

WHAT YOU NEED TO KNOW AND WHAT YOU MUST DO NOW

United Health, Broadcom, KB Homes and Sycamore Networks: public companies big and small, new and old are all under intense scrutiny by the Federal Government, plaintiffs attorneys, state investigators and shareholders for any evidence of improper backdating of options, misdating, springloading and bullet-dodging. Two criminal indictments have already been announced. Over 100 other companies have disclosed that they are under investigation by the SEC, the DOJ or both. The headlines from the *Wall Street Journal* are now an issue of immediate concern for any conscientious public company that has employed options as a form of compensation.

Erik Lie, the associate professor of finance at the University of Iowa, who conducted the research credited with starting the wave of investigations, claims there are over 2,000 publicly traded companies which engaged in stock option backdating during the late 1990's and early 2000's. Lie says, "I am confident that the number of companies who have done this is much higher" than the number currently being investigated. Lie plans to release new research in the coming weeks identifying additional companies' option practices. Federal prosecutors and state investigators are pursuing investigations into past practices and the federal government has established a special task force in the Northern District of California to coordinate the investigative efforts. Published reports suggest that companies within the Silicon Valley, where stock options were heavily used to attract the best employees, are the most likely to come under scrutiny.

WAIT AND SEE OR BE PROACTIVE?

Notwithstanding the current environment, a recent survey indicates that only 56% of publicly traded companies have undertaken any sort of internal investigation to insure they do not have exposure to the most current corporate fraud scandal. Unlike some of the other recent national investigations, however, companies cannot afford to fail to determine whether there are any concerns about the handling of their own stock option programs. Outside accounting firms are once again being questioned for their failure to detect the widespread practice of backdating stock option grants.

Every publicly traded company can reasonably expect the issue of stock option timing to be a part of any up-coming year end audit. Because the backdating of stock options can necessitate the immediate expensing of the portion of the option "in the money," the practice can significantly affect a company's financial statements, and many companies have already been forced to restate their financial statements for prior years in which the practice went on. Institutional investors are looking for indications and sometimes asking for assurances that companies do not have any exposure to improper backdating allegations. With such significant attention being focused on the issue, companies must also

be concerned with disgruntled employees and class action lawyers who will be eager to expose new companies as part of the stock option backdating scandal.

To that end, Sycamore Networks, one of the latest companies to be named, was turned in by a former employee, Stephen Landry, who said in a lawsuit that the maker of network gear fired him for complaining about the company's stock-options practices. A copy of the complaint filed by Landry includes a memo that he claims came from Sycamore. Landry claims the memo instructs human resources employees at Sycamore to change the start dates for some workers to coincide with options grants and indicates that the author knew the practice could be construed as illegal. Some companies, like Apple, have started their own internal investigations into their options-granting practices before waiting for regulators to step in, and it would behoove other companies to follow suit. What a company has done to clean itself up is a major factor that the SEC and prosecutors will look at.

BEST PRACTICES FOR TODAY'S ENVIRONMENT

The quickly emerging best practice is for companies to conduct an internal investigation of their own before outside auditors, class action lawyers or the government decides to conduct an investigation. The advantages of being proactive are many, for example:

- Unlike a review done by outside auditors, an internal investigation done under the auspices of counsel has all the protections of the attorney-client and attorney work product privileges.
- A reliable and independent internal investigation can provide significant reassurance to investors that a company does not have legal issues surrounding the past handling of its stock option program.
- If concerns are discovered, a company has the ability to evaluate its alternatives on its own terms instead of terms dictated by any of the possible outside entities.

Because it is an issue that companies cannot just hope will go away on its own, the best practice is to proactively address the issue to provide the company as much control as possible over the situation.

Best practices also encourage companies to have these investigations conducted by an outside law firm, and generally by a firm that does not handle the company's everyday affairs. This is true whether the company is concerned there may be a problem or convinced there is no issue. Institutional investors are particularly interested in seeing independence exercised over any internal investigation, and even more so when the matters involved could affect the company's financial statements.

WHO WE ARE

The PREVENE Group is a law specialty group established to allow companies to proactively address corporate compliance issues by incorporating the prosecutor's perspective to all its efforts. The PREVENE Group is headed by Jim Martin, the former U.S. Attorney for the Eastern District of Missouri. Along with other former prosecutors, former federal agents, accounting experts and experienced securities attorneys, The PREVENE Group can provide experienced guidance. We aggregate and manage a specialized team capable of analyzing your company's situation and then provide a solution to any real or perceived problem. With offices in Washington D.C., St. Louis and San Francisco, The PREVENE Group can bring a focused approach and solution anywhere in the country.

WHAT WE DO

The PREVENE Group provides immediate investigative services for your company's internal audit. We design, coordinate and execute a proven strategy to help your company quickly evaluate its exposure, if any. We also provide counsel to negotiate with federal and state agencies should there be an issue. Most importantly, we provide all services under the protections of the attorney work product and attorney-client privileges, affording the company the time and latitude to address this issue on its terms with the appropriate parties instead of being taken off-guard by a whistle-blower, U.S. attorney subpoena or adverse press release.

For further information or guidance on how to navigate your company in this latest corporate challenge without making a misstep, please contact Jim Martin at 866.209.2458 or e-mail jmartin@prevenegroup.com.

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St. Louis Office

One Metropolitan Square, Suite 2600
St. Louis, Missouri 63102

Washington, D.C. Office

1901 Pennsylvania Avenue, NW, Suite 601
Washington, D.C. 20006

San Francisco Office

Three Embarcadero Center, Suite 2310
San Francisco, CA 94111