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THE INSIDERS | A MERCURY NEWS SPECIAL REPORT

Restoring investor trust won't be easy

WHAT TOP 50 INSIDERS MADE

CHART BREAKS DOWN HOW MUCH THEY REAPED FROM SELLING STOCK IN COMPANIES THAT LATER PLUNGED BY AT LEAST 99.5% | **PAGE 18A**

DIVERSE GROUPS PROPOSE VARIOUS COMPENSATION REFORMS

By Chris O'Brien
Mercury News

In the wake of massive sales of stock by insiders during the economic boom, reform advocates have called for numerous changes in rules for corporate governance and executive compensation to restore investors' faith.

These proposals come from a diverse array of community groups, pension funds, politicians and even industry groups. The solutions they recommend include new laws, regulations and accounting procedures.

Despite differences in philosophical backgrounds, the reformers agree that changes are needed to a system that allowed insiders to cash out billions of dollars of stock even when their companies were disasters.

"I don't think the average shareholder is close

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ABOUT THE SERIES

SUNDAY: How some valley executives made fortunes while their companies' values plunged.

MONDAY: A look at Cupertino's Portal Software, and how its executives profited.

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REFORM | Diverse groups propose various changes

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to regaining their trust in the markets,'' said Scott Klinger, co-director at United for a Fair Economy. "It really wasn't a time of exceptional economy. It wasn't a time of amazing growth. It wasn't a New Economy. It was a phony economy.''

But others defend the system, saying that it has helped the economy flourish by raising and channeling money for growth, innovation and risk taking. They also note that insiders generally reaped the windfalls legally.

Frederick Lawrence, former chief executive of Adaptive Broadband, a fixed wireless company that filed for bankruptcy last year, pointed out that in some ways, the boom created a one-time opportunity for the kind of heavy selling that occurred, and that many rank-and-file employees also profited.

"When there's an economic bubble, everyone has an opportunity for a windfall,'' Lawrence said.

Others worry that making drastic changes could have unintended consequences.

"Everything's got its pros and cons,'' said Graef Crystal, a compensation expert in Las Vegas. "If you make people hold their stock, they may leave the company early just to sell. I'm not sure that really accomplishes a lot.''

But even those who have benefited from the recent boom worry that something needs to be done. Klinger's organization consists of members whose wealth puts them in the top 5 percent of Americans. They are increasingly alarmed by what they see as growing inequality in the United States that's driven by rising executive pay.

Fair Economy's latest report on executive compensation said that even after the economic bust of the past few years, the current CEO-to-worker pay ratio of 411-to-1 in the United States is nearly 10 times bigger than the 42-to-1 ratio two decades earlier, in 1982.

Much of that disparity was driven by the increased use of options and the ability to cash out stock, Fair Economy said.

Already, some changes have been made that would limit the ability of insiders and board members to cash out. On July 30, President Bush signed into law the Sarbannes-Oxley Act which, among other things, banned loans from companies to executives, prohibited executive stock sales during certain blackout periods, and increased criminal penalties for white collar crime.

The New York Stock Exchange wants to require that all stock options plans be approved by shareholders and for board members to be more independent. The Nasdaq has proposed more limited versions of these changes.

While many groups think this is a good start, they argue that more needs to be done to ensure that executives and board members focus more on the long-term health of their companies.

The reforms being discussed fall into three broad categories.

■ **Limit Compensation:** There's a strong push — opposed by most valley companies — to require companies to subtract the cost of stock options from profit. Other groups would like to go further by eliminating all remaining corporate tax breaks on options and enacting new taxes on executive compensation.

If companies continue to use stock-based compensation, Nell Minow, editor of the Corporate Library, a research group, believes directors and executives should not be allowed to sell their shares until three years after they have left a company.

"I'm very unsympathetic at any attempt to justify stock sales,'' Minow said. "The whole purpose of giving them stock is to align their interests with shareholders. You don't want the captain of the ship to bail out when it's sinking.''

■ **Disclosure:** Under the current system, insiders are required to file a form with the SEC when they sell their shares. However, insiders have up to six weeks after a sale to report it.

Critics want more complete and timely disclosure rules that could include notifying shareholders 30 days in advance that an insider plans to sell. In September, the Conference Board recommended that quarterly earnings reports explain in clearer terms the impact compensation plans will have on the company's bottom line.

"Shareholders and markets need accurate and timely information to make informed decisions,'' the Conference Board report said.

■ **Oversight:** Advocates for change would like to see shareholders gain more authority and directors who are more skeptical and independent of management.

Several groups want investors to be allowed to vote on all compensation plans and other things that might have a material effect on a company. Fair Economy wants shareholders to have more power to nominate board members.

There have also been calls to broaden the range of people who typically sit on corporate boards to include leaders of foundations, non-profits, community leaders and union members. And critics would like more aggressive board members who don't have conflicts, like being major customers of the business.

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CASHING IN

This charts shows how much money 50 insiders reaped from selling stock in companies that ultimately saw their stock values plunge. The Mercury News examined insider stock sales at 40 Silicon Valley companies that lost at least 99.5 percent of their value from the end of the first quarter of 2000, when the Nasdaq market peaked, to the end of the third quarter of this year. This charts lists directors, venture capitalists, major investors and executives deemed to be "insiders" by each company, and ranks them by the value of the stock they sold since 1997. Some transactions on behalf of trusts have been included.

INSIDER	COMPANY	POSITION	VALUE OF STOCK SOLD SINCE 1997 (IN MILLIONS)
Wen Chang Ko[1]	Clarent	Director	$211.5
Thadeus J. Mocarski[1]	Exodus Communications	Director	$155.9
Dennis L. Barsema	Redback Networks	Chief executive	$138.5
K.B. Chandrasekhar	Exodus Communications	Chief executive	$135.1
Paul Gauthier	Inktomi	Chief technical officer	$130.6
John E. Little	Portal Software	Chief executive	$127.5
James R. Swartz	Portal Software	VC	$124.5
Oak Investment	Inktomi	VC	$120.3
David C. Peterschmidt	Inktomi	Chief executive	$90.5
James Robert Shaw[1]	Excite@Home	Investor	$86.1
Arthur C. Patterson	Portal Software	Director, VC	$82.5
James W. Breyer	Portal Software	Director, VC	$73.8
David S. Labuda	Portal Software	Chief technical officer	$57.1
Randall J. Kruep	Redback Networks	Director	$54.8
Dennis L. McEvoy	Inktomi	VP	$50.4
Thomas A. Jermoluk	Excite@Home	Chief executive	$50.3
Frederick Lawrence	Adaptive Broadband	Chief executive	$47.8
Jerry M. Kennelly	Inktomi	Chief financial officer	$44.9
James W. Thanos	Broadvision	Exec. VP	$44.4
Jack L. Acosta	Portal Software	Chief financial officer	$43.8
Richard S. Stolz	Exodus Communications	COO	$42.8
Gaurav Garg	Redback Networks	VP, director	$42.4
James R . Swartz	Redback Networks	VC	$39.6
Syaru Shirley Lin[1]	Clarent	Director	$36.1
Mong Hong Wu	Clarent	Sr. VP	$35.7
Eric A. Brewer	Inktomi	Director, Chief scientist	$35.3
Steven R. Sommer	Portal Software	VP	$34.0
Fleet Funds	Exodus Communications	Investor	$33.1
Christopher Vannelli	Inktomi	VP	$32.6
Bassam S. Mohamad	Exodus Communications	Sr. VP	$32.4
Arthur C. Patterson	Redback Networks	VC	$32.0
Todd A. Garrett	Broadvision	Director	$32.0
E. Patterson Partners	Portal Software	VC	$30.9
Peter A. Howley	Exodus Communications	Director	$30.7
Michael E. Regan	Portal Software	VP	$24.9
Daniel C. Lynch	Exodus Communications	Director	$24.6
Richard B. Pierce	Inktomi	VP	$24.4
William C. Klintworth	Nexprise	Director	$24.0
Fredric W. Harman	Inktomi	Director, VC	$21.9
Luke Basil Evnin	Redback Networks	VC	$21.8
James R. Flach	Redback Networks	Director	$21.1
Michael F. Vargo	Clarent	Chief executive	$20.8
G. Carter Sednaoui	Portal Software	VC	$19.8
David P. Bagshaw	Excite@Home	Chief technical officer	$17.8
Yogen K. Dalal[1]	Broadvision	Director, VC	$17.8
Geoffrey C. Darby	Redback Networks	Chief financial officer	$17.7
Luke Basil Evnin	Portal Software	VC	$17.4
Samuel Jerrold Kaplan	Egghead Com New	Chief executive	$17.4
Mark S. Gainey	Kana Software	Chairman	$17.1
James Breyer	Redback Networks	VC	$17.0

[1] *Some or all of the shares listed were sold on behalf of the investment firm the insider represents.*

Source: Thomson Financial, Securities and Exchange Commission filings

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