Study ties CEO's clout, backdating

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Corporations that systematically backdated stock options were headed by strong chief executives who influenced boards that had a minority of outside, or independent, directors, a new Harvard Law School research report suggests.

The report documents statistically what securities regulators have charged and many corporations have owned up to: that many corporate boards manipulated the dates of stock options to executives to give the recipients an instant profit.

The practice, once thought to be a phenomenon of "new economy" start-ups, was widespread across all industry groups, the report found.

"We estimate that about 10 percent of all CEOs and about 12 percent of all companies engaged in backdating," research leader Lucian A. Bebchuk said in a telephone interview.

The options were usually dated from the stock's lowest price in the grant month, but about 43 percent of the grants studied were awarded from the lowest price of the quarter, the research found.

Bebchuk is a professor of law, economics and finance at Harvard Law School and also director of the university's Program on Corporate Governance. Among his books is a study of executive compensation, "Pay Without Performance: The unfulfilled promise of executive compensation."

Pricing a stock option at an arbitrary date is not illegal. But failure to disclose the practice under accounting rules then in effect was, and that's what has gotten companies in trouble with the Securities and Exchange Commission and other government regulators.

According to Bebchuk, the Harvard research was initiated early this year as a result of publicity surrounding the backdating issue. He said the aim was "to put forward some evidence that people can use" in dealing with the issue.

"The numbers are quite telling, however one comes to this issue," he said.

As a practical matter, backdating is no longer practiced because of new regulatory and accounting rules, said Laura Thatcher, who heads the executive compensation practice at Alston & Bird LLC, an Atlanta law firm.

"Changes in securities laws and accounting rules make it practically impossible to backdate now," she said. Companies now must report stock options within two days of the grant, and treat the options as an immediate expense on the books.

Thatcher said the latter rule relating to expensing options "removes the compelling reason to backdate an options."

But historically, backdating was an issue waiting to surface as a controversy. It was discovered in the 1990s by academic researchers who noticed that the coincidence of options grants to subsequent share price gains of certain executives was statistically suspect.

And that's basically what Bebchuk and his researchers — Yaniv Grinstein and Urs Peyer — looked at. They studied the options practices of 6,000 public companies from 1996 through 2005.

"We found a huge asymmetry between the 12 percent of the grants that were awarded at monthly lows, in contrast with only 4 percent that were awarded at the stock's highest price. That's not what one would expect," he said.

Bebchuk referred to the recipients of these grants as "lucky CEOs," and the options as "lucky grants."

"We estimate that about 1,150 lucky grants — roughly half of all lucky grants in our sample — owe their status to opportunistic timing rather than mere luck," the research report declares.

Not only did the lucky recipients get options dated from the lowest monthly stock price, about 1,000 — 43 percent of the sample — were "super lucky," being given grants dated to the lowest price of the quarter.

The Harvard study does not make any recommendations. But it does make some other connections, such as the preponderance of backdating by boards with a minority of outside directors. Researchers also found that backdating was more likely at companies where the CEO "had longer tenure."