

## Backdating: Is It A Crime or Debt To Shareholders?

# Investors Fare Well in Suits Over Backdating

**By Gabe Friedman**  
Daily Journal Staff Writer

Three years ago, a scandal erupted in corporate America over the practice of backdating stock options to make them more lucrative for executives, with hundreds of companies suddenly announcing financial restatements to reflect their cost.

Now the era is rapidly winding down to a murky conclusion.

Last week, Juniper Networks announced a \$169 million settlement to a shareholder class action over stock option backdating.

On the same day, a federal judge in St. Louis abruptly dismissed a case mid-way through trial, in which the Securities and Exchange Commission had brought civil fraud charges against an outside director of a company, military contractor Engineered Support.

The two different outcomes underscore the wide range of opinions and uncertainty surrounding the practice of backdating stock option grants: Though plaintiff lawyers continue to achieve great success for investors who claim they were defrauded by the practice, many judges around the nation looked skeptically at government efforts to treat backdating as a civil or criminal offense.

The era is not quite over, with two more criminal trials to finish in the next month. Former Brocade chief executive Gregory Reyes in San Francisco was convicted in 2007, but an appeals court overturned

the conviction last year. Jury selection in his retrial begins this Thursday. And next month in Los Angeles, former KB Home CEO Bruce Karatz goes to trial.

Stuart Gasner, of Kecker & Van Nest in San Francisco, represented Michael Shanahan Jr., the outside director at Engineered Support who was in trial against the SEC for backdating until a judge abruptly dismissed the case on Friday.

"One of the big beams of our defense," said Gasner, "was that unlike at Enron or other companies that had performance issues, our company was incredibly successful. This was really a peripheral accounting issue."

The term backdating refers to the practice of pricing stock option grants at dates in the past when the stock price was lower, making them more valuable. An academic study in 2006 discovered the practice had been prevalent, and that companies were not accounting for stock options properly.

At most companies, the practice had ended by 2003, when new laws took effect. But prosecutors and SEC lawyers opened a series of investigations throughout 2006. Now, many of those cases are reaching their conclusion.

Gasner's victory against the SEC last week trailed a more high-profile dismissal of criminal charges against former Broadcom executives in December in Orange County.

In that case, federal prosecutors alleged

five top Broadcom executives, including its two billionaire co-founders, Henry T. Nicholas III and Henry Samueli, conspired to backdate stock options to lower the company's compensation expenses.

But U.S. District Judge Cormac J. Carney issued a series of dismissals and acquittals just before the closing arguments took place in the nine-week trial of the former chief financial officer William J. Ruehle. Carney said he was tossing the entire case because accounting rules surrounding stock option grants were too confusing.

The judge also said prosecutors had committed misconduct by pressuring witnesses to testify in support of their case.

"What was happening at Broadcom was open," Carney said at a hearing in late January.

But the judge's decision was far from a total victory for Broadcom or its executives. The same week the criminal charges were dismissed, Broadcom announced a \$160 million class action settlement with shareholders who claimed they were defrauded by backdating.

Other companies have also paid dearly for the practice: UnitedHealth Group settled a shareholder class action over backdating for \$895 million, in the largest shareholder settlement of its kind.

Juniper disclosed to shareholders last week in an SEC filing that it has agreed to make a \$169 million cash payment to settle its shareholder class action. None of its executives ever faced criminal charges.