



IOPA INVESTOR BRIEF

PHARMACEUTICAL COMPANIES AND THE OPIOID CRISIS

**Executive Compensation and
Executive Accountability**

FEBRUARY 2023

IOPA INVESTORS FOR OPIOID AND
PHARMACEUTICAL ACCOUNTABILITY



Why Accountability? Why Compensation?

The opioid epidemic is foremost a story of people, people whose lives, and that of their families and communities, have been devastated as a result of corporate decisions that led to the production, distribution, over-prescription and sale of opioids.

It is also a story frequently told in numbers. There have been more than 263,000 deaths in the United States from overdoses involving prescription opioids, between 1999 and 2020,¹ and 841,000 deaths since 1999 as people with addictions seek out even more unsafe sources.² Additionally, almost 58 opioid prescriptions written for every 100 Americans in 2017—down from its peak of 81.2 in 2010 but still three times higher than in 1999³—and as many as one in four patients receiving long-term opioid therapy in a primary care setting, struggle with opioid addiction.⁴

263,000+

deaths in the United States from overdoses involving prescription opioids between 1999 and 2020

841,000

deaths since 1999 as people with addictions seek out even more unsafe sources

**58 opioid prescriptions
written per 100
Americans in 2017**

¹ <https://www.cdc.gov/drugoverdose/deaths/prescription/overview.html>

² "Drug Overdose Deaths," Centers for Disease Control and Prevention, available at: <https://www.cdc.gov/drugoverdose/deaths/index.html>

³ <https://www.cdc.gov/drugoverdose/deaths/prescription/practices.html>

⁴ <https://www.cdc.gov/opioids/basics/prescribed.html>

More recently, the epidemic has been a story of a new set of numbers: the gigantic legal settlements reached between state, local and tribal governments and the companies that produced and distributed opioids, now totaling more than US \$50 billion and counting.⁵

But there is one more set of numbers and one group of people that, unlike those that have suffered from addiction and its impacts, have been relatively untouched by the opioid epidemic. Those people are the executives who made the decision to produce, market and distribute opioids, and those numbers are their executive bonuses and compensation packages. In too many cases, those numbers have gone up.

Alex Gorsky, CEO of Johnson & Johnson, received nearly \$30 million in pay in 2020—and also benefited from an increase to his long-term incentive opportunity that year (125% of target)—even as Johnson & Johnson booked more than \$5 billion in settlement charges that wiped out a third of the company’s net income.

How did this happen? When pharmaceutical companies set targets for executive performance, and base the amount of their compensation on meeting those targets, they often use profit metrics that are not based on Generally-Accepted Accounting Principles (like “Adjusted Earnings Per Share”) which routinely filter out legal settlement costs and fines from the end result. By excluding the \$5 billion in opioid charges from the calculation of its key earnings metric (“Operational Earnings Per Share”), for example, the board at Johnson & Johnson inflated CEO payouts by more than \$2 million in 2019 and 2020.

We believe this is a salient issue for investors because performance metrics for executives help incentivize the right level of risk-taking. If they routinely filter out the real-world results of that risk-taking, the incentives are skewed and executives are not held accountable for their decisions.

We support compensation arrangements that incentivize senior executives to drive growth and shareholder value while safeguarding company operations, corporate reputations over the long-term, and the people, communities and environment affected by executive decisions. We take issue with the practice

US \$50,000,000,000+

in legal settlements reached between state, local and tribal governments and the companies that produced and distributed opioids

of adjusting litigation expenses to insulate executives from the consequences of their decisions and the financial penalty bore by investors.

What is the IOPA proposing to change?

Investors for Opioid & Pharmaceutical Accountability (IOPA) has engaged with selected pharmaceutical companies, asking them to adopt a policy which reverses the onus when calculating executive performance metrics.

That is, rather than ordinarily excluding one-time large legal settlement charges from the calculation of performance metrics like Adjusted Earnings Per Share, we proposed that boards and compensation committees ordinarily include those charges unless there is a compelling reason to exclude them – such as when evaluating a new CEO who was not in charge at the time of the decisions that led to the legal action.

The IOPA proposal seeks to reverse the current expectation at most pharmaceutical corporations that charges related to compliance breakdowns will automatically not impact executive pay. Our proposal allows board discretion to exclude charges when there are mitigating reasons for excluding the costs, but requires robust disclosure to justify the use of, what is effectively, positive discretion.

In so doing, the proposal aims to ensure executives are held accountable for events that occur on their watch, that incentive payouts reflect the financial experience of shareholders, and that executives are fully incentivized to focus on what ought to be their number one priority – the safe and secure distribution of beneficial medicines.

⁵ <https://www.opioidsettlementtracker.com/globalsettlementtracker/#pot>



What has IOPA done about this practice?

The IOPA has **met privately** with boards of pharmaceutical firms to discuss changes to executive compensation practices and performance measures, explaining our concerns and debating ways to address it. Our members have also **filed shareholder proposals** at companies to alter those practices and measures on a permanent basis, and to change the incentives for executives and hold them accountable for their decisions.

For example, the International Brotherhood of Teamsters, supported by IOPA, filed a shareholder proposal at AmerisourceBergen for its March 2022 annual meeting, asking that the financial performance metrics used in executive pay plans are not automatically adjusted to exclude expenses or charges associated with any investigation, litigation or enforcement action related to drug distribution. That proposal secured 53% of the votes of shares not held by insiders, a significant early win for IOPA's position.

At Johnson & Johnson's 2022 annual meeting, a similar proposal filed by the Vermont Pension Investment Commission received a vote of 47.7% from shareholders, just shy of a majority.

Finally, where we have encountered egregious pay practices and little accountability, we have run "vote no" campaigns targeting companies' advisory votes on executive compensation.

For example, IOPA launched a "vote no" campaign targeting the "say on pay" vote at the 2021 Johnson & Johnson stockholder's meeting, where 43% of shareholders ultimately voted against the board's approach.⁶

Similarly, IOPA launched a "vote no" campaign at the 2021 AmerisourceBergen annual meeting. More than 72% of the shares not held by insiders were cast against the board's approach to executive pay. The vote was a resounding rebuke of the company's failure to account for the \$6.6 billion in opioid-related charges in its incentive plans, a direct result of AmerisourceBergen's practice of adjusting out such costs when determining financial performance.

⁶ In fact, of the top 123 investors in J&J—which includes all shareholders with stakes of 0.1 percent and higher—70 (57 percent) voted against board's approach to compensation in 2021, one voted to abstain, and five fund providers logged split votes, according to data provider Proxy Insight. Available data shows more than 100 funds specifically referenced the litigation expense calculation in their rationale for opposing the say-on-pay in 2021, according to Proxy Insight and Segal Marco Advisors.

What has been accomplished so far?

Responding to IOPA’s campaigns and the significant vote by shareholders at its 2021 annual meeting, AmerisourceBergen reduced its CEO’s 2021 bonus by \$1.8 million.

Similarly, McKesson Corp. announced that it would reduce its CEO’s 2021 compensation by \$2.6 million for 2021 after the company booked \$8.1 billion in charges for anticipated settlement costs of opioid-related litigation. Cardinal Health reduced its CEO’s pay by \$1.4 million after booking a \$1.2 billion opioid charge in its 2021 fiscal year and \$5.6 billion the year before.

While these were welcome one-time changes, they did not get at the structural incentives that are built in to each company’s approach to executive compensation.

How asset managers voted on these proposals and why

During the 2022 proxy season, IOPA’s shareholder proposals on executive compensation at Johnson & Johnson and AmerisourceBergen received significant support from investors, especially for a first-time proposal. However, the results would have been higher at both companies if certain asset management firms had voted in favor of this change.

The following table identifies selected asset managers that hold significant positions in Johnson & Johnson and AmerisourceBergen, and how they voted on our 2022 proposals.

ASSET MANAGEMENT FIRM	JOHNSON & JOHNSON PROPOSAL	AMERISOURCEBERGEN PROPOSAL
BlackRock	Against	Against
Capital Group	For	For
Fidelity Investments	Against	For
J.P. Morgan	For	Against
Northern Trust	For	For
State Street Global Advisors	Against	Against
T. Rowe Price	Against	For
Vanguard	Against	Against
Wellington	For	For

Figure 1 - Data from Insightia Limited

The asset managers that voted against the shareholder proposals on executive compensation highlighted three primary reasons for voting against the proposal. Below, we outline those concerns and our response.

ASSET MANAGER ARGUMENT	OUR RESPONSE
<p>Ordinary business – Some asset managers argued that executive compensation matters should be left to the board’s compensation committee, which can be held accountable for its decisions through the election of directors and annual advisory votes on compensation (“Say on Pay”).</p>	<p>Our proposal is not aimed at executive compensation, generally, but at an incentive system that signals to executives that they will not be held accountable for decisions they make. The board and its compensation committee are still charged with responsibility for general executive compensation matters, but we ask that they ensure executive accountability for significant compliance failures – like a company’s contribution to the opioid epidemic – which have resulted in massive legal settlements for which shareholders must bear the cost. Further, where we have already logged significant shareholder votes against the Say on Pay vote, our proposal suggests a manner in which the board can address those concerns.</p>
<p>Too prescriptive – Some asset managers argued the problem and/or terms outlined in the shareholder proposal were too prescriptive and/or inflexible, and may not be in the purview of shareholders.</p>	<p>The IOPA proposal allows the Board discretion to opt out of the policy when conditions warrant. The proposal states, “The Board shall have discretion to modify the application of this policy in specific circumstances for reasonable exceptions and in that case shall provide a statement of explanation.”</p> <p>The Board is free to determine the circumstances for reasonable exceptions which might include, for example, instances where the current executives were not in place when the liabilities were incurred. We ask that those instances be documented and disclosed to shareholders.</p>
<p>Substantially implemented – Some asset managers argued that the company has already taken sufficient actions, made sufficient progress, and/or has related actions pending to address proponent request.</p>	<p>In the two cases where executive pay was reduced after significant shareholder protest, we note that the relatively small reductions in compensation were quickly recouped through other incentive offers. For example, even while docking AmerisourceBergen’s CEO’s 2021 bonus pay by \$1.8 million, the board increased his target compensation by \$1.15 million in fiscal 2021, while his fiscal 2022 Long-Term Incentive (LTI) opportunity, granted around the time of the bonus reduction, looks to have increased by \$750,000 from fiscal 2021.</p> <p>Further, one-time reductions do little to address the presumption that in the normal course of business, executives can expect that the cost of legal liabilities incurred as a result of their decisions will be borne entirely by shareholders, with no effect on their own compensation.</p>



What's next? IOPA's 2023 shareholder proposals

For the 2023 proxy season, IOPA members are filing a proposal at six pharmaceutical firms to make accountability a core part of executive compensation decisions. The same proposal has been filed at Teva Pharmaceutical Industries Ltd (TEVA), Abbott Laboratories (ABT), Johnson & Johnson (JNJ), Pfizer Inc. (PFE), Abbvie Inc. (ABBV), and Bristol-Myers Squibb Company (BMY). The full text of the resolution reads:

RESOLVED that shareholders of COMPANY urge the Board of Directors to adopt a policy that no financial performance metric shall be adjusted to exclude Legal or Compliance Costs when evaluating performance for purposes of determining the amount or vesting of any senior executive Incentive Compensation award. "Legal or Compliance

Costs" are expenses or charges associated with any investigation, litigation or enforcement action related to drug manufacturing, sales, marketing or distribution, including legal fees; amounts paid in fines, penalties or damages; and amounts paid in connection with monitoring required by any settlement or judgement of claims of the kind described above. "Incentive Compensation" is compensation paid pursuant to short-term and long-term incentive compensation plans and programs. The policy should be implemented in a way that does not violate any existing contractual obligation of the Company or the terms of any compensation or benefit plan. The Board shall have discretion to modify the application of this policy in specific circumstances for reasonable exceptions and in that case shall provide a statement of explanation.

Although we are meeting with company boards and personnel to discuss the proposals, we anticipate that many of these proposals will ultimately be put to a vote in the spring of 2023.

IOPA will look to institutional investors and asset management firms to consider the proposal and the material presented above, and to take the opportunity to hold executives accountable for the decisions that they make by voting in favor of our proposals.

About the IOPA

The Investors for Opioid and Pharmaceutical Accountability (IOPA) is a diverse coalition of global institutional investors with 67 members representing over \$4.2 trillion in assets under management. IOPA was established in July 2017 to engage with opioid manufacturers, distributors and retail pharmacies on opioid business risks that have implications for long-term shareholders, communities and the economy.

IOPA is co-chaired by Kevin Thomas at SHARE (Shareholder Association for Research & Education) and Chirag Acharya at Wespeth Benefits and Investments.

Acknowledgements

This investor brief was prepared with contributions from Kevin Thomas (SHARE), Manna Jacob (SHARE), Juana Lee (SHARE), Chirag Acharya (Wespeth Benefits & Investments), and Maureen O'Brien (Segal Marco Advisors).

Report design by Meredith MacKinley,
featuring illustrations from © Rick /
Adobe Stock

Disclaimer

This investor brief was developed using a combination of existing frameworks and literature in the public domain and public corporate reporting. This document was prepared for general informational purposes only and is not and should not be regarded as financial advice, investment advice, trading advice or any other type of advice, or as a recommendation regarding any particular investment, security or course of action. The information in the brief is provided with the understanding that readers will make their own independent decisions as to whether a course of action is appropriate or proper based on their own judgment, and with the understanding that readers are capable of understanding and assessing the merits of a course of action.