1.17 billion [of that total]. Without that \$1.17

billion in pre-tax "pension income" IBM's reported net profit would have fallen from the prior year [to just \$6.9 billion].

A third alternative would go another step further, by specifying the total amount of IBM's pre-tax income, so that investors would be able to determine, at least on a pre-tax basis, the proportion of IBM's income that was derived from its DB funds:

"IBM reported "record after-tax profit of \$8.1 billion" for 2000. But pre-tax "net periodic pension income from the company's defined benefit plans accounted for \$1.17 billion of IBM's total pre-tax income of \$11.5 billion [that total]. Without that \$1.17 billion in "pension income" IBM's reported net profit would have fallen from the prior year [to just \$6.9 billion].

A fourth alternative would require IBM to volunteer the amount of "net periodic pension income" that actually did flow through to the bottom line, if IBM did in fact subtract any "deferred tax liability" from the pre-tax amount of its pension income in computing its after-tax net income for 2000. This is apparently a number that is in the possession and control of IBM. In that event, the paragraph could be revised by the simple substitution of the appropriate after-tax number for the pre-tax number of \$1.17 billion, and the \$6.9 billion figure in the last sentence could be altered to reflect the difference in the amount subtracted.

Each of the four alternatives reflects the fact that the third sentence of the paragraph is accurate insofar as it states that "IBM's reported net profit would have fallen from the prior year." Since the difference between IBM's reported after-tax profit of \$8.193 billion for 2000, and its \$7,712 million profit for the prior year is only \$381 million, it would take a "deferred tax liability" of \$790 million, in relation to the total pension income of \$1.17 billion, to make the quoted statement inaccurate. And a "deferred tax liability" of that magnitude would appear to be impossible, in view of the fact that the effective tax rate for IBM was only 29.8 per cent in 2000, and the maximum corporate income tax rate is only 40 per cent.

A fifth alternative would be the deletion of paragraph 3 in its entirety, together with the first three words of paragraph 4. However, removal of the paragraph would deprive shareholders of any information within the four corners of the Proposal and the Statement of Support, concerning the extent to which "net periodic pension income" contributed to the earnings that IBM reported for the year. Whether the ultimate impact is close to \$1 out of every \$8 that the Company earned on an after-tax basis if no "deferred tax liability" was deducted, or \$1 out of every \$10 that it earned on a pre-tax basis, the paragraph clearly makes an important point that a reasonable shareholder would consider important in determining whether the proposal ought to be adopted.

The other important point for shareholders to know is the fact that, without that pension income, IBM would not have been able to report "record after-tax profit of 8.1 billion, and earnings improvement of 19%, year-to-year . . . to a record \$4.44 per share," as it stated on page 13 of its proxy statement. Instead, even if the pre-tax amount of \$1.17 billion was treated as if it were taxable at a much higher rate than the maximum corporate income tax rate that the Internal Revenue Code has imposed, IBM would still have been required to report a drop in after-tax profits from the prior year in the absence of that pension income.

C. Response to Arguments Concerning Paragraphs
2, 4 and 6 of the Statement of Support

Contrary to the arguments of the company lawyer, there is nothing that is false or misleading in the remaining paragraphs of the Statement of Support. The arguments of the company lawyer with respect to paragraphs 2, 4, and 6 of that Statement are based entirely on his own mischaracterizations of what the proponent has said. (pp. 7-8).

Paragraph 2 contains factual statements about various factors that contributed to the accumulation of a \$10.7 billion pension surplus at IBM. Each separate statement is completely truthful and accurate as it stands. Contrary to the claims of the company lawyer on page 7, there is nothing whatsoever in paragraph 2 to "falsely imply" that any actions were taken with an intent or purpose "that the executive compensation payouts could also be raised," nor is

there any charge that IBM "wrongfully withheld" cost of living adjustments from retirees. (emphasis added).

In the context of cost of living adjustments, the company lawyer goes on to claim that "it is both false and misleading to suggest that IBM 'withheld' any such amounts from its retirees." (p. 7). But the American Heritage Dictionary defines "withhold" to mean "to refrain from giving [or] granting." And despite the existence of a massive pension surplus, "to refrain from giving [or] granting" cost of living increases is precisely what IBM did. It does not matter, for purposes of paragraph 2, whether any cost of living adjustments may have been payable, or not. Nor does it matter whether IBM may have been "wrongful," or within its rights.

The company lawyer also objects to paragraph 4 on the ground that it uses the word "given" in sentences that communicate the amounts of compensation that IBM's top five executives received. (p. 8). He claims that "IBM executives were not 'given' either their 'cash bonus awards" or their long-term incentive payments." (p. 8). But the American Heritage Dictionary makes clear that the word "given" means "to deliver in exchange or in recompense," as in the case of "pay." It also means to officially "bestow." Accordingly, there is nothing whatsoever that is false or misleading about the use of the word "given" in the paragraph 4. It is both precise and accurate.

Finally, the company lawyer claims that the two sentences in paragraph 6 of the statement of support are false and misleading. This claim is based on his own completely false allegations that those sentences "suggest that the Company is engaged in earnings management," and include an "intimation . . . that the Company undertook various steps in order 'to increase the compensation of senior executives by millions of dollars.'" (p. 7).

In fact, the first sentence of paragraph 6 explicitly refers to "the possibility," cited in a published report, "that companies can use pension accounting to manage their earnings" (emphasis added). That future-oriented sentence is plainly a far different matter than the making of a charge, or a suggestion, or even an intimation, that IBM has actually done any such thing.

Moreover, the second sentence of paragraph 6 explicitly states that the aforesaid "possibility of earnings management is increased when changes in assumptions, or cuts in retirement benefits, have the potential to increase the compensation of senior executives by millions of dollars." (emphasis added). This statement is undoubtedly true as it stands. Contrary to the blatantly false claims of the company lawyer, the two underlined words make it absolutely clear that there is no charge or suggestion or intimation whatsoever that IBM has taken any such steps in the past "in order to increase the compensation of senior executives by millions of dollars."

When read in context, the two sentences are plainly truthful and accurate. They make the legitimate point, as a supplemental reason for adoption of the Proposal, that it would be prudent to change IBM's existing compensation policies to prevent any future possibility that such issues may arise in the future.

IV. Conclusion

For the reasons set forth above, the company has failed to meet its burden of proof under Rule 14a-8(g). As a result, the request for a no-action letter should either be denied in its entirety, or withheld on the condition that the proponent make specified changes to clarify paragraph 3 of the Statement of Support.

Please do not hesitate to contact me if you should have any questions. I have enclosed six copies of this letter for the staff, and am sending copies to counsel for the company and the proponent.

Sincerely,

Frederick B. Wade

Frederick B. Wade

EXHIBIT A: Excerpt from Ria's Analysis of Federal Taxes

cc: Stuart S. Moskowitz
Donald S. Parry

00029

December 21, 2001

**Response of the Office of Chief Counsel
Division of Corporation Finance**

Re: International Business Machines Corporation
Incoming letter dated November 15, 2001

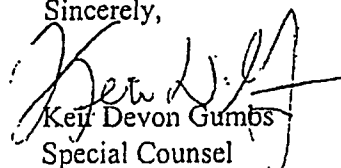
The proposal requests that the board of directors adopt a policy that "executive compensation will be determined in the future without regard to any pension fund money that accounting rules may require the company to treat as income."

We are unable to concur in your view that IBM may exclude the entire proposal under rule 14a-8(i)(3). However, there appears to be some basis for your view that portions of the supporting statement may be materially false or misleading under rule 14a-9. In our view, the proponent must:

- recast the sentence that begins "To the extent . . ." and ends ". . . pay for performance" as the proponent's opinion;
- delete the statement that begins "withholding of retiree cost . . ." and ends ". . . from 1989 to 2001;"
- delete the paragraph that begins "IBM reported . . ." and ends ". . . just \$6.9 billion;"
- delete the statement that begins "It should not be distorted . . ." and ends ". . . performance of executives;"
- delete the paragraph that begins "A related concern . . ." and ends ". . . by millions of dollars."

Accordingly, unless the proponent provides IBM with a proposal and supporting statement revised in this manner, within seven calendar days after receiving this letter, we will not recommend enforcement action to the Commission if IBM omits only these portions of the supporting statement from its proxy materials in reliance on rule 14a-8(i)(3).

Sincerely,


Keith Devon Gumbs
Special Counsel