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Backdated Stock Options: A New Frontier in Securities Litigation

What started as a year long probe by the SEC into a disturbing trend involving a number of companies allegedly manipulating the timing of option grants to senior executives has quickly exploded into a major government investigation. With the number of subpoenas issued from the Department of Justice and U.S. Attorney offices continuing to rise, it has put executive compensation back on the front page of the papers giving the plaintiff's bar carte blanche to exact more information on company practices. Shareholders have also begun seizing upon the disclosure issues raised by these investigations in alleging securities fraud violations. Poised to lead the charge is one of the country's foremost securities class-action firms.

Sheer coincidence alone can not account for the impeccable timing of so many option grants at so many different companies. As of late, over thirty companies are presently under investigation by the SEC or federal prosecutors and over 50 shareholder suits have been filed. Although the investigation cuts across industry lines, there appear to be a high number of high tech companies under the microscope given industry practices. Additionally, there have been an increasing number of executives who have resigned in the wake of these scandals signaling some sign of trouble.

Backdating is a relatively simple concept for a jury to grasp. Granting these options when share prices are at all time lows presents a great opportunity for executives to reap huge gains. Since stock options are commonly offered as incentives in executive compensation packages, the practice of backdating undermines their fundamental purpose. Moreover, backdating is indicative of deeper problems beyond the fact that it may violate numerous securities laws. Civil penalties aside, the issuance of option grants absent board approval can result in a whole host of criminal charges against companies and individuals alike.

Backdating poses very serious risks to directors and officers. Many times the crux of the problem goes back to the accounting methodology for these options. Companies that fail to properly account for these options could end up having to issue a financial restatement the repercussions of which could be disastrous to your D&O policy.

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