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Aid for employees could include repriced options or bonus checks

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Time will tell how far valley companies will go to buffer innocent rank-and-file workers from the fallout caused by backdated options. For starters, they could offer workers the chance to reprice options, or cut checks for the lost discount. As for employee stock purchase plans, or ESPPs, companies could pay bonuses to make up for the lost investment opportunity.

Under new federal tax rules, employees face a 20 percent tax on discounted options under Section 409A of the tax code. There are two basic ways recipients can dodge the tax hit: Reprice the options to remove the discount, or schedule when they'll exercise the options, a choice few people will find palatable.

Companies have until Dec. 31 to fix the problems for rank-and-file workers. But a wave of companies provided clues about what might follow for workers when they faced a Dec. 31, 2006, deadline for options granted to top executives.

In December, at least 10 Silicon Valley companies raced to reprice 4.2 million tainted options to spare 35 executives and directors from the new taxes, according to Equilar, a San Mateo firm that tracks executive compensation. They included five of the 50 biggest companies here: Nvidia, KLA-Tencor, Atmel, VeriSign and BEA Systems.

Two companies -- KLA-Tencor and Trident Microsystems -- took the controversial step of paying bonuses to executives to compensate them for the improper discounts. For example, KLA-Tencor raised the price of options given to Chief Executive Richard Wallace 25 to 55 percent and will pay him nearly \$369,000 in 2008 to make up for the lost discount.

KLA-Tencor hints something is in the pipeline to help thousands of rank-and-file workers facing Section 409A taxes. But it's hamstrung legally because it can't offer to reprice employee options until it issues current financial results and its trading blackout is lifted. The company also is tracking an industry proposal that would let workers keep tainted options if companies paid a portion of the tax bill.

"Our attitude as a company is we feel we have an obligation to employees to do the right thing and put them in a position where they are the least affected by this as we can," said General Counsel Larry Gross. "That's what we're working on."

The tactic of paying bonuses when options are repriced is a touchy one with corporate governance experts. The Corporate Library has called on companies to reprice options given to executives to remove the discount but cancel options if executives manipulated dates for personal gain.

"The practice of cutting checks for the difference flabbergasts me," said Paul Hodgson Sr., a senior research associate who likens receiving a discounted option to discovering extra money was erroneously tacked onto a paycheck. "It was based on a mistake that was fraudulent."

The Corporate Library is less resolute, however, if companies take similar steps to reprice options for rank-and-file workers to beat the Dec. 31 deadline. On one hand, it's money workers weren't entitled to. On the other hand, penalizing workers could strain morale.

"It's a little like a Hobson's choice where there is no right choice," Hodgson said.