# The $100 million CEO club

## Rewarding execs with big stock options made many a millionaire in the 90's

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Executives have been doing a lot of complaining lately. Dealing with the Sarbanes-Oxley Act is too stressful, shareholders are too aggressive and boards no longer tolerate minor ethical lapses. It's a hard-knock life — but, hey, the money's good.

Very good. More than 30 CEOs have fully vested stock options worth $100 million or more. The main reason: Until 2004, companies didn't have to treat options as an expense, so they could lavish them on executives without hurting earnings per share. Some companies didn't even realize how big the honey pot would grow if they kept doling out options.

"It's only recently that a few companies have started to calculate what the potential value of stock options could be," says Paul Hodgson, senior research associate at the Corporate Library, which tracks executive compensation. "Sometimes when you grant stock options and the stock just explodes, it really takes you by surprise."

But some boards knew exactly what they were doing: Making their executives rich. In the late 1990s, when technology companies were short on profits but drunk with soaring stock prices, boards handed out options like candy.

"We had kind of an ethics-free period in the late 1990s, particularly on the West Coast, where the market for executives got out of whack," says Michael Melbinger, a partner who heads the executive compensation practice at law firm Winston & Strawn. "Executives typically got whatever they wanted."

That's not to impugn the ethics of every company that granted huge stock option packages. Most of the companies in our $100 Million CEO Club haven't been implicated in the recent backdating scandal, in which executives at dozens of firms received option grants suspiciously timed to maximize their value.

Stock options give recipients the right to buy shares in the future at the current price, known as the "strike" or "exercise" price. The higher the stock rises, the richer executives can become. Generally, the strike price is set as the closing price on the day options are granted.

But many firms, particularly during the dot-com boom, consistently granted options when the stock hit a monthly or yearly low, suggesting they chose the grant date with the benefit of hindsight. Backdating itself isn't illegal, but failing companies that don't disclose it properly risk the wrath of the Securities and Exchange Commission and the Department of Justice.

A few companies in the club are tangled in the backdating brouhaha. Number one on our list is William W. McGuire, CEO of UnitedHealth Group, who has $1.6 billion in stock options. The

SEC is investigating the company's option-granting practices, and the company has said that it may have to restate earnings. Earlier this year, UnitedHealth also changed its stock-grant policy in response to investor furor over McGuire's pay; he and other senior executives will no longer receive equity-based awards.

The SEC is also investigating Caremark Rx, Electronic Arts and KB Home, all of which made our list.

Stock options haven't always been so controversial. It's ironic that options are in the doghouse right now, because ten years ago they were supposed to save the world. In theory, stock options encourage executives to do their jobs well. After all, they aren't worth anything unless the stock price rises.

But options should lose their lure when a CEO already owns a huge stake in the company, Hodgson says. Larry Ellison of Oracle, for example, has $475 million in vested options. But he already owns 24.5 percent of the firm's stock. If that's not an incentive to perform, a few more millions probably won't help.

It may be time for firms to change the way they distribute equity awards. Firms could tie options more closely to performance by forcing executives to hold them longer, says Lucian Bebchuk, a professor at Harvard Law School and author of Pay Without Performance: The Unfulfilled Promise of Executive Compensation.

Or, they could tie options to an index, so executives are only rewarded if their firms perform better than the industry as a whole. "I think we should fix stock options rather than drop them," Bebchuk says.