come an over-privileged class in a democratic society. Their power to overpay themselves, with legal sanction, could, if unchecked, erode the very structure on which they and their corporations depend for survival. Corporate power could become synonymous with grab-bag morality." (*The American Stockholder*)

In view of all that we have said thus far, it is not hard to understand why some of the most vehement critics of stock option plans have been stockholders themselves. The tremendous stock option profits, which have little to do with executive performance, are made, at least in part, at their expense.

In more than half of the twenty-five new plans recently surveyed by NICB the number of shares authorized for optioning was equal to more than 5 percent of the company's outstanding stock. In one case, the number of shares allotted equaled almost 10 percent of the outstanding stock.

Where do these shares come from? They may be authorized shares which have never been issued. Or they may be issued shares which have been reacquired by the company.

The distribution of stock which has never been issued before dilutes the equity of existing shareowners. They end up owning a smaller percentage of the enterprise and their claim to its earnings is correspondingly reduced. The assets and earnings of the corporation may be increased with the money obtained from the sale of the stocks but they may not be increased sufficiently to offset the effect of the reduced equity (in percentage terms) of individual shareholders. In any case, they will be increased less than if the corporation obtained the full market value of the stock.

Aside from the dilution of stockholders' equity, stock options represent a cost to the company whether the stock involved is newly issued or has been previously issued and reacquired. Ordinarily, the company would be able to sell such shares at market value. When it turns them over to executives at bargain prices, the difference in revenue flowing into the company's treasury represents a real cost. In our hypothetical example (pages 3 and 4), the sale of 5,000 shares to Mr. Smith at $95 per share rather than the current market price of $250, cost shareholders $775,000. In the Alcoa case, the $48.75 reduction in stock option prices represented a potential savings of $9 million to optionees. To existing shareholders, however, it represented a potential *cost* of $9 million. What is more, such costs are not deductible for for tax purposes.

Though sharply critical of stock option plans, stockholders have been too disorganized and scattered to make their opposition count. Some have proposed resolutions at stockholders' meetings and instituted law suits to block such plans. But management is in the driver's seat. With its control over proxies, it is able to do pretty much as it pleases. In effect, corporate management sets its own compensation.

In summary, stock option plans provide tax-privileged, risk-free profit

opportunities unrelated in any meaningful way to executive performance and unchecked by effective stockholder control. The taxpayer, the consumer and the stockholder, all pay for such opportunities in one form or another.

Eliminate Favored Tax Status of Stock Options

At least two remedies immediately suggest themselves. First, at the very least, the tax provisions in effect prior to 1950 should be restored. If this is done, the difference between the option price and the market value at the time stocks are purchased under the option will be treated as ordinary income and taxed at regular rates leaving the remaining profits to be taxed at the capital gains rate. An estimated $100 million in revenue could be raised by this measure alone.

Secondly, under present reporting requirements, it is extremely difficult for stockholders and the interested public to learn the extent to which company executives really benefit from stock option plans. Few probably realize that stock option gains frequently far exceed the direct compensation received by such officers. (See Appendix, Table 3)

Proxy statements do contain some data regarding option grants and purchases made under such grants, but the figures they provide from year to year are not cumulative, they often overlap and they frequently fail to make clear the effect of stock splits and stock dividends on options exercised during prior years. As a result, the average person is caught in a maze if he attempts to obtain some idea of the value of stock options granted to specific individuals.[11] Clearer disclosure of stock option transactions, then, is another necessary course of action.

More broadly, our discussion of stock options underlines the need for careful study and more intense public scrutiny of the whole subject of executive compensation. It points up the basically deceptive character of so much of that compensation—the free and easy expense account; the various forms of deferred compensation paid in tax-reducing installments under the pretense, sometimes, of compensation for post-retirement consultant services; the enormous pensions; etc. The public ought to know the real truth underlying the hue and cry about "confiscatory" tax rates which "destroy" incentives and leave top executives in a state of "impoverishment."

Beyond this, there are even broader implications. The stock option scandal raises a question as to the ends to which corporate power should rightfully be devoted. Economic catastrophe and congressional exposure toppled the "idols of the market place" from their pedestal in the early thirties. However, aided by reform legislation, which they bitterly opposed, they have since been restored to positions of respectability. Their influence

[11] Sales of stock purchased under option plans are more difficult to get at because shares which are purchased under an option are indistinguishable when resold from shares obtained through regular purchases, stock bonuses, etc.