SAY ON GOLDEN PARACHUTE

A Look at Say on Pay's Lesser-Known Cousin

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Are golden parachutes delivering what they promise?

Golden parachutes became common in the hostile takeover years of the 1980s, when executives worried about losing their jobs to corporate raiders. The golden parachutes provided executives with lump-sum payments, immediate vesting of equity awards and continued participation in benefits following a change in control.

Media reports and debacles about failed financial service companies in the 2000s raised public ire over these arrangements. The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 advanced a mandate for shareholders to review these parachute arrangements prior to completion of a corporate merger or change in control. The mandate became known as say on golden parachutes and complemented say on pay, a mandate for routine shareholder pay program reviews. Both mandates are advisory and nonbinding.

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Five years later, it can be interesting to assess each mandate's impact on executive compensation.

Say on pay unquestionably shifted the executive compensation landscape: it has fostered direct engagement between companies and their stakeholders on pay programs. It has also impacted pay design norms as an outcome of engagement: away from discretionary bonus plans, stock options, and perquisites/retirement benefits and toward formula-based, performance-driven pay. Say on pay has also increased the length, quality and look of proxy statements.

Say on golden parachutes' influence is less clear. The mandate has reinforced some notions of good governance. For instance, it is now typical for companies to only vest equity upon both a change-in-control and a job termination, called "double-trigger." According to Equilar, 20 percent of large companies had these provisions before the Dodd-Frank law. However, the vote hasn't generated publicity, momentum or design traction like say on pay.

Semler Brossy compared say-on-golden-parachute vote outcomes to say on pay during the past five years to further understand its influence on executive compensation. In addition, the firm looked at relevant cases to grasp the consequences of failing votes. Findings included:

Say-on-golden-parachute vote results tend to fare worse than merger results. Shareholders are often eager to endorse merger transactions, but less enthusiastic about compensation arrangements:

- Seven of every 10 merger proposals receive support from 95 percent or more of shareholders
- By comparison, two of every 10 say-on-golden-parachute proposals receive support from 95 percent or more of shareholders

Similarly, say on golden parachute proposals have garnered

Figure 1 | **Percent Approval: Say on Golden Parachute vs. Merger**

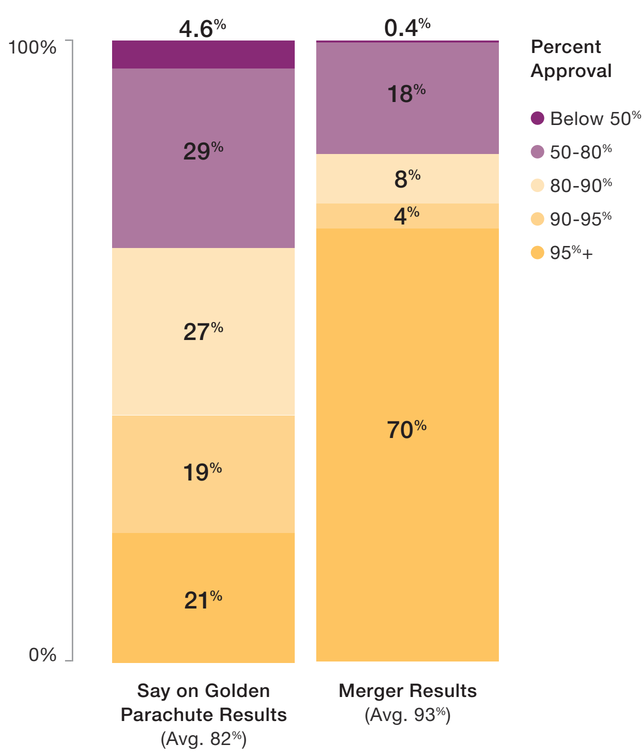


Figure 2 | **Average Vote Support: Say on Golden Parachute vs. Say on Pay (2011-2015)**

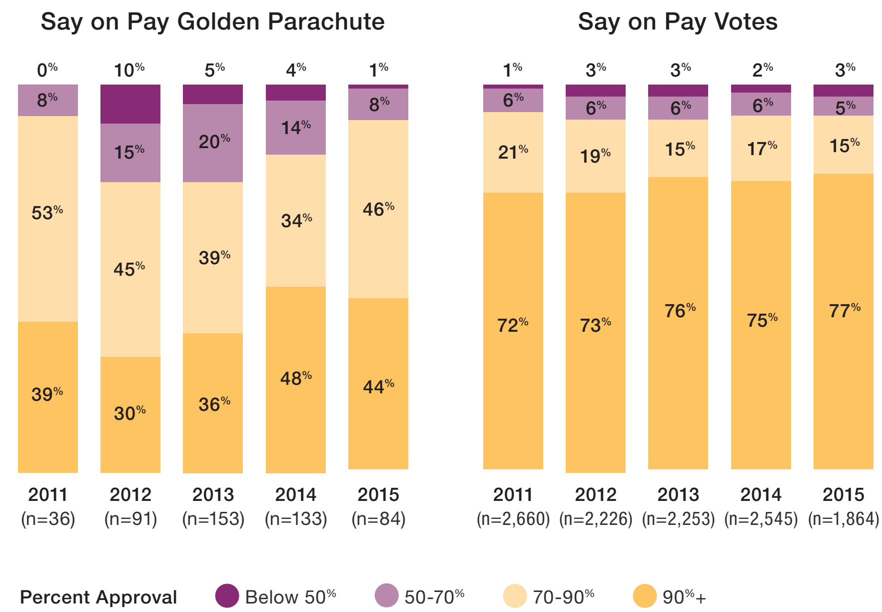
less shareholder support than say on pay proposals since the Dodd-Frank implementation:

- Average vote support for say on pay has been around 91 percent
- Average vote support for golden parachutes has been around 82 percent. Interestingly, golden-parachute votes have fluctuated more by year than say on pay:
- In 2012, 10 percent of companies failed golden-parachute votes. In 2011 and 2015, fewer than 2 percent of companies failed votes.
- By comparison, 1 to 3 percent of companies have failed say on pay between 2011 and 2015.

Market Examples

Semler Brossy considered six different merger situations — of various size and circumstance — to try and get to the "root" of these outcomes. The firm analyzed the parachute vote relative to legacy say on pay and merger results.

Figure 3 | Breakdown of Say on Golden Parachute vs. Say on Pay Votes (2011-2015)



Also considered were implications of the parachute vote afterward: on future say on pay, media coverage and director elections.

All six of these mergers received low say-on-golden-parachute vote support, influenced by common proxy adviser and shareholder concerns, which included: accelerated equity vesting upon the change in control called "single-trigger," excessive cash or equity payments or additional tax benefit paid by the company also known as gross-up.

What Should Be Considered

Semler Brossy's anecdotes and research support an unclear trajectory for companies that fare poorly on say-on-golden-parachute votes. Voting outcomes have been below say on pay; shareholders are explicit that executives shouldn't earn "gilded severance" following an acquisition. However, consequences of doing poorly in the vote are less obvious. Some considerations for companies are:

- **Shareholders may overlook questionable severance packages during annual say-on-pay votes, but take severance packages more seriously upon a golden parachute vote.** Evidence shows opposing outcomes on say-on-pay and say-on-golden-parachute votes even when conditions have not changed (e.g., PacWest received 50 percent less support on its say-on-golden-parachute vote the year after receiving 97 percent support on say on pay). Shareholders have even voted differently on the two when they are on the same proxy ballot and contain the same change in control agreements (e.g., US Airways received 45 percent less support on its say-on-golden-parachute vote than on its say on pay vote on the same proxy ballot).
- **Shareholders may be more lenient after completion of the merger given board turnover and other integration concerns.** Each market example above is different, but most of the cases were not impacted in

Figure 4 | Examples of Merger Situations

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
Cooper Industries (CBE) Acquired by Eaton (ETN) in 2012	CBE: 41% ETN: 52%	CBE: 68% ETN: 78%	CBE: 50% ETN: 72%	92%	X	

- Cooper Industries had legacy say-on-pay concerns after a 29 percent vote in 2012 and 50 percent vote in 2011
- Cooper Industries' golden-parachute concerns related to change in control agreements providing for single-trigger equity acceleration (including vesting performance awards at target) and tax gross-ups
- Eaton Corp. also held a golden-parachute vote because the post-merger entity triggered an adverse tax implication for outstanding equity awards. The company approved tax gross-up payments to NEOs in order to avoid adverse financial impact

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
Coventry (CVH) Acquired by Aetna (AET) in 2012	CVH: 35%	CVH: 76%	CVH: 80% AET: 71%	88%		

- Coventry had legacy director election concerns going into the merger with votes support from 71 percent to 79 percent
- Golden parachute concerns related to amendments to CEO agreement to provide for single-trigger equity acceleration and provide for equity grants and salary increases that had the effect of tripling the golden-parachute payment
- Also offered to pay for underwater stock options conditioned upon employment for a year following the close of the merger with Aetna

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
US Airways (LCC) Acquired by American Airlines (AAL) in 2013	LLC: 52%	LLC: 100%	LLC: 81% AAL: 88%	98%		

- US Airways had a near failing say-on-golden-parachute vote on the same proxy ballot as a say-on-pay vote that received 97 percent support
- Golden parachute concerns related to CEO arrangement providing for pay upon voluntary termination following the change in control, tax gross-ups, lifetime travel benefits and equity awards exercisability for three years.

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Figure 4 | Examples of Merger Situations (continued)

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
CapitalSource (CSE) Acquired by PacWest (PACW) in 2014	PACW: 47% CSE: 88%	PACW: 100% CSE: 98%	PACW: 97% CSE: 79%	60%	X	X

- PacWest's merger with CapitalSource triggered a change in control for both companies
- PacWest's golden-parachute concerns related to employment agreements for all executives that provided for tax gross-ups and single-trigger equity acceleration, including vesting outstanding performance-based awards at target; PacWest's CEO remained the CEO of the combined company and also received significant golden-parachute payments
- PacWest failed say on pay after the merger due to several shareholder concerns including poor governance practices in connection with the change in control
- In 2015, PacWest's Compensation Committee members received 74 percent support, on average, while other directors received 97 percent support, on average, due to a lack of response from committee members to the failed votes in 2014. While PacWest did eliminate tax gross-ups from change in control agreements and adopted double-trigger equity acceleration, the company did not disclose detail on shareholder outreach efforts and also moved away from performance-based equity awards (without disclosing a rationale for the change)

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
Hospira (HSP) Acquired by Pfizer (PFE) in 2015	HSP: 33%	HSP: 99%	HSP: 71% PFE: 96%	N/A	X	

- Hospira failed say on pay with 32 percent support immediately prior to the say-on-golden-parachute vote
- Concerns for both say-on-pay and say-on-golden-parachute votes related to amended change in control agreements, in connection with the merger, to provide for excise tax gross-ups

Situation	SOGP Vote Result	Merger Vote Result	Prior Year SOP	Outcome: Future Year SOP	Outcome: Negative Media Coverage	Outcome: Director Election Trouble
Office Depot (ODP) Acquired by Staples (SPLS) in 2015	ODP: 55%	ODP: 100%	ODP: 70% SPLS: 46%	N/A	X	

- Office Depot had a near failing say-on-golden-parachute vote on the same proxy ballot as a say-on-pay vote that received 98 percent support
- SOGP concerns related to modifications to change in control agreements providing for single-trigger equity acceleration, including vesting performance awards above target
- Office Depot also had legacy SOP concerns from a prior merger with OfficeMax

future years in terms of director re-elections or say on pay. Negative media coverage is one clear consequence, but it has tended to dissipate over time.

- **Shareholders may be less concerned when they reap benefits from the transaction's value creation (as is often the case).** Shareholders may voice disapproval, but give the company post-acquisition/transaction a fresh start as the board turns over and accountability for wasteful payments becomes murky.

Companies in this situation should approach the matter as they do with say on pay, which is through a rigorous review of programs and routine and proactive engagement with shareholders. Mergers and acquisitions often take place at the speed of light. Button up programs preemptively to avoid the distractions during this busy time — and rely on pre-formed relationships with shareholders.

There is a reputational and legal risk for having poor outcomes on the golden-parachute vote, especially for the companies and participants involved. Companies and directors have duties to shareholders to steward companies for shareholder benefits. Alleged misuses of corporate assets can inspire heavy media finger-pointing and even lawsuits. Proceed with caution. ws

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