

Executive Pay: The 9/11 Factor

As stocks sank after the attacks, scores of companies rushed to issue options to top officials. Some reaped millions.

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ON SEPT. 21, 2001, rescuers dug through the smoldering remains of the World Trade Center. Across town, families buried two firefighters found a week earlier. At Fort Drum, on the edge of New York's Adirondacks, soldiers readied for deployment halfway across the world.

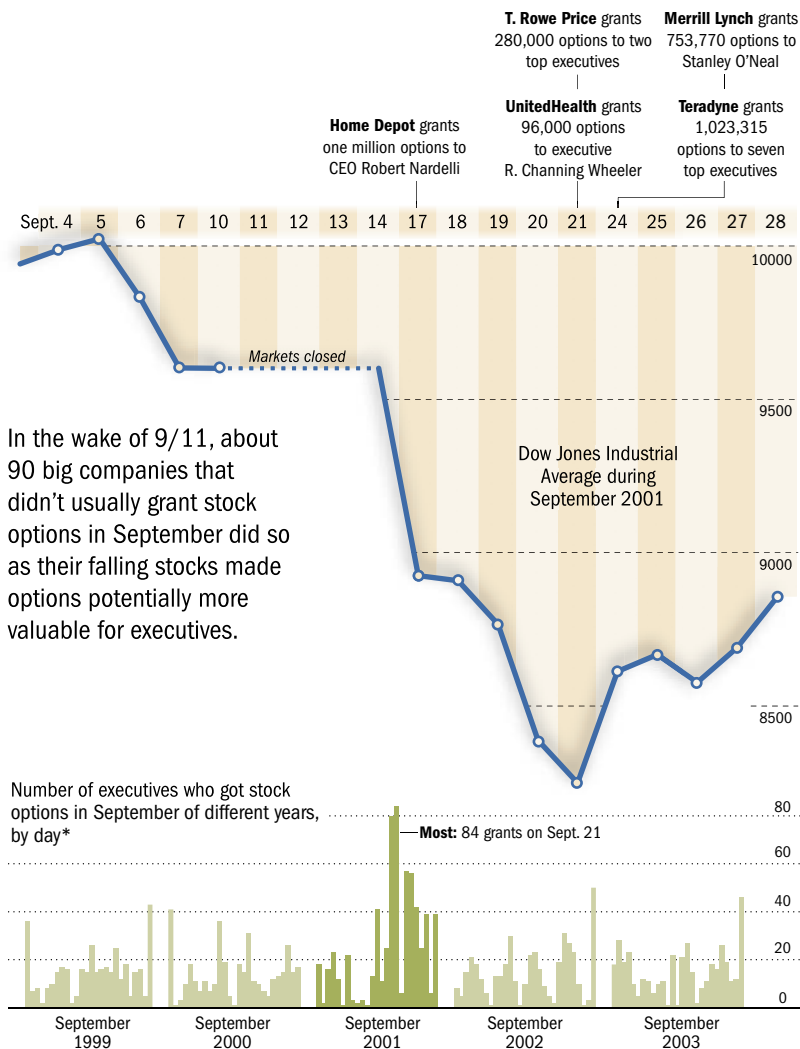
Boards of directors of scores of American companies were also busy that day. They handed out millions of bargain-priced stock options to their top executives.

The terrorist attack shut the U.S. stock market for days. When it reopened Sept. 17, stocks skidded more than 14% over five days, in the worst full week for the Dow Jones Industrial Average since Germany invaded France in May 1940. But for recipients of options, the lower their company's stock price when options are awarded the better, since the options grant a right to buy shares at that price for years to come. The grants set recipients up for millions of dollars in profit if the shares recovered.

A Wall Street Journal analysis shows how some companies rushed, amid the post-9/11 stock-market decline, to give executives especially valuable options. A review of Standard & Poor's ExecuComp data for 1,800 leading companies indicates that from Sept. 17, 2001, through the end of the month, 511 top executives at 186 of these companies got stock-option grants. The number who received grants was 2.6 times as many as in the same stretch of September in 2000, and more than twice as many as in



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In the wake of 9/11, about 90 big companies that didn't usually grant stock options in September did so as their falling stocks made options potentially more valuable for executives.

Note: Grant data, from Standard & Poor's ExecuComp, encompass 1,800 leading companies. Data include options to companies' top executives—typically the CEO and the four next most highly compensated officers. Option totals are adjusted for splits.

*Estimates of grant dates based on expiration dates. Based on entire S&P ExecuComp database of 1,800 companies.

Sources: Standard & Poor's ExecuComp; WSJ research; WSJ Market Data Group

the like period in any other year between 1999 and 2003.

Ninety-one companies that didn't regularly grant stock options in September did so in the first two weeks of trading after the terror attack. Their grants were concentrated around Sept. 21, when the market reached its post-attack low. They were worth about \$325 million when granted, based on a standard method of valuing stock options.

The 91 companies included such corporate icons as Home Depot Inc., Black & Decker Corp. and UnitedHealth Group Inc. It included two companies di-

rectly touched by the tragedy. Merrill Lynch & Co., across the street from the Twin Towers, lost three employees. On Sept. 24, Merrill granted its president options to buy more than 750,000 shares, at a price 15% below the pre-attack level. At Teradyne Inc. in Boston, an employee delayed a business trip until Sept. 11 to attend a son's soccer game and died on American Flight 11. Teradyne that month gave its CEO more than 600,000 options at a price enabling him to buy stock at 24% below its pre-attack level.

At Stryker Corp., a Michigan maker of orthopedic products, one-time stock-option-committee member (Please Turn to Page A4, Column 1)

FROM PAGE ONE

Continued from page 1

John Lillard said he didn't regret the decision to award options nine days after the attack. "If you believe the company is going to do well, and here is an external event that is affecting the market and you've made a decision to reward executives, you go ahead with it," Mr. Lillard said. "Life goes on."

There's nothing illegal about granting options after the market plunges. But acting so quickly after a national tragedy drove down stocks shows the eagerness of some companies to increase their executives' potential wealth. These grants also offer important new fodder for an already fractious debate over what constitutes the proper use of options in executive compensation.

Dozens of companies are under investigation for possibly backdating option grants to a day when the stock was lower, a practice that could mean the companies have made false disclosures and perhaps reported financial results incorrectly. Other companies are being investigated on suspicion of timing options grants ahead of good corporate news.

The multiple options grants after 9/11 raise a different question: Did companies take unseemly advantage of a national tragedy?

Some companies say they issued options to capture the new more favorable prices as a way of calming and motivating managers rattled by the terrorist attacks and the ensuing economic fears. Others say their granting of options at that time had nothing to do with the Sept. 11 events. Some say that mid- or late-September meetings of the compensation committees of their corporate boards had been scheduled weeks in advance. Companies note that for all they knew, their stocks might have gone lower still in succeeding weeks.

Stock options were originally designed to align executives' incentives with the goals of shareholders, encouraging recipients to work hard to improve their companies' stock price. When those options are granted at favorable prices, executives get some of their gain free -- that is, they get a chance to buy in an unusual dip below the price many investors have paid.

Black & Decker, the tool maker, wasn't in the habit of giving options to its very top executives in September. Proxy filings, which typically list grants to the companies' five highest-paid executives, indicate Black & Decker hadn't given them options in September since at least 1994. But on Sept. 21, 2001, with the stock down nearly 20% in the wake of the attack, directors granted hundreds of thousands of options to the top five executives and 37 others.

Black & Decker said the grants came about because the board had been worried for months about the departure of some key employees. It thus had decided to defer options grants to top executives, normally given in April, until it could come up with a retention plan, a spokesman said. That it completed this retention program with stock-option grants 10 days after the attack was coincidence, the spokesman said.

Nolan Archibald, Black & Decker's chief executive, received options to buy 200,000 shares. If cashed out today, they would bring him a profit of about \$9 million. While most of that is due to the overall performance of the company and its stock, it's about \$1.4 million more than it would be if the grant had been based on the stock price just before 9/11.

"It did not bother the board that it was at an advantageous strike price, because that helped the retention aspect," said Black & Decker's spokesman, Roger Young. He called the propitious timing "water under the bridge." The company didn't make Mr. Archibald available for an interview.

In the first days after the attack, with the stock market shut down, American government and business leaders scrambled to reassure investors and soften a blow they knew would come when the market reopened the following Monday. Famed investor Warren Buffett appeared on CBS's "60 Minutes," saying he "won't be selling anything." Vice President Dick Cheney, on NBC's "Meet the Press," urged the financial community not to be disrupted. Companies lined up to invest cash in their own shares, often trumpeting their decisions in patriotic tones.

Minutes after the bell rang Sept. 17 at the New York Stock Exchange, New York Mayor Rudy Giuliani, who'd attended the solemn reopening ceremony, told CNBC, "Everybody should step up to the plate right now and show the strength of the American economy." He added: "We depend on this. A lot of jobs and the future of America and the world rests on what happens here."

The market fell nonetheless. And on that Monday, Home Depot broke with a regular pattern of issuing stock options in February and made a huge grant to its chief executive, Robert Nardelli. The grant permitted Mr. Nardelli, for the next 10 years, to buy one million Home Depot shares at that tumultuous September day's closing price of \$36.20 a share. This was 10.7% below the Sept. 10 closing price of \$40.55.

The following day, Home Depot gave more grants: 50,000 options to each of four other executives, all of whom had already received options earlier in 2001. With Home Depot shares now trading at about \$34, the options are currently out of the money.

In a written statement, Home Depot said its directors "approved a special equity award" on Sept. 17 and 18 "to retain the key executives necessary to drive the transformation of the company."

Mr. Nardelli, however, had come to Home Depot only nine months earlier, at which time he'd been given a mammoth grant of 3.5 million stock options, at a higher exercise price. Two of the other four managers to whom Home Depot gave post-attack retention grants had joined earlier that year, and had received options when they arrived.

Home Depot's compensation committee at the time was led by John L. Clendenin, a former chief executive of BellSouth Corp. He didn't return calls seeking comment. Other

members of the board committee at the time declined to comment, didn't return calls or couldn't be reached.

At Merrill Lynch in downtown Manhattan's World Financial Center, many of the thousands of staff members fled during the attack. They were later dispersed to sites in New Jersey, New York and Connecticut while Merrill's damaged offices were rebuilt.

A Sept. 24 grant of 753,770 options to Merrill's E. Stanley O'Neal, then president and chief operating officer, came at \$39.80, 15% below the Sept. 10 closing price. Merrill stock now trades at more than \$67 a share. Mr. O'Neal's potential profit from the grant is \$5 million greater than it would have been had the grant come on Sept. 10.

A Merrill spokesman said the options award was directly tied to Mr. O'Neal's promotion in July 2001, and that records show the September grant date was the first time the board's compensation committee had had an opportunity to meet to approve the one-time grant.

Robert Luciano, who then headed that committee, was emphatic that Merrill hadn't timed its option grants to hit lows in the stock price. Attempting to do so, he said, would undermine the purpose of options: motivating employees to improve a company's performance. "It's a locked-in gain. It makes no sense," Mr. Luciano said. "That's why I think it is unconscionable."

Of the grant to Mr. O'Neal in September 2001, Mr. Luciano said, "I don't think we timed it to coincide with the tragedy. Gamesmanship like that gives a bad look to the whole process. I just don't tolerate it."

The Merrill spokesman said Mr. O'Neal, now CEO and chairman, wasn't involved in the decision to award the grant that day. "We had dead employees and people spread out over three states," said the spokesman, Jason Wright. "The last thing he was thinking about was getting paid. He had other things to do."

Mr. Wright said that Mr. O'Neal had a strong sense that Merrill's stock would fall further following the grant, as the company was poised to undergo a major restructuring. "If anything, he thought, 'Thanks a lot, guys,' " for options that would soon be under water. As it happened, Merrill shares rose steadily in the months following the grant, but then slid in 2002.




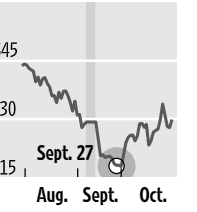
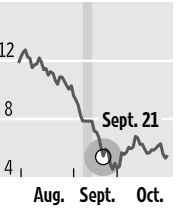
The terror attack was rough on many financial-services firms. Mutual-fund provider T. Rowe Price saw its stock fall 27% in the week trading resumed. On Sept. 21, the stock's low for the year, the firm gave stock options to two senior officers. That included 160,000, adjusted for stock splits, to James A.C. Kennedy, who is slated to become president later this year or early next year.

T. Rowe Price Chairman and President George Roche said after checking meeting minutes that the option grants were approved at a morning conference on Sept. 21. Mr. Roche said the company doesn't try to time its options grants to price fluctuations and wasn't

Continued on page 3

FROM PAGE ONE

Examples of companies that granted options following 9/11

Dates of options granted Stock prices adjusted for splits	Home Depot	J. Jill Group	Merrill Lynch	PeopleSoft	SanDisk
					
Date of grant	Sept. 17	Sept. 25	Sept. 24	Sept. 27	Sept. 21
Number of top-level executives receiving grants	5	5	1	2	2
Total estimated Black-Scholes value at time of grants	\$19.2 million	\$2.5 million	\$14.4 million	\$2.0 million	\$2.1 million
Difference between Sept. 10 close and the options' exercise price	Down 10.7% as of 9/17 Down 9.5% as of 9/18	Down 34.2%	Down 15%	Down 38.4%	Down 30.9%
Company comment	Said board approved "special equity award" on Sept. 17 and Sept. 18 to retain key executives.	Former director said he can't recall any effort to time award to low stock price. Talbots, which acquired J. Jill, said it can't comment because events happened before acquisition.	Said grant to Stanley O'Neal was directly tied to his July promotion to president, not related to 9/11. Ex-head of committee said firm would never try to time grants to occur after a national tragedy.	Cyril Yansouni, a former director, said he had "absolutely no recollection" of 2001 grants but said company didn't try to time options grants to hit market lows.	Declined to comment.

Sources: FactSet Research Systems, WSJ Market Data Group; Standard & Poor's ExecuComp; the companies; WSJ research

Continued from page 2

trying to hit a low with its 2001 grant. He said there would be little point in doing so because "you didn't know that there wasn't going to be a second round of attacks" that would further depress the stock. The grants "had nothing to do with 9/11," Mr. Roche said, adding that the firm customarily awards options in the second half of the year.

Richard L. Menschel, who headed the T. Rowe Price executive compensation committee in September 2001, said he vaguely recalled option grants to some senior executives that month at "what seemed to me a particularly attractive price." Mr. Menschel, a former Goldman Sachs executive, declined to comment on whether he thought that was appropriate.

In any case, the mutual-fund firm's Mr. Kennedy said he didn't think companies that gave stock options to executives at the time were capitalizing on the tragedy. He likened the grants to him and others to decisions by individual investors to buy stocks. "People who have faith in humanity and believe that the world is not coming to an end, are they taking advantage? No, they are stepping up." It was an "ugly time and a lot of people panicked," Mr. Kennedy said. This was a chance "to get up there and swing the bat."

Some of the post-9/11 grants were extraordinarily well-timed, hitting the exact low for the period. At least six of the companies that granted options dated after the attack are under investigation in the wider options-timing probe. That raises the question of whether some grants that appear to have been granted in the post-attack period were actually made

later, then backdated.

UnitedHealth, which granted stock options shortly after the terror attack, also faces investigations of its other options practices by the Securities and Exchange Commission and federal prosecutors. The former CEO of one UnitedHealth unit, R. Channing Wheeler, received option grants dated on quarterly lows for four straight years, 1999 through 2002. In September 2001, UnitedHealth gave Mr. Wheeler 96,000 options, adjusted for later stock splits, priced at the managed-care company's post-9/11 quarterly low. UnitedHealth declined to comment and Mr. Wheeler didn't return calls.

On UnitedHealth's compensation committee in September 2001 were New York investor William Spears, Columbia University nursing dean Mary Munding and former New Jersey Gov. Thomas Kean -- later head of the federal commission that investigated Sept. 11 intelligence failures. Mr. Kean and Ms. Munding didn't return calls, while Mr. Spears declined to comment.

Among many U.S. companies that offered charitable aid, as the nation reeled in the days after the attack, was Apollo Group Inc., a for-profit education provider that runs the University of Phoenix. "The employees of Apollo offer their condolences and concern to the victims, their families and the rescue teams affected by this unthinkable tragedy," said John Sperling, chairman, in announcing on Sept. 18 that Apollo would donate \$1 million to the Twin Towers Fund.

Three days later, Apollo's board granted Mr. Sperling and four other top executives a

total of 536,000 stock options. They also received options to buy 513,000 shares of an Apollo subsidiary, which later were converted to parent-company options. The price at which the Apollo options could be exercised was the stock's lowest close in the 2001 second half. By the end of the year, the stock was 29% higher. Mr. Sperling currently is sitting on a paper profit of about \$12 million from his post-9/11 options. He hasn't yet exercised any, according to regulatory filings.

"I would agree that it was fortuitous timing for the receiver of the grant," said John R. Norton III, a member of the Apollo board's compensation committee. But, he said, "there's nothing illegal about issuing an option when the stock is at a low point," adding that in any case there's no way of knowing what a stock will do over the next 60 or 90 days.

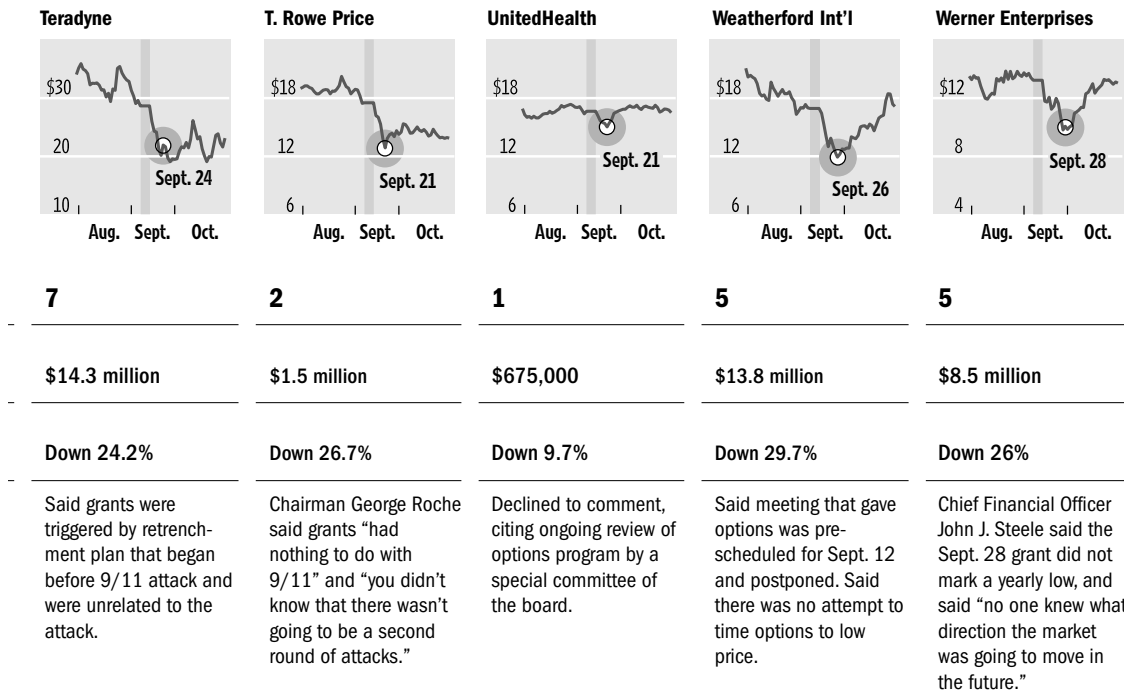
Mr. Norton continued: "I know what you're getting at -- that right after the World Trade Center, when the world went to hell, we issued stock options on the low that enriched people in a manner that could be suspect. That's not true. I don't know why we issued those at that particular time."

Apollo is also among the companies under federal investigation for the possibility of options timing problems. Apollo said it believes it has complied with all applicable laws and done no backdating. But it said the company and Mr. Sperling would have no comment on the September 2001 options until its own review of its practices is complete.

Todd Nelson, who was Apollo's chief executive in September 2001, cashed in most of his

Continued on page 4

FROM PAGE ONE



Continued from page 3

options from that month for a profit of more than \$14.4 million. He didn't return calls seeking comment.

Some companies that granted options at post-attack lows favorable to their executives said the moves were necessary to retain rattled employees. "We did it because people were shaken and we wanted to give them some incentives to stay focused," said David Strohm, a director of Internet Security Systems Inc., which gave several executives options dated Sept. 28. "We really wanted to say to people: 'We believe in the company, you have a great opportunity.'" The grants enabled the executives to buy stock in the Atlanta company for \$9.11 a share, which proved to be the lowest closing price in its history.

In some cases, executives appear to have been instrumental in picking their own post-9/11 grant dates.

At Teradyne, Chairman and CEO George Chamillard received 602,589 options on Sept. 24, 2001, after the terror attack and business woes had driven Teradyne's stock price down by nearly one-fourth. That was four times the number he received the prior year. A spokesman for the maker of electronic test equipment said the grants followed the company's normal process: The chairman calls compensation-committee members and suggests it would be a good time to issue stock options. If the committee agrees, it approves them.

In a later securities filing, Teradyne said part of Mr. Chamillard's grant was a one-time award of 300,000 options "in recognition of his additional responsibilities as Chairman

since May 2000."

The head of the Teradyne board's stock-option committee at the time, Patricia S. Wolpert, declined to comment. Other committee members either didn't return calls or couldn't be reached.

Teradyne spokesman Tom Newman said that at the time of the attack, the company was in distress. It had begun layoffs just hours before the first plane hit the WTC north tower, had cut the pay of higher-paid staffers, and had promised remaining employees they would soon be getting a special options grant. He said it made sense to give Mr. Chamillard and other top officers their annual grants at the same time it doled out the special awards to rank-and-file employees, adding that the timing had nothing to do with Sept. 11.

In hindsight, Mr. Newman said, "maybe we should have done something separately ... and delayed" the large grant to Mr. Chamillard. The prior year, Teradyne had awarded options to top officers in late October. Mr. Chamillard still holds his post-9/11 options, which show no current paper profit because Teradyne's stock is about half the price at which they were awarded.

The spokesman said Mr. Chamillard wouldn't be available for an interview because "I don't want to put him in the position of answering how does he feel about potentially benefiting from the 9/11 tragedy."

At Stryker, in Kalamazoo, Mich., post-9/11 stock-option grants to several executives appear to have been initiated by the chairman and CEO at the time, John W. Brown. They

were dated Sept. 20, 2001, at the bottom of a sharp "V" pattern in the share price.

Mr. Brown would "periodically tell us if he thought the stock was attractive," and then the board would decide whether to award options, said Mr. Lillard, the former member of Stryker's stock-option committee. "We didn't just sit down after Sept. 11th and say, 'Gee, how can we take advantage of this?'" Mr. Lillard said. Besides, he added, no one could have known whether the stock would rebound immediately or continue to slide.

Mr. Brown said that for the past 10 to 12 years, the company, to compensate for a relatively small number of options given to executives, has tried to "pick what we think would be the low point of the year. That's what we're gunning for."

Stryker's option grant came on the lowest closing stock price for the second half of the calendar year. Mr. Brown said he believes that he called both members of the stock-option committee on Sept. 20 to recommend they choose that day to grant options. He added that he couldn't remember a time when the board didn't follow his advice.

Mr. Brown said that while he didn't remember the details of the 2001 grant, "that was the year of 9/11. I'm sure that the market hammered us and that was the reason I was doing it at that time."

Mr. Brown, still chairman but no longer CEO, said he could understand how it might strike some as unseemly to give executives stock options so soon after a catastrophe. "That would be a legitimate point, I suppose,"

Continued on page 5

FROM PAGE ONE

Continued from page 4

he said.

He added that in retrospect, he probably wouldn't have advised that the grant be given. Today, Mr. Brown said, Stryker gives its grants during a relatively narrow period in the spring.

Mr. Brown said he hasn't exercised any of the September 2001 options. If he did so today, he'd make a profit of about \$2 million. ♦
