US: opposition erupts over rule to expense stock options

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The opposition that has been generated by a proposed rule requiring corporations to expense stock options is the latest indication that corporate looting in the United States continues unabated. Despite the great publicity given to the trial of a handful of executives, powerful sections of the American corporate and political establishment are determined to ensure that the parasitic structure of American capitalism—a structure that has allowed for the vast accumulation of wealth by a tiny section of the population—goes unaltered.

The rule was drafted by the Financial Accounting Standards Board (FASB), the private organization tasked by the government to set standards on accounting procedures. It is currently under a period of public comment, after which the board will decide whether and when the rule will go into effect.

Prominent voices within American big business and their allies in Congress have moved to preempt the board's decision by pushing for legislation that would reverse the rule before it is even enacted.

Opposition to the rule is especially strong among representatives from California, the home of many high-tech companies. Over the past decade, technology and telecommunications companies have been the most enthusiastic users of stock options and thus would be hardest hit by mandatory expensing. California Senator Barbara Boxer and House Democratic leader Nancy Pelosi (the latter represents the San Francisco district) have joined hands with right-wing Republicans such as House Speaker Dennis Hastert in supporting legislation to block the rule. President Bush reportedly supports these efforts.

In taking this position, Boxer and Pelosi, who both fashion themselves as liberal Democrats, have demonstrated their basic subservience, and that of their party, to their corporate paymasters. Whatever the divisions between the Democrats and Republicans, the officials of both parties are, in the end, answerable to the corporate interests that finance their election campaigns as well as control the media monopolies that play such a commanding role in manipulating the electoral and legislative processes.

The outcome of the effort to block the FASB rule remains uncertain, but the very fact that it is being waged is revealing, given the public exposure only two years ago of the scandalous use of unexpensed stock options by top corporate executives, who enriched themselves at the expense of their own companies' financial stability and the interests of their shareholders, their employees and the general public.

There is, from the standpoint of sound accounting methods, no valid reason *not* to require the expensing of options. A stock option represents a commitment by a company to sell stock at a fixed price to the individual holding the option. If the actual stock price at some future time is above the set option price, the holder can pocket the difference by "exercising" his or her option and then selling back the stock at the prevailing market price.

Options are clearly a potential expense for the company providing them, and by all accounting principles should be deducted from the company's reported earnings. Moreover, by increasing the number of shares on the market, they exert enormous pressure on corporate management to spend great sums on stock buybacks, a generally wasteful outlay aimed at keeping the flood of shares from diluting the price of the company's stock. In this way, huge sums are diverted from investment in plant, equipment, and research and development, not to mention compensation to employees and other socially important matters such as workers' health and safety and anti-pollution efforts.

Unlike all other forms of compensation, companies are currently not required to deduct stock options from their reported earnings. Instead, they are merely required to footnote the value of these options in their financial reports.

Stock options have served as a critical mechanism for self-enrichment by corporate executives. The use of options as compensation exploded during the stock market boom of the late 1990s. For example, in 1992, long-term incentives, including stock options, accounted for only 27 percent of CEO pay, while by 2000 this figure had risen to 60 percent.

The heavy use of options has been closely associated with attempts to falsify earnings reports in order to keep stock prices high (and thereby keep options valuable). The excessive focus on stock price has undermined the long-term health of many companies.

This became clear after the wave of corporate corruption scandals that began with the collapse of energy giant Enron in December 2001. Although these revelations generated a sharp fall in the stock price of many companies, executives were able to bail out by exercising options before the fall. Enron executives, including CEO Kenneth Lay, exercised millions of dollars in options shortly before the company collapsed in late 2001. Over the previous years, Enron had carried out massive accounting manipulations to keep reported earnings in line with Wall Street expectations.

The collapse of the stock market was followed by a push from some investors to pass legislation mandating option expensing, though these attempts were eventually scuttled by a bipartisan push in Congress. Some big investors, such as multibillionaire Warren Buffett, favor expensing, as it would force a more realistic and transparent representation of company finances. Companies that do not use options heavily also favor expensing, since they feel at a competitive disadvantage.

Highlighting these divisions, G. Michael Crooch, a member of FASB, noted, “It is not a level playing field. [Stock options] are compensation. They ought to be expensed as compensation.... We believe our job is to provide high-quality, neutral financial information so people who make decisions based on financial statements have neutral information.”

The decline in the stock market dampened enthusiasm for options somewhat; however, many executives are loathe to part with this method of self-enrichment. Craig Barrett, the CEO of Intel, received 1.35 million shares in stock options in 2003. It is no surprise, therefore, that Barrett has been one of the leading opponents of the new FASB rule, denouncing the proposal in a March 31 opinion piece in the *Wall Street Journal*.

Barrett has good reason to worry. A report by analyst Bear, Stearns & Co. estimated that companies listed on the technology-heavy Nasdaq index would have faced a 44 percent drop in net income in 2003 if they were forced to deduct stock options from their bottom lines. According to Credit Suisse First Boston, telecommunications companies would have seen a 117 percent drop in net income. The effect on the companies listed on the broader Standard & Poor’s 500 stock index would have been substantially less, only 8 percent.

Technology companies worry that the reduced earnings that would follow from the implementation of the rule would send stock prices down. This would reduce available capital to these companies and damage the interests of corporate executives who are heavily invested in company stock and stock options.

Opposition to stock option expensing is not limited to tech companies, however. Top CEOs at many corporations have been able to use this form of compensation to pull in hundreds of millions of dollars over the past several years. For example, the chairman of credit card banking giant MBNA, Alfred Lerner, cashed in on $168.9 million in stock options in 2002.

Although companies have benefited by not accounting for options on earnings reports, many have claimed these same options as expenses for tax purposes. This has allowed companies to substantially reduce tax expenditures, and many have not paid any taxes for years. A new study by the General Accounting Office (GAO), the investigative arm of Congress, found that 63 percent of US-owned companies paid no taxes in 2000. The heavy use of stock options helped Enron report a $3 billion loss to the Internal Revenue Service (IRS) between 1996 and 1999, thereby exempting it from taxes, even as it reported profits of $2.3 billion to investors.