Valeant CEO's Pay Package Draws Praise as a Model

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J. Michael Pearson paid plenty to become chief executive of Valeant Pharmaceuticals International in 2008. He'll be paid plenty more if he succeeds.

Mr. Pearson's unusual pay package wins praise from compensation critics, who say it may offer a model for other public companies. Directors of the midsize drug maker required him to buy at least $3 million in stock, forgo routine annual equity grants and hold many shares for years before selling.

No single element is unique, but the combination is rare -- for a public company. G. Mason Morfit, chairman of Valeant's board compensation committee and main architect of the package, says he wanted to mimic executive-pay deals at businesses controlled by private-equity firms. Mr. Morfit is a partner of ValueAct Capital, an activist hedge fund whose 22% stake makes it Valeant's biggest stockholder.

Pay experts say the deal gives Mr. Pearson incentives to boost long-term value for investors. For example, the 49-year-old CEO only gets to keep certain restricted shares if Valeant's share price increases at least 15% a year through February 2011. Mr. Pearson can't sell most restricted shares or exercised stock options for two years after they vest.

"It goes a substantial distance toward addressing my concerns about executive-pay arrangements," says Lucian Bebchuk, a Harvard law professor and frequent pay critic.

"Many companies would benefit from imitating this or moving in this direction," adds Steven N. Kaplan, a University of Chicago business professor and pay researcher. "More pay for performance is a good thing."

Mr. Pearson will certainly be well paid if Valeant performs well. Directors awarded him equity initially valued at $18.1 million, according to the Aliso Viejo, Calif., company's latest proxy statement. If Valeant shares are at $37.16 or higher in February 2011, the package will be worth $88 million, Mr. Morfit estimates.

Valeant shares closed Friday at $27.17, more than double the level when Mr. Pearson arrived and near a seven-year high. The new CEO has sold poor-performing businesses, slashed research spending, found a rich partner to help introduce a promising epilepsy drug and spent $394 million to acquire three companies with approved dermatology products.
Bigger Bang for the Buck?

Investor G. Mason Morfit, chairman of the board compensation committee at Valeant Pharmaceuticals International, offers these suggestions for shareholder-friendly pay packages:

The pay formula is no guarantee of success. Several concerns controlled by private equity failed recently, including Chrysler Group LLC. Former Merrill Lynch & Co. CEO John Thain bought more than $11 million of shares during his first year, according to pay researcher Equilar Inc. He was forced out in January after Bank of America Corp. acquired Merrill amid mounting losses.

Some compensation specialists worry that Valeant's approach could spur moves that briefly boost shares, but ultimately hurt the company. Certain analysts have questioned the research cuts, for example. "It creates some incentive to jack up the stock price in year three to hit these [performance] hurdles," Mr. Kaplan says.

"I don't worry about that issue," Mr. Morfit replies. He says the board keeps close tabs on management, and he talks to Mr. Pearson daily.

Valeant wasn't always on the cutting edge of pay practices. In 2003, directors of the company then known as ICN Pharmaceuticals Inc. sued former CEO Milan Panic to recoup a $33 million bonus. Mr. Panic, who was ousted following a proxy fight, later agreed to repay $20 million.

Mr. Morfit, 33 years old, joined Valeant's board in May 2007. He's a rarity, one of just 28 compensation committee chairmen at 3,367 companies holding more than a 20% stake, according to the Corporate Library, a governance-research firm.

Valeant directors began seeking a new CEO in December 2007. Mr. Morfit told Mr. Pearson and two other finalists that he liked the private-equity model for executive pay "because it aligns management's incentives with those of the investor," he recalls. "Nobody was scared off."

Mr. Pearson already was advising Valeant as head of the global pharmaceutical practice at consulting firm McKinsey & Co. He had the cash to meet the stock-purchase requirement. He ended up buying $5 million of shares, at an average price of $16.65. "I thought it was a great deal," he says.

Mr. Pearson and fellow directors then adopted the same approach for new senior executives, requiring them to buy big chunks of company stock. The requirement restricted Valeant's management talent pool to affluent risk takers. But Mr. Pearson says he found already successful people willing to take less guaranteed pay up front.

Certain recruits initially had qualms. Rajiv De Silva, hired last January as chief operating officer of Valeant's specialty pharmaceuticals business, must purchase $425,000 of Valeant shares by January.

The mandate bothered his wife, who warned, " 'I hope you know what you're getting into,'" recalls Mr. De Silva, a former Novartis AG manager who previously worked for Mr. Pearson at McKinsey. He won her over by pledging to limit other investments. Mr. De Silva has bought $200,000 of Valeant shares so far.

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