

# Stock Options Backdating Issue Haunts Jobs

*USA Today*

Greg Farrell & Jon Swartz

January 9, 2007

SAN FRANCISCO — When Steve Jobs steps to the podium Tuesday at the Macworld Conference here to introduce what is expected to be the newest Apple iPod, he won't be just another CEO hawking a fad product.

Instead, Apple's iconoclastic founder will be greeted by most attendees as the visionary who changed the way the world works and the messiah who saved Apple ([AAPL](#)) from oblivion a decade ago. His address is considered the crowning achievement of the year for Apple and its legion of fervent customers.

Yet on the day of Jobs' triumphant moment, he finds himself on the defensive over an issue that swept through Silicon Valley and a swath of Corporate America in 2006 like a California brushfire: the backdating of stock options.

Federal prosecutors and the Securities and Exchange Commission are poring over an internal Apple investigation that examined two huge options grants to Jobs in 2000 and 2001. The 2001 grant was the most problematic. It gave Jobs options to buy 7.5 million shares at \$18.30 a share instead of the \$21.01 market price of Apple's shares on the date the grant was finalized two months later.

The investigation also disclosed that more than 6,400 stock option grants made on 42 dates from 1997 to 2002 were backdated to give employees a lower strike price.

Apple's report on its internal investigation said that Jobs was aware of or recommended some favorable grant dates but that he did not appreciate the accounting implications. It found no evidence of misconduct by current management, it said.

The company also said Jobs didn't benefit financially from the backdating. Indeed, the two grants to Jobs, totaling 17.5 million options, were canceled in March 2003 (when Apple's stock price was below the options' strike price) and replaced with an award of 5 million shares of restricted stock.

According to data from Thomson Financial, Jobs has never sold shares of Apple stock for profit. His one sale of stock last March — in which he returned 4.5 million shares to the company for nearly \$300 million — was to satisfy tax withholding requirements.

But Lucian Bebchuk, director of Harvard Law School's program on corporate governance, says that Jobs clearly gained from the favorable backdating.

Even if one accepts Apple's explanation that Jobs didn't benefit because his options were canceled, the options' replacement with a grant of restricted stock meant they were worth something, Bebchuk says.

Apple says it is cooperating with authorities. What happens next depends on whether the SEC or the U.S. Attorney's office in San Francisco determines that laws were broken.

The backdating of options grants isn't illegal if companies and recipients make the proper SEC disclosures and follow accounting and tax rules. In Apple's case, the improper accounting forced the company to make a financial restatement of \$84 million to correct misdated grants from 1997 to 2006.

Apple's board has affixed all blame for the backdating on two unnamed former executives who have left the company. Lawyers for two former executives — former general counsel Nancy Heinen, who left Apple last year, and former chief financial officer Fred Anderson, who left Apple's board last year — deny that either of them did anything wrong.

Bebchuk has trouble believing that the widespread practice of options backdating at Apple was the work of only two executives.

"They are two former executives who had positions that usually don't involve primary responsibility for attracting and compensating people. What incentive did they have to engage in improper dating without implicit support from senior members of the executive team?" Bebchuk asks.

Like most of the 200-plus companies that have admitted to engaging in some form of options backdating, Apple also has to contend with civil suits claiming that shareholders were defrauded by the practice. A lawsuit filed last month in federal court in San Jose accuses Jobs and other top Apple executives of using backdating to benefit themselves. The lawsuit also alleges there was backdating at another company Jobs ran, the animation studio Pixar now owned by Disney.

## **Legal questions**

Apple's report on its investigation, contained in SEC filings on Dec. 29, left legal experts with new questions. In particular, Apple said one options grant was recorded as approved at a special board meeting on Oct. 19, 2001, but no such meeting took place.

"The statement Apple put out is a little bit pregnant with ambiguity," says John Coffee, an expert in securities law at Columbia University. "It wasn't a strong statement, in which the board investigated and determined that he had done nothing wrong. Instead, they said, 'We haven't caught him red-handed.' "

"When Apple said Jobs was aware of the options-granting process, and recommended them, they are saying Jobs tacitly orchestrated plans to produce phony records," says Christopher Bebel, a former SEC counsel and prosecutor.

But because Jobs did not exercise his options, it will make prosecutors hesitant to pursue criminal charges. "There was a wrong committed, but he didn't line his pockets," Bebel says.

As for the board's statement that Jobs did not "appreciate the accounting implications" of backdating, longtime observers were bemused. Jobs likes to keep track of everything at his company, they say.

"The notion that he doesn't know (the full implications of Apple's accounting procedures) is ludicrous," says Alan Deutschman, author of *The Second Coming of Steve Jobs*. He interviewed dozens of Apple employees, analysts and industry insiders shortly after Jobs returned to the company he co-founded.

Jobs' exacting attention to detail is most apparent when demanding minuscule changes to product designs or rehearsing for hours to perfect product introductions. And it is Jobs' perfectionism that rescued Apple from almost certain doom in the late 1990s. He pruned the company's then-bloated product line and engineered the release of mega-hit products such as the iPod, say financial analysts.

"Steve is the only person who could have saved Apple and made it what it is today," says analyst Charles Wolf, who has followed Apple for more than a decade, expressing a widely held view in the financial community. "Apple is Steve."

Most financial analysts and investors so far have shrugged off the ongoing stock-option scandal. They expect little impact as long as Jobs remains untouched. "We're not concerned, given the depth of Apple's internal review," says Gene Munster of Piper Jaffray.

Reflecting that faith, investors have boosted Apple's stock to \$86.18 a share, near its 10-year high.