Study Cites Role Outside Directors Had With Options

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A new academic study suggests that many outside directors received manipulated stock-option grants, a finding that may help explain why the practice of options backdating wasn't stopped by the boards of some companies.

The statistical study, which names no individuals or firms, estimates that 1,400 outside directors at 460 companies received questionable option grants, suggesting the widespread practice extended well beyond the executive suite.

The study is notable because it suggests that outside, or independent, directors -- who are supposed to play a special role safeguarding against cozy board relationships with management -- may have been co-opted in options backdating by receiving manipulated grants themselves. The New York Stock Exchange requires that a majority of board seats, and all compensation- and audit-committee members, be independent. The study doesn't address whether directors were aware that their options were propitiously timed.

The evidence "contributes to understanding the possible factors that led to or enabled manipulation to occur," states the unpublished study, which was conducted by professors at Harvard and Cornell universities and the French business school Insead.

More than 130 companies are under investigation by U.S. authorities for backdating or otherwise manipulating stock-option grants, the biggest corporate-fraud probe in decades. To date, more than 60 executives and directors have lost their jobs.

Options typically allow recipients to buy company shares in the future at the price on the day they are granted. Recipients benefit if share prices rise. Backdating involves pretending the grant date was earlier than it really was, so the recipient can later buy for a lower price, thus enhancing profit.

Several outside directors already have figured in the backdating scandal. In May, **Brooks Automation** Inc., a semiconductor firm in Chelmsford, Mass., said that two outside directors who received highly favorable stock options in 2000 had resigned and would "renounce" all of their options and restricted stock.

Several outside board members on **Monster Worldwide** Inc.'s compensation committee also received a grant in April 2001 at the nadir of a steep but short-lived decline in the share price of the job-search firm. The company last week said former officials, which it didn't name, "intentionally" backdated option grants during a six-year period.

The new study examined nearly 29,000 option grants awarded to outside directors at 6,577 firms between 1996 and 2005. It found that 9% of the grants fell on days when the stock price was equal to a monthly low. A random selection would lead to about 5% of grants being awarded at monthly lows. In addition, 3.8% of the grants were awarded when the share price was at the lowest price of the calendar quarter, also higher than would be expected based on random selection.

Lucian Bebchuk, a law professor at Harvard, said the study didn't calculate how much extra money outside directors may have received by exercising options with fortuitous grant dates. "We don't expect the numbers to be very large," he said. "Directors don't get very large grants."