

Union Calendar No. 367

108TH CONGRESS
2D SESSION

H. R. 3574

[Report No. 108-609, Part I]

To require the mandatory expensing of stock options granted to executive officers, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

NOVEMBER 21, 2003

Mr. BAKER (for himself, Ms. ESHOO, Mr. DREIER, Mr. KENNEDY of Minnesota, Mr. HONDA, Mrs. TAUSCHER, Ms. LOFGREN, and Mr. CANTOR) introduced the following bill; which was referred to the Committee on Financial Services

JULY 15, 2004

Reported with an amendment and referred to the Committee on Energy and Commerce for a period ending not later than July 16, 2004, for consideration of such provisions of the bill and amendment as fall within the jurisdiction of that committee pursuant to clause 1(f), rule X

[Strike out all after the enacting clause and insert the part printed in italic]

JULY 16, 2004

Additional sponsors: Mr. BURR, Mr. HAYWORTH, Mr. JOHN, Mr. BRADY of Texas, Mr. SHADEGG, Ms. HOOLEY of Oregon, Mr. BLUMENAUER, Mr. INSLEE, Mr. MCGOVERN, Mr. HOUGHTON, Mr. DOOLITTLE, Mr. DOOLEY of California, Mr. CROWLEY, Mr. CARTER, Mr. SOUDER, Mr. MCINTYRE, Mr. CAPUANO, Mr. FLAKE, Mr. SMITH of Texas, Mr. MOORE, Mr. DAVIS of Tennessee, Mr. BOUCHER, Mrs. BIGGERT, Mr. SESSIONS, Mr. HINOJOSA, Mr. DAVIS of Alabama, Mr. GONZALEZ, Mr. TOM DAVIS of Virginia, Mr. HEFLEY, Mr. PUTNAM, Mr. THOMPSON of California, Mr. ROSS, Mr. GOODLATTE, Mr. PEARCE, Mr. ENGLISH, Ms. HARMAN, Mr. BACHUS, Mr. HERGER, Mr. GRIJALVA, Ms. HARRIS, Mr. BLUNT, Mr. MENENDEZ, Ms. PELOSI, Mr. ROYCE, Mr. CARSON of Oklahoma, Mr. MEEKS of New York, Mr. SCOTT of Georgia, Mr. OTTER, Mr. ISAKSON, Mr. REYNOLDS, Mr. WU, Mr. CRANE, Mr. ISRAEL, Mr. RYUN of Kansas, Mr. ISSA, Ms. GINNY BROWN-WAITE of Florida, Ms. MCCARTHY of Missouri, Mr. MEEHAN, Mr. FARR, Mr. KIND, Mr. CUNNINGHAM, Mr.

1 “(m) *MANDATORY EXPENSING OF STOCK OPTIONS.*—

2 “(1) *NAMED EXECUTIVE OFFICER.*—As used in
3 this subsection, the term ‘named executive officer’
4 means—

5 “(A) all individuals serving as the chief ex-
6 ecutive officer of an issuer, or acting in a simi-
7 lar capacity, during the most recent fiscal year,
8 regardless of compensation level; and

9 “(B) the 4 most highly compensated execu-
10 tive officers, other than an individual identified
11 under subparagraph (A), that were serving as
12 executive officers of an issuer at the end of the
13 most recent fiscal year.

14 “(2) *IN GENERAL.*—Subject to paragraph (4),
15 every issuer of a security registered pursuant to sec-
16 tion 12 shall show as an expense in the annual report
17 of such issuer filed under subsection (a)(2), the fair
18 value of all options to purchase the stock of the issuer
19 granted after December 31, 2004, to a named execu-
20 tive officer of the issuer.

21 “(3) *FAIR VALUE.*—

22 “(A) *IN GENERAL.*—The fair value of an
23 option to purchase the stock of the issuer that is
24 subject to paragraph (2) shall—

1 “(i) be equal to the value that would be
2 agreed upon by a willing buyer and seller
3 of such option, who are not under any com-
4 pulsion to buy or sell such option; and

5 “(ii) take into account all of the char-
6 acteristics and restrictions imposed upon
7 the option.

8 “(B) *PRICING MODEL*.—To the extent that
9 an option pricing model, such as the Black-
10 Scholes method or a binomial model, is used to
11 determine the fair value of an option, the as-
12 sumed volatility of the underlying stock shall be
13 zero.

14 “(4) *EXEMPTIONS*.—

15 “(A) *SMALL BUSINESS ISSUERS*.—This sub-
16 section shall not apply to an issuer, if—

17 “(i) the issuer has annual revenues of
18 less than \$25,000,000;

19 “(ii) the issuer is organized under the
20 laws of the United States, Canada, or Mex-
21 ico;

22 “(iii) the issuer is not an investment
23 company (as such term is defined under sec-
24 tion 3 of the Investment Company Act of
25 1940 (15 U.S.C. 80a-3));

1 “(iv) the aggregate value of the out-
2 standing voting and non-voting common eq-
3 uity securities of the issuer held by non-af-
4 filiated parties is less than \$25,000,000;
5 and

6 “(v) in the case of an issuer that meets
7 the criteria in clauses (i) through (iv) and
8 is a majority-owned subsidiary, the parent
9 of the issuer meets the requirements of this
10 paragraph.

11 “(B) *DELAYED EFFECTIVENESS.*—The re-
12 quirements of this subsection shall not apply to
13 an issuer before the end of the 3-year period be-
14 ginning on the date of the completion of the ini-
15 tial public offering of the securities of the issuer,
16 and shall only apply to an option to purchase
17 the stock of an issuer granted after such date.”.

18 **SEC. 3. PROHIBITION ON EXPENSING AND ECONOMIC IM-**
19 **PACT STUDY.**

20 (a) *PROHIBITION.*—Section 19(b) of the Securities Act
21 of 1933 (15 U.S.C. 77s(b)) is amended by adding at the
22 end the following:

23 “(3) *PROHIBITION ON EXPENSING STANDARDS.*—

24 “(A) *IN GENERAL.*—The Commission shall
25 not recognize as ‘generally accepted’ any ac-

1 *counting principle relating to the expensing of*
2 *stock options unless—*

3 *“(i) it complies with the requirements*
4 *of subparagraph (B); and*

5 *“(ii) the economic impact study re-*
6 *quired under section 3(b) of the Stock Op-*
7 *tion Accounting Reform Act has been com-*
8 *pleted.*

9 *“(B) REQUIREMENTS.—A standard referred*
10 *to in subparagraph (A) shall require that—*

11 *“(i) if an option to purchase the stock*
12 *of an issuer that is subject to the require-*
13 *ments of section 13(m) of the Securities Ex-*
14 *change Act of 1934 is exercised—*

15 *“(I) any expense that had been re-*
16 *ported under that section 13(m) with*
17 *respect to such option shall be recom-*
18 *puted as of the date of exercise and*
19 *shall be equal to the difference between*
20 *the price of the underlying stock and*
21 *the exercise price; and*

22 *“(II) to the extent the recomputed*
23 *amount differs from the amount pre-*
24 *viously reported under section 13(m)*
25 *with respect to such option, the dif-*

1 ference shall be reported in the fiscal
2 year in which the option is exercised
3 as a reduction or increase, as the case
4 may be, of the total expense required to
5 be reported under that section 13(m)
6 during that fiscal year;

7 “(ii) if an option to purchase the stock
8 of an issuer that is subject to the require-
9 ments of section 13(m) of the Securities Ex-
10 change Act of 1934 is forfeited or expires
11 unexercised, any expense that had been re-
12 ported under that section 13(m) with re-
13 spect to such option shall be reported in the
14 fiscal year in which the option expires or is
15 forfeited as a reduction of the total expense
16 required to be reported under that section
17 13(m) during that fiscal year; and

18 “(iii) to the extent that any reduction
19 required under clause (i) or (ii) exceeds
20 total option expenses for any fiscal year,
21 such excess shall be reported as income with
22 respect to options to purchase the stock of
23 the issuer.”.

24 (b) *ECONOMIC IMPACT STUDY*.—Not later than 1 year
25 after the date of enactment of this Act, the Secretary of

1 *Commerce and the Secretary of Labor shall conduct and*
2 *complete a joint study on the economic impact of the man-*
3 *datory expensing of all employee stock options, including*
4 *the impact upon—*

5 *(1) the use of broad-based stock option plans in*
6 *expanding employee corporate ownership to workers*
7 *at a wide range of income levels, with particular*
8 *focus upon non-executive employees;*

9 *(2) the role of such plans in the recruitment and*
10 *retention of skilled workers;*

11 *(3) the role of such plans in stimulating research*
12 *and innovation;*

13 *(4) the effect of such plans in stimulating the*
14 *economic growth of the United States; and*

15 *(5) the role of such plans in strengthening the*
16 *international competitiveness of businesses organized*
17 *under the laws of the United States.*

18 **SEC. 4. IMPROVED EMPLOYEE STOCK OPTION TRANS-**

19 **PARENCY AND REPORTING DISCLOSURES.**

20 *(a) ENHANCED DISCLOSURES REQUIRED.—Not later*
21 *than 180 days after the date of enactment of this Act, the*
22 *Commission shall, by rule, require each issuer filing a peri-*
23 *odic report under section 13(a) or 15(d) of the Securities*
24 *Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)) to include*
25 *in such report more detailed information regarding stock*

1 *option plans, stock purchase plans, and other arrangements*
2 *involving an employee acquisition of an equity interest in*
3 *the company. Such information shall include—*

4 (1) *a discussion, written in “plain English”, in*
5 *accordance with the Plain English Handbook pub-*
6 *lished by the Office of Investor Education and Assist-*
7 *ance of the Commission, of the dilutive effect of stock*
8 *option plans, including tables or graphic illustrations*
9 *of such dilutive effects;*

10 (2) *expanded disclosure of the dilutive effect of*
11 *employee stock options on the issuer’s earnings per*
12 *share;*

13 (3) *prominent placement and increased com-*
14 *parability and uniformity of all stock option related*
15 *information;*

16 (4) *the number of outstanding stock options;*

17 (5) *the weighted average exercise price of all out-*
18 *standing stock options; and*

19 (6) *the estimated number of stock options out-*
20 *standing that will vest in each year.*

21 (b) *DEFINITIONS.—As used in this section:*

22 (1) *COMMISSION.—The term “Commission”*
23 *means the Securities and Exchange Commission.*

1 (2) *ISSUER.*—The term “issuer” has the meaning
2 provided in section 2(a)(7) of the Sarbanes-Oxley Act
3 of 2002 (15 U.S.C. 7201(a)(7)).

4 (3) *EQUITY INTEREST.*—The term “equity inter-
5 est” includes common stock, preferred stock, stock ap-
6 preciation rights, phantom stock, and any other secu-
7 rity that replicates the investment characteristics of
8 such securities, and any right or option to acquire
9 any such security.

10 **SEC. 5. PRESERVATION OF AUTHORITY.**

11 Nothing in this Act shall be construed to limit the au-
12 thority over the setting of accounting principles by any ac-
13 counting standard setting body whose principles are recog-
14 nized by the Securities and Exchange Commission under
15 section 19(b)(1) of the Securities Act of 1933 (15 U.S.C.
16 77s(b)(1)).

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The Committee on Energy and Commerce discharged; committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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