

The Consequences of Inaccurate Perquisite Disclosure

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On July 2, 2018, the Securities and Exchange Commission (“SEC”) issued a cease-and-desist order¹ finding that The Dow Chemical Company’s (“Dow”) disclosure of executive perquisites in its annual proxy statements from 2013 to 2016 understated its disclosed perquisites and omitted disclosure of approximately \$3 million worth of perquisites received by its CEO from 2011-2015.

These amounts should have been disclosed as “other compensation” in the Compensation Discussion & Analysis (“CD&A”) section of such proxy statements. Specifically, Dow failed to apply the SEC’s principles-based, two-step perquisite framework and instead used a business purpose test, which was previously considered but not adopted by the SEC² in 2006, to evaluate the “perquisites” received by its named executive officers.

In its 2006 adopting release, the SEC provided a principles-based framework to help make a determination as to what constitutes a disclosable perquisite. This framework is based on the following two-step analysis:

- (1) An item is not a perquisite or personal benefit if it is “integrally and directly” related to the performance of the executive’s duties.
- (2) 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.

Even if an item is a perquisite, disclosure will not be required if certain value thresholds are not met. Perquisites and personal benefits may be excluded as long as the total value of all perquisites and personal benefits for a named executive officer is less than \$10,000. If the total value of all perquisites and personal benefits is \$10,000 or more for any named executive officer, then each perquisite or personal benefit, regardless of its amount, must be identified by type. If perquisites and personal benefits are required to be reported for a named executive officer, then each perquisite or personal benefit that exceeds the greater of \$25,000 or ten percent of the total amount of perquisites and personal benefits for that officer must be quantified and disclosed in a footnote to the Summary Compensation Table.

Applying this analysis, the SEC took the view that Dow failed to properly include the following items as perquisites: the use of the company aircraft for personal purposes including travel to outside board meetings and sporting events; club memberships; use of personal assistant time; and membership fees to sit on the

¹ The SEC’s order is available [here](#).

² See Commission’s Executive Compensation and Related Person Disclosure Final Rule adopting release, Release Nos. 33-8732A; 34-54302A; IC-27444A; File No. S7-03-06 (August 29, 2006).

board of a charitable organization. Determining whether a payment is “integrally and directly” related to job performance can be difficult and subjective, but the SEC reiterated that the exception is “narrow” and only applies to items that an executive “needs [...] to do the job.” In Dow’s case, the SEC found that the CEO’s disclosed perquisites were understated by approximately \$414,000 (61 percent) in 2011, \$849,000 (70 percent) in 2012, \$867,000 (69 percent) in 2013, \$523,000 (56 percent) in 2014 and \$318,000 (34 percent) in 2015.

In addition to failing to disclose these perquisites, the SEC concluded that Dow had failed to train employees in key roles, including those tasked with drafting the CD&A disclosure, and that it maintained inadequate processes and procedures to ensure proper reporting of perquisites.

Dow agreed to pay a civil penalty of \$1.75 million. In addition, it agreed to cease and desist from violating proxy disclosure and reporting rules and has further agreed to hire an independent consultant for a period of one year to help it implement improved policies and procedures to ensure that perquisites are accurately reported in the future.

Practical Considerations

In light of this development, it is important for companies to ensure that any benefits provided to executive officers are evaluated under the appropriate disclosure standard and that adequate procedures are put in place to ensure all perquisites are properly approved and disclosed. This should include: (i) having the compensation committee approve any perquisites to be received by executive officers in advance, (ii) ensuring that there are appropriate controls and procedures to track perquisites provided to executive officers and their usage, and (iii) confirming that the methodology being applied for calculating the aggregate incremental cost of perquisites is consistent with SEC requirements.

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