Google unveils unorthodox stock option auction

By Elinor Mills
Staff Writer, CNET News.com
Published: December 12, 2006, 5:48 PM PST

Google plans to start an unorthodox stock options program in April that will allow employees to sell their vested options in an online auction, the search giant announced late Tuesday.

Traditionally, employees have two ways to deal with stock options: exercise (take ownership of) them once they have "vested" and sell them at the current trading price, and pay back the company for their so-called strike price (that's typically the trading price the day the options were granted), or hold on to them after exercising them.

HIGH IMPACT
THE STORIES YOU SHOULD NOT MISS

What's new:
A new Google program will allow employees to sell their vested options in an online auction.

Bottom line:
Google execs believe big buyers of Google "options" on the public markets may see auctions as a place to bargain hunt. However, the financial institution buying the options assumes a risk: mainly, that Google's stock will keep going up.

More stories on this topic

This new, Transferable Stock Option program gives nonexecutive Google employees a third option: a secondary market of sorts managed by Morgan Stanley where preapproved financial institutions can bid on vested options. It doesn't apply to options granted prior to the search giant's initial public offering.

For employees who have arrived at Google long after its stock price started to climb, the auction potentially presents a more profitable alternative to trading on the public markets. It would work like this: once an employee's options are vested, he or she can look for bidders in the private auction. A financial institution may offer the employee, for example, $150 per option. If the employee's strike price was $400 and the stock was trading at $500, the employee would have made $50 more per option going the auction route rather than selling them on the public market. Employees can also set a minimum price at which to sell.

So why would a financial institution buy into this? Google execs believe big buyers of Google "options" on the public markets may see this as a place to bargain hunt. But the financial institution buying that option assumes a risk: mainly, that Google's stock will keep going up. To hedge their bets, financial institutions may "short" the stock, usually a complicated, three-way transaction where the short-seller makes money when a company's stock price goes down.

So why is Google doing this? Executives say it's to make things fair for newer employees. The company's stock closed trading Tuesday at $481.78 and, despite its long, upward climb, some justifiably wonder how high the stock price can go and whether the options for newer employees will be worth anything when they vest. Google's employee stock options vest after four years and typically expire after 10 years.

"Our expectation is that banks would be willing to pay employees a premium for the right to continue holding the stock," said Dave Rolefson, equity and executive compensation manager at Google.

Google co-founder Sergey Brin was an early proponent of the auction system, which he saw as a way to improve the fairness of the options system for newer employees whose strike prices are much higher than people even hired shortly before them, said Allan Brown, director of recognition and human resource

systems at Google.

Financial experts who have been briefed on the program say it's certainly innovative, but wonder how many Google employees will opt for it rather than rolling with company's seemingly ever-increasing stock price.

"It's very creative and innovative; what you would expect from Google," but it's likely Googlers will choose to sell rather than hold onto options, said Nell Minow, editor at The Corporate Library, an independent research firm specializing in corporate governance. "The question is, given that it would defy the law of physics for this stock to continue to perform at the level it has since the company went public, is the smart money going to go for cashing out more quickly or for holding on?"

But Silicon Valley employees, in particular, are more used to seeing a $5 stock go to $10 than a $550 stock rise to $1,000. "The perceived value is much less than the financial calculated value," said Ted Buyniski, a compensation consultant at Radford Surveys + Consulting. "This enables Google to close that perception gap."

Google's accounting will not change as a result of the new program, but the amount of stock-based compensation expense will be higher than it would be if not for the program, said Mark Fuchs, chief accountant for Google. The company said it has discussed the program with the Securities & Exchange Commission.

News of the Google stock options plan provoked "mild grousing" from one shareholder advocate who said companies should not encourage employees to sell options, or even sell stock in general, in the company because it could lessen the incentive for employees to contribute at their jobs.

"The point of equity is to give you a stake in the company so that your actions as an employee further the interest of the company, to link your personal wealth with the company's success," said Charles Elson, director of the Weinberg Center for Corporate Governance at the University of Delaware. "I'd rather see (employees) keep the money in the company they work for."

However, Elson said he would be more concerned if executives were included in the new stock option program.

A finance expert called the Google plan "cool."

"This is great for Google employees because it means their options are much more valuable than they would otherwise be," said James J. Angel, an associate finance professor at Georgetown University. "Options are usually worth more alive than dead."

The program is unprecedented, Google said. Microsoft and Comcast have offered one-time auction transactions to a single bidder, whereas Google's program is ongoing and involves multiple bidders, Google said. And Cisco Systems proposed creating a security in an attempt to measure for accounting purposes the market value of employee stock options, but the company did not allow employees to transfer the options like Google is doing, according to Google.

Now on News.com:

- A short circuit for cellular E911
- Into the wild blue virtual yonder
- Newsmaker: Getting 'broadband into our brain'
- Extra: Antispam tech reborn as Web activist tool
- Video: Reporters' Roundtable: Goofiest tech moves of 2006