THE INSIDERS

How Five New Players Aid Movement to Limit CEO Pay

Mainstream Figures Mix with Activists; A Fix 'From Within'

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Meredith Miller, a low-key state official with a lot of clout, is helping rev up the movement to limit executive pay. Charged with helping protect Connecticut's $24-billion public-employee pension fund, she recently prodded financial powerhouses such as Morgan Stanley into making changes to their compensation practices.

Ms. Miller, 51 years old, is part of an unusual new movement that has turned executive-pay activism into a potent mainstream force, and not just the redoubt of gadflies. It now counts as members academics, mutual-fund trustees, foreign institutional investors, union leaders and politicians.

EXECUTIVE PAY[1]

For an in-depth look at CEO compensation sums in proxy statements, check out WSJ.com's **CEO Compensation Scorecard**[2].

Last year, mutual-fund companies withheld votes to re-elect directors at **Pfizer** Inc. and **Home Depot** Inc., whose chief executives enjoyed big pay packages despite their companies' poor share performance; both have since resigned. This year through March 9, investors had submitted 266 shareholder proposals related to executive pay, almost double the year-earlier period, according to proxy adviser Institutional Shareholder Services.

Rep. Barney Frank, meanwhile, held a hearing last week on a bill that would require companies to give shareholders an advisory vote on executive-pay deals. Mr. Frank, chairman of the House Financial Services Committee and a Massachusetts Democrat, previously introduced legislation to give shareholders a veto. He says he made the change to gain congressional Republican support and improve the chances that President Bush will sign the bill.

The New Activists

Jesse Brill
Publisher of the Corporate Counsel and chair of the National Association of Stock Plan Professionals
From WSJ interview:
"Seeing people trying to justify amounts [of pay] that were not justifiable -- it got to the point where I had to say and do something about it." Compensation consultants "know that what I write about and talk about is the right thing. Some are frustrated because they know their clients don't want to implement those practices." … "If companies don't take the initiative here [on executive pay], there are going to be political solutions that are not going to be to anybody's liking."
Related Links:

- CompensationStandards.com:[5] A board advisory Web site containing resources devoted to responsible compensation practices
- TheCorporateCounsel.net[6]: Corporate, securities and corporate governance web site
- National Association of Stock Plan Professionals:[7] Association of lawyers and other professionals who work with stock and other compensatory plans and arrangements
- Winter issue of the Compensation Standards newsletter:[8] A board newsletter that suggests three fixes for CEOs and boards to implement
- September-October 2006 issue of The Corporate Counsel[9]: A board adviser newsletter that suggests compensation fixes
- The September-October 2005 Issue[10] and the May-June[11] and September October 2004[12] issues: Board adviser newsletters that set forth a 12-step roadmap on executive compensation

"Heck, even the president says there's a problem," says Mr. Frank, referring to a speech given by President Bush in January urging boards to guard against oversized CEO paychecks.

These activists sometimes form loose networks to share strategies and lobby for each others' causes. A few are uncomfortable with the "activist" label. John A. Hill, chairman of the board of trustees at mutual-fund giant Putnam Funds, says he joined the debate partly because he didn't "want to cede the terrain" to traditional activists with little business background.

Some are driven by professional motives, others by political ones. Uniting them all is distaste for large exit packages given to ousted chief executives and recent revelations about rigged stock options. Executives who collect sky-high pay despite poor corporate performance are a particular target. Unlike the public grandstanding common to some activists in the past, this crowd prefers to work behind the scenes, often through persuasion rather than confrontation.

Recent regulatory changes reflect the movement's clout, and have also helped stoke its fires. Under new federal disclosure rules, companies have to give investors more information about executive pay, perks and retirement benefits in their proxy statements. The tallies, which are slowly being released, could be eye-popping.

It's hard to say whether the new activism will curb pay. Past efforts have fallen short, sometimes because companies found new ways to compensate executives, and sometimes because regulations had the perverse effect of pushing pay higher. Mark Reilly, a partner at 3C Compensation Consulting

Lucian Bebchuk
Professor, Harvard Law School
From testimony during the March 8, 2007 hearing before the House Financial Services Committee on Chairman Barney Frank's bill to give public-company shareholders an advisory vote on executive pay deals.
"Why does executive compensation raise serious concerns for investors? The issue is not merely symbolic but rather of practical significance. To begin, the amounts received by top executives are far from small change. They do affect investors' bottom line….Flaws in pay arrangements have costs beyond the excess amounts paid to executives. Such flaws can dilute and distort the incentives of top executives."
• Lucian Bebchuk's Web site at http://www.law.harvard.edu/faculty/bebchuk/[13]

Meredith Miller
An assistant state treasurer for Connecticut
From WSJ interview:
Shareholders and directors should combine forces "because many companies have excess pay and poorly performing compensation committees," Ms. Miller says. "If we can't break through in this coming annual meeting season, the only other option for activists will be to pursue board seats."
• More on her campaign to improve the independence of board pay consultants at http://www.state.ct.us/ott/[14] .

John A. Hill
Chairman of the board of trustees, Putnam Funds
From WSJ interview:
"I don't mind if people are well paid if they're creating millions of dollars for their shareholders. What I mind is when they're well paid for little, or negative, value." … "I think management ought to know their customers -- their shareholders.... That's part of what we're doing at Putnam: getting them to take shareholders seriously." … "I think there's a real momentum building on this [in mutual funds] -- not only executive pay, but activism. That can only be good."
• John Hill's letter to shareholders[15], describing Putnam's proxy-voting philosophy (PDF)
• Putnam Funds' 2007 Proxy-Voting Guidelines[16] (PDF)

Consortium, estimates that under the new disclosure rules, nearly half of the 500 biggest public companies will reveal CEO pay packages of around $100 million -- including 2006 compensation, stock-option exercises and accumulated pension benefits.

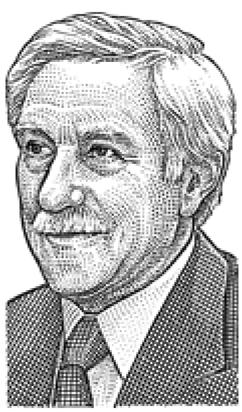
- **The Issue:** An unusual group of allies has transformed executive-pay activism into a powerful mainstream force.
- **What's at Stake:** These efforts are helping push corporate boards to intensify scrutiny of multimillion-dollar packages for top brass.
- **Bottom Line:** Fewer senior executives are likely to reap rich rewards for poor corporate performances.

Here are five people who represent the new, mainstream activism.

Edward Durkin
Director of corporate affairs for the carpenters' union
From WSJ interview:
"We actually do think compensation is too high. But how do you change the composition of compensation -- begin to rationalize compensation so we don't have these runaway numbers?" … "Today in compensation -- whether it's SERP [supplemental executive retirement plan] reform or something else -- you've got to go out there and create a standard, then try to create enough fuss around it to drive it home." … "From a union pension plan perspective, it would be in us to be really strident on this issue [of compensation]. There is some level of outrage in our activism. But at the same time, we've got to get results."
Status of this year's pay-related shareholder resolutions from the United Brotherhood of Carpenters:
• On "SERP-executive pension[17]," asking companies to limit executive retirement benefits. SERP is "Supplemental Executive Retirement Plan" (Excel spreadsheet)
• On "Pay for Superior Performance[18]," asking companies for better ties between pay and performance. (Excel spreadsheet)

The Networker

In late 2003, Berkeley, Calif., lawyer Jesse Brill received an email from a compensation consultant urging directors to "tally up" what they would owe a departing CEO. The message followed Dick Grasso's resignation as CEO of the New York Stock Exchange amid a furor over his $187.5 million compensation package.


Jesse Brill

Mr. Brill, who has been publishing newsletters about corporate law since the 1970s, seized the idea. He suggested directors include current and future compensation, and dubbed the result a "tally sheet." Then he aggressively promoted the notion to the 30,000 readers of his newsletters and Web sites, who include corporate lawyers, pay consultants and directors.

Mr. Brill, 64, says he didn't want to retire without addressing the issue of soaring executive pay. He made little headway at first. "People thought it was Jesse's little fixation," says John Olson, a senior partner at law firm Gibson, Dunn & Crutcher LLP, who advises corporate boards.

After Mr. Olson saw support for the idea grow, he urged a board he was advising to develop a tally sheet. Mr. Olson won't name the company. Directors were shocked at the numbers. They trimmed the amounts executives would receive if the company changed hands and cut perks, recalls Mr. Olson. Compensation consultant Pearl Meyer says Mr. Brill prompted her to add pension benefits and perks to the pay summaries she presents to clients.

In October 2004, Mr. Brill hosted a conference whose speakers included Alan Beller, then an attorney for the Securities and Exchange Commission, who had begun drafting new rules to expand disclosure of executive compensation. When those rules were issued last year, they required companies to list executives' "total compensation" -- a concept similar to Mr. Brill's tally sheet. Mr. Beller says Mr. Brill was "one of the people who was influential in our thinking" about compensation.

Mr. Brill talks and emails constantly with compensation consultants and corporate lawyers before publicizing the good ideas and the pitfalls. These days, he's advocating an analysis that would help trim the pay gap between the CEO and other executives. **Starbucks** Corp. and **MDU Resources Group** Inc., an energy and construction company, discussed the idea for the first time in their 2007 proxies.

"I don't view myself as being one of the reformers," says Mr. Brill. "I want to fix the system from within."

The Professor

Harvard Law School Professor Lucian Bebchuk is one of the intellectual engines of the pay-restraint movement, producing studies arguing that weak boards are paying executives without regard to company performance.

Lucian Bebchuk

Mr. Frank has cited Mr. Bebchuk's research showing executives claiming a growing share of corporate profits. SEC Commissioner Roel Campos says Mr. Bebchuk's pension research was "very influential" in crafting the new disclosure rules.

In 2000, Mr. Bebchuk, who holds doctorates in both law and economics, began working on compensation issues, using as a base his previous work on boards' lack of accountability during takeovers. In 2004, he co-wrote a book, "Pay Without Performance," which criticized boards for offering CEOs sizable pay deals.

"I view the problem of executive pay as being partly the product of excessive insulation of boards from shareholders, and the weakness of shareholder rights," says the Polish-born, Israeli-raised academic, whose gold-rimmed glasses perch halfway down his nose.

Mr. Bebchuk, 51, is playing a pivotal role in promoting a tactic for curbing compensation: revising corporate bylaws, the rules that govern companies' internal affairs. Last year, he submitted amendments at two companies, including Home Depot, that would have required more disclosure about pensions. Each received more than 40% of votes cast, a significant tally, albeit a losing one. This year, he proposed bylaws at four companies to require that CEO compensation packages be approved by at least two-thirds of independent directors.

Home Depot's board adopted his proposal Jan. 4, two days after CEO Robert Nardelli resigned amid complaints about his pay. A spokesman calls the change "a reasonable extension" of Home Depot's prior policy.

Some corporate advisers aren't sold. Theodore Mervis, a partner at Wachtell, Lipton, Rosen & Katz in New York, calls Mr. Bebchuk "the Elvis Presley of executive compensation," a reference to the academic's fondness for the media spotlight. Bylaw amendments "create legal gobbledygook without understanding the underlying issue," Mr. Mervis contends.

The Bureaucrat

Meredith Miller

Ms. Miller is an assistant treasurer for the state of Connecticut. In October, she drafted a letter to 25 large companies seeking information about whether compensation consultants hired by the board had conflicts of interest. Activists worry that a consulting company won't give the board impartial advice on pay packages if the firm is also advising executives. The new SEC disclosure rules don't address such conflicts.

The letter was signed by 12 other big pension funds, including those of several unions, representing in total about $850 billion in assets.

As a result, **Morgan Stanley** directors dropped Hewitt Associates Inc. as their compensation consultant because Hewitt also advised the bank's management about pensions. A Morgan Stanley spokesman calls the letter the "primary reason" for the change. Morgan Stanley's board says it will choose a new consultant with no ties to the firm. Hewitt declines to comment.

Ms. Miller later sent to the same companies responses from the 10 who she thought had the best practices. At **Wachovia** Corp., directors already had a policy to use independent pay consultants. But Ruth G. Shaw, chairman of the bank's compensation committee, expects the panel to put the policy in writing after Ms. Miller highlighted other boards that do so. "My hat is off to Meredith Miller," Ms. Shaw says. "She is having some real impact here."

Ms. Miller says she has drawn on Mr. Bebchuk's writing about potential conflicts. She traces her interest in shareholder activism to the late 1970s, when, as a Cornell University graduate student, she heard a campus speaker suggest that unions invest solely in pro-labor businesses. She worked for organized labor and gave her daughter a middle name of "Debs," after union leader Eugene V. Debs.

In 1999, Connecticut Treasurer Denise Nappier hired Ms. Miller, then a Clinton-administration pension official, to spearhead corporate governance advocacy for the state pension fund. She recalls that her "heart was racing" when she addressed the annual meeting of Office Depot Inc. in 2001. She urged shareholders to recommend the company adopt tighter ties between compensation and performance.

The measure won just 18% of voting shares. Shortly before a 2002 vote on a similar proposal, Office Depot revamped its practices to include performance-based stock options, among other things. The change "wasn't a response to Connecticut," says David Fannin, the retailer's general counsel.

The Mutual-Fund Trustee

One line in **Bank of America** Corp.'s 2005 proxy statement galvanized Putnam's Mr. Hill to action on executive pay. The bank said it paid CEO Kenneth Lewis about $25 million in part as a reward for the "success" of its recent merger with FleetBoston Financial Corp. Mr. Hill, who has been a Putnam trustee since 1985, was skeptical.

"I'm in the buyout business," says Mr. Hill, vice chairman of **First Reserve** Corp., Greenwich, Conn. "You don't know whether something's going to be good for several years." Putnam's trustees protested Mr. Lewis's pay package by withholding votes to re-elect him to Bank of America's board in 2005. Bank of America declines to comment.


John Hill

Mr. Hill and the Putnam trustees, who oversee the firm's $123 billion in mutual-fund assets, represent an important new voice for restraint in executive pay. Big institutional investors have traditionally sided with management on governance and pay issues, and tended to sell shares rather than protest if they disagreed. In 2006, 29 mutual-fund companies surveyed by governance tracker Corporate Library supported, on average, 92% of management resolutions and 91% of management-backed director candidates.

Mr. Hill, 65, a former federal energy official and avid big-game fisher, says Putnam became more assertive following the 2001 collapse of Enron Corp. Suddenly, it was clear the governance issues, in particular ensuring that directors were independent and watchful, had become a subject of vital importance for investors.

Last year, Putnam was among the firms that withheld their votes to re-elect directors at Pfizer and Home Depot. Mr. Hill followed up with personal letters to the CEOs.

"You have been paid exceedingly generous cash and equity compensation" despite Home Depot's declining share price, Mr. Hill wrote to then-CEO Nardelli in June last year. Mr. Nardelli telephoned Mr. Hill, recalls the Putnam trustee, saying he didn't agree with Mr. Hill's views but was sure the compensation committee would "consider" them. "I hope so," Mr. Hill recalls saying. "Because I don't want to be writing you this letter again next year." A lawyer for Mr. Nardelli didn't respond to requests for comment.

The Union Leader


Edward Durkin

In 1995, Edward Durkin, an official of the United Brotherhood of Carpenters and Joiners, rose to speak at the annual meeting of **Archer-Daniels-Midland** Co. Then-CEO Dwayne Andreas cut him off, banging the gavel and yelling, "This is my company, my meeting," recalls Mr. Durkin.

These days, Mr. Durkin, 53, who oversees governance issues for the union's pension fund, says he's more effective when lobbying corporate executives in private. He spends hours on the phone discussing the minutiae of pay plans and exploring compromises. Mr. Durkin often withdraws shareholder resolutions the union has backed when companies agree to make changes, or even to talk.

He calls the process "mind-numbing and labor intensive," but necessary to enhance the value of the union's $40-billion pension fund. "Compensation is clearly the most demanding and frustrating area of advocacy," he says.

The union is currently pursuing shareholder proposals relating to executive compensation at 43 companies, including **Johnson & Johnson** and **Yahoo** Inc.

Mr. Durkin has used similar tactics in past campaigns. In 2000 and 2001, the union won roughly 100 shareholder votes urging companies to treat stock options as an expense. Mr. Durkin then pushed to give shareholders a bigger voice in electing directors by bringing together representatives of 15 companies and three other unions. Intel Corp., a participant in the talks, adopted a rule requiring director nominees to win a majority of votes to be elected. Typically, directors can be elected by a plurality.

This year, the carpenters union withdrew a shareholder proposal at **American Express** Co. after the company said it would reduce executive retirement benefits. Mr. Durkin also withdrew a resolution at Norfolk Southern Corp. after CEO Charles W. Moorman called and promised to discuss the railroad's retirement-benefits policy.

Mr. Durkin is a third-generation union leader whose grandfather, a steamfitter, served briefly as Labor Secretary under Dwight D. Eisenhower. A summer job doing electrical work convinced Mr. Durkin his talents "lay elsewhere." He got a law degree and joined the carpenters union in 1983, jumping into shareholder activism soon after.

Mr. Durkin says he hopes to ease the "hand-to-hand combat" of negotiating separately with each company. Last year, he suggested that his union and the U.S. Chamber of Commerce co-sponsor a study group on executive pay. The group met for the first time in late February, with six companies and five unions represented. Mr. Durkin is "a thoughtful guy," says David Chavern, the chamber's chief operating officer.

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