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Golden parachutes are soaring to platinum levels

By Tim McLaughlin
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*Ex-May CEO could
get \$10.94 million*

Though the practice is changing, CEOs' exit pay often is set by other CEOs.

Top executives at publicly traded corporations receive huge sums just like superstar athletes. There is one key difference, however.

Superstar athletes do not set each other's pay. Imagine New York Yankees slugger Alex Rodriguez - he of the 10-year, \$252 million contract - determining the pay scale of St. Louis Cardinals slugger Albert Pujols. As you might imagine, things could get out of hand real fast.

But in corporate boardrooms, it's not uncommon for chief executives and ex-CEOs to sit on compensation committees, setting the pay of other CEOs. Equilar Inc., a compensation research firm based in San Francisco, said that about 42 percent of the companies in the Standard & Poor's 500 index have at least one member of their compensation committee currently holding the title of CEO at another company.

And when one of their brethren is shown the door, the payout can be huge, even for mediocre performers.

"It reminds me of that song by The Fifth Dimension, 'Up, up and away in my beautiful balloon,'" said Bruce Ellig, a compensation expert. An adviser to some 20 corporate boards, Ellig also wrote the book "The Complete Guide to Executive Compensation."

One such lofty deal happened in July when May Department Stores Co. disclosed the separation agreement of Eugene S. Kahn, the St. Louis retailer's former chairman and chief executive. He resigned in January, just before May began negotiating its sale to Federated Department Stores Inc. of Cincinnati.

Later, after several months of negotiations, May's executive compensation and development committee determined that Kahn should receive a payout worth \$10.94 million as part of his no-compete, non-solicitation agreement.

"It's pretty amazing," said Michelle Leder, author of the book "Financial Fine Print: Uncovering a Company's True Value." "It's a lot of money and you usually don't see negotiations so far after the fact."

The size of Kahn's golden parachute may have shocked some, given that he presided over declining sales and profit. Shareholder return also languished during his tenure. May's stock fell 32 percent between the time Kahn became CEO

in May 1998 and his resignation, according to Bloomberg market data. In contrast, during the tenure of his predecessor, David Farrell, shareholders realized a compound return of 18 percent a year.

Investors celebrated Kahn's departure, pushing May shares up 16 percent in the first trading session after the announcement of his resignation. Today's severance packages, however, are grounded in boardroom logic that took root in the late 1970s and early 1980s, Ellig said. Back then, CEOs wanted protection against takeovers, and negotiated deals that paid them three times their salary and bonus in the event they lost their jobs.

Part of the logic behind the golden parachute, Ellig explained, is that it's a lot easier for a clerk to get a job than a CEO. There are fewer jobs and the pay tends to be high, the reasoning goes.

The AFL-CIO has been critical of CEO pay for several years, complaining that compensation committees are too cozy with, or too sympathetic to the executives they oversee.

Severance payouts escalated further when lawyers for CEOs negotiated deals that allowed their stock options to vest immediately, rather than forfeiting the compensation when they left the company.

"Now, we're talking big money," Ellig said. "The payouts went into the stratosphere."

These days golden parachutes can turn into platinum regardless of whether you're a superstar, journeyman or bum. Part of the explanation is that CEOs remain entrenched in corporate boardrooms, not to mention taking seats on powerful compensation committees.

May's executive compensation and development committee consisted of a trio of independent, non-management directors. The committee's chairman in 2004 was James Kilts. As chairman and CEO of Gillette Co., he engineered the razor maker's sale to Procter & Gamble Co. for \$57 billion. In Boston, where Gillette is based, Kilts took heat for selling the venerable company while positioning himself to collect a \$165 million payout as part of the deal.

"Given his package, Kahn's package doesn't look so bad," Leder said.

In a July interview published in the Boston Globe, Kilts took credit for increasing Gillette's shareholder value by almost \$20 billion.

"And I make no apologies about the compensation," he told the newspaper.

Gillette spokesman Eric Kraus said Kilts was not available to comment on Kahn's severance arrangement. Kahn also has declined comment.

Ellig said corporate boards are reforming, though not as quickly as activists would like. As an example, he said boards are moving away from the practice that allows CEOs to handpick outside consultants to help determine their pay.

He estimates that more than half of the compensation committees at Fortune 100 companies are hiring the pay consultants rather than the CEO.

"This is considered best practice," Ellig said. "I'm optimistic, but (reform) is not happening overnight."

A recent study by professors from the University of Pennsylvania's Wharton School, and a professor from Canada's Simon Fraser University, found that CEOs who had any link to someone on the company's compensation committee received, on average, \$453,688 more than CEOs who had no such links. The study examined 22,074 directors at 3,114 companies. The authors analyzed the structure and influence of social networks.

"Our study has several implications for corporate governance," the authors said. "First, the results lend support to the claims of regulators and rating

agencies that have questioned the ability of boards with substantial ties between directors to serve as effective monitors of management."

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