← More on New ISS & Glass Lewis Policies | Main |

December 3, 2015

Director Pay: In the News

– **Broc Romanek**, CompensationStandards.com

This story ran in the Boston Globe yesterday – front page above the fold – entitled "Few hours, soaring pay for corporate board members":

> Michael Heffernan earned $1 million from Ocata Therapeutics Inc. in Marlborough last year, including stock and stock options. William D. Young received $1.7 million in compensation from Vertex Pharmaceuticals Inc. of Boston. And Phillip A. Sharp hauled in $1.9 million from Cambridge-based Alnylam Pharmaceuticals Inc. But the men are not chief executives or vice presidents. They're not even full-time employees. They're corporate board members, receiving premium paychecks in exchange for, typically, attending a meeting every few weeks. The Boston Globe calculated the men earned more per board meeting than the average Major League Baseball player received per game.
>
> Like pay for chief executives, compensation has skyrocketed for board members at publicly traded companies across Massachusetts and the United States over the past 15 years, even as wages have stalled for most American workers. Board pay has nearly doubled at the 200 largest US public companies since 2000 to a median of $258,000 last year, according to a Globe analysis of data from the National Association of Corporate Directors. And the pay — which is typically set by the board members themselves — has risen at an even faster clip at smaller and midsize companies. By contrast, weekly wages for full-time US workers overall rose just 37 percent during the same span, according to the Bureau of Labor Statistics. Million-dollar pay packages for board members are "very, very troubling," said Charles M. Elson, director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. "It's tough to justify."
>
> Directors play a pivotal role in corporate America, with responsibility for overseeing management, hiring and firing CEOs, ratifying key decisions, and helping set long-term strategy. But in a series of stories that begins today, the Globe shows that escalating compensation could create a disincentive for directors to challenge executives and that the boardroom remains the preserve of white men.
>
> And service remains a part-time gig. On average, board members report that they generally work fewer than five hours per week per board. Many directors also hold full-time jobs. "The idea that a director would receive half a million dollars or more from service on one board speaks to growing inequality in our society," said Brandon Rees, deputy director of the AFL-CIO's Office of Investment, which studies corporate governance. Corporate watchdogs are worried about more than basic fairness. Some say the director pay at some companies has become so lucrative that it could discourage directors from questioning excessive perks for chief executives for fear of upsetting the rest of the board and losing their coveted positions. Elson said that some directors' compensation packages have become "so large that it incents you to act in a way that keeps your fee, as opposed to in a way that furthers the company's interest."
>
> A 2006 study in the Journal of Corporate Finance found a strong correlation between excessive pay for directors and chief executives and noted that the companies paying their directors the most also underperformed their peers financially. A study last year in the International Journal of

Business and Finance Research concluded that high chief executive and board pay go hand-in-hand due to "mutual back-scratching." It's easy to find examples in which high-paid directors were accused of not doing enough to oversee the companies and senior executives:

Enron, the Texas energy-trading giant, had one of the highest-paid boards in the country in 2001, the same year it collapsed amid allegations of accounting fraud and excessive executive pay. The company paid out $55 million in bonuses to employees just days before filing for bankruptcy. Chesapeake Energy, which was rocked by a scandal of its own in 2012, paid directors far more than its peers and allowed its board members to use its corporate jet for personal travel. Investors later accused directors of failing to monitor the chief executive's spending and potential conflicts of interest, including taking personal stakes in thousands of the company's oil wells. And Boston-based Vertex this year came under fire for approving a $37 million pay package — among the highest in the country — for its chief executive, even though the company has made an annual profit only once in its 26-year history. Financial filings show Vertex directors awarded themselves a median of $788,000 in total compensation last year, double the median for companies Vertex identified as its peers.

But many people in corporate America defend rising director pay, arguing that board work has become more rigorous and time-consuming because of new regulations and laws, including the Sarbanes-Oxley Act of 2002 and the Dodd-Frank financial overhaul measure of 2010. "Fifteen years ago, most people who were on boards were members of the country club, they were friends of the CEO, and they didn't do a heck of a lot of work for the money," said Martin M. Coyne 2d, a former executive vice president at Eastman Kodak Co. who has served on a number of boards. "Now it's a much harder job. You have to do your homework, work at it, stay current on things, and you have a tremendous amount of personal exposure if things go wrong."

Nationally, directors estimated they spent an average of 248 hours per year on each board they served on last year — just under 5 hours a week per board — up from 156 hours in 2003, according to surveys by the National Association of Corporate Directors. That includes attending committee and board meetings, as well as travel and preparation for those gatherings. Directors can spend more time if a company becomes the target of a hostile takeover or faces a financial crisis, forcing directors to hold emergency meetings. But they often spend only a few hours a week on each board.

JoAnn A. Reed, a health care consultant who serves on the boards of three publicly traded companies, estimated she spends more than three hours a week on average on each board she serves on, although that time is often clustered in full days of travel, preparation, and discussions. Last year, for instance, she earned more than $900,000 serving on the boards of Waters Corp. in Milford, Mass., Boston-based American Tower Corp., and Mallinckrodt Pharmaceuticals PLC of Ireland.

Phillip A. Sharp received in $1.9 million in 2014 for serving on the board of Cambridge-based Alnylam Pharmaceuticals Inc. Reed argued the national growth in director pay is justified, noting that firms are competing to recruit experienced executives, especially chief executives and chief financial officers. Reed herself served as a chief financial officer for a major pharmacy benefits company for a dozen years. And Alnylam director Sharp has a Nobel Prize under his belt.

"I think the caliber of individuals [on boards] has improved since the early 2000s," Reed said. "You have more people who are specialized." Reed also argued the increased pay was justified because many companies have become larger and more valuable over time. For example, median pay for directors at Waters Corp. has more than doubled over the past eight years to $336,360, but so has the value of Waters' stock, benefiting shareholders. "Your stock price is increasing, therefore the compensation numbers are increasing," Reed said. That is not the case everywhere, however. Overall, the S&P 500 stock index has climbed 43 percent since 2000, even as director pay more than doubled during the same period. And it is hard to measure how the quality of directors has changed over time. Many older directors on boards now were also on boards 15 years ago.

Meanwhile, pay continues to march upward. In Massachusetts, director pay has risen almost 60 percent over the past seven years, according to a Globe review of financial filings at more than 100 publicly traded companies. At Massachusetts firms alone, the Globe found dozens of directors earning more than $500,000, including at least a half-dozen who topped the $1 million mark in total compensation last year.

Some directors even earn as much as chief executives for serving on a single board. For instance, former Merck & Co. chief executive Dr. P. Roy Vagelos, 86, earned $20.5 million last year, mostly in stock options, for serving as chairman of the board of Regeneron Pharmaceuticals Inc. of Tarrytown, N.Y. That's double the amount the average chief executive earned at an S&P 500 company, according to the most recent report by Equilar, which tracks executive compensation.

A Regeneron spokeswoman, Alexandra Bowie, argued Vagelos was "technically an employee" because he was given an employment agreement in 1998 that requires him to work 30 to 50 hours a month, or an average of nine hours a week. The pay works out to nearly $43,000 per hour. Regeneron also had one of the highest-paid chief executives in the country: Dr. Leonard S. Schleifer earned nearly $42 million last year, mostly in stock options. Still, Regeneron and other companies pointed out that much of the board compensation came in the form of restricted stock and stock options, which can take years to vest and fluctuate in value.

Stock options in particular are tricky to value. Companies typically report an estimate of what the options would be worth on the day they were granted, assuming they could be sold on the open market. But the actual amount of cash directors reap could ultimately be much higher or lower, depending on how the stock performs and when directors exercise the options. Vertex spokeswoman Dawn Kalmar said its director pay is almost "100 percent performance-based" because so much is in the form of stock options. She said the structure gives directors an incentive to boost the company's stock price, which has more than tripled in the past three years. "Those options have no value if the share price does not go up," Kalmar said. She said the bulk of Young's $1.7 million compensation last year was based on a one-time additional package of stock options he received upon joining the board. Yet Young was also immediately put on the compensation committee that awarded the chief executive's controversial pay package. The pay was so high that a majority of investors voted against the pay in a nonbinding shareholder vote earlier this year. Vertex, however, said it plans to reduce the amount of compensation it pays directors and change the mix to give directors more in cash and less in stock options. Kalmar said the change would align Vertex with the pay structures of similar life sciences companies.

Similarly, Alnylam noted the bulk of its director compensation is based on stock options. In fact, Alnylam gave out such large packages that four of its directors earned more than $1.2 million in total compensation last year. Sharp, who earned $1.9 million, was the highest-paid director. However, Alnylam spokeswoman Christine Lindenboom said the company recently decided to reduce the number of options its board members receive by 25 percent to reflect its substantial increase in share price. As a result of that change, Alnylam's board pay will better match its peers. And Ocata spokesman Christopher R. Hippolyte said Heffernan's $1 million compensation package included a "one-off stock option grant" that was valued at nearly $800,000. He noted the options could be worthless if the stock does not go up.

The argument rings hollow to David Zweig, coauthor of the 2010 book "Money for Nothing: How CEOs and Boards Are Bankrupting America." Most restricted stock and options, he noted, do wind up being worth real money — even if that amount differs from their estimated value in financial filings. Most stocks do rise over time, even if the company has average performance. And companies typically give out a raft of new options every year. So even if a company's stock price plummets, directors typically get a new round of options at that lower price. Indeed, options can often be worth millions just based on normal fluctuations in a firm's stock price. "It's like buying a lottery ticket you have a pretty good chance of winning," Zweig said. "That's not skin in game; that's getting a skin graft from someone else."

Overall, total pay packages have soared so high that some watchdogs worry it has gotten out of hand. "You have to pay them, obviously, for their effort, time, and potential liability," said Elson, the University of Delaware professor. "But when you start looking at director compensation that looks like managerial compensation, that's where you run into problems."

Posted by Broc Romanek
Permalink: http://www.compensationstandards.com/member/Blogs/consultant/2015/12/director-pay-in-the-news.html