Is Legendary Apple CEO on the Way Out?

Options scandal a big liability

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Apple Computer Inc.'s chief executive, Steve Jobs, is expected to captivate an audience of thousands at San Francisco's Moscone Convention Center tomorrow as he unveils Apple's newest products at the company's annual trade show.

But this year's show-and-tell is more keenly anticipated than most, and not just because Apple's expected to offer a combination cellphone-digital music player, along with a way to beam video and music from personal computers to home stereos and TV sets. Some industry-watchers think the appearance could be Jobs's last, because the company was caught back-dating stock options.

"If Steve Jobs were anything other than what he is, he'd already be gone," said Rob Enderle, principal analyst at Enderle Group, a high-tech research firm. "There was a crime committed . . . it looks like Steve Jobs was kind of the ringleader."

Jobs is credited with Apple's dramatic resurrection. After he was ousted from the company in a 1985 boardroom power play, Apple spent the next decade staggering toward bankruptcy. Since his comeback in 1997, Apple's core personal computer business has been reborn, with elegant new Macintosh machines and a powerful upgrade of the Mac operating system software.

The introduction of the iPod music player in 2001 was Jobs's greatest triumph. The iPod, along with Apple's iTunes Internet music-download service, altered the listening habits of millions worldwide. The newest iPods, which can be used to watch TV shows and movies, have made Apple a major force in video entertainment, as well.

Jobs's renowned perfectionism and his love of elegant design are credited for most of the company's success. That's why Apple investors and the company's board are desperate to shield Jobs from the scandal, said Lucian Bebchuk, director of the Program on Corporate Governance at Harvard Law School. Apple stock jumped nearly 5 percent last month after the board issued a report from a panel led by former Vice President Al Gore that concluded Jobs had broken no laws.

"It's clear that the board very much wanted him to stay," Bebchuk said. "The market likes an outcome under which he can stay."

But Rakesh Khurana , associate professor at the Harvard Business School, said the worry over Jobs's future shows the peril of making a business too dependent upon a single charismatic leader. He said Apple employees have an almost cultlike devotion to their company and its leader, but added, "the difference between a cult and a religion is that a religion has the potential to outlast the founder."

Apple, like many other technology firms, has often given stock options to key employees. Options give the holder the right to buy company stock at a predetermined price, say $10 a share. If the stock then rises to $20, the option holder can still buy the shares for just $10, even though they're worth twice as much.

But companies have gotten into hot water because of a practice called backdating. This involves issuing options but altering their issuance date to an earlier time when the share price was lower than the present price. It only takes the stroke of a pen, but backdating can sharply increase the value of options. It's perfectly legal, too -- as long as the company accurately records the true value of the options as a compensation expense.

However, federal securities investigators have found hundreds of instances in which backdated options weren't correctly accounted for, thus reducing the companies' expenses and artificially boosting earnings.

Allegations of backdating have ensnared executives at dozens of technology companies. Some, like George Samenuk, chief of the security software company McAfee Inc., and UnitedHealth Group Inc. chairman William McGuire, have lost their posts as a result.

Apple is among the companies that engaged in this practice, and the company's own investigation found that Jobs agreed to the backdating of some option grants, including one to Jobs himself in 2001, for 7.5 million option shares. Apple has since restated its 2001 earnings by $20 million to cover the extra value of Jobs's options. In total, the company lowered its earnings by $84 million between 1998 and 2006 to account for the cost of backdated options.

According to the Apple investigation, Jobs never exercised the options, trading them instead for shares of restricted stock. As a result, Jobs didn't receive a direct financial benefit from the backdating. The report also found that Jobs did not realize that the backdating had resulted in accounting errors. Instead, the board said its investigation raised "serious concerns" about accounting practices approved by two former Apple executives. The report does not name the two executives, but The Wall Street Journal last month said they were former general counsel Nancy Heinen and former chief financial officer Fred Anderson.

Attorneys for both executives said their clients did nothing wrong. Apple officials declined to comment.

David Yermack, professor of finance at New York University, noted that while Jobs did not cash in his options, he traded them for 5 million shares of Apple stock, thus giving him a hefty indirect benefit. Besides, Yermack said, as chief executive Jobs is responsible for the faulty accounting. "They admitted that he had knowledge and even participation in falsifying corporate records," Yermack said.

"I'm not sure how the directors can really differentiate between different forms of fraud and different forms of misleading investors . . . If he had knowledge and participation in events of this type he needs to resign."

It could come to that. Yermack said the Securities and Exchange Commission will probably investigate, as it has in other options cases. The SEC refused to confirm or deny that it's investigating.

Jobs is also under scrutiny for apparent options backdating at Pixar Animation Studios, the computer animation company he once owned. While Jobs himself never got Pixar options, the company used them to reward other top executives, including John Lasseter, director of hit Pixar movies like "Toy Story."

Walt Disney Co. bought Pixar for $7.4 billion in 2006. Jobs is now one of the largest shareholders in Disney and sits on the company's board. Thus his involvement with options backdating could tarnish not one but two legendary firms.