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# Executive Excess 2006

## Defense and Oil Executives Cash in on Conflict

13<sup>th</sup> Annual CEO Compensation Survey

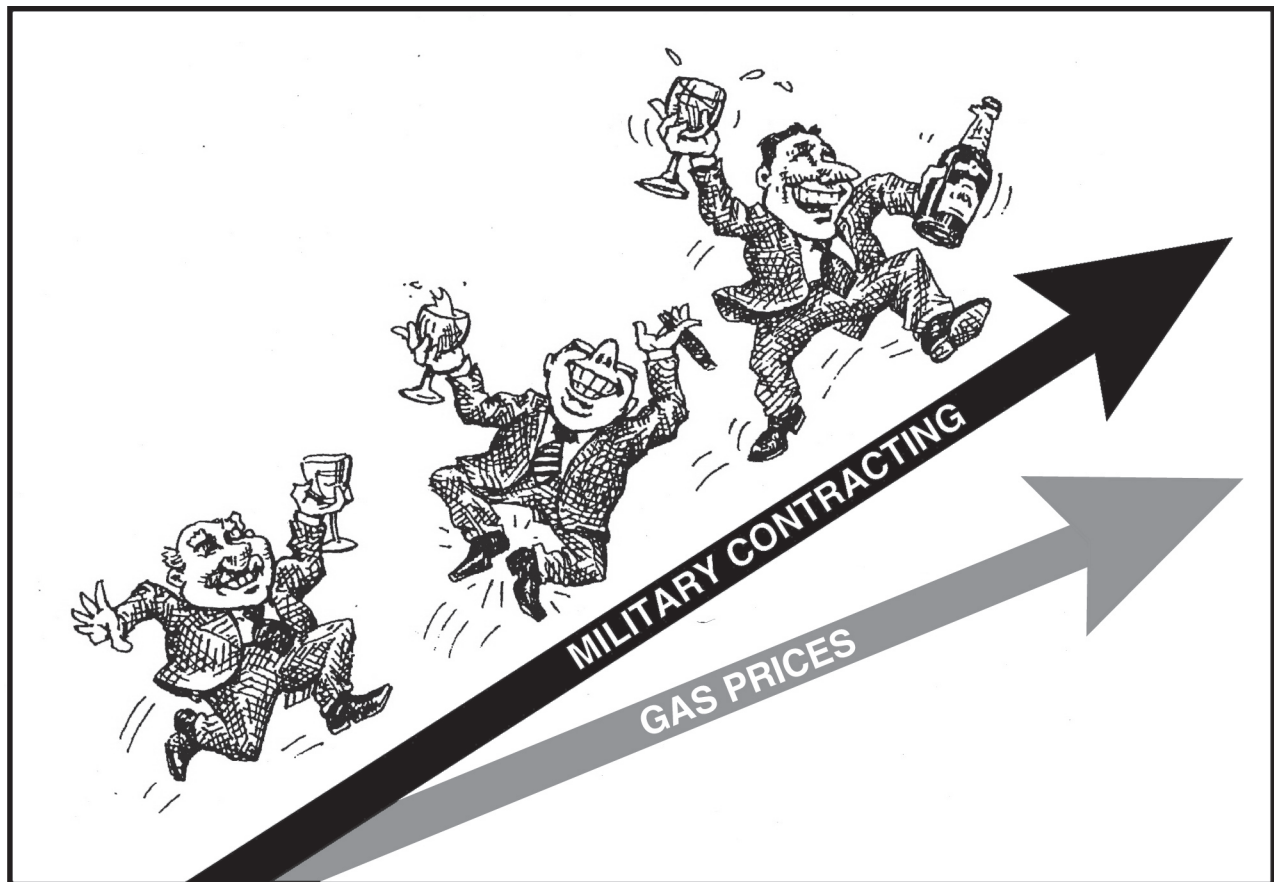


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# Key Findings

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## 1. Ratio of CEO pay to average worker pay now 411-to-1

- Since we first started tracking the CEO-worker pay gap in 1990, it has grown from 107-to-1 to 411-to-1 in 2005. Today's gap is nearly 10 times as large as the 1980 ratio of 42-to-1, calculated by *Business Week*. If the minimum wage had risen at the same pace as CEO pay since 1990, it would be worth \$22.61 today, rather than the actual \$5.15.

## 2. CEOs of the biggest defense contractors continue to profit from a privatized war

- Since the "War on Terror" began, the CEOs of the top 34 defense contractors have enjoyed average pay levels that are double the amounts they received during the four years leading up to 9/11. Their average compensation jumped from \$3.6 million during the pre-9/11 period of 1998-2001 to \$7.2 million during the post-9/11 period of 2002-2005.
- Defense CEO pay was 108 percent higher on average in 2005 compared to 2001, whereas pay for their counterparts at other large U.S. companies increased only 6 percent during this period.
- Since 9/11, the 34 defense CEOs in our sample have pocketed a combined total of \$984 million, enough to cover the entire wage bill for more than a million Iraqis for a year.
- Defense CEO pay was 44 times that of a military general with 20 years of experience and 308 times that of an Army private in 2005. Generals made \$174,452 and Army privates made \$25,085, while average defense CEO pay was \$7.7 million.
- The highest-paid defense executive was **George David of United Technologies**, who hauled in more than \$200 million during the period 2002 to 2005. Meanwhile, David is suing the Pentagon to keep the public from seeing documents about alleged problems with its Black Hawk helicopters.
- The largest post-9/11 total pay increase went to **Health Net CEO Jay Gellert**, whose managed care services for military personnel and their families is booming thanks to the Iraq War.
- **Halliburton CEO David Lesar** made \$26.6 million last year, despite a continuing stream of scandals related to the company's work in Iraq, the latest being reports that the contractor infected soldiers with contaminated wastewater. While Halliburton's future Iraq work is uncertain, Lesar will enjoy the nearly \$50 million he has made since the "War on Terror" began.

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## 2. Oil Barons Cash in on Conflict

- The top 15 U.S. Oil Barons are paid 281 percent of the average CEO compensation in comparably sized businesses. The top 15 U.S. Oil CEOs were paid an average of \$32.7 million in 2005 while the average compensation for CEOs of large U.S. firms in all industries was \$11.6 million.<sup>1</sup>
- These top 15 Pump Profiteers are paid 518 times the average worker in the oil and gas industry. The disparity between U.S. CEOs as a whole and average U.S. workers is 411-to-1.
- The top 15 Petroleum Profiteers got an average raise of 50.2 percent of their 2004 pay packages. Meanwhile, the annualized average hourly wage of production workers in the oil and gas industry increased by only 4.1 percent from their 2004 levels.<sup>2</sup>
- Top three highest paid U.S. oil chieftains in 2005:  
#1 William Greehey (**Valero Energy**) = \$95.2 million  
#2 Ray R. Irani (**Occidental Petroleum**) = \$84.0 million  
#3 Lee Raymond (outgoing CEO of **ExxonMobil**) = \$69.7 million  
And the lowest paid: Chad Deaton, CEO of **Baker Hughes** = \$6.6 million
- The second- and third-largest oil companies in the world are both foreign firms, **British Petroleum** and **Royal Dutch Shell**. Both pay their CEOs considerably less than comparable U.S. oil companies. While they operate in the same global marketplace, their average pay was \$4.8 million, compared to the average of \$39.2 million for the top 2 U.S. oil CEOs.<sup>3</sup>
- Construction laborers, who are among the lowest paid workers in the oil and gas industry, are paid an average of \$22,240 per year.<sup>4</sup> It would take one of these workers 4,279 years to earn what CEO William Greehey of **Valero Energy** earns in a year.
- The average annual pay for a rotary drill operator is \$43,450.<sup>5</sup> Ray Irani's 2005 compensation at **Occidental Petroleum** would cover the wage bill for 1,932 rotary drill operators.
- The average annual pay for a petroleum engineer is \$107,990.<sup>6</sup> It would take 645 engineers to earn the amount that **ExxonMobil's** Lee Raymond got paid in 2005.

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# I. Introduction

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Over the 13 years that researchers at the Institute for Policy Studies and United for a Fair Economy have been documenting CEO pay, we have chronicled levels of greed and excess that defy both reason and any old-fashioned sense of shame. The shamelessness continues. Average CEO pay packages in the United States, our latest analysis reveals, now weigh in at 411 times average worker pay. In 2005, our nation's most lavishly paid CEO, Richard Fairbank of Capital One Financial, raked in \$250 million.

Numbers this grotesque are generating a growing popular backlash against excess that reminds us how strong our democracy remains and points to a more reasonable future. The voices in opposition to excessive executive pay today extend far beyond labor and religious circles to include both prominent business leaders and members of Congress. In this research, these reformers will find ample new statistical evidence that substantiates just how broken our corporate compensation systems have become.

In this year's report, we focus on the two corporate sectors where Executive Excess may be the most inexcusable, the defense industry and the oil industry. In both these sectors, windfalls from war are driving executive pay to record levels.

Our first section updates last year's look at compensation levels for top U.S. defense contractors. Over a half century ago, Presidents Franklin Delano Roosevelt and Harry Truman considered profiteering off war among the worst of immoralities. We share their conviction, and, in these pages, we present solid evidence that several dozen leading CEOs are engaging in just the sort of profiteering that FDR and Truman so abhorred.

We are happy to report that the executive we exposed last year as the nation's top "war profiteer," David H. Brooks, has been forced to resign as CEO of armored vest maker DHB Industries. Brooks is currently under criminal investigation. Criminal prosecutions offer one way to stop war profiteering. This year's report suggests several others.

In our second focus area—the energy industry—executives are exploiting "War on Terror" oil market instability to cash in as grandly as the oil barons President Teddy Roosevelt went after so aggressively a century ago. With average Americans feeling the pinch at the pump and death tolls mounting in the Middle East, today's oil executives are reaping record take-homes. We outline some innovative solutions to "share the wealth."

The levels of inequality this report describes will, if left unaddressed, soon threaten the foundation of democracy in our nation, for democracies decay when one segment of society flourishes at another's expense, when fortunes—and power—concentrate at the top. On this holiday that sees our nation pause to celebrate "labor," we offer an agenda to narrow our dangerous divides and reinvigorate our democracy.

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## II. Defense Executives: Personal Profits in a Privatized War

In the most privatized war in history, lucrative opportunities abound for chief executives of an increasingly wide range of defense contractors.

Giants of what President Eisenhower called the Military Industrial Complex like Lockheed Martin and Boeing continue to reap the largest deals. But in our contemporary outsourcing age, contractors are scoring big profits performing many tasks previously handled by the military itself, everything from training U.S. interrogators and Iraqi police to recruiting U.S. troops, feeding them in the battlefield and providing their health care.

This unprecedented outsourcing reflects the conventional wisdom, in and around the Bush administration, that private corporations can always perform more efficiently than public sector institutions. Has privatizing the “War on Terror” indeed made the U.S. war effort more efficient? We don’t really know, because we have, in this war, no serious government oversight effort in place.<sup>7</sup>



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*“We must guard against the acquisition of unwarranted influence, whether sought or unsought, by the military-industrial complex.”*

—President Dwight D. Eisenhower<sup>8</sup>

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Still, even if we can’t determine what privatization has meant for the war’s prosecution, we can explore what privatization has meant for the war’s leading privatizers, the top executives at the companies that have received the most defense contracts. And as the human and economic costs continue to mount, it is important to take a hard look at who might be benefiting from a “War on Terror” with no end in sight.

### The Post-9/11 Jackpot

The companies included in our sample are the 34 publicly traded U.S. corporations that were among the top 100 defense contractors in 2005 and took at least 10 percent of their total revenues from defense contracts.<sup>9</sup>

The CEOs at these 34 companies have enjoyed, since the “War on Terror” began, average pay levels that are double the amounts they received during the four years leading up to 9/11. Average total compensation, including options gains, jumped from \$3.6 million during the pre-9/11 period of 1998-2001 to \$7.2 million during the post-9/11 period of 2002-2005 (see Appendix 1 for details).

### Defense Spending Flows into Executives’ Pockets

The sharp rise in pay for defense industry executives since 9/11 closely tracks the post-9/11 boom in U.S. military expenditures. In 2005 alone, defense contracts totaled \$269 billion, up from \$154 billion in 2001. This flood of funding has



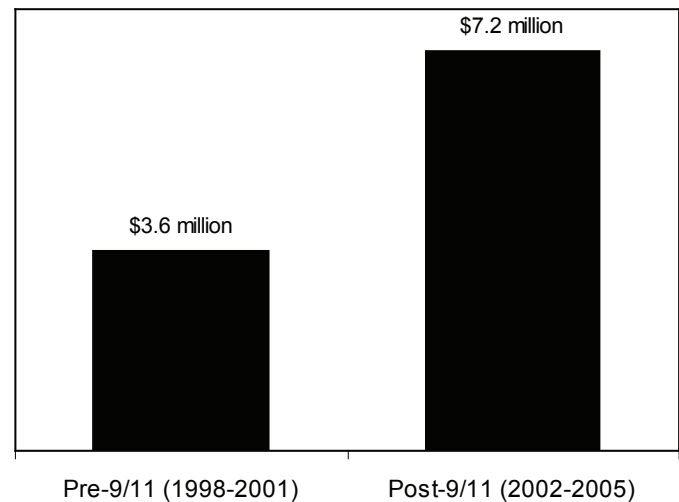
contributed to a massive surge in defense contractor profits. Between 2001 and 2005, average profits for the 34 firms in our sample jumped 189 percent. In that same period, U.S. corporations as a whole saw their profits rise only 76 percent.<sup>10</sup>

Wall Street has taken notice. Between the end of the year 2000 and the end of 2005, the share prices of the 34 companies in our sample increased 48 percent on average, compared to a 5 percent drop for the S&P 500 during that period.<sup>11</sup> This has translated into big paydays for defense industry executives. In fact, defense CEO pay has risen even faster than our mushrooming military budget. The value of all Department of Defense contracts rose 75 percent between 2001 and 2005, while pay for the 34 defense CEOs in our sample rose 108 percent.

Defense CEOs also enjoyed higher pay rate hikes than their counterparts at other leading U.S. corporations. Historically, pay for top defense industry executives has lagged behind the pay for other large company CEOs. That gap has narrowed since the War on Terror began. In 2005, average total compensation for the CEOs of large U.S. corporations as a whole was only 6 percent above 2001 figures, whereas defense CEO pay was 108 percent higher.

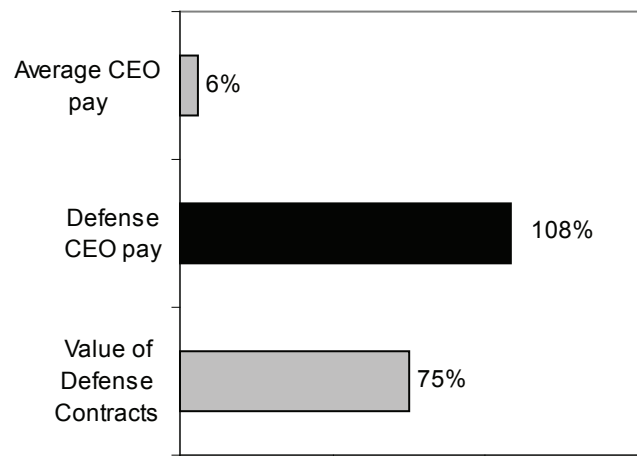
In the four years since the War on Terror began, the 34 defense CEOs in our sample have pocketed a combined total of \$984,008,400. To put that huge sum in some perspective, it would be large enough to cover the entire wage bill for more than a million Iraqis for a year.<sup>12</sup> Iraqi and U.S. officials acknowledge that the millions of Iraqis who have been without steady jobs since the 2003 invasion create a vast pool of potential recruits for insurgents.<sup>13</sup>

**Figure 1: Defense CEO Pay, Pre-9/11 and Post-9/11 (Average Total Compensation)**



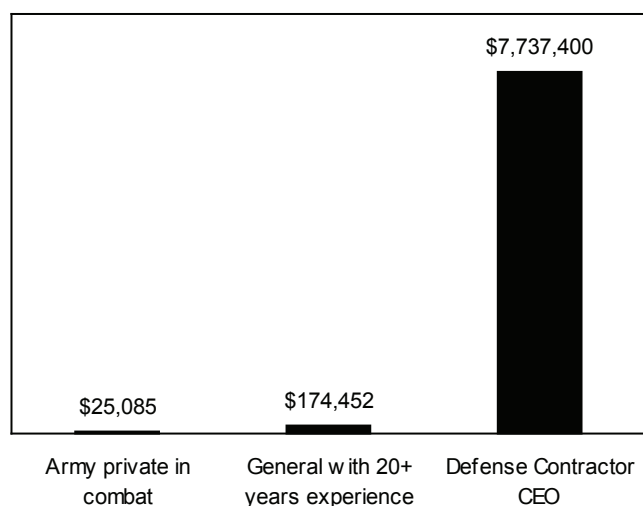
Source: company proxy statements.

**Figure 2: Defense CEO Pay vs Defense Contracts and Average CEO Pay(% Increase 2001–2005)**

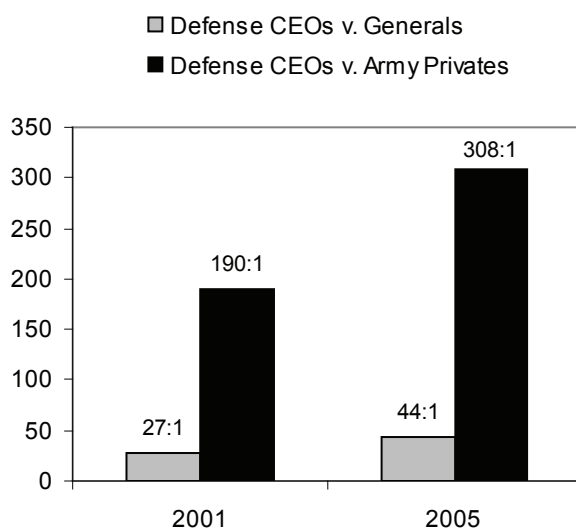


Sources: Calculated by authors based on Wall Street Journal executive compensation survey, April 10, 2006; company proxy statements; and Department of Defense, Summary of Procurement Awards.

**Figure 3: Military-Related Pay, 2005**



**Figure 4: Change in Pay Ratios, 2001-2005**



Sources: Department of Defense, Defense Finance and Accounting Service, 2001 and 2005 Military Pay Rates for E-2 (second-lowest rank enlisted personnel) and O-10 (Generals). Includes: base pay, housing allowance, and imminent danger/hostile fire pay. Some military personnel qualify for additional assistance, such as a \$250 monthly allowance for family separation.

## Defense CEO Pay and Battlefield Pay: A Comparison

Defenders of current CEO pay levels often argue that corporate leaders deserve the ample compensation that comes their way since they bear such tremendous responsibility and operate in such a complex and risky business environment. Military generals also face tremendous responsibility and operate in difficult environments. Yet they receive only a tiny fraction of typical defense contractor executive pay.

In 2005, military generals with 20 years of experience made \$174,452, housing allowances and extra combat pay included. The average 2005 pay for a defense CEO: more than \$7 million.

Army privates in combat, for their part, faced considerably more everyday risk than CEOs—or generals for that matter. Yet they averaged only \$25,085 in 2005.

The defense industry-military pay gap is actually growing. Since September 11, 2001, the ratio between average pay for defense contractor CEOs and pay for military generals with 20 years of experience has increased from 27-to-1 to 44-to-1. The pay gap between defense CEOs and low-ranking enlisted personnel—army privates (E-2 grade), for instance—has jumped from 190-to-1 to 308-to-1.<sup>14</sup>

These disparities are, not surprisingly, accelerating the virtual revolving door between the Pentagon and private contractors. One prominent example: former Defense Secretary William S. Cohen, who left his post in 2001 with a pile of credit card debt and quickly made a fortune lobbying for defense contractors. Cohen now helps Lockheed Martin, United Technologies, Northrop Grumman and other major contractors get deals from his former underlings in the Defense Department.<sup>15</sup>

## Defense CEO Defends Military Pay Gap

In a blistering seven-page letter responding to our 2005 report, Jack London, the chief executive of defense contractor CACI International, argued that defense

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executives fully deserve much more pay than military generals. In London's view:

"Generals are responsible for their command, just as CEOs are responsible for work they perform and the livelihoods of their employees and respective families. However, CEOs of publicly owned companies also bear additional fiduciary responsibilities to their shareholders, financial markets and federal oversight groups. Generals do not. Companies are accountable for profitable performance and sustained customer satisfaction. Generals are not. CEOs are responsible for the growth of their organizations. Generals are not. Because of the varied and differing, and additional responsibilities, CEOs are currently rewarded additional compensation."<sup>16</sup>

London's company has had some problems on the "customer satisfaction" front of late. CACI International drew headlines in 2004 when investigators linked a CACI employee working as an interrogator with the Abu Ghraib prison scandal. The firm later announced a pullout of all personnel from the country as of September 2005.<sup>17</sup> But CACI remains a major provider of vaguely defined information technology, logistics and administrative services to defense and intelligence agencies. In 2005, the company received \$765 million in defense contracts and London made \$3.6 million.

## The Biggest Defense CEO Winners

### The Highest-Paid Defense Executive:

#### United Technologies CEO George David

##### *Helicopter Maker Suing Pentagon to Keep Secrets About Alleged Defects*

George David of United Technologies Corporation (UTC) has hauled in far more than any other defense executive since September 11, with total compensation of more than \$200 million during the period 2002 to 2005. In his peak pay year, 2004, he amassed \$88.3 million in annual total compensation, including options gains. His pay dropped last year to \$31.9 million, but that take-home still put him at the head of the defense executive pack, followed by Boeing's new CEO W. James McNerney Jr., with \$28.4 million.

Taxpayers, through defense contracts, provide about a third of United Technologies' operating income and, presumably, have the right to know how their tax dollars are getting spent.<sup>20</sup> United Technologies apparently disagrees. The company has filed suit to keep secret documents with information about alleged problems with United Technologies products that may have endangered lives.

The secrecy push began after a 2003 scandal in which the Defense Contract Management Agency cited UTC subsidiary Sikorsky with 19 quality control concerns about its Black Hawk helicopters, including installation of "unqualified" parts.<sup>21</sup> Military officers told an investigator for Connecticut-based WTNH television that Sikorsky had delivered defective Black Hawk replacement parts to bases in Iraq.<sup>22</sup> The company subsequently claimed that all problems had been immediately fixed. But Pentagon officials were concerned enough about the situation, in 2004, to temporarily halt deliveries of the helicopters.<sup>23</sup>

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WTNH pursued the story by filing a Freedom of Information Act request for Sikorsky's quality control documents. Around the same time, the *Hartford Courant* filed a similar request related to concerns about another UTC subsidiary, jet engine maker Pratt & Whitney. The Defense Department agreed to release the documents in 2005, but the company filed an unprecedented suit against the Pentagon to block the release.<sup>24</sup> The case is now pending.

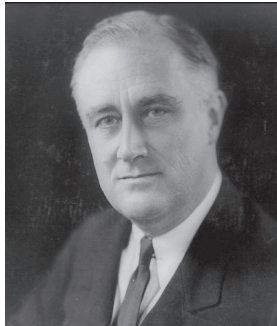
Meanwhile, despite the lawsuit, the Bush administration was generous to the company in its 2006 defense budget, requesting \$2.3 billion for Black Hawk-class helicopters and several billions more for Pratt & Whitney aircraft engines.<sup>25</sup> In 2005, United Technologies ended up the year as the 7th-largest U.S. defense contractor, with orders totaling more than \$5 billion.

## Top Post-9/11 Total Pay Increase:

### Health Net CEO Jay Gellert

#### *Military Mental Health Care a Booming Business for Managed Care Provider*

Health Net CEO Jay Gellert has seen his fortunes soar as the massive deployment of troops in Iraq and Afghanistan has boosted demand for the company's managed care services. Between 2002 and 2005, Gellert took home more than \$28 million, 1,134 percent more than his \$2.3 million compensation over the four preceding years.



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*"I don't want to see a single war millionaire created in the United States as a result of this world disaster."*

—President Franklin D. Roosevelt<sup>18</sup>

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Thanks to Pentagon outsourcing, Health Net currently holds contracts to provide health services to as many as three million active duty military personnel, veterans and family members. Health Net revenues from military contracts, the company notes in its most recent 10-K report, increased by \$286 million in 2005 "resulting from a rise in demand for private sector services as a direct result of continued and heightened military activity."

"Heightened military activity" juices Health Net's bottom line in a variety of ways. Dependents of National Guard and Reserve troops become eligible for benefits once family members are called up for duty. In addition, war increases the demand for the doctors in Health Net's private network, as military doctors at domestic bases are dispatched to battle zones. War-time stresses also increase the demand for Health Net mental health counseling.

Health Net, sums up company spokesperson Steve Cell, helps "servicemen and women and their families deal with the issues of troop mobilization around the world and issues of the conflicts that they're dealing with."

"That," he adds, "is a fast-growing business for us."<sup>26</sup>

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The Pentagon made its privatized health system, called TRICARE, attractive to contractors by offering a “risk-sharing” arrangement through which taxpayers pick up the bill for cost overruns above a certain level.<sup>27</sup> This taxpayer generosity has helped Health Net register, since 2003, a 26 percent increase in profits on the company’s military contracting. On the commercial side, the company has actually been losing money. In fact, if not for Pentagon business, Health Net would have ended 2004 \$27 million in the red.

What would happen to Health Net if troops were withdrawn from Iraq? Health Net CEO Gellert isn’t worried. His company, he told an institutional investor recently, will do fine even if troops withdrew from Iraq since the military’s own medical capacity will be stretched “into the foreseeable future” by the huge number of injured troops.<sup>28</sup>

## **Second-biggest Post-9/11 Total Pay Increase: Anteon International CEO George Kampf**

### ***Privatized Spy Training Drives Skyrocketing Pay***

Anteon International CEO George Kampf may be the poster boy for military privatization success. In the three years before 9/11, Kampf earned annual compensation in the mere six figures, about \$600,000. Last year, thanks to lucrative intelligence-related contracts, he pulled in more than \$9 million, up from \$6.2 million in 2004.

Pentagon intelligence outsourcing has helped drive Anteon International earnings up tenfold over the past decade. Anteon’s most recent 10-K report boasts that its intelligence training exercises “have played a major part in preparation of United States and Coalition Forces to meet the global war on terrorism and operation Iraqi freedom.”

Anteon currently holds a contract to conduct intelligence classes on an Arizona military base, work traditionally performed by the base’s own military intelligence brigade. Many of the interrogators working in Guantanamo and the Abu Ghraib prison in Iraq, notes CorpWatch investigator Pratap Chatterjee, received training at this site.<sup>29</sup>

Anteon also runs simulation exercises for the Pentagon, providing such hi-tech training at more than 80 sites throughout the United States, Germany, Italy and South Korea. It also builds what Chatterjee describes as “fake villages where soldiers can practice urban warfare.” At one advanced site in Fort Polk, Louisiana, trainers can watch every second of how soldiers perform in simulated war situations through nearly 1,000 cameras.<sup>30</sup>

Anteon’s 2005 annual report confidently projects strong future earnings, based on continued military outsourcing and high levels of military spending. General Dynamics will reap the fruits of these future earnings. This defense giant purchased Anteon this year for \$2.1 billion.

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## **Top Earner Among Scandal-Plagued Iraq Contractors: Halliburton CEO David Lesar**

*Iraq Windfalls May be Ending but CEO has \$50 million to Fall Back on*

Halliburton CEO David Lesar took home \$26.6 million last year, a bigger package than the \$24.2 million send-off awarded his predecessor, Richard Cheney, before he left the job for the Vice Presidency.

Lesar's haul amounted to quite an achievement, given Halliburton's record as the most scandal-plagued of Iraq contractors. The company has held the lion's share—52 percent—of Pentagon contracts for wartime services, from oilfield services to feeding the troops.<sup>31</sup> A steady stream of audits, employee testimony, and other evidence suggest that Halliburton has greatly abused this privileged position. Accusations have included bribe-taking, abandoning government property, overcharging the military, and even infecting soldiers with contaminated wastewater.<sup>32</sup> Government auditors have slammed Halliburton subsidiary Kellogg, Brown and Root for “inadequate” internal financial controls and identified more than \$1 billion in questionable costs.<sup>33</sup>

Attempts to hold the company accountable have so far fallen short. The top Army Corps of Engineers' civilian contracting official actually found herself demoted after she called a multibillion-dollar no-bid contract granted to Halliburton the “most blatant and improper contract abuse I have witnessed.”<sup>34</sup> When the Pentagon's own auditors contested \$253 million in Halliburton bills for delivering fuel and repairing oil equipment in Iraq, the Army reimbursed the company anyway.<sup>35</sup> Finally, in July 2006, the Army announced it was discontinuing a controversial Halliburton mega-contract to provide logistical support to U.S. troops. The contract will be broken up into three parts and opened to corporations (including Halliburton) for competitive bidding. Another Halliburton deal for oilfield services will be discontinued as U.S. funding for Iraq reconstruction is phased out.<sup>36</sup> Even so, whatever Halliburton's future in Iraq, David Lesar will be able to make ends meet with the nearly \$50 million he has made since the War on Terror began.

## **Second-Biggest Iraq Reconstruction Paycheck: URS CEO Martin Koffel**

*Koffel's \$14.4 million Highlights the CEO-Worker Divide in Wartime*

Outside of Halliburton's David Lesar, no CEO active in Iraq reconstruction work appears to have taken home a bigger paycheck in 2005 than Martin Koffel, the top executive at engineering company URS. Koffel walked away with \$14.4 million in 2005, more than double his \$6.4 million pay in 2004.

In Iraq, URS has partnered with the Louis Berger Group to oversee repairs to Iraq's communication system, hospitals and courthouses.<sup>37</sup> The company also provides extensive engineering and maintenance services for the military in Iraq.

The company's work—on the ground in Iraq—can be hazardous. Mechanics, as the company explained in a help-wanted ad, should expect: “extreme danger, stress, physical hardships and possible field living conditions associated with this position. Only those willing to work and live under these conditions should ap-



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ply...you should expect to work 12 hour days, seven days a week.”<sup>38</sup> For agreeing to these terms, URS was paying mechanics \$80,000 a year. Koffel, in his somewhat less hazardous office environs in San Francisco, made 180 times that amount.

The URS web site, interestingly, fails to mention the company’s operations in Iraq. We found a similar reticence from other reconstruction contractors in our sample. With some major Iraq reconstruction contractors, we can’t even learn how much the companies or their CEOs have actually made off the war because they are privately held companies that are not required to report this information (e.g., Bechtel and Parsons).

Also missing, for both publicly traded and privately held contractors, are basic performance data. In a February 2006 report, the U.S. Government Accountability Office complained of the absence of this data, observing, for example, that government reporting on water projects has focused on numbers of projects completed, not how much clean water is reaching intended users. On electricity, reports note progress in restoring generation capacity, but not whether intended users have uninterrupted and expanded service.<sup>39</sup> Information about contracts, work proposals, and much of the bidding processes is also kept from public view.

## Highest Pay Among Defense CEOs Under SEC Investigation: ESSI’s Gerald Potthoff

### *President Bush’s “Uncle Bucky” also a Winner*

The War on Terror has been good for business at the logistical services company Engineered Support Systems International (ESSI). As CEO Gerald Potthoff candidly if somewhat indelicately told a reporter who queried him about the impact of the war on the company stock: “obviously, we got a pop during the Iraq and Afghani thing.”<sup>40</sup>

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*“There is such a thirst for gain [among military suppliers]...that it is enough to make one curse their own Species, for possessing so little virtue and patriotism.”*

—President George Washington, 1778<sup>19</sup>

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A big pop. A series of war-related contracts, some awarded on a no-bid basis, drove company earnings to record levels and set up executives for a lucrative sale of the company to another defense contractor, DRS Technologies, in January 2006. Among the beneficiaries of that sale: President George W. Bush’s Uncle, William H. T. Bush, an ESSI director. “Uncle Bucky” cleared \$2.7 million in cash and stock as a result of the sale.<sup>41</sup> Known to the President as “Uncle Bucky,” he claims he had nothing to do with the company landing lucrative defense contracts.

Company executives don’t seem to have been particularly satisfied with these lucrative contracts. The federal Securities and Exchange Commission is now investigating whether company officials manipulated option grant dates to boost pay for current CEO Potthoff, co-founder Michael Shanahan Sr., and other company executives.<sup>42</sup> In all, the company’s top four executives have cashed in a

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total of \$104 million in options gains over the past five years, a sum equivalent to more than 40 percent of the company's net profit during that period. Analysts who have looked carefully at the company's option pricing claim the chances of the gains occurring *without* manipulation are remote.<sup>43</sup>

## Special Update: The Rise and Fall of a Bulletproof Vest Profiteer

Last year's *Executive Excess* report exposed the scandal of bulletproof vest maker David H. Brooks, who cashed in nearly \$70 million in options in 2004, as part of a \$186 million stock sale that sent stock in his company, DHB Industries, into a tailspin. Shortly thereafter, the military began recalling thousands of the company's Interceptor body armor over concerns about its effectiveness.

In November 2005 Brooks gained even greater notoriety by blowing a pile of his war windfalls on a celebrity-studded bash in New York City's Rainbow Room. For Brooks, the highlight of the gala, estimated to cost \$10 million, was a performance by rockers from Aerosmith. So pumped was the middle-aged Long Island businessman that he reportedly donned a hot pink, metal-studded suede pantsuit to cavort onstage with Steven Tyler.

But Brooks' reign as America's most ostentatious war profiteer was short-lived. On July 10, 2006, the DHB Board of Directors put Brooks on indefinite "administrative leave" pending the outcome of unspecified investigations. Three days later, he was forced to resign as part of a settlement with shareholders who had accused Brooks and other company officials of a "pump and dump" scheme to inflate the value of DHB stock before the massive sell-off in 2004.

The Justice and Defense Departments are also jointly investigating Brooks for possible criminal fraud and insider trading. The company was booted from the American Stock Exchange in June 2006 for failing to file financial reports.

Getting canned from a company you named after yourself must be painful. But Mr. DHB's forced resignation hardly makes up for the troubles he's caused shareholders, taxpayers and soldiers as he capitalized on the "War on Terror."

The war has been very good to Brooks. In the early 1990s, he was running a small brokerage business with his brother until the SEC temporarily barred him in 1992 over insider trading violations. Seeking a new line of work, Brooks turned his attention to a small body armor company he'd purchased for \$800,000 from a firm on the verge of bankruptcy. His fortunes turned dramatically when Brooks successfully lobbied in 1998 for an exclusive contract to make the vests used in the body armor now issued to every U.S. soldier in Iraq.

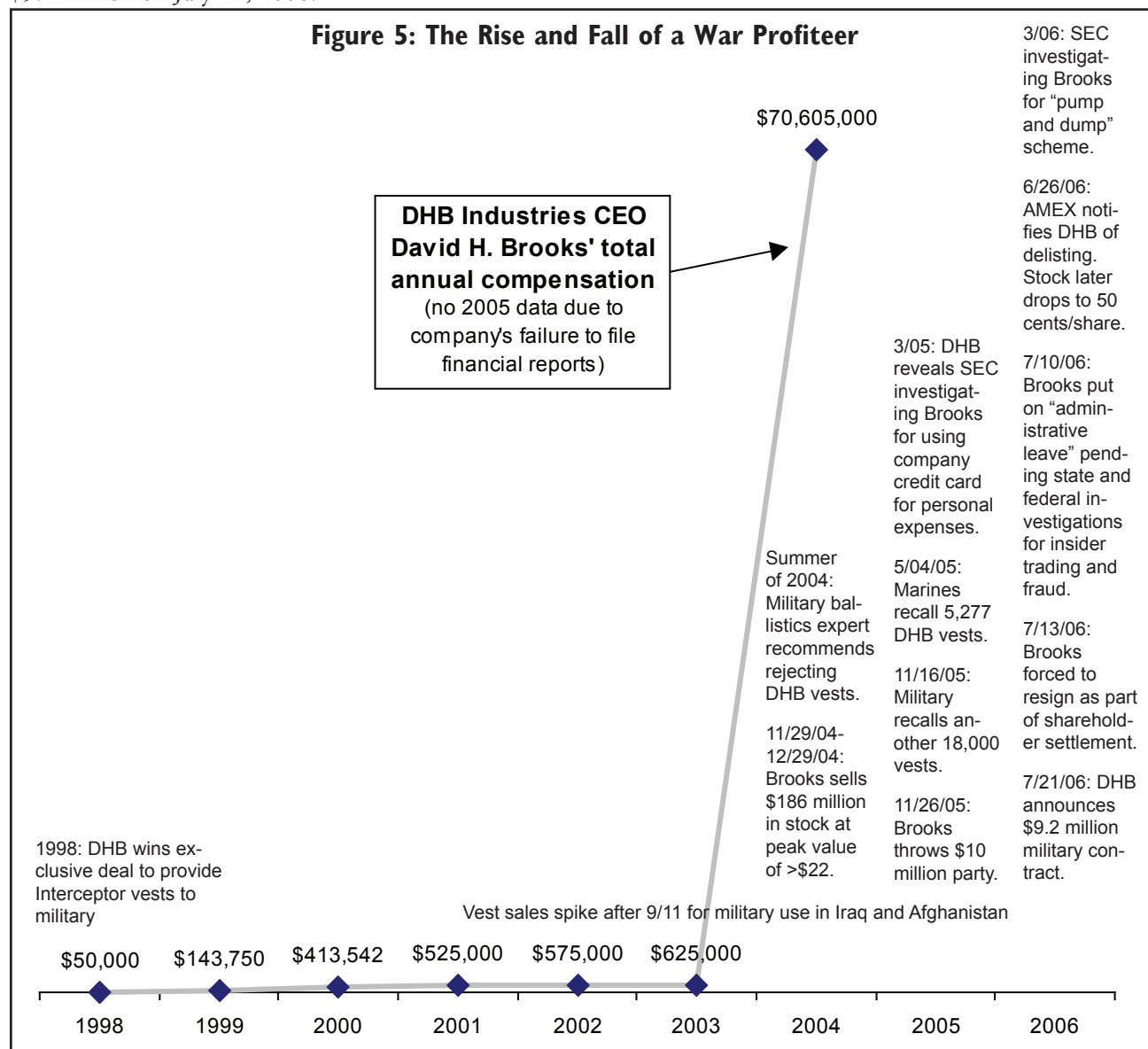
A retired Marine colonel and former head of DHB's Point Blank subsidiary told the *Washington Post* that by hiring only DHB, rather than spreading the work around to the 20 or so qualified companies, the military created a bottleneck that kept many troops in Iraq from having state-of-the-art body armor until nine months after the war began.<sup>44</sup>



Eventually, the Pentagon broke DHB's monopoly to speed up production, but that wasn't the end of the military's problems with the company. Over the course of 2005, the Marines and Army recalled a total of 23,000 vests—all of them produced by DHB—after an investigation by the Marine Corps Times revealed that the vests had failed ballistics tests for stopping 9 mm bullets. The exposé showed that Pentagon officials had dismissed inspectors' recommendations that DHB vests be rejected."<sup>45</sup>

The military's line on the scandal continues to be perplexing. They maintain that the recall was merely to calm fears stoked by the Marine Corps Times exposé—fears they claim are unfounded because subsequent tests on a sample of the vests found nothing wrong.

While Brooks' personal fortunes may have soured, the company remains in good standing with Pentagon procurement officers. DHB raked in a total of \$145 million in defense orders in 2005 and announced a new body armor contract for \$9.2 million on July 21, 2006.



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## **What's Wrong with Profiting from War?**

A substantial number of the companies included in this study have had strong earnings growth during the War on Terror, kept their shareholders happy, and refrained from committing major contract abuse or fraud (at least to our knowledge). Why then should we begrudge the top executives of these companies their hundreds of millions in compensation rewards?

We see three major problems:

### **Excessive CEO Pay Sends the Wrong Message**

Throughout American history, times of war have called for shared sacrifice. We remember our “Greatest Generation,” the men and women who defeated Nazism and fascism, for their common commitment and social solidarity. In World War II, a number of top business executives became “dollar-a-year” men who donated their know-how to the war effort for a token sum. That sort of sacrifice sent a powerful, positive message to soldiers at the front lines. What message gets sent when those at the front lines see contemporary CEOs strike it fabulously rich year after year?

### **Excessive CEO Pay Drains Brainpower from Public Service**

A generation ago, commentators described a global “brain drain” that worked to the benefit of the United States. Good salaries and working conditions in American workplaces were attracting “the best and the brightest” from many foreign locales. We’re now witnessing a perverse “brain drain,” the direct consequence of turbo-charged executive salaries that lure top military managers into the private sector—and the fast-track to fortune. In this environment, military service tends to become less a calling and more a foot in the revolving corporate door.

### **Excessive CEO Pay Creates the Risk of a Profit Motive for War**

War, as Civil War General Sherman once famously stated, truly is hell. The decision to go to war, for a democracy, should never be made either lightly or for ulterior motives. Excessive CEO pay in wartime raises the risk of a profit motive for continuing the conflict or getting into new ones in other parts of the world. And that is a risk no one should have to bear—no matter what one’s position on the Iraq War.

The vast potential for war profiteering should be of even greater concern during this war than in past ones because of the extent to which the war and the reconstruction effort have been privatized.

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## What Should be Done?

### A. Require Defense Contractors to Restrain Pay During Wartime

It is important to remember that it is public money which defense CEOs are siphoning off for their own personal profits. Taxpayers have every right to insist that strings be attached to these contracts which would set a more reasonable standard for defense executive pay.

In fact, U.S. law already imposes a cap on allowable compensation for contractor executives, which stood at \$473,318 in 2005.<sup>46</sup> This cap was established in 1995, in reaction to public concern over mass layoffs in the defense industry. However, in practice the law has been meaningless. Companies that receive defense contracts remain free to pay their executives whatever they please. They just cannot bill the government directly for any of that compensation above the “cap.” If a government contract sends a company’s share price soaring—and sets up a stock option windfall or hefty “golden parachute” in a merger deal—the cap does not apply.

We need a meaningful cap. That doesn’t have to mean a fixed dollar amount. Procurement rules could, instead, deny defense contracts to companies that pay their top executives more than 20 times what the lowest paid worker at the company receives. This is the standard proposed by management guru Peter Drucker, who argues that “the ratio of pay between worker and executive can be no higher than 20 to 1 without injury to company morale.”<sup>47</sup> J.P. Morgan, the renowned financier of a hundred years ago, also supported a ceiling on executive pay of no more than 20 times worker pay.<sup>48</sup>

Defense contractors whose CEOs are unwilling to focus on serving the country rather than maximizing their personal profits should be ineligible for contracts. The same should hold for companies that have violated the law or not fulfilled the terms of past contracts.

### B. Encourage Voluntary Pay Restraint

Until we have stronger government oversight over defense-related pay, companies should voluntarily restrain their executive pay and ban stock options exercises during wartime. Over the years, thoughtful CEOs have voluntarily passed up bonuses in situations where company workers had to be laid off. To do otherwise, these executives reasoned, would undermine consumer confidence and worker morale.

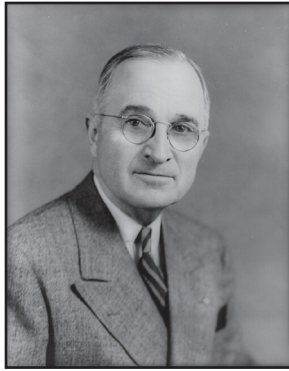
These concerns are also relevant to the disparities between the payday bonanzas taken by defense executives and military compensation, especially given the cynicism fostered by well known ties between these companies and top officials in government. These executives stand as part of a broader “War on Terror” in which thousands of people have lost their lives. With so many suffering, CEOs should not be cashing in.

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## C. Strengthen Government Oversight of Wartime Contracts

Outrage over the defense CEOs' fat paychecks is exacerbated by the fact that U.S. taxpayers have little reason to feel confident they are not being ripped off by these companies. Congress has done precious little to oversee the massive funding that goes to the military each year, despite public anger over non-competitive contracting and evidence of widespread fraud, corruption and waste.

Congress did appoint a special inspector general for Iraq reconstruction who has identified billions in missing funds and uncovered evidence that led to four convictions for bribery and fraud.<sup>49</sup> But the mandate of the Inspector General does not extend to the hundreds of billions of dollars in defense contracts that are unrelated to reconstruction. Moreover, the IG's office is a temporary agency, while the overall war on terrorism has no end in sight.



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*"I have never yet found a contractor who, if not watched, would not leave the Government holding the bag."*

—President Harry S. Truman, 1941 speech calling for special committee to investigate war-time contracts.<sup>52</sup>

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Congress should establish a permanent independent investigative subcommittee, responsible for investigating waste, fraud and abuses associated with any war-related contracting, modeled on the World War II-era Truman Committee. That panel, led by Harry S. Truman when he was still a senator, helped save taxpayers some \$15 billion (in 1940s dollars) and prevented hundreds, if not thousands of deaths by exposing faulty military equipment.<sup>50</sup> We need similar investigative zeal today. Unfortunately, bipartisan bills to create a modern-day Truman Committee on wartime contracts have languished in both the Senate and the House of Representatives.<sup>51</sup>

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### III. Oil Barons: Profiting from Pain at the Pumps and in the Middle East

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It's Labor Day weekend, and you're standing at the gas pump, daydreaming about those wonderful and distant days gone by—some 18 months ago—when gas ran only \$1.75 a gallon.

Seven of every ten Americans, the latest polls show, are now feeling a real family fiscal pinch from higher fuel prices at the pump.<sup>53</sup> And that should be hardly surprising. U.S. consumers, since late 2004, have experienced a deep and continuing consumer shock, as oil prices have climbed from \$40 a barrel to more than \$70 in just a year and a half. While increased demand is part of the explanation, most analysts also point to the instability caused by the Middle East conflicts, from Baghdad to Beirut, as a major factor in skyrocketing gas prices.<sup>54</sup>

U.S. consumers are expected to pay an additional \$200 billion this year for oil and gas products. These billions, notes Senator Byron Dorgan, amount to a “massive transfer of wealth from average Americans who can't afford it, to big oil companies who already were experiencing all-time record profits.”<sup>55</sup>

#### Oil-Greased Paychecks

While ordinary Americans are forking over upwards of \$3 for a gallon of gas, 15 distinctly unordinary Americans—the CEOs of the largest U.S. oil industry companies—are celebrating their biggest paychecks on record. These CEOs last year took home an average \$32.7 million in compensation—518 times more than average oil industry workers in 2005. (see Appendix 3 for details)

The Oil Barons' take even far exceeded their excessively paid counterparts at other leading U.S. firms. Their \$32.7 million average pay was 181 percent higher than the average of \$11.6 million for CEOs at 350 large corporations surveyed by the *Wall Street Journal*.<sup>56</sup>

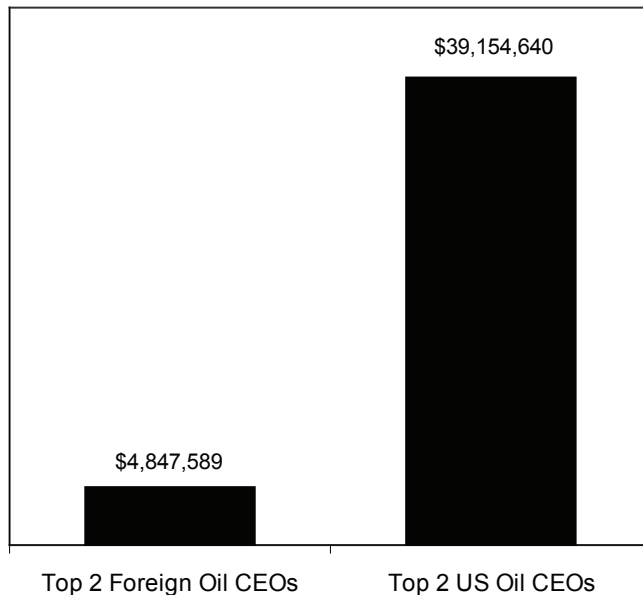
The three highest-paid U.S. oil chieftains in 2005: William Greehey of Valero Energy (\$95.2 million), Ray R. Irani of Occidental Petroleum (\$84 million), and Lee Raymond, outgoing CEO of ExxonMobil (\$69.7 million). The lowest-paid major U.S. oil executive: Chad Deaton, CEO of Baker Hughes (\$6.6 million).

“Obviously, these are very, very large numbers,” ConocoPhillips CEO James Mulva acknowledged in an appearance earlier this year on *Good Morning America*. Between 2004 and 2005, Mulva saw his personal paycheck almost double, from \$16.6 million to \$31.1 million.

“But on the other hand,” Mulva said, “if you look at the oil companies, the international oil companies, there are huge responsibilities with respect to asset bases and hundreds of billions of dollars.”<sup>57</sup>

One of these responsibilities, as some analysts point out, is to plan for the lean years—either by building capital reserves or making investments to ensure

**Figure 6: Average Oil CEO Pay Comparison:  
Top US vs. Top Foreign**



Source: Company Proxy Statements and Wall Street Journal 2005 Executive Compensation Survey

future profits. These analysts implore oil companies to dedicate their “mountains of excess cash” toward seeking new energy sources before rising fossil fuel prices break the backs of world economies.<sup>58</sup> These companies run inspiring TV ads claiming they are indeed preparing for the future. However, when they throw massive windfall profits at chief executives, they seem to be signaling that the coming lean years will be somebody else’s problem.

Interestingly, the top executives of the second- and third-largest oil companies on the planet—British Petroleum and Royal Dutch Shell—operate in the same global marketplace and face the same “huge responsibilities” as the top executives of U.S.-based oil industry giants. Yet CEOs at the top two oil companies in the United States made eight times more last year than their foreign counterparts from BP and Shell.

BP CEO Lord Browne pulled in \$5.6 million in 2005, Shell CEO Jeroen van der Veer just \$4.1 million. While hardly suffering, their combined average pay was a mere 12.4 percent of the average

pay of the top two U.S. oil company CEOs.<sup>59</sup>

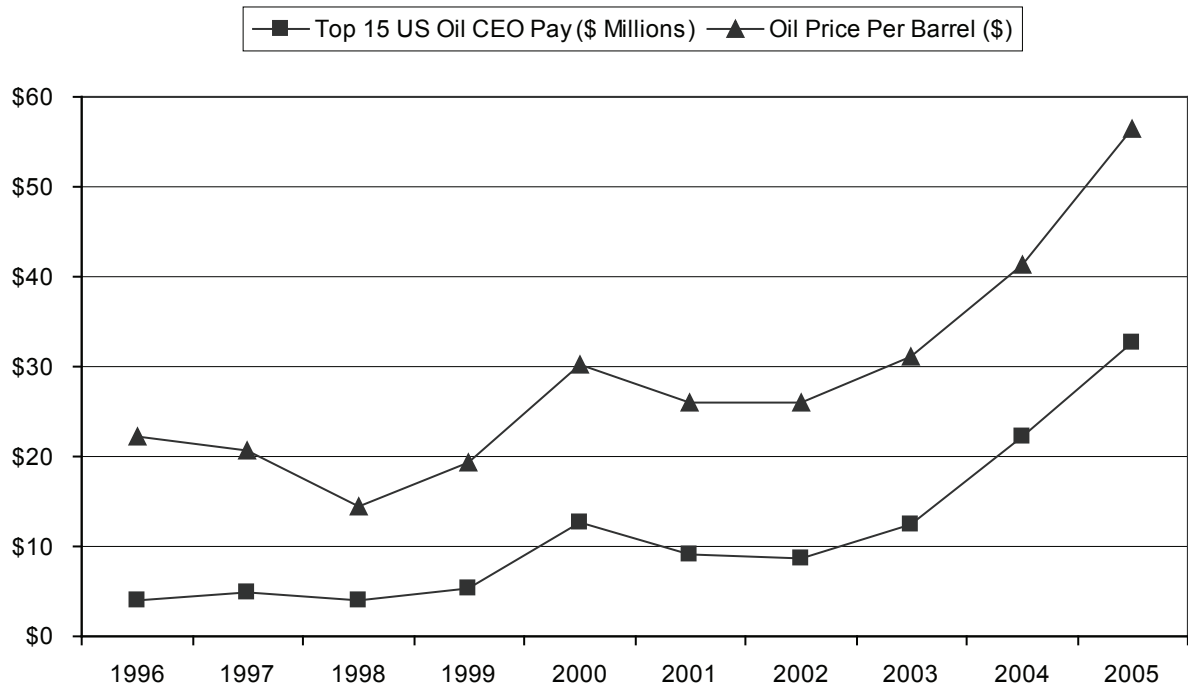
## Performance or Luck?

Big Oil CEOs in the United States contend that high oil prices, not greed, are the cause of skyrocketing prices at the pump.<sup>60</sup> U.S. oil companies, the argument goes, operate in a global marketplace they can’t control. If soaring oil company profits follow inexorably from global supply-and-demand factors that oil company executives have no power to influence (e.g. war or natural disasters), then CEOs deserve no particular personal credit for these profits.

In fact, the close historical relationship between the trend in CEO pay and oil prices suggests that executives are simply reaping windfall pay boosts beyond their managerial performance. Our analysis indicates a 52 percent dependency between the price of gas and the pay of the top 15 U.S. oil magnates. This means that the trend in pay of these top pump profiteers is unrelated to the trend in oil prices only 48 percent of the time.<sup>61</sup>

Even if oil company CEOs do deserve some credit for soaring company profits, broader criteria should be used to judge their performance, including their record on the environment.

**Figure 7: Top 15 Oil CEO Pay and Oil Prices**



Sources: Company Proxy Statements; Dow Jones, West Texas Intermediate Spot Oil Price, June 1, 2006.

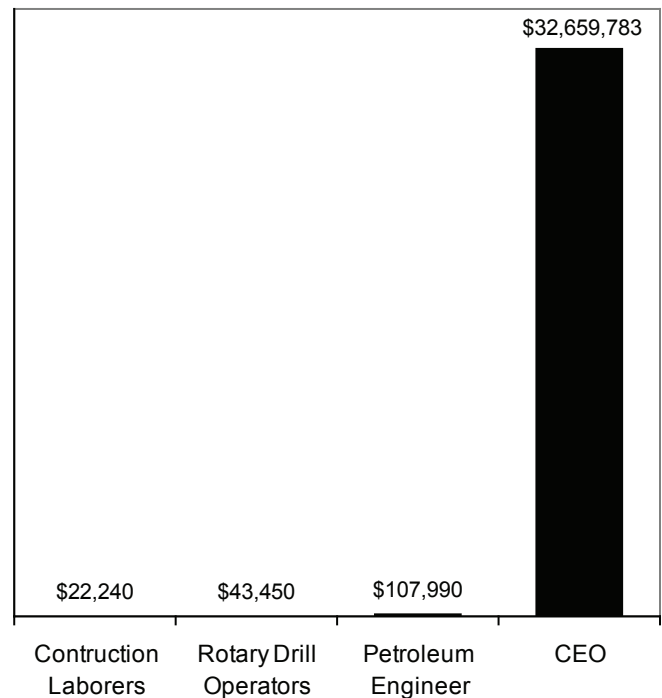
## Oil Baron and Oil Worker Pay: A Comparison

In one sense, whether oil companies owe their “success” to pure luck or high performance does not matter. The men at the top didn’t do it alone. If luck explains why oil company profits are soaring, then the benefits of that happy fluke ought to be shared with employees who were also in the right place at the right time. And if oil companies have “performed” their way to high profits, then surely the tens of thousands of workers at these companies played some role in contributing to this improved performance.

Pay disparities between top managers and average workers in the oil industry extend even wider than manager-worker pay disparities in the overall economy. Last year, the top fifteen Pump Profiteers took home 518 times the pay of average workers in the oil and gas industry. The average disparity between U.S. CEO and average U.S. worker: 411-to-1.

The top 15 Petroleum Profiteers last year saw

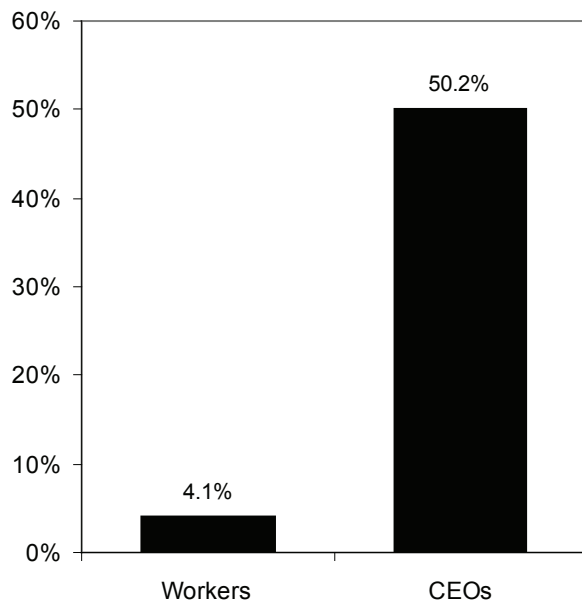
**Figure 8: Pay Disparities in Oil Companies**



Sources: CEO: Top 15 U.S. Oil CEO average pay. Other occupations from Bureau of Labor Statistics May 2005 National Industry-Specific Occupational Employment and Wage Estimates NAICS 211000 - Oil and Gas Extraction.



**Figure 9: Oil CEO Pay vs Oil/Gas Worker Pay  
(% change, 2004-2005)**



Sources: Calculated by authors based on 2004/2005 *Wall Street Journal* executive compensation survey and company proxy statements. U.S. Dept. of Labor Series CEUI021100006 NAICS 211—Average Hourly Earnings of Production Workers in Oil and Gas Extraction industry.

average raises of 50.2 percent over their 2004 pay packages. In 2005, the annualized average hourly earnings of production workers in the oil and gas industry increased by only 4.1 percent over 2004 levels.

The lowest-paid workers (for which there are BLS employment level statistics) in the oil and gas industry today are the construction laborers. Among other things, these workers perform tasks involving physical labor at heavy construction projects, tunnel and shaft excavations, and demolition sites. They may also clean and prepare sites, dig trenches, set braces to support the sides of excavations, erect scaffolding, clean up rubble and debris, and remove asbestos, lead, and other hazardous waste materials.<sup>62</sup> As risky and laborious as these tasks are, these workers averaged only \$22,240 last year.<sup>63</sup> One of these construction laborers would have to work 4,279 years to earn what the CEO of Valero Energy, William Greehey, last year earned in one year.

Rotary drill operators are also critical to the oil industry. These are the workers who set up or operate a variety of drills to remove petroleum products from the earth and to find and remove core samples for testing during oil and gas exploration. The average annual paycheck for a rotary drill operator stands at \$43,450.<sup>64</sup> Some 1,932 of these paychecks would be needed to equal the paycheck that went to CEO Ray Irani of Occidental Petroleum in 2005.

Highly educated petroleum engineers, who oversee drilling and develop improved production methods, are among the better-paid workers in the sector, with an average annual salary of \$107,990.<sup>65</sup> Even at this occupational level, it would take 645 such engineers to match the 2005 salary of ExxonMobil's Lee Raymond.

## Big Oil and Big Money

In our nation's capital, no politically wired constituency swings more weight than Big Oil. Since the 1990 election cycle, oil industry groups have funneled over \$192 million to candidates and parties, 75 percent of which has gone to Republicans, according to the independent Center for Responsive Politics.<sup>66</sup>

In 2004, the oil industry contributed \$2,627,825 toward the 2004 election of George Bush. The next largest contributions went to John Kerry (\$305,610) and a number of Southern senators who regularly look out for oil company interests. Among these senators: Kay Bailey Hutchison, a Texas Republican who received \$242,070 in Big Oil money, and David Vitter, a Louisiana Republican who accepted \$262,446 in Big Oil contributions.



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These political leaders have faithfully advanced the cornerstones of the Big Oil political agenda: the deregulation of the oil industry, the reduction of gasoline taxes, the opening of the Alaska wilderness for new drilling, and the lifting of bans on off-shore drilling.

## **Petroleum Profiteer Profiles**

### **At the Top Again: William Greehey, Valero Energy**

**2005 Compensation: \$95,157,943**

Five years ago, in 2001, Valero Energy's William Greehey picked up a \$5 million bonus for completing a merger with Ultramar Diamond Shamrock, a key step in the march that has made Valero the nation's biggest oil refiner.<sup>67</sup> Greehey felt no need to be defensive about his bonus.

"That's the way it should be," he noted. "When you do well, you should get paid for it."<sup>68</sup>

Greehey has continued to do well, at least personally. He ended 2002 as the highest-paid executive of any publicly traded U.S. oil and gas company.<sup>69</sup> Last year, he took home \$95,157,943.

The refinery industry mergers that have greased Greehey's rise to the top have so far generated little relief for American consumers. "Economies of scale" so far don't seem to have materialized. What has materialized: a powerful political push from Greehey to set aside environmental protections. Greehey has made over \$89,000 in personal campaign contributions to Republicans and Democrats.<sup>70</sup>

"We have been spending all of our money meeting the environmental requirements," complains Greehey, who last year pocketed \$83,538,994 more than the average for CEOs at other large U.S. companies. "We really haven't had the money to spend on strategic projects."<sup>71</sup>

### **Satisfaction Guaranteed: Ray Irani, Occidental Petroleum**

**2005 Compensation: \$83,963,948**

In 1990, Ray Irani became the Occidental Petroleum chief executive with an exceptionally sweet seven-year employment agreement that guaranteed him a \$1.9 million annual salary, an annual bonus that equaled no less than 60 percent of his salary, and an annual award of company shares worth no less than 101 percent of his salary.

On top of that, the agreement fixed Irani's pension at 50 percent of the highest of his total annual final salary, bonus, and free share award, with a cost-of-living rider to boot. The company also picked up the tab for Irani's entire California state income tax, which totaled more than \$1 million some years.

This pay agreement would spur so much hostile comment that the Occidental board would eventually feel compelled to replace Irani's elaborate pay pact with

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a more modest package. The new agreement would last only five years and guarantee only a \$1.2 million salary, without guaranteed bonuses and free shares.

But in negotiations with Irani, the board decided to throw in a special \$97 million one-time payment. In effect, the new agreement actually gave Irani a raise.

In 2000, the plot would thicken. The Occidental board and Irani would negotiate still another new employment agreement, this one for seven years.<sup>72</sup> The Corporate Library, an independent corporate watchdog group, would later give Occidental's 2004 pay package for Irani an F rating.<sup>73</sup>

Where did all this Occidental wheeling and dealing leave Irani? In 2005, after figuring in the value of options exercised, Irani's total direct compensation was \$83,963,948—a whopping 623 percent above the average pay of CEOs at comparably sized companies.

Irani ended 2005 as one of the highest-paid executives in Los Angeles county. To equal his 2005 take-home, an average petroleum engineer in the oil industry would have to work 778 years, an average rotary drill operator 1,932 years, and an average construction laborer 3,775 years.

### **Platinum Parachutes: Lee Raymond, ExxonMobil** **2005 Compensation: \$69,684,030**

In 2005, ExxonMobil collected \$36 billion in profit, the grandest annual profit total ever recorded anywhere.

Last November, called before Congress to explain the rising gas prices that appear to have fueled these record profits, ExxonMobil's Lee Raymond explained that rising prices reflect global supply and demand, nothing more.

"We are all," Raymond assured Congress, "in this together, everywhere in the world."<sup>74</sup>

We're all in this together, except Raymond. As ExxonMobil CEO in 2005, his basic salary alone ran 63 times the average paycheck in the oil industry. Raymond's \$4 million salary last year amounted to a weekly take-home of \$83,333.

But Raymond hardly had to content himself with just salary in 2005. His overall pay for the year totaled \$69,684,030.

Raymond retired from ExxonMobil at the end of 2005, and his near \$70 million in compensation for the year seemed, at the time, a more than ample reward for his career of service to company shareholders. Company directors disagreed. This past April, news reports revealed that Raymond walked off into the retirement sunset with a going-away pay package that sets a staggeringly new golden parachute standard.

This retirement package—a grab-bag of stock options, restricted stock awards from previous years, retirement-independent salary, and bonuses, plus a \$1

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million consulting contract, security services, a car and driver, access to the company corporate jet, and \$210,800 in country club fees<sup>75</sup>—would add up to nearly \$400 million.

“He is a porker of the first order,” executive pay expert Graef Crystal noted after the news of Raymond’s good fortune broke. “Those CEOs out there who are doing better at the trough must be thrilled he’s flying fighter cover for them.”<sup>76</sup>

## **A Hefty Raise: CEO Clarence P. Cazalot, Jr., Marathon** **2005 Compensation: \$37,940,885**

By being in the right place at the right time to ride the wave of record oil and natural gas profits, Marathon CEO Clarence Cazalot received a more than 780 percent raise in 2005, with \$37.9 million in total compensation. That haul made him the 19th highest paid CEO in America.<sup>77</sup>

Like many of our petrol profiteers, Cazalot is a major winner in the merger and acquisition derby. He used to work at Texaco when it was acquired by Chevron. Marathon acquired additional U.S. refineries, with the Ashland stake. Overseas, Marathon acquired CMS Energy’s assets in Equatorial Guinea in 2002. In 2003, it extended its reach to Russia by acquiring Khanty Mansiysk Oil Corporation.<sup>78</sup> More recently, Cazalot became one of the first to take advantage of a thaw in U.S.-Libya relations by cutting a deal to return the company’s production to the Libyan oil fields in what Cazalot called “a historic day for Marathon.”<sup>79</sup>

CEO oil baron Cazalot understands the importance of economic and political power in the oil industry. He sits on the board of Baker Hughes, a supposedly competing oil company.<sup>80</sup> He is one of the more active political donors in the oil business. Since 2002, he and his family have given \$88,708 to candidates. Together with his wife and children, he has given the maximum gifts to Texas Senator Kay Bailey Hutchinson, the candidate of preference of petrol pirates on Capitol Hill. He has given \$10,000 a year to the Republican National Committee, but hedging his bets in the 2004 Presidential election, he also gave a one time contribution of \$5,000 to the Democratic Senatorial Committee. He understands the meaning of buy-partisan.<sup>81</sup>

## **Under the Radar: Mark G. Papa, EOG Resources** **2005 Compensation: \$36,343,142**

EOG Resources CEO Mark Papa doesn’t get much attention—in national business circles. He may like things that way. Papa has neatly sidestepped acclaim—and controversy—on his way to an annual take-home that last year exceeded the *Wall Street Journal* CEO average by nearly \$25 million.

EOG, formerly known as Enron Oil & Gas, split off from its notorious parent in 1999, two years before Enron self-destructed.<sup>82</sup> The company now ranks number two on the *Houston Chronicle*’s top 100 list of oil and gas producers, but, despite that lofty ranking, Papa wasn’t invited to the congressional hearings exploring oil industry profiteering.

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In 2005, Papa's \$36,343,142 in total compensation outpaced average oil industry worker take-home by 576 times. Rising energy prices, he once acknowledged, make his job considerably easier. Just a dime annual increase in natural gas prices, Papa observed before the current run-up in energy prices, translates into an 18 cents-per-share increase in his company's cash flow.<sup>83</sup>

### **The Free Market Forever: G. Steven Farris, Apache** **2005 Compensation: \$13,645,217**

G. Steven Farris, the CEO of the Apache Corporation, worries about the vast merger wave that has consolidated control of America's natural gas in the hands of a precious few super-sized companies.

In 2002, with these few companies controlling 80 percent of the gas that flows through U.S. pipelines, Farris warned about the "potential for market-power abuse," the ability of big-time players to distort the natural give-and-take of free-market supply and demand.<sup>84</sup>

But Farris has so far failed to issue any warnings about the big-time players who can distort supply and demand in executive pay. Today, all across Corporate America, the company compensation committees responsible for determining CEO compensation consist, to a large extent, of current, soon-to-be, and former CEOs from other companies, powerful people who have a vested interest to setting executive pay at levels as high as possible.

Last year, Farris pulled in \$13,645,217, a 155 percent increase in pay from his \$5,351,875 in 2004. The compensation committee that made this generous pay boost possible included a current CEO and Chairman (A.D. Frazier Jr., Danka Business Systems PLC), a former CEO (George D. Lawrence, Phoenix Resource Companies—acquired by Apache in 1996), and a retired chief operating officer (Frederick M. Bohen, Rockefeller University).<sup>85</sup>

Average production workers in the oil and gas industry don't have the option of having other production workers set their pay. That may explain why their pay increased only 4.1 percent last year. Petroleum engineers, who currently average a healthy \$107,990, would have to labor 126 years to equal the 2005 take-home of Apache's Farris.

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## What Can be Done to Control Petrol Profiteering?

What is good for ExxonMobil and Lee Raymond—and all the other giants of the contemporary American oil and gas industry—has *not* been good for average Americans. Energy executives have walked off with record profits and over-stuffed wallets. We face sticker shock every time we fill up.

But what can be done about petrol profiteering? In the overall conclusion to this report, we will examine specific proposals to address excessive executive pay. Here, in this section, we examine solutions more targeted to the oil and gas industry.

### Not Price Gouging...Just Profit Protectionism

Oil and gas companies, the Federal Trade Commission has ruled, cannot be guilty of price gouging if the prices they set reflect real costs or “national or international market trends.”<sup>86</sup>

These national and international market trends have certainly been kind to America’s energy giants and their top executives. In 2005, the industry netted over \$140 billion, with over three-quarters of that—76 percent, to be exact—going to the five biggest integrated oil companies.<sup>87</sup>

The market clout of these five companies makes marketplace competition, the classic antidote to excessively high prices, a nonstarter in the energy industry. With so much control in so few corporate hands, America’s energy giants can establish their own “market trends.”

American consumers, for their part, have little choice. Without sufficient access to real energy alternatives, consumers who have to heat their homes and drive to work—whatever the cost—will pay almost any price.

Buyers may have little or no choice, but producers certainly do. According to the Energy Information Administration, oil company refineries are currently operating at only an average 86 percent capacity. Overall gasoline production averages 24 million fewer gallons per day than one year ago.

Oil companies, as an explanation, plead poverty. They must operate, we are told, under financial constraints.

“It is difficult to imagine how the oil industry could be financially constrained from increasing its commitment to domestic refining capacity,” responds Rep. Joe Barton, the chairman of the House Energy and Commerce Committee, “when the three largest U.S. integrated oil companies alone have cash reserves in excess of \$40 billion.”<sup>88</sup>

The top three U.S. oil companies reported first quarter profits in 2006 of \$15.7 billion, earnings up 17 percent over the first quarter last year. ExxonMobil, despite earning a record \$36 billion in 2005, has invested only \$3.3 billion toward systems improvements over the last five years.<sup>89</sup>

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ExxonMobil's second quarter 2006 profits were \$10.36 billion, 36 percent higher than a year ago. This gain is the second largest quarterly profit recorded by a publicly traded U.S. company. ConocoPhillips registered a 65 percent gain to \$5.18 billion.<sup>90</sup> Chevron saw their second quarterly earnings rise 11 percent over last year, to \$4.35 billion. Even though this was a record for the company, Wall Street wanted more and the stock price dipped 3 percent on the day after the announcement.<sup>91</sup>

Awash in profits, flush with overpaid executives, oil companies can afford to do more to lower oil prices. Much more.

## Environmental Nonperformance

The problem with record oil company profits and CEO pay doesn't end with prices at the pump. We need to examine these profit and pay numbers in a much broader global context.

Oil companies have become a massive source of the greenhouse gas emissions that have unleashed a planet-wide climate crisis. Each of today's giant oil firms has it within their power to shift massive financial resources toward a clean energy future. Yet only two have taken even small steps in this direction (BP and Shell), while the others, most notably ExxonMobil, still challenge the science behind climate change. Our nation's biggest oil CEOs have lobbied hard for energy legislation that emphasizes drilling in the fragile Alaskan tundra over fuel efficiency and clean energy alternatives.

Oil CEOs, over recent years, have "performed" well for their shareholders. They have performed poorly for the planet. The pay windfalls that continue to come their way only give them an incentive to continue this poor—and incredibly reckless—performance.

## Steps Toward Change

### *A. Rebate Oil Windfall Profits*

Oil industry windfall profits currently end up lining the pockets of top oil executives. They could instead be earmarked for public energy conservation projects and efforts to reduce energy costs for the poor.

A number of lawmakers in Congress have already made such proposals. Senator Byron Dorgan (D-ND) has proposed that a 50 percent tax be applied to profits earned by major U.S. oil companies on the sale of crude oil above \$40 per barrel. To encourage the reinvestment of oil profits, this proposal would exempt investments in the exploration and development of new sources of oil and gas, in the production of renewable fuels, or in increases for domestic refinery capacity.<sup>92</sup>

Congressional House member Dennis Kucinich (D-OH) has a similar tax proposal that would generate funds for a tax credit for the purchase of efficient passenger vehicles and mass transit.<sup>93</sup>

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## ***B. Eliminate Taxpayer Subsidies for the Oil Industry***

The oil industry, a most “mature” industry, doesn’t need government tax breaks and subsidies. But that doesn’t stop oil lobbyists from pressing Congress to channel Big Oil billions of dollars in subsidies and tax breaks each year. This “corporate welfare” encompasses both massive tax breaks and the use of public lands to extract oil at below-market prices.

### **1) Tax Breaks for Oil and Gas**

Taxpayers have actually subsidized excessive CEO pay in the oil industry through tax breaks and other “corporate welfare.” The independent Taxpayers for Common Sense has identified 16 subsidies for the fossil fuel industry totaling \$5 billion a year.<sup>94</sup>

All these could be safely eliminated.

### **2) Subsidized Use of Public Lands for Oil Companies**

Congress should not allow oil companies to extract oil from public lands at below-market prices. Over the next five years, according to the Department of Interior, energy companies will likely remove \$65 billion in oil and gas from federal lands without paying a full royalty.<sup>95</sup>

Senator Dianne Feinstein (D-CA) has proposed legislation that requires oil companies to pay higher royalties from oil extracted from public land during emergency periods of high oil and gas prices. Her legislation would require the Secretary of the Interior to renegotiate existing oil and gas leases.

## ***C. Institute Rigorous Anti-Trust Measures in the Oil and Gas Industry***

There has been tremendous concentration in the oil industry, with over 23 major mergers in the last decade (see timeline on p. 28). Not since the 1911 anti-trust break-up of John D. Rockefeller’s Standard Oil Company has the country witnessed such a concentration of petroleum power.

“It is time the Congress took a very serious look at modifying the anti-trust laws,” said Senator Arlen Specter (R-PA), who convened a Judiciary Committee hearing on the consolidation of the oil industry in February 2006. A bi-partisan group of Senators has introduced several pieces of legislation aimed at preventing anti-competitive mergers and strengthening anti-trust intervention in the oil and gas industry.<sup>96</sup>

Senator Specter and other Senate leaders have pointed to the ways in which rapid consolidation has created a “collusive environment” in the industry and has facilitated the “withholding of supply and information sharing” by industry participants. According to Specter, this consolidation conferred “market power on remaining players, and with it, the opportunity to increase prices. As we have learned in the [Judiciary] Committee, there is some evidence that consolidation in the industry has increased wholesale gasoline prices.”<sup>97</sup>



## Major Oil and Gas Merger Timeline

### 1996:

Exxon acquires Nalco Energy

### 1997:

Baker Hughes acquires Petrolite

### 1998:

BP acquires Amoco

Halliburton acquires Dresser Industries

Marathon Oil joint ventures with Ashland, Inc. (MAP)

Baker Hughes acquires Western Atlas

### 1999:

Exxon acquires Mobil

Devon acquires Pennz Energy

Kerr-McGee acquires Oryx Energy

### 2000:

Phillips joint ventures with Chevron

Occidental Petroleum acquires Altura Energy

Anadarko Petroleum acquires Union Pacific Resources

### 2001:

Chevron acquires Texaco

Phillips acquires Tosco Corp.

Conoco acquires Gulf Canada Resources Ltd.

Valero acquires Ultramar Diamond Shamrock Corp.

Marathon Oil acquires Pennaco

Anadarko acquires Berkley Petroleum Corp.

Amerada Hess acquires Triton Energy

### 2002:

Conoco acquires Phillips Petroleum

### 2003:

Devon acquires Ocean Energy

Marathon Oil acquires Khanty Mansiysk Oil Corporation

### 2004:

Valero acquires El Paso's Aruba refinery

### 2005:

Valero acquires Premcor, Inc.

Marathon becomes 100% owner of MAP

Chevron acquired Unocal

### 2006:

ConocoPhillips acquires Burlington Resources

Anadarko acquires Kerr-McGee and Western Gas Resources

## D. Separate Oil and State

At a more basic level, no meaningful progress will be made on the initiatives described above until we separate "oil and state."

The overwhelming influence of Big Oil donations has blocked efforts to implement legislation promoting energy alternatives and rein in executive excess. In California, for instance, Big Oil companies like Chevron, ConocoPhillips, and Occidental Petroleum have successfully stalled or killed a number of bills that address pricing issues, refining capacity, and alternative energy solutions.<sup>98</sup>

Viable technologies for alternative energy have become readily available,<sup>99</sup> but our politicians continue to use our tax money to subsidize Big Oil.<sup>100</sup> The 2005 Energy Bill alone handed over \$6 billion to the oil industry in tax breaks for oil exploration, reduced royalty payments, and direct subsidies.<sup>101</sup>

Meanwhile, the annual budget for the National Renewable Energy Laboratory, the country's primary research and development facility for renewable energy technologies, stood at just \$174 million in fiscal year 2006, \$28 million less than for fiscal 2005.<sup>102</sup>

A new coalition, Oil Change International, is calling on legislators to wean themselves from oil industry contributions and vote for policies that will truly move the U.S. toward oil independence and clean energy. Big Oil, notes Oil Change International, constitutes the most basic political barrier to a clean energy transition.<sup>103</sup>

We may also benefit from the example put forward by BP's Lord Browne in banning company political contributions anywhere in the world.<sup>104</sup>



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### *E. Make CEO Option Pay Accurately Reflect True “Performance”*



Stock option rewards for top oil company executives should reflect responsible performance, including performance on mitigating climate change, not just oil barrel price increases completely unrelated to an executive's own performance.

Option plans, if appropriately designed, can filter out stock price increases unrelated to an executive's personal performance. Using benchmarks or indices, as opposed to simply the absolute share price, can more closely fulfill the goal of using options as incentives for executive performance.<sup>105</sup> Unfortunately, in 2001, only 5 percent of the 250 largest U.S. public firms designed their stock option reward plans this way.<sup>106</sup>

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## IV. CEO Pay: A Decade and a Half in Review

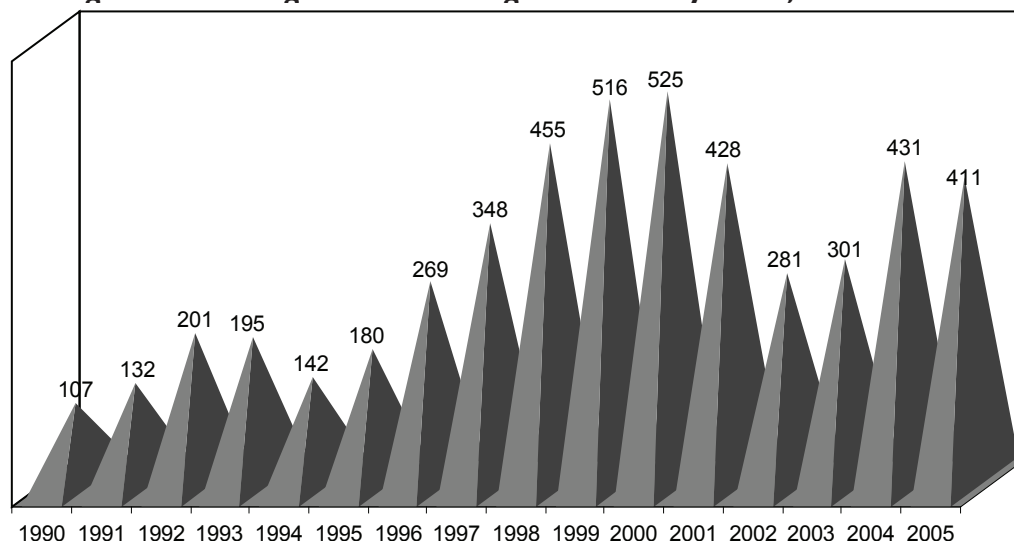
This section updates popular statistics featured in our report every year.

### CEO v. Worker Pay Data

In 2005, average total compensation for CEOs of 350 leading U.S. corporations was \$11.6 million, down slightly from \$11.8 million in 2004.<sup>107</sup> The ratio of CEO pay to average worker pay was 411-to-1 in 2005. While this is still smaller than the 2000 peak of 525-to-1, it is nearly 10 times as large as the 1980 ratio of 42-to-1.<sup>108</sup>

Total executive compensation is defined throughout this report as salary, bonuses, restricted stock awarded, payouts on other long-term incentives, and the value of options exercised in a given year; we do not include the estimated value of stock options awarded.

**Figure 10: Average CEO to Average Worker Pay Ratio, 1990-2005**

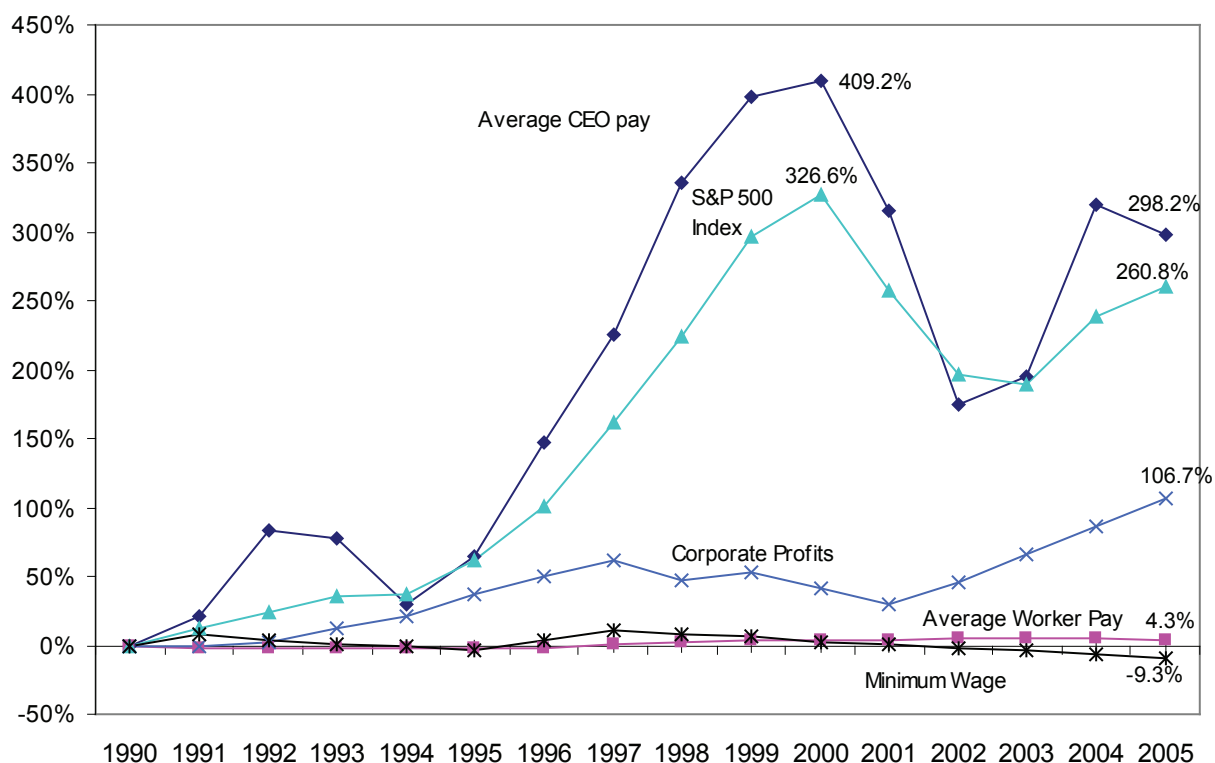


Source: see box on following page.

### CEO Pay Outstrips Other Economic Indicators

Although average executive compensation dropped slightly in 2005, it is still up almost 300 percent since 1990, after adjusting for inflation. By contrast, the average worker has scraped along with less than 5 percent in pay raises over 16 years. Minimum wage workers have fared even worse. Their pay has dropped by over 9 percent in real terms since 1990. CEO pay has also risen at a much faster rate than the stock market or corporate profits.

**Figure 11: Cumulative Percent Change in Economic Indicators, from 1990 (in 2005 dollars)**



Source: see box below.

#### Data Sources for This Section:

Total executive compensation: 2005 data based on *Wall Street Journal* survey, April 10, 2006; all other years based on similar sample in *Business Week* annual compensation surveys (now discontinued). Includes: salary, bonus, restricted stock, payouts on other long-term incentives, and the value of options exercised.

S&P 500 Index: Economic Report of the President, 2006 Table B-96; 1997, 2000 Table B-93; average of daily closing prices.

Corporate Profits: U.S. Department of Commerce, Bureau of Economic Analysis, National Income and Product Accounts, Table 6.16, with inventory valuation and capital consumption adjustments.

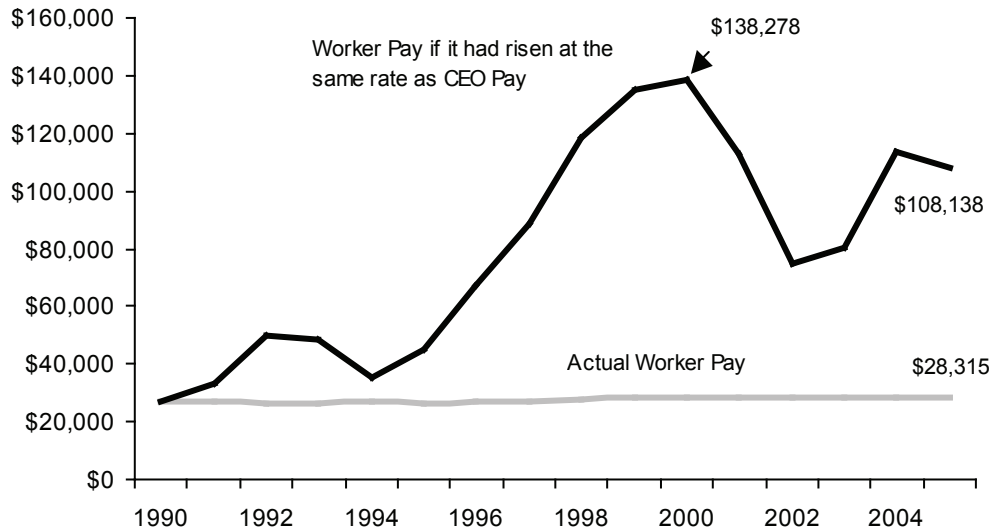
Average worker pay: Based on U.S. Department of Labor, Bureau of Labor Statistics, Employment, Hours, and Earnings from the Current Employment Statistics Survey (average hourly earnings of production workers x average weekly hours of production workers x 52).

Minimum wage: Lowest mandated federal minimum wage, nominal; U.S. Dept. of Labor, Employment Standards Administration, Wage and Hour Division.

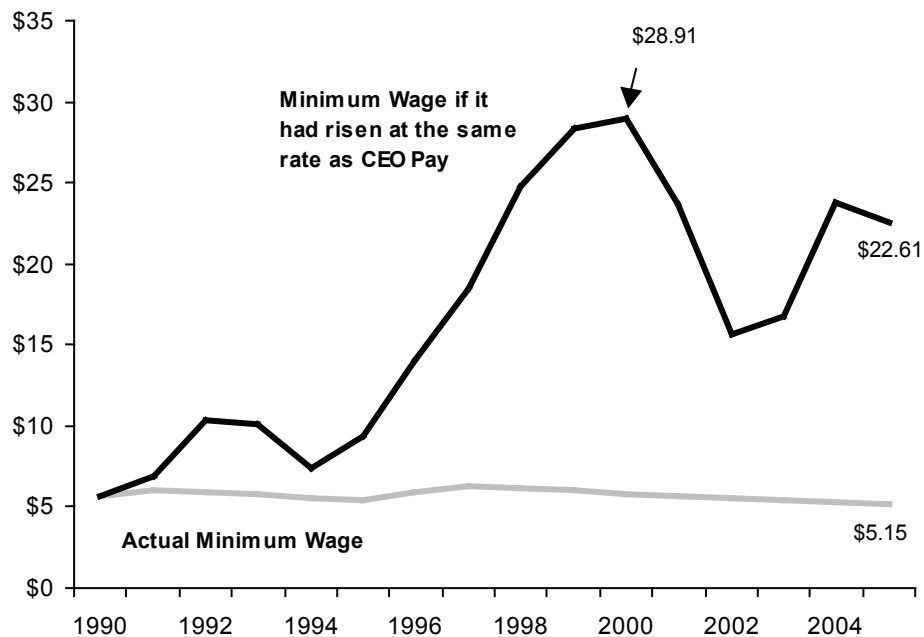
Adjustment for inflation: BLS, Average Annual CPI-U, all urban consumers, all items.

To put the CEO-worker pay gap in perspective, we calculated how much average production worker pay would be worth today if it had grown at the same rate as CEO pay. In 2005, the average worker would have made \$108,138, compared to the actual average of \$28,314. Similarly, if the federal minimum wage had grown at the same rate as CEO pay, it would have been \$22.61 in 2005, instead of \$5.15.

**Figure 12: Value of CEO Pay and Average Production Worker Pay, 1990-2005 (in 2005 dollars)**



**Figure 13: Value of CEO Pay and the Minimum Wage, 1990-2005 (in 2005 dollars)**



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## V. Reforming CEO Pay

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“Everyone should have an interest in controlling this explosion in executive pay. The wealth of America has been built through the returns of our public corporations, and if those returns are being redirected to company managements, then the people who get the short end of the stick are the people who hope to retire someday.”

—Frederick E. Rowe Jr., chairman, Texas Pension Review Board<sup>109</sup>

For almost two decades, the issue of excessive executive compensation has been simmering in the media and public consciousness. Hardly a week goes by without some iconoclastic business leader or media figure railing against the excesses of overpay or getting exercised about runaway stock options.

Nearly ten years ago, in 1997, *Business Week* declared executive pay “out of control.” A year later, the magazine complained: “Pay for performance? Forget it. These days, CEOs are assured of getting rich—however the company does.”<sup>110</sup>

Today, almost a decade later, nothing has changed, except perhaps the number of people complaining. Even corporate board members, the very people who set executive pay levels, now think things have gone overboard. A recent survey by PricewaterhouseCoopers, published in *Corporate Board Member* magazine, found that 70 percent of corporate directors consider executive compensation excessive, though not necessarily, of course, at the particular company they happen to govern.<sup>111</sup>

Can some semblance of compensation common sense be restored to America’s executive suites? Reformers have advanced an array of proposals that address executive pay excess, either through new statutes, improved regulations, or institutional change within corporations. The most commonly debated proposals aim to put into place:

- rules that require *greater transparency and disclosure* in all matters executive pay-related. The Security and Exchange Commission, the federal agency that regulates publicly traded corporations, earlier this summer pronounced new regulations that should substantially increase the data about executive pay available to investors.
- corporate governance reforms that encourage *greater corporate board independence* and eliminate conflicts of interest on board compensation committees.
- regulations that increase *shareholder power* in corporate decision making, in everything from board elections to compensation setting.

These proposed disclosure and governance reforms would certainly have an impact on the nation’s executive pay landscape. But this report recommends far more basic changes to address the economic insecurity and chaos that CEO pay excess engenders. These recommended changes would:

- give shareholders and communities the clout they need to recapture

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illegitimate executive compensation.

- eliminate the different ways taxpayers, communities, and workers are effectively subsidizing excessive executive pay.

Most fundamentally, we need to recognize that all Americans, not just shareholders, have a real stake in how corporations are run and CEOs are paid. And if more people than just traditional shareholders have a stake in corporate governance, then our corporate governance rules and regulations need to reflect these moral “facts on the ground.”

Closing the grotesque pay gap of 411:1 between CEOs and workers also requires urgent steps to increase pay at the bottom. It should be a source of national shame that the federal minimum wage has remained at \$5.15/hour for 9 years, despite the rise in inflation over these years. Local, municipal, and state-wide campaigns to raise the minimum wage are critical beacons of hope for low-wage workers and for American democracy. In July 2006, for example, the Chicago City Council passed an ordinance that will raise the minimum wages of Wal-Mart and other “big box” workers to \$10/hour. Such actions are vital in closing the pay gap.

## Disclosure and Transparency Reforms

“Disclosure is like aspirin; it can make you feel a little better, but it can’t even cure the common cold.... The fact is, a board that overpays the C.E.O. is in all probability not minding the store on the other issues, either.”

—Charles M. Elson, director, John L. Weinberg Center for Corporate Governance, University of Delaware<sup>112</sup>

In a sense, we already have transparency in executive pay. Nearly every major newspaper and business magazine in the United States is now publishing an annual CEO pay report. These reports all draw their data from filings that public traded corporations are required, under existing regulations, to make.

These regulations, put into effect in 1992 in response to the soaring executive pay rates of the 1980s, helped flood the 1990s with far more information about executive pay than ever before available. Unfortunately, this increased disclosure did not have any moderating impact on executive pay levels. Executive compensation actually increased at higher rates in the 1990s than in the 1980s.

Transparency, despite this history, remains the most widely advocated CEO pay reform. Whenever outrage over CEO pay boils over, new proposals for greater voluntary and legally required disclosure inevitably emerge. If we knew more about what CEOs were really making, the assumption goes, CEO pay would surely be more reasonable.

“I have a feeling that when people are forced to undress in public,” as SEC Chairman Christopher Cox colorfully quipped at a recent hearing, “they’ll pay more attention to their figures.”<sup>113</sup>

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This past January, the Securities and Exchange Commission circulated new draft rules designed to promote greater executive pay disclosure. In July, after receiving a record-breaking 20,000-plus public comments, the SEC issued final rules, the first significant changes in SEC oversight of executive compensation in 14 years.

The new transparency rules require corporations to explain their executive pay packages in “plain English,” not the mish-mash of legalese that has characterized pay disclosure data in the past. The just-released rules mandate that publicly traded corporations:

- present a tally sheet that discloses the total dollar value of the pay packages going to each corporation’s top five executives. Corporations will have to account fully for all pension-related compensation, something they haven’t had to do in past years.
- disclose once-hidden executive perks such as country club memberships, professional sports tickets, and the personal use of corporate jets and company luxury apartments.
- reveal arrangements that guarantee executives “golden parachutes” should their companies be merged or acquired.

All these mandates make eminent sense. But they don’t go far enough. Corporate proxy statements should, for example, also be required to:

- disclose whether the compensation consultants hired by corporations to devise appropriate executive pay packages have any potential conflict of interest with the company, such as contracts to perform other business services. The Conference Board recommends that boards hire their own compensation consultants to fashion executive pay packages, men and women who have not done previous work for the company or its current management.
- disclose the market value of executive perks, not just their incremental cost. For instance, if CEOs want to use a company jet for personal trips, they now only have to disclose the extra cost to the company of adding the trip, as opposed to the trip’s actual market value.

Greater transparency, as the new SEC disclosure regulations go into effect, will no doubt have some impact on excessive pay.

“Right now, there’s a lot of comp that just slides under the radar screen,” says James Clary, an expert on benefits and CEO of MullinTBG.

#### **Who are the compensation consultants?**

Who are the people that advise boards what to pay their top executives? Do these consultants have any reason to provide anything other than a completely independent perspective on executive pay?

To help answer these questions, consider Hewitt Associates, the company that advises the Verizon board of directors on compensation matters. Hewitt holds lucrative contracts to run Verizon’s employee benefit plans, provide the company actuarial services, and advise Verizon on human resources issues.<sup>114</sup>

Could these contracts be in jeopardy if Hewitt were to propose, for the executives ultimately responsible for approving these contracts, a level of compensation these executives felt inadequate? Ethicists have a phrase for this sort of workplace predicament: conflict of interest.

“The upshot is,” says superinvestor Warren Buffett, “that a mediocre or worse C.E.O.—aided by his handpicked V.P. of human relations and a consultant from the ever-accommodating firm of Ratchet, Ratchet & Bingo—all too often receives gobs of money from an ill-designed compensation arrangement.”

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“There will be a whole new round of scrutiny in terms of what’s fair, and the appropriate levels of compensation.”<sup>115</sup>

But will the new SEC transparency standards make a real difference? Some skeptics feel that companies will merely do what they have done in the past when confronted by new disclosure rules: shift compensation out of pay categories in the media spotlight into categories with less notoriety.

Companies, for instance, will likely transfer compensation dollars out of previously hidden—and easily ridiculed—executive perks into less controversial increases in straight salary.

Disclosure, in sum, will change corporate behavior, but not necessarily act as a check on overall corporate executive compensation. Disclosure alone, as the last two decades demonstrate, doesn’t address the basic corporate power dynamics that sit behind our nation’s exploding executive pay figures.

## **Corporate Governance Reform: The Limits of Shareholder Power**

Many critics of current executive compensation practices believe that empowering shareholders will help rein in runaway CEO pay.

“When all is said and done,” SEC chairman Cox told a recent meeting of the Council of Institutional Investors, “all of you will have more useful tools to exercise your rights and responsibilities as shareholders.”<sup>116</sup>

But this notion that shareholders have significant “rights and responsibilities,” that they “own” their companies, actually confuses how today’s major corporations operate. Under our current corporate governance arrangements, the odds stand stacked against shareholders who want to actively influence management decisions.

The stacked odds start at board election time. The members of most corporate boards are chosen in Soviet-style show elections, complete with fixed slates, uncontested elections, and anti-democratic voting systems.

Shareholders can, to be sure, enact protest resolutions at annual corporate meetings, but these resolutions have no binding impact on the boards of directors “elected” to set actual corporate policy.

Many reformers want to see these realities change. They face stiff opposition from key corporate groups. Earlier this year, at a May House hearing, business leaders acted as if a proposal to allow shareholders to vote on executive pay packages might end Western civilization as we know it.

“We should not ruin our free-market system because of a few rogues,” testified Thomas Lehner, director of public policy at the Business Roundtable, the national group whose members include the CEOs of some 160 top corporations. “We strongly believe that the current system has worked well and should not be changed.”<sup>117</sup>



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Those who believe the system has worked anything but well are, for their part, advancing a number of corporate governance reforms to refashion the internal corporate power equation.

## A. Competitive Elections

Most corporate boards are self-nominating and composed of current and retired CEOs, an arrangement that virtually assures an ever-rising executive pay spiral. Reformers want shareholders to be allowed the right to vote for alternative board of director's candidates or slates. The SEC proposed such a change in 2003, but the proposal, opposed by the powerful Business Roundtable, never advanced, despite overwhelming support from shareholder groups.

## B. "None of the Above": Majority Support Election Rules

If shareholders are not going to be allowed to vote for the candidates they really want to see serving on their company's board of directors, these shareholders should at least be able to withhold support from board candidates they oppose—and have this withholding matter. Under current rules, board candidates can be "elected" even if an overwhelming majority of shareholders withhold support from them. This past year, over 100 shareholder resolutions to change this practice came before corporate annual meetings.<sup>118</sup> These resolutions required that board candidates receive at least 50 percent of the shareholder vote to be considered elected.

The adoption of such a rule would give shareholders the power, even if they faced an uncontested slate of candidates, to withhold support for a particular director.

## C. Shareholder Approval of Executive Compensation Policies

Under British corporate law, shareholders must directly approve corporate pay packages, a relatively new development that some feel has contributed to greater executive pay restraint. A quarterly survey of American chief financial officers recently found that 64 percent of CFOs in the United States oppose granting shareholders any direct say on executive pay. Interestingly, a third of CFOs say they *would* approve such a change.<sup>119</sup>

Last November, Rep. Barney Frank (D-Mass.) introduced legislation—the Protection Against Executive Compensation Abuse Act, H.R. 4291—that would require corporations to bring their executive pay plans before shareholders. Each plan would have to include a sweeping disclosure of all intended executive pay, including short and long-term performance goals.

In addition, the Frank legislation would require companies to recapture pay incentives that subsequent financial results show were unjustified. H.R. 4291 would also require shareholder approval for "golden parachute" packages that coincide with the sale or purchase of company assets.

"This provision," explains a legislative summary of the bill, "is designed to

empower shareholders to protect themselves from senior management's natural conflict of interest when negotiating an agreement to buy or sell a company while simultaneously negotiating a personal compensation package."

## Beyond Transparency and Shareholder Rights

By extending transparency and strengthening shareholder rights, policy makers would be speaking to some of the factors that grease the CEO pay up-escalator. But we need more far-reaching reform to address the gross inequality in America's corporate workplaces.

Several proposals now entering the CEO pay debate would institutionalize new norms and directly address the power imbalance between corporate managements, shareholders, and other stakeholders in the decisions major corporations reach. These other stakeholders include everyone from company employees and retirees to consumers of a company's products and residents of the communities where companies do their business.

## Runaway Pay Clawbacks

What can shareholders and the public do when top managers fleece a company? Under current law, not much.

**One example:** Sanjay Kumar, the ousted former CEO of Computer Associates, pled guilty this past April to charges he had overstated the company sales figures in 1999 and 2000 and then obstructed the investigation into this overstatement.

Kumar took in \$300 million in bonuses based on his company's inflated and fraudulent financial reports.

### Fishy Numbers, Big Bonuses<sup>121</sup>

A number of CEOs have received large bonuses over recent years only to have to acknowledge later that the bonuses were based on overstated corporate earnings reports. But in most cases the CEOs have kept their bonuses, even after the overstatements have been acknowledged. Here are just a few examples.

Frank Dunn, Nortel Research. Bonus money: \$5.7 million. Restatement: \$1.2 billion in phantom revenue.

Hank Greenberg, American International Group (AIG). Bonus money: \$19.5 million. Restatement: \$3.9 billion in phantom earnings.

Sanjay Kumar, Computer Associates. Bonus money: over \$300 million. Restatement: At least \$2.2 billion in phantom revenue.

Scott Livengood, Krispy Kreme. Bonus money: \$1.6 million. Restatement: \$22.2 million in phantom earnings.

What now happens to that \$300 million? The post-Enron Sarbanes-Oxley corporate reform legislation does, in Section 301, allow "clawbacks" in the case of "misconduct." But this legislation fails to define what constitutes misconduct or note whose misconduct matters.

CALPERS, the giant California pension fund, is pushing companies to adopt stiff clawback rules as part of their corporate governance policies. One major company, Bristol-Myers Squibb, has already incorporated such an approach, but most companies are taking no steps in that direction—and likely won't without outside pressure. Activist shareholder groups like Amalgamated Bank's LongView Collective Investment Fund have introduced various shareholder resolutions calling for reforms in this area.<sup>120</sup>

Ultimately, only the threat of congressional action figures to make change real here. Rep. Barney Frank's Protection Against Executive Compensation Abuse Act, HR 4291, requires that companies put in place plans to recapture compensation that is inappropriate or based on fraud.

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## Eliminating Subsidies for Excessive Pay

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Average citizens, workers, and communities currently subsidize excessive executive pay—unknowingly—through their tax dollars, either directly through government contracts and economic development subsidies to corporations or indirectly through tax breaks that inflate corporate earnings.

### Tax Subsidies

Under current federal tax law, companies can deduct off their taxes, as a business expense, the bloated pay packages they award their top executives as “incentives.” The more of these “incentives” that corporations award, the lower their tax bills, a prime reason why the corporate share of the federal tax burden has shrunk.

At tax time, in effect, the federal government is rewarding corporations that outrageously overpay their executives.

The Income Equity Act, legislation introduced by Minnesota Congressman Martin Olav Sabo, would end this federal tax break for corporate executive overcompensation. Rep. Sabo’s bill would eliminate corporate tax deductions on any executive compensation that exceeds 25 times the pay of a company’s lowest-paid workers.

If a company’s lowest-paid workers took home \$25,000, for instance, then the company would only be able to claim as a legitimate business expense \$625,000 for each top executive.

The Income Equity Act would give companies an incentive to pay workers decent wages. Within Corporate America today, the existing incentives all run the other way. The more companies squeeze wages—through outsourcing, for instance, or threatening to outsource—the greater the personal rewards for the company’s executives. The result: wildly extreme pay disparities between workers and executives.

“Instead of such high ceilings and such low floors for compensation in American business,” Rep. Sabo notes, “my legislation encourages companies to review how they are paying all of their employees.”

The Income Equity Act would not, if enacted, dictate what companies pay top managers. The legislation simply would deny favorable tax treatment to corporations that excessively overpay executives.

Passage of Rep. Sabo’s Income Equity Act would substantially boost corporate tax collections. But the bill’s passage would, even more importantly, help establish an important principle: Our society, as a matter of public policy, should be discouraging, not encouraging, unconscionable pay disparities in America’s workplaces.

The bill’s passage, in Rep. Sabo’s words, would “send a message that those who work on the factory floor are as important to a company’s success as those who work in the executive suite.”

## Bailouts and Bonuses

Shortly after the terrible 9/11 attacks, lawmakers in Congress established an important precedent to limit windfall profit-taking in industries that receive substantial government assistance. The \$15 billion airline industry bailout Congress okayed that fall required that airline companies accepting bailout dollars ban raises and limit severance for all executives who had taken home over \$300,000 the year before.

Unfortunately, Congress has not so far applied this anti-profiteering mandate to major defense contractors and oil companies. The pages of this report make the consequence of that decision clear. Defense and oil company executives have turned the War on Terror into one record-breaking personal profit windfall after another.

In theory, existing law prevents at least some corporations with government contracts from pouring tax dollars, at excessive levels, into executive pockets. Section 808 of the FY 1998 National Defense Authorization Act makes “not allowable as costs under defense contracts” any executive compensation that exceeds an executive pay maximum that the Office of Management and Budget establishes annually.

In the 2005 fiscal year, this maximum stood at \$473,318. But this benchmark only limits the executive pay a defense company can directly bill the Pentagon for reimbursement and, as such, has no real moderating impact on executive pay. Defense companies remain absolutely free to reward their executives at whatever level they choose.

These companies, awash in War on Terror contract profits, have chosen to reward their executives, as this report documents in earlier pages, at rates that far exceed the \$473,318 standard.

## Procurement and Development Subsidies

Rep. Sabo’s Income Equity Act, by proposing a 25-times standard for corporate compensation reasonableness, offers a precedent that could be extended more broadly, to any situations that involve the transfer of tax dollars to private corporate entities, either to procure services or stimulate economic development.

Government contracts, for instance, could be denied to corporations that compensate their top executives at over 25 times the pay of their workers. Economic development subsidies, similarly, could be reserved only for those corporate entities that compensate within a 25-to-1 ratio.

Such “strings” on how we expend our tax dollars would build upon already existing safeguards against racial and gender bias. Our current statutes deny government procurement dollars to companies that discriminate, in their hiring and other employment policies, against women and people of color. We have determined, as a society, that our tax dollars must not subsidize corporate practices that widen racial and gender inequality. Why should we let our tax dollars subsidize corporate practices that widen economic inequality?

Over the past dozen years, many local jurisdictions across the United States have taken steps in this direction, by enacting “living wage” ordinances. These initiatives require corporations that gain government contracts to pay their workers a “living wage,” enough to lift their families out of poverty. Governments, the living wage movement takes as a given, should not be rewarding companies that pay poverty-level wages.

Neither should governments, at any level, be rewarding companies that drive the economic gaps that divide Americans ever wider.

## Conclusion: Shareholders or Stakeholders?

In the years ahead, who in American society will “fix” our executive pay scandal and end, once and for all, the looting of our corporations that windfall earnings so intensely encourage?

Many executive pay reformers today place that responsibility on shareholders, and shareholders alone.

We do not.

We support reforms that give shareholders more access to corporate data, more

say about executive pay decisions, more of a voting capacity to depose rubber-stamp corporate directors.

But men and women throughout American society, not just corporate shareholders, have a stake in how corporations pay their top executives. Why should we let shareholders be the ultimate arbiter on the size of CEO rewards when these rewards can and do create incentives for CEO behaviors that hurt people who aren't shareholders?

These other people include workers and retirees, consumers and local residents who live near corporate facilities, even people who simply may want to enjoy the environment a corporate decision may befoul. All these people count as "stakeholders." They each have a stake in moderating out-of-control executive compensation.

Communities count as stakeholders, too. Communities where corporations are based have a stake in ensuring that employers compensate their employees fairly and pay their fair share of local taxes.

Communities need to be able to know how much corporations are paying both workers and executives. They need to be able to link economic development subsidies to performance criteria that lower pay ratios between highest- and lowest-paid employees. And they should be able to seek remedies when corporations fail to abide by community standards.

Corporate governance reforms that would allow more institutional investors to have seats on corporate boards make eminent sense. But workers, communities, and other stakeholders need representation as well. Many European corporations already embody elements of co-management or stakeholder governance in their ongoing operations. These companies can become useful models for corporate governance change here in the United States.

In the end, we need to be talking about power, not just pay. Addressing the root causes of excessive executive compensation will require our society to address, more seriously than ever before, the grotesque imbalances of power that currently define our contemporary Corporate America.

### Setting a Fair Pay Ratio Standard

Executives who take home over 400 times what their average employees are earning are, most Americans would likely agree, taking home too much.

What would constitute a more appropriate workplace pay ratio? Rep. Martin Sabo, in his proposed Income Equity Act, has taken a stab at answering that question. His legislation would deny tax benefits to corporations with a pay gap between top and bottom that exceeds 25-to-1.

This 25 times ratio, Congressman Sabo has noted, reflected the approximate gap between the annual take-home of a minimum-wage worker and the salary of the President of the United States in the early 1990s, when Sabo first introduced his Income Equity Act legislation.

This 25-to-1 ratio also corresponds with the pay gaps that other corporate leaders and scholars have advanced over the years. A century ago, the widely celebrated J. P. Morgan, the most eminent business leader of his day, considered 20-to-1 the appropriate pay gap between workers and CEOs.

In more recent times, Peter Drucker, the esteemed founder of modern management science who passed away last November, advocated the same 20-to-1 ratio. No executives, Drucker wrote in 1982, should earn more than 20 times the pay of their workers.

Over the next two decades, as pay gaps rose from the 35-to-1 ratios that typified the corporate pay scene in the 1960s to 200-, 300-, even 400-to-1, Drucker remained committed to his earlier standard. Drucker never stopped criticizing executive pay levels he considered excessive—and paid particular attention to the perverse incentives that stock option windfalls can create.

"Stock option plans reward the executive for doing the wrong thing," Drucker once noted. "Instead of asking, are we making the right decision?' he asks, 'How did we close today?' It is encouragement to loot the corporation."

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## Resources

See Friends of the Earth's Handbook on "Confronting Companies Using Shareholder Power"

<http://www.foe.org/international/shareholder/>

CALPERS Governance

<http://www.calpers-governance.org/forumhome.asp>

ICCR Resolutions

[http://www.iccr.org/shareholder/proxy\\_book06/06statuschart.php](http://www.iccr.org/shareholder/proxy_book06/06statuschart.php)

## Appendix I: Defense CEO Compensation—Pre-9/11 (1998-2001) and Post-9/11 (2002-2005)

To measure CEO pay in the defense industry, we examined the 34 publicly traded U.S. corporations that were among the top 100 Department of Defense contractors in 2005 and for which defense contracts made up more than 10 percent of their total revenues. These contracts do not include those administered by the U.S. Agency for International Development for Iraq reconstruction. Total direct compensation covers salary, bonuses, gains from options exercises, other long-term incentive payouts and the value of restricted shares at the time of the grant.

	Company	1998	1999	2000	2001	2002	2003	2004	2005	total, 2002-05
1	Alliant Tech- systems	1,130.8	1,382.7	1,400.0	2,824.3	10,534.1	16,765.7	1,871.4	1,713.5	30,884.7
2	Anteon Inter- national (I)	n/a	600.0	631.5	655.9	756.6	975.0	6,200.1	9,058.3	16,990.0
3	Armor Hold- ing	1,710.4	1,838.8	2,537.8	898.0	4,657.5	5,334.0	8,200.1	11,121.5	29,313.1
4	Boeing	3,026.1	4,425.4	19,633.6	3,929.0	4,145.0	3,811.0	3,994.8	28,428.7	40,379.5
5	CACI Interna- tional	560.2	676.1	4,806.2	1,094.2	1,652.2	2,262.7	2,951.6	3,633.0	10,499.6
6	Computer Sciences	2,175.8	980.8	2,303.7	2,146.0	1,734.0	7,842.6	19,782.6	14,719.6	44,078.8
7	Cubic	539.3	672.9	596.4	752.2	853.7	895.5	1,405.3	910.0	4,064.6
8	DRS Tech- nologies	651.1	784.9	1,755.3	1,060.0	3,903.6	1,375.5	2,694.7	3,169.9	11,143.6
9	Edo	770.9	519.5	192.8	893.2	1,005.6	1,411.8	1,618.8	1,783.7	5,820.0
10	Engineered Support Sys- tems	762.3	1,076.0	6,687.6	17,094.5	1,614.0	3,542.0	39,730.0	720.0	45,606.0
11	General Dy- namics	10,085.0	12,536.1	10,119.4	5,719.0	15,245.0	9,268.7	31,528.4	9,850.6	65,892.7
12	GTSI	379.8	417.5	392.6	382.4	838.1	913.9	1,159.4	3,120.9	6,032.3
13	Halliburton	3,863.0	6,304.2	24,222.0	6,682.0	7,302.0	4,165.0	11,421.6	26,602.5	49,491.1
14	Harris	4,916.7	2,234.8	2,137.8	1,824.0	4,099.6	3,874.8	2,681.4	3,478.1	14,133.9
15	Health Net	500.0	500.0	586.5	686.9	1,454.8	14,087.9	934.6	11,567.2	28,044.5
16	Humana	1,497.6	205.0	1,240.0	1,530.0	1,372.0	2,256.0	1,970.5	2,980.4	8,578.9
17	ITT Industries	3,030.7	6,192.8	7,553.0	2,992.0	12,526.0	14,728.0	11,846.1	5,557.8	44,657.9
18	L-3 Communi- cations Titan	668.4	1,078.5	1,250.0	1,511.0	1,675.0	12,334.0	2,025.0	2,175.0	18,209.0
19	Lockheed Martin	2,343.8	1,258.0	5,723.9	16,556.0	25,337.0	13,696.0	6,733.3	4,498.8	50,265.1
20	Mantech (2)	n/a	n/a	n/a	1,960.8	1,000.0	1,595.6	1,171.9	1,800.6	5,568.1
21	Northrop Grumman	900.0	22,595.6	6,878.4	7,267.3	9,222.0	5,785.0	6,739.9	8,302.9	30,049.8
22	Oshkosh Truck	770.0	2,256.5	1,320.0	896.0	8,736.2	9,134.3	3,765.5	18,145.7	39,781.7
23	Raytheon	5,838.9	1,801.0	8,004.8	2,588.0	8,922.0	6,336.0	5,343.7	6,805.3	27,407.0
24	Rockwell Col- lins	775.0	5,486.8	1,949.9	783.0	1,161.0	3,778.0	2,687.9	3,379.5	11,006.4
25	Science Appli- cations Int'l	1,323.1	1,323.1	1,726.9	1,873.0	6,993.7	1,988.9	1,260.0	2,800.0	13,042.6
26	Shaw Group	589.3	979.0	1,733.3	2,941.7	1,953.5	950.0	2,876.2	4,447.9	10,227.6
27	Stewart & Stevenson Services	395.0	486.0	526.5	637.7	425.0	2,240.6	750.0	2,250.0	5,665.6
28	Tetra Tech	270.0	195.0	354.7	1,532.1	334.6	552.3	315.0	688.7	1,890.6
29	Textron	2,160.7	20,306.3	4,455.3	7,632.0	4,684.0	8,004.0	14,855.5	17,559.6	45,103.1
30	United Indus- trial	1,098.8	440.0	440.0	580.9	897.1	470.4	765.5	1,021.6	3,154.7



	<b>Company</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>total, 2002-05</b>
31	United Technologies	12,152.1	16,666.3	18,747.0	22,636.0	9,664.0	70,452.0	88,321.6	31,866.3	200,303.9
32	URS	1,010.5	7,895.9	3,974.8	4,534.0	2,604.2	3,069.7	6,442.9	14,434.2	26,551.0
33	VSE	421.1	309.0	279.0	279.0	148.0	210.2	240.0	330.0	928.2
34	Washington Group Int'l (3)	673.5	0.0	0.0	824.6	2,061.6	3,114.5	1,803.9	4,148.6	11,128.5
	average	2,093.4	3,770.4	4,368.5	3,711.7	4,691.6	6,977.1	8,708.5	7,737.4	28,114.5
	Total	69,083.2	128,195.0	148,528.9	129,908.5	164,204.5	244,198.6	304,797.7	270,807.6	984,008.4
Source: company proxy statements.										
Notes:										
1. First proxy filing in 1999.										
2. First proxy filing in 2001.										
3. CEO received options in lieu of cash compensation in 1999 and 2000.										

## Appendix 2: Defense Contractor CEOs, Contract Value, and Key Products/Services

	Company	CEO in 2005 (9)	Value of defense contracts in 2005 (\$)	Defense as % of 2005 revenue	Key Product / Service
1	Alliant Techsystems	Daniel J. Murphy	1,274,541,046	45.5	Ammunition, including depleted uranium shells and cluster bombs
2	Anteon International (1)	Joseph M. Kampf	938,637,452	62.9	Intelligence training, video game warfare simulators, soldier recruitment
3	Armor Holding (2)	Warren B. Kanders	711,949,790	43.5	Protective equipment for military personnel and vehicles
4	Boeing (3)	W. James McNerney Jr.	18,920,031,754	34.5	F-15 fighter, C-17 air transport, Apache Helicopter, JDAM "smart" bombs
5	CACI International	J. P. (Jack) London	764,655,418	47.1	Information technology, prisoner interrogation (until 9/05)
6	Computer Sciences	Van B. Honeycutt	2,827,726,732	17.8	Information technology, biometric ID systems for US military facilities in Iraq
7	Cubic	Walter J. Zable	289,395,317	36.0	"Combat training systems and communications electronics"
8	DRS Technologies	Mark S. Newman	409,913,756	23.6	Electronic systems for surveillance, weapons targeting, flight recorders, thermal imaging, air combat training, and video recording
9	Edo Corporation	James S. Smith	306,989,514	47.3	Components of Raytheon's "Paveway" guided bomb; "Warlock" cell phone jammers
10	Engineered Support Systems	Gerald Potthoff	769,274,209	75.5	Power generation, fuel and water distribution, telecommunications, other logistics services
11	General Dynamics (4)	Nicholas D. Chabreja	12,154,074,852	56.7	Abrams M1 tank, Trident submarine
12	GTSI	M. Dendy Young	277,344,251	25.8	Computers, software, and networking products
13	Halliburton	David L. Lesar	5,827,623,078	27.8	Oil field services, logistics, including feeding troops
14	Harris	Howard L. Lance	736,700,728	24.6	Microwave, satellite, radio, digital and wireless communications equipment and systems
15	Health Net	Jay M. Gellert	2,031,991,411	17.0	Managed care programs for active and retired military and their dependents
16	Humana	Michael B. McCallister	2,260,685,194	15.7	Managed care programs for active and retired military and their dependents
17	ITT Industries	Steven R. Loranger	2,493,318,283	31.8	Combat radios, night-vision devices, airborne electronic-warfare systems
18	L-3 Communications Titan (5)	Frank C. Lanza	5,001,337,038	53.0	Satellite, avionics, missile defense, marine communications
19	Lockheed Martin	Robert J. Stevens	19,447,130,633	52.3	F-16, F/A-22 jet fighters, C-130J air transport, Hellfire, Javelin missiles
20	Mantech	George J. Pederson	404,357,230	41.2	IT services and physical and cyber security for intelligence agencies.
21	Northrop Grumman	Ronald D. Sugar	13,512,356,291	44.0	B-2 stealth bomber, amphibious assault ships, training Iraqi army

	<b>Company</b>	<b>CEO in 2005 (9)</b>	<b>Value of defense contracts in 2005 (\$)</b>	<b>Defense as % of 2005 revenue</b>	<b>Key Product / Service</b>
22	Oshkosh Truck	Robert G. Bohn	1,473,875,526	49.8	Heavy-payload tactical trucks
23	Raytheon	William H. Swanson	9,109,329,221	41.6	Patriot and Tomahawk missiles, "Bunker Buster" bomb, "Paveway" laser guided bomb
24	Rockwell Collins	Clayton M. Jones	759,010,311	22.0	Aviation electronics and communications equipment
25	Science Applications Int'l	Kenneth Dahlberg	2,795,942,100	34.9	Telecommunications, training Iraqi police
26	Shaw Group	James M. Bernhard Jr	560,732,461	17.2	Power generation engineering and construction
27	Stewart and Stevenson Services (6,8)	Max L. Lukens	1,295,813,335	112.0	Medium tactical vehicles, including cargo trucks and troop carriers
28	Tetra Tech	Geoffrey M. Hertel	299,522,174	23.3	"Management consulting and technical services"
29	Textron (7)	L.B. Campbell	2,202,093,553	18.4	V-22 Osprey aircraft
30	United Industrial	Frederick M. Strader	468,951,882	90.7	Automatic test equipment for avionics, electronic warfare test and training systems and aircraft maintenance
31	United Technologies	George David	5,021,702,617	11.8	Black Hawk helicopters and engines for F-15 and F-16 fighter jets
32	URS	Martin M. Koffel	1,522,958,486	38.9	Defense systems engineering and repair of Iraqi communications system, hospitals and courthouses
33	VSE (8)	Thomas Dacus	284,938,001	101.7	Engineering, testing and logistics services
34	Washington Group International	Stephen G. Hanks	879,146,162	27.6	Military base construction, repair of electrical, water and other infrastructure in Iraq and Afghanistan

Sources: contracts: Department of Defense Directorate for Information Operations and Reports, table 3--DoD Top 100 Companies and Category of procurement--fiscal year 2005; revenues: Fortune magazine, April 17, 2006 and company annual reports.

1. Purchased by General Dynamics in December 2005.
2. Includes value of contracts to subsidiaries American Body Armor and Equipment and Simula Inc.
3. Includes 50% of the value of contracts to Bell Boeing Joint Program.
4. Includes value of contracts to GM GDLS Defense Group.
5. Includes value of contracts to subsidiary Army Fleet Support.
6. Purchased by Armor Holdings in January 2006.
7. Includes 50% of the value of contracts to Bell Boeing Joint Program.
8. Value of defense contracts can exceed revenues due to a backlog of funded contracts not yet completed.
9. Report includes CEO compensation data regardless of whether the individuals holding that post changed over the course of the period studied. Of those who were CEOs in 2005, 14 had been in that post for all years surveyed.

## Appendix 3: Oil CEO Compensation (U.S. and Foreign), 2004-2005

To measure CEO pay in the oil industry, we examined the top 15 publicly traded U.S. corporations ranked by market value by *Forbes* (as of 5/21/06). Figures were obtained from either the *Wall Street Journal* Executive Compensation Survey on April 10, 2006, or the companies' proxy statements. Total direct compensation covers salary, bonuses, gains from options exercises, other long-term incentive payouts and the value of restricted shares at the time of the grant.

United States					
Rank, by 2005 market value	Company	CEO	Total Direct Compensation (\$ thousands)		
			2004	2005	% change
1	ExxonMobil	Lee Raymond	81,330.9	6,9684.0	-14.3%
2	Chevron	Dave O'Reilly	7,964.9	8,625.3	8.3%
3	ConocoPhillips	James J. Mulva	16,550.5	31,069.2	87.7%
4	Occidental Petroleum	Ray R. Irani	66,401.2	83,963.9 (2)	26.4%
5	Haliburton	David J. Lesar	11,421.6	26,602.5 (3)	132.9%
6 (1)	Valero Energy	William E. Greehey	44,748.7	95,157.9	112.6%
7	Devon Energy	Larry Nichols	9148.6	10,224.1	11.8%
8	Marathon Oil	Clarence P. Cazalot Jr.	4,281.6	37,940.9 (4)	786.1%
9	Anadarko Petroleum	James T. Hackett	2,915.0 (5)	7,140.0	144.9%
10	Baker Hughes	Chad C. Deaton	4,198.1	6,625.4	57.8%
11	Apache Corp.	G. Steven Farris	5,351.9	13,645.2	155.0%
12	EOG Resources	Mark G. Papa	10,836.1	36,343.1	235.4%
13	XTO Energy	Bob R. Simpson	48,438.9	32,016.7	-33.9%
14	Amerada Hess	John B. Hess	6,797.2	23,016.6	238.6%
15	Kerr-McGee	Luke R. Corbett	5,824.8	7,841.9	34.6%
		average	21,747.3	32,659.8	50.2%
(1) Burlington Resources was ranked #6 in 2005, however CEO compensation information was not available due to the company's acquisition by ConocoPhillips.					
(2) Does not include \$1,073,436 in perquisites, \$625,770 credited to Supplemental Retirement Plan, and \$713,451 accrued interest on deferred compensation.					
(3) Includes payments under the Annual Performance Pay Plan for Mr. Lesar—\$2,772,000.					
(4) Does not include \$200,000 retention bonus.					
(5) Does not include \$1 million signing bonus and a \$5.7 million payment in recognition of Mr. Hackett's loss of his right to receive certain compensation from his previous employer as a result of his termination of that employment prior to May 1, 2004.					

Top Foreign Oil Companies			
Rank, by 2005 market value	Company	CEO	2005 Total Direct Compensation (\$ Thousands)
1	British Petroleum	Lord Edmund John Phillip Browne	5,588.3
2	Royal Dutch Shell	Jeroen van der Veer	4,106.9 (6)
	average		4,847.60
(6) 2005 salary figure as stated here excludes a payment of €32,500 relating to his November and December 2004 salary.			

### Sampling of Occupations in the Oil/Gas Extraction Industry

Pay gaps in the oil industry based on the average annual wage from the U.S. Dept. of Labor's May 2005 National Industry-Specific Occupational Employment and Wage Estimates—NAICS 211000 Oil and Gas Extraction Industry.

Occupation Number	Occupation Title	Average Annual Wage
47-2061	Construction Laborers	22,240.00
47-5012	Rotary Drill Operators	43,450.00
17-2171	Petroleum Engineers	107,990.00
<b>All Occupations</b>	<b>All Occupations</b>	<b>63,100.00</b>

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## Appendix 4: Understanding CEO Compensation and Our Numbers

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### How we calculate CEO pay

For 13 years, our Executive Excess reports have followed the traditional methodology used by the *Wall Street Journal*, *Forbes* and *Business Week* for calculating total direct compensation. This is based on salary, bonuses, restricted stock awards, payouts on other long-term incentives, and the value of options exercised in a given year.

Some other business publications and researchers include the estimated value of stock options grants. We prefer the definition that includes options exercised and not options granted because it fits the common-sense definition of pay understood by most laypeople of “how much money you got this year.” Estimated values of option grants are just that, estimates. What the CEO eventually puts in his pocket is often drastically different.

### How we calculate CEO-Worker Ratios

Calculating CEO-worker pay ratios has become a bit of a cottage industry, with widely varying figures. This year, we calculated the gap at 411-to-1. Our figure for average CEO pay is based on a Wall Street Journal/Mercer survey of 350 companies with revenue of \$1 billion or more. Our figure for worker pay is based on Labor Department statistics for all private sector workers, including those who work less than 35 hours per week. This results in a lower figure for average worker pay (\$28,315 in 2005) than in other ratios based on compensation for full-time workers. We prefer to include part-time workers because they make up 23% of the U.S. workforce and we want to capture the reality of working life in America. Another reason some other ratios are smaller than ours is because they base worker pay on the total cost of compensation to employers, which includes healthcare, contributions to pensions, and other benefits that are not included on the CEO side. Since we have strongly criticized the absence of accurate public information on executive perks and benefits, we think it is important to use worker pay data that does not include these costs either.

### Proxy term definitions

Data on CEO pay comes from the proxy statements that companies are required to file with the Securities and Exchange Commission (SEC). These annual statements report on the status of the company and solicit votes from shareholders on issues to be decided at the companies’ upcoming shareholder meetings. Each company’s proxy statement provides detailed information on top executives’ compensation, including:<sup>120</sup>

**Salary:** The payment received just for showing up to work. Typically a small portion of a CEO’s total pay package, the salary very rarely declines during down years.

**Bonus:** An annually determined cash payment reflecting general achievement of objectives. Although bonuses sometimes decline during years of poor perfor-

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mance, they are often significantly higher than the salary.

**Other Annual Compensation:** This catchall category reflects the perks and other benefits provided to the CEO on an annual basis. (This is different than the proxy category “All Other Compensation,” which represents perks not provided on an annual basis). It includes company payments to various financial plans and personal benefits like country club memberships.

**Restricted Stock Awards:** Unlike options, which represent the right to purchase stock in the future, stock grants are made up of actual shares of stock. Usually, these awards are subject to some restrictions, which prevent the stock from being sold or transferred for a certain period of time, or until certain earnings thresholds have been met. Stock awards are valued based on the market price of the stock on the grant date.

**Long Term Incentive Plan (LTIP) Payouts:** In response to shareholder criticisms that CEOs’ pay was too short-term oriented, Long-Term Incentives were created. The plans offer financial rewards (of cash or stock) for performance over a longer time period, commonly three to five years.

**Stock Options:** Stock options represent the right to purchase a certain number of shares of company stock at a set price (the strike price) after waiting a set interval of years. Only if stock prices go up do stock options become valuable.

**Present Value of Stock Option Grants:** Companies must calculate the theoretical worth (in current dollars) of options granted in the fiscal year covered by the proxy, based on one of two formulas mandated by the SEC.

**Value Realized from Stock Options Exercised:** This represents the actual money a CEO has gained through the stock options he or she has exercised in the fiscal year. It is calculated by finding the difference between the market price of the shares the CEO purchases when he or she exercises the option and the strike price.



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## Endnotes

- 1) Based on *Wall Street Journal* CEO Compensation Survey, April 10, 2006.
- 2) Bureau of Labor Statistics.
- 3) Company Proxy filings.
- 4) Bureau of Labor Statistics, May 2005 National Industry-Specific Occupational Employment and Wage Estimates NAICS 211000 - Oil and Gas Extraction.
- 5) Bureau of Labor Statistics, May 2005 National Industry-Specific Occupational Employment and Wage Estimates NAICS 211000 - Oil and Gas Extraction.
- 6) Bureau of Labor Statistics, May 2005 National Industry-Specific Occupational Employment and Wage Estimates NAICS 211000 - Oil and Gas Extraction.
- 7) See: Statement of Joseph A. Christoff, "Rebuilding Iraq: Stabilization, Reconstruction, and Financing Challenges," United States Government Accountability Office, February 8, 2006 (GAO-06-428T).
- 8) Public Papers of the Presidents, Dwight D. Eisenhower, 1960, pp. 1035-1040.
- 9) List of contractors from Department of Defense Directorate for Information Operations and Reports, table 3--DoD Top 100 Companies and Category of procurement--fiscal year 2005. Revenues: *Fortune* magazine, April 17, 2006 and company annual reports. Note: of the top 100 companies, 66 were excluded because they either had less than 10% of revenues in defense (22 companies); were privately held (21); were foreign (11); were joint ventures or subsidiaries of other companies on the list (6); were non-profits (4) or were government-owned (4).
- 10) Calculated by the authors based on profits data in *Fortune* 500 surveys and [www.hoovers.com](http://www.hoovers.com) and national corporate profits from the Bureau of Economic Analysis, NIPA, Table 6.16.
- 11) Calculated based on data for last trading day for each year from [www.bigcharts.com](http://www.bigcharts.com).
- 12) Based on \$85 monthly base wage negotiated by workers in the Iraqi oil industry, one of the better-paid sectors, cited in David Bacon, "Oil and freedom: Iraqi workers struggle for rights and resources," *ILWU Dispatcher*, August 11, 2005 (<http://www.uslaboragainstar.org/article.php?id=8977>).
- 13) Jonathan Finer and Omar Fekeiki, "Tackling Another Major Challenge in Iraq: Unemployment," *Washington Post*, June 20, 2005.
- 14) Pay ratio data for 2001 differs from figures used in our 2005 report because this year's figures are based on average, rather than median defense executive compensation, for the purpose of consistency with other figures in the report.
- 15) David S. Hilzenrath, "Former Pentagon Chief Cohen Serves Defense Contractors," *Washington Post*, May 28, 2006.
- 16) Letter to Sarah Anderson, John Cavanaugh [sic], Scott Klinger, and Liz Stanton, from Dr. J. P. London, Chairman of the Board, President, and Chief Executive Officer, CACI International, September 26, 2005.
- 17) Ellen McCarthy, "Firm Was Entangled in Abu Ghraib," *Washington Post*, September 15, 2005.
- 18) Quoted in Stuart D. Brandes, *Warhogs: A History of War Profits in America* (University Press of Kentucky, 1997) p. 227.
- 19) Quoted in Chris Kromm, "Making a Killing: The New War Profiteers," *Southern Exposure*, Winter 2003/2004.
- 20) Profit figure estimated based on company's 2005 Annual Report and e-mail communication from UTC investor relations department dated July 20, 2006. Christopher Byron, "Black Hawk Clown," *New York Post*, June 5, 2006.
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The reports listed below are available online at [www.FairEconomy.org](http://www.FairEconomy.org).

**Executive Excess 2005: Defense Contractors Get More Bucks for the Bang.** Examines CEO compensation at top defense contractors and reviews and updates some of the most harmful pay trends of the past decade and a half.

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**More Bucks for the Bang: CEO Pay at Top Defense Contractors.** CEOs at the nation's largest military contractors rose 79 percent in 2002, compared to a six percent increase for typical CEOs.

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### Center for Corporate Policy

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