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FAIR GAME

Making Managers Pay, Literally

By [GRETCHEN MORGENSON](#)

SHAREHOLDERS have been rightly aggrieved in recent years at their boards' reluctance to recover money paid to executives involved in financial misconduct. While cooking the books to generate hefty pay became common in Scandalot — what regulators say happened at [Fannie Mae](#), [Bristol-Myers Squibb](#) and Computer Associates — instances where even some of that money was returned to shareholders have been depressingly rare.

That may be changing. Judging by this season's executive pay filings, provisions that would require so-called clawbacks of pay are becoming much more prevalent at major corporations. They are becoming broader as well, extending to the recovery of gains from stock options that may have been exercised while dubious practices were taking place.

Even better news is that companies are no longer just talking the talk on these recovery plans, according to Michael Melbinger, a partner at the law firm Winston & Strawn in Chicago who leads its executive compensation practice. In his practice, he says, he has seen 10 recent cases of companies actually recovering money from executives. "Boards are getting deadly serious about this," Mr. Melbinger said. "The old agreements were extremely executive-friendly, and we are moving to a less executive-friendly environment. But not everybody's there yet."

Happily, boards are recognizing that instituting clawback provisions makes sense, Mr. Melbinger said.

He added that chief executives whose employment agreements include these provisions have not objected to them, either. "We're putting them into every new employment agreement we draft," he said.

Not surprising, then, that they are showing up in more proxy filings this year. In November, Equilar, an executive compensation research firm in San Mateo, Calif., looked for pay recovery provisions at the 100 largest companies in the United States. It found that about 18 percent of them had disclosed such policies for the previous year.

Not all of those 100 companies have filed their proxies yet for 2007. But among the 50 that have, Equilar found 44 percent with clawback provisions. Six of those 50 said they put their policies in place last year.

Among those companies instituting policies and disclosing them in 2007 are [Edison International](#), Kellogg, KeyCorp, [Kraft Foods](#), [United Technologies](#) and [Washington Mutual](#).

Some of these disclosures are a result of the Securities and Exchange Commission's new rules. But Alexander Cwirko-Godycki, a senior analyst at Equilar, said that what intrigues him is how much the policies cover.

"It appears that the breadth of clawback policies has increased," he said, "as more companies are moving beyond policies which only allow for the recovery of bonuses to include provisions allowing companies to take back unvested equity awards and even equity gains."

Kraft's provision, for example, is very broad. Under its terms, recovery of compensation after a financial restatement at the company can require the partial or full repayment of a bonus, of gains on exercised stock options, or of the sale of vested shares. The company can also cancel the executive's restricted stock grants and stock options.

In previous years, policies to recover pay were typically limited to executives who were fired for cause or who went to work for a competitor. Now, they extend to executives who resign or who remain at the company.

The new policies to recoup pay also augment the provisions under Sarbanes-Oxley, the law passed after Enron and WorldCom failed. The Sarbanes-Oxley rules apply to only the chief executive and the chief financial officer, and leave plenty of wiggle room.

This is where the newly assertive boards come in, said James F. Reda, an independent executive compensation consultant with his own firm in New York.

"Some of these companies are so serious about these provisions that they are putting them into the compensation committee charter," Mr. Reda said. "They are hard-wiring it to be more than just a policy; it is a requirement, and plainly stated for everyone to see."

That is a good thing, Mr. Reda said, and an indication of a major shift in thinking among directors. And extending the policies to include option gains sends an important message, according to Mr. Melbinger.

"If you really want to have teeth in the provision, it's got to go into the option gains area

because if there is a financial misstatement or some real wrongdoing, the biggest risk is that the stock price spiked up and the executive exercised and sold the stock,” Mr. Melbinger said.

“What we tell people is, the only thing worse than having the bad news hit about a financial misstatement or wrongdoing is having news hit the press seven days later that the executive left with \$100 million.”

CLAWBACK provisions are not the only measures boards are taking to pare eye-popping payouts.

Mr. Melbinger described a recent board meeting called to fire a chief executive who had a very favorable contract. Instead of paying him the more than \$100 million that his contract entitled him to, the board decided to give him \$22 million.

“From the first minute we entered that meeting, the board was very sensitive to how this was going to look, and the amount of pay that could be made to this guy and how their duties weighed on them,” Mr. Melbinger said. “Not that \$22 million isn’t a lot, but it was a major victory. Boards are keenly aware of their duties now — much, much more so than five or six years ago.”

After years of shareholders shouting themselves hoarse over pay, they are finally being heard — in some boardrooms, at least.

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