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POUND FOOLISH: CHALLENGING EXECUTIVE COMPENSATION IN THE U.S. AND THE U.K.

"It's good to be the king."[1]

I. INTRODUCTION

Astronomical executive pay has been referred to as "the most egregious governance failure of the 20th century."[2] Although excessive executive remuneration has long been a newsworthy topic in the United Kingdom ("U.K."), beginning in the early and mid-1990s "interest in the topic reached unprecedented levels."[3] There were several reasons for this piqued interest in the salaries of the country's executives. For one, the "gross pay of chief executives in larger U.K. public companies rose nearly 600% between 1979 and 1994."[4] In addition, "remuneration levels seemed to bear little relation to corporate performance."[5] Finally, as corporations were increasing their executives' pay, they were also cutting back on rank and file employee positions.[6] Although executive pay was a hot topic in the United States ("U.S.") throughout the 1990s, it didn't reach its pinnacle until early 2001.[7] This was mainly due to the thriving U.S. economy — investors and shareholders were "too optimistic about their personal economic future to be very concerned about executives getting rich."[8] However, with the economic slowdown beginning in early 2001, and the recent corporate scandals such as Enron, Worldcom, and Tyco, good corporate governance is now on the radar screen of most shareholders.[9]

1. History of the World Part I (Twentieth Century Fox 1981).
2. Louis Lavelle, *The Best & Worst Boards, How the Corporate Scandals are Sparking a Revolution in Governance*, BUS. WEEK, Oct. 7, 2002, at 108.
3. Brian R. Cheffins & Randall Thomas, *Should Shareholders Have a Greater Say over Executive Pay?: Learning from the U.S. Experience*, 1 J. CORP. L. STUD. 277, 278 (2001). For a general discussion, see *id.* at 278–82.
4. *Id.* at 279.
5. *Id.*
6. *Id.*
7. *Id.* at 298–99.
8. *Id.* at 279.
9. *Id.* at 299. *See also* Jerry Useem, *Have They No Shame?,* FORTUNE, Apr. 28, 2003, at 59; Andrew Hill & Caroline Daniel, *U.S. Investors Are Grow-*

Essentially, within the realm of corporate governance topics, executive pay has preoccupied investors the most. Indeed, in 2003 "[e]xecutive pay ha[d] taken over as the top concern of corporate governance from last year's biggest worry, the independence of auditors."[10] "Yet although executive compensation was one of the first targets that critics of corporate America attacked after the spate of scandals [in 2002], it is still proving the toughest to reform."[11]

This Note analyzes the issue of executive compensation through a comparison of the U.S. and the U.K., with a focus on the rights and responsibilities of shareholders in challenging executive pay. Part II compares the U.S. and U.K. systems of corporate governance, including corporate structure, composition of share ownership and corporate governance laws in both countries. Part III examines whether executive compensation is excessive. Part IV discusses the details of setting compensation and the related disclosure regimes in the U.K. and the U.S. In particular, it examines the methods by which executives are paid and sets out the laws regulating the setting of compensation in both countries. Part V addresses the issue of how shareholders can challenge executive compensation, with a focus on challenges through voting. Specifically, this section discusses challenges by shareholder proposals, challenges to share option plans, and challenges at the annual meeting. Part VI focuses on recent amendments to the U.K. Companies Act and to the New York Stock Exchange listing rules. Finally, Part VII discusses shareholder responsibilities and stresses the need for greater shareholder involvement in the compensation process.

II. COMPARING THE U.S. AND U.K. SYSTEMS OF CORPORATE GOVERNANCE

There are many similarities between the corporate sectors of the U.S. and the U.K.. Both systems are "characterized by a relatively large number of quoted companies, a liquid capital market where ownership and control rights are traded fre-

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ing Restive Over Lavish Boardroom Pay, But Will They Fall Quiet Once the Bear Market Recedes, FIN. TIMES, May 5, 2003, at 9.

10. *Fat Cats Feeding*, ECONOMIST, Oct. 11, 2003, at 64.

11. Hill & Daniel, *supra* note 9, at 9.

quently, and few inter-corporate holdings."[12] In other words, both systems have capital markets and wide dispersal of ownership.[13] Since dispersed ownership is found in both the U.S. and the U.K., "[t]he U.S. is…a particularly important country against which to compare U.K. governance because unlike Continental Europe and most of the rest of the world, the underlying structure of its capital markets and companies is similar."[14]

A. Corporate Structure in the U.S. and U.K.

At the outset, it is important to note some specific similarities between corporate structure in the U.S. and U.K. Both the U.S. and the U.K. "have a 'shareholder economy' where private enterprise is about maximizing profits for those who invest."[15] As a result, "shareholders occupy the central position with respect to companies."[16] The system of ownership and control in both countries has been called an "outsider/arm's-length" system.[17] "Outsider" refers to the fact that most firms do not have a "core" group of shareholders with "inside" influence, but rather have dispersed ownership "among a large number of institutional and individual investors rather than being concentrated in the hands of family owners, banks or affiliated firms."[18] The term "arm's-length" is used to describe the fact that investors "are rarely poised to intervene and take a hand in running a business."[19] Essentially, this role is left to the corporate executives.[20]

Since the U.S. has a common law legal system and market-based economy, the main form of corporation in the U.S. is the publicly-held company with widely-dispersed ownership. This creates an agency problem between the shareholders, who own

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12. G.P. STAPLEDON, INSTITUTIONAL SHAREHOLDERS AND CORPORATE GOVERNANCE 3 (1996).

13. *See* Julian Franks & Colin Mayer, *Governance as a Source of Managerial Discipline*, 2, Apr. 10, 2000 (prepared for the Company Law Review, Committee E on Corporate Governance), *available* at http://www.dti.gov.uk/cld/franksreport.pdf.

14. *Id.*

15. Cheffins & Thomas, *supra* note 3, at 297.

16. *Id.*

17. *Id.* at 297–98.

18. *Id. See generally* Rafael La Porta et al., *Corporate Ownership Around the World*, 54 J. OF FIN. 471 (1999).

19. Cheffins & Thomas, *supra* note 3, at 298.

20. *Id.*

the company, and the executives and directors, who manage the company.[21]

Each of the fifty U.S. states has its own business corporations law and each corporation is governed by the law of the state of its incorporation.[22] Each corporation draws up articles of incorporation setting out the duties and rights of shareholders and directors.[23] The shareholders, being owners of the corporation, are given certain rights, including the right to vote, such as voting for the board of directors.[24] The board, in turn, chooses executives to run the day-to-day operations of the firm and set dividends.[25] Often, in the U.S., the positions of chairman of the board of directors and chief executive officer are held by one person.[26]

The U.K.'s corporate structure is similar to that of the U.S. At least part of the U.K.'s corporate governance system has been shaped by "its political and social history and attitudes."[27] It has been suggested that the fact that the U.K. is an island has led to its "[i]nsularity" which "has bequeathed the U.K. a sense of welcome separateness which no amount of foreign entanglement can destroy."[28]

The general model of corporate management and control in the U.K. involves "two main organs: the board of directors and the general meeting of members."[29] Pursuant to a company's articles of association, the board may "appoint and confer any of their powers upon one or more executive (or 'managing') direc-

21. *See* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539, 542–43 (2000).

22. *See* JONATHAN P. CHARKHAM, KEEPING GOOD COMPANY: A STUDY OF CORPORATE GOVERNANCE IN FIVE COUNTRIES 174 (1994).

23. *See* GREGORY V. VARALLO & DANIEL A. DREISBACH, FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL 14–15 (American Bar Association, 1996).

24. *See* DOUGLAS M. BRANSON, CORPORATE GOVERNANCE, Director's Selection, §1.01, at 1–2 (The Michie Company, 1993) ("Most central to shareholders' role then is their power to elect directors, and statutes typically refer to that shareholder power expressly."). *See also* CHARKHAM, *supra* note 22, at 182.

25. *See* CHARKHAM, *supra* note 22, at 183, 194–96.

26. *Who's in Charge?,* ECONOMIST, Oct. 25, 2003, at 20.

27. CHARKHAM, *supra* note 22, at 249. *See generally* Roe, *supra* note 21.

28. CHARKHAM, *supra* note 22, at 250.

29. STAPLEDON, *supra* note 12, at 6.

tors, which in effect allows the creation of a third organ —— executive management."[30]

Essentially, "the board of directors is the most important day-to-day organ in the company."[31] The board of directors has "the power to manage the business of the company, and the general meeting is not permitted to interfere with its exercise."[32] However, this does not mean that the annual general meeting ("AGM") (analogous to the "annual meeting" in the U.S.) is without purpose. At the AGM, the shareholders may remove directors without cause by vote, which requires a simple majority.[33] In addition, shareholders may vote at the general meeting to alter the articles of association, which requires a three-quarters super-majority.[34] The board of a typical public company in the U.K. is comprised of both non-executive directors and executive directors.[35] The board, as a whole, does not typically manage the day-to-day operations of the company; rather, the board delegates these duties to the chief executive (also called the "managing director") and other executive directors.[36] Unlike in the U.S., the roles of chairman and chief executive are generally separated.[37] The executive management of the company, which consists of executive directors and executive officers (who are not members of the board), plan the company's

30. *Id*.

31. STAPLEDON, *supra* note 12, at 6–7.

32. *Id.* at 7.

33. Companies Act 1985, c. 6, § 303 (Eng.).

34. Companies Act 1985, c. 6, § 9.

35. STAPLEDON, *supra* note 12, at 7. Although this is not a requirement under U.K. law, the Combined Code suggests that the board have an appropriate balance of executive and non-executive directors (including independent non-executives) so that no individual or group of individuals can dominate the board's decision making. *See* Financial Services Authority, Listing Rules, § 1, paras. B1–B3, Schedules A, B (June 1998). *See also* DEPARTMENT OF TRADE AND INDUSTRY ("DTI"), CONSULTATION PAPER, REVIEW OF THE ROLE AND EFFECTIVENESS OF NON-EXECUTIVE DIRECTORS (June 7, 2002) [hereinafter Higgs Report].

36. STAPLEDON, *supra* note 12, at 7.

37. *Who's in Charge?, supra* note 26, at 20. *See also* Press Release, Pensions Investment Research Consultants, Companies Face Increasing Risks By Ignoring Shareholders' Views On Corporate Governance (Dec. 2003), *available at* http://www.pirc.co.uk/Annual_review_2003.pdf [hereinafter PIRC] (approximately 10% of companies have a combined chairman and chief executive).

strategy.[38] However, "it is normally necessary for the approval of the board to be obtained for major transactions or changes in strategy, and [it is] sometimes necessary for shareholder approval to be obtained as well."[39] In an average company, the board of directors will meet monthly to discuss strategy and to monitor the performance of executive management.[40] The board of directors and senior executives owe a fiduciary duty to the "company as a legal entity separate from its shareholders and creditors."[41] However, directors also have the duty, when making decisions, to consider the interests of the company's employees (stakeholders).[42]

The right to vote is common in most ordinary shares of publicly listed companies in the U.K.[43] Most of the publicly listed U.K. companies "have only one class of ordinary shares, with each ordinary share carrying one vote on a poll at a general meeting of the company."[44] Similar to the U.S. system, the articles of association of the U.K. company will set out this one-share, one-vote system. There are two types of general meetings where shareholders exercise their right to vote: the AGM and the extraordinary general meetings ("EGM"). The matters upon which shareholders are required to vote are set out in the Companies Act of 1985, the company's articles of association, the London Stock Exchange Listing Rules and the general law.[45] Some examples of matters on which shareholders have a right to vote include: changes to the articles of association,[46] the company and purchase of its own shares,[47] removal of directors,[48]

38. STAPLEDON, *supra* note 12, at 7.
39. *Id.*
40. *Id.*
41. *Id.* at 8.
42. Companies Act 1985, c. 6, § 309.
43. STAPLEDON, *supra* note 12, at 82.
44. *Id. See also* Companies Act 1985, c. 6, § 370(6) (there is a presumption of one vote per share on a poll and non-voting and restricted-voting shares do exist, but are not common).
45. *See* STAPLEDON, *supra* note 12, at 82. *See also* Cheffins & Thomas, *supra* note 3, at 287.
46. Companies Act 1985, c. 6, §§ 4, 9 & 17.
47. Companies Act 1985, c. 6, §§ 164 & 166.
48. Companies Act 1985, c. 6, § 303.

transactions between the company and someone related to the company[49] and a voluntary winding up of the company.[50]

B. Composition of Share Ownership in the U.K.

According to the most recent U.K. government survey of share ownership on the U.K. Stock Exchange, released in July 2003, overseas/foreign investors account for 32.1% of U.K. equity; individuals account for 14.3%;[51] banks accounts for 2.1%; and insurance companies, pension funds, and other institutional shareholders account for 49.4%.[52] Therefore, in the U.K., institutional shareholders hold a sweeping majority of equity capital of publicly-listed companies.[53] Despite such a large percentage of equity ownership in public companies, institutional shareholders (e.g., pension fund trustees) are not required to exercise their vote.[54]

The market where most publicly listed stocks are traded in the U.K. is the London Stock Exchange ("LSE").[55] The LSE is one of Europe's leading exchanges and consists of both domestic and international companies. Although the LSE has been in existence for approximately 200 years, in 1986 it experienced what is considered the "Big Bang" — when the market truly opened its doors and grew exponentially. Currently, the LSE

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49. Financial Services Authority, Listing Rules, 2000, c. 11 (Eng.).

50. Insolvency Act, 1986, c. 45, § 84(1) (Eng.).

51. The proportionate share ownership of individuals has decreased steadily in the U.K. In 1963, approximately 54% of U.K. equities were held by individuals while in 1998, the figure dropped to a mere 16.5%. *See* Geof Stapledon, *Analysis and Data of Share Ownership and Control in U.K.*, at 4, *at* http://www.dti.gov.uk/cld/staple.pdf (last visited Jan. 2, 2004). Stapledon attributes this decline to "the growing proportionate holding of the institutions, and…individuals swapping their money from directly held shares to indirect investment in equities via investments in unit trusts, investment trusts and pension funds." *Id.*

52. Press Release, Office of National Statistics, Share Ownership 2002, July 18, 2003, *available at* http://www.statistics.gov.uk/pdfdir/sha0703.pdf.

53. STAPLEDON, *supra* note 12, at 4. Since the early 1960s, institutional investor equity holdings in public companies has increased significantly. In 1963, individuals owned approximately 54% and institutional investors owned 29%. However, in 1994, individuals owned a mere 20% and institutional investors owned approximately 60%. *Id.* at 4–5.

54. STAPLEDON, *supra* note 12, at 85.

55. Information about the LSE is available at http://www.londonstockexchange.com.

has about 2,700 companies which trade on its markets (the main market[56] has more than 2000 companies, with approximately 400 international issuers, and the secondary AIM market[57] has more than 700 companies with approximately 50 overseas issuers)[58] for a market value of approximately £3 trillion (or $5.49 trillion U.S. dollars).[59]

C. Corporate Governance Law in the U.S. and U.K.

Before delving into the specifics of corporate governance law in both countries, it is important to note that the U.S. and U.K. have a "shared legal heritage encompassing the common law and principles of equity."[60]

In the U.S., corporate governance is monitored through a combination of state and federal statutes, SEC rules (regarding disclosures, proxies, and proposals), and common law. Generally speaking, the board of directors has a fiduciary duty to the corporation to act in the corporation's best interest. This means that directors are prohibited from self-dealing and from using corporate control for their own financial gain (i.e., insider trading). Common law governs subjects such as conflicts of interest, fiduciary duties, self-dealing, business judgment, and waste. Much like the U.S., the U.K. is a common law country with its corporate governance law comprised of an amalgamation of different sources: Codes (mainly voluntary), the Companies Act of 1985, the Stock Exchange Listing Rules, and common law.

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56. Within the main market there are special groupings for certain sectors including techMARK (an international market for innovative technology companies), techMARK Mediscience (for healthcare companies), and landMARK (for U.K. regional companies). *See* London Stock Exchange website, *at* http://www.londonstockexchange.com (last visited Feb. 12, 2004).

57. The Alternative Investment Market (AIM) is a market for growing companies and has only been around since 1995. *See* London Stock Exchange website, *at* http://www.londonstockexchange.com (last visited Feb. 12, 2004).

58. Despite the fact that about 85% of the 2,700 companies listed on the Exchange are U.K. companies, approximately 61% of the LSE's equity market value derives from international companies. This is most likely because the foreign companies which choose to trade on the LSE are comparably large. *See* London Stock Exchange website, *at* http://www.londonstockexchange.com (last visited Feb. 12, 2004).

59. As of the time of publication, the exchange rate is £1 to $1.86 (Feb. 9, 2004).

60. Cheffins & Thomas, *supra* note 3, at 297.

There are four corporate governance codes in the U.K., which act as "self-regulatory controls and [are] enforceable only through shareholder pressure and the Stock Exchange Listing Rules."[61] The Cadbury Code, issued in 1992, was the first such code promulgated in the U.K.[62] The Code recognized the importance of corporate governance to the U.K.'s competitive economy[63] and recommended a "Code of Best Practice,"[64] which focused mainly on "openness, integrity and accountability."[65] This Code of Best Practice included nineteen recommendations relating to the board of directors, non-executive directors, executive directors, and auditors.[66] For purposes of remuneration, it is important to note that the Cadbury Report suggested that shareholders be given a vote on directors' service contracts and that there be full and clear disclosure of the salaries of directors and executives.[67] In addition, the Cadbury Code recommended that publicly listed corporations have remuneration committees comprised of non-executive directors.[68]

In 1995, a second code, named the Greenbury Code, was issued by the Greenbury Committee, focusing solely on managerial remuneration.[69] The Code focused on increased disclosure of compensation, especially in annual reports to shareholders.[70] Similar to the preceding Cadbury Code, the Greenbury Code also suggested that remuneration committees for publicly listed

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61. Jacqueline Cook & Simon Deakin, *Empirical Evidence on Corporate Control*, *in* LITERATURE SURVEY ON FACTUAL, EMPIRICAL AND LEGAL ISSUES ch. 10, at 1 (1999).

62. Committee on the Financial Aspects of Corporate Governance (chaired by Sir Adrian Cadbury), REPORT (1992) [hereinafter Cadbury Code].

63. *Id.* at para. 1.1.

64. *Id.* at paras. 3.1–3.16.

65. *Id.* at para. 3.2.

66. *Id.* at paras. 3.1–3.16.

67. *Id.* at para. 4.40.

68. *Id.* at para. 4.42.

69. DIRECTORS' REMUNERATION: REPORT OF A STUDY GROUP CHAIRED BY SIR RICHARD GREENBURY (1995) [hereinafter GREENBURY REPORT]. "The Greenbury Committee was set up on the initiative of the Confederation of British Industry in reaction to controversies surrounding increases in managerial remuneration, especially in privatized utilities, and in an attempt to pre-empt government action to deal with executive pay." Cook & Deakin, *supra* note 61, at ch. 10, at 1.

70. GREENBURY REPORT, *supra* note 69, at B1–B12.

corporations consist of non-executive directors.[71] It went further to suggest that shareholders should have direct access to the chairman of the company's remuneration committee at the annual meeting.[72]

In 1998, the Hampel Report was published, restating, many of the same corporate governance concerns.[73] The Report stressed the end of the "box ticking" approach to corporate governance[74] — the drafters of the Report did not want U.K. companies to merely look down a list of good corporate governance practices and check them off as they accomplished them. In other words, the Report aimed for corporate governance as a means (to a competitive international economy in the U.K.), not as an end in itself.[75] The Report developed a set of principles, as opposed to the guidelines which the preceding codes had delineated.[76] According to Hampel, the single overriding objective of all listed companies should be to enhance shareholder wealth. The Report, however, was met with a mixed reaction since it left open many questions, such as "What is a principle, and what is a rule?" and "What will companies have to comply with?"[77]

The Combined Code, which followed the Hampel Report and is known as the Code of Codes, is essentially a combination of all three voluntary codes.[78] It adopted the principles set out in the Hampel Report and covered all issues of corporate governance including, board issues, remuneration, the role of the

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71. *Id.* at A1, A4.

72. *Id.* at A8.

73. COMMITTEE ON CORPORATE GOVERNANCE, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (London, Gee Publishing, 1998) [hereinafter HAMPEL REPORT].

74. The "box-ticking" approach refers to a corporate practice by which "shareholders are only interested in whether the letter of the rule ha[s] been complied with." *See* HAMPEL REPORT, *supra* note 73, at paras. 1.11–1.14. *See also Unpacking Hampel, The Committee's Preliminary Report*, INTELLIGENCE (July/Aug. 1997).

75. HAMPEL REPORT, *supra* note 73, at para. 1.21.

76. *Id.* at paras. 2.1-2.2.

77. *See Unpacking Hampel*, *supra* note 74 (also stating that "one auditor told the Financial Times, 'it's all pretty confusing.'").

78. The Combined Code is included in the appendix to the Listing Rules, which are administered by the U.K. Financial Services Authority in its capacity as the U.K. Listing Authority ("UKLA"). *See* Financial Services Authority, Listing Rules, § 1, paras. B1–B3, Schedules A, B (June 1998).

shareholders, financial reporting, auditing and transparency. The Combined Code is unique among its predecessors, whereas the other codes were voluntary, it is made mandatory to publicly listed companies by Rule 12.43A of the Listing Rules for the LSE. Although it technically has the force of law, a company may choose not to comply with the Combined Code, which is conditioned on the company explaining the reasons for its noncompliance — often called "comply or explain." Unfortunately, "in many cases the companies' explanations for non-compliance are either weak or non-existent."[79] In addition, "while compliance has improved [since the Code was promulgated], only around one in three listed companies (34%) fully complies with the existing Combined Code." [80] Therefore, despite the fact that the Combined Code leads to greater transparency of corporate governance practices, it loses some of its "bite" since a company still has a choice not to comply as long as it justifies its reasons.[81] Recently, the Code was amended to incorporate recommendations regarding non-executive directors and audit committees.[82]

In January 2003, a report entitled "Review of the Role and Effectiveness of Non-Executive Directors" was published by a committee led by Derek Higgs.[83] This report is more widely known as the Higgs Review or the Higgs Report. The review focused on issues such as the role of non-executive directors, attracting and recruiting non-executive directors, the ways in which the effective performance of non-executive directors could be enhanced and the relationship between shareholders and

79. PIRC, *supra* note 37.

80. *Id.*

81. Financial Services Authority, Listing Rules, pmbl., paras. 3–5 (June 1998).

82. The new Combined Code was published by the Financial Reporting Council on July 23, 2003.

83. *See* Higgs Report, *supra* note 35. It should be noted that on the same day, the Smith Report was also published, which clarified and expanded the roles and responsibilities of audit committees. Clearly, the Smith Report was a "response to issues raised by the major corporate failures in 2002." Michael Hammill, *Corporate Governance — Proposed Changes in the U.K.*, INT'L COMPANY & COMM. L. REV., 2003, 14(9), N102-104, at N102 (also summarizing the main key recommendations of the Smith Report). While noteworthy, the Smith Report is beyond the scope of this Note.

non-executive directors.[84] The report made proposals with regard to each of these topics, including a proposal that quoted company boards should be comprised of a majority of non-executive directors and only these non-executive directors should comprise the remuneration board.[85] In general, the report "envisages a more demanding and important role for non-executive directors."[86] Higgs was generally met with favorable reviews, which included an endorsement from Patricia Hewitt, Secretary of State of the U.K. Department of Trade and Industry (hereinafter "DTI").[87] The Higgs Report was incorporated into the amended Combined Code in July 2003.[88]

Indeed, the DTI has been very active in making recommendations to the U.K. government regarding directors' remuneration. The DTI has published three consultative documents and has made many noteworthy proposals to the U.K. government to enhance corporate governance in the area of executive pay.[89]

In July 1999, the DTI published its first consultative document on the topic of directors' remuneration.[90] In its foreword, the Secretary of State for Trade and Industry noted the importance of British companies offering remuneration packages that attracted the "best executives to run their businesses" while simultaneously linking pay to performance.[91] This document focused principally on the following issues: 1) the independence and effectiveness of the board's remuneration committee; 2) the way in which rewards are linked to performance to encourage enhanced performance by directors; 3) companies' reporting to

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84. *See* Higgs Report, *supra* note 35, at 5–10 (Summary of Recommendations).

85. *Id.*

86. Hammill, *supra* note 83, at N102 (summing up the main key recommendations of the Higgs Report).

87. Press Release, DTI and Her Majesty's Treasury, Government Welcomes Reports on the Role and Effectiveness of Non-Executive Directors and on Audit Committees (Jan. 20, 2003), *available at* http://www.dti.gov.uk. *But see* Alistair Alcock, *Higgs — The Wrong Answer*, COMP. L. 24(6), 161 (2003) (arguing that the Higgs proposals will lead to increased domination of the CEO).

88. Alcock, *supra* note 87, at 161.

89. *See infra* notes 90–102 and accompanying text.

90. *See* DTI CONSULTATIVE DOCUMENT, DIRECTORS' REMUNERATION (July 1999).

91. *See id.* at Foreword.

shareholders of their general policy on executive remuneration, particularly with regard to linkage to performance; 4) compensation payments to directors on loss of office; and 5) the board's accountability to shareholders on remuneration policy.[92] DTI recommended that all quoted companies should have a remuneration committee composed of independent non-executive directors, that executive pay should be linked to performance, and that the disclosure for individual directors' remuneration should be simplified for easier comprehension.[93] In addition, the DTI recommended strengthening the disclosure provisions on service contracts and compensation arrangements improving accountability by requiring quoted companies to ask shareholders to vote on the board's remuneration every year, as well as voting on its remuneration policy.[94] Other proposals included requiring directors of quoted companies and the chairman of the remuneration committee to stand for election or re-election every year and for the creation of special procedures by which shareholders could move a remuneration resolution at the AGM.[95]

In December 2001, the DTI published its second consultative document on executive pay.[96] This document recommended that companies: (1) publish a report on directors' remuneration as part of the company's annual reporting cycle; (2) disclose within the report details of individual directors' remuneration packages, remuneration policy, the remuneration committee, the policy on the duration of directors' contracts, and the payments made upon severance; (3) display a line graph showing company performance; and (4) put an annual resolution to shareholders on the remuneration report.[97]

In June 2003, the DTI published a third consultative document on directors' remuneration, entitled "'Rewards for Failure'

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92. *See id.* at ch. 1, para. 1.2.

93. *See id.*

94. *See id.* at paras. 5.10–5.11, 6.12–6.13.

95. *See id.* at paras. 7.17–7.23.

96. *See generally* DTI, CONSULTATIVE DOCUMENT, DIRECTORS' REMUNERATION (Dec. 2001).

97. *Id.* at para. 1.1. This proposal became law when the U.K. Parliament passed an amendment to the U.K. Companies Act, which went into effect on August 1, 2002. *See* Directors' Remuneration Report Regulations, (2002) SI 2002/1986, §§ 3, 7–9.

Directors' Remuneration — Contracts, Performance and Severance" which focused mainly on severance payments to directors.[98] Patricia Hewitt, the Secretary of State for Trade and Industry, stated in the foreword to this document that the "increase in the level of shareholder activism on the issue of directors' remuneration…is very much a result of the new requirements on disclosure and a shareholder vote which the Government has introduced."[99] Despite progress, DTI recognized that further reforms were necessary. For example, they made the following suggestions: (1) amending the Companies Act of 1985 to require compensation payments to be fair and reasonable[100] and (2) amending section 319 of the Companies Act of 1985 to reduce the statutory contract period.[101] The U.K. government should soon be responding to this latest consultative document by announcing how it proposes to proceed.[102]

98. *See* DTI, CONSULTATIVE DOCUMENT, "REWARDS FOR FAILURE" DIRECTORS' REMUNERATION – CONTRACTS, PERFORMANCE AND SEVERANCE (June 2003), *available at* http://www.dti.gov.uk/cld/published.htm [hereinafter REWARDS FOR FAILURE].

99. *Id.*

100. A bill entitled "Company Directors' Performance and Compensation," published on December 11, 2002 and now withdrawn, was introduced by Archie Norman in Parliament and suggested the insertion of a new section 316A into the Companies Act of 1985. This new section would require that upon a director's termination from office or employment, the amount of compensation paid to such director should be "fair and reasonable having regard to any failure by the director in the performance of his duties either in his office as director or as an employee or both." The full text of the bill is available at http://www.publications.parliament.uk/pa/cm200203/cmbills/022/2003022.htm. For a brief discussion of the proposed bill, entitled the "Company Directors' Performance and Compensation Bill," see Mike Woodley, *Big Rewards for Big Failures*, COMPANY L. 2003, 24(8), 247–48 (2003).

101. Currently, § 319 allows companies to enter into contracts with executives in excess of five years if shareholders give their approval. *See* Companies Act 1985, § 319. The DTI proposes lessening this five year period to three years. *See* REWARDS FOR FAILURE, *supra* note 98, at paras. 3.16–3.20.

102. The consultation period, during which commentary on the report is received, closed on September 30, 2003. The next step is for the U.K. government to publish a summary of the responses and announce its own actions. *See* Hammill, *supra* note 83, at N122. Hammill has noted that "[c]ommentaries on the Consultative Document and responses published to date show a polarization of opinions." *Id.*

III. IS EXECUTIVE COMPENSATION EXCESSIVE?

Before embarking on a discussion regarding how shareholders can "fix" the problem of excessive executive compensation, the question must first be asked: Are executives being paid too much?[103]

There are two classes of people arguing the issue of executive compensation: those who believe that executive compensation is excessive and those who do not.[104] Those who believe that executives are overpaid argue that there is little relationship between executive compensation and executive performance.[105] Indeed, "pay for performance" has caustically been referred to as "pay-for-attendance."[106] This group argues that the substantial pay differential between executives and rank and file employees (especially in the U.S.) is a justification for lowering executive compensation.[107] Indeed, the pay differential between executives and rank and file employees is spiraling out of control.[108] For example, in 1980, executives in the U.S. earned approximately 40 times that of the average production worker.[109] This figure rose to 85 in 1990, and today it is approximated that executives earn about 400 times more than the average production workers.[110] Recently, the chairman of the Catholic Funds, a

103. Mark J. Loewenstein, *The Conundrum of Executive Compensation*, 35 WAKE FOREST L. REV. 1, 4 (2000) ("No serious consideration of solutions to the 'problem' of executive compensation should proceed before determining whether, in fact, CEOs are overpaid.").

104. *Id.* at 2.

105. *Id*. For example, executives of utility companies in the U.K., that were privatized under Margaret Thatcher's Conservative Government, were awarded substantial increases in pay despite the fact that profits were a result of "privileged access to markets" and not executive performance. Cheffins & Thomas, *supra* note 3, at 279.

106. Useem, *supra* note 9, at 59 (quoting Matt Ward, an independent pay consultant).

107. Susan J. Stabile, *My Executive Makes More than Your Executive: Rationalizing Executive Pay in a Global Economy*, 14 N.Y. INT'L L. REV. 63, 64–65 (2001) [hereinafter *My Executive Makes More than Your Executive*].

108. *See* Gretchen Morgensen*, Explaining (or Not) Why the Boss is Paid So Much*, N. Y. TIMES, Jan. 25, 2004, sec. 3 at 1.

109. *Where's the Stick? Carrots, Sticks and Bosses' Pay,* ECONOMIST, Oct. 11, 2003, at 13.

110. *Id.* A study conducted in 2000 by Towers Perrin found that the pay differential between CEOs and lower-level employees was closer to 531 to 1.

$30 million fund company in Milwaukee, submitted a proposal to seven companies which would limit CEO pay to a figure that is 100 times that of the average worker.[111] As of 2000, in the U.K., it was estimated that executives earned only twenty-five times more[112] than rank and file employees.[113] "According to a recent Incomes Data Services report, the total earnings of FTSE 100 chief executives rose 89% in the five years [leading up] to 2001, while full-time employees received a 28.7% rise."[114]

Those who argue that executive pay is not excessive suggest that a "free market fixes compensation."[115] In other words, this group believes that executive compensation can be rationalized due to the combination of a "large pool of potential executives," "companies bidding for their services," and a "wealth of information available about compensation."[116] Others argue that it would be too difficult to link executive pay to performance because the company cannot "distinguish between those achievements stemming from the CEO's contribution versus those that are a result of favorable economic conditions or other factors."[117] In the same vein, it is too difficult to link the success or failure

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Morgensen*, Explaining (or Not) Why the Boss is Paid So Much, supra* note 108, at sec. 3 at 1.

111. *See* Morgensen*, Explaining (or Not) Why the Boss is Paid So Much, supra* note 108, at sec. 3 at 1. The seven companies included Cendant, Compuware, Delta Air Lines, the El Paso Corporation, International Paper, Sun Microsystems, and Viacom. The SEC must determine whether the proposal will be allowed to be included in the companies' proxy materials. *Id.*

112. Another study has stated that the pay differential in the U.K. is closer to 20 to one. *See* Cheffins & Thomas, *supra* note 3, at 279.

113. *See* Morgensen*, Explaining (or Not) Why the Boss is Paid So Much, supra* note 108, at sec. 3 at 1. The study was conducted by Towers Perrin in 2000. It also found that in Brazil the pay gap is 57 to 1; in Mexico it is 45 to 1; in Canada it is 21 to 1; in France it is 16 to 1; in Germany, it is 11 to 1; and in Japan, it is approximately 10 to 1. *Id.*

114. Julia Finch & Jill Treanor, *Executive Pay Leaps Ahead 17%*, GUARDIAN, Oct. 4, 2002, *available at* http://www.guardian.co.uk/executivepay/story/0,1204,804389,00.html.

115. Loewenstein, *supra* note 103, at 2.

116. *Id. Cf.* Joshua A. Kreinberg, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 DUKE L.J. 138 (1995) (arguing that the pay-for-performance method of compensation is inadequate to address the concerns of excessive compensation and that the courts should focus on equity ownership as a solution).

117. *See* Morgensen*, Explaining (or Not) Why the Boss is Paid So Much, supra* note 108, at sec. 3 at 1.

of a corporation to the performance of one individual.[118] Some among this group believe that executive compensation is not a matter for public debate — it is simply "a matter for the company and shareholders."[119] Indeed, "by and large, [even] governments are reluctant to intervene in the private matter of employment contracts."[120] Yet, there is substantial commentary and evidence finding that the market for executives is simply inefficient.[121] This has come to be known as the Lake Woebegon effect — taking its title from the novel by Garrison Keillor entitled "Lake Woebegon Days," wherein all of the children in Lake Woebegon are "above average."[122] A market has developed for corporate executives in which all executives are considered "above average" and, consequently are paid at "above average" prices — thus causing "bosses' pay to spiral[] upwards."[123] CEO pay has ratcheted upward because "[n]o [executive] selection committee wants to award their new [executive] less than the industry average."[124] Others have referred to the free-market system for corporate executives as "the Golden Rule gone wrong, CEOs do unto others as they would have [the executives] do unto them."[125] Further adding to the Lake Woebegon effect is the globalization of the market for executives.[126] With the market for executives becoming increasingly global (in 2002, a study found that 10% of CEOs on the FTSE 100 were non-

118. *Id.*

119. Saleem Sheikh, *The Greenbury Report: Fond Hope, Faint Promise*, 10 (11) J. INT'L BUS. L. 471 (1995).

120. *Fat Cats Feeding*, *supra* note 10, at 64.

121. *See Bosses for Sale*, ECONOMIST, Oct. 5, 2002, at 57 (suggesting that the market for executives is secretive, restricted, bad at price-settings and generally run by the head hunter firms). *See also Where's the Stick?, supra* note 109, at 13; Useem, *supra* note 9, at 58.

122. Where's the Stick?, *supra* note 109, at 13.

123. *Id.*

124. *Fat Cats Feeding*, *supra* note 10, at 66.

125. Useem, *supra* note 9, at 64 (quoting Harvard Business School Professor Rakesh Khurana).

126. Therese Raphael, *Hunting Fat Cats, Shooting Wild*, WALL ST. J. (Europe), June 26, 2002, at A9 (stating that the global market for executives has increased executive pay in the U.K.). *See also* Evelina Shmukler, *HBOS Girds to Approve Executive-Pay Schemes*, WALL ST. J. (Europe), May 14, 2002, at M6 (stating that since the market for executives is international, U.K. banks must increase salaries to attract executive talent and "keep up with the compensation offered across the ocean").

British),[127] countries must increase salaries in order to attract talented executives.[128]

There are also those that agree that compensation is substantial, but find that it is justified by a variety of factors. For example, some argue that, empirically speaking, "[m]uch of the increase in CEO pay is directly attributable to the increase in stock prices over the past two decades, as the portion of CEO pay in stock options has risen dramatically in the past several years."[129] Moreover, this group justifies the substantial pay differentials between executives and rank and file employees by arguing that the figures should not be taken at face value.

Perhaps the U.S.' pay differential is not as bad as it appears at first glance.[130] For example, "certain valuable and traditional components of an American compensation package take the form of benefits that are governmentally provided in other countries."[131] In addition, since tax rates in many other countries are higher than in the U.S., executives in other countries may receive a "significant amount of nontaxable compensation, far in excess of the types of fringe benefits most American executives are accustomed to receiving."[132] Lastly, they argue that CEOs in the U.S. actually have a more substantial job description, and thus have a "high level of responsibility and direct

127. Raphael, *supra* note 126, at A9.

128. *Id. See also* Shmukler, *supra* note 126, at M6. *But see* Nick Isles, *Life at the Top: The Labour Market for FTSE-250 Chief Executives*, The Work Foundation, *available at* http://www.theworkfoundation.com/pdf/Life_atthe_Top.pdf (last visited Feb. 4, 1004) (arguing that "the FTSE-250 market is very home-grown…[and] [c]ompanies are behaving rationally by grooming talented members of staff to take over the top job when it becomes available.").

129. Loewenstein, *supra* note 103, at 4–5.

130. *Id.* at 5 ("Had the stock market declined over this period [of the past two decades], the change in the differential between CEO and average worker compensation would look quite different, as the average worker is not paid in stock options."). Others argue that U.S. culture is simply more accepting of greater pay differentials than other countries. *See* Norma Cohen, *Britain Points Up Cultural Divide*, FIN. TIMES, May 5, 2003, at 9 (quoting Stuart Bell, research director at PIRC: "The main difference is that U.S. society is more encouraging of, and tolerant of, a high-earning culture.").

131. *My Executive Makes More than Your Executive, supra* note 107, at 66.

132. *Id.* at 65. For example, "[g]enerous housing allowances are not uncommon and it is not unheard of for bonuses to be paid outside of the executive's country to avoid the imposition of income tax." *Id.* at 65–66. In Germany, a company may pay its executives a "second salary in a tax haven, which is not reported." Loewenstein, *supra* note 103, at 66–67.

involvement in managing the corporation."[133] Indeed, although CEO compensation in the U.S. has risen faster than that of the average employee, it "has risen much slower than the pay of professional athletes."[134]

Still, when comparing the U.S. and the U.K., the empirical data is undeniable: CEOs in the U.S. earn 45% higher cash compensation and 190% higher total compensation.[135] One study found that salary levels for U.S. CEOs can be up to ten times higher than their U.K. counterparts.[136] For example, Disney's CEO, Michael Eisner, nicknamed the "Prince of Pay,"[137] exercised options in 1997 that were worth more than the aggregate salaries of the top 500 CEOs in the U.K.[138] More recently, when Eisner failed to meet the requirements that would entitle him to a bonus two years in a row, "his board lowered the performance bar" so he could receive a bonus.[139] In fact, Britain's highest-paid executive in 1999,[140] Sam Chisolm (of British Sky Broadcasting), "would only [have] rank[ed] as the 97th highest among U.S. chief executives."[141] Mark Swartz, former Chief Fi-

133. *My Executive Makes More than Your Executive*, *supra* note 107, at 66–67.

134. Loewenstein, *supra* note 103, at 5 ("During the period 1980-95, the pay of the average worker increased 60%, that of CEOs 380%, National Basketball Association players 640%, National Football League players 800%, and Major League Baseball players 1000%.").

135. Martin J. Conyon & Kevin J. Murphy, *The Prince and the Pauper? CEO Pay in the U.S. and U.K.*, 110 ECON. J. F640, F641 (2000). *But see* Graef Crystal, *U.K. CEO Pay has Nothing to Do with Performance*, BLOOMBERG NEWS, Oct. 15, 2002 (stating that "[c]hief executive officers' pay in the U.K. defies reason even more than it does in the U.S.") (on file with author).

136. Isles, *supra* note 128.

137. Bloomberg columnist and long time pay-critic Graef Crystal gave Eisner this title in 1991. *See* Conyon & Murphy, *supra* note 135, at F640.

138. *Id.*

139. Useem, *supra* note 9, at 59.

140. In 2002, Bart Becht, Chief Executive of Reckitt Benckiser, an Anglo-Dutch household products conglomerate, was the highest paid executive in the U.K., earning £9million — approximately $14 million (which includes £5.7 million — about $10.4 million — in stock options). Richard Wray, *Low Profile of Highest Paid Boss,* GUARDIAN, Oct. 4, 2002.

141. Conyon & Murphy, *supra* note 135, at F640–41. Since U.S. companies are larger, more successful, or in faster growing industries, the empirical study accounted and controlled for firm size, industry, growth opportunities, and CEO's individual skills and abilities. *Id.* The current CEO of BSkyB, Tony Ball, earned £7.8 million in 2001 even though the company performed

nancial Officer of Tyco, won the prize for top-paid executive at an S&P 500 company in 2002 — "pull[ing] in a whopping $136 million."[142] Swartz's cohort, Dennis Kozlowski, former CEO of Tyco, was the second-highest-paid executive with $82 million.[143] In fact, a study by Equilar, an independent provider of compensation data, found that the median compensation of CEOs of the 100 largest companies in the U.S. rose 14% in 2002, while the Standard & Poor's 500 plunged 22.1% that same year.[144] Undoubtedly, the recent scandal over the $140 million lump-sum cash payments given to Richard Grasso, chairman of the New York Stock Exchange ("NYSE"), which were in addition to his base salary of $1.4 million and bonus of at least $1 million, sparked the most controversy of all U.S. compensation payouts in 2003.[145] Part of the outcry related to the fact that the NYSE is not a publicly traded entity and, as the world's largest stock exchange, serves as a "quasi-public institution with an important regulatory function."[146] Accordingly, these payments were "more in line with what chief executives of public corporations are paid and are far above the pay of top officials at the Securities and Exchange Commission, NASD and even Nasdaq, a primary competitor to the Big Board."[147] Under a cacophony of calls for resignation from the NYSE, institutional investors, and even politicians, Grasso resigned from the NYSE in September 2003.[148]

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extremely poorly that year. *See* Finch & Treanor, *Executive Pay Leaps Ahead 17%, supra* note 114.

142. Useem, *supra* note 9, at 57.

143. *Id.*

144. *Id.* at 58. The study also found that average CEO compensation dropped by 23% in 2002, but Fortune magazine attributed this decline to the significant pay decrease of a few "mega-earners." *Id.*

145. Landon Thomas, Jr., *Big Board Chief Will Get a $140 Million Package*, N.Y. TIMES, Aug. 28, 2003, at C1; Landon Thomas, Jr., *A Pay Package That Fat Cats Call Excessive*, N.Y. TIMES, Aug. 29, 2003, at C1; Susanne Craig & Kate Kelly, *Large Investors Call for Grasso to Leave NYSE*, WALL ST. J., Sept. 17, 2003, at C1.

146. Thomas, *supra* note 122, at C6.

147. *Id.*

148. Kate Kelly & Susanne Craig, *Grasso, Who Wanted to be a Cop, In the End Showed that he Knew When It Was Time to Surrender*, WALL ST. J., Sept. 18, 2003, at C1.

This is not to suggest, however, that executive remuneration in the U.K. is not excessive.[149] In fact, one study reported that "[f]rom 1993 to 2002, the median salary of the highest paid director in FTSE 100 companies rose 92% from £301,000 to £579,000."[150] In addition, "[t]he maximum level of annual bonuses [] significantly increased" — in 1999, annual bonuses were the equivalent of 40-60% of an executive's salary, while in 2000, they were the equivalent of 100% or more.[151] The study also found "[a] similarly inflationary trend…for share-based incentive schemes."[152] "A recent poll in Britain found that 80% of people believe that top directors are overpaid."[153] Comparatively, "British executives earn more than their European counterparts on average, but less than Americans."[154] Indeed, "the U.K. is second only to the U.S. in terms of the global league for CEO pay."[155] Unfortunately, these pay standards are on the rise.[156]

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149. *See British Solutions to 'Fat Cat' Pay,* PAY FOR PERFORMANCE REPORT, Oct. 1, 2001, *available at* www.ioma.com/mr/uploads/pfp2_smp.pdf ("Although executive compensation in the U.K. takes different forms from that in the U.S., 'the politically charged issue of boardroom pay continues to hit the headlines'….") (citation omitted). *See, e.g.,* Kreinberg, *supra* note 116, at 139 (suggesting that the collapse of Barings PLC, a 233-year-old British banking institution, may have been caused by Barings' excessive incentive compensation plan, which "led to the payment of 50% of gross earnings in the form of bonuses").

150. Press Release, PIRC, PIRC Highlights Huge Increase In Potential And Real Directors' Remuneration In Trade & Industry Committee Evidence (July 1, 2003), *available at* http://www.pirc.co.uk/trade%20&%20industry%20ctte.pdf.

151. *Id.*

152. *Id.*

153. *Where's the Stick?*, *supra* note 109, at 13.

154. Raphael, *supra* note 104, at A9.

155. Isles, *supra* note 128.

156. Raphael, *supra* note 104, at A9. Raphael attributes the rise of salaries of British executives to the globalization of British companies and the fact that the market for executives has become more global. She states that 10% of CEOs on the FTSE 100 are non-British, compared to 2% a decade ago. She also states that greater transparency "has made CEOs more aware of what their peers are earning." *Id.* *See also* Crystal, *supra* note 136 (stating that "CEO pay in the U.K., which seriously lagged behind the pay of American CEOs for years, is on its way to catching up" and finding that the gap between pay in the two countries has narrowed from U.S. CEOs earning 3.2 times that of U.K. counterparts in 1993, to only 1.1 times in 2002).

Regardless, these extravagant executive salaries have not gone unnoticed by shareholders in the U.K. For example, shareholders of Vodafone were quite vocal when Vodafone "proposed making a £10 million[157] 'one-off' bonus payment to the chief executive [Christopher Gent] who had orchestrated acquisitions that resulted in the company becoming the world's largest mobile telephone concern."[158] Despite heavy criticism following these events in 2000, Gent only recently volunteered to step down as chief executive.[159] Termination contracts, to reward executives leaving a corporation, are also a problem in the U.K. These "golden goodbyes"[160] have caught the eye, and voice, of shareholders. For example, when Ken Berry, music industry veteran, was paid £6.1 million (approximately $11.2 million U.S. dollars) last year upon leaving the corporation, shareholders were outraged and, subsequently, there was "a redesign of the company's pay structure."[161] The DTI's third consultative document, published in June 2003, focused specifically on severance packages of executives and made recommendations to

157. This is the equivalent of approximately $18.6 million U.S. dollars (as of February 9, 2004).

158. Cheffins & Thomas, *supra* note 3, at 281. Oliver Burkeman, *You'd be Smiling Too,* GUARDIAN, Dec. 15, 2003, *available at* http://www.guardian.co.uk/mobile/article/0,2763,1107234,00.html (describing how Gent was rewarded with a £10 million "transaction bonus," in addition to his £1.2 million salary after negotiating the takeover of Mannesmann, a German telecom giant, which shareholders felt was "obscenely overvalued."). In 2000, Gent was paid nearly £6 million, despite the fact that shareholders lost nearly 20%. John Duckers, *Time to Stop These Fat-Cats Running Away With Cream*, BIRMINGHAM POST, Sept. 11, 2001, at 26. After criticism from institutional investors and several publications, Gent "was persuaded to take half the sum in shares." *See* Burkeman, *You'd be Smiling Too, supra* note 158.

159. Burkeman, *You'd be Smiling Too, supra* note 158. Notably, however, on June 19, 2002, Vodafone issued a press release stating that it had engaged in extensive consultation over its new remuneration policy with shareholder groups.

160. *See* Jill Treanor, *Multimillion Deals Give a Golden Goodbye to Ousted Executives,* GUARDIAN, Oct. 4, 2002 (Seven directors in the U.K. were given more than £1million to leave their executive positions in 2001).

161. *See id*. Mr. Berry had made his reputation by signing the Spice Girls, but then lost it after signing Mariah Carey to a contract for an album that flopped. As a result of Berry's poor judgment, EMI paid almost £38 million to terminate the contract with Mariah Carey. *Id.* *See also* Finch & Treanor, *Executive Pay Leaps Ahead 17%, supra* note 114.

the U.K. government.[162] Regardless of whether the company is located in the U.S. or the U.K., there is guaranteed to be lively debate and outright criticism regarding the sometimes outrageous compensation paid to executives.

IV. SETTING EXECUTIVE COMPENSATION AND DISCLOSURE RULES

Aside from the issue of *whether* CEOs are being paid too much, there is also the issue of *why* CEOs are being so well compensated.[163] This question is intertwined with yet another question: *Who* sets remuneration figures and policies, and how much do they have to *disclose* about such issues?

In fact, in public companies in the U.S. and the U.K. "executive pay is set in much the same way."[164] In both countries, the board is empowered not only to appoint executives, but also to set their compensation. However, "the prevailing orthodoxy is that directors of a publicly quoted company should delegate decisions concerning executive pay to a remuneration or 'compensation' committee made up of outside directors."[165] Ironically enough, both countries are concerned that the "outside directors" are not truly "outside" and are thus influenced in their decision-making by the directors who appointed them.

A. *By what methods or financial instruments are executives paid?*

Beside the difference in the *amount* of executive payment between the U.S. and the U.K., there is also a difference in the *manner* of payment. Executive compensation can take the form of annual salary, bonuses, share/stock options, and long-term incentive plans (LTIPs).[166] In fact, both U.S. and U.K. execu-

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162. *See generally* DTI, Consultative Document, Directors' Remuneration (Dec. 2001).

163. *See* Loewenstein, *supra* note 103, at 4 ("Overlaying all of these arguments [that CEOs are paid excessively] is the structural argument — corporate boards are 'captured' by the CEO and thus incapable of bargaining with the CEO.").

164. Cheffins & Thomas, *supra* note 3, at 298.

165. *Id.*

166. In the U.K., LTIPs are usually grants of shares of stock that become vested (ownership is transferred) upon attainment of specified performance objectives by the executive. In the U.S., LTIPs take the form of either (1) "'re-

tives are paid through a combination of these financial instruments.[167] However, the percentage of each that comprises the executive's overall salary differs from one to the other.

In the U.S., an executive's annual base salary comprises approximately 18% of his total compensation; whereas, in the U.K., an executive's annual base salary is closer to 40%.[168] On average, stock options comprise 61% of executive compensation in the U.S.,[169] whereas they compromise only 45% payment of executive compensation in the U.K.[170] Thus, U.S. corporate executives rely less on salary and more on stock options; whereas, U.K. executives rely more on fixed salary.[171] However restricted stock, is becoming more popular as a form of executive pay in the U.S.[172]

Both U.S. and U.K. executives are paid annual bonuses, as well. In a 2000 study, it was found that 17% of U.S. executives compensation was in the form of an annual bonus; whereas, in the U.K., approximately 18% of executives compensation is through an annual bonus.[173] Although these percentages are close, in the U.K. an increasing amount of executive compensation is being paid as bonuses.[174] Generally speaking, however, U.S. executives are awarded annual bonuses that are approximately three times more than their U.K. counterparts.[175]

It is important to note that the manner of payment can affect the link between executive pay and share performance.[176] It

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stricted stock' grants that vest with the passage of time" (and are unrelated to pre-stated performance objectives), or (2) multi-year bonus plans, which are usually based on "rolling-average three or five-year cumulative accounting performance." Conyon & Murphy, *supra* note 135, at F644.

167. *Id.*

168. Wade Lambert, *Shared Pain: Teaching a Lesson in Entrepreneurship Costs One CEO Dearly – Forgoing Salary for Stock Doesn't Pay for International Power's Peter Giller,* WALL ST. J. (Europe), June 12, 2002, at A1.

169. *Id.*

170. *Id.*

171. *Id.*

172. Hill & Daniel, *supra* note 9, at 9.

173. Conyon & Murphy, *supra* note 135, at F640–41.

174. Isles, *supra* note 128 (citing statistics that five years ago, the upper limit for annual bonuses was 40% to 60% of an executive's base salary, but by 2003 that upper limit rose to 100% of base salary).

175. *See* Conyon & Murphy, *supra* note 135, at F648.

176. Susan J. Stabile, *Viewing Corporate Executive Compensation Through a Partnership Lens: A Tool to Focus Reform*, 35 WAKE FOREST L. REV. 153,

would seem that CEOs with a greater percentage of their total pay in the form of stock options would have a greater incentive to increase the price of those shares. However, the grant of large stock options can have one of two results: it will either make the CEO work harder to increase the value of the company and its shares, or it will give the CEO incentive to manipulate the stock price (because of his or her own stake in the price of the shares).[177]

B. The Law Regarding Setting Executive Compensation in the U.S.

In a U.S. corporation, the articles of incorporation empower the board of directors to appoint executives.[178] In addition, the board of directors is generally responsible for setting executive compensation.[179] In most publicly-listed U.S. corporations, however, the board of directors delegates the job of determining compensation to a compensation committee.[180] The corporation's human resources department submits pay proposals for compensation committee considerations, with the help of an independent, outside compensation consultant.[181] The compensation committee will then make a recommendation to the board of executives, which routinely approves such recommendations

202–20 (2000) [hereinafter *Vieweing Corporate Executive Compensation Through a Partnership Lens*].

177. The details of such arguments are beyond the scope of this Note, but it should be noted that both consequences exist. *Id.*

178. *See* DOUGLAS M. BRANSON, *supra* note 24, §1.01, at 1–2; VARALLO & DREISBACH, *supra* note 23, at 14–15.

179. *Viewing Corporate Executive Compensation Through a Partnership Lens*, *supra* note 176, at 187.

180. Randall S. Thomas & Kenneth J. Martin, *The Effect of Shareholder Proposals on Executive Compensation*, 67 U. CIN. L. REV. 1021, 1026 (1999).

181. *Id.* at 1026–27. "Most of these experts come from a handful of well-known consulting firms specializing in executive compensation matters, many of which provide a wide variety of other consulting services to the company." *Id.* This practice of hiring a high-paid compensation consultant has been criticized by Warren Buffet, the chairman of Berkshire Hathaway and an outspoken proponent of strong corporate governance. Buffett has stated that "when the compensation committee — armed as always with support from a high-paid consultant — reports on a mega-grant of options to the CEO, it would be like belching at the dinner table for a director to suggest that the committee reconsider." *Fat Cats Feeding*, *supra* note 10, at 64 (quoting Warren Buffett).

"without much inquiry."[182] It is important to note that "[s]hareholders have no direct input in this process…They can voice their opinions to the board of directors in a variety of ways before and after the package is approved, but this only indirectly affects the outcome of the process."[183]

Disclosure is one aspect of U.S. corporate governance law that has a profound effect on compensation policies since "there is reason to believe that disclosure might have a restraining effect on the level of compensation."[184] Some argue, however, that disclosure "encourages better compensation plans (in terms of aligning managers' interests with shareholders')."[185] Unsurprisingly, the SEC, with regard to disclosure of executive compensation and compensation policies, favors heightened disclosure by companies.[186]

In the early 1990s, the SEC tightened its disclosure regulations regarding executive compensation. Although it does not limit or cap executive compensation, the SEC enacted rules affecting corporate disclosure of executive compensation for proxy and information statements.[187] For example, corporations are required to produce and disclose a "Summary Compensation Table," which shows annual and long-term compensation in a single comprehensive form.[188] In addition, the board's Compensation Committee must report the corporate performance factors it relied on in making specific compensation awards, and must also report the corporation's general compensation policies.[189] Finally, the corporation must prepare a "Performance Graph," comparing shareholder return over the past five years

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182. Thomas & Martin, *supra* note 180, at 1027.

183. *Id.* (but noting that boards will take shareholders' views into consideration to insure the passage of any proposed stock option plan).

184. Loewenstein, *supra* note 103, at 23.

185. *Id.*

186. *See generally* Executive Compensation Disclosure, Exchange Act Release No. 33-6962, 57 Fed. Reg. 48,126 (Oct. 21, 1992). *See also* SEC, *Executive Compensation: A Guide for Investors, available at* http://www.sec.gov/investor/pubs/exec omp0803.htm (last visited Jan. 3, 2004). Extensive disclosure should lower the cost of monitoring for shareholders. *Id.*

187. *See* SEC Executive Compensation Disclosure Release of 1992, *supra* note 186.

188. *See* 17 C.F.R. §§ 228.402, 229.402 (1999).

189. *See id.*

to shareholders in the Standard & Poor's 500 index, and to a group of peer companies chosen by the corporation.[190]

Setting compensation is an area that is mainly left to the good judgment of the corporation and is thus an area that the judicial system usually declines to examine.[191] Courts generally leave compensation questions to the business judgment of a corporation or the SEC.[192] For example, in *Lewis v. Vogelstein*, a leading case on the issue of shareholder derivative suits for excessive executive pay, the Delaware Chancery Court held that plaintiff's complaint did not state a claim for breach of the duty of disclosure (regarding executive stock options plans which were approved by shareholder vote) primarily because the company's failure to disclose the value of the stock options was more a result of uncertainty in valuing stock options than intentional manipulation on the part of the board.[193] Although the court did not dismiss the complaint entirely, it did note that the plaintiffs would face the large burden of overcoming Delaware's high waste standard in order to proceed.[194] In order to determine that the stock options constituted waste of the corporation's assets, the plaintiffs would have to show that the stock options were "in effect a gift" and that *no* substantial consideration was received by the corporation in exchange for the grant.[195] The court noted that the corporation gets the benefit of a "*good faith judgment* that in the circumstances the transaction is worthwhile."[196] More recently, however, the Delaware Court of Chancery allowed a shareholder derivative action to go forward, basing their decision on the Disney Company's lack of due care in granting a $140 million severance package and

190. *Id.*
191. *See Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 176, at 181–82.
192. *See* Lewis v. Vogelstein, 699 A.2d 327, 332–33 (Del. Ch. 1997) ("Judgments concerning what disclosure, if any, of estimated present values of options should be mandated are best made at this stage of the science, not by a court under a very general materiality standard, but by an agency with finance expertise….[such as] the Securities and Exchange Commission.").
193. *Id.*
194. *Id.* at 336.
195. *Id.*
196. *Id.*

other employment perks to Michael Ovitz.[197] The court found that the facts alleged, if true, "belie any assertion" that Disney's directors "exercised *any* business judgment or made *any* good faith attempt to fulfill the fiduciary duties they owed to Disney and its shareholders."[198] In particular, the court pointed to the plaintiff's allegations that the board and the compensation committee both spent less than an hour reviewing Ovitz's qualifications to serve as president of Disney, that neither the board nor the compensation committee reviewed the actual employment agreement or salary and severance provisions therein, and that no expert was hired to evaluate the terms of Ovitz's employment package.[199] While this decision may signal the beginning of more litigation in this area, such a conclusion is merely speculative at this point.[200]

C. The Law Regarding Setting Executive Compensation in the U.K.

According to the DTI, compensation of U.K. executives should be linked to performance.[201] Article 82 allows directors "such remuneration as the company may by ordinary resolution determine."[202] Moreover, Article 84 provides that directors may appoint a managing director or other executive officer and remunerate such person as they see fit.[203] Generally speaking, a public company's articles of association will empower the board to set executive remuneration.[204] Since the early 1990s, most publicly traded U.K. companies have established remuneration committees, pursuant to the disclosure-oriented guidance out-

197. *See generally In re* The Walt Disney Co. Derivative Litigation, 825 A.2d 275 (Del. Ch. 2003).

198. *Id.* at 287.

199. *Id.*

200. For a general discussion of the recent success of shareholder litigation in the area of corporate governance, see John Gibeaut, *Stock Responses*, 89 A.B.A. J, 38, 38 (2003). *See also* Gretchen Morgensen, *Shareholders Win in Effort to Alter Pay*, N.Y. TIMES, Aug. 27, 2003, at C1 (discussing corporations settling lawsuits with shareholders by agreeing to change offensive corporate governance practices).

201. *See generally* REWARDS FOR FAILURE, *supra* note 98.

202. Companies Act, 1985, c. 6, art. 82.

203. *Id.* art. 84.

204. Cheffins & Thomas, s*upra* note 3, at 286–87.

lined in the Combined Code.[205] The Combined Code suggests that such committees be composed "exclusively" of non-executive directors free from managerial influence.[206]

The Combined Code gives guidance on other remuneration-related issues. For example, the Code suggests that the level of remuneration should only be sufficient to retain directors with the competence to run the company, but not higher, and should be structured to link compensation awards to performance.[207] The Code also suggests that grants under option and other incentive plans be parceled out over time, rather than awarded in one large block.[208] The Combined Code also addresses the appropriate composition of remuneration. It suggests that annual bonuses and long term incentive schemes be supplemental to a director's salary and that any such deferred remuneration or options not be exercised for at least three years.[209] A one-year limit on service contracts, especially for newly recruited directors, is also recommended.[210] By suggesting that directors remain uninvolved in setting his or her own compensation, the Code maintains its focus on independent and transparent remuneration-setting procedures.[211] In addition, director performance should be factored into bonuses[212] and criteria such as the company's status and success in relation to other similarly-situated companies should factor into incentive schemes.[213] Disclosure is another keystone of the Combined Code. In its annual report, the Code suggests that companies disclose the membership of the remuneration committee,[214] the remuneration policy,[215] and details of each individual director's remuneration package (and reasons for such remuneration).[216] The Code also recommends that shareholders have a vote at the AGM to

205. Financial Services Authority, Listing Rules, paras. B.2.1 (June 1998).
206. *Id.* at para. B.2.1.
207. *Id.* at para. B.1.
208. *Id.* at schedule A, para. 4.
209. *Id.* at schedule A, paras. 1–2.
210. *Id.* at paras. B.1.7–1.8.
211. *Id.* at para. B.2.
212. *Id.* at schedule A, paras. 1–2.
213. *Id.* at schedule A, para. 4.
214. *Id.* at para. B.2.3.
215. *Id.* at paras. B.3.1–3.2.
216. *Id.* at schedule B, paras. 1–3.

approve the board's annual remuneration report[217] and that shareholders vote to approve any new long term incentive schemes.[218]

Unfortunately, a large portion of listed companies do not comply with the Code and, indeed, have at least one senior executive on the remuneration committee.[219] Indeed, a recent study by the Pensions Investment Research Consultants suggests that less than 40% of the average remuneration committees in the U.K. is comprised of fully independent directors.[220] Interestingly enough, even one member of the renumeration committee of the London Stock Exchange's (a publicly listed company) is not independent.[221] However, even if such committees were truly "independent" bias would remain an issue. This is because "[i]n most listed companies, a nominating committee will work together with the chairman of the board to select the individuals who ultimately serve as non-executive directors."[222] These individuals "have been chosen on the basis that they 'fit-in' with the company, in the sense that they identify with its goals and are compatible with the management team."[223] Exacerbating this potential bias is the fact that CEOs often attend such meetings. The PIRC studied compliance with the Combined Code in 1999 (the year it first became effective) and determined that director's pay was one area where compliance was poor.[224] With regard to one-year contracts for executives,

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217. *Id.* at para. B.3.5 & schedule A, para.3.

218. *Id.* at paras. B.2.4, B.3.2, B.3.5.

219. *See* PENSIONS INVESTMENT RESEARCH CONSULTANTS, CORPORATE GOVERNANCE ANNUAL REVIEW (2002). *See also* Press Release, PIRC, Boards Dominated By Executives And Connected Directors (Dec. 12, 2002) ("After four years of operation, 34% of companies state that they fully comply with the Combined Code on Corporate Governance." More than 75% of company boards in the UK are controlled by executives and no-executives who are not independent.)

220. *See* PENSIONS INVESTMENT RESEARCH CONSULTANTS, CORPORATE GOVERNANCE ANNUAL REVIEW (2002), *supra* note 219. *See also* Press Release, Boards Dominated By Executives And Connected Directors, *supra* note 219.

221. LONDON STOCK EXCHANGE ANNUAL REPORT 34 (2002).

222. Cheffins & Thomas, s*upra* note 3, at 285.

223. *Id.* at 285.

224. *See* PIRC DIRECTORS' REMUNERATION: RESPONSE TO THE CONSULTATIVE DOCUMENT (Oct. 1999), *available at* http://www.pirc.co.uk/docind.htm. *See also* PIRC Press Release, Compliance with Combined Code Worst on Directors' Pay Issues (Dec. 20, 1999), *available at* http://www.pirc.uk/pr20dec.htm.

voting on remuneration reports, and fully independent remuneration committees, the PIRC found that only 51% of companies had one year contracts for executive directors, only 27% of companies disclosed that their board had considered voting on remuneration committee reports at their annual meeting, and approximately 77% of companies had a wholly independent remuneration committee.[225] In addition, in 1999, the DTI commissioned PricewaterhouseCoopers ("PWC") to monitor compliance by listed companies with both the Greenbury best practice framework and the Combined Code.[226] PWC found that only 7 out of 270 companies (3%) complied with the Greenbury Report recommendation that shareholders should have a vote at the AGM on remuneration policies.[227] PWC also found that in 81 out of 298 companies (27%), the board chairman was also the chair of the remuneration committee; in only 17 of 298 companies (6%) the majority of the members of the remuneration committee were non-independent, non-executive directors.[228] These numbers show poor compliance with the Combined Code's recommendation that "[r]emuneration committees should consist exclusively of non-executive directors who are independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment."[229]

Traditionally, U.K. shareholders, specifically institutional shareholders, have been hesitatnt to bring derivative lawsuits relating to corporate governance issues because of procedural, financial, and substantive hurdles.[230] In addition, U.K. judges have been, and continue to be, reluctant to interfere with executive compensation.[231] Legislation is one area where sharehold-

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The survey covers 468 companies from the FTSE All Share Index and covers the period from Dec. 31, 1998 until June 30, 1999. *Id.*

225. *See* PIRC DIRECTORS' REMUNERATION: RESPONSE TO THE CONSULTATIVE DOCUMENT, *supra* note 224.

226. *See* DTI CONSULTATIVE DOCUMENT, DIRECTORS' REMUNERATION (July 1999), at annex A (July 1999).

227. *Id.*

228. *Id.*

229. *See* Financial Services Authority, Listing Rules, para. B.2.2 (June 1998).

230. STAPLEDON, *supra* note 12, at 131–33.

231. *See* Henderson v. Bank of Australia, LR 40 Ch. D. 170, 181 (1889) (stating that "[i]t is not for the judge to express any opinion upon such matters as

ers can turn for support since executive remuneration in the U.K. is somewhat regulated through the Companies Act of 1985. For example, under section 311 of the Companies Act, a company is prohibited from paying a director remuneration that is not subject to income tax.[232]

With sparse procedural safeguards for concerned U.K. shareholders, the issue becomes whether such shareholders have their own voice in the remuneration debate. As Cheffins and Thomas observe, "[w]hile the general rule in the U.K. is that shareholders do not have a direct say over executive pay, the pattern is subject to exceptions."[233] Some sections of the Companies Act give shareholders a voice in setting remuneration. For instance, sections 312 through 314 of the Companies Act of 1985 provide that a company's shareholders have the right to vote by resolution on employment contracts for executives. Section 312 specifically proscribes that a company first obtain shareholders' approval before it may compensate a director for leaving the corporation.[234] A company cannot enter into an employment contract with a director for a term of more than five years without the shareholders consent by such resolution.[235] Finally, section 232, a disclosure provision, requires that the company disclose, in the notes to the accounts, payments and other benefits given to directors.[236] In the U.K., shareholders can attempt to challenge executive remuneration as constituting "unfair prejudicial conduct" under section 459 of the Companies Act.[237] Although the phrase "unfair prejudicial conduct"

whether the amount [of directors' remuneration] is too large or too small: the directors of the company know a great deal [more] about these matters than [a judge] can possibly do"); *In Re* Saul D. Harrison & Sons, [1994] B.C.C. 475 (C.A.) (holding that the directors did not violate their fiduciary powers despite the fact that the petitioner alleged that the directors had kept the struggling company going for the sole purpose of paying themselves compensation).

232. Companies Act, 1985, c. 6, § 311.

233. Cheffins & Thomas, s*upra* note 3, at 287.

234. Companies Act, 1985, c. 6, § 312.

235. *Id.* §§ 312–14.

236. *Id.* § 232. In 2002, the U.K. government made it mandatory that shareholders give an advisorial vote at the AGM on remuneration packages and policies. *See infra* Part VI.

237. Companies Act, 1985, c. 6, § 459. *See also In Re* Saul D. Harrison & Sons, [1994] B.C.C. 475 (C.A.), (petitioner arguing that directors engaged in "unfair prejudicial conduct," violating section 459, when they paid themselves excessive salaries despite the fact that the business was operating at a loss).

is not defined in the statute, "various meanings have been attributed to it including from 'oppression,' 'discrimination,' or 'incompetence.'"[238]

Another place shareholders can look to for rights is the U.K. Listing Authority Listing Rules. The Listing Rules give shareholders in a listed company the right to approve executive share option schemes and LTIPs.[239]

Although some commentators have debated about the shareholders' role in setting compensation in the first instance, the next section of this Note focuses on how shareholders can challenge compensation after it has been set.[240]

V. CHALLENGING EXECUTIVE COMPENSATION

There are three basic methods by which a shareholder can challenge executive compensation: suing, selling, and voting.[241] As previously mentioned, suing is not usually a viable option for shareholders in either the U.S. or the U.K. because courts apply a "hands off" approach when it comes to compensation issues, preferring to leave such decisions to the corporation.[242] In addition, at least in the U.S., the procedural and economic hurdles to bringing a derivative suit for excessive compensation are immense.[243] Of course, shareholders can always sell their shares[244] or refuse to invest in companies that they feel overpay

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238. Companies Act, 1985, c. 6, §§ 312–14.

239. Financial Services Authority, Listing Rules, *supra* note 49, at para. 13.13. For long term incentive plans, see para. 13.13A, defining "long-term incentive scheme." A listed company that does not obtain shareholder approval in accordance with these Rules can be censured or delisted. *See also* Cheffins & Thomas, *supra* note 3, at 287.

240. *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 175, at 187–201.

241. *See generally* Randall S. Thomas & Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 WASH. U. L.Q. 569 (2001).

242. Cheffins & Thomas, *supra* note 3, at 300 ("In the U.K., this course of action has only rarely been pursued.").

243. *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 175, at 187–201.

244. "Historically, shareholders unhappy with the management of a company simply 'vote[d] with their feet' by selling their shares." *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 175, at 187–88.

their executives.[245] However, selling does not necessarily guarantee a change in remuneration policy. This Note focuses on challenging executive compensation through shareholder voting.

A. Challenges by Proposal

There are three main avenues by which shareholders may choose to challenge pay practices by proposal: (1) proposals that restrict or cap executive pay; (2) proposals that would alter corporate compensation policy so that shareholder approval of pay is required; and (3) proposals that would restrict repricing of stock options without first securing shareholder approval.[246]

In the U.S., SEC Rule 14a-8 (federal proxy rules) gives shareholders the option of putting forth a proposal to be voted on at the annual meeting.[247] Such proposals are not self-executing, but rather serve as mere recommendations to the board. However, if the proposal consists of an amendment to the corporation's bylaws, it can become part of the governance structure of the corporation. While this may sound like an idyllic solution for a concerned shareholder, "[b]ylaw amendments, especially those dealing with pay issues, are a relatively rare phenomenon."[248] In 1998 the SEC recognized this problem[249] and suggested that "shareholders could use Rule 14a-8 to propose bylaw amendments related to pay practices."[250] To be eligible to submit a proposal, a shareholder "must have continuously held at least $2,000 in market value, or 1% of the company's securities entitled to be voted on the proposal at the meeting for at

245. *See* Loewenstein, *supra* note 103, at 25–26 (noting that "[i]f one believes that excessive pay is pervasive in corporate America, then exiting one company would logically mean exiting the market.").

246. *Id.* at 26–27.

247. 17 C.F.R. § 240.14a-8 (1998).

248. Loewenstein, *supra* note 103, at 26. *See also* 17 C.F.R. § 240.14a-8 (1998).

249. *See* Final Rule: Amendments to Rules on Shareholder Proposals, Release No. 34-40018, 17 C.F.R. Part 240 (1998). The SEC suggested this same practice in 1992. SEC Executive Compensation Disclosure Release, 57 Fed. Reg. at 48,126.

250. *See* Final Rule: Amendments to Rules on Shareholder Proposals, Release No. 34-40018, 17 C.F.R. Part 240 (1998). *See also* Loewenstein, *supra* note 103, at 25–26.

least one year by the date you submit the proposal."[251] Each shareholder may submit only one proposal per meeting[252] and the burden is "on the company to demonstrate that it is entitled to exclude the proposal."[253]

Another limitation on shareholder proposals is that there is a deadline by which the proposal must be sent to the corporation. Pursuant to Rule 14a-8, if the proposal is to be included in the proxy materials for the annual meeting, it must be "received at the company's principal executive offices not less than 120 calendar days before the date of the company's proxy statement released to shareholders in connection with the previous year's annual meeting."[254] For proposals that are submitted for special meetings (any meeting other than the annual meeting), the materials must be received by the corporation "a reasonable time before the company begins to print and mail its proxy materials."[255]

When a corporation disagrees with a shareholder proposal and wishes to exclude the proposal, it will usually advise the SEC and attempt to justify its position.[256] If the SEC agrees with the justification, it will issue a "no-action" letter, advising the shareholder not to pursue the proposal further.[257]

Regardless of whether shareholder proposals relating to executive pay take the form of non-binding recommendations or bylaw amendments, historically such "shareholder proposals in

251. 17 C.F.R. § 240.14a-8(b)(1) (1998). The shareholder must hold the securities through the date of the meeting.

252. 17 C.F.R. § 240.14a-8(c) (1998). The proposal cannot exceed 500 words. *See* 17 C.F.R. § 240.14a-8(i)(7) (1998).

253. 17 C.F.R. § 240.14a-8(g) (1998). However, many corporations regularly exclude proposals based on the grounds that the proposal is within the ordinary business operations of the company. *See* 17 C.F.R. § 240.14a-8(i)(7) (1998).

254. 17 C.F.R. § 240.14a-8(e)(2) (1998).

255. 17 C.F.R. § 240.14a-8(e)(3) (1998).

256. 17 C.F.R. § 240.14-8(g) (1998) ("The burden is on the company to demonstrate that it is entitled to exclude a proposal."). *See also* 17 C.F.R. § 240.14-8(j)(1)-(2) (1998).

257. While shareholders who receive such letters may not submit their proposals to a shareholder vote, they may still pursue the matter in court. *See generally* Donna M. Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921, 923–46 (1998).

this area generally have not fared well."[258] Indeed, "[i]t is true that shareholder proposals on executive compensation issues frequently do not succeed."[259] In 1998, the Investor Responsibility Research Center conducted a study which calculated the percentage of votes for shareholder proposals regarding remuneration.[260] The 1998 survey results demonstrated that, not only had voting decreased on shareholder proposals to limit compensation, but that the number of proposals had also decreased.[261] Moreover, the study concluded that "[s]hareholder support for executive compensation proposals is not as high as with most other types of shareholder proposals."[262] Encouragingly, in 2002 there were "275 shareholder proposals to rein in executive pay" — a record number.[263] Only two of the proposals, however, received majority votes, and regardless, "management is free to ignore those mostly nonbinding resolutions and routinely does."[264]

Similar to Rule 14a-8, section 376 of the Companies Act of 1985 allows shareholders to submit proposals to be voted on at the AGM. Unlike Rule 14a-8, however, shareholders submitting proposals in the U.K. have more freedom regarding the substance of the proposal, mainly because the Companies Act takes a hands-off approach to the matter.[265]

There are some obstacles for shareholders wishing to utilize section 376. First, unlike Rule 14a-8 of the U.S. federal proxy rules, which allows proposals at both annual and special meetings of shareholders, section 376 limits shareholder proposals to annual meetings.[266] Despite a more flexible approach to the *sub-*

258. Loewenstein, *supra* note 103, at 26.

259. *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 175, at 195.

260. *See* INVESTOR RESPONSIBILITY RESEARCH CENTER, SUMMARY OF 1998 U.S. SHAREHOLDER RESOLUTIONS 2 (Feb. 3, 1999).

261. *See id.*

262. *Id.* It is possible that as a result of the Enron debacle and consequent corporate governance reforms (and increased shareholder activism), shareholder proposals in this area could become more widespread.

263. Useem, *supra* note 9, at 64.

264. *Id.* (Hewlett-Packard and Tyco were the only two companies where shareholder proposals regarding executive pay received a majority of votes).

265. There is no exception in the Companies Act for "ordinary business operations" as in Rule 14a-8. *See* Companies Act, 1985, c. 6, §§ 376–81.

266. *Id.* § 376.

stance of shareholder proposals, the U.K. takes a fairly rigid approach to the procedural hurdles that a shareholder must surpass to succeed in getting a proposal approved.[267] As mentioned earlier, the cost of circulating a proposal will usually be borne by the proposal's proponent.[268] The corporation has the right to request that the shareholder pay for the costs of the circulation of the resolution and any accompanying statement.[269]

Statutory ownership thresholds are another barrier for shareholders in the U.K. In order to make a proposal, an individual shareholder or group of shareholders must own at least 5% of the voting rights of the company.[270] Due to the fact that few individual shareholders can satisfy this ownership requirement, it is necessary for institutional shareholders, who will meet the statutory threshold percentage, to take the lead.[271] Another problem is that such proposals are advisorial only — even if a shareholder resolution is passed, management is allowed to disregard the resolution.[272]

B. Challenges to Share Option Plans

In the U.S., some shareholders may have a vote regarding stock options paid to executives. For example, some state laws require that shareholders approve stock option plans before they can be effectuated.[273] However, many states follow the Model Business Corporations Act, which does support such shareholder voting.[274] In fact, Delaware (where many U.S. companies choose to incorporate) follows the Model Business Corpo-

267. *Id.* § 377.
268. *Id.*
269. *Id.* § 377(1)(b).
270. *Id.* § 376(2).
271. *See, e.g.,* Tony Tassell, *Investors Push For Cap on Executive Pay-offs: Pension Funds Move to Stem Rising Compensation Tide*, NAT. POST, Apr. 18, 2002, at FP16 ("Leading investor groups are holding talks about stemming the rising tide of pay-offs for sacked executives.").
272. *See* Directors' Remuneration Report Regulations, (2002) SI 2002/1986, § 7.
273. In New York, shareholders used to get a vote on such plans under New York Business and Corporations Law, § 505(d). However, this section was changed, and shareholders of New York corporations no longer have this right. Under New York, if the stock exchange rules require voting, then New York will also. *See* N.Y. BUS. CORP. LAW § 505(d) (McKinney 2003).
274. *See* REV. MODEL BUS. CORP. ACT § 624(a) (2003).

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rations approach in not allowing shareholder votes regarding stock options.[275] This is unfortunate since, as noted above, share options constitute a substantial percentage of an executive's pay in the U.S.[276] and therefore a vote on stock options could increase shareholder involvement in setting executive pay. In addition, corporations can benefit from tax deductions if they put executive compensation plans to a shareholder vote.[277]

The NYSE, the NASDAQ Stock Market, and the American Stock Exchange all have listing rules that require shareholder votes on option plans, with certain exceptions.[278] However, "the New York Stock Exchange and NASDAQ are contemplating changing their listing rules to address a loophole which allows companies to bypass the shareholder approval process where plans include a substantial number of employee participants as well as corporate executives."[279] In addition, as discussed in Part VI (Recent Developments) *infra*, the NYSE has just proposed a new rule which would require that shareholders approve equity-compensation plans within twelve months for adoption by the board of directors, as per the Internal Revenue Code.[280]

In both the U.S. and the U.K. executive compensation may potentially be challenged based on breach of fiduciary duties.[281]

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275. *See* DEL. CODE ANN. tit. 8, § 157 (2003).

276. Lambert, *supra* note 168, at A1.

277. A provision of the Internal Revenue Code ("IRC") provides that a corporation that pays an executive more than $1 million annually, may receive a tax deduction, but only if the amount was paid pursuant to a "performance-based plan." *See* 26 U.S.C. § 162(m)(4)(C) (1998). According the IRC, a plan is only considered "performance-based" if it is ratified by shareholders.

278. *See* NYSE LISTED COMPANY MANUAL, Corporate Governance Rules, § 303A, *available at* http://www.nyse.com/pdfs/finalcorpgovrules.pdf (last visited Feb. 12, 2004); AMERICAN STOCK EXCHANGE COMPANY GUIDE, Options to Officers, Directors, or Key Employees, part 7, §§ 710-713, *available at* http://wallstreet.cch.com/AmericanstockeangeAMEX/AmexCompanyGuide/PART7/SHAREHOLDERSAPPROVALSS710-713/072F000379.asp (last visited Feb. 12, 2004); NASDAQ MARKETPLACE RULES, IM-4350-5, Shareholder Approval for Stock Option Plans or Other Equity Compensation Arrangements, *available at* http://cchwallstreet.com/nasd/nasdviewer.asp?Se leNode=4&FileName=/nasd/nasd_rules/RulesoftheAssociation_mg.xml#chp_1_4.

279. Cheffins & Thomas, *supra* note 3, at 300.

280. *See infra* Part VI.

281. There is some evidence to conclude that shareholder derivative suits challenging breach of fiduciary duties are more successful in the U.S. and

In derivative litigation in the U.S., the board will typically have the burden of proving the fairness of the compensation award if it is a self-interested transaction,[282] and might therefore have incentive, from a litigation perspective, to allow a shareholder vote on share option plans.

C. Challenges at the Annual Meeting

It has been suggested that shareholders should have a right to a non-binding, advisory vote at the annual meeting on executive compensation matters.[283] Some argue that there is support for the fact that management will pay attention to shareholder votes on remuneration issues at the annual meeting,[284] the U.K., recently amended the Companies Act to grant shareholders this right.[285]

Aside from voting directly on compensation, shareholders can exercise other voting rights. For example, shareholders of publicly listed companies in both the U.S. and the U.K. are given the right to elect directors.[286] Thus, such shareholders may vote not to re-elect directors on the remuneration committees whom they feel either pay excessive compensation or promulgate compensation policies that are too flexible.[287] In the U.K., the National Association of Pension Funds ("NAPF") did just this.[288] In 2001, the NAPF (whose members own almost 25% of the UK stock market), reacting to excessive pay given to the Royal Bank of Scotland's executives, "urged shareholders to register a protest in this fashion."[289] In the U.S., the SEC has recently proposed that shareholders have greater power to nominate and

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therefore serve as a better check on excessive executive remuneration. *See* Cheffins & Thomas, *supra* note 3, at 300–01.

282. *See* Lewis v. Vogelstein, 699 A.2d 327 (Del. Ch. 1997).

283. *See* Loewenstein, *supra* note 103, at 28; *see also* Thomas & Martin, *The Effect of Shareholder Proposals supra* note 180, at 1046–48.

284. *Id.*

285. *See infra* Part VI.

286. *See* DOUGLAS M. BRANSON, *supra* note 24, §1.01, at 1–2 (1993) ("Most central to shareholders' role then is their power to elect directors, and statutes typically refer to that shareholder power expressly."); CHARKHAM, *supra* note 22, at 182; Companies Act, 1985, c. 6, § 303.

287. *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 176, at 191.

288. Cheffins & Thomas, *supra* note 3, at 289.

289. *Id.*

appoint directors.[290] At the annual meeting, U.K. shareholders are given a vote on the company's accounts.[291] Shareholders that choose to vote against the accounts are making a statement — that they object to the corporation's pay policies.[292]

Unfortunately, neither voting against the re-election of directors nor voting against the company accounts are all that meaningful. For one, questionable directors may not be up for vote at the time the shareholder votes. Also, many shareholders will choose not to vote against a remuneration committee director if that shareholder feels that the director provides useful skills for other aspects of running the corporation.[293] Moreover, there is a strong argument that many shareholders do not even vote — that "shareholders are apathetic and often fail to open their proxy materials, much less take the time to complete a proxy card and mail it back to the company."[294] Indeed, the most recent figures from a study conducted by Pensions Investment Research Consultants suggest that voting turnout, while showing an improvement during 2001-2002,[295] did not improve during 2002-2003.[296]

VI. RECENT LEGAL DEVELOPMENTS

There have been recent developments in both the U.S. and the U.K. regarding shareholder voting on executive pay. At the

290. S.E.C. Proposed Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 17 C.F.R. Parts 239, 249, and 274, Release Nos. 33-8131, 34-46518, IC-25739.

291. *See* Directors' Remuneration Report Regulations, (2002) SI 2002/1986, § 7.

292. This is because directors must prepare a remuneration report as part of the company's accounts. *Id.* § 3.

293. *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 176, at 200.

294. *See* Loewenstein, *supra* note 103, at 27.

295. *See* Press Release, PIRC, Growing Voting Opposition at UK Listed Companies (Oct. 9, 2002) (finding that average voting levels for FTSE 350 companies rose from 51% to 55% and for FTSE All Share companies there was a rise from 50% to 53%). The study also found that "[d]irectors' pay remains important but is not the main issue which has attracted dissenting votes during the year." *Id.* Remuneration issues such as excessive share schemes and remuneration policies attracted an increasing number of dissenting votes. *Id.*

296. *See* Press Release, PIRC, Upward Voting Trend Halted Says PIRC: PIRC's Annual Survey Highlights "Shareholders Continued Failure To Vote At U.K. Listed Companies" (Aug. 29, 2003).

end of 2002, the U.K. Parliament implemented a new voting policy for shareholders at the AGM and the NYSE just amended its listing rules to give shareholders a right to vote on equity compensation plans[297] — both of which should have positive effects for shareholder voting rights. In addition, the SEC has weighed in with proposals related to important issues in this area.[298] The U.K. Parliament passed an amendment to the U.K. Companies Act, which went into effect on August 1, 2002.[299] The new amendment requires that shareholders vote at the AGM on the directors' remuneration report.[300] Schedule 7A[301] of the new regulations provides that the directors' remuneration report must contain several disclosures to the voting shareholders.[302]

Pursuant to Part 2 of Schedule 7A, the report must contain information regarding four areas of compensation. First, the report must disclose "the circumstances surrounding the consideration by the directors of matters pertaining to directors' remuneration."[303] Second, the report must contain "a statement of the company's policy on directors' remuneration for the following financial year."[304] Third, the report must contain a performance graph "which sets out the total shareholder return of the company on the class of equity share capital, if any, which caused the company to fall within the definition of 'quoted company.'"[305] Lastly, the report must include certain information regarding each director's service contract.[306] Part 3 of Schedule 7A sets out other areas of compensation which must be disclosed in the remuneration report, including share options, long

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297. *See* Directors' Remuneration Report Regulations, (2002) SI 2002/1986, § 7; *See* NYSE LISTED COMPANY MANUAL, *supra* note 278, § 303A.

298. *See* NYSE LISTED COMPANY MANUAL, *supra* note 278, § 303A; *Viewing Corporate Executive Compensation Through a Partnership Lens, supra* note 176, at 188–91.

299. *See generally* Directors' Remuneration Report Regulations, (2002) SI 2002/1986.

300. *See id.* § 7. The new shareholder voting requirement has been inserted as § 241A of the Companies Act.

301. Schedule 7A is now inserted after the already existing Schedule 7 of the Companies Act. *Id.* § 9.

302. *Id.* at sched. 7A.

303. *See id.* at "Explanatory Note."

304. *Id.*

305. *Id.*

306. *Id.*

term incentive plans, pensions, and compensation and excess retirement benefits of each director.[307]

Although much of this disclosure is already required by the SEC in the U.S.,[308] the mandatory shareholder vote at the AGM is not required in the U.S.[309] Despite the fact that the new U.K. shareholder vote is only advisory, it seems as though, at the very least, shareholders now have an opportunity to voice their opinion. In fact, the new legislation basically codifies the suggestions from the voluntary codes.[310] Indeed, the new voting amendment, albeit merely advisory, is preferable to the former voluntary scheme. Under the voluntary scheme, whereby companies had the option of putting the remuneration packages up for shareholder vote, few companies allowed such votes.[311]

However, the U.S. is not standing idly by with regard to excessive executive compensation. On June 30, 2003, the SEC approved a proposal by the NYSE which requires that shareholders approve executive equity-compensation plans.[312] The text of the new rule, codified in Section 303A(8) of the Exchange's Listed Company Manual, reads as follows: "Shareholders must be given the opportunity to vote on all equity-compensation plans and material revisions thereto, with limited exceptions."[313] The Exchange commented that such equity-compensation plans (which would include plans under which directors pay less than fair market value for shares and which are not available to shareholders generally), "can help align shareholder and management interests."[314] In addition, the Ex-

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307. *Id.*

308. *See* 17 C.F.R. §§ 228.402, 229.402 (1999).

309. *See* SEC Executive Compensation Disclosure Release of 1992, *supra* note 186.

310. *See* discussion *supra* Part II.C.

311. In 2001, only 30 of the FTSE 350 companies allowed shareholders a vote on executive compensation. *See* Jill Treanor & Richard Wray, *Top Pay Vote 'Not Enough,'* GUARDIAN, Oct. 20, 2001, *available at* http://www.guardian.co.uk/executivepay/story/0,1204,577504,00.html.

312. *See* NYSE LISTED COMPANY MANUAL, *supra* note 278, § 303A.

313. *Id.* § 303A.08 (Shareholder Approval of Equity Compensation Plans). The new rule is also referenced in § 312.03(a) of the Exchange's Listing Rules (Shareholder Approval). "Equity-compensation plan" is defined broadly to include a "compensatory grant of options or other equity securities that is not made under a plan." *Id.*

314. *Id*.

change noted that part of the purpose of this stockholder approval was "to provide checks and balances on the potential dilution resulting from the process of earmarking shares to be used for equity-based awards."[315] The commentary also mentions that there are exceptions to the voting requirement — some plans are exempt from the requirement of shareholder approval.[316] For example, employment inducement awards are not subject to such a vote in the context of mergers and acquisitions.[317] The NYSE's most recent corporate governance standards, as set forth in the Exchange's Listing Company Manual, Section 303A, and approved by the SEC on November 4, 2003, also require that listed companies have a compensation committee composed entirely of independent directors.[318] In addition, the compensation committee "must have a written charter that addresses the committee's purpose and responsibilities…to review and approve corporate goals and objectives relevant to CEO compensation, evaluate the CEO's performance in light of those goals and objectives and…determine and approve the CEO's compensation level based on this evaluation."[319] The compensation committee must also have a written charter that addresses "an annual performance evaluation of the compensation committee."[320]

VII. LOOKING AHEAD — A FOCUS ON SHAREHOLDER RESPONSIBILITIES

Unfortunately, "[e]nthusiasts for corporate governance do not spend much time discussing the shareholders' responsibilities, preferring to concentrate on shareholders' rights instead."[321] Perhaps a paradigm shift is necessary to avoid the almost ironic inevitability of investors who are passive regarding corporate governance, but then become irate when executives pillage the very companies the investors own, in which they have little in-

315. *Id*. It is important to note here that "material revisions" to such plans (i.e., a material increase in the number of shares available under the plan) are also subject to shareholder vote under this new rule. *Id.*

316. *Id.*

317. *Id.*

318. *See* NYSE LISTED COMPANY MANUAL, *supra* note 278, § 303A.05(a).

319. *Id.* § 303A.05(b)(i)(A).

320. *Id.* § 303A.05(b)(ii).

321. *Who's in Charge?, supra* note 26, at 21.

volvement. One author has noted that "[s]omewhere along the line, managers – who are, after all, just hired hands — started behaving as if they owned the place. And the real owners — mostly mutual funds and pensions — starting behaving as if they didn't."[322] This same author, somewhat cryptically began an article critiquing CEO pay with a quotation from George Orwell's novel "Animal Farm": "But the pigs were so clever that they could think of a way round every difficulty."[323] Is this then, the destiny of the regulations regarding executive greed — to be one-step behind clever corporations and over-paid executives at all times?[324] As per the "Law of Unintended Compensation," "any attempt to reduce compensation has the perverse result of increasing it."[325] Indeed, one need look no further than the scandal involving Richard Grasso to see that regulations cannot be the sole impetus to curtail excessive executive pay.[326] While the NYSE was in the process of proposing new amendments to its Listing Manual, which have since become the amended voting rules on equity compensation plans, the NYSE was paying Grasso amounts which made some Wall Street CEOs blush.[327]

Perhaps, the answer is not through regulation, as discussed previously, but activism from below. In 2002, the CEO of Cendant Corp., a corporation which has been "revamping its corporate governance since its 1998 accounting scandal" to include such provisions as shareholder approval of executive stock options, stated: "I think the real impetus [for reform] will not be the NYSE, the President, or Congress — it will be the reality of

322. Useem, *supra* note 9, at 57, 64.

323. *Id.* at 57.

324. Useem also notes in his article: "Regulation is a spur to innovation, and in the pay arena innovation always means "more." *Id.* at 59.

325. *Id.* at 59. (Citing examples from 1989, 1992, and 1993, wherein Congress attempted to place hurdles in the way of rising executive compensation only to have the perverse effect of compensation skyrocketing as a result).

326. *See* Thomas, *Big Board Chief Will Get a $140 Million Package*, *supra* note 145, at C1; Thomas, *A Pay Package That Fat Cats Call Excessive, supra* note 145, at C1; Craig & Kelly, *supra* note 145, at C1; Kelly & Craig, *supra* note 148, at C1.

327. *See* Thomas, *Big Board Chief Will Get a $140 Million Package*, *supra* note 145, at C1; Thomas, *A Pay Package That Fat Cats Call Excessive, supra* note 145, at C1; Craig & Kelly, *supra* note 145, at C1; Kelly & Craig, *supra* note 148, at C1.

the marketplace."[328] Shifting the focus from government regulation to shareholders, "the ostensible owners of companies," to play a larger role in setting executive pay would "play to capitalism's strength — its flexibility."[329] The SEC has taken just this stance by passing a new disclosure-oriented rule, which will take effect in the summer of 2004, requiring mutual funds to disclose the way they vote their shares.[330] Until recently, only a handful of mutual funds have disclosed how they voted proxies.[331] In the U.K., mutual funds are not obligated to reveal how they vote.[332] Part of the problem with mutual funds and other institutional investors may stem from conflicts of interest — "banks, insurance companies and mutual funds all want a company's banking, insurance or pensions business, so they will hesitate to cast the proxy votes of their investment arms against the management."[333] Indeed, "some company directors are known to meet the institutional shareholders privately to make presentations or discuss with them the future of the company."[334] When this scenario occurs, institutional investors are not flexing their "financial muscles" on behalf of those they have a fiduciary duty to represent.[335] CalPERS, one of America's largest investment funds, is a role model for other institutional investors.[336] CalPERS has been active in "publicly con-

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328. Lavelle, *supra* note 2, at 112.

329. *Where's the Stick?*, *supra* note 109.

330. *See* SEC Proposed Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 17 C.F.R. Parts 239, 249, and 274 (One of the goals of this proposed rule is "increased transparency" to "enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies, which could have a dramatic impact on shareholder value."). *See also* Useem, *supra* note 9, at 64.

331. *See* John Wasik, *Speak Loudly — Or Lose Your Big Stick,* FIN. TIMES, July 24, 2002, at 26 (only eight retail mutual fund groups openly disclose how they vote on proxies).

332. Polly Toynbee, *Starve the Fat Cats,* GUARDIAN, May 16, 2003, *available at* http://www.guardian.co.uk/comment/story/0,3604,957194,00.html (urging that a change in the law which does not require disclosure of mutual fund voting in the U.K. is necessary).

333. *Id.*

334. Mohammed B. Hemraj, *How Shareholders' Activism Can Refrain Directors from Highjacking the Company,* COMPANY L. 24(11), 345–46 (2003).

335. *Id.*

336. Craig & Kelly, *Large Investors Call for Grasso to Leave NYSE*, *supra* note 145, at C1, C3.

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fronting companies whose governance it questions," such as Walt Disney Co., eBay Inc., Time Warner, and most recently, the NYSE.[337]

In addition, private shareholders are often uninterested in exercising their ownership privileges, such as voting, because they merely "want a financial product."[338] But what worth does a *right* have when it remains unexercised? For example, the U.K. Parliament passed an amendment to the U.K. Companies Act, which went into effect on August 1, 2002, requiring that shareholders vote at the AGM on the directors' remuneration report.[339] Yet, in just over one year since its inception, institutional shareholders have only voted against one existing pay package — at GlaxoSmithKline.[340] At the very least, shareholders should take advantage of their right to vote in order to embarrass executives. Indeed, in the U.S., embarrassed executives have returned at least a portion of their astronomical pay. For example, in 2002, the CEO of E*Trade Group, Inc., Christos M. Cotsakos "returned $21 million in pay after shareholder anger over his $80 million pay package boiled over."[341] In July 2002, the CEO of Dollar General Corp., Cal Turner, Jr., returned $6.8 million which "he received as the result of financial results that were later restated."[342] A spokesperson for the board of the NYSE recently stated that it plans to recommend that federal and state regulators pursue legal action against Richard

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337. *Id.*

338. Toynbee, *supra* note 332.

339. *See generally* Directors' Remuneration Report Regulations, (2002) SI 2002/1986. The shareholder voting requirement has been inserted as § 241A of the Companies Act. *Id.* § 7.

340. *Where's the Stick?, supra* note 109. Shareholders voted down a financial package that would have given chief executive Jean-Pierre Garnier £22 million for leaving the company before his contract had expired, despite a significant fall in the company's share price. *See DTI Consults Over Compensation for Termination of Directors' Contracts,* COMPANY L. 24(9), 271–72 (2003). For more information, see also *Glaxo Bows to Pressure over Executive Pay,* GUARDIAN, Dec. 15, 2003, *available at* (discussing the revised pay policy put forth by Glaxo seven months after its pay package was voted down at the AGM).

341. Lavelle, *supra* note 2, at 108. For more information on Cotsakos' compensation packages from E*Trade, see Troy Wolverton, *E*Trade Pays Exec the Big Bucks*, Apr. 30, 2002, *available at* http://news.com.com/2100-1017-895842.html.

342. Lavelle, *supra* note 2, at 108–09.

Grasso, the former chairman of the NYSE, unless he agrees to return a substantial portion of his pay.[343]

The SEC also recently proposed "an increase in the power of shareholders to nominate and appoint directors."[344] In effect, this would allow shareholders to break through the "pay-for-attendance" model of corporate leadership and put a stop to the "you-scratch-my-back-I'll-scratch-yours" phenomenon of executive remuneration.[345] Such a proposal would be especially important in the U.K. where the reality is that "the non-executive directors in an audit committee are appointed by the executive directors who fix their salary."[346] In addition, it is a model for the U.K. in the sense that the proposal shows a burden shift, albeit a small one, towards placing the responsibility for controlling corporate governance in the hands of the shareholder-owners.[347] The U.K. government has not yet focused on the shareholder's responsibility. For example, in its 1999 Consultative Document, the U.K. Department of Trade and Industry looked principally at the activities of U.K. companies, their remuneration committees, and their accountability to shareholders.[348] Moreover, despite the 2002 Amendment to the Companies Law, which gave shareholders the right to vote at the AGM on executive pay packages, GlaxoSmithKline is the sole example of shareholders taking advantage of the new amendment.[349]

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343. Landon Thomas, Jr., *Exchange Said to Want Move on Grasso Pay*, N.Y. TIMES, Jan. 8, 2004, at C1 ("John S. Reed, the interim chairman of the stock exchange, has said that he expects Mr. Grasso to return as much as $150 million of his compensation.").

344. SEC Proposal Rule, *supra* note 244. *See also Where's the Stick?*, *supra* note 109.

345. Hemraj, *supra* note 334, at 345–46. *See also Fat Cats Feeding*, *supra* note 10, at 66 ("The 'you scratch my back, I'll scratch yours' atmosphere of company boardrooms has been recognized for decades.").

346. *Id. See also* Press Release, Boards Dominated By Executives And Connected Directors, *supra* note 219. ("Over 75% of UK company boards are dominated by executives and non-executives who are not independent, according to PIRC's Annual Review of Corporate Governance published today.").

347. *See, e.g.*, Toynbee, *supra* note 332.

348. *See* DTI CONSULTATIVE DOCUMENT, DIRECTORS' REMUNERATION (July 1999), *supra* note 90.

349. Heather Timmons, *Glaxo Shareholders Revolt Against Pay Plan for Chief*, N.Y. TIMES, May 20, 2003, at W1 (noting that the pay package was voted against "by a slim margin of 50.72 percent to 49.28 percent"). Two large institutional investors who voted against the proposal included Isis Asset

Increased regulation regarding exorbitant pay is only the first step toward curbing it. The next step is to place responsibility in the laps of shareholders to be instrumental in ensuring that such regulations succeed. Thus some of the focus of the U.S. and the U.K. should be shifted toward the responsibility of the shareholder.

In the end, it is evident that "a combination of a bear market, some muted shareholder activism, and negative media commentary difficult to dismiss as mere *Schadenfreude*, [are necessary] to effect change at the top."[350] Then, in a bull market, will executive compensation be a moot issue? There is a strong argument that in times of financial stability, apathy toward excessive compensation will increase. Some commentators are hopeful that change is afoot and that the balance in power between executives and investors is changing.[351] For instance, Carol Bowie, director of governance research services at the Investor Responsibility Research Center in Washington was optimistic due to the success of recent shareholder lawsuits: "The shareholder-management relationship is going through a sea change, with shareholders asserting their prerogative as owners of the company. We went through a long period where shareholders didn't interfere with management. These lawsuits are not just to recoup money anymore — they involve forcing companies to change their practices."[352]

At least one thing is clear, however, "[i]ncome inequality in society has damaging effects. It reduces overall levels of well-being, creates a well-spring of resentment and helps trigger antisocial behaviors and outcomes."[353] In addition, a large pay differential between executives and lower-level employees is "bad for the long-term performance of a company because it breaches the trust between top management and the people who work for

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Management, which manages £58.8 billion in assets ($95.4 billion) and California Public Employees' Retirement System (known as CalPERS), one of the world's largest investors. *Id.*

350. Isles, *supra* note 128.

351. *See generally* Gibeaut, *supra* note 200; *Morgensen, Shareholders Win in Effort to Alter Pay, supra* note 200, at C1, C10.

352. Morgensen, *Shareholders Win in Effort to Alter Pay, supra* note 200, at C10.

353. Isles, *supra* note 128.

them."[354] If "[o]rganizations are microcosms of wider society"[355] it will be necessary to continue compensation reforms even in a bull market and during times of increased profitability. Another thing is also clear – increased regulations are the first step in equalizing the playing field. The next step is for shareholders to exercise their ownership status and get in the game.

In both the U.S. and the U.K. it seems as though there is an obvious inconsistency between "the outrage expressed in the popular press and the lack of shareholder voice."[356] This can be attributed to shareholder apathy or a penchant for simply selling one's shares instead of fighting to substantiate change. In addition, it is possible that the "free market system" for executives just does not work all that well.[357] Most people are familiar with the age-old saying: "to the victor, go the spoils."[358] By applying this tenet to the present day pay controversies, it is possible to reach the conclusion that perhaps, performance aside, executives have *earned* a right to substantial compensation by the nature of simply *getting to be an executive.* Perhaps this way of thinking has remained ingrained in our corporate governance models — though recent developments show a shift away from such shareholder apathy. Clearly, the governments and regulating agencies in the U.S. and the U.K. are making strides toward fixing the problem of astronomical executive pay.

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354. Morgensen*, Explaining (or Not) Why the Boss is Paid So Much, supra* note 108, at section 3, at 1.

355. Isles, *supra* note 128.

356. Loewenstein, *supra* note 103, at 28.

357. *See generally Bosses for Sale, supra* note 121, at 57 (noting that the market for executives is secretive, restricted, bad at price-settings and generally run by the head hunter firms).

358. Bartlett's Quotations attributes this quote to William L. Marcy (1786-1857) during a speech in the United States Senate in January, 1832 ("They see nothing wrong in the rule that to the victors belong the spoils of the enemy."). *See* JOHN BARTLETT, BARTLETT'S FAMILIAR QUOTATIONS 419 (17th ed., Justin Kaplan ed. 2002).

Yet, until shareholders speak with one, loud, unified voice, pay will continue to spiral upward, despite increased government regulation. Institutional investors, generally the largest and most powerful owners of corporations in the U.S. and the U.K., have begun to flex their muscles and demand that executives perform in accordance with how they are paid. However, at least for now, it is still good to be the king.

Jaclyn Braunstein[*]

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