

Back in Time

By Reg P. Wydeven
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Growing up in the 1980s, one of my favorite movies was 'Back to the Future', starring Michael J. Fox as the cool Marty McFly and Christopher Lloyd as the wacky Dr. Emmett Brown. Thanks to the flux capacitor, Marty was able to use Doc Brown's DeLorean to go back in time.

What a wonderful concept. With the gift of hindsight, a time machine would be extremely handy. For example, I would hop into that DeLorean to go back to Valentine's Day 2001 so I could buy my wife jewelry as a gift instead of gardening tools. I would also go back to June 24, 1998, to tell Milwaukee Bucks GM Bob Weinbauer to reconsider trading Dirk Nowitzki and Pat Garrity to the Dallas Mavericks for Robert Traylor.

While none of us have the luxury of going back in time, the innovative minds at Apple Inc., who brought us such products as the Mac and the Ipod, have created something almost as effective as the flux capacitor – backdated stock options.

The U.S. Securities and Exchange Commission filed civil charges against Apple's former CFO Fred Anderson and former general counsel Nancy Heiden for their alleged roles in backdating stock options. Anderson settled his case by paying \$3.5 million in fines and penalties, however, Heiden intends to have her day in court.

A standard employee stock option involves a corporation granting an employee the option to buy stock in the company at the closing price on the date of the grant. The employee can then exercise the option for up to a year or longer. Therefore, if the price of the company's stock goes up, the employee instantly profits by exercising the option. Backdated options, however, occur when a company allows an employee to purchase stock at a historical price that is lower than the value of the stock as of the date of the grant.

The SEC characterizes backdated options as being tantamount to handing cash over to the employee at the expense of the shareholders, comparing the practice to being able to pick your lotto numbers after the winning ticket is announced. If the backdating is concealed, it is also illegal.

Well over 100 corporations suspected of fraudulently backdating stocks, including Fortune 500 companies, are currently being investigated by the SEC. The FBI is also conducting criminal investigations for companies the Bureau believes have granted backdated options.

The practice of backdating options was uncovered by Erik Lie, a Norwegian professor of finance at the University of Iowa. Lie scrutinized 8,000 companies and discovered that 29% of them, more than 2,000 corporations, experienced a jump in the price of their stock after awarding options. Lie estimates that the odds of such jumps are "at least one in a billion."

One of the companies Lie examined was Apple, which led to the SEC's charges against Anderson and Heiden. Apple also confirmed that CEO Steve Jobs was awarded backdated options that carried a false date in October 2001. Apple's 10-K report filed with the SEC reflects the award was "improperly recorded as occurring at a special board meeting," when in fact "such a board meeting did not occur."

Jobs was cleared of any wrongdoing by a review committee appointed by Apple, which included former Vice President Al Gore, a member of Apple's board. Gore would probably characterize Jobs' backdated stock as "an inconvenient truth."

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