



Executive Perquisites: Stealth Compensation at Its Best!



Why the GE case intensified scrutiny from the SEC resulting in stricter disclosure requirements.

By: Brent Longnecker

Jack Welch – a past CEO of GE – might be known for a lot of things, but for me, he will always be the reason the SEC will forever watch, review, and opine on executive perquisites (perks). He had a true stealth package of perks until he decided to divorce his wife of fourteen years and offer her a ridiculously low settlement. As a result, his compensation quickly went from the boardroom to the courtroom. And once known in the courtroom, the SEC took note and would forever change the disclosure required around departed executives AND executive perks.

GE's Reporting Failures Result in Increased Scrutiny on Compensation Disclosures

On September 23, 2004, the SEC wrote:

Washington, D.C., Sept. 23, 2004 — The Securities and Exchange Commission announced today that it has instituted settled enforcement proceedings against General Electric Company. The Commission charged that GE failed to fully describe the substantial benefits it had agreed to provide its former chairman and CEO John F. "Jack" Welch, Jr., under an "employment and post-retirement consulting agreement." GE settled the proceedings by consenting to the entry of an Order that it cease and desist from violating the proxy solicitation and periodic reporting provisions of the federal securities laws.

"Shareholders have a clear interest in knowing how public companies compensate their top executives," said Paul R. Berger, Associate Director of the SEC's Division of Enforcement. "Compliance with SEC disclosure rules ensures that shareholders are provided a full and accurate understanding of senior executives' compensation arrangements."

The Commission found that in proxy statements and annual reports filed with the Commission from 1997-2002, GE failed to fully and accurately describe the retirement benefits Welch was entitled to receive from the company. In December 1996, GE and Welch entered into an "employment and post-retirement consulting agreement" under which Welch agreed to continue as CEO until he was 65 and serve as a consultant thereafter. In the agreement, Welch received, as his principal form of compensation, lifetime access to the perquisites and benefits he had received as GE's chairman and CEO. GE's proxy statements only referred to Welch's entitlement

to “...continued lifetime access to Company facilities and services comparable to those that are currently made available to him by the Company,” but did not provide any other specific information about the “facilities and services” Welch would receive in retirement.

The agreement itself, which was appended as an exhibit to GE’s 1996 annual report, stated that Welch was entitled to receive in retirement “continued access to Company facilities and services comparable to those provided to him prior to his retirement, including access to Company aircraft, cars, office, apartments, and financial planning services,” but did not provide further meaningful and complete disclosure of those “facilities and services.” Moreover, GE made no other disclosures in its SEC filings that allowed investors to understand the nature and scope of Welch’s retirement benefits—specifically, investors could not learn from GE’s previously filed proxy statements many of the most significant “facilities and services” Welch had been provided prior to his retirement, including personal use of GE-owned aircraft, personal use of chauffeured limousines and home security systems.

The Commission further found that in the first year following Welch’s retirement in September 2001, Welch received approximately \$2.5 million in benefits under the agreement, which included access to GE aircraft for unlimited personal use and for business travel; exclusive use of a furnished New York City apartment that, according to GE, in 2003, had a rental value of approximately \$50,000 a month and a resale value in excess of \$11 million; unrestricted access to a chauffeured limousine driven by professionals trained in security measures; a leased Mercedes Benz; office space in both New York City and in Connecticut; the services of professional estate and tax advisors; the services of a personal assistant; communications systems and networks at Welch’s homes, including television, fax, phone and computer systems, with technical support; bodyguard security for various speaking engagements, including a book tour to promote his autobiography *Jack: Straight from the Gut*; and installation of a security system in one of Welch’s homes and continued maintenance of security systems GE previously installed in three of Welch’s other homes.

The Commission concluded that GE’s inadequate disclosures violated Sections 13(a) and 14(a) of the Securities Exchange Act of 1934 and Rules 13a-1, 14a-3, and 14a-9 thereunder. Without admitting or denying the Commission’s findings, GE consented to the issuance of the Order, which orders GE to cease and desist from committing or causing any violations and any future violations of the foregoing statutory provisions and rules.

I’m not here to judge, but Jack and GE should have known better and done a better job for shareholders. But he is not alone, several companies over the years have come under scrutiny for unreasonable perks – including some well-known non-profits. Most notably, United Way – years ago they were thrust into the media limelight due to excessive perks to the national CEO. And one research piece I studied while working on this piece from the University of Chicago called perks “corporate heroin.”

SEC Provides Guidance on Executive Compensation & Perquisites Disclosures

In October of 2004, the SEC gave a speech that focused on executive compensation and perks. It included the following points:

- An important part of the directors' responsibilities is to oversee and properly incentivize and reward management.
- Too many boards operate on the principle that compensation must be in the top half or even the top quartile of some benchmark group, which produces the Lake Wobegon effect, where everyone is above average.
- Too many issuers and their advisors have followed a pattern of opaque or unhelpful disclosure, saying as little as possible, rather than seeking to inform.
- The Compensation Committee must understand each element of executive compensation, the role each plays in motivating short-term and long-term performance, the cost of each, and the total cost.
- The SEC's rules require, and the Compensation Committee is responsible for, the clear, concise, and understandable disclosure of all executive compensation.
- **All** compensation must be disclosed even if "literal compliance" with SEC rules does not require it.
- Inside and outside counsel must remember that their client is the company and not its management in deciding what should be disclosed.
- Personal use of company aircraft and automobiles should be disclosed.
- Serious consideration should be given to properly characterizing many items as perquisites which often are called business expenses (e.g., housing, security systems, automobiles).
- The valuation of perquisites should be carefully examined. The appropriate measure of value is the aggregate incremental cost to the company, not the tax value of the benefit.
- Material deficiencies in disclosure of executive compensation expose companies to potential enforcement actions, citing the proceeding against GE and Mr. Welch.
- Compensation Committee reports should avoid boilerplate. Many committees would benefit from taking a fresh look at their reports.
- There needs to be a better focus on long-term performance, rather than short-term results or limited specific measures.
- The staff is re-examining numerous aspects of its rules regarding executive compensation, including categorizing and valuing perquisites, disclosure of deferred compensation, supplemental retirement, severance, and change-in-control provisions, and disclosure of related party transactions.

Lessons Learned Concerning Executive Perquisites Disclosures

The lessons coming from the SEC's enforcement actions against Tyson, GE, and others include:

- The value of all perquisites and personal benefits must be identified, quantified, and disclosed, subject to the de minimis exception of Item 402(b).
- Perquisites must be described with sufficient specificity and clarity so that stockholders can understand the nature and scope of the benefits.
- The nature and amount of any substantial perquisites should be reported to and authorized by the Compensation Committee or the Board of Directors.
- Compensation Committees should require a tally sheet that identifies and values individually each element of compensation, including salary, bonus, perquisites, and benefits, provided to current and former executives.
- The tally sheets should include both the incremental cost to the company and the true value to the executive of each perquisite.
- The true value of non-cash perquisites, including personal use of company aircraft, limousines, and apartments, must be disclosed.
- The appropriate measure of value is the aggregate incremental cost to the company, not the tax value of the benefits.
- Those responsible for compensation disclosure – including employees, members of the Compensation Committee, and outside lawyers and advisors – may face personal liability for inaccurate or incomplete disclosure.
- Directors and executives are responsible for ensuring that their annual questionnaires and the proxy statement disclosure of their compensation are complete and accurate.
- Distinguish between business expenses and perquisites. The SEC has suggested that one test is whether the expense is available to employees generally on a non-discretionary basis (reimbursement for a taxi across town for a meeting) or whether it is a benefit for a chosen few (commuting on a company aircraft to a personal residence).
- Disclose the specific method of valuing personal use of company aircraft.

Conclusion

The old adage: “Tell the truth, or someone else will tell it for you” is perfect when it comes time for the disclosures of executive pay and perquisites. And besides, we only have one reputation – we should strive to make it the best possible.

Sources

- [SEC Sharpens Focus on Disclosure of Executive Perks](#)
- [General Electric Settles SEC Action for Disclosure Failures in Connection with Its Former CEO's Benefits Under His Employment and Retirement Agreement](#)