

Golden Parachutes Are Lead Balloon For Investors

He may lose his job as [TRW Automotive](#) chief executive, but John Plant will still have reason to cheer if Germany's ZF Friedrichshafen completes [a \\$12.4bn takeover](#) of the US automotive supplier later this year.

Depending on the timing of his departure from TRW, the British executive could walk away with up to \$87.7m, according to a regulatory filing.

Mr Plant's possible exit windfall puts him in gilded company. A surge in mergers and acquisitions in 2014 has been accompanied by a rash of large 'golden parachute' payments, to cushion the departure of executives at the target companies.

For the CEOs of the 10 biggest companies taken over in 2014, [golden parachute payments](#) could total \$430m, according to data compiled by Equilar, the executive pay research firm.

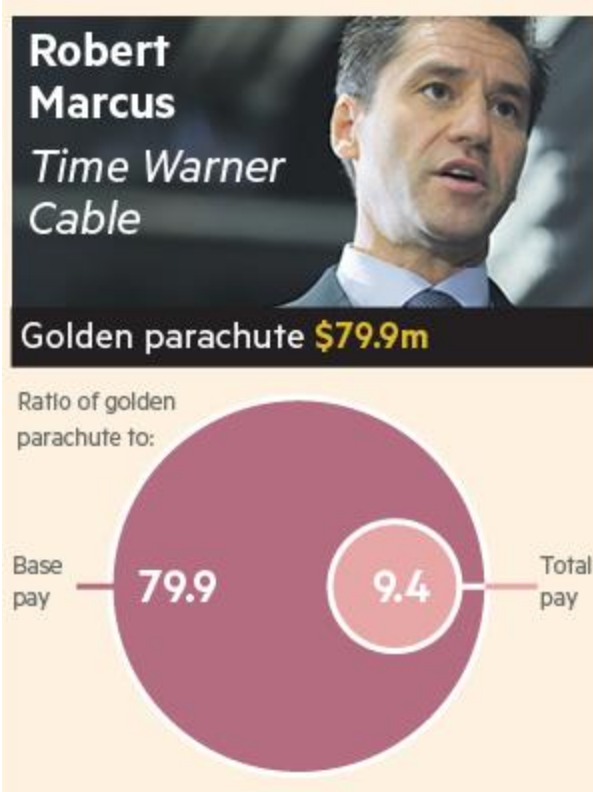
Rob Marcus, chief executive of [Time Warner Cable](#), could receive \$79.9m in cash, equity and benefits if [Comcast](#) completes [its takeover](#), even though the deal was announced less than two months after he took up the post.

Similarly, David Pyott, chief executive of [Allergan](#) could receive \$117.6m in cash, equity and benefits if he leaves following his company's [acquisition](#) by pharmaceutical rival [Actavis](#), according to [Equilar](#). Mr Pyott, also a Brit, fought to keep Allergan independent but ultimately struck a deal with Actavis to prevent a takeover by rival [Valeant](#).

Other potential recipients of parachute payments based on last year's largest deals include José Almeida of Covidien, Murray Kessler of Lorillard and Jeffrey Binder of Biomet.

Merger-related windfalls for executives grew in popularity in the 1980s as a way to ensure an executive at a target company would always act in the best interest of shareholders — even though he could lose his job in the event of a takeover.

Since then, the payouts have ballooned. In 2013, the average value of change-in-control benefits provided to a CEO was \$29.9m, according to [a study](#) of 200 large publicly listed US companies conducted by Alvarez & Marsal Taxand, the tax consultancy.

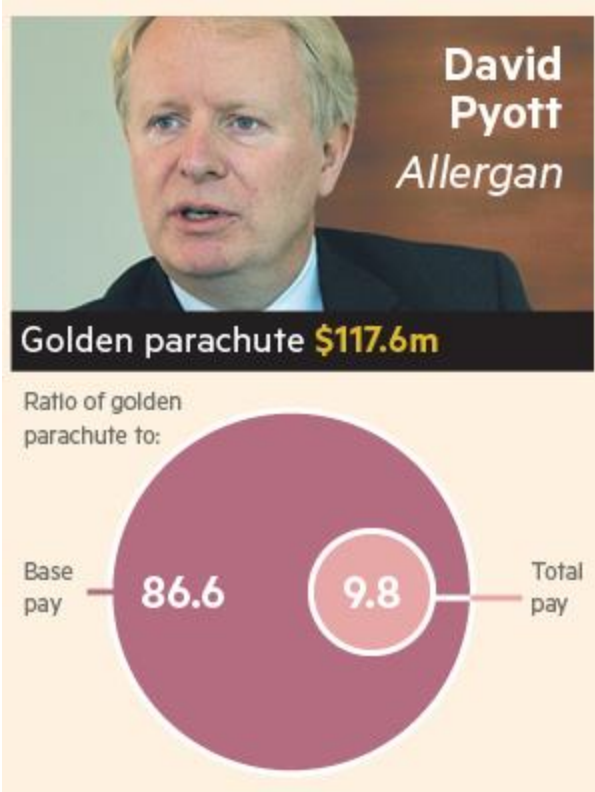


But Charles Elson, professor of corporate governance at the University of Delaware, questions whether they have the desired effect in a takeover situation. “The parachute says: don’t worry about losing your job, as we’re paying you a little extra to do your [fiduciary] duty,” he explains.

“But it creates a perverse incentive of paying someone extra to do their duty when the company should be sold anyway . . . [or] to go against the shareholder interest when the company shouldn’t be sold. Shareholders complain about it and they are right to complain about it.”

A corporate governance specialist at a large institutional investment company concurs. “If management of a company need a mega payout to do a deal, then there is something deeply flawed with the management . . . Companies are not a job protection agency for the CEO.”

In Europe, golden parachutes are less common and generous than in the US. However, with [cross-border takeovers](#) on the rise, European companies can find themselves paying for windfalls for US executives.



For example, [Infineon](#), the German chipmaker, may have to foot a bill of up to \$80m for change-in-control payments for executives at California-based [International Rectifier](#), which it agreed [to acquire for \\$3bn](#) last year. Infineon has declined to comment on the payments.

For ZF, the total cost of golden parachute payments — including Mr Plant's — could reach \$130m. Its German chief executive, Stefan Sommer, says he is unhappy that such a large amount has to be paid, but is powerless to do anything about it.

Larry Cagney, who chairs the executive compensation and employee benefits group at law firm Debevoise & Plimpton, says the size of golden parachutes at US companies often surprises overseas acquirers — particularly those from Europe and Japan

“There is a good deal of having to educate the acquirer because the US structure is so different,” Mr Cagney notes. “But I tell them what you are looking at is typical for a US company. It’s not greedy or incredibly crazy.”

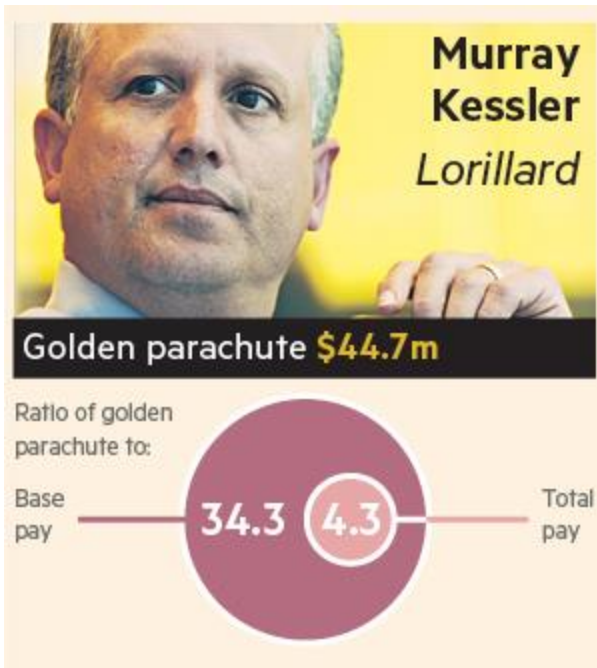


Even so, a combination of greater regulatory disclosure and growing shareholder pressure has meant US executives are no longer having it all their own way.

John Roe, executive director of ISS Corporate Solutions — the advisory arm of proxy adviser Institutional Shareholder Services — believes greater scrutiny of executive pay in the wake of the financial crisis is having “a spillover effect” into other areas of compensation, including golden parachutes. “I would expect these to increase only at a modest rate in the coming years,” he says.

The Dodd-Frank Reform Act of 2010 requires companies to hold [say-on-golden parachute votes](#) at the special meetings held to approve deal transactions.

These votes are non-binding but proxy advisers such as ISS and Glass Lewis are using them to shine a light on severance pay elements they deem problematic and thereby to catalyse a more widespread reform.

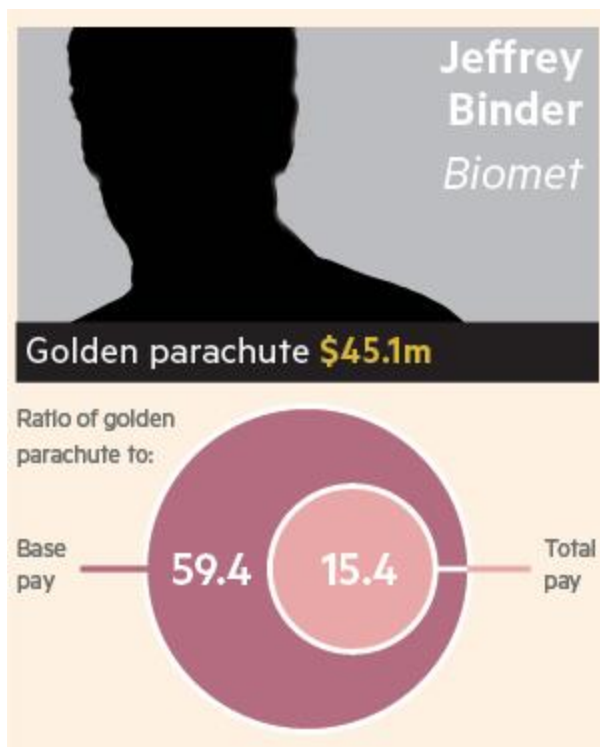


“It’s really been about stripping away some of the provisions that shareholders felt were most shareholder unfriendly,” said Robert Newbury, director of executive compensation resources at Towers Watson.

These include “excise tax gross-up clauses” — payments that are supposed to compensate executives for extra tax due on large payouts — as well as “single trigger clauses”, such as payouts in the event of a change-in-control, regardless of whether executives actually lose their jobs. Both are now becoming much less common.

“Has investor pressure started to have an impact on change-in-control agreements? The answer is yes,” says Mr Roe of ISS.

Shareholders in companies that become targets for a takeover have typically given golden parachute payments little attention — focusing instead on the premium being offered for their shares by the bidders.



However, votes in favour of golden parachute payments tend to be smaller than the votes in favour of takeover deals themselves. In a handful of cases — including TRW — a majority of shareholders has actually voted against the payouts.

About 5 per cent of golden parachutes votes held between 2012 and 2014 went against the proposed payments, according to data compiled by FactSet, the financial data company.

“It remains to be seen what are the consequences [of a no-vote] as the deal gets done and the entity goes away, so there is little recourse,” said Mr Newbury.

Golden parachute figures are estimates. These are subject to change depending on the final purchase price of the relevant companies

What do golden parachute payments consist of?

Nowadays, basic severance pay does not usually exceed three times salary, for tax reasons. Instead, by far the biggest component of golden parachutes tends to be the immediate vesting of unvested stock options and other forms of equity-linked compensation.

Trade union bodies such as the Amalgamated Bank, AFL-CIO and International Brotherhood of Teamsters are therefore focusing in particular on this aspect of golden parachute payouts.

Lombard on copper



Lord Copper, a press baron invented by writer Evelyn Waugh, was too important ever to be wrong. The stock response of subordinates to his counterfactual assertions was “up to a point, Lord Copper”. The phrase may now come in handy for acquaintances of the real-life Lord Copper, Michael Farmer, a commodities investor elevated to the peerage last October, *writes Jonathan Guthrie*.

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They note that had a takeover not occurred, these equity awards would often not have become available to executives for several years — and, then, often only on condition that certain performance targets were met.

Scott Zdrazil, director of corporate governance at Amalgamated Bank says: “Exit packages remain one area where there is often a gross disconnect between pay and actual performance delivered”.

Limits on accelerated vesting of stock options are already in place at tech giants [Apple](#), [IBM](#), [Intel](#) and [Microsoft](#), as well as oil companies such as [Chevron](#) and [ExxonMobil](#), according to the Teamsters.

Elsewhere, though, companies have tended to resist reform, arguing that accelerated vesting is common practice, aligns management interests with shareholders and, if discarded, would create a competitive disadvantage in attracting executive talent.

Unions remain unpersuaded and are raising the issue of accelerated vesting in closed door meetings with company directors as well as in resolutions at annual general meetings.

For example, shareholders at [Valero Energy](#), which makes transportation fuels and petrochemical products, passed a resolution that unvested equity awards should be prorated — vesting proportionately to the time an executive has served.

Similar votes against accelerated vesting of equity awards last year received majority shareholder support at media company [Gannett](#), Boston Properties and Dean Foods.

*Attributed by Financial Time
Published January 14, 2015*