

Disclosure Won't Tame C.E.O. Pay

The New York Times

By Joseph Nocera

January 14, 2006

THIS Tuesday, the Securities and Exchange Commission plans to unveil its first overhaul of executive compensation disclosure rules in 14 years. The new rules, which were leaked to the news media this week, are intended to give investors a fuller picture of the staggering amounts of money going to America's chief executives and other top corporate officers.

Under the proposal, companies will have to disclose much more than just information about outside salaries and bonuses. An estimated dollar value will be placed on obscene grants of stock options. The details of bloated retirement packages will be made public. And companies will have to list all the absurd perquisites that have accrued to chief executives in recent years -- including the latest twist, the practice of having companies pay the boss's taxes. Nor will companies be able to bury this stuff in the proxy statement, as they've long done; it will all have to be put in one place, where it can be easily seen and understood.

All in all, it's going to be a pretty sickening sight.

It is fitting that this is the first initiative of the new S.E.C. chairman, Christopher Cox; better disclosure, in all sorts of areas, is likely to be his hallmark. "Disclosure of material information has been one of the priorities of the S.E.C. for 70 years," Mr. Cox told me a few days ago. "It's a priority I inherited."

In the case of compensation, it was Mr. Cox's view that such disclosure had become "less accurate and less useful" in recent years -- and who can doubt it? Think back to 2002, when the world learned about Jack Welch's retirement perks -- including Red Sox tickets, a Manhattan apartment for life, country club memberships and free use of a corporate jet -- not from the General Electric proxy statement, but from his angry wife's divorce papers. After taking down some \$1 billion in the two decades he ran G.E., it appeared that he had negotiated a retirement plan that would cause him to never have to take cash out of pocket to pay for anything.

BETTER disclosure rules are all fine and well, but we already know plenty about executive pay. We know that it is out of control, socially corrosive and divorced from any real rationale (did Michael Dell really need stock options to "incent" him?). Nor is it economically insignificant. According to Lucian A. Bebchuk, an executive compensation expert at Harvard, from 2000 to 2003, the total compensation of the five best-paid officers of all publicly held companies amounted to 10 percent of corporate earnings.

But when I asked Mr. Cox whether he thought the new disclosure rules would help rein in executive pay, he punted. "It is not the role of the S.E.C. to determine the level of compensation," he replied. "It is the role of directors and shareholders." And hence the problem: when the S.E.C.'s new rules are instituted, some months down the road, it won't be just you and me who

are getting a fuller picture of executive compensation -- so will the nation's chief executives. And history suggests that whenever they discover a fellow C.E.O. is getting something they don't have, they make a grab for it. In other words, as laudable as more disclosure is, there is a real possibility that it will make a bad situation worse.

Take, for instance, 1993, the year Congress passed a law eliminating the tax deduction for any executive salary that exceeded \$1 million. What happened? First, the new law accelerated the trend of giving C.E.O.'s hefty stock option grants. Second, it made \$1 million the new salary floor. "In the hall of fame of unintended consequences," said Nell Minow of the Corporate Library, a corporate governance monitoring group, "that has to rank right near the top."

Or take the last time the S.E.C. pushed through executive pay disclosure rules. "I was a consultant to Richard Breeden when the S.E.C. did its disclosure rules in the early 1990's," recalled Graef Crystal, the grand old man of executive compensation critics, referring to the S.E.C. chairman at the time. "I absolutely thought it would cause comp to go down because the disclosures would be so embarrassing. But it turned out that when somebody is hauling in \$200 million, he's not embarrassable."

Mr. Crystal, who ran the Towers Perrin compensation consulting practice before becoming a critic ("atoning for my sins," he likes to call it), points out that the information currently disclosed in proxies has been a huge force in driving compensation upward. Compensation consultants use it to compile surveys of C.E.O. perks and pay, allowing for easy comparison. Such surveys, which most boards rely on to set their own C.E.O.'s pay, are one of the most invidious tools in the comp racket. And with the Internet, compensation information is available the instant the proxy is filed with the government. "The consultant will call within 30 seconds saying, 'Michael Eisner just got a huge grant. We have to do more for you,'" Mr. Crystal said.

So what do we do about what I've come to think is the single most intractable problem in corporate America? How do we put a lid on executive greed?

There are many people in the field who think the essential problem is that pay is disconnected to performance, and that is certainly true. "If a C.E.O. gets a million stock options and the stock goes up a buck, that's not what I'd call pay for performance," Ms. Minow said. Mr. Crystal says that most so-called pay for performance plans are really "pay for pulse" plans.

But I think the problem is deeper than that. Even C.E.O.'s who do perform well are often paid too much. There is a huge disconnect between the amount executives are paid and society's expectation of what is reasonable to pay someone to manage a big company. Nobody begrudges Bill Gates his wealth; he became the richest man in the country because he founded a hugely successful company. But lots of people begrudge, say, James M. Kilts, who ran Gillette for just four years -- and then pocketed \$175 million when he sold the company to Procter & Gamble, because the sale put in play the options he was handed during his short tenure. There is simply no excuse for showering Mr. Kilts (who is on the board of The New York Times Company) with that kind of wealth.

There are plenty of ideas out there for getting C.E.O. pay more in line with investors'

expectations, though none of them strike me as the perfect solution. Representative Barney Frank, Democrat of Massachusetts, has filed a bill that would allow shareholders to vote on "change of control" compensation schemes -- like the one that enriched Mr. Kilts -- and would also force executives to return compensation if the company subsequently had to restate its earnings. But Mr. Frank told me that he is leery of trying to legislate the appropriate level of executive pay. "It is the shareholders' money," he said. "If they want to pay for Jack Welch's newspaper, they have that right."

Ms. Minow thought that giving shareholders the means to put additional heat on boards would help. "There is no such thing as an independent director if C.E.O.'s are picking them," she said. As a result, she added, "I am very committed to the most significant shareholder initiative right now: majority vote." If shareholders could oust directors with a simple majority vote, she believes, they would start voting against compensation committee members "who approve these absurd packages."

Leo J. Hindery Jr., the former C.E.O. of a number of telecommunications companies, attacks executive compensation practices in his new book, "It Takes a C.E.O." He has an idea that came from his time running the YES Network for George Steinbrenner and Major League Baseball decided to crack down on sky-high team payrolls. "When the Yankees exceed the salary cap," he said, "Steinbrenner has to pay a luxury tax. Writing a check gets his attention." Mr. Hindery believes that there should be a ratio between what the C.E.O. makes and what the average worker in the company makes -- say, 25 to 1. (It is currently over 400 to 1.) If the chief executive's pay exceeded the ratio, the company would have to pay a luxury tax, just as Mr. Steinbrenner does.

Indeed, one prominent compensation consultant has begun advocating for what he calls "internal pay equity." That is Frederic W. Cook, who has been in the field for nearly four decades. "I am proposing it," he told me, "as an alternative to this 100 percent reliance on surveys. There has to be some other way. Surveys are flawed."

Mr. Cook put this idea into practice in 1990, when he was advising DuPont. Its C.E.O. at the time, Edward Woolard, decided to set his pay at 1.5 times the pay of his senior managers. He did so, he said in a recent speech, because he thought it was "equitable."

He didn't care that his peers were making much more; indeed, he felt they were giving corporate chieftains a bad name. Of course, if all C.E.O.'s were as public-minded as Mr. Woolard, we wouldn't have the problem.

So how would you fix the executive pay problem? Send me your ideas at tsnocera@nytimes.com. If I get enough good ones, I'll revisit the subject. And if not, I'll just keep wringing my hands, like everyone else.