

Asserting APA Violations in Dissenting on Pay Ratio Rule Adoption

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“Remember what we learned in school. Acquiescing to bullies only gives them more ammunition and makes it worse.”

Those were part of Commissioner Piowar’s passionate remarks during the SEC open meeting adopting the final pay ratio rule, or, as he said, the “name and shame” rulemaking from the “Big Labor playbook.” He also questioned the timing of the vote as “peculiar” since some members of Congress have recently introduced bills to repeal the pay ratio provision and were heading into recess. He urged the Commission to “stand up to the bullies” because they “will be back for more,” perhaps in the form of political spending disclosure or share buyback prohibitions.

Part two of Commissioner Piowar’s dissenting comments were simply posted on the SEC website. Unlike his public remarks, it contains a detailed list of perceived defects in the rulemaking procedures that provides an outline of possible litigation issues, including allegations that the SEC:

- Failed to provide sufficient notice under the Administrative Procedure Act (APA). Commissioner Piowar argues that the proposing release did not identify the basis and purpose of the rules as required under the APA, which made it impossible to comment on whether the regulation is arbitrary and capricious.
- Failed to disclose the Commission’s understanding of what the statute was intended to accomplish. Commissioner Piowar states that the SEC did not explain its interpretation of Congressional objectives until adopting the rules, which precluded public discussion on whether its views were correct and the extent to which the proposal satisfied those objectives.
- Failed to consider the quantitative effects that providing flexibility would have on the accuracy of the pay ratio, and as a result, acted in an arbitrary and capricious manner when it limited the de minimis exclusion of non-U.S. employees to 5%. Commissioner Piowar questioned the basis for the selection of 5% as the threshold, given that the Commission never discussed the level of desired precision against the rule’s objectives.
- Acted arbitrarily and capriciously when it defined “employee” to exclude contract workers only if they are employed by an unaffiliated third party. According to Commissioner Piowar, this limited definition in the adopting rule could include any number of self-employed individuals or consultants who perform work for public companies and went beyond the proper scope of the proposing release for purposes of the APA.
- Failed to consider academic studies as to whether the pay ratio might create pressure to increase CEO compensation and in addition, he also suggested that the use of pay ratio for comparative purposes may violate an investment adviser’s fiduciary duty under the Investment Advisers Act. Given that the Commission specifically warned that there are significant limitations in using the pay ratio to compare companies, Commissioner Piowar cautions that advisers who compare pay ratios when providing advice or making recommendations may be breaching their fiduciary duties, since the advisers are required to have a reasonable basis. This appears to be a clear message to proxy advisory firms on how to analyze pay ratios.

See Davis Polk’s memo on the final pay ratio rules [here](#).

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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