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Options Aren't Opti nal in Silicon Valley

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By T.J. Rodgers

Talk about collateral damage. Sen. Carl Levin (D., Mich.) just fired his latest shot in the Rust Belt wars at home-state auto executives by launching a bill deceptively entitled the "Ending the Double Standard for Stock Options Act." Sen. Levin keeps shooting at the auto executives and keeps hitting Silicon Valley. This time it could be a real problem.

Sen. Levin and his co-sponsors claim that, like Enron, American high-tech companies are legally avoiding fair taxation and legally over-reporting earnings. They couldn't be further off base.

Broad employee stock ownership, after all, is the genius behind Silicon Valley's economic miracle. Mr. Levin's new law, disguised as a tax equity change, is actually an accounting change which threatens to kill our employee options system by forcing companies to write off as losses the stock-option gains of their employees (who also then pay taxes on them).

Mr. Levin has had the knives out for options for a while. The shiny new act he's pitching with Sen. John McCain (R., Ariz.) is really a rehash of a bill that failed back in 1997. All the way back in 1994, Mr. Levin had the dubious distinction of precipitating the only spontaneous Silicon Valley political rally since the days of Cesar Chavez with the same warmed-over blather about "fairness" and "loopholes." (That legislation nosedived into oblivion with an 88-9 Senate vote.)

Now it's all been resurrected because of Enron. In a Senate speech, Mr. Levin claimed that stock options were "a driving force behind management decisions at Enron that focused on increasing Enron's stock price rather than the solid growth of the company." Never mind that we have seen quite clearly that Enron's problems are hardly about stock options. Riding the coattails of corporate malfeasance into any regulatory bill is apparently *de rigeur* in Washington these days.

If Sens. Levin and McCain get their way, the fallout for companies like mine could be startling. The proposed legislation, instead of cleaning up corporate accounting as it is intended to do, would skewer what has proven an incredibly effective incentives system and reduce the earnings of every Silicon Valley company.

Nor will it solve any of the problems Sens. Levin and McCain claim to be concerned with. As a founder and CEO of a Silicon Valley company, I have held options for 19 years. Wall Street earnings pressures notwithstanding, I have always viewed deceiving investors as a quick path to unemployment and financial ruin, the fate that Enron's CEO currently suffers. Silicon Valley's success, now in its 63rd year since the founding of Hewlett-Packard, is Enron's counterpoint. It has demonstrated that stock options promote long-term thinking, astonishing invention, progress, and broad wealth creation.

Not one of the five sponsors of the bill—Sens. Levin, McCain, Dick Durbin (D., Ill.), Mark Dayton (D., Miss.) and Peter Fitzgerald (R., Ill.)—has ever been a CEO or a CFO. It shows: What person with any business acumen would say a law mandating losses for American corporations is just what the economy needs right now?

Part of the impetus for the bill has been what the senators have characterized as a "double standard" created by companies reporting two different sets of numbers. But for the source of the problem, the senators might look first in their own backyard. What troubles them is related to the fact that Washington requires companies to keep one set of books for the Securities and Exchange Commission and one for the Internal Revenue Service. But these two bureaucracies have never tried to coordinate their demands. Moreover, the problem is hardly unique to options: There are "double standards" in the accounting for revenue recognition, depreciation, reserves, vacation pay, foreign sales, compensation, and so forth. So what?

There are only two relevant questions: Are any companies or individuals legally avoiding fair taxes? And, are companies legally overstating their earnings? The answer to both questions is an emphatic *no*.

Profits realized by employees from options are treated like other wages paid by their employer, who is allowed to subtract them from company profits before taxes. This is the business expense that Sen. Levin is unreasonably painting as unscrupulous tax avoidance. Further, the tax liability for option profits, just as for wages, falls on the employee. There's nothing to "fix" in this straightforward transaction.

John McCain recently said in a Senate speech that "corporations can hide these multi-million-dollar compensation plans from shareholders . . . because these plans are not counted as expenses when calculating company earnings." Sorry, John: Shares outstanding, including options, are reported to investors quarterly and also dilute the earnings per share. And shareholders must vote to approve executive option plans before the options are granted.

How many more times would Mr. McCain like us to report these things? By his math, Silicon Valley companies should pay for stock options twice, first through the dilution of earnings caused by the share count increase and then again by the newly mandated expense—a change that would effectively kill Silicon Valley's egalitarian stock-option programs.

At my company, our options pool—including executive options—amounts to 23.3% of all outstanding shares. The Levin-McCain paper loss generated by those options could easily reduce our earnings by $50 million a year, devastating our profitability. The same scenario would be repeated throughout Silicon Valley.

In the zeal to attack what Sen. Levin calls "stealth compensation," Congress threatens to create a lose-lose proposition—the $50 million my company would lose accrues to the benefit of no one. Mr. Levin's attack on "executive abuse" would fall directly on the rank and file of Silicon Valley. Far from the scenario he imagines in which top executives hog all the options, my personal options and those of our board of directors and executive staff amount to only 18.5% of options outstanding. Our employees hold the other 81.5%.

Grass-roots ownership created Silicon Valley. Why would we even consider letting the Enron failure harm that magnificent engine of wealth and innovation?

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