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Securities Disclosure As Soundbite: The Case of CEO Pay Ratios

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SECURITIES DISCLOSURE AS SOUNDBITE: THE CASE OF CEO PAY RATIOS

STEVEN A. BANK
GEORGE S. GEORGIEV

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SECURITIES DISCLOSURE AS SOUNDBITE: THE CASE OF CEO PAY RATIOS

STEVEN A. BANK*
GEORGE S. GEORGIEV**

Abstract: This Article analyzes the history, design, and effectiveness of the highly controversial CEO pay ratio disclosure rule, which went into effect in 2018. Based on a regulatory mandate contained in the Dodd-Frank Act of 2010, the rule requires public companies to disclose the ratio between CEO pay and median worker pay as part of their annual filings with the Securities and Exchange Commission (SEC). The seven-year rulemaking process was politically contentious and generated a level of public engagement that was virtually unprecedented in the long history of the SEC disclosure regime. The SEC sought to minimize compliance costs by providing firms with maximum methodological flexibility, expressly foregoing any effort to ensure data comparability across firms. The sizable pay gaps highlighted by the newly reported pay ratios attracted extensive attention from the media and various non-corporate constituencies, fueling public outrage, motivating new proposed legislation, and reinforcing concerns over pay inequity and economic inequality. At the same time, the pay ratio's role in investor decisionmaking remains uncertain. We suggest that the pay ratio disclosure rule represents a unique approach to disclosure, which we term *disclosure-as-soundbite*. This approach is characterized by (1) high public salience—the pay ratio is superficially intuitive and resonates with the public to an extent much greater than other disclosure, and (2) low informational integrity—the pay ratio is a relative outlier in terms of certain baseline characteristics of disclosure, meaning that the information is lacking in accuracy, difficult to interpret, and incomplete. We find that in its current formulation, the rule is ineffectual and potentially counterproductive when viewed as a means of generating useful and reliable information for investors, or influencing firm behavior on matters of worker and executive compensation. The pay ratio is more successful in fomenting or contributing to public discourse on broader societal matters relating to pay inequity and economic inequality, though the quality of the under-

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lying information likely limits the quality of the discourse. Given the low probability of legislative action in this area in the near term, we propose that the SEC should seek to improve the rule's informational integrity by mandating a narrative disclosure approach that provides information about median worker pay and the resulting pay ratio with more context, nuance, and explanation. This would be consistent with the format of existing disclosure requirements relating to executive compensation, and it would represent a positive move away from the disclosure-as-soundbite approach. A related and broader question about the need for disclosure of non-executive compensation and human capital management practices deserves further academic study.

INTRODUCTION

With skillful framing, simple statements about otherwise complex matters such as compensation arrangements are capable of evoking strong, even visceral reactions. For example, a rank-and-file worker may be upset when she reads that her company's CEO makes more in a single day than she does over the course of an entire year.[1] A senior citizen may be displeased when he reads that, after losing 18 percent of its value in a year, a company in his retirement portfolio rewarded its CEO by paying him 522 times more than its typical worker.[2] A taxpayer may be surprised when she learns that a company that receives close to $300 million per year in government subsidies pays its CEO 295 times more than its typical worker.[3] And a consumer may be taken aback when he finds out that the product he is about to buy is made by a company where the CEO gets paid 5,000 times more than the typical worker.[4]

Each of these examples links the pay of workers to that of the CEO, and each is based on the regulatory filings of a real, well-known U.S. company. The underlying information became available for the first time in the spring of 2018 as a result of the implementation of the controversial pay ratio disclosure mandate adopted by Congress as part of the Dodd-Frank Act of 2010 ("Dodd-Frank"). Pursuant to this mandate, over 3,000 publicly-traded companies in the United States are required to disclose the annual total compensation paid to the CEO, the annual total compensation paid to the median (i.e., typical) employee, and the ratio between the two.[5]

The newly-disclosed pay ratio figures have captured public imagination in ways that the typically long and technical corporate disclosure documents never do. The sizable pay gaps highlighted by the data have generated exten-

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[1] *See infra* note 208 and accompanying text.
[2] *See infra* note 212 and accompanying text.
[3] *See infra* note 251 and accompanying text.
[4] *See infra* note 180 and accompanying text.
[5] *See infra* Part I.

sive media coverage, fueling public outrage and reinforcing concerns over pay inequity and economic inequality.[6] Progressive politicians, including Senator Elizabeth Warren and Senator Bernie Sanders, have cited the pay ratio data when proposing new business regulation bills. The city of Portland, Oregon has imposed a penalty business tax on firms whose pay ratio exceeds 100:1.[7] Similar measures have been proposed in states from California to Illinois to Massachusetts, and at the federal level.[8] All the while, corporate boards and managers have worked to calculate the data and contain the public relations impact, whereas investors have been uncertain on how to incorporate the data in their decisionmaking.[9] In short, the pay ratio disclosures have already touched many aspects of public and economic life in the United States. This incredible flurry of activity is ripe for academic analysis.

Our Article presents the first comprehensive study of the pay ratio regulatory project—its history, design, and effectiveness. We suggest that the pay ratio disclosure rule reflects a unique approach to securities disclosure, which we term *disclosure-as-soundbite*. The uniqueness of this approach is a function of two key attributes: the pay ratio's high public salience and its low informational integrity.

High public salience is a deliberate and ingenious design feature of the rule. By linking the earnings of workers to those of corporate executives, the pay ratio takes on a personal dimension and resonates with the public to an extent that is much greater than information about CEO pay alone. The single-number ratio is superficially simple and intuitive, and can appear to carry a great deal more information than it actually does.[10] This explains its success in attracting the attention of a broad set of audiences, including the news media, national politicians, state and local governments, labor unions, think tanks, and firms' employees and customers (in addition to corporate decisionmakers and advisers). We detail each of these audiences' uses of pay ratio data in Part III.

The flipside of the pay ratio's high public salience is its low informational integrity relative to the rest of the securities disclosure regime. Though not perfect, disclosure rules generally share certain baseline characteristics—accuracy, comprehensibility, and completeness. The pay ratio is an outlier on each of these counts. The accuracy of the information is questionable because of the broad ways in which the SEC defined the underlying inputs, median worker pay and CEO pay, along with the methodological flexibility it granted

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[6] *See infra* Part III.A.
[7] *See infra* notes 235–239 and accompanying text.
[8] *See infra* note 241 and accompanying text.
[9] *See infra* Part III.D.
[10] *See infra* Part V.A.

firms in making the relevant calculations. Each firm's pay ratio also presents a challenge of interpretation, and hence comprehensibility, because of the absence of objective pay ratio benchmarks and the lack of comparability among different firms' ratios. Finally, the SEC rule requires firms to disclose only numbers, without explanation or context, which renders the information incomplete in what we believe are important ways.[11]

The pay ratio's low informational integrity is illustrated by the ease with which individual firms' characteristics can skew the reported figures. A firm with a founder-CEO who draws a modest annual salary while holding a large block of stock would report a low pay ratio, hiding the fact that the founder-CEO may have profited greatly from the annual appreciation of his stock holdings. Firms organized as limited partnerships, a common model in the private equity industry, compensate their CEOs primarily through partnership distributions. Because those are not included in the calculation of annual total compensation, such firms may also report pay ratios that are artificially low. Finally, if two firms in the same industry differ only in the way their labor force is organized, with one of them outsourcing its low-paid jobs, the firms would report widely different pay ratios, which would obscure internal pay equity rather than illuminate it.[12]

The nature of the pay ratio also makes any aggregate information extremely malleable. Different news stories during the 2018 corporate reporting season contained different aggregate CEO-to-worker pay ratios, ranging from 361:1 at the high end to 144:1 at the low end, with several other reported ratios occupying spaces in between. These differences were due to different sample sizes, the timing of aggregation, the aggregation methodology (average vs. median), and other factors.[13] On a superficial level, however, each of the ratios purported to reflect the economy-wide CEO-to-worker pay ratio. Even when the precise method of aggregation was flagged in the reports, it likely did not register with the public. Without context, the various aggregate figures function as little more than soundbites that can be deployed in the service of various rhetorical points.

How did this unusual disclosure rule come to be? How did it emerge from the SEC rulemaking process? And is there a way to address its problems short of scrapping it altogether? The full story of the pay ratio is interesting in its own right and has not been told before. The pay ratio disclosure mandate was a brief—and last-minute—addition to the 2,300-page Dodd-Frank Act. Though not directly related to the financial crisis, the pay ratio rule generated

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[11] *See infra* Part IV.
[12] *See infra* Part II.C.
[13] *See infra* Parts II–III.

the most public controversy of the 86 rules the SEC was tasked with writing under Dodd-Frank. During a multi-stage, seven-year rulemaking process, the SEC received over 2,000 unique comment letters and over 320,000 form letters about the rule from a wide range of stakeholders. Without any legislative history to go by and under constant pressure from ardent opponents and proponents of pay ratio disclosure, the SEC had to work to fit the congressional mandate within the existing tapestry of federal securities regulation. To do so, the SEC justified the rule with reference to informing investors' say-on-pay voting decisions, and sought to minimize the costs of compliance by affording firms broad flexibility in calculating the pay ratio.[14]

A close examination of the political dialogue and rulemaking process reveals that stakeholders have ascribed several different functions to the rule, in addition to or in lieu of, the informational function that the SEC endorsed. One of these is a behavioral function—the pay ratio as a means of influencing corporate decisionmaking in substantive ways. For example, the disclosure requirement could in theory induce firms to improve their pay ratio by reducing CEO pay or increasing median worker pay, or, more generally, encourage them to devote more attention to employee compensation matters. Another is a public discourse function—the pay ratio as a means of fostering or contributing to a public conversation about economy-wide pay inequities and economic inequality more broadly. The informational, behavioral, and public discourse functions are not exclusive of one another, and this overall ambiguity about the rule's functions is an important part of understanding the rule itself.[15]

Our assessment of the pay ratio's effectiveness takes these different functions into account. We find that the pay ratio rule is ineffectual and potentially counterproductive in fulfilling an informational or a behavioral function due to its low informational integrity—the inherent lack of accuracy, difficulty in interpretation, and incompleteness of the information. The pay ratio's high public salience does nothing to help in this regard. On the flipside, high public salience renders the pay ratio rule more successful in fulfilling a public discourse function: The nature of the subject matter and the superficial simplicity of the information can be very effective in attracting public attention to questions of pay inequity and economic inequality. The quality of the discourse, however, is limited by the rule's low informational integrity.[16]

Our policy proposal focuses on improving the pay ratio's informational integrity and moving beyond the disclosure-as-soundbite approach. As cur-

[14] *See infra* Parts I.B–I.C.
[15] *See infra* Part I.D.
[16] *See infra* Part V.B.

rently formulated, the rule does not require firms to provide context or explanation for the disclosed pay ratio numbers. In other words, in an effort to ensure maximum flexibility and minimize compliance costs, the SEC adopted a numbers-only approach to pay ratio disclosure. We suggest that the SEC should revisit this decision and mandate a narrative disclosure approach that provides information about median worker pay and the resulting pay ratio with more context, nuance, and explanation. Doing so would make firms' disclosures easier to interpret and more complete, which should improve the pay ratio's ability to fulfill an informational or a behavioral function. It could also improve the quality and increase the quantum of compensation-related information that can be used as part of public discourse. This narrative disclosure approach would be in line with the format of existing disclosure requirements relating to executive compensation.[17]

Two brief caveats are in order. First, the pay ratio disclosure rule has been the target of repeated repeal efforts and remains highly controversial.[18] Though we acknowledge the various policy arguments against the rule and in its favor, we do not take a position on them in this Article. Instead, we assume that the rule will not be repealed in the near term, and seek to define its shortcomings, explain the reasons for them, and put forward a strategy for overcoming them. Second, our analysis draws on the history of the pay ratio disclosure project since 2010 and on the first season of pay ratio reporting, which concluded in 2018. During this period, the pay ratio has generated a great deal of evidence, which we draw on throughout the Article. Nevertheless, we are still in the early days of pay ratio reporting.

Our Article engages with two important strands of the scholarly literature. In the areas of securities regulation and corporate governance, our analysis of the pay ratio disclosure project provides new evidence for debates over the effects and merits of important federal statutes such as the Sarbanes-Oxley Act of 2002 and the Dodd-Frank Act of 2010, which have redefined the corporate governance regulatory landscape over the past 16 years.[19] Our analysis also highlights the growing heterogeneity of regulatory interventions in the area of executive compensation. Whereas executive compensation regulation has traditionally sought to link executive pay to shareholder returns,[20]

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[17] *See infra* Part VI.

[18] *See infra* notes 69–72 and accompanying text.

[19] *See, e.g.*, Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817 (2007); John C. Coates IV, *The Goals and Promise of the Sarbanes-Oxley Act*, 21 J. ECON. PERSP. 91 (2007); Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1781 (2011); Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521 (2005).

[20] *See, e.g.*, Lucian Bebchuk & Jesse Fried, *Paying for Long-Term Performance*, 58 U. PA. L. REV. 1915 (2010).

the CEO pay ratio for the first time links executive compensation to employee compensation, through imperfect means and to uncertain ends.

The Article proceeds as follows: Part I traces the origins of the pay ratio disclosure requirement by presenting the history of compensation ratios, the adoption of the pay ratio disclosure mandate by Congress, and its subsequent implementation through SEC rulemaking. Drawing on this history, Part I also suggests three possible conceptions of the rule's functions. Part II describes the architecture of the rule, the results from the first year of pay ratio reporting, and the reliability and comparability problems associated with the data. Part III shows that, despite such problems, the pay ratio disclosures have received extensive attention from an unusually broad set of audiences: the media, national politicians, state and local governments, and other public actors, in addition to the traditional corporate constituencies. Part IV describes the low informational integrity of the pay ratio disclosure rule relative to the rest of the securities disclosure regime. Part V.A defines the rule's unique disclosure-as-soundbite approach as a function of its high public salience and low informational integrity. Part V.B offers an assessment of the rule's effectiveness in light of each of its possible functions. Part VI presents our proposal for moving beyond the disclosure-as-soundbite approach by requiring firms to present pay ratio information in a narrative format that provides more context, nuance, and explanation.

I. THE ORIGINS AND CHALLENGES OF THE PAY RATIO DISCLOSURE RULE

The implementation date of the pay ratio disclosure rule, January 1, 2018, marked the start of the public reporting of pay ratio data from over 3,000 U.S. public companies.[21] This date also marked the end of a process that was remarkable in itself: a seven-year legislative and regulatory battle over the precise content and even survival of the Dodd-Frank pay ratio disclosure mandate. Though the U.S. pay ratio disclosure rule was pathbreaking in a number of respects, compensation ratios have a long history. This Part presents the historical context and then traces the evolution of the pay ratio disclosure rule from an abstract idea into a legal reality, and considers the possible functions that the rule can be viewed as fulfilling.

[21] The rule became "effective" on January 1, 2017, requiring public companies to disclose pay ratios for the fiscal year starting on or after that date. As a result, the actual pay ratio disclosures began appearing a year later, after January 1, 2018. We refer to January 1, 2018 as the implementation date because as late as the fall of 2017, it was still unclear whether the rule was going to survive. *See infra* Part I.C.

A. The History and Uses of Compensation Ratios

How much is one's labor worth? Over centuries of human history, there has been no shortage of attempts to answer this fundamental question, drawing on perspectives ranging from ethics and religion, to politics and ideology, to economics and management science.[22] Because most conceptions of value are relative, the answers have often relied on comparisons between different members of society, or different members of an economic unit, such as a firm. Compensation ratios offer a simple and effective way to express such comparisons—they show how many times more one person (or a group of persons) makes compared to another. As a result of their ability to condense information, compensation ratios have been deployed in a wide variety of contexts. We focus on ratios showing CEO pay relative to the pay of rank-and-file workers (who are also referred to colloquially as "typical" or "average" workers).[23] The ways in which such ratios are used can be separated into three overlapping categories—descriptive, normative, and analytical—each with its own policy dimension.

1. Descriptive Uses

The most uncontroversial and, until 2018, most prevalent use of pay ratios has been to illustrate societal trends and make cross-country comparisons in connection with debates over executive compensation and income inequality. Concerns about excessive executive compensation have animated public discourse in the United States since the 1930s.[24] What precisely constitutes "excessive" pay can be up for debate, and this makes pay ratios particularly useful. By relating CEO pay to rank-and-file worker pay, a pay ratio can provide an intuitive measuring stick, with the added advantage of showing trends over time.

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[22] *See generally* JOHN W. BUDD, LABOR RELATIONS: STRIKING A BALANCE (2017) (discussing labor relations as a means for balancing employment relationship goals and the rights of labor and management, as well as alternative perspectives on the nature of the employment relationship).

[23] Different methodologies use different proxies for rank-and-file, or "average," or "typical" worker pay. The SEC pay ratio disclosure rule asks firms to identify the *median employee* and report that person's compensation. *See infra* Part II.A. The extent to which the median worker's pay is representative of the pay of the typical worker would depend on the pay distribution within an organization. *See infra* Part IV.B. More generally, a variety of different compensation ratios are conceptually possible; for example, in 2018, the United Kingdom implemented a rule requiring firms to report the ratio of the pay of male employees to that of female employees. *See infra* notes 319–320 and accompanying text.

[24] *See generally* Harwell Wells, *"No Man Can Be Worth $1,000,000 a Year": The Fight Over Executive Compensation in 1930s America*, 44 U. RICH. L. REV. 689 (2010) (tracing public concerns about levels of executive compensation in the early 1930s).

The resulting rhetorical points can be powerful. For example, in the 1950s U.S. executives were making about 20 times more than the average employee, whereas by the early 1990s they were making 120 to 150 times more.[25] By the mid-2000s, this figure had risen to 350.[26] Present-day estimates vary, but one widely reported figure in 2018 was 361:1.[27] Such figures can also be used to highlight how much of an outlier the United States is compared to countries such as Australia (93:1), Germany (147:1), Japan (67:1), Switzerland (148:1), or the United Kingdom (84:1).[28] Policy proposals connected with this use of pay ratios do not set specific pay ratio targets; instead, they use pay ratios to illustrate the need for action on pervasive economy-wide issues, such as income inequality.[29]

2. Normative Uses

In addition to describing societal trends, compensation ratios have also been used to illustrate optimal levels of pay, or distribution of pay, according to various normative criteria. Perhaps the earliest recorded instance of presenting an optimal compensation ratio comes from Plato, who argued that the highest-paid members of society should earn no more than five times the income of the lowest-paid.[30] Such normative judgments about what is optimal have inspired various policy proposals in modern times, in the United States and abroad. In 2016, Portland, Oregon passed a city ordinance imposing special business taxes on firms with CEO-to-median worker pay ratios higher than 100:1.[31] The same year, Israel adopted a law limiting the deductibility of

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[25] *See* GRAEF S. CRYSTAL, IN SEARCH OF EXCESS: THE OVERCOMPENSATION OF AMERICAN EXECUTIVES 27 (1991).

[26] *See, e.g.,* Jeffrey N. Gordon, *"Say on Pay": Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In*, 46 HARV. J. ON LEGIS. 323, 324 (2009) (reporting data and noting that the pay gap generated controversy both in the political realm and in corporate boardrooms).

[27] *See infra* Part III.B.

[28] *See* Roberto A. Ferdman, *The Pay Gap Between CEOs and Workers Is Much Worse Than You Realize*, WASH. POST (Sept. 25, 2014), https://www.washingtonpost.com/news/wonk/wp/2014/09/25/the-pay-gap-between-ceos-and-workers-is-much-worse-than-you-realize [https://perma.cc/AVU9-2DZF] (reporting comparative international data based on current estimates).

[29] *See, e.g.*, INST. FOR POL'Y STUD., A DECADE OF EXECUTIVE EXCESS: THE 1990S (1999), https://ips-dc.org/wp-content/uploads/1999/09/Executive-Excess-1999.pdf [https://perma.cc/M48G-4PY9].

[30] *See* Charles Tilley, *For Fair Pay, See Plato*, THE GUARDIAN (June 3, 2010), https://www.theguardian.com/commentisfree/2010/jun/03/public-sector-pay-cameron-executive-bonuses [https://perma.cc/99ES-SF44].

[31] *See* PORTLAND, OR., CITY CODE ch. 7.02, § 500 (2019), https://www.portlandoregon.gov/citycode/28807#cid_714103 [https://perma.cc/5GGN-U3DA]; *see also infra* notes 235–239 and accompanying text. For a discussion of other legislative proposals from the United States, *see infra* Part III.B.2.

CEO pay for firms in the financial sector to 44 times the pay of their lowest-paid worker.[32] In the United Kingdom, politicians have proposed using pay ratios to set caps on pay for government workers and contractors.[33] A 2013 referendum in Switzerland sought to cap companies' pay ratios at 12:1, and, though it ultimately failed, it attracted considerable public attention.[34]

Optimal pay ratios have also been judged with reference to firm productivity: Management expert Peter Drucker thought extensively about the issue, advocating for ratios in the 25:1–30:1 range in 1977, and in the 15:1–20:1 range in 1984.[35] At the beginning of the twentieth century, financier J.P. Morgan suggested that a 20:1 ratio would be optimal.[36] (Incidentally, in 2017 the CEO of the eponymous firm he founded earned 364 times what the median worker made.)[37] Individual firms have also used compensation ratios to take a normative stance. For a number of years, Ben & Jerry's had a company-mandated policy whereby the highest-paid worker would make no more than five times the lowest-paid worker; over time, this increased to a 17:1 pay ratio.[38] Before it was acquired by Amazon, Whole Foods maintained a CEO-to-average worker pay ratio of 19:1 (which also served as a cap on CEO pay).[39]

The challenge in using specific pay ratios in such normative ways is that there is no objective benchmark for what constitutes an optimal pay ratio, either overall or in a given context. It is unlikely that optimal pay ratios can be determined empirically. Notions of fairness likewise have multiple dimen-

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[32] Steven Scheer, *Israel Passes Law to Cap Bankers' Salaries*, REUTERS (Mar. 29, 2016), https://www.reuters.com/article/israel-banks-wages/israel-passes-law-to-cap-bankers-salaries-id USL5N1713AP [https://perma.cc/N2N7-X6HR].

[33] *See* May Bulman, *Labour to Set a 'Cap' on Salaries of Top Executives in Government-Employed Companies, Says John McDonnell*, THE INDEPENDENT (Apr. 19, 2017), https://www.independent.co.uk/news/uk/politics/labour-government-employed-companies-pay-restrict-top-executives-john-mcdonnell-manifesto-jeremy-a7691236.html [https://perma.cc/4U6P-Y975].

[34] *See* John Hooper, *Switzerland Votes Against Cap on Executive Pay*, THE GUARDIAN (Nov. 24, 2013), https://www.theguardian.com/world/2013/nov/24/switzerland-votes-against-cap-executive-pay [https://perma.cc/782W-PK67].

[35] *See* Peter F. Drucker, *Is Executive Pay Excessive?*, WALL ST. J., May 23, 1977, at 20; Peter F. Drucker, *Reform Executive Pay or Congress Will*, WALL ST. J., Apr. 24, 1984, at 34.

[36] *See* Rosanna Landis Weaver, *Will New Pay Ratio Disclosure Lead to "Public Infamy?,"* AS YOU SOW (Jan. 8, 2018), https://blog.asyousow.org/will-new-pay-ratio-disclosure-lead-to-public-infamy-66e48912d062 [https://perma.cc/3YAD-X2PX].

[37] *See* Ben McLannahan, *Dimon Pay Day Means a Year's Wages for Typical JPMorgan Staff*, FIN. TIMES (Mar. 22, 2018), https://www.ft.com/content/aac3a27a-2de4-11e8-9b4b-bc4b9f08f381.

[38] *See* Mitchell Weiss, *A Sweet Solution to the Sticky Wage Disparity Problem*, ABC NEWS (Aug. 10, 2013), https://abcnews.go.com/Business/companies-follow-ben-jerrys-lead-wages/story?id=19920634.

[39] *See* John Mackey, *Why Sky-High CEO Pay Is Bad Business*, HARV. BUS. REV. (June 17, 2009), https://hbr.org/2009/06/why-high-ceo-pay-is-bad-business [https://perma.cc/BLW9-E4VJ].

sions that would suggest different optimal pay ratios.[40] There is, however, a perception—shared across countries and political persuasions—that the optimal pay ratio is significantly lower than the actual pay ratios.[41] Legislation utilizing specific pay ratios gives the appearance that it is acting on this shared public perception in a direct manner, which likely explains its enduring appeal to politicians.

3. Analytical Uses

Pay ratios have also been used by investors and others to help analyze individual firms, as well as to compare firms to one another. As a policy matter, *requiring* firms to disclose their CEO-to-worker pay ratios can be seen as an effort to facilitate such analytical uses.[42] Even though data about pay ratios in a given industry or country has been reported for some time, such data has not been firm-specific and has been based on *estimates* from national statistical agencies.[43] By contrast, when public companies provide pay ratio information pursuant to a disclosure requirement, it becomes possible to make firm-to-firm comparisons (even if they may be flawed). The U.S. pay ratio mandate, adopted in 2010, was the first example of such a disclosure requirement. Since then, similar disclosure rules have been adopted in the United Kingdom (with effect from 2020)[44] and India (with effect from 2013),[45] and have been mooted in Australia[46] and at the European Union level.[47]

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[40] In the area of executive and worker compensation, commentators have distinguished between distributive fairness, procedural fairness, and interactional fairness. *See, e.g.*, Jim Bowers & Fred Whittlesey, *Understanding Executive Pay Equity and Fairness: Ratios and Rationality*, 19 WORLDATWORK J., no. 3, 2010, at 6, 8, http://compensationventuregroup.com/wp-content/uploads/2014/05/WorldatWork-Pay-Ratio-Article.pdf [https://perma.cc/WH5J-GQUC].

[41] *See* Sorapop Kiatpongsan & Michael I. Norton, *How Much (More) Should CEOs Make? A Universal Desire for More Equal Pay*, 9 PERSP. ON PSYCH. SCI. 587, 587–88 (2014) (reporting evidence based on a survey of over 55,000 respondents from the United States and 39 other countries showing that the ideal ratio is significantly lower than both the public's estimates of the actual ratio and the actual ratio).

[42] The rationale behind pay ratios could also be to change firm behavior or contribute to public discourse. We discuss these alternatives in Part I.D.

[43] *See, e.g.*, CRYSTAL, *supra* note 25.

[44] *See* Sarah Gordon, *UK Set to Force Companies to Reveal Ratio of CEO Pay to Workers*, FIN. TIMES (Apr. 21, 2018), https://www.ft.com/content/d8e01ac4-43c1-11e8-803a-295c97e6fd0b; *infra* notes 319–320 and accompanying text.

[45] *See* India Companies Act 2013, No. 18 of 2013, § 197(12) (2018), https://indiacode.nic.in/bitstream/123456789/2114/1/A2013-18.pdf [https://perma.cc/55AQ-A2XK].

[46] *See* Eryk Bagshaw, *Labor to Force Companies to Reveal CEO to Employee Pay Ratio*, SYDNEY MORNING HERALD (Oct. 2, 2018), https://www.smh.com.au/politics/federal/labor-to-force-companies-to-reveal-ceo-to-employee-pay-ratio-20181001-p5073z.html [https://perma.cc/WNA9-8YQY].

[47] In April 2014, the European Commission published a proposal to amend the Shareholder Rights Directive to require disclosure of the ratio between the average executive's compensation

The idea of requiring individual firms to disclose CEO-to-worker pay ratios has an interesting intellectual pedigree, which illustrates the analytical use of pay ratios and helps set the stage for our discussion of the Dodd-Frank pay ratio mandate. The idea was first put forward by James Cotton in a little-known law review article published in 1997.[48] Cotton drew inspiration from financial ratios, such as the working capital ratio, liquidity ratio, and capitalization ratio, that are routinely used by investors to analyze and compare companies.[49] Cotton believed that compensation ratios could serve a similar purpose and proposed that public companies be required to disclose three compensation ratios. These ratios would present the relationship between CEO pay, and the average annual salary of, respectively, a firm's top executive officers, a firm's management employees who are not officers, and all employees.[50] The SEC's CEO-to-median worker pay ratio closely resembles the latter of Cotton's proposed ratios with one difference—the SEC rule uses *median* worker pay as opposed to *average* worker pay. [51] According to reports, Cotton sent his article to policymakers, the SEC, and the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) upon publication.[52] Over the following decades, it appeared that the idea had gone unnoticed, until in 2010 it unexpectedly entered the public domain, and, shortly thereafter, the statute book.

B. The Congressional Pay Ratio Disclosure Mandate

The pay ratio disclosure mandate is contained in Section 953(b) of the Dodd-Frank Act, which was signed into law in July 2010.[53] The provision requires public companies to calculate and disclose: (a) the annual total compensation of the median worker; (b) the annual total compensation of the

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and the compensation of the average full-time employee. *See* European Commission Press Release IP/14/396, European Commission Proposes to Strengthen Shareholder Engagement and Introduce a "Say on Pay" for Europe's Largest Companies (Apr. 9, 2014), http://europa.eu/rapid/press-release_IP-14-396_en.htm [https://perma.cc/NQ85-PJ8N].

[48] *See* James A. Cotton, *Toward Fairness in Compensation of Management and Labor: Compensation Ratios, a Proposal for Disclosure*, 18 N. ILL. U. L. REV. 157 (1997).

[49] *Id.* at 175–78 ("It is commonly accepted in the financial world today that certain ratios are used regularly to evaluate the performance of a corporation and to determine how financially healthy it is.").

[50] *Id.* at 179–80.

[51] Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 953(b), 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n (2012)).

[52] Elliot Blair Smith & Phil Kuntz, *CEO Pay 1,795-to-1 Multiple of Wages Skirts U.S. Law*, BLOOMBERG (Apr. 30, 2013), https://www.bloomberg.com/news/articles/2013-04-30/ceo-pay-1-795-to-1-multiple-of-workers-skirts-law-as-sec-delays.

[53] Dodd-Frank Act, § 953(b).

CEO; and (c) the ratio of the two.[54] The inclusion of Section 953(b) in Dodd-Frank was almost an afterthought—the provision was not subject to debate and generated virtually no legislative history.[55] This was not surprising: Over 2,300 pages long, the primary goal of the Dodd-Frank Act was to address major problems related to the 2008 Global Financial Crisis, such as too-big-to-fail, excessive risk-taking by financial institutions, insufficient coordination by federal financial regulators, conflicts of interest within credit rating agencies, and inadequate consumer financial protections.[56] Understandably, the far-reaching provisions responding to these problems attracted the most attention and discussion in the run-up to the Act's adoption.

The pay ratio disclosure mandate was part of Subtitle E of "Title IX—Accountability and Executive Compensation" of Dodd-Frank, which contained provisions requiring firms to provide additional pay-for-performance disclosures[57] and disclosures relating to hedging policies for employees and directors,[58] adopt so-called clawback policies for improperly awarded executive compensation,[59] and hold advisory say-on-pay shareholder votes, among others.[60] These provisions sought to align executive pay with corporate performance, a redoubling of decades-long efforts in this area, and give shareholders more voice in matters of executive compensation.[61] The pay ratio

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[54] *Id.* The pay ratio rule does not apply to certain special categories of public companies, such as smaller reporting companies, emerging growth companies, and foreign private issuers. *Id.*

[55] *See infra* notes 63–65 and accompanying text; *see also* J. Robert Brown, Jr., *Dodd-Frank, Compensation Ratios, and the Expanding Role of Shareholders in the Governance Process*, 2 HARV. BUS. L. REV. ONLINE 91 (2011), http://www.hblr.org/wp-content/uploads/2011/10/Brown-Executive-Compensation-and-Shareholders.pdf [https://perma.cc/EJ6Z-3PJA].

[56] *See generally* DAVID SKEEL, THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES (2011).

[57] *See* Dodd-Frank Act, § 953(a) (setting out pay-for-performance disclosure mandate); Pay Versus Performance, Dodd-Frank Act Release No. 34-74835 (proposed Apr. 29, 2015), 80 Fed. Reg. 26,330 (May 7, 2015) (proposing an SEC rule seeking to implement the congressional mandate). As of January 1, 2019, the SEC has not yet adopted this rule.

[58] *See* Dodd-Frank Act, § 955 (setting out mandate for disclosure of hedging transactions related to company securities by employees and directors); Disclosure of Hedging by Employees, Officers and Directors, Exchange Act Release No. 34-8488 (Dec. 20, 2018), 84 Fed. Reg. 2402 (Feb. 6, 2019) (to be codified at 17 C.F.R. pts. 229, 240) (adopting an SEC rule to implement the congressional mandate).

[59] *See* Dodd-Frank Act, § 954 (setting out the clawback policy mandate); Listing Standards for Recovery of Erroneously Awarded Compensation, Dodd-Frank Act Release No. 33-9861 (July 1, 2015), 80 Fed. Reg. 41,144 (proposed July 14, 2015) (proposing an SEC rule seeking to implement the congressional mandate). As of January 1, 2019, the SEC has not yet adopted this rule.

[60] *See* Dodd-Frank Act, § 951 (setting out the say-on-pay mandate); Shareholder Approval of Executive Compensation, Dodd-Frank Act Release No. 33-9178 (Jan. 25, 2011), 76 Fed. Reg. 6010 (Feb. 2, 2011) (adopting an SEC rule establishing the say-on-pay regime).

[61] *See* Steven A. Bank & George S. Georgiev, *Paying High for Low Performance*, 100 MINN. L. REV. HEADNOTES 14, 16 (2016), http://www.minnesotalawreview.org/wp-content/uploads/2016/02/BankGeorgiev_PDF.pdf [https://perma.cc/CHD8-RRNC].

mandate looked like an outlier in this context, because it was not immediately clear how it furthered either goal. Instead, it appeared to share more similarity with other highly specific and unorthodox disclosure mandates contained in Dodd-Frank, which pertained to conflict minerals and mine safety.[62]

The first legislative appearance of the pay ratio disclosure concept was in the Corporate Executive Accountability Act of 2010, introduced by Senator Robert Menendez, Democrat of New Jersey, in February 2010.[63] This bill was subsequently subsumed by the mammoth Dodd-Frank Act. None of Senator Menendez' statements in connection with either bill addressed the specific purpose of the pay ratio mandate.[64] The Senate Report on the Dodd-Frank Act noted only in general terms that the goal of the bill's executive compensation provisions was to "empower[] shareholders in a public company to have a greater voice on executive compensation and to have more fairness in compensation affairs."[65] The views of several senators in the Republican minority at the time did mention the pay ratio in passing and criticized it for playing into "popular notions that [CEO] salaries are too high,"[66] and for paving the way for the pursuit of "'social justice' in income distribution."[67]

Though the pay ratio disclosure mandate did not generate any meaningful debate or stakeholder input before its adoption, it did so afterwards. The provision was swiftly criticized by business associations and lobbyists such as

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[62] *See* Dodd-Frank Act, § 1502 (codified at 15 U.S.C. § 78m(p)) (conflict minerals disclosure); Dodd-Frank Act, § 1503 (codified at 15 U.S.C. § 78m-2) (mine safety disclosure).

[63] S. 3049, 111th Cong. (Feb. 26, 2010), https://www.congress.gov/bill/111th-congress/senate-bill/3049 [https://perma.cc/XR9D-P5VC]. The bill's preamble noted that its goal was "[t]o give shareholders a vote on executive pay, to hold executives accountable for failure or fraud, to structure executive pay to encourage the long-term viability of companies, and for other purposes." *Id*.

[64] In a press release on the proposed Corporate Executive Accountability Act of 2010, Senator Menendez stated: "What everyone has learned all too painfully over the past year and a half is that risky behavior, excesses, and a lack of accountability on Wall Street can end up squeezing families on Main Street . . . . Corporate executives must be held accountable, and that is the purpose of this legislation." *See* Press Release, Office of Senator Bob Menendez, Menendez Aims to Hold Corporate Executives Accountable with New Bill (Feb. 26, 2010), https://www.menendez.senate.gov/news-and-events/press/menendez-aims-to-hold-corporate-executives-accountable-with-new-bill [https://perma.cc/N5YE-D6XE].

[65] *See* COMM. ON BANKING, HOUSING, & URB. AFF., RESTORING AMERICAN FINANCIAL STABILITY ACT OF 2010, S. REP. NO. 111-176, at 37 (Apr. 30, 2010), https://www.congress.gov/congressional-report/111th-congress/senate-report/176/1 [https://perma.cc/8GUL-NALP].

[66] *Id*. at 245 (reporting on minority views).

[67] 156 CONG. REC. 8843 (2010) (statement of Sen. Shelby) ("The grab bag includes puzzling items, like a . . . provision that requires disclosure of the ratio of the median employee's compensation to the chief executive officer's compensation. It looks to me like the way is being paved to achieve so-called 'social justice' in income distribution. This is another disturbing example of the government getting its nose under the private sector's tent.").

the U.S. Chamber of Commerce.[68] Between 2011 and 2017, five separate bills were introduced in the House of Representatives to repeal the pay ratio mandate.[69] One of them, the Financial CHOICE Act of 2017, passed through the House but was not taken up by the Senate.[70] Repealing the pay ratio mandate was also high on the list of recommended regulatory rollbacks contained in a special report prepared by the Treasury Department in October 2017.[71] So far, the pay ratio has survived these repeal efforts. Further, even though Congress was eventually successful in passing a bill rolling back some of Dodd-Frank's most significant provisions, the pay ratio mandate was not included in that bill.[72]

These efforts to delegitimize and repeal the pay ratio mandate were countered by sustained efforts to ensure its implementation. The SEC rulemaking process generated hundreds of thousands of letters from investors and the public in support of the pay ratio provision.[73] In addition, members of Congress wrote numerous letters to the SEC urging it to speed up the rule's adoption. Statements contained in these letters provide a glimpse into legislative intent, even if some of it may have been determined retroactively. Such statements, however, do not resolve fully the underlying ambiguity about the goals Congress aimed to achieve through the pay ratio disclosure mandate.

Our review of letters written by members of Congress who were involved in the passage of Dodd-Frank suggests two broad justifications for the

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[68] *See, e.g.*, Jerry Markon & Dina ElBoghdady, *Dodd-Frank Executive Pay Rule Still in Limbo Amid Pushback from Corporate America*, WASH. POST (July 6, 2013), http://articles.washingtonpost.com/2013-07-06/politics/40404900_1_rule-financial-overhaul-legislation-agency [https://perma.cc/T3G7-9PJZ]; *see also* Letter from Am. Benefits Council & 23 Other Industry Groups and Associations to Mary L. Schapiro, Chair, U.S. Sec. & Exch. Comm'n Regarding Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Jan. 19, 2012) [hereinafter Am. Benefits Council et al. Letter], http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-1.18-Trades-Ltr-to-SEC-re-pay-ratio-rules1.pdf [https://perma.cc/DTT3-MZ5R].

[69] Financial CHOICE Act of 2017, H.R. 10, 115th Cong. (introduced Apr. 26, 2017); Financial CHOICE Act of 2016, H.R. 5983, 114th Cong. (introduced Sept. 9, 2016); Burdensome Data Collection Relief Act, H.R. 414, 114th Cong. (introduced Jan. 20, 2015); Burdensome Data Collection Relief Act, H.R. 1135, 113th Cong. (introduced Mar. 13, 2013); Burdensome Data Collection Relief Act, H.R. 1062, 112th Cong. (introduced Mar. 14, 2011).

[70] *See* Alan Rappeport, *Bill to Erase Some Dodd-Frank Banking Rules Passes in House*, N.Y. TIMES (June 8, 2017), https://www.nytimes.com/2017/06/08/business/dealbook/house-financial-regulations-dodd-frank.html [https://perma.cc/L95Q-RRX7].

[71] *See* Andrew Ackerman & Gabriel T. Rubin, *Trump Administration Calls for Scrapping CEO Pay Rule*, WALL ST. J. (Oct. 6, 2017), https://www.wsj.com/articles/trump-administration-proposes-wide-ranging-rethink-of-market-regulations-1507298400 [https://perma.cc/M436-7LLJ].

[72] *See* Alan Rappeport & Emily Flitter, *Congress Approves First Big Dodd-Frank Rollback*, N.Y. TIMES (May 22, 2018), https://www.nytimes.com/2018/05/22/business/congress-passes-dodd-frank-rollback-for-smaller-banks.html [https://perma.cc/3WDT-825Y].

[73] *See infra* notes 80–115 and accompanying text.

pay ratio disclosure mandate. The first stems from concerns over income inequality and focuses primarily on workers, rather than investors. According to this view, the pay ratio disclosures are meant to relate runaway executive compensation to stagnant worker wages and thereby highlight income inequality. For example, a 2012 letter to the SEC from Senator Menendez and four other senators, in which they requested swift action on the pay ratio mandate, discussed historical trends in income inequality, and noted that the pay ratio mandate "was intended to shine a light on [pay disparity] figures . . . at each company."[74] In another letter to the SEC, Senator Menendez wrote that "[a]t a time when companies are laying off workers, employees deserve to know whether their executives are sharing proportionally in any sacrifices."[75] Statements by Senator Menendez during a Senate Banking Committee hearing in 2013 carried a similar motif.[76] These concerns resonate in some of the unusual ways the actual pay ratio disclosures have been used in the public realm, which we discuss in Part III.

Members of Congress also offered a second justification for the pay ratio, which focused more closely on investors. In a nutshell, the argument was that the goal of the pay ratio mandate is to provide investors with information about firms' pay practices, because this information is material to investors. To support this point, Senator Menendez and 36 other members of Congress noted in a 2017 letter to the SEC that investors can use the pay ratio information to determine the "fairness" of a company's compensation structure, which in turn would inform investors' advisory say-on-pay votes.[77] The same

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[74] Letter from Senator Robert Menendez et al. to Mary L. Schapiro, Chair, U.S. Sec. & Exch. Comm'n (Mar. 8, 2012), https://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-313.pdf [https://perma.cc/L6HZ-YNZC] ("[I]ncome inequality is a growing concern among many Americans. Incomes at the very top have skyrocketed in recent years while workers' wages and incomes have stagnated. In fact, over the last decade, median family income actually fell for the first time since the Great Depression.").

[75] Letter from Senator Robert Menendez to Mary L. Schapiro, Chair, U.S. Sec. & Exch. Comm'n (Jan. 19. 2011), https://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-59.pdf [https://perma.cc/3F2A-235N].

[76] *See* Press Release, Office of Senator Bob Menendez, Menendez Calls on SEC to Expedite Adoption of CEO-to-Median Pay Disclosure Rule (Mar. 12, 2013), https://www.menendez.senate.gov/news-and-events/press/menendez-calls-on-sec-to-expedite-adoption-of-ceo-to-median-pay-disclosure-rule [https://perma.cc/Q6TU-H9AL] [hereinafter Menendez Press Release] ("Income inequality is a real, growing concern in our nation, as it should be. We have middle class Americans that have gone years without seeing a raise, while CEO pay is soaring . . . . And the excuse used by the industry that this rule is too costly and too burdensome for companies just doesn't pass muster when their CEOs are raking in multi-million dollar bonuses. What's too costly here are the big paydays for CEOs. And the burden is falling on workers with stagnant wages.").

[77] Letter from Senator Robert Menendez et al. to Michael Piwowar, Acting Chairman, U.S. Sec. & Exch. Comm'n (Mar. 14, 2017), https://www.sec.gov/comments/pay-ratio-statement/cll3-1660758-148835.pdf [https://perma.cc/T45N-AKT7] ("This pay ratio information will benefit investors by giving them valuable information for ascertaining whether company employees are

letter argued that the information is relevant to investors because high pay ratios are associated with "the kind of risky investments that brought on the global financial crisis."[78] The letter also linked investor concerns to broader societal concerns by noting that "paying CEOs hundreds of times more than the typical employees hurts working families, is detrimental to employee morale, and goes against what research shows is best for business," and that such pay practices "contribut[e] to stunning widening of economic inequality."[79]

Whereas the first post-enactment justification for the pay ratio disclosure mandate may better reflect the primary concerns that drove its adoption, the second justification places the pay ratio disclosure mandate more squarely within the purview of the SEC disclosure regime. The emphasis on investor concerns was no doubt strategic, because it made it more likely that the SEC would continue to pursue the rule. In addition, the investor-focused approach mirrored the SEC's own framing of the pay ratio disclosure mandate during the multi-stage implementation process, which we turn to next.

C. The SEC Pay Ratio Rulemaking Process

Even though Congress was highly prescriptive with respect to the format of the required pay ratio disclosures, it left it to the SEC to write the actual rule. The rulemaking process, which started in 2010 and did not end until 2017, was highly contentious, splitting SEC Commissioners along political lines and generating a level of public engagement that was virtually unprecedented in the 85-year history of the SEC.[80] The pay ratio rule was one of 86 rules that the SEC was tasked with writing pursuant to the Dodd-Frank Act, including 13 rules in the area of executive compensation and corporate governance.[81]

Soon after the Dodd-Frank Act became law, the SEC began receiving pressure from proponents of the rule, who sought speedy implementation,[82]

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fairly compensated and help them decide how to cast their 'say-on-pay' advisory votes on executive compensation.").

[78] *Id.*

[79] *Id.*

[80] The pay ratio rule likely ranks behind a rulemaking petition urging the SEC to adopt a disclosure rule on corporate political spending. *See* Lucian A. Bebchuk & Robert J. Jackson, Jr., *Hindering the S.E.C. from Shining a Light on Political Spending*, N.Y. TIMES (Dec. 21, 2015), https://www.nytimes.com/2015/12/22/business/dealbook/hindering-the-sec-from-shining-a-light-on-political-spending.html [https://perma.cc/5HZF-BEC6] (noting that the SEC has received more than 1.2 million comments on the proposal).

[81] *See Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, U.S. SEC. & EXCH. COMM'N (Feb. 14, 2019), https://www.sec.gov/spotlight/dodd-frank.shtml [https://perma.cc/63SR-GGNJ]. As of January 1, 2019, the SEC had implemented 68 of the 86 rulemakings, and 8 out of the 13 executive compensation and corporate governance ones.

[82] *See supra* note 74 and accompanying text.

and from opponents of the rule, who urged the SEC to delay it.[83] For the most part, the rule's proponents put forward the income inequality and investor interest arguments discussed in Part I.B. The rule's opponents, on the other hand, argued that there would be "significant hurdles and burdens" associated with compliance.[84] They also suggested holding a roundtable with the business community, or subjecting the rule to rigorous Office of Information and Regulatory Affairs ("OIRA") review—measures aimed at highlighting the costs of compliance.[85] Even before it started implementing the pay ratio rule, the SEC had received 260 unique comment letters, which expressed a multitude of views and concerns.[86] Public support for the not-yet-proposed rule was strong: The SEC received approximately 22,600 form letters and a petition with approximately 84,700 signatories in favor of the pay ratio.[87] Opinions in the popular press on the merits of the rule were also divided.[88]

The SEC issued a proposing release for the pay ratio rule in September 2013. The release highlighted the rule's ambiguities and the numerous methodological challenges associated with identifying the median employee, determining median worker pay, and calculating the pay ratio.[89] The SEC also noted, with some skepticism, that "neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision or a specific market failure, if any, that is intended to be remedied."[90] As a result, though very extensive, the agency's cost-benefit analysis in the proposing release was inconclusive; at times, it also appeared to place the burden on proponents of the rule to identify and quantify the specific benefits of implementing a rule that the SEC was in any event required to implement pursuant to Dodd-Frank.[91] Overall, the release asked for stakeholder input on 69 de-

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[83] *See, e.g.*, Am. Benefits Council et al. Letter, *supra* note 68 (presenting arguments against the pay ratio disclosure rule and other provisions of the Dodd-Frank Act).

[84] *Id.* at 3.

[85] *Id*. at 4.

[86] Pay Ratio Disclosure, Dodd-Frank Act Release No. 33-9452 (proposed Sept. 18, 2013), 78 Fed. Reg. 60,560, 60,561 n.9 (Oct. 1, 2013), https://www.gpo.gov/fdsys/pkg/FR-2013-10-01/pdf/2013-23073.pdf [https://perma.cc/8NLJ-W9F2] [hereinafter Pay Ratio Proposing Release].

[87] *Id.* at 60,561.

[88] *See* Editorial, *Overpaid? Or Worth Every Penny?*, N.Y. TIMES (July 13, 2013), http://www.nytimes.com/2013/07/14/opinion/sunday/overpaid-or-worth-every-penny.html [https://perma.cc/A2HN-FULP] (expressing optimism about the rule's effectiveness); Steven Davidoff Solomon, *A Simple Solution That Made a Hard Problem More Difficult*, N.Y. TIMES (Aug. 27, 2013), http://dealbook.nytimes.com/2013/08/27/a-simple-solution-that-made-a-hard-problem-more-difficult [https://perma.cc/C4TD-PLHA] (discussing the various problems associated with the pay ratio disclosure mandate).

[89] Pay Ratio Proposing Release, *supra* note 86.

[90] *Id*. at 60,582.

[91] *Id*. at 60,582–99.

tailed questions pertaining to every aspect of the rule.[92] The rule proposal divided the SEC, with three Commissioners voting in support, and two against.[93] SEC Chair Mary Jo White emphasized that the agency's approach in the proposed rule sought to provide companies with significant flexibility to ease the burdens of compliance.[94]

The SEC faced additional political pressure after the release of the proposed rule: Republican members of Congress demanded to know how much time the SEC was spending on the pay ratio rule and urged the SEC to prioritize other rulemaking; Democratic members of Congress pressured the SEC to continue with the rule's implementation.[95] Industry groups mobilized further in opposition to the rule, and argued that the total annual compliance costs for all affected companies would be "egregious" at $710.9 million.[96] Proponents of the rule organized a form letter writing campaign which generated over 285,000 letters in support.[97] Separately, the SEC received over 1,540 individual comment letters from members of the public, investors, companies, industry associations, and other stakeholders; these letters once again expressed a wide variety of views.[98]

The SEC adopted the final pay ratio rule on a split three-to-two vote in August 2015, two years after issuing the proposal.[99] The final rule provided firms with additional methodological flexibility in making the relevant calcu-

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[92] *Id.*

[93] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rules for Pay Ratio Disclosure (Sept. 18, 2013), https://www.sec.gov/news/press-release/2013-186 [https://perma.cc/SVF2-X5WP].

[94] *Id.* ("This proposal would provide companies significant flexibility in complying with the disclosure requirement while still fulfilling the statutory mandate . . . . We are very interested in receiving comments on the proposed approach and the flexibility it affords.").

[95] *See* Cydney Posner, *How Many Hours Does It Take to Create Pay-Ratio Rules?*, COOLEY PUBCO (Dec. 18, 2014), https://cooleypubco.com/2014/12/18/how-many-hours-does-it-take-to-create-pay-ratio-rules [https://perma.cc/GJ4D-AQ5W].

[96] IKE BRANNON, CTR. FOR CAPITAL MKTS. COMPETITIVENESS, THE EGREGIOUS COSTS OF THE SEC'S PAY-RATIO DISCLOSURE REGULATION 7 (2014), http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Egregious-Cost-of-Pay-Ratio-5.14.pdf [https://perma.cc/3DTA-XVS4] (reporting data based on a survey of covered companies).

[97] *See* Pay Ratio Disclosure, Dodd-Frank Act Release No. 33-9877, 80 Fed. Reg. 50,104, at 50,108 (Aug. 18, 2015), https://www.gpo.gov/fdsys/pkg/FR-2015-08-18/pdf/2015-19600.pdf [https://perma.cc/8YQF-7QM5] [hereinafter Pay Ratio Adopting Release].

[98] *See id.* at 50,108–09.

[99] *See* Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rule for Pay Ratio Disclosure, Aug. 5, 2015, https://www.sec.gov/news/pressrelease/2015-160.html [https://perma.cc/NW3Z-KX3M]. The two Democratic Commissioners and the SEC Chair voted in favor, while the two Republican Commissioners voted against.

lations.[100] Similar to the 2013 proposing release, the 2015 adopting release noted that the objectives or intended benefits of the rule are unclear from the statute or legislative history.[101] This time, however, the SEC took a more concrete view of how the pay ratio disclosure rule fits within the existing executive compensation regulatory framework.

The SEC stated that it believed, "based on [an] analysis of the statute and comments received, that Section 953(b) was intended to provide shareholders with a company-specific metric that can assist in their evaluation of [the company's] executive compensation practices,"[102] and that the pay ratio disclosure "may provide a more useful or relevant data point for shareholders making their say-on-pay votes . . . ."[103] The SEC also noted that the pay ratio data may be useful to investors in making their investment decisions.[104] This statement of the goals of the rule is notable as much for what it did not say as for what it did. There is no discussion of income inequality, suggesting that the SEC did not think that pay ratio disclosures were intended to highlight income inequality.[105] In addition, the SEC emphasized that pay ratio disclosures are firm-specific and not suitable for comparisons across firms.[106] As we show in Part III, however, the actual use of the pay ratio data during the 2018 reporting season contravenes these precepts.

A final twist in the story of the implementation of the pay ratio rule came in February 2017, when the then-Acting SEC Chair, Michael Piwowar, issued a statement soliciting detailed public comments from firms on whether they were experiencing any "unexpected challenges" in complying with the

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[100] *See infra* Part II. In line with general practice, smaller reporting companies, emerging growth companies, and foreign companies with SEC reporting obligations were exempted from compliance with the rule.

[101] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,150.

[102] *Id*. Elsewhere in the release, the SEC affirmed its belief that this is "the primary benefit that Congress intended with pay ratio disclosure." *Id*. at 50,149.

[103] *Id.* at 50,137.

[104] *Id.* at 50,114 ("[A]lthough we understand the primary purpose of the pay ratio disclosure to be to inform shareholder's say-on-pay votes . . . , we acknowledge that some commenters indicated the disclosure could be useful to investors in making investment decisions.").

[105] The SEC Pay Ratio Adopting Release mentions "income inequality" and "inequitable wealth distribution" only when summarizing the public comments it received. *Id.* at 50,109, 50,153.

[106] *Id.* at 50,106 ("[W]e believe the final pay ratio rule should be designed to allow shareholders to better understand and assess a particular [company's] compensation practices and pay ratio disclosures rather than to facilitate a comparison of this information from one [company] to another."). The SEC reiterated this point in the 2017 guidance release on the pay ratio disclosure rule. *See infra* note 115 and accompanying text.

rule.[107] Acting Chair Piwowar also directed the SEC staff to "reconsider the implementation of the rule" based on the comments received, and to determine whether additional guidance or regulatory relief would be appropriate.[108] This move was as controversial as it was unusual.[109] After all, Piwowar's status at the helm of the agency was temporary and he was outvoted by the other Commissioners when the rule was adopted by the SEC in 2015 (which had prompted him to issue two vehement dissents).[110]

This additional rulemaking round generated a new set of comments: over 230 unique comment letters and over 14,000 form letters.[111] Firms and industry associations argued for additional flexibility.[112] Investors, legislators, and members of the public wrote in support of the rule, using the same arguments and intensity as in prior rounds.[113] Meanwhile, a new SEC Chair was confirmed in May 2017, and he expressed no interest in a political battle over the pay ratio disclosure rule or the similarly-controversial conflict minerals disclosure rule, which had also been placed under review.[114] In September 2017, the SEC staff concluded the pay ratio review by issuing additional technical guidance on making the relevant calculations.[115] This completed the

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[107] Acting Chairman Michael S. Piwowar, *Public Statement on Reconsideration of Pay Ratio Rule Implementation*, U.S. SEC. & EXCH. COMM'N (Feb. 6, 2017), https://www.sec.gov/news/statement/reconsideration-of-pay-ratio-rule-implementation.html [https://perma.cc/KQ4L-FMEY].

[108] *Id*.

[109] The move prompted a letter from four senators demanding that the SEC's Inspector General investigate Piwowar's actions. *See* Letter from Senators Sherrod Brown, Elizabeth Warren, Robert Menendez and Brian Schatz to the Hon. Carl W. Hoecker, SEC Inspector General (Mar. 29, 2017), https://www.warren.senate.gov/files/documents/2017_03_29_SEC_IG_letter.pdf [https://perma.cc/B63D-UNMP].

[110] *See* Commissioner Michael S. Piwowar, *Dissenting Statement at Open Meeting on Pay Ratio Disclosure*, U.S. SEC. & EXCH. COMM'N (Aug. 5, 2015), https://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-on-pay-ratio-disclosure.html [https://perma.cc/HL4N-QSVJ] [hereinafter *Piwowar Dissenting Comments*]; *see also* Commissioner Michael S. Piwowar, *Additional Dissenting Comments on Pay Ratio Disclosure*, U.S. SEC. & EXCH. COMM'N (Aug. 7, 2015), https://www.sec.gov/news/statement/additional-dissenting-statement-on-pay-ratio-disclosure.html [https://perma.cc/2LNY-CXH2].

[111] *See Comments on the Statement on the Commission's Pay Ratio Rule*, U.S. SEC. & EXCH. COMM'N (Apr. 9, 2018), https://www.sec.gov/comments/pay-ratio-statement/payratiostatement.htm [https://perma.cc/JE7K-LN25].

[112] *See, e.g.*, Letter from Jeffrey Shuman, Senior Vice President, Quest Diagnostics, to Michael S. Piwowar, Acting Chairman, U.S. Sec. & Exch. Comm'n (Mar. 23, 2017), https://www.sec.gov/comments/pay-ratio-statement/cll3-1666293-148965.pdf [https://perma.cc/W96Q-JBR8] (asking the SEC to limit the rule's applicability to U.S. employees only).

[113] *See Comments on the Statement on the Commission's Pay Ratio Rule*, *supra* note 111.

[114] *See* Laura Anthony, *SEC Announces Regulatory Agenda*, HUFFPOST (Sept. 25, 2017), https://www.huffingtonpost.com/entry/sec-announces-regulatory-agenda_us_59c96473e4b0b7022a646ce3 [https://perma.cc/UQZ9-HDYX].

[115] Commission Guidance on Pay Ratio Disclosure, Securities Act Release No. 33-10415, 82 Fed. Reg. 44,917 (Sept. 27, 2017), https://www.sec.gov/rules/interp/2017/33-10415.pdf [https://perma.cc/FC46-MX5M] [hereinafter Pay Ratio Guidance Release]; *Division of Corpora-*

seven-year SEC rulemaking process, and, shortly thereafter, over 3,000 U.S. public companies started reporting their CEO-to-median worker pay ratios.

D. The Rule's Function: Three Possible Conceptions

Our discussion of the origins of the pay ratio disclosure rule would be incomplete without exploring a fundamental question that can easily become obscured by the official framing of the pay ratio during the rulemaking process: What function, or functions, is the pay ratio disclosure rule supposed to fulfill?

Recall that the SEC justified the pay ratio rule with reference to investors' say-on-pay voting decisions.[116] In letters to the SEC, however, the originator of the pay ratio mandate, Senator Menendez, spoke about the pay ratio's importance both in terms of shining light on income inequality for the benefit of employees, and helping investors evaluate the fairness of firms' compensation practices.[117] Stakeholders have offered a number of alternative views of the pay ratio—sometimes even offering one interpretation as part of the official process and a different one when speaking to broader constituencies.[118] In their criticism, opponents of the pay ratio have also suggested a variety of different conceptions of the rule.[119] In short, the public understanding of the pay ratio rule and its functions can be characterized as polyphonic, and even discordant.

We have identified three possible functions that the pay ratio could be expected to fulfill: an informational function, a behavioral function, and a public discourse function. Stakeholders' *true* views of the pay ratio, which are unobservable, could reflect one or a combination of these functions (or, indeed, some other possible function). In Part V, we consider—based on the evidence and analysis presented in this Article—the extent to which the pay ratio is fulfilling these functions.

We do not attempt to determine the "right" function, because this is a question involving legislative history, which in the pay ratio's case is indeterminate, and policy preferences, which are always contingent. By exploring

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tion Finance Guidance on Calculation of Pay Ratio Disclosure, U.S. SEC. & EXCH. COMM'N (Sept. 21, 2017), https://www.sec.gov/corpfin/announcement/guidance-calculation-pay-ratio-disclosure [https://perma.cc/2XQ8-JNX9].

[116] *See supra* notes 102–105 and accompanying text.

[117] *See supra* notes 74–79 and accompanying text.

[118] *See supra* note 113 and *infra* note 127, and accompanying text (using the AFL-CIO as an example).

[119] *See, e.g.*, *Piwowar Dissenting Comments*, *supra* note 110 (arguing that the pay ratio rule does not provide investors with material information and that it seeks to influence the levels of executive compensation).

the full variety of possible functions of the pay ratio instead, we seek to map out the multiple possible social constructions of the pay ratio disclosure rule and the grounds on which the contests over its meaning and legitimacy are being held.[120]

1. Informational Function

The conception of the pay ratio disclosure rule as a means of generating information to be used by investors fits neatly within the framework of the securities disclosure regime. At its most basic, disclosure is about providing investors with information, and there is no controversy over whether this constitutes a legitimate function for a securities disclosure rule.

Viewing the pay ratio through an investor information lens was the safest, and likely the only, way the SEC could approach the rule in the absence of specific instructions from Congress as to the rule's purpose. This framing by the SEC in turn determined the way stakeholders discussed the rule during the notice-and-comment rulemaking process. Opponents of the rule asserted that investors would not find the pay ratio information useful, or material, based on the low level of interest investors had previously expressed in such information.[121] Proponents of the rule, including the hundreds of thousands of form comment letters, asserted that investors need the information the pay ratio would provide.[122] Comment letters by the AFL-CIO, a strong supporter of the rule, focused exclusively on the pay ratio's informational benefits, citing a variety of economic studies showing the relevance of compensation-related information to investors.[123]

2. Behavioral Function

Instead of, or in addition to, providing investors with information, the pay ratio disclosure rule could be seen as a way to influence corporate deci-

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[120] In this respect, the pay ratio disclosure rule bears resemblance to the Sarbanes-Oxley Act of 2002, which was similarly controversial upon its adoption and which also underwent a lengthy period of contestation. *See* Langevoort, *supra* note 19, at 1944 (discussing the social construction of the Sarbanes-Oxley Act).

[121] *See, e.g.*, Letter from David T. Hirschmann, President and CEO, Ctr. for Capital Mkts. Competitiveness, U.S. Chamber of Commerce, to Elizabeth M. Murphy, Secretary, U.S. Sec. & Exch. Comm'n (Dec. 2, 2013), https://www.sec.gov/comments/s7-07-13/s70713-567.pdf [https://perma.cc/7WG9-L6RF].

[122] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,150–52.

[123] *See, e.g.*, Letter from Brandon J. Rees, Deputy Director, Office of Investment, AFL-CIO, to Michael S. Piwowar, Acting Chairman, U.S. Sec. & Exch. Comm'n (Mar. 22, 2017), https://www.sec.gov/comments/pay-ratio-statement/cll3-1661366-148849.pdf [https://perma.cc/LRY5-GSRH] (citing studies suggesting that high pay ratios inhibit teamwork and lead to lower job satisfaction and morale, higher employee turnover, reduced productivity and inferior product quality).

sionmaking in substantive ways. For example, the fact that firms are required to publicly disclose their median worker pay figures, as well as the ratio of CEO pay to median worker pay, may induce them to make the figures look more acceptable to investors, employees, or other stakeholders. They could do so by increasing median worker pay, reducing CEO pay, or doing both at the same time. In addition, disclosure may lead board compensation committees, which deal primarily with *executive* compensation, to focus more closely on the levels and structure of *employee* pay. Though less common, securities disclosure rules with a behavioral function are not outside the norm.[124]

Both supporters and detractors of the pay ratio disclosure rule have referred to its potential behavioral function. For example, Senator Menendez noted that "by requiring companies to disclose just how much, and how skewed, CEO pay can be, there's a strong possibility they'll think more about their compensation structures."[125] This thread was also evident in a number of the comment letters to the SEC.[126] It also appears in statements made outside of the rulemaking process: Prior to the rule's adoption, the AFL-CIO website noted that "[d]isclosing this pay ratio will shame companies into lowering CEO pay."[127] This "name and shame" rationale has also been acknowledged by opponents of the rule, who have used it to argue against the rule's legitimacy.[128] For its part, the SEC took the position that the pay ratio is not meant to fulfill a "name and shame" function.[129] Overall, the behavioral conception

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[124] Consider, for example, two provisions contained in the Sarbanes-Oxley Act of 2002: Section 406 requires companies to disclose whether they have a code of ethics for senior officers, and, if not, why not; this practically guarantees that all companies will adopt a code of ethics. Section 407 requires companies to disclose whether at least one financial expert serves on the board audit committee, and, if not, why not; again, this practically guarantees that virtually all companies will have such an expert. *See* Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 406, 407, 116 Stat. 745, 789–90 (2002) (codified as amended at 15 U.S.C. §§ 7263–7265 (2012)).

[125] *See* Menendez Press Release, *supra* note 76.

[126] *See, e.g.*, Comment Letter Type L on Pay Ratio Disclosure, U.S. Sec. & Exch. Comm'n (July 15, 2015), https://www.sec.gov/comments/s7-07-13/s70713-1571.htm [https://perma.cc/3J3V-5JEM] ("Disclosing corporate pay disparities will discourage lavish CEO pay practices that reward recklessness and greed—and that fueled the 2008 economic crash.").

[127] *See* Jena McGregor, *What if We Knew How Much CEOs Made vs. Their Workers?*, WASH. POST (Aug. 22, 2013), https://www.washingtonpost.com/news/on-leadership/wp/2013/08/22/what-if-we-knew-how-much-ceos-made-vs-their-workers [https://perma.cc/4XNR-E39Q] (quoting the AFL-CIO website); *see also* Peter Schroeder, *Disputed Rule Intended to Shame CEOs*, THE HILL (Feb. 2, 2012), http://thehill.com/business-a-lobbying/208161-disputed-rule-intended-to-shame-ceos [https://perma.cc/D9AD-MC2R] ("They will be embarrassed, and that's the whole point," quoting a statement on the pay ratio rule by an AFL-CIO official).

[128] *See, e.g.*, *Piwowar Dissenting Comments*, *supra* note 110 (writing that "the pay ratio disclosure is a blatant attempt to limit executive compensation").

[129] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,106 n.20 ("We note that some commenters contended that the pay ratio disclosure is intended to publicly 'shame' registrants concerning the size of the disparity between their CEO's compensation and their typical worker's

of the pay ratio rule echoes a hope that critics of high CEO pay have expressed many times in the past, namely that executive compensation disclosure rules might help reduce CEO pay.[130]

3. Public Discourse Function

The pay ratio disclosure rule can also be conceived of in ways that have little to do with investor decisionmaking or the compensation structures at the individual firms providing the disclosures. Instead, the rule could be viewed as a means of fostering or contributing to a public conversation about income inequality. This umbrella term could refer to the high disparities between the pay of rank-and-file workers and corporate executives within firms across the economy (pay inequity), or to broader inequalities in wealth distribution within society (economic inequality).[131]

An SEC-mandated pay ratio disclosure rule has the capacity to facilitate this public conversation in two powerful ways: First, it generates information from companies that are household names to illustrate pay disparities; this is potentially more effective rhetorically than using pay ratio estimates covering the entire economy, which have been available for decades.[132] Second, an SEC pay ratio rule potentially ensures that the public conversation would take place every year, because the disclosures are provided on an annual basis, and that the conversation would last several months, because firms release their annual reports at different times. The CEO pay information released under

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compensation. . . . [W]e have reached a different conclusion based on principles of statutory construction and have taken no such objective into account in framing the rule.").

[130] Evidence based on the disclosure of executive compensation information over the past decades suggests that disclosure rules have not led firms to reduce CEO pay. To the contrary, disclosure may have helped drive CEO pay up, because it makes it easier for firms to determine the average pay for a peer group and construct an above-average pay package in order to attract or retain CEOs. *See generally* Charles M. Elson & Craig K. Ferrere, *Executive Superstars, Peer Groups and Overcompensation: Cause, Effect and Solution*, 38 J. CORP. L. 487 (2013) (suggesting that the rise in executive compensation is due to the standard benchmarking practice of comparing CEO pay to peer groups and that disclosure requirements have not led to reduced CEO pay). We cannot, however, automatically draw the conclusion that the same effect will obtain in the case of the pay ratio disclosure rule, because—for the first time—firms are required to disclose median worker pay and relate CEO pay to it.

[131] These concepts do not have universally-agreed definitions; we discuss them further in Part V.B.3.

[132] *See* Lawrence Mishel, *The CEO-to-Worker Compensation Ratio in 2012 of 273 Was Far Above That of the Late 1990s and 14 Times the Ratio of 20.1 in 1965*, ECON. POL'Y INST. (Sept. 24, 2013), https://www.epi.org/publication/the-ceo-to-worker-compensation-ratio-in-2012-of-273/ [https://perma.cc/UH7W-HYH3].

existing rules has always generated media and public interest.[133] By relating CEO pay to the pay of rank-and-file workers, however, the new pay ratio disclosures could amplify the conversation, or even change its tenor.

Setting aside the legitimacy and normative desirability of this strategy, there is evidence that the pay ratio was originally viewed as fulfilling a public discourse function, at least in part. The early statements of Senator Menendez, made before the SEC framed the pay ratio exclusively with reference to investor decisionmaking, contain lengthy discussions of income inequality.[134] A congressional critic of the pay ratio provision at the time of its adoption conceptualized it in similar terms.[135] The Dodd-Frank Act itself was adopted at a time of economic uncertainty and sought to address the worst economic crisis in generations. Separately, the use of the actual pay ratio disclosure data during the 2018 reporting season, which we discuss in Part III, suggests that the pay ratio may be taking on a public discourse meaning among certain constituencies.

II. RULE DESIGN, INITIAL EVIDENCE, AND METHODOLOGICAL CHALLENGES

Implementing the pay ratio disclosure rule was challenging for the SEC due to the nature of the Dodd-Frank mandate, which was highly prescriptive in terms of format, but vague in various other respects. In this Part, we describe the design of the pay ratio rule, the results from the first year of pay ratio reporting, and the reasons why individual firms' pay ratios may not be reliable and why they are not fit for comparison with the ratios of other firms. The reliability and comparability problems are due in part to the inevitable operational differences among firms, and in part to the significant methodological flexibility that the SEC built into the rule. We illustrate these points with examples from the 2018 pay ratio disclosures of various firms. (Preliminary results from the 2019 reporting season that became available as the Article went to press suggest that the disclosure trends, approaches, and problems discussed in this Part remain unchanged during the second year of pay ratio reporting).[136]

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[133] *See, e.g.*, John E. Core, Wayne Guay & David F. Larcker, *The Power of the Pen and Executive Compensation*, 88 J. FIN. ECON. 1 (2008) (discussing the role of the press in monitoring and influencing executive compensation).

[134] *See supra* notes 74–76 and accompanying text.

[135] *See supra* note 67 and accompanying text.

[136] *See* ERIC HOSKEN ET AL., COMP. ADVISORY PARTNERS, A DEEP DIVE INTO THE SECOND YEAR OF CEO PAY RATIO DISCLOSURES (2019), https://www.capartners.com/wp-content/uploads/2016/08/CAPintel-19-04-10-CEO-Pay-Ratio-v2.pdf.

A. The SEC's Interpretation of the Congressional Pay Ratio Mandate

As a math problem, the CEO-to-median worker pay ratio is simple to calculate. For example, if the total compensation for the company's CEO is $1 million and the median employee makes $50,000, the pay ratio is 20:1, because $1 million is 20 times greater than $50,000. What makes calculating a pay ratio difficult is the inputs rather than the math. The costs associated with compliance became apparent as soon as the pay ratio mandate was adopted by Congress and this generated much of the early controversy surrounding the rule.[137] To this end, the SEC devoted significant attention throughout the rulemaking process to defining the inputs in ways that would be consistent with the congressional mandate but that also "provide flexibility in a manner that would reduce costs and burdens" on firms.[138] This is reflected in the final SEC rules, which are contained in Item 402(u) of Regulation S-K, as supplemented by the additional guidance contained in the 2015 Pay Ratio Adopting Release and the 2017 Commission Guidance Release (collectively, the "regulations").[139]

On the whole, the SEC afforded companies wide latitude on matters such as who to include in their employee population, what methodology to use in identifying the median employee, and how to calculate the median employee's total compensation. The SEC also did not require firms to provide narrative disclosure explaining the reported figures or the factors driving them; instead, the regulations merely give firms the option to do so.[140] Overall, this flexibility led to significant reductions in firms' estimated compliance costs.[141] It did, however, also come at the cost of reliability and comparability.

The statutory text requires firms to take into account the annual total compensation of *all employees* in calculating the pay ratio.[142] Most firms' labor forces, however, are far from homogenous: In addition to full-time domestic workers, they may also contain seasonal workers, part-time workers, and overseas workers; many firms also rely on leased workers and independ-

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[137] *See supra* notes 83–85 and accompanying text.

[138] Pay Ratio Guidance Release, *supra* note 115 (internal quotation marks omitted).

[139] *See* Regulation S-K, Item 402(u), 17 C.F.R. § 229.402(u) (2018); Pay Ratio Adopting Release, *supra* note 97; Pay Ratio Guidance Release, *supra* note 115.

[140] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,107.

[141] For example, before the SEC indicated how it will interpret the congressional mandate, Intel's estimate for its annual compliance costs was in the $250,000–$500,000 range. After applying the flexible approach set out in the 2013 Proposing Release, Intel's estimate went down by 90%, to $15,000. *See* Intel Corp., Comment Letter on Proposed Rule Regarding Pay Ratio Disclosure Pursuant to Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Nov. 27, 2013), https://www.sec.gov/comments/s7-07-13/s70713-658.pdf [https://perma.cc/PGU8-7RTL].

[142] Regulation S-K, Item 402(u)(3), 17 C.F.R. § 229.402(u)(3) (2018).

ent contractors.[143] The business models of different firms and the industries in which they operate require a different mix of worker categories. Including all of them in the definition of "employees" would reflect the most literal reading of the congressional mandate, but would require the most data-gathering and result in a median worker figure that may not contain much meaningful information.[144]

After taking into account the extensive feedback of various stakeholders, the SEC determined that the term "employee" should cover any "individual employed by the [company] . . . whether as a full-time, part-time, seasonal, or temporary worker," but that it would not cover leased workers or independent contractors.[145] Foreign workers are included in this definition, subject to a data privacy exemption and a de minimis exemption.[146] Firms are allowed to exclude individuals who became employees as a result of a business combination or acquisition in the fiscal year in which the transaction occurred.[147] The regulations also provide flexibility as to when the total employee population is counted.[148]

Though the term "median worker pay" has replaced it in common usage, the statute actually uses the term "median of the annual total compensation of all employees," without elaborating how it should be determined.[149] The SEC made a number of determinations in this context, many of which reflect its desire to provide firms with maximum flexibility.

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[143] *See* Jay Shambaugh, Ryan Nunn & Lauren Bauer, *Independent Workers and the Modern Labor Market*, BROOKINGS (June 7, 2018), https://www.brookings.edu/blog/up-front/2018/06/07/independent-workers-and-the-modern-labor-market [https://perma.cc/8U3G-TWRK] (discussing the number of American employees working in alternative employment arrangements).

[144] *See infra* Part IV.B.

[145] Regulation S-K, Item 402(u)(3), 17 C.F.R. § 229.402(u)(3) (2018) ("The definition of employee . . . does not include those workers who are employed, and whose compensation is determined, by an unaffiliated third party but who provide services to the registrant or its consolidated subsidiaries as independent contractors or 'leased' workers."). To make things easier, the SEC clarified that this provision "was not intended to serve as an exclusive basis for determining whether a worker is an employee of the registrant" and that it would be permissible "for a registrant to apply a widely recognized test under another area of law that the registrant otherwise uses to determine whether its workers are employees." Pay Ratio Guidance Release, *supra* note 115, at 44,918.

[146] Under the data privacy exemption, firms may exclude workers employed in jurisdictions where the privacy laws prohibit disclosure of the information. Under the de minimis exception, firms may exclude foreign workers where they constitute less than 5% of the total employees of the company. *See* Regulation S-K, Item 402(u)(4), 17 C.F.R. § 229.402(u)(4) (2018).

[147] *Id.* at Item 402(u), Instruction 7(2).

[148] *Id.* at Item 402(u)(3). The calculation may be performed as of any date within the last three months of the company's last completed fiscal year. *Id*.

[149] *Id*. at Item 402(u)(1).

In order to determine median worker pay, a firm must first identify an actual median employee.[150] In doing so, however, the firm does not actually have to find the employee who is at the exact median of its entire employee population. Instead, it may use what the regulations describe as "statistical sampling and/or other reasonable methods" so as to determine the median from a smaller base of employees.[151] Though pay ratio disclosure is required on an annual basis, the exercise of identifying the median employee can be performed once every three years, subject to certain conditions.[152]

Firms are also afforded wide flexibility in the methodology they employ to determine the median employee's annual total compensation. As long as it uses what the regulations call a "consistently applied compensation measure" ("CACM"), and briefly explains the methodology and the underlying assumptions, a firm has several options: It may follow the rules applicable to reporting executive compensation under Item 402(c)(2)(x), or, alternatively, it may choose to use "*any other* compensation measure that is consistently applied to all employees," such as the company's tax and/or payroll records.[153] The latter is permissible "even if those records do not include every element of compensation, such as equity awards widely distributed to employees."[154] A company may also make certain adjustments in calculating employee compensation, including annualizing the total compensation for permanent employees who were employed less than the full year,[155] making a cost-of-living adjustment for employees living in a jurisdiction different than the one in which the CEO resides,[156] and including a certain amount of personal benefits.[157]

B. Results from the 2018 Reporting Season

As soon as individual firms began disclosing their pay ratio information for the first time in 2018, various third parties started amassing aggregate data and analyzing it to discern trends, make comparisons, and uncover anomalies. The SEC has emphasized that individual pay ratios are not comparable, and,

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[150] Pay Ratio Adopting Release, *supra* note 97, at 50,137.

[151] Regulation S-K, Item 402(u), Instruction 4(2), 17 C.F.R. § 229.402 (2017).

[152] *Id.* at Item 402(u), Instruction 2. The exercise must be carried out more frequently if there have been changes in the employee population or compensation arrangements that the firm believes would significantly affect its pay ratio. *Id*.

[153] *Id.* at Item 402(u), Instructions 4(3) & 4(5).

[154] Pay Ratio Guidance Release, *supra* note 138, at 44,918.

[155] Regulation S-K, Item 402(u), Instruction 5, 17 C.F.R. § 229.402 (2017). It may not, however, annualize compensation for temporary, seasonal, or part-time employees. *Id.*

[156] *Id.* at Item 402(u), Instruction 4(4).

[157] *Id.* at Item 402(u), Instruction 4(6). The personal benefits must be less than $10,000 in the aggregate and the items must also be included in the CEO's compensation. *Id.*

therefore, should not be aggregated or compared.[158] For indicative purposes, and subject to this important caveat, we present some of the 2018 data below.

When aggregated based on market capitalization, the 2018 pay ratios differ substantially. For instance, the median reported ratio for companies in the S&P 500 index was 155:1, whereas the median ratio in the broader Russell 3000 index was a significantly lower 70:1.[159] Based on a sample of over 2000 firms, compensation advisory firm Pearl Meyer reported an average ratio of 144:1, and a median ratio of 69:1.[160] (As we discuss in Part III, other stakeholders reported different aggregate pay ratio numbers. The AFL-CIO, for example, reported an average pay ratio of 361:1 for firms in the S&P 500.)

An analysis of the data by compensation advisory firm Equilar found a correlation between the pay ratio and market capitalization in Russell 3000 companies, with higher market capitalization companies reporting higher pay ratios (see Figure 1).[161] There is a similar correlation between the pay ratio and total employee population, with companies with more employees reporting higher pay ratios (see Figure 2).[162]

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[158] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,106.

[159] *See* Ira Kay & Blaine Martin, *The CEO Pay Ratio: How Should Compensation Committees Evaluate Their Ratios? Measuring the Impact of "Median Employee Pay,"* PAY GOVERNANCE (May 24, 2018), http://paygovernance.com/the-ceo-pay-ratio-how-should-compensation-committees-evaluate-their-ratios-measuring-the-impact-of-median-employee-pay [https://perma.cc/6WPN-7EU2] (providing the median ratio for the S&P 500 index); Jessica Phan, *CEO Pay Ratio: A Deep Data Dive*, HARV. LAW SCH. F. ON CORP. GOVERNANCE & FIN. REG. (May 31, 2018), https://corpgov.law.harvard.edu/2018/05/31/ceo-pay-ratio-a-deep-data-dive [https://perma.cc/MY7A-XWPY] (noting the median ratio for the Russell 3000 index).

[160] PEARL MEYER, THE CEO PAY RATIO DATA: PERSPECTIVES FROM THE 2018 PROXY SEASON 6 (2018), https://www.pearlmeyer.com/ceo-pay-ratio-data-and-perspectives-2018-proxy-season.pdf [https://perma.cc/Q64A-PGJN].

[161] Phan, *supra* note 159.

* All graphs in this Article are also available online at https://www.bc.edu/content/dam/bc1/schools/law/pdf/law-review-content/BCLR/60-4/bank-georgiev-graphics.pdf [https://perma.cc/QKY9-PVBJ].

[162] *Id*.

Figure 1: Median CEO Pay Ratio for Firms in the Russell 3000 Index by Market Capitalization*

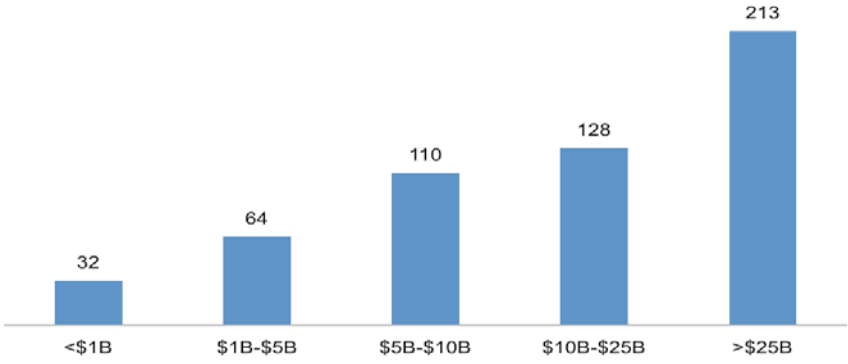
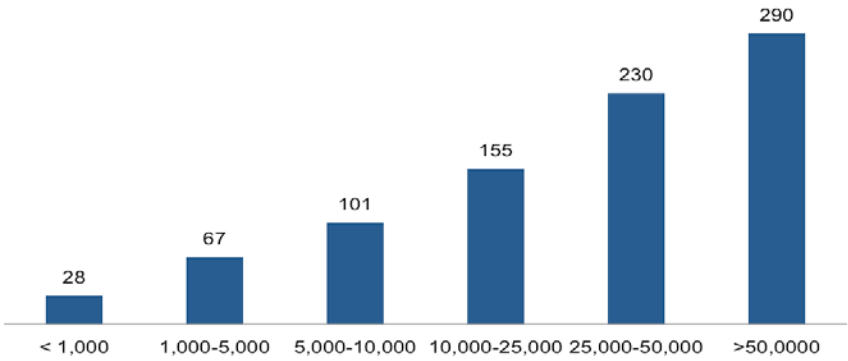


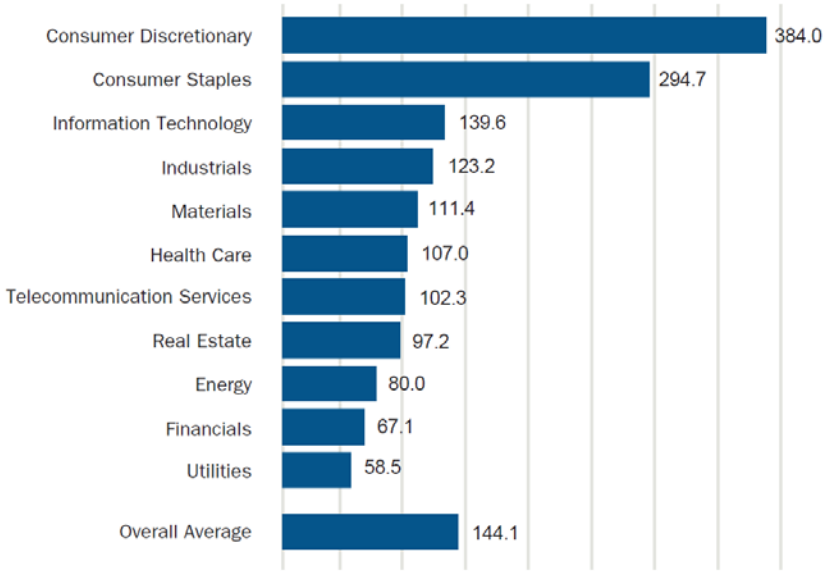
Figure 2: Median CEO Pay Ratio for Firms in the Russell 3000 Index by Employee Count



The pay ratios also show significant variation when aggregated by industry (see Figure 3).[163] The consumer goods or retail sector, where the workforce is often part-time and seasonal, has the highest pay ratios, with a median pay ratio of 384:1.[164] By contrast, in utilities, where employees are more likely to be full-time, the pay ratios are much lower, with a median of 58:1.[165]

[163] *See* PEARL MEYER, *supra* note 160, at 6.
[164] *Id.*
[165] *Id.*

Figure 3: Median CEO Pay Ratio by Industry Sector



Although the 2018 data suggests that there are broad trends that have emerged based on size and industry, there are many outliers. For example, the highest reported ratios were 5,908:1 (Weight Watchers) and 4,987:1 (Mattel), but there were companies with a 1:1 ratio (Apollo Global Management, The Carlyle Group), and even a ratio of 0 or close to 0 (Twitter, RE/MAX Holdings, Alphabet/Google).[166] These outlier ratios were driven by idiosyncratic reasons, which we discuss below.

C. Reliability and Comparability Problems

Two sets of reasons undermine the reliability and comparability of the pay ratio data and call into question the utility of the entire regulatory enterprise. Most importantly, companies often operate very differently, even if they are the same size or in the same industry. As a result, they may differ in the way they compensate their executives, in how they are organized, or in the labor markets upon which they draw. The pay ratio regulations do not,

[166] Tomi Kilgore, *CEO Pay Ratio Disclosures Provide Little More Than Noise for Investors*, MARKETWATCH (May 28, 2018), https://www.marketwatch.com/story/ceo-pay-ratios-provide-little-more-than-noise-for-investors-2018-04-20 [https://perma.cc/J8FM-9X8M] (noting the pay ratios of Weight Watchers and Mattel); David McCann, *Pay Ratio Disclosures Mislead Investors*, CFO (Mar. 14, 2018), http://ww2.cfo.com/compensation/2018/03/pay-ratio-disclosures-mislead-investors [https://perma.cc/N3WF-KLQ2] (noting the pay ratios of Apollo and Carlyle); *see* Phan, *supra* note 159 (noting the pay ratios of Twitter, RE/MAX and Alphabet/Google).

and, for the most part, cannot adequately account for these differences. In addition, the broad methodological flexibility afforded to companies allows them to choose the pay ratio that places them in the best light. Thus, two similarly situated companies can report quite different numbers simply because they are permitted to use different inputs or methods of calculating those numbers.

1. Operational Differences

Rather than providing an indicator of firm quality or governance, differences in pay ratios are most likely to reflect the basic fact that each firm is different. When a firm is well-run, it uses a compensation scheme tailored to its individual characteristics. We illustrate how three such differences distort the pay ratio data and compromise comparisons among firms.

a. Low Pay CEOs

In companies where the CEO is the founder or has otherwise amassed a significant amount of stock in the company, the cash salary is viewed as a trivial component of the executive's compensation.[167] As a result, they are only paid a nominal amount, some down to as little as $1. This obviously has a significant distortionary effect on the company's pay ratio.

For example, as mentioned previously, Alphabet's pay ratio in 2018 was a scant 0.000005:1, because its CEO, Larry Page, was paid $1 for the year, while the median employee received $197,274.[168] Similarly, Amazon reported a low pay ratio of 59:1, even though Jeff Bezos, the company's CEO, is one of the wealthiest people in the world.[169] That wealth, however, is due to his stock holdings—in 2017, he owned 78.9 million shares in Amazon, worth approximately $33 billion—and not due to his reported compensation, which was a relatively modest $1.68 million.[170]

These low pay arrangements do not mean that executives such as Page or Bezos are getting little current compensation from the company. Rather,

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[167] *See generally* Emily Stewart, *11 CEOs That Make Less Money Than You Do*, THE STREET (June 12, 2015), https://www.thestreet.com/story/13111869/1/10-super-rich-ceos-who-only-make-one-dollar-in-salary.html [https://perma.cc/QC2G-GTJ6] ("What CEOs aren't getting in base pay they often receive in stock, options, bonuses and perks. In many cases, they've already amassed fortunes large enough to render any reasonable base pay irrelevant.").

[168] Alicia Ritcey & Jenn Zhao, *Alphabet CEO Page Makes a Tiny Fraction Compared to Its Median Employee*, BLOOMBERG (July 19, 2018), https://www.bloomberg.com/graphics/ceo-pay-ratio [https://perma.cc/67NA-DYX2].

[169] Kilgore, *supra* note 166.

[170] *Id.* Moreover, only $81,840 of Bezos' total annual compensation constituted salary and the remainder was the cost of security arrangements for him. *Id.*

the bulk of their compensation comes in the form of investment returns from dividends and appreciation, which are not counted for pay ratio purposes. For example, Berkshire Hathaway disclosed a pay ratio of 1.9:1, because CEO Warren Buffett's annual compensation was $100,000, the same salary he has received for the past 25 years, and the median employee's pay was $53,510.[171] In 2017, however, Buffett's stock in Berkshire Hathaway rose in value by approximately $15.1 billion, which, when combined with his salary, would result in a pay ratio of 282,435:1.[172] This begs the question: Which of these two numbers paints an accurate picture of the relationship between CEO pay and median worker pay at Berkshire Hathaway?

b. Choice of Entity

Some executives receive most of their compensation in the form of investment return not because of their stockholdings, as in the cases of Page and Bezos, but because of the organization of their firm. For example, Apollo Global Management, the Carlyle Group, and Dorchester Minerals each reported very low pay ratios. Apollo's was 1:1 because CEO Leon Black's compensation of $251,888 was almost the same as the $249,750 received by the firm's median employee.[173] Carlyle had a similar arrangement, paying each of its three "co-principal executive officers" $281,750 while paying $201,315 to its median employee, leading to a 1.4:1 pay ratio.[174] Dorchester had an even lower ratio of 0.9:1, because CEO William McManemin was paid $96,000, while the median employee received $106,385.[175]

In all three cases, the low CEO salaries were a function of the organization of the firms as publicly-traded limited partnerships.[176] In such a structure, the CEO is also a partner and receives a substantial amount of his or her income in the form of distributions from partnership profits, which are not included in the calculation of CEO pay under the pay ratio regulations. Thus, for example, even though Leon Black of Apollo received $191.3 million in

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[171] Len Boselovic, *You Can Now Compare a CEO's Pay to an Average Worker's Wage. But How Much Can You Learn from That?*, PITTSBURGH POST-GAZETTE (June 11, 2018), http://www.post-gazette.com/business/career-workplace/2018/06/11/fortunate-50-CEO-pay-ratios-average-worker-wage-pittsburgh-companies/stories/201806100011 [https://perma.cc/TK2K-Z7AS]; Matt Levine, *Warren Buffett Is Just an Average Employee*, BLOOMBERG (Mar. 19, 2018), https://www.bloomberg.com/view/articles/2018-03-19/warren-buffett-is-just-an-average-employee [https://perma.cc/2MWW-PL9H].

[172] Levine, *supra* note 171. As Levine concedes, though, "perhaps the median Berkshire employee also owns some stock that appreciated last year." *Id.*

[173] McCann, *supra* note 166.

[174] *Id.*

[175] *Id.*

[176] *Id.*

his capacity as partner last year, none of it was included in his total compensation for purposes of the pay ratio.[177] Similarly, Carlyle excluded the $66.3 million that went to one of its chief executives and the $62.7 million that went to each of the other two.[178]

c. Labor Markets

By its design, the pay ratio combines data from the labor market for executives and the markets for rank-and-file employees. Each of these markets, however, is subject to different dynamics, different supply and demand, and different levels of pay. The "median worker" by necessity is part of a labor market, but that market may not even be the market from which the majority of the firm's labor force is drawn.[179] In large firms, many of which are conglomerates, the median worker is likely to come from a specialized market with its own dynamics. There could be some rationale for comparing the levels of pay in two labor markets through a ratio, but in the case of the pay ratio, the comparison is a random one because *the labor market* from which the "median worker" is drawn is close to random, and certainly not comparable among firms.

Beyond the problems in comparing the labor markets for median employees, the composition of each firm's labor force is unique. This leads firms that otherwise look similar to report very different pay ratios. Consider, for example, Mattel and Hasbro, two public companies in the toy industry. Mattel's reported pay ratio of 4,987:1 dwarves Hasbro's ratio of 160:1.[180] This huge disparity does not indicate that Hasbro is a "better" company or that it is "more fair" to its employees. Instead, the disparity is explained by two completely idiosyncratic factors.

The first factor has to do with the denominator of the pay ratio: median worker pay. Mattel relies heavily on temporary and seasonal employees, and 78% of its workforce is located outside the United States, both of which help explain its low median employee pay of $6,271.[181] By contrast, Hasbro,

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[177] *Id.*

[178] *Id.* No information was available on McManemin's share of Dorchester's profits, but "in recent years Dorchester's per share dividend payouts have far surpassed its per-share earnings." *Id.*

[179] *See* Kay & Martin, *supra* note 159 ("This larger variation occurs because each company is disclosing the pay of a *single* employee. This one employee's pay level and the overall pay structure are impacted by many opaque, firm-specific business model issues . . . . Thus, a company's specific median employee pay cannot be directly compared with that of another company in a different industry or even compared with an industry peer that has a different business model.").

[180] Kilgore, *supra* note 166.

[181] *Id*. Mattel's median employee works in a factory in Malaysia. The company disclosed that its median wage for its U.S. employees "is more than quadruple the global figure." Theo Francis, *Why*

whose employees are generally full-time and located in the United States, reported median employee pay of $74,207.[182] These disparities reflect different operating models. Mattel does most of its work in its own factories, employing 35,820 people in "low-wage regions in Asia, including China."[183] It claims "it does so to maintain better control over quality and because managers have felt it was more efficient than contracting out."[184] Hasbro, which only employs 5,400 people, disclosed in its annual report that it outsources most of its toy production through "unrelated third party manufacturers in various Far East countries, principally China."[185] The outsourced workers have no effect on the pay ratio. At both companies, the actual toys are likely made by a similar number of workers who make a competitive wage and likely work in similar locations. Despite these similarities, the two companies report radically different median worker pay figures because one company employs those workers directly and the other does so only indirectly.

The second factor has to do with the numerator of the pay ratio: CEO pay. Mattel's CEO, Margo Georgiadis, was hired in February of 2017, so her total compensation of $31.28 million primarily reflected the stock and stock option awards valued at $28.05 million.[186] Hasbro's CEO, Brian Goldner, who has held the position since 2008, received total compensation of $11.85 million, which does not reflect the appreciation in stock he already received in prior years.[187] Ironically, Georgiadis exited Mattel after only a little more than a year on the job.[188] The difference in stability at the top in the two companies may also exacerbate the difference in CEO pay.[189]

This dynamic is not unique to Mattel and Hasbro. Other direct competitors have also reported very different pay ratio and median worker pay fig-

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Mattel and Hasbro Workers Are a World Apart on Pay, WALL ST. J. (Apr. 13, 2018), https://www.wsj.com/articles/why-mattel-and-hasbro-workers-are-a-world-apart-on-pay-1523611801 [https://perma.cc/39ZD-LHZQ]. The income of temporary and seasonal employees may not be annualized under the regulations, thus preventing a true comparison with a full-time employee's annual compensation. *See* Regulation S-K, Item 402(u), Instruction 5, 17 C.F.R. § 229.402 (2017).

[182] Kilgore, *supra* note 166.

[183] Francis, *supra* note 181.

[184] *Id.*

[185] *Id.* (quoting Hasbro's annual report).

[186] Kilgore, *supra* note 166.

[187] *Id.*

[188] Paul R. La Monica, *Mattel CEO Leaves After Just Over a Year on the Job*, CNN BUS. (Apr. 19, 2018), https://money.cnn.com/2018/04/19/investing/mattel-ceo-steps-down-margo-georgiadis-ynon-kriez/index.html [https://perma.cc/7HFA-N5ZH].

[189] Not only can new CEOs be more expensive simply because they have to be paid at a market rate that is higher than when the previous CEO was hired, but external candidates generally receive higher pay. *See* MICHAEL B. DORFF, INDISPENSABLE AND OTHER MYTHS 78 (2014); Kevin J. Murphy & Jan Zabojnik, *CEO Pay and Appointments: A Market-Based Explanation for Recent Trends*, 94 AM. ECON. REV. 192, 193 (2004).

ures, not because one company is more generous to its employees than the other, but because of the way the companies are structured. For example, Verizon and AT&T are both large, publicly-traded, telecommunication companies that appear to be quite similar. Yet, Verizon's median worker made $127,000, whereas AT&T's only made $78,000.[190] It would be inapt to compare these figures and draw conclusions about the two companies because they are very different operationally. AT&T is based in a lower-cost part of the country than Verizon, AT&T focuses more on landline operations that rely on lower paid-workers, while Verizon is focused in wireless, and AT&T owns more of its own retail stores, with the accompanying low-paid sales staff, whereas Verizon outsources more of its lower-paid work.[191]

2. Differences in Methodology

Beyond operational differences, the pay ratio numbers are also distorted by the methodological flexibility afforded to companies. As discussed earlier, the regulations give companies flexibility in how they identify the median employee, whether they exclude certain employees who meet specified criteria, and what compensation to include in the calculations. This flexibility may allow companies the ability to provide a more nuanced and sophisticated picture of themselves. It may, however, also allow them to game the rules to come up with a more favorable ratio, which, according to early evidence, is the more likely outcome.[192] In either case, methodological flexibility comes at the cost of accuracy and comparability. The following four examples illustrate the problem.

Statistical Sampling. Under the regulations, a firm can identify its median employee using statistical sampling rather than surveying its workforce.[193] This method was used by 2.9% of all Russell 3000 companies and 6.8% of all Equilar 500 companies.[194] Although a small minority in the overall scheme of things, it may have had a noticeable effect in the companies that did use it. One company that adopted this sampling approach was Fresh Del Monte.[195] It employs 39,089 employees, but it only used a sample size of 217 employees to identify its median employee, a mere 0.5% of the total employee popu-

[190] Theo Francis, *Does Verizon Really Pay the Typical Worker 60% More Than AT&T?*, WALL ST. J. (Mar. 28, 2018), https://www.wsj.com/articles/does-verizon-really-pay-the-typical-worker-60-more-than-at-t-1522238400 [https://perma.cc/4A9R-BQU5].

[191] *Id*.

[192] *See infra* notes 362–363 and accompanying text.

[193] Regulation S-K, Item 402(u), Instruction 4(2), 17 C.F.R. § 229.402 (2017).

[194] Phan, *supra* note 159.

[195] McCann, *supra* note 166.

lation.[196] It is unlikely that the company chose this approach to make its pay ratio look good—at 1,465:1, it was one of the highest ratios reported—but the sampling could have contributed to its low reported median employee pay of $5,833.[197] As one observer noted, "an employee may see the average pay listed for their company and think they are being under- or overpaid . . . . Instead, the differences may be based on how the calculation was done."[198]

De Minimis Exception. One of the concessions the regulations make to the problem of including foreign workers is the de minimis exception. As discussed in Part II.A, this permits companies to exclude foreign workers if they constitute no more than 5% of the company's workforce. The de minimis exception has been one of the most frequently used, with approximately 24.5% of Russell 3000 companies and 36.7% of all public companies excluding foreign workers.[199]

Consistently Applied Compensation Methodology ("CACM"). An analysis of pay ratio disclosures as of July 2018 found that the CACM used in determining the median employee's compensation varied wildly, with 39% using total cash compensation, 28% using base pay and wages, 14% using the amount of wages reported on employee W-2 statements, and 25% using total direct compensation.[200] This can have a significant impact on the comparability of pay ratios.

Consider again the case of Verizon and AT&T's divergent median employee pay numbers. In addition to the operational differences discussed above, differences in methodology may have also played a significant role. AT&T used cash compensation to calculate median worker pay, even bypassing the first employee it identified because of "an unusual pension benefit."[201] Verizon, by contrast, included company-paid health care, plus "estimates for company contributions to 401(k) and supplemental-retirement plans, as well as an estimate of the present value of any annual gains in the employee's future pension benefits."[202] Thus, not only did Verizon's methodology include

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[196] *Id.*

[197] *Id.*

[198] Carol Wolf, *How the New CEO-to-Worker Pay Ratios Can Mislead*, CBS NEWS (May 14, 2018), https://www.cbsnews.com/news/how-the-new-ceo-to-worker-pay-ratios-can-mislead [https://perma.cc/Z79Q-AZEU].

[199] Phan, *supra* note 159.

[200] CLEARBRIDGE COMP. GRP., CEO PAY RATIO 9 (2018), https://www.clearbridgecomp.com/wp-content/uploads/The-ClearBridge-100-Report-CEO-Pay-Ratio-July-2018.pdf [https://perma.cc/4JHZ-T29P].

[201] *See* Francis, *supra* note 190.

[202] *Id.* According to a Deloitte study, 16% of companies in its sample included health benefits in the total annual compensation figure. *See* DELOITTE CONSULTING, CEO PAY RATIO OVERVIEW 4 (2018), http://scsgp.informz.net/SCSGP/data/images/Documents/2018_04_17%20CEO%20Pay%20Ratio%20Overview_vF.pdf [https://perma.cc/5V6U-3BXJ].

inputs that may not have been in AT&T's calculation, but it required assumptions that may have inflated the median employee's compensation even further.

Alternate Pay Ratios. The regulations permit companies to include pay ratios different than the required ratio if they are necessary to reflect some unusual pay arrangements, such as a one-time bonus paid to a CEO in connection with a merger.[203] One survey found that 13% of companies disclosed an alternative ratio, with the most common rationales being the exclusion of certain types of compensation, such as one time bonuses, pension values, or certain equity in long-term incentive structures, or the exclusion of certain categories of employees, such as displaying a domestic employee-only ratio.[204] Most companies disclosed lower alternative pay ratios, but several disclosed alternative ratios that were actually higher than the required ratio, suggesting that they may have been communicating with their own employees (who might otherwise individually think they were underpaid).[205]

III. THE PAY RATIO'S MULTIPLE AUDIENCES AND USES

Despite the reliability and comparability problems discussed in Part II, the pay ratio data has attracted the attention of a broad set of audiences: the news media, national politicians, state and local governments, labor unions, think tanks, corporate decisionmakers and advisers, and firms' employees and customers. In this Part, we present the first comprehensive analysis of the use of the pay ratio disclosures by these audiences to date.[206]

Four general patterns emerge. First, the number of audiences and the amount of attention they have devoted to the pay ratio disclosures are unusually high compared to other types of corporate disclosure. Second, though the stated purpose of the pay ratio was to inform investor decisionmaking, the data has been used by non-corporate constituencies to make rhetorical points, exert influence on firms, or highlight issues such as pay disparities within firms, or economic inequality more broadly. This supports the notion, suggested in Part I.D, that certain stakeholders expect the pay ratio to fulfill additional functions,

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[203] *See* Matthew B. Grunert & Emily E. Cabrera, *CEO Pay Ratio Disclosure: What We've Seen in Filings So Far*, NAT'L L. REV. (Feb. 28, 2018), https://www.natlawreview.com/article/ceo-pay-ratio-disclosure-what-we-ve-seen-filings-so-far [https://perma.cc/8T4L-W49J].

[204] DELOITTE CONSULTING, *supra* note 202, at 12.

[205] *Id.* We discuss employee perceptions of pay ratios in Part III.E.1.

[206] Though timely, our analysis is by definition limited by the fact that pay ratio reporting has been in effect only since January 2018. Because of the long run-up to the release of the first set of pay ratio figures and in light of existing experience with CEO pay disclosures, many trendlines can be identified already. Where the available evidence is more tenuous, we have framed our analysis accordingly.

such as a behavioral function or a public discourse function. Third, the media and various stakeholders referred to a range of different aggregate pay ratio numbers, each of which was intended to convey an impression of the economy-wide pay ratio. Finally, the data's deficiencies have received practically no attention and virtually all users have engaged in data comparisons among firms despite the SEC's admonition that the data is not fit for such comparisons. These patterns help to set the pay ratio disclosure rule apart from other rules within the SEC disclosure regime, a point we explore in Part V, when we discuss the pay ratio's unique disclosure-as-soundbite approach.

A. Media Coverage

The first set of pay ratio disclosures released in 2018 generated widespread coverage in national, international, and local media outlets. Even though public companies regularly disclose large volumes of information on various topics as part of their SEC reporting obligations, no disclosure topic apart from corporate earnings was covered by the national media to the same extent as the pay ratio disclosures. Between January 1 and June 30, 2018, the *Wall Street Journal* ran 14 articles discussing the pay ratio rule or pay ratio data.[207] The *New York Times*, the *Washington Post*, and the *Huffington Post*, to name a few, also ran prominent articles about the pay ratio.[208] The *Bloomberg* website displayed a tracker, updated on an ongoing basis, providing comprehensive and user-friendly pay ratio data, which informed articles about the pay ratio in other media outlets.[209] Local newspapers, despite shrinking newsrooms, published original stories focused on pay disparities at local

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[207] Authors' survey of articles in the *Wall Street Journal* during the specified period, which captures the annual proxy season, along with its run-up and immediate aftermath. Excluded from the count were articles that mentioned the pay ratio alongside other executive compensation data but did not focus on it.

[208] *See, e.g.*, Arthur Delaney & Dave Jamieson, *Companies Are Disclosing How Much Less They Pay Workers Than Executives*, HUFFPOST (Mar. 13, 2018), https://www.huffingtonpost.com/entry/ceo-pay-disclosure_us_5aa6da18e4b03c9edfae9aec [https://perma.cc/YD8F-FCPL]; David Gelles, *Want to Make Money Like a C.E.O.? Work for 275 Years*, N.Y. TIMES (May 25, 2018), https://www.nytimes.com/2018/05/25/business/highest-paid-ceos-2017.html [https://perma.cc/BN6D-RTEX]; Jena McGregor, *As Companies Reveal Gigantic CEO-to-Worker Pay Ratios, Some Worry How Low-Paid Workers Might Take the News*, WASH. POST (Feb. 21, 2018), https://www.washingtonpost.com/news/on-leadership/wp/2018/02/21/as-companies-reveal-gigantic-ceo-to-worker-pay-ratios-some-worry-how-low-paid-workers-might-take-the-news/ [https://perma.cc/VG34-PZE6].

[209] *How Your Pay Stacks Up With the CEO's*, BLOOMBERG, https://www.bloomberg.com/graphics/ceo-pay-ratio/ [https://perma.cc/FQW4-GNJU]; *see, e.g.*, Emily Stewart, *How Does a Company's CEO Pay Compare to Its Workers'? Now You Can Find Out.*, VOX (Apr. 8, 2018), https://www.vox.com/policy-and-politics/2018/4/8/17212796/ceo-pay-ratio-corporate-governance-wealth-inequality [https://perma.cc/R646-FSG3].

companies.[210] Publications with a global readership, such as the *Financial Times* and the *Economist*, also featured articles on the pay ratio disclosures of U.S. public companies.[211] Even stories that focused primarily on outsized executive compensation included the new pay ratio figures alongside metrics such as annual total shareholder return in order to place CEO pay in context.[212]

What made the pay ratio disclosures so newsworthy? Apart from novelty, it was the accessibility of the information and its capacity to generate click-worthy headlines that resonate with readers: "Want to Make Money Like a C.E.O.? Work for 275 Years,"[213] or, in a local example, "Colorado CEOs Earn in Three Days What the Typical Worker Earns in a Year."[214] Websites offered interactive tools inviting employees to compare how their pay "stacks up with the CEO's."[215] Coverage often focused on the high pay ratios of household names, such as Wal-Mart, Mattel, and Time-Warner.[216]

News stories broke down and analyzed the pay ratio data according to various firm attributes, including industry, market capitalization, workforce

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[210] *See, e.g.*, James Dornbrook, *Filing Reveals Cost of CEO Change at H&R Block, Extraordinarily High CEO-to-Median Employee Pay Ratio*, KANSAS CITY BUS. J. (Aug. 3, 2018), https://www.bizjournals.com/kansascity/news/2018/08/02/hr-block-executive-compensation.html; Alexia Elejalde-Ruiz, *The Boss Makes How Much? Illinois Companies Reveal CEO-to-Worker Pay Ratio*, CHI. TRIB. (Apr. 27, 2018), http://www.chicagotribune.com/business/ct-biz-ceo-pay-ratio-20180427-story.html; Bruce Murphy, *CEOs Paid 1,000 Times More Than Average Workers*, URBAN MILWAUKEE (May 22, 2018), https://urbanmilwaukee.com/2018/05/22/murphys-law-ceos-paid-1000-times-more-than-average-workers/ [https://perma.cc/5ZMF-HYLH]; Aldo Svaldi, *Colorado CEOs Earn in Three Days What the Typical Worker Earns in a Year, New Disclosures Show*, DENVER POST (Apr. 20, 2018), https://www.denverpost.com/2018/04/20/colorado-ceo-worker-pay-gap [https://perma.cc/S9Q3-C3SF].

[211] *See, e.g.*, Patrick Jenkins, *Bosses' Pay Disclosures Fuel Staff Dissatisfaction*, FIN. TIMES (Mar. 26, 2018), https://www.ft.com/content/ebd90ac0-2ec5-11e8-9b4b-bc4b9f08f381; *American Firms Reveal the Gulf Between Bosses' and Workers' Pay*, THE ECONOMIST (May 26, 2018), https://www.economist.com/business/2018/05/26/american-firms-reveal-the-gulf-between-bosses-and-workers-pay [https://perma.cc/BC5L-26E6].

[212] *See, e.g.*, Brent Lang & David Lieberman, *Breaking Down the Salaries of Media's Most Powerful Executives*, VARIETY (May 8, 2018), https://variety.com/2018/biz/news/media-executive-salaries-leslie-moonves-bob-iger-rupert-murdoch-1202801568 [https://perma.cc/3JMD-KCK5] (reporting that the CEO of Discovery Communications received $42.2 million in 2017, while total shareholder return was -18.4%, and the pay ratio was 522:1).

[213] *See* Gelles, *supra* note 208.

[214] *See* Svaldi, *supra* note 210.

[215] *See How Your Pay Stacks up with the CEO's*, *supra* note 209; *see also* Sarah Nassauer, *At Walmart, the CEO Makes 1,188 Times as Much as the Median Worker*, WALL ST. J. (Apr. 20, 2018), https://www.wsj.com/articles/at-walmart-the-ceo-makes-1-188-times-as-much-as-the-median-worker-1524261608 [https://perma.cc/4DK4-DT66] (providing a "check your pay" feature).

[216] *See, e.g.*, David Gelles, *Six C.E.O. Pay Packages That Explain Soaring Executive Compensation*, N.Y. TIMES (May 25, 2018), https://www.nytimes.com/2018/05/25/business/top-ceo-pay-packages.html [https://perma.cc/PG4B-LFMH].

size, and region,[217] despite the fact that when adopting the rule the SEC expressly noted that the pay ratio data would be unfit for making such comparisons.[218] The *New York Times* even came up with a creative derivative statistic, "the Marx ratio," which used the new median worker pay data as an input to capture the relative returns on labor and capital within firms, again for the purpose of making comparisons.[219] In short, the 2018 pay ratio data presented the media with an irresistible source of news stories about high pay disparities at well-known companies.

The new pay ratio data did not merely attract significant media attention, but it also shifted the nature of the coverage of corporate compensation issues. Before 2018, firms were required to disclose only the total compensation received by the five highest-paid executives. As a result, when reporting on these annual disclosures the media generally focused on the sheer size of executive pay packages—often amounting to tens of millions of dollars, on comparisons among CEOs across firms and industries, and on the persistent disconnect between executive pay and corporate performance.[220] The key takeaway of pre-2018 news stories was that U.S. CEOs are overpaid and executive compensation practices are broken.[221]

By contrast, the availability of company-specific data in 2018 zeroed the media's attention on pay disparities between rank-and-file workers and management, and, more broadly, on income inequality. Even standing on its own, the pay ratio shows the disparity between CEO pay and median worker pay inside a given firm. Many of the news stories and commentary drew an express link between high pay ratios and societal income inequality.[222] Going a

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[217] *See American Firms Reveal the Gulf Between Bosses' and Workers' Pay*, *supra* note 211; *see also* Vanessa Fuhrmans & Theo Francis, *How Does the Boss's Pay Compare to the Rank and File?*, WALL ST. J. (Feb. 1, 2018), https://www.wsj.com/articles/an-early-look-at-the-ceo-worker-pay-ratio-1517505343 [https://perma.cc/VWE5-65TF].

[218] *See supra* note 110 and accompanying text.

[219] Neil Irwin, *Is Capital or Labor Winning at Your Favorite Company? Introducing the Marx Ratio*, N.Y. TIMES (May 21, 2018), https://www.nytimes.com/interactive/2018/05/21/upshot/marx-ratio-median-pay.html [https://perma.cc/H6Z8-LRU3].

[220] *See, e.g.*, Tim Mullaney, *Why Corporate CEO Pay Is So High, and Going Higher*, CNBC.COM (May 18, 2015), https://www.cnbc.com/2015/05/18/why-corporate-ceo-pay-is-so-high-and-going-higher.html [https://perma.cc/SL3N-J3NZ].

[221] Stories about executive compensation did occasionally mention the ratio between CEO pay and average worker pay, but this statistic was an estimate representing compensation practices for the entire U.S. economy and did not contain any information about individual companies. *See, e.g.*, Jennifer Reingold, *Executive Pay*, BUS. WK., Apr. 17, 2000, at 110.

[222] *See, e.g.*, Gelles *supra* note 208 (characterizing high pay ratios as "stark illustrations of income inequality"); Jon Talton, *It's Suite at the Top, but Runaway CEO Pay Doesn't Help the Economy*, SEATTLE TIMES (July 20, 2018), https://www.seattletimes.com/business/economy/its-suite-at-the-top-but-runaway-ceo-pay-is-bad-for-capitalism [https://perma.cc/5LQH-98YQ] (sug-

step further, the *Financial Times* warned that "failing to narrow the pay gap within companies will imperil capitalism," and the use of a "Marx ratio" by the *New York Times* seemed designed to make a similar point.[223]

B. Policymakers

When the pay ratio concept entered the public eye in 2010, politicians immediately linked it to concerns over income inequality.[224] The release of the first set of pay ratio figures in 2018 accelerated these trends. What is more, none of them occur in a vacuum: The political attention simultaneously contributes to and feeds off of the media coverage of the pay ratio. This attention is also intertwined with the work of labor unions and other advocacy groups, which we discuss in Part III.C. These players have all used the pay ratio as a means of fomenting or amplifying public discourse about income inequality.

1. National Politicians

The 2018 pay ratio data quickly proved useful to progressive politicians in motivating new policy proposals. In August 2018, Senator Elizabeth Warren introduced the Accountable Capitalism Act, a bill that contains a number of wide-ranging policy proposals, which, if implemented, will remake the basic infrastructure of U.S. corporate law.[225] Upon the release of the ambitious bill, Senator Warren published an op-ed in the *Wall Street Journal* noting that the driving force behind the legislation was income inequality and relying on pay ratio data to illustrate the increase in income inequality over time.[226] The aggregate pay ratio figure used by Senator Warren was 361:1, which came from the AFL-CIO.[227]

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gesting that the patterns of CEO and worker pay are symptomatic of serious economy-wide problems).

[223] *See* Irwin, *supra* note 219; Jenkins, *supra* note 211.

[224] *See supra* Part I.B.

[225] *See* Press Release, Office of Senator Elizabeth Warren, Warren Introduces Accountable Capitalism Act (Aug. 15, 2018), https://www.warren.senate.gov/newsroom/press-releases/warren-introduces-accountable-capitalism-act [https://perma.cc/GRP8-X4YM]. As an example of its scope, the bill would require large corporations to obtain a federal charter, require boards to consider the interests of all stakeholders when making decisions, and enable employees to elect at least 40% of the board of directors. *Id*.

[226] *See* Elizabeth Warren, Opinion, *Companies Shouldn't Be Accountable Only to Shareholders*, WALL ST. J. (Aug. 14, 2018), https://www.wsj.com/articles/companies-shouldnt-be-accountable-only-to-shareholders-1534287687 [https://perma.cc/LZ8R-FY6S] ("The average CEO of a big company now makes 361 times what the average worker makes, up from 42 times in 1980.").

[227] *See infra* note 248 and accompanying text.

Driven by similar concerns, in September 2018, Senator Bernie Sanders and Representative Ro Khanna introduced a bill proposing a tax on large corporations equal to the federal benefits received by their low-wage employees.[228] The bill's title, Stop Bad Employers by Zeroing Out Subsidies (BEZOS) Act, made direct reference to Amazon's CEO, Jeff Bezos. In public statements surrounding the bill's release, Senator Sanders singled out Amazon's poor workplace conditions and worker treatment. The same statements referenced the median worker pay figure from Amazon's pay ratio disclosure, $28,446. Senator Sanders then combined this figure with the appreciation of the CEO's Amazon stock holdings (and not with his SEC-reported annual salary) to note that in ten seconds, Amazon's CEO made as much as Amazon's median worker did in all of 2017.[229]

Another prominent example of the political use of the new pay ratio data is a report by Representative Keith Ellison, entitled *Rewarding or Hoarding: An Examination of Pay Ratios Revealed by Dodd-Frank*, and published in May 2018.[230] The report starts by providing an accessible overview of the pay ratio's history and calculation methodology, and discusses the magnitude of the reported pay ratios in a somewhat populist manner.[231] Using well-known companies as examples, the report highlights statistics such as the number of median employees a company can hire with the CEO's salary, and the number of years a median worker would need to work to earn the CEO's annual salary.[232] The report links such pay inequity to income inequality, which is its central theme. Overall, the report was quite successful in generating additional coverage of the pay ratio data.[233] The report included an aggregate pay ra-

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[228] *See* Press Release, Office of Senator Bernie Sanders, *Sanders, Khanna Introduce Bill to Get Billionaires Off Welfare* (Sept. 5, 2018), https://www.sanders.senate.gov/newsroom/recent-business/sanders-khanna-introduce-bill-to-get-billionaires-off-welfare [https://perma.cc/T3T4-UG7J].

[229] *Id.*

[230] *See* STAFF OF REP. KEITH ELLISON, REWARDING OR HOARDING? AN EXAMINATION OF PAY RATIOS REVEALED BY DODD-FRANK (2018) [https://perma.cc/CW9X-ECL5] [hereinafter REWARDING OR HOARDING?]. The report was released in May 2018, before the end of the 2018 proxy season, and covered the first 225 Fortune 500 companies to publicly disclose their pay ratios. *Id.* at 2.

[231] The report opens as follows: "If your boss made your annual salary in less than a single day, how would you feel? Demoralized? Disgusted? Many Americans are now learning how pay is shared (or not) . . . . The CEO-worker pay ratio is a dramatic indicator of our country's extreme economic divide." *Id.* at 1.

[232] *Id.* at 2, 11.

[233] *See, e.g.*, Max Greenwood, *Keith Ellison Releases Study Showing CEOs Average 339 Times Median Worker's Salary*, THE HILL (May 16, 2018), http://thehill.com/homenews/house/387922-keith-ellison-releases-study-showing-ceos-on-average-make-339-times-median [https://perma.cc/B5L5-WXBP]; Edward Helmore, *'CEOs Don't Want This Released': U.S. Study Lays Bare Extreme Pay-Ratio Problem*, THE GUARDIAN (May 16, 2018), https://www.theguardian.com/us-news/2018/may/16/ceo-worker-pay-ratio-america-first-study [https://perma.cc/WL9U-

tio of 339:1, representing the average of the pay ratios of 225 Fortune 500 companies that had already disclosed their ratios at the time the report was compiled.[234]

2. State and Local Governments

Whereas national politicians have been using the pay ratio data to highlight income inequality and shame individual companies, policymakers at the state and local level are going one step further by seeking to actually penalize firms with high pay ratios. The most prominent example is a Portland, Oregon city ordinance adopted in December 2016, which increased the local business license tax liability of companies with high pay ratios.[235] Companies with a pay ratio of at least 100 and not more than 249 are subject to a 10% extra tax (or surtax), and companies with a pay ratio equal to or above 250 are required to pay a 25% surtax.[236] The ordinance relies on the SEC disclosures of firms doing business in Portland and is expected to affect around 500 of them. The revenue from the surtax is projected at approximately $3 million in the first year and has been earmarked for funding affordable housing and police and fire services.[237] It appears that the primary impetus behind the Portland ordinance was addressing income inequality, as evidenced by the statements of its principal author[238] and the discussion of studies of income inequality contained in the bill's text.[239]

TPVL]; Joseph Lawler, *Keith Ellison Highlights Big CEO Pay Using Long-Awaited Dodd-Frank Rule*, WASH. EXAMINER (May 16, 2018), https://www.washingtonexaminer.com/policy/economy/keith-ellison-highlights-big-ceo-pay-using-long-awaited-dodd-frank-rule [https://perma.cc/PWT2-3AEF].

[234] *See* REWARDING OR HOARDING?, *supra* note 230.

[235] PORTLAND, OR., CITY CODE ch. 7.02, § 500 (2019), https://www.portlandoregon.gov/citycode/28807#cid_714103 [https://perma.cc/5GGN-U3DA].

[236] *Id.*; Portland, Or., Revenue Division, Business Tax Administrative Rule 500.17-1 Pay Ratio Surtax (Sept. 26, 2017), https://www.portlandoregon.gov/revenue/article/656905 [https://perma.cc/F8BL-4MRE].

[237] Jacob Rund, *Portland Spurs Efforts to Rein in CEO-to-Worker Pay Gaps*, BLOOMBERG LAW: BIG L. BUS. (June 1, 2018), https://biglawbusiness.com/portland-spurs-efforts-to-rein-in-ceo-to-worker-pay-gaps [https://perma.cc/9NGS-V7S3].

[238] The bill's author, Steve Novick, is quoted as saying: "CEO pay is not just an eye-catching example of, but a major cause of, extreme economic inequality . . . . Extreme economic inequality is—next to global warming—the biggest problem we have in our society." *See* Sarah Anderson, *This City Just Came up with a Novel Way to Fight Inequality: Taxing Corporations with Extreme Pay Gaps*, THE NATION (Dec. 8, 2016), https://www.thenation.com/article/his-city-just-came-up-with-a-novel-way-to-fight-inequality-taxing-corporations-with-extreme-gaps-between-ceo-and-worker-pay [https://perma.cc/QVU2-YPX8].

[239] PORTLAND, OR., CITY CODE ch. 7.02, § 500 (citing data on trends in income inequality from Thomas Piketty's, *Capital in the Twenty-First Century*, think tank reports, and other sources).

When the Portland ordinance passed, one report noted that it may mark "the dawn of a new 'pay ratio politics.'"[240] This has proved prescient: Since 2016, Portland-style surtax measures have been put forward in California, Connecticut, Illinois, Massachusetts, Minnesota, New Hampshire, Rhode Island, Washington, San Francisco, and even at the federal level.[241] In a similar vein, proposed legislation in Connecticut would disqualify companies with high ratios from receiving state subsidies and grants, and proposed legislation in Rhode Island would give preferential treatment in state contracting to firms where the CEO is paid no more than 25 times the median worker.[242]

Some of these pay ratio proposals have expired or have been put on hold, and it remains to be seen whether any would be successful.[243] Similar measures have been mooted before, only to be abandoned.[244] Two things, however, are different this time around: firm-specific pay ratio data is now required to be calculated and reported on an annual basis, and the substantial publicity from these disclosures may increase the perceived legitimacy of pay ratios as a policy lever.

C. Advocacy Groups

Another set of public actors who have focused on the pay ratio can be placed under the loose banner of advocacy groups. These include labor unions and think tanks working on income inequality and labor-related issues. The reactions of these advocacy groups show a range of approaches.

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[240] *See* Anderson, *supra* note 238.

[241] *See* Taylor French, *You've Disclosed Your Pay Ratio… Now Time to Check Your State & Local Taxes*, MCGUIRE WOODS CONSULTING (Apr. 10, 2018), https://www.takestockblog.com/category/executive-compensation [https://perma.cc/89ZN-R26V] (referring to proposals in New Hampshire and San Francisco); *CEO-Worker Pay Resource Guide*, INEQUALITY.ORG, https://inequality.org/action/corporate-pay-equity [https://perma.cc/QFG6-G7UW] (referring to proposed legislation in California, Connecticut, Illinois, Massachusetts, Minnesota, Rhode Island, and Washington, as well as a federal bill).

[242] *CEO-Worker Pay Resource Guide*, *supra* note 241.

[243] *See* Cydney Posner, *Will Pay-Ratio Results be the Catalyst for Local Action?*, COOLEY PUBCO (June 11, 2018), https://cooleypubco.com/2018/06/11/pay-ratio-catalyst-for-local-action/ [https://perma.cc/TV4K-NQLU].

[244] *See* Robert Schroeder, *Republican Aims to Block Export-Import Aid to Companies with Hefty CEO Pay*, MARKETWATCH (Nov. 3, 2015), https://www.marketwatch.com/story/republican-aims-to-block-export-import-aid-to-companies-with-hefty-ceo-pay-2015-11-03 [https://perma.cc/Q33J-VDQZ] (reporting on 2015 efforts by Representative Mick Mulvaney to prevent the U.S. Export-Import Bank from subsidizing any company where CEO pay is over 100 times greater than median worker pay); *see also* David I. Walker, *A Tax Response to the Executive Pay Problem*, 93 B.U. L. REV. 325, 376 n.216 (2013) (summarizing past pay ratio-related proposals by Senator Richard Durbin and Representative Martin Sabo).

1. Labor Unions

As we saw in Part I, the support of labor unions was crucial to the survival and implementation of the pay ratio rule. One of these organizations, the AFL-CIO, has produced an annual "Executive Pay Watch" since the 1990s.[245] That report has traditionally focused on the companies with the highest-paid CEOs, providing critical commentary about their executive compensation practices.[246] In prior years, the report also presented general pay ratio data based on Bureau of Labor Statistics estimates. The 2018 pay ratio data enabled an enhancement of this approach: the Pay Watch reported and ranked the pay ratios of individual companies.[247] As in prior years, the AFL-CIO's 2018 Executive Pay Watch attracted media attention, which linked executive pay practices to income inequality.[248] The AFL-CIO reported an aggregate pay ratio of 361:1, describing this as the pay of the average CEO of an S&P 500 company divided by the pay of the average production and nonsupervisory worker in an S&P 500 company.[249]

2. Think Tanks

The Institute for Policy Studies ("IPS") has published an annual report in an "Executive Excess" series since 1994. Over the years, the reports have linked executive compensation to problems such as pay inequity, bailouts, outsourcing, and corporate fraud.[250] The 2018 IPS report was dedicated solely to the new pay ratio data and was entitled *How Taxpayers Subsidize Giant*

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[245] *See* Tim Smart, *An Eye-Popping Year for Executive Pay*, WASH. POST (Mar. 22, 1998), https://www.washingtonpost.com/archive/business/1998/03/22/an-eye-popping-year-for-executive-pay/d0bf4c4b-6eca-411e-96ce-8527f4261eba [https://perma.cc/PX3D-DDF4] (reporting data from the AFL-CIO's Executive Pay Watch website).

[246] *See, e.g.*, *Executive Paywatch*, AFL-CIO, https://aflcio.org/paywatch [https://perma.cc/VF6K-T834].

[247] *See* Kenneth Quinnell, *Executive Paywatch 2018: The Gap Between CEO and Worker Compensation Continues to Grow*, AFL-CIO (May 22, 2018), https://aflcio.org/2018/5/22/executive-paywatch-2018-gap-between-ceo-and-worker-compensation-continues-grow [https://perma.cc/P7HJ-4U9G]; *Terms and Data Sources*, AFL-CIO, https://aflcio.org/paywatch/terms-and-data-sources [https://perma.cc/V2D6-X8JP] (stating that the average annual median worker income is taken from the U.S. Bureau of Labor Statistics' Current Employment Statistics survey).

[248] *See* Diptendu Lahiri, *CEOs Earn 361 Times More Than the Average U.S. Worker—Union Report*, REUTERS (May 22, 2018), https://www.reuters.com/article/us-usa-compensation-ceos/ceos-earn-361-times-more-than-the-average-u-s-worker-union-report-idUSKCN1IN2FU [https://perma.cc/9AVA-K5AV] (quoting AFL-CIO secretary-treasurer as saying that the report "provides further proof of America's income inequality crisis").

[249] *Id*.

[250] *See Executive Excess*, INST. FOR POL'Y STUD., https://ips-dc.org/global-economy/executive-excess [https://perma.cc/4MEC-CHDB].

Corporate Pay Gaps.[251] The report focused on the pay ratios of the 50 largest federal contractors and the 50 companies that receive the most in government subsidies. It used the pay ratio data to generate memorable statistics, such as the number of top 50 contractors with a CEO-to-median worker ratio higher than 100:1 (68%), the value of federal contracts awarded to those firms in 2017 ($167 billion), and the average CEO pay at those firms ($18 million).[252] The report also used the pay ratio data to draw attention to the pay practices of a number of well-known companies.

In addition to highlighting the new data, the IPS report made concrete recommendations that deploy the pay ratio to "ensure that taxpayers are not subsidizing extreme CEO-worker pay gaps . . . through tax, contracting, or subsidy policies," and to "leverage the power of the public purse to narrow [such] dangerous divides."[253] These policy recommendations include using the pay ratio data to treat firms differentially in terms of business taxation, public procurement, and corporate subsidies and bailouts—punishing firms where the ratios are "too high" and rewarding firms where the ratios are within a desired norm.[254] These recommendations echo the Portland tax bill and other proposed bills at the state and local level, which we discussed in Part III.B.2.

Another think tank, the Economic Policy Institute ("EPI"), took a different approach to the pay ratio data. EPI had focused on pay disparities and stagnant wages long before the advent of the SEC-mandated pay ratio disclosures, and it had also devised its own detailed methodology for estimating pay ratios.[255] EPI's 2018 report on executive compensation noted the availability of new pay ratio data disclosed pursuant to firms' SEC reporting obligations. Instead of embracing the new data, however, EPI discussed its methodological shortcomings, noting that "fierce business resistance" had "watered down" its usefulness.[256] As a result, the EPI annual report continued to use

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[251] *See generally* SARAH ANDERSON & SAM PIZZIGATI, INST. FOR POL'Y STUD., HOW TAXPAYERS SUBSIDIZE GIANT CORPORATE PAY GAPS (2018), https://ips-dc.org/wp-content/uploads/2018/09/EE18-FINAL.pdf [https://perma.cc/G2YP-3XK6].

[252] *Id.* at 5.

[253] *Id.* at 17.

[254] *Id.* at 17–18.

[255] *See* Lawrence Mishel & Natalie Sabadish, *Methodology for Measuring CEO Compensation and the Ratio of CEO-to-Worker Compensation, 2012 Data Update* (Econ. Pol'y Inst., Working Paper No. 298, 2013), https://www.epi.org/files/2013/wp298-ceo-to-worker-pay-methodology.pdf [https://perma.cc/JH67-MVR7].

[256] *See* LAWRENCE MISHEL & JESSICA SCHIEDER, ECON. POL'Y INST., CEO COMPENSATION SURGED IN 2017, at 13 (2018), https://www.epi.org/files/pdf/152123.pdf [https://perma.cc/L3XN-MFE3].

the EPI's own pay ratio estimates, which it argued were more accurate.[257] The aggregate pay ratio reported by EPI was 312:1.[258] The EPI report did not give up on the pay ratio disclosure rule altogether: It expressed hope that the SEC could improve its methodology over time, and included as a potential policy proposal the idea of taxing firms with high pay ratios at higher rates.[259]

D. Corporate Decisionmakers and Advisors

Despite the extensive public and media attention, it is worth recalling that according to the SEC the pay ratio's intended audience consists of investors and not the general public.[260] In theory, investors serve as a check on the executive compensation decisions made by corporate boards. In exercising their respective functions, investors are aided by proxy advisory firms, whereas boards receive help from executive compensation advisors. All four groups have had a hard time working with the pay ratio rule. The evidence thus far suggests that boards and investors are not ignoring the pay ratio, though it is unclear precisely how it figures into their decisionmaking.

1. Executive Compensation Advisors

Executive compensation advisors focus on helping boards and boards' compensation committees benchmark executive pay, structure executive compensation to align pay with performance, and ensure compliance with relevant SEC disclosure requirements. Quite naturally, the pay ratio disclosure mandate was a hot topic for compensation advisors ever since its adoption in 2010. In the run-up to the first set of disclosures in 2018, executive compensation advisors performed a significant amount of useful work educating firms about the rule, providing updates at the various stages of the rule's implementation, and exploring compliance strategies and data calculation methodologies.[261]

After firms started releasing their pay ratio disclosures in the spring of 2018, the attention of executive compensation advisors turned to analyzing

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[257] The Economic Policy Institute explained that its methodology removed distortions in the SEC data that could result from the extensive use of subcontracting, from the identical treatment of seasonal, part-time, and full-time workers, and from the inclusion of international workers in the calculations. *Id.* at 14.

[258] *Id.* at 1.

[259] *Id.* at 2, 14.

[260] *See supra* note 103 and accompanying text.

[261] *See, e.g.*, Deb Lifshey, *CEO Pay Ratio Disclosure Requirement Now Imminent: SEC Releases Additional Guidance*, PEARL MEYER (Sept. 2017), https://www.pearlmeyer.com/knowledge-share/client-alert/ceo-pay-ratio-disclosure-requirement-now-imminent-sec-releases-additional-guidance [https://perma.cc/H2DP-34MX].

the new data in great detail. The resulting reports broke down median worker pay and the pay ratio by firm size, industry, revenue, and number of employees, among other attributes.[262] At least one report performed statistical analysis of the data in an effort to answer fairly complex questions such as how much of the variation in pay ratios is associated with CEO or median worker pay, and what variables affect the pay ratio, both across the full sample of companies and at companies at the top and bottom deciles of the pay ratio distribution.[263] Most of the reports acknowledged the methodological and comparability problems, but analyzed and compared the data nonetheless.[264] The findings of the reports were covered in specialized and general publications.[265] Ultimately, the analytical work done by compensation advisors helped publicize the flawed data.[266]

2. Boards of Directors

As a general matter, the pay ratio rule represents a unique and vexing challenge for corporate boards. On the one hand, setting and approving executive compensation—including CEO pay—is among the most important responsibilities they have.[267] On the other hand, however, boards have no direct control over the second component of the pay ratio, median worker pay. Accordingly, even if boards follow best practices in setting CEO pay, the pay ratio may still be an outlier due to the median worker pay figure, and thus draw negative attention to the board's executive compensation policies or to the firm more generally.

Although board deliberations are private, two observations offer some clues about boards' use of the data. On the one hand, the executive compensation advisors who work directly with boards devoted significant attention to

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[262] *See, e.g.*, PEARL MEYER, *supra* note 160; Phan, *supra* note 159.

[263] *See* Kay & Martin, *supra* note 159.

[264] One could argue that executive compensation consultants prepared comparative reports at the behest of boards, which wanted to know how they stack up against their peers, even if the pay ratio data itself is not meant to be comparable. If there was such demand from boards, however, the comparative reports could have been prepared only for their benefit without being widely disseminated. This could have mitigated the negative effects from publicizing the data described here.

[265] *See, e.g.*, Fuhrmans & Francis, *supra* note 217; Cydney Posner, *Early Pay-Ratio Trends from Compensation Consultants*, COOLEY PUBCO (Mar. 21, 2018), https://cooleypubco.com/2018/03/21/pay-ratio-trends-compensation-consultants [https://perma.cc/NH6H-6599].

[266] To be sure, executive compensation advisors cannot be faulted for focusing on the pay ratio data once it was released, because as a matter of course they regularly cover executive compensation developments, including the outcomes of say-on-pay votes and trends in CEO compensation.

[267] *See, e.g.*, Jeffrey N. Gordon, *Executive Compensation: If There's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis,"* 30 J. CORP. L. 675, 695 (2005).

the pay ratio disclosures, suggesting that there was at least some demand from boards for this kind of information.[268] On the other hand, it appears that boards did not formally consider the pay ratio when making decisions about CEO pay: Under SEC rules, companies are required to disclose "material factors underlying compensation policies and decisions" in the Compensation Discussion & Analysis ("CD&A") report contained in the proxy statement.[269] Consequently, if the compensation committee of the board of directors considered the pay ratio in determining CEO pay, the pay ratio would need to be mentioned in the CD&A section. According to a survey of corporate filings, however, only five percent of companies discussed the pay ratio in the CD&A section of their proxy statements in 2018.[270] If the goal of the pay ratio rule was to induce boards to cut headline CEO pay (the part of the ratio they can control), it appears that they have not yet taken up the mantle.

3. Proxy Advisory Firms

Even more than executive compensation consultants, the proxy advisory firms, primarily ISS and Glass Lewis, play an important role in corporate governance. They issue formal recommendations, which directly influence investor voting decisions on matters such as the election of directors, various shareholder proposals, and the approval of firms' compensation policies. The proxy advisory firms also issue voting guidelines setting forth their general policies with respect to important corporate matters. Finally (and somewhat controversially), they also provide advisory services to individual firms, including on compensation policies.[271]

The proxy advisory firms remained mostly silent during the lengthy debates over the pay ratio between 2010 and 2017, but this posture became untenable in the run-up to the 2018 proxy season. Ultimately, the proxy advisory firms chose to adopt a wait-and-see approach: not ignoring the new disclosures or dismissing their potential relevance, but also not embracing them. Both ISS and Glass Lewis announced that they will reproduce firms' pay ratios and median worker pay figures in their research reports and proxy papers,

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[268] *See supra* notes 261–266 and accompanying text.

[269] *See* Executive Compensation and Related Person Disclosure, Exchange Act Release No. 54302A (Aug. 29, 2006), 71 Fed. Reg. 53,158 (Sept. 8, 2006) (discussing the Instruction to Item 402(a)(3) of Regulation S-K).

[270] *See* LAUREN PEEK ET AL., COMP. ADVISORY PARTNERS, 2018 PROXY SEASON: EARLY TRENDS IN PAY RATIO DISCLOSURE (2018), https://www.capartners.com/wp-content/uploads/2018/03/CAPintel-18-03-12-2018-Proxy-Season.pdf [https://perma.cc/56RH-LV7V].

[271] *See generally* Stephen J. Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869 (2010).

thereby giving investors ready access to the information.[272] At the same time, however, both proxy advisors refused to link the pay ratio disclosures to their voting recommendations for the 2018 proxy season. ISS declared that the pay ratio "would not impact vote recommendations," whereas Glass Lewis stated that the pay ratio would not be "a determinative factor."[273] Leaving some room for maneuver, Glass Lewis noted that the pay ratio may provide "additional insight" into a company's pay practices, and ISS undertook to continue to assess CEO pay data and seek investor input on its usefulness.[274]

Additional publications released by ISS illustrate the difficulty of using the pay ratio data in the absence of context. In its 2018 Benchmark Policy Recommendations, ISS recommended that investors vote case-by-case on proposals "calling for an analysis of the pay disparity between corporate executives and other non-executive employees."[275] ISS also recommended that investors reject proposals "calling for the company to use the pay disparity analysis or pay ratio in a specific way to set or limit executive pay."[276] In its separate capacity as an advisor to companies, ISS encouraged them to "help shareholders by putting [the] pay ratio disclosure in context," and offered a set of detailed questions to help guide such contextual disclosures.[277] As we saw in Part II, however, firms did not heed this advice.

4. Investors

Though important, assessing whether and how investors are using the pay ratio disclosures is also difficult: Investors are a widely heterogeneous group, with different investor types making decisions according to different sets of preferences. To complicate matters further, investors routinely make a

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[272] *See* INSTITUTIONAL SHAREHOLDER SERVICES., U.S. COMPENSATION POLICIES: FREQUENTLY ASKED QUESTIONS 30 (2018), https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf [https://perma.cc/BH2B-YVGX] [hereinafter ISS COMPENSATION POLICIES]; GLASS LEWIS, 2018 PROXY PAPER GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE 33 (2018), http://www.glasslewis.com/wp-content/uploads/2018/01/2018_Guidelines_UNITED_STATES.pdf [https://perma.cc/2YFM-EYAQ] [hereinafter GLASS LEWIS PROXY GUIDELINES].

[273] ISS COMPENSATION POLICIES, *supra* note 272, at 30; GLASS LEWIS POLICY GUIDELINES, *supra* note 272, at 33.

[274] ISS COMPENSATION POLICIES, *supra* note 272, at 30; GLASS LEWIS POLICY GUIDELINES, *supra* note 272, at 33.

[275] INSTITUTIONAL SHAREHOLDER SERVICES, U.S. PROXY VOTING GUIDELINES: BENCHMARK POLICY RECOMMENDATIONS 49 (2018), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf [https://perma.cc/2Y3D-RU66].

[276] *Id.* at 50.

[277] *See* Peter Kimball, *Beyond the Hype: What Companies Need to Know About the Proposed Pay Ratio Rule*, ISS EXEC. COMP. INSIGHTS, Vol. 13.5 (2013), https://www.issgovernance.com/file/publications/ExecComp_Insights_Vol__13_5_-_Pay_Ratio.pdf [https://perma.cc/U8W3-Z47D].

number of decisions across different companies and rarely report the reasons.[278] Sometimes, investors make no decisions at all, either choosing not to vote or automatically relying on the recommendations of proxy advisory firms.[279] With the foregoing caveats in mind, our findings suggest that investors have not ignored the newly-released pay ratio data, though it is unclear whether they are factoring it into their decisionmaking in any meaningful way.

A large-scale survey of institutional investors by ISS in 2017, prior to the release of the pay ratio data, found that 63% of respondents planned to both compare pay ratios across firms or industry sectors and assess year-on-year changes in individual firms' ratios. A further 9% planned to use one of these tools of analysis. Only 16% reported that their organization did not plan to use the pay ratio information.[280] Separately, three of the largest institutional investors have indicated that the pay ratio would not be a significant factor in their compensation analysis for proxy voting purposes.[281] The disclosure of an outlier ratio without sufficient context, however, could be a trigger for engagement, according to one of these investors.[282]

During the 2018 proxy season, several of the companies that received negative publicity due to high pay ratios also lost their say-on-pay votes, a rare vote of no confidence from investors.[283] It seems likely, however, that this was primarily due to the amount and structure of CEO compensation, rather than the pay ratio.[284] We have no data on whether investors made buying or selling decisions based on the pay ratio. Such decisions are even more

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[278] *See generally* Tom C.W. Lin, *Reasonable Investor(s)*, 95 B.U. L. REV. 461, 466–476 (2015); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561 (2006).

[279] *See* Choi, Fisch & Kahan, *supra* note 271, at 871.

[280] INSTITUTIONAL SHAREHOLDER SERVICES, 2017–2018 ISS GLOBAL POLICY SURVEY: SUMMARY OF RESULTS 12 (2017), https://www.issgovernance.com/file/policy/2017-2018-iss-policy-survey-results-report.pdf [https://perma.cc/R46Z-9TJS]. The survey covered 121 institutional investors (103 asset managers and 18 asset owners), as well as 10 organizations that represent or provide services to institutional investors. *Id.* at 2.

[281] *See, e.g.*, Donald Kalfen, *Proxy Advisors and Investors Announce How They Will Use CEO Pay Ratios in 2018*, MERIDIAN COMP. PARTNERS LLC (Oct. 24, 2017), http://www.meridiancp.com/proxy-advisors-investors-announce-will-use-ceo-pay-ratios-2018 [https://perma.cc/V69K-NHYX].

[282] *Id.*

[283] *See* SEMLER BROSSY, 2018 SAY ON PAY AND PROXY RESULTS 6 (2018), https://www.semlerbrossy.com/wp-content/uploads/SBCG-2018-Year-End-SOP-Report.pdf [https://perma.cc/Z2Z7-SF47] (reporting on failed say-on-pay votes at Mattel, Mondelez, and Wynn Resorts, and noting the low overall percentage of failed votes).

[284] *See, e.g.*, Joe Cahill, *Listen to Shareholders, Mondelez, and Reduce Exec Comp*, CRAIN'S CHI. BUS. (May 18, 2018), https://www.chicagobusiness.com/article/20180518/BLOGS10/180519865/mondelez-should-reduce-executive-pay-after-say-on-pay-vote [https://perma.cc/MAK7-EHYJ].

difficult to observe and interpret than voting decisions. We note that prior to the rule's adoption, pro-social (or socially-responsible) investors indicated that they do consider labor relations issues in making investment choices.[285] Judging by the overall tenor of the 2018 proxy season, however, it appears that "pay for performance" remains the principal driver of investor voting decisions.[286]

E. Corporate Stakeholders

The compensation practices of individual firms are of relevance to two additional groups in the corporate nexus: employees and customers. Conventionally referred to as corporate stakeholders, they do not have formal decisionmaking power akin to that of management, boards, and shareholders. Firms are nonetheless highly dependent on them, either because they provide a key input in the form of labor (employees), or because they pay for firms' outputs (customers). There is evidence to suggest that both employees and customers are interested in and influenced by the new pay ratio data, and this serves to amplify further the overall impact of the pay ratio disclosure rule.

1. Employees

Corporate pay structures are notoriously opaque and, consequently, most workers do not know how their pay compares to that of others within their firm or industry.[287] The exception prior to 2018 was the compensation of the five highest-paid executives at public companies, but this did not provide a relevant source of comparison for rank-and-file employees. The mandated disclosure of median worker pay as part of the pay ratio rule changed that: For the first time, employees were provided with a more relevant number against which to benchmark their own pay. Although pay comparisons are particular to each individual, the basic logic within the context of the pay ratio is intuitive. Higher-than-expected median worker salary relative to one's

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[285] *See, e.g.*, Board of Trustees of the CUPE Employees' Pension Plan, Comment Letter on Amendments to Item 402 of Regulation S-K to Require Pay Ratio Disclosure (Nov. 21, 2013), https://www.sec.gov/comments/s7-07-13/s70713-496.pdf [https://perma.cc/6MWD-LN48] (noting that "[h]igh pay disparities inside a company can be detrimental to employee motivation and productivity, increase turnover and have a negative impact on a company's overall performance").

[286] *See Legal Update: 2019 Proxy and Annual Reporting Season: Let the Preparations Begin*, MAYER BROWN (Sept. 17, 2018), https://www.mayerbrown.com/files/Publication/e6cedd0b-c795-49ab-bd0b-4bdb7930d157/Presentation/PublicationAttachment/9175842f-d8c1-4046-a23e-5fb8c1d62c82/proxy-reporting.pdf.

[287] *See, e.g.*, Benjamin Harris, *What if Companies Were Required to Tell Workers What Their Colleagues Earn?*, HARV. BUS. REV. (Mar. 14, 2018), https://hbr.org/2018/03/what-if-companies-were-required-to-tell-workers-what-their-colleagues-earn [https://perma.cc/SZ6F-HN8B].

own salary, or a higher-than-expected median worker salary at peer firms can lead to employee dissatisfaction.[288] It is known that relative pay, and not just pay in absolute terms, motivates workers and affects worker morale.[289] This effect can be expected to be particularly pronounced in labor markets where talent is scarce and geographically-concentrated, such as Silicon Valley, which raises both the permeability of relative pay information and its relevance.

In acknowledgment of the potential risks surrounding the release of the pay ratio data, in the run-up to the 2018 proxy season a number of corporate advisors suggested that employers should preemptively engage their workers to communicate the information and provide context.[290] Suggested topics for discussion included the company's compensation philosophy, calculation methodology, and unique company characteristics that might result in a skewed pay ratio or median worker pay number compared to peers.[291] Based on this outreach and the overall media attention, we can assume that employees became aware of the median worker pay figure and that the data, however flawed, likely affected their perspective on their employer.

2. Customers

Apart from employee morale, there is evidence that firms' pay ratio disclosures also influence the purchase decisions of consumers by informing perceptions of wage fairness. Drawing on experimental studies involving U.S. consumers, researchers at Harvard Business School found that the disclosure of a retailer's high pay ratio reduces purchase intentions relative to firms with lower ratios; that lower pay ratios improve consumer perceptions of firm competence; and that a high-ratio firm must offer a significant price

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[288] Highlighting the potential for disparities in median worker pay among companies viewed as comparable, the 2018 figure at Verizon was $127,000 against $78,000 at AT&T, a 60% difference. *See* Francis *supra* note 190.

[289] EILEEN APPLEBAUM ET AL., MANUFACTURING ADVANTAGE: WHY HIGH-PERFORMANCE WORK SYSTEMS PAY OFF 44 (2000) (finding that "extreme wage differentials between workers and management discourage trust and prevent employees from seeing themselves as stakeholders"). *See generally* Gary E. Bolton & Axel Ockenfels, *ERC: A Theory of Equity, Reciprocity, and Competition*, 90 AM. ECON. REV. 166 (2000) (noting that relative pay motivates people).

[290] *See, e.g.*, Donna Westervelt, *Preparing for Employee Reactions to the CEO Pay Ratio Disclosure*, CONDUENT (Dec. 6, 2017), https://insights.conduent.com/hr-insights/preparing-for-employee-reactions-to-the-ceo-pay-ratio-disclosure [https://perma.cc/F9S7-GBRX]; Press Release, Willis Tower Watson, Employee Reaction Is U.S. Employers' Biggest Challenge to Pay Ratio Disclosure (Oct. 9, 2017), https://www.willistowerswatson.com/en/press/2017/10/employee-reaction-is-us-employers-biggest-challenge [https://perma.cc/9PWJ-22UH].

[291] *See, e.g.*, Jingcong Zhao, *What to Tell Employees When You Disclose the CEO Pay Ratio*, PAYSCALE (May 30, 2018), https://www.payscale.com/compensation-today/2018/05/ceo-pay-ratio-disclosure [https://perma.cc/3HBE-TLGT].

discount to be viewed by consumers as favorably as a low-ratio firm charging full price.[292] These results are corroborated by an analysis of consumer behavior following the failed 2009 Swiss referendum that sought to cap pay ratios.[293] The extensive media coverage of the referendum publicized firms' pay ratios, and, on average, firms' sales decreased when their pay ratios increased and were in the news.[294] Based on these studies, it should be expected that the 2018 pay ratio data affected U.S. consumers' perception of individual firms to some extent, to the detriment of firms with high pay ratios.

IV. THE PAY RATIO'S INFORMATIONAL INTEGRITY IN CONTEXT

Thus far, we have identified the origins of the pay ratio disclosure rule (Part I), the methodological and comparability problems associated with the pay ratio data (Part II), and the data's use by multiple audiences, many of which are not ordinarily interested in securities disclosure (Part III). We now consider how the quality of the information released pursuant to the pay ratio disclosure rule compares to the quality of the information released pursuant to the other rules that comprise the securities disclosure regime. To do so, we construct the notion of *informational integrity*: the relative extent to which the pay ratio information conforms to three baseline characteristics of securities disclosure—accuracy, comprehensibility, and completeness. Even though not every existing disclosure rule is perfect on these counts, we find that the quality of the pay ratio information—the pay ratio's informational integrity—is so low as to be an outlier within the context of the securities disclosure regime.

A. Overview

Securities disclosure rules share certain basic desirable characteristics. Though these characteristics are not enumerated in a statute, they derive from the purpose of the securities disclosure regime, which is to provide investors and markets with information that can ensure the accurate valuation of firms' securities and inform investors' buy/sell and voting decisions.[295] According to

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[292] *See* Bhavya Mohan, Michael I. Norton & Rohit Deshpandé, *Paying up for Fair Pay: Consumers Prefer Firms with Lower CEO-to-Worker Pay Ratios* (Harvard Bus. Sch., Working Paper No. 15-091, 2015), https://www.hbs.edu/faculty/Publication%20Files/15-091_eb472863-c73b-4aca-a8ee-d7dc1748a91d.pdf [https://perma.cc/9JMG-GH34] (summarizing the results of six studies).

[293] *See supra* note 34 and accompanying text.

[294] Bhavya Mohan, Tobias Schlager, Rohit Deshpandé & Michael I. Norton, *Consumers Avoid Buying from Firms with Higher CEO-to-Worker Pay Ratios*, 28 J. CONSUMER PSYCH. 344, 347–48 (2018).

[295] Even though there is disagreement about the goals of securities regulation (investor protection only vs. investor protection in addition to other goals), there is no dispute that the disclosure

the SEC, public companies are required to provide "meaningful financial and other information to the public," and this information should be "timely, comprehensive, and accurate."[296] One commentator has summarized the general expectations for securities disclosure as "accurate, complete, comprehensible, and accessible."[297] Because much of securities disclosure is based on financial accounting information, the standards for such information promulgated by the Financial Accounting Standards Board (FASB) provide another useful reference point. FASB has identified "relevance and faithful representation" as the two fundamental qualitative characteristics of financial accounting information, and "comparability, verifiability, timeliness, and understandability" as enhancing qualitative characteristics.[298]

These characteristics are somewhat overlapping, ideal types; each of them should be viewed not as a binary variable but as part of a continuum. Our question here is about the relative position of the pay ratio information along these continuums, or, in other words, about the pay ratio's overall informational integrity relative to other disclosure rules. To lend structure to the analysis, we have grouped the baseline characteristics of disclosure into three categories: (1) accuracy; (2) comprehensibility; and (3) completeness. In each category, we compare the performance of the pay ratio disclosure rule against the performance of existing disclosure rules. It bears noting that informational integrity as a concept is distinct from the concept of materiality.[299]

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regime is one of the means for fulfilling the goals of securities regulation. According to the SEC, "[t]he laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it." *See What We Do*, U.S. SEC. & EXCH. COMM'N (June 10, 2013), https://www.sec.gov/Article/whatwedo.html [https://perma.cc/B4NA-ZCMP].

[296] *Id*.

[297] Henry T.C. Hu, *Too Complex to Depict? Innovation, "Pure Information," and the SEC Disclosure Paradigm*, 90 TEX. L. REV. 1601, 1608 (2012).

[298] *See* FINANCIAL STANDARDS ACCOUNTING BOARD, CONCEPTUAL FRAMEWORK FOR FINANCIAL REPORTING—STATEMENT OF FINANCIAL ACCOUNTING CONCEPTS NO. 8, ¶¶ QC1–QC39 (2010), https://www.fasb.org/resources/ccurl/515/412/Concepts%20Statement%20No%208.pdf [https://perma.cc/BNK2-UW3F].

[299] As regards a particular piece of information, materiality focuses on whether there is a substantial likelihood that a reasonable investor would attach importance to this information in making an investment or voting decision. *See* George S. Georgiev, *Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation*, 64 UCLA L. REV. 602, 620–25 (2017) (discussing the definition and use of the materiality standard in the securities disclosure regime). As noted in Part I, there is disagreement between critics and proponents of the pay ratio disclosure rule on whether pay ratio information is material. We believe the answer to this question hinges at least in part on empirical evidence and on the regulator's choice among different models of investor decisionmaking. Informational integrity looks at the *quality* of the pay ratio information, a more objective inquiry, and not at its *significance* to investors, though it certainly can and should inform policy debates about the pay ratio's significance and utility.

We acknowledge that existing disclosure rules, and, relatedly, financial accounting rules suffer from various problems. For example, scholars of accounting have questioned whether certain aspects of the current accounting system produce information that is accurate, comprehensible, and complete, and even whether it is possible to design a system that can produce such information.[300] These are important debates, but they lie outside the scope of our Article. For the reasons discussed in the remainder of this Part, we believe that, even if we were to take a fairly skeptical view of the efficacy of the existing disclosure regime, the pay ratio information is still uniquely deficient by comparison.

B. Accuracy

The need for accuracy in securities disclosure is intuitive: If investors are making decisions based on firm-disclosed information, then the integrity of these decisions depends on the integrity of the underlying information. Similarly, if disclosure is to promote the accuracy of security prices, then accurate prices depend on accurate information. On a basic level, the accuracy of the information in corporate filings is supported by a robust liability regime, which provides investors with remedies when they suffer losses related to false or misleading disclosures.[301]

Ensuring the accuracy of securities disclosure goes much further than deterring fraud. The process of accurately translating a complex objective reality into digestible securities disclosure involves many processes and participants.[302] For example, the historical information pertaining to a company's financial condition and results of operations in the financial statements goes through a number of checks to ensure its accuracy: The information is prepared in compliance with a large body of "generally accepted accounting principles" ("GAAP"), it is audited by an accounting firm prior to disclosure, and it is also subject to certification by the company's CEO and CFO.[303] As an additional effort to ensure accuracy, financial information is also verifiable because the accounting rules are designed to provide detailed guidance that

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[300] *See generally* BARUCH LEV & FENG GU, THE END OF ACCOUNTING AND THE PATH FORWARD FOR INVESTORS AND MANAGERS (2016).

[301] *See generally* 4 THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION, §§ 7.0–7.17, 12.1–13.2 (6th ed. 2009).

[302] Professor Henry Hu describes this process as follows: "[a]n intermediary—for instance, a corporation issuing shares—stands between the investor and an objective reality. The intermediary observes the reality, crafts a depiction of reality, and transmits that depiction to investors." Hu, *supra* note 297, at 1608. The intermediary is aided in this process by securities regulators, and lawyers, accountants, underwriters, and other gatekeepers. *See id*.

[303] *See How to Read a 10-K*, U.S. SEC. & EXCH. COMM'N (July 1, 2012), https://www.sec.gov/fast-answers/answersreada10khtm.html [https://perma.cc/NCD4-BWR4].

would enable a different set of preparers to replicate the information. Indeed, the very purpose of the audit process is to verify the financial statements before they are disclosed to investors.[304] For both financial and non-financial information, the SEC uses the broad set of tools at its disposal to provide detailed guidance to firms and their advisors about what should be disclosed, and how it should be disclosed.[305]

The pay ratio rule does not fit this mold. Investors can be certain of the accuracy of the mathematical calculation of the actual ratio (dividing CEO pay by median worker pay), but not much else. For something to be capable of accurate numerical representation, it ought to be defined with specificity. As discussed in Part II, both CEO pay and median worker pay are imprecise concepts, which are calculated in ways that afford companies a considerable degree of methodological flexibility. As a result, the level of accuracy of the underlying figures, and the pay ratio itself, is unknowable. The methodological flexibility also renders these figures unverifiable. For example, without knowledge of the judgment calls made by the company, a different set of preparers could easily come up with a different median worker, and a different median worker pay figure.[306]

Interestingly, the pay ratio's framing also muddles the underlying reality the pay ratio is supposed to represent, making it even less capable of "accurate" description. Presumably, the pay ratio is supposed to reflect internal pay equity within an organization—how "pay at the top" relates to the pay of rank-and-file workers. Even if we assume that pay equity can be expressed with any degree of fidelity through a simple ratio, the CEO-to-median worker pay ratio may not be the appropriate ratio. The "annual total compensation paid to the CEO" is not necessarily an accurate proxy for pay at the top, since CEOs sometimes make much more than other top executives, and sometimes they make much less than other top executives when judged on this metric (as, for example, do the CEOs of Amazon, Berkshire Hathaway, and Alpha-

[304] When the accounting rules are not clear and judgment calls need to be made, the judgment calls themselves are subject to disclosure under a "critical accounting policies" caption. *See* Cautionary Advice Regarding Disclosure About Critical Accounting Policies, Securities Act Release No. 8040, Exchange Act Release No. 45,149, 66 Fed. Reg. 65,013 (Dec. 17, 2001).

[305] The SEC's expansive toolkit includes: providing detailed instructions as part of disclosure rules; publishing so-called "interpretive releases," "staff legal bulletins," "compliance and disclosure interpretations," "dear CFO letters," as well as a "financial reporting manual;" periodically reviewing and commenting on firms' disclosure documents; responding to no-action letters from firms; providing informal guidance; and, in cases of clear rule violations, pursuing enforcement proceedings. *See Staff Interpretations*, U.S. SEC. & EXCH. COMM'N (Dec. 12, 2012), https://www.sec.gov/interps.shtml [https://perma.cc/V542-VSSY].

[306] Recall that, subject to narrow exceptions, companies are not required to detail the methodological choices they make as long as those are consistent with the SEC's permissive guidance. *See supra* notes 137–205 and accompanying text.

bet/Google, whose low annual pay we discussed in Part II.C). Similarly, median worker pay may not be an accurate proxy for the pay of rank-and-file or typical workers because, again as discussed in Part II.C, large modern corporations do not have one worker that is typical of the entire employee population.

The low standard set by the SEC for liability in connection with false or misleading pay ratio disclosures serves as further evidence of the problem of determining what an accurate pay ratio looks like. In its 2017 Pay Ratio Guidance Release, the SEC advised that "if a [company] uses reasonable estimates, assumptions or methodologies, the pay ratio and related disclosure that results from such use would not provide the basis for Commission enforcement action unless the disclosure was made or reaffirmed without a reasonable basis or was provided other than in good faith."[307]

C. Comprehensibility

Traditional corporate disclosure rules produce information that is meant to be comprehensible and useful to investors. For example, the "description of business" rubric in corporate filings helps investors understand the company's business, assess how it has changed over time, and compare it to other companies.[308] The "risk factors" rubric provides information about the risks facing the company, which can be compared over time, and against other companies' risk profiles.[309] The "executive compensation" rubric allows investors to compare CEO pay with prior periods and with other companies and gain an understanding of the company's compensation philosophy for top management.[310] To facilitate comparisons among firms, the SEC seeks to standardize the ways in which different firms present the same information.[311] In addition, the SEC regularly fine-tunes its rules based on investor input,[312] and it directs companies to explain the significance of information and pro-

[307] Pay Ratio Guidance Release, *supra* note 115, at 44,917.

[308] Regulation S-K, Item 101, 17 C.F.R. § 229.101 (2018).

[309] *Id.* at Item 503.

[310] *Id.* at Item 402.

[311] Indeed, standardization for the purposes of comparability is one of the justifications for the existence of a mandatory disclosure regime, as opposed to a regime based on voluntary reporting. *See, e.g.*, Virginia Harper Ho, *Nonfinancial Risk Disclosure and the Costs of Private Ordering*, 55 AM. BUS. L.J. 407 (2018) (illustrating the importance of standardization in the context of nonfinancial risk disclosure).

[312] For example, the SEC has issued a series of detailed releases and other guidance over the years on the Management's Discussion and Analysis section of disclosure reports. *See* Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056 (Dec. 29, 2003) (providing supplemental guidance on key topics and summarizing prior guidance).

vide context where necessary.[313] All of these are essential features of the securities disclosure regime aimed at ensuring the comprehensibility and usefulness of the disclosed information.

Because of investors' heterogeneity, not all of them consume securities disclosure in the same way. Certain investor types may be unable to comprehend some of the information, and others may choose to ignore disclosure altogether. Even then, however, securities disclosure serves a purpose. So-called information intermediaries, such as research analysts, rating agencies, and proxy advisory firms, analyze and translate the information, making it more accessible to both sophisticated and unsophisticated investors.[314] Moreover, so-called information traders act on firms' disclosures by buying and selling securities, which causes the information to get incorporated and reflected in firms' securities prices; this, in turn, ensures that securities prices are more accurate—a benefit to all investors.[315] These mechanisms do not always work perfectly, but they do highlight the central role of securities disclosure in financial markets.

For investors, information intermediaries, and information traders to *comprehend* a piece of corporate disclosure, however, they first need to know how to *interpret* it. Unfortunately, the pay ratio rule presents an intractable interpretation challenge. Interpretation requires a way to place the information in context and assess it either against an objective benchmark or in comparison to the information provided by other firms. Neither approach is viable in the case of pay ratio information. There is no objective benchmark, because there is no agreement over what constitutes a "good" pay ratio, or a "good" median worker salary. The pay ratios that were reported during the 2018 proxy season were much higher than the public's notion of what is an appropriate pay ratio, so in that sense all firms' pay ratios are "bad."[316] This inference, however, is not particularly helpful to market participants seeking to analyze firms and distinguish among different investment options.

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[313] *See, e.g.*, Exchange Act Rule 12b-20, 17 C.F.R. § 240.12b-20 (2018) (requiring firms to disclose "[i]n addition to the information expressly required to be included in a statement or report, . . . such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading").

[314] *See generally* Ronald J. Gilson & Reinier H. Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549 (1984); Jeffrey N. Gordon & Lewis A. Kornhauser, *Efficient Markets, Costly Information, and Securities Research*, 60 N.Y.U. L. REV. 761 (1985).

[315] *See generally* Zohar Goshen & Gideon Parchimovsky, *The Essential Role of Securities Regulation*, 55 DUKE L.J. 711 (2006) (exploring the links between securities disclosure and market efficiency).

[316] *See* DAVID F. LARCKER ET AL., AMERICANS AND CEO PAY: 2016 PUBLIC PERCEPTION SURVEY ON CEO COMPENSATION 4 (2016), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survey-2016-americans-ceo-pay.pdf [https://perma.cc/Y45L-CUEX]; Kiatpongsan & Norton, *supra* note 41, at 592; *infra* note 346 and accompanying text.

For any individual firm's pay ratio to attain meaning, therefore, it must be compared against the pay ratios of other firms. Put simply, even if all ratios are "bad," some must be "less bad" than others. But, as we have had occasion to note more than once already, the SEC has expressly stated that such cross-firm comparisons are meaningless due to the design of the rule.[317] This presents a Catch-22 situation: The information of any given firm has utility for investors only when it is compared with the information released by other firms, and yet the pay ratio information cannot be compared across firms. As we saw in Part III, each of the constituencies that engaged with the 2018 pay ratio data relied on comparisons to draw inferences, which makes those inferences suspect.

There is a limited scenario where the pay ratio data may have utility *without* the need to compare it to other firms. In theory, observing a firm's compensation trends over time could show whether increases in median worker pay are keeping up with increases in CEO pay. The problem is that CEO pay is determined according to complicated formulas that rely on external inputs, such as stock price, which fluctuate over time.[318] Such external inputs are not normally part of determining median worker pay. As a result, CEO pay varies more from year to year than median worker pay. Year-on-year comparisons of median worker pay may be somewhat more helpful than pay ratio comparisons, but their information value would still be limited because by definition they show only one worker—the *median worker*. Assuming the structure of a firm's workforce remains constant, trends in *average worker* pay, which would cover the entirety of a firm's labor force, would be more useful, but the pay ratio rule does not call for the disclosure of this information.

Contrast the utility of the pay ratio information with a disclosure requirement from the United Kingdom, which exhibits some superficial similarities. The U.K.'s new gender pay gap disclosure rule requires all firms with more than 250 employees to report the difference between what they pay their male and female employees.[319] Like the pay ratio, the gender pay gap rule also results in pithy information on a topic of public importance. Nonetheless, it does not pose the same interpretation difficulties because there is a clear normative guideline embedded in the gender pay gap rule: equal pay for

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[317] *See supra* note 106 and accompanying text.

[318] *See, e.g.*, Elizabeth Peterson, *How Is CEO Compensation Determined? It's Complicated*, BUS. NEWS DAILY (Apr. 22, 2014), https://www.businessnewsdaily.com/6275-ceo-compensation-formula.html [https://perma.cc/L6M6-8249].

[319] Aleksandra Wisniewska et al., *Gender Pay Gap: How Women Are Short-Changed in the UK*, FIN. TIMES (Apr. 5, 2018), https://ig.ft.com/gender-pay-gap-UK (providing an overview of the rule and an analysis of the data).

equal work. Hence, the narrower the pay gap, the "better" the firm. This allows each firm's gender pay gap disclosure to stand on its own in a way that the pay ratio data does not.[320] Absent normative priors about the "right" pay ratio number, and absent the ability to compare with other firms, the pay ratio is not comprehensible in the context of the securities disclosure regime.

D. Completeness

The third baseline characteristic of securities disclosure, completeness, plays a part in defining the previous two: For disclosure to be accurate and for it to be comprehensible to investors, it should not be incomplete. Like accuracy and comprehensibility, completeness is an abstract, non-binary concept. Several features of the disclosure regime are in place to enhance the completeness of the disclosed information.

First, all existing disclosure rules are supplemented by an overarching requirement for firms to provide "such further material information, if any, as may be necessary to make the required [disclosures], in the light of the circumstances under which they are made, not misleading."[321] In practice, this provision serves as a gap filler: it ensures that with respect to any matter for which disclosure is required firms also present additional related material information, if the absence of the additional information would render the underlying information misleading. When firms fail to make the additional disclosures, they could be subject to securities law liability.[322] This precept is not particularly helpful in the pay ratio context, however, because it is unclear how the pay ratio could be "misleading," as long as the disclosing firm has made a good faith effort to calculate it in accordance with the SEC's flexible guidance.[323]

More important for our purposes, the goal of completeness also plays a role in the regulatory design of particular disclosure rules. As noted, firms are required to provide disclosure about the compensation of their five highest-paid executives.[324] Recognizing that numerical information alone might paint an incomplete picture of compensation arrangements, the SEC has expanded

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[320] The U.K. gender pay gap disclosure rule contains several methodological challenges of its own, but those are not as serious as the problems with the pay ratio rule and lie outside the scope of our Article. The gender pay gap rule is also more effective in that it applies to all companies—public and private alike—that have more than 250 employees in the United Kingdom, including foreign companies. By contrast, the pay ratio disclosure rule applies only to U.S. public companies.

[321] Exchange Act Rule 12b-20, 17 C.F.R. § 240.12b-20 (2018).

[322] *See* HAZEN, *supra* note 301, §§ 7.0–7.17, 12.1–13.2.

[323] *See supra* notes 138–157 and accompanying text.

[324] Regulation S-K, Item 402, 17 C.F.R. § 229.402 (2018).

the rules over time to require that firms also present "a narrative description of any material factors necessary to an understanding of the information disclosed in the [numerical] tables."[325] Even though the pay ratio disclosure rule also deals with compensation-related information and bears close similarity to executive compensation information, it requires the disclosure only of numbers, without additional narrative description. (We return to this point in Part VI.)

The principle of completeness, along with accuracy, also plays a role in limiting the ways in which firms are allowed to present information. In fact, under what could be characterized as an "anti-soundbite principle," firms are prohibited from reporting information that is incomplete and lacks context. Companies are often tempted to devise non-standard financial metrics that make their results of operations, financial condition, or prospects appear more favorable than they are in actuality. Such company-devised metrics are known as pro forma metrics, or non-GAAP metrics.[326] Much like pay ratio figures, non-GAAP metrics often lack context and nuance, and may paint an incomplete or misleading picture of the underlying topic.

The use of non-GAAP metrics came to be seen as a problem in the wake of the corporate accounting scandals of the early 2000s,[327] and the SEC brought its first case challenging misleading pro forma earnings information in 2002.[328] Congress addressed this issue in the Sarbanes-Oxley Act, passed later the same year, by directing the SEC to adopt a regulation (which subsequently came to be known as Regulation G) requiring companies that choose to disclose non-GAAP financial metrics to also include a presentation of the most directly-comparable GAAP financial metrics and to give those metrics equal or greater prominence.[329] In addition, companies are required to provide a reconciliation of the disclosed non-GAAP financial metrics to the most directly comparable GAAP financial metric.[330]

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[325] Regulation S-K, Item 402(e)(1), 17 C.F.R. § 229.402(e)(1) (2018).

[326] *See* Final Rule: Conditions for Use of Non-GAAP Financial Measures, Securities Act Release No. 8176, Exchange Act Release No. 47,226, 68 Fed. Reg. 4819 (Jan. 30, 2003).

[327] *See* Penelope Patsuris, *The Corporate Scandal Sheet*, FORBES (Aug. 26, 2002), https://www.forbes.com/2002/07/25/accountingtracker.html [https://perma.cc/TEQ2-LCRP] (listing numerous corporate scandals in the early 2000s).

[328] Press Release, U.S. Sec. & Exch. Comm'n, *SEC Brings First Pro Forma Financial Reporting Case—Trump Hotels Charged with Issuing Misleading Earnings Release* (Jan. 16, 2002), https://www.sec.gov/news/headlines/trumphotels.htm [https://perma.cc/TUU9-VYJW]. The SEC's Director of Enforcement at the time noted: "In this case, the method of presenting the pro forma numbers and the positive spin the Company put on them were materially misleading. The case starkly illustrates how pro forma numbers can be used deceptively and the mischief that they can cause." *Id*.

[329] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 401(b), 116 Stat. 745 (2002) (codified as amended at 15 U.S.C. § 7261(b) (2012)).

[330] *Id*.

Zooming out of the technical requirements of specific disclosure rules, it is worth recalling our broader point: Through various devices, the securities disclosure regime generally takes care to ensure the informational integrity (i.e., the accuracy, comprehensibility, and completeness) of the information firms are required to disclose. By comparison, and in its current formulation, the pay ratio disclosure rule fails to exhibit these baseline attributes of securities disclosure.

V. THE DISCLOSURE-AS-SOUNDBITE APPROACH: FEATURES AND EFFECTIVENESS

Our discussion so far has sought to present a comprehensive and objective account of the pay ratio disclosure project. Building on this evidence, in this Part we suggest that the pay ratio rule represents a unique approach to securities disclosure characterized by high public salience and low informational integrity, which we term *disclosure-as-soundbite*. Our overall assessment of the effectiveness of this approach differs depending on what we accept to be the proper function(s) of the rule. We find that the pay ratio is ineffectual and potentially counterproductive in fulfilling an informational or a behavioral function, but that it could be more successful, though still suboptimal, in fulfilling a public discourse function.

A. The Unique Disclosure-As-Soundbite Approach

One of the goals of this Article is to point out the numerous idiosyncrasies of the pay ratio disclosure rule. Two of these define the pay ratio: its capacity to draw in multiple audiences by virtue of its simplicity and accessibility, which we discussed in Part III and which results in what we call high public salience, and its low informational integrity, which we explored in Part IV. The disclosure-as-soundbite label aims to capture these distinctive attributes of the pay ratio.

The information produced as a result of most traditional SEC disclosure rules rarely draws the attention of non-corporate constituencies. In part, this is due to the topics of those rules, which have limited direct relevance to public policy and are of interest primarily to investors. In part, this is also due to the rules' design, which ensures that relevant information is explained and placed in context. Disclosure reports filed with the SEC generally attract public attention only when there is a corporate crisis or scandal and remain out of public view the rest of the time.[331]

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[331] *See, e.g.*, Dave Michaels & Georgia Wells, *SEC Probes Why Facebook Didn't Warn Sooner on Privacy Lapse*, WALL ST. J. (July 12, 2018), https://www.wsj.com/articles/sec-probes-

The pay ratio rule shrewdly flips this disclosure model on its head. By linking the earnings of rank-and-file workers (through the concept of median worker pay) to those of corporate executives, the pay ratio takes on a personal dimension and resonates with the public to an extent that is much greater than information about CEO pay alone. Recent experimental evidence confirms that the pay ratio has a strong impact on shaping opinions: When presented with pay ratio data, laypersons zero in on it and become indifferent to information about firm performance.[332] This public resonance is further enhanced by the superficial simplicity and accessibility of the single-number ratio: a succinct bit of data that can easily appear to the person consuming it to carry a great deal more information than it actually does.

One way to summarize the confluence of these factors is *high public salience*. Typically, salience is used in the behavioral law and economics literature to refer to risks that are highly known and immediately grasped, such that the average person may overweight their importance.[333] Environmental right-to-know laws provide one example: The mandated disclosure to consumers of dangerous-sounding chemicals in the air or as product ingredients may lead those consumers to misperceive risks, misallocate resources, and frustrate health, safety, and environmental objectives.[334] Information about taxes, which resemble the pay ratio in that they relate to persons' finances, may in certain cases be so salient that it could influence voter decisions and legislation.[335]

The pay ratio disclosure rule introduces this dynamic to the securities disclosure context. An oft-repeated argument in securities regulation is that the presentation of too much information or of information in a format that is not easily digestible may reduce the usefulness of the disclosure through "information overload."[336] On the flipside, however, information could also be made more salient by manipulating its format by, for example, simplifying

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why-facebook-didnt-warn-sooner-on-privacy-lapse-1531422043 [https://perma.cc/7ZKH-Z3U3] (discussing SEC probe into Facebook's disclosure reports following revelations of massive data breaches in 2016).

[332] *See* Minor Myers & Justin Sevier, *The Paradox of Executive Compensation Regulation*, 44 J. CORP. L. (forthcoming 2019).

[333] *See* Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1525 (1998).

[334] *See* Alexander Volokh, *The Pitfalls of the Environmental Right-to-Know*, 2002 UTAH L. REV. 805, 807.

[335] *See* David Gamage & Darien Shanske, *Three Essays on Tax Salience: Market Salience and Political Salience*, 65 TAX L. REV. 19, 20 (2011) (discussing political salience in the context of tax legislation); Deborah H. Schenk, *Exploiting the Salience Bias in Designing Taxes*, 28 YALE J. ON REG. 253, 273 (2011) (same).

[336] *See* Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 WASH. U. L.Q. 417, 473 (2003).

the language or reducing the narrative discussions.[337] The pay ratio disclosure rule does just that. The resulting phenomenon is new to the securities disclosure regime and it could represent a more pernicious corollary to information overload.

Part of the challenge is that there is a trade-off between public salience and informational integrity. The features that underlie the pay ratio's success in drawing in multiple audiences come at the cost of low informational integrity. As discussed in Part IV, it is not possible for a ratio that is the product of methodologically complex concepts such as median worker pay and CEO pay to exhibit a degree of accuracy, comprehensibility, and completeness in line with disclosure rules that require a detailed and nuanced presentation of mainstream corporate information.

To be sure, certain types of corporate disclosure share some of the pay ratio's characteristics, though none match the disclosure-as-soundbite approach in full. For example, data on CEO pay and the existence of golden parachute arrangements often makes its way from corporate filings into the public realm, suggesting that it also has high public salience.[338] Still, executive compensation information is different because it exhibits a degree of informational integrity that the pay ratio information does not have: The CD&A report, which features numerical information about CEO pay, also contains a lot of nuanced and detailed information placing executive compensation data in context.[339] Even if most of the nuance gets lost as part of the publicity, the underlying executive compensation disclosure is generally sound and comparable across firms.

B. Does the Pay Ratio Rule Fulfill Its Potential Functions?

Our assessment of the effectiveness of the pay ratio disclosure rule is framed with reference to the three potential functions discussed in Part I.D. Recall that even though the SEC determined that the pay ratio rule is intended to fulfill an informational function, stakeholders have ascribed other functions to the rule, in addition to or in lieu of the informational function. This polyphonic quality is also illustrated by the actual use of the pay ratio information by multiple audiences, discussed in Part III. As noted in Part I.D, we do not take a position on the appropriate function of the rule, or the appropriate mix

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[337] *Id*. at 475–76 (providing an overview of the cognitive psychology literature).

[338] *See, e.g.*, Stan Choe, *Top 10 Highest Paid CEOs in 2016*, USA TODAY (May 23, 2017), https://www.usatoday.com/story/money/2017/05/23/ceo-pay-highest-paid-chief-executive-officers-2016/339079001 [https://perma.cc/C3ME-YBP2] (reporting the results of an annual survey of CEO pay by the Associated Press and executive compensation firm Equilar based on an analysis of corporate filings).

[339] *See infra* notes 358–360 and accompanying text.

of functions; instead, we offer separate assessments of the rule's relative success in fulfilling each of the three possible functions.

1. Informational Function

For the pay ratio rule to fulfill its informational function, it must produce disclosure that can inform investors' voting and buy/sell decisions. Since the information released pursuant to the rule is characterized by low informational integrity, as discussed in Part IV, the rule is ineffectual on this count. What is more, the rule may also be counterproductive or harmful, because it has the potential to disrupt and distort investor decisionmaking.

From the point of view of investors, attempting to interpret the pay ratio data can easily lead to flawed inferences. The assumption behind the pay ratio is that "high" pay ratios would be viewed negatively by investors. This would generally be true for pro-social investors concerned primarily with pay equity.[340] But for an investor concerned solely or primarily with financial returns, a high pay ratio could send *both* positive and negative signals.

On the one hand, a high pay ratio may indicate that executive compensation is "too high" and corporate resources are being wasted, or that the board is captured by management—all negative signals.[341] On the other hand, a highly-paid CEO and a high pay ratio may mean that the pay-for-performance principle is embedded in the firm's compensation philosophy. When comparing two firms with an identical labor force, the CEO of the *better*-performing firm should therefore receive *higher* compensation than the CEO of the worse-performing firm, and higher CEO pay would result in a *higher* pay ratio. In this case the high pay ratio should send a positive signal: the firm is performing well and rewards executives accordingly, which can be expected to create the conditions for sustained strong performance in the future.[342]

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[340] Such investors are still interpreting methodologically flawed data. They still need some external benchmark to determine what constitutes a "high" and what constitutes a "low" pay ratio. In the very least, however, they know that low pay ratios are positive signals and high pay ratios are negative signals.

[341] These intuitions are supported by empirical evidence suggesting that firms with higher pay gaps are less profitable than firms with smaller pay gaps. *See, e.g.*, SAMUEL BLOCK, MSCI, INCOME INEQUALITY AND THE INTRACORPORATE PAY GAP (2016), https://www.msci.com/documents/10199/b94ae705-4d36-49e5-8873-b6fe42fdd291 [https://perma.cc/6J2D-PFB9].

[342] The incentive-based theory underlying pay-for-performance is intuitive and generally accepted, but the practical tasks of implementing effective pay-for-performance compensation models, or even quantifying "performance," have been a perennial challenge. *See, e.g.*, RIC MARSHALL & LINDA-ELING LEE, MSCI, ARE CEOS PAID FOR PERFORMANCE?: EVALUATING THE EFFECTIVENESS OF EQUITY INCENTIVES (2016), https://www.msci.com/documents/10199/91a7f92b-d4ba-4d29-ae5f-8022f9bb944d [https://perma.cc/EW4K-LZ67] (reporting the results of an empirical study showing inverse correlation between measures of CEO pay and firm performance over a 10-year period).

The result of this interpretation challenge is that investors may misidentify firms and misallocate capital. Moreover, when investors fail to invest in high-quality firms with effective pay-for-performance compensation schemes because the resulting (high) pay ratios are erroneously perceived as a negative signal, this undermines the SEC's goal of aligning executive pay with corporate performance.

2. Behavioral Function

Whether or not the pay ratio rule fulfills a behavioral function is a slightly more complicated question because in theory the pay ratio data does have the potential to "shame" companies and influence corporate behavior. If boards expect that the pay ratio disclosures will be subjected to scrutiny from investors, employees, or the public, they may seek to improve the pay ratio by reducing CEO pay or increasing median worker pay, or, more generally, devote more attention to employee compensation matters. While possible in theory, these effects are unlikely to obtain in any systematic way in practice because of the muddled nature of the pay ratio information and the attenuated linkages between pay ratio disclosure and the desired changes in corporate behavior. Ultimately, the pay ratio appears to be ineffectual in fulfilling a behavioral function, and it could potentially have counterproductive or harmful effects on corporate conduct.

Consider how the pay ratio affects corporate decisionmaking. The pay ratio data influences perceptions easily due to its high public salience, a design feature of the disclosure-as-soundbite approach discussed in Part V.A. In this context, firms may rationally choose to manage pay ratio optics at the expense of sound business decisions, even though they realize the problematic nature of the pay ratio information. Corporate boards control CEO pay, one of the two components of the pay ratio, so they can reduce the pay ratio by reducing CEO pay. An unjustified reduction in CEO pay, however, may undermine the firm's pay-for-performance compensation model, and it may also lead the firm to lose talent. The two sets of incentives at play in this case point in opposite directions.

The other way of improving the pay ratio—by increasing median worker pay—is even more problematic. It is true that firms can improve the median worker pay figure by increasing pay throughout the organization, which would be a positive effect. But firms can also achieve the same result more cheaply by engaging in a range of behaviors with negative welfare consequences. For example, a firm can redistribute income from the lowest-paid workers to workers at the median. This counterproductive strategy would not increase the total amount the firm spends on employee compensation, but it will increase its median worker pay figure. The firm looks better without pay-

ing workers more. A firm can also outsource the work done by the lowest-paid workers. Once those workers are off the firm's payroll and on the payroll of a subcontractor, the firm's median worker pay figure would automatically go up, again making the firm look better, even if the outsourced employees are paid the same (or less) by the subcontractor.[343]

To be sure, the frequency with which firms will engage in these forms of manipulation cannot be predicted, and, moreover, some of the manipulation may be unobservable even when it occurs. There could also be one-off cases where sustained pressure, including by means of highlighting a high pay ratio, could lead firms to reform their pay practices for the lowest-paid workers.[344] Our principal point is that the pay ratio is unlikely to move CEO pay or median worker pay in a desirable direction, in a systematic way.

For policymakers seeking to shape corporate behavior through disclosure, the U.K. gender pay gap disclosure rule discussed in Part IV.C provides an instructive counter-example. The behavioral aspect of the disclosure rule is clear: to nudge (or shame) firms into achieving gender pay equity. There is a clear link between the information that is required to be disclosed (the pay gap) and the public policy objective (pay equity). What is more, though there are two ways to narrow the gender pay gap, either by paying women more or men less, neither one of these carries the risk of unforeseen negative effects similar to the ones observed with the pay ratio disclosure rule.[345]

3. Public Discourse Function

As we showed in Part III, the pay ratio data has received significant attention from the news media, national politicians, state and local governments, labor unions, and think tanks. Those in the public sphere who analyzed the pay ratio disclosures did so with reference to income inequality;

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[343] This is not an exhaustive list of the ways in which firms might manipulate the pay ratio. For example, firms can also adopt a compensation scheme under which the total economic value of CEO pay is not captured by the chosen methodology, as would be the case with performance-based stock options not included under an all-cash compensation methodology. More broadly, CEO pay is notoriously complex and susceptible to manipulation. *See, e.g.*, Ross Kerber, *Nobel Winner Says CEO Pay Too Complex, Echoing Investor Gripe*, REUTERS (Oct. 11, 2016), https://www.reuters.com/article/us-nobel-prize-ceopay-idUSKCN12B2QG [https://perma.cc/F96H-T9UL] (noting that the extreme complexity of CEO pay structures make them difficult to understand and manage).

[344] *See, e.g.*, Alex Shephard, *Why Amazon Raised Its Minimum Wage*, NEW REPUBLIC (Oct. 3, 2018), https://newrepublic.com/article/151521/amazon-raised-minimum-wage [https://perma.cc/LM2C-GRQ6] (reporting on the success of a campaign by Senator Bernie Sanders to pressure Amazon into raising its minimum wage); *supra* notes 228–229 and accompanying text for a discussion of the use of pay ratios in connection with this campaign.

[345] To be sure, the gender pay gap rule can be criticized in various ways. Our point is simply that it is superior in its design to the U.S. pay ratio rule.

those who used pay ratios as part of legislation justified the legislation as a means of combatting income inequality; those who merely cited pay ratio figures to make rhetorical points also did so on questions relating to income inequality. As a factual matter, then, the pay ratio rule has not simply become part of public discourse—it has also achieved a level of public visibility that, for the time being, is unmatched by other disclosure rules. But what is the quality of the pay ratio's contribution to public discourse, and what other effects might this have?

Because of its high public salience and the attention it generates, the pay ratio data likely increases public consciousness of CEO-to-worker pay disparities. Survey evidence suggests that the public consistently underestimates the magnitude of these disparities: The average member of the public believes the economy-wide CEO-to-median worker pay ratio to be 10:1, which is significantly lower than the actual ratios.[346] In this context, the informational integrity and comparability of the pay ratio data matter very little, because the gap between public perception and reality is so large. The actual pay ratio figure is merely a conceptual hook that ensures the public salience of the information. The message that is doing the work is that a large pay gap exists and that it persists.

The pay ratio's frequent association with income inequality also likely reinforces existing anxieties about pay inequities and economic inequality. In this context, the trade-offs between public salience and informational integrity become important. The rule is designed to ensure that public discourse will take place, and that it will be repeated every year during the annual corporate reporting season, which stretches several months. Apart from frequency, however, there should also be a concern with the quality of public discourse, which depends on the quality of the information that is used as part of this discourse.

Once we shift the focus to the quality of public discourse, linking the pay ratio to income inequality becomes potentially problematic. Income inequality is an imprecise umbrella term used to refer to a variety of interrelated problems. In the pay ratio context, those could include the high disparities between the pay of rank-and-file workers and corporate executives within firms across the economy (pay inequity), or to broader inequalities in wealth distribution within society (economic inequality). Economic inequality, however, is better understood as *wealth* inequality.[347] Yet, the pay ratio's focus on

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[346] *See* LARCKER ET AL., *supra* note 316, at 4; *see also* Kiatpongsan & Norton, *supra* note 41 and accompanying text.

[347] *See generally* EDWARD N. WOLFF, A CENTURY OF WEALTH IN AMERICA (2017) (documenting major decreases in average U.S. household wealth in the aftermath of the 2008 financial crisis).

disparities in income does nothing to capture relative wealth. It would also be simplistic to view the executive compensation packages of public company CEOs and the ratios of CEO pay to median worker pay as useful proxies for inequality: Public companies represent a limited sample of the economy, and the pay packages of public company CEOs pale in comparison to those of private equity executives, many of whom often receive more than $1 billion annually.[348] Ultimately, there is evidence that inequality is associated with other factors, such as the persistent gap between increases in productivity and increases in wages,[349] growing automation,[350] and firms' potentially unlawful market power.[351]

Relying too much on pay ratios also has the capacity to distract and even backfire. Their use in substantive tax legislation is, quite plainly, poor public policy, because pay ratios are so imprecise and easily-to-manipulate.[352] When Portland-style regulatory measures attract public scrutiny, the focus falls on the inadequacies of the data and peculiarities of the pay ratio disclosure rule, not on the important problems these measures are trying to solve. There could also be undesirable placebo effect at play: If the public's association between pay ratio information and inequality becomes strengthened, any subsequent decreases in firms' pay ratios could be easily misinterpreted as a sign that inequality is becoming less of a problem, even if the underlying evidence does not support this.

The pay ratio disclosure rule has also been a challenge for the SEC, a much narrower concern, but one that could have important regulatory consequences. The seven-year implementation process, during which the SEC received hundreds of thousands of comment letters and had to resolve multiple

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[348] *See, e.g.*, Ben Protess & Michael Corkery, *Just How Much Do the Top Private Equity Earners Make?*, N.Y. TIMES (Dec. 10, 2016), https://www.nytimes.com/2016/12/10/business/dealbook/just-how-much-do-the-top-private-equity-earners-make.html [https://perma.cc/KXV6-KNTM].

[349] *See, e.g.*, *The Productivity-Pay Gap*, ECON. POL'Y INST. (Aug. 2018), https://www.epi.org/productivity-pay-gap [https://perma.cc/AP5T-5URY].

[350] *See, e.g.*, Nicolas Yan, *Automated Inequality*, HARV. POL. REV. (Oct. 2, 2016), http://harvardpolitics.com/world/automation [https://perma.cc/M5FS-76H7].

[351] *See, e.g.*, Alan B. Krueger & Eric Posner, Op-Ed., *Corporate America Is Suppressing Wages for Many Workers*, N.Y. TIMES (Feb. 28, 2018), https://www.nytimes.com/2018/02/28/opinion/corporate-america-suppressing-wages.html [https://perma.cc/3RKS-VSRC] (suggesting that practices such as non-compete clauses in employment contracts are suppressing worker wages); Suresh Naidu, Eric Posner & Glen Weyl, *More and More Companies Have Monopoly Power Over Workers' Wages. That's Killing the Economy*, VOX (Apr. 6, 2018), https://www.vox.com/the-big-idea/2018/4/6/17204808/wages-employers-workers-monopsony-growth-stagnation-inequality [https://perma.cc/G9QB-4DB7] (linking depressed worker wages and income inequality to firms' monopoly power).

[352] Recall that the integrity of the SEC data has been criticized by EPI, a think tank generally sympathetic to the use of pay ratios as regulatory tools, which further suggests that the SEC pay ratio rule is not fit for this purpose. *See supra* notes 255–259 and accompanying text.

interpretative ambiguities, has been a drain on the agency's administrative resources. The charged nature of the subject matter exposed the SEC to uncomfortable political pressure on a number of occasions, an issue that former SEC Chair Mary Jo White lamented.[353] The pay ratio disclosure rule has also been used as Exhibit A in debates over the utility of the SEC disclosure regime, giving ammunition to those who argue that the entire regime is overly burdensome and ought to be scaled back.[354] Even setting such efforts aside, the fact that the pay ratio is characterized by low informational integrity may undermine the overall integrity of the disclosure regime as it exists today.

Based on the evidence available so far, our assessment is that the pay ratio could make a limited positive contribution to public discourse. The low informational integrity of the data, however, creates the risk that instead of shining a light on issues of inequality, the pay ratio might divert the spotlight away from them and even do damage to the very cause it is trying to advance.

VI. POLICY IMPLICATIONS

Many of the problems associated with the pay ratio rule result from the high public salience and low informational integrity of the pay ratio data (the disclosure-as-soundbite approach), and not necessarily from the nature of the information being reported (executive pay and median worker pay). To this end, we argue for a move away from the disclosure-as-soundbite approach. We suggest that, instead, the underlying information should be presented in a narrative approach that provides more context, nuance, and explanation. In practice, this means that the pay ratio information would be treated in the

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[353] Cydney Posner, *In Her Final Speech as SEC Chair, White Identifies Current Trends Assailing SEC Independence*, COOLEY PUBCO (Jan. 20, 2017), https://cooleypubco.com/2017/01/20/in-her-final-speech-as-sec-chair-white-identifies-current-trends-assailing-sec-independence [https://perma.cc/7PH2-CH6E] (noting that the pay ratio disclosure rule exemplifies the trend toward "highly prescriptive [congressional] mandates" which threatens SEC independence).

[354] *See, e.g.*, Society of Corporate Governance Professionals, Comment Letter on Reconsideration of Dodd Frank Section 953(b), The Pay Ratio Rule (Mar. 24, 2017), https://www.sec.gov/comments/pay-ratio-statement/cll3-1664965-148929.pdf [https://perma.cc/W4HZ-RNN7] (asserting that the pay ratio disclosure rule "exacerbates a significant problem with the current disclosure [regime]—overloading disclosure documents with information that is not material to investors"); Business Roundtable, BRT Letter on the Core Principles for Regulating the U.S. Financial System (Sept. 1, 2017), https://www.businessroundtable.org/brt-letter-on-the-core-principles-for-regulating-the-us-financial-system [https://perma.cc/BMS2-EKSF] (asserting that certain disclosure rules, including the pay ratio disclosure rule, are in conflict with "the materiality standard for public company disclosure . . . [and] long-term interests of ordinary investors"); *see also* U.S. DEP'T. OF TREASURY, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: CAPITAL MARKETS 29 (2017), https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf [https://perma.cc/YB9L-CPT7] (recommending legislation to "remove non-material disclosure requirements," including, among others, the pay ratio disclosure rule).

same way as the executive compensation information that is currently part of the disclosure regime: whenever existing rules require numerical disclosures about executive pay, the numbers are always followed by a narrative explanation.

The scope of our policy proposal is framed by the assumption that the pay ratio disclosure rule will not be repealed in the near term. Though the rule has been the target of repeated repeal efforts and remains highly controversial, it has been remarkably resilient even as other Dodd-Frank rules have been struck down by Congress.[355] Experience with similar executive compensation rules, such as IRS Section 162(m), also suggests that even when the rules are widely viewed as deficient, they can be difficult to repeal.[356]

As discussed in Part II, the SEC sought to minimize compliance costs by giving firms considerable methodological flexibility in identifying the median worker and calculating the median worker's salary and the resulting pay ratio. Driven by the same compliance cost concerns, the SEC *also* chose not to require firms to provide narrative disclosure explaining the reported figures and the majority of the associated methodological choices.[357] In other words, the SEC adopted a "numbers-only" approach.

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[355] *See supra* note 72 and accompanying text.

[356] *See* I.R.C. § 162(m) (2012) (imposing a $1 million cap on the deductibility of executive compensation). For criticism of Section 162(m), see Steven A. Bank, *Devaluing Reform: The Derivatives Market and Executive Compensation*, 7 DEPAUL BUS. L.J. 301, 332 (1995); Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877, 920 (2007). Under the Tax Cuts and Jobs Act, Section 162(m) was amended to remove the performance pay exception to the deductibility cap, but it was not repealed and may not even have closed the performance-based exception. *See* David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Legislation*, 103 MINN. L. REV. 1439, 1518–19 (2019) (suggesting ways to retain the performance-based exception through appropriate structuring post-2017 Act).

[357] In the Pay Ratio Adopting Release, the SEC explained its approach as follows:

> [W]e recognize the possibility that, based on the specific facts and circumstances of a registrant's work force and corporate operations, the pay ratio disclosure may warrant additional disclosures from a registrant to ensure that, in the registrant's view, the pay ratio disclosure is a meaningful data point for investors when making their say-on-pay votes. While Congress appears to have believed that the pay ratio disclosure would be a useful data point, we recognize that its relative usefulness—taken alone without accompanying disclosures to provide potentially important context—may vary considerably. Rather than prescribe a one-size-fits-all catalogue of additional disclosures that registrants should provide to put the pay ratio disclosure in context, we believe it is the better course to provide registrants the flexibility to provide additional disclosures that they believe will assist investors' understanding of the meaning of pay ratio disclosure when making say-on-pay votes. In this way, we believe we can best fulfill Congress's directive in Section 953(b) while avoiding unnecessary costs and complexities that might result from mandating additional disclosures.

Even though it may not have been apparent at the time, those were two separate decisions, and the compliance costs should not have been conflated. It is true that giving firms methodological flexibility along the lines described in Part II served to reduce compliance costs considerably. In fact, it probably would have been impossible to implement the pay ratio mandate without such methodological flexibility. It is, however, at best uncertain whether not requiring firms to explain the numbers results in any meaningful compliance cost savings. Yet, this lack of explanation inflates the public salience and reduces the informational integrity of the pay ratio information. In arguing for additional context, nuance, and explanation, we therefore seek to move away from the flawed disclosure-as-soundbite approach. And, because firms already have the requisite information to provide these additional clarifying disclosures, our proposal is unlikely to result in substantial additional costs.

As to the content of the additional narrative information, we propose that the SEC follow the well-established template of the CD&A section, which is governed by Item 402 of Regulation S-K (the "CD&A rules").[358] Specifically, the CD&A rules require firms to disclose in tabular format the compensation received by the five highest-paid executives broken down by type (salary, stock options, etc.), as well as any incentive plan-based compensation. Immediately following these tables, the CD&A rules require firms to provide "a narrative description of any material factors necessary to an understanding of the information disclosed in the tables"; the rules also guide firms by providing a non-exhaustive list of examples of such factors.[359] The CD&A rules follow the exact same approach with respect to each of the many categories of quantitative information required to be presented in tabular format: outstanding equity awards; option exercises and stock vested; pension benefits; deferred compensation; and compensation of directors.[360] In short, any table containing numbers is to be followed by a narrative that discusses the material factors necessary for understanding the information. We suggest that the same should be done for the pay ratio numbers.

Potential examples of material factors necessary to an understanding of the pay ratio information may include the firm's philosophy for determining the pay of the median worker; a discussion of the structure of the labor force (for example, whether the firm uses contractors, part-time employees, and offshore workers, and whether it relies extensively on automation); and an explanation of the reasons for any significant changes from prior years. As with the rest of the CD&A rules, the SEC should come up with basic exam-

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Pay Ratio Adopting Release, *supra* note 97, at 50,107.

[358] Regulation S-K, Item 402, 17 C.F.R. § 229.402 (2018).

[359] *Id.* at Item 402(e)(1).

[360] *Id.* at Item 402.

ples of material factors in consultation with companies and investors. It should then place the onus on companies to identify the unique factors that are material to them—an inquiry that is meant to be contextual and nuanced. Adopting this approach would be consistent with the evolution of the SEC disclosure regime in the area of executive compensation. Many of the early disclosure rules in this area did not require companies to provide explanations, but the mounting frustration with the difficulty of interpreting numbers-only disclosures gradually led to the introduction of rules requiring narrative discussions.[361]

In the Pay Ratio Adopting Release, the SEC took the view that giving firms "flexibility to provide additional disclosures . . . [to] assist investors' understanding of the meaning of pay ratio disclosure" would lead firms to provide such disclosure voluntarily when appropriate.[362] The evidence from the first season of pay ratio reporting suggests that the SEC was too optimistic. An empirical study looking at supplemental ratios (which can be viewed as a proxy for supplemental information) found that only 14% of firms in a sample of 1,125 large firms reported such supplemental ratios, and many did so for opportunistic reasons.[363] These results are consistent with experts' advice to firms prior to the rule's effectiveness: when it comes to pay ratio disclosure, less is more.[364] As in other areas of the securities disclosure regime, the absence of a mandatory disclosure rule results in selective voluntary reporting.[365] This suggests that the best way to improve the pay ratio rule would be to require all public companies to provide information about the material factors driving the pay ratio numbers.

Our suggestion that in the pay ratio context less is *not* more finds some independent confirmation in the design of the U.K. pay ratio disclosure rule,

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[361] *See Executive Compensation and Related Person Disclosure*, *supra* note 269.

[362] *See* Pay Ratio Adopting Release, *supra* note 97, at 50,107.

[363] Sun Moon Jung et al., Why Do Firms Disclose a Supplementary CEO-to-Median Worker Pay Ratio? Initial Evidence from Dodd-Frank Act Section 953(b), at 3 (Dec. 3, 2018) (unpublished manuscript), https://papers.ssrn.com/sol3/abstract_id=3234013 [https://perma.cc/2XK4-JTZ4]. The authors found that among the firms that did provide supplemental ratios, 86% reported a supplemental ratio that was lower than the main ratio. Firms with greater excess CEO compensation and a higher-than-industry median pay ratio were also more likely to provide a supplemental pay ratio. *Id.*

[364] *See, e.g.*, James D. C. Barrall, *On Governance: CEO Pay Ratio Planning: 10 Consensuses from Thought Leading Companies*, THE CONFERENCE BOARD (Nov. 14, 2017), https://www.conference-board.org/blog/postdetail.cfm?post=6596 [https://perma.cc/TTF2-S8VD] (reporting "[t]he strong consensus of the thought leading companies and their advisors" that during the first season of pay ratio reporting firms should not provide more pay ratio disclosure than what is strictly required).

[365] *See* Edward Rock, *Securities Regulation as Lobster Trap: A Credible Commitment Theory of Mandatory Disclosure*, 23 CARDOZO L. REV. 675, 686–88 (2002) (discussing the reasons for the undersupply of information in the absence of a system of mandatory disclosure).

which was adopted three years after the U.S. rule, in July 2018.[366] The U.K. rule requires firms to relate CEO pay to the pay of not one but three different employees—the median employee, the 25th percentile employee, and the 75th percentile employee, and report three pay ratios. In addition, the U.K. rule defines three consistent methodologies for calculating the ratio and requires firms to identify which methodology they have followed. The U.K. rule also calls for narrative disclosure on "whether, and if so why, the company believes the median pay ratio for the relevant financial year is consistent with the pay, reward and progression policies for the company's U.K. employees taken as a whole."[367] This approach can be expected to result in disclosures that have higher informational integrity. The contextual information that will accompany the pay ratio numbers can also be expected to moderate the public salience of the information and make it more difficult to sensationalize.

In summary, our proposal to move beyond the numbers-only approach in the United States aims to enhance the relative informational integrity of pay ratio disclosure. We believe that this improvement in the quality of the disclosed information would make the pay ratio more useful to investors, and, consequently, go some way toward fulfilling the pay ratio rule's informational function. Our proposal would also make it more difficult for firms to improve their pay ratio optics by manipulating the pay ratio without detection by altering the structure of their workforce. This would ameliorate some of the counterproductive behavioral effects of the pay ratio rule as it currently stands. Finally, the additional information may contribute to improving the quality of public discourse on matters related to pay inequity and economic inequality. The new pay ratio disclosures may have somewhat lower public salience as a result of the increase in the quantum of information, but this could well be a price worth paying.

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[366] *See* The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860, Explanatory Memorandum ¶ 2.1 (Eng.), http://www.legislation.gov.uk/uksi/2018/860/pdfs/uksiem_20180860_en.pdf [https://perma.cc/NP8E-2HC6].

[367] The Companies (Miscellaneous Reporting) Regulations 2018, SI 2018/860, arts. 19B–19F (Eng.), http://www.legislation.gov.uk/uksi/2018/860/pdfs/uksi_20180860_en.pdf [https://perma.cc/8JWH-L495]. The U.K. rule also contains certain other requirements which will make the information released pursuant to it more detailed and nuanced than the information required under the U.S. pay ratio rule. *See id.* The U.K. pay ratio disclosures will not start appearing until 2020, so it remains to be seen whether the U.K. approach leads to a pay ratio experience qualitatively different from the U.S. one.

CONCLUSION

The many idiosyncratic aspects of the pay ratio disclosure rule have made for a recurring theme throughout this Article. The congressional mandate contained in the Dodd-Frank Act was highly specific on the required disclosure output, but silent on the definitions of the unusual disclosure inputs. This challenged the SEC's rulemaking apparatus and placed the agency at the center of near-unprecedented political controversy. The rule as it exists today is characterized by what we describe as high public salience. This quality is evidenced by the attention the data has received from multiple audiences; it is explained by the nature of the required information and its superficial simplicity. The rule is also characterized by low informational integrity relative to the rest of the securities disclosure regime. These two aspects, high public salience and low informational integrity, define the unique disclosure-as-soundbite approach.

Taking a step back, we find that there is another question lurking beneath the surface, a question that has been obscured by the pay ratio's many peculiarities: What, if any, workforce compensation information should be part of firms' disclosure obligations? For all its failings, the pay ratio rule is notable for being the first rule in the 85-year history of the SEC disclosure regime to require firms to disclose any information about how they pay their workers. In fact, the only other disclosure rule dealing with workers simply requires firms to report their total number of employees.[368] Beyond this single number, even basic information, such as the total amount spent on compensation, is not subject to disclosure. This oversight is all the more remarkable in light of the fact that firms are required to provide detailed information about executive compensation, which routinely results in tens of pages about the pay received by just a handful of executives.[369] Why is it that under the current regulatory regime "labor" as a factor of production—aside from *executive* labor—is practically invisible in corporate filings?[370] This and other re-

[368] Regulation S-K, Item 101(c)(xiii), 17 C.F.R. § 229.101(c)(xiii) (2018) (requiring firms to disclose "the number of persons employed" by them).

[369] *Executive Compensation Filings Grow to Nearly 10,000 Words on Average*, EQUILAR (Feb. 7, 2018), https://www.equilar.com/press-releases/95-exec-comp-filings-grow-to-nearly-10K-words.html [https://perma.cc/SV98-DQYH] (reporting that in 2017 the average word count of the CD&A section of the proxy statements of the 100 largest companies was 9490 words).

[370] Depending on the circumstances, information about the workforce may be released pursuant to other existing line item disclosure requirements, if the information is material. For example, the possibility of strikes is sometimes disclosed as a risk factor. As a practical matter, the lack of line item disclosure requirements specifically devoted to labor and the need to engage in complex materiality determinations make such disclosures scarce. *See generally* Georgiev, *supra* note 299 (discussing the uncertain outcomes of the materiality determinations required by the disclosure regime).

lated questions about the need for workforce compensation and human capital disclosure are both fascinating and expansive, and we intend to pursue them in future work.[371]

[371] *See* Steven A. Bank & George S. Georgiev, Non-Executive Compensation, Human Capital Management, and Corporate Governance (on file with authors).