

# A Republican Senator's Corporate Misdeeds

*AlterNet*

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On October 20, 2000 - just 18 days before former Virginia Governor George Allen was elected to the U.S. Senate -- Xybernaut, a Virginia-based technology company, on whose board Allen served, held an early annual shareholder meeting and awarded Allen a tidy bonus of 50,000 stock options. Allen was granted the stock as part of his re-election to the board at a time when polls showed him to be the favorite in the impending senate election against Democrat Chuck Robb, and when it was clear that he would have to resign his board seat if and when he became a senator. Senate rules forbid members from serving on corporate boards.

The issuance of these options, whose existence is confirmed by the [Form Five filing](#) with the Securities and Exchange Commission, raises questions about why Xybernaut (which filed for bankruptcy in 2005) granted them to Allen so soon before his election to the Senate, and what, if anything, the company expected in return for them. Stock options, a controversial form of director compensation, "are designed to encourage future risk taking and align the interest of the director with the interests of the shareholder," says attorney Beth Young, a corporate governance expert now lecturing at Harvard Law School. Re-electing a director who might have to resign within weeks "is a little unusual," she says, and granting him additional options prior to his anticipated departure at an early annual meeting is "very unusual."

Allen's campaign has struggled to explain his financial relationship with Xybernaut. An attorney for Allen told reporters as recently as this October that all of the senator's stock options expired within 90 days of his resignation from the Xybernaut board in December 2000. However, in 2001 and subsequent years, Allen filed disclosure reports with the secretary of the Senate stating that he continued to hold potentially valuable Xybernaut stock options. ([Here](#) are the relevant pages from his June 2001 filing; here are his complete filings covering [2002](#) and [2003](#).) While Allen's campaign has given reporters conflicting explanations, it has confirmed an early October Associated Press report that Allen wrote a letter to the Army in December 2001 on Xybernaut's behalf -- a period in which Allen reported that he held Xybernaut stock options.

Allen is currently locked in a tight re-election contest with Democrat James Lee Webb. His substantial lead over Webb has eroded in recent months, due in part to Allen's controversial racial remarks, as well as questions raised by his financial dealings with Xybernaut, a long-beleaguered hi-tech firm that marketed wearable computers.

The October 20, 2000, shareholder meeting stands out for its unusual timing close to the election, and also for its deviation from past company practice. The company had held its 1999 shareholder meeting in late December. Beginning in 2001, it held its shareholder meetings in June. But in September 2000, the company sent a proxy filing to shareholders announcing the October meeting. The filing stated that its policy was to reward directors with 50,000 stock options upon their initial election to the board, and then with 10,000 additional options annually. Xybernaut's compensation rules as outlined to the shareholders did not grant directors additional options upon their re-election to the board. And yet Allen received 50,000 additional options on the same day as that annual meeting, according to his Form Five filing. The new options awards

proved to be a short-lived phenomenon, however: Xybernaut board members re-elected in 2001 did not receive the re-election bonus given to Allen.

The company's failure to tell shareholders that rule changes would benefit Allen, at the same time that it was soliciting votes for Allen for his re-election to the board, could raise serious legal questions, since shareholders were not told that Allen's re-election would trigger the issuance of more options. Moreover, though corporations are required to report stock options awarded to directors in their Security and Exchange Commission filings, Xybernaut managed to avoid disclosing the pre-election 2000 award of the 50,000 shares to Allen in its 2001 filings, since Allen had by then resigned. Xybernaut did not respond to the *Prospect's* queries.

Xybernaut executives were hardly taken by surprise by Allen's Senate victory. As first [reported](#) by *The American Prospect* in August, as early as 1999, company CFO John Moynahan wrote to the Xybernaut Corp. Yahoo! Group, an investor forum, that, "George Allen, the former governor of Virginia and candidate for the Senate in 2000, is on Xybernaut's board of directors and is very helpful in dealings with government." On November 8, 2000, the day after Allen won his senate race, Moynihan informed the Yahoo! Group investors about Allen's pending departure from the board due to Senate conflict-of-interest rules, adding, "While his contributions to the board will certainly be missed, I believe that our shareholders are better off with a staunch supporter of Xybernaut in the U.S. Senate."

By the time of Allen's election to the Senate, Xybernaut was clearly a company in financial distress. In September, 1999, the company's accounting firm, PricewaterhouseCooper, issued a "going concern" letter with a grim assessment of the company's financial health. (A going concern letter is how accountants officially express substantial doubt about a company's ability to continue in business.) Beginning in 2000, the company increasingly turned to a newly popular financial instrument to keep growing -- and going: so-called PIPE deals, short for "private investments in public equity," in which private investors are granted warrants or convertible debentures for stock at below-market rates in exchange for financing. On November 15th, 2000, one week after Allen's election, Xybernaut received \$15.4 million in a private investment, the largest single infusion of capital the company had received since early 1998.

According to their initial Form Five filings, two other re-elected directors were granted 50,000 options at the same October 2000 meeting. In later years, however, they declared on legally binding federal forms that their additional options had actually been granted in January, 2001, nearly two months after Allen had become Virginia's senator-elect. Only one other director was re-elected in October 2000, and his new options grant was ultimately cancelled for unrelated business reasons.

Allen's campaign had asserted that all his stock options -- the 50,000 he received upon his initial election to the board, the 10,000 he received the following year, and the 50,000 he received in October 2000 -- soon lapsed. "By company rule ALL 110,000 options (vested and non-vested) lapsed 90 days after he left the Board," Allen's spokesman John Reid told the *Prospect* in early August. The options granted upon Allen's re-election to the board "would have taken 12 months to vest but never did due to then Senator-Elect Allen's resignation from the Board in December of 2000."

However, a close examination of company rules and Allen's own financial filings contradict both assertions, as have the Allen campaign's subsequent statements. Indeed, by October 2006,

Allen was making a point of noting his disclosures of Xybernaut stock option holdings as late as 2003 -- and plastering those disclosures all over his web site.

The vesting and expiration rules for each grant of stock from Xybernaut to Allen were written on separate contracts with rules that were allowed to vary by contract. The terms governing the expiration of these options, however, are known only to Allen and Xybernaut. Allen has not made public his option contracts with Xybernaut, and his campaign office did not return calls or an email. Reid, his Senate aide, declined to comment.

Also in dispute is when Allen's options vested. In August, 2001, Allen filed an amendment to his 2000 Senate financial disclosure claiming ownership not just of the vested stock from 1998 and 1999, but of additional "Fully vested options to purchase 50,000 shares." This strongly suggests that the vesting rules for the pre-election options were different from those governing the other grants, or else that company policies on vesting rules were not followed in granting Allen those options.

Indeed, according to the Form Five Allen filed with the SEC in February 2001, the pre-election stock granted to him was "immediately" exercisable on the date it was granted to him -- October 20, 2000 -- with no waiting period. So were all the other stock options granted to Allen during his tenure on the Xybernaut board, according to the same form.

The many contradictory statements of Allen and his campaign notwithstanding, what's clear is that Xybernaut did grant him 50,000 options on the eve of his election to the Senate and that he reported retaining those options for several years thereafter. Why those options were granted in the unusual manner they were is a question that has yet to be answered.

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