
# CHAPTER 21
# PROXY STATEMENTS

BUSINESS BEATS BASICS

# PROXY STATEMENTS

## INTRODUCTION

Of all the documents that companies produce, proxy statements are among the most useful for reporters, in terms of finding story ideas, adding context to stories, and even breaking news.

Proxy statements tell you what the top directors in a company are paid, from cash and stock to free jet rides. They lay bare conflicts of interest that entangle executives and board members. They let shareholders vote on everything from mergers to hot political issues. They can even provide a front-row seat to brawls between a company and powerful shareholders.

Proxies are too varied for any guide to be truly comprehensive, so this chapter will focus on the kind you're most likely to run into: annual proxy statements issued by U.S. companies that are publicly traded (i.e., have shares traded on exchanges or markets) and filed with the Securities and Exchange Commission (SEC). Very small public companies, closely held companies, and firms based outside the U.S. generally follow different rules.

### WHAT A PROXY IS – AND ISN'T

Proxies amount to an open letter to a company's shareholders. And as federal securities rules require much of the information to be presented in a consistent and systematic way, proxies tend to be more accessible than most other corporate filings.

Most fundamentally, annual proxy statements tell shareholders what they can vote on at the company's annual meeting. Typically, that's electing or re-electing company directors (board members), approving the company's auditor, and voting on any proposals made by management or shareholders.

Companies are supposed to include context and background to give investors an informed choice. That makes it a wellspring of data and insight for reporters writing about those topics and many others. Most of the information covers the prior fiscal year, but some look back further than that.

# WHERE TO BEGIN

## WHO FILES PROXY STATEMENTS?

Most proxies are filed by the company itself and written by the company, from the company's perspective. As a result, the formal conclusions and recommendations tend to be predictable. The data, explanations, and context are usually more useful for reporters.

Some proxies are filed by other parties in order to achieve a particular aim. One common example is a proxy statement filed by minority shareholders seeking to oust some or all of a company's board. That's called a proxy battle, and it almost always means news.

## WHEN ARE THEY FILED?

A company is required to file proxy statements with the SEC no later than the date those materials are first given to shareholders. For that reason, proxies are usually filed in advance of an annual shareholder meeting. The precise timing is governed by a mesh of state and federal rules, but annual proxy statements typically come out 30 to 60 days before the annual meeting and usually after the company has filed its Form 10-K (More on 10-Ks in Chapter 20).

For many companies – especially "calendar year" companies ending their fiscal years on Dec. 31 – the annual proxy comes out in April or early May. There are plenty of exceptions, though. For example, Apple Inc. ends its year in late September and files its proxy in early January.

As a practical matter, look at when a company filed its last annual proxy statement – the next one will probably appear about a year later. If the company won't say when it plans to file, keep checking around that date.

Companies also file proxy statements ahead of special shareholder meetings, notably those convened to consider a merger or acquisition. These are called merger proxies.

## WHERE TO FIND PROXY STATEMENTS

Proxy statements can always be found on the SEC's EDGAR database, and they can often be found on corporate websites or investor-relations pages. Additionally, there are companies that offer services to make it easier to search and analyze filings; a few are listed under the Resources section of this chapter.

Every kind of filing has a code in EDGAR, and a company's final, or "definitive," proxy – the one you'll use for most stories – is coded as a DEF 14A (after Section 14A of the 1934 securities law that governs the documents). Preliminary proxies, coded as PRE 14A filings, are essentially rough drafts; they can help you get a jump on the competition and are usually filed 10 days or more before the definitive version. Amendments and supplementary documents show up as DEFA14A or PREA14A filings, and there can be several in sequence. Revisions, coded DEFR14A, are rarer.

Watch for DEFC14A filings. They're contested proxy solicitations, a volley in a proxy battle, typically waged by activist investors against a company's existing management and board. The activist investors lay out their beefs, often in strong terms, in a bid to get shareholders to vote for dissident board candidates. You won't find these on the company's website, which is a good reason to get used to using EDGAR or a third-party service to do your research. Companies typically file responses, also coded as DEFC14As, so you may have to wade through multiple rounds of back-and-forth – or a series of follow-ups – to get the full picture.

# COMPENSATION BASICS

Reporters most often use proxies to report on executive pay. This is where proxies shine, thanks to federal rules requiring uniform calculations and disclosure. The centerpiece of executive pay disclosure is the Summary Compensation Table, typically toward the middle of the proxy statement. This is the primary pay disclosure in a proxy filing that includes columns for salary, bonus, stock options, stock compensation, non-equity incentive pay, pension, deferred-compensation gains, and other compensation (including perks and benefits) with up to three years of pay data. Let's go over each of those columns and what they include.

## SALARY

This is pretty straightforward, as it is a fixed regular payment paid by the employer to the employee over the course of the year that is not directly linked to individual or company performance measures.

## BONUS

This can mean many things, but here it refers to only "discretionary" bonuses: one-time payouts not tied explicitly to a company or individual performance plan. Incentive bonuses appear three columns later. The bonus column can include sign-on bonuses, special awards, severance, and any number of other payouts. These are usually cash payments and can often be deferred. Check the table's footnotes for specifics.

## EQUITY OR STOCK-BASED COMPENSATION

These appear in the next two columns. Unlike salary, these are essentially estimates: The true value will fluctuate over time with the company's stock price or other factors. The amounts reported in the table, however, are calculated by more or less set methods, as of the date that the awards are made to the executive.

### STOCK AWARDS

Include ordinary shares of company stock, but more commonly restricted stock or restricted stock units, as well as any performance shares, phantom stock, or a variety of other similar instruments. They're all alike in that the value shown in the table is essentially the stock price multiplied by the number of shares or units the executive gets. The ultimate value will fluctuate with the company's stock price, but that isn't reflected here.

### OPTION AWARDS

Include stock options, but also less familiar instruments like stock-appreciation rights. These are all similar in that the ultimate value to the executive depends on the difference between the share price when they receive the awards, and the share price when they cash them in (often years later). The dollar figure shown in the table will reflect an estimate or projection valuation.

## NON-EQUITY INCENTIVE PLAN COMPENSATION

Includes a variety of cash payouts tied to the company's or individual's performance. The most common is the annual incentive bonus, but many companies also have long-term incentive plans based on two or three years of company performance.

## CHANGE IN PENSION VALUE AND NONQUALIFIED DEFERRED COMPENSATION EARNINGS

Adds together two largely unintuitive amounts. One is the growth of the executive's pension during the year (not its total value); the other includes some but not all of the interest earned on the executive's deferred compensation account. The breakdown is usually in a footnote. Some companies try to argue that these amounts shouldn't be counted as part of a given year's pay, but it's compensation for work performed and amounts the executive will get in the future – in the same way that money put into your 401(k) is part of your pay. At the very least, it reflects a growing and sometimes enormous IOU from the company to the executive.

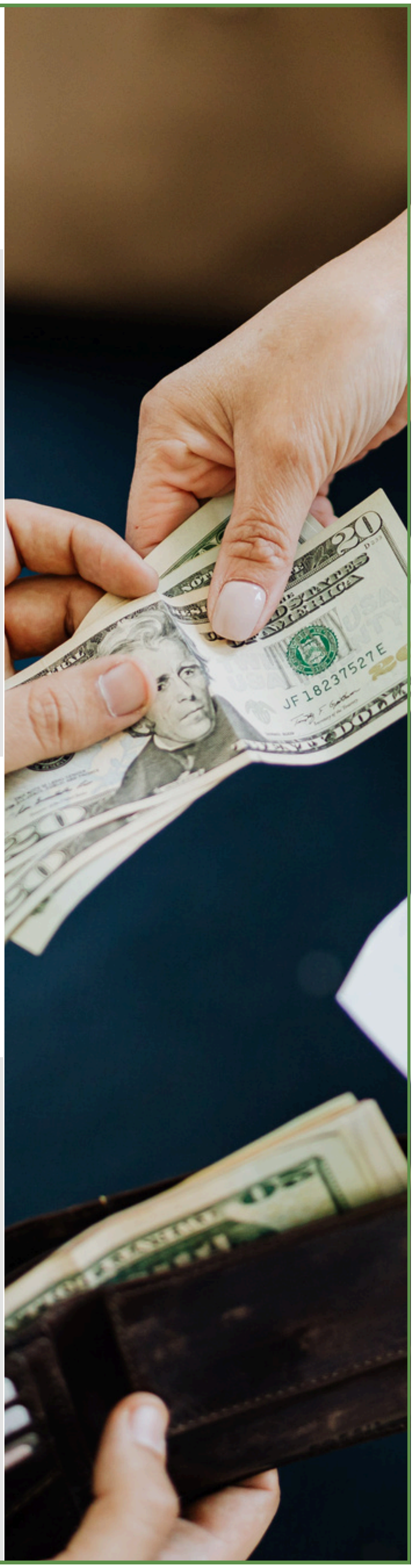
## ALL OTHER COMPENSATION

A catch-all for special benefits and perks, from souped-up life insurance and discounted sports tickets to free jet rides or even company-subsidized home renovations. Anything over $10,000 must be itemized, usually in a footnote following the Summary Compensation Table or in a separate table – which often has footnotes of its own. Always look closely.

## TOTAL

The most valuable column for reporters on a deadline. It's the sum of the other columns, just like it sounds. Some news organizations have formulas to calculate their own version of "total" pay, and companies often argue that other measures make more sense. But this is the universal standard; it's defined by federal regulation and comparable across companies. You're on firm ground if you use it, especially if you tell your audience what number you're using – "total pay as reported to federal securities regulators," for example.

You may have noticed several references to footnotes. Read them – they often hold the most interesting and eye-opening details in the proxy.



## DIRECTOR COMPENSATION

This is treated much the same way as executive pay, though in a less detailed table covering only the most recent year. Columns vary based on pay practices, but can include fees paid in cash; stock awards; option awards; non-equity incentive awards; pension and deferred-comp gains (which are unusual for directors); and all other compensation, including perks (check those footnotes!), as well as a Total column. Note that this table generally includes only non-employee directors – executives who also sit on the board are usually in the Summary Compensation Table, not here.

## COMPENSATION DISCUSSION AND ANALYSIS

The most extensive compensation section in the proxy tends to be the least useful: the CD&A (sometimes misheard as "CDNA"). This is the section of an annual proxy statement in which the company explains how and why it decided to pay its top executives what it did, but it's usually long on boilerplate and justification and short on useful detail. Still, companies are supposed to explain how executives got what they did and why. So don't ignore it. Sometimes the reasoning for lavish perks can be amusing, and the contrast between what a company says and does can be newsworthy. Just understand that it can be difficult to decipher.

# FIND EXPERTS

### COMPENSATION CONSULTANTS

Compensation consultants are also often willing to comment on or even analyze pay packages and related issues for reporters, including Pearl Meyer & Partners, Steven Hall & Partners, and Compensia. Equilar has become a major source of executive-compensation data and has often been willing to work with reporters in the past. The Corporate Counsel keeps on top of a wide range of governance and pay issues, and its blog can be a helpful resource.

### PROXY-ADVISORY FIRMS

For insight into hot governance and pay issues of the moment, check out the major proxy-advisory firms, including ISS (formerly Institutional Shareholder Services, at issgovernance.com) and Glass Lewis (glasslewis.com). They advise professional investors on how to cast proxy votes, are openly critical of practices they see as abusive or bad for shareholders, and have become very influential (too influential, according to some companies).

# TIPS FOR USING THE PROXY

A newly issued proxy can generate news on its own, such as when a CEO's pay doubles, lavish perks contrast sharply with layoffs and cost-cutting, or a shareholder wages a proxy fight, for example. But it's also a useful reference tool for stories that originate with other events or ideas. Here are some of the most common ways a proxy can be useful, both as a primary news element and in supporting roles.

## PIN THE RAISE (OR THE PAY CUT) ON THE CEO

This is a tried-and-true approach: use the Summary Compensation Table to calculate the increase or decrease in the total pay of the chairman or CEO. If the CEO is newly appointed, you can usually compare their pay to their predecessor's, though you may need to pull the prior year's proxy to do so. For long-time CEOs, consider looking at multi-year trends.

## TAKE STOCK (AND OPTIONS, AND CASH...)

Don't forget to compare how different components of pay have changed. More cash and less stock could indicate managers have little incentive to generate good returns for shareholders. More stock and less cash means more of an executive's pay is at risk – which could spur better management or a riskier swing-for-the-fences mentality. It may also suggest management and the board are bullish about the future. Weigh the possibilities by talking to compensation experts and investors and analysts knowledgeable about the company.

## UNSCRAMBLE THE NEST-EGG

Be sure to check the sixth column, showing pension and deferred-comp changes. As executives approach retirement age, pension values can skyrocket. A dedicated pension-benefits table, which usually follows the summary-comp table, gives more detail. It lays out not only the annual increase, but also a total "present value" of the pension — its value in today's dollars, a number that can be enormous. Footnotes or text nearby explain underlying pension formulas and other context, though often the numbers are enough.

If the footnotes for the sixth column show big bucks from an executive's deferred-compensation account, check the deferred-compensation table, which usually follows the pension section. It breaks down how much each executive set aside in deferred pay the prior year – roughly the equivalent of a super-charged 401(k) plan – as well as how much the company contributed to the account during the year, which can be significant. Other columns show gains or losses on the account (which the company pays) and any amounts the executive withdrew during the year. The total column gives the executive's account balance as of the end of the last fiscal year.

## PERK THINGS UP A BIT

Perks and special executive benefits make great articles and attract attention. The details are usually in a footnote to the Other Compensation column of the Summary Compensation Table, or a nearby table of their own. In the Compensation Discussion and Analysis section, the company often justifies the various perks briefly.

## STAKE OUT THE OWNERS

A table of beneficial owners shows how many shares of company stock are held by each director and named executive, plus an aggregate number for all directors and officers. It also shows the stakes of major shareholders (those owning 5 percent of shares or more). This is a snapshot in time, as of the end of the last fiscal year.

Look here during takeover battles to see how much of a stake management has on its own. You can also use it to quantify how much an executive has lost or gained (on paper) from sudden changes in share price. If there's a merger underway, or the company is being acquired or taken private, you can estimate how much executives will make on their shares – just multiply the share count listed by the change in stock price or, for deals, the proposed share price.

## UNTANGLE TIES THAT BIND

Corporate directors and the executives they supervise sometimes have business dealings or other relationships beyond the company they run together. Those ties are supposed to be laid out in the related-party transaction disclosure (sometimes labeled "related persons," "related transactions," or other terms). Relationships can be direct or through other entities, such as a director's employer or an executive's family trust or investment partnership.

Some real-life examples from years past: A company that rented the chairman's fishing lodge for business entertainment, and another that paid millions for the CEO's map collection.

## EMCEE A PROXY FIGHT

Proxy fights don't come around often, but they're often news when they do. Typically, a big investor puts forward one or more candidates to contest incumbent directors, who generally run unopposed. Activist investors must produce and distribute proxy materials themselves, making the case against the company's existing management; it's an expensive proposition. Moreover, proxy fights often come after months of behind-the-scenes negotiations with the sitting board, so shareholders that go this far are usually pretty serious.

These are typically straightforward conflict pieces, but don't forget to mine the documents for key details mentioned above, including sizing up the stakes each side has in the company, and looking for potential conflicts in the related-party disclosures and director bios. Then keep up with the filings, since both sides may file rebuttals until shortly before the annual meeting.

## TALLYING VOTES THAT COUNT (SORT OF)

Don't forget the items facing a vote: shareholder and management proposals. These often appear near the end of the filing. Some are routine, such as renewing the outside auditing firm's contract. But even there, pay attention when companies switch to smaller, lesser-known auditing firms: It can be a sign of trouble.

The more interesting proxy measures tend to be proposed by unhappy shareholders. Some are essentially political or social statements: Tyson Foods is routinely asked to treat its chickens more humanely, while Apple in 2012 faced an unusual demand to elaborate on directors' potential conflicts of interest from a D.C. think-tank that suggested Al Gore had benefited financially from company policies – an allegation Apple rejected.

Other proxy measures turn on broader philosophies of corporate governance, such as separating a company's chairman and CEO positions, or giving big shareholders a more direct say in calling special meetings.

Companies provide detailed rebuttals to proposals they oppose (which is most of them). Some of these shareholder proposals appear dry, but can actually reflect a bid by unions or an activist investor to make it easier later on to challenge management or put outside faces on the board. Such challenges generally aren't subtle, so read the arguments on both sides to figure out what's going on.

In the end, these shareholder proposals tend to be advisory proposals, meaning the board can ultimately ignore them – but there are often longer-term consequences for antagonizing shareholders, such as a proxy battle with dissatisfied hedge funds.

## WATCH FOR CHANGES

If you spot a preliminary proxy statement (PRE 14A filing) before the final version comes out, use it to write about the company as you would with the real thing; just tell your audience that it's preliminary. Also realize some information may be missing – and be sure to check for changes when the definitive proxy comes out. An easy way to do that is to use a "compare documents" feature online or in Microsoft Word.

## ORGANIZATIONS

### The Society of Corporate Secretaries & Governance Professionals

corpgov.net

An association for the company officials that draft proxies, and it has chapters across the country.

### The Conference Board

conference-board.org

This group also writes about these issues, and sponsors roundtables and panels on the topic (many of them webcast).

### Council of Institutional Investors

cii.org

For an investor's perspective, consider this influential group of pension and investment funds that push companies to improve corporate governance and pay practices.

# CHALLENGES AND PITFALLS

No guide can cover all the possibilities of what you may see in a proxy filing, but here are some common problems and points of confusion you can avoid.

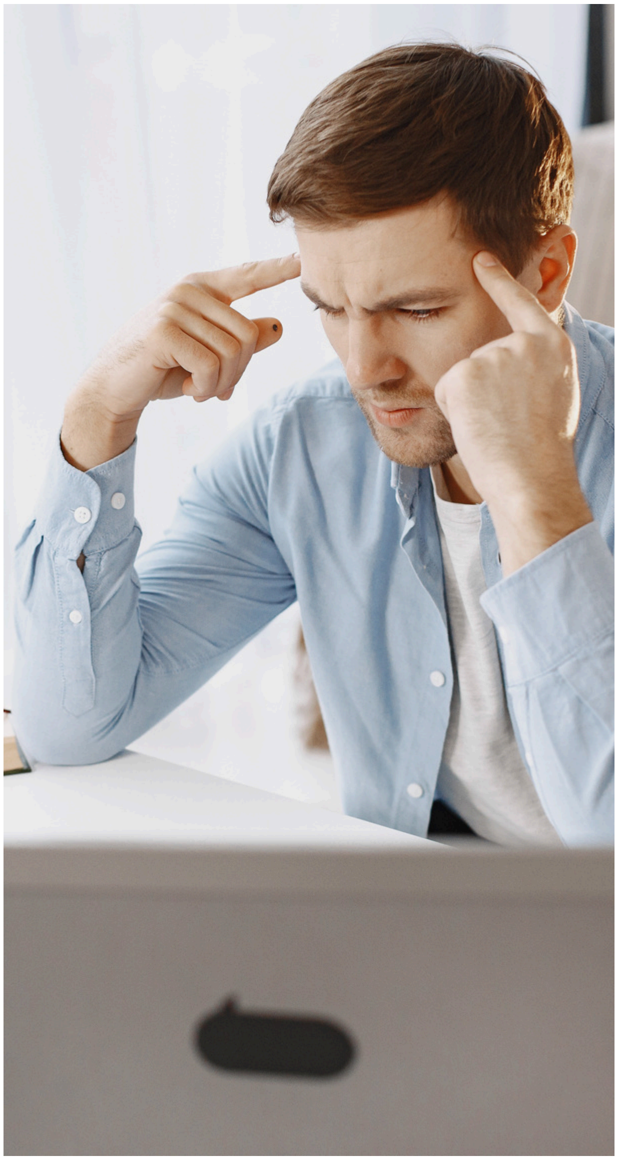
## CONTROLLED COMPANIES

If over 50% of the voting power of a company is held by an individual or group, that company is considered a "controlled company." In those cases, they get more freedom to set executive pay and may not need to have a majority of independent directors. In some cases, they can even issue what amounts to an informational proxy statement that leaves other shareholders little say. Still, such proxies contain most of the compensation, governance and background information of other proxies.

## MISSING INFORMATION

If anything is missing, check the company's annual report – the 10-K filing, not the glossy booklet mailed to shareholders.

Technically, most of the information commonly found in the proxy can appear in Section III of the 10-K, or in an amended filing filed later (coded as a 10-K/A).



## STALE INFORMATION

Definitive proxies typically come out once a year, and they largely present information as of the end of the last fiscal year – meaning they're a few months out of date from the start, and it gets only worse as the year wears on. Still, most of the time, they represent the best information available. With a little luck and a lot of work, it can be possible to piece together changes in executive pay or perks since the last proxy.

Stock-holdings data are a little easier. Services such as InsiderScore and FactSet specialize in keeping track of who owns what; they stay on top of the flurry of ownership documents filed throughout the year by companies and individuals. Many of these services are happy to help reporters. Otherwise, you can dig up the most recent Form 4 filing for the executive (or director); it should list how many shares and options the executive held as of the date on the document.

As a bonus, companies will sometimes cough up more recent information when faced with proxy info that's months out of date. Otherwise, use the information from the proxy, but let readers know what time period it reflects.

## DOWNPLAYED PERKS & BENEFITS

Some companies legitimately provide executives with few or no perks. Becton, Dickinson & Co., for example, provides most executives only matching retirement contributions and term life insurance. But others claim to abstain while still providing the CEO or other executives free personal travel on the company’s dime, costly home-security systems, or other goodies.

They argue that these aren’t perks, perhaps because the executives are required to use them for safety or other official reasons. Drugstore chain CVS, for example, calls its executive perks “very limited” — but gave one executive a company car and free personal air travel, plus $75,000 in financial planning and an executive assistant for five years when he retired.

Regardless, the cost should still be disclosed under Other Compensation if it exceeds $10,000 in a year. Talk to experts or readers to decide whether the benefits are a necessity or not.

## COMPARING APPLES AND ORANGES

Especially where companies have more freedom to customize tables, read footnotes and column headings carefully. Sometimes you’ll find companies switching gears without much warning, making it tough to get an accurate picture.

IBM, for example, has for at least two years shown a single table listing potential severance, retirement, and other termination benefits for top executives. But some of the numbers are lump-sum amounts, while others represent annual payments that actually would repeat for several years at least. Just adding the numbers across the rows of the table drastically understates the potential payouts, since that includes just one year’s worth of the annual payouts. Getting comparable numbers for all IBM’s potential payments during these years required looking at tables elsewhere in the filing.

## EVALUATING THE NEW GUY

It's easy enough to see if a longtime CEO got a raise or a pay cut. But what if you’re looking at an executive who is new to the job? Consider comparing his pay to his predecessor’s. New hires often get less than veterans, but there can be exceptions. And big one-time payments — sign-on bonuses, or stock and cash awards meant to replace benefits the executive gave up by leaving the last job – can sometimes be the difference between landing a top candidate and losing one.

If one or both of the executives worked only a partial year, it becomes more complicated. You could find full-year pay targets (salary, bonus, stock, etc.) in the proxy’s summary of contract terms for the executive. It could appear pretty much anywhere in the document, so try searching for the words “employment agreement.” The Compensation Discussion & Analysis section also often includes full-year figures, for both the prior year and the subsequent one. Compare the figures that you find to the predecessor’s base salary and targets, pulling them from a previous proxy, if necessary.

**This chapter is based on material originally written in 2013 for businessjournalism.org by Theo Francis, a financial and investigative reporter for The Wall Street Journal.**