December 1, 2013

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

File Number S7-07-13 Pay Ratio Disclosure

Dear Ms. Murphy,

I submit this comment letter in response to SEC Release No, 33-9452; 34-70443 (2013) regarding Pay Ratio Disclosure. This Release discusses the benefits and costs to investors and others of pay ratio disclosure.

Congress has already determined that there are benefits of pay ratio disclosure with its act of passing Section 953(b) of the Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). It has not given to the Commission discretion to determine whether such disclosure is required but only the manner of such disclosure. Subsequent to the passage of the Dodd-Frank Act, Congress has had the opportunity to pass bills that would repeal the Dodd-Frank Act as a whole or Section 953(b) in particular but it has declined to do so.1 The disclosure of the pay ratio therefore represents the will of Congress.

The Commission's discussion of the benefits of disclosure, however, is relevant in assuring itself that the costs of compliance are not unduly high. It is in this context that I discuss in this letter one of the benefit of the pay ratio disclosure that may assist the Commission in its evaluation of the benefits of such disclosure. In my research I found that large pay disparities contribute to an unethical culture within corporations.2 This is a topic material to investor and shareholders as well as employees. Large pay disparities constitute a message by corporate leaders to employees about the values of the corporation they work for. Scholars have stressed the importance of corporate leaders in setting the moral tone for their corporations.3 Moreover

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[1] H.R. 87, 112th Congress; H.R. 1135, 112th Congress.

[2] Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and Their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L. J. 1, 36-38 (2003)

[3] *Id.* at 40-42; Mary Zey-Ferrell & Larry G. Gresham, *A Contingency Framework for Understanding Ethical Decision-Making in Marketing*, 49 J. MARKETING 87, 91 (1985); W. Michael Hoffman et al., *Integrating Ethics into Organizational Cultures*, in BUSINESS ETHICS 39, 43-44 (Chris Moon & Clive Bonny eds., 2001); Chris Moon & Clive Bonny, *Attitude and Approaches*, in BUSINESS ETHICS 22, 28-30, 34 (Chris Moon & Clive Bonny eds., 2001); Randall S. Upchurch & Sheila K. Ruhland, *The Organizational Bases of Ethical Work Climates in Lodging*

they have classified firm cultures as selfish (instrumental-egotistical), benevolent or principled, finding that selfish cultures contribute to unethical behavior within firms.4 Corporate leaders send a message to others working within their corporations when they pay themselves enormous pay packages. They make individual self-interest particularly salient. Large disparities in compensation, as indicated by the pay ratio, contribute to employees' perception of this message from their leaders that the corporation's main function is to serve individual self interest.5 In contrast low pay disparities encourage and validate an attitude of caring and principled behavior within the corporation.

A compensation system that is perceived by employees as fair also contributes to an ethical culture within the corporation.6 One scholar notes, "[t]he importance placed on fairness is related less to the possibility that pay inequities will result in lower effort among disgruntled employees than to a larger concern with creating a set of corporate values that will be perceived as legitimate and moral by the work force."7 Large pay disparities send a negative message concerning the legitimacy and morality of corporate authority.

Finally, large disparities indicate a psychological distancing of the CEO from the human relationships that contribute to the corporation's success or failure.8 Instead CEOs and other executive officers have focused on stock prices which has often resulted in earning management through cost cutting measures. This short-termist behavior is not beneficial to long-term shareholders and employees of corporations.9

Both investors and employees understand the value of a disparity between the pay of the CEO and the median employee, but the magnitude of this disparity has grown at alarming rates over the years. CEOs in 1965 earned 20.13 times more than an average worker, which increased

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Operations as Perceived by General Managers, 15 J. BUS. ETHICS 1083 (1996); James C. Wimbush & Jon M. Shepard, *Toward an Understanding of Ethical Climate: Its Relationship to Ethical Behavior an Supervisory Influence*, 13 J. BUS. ETHICS 637, 642 (1994).

[4] Dallas, *supra* note 2, at 25-32; Bart Victor & John B. Cullens, *The Organizational Bases of Ethical Work Climates*, 33 ADMIN. SCI. Q. 101, 104-113(1988)(developing the ethical classification system for corporate cultures); Wimbush et al., *Empirical Examination of the Multi-Dimensionality of Ethical Climate in Organizations*, 16 J. BUS. ETHICS 67, 74-75 (1997) (finding support for this classification system); Wimbush & Shepard, *supra* note 3, at 641 (finding that the self-interested cultures foster unethical behavior).

[5] Dallas, *supra* note 2, at 36.

[6] *Id*. at 37-38; Peter B. Doeringer, *The Socio-Economics of Labor Productivity*, in MORALITY, RATIONALITY, AND EFFICIENCY 108 (Richard M. Coughlin ed, 1991); Moon & Bonny, *supra* note 3, at 29 (discussing a 1999 employee survey demonstrating that fairness was one of the most important factors in a successful ethics program); Harvey S. James, Jr., *Reinforcing Ethical Decision-Making Through Organizational Structures*, 28 J. BUS. ETHICS 43, 54 (2000).

[7] Doeringer, *supra* note 6, at 108-109 (citations omitted).

[8] Lynne L. Dallas, *The New Managerialism and Diversity on Corporate Boards of Directors*, 76 TULANE L. REV. 1363, 1378 (1378) (hereinafter *New Managerialism*); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. Corp. L. 265, 321 (2012) (hereinafter *Short-Termism*).

[9] Dallas, *New Managerialism*, *supra* note 8, at 1380-83; Dallas, *Short-Termism*, *supra* note 8, at 278-281, 320-21, 355-56.

in 1989 to 55.9 times, in 1999 to 106.9 times, and in 2007 to 275 times.[10] These disparities signal negative consequences for a number of reasons, including its impact on the ethical culture of corporations as I have explained in this letter.[11] Ethical corporate cultures have become increasingly important and have a dramatic impact on both investors and the economy generally, as exhibited by the contributions of corporate cultures to the financial scandals of the early 2000s and the recent financial crisis.[12]

Disclosure of pay ratio information will assist investors and employees in demanding changes in the pay structures of corporations which are central to ethical corporate cultures and over time these large disparities may decrease substantially. This disclosure provides a focal point for discussion and is expected to influence corporations to move in a positive direction. That some corporations have voluntarily disclosed such ratios is a strong indication of their materiality to investors.

In conclusion, a number of benefits have been put forward for the pay ratio disclosure, including the benefits discussed in this letter. In my opinion the Commission should recognize that although these benefits are often heavily supported by experts in their field, in general benefits are usually more difficult to quantify than the costs of compliance. This difficulty, however, should not result in the Commission placing a heavier weight on the scale for compliance costs. After all, the values represented by benefits are often more intangible. Additionally, they are based on a proposed state of affairs that does not currently exist. Moreover, they often involve predictions of behavior that are difficult to disentangle empirically from other factors and developments. Note also that over-reliance on quantified values or numbers has its own problems. Consider, for example, the contributions to the financial crisis of over-reliance on the prices of derivatives and mathematical modeling. As for compliance costs, in my view the Commission has admirably decreased the cost of compliance with the pay ratio requirement by providing corporations with various options for calculating the ratio. At this point the options seem advisable. Experience with these options will allow the Commission to reassess in the future whether modifications are necessary to assure meaningful disclosure. Too much flexibility may undermine the comparability and meaningful nature of the pay ratio disclosure required. Moreover, coupling the ratio disclosure with adequate disclosure of the methodologies used and requiring an audit of the underlying data and calculations may contribute to its reliability.

Thank you very much for your consideration of my letter.

Respectfully,

Lynne L. Dallas,

Professor of Law

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[10] LAWRENCE MISHEL ET AL., THE STATE OF WORKING AMERICA 2000/2001, at 211 (providing data for the years 1965, 1978, 1989 and 1999; David J. Morrissey, *Executive Compensation and Income Equality*, 4 WM & MARY BUS. L. REV. 1, 13 (2013 (providing data for the year 2007).

[11] As others have offered in comment letters in response to the Commission's Release on Pay Ratio Disclosure, large disparities have a negative impact on loyalty and teamwork within corporations and encourage a tournament mentality.

[12] Dallas, *Short-Termism*, *supra* note 8, at 316-23, 355-61 (exploring the culture of financial and nonfinancial firms); Dallas, *supra* note 2, at 45-55 (discussing Enron's culture).