

FORGENT NETWORKS INC
Form DEF 14A
April 27, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
 Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
 Definitive Proxy Statement
 Definitive Additional Materials
 Soliciting Material Pursuant to §240.14a-12

Forgent Networks, Inc.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

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FORGENT NETWORKS, INC.
108 Wild Basin Road
Austin, TX 78746

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
To Be Held Tuesday May 23, 2006

Dear Stockholder:

You are cordially invited to attend the 2006 annual meeting of stockholders of Forgent Networks, Inc., to be held at 108 Wild Basin Road, Austin, Texas, on Tuesday, May 23, 2006 at 10:00 a.m. local time.

At the annual meeting, you will be asked to act on the following matters:

1. To elect six directors to the board of directors to hold office until the next annual meeting of stockholders or until their respective successors are duly elected and qualified;
2. To ratify the Audit Committee's appointment of Ernst & Young LLP, independent accountants, as our independent auditors for the year ending July 31, 2006; and
3. To consider and act upon a proposal to amend the Forgent Network, Inc.'s 1998 Restricted Stock Plan to add consultants and non-employee directors as participants; and
4. To transact such other business as may properly come before the meeting or any adjournment thereof.

YOUR BOARD OF DIRECTORS HAS UNANIMOUSLY APPROVED AND RECOMMENDS THAT AN AFFIRMATIVE VOTE BE CAST IN FAVOR OF EACH OF THE PROPOSALS LISTED IN THE PROXY CARD.

Only holders of record of common stock at the close of business on April 21, 2006 will be entitled to notice of and to vote at the annual meeting or any adjournment thereof.

Stockholders are urged to review carefully the information contained in the proxy statement attached hereto prior to deciding how to vote their shares at the annual meeting. Your participation in the annual meeting, in person or by proxy, is important. We hope you will be able to attend the annual meeting. **WHETHER OR NOT YOU PLAN TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, SIGN, DATE AND RETURN THE ENCLOSED PROXY CARD PROMPTLY.** If you attend the annual meeting, you may revoke your proxy and vote in person if you wish, even if you have previously returned your proxy card. Simply attending the annual meeting, however, will not revoke your proxy; you must vote at the annual meeting. If you do not attend the annual meeting, you may still revoke your proxy at any time prior to the annual meeting by providing a later dated proxy or by providing written notice of your revocation to the Secretary of the Company. Your prompt cooperation will be greatly appreciated.

Sincerely,

RICHARD N. SNYDER
Chief Executive Officer

This proxy statement is dated April 27, 2006 and is first being mailed to stockholders on or about April 28, 2006.

FORGENT NETWORKS, INC.
108 Wild Basin Road
Austin, TX 78746

PROXY STATEMENT
FOR 2006 ANNUAL MEETING OF STOCKHOLDERS

May 23, 2006

The enclosed form of proxy is solicited by the board of directors to be used at the 2006 annual meeting of stockholders to be held at 108 Wild Basin Road, Austin, Texas, on May 23, 2006 at 10:00 local time.

We will bear the entire cost of solicitation of proxies, including preparation, assembly, printing and mailing of this proxy statement, the proxy and any additional information furnished to you. Copies of solicitation materials will be furnished to banks, brokerage houses, fiduciaries and custodians holding in their names shares of our common stock beneficially owned by others to forward to such beneficial owners. We may reimburse persons representing beneficial owners of common stock for their costs of forwarding solicitation materials to such beneficial owners. Original solicitation of proxies by mail may be supplemented by telephone, telegram or personal solicitation by our directors, officers or other regular employees. No additional compensation will be paid to directors, officers or other regular employees for such services.

Some banks, brokers and other record holders have begun the practice of "householding" proxy statements and annual reports. "Householding" is the term used to describe the practice of delivering a single set of proxy statements and annual reports to any household at which two or more stockholders reside if a company reasonably believes the stockholders are members of the same family. This procedure would reduce the volume of duplicate information stockholders receive and would also reduce a company's printing and mailing costs. We will promptly deliver an additional copy of either document to any stockholder who writes or calls us at the following address or phone number: Investor Relations, Forgent Networks, Inc., 108 Wild Basin Road, Austin, Texas 78746, (512) 437-2678.

VOTING SECURITIES OUTSTANDING; QUORUM

The record date for the determination of stockholders entitled to notice of and vote at the annual meeting was the close of business on April 21, 2006. At the close of business on April 21, 2006, there were 25,380,432 shares of our common stock, \$.01 par value, issued and outstanding, each entitled to one vote on all matters properly brought before the annual meeting. There are no cumulative voting rights.

The presence in person or by proxy of the holders of a majority of the issued and outstanding shares of common stock entitled to vote as of the record date is necessary to constitute a quorum at the annual meeting. Abstentions and broker non-votes are treated as present at the meeting and are therefore counted to determine a quorum. If a quorum is not present, the stockholders entitled to vote who are present in person or represented by proxy at the annual meeting have the power to adjourn the meeting from time to time, without notice other than an adjournment at the meeting, until a quorum is present or represented. At any adjourned meeting at which a quorum is present, any business may be transacted that might have been transacted at the annual meeting as originally notified.

Directors are elected by a plurality of the votes of the shares present in person or represented by proxy at the annual meeting and entitled to vote on the election of directors. Abstentions may be specified on all proposals except the election of directors. Abstentions, with respect to any proposal other than the election of directors, will have the same effect as a vote against such proposal. Broker non-votes will have no effect on the outcome of the election of directors or the ratification of independent auditors, as they will not be deemed to count for or against such proposals. With regard to the election of directors, votes may be cast in favor of or withheld from each nominee; votes that are withheld will be excluded entirely from the vote and will have no effect.

THE ANNUAL MEETING OF STOCKHOLDERS

This proxy statement is provided in connection with the annual meeting of stockholders of Forgent Networks, Inc., and any adjournment or postponement of the meeting. The accompanying proxy is solicited by the board of directors. This proxy statement and the accompanying form of proxy are first being sent or given to stockholders beginning on or about April 28, 2006.

Time and Place

The annual meeting of stockholders of Forgent will be held at 108 Wild Basin Road, Austin, Texas, on May 23, 2006 at 10:00 a.m. local time.

Purposes

At the annual meeting, you will be asked:

To elect six directors to the board of directors to hold office until the next annual meeting of stockholders or until their respective successors are duly elected and qualified;

To ratify the Audit Committee's appointment of Ernst & Young LLP, independent accountants, as our independent auditors for the year ending July 31, 2006; and

To consider and act upon a proposal to amend the Forgent Network, Inc.'s 1998 Restricted Stock Plan to add consultants and non-employee directors as participants; and

To transact such other business as may properly come before the meeting or any adjournment thereof.

The board of directors knows of no other matters to be presented for action at the annual meeting. If any other matters properly come before the annual meeting, however, the persons named in the proxy will vote on such other matters in accordance with their best judgment.

Record Date; Stockholders Entitled to Vote

Holders of record of our shares of common stock at the close of business on April 21, 2006 will be entitled to vote on all matters at the annual meeting. Each share of common stock will be entitled to one vote. On April 21, 2006 a total of 25,380,432 shares of common stock were outstanding.

Quorum

A majority of the voting power of the outstanding shares of common stock entitled to vote, represented in person or by proxy, will be required to constitute a quorum for the annual meeting.

Vote Required

Directors are elected by a plurality of the votes of the shares present in person or represented by proxy at the annual meeting and entitled to vote on the election of directors. The ratification of the appointment of independent auditors and to consider and act upon a proposal to amend Forgent Networks, Inc.'s 1998 Restricted Stock Plan must be approved by holders of a majority of the shares of common stock present in person or represented by proxy at the annual meeting and entitled to vote thereon.

Board Recommendation

The board of directors recommends that an affirmative vote be cast in favor of each of the proposals listed in the proxy card.

Voting Your Shares

The board of directors is soliciting proxies from our stockholders. By completing and returning the accompanying proxy or by completing the telephone or internet procedures, you will be authorizing Jay C. Peterson and Richard N. Snyder to vote your shares. If your proxy is properly signed and dated, it will be voted as you direct. If you attend the annual meeting in person, you may vote your shares by completing a ballot at

the meeting.

Changing Your Vote by Revoking Your Proxy

Your proxy may be revoked at any time before it is voted at the annual meeting by giving notice of revocation to us, in writing, by execution of a later dated proxy or by attending and voting at the annual meeting. Simply attending the annual meeting, however, will not revoke your proxy; you must vote at the annual meeting.

How Proxies are Counted

If you return a signed and dated proxy card but do not indicate how your shares are to be voted, those shares will be voted FOR each of the listed proposals. Votes cast by proxy or in person at the annual meeting will be tabulated by the election inspectors appointed for the annual meeting.

Shares voted as abstentions on any matter will be counted for purposes of determining the presence of a quorum at the annual meeting and treated as unvoted, although present and entitled to vote, for purposes of determining the approval of each matter as to which a stockholder has abstained. As a result, abstentions with respect to any proposal other than the election of directors, will have the same effect as a vote against such proposal. If a broker submits a proxy that indicates the broker does not have discretionary authority as to certain shares to vote on one or more matters, those shares will be counted for purposes of determining the presence of a quorum at the annual meeting, but will not be considered as present and entitled to vote with respect to such matters.

Cost of Solicitation

We will pay all expenses in connection with this solicitation. Our officers, directors and other regular employees, who will receive no extra compensation for their services, may solicit proxies by telephone, telegram or personal solicitation.

ELECTION OF DIRECTORS (ITEM 1)

Directors are elected annually and serve a one-year term. There are six nominees for election this year. Director nominees are recommended for selection to the board of directors by a majority of directors who meet the independence standards of the NASDAQ Stock Market. The full board of directors then selects and recommends candidates for nomination as directors for stockholders to consider and vote upon at the annual stockholders meeting. The board of directors reviews and considers any candidates submitted by a stockholder or stockholder group in the same manner as all other candidates. Each nominee has consented to serve until the next annual meeting if elected, and until his or her successor is elected and qualified. You will find detailed information on each nominee below. If any director is unable to stand for re-election after distribution of this proxy statement, the board may reduce its size or designate a substitute. If the board designates a substitute, proxies voting on the original director candidate will be cast for the substituted candidate. Proxies cannot be voted for a greater number of persons than the number of nominees named on the enclosed form of proxy. A plurality of the votes cast in person or by proxy by the holders of common stock represented at the annual meeting is required to elect a director.

Nominee	Age	Present Office(s) Held In Our Company	Director Since
Richard N. Snyder	61	Chairman of the Board, President and Chief Executive Officer	1997
Kathleen A. Cote	57	None	1999
James H. Wells	59	None	1999
Lou Mazzucchelli	50	None	2002
Richard J. Agnich	63	None	2003
Ray R. Miles	54	None	2003

The following information regarding the principal occupations and other employment of the nominees during the past five years and their directorships in certain companies is as reported by the respective nominees:

Richard N. Snyder, age 61, has served as a director of our company since December 1997 and was elected chairman of the board in March 2000. In June 2001, Mr. Snyder was elected president and chief executive officer of our company. From September 1997 until assuming the positions of president and chief executive officer of our company, Mr. Snyder served as founder and chief executive officer of Corum Cove Consulting, LLC, a consulting firm specializing in providing strategic guidance to high technology businesses. From 1996 until 1997, Mr. Snyder was the senior vice president of World Wide Sales, Marketing, Service and Support of Compaq Computer Corp., a worldwide computer company. From 1995 until 1996, Mr. Snyder was the senior vice president and general manager of Dell Americas, a computer manufacturer and marketer. Prior to 1995, Mr. Snyder served as group general manager of the Deskjet Products Group of Hewlett Packard. He also serves as a director of Symmetricom, Inc., based in San Jose, California.

Kathleen A. Cote, age 57, has served as a director of our company since December 1999. From May 2001 through June 2003, she was chief executive officer of Worldport Communications, Inc., a provider of internet managed services to the European market. In January 1998, Ms. Cote founded Seagrass Partners, a provider of expertise in business planning and strategic development, and served as its president until May 2001. From November 1996 to January 1998, Ms. Cote served as chief executive officer of Computervision Corporation, an international provider of software for data management and product development software and services. From November 1986 to November 1996, she held various senior management positions with Computervision Corporation. In January 1998, Computervision Corporation was acquired by Parametric Technology Corporation. Ms. Cote is also a director of Western Digital Corporation.

James H. Wells, age 59, has served as a director of our company since December 1999. He currently consults with early stage internet start-up companies. Mr. Wells was the senior vice president of marketing and business development of Dazel, a Hewlett Packard enterprise software company, from January 1999 through February 2000. From April 1995 to March 1998, Mr. Wells served as vice president of sales and was a founding officer in the internet streaming

company, RealNetworks, Inc.

Lou Mazzucchelli, age 50, has served as a director of our company since February 2002. He is currently a venture partner at Ridgewood Capital, a venture capital firm focusing its investments in the information technology industry. Prior to joining Ridgewood Capital in 2001, Mr. Mazzucchelli was an investment banker at Gerard Klauer Mattison in New York, which he joined in 1996 as their PC and digital media technology analyst. Previously, Mr. Mazzucchelli spent 13 years leading Cadre Technologies, a pioneering computer-aided software engineering tools company that he founded in 1982 and grew to become one of the top 50 U.S. independent software vendors before its sale in 1986.

Richard J. Agnich, age 63, has served as a director of our company since March 2003. He is currently an advisor to technology start-ups, is a trustee of Austin College and chair of the Entrepreneurs Foundation of North Texas. Mr. Agnich is also currently serving as a director of ST Assembly Test Services, Ltd. (STTS, NASDAQ), a leading semiconductor test and assembly service provider headquartered in Singapore. Prior to his retirement in 2000, Mr. Agnich served as Senior Vice President, General Counsel and Secretary and various other positions at Texas Instruments Incorporated since 1973.

Ray R. Miles, age 54, has served as a director of our company since March 2003. He is currently working with Rajko Associates, a company that provides consulting services on corporate strategy. From 2001 to 2002, Mr. Miles served as the President of Communications Services, a service line of the Operations Solutions business of EDS, Inc. Prior to joining Communications Services, Mr. Miles was a business manager and manager of software strategy at Texas Instruments from 1999 to 2001. From 1996 to 1999, Mr. Miles served as a branch manager and then Chief Operating Officer of Deutsche Telekom Alliance, a strategic alliance between Texas Instruments Incorporated and Deutsche Telekom.

None of the nominees is related to any other nominee or to any executive officer or director of our company by blood, marriage or adoption (except relationships, if any, more remote than first cousin).

THE BOARD OF DIRECTORS RECOMMENDS VOTING FOR EACH OF THE SIX NOMINEES.

CODE OF BUSINESS CONDUCT AND ETHICS

We have adopted a Code of Business Conduct and Ethics that applies to all our directors, officers and employees, including our Chief Executive Officer, Chief Financial Officer and Principal Accounting Officer. These individuals are required to abide by the Code of Business Conduct and Ethics to insure that our business is conducted in a consistently legal and ethical manner. Our Code of Business Conduct and Ethics covers all areas of professional conduct, including employment policies, conflicts of interest, intellectual property and the protection of confidential information, as well as strict adherence to all laws and regulations applicable to the conduct of our business. Any waivers of the Code of Business Conduct and Ethics for directors or executive officers must be approved by the board of directors.

The full text of our Code of Business Conduct and Ethics is published on our web site, at www.forgent.com, under the Company-Corporate Governance captions. We intend to disclose future amendments to, or waivers from, provisions of our Code of Business Conduct and Ethics on our web site within four business days following the date of such amendment or waiver.

EQUITY COMPENSATION PLANS**Equity Compensation Plan Information**

The following table provides information as of July 31, 2005 with respect to the shares of our common stock that may be issued under our existing equity compensation plans.

	A	B	C
	Number of Securities to be Issued upon Exercise of Outstanding Options	Weighted Average Exercise Price of Outstanding Options	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A)
Equity Compensation Plans Approved by Stockholders(1)	1,556,979(3) \$	2.706(3)	3,489,739(4)
Equity Compensation Plans Not Approved by Stockholders(2)	-0-	N/A	-0-
Total	1,556,979 \$	2.706	3,489,739

(1) Consists of the 1989 Stock Option Plan, the 1992 Director Stock Option Plan, the 1996 Stock Option Plan, the Restricted Stock Plan and the Employee Stock Purchase Plan.

(2) All of our equity compensation plans have been previously approved by our stockholders.

(3) Excludes purchase rights accruing under the Company's Restricted Stock Plan and Employee Stock Purchase Plan which have a combined shareholder approved reserve of 907,282 shares. Under the Employee Stock Purchase Plan, each employee may purchase up to 2,500 shares per quarter (but in no case can the participant contribute more than 15% of base pay) of common stock at quarterly intervals on the last day of the calendar quarter (i.e. March, June, September and December) each year at a purchase price per share equal to 85% of the lower of (i) the average selling price per share of common stock on the first day of the quarter or (ii) the average selling price per share on the quarterly purchase date.

(4) Includes shares available for future issuance under the Employee Stock Purchase Plan and the Restricted Stock Plan. As of July 31, 2005, 112,832 shares of common stock were available for issuance under the Employee Stock Purchase Plan and 794,450 shares of common stock were available for issuance under the Restricted Stock Plan.

BOARD OF DIRECTORS AND COMMITTEES

The board of directors held five regularly scheduled meetings and six special meetings during the fiscal year ended July 31, 2005.

The board of directors uses working committees with functional responsibility in the more complex recurring areas where disinterested oversight is required. Working committees of the board of directors include the Audit Committee and the Compensation Committee, each of which operates under a charter that has been approved by the board of directors. Current copies of each of these charters are posted on our website, www.forgent.com. Our committees will continue to monitor and review legislative, regulatory and NASDAQ Stock Market actions in connection with corporate governance, and our committees will adopt policies and procedures in response to such actions.

The board of directors consists of a majority of independent directors as such term is defined under the rules of the NASDAQ Stock Market. The board of directors has determined that Ms. Cote and Messrs. Wells, Mazzucchelli, Agnich and Miles are independent. The board of directors has determined that all of the members of both of the board's working committees are independent as defined under the rules of the NASDAQ Stock Market, including, in the case of all members of the Audit Committee, the independence requirements contemplated by Rules 10A-3 under the Securities Exchange Act of 1934.

Audit Committee

The Audit Committee is the communication link between the board of directors and our independent auditors. In addition to recommending the appointment of the independent auditors to the board of directors, the Audit Committee reviews the scope of the audit, the accounting policies and reporting practices, internal auditing and internal control, compliance with our policies regarding business conduct and other matters as deemed appropriate. The Audit Committee held seven meetings in fiscal 2005 with the independent auditors and our management. The members of the Audit Committee during the fiscal year ended July 31, 2005 were Ms. Cote (Chairperson), Mr. Wells, and Mr. Miles.

Policy On Audit Committee Pre-Approval Of Audit And Permissible Non-Audit Services Of Independent Auditor

Consistent with Securities and Exchange Commission (SEC) policies regarding auditor independence, the Audit Committee has responsibility for appointing, setting compensation and overseeing the work of the independent auditor. In recognition of this responsibility, the Audit Committee has established a policy to pre-approve all audit and permissible non-audit services provided by the independent auditor.

Prior to engagement of the independent auditor for the next year s audit, management will submit an aggregate of services expected to be rendered during that year for each of four categories of services to the Audit Committee for approval.

1. **Audit Services.** Audit services include audit work performed in the preparation of financial statements, as well as work that generally only the independent auditor can reasonably be expected to provide, including comfort letters, statutory audits, and attest services and consultation regarding financial accounting and/or reporting standards.

2. **Audit-Related.** Audit-related services are for assurance and related services that are traditionally performed by the independent auditor, including due diligence related to mergers and acquisitions, employee benefit plan audits, and special procedures required to meet certain regulatory requirements.

3. **Tax Services.** Tax services include all services performed by the independent auditor s tax personnel, except those services specifically related to the audit of the financial statements, and includes fees in the areas of tax compliance, tax planning, and tax advice.

4. **Other Fees.** Other fees are those associated with services not captured in the other categories. We generally do not request such services from the independent auditor.

Prior to engagement, the Audit Committee pre-approves these services by category of service. The fees are budgeted and the Audit Committee requires the independent auditor and management to report actual fees versus the budget periodically throughout the year by category of service. During the year, circumstances may arise when it may become necessary to engage the independent auditor for additional services not contemplated in the original pre-approval. In those instances, the Audit Committee requires specific pre-approval before engaging the independent auditor.

The Audit Committee may delegate pre-approval authority to one or more of its members. The member to whom such authority is delegated must report, for informational purposes only, any pre-approval decisions to the Audit Committee at its next scheduled meeting.

Compensation Committee

The Compensation Committee is responsible for approving the compensation arrangements of senior management and recommending approval by the board of directors of amendments to our benefit plans. At one regularly scheduled meeting during the fiscal year ended July 31, 2005 the Compensation Committee approved the appointment of Nancy Harris as an executive officer and her related compensation. The Compensation Committee acted by unanimous consent during the fiscal year ended July 31, 2005 to approve the acceleration of employee stock options. The Compensation Committee was composed of Mr. Mazzucchelli (Chairperson) and Mr. Wells for the fiscal year ended July 31, 2005.

Meeting Attendance by Directors

No director attended fewer than 75% of the aggregate of (i) the total number of meetings of the board of directors and (ii) the total number of meetings held by all committees of the board of directors on which such director served. The board of directors requires that directors make a reasonable effort to attend the company s annual meeting of stockholders. One board member attended the 2005 annual meeting of stockholders.

Communication with the Board of Directors

A stockholder who wishes to communicate with the board of directors, or specific individual directors, may do so by directing a written request addressed to such directors or director in care of Jay C. Peterson, secretary, at the address appearing on the first page of this proxy statement. Communication(s) directed to members of the board of directors will be relayed to the intended board member(s).

Director Nominations

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In the past our company did not have a nominating committee, but in April 2006 the board of directors established a Nominating Committee with independent directors (as such term is defined under the rules of the NASDAQ Stock market) Mr. Agnich and Mr. Wells as members. The Nominating Committee is currently in the process of adopting a charter that that is consistent with the bylaws of the company and the standards of the NASDAQ Stock Market.

Director Compensation

During fiscal 2005, each non-employee director was paid a retainer of \$3,000 for each quarter. Additionally, each non-employee director was paid \$1,000 for the regularly scheduled and special meetings of the board of directors he or she attended and \$250 for participation in each telephonic meeting not considered an official board of directors meeting. Total director fees earned in fiscal 2004 were \$91,250.

All non-employee directors participate in our 1992 Director Stock Option Plan. Non-employee directors receive, upon their initial election or appointment to the board of directors, stock options to purchase 25,000 shares of our common stock, having an exercise price equal to the market price of our common stock on the date of grant. Thereafter, each non-employee director will receive options to purchase 10,000 shares of our common stock on the anniversary date of his or her election or appointment to the board of directors. All of these options vest in equal amounts monthly over a three-year period but cease vesting at the time the director ceases to be a director. Currently the 1992 Director Stock Option Plan does not have sufficient options available for the granting of additional options to non-employee directors.

The compensation of our employee directors is discussed at Executive Compensation below.

Report of the Audit Committee

The Audit Committee is composed of three outside directors and operates under a charter adopted by the board of directors according to the rules and regulations of the SEC and the NASDAQ Stock Market. The Audit Committee members during the fiscal year ended July 31, 2005 were Ms. Cote (Chairperson), Mr. Wells, and Mr. Miles. The board of directors believes that all of these directors are independent as defined under the rules of the NASDAQ Stock Market.

The board of directors has determined that Ms. Cote has the qualifications and experience necessary to serve as an audit committee financial expert, as defined by the SEC.

The following is the report of the Audit Committee with respect to our audited financial statements for the fiscal year ended 2005 which include our consolidated balance sheets as of July 31, 2005 and 2004, and the related consolidated statements of operations, stockholders equity (deficit) and cash flows for each of the three years in the period ended July 31, 2005 and the notes thereto. The information contained in this report shall not be deemed to be soliciting material or to be filed with the SEC, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933, as amended, or the Securities Exchange

Act of 1934, as amended, except to the extent that we specifically incorporate it by reference in such filing.

Review With Management

The Audit Committee has reviewed and discussed our audited financial statements with management.

Review and Discussions With Independent Accountants

The Audit Committee has discussed with Ernst & Young LLP, our independent accountants, the matters required to be discussed by SAS 61 (Codification of Statements on Accounting Standards) that includes, among other items, matters related to the conduct of the audit of our financial statements.

The Audit Committee has received the letter from Ernst & Young LLP required by Independent Standards Board Standard No. 1, that relates to the accountant's independence from our company and its related entities, and has discussed with Ernst & Young LLP their independence from our company.

Based on the review and discussions referred to above, the Audit Committee recommended to the board of directors that our audited financial statements be included in our annual report on Form 10-K for the fiscal year ended July 31, 2005.

Submitted by the Audit Committee of the Board of Directors

Kathleen A. Cote
James H. Wells
Ray R. Miles

Fees

Audit Fees

The company incurred fees in the amount of \$200,000 and \$185,150 for professional audit services rendered by Ernst & Young LLP for the audit of the company's annual financial statements and the reviews of the financial statements included in the company's 10-Qs, for the fiscal years ended July 31, 2005 and 2004, respectively. The services included work generally only the independent auditor can reasonably be expected to provide, such as those in connection with statutory and regulatory filings.

Audit Related Fees

The company incurred fees in the amount of \$53,150 and \$44,450 for professional audit services rendered by Ernst & Young LLP related principally to the audits of employee benefit plans, Sarbanes-Oxley compliance and merger and acquisition due diligence for the fiscal years ended July 31, 2005 and 2004, respectively.

Tax Fees

The company paid \$0 and \$67,455 for professional tax services rendered by Ernst & Young LLP during the fiscal years ended July 31, 2005 and 2004, respectively.

Other Fees

All fees paid to Ernst & Young LLP by the company are reported under the fee categories listed above. There were no other fees paid during the fiscal years ended July 31, 2005 and 2004.

The Audit Committee has determined that the provision of services covered by the two preceding paragraphs is compatible with maintaining the independent auditors' independence from the company.

Report From the Compensation Committee Regarding Executive Compensation

Members of the Compensation Committee have a duty to administer the executive compensation program for our company. The Compensation Committee is responsible for establishing appropriate compensation goals for the executive officers of our company and evaluating the performance of our executive officers in meeting these goals. The elements of the executive compensation program described below are implemented and periodically reviewed and adjusted by the Compensation Committee.

The goals of the Compensation Committee in establishing our executive compensation program are as follows:

To fairly compensate our executive officers for their contributions to our company's short-term and long-term performance. The elements of our executive compensation program are:

annual base salaries;

quarterly performance bonuses; and

equity incentives.

To allow our company to attract, motivate and retain the management personnel necessary to our company's success by providing an executive compensation program comparable to that offered by companies with which we compete for such management personnel.

To provide an executive compensation program with incentives linked to the financial performance of our company, and thereby enhance stockholder value. Under this program, incentive compensation for executive officers is linked to the financial performance of our company as measured by earnings per share and revenue.

Base Salaries. Historically, the annual base salaries of our executive officers have been determined based on individual performance, experience, duties, levels of responsibility and a comparison with salary ranges of a representative group of public companies within the technology sector of a similar size and similar annual range of revenues derived from a review of recent publicly filed proxy statements by ten public companies. A comparison is also made with published surveys of executive compensation paid in similar industries with comparable revenues. Historically, we have used the Radford Executive Compensation Survey, published by Radford Associates, a provider of national compensation surveys. The comparison groups used in these surveys are not the same group as used by us as our peer group for comparative total returns purposes. The comparison groups used in these surveys are chosen on a narrower basis using revenue size as well as industry focus, while the peer group is solely industry focused. The Compensation Committee believes that a narrower focus, using revenue size as well as industry focus, provides more appropriate comparison information on which to base salary decisions than one that does not take into account the size of the comparison group members. The financial performance of comparative group members relative to our financial performance is only one of the factors used by the Compensation Committee in assessing compensation. The Compensation Committee does not use empirical formulas based on financial performance or other factors in setting compensation for the company's executive officers, but instead considers comparative companies' income, market capitalization and total assets in conjunction with individual performance and experience of the company's officers in determining the appropriate level of compensation. During fiscal 2005 the Compensation Committee did not conduct a detailed analysis of executive compensation and thus no increases were approved for executive officers. See Summary Compensation Table .

Quarterly Bonus. The quarterly bonuses available to our executive officers are based upon the achievement of certain earnings per share, revenue and operating expense goals, development milestones and other personal objectives for our company set by the Compensation Committee prior to the beginning of such measurement period.

No quarterly bonus was paid to executive officers for the first, third and fourth quarters of fiscal year 2005. Two of our executive officers received bonuses for the second quarter of fiscal year 2005, totaling \$14,145, which was 10% of the target bonus of \$140,625 for the executive officer group. The potential bonus that may be earned by each of our executive officers, other than our chief executive officer, in the aggregate is 50% of their base salary. Our chief executive officer may earn a bonus of up to 100% of his base salary. The potential bonus is allocated among the performance objectives which are based upon company-wide objectives, departmental objectives and individual performance objectives, each of which is weighted based upon relative priority. The percentage which is attained of each objective by the applicable executive officer determines the bonus amount, but generally no bonuses are awarded unless the company-wide objectives are attained. During fiscal 2005, assuming all targets were achieved by our executive officers, the officers could have received \$545,625, however, \$14,145, or 3%, of the target bonuses was actually paid out.

Equity Incentives. Equity incentives, including grants of stock options and restricted stock, are determined based on the Compensation Committee's assessment of the ability of such officers to positively impact our company's future performance and enhance stockholder value as determined by their individual performances, as opposed to our overall corporate performance. The Compensation Committee assesses the nature and scope of the officer's responsibilities; the officer's contribution to the company's financial results; and the officer's effectiveness in leading our initiatives to increase stockholder value. The Compensation Committee also considers the compensation levels of the top four highest paid executives with a comparison group of companies provided by Watson Wyatt & Company, a global consulting firm focused on human capital and financial management. Restricted stock awards are granted periodically by the Compensation Committee, principally to the company's executive officers, and generally vest over one to two year period.

In fiscal 2005, no stock option or restricted stock was granted to executives. See Executive Compensation Stock Option Grants During Fiscal 2005.

Equity and cash incentives are not limited to executive officers. Grants of stock options are made to all employees upon joining our company in amounts determined by the Compensation Committee and are also made to selected employees as performance related awards and as awards for certain job promotions. The amounts of such grants are determined based on the individual employee's position with our company and his or her

potential ability to beneficially impact the performance of our company. Stock option grants and other equity incentives are not awarded annually, but rather as warranted by individual performance and experience. Option awards generally vest over a 48-month period. The amount and vesting of stock options generally are not contingent on achievement of any performance targets. By giving all employees a stake in the financial performance of our company, the Compensation Committee's goal is to provide incentives to all employees of our company to enhance the financial performance of our company and, thus, stockholder value.

Fiscal 2005 Compensation of the CEO. Historically, the chief executive officer's salary has been primarily based on a comparison with the compensation levels of chief executive officers from a comparison group of companies provided by Watson Wyatt & Company. Additionally, the Compensation Committee assesses the nature and scope of the chief executive officer's responsibilities and the chief executive officer's contribution to the company's financial results. Mr. Snyder's, our company's chief executive officer responsibilities include the day-to-day management of the company, including the management and direction provided to members of the company's senior management team, development, articulation and supervision of the implementation of the company's business realignment and implementation of the company's long-term business strategy and product development plans, selection and management of the disposition of underperforming business units and the launch of the company's two new businesses, scheduling software and intellectual property licensing. During fiscal 2005, Mr. Snyder received \$300,000 in base salary, the same as in the prior year. Mr. Snyder's potential annual bonus is 100% of his base salary. Mr. Snyder received a no bonus for fiscal year 2005.

Omnibus Budget Reconciliation Act of 1993. The Omnibus Budget Reconciliation Act of 1993 added Section 162(m) to the Internal Revenue Code. With certain exceptions, beginning with the taxable year commencing January 1, 1994, Section 162(m) will prevent publicly held corporations, including our company, from taking a tax deduction for compensation in excess of one million dollars paid to our chief executive officer and the other persons named in the Summary Compensation Table in this proxy statement. Section 162(m) will not apply to limit the deductibility of performance-based compensation exceeding one million dollars if:

it is paid solely upon attainment of one or more performance goals;

it is paid pursuant to a performance-based compensation plan adopted by the Compensation Committee; and

the terms of the plan are approved by the stockholders before payment of the compensation.

The Compensation Committee has reviewed our compensation plans with regard to the deduction limitation set forth in Section 162(m). The Compensation Committee believes that option grants under our equity plans meet the requirements for deductible compensation. The Compensation Committee has decided for the present not to alter our other compensation plans to meet the deductibility requirements of the regulations promulgated under the Internal Revenue Code. The Compensation Committee will continue to review the issue and its determination under the regulations under Section 162(m) and monitor whether our compensation plans should be amended in the future to meet the deductibility requirements. The Compensation Committee does not anticipate that Section 162(m) will limit the deductibility of any compensation paid in fiscal year 2005. None of our executive officers were affected by Section 162(m) in fiscal year 2005.

Compensation Committee

James H. Wells
Lou Mazzucchelli

If a market disruption event occurs or is continuing on the determination date, then the determination date will be postponed to the first succeeding trading day on which a market disruption event has not occurred and is not continuing; however, if such first succeeding trading day has not occurred as of the eighth trading day after the originally scheduled determination date, that eighth trading day shall be deemed to be the determination date. If the determination date has been postponed eight trading days after the originally scheduled determination date and a market disruption event occurs or is continuing on such eighth trading day, the calculation agent will determine the closing level of the underlier on such eighth trading day in accordance with the formula for and method of calculating the closing level of the underlier last in effect prior to commencement of the market disruption event, using the closing price (or, with respect to any relevant security, if a market disruption event has occurred with respect to such security, its good faith estimate of the value of such security at the scheduled closing time of the relevant stock exchange for such security or, if earlier, the actual closing time of the regular trading session of such relevant stock exchange) on such date of each security included in the underlier. As used herein, closing price means, with respect to any security on any date, the relevant stock exchange traded or quoted price of such security as of the scheduled closing time of the relevant stock exchange for such security or, if earlier, the actual closing time of the regular trading session of such relevant stock exchange.

Adjustments to the Underlier

If at any time the sponsor or publisher of the underlier (the underlier sponsor) makes a material change in the formula for or the method of calculating the underlier, or in any other way materially modifies the underlier (other than a modification prescribed in that formula or method to maintain the underlier in the event of changes in constituent stock and capitalization and other routine events), then, from and after that time, the calculation agent will, at the close of business in New York, New York, on each date that the closing level of the underlier is to be calculated, calculate a substitute closing level of the underlier in accordance with the formula for and method of calculating the underlier last in effect prior to the change, but using only those securities that comprised the underlier immediately prior to that change. Accordingly, if the method of calculating the underlier is modified so that the level of the underlier is a fraction or a multiple of what it would have been if it had not been modified, then the calculation agent will adjust the underlier in order to arrive at a level of the underlier as if it had not been modified.

Discontinuance of the Underlier

If the underlier sponsor discontinues publication of the underlier, and the underlier sponsor or another entity publishes a successor or substitute equity index that the calculation agent determines, in its sole discretion, to be comparable to the underlier (a successor underlier), then, upon the calculation agent's notification of that determination to the trustee and Wells Fargo, the calculation agent will substitute the successor underlier as calculated by the relevant underlier sponsor or any other entity and calculate the final underlier level as described above. Upon any selection by the calculation agent of a successor underlier, Wells Fargo will cause notice to be given to holders of the securities.

In the event that the underlier sponsor discontinues publication of the underlier prior to, and the discontinuance is continuing on, the determination date and the calculation agent determines that no successor underlier is available at such time, the calculation agent will calculate a substitute closing level for the underlier in accordance with the formula for and method of calculating the underlier last in effect prior to the discontinuance, but using only those

securities that comprised the underlier immediately prior to that discontinuance. If a successor underlier is selected or the calculation agent calculates a level as a substitute for the underlier, the successor underlier or level will be used as a substitute for the underlier for all purposes, including the purpose of determining whether a market disruption event exists.

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If on the determination date the underlier sponsor fails to calculate and announce the level of the underlier, the calculation agent will calculate a substitute closing level of the underlier in accordance with the formula for and method of calculating the underlier last in effect prior to the failure, but using only those securities that comprised the underlier immediately prior to that failure; *provided* that, if a market disruption event occurs or is continuing on such day, then the provisions set forth above under **Market Disruption Events** shall apply in lieu of the foregoing.

Notwithstanding these alternative arrangements, discontinuance of the publication of, or the failure by the underlier sponsor to calculate and announce the level of, the underlier may adversely affect the value of the securities.

Events of Default and Acceleration

If an event of default with respect to the securities has occurred and is continuing, the amount payable to a holder of a security upon any acceleration permitted by the securities, with respect to each security, will be equal to the cash settlement amount, calculated as provided herein. The cash settlement amount will be calculated as though the date of acceleration were the determination date.

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The S&P 500 Index

The S&P 500 Index is an equity index that is intended to provide an indication of the pattern of common stock price movement in the large capitalization segment of the United States equity market. Wells Fargo & Company is one of the companies currently included in the S&P 500 Index. See "Description of Equity Indices - The S&P 500 Index" in the accompanying market measure supplement for additional information about the S&P 500 Index.

Historical Information

We obtained the closing levels set forth in the graph below from Bloomberg Financial Markets without independent verification.

The historical performance of the underlier should not be taken as an indication of the future performance of the underlier during the term of the securities.

The following graph sets forth the daily closing levels of the underlier for each day in the period from January 1, 2006 through January 22, 2016. The closing level on January 22, 2016 was 1,906.90.

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ERISA Considerations

Each fiduciary of a pension, profit-sharing or other employee benefit plan to which Title I of the Employee Retirement Income Security Act of 1974 (ERISA) applies (a plan), should consider the fiduciary standards of ERISA in the context of the plan's particular circumstances before authorizing an investment in the securities. Accordingly, among other factors, the fiduciary should consider whether the investment would satisfy the prudence and diversification requirements of ERISA and would be consistent with the documents and instruments governing the plan. When we use the term holder in this section, we are referring to a beneficial owner of the securities and not the record holder.

Section 406 of ERISA and Section 4975 of the Code prohibit plans, as well as individual retirement accounts and Keogh plans to which Section 4975 of the Code applies (also plans), from engaging in specified transactions involving plan assets with persons who are parties in interest under ERISA or disqualified persons under the Code (collectively parties in interest) with respect to such plan. A violation of those prohibited transaction rules may result in an excise tax or other liabilities under ERISA and/or Section 4975 of the Code for such persons, unless statutory or administrative exemptive relief is available. Therefore, a fiduciary of a plan should also consider whether an investment in the securities might constitute or give rise to a prohibited transaction under ERISA and the Code.

Employee benefit plans that are governmental plans, as defined in Section 3(32) of ERISA, certain church plans, as defined in Section 3(33) of ERISA, and foreign plans, as described in Section 4(b)(4) of ERISA (collectively, Non-ERISA Arrangements), are not subject to the requirements of ERISA, or Section 4975 of the Code, but may be subject to similar rules under other applicable laws or regulations (Similar Laws).

We and our affiliates may each be considered a party in interest with respect to many plans. Special caution should be exercised, therefore, before the securities are purchased by a plan. In particular, the fiduciary of the plan should consider whether statutory or administrative exemptive relief is available. The U.S. Department of Labor has issued five prohibited transaction class exemptions (PTCEs) that may provide exemptive relief for direct or indirect prohibited transactions resulting from the purchase or holding of the securities. Those class exemptions are:

PTCE 96-23, for specified transactions determined by in-house asset managers;

PTCE 95-60, for specified transactions involving insurance company general accounts;

PTCE 91-38, for specified transactions involving bank collective investment funds;

PTCE 90-1, for specified transactions involving insurance company separate accounts; and

PTCE 84-14, for specified transactions determined by independent qualified professional asset managers.

In addition, Section 408(b)(17) of ERISA and Section 4975(d)(20) of the Code provide an exemption for transactions between a plan and a person who is a party in interest (other than a fiduciary who has or exercises any discretionary authority or control with respect to investment of the plan assets involved in the transaction or renders investment advice with respect thereto) solely by reason of providing services to the plan (or by reason of a relationship to such a service provider), if in connection with the transaction of the plan receives no less, and pays no more, than adequate consideration (within the meaning of Section 408(b)(17) of ERISA).

Any purchaser or holder of the securities or any interest in the securities will be deemed to have represented by its purchase and holding that either:

no portion of the assets used by such purchaser or holder to acquire or purchase the securities constitutes assets of any plan or Non-ERISA Arrangement; or

the purchase and holding of the securities by such purchaser or holder will not constitute a non-exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or similar violation under any Similar Laws.

Due to the complexity of these rules and the penalties that may be imposed upon persons involved in non-exempt prohibited transactions, it is particularly important that fiduciaries or other persons considering purchasing the securities on behalf of or with plan assets of any plan consult with their counsel regarding the potential consequences under ERISA and the Code of the acquisition of the securities and the availability of exemptive relief.

The securities are contractual financial instruments. The financial exposure provided by the securities is not a substitute or proxy for, and is not intended as a substitute or proxy for, individualized investment management or advice for the benefit of any purchaser or holder of the securities. The securities have not been designed and will not be administered in a manner intended to reflect the individualized needs and objectives of any purchaser or holder of the securities.

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Each purchaser or holder of the securities acknowledges and agrees that:

- (i) the purchaser or holder or its fiduciary has made and shall make all investment decisions for the purchaser or holder and the purchaser or holder has not relied and shall not rely in any way upon us or our affiliates to act as a fiduciary or adviser of the purchaser or holder with respect to (a) the design and terms of the securities, (b) the purchaser or holder's investment in the securities, or (c) the exercise of or failure to exercise any rights we have under or with respect to the securities;
- (ii) we and our affiliates have acted and will act solely for our own account in connection with (a) all transactions relating to the securities and (b) all hedging transactions in connection with our obligations under the securities;
- (iii) any and all assets and positions relating to hedging transactions by us or our affiliates are assets and positions of those entities and are not assets and positions held for the benefit of the purchaser or holder;
- (iv) our interests may be adverse to the interests of the purchaser or holder; and
- (v) neither we nor any of our affiliates is a fiduciary or adviser of the purchaser or holder in connection with any such assets, positions or transactions, and any information that we or any of our affiliates may provide is not intended to be impartial investment advice.

Purchasers of the securities have the exclusive responsibility for ensuring that their purchase, holding and subsequent disposition of the securities does not violate the fiduciary or prohibited transaction rules of ERISA, the Code or any Similar Law. Nothing herein shall be construed as a representation that an investment in the securities would be appropriate for, or would meet any or all of the relevant legal requirements with respect to investments by, plans or Non-ERISA Arrangements generally or any particular plan or Non-ERISA Arrangement.

United States Federal Tax Considerations

The following is a discussion of the material U.S. federal income and certain estate tax consequences of the ownership and disposition of the securities. It applies to you only if you purchase a security for cash in the initial offering at the issue price, which is the first price at which a substantial amount of the securities is sold to the public, and hold the security as a capital asset within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the Code). It does not address all of the tax consequences that may be relevant to you in light of your particular circumstances or if you are an investor subject to special rules, such as:

a financial institution;

a regulated investment company ;

a tax-exempt entity, including an individual retirement account or Roth IRA ;

a dealer or trader subject to a mark-to-market method of tax accounting with respect to the securities;

a person holding a security as part of a straddle or conversion transaction or who has entered into a constructive sale with respect to a security;

a U.S. holder (as defined below) whose functional currency is not the U.S. dollar; or

an entity classified as a partnership for U.S. federal income tax purposes.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds the securities, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and the activities of the partnership. If you are a partnership holding the securities or a partner in such a partnership, you should consult your tax adviser as to your particular U.S. federal tax consequences of holding and disposing of the securities.

We will not attempt to ascertain whether any of the issuers of the underlying stocks of the underlier (the underlying stocks) is treated as a U.S. real property holding corporation (USRPHC) within the meaning of Section 897 of the Code or as a passive foreign investment company (PFIC) within the meaning of Section 1297 of the Code. If any of the issuers of the underlying stocks were so treated, certain adverse U.S. federal income tax consequences might apply to you, in the case of a USRPHC if you are a non-U.S. holder (as defined below) and in the case of a PFIC if you are a U.S. holder (as defined below), upon the sale, exchange or other disposition of the securities. You should refer to information filed with the Securities and Exchange Commission or another governmental authority by the issuers of the underlying stocks and consult your tax adviser regarding the possible consequences to you if any of the issuers of the underlying stocks is or becomes a USRPHC or PFIC.

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This discussion is based on the Code, administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date of this pricing supplement, changes to any of which subsequent to the date of this pricing supplement may affect the tax consequences described herein, possibly with retroactive effect. This discussion does not address the effects of any applicable state, local or non-U.S. tax laws or the potential application of the alternative minimum tax or of the Medicare tax on investment income. You should consult your tax adviser concerning the application of U.S. federal income and estate tax laws to your particular situation (including the possibility of alternative treatments of the securities), as well as any tax consequences arising under the laws of any state, local or non-U.S. jurisdiction.

Tax Treatment of the Securities

In the opinion of our counsel, Davis Polk & Wardwell LLP, which is based on current market conditions, a security should be treated as a prepaid derivative contract that is an open transaction for U.S. federal income tax purposes. By purchasing a security, you agree (in the absence of an administrative determination or judicial ruling to the contrary) to this treatment.

Due to the absence of statutory, judicial or administrative authorities that directly address the U.S. federal tax treatment of the securities or similar instruments, significant aspects of the treatment of an investment in the securities are uncertain. We do not plan to request a ruling from the IRS, and the IRS or a court might not agree with the treatment described below. Accordingly, you should consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the securities. Unless otherwise indicated, the following discussion is based on the treatment of the securities as prepaid derivative contracts that are open transactions.

Tax Consequences to U.S. Holders

This section applies only to U.S. holders. You are a U.S. holder if you are a beneficial owner of a security that is, for U.S. federal income tax purposes:

a citizen or individual resident of the United States;

a corporation created or organized in or under the laws of the United States, any state therein or the District of Columbia; or

an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

Tax Treatment Prior to Maturity. You should not be required to recognize income over the term of the securities prior to maturity, other than pursuant to a sale, exchange or retirement as described below.

Sale, Exchange or Retirement of the Securities. Upon a sale, exchange or retirement of the securities, you should recognize gain or loss equal to the difference between the amount realized on the sale, exchange or retirement and your tax basis in the securities that are sold, exchanged or retired. Your tax basis in the securities should equal the amount you paid to acquire them. This gain or loss should be long-term capital gain or loss if at the time of the sale, exchange or retirement you held the securities for more than one year, and short-term capital gain or loss otherwise. Long-term capital gains recognized by non-corporate U.S. holders are generally subject to taxation at reduced rates. The deductibility of capital losses is subject to certain limitations.

Possible Alternative Tax Treatments of an Investment in the Securities

Alternative U.S. federal income tax treatments of the securities are possible that, if applied, could materially and adversely affect the timing and/or character of income, gain or loss with respect to them. It is possible, for example, that the securities could be treated as debt instruments governed by Treasury regulations relating to the taxation of contingent payment debt instruments. In that case, regardless of your method of tax accounting for U.S. federal income tax purposes, you would be required to accrue income based on our comparable yield for similar non-contingent debt, determined as of the time of issuance of the securities, in each year that you held the securities, even though we are not required to make any payment with respect to the securities prior to maturity. In addition, any gain on the sale, exchange or retirement of the securities would be treated as ordinary income.

Other possible U.S. federal income tax treatments of the securities could also affect the timing and character of income or loss with respect to the securities. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. The notice focuses in particular on whether to require holders of these instruments to accrue income over the term of their investment. It also asks for comments on a number of related topics, including the character of income or loss with

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respect to these instruments; whether short-term instruments should be subject to any such accrual regime; the relevance of factors such as the exchange-traded status of the instruments and the nature of the underlying property to which the instruments are linked; and whether these instruments are or should be subject to the constructive ownership regime, which very generally can operate to recharacterize certain long-term capital gain as ordinary income and impose a notional interest charge. While the notice requests comments on appropriate transition rules and effective dates, any Treasury regulations or other guidance promulgated after consideration of these issues could materially and adversely affect the tax consequences of an investment in the securities, possibly with retroactive effect. You should consult your tax adviser regarding the possible alternative treatments of an investment in the securities and the issues presented by this notice.

Tax Consequences to Non-U.S. Holders

This section applies only to non-U.S. holders. You are a non-U.S. holder if you are a beneficial owner of a security that is, for U.S. federal income tax purposes:

an individual who is classified as a nonresident alien;

a foreign corporation; or

a foreign estate or trust.

You are not a non-U.S. holder for purposes of this discussion if you are (i) an individual who is present in the United States for 183 days or more in the taxable year of disposition or (ii) a former citizen or resident of the United States. If you are or may become such a person during the period in which you hold a security, you should consult your tax adviser regarding the U.S. federal tax consequences of an investment in the securities.

Sale, Exchange or Retirement of the Securities. Subject to the possible application of Section 897 of the Code, you generally should not be subject to U.S. federal income or withholding tax in respect of amounts paid to you, provided that income in respect of the securities is not effectively connected with your conduct of a trade or business in the United States.

If you are engaged in a U.S. trade or business, and if income from the securities is effectively connected with the conduct of that trade or business, you generally will be subject to regular U.S. federal income tax with respect to that income in the same manner as if you were a U.S. holder, unless an applicable income tax treaty provides otherwise. If you are such a holder and you are a corporation, you should also consider the potential application of a 30% (or lower treaty rate) branch profits tax.

Tax Consequences Under Possible Alternative Treatments. If all or any portion of a security were recharacterized as a debt instrument, subject to the possible application of Section 897 of the Code and the discussion below regarding FATCA, any payment made to you with respect to the security generally should not be subject to U.S. federal withholding or income tax, provided that: (i) income or gain in respect of the security is not effectively connected with your conduct of a trade or business in the United States, and (ii) you provide an appropriate IRS Form W-8 certifying under penalties of perjury that you are not a United States person.

Other U.S. federal income tax treatments of the securities are also possible. In 2007, the U.S. Treasury Department and the IRS released a notice requesting comments on the U.S. federal income tax treatment of prepaid forward contracts and similar instruments. Among the issues addressed in the notice is the degree, if any, to which income

with respect to instruments such as the securities should be subject to U.S. withholding tax. While the notice requests comments on appropriate transition rules and effective dates, it is possible that any Treasury regulations or other guidance promulgated after consideration of these issues might materially and adversely affect the withholding tax consequences of an investment in the securities, possibly with retroactive effect. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. Accordingly, you should consult your tax adviser regarding the issues presented by the notice.

U.S. Federal Estate Tax

If you are an individual non-U.S. holder or an entity the property of which is potentially includible in such an individual's gross estate for U.S. federal estate tax purposes (for example, a trust funded by such an individual and with respect to which the individual has retained certain interests or powers), you should note that, absent an applicable treaty exemption, the securities may be treated as U.S. situs property subject to U.S. federal estate tax. If you are such an individual or entity, you should consult your tax adviser regarding the U.S. federal estate tax consequences of investing in the securities.

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Information Reporting and Backup Withholding

Amounts paid on the securities, and the proceeds of a sale, exchange or other disposition of the securities, may be subject to information reporting and, if you fail to provide certain identifying information (such as an accurate taxpayer identification number if you are a U.S. holder) or meet certain other conditions, may also be subject to backup withholding at the rate specified in the Code. If you are a non-U.S. holder that provides an appropriate IRS Form W-8, you will generally establish an exemption from backup withholding. Amounts withheld under the backup withholding rules are not additional taxes and may be refunded or credited against your U.S. federal income tax liability, provided the relevant information is timely furnished to the IRS.

FATCA Legislation

Legislation commonly referred to as FATCA generally imposes a withholding tax of 30% on payments to certain non-U.S. entities (including financial intermediaries) with respect to certain financial instruments, unless various U.S. information reporting and due diligence requirements have been satisfied. An intergovernmental agreement between the United States and the non-U.S. entity's jurisdiction may modify these requirements. This legislation applies to certain financial instruments that are treated as paying U.S.-source interest or other U.S.-source fixed or determinable annual or periodical income. If the securities were treated as debt instruments, the withholding regime under FATCA would apply to any amounts treated as interest. If withholding applies to the securities, we will not be required to pay any additional amounts with respect to amounts withheld. If you are a non-U.S. holder, or a U.S. holder holding securities through a non-U.S. intermediary, you should consult your tax adviser regarding the potential application of FATCA to the securities.

The preceding discussion constitutes the full opinion of Davis Polk & Wardwell LLP regarding the material U.S. federal tax consequences of owning and disposing of the securities.

You should consult your tax adviser regarding all aspects of the U.S. federal income and estate tax consequences of an investment in the securities and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.