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Shareholders Put Pressure on Severance Plans

By Jack Buehrer March 25, 2013

With M&A on the rise, so too are opportunities for shareholders to vote on change-of-control and severance pay packages. And governance experts say they are tracking more instances of investors' rejecting the so-called say-on-golden-parachute proposals, although few see the failed votes as anything more than symbolic.

All of the failed parachute votes have occurred in 2012 or 2013, with most occurring since the beginning of the fourth quarter of 2012, when M&A activity began to increase after five years of stagnation. With corporations sitting on mountains of cash yet still skittish about investing internally, many have begun looking to buy thanks to the availability of cheap debt and steadily climbing stock indexes.

“The increase in negative votes is a direct reaction to an increase in mergers overall,” says **Kelly Crean**, a senior principal with **Mercer HR Consultants** who specializes in corporate governance issues.

Since the Dodd-Frank Act mandated that starting in 2011, advisory shareholder votes would be required for all future golden parachute proposals, most companies have held off on holding those votes until there was a transaction that required shareholder approval. According to **ISS**, there have been 140 say-on-golden-parachute votes since the Dodd-Frank rule went into effect in January 2011, all of which were part of a merger deal. Only eight of the votes failed, with all of the mergers having been approved. There are also 20 pending special meetings to approve mergers and golden parachute advisory votes.

Many experts believe those failed votes represent a statement against certain pay provisions that investors deem poor governance.

“Investors are pretty clearly starting to use [golden parachute packages] as a protest vote,” says **Pat McGurn**, special counsel at ISS. “It’s an advisory vote, and it’s one that hasn’t led to any real legal repercussions, and the deals are still going through,” he explains. “So if they like the underlying deal, I think they view it as a free vote with few consequences and a way to send a message out to the corporate community.”

The votes being tracked by ISS show mergers receive 20% more support from shareholders on average than votes for golden parachutes. In 2012, all of the companies that lost their parachute votes had deals that were approved with more than 99% shareholder support.

“[Say-on-golden-parachute votes] are the weakest kind of advisory vote since the company making the payments generally disappears into the purchaser and ceases to be accountable for any pay or governance issues,” says **Jim Barrall**, a partner with **Latham & Watkins**.

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Still, the advisory votes have already caused widespread change in severance packages. With more protest votes expected, it’s likely there will be continued pressure on comp committees to eliminate what they perceive as poor pay practices.

“Everyone pretty much expects that in the next year or two we’re going to keep seeing a lot more mergers and acquisitions since companies seem to have cash, yet can’t grow themselves organically,” says **Fred Foulkes**, who chairs the compensation committees for both **Panera Bread Company** and **Bright Horizons Family Solutions** and who heads the Human Resources Policy Institute at **Boston University**.

“If suddenly this is something that is going to get in the way of these deals, directors might want to reconsider how they’re designing these packages. In many ways, they already are.”, Foulkes says

Experts say boards have shown a greater awareness to shareholder concerns about golden parachutes in the years since Dodd-Frank. Few companies are adding 280G gross-up payments or single-trigger cash severance arrangements into their plans, Barrall says. Additionally, most plans now eschew excessive golden parachute payments in favor of more modest payouts of three times base plus bonus for departing executives, all of which have been included in ISS’s new modified recommendations for 2013.

“Parachute practices have changed dramatically since say on pay,” says Barrall. “The vast majorities of Russell 3000 companies have already responded to proxy advisor voting policies and have eliminated problematic practices like excess severance, gross-ups and single-trigger change-in-control payments.”

In fact, each of the failed parachute votes occurred in instances where the boards went back and made changes to their existing severance policies in advance of their merger votes. For example, in the case of this year’s lone failed parachute vote, **Ralcorp’**s shareholders approved a merger with **ConAgra Foods** with more than 99% support but rejected the advisory vote on the change-of-control payments by a 49% to 44% margin with 6% abstaining. Prior to the shareholder vote, Ralcorp CEO **Kevin Hunt**’s double-triggered cash severance was modified to a single-trigger.

The package also included an excise tax gross-up and a retention payment of $1 million to remain as a consultant.

In all, Hunt’s golden parachute package totaled $36.1 million. The shareholders’ vote didn’t prevent Hunt from collecting his money, but experts say votes like this could have an effect on future CIC arrangements.

“We see a lot of cases where the concerns among shareholders are that these changes are being made in terms of the [existing] payment agreements,” says **Jim Kroll**, senior consultant at **Towers Watson**. “Shareholders are saying [with these votes] that they want to send a message. It’s becoming an outlet for them to express unhappiness with certain provisions related to changing control.”