

Via Hand Delivery

April 2, 2007

Conrad Hewitt
Chief Accountant
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Zions Bancorporation ESOARS

Dear Mr. Hewitt:

I am writing on behalf of the Council of Institutional Investors, an association of more than 135 public, corporate and union pension funds with combined assets of over \$3 trillion (“Council”). This letter is a follow-up to our letter to you of February 5, 2007,¹ regarding your office’s approval of Zions Bancorporation’s (“Zions”) Employee Stock Option Appreciation Rights Securities (“ESOARS”) for use as a market-based approach for valuing employee share-based payment awards under Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (“Statement 123R”).² We very much appreciate your February 23, 2007, letter in response to our February 5th letter, and the related telephone call by Joe Ucuzoglu of your office.³

As indicated in our February 5th letter, the Council has been, and continues to be, a strong proponent of Statement 123R.⁴ We believe Statement 123R improves financial accounting and reporting of share-based payment awards by requiring that, consistent with the Council’s corporate governance policies, all employee share-based payment awards be accounted for as compensation costs appropriately reducing reported earnings.⁵

¹ Letter from Jeff Mahoney, General Counsel, *Council of Institutional Investors*, to Conrad Hewitt, Chief Accountant, *Securities and Exchange Commission* (Feb. 5, 2007).

² Letter from Conrad Hewitt, Chief Accountant, *Securities and Exchange Commission*, to Mr. James G. Livingston, Vice President, *Zions Bancorporation* 1 (Jan. 25, 2007) (“Based on our review of your Submissions, and subject to your adoption of the modifications recommended in the following paragraph, the SEC staff concurs with your view that the ESOARS instrument is sufficiently designed to be used as a market-based approach to valuing employee share-based payment awards under Statement 123R.”).

³ Letter from Conrad Hewitt, Chief Accountant, *Securities and Exchange Commission*, to Jeff Mahoney, General Counsel, *Council of Institutional Investors* (Feb. 23, 2007).

⁴ Letter from Jeff Mahoney, *supra* note 1, at 1 n.3.

⁵ *Id.* at 1 n.4.

We also are a strong proponent of the fair value measurement objective and related implementation guidance contained in Statement 123R.⁶ We agree, as stated in that guidance, that “[o]bservable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, should be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees.”⁷

As also indicated in our February 5th letter, and in my telephone conversation with Mr. Ucuzoglu, the Council would “. . . (1) carefully analyze Zions’ ESOARS, (2) consult with leading valuation and accounting experts, and (3) report to your office any concerns about whether the approach produces sufficiently reliable values for financial reporting purposes.”⁸ Since February 5th I have had numerous informal conversations with many leading valuation and accounting experts to obtain their views on Zions’ ESOARS. In addition, the Council retained Compensation Valuation Inc. (“CVI”), a firm specializing in the valuation of employee stock options, to perform an evaluation of Zions’ ESOARS.

CVI’s report containing its assessment and recommended remedies regarding the “suitability of the ESOARS product for purposes of financial disclosure under FAS 123R” is attached to this letter for your review (“CVI Report”).⁹ In summary, consistent with the views of other leading valuation and accounting experts, the CVI Report concludes:

. . . the ESOARS product is too flawed to serve as a reliable valuation tool for FAS 123R purposes. While the tracking security itself is imperfect but not unreasonable, in combination with the auction mechanism and surrounding conditions and incentives, the design serves primarily to produce a predictably downward biased result.¹⁰

The CVI Report offers several “major modifications” designed to remedy the defects with Zions’ ESOARS including: (1) significantly increasing the issuance size and eliminating the artificial restrictions on bidders and holders of Zions’ ESOARS, and (2) reversing the Zions’ ESOARS so that Zions (and other companies valuing their employee stock options) must purchase (rather than sell) the ESOARS from third party suppliers.¹¹ The CVI Report notes that

. . . [w]ithout remedies or alternatives such as those proposed above, the ESOARS price should not be accepted by auditors nor certified by senior executives as correctly measuring the cost of a company’s ESOS.¹²

⁶ *Id.* at 1.

⁷ Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment*, ¶ A7 (footnote omitted).

⁸ Letter from Jeff Mahoney, *supra* note 1, at 2.

⁹ Compensation Valuation Inc., Zions Bancorp ESOARS: An Evaluation 1 (March 30, 2007).

¹⁰ *Id.* at 6; *see also* William Ortner et al., *Equity Compensation and the Capital Markets*, Citigroup Corporate and Investment Banking 19 (Aug. 15, 2006) (Zions’ ESOARS result . . . “in the ‘market’ bid for the instrument certainly being a lowball one.”).

¹¹ Compensation Valuation, Inc., *supra* note 9, at 6-8.

¹² *Id.* at 8.

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As indicated in our February 5th letter, it is our understanding that Zions plans to hold an auction for ESOARS within the next few weeks for purposes of valuing their own employee stock options for financial accounting and reporting.¹³ It is also our understanding that Zions plans to “handle” ESOARS auctions for a number of clients in the coming months and that those companies will use the auctions to value and report the fair value of their own employee stock options.¹⁴

Given the findings of the CVI Report and the results of my conversations with other leading valuation and accounting experts, we are deeply concerned that Zions’ ESOARS will result in information reported to investors that will not faithfully reflect the true costs of an enterprise’s employee share-based awards. Investors have long been misled about the costs of employee share-based compensation, as evidenced most recently in connection with the far too common practice of stock option backdating.

Given the magnitude of employee share-based compensation (over \$40 billion for the S&P 500),¹⁵ and its continued prevalent use, investors cannot afford to continue to be given purposely biased information about the costs of these awards. We, therefore, would respectfully request that your office prohibit Zions and all other public companies from using the Zions’ ESOARS product to value employee share-based payment awards for financial accounting and reporting purposes unless and until the fundamental failings of the product have been remedied.

We look forward to meeting with you and other SEC staff in the near future to discuss this letter and the CVI Report in more detail. In the meantime, please contact me with any questions or if you need any additional information.

Sincerely,

Jeff Mahoney
General Counsel

Attachment

CC: Chairman Christopher Cox
Commissioner Paul S. Atkins
Commissioner Roel C. Campos
Commissioner Kathleen L. Casey
Commissioner Annette L. Nazareth
Chester Spatt, Chief Economist, Office of Economic Analysis
John W. White, Director, Division of Corporation Finance

¹³ David Reilly and Serena Ng, *SEC Clears Market-Based Way To Value Staff Stock Options*, Wall St. J., Jan. 30, 2007, at C5.

¹⁴ *SEC approves Zions’ stock-option valuation system*, Salt Lake Trib., Jan. 31, 2007, at 1.

¹⁵ Jack T. Ciesielski, *A Sputtering Love Affair: Stock Options of the S&P 500, 2005*, 15 Analyst’s Acct. Observer 1 (May 2, 2006).

