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Stock Options in and for Emerging Capital Markets: What could be Transplanted from the United States

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ABSTRACT

This thesis examines the potential role of stock options in emerging markets, focusing on their use as an incentive for company officers and employees, as well as their investment implications. While jurisdictions like the United States (U.S.), especially at the state level, have developed well-established regulatory frameworks governing stock options,[2] many emerging capital markets, including Azerbaijan, lack clear legal structures for their effective implementation.[3] The U.S. thus serves as one of the most tested and instructive jurisdictions in this field. The advantages and challenges of implementing legal transplants of the U.S. stock option regulatory frameworks in Azerbaijan are examined in this thesis. Therefore, the primary research question of this thesis is how Azerbaijan could introduce and effectively regulate stock options and their uses by transplanting and adapting the relevant laws and best practices from the U.S.

The study also examines how stock options can function as effective tools for incentivizing employees in emerging markets. It offers policy recommendations for Azerbaijani lawmakers and businesses aiming to implement a regulatory model that balances market development with employee protection. The research combines legal and economic perspectives and contributes to broader discussions on equity compensation, innovation, and talent retention in developing economies.[4]

In addition, the thesis considers the legal structure of stock option compensation plans, including the protective role of shareholder ratification, except in cases where the size of such

[2] William W Bratton, *Corporate Finance: Cases and Materials* (Ninth edition, West Academic Foundation Press 2021), 221-232.
[3] Ulvia Zeynalova-Bockin, 'DERIVATIVES REGULATION IN AZERBAIJAN' (2016) 36, 1-3.
[4] Jerry W Markham, *Corporate Finance: Debt, Equity, and Derivative Markets and Their Intermediaries* (3rd ed., Thomson/West 2011), 781-803.

plans constitutes corporate waste.[5] Ultimately, the thesis aims to provide implementable guidance for legislative reform regarding stock options in Azerbaijan.

[5] 'Lewis v Vogelstein (Court of Chancery of Delaware, 1997) 699 A.2d 327' (*Justia Law*).

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LIST OF ABBREVIATIONS

AR	Azerbaijan Republic
CC	Civil Code of Azerbaijan Republic
DGCL	Delaware General Corporation Law
IFC	International Finance Corporation
MBCA	Model Business Corporation Act
NYBCL	New York Business Corporation Law
NYSE	New York Sock Exchange
CBA	Central Bank of Azerbaijan Republic
IRC	Internal Revenue Code

1. INTRODUCTION

1.1 Significance of the topic

Stock options, a form of derivative instrument, are widely recognized for their dual role: as investment, hedging tools, and as corporate officer and employee incentives.[6] In developed markets, especially in the U.S., they are central to corporate compensation structures, particularly in high-growth industries.[7] However, their application and regulatory treatment in emerging capital markets remain limited and underdeveloped.[8]

This thesis focuses on stock options because they can play a critical role in fostering entrepreneurial growth, improving corporate governance, and retaining skilled talent.[9] In the context of Azerbaijan, where capital markets are still developing, introducing structured and legally supported stock option plans could provide a significant boost to both public and private enterprises.[10] Despite these potential benefits, there is currently no specific law governing stock options in Azerbaijan. This has led to a lack of clarity on how such instruments could be legally used. Therefore, understanding how a tested jurisdiction like the U.S. regulates and applies stock options can provide important guidance for shaping a suitable Azerbaijani legislative framework.

[6] Markham (n 3).
[7] 'THE NEXT BEST THING TO FREE MONEY SILICON VALLEY'S STOCK-OPTION CULTURE IS DOING A WHOLE LOT MORE THAN MAKING TECHIES RICH. IT'S TAKING OVER THE COUNTRY. IS THAT GOOD OR BAD? - July 7, 1997' <https://money.cnn.com/magazines/fortune/fortune_archive/1997/07/07/228627/> accessed 15 June 2025.
[8] 'International Organization of Securities Commissions, Development of Emerging Capital Markets: Opportunities, Challenges and Solutions' <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD663.pdf> accessed 15 June 2025.
[9] 'Understanding Your Compensation Package: What Are Stock Options and How Do They Work?' (2 April 2025) <https://n26.com/en-eu/blog/what-are-stock-options> accessed 15 June 2025.
[10] Zeynalova-Bockin (n 2), 4.

1.2 The Jurisdictions within the Purview of the Thesis

This thesis adopts a comparative legal methodology, focusing primarily on the U.S., specifically Delaware, and one Model Business Corporation Act (MBCA) jurisdiction (New York) in comparison with Azerbaijan. The U.S. has the most advanced legal infrastructure concerning equity compensation, combining federal securities law, state corporate law, and an extensive body of case law.[11] Delaware was chosen due to its prominence in U.S. corporate law and the volume of stock option-related litigation, while New York represents a standardized MBCA state and offers a contrasting perspective.[12] Delaware jurisdiction was also preferred because of its rich case law practice, and it is known for its Delaware Court of Chancery, which adjudicates a wide variety of cases involving commercial litigation.[13] Understanding the MBCA, a harmonized statutory framework that simplifies the legal treatment of stock options, is crucial as it is followed by 30 U.S. states.[14] These jurisdictions offer comprehensive models of how stock option plans are regulated and executed, both from a statutory and case law standpoint.

1.3 Research and Methodology Issues

In conducting this research, one of the major challenges was the scarcity of publicly available legal sources and case law from Azerbaijan. The lack of Azerbaijani court decisions, legal commentary, and scholarly articles on stock options severely limited the ability to analyze the domestic regulatory environment in depth. This deficiency may be attributed to several factors, including the underdevelopment of the capital market, limited use of equity-based

[11] Markham (n 3).
[12] ibid.
[13] 'What Is the Delaware Court of Chancery? | Harvard Business Services' (*The HBS Blog*) <https://www.delawareinc.com/blog/what-is-the-delaware-court-of-chancery> accessed 15 June 2025.
[14] 'Model Business Corporation Act Resource Center' <https://www.americanbar.org/groups/business_law/resources/model-business-corporation-act/> accessed 15 June 2025.

compensation by Azerbaijani companies, and low levels of transparency in corporate litigation. These methodological challenges necessitated a heavier reliance on theoretical and comparative analysis, using the U.S. model as a benchmark while identifying the specific legal gaps in the Azerbaijani framework. Azerbaijan's experience under Soviet socialist governance has significantly contributed to the scarcity of sources and limited development of broad legal and corporate practice in the area.

1.4 Roadmap to the Thesis

The structure of the thesis has been designed in a way to gradually build an understanding of stock options, addressing both theoretical and practical standpoints, starting with foundational concepts, culminating in policy recommendations. In light of that, after this Chapter 1 containing the hereinbefore Introduction, Chapter 2 begins with a detailed analysis of the legal definition, historical development, and economic functions of stock options. It explains their structure, types, and their role in corporate governance and labor markets. Therefore, Chapter 2 acts as a background part and sets the scene for further analysis. Chapter 3 examines the U.S. regulatory framework governing stock options, with a focus on Delaware and MBCA. It outlines federal securities regulation, key case law, and corporate governance practices that shape how stock options are used and enforced. Following this, Chapter 4 shifts to the Azerbaijani legal framework. It identifies existing legislative gaps and uncertainties regarding the regulation and the practice of stock options. Particular attention is given to securities law, tax law provisions that may indirectly affect the use of such instruments. Finally, The Conclusion concludes with policy recommendations tailored for Azerbaijani legislators, regulators, and businesses. It suggests a regulatory framework that balances flexibility, legal certainty, and investor and employee protection.

This structure ensures a logical progression from problem identification to solution formulation, with each chapter laying the background for the next. The overall aim is to provide

both academic and practical recommendations for advancing stock option regulation in Azerbaijan and similar emerging markets.

2. STOCK OPTIONS DEFINED: A U.S. PERSPECTIVE

2.1 Concept and history of derivatives

"All wise rulers in all ages have valued cereals (i.e. rice) and despised money."

18th century, Japanese idiom

Derivatives are financial instruments whose value is derived from underlying assets or transactions.[15] The underlying asset might be equity securities, debt securities, interest in funds, interest rates, credit risk, energy, and so on.[16] The most frequently used types of derivatives are futures, forwards, swaps, and options in the U.S.[17] Although the use of derivatives can be seen as a new activity in the business world, the logic behind derivatives was known and used in ancient times, too.

The origins of derivatives can be traced back over 4000 years.[18] In later periods, such as during the Byzantine Empire, agreements for the future delivery of goods are believed to have been used throughout the Eastern Mediterranean and Western Europe.[19] There is historical evidence that an organized derivatives market operated in Osaka, the center of Japan's rice trade, in the early 18th century.[20] In this market, traders and buyers drew up documents called "rice vouchers".[21] These vouchers represented the right to receive a certain quantity of rice at a future

[15] 'Derivatives - The Key Principles | Westlaw UK' (*Practical Law*) <https://uk.practicallaw.thomsonreuters.com/Document/ID09725D0025011DFAE1CE645A47DA29D/View/FullText.html?originationContext=document&transitionType=DocumentItem&ppcid=6e1e57d792054e49b85fa82fa0fa5349&contextData=(sc.Default)&comp=wluk> accessed 15 June 2025. 1.

[16] ibid.

[17] Markham (n 3).

[18] Christian Pauletto and Steve Kummer, *The History of Derivatives: A Few Milestones* (2012). 1-4.

[19] ibid.

[20] 'History of Derivatives | FOW' <https://www.fow.com/insights/history-of-derivatives> accessed 15 June 2025.

[21] ibid.

date at a pre-agreed price.[22] These rice vouchers are considered one of the earliest and most formal examples of forward contracts.[23] The main advantage of using derivatives from ancient times, with or without direct intention, is shifting the risks from one party to another party that is more able to assume the risk, with the latter party aiming to make more money from it.[24] Under the Code of Hammurabi, Mesopotamian law, the 48th law in contract terms can be understood in modern languages as follows.[25] A farmer who mortgages his land must pay annual interest on the grain. However, if his crop fails, he is not required to pay, and the lender must accept the loss without recourse. It will be classified as a put option in modern terminology. This means that if the farmer has a good harvest and can afford to pay the interest, the option is not exercised.[26] However, if the harvest is poor, the farmer can choose not to pay, essentially "exercising" his right under the contract to avoid paying interest. From the perspective of U.S. securities law, if we were to analyze this ancient transaction under the Howey test, which determines whether a financial arrangement qualifies as an "investment contract" and thus a security, we would assess whether there is 1) an investment of money, 2) in a common enterprise, 3) with an expectation of profits, 4) derived from the efforts of others.[27] In this case, while there is a transfer of value (the mortgage), there is no expectation of profit by the farmer through the efforts of another; rather, the risk and performance depend on natural factors like harvest yield. Therefore, this arrangement would likely fall outside the scope of a security under the Howey test, reinforcing its classification as a contractual derivative rather than an investment contract.[28]

[22] ibid.
[23] ibid.
[24] Alan N Rechtschaffen, *Capital Markets, Derivatives, and the Law: Positivity and Preparation (Edition 3)* (Third edition, Oxford University Press 2019).
[25] Pauletto and Kummer (n 17).
[26] ibid.
[27] 'SEC v. W.J. Howey Co., 328 U.S. 293 (1946)' (*Justia Law*) <https://supreme.justia.com/cases/federal/us/328/293/> accessed 15 June 2025.
[28] ibid.

2.2 Key features of options

An option is a contract that gives its owner the right to buy or sell an underlying asset at a predetermined price on the date of contract conclusion.[29] The premium refers to the price paid by the buyer of an option and reflects a dynamic measure of the factors that affect the option's value.[30] Option contracts can be categorized into different types based on the rights granted to the derivative's owner. A "call" option contract gives the right to "call" (buy) the asset away from the seller in the future at a pre-agreed price.[31] In the contrary, a "put" option gives the owner the right to sell an asset in the future at a pre-agreed price.[32]

The nature of option contracts may vary based on the timing flexibility of exercising options in different jurisdictions. The "American" option allows the owner to exercise the option at any time before expiration.[33] In contrast, "European" and "Bermuda" (hybrid) options are subject to restrictions on exercise dates, and exercise is only possible on specific dates or only on the expiration date.[34] In Azerbaijan, the law does not yet provide a detailed classification or recognition of such option types. The legislation, particularly the CC and "Law on Securities", mention derivative instruments in general but lack specific provisions distinguishing between American, European, or hybrid-style options.[35]

Understanding basic types of options is essential before considering their application in real-world trading and practice. Stock options are option contracts in which the underlying asset is stock.[36] They can be exercised until the expiration date of a stock option at a specific time and a pre-agreed price.[37] For the sake of clarity and consistency, the terms: option and stock option

[29] Bratton (n 1).
[30] Rechtschaffen (n 23).
[31] Bratton (n 1).
[32] ibid.
[33] Ronald H Filler, *Regulation of Derivative Financial Instruments: (Swaps, Options and Futures) : Cases and Materials* (West Academic Publishing 2014).
[34] ibid.
[35] Zeynalova-Bockin (n 2).
[36] Markham (n 3).
[37] ibid.

will be used interchangeably throughout this thesis unless otherwise expressly stated or clearly understood from the context.

2.3 Core characteristics and use of stock options

Options are usually considered a less expensive way of investing.[38] The reason is that the maximum loss that an investor can suffer is the loss of his premium price of an option.[39] Among the different types of options, one of the most widely used and practically significant is the stock option.[40] Stock options are a subset of derivative contracts in which the underlying asset is a share of stock.[41] They come in two main forms: call options, which give the holder the right to buy shares at a pre-determined price, and put options, which give the holder the right to sell shares at a pre-agreed price.[42] The value of options is directly tied to the market price of the underlying stock.[43]

Stock options are used for different purposes, including as an investment, hedging against stock price fluctuations, speculation, and, most notably, as an incentive for company officers and employees.[44] Stock option holders differ from stockholders in that they do not have the rights of a shareholder, in particular, voting and the right to dividends, if declared and distributed, until the stock option is exercised and the holder receives shares.[45] Three factors made option trading an attractive prospect for many people in finance for the following main reasons.[46] First options allow investors to gain exposure to the full value of an underlying asset by paying only a fraction of its cost, known as the premium.[47] This makes options a cost-efficient investment

[38] Philip Wood, *Title Finance, Derivatives, Securitisations, Set-off, and Netting* (Sweet & Maxwell 1995).
[39] ibid.
[40] 'Stock Options: Overview' (*Practical Law*) <https://uk.practicallaw.thomsonreuters.com/w-008-0930?transitionType=Default&contextData=%28sc.Default%29> accessed 15 June 2025.
[41] ibid.
[42] ibid.
[43] ibid.
[44] Sandy McKenzie, *Risk Management with Derivatives* (Macmillan 1992). 43-47.
[45] ibid.
[46] ibid.
[47] ibid.

strategy, as the potential loss is limited to the premium paid, while the potential gain can be significant.[48]

Second, stock options offer a high degree of flexibility, allowing investors to pursue different strategies such as hedging or speculation.[49] Hedging involves using financial instruments to offset potential losses in other investments.[50] For example, an investor holding many shares in a company can purchase put options to protect against a potential decline in the stock's price. If the stock price falls, the gain from the put option can help offset the loss in the value of the shares.[51] Thus, options serve as a form of insurance and risk management.[52]

Third, options enable investors to profit from market volatility, not just from rising or falling movements in stock prices.[53] Traders can use strategies such as straddles or strangles to benefit from significant price movements in either direction.[54]

Lastly, stock options provide strategic advantages in portfolio diversification and capital efficiency.[55] By using options, investors can create complex positions that mimic stock ownership or hedge against macroeconomic risks without tying up large amounts of capital.[56]

Stock options can be an attractive investment opportunity if there is a certain directional movement in the price of a stock, the right to "call" (buy) or "put" away (sell) that stock at a pre-agreed price.[57]

[48] ibid.
[49] ibid.
[50] 'Hedging - Definition, How It Works and Examples of Strategies' <https://corporatefinanceinstitute.com/resources/derivatives/hedging/> accessed 15 June 2025.
[51] ibid.
[52] McKenzie (n 43).
[53] ibid.
[54] ibid.
[55] ibid.
[56] ibid.
[57] Markham (n 3).

2.3.1 Stock options used for incentivization

While options are widely used by investors for speculation, hedging, or income generation, their most prevalent use is as a form of compensation for company officers.[58] Granting stock options to corporate officers and employees serves as a performance-based incentive, aligning their interests with those of shareholders.[59] Employees may also receive stock options, particularly in startups or technology firms, but this remains the exception rather than the rule.[60] In both cases, stock options function not only as a financial tool but also as a mechanism for talent retention and corporate growth. In such cases, companies grant employees the opportunity to purchase shares at a pre-determined price (known as the strike price) after a specified vesting period.[61] Vesting period refers to the time an owner of stock options must work for the company to gain non-forfeitable ownership over stock options.[62]

Granting stock options to employees has a dual function: in addition to serving as a capital market tool to attract employees and investors, it also introduces elements of collective ownership by giving employees a stake in the company.[63] As Manuel Castells (2000) noted, the practice of compensating workers wth stock options ironically revives elements of anarchist ideology, particularly the concept of self-management.[64] By becoming partially owned through capital, workers are no longer simply wage earners but are positioned as both owners and contributors to the success of the firm, blurring the traditional boundaries between labor and

[58] 'Stock Options: Overview' (n 39).
[59] 'What Are Employee Stock Options? | AngelList Education Center' (1 April 2022) <https://www.angellist.com/learn/employee-stock-options> accessed 15 June 2025.
[60] ibid.
[61] ibid.
[62] ibid.
[63] Kuntara Pukthuanthong and Thomas Walker, 'On the Pros and Cons of Employee Stock Options: What Are the Alternatives?' (2006) 4 Corporate Ownership and Control. 267-271
[64] Manuel Castells Oliván (Catalan; born 9 February 1942) is a Spanish sociologist. He is well known for his authorship of a trilogy of works, entitled The Information Age: Economy, Society and Culture. He is a scholar of the information society, communication and globalization. See: Wikipedia, 'Manuel Castells' (last modified 2 June 2025) https://en.wikipedia.org/wiki/Manuel_Castells accessed 2 June 2025.

capital.[65] This paradox is not entirely new. Historically, similar hybrid structures have emerged, such as the Ford Motor Company's use of hybrid certificates in the early 20th century, which granted employees partial ownership-like benefits without full shareholder rights.[66] These certificates served as a tool to align workers' interests with corporate success, much like modern stock options do, blending capitalist incentives with quasi-collectivist elements.[67]

Startups often use stock options as an incentive tool, offering equity-based compensation instead of competitive salaries due to limited cash flow.[68] By granting stock options, startups can attract, motivate, and retain talent by offering potential future ownership in the company.[69] Warren Buffett has criticized the way stock options are sometimes structured in corporate settings, noting that many stock options in the corporate world have worked that way: they have gained value not simply because management has done well with the capital they have received, but because of retained earnings.[70] This suggests that stock options can reward executives even without effective capital reinvestment, potentially creating a link between compensation and actual performance.

While stock options are widely used as executive incentives, they also present significant disadvantages, including misalignment with the interests of shareholders, potential dilution of stock prices owned by shareholders, governance risks, and an increase in derivative suits on misuse of stock option plans.[71] After granting stock options to executives, they might pursue short-term stock price increases rather than long-term company value, especially if their

[65] Pukthuanthong and Walker (n 62).
[66] 'Ford Stock Certificate: Everything You Need to Know' (*Pocket Option blog*, 24 March 2025) <https://pocketoption.com/blog/en/knowledge-base/trading/ford-stock-certificate/> accessed 15 June 2025.
[67] ibid.
[68] Andrew Pendleton and others, 'Theoretical Study on Stock Options in Small and Medium Enterprises : Final Report to the Enterprise-Directorate General, Commission of the European Communities'.
[69] ibid.
[70] Warren Edward Buffett is an American investor and philanthropist who currently serves as the chairman and CEO of Berkshire Hathaway. See: Wikipedia: https://en.wikipedia.org/wiki/Warren_Buffett (last access: 13.04.2025)
[71] Pukthuanthong and Walker (n 62).

compensation solely depends on the performance of stocks.[72] This leads to abusive practices like backdating of stock option plans or manipulative earnings management.[73] Another downside of stock option plans for executives is dilution of existing shareholder ownership when the executives exercise options and new shares are issued.[74] Granting of stock option plans to executives might lead to executives gaining substantial controlling power, shifting the balance of corporate power.[75] In jurisdictions like the U.S., shareholders may file derivative suits if they find that executives have misused stock option plans or breached fiduciary duties.[76] This opportunity may discourage companies from fully offering stock option plans.

[72] ibid.
[73] ibid.
[74] 'What Is Equity Dilution? A Guide' (*Morgan Stanley at Work*) <https://www.morganstanley.com/atwork/articles/what-is-equity-dilution> accessed 15 June 2025.
[75] ibid.
[76] Byron F Egan and Christopher R Bankler, 'Derivative Actions Under the Business Organizations Code'. 20-30.

3. REGULATION OF STOCK OPTIONS IN THE UNITED STATES

3.1 History of regulation of derivatives: stock options in the United States

The development of derivatives trading reflects a dual narrative: one marked by financial innovation and economic utility, and the other by controversy and systemic failure.[77] From their early origins in 17th-century Europe to their prominent role in the 2008 Financial Crisis (Credit Crunch), the evolution of derivatives has shaped global financial markets.[78] A comprehensive understanding of the role of derivatives in the Financial Crisis requires a comprehensive analysis of their historical trajectory and the regulatory frameworks that governed their use.[79] The use of derivatives has its roots in the agricultural sector, where farmers and traders were looking for ways to manage uncertainties in crop prices and seasonal markets.[80] Therefore, the development of derivatives markets in the U.S. is best understood through their early application in agriculture, particularly as the country shifted to a more connected and industrialized national economy in the mid-19th century.[81] While these instruments were originally tied to tangible goods like wheat or cotton, the underlying principle of risk management later evolved and found application in financial markets, including corporate settings.[82] This evolution gave rise to modern financial derivatives such as stock options, which, although structurally different from agricultural futures, serve a similar function of allocating and managing risk, this time within the context of equity ownership and executive compensation.[83] Thus, the historical development of derivatives in agriculture

[77] Michael S Barr, *Financial Regulation: Law and Policy* (Foundation Press 2016). 1066.
[78] ibid.
[79] ibid.
[80] ibid.
[81] ibid.
[82] ibid.
[83] ibid.

established the conceptual foundation for the sophisticated financial instruments used in corporate finance today.[84]

The NYSE was founded in 1791, and it did not take long for a stock options market to develop among informed and speculative investors.[85] However, since there was no centralized market, these early options transactions were conducted over the counter. Broker-dealers played a key role in facilitating this trade by matching buyers and sellers.[86] Each of the nuances of options, such as the exchange price, the expiration date, and the premium, had to be negotiated individually, resulting in a lack of standardization and limited market transparency.[87] Although stock options existed before 1950, they were rarely used as a form of executive compensation due to their unfavorable tax treatment: they were taxed like ordinary income.[88] According to a 2007 study published in the Journal of Economic History, this significantly reduced their attractiveness.[89] The landscape changed with the enactment of the Revenue Act of 1950, which introduced a provision that allowed executives to sell stock options at a lower capital gains tax rate of 25 percent.[90] This legislative change marked a turning point in the popularity and structure of stock-based executive compensation.[91]

Today, employee stock options have become a hallmark of Silicon Valley's flourishing economy.[92] People who get in on the ground floor of promising startups often see millions of dollars in returns when their companies eventually go public or are acquired.[93] The stories of

[84] ibid.
[85] 'Stock Option History - The Options Playbook' <https://www.optionsplaybook.com/options-introduction/stock-option-history> accessed 15 June 2025.
[86] ibid.
[87] ibid.
[88] Wan-Kyu Park and Toni Smith, 'On the Progress of Option-Regulating Legislation' (2004) 2 The ATA journal of legal tax research 75-83.
[89] ibid.
[90] ibid.
[91] ibid.
[92] 'THE NEXT BEST THING TO FREE MONEY SILICON VALLEY'S STOCK-OPTION CULTURE IS DOING A WHOLE LOT MORE THAN MAKING TECHIES RICH. IT'S TAKING OVER THE COUNTRY. IS THAT GOOD OR BAD? - July 7, 1997' <https://money.cnn.com/magazines/fortune/fortune_archive/1997/07/07/228627/> accessed 15 June 2025.
[93] ibid.

people who got rich with stock options in Silicon Valley highlight how these incentives have evolved into a powerful tool for attracting and retaining talent in the dynamic world of technology.[94]

3.2 Use of Stock Options in the U.S.

3.2.1. Stock options as executive compensation in the U.S.

Stock options give the holder the right to benefit from increases in the value of a company's shares between the grant and exercise dates.[95] However, holders do not have shareholder rights until they exercise the option and receive actual shares.[96] Stock options have been one form of compensation in the U.S. and other countries for many years, reaching their highest popularity during the 1990s market boom.[97] While they were originally offered mainly to executives and key employees, they eventually became widespread among all employees, particularly in high-growth industries.[98]

Their popularity declined in the 2000s due to several factors: 1. New accounting rules in 2006 that required expensing options;[99] 2. Scandals involving stock option backdating.[100] For example, on April 24, 2007, the SEC filed charges against two former senior executives of Apple, Inc. for participating in the fraudulent backdating of options granted to Apple's top officers that caused the company to underreport its expenses.[101] Another scandal involves

[94] ibid.
[95] Tito Boeri and others, *Executive Remuneration and Employee Performance-Related Pay: A Transatlantic Perspective* (1st edn, OUP Oxford 2013).
[96] 'Stock Options Explained: Types of Options & How They Work' (*Carta*) <https://carta.com/learn/equity/stock-options/> accessed 15 June 2025.
[97] Boeri and others (n 94).
[98] ibid.
[99] ibid.
[100] Backdating refers to the process of altering the date of granting of stock options to the earlier date when the price of stock options was particularly low and gaining immediate income without exercising stock options or paying taxes on it. Aharon Mohliver, 'How Misconduct Spreads: Auditors' Role in the Diffusion of Stock-option Backdating'Administrative Science Quarterly, Vol. 64, No. 2 (June 2019), pp. 312-313
[101] 'SEC.Gov | Nancy R. Heinen and Fred D. Anderson', Litigation Release No. 20086 / April 24, 2007 <https://www.sec.gov/enforcement-litigation/litigation-releases/lr-20086> accessed 15 June 2025.

Marvell Technology Group, Ltd, where SEC charged Marvell Technology Group, Ltd., and former chief operating officer Weili Dai for providing potentially lucrative "in-the-money" options (granted at below-market prices) to employees, then backdatng them to earlier dates with lower stock prices, and falsely representing that the options had been granted "at-the-money" (at market price) on earlier dates.[102] 3. The 2008 financial crisis and the Dodd-Frank Act of 2010 introduced shareholder “say-on-pay” votes.[103]

Stock options offer several advantages. They can be cost-effective for companies, particularly since non-qualified stock options provide a tax deduction upon exercise.[104] They may motivate employees by aligning their interests with shareholders through participation in the company’s growth.[105] Stock options can also support employees’ long-term savings goals and, in some cases, offer favorable tax treatment.[106]

However, stock options also come with notable disadvantages. Their tax treatment is complex and often difficult for employees to fully understand.[107] Unless tied to individual performance metrics, options may reward general company performance rather than personal contributions.[108] However, it is crucial to note that it differs in the case of corporate officers, where personal performance also plays an important role in the granting of stock options.

[102] ‘SEC.Gov | Marvell Technology Group, Ltd. and Weili Dai’ <https://www.sec.gov/enforcement-litigation/litigation-releases/lr-20559> accessed 15 June 2025.
[103] Boeri and others (n 94).
[104] ibid.
[105] ibid.
[106] ‘Understanding Stock Options’ (*Morgan Stanley at Work*) <https://www.morganstanley.com/atwork/employees/learning-center/articles/understanding-stock-options> accessed 15 June 2025.
[107] Boeri and others (n 94).
[108] ibid.

If the company's stock fails to rise, options lose much of their incentive value compared to Restricted Stock Units[109] (RSU).[110] Additionally, employees must pay the exercise price to realize any benefit, and options are often challenging to value accurately.[111]

The effectiveness of a stock option plan depends heavily on the company's specific goals and the individuals it aims to incentivize.[112] Options tend to be most effective for high-growth companies where employee performance has a direct impact on stock value.[113] Conversely, they may not be suitable for private companies with no plans to go public or be acquired, as there is no liquid market for the stocks.[114]

3.2.2. Types of stock options

There are two types of stock options: incentive stock options (ISO) and nonqualified stock options (NSO), which differ primarily in how and when they are taxed.[115] For an option to qualify as an ISO under U.S. tax law, it must meet several strict requirements. [116] First, the option must be granted under a written plan that specifies the total number of shares available for issuance and the class of employees eligible to receive options.[117] The shareholders must approve this plan within 12 months before or after its adoption.[118] The ISO must be granted within 10 years of the plan's adoption or shareholder approval, whichever comes first, and it

[109] Restricted stock units give employees interest in their employer's equity but have no tangible value until they are vested. Unlike options, RSUs will still be worth something even if the stock price goes down. ibid. accessed 15 June 2025.
[110] Boeri and others (n 94).
[111] ibid.
[112] 'Understanding Stock Options' (n 105).
[113] 'Stock Options Explained: Types of Options & How They Work' (n 95).
[114] ibid.
[115] 'Stock Options: Overview' (n 39).
[116] ibid.
[117] '26 U.S. Code § 422 - Incentive Stock Options' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/uscode/text/26/422> accessed 16 June 2025.
[118] ibid.

cannot be exercisable more than 10 years after the grant date.[119] The option exercise price must be no less than the fair market value of the stock at the time of the grant.[120]

ISOs must also be non-transferable, except by will or inheritance, and can be exercised only by the individual during their lifetime.[121] Additionally, the option holder must not, at the time of the grant, own more than 10 percent of the total voting power of all classes of the employer's stock unless the exercise price is at least 110 percent of the fair market value and the option expires within five years.[122] Importantly, ISOs cannot contain a provision stating that they will not be treated as such, and they are disqualified if the employee elects to defer taxation under Section 83(i) for shares acquired upon exercise.[123] If all these conditions are satisfied, the stock option may qualify for favorable tax treatment as an ISO.[124]

3.2.3. Evolution of the stock option plans as executive compensation in the United States

Between 1970 and 2009, average CEO compensation in S&P 500 firms rose sharply, from about EUR 800,000 to EUR 6 million, reaching over EUR 12 million in 2000.[125] Most of this increase was driven by a rise in equity-based pay, especially stock options, which grew from a minor component in the 1970s to the dominant form by the late 1990s.[126] CEO pay also grew much faster than average worker wages by 2009: CEOs earned over 260 times more than production workers.[127] These trends were shaped by changes in tax policy, disclosure rules, accounting standards, and corporate governance reforms, often in response to public outcry

[119] ibid.
[120] ibid.
[121] ibid.
[122] ibid.
[123] ibid.
[124] ibid.
[125] Boeri and others (n 94).
[126] ibid.
[127] ibid.

over pay practices.[128] This evolution underscores how regulatory and policy factors play a significant role in shaping the U.S. executive compensation, with consequences that extend beyond worldwide.

Stock options gained popularity in the 1950s due to favorable tax treatment under the Revenue Act of 1950.[129] Restricted stock options allowed executives to pay lower capital gains taxes instead of higher income taxes.[130] However, tax reforms in 1964 and 1969 reduced their advantages, leading to a decline in use.[131] The stagnating stock market of the 1970s further discouraged stock option grants.[132]

During the 1990s, stock options became the dominant form of executive compensation in the U.S., driven by a convergence of regulatory, market, and political factors.[133] Key contributors included shareholder activism demanding pay-performance alignment, favorable tax treatment, and SEC and NYSE rule changes that facilitated broader use of stock options without shareholder approval.[134] Additionally, accounting rules allowed options to be granted without expensing them, encouraging the belief that options were a "costless" form of compensation.[135] Together, these factors contributed to an unprecedented rise in stock option grants, often without reducing other pay components, inflating overall executive compensation while embedding equity-based incentives in corporate governance.[136]

The early 2000s marked a significant shift in executive compensation from stock options to restricted stock, driven primarily by changing accounting standards and corporate scandals.[137] While the 2000 market crash and subsequent decline in stock prices initially diminished the

[128] ibid.
[129] Reece A Gardner, 'Employee Stock Options' (1952) 50 Michigan law review 414-418.
[130] ibid.
[131] Jack D Edwards, 'Executive Compensation: The Taxation of Stock Options' (1959) 13 Vanderbilt law review 475.
[132] Boeri and others (n 94).
[133] ibid.
[134] ibid.
[135] ibid.
[136] ibid.
[137] ibid.

attractiveness of stock options, the decisive factor was the introduction of FAS123R in 2005, which mandated firms to expense options at their grant-date fair value.[138] This removed the perceived accounting advantages of options over restricted stock.[139] Amid rising shareholder activism and scrutiny over corporate disclosures following major scandals, firms increasingly adopted restricted stock, which provided more predictable costs and payouts.[140] The shift reflects not just market conditions, but a broader transformation in governance and financial reporting practices.

3.3. Regulatory approach

> *"It should be our national policy to restrict, as far as possible, the use of these [futures] exchanges for purely speculative operations."*
>
> **President Franklin D. Roosevelt (message to Congress, Feb. 9, 1934)**

Congressional investigations after the 1929 crisis revealed that stock options enabled widespread market manipulation by allowing syndicates[141] to operate with minimal financial risk.[142] Although initially viewed as a tool for manipulation, stock options were ultimately preserved due to their perceived stabilizing function in the market.[143] In response to abuses revealed after the 1929 crash, early drafts of the Securities Exchange Act of 1934 proposed banning all stock options.[144] However, the Committee of Put and Call Brokers in New York opposed the ban, arguing that options had been used effectively for over 200 years.[145] They

[138] ibid.
[139] ibid.
[140] ibid.
[141] Syndicates are groups of investors or traders who pool their resources and coordinate actions to manipulate securities markets, often to create artificial price movements or corner a market. Markham (n 3).
[142] ibid.
[143] ibid.
[144] ibid.
[145] ibid.

emphasized that options provided protection against loss, stabilized markets, and offered small investors a low-risk way to hedge positions, much like insurance.[146] As a result, the final version of the Act did not prohibit options but placed them under the SEC's regulatory authority in Section 9.[147] The SEC did not exercise this authority until the launch of the Chicago Board Options Exchange (CBOE), when it adopted Rule 9b-1.[148] This rule allowed options trading only under SEC-approved plans and gave the SEC power to modify or reject those plans.[149]

The deregulation of financial markets in the United States during the late 20th century marked a fundamental shift in the structure of financial oversight.[150] Before the 1980s, the regulatory framework established under the New Deal subjected key financial instruments to stringent government control, aiming to mitigate systemic risk and ensure transparency in financial markets.[151] However, starting in the 1980s and gaining momentum throughout the early 1990s, critical financial assets, particularly derivatives, were increasingly exempted from these regulatory safeguards.[152] This shift in philosophy toward market liberalization, supported by both political and financial institutions, allowed the rapid expansion of over-the-counter (OTC) derivatives, which operated largely beyond the scope of regulatory scrutiny.[153] As noted by Lawrence Lessig, this exemption fostered a market environment wherein only insiders possessed meaningful knowledge of risk structures, ultimately undermining systemic stability.[154] This era of deregulation established the conditions for the opaque and risk-prone derivatives markets that would play a pivotal role in the 2008 Credit Crunch.[155]

[146] ibid.
[147] ibid.
[148] ibid.
[149] ibid.
[150] Matthew Sherman, 'A Short History of Financial Deregulation in the United States' [2009] CEPR, July 2009 8.
[151] ibid.
[152] ibid.
[153] ibid.
[154] Lawrence Lessig, *Republic, Lost: How Money Corrupts Congress--and a Plan to Stop It* (1st ed., Twelve 2011) 70.
[155] 'Legal Currents: Securities & Executive Compensation, "The Impact of the Dodd-Frank Act on Executive Compensation and Corporate Governance" (August 2010)'

The regulatory approach to options and derivatives has continued to evolve, particularly since the 2008 Financial Crisis, which highlighted the systemic risks of unregulated OTC derivatives.[156] Today, the U.S. regulatory framework for derivatives is being shaped by the Dodd-Frank Wall Street Reform and Consumer Protection Act, which aims to increase transparency and reduce systemic risk in derivatives markets.[157]

Much of derivatives regulation is based on the assumption that derivatives are inherently riskier than other financial instruments.[158] This perception has led to laws that treat all derivatives equally, often regulating them as if they pose a unique risk, even though not all derivatives necessarily pose the same level of systemic risk.[159] The term "blunderbuss strategy" describes the comprehensive nature of this regulatory approach.[160] It is comparable to trying to hit a specific target with a shotgun (a blunderbuss): all derivatives are regulated as if they present identical risks, when in fact they may not all pose the same level of danger.[161] The reforms carried out over the past century and their consequences demonstrate the important need for strong regulatory frameworks in derivatives markets.[162] At the same time, providing certain incentives, such as tax privileges for employee stock options, can encourage the constructive use of derivatives while maintaining market stability and fairness.

<https://www.hselaw.com/files/Impact_of_the_Dodd-Frank_Act_on_Executive_Compensation_and_Corporate_governance.pdf> accessed 16 June 2025.

[156] Barr (n 76).

[157] 'Legal Currents: Securities & Executive Compensation, "The Impact of the Dodd-Frank Act on Executive Compensation and Corporate Governance" (August 2010)' (n 154).

[158] Steven L Schwarcz, 'Regulating Derivatives: A Fundamental Rethinking' (2020) 70 Duke law journal 557.

[159] ibid.

[160] ibid.

[161] ibid.

[162] ibid.

3.3.1. The Dodd-Frank Act and its impact on executive stock options

Following the 2008 Financial Crisis, the Credit Crunch, the U.S. Congress enacted comprehensive financial regulations to prevent future economic downturns.[163] This law, known as the Dodd-Frank Wall Street Reform, included measures such as the Volcker Rule, which limited banks' ability to trade their funds.[164] It also strengthened oversight of systemic risks, applied stricter regulations on financial products, and introduced consumer protection initiatives.[165] The Dodd-Frank Wall Street Act (Title 7) was drafted to promote four principles: transparency of pricing and trading of derivatives, reduced systemic risk through the use of clearinghouses, as well as capital and margin rules, business conduct regulation of dealers and market participants, and oversight of trading and clearing facilities.[166] The Dodd-Frank Act represents the most comprehensive financial regulatory reform since the Great Depression of the 1930s.[167] It aims to promote financial stability, achieving a "too big to fail" outcome, protecting consumers, and creating transparency in previously unregulated areas such as derivatives markets.[168]

While much of the Dodd-Frank Act focuses on systemic financial risks and the regulation of derivatives markets generally, several provisions are of direct relevance to stock options, particularly those granted as executive compensation.[169] One of the most important is the "say-on-pay" provision under the Dodd-Frank Act, which requires public companies to submit executive compensation packages, including stock options, for regular, non-binding

[163] 'Legal Currents: Securities & Executive Compensation, "The Impact of the Dodd-Frank Act on Executive Compensation and Corporate Governance" (August 2010)' (n 154).
[164] ibid.
[165] Robert E Prasch, 'The Dodd-Frank Act: Financial Reform or Business as Usual?' (2012) 46 Journal of economic issues 549-556.
[166] Barr (n 76).
[167] ibid.
[168] Schwarcz (n 157).
[169] 'Legal Currents: Securities & Executive Compensation, "The Impact of the Dodd-Frank Act on Executive Compensation and Corporate Governance" (August 2010)' (n 154).

shareholder votes.[170] Although these votes have no legal force, they increase transparency and place greater obligations on boards to align executive compensation with performance. Furthermore, the law introduced stricter disclosure requirements, obliging companies to report the ratio of CEO compensation to average employee pay and to disclose the use and structure of performance-based compensation, including stock awards.[171] These reforms aim to prevent excessive risk-taking due to poorly structured stock option plans, thereby strengthening corporate governance and investor protection.[172] While Dodd-Frank did not regulate stock options as financial instruments, it did provide greater oversight and transparency regarding their use in executive compensation systems.[173]

3.4.1. "Say on pay" provisions and Disclosure requirements

A key provision of the Dodd-Frank Act is the so-called say-on-pay vote.[174] Public companies are required to allow their shareholders to vote on executive compensation packages.[175] This vote is non-binding but provides shareholders with an opportunity to express their opinion on executive compensation.[176]

Before the adoption of the Dodd-Frank Act, several companies voluntarily implemented say-on-pay voting, allowing shareholders to vote on executive compensation.[177] However, the Dodd-Frank Act marked a turning point, as it was the first law requiring regular, non-binding

[170] 'DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT' <https://www.congress.gov/111/plaws/publ203/PLAW-111publ203.pdf> accessed 16 June 2025 s 951.
[171] ibid.
[172] Schwarcz (n 157).
[173] 'DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT' (n 169).
[174] Andy Tsang and Joseph Bachelder, 'What Has Happened To Stock Options?' (*The Harvard Law School Forum on Corporate Governance*, 2 October 2014) <https://corpgov.law.harvard.edu/2014/10/02/what-has-happened-to-stock-options/> accessed 16 June 2025.
[175] ibid.
[176] ibid.
[177] Tyler Huddleston, 'Say on Pay in the Dodd-Frank Act: Implications of the Results in the United Kingdom' (2012) 11 Washington University global studies law review 483.

say-on-pay votes for all companies listed on U.S. stock exchanges.[178] The introduction of the say-on-pay provision in the Dodd-Frank Act not only strengthened shareholder influence over executive compensation but also established a standardized approach for all publicly traded companies, ensuring transparency and accountability in executive compensation.[179]

In addition to the "say-on-pay" provisions, the Dodd-Frank Act introduced several important disclosure requirements aimed at improving transparency and accountability in executive compensation, including stock options.[180] New regulations require disclosure of the role and potential conflicts of interest of compensation advisors or consultants.[181] It also requires the SEC to direct stock exchanges to adopt listing standards that ensure greater independence of compensation committee members.[182] Disclosure requirements are also being expanded to include the relationship between executive compensation and company performance, as well as the relationship between CEO compensation and the median compensation of all other employee metrics, which often include equity-based instruments such as stock options.[183] The law authorizes the SEC to order stock exchanges to delist companies that do not maintain effective clawback policies for incentive compensation, such as stock options, granted based on inaccurate financial statements.[184] Furthermore, companies must disclose whether their executives or employees are permitted to hedge against potential stock price declines, a practice that can weaken the intended motivational effect of stock options.[185] Taken together, these measures are intended to promote the responsible and transparent use of stock-based compensation consistent with long-term shareholder interests.

[178] ibid.
[179] ibid.
[180] 'DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT' (n 169).
[181] ibid s. 952.
[182] ibid s. 952.
[183] ibid s. 953.
[184] ibid s. 954.
[185] ibid s. 954.

3.4. State-level regulation of stock options in the United States

In the U.S., the regulation of stocks varies at the state level, with Delaware and New York (a jurisdiction influenced by the MBCA) offering distinct but influential legal approaches. Delaware, the state with the highest rate of business formation, plays a central role in shaping corporate governance practices, including the use of stock options.[186] Under the Delaware General Corporation Law (DGCL), stock option plans must be approved by the company's board of directors.[187] Shareholder approval is also generally required under federal tax law when options are granted as equity compensation to directors or officers.[188] Delaware courts have developed extensive case law clarifying fiduciary duties related to the issuance of options. For example, in *Lewis v. Vogelstein* (1997), the court emphasized that option grants are subject to fiduciary duties and a comprehensive fairness scrutiny if made without proper shareholder approval or if board members personally benefit.[189] In contrast, New York State, which follows a version of the MBCA, also requires board approval for stock option grants and includes provisions designed to protect shareholders by mandating disclosure requirements and compliance with the company's purpose.[190] Under the New York Business Corporation Law (NYBCL), Section 505 permits the issuance of rights and options provided the board acts in good faith and the best interest of the company.[191] Although New York lacks as rich a legal tradition in this area as Delaware, it adheres to the principles of the MBCA, which promote transparency and protect against abuse in executive compensation. Overall, while Delaware

[186] C Stephen Bigler and Pamela H Sudell, 'In Recent Opinions, the Delaware Court of Chancery Has Denied Motions to Dismiss Stockholder Complaints That Directors Who Approved Backdated or Spring-Loaded Options Had Breached Their Fiduciary Duties to Their Corporations and Stockholders. The Authors Discuss These Cases and Review Other Possible Challenges to Option Grants under Delaware Law.'
[187] 'DGCL, title 8 subsection 157 <https://delcode.delaware.gov/title8/c001/sc05/index.html> accessed 16 June 2025.
[188] '26 CFR § 1.422-3 - Stockholder Approval of Incentive Stock Option Plans.' (*LII / Legal Information Institute*) <https://www.law.cornell.edu/cfr/text/26/1.422-3> accessed 16 June 2025.
[189] Lewis v. Vogelstein (Court of Chancery of Delaware, 1997) 699 A.2d 327
[190] MBCA 6.24
[191] NYBCL, 505

offers a more flexible but legally scrutinized environment, MBCA-based jurisdictions like New York offer a more standardized legal framework with built-in shareholder protections and the key differences arise from procedural and governance issues.[192]

3.4.1. The Case of *Lewis v. Vogelstein*

The 1997 Delaware Chancery Court decision in *Lewis v. Vogelstein* marked a significant turning point in the judicial treatment of executive compensation, particularly the granting of stock options to directors.[193] This shareholder lawsuit challenges a stock option plan for the executive officers of Mattel, Inc., which was approved or ratified by the company's shareholders at its 1996 annual meeting of stockholders.[194] The court took a restrained approach, holding that directors have no fiduciary duty to disclose the estimated present values of stock options, such as those calculated using the Black-Scholes model, when seeking shareholder approval.[195] Instead, the court emphasized that disclosure requirements for complex financial instruments should be the responsibility of regulatory agencies such as the SEC.[196] Although the court allowed a corporate waste suit in extreme cases of alleged overcompensation, it reaffirmed the strong presumption in favor of shareholder-ratified compensation plans.[197]

This judicial deference led to a governance vacuum in which courts largely refrained from interfering in executive compensation decisions unless they met stringent standards for corporate waste.[198] Over time, this led to growing concerns about the adequacy of shareholder oversight and the risks of excessive or misguided incentives, particularly in the financial

[192] ibid.
[193] 'Lewis v Vogelstein (Court of Chancery of Delaware, 1997) 699 A.2d 327' (n 4).
[194] ibid.
[195] ibid.
[196] ibid.
[197] ibid.
[198] ibid.

sector.[199] These concerns reached a tipping point during the global financial crisis of 2008–2010, when incentive structures were widely criticized for encouraging short-term risk-taking.[200]

The Dodd-Frank Act of 2010 can therefore be seen as a legislative response to the limitations highlighted in cases such as *Lewis v. Vogelstein.* Where courts had rejected disclosure of option valuations or interference with compensation practices, Dodd-Frank introduced new levels of shareholder oversight, transparency, and accountability.[201] It introduced say-on-pay voting, mandated disclosure of CEO compensation ratios, imposed clawback obligations, and required independent compensation committees, all mechanisms designed to address problems that had long been left unaddressed by the courts.[202]

In this way, *Lewis v. Vogelstein* serves as a precedent for post-crisis regulatory change. The case illustrates why legislative reform, rather than judicial intervention, ultimately became the primary means of curbing excessive executive compensation and restoring investor confidence in corporate governance practices.

3.4.2. The Case of *In re Walt Disney Derivative Litigation*

The Delaware Chancery Court's decision in *In re Walt Disney Derivative Litigation* (2005) reaffirmed and expanded on the principles set forth in *Lewis v. Vogelstein* and painted a clearer picture of the judicial reluctance to scrutinize executive compensation approved by the board, even in cases of flawed governance processes.[203] The case of *In re The Walt Disney Co. Derivative Litigation* concerns the board's decision to approve a large severance package for

[199] Jerry W Markham, 'REGULATING EXCESSIVE EXECUTIVE COMPENSATION —WHY BOTHER?' 18
[200] ibid.
[201] Stuart Gelfond and others, 'Dodd-Frank Reform Brings Flexibility For Stock Compensation'.
[202] ibid.
[203] 'In Re THE WALT DISNEY COMPANY DERIVATIVE LITIGATION' (The Delaware Chancery Court 2005) <https://www.law.upenn.edu/live/files/6716-a> accessed 16 June 2025.

Michael Ovitz, former president of The Walt Disney Company.[204] The lawsuit was filed by Disney shareholders who alleged that the board breached its fiduciary duties and engaged in corporate waste.[205] The Disney board's approval of a compensation package that ultimately resulted in a $140 million severance payment for Michael Ovitz after only fourteen months of employment sparked public outrage and shareholder litigation.[206] Nevertheless, applying the business judgment rule, the court ruled that the board's actions constituted neither gross negligence nor bad faith.[207]

As in the case of *Lewis vs. Vogelstein*, the Disney court recognized governance failures, including the compensation committee's lack of comprehensive consultation and expert analysis.[208] But again, the court refrained from assigning liability, instead citing the subjective good faith and rational basis of the board's decisions.[209] Chancellor Chandler even described CEO Michael Eisner's dominance as autocratic but concluded that this did not constitute a breach of trust.[210]

This judicial reluctance to consider process over substance, absent evidence of disloyalty or deliberate misconduct, raised concerns among shareholders and commentators that boards could approve excessive compensation with impunity.[211] The courts sent a powerful signal: unless the process is seriously flawed and accompanied by bad faith, even highly questionable compensation decisions will be upheld.[212]

[204] ibid.
[205] ibid.
[206] 'In Re THE WALT DISNEY COMPANY DERIVATIVE LITIGATION' (n 202).
[207] ibid.
[208] ibid.
[209] ibid.
[210] ibid.
[211] ibid.
[212] ibid.

Taking these cases together, they demonstrate that fiduciary duties under Delaware law impose minimal practical restrictions on executive compensation, particularly where shareholder approval is present. They also underscore the gap between corporate governance best practices and legal requirements, a gap that increased public scepticism following corporate scandals such as Enron and WorldCom.

3.4.3. The Case of *Calma v. Templeton*

In contrast to *Lewis v. Vogelstein* and *In re Walt Disney Derivative Litigation*, in which Delaware courts demonstrated marked judicial restraint and reaffirmed a deferential attitude toward board-approved executive compensation*, Calma v. Templeton* represents a decisive turning point.[213] In this derivative action, a shareholder of Citrix Systems, Inc. challenged the compensation of non-employee directors.[214] He argued that their RSU awards, granted under a shareholder-approved stock option plan, were excessive, along with cash payments, compared to peer companies.[215] The court in *Calma v. Templeton* departed from traditional restraint by not considering general shareholder approval of a stock compensation plan as blanket approval of executive compensation.[216] Instead, it reaffirmed the role of the judiciary in reviewing self-serving compensation decisions under the "residual fairness" standard when shareholder approval lacks specific, board-focused limits.[217] Calma signalled a shift toward greater accountability and substantive oversight of board transactions and marked a turning point in Delaware jurisprudence, better aligning judicial standards with the heightened governance

[213] 'Insights, The Corporate & Securities Law Advisor, "Director Liability: New Delaware Court of Chancery Opinion Provides Guidance for Director Compensation Practices" Volume 29, Number 6, June 2015' <https://www.rlf.com/wp-content/uploads/2020/05/11804_Insights-0615_Zeberkiewicz.pdf> accessed 16 June 2025.
[214] 'Calma v. Templeton, COURT OF CHANCERY OF THE STATE OF DELAWARE, 2015'.
[215] ibid.
[216] ibid.
[217] ibid

expectations embodied in post-crisis reforms such as the Dodd-Frank Act.[218] Both Calma and Dodd-Frank represent parallel efforts, one judicial and one legislative, to ensure that director and executive compensation decisions are subject to effective oversight and aligned with shareholder interests.[219]

3.4.4. The Case of *Marx v. Akers*

Marx v. Akers reflects the New York judiciary's cautious approach to interfering with board-approved compensation decisions, particularly when procedural safeguards such as director independence and statutory authorization are ostensibly in place.[220] *In Marx v. Akers*, a shareholder derivatives case, the New York Court of Appeals addressed the question of lack of merit in shareholder derivatives litigation.[221] The case centered on allegations that IBM's board of directors wasted company assets by awarding excessive compensation to executives and outside directors during a period of declining profitability.[222] Although the court recognized that directors who set their own compensation are inherently acting self-interestedly, thus excusing a claim under Business Corporation Law Section 626(c), it ultimately dismissed the claim on the grounds that corporate waste was not sufficiently justified.[223] This illustrates the narrow judicial review function, where even self-dealing must involve blatant excess or bad faith to prevail. In contrast, *Calma v. Templeton* marked a more active approach under Delaware law by applying the entire fairness standard when director compensation lacked explicit shareholder-imposed limits.[224] Taken together, these cases reveal a crucial divergence:

[218] 'Legal Currents: Securities & Executive Compensation, "The Impact of the Dodd-Frank Act on Executive Compensation and Corporate Governance" (August 2010)' (n 154).
[219] ibid.
[220] 'Marx v. Akers, Court of Appeals of the State of New York, 1996' (*Justia Law*) <https://law.justia.com/cases/new-york/court-of-appeals/1996/88-n-y-2d-189-0.html> accessed 16 June 2025.
[221] ibid.
[222] ibid.
[223] ibid.
[224] 'Calma v. Templeton, COURT OF CHANCERY OF THE STATE OF DELAWARE, 2015' (n 213).

Marx v. Akers emphasized compliance with formal procedural requirements, whereas *Calma v. Templeton* emphasized the substantive fairness of directors' self-compensation.

4. THE UNITED STATES REGULATORY EXPERIENCE: LESSONS FOR AZERBAIJAN'S FINANCIAL SECTOR

4.1. Regulatory framework in Azerbaijan

The origins of capital market activities in Azerbaijan date back to the late 19th and early 20th centuries, marked by the establishment of the first trading platform, the Baku Stock Exchange, in 1886.[225] From the late 19th century onward, Baku developed into a major commercial hub by 1900 due to its strategic location on the Caspian Sea and its integration into the Russian railway network.[226] The region's economic transformation was driven primarily by breakthroughs in crude oil production, beginning with the first drilling by the Baku Society of Mining Engineers and the construction of the first oil refinery in 1872.[227] This rapid economic development laid the foundation for the emergence of financial institutions. Key milestones of this early phase include the issuance of bonds in 1909 to finance the construction of the Shollar Water Pipeline and the first share issue in 1913.[228] After Azerbaijan's accession to the Soviet Union in 1920, all banks and credit institutions were nationalized and placed under the control of the Azerbaijan People's Bank, which primarily handled household transactions and no longer granted loans.[229] The operations of the Baku Stock Exchange came to an end in 1930.[230]

In the 1920s, Lenin's New Economic Policy (NEP) reintroduced restricted stock market activity and the issuance of government bonds to mobilize citizens' savings for government needs.[231]

[225] 'The History of BSE' <https://www.bfb.az/en/the-history-of-bse> accessed 16 June 2025.
[226] Tofig Aliyev and Hajiaga Rustambeyov, 'ON A HISTORY OF DEVELOPMENT OF THE SECURITIES MARKET IN AZERBAIJAN' (2020) No 1 İPƏK YOLU No 1 5.
[227] ibid.
[228] 'The Baku Stock Exchange » Caspian Energy Club' (*Caspian Energy Club*) <https://caspianenergy.club/en/uzvler/767-the-baku-stock-exchange.html> accessed 16 June 2025.
[229] ibid.
[230] ibid.
[231] Aliyev and Rustambeyov (n 223).

These bonds were often mandatory, interest-free, and had no secondary market.[232] After the end of the NEP, government bonds such as the "Golden Credit" dominated the market in the 1980s, serving more as a tool for government financing than as an investment.[233] The lack of genuine financial instruments and the mandatory nature of participation led to widespread public distrust of non-cash financial institutions.[234] This distrust, rooted in the Soviet era, contributed to the growth of the shadow economy and continues to hinder the development of transparent capital markets in post-Soviet countries.[235] In Azerbaijan, these historical factors continue to pose major obstacles to the development of a securities market comparable to that in Western Europe.[236]

The early 1990s marked the collapse of the Soviet Union and the emergence of Azerbaijan as an independent republic.[237] Like other post-Soviet states, Azerbaijan suffered from severe political and economic instability, triggering financial crises and long-term socioeconomic challenges.[238] Despite these difficulties, the government initiated fundamental reforms, including the adoption of the first stock exchange law in 1992, demonstrating its recognition of capital markets as vital to economic development.[239] However, the lack of a regulatory framework and institutional capacity, coupled with the ongoing Karabakh conflict, hyperinflation, and mismanagement, hampered any significant market growth.[240]

[232] ibid.
[233] ibid.
[234] ibid.
[235] Osman Nuri Aras, Suleymanov Elchin and Karim Mammadov, *Economy of Azerbaijan : 25 Years of Independence* (2016).
[236] ibid.
[237] 'Collapse of the Soviet Union | Causes, Facts, Events, & Effects | Britannica' <https://www.britannica.com/event/the-collapse-of-the-Soviet-Union> accessed 16 June 2025.
[238] Aliyev and Rustambeyov (n 223) 5–18.
[239] ibid.
[240] OECD, *Securities Markets in Eurasia* (OECD 2005) <https://www.oecd.org/en/publications/securities-markets-in-eurasia_9789264012233-en.html> accessed 16 June 2025.

During this period, several financial institutions and quasi-stock exchanges emerged, such as Vahid Bank, Xeyal Bank, and the Baku Investment Stock Market.[241] These institutions operated with minimal oversight and often engaged in speculative and deceptive practices.[242] Their eventual collapse resulted in significant public losses and undermined confidence in financial institutions, a legacy that continues to hamper stock market development in Azerbaijan and other post-Soviet economies.[243]

By 1993, under the leadership of President Heydar Aliyev, reforms were initiated to stabilize the economy.[244] These included market liberalization, privatization, and the establishment of institutions such as the National Deposit Center "Mulk," which laid the foundation for a modern securities market.[245] By the mid-1990s, there were approximately 1,000 joint-stock companies and over 70,000 investors in Azerbaijan.[246] Key developments included the 1991 Cabinet decision to issue short-term government bonds and the establishment of the Baku Interbank Currency Stock Market in 1993.[247] However, the lack of coherent legislation and developed regulatory standards continued to limit market effectiveness. A turning point came in 1998 with the adoption of the Stock Exchange Law and the establishment of the State Committee for Securities, which created the first comprehensive legal and institutional framework for the Azerbaijani capital market.[248]

The reestablishment of the Baku Stock Exchange (BSE) in 1997 marked a significant milestone in the modernization of Azerbaijan's capital markets.[249] Trading officially began on September 1, 2000, and was gradually expanded to include corporate bonds, equities, and central bank

[241] Aliyev and Rustambeyov (n 219) 5-18.
[242] ibid.
[243] ibid.
[244] ibid.
[245] ibid.
[246] ibid.
[247] ibid.
[248] ibid.
[249] 'The History of BSE' (n 221).

bonds by 2004.[250] Over the years, the BSE has achieved several important milestones. Interbank REPO transactions were introduced in 2006, followed by mortgage bond trading in 2009.[251] The establishment of the first market-making institution in 2013 and the launch of SOCAR bonds and the centralized CETA trading platform in 2016 contributed to further improving the market infrastructure.[252] In 2018, the first securities issuance by a non-financial sector company was recorded.[253]

4.2. Financial Market Reform After Boom Years[254]

Azerbaijan's economy has long been heavily dependent on oil, which accounts for around 90% of its exports and a significant portion of its GDP.[255] This reliance made the country extremely vulnerable to external shocks, as demonstrated by the sharp decline in oil prices beginning in 2014.[256] The resulting decline in revenues led to currency devaluations, inflation, and a financial crisis characterized by rising non-performing loans and weakened bank balance sheets.[257] Macroeconomic instability, coupled with limited private sector development, highlighted the urgent need for diversification and structural transformation.[258] The introduction of new securities law and amendments to existing laws in Azerbaijan were

[250] ibid.
[251] ibid.
[252] ibid.
[253] ibid.
[254] In the history of Azerbaijan economy, 2007-2015 is characterised to be boom years due to high oil prices. Since the economy of Azerbaijan, is oil-based one, meaning the main revenues are from oil exports, the fall in petroleum prices since 2010 has made a huge impact on overall economy. https://www.postsovietarea.com/jour/article/view/332/301 last accessed: 02.06.2025; https://en.wikipedia.org/wiki/Economic_history_of_Azerbaijan last accessed: 02.06.2025.
[255] IMF News, 'Azerbaijan's Opportunity to Reboot, Diversify Economy' (*IMF*) <https://www.imf.org/en/News/Articles/2016/09/15/NA091516-Azerbaijan-Opportunity-to-Reboot-Diversify-Economy> accessed 16 June 2025.
[256] ibid.
[257] ibid.
[258] ibid.

primarily driven by these vulnerabilities, particularly the risks of oil dependence, and aimed at creating a more resilient, diversified, and internationally integrated financial system.[259]

4.2.1. Developments in Securities and Derivatives Regulation After the Boom Years

The adoption of the Law on Securities Market in 2015 marked a pivotal moment in Azerbaijan's efforts to modernize its financial infrastructure and align it with international standards.[260] The law, which entered into force on July 15, 2015, established a comprehensive legal framework for the issuance, registration, and public offering of securities and derivatives, while defining the roles, licensing requirements, and legal status of market participants such as investment agencies, stock exchanges, and the Central Depository.[261] With a strong focus on investor protection, the law introduced oversight mechanisms, clarified the multi-stage issuance process, and officially designated the National Depository Center as the central depository for risk management and accounting.[262] The Securities Market Law contains provisions on investor protection across multiple sections and underlines Azerbaijan's gradual alignment with international regulatory standards. However, the actual need for robust investor protection mechanisms may have been less urgent in Azerbaijan than in the U. S., where dispersed private ownership prevails. In Azerbaijan, the state and state-affiliated entities remain the largest shareholders in many companies, reducing the scope and urgency of protecting individual or minority investors.

[259] Zeynalova-Bockin (n 2).
[260] 'Azerbaijan's New Securities Market Law' (30 September 2015) <https://news.bloomberglaw.com/securities-law/azerbaijans-new-securities-market-law> accessed 16 June 2025.
[261] Law on Securities Market of the Republic of Azerbaijan (2015). Preamble. https://e-qanun.az/framework/30333 .
[262] ibid.

The adoption of the new law on securities explicitly recognized derivatives and established the legal basis for their trading and regulation.[263] Complementary amendments to the Civil Code introduced formal definitions of derivative financial instruments and distinguished them from speculative contracts, thereby granting them full legal recognition.[264] Secondary regulations of the State Securities Committee clarified the procedural rules for derivatives trading on the exchange. Although the 2015 law represented an important milestone, evolving market demands and practical challenges led to ongoing amendments.[265] Starting in 2025, the Central Bank and other stakeholders, including the Azerbaijan Finance and Banking Association, are actively working on a new draft law that will address current deficiencies and ensure that the legal framework continues to promote market development, investor protection, and broader economic participation.[266] The primary objective was to assess whether the legislation fully meets modern market requirements.[267] In addition to practical discussions on existing challenges, the goal is to develop a legal framework that supports market growth, protects investor rights, and strengthens business interests.[268]

To complement the 2015 Securities Market Law, the inclusion of Article 403-1 in the Civil Code of Azerbaijan represented a significant legal innovation, formally introducing and defining derivative financial instruments into the national legal system.[269] According to this

[263] ibid.
[264] Civil Code of the Republic of Azerbaijan (adopted 1999) article 403-1. https://e-qanun.az/framework/46944 .
[265] Zeynalova-Bockin (n 2).
[266] 'Azərbaycanda qiymətli kağızlarla bağlı yeni qanun layihəsi hazırlanır' (*Apa.az*) <https://apa.az/maliyye/azerbaycanda-qiymetli-kagizlarla-bagli-yeni-qanun-layihesi-hazirlanir-890244> accessed 16 June 2025.
[267] ibid.
[268] ibid.
[269] Civil Code,
Maddə 403-1. Törəmə maliyyə alətləri
403-1.1. Törəmə maliyyə aləti hər hansı baza aktivini almaq, satmaq və ya dəyişdirmək hüququnu təsbit edən müqavilədir. Baza aktivi qismində qiymətli kağız (investisiya fond payı istisna olmaqla), valyuta, faiz dərəcəsi, gəlirlik, törəmə maliyyə aləti, əmtəə, maliyyə indeksi, kredit riski və s. çıxış edə bilər.
403-1.2. Törəmə maliyyə alətlərinin standartlaşdırılmış formada fond birjası vasitəsilə yerləşdirilməsi və tədavülü qaydası Mərkəzi Bank tərəfindən müəyyən edilir. "Qiymətli kağızlar bazarı haqqında" Azərbaycan Respublikasının Qanununda nəzərdə tutulmuş hallarda törəmə maliyyə alətləri ilə əməliyyatlar digər ticarət

provision, a derivative financial instrument is a contract that establishes the right to buy, sell, or exchange an underlying asset, such as securities (excluding investment fund shares), currencies, interest rates, yields, other derivatives, commodities, financial indices, or credit risks.[270] The Civil Code further divides standardized derivatives into futures, options, and swaps, each of which differs in its structure and contractual nature.[271] Futures are agreements for the purchase or sale of a specified quantity and type of an underlying asset at a pre-determined price and date.[272] Options grant the holder the unilateral right to buy, sell, or swap the underlying asset.[273] Swaps involve an exchange of the same type of underlying assets between two parties.[274] The regulation of the issuance and circulation of standardized derivative instruments through the stock exchange is under the authority of the Central Bank of Azerbaijan, with alternative trading platforms applying their own rules if permitted under the securities legislation. Amendments to the Civil Code of Azerbaijan contributed

sistemində aparıldıqda, törəmə maliyyə alətlərinin yerləşdirilməsi və tədavülü həmin ticarət sisteminin qaydalarına müvafiq olaraq həyata keçirilir.
403-1.3. Törəmə maliyyə alətlərinə fyuçers, opsion və svop aiddir.
403-1.4. Fyuçers baza aktivinin müəyyənləşdirilmiş növdə və sayda əvvəlcədən razılaşdırılmış tarixə və qiymətə alqı-satqısı üzrə törəmə maliyyə alətidir.
403-1.5. Opsion sahibinə birtərəfli qaydada baza aktivini almaq, satmaq və ya svop etmək hüququnu verən törəmə maliyyə alətidir.
403-1.6. Svop iki tərəf arasında eyni növ baza aktivlərinin dəyişdirilməsi üzrə törəmə maliyyə alətidir.
Translation in English:
Article 403-1. Derivative Financial Instruments
403-1.1. A derivative financial instrument is a contract that establishes the right to buy, sell, or exchange any underlying asset. The underlying asset may be a security (excluding investment fund units), currency, interest rate, yield, another derivative financial instrument, commodity, financial index, credit risk, etc.
403-1.2. The rules for the placement and circulation of derivative financial instruments in standardized form through a stock exchange are determined by the Central Bank. In cases provided by the Law of the Republic of Azerbaijan "On the Securities Market," if transactions with derivative financial instruments are carried out on another trading system, their placement and circulation shall be conducted in accordance with the rules of that trading system.
403-1.3. Futures, options, and swaps are considered derivative financial instruments.
403-1.4. A future is a derivative financial instrument for the purchase or sale of a specific type and quantity of an underlying asset at a pre-agreed date and price.
403-1.5. An option is a derivative financial instrument that grants the holder the unilateral right to buy, sell, or swap the underlying asset.
403-1.6. A swap is a derivative financial instrument involving the exchange of the same type of underlying assets between two parties.
[270] Civil Code, art. 403-1.
[271] Civil Code, art. 403-1.3.
[272] Civil Code, art. 403-1.4.
[273] Civil Code, art. 403-1.5.
[274] Civil Code, art. 403-1.6.

significantly to legitimizing the use of derivative financial instruments in the country's legal and financial system.[275]

4.2.2. Stock Options in Azerbaijan

These reforms created a legal foundation for the issuance, registration, and trading of derivatives, including stock options, on licensed exchanges.[276] The BSE serves as a central platform for such transactions, although the derivatives market, including stock options, remains underdeveloped in practice. Issuers are required to register securities and derivatives with the CBA, submit a prospectus, and comply with disclosure and reporting requirements.[277] The regulatory framework includes investor protection measures such as mandatory disclosure of material information, oversight by the CBA, and a centralized depository system.[278] Minority shareholders of joint-stock companies are granted rights such as access to information, voting rights, and legal remedies.[279] While the tax law of AR regulates income from securities, the specific tax treatment of employee stock options is unclear. Furthermore, the use of stock options as part of corporate governance or employee incentive structures is not yet widespread and falls under general corporate and securities law.[280] Although stock options are legally permissible, their practical application in Azerbaijan is still in its development phase, with ongoing reforms focusing on market development, transparency, and alignment with international standards.[281]

[275] Zeynalova-Bockin (n 2).
[276] 'The History of BSE' (n 221).
[277] OECD (n 236).
[278] ibid.
[279] ibid.
[280] ibid.
[281] ibid.

4.3. Lessons and Recommendations for Azerbaijan

Stock option regulation in the United States reflects a complex interplay of legislative development, legal interpretation, and market dynamics. Originally introduced in the 1950s as a tax-advantaged compensation instrument, stock options emerged as a dominant form of executive compensation in the 1990s.[282] Their popularity was based on favourable tax treatment, minimal accounting burdens, and the perceived alignment of executive and shareholder interests.[283] However, scandals, regulatory reforms, and changing market realities revealed critical flaws in this model. The post-2000 period saw a decisive shift in regulatory priorities from a permissive framework to greater transparency, accountability, and shareholder oversight.[284] The passage of the Dodd-Frank Act in 2010 marked a turning point, not by regulating stock options as financial instruments, but by embedding them within a broader framework of executive compensation regulation.[285] Provisions such as say-on-pay, CEO pay ratio disclosure, clawback mandates, and hedging transparency reflect an effort to restore investor confidence and curb excessive or poorly structured compensation packages.[286]

At the state level, Delaware law remains highly influential, emphasizing fiduciary standards, shareholder confirmation, and consideration of business judgment.[287] However, cases such as *Lewis v. Vogelstein*, *In Re Walt Disney derivative litigation,* and *Calma v. Templeton* illustrate a gradual shift toward more substantive scrutiny, particularly when equity compensation plans lack clear limitations or controls.[288] In contrast, New York, based on the MBCA principles,

[282] Boeri and others (n 94).
[283] Edwards (n 130).
[284] Gelfond and others (n 200).
[285] Prasch (n 164).
[286] Huddleston (n 176).
[287] Bigler and Sudell (n 185).
[288] ibid.

offers a more codified and procedural framework, but continues to impose a high barrier to judicial intervention in compensation disputes.[289]

Overall, the US experience shows that a well-functioning stock option system must combine clear legal rules, transparent disclosure requirements, and institutional oversight mechanisms. While courts can defer to the board's judgment under the business judgment rule, laws such as the Dodd-Frank Act close this gap by giving shareholders more flexibility and strengthening standards of fairness and accountability.[290] This multifaceted regulatory approach offers valuable insights for emerging markets seeking to introduce stock options as both an incentive tool and a regulated instrument of corporate governance.

In light of the comparative legal analysis and the identified regulatory gaps in Azerbaijani law, this section outlines policy recommendations for the introduction and effective regulation of stock options in Azerbaijan. These measures are intended to promote legal certainty, stimulate investment, and facilitate the use of stock-based compensation in both private and public companies.

Azerbaijan should establish clear legal definitions and frameworks for stock options in relevant laws, such as the Securities Market Law. These provisions should define stock options, specify eligibility criteria, issuance procedures, and vesting conditions, terms of exercise, and clarify the legal nature and enforceability of stock option agreements. Such detailed codification would provide clarity and encourage adoption and use by local companies.

To ensure corporate responsibility and protect shareholder interests, Azerbaijan legislation should require mandatory shareholder approval of all stock option plans at general meetings, full disclosure of plan terms, beneficiaries, and potential dilution, as well as legal safeguards

[289] 'Marx v. Akers, Court of Appeals of the State of New York, 1996' (n 218).
[290] Prasch (n 164).

against excessive or abusive option grants, including recognition of the doctrine of corporate waste. These measures would improve corporate governance and increase confidence in stock option programs.

While the requirements of shareholder approval of stock option plans, full disclosure is crucial from a shareholder's rights perspective, the inclusion of the detailed rules in derivative litigation could enhance the applicability of this requirement and encourage greater shareholder engagement and adoption of such plans. Azerbaijani corporate law contains a general rule on this issue. The last sentence of Article 49.3 of the Civil Code states that a shareholder of a company may demand compensation from a responsible person for damages caused to the company.[291] However, it should be noted that this rule, in its current form, is not yet sufficiently developed, and several procedural issues still need to be clarified for its effective application.[292]

Stock option plans should be subject to increased transparency requirements: 1. Publication of information on stock options in annual reports and audited financial statements; 2. Oversight mechanism by independent compensation committees of companies, particularly in publicly listed companies (Banks); 3. Ongoing disclosure requirements for plan amendments and significant exercises. This approach is consistent with international best practices and strengthens market integrity and trust in securities markets.

[291] Civil Code, art 49.3.
49.3. Hüquqi şəxsin nizamnamə kapitalında ən azı 5 faiz paya (səhmə) malik olan iştirakçısının (iştirakçılarının) tələbi ilə o, vəzifələrini pozduğu halda, pozuntu nəticəsində hüquqi şəxsə dəymiş zərərin əvəzini ödəməlidir.
49.3.One (or more) shareholders holding at least 5 percent of the shares (or stocks) in the registered capital of a legal entity may demand compensation from the person who has breached his or her obligations for the damage caused to the legal entity as a result of the breach.
[292] Emin Karimov, 'Azərbaycan Korporativ Hüququ' (2014) 33.

Given the negative impact of the 1964 and 1969 tax reforms in the United States on the use of stock options,[293] the introduction of more favorable tax rules for stock option plans could significantly promote the use of stock options in Azerbaijan.

Regulatory oversight should be expanded to include monitoring of stock option issuance and compliance by the capital market participants, establishing registration or reporting requirements for listed companies that issue options, and publishing regulatory guidance and monitoring reports. A strong regulatory presence is essential to ensure transparency and market stability in countries with an underdeveloped capital market system. As a transitional measure, the government could:

– Introduce pilot programs in sectors with high growth potential; in the context of Azerbaijan, banking sector would be a particularly suitable candidate;

– Provide stock option plan templates and technical support to participating companies;

– Monitor and evaluate the results of the pilot projects to facilitate more comprehensive legislative reforms.

This phased approach would allow Azerbaijan to test regulatory models and gradually build institutional capacity.

[293] Edwards (n 130).

CONCLUSION

This study has examined the potential for the introduction and regulation of stock options in Azerbaijan based on established and tested U.S. legal frameworks and practices. It has explored stock options not only as an investment vehicle, but more importantly as mechanisms for motivating employees, corporate officers, and aligning their interests with those of shareholders. In developed markets such as the U.S., stock options play a critical role in fostering innovation, supporting startup ecosystems, and retaining talent in highly competitive industries.

In contrast, Azerbaijan lacks a specific legal framework for stock options, limiting their availability and effectiveness as an incentive tool for companies. The study identified significant regulatory gaps in Azerbaijani law, including the lack of statutory definitions, procedural requirements, and protections for shareholders and employees. These deficiencies pose serious challenges for companies seeking to implement modern compensation systems, as well as for the overall development of capital markets in the country.

Through a comparative legal analysis focusing on the US states of Delaware and New York, this thesis has shown that stock option regulation in successful jurisdictions relies not only on legislation but also heavily on case law and corporate governance practices. These jurisdictions offer proven models that Azerbaijan could adapt, considering its own legal, economic, and institutional context.

While legal transplants must be handled with care to ensure compatibility with local frameworks, the US experience illustrates how effective stock option regulation can contribute to economic modernization and corporate transparency. To this end, the dissertation proposes

policy recommendations tailored to Azerbaijan, including the introduction of basic legal definitions, shareholder approval requirements, anti-abuse safeguards, and regulatory oversight mechanisms.

The dissertation also addresses the methodological challenges of the research, in particular the lack of Azerbaijani court decisions and academic commentaries on the topic. This limitation underscores the need for future academic and policy-oriented work to explore the practical dimensions of equity compensation in emerging markets.

In summary, by adapting proven elements from U.S. regulatory models and grounding them in the legal and economic reality of Azerbaijan, a stock option system can be created that promotes innovation, strengthens investor confidence, and contributes to the overall development of the country's capital markets.

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