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COMMENT

COULD THE PAY RATIO DISCLOSURE BACKFIRE? EXAMINING THE EFFECTS OF THE SEC'S PAY RATIO DISCLOSURE RULE

*by Jillian Loh**

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I. Introduction

At the signing of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), President Barack Obama asserted that, "We all win when investors around the world have confidence in our markets. We all win when shareholders have more power and more information. . . . And we all win when folks are rewarded based on how well they perform, not how well they evade accountability."[1] After the financial crisis in 2008, the Obama Administration recognized the need to reconstruct the existing American financial regulatory system to ensure that a financial meltdown would never happen again.[2]

It is quite clear that Congress's purpose behind the Dodd-Frank Act is to redevelop the financial system to ensure that the 2008 financial crisis will never be repeated.[3] However, the Dodd-Frank Act contains considerable provisions that add substantial new requirements for certain publicly traded companies based in the United States.[4] Analysts have theorized that the creation of new regulations relating to executive compensation and corporate governance was due to assertions that large executive pay contributed to the financial crisis.[5] There has been much debate over whether such changes to executive compensation and corporate governance practices under Title IX of the Dodd-Frank Act are meeting the intended goals of financial system reform.[6]

Traditionally, the U.S. Securities and Exchange Commission ("SEC" or "Commission") has focused only on the compensation of executive officers and directors when it implements compensation disclosure rules.[7] But on September 18, 2013, more than three years after

1. President Barack Obama, Remarks by the President at Signing of Dodd-Frank Wall Street Reform and Consumer Protection Act (July 21, 2010), https://obamawhitehouse.archives.gov/the-press-office/remarks-president-signing-dodd-frank-wall-street-reform-and-consumer-protection-act [https://perma.cc/K38D-8P72] [hereinafter Remarks at the Signing of Dodd-Frank Act].

2. *Wall Street Reform: The Dodd-Frank Act*, White House, https://obamawhitehouse.archives.gov/economy/middle-class/dodd-frank-wall-street-reform [https://perma.cc/3JFE-LAGG].

3. *Id.*

4. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, §§ 951–957, 124 Stat. 1376, 1899–1907 (2010).

5. *See* Squam Lake Working Grp. on Fin. Regulation, *Regulation of Executive Compensation in Financial Services* 2 (Council on Foreign Relations Squam Lake Working Grp. on Financial Regulation, Paper No. 8, 2010), i.cfr.org/content/publications/attachments/Squam_Lake_Working_Paper8.pdf [https://perma.cc/7BYP-8UJV] ("Many people argue that inappropriate compensation policies in financial companies contributed to the World Financial Crisis.").

6. *See id.* ("We have seen no convincing evidence that high levels of compensation in financial companies are inherently risky for the companies themselves or the overall economy.").

7. Pay Ratio Disclosure, 78 Fed. Reg. 60,560, 60,582 (proposed Oct. 1, 2013) (codified at 17 C.F.R. pts. 229, 240, 249 (2016)).

the Dodd-Frank Act became law, the SEC voted 3–2[8] to propose rules to implement the pay ratio disclosure provision.[9] Section 953(b) of the Dodd-Frank Act directs the SEC to amend existing executive compensation disclosure rules to require certain publicly traded companies to disclose in a wide range of its SEC filings, including registration statements, annual reports and proxy statements:

1) the median of the annual total compensation of all employees other than the chief executive officer ("median employee pay");
2) the annual total compensation of the chief executive officer ("CEO pay"); and
3) the ratio of the annual total compensation of the median employee to the annual total compensation of the chief executive officer ("pay ratio").[10]

According to the SEC's press release, the intended purpose behind Section 953(b) and the final pay ratio rule is to provide investors with another piece of information to consider when determining whether the compensation of their chief executive officer ("CEO") is appropriate.[11]

The mission of the SEC is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[12] Interpretations of the mission statement suggest that the SEC's proxy disclosure rules for public companies are intended to provide investors with *material* information—information to "educate investors and promote their understanding of a company's executive compensation practices so that they can make better investment decisions."[13] But many argue that a pay ratio is not material information, and obliging companies to calculate and disclose information about the disparities between executive and median worker pay will do little to advance the SEC's core mission of investor protection.[14] In formulating the Pay Ratio Disclosure Rule ("the Rule"), the SEC did not investigate

8. The Securities and Exchange Commission is run by five President-appointed Commissioners, who vote on enforcement actions and rulemaking. *See Current SEC Commissioners*, U.S. Sec. & Exchange Commission, https://www.sec.gov/about/commissioner.shtml [https://perma.cc/RCW7-NBJ5].

9. Press Release, U.S. Sec. & Exch. Comm'n, SEC Proposes Rules for Pay Ratio Disclosure (Sept. 18, 2013), http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539817895 [https://perma.cc/DJ4D-69R7].

10. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 953(b)(1), 124 Stat. 1376, 1904 (2010) (codified as amended at 15 U.S.C. § 78l). Collectively, this information is referred to as the "pay ratio disclosure."

11. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rule for Pay Ratio Disclosure (Aug. 5, 2015), http://www.sec.gov/news/pressrelease/2015-160.html [https://perma.cc/66UV-PT6M] [hereinafter Press Release, SEC Adopts Rule for Pay Ratio Disclosure].

12. *What We Do*, U.S. Sec. & Exchange Commission, http://www.sec.gov/about/whatwedo.shtml [https://perma.cc/R5X4-B2KW].

13. *Pay Ratio*, Ctr. on Executive Compensation, http://www.execcomp.org/Issues/Issue/pay-ratio [https://perma.cc/NB9R-LCM7].

14. *Id.*

whether or how investors would use this information in practice.[15] There are several legitimate questions about the effectiveness of the Rule; therefore, understanding it and its implications is critical before coming to a conclusion.

Companies should not be forced to publicize certain information if such disclosure is intended merely to "name and shame" companies into limiting CEO pay. The various arguments in favor of the Pay Ratio Disclosure Rule depend on the unexamined assumption that investors would find the median employee's pay relevant and useful when making their investment decisions. This Comment will closely examine the Rule and its correlation to Congress's goals in enacting the Dodd-Frank Act, exposing the conclusion that the true purpose behind this rule was to name and shame American business executives, not to protect investors or to prevent deception of consumers. Unless defined benefits can be presented, Congress should promptly move to repeal the Rule based on the reasons set forth in this Article.

This Comment challenges the intent behind, and the merits of, the Pay Ratio Disclosure Rule. Part II of this Comment summarizes the background leading up to the promulgation of the Rule, describing the public criticisms and media attention it generated. Part III examines the final rule in detail, highlighting the most significant changes from the proposed rule. Part IV explains reasons why the disclosure of the median employee's compensation deviates substantially from the principle of materiality. Part V discusses the flaws in the Rule, while pointing out the potential pitfalls and consequences involved in compliance with the new disclosure requirements. And finally, Part VI concludes that the Rule is unlikely to achieve its goals and may arbitrarily harm investors.

II. The Rise of Pay Ratio Disclosure

Several publications have reported the dramatic growth of CEO pay over the past few years, which has led to heightened discussions relating to the practices of paying corporate executives. U.S. Senator Robert Menendez, author of the pay ratio provision in the Dodd-Frank Act, proclaimed, "We have middle class Americans who have gone years without seeing a pay raise, while CEO pay is soaring. This simple benchmark will help investors monitor both how a company treats its average workers and whether its executive pay is reasona-

15. *See* Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Dissenting Statement at Open Meeting on Pay Ratio Disclosure (Aug. 5, 2015), https://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-on-pay-ratio-disclosure.html [https://perma.cc/AJB2-JBDD] [hereinafter Piwowar, Dissenting Statement at Open Meeting on Pay Ratio Disclosure].

ble."[16] However, many critics question how this mandatory disclosure would actually achieve greater "investor protection."

Since the Dodd-Frank's enactment, Section 953(b) has been the subject of intense scrutiny and debate. This provision has generated significant media attention and elicited substantial opinions among companies, labor unions, and politicians over the benefits and disadvantages of the pay ratio. The SEC also requested public comments on the proposed rule.[17] The SEC received over 287,400 comment letters—including more than 1,540 individual letters—that revealed numerous concerns with the proposed rule and "the potential costs and benefits associated with its requirements."[18]

A. *The Public Debate*

Implementation of the pay ratio disclosure provision was obviously not a simple task. It took the SEC more than five years from the date of the enactment of Dodd-Frank in 2010 to finalize the Rule. The SEC adopted the final rule in a split vote along party lines.[19] Democratic Commissioners Luis A. Aguilar and Kara M. Stein voted in favor of the Rule, while Republican Commissioners Daniel Gallagher and Michael Piwowar voted against it.[20] Voting in favor of enacting the provision, Independent Chairwoman Mary Jo White cast the tie-breaking vote.[21] The Center on Executive Compensation calls it "one of the most contentious and conflicted rulemakings in SEC history."[22]

The proposed rules were harshly scrutinized by the two dissenting SEC commissioners, with Commissioner Piwowar stating that the SEC's rule "unambiguously harms investors, negatively affects competition, promotes inefficiencies, and restricts capital formation."[23] In his dissenting statement, Commissioner Gallagher strongly urged in-

16. Press Release, Bob Menendez for New Jersey, Menendez Applauds SEC Movement on Disclosing CEO-to-Worker Pay Ratios (Sept. 18, 2013), http://www.menendez.senate.gov/news-and-events/press/menendez-applauds-sec-movement-on-disclosing-ceo-to-worker-pay-ratios [https://perma.cc/5TU5-CNUJ].

17. *See* Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,108 (Aug. 18, 2015) (codified at 17 C.F.R. pts. 229, 240, 249) ("[W]hether the proposed rule would address sufficiently the practical difficulties of data collection, whether other alternative approaches consistent with Section 953(b) could provide the potential benefits of pay ratio information at a lower cost, and whether the proposed flexible approach would appropriately implement Section 953(b).").

18. *Id.*

19. Bill Chappell, *SEC Adopts CEO Pay Ratio Rule, Five Years After It Became Law*, NPR (Aug. 5, 2015, 9:58 AM), http://www.npr.org/sections/thetwo-way/2015/08/05/429628037/sec-to-vote-on-requiring-companies-to-disclose-ceo-pay-ratio.

20. *See* Ctr. on Exec. Comp., *The SEC's Final Pay Ratio Rule: Analysis and Implications*, Ctr. on Executive Compensation (Aug. 18, 2015), http://www.execcomp.org/Docs/HRPA_CallSlides.pdf [https://perma.cc/SB2J-R4CY].

21. *See id.*

22. *Id.*

23. Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Statement at Open Meeting Regarding Municipal Advisors and Pay Ratio Disclosure (Sept. 18, 2013),

vestors, public companies, and other individuals impacted by the proposed rules to submit "detailed, data-heavy comments."[24] Regardless of the added flexibility in the final rule, Commissioners Gallagher and Piwowar were still not convinced. Each issued strong dissenting statements against the Rule.[25] Commissioner Piwowar issued the following statement in regards to the final rule:

> Pursuing a pay ratio rulemaking was wrong then and remains wrong now. Today's rulemaking implements a provision of the highly partisan Dodd-Frank Act that pandered to politically-connected special interest groups and, independent of the Act, could not stand on its own merits. I am incredibly disappointed the Commission is stepping into that fray.[26]

There have been ongoing debates about the significance and effectiveness of the CEO-to-median-employee pay ratio information. Many have objected to the Rule, arguing that it provides no economic benefit to investors and would be difficult and costly to calculate. Republicans in Congress have made numerous attempts to repeal the pay ratio provision and have made efforts to pressure the SEC into delaying the Rule's final adoption, arguing that calculating the ratio would be extremely complicated, expensive, and of little value to investors.[27] Likewise, business organizations, major law firms, and other opponents of the pay ratio disclosure argue that such information would provide investors with little to no insight into the comparable compensation practices of public companies.[28] Because the median employee's pay fluctuates based on various factors, such as "differences in organizational structures, geographical distribution of em-

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http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542565153 [https://perma.cc/KT5H-84BN].

24. Daniel M. Gallagher, Comm'r, U.S. Sec. & Exch. Comm'n, Dissenting Statement of Commissioner Daniel M. Gallagher Concerning the Proposal of Rules to Implement the Section 953(b) Pay Ratio Disclosure Provision of the Dodd-Frank Act (Sept. 18, 2013), http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542558873 [https://perma.cc/P7CQ-6X4Y].

25. *See* Daniel M. Gallagher, Comm'r, U.S. Sec. & Exch. Comm'n, Dissenting Statement at an Open Meeting to Adopt the "Pay Ratio" Rule (Aug. 5, 2015), https://www.sec.gov/news/statement/dissenting-statement-at-open-meeting-to-adopt-the-pay-ratio-rule.html [https://perma.cc/D68S-WTHH]; *see also* Michael S. Piwowar, Comm'r, U.S. Sec. & Exch. Comm'n, Additional Dissenting Comments on Pay Ratio Disclosure (Aug. 7, 2015), http://www.sec.gov/news/statement/additional-dissenting-statement-on-pay-ratio-disclosure.html [https://perma.cc/2DCX-WJXM].

26. Piwowar, Dissenting Statement at Open Meeting on Pay Ratio Disclosure, *supra* note 15.

27. *See* Patrick Temple-West, *SEC Agenda 2015: Swaps, 'Pay Ratio' and New Republican Oversight*, POLITICO (Jan. 2, 2015, 1:04 PM), http://www.politico.com/story/2015/01/sec-agenda-2015-swaps-pay-ratio-and-new-republican-oversight-113925 [https://perma.cc/UPM8-PNTM].

28. Kevin Douglas & Andrea Orr, *SEC's Proposed CEO Pay Ratio Rules Provide Companies with Flexibility to Satisfy Dodd-Frank Mandate*, BLOOMBERG BNA (Sept. 27, 2013), http://www.bna.com/secs-proposed-ceo-pay-ratio-rules-provide-companies-with-flexibility-to-satisfy-dodd-frank-mandate/ [https://perma.cc/BV3A-CCNC].

ployees and degree of reliance on seasonal and outsourced workers," opponents maintain that the data used primarily relates to the size and structure of a company's workforce rather than to the size of its CEO's pay or the company's financial performance.[29] They also argue that any value to investors from the ratio is far outweighed by the challenges and time-consuming efforts of calculating the median employee pay, particularly for companies that have large diverse workforces, multinational operations, and multiple payroll and other compensation systems.[30]

Conversely, Democrats have pressured the SEC to accelerate its implementation of the pay ratio provision.[31] Unions, labor advocates, and other supporters of the pay ratio disclosure claim that the pay ratio is in fact material information for investors.[32] They argue that the increase in income disparity between CEO pay and that of the median worker has a direct impact on employee morale and productivity which leads to a negative effect on the overall corporate profitability.[33]

Commenters that supported the proposed rule expected that it would: inform investors about CEO compensation matters, specifically with regard to say-on-pay voting; demonstrate a company's focus on its long-term health as opposed to short-term gains that benefit its CEO at the expense of its investors; discourage the pay practices that led to the 2008 financial crisis; reduce the inequitable wealth distribution in the U.S.; and highlight potential problems in a company due to the negative impact of a high pay ratio on employee morale and productivity.[34] However, several of these individuals supported the proposed rule's inclusion of *all* employees, which included non-U.S. employees.[35] In other words, they supported the idea of adopting the rule based on a strict interpretation of Section 953(b).[36] After the SEC's proposal of the final rule, commenters asserted that the flexibility built into the rule gave companies too much latitude to create a methodology for identifying its median employee.[37] They claim that allowing companies to calculate the pay ratio in the way that best suits their particular business structures, permits them to manipulate the ratio in their favor, and therefore such information, in essence, will be

29. *Id.*
30. *Id.*
31. *See* Temple-West, *supra* note 27.
32. Douglas & Orr, *supra* note 28.
33. *Id.*
34. *See* Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,109 (Aug. 18, 2015) (codified at 17 C.F.R. pts. 229, 240, 249).
35. *Id.* at 50,120.
36. "[T]he median of the annual total compensation of *all employees* of the issuer . . . ." Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 953(b)(1)(A), 124 Stat. 1376, 1904 (2010) (codified as amended at 15 U.S.C. § 78l) (emphasis added).
37. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,109.

distorted.[38] Despite the steps taken by the SEC to reduce compliance costs, companies and other market participants continue to express their concerns that the Rule creates an added costly burden on companies who must invest time and resources to accurately prepare the disclosure, without providing any useful information to investors.[39]

Given the Rule's more flexible approach, it raises critical questions and concerns as to whether the pay ratio disclosure would in fact be as useful and relevant as supporters had hoped for. Even those in favor of addressing the inequities in income have questioned whether the disclosure would actually limit excessive executive compensation, arguing that the Rule's flexibility would substantially diminish any potential usefulness of the disclosure.[40] These concerns addressed by supporters regarding the Rule's overall effectiveness suggest that the pay ratio disclosure does not provide information that would be helpful to investors when making their assessments about a company's financial health and future profitability.

B. *What Is the Underlying Purpose Behind the Pay Ratio Disclosure Rule?*

After signing the most sweeping financial industry reform legislation since the Great Depression into law, President Obama vowed that the new law would bring the strongest financial protections for consumers and would put an end to reviled bank bailouts.[41] Based on President Obama's remarks at the signing, it is apparent that the primary purpose behind the Dodd-Frank Act is to reform the existing financial system to prevent the recurrence of events that caused the 2008 financial crisis.[42] However, it remains unclear what Congress had intended to achieve in enacting the pay ratio provision.[43] Notably, in promulgating the Rule, the SEC recognized the indefiniteness of Congress's core mission. In its final rule, it stated that "Congress did not expressly state the specific objectives or intended benefits of Section 953(b), and the legislative history of the Dodd-Frank Act also does not expressly state the Congressional purpose underlying Section 953(b)."[44]

Based on the SEC's interpretation of the statute and the comments it received, the SEC majority believes that the Congressional intended

38. *Id.* at 50,117.
39. *See id.* at 50,120.
40. *See id.* at 50,132–33.
41. *See* Remarks at the Signing of Dodd-Frank Act, *supra* note 1.
42. *Id.*
43. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,150 ("[W]hile neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision, we believe . . . that Section 953(b) was intended to provide shareholders with a company-specific metric that can assist in their evaluation of . . . executive compensation practices.").
44. *Id.* at 50,105.

purpose of the pay ratio disclosure was to increase transparency by providing investors with additional information with which to make informed decisions when exercising their say-on-pay voting rights under Section 951.[45] But the numerous responses from commenters have failed to specify the intended objective of the pay ratio. In adopting the final rule, the SEC noted its assumption that the purpose of the pay ratio disclosure is to provide investors with a company-specific metric that they can use to evaluate the CEO's compensation "within the context of their company" rather than "to facilitate a comparison of this information from one [company] to another."[46] Concluding that it is "apparent" that Congress had already determined the pay ratio disclosure to be useful as a data point for investors to use in making their voting decisions on executive compensation, the SEC majority adopted the final rule[47] without ascertaining its true value to investors. To that effect, the SEC finalized the Rule based on preconceptions and speculation rather than on empirical data.

The final rule reflects the SEC's attempt to address the purpose behind its statutory directive under Section 953(b) while providing flexibility and accommodations in a manner that it believes will ease the costs and burdens for companies subjected to this requirement.[48] Considering the release describing the Rule is a 294-page document,[49] it is evident that implementation is not going to be as straightforward as it may appear. In effect, the Rule is much more complex, and it raises legitimate doubts as to whether the objectives expressed by the SEC—to increase investor protection—will be achieved.

III. Overview of the Pay Ratio Disclosure Rule

A. *General Highlights of the Final Rule*

After a long delay and after overcoming significant resistance from business advocates, the SEC finally approved its final rule in a narrow 3–2 vote on August 5, 2015, five years after the Dodd-Frank's enactment.[50] The final rule added new paragraph (u) to Item 402 of Regu-

45. *Id.* at 50,106. In general, say-on-pay rules give investors the right to vote on executive compensation at publicly-traded companies; however, management does not necessarily have to listen since the votes are advisory and nonbinding. *See* Office of Inv'r Educ. & Advocacy, U.S. Sec. & Exch. Comm'n, Investor Bulletin: Say-on-Pay and Golden Parachute Votes 1 (2011), https://www.sec.gov/investor/alerts/sayonpay.pdf [https://perma.cc/4YFT-XVUR].

46. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,106.

47. *Id.* at 50,107.

48. *Id.*

49. Pay Ratio Disclosure, Dodd-Frank Wall Street Reform and Consumer Protection Act Releases Nos. 33-9877; 34-75610, 80 Fed. Reg. 50,104 (Aug. 5, 2015), https://www.sec.gov/rules/final/2015/33-9877.pdf [https://perma.cc/U5P4-3U6L].

50. Chappell, *supra* note 19.

lation S-K[51] to implement its statutory directive under Section 953(b), which requires publicly traded companies to disclose in their SEC filings the ratio of the compensation of the CEO to that of the median employee.[52]

Although the final rule became effective on October 19, 2015, companies are not required to report the pay ratio disclosure until their first full fiscal year beginning on or after January 1, 2017.[53] The pay ratio will have to be included in all SEC filings in which executive compensation disclosure is required by Item 402 of Regulation S-K (e.g., Form 10-K, proxy and information statements, and registration statements).

As many supporters of the Rule have failed to acknowledge, calculating the pay ratio is not as simple as it may sound. Although the Rule is simply described, its implementation is a complicated task.[54] In the most basic terms, in order to calculate the ratio companies must first determine its employee population. Once the employee population is determined, the median employee (i.e., the point at which half the employees earn more and half earn less) must be identified. Once identified, such employee's annual total compensation can then be calculated in accordance with the Summary Compensation Table as calculated under Item 402(c)(2)(x) of Regulation S-K.[55] However, digging into the data, and considering the complex factors that influence the numbers, it's clear the pay ratio can be complicated to calculate and interpret.[56]

While the final rule's overall framework is largely similar to the SEC's proposed rule issued in September 2013, the final rule contains a few notable revisions that are intended to help reduce the compliance costs and burdens of companies that are subjected to the requirement.[57] The most criticized revision deals with the identification of the median employee. In adopting the final rule, the SEC decided to allow each company the flexibility to determine its own method of calculat-

51. In general, Item 402 of Regulation S-K requires disclosure of the compensation of high-ranking executives in publicly-traded companies. *See* 17 C.F.R. § 229.402 (2016).

52. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 953(b), 124 Stat. 1376, 1904 (2010) (codified as amended at 15 U.S.C. § 78l).

53. Pay Ratio Rule, 80 Fed. Reg. at 50,104.

54. *See, e.g.*, Stephen Miller, *Determining CEO Pay Ratio Isn't So Simple*, SHRM (Aug. 7, 2015), https://www.shrm.org/resourcesandtools/hr-topics/compensation/pages/ceo-pay-ratio.aspx [https://perma.cc/32LG-UU5Y].

55. In general, the Summary Compensation Table displays a comprehensive overview of a company's executive pay practices. *See* 17 C.F.R. § 229.402(c) (2016).

56. *See* Miller, *supra* note 54.

57. *See* Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,107 (Aug. 18, 2015) (codified at 17 C.F.R. pts. 229, 240, 249 (2016)).

ing its median employee's annual compensation.[58] The following section provides a brief summary of the significant changes from the proposed rule.

B. *Key Changes from the Proposed Rule*

The primary concern addressed in the comment letters was potentially high compliance costs.[59] When drafting the Rule, the SEC took into consideration the rationale and views of many commenters that the compliance costs associated with the disclosure requirement could be significant for many companies, and compliance with a strict interpretation of Section 953(b) would be nearly impossible.[60] Responding to these concerns, the SEC declined to propose a specific pay ratio calculation method, instead adopting a rule which gives companies the freedom to choose a method to identify their median employee and calculate the employee's median pay in a manner that is suitable for the size and composition of their businesses and compensation structures.[61]

This relaxed approach generated supporters' concerns about the Rule's overall effectiveness while opponents continue to argue that the required disclosure would not provide the benefits sufficient to justify the compliance costs.[62] Therefore, the key changes made to the original rule were designed to alleviate the overall compliance costs associated with the pay ratio disclosure while remaining consistent with Section 953(b).[63]

1. Definition of "Employee"

The final rule defines "employee" to include all worldwide full-time, part-time, seasonal, and temporary employees employed by the company or any of the company's consolidated subsidiaries.[64] The final rule retains the requirement that all U.S., non-U.S., full-time, part-time, seasonal, and temporary workers must be included in the calculation.[65] However, unlike the initial rule proposal, the SEC provides two tailored exemptions for non-U.S. employees from the definition of "employee."[66] In other words, companies can exclude their employees located outside the United States from the median-employee pay calculation in two instances.

58. Pay Ratio Rule, 80 Fed. Reg. at 50,135 (codified at 17 C.F.R. § 229.402 (2016)).
59. *See id.* at 50,110.
60. *See id.* at 50,150, 50,157–58.
61. *See supra* Section III.A.
62. *See supra* Section II.A.
63. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,107.
64. 17 C.F.R. § 229.402(u)(3) (2016).
65. 17 C.F.R. § 229.402(u)(2)(i).
66. Pay Ratio Rule, 80 Fed. Reg. at 50,111 (codified at 17 C.F.R. § 229.402(u)(4) (2016)).

The first exemption is referred to as the data privacy exemption.[67] In this instance, the definition of "employees" does not apply to workers who are employed in a foreign jurisdiction where its data privacy laws or regulations prevent a company from gathering the information necessary to prepare its pay ratio disclosure.[68] To qualify for this exemption, the company must first make "reasonable efforts" to collect the required compensation data.[69] The Rule provides that such efforts would involve seeking an exemption under the applicable jurisdiction's data privacy laws and using that exemption if it is granted.[70] The Rule also requires the company to disclose additional information if it uses the data privacy exemption.[71]

The second exemption is known as the de minimis exemption.[72] For this exemption to apply, a company must have a non-U.S. employee workforce that makes up 5% or less of the total employee base of the company and its consolidated subsidiaries.[73] Such company may choose to exclude all of those non-U.S. employees when determining the median employee but is not allowed to exclude only a portion of its non-U.S. workforce.[74] If more than 5% of a company's workforce is made up of non-U.S. employees, the company may exclude up to 5% of those employees; however, it must exclude all employees located in a specific jurisdiction.[75] In other words, the company cannot exclude a subset of employees from one jurisdiction and employees from other jurisdictions to meet the 5% threshold.[76] Disclosure of additional information is required if a company chooses to use this exemption.[77]

Non-U.S. employees excluded from the definition of "employee" under the data privacy exemption would count against the 5% de minimis threshold.[78] A company may exclude any non-U.S. employee that meets the data privacy exemption.[79] But if the number of excluded employees under the data privacy exemption equals or exceeds 5% of total employees, the company cannot use the de minimis exemption to exclude additional employees.[80]

67. *Id.* at 50,123 (codified at 17 C.F.R. § 229.402(u)(4)(i) (2016)).
68. 17 C.F.R. § 229.402(u)(4)(i) (2016).
69. *Id.*
70. *Id.*
71. *Id.*
72. Pay Ratio Rule, 80 Fed. Reg. at 50,124 (codified at 17 C.F.R. § 229.402(u)(4)(ii) (2016)).
73. 17 C.F.R. § 229.402(u)(4)(ii) (2016).
74. *Id.*
75. *Id.*
76. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,124.
77. 17 C.F.R. § 229.402(u)(4)(ii) (2016).
78. 17 C.F.R. § 229.402(u)(4)(ii)(A).
79. *Id.*
80. *Id.*

2. Identification of the Median Employee

The final rule retained the flexibility of the proposed rule, which allows companies to determine the median employee from among the total employee population, a statistical sample, or any other reasonable method.[81] However, the final rule authorizes companies the additional flexibility to choose any method to identify the median employee based on their own facts and circumstances.[82]

The Rule provides that a company may identify its median employee in the population or sample using annual total compensation or any other consistently applied compensation measure, such as compensation amounts reported in its payroll or tax records.[83] In addition, the final rule also allows companies to use reasonable estimates in calculating the annual total compensation or any elements of compensation for employees other than the CEO.[84] In any event, the company must disclose the methodology used, and any estimates or assumptions made.[85]

3. Use of the Identified Median Employee

Companies are allowed to select a date within the last three months of their last-completed fiscal year on which to determine the employee population for purposes of identifying their median employee, instead of the last day of the company's last completed fiscal year as was in the proposal.[86] In addition, the final rule provides that the median employee only has to be identified once every three years, instead of every year, as long as no changes have occurred in the company's employee compensation arrangements or employee population that the company reasonably believes would significantly impact the pay ratio.[87] If the median employee departs from the company or his position changes, the company may use another employee with compensation that is substantially similar to that of the median employee.[88]

4. Calculation of the Median Employee Pay

The final rule allows companies to make cost-of-living adjustments for employees outside of the jurisdiction in which the CEO resides in order to reflect the cost of living applicable in the jurisdiction where

81. Pay Ratio Rule, 80 Fed. Reg. at 50,135 (codified at 17 C.F.R. § 229.402(u) (2016)).
82. *Id.* at 50,130 (codified at 17 C.F.R. § 229.402(u) (2016)).
83. 17 C.F.R. § 229.402(u) (2016).
84. *Id.*
85. *Id.*
86. Pay Ratio Rule, 80 Fed. Reg. at 50,112 (codified at 17 C.F.R. § 229.402(u) (2016)).
87. *Id.* (codified at 17 C.F.R. § 229.402 (2016)).
88. *Id.*

the CEO resides.[89] If the company chooses to use a cost-of-living adjustment to identify the median employee, and the median employee is in a jurisdiction other than the jurisdiction in which the CEO resides, the company must use the same adjustment in calculating the total compensation paid to the median employee and disclose the median employee's jurisdiction.[90] In addition, the company will also need to disclose the following: (1) a brief description of the cost-of-living adjustments used; (2) the median employee's annual total compensation without the cost-of-living adjustment; and (3) the pay ratio without the cost-of-living adjustment.[91]

5. Calculation of the CEO Pay

The final rule provides two different methods for calculating the CEO annual total compensation when a company has had more than one CEO during its fiscal year.[92] The first method is to combine the compensation of each individual who served as CEO during the year for time served as CEO.[93] The second method is to look to the individual serving as CEO on the date the company selects, and identify the median employee and annualize that CEO's compensation.[94] Regardless of which method is used, the company must disclose which method it chose and disclose how it calculated its CEO's annual total compensation.[95]

If a CEO's salary or bonus is not yet determined, the company may omit its disclosure until such amounts are calculable and disclose when this is expected.[96] Thus, the pay ratio disclosure is only required when the CEO's salary or bonus becomes calculable in whole.[97]

6. Postponement of Compliance Date

Each company subject to the Rule will be required to report its pay ratio information for its first fiscal year. The final rule postpones the initial date of compliance with the Pay Ratio Disclosure Rule until the first fiscal year beginning on or after January 1, 2017.[98] Thus, companies must include their 2017 pay ratio disclosures in their 2018 reports.[99] This transition rule also applies to companies that cease to be smaller reporting companies or emerging growth companies, as well

89. 17 C.F.R. § 229.402(u) (2016).
90. *Id.*
91. *Id.*
92. *Id.*
93. *Id.*
94. *Id.*
95. *Id.*
96. *Id.*
97. Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,146 (Aug. 18, 2015) (codified at 17 C.F.R. § 229.402(c) (2016)).
98. *Id.* at 50,112 (codified at 17 C.F.R. § 229.402(u) (2016)).
99. *See id.* (codified at 17 C.F.R. § 229.402(u) (2016)).

as companies engaging in business combinations or acquisitions (i.e., IPOs).[100]

C. *In-Depth Look at the Final Rule*

The changes in the final rule were primarily made to resolve the concerns regarding the burden of compliance costs as weighed against the lack of benefits that could be identified. Prior to the adoption of the final rule, the SEC estimated that the overall initial compliance costs for all companies subject to the Rule could be as high as $1.3 billion the first year[101] and $526 million per year thereafter.[102] To gain a better understanding of the Rule's implications, the following segments will discuss the Rule in greater detail.

1. Companies Not Subject to Disclosure

New Item 402(u) of Regulation S-K applies only to companies required to prepare a summary compensation table pursuant to Item 402(c) of Regulation S-K.[103] Therefore, the pay ratio rule would not apply to the following: (1) smaller reporting companies;[104] (2) emerging growth companies;[105] (3) foreign private investors;[106] or (4) U.S.-Canadian Multijurisdictional Disclosure System filers.[107]

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100. *See id.* at 50,113 (codified at 17 C.F.R. § 229.402(u) (2016)).

101. *Id.* at 50,161.

102. *Id.*

103. *See id.* at 50,115 (codified at 17 C.F.R. § 229.402(u) (2016)).

104. *Id.* What constitutes as a "smaller reporting company" is defined in Item 10(f)(1) of Regulation S-K. A "smaller reporting company" is an issuer that "[h]ad a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter" or "had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available." *See* 17 C.F.R. § 229.10(f)(1) (2016).

105. Pay Ratio Rule, 80 Fed. Reg. at 50,115 (codified at 17 C.F.R. § 229.402(u) (2016)). Defined in Section 3(a) of the Exchange Act, an "emerging growth company" is an issuer that (1) had total annual gross revenues of less than $1 billion during its most recently completed fiscal year; (2) has not reached the fifth anniversary of the date of the first sale of its common equity securities pursuant to an effective registration statement under the Securities Act; (3) had not issued $1 billion in non-convertible debt during the previous three-year period; or (4) is deemed to be a "large accelerated filer." *See* 15 U.S.C. § 78c(a)(80) (2015).

106. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,115 (codified at 17 C.F.R. § 229.402(a) (2016)). A "foreign private investor" is any foreign issuer other than a foreign government, except for a registrant that, as of the last business day of its most recent fiscal year, has more than 50% of its outstanding voting securities held of record by United States residents and any of the following: a majority of its officers and directors are citizens or residents of the United States, more than 50% of its assets are located in the United States, or its business is principally administered in the United States. *See* 17 C.F.R. §§ 240.3b–4(c) (2016).

107. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,115. A U.S.-Canadian Multijurisdictional Disclosure System ("MJDS") filer is a registrant that files annual reports and registration statements on Form 40-F in accordance with the requirements of the MJDS. *Id.* at 50,114.

2. Identifying the Median Employee

The Rule requires a company to identify its median employee once every three years and calculate the total compensation of that employee once each year, provided that there has not been a "change in its employee population or employee compensation arrangements that it reasonably believes would result in a significant change to its pay ratio disclosure."[108] If no such changes are made the following year, a company is required to disclose that it is using the same median employee in its pay ratio calculation and must briefly describe the basis for its belief that there were no changes that would significantly affect its pay ratio disclosure.[109] For any year in which a company believes a significant change has occurred, it must re-identify its median employee.[110] Regardless of whether the company uses the median employee identified during the prior year, it must calculate that median employee's annual total compensation each year and use the updated figure to calculate its pay ratio.[111]

A company may select any date within the last three months of its last completed fiscal year to identify its median employee.[112] When identifying the median employee, a company must include all full-time, part-time, seasonal, and temporary employees of the company and its consolidated subsidiaries, whether located in the U.S. or overseas, and without regard to whether the individual is on salary or hourly pay.[113] However, individuals who provide services to the company or any of its consolidated subsidiaries as independent contractors or leased workers are not included in the pay ratio calculation, as long as they are employed and their compensation is determined by an unaffiliated third party.[114] Companies are not permitted to voluntarily include independent contractors or leased workers in their pay ratio calculations "if such persons make up a significant portion of the workforce."[115] However, companies may discuss their reliance on leased workers in their narrative disclosures and may also provide additional ratios that include such workers, "as long as any additional ratios are not misleading and are not more prominently displayed than the required ratio."[116]

Although employees employed in a foreign jurisdiction are included in the Rule's definition of "employee," the Rule provides two exemp-

108. 17 C.F.R. § 229.402(u) (2016).
109. *Id.*
110. *Id.*
111. Pay Ratio Rule, 80 Fed. Reg. at 50,130 (codified at 17 C.F.R. § 229.402(u) (2016)).
112. 17 C.F.R. § 229.402(u)(3) (2016).
113. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,117–18 (codified at 17 C.F.R. § 229.402(u)(2)–(4) (2016)).
114. 17 C.F.R. § 229.402(u)(3) (2016).
115. Pay Ratio Rule, 80 Fed. Reg. at 50,118.
116. *Id.* (codified at 17 C.F.R. § 229.402(u) (2016)).

tions for excluding non-U.S. employees in certain circumstances.[117] As mentioned earlier, reporting companies may exclude individuals who fall under the Rule's data privacy exemption or de minimis exemption from their pay ratio calculations.[118] In addition, a company may exclude any employees of a newly acquired entity in the year a business combination or acquisition occurs.[119]

When identifying the median employee, companies are not required to calculate total compensation for every employee in the same manner as required for the CEO. As mentioned earlier, the Rule instead allows a company to select an appropriate methodology for identifying its median employee and use reasonable estimates based upon its particular facts and circumstances.[120] In determining which employees will be used to identify the median, a company has the flexibility to use any of the following approaches: (1) its employee population; (2) statistical sampling; or (3) other reasonable methods.[121] The company must disclose any material assumptions, adjustments, or estimates it used.[122]

The Rule does not require a company to use a specific compensation measure in identifying its median employee. Rather, a company may identify its median employee based on any compensation measure that is consistently applied to all employees.[123] For example, a company may use information derived from its payroll or tax records to identify its median employee (e.g., base salary, total cash compensation, and W-2 earnings).[124] A company may use a measure that is defined differently across jurisdictions and may use the same annual period that is used in the records from which such compensation is derived.[125] In other words, the median employee can be identified using any reasonable definition of compensation as long as it is consistently applied to all employees and is disclosed with the pay ratio.[126]

The Rule further provides additional flexibility by allowing a reporting company to make certain adjustments when identifying the median employee. A company may annualize compensation for its permanent part-time and full-time employees who were not employed during the entire fiscal year, but may not annualize the compensation of its seasonal or temporary employees or make any full-time adjustments for its part-time employees.[127] Also, a company may make cost-

117. 17 C.F.R. § 229.402(u)(4) (2016).
118. *See supra* Section III.B.1.
119. *See* 17 C.F.R. § 229.402(u) (2016); *see also supra* Section III.C.1.
120. *See supra* Section III.B.2.
121. 17 C.F.R. § 229.402(u) (2016) (*Instruction 4 to Item 402(u)*).
122. *Id.*
123. *Id.*
124. *See id.*
125. *Id.*
126. *Id.*
127. 17 C.F.R. § 229.402(u) (*Instruction 5 to Item 402(u)*).

of-living adjustments to the compensation of employees in jurisdictions other than the jurisdiction in which the CEO resides.[128] These adjustments must be consistently applied to all employees of a jurisdiction where any adjustment is made.[129]

The median employee must be an actual, individual employee.[130] Companies are not required to, and should not, identify the median employee by name or use any other personally identifiable information other than that employee's annual total compensation.[131] However, companies may choose to disclose the median employee's position in general to place the compensation in context, but the Rule specifies that companies should not do so if providing the information could identify any specific individual.[132]

3. Calculating Annual Total Compensation of the Median Employee and CEO

The Rule requires a company to calculate the annual total compensation for both its CEO and median employee using the requirements in Regulation S-K Item 402(c)(2)(x).[133] Regulation S-K Item 402(c)(2)(x) sets forth the calculation of "annual total compensation" of a public company's named executive officers for purposes of the Summary Compensation Table, which is typically included in an annual meeting proxy statement.[134] "Total compensation" as applied to the median employee has the same meaning as in the compensation disclosure rules that apply to named executive officers.[135] Therefore, the annual total compensation for both the CEO and median employee must be calculated for the company's last completed fiscal year and in accordance with Item 402(c)(2)(x).

MEDIAN EMPLOYEE PAY. Once the median employee has been identified, the company must gather applicable compensation data and make necessary assumptions to calculate the annual total compensation in accordance with the Summary Compensation Table elements under Item 402(c)(2)(x).[136] In recognizing that the factors of the median employee's compensation may vary from those of named executive officers, the Rule allows companies to use reasonable estimates when valuing the elements of its median employee's total com-

128. *See supra* Section III.B.4.
129. *See* 17 C.F.R. § 229.402(u) (2016) (*Instruction 4 to Item 402(u)*).
130. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,137 (codified at 17 C.F.R. § 229.402(u)(3) (2016)).
131. 17 C.F.R. § 229.402(u) (2016) (*Instruction 11 to Item 402(u)*).
132. *Id.*
133. 17 C.F.R. § 229.402(u)(1).
134. *See* 17 C.F.R. § 229.402(c)(2)(x).
135. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,139 (codified at 17 C.F.R. § 229.402(u)(2) (2016)).
136. *See* 17 C.F.R. § 229.402(u) (2016).

pensation.[137] While the SEC has not recommended what a reasonable estimate would be, the Rule only requires that companies "must have a reasonable basis to conclude that their estimates approximate the actual amounts of Item 402(c)(2)(x) compensation . . . paid to the median employee" and "must clearly identify any estimates used."[138]

For non-salaried employees, references in the rules to "base salary" and "salary" will refer to "wages plus overtime" instead.[139] For non-U.S. employees, any accrued pension benefits paid by the government under a government-mandated pension plan (i.e. Social Security benefits) are not considered compensation for purposes of Item 402 nor are they included in the calculation of total compensation.[140]

CEO PAY. For purposes of the pay ratio, the Rule allows companies to select one of two methods for calculating the CEO's total compensation when a CEO is hired mid-year.[141] Where more than one person has served as CEO during the year, the company may choose either of the following methods:

1) calculate the total compensation pursuant to Item 402(c)(2)(x) for each CEO that served during that fiscal year and combine those figures; or
2) use the total compensation for the CEO serving in that position on the date the company has selected to identify the company's median employee and annualize that CEO's compensation.[142]

For purposes of the CEO compensation, total compensation does not include only cash payment, but also includes the grant-date value of stock options and other equity awards, the cumulative change in pension value and nonqualified deferred compensation earnings, and the value of certain other compensation, including personal benefits.[143]

4. Content and Format of the Disclosure

In reporting the pay ratio, companies are permitted to present the information in one of two ways: first, to express the ratio numerically, with the median employee's annual total compensation equal to one and the CEO's compensation presented as the number compared to one (e.g., 100 to 1)[144] and second, to report the pay ratio narratively

137. *See* Pay Ratio Disclosure, 78 Fed. Reg. 60,560, 60,573–74 (proposed Oct. 1, 2013) (codified at 17 C.F.R. § 229.402(u) (2016)); *see also* 17 C.F.R. § 229.402(u) (2016) (*Instruction 4 to Item 402(u)*).
138. Pay Ratio Rule, 80 Fed. Reg. at 50,139 (codified at 17 C.F.R. § 229.402(u) (2016)).
139. 17 C.F.R. § 229.402(u)(2)(i) (2016).
140. Pay Ratio Rule, 80 Fed. Reg. at 50,140.
141. *See supra* Section III.B.5.
142. 17 C.F.R. § 229.402(u) (2016) (*Instruction 10 to Item 402(u)*).
143. *See* 17 C.F.R. § 229.402(c) (2016).
144. Pay Ratio Rule, 80 Fed. Reg. at 50,113 (codified at 17 C.F.R. § 229.402(u)(1)(iii) (2016)).

by stating how many times higher or lower the CEO's annual total compensation is than that of the median employee (e.g., "the CEO's annual total compensation is 100 times that of the median of the annual total compensation of all its employees").[145]

The Rule also allows companies to supplement the required disclosure with additional ratios or other information that it believes will help investors understand its pay ratio disclosure, provided that any additional ratios are "clearly identified, not misleading, and not presented with greater prominence than the required ratio."[146]

5. Additional Disclosure Requirements

The Rule also requires companies to disclose certain information beyond its pay ratio. Companies must disclose and briefly describe the methodology used to identify the median employee and any material assumptions, adjustments, estimates, and/or exclusions used to identify the median employee or to determine the total compensation or any elements thereof.[147] This includes modifications related to cost-of-living, non-U.S. employees, and business combinations or acquisitions.[148] Companies must clearly identify the estimates used.[149] To the extent a company changes its methodology or adjustments from the previous year, it must describe the modification as well as reasons for making such change if the effects of the change are material.[150]

6. Timing of Disclosure

Companies subject to the Rule will not be required to report pay ratio information until the 2018 proxy season.[151] Each company will be required to calculate its pay ratio for its first fiscal year that begins on or after January 1, 2017, and report that information in the following year's proxy statement.[152] Similar to the requirements for executive compensation in proxy statements, the pay ratio disclosure must be filed no later than 120 days after the end of the fiscal year.[153]

The Rule provides transition periods for certain public companies where such companies can defer reporting their pay ratios. A company that had not previously been a reporting company would be required to report its pay ratio for the first fiscal year following the year in which it becomes a reporting company.[154] These transition rules ap-

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145. *Id.*
146. 17 C.F.R. § 229.402(u) (2016) (*Instruction 9 to Item 402(u)*).
147. *See supra* Section III.C.2.
148. *See supra* Section III.C.2.
149. *See supra* Section III.C.3.
150. *See supra* Section III.C.2.
151. *See* Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,147 (Aug. 18, 2015) (codified at 17 C.F.R. § 229.402(u) (2016)).
152. *See id.*; *see also* 17 C.F.R. § 229.402(u) (2016) (*Instruction 7 to Item 402(u)*).
153. 17 C.F.R. § 229.402(u) (*Instruction 3 to Item 402(u)*).
154. 17 C.F.R. § 229.402(u) (*Instruction 7 to Item 402(u)*).

ply to newly public companies,[155] companies ceasing to be smaller reporting companies or emerging growth companies,[156] and companies engaging in business combinations or acquisitions.[157]

Newly public companies (i.e. IPOs) subject to the Rule are not required to report their pay ratios until the first fiscal year beginning on or after the date that they become subject to the requirements of Section 13(a) or 15(d) of the Exchange Act.[158] Smaller reporting companies and emerging growth companies are exempt from the Rule until the first fiscal year beginning on or after the date that such company exits its status as a smaller reporting company or emerging growth company.[159] A company engaged in a business combination or acquisition may exclude individuals who become employees as a result of the acquisition or combination from its pay ratio calculation for the fiscal year in which the transaction became effective.[160] However, such a company must identify the acquired business and disclose the approximate number of employees it is omitting.[161]

IV. Fails the Test of Materiality

Deviation from the principle of materiality results in excessive costs and burdens to companies, harms investors, and distracts the SEC from its core statutory mission. The congressional mandate under Section 953(b) requires the SEC to implement a rule that is beyond the scope of its mission to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[162] As a result, the legislation of the pay ratio disclosure requirement ignored whether the information is in fact material to investors in making informed investing or voting decisions. It is yet another instance of Congress's use of federal securities laws to address alleged societal issues that have no important bearing upon investment and voting decisions.

A. *The Scope of Disclosure Regulations Lies in the Materiality Standard*

Financial and business disclosure is the underpinning of federal securities law. The power granted to the SEC is to promulgate disclosure rules that would provide investors with the material information they need to make informed investment and voting decisions. The effectiveness of disclosure should be measured by the degree to which

155. Pay Ratio Rule, 80 Fed. Reg. at 50,147 (codified at 17 C.F.R. § 229.402(u) (2016)).
156. *Id.* at 50,148 (codified at 17 C.F.R. § 229.402(u) (2016)).
157. *Id.* at 50,149 (codified at 17 C.F.R. § 229.402(u) (2016)).
158. 17 C.F.R. § 229.402(u) (2016) (*Instruction 7 to Item 402(u)*).
159. *Id.* (*Instruction 7, 8 to Item 402(u)*).
160. *Id.* (*Instruction 7 to Item 402(u)*).
161. *Id.*
162. *What We Do*, *supra* note 12.

the disclosure helps investors understand and evaluate a company when making investment decisions. An effective disclosure provides all investors the information that they need but does not overpower them with superfluous information that can obscure what is material and distract investors from what really matters about a company.[163]

Since securities laws were enacted, specifically in more recent years, the disclosure documents that companies file with the SEC have continued to grow in length—which is reflected by the extensive annual reports on Form 10-K and proxy statements that are provided to investors. Recognizing the negative impact that information overload has on the effectiveness of disclosure, the SEC recently issued a concept release for the purpose of developing recommendations to update and enhance the scope of its disclosure requirements.[164] According to SEC Chairwoman Mary Jo White, the number and type of issues that companies must disclose have grown to be "more and more detailed."[165] She went on further to question whether investors need or are well-served by all that kind of information.[166] As Chairwoman White explained:

> When disclosure gets to be "too much" or strays from its core purpose, it could lead to what some have called "information overload"—a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.[167]

Based on its release, the SEC is well-aware of the concern that current disclosure documents are filled with too much information that is outdated, unnecessarily repetitive, or otherwise not useful to investors.[168]

Disclosures are less effective when investors become overloaded with extraneous information that is not useful—making it difficult and confusing for investors to identify the important information about a company. For example, a study of institutional investors conducted by Stanford University in 2015 revealed that the majority found proxy statements to be too long and difficult to read, and only a third of the

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163. *See, e.g.*, Mary Jo White, Chair, U.S. Sec. & Exch. Comm'n, The Path Forward on Disclosure, Remarks at the National Association of Corporate Directors Leadership Conference (Oct. 15, 2013), https://www.sec.gov/News/Speech/Detail/Speech/1370539878806 [https://perma.cc/2SMK-YSJM] [hereinafter The Path Forward on Disclosure].

164. *See generally* Business and Financial Disclosure Required by Regulation S-K, Securities Act Release No. 33-10064, Exchange Act Release No. 34-77,599, 81 Fed. Reg. 23915 (proposed Apr. 13, 2016) (to be codified at 17 C.F.R. pts. 210, 229, 230, 232, 239, 240, 249).

165. *See* The Path Forward on Disclosure, *supra* note 163.

166. *Id.*

167. *Id.*

168. *See* Business and Financial Disclosure Required by Regulation S-K, 81 Fed. Reg. at 23,917.

information disclosed was relevant.[169] Even former SEC Commissioner Troy A. Paredes has pointed out that investors may decide to ignore dense, lengthy documents altogether as they find much of the information unhelpful or too time consuming to sort through.[170] This problem becomes worse when disclosures become too excessive and convoluted.[171] An expansive disclosure document is unlikely to help an investor make an informed decision and can result in even worse decisions.[172] Therefore, the test of materiality should be applied to ensure that expanded disclosure rules help investors make better-informed investment and voting decisions.

The scope of disclosure regulations is fundamentally grounded on the standard of materiality, which helps filter out irrelevant information. The concept of materiality has long been the "dividing line" for determining what should be disclosed and what should not have to be disclosed under the federal securities law.[173] Forty years ago, the U.S. Supreme Court refused to find that a fact is material just because an investor *might* find it important.[174] The Court held that a fact is "material" if "there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[175] The Court explained the harms of a low materiality standard, stating:

> [N]ot only may the corporation and its management be subjected to liability for insignificant omissions or misstatements, but also management's fear of exposing itself to substantial liability may cause it simply to bury the shareholders in an avalanche of trivial information—a result that is hardly conducive to informed decision making.[176]

Concerned with the unintended and harmful consequences resulting from information overload, the Court therefore adopted a more stringent test of materiality—making it clear that the focus should be on information relevant to informed investment decision-making.[177]

The Rule does not satisfy the test of materiality. The ratio is unnecessarily redundant and is otherwise not useful to investors. Such information is already readily available to investors in order for them to

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169. David F. Larcker et al., *2015 Investor Survey Deconstructing Proxy Statements—What Matters to Investors*, STAN. GRADUATE SCH. BUS. 1 (Feb. 2015), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf [https://perma.cc/EN6W-GCG7].

170. Troy A. Paredes, *Information Overload and Mandatory Securities Regulation Disclosure*, REG. REV. (June 16, 2015), http://www.regblog.org/2015/06/16/paredes-mandatory-securities-disclosure/ [https://perma.cc/Y2FF-UGKR].

171. *See id.*

172. *Id.*

173. *See* Wendy Gerwick Couture, *Materiality and a Theory of Legal Circularity*, 17 U. PA. J. BUS. L. 453, 460 (2015).

174. TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 445–50 (1976).

175. *Id.* at 449.

176. *Id.* at 448–49.

177. *Id.*

get a clearer and more complete picture of the CEO compensation.[178] In 2006, the SEC began requiring companies to disclose executive compensation of its CEOs and directors.[179] Investors who do not understand the Rule's implications will likely misinterpret the ratio and use it to their disadvantage. For the ratio to have any real probative value, the investor would need to gain a good understanding of what the Rule entails. As a result, it could overwhelm the reasonable investor as he or she would simply ignore the ratio altogether, finding it to be too time-consuming to go through the ins and outs of how the company had formulated that number.

Based on precedent, when determining the materiality of the information, the Supreme Court has consistently based its decision upon an objective standard of a "reasonable investor."[180] Such a threshold helps to ensure that what is disclosed is related to advancing the goals of the federal securities laws, as reflected in the SEC's mission to protect investors.[181]

B. *The Reasonable Investor Would Likely Ignore the Pay Ratio in Investment Decisions*

Because the U.S. Supreme Court does not attribute a "child-like simplicity" to the reasonable investor when determining materiality,[182] neither should lawmakers.[183] Materiality should not be judged on the basis of the needs of an investor who is not representative of the general investment community or who is looking to further some public-policy interest. The SEC's rulemaking authority is not meant to be used as a tool to advance policy goals that are far beyond the scope of those reflected in its core statutory mission. Because materiality is defined as information that a reasonable investor would regard as im-

178. *See, e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, SEC Votes to Adopt Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters (July 26, 2006), https://www.sec.gov/news/press/2006/2006-123.htm [https://perma.cc/T297-L93W].

179. *Id.*

180. *See* Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (reaffirming the standard of materiality). The Court in *Basic Inc.* held that the materiality requirement is satisfied when there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *Id.* (quoting *TSC Indus., Inc.*, 426 U.S. at 449). Not long ago, the Supreme Court resolved a circuit split on the materiality standard under federal securities law by reestablishing the long-standing test for materiality set forth twenty-nine years ago in the *Basic Inc.* case. *See* Matrixx Initiatives, Inc. v. Siracusano, 563 U.S. 27 (2011) (readdressing materiality).

181. *See Basic Inc.*, 485 U.S. at 234.

182. *Id.*

183. *See, e.g.*, Barbara Black, *Behavioral Economics and Investor Protection: Reasonable Investors, Efficient Markets*, 44 LOY. U. CHI. L.J. 1493, 1493 (2013) ("The judicial view of a 'reasonable investor' plays an important role in federal securities regulation. Courts express great confidence in the reasonable investor's cognitive abilities . . . .").

portant in making investment decisions, the SEC should maintain the reasonable-investor standard to distinguish between material and immaterial statements when assessing disclosure requirements.

The purpose of securities law is to "protect [investors] against . . . economic losses that misrepresentations actually cause."[184] For purposes of materiality determinations in securities fraud actions, courts have ascribed reasonable investors with certain skills and knowledge. Professor Wendy Gerwick Couture has described the judicial view of a "reasonable investor" as one who is able "to grasp the time-value of money, the taxation of different investments, basic accounting treatment, diversification and risk, the nature of margin accounts, and the security industry's compensation structure."[185] Judicial conceptions of the "reasonable investor" suggest that any information that would affect the company's operating performance, valuation, and equity returns is the type of information a reasonable investor would attach importance to when making its investment decisions. Therefore, it seems rational to assume that those who invest in the financial markets would have a strong incentive to undertake profitable investments.

Instead of asking mainstream investors whether the pay ratio is material or not, perhaps the proper question to pose is: how does the median employee's pay correlate with a company's operating and stock-price performance? Unlike the CEO compensation, there are no studies that show how a median employee's compensation is tied to the company's operating or stock-price performance. Based on a survey conducted by the Rivel Research Group, a significant majority of investors are highly likely to vote in support of CEO compensation plans as part of the annual say-on-pay voting process.[186] Notably, the majority reported that they are more likely to vote against a company's compensation plan not because pay levels are egregious, but because there is a disconnect between CEO pay and performance.[187] The survey further revealed a consensus among the majority that the pay ratio disclosure is not useful information.[188] Not only do these

184. *See* Dura Pharms., Inc. v. Broudo, 544 U.S. 336, 345 (2005).

185. *See* Couture, *supra* note 173, at 479.

186. *See* David F. Larcker et al., *The "Buy Side" View on CEO Pay*, STAN. GRADUATE SCH. BUS.: STAN. CLOSER LOOK SERIES 2 (Sept. 1, 2016), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-60-buy-side-ceo-pay.pdf [https://perma.cc/U379-B7CK] ("The majority of respondents in Rivel's research panel report voting in favor of say on pay between 70 percent and 90 percent of the time.").

187. Forty-two percent of the majority indicated that they are "likely to vote against the [CEO's compensation] plan because of a disconnect between pay and performance," whereas 25% are likely to vote against the plan due to the egregiousness of the pay levels. *Id.*

188. Even if the SEC's final rule allows for the pay ratio to be used as a comparison tool across industries, 63% of the respondents in Rivel's research panel believe that this figure is an inaccurate comparison tool. *Id.* at 8.

results corroborate the assumption that investors primarily seek profitable investments, they also strongly suggest that the Rule was politically motivated rather than promulgated in response to investor pressure. If the pay ratio provided meaningful insight into assessing the value of a company, investors certainly would have been insistent in demanding its disclosure. Is this something that investors actually want, or is it a political issue?

An analysis of the ratios widely used by the investor community in making investment decisions further clarifies that materiality centers on the financial and operational performance of companies and on investment returns for investors. The principal tools for the analysis of a company's financial health and its record of performance are financial ratios, which are derived from the various figures that are found in financial statements.[189] Historical empirical studies have demonstrated the usefulness and applicability of financial statements in making investment decisions.[190] It is universally accepted in today's financial world that certain ratios are regularly used to gain insight into a company's operating performance and financial health in terms of profitability, operational efficiency, liquidity, leverage, and market valuation. There are several commonly used ratios for financial analysis.[191] The following are examples of some of these commonly accepted ratios: current ratio,[192] debt-to-equity ratio,[193] inventory turnover ratio,[194] operating margin,[195] price-to-earnings ratio,[196] divi-

189. *See* J. Edward Ketz et al., A Cross-Industry Analysis of Financial Ratios: Comparabilities and Corporate Performance 1 (1990).

190. *See generally* Kung H. Chen & Thomas A. Shimerda, *An Empirical Analysis of Useful Financial Ratios*, 10 Fin. Mgmt. 51 (1981).

191. *Id.*

192. The current ratio is used to determine a company's liquidity by comparing the proportion of current assets to the total current liabilities. *See* Merrill Lynch, How to Read a Financial Report 22 (2000), http://e145.stanford.edu/upload/Merrill_Lynch.pdf. The concept behind this ratio is to assess whether a company's short-term assets are readily available to pay off its short-term liabilities. *See id.* In theory, an increase in the current ratio is an indication of improved financial strength. *See id.*

193. Debt-to-equity ratio compares a company's total debt to investors' equity, which are figures found on a company's balance sheet. *Id.* at 23. This ratio is "an indicator of whether the company is using debt excessively." *Id.* For example, if a company has a debt-to-equity ratio of 2 to 1, it means that the company is taking on debt at twice the rate that its investors are investing in the company.

194. Inventory turnover ratio compares a company's cost of sales on its income statement with its average inventory balance for the period. *See id.* at 24. This ratio tells an investor "how many times a year goods purchased by a company are sold to its customers." *Id.*

195. Operating margin compares a company's operating income to net revenues, which are figures that can be found on a company's income statement. *See id.* at 30. It shows what percentage was profit for each dollar of sales. *See id.*

196. Price-to-earnings ratio compares a company's common stock price with its earnings per share. *See id.* at 35. For example, if a company's stock is selling at $25 per share and the company is earning $2 per share, then the company's price-to-earnings ratio is 12.5 to 1. *Id.* In other words, the company's stock is selling at 12.5 times its

dend payout ratio,[197] and dividend yield.[198] The additional disclosure of a company's median employee pay is both irrelevant and immaterial, as a reasonable investor's evaluation of a company's financial health and future profitability would not change based on this information.

Likewise, an analysis of the Form 10-K reveals information regarding a company's financial health in terms of its risks and future profitability.[199] The Form 10-K includes information such as company history and its business development, executive compensation, equity, subsidiaries, organizational structure, and audited financial statements.[200] All of which give meaningful insights on the company's financial performance and financial health. The pay ratio falls outside of this context. Information concerning how much a company pays its median employee is neither important nor the type of information that would help an investor assess a company's financial health.

No single financial statement gives a complete picture, but when combined by the use of ratio analysis, financial statements provide investors with meaningful and useful information about a company. It is unlikely that a pay ratio would provide the same effect or become an acceptable tool for financial analysis. A ratio between CEO and median employee pay does not give insight to a company's financial health. Not only are ratios used by investment professionals and the investing public to evaluate the financial health of a specific company, they are commonly used to compare a potential investment in one company with that of another. Investors generally use ratios to compare their company's ratio with that of other companies in the same industry to determine the optimal investment. The SEC has explicitly cautioned that the Rule would not enable the public to compare the pay ratios between different companies[201]—which the uninformed reasonable investor is most likely to do when he or she sees the ratio.

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earnings. *Id.* A high price-to-earnings ratio generally means that "investors have confidence in the company's ability to produce higher future profits." *Id.* at 36.

197. Dividend payout ratio tells investors how much of the company's profits goes out in dividends. *Id.* This ratio identifies the percentage of earnings per share paid to investors. *See id.* The dividend payout ratio is an indicator of how well earnings support the dividend payment. *See id.*

198. Dividend yield is a financial ratio that measures the amount of dividends a company distributes to its investors in relation to the market value per share. *Id.* at 37. It is generally expressed as a percentage and is calculated by dividing the company's annual cash dividend per share by the current market price of the stock. *Id.* A high dividend yield can be an indicator that a stock is underpriced or that the company is going through a difficult time and future dividends will not be as high as prior ones.

199. *See generally Fast Answers: How to Read a 10-K*, U.S. SEC. & EXCHANGE COMMISSION, https://www.sec.gov/answers/reada10k.htm [https://perma.cc/LXF4-83XB].

200. For related reading, see generally https://www.sec.gov/about/forms/form10-k.pdf.

201. *See* Pay Ratio Rule, 80 Fed. Reg. 50,104, 50,173 (Aug. 18, 2015) (codified at 17 C.F.R. pts. 229, 240, 249 (2016)).

The pay ratio is a single eye-popping number that is nothing more than a misleading number that could make investors miss a great investment.

For these reasons, it is unconvincing that the average prudent investor would factor in a company's median employee pay when deciding to invest in a particular company as it is not useful for understanding and evaluating a company. Consequently, the Rule fails the materiality test because there is not a substantial likelihood that reasonable investors would consider this type of data point essential, nor useful in their voting and investment decisions.

V. Flaws in the Pay Ratio Rule

The SEC's formula for the CEO-to-median-employee pay ratio is flawed and unlikely to achieve the goals the SEC wants. With over 287,000 comments received by the SEC, the pay ratio proposal is one of the most commented upon proposals in SEC history.[202] Despite significant scrutiny and opposition, the SEC elected to largely adopt the Rule as originally proposed, leaving many of the most controversial concerns still intact. The inclusion of only minimal revisions in the final rule reflects the SEC's reluctance to compromise on the controversial issues posed by the Rule.

One major flaw in the SEC's pay ratio calculation is that by using the median employee's compensation in the denominator of the ratio, the SEC is inadvertently distorting the calculation. For example, Company A has five employees who are paid $20,000 a year, one employee who is paid $50,000 a year, and five employees who are paid $80,000 a year. The median employee pay here would be $50,000, even though half of Company A's employees are paid far below that amount. In effect, this would reduce the pay ratio, which is not a reasonable representation of the company's corporate governance practices. It does not appropriately reflect the performance of executives or the condition and circumstances of the businesses that they manage.

Another flaw is the SEC's decision to allow companies leeway in identifying the median employee. This includes the use of statistical sampling,[203] which is generally open to subjectivity and might enable companies to game the system. For example, in a situation where the median employee's pay is substantially low, a high pay ratio would be produced. In this scenario, a company could hire an additional person on the higher end of the income distribution to increase the median, or fire an existing employee on the lower end. Applying the facts from the above example, that would mean the median employee pay would

202. Joe Mont, *How Comment Letters Could Shape the Pay Ratio Rule*, Compliance Week (July 28, 2015), https://www.complianceweek.com/news/news-article/how-comment-letters-could-shape-the-pay-ratio-rule [https://perma.cc/5MUB-H2AU].

203. *See supra* Section III.C.2.

increase to $65,000, which is calculated by averaging the two middle wages, $50,000 and $80,000. By increasing the median employee pay, the pay ratio is further skewed, weakening the Rule's intended objective of creating greater transparency to demonstrate how median employee pay compares with CEO compensation. Because there is a great likelihood of producing inaccurate information based on the Rule's requirements, it could arbitrarily harm companies by misinforming investors.

As a result, the pay ratio disclosure in essence does nothing to protect investors. It was mandated to see whether it would spark new resistance from investors and consumers, thereby arbitrarily harming investors. The Rule itself does not carry any benchmarks or penalties[204]—it merely puts an additional light on the growing pay disparities between CEOs and their employees. Nothing in the Rule requires that the CEO pay should stay below some pre-determined level, which further diminishes its effectiveness.

In addition, the disclosure of a pay ratio does not come without compromising other aspects of a company. There is a risk that disclosing pay ratio information can result in negative consequences. While many argue that excessive executive compensation contributed to the 2008 financial crisis, governments should not regulate the level of executive compensation. There has been "no convincing evidence that high levels of [CEO] compensation . . . are inherently risky for the companies themselves or the overall economy."[205] Again, the Rule distills CEO pay practices down to one ratio. This is troubling because a pay ratio is not generally accepted as providing meaningful information to investors. Therefore, the attempt to limit executive pay through this Rule is likely to cause unintended consequences that may actually affect companies' business practices.

The authors of Section 953(b) may have thought that by disclosing the ratio, public company boards would be pressured to limit compensation of CEOs and to find ways to increase the salaries of their average workers. However, it will likely produce the opposite outcome. A possible unexpected consequence of the Rule is that it could depress employee morale, which is relevant to the productivity and function of a company. If the ratio shows a large gap in pay between the CEO and the rest of a company's employees, it is likely to hurt productivity and increase turnover, ultimately affecting profitability and investor returns. The employees below the median baseline may wonder what it

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204. *See* Pay Ratio Rule, 80 Fed. Reg. at 50,173.

205. *See* Squam Lake Working Grp. on Fin. Regulation, *supra* note 5, at 2; *see also* Michael C. Jensen & Kevin J. Murphy, *CEO Incentives—It's Not How Much You Pay, But How*, 3 Harv. Bus. Rev. 138, 138 (May 1990) ("There are serious problems with CEO compensation, but 'excessive' pay is not the biggest issue. The relentless focus on *how much* CEOs are paid diverts public attention from the real problem—*how* CEOs are paid.").

takes to get them to that median pay level, and why the company is not paying them more. Employees at or above the median may wonder whether their pay levels are determined fairly, or possibly how the level of CEO pay might be hindering their pay increases. Employees may also attempt to look at other similarly situated companies and speculate whether their median pay is higher, and if so, whether to seek employment there. Consequently, this type of disclosure would most likely impair employee morale and productivity, and as a result, impact the company's overall performance negatively, which would arbitrarily harm the company's investors.

If the goal is to raise the wages of average Americans, publishing the pay ratio is not going to work.[206] At most, it attempts to create public outrage by disclosing an eye-catching disparity in pay to shame companies into reducing executive compensation.[207] Thus, the pay ratio disclosure is highly likely to be misused for other purposes. As discussed earlier, a big pay gap is not likely to make a substantial impact on investors' decision making because investors may not realize any economic benefits associated with their decision making based on this type of information.[208]

Even if the whole plan was to use the pay ratio disclosure as a bullying "name and shame" tactic, it is not going to work to reduce or limit CEO pay. Unlike current benchmarking disclosures, the pay ratio disclosure will not likely provide an incentive to keep executive compensation in check. In fact, it will likely produce the opposite outcome. The SEC's last major effort to rein in executive compensation led to the unintended consequence of increasing company expenses.[209] Boards and CEOs may not even feel pressure from the public disclosure. Public disclosures have continually drove up executive compensation as executives became aware of what other executives were being paid and demanded the company on matching or exceeding

206. *See* Michele A. Carlin, *Yes: The Rule Offers Little Useful Information—to Anyone*, *in Should Congress Rescind the Pay-Ratio Rule?*, WALL ST. J. (Feb. 28, 2016, 10:19 PM), https://www.wsj.com/articles/should-congress-rescind-the-pay-ratio-rule-1456715962 [https://perma.cc/9YWY-UCXF].

207. The AFL-CIO, which lobbied for the Rule's inclusion in the Dodd-Frank Act, has stated its true purpose: "Disclosing this pay ratio will shame companies into lowering C.E.O. pay." Andrew Ross Sorkin, *S.E.C. Has Yet to Set Rule on Tricky Ratio of C.E.O.'s Pay to Workers'*, N.Y. TIMES: DEALBOOK (Jan. 26, 2015, 8:17 PM), https://dealbook.nytimes.com/2015/01/26/tricky-ratio-of-chief-executives-pay-to-workers/ [https://perma.cc/4387-7TU2].

208. *See supra* Section IV.B.

209. *See, e.g.*, Andrew Thompson, *Accounting Professor: Transparency Won't Necessarily Control CEO Pay*, TEMP. U.: TEMP. NOW (Oct. 17, 2007), http://news.temple.edu/news/accounting-professor-transparency-won%E2%80%99t-necessarily-control-ceo-pay [https://perma.cc/V239-XELV] ("Despite [the SEC's disclosure rules], average CEO compensation climbed from $2.3 million in 1992 to $5.6 million in 2005 — faster than the pace of inflation.").

those amounts when it came to determining their own pay.[210] Furthermore, if the goal is to decrease business expenses due to excessive CEO pay, it will likely result in an increase of expenses as the costs to comply with the Rule's requirements are substantial. Therefore, the pay ratio disclosure is not likely to influence corporate pay practices. As a result, the Rule also fails to achieve greater equity in compensation.

Moreover, there are potential consequences beyond investors. The magnitude of the pay ratio disclosure is likely to exacerbate existing concerns among the investors, labor groups, and other constituencies involved in executive compensation practices.[211] This type of disclosure has the possible effect of encouraging state legislators to create or revise state laws based on the now public information, such as imposing taxes on companies with high CEO pay ratios. As a result, this would ultimately impact consumers, as companies will attempt to pass on the increases in costs to them. This is not what Congress intended when it legislated the pay ratio disclosure rule.

Accordingly, the Rule will likely do more harm than good. Without having any indication of how investors will use the pay ratio, the SEC's Rule benefits no one while harming the companies that are subjected to this overly burdensome requirement and their investors.

VI. CONCLUSION

While the Dodd-Frank Act mandated the pay ratio disclosure, the statute did not set a time frame for the SEC to act, which raises legitimate questions about the actual usefulness of the proposed disclosure to investors. Although the Pay Ratio Disclosure Rule may be designed to increase transparency, it does not, however, provide investors more information with which to make informed decisions when exercising their say-on-pay voting rights. Unfortunately, this disclosure mandate is yet another example of Congress using the SEC to advance public policy goals not squarely rooted in the SEC's historic mission to protect investors.

In light of the controversial and political nature of the Rule, there are likely to be legal challenges to it.[212] Courts have a tendency to

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210. *Id. See also* Steven M. Davidoff & Claire A. Hill, *Limits of Disclosure*, 36 SEATTLE U. L. REV. 599, 624 (2013).

211. *See, e.g.*, Steve Seelig, *CEO Pay Ratio Opens Fair-Pay Debate to Everyone*, CFO (Oct. 1, 2015), http://ww2.cfo.com/compensation/2015/10/ceo-pay-ratio-opens-fair-pay-debate-everyone/ [https://perma.cc/LWP2-A7FP] ("Local and national politicians will see the numbers, which will predictably lead to more controversy when it comes to tax laws, government contracting regulations, wage and hour laws, and other public policies. Unions will use it to promote their case for worker rights and higher wages.").

212. On February 3, 2017, President Donald Trump issued an executive order that directs federal agencies to conduct a sweeping review of the Dodd-Frank Act rules. *See* Gregory Korte & David Jackson, *Trump to Dismantle Dodd-Frank Wall Street*

throw out the SEC's rulemaking because they have failed to conduct an adequate analysis of the costs and benefits of the rule. As a matter of fact, the agency has faced a number of challenges in the last few years.[213] The pay ratio disclosure rulemaking here is no better than mere speculation. Thus, it is highly unlikely that the SEC's rulemaking will survive judicial scrutiny as the SEC has failed to investigate whether or how investors would use the pay ratio in practice.[214]

The pay ratio disclosure will likely do nothing to further any aspect of the SEC's mandate to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Nor will it do anything further to protect investors as Congress had intended for it to. It will instead lead to unintended consequences that will negatively affect the overall operations of companies and arbitrarily harm investors. Even if the true intended goal was to only name and shame companies into limiting CEO pay, the disclosure of a CEO-to-median-employee pay ratio also fails to achieve this objective. While the Rule may be well-intentioned, it is likely to backfire. Unless it can be shown that the Pay Ratio Disclosure Rule will reap clear benefits for investors, Congress should promptly move to repeal it.

Rules Through Executive Orders, USA TODAY (Feb. 8, 2017, 9:26 AM), http://www.usatoday.com/story/news/politics/2017/02/03/through-executive-orders-trump-takes-aim-financial-regulations/97431284/ [https://perma.cc/RDE3-JZ2H]. According to Brian Breheny, a former deputy director in the SEC's Division of Corporation Finance, the SEC has "not had the best track record" when it has been challenged on its rulemaking mandates under the Dodd-Frank Act. Michael Greene, *Lawsuit Likely over SEC Pay Ratio Rule: Attorney*, BLOOMBERG BNA (Sept. 23, 2015), https://www.bna.com/lawsuit-likely-sec-n57982058656/ [https://perma.cc/RX2L-Z7MD].

213. *See* Jill E. Fisch, *The Long Road Back:* Business Roundtable *and the Future of SEC Rulemaking*, 36 SEATTLE U. L. REV. 695, 695 nn.1–5 (2013).

214. *See, e.g.*, *Recent Regulation: Securities Regulation—Dodd-Frank Wall Street Reform and Consumer Protection Act—SEC Finalizes Regulations Requiring Companies to Disclose Pay Ratio Between the CEO and Median Employee.—Pay Ratio Disclosure, 80 Fed. Reg. 50,104 (Aug. 18, 2015) (to be codified at 17 C.F.R. pts. 229, 240, 249)*, 129 HARV. L. REV. 1144, 1144 (2016) ("In promulgating this rule, the SEC did not investigate whether or how investors would use this information in practice. As a result, the SEC may have left itself open to [legal] challenges . . . .").