

GraefCrystal.com

The Crystal Report on Executive Compensation



Delta Air Lines Merges; CEO Celebrates Early

by Graef Crystal

May 11, 2009

Last October, Delta Air Lines Inc. acquired Northwest Airlines Corp. It's not at all clear to me that the merger did much more than make the combined company bigger. But that didn't stop a pay celebration that gave Delta's CEO millions the day the merger occurred.

Pay

But first, let's back up a bit. On Sept. 4, 2007, Delta Air Lines brought in Richard Anderson as its CEO. Immediately prior to joining Delta, he had been an EVP of United Health Group Inc. But before that, he had wide experience in the airline industry, rising to CEO of Northwest between Feb. 2001 and Oct. 2004.

When he joined Delta, Mr. Anderson received an impressive "Welcome Aboard" pay package:

- He was contingently-granted performance shares with a grant date fair value of \$2.1 million. (He later agreed to relinquish these shares.)
- He also received restricted shares worth \$5.8 million. These shares vest over time simply by his remaining with the company.
- Finally, he was handed a stock option with a grant date fair value of \$2.7 million.

Now we come to 2008. On April 3, 2008, Mr. Anderson again received simultaneous grants of performance shares, restricted shares and stock options with a combined total grant date fair value of \$3.4 million.

Then came the big merger with Northwest on Oct. 29, 2008. On that day, he received an option covering 1.52 million shares and carrying a strike price of \$7.99 a share. (On May 8, Delta stock closed at \$6.96.) The grant date fair value of this option was \$7.3 million

One could argue that this new option was needed to juice up Mr. Anderson more than he was already juiced up, what with his previous grants of performance shares, restricted shares and option shares. The flip side, though, is that he already had plenty of motivation to make the merger work, including the negative motivation that if it didn't work he'd likely be out in the street.

But what I fail to understand is the companion grant made on Oct. 29, 2008. That covered 760,000 more restricted shares worth \$6.1 million on the date of grant. Being free, those shares are set to confer rewards on Mr. Anderson even though the merger fails abysmally.

In short, and in my opinion, Mr. Anderson's is a case rarely found in the medical literature, namely, "premature congratulation".

But in fairness to Mr. Anderson, he did not receive any bonus for 2008. (Although, in my view, he didn't deserve one either, given that operating income dropped 90 percent and the company lost \$8.9 billion.)

In a story published on April 30 (the very day the proxy came out) by *USA Today*, which quotes an *Associated Press* (AP) story, there appears the following: "Delta Air Lines top two executives sought to prepare employees and investors Wednesday for what they will see when the world's largest airline operator files its proxy: Large total compensation figures for the leaders in 2008, a year in which the company posted a net loss of \$8.9 billion." The AP quote went on to say that the Delta top executive pay "comes at a time Americans are increasingly scrutinizing high executive pay amid massive job losses among rank-and-file employees in numerous industries due to the deep economic downturn in the U.S."

"Consciousness of guilt", as the lawyers put it?

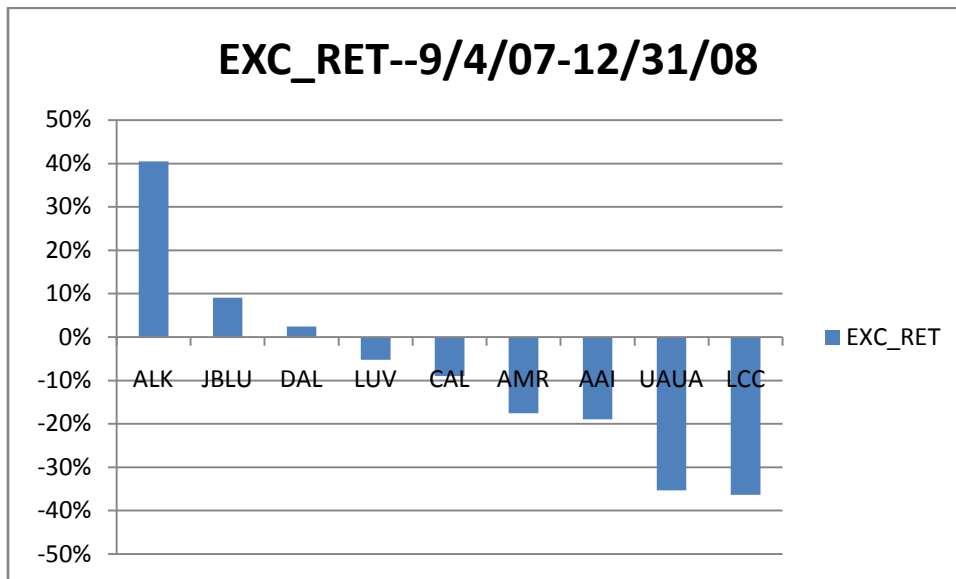
Performance

So how has Mr. Anderson performed?

To answer this question, I looked at eight airlines besides Delta itself, including, in no particular order, Southwest (ticker symbol LUV), American (AMR), Jet Blue (JBLU), Continental (CAL), AirTran (AAI), Alaska (ALK), United (UAUA) and US Airways (LCC).

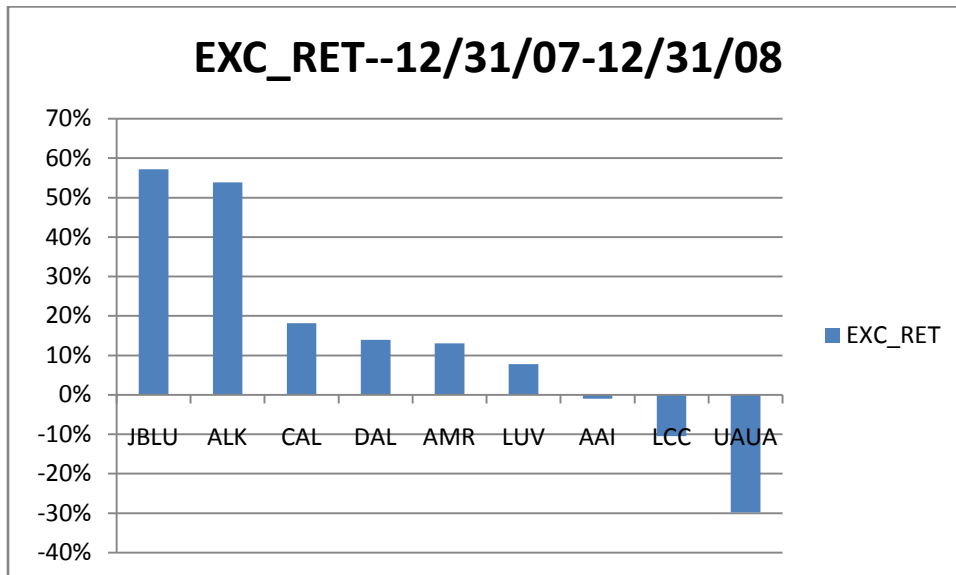
Herewith are three charts.

The first chart shows the "excess return" of each airline for the period beginning Sept. 4, 2007, the day Mr. Anderson became CEO of Delta, and Dec. 31, 2008. In each case, the annual return on the Standard & Poors 500 Index was deducted from the company's own annual return.



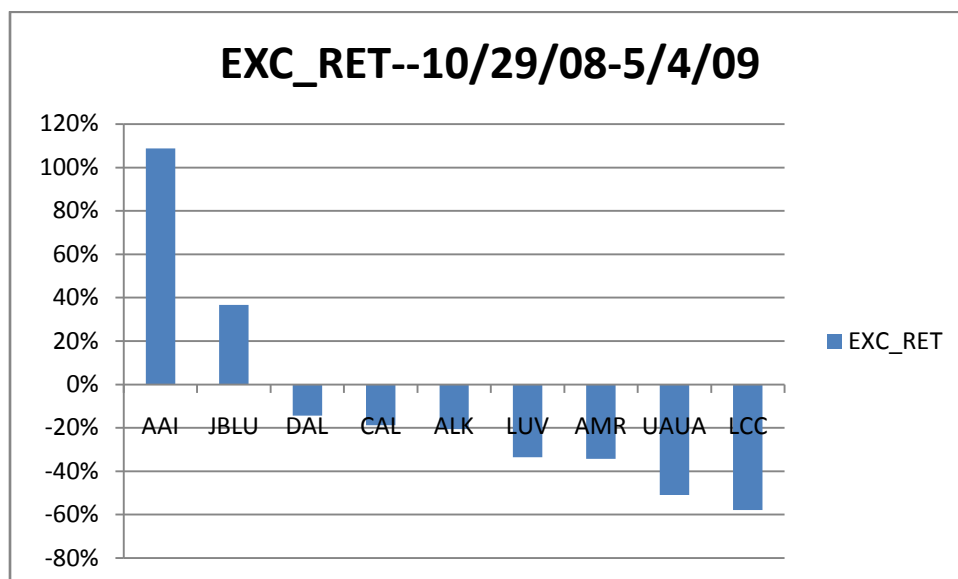
You can see from this chart that Delta ranked third during this period, with an excess return of a positive 2.4 percent.

The second chart shows the excess returns for the single year ended Dec. 31, 2008.



When the time window is narrowed to the most recent fiscal year, Delta's rank drops to four from three. Even so, the company's excess return was a positive 13.9 percent.

Finally, the third chart shows the annualized post-merger excess returns, beginning Oct. 29, 2008 and ending this May 8.



As can be seen, Delta improves a bit. Whereas it was ranked third in the first chart and fourth in the second chart, it has now regained its third place. But its annualized excess return dropped to a negative 14.4 percent.

Still, to my way of thinking, nothing much has changed, except for the fact that Mr. Anderson is now running a much larger company.

Wouldn't it have been better to wait, say, for a year after the merger to see how things were turning out before engaging in what looks to be, and may turn out to be, a premature pay celebration?

////////////////////

The members of the Delta board compensation committee are:

- David Goode, chair, 68, retired chairman of Norfolk Southern Corp.
- John Brinzo, 67, retired chairman of Cleveland-Cliffs Inc.
- Kenneth Woodrow, 64, retired vice chairman of Target Corp.

2009 marks Graef Crystal's 50th anniversary in the executive compensation field. He has been a director of compensation for General Dynamics and Pfizer, worked as a consultant for Booz, Allen & Hamilton, served as worldwide practice director at Towers Perrin for 18 years, was a professor at the University of California at Berkeley's Haas School of Business for 10 years and

a syndicated columnist for Bloomberg News for almost nine years. He has written six books and more than 1,600 articles on executive pay.