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Sent via electronic mail: rule-comments@sec.gov

August 11, 2011

Ms. Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Implementation of Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

Dear Ms. Murphy:

On behalf of the American Federation of Labor and Congress of Industrial Organizations (the "AFL-CIO"), I am writing to provide comment to the Securities and Exchange Commission (the "SEC") on Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 953(b) seeks to provide investors with improved disclosure of public company compensation practices, including the median annual total compensation of all employees (excluding the CEO), the annual total compensation of the CEO, and the ratio of the CEO's total compensation to the median of the annual total compensation of all employees of the issuer.

CEO-to-Employee Pay Ratios are Material Information to Investors

In crafting a regulation to implement Section 953(b), the Commission should consider why CEO-to-employee pay ratios matter to investors. First of all, Congress required disclosure of CEO-to-employee pay ratios because investors are concerned about growing CEO pay levels relative to those of other employees. CEO-to-employee pay ratio disclosure will help reduce CEO pay by encouraging Boards of Directors to consider the relationship of the chief executive's pay to other company employees. Shareholders may also consider pay disparities when voting on say-on-pay resolutions.[1]

[1] *See e.g.,* United States Proxy Exchange, Shareowner Guidelines for Say-on-Pay Voting, August 3, 2011, *available at* http://proxyexchange.org/wp-content/uploads/2011/08/standards_2.pdf.

CEO-to-employee pay ratios also matter to investors because high pay ratios can hurt employee morale and productivity. Employees of public companies already know how much their CEO makes relative to their own pay. Academic studies show that large pay disparities within a company can hurt employee teamwork, loyalty, and motivation. The impact of CEO pay on employee morale is particularly important in today's weak economy where workers are being asked to do more for less.

There is no one-size-fits-all answer for the ideal ratio of CEO-to-employee compensation. Rather, disclosure of CEO-to-employee pay ratios will permit investors to compare the employee compensation structures of companies over time and to their competitors. Disclosure of median employee compensation data also provides valuable information to investors about their companies' human resources practices. Investors will be better able to determine which companies are investing in their human capital, an increasingly important contributor to shareholder value in today’s economy.

The value to investors of Section 953(b) disclosures is discussed in greater detail in the enclosed paper, attached as Appendix A. Given the potential usefulness of this data to investors, the SEC should encourage issuers to supplement their Section 953(b) disclosures to provide greater context for investors. For example, issuers should be encouraged to provide a narrative discussion of their employee compensation practices. Issuers could also provide a breakdown of median employee compensation levels by categories such as part-time vs. full time, or U.S. vs. international employees.

The SEC May Permit Statistical Sampling to Calculate the Median

A few commentators on Section 953(b) have expressed concerns that identifying a company’s median employee compensation level will be an unduly burdensome and expensive task. These criticisms of Section 953(b) wrongly assume that companies must be required to tabulate the total compensation of every single company employee to determine the median. The SEC can minimize issuer compliance costs with Section 953(b) by permitting the use of random statistical sampling to calculate the median of the annual total compensation of all employees of the issuer.

Judicial, statutory, and regulatory precedents indicate that the SEC can permit issuers to comply with Section 953(b)’s disclosure requirements through the use of statistical sampling. Such techniques are common and widely accepted in the field of statistics, and are frequently used when calculating median income levels. For example, the U.S. Census Bureau and the Department of Labor’s Bureau of Labor Statistics use such techniques for their calculations of median income. A more thorough discussion of these precedents is attached to this letter as Appendix B.

Section 953(b) does not specify how issuers must calculate the median of the annual total compensation of all employees. Because the median is a statistical term that is frequently used to describe a set of observations randomly drawn from a larger population, it is reasonable for the SEC to permit issuers to sample their employee populations to calculate the median. For this reason, a regulation that permits the use of statistical sampling to calculate the median will be upheld by the courts as a reasonable interpretation of Section 953(b).

The U.S. Supreme Court recently decided a case relevant to this analysis. In *Zuni Pub. Sch. Dist. No. 89 v. Dep't of Educ.,* 550 U.S. 81 (2007), the Court upheld a Department of Education regulation that specified the calculation methods to be used in identifying school districts at the 5th and 95th percentiles of per pupil funding. A statute in that case required that these percentiles be identified, but did not specify the statistical method to be used to calculate them. Because the median is simply a specific percentile, namely, the 50^{th} percentile, this case is highly analogous to the situation presented by Section 953(b).

The SEC should issue guidance to issuers on how to construct their sample methodology. For example, the SEC could specify the required sample size (e.g., 1 percent of the employee population) for determining median employee pay levels. Alternatively, the SEC could specify a specific confidence interval for calculating the median (e.g., for the 95 percent confidence level). The SEC could also permit issuers to proportionally allocate the sample according to the number of employees at each of the issuers' divisions, subsidiaries, or locations. This stratified sampling would allow issuers to use a smaller sample size to achieve the same level of precision.

Selecting the Median Employee Based on Cash Compensation

To further help reduce compliance costs, the SEC may also consider permitting issuers to identify their median employee based on cash compensation. Once the median employee has been identified, issuers could then calculate that employee's total compensation as called for by Section 953(b). It is likely that for many issuers, their median employee's cash compensation will be identical to the employee's total compensation as calculated under Regulation S-K Item 402. For example, few employees receive forms of compensation that are required to be disclosed under Item 402(c)(2)(ix) such as more than $10,000 in perquisites or personal benefits.

The use of cash compensation to identify the median employee for Section 953(b) purposes would reduce issuers' compliance costs. For domestic employees, corporations are already required to compile and calculate cash compensation for tax reporting purposes, and most other countries have similar requirements. Until 2006, the SEC itself specified that just such a cash-only method was to be used to identify a company's top five most highly paid Named Executive Officers (NEOs), whose total compensation for reporting practices would then be calculated using more extensive metrics. *See* 71 Fed. Reg. 53158, 53190 (Sept. 8, 2006).

International and Part-Time Employees Should Be Included In the Median

To be meaningful to investors, the SEC should require issuers to calculate the median total compensation of all employees counted for the purpose of complying with Regulation S-K Item 101(c)(1)(xiii) that calls for disclosure of the number of persons employed. In particular, the inclusion of international and part-time employees in Section 953(b) disclosures will provide a more accurate picture of issuers' worldwide compensation practices. Any methodological issues that arise from including international or part-time employees in Section 953(b) disclosures can be addressed by SEC guidance.

The inclusion of international employees is important because many issuers such as Caterpillar, PepsiCo, and Tyco have a majority of their workforce outside the U.S. Although some international employees may receive in-kind compensation not frequently used in the U.S. (for example, dormitory housing), such compensation need only be counted if it exceeds $10,000 a year. *See* 17 C.F.R. § 229.402(c)(2)(ix)(a). The SEC could specify a standardized source by which to obtain foreign exchange rates for the purposes of these calculations. If necessary to avoid any potential violation of international privacy laws, issuers can collect Section 953(b) data on an anonymous basis without tracking the identity of their international employees.

Part-time employees should also be counted for the purpose of determining the median level of employee compensation under Section 953(b). The workforces of issuers in the retail or fast food industries may consist of a majority of part-time employees. To be meaningful to investors, Section 953(b) should not ignore these employees whose part-time status may be integral to understanding issuers' human resource policies and practices. If the SEC permits issuers to annualize the total compensation of part-time employees as full-time equivalent employees, issuers should be required to disclose their assumptions in making this adjustment.

Section 953(b) Data Should Be Disclosed Annually in Issuer Proxy Statements

The SEC has clear regulatory authority to determine which filings the required Section 953(b) disclosures must be made and how frequently the data must be calculated. Section 953(b)(1) states that the Commission must require disclosure "in **any** filing of the issuer" (emphasis added). As used by the statute, the term "any" refers to one or more items without specification or identification of a particular filing described in 17 CFR 229.10(a). This does not mean (as some commentators have incorrectly suggested) that the information must be disclosed in "all" fillings of the issuer.

The proxy statement is the most reasonable place for Section 953(b) disclosures to be provided. The fact that Section 953(b) calls for the disclosure of "**annual** total compensation" (emphasis added) suggests that this information should be disclosed on an annual basis (i.e., according to the issuers' fiscal year). In addition, Section 953(b)(2) itself references Item 402(c)(2)(x) of Regulation S-K which specifies the methodology for disclosing the summary compensation table in proxy statements. If for some reason this data is needed in other filings, Section 953(b) information may be incorporated by reference to the most recent proxy statement. Existing SEC regulations already permit certain information to be recalculated less often than it is reported.

Conclusion

Thank you for considering our views on how the Commission may implement Section 953(b) in ways that are faithful to the statute while minimizing compliance costs for issuers. Issuers with adequate internal controls over their payroll and employee benefit systems will have no difficultly complying with Section 953(b)'s reporting requirements. We strongly believe that Section 953(b) will prove to be of tremendous value to investors, and we therefore encourage the SEC to issue its final rulemaking no later than June 2012. Please contact Brandon Rees at (202) 637-5152 if the AFL-CIO can be of further assistance as you implement these statutory provisions.

Sincerely,

D. F. Pedrotty

Daniel F. Pedrotty
Director, AFL-CIO Office of Investment

Enclosures

DFP/sdw
opeiu #2, afl-cio

CC: Chairman Mary L. Schapiro
Commissioner Kathleen L. Casey
Commissioner Elisse B. Walter
Commissioner Luis A. Aguilar
Commissioner Troy A. Paredes
Director Meredith Cross

Dodd-Frank Section 953(b): Why CEO-to-Worker Pay Ratios Matter For Investors

Introduction

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 introduces new reporting requirements for publicly traded companies to disclose the median of the annual total compensation of all employees (except the CEO) and the ratio of CEO compensation to median employee compensation. The U.S. Securities and Exchange Commission has announced its intention to issue regulations implementing this pay ratio disclosure requirement in the fall of 2011.

This new disclosure requirement seeks to address public and investor concerns about growing levels of executive compensation. CEO pay levels have increased dramatically over the past three decades. Excessive levels of CEO pay come at the expense of shareholders who are the owners of publicly traded companies. High levels of pay also provide incentives for CEOs to take excessive risks. For example, inappropriate executive compensation packages at financial services companies have been identified as a contributor to the Wall Street financial crisis.

By requiring that public companies disclose CEO-to-worker pay ratios, the Dodd-Frank Act encourages boards of directors to consider the relationship between CEO pay and the compensation paid to other employees. This provision provides greater transparency to investors about their companies' compensation practices for rank-and-file employees. Company-specific employee compensation data is not currently available to investors under existing disclosure requirements. This disclosure will allow investors to compare employee compensation practices between companies.

CEO-to-Worker Pay Ratios Indicate CEO Pay Levels Are Excessive

In recent decades, CEO pay has grown dramatically in the United States. Between the 1930s and the 1970s, CEOs of the largest companies received approximately $1 million in total annual compensation (adjusted for inflation in year 2000 dollars).[1] During this period, the ratio of CEO-to-worker pay narrowed as workers' wages grew and CEO pay rose modestly.[2] By the 1990s CEO pay grew dramatically. *Business Week* estimated that CEO pay at the largest companies grew from 42 times the average worker's pay in 1980 to 531 times the average worker's pay in 2000.[3] In 2010, large company CEOs received $11.4 million, or 343 times worker pay, according to calculations by the AFL-CIO's Executive Paywatch website.[4]

[1] Carola Frydman and Raven E. Saks, *Executive Compensation: A New View from a Long-Term Perspective, 1936-2005*, July 6, 2007, http://web.mit.edu/frydman/www/trends_frydmansaks_rfs.pdf.
[2] *Id.*
[3] *CEOs: Why They're So Unloved*, Business Week, April 22, 2002.
[4] AFL-CIO Executive Paywatch analysis of 299 companies in the S&P 500, http://www.paywatch.org.

At most publicly-traded companies, CEO pay is set by a compensation committee of the Board of Directors. These compensation committees frequently hire compensation consultants who conduct peer group analyses of what CEOs are paid at similar companies. While the CEO's final pay package may depend on company performance, compensation committees use these peer group studies to target the amount of compensation for the CEO. Chief executives also use peer group pay data when negotiating their compensation packages with compensation committees.

Peer group benchmarking has contributed substantially to CEO pay inflation. Not every CEO can be paid above average, yet no CEO wants to be in the "below average" category. Boards and compensation committees likewise often want to avoid being seen as "below average," whether out of concern for company prestige or fear that the CEO will leave. Thus, as each member of a peer group of companies seeks to raise its CEO compensation above the average, the net effect is a ratcheting up of executive compensation for the entire group.[5] This spiraling effect is further exacerbated because some companies aim their compensation target at the 75th percentile,[6] while other companies choose as their peer group companies that are larger than them and have higher CEO pay to start with.[7]

What is wrong with CEOs receiving ever greater amounts of compensation? CEO pay comes out of the pocketbooks of shareholders. Top executives at large public companies now keep for themselves an average of 10% of their companies' net profits; approximately double the rate in the early 1990s.[8] Perhaps of even more concern, large compensation packages can provide an irresistible incentive for executives to make business decisions that are not in the best interests of their companies. For example, executive pay packages created an incentive for accounting fraud at Enron and Worldcom.[9] More recently, the structure of executive pay packages at Bear Stearns and Lehman Brothers have been blamed for encouraging excessive risk taking by company executives.[10]

[5] Thomas A. DiPrete, Greg Eirich, and Matthew Pittinsky, *Compensation Benchmarking, Leapfrogs, and The Surge in Executive Pay*, November 23, 2009, http://www.columbia.edu/~tad61/frog11232009.pdf. *See also* Charles Elson and Craig Ferrere, *Punting Peer Groups: Resolving the Compensation Conundrum*, BNA Corporate Governance Report, May 2, 2011.
[6] *See e.g.,* Abercrombie and Fitch, 2010 Proxy Statement, page 39.
[7] Cari Tuna, *Picking Big 'Peers' to Set Pay, Executive Compensation Is Often Skewed by Comparisons*, The Wall Street Journal, August 17, 2009.
[8] Lucian Bebchuk and Yaniv Grinstein, *The Growth of Executive Pay*, Oxford Review of Economic Policy, Vol 21 (2005).
[9] Janice Kay McClendon, *Bringing the Bulls to Bear: Regulating Executive Compensation to Realign Management and Shareholders' Interests and Promote Corporate Long-Term Productivity* (Winter 2004). Wake Forest Law Review, Vol. 39, No. 4, 2004.
[10] Lucian Bebchuk, Alma Cohen, and Holger Spamann, *The Wages of Failure: Executive Compensation at Bear Stearns and Lehman 2000-2008*, Yale Journal on Regulation, Vol. 27, 2010, pp. 257-282.

CEO-to-Worker Pay Ratio Disclosure Will Help Limit CEO Pay

The ratio of CEO-to-worker pay has long been recognized as an important ratio. Over one hundred years ago, investment banker J.P. Morgan argued that CEO pay should not exceed 20 times the average worker's pay. Management consultant Peter Drucker would often tell his clients that "a 20-to-1 salary ratio is the limit beyond which they cannot go if they don't want resentment and falling morale to hit their companies."[11] Disclosure of CEO-to-worker pay ratios will encourage compensation committees to consider pay disparities between the CEO and company employees. As Peter Drucker famously said, "what gets measured, gets managed."

In 1997, James Cotton, a law professor at Texas Southern University who previously spent 25 years in IBM's Corporate Law Department, published an article calling for disclosure of CEO-to-worker pay ratios as a way to bring context and a degree of reasonableness to executive pay packages.[12] Investors recognize that the pay relationship between CEOs and company employees is important. For example, the Council of Institutional Investors recommends that compensation committees consider the "goals for distribution of awards throughout the company" and "the relationship of executive pay to the pay of other employees" as factors in developing their executive pay philosophy.[13]

Measuring CEO-to-worker pay ratios will encourage companies to compensate their CEOs as part of a team. Jim Collins, who served as a lecturer at the Stanford Graduate School of Business before starting his own consulting firm, conducted an exhaustive survey to identify companies that are truly "great," defined as those which generated, over fifteen years, cumulative stock returns that exceeded the market by at least three times. Of the nearly 1,500 companies that Collins surveyed, not one of the "great" companies had a high-paid, celebrity CEO.[14] Such celebrity CEOs turn a company into "one genius with 1,000 helpers," taking focus away from the motivation and creativity needed from all of a company's employees.[15]

It is for this reason that investment analysts have begun calling for enhanced disclosure requirements to enable comparisons of CEO pay to the key company expenditures that actually drive a company's success, such as compensation for other employees and research and design.[16] Moody's Investors Services, for instance, has

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[11] The Drucker Institute, Comment Letter to the SEC on Section 953(b) of Dodd-Frank, February 17, 2011, http://thedx.druckerinstitute.com/wp-content/uploads/2011/02/SECcomment.pdf.
[12] James Cotton, *Toward Fairness in Compensation of Management and Labor: Compensation Ratios, A Proposal for Disclosure*, Northern Illinois University Law Review, 1997.
[13] Council of Institutional Investors, Corporate Governance Policies, September 29, 2010, http://www.cii.org/CouncilCorporateGovernancePolicies/.
[14] Jim Collins, *Good to Great: Why Some Companies Make the Leap . . . and Others Don't*, (HarperBusiness, 2001).
[15] Interview with Jim Collins, *Great Answers to Good Questions*, Fast Company, August 31, 2001.
[16] Jack T. Ciesielski, *S&P 500 Executive Pay: Bigger Than . . . Whatever You Think It Is*, The Analyst's Accounting Observer, Vol 20, No. 7, May 23, 2011. For additional commentary from Mr. Ciesielski, see *Paychecks as Big as Tajikistan*, The New York Times, June 18, 2011.

noted that sharp imbalances between CEO pay and that of other key personnel may suggest a weak board and poor decision-making.[17] Additional disclosures, such as the CEO-to-worker pay ratio, will allow analysts to perform fuller assessments of companies, giving shareholders more information to make informed decisions.[18]

The Ratio of CEO-to-Worker Pay Is Material Information

The ratio of CEO-to-worker pay can affect the performance of companies. Because CEO pay levels are publicly disclosed, employees can easily compare their pay to their CEO. It is well documented that organizations with a high disparity of pay between top earners and those at the bottom suffer a decline in employee morale and commitment to the organization.[19] Extreme disparities between CEO and employee pay have been shown to produce significant deterioration in the quality of products produced by employees.[20] A recent study demonstrated that in companies where CEO compensation is strongly disproportionate to that of other employees, the negative impacts extend at least ten levels down the chain of command, resulting in higher employee turnover and lower job satisfaction.[21] Another study found that firms with high levels of CEO pay relative to other top executives have reduced performance.[22]

Although the evidence suggests that CEO-to-worker pay ratios have an impact on employee performance, this does not mean that there is a single "one-size-fits-all" ratio that is optimal for all companies. Some research does document benefits to company performance from pay stratification amongst employees.[23] Yet, these effects taper off and become harmful to companies once pay stratification becomes too extreme.[24] The impacts of pay disparities are particularly strong in industries based on

[17] Moody's Corporate Governance, *Key Governance Features of Investment Grade North American Independent Exploration and Production Issuers*, September 2007.
[18] *See e.g.* Editorial, *The Real Say on Pay*, New York Times, September 1, 2010, arguing that investors need company-specific data on CEO to worker compensation ratios in order to facilitate analyses of the effects that pay structures have on company performance and the broader economy.
[19] *See e.g.* Jeffrey Pfeffer, *Human Resources from an Organizational Behavior Perspective: Some Paradoxes Explained*, Journal of Economic Perspectives, Vol. 21 (2007).
[20] Douglas Cowherd and David Levine,*Product Quality and Pay Equity Between Lower-Level Employees and Top Management*, Administrative Science Quarterly, Vol. 37 (1992).
[21] Matt Bloom and John Michel, *The Relationships Among Organizational Context, Pay Dispersion, and Managerial Turnover*, Academy of Management Journal, (2002). *See also* James Wade, Charles O'Reilly III, and Timothy Pollock, *Overpaid CEOs and Underpaid Managers: Fairness and Executive Compensation*, Organization Science (2006), finding the same effects stretching down at least five levels down the chain of command.
[22],Lucian Bebchuk, Martijn Cremers, and Urs Peyer, *The CEO Pay Slice*, September 2010, forthcoming in the *Journal of Financial Economics*.
[23] *See e.g.* Daniel Dinga, Syed Akhtarb and Gloria L. Ge, *Effects of Inter- And Intra-Hierarchy Wage Dispersions on Firm Performance in Chinese Enterprises*, The International Journal of Human Resource Management, Vol. 20 (2009).
[24] Nils Braakmann, *Intra-Firm Wage Inequality and Firm Performance – First Evidence From German Linked Employer-Employee-Data*, February 14, 2008, http://www.uni-graz.at/socialpolitik/papers/Braakmann.pdf.

technology, creativity, and innovation.[25] These sectors are crucial to America's future economic success, and they depend significantly on the ability of employees to collaborate, share ideas, and function effectively as teams, all of which are damaged by extreme differentials in compensation amongst employees.[26]

Companies with high levels of employee morale have outperformed their competitors. In 1998, *Fortune Magazine* began to publish an annual ranking of the "100 Best Companies to Work for in America." This list was based on extensive surveys that asked employees about the fairness of their companies' compensation policies, their attitudes towards management, whether they felt respected at work, and their overall job satisfaction. Starting in 1998, $100,000 invested in a weighted index of the "Best Companies to Work for in America" would have grown to about $240,000 as of 2009, compared with only $150,000 in value for the same money invested in the stock market as a whole.[27] That's an average of 4.1% better performance per year, according to a recent study by Alex Edmans, Assistant Professor at the University of Pennsylvania's Wharton School of Business.[28] Given that executive pay disparities impact employee morale, and that employee morale impacts company performance, investors have every reason to consider the ratio of CEO to median worker compensation to be a highly material metric informing their investment decisions.

Median Employee Pay Data Is Also Valuable For Investors

Section 953(b) requires that companies disclose the median compensation level of all company employees. Because mathematical averages are skewed by high levels of executive pay, the disclosure of median employee compensation levels will best represent the compensation received by a typical company employee. This information will provide investors with valuable insight to how their companies compensate their employees. For many companies, the cost of employee compensation and benefits is the company's largest expense. However, few companies provide their investors with any disclosure of how this compensation is allocated across their workforce.[29]

There are a variety of reasons why median employee pay levels are material to investors. Fundamentally, higher wages suggest that a company is making strategic investments in human capital, something not as readily apparent based on existing corporate disclosures. Human capital was less important 100 years ago, when workers

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[25] *See* Phyllis Siegel and Donald C. Hambrick, *Pay Disparities Within Top Management Groups: Evidence of Harmful Effects on Performance of High-Technology Firms*, Organization Science, Vol. 16 (2005). *See also* Aneika L. Simmons, *Organizational Justice: A Potential Facilitator or Barrier to Individual Creativity*, Doctoral Dissertation, Texas A&M University, December 2006.
[26] Phyllis Siegel and Donald C. Hambrick, *Pay Disparities Within Top Management Groups: Evidence of Harmful Effects on Performance of High-Technology Firms*," Organization Science, Vol. 16 (2005).
[27] *Investing in Happy Workers, Profiting from Happiness*, The Economist, February 17th, 2009.
[28] Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, Journal of Financial Economics, March 30, 2011.
[29] Notable examples of companies that have voluntarily disclosed employee compensation data to their investors include MBIA and Whole Foods. Other companies such as El Paso and Intel disclose that they consider pay equity issues when setting executive compensation.

performed simple tasks with easily measurable outputs. In such situations, the knowledge and motivation of employees was relatively unimportant.[30] Modern tasks are more difficult to quantify and assess, and require more nuanced skills.[31] For firms whose business success depends on such tasks, the increased motivation and decreased turnover that come from higher wages and more equitable pay structures can be crucial.[32]

It is this investment in human capital that has been a key factor, amongst others, in allowing Costco to outperform Wal-Mart, even while paying an average of $17/hour instead of $10/hour to employees in similar positions.[33] Similarly, higher pay levels may indicate that a company pays “efficiency wages,” i.e., more than the minimum level needed so that the company can attract the best qualified employees and improve employee productivity.[34] Relatively higher levels of median employee compensation may also make it easier to retain workers and reduce employee turnover. Finally, higher employee pay levels likely indicate that a company employs a workforce that is relatively highly skilled. As pay information becomes publicly available, investors will be able to make more informed investment decisions based on more accurate assessments of companies’ investments in human capital.

Some critics of Section 953(b) have argued that investors will be misled by CEO-to-worker pay disclosure. To be sure, companies in different industries will disclose different pay levels and ratios. A Wall Street investment bank will likely have very different employee compensation numbers compared to a retail department store company. Yet the same argument could be made with regards to a company’s debt-to-equity ratio, gross profit margin, return on equity, or any number of other financial ratios. The point of disclosure is not to give a single figure that completely describes a company, but to provide another data point that helps investors get a fuller understanding of their company’s compensation practices.

Companies are free to supplement their Section 953(b) disclosures with their own narrative discussion of their workforce compensation practices. For example, a company that has many employees offshore could provide a compensation breakdown of its U.S. and international workforces. Companies that have a large number of part-time employees could provide a compensation breakdown of their full-time and part-time employees. Compensation consultant firm Radford has recommended that their clients offer more specific data and fuller explanations of their compensation structures

[30] Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, Journal of Financial Economics, March 30, 2011.
[31] *Id.*
[32] *See* the research of scholars such as Matt Bloom, Charles O'Reilly, and others, cited above.
[33] *See* Wayne Cascio, *Decency Means More than “Always Low Prices”: A Comparison of Costco to Wal-Mart’s Sam’s Club,* Academy of Management Perspectives, Vol. 20, August 2006.
[34] *See e.g.,* George Akerlof and Janet Yellen, Eds., *Efficiency Wage Models of the Labor Market,* Cambridge University Press, Cambridge UK (1987). *See also* George Akerlof, *Labor Contracts as Partial Gift Exchange*, Quarterly Journal of Economics, Vol 97 (1982).

and strategies.[35] The Securities and Exchange Commission could also require this type of supplemental disclosure under the Securities Exchange Act of 1934.

Conclusion

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 is valuable to investors for many reasons. Most importantly, CEO-to-worker pay ratio disclosure will encourage a moderation of the level of CEO pay by highlighting the effect of pay disparities on employee morale and productivity. These disclosures will give investors context to assess whether compensation is being awarded broadly across the entire company or concentrated at the top. Furthermore, CEO-to-worker pay disclosure will help investors identify companies that are likely to have satisfied and motivated workforces, and those that are investing in their human capital, both of which have been shown to be reliable indicators of profitable and successful companies.

[35] Radford Consulting, *Dodd-Frank Act: The Importance of Putting CEO Pay Multiples Into Context*, November 16, 2010.

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How The SEC Can Minimize Dodd-Frank Section 953(b) Compliance Costs By Permitting the Use of Statistical Sampling to Calculate the Median

Introduction

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 instructs the U.S. Securities and Exchange Commission (the "SEC") to amend the executive compensation provisions of Regulation S-K, Item 402, so as to require companies to disclose the median annual total compensation of all employees apart from the chief executive officer, the total annual compensation of the chief executive officer, and the ratio between these two numbers. Critics of Section 953(b) have argued that companies may incur significant compliance costs if they are required to perform complex calculations to determine the total compensation for each company employee in order to determine the median.

The text of Section 953(b) is silent on how companies are to calculate the median annual total compensation of all employees. Because Section 953(b) does not define how the median should be calculated, the SEC has the latitude to permit companies calculate the median based on a statistical sample of their employee population. As we illustrate below, other federal agencies that calculate median figures – such as the Census Bureau or the Bureau of Labor Statistics – use sampling methodology. This approach will minimize Section 953(b) compliance costs while at the same time providing investors with the median annual total compensation of all employees with a high degree of statistical accuracy.

Interpreting the Statutory Text of Section 953(b)

Section 953(b) instructs the SEC to amend 17 C.F.R. § 229.402 (Regulation S-K, Item 402) to require issuers to disclose, in any filing described in 17 C.F.R. § 229.10(a) (Regulation S-K, Item 10):

> (A) the median of the annual total compensation of all employees of the issuer, except the chief executive officer (or any equivalent position) of the issuer;
> (B) the annual total compensation of the chief executive officer (or any equivalent position) of the issuer; and
> (C) the ratio of the amount described in subparagraph (A) to the amount described in subparagraph (B).

Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, Title IX, Subtitle E, § 953(b), 124 Stat. 1904 (2010).

The Act further states that "[f]or purposes of this subsection, the total compensation of an employee of an issuer shall be determined in accordance with section 229.402(c)(2)(x) of title 17, Code of Federal Regulations, as in effect on the day before the date of enactment of this Act." *Id.* CFR Section 229.402(c)(2)(x) provides a

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formula for the disclosure of chief executive officer total compensation in company proxy statements. By fixing this total compensation formula according to the date that the Dodd-Frank Act became law, compliance costs are reduced because companies will not need to update their payroll systems if CFR Section 229.402(c)(2)(x) is amended.

Section 953(b) notably calls for disclosure of "median" employee compensation levels. In contrast to the average or "mean" statistic, the median is considered to be a more reliable statistical description of skewed distributions (such a sample of income data when there are highly-compensated outliers in the population). *See* George W. Snedecor & William G. Cochran, *Statistical Methods*, 136 (8th ed. 1989). By requiring that issuers report median employee compensation instead of mean employee compensation, Section 953(b) will provide investors with a more representative statistic of what the typical employee of a company receives in total compensation.

While Section 953(b) is clear on how the total compensation of an employee is to be calculated, it does not specify how the "median" is to be measured. As discussed below, Section 953(b)'s silence on the term "median" gives the SEC the necessary regulatory flexibility to permit companies to use statistical sampling to determine the median. The word "median" is a statistical term that is frequently used to describe the characteristics of a set of random observations taken from a larger population. For example, the *Concise Oxford Dictionary of Mathematics* provides a simple definition of the median by reference to statistical sampling:

> **median** (in statistics) Suppose that the observations in a set of numerical data are ranked in ascending order. Then the (sample) median is the middle observation if there are an odd number of observations, and is the average of the two middlemost observations if there are an even number […]

Christopher Clapham & James Nicholson, *Concise Oxford Dictionary of Mathematics*, 294 (3d ed. 2005). This definition of the median as a description of a set of observations is widely used given that a great deal of modern statistics is based upon the ability to draw conclusions about a large population by studying the characteristics of a smaller set of random observations of that population.

Chevron Deference and the Use of Statistics in Administrative Agency Rules

The U.S. Supreme Court has recognized a two-step test under which courts are to defer to the interpretations of a law supplied by an administrative agency tasked with implementing that law. Under the *Chevron* doctrine, a reviewing court will ask first whether the meaning of a statute is clear or whether "the statute is silent or ambiguous with respect to the specific issue." *Chevron U.S.A. Inc. v. Natural Res. Def. Council*, 467 U.S. 837, 843-44 (1984). If the statute is silent or ambiguous, the court will secondly ask whether the agency's interpretation is "reasonable" and whether it is "based on a permissible construction of the statute." *Id*. If both of these requirements are met, the court will defer to the agency's interpretation of the statute, rather than supplying the court's own. *Id.* at 843.

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In *Zuni Pub. Sch. Dist. No. 89 v. Dep't of Educ.*, 550 U.S. 81 (2007), the Supreme Court established that *Chevron* deference is pertinent when an administrative agency issues regulations that specify the procedure by which a statutorily mandated statistical test is to be performed. In *Zuni*, the statute in question called for the Secretary of Education to make certain funding decisions that required identifying school districts in each state "with per-pupil expenditures . . . above the 95th percentile or below the 5th percentile of such expenditures . . . in the State." *Id.* at 84 (quoting 20 U.S.C. § 7709(b)(2)(B)(i) (2000)). Because the law at issue in *Zuni* did not specify how these percentiles were to be calculated, the Secretary of Education promulgated regulations stating that the percentiles were to be calculated based on the total number of pupils in each district. *Id.*

The plaintiffs in *Zuni* were several school districts that received less funding under the Secretary's method of calculating percentiles than they would have under an alternate methodology, which they claimed was the only permissible reading of the statute. 550 U.S. 81, 88-89. The plaintiffs argued that this statutory language about disregarding "per-pupil expenditures . . . above the top 95^{th} or below the 5^{th} percentile" required the Secretary to count the number of school districts meeting these standards rather than consider the number of pupils per district. *Id.* at 89.

Nevertheless, the Court found that the statute, by simply calling for a calculation based on certain percentiles, left sufficient ambiguity to permit the agency to issue regulations providing procedures for calculating those percentiles. *Id.* at 99. The Court further found that the procedures provided by the regulation were a reasonable interpretation of the statute. *Id.* In support of this conclusion, the Court reasoned that calculation methods such as this are "the kind of highly technical, specialized interstitial matter that Congress often does not decide itself, but delegates to specialized agencies to decide." *Id.* at 94.

The Court further quoted from a number of dictionaries and professional manuals to indicate that the term "percentile" is open to a variety of meanings and calculation techniques. *Id.* at 95. Notably, one of these sources, quoted directly by the Court, was the *Concise Oxford Dictionary of Mathematics*, which stated that in some instances, percentiles can be "applicable to . . . a large sample ranked in ascending order." *Id.* (quoting Christopher Clapham & James Nicholson, *Concise Oxford Dictionary of Mathematics*, 378-89 (3d ed. 2005)). Finally, the Court examined the legislative history of the statute, and found nothing to suggest that the Secretary's interpretation and calculation technique would run counter to the intent of Congress in passing the law. *Zuni*, 550 U.S. at 90.

Section 953(b) is "Silent or Ambiguous" on the Methods to be Used in Calculating the Median of the Annual Total Compensation of All Employees of an Issuer

Section 953(b), by calling for reporting of median employee compensation but not specifying how that median is to be calculated, "is silent or ambiguous with respect

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to [that] specific issue." *See Chevron,* 467 U.S. 837, 842-43. Where the drafters of Section 953(b) wanted to be explicit about calculation methodologies, they clearly knew how to do so. Section 953(b)(2) specifically provides for the exact values to be used in calculating the total value of the median employee's compensation. That Congress did not use this same level of specificity to describe the statistical procedures for identifying the median suggests that this is "the kind of highly technical, specialized interstitial matter that Congress often does not decide itself, but delegates to specialized agencies to decide." *See Zuni*, 550 U.S. at 94.

The only way in which this language could be viewed as specific enough to provide the "unambiguously expressed intent of Congress," *Chevron,* 467 U.S. 837, 843 (1984), would be if the word "median" possessed a single, clear definition that explicitly included procedures for calculating it in a situation such as this. The Supreme Court in *Zuni* recognized that there may be multiple ways of analyzing a large set of multi-variable figures, and thus rejected the notion that a single term could fully encapsulate the complexities of modern statistical practices. 550 U.S. at 95. As the Court remarked:

> We are not experts in statistics, but a statistician is not needed to see what the dictionary does not say. No dictionary definition we have found suggests that there is any *single* logical, mathematical, or statistical link between, on the one hand, the characterizing data (used for ranking purposes) and, on the other hand, the nature of the relevant population or how that population might be weighted for purposes of determining a percentile cutoff.

Id. at 96 (emphasis in the original).

Moreover, the fact that Section 953(b) calls for the SEC to implement its disclosure provisions by regulation indicates that Congress anticipated the SEC would play a role in shaping the implementation specifics for this provision. Section 953(b) could have bypassed regulation altogether by simply making its disclosure requirements mandatory as a matter of law. Alternatively, Section 953(b) could have provided specific language to insert into the regulation, stipulating that the SEC was to insert that language and no more. Yet, Section 953(b) does neither of these.

Instead, Section 953(b) calls for its provisions to be incorporated into Reg. S-K Item 402, which is itself a complex yet at times flexible document, created through years of discretionary rulemaking by the SEC. Throughout Reg. S-K, Item 402 the SEC provides clarification for calculation techniques. *See, e.g.,* 17 C.F.R § 229.402 (2011), Instructions to Item 402(c)(2)(viii), providing procedures for calculating the value of interest on deferred compensation. Item 402 also provides for exceptions and flexibility in certain circumstances. *See, e.g.,* 17 C.F.R § 229.402 (2011), Instructions to Item 402(a)(3), exempting reporting on executives making less than $100,000 / year.

Indeed, it would seem quite unusual for new provisions to be added to Item 402 in a way that denied the SEC any discretion in issuing the specific instructions and guidance that characterize the document. There is nothing to suggest that this is what Congress intended Section 953(b) require. Thus, in no way does Section 953(b) "unambiguously express[] [the] intent of Congress," with regards to every methodological detail for performing the statistical calculations it mandates. Rather, Section 953(b) identifies a clear objective of information to be disclosed and then provides great specificity with regards to some aspects of its application while leaving others to the practical experience and technical expertise of the SEC to implement.

The Use of Statistical Sampling to Calculate the Median is a "Reasonable" Interpretation of Section 953(b) and Therefore Would Receive *Chevron* Deference

Given then that Section 953(b) contains ambiguity with regards to calculating the median, the next question under the *Chevron* analysis is whether the SEC's resolution of that ambiguity by implementing a statistical sampling methodology would be a "permissible construction of the statute." *Chevron,* 467 U.S. 837, 842-43. As society and administrative processes have become more complex and data driven, the use of statistics within government functions has increased. Numerous laws[1] and even larger numbers of regulations[2] now mention the use of statistical calculations. Because statistics is a vast and often highly technical subject matter, it is not surprising that Congress has generally not attempted to precisely define in legislation how particular calculations are to be performed.[3]

By the standards established in *Chevron* and *Zuni*, a regulation implementing Section 953(b) by use of a statistical sampling technique to calculate median employee compensation would clearly be a permissible interpretation of the Dodd-Frank Act. Again, *Zuni* is very closely analogous, in that it upheld an agency's procedures for calculating a statistic whose use was required by statute. 550 U.S. 81. In fact, the Secretary of Education's regulations in question in *Zuni* permitted the use of statistical sampling for counting the number of pupils in each school district. The regulations provided that the number of pupils in each district, an essential number for determining the percentiles, was to be calculated "in accordance with whatever standard measurement of pupil count is used in the State." *Id.* Appendix A.

Such state methods in *Zuni* often use sampling and estimation techniques. *See, e.g.,* Michigan's provisions, MCLS § 388.1606(4) (Bender 2011), providing for

[1] *See*, *e.g*., 12 U.S.C. § 1703 (2006), referencing median house price; 42 U.S.C. § 300g-3 (2006); referencing water safety standards calibrated to the 90th percentile of sampling; 42 U.S.C. § 1395x capping payments for health services at 105% of the median payments for such services; etc.
[2] *See*, *e.g.*, 40 C.F.R. § 799.9120 (2011), providing for the use of medians in toxic substance tests; 7 C.F.R. § 246.7 (2011), restricting certain payments to families below 50% of the median income in an area; 10 C.F.R. § 835.2 (2011), requiring calculation of median particle size within an aerosol; etc.
[3] *See*, *e.g.*, 42 U.S.C. § 8624 (2006), restricting certain federal aid payments to families below 60% of state median income, but not specifying calculation procedures for that median figure; *see also* 45 C.F.R. § 96.85 (2011), a regulation implementing 42 U.S.C. § 8624 and specifying the procedures for calculating the required median figures.

estimation of school district populations based on attendance figures for all pupils for every school day statewide, but rather on two annual "pupil membership count day[s]." Furthermore, not only did the procedures in *Zuni* also involve the potential use of statistical sampling, the regulation in question actually delegated to a group of third parties, the states, the task of deciding whether and how the sampling would be conducted. 550 U.S. 81,103, Appendix A. Thus, in many ways *Zuni* upheld a regulation that provided for a far broader range of interpretation of the original statute than would be the case in this situation, in which the SEC could specify the procedures for the statistical sampling rather than delegating the decision to third parties.

Section 953(b) and the statute at issue in *Zuni* are far from the only instances in which statutes call for the use of statistical measures without specifying procedures for their calculation, thereby leaving administrative agencies to fill in the specifics via regulation. For instance, 42 U.S.C. § 8624 provides for a Low Income Energy Assistance Program, funded by the federal government but administered by states. The law specifies that payments cannot go to households with incomes above "60 percent of the State median income." 42 U.S.C. § 8624 (2006). The law says nothing more about this "median income" figure or how it is to be calculated. A regulation, however, promulgated by the Department of Health and Human Services, specifies that this calculation can be made using "state median income estimates." 45 C.F.R. § 96.85 (2011).

These state median income estimates are generated by the federal government, based on a sampling procedure conducted by the US Census. *See* State Median Income Estimate for a Four-Person Family: Notice of the Federal Fiscal Year (FFY) 2011 State Median Income Estimates for Use Under the Low Income Home Energy Assistance Program (LIHEAP) 75 Fed. Reg. 26780-82 (May 12, 2010); *See also* U.S. Dept. of Commerce, Economics and Statistics Administration, U.S. Census Bureau, *Design and Methodology, American Community Survey (2009)*, available at http://www.census.gov/acs/www/methodology/methodology_main/ for a description of the Census' sampling methodology and statistical estimation techniques.

An additional reason why statistical estimation techniques of the median are a reasonable interpretation of Section 953(b) is that Reg. S-K, Item 402, the regulation that Section 953(b) modifies, already makes use of estimation techniques for other figures it requires issuers to disclose. For instance, the instructions to Item 402(c)(2)(vii), Section 2(A), provides for the reporting of the actuarial present value of accumulated pension benefits. Such an actuarial valuation is by definition an estimate, based upon educated guesses concerning life expectancy, interest rates, and so on. The fact that Item 402 already makes use of estimation techniques for reported figures further supports the notion that the additional Item 402 reporting requirements under Section 953(b) could be calculated using estimation techniques.

The use of sampling techniques to implement Section 953(b) is also a reasonable statutory interpretation because it comports with well-established practices in statistical calculations of median income. Calculations of median income are in fact

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one of the most common instances in which statistical sampling techniques are used to estimate a median value. *See* George W. Snedecor & William G. Cochran, *Statistical Methods*, 136 (8th ed. 1989). As noted above, such sampling and estimation is used by the U.S. Census in its calculations. A similar methodology is also used by the Bureau of Labor Statistics. *See* United States Department of Labor, Bureau of Labor Statistics, *Technical Notes for May 2010 OES Estimates*, available at http://www.bls.gov/oes/current/oes_tec.htm for a description of its methodology.

Conclusion: The SEC May Permit Use of Statistical Sampling to Calculate the Median of the Annual Total Compensation of All Employees of an Issuer

Section 953(b) does not specify how issuers must calculate the median of the annual total compensation of all employees. Because the median is a statistical term used to describe a set of observations, it is reasonable for the SEC to permit issuers to sample their employee populations to calculate the median. This approach will provide highly accurate information to investors with reduced compliance costs for issuers.

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