Apple Chief Benefited From Options Dating, Records Indicate

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Apple Inc. chief executive Steve Jobs confirmed his place this week as the premier impresario of the Internet age, taking the stage in San Francisco to unveil a smart phone that won a raucous endorsement from thousands of fans in the audience and sent Apple stock rocketing to a record high.

But his signature performance at the annual Macworld Conference and Expo did not dispel the scandal swirling around Apple over its backdating of stock options. Despite the company's defense that Jobs never personally benefited from a pair of stock option grants he received -- he gave them up in 2003, long before allegations of wrongdoing surfaced -- filings with the Securities and Exchange Commission show that his options were exchanged for 5 million shares of restricted Apple stock.

That stock was worth $75 million at the time, nearly the same as the value of the options he relinquished, using a technique for calculating the value of investments popular with financial analysts and used by Apple.

Steve Dowling, Apple's director of corporate communications, said the 2003 transaction did not directly benefit Jobs because he could not sell the restricted shares until he had remained at Apple for another three years.

Some investor advocates call that explanation disingenuous. "You are torturing the English language to say he did not benefit from the options," said Patrick McGurn, executive vice president of Institutional Shareholder Services. "He certainly benefited from the grant because the grant was converted on a value-to-value basis."

McGurn and other analysts also said the amount of stock Jobs received appeared to be inflated because the value of his options was exaggerated, at least in the case of one grant, by the improper backdating.

The 5 million shares, which doubled in number when the stock split, continued to increase in value until last March, when Jobs was eligible to sell the shares. At that point, they were worth nearly $650 million. Jobs sold nearly half of them as soon as he could, in March, for $295.7 million.

Jobs is a unique figure in the technology industry. He is a rock star in the realm of geeks, the visionary behind such totems of the computer age as the Mac and the iPod and an evangelist of such charisma that his followers attribute to him the ability to make them rethink reality. His achievements have earned him a fortune estimated recently at $4.9 billion. After co-founding

Apple, Jobs left the company after a power struggle, only to return in 1996 and revive its flagging fortunes. He was also chief executive of Pixar Animation Studios and, after it was bought by Walt Disney Corp., became Disney's largest shareholder.

While senior executives at other companies have recently been forced from their posts over allegations that they were involved in improper booking of stock options, Wall Street analysts have said Apple would be reluctant to oust Jobs even if he were clearly implicated in similar practices. His leadership is synonymous with the company's success.

Nearly 200 companies have acknowledged or are under investigation for the backdating of stock options, a practice that involves picking an effective date for an option when the stock price was low so that the recipient can make more money when he sells it. None of those companies is as prominent as Apple, and Apple has confirmed that federal authorities are looking into its practices.

Apple disclosed to the Securities and Exchange Commission late last month that it had falsified the approval of 7.5 million stock options given to Jobs in 2001 by recording a fictitious October meeting to ratify the options. The company acknowledged that the options were actually finalized on Dec. 18, 2001. That date's stock price, which Apple now concedes should have been the basis for the option price, was 15 percent higher than it was on the date of Jobs's grant.

The company told the SEC that it would take a $20 million charge to account for the improper pricing of the grant. The company said an internal investigation had discovered that 6,428 option grants to executives and other employees made on 42 occasions were improperly dated and agreed to take an $84 million after-tax expense as part of restating its finances.

Though Apple said Jobs may have recommended the selection of some favorable dates for options, it said he did not appreciate the accounting significance of choosing false dates. The company said its internal review found no misconduct by current members of Apple management.

Though the 2001 award to Jobs has gained the most attention, an earlier, more generous grant in 2000 is also at issue. The Apple board finalized an award of 10 million stock options to Jobs on Jan. 12, 2000, and said in its filings last month that it was correct in using Jan. 12 as the date for the options' price.

Apple stock on that date happened to be at its lowest level for a six-month period, including about 10 weeks prior, making the stock options especially lucrative. By Jan. 18, when Apple said the board transmitted its unanimous written consent to the grant, the stock price had increased nearly 20 percent.

Lucian Bebchuk, director of Harvard Law School's program in corporate governance, said Jobs falls into a category of chief executives that Bebchuk has labeled "super-lucky." These are the people who have received stock options on dates representing the lowest price of the financial quarter.

"He has some company. He is not the only one to be as fortunate," Bebchuk said. He and his fellow researchers found in a study released two months ago that about 1,000 CEO grants from 1996 to 2005 fell into this category. For most of these options, he said, the dates were more likely to have been the result of "manipulation" rather than good fortune.

Backdating stock options is not illegal. But not disclosing the practice to investors or falsifying documents to cover it up may be.

In lawsuit filed last month in federal court in Northern California, Apple shareholders alleged that company officers and directors had manipulated the price of stock options for Jobs and other executives by repeatedly selecting dates with favorable stock prices. The plaintiffs allege that by doing so, Apple officers and directors unlawfully enriched Jobs and his fellow executives and concealed the practice.

Dowling, the Apple spokesman, declined to comment on the lawsuit. Nor would he comment on how Apple selected the dates for the sets of options awarded to Jobs, saying any available details were contained in SEC filings.

Apple reported in its filings that Jobs voluntarily gave up his stock options in March 2003 and "in exchange for his cancelled options" received the 5 million shares of restricted stock. The filing said Jobs relinquished the options partly because he was concerned that the number of unexercised options at the company had grown too large for its financial health. Apple's stock price had declined sharply in previous years, making many of those with options reluctant to use them. With the exercise price higher than the market price at the time, the options were said to be "underwater," meaning that anyone who exercised such an option immediately would lose money.

But while it would be unwise to exercise options under those circumstances, the options were far from worthless. They were good for up to 10 years after they were issued, allowing time for Apple stock to rebound, as it subsequently did.

The value of stock options on a specific date can be estimated with the Black-Scholes model, a widely used technique that factors in variables such as exercise and market prices, interest rates, dividends, expiration date, and stock volatility. Based on Apple's figures, disclosed in SEC filings, the combined value of Jobs's two stock option grants when he relinquished them in March 2003 was $81.3 million.

Graef Crystal, a retired consultant who is widely recognized as an expert on executive compensation, recently conducted a separate calculation using the same approach. But instead of using Apple's estimate of the stock's expected volatility, a crucial variable, he measured its actual volatility in the market. He also used his estimate of how long executives hold options before using them, based on experience instead of Apple's projection. Crystal calculated that Jobs's options were worth $76.6 million when he gave them up.

Financial analysts said that both estimates show that the options were of generally the same value as the stock Jobs received. Crystal said this showed that the exchange of options for stock was based on "some kind of parity."

Crystal and other financial experts said Jobs appeared not only to benefit from his options in general but specifically from the favorable dates when they were issued because lower prices for the options could ultimately translate into more shares of stock when he made the exchange.

In the case of the 2001 grant, for instance, the difference between the false October date and the December date, which Apple now says was the proper one, was worth about $5 million to Jobs when he traded the options in. Had the lower value been used in calculating the amount of stock he would get in return, he would have received 630,000 fewer shares. By the time he could sell them three years later, these shares would have been worth more than $40 million because of the soaring price of Apple stock.