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A Double Shot Of Nostalgia For Starbucks

JOE NOCERA

TALKING BUSINESS

Is it possible that there are actually two Howard Schultzes lurking around Starbucks headquarters in Seattle? I think it is.

The first Howard Schultz is the man who has coffee in his veins. He's the one who bought what was then the tiny Starbucks company in 1987 and turned it into one of the dominant brands of the age. Starbucks coffee was a step above other coffee, and it also offered a "coffee experience" that made customers willing to pay $4 for something that used to cost them 60 cents.

Starbucks was a place where people could hang out, read the paper, and make friends with the "baristas" behind the counter; Mr. Schultz used to call it the "third place," a respite from both the workplace and the home front. Starbucks had its own language and culture. Its part-time staff got stock options and health insurance. It didn't exploit its coffee growers. It had a huge social responsibility program. And Mr. Schultz, who is chairman of Starbucks, took deep pride in all the things that made Starbucks special.

Last week, this Mr. Schultz was on vivid display when an internal memo he wrote to his top executives was leaked to Starbucksgossip.com. The memo is a cri de coeur from Mr. Schultz, a lament for what has been lost as Starbucks has grown from 6 stores in 1987 to more than 13,000 stores today. He pointed, for instance, to the company's decision some years ago to install automatic espresso machines, which, he wrote, "solved a major problem in terms of speed and service," but also made buying a cup of Starbucks coffee a more antiseptic experience.

He complained about the loss of aroma because the baristas no longer scooped fresh coffee beans from bins and ground them in front of customers. He said that streamlining the company's store designs had caused them to lose "the soul of the past and reflect a chain of stores vs. the warm feeling of a neighborhood store." He said that the Starbucks experience was becoming commoditized, and he urged the executive team to "go back to the core."

The memo was widely lauded as an example of an entrepreneur who understood the importance of recapturing what made his business special before it was too late. "While I wouldn't argue that the Starbucks brand is in its death knell, I would argue that the efficiencies and economies of scale have introduced a virus in need of serious care," wrote Mike Neiss on the Web site of the Tom Peters Company. "And it looks like Howard Schultz just might be the healer they need."

Warren Bennis, the leadership guru who has served as an informal mentor to Mr. Schultz, said, "This is something every successful chief executive should do every once in a while."

But then there's the other Howard Schultz, the one who signed off on the very compromises he complained about in the memo, precisely because they would help the company grow faster. This second Howard Schultz can talk Wall Street's language: he goes on the quarterly conference calls and spits out data about same-store sales, return on investment, and, most of all, growth. Though it has lagged recently, his company's stock price has risen 5,000 percent since it went public in 1992, in large part because Mr. Schultz has been so fanatical about growth. It closed yesterday at $29.88.

"Starbucks is the fastest-growing retail story of all time," said John

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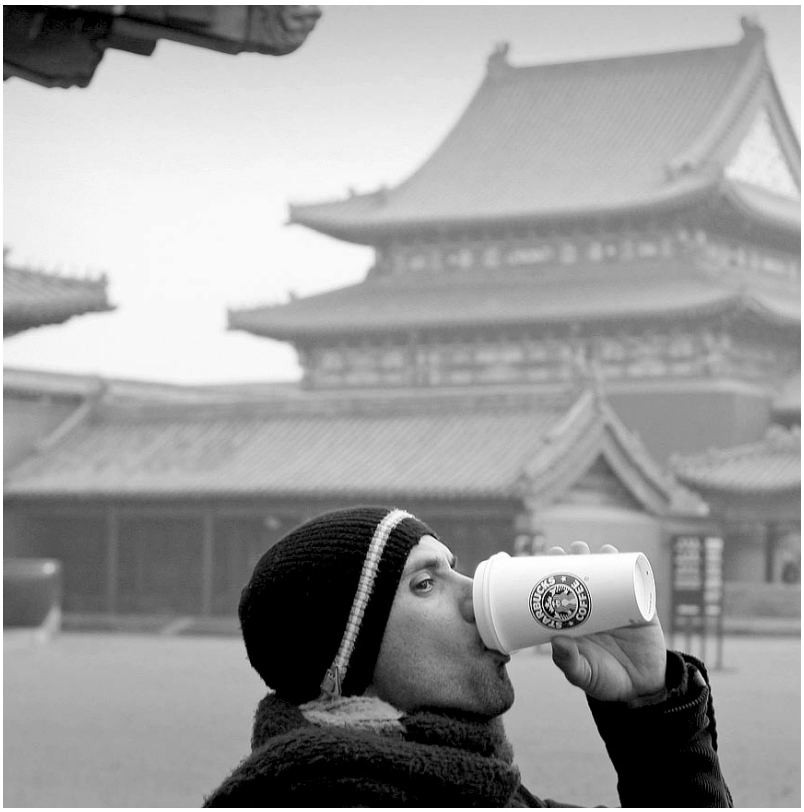

Peter Parks/Agence France-Presse — Getty Images

Starbucks's 13,000 stores include one in the Forbidden City in Beijing. Howard Schultz, the company chairman, says he wants 40,000.

Ted S. Warren/Associated Press

Howard Schultz has made Starbucks, and its cups, ubiquitous.

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Glass, an analyst with CIBC. "It has grown faster than McDonald's ever did."

This second Howard Schultz shows no signs of slowing down anytime soon. "I want to say this as loud as I possibly can," he told Maria Bartiromo on CNBC last November, after Starbucks released its quarterly earnings. "Three to five years, 20 percent revenue growth, 20 to 25 percent earnings per-share growth. And we're headed to 40,000 stores." Those are astounding goals for a company the size of Starbucks: no company in history has ever built 40,000 retail outlets. (McDonald's, by contrast, has 30,000 stores worldwide.) And 25 percent earnings growth is something only the most aggressive of growth companies shoot for.

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The quandary Mr. Schultz faces, assuming there is only one of him, is that he wants two things that are incompatible. If he wants to recapture the soul of the old Starbucks, then he has to slow down the company's growth. But if he slows the growth, the stock will collapse. He has to choose. Truth is, though, Mr. Schultz has already chosen.

ONCE, maybe 10 years ago, Mr. Bennis asked Mr. Schultz why it was so important to him that Starbucks grow so rapidly. "He said something to the effect that if he didn't do it, Starbucks could be cannibalized by another chain that would wipe it out," Mr. Bennis told me.

As I discovered when I asked around, Mr. Schultz is an enormously competitive businessman; I wound up thinking that the idea of relentless growth is just as powerful a driving force for him as coffee itself. In the memo, he complained that Starbucks' competitors have become emboldened to go after Starbucks customers. "This must be eradicated," were the startling words he used.

But to give him his due, Mr. Schultz has always struggled with the problem of trying to stay true to the company's roots while growing aggressively. "Last October or November, he made comments very similar to the thoughts in the memo at a dinner with investors," Mr. Glass said. And according to Anne Saunders, Starbucks' senior vice president for global brand strategy, what he wrote in the memo was nothing Starbucks executives hadn't heard from him many times in the past. "Howard is often challenging us," she said.

"We have grown as a company because we have chosen to do business in a different kind of way," she continued. "If growth comes from doing things that are out of whack, then it is not the right kind of growth." Ms. Saunders went on to say that she, and the rest of the company's managers, believed that the company had grown in ways that remained compatible with its culture.

Maybe. But from where I'm sitting, it just looks as though whenever push has come to shove, the growth imperative has usually won out.

Take, for instance, food. "I remember when Starbucks went public," said Ron Paul of Technomic, a food retail consulting firm. "I went to one of the roadshow presentations. Howard said that they would never serve food. He thought it would dilute the experience." (A Starbucks spokeswoman said Mr. Schultz was pointing out that Starbucks was a coffee company, not a restaurant chain.)

But one of the most important metrics for Wall Street is same-store sales increases. If growth is being generated purely from the opening of new stores — and not from increased sales in stores that are already open — that's viewed as a bad sign. It means that once the company runs out of places to put stores, it will stop growing. For Starbucks, there was always going to be a limit to how much coffee it could sell in any one location, so to goose same-store sales, it began selling food. (Not very good food either, but that's a whole other story.) Most recently, it has begun selling hot breakfast sandwiches in a number of markets, yet another move it would never have made, say, five years ago. The same principle applies to music, to books and all the other things Starbucks now sells in its stores.

The food and brand consultants I spoke to were unanimous in their feeling that Starbucks had hurt itself by expanding so far beyond its coffee and coffeehouse roots — and that it needed to return to those roots. "He is right that Starbucks is losing its soul," said Harvey Hartman, who heads the Hartman Group in Bellevue, Wash. "They were built on the coffee experience, and by moving so far beyond that, they are jeopardizing everything else."

A chairman longs for an aroma, and growth in same-store sales.

Robert Passikoff, president of the brand consultant Brand Keys, said that Starbucks had taken its eye off the brand. "In trying to migrate from a coffee brand to a lifestyle brand, there has been a certain brand dilution." He agreed that the "whole European coffeehouse experience" was no longer how people thought about Starbucks, to the company's detriment. Mr. Passikoff's firm just completed a survey of 20,000 people by phone and in person that showed that Dunkin' Donuts now had higher customer loyalty than Starbucks. He also pointed out that Consumer Reports recently asserted that McDonald's coffee was superior to Starbucks's. Both Mr. Passikoff and Mr. Hartman felt that the memo made a great deal of sense.

The Wall Street folks I spoke to, though, saw the memo differently — as a kind of longing for a memory that will never return. "When you grow as big and as fast as they have, you have to make compromises," said Howard Penney, who covers the company for Prudential. "The complexity of the menu has changed dramatically since it first opened," he said. That complexity required automation and other techniques to keep waits for coffee from being too long. (As anyone who buys Starbucks coffee in New York knows, the company doesn't always succeed.)

Mr. Glass of CIBC said: "If it remained a coffee destination and nothing else, same-store sales would not increase. It's a public company. Their job is to make money for the shareholders by selling more stuff." Both Mr. Glass and Mr. Penney pointed out that Starbucks plans to open 2,400 stores this year. That's more than six new stores every day. Tell me how you're going to do that if the baristas start grinding coffee by hand again?

Of course, that's never going to happen, as Ms. Saunders of Starbucks quickly acknowledged when we spoke. "Our business has never been better," she said. "We are really doing well." But the company didn't want to ever rest on its laurels — and it didn't want to sacrifice what made it special just for the sake of growth, she said. "The question is always, How do you keep things in balance?"

For lovers of Starbucks, I suppose it's comforting to know that Mr. Schultz and his team sit around worrying about whether they are watering down the customer experience. But it would be even more comforting if they actually did something about it. Because someday, the growth will slow and the stock will slide — that's inevitable. And how will customers feel if, when that happens, their customer experience has been turned into a drive-through window, just like McDonald's.

Oops, I forgot. Starbucks has already started putting in drive-through windows.

Business Day

The New York Times

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Well-Meaning But Misguided Stock Screens

JOE NOCERA

TALKING BUSINESS

In a small, packed meeting room at the Manhattan headquarters of TIAA-CREF, an earnest man named James W. Keady rose to make a speech. TIAA-CREF, as you probably know, is a huge financial services firm, with more than $400 billion in assets. Mr. Keady, 35, a former college soccer player with a master's degree in theology, is the founder of a group called Educating for Justice, which consists, essentially, of himself and his wife. It has a budget of $80,000.

TIAA-CREF's primary mission is to manage the retirement accounts for over three million academics, researchers, hospital workers and other members of the nonprofit universe. (The initials stand for Teachers Insurance and Annuity Association-College Retirement Equities Fund.) Educating for Justice's mission is narrower: Mr. Keady wants to bring the giant Nike Corporation to its knees.

Or at least to force Nike to drastically improve the pay and working conditions of the thousands of people in developing countries who work in the factories that produce its footwear. In 1997, Mr. Keady was forced off the St. John's University soccer coaching staff because he objected so strenuously to a multimillion-dollar deal the school was negotiating with Nike. He has made Nike his life's work ever since, even living in Indonesia for a while to better understand the working conditions of the factory employees.

"Nike executives feel certain that the wages earned by people producing Nike products are sufficient for meeting an individual's basic needs in the local towns where goods are produced," he said Tuesday at the TIAA-CREF mutual funds shareholder meeting, his eyes ablaze with passion. "Unfortunately, based on Educating for Justice's ongoing research of the same, we are not as convinced."

Which company is socially responsible? It's hard to tell.

Like many activists, Mr. Keady was making his complaint to TIAA-CREF largely because of the firm's reputation for a kind of genteel activism. It also supports what's called socially responsible investing: that is, investing in companies that have strong records in areas like the environment and human rights, and avoiding companies with poor records. In 1990, in response to complaints by some of its academic clients who wanted to avoid investing in mutual funds that held oil, tobacco, military and other "bad" stocks, TIAA-CREF began offering its first "socially screened" investment product.

It currently has two; one of them, the CREF Social Choice Account, is the largest socially responsible investing vehicle in the country, with $9 billion in assets. And it clearly plans to do more. A few weeks ago, TIAA-CREF came out with an updated policy statement on corporate governance that stressed its desire

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to "engage with companies on governance, environmental, social and performance issues." One of its executives, John Wilcox, does nothing but manage the firm's work in this area.

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Indeed, after the meeting, Mr. Wilcox approached Mr. Keady, and they huddled for about 10 minutes. Mr. Wilcox listened respectfully, and offered to meet with Mr. Keady for a longer discussion.

But then I spoke to Mr. Wilcox, and discovered something that surprised me. Nike, which had been kicked out of TIAA-CREF's socially responsible funds back when it was first engulfed in controversy over the treatment of workers in overseas factories, was reinstated in the summer of 2005. Which means that TIAA-CREF had come to the view that Nike had earned the right to rejoin the ranks of socially responsible companies. But what, exactly, was that judgment based on?

I should concede right here that I've always harbored some suspicion about socially responsible investing. The longstanding complaint from skeptics is that it forces investors to accept lower returns — because lots of rising stocks are excluded — for dubious social good. But performance isn't really the problem. A number of socially screened mutual funds have done just fine, and the benchmark Domini 400 index, which is made up entirely of companies viewed as socially responsible, has actually outperformed the Standard & Poor's 500-stock index over the course of its 16-year existence. Besides, most mainstream mutual fund managers don't consistently beat the market, so why should socially responsible fund managers be held to a higher standard?

No, my problem is that socially responsible investing oversimplifies the world, and in so doing distorts reality. It allows investors to believe that their money is only being invested in "good companies," and they take foolish comfort in that belief. Rare is the company, after all, that is either all good or all bad. To put it another way, socially responsible investing creates the illusion that the world is black and white, when its real color is gray.

Take oil companies. It's fair to say that the socially responsible crowd has no use for energy companies. For years, the only oil company such funds would even consider was BP, because of its early warnings about global warming and its embrace of environmental values. But in 2005, a BP refinery in Texas had a major explosion, killing 15 workers and injuring more than 100 others. And last year, the company spilled oil in the North Slope of Alaska. The world woke up to the fact that BP had a pretty shoddy safety and maintenance record.

At the other extreme is Exxon Mobil, a company many socially responsible investors detest, because of its longstanding (and recently abandoned) reluctance to embrace the global warming consensus. Yet Exxon has a terrific worker safety record, and it hasn't had a serious oil spill since the Exxon Valdez in 1989. So which is the "real" good company here? You can probably guess which way I'd vote.

The Nike case offers, I think, an even better illustration of the underlying contradictions of socially responsible investing. It turns out that the reason TIAA-CREF put Nike's stock back in its socially responsible portfolio is that a company in Boston, KLD Research & Analytics, had given Nike its seal of approval. KLD is a small firm that constructs socially responsible indexes, including the Domini 400. Its 40-member staff includes about two dozen researchers who supposedly dig into companies and decide which should be included in its indexes — and which should be excluded. Its biggest index, the KLD Broad Market Social Index, uses the Russell 3000 as its universe, which it has whittled down to 2,050 companies it deems acceptable.

TIAA-CREF is a client of KLD. That means that in addition to licensing the KLD Broad Market Social Index and KLD's research products, the larger firm accepts KLD as its ultimate arbiter of which companies are socially responsible. Indeed, the prospectus for TIAA-CREF's socially responsible equity fund specifically states that its criteria for choosing companies are based on the KLD broad market index.

Thus, last year, when KLD decided to toss Coca-Cola out of its indexes —

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for reasons including "controversies over how they market the product to schools," according to Eric Fernald, KLD's research director — TIAA-CREF automatically followed suit. (I should point out that this applies only to TIAA-CREF's socially responsible funds, not its other investment products.) Although not every one of its clients accepts KLD's word as gospel, the firm's screening methodology is widely accepted among socially responsible fund managers, and it consequently has a great deal of sway.

I spent a lot of time this week talking to people at KLD, including its cofounder and president, Peter Kinder. They are smart and likeable, and their heart is in the right place. But I came away thinking that that sway was undeserved.

Consider, first, the size of the place. Two dozen researchers are monitoring 3,000 companies — and writing in-depth reports? How is that even possible? It's not. Mr. Kinder told me that the employees almost never go abroad to do on-site inspections, but rely on media reports, blogs, interactions with activist organizations and conversations with the company itself. That hardly seems like enough to make a decision on whether a company is good or bad.

Then there's the question of how KLD goes about reaching its conclusions. Nike's relationship with its manufacturers abroad was first brought to light by activists in the 1990s, who wanted to find a big brand that captured people's attention. As the largest seller of athletic shoes in the world, Nike was the obvious target. But Nike was using the same factories as Reebok and other shoe manufacturers, including Timberland, a darling of the socially responsible crowd. While Reebok and Timberland stayed, only Nike was ousted from the KLD index.

When I asked Mr. Fernald to explain why Nike was bad, but Reebok was good, he said, "We wrestled with that at the time." Reebok, he said, had taken some positive steps, but more than that: "Nike was the market leader. And there is an extra burden for the market leader." In other words, Nike was being punished because it had beaten its competitors in the marketplace, not because its practices were any worse than anyone else in the industry.

Monitoring that has good intentions, but is often full of holes and inconsistencies.

Today, a decade later, there is no doubt that Nike has done a lot to change its ways. It monitors its supply chain rigorously. It publishes data on its Web site. It has become a company deeply invested in corporate social responsibility, with 97 employees working solely on that division. Hannah Jones, who leads Nike's efforts, told me that corporate responsibility was now embedded in the fabric of the company.

Ms. Jones also said that the company has come a long way in helping those factory workers. And virtually everyone I spoke to, with the exception of Mr. Keady, agreed.

But it is also true that for most of those workers, pay is still low, conditions are still less than ideal and change is slow in coming, something Nike is pretty forthright in conceding. There are still lots of problems at the factories that make Nike sneakers.

Yet Nike is now back in KLD's good graces. Which is fine. But when I read a recent KLD report about Nike I had no sense that the firm had any deep knowledge of what is actually going on in those factories and how much of it is Nike's responsibility. Mostly, it was compiled from news clips and the like, much of which was from 2004 or even earlier.

"To throw them out was a questionable decision," said Dara O'Rourke, an associate professor at the University of California, Berkeley, who has closely studied Nike's overseas outsourcing. "And to put them back in was equally questionable." In his opinion, both decisions were based more on public perception than reality.

Surely, he's right. It would be nice if we could invest our money only in companies that had terrific human rights record, fabulous environmental values and wonderful compassionate cultures.

Too bad it's impossible.

Business Day

The New York Times

SATURDAY, APRIL 28, 2007

Weighing Jobs's Role In a Scandal

JOE NOCERA

TALKING BUSINESS

In June 2001, Fortune magazine put Steven P. Jobs on its cover. This, I realize, is not exactly breaking news; the magazine put Mr. Jobs on its cover with shameless regularity.

This time was different, though. The headline read, "Inside the Great CEO Pay Heist," and Mr. Jobs, Apple's legendary chief executive, was showcased not because he had some slick new product to peddle, but because in January 2000, he had been granted 10 million stock options.

Fortune valued the grant, disclosed in Apple's 2001 proxy statement, at $872 million, making it "by far" the largest option grant ever. (Apple's stock split in June 2000, giving Mr. Jobs 20 million options.)

The reason I remember that cover is because I worked on it. As a Fortune editor, I was part of a team that put together a package of articles about the "highway robbery"— to use our phrase — that executive compensation had become. I also recall being quite happy with the cover.

What a delicious surprise to discover that Mr. Jobs, who had ostentatiously taken only $1 in salary since returning to Apple in 1997, had a stock option package bigger than any ever bestowed on such well-known greed heads as Sanford I. Weill of Citigroup or Michael D. Eisner of Disney.

Fortune magazine featured Steven Jobs on its June 2001 cover.

Mr. Jobs, however, was not so happy. He railed about the "unfairness" of the cover. And he wrote a scornful letter to the editor, asserting that because Apple's stock had fallen almost $20 a share since the options grant was made, they weren't worth $872 million — "they are worth zero."

That is not how options are valued, but never mind. In a tone dripping with sarcasm, Mr. Jobs offered to sell Fortune the options for half their supposed $872 million value.

What we didn't know at the time was that the article so infuriated Mr. Jobs that he began agitating to have the options package canceled. The options were so far underwater that

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he felt it wasn't worth the bad press to hold onto them.

Did that mean that Mr. Jobs was willing to go back to his $1 a year salary? Hardly. At the same time, he and the board began negotiating a new package: 7.5 million stock options this time, at a price of $17.83.

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Those options were agreed to by the board in August 2001, barely two months after the Fortune article, but the final negotiations with Mr. Jobs weren't completed until mid-December.

And although those options also never paid off for him, and were finally replaced in 2003 by a huge restricted stock grant, they had enormous consequences. They were one of two big options grants that ultimately embroiled Apple and its leader in the backdating scandal.

Among other things, an Apple underling created fictitious board minutes, two of Mr. Jobs's closest associates were forced out of the company and faced charges brought by the Securities and Exchange Commission, and Mr. Jobs's own actions and ethics were brought into question.

Rarely have so many avoidable problems been created by one man's obsession with his own image. Then again, this *is* Steve Jobs we're talking about.

THIS has been quite the week for Apple shareholders. The company reported an incredible quarter, with profits up 88 percent, blowing past analysts' estimates. Its stock pushed above $100 a share for the first time ever. (It closed yesterday at $99.92.)

And then there was this week's options backdating news: The S.E.C. brought formal charges against Apple's former general counsel, Nancy Heinen, and its former chief financial officer, Fred Anderson.

(Mr. Anderson settled the charges against him for $3.5 million without admitting or denying guilt, while Ms. Heinen's lawyers vowed to fight the charges against her.)

These were the two executives the Apple board has been pointing the finger at ever since it completed its internal investigation last fall.

The S.E.C. seemed to agree: its body language this week strongly suggested that it had zero interest in pursuing Mr. Jobs.

The agency's position seems to be that the financial chief and general counsel are the ones who are supposed to ensure that options are handled correctly, and therefore both Mr. Jobs and the Apple board are off the hook.

But almost immediately upon settling the charges, Mr. Anderson pointed the finger right back at his old boss.

Mr. Anderson had been involved in an options grant that Mr. Jobs made to his executive team in early 2001 — it was the second big grant under scrutiny — and he claimed that he told Mr. Jobs there might have to be an accounting charge if the options were not handled correctly.

There is not much doubt that Mr. Anderson made his statement this week because he felt unfairly scapegoated by Apple and Mr. Jobs.

With all the finger-pointing, it is difficult to parse whether Mr. Anderson, a wealthy, widely respected figure in Silicon Valley, did something deserving of government sanction. What is clear, however, is that Mr. Jobs does not deserve the free ride

he's been getting from the Apple board, the company's investors and government regulators.

I am not saying Mr. Jobs committed a crime. What I am saying is that it is pretty obvious by now that he was extremely involved in both of the options grants that have become such problems.

So it is hard to see how he doesn't deserve his share of the blame for what happened.

Let's start with the "executive team" grant that Mr. Anderson was involved in. At the time, Mr. Jobs was under pressure to make large grants to key executives to keep them from leaving. (Remember, this was the tail end of the dot-com bubble.) The board gave him free rein to hand out options as he saw fit.

The directors approved the grants, a total of 4.8 million options, which were set to go into effect on Jan. 2.

So far, so good. But then Ms. Heinen suggested the date be changed to later in January to move it past the company's MacWorld event. She didn't want it to look as if Apple executives were taking options in anticipation of a stock bump. Mr. Jobs agreed.

At the end of January, after some back and forth, he chose Jan. 17 as the new date, according to an e-mail message Ms. Heinen sent around at the time.

The board, in turn, approved the Jan. 17 options on Feb. 7. By then, though, Apple's stock price had indeed bumped up, by $3.94 more than the Jan. 17 strike price. Which meant, of course, the options had been backdated, and should have been both expensed and disclosed. Neither happened.

There are lots of people in Silicon Valley who strongly believe that this sequence of events is hardly worth a parking ticket, much less a big-time S.E.C. investigation. But the S.E.C. clearly viewed it as serious enough to charge Mr. Anderson.

A focus on underlings and a pass for Apple's celebrated chief.

So why not Mr. Jobs? He's the one who made the grants in the first place. He was clearly involved in choosing the new date — two weeks after it had come and gone. And as chairman of the board, he knew — or should have known — that the grants weren't final until Feb. 7.

To conclude that Mr. Anderson, but not Mr. Jobs, did something wrong requires some serious mental gymnastics.

Now let's look at the other grant: the 7.5 million options to Mr. Jobs himself. This was the case in which one of Ms. Heinen's subordinates drew up fictitious board minutes to make it appear that the Apple board had approved the grant in October when the real date was December.

(The underling says she was instructed to do so by her boss, which Ms. Heinen denies.) Certainly, you can't blame Steve Jobs for that.

What you can blame him for is creating an atmosphere in which these things could happen in the first place.

Consider, first, Mr. Jobs's desire to replace the 20 million options with the 7.5 million options. What he was really trying to do was reprice his options without actually admitting that

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— because repricing would entail an accounting expense. To avoid the expense, he was supposed to wait six months and a day after the cancellation of the first package before Apple gave him the new package.

But he was Steve Jobs, and he wasn't about to go optionless for six months and a day.

The Apple directors would later claim that they didn't want him to go optionless either — because then he would have an incentive to drive down the stock price until he got his new options package. (Have you ever heard a nuttier rationale?)

In any case, Mr. Jobs held onto the 20 million options while negotiating at length for a better vesting schedule for the 7.5 million. If he had accepted a normal vesting schedule — he wound up getting a quarter of his options vested immediately — the issue would have been avoided.

Instead, the negotiations went on so long that they bumped into a new fiscal year, causing all kinds of problems for people like Nancy Heinen.

You get the strong impression that nobody dared to say no to Mr. Jobs, a notoriously difficult and abrasive chief executive. One imagines the trepidation of the compensation committee members — or Ms. Heinen — in telling him that he couldn't get a low option price because the stock had risen during the negotiations.

So instead, they found a date in October that approximated the stock price in August — and an underling created phony board minutes.

What is particularly galling is the double standard. You hear from lots of sophisticated investors that it would be terrible if Mr. Jobs were forced out at Apple. How, they say, would that help Apple shareholders?

But lots of other chiefs have lost their jobs because of options backdating, and several have even been indicted. However indispensable he may be, the notion that Mr. Jobs can't be touched because he's Steve Jobs is something terribly corrosive.

If the S.E.C. is coming to the view that options backdating is just a peccadillo, as Silicon Valley has claimed all along, it should say so. But if it believes this is serious stuff, then it shouldn't be making excuses for Steve Jobs, as it appears to be doing.

As for Mr. Jobs, as hard as he's worked to convey the image of an above-the-fray visionary, that's not quite the reality, is it? I recently stumbled across this comment from him, circa 1985: "I'm at a stage where I don't have to do things just to get by. But then I've always been that way, because I've never really cared about money."

Yeah, right.

Business Day

The New York Times

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IPhone Spin Goes Round And Round

JOE NOCERA

TALKING BUSINESS

By Wednesday morning, the iPhone tom-toms were beating in earnest.

They'd been building for some time, even before Apple's chief executive, Steven P. Jobs, announced at the Macworld conference that his company was months away from unleashing its "revolutionary" hand-held device, a machine that combined cellphone, music and Internet.

It sounds so prosaic when I phrase it like that, but on the Macworld stage that January morning, Mr. Jobs screened an iPhone demo, and it was dazzling — so beautiful and elegant it could have been designed by the gods. Who had ever seen such a gorgeous screen? Or such amazing functionality in so slim a package? Or so many sweet new touches?

Yesterday evening, the "Jesus phone," as some technology bloggers call it, finally went on sale, with a hefty price tag of $499 or $599, depending on whether you buy a 4-gigabyte or an 8-gigabyte iPhone. But it was Wednesday, really, that the iPhone hype began building to its Jobs-orchestrated crescendo. That was the day the first reviews were published. There were only four of them, for Apple had allowed only four select reviewers, including Walter S. Mossberg of The Wall Street Journal and David Pogue of The New York Times, to take iPhone test drives.

They all raved. "A beautiful and breakthrough computer," wrote Mr. Mossberg and Katherine Boehret, his Wall Street Journal aide de camp. "It does things no phone has ever done before," wrote Mr. Pogue.

But Mr. Pogue also pointed out that "it lacks features found even on the most basic phones," and in the course of his review he listed a number of drawbacks. It didn't have voice dialing. AT&T's cellular network was so slow for Internet access it made you long for dial-up. Mr. Mossberg wrote that you have to switch to a different keyboard view — the iPhone has two — every time you want to insert a comma or period. How annoying is that?

Oscar Hidalgo/The New York Times

Nikolay Sorokin was willing to sell his spot in line at an Apple store in Manhattan. For others, the payoff was getting inside. Page C3.

But deep in Mr. Pogue's review came the paragraph that stopped me in my tracks. Pointing out that the iPhone, unique among cellphones, doesn't have a removable battery, Mr. Pogue wrote: "Apple says the battery starts to lose capacity after 300 to 400 charges. Eventually, you'll have to send the phone to Apple for battery replacement, much as you do now with an iPod, for a fee."

Huh? That couldn't be, could it? Did Apple really expect people to mail their iPhones to Apple HQ and wait for the company to return it with a new battery? It was bad enough that the company did that with the iPod — but a cellphone? Cellphones have become a critical part of daily life, something we can barely do without for an hour, much less days at a time. Surely, Mr. Jobs realized that.

Didn't he?

When you do what I do for a living, this sort of question is usually pretty easy to clear up. You ring up a company spokesman, and get an answer. But at Apple, where according to Silicon Valley lore even the janitors

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have to sign nondisclosure agreements, there is no such thing as a straightforward answer. There is only spin.

"Apple will service every battery that needs to be replaced in an environmentally friendly matter," said Steve Dowling, an Apple spokesman. He went on: "With up to 8 hours of talk time, 6 hours of Internet use, 7 hours of video playback or 24 hours of audio playback and more than 10 days of standby time, iPhone's battery life is longer than any other smartphone."

JOE NOCERA

TALKING BUSINESS

This response didn't even attempt to answer the question I'd asked him, which was how Apple planned to service its batteries. But never mind. This is another Apple innovation: the robotic spokesman, who says only what he's been programmed to say.

With Apple taking the position that the battery replacement issue was not something it needed to share with reporters — much less buyers of the iPhone — I went elsewhere in search of answers. I talked to design experts, battery wonks, technology geeks, and Mr. Mossberg of The Journal, the dean of technology reviewers.

One thing I wanted to know was why Apple had made a cellphone without a removable battery in the first place; it seemed like such an extreme act of consumer unfriendliness. If the iPod was any guide, batteries were inevitably going to run down. With most cellphones, when the battery has problems, you take it to a store, buy a new battery, let the salesman pop it in, and start using it again. Why wasn't Apple willing to do that?

"It is about assured obsolescence," said Rob Enderle of the Enderle Group, a technology consulting firm. "That is why they don't have a replaceable battery in the iPod. But the problem here is that the iPhone will run out of battery life before the two-year service contract runs out."

"Steve Jobs has always worshipped at the altar of closed systems," mused Mark R. Anderson of Strategic News Service, a technology newsletter. "Go back to the original MacIntosh. To get into the Mac computer required factory-only tools." He added, "I don't think it serves the consumer."

Larry Keeley, the president of the innovation and design firm Doblin Inc., had another theory.

"The real issue is that Steve and Jonathan Ive" — Apple's design chief — "have decided to emphasize sexiness and a different basic experience" over such ho-hum consumer needs as a replaceable battery. He was convinced that it was primarily a design issue; indeed, he thinks Apple is using a lithium polymer battery in the iPhone, which can be stretched into different shapes — and thus can be tucked into an extremely thin space.

The iPhone, Mr. Keeley said, "has been designed with a lot of consumer sacrifice problems," not just the battery but AT&T's sluggish network, which Mr. Jobs chose because a faster network would — how's this for circular logic? — drain the battery too fast.

On the other hand, those who have drunk from the iPhone Kool-Aid were not remotely bothered by the removable battery issue. My assumption was that if the battery does indeed last for 300 to 400 charges, it will probably start to lose its capacity in about a year, at least for heavy users. Of course the iPhone warranty also lasts a year, so if my calculation is right, it means that the batteries will need to be replaced just as the warranty runs out. Meaning that iPhone customers will have to pay for a new battery instead of getting it free — just like the iPod.

Bells and whistles but no straight answer to basic queries about the battery.

But maybe I'm being too conspiratorial. Tim Bajarin of Creative Strategies, a well-respected technology consultant, told me, "I think this is much ado over nothing." Yes, he said, there would be heavy users who had to recharge their iPhones every day, but most people would get two full years out of their batteries. So it would at least last as long as the service contract.

"All I can tell you," Mr. Mossberg said, "is that 100 million people bought an iPod without a replaceable battery." He quickly added, "If they had made it with a replaceable battery, it would have been better."

Still, Mr. Mossberg was knocked out by

TimesSelect: Meet Joe Nocera at nytimes.com/nocera.

what he has seen of the iPhone battery so far — "I watched 'Pirates of the Caribbean,' which runs two and a half hours, three times! On a phone! Can you imagine doing that on a Treo?" (What I really can't imagine is watching "Pirates of the Caribbean" three times.)

One of the battery experts I talked to, Robert L. Kanode, the chief executive of Valence Technology, a small company that is developing a new kind of lithium battery, said that the technology has advanced so much — as has the ability of companies like Apple to manage power inside their devices — that it was "perfectly possible that it will get you to two years."

So maybe it will get two years. But let's think about what that means. Those who are dismissive of the battery issue are saying, essentially, that when the two years are up, and the battery needs to be replaced, customers will purchase a new and improved iPhone instead. That's why it is a nonissue for them — they are buying into the idea of assured obsolescence. If all you want is a new battery after two years — and don't lust after whatever new phone gadget Mr. Jobs has come up with by then — then you're just not with it.

Besides, don't most cellphone users get a new phone within two years? The answer, of course, is yes. But most cellphone purchases are heavily discounted — costing $100 or less — and are tied to an extension of the service contract. Is Apple really going to play that game? I'm betting the answer is no. Buying a new iPhone is going to be an expensive proposition for the foreseeable future — which of course is great for Apple's bottom line, but not so great for its customers.

And what about the people who have early battery problems? Or those who are such heavy users of their iPhone that they need a new battery after a year? The question remains, What are they supposed to do? Go without a cellphone while Apple is replacing the battery? From where I'm sitting, this is classic Apple behavior. It is perfectly happy to sell you the coolest $599 device you've ever seen. Just don't expect them to be especially helpful when it runs into problems.

Then again, maybe there is a different explanation. Maybe Apple itself hasn't figure out what to do about the battery replacement issue — and is avoiding admitting that by not saying anything. Yesterday morning, when I got into the office, I found a voice message from an Apple public relations hand named Jennifer Bowcock. Mr. Dowling was away, and she wanted to see if she could answer my battery questions.

So I asked her the same question I'd been asking Mr. Dowling: how was Apple going to handle battery replacement? "I'll look into that and get back to you," she said cheerily. I could hear someone standing next to her say: "We're not talking about that."

An hour later, she sent me an e-mail message. "You asked why the iPhone does not have a removable battery," it began. "With up to 8 hours of talk time, 6 hours of internet use, 7 hours of video playback, 24 hours of audio playback and 10 days of standby time, iPhone's battery life is longer than any other smartphone."

I give up. Have a great launch, Mr. Jobs.

Business Day

The New York Times

SATURDAY, AUGUST 4, 2007

How The Bancrofts Blew It

JOE NOCERA

TALKING BUSINESS

"The primary reason I was in favor of the deal," said Elisabeth Goth Chelberg on Wednesday, "is because I did not think that family ownership was ever going to be in the best interest of the company." She paused for a second, and then offered a small, sad correction. "I mean *this* family ownership."

"I just didn't realize that they were so disorganized," said Rupert Murdoch on Thursday. He shook his head in wonder. "I thought we would have a rational series of meetings. They didn't want that."

Ms. Chelberg is a striking 43-year-old woman who lives half time in Prague, where her husband is an entrepreneur, and half time near Lexington, Ky., where she raises show horses that she rides, with immense success, in competitions all over the world. Rupert Murdoch, of course, is a 76-year-old, Australian-born captain of industry who has spent his adult life single-mindedly building the News Corporation into a dominant global media company.

In other words, it would be hard to find an unlikelier pair of allies. But Ms. Chelberg is also a Bancroft, and over the last three months, as her family flagellated itself over whether to sell its beloved Wall Street Journal to Mr. Murdoch, Ms. Chelberg never wavered. Yes, her family had owned The Journal's publisher, Dow Jones, for 105 years, and yes, it was a source of immense pride. But her fundamental belief was that her family had long since forfeited the right to own the asset. Benign neglect does not true ownership make.

Ms. Chelberg did not have a vote in the sale to Mr. Murdoch; her 800,000 shares were held in a trust controlled by her uncle, Christopher Bancroft, who fiercely opposed selling to Mr. Murdoch, fearing that he would destroy the paper's editorial independence. But she played a big role nonetheless. Indeed, it is not too much to say that this all started with her, 10 years ago. And what she started, Mr. Murdoch finished, as enough family members finally agreed to sell to him early this week. As the dust began to settle, I went to see them both.

"I really went to a lot of trouble 10 years ago," Ms. Chelberg said with a laugh as we sat at her dining room table in Kentucky. She had dug up some papers for me. One was a January 1997 letter to her family, imploring them to "act as the owners we are." Several were legal bills: $73,000 in January 1997, $94,000 in April. "That went on for two years," she said with a grimace.

Ms. Chelberg was 33 then, single, a recovering alcoholic whose mother, Bettina Bancroft, had died the year before, leaving her an inheritance. Virtually all of it was in Dow Jones stock, some of which was in trust and some of which she owned outright. Not knowing a thing about the company — not really knowing anything about business — Ms. Chelberg decided she needed to understand this asset she now owned. As she wrote in that same 1997 letter, "I was very disturbed to discover that my investment in what I had been taught to consider an unassailable company had diminished in value — by approximately 40 percent from its 1987 peak to its recent levels."

Her search to understand what was wrong at Dow Jones caused her to seek out Warren E. Buffett, among others. She learned how other media companies had surpassed Dow Jones. She came up with a list of possible new board members. She even asked to go on the board herself. Her goal was never to see the company sold; rather it was to rouse her family, to make them realize that simply

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Patrick Andrade for The New York Times

Rupert Murdoch on Tuesday night after Dow Jones decided to accept his offer to buy the storied company.

Kiichiro Sato/Associated Press

Many wonder how The Wall Street Journal will change now.

Continued From First Business Page

accepting management's view of the world was not the way to act like owners.

Her attempted wake-up call could have been a turning point for the Bancrofts and the company. In retrospect, she had given her family a 10-year window to grab control of the company, install new management, and give Dow Jones a fighting chance. But instead of being thanked, she and her cousin, William Cox III, who was also talking about management's failures, were scorned and vilified. She wound up selling the shares she owned outright. The shares in trust, however, she was stuck with.

"We were disenfranchised," Ms. Chelberg told me; it was years before she and Mr. Cox could even attend family meetings again. Some years later, several other cousins, including Crawford Hill, who would write a 4,000 word e-mail message supporting Mr. Murdoch, tried to raise many of the same issues. The same thing happened. "We all tried to work within the system, but there was no system to work within," she said.

Last fall, someone representing Mr. Murdoch came to see her and Mr. Cox to discuss the possibility of making a bid for Dow Jones. She didn't take it all that seriously; over the years, suitors had come and gone. So she was shocked in April when CNBC broke the news that Mr. Murdoch had made his audacious $60-a-share bid for the company.

What didn't shock her was what stunned the rest of us: the extent to which the family's dysfunctional nature was placed on vivid and painful display. Christopher Bancroft, who is a board member as well as a trustee, absurdly boycotts a crucial family meeting — and then, even more absurdly, asks Mr. Murdoch to pick up his personal expenses in exchange for abstaining from voting, only to discover that the trust doesn't allow it. Another family board member, Leslie Hill, decides after meeting him that she doesn't like Mr. Murdoch, and refuses to take his phone calls after that. The family keeps asking for Mr. Murdoch to up his offer, failing to understand that he has zero incentive to bid against himself. A family matriarch resigns as a trustee the day before the voting. And on, and on.

Watching the family flail these past few months, one couldn't help agreeing with Ms. Chelberg's assessment: the Bancrofts simply weren't capable of owning Dow Jones. They were barely capable of selling it. "We took from this asset, instead of giving to it," she said, speaking of the hefty dividend that cut into Dow Jones's earnings. She, meanwhile, had spoken again to Mr. Buffett, who told her that Dow Jones would have trouble competing as an independent company. So did other experts she spoke to.

She acknowledges that Mr. Murdoch could wreck the paper. "But that is a risk you would take with any new owner," she said. "He has a tremendous opportunity," she continued, "and I don't think he's going to blow it. He's going to put money in the company, he'll grow the brand, and he can do things through his distribution channels we never could. TV? We lost that chance 20 years ago."

Was she happy Dow Jones had been sold? No, she said, but she had made her peace with it. "Ultimately, my love of The Wall Street Journal is what caused me to support the sale."

WHEN I went to see Mr. Murdoch the next day in New York, he succinctly made the point that Ms. Chelberg had been working toward the previous afternoon. "The first road to freedom," he said, "is viability."

What he means, of course, is that a newspaper has a lot better chance of being editorially independent if it makes healthy profits. What he didn't say is that if the Bancrofts had turned down his deal, Dow Jones's steady, inexorable decline would likely have continued. But then, he didn't have to say it. Enough Bancrofts finally understood what their negligence had wrought. That's why they sold him the paper.

We had breakfast in a small private dining room in the News Corporation's Manhattan headquarters. Seeing that I had come tieless, Mr. Murdoch quickly doffed his tie and jacket, leaned back in his chair and happily recounted stories from the deal.

Was there ever a time he thought of pulling the offer? I asked. "Yeah," he replied. "After they sent that letter. It was so insulting." That was the letter in which the Bancrofts hoped to ensure editorial integrity by giving themselves the right to nominate News Corporation directors as well as a special editorial board for The Wall Street Journal. He swiftly rejected it, and eventually the Dow Jones board took over the negotiations that resulted in the creation of a small oversight board to protect the paper's editorial independence.

Mr. Murdoch himself seemed unruffled by the need for such an agreement — or even by the accusations that he runs roughshod over the newspapers he owns. "I'm used to it," he shrugged. He dismissed the idea that he would meddle inappropriately with a quick one-liner: "I won't meddle any more than Arthur Sulzberger does," he joked. (Arthur Sulzberger Jr. is the chairman of The New York Times Company.)

My own view is that the chances of Mr. Murdoch wrecking The Journal are lower than you'd think; he needs a credible Journal for his own strategic purposes, and at 76, he surely must be thinking about his legacy. Besides, in The Journal's cantankerous, provocative, deeply conservative editorial page, he already has the opinion page of his dreams, and one that packs enormous political clout.

Which is not to say he isn't going to *change* The Journal. "We have lots of decisions to make," he said. "How much should we really spend developing the Saturday paper? What should we do digitally? Should we remain subscription-based on the Web, or should we make it free? How much should we spend beefing up political and international coverage? I want it to be more competitive with The New York Times," he added. "But that will be expensive."

He suddenly picked up a Wall Street Journal that was lying in front of him, and I could almost see the ink flowing through his veins. "I would like to see real breaking news," he said. "I like A-heds" — the famous less-than-serious feature that often runs down the middle of the front page, "but I don't like a whole page of A-heds."

He scanned the front page up and down. Sometimes his expression suggested deep approval of what he was seeing; but sometimes he frowned, suggesting that he had a different idea of what ought to run on the front page of this great newspaper he would soon own. "I just think The Journal needs a little more urgency," he said finally.

Myself, I'll miss the A-heds if Mr. Murdoch decides they should disappear. But I won't view it as the End of Journalism as We Know It, nor will I view it as evidence that Mr. Murdoch is destroying the editorial integrity of The Wall Street Journal. Rather, I'll view it as an example of a new boss who has strong views about what people want from a newspaper.

And if the Bancrofts miss the A-heds? They can't say they weren't warned.

TimesSelect: Meet Joe Nocera at nytimes.com/nocera.

Business Day

The New York Times

SATURDAY, OCTOBER 13, 2007

What If C.E.O. Pay Is Fair?

JOE NOCERA

TALKING BUSINESS

"I really don't want to answer that question," said Ira T. Kay, flashing me some combination of half-grin and half-grimace. "I have clients."

Does he ever. Mr. Kay, 57, heads the executive compensation practice at Watson Wyatt Worldwide, which is one of the country's leading compensation consulting firms. He is a funny, gregarious man, quick with a clever retort, and utterly without guilt about what he does for a living — not only enabling big-time chief executives to make oodles of money, but defending most of the practices that allow corporate chieftains to reap their millions.

For years, Mr. Kay has overseen an annual Wyatt Watson executive compensation survey, which the firm describes as an effort to provide "perspective on the executive pay model in general, pay for performance, stock ownership and share usage." The Ira Kay perspective, not surprisingly, is that while there may be a few problems here and there (about which more later), the model is a darn good one.

A few months ago, Mr. Kay wrote a book entitled "Myths and Realities of Executive Pay" (Cambridge University Press), with Steven Van Putten, a Watson Wyatt colleague, that goes even further. "It is not a coincidence that the Dow Jones industrial average, which stood at 5,000 in 1996, is now well above 13,000," the authors write. "While U.S. executive pay practices do not entirely explain this rise, there is little doubt that it would not have occurred without them." I've heard Mr. Kay make this point before — and even debated him on it. He really does seem to believe that all of the great economic benefits we've enjoyed in this country during the past two decades or so can be traced back, in no small part, to the way we pay our chief executives. I, on the other hand, believe he's got the cause and effect exactly backward: that it was the rising market that made the lucky fellas running America's corporations look like geniuses — and made them richer than they'd ever imagined, thanks to the shift to stock options as the primary way to reward executives.

One proponent links sky-high pay with booming economies.

When I went to see him this week to talk about his book, Mr. Kay made the point in a more specific, Gordon Gekko kind of way. "There is no question," he told me, "that these programs motivate superior performance. They cause C.E.O.'s to make difficult decisions that are otherwise unpleasant. They sell off businesses. They move offshore. The desire for personal gain causes them to do the hard stuff." In other words, greed is good.

But then I asked him the ques-

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tion that caught him up short. I wanted to know whether he believed that the many critics of executive compensation — all of us who think there is something fundamentally wrong with a system that allows the C.E.O. to make 400 times what the average worker makes — were practicing a form of class warfare? In other words, is there a moral element to the debate over C.E.O. pay? Those were the questions the normally loquacious Mr. Kay didn't want to answer. They are also questions, I realized, that I've been avoiding as well.

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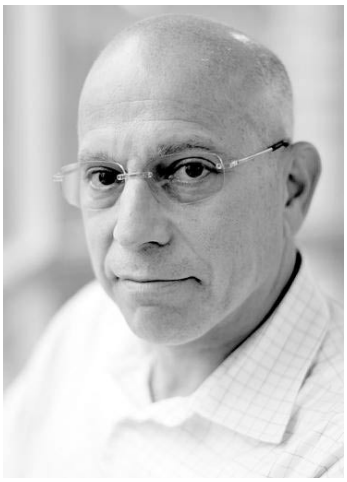
Here's a thought exercise. Suppose we lived in an ideal world, where the pay-for-performance system of executive compensation was a reality, instead of the mirage it is today. Suppose that boards of directors actually conducted tough arms-length negotiations with chief executives. And chief executives had deals that brought them mega-wealth only if the company's profits rose sharply and the stock price went up. And that if they failed to increase profits and the stock price, and got fired, they didn't get to line their pockets on their way out the door. If that were the case, would you still be outraged at the staggering sums chief executives make?

Interesting question, isn't it? Among institutional investors and in the media, the argument against multimillion-dollar C.E.O. pay packages is almost always phrased as a problem with the pay-for-performance model that Mr. Kay so stoutly defends. For instance, the furor that arose last year over the compensation of Robert L. Nardelli, the former chief executive of Home Depot, was not simply that he made an outrageous amount of money — but that Home Depot's stock price hadn't done a thing in the five years he'd run the company. His pay didn't justify his performance.

But it's hard to believe that those leading the charge against his pay package, starting with the American Federation of State, County and Municipal Employees, weren't upset mainly by the fact that Mr. Nardelli had a $200 million pay package in the first place — no matter how he had performed. Indeed, if you go to the Web site of many of the big unions — not to mention the many religious organizations that have taken to shareholder activism — you'll see manifestoes decrying the enormous C.E.O. pay packages that are par for the course today. Many of them are especially mournful of the growing gap between the pay of the chief executive and that of the average employees. When the big unions target underperforming C.E.O.'s each year, they are doing so mainly because it is the easiest way to generate outrage over the fact that all chief executives are paid so much.

I've long been a member of the "chief executives make too



TYLER HICKS/THE NEW YORK TIMES

Ira T. Kay, a champion of high chief executive compensation.

Rigged? There is no guarantee that the 'real' market would yield lower pay.

much" school. I think executive compensation is a socially corrosive issue, especially when the middle class is struggling. I think it creates morale problems when the C.E.O. makes so much more than even other top executives. But what offends me most is a somewhat different issue: that the market for executive compensation is so clearly rigged. Chief executives sit on one another's boards, so they have an incentive to take care of one another. Directors are predisposed to want to make the chief executive happy since, after all, he or she is the one who picked them for the board. Far too often, a chief executive's pay isn't a result of an arms-length negotiation, but a result of a kind of a corporate buddy system.

Mr. Kay, of course, insists that there is a real market for C.E.O. pay — rather than the rigged market I just described — though he does grant that "C.E.O.'s have relative power compared to their boards." He can cite statistic after statistic, using such measures as "realizable long-term incentive pay," showing that high-performing chief executives put more money in their pockets than those whose companies do poorly.

But what struck me in speaking to him was the way in which he himself seemed to acknowledge that, at long last, the game itself was becoming at least a little less rigged. The constant clamor by institutional investors has had an effect on boards, he said. What's more, "boards are starting to play hardball on severance, pensions and perquisites." He added, "It is a strategic shift in the labor market, because these goodies used to come with the package."

Indeed, he told me he had begun recommending to boards

that the severance packages for chief executives, which have been such a source of controversy, be pared back, especially for chief executives who have been on the job for a while and have reaped considerable compensation rewards. Two companies, he added, had agreed to do so — though he declined to identify them. (They're clients after all.) A few days after he spoke to me, Mr. Kay spoke at a conference run by Jesse M. Brill, one of the loudest executive compensation critics and publisher of CompensationStandards.com. When I spoke to Mr. Brill the day before the conference, he was practically beside himself with excitement — Mr. Kay, he told me, was going to publicly denounce outsize, and unnecessary, severance packages. "It's a very big deal," he said.

And it could be — if it leads other compensation consultants to follow his lead, and boards to begin rethinking big severance packages for C.E.O.'s who have either failed to perform or have been in the job so long they have already reaped tremendous rewards. But it's also just a start. What we really need is confidence that boards are finally treating the shareholders' money as if it were their own — and negotiating as fiercely as, say, Theo Epstein of the Boston Red Sox negotiates with Scott Boras, the famous player's agent. Which leads to one last thought exercise. Baseball players also make outsize salaries, as do actors and rock stars. You could easily make the argument that their pay is also socially corrosive — part of the growing gap between rich and poor — and even unfair given how little teachers make by comparison. But even many of the same people who think C.E.O.'s are paid too much don't take the same position about these other highly paid professions.

Why not? The reason, I'm convinced, is that we feel confident that they are being paid what the market says they're worth. Their compensation has been set by a real market, not a rigged one. And markets, in the end, aren't moral or immoral. They just are. We accept their judgment.

I asked Lucian Bebchuk, the big compensation critic at Harvard, what would happen if C.E.O. pay was finally subjected to real market forces. My worry is that it has risen so high in the rigged market that it would never come down, even in a real one. Professor Bebchuk disagreed. "We cannot predict the true market level because we have not had a well functioning market," he said. "But markets do adjust. If the true market level were significantly below the current level, then compensation would go down. It wouldn't happen overnight, but it would happen."

And if it didn't come down? If it turned out that in a real market for C.E.O. pay, their compensation remained in the stratosphere? I might not like it, but I could live with it.

Could you?

Business Day

The New York Times

SATURDAY, DECEMBER 8, 2007

The Pursuit Of Justice, Or Money?

JOE NOCERA

TALKING BUSINESS

"If I don't bring the lead paint industry to its knees in three years, I will give them my boat."

So declared Ronald L. Motley to The Dallas Morning News in the fall of 1999 — and why not? In addition to being the owner of a very large yacht, Mr. Motley is also one of the country's pre-eminent plaintiffs' lawyers, the titular head of the 70-lawyer firm Motley Rice, based in Charleston, S.C.

At the time of that interview, he was on top of the world. He had just spearheaded the drive against the tobacco industry, resulting in a $246 billion settlement with the 50 states. His fees ran into the hundreds of millions, if not billions, of dollars.

"Retire?" he scoffed in that same interview. "There are too many corporate crooks out there manufacturing dangerous products and injuring kids as a result." He vowed to use his tobacco winnings to go after more bad guys, like those evildoers populating the lead paint industry. And that he has.

Paint makers are in the cross hairs over lead they once used.

In the wake of the Merck-Vioxx column I wrote a few weeks ago — in which I took the position that plaintiffs' lawyers aren't always on the side of the angels — I was deluged with e-mail messages from readers who said, in effect, "Oh yes they are!"

And up to a point, I would agree: who can argue with the billions of dollars the plaintiffs' bar extracted from the big banks that enabled Enron? (I can't help noting, however, that the lead lawyer in the Enron lawsuits, William S. Lerach, will soon be in prison, having pleaded guilty to a felony directly related to the way he used to practice law.)

But for every Enron, there are cases where lawyers abuse the legal system. In these cases, litigation can look more like an income- redistribution racket than a search for justice. So I come forward this morning with a new example of litigation run amok. I offer you Mr. Motley's lead paint litigation.

Lead is poisonous. We all know that, though a century ago, we thought that people needed to have a lot of lead in their systems for it to present a health problem. But now we also know that lead in the bloodstream, even in small doses, has the potential to cause problems in babies. Today, any child who has more than 10 micrograms per deciliter is considered to have an elevated blood lead level — though under these modern standards, the entire baby boomer generation had elevated blood lead levels as children.

Here's what else we know. We

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know how to get the lead problem under control. In the mid-1970s, the government passed laws eliminating lead in gasoline, paint and tin cans. (Lead in gasoline was by far the biggest cause of elevated blood lead levels.) And states and cities passed laws mandating that landlords keep their properties freshly painted — so that old lead paint chips would not fall off and be eaten by children.

"Basically, what we have succeeded in doing in this country is reduce the incidence of lead poisoning by 90 percent and the blood lead levels by 90 percent," said Dr. Philip J. Landrigan, the head of the Department of Community and Preventive Medicine at Mount Sinai School of Medicine. He told me that this constituted "a great public health triumph." Despite this belief, however, Dr. Landrigan has testified as an expert witness on behalf of plaintiffs.

Although lead was outlawed in paint in 1978 — and though many industry players had removed it even earlier than that — the lawsuits began in 1987. These were not, however, Motley Rice lawsuits. Most were product liability suits that claimed the pigment manufacturers knew that lead was dangerous and had therefore knowingly harmed the consumer.

The cases went nowhere, for two primary reasons. First, it was hard to make the case in court that the companies had done anything wrong. Yes, there were "bad documents"— there are always bad documents — but most of them were a half a century old, as the science around lead was emerging in this country. They mainly showed that the Lead Industries Association was less than keen about embracing the emerging consensus about the dangers of lead to small children. But the industry didn't try to cover up the science, and as the science became clearer in the 1950s, the industry voluntarily took lead out of interior paint. I realize that many people think companies should rush to abandon legal products at the first whiff of a problem, but if that were really the standard, the shelves would be bare.

The second problem is that it was impossible to know which manufacturer's paint had been used on a particular house. For most judges, that was the real deal-breaker. For as long as there has been product liability law, it has been rooted in the notion that in order to sue a wrongdoer, you have to know who the wrongdoer is. Plaintiffs' lawyers tried to argue that since all the manufacturers used lead pigment, they were all guilty — and their guilt should be proportional to their market share. But aside from Wisconsin, this was universally rejected by the courts.

And there things stood until Motley Rice arrived on the scene. In Rhode Island, where Motley Rice has an office — and lots of political ties — the firm agreed to join forces with the attorney general's office, just as it had in the tobacco case, and take 16.7 percent of the proceeds if its side won. A lawyer named Fidelma Fitzpatrick came up with the most novel theory yet: the state should sue the companies on the ground that lead paint was a "public nuisance." It was so far-fetched that another lawyer in the office would later tell a reporter that, at first, they called it

Making the tobacco companies say uncle has inflated lawyers' egos too much.

Fidelma's Wacky Idea.

Ms. Fitzpatrick explained to me that since the substance was still so prevalent, it was a public nuisance and therefore all the companies were guilty of creating that nuisance. See how easy that was? Suddenly, the case was no longer about an individual who had been harmed by lead — or an absentee landlord who hadn't maintained his property. It was about those dastardly pigment makers who had put lead in paint.

Armed with this new theory, Motley Rice went to trial in Rhode Island in 2002. Hung jury. Then, in 2006, the case was retried — and Motley Rice won. "Evidence?" laughed Jane Genova, a blogger who has followed the case closely. "There was no evidence. The judge's instructions said you didn't need evidence." If the jurors found that lead paint created a public nuisance, then they should find for the plaintiffs. Sure enough, they did. (It didn't help that the companies didn't put on a defense, so sure were they of victory.)

In the last year, it's gotten even worse for the defendants, at least in Rhode Island. The state, with the help of its friends at Motley Rice, recently unveiled an abatement plan that would require the companies to pay for the inspection of a staggering 240,000 homes as well as thousands of other structures like hospitals and day care centers, and remove lead from most of them. The estimated cost for doing this — almost surely understated — is $2.4 billion, with a hefty chunk of that going to the lawyers, of course. Never mind that for the vast majority of homes, the far better and cheaper solution is simply to keep them maintained. Or that this plan has been ginned up even though the case is still on appeal.

Meanwhile, to capitalize on its success in Rhode Island, Motley Rice and other big-time plaintiffs' lawyers have raced all over the country, trying to get other jurisdictions interested in suing the same defendants on the same grounds. Fortunately, they have had less luck. This past summer, the public nuisance theory was rejected by high courts in New Jersey and Missouri. In Wisconsin, two high-profile trials were held this year; the plaintiffs lost them both.

Still, Motley Rice has cases going in Ohio, California and Wisconsin. "I think New Jersey is going to be an aberration," Ms. Fitzpatrick said. She made it sound as if her firm remained undeterred — since, after all, it is on the side of the angels. "There is no doubt they knew," she said of the companies. When I brought up her contingency fee, she bit my head off. "The real story here is the amount of money the defendants have spent defending these cases," she said. "We're the only group of lawyers who haven't been paid in 10 years." No wonder she's still at it.

But what are the companies supposed to do? Let Motley Rice bankrupt them because of something they did three decades ago that was perfectly legal? When I asked Dr. Landrigan why he was working for the plaintiffs he said: "The removal of paint from apartment buildings is expensive. States and cities are chronically underfunded. So basically, getting a judgment against the companies is a way to get revenue to do the removal." You will never hear a purer distillation of the real motivation for bringing these suits. The companies have lots of money, so make them pay — no matter what the evidence.

One thing I couldn't help wondering was why the gasoline makers weren't subject to these kinds of lawsuits. After all, gasoline, not pigment, was the primary cause of elevated blood lead levels back in the day. When I mentioned this to David Rosner, a Columbia professor who has served as an expert witness for the plaintiffs, he reassured me.

"I think there might be a suit like that filed next week," he said.