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Managing How to Fire a CEO

More Bosses Are Getting the Boot, But It's Harder to Sack Them Without Paying for the Privilege

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Increasingly assertive corporate directors are ousting more chief executives. But it's harder than ever to say goodbye to a CEO without a big check.

Three times in recent weeks, a former chief has won millions after challenging a board that fired him "for cause." A chief executive terminated because the board believes he committed such serious misdeeds usually can't collect severance or other exit payments.

In the most notable case, Massachusetts Mutual Life Insurance Co. dismissed CEO Robert J. O'Connell last year, saying that he padded a retirement account by millions of dollars, misused corporate aircraft and conducted an affair with a female executive. But a panel of arbitrators said last month that MassMutual should not have terminated Mr. O'Connell for cause. The arbitrators found that Mr. O'Connell made questionable moves to benefit the retirement account and had affairs with two other employees, but said these did not amount to "willful gross misconduct" that materially damaged the company -- as his contract required. MassMutual has appealed the decision, which could force it to pay Mr. O'Connell more than $40 million.

Mr. O'Connell is only the latest CEO, assisted by a well crafted employment contract and sophisticated lawyers, to successfully challenge a dismissal. For a board to fire a CEO for cause, "you have to burn the building down or have major, major embezzlement," says Pearl Meyer, senior managing director of Steven Hall & Partners, a New York pay consultancy.

It's so hard to fire a CEO for cause that many boards don't try, even when ethical problems are involved. Some boards work out other departure arrangements that allow the CEO to leave with severance or other benefits intact.

Both Phil Condit and Harry Stonecipher resigned the top job at **Boeing** Co., one amid government-contract scandals involving other executives and the other after acknowledging an affair with another Boeing executive. **American International Group** Inc.'s Maurice "Hank" Greenberg retired shortly before he and a top lieutenant were accused of using improper accounting to bolster AIG's bottom line even though he continues to deny he did anything wrong. None of them received severance pay. Other CEOs under attack leave quietly to "pursue other interests."

"Most of these people are paid to leave quietly," says David Yermack, a New York University finance professor who has studied the issue. Boards "want to minimize adverse publicity, cost and distraction."

Most CEOs fired for cause are allowed to keep accumulated contributions to a 401 (k) plan and benefits provided to all former employees. But they lose restricted stock, unvested stock options and supplemental pension plans, as well as severance, according to Ms. Meyer. However, "there are exceptions" -- especially when the departing executive squawks, she says.

Bristol-Myers Squibb Co.'s Peter Dolan was fired without cause last month. The board acted after a federally appointed outside monitor said Mr. Dolan didn't adequately inform directors about efforts to protect the company's best-selling drug, Plavix. Mr. Dolan lacked a contract guaranteeing a lucrative severance deal, but directors are crafting a conservative exit package, according to one person close to the situation.

Nearly three-fourths of the CEOs of companies in the Standard & Poor's 500-stock index have employment contracts or severance plans, estimates Corporate Library, a Portland, Me., research group. The accords typically let boards remove a chief for cause in cases of deliberate neglect of duties, gross misconduct, a felony conviction or company-related fraud.

Executives insist on these protections in case of disagreements with directors. But the terms are often vague, leaving much to the interpretation of arbitrators, judges and juries. Decisions such as MassMutual's may dissuade more boards from firing a chief for cause.

The ruling, if it stands, "will have a chilling impact," suggests Mark Roellig, MassMutual's general counsel. But Michael Keating, one of Mr. O'Connell's lawyers, says boards "should be more reluctant to fire [an executive] for cause" if they don't have a good case.

Similarly, a Minnesota jury in September ordered Metris Cos. to pay former CEO Ron Zebeck $30.2 million for improperly firing him in 2002. The credit-card company said it dismissed Mr. Zebeck for strategic blunders and personal use of corporate funds. But Mr. Zebeck argued that the charges were "trumped up" after his dismissal to avoid paying him millions, says his lawyer, Lewis Remele. Metris was acquired by British banking giant **HSBC Holdings** PLC in 2005. An HSBC spokesman says the company was "disappointed" with the verdict and is pursuing legal efforts to reverse it.

Also in September, **Pizza Inn** Inc. agreed to pay former CEO Ronnie Parker $2.8 million to settle a feud over his dismissal. The Dallas pizza chain had fired Mr. Parker in late 2004 for what it said were "intentional acts of fraud," including improperly arranging a lucrative exit package in case the company changed hands or he quit for minor reasons.

Mr. Parker challenged his termination and sought $5.4 million in severance and related payments. The board submitted the case to arbitration. Mr. Parker says he pursued his fight partly to restore his reputation. With the promised settlement, he says, "I believe I do have my good name back." Pizza Inn's current CEO, Timothy P. Taft, says the company settled so "we could all move on with our lives."

There are plenty of practical reasons not to stir up a legal battle with a fired CEO. For one thing, these spats can last for years -- and run up big bills. "Senior executives don't go quietly into the night," says Mark Lipis, a Los Angeles pay consultant who testified on Mr. Zebeck's behalf in the Metris case. "It's not their personality."

Parting Shots

Companies prefer resignations to firing CEOs 'for cause.' Fired executives often win big severance payments from legal challenges.

EXECUTIVE	COMPANY	STATED REASON FOR LEAVING	SEVERANCE	SUBSEQUENT ACTION
Maurice 'Hank' Greenberg	American International Group	Retired	No	Lawsuits pending*
Chuck Watson	Dynegy	Resigned	No	Paid $22 million after Dynegy lost arbitration with another executive
Richard Scrushy	HealthSouth	Removed	No	Lawsuits pending
Robert O'Connell	MassMutual	Fired 'for cause'	No	Arbitrators ruled for Mr. O'Connell; could get $40 million or more
Ron Zebeck	Metris	Fired 'for cause'	No	Jury awarded Mr. Zebeck $30 million
William McGuire	UnitedHealth	Resigned	Under discussion	None

*Lawsuits are between AIG and Starr International, in which Mr. Greenberg holds a significant stake

Sources: SEC filings; the companies; WSJ research

Consider Lars Bildman, former chief executive of Astra USA Inc., now part of Anglo-Swedish pharmaceutical maker **AstraZeneca** PLC. Astra dismissed him for cause in 1996, claiming he had engaged in "inappropriate behavior" at company parties and used $2 million in company funds for personal expenses, including renovating three homes. In 1998, Astra paid nearly $10 million to settle federal charges that senior managers had harassed scores of female sales representatives during his tenure. That same year, Mr. Bildman pleaded guilty to underreporting his income by more than $1 million. He spent 18 months in prison.

Mr. Bildman's contract allowed Astra to fire him for cause following a criminal conviction, among other things. The company also sued him for fraud, waste of corporate assets and sexual harassment. He countersued for breach of contract and wrongful termination, arguing the company had no grounds to dismiss him for cause. "My career was ruined," he says.

A Boston state court jury awarded Astra about $837,000 in February 2002. Jurors also upheld Mr. Bildman's removal for cause. But Astra lost a second trial where it tried to recoup the $5.6 million in salary and bonuses paid Mr. Bildman between 1991 and 1996. Appeals continue, a decade after the firing.

HealthSouth Corp. is still wrangling with former CEO Richard M. Scrushy, whom directors ousted in 2003 amid a massive accounting fraud. Mr. Scrushy sued HealthSouth last December in state court in Jefferson County, Ala., seeking more than $70 million, after he was acquitted of criminal charges in the fraud. HealthSouth countersued, accusing Mr. Scrushy of trying to "pillage" the company of more than $100 million.

Some big companies are making it easier to terminate their chiefs for cause. The additional grounds for dismissal often are modest, however. **Walt Disney** Co., for example, could fire CEO Robert Iger for cause if he refuses to provide testimony or cooperate with an investigation "into his or the company's business practices," his October 2005 contract states.

That contract came months after a Delaware judge ruled that Disney directors did not abuse their discretion by awarding a $140-million exit package to former President Michael Ovitz in 1996. Mr. Ovitz was fired without cause after 14 months on the job when he couldn't get along with Disney's then-chairman Michael Eisner; his 1995 contract said he could be fired for cause only in cases of "gross negligence or malfeasance."