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Still making their ascent

Disclosure rules don't hinder CEOs from big paydays, perks, as salaries for top-level heathcare execs rose 4% in 2007

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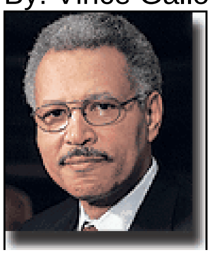


Williams

With much fanfare a year ago, companies began disclosing the pay and perks of their chief executive officers in much greater detail to comply with securities regulations. Critics who hope that more disclosure will slow the CEO pay train should consider history.

The last radical change in disclosures came in the early 1990s, and that included a tax change that limited the amount that companies could write off as an expense on their income taxes, according to Tim Pollock, professor of management with the Smeal College of Business at Pennsylvania State University.

View the list of healthcare's compensation leaders

“If the idea was that providing more information was going to shame them into having more modest compensation,” Pollock said, “it didn’t work.”

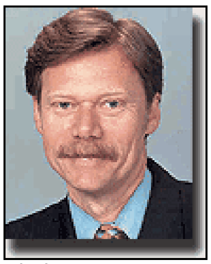
Modern Healthcare’s sixth-annual report on corporate CEO pay bears that out. Eleven of the 30 CEOs covered in the report raked in $10 million or more in compensation in 2007, although those figures include proceeds from exercising stock options that were granted in prior years. Salaries for top-level healthcare executives rose by about 4% in 2007 compared with 2006, a figure that is consistent with previous years, according to Jim Nelson, executive vice president and compensation practice leader at Integrated Healthcare Strategies, Minneapolis. For executives who have held their positions for more than a year, the increases are between 4% and 5%.

The pressure that the strained economy has put on reimbursements and bottom lines seems to be affecting incentive payments, however, Nelson said. “Incentive payouts, as a percentage of opportunities, have dropped from five years ago,” Nelson said. “Five years ago, the average incentive award was 100% to 106% of target. Last year, it was, on average, 92% of target. Actually, incentive awards overall have dropped.”

The broader disclosures may help companies wring out perks such as personal use of corporate aircraft or even more egregious items such as paying the cost of providing an executive with fresh-cut flowers, for example, Pollock said. There is a danger, however, that looking at these items—which are low in value compared with salaries, bonuses and equity-based compensation—may obscure something a lot more significant.

"The important thing is to look at how pay affects CEO decisionmaking," Pollock said. "The goal is to encourage CEOs to take appropriate risks." Options do in fact do that, but the problem is that they strike out more than they hit home runs, Pollock said, citing research done by colleagues at Penn State. "I personally think restricted stock is better than options. It gives them real skin in the game. Until an option is exercised, it isn't worth much. If it's underwater, you haven't lost anything," Pollock said. "The restricted stock, if the value goes down, the executive has lost something."

(Story continues below.)


Shulman

Evolving with a twist

Plans today are more outcomes-based than they have been in the past. "That's the biggest change in incentive plans over the last few years," Nelson said. "In the early days of qualitative measures, they were process-oriented, as in implementing programs. Now they're not concerned with the process, but the actual outcomes. There was less data available that boards and management could measure their outcomes of quality initiatives to others," he added. But with the Institute for Healthcare Improvement and CMS outcomes data, "organizations now are comparing themselves to their peers as opposed to, 'how we performed before.' "

U.S. companies have shifted to restricted stock in recent years. Among companies in the Fortune 1000, 45% used stock options as compensation, and 4% used restricted stock in 2004, but in 2006, only 28% of companies granted stock options and 11% made restricted stock grants, according to Equilar, a Redwood Shores, Calif.-based executive compensation research firm. Companies began to expense the stock options used to compensate executives and other employees earlier this decade, in response to pressure by some investors. U.S. accounting regulations require companies to do this starting with fiscal years that began after June 15, 2005.

Despite the clamor for reining in executive pay increases, compensation continues to rise because of a dearth of available talent, Nelson said. And given the high rate of CEO turnover, Nelson said, companies are focusing more on growing their own talent from within to retain their future top executives.

Pollock and Ravi Dharwadkar, professor of management at the Whitman School of Management at Syracuse University, agreed that academic research into the new disclosures is likely to bear fruit in 2009, with two years of data available. Dharwadkar also expects two other themes on executive compensation in the coming year.

One is that he expects more cases related to companies backdating their stock-option grants. Dozens of companies, including UnitedHealth Group, have dealt with accusations that option grant dates were manipulated to pick the lowest possible exercise price, thereby increasing their value to executives. Dharwadkar's current research, still unpublished, suggests that many more companies backdated options and could face class-action lawsuits by shareholders, he said.

The other theme to watch is the 2008 presidential election, Dharwadkar said. If presumptive

Democratic presidential candidate Barack Obama wins the election, Dharwadkar said, there could be legislation on executive pay. **Hospitals have weak year**

Compensation usually reaches its peak with an exercise of stock options, but the weak year for the seven publicly traded companies on the hospital portion of *Modern Healthcare*'s list put hospital CEOs behind many of their colleagues at health plans and specialty-care providers. Wayne Smith, chairman, president and CEO of Community Health Systems, Franklin, Tenn., topped the list of hospital CEOs with nearly $9.8 million in total compensation, but Smith would have ranked sixth among insurers and seventh among specialty-care providers.

Smith's pay was bolstered by Community's acquisition of Triad Hospitals, Plano, Texas, which roughly doubled its size. The company's board granted him restricted stock valued at nearly $5.4 million on the day the transaction closed, July 25, 2007, according to the company's proxy statement. Community must meet certain performance objectives for those restricted shares to vest. On the same day, the board also granted Smith 500,000 stock options with an exercise price of $40.41, which was the price at which the company's stock closed that day. The shares vest over three years. Smith also made personal use of corporate aircraft worth nearly $219,000. A Community spokeswoman declined to comment.

Alan Miller, chairman, president and CEO of Universal Health Services, King of Prussia, Pa., was again the second-highest earner among hospital CEOs. Jack Bovender Jr., chairman and CEO of HCA, Nashville, fell from the top spot to No. 4 on this year's list. Most of Bovender's nearly $35.9 million in compensation for 2006 resulted from the leveraged buyout of HCA in November 2006, which triggered the vesting and paying out on all options and restricted shares held by Bovender and other managers. HCA's management committed most of the funds from these payouts as investment in the leveraged buyout, per terms of the buyout agreement with three private equity groups and members of the Frist family.

The acquisition of Triad ended former Chairman and CEO Denny Shelton's five-year streak on the list. Shelton, who is now nonexecutive chairman of Legacy Hospital Partners, Plano, was replaced by Robert Thornton Jr., chairman and CEO of SunLink Health Systems, Atlanta.**Notable changes at insurers**

The revolving door and big stock option cash-ins meant some notable changes in our annual compensation rankings among major publicly traded health insurers. Top executives at the two biggest U.S. health insurers—WellPoint and UnitedHealth Group—ranked low on this year's list. Angela Braly replaced the retiring Larry Glasscock as president and CEO of WellPoint in June 2007. Braly's total compensation (about $3.9 million, which includes five months as executive vice president) last year was about $25.6 million less than Glasscock's the prior year. UnitedHealth Group President and CEO Stephen Hemsley also kept a relatively low profile, earning $5 million in 2007.

The Minnetonka, Minn.-based insurer settled with its prior well-heeled leader, William McGuire, last December over a stock backdating scandal, whereby McGuire agreed to forfeit $618 million. McGuire said he would pay a record fine to the Securities and Exchange Commission of $7 million, but he still may be allowed to keep UnitedHealth stock options worth an estimated $800 million.

Ronald Williams, Aetna's chairman and CEO, jumped to No. 1 on *Modern Healthcare*'s list, thanks to a big stock option payout of $32.8 million. In 2006, Williams didn't exercise any stock options and ranked fifth. Aetna did not respond to requests for comment. Aetna reported that Williams made private use of the corporate jet, totalling $77,000.

Also moving up on the list is Dale Wolf, CEO of Coventry Health Care, a mostly government-sponsored managed-care company. Wolf cashed in $13.1 million in stock options in 2007—amounting to nearly his total compensation the prior year. Wolf made $20.2 million in 2007, including close to $342,000 in corporate jet use. H. Edward Hanway, Cigna's chairman and CEO, who made nearly $31 million last year, up from $29.4 million in 2006, reported $15,344 spent for private use of the corporate jet.

Two major insurers are noticeably absent this year. As of mid-July, WellCare Health Plans still had not filed its full 2007 financial statements with the SEC. A WellCare spokeswoman said that she did not know when those documents would be released, as federal and state investigations into the managed-care company are ongoing. In October 2007, nearly 200 FBI agents raided WellCare's Tampa, Fla., headquarters, seizing files. Three months later, in January, WellCare's board of directors announced an executive shake-up, including the departure of Chairman, President and CEO Todd Farha, its chief financial officer and its general counsel.

WellCare said it is continuing to cooperate with the Florida and Connecticut attorneys general, the SEC and the U.S. Justice Department in the investigations, which it believes are centered on a behavioral-health subsidiary and Medicaid transactions in two states. Last week, WellCare restated its earnings for the past three years, citing accounting errors, and said it overcharged Illinois and Florida as much as $46.5 million in Medicaid and other managed-care contracts.

Also absent from our compensation list is Sierra Health Services, which was acquired by UnitedHealth Group in February for $2.8 billion. Anthony Marlon, Sierra Health's chairman and CEO, sold 4.4 million shares in the company held in four family trusts on the acquisition's closing date, a 401(k) and other accounts, for $43.50 a share.

Marlon, who started Las Vegas-based Sierra in 1984, owned 8% of the company. Marlon held 24,000 shares at a strike price of $30.06 per share, netting him $322,560. He also owned 168,000 restricted stock units, valued at $7.6 million at the time of the acquisition, according to SEC filings.

As reported last year, Marlon will earn $4 million in annual salary and bonuses for staying on at the helm of Sierra Health. Under SEC rules, Sierra Health is not required to file detailed financial statements, including executive compensation, for 2007 because of the acquisition. Marlon's total payment for the sale of Sierra Health remains unknown.

Those who opposed the Sierra Health acquisition, including the American Medical Association, cited the undisclosed executive compensation terms as one reason for their displeasure with the deal, though the Nevada insurance commissioner stipulated that Sierra Health member premiums not be used to finance the transaction.

"This is one of the weaknesses of the oversight system that we have," says Larry Matheis, executive director of the Nevada State Medical Association. "Executive compensation is something that should be disclosed to the public. It's really another question of the way mergers and acquisitions are being dealt with today."

Shulman at top for specialty care

After a three-year run at the top of the specialty-care provider list, Kent Thiry, chairman and CEO of renal-care provider DaVita, was surpassed in 2007 by Steven Shulman, current nonexecutive chairman and former CEO of Magellan Health Services, thanks to Shulman's departure in February.

In February, Magellan said physician Rene Lerer would succeed Shulman as CEO when Shulman's service ended, according to a securities filing. Shulman had held the position at Magellan, which manages behavioral-health, radiology and specialty-pharmacy services for payers, since 2002.

Under the transition agreement, Shulman was paid $1.8 million as a bonus for 2007, about $155,000 as a pro rata target bonus for his service during 2008, and an additional amount equal to $4.5 million, which represents two times the sum of his then-applicable base salary ($1.1 million) and target bonus ($1.1 million). His total compensation was $35.2 million.

Since July 2006, Shulman has served as a director for HealthMarkets, which provides health insurance for the self-employed, individuals and families, small businesses and Medicare beneficiaries through its underwriting companies, the Mega Life and Health Insurance Co., Mid-West National Life Insurance Company of Tennessee and the Chesapeake Life Insurance Co.

Last week regulators from 29 states agreed to a $20 million settlement with HealthMarkets and its affiliated companies following a three-year, multistate probe that found problems related to consumer disclosure, oversight and training of agents, claims handling and complaint handling, according to a news release from Washington state's insurance commissioner.

DaVita's Thiry ranked second on the list. A fellow member of the list, Paul Diaz who is president and CEO of long-term acute-care provider Kindred Healthcare, joined the board of DaVita last August.

Diaz—who was named to *Modern Healthcare*'s Top 25 Minorities in Healthcare this year (April 7, p. 6)—received a total of $46,251 for his efforts as a DaVita director last year.

A notable change to the post-acute segment of this year's list relates to the much-scrutinized $6.3 billion buyout of Manor Care, Toledo, Ohio, led by the Carlyle Group, a private equity firm. The deal was announced in July 2007 and completed in December.

In that deal, Manor Care President and CEO Paul Ormond received $77.3 million in consideration for stock options (Jan. 7, 2008, p. 17). The newcomer to the list, replacing Manor Care's Ormond, is really an old-timer: Timothy O'Toole, CEO of hospice-care provider Vitas Healthcare Corp. He made the list in 2006, but not 2007.

O'Toole also serves as executive vice president of Chemed Corp., the parent company for Vitas, which was established in 1978.**What do you think?**
Write us with your comments. Via e-mail, it's mhletters@crain.com; by fax, 312-280-3183.
