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Option and Other Equity Grant Practices

The practices used by companies in making option and other equity awards to their executives, employees and directors have been subject to intense attention in the past year. Provided below is a summary of developments in this area, as well as guidance regarding grant practices that boards of directors and senior management should consider adopting.

Summary of Recent Developments

In the past year over 200 companies, including some of the best known and most successful in the U.S., have reported that they have commenced internal reviews of their option grant practices. These reviews were initially prompted by academic studies – given prominence by media reports – that suggested, based on statistical evidence, that the exercise price of option grants made by a number of prominent companies to their executives and other employees may have been set at below-market prices, contrary to the companies' purported practice of only issuing options with an exercise price equal to the market price on the date of grant. Many of these reviews have found that option grants were in fact misdated, with profound results.

Because of the misdating of option grants, many companies have reported that their accounting for options was erroneous and that they must take additional charges for compensation expense against their income. A significant portion have restated, or expect to restate, their historical financial statements to reflect these charges and have announced that, as a result, their previously issued financial statements can no longer be relied upon, in some cases going back more than a decade. Numerous private derivative and class action shareholder lawsuits have been filed in the wake of these disclosures. At some companies, senior executives, including in some instances the chief executive, have been dismissed based on the findings of their option reviews.

In addition, in many instances the companies that have identified option accounting problems have not been able to file their periodic SEC reports when due, as they have not yet been able to determine the amount of the compensation charges they will need to take and, accordingly, cannot prepare consistent and comparable financial data for current and prior periods. Some of these companies are at risk of being delisted because of their inability to file with the SEC required periodic reports (a few have already been delisted) and others have encountered other serious problems. The failure to file current periodic reports and/or material errors in previously issued financial statements may violate covenants or representations or warranties in debt instruments, presenting a risk of default (and in some instances have produced declarations of default by lenders), may disable the company from satisfying in a timely manner regulatory requirements relating to financial reporting or other aspects of their business and/or may disrupt key license, joint venture or other business relationships for which current SEC reporting or financial statements are required.

Based on allegations of improper financial reporting of option grants and/or intentional misconduct intended to mislead security holders regarding option grants, the SEC over the past year has undertaken some highly publicized enforcement actions[1] and reportedly has underway at this time over 130 investigations into option grant practices.[2] The essence of the claimed violations has been the use of option grant practices that were misleading to shareholders because they violated explicit or implicit

representations (by reason of the treatment of the options in the company's financial reports and/or otherwise) that the company had issued the options only "at the market." In some instances, the SEC investigation has been accompanied by an investigation by the U.S. Attorney's office of potential criminal wrongdoing in the option grant process. IRS investigations of improper tax reporting regarding options have also been reported.

The options investigations have introduced a new vocabulary to the discussion of options – "backdating," "spring-loading" and "bullet-dodging" – although at this point no precise legal definitions of the terms have emerged. "Backdating" usually refers to the selection of a grant date with the benefit of hindsight so that the date is earlier than the date the grant was approved (usually a date when the market price of the shares to be acquired pursuant to the option was lower than on the approval date), with the result that the option when issued has "intrinsic value," *i.e.*, an exercise price below the prevailing market price, contrary to explicit or implied representations that the option was issued only "at the market."[3] "Spring-loading" generally refers to the practice of granting options in anticipation of the disclosure of material information that is expected to produce an increase in the market price of the shares to be acquired pursuant to the option, *i.e.*, under circumstances where it is intended that the options will in fact have intrinsic value. The corollary practice of "bullet-dodging" has also been identified, which involves the intentional setting of an option grant date after the approval date so that material information that is expected to cause a decrease in the market value of the related shares can first be disclosed, or the intentional timing of option grants so as to follow the release of material information of such nature, in either case with the result that the exercise price will reflect the market's reaction to the information and be lower than it otherwise would be. Arguably, both spring-loading and bullet-dodging are inconsistent with an explicit or implicit representation that only "at-the-market" options have been issued.

Issuing options with an exercise price less than the market price of the shares on the date of grant is not inherently improper as long as the issuance complies with the terms of the stock option plan approved by the shareholders (including representations about pricing "at the market," if any) and the issuance is properly approved, disclosed and accounted for, and the appropriate income tax treatment for such "discount options" is applied.[4] However, the customary practice in issuing options to officers, other employees and directors has long been to set the exercise price for the shares to be purchased pursuant to the option at the market value of the shares at the time the option is granted, *i.e.*, to issue only "at-the-market" options.[5] The intended result of this customary practice is that the options have value only if, after the date of grant and at the time the options are exercised, the market value of the related shares has increased and, thus, that the options serve as a form of incentive compensation but not as a form of immediate remuneration. Few companies have indicated that they have issued, or would consider issuing, discount options to officers, other employees or directors. In some cases, institutional and other investors may have voted to approve an option plan on the basis that it only permitted the issuance of "at-the-market" options.[6] Absent disclosure that option grants have been made on a different basis, there is arguably a representation that all options issued to directors, officers or employees were issued "at the market."[7]

When options have been backdated, the normal consequences of issuing "at-the-market options" are circumvented and, when backdating is uncovered, the accounting, disclosure and other problems identified above ensue. Backdating also raises issues with respect to the scope of the authority of corporate officers (inasmuch as the issuance of options usually requires board authorization or delegation), adherence to fiduciary requirements by officers or directors engaging in such practices without proper authorization and the adequacy of internal controls over financial reporting and disclosure controls and procedure, all of which are being scrutinized. The consequences of spring-loading and bullet-dodging are less clear. Neither has yet been recognized in an SEC enforcement action as a securities law violation[8] but the

potential for such practices to be considered a violation is serious. Moreover, the Delaware Court of Chancery recently held that allegations of spring-loading options granted in violation of a stock option plan providing only for issuance of "at-the-market" options could support a claim against directors for breach of the fiduciary duties of loyalty and good faith.[9]

Accounting errors are a key issue in option backdating situations. While most companies were required, beginning with their first quarter 2006 financial statements, to take compensation expense charges for options issued to employees, officers and directors in accordance with Statement of Financial Accounting Standards No. 123R, in prior years most companies had applied Accounting Principles Board Statement No. 25 in accounting for options. Under APB 25, no compensation charges for "at-the-market" option grants to employees, officers and directors were required to be recorded. However, upon review of their option grant practices, many companies have found that their practices did not support the use of the date they had recorded as the date of grant because the grant process (including the identification of substantially all the option recipients, the number of options each recipient was granted and the due authorization of the grants by the compensation committee or authorized officer) had not been completed by that date as required by APB 25. In some instances, this was due to the intentional selection of an earlier date as the grant date in order to confer an additional benefit on option recipients. In other instances, it resulted from confusion regarding the grant process and the proper accounting for option grants, combined with record-keeping deficiencies and other lax controls. In September 2006 the SEC's Chief Accountant issued some guidance on the application of APB 25 in option backdating situations,[10] and in January 2007 the SEC Division of Corporation Finance issued some guidance concerning how to effect the restatement of financial statements and the amendment of SEC periodic reports to correct option backdating errors.[11]

In light of the emerging concern over options-related financial statement errors, in July 2006 the Public Company Accounting Oversight Board issued guidance requiring auditors to review more carefully company option grant practices.[12] Thus, as part of their audits, companies should expect that their auditors will focus on grant practices and controls and may require more detailed representations from management regarding grant practices.

In addition, the SEC's new executive compensation disclosure rules require much more extensive disclosure than was previously required regarding option grant practices, in order to identify when options are not issued "at the market" and also when spring-loading and bullet-dodging practices are being used. In particular, disclosure is required as to whether a company has issued an option to a named executive officer with an exercise price that is different than the closing market price on the date of grant.[13] Disclosure is also required as to how determinations are made about when option or other equity grants are to be made.[14] The SEC has taken the position that in addressing the timing of the granting of options or other equity awards disclosure is required, if material, as to whether the timing of the making of such awards is coordinated with the company's release of material nonpublic information. If the company has a program, plan or practice of doing so, it should specifically disclose that option or other equity grants may be made at times when the company is in possession of material nonpublic information.[15] Note that, even if spring-loading and bullet-dodging are determined not to constitute securities law violations, starting with 2006 annual reports, a failure to disclose adequately the use of such practices may constitute a disclosure violation.

Guidelines for Reviewing Options and Other Equity Grant Practices

In the context of the developments discussed above, senior management and boards of directors (particularly compensation committees) should now be reviewing their equity grant practices. The multi-faceted goal of these reviews should be to assure proper authorization, disclosure, accounting and tax treatment of equity grants and compliance with undertakings that only "at-the-market" options would be issued, as well as to avoid spring-loading and bullet-dodging. A number of companies that have uncovered problems with their option grant practices have publicly announced new policies and practices. Because of the variety of ways in which companies use options and other equity awards as part of their executive, employee and director compensation programs, no single set of practices will be appropriate for all companies. However, the following guidelines identify areas for consideration in determining the practices that are appropriate, as well as some practices that appear generally advisable. Because of the complexity involved in reviewing and implementing appropriate equity grant practices, the compensation committee should consider whether it needs the assistance of an independent compensation consultant and/or separate counsel.

- Determine and articulate the role equity grants play in the company's employee compensation philosophy.
    - Determine whether equity grants are to be a regular part of the compensation of employees generally or only of the compensation of management employees above a certain rank or only of executive management.
    - Determine how much of long-term management compensation should be in the form of equity grants, as distinguished from long-term cash bonus or other long-term incentive compensation programs.
    - Determine the degree to which options should be used as equity compensation, in comparison to restricted share grants, stock appreciation rights or other forms of equity compensation.

  The role equity grants, particularly options, play in the company's employee compensation program will influence the company's policies for making equity grants, including the frequency of grants and the method by which grants are determined and approved.
- Review the terms of the company's existing equity incentive plans and determine if changes are needed to bring them up to the "state of the art," including any provisions needed to authorize and implement practices concerning the matters discussed below, such as delegation to management of grant-making authority.
- Develop standard grant terms (*e.g.*, length of option, vesting schedule and events of acceleration) and standard grant documentation, which should be approved by the compensation committee; variations from standard terms should be made only with specific compensation committee approval.
    - Where not addressed by plan provisions, consider formalizing the company's policy regarding the granting of options with a below-market exercise price and the manner for determining the trading price on the date of grant[16] (*e.g.*, prohibiting below-market exercise prices unless specifically authorized by the compensation committee).
    - Standard grant documentation should include an appropriate prospectus in compliance with the requirements of Form S-8 under the Securities Act of 1933 and procedures for the timely delivery to grantees of such prospectuses.[17]

- Designate one or more appropriate members of the company's in-house human resources staff, legal staff and accounting staff to oversee the documentation, accounting and disclosure of all equity grants (including timely filing of Forms 3, 4 and 5). These individuals should be provided appropriate training with respect to equity plan provisions and compensation committee policies and in the disclosure, accounting and other issues raised by the use of equity grants in employee compensation programs.
- Determine a regular schedule for the making of grants, including in connection with annual performance reviews, promotions and new hires; variations from this schedule should be made only when warranted by extraordinary circumstances approved by the compensation committee (such as grants made in connection with business combination transactions or exceptional performance).
  - Grants made in connection with annual performance reviews should generally be made at the same time each year in respect of both executives and other employees, with the same grant date applicable to all such grants.
  - A set date, such as the last trading day of the month, should be established for grants made in connection with promotions and new hires, subject to exception only where specifically approved by the compensation committee.
- Grants to executive officers and, unless pursuant to clearly delegated authority (as further discussed below), all grants to employees (and consultants) generally should be made only at duly convened, regularly scheduled compensation committee meetings and should be documented at the time of the meeting. Grants should be made by written consent of the compensation committee only where required by exigencies; "*as of*" consents should not be used.
  - If grants to non-executives are to be delegated to executive management, the overall terms of such grants (*e.g.*, the maximum number of options that can be granted pursuant to delegated authority to all grantees during a year and to any particular employee at a designated level) should be approved in advance by the compensation committee and the specific limits of delegated authority should be established and documented and specific requirements for regular reporting to the compensation committee of actions taken pursuant to delegated authority should be established. Delegation may only be made to the extent permitted by applicable corporation law and consistent with the terms of the option plan under which the options are to be issued.[18]
  - Where executives are delegated authority to make grants, standard documentation evidencing the grant award should be used. Where non-executive employees will have authority to recommend grants to be made in connection with promotions and new hires, option request documentation should be formalized and include the reason for grant and relevant information bearing on the timing and amount of the grant (*e.g.*, date of promotion, job title, etc.).
  - Lists with names of grantees, grant amounts, grant prices (as needed) and any non-standard terms should be complete at the grant date and included in the company's records. Generally, records should be retained of recommendations made to the compensation committee or delegated officer regarding grants to be made. A final list of grants should be signed and dated by the compensation committee chair or executive with delegated authority.
- To minimize or eliminate the risk of spring-loading and bullet-dodging, consider granting options (and, possibly, all equity grants) only at pre-established times of the year after the company has filed its periodic SEC reports or issued an earnings release. These may be the same as the "window periods" during which trading by officers and directors in company stock is permitted under the company's insider trading policy. For example, if the company makes grants on an annual basis, such grants would

be made only during a short period following the release of the company's year-end earnings or the filing of its annual report on Form 10-K. (However, adopting such a policy may require a change in the company's schedule for making personnel evaluations and paying bonuses or making other incentive awards, so that option and other equity grants can be made at the same time.) Alternatively, if grants are made on quarterly basis, such grants would be made only during a short period following the release of the company's quarterly earnings results or the filing of its reports on Form 10-Q, as well as the release of year-end earnings or the filing of its Form 10-K. Grants made in connection with promotions or new hires may be treated differently but, as discussed above, might be made only on a set day of the month.

- No changes should be made to the lists of grantees after the grant date, other than to withdraw a grant to an individual in its entirety because of a change in circumstances between approval of the grant and issuance of the award to the recipient; any other change (including to correct errors) should be considered a new grant subject to the company's normal grant-making process. For example, adjustments in award amounts in the course of giving to employees their performance reviews would not be permitted.
- Pursuant to standard procedures to be established by executive management and approved by the compensation committee, all grants should be communicated to grantees "*within a relatively short time period after the grant date*" (in compliance with FAS 123R-2).[19]
- If option grants are to be made to directors, the options should be issued insofar as practicable on an automatic basis or, if grants to directors are to involve the exercise of discretion by the board or a board committee, the grants should be made only on a date set well in advance of the actual date of issuance pursuant to an established policy. For example, a director compensation plan may provide that directors should receive options only for a pre-established number of shares on the last trading day of the year or the last trading day of the month of election or re-election to the board and at the market price on such date.
- Equity grants should be subject on a regular schedule to appropriate internal audit procedures to confirm the due approval and documentation of grants and the correct accounting.
- Explanation of the company's enhanced option grant processes and procedures and documentation (including record-maintenance) requirements should be distributed to all involved personnel and updates should be distributed on a regular basis. Training and education programs should be established designed to ensure that all relevant personnel involved in the administration of stock option grants understand the terms of all of the company's equity incentive plans, company policies, the relevant accounting requirements under generally accepted accounting principles for stock options and other share-based payments and other applicable disclosure requirements.

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If you have any questions on these matters, please do not hesitate to speak with your regular contact at Weil, Gotshal & Manges LLP or members of the Firm's Public Company Advisory Group: Howard B. Dicker, 212-310-8858; Cathy Dixon, 202-682-7147; Gil Friedlander, 214-746-8178; Holly J. Gregory, 212-310-8038; P.J. Himelfarb, 202-682-7197; Robert L. Messineo, 212-310-8835; and Ellen J. Odoner, 212-310-8438. Our email protocol is firstname.lastname@weil.com.

ENDNOTES

[1] To date, these actions have been brought against officers of companies and not against the companies themselves. *See* SEC v. Reyes, N.D. Cal. No. 06-CV-4435, SEC Litig. Rel. No. 19768 (July 20, 2006) (relating to Brocade Communications Systems, Inc.); U.S. v. Gregory L. Reyes, et al., N.D. Cal. No. 06-CR-70450 (related criminal complaint filed July 20, 2006); SEC v. Alexander et al., E.D.N.Y. No. 06-CV-3844 (JV), Aug. 9, 2006; SEC Litig. Rel. No. 19796 (Aug. 9, 2006), 19878 (Oct. 24, 2006), 19964 (Jan. 10, 2007) (related to Comverse Technology, Inc.); SEC v. Olesnyckyj, S.D.N.Y. No. 07-CV-1176 (HB), Feb. 15, 2007, SEC Litig. Rel. No. 2558 (Feb. 15, 2007) (relating to Monster Worldwide, Inc.). Before these cases, the SEC had made option backdating claims (among many other unrelated fraud allegations) in enforcement actions against Peregrine Systems, Inc., SEC v. Peregrine Systems, Inc., S.D. Cal. No. 03-CV-1276 (complaint filed June 30, 2003 at ¶ 29), SEC Litig. Rel. No. 18290 (Aug. 14, 2003), and against Symbol Technologies, SEC v. Symbol Technologies, Inc., E.D.N.Y. No. 04-CV-2267, SEC Litig. Rels. No. 18734 (June 3, 2004) and 19585 (March 2, 2006). *See also* In the Matter of Leonard Goldner, SEC Admin. Proc. File No. 3-12217, SEC Exchange Act Rel. No. 53375 (Feb. 27, 2006) (related action against Symbol Technologies' former General Counsel); Form 10-K Annual Report of Analog Devices, Inc. for the year ended October 28, 2006, Item 3 (discussing tentative settlement with the SEC of claims of spring-loading; a settlement apparently not yet approved by the Commission).

[2] *See* Commerce Clearing House, Inc., *SEC Today*, Vol. 2007-9 (Jan. 16, 2007) (reporting on comments by the Deputy Directors of the SEC Division of Enforcement).

[3] "Intentional backdating" is usually understood to refer to backdating done with the intent of conferring on the recipients of options an improper benefit by reason of the exercise price being below-market. Intentional backdating may represent a breach of fiduciary duty to the company by the persons setting the grant dates. *See* Ryan v. Gifford, Del. Ch. Civ. Action No. 2213-N, Feb. 6, 2007.

[4] Discount options are ineligible for the favorable income tax treatment provided to "incentive stock options" under Section 422 of the Internal Revenue Code of 1986, as amended. Consequently, if an option that was thought to qualify as an incentive stock option is found to have been issued at a discount to the market price of the related shares, this treatment is not available, with adverse consequences to the holder of the option and a possible failure on the part of the recipient's employer to withhold sufficient taxes from the recipient's compensation. Moreover, for purposes of the application of Section 162(m) of the Internal Revenue Code, discount options cannot qualify as "performance based compensation." Consequently, the income realized by certain of the company's executive officers as a result of discount options will be included in the compensation that will be subject to the $1 million limit established by such section on the deductibility of executive compensation. In addition, in 2004 the income tax treatment of discount options was changed by the adoption of Section 409A of the Internal Revenue Code, which established a new regime with respect to the taxation of deferred compensation. Under Section 409A, discount options are considered a form of compensation ineligible for deferral treatment unless certain requirements – which options would almost never satisfy – are met. As a consequence, under Section 409A discount options give rise to income in the amount of the difference between the exercise price and the fair market value of the related shares at the time at which the options vest (if after December 31, 2004, the effective date of Section 409A) – income which is also subject to an excise tax (subject to certain transitional rules under which the ineligibility can be cured). Where a discount option that vested after 2004 was exercised in 2006, the transitional rules will not be available to protect against the excise tax. IRS Announcement 2007-18, Feb. 8, 2007. As a result, a large number of individuals may find that they received discount options as a result of option backdating problems at their employer or former employer and face excise tax payment in respect of their 2006 income. The Internal Revenue Service recently announced a new compliance program that facilitates the payment by companies on behalf of employees and former employees, other than those required to make reports under Section 16(a) of the Securities Exchange Act of 1934, as amended, of the excise tax and also related income taxes. *Id.* This program, as to which companies must make an election by February 29, 2007 to participate, is discussed in our Weil/Briefing: Tax Developments dated February 7, 2007, available at http://www.weil.com/wgm/cwgmhomep.nsf/Files/Briefing001_2007/$file/Briefing001_2007.pdf. Because of the different tax treatment accorded to discount options in comparison to "at-the-market" options, companies have found that, in addition to the need to take additional compensation charges as a result of having issued discount options, their accounting for their income tax liabilities may also have been erroneous.

[5] There is, however, one context in which discount options are issued with some frequency: A company acquiring a business may issue options to executives of the acquired company upon the closing of the acquisition but with an exercise price equal to the market price of the acquiring company shares immediately before the public announcement

of the acquisition. Although, as discussed in note 7 below, option plans sometimes only permit "at-the-market" option issuances, issuance of options in connection with a business combination is an exception to the NYSE and Nasdaq shareholder approval requirements for option issuances to directors, officers and employees and, thus, even where a listed company has an option plan containing such a provision, below-market options can be issued in such context outside of a shareholder approved plan.

[6] *See, e.g.*, ISS U.S. Corporate Governance Policy 2007 Updates at 19, *available at* http://www.issproxy.com/pdf/2007%20US%20Policy%20Update.pdf.

[7] The stock option plans of some companies provide only for the issuance of options "at the market." In addition, a company may have disclosed that the options it issued qualified as incentive stock options under the Internal Revenue Code. Thus, where options have been issued under such a plan or have been disclosed as incentive stock options, the representation that they were issued "at the market" is more than implicit. Moreover, for companies listed on the NYSE or Nasdaq, with exceptions for a few circumstances, all option grants to directors, officers and employees must be approved by or pursuant to arrangements approved by shareholders. (In addition, some state corporation laws have provisions to the same effect. *See* New York Business Corporation Law Section 505.) Thus, where a company's shareholder-approved option plan limits option issuance to "at-the-market" grants, this representation is implied as to all option issuances to directors, officers and employees (other than those made in the limited circumstances where issuances may be made without shareholder approval). Even where the company's option plan does not so provide, the company in disclosing its compensation programs may have stated or implied that it has issued options to employees only "at the market." In addition, as discussed below, the company's accounting for options may imply this. Under the SEC's recently adopted executive compensation disclosure requirements, companies will be required to disclose their policies regarding the selection of the exercise price of options issued to named executive officers, as discussed below.

[8] Indeed, one SEC Commissioner in a speech this summer identified circumstances where spring-loading may be considered legitimate business practice, noting: "[W]e need to ask ourselves whether there has been a securities law violation even if a nexus can be identified between the grant and the news event. Isn't the grant a product of the exercise of business judgment by the board? For example, a board may approve an options grant for senior management ahead of what is expected to be a positive quarterly earnings report. In approving the grant, the directors may determine that they can grant fewer options to get the same economic effect because they anticipate that the share price will rise. Who are we [*i.e.*, the Commission] to second-guess that decision?" Paul S. Atkins, Remarks before the International Corporate Governance Network 11th Annual Conference, July 6, 2006, *available at* www.sec.gov/news/speech/2006/spch070606psa.htm.

[9] In re Tyson Foods, Inc., Del. Ch. Ct. Consolidated C.A. No. 1106-N, Feb. 6, 2007, slip op. at 52-55 ("A director who intentionally uses inside knowledge . . . to enrich employees while avoiding shareholder imposed requirements cannot . . . be said to be acting loyally and in good faith as a fiduciary. This conclusion . . . rests upon at least two premises, each of which should be . . . alleged . . . to show that a spring-loaded option issued by a disinterested and independent board is nevertheless beyond the bounds of business judgment. First, a plaintiff must allege that the options were issued according to a shareholder approved employee compensation plan. Second, a plaintiff must allege that the directors that approved the spring-loaded (or bullet-dodging) options (a) possessed material non-public information soon to be released that would impact the company's share price, and (b) issued those options with the intent to circumvent otherwise valid shareholder-approved restrictions upon the exercise price of the options." *Id.* at 54-55.) *See also* Ryan v. Gifford, C.A. No 2213-N at 30 (Delaware Court of Chancery, Feb. 6, 2007) (in the context of alleged backdating of options, "the intentional violation of a shareholder approved stock option plan, coupled with fraudulent disclosures regarding the directors' purported compliance with that plan, constitute conduct that is disloyal to the corporation and is therefore an act in bad faith").

[10] *See* Letter, dated September 19, 2006, of Conrad Hewitt, Chief Accountant of the SEC, to Lawrence Salva and Sam Ranzilla, *available at* http://www.sec.gov/info/accountants/staffletters/fei_aicpa091906.htm.

[11] *See* Div. of Corporation Finance, SEC, Sample Letter Sent in Response to Inquiries Related to Filing Restated Financial Statements for Errors in Accounting for Stock Option Grants, *available at* http://www.sec.gov/divisions/corpfin/guidance/oilgasltr012007.htm.

[12] PCAOB, Staff Audit Practice Alert No. 1, "Matters Relating to the Timing and Accounting for Option Grants," July 28, 2006, *available at* http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2006/07-28_APA_1.pdf.

[13] Companies are now required to disclose if the company has granted a named executive officer an option with an exercise price that is less than the closing market price on the date of grant (or, if there is no trading market for the shares on the date of grant, to describe the formula or other means for determining the price provided by the arrangement pursuant to which the option was issued) and, if the exercise price was not the closing market price on the

date of grant, to describe the methodology used to determine the exercise price. For this purpose, the date of grant must be determined in accordance with the financial reporting requirements established by FAS 123R. In addition, companies are required to disclose if the grant date of an option or other equity award is different from the date the board of directors or the compensation committee or other appropriate board committee "takes action or is deemed to take action to grant such award." Regulation S-K, Item 402(a)(6)(iv) & (d) & Instr. 3 thereto.

[14] Regulation S-K, Item 402(b)(2)(iv). An item specifically required to be disclosed is the role an executive officer plays in the grant process.

[15] *See* SEC Rel. No. 33-8732A, Executive Compensation and Related Person Disclosure, at Section II.A.2(b)(ii) (Aug. 11, 2006), *available at* http://www.sec.gov/rules/final/2006/33-8732a.pdf.

[16] Under FAS 123R, which governs the accounting for options, if the exercise price of an option is determined on a basis different than the trading price of the related shares on the date of grant, the accounting charge for the option may nevertheless be required to be determined based on the trading price of the shares. *See also* note 13 above.

[17] A Form S-8 Registration Statement and related prospectus is not required where equity is issued only to executives and directors on a private offering basis, in accordance with Regulation D under the Securities Act of 1933 or under Section 4(2) of the Act. Shares so issued will, however, then be "restricted securities" and will not be freely tradeable.

[18] Pertinent corporate law provisions should be considered, as board authorization of the issuance of shares and options and rights to acquire shares is usually required and the relevant provisions vary from state to state. Insofar as compensation includes the issuance of bonus or restricted or performance shares or options or rights to receive such shares, under most corporation statutes authorization of the issuance requires action by the board or an authorized committee of the board and some statutes do not authorize the delegation to management of authority to approve the issuance of all or certain of such share awards (other than to a management member who is a board member acting as a committee of the board) or authorize such delegation only within specified limits. *See, e.g.*, Delaware General Corporation Law §§151, 152 & 157; New York Business Corporation Law §§504 & 505; Model Business Corporation Act §§6.21 & 6.24. Note that greater flexibility may be provided with respect to the issuance of options than other share award issuances and with respect to issuances under stockholder-approved stock compensation plans than those not pursuant to such plans. In addition, the ability of a board or board committee to delegate to management its authority to make stock-based awards may be addressed by the company's stock-based compensation plan. Under both NYSE and Nasdaq requirements, equity may be issued to directors, officers and employees only pursuant to shareholder approval or a shareholder approved plan, subject to certain exceptions. *See* NYSE Listed Company Manual Section 303A.8; Nasdaq Marketplace Rule Section 4350(i).

[19] The FASB Staff has provided guidance on how to implement this requirement. *See* FSP FAS 123(R)-2, Practical Accommodation to the Application of Grant Date As Defined in FASB Statement No. 123(R) (Oct. 18, 2005), *available at* http://www.fasb.org/fasb_staff_positions/fsp_fas123r-2.pdf.

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