CEO Pay Soars in 2005 as a Select Group Break the $100 Million Mark

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Even after a decade of sharply rising CEO pay, 2005 proved a watershed for a select group of executives. Their paydays or potential paydays broke $100 million.

Led by Capital One Financial's Richard Fairbank, several corporate chieftains earned nine-figure sums or the prospect of that much.

Compensated only by stock options since 1997, Fairbank claimed one of the biggest windfalls among CEOs, exercising 3.6 million options for gains of nearly $250 million. His personal haul exceeded the annual profits of more than 550 *Fortune* 1000 companies, including Goodyear Tire & Rubber, Reebok and Pier 1.

Fairbank, 55, pulled in $56 million from options in 2004. Capital One says Fairbank had to exercise options last year because they were set to expire. The company also noted its 24.6% annual shareholder returns the past decade.

Lifted by Wall Street's three-year bull market, 14 consecutive quarters of rising corporate earnings, mergers and turnover in the corner office, scores of other CEOs enjoyed less stratospheric but still Olympian pay packages.

Median 2005 pay among chief executives running most of the nation's 100 largest companies soared 25% to $17.9 million, dwarfing the 3.1% average gain by typical American workers, USA TODAY found in its annual analysis of CEO pay.

"Overall, we're still seeing solid cash and bonus payouts," says Ian Singer of pay-tracker eComp Data Services, which compiled data from Securities and Exchange Commission filings for USA TODAY's study. "I don't think that's ever going to change when you're at the jumbo level."

Compensation includes salary, bonus, incentives, stock, stock-option gains and potential returns from fresh option grants. Median gains were bolstered by larger stock grants, long-term incentive pay, supplemental retirement pay and options gains.

Failure also played a role: The golden parachutes for ousted CEOS and huge sign-on packages of their replacements lifted median CEO pay and promised to set benchmarks for future pay packages.

Coming off 2004's 25% jump in big-company CEO pay, the sharp rise in executive

compensation perplexes corporate governance experts who expected temperance following scandals at Enron, WorldCom and Tyco, increasing scrutiny by regulators and shareholder activists, and starting this year, new accounting rules requiring expensing of stock options.

"Corporate boards are under more pressure to ensure there's a linkage to performance and shareholder returns, but they'll still be looking for ways to maximize pay packages to stay competitive," says Carol Bowie, head of governance research at proxy adviser Institutional Shareholder Services.

One of 2005's largest windfalls so far among those reported during this proxy season came not to a CEO, but to Omid Kordestani, head of global sales at Internet search engine Google. He exercised stock options for a $287.9 million gain. Neither Kordestani, 42, nor Google responded to calls.

Google CEO Eric Schmidt and co-founders Sergey Brin and Larry Page who requested in 2004 that their salaries be reduced to $1 and refused 2006 raises exercised no options. But they own big Google stakes; Brin and Page each own stock worth about $12.5 billion.

Another huge payout came to Analog Devices CEO Jerald Fishman, who cashed out $144.7 million from his deferred compensation plan and made another $4.3 million in salary, bonus and options gains.

Hires, fires = big $$$

Whatever the company size, rising turnover in the corner office could prompt higher pay benchmarks to attract new hires. Employment tracker Challenger Grey & Christmas says 2005 CEO departures doubled to 1,322, vs. 663 in 2004. Through the first quarter of 2006, 337 CEOs were replaced.

Among new CEOs with big pay packages:

•Broadcom's Scott McGregor, hired by the semiconductor maker in January 2005, received $7.7 million in pay and bonus, plus stock options with a potential value of $101.9 million. Broadcom says McGregor's compensation is "competitive, fair and reasonable," citing Broadcom's 46% stock price gain.

•3M's James McNerney, who replaced Boeing CEO Harry Stonecipher in June, received $25.3 million in Boeing stock to compensate him for losing potential payouts at 3M. His last six months at 3M proved lucrative, too. He got almost $41 million $8.4 million in compensation and $32.4 million exercising 3M stock options. There was no golden parachute for Stonecipher, forced out after the revelation of an affair with a subordinate. But Stonecipher made $39.5 million, including $11 million in incentive pay and $26.9 million exercising stock options.

•John Mack, who replaced ousted Morgan Stanley chief Philip Purcell in June, pulled in more than $68 million, including $37.8 million in restricted stock and $30 million exercising stock options.

Purcell's golden parachute was valued at about $52 million, including a $44 million bonus.

Morgan Stanley co-president Stephen Crawford, who also left, received a settlement worth $36 million.

Such payouts whose key provisions are largely negotiated as part of employment contracts have become boilerplate as corporate boards agree to lucrative retention agreements designed to prevent CEO "flight risk," says Ira Kay of pay consultant Watson Wyatt and author of *Myths and Realities of Executive Compensation*, due out later this year.

"It's a seller's market, and executives have real market power," Kay says. "Most directors are as obsessed with retaining their CEOs as they are satisfying shareholders. Directors know if they have the right team in place, they have to do whatever they can to retain it."

Most compensation advisers and corporate governance experts doubt a Securities and Exchange Commission proposal requiring boards to provide more clarity, justification and disclosure about pay, perks and supplemental retirement will curb CEO pay. "You'll still see extraordinarily egregious deals going down," says Bowie.

New accounting rules that require companies to expense stock options beginning this year aren't likely to limit new option grants to CEOs, either.

"We'll see fewer options granted to lower and middle management employees, but there'll be no effect on option grants to CEOs," says John England, who advises directors for compensation consultant Towers Perrin. "Most directors still believe options are an important piece of senior management's compensation."

Boards are under more scrutiny from shareholders and regulators. Bowie says shareholders will vote on nearly 150 proposals aimed at making boards more accountable. Measures include director term limits, annual elections and provisions to remove directors receiving less than 50% of votes cast by shareholders.

There are about as many ballot measures regarding directors as are being floated to curb CEO pay. Yet, most resolutions are non-binding and ignored by directors, even those overwhelmingly approved by shareholders. Most companies oppose provisions such as annual director elections, which tend to make boards less insular and beholden to management.

Some reformers believe fundamental changes in the way CEOs are compensated won't occur until corporate directors are held more accountable. "They're not sufficiently dependent on shareholders, who lack real power to remove them from boards," says Harvard University professor Lucian Bebchuk, who decries the lack of connection between pay and performance and is pushing for bylaw changes at several firms.

Increased shareholder activism is putting more pressure on some boards to weigh compensation practices, such as covering CEOs' income taxes, more closely, says Temin & Co. pay consultant Bruce Ellig, author of *The Complete Guide to Executive Compensation*.

Moreover, some boards have begun acquiescing to investor pressure. Prompted by the Teamsters union, Coca-Cola said it would seek shareholder approval of future executive severance packages. The move comes after the soft-drink giant fitted former CEO Douglas Ivester with a golden parachute worth $119 million after four years and successor Douglas Daft, who lasted three, $36 million in severance.

Other companies are already providing more extensive compensation disclosure to shareholders, and board advisers say there's far more backroom discussion among directors about CEO pay.

"There's a change that outsiders wouldn't see directors asking about the cost implications, disclosure implications, what could go wrong with a plan that pays too much for performance that isn't justified," says England. "Board members are saying they don't want their reputation besmirched."

Overcompensating?

For now, among many corporate boards, looking to enhance pay for already handsomely compensated CEOs remains the norm.

United Technologies' George David has made nearly $300 million in compensation since he became CEO in 1994, including about $40 million in salary and bonuses and more than $250 million from stock option gains, according to SEC filings. He holds exercisable options valued at $138 million. Directors boosted his salary 42% to $1.7 million in 2005, saying it was his first raise since 1998, and awarded fresh options valued at $24 million.

Directors cited his long tenure, leadership, an *Institutional Investor* magazine survey ranking him tops among his aerospace and defense electronics industry peers and the company's "exceptional" performance. Most longtime shareholders might not quibble: They've gained about 18% annually under David.

"We can all argue how we value CEOs and if their pay makes sense," says Alan Johnson, a

principal in compensation consultant Johnson Associates. "But we chronically overvalue CEOs. Until that's addressed, higher pay will continue."

At poor-performing companies, some boards are ignoring performance guidelines to reward executives. Sun Microsystems, down more than 90% from its 2000 peak, gave CEO Scott McNealy a $1.1 million "discretionary" bonus last year, even though Sun failed to meet income or earnings targets. The board cited a "one-time need" to recognize McNealy's performance. McNealy gained $11.8 million exercising options. Already Sun's largest individual shareholder, McNealy also received fresh options worth $7.6 million.

"There's a point where a board should tell the CEO, 'You have enough to incentivize you,' " says Paul Hodgson, pay analyst for The Corporate Library, a governance watchdog group. "But it's still business as usual at most companies. It's all about keeping up with the Joneses. There's still a disconnect between paying for performance and actually delivering it. There's no shame factor."

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