More Than Backdating in Common

Study Links Options Abuses to Inside Directors, Long-Term CEOs

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Companies that lacked a majority of independent board members and that had long-serving chief executives were more likely to award questionably timed stock options to senior executives, according to a study to be released today.

The research, by a trio of business professors, suggests that recent stock-option abuses have their roots in broader corporate governance problems -- and not only at technology companies that have been a focus of a widening scandal over the backdating of option grants.

In addition, Harvard University professor Lucian Bebchuk said, companies in the study that were implicated in backdating already paid their top executives high cash compensation, which was increased by backdated options by more than 10 percent a year on average.

In all, more than 130 companies have disclosed probes into their awards of stock options, which give employees the right to buy shares at a set price and within a specific time frame. Typically, the grants give the executive the right to buy stock at the market price on the date of the grant, thus allowing him to profit from a rise in the stock without actually investing in it.

In backdating, some executives appear to have selected grant dates after the fact, when the stock price was low. This created a built-in profit on the day of the grant. Backdating is not in itself illegal, but companies must disclose such maneuvers to investors and board members.

Widespread investigations have led to the departure under pressure of the chief executives of United Health Group and KB Home.

Thus far, federal prosecutors have lodged criminal charges against former officials of Brocade Communications Systems Inc. and Comverse Technology Inc. over backdated stock options.

The Justice Department and the Federal Bureau of Investigation continue to scrutinize scores of companies for potential violations of the law.

Problems with stock options awards came to light with a 2005 report by the University of Iowa's Erik Lie, who last summer published new research that said more than 2,000 companies had employed backdated stock options.

The latest study, by Bebchuk, Cornell University's Yaniv Grinstein and visiting University of Chicago professor Urs Peyer, examined stock grants between 1996 and 2005.

The Sarbanes-Oxley Act, passed by Congress in 2002 after the failures of Enron Corp. and WorldCom Inc., tightened disclosure requirements for stock option awards. Many of the issues coming to light now have their roots in the 1990s stock market boom.