Doubt Cast on Stock Options of Directors
A study suggests that hundreds of board members may have gained from backdating

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Nearly 1,400 corporate board members appear to have profited from the manipulation of stock option grant dates over a 10-year period, according to a study being released today.

The analysis raises the possibility that hundreds of board members were aware that options were backdated to boost their value to themselves and company executives. That could be seen as a conflict with their role as advocates for all company shareholders.

"Rather than merely failing to notice or stop the manipulation of executives' grants, many outside directors have received manipulated option grants and thus directly benefited from the manipulation practices," according to the study by Harvard professor Lucian Bebchuk and two other scholars.

Stock options are rights to buy company shares at a set price in the future. The option price generally is set at the market price on the grant date. The lower the price on that date, the more likely the recipient would be to profit.

The study reviewed 29,000 stock option grants from 1996 to 2005 to so-called outside directors, or board members who are not executives of the company.

About 9% of the time, options were granted on days when the stock price was at a monthly low — a coincidence that suggests the date may have been picked in hindsight, or backdated, to ensure maximum benefit.

Corporate watchdogs said the 9% figure was significant, even though it suggested that the timing was not suspicious for the overwhelming majority of grants. That's because board members are supposed to be looking out for average investors, not using their positions for self-profit, these critics say.

"It's appalling," said Claudia Allen, chairwoman of the corporate governance practice at Chicago law firm Neal, Gerber & Eisenberg. "Directors are fiduciaries for all stockholders; to act in their own self-interest is a breach of loyalty. It's the cardinal sin."

The study did not name any companies, nor did it offer any hard evidence that directors played a direct role in the backdating of options.

It did conclude that backdating occurred across a wide range of industries. The one exception was the utilities sector, which issues few options to directors.
The backdating scandal emerged this year after academic research by Erik Lie of the University of Iowa, leading to resignations and investigations at scores of companies.

Most of the focus has been on corporate executives, who make far more in option grants than board directors. But the study's authors and others say the role of directors deserves scrutiny.

"It seems less significant because there is less money involved, but the betrayal of trust is far greater," said Paul Hodgson, senior research associate at Corporate Library, a governance research firm based in Maine.

Questionable grants were sometimes given to executives and directors on the same date, according to the study, coauthored by Yaniv Grinstein of Cornell and Urs Peyer of the University of Chicago.

At other times, directors were given options on dates that executives did not receive them, the study found. In those cases, 71% of the options granted appeared to involve some kind of date manipulation.

Bebchuk said suspicious grants were far more likely to happen at companies that had management structures that tended to give chief executives more power. These include provisions for staggered terms of board members, weakening their clout, and so-called poison pill measures and other defenses against hostile takeovers.

Lie of the University of Iowa said the new study underscored the important role directors should play in guarding against management abuses.

"It's hard for shareholders to understand what's going on in a company because you can't be there," Lie said. "That's why you delegate the responsibility to a few people, the directors, who represent you. You have to have trust in those people and they have to act in a trustworthy manner."