Stock-Option Repricing Lets Employees Sidestep Crash (Update6)

By Ian King and Connie Guglielmo

March 23 (Bloomberg) -- **EBay Inc.**, **Advanced Micro Devices Inc.** and dozens of other companies are asking shareholders to do something for employees that investors can't do for themselves: sidestep the worst market **crash** since the Great Depression.

Since the start of 2008, 114 companies have proposed or completed plans that would exchange underwater stock options, according to research firm **Equilar Inc.** The companies swap options for ones with lower prices, increasing employees' chances of making a profit.

The trend creates a dilemma for investors. The option exchanges lift employee morale and help retain valuable workers. At the same time, the programs don't seem fair to some investors, since regular shareholders don't get the same deal. They can also dilute the stock's value when employees exercise their options.

"I remain skeptical about these types of proposals for obvious reasons," said **Paul Wick**, a fund manager at J&W Seligman & Co., part of Ameriprise Financial, which had $372 billion under management at the end of 2008. "There's no way for public investors to reboot and reprice their entry when they bought shares."

More than 70 percent of the largest 500 companies had options with exercise prices higher than their market price in mid-February, according to Redwood City, California-based **Equilar**. Companies ranging from Williams-Sonoma Inc. to **Google Inc.** have repriced employee stock options or announced plans to do so. Intel Corp. unveiled an options-exchange program today.

'Pent-Up Demand'

Google rose $18.44 to $348.60 at 4 p.m. New York time in Nasdaq Stock Market trading. **EBay gained** 97 cents to $13.06. **AMD advanced** 35 cents to $3.02 on the New York Stock Exchange.

"We're seeing a lot of pent-up demand for options exchanges," said **Patrick McGurn**, special counsel at proxy adviser Institutional Shareholder Services, a unit of New York- based RiskMetrics Group. "We're seeing some of the first ripples hitting the shore, but sooner or later there's going to be a tsunami."

The **Standard & Poor's 500 Index** had dropped 15 percent this year before today, the worst start to a year in its eight-decade history, following a 38 percent decline in 2008 that was the steepest annual retreat since 1937.

Google, whose stock **slumped** 56 percent in 2008, repriced employee stock options this month to restore their value.

"Because motivating and retaining employees is a good thing, both for those employees and our shareholders, we believe this exchange works for all involved," Google spokeswoman **Jane Penner** said in an e-mailed statement.

No Permission

Google swapped employee's options for the same number of new ones. The company conducted the exchange without shareholders' approval and allowed executives in on the plan.

The move sparked concern that other companies would exchange options without asking investors' permission. Seligman's Wick said he would vote against proposals patterned after Google's plan.

Few will be able to mirror **Google**'s approach, McGurn said. After the repricing frenzy that followed the dot-com bust, the New York Stock Exchange and the Nasdaq Stock Market introduced rules in 2003 forcing most companies to get shareholder approval before enacting programs.

Google has a clause in its 2004 stock plan that exempts it from a shareholder vote. Most companies don't have that kind of exclusion, and even those that do will likely seek investor approval, McGurn said.

Shareholder Value

"To ignore shareholder value in terms of the dilution would be completely detrimental to future shareholders," said **Daniel Morgan**, a fund manager at Atlanta-based Synovus Securities Inc., which owns shares of **Apple Inc.**, Cisco Systems Inc. and **Intel.** "If they allow the type of things that happened in the past, then shareholders will be screwed."

To lure and keep employees, companies hand out options that give them the right to buy stock at a set price in the future. The idea is if the company does well, the stock price rises above the strike price of the option. That rewards employees, who can buy shares for less than the market price.

Under **Google**'s repricing plan, employees had the option to buy the stock at $308.57. That compares with the peak market price of $747.24 in November 2007. All company executives could participate -- except for co-founders **Larry Page** and **Sergey Brin**, and Chief Executive Officer **Eric Schmidt**, who don't hold options.

Program Cost

The program will cost about $460 million, which will be recorded as stock-based compensation, Google said Jan. 22. Google shares rose 22 cents to $330.16 on March 20 in Nasdaq Stock Market trading.

As stock markets plunged during the economic crisis, technology companies ranging from mobile-phone maker Motorola Inc. to Internet-media seller RealNetworks Inc. proposed employee-stock exchanges. About 51 percent of the 97 companies tracked by Equilar are in the technology business.

The rest span a variety of industries. Casino owner **MGM Mirage**, biotechnology company United Therapeutics Corp. and coffee-shop giant **Starbucks Corp.** all proposed or completed options exchanges over the past year, Equilar said.

"We just don't buy companies that engage in too much option shenanigans, but it is so widespread as to be difficult to avoid completely," said Brian Barish, Denver-based president of Cambiar Investments LLC, which manages about $4 billion. "It really ticks me off as a shareholder and steward of other people's capital that companies and boards see fit to move the goalposts largely as it suits them."

Motivating Workers

Repricing or exchanging stock options is legal and unrelated to the practice of backdating, or changing the grant dates of options to days when the shares traded lower. That kind of manipulation can amount to fraud, regulators say.

"The thought is that to retain and motivate employees, you should remedy underwater options," said **Alexander Cwirko- Godycki**, a researcher at Equilar. "From an employee perspective, it's a morale booster."

Companies can adopt a variety of terms and conditions to make their repricing plans more palatable to shareholders, said Brett Harsen, vice president of compensation-consulting company Radford, a unit of Chicago-based **Aon Corp.**

Harsen **recommends** companies exclude executives and directors from repricing programs and give

employees fewer new options than they were originally granted, reducing the overall pool of outstanding options. Companies should also exclude options that aren't "significantly underwater" and cancel exchanged options so the potential for diluting the stock is reduced.

'Negative Connotation'

"Repricings have a negative connotation to them that's been earned by some past negative abuses," said Harsen, whose firm designed the repricing program for **Starbucks**. It was approved by shareholders March 18. "It's a sign of how bad the times are that these companies are finally getting to a point where they want to go to the shareholders."

In a letter to employees filed with regulators on March 10, EBay CEO **John Donahoe** said the Internet auctioneer will ask shareholders April 29 for approval to swap options that are "deeply underwater." Donahoe and other EBay executives are excluded from the program.

Nvidia Corp., a graphics-chip maker that supplies products to Apple Inc., aims to boost employee morale and get a return for the expenses it has already recorded for stock-option grants, said **Derek Perez**, a spokesman for the Santa Clara, California, company.

"Even in this climate, good employees can find jobs elsewhere," Perez said. "The options are no longer serving their business purpose -- to motivate and retain the employees."

Even with changes to option-exchange programs, shareholders should still be wary of the plans, RiskMetrics' McGurn said.

"I'm never going to view this as a good thing," he said. "But the situation and the environment mean that it can be a prudent thing."

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