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Plenty of Legal, Political Fighting Left After SEC Adopts CEO Pay Ratio Disclosure

The Securities and Exchange Commission has adopted its chief executive pay ratio disclosure rule, but partisan discord over the rule shows little sign of abating, and experts agree the legal and political fight will continue well into the future.

The rule, adopted Aug. 5 by the SEC, will require companies to disclose the ratio of their chief executive's annual pay to their median employee's annual pay, starting in fiscal years that begin on or after Jan. 1, 2017 (See previous story, 08/06/15). It was required by Section 953(b) of the Dodd-Frank Act.

''We have a final rule, but it's clear that the debate will continue and that the final outcome is still uncertain,'' James Barrall, of Latham & Watkins LLP in Los Angeles, told Bloomberg BNA. ''We now have a final rule, but we are not ready to start drafting proxy disclosures.''

Legal Challenges. Business groups have opposed the rule since its proposal, arguing that compliance is onerous and the number provides little or no value to most investors.

''I think there's a good chance that litigation will be brought,'' Laura Richman, counsel at Mayer Brown LLP in Chicago, told Bloomberg BNA.

One possible challenge could rely on First Amendment principles of compelled speech, and another could call into question the rigor of the SEC's economic analysis in preparing the rule.

''I expect this will be challenged in court,'' Bartlett Naylor, a financial policy advocate at Public Citizen, told Bloomberg BNA.

First Amendment. SEC Commissioner Daniel Gallagher, who voted against adopting the rule, hinted at the first avenue of attack in his dissenting statement.

''We've seen from our conflict minerals rule that naming-and-shaming rules can fall afoul of the First Amendment, and so the question is raised in my mind whether pay ratio disclosures are constitutional,'' he said.

Gallagher was referring to a ruling by the U.S. Court of Appeals for the District of Columbia Circuit striking down a Dodd-Frank Act rule that required disclosures about conflict minerals used in a company's supply chain, holding the disclosures to be unconstitutional compelled speech (72 DER EE-8, 4/15/14).

'Just One Number.' The required disclosures under the pay ratio rule, however, are shorter than those under the challenged conflict minerals rule.

''I think the conflict minerals [case] involves a lot more issues that this doesn't necessarily raise,'' Mary Mullany, a partner with Ballard Spahr LLP in Philadelphia, told Bloomberg BNA. ''After all, it's just one number. It's not disruptive to your supply chain.''

Economic Analysis. Another avenue of attack could be on the SEC's economic analysis of the rule, similar to how its resource extraction disclosure rule was knocked down by a federal district court in July 2013 (128 DER EE-12, 7/3/13). The court based its holding in part on an insufficient analysis by the SEC on the costs to issuers.

A similar challenge to the pay ratio rule represents more of an uphill battle.

''People should not assume that a court is going to overturn this,'' Richman told Bloomberg BNA. ''In terms of the economic analysis, we clearly see the SEC is beefing up that element'' of its rulemakings.

The agency devoted nearly 100 pages of its adopting release explaining its economic analysis.

''I think the cost-benefit analysis is prodigious,'' Naylor told Bloomberg BNA. ''Some of the claims by industry as to the cost are, in my opinion, outrageous, for starters. But to the extent the SEC nevertheless takes as sincere their numbers, it's not the SEC's requirement that benefits exceed costs, simply that cost-benefit analysis be done.''

Mullany, though, warned that such a challenge would be ''stronger'' if it emphasized ''no definitive showing that there's a meaningful benefit contrasted with the cost.''

No Commitment Yet. Some of the most vocal opponents of the rule haven't publicly committed to a legal challenge.

''For now, our position is that it is too soon to tell whether we would challenge the rule, but that we will keep our options open,'' Timothy Bartl, president of the Center on Executive Compensation, told Bloomberg BNA through a spokeswoman. ''We are in the process of evaluating the final release and it is still very early.''

Similarly, U.S. Chamber of Commerce Center for Capital Markets Competitiveness President and CEO

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David Hirschmann said in a statement, ''we will continue to review the rule and explore our options for how best to clean up the mess it has created.''

Political Play. The rule as adopted won't affect companies until 2017, leaving plenty of time for more political maneuvering to unfold as well.

''I think this will play out in the political arena for the next year or two,'' Barrall told Bloomberg BNA. ''The deferred application date will mean that before companies need to comply we'll get through the 2016 elections, we'll have a new Congress, we'll have a new president, and we may have lawsuits challenging the rules.''

Republican lawmakers have introduced bills to repeal the section of Dodd-Frank that authorized the rule—Rep. Bill Huizenga (R-Mich.) in the House and Sen. Mike Rounds (R-S.D.) in the Senate. House Financial Services Committee Chairman Jeb Hensarling said his panel would take up Huizenga's bill in the fall.

''I don't know if you can read anything into'' the effective date, Richman said. ''I suppose you could take a cynical view that maybe it was the result of a compromise to allow time to see if there was going to be a court response or a legislative response.''

As proposed, the rule would have taken effect in the subsequent fiscal year.

''Goodness knows what might happen before the rules require any disclosure,'' Barrall said.

BY ROB TRICCHINELLI

To contact the reporter on this story: Rob Tricchinelli in Washington at rtricchinelli@bna.com

To contact the editor responsible for this story: Phyllis Diamond at pdiamond@bna.com

For the adopting release on the pay ratio rule, visit https://www.sec.gov/rules/final/2015/33-9877.pdf