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## ORIGINS OF THE PRINCIPLES FOR REVIEW OF EXECUTIVE COMPENSATION 1992-93

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### ABSTRACT

This paper looks at the 1992-3 compensation controversy at the University of California in light of the factors that shaped the board's policy response to the controversy, the Principles for Review of Executive Compensation. It discusses the events of 1992-3 in the context of the public and political debate over the appropriate model for executive compensation in elite public universities and the special difficulties these universities face in setting, explaining, and defending executive compensation policies and practices. It concludes by assessing the ways in which the University did and did not succeed in addressing the issues raised by the controversy—including the clash between public-service and market perspectives.

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### Introduction

Of the three major public controversies the University of California has faced in the past fifteen years, two have focused on executive compensation—the first in 1992-3, the second in 2005-6. Both were the unintended fallout of efforts to solve a persistent problem: the University's lagging competitiveness in the higher-education market for executive talent. An October 2004 report by the California Postsecondary Education Commission, for example, compared UC chancellors' average compensation from 1993 to 2004 with those of their counterparts at twenty-two similar institutions, public and private. In 1993, UC chancellors' salaries lagged the others by 18.6 percent; in 2003-4, the gap had widened to 37.5 percent.<sup>1</sup>

Whatever the data seem to show, the two controversies are proof that the pursuit of competitiveness can be perilous for elite public universities. When executive compensation captures public attention, it tends to pull other and larger issues into its orbit—popular and political attitudes toward higher education, the requirements of a public service mission, the nature of a public university itself. For both faculty and executive compensation, the University of California defines its market by comparing UC salaries and benefits to those at similar private and public universities. Nonetheless, many citizens and some elected representatives view academic administration as a profession in which public-service concepts should prevail over market considerations, especially when an institution is enduring hard economic times.

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<sup>1</sup> "Executive Compensation in California Public Higher Education, 2003-4," California Postsecondary Education Commission, October 2004, p. 9.

This conviction, or something like it, is shared by some members of the higher-education community as well. During the first executive compensation controversy in 1992, the Berkeley Division of the Academic Senate passed a resolution contesting the argument that executive compensation should be shaped by such factors as the size and complexity of the institution and the need to compete for administrative talent. "We believe these views are based upon standards derived from the commercial sector, standards which are fundamentally inappropriate to the academic world, and especially wrong for a publicly funded university. . . . It should be the policy of any institution of higher learning that the total compensation paid to any executive officer should not exceed twice the average amount paid to its Full Professors."<sup>2</sup> Early in the 2005-6 controversy, David Longanecker, Executive Director of the Western Interstate Commission for Higher Education, testified at a legislative hearing in response to a request to "comment about how the University of California's [executive compensation] practices compare, in general terms, with the industry standards." He concluded that the executive benefits UC offered were generally no different from those offered at similar institutions—a rare piece of contextual information that went mostly unreported. But he went on to add that in terms of executive compensation at American universities, "we've all lost our way," and the culprit is "the seduction of the private market philosophy."<sup>3</sup> Public universities face philosophical and political constraints on their efforts to compete, not just fiscal ones.

Once launched, executive compensation controversies tend to unfold along a predictable trajectory, as the events of 1992-3 and 2005-6 make clear. Both began with sensationalized newspaper accounts of executive extravagance and allegations of institutional secrecy, followed by public and legislative outrage, official audits, and Regental efforts at reform. Both occurred within a context of severe budgetary stress and rising student fees that made defending executive salary levels and benefits unusually challenging. Both show how difficult it can be for a large public university to defend itself once the media floodgates have opened, especially when the subject is executive compensation and the technicalities and specialized vocabularies of personnel benefits and bureaucratic regulations. And both demonstrate how vulnerable the central office of a multicampus system can become once intense public criticism has set off a dynamic of internal conflict among faculty, students, administrators, and trustees. Local incidents of mismanagement or administrative oversight can become the springboard for global solutions that have large implications for governance. Roger Heyns, chancellor of UC Berkeley in the turbulent 1960s, described this phenomenon as the inherent tendency of universities to turn public controversies into crises of governance.

Viewing the events of 2005-6 as nothing more than a repeat of what happened more than a decade earlier, however, obscures a richer and more complicated story. The purpose of this account of the compensation crisis of 1992-3 is, first of all, to explain the origins of the Principles for Review of Executive Compensation, a key document in understanding both controversies. The Principles were the UC Board of Regents' initial response to public criticism of the University's compensation policies and practices. They were both a broad statement of the board's commitment to openness and a directive on how executive compensation was to be presented, approved, and disclosed to the public. This paper will also discuss a second step taken by the Regents and the president, which was to publicly address the substantive issue raised by the controversy: What kind and level of executive compensation are appropriate to a public university? It is a question that, as the 2005-6 controversy shows, has yet to be resolved.

### **The 1992 Controversy**

In the fall of 1991, University of California President David P. Gardner announced his intention to retire. Gardner was a respected and effective president who had just completed the eighth year of a highly successful tenure. His wife had died after a brief illness the previous February, and by November Gardner had concluded that the burdens of serving as president were too great without her companionship and support. He told the Regents he would step down in fall of 1992.

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<sup>2</sup> Faculty statement approved at a special meeting of the Berkeley Division of the Academic Senate, May 6, 1992.

<sup>3</sup> David A. Longanecker, Testimony to the California Senate Education Committee, February 8, 2006.

As president, Gardner had been determined to restore the competitiveness of UC faculty and administrative compensation, badly damaged by the tough budget years of the 1970s and early 1980s. During his first months as president, he successfully negotiated a State-funded budget that brought faculty salaries up to market in a single year, the first of a series of strong budgets for the University. Administrative salaries still trailed the market, according to several studies by the University's compensation consultants, Towers, Perrin, Forster and Crosby. Yet the University was an institution of formidable scale and scope, and by the mid-1980s it was planning for a huge surge in enrollments to accommodate the children of the Baby Boomers. UC's nine—later ten—campuses were the public face of a vast academic and corporate enterprise with a total budget greater than those of some states. The University's dilemma was how to attract strong and experienced administrators in a higher-education market that was beginning to take off, nationally and in California.

President Gardner and his senior vice president for administration, Ronald W. Brady, proceeded to put before the Regents a variety of new executive benefits to boost total compensation and strengthen UC's market competitiveness. Among them were provisions for severance pay, reimbursement for the cost of estate planning and tax preparation, and higher life insurance. One—a special retirement payment for spouses of the president and the chancellors to recognize their contributions to the University—was an innovation for which Gardner was hailed in the *New York Times* story about his decision to step down.

Another innovation was a new deferred compensation program for top executives, under which income could be accrued during service but not received until the incumbent left his or her position. Changes in the tax code had made the use of deferred compensation—common in the private sector but not in public higher education—an attractive option for maintaining UC's ability to compete. The possibility of using it at the University was first floated as an incentive to persuade a candidate to accept a campus chancellorship. From there it was a short step to the idea that if offering deferred compensation bolstered UC's competitiveness in recruiting chancellors, why not use it to improve the University's ability to attract executive leadership? Brady raised the question with several key Regents, then with the Board of Regents' Committee on Finance.

In explaining how the deferred compensation program would work, Brady mentioned a complication posed by the Tax Reform Act of 1986. Section 457(a) of the Internal Revenue Code required that deferred compensation programs in the public sector must build in a risk of forfeiture if the executive did not work until an agreed-upon vesting date. One Regent asked about exceptions—were they ever allowed? The response was that exceptions as a matter of practice would of course not be acceptable to the Internal Revenue Service; an occasional exception probably would.

The advantages of deferred compensation as a solution to the competitiveness dilemma seemed clear. In September 1987, the Regents approved the Non-qualified Deferred Income Plan (NDIP), for the president, the chancellors, and several other executives. Translated into base salary, an individual NDIP would equate to an increase somewhere between ten and twenty percent. The NDIP program became a routine part of UC executive compensation and drew little attention over the next five years.

That changed in March 1992, when the Regents met to consider two proposals regarding the president's retirement. The recommendations, which came to the full board through the Subcommittee on Officers' Salaries and Administrative Funds and the Committee on Finance, were that Gardner receive a three-month paid leave of absence and almost \$738,000 in deferred compensation. The \$738,000 figure was the total of five separate NDIPs and two Special Supplemental Retirement (SSR) agreements.<sup>4</sup> As required by the Internal Revenue Code, both the NDIPs and the SSRs had included a forfeiture provision if Gardner did not remain in office until the dates specified in the agreements, which ranged from 1993 to 1998. Gardner's official retirement fell on December 31, 1992, which

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<sup>4</sup> The Special Supplemental Retirement Program was adopted by the board in 1985 to compensate for retirement benefits executives would forfeit by moving from another institution to UC in mid-career; it was also used as a retention tool. A second SSR was approved in 1988 to offset benefit limitations imposed by the Tax Reform Act of 1986.

meant that an exception would be required if he were to receive any of the NDIP and SSR funds. In light of his many contributions as president and the unusual circumstances of his decision to step down, however, the Regents voted to waive the forfeiture provisions and change the vesting dates to coincide with his December 31<sup>st</sup> retirement.

The Regents did not come to their decision easily. Deferred compensation was a response to the challenge of competitiveness and the constraints of the federal tax code in the prosperous 1980s. The first executive NDIPs and SSRs, however, were being paid out in the economically pinched 1990s. At nearby Stanford University, President Donald Kennedy had been pilloried in the media over allegations that his university had misused federal overhead funds for research in various inappropriate ways, including an expenditure of \$7,000 for bed linens for the president's house and \$1,600 for a shower curtain. These and other highly publicized charges were ultimately disproved, but they contributed to a hostile political environment for research universities everywhere.

At the University of California, it was a time of tight budgets, stagnant salaries for staff, and mounting fees for students. In January 1992, the board voted to raise student fees by twenty-two percent—the third fee increase in three years, and a move that sparked student protests across the University.

That same month, several Regents asked for information on the president's retirement arrangements, and the administration put together a binder spelling out the details. As the Regents read through it, the combustible possibilities of the situation became clear. What to do was the topic of a February meeting attended by the chair of the board, Meredith Khachigian, and several other Regents, as well as Brady and General Counsel James Holst. One Regent had serious reservations about awarding Gardner the usual year's leave with pay, given the public criticism that had greeted the announcement of a similar leave for Stanford's President Kennedy; the compromise was a leave of three months. The proposed change in the deferred compensation vesting dates and the waiver of the forfeiture provisions of the president's NDIPs and SSRs were also discussed. Holst told the group that a Regental decision to do both would stand up in a court of law.<sup>5</sup> Whether it would stand up in the court of public opinion, he added, was another matter.

How to release the news that the Regents were approving these actions was therefore the subject of intense discussion in March, first in a preliminary meeting between Brady and the Regents' leadership, and later during the closed-session meetings of both the Subcommittee on Officers' Salaries and Administrative Funds and the full board. In the end, the announcement simply said that the president had been granted a three-month paid administrative leave, that vesting dates for his separation had been approved, and that he had agreed to serve as an unpaid consultant to the University for the next three years. No figures were mentioned.

Gardner left on a trip to Asia after the March Regents' meeting. He came home to a firestorm of press reports, led by the *San Francisco Examiner*, on his retirement arrangements. Some of the stories about Regental secrecy and bloated executive pay had been fueled by a few unhappy Regents. On April 2, Regent Jeremiah Hallisey released a March 23<sup>rd</sup> letter he had sent to Governor Pete Wilson (an ex-officio member of the Board of Regents) describing his doubts as to the "propriety and methodology employed [in arriving at Gardner's retirement package] and to the merits of the actions taken re President Gardner's severance benefits." Hallisey concluded his letter with a call for rescinding the Regents' actions on Gardner's retirement at the board's May 1992 meeting. That same day, state senator Quentin Kopp issued a statement denouncing the board's action and charging the Regents with "secrecy" in approving "a staggering financial 'package' in a closed-door subcommittee meeting on March 19, 1992 . . . ."<sup>6</sup>

Gardner immediately called for a public meeting to lay out his compensation arrangements so the Regents could consider "affirmance, modification, or rescission" of the retirement compensation they had approved in March. The special meeting took place on April 20. Before the public meeting, Gardner had spoken with Willie Brown, the powerful speaker of the Assembly and, like the governor, an ex officio member of the Board of Regents. Brown told

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<sup>5</sup> See footnote 10.

<sup>6</sup> Quentin L. Kopp, "Kopp Denounces \$1,400,000 Secret Severance Pay to Retiring UC President," April 2, 1992.

him he had no objections either to the compensation arrangements or to the process by which they were approved. Governor Wilson was also supportive, as were a number of key Regents.

The April 20th meeting was a study in contrasts. Regent Hallisey distributed a document describing the president's retirement pay and benefits. He questioned the accuracy of the administration's claim, based on the Towers Perrins findings, that the president's compensation fell below that of similar university executives. And he asserted that many Regents were either unacquainted with, or did not fully understand, the various perquisites that Gardner had received during his service as president. Lieutenant Governor Leo McCarthy picked up on Hallisey's last point, criticizing the board's process for approving executive compensation as lacking in clarity and in need of a major overhaul. Assemblyman Tom Hayden pointed out that, even as executive pay rose over the previous decade, so did the burden on students, whose fees had increased 230 percent during that same period. He called on the Board of Regents to do more of its business in the public eye.

On the other side, Regent Harold Williams made a passionate defense of UC's executive salaries as essential to running a university whose scope and complexity had no real parallels in American higher education. The risk of forfeiture in Gardner's deferred compensation was simply the result of complexities in the Internal Revenue Code that would have denied the president well-earned financial recognition of his accomplishments, had the Regents not voted to make an exception and change his vesting dates. It was therefore unfair and unwarranted that he should "leave the University under a cloud." Williams was chair of the committee on finance, which had made the recommendations regarding the president's retirement arrangements to the board, and he addressed directly the ensuing divisions among the Regents:

In the early discussions of this matter, one could have attributed the differences in opinion about the Regents' action to either a failure of communication on the part of those of us responsible for considering and making the recommendation to the full Board or a failure of understanding on the part of those hearing and interpreting the recommendation. At this point, neither rationale justifies this cloud of controversy. What the motivation is I cannot discern, but it is clearly not fair to the University or to President Gardner.<sup>7</sup>

Governor Wilson underscored Williams' remarks by stating his vigorous support for the actions the Regents had taken in March, and his conviction that rescinding them now would represent a significant moral breach of the board's obligations. He noted that the University's constitutional status was intended to protect it from legislative and other political interference—a reference to Hallisey, Kopp, and Democratic legislators like McCarthy and Hayden. But the person who decisively turned the tide was Democrat Willie Brown, who effectively squelched some of the more vocal protestors and delivered a fiery defense of Gardner, arguing that his supplemental retirement benefits and deferred compensation constituted a contract the board was bound to honor. The Regents voted 16-2, with three abstentions, to reaffirm its March actions.

The board's cohesion in the April 20<sup>th</sup> vote masked some serious fractures. One was caused by the feeling among some Regents that the administration had not provided them with sufficient background on executive compensation programs or on the specific perquisites given to the president. Years later, Brady said in his oral history that he had briefed the board on various aspects of executive compensation at a four-hour meeting about six months before the controversy broke. It is significant, however, that this briefing was done at the urging of an individual Regent who felt the board was not fully informed about the subject and needed more background.<sup>8</sup> And it did not change the view of a number of Regents that, while they had approved deferred compensation and other benefits along the way, they had done so without a full grasp of the implications of their decisions or of the magnitude of the sums involved. Most Regents viewed the NDIPs and other perquisites as legal commitments that had to be honored, and thus were

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<sup>7</sup> Regent Harold Williams, Statement to the Board of Regents, April 20, 1992.

<sup>8</sup> *The University of California Office of the President and its Constituencies, 1983-1995, Volume I* (UC Berkeley Regional Oral History Office, 2003), p. 177.

relieved at the outcome of the April 20<sup>th</sup> meeting.<sup>9</sup> But a subset of the board was far from happy, and much of the unhappiness focused on the way the Subcommittee on Officers' Salaries and Administrative Funds operated.

Established in 1954, the Subcommittee on Officers' Salaries and Administrative Funds' original charge was "to study the subject of persons in the University who had been overlooked and whose salaries had not properly been adjusted." By the early 1990s, it had evolved into a powerful subcommittee of the board responsible for recommendations on all aspects of executive compensation. Its meetings took place in closed session and only subcommittee members could attend. Under several delegations of authority from the board, the chair of the subcommittee was empowered to make decisions about certain aspects of individual officers' compensation, as long as these decisions were made in concert with the chair of the board and the chair of the Committee on Finance, in consultation with the president (or, when the president's compensation was involved, with the senior vice president for administration). These delegations did not include a requirement that actions taken under their authority be reported to the full board.

This arrangement became a flashpoint because several special perquisites for the president were approved under these delegations of authority that later became controversial. Among them were Gardner's two Special Supplemental Retirement Agreements, and several actions related to his housing.

On his recruitment, Gardner and the Regents had agreed that he would use the president's official residence, Blake House, for entertaining but would not live there because it was unsuitable for his family circumstances. His employment agreement therefore included provisions for a personal residence, with a commitment to see that he was not financially disadvantaged by his move from Salt Lake City's relatively low-cost housing market to the higher-priced Bay Area. This commitment required some complicated arrangements and tradeoffs involving his housing, and these were approved by the board at the time of Gardner's appointment in 1983. But over time a few other housing-related perquisites were added, under the special delegations of authority, that the full board did not know about. In 1987, for example, the three chairs approved reimbursing Gardner for the property taxes on his personal residence. Several justifications were later advanced for this decision; one was apparently a desire to reward the president for his performance in a way that would not involve raising his salary.

These actions came as a revelation to most Regents when the full board learned of them in the context of Gardner's retirement arrangements. The amount of detailed compensation information available to the subcommittee but not to the board as a whole was something of a revelation as well. Some Regents felt the complaints about the subcommittee and the board's compensation procedures amounted to little more than "picking at the process," in the words of one former Regent, given the delegations of authority that had been made. The board split between those who, for the most part, had no problem with either the Gardner compensation arrangements or the subcommittee's procedures, and those who felt blindsided and wanted the delegations withdrawn and the subcommittee abolished.

Another source of contention was the way the news of the Gardner retirement arrangements had been made public. Gardner later noted that the brief press release announcing the Regents' action was handled in the usual way—issued a few days after the Regents' meeting—with the usual assumption that reporters or others who wanted to

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<sup>9</sup> The University's Office of the General Counsel sought opinions from outside law firms on two issues: 1) whether the Regents had the constitutional authority to waive the forfeiture provisions and change the vesting dates of the NDIPs and SSRs; and 2) in the case of the NDIPs, whether doing so would have adverse tax consequences for the University or for individual participants in the program. The law firm of Morrison and Foerster responded to 1) in a March 19<sup>th</sup> letter to the UC General Counsel, concluding that the board's actions were a valid exercise of its authority under the California constitution. Regarding 2), O'Melvany and Myers opined in an April 9<sup>th</sup> letter to the General Counsel that the Regents' actions would have no adverse tax consequences for the University or for individual participants in the NDIP as long as the University did not establish a pattern of such waivers.

know more could call the press office.<sup>10</sup> But the elliptical character of the press release contributed to perceptions that it was intended to downplay the story. William Bagley, a Regent and former legislator, wrote a letter to every member of the legislature in which he defended the appropriateness of the retirement arrangements but apologized for the way in which they had been disclosed, adding that the board had violated the 1967 State Open Meeting Act, which he himself had written. "In retrospect," he said, "I blame myself for not insisting on an immediate, full, dollar-specific public statement of the board's action."<sup>11</sup> The University subsequently held a well-attended press briefing in which the details of the Regents' actions were laid out. But it was too late to stem the developing public-relations crisis, and the Regents intended that future communication with the public and the media would be carried out in more straightforward fashion.

Chair Khachigian announced at the April 20<sup>th</sup> meeting that work was already underway on a new executive compensation policy. Three issues were uppermost in the minds of the Regents who wrote it: the Subcommittee on Officers' Salaries and Administrative Funds; the overwhelmingly negative public reaction to deferred compensation and other executive perquisites; and the appearance of secrecy in the way the board discussed and disclosed actions on executive compensation.

### What the Principles Required

The Principles for Review of Executive Compensation were approved by the board at its May 1992 meeting. At the same meeting, the Regents withdrew the delegations of authority related to three executive compensation programs—University housing allowances, supplemental retirement, and severance pay—that had been given to the chair of the Subcommittee on Officers' Salaries and Administrative Funds and several other members of the board. Now the full board would have to approve. Gardner supported all of these actions and expressed the hope that they would "remove any sense of confusion or lack of communication" on executive compensation.

The Principles mandated a number of changes in the way the Board of Regents dealt with compensation issues:

- Executive compensation *programs* would be discussed and acted on in open session. The compensation and performance of *individuals* would continue to be discussed and acted upon in closed session, to protect the privacy of individual officers.
- Release of Regents' actions to the public was to take place "in a timely manner," and the University's "administrative mechanisms" for public disclosure were to be "coordinated, strengthened, and refined."
- Meetings of the Subcommittee on Officers' Salaries were to be open to any Regent who wished to attend.
- Background materials on compensation programs and on individuals must be sufficient to give the board a "full understanding" of the topic, including "all compensation elements relevant to each individual officer under consideration."
- The president would report to the Regents on any paid leave of absence he or she awarded to a University employee. Paid administrative leaves for the president, the general counsel, the treasurer, and the secretary of the Regents would be approved by the board.
- The administration was to prepare an annual report describing salary and other kinds of compensation for Officers of the University and Principal Officers of The Regents.<sup>12</sup> After submission to the board, these reports would be distributed to the California Postsecondary Education Commission as the state agency responsible for

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<sup>10</sup> For Gardner's account of the controversy, see David P. Gardner, *Earning My Degree: Memoirs of an American University President* (University of California Press, 2005), pp. 341-356, and his oral history, *A Life in Higher Education: Fifteenth President of the University of California, 1983-1992* (UC Berkeley Regional Oral History Office, 1997), pp. 574-615.

<sup>11</sup> "UC Regent Takes Blame in Flap over Pay," *San Francisco Chronicle*, April 11, 1992.

<sup>12</sup> Officers of the University include the president, vice presidents, associate and assistant vice presidents, the university auditor, chancellors, vice chancellors, directors of UC hospitals, and directors and deputy directors of the three national laboratories UC manages for the federal government—the Lawrence Berkeley National Laboratory, the Lawrence Livermore National Laboratory, and the Los Alamos National Laboratory. Principal Officers of The Regents are the general counsel, the treasurer, and secretary (now the secretary and chief of staff).

coordinating public higher education activities, the Joint Legislative Budget Committee, and “relevant policy and fiscal committees of the Legislature and the Governor.”

It is clear how these provisions respond to the problems uncovered in the compensation controversy. The Regents wanted more information on both programs and individuals; they wanted the board’s actions on executive compensation to be clearly stated and shared with the public and the media without undue delay; and they wanted to mend the structural glitch in the board’s organization—the Subcommittee on Officers’ Salaries and Administrative Funds, along with certain delegations of authority—that some members believed had contained the seeds of the compensation crisis in the first place. And, with reluctance on the part of some Regents who worried about competitiveness, they wanted one other thing; to change the University’s compensation policies and practices to make executive benefits similar to those of other UC employees.

### Changing Compensation

On October 1, 1992, UC Irvine chancellor Jack Peltason took office as president. A man of unshakable civility, Peltason had a reputation for integrity and the respect of the Regents, the legislature, and the University community. In terms of executive compensation, he had two aims. One was to resolve the controversy as expeditiously and with as little internal recrimination as possible. The other was to strike a balance between what the public would accept in terms of compensation, and what the University could accept and still remain competitive. Regaining the confidence of the public, the legislature, and the faculty was essential to UC’s future. Regaining the confidence of the Regents was indispensable to retaining the board’s delegations of authority to the Office of the President and the campuses. In Peltason’s view, these delegations guaranteed the campuses the flexibility and relative independence that had historically been so important to the University’s success as a multicampus system.

The faculty was high on Peltason’s list of concerns, and faculty opinion on the University’s executive compensation system was largely negative, at least as expressed through the Academic Senate. The faculty at UC Davis joined their Berkeley colleagues in condemning what they saw as the application of private-sector standards to university administrators: “The patterns of executive compensation found in the corporate world have no place in the University of California.”<sup>13</sup> The chair of the systemwide Academic Council, W. Elliott Brownlee, later told the Regents that many faculty thought executives received excessive and overly complicated compensation packages; even those faculty members who were willing to suspend judgment felt the compensation issue had been handled without sufficient sensitivity to public opinion. The faculty wanted a simpler, less market-based methodology, and a less elaborate executive personnel program.<sup>14</sup>

During the summer of 1992, President Gardner invited A. Alan Post, the former State legislative analyst, to give his recommendations on UC’s executive compensation policies and practices. Post had retired in 1977 after serving as the California legislature’s chief financial adviser for twenty-seven years. He had a long record of public service, including chairmanship of the California Commission on Government Reform, appointed in 1978 by Governor Jerry Brown in the wake of the tax revolt precipitated by passage of Proposition 13. Post submitted his findings and recommendations on UC compensation in September 1992 and presented them to the Regents at a public meeting in October.

His sixteen-page report, stern and highly rational in tone, was an unsparing critique of virtually every aspect of the University’s compensation policies and practices. He began by emphasizing the University’s constitutional status as a public trust—“A public trust, not a moneymaking enterprise governed by the ‘invisible hand’ of Adam Smith.” From this premise, he went on to distinguish between benefits, which every employee should receive, and executive perquisites, which were really supplemental income. The University should eliminate these “ill-advised” perquisites, among them deferred-income programs for executives, the special retirement payment for spouses of the president and the chancellors, the special supplemental retirement program, the executive severance pay plan, the automobile

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<sup>13</sup> Meeting of the Davis Division of the Academic Senate, May 8, 1992.

<sup>14</sup> W. Elliott Brownlee, “Statement on Executive Compensation,” Regents’ Meeting, October 5, 1992.



allowance (in favor of mileage reimbursement), the allowance for tax planning, and the special life insurance program. He also urged the Regents to end the practice of providing housing or housing allowances to the two senior vice presidents, and to require the president and the chancellors, without exception, to live in University-provided housing. And he proposed eliminating payment of property taxes on personal residences (since the president and chancellors should be living in tax-exempt University-provided housing anyway).

Post's perspective was strongly influenced by civil service principles and his view that the logical starting point for executive compensation ought to be faculty pay. He was skeptical about the practice of using market consultants and comparing UC's salaries and benefits with those of executives at similar institutions. Instead, he advised the Regents to rely on a "logic-based internally consistent relationship" among executive positions. The basis of this system would be the salary of a full professor, as reflected in the eight universities—four public and four private—that UC used for comparison purposes in setting faculty salaries. "This approach," he concluded, "does not suffer the dubious characteristics of an externally constructed executive comparison group."

Few had expected this sweeping deconstruction of the University's executive compensation system. Gardner wrote a response to Post's report, emphasizing that the University was not competing for talent with either the civil service or the private sector, but with similar public and private research universities. If its executive salaries and benefits ceased to be competitive, he wrote, "we won't long be an institution of the kind and character that we [now] are."<sup>15</sup>

On the other hand, the faculty's official response to the compensation issue (which did not come until January 1995) endorsed the reasonableness of linking administrative to faculty salaries. They agreed with Post that compensation comparison studies had their weaknesses and in any case were not the appropriate standard for academic administrators in public universities. But the faculty's reasons centered more on the effects of compensation disparities on the relationship between the faculty and the institution's administrative leaders. Quoting Harvard president Derek Bok for support, the Senate Task Force Report on Administrative Compensation argued that large differences between presidential and faculty salaries tend to weaken the faculty's sense of loyalty to, and identification with, the president, even though he or she is also a member of the professoriate.<sup>16</sup> The task force concluded that a reasonable limit on presidential salaries would be two-and-a-half times the average salary of full professors, or about \$250,000 in 1995 dollars. Chancellors' salaries, except for that of UC San Francisco, the University's exclusively health-sciences campus, should not exceed twice the average salary of full professors, or \$200,000. Even though the Senate task force report was released well after Post's, the idea of tying executive to faculty compensation had already been floated in the Berkeley Division's statement of May 1992.

The compensation dispute thus produced three distinct perspectives on executive pay and benefits: Gardner's argument in favor of the prevailing view that compensation should be set in terms of the higher-education marketplace for top administrators; Post's argument that executive compensation should incorporate internally and logically derived relationships among positions, using faculty compensation at comparable universities as a base; and the faculty argument that administrative pay and benefits should reflect a clear relation to the pay and benefits accorded faculty at UC.

Peltason and the Regents, who were facing an institutional crisis rather than an abstract debate about compensation theory, took a fourth position. They recognized the imperative to compete for executive talent and therefore did not abandon the concept of the higher-education marketplace. But they did acknowledge public and faculty criticisms about the level and complexity of executive salaries and benefits. The result was a compromise that sought to keep compensation at a standard that would allow UC to compete while also simplifying and streamlining executive compensation programs.

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<sup>15</sup> President David P. Gardner to Regent Khachigian and President-designate Peltason, September 25, 1992.

<sup>16</sup> Report of the Senate Task Force on Administrative Compensation, January 13, 1995, pp. 2-3.

The Regents kept the Senior Management Severance Pay Plan, a lump-sum payment executives received when they left or retired from the University. They retained automobile and relocation allowances, which were more or less standard in higher education. They rejected Post's recommendation that administrators' salaries should be tied to faculty salaries, rather than to executive compensation at similar universities.<sup>17</sup> Both the Regents and the administration were convinced this would impose a major competitive disadvantage on the University.

Peltason voluntarily forfeited more than \$300,000 in compensation benefits: the year's administrative leave with pay he had been promised at the conclusion of his presidency; the \$42,000 housing allowance the Regents had granted him when he became president; and all deferred compensation for which he was eligible, expressing the wish that the Regents devote the funds to student scholarships. Between September and December of 1992, the University slashed administrative funds by one-third and set new policy restrictions on their use; these monies were used for executive travel, entertainment, and other business-related expenses. Peltason announced a ten-percent budget cut in Office of the President expenditures and the elimination of various executive benefits, including a tax and financial planning allocation, supplemental vacation, and the NDIP program.<sup>18</sup> The special retirement payment for spouses of the president and the chancellors was suspended. By the time they were finished, the president and the Regents had stripped the University's executive compensation program of virtually every benefit added during the Gardner administration. Future benefits offered to UC executives would be determined by their prevalence among similar public and private universities and their usefulness in recruiting and retaining key administrative officers. Total cash compensation was to be the vehicle for keeping up with the market and rewarding individuals.

As the long and politically disastrous year drew to a close, the Regents and the administration alike believed they had resolved what board chair Meredith Khachigian called the "serious issues and questions," both internal and external, that the executive compensation controversy had thrust upon the University.

### **The 1993 revision**

Their optimism was premature. The issue of executive compensation exploded again in early 1993, with a focus this time on paid administrative leaves. As one of his last acts as president at the end of September 1992, David Gardner wrote Senior Vice President Ron Brady a letter granting him a one-year leave of absence with pay. Eleven such leaves had been granted since 1983, most of them to departing chancellors. This action, made under Gardner's presidential authority, was communicated to the Regents but did not become public until May 1993.<sup>19</sup>

The 1992 Principles had only required that the president report leaves of any duration. But in June 1993, Peltason recommended revising Standing Order 100.4(e) to remove authority for granting paid leaves of more than three months from the president and invest that authority in the Board of Regents. The Regents approved his recommendation.

Word of the Brady leave gave new impetus to a bill, SB 504, that state Senator Tom Hayden had introduced in March 1993. SB 504 required the Regents to hold an open session when acting on compensation for certain University officers; to give public notice of the action; and to have it approved by the full Board of Regents. Hayden's bill would have prohibited the Regents from acting on the performance and compensation of the president, vice presidents, chancellors, and several other high-ranking executives in closed session, as the Principles allowed them to do. The intent of SB 504 was twofold: 1) to force the Regents to discuss the compensation of its highest-paid managers in public, and 2) to prohibit any element of compensation from being approved by less than a majority of the board. The

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<sup>17</sup> UC policy called for the Regents to set average compensation levels based on a combination of market factors, individual experience and performance, and internal alignment among chancellorial positions and executive positions in the Office of the President.

<sup>18</sup> With the exception of President Peltason, deferred compensation was incorporated into the base salary of NDIP participants as of January 1, 1993.

<sup>19</sup> Brady took his paid administrative leave but agreed to forfeit his deferred compensation when he left the University in July 1993.

1992 Principles had said that executive compensation meant “base salary, all forms of deferred compensation, supplemental retirement, and all components of housing allowances”—aspects of the Gardner retirement arrangements that had been controversial. In a move that would prove to be significant later, the Hayden bill redefined executive compensation to include “salary, benefits, perquisites, certain severance payments, retirement benefits, or any other form of compensation”—in other words, just about everything.

The University originally opposed SB 504, arguing that the first of its stipulations would cripple the University's competitiveness by requiring public discussion of individual salaries and performance, and that the second was unconstitutional, given UC's constitutional autonomy, because it dictated to the Regents how they would conduct their own business. But UC dropped its opposition when Hayden agreed to amend the bill to say that compensation for the University's top executives could be *discussed* in closed session but must be *voted on* in public.

SB 504 was coupled with a companion measure sponsored by Senator Kopp, SB 367. SB 367 imposed new requirements regarding public appearances before the boards of State agencies, including the University. The most important were to give the public notice that a vote on an executive compensation proposal was likely to happen, and to ensure that members of the public present at the meeting had a chance to see the proposal before the Regents' vote.

The Regents took up both bills at their November 1993 meeting. They adopted several new procedures that, in the words of the General Counsel, were “intended to satisfy the letter and spirit of this legislation.” The Principles for Review of Executive Compensation were amended to reflect these changes. The new and expanded definition of executive compensation was also incorporated, without discussion or comment. This amendment, seemingly innocuous at the time, took on major significance thirteen years later, when it became the basis for a comprehensive re-interpretation of the Principles.<sup>20</sup>

The revision of the Principles did not extinguish the executive compensation controversy. The next flare-up occurred in January 1994, when Peltason recommended a year-long paid administrative leave for outgoing Davis Chancellor Ted Hullar. The Regents approved it, despite the now-routine public criticism, but made it clear that similar recommendations would not be welcomed in the future. The issue of granting yet another leave came to a head in the spring over the impending departure of Barbara Uehling, chancellor at UC Santa Barbara. Peltason supported the idea as a matter of fairness, but soon found himself at odds with both the campus and the systemwide faculty leadership. They objected to a one-year leave at full administrative pay for a chancellor who did not intend to return to teaching and research and threatened to take the matter to the Regents and the legislature. It soon became clear that the Uehling leave could escalate into a confrontation involving the faculty, the Regents, and Sacramento. Peltason therefore decided to end the practice of offering paid administrative leaves entirely, and this embargo would apply to current as well as future chancellors, vice presidents, and laboratory directors. The chancellors agreed to support this action under one condition—that Uehling be given her year's leave before the policy went into effect. With great reluctance, Peltason refused. Even though such leaves were customary in American higher education, consensus about their legitimacy had crumbled within and outside the University, and he was convinced that asking the Regents to approve another leave would be damaging to UC, given the politically charged climate of California higher education. It was, he said, “the most difficult decision I have had to make in a long administrative life, a dilemma in which I am torn between doing the right thing for a colleague and doing what is in the best interests of the University.”<sup>21</sup>

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<sup>20</sup> For a discussion of the 2005-6 controversy and its relation to the Principles for Review of Executive Compensation, see Patricia A. Pelfrey, “Executive Compensation at the University of California: An Alternative View,” May 2008, Center for Studies in Higher Education Research and Occasional Papers at <http://cshe.berkeley.edu/publications/publications.php?s=1>.

<sup>21</sup> J. W. Peltason, “Executive Compensation: Next Steps,” Special Regents' Meeting, April 6, 1994. Uehling later sued the University for breach of contract. A binding arbitration process was agreed upon, and the arbitrator ruled that Uehling was entitled to a one-year leave with pay.

## Conclusions

In 1992 and 1993, the University faced a battle on two fronts—the fight to restore public and legislative confidence and the struggle to regain the internal equilibrium that the public crisis had upset. It succeeded in the following ways:

- Adoption of the Principles addressed the external issues by articulating the Regents' commitment to openness in discussion and disclosure to the public. They spoke to the internal problems of information and communication by including all Regents in discussions of compensation issues and specifying the kinds of information the board needed from the administration to do its job.
- Through the April 20, 1992 meeting and later the Post report, the Regents and the president provided public forums for debate about the Gardner arrangements specifically and executive compensation generally. There were risks involved in this strategy. At the time, the decision to ask for Post's assessment seemed to have backfired: his criticisms obviously complicated the University's efforts to explain and defend its compensation policies. But in retrospect the Post review was not entirely negative for the University. It demonstrated UC's willingness to open the subject to public discussion and clarified the underlying values at stake in the compensation debate.
- The Regents resisted the tendency of many boards under siege to centralize authority. Why they did so is a matter of speculation, but two factors may be relevant. One is the board's recognition that at least part of the problem lay with its own internal organization—the Subcommittee on Officers' Salaries and Administrative Funds—not in the organization of the Office of the President. Another was an action taken jointly by Gardner and Peltason in May 1992. They appointed a transition team, headed by UCLA Chancellor Charles E. Young, to assess the University's administrative structure, including the relationship between the Office of the President and the campuses, in light of the budgetary and other challenges to UC's academic mission. Decentralization was the overriding message of the Transition Team's September 1993 report. Peltason and the Regents, through the Special Committee on Regents' Procedures, acted quickly on many of the report's recommendations even before it reached final form, including its recommendation that more authority over routine matters on the board's agenda be delegated to the president, so the Regents would have more time to concentrate on large policy issues. The compensation crisis and the work of the Transition Team overlapped throughout much of 1992 and 1993. As a result, the advantages of sharing authority were in the forefront of Regental attention just when circumstances might have influenced the board to withdraw it.
- In the aftermath of the controversy, presidential leadership made a difference. The compromises Peltason forged on executive compensation reflected his conviction that the crisis threatened not only UC's public standing but also cooperative relationships among faculty, administration, students, and Regents. His candor and integrity were important; so was his willingness to forfeit compensation he had been promised in the interest of demonstrating the University's commitment to listen to its critics. His leadership bred new confidence in the University among its external constituents and helped restore morale within the Office of the President.

Among the lingering after-effects of the 1992 controversy, two stand out:

- A vast intellectual gulf still separates those who believe academic administration should be governed by the market and those who do not. The dilemma public universities face in competing for administrative talent was clearly laid out at the April 1992 Regents' meeting. Should public university administrators expect to be compensated at a level commensurate with the marketplace, or should they regard their profession as a form of public service and accept less, particularly in times of budgetary hardship for the institution? And if there is a middle ground between these two extremes, how can that territory be defined? Alan Post stated the case for uncoupling administrative salaries from the market. But he left unanswered the question of how elite public universities compete in that market with their private counterparts. Public and media attention to compensation issues waxes and wanes, and hostile scrutiny is more likely to erupt in times of budget stress. In terms of the public debate over the legitimate basis for executive compensation in universities, however, we have not advanced beyond the discussion in 1992.

- The Principles were a statement of the broad values that would govern the board's actions on executive compensation, but they were also designed to meet specific issues raised by the controversy of 1992 and 1993. They were drafted in a matter of weeks, under the pressure of a public and political crisis of confidence, and during a transition from one presidential administration to another. When the 2005-6 controversy occurred, they were interpreted in a way that failed to take account of the circumstances of their creation or the history of their implementation. This constituted a lapse of institutional memory that has had significant implications for governance.

Public controversies are never good news for universities. They have lessons to teach, but defining precisely what those lessons are is sometimes difficult; the line between correcting and overcorrecting is hard to draw. Their short-term consequences are almost always negative, their long-term consequences uncertain. Perhaps the last word is best left to President Emeritus Jack Peltason: "Today's problem is yesterday's reform."