Pearl Meyer

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Executive Perquisites: Two Not-so-Simple Steps to Determine if You Should Disclose

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We've heard quite a bit of buzz around executive perquisites over the last month. Ever since the amended disclosure rules were released back in 2007, we've seen very few SEC enforcement actions in the area of failure to disclosure perquisites. Now, in the past week, we've seen two of them! Many of you have been asking whether the rule has changed and the simple answer is no. When we look at the facts behind these actions, however, it's easy to see that the rules have not changed, but companies are clearly going the direction of taking more privilege with the SEC's somewhat flexible definition of a perk for reporting purposes.

In the first reported incident, the SEC issued an order penalizing Dow Chemicals for its inadequate perk disclosure from 2013-2016. In this case, the SEC did an audit and found that the company failed to report around $3 million in value associated with:

- The CEO's personal use of aircraft;
- Travel to outside board meetings;
- Sporting events;
- Club memberships;
- Use of personal assistant time; and
- Membership fees to sit on charitable organization boards.

In response, the SEC:

- Ordered the company to pay a fine for breach of securities disclosure rules of $1.75M;
- Criticized the company not only for failing to disclose, but for not training employees in key roles, including those drafting the CD&A and those keeping track of perks; and
- Ordered the company to retain an independent consultant for 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.

Dow did not admit or deny the charges, and no one person was deemed to be at fault.

While admittedly, there is a lot of gray area in determination of perks for reporting purposes, the Dow disclosure seemed to ignore the basic framework of the rule, which is typically a two-step process:

1. An item is not a reportable perquisite or personal benefit if it is integrally and directly related to the performance of the executive's duties—in the adopting release, the SEC notes that this is to be interpreted narrowly (i.e., you really need it to get the job done); and

2. If the answer to the above is “No,” then the item is a reportable perk 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 nondiscriminatory basis to all employees).

Instead of following the above standards, Dow seemed to incorrectly apply a position that a business purpose (even if tangentially) related to the executive’s job was sufficient to determine that a benefit is not a reportable perquisite. The SEC found that the perquisites described above conferred a benefit on the executive and were not “integrally and directly” related to the job so they should have been disclosed. The SEC rejected the argument that because some of these perks may have had some ancillary benefit to the business, they did not need to be reported.

In the second reported incident, the failure to disclose perks was even more egregious, yet ancillary to the bigger issue of charging a former CEO with hiding more than $10 million in personal loans that he obtained from the company. According to the SEC’s complaint, CEO John D. Schiller Jr. maintained an extravagant lifestyle by using a highly leveraged margin account secured by his Energy XXI stock. The complaint alleges that in 2014, when faced with significant margin calls, Schiller extracted more than $7.5 million in undisclosed personal loans from company vendors in exchange for business contracts with Energy XXI. The complaint also alleges Schiller received undisclosed compensation and perks in the form of lavish social events, first-class travel, a shopping spree, donations to Schiller-preferred charities, legal expenses for personal matters, and an office bar stocked with high-end liquor and cigars. As a result, the SEC found that Energy XXI failed to report at least $1 million in excess compensation in its executive compensation disclosures over a five-year period.

Again, while the test of what is and is not a perk is not crystal clear under the SEC’s guidance, we have been helping clients sort out perk reporting since 2007. Feel free to contact us if you have questions about this or other mandated disclosure issues.

About the Author

Deborah Lifshey is a managing director at Pearl Meyer, where she specializes in advising clients on compensation matters from a legal perspective including securities disclosure, taxation and corporate governance issues, negotiation contracts, and reasonableness opinion letters.

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