

More Transparency Required: PG&E as A Model

Dear Chairman Cox,

The Greenlining Institute hereby submits the following comments in response to the Securities & Exchange Commission (SEC or Commission)'s request for public comments on its Proposed Rules Executive Compensation and Related Party Disclosure (SEC File No. S7-03-06).

The Greenlining Institute

The Greenlining Institute is a multi-ethnic, economic development and advocacy organization working to advance corporate citizenship and responsibility, including executive compensation based upon performance. In the past three years, Greenlining has raised executive compensation issues in a broad range of cases including those affecting AT&T, Verizon, Southern California Edison, and Pacific Gas & Electric. Further, Greenlining has taken the lead role in the California Public Utility Commission's holding company proceeding that will examine not only transparency but appropriateness of executive compensation packages.¹

Executive Summary

Greenlining commends the SEC and Chairman Cox for a good first step in terms of corporate transparency, including requiring the generally hidden severance packages and retirement packages to be appropriately valued. Greenlining, however, believes that the proposed transparency is insufficient, that there are corporate models that should be used to expand the proposed transparency rules, and, most importantly, that transparency for executive compensation requires a frame of reference.

Specifically, Greenlining urges that all officers of corporations should be subject to the SEC rules, much as the SEC is subjecting all directors to its corporate transparency rules. Pacific Gas & Electric, with some input from Greenlining, has developed such a corporate transparency model and since 2004, it has filed annually with the CPUC and on-line.

Secondly, as critics of executive compensation have stated, excessive executive compensation cannot be reigned in merely by traditional corporate transparency methods. See, for example, *The New York Times* April 9 Sunday Business section "Spotlight on

¹ The Greenlining Coalition includes but is not limited to the following groups: Allen Temple Baptist Church; American G.I. Forum; Asian Business Association; Black Business Association; California Hispanic Chambers of Commerce; California Rural Legal Assistance; Chicano Federation; Council of Asian American Business Associations; Filipino-American Political Association; First AME Church, Los Angeles; Hermandad Mexicana Nacional; Hmong American Political Association; Latino Business Association; Latino Issues Forum; MABUHAY; Korean Health Education, Information and Research Center (KHEIR); Mexican-American Grocers Association; Mexican-American Political Association; Oakland Citizens Committee for Urban Renewal (OCCUR); Phoenix Urban League; San Francisco Black Chamber of Commerce; Search to Involve Filipino Americans; Southeast Asian Community Center; TELACU; Vietnamese Community of Orange County, Inc.; West Los Angeles Church of God in Christ; and West Coast Black Publishers.

Pay Could Be a Wild Card.” In this article, it states that a recent poll conducted by Watson Wyatt Worldwide shows that 70% of companies said corporate transparency, pursuant to the SEC rules, would not change their executive compensation policies and only 10% said that it might make a change.²

Since this Commission is not prepared at this time to set forth guidelines for executive compensation, although Greenlining would prefer that the Commission do so, we propose the following additions to corporate transparency that may serve as partial voluntary guidance:

- the executive compensation package for the CEO be referenced to show how many times it exceeds the median and average wages of non-management employees at the company and/or of the average American worker; and
- the aggregate compensation package of the CEO be referenced in regard to cash philanthropy by the corporation directed at nonprofits serving low-income communities.

Thirty years ago, CEO compensation was generally no more than thirty to forty times average worker compensation. Today, it generally exceeds 400 times average worker compensation. Further, no other nation has such a large disparity between average worker compensation and CEO compensation. As the *New York Times* states (“Off to the Races Again, Leaving Many Behind,” April 9, 2006, Sunday Business section), the average pay for CEOs increased 27% in 2005 and is now at \$11.3 million, according to a survey of 200 large companies by Pearl Meyer & Partners. In contrast, recent wage data from the Labor Department states that workers’ weekly pay was up less than 3% and failed to keep pace with even the 2005 inflation rate. As a result, the average pay for a worker is just \$43,000 or up only less than one percent (0.8%) a year over the last 25 years.

To make disclosure of executive compensation actionable by shareholders, Greenlining recommends the following revisions to the proposed rules:

- 1) require compensation transparency by applying disclosure requirements to all the corporation’s officers as PG&E presently does;
- 2) require a plain-language comparison of the CEO’s total compensation with that of the total compensation of the average worker at the CEO’s company; and
- 3) require a plain-language comparison between the CEO’s compensation and the corporation’s cash philanthropy to low-income nonprofits.

² Greenlining also questions the so-called independence or objectivity of executive compensation consulting firms such as Towers Perrin, Watson Wyatt, and Hewitt Associates. According to Greenlining’s expert hired in the executive compensation issues before the CPUC in the Southern California Edison rate and PG&E rate and bankruptcy cases, Hewitt Associates’ independence is highly questionable, and compiled comparative lists of executive compensation merely serve to escalate average executive compensation within the industry. Further, Hewitt Associates, apparently deliberately, or under instructions from top executives, provided no estimates or comparisons of severance packages or retirement benefits for the CEO of other top five executives.

Increase Scope of Disclosure to Achieve Full Transparency.

The proposed rules would require disclosure of compensation packages of a company's 5 highest-paid executives. This would purportedly aid the shareholder to calculate its true agency costs. But can a shareholder truly gain an accurate perception of corporate costs by looking at the compensation of only five employees?

As mentioned above, PG&E instituted a policy of disclosing the compensation packages of its top 25 executives. Representing the only one of its kind among Fortune 500 companies, PG&E's model of transparency should be emulated by its peers in the Fortune 500. Such a model gives the shareholders at PG&E a more complete basis of knowledge from which to measure agency costs.

Providing shareholders with such an opportunity is congruent with the SEC's objective to give investors the information they need to take action. Chairman Cox emphasized this point in his remarks on the proposed rules when he said, "Our job is to ensure that investors have available to them *all* of the compensation information they need, presented in a clear and understandable form that they can use." (emphasis added)³ In no uncertain terms, Chairman Cox stated that it is the job of the SEC to provide all the information that investors need. Greenlining unequivocally concurs with the Chairman's description of the SEC's duty to serve investors.

Those who are interested in keeping a veil of secrecy around compensation packages may assert that the burdens of full transparency would outweigh the benefits. Providing the shareholders with the tools to hold their executives accountable is not a burden at all, but a basic duty of all corporate executives. The main benefit of transparency is the manifestation of a shareholder class that can hold their corporate executives accountable as stewards of their investments.

The proposed rules provide the means to gain a clear understanding of the very top executive compensation packages. But this limited piece of information, although significant, does little to help shareholders develop a complete and fair understanding of executive agency costs. The Commission should not allow executives to escape their duties as stewards of their respective corporations by implementing rules that fall short of full transparency.

Investor Understanding of Executive Compensation is Predicated on Comparison.

Even with full transparency, there seems to be a pervasive sentiment among investors that the SEC's rules will not help them at all. Some investors seem to believe that disclosing information on executive compensation on a wider scale will detrimentally impact their ability to monitor it.

Just before the Commission publicly announced the proposed rules, *The New York Times* reporter, Joseph Nocera, reflected on this sentiment, saying that, "history suggests that

³ Cox, Christopher, *Chairman's Opening Statement to the Proposed Revisions to the Executive Compensation and Related Party Disclosure Rules*, United States Securities and Exchange Commission, Washington, DC, January 17, 2006.

whenever they [CEOs] discover a fellow CEO is getting something they don't have, they make a grab for it. In other words, as laudable as more disclosure is, there is a real possibility that it will make a bad situation worse."⁴

It is true that when negotiating their compensation, CEOs use peers as benchmarks. So even full disclosure, by itself, may exacerbate, rather than remedy, runaway executive compensation.

What is needed is added context. Currently, information on CEO compensation packages will spur other executives to "make a grab for it." If CEO compensation packages are directly compared to the compensation packages of their company's average worker, this added context might shift how corporate constituencies will use this information. Rather than treating information on compensation as a source of competition, it would be a source for moral accountability.

Greenlining, thus, recommends requiring a plain-language comparison of the CEO's total compensation with that of the total compensation of the average worker at the CEO's company. Such a model can be presented in a simple chart, such as the one below:

X Company's CEO Total Compensation Value	\$20,000,000
X's Company's Average Worker Total Compensation Value	\$40,000

Such a comparison is not meant to demonize corporate executives, but to provide proper context to investors. This information would help to remind shareholders of the status of other corporate constituencies who contribute to the welfare of the corporate entity in relation to the CEO.

Michael Phillips, one of the architects of the PG&E compensation transparency model, submitted statements to this Commission emphasizing the moral dilemma of excessive executive compensation. Mr. Phillips discerns that "the current secrecy in reporting executive compensation is partially because executives and their boards of directors sense a public perception of a moral problem."⁵ Mr. Phillips describes the smoke-and-mirrors tactics of executive compensation "disclosure" as a system of *obscurantism*, motivated by less than noble objectives. For example, Mr. Phillips described his experience with one Fortune 100 company's legal officer, who had to spend an hour to find all the separate line items in an annual report to calculate the \$83 million in executive compensation bonuses. The calculation of bonuses was scattered structured like a cat-and-mouse game because the company's executives were trying to obfuscate how they profited while the company was mired in bankruptcy.

But what does obscurantism have to do with salary of an average worker? The answer is that obscurantism leads to inter-corporate agency tension, which hurts investors.

⁴ Nocera, Joseph, "Disclosure Won't Tame CEO Pay," *The New York Times*, January 14, 2006.

⁵ Phillips, Michael, statement submitted to SEC (File No. S7-03-06), Feb 13, 2006.

“Investors can be hurt directly when secret agreements are discovered by entities such as unions who proceed to cancel contracts after finding out guarantees for executive pension compensation. Such was the case with American Airlines.”⁶

Providing informational assessment in addition to disclosure can avoid the surprise of employee discontent. This assessment will give shareholders the tools to pre-empt the inefficient and unprofitable results of management-labor tension.

Informational assessment may also make investors less susceptible to inaccurate appraisals of how agency costs affect the bottom line. The Corporate Library reports that in 1993, compensation of the top 5 executives of US public companies took up an average of 4.8% of company profits.⁷ In 2003, the compensation of the top 5 executives usurped an average of 10.3% of corporate profits.⁸ In other words, more than 10% of an average corporation’s profits were given to 5 individuals! So the next time executives recommend cutting costs by laying off employees, investors will at least have a better idea of which agency cost is truly affecting profits and share dividends.

Disclosure of executive compensation, by itself, is insufficient for investors to make informed decisions on fundamental issues that affect their return on investment. Requiring plain-language comparisons between executive compensation and average worker salaries will give investors the depth of information to hold executives accountable as stewards of corporate entities.

The SEC Can Align Investor and Business Interests Through Philanthropy.

The nexus of moral accountability and profitability is not limited to compensatory discrepancy. Investors can also be empowered to employ moral accountability to increase their returns if given the ability to compare executive compensation with the corporation’s cash philanthropy. Greenlining thus proposes that the proposed rules be modified to require a plain-language comparison of executive compensation of the top 25 executives with the corporation’s total cash philanthropy.

Cash philanthropy is a valuable means to provide the proper context to the impact of executive compensation. This is because cash philanthropy, as an investment method, can align shareholder and business interests.

In an interview with National Public Radio (NPR), Chairman Cox described how the proposed rules have sparked another manifestation of the contentious relationship between investors and businesses. More specifically, although the SEC and the US Chambers of Commerce have often been on opposite sides of the table, Chairman Cox asserted that the new rules were drafted because he realized that “the interests of businesses and investors need to be harmonized.”⁹ Philanthropy can harmonize these interests.

⁶ *Id.*

⁷ Bebchuk, Lucian & Grinstein, Yaniv, *The Growth in Executive Pay*, The Corporate Library, 2005.

⁸ *Id.*

⁹ Cox, Christopher, National Public Radio, *Morning Edition*, January 17, 2006.

There are tangible returns to cash philanthropy if a corporation is committed to and strategic about its philanthropic practice. Just as distribution of agency costs affect corporate profits, philanthropic investments (or the lack thereof) can significantly impact investor returns. It would thus be helpful for investors to see a direct comparison between executive compensation and philanthropy to see how revenues that could be spent towards philanthropy are instead allocated to compensation packages of its top 25 executives.

The obvious benefit of philanthropic investment is an enhanced corporate image as well as indirect competitive marketing. Corporate image is a concern across the board as it seems to have reached its nadir following the Enron and WorldCom debacles. But philanthropy can also result in tangible returns in the form of consumer recognition and market share.

Philanthropy helps business owners and investors realize their mutual interest – profit. Because of the harmonizing effect of philanthropy, investors should be given a fair opportunity to assess how executive compensation impacts philanthropic initiatives. Investors should be given the tools to ask themselves, *What is the marginal impact on profits of a \$1 million bonus to the CEO, as opposed to a \$1 million donation to the Martin Luther King, Jr. Community Center in Dallas?* The Commission should thus revise its proposed rules to require a corporate assessment comparing cash philanthropy to executive compensation.

Conclusion

To spur collective action among investors, the SEC must propose rules that will provide information that not just disclose raw numbers, but gives insight as to how those numbers impact the corporate entity. This requires that investors be given a fully transparent audit of executive compensation of more than just a handful of its top executives.

Executive compensation must also be examined within the proper context so that shareholders can properly assess and understand how executive compensation affects returns on investment. As Chairman Cox aptly stated, the proposed rules are about “wage clarity, not wage controls.”¹⁰ Helping the investor attain clarity around issues of executive compensation requires depth of information. Using comparative instruments that enable investors to invoke moral accountability provides this depth of understanding and serves as a pragmatic medium for business decisions.

If investors are only given information focusing exclusively on executive compensation, they will likely misinterpret the rules as an impetus for wage controls. Helping investors attain wage clarity can only be achieved through thoughtful consideration of how executive compensation affects the corporate entity as a whole. Using measures of moral

¹⁰ Cox, Christopher, *Chairman's Opening Statement to the Proposed Revisions to the Executive Compensation and Related Party Disclosure Rules*, United States Securities and Exchange Commission, Washington, DC, January 17, 2006.

accountability addresses the public perception of the moral dilemma of excessive executive compensation while also employing a pragmatic vehicle for profitability. Investors cannot attain wage clarity absent a medium to assess moral clarity.

For all the foregoing reasons, Greenlining respectfully asks that the recommendations set forth above be adopted.

Sincerely,

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