SEC Issues Sanctions for Inadequate Perk Disclosure

July 5, 2018

A rare enforcement action offers a reminder that the SEC takes executive compensation disclosure seriously.

On July 2, 2018, the SEC issued an **order**[1] criticizing an issuer's disclosure of executive perquisites and requiring the issuer to take measures to ensure that its future disclosures comply with SEC standards. The SEC staff alleged that, over the course of 2013 to 2016, annual proxy statements issued by The Dow Chemical Company omitted disclosure of about $3 million worth of perquisites which, according to the staff, should have been disclosed as "other compensation" to its named executive officers in the Compensation Discussion & Analysis (CD&A).

In a surprisingly strong response, the SEC ordered the company to retain an independent consultant for a period of one year to review the company's policies, procedures, controls and training relating to the characterization and disclosure of expense reimbursements and other payments as perks, and to adopt recommendations made by the consultant to ensure compliance with the SEC's rules governing perk disclosure. The company was also charged with violating Rule 14a-9, which prohibits materially false or misleading information in proxy statements, and fined $1.75 million. As is typical in settled SEC enforcement proceedings, the company neither admitted nor denied fault. No individuals were charged.

According to the SEC, the company did not follow SEC guidance for disclosing perks, which provides that:

- "An item is not a perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties."
- "Otherwise an item is a perquisite or personal benefit if it confers a direct or indirect benefit that has a personal aspect without regard to whether it may be provided for some business reason or for the convenience of the company, unless it is generally available on a non-discriminatory basis to all employees."

This standard, adopted as part of the 2006 overhaul of executive compensation disclosure requirements, is notoriously difficult to apply, and determining whether a payment is "integrally and directly" related to job performance is a matter about which reasonable people can sometimes disagree. That said, the SEC took the company to task for applying a standard that it specifically rejected in 2006: a business-purpose test – as long as the payment had a business purpose, the company erroneously concluded that it was not required to be disclosed as a perk. The SEC reiterated a point it first made in 2006 – that the integral-and-direct exception is a "narrow" one that only applies to something that an executive "needs […] to do the job." In this case, the SEC took the view that the company failed to properly include the following as perks: the use of the company aircraft for personal purposes, such as travel to outside board meetings and sporting events; club memberships; use of personal assistant time; and membership fees to sit on the board of a charitable organization.

[1] The SEC also provided an Administrative Summary, which is located **here**.

In addition to faulting the company for failing to disclose the perks as required, the SEC concluded that it had failed to train employees in key roles, including those tasked with drafting the CD&A, and that it maintained inadequate processes and procedures to ensure proper reporting of perks. These findings motivated the SEC to take the somewhat unusual step of demanding that the company retain an independent consultant.

Disclosure lapses involving perks can be difficult for the SEC staff to detect and, as a result, enforcement proceedings of this type are rare. In this case, independent reporting indicates that the alleged lapses were flagged by a former employee who was involved in a publicized dispute with Dow and reportedly notified the SEC of the alleged lapses in a whistleblower claim. In any event, this proceeding, especially the terms of the settlement, serves as a loud reminder that the SEC takes executive compensation disclosure seriously, and will not hesitate to impose sanctions when it finds problems with a company's disclosure practices.

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