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CEO pay: They didn't earn it - and should return it

As CEO paychecks escalate, some are sitting on millions of dollars that they didn't actually earn. But just try getting it back.

By [Matthew Boyle](#), FORTUNE writer

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FORTUNE

(FORTUNE Magazine) - Last month in a Brooklyn federal courtroom, Sanjay Kumar, the ousted CEO of [Computer Associates \(Research\)](#) (now called CA), pled guilty to charges that he had inflated the company's sales in 1999 and 2000 and interfered with a subsequent investigation.

Kumar faces serious jail time, but it's unclear whether he will ever have to return more than \$300 million in bonuses he received that were based in part on fraudulent financial results.

As CEO paychecks escalate inexorably to ridiculous heights, it's scandalous enough that CEOs such as Kumar are sitting on millions of dollars that they didn't actually earn. (There were 1,195 financial restatements in 2005, nearly double the previous year's figure, according to proxy advisory firm Glass Lewis.)

Even more galling, though, is that companies are doing nothing to recoup (or "claw back") those unmerited gains - despite the presence of a law specifically addressing the issue.

So why is nothing happening?

First, because the law stinks. Section 304 of Sarbanes-Oxley states that claw backs would occur in cases of "misconduct" but fails to spell out what constitutes misconduct or specify whose misconduct qualifies. (The CEO's? Or some overzealous finance guy's?)

"For a statute that contains a lot of inartfully drafted provisions, this is among the most inartful," says Joseph Grundfest, a Stanford professor of law and business.

It gets worse. Two U.S. district courts have ruled that Section 304 does not provide a "private right of action," a legal term that means shareholders cannot sue under 304.

The SEC, meanwhile, has its own power to seek disgorgement of ill-gotten gains. Thus, "the government doesn't need it, and private parties can't use it," says Therese Pritchard, a lawyer formerly with the SEC.

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Some CEOs, like Fannie Mae's Franklin Raines, could still face claw backs, despite 304's shortcomings. (Fannie's restatement is pending.)

One precedent: An Alabama circuit court ruled in January that former [HealthSouth \(Research\)](#) CEO Richard Scrushy must repay \$48 million in bonuses. (He's fighting it.) And telecom giant [Nortel \(Research\)](#) has taken the unusual step of suing former CEO Frank Dunn to recoup bonuses that were based on cooked books.

Calpers, the huge California pension fund, now recommends that companies adopt claw back policies as good corporate governance. Some, like [Bristol-Myers Squibb \(Research\)](#), have done so already, but by and large, boards lack the stomach for it.

"Directors are supposed to act like owners," says Betsy Atkins, a governance guru and a director at three companies. "Shareholders should expect action."

One party that's taken matters into its own hands is Amalgamated Bank's LongView Collective Investment Fund. Amalgamated has filed shareholder proposals to urge a few companies to adopt claw back policies. That helped prod [Eastman Kodak \(Research\)](#) to agree to "review" executive bonuses in the future.

Discouragingly, most shareholders have failed to join the call for reform. When Amalgamated put a claw back proposal before shareholders two years ago at Computer Associates, it got only 26 percent of the votes cast. ■

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