Outside Director Not Guilty of Securities Fraud for Issuing Backdated Stock Options Pre-Sarbanes-Oxley

August 8, 2011

The Securities and Exchange Commission ("SEC") brought a civil action against a company's outside director.?Ã¡ The SEC charged the director with securities fraud for granting undisclosed backdated ?ÃÂ£in-the-money?ÃÂ¥ stock options from 1996 to 2002 to the CEO.?Ã¡ The SEC claimed that option pricing statements in the company's proxy statements and financial statement footnotes were materially false.?Ã¡ The statements provided that all options had been and would continue to be granted at an exercise price equal to the fair-market price.?Ã¡ To establish a violation of the antifraud provisions of the federal securities laws, the SEC had to prove that the director (1) made a material misstatement or omission in connection with the offer, sale, or purchase of a security by means of interstate commerce, (2) made the misrepresentation or misleading omission with scienter and (3) acted negligently.?Ã¡ The district court concluded that the SEC had failed to prove the requisite elements of scienter and negligence.?Ã¡ The United States Court of Appeals for the Eighth Circuit affirmed, holding that even if the outside director should have perceived an apparent contradiction between the option dating and pricing practice and its disclosures, he was not liable for securities fraud unless he recklessly failed to see an obvious danger that investors would be materially misled.?Ã¡?Ã¡ Before Sarbanes-Oxley, it was not perceived that a grant of in-the-money stock options which had no impact on the company's financial performance would be a material misstatement or omission.?Ã¡ After Sarbanes-Oxley ?ÃÂ£'backdating' took on the universal look of inherent evil. But evil must be proved based on contemporaneous standards..."?Ã¡ *SEC v. Shanahan Jr.*, No. 10-1820 (8th Cir. July 19, 2011).

© 2026 Haynes and Boone, LLP