

## 3M, Chevron Cut Multiplier for Severance

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The pay multiple that some companies are using to calculate executives' cash severance benefits is becoming much smaller at companies including **3M Co.** and **Chevron**.

Both companies had been using what had become something of a standard corporate multiple of three times salary and bonus. 3M cut this from three to two, while Chevron lowered the number to 2.5.

Research by Equilar has shown roughly three fifths of the largest 100 companies have formal severance protections in place for execs, many of them as part of employment agreements.

In reducing the severance multiple in these agreements or in company policies or programs to well below three, these companies are distinguishing their severance programs from those of many companies that have been using this multiple (or 2.99) in recent years in virtually pro forma fashion.

"This is starting to come down at more companies," says Dick Wagner, president of Strategic Compensation Research Associates. "The trend is reflective of how three times pay was overreaching."

Companies that blazed the reduced-severance trail include **JPMorgan Chase**, **Fiserv**, **Bank of America** and **Lucent Technologies**. So what began as a trickle of companies lowering their multiples could now become a steady stream.

Comp committees are in a difficult position on severance in general because they need to offer these benefits to attract and retain top executive talent. The idea is that execs need the protection of severance to leave their old job and take a chance on a new company.

However, if executives have been with their companies for several years, they've had time to accumulate numerous equity incentive awards providing an opportunity to become financially secure by growing the company's value — and with it, shareholder value. And many have also had time to plan for their retirement through deferred compensation and other wealth-accumulation plans. In most cases, the executives would take these benefits and awards with them, should they be fired. In recent years, there's been increasing governance pressure to get execs to give up their severance benefits or, failing that, to reduce the multiple.

Reducing the multiple is far easier, of course, when there's turnover at the top.

When 3M announced the appointment of its new CEO, George Buckley, earlier this year it disclosed key terms of his employment agreement. It provides that, if he's fired without cause or quits for good reason, he is to be paid "cash severance equal to two times the sum of his annual base salary and target annual bonus payable in the form of 24 equal monthly installments," according to the company's last proxy statement. If he loses his job because of a change in control, Buckley would receive the benefits as a lump sum.

Buckley's predecessor, W. James McNerney, had a provision that would pay him "a lump-sum cash payment equal to three times his annual base salary and profit sharing."

Also this year, the Chevron board of directors announced in an 8-K filing that it was amending its change-in-control severance benefits for top executives by reducing payments from three times base salary and target bonus to 2.5 times base salary and target bonus.

That decision by the board followed a shareholder proposal that passed with 56% of the vote requiring shareholder approval for cash severance above 2.99 times base and bonus. Similar proposals passed last year at **Albertson's**, **Kohl's** and **PG&E**. Shareholder pressure intensified this past proxy season and experts expect more companies to pare the multiple of pay in their severance agreements or plans.

"Some institutional shareholders have been on the warpath over severance benefits in the last several years and companies will continue to feel pressure to reduce the multiples of pay and numbers of covered executives," says Jim Barrall, a comp attorney with Latham and Watkins

Another reason companies may be reducing the multiple, say experts, is to reduce the likelihood of triggering the hurtful excise tax on severance payments above a certain amount connected with a change in control, or golden parachutes.

Although many companies in recent years had reduced their multiple from three to 2.99 to avoid triggering the tax, this is a slippery slope because of numerous tax rules involving compensation other than salary or bonus that, if included in the overall severance arrangement following a change in control can substantially increase the total figure that triggers the tax. These included accelerated vesting of outstanding equity and other incentive awards, and deferred compensation.

Moreover, to attract top talent, many companies agree to gross executives up on the tax. Then directors can come under criticism for paying this, as gross-ups are a pet peeve among shareholder advocates. So companies cutting the multiple are increasing their chances of eliminating this governance concern.

Yet even multiples of two could still trigger the excise tax when other comp elements are factored in. For this reason, it appears that the primary motivation remains shareholder pressure.

Bank of America, for example, states in its proxy statement that it will not enter into agreements with executives that "provide severance benefits exceeding two times base salary and bonus, unless the agreement has been approved by the stockholders."

### Reduced Severance Multiples

Lucent Technologies	1
3M Co.	2
Bank of America	2
E*Trade	2
Fiserv	2
Hewlett-Packard	2
JPMorgan Chase	2
Chevron	2.5