Should Dick Grasso Return the Dough?

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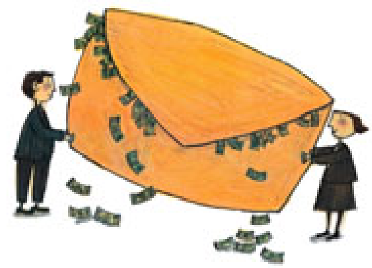

It's today's $139.5 million question: Why doesn't Richard Grasso, former chairman of the New York Stock Exchange, give back at least some of the nearly $140 million in compensation that he was granted by the NYSE's board of directors? That the question is even being raised, of course, speaks to the sudden change in thinking about such issues as corporate governance and executive compensation. While some say that the New York Stock Exchange should be held as accountable as Grasso, right now it's the former chairman who is facing the most outrage. The sentiment among corporate governance experts at Wharton is that Grasso should a) give some of the money back, or b) at least start talking about giving it back.

"I can understand why the public would think he is greedy," says Wharton legal studies professor Thomas W. Dunfee. "No question but that social norms are changing in this area. One of the charges brought by the dissidents against Michael Eisner is that he received a $5 million bonus in a year in which the market value of Disney declined substantially."

There's no agreeement, however, on whether returning some of the money will help quell the barrage of criticism that Grasso has faced over the past few months. "Some actual give-back beyond the cancellation of the amount he claims to still be owed to him would probably suffice," Dunfee suggests. "I don't think it would have to be a large sum. The dumbest thing would be for him to sue the exchange for the amount still owed."

Yes, but it may be too late for Grasso to win back his reputation, even if he returns the money or a substantial portion of it, according to Wharton accounting professor David F. Larcker, an expert in the design of executive compensation plans. "Let's say he gave back $100 million. Would that do him any good? They would say he should not have taken so much in the first place. He might think, 'I am going to get the bad parts of this anyway, so I might as well keep it all.' From an ethical point of view, he should return some of it, but he should not have taken it in the first place. It is like trying to turn back the hands of time."

Grasso himself seems to have made the same calculation as Larcker. Through his attorneys, he has blasted the exchange for its temerity in asking him to return the package. The exchange, having concluded an internal investigation, has welcomed the intervention of the Securities and Exchange Commission and New York Attorney General Eliot Spitzer, although neither of them needed such encouragement. Regulators are looking into the details of Grasso's compensation, his activities as an outside director and his business relationships with former directors, according to press reports.

Going by statements his lawyers have made to the media, Grasso is acting like a man who has already lost his good name and does not also want to lose his wealth. Leave me alone, or I will ask for the $48 million I left on the table, he says, setting the stage for a long and contentious catfight.

Conscience, not Corporate Governance

Wharton management professor Martin J. Conyon has a different perspective on the situation. “The compensation committee and the board signed off on [the package], so in this regard the system worked as it should. A contract was struck and, assuming there was nothing unusual about the contract, that is the deal. One side agreed on a payment for services, those services presumably were rendered, and that’s that … The tone in corporate America has certainly changed since the passage of Sarbanes-Oxley and the high profile corporate scandals. However, returning compensation is probably a matter of conscience rather than corporate governance.”

In this case, however, it may not be that simple. Preliminary reports suggest Spitzer is looking at New York State laws that govern the fiduciary responsibilities of boards and executives of non-profit organizations. The stock exchange is a not-for-profit enterprise. Normally Grasso might be insulated by the fact that he had a contract with the exchange, but in the context of non-profits, Grasso’s compensation “meets the test of ‘excessive,’ hands down, without a question,” says Robert E. Mittelstaedt, Jr., director of the Aresty Institute of Executive Education at Wharton and soon to be dean of the business school at Arizona State University. “If he doesn’t return the money he has a big problem on his hands.”

Mittelstaedt doesn’t put a dollar figure on just how much Grasso should offer to return. “I would say he has got to negotiate something. In the current environment he is just going to make it worse by stonewalling.” The amount of money Grasso received was “astronomical for a job that is basically a regulator’s job,” adds Larcker, echoing widespread sentiment. “The other [piece of information] I found amazing was that the exchange’s compensation committee was surprised at the sum of money paid out … There were some odd circumstances surrounding it.”

Whether Grasso was overpaid depends on which prism you look through, according to Tim Ranzetta, president and COO of Equilar, a compensation analysis firm in San Mateo, Calif.“The biggest issue is, what is the right peer group? Whom can you compare the NYSE to – to Wall Street firms, or is it more like governmental or regulatory bodies? Arguments probably can be made on both sides.”

Grasso’s $30.5 million compensation package for 2001 – including salary and deferred payments – was higher than what the chief executives of Goldman Sachs, Charles Schwab and Merrill Lynch took home that year. Among key financial regulatory figures, Alan Greenspan’s salary at the helm of the Federal Reserve is $172,000. William Donaldson, head of the Securities and Exchange Commission, earns about $140,000.

There’s no magic formula for determining executive compensation, Larcker says. “It is hard to put everybody in the same box. If you have somebody who is a fantastic manager and strategist, everybody agrees you have to pay that person a lot of money. Bill Gates or Michael Dell or Jack Welch, these people maybe are worth huge money. But you find others who are paid a lot and it is just not clear they are any better than other people who would work for a lot less.”

According to Mittelstaedt, there is a history of government monitoring of compensation at non-profits such as universities and charities. Some years ago the head of United Way was sanctioned, and “those numbers were nowhere near Grasso’s compensation,” he says. Dunfee speculates that any action to recover money from Grasso would be similar to the action brought against Sherif Abdelhak, the ousted head of the Allegheny Health, Education and Research Foundation in Pennsylvania, who was sued by shareholders and investigated by numerous government agencies for fiscal irresponsibility and mismanagement prior to AHERF's bankruptcy filing in July 1998.

Board Responsibility

"It could get very complicated from Grasso's point of view, but the people for whom this can really get ugly are the former board members," Larcker says. "They had the ethical and fiduciary responsibility. These people are senior, well-established members of the investment community." He predicts "a big pushback on capping executive pay," adding that he doesn't expect pay to be legislated, but rather that there will be "much more rigorous discussion of justifying pay" instead of just leaving it to the professionals. Companies will have to defend more rigorously "why someone is worth $20 million, especially as the economy goes sideways."

Much of that burden will have to be carried by boards and compensation committees, says Mittelstaedt, who serves on the boards and compensation committees of several companies. "Boards have not always looked into things as closely as they should have, in part because compensation contracts can be complex, with pay often contingent on company performance or the occurrence of specific events such as a merger, change of control, retirement or termination. Grasso's contract, for example, involved bonuses, incentives, deferred compensation and retirement pay. He or his team may have proposed something and board members did not play out all the possible scenarios. It wasn't as obvious as someone being paid a straight $50 million a year."

At the end of the day, however, personal integrity is what still counts above all. Mittelstaedt notes that L. Dennis Kozlowski, now being tried on charges of grand larceny, attended a Wharton executive education course six years ago. "He talked about how important good corporate governance is to a well-run company. Clearly integrity is not about taking courses but about one's own moral compass."