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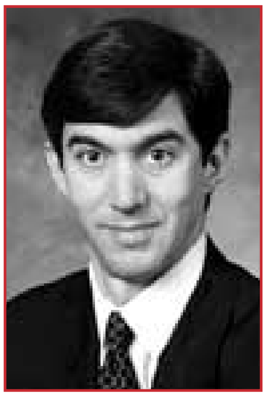
## *SORDID TALES OF EXECUTIVE OVER-COMPENSATION*

*By Robert Gans*



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Nearly three years ago, when the Council of Institutional Investors challenged the payment by the Walt Disney Company of nearly $140 million in cash and fully vested stock options to Michael Ovitz after firing him for fourteen months of incompetence as the Company's president, the *Advocate* triumphantly proclaimed "An End To Mickey Mouse Corporate Governance." While courts historically have not been receptive to shareholder claims based on excessive compensation for top executives, the Disney case seemed to break new ground. Indeed, the Delaware Supreme Court proclaimed that "the sheer size of the payout to Ovitz...pushes the envelope of judicial respect for the business judgment of directors in making compensation decisions." Reading this pronouncement, it was clear that, in the new age of institutional shareholder activism, excessive compensation through outrageous bonus and stock option awards would soon be a thing of the past.

Not so. Indeed, one might well yearn for the days when a mere $100 million satisfied a top executive. Meet the "Fortune 25"—the 25 public companies with the greediest officers and directors between January 1999 and May 2002, as determined by *Fortune* magazine, Thomson Financial Services, and the University of Chicago's Center for Research in Securities Pricing. *Fortune* used three criteria to come up with its list, which appeared in its September 2, 2002 issue. The list does not purport to be exhaustive; it does not even include income earned through salary, bonuses, or "loans" that never seemed to be repaid. Instead, *Fortune* measured only the proceeds of stock sales by the top officers and directors of companies whose market capitalization peaked above $400 million at the height of the market frenzy, and which has since plummeted by at least 75%. *Fortune* also limited its search to stock sales and option exercises that took place since 1999.

The results are astounding: Stock sales by 466 individuals running the 25 companies on *Fortune's* list yielded proceeds of approximately $23 billion, or an average of more than $50 million per person, between January 1, 1999, and May 31, 2001. The list itself is a veritable Who's Who of law enforcement targets and civil defendants. Qwest Communications chairman Phil Anschutz sold $1.57 billion worth of stock in May 1999 for $47.25 per share, or about $43 per share more than where it currently trades after the Company restated its financial results for the past three years. Enron and Global Crossing also made the list, providing stock sale proceeds of $994 million and $951 million to their top officers and directors, including $508 million to Global Crossing chairman Gary Winnick alone!

Some prominent names missed the cut. Former Tyco CEO Dennis Kozlowski was left out despite having sold at least $258 million in stock (and possibly another $137 million through a family partnership). Nevertheless, Kozlowski will likely have ample opportunity to explain his sales, along with the tens of millions of dollars that Tyco supplied for his living expenses, at his upcoming criminal trial for securities fraud—unless, of course, he follows the example of his Enron colleagues by invoking his 5th Amendment right against self-incrimination. WorldCom also missed the Fortune 25, but not for lack of trying: Although the top officers of the bankrupt giant pocketed a mere $150 million from stock sales, former CEO Bernard Ebbers "borrowed" another $400 million that was collateralized by his now worthless WorldCom shares.

*Continued on next page.*

Stock sales are not the only measure of corporate greed. Consider the case of Robert Elkins, the founder and former CEO of Integrated Health Services, an operator of nursing homes that has descended into bankruptcy and is the subject of various investigations for Medicare fraud. Between 1991 and 1997, the company's annual revenues grew nearly ten-fold, from $202 million to $2 billion, as its stock price exceeded $37 per share. When Medicare changed its reimbursement regulations in 1998, however, Integrated's fortunes declined rapidly. By the beginning of 1999, the Company's stock price was down to $14 per share, while its debt exceeded $3 billion.

None of these developments discouraged Elkins, who always found creative uses for Integrated's "excess" cash. As the company's prospects dimmed, Elkins devised various "executive loan programs" through which he and other Integrated officers borrowed nearly $60 million in cash — virtually all of which was to be forgiven if Elkins ever left the company. Elkins also decided that 1999 was a good time to begin investing in art — with the proceeds of the company's executive retirement plan. During 1999 and 2000, Elkins spent over $8 million of Integrated funds on various art pieces, which he graciously agreed to "store" on the walls of his $28 million Naples, Florida mansion. On January 28, 2000, Elkins made his final art purchase for $1 million, and the price of Integrated stock closed at approximately $0.09 per share. Less than one week later, the Company declared bankruptcy. For his efforts, Elkins was rewarded with a separation agreement that forgave his loans and paid him an additional $1.5 million in cash. Elkins even managed to repurchase one of the paintings he had acquired with retirement fund money at an auction staged by Integrated — or less than one-half the original price.

Unsecured creditors of Integrated have filed a derivative complaint in the Delaware bankruptcy court seeking to hold the former directors of the company responsible for the various fiduciary breaches that provided the means for Elkins and his cohorts to siphon millions of dollars from Integrated's coffers. The case will be decided under Delaware corporate law that has been resistant to executive compensation challenges. Nevertheless, one would hope that the court will find that the excessive payments to Elkins "push the envelope" in much the same way that the substantial payouts to Ovitz stretched the bounds of reasonableness in the Disney case.

Indeed, the aggressive pursuit by institutional investors of ill-gotten gains by corporate profiteers may substantially deter future misconduct, even if the amount recovered does not materially increase the recovery to investors as a whole. For example, in the recent case of the Baptist Foundation of Arizona, a ponzi scheme in which elderly investors were robbed of nearly $600 million, investors did not stop after recovering more than $200 million from the foundation's auditor, Arthur Andersen. Instead, these investors are continuing to pursue the top officers of the foundation for their role in this massive fraud. The willingness of investors to pursue them should send a powerful message to top executives who believe that they can cash out with impunity.

The dramatic rise of shareholder awareness and activism in recent months, particularly in the wake of highly-publicized corporate scandals, is contributing to increased corporate responsibility. It is clear, however, that only continued and sustained vigilance by institutional investors will meaningfully deter misconduct and prevent the sort of enormous and unjustified executive compensation packages at the heart of scandals, such as Enron and Qwest. With continued leadership from the institutional investor community, we may ensure meaningful future corporate responsibility.

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