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## Hire by the Contract Now, Risk a Big Regret Later

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The new heads of [Exxon Mobil](#), [PepsiCo](#) and [Pfizer](#) don't have one. Nor do the chief executives at [Citigroup](#), [General Electric](#) and [Procter & Gamble](#). And some corporate governance experts say shareholders are better off as a result.

It is an employment contract, and it has been in the spotlight ever since a number of prominent chief executives were ousted with golden goodbyes — Robert L. Nardelli's \$210 million exit package from [Home Depot](#) being the most recent. Employment contracts, agreed upon when a new leader arrives, have been blamed for virtually guaranteeing such huge payouts even when that executive fails.

"Time and time again, the smoking gun of any major compensation problem is in the form of a contract that was executed at a earlier date," said Patrick McGurn of Institutional Shareholder Services, a proxy advisory firm. "It was at the heart of Home Depot. People never imagine when they ink these contracts that it could go wrong."

While they may be tarred by controversy, employment agreements are still common at many large corporations. And compensation experts do not see them going away soon.

"Rumors of the employment contract's demise are greatly exaggerated," said Jannice L. Koors, a managing director at Pearl Meyer & Partners. "As long as you need to do things to lure top executives from positions they are already in, you are going to have to offer them some kind of protection to get them to say yes."

Today, 55 chief executives at the biggest 100 companies in the United States have signed an employment or severance contract, according to an analysis by Equilar, a compensation research firm in San Mateo, Calif. Most ordinary professionals — including managers just two or three layers down in the organization — are typically not given any guarantees.

Executives who are being recruited argue that they need contracts because of the risks involved. Top executive turnover is at record levels: roughly 35 percent of departing chiefs in 2005 were forced out, according to Booz-Allen Hamilton, the consulting firm. Orchestrating a

turnaround can take several years to pay off. And the relationship with the board may not work out.

Among the 16 chief executives of the top 100 companies who were recruited from outside in the last three years, 13 had an employment or severance contract; among the 10 executives who were promoted, 6 had a contract.

While every agreement is different, it generally sets out the terms of a new executive's salary, bonus, perks and stock awards. It also describes what happens to the executive's pay package if he or she is fired or forced out.

In theory, the agreements work to ensure employment conditions while providing some protection for the company if things do not work out. A company might agree to certain amount of severance pay, for example, to prevent a chief executive from immediately working for a competitor or poaching top staff.

In reality, however, many agreements appear to be negotiated in the executive's favor. Among the poor practices, compensation experts say: guaranteeing bonuses two or three years after the executive has been at the helm; offering so-called evergreen clauses that automatically renew the contract every few years, narrowly defining the conditions for which an executive can be fired and providing lucrative severance payouts.

"It's not that employment agreements are bad," said Paul Hodgson, senior analyst at the Corporate Library, a governance watchdog group. "It's what's in them."

Consider a recent analysis by James F. Reda, an independent compensation consultant in New York who examined the impact of severance agreements. The average American worker might receive about two weeks' salary for every year they worked at a company, Mr. Reda said. The average chief executive without an agreement received the equivalent of about 18 weeks of salary for each year of service.

At Home Depot, Mr. Nardelli's contract entitled him to 568 weeks of salary for each of the six years he was chief executive. [Michael D. Eisner](#) took home the equivalent of nearly 536 weeks of salary after he left the [Walt Disney Company](#). Of course, that pales in comparison with the former lieutenant he dismissed: Michael Ovitz, Disney's former chief operating officer, was paid the equivalent of more than 5,000 weeks of salary after just over a year on the job.

Not every employment contract, however, calls for lavish severance payouts or income guarantees.

At Intuit, for example, Stephen M. Bennett, its chief executive, is entitled to severance pay equal to six months his current salary, which was \$1.1 million in 2006, and limited vesting of stock options and restricted stock awards that he is not yet able to exercise. Likewise, [Walgreen](#) and Whole Foods hold the line on large change-in-control payouts.

If properly negotiated, some compensation experts say, employment contracts can benefit both the executive and the company by clarifying the exit package. When James Dimon took over at Bank One in March 2000, he signed a contract that gave him a guaranteed \$9.5 million bonus in cash and stock for at least his first five years at the helm. It also provided a generous exit package if he was forced out.

Six months later, Mr. Dimon said he voluntarily scrapped his contract's income guarantee and declined to take the \$2.5 million cash portion of his bonus. But he said he "would not have taken the job" without a severance plan, especially since he had spent six months negotiating his exit at Citigroup after a falling out with [Sanford I. Weill](#), his former mentor and boss.

If it happens again, "I don't want to negotiate with anybody. I want to know exactly what it is," Mr. Dimon, now chairman and chief executive of JPMorgan Chase, said at a 2005 conference on executive pay.

William D. Perez, Wrigley's new chief executive who has been at three companies in the last three years, said that "trust and fit" mattered when he has contemplated an employment contract. At S. C. Johnson, where he rose through the ranks to become chief executive, Mr. Perez said he never had an employment agreement.

[Nike](#), which had had a history of rejecting executives recruited from outside, was a different story. Mr. Perez said he was leaving behind a 34-year career to enter the "unpredictable world of Nike."

It "would have been foolhardy without some sort of contract," Mr. Perez said in an e-mail message. He was paid \$14 million when he left Nike after 13 months.

Now, Mr. Perez is working at Wrigley without any formal agreement or severance plan. "If you know the people you are going to be working for, if you have a good feel for the culture, and if you think your performance will be objectively assessed, why do you need a contract?" he wrote. "That's why I don't have a contract at Wrigley and why, it turns out, I needed one at Nike."

Still, not everyone agrees that employment contracts are necessary at all. [Jeffrey R. Immelt](#),

General Electric's chairman and chief executive, said recently that he did not think that chief executives should have contracts. Kenneth D. Lewis, [Bank of America](#)'s chairman and chief executive, suggested that having one was unfair to other employees. "I don't understand why a C.E.O. should have a safety net when others don't," he said in an interview last summer.

But most often, chief executives recruited from the outside are able to get a contract if they want. Without strong internal candidates, boards often feel the need to hire a superstar to fill a leadership void.

The problem is compounded, critics charge, by directors who often have close personal ties to the chief executive or are being advised by a general counsel who will call the man at the other side of the table "boss" the following week. And boards often make the mistake of focusing on a single candidate and lose sight of their negotiating clout.

"It's like a prenuptial agreement," said Ms. Koors, the compensation consultant. "You are negotiating what you are going to give someone if it ends at a time when you are in love with each other, wearing rosy sunglasses and all aglow — and it's never going to happen."

It was not always this way. Forty years ago, fewer than 25 percent of chief executives at big companies signed an employment contract that laid out the salary and bonus terms as well as potential severance, according to Joseph E. Bachelder, a compensation lawyer who has represented many chief executives.

Today, however, some sense that changes may be brewing. Robert J. Stucker, who negotiated Mr. Nardelli's pay contract, tempered some of his demands, according to someone who has worked closely with him on several negotiations. Gerard R. Roche, the senior chairman of Heidrick & Struggles who helped bring Mr. Nardelli to Home Depot, has adjusted some of the advice he now gives boards.

"There was a phrase I used to use: whatever it takes," Mr. [Roche](#) said. "That 'whatever it takes' has become a much more relative phrase — there is a much more conservative approach."

And Home Depot's board appears unlikely to guarantee their next leader's pay upfront. Frank Blake, a Home Depot senior executive who was named Mr. Nardelli's successor, is not expected to have an employment contract, according to a person close to the board's discussions.