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Executive pay remains mind-boggling

But regulatory changes to make compensation clearer muddy this year's compilation

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By Len Boselovic, Pittsburgh Post-Gazette

Experts say new regulations requiring companies to disclose more information about executive compensation will put more pressure on those companies to do a better job of aligning pay with performance.

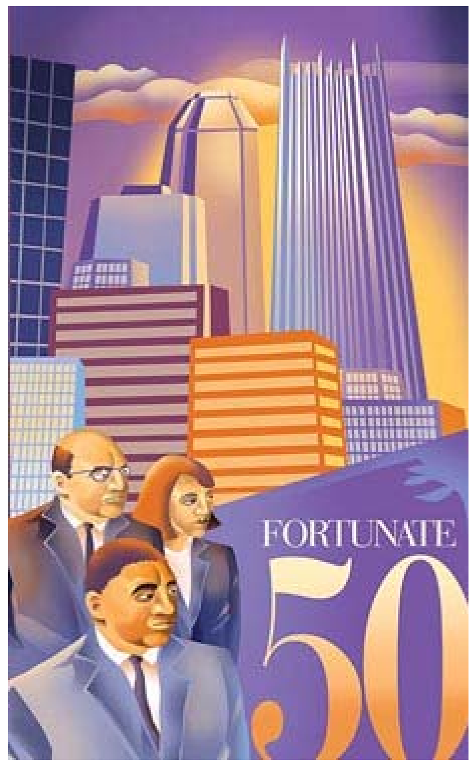
It may take awhile, however.

"Do I think there's going to be a revolution? No. But I do think there's going to be some changes," said Timothy G. Pollock, a Penn State Smeal College of Business professor who has studied executive compensation for years.

There are few signs in the Post-Gazette's Fortunate 50 -- the newspaper's annual look at the 50 highest-paid executives at local public companies -- that a revolution is pending. The compensation champ for 2006 is rookie Robert P. Kelly, named Mellon Financial's chairman, president and CEO in February 2006 following the departure of Martin G. McGuinn. The ex-Wachovia executive was paid $20.4 million last year, about $5 million more than No. 2, American Eagle Outfitters' James V. O'Donnell.

Fortunate 50 eligibility requirements changed this year because of new Securities and Exchange Commission regulations. The rules, which apply to companies whose fiscal year ended on or after Dec. 15, require more details on a host of pay categories including pension plans and severance benefits.

Because of the changes, money that executives receive for exercising stocks options awarded in previous years is not taken into account in the tally for 2006. Instead, the Fortunate 50 is based on the estimated future value of restricted stock and option grants



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awarded last year.

The new formula means executives who would have easily qualified for our top 50 under the old rules finished well out of the running. For example, take Michael F. Hines, Dick's Sporting Goods' former chief financial officer. Mr. Hines was paid $2.2 million last year, including $1 million in stock awards, ranking him 81st among more than 100 executives examined by the Post-Gazette. But if the $34.9 million Mr. Hines realized by exercising previously awarded options is included, his pay jumps to $37.1 million *(see chart on D-3)*.

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Equitable Resources Chairman Murry S. Gerber, the 2005 Fortunate 50 champ, ranked 86th last year, with compensation of $1.6 million.

But that figure excluded $12.9 million from exercising stock options, which also figured greatly in his payout of $54.9 million in 2005, when he realized $34.3 million from cashing in options.

Two females made this year's Fortunate 50, twice as many as last year but down from three two years ago. Both are from American Eagle: Executive Vice President Kathy J. Savitt (33rd) and President Susan P. McGalla (35th), who made the list for the third consecutive year.

The average Fortunate 50 executive was paid $6.7 million last year: a salary of $687,000, a bonus of $622,000, grants of restricted stock and options with an estimated value of $3.1 million, incentive payments of $1.7 million and other compensation of $569,000. In addition, each realized an average of $1.9 million from exercising options awarded in prior years and gained control of $2.6 million in restricted stock that vested in fiscal 2006.

Two metals producers -- Allegheny Technologies and Alcoa -- accounted for 20 percent of the Fortunate 50, each placing five executives on the roster. Allegheny Technologies, led by former Alcoa executive L. Patrick Hassey, was the best-performing stock in the Standard & Poor's 500 last year and generated annualized returns (stock price appreciation plus dividends) of 44 percent over the five years ended Dec. 31. Mr. Hassey's former employer generated negative annualized returns of 1.3 percent over the same period.

The only non-Alcoa executive who made the Fortunate 50 despite his or her firm's turning in negative five-year shareholder returns is Ariba Chairman and CEO Robert M. Calderoni (25th). The online procurement software provider delivered negative annualized returns of 7.7 percent over its five most recent fiscal years.

Two Fortunate 50 newcomers wouldn't have joined the club without "other" compensation they received.

Nearly two-thirds of HFF Inc. CEO John H. Pelusi Jr.'s $7.1 million paycheck last year fell into the other category. Most of that $4.5 million came from his share of the profits at HFF Holdings, which is what the Downtown real estate services provider was called before it went public this year.

Nearly half of former Wheeling-Pittsburgh Corp. CEO James G. Bradley's 2006 compensation of $4.8 million came from other compensation, including $1.6 million in severance and a $600,000 contribution to a supplemental pension plan.

Penn State's Mr. Pollock believes the new disclosure requirements, particularly information on severance payments, will provide more ammunition for pay critics. They may even open the eyes of some board members, he adds.

"A lot of directors are not necessarily aware of some of the provisions in some of these CEO contracts," he said.

But compensation consultant Pearl Meyer expects the rules will have unintended consequences because shareholders aren't the only ones looking at the additional information. Companies who discover they are paying much more than their competitors may rein in compensation, says Mrs. Meyer, senior managing director of Steven Hall & Partners.

Of course, the opposite could prove true, too, she said. "Others who are not leaders of the pack will say 'Hey, we're very much behind. Let's catch up.' "

She recalled that the SEC's last major revision of pay disclosure rules in 1992 had an inflationary impact on executive compensation as many companies rushed to play catchup.

Like many, Mrs. Meyer has problems with some of the requirements and the way companies are implementing them. She says the summary compensation table in proxy statements doesn't provide enough information to relate pay to performance. Information from other tables can help experts make a better judgment on that, but even they come up with different figures. For example, Mrs. Meyer noted that three proxy voting services who examined one company's disclosures came up with three different totals for the CEO's pay.

Despite the shortcomings, the new disclosure should help some shareholders make more informed decisions, says Mel Fugate, a Southern Methodist University business professor. But there are limits to how much disclosure alone will accomplish. "More fundamentally, this issue is more of a leadership issue," he said. "Do we want more accountability or just more information?"

Mr. Fugate cites the example of Best Buy CEO Brad Anderson, who last year donated 334,000 of his options to a fund to be used to reward non executive employees. A short time later, the top executive at rival Circuit City made a similar contribution, he says.

"What if Exxon Mobil's Lee Raymond had done something like that?" Mr. Fugate asked, referring to the former CEO who accepted at $147 million pay and pension package last year.

Those kinds of gestures send more profound messages, the kind that can't be found in SEC regulations, he says.

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