

LATTICE SEMICONDUCTOR CORP  
Form DEF 14A  
April 03, 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  x

Filed by a Party other than the Registrant  o

Check the appropriate box:

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

Lattice Semiconductor Corporation  
(Name of Registrant as Specified In Its Charter)

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

Payment of Filing Fee (Check the appropriate box):

- x No fee required.
- o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.
  - (1) Title of each class of securities to which transaction applies:
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- o Fee paid previously with preliminary materials.
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  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:

April 3, 2006

TO OUR STOCKHOLDERS:

You are cordially invited to attend the annual meeting of the stockholders of Lattice Semiconductor Corporation, which will be held on Tuesday, May 2, 2006, at 1:00 p.m., at our Corporate Headquarters, 5555 NE Moore Court, Hillsboro, Oregon, 97124-6421.

The attached Notice of Annual Meeting of Stockholders and Proxy Statement describe the matters to be acted upon at the meeting. Included with the Proxy Statement is a copy of our 2005 Annual Report to Stockholders on Form 10-K. Also included is a proxy card for you to record your vote and a return envelope for your proxy card.

**It is important that your shares be represented and voted at the meeting whether or not you plan to attend. Therefore, we urge you to vote your shares by signing and dating the enclosed proxy card and returning it in the envelope provided.**

Sincerely,

Steve Skaggs  
President and Chief Executive Officer

**Whether or not you plan to attend the meeting, please vote your shares by signing and dating the enclosed proxy card and returning it in the envelope provided. If you receive more than one proxy card because you own shares that are registered differently, then please vote all of your shares shown on all of your proxy cards following instructions listed on each of the individual proxy cards. Thank you.**

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5555 NE Moore Court  
Hillsboro, Oregon 97124-6421

**NOTICE OF ANNUAL MEETING OF STOCKHOLDERS**

**May 2, 2006**

TO OUR STOCKHOLDERS:

The Annual Meeting of Stockholders of Lattice Semiconductor Corporation will be held at our Corporate Headquarters, 5555 NE Moore Court, Hillsboro, Oregon, 97124-6421, on Tuesday, May 2, 2006, at 1:00 p.m., Pacific Time, for the following purposes:

1. To elect two Class II directors, for a term of three years;
2. To approve amendments to the 2001 Outside Directors Stock Option Plan;
3. To ratify the appointment of PricewaterhouseCoopers LLP as our independent registered public accounting firm for the fiscal year ending December 30, 2006; and
4. To transact such other business as may properly come before the meeting.

Only stockholders of record at the close of business on March 7, 2006, are entitled to vote at the meeting or any adjournment thereof.

All stockholders are invited to attend the meeting in person. **Whether or not you plan to attend the meeting, to assure your representation at the meeting, please promptly sign and return the accompanying proxy card in the enclosed return envelope.** Any stockholder of record entitled to vote at the meeting may vote in person at the meeting even if he or she has returned a proxy.

*By Order of the Board of Directors*

Martin R. Baker  
*Secretary*

Hillsboro, Oregon

April 3, 2006

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**5555 NE MOORE COURT  
HILLSBORO, OREGON 97124-6421**

**PROXY STATEMENT FOR ANNUAL MEETING OF STOCKHOLDERS**

**INFORMATION CONCERNING SOLICITATION AND VOTING**

**General**

Our board of directors is soliciting proxies to be used at the 2006 annual meeting of stockholders to be held at our Corporate Headquarters, 5555 NE Moore Court, Hillsboro, Oregon, 97124-6421 on Tuesday, May 2, 2006, at 1:00 p.m., Pacific Time, or at any adjournment thereof.

This proxy statement, the accompanying proxy card and our Annual Report on Form 10-K were mailed on or about April 3, 2006, to all stockholders entitled to vote at the meeting.

**Who Can Vote**

Record holders of common stock at the close of business on March 7, 2006, may vote at the meeting. On March 7, 2006, there were 113,719,506 shares of common stock outstanding. Each stockholder has one vote for each share of common stock owned as of the record date. The common stock does not have cumulative voting rights.

**How To Vote**

Stockholders may vote their shares in person by attending the annual meeting. Stockholders may also vote by mail by signing, dating and mailing the enclosed proxy card. The proxy holders will vote your shares in accordance with the instructions on your proxy card. Stockholders who hold their shares through a bank or broker should vote their shares in the manner prescribed by the bank or broker. If you do not specify how to vote your shares on your proxy card, we will vote them (i) for each of the nominees for director named herein, (ii) for approval of the amendments to the 2001 Outside Directors Stock Option plan, (iii) for ratification of PricewaterhouseCoopers LLP as our independent registered public accounting firm for fiscal 2006, and (iv) in accordance with the recommendations of our board of directors, or, if no recommendation is given, in the discretion of the proxy holders, on any other business that may properly come before the meeting or any adjournment or adjournments thereof.

**Revoking Your Proxy**

You may revoke your proxy at any time before it is exercised by:

- sending a written notice of revocation to the Secretary of Lattice;
- submitting a properly signed proxy with a later date; or
- voting in person at the meeting.

**Quorum; Abstentions; Broker Non-Votes**

A majority of the shares of common stock issued and outstanding on March 7, 2006, present in person at the meeting or represented at the meeting by proxy, will constitute a quorum. Shares that are voted FOR , AGAINST , ABSTAIN , or WITHHELD from a proposal are treated as being present at the meeting for purposes of establishing a quorum.

The total number of votes that could be cast at the meeting is the number of votes actually cast plus the number of abstentions. Abstentions are counted as shares present at the meeting for purposes of determining whether a quorum exists and have the effect of a vote against any matter as to which they are specified. Proxies submitted by brokers that do not indicate a vote for some or all of the proposals because they do not have discretionary voting authority and have not received instructions as to how to vote on those proposals (so-called broker non-votes ) are counted as present and entitled to vote and are, therefore, included for purposes of determining whether a quorum is present at the annual meeting; however, broker non-votes are not deemed to be votes cast. As a result, broker non-votes are not included in the tabulation of the voting results on the election of directors or issues requiring approval of a majority of the votes cast and, therefore, do not have the effect of votes against the proposal.

**PROPOSAL 1: ELECTION OF DIRECTORS**

Our board of directors is divided into three classes. Directors are elected to serve staggered three-year terms, such that the term of one class of directors expires each year. Classes consist of two or three directors. Pursuant to action by the nominating and governance committee of the board of directors, the company will be nominating two Class II directors, named below, at the meeting to serve three-year terms ending in 2009. We will vote your shares as you specify when providing your proxy. If you do not specify how you want your shares voted when you provide your proxy, we will vote them for the election of the nominees listed below. If unforeseen circumstances (such as death or disability) make it necessary for the board of directors to substitute another person for the nominee, we will vote your shares for that other person.

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The following table briefly describes the nominees for director and the directors whose terms will continue. Except as otherwise noted, each has served in his principal occupation for at least five years. There are no family relationships among any of our directors or officers.

Nominee	Age	Principal Occupation and Other Directorships	Director Since	Current Term Expires	Class
Daniel S. Hauer	69	Business consultant since November 1998; Chairman of the Board of Epson Electronics America until November 1998.	1987	2006	II
Balaji Krishnamurthy	52	Chairman, President and Chief Executive Officer of Planar Systems, Inc. until September 2005.	2005	2006	II
<b>Continuing Directors</b>					
David E. Coreson	59	Former Senior Vice President of Tektronix Inc.	2005	2007	III
Gerhard Parker	62	Former Executive Vice President of Intel Corporation; member of Board of Directors of Applied Materials Inc. and FEI Co.	2005	2007	III
Patrick S. Jones	61	Former Chief Financial Officer of Gemplus SA, former Vice President, Finance and Corporate Controller of Intel Corporation; member of Board of Directors of Genesys SA.	2005	2008	I
Harry A. Merlo	80	President of Merlo Corporation since July 1995; President and Chairman of the Board of Louisiana-Pacific Corporation until June 1995.	1983	2008	I
Stephen A. Skaggs	43	Our Chief Executive Officer since August 2005 and President since October 2003; previously served as Senior Vice President and Chief Financial Officer from August 1996 until October 2003, and as Secretary from August 1996 until August 2005.	2005	2008	I

The board of directors appointed two new directors, Gerhard Parker and Balaji Krishnamurthy, in December 2005. Mr. Krishnamurthy is one of the two class II directors standing for election at this annual meeting. Along with several other potential candidates, both Mr. Parker and Mr. Krishnamurthy were identified by an outside executive search firm engaged by the nominating and governance committee. After considering the qualifications of many candidates identified by the search firm, as well as interviewing certain candidates, the nominating and governance committee recommended that the board of directors appoint Mr. Parker and Mr. Krishnamurthy to the board.

**Following the promotion of Stephen A. Skaggs to the office of Chief Executive Officer in August 2005, the board of directors, on the recommendation of the nominating and governance committee, appointed him as a director in November 2005.**

In January 2006, Soo Boon Koh, one of our current Class II directors, informed the board of directors that she would not stand for re-election.

Under the terms of our amended and restated bylaws and corporate governance guidelines, which were approved by the board of directors in January 2006, any director appointed by the board of directors to fill future vacancies on the board will be required to stand for election at the first annual stockholders meeting following the director's appointment.

#### **Required Vote**

The nominees receiving the highest number of affirmative votes of the votes cast at the meeting on this matter shall be elected as the Class II directors.

#### **THE BOARD OF DIRECTORS RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR THE ELECTION OF DANIEL HAUER AND BALAJI KRISHNAMURTHY AS CLASS II DIRECTORS OF THE COMPANY.**

If the election of directors at this annual meeting is uncontested and any director receives a greater number of withheld votes than for votes, then pursuant to our Corporate Governance Policies, such director shall submit a letter of resignation for consideration by the nominating and governance committee. The nominating and governance committee shall recommend to the board the action to be taken with respect to such offer of resignation. Within 120 days of the shareholder meeting, the board shall act with respect to such offer of resignation.

#### **Director Independence**

The board has determined that each of the directors, except Mr. Skaggs, is independent within the meaning of the applicable rules and regulations of the Securities and Exchange Commission ( SEC ) and the Nasdaq Stock Market, Inc. ( Nasdaq ) director independence standards, as currently in effect. Furthermore, the board has determined that each of the members of each of the committees of the board is independent within the meaning of the applicable rules and regulations of the SEC and the Nasdaq director independence standards, as currently in effect.

#### **Annual Meeting Attendance**

Although we do not have a formal policy regarding attendance by members of the board at our annual meetings of stockholders, directors are encouraged to attend. All directors attended the last annual meeting of stockholders.

#### **Board Meetings and Committees**

In 2005, the board of directors held a total of eight meetings, and acted once by written consent. The independent directors meet regularly without the presence of management. Mr. Merlo, in his capacity as the presiding independent director, led meetings of independent directors for a portion of 2005. The board of directors appointed Patrick S. Jones, also an independent director, chairman of the board in June 2005. Each of our current directors attended or participated in more 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 on which such director served.

Our board of directors currently has three standing committees: the audit committee, the compensation committee, and the nominating and governance committee. Each of these committees operates under a written charter adopted by the board. Our board of directors also formed a special litigation committee in January 2005 in response to the shareholder derivative actions filed against certain

of our current and former directors and officers. The work of the committee concluded with the settlement of the derivative actions in January 2006.

#### *Audit Committee*

The company has a separately designated standing audit committee established in accordance with Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The audit committee oversees the accounting and financial reporting process and the external audit process of the company and assists the board of directors in the oversight and monitoring of (i) the integrity of the financial statements of the company, (ii) the internal accounting and financial controls of the company, (iii) compliance with legal and regulatory requirements, and (iv) the qualifications, performance, and independence of the company's independent registered public accounting firm. In this capacity, the audit committee is responsible for appointing, approving the compensation of, and overseeing the work of the independent registered public accounting firm. In addition, the audit committee reviews and approves all work performed by the independent registered public accounting firm. The audit committee meets with management and our independent registered public accounting firm, who have access to the audit committee without the presence of management representatives.

During 2005, the audit committee was composed of Mr. Jones, Mr. Merlo, and Soo Boon Koh, and, for portions of the year, Mr. Parker and former director Mark Hatfield. The audit committee met fourteen times in 2005. Currently, the committee is composed of Mr. Jones, Mr. Merlo, Mr. Parker, and Ms. Koh, who will no longer serve as a member of the audit committee as of our annual meeting of stockholders. Our board of directors has determined that both Mr. Jones and Mr. Merlo qualify as audit committee financial experts as this term has been defined under the rules and regulations of the SEC.

The charter of the audit committee is available on our website at <http://www.latticesemi.com/corporate/investorrelations/governance/index.cfm>.

#### *Compensation Committee*

The compensation committee evaluates and, subject to obtaining the agreement of all the independent directors, approves our chief executive officer's compensation, including salary, equity, and bonus compensation, and evaluates and approves the compensation of our other executive officers. The committee also administers our employee stock option plans and handles other compensation issues. During 2005, the compensation committee was composed of Mr. Coreson, Mr. Hauer, our former director Mr. Hatfield, and, for a portion of the year, Mr. Krishnamurthy. The compensation committee met nine times and acted two times by unanimous written consent in 2005. Currently, the committee is composed of Mr. Coreson, Mr. Hauer, and Mr. Krishnamurthy.

The charter of the compensation committee is available on our website at <http://www.latticesemi.com/corporate/investorrelations/governance/index.cfm>.

#### *Nominating and Governance Committee*

The nominating and governance committee identifies qualified persons to become directors and recommends candidates for all vacant directorships to be filled by the board or by the stockholders, reviews and evaluates the performance of the board of directors and each committee of the board, makes recommendations to the board for nominees to the committees of the board, and oversees compliance with our corporate governance policies. During 2005, the nominating and governance committee was composed of Mr. Jones, Mr. Merlo, and, for a portion of the year, Mr. Hauer, Ms. Koh, and our former director Mr. Hatfield. The nominating and governance committee met four times in 2005. Currently, the committee is composed of Mr. Jones and Mr. Merlo.



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The nominating and governance committee believes that each company director should have certain minimum personal qualifications, including the following:

- professional competence, expertise, and diversity of background that is useful to the company;
- the desire and ability to serve as a director, and to devote the time and energy required to fulfill the responsibilities of the position successfully;
- character, judgment, experience, and temperament appropriate for a director; and
- independence, together with personal and professional honesty and integrity of the highest order.

The committee evaluates candidates for nomination on the basis of their individual qualifications, and also on the basis of how such individuals would fill a need on the board of directors. Factors in such determination include:

- the current size and composition of the board;
- the independence of the board and its committees;
- the presence on the board of individuals with expertise in areas useful to the company;
- the diversity of individuals on the board, including their personal characteristics, experiences, and backgrounds;
- the number of other boards on which the candidate serves; and
- such other factors as the committee or the board consider significant.

The nominating and governance committee will consider candidates for our board of directors suggested by its members, other members of the board of directors, our senior management, individuals personally known to members of our board, and our stockholders. From time to time, the committee may solicit proposals for candidates from interested constituencies, or may use paid third-party search firms to identify candidates. Under the terms of its charter, the committee is obligated to consider in good faith any candidate recommended by one or more of our ten largest unaffiliated stockholders of record, provided that, in the committee's judgment, the candidate satisfies the criteria for board service set forth in the committee's charter. The committee evaluates candidates in the same manner regardless of how such candidates are brought to the attention of the committee.

Stockholders who wish to submit names of candidates for our board of directors for consideration by the nominating and governance committee should do so in writing, addressed to the nominating and governance committee, c/o Secretary, Lattice Semiconductor Corporation, 5555 NE Moore Court, Hillsboro, Oregon 97124-6421, and should include the following information:

- A statement that the writer is a stockholder and is proposing a candidate for consideration by the committee (if the stockholder believes that they are one of our ten largest unaffiliated stockholders, then the stockholder should include language to this effect in their statement);
- The name and contact information for the candidate;
- A statement of the candidate's occupation and background, including education and business experience;
- Information regarding each of the factors listed above, sufficient to enable the committee to evaluate the candidate;

- A statement detailing (i) any relationship or understanding between the candidate and the company, or any customer, supplier, competitor, or affiliate of the company; and (ii) any

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relationship or understanding between the candidate and the stockholder proposing the candidate for consideration, or any affiliate of such stockholder;

- A statement that the candidate is willing to be considered for nomination by the committee and willing to serve as a director if nominated and elected.

Additional information may be requested by the committee as appropriate.

In addition, our bylaws permit stockholders to nominate individuals to stand for election to our board of directors at an annual stockholders meeting. Stockholders wishing to submit nominations must notify us of their intent to do so on or before the date specified under *Stockholder Proposals*, *Other Stockholder Proposals* and *Director Nominations*. Such notice must include the information specified in our bylaws, a copy of which is available from our corporate secretary upon written request.

The charter of the nominating and governance committee is available on our website at <http://www.latticesemi.com/corporate/investorrelations/governance/index.cfm>.

#### *Special Litigation Committee*

As previously disclosed by the company, in September and October 2004, two shareholder derivative complaints were filed, purportedly on behalf of Lattice Semiconductor Corporation, in the Circuit Court of the State of Oregon for the County of Washington, against all of our then current directors, certain former directors, and certain executive officers. The derivative plaintiffs made allegations substantially similar to those in the putative class action complaints against the company, which relate to the restatement of the company's financial results for the first, second, and third quarters of 2003, as well as allegations of breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment. Consistent with the usual procedures for cases of this kind, these cases were consolidated into a single putative shareholder derivative action.

In January 2005, the board of directors deemed it advisable to establish a special litigation committee to conduct an investigation of the claims alleged in the derivative action to determine whether the company should undertake or defend against any litigation against one or more of the directors, former directors, officers of the company or others. The board further authorized the committee to undertake and supervise any necessary action to implement any of the findings and determinations resulting from its investigation, including but not limited to court filings, motions, settlement discussions or agreements. The board appointed Mr. Coreson and Mr. Jones, neither of whom had been named as a defendant in the derivative action or had been involved in the matters referred to in the action, to serve as members of the special litigation committee. The committee met nine times in 2005.

In December 2005, the special litigation committee agreed with counsel for the derivative plaintiffs on a settlement of the derivative action on terms that, among other things, provided for the board of directors to adopt specified corporate governance changes, for the dismissal with prejudice of all claims asserted by the derivative plaintiffs, and for the payment of plaintiffs' counsel's fees and expenses. The stipulation of settlement entered into by the parties did not contain any finding of fault or admission of wrongdoing or liability on the part of Lattice or any of the individual defendants in the litigation. The settlement was approved by the Circuit Court and the derivative litigation was dismissed on January 30, 2006. The agreed upon corporate governance changes, and additional corporate governance changes initiated by the board of directors, were adopted by the board on January 31, 2006.

The work of the special litigation committee concluded with the settlement of the derivative actions.

## Communications with the Board

Stockholders may communicate with the board of directors by writing to us c/o Secretary, Lattice Semiconductor Corporation, 5555 NE Moore Court, Hillsboro, Oregon 97124-6421. Stockholders who would like their submission directed to a member of the board of directors may so specify, and the communication will be forwarded, as appropriate.

## Director s Compensation

Directors who are also our employees (currently Mr. Skaggs) receive no additional or special compensation for serving as directors. Each non-employee director receives an annual retainer of \$20,000, plus \$1,500 for each board meeting and \$1,000 for each committee meeting they attend. The directors who chair the standing committees of the board receive annual fees in the following amounts: audit committee \$10,000, compensation committee \$5,000, and nominating and governance committee \$5,000. Members of the special litigation committee formed in 2005 received a \$10,000 retainer, plus \$1,000 for each committee meeting they attended. The board of directors limited total compensation for service on the special litigation committee to \$20,000 per member, inclusive of the retainer. Additionally, our chairman of the board, Patrick S. Jones, receives a monthly retainer of \$5,000 for his service as chairman.

Non-employee directors also receive options to purchase shares of our common stock. Director options were issued in 2005 under our 2001 Outside Directors Stock Option Plan (the 2001 Plan ), which provides for automatic grants of stock options to non-employee directors. Under the 2001 Plan, new non-employee directors are granted an option exercisable for 72,000 shares upon initial appointment to the board. These options generally vest quarterly over a four-year period and expire ten years from the grant date. In addition, each year our non-employee directors are granted an option exercisable for 18,000 shares (directors appointed in that year receive a prorated number of shares based on when they joined the board of directors). These options generally vest quarterly over a one-year period beginning three years after the grant date and expire ten years from the grant date. In 2005, Mr. Hauer, Ms. Koh, Mr. Merlo, and our former director Mr. Hatfield were each granted an option exercisable for 18,000 shares. Mr. Coreson and Mr. Jones were each granted options exercisable for 72,000 and 9,000 shares. Mr. Krishnamurthy and Mr. Parker were appointed as directors in December 2005, and each of them was granted an option exercisable for 72,000 shares in January 2006.

As discussed in greater detail hereafter in Proposal Two, stockholders are being asked to approve an amendment to the 2001 Plan to, among other things, increase the number of shares initially granted to each director from 72,000 to 90,000, to increase the number of shares granted each year thereafter from 18,000 to 22,500, and to change the vesting schedules for such option grants.

## Employment Agreements

On August 9, 2005, the Company and Mr. Skaggs entered into an employment agreement. Under the terms of the employment agreement, Mr. Skaggs base annual salary is \$400,000. He also received an option to purchase 650,000 shares of common stock. The option has a ten-year term and will vest at a rate of 6.25% of the shares every three months so long as Mr. Skaggs continues as a service provider to the Company.

The agreement also entitled Mr. Skaggs to receive a bonus for the 2005 fiscal year of up to \$150,000, 50% of which was earned on December 30, 2005 on the basis of Mr. Skaggs s continued employment as of such date. The remaining potential 50% of his 2005 fiscal year bonus compensation was based on the achievement of performance objectives that were mutually agreed upon in writing by the compensation committee and Mr. Skaggs. On January 31, 2006, the compensation committee recommended to the board and the board approved a payment of a bonus of \$127,500 to Mr. Skaggs. For subsequent fiscal years, Mr. Skaggs will participate in an executive bonus plan that was established by the Company. Under this

plan, Mr. Skaggs will be eligible to receive a target bonus of up to 70% of his annual base salary (or such higher figure as determined by the compensation committee) based on the achievement of specific milestones to be mutually agreed upon by the compensation committee and Mr. Skaggs, provided that Mr. Skaggs may receive an annual bonus of up to twice his annual salary for superior achievement of the milestones.

The employment agreement is at-will, and the Company may terminate Mr. Skaggs' employment with or without Cause (as defined in the employment agreement) by giving Mr. Skaggs 30 days advance written notice. Mr. Skaggs may also terminate his employment by giving the Company 30 days advance written notice.

If the Company terminates Mr. Skaggs' employment without Cause or if Mr. Skaggs terminates his employment with Good Reason (as defined in the employment agreement), then he will be entitled to receive (i) a severance payment equal to 1.5 times his then annual base salary plus 1.0 times his then target bonus, (ii) reimbursement of health insurance premiums for a period of 18 months following his termination date (or such earlier date upon which he receives comparable medical coverage), and (iii) immediate vesting under all of his then outstanding equity awards as if he had continued employment for an additional 12 months following his termination date. In addition, if Mr. Skaggs is terminated without Cause or terminates his employment with Good Reason within 24 months of a Change in Control (as defined in the employment agreement), then (x) he will receive a severance payment equal to 2.0 times his then current base salary plus 2.0 times his target bonus, (y) he will receive reimbursement of health insurance premiums for 24 months, and (z) all of his outstanding equity awards will become fully vested and exercisable on the termination date. All severance payments are conditional upon the execution by Mr. Skaggs of a release of claims against the Company and his compliance with certain obligations owed to the Company under his employment agreement.

If any of the benefits and payments provided under the employment agreement are considered parachute payments within the meaning of Section 280G of the Internal Revenue Code (the Code) and are thus subject to the excise tax imposed by Section 4999 of the Code, the Company will provide Mr. Skaggs with a payment sufficient to cover such excise tax and an additional payment to cover the federal and state and employment taxes that will arise from this payment from the Company, not to exceed \$1,000,000.

On November 3, 2005, the Company entered into employment agreements with three of its executive officers: Jan Johannessen, its Senior Vice President and Chief Financial Officer, Martin Baker, its Corporate Vice President, General Counsel and Secretary, and Stephen Donovan, its Corporate Vice President, Sales.

Under the terms of his employment agreement, Mr. Johannessen's base annual salary is \$262,096. The agreement also entitled Mr. Johannessen to receive a bonus for the 2005 fiscal year of up to \$100,000, 50% of which was earned on December 30, 2005 on the basis of Mr. Johannessen's continued employment as of such date. The remaining potential 50% of his 2005 fiscal year bonus compensation was based on the achievement of performance objectives that were mutually agreed upon in writing by the compensation committee and Mr. Johannessen. On January 31, 2006, the compensation committee approved payment of a bonus of \$85,000 to Mr. Johannessen. For subsequent fiscal years, Mr. Johannessen will participate in an executive bonus plan established by the Company. Under this plan, Mr. Johannessen will be eligible to receive a target bonus of up to 40% of his annual base salary (or such higher figure as determined by the compensation committee) based on the achievement of specific milestones to be mutually agreed upon by the compensation committee and Mr. Johannessen; provided that Mr. Johannessen may receive an annual bonus of up to 250% of the target bonus for superior achievement of the milestones.

Under the terms of his employment agreement, Mr. Baker's base annual salary is \$224,698. The agreement also entitled Mr. Baker to receive a bonus for the 2005 fiscal year of up to \$80,000, 50% of which was earned on December 30, 2005 on the basis of Mr. Baker's continued employment as of such date. The remaining potential 50% of his 2005 fiscal year bonus compensation was based on the achievement of performance objectives that were mutually agreed upon in writing by the compensation committee and Mr. Baker. On January 31, 2006, the compensation committee approved payment of a bonus of \$68,000 to Mr. Baker. For subsequent fiscal years, Mr. Baker will participate in an executive bonus plan established by the Company. Under this plan, Mr. Baker will be eligible to receive a target bonus of up to 30% of his annual base salary (or such higher figure as determined by the compensation committee) based on the achievement of specific milestones to be mutually agreed upon by the compensation committee and Mr. Baker; provided that Mr. Baker may receive an annual bonus of up to 250% of the target bonus for superior achievement of the milestones.

Under the terms of his employment agreement, Mr. Donovan's base annual salary is \$227,115. The agreement also entitled Mr. Donovan to receive a bonus for the 2005 fiscal year of up to \$40,000, 50% of which was earned on December 30, 2005 on the basis of Mr. Donovan's continued employment as of such date. The remaining potential 50% of his 2005 fiscal year bonus compensation was based on the achievement of performance objectives that were mutually agreed upon in writing by the compensation committee and Mr. Donovan. On January 31, 2006, the compensation committee approved payment of a bonus of \$34,000 to Mr. Donovan. For subsequent fiscal years, Mr. Donovan will participate in an executive bonus plan established by the Company. Under this plan, Mr. Donovan will be eligible to receive a target bonus of up to 30% of his annual base salary (or such higher figure as determined by the compensation committee) based on the achievement of specific milestones to be mutually agreed upon by the compensation committee and Mr. Donovan; provided that Mr. Donovan may receive an annual bonus of up to 250% of the target bonus for superior achievement of the milestones.

Each of the employment agreements with Mr. Johannessen, Mr. Baker, and Mr. Donovan is at-will, and the Company may terminate the employment of any of them with or without Cause (as defined in the employment agreement) by giving the executive officer 30 days advance written notice. Each of Mr. Johannessen, Mr. Baker, and Mr. Donovan may also terminate his employment by giving the Company 30 days advance written notice.

If the Company terminates the employment of any of Mr. Johannessen, Mr. Baker, or Mr. Donovan without Cause or if any of these executive officers terminates his employment with Good Reason (as defined in the employment agreement), then the executive officer will be entitled to receive (i) a severance payment equal to 1.0 times his then annual base salary plus 1.0 times his then target bonus (adjusted pro rata on a monthly basis depending on the month the termination occurs) and (ii) reimbursement of health insurance premiums for a period of 12 months following his termination date (or such earlier date upon which he receives comparable medical coverage). In addition, if any of Mr. Johannessen, Mr. Baker, or Mr. Donovan is terminated without Cause or terminates his employment with Good Reason within 24 months of a Change in Control (as defined in the employment agreement), the executive officer will (i) receive a severance payment equal to 1.0 times his then current base salary plus 1.0 times his target bonus (without any pro rata adjustment) and (ii) receive reimbursement of health insurance premiums for 12 months. All severance payments are conditioned upon the execution by the executive officer of a release of claims against the Company and his compliance with certain obligations owed to the Company under his employment agreement.

If any of the benefits and payments provided under the employment agreement are considered parachute payments within the meaning of Section 280G of the Internal Revenue Code (the Code) and are thus subject to the excise tax imposed by Section 4999 of the Code, then the executive officer's benefits under the employment shall be payable either (1) in full, or (2) as to such lesser amount which would result in no portion of such benefits being subject to excise tax under Section 4999 of the Code,

whichever of the foregoing amounts, taking into account the applicable federal, state, and local income taxes and the excise tax imposed by Section 4999, results in the receipt by the executive officer of the greatest amount of after-tax benefits under the employment agreement.

### Audit and Related Fees

Under its charter the audit committee reviews and pre-approves all audit and permissible non-audit services performed by PricewaterhouseCoopers LLP as well as the fees charged by PricewaterhouseCoopers LLP for such services. In its review of non-audit services, the audit committee considered whether the provision of such services is compatible with maintaining the independence of PricewaterhouseCoopers LLP. The following table sets forth the aggregate fees billed by PricewaterhouseCoopers LLP in connection with the following services during 2005 and 2004:

	2005	2004
Audit Fees(1)	\$ 852,475	\$ 570,700
Audit-Related Fees(2)	59,556	37,483
Tax Fees(3)	4,389	8,965
All other fees(4)	1,500	1,500
<b>Total fees</b>	<b>\$ 917,920</b>	<b>\$ 618,648</b>

(1) This category includes fees, billed to date for 2005 and 2004, respectively, for services rendered for the audit of the annual financial statements included in our Annual Report on Form 10-K, review of the quarterly financial statements included in our quarterly reports on Form 10-Q, issuance of consents and assistance with and review of documents filed with the SEC.

(2) This category includes fees billed in 2005 and 2004, respectively, for services relating to the audit of employee benefit plans, accounting for the retirement of convertible notes, fees for other statutory filings and audits.

(3) This category includes fees billed in 2005 and 2004, respectively, for tax compliance, planning, and advice.

(4) This category includes fees billed in 2005 and 2004, respectively, for a subscription to an online technical accounting and auditing research service.

The audit committee has determined that the provision of services rendered above for non-audit services is compatible with maintaining the independence of PricewaterhouseCoopers LLP.

### Audit Committee Report

The responsibilities of the audit committee are fully described in the audit committee charter. Management is responsible for maintaining our financial controls and preparing our financial reports. Our independent registered public accounting firm is responsible for performing an independent audit of our consolidated financial statements in accordance with generally accepted auditing standards and for issuing an audit report. The audit committee's responsibility is to execute the audit committee charter and oversee these processes. In fulfilling its responsibilities, the audit committee has reviewed and discussed the audited financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2005 with management and our independent registered public accounting firm.

The audit committee discussed with our independent registered public accounting firm matters required to be discussed by the Statement on Auditing Standards No. 61, Communication with Audit Committees. In addition, the audit committee discussed with our independent registered public accounting firm their independence from Lattice and our management, including the written disclosures

and the letter submitted to the audit committee by our independent registered public accounting firm as required by the Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees .

Based upon the audit committee s discussions with management and our independent registered public accounting firm and the audit committee s review of the representations of management, the report of our independent registered public accounting firm, and the information referenced above, the audit committee recommended that the board of directors include the audited consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2005, for filing with the Securities and Exchange Commission.

#### Audit Committee

Patrick S. Jones, Chairman  
Harry A. Merlo  
Soo Boon Koh  
Gerhard H. Parker\*

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\* Appointed December 2005

#### Compensation Committee Interlocks and Insider Participation

The members of our compensation committee during 2005 were Mr. Coreson, Mr. Hauer, our former director Mr. Hatfield, and, for a portion of the year, Mr. Krishnamurthy. None of the members of the committee was or is one of our officers or employees. None of our executive officers serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

#### Report of the Compensation Committee

The compensation committee, comprised of independent directors, sets, reviews, and administers our executive compensation program. The role of the compensation committee is to evaluate and make recommendations to the board of directors regarding the salary and incentive compensation of our chief executive officer and evaluate and approve the compensation of our other executive officers based upon the recommendation of our chief executive officer. The committee also administers our employee equity incentive plans, and reviews and approves all stock option grants to our employees.

*Change in Chief Executive Officer and in Executive Compensation Components.* Substantial changes in the senior management of our company occurred during 2005. On June 14, 2005, our former chief executive officer, Cyrus Tsui, and another former executive officer were placed on paid leave of absence by the Board pending completion of an independent examination by our audit committee of issues primarily related to executive compensation and internal controls. Stephen A. Skaggs, then our president, was named interim chief executive officer pending completion of the investigation. On August 8, 2005, the board terminated Mr. Tsui s employment, and appointed Mr. Skaggs as our chief executive officer. At the same time, we adopted changes to our internal controls concerning many aspects of executive compensation.

*Compensation Philosophy.* We believe that executive compensation arrangements and practices should be clear and unambiguous, and should be fully approved by the compensation committee and disclosed to stockholders. Our compensation philosophy is that bonus compensation of executive officers should be directly linked to our short-term performance while longer-term incentives, such as stock options, should be aligned with the objective of enhancing stockholder value over the long term. We believe the use of stock options strongly links the interests of our officers and employees to the interests of



our stockholders. In addition, we believe that our total compensation packages must be competitive with other companies in our industry to ensure that we can continue to attract, retain, and motivate the senior executives whom we believe are critical to our long-term success.

*Components of Executive Compensation.* The principal components of executive compensation are base salary, annual Executive Bonus Plans, and stock options.

Base salaries are set based on competitive factors and the historic salary structure for various levels of responsibility within Lattice. The compensation committee periodically conducts surveys of companies in our industry in order to determine whether our executive base salaries are in a competitive range. Generally, salaries are set in the middle of this range.

Our 2005 Executive Bonus Plan is a bonus plan linked directly to measurable objectives. It was adopted in 2005 and applied through the end of 2005, and replaced the Executive Incentive Plan that had previously been used to pay executive bonuses. Under the terms of our 2005 Executive Bonus Plan, our executive officers and other vice presidents have defined target bonus amounts. For each of our executive officers and certain other vice presidents specified in the plan, 50% of their target bonus amount was payable if they remained employed by Lattice as of December 30, 2005. We decided to include this retention component of the bonus based on the substantial changes that occurred in our company during the last year, which we describe above. We do not currently expect future bonus plans to include a retention component. For each of our executive officers and those certain other vice presidents specified in the plan, the other 50% of the target bonus amount is dependent on the achievement of certain milestones relating to product development, technology qualification, new product design-ins, new product revenue, and total revenue. This plan emphasizes our belief that the bonus compensation of our executives should be dependent on well-defined goals that complement Lattice's business plan objectives. The compensation committee retained the power to withhold or delay payment of bonuses due to business conditions or other relevant considerations. Bonuses were paid pursuant to this plan in February 2006.

In 2005, the compensation committee and the board of directors also approved the 2006 Executive Bonus Plan, to establish a mechanism for determining senior management bonus amounts for the 2006 fiscal year. Our chief executive officer and other executive officers, as well as other members of senior management, as recommended by the chief executive officer and approved by the compensation committee, are eligible to participate in the 2006 Executive Bonus Plan. Under the terms of this plan, the bonus payout for each participant will be based both on company performance, as measured by achievement of revenue and operating income performance goals approved by the Board prior to the commencement of the plan year, and individual performance. The revenue and operating income goals will be equally weighted in calculating the bonus payout. The compensation committee will determine the individual performance of the chief executive officer, and the chief executive officer will determine the individual performance of the other participants. For each participant, a specified minimum achievement against the revenue and operating income objectives is required for any bonus payment. The compensation committee approved a target bonus and a maximum bonus for each participant, based on the participant's annual salary. The target bonus for our chief executive officer is 70% of base salary, and the maximum bonus is 200% of base salary. For other participants, target bonuses range from 20% to 40% of base salary, and the maximum bonuses range from 50% to 100% of base salary.

The principal equity component of executive compensation is our employee stock option program. Stock options are generally granted when an executive joins us and on an annual basis thereafter under a replenishment program. Initial stock option grants vest over a period of four years. The purpose of the annual replenishment program is to ensure that our executives always have options that vest in increments over a subsequent four-year period. Stock options are also occasionally granted for promotions or other special achievements. Stock options provide a means of retention and motivation for our executives and also align their interests with long-term stock price appreciation. In addition, executives are eligible to

participate in a payroll deduction employee stock purchase plan. Under this plan, available to all domestic employees, company stock may be purchased at 85% of the fair market value at the beginning or end of a six month offering period, whichever is less (up to a maximum of \$25,000 worth of stock per calendar year or 10% of salary, whichever is less).

Executives also participate in our profit sharing plan. Under this plan, a specified percentage of operating income, excluding charges associated with one-time in-process research and development and amortization of intangible assets, is set aside and distributed among all domestic employees based on tenure. For 2005, no distributions were made under our profit sharing plan. Other elements of executive compensation include participation in a company-wide life and disability insurance program, supplemental life insurance, long-term disability insurance, company-wide medical benefits, and the ability to defer compensation pursuant to both a company-wide 401(k) plan and an executive deferred compensation plan. No discretionary contributions to the company-wide 401(k) plan are currently made by the company, and no company contributions are made to the executive deferred compensation plan.

During 2005, the company entered into an employment agreement with its chief executive officer. The agreement provides for at-will employment and sets forth the basic terms of the chief executive officer's compensation package, including base salary, potential bonus compensation, and equity compensation. Under the terms of the agreement, the board of directors may terminate the employment of the chief executive officer with or without cause (as defined in the employment agreement) by giving 30 days advance written notice. In turn, the chief executive officer may also terminate his employment by giving the company 30 days advance written notice.

If the board of directors terminates the chief executive officer's employment without cause or if the chief executive officer terminates his employment with good reason (as defined in the employment agreement), then he will be entitled to receive certain severance benefits. In addition, if the chief executive officer is terminated without cause or terminates his employment with good reason within 24 months of a change in control (as defined in the employment agreement), he will receive certain severance benefits. For more information regarding these severance benefits, please see the section of this Proxy Statement entitled "Employment Agreements". All severance payments are conditioned upon the execution by the chief executive officer of a release of claims against the company and his compliance with certain obligations owed to the company under his employment agreement.

The other executive officers and certain other members of senior management also entered into similar employment agreements with the company. These agreements outlined the basic terms of each such person's compensation package. In addition, these agreements provide for certain severance benefits to be paid to such executive officers and other officers under the same conditions that such benefits would be required to be paid under the chief executive officer's employment agreement. For more information regarding these severance benefits payable to our executive officers, please see the section of this Proxy Statement entitled "Employment Agreements". All severance payments are conditioned upon the execution by the recipient of the payment of a release of claims against the company and his compliance with certain obligations owed to the company under his employment agreement.

*Other Compensation Considerations.* The compensation committee has studied Section 162(m) of the Internal Revenue Code and related regulations of the Internal Revenue Service, which restrict the deductibility of executive compensation paid to any of our five most highly-paid executive officers at the end of any fiscal year to the extent that such compensation exceeds \$1 million in any year and does not qualify for an exemption under the statute or related regulations. We have qualified our 1996 Stock Incentive Plan and our 2001 Stock Plan as performance based plans and therefore compensation realized in connection with exercises of options and payment of certain performance bonuses granted under these plans is exempt under the Internal Revenue Code. To maintain flexibility in compensating executive

officers in a manner designed to promote varying corporate goals, the compensation committee has not adopted a policy that all compensation must be tax deductible.

*Chief Executive Officer Performance and Compensation.* As described above, the board of directors placed our former chief executive officer, Cyrus Tsui, on leave on June 14, 2005, and terminated his employment on August 8, 2005. Prior to his termination, Mr. Tsui's base salary had been \$720,024 per year. Mr. Tsui's base salary had last been modified in April 2004. Mr. Tsui did not receive a regular performance review or a salary adjustment during 2005 prior to his being placed on leave. He also did not receive a bonus or an employee stock option grant in 2005. Mr. Tsui also received other fringe benefits as chief executive officer, including, among other things, certain health benefits, access to a corporate apartment, and reimbursement for certain automobile expenses. Under the terms of Mr. Tsui's September 2, 1988 employment agreement with the company, Mr. Tsui's salary continued for six months after his termination. Additionally, the 1988 agreement provides that, during a period of six months following his termination, Mr. Tsui was permitted to exercise his stock options that had vested as of the time of his termination.

The compensation committee reviewed the performance of our current chief executive officer, Stephen A. Skaggs, based upon the compensation philosophy and specific compensation components described above. In connection with his promotion to chief executive officer and the resulting increase in responsibility associated with the promotion, Mr. Skaggs received an increase in his base salary to a rate of \$400,000 per year. Mr. Skaggs also received a bonus of \$127,500, based upon the company's performance against defined goals, pursuant to the 2005 Executive Bonus Plan. In addition, pursuant to our philosophy of retaining and motivating our executives and aligning their interests with long-term stock appreciation, Mr. Skaggs received a stock option grant in 2005. All other benefits and other aspects of Mr. Skaggs' compensation are defined in the employment agreement with Mr. Skaggs, which is described above in the section of this Proxy Statement entitled "Employment Agreements" and is filed as an exhibit to our Annual Report on Form 10-K. In determining Mr. Skaggs' compensation, the compensation committee consulted with an outside firm that provides executive compensation advisory services. The outside firm provided the compensation committee with information regarding compensation packages for chief executive officers at comparable companies. In addition, the compensation committee also considered Mr. Skaggs' performance as president and his performance as interim chief executive officer as part of its deliberations concerning Mr. Skaggs' compensation package.

In determining the compensation package for the chief executive officer and the company's other named executive officers, the compensation committee considered all components of the officers' compensation. Based on the factors discussed above, the compensation committee finds that the total compensation of the chief executive officer and the other named executive officers of the company, including the potential payouts in the case of severance and change of control arrangements, to be reasonable and not excessive.

Compensation Committee

Daniel S. Hauer, Chairman  
David E. Coreson  
Balaji Krishnamurthy\*

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\*Appointed December 2005

**EXECUTIVE COMPENSATION****Summary of Compensation**

The following table provides certain summary information concerning compensation paid to or accrued for each person who served as our Chief Executive Officer during the 2005 fiscal year and each of our four other most highly compensated executive officers during fiscal 2005 who were serving as executive officers at the end of fiscal 2005, for each of the last three completed fiscal years. We refer to the individuals below as our named executive officers .

**SUMMARY COMPENSATION TABLE**

Name and Principal Position	Fiscal Year	Annual Compensation		Other Annual Compensation (3),(4)	Long-Term Compensation	All Other Compensation	
		Salary(1)	Bonus(2)		Securities Underlying Options (# of Shares)		
Skaggs, Stephen A.(5) President & CEO	2005	\$ 356,905	\$ 127,500	\$ 2,037	650,000	\$ 3,709	(7)
	2004	\$ 280,046	\$ 0	\$ 3,090	230,000	\$ 3,709	(8)
	2003	\$ 259,904	\$ 0	\$ 3,571	597,086 (6)	\$ 8,709	(9)
Johannessen, Jan Senior VP & CFO	2005	\$ 255,565	\$ 85,000	\$ 857	100,000	\$ 1,560	(7)
	2004	\$ 232,086	\$ 0	\$ 1,192	100,000	\$ 1,431	(8)
	2003	\$ 215,418	\$ 0	\$ 366	156,429 (6)	\$ 380	(9)
Donovan, Stephen M. Corporate VP, Sales	2005	\$ 226,293	\$ 34,000	\$ 2,456	45,000	\$ 4,472	(7)
	2004	\$ 215,282	\$ 0	\$ 3,726	60,000	\$ 4,472	(8)
	2003	\$ 214,038	\$ 0	\$ 4,305	156,123 (6)	\$ 4,472	(9)
Baker, Martin R. Corporate VP & General Counsel	2005	\$ 208,054	\$ 68,000	\$ 2,047	45,000	\$ 3,728	(7)
	2004	\$ 183,949	\$ 0	\$ 1,477	35,000	\$ 1,773	(8)
	2003	\$ 171,883	\$ 0	\$ 3,589	151,599 (6)	\$ 3,728	(9)
<b>Former Officers:</b>							
Tsui, Cyrus Y.(10) Former CEO	2005	\$ 743,552	\$ 0	\$ 23,493	0	\$ 544,974	(7)
	2004	\$ 701,781	\$ 0	\$ 34,290	525,000	\$ 41,556	(8)
	2003	\$ 659,361	\$ 0	\$ 38,356	1,864,072 (6)	&nbsp;	