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Beyond Wall Street: Germany, the United States, and Executive Compensations

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BEYOND WALL STREET: GERMANY, THE UNITED STATES, AND EXECUTIVE COMPENSATION

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INTRODUCTION

In 1933, Senator Burton Wheeler issued the following appeal: "For the captains of industry to be drawing down large salaries is unconscionable and unpatriotic . . . . The practice must be curbed by legislation, through taxation and publicity."[1] In the years since his plea, Wheeler's refrain has been echoed countless times by academics, the press, and politicians.[2] Lately, even some wealthy investors are losing their patience: Warren Buffet, the CEO of Berkshire Hathaway, has repeatedly argued for change, noting that "[t]oo often, executive compensation in the U.S. is ridiculously out of line with performance."[3] President Obama joined the fray in 2009, calling the bonuses Wall Street announced in January of that year

1. Thomas F. Cooley, *The Pay Czar's Dilemma*, FORBES.COM (Aug. 19, 2009, 12:01 AM), http://www.forbes.com/2009/08/18/andrew-hall-executive-pay-citigroup-opinions-columnists-thomas-cooley.html.
2. *See, e.g.*, *id*.
3. Letter from Warren Buffett, CEO of Berkshire Hathaway, to Shareholders (Feb. 28, 2006), *available at* http://www.berkshirehathaway.com/letters/2005.html.

"shameful" and "the height of irresponsibility."[4] Yet actual reforms have been rare,[5] generally adopted only to curb highly publicized, company-specific excesses. Section 409A of the Internal Revenue Code ("Tax Code"), for example, was enacted after the Enron scandal and aims to prevent executive plunder of companies at the expense of shareholders and employees.[6] The limit on the amount of annual compensation that companies are allowed to deduct as a reasonable and necessary business expense under Section 162(m) of the Tax Code was similarly targeted.[7] But with the events that triggered the Great Recession vindicating scholars' long-standing claim that existing pay regulations fail to incentivize sound corporate governance,[8] such criticism gained a foothold with voters, vaulting systemic reform to the top of many a political agenda.[9] Indeed, the focus on executive compensation at the September 2009 G20 Summit in Pittsburgh reflected global pressure to recalibrate practices to both speed economic recovery and avoid further crises, with Germany and France advocating aggressive global regulation and significant change.[10]

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4. Sheryl Gay Stolberg & Stephen Labaton, *Obama Calls Wall Street Bonuses 'Shameful,'* N.Y. TIMES, Jan. 30, 2009, at A1.

5. Warren Buffet famously lamented the situation in his 2003 letter to Berkshire Hathaway shareholders: "In judging whether Corporate America is serious about reforming itself, CEO pay remains the acid test. To date, the results aren't encouraging." Letter from Warren Buffett, CEO of Berkshire Hathaway, to Shareholders (Feb. 27, 2004), *available at* http://www.berkshirehathaway.com/letters/letters.html.

6. *See* Andrew Liazos, *Ghost of Enron Wreaks New Havoc on Exec Pay*, CFO.COM (June 13, 2011), http://www.cfo.com/article.cfm/14581582/c_14581713.

7. *See* Daniel Nelson, *Section 162(m) Revisited*, TAXPROF BLOG 1 (Jan. 14, 2005), http://www.lawprofessorblogs.com/taxprof/linkdocs/2005-686-1.pdf.

8. *See* FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 61–64 (2011), *available at* http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

9. Nina Easton, *Main Street Turns Against Wall Street*, CNN MONEY, http://money.cnn.com/2008/09/26/news/economy/easton_backlash.fortune/index.htm (last updated Sept. 28, 2008, 11:03 AM).

10. *See* Edmund L. Andrews, *Leaders of G-20 Vow to Reshape Global Economy*, N.Y. TIMES, Sept. 26, 2009, at A1; Markus Dettmer et al., *G-20 Nations Divided over How to Fix World Economy*, SPIEGEL ONLINE INT'L (Sept. 22, 2009), http://www.spiegel.de/international/world/0,1518,650449-2,00.html.

Finding a "fix" is of course easier said than done. As they choose which kinds of regulations to enact in order to avoid another Great Recession, government leaders around the world must grapple with the difficult issues that lie at the heart of executive compensation reform, implementing sound corporate governance measures that allow boards the necessary flexibility to recruit the talented professionals needed to grow the company and benefit its shareholders without enthroning a management team whose cost outweighs the benefits it provides. This requires regulators to choose where to draw the line between short-term profit maximization and long-term company stability and performance, a difficult task further complicated by seemingly irreconcilable interests. Fortune 500 companies, fearful of losing their ability to attract "the best and the brightest," lobby intensely against pay restrictions.[11] This lobbying is in turn viewed with outraged contempt by academia, the public, and the media, who find it deeply unfair that the very institutions and individuals that brought the world economy to its knees continue to enjoy extraordinary benefits.[12] In response to the banking crisis following the collapse of Lehman Brothers in September 2008, regulators were more or less forced to take some action, implementing policies targeting the financial services sector. For example, in October 2009, Kenneth Feinberg, President Obama's Pay Czar, announced severe pay cuts for senior management at institutions that had received—but not repaid—funds through the Troubled Asset Relief Program ("TARP").[13] In France, laws enacted in the fall of 2008 required banks receiving bailout money to curb executive

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11. *See* Colin Barr, *Who Cares if Wall Street 'Talent' Leaves?*, CNN MONEY, http://money.cnn.com/2009/10/23/news/newsmakers/fed.feinberg.fortune/?postversion=2009102310 (last updated Oct. 23, 2009, 10:13 AM). For reactions to the Pay Czar's salary cuts, see David Ellis & Ed Henry, *Pay Czar Issues Salary Caps for Execs*, CNN MONEY, http://money.cnn.com/2009/12/11/news/companies/feinberg_compensation/index.htm (last updated Dec. 11, 2009); Steven Brill, *What's a Bailed-Out Banker Really Worth?*, N.Y. TIMES, Jan. 3, 2010, at MM32.

12. *See*, *e.g.*, Patricia O'Connell, *Executive Compensation and Public Outrage*, BUSINESSWEEK.COM (Mar. 1, 2010), http://www.businessweek.com/managing/content/feb2010/ca20100224_089346.htm.

13. *See* Stephen Labaton, *U.S. to Order Pay Cuts at Firms That Got Most Aid*, N.Y. TIMES (Oct. 21, 2009), http://www.nytimes.com/2009/10/22/business/22pay.html.

pay practices and shift their business strategies to prioritize credit for homeowners and small businesses.[14] However, despite a proliferation of these types of limited reforms, action was lacking when it came to comprehensive compensation regulations; efforts to reach a consensus at the Pittsburgh G20 Summit a year later belied the trepidation of many world leaders in the immediate aftermath of the financial crisis.[15]

One notable exception to the then-global failure to commit was Germany, which took decisive action to try to systemically change executive compensation structures extraordinarily quickly. In addition to its advocacy for global reform at the Pittsburgh G20, Germany passed the *Vorstandsvergütungsangemessenheitsgesetz* ("VorstAG") on June 18, 2009.[16] Applicable to all publicly traded German companies, the VorstAG aimed to change the way executive compensation is discussed and structured, increase the transparency of executive compensation, and encourage companies to focus on long-term performance in lieu of short-term gains.[17] Among other things, the VorstAG holds supervisory boards liable for compensation choices, introduces "Say-on-Pay" measures to allow shareholders to vote on executive pay, and requires a long-term basis for performance assessment.[18] Enacting these laws was a particularly significant step in buttressing German corporate governance requirements in securities regulation and in executive compensation, which have historically been less robust than corporate governance measures affecting U.S. companies.[19]

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14. *See France—Economy and Trade of France*, QFINANCE, http://www.qfinance.com/country-profiles/france (last visited Dec. 26, 2012); Lionel Laurent, *A Modest Bailout for France's Banks*, FORBES.COM (Oct. 21, 2008, 2:45 PM), http://www.forbes.com/2008/10/21/bnp-banks-update-markets-equity-cx_ll_1021markets14.html.

15. *See* Dettmer et al., *supra* note 10. Even then, the final decision related only to banker bonuses, a far cry from comprehensive regulation. *See* Patrick Wintour & Andrew Clark, *G20 Leaders Split over Banker Bonus Curbs*, GUARDIAN, Sept. 25, 2009, at 1.

16. For a good explanation of the law and situating the law within the broader context of reform, see, for example, KPMG's Audit Comm. Inst., *Auf einen Blick: Die neue Vorstandsvergütung* KPMG (July 2009), http://www.kpmg.de/Themen/15882.htm.

17. *Germany Introduces New Rules on Management Board Compensation*, Briefing (Freshfields Bruckhaus Deringer, London, U.K.), Aug. 2009, at 1.

18. *Id.* at 2, 3.

19. While Germany is often cited as lagging behind the United States in corporate governance matters, this is untrue in a large number of areas, such

That the reform laws were pushed through by German Chancellor Angela Merkel over strong objections from the business community, a group that traditionally supports Merkel's conservative party, also signals German dedication to new executive compensation structures.[20]

Too often, discussions about executive compensation reform devolve into abstract discussions of hypothetical and assumed interests, reactions, and consequences, leading to paralysis rather than action. One need only look to the missed deadlines and extended wrangling over the Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), both before and after its passage, for confirmation.[21] By analyzing and evaluating the new German executive compensation laws contained in the VorstAG, this Article seeks to inject a dose of reality into the debate. The VorstAG, as detailed below, makes an excellent candidate for this type of evaluation for several reasons. First, all public companies discuss their compensation strategies in their annual reports, which are freely available on their respective websites. Second, VorstAG became applicable law within a very short time frame; it was passed by the Bundestag on June 18, 2009, and entered into force in its entirety before the end of

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as takeover law. For a more complete coverage of German corporate governance measures in this and other areas, see generally STEFAN GRUNDMANN, EUROPEAN COMPANY LAW: ORGANIZATION, FINANCE AND CAPITAL MARKETS (2d ed. 2012).

20. *See* Joachim Jahn, *Gesetzespläne Experten: Manager aus Aufsichtsrat fernhalten*, FRANKFURTER ALLGEMEINE (May 25, 2009), http://www.faz.net/aktuell/wirtschaft/recht-steuern/gesetzesplaene-experten-manager-aus-aufsichtsrat-fernhalten-1626988.html; *see also Letter from Berlin: Merkel Takes on the Fat Cats*, SPIEGEL ONLINE INT'L (Dec. 11, 2007), http://www.spiegel.de/international/germany/0,1518,522480,00.html.

21. *See* DealBook, *Senator Dodd to Press Financial Reform Ahead*, N.Y. TIMES (Dec. 8, 2009, 5:14 AM), http://dealbook.nytimes.com/2009/12/08/senator-dodd-to-press-financial-reform-ahead-aides/?scp=11&sq=dodd+frank&st=nyt; Peter Alpern, *Dissent and Political Wrangling Leaves Financial Overhaul Tottering*, BUSINESSFINANCE (June 20, 2011), http://businessfinancemag.com/article/dissent-and-political-wrangling-leaves-financial-overhaul-tottering-0620. The post-bill passage wrangling was satirically documented on *The Daily Show with Jon Stewart*, in which John Oliver portrayed a tattered version of the bill. *The Daily Show: Dodd Frank Update*, (Comedy Central television broadcast July 28, 2011), *available at* http://www.thedailyshow.com/watch/thu-july-28-2011/dodd-frank-update.

the summer—the majority of it the next day.[22] The timing makes it relatively simple to pinpoint the moment when companies were required to incorporate VorstAG-related changes into their compensation policy. Third, the laws were cohesive and extensive enough to outline a clear compensation philosophy, resulting in clear strategies that public companies needed to adopt. It is therefore relatively simple to identify certain types of changes in annual reports or other ad hoc press releases that can be traced back to the VorstAG. Finally, the rule was not adopted in connection with broader corporate governance or executive compensation reform, on either the German or the European level. The law stands alone, and as such, it is relatively safe to surmise that the VorstAG was the catalyst for changes to executive compensation policy by public companies that were implemented in its immediate aftermath. In short, the VorstAG is a targeted, measurable law, and a thoughtful examination of whether and how it prompted changes in executive compensation structure and disclosure can provide facts about what has worked and what has been a challenge, and can thereby help address the speculative "what ifs" of the debate on executive compensation reform. Did the VorstAG endanger German management practices and even German companies as the critics feared?[23] Did the law inaugurate a new era of corporate governance as the proponents hoped?[24] And on a more basic level, did anything in fact change?

An examination of the publicly available documents from the Deutscher Aktien IndeX, or the DAX 30, answers the final question with a resounding "yes."[25] The compensation disclosure of DAX 30 companies today looks far different than it did even three years ago. By requiring companies to shift their compensation strategies to focus on "sustainability," the gov-

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22. *See* Benedikt Hohaus & Christoph Weber, *Inkrafttreten des Gesetzes zur Angemessenheit der Vorstandsvergütung und Änderungen des deutschen Corporate Governance Kodex*, P + P Pöllath & Partners (June 23, 2009), http://www.pplaw.de/_downloads/publications/Mdt-Info/090623-CI-Vorstandsverguetung.pdf.

23. *See, e.g.*, *Manager protestieren bei Merkel*, FRANKFURTER ALLGEMEINE (May 22, 2009), http://www.faz.net/-gqi-12khh.

24. *VorstAG, Bundestag verschärft Regelungen zur Vorstandsgütung*, PERSPEKTIVEMITTELSTAND, (June 19, 2009), http://www.perspektive-mittelstand.de/VorstAG-Bundestag-verschaerft-Regelungen-zur-Vorstandsguetung/management-wissen/2714.html.

25. For details on the changes, see *infra* Parts III and IV.

ernment explicitly extends Germany's sustainability-based approach to corporate governance into the compensation realm. German companies have historically been run on the stakeholder basis: the company has responsibility not only to shareholders, as in the American model, but also to employees, creditors, suppliers, and anyone else who might have a stake in the company.[26] Maximizing profits at the expense of one group is anathema, and the VorstAG makes clear that compensation packages are not exempt from this consideration.

This Article, then, analyzes and evaluates the new German executive compensation standards set forth the VorstAG on their own terms and seeks to find applicable lessons from their implementation in Germany that could help shape additional U.S. compensation reform or even provide a basis for international regulation. Part I examines the American side of the equation, including the much-decried compensation culture, the discussion surrounding it, and attempts to reform it, up to and including the latest Dodd-Frank developments. Part II crosses the Atlantic to explore corporate governance culture in Germany and how it has grown, including the development and implementation of the VorstAG. Part III addresses the concrete ways in which compensation structure and disclosure within the DAX 30 have changed since the implementation of the VorstAG, based on a careful examination of the compensation disclosures of these companies, largely in their annual reports, from 2008 to 2010. Part IV takes a hard look at the actual effects of the VorstAG based on the material discussed in Part III, discusses how executive compensation practices and culture in Germany were expected to change as a result of the new law, and evaluates the degree to which any changes lived up to expectations, whether of the lawmakers or of the critics. Part V presents lessons that can be drawn from the VorstAG in Germany that might help reinvigorate the largely stalled U.S. discussion about how to solve the executive compensation problem. The possibilities for harmonizing executive compensation regulation at the international level also receive consideration in Part V, before turning to a brief conclusion.

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26. *See infra* text accompanying note 101.

I. U.S. BACKGROUND

A. Prior Compensation Reform

It is not surprising that executive compensation is particularly contentious in the United States. As the "land of opportunity," the United States provided fertile ground for successful businessmen to earn vast amounts of money; critics followed shortly on their heels. The sums earned and spent by the so-called robber barons at the turn of the twentieth century were detailed—and heavily criticized—in the press in hopes of giving rise to reform.[27] Indeed, the detailed coverage of one particularly lavish party thrown in 1905 by James Hyde, the majority shareholder of Equitable Insurance, that cost at the time anywhere between $50,000 and $200,000 depending upon the source, led to a government investigation to determine whether any company funds had been misused to fund the festivities, and ultimately to new laws regulating the insurance industry.[28] Despite such public outcry, salaries continued to climb. By 1928, executives running some of the largest U.S. corporations were earning as much as 1.5 million U.S. dollars ("USD") annually.[29] Understandably, executive compensation came under sharp criticism shortly after the onset of the Great Depression. President Franklin Roosevelt minced no words with respect to what he viewed as irresponsible business practices, making clear in his 1933 inauguration speech his disdain for those same executives who had ruled over commercial exchange in the pre-Depression era.[30] Accordingly, the New Deal Congress moved quickly to impose the first regulations on executive compensation, which can be found in the Securities Act of 1933, the Securities Exchange Act of 1934, and the Revenue Acts of 1934, 1936, and 1938.[31]

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27. *See* Jerry W. Markham, *Regulating Executive Compensation—Why Bother?*, 2 J. BUS. & TECH. L., 277, 279–80 (2007).

28. *See generally* PATRICIA BEARD, AFTER THE BALL (2003) (recounting James Hyde's lavish costume ball and describing the ensuing government investigation and outcries for reform).

29. George T. Washington, *The Corporation Executive's Living Wage*, 54 HARV. L. REV. 730, 734 (1941).

30. President Franklin Delano Roosevelt, First Inaugural Address (Mar. 4, 1933), *available at* http://millercenter.org/president/speeches/detail/3280.

31. *See* Washington, *supra* note 29, at 735.

After this flurry of activity, which also included some lingering court challenges to various executive compensation packages,[32] the issue remained largely dormant until the early 1990s. The nineties saw the start of what we will call the modern executive compensation reform era, which has seen a high level of regulation and contention and stretches into the present day. It is marked by a cycle of targeted regulations to curb certain excesses, followed first by one or more executive pay scandals and then by new targeted regulations to root out previously ignored excesses perceived to have caused the problem. This era began in 1991, when then-presidential candidate Bill Clinton included in his platform a promise to trim the over-the-top executive compensation of the 1980s through the Tax Code by limiting the amount companies could deduct from their taxes as reasonable and necessary compensation to 1 million USD, unless the pay was tied to performance criteria.[33] Passed into law as Section 162(m) of the Tax Code by the Omnibus Budget Reconciliation Act of 1993, the Act was actually credited with allowing remuneration to spiral even higher due to its watered-down language.[34]

Indeed, despite the new regulation, two executive scandals followed shortly on its heels: the *Disney* case and the Enron collapse. In *Disney*, shareholders brought a derivative lawsuit against Disney in 1997 for wasting corporate assets by paying Michael Ovitz a severance package worth approximately 130 million USD, of which roughly 38.5 million USD was cash, when he was forced out of the company after less than two years on the job as president.[35] The media coverage and the length of time between the actual filing and the decision—a decade or so—kept the case in the public eye and heightened

32. *See* Markham, *supra* note 27, at 282–83 (mentioning challenges to executive pay at Bethlehem Steel in 1931 and National City Bank in 1934).

33. *See How Bill Clinton Helped Boost CEO Pay*, BUSINESSWEEK.COM (Nov. 26, 2006), http://www.businessweek.com/magazine/content/06_48/b4011079.htm.

34. *See id.*; Kevin J. Ryan, Note, *Rethinking Section 162(m)'s Limitation on the Deduction of Executive Compensation: A Review of the Commentary*, 15 VA. TAX REV. 371, 371–72 (1995).

35. *See In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 35, 56–57 (Del. 2006).

public outrage.[36] Interestingly, there was no specific regulatory backlash; that was reserved for the Enron scandal, which hit in 2001. Enron, America's seventh largest company at the time of its demise, was an energy company that manipulated its statements of earnings, overstating its profits thanks in large part to an inflated valuation mechanism and the use of offshore accounts to mask losses and debts.[37] When Enron hit its highest price of 90 USD per share in August of 2000, senior executives, knowing that the stock price was massively inflated from the revenue manipulations, began selling their shares while telling the general public to buy. When the true nature of Enron's accounts was revealed, the share price plummeted, leaving shareholders with worthless shares and also leaving legions of employees who had sunk their savings into the company with nothing for retirement.[38] The story was in the news for months[39] and spawned a library of books[40] as well as an Academy Award-nominated documentary in 2006, five full years after the company entered bankruptcy.[41] The movie's tagline—"Come see where all your money went"—encapsulated the public outrage.[42] Enron was no Disney, which struggled but remained profitable. Instead, the Enron executives had fed their

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36. *See id.*; *Judge: Ovitz Can Keep $140 Million*, NBCNEWS.COM (Aug. 10, 2005, 10:35 AM), http://www.msnbc.msn.com/id/8887620/ns/business-us_business/t/judge-ovitz-can-keep-million-disney-pay/#.UNvjJI6_3fg.

37. *See* Dan Ackman, *Enron the Incredible*, FORBES.COM (Jan. 15, 2002, 12:00 PM), http://www.forbes.com/2002/01/15/0115enron.html.

38. *See* Kurt Eichenwald with Diana B. Henriques, *Enron Buffed Image to a Shine Even as It Rotted From Within*, N.Y. TIMES, Feb. 10, 2002, at 1; Leslie Wayne, *Before Debacle, Enron Insiders Cashed in $1.1 Billion in Shares*, N.Y. TIMES, Jan. 13, 2002, at 1; ENRON: THE SMARTEST GUYS IN THE ROOM (Jigsaw Productions 2005).

39. The Enron whistleblower Sherron Watkins was one of TIME's "Persons of the Year," along with Cynthia Cooper and Colleen Riley, also whistleblowers. Richard Lacayo & Amanda Ripley, *Persons of the Year 2002: The Whistleblowers*, TIME (Dec. 30, 2002), http://www.time.com/time/magazine/article/0,9171,1003998,00.html.

40. A quick search on Amazon.com reveals an astonishing array of plays, LUCY PREBBLE, ENRON (2011), carefully researched nonfiction by outsiders, BETHANY MCLEAN & PETER ELKIND, SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2004), and insider tell-alls, BRIAN CRUVER, ENRON: ANATOMY OF GREED (2006).

41. *See Enron: The Smartest Guys in the Room*, IMDB, http://www.imdb.com/title/tt1016268/ (last visited Dec. 27, 2012).

42. *See id.*

insatiable desire for personal gain at the expense of the public, driving the company into the ground and wiping out the pensions of far too many.[43] Unstructured executive compensation arrangements that had allowed the executives to make a "run on the bank" were to blame.

The political reaction was swift. The Sarbanes-Oxley Act ("SOX"), which was passed in July 2002, contained the first real attempt to reform executive compensation through direct regulation since President Clinton's ill-fated initiative of the early 1990s. Seeking to avoid another Enron-type situation, it imposed restrictions on company stock sales during retirement plan blackout periods, required executive pay to be disgorged in the event of an accounting restatement, and also imposed a freeze on extraordinary payments to executives where those individuals were charged with violating securities laws.[44] Even if SOX had not been explicitly passed as a reaction to the outcry over Enron, as well as the similar WorldCom,[45] an American public intimately familiar with the facts of the case could see how the government was trying to shore up the system to prevent recurrence. Two years after SOX was passed, Enron was still affecting compensation legislation. Under the American Jobs Creation Act of 2004, Section 409A was added to the Tax Code to try to prevent executive plunder of companies at the expense of shareholders and employees by placing strict

43. *See An Overview of the Enron Collapse: Hearing Before the S. Comm. on Commerce, Sci., and Transp.*, 107th Cong. 13–15 (2001) (statement of Robert Vigil, Elec. Machinist Working Foreman, Portland Gen. Elec. Pelton/Round Butte Hydroelectric Project), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-107shrg82282/pdf/CHRG-107shrg82282.pdf; Paul Murphy, *Outrage at Enron's $55m Bonuses*, GUARDIAN (Dec. 7, 2001), http://www.guardian.co.uk/business/2001/dec/07/corporatefraud.enron; Don van Natta, Jr., *Bipartisan Outrage but Few Mea Culpas in Capital*, N.Y. TIMES (Jan. 25, 2002), http://www.nytimes.com/2002/01/25/business/enron-s-collapse-the-impact-bipartisan-outrage-but-few-mea-culpas-in-capital.html.

44. *See Sarbanes-Oxley Act—Implications for Executive Compensation*, MCDERMOTT, WILL & EMERY (Aug. 2002), http://www.mwe.com/publications/uniEntity.aspx?xpST=PublicationDetail&pub=5788. Nearly all law firms have devoted significant online resources to explaining SOX provisions to their clients and helping them with compliance. *See, e.g.*, *id.*

45. For a pessimistic take, see Liazos, *supra* note 6.

limits on deferred compensation.[46] It did so mainly by ensuring that executives could not influence the timing of severance and other payments, thereby eliminating their ability to "raid the bank" and withdraw massive amounts when such sums were most needed by the company to stay afloat.[47]

B. Culture

The new millennium also saw the rise of a new movement of academic criticism from the legal perspective, starting with an article published in the *University of Chicago Law Review* by Lucian Bebchuk, Jesse Fried, and David Walker entitled "Managerial Power and Rent Extraction in the Design of Executive Compensation."[48] Rather than seeing executive compensation as the result of an "optimal contract approach," whereby the goal is to minimize agency costs between principals (*i.e.*, shareholders, who own the company) and agents hired to run the business on their behalf (*i.e.*, executives) so as to maximize shareholder value,[49] the authors took a darker view of the matter.[50] They instead saw compensation schemes as resulting from the "managerial power" approach. Under the "managerial power" theory, setting compensation is not the result of an arms-length bargain, but rather the managers' use of their power to inflate their salaries and extract rent payments far higher than they deserve.[51] The executive's insatiable appetite is not constrained by the board as another agent of the shareholders, but instead by the "outrage" their package will generate vis-à-vis the shareholders and the public at large.[52] While these "outrage costs" limit executive demand, they also incen-

46. *See Executive Compensation After the American Jobs Creation Act*, EXEC. COMP. L. ALERT (Loeb & Loeb LLP, L.A.), Jan. 2010.

47. *See id.* For an overview of the ways 409A affects severance arrangements, see generally James V. Telfer & Emilie C. Mathieu, *Drafting Severance Provisions in Executive Employment Agreements After I.R.C. §409A*, BENDER'S CAL. LAB. & EMP. BULL., Jan. 2008, at 20.

48. Lucian Arye Bebchuk, Jesse M. Fried, & David I. Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751, 753–54 (2002).

49. For a more detailed description of this agency relationship, see Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

50. *See* Bebchuk, Fried, & Walker, *supra* note 48, at 754–55.

51. *See id.*

52. *Id.* at 756.

tivize executives to act less than honorably, resorting to more complicated pay structures to "camouflage" their actual compensation, including options,[53] which incidentally are often conveniently structured to be performance-related and therefore benefit from Section 162(m). The ensuing reduction in shareholder value from these typically economically inefficient remuneration schemes adopted largely for the sake of camouflage is one of the most pernicious results of the managerial power approach, according to Bebchuk, Fried, and Walker.[54] They go on to cite numerous examples of perverse pay practices that can only be explained by a managerial power approach, including use of in-the-money options, option repricing, and golden parachute payments.[55]

This argument—later the basis for a book co-authored by Bebchuk and Fried, *Pay Without Performance*—has changed the way that executive compensation is discussed and regulated in the United States.[56] By highlighting the endemic structural problem in executive compensation, Bebchuk, Fried, and Walker established a causal link between corporate culture and the "problem" of executive compensation.[57] Subsequent litera-

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53. *Id.* at 756–57.

54. *Id.*

55. *See id.* at 757–61. An in-the-money option is an option to buy a stock for a price less than its current market value. Option repricing is a procedure whereby stocks that are significantly out of the money, *i.e.*, their strike price is far greater than their fair market value, are repriced so that the strike price is less than fair market value. Finally, a golden parachute is a payment typically included in a CEO's employment agreement entitling her to a significantly larger-than-usual severance payment in the event that she leaves within a certain time period before or after a change of control (*e.g.*, merger, acquisition, hostile takeover, etc.).

56. It has also turned Bebchuk and Fried into household names in the executive compensation arena. Indeed, Bebchuk was asked to give expert testimony in 2007 to the House Financial Services Committee on Shareholder Advisor Votes on Compensation. *Hearing on Empowering Shareholders on Executive Compensation Before the H. Comm. on Financial Services,* 110th Cong. (2007) (written testimony of Lucian A. Bebchuk, William J. Friedman and Alicia Townsend Friedman Professor of Law, Economics, and Finance, and Director of the Corporate Governance Program Harvard Law School), *available at* http://www.law.harvard.edu/faculty/bebchuk/.

57. For articles exploring this topic, see Arthur Levitt, Jr., *Corporate Culture and the Problem of Executive Compensation*, 30 J. CORP. L. 749, 749–50 (2004); Jeffrey N. Gordon, *Executive Compensation: If There's a Problem, What's the Remedy? The Case for "Compensation Discussion and Analysis,"* 30 J. CORP. L. 675, 676 (2004).

ture has in large part been guided by their article and falls into two groups. The first includes those who built on various portions of what Bebchuk, Fried, and Walker had described, including further elaboration on the kinds of inefficiencies stock options created and the risks they incentivized,[58] and assessments of whether compensation consultants are truly independent or simply another tool managers use to extract higher rents under the managerial power theory.[59] The second group includes those who try to find a solution to the problem of managerial power posed by Bebchuk, Fried, and Walker, namely via some other form of control, such as transparency in the Compensation Discussion and Analysis ("CD&A") portion of a company's proxy statement[60] or the mitigating influence of the institutional investor.[61] There have been astonishingly few articles that argue against Bebchuk, Fried, and Walker's basic premise; even Judge Richard Posner acknowledges, albeit in a limited manner, that the pay without performance problem is real and more dire than he had foreseen.[62] He goes so far as to suggest that colleagues who say the costs of regulation outweigh the benefits should not stand in the way of reform.[63] In evaluating political reforms since Bebchuk, Fried, and Walker's 2002 publication, it is easy to identify how the dialogue around their article has changed the concept of the problem to be fixed. For example, the rules on taxation of deferred compensation passed in 2004 and required to be implemented for all existing compensation arrangements by December 31, 2008, essentially

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58. *See* Wm. Gerard Sanders & Donald C. Hambrick, *Swinging for the Fences: The Effects of CEO Stock Options on Company Risk-Taking and Performance*, 50 ACAD. MGMT. J. 1055 (2007); Simone M. Sepe, *Making Sense of Executive Compensation*, 36 DEL. J. CORP. L. 189 (2011).

59. *See*, *e.g.*, Kevin J. Murphy & Tatiana Sandino, *Executive Pay and "Independent" Compensation Consultants*, 49 J. ACCT. & ECON. 247 (2009).

60. For further discussion about how regulation and transparency may be a bad thing, see Jennifer G. Hill, *Regulating Executive Remuneration: International Developments in the Post-Scandal Era*, 3 Eur. Company L. 64 (2006).

61. *See* Jay C. Hartzell & Laura T. Starks, *Institutional Investors and Executive Compensation*, 58 J. FIN. 2351 (2003); Gavin S. Smith & Peter L. Swan, *Too Good to Be True: Do Concentrated Institutional Investors Really Reduce Executive Compensation Whilst Raising Incentives?*, (20th Australasian Fin. and Banking Conf. 2007, Working Paper, 2007), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=979525.

62. Richard A. Posner, *Are American CEOs Overpaid, and, if So, What if Anything Should Be Done About It?*, 58 DUKE L. J. 1013, 1045–47 (2009).

63. *Id.*

force companies to set a rigid payment structure in place or else face excise taxes that can essentially wipe out the value of any payments.[64] Thus, the Tax Code structures the timing of the payments,[65] not the executive or the board because, as established by Bebchuk, Fried, and Walker's premise, the two are colluding, whether or not they mean to. The clear implication is that the parties negotiating executive compensation are not to be trusted. The clearest result of Bebchuk, Fried, and Walker's influence, however, was the U.S. legislative reaction to the 2007 financial crisis, the Dodd-Frank Act, which sought to require a very clear disclosure tactic to cut through the camouflage—the comparison of CEO pay to median pay, a rule which has yet to be implemented.[66]

C. Dodd-Frank

The 2007 financial crisis was arguably the first great economic crisis in America for which compensation explicitly bore a significant amount of the blame, which is perhaps why the legislative response was slightly broader than prior targeted attempts.[67] Though the cause of the crisis was largely deemed to

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64. *See* Telfer & Mathieu, *supra* note 47. For this reason, law firms started warning their clients about compliance early on in 2008. For example, Orrick, Herrington & Sutcliffe's Compensation & Benefits group sent out two client alerts in 2008 within the space of a month and a half: one on July 31, 2008 and another on September 15, 2008. *See Compensation and Benefits Publications*, *Alerts*, ORRICK, http://www.orrick.com/publications/practice_alerts.asp?practiceID=9&practice=Compensation%20and%20Benefits (last visited Dec. 28, 2012).

65. *See* Telfer & Mathieu, *supra* note 47.

66. The SEC was supposed to issue these rulings between July and December of 2012. *See SEC Updates Its Dodd-Frank Rulemaking Schedule*, DAVIS POLK & WARDWELL LLP (Jan. 3, 2012, 11:25 AM), http://www.davispolk.com/briefing/corporategovernance/blog.aspx?entry=137. However, as of press time, no final regulations have been issued; the rulemaking is noticeably absent from the SEC's list of "accomplishments," which includes both proposed and finalized regulations. *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Accomplishments*, U.S. SEC. & EXCH. COMM'N, http://www.sec.gov/spotlight/dodd-frank/accomplishments.shtml#cgov (last modified Feb. 6, 2013).

67. In the Great Depression, criticism of executive compensation came afterwards as part of a continuing pattern of trouble in America, and the small 2001–2002 recession had more to do with the tech bubble bursting and 9/11 than it ever did with compensation. However, given that even these ma-

be the real estate bubble and the sale of derivatives that packaged the resulting mortgages together,[68] investment in these toxic financial products was seen as being a matter of executive compensation.[69] More specifically, these funds were created, sold, and chosen as investment vehicles because they brought significant short-term gain, which CEO compensation packages were geared to reward.[70] Even before analyses of the roots of the financial crisis came to the fore, tempers were already flaring over the division of riches: while the American economy fell headlong into recession, layoffs and all, during the fall and winter of 2008 to 2009, the very banks that had been propped up by taxpayer money were preparing to pay millions in bonuses.[71] The restrictions on executive pay to ailing financial institutions receiving federal aid contained in the October 2008 Emergency Economic Stabilization Act ("EESA")[72] and the appointment of a federal "Pay Czar" to oversee pay packages at such institutions did little to calm the ensuing furor. In January 2009, a bill was introduced in the Senate to limit total executive compensation at bailed-out financial institutions to a total of 400,000 USD.[73] In introducing the bill, sponsor Senator Claire McCaskill "call[ed] Wall Street executives 'a bunch of idiots' who were 'kicking sand in the face of the American taxpayer.'"[74] Though the final EESA regulations, which were also

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jor economic setbacks only resulted in highly specific regulation, as described above, passing a broader package is no small feat.

68. FINANCIAL CRISIS INQUIRY COMM'N, *supra* note 8, at xvi.

69. *Id.* at 64.

70. *Id.*

71. *See* Andrew Ross Sorkin, *If This Won't Kill the Bonus, What Will?*, N.Y. TIMES DEALBOOK (Oct. 7, 2008, 3:06 AM), http://dealbook.nytimes.com/2008/10/07/if-this-wont-kill-the-bonus-what-will/.

72. *See generally Executive Pay Restrictions for TARP Recipients: An Assessment: Hearing on TARP and Executive Compensation Restrictions Before the U.S. Cong. Oversight Panel*, 111th Cong. (2010) (testimony of Kevin J. Murphy, Kenneth L. Trefftzs Chair in Finance, University of Southern California Marshall School of Business) [hereinafter Murphy, *Hearing on TARP*], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1698973. As a point of comparison, according to an annual Associated Press survey, in 2007, U.S. CEOs of S&P 500 companies on average in 2007 earned over 8 million dollars. Ely Portillo, *CEO Pay on the Rise*, WCNC.COM, (June 19, 2011, 6:31 PM), http://www.wcnc.com/news/CEO-pay-on-the-rise-124164279.html.

73. Murphy, *Hearing on TARP*, *supra* note 72, at 5.

74. *Id.*

"blended" with additional compensation regulations proposed by the Obama team, were indeed comprehensive and changed executive pay at least in the short run,[75] the restrictions only applied to those institutions that had accepted emergency funds from the government, namely large firms in the financial sector.[76] As such, EESA fits within the general piecemeal pattern of prior regulation. The situation also offered a sort of perfect storm for more stringent regulations: given that these companies were arguably being kept afloat by taxpayer money, the government had viable leverage to impose restrictions far more severe than it would have otherwise been able to. Indeed, the financial institutions found these restrictions so onerous that many hurried to repay federal assistance solely for the purpose of regaining control over their compensation policies.[77]

The first attempt at comprehensive pay regulation to deal with the broader lessons of the Great Recession came almost two years after EESA in Dodd-Frank, signed into law by President Obama on July 21, 2010.[78] Over a year in the making, the law was contentious from the start, passing only on party-line voting under a Democratic Congress,[79] and drew its power largely from the authority granted to it to regulate public companies under the Securities and Exchange Acts. Rather than treating the symptoms, it aimed to stem the cause of the problems, with the ambitious aim of combating the compensation failures at public companies that had more broadly hastened, or at least contributed to, the onset of the financial crisis.[80] Under Dodd-Frank, public companies are required to give shareholders a non-binding say-on-pay vote at least once every three years; implement and disclose a clawback policy; disclose whether the CEO and chairman positions are held by the same person and if so, why; ensure its compensation committee

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75. *See id.* at 8–9.

76. *See id.* at 4, 8–9.

77. *See* Brill, *supra* note 11.

78. *See* Helene Cooper, *Obama Signs Overhaul of Financial System*, N.Y. TIMES, July 22, 2010, at A3.

79. *See* Brady Dennis, *Congress Passes Financial Reform Bill*, WASH. POST, July 16, 2010, at A1; David Dayen, *Dodd-Frank Passes House*, FIREDOGLAKE (June 30, 2010, 4:02 PM), http://news.firedoglake.com/2010/06/30/dodd-frank-passes-house/.

80. *See* Press Release, U.S. Dep't of the Treasury, Statement by Treasury Secretary Tim Geithner on Compensation (June 10, 2009), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg163.aspx.

members are fully independent, not unlike audit committee members, and wield certain oversight responsibilities; and draft annual proxy statements that contain a clear description of the relationship between executive compensation and the company's performance as well as the ratio of the median of all salaries, excluding that of the CEO, to the CEO's compensation.[81]

Dodd-Frank, then, would seem to imply a new era of executive compensation regulation in the United States, providing investors with new information and giving them a say on compensation which, while non-binding, has been shown, at the very least, to mitigate so-called "pay for failure."[82] However, the law remains highly contentious. Republicans in particular are vociferous in calling for its repeal, in whole or in part; the financial industry has spent a great deal of money lobbying against it; and the law has also suffered setbacks in court.[83] In addition, the Securities and Exchange Commission ("SEC"), charged with enacting many of the rules and regulations to

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81. *See* Stephen M. Bainbridge, *The Corporate Governance Provisions of Dodd-Frank* 2 (UCLA Sch. of Law, Law-Econ Research Paper No. 10-14, 2010), *available at* http://ssrn.com/abstract=1698898; PricewaterhouseCoopers, *Dodd-Frank Wall Street Reform and Consumer Protection Act—an Overview*, TO THE POINT, Fall 2010, at 1, 1, 7, *available at* http://www.pwc.com/us/en/corporate-governance/assets/to-the-point-fall-2010.pdf.

82. *See, e.g.*, Fabrizio Ferri & David Maber, *Say on Pay Vote and CEO Compensation: Evidence from the UK*, J. FIN. (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1420394.

83. *See House Republicans Give Dodd-Frank a Failing Grade*, REUTERS, July 15, 2011, *available at* http://www.reuters.com/article/2011/07/15/us-financial-regulation-republicans-idUSTRE76E4W120110715; Ben Protess, *Wall Street Continues to Spend Big on Lobbying*, N.Y. TIMES DEALBOOK (Aug. 1, 2011, 2:33 PM), http://dealbook.nytimes.com/2011/08/01/wall-street-continues-to-spend-big-on-lobbying/. Republicans have also introduced several bills to try to overrule various portions of the law. *See* Meredith Shiner, GOP Begins Rollback of Wall St. Reform, POLITICO (Mar. 16, 2011, 8:50 PM), http://www.politico.com/news/stories/0311/51458.html#ixzz1GtVghkik. For examples of setbacks in court and explanations as to why so many cases have gone against the SEC, see Ben Protess, *Court Ruling Offers Path to Challenge Dodd-Frank*, N.Y. TIMES DEALBOOK (Aug. 17, 2011, 8:41 PM), http://dealbook.nytimes.com/2011/08/17/court-ruling-offers-path-to-challenge-dodd-frank/; Eugene Scalia, *Why Dodd-Frank Rules Keep Losing in Court*, WALL ST. J. (Oct. 3, 2012, 7:04 PM), http://online.wsj.com/article/SB10000872396390444004704578032223012816236.html.

carry out the law, including all of the executive compensation provisions, is woefully behind on its rule-making schedule.[84] According to a one-year anniversary report on the progress made in implementing Dodd-Frank published by the law firm Davis Polk & Wardwell LLP, as of July 22, 2011, regulators had only completed thirty-three of the 163 required rulemakings; in other words, they had only met roughly 20% of the rulemaking requirements in the year following Dodd-Frank's passage.[85] Furthermore, executive compensation has received only secondary attention—the top five topics for meetings with outside groups on proposed regulations as of the one-year anniversary did not include executive compensation.[86] Rulemaking has also progressed at a slow pace: while say-on-pay rules were promulgated in January 2011, it was not until a year and a half later in June 2012 that the SEC re-visited the topic of executive compensation, and no rules have been issued in the months since.[87]

Where, then, does this leave executive compensation reform in America? Those who had hoped that Dodd-Frank might answer that question are left unsatisfied, with major topics left unanswered. But perhaps that is part of the answer: we have yet to truly commit to enacting the necessary rules. On the one side, businesses have complained loudly about how onerous the regulations are, particularly the CEO-to-mean salary ratio.[88] On the other side, public ire is alive and well. An article in *The*

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84. *See* Reese Darragh, *Dodd-Frank, One Year Later*, COMPLIANCE WEEK (July 26, 2011), http://www.complianceweek.com/dodd-frank-one-year-later/printarticle/208135/.

85. *Dodd-Frank Progress Report: One-Year Anniversary Report*, DAVIS POLK & WARDWELL (July 22, 2011), http://www.davispolk.com/files/uploads/FIG/072211_Dodd_Frank_Progress_Report.pdf. The two-year anniversary report showed a slight increase: 30% of the overall required rulemaking to date has in fact occurred. *Dodd-Frank Progress Report: Two-Year Anniversary Report*, DAVIS POLK & WARDWELL (July 18, 2012), http://www.davispolk.com/Dodd-Frank-Rulemaking-Progress-Report/ (follow "Access Report" hyperlink under "Dodd-Frank Two-Year Anniversary Progress Report").

86. *Dodd-Frank Progress Report: One-Year Anniversary Report*, *supra* note 85.

87. *Implementing Dodd-Frank Wall Street Reform and Consumer Protection Act—Accomplishments*, *supra* note 66.

88. Arielle Bikard, *Debate Heats up over CEO Pay Ratio Disclosure*, COMPLIANCE WEEK (Mar. 29, 2011), http://www.complianceweek.com/debate-heats-up-over-ceo-pay-ratio-disclosure/printarticle/199177/.

Washington Post in the summer of 2011 drew strings of heated comments from readers,[89] to say nothing of the Occupy Wall Street movement. Even the Pay Czar himself, Ken Feinberg, has grown tired of the refrain that increased pay regulation will mean a mass departure of all the "best and the brightest" from the very firms that need them the most.[90] In addition, while Dodd-Frank's specific executive compensation changes were built on solid principles, they remain, to a certain degree, pointed: disclosure is to be changed here, requirements upgraded there, without articulating a true philosophy that could give investors and companies alike a default. With this in mind, it is interesting to turn to Germany—a country that enacted a law quickly, which also came into force quickly—to see whether the United States might learn lessons that could alter the debate and instigate real change.

II. German Background

A. Compensation Culture

Though compensation culture in Germany diverges sharply from that in the United States in many respects, they have at least one point in common: excessive compensation in Germany is also hotly debated in politics, the media, and academic research.[91] The uproar two years ago caused by the fifty million euro severance package paid to the exiting CEO of Porsche, Wendelin Wiedeking, is a story similar to many of the excessive compensation narratives in the U.S. media.[92] It is, however,

89. Peter Whoriskey, *With Executive Pay, Rich Pull away from the Rest of America*, Comments, WASH. POST, (June 18, 2011), http://articles.washingtonpost.com/2011-06-18/business/35234600_1_income-gap-personal-income-capital-gains.

90. *See* Kenneth R. Feinberg, Special Master for TARP Executive Compensation, A Conversation with Kenneth Feinberg (Mar. 4, 2010) (transcript available at http://www.cfr.org/financial-crises/conversation-kenneth-feinberg/p21614).

91. Ann-Kristin Achleitner et al., *Ausgewählte Aspekte der Vorstadsvergütung in börsennotierten Unternehmen: Familien- versus Nicht-Familienunternehmen* [*Selected Aspects of Executive Remuneration in Listed Firms: Family vs. Non-Family Firms*], 3 ZEITSCHRIFT FÜR CORPORATE GOVERNANCE 113, 113–118 (2010).

92. *See* William Boston, *Is Porsche's Exiting Boss a Symbol of Capitalist Excess?*, TIME (July 25, 2009), http://www.time.com/time/world/article/0,8599,1912669,00.html.

worth noting that unlike what his American counterpart likely would have done, Wiedeking not only requested a more modest amount, but also almost immediately promised to donate half of his payout to a charity sponsored by Porsche.[93] Rather than the exception, Wiedeking is the product of a different compensation culture than the United States, one where executive compensation has only recently reached heights of extraordinary contention. This was due, likely not in small part, to the fact that executive compensation remained relatively low until around the end of the twentieth century. In 1997, *Focus*, a German magazine, published an article claiming that German executives were underpaid given the results they produced.[94] An examination of the list of top earners in both countries underlined the point. While the top executives at Daimler-Chrysler, BMW, VEBA, and Siemens in Germany earned between 2 and 3.5 million deutschmarks per year, their American counterparts at Daimler-Chrysler, GE, Intel and Healthsouth earned between 20 and 181 million deutschmarks.[95]

Two historical reasons help explain the imbalance. First, German public companies are governed by the *Aktiengesetz*, which for a long time did not allow them to offer the kinds of stock option plans that had been pushing executive compensation in the United States upwards.[96] Thus, until around 1998, German companies simply did not have the tools to pay their executives on a scale anywhere equal to executives employed by U.S. companies.[97] The other reason has to do with German corporate governance. While the United States deploys what has been termed by some authors as "stock market" or "Anglo-American capitalism," Germany's businesses have long prac-

93. *Id.*

94. *See* Julie Ann Elston & Lawrence G. Goldberg, *Executive Compensation and Agency Costs in Germany*, 27 J. BANKING & FIN. 1391, 1393 (2003).

95. *Id.* The deutschmark was rendered obsolete by the introduction of the euro in 2000, but these sums would be respectively over 131 million USD for the U.S. group of CEOs, and between approximately 1.5 and 2.5 million USD for the German CEOs. *See German Mark (DEM) Currency Exchange Rate Conversion Calculator*, COINMILL.COM, http://coinmill.com/DEM_calculator.html (last visited Dec. 29, 2012). Regardless of the currency conversions, it is the scale that is impressive, with some U.S. CEOs earning ten times what their German counterparts did.

96. *See* Brian R. Cheffins, *The Metamorphosis of "Germany Inc.": The Case of Executive Pay*, 49 AM. J. COMP. L. 497, 511 (2001).

97. *See id.*

ticed "welfare capitalism" instead.[98] Under the Anglo-American model, the company is seen as being run for the benefit of the shareholders, which means stock value is paramount, along with the mutually reinforcing institutions that allow this value to properly reflect that of the company, including disclosure and accounting rules promoting a full and fair depiction of the company, and hostile takeovers, by which an inefficient management board is replaced by another that will better run the company for the shareholders.[99] The company is highly capitalized and has a dispersed shareholder base.[100] Welfare capitalism, on the other hand, prioritizes all of the stakeholders of the company, from employees to creditors to shareholders.[101] Groups of influential stakeholders tend to be employees and banks, who, as insiders, benefit from strong information disclosure, as opposed to outsiders, who receive far less information than under the Anglo-American model.[102] The company is not as highly capitalized, seeking much of its financing from banks that have close ties to the company as shareholders and major creditors.[103] The difference in models has a significant impact on executive compensation, among other strategic decisions.[104] The argument for share-based compensation theoretically makes a great deal more sense under the Anglo-American model, because it ties the interests of the executive to those of the constituency he or she is expected to serve. Under welfare capitalism, the argument goes, executive compensation will be kept low because of the influence of employees and creditors on the compensation-setting process. In short, welfare capitalism should, in theory, be more egalitarian and more sustainable than the Anglo-American model.[105]

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98. Trevor Buck & Azura Shahrim, *The Translation of Corporate Governance Changes Across National Cultures: The Case of Germany*, 36 J. INT'L BUS. STUD. 42, 43 (2005).
99. *Id.*
100. *See* Cheffins, *supra* note 96, at 498–99.
101. Buck & Shahrim, *supra* note 98, at 43.
102. *Id.*
103. *See* HORST SIEBERT, THE GERMAN ECONOMY: BEYOND THE SOCIAL MARKET 228–29 (2005); GRUNDMANN, *supra* note 19, at 333.
104. Buck & Shahrim, *supra* note 98, at 43.
105. *See id.* at 48; Cheffins, *supra* note 96, at 500–01.

However, in the past ten years, much ink has been spilled proclaiming the end of welfare capitalism.[106] The two largest executive compensation sensations in Germany prior to the financial crisis (and to Wiedeking's severance controversy) both spurred public outrage and served as examples to prove that changing compensation structures marked a shift away from welfare capitalism, bringing with it the need for increased regulation. The first of these sensations was the Daimler-Chrysler merger at the end of the 1990s. As pointed out in numerous articles at the time, the difference in compensation philosophy and actual pay at the two companies was astonishing. In 1997, the entire management board of Daimler—ten people—collectively earned two million USD less than the vice-chairman of Chrysler alone.[107] Though some suggested that the Americans would have to tone down their monetary expectations, at least one compensation expert read the cards right, saying, "Over time, you'll see the Daimler-Chrysler executive pay practice evolve into something much closer to what Chrysler management is used to."[108] Indeed, in 2000, Daimler-Chrysler implemented a five-year American-style stock option plan, covering some 4000 non-U.S. executives.[109] By 2004, a mere six years after the merger, Daimler-Chrysler faced wrath from all sides, including the former CEO of Daimler-Benz, because executive pay had risen 130% even as the company was preparing to announce layoffs.[110] Politicians, both liberal and

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106. *See* Harald Baum, *Change of Governance in Historic Perspective: The German Experience*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES AND MARKETS IN EUROPE, JAPAN, AND THE US 3, 14 (Klaus J. Hopt et al. eds., 2005); Cheffins, *supra* note 96, at 501; Nuno G. Fernandes et al., *Are US CEOs Paid More? New International Evidence* 28 (European Corporate Governance Inst., Finance Working Paper No. 255/2009, 2012), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1341639.

107. *DaimlerChrysler Will Face Wide Gap in Executive Pay*, WARDSAUTO (June 1, 1998), http://wardsautoworld.com/ar/auto_daimlerchrysler_face_wide/.

108. *Id. Cf.* Joseph Sargent, *What Daimler-Chrysler Means to Shareholders*, 12 GLOB. FIN. 8 (1998) ("Daimler shareholders fear that executive pay will skyrocket.").

109. Kemba J. Dunham, *Why US-Based Executives Get Paid More*, EXPATICA.COM (Aug. 19, 2004), http://www.expatica.com/hr/story/why-us-based-executives-get-paid-more-10840.html.

110. Deutsche Welle Staff, *Calls Go out to Limit Executive Salaries*, DEUTSCHE WELLE (July 21, 2004), http://www.dw-world.de/dw/article/0,,1273121,00.html.

conservative, were quick to condemn the payments,[111] and in the face of the outrage and strikes by employees, executives agreed to forego up to 10% of their pay.[112]

Also in 2004, another major compensation sensation exploded in Germany. January marked the start of the Ackermann trial as a result of the Mannesmann affair,[113] Germany's version of the *Disney* litigation. In November 1999, Vodafone launched a hostile bid to take over Mannesmann AG, a German cell phone company.[114] Following the lead of its CFO, Klaus Esser, shareholders rejected the deal of 240 euro per share (Mannesmann had, at the time, a market value of 203 euro per share), and hostilities continued between the companies until a final deal was reached giving the shareholders 360 euro per share.[115] On the heels of the deal, Esser was awarded a 10 million pound sterling bonus by members of the supervisory board, including Ackermann.[116] The reaction by the public was overwhelmingly negative, but the bonus was paid nevertheless, and a month later, the federal attorney's office in Düsseldorf filed charges against the responsible members of the board, *inter alia*, alleging a breach of trust.[117] The matter was ultimately settled out of court with a payment of 5.8 million euro.[118]

Though there were no further large severance payment scandals until Wiedeking's in 2007, the stage had already been set. Despite a relative lack of scandals and a shorter history of outrage, executive compensation became an issue as much ingrained in the public ire in Germany as it was in the United

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111. *Id.*

112. Just-Auto.com Editorial Team, *Government Welcomes DaimlerChrysler Offer to Cut Board Member Pay in Working Hours Dispute*, JUST-AUTO.COM, July 19, 2004, http://www.just-auto.com/news/government-welcomes-daimlerchrysler-offer-to-cut-board-member-pay-in-working-hours-dispute_id69013.aspx.

113. *Ackermann Criticizes German Law at Mannesmann Trial*, BLOOMBERG (Jan. 21, 2004), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aKzAkqAtscS0&refer=europe.

114. Franklin A. Gevurtz, Disney *in a Comparative Light* 7 (Feb. 26, 2007) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=965596.

115. *Id.*

116. *Id.* at 8.

117. *Id.*

118. *Id.* at 9.

States. Beyond that, however, there are few similarities. Perhaps these few scandals were treated with such venom because, in a country used to relatively modest compensation, these offenses seemed particularly egregious. Or perhaps the reaction was a call of alarm, channeling a sense that change was indeed afoot and that compensation was shifting to astronomical proportions, much to the dissatisfaction of many.[119]

B. Corporate Governance and Executive Compensation Regulation in Germany

1. German Level

Generally speaking, Germany got into the corporate governance game relatively late. Unlike the United States, Germany is an entirely code-based system—new laws must be enacted by the Bundestag, which, for the majority of the country's post-World War II history, was reluctant to enact changes in corporate law.[120] Whereas many corporate governance provisions in the United States tend to be enacted administratively, through the SEC—such as the requirement of a CD&A section or the recent addition of say-on-pay under Dodd-Frank—Germany has no SEC equivalent, and capital market law, far from being advanced to the point of a corporate governance tool, was barely regulated.[121]

It is also possible that corporate structure played a role. Whereas in the United States, a public company is run by a single board of directors consisting of company management, such as the CEO and CFO, as well as directors from outside the company, a public company in Germany (an "*Aktiengesellschaft*" or "*AG*") has two boards, or more precisely, a two-tier

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119. *See generally, e.g.,* Michael Adams, *Vorstandsvergütungen—Die Fälle Mannesman und DaimlerChrysler*, *in* REGULIERUNG, WETTBEWERB UND MARKTWIRTSCHAFT / REGULATION, COMPETITION, AND THE MARKET ECONOMY. FESTSCHRIFT FÜR C.-C. VON WEIZSÄCKER ZUM 65. GEBURTSTAG 295–364 (Hans G. Nutzinger ed., 2003). Since reunification, however, reform has proceeded at a significantly sharper pace, both on the national and European Level, enacting essentially significant reform every other year since 1998. For excellent coverage of European and German national corporate governance, see Section 14 GRUNDMANN, *supra* note 19.

120. *See* Gerald Spindler, *Scandals, Regulation, and Supervisory Agencies*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES AND MARKETS IN EUROPE, JAPAN, AND THE US, *supra* note 106, at 112–13.

121. *See id.*

board.[122] One board, a management board called the *Vorstand*, is composed of "inside" directors who are employed by the company and typically includes the CEO, CFO, and other important executives.[123] Under the *Aktiengesetz*, the law governing *AG*s, the *Vorstand* is charged with running the company, which it does in accordance with its own business rules and judgment.[124] The other board, a supervisory board called the "*Aufsichtsrat*", is made up of "outside" directors whose task is to supervise the work of the *Vorstand* and how it manages the company.[125] The *Aufsichtsrat* cannot specifically instruct the *Vorstand*, but it must be consulted on certain important matters and formally approve the financial statements.[126] With a formal supervisory system built into the AG, which contains its own strict demands in terms of organization, accounting, and legal housekeeping,[127] perhaps the need for Anglo-American style corporate governance measures becomes less pressing.[128]

In any case, change came from without, not from within, in the form of global competition. With the increasing Anglo-Americanization of the international business world, retaining investors required investing in the Anglo-American corporate governance model.[129] For international business, the New York Stock Exchange remains paramount, and companies listed on that exchange must comply—to differing extent for domestic and foreign companies—with the corporate governance provisions woven into the fabric of the SEC regulations.[130] Though foreign listed companies must comply with fewer disclosure re-

122. GERHARD WIRTH ET AL., CORPORATE LAW IN GERMANY 71–72 (rev. 2d ed. 2010).

123. *Id.* at 71–72, 100.

124. *Id.*

125. *Id.* at 116.

126. *Id.* at 100, 116–17.

127. *Id.* at 71.

128. Dr. Carsten Jungmann, *The Dualism of One-Tier and Two-Tier Board Systems in Europe*, Summer School on European Business Law 2008, Düsseldorf Law School, http://www.duslaw.eu/de/veranstaltungen/intensiv/summer-school/2008-08-04.

129. *See* Baum, *supra* note 106, at 18; Klaus J. Hopt, *European Company Law and Corporate Governance*, *in* CORPORATE GOVERNANCE IN CONTEXT: CORPORATIONS, STATES AND MARKETS IN EUROPE, JAPAN, AND THE US, *supra* note 106, at 133.

130. *See* Ted Kamman et al., *Foreign Private Issuers of Equity Securities in the United States*, JONES DAY, May 2009, at 30–31, 35–36. This is particularly true with respect to executive compensation disclosure. *See id.* at 13.

quirements, existing U.S. requirements have historically tended to be more stringent than those in Germany at any given time. For example, disclosure of the compensation of individual executives at public companies has only been required in Germany since the *Vorstandsvergütungs-Offenlegungsgesetz* ("VorstOG") came into power on August 11, 2005;[131] the U.S. requirement to disclose the compensation of the CEO and the four highest paid officers, who would typically sit on the *Vorstand* if the company were German, has been required since 1994.[132] Investors were used to seeing NYSE-listed DAX 30 companies like Siemens and Deutsche Bank reveal this information; therefore, it is little wonder that they might have soon questioned why the same information was not available from other German companies like Lufthansa and BMW.[133]

The corporate governance debate began in earnest in Germany in the mid-1990s.[134] In 2000, the German government set up a Corporate Governance Commission charged with identifying weaknesses in the German leadership and control systems in place in corporations, and to modernize the German system in light of increased globalization and international competition.[135] In July 2001, the Commission presented its report, the fruit of twelve months of intensive discussion and international comparison, particularly with the British Company Law Steering Group.[136] Many of the most important themes of the report could be categorized as allowing for better policing of the relationship between the *Aufsichtsrat* and the *Vorstand*. The report

131. Sybille Flindt, *German-listed Companies Now Required to Disclose Board Member Remuneration*, MCDERMOTT, WILL & EMERY: UPDATE FROM GERMANY, April 2006, at 3, *available at* http://www.mwe.com/info/news/gu0406.pdf.

132. Robert Lavasseur, *Executive Compensation in the Public and Private Sectors*, www.mcdowallassociates.com (last visited Feb. 13, 2013).

133. This ripple effect of U.S. public company regulation makes compensation disclosure in the United States all the more interesting and powerful—there are fewer opportunities to influence policy worldwide than via this avenue.

134. MATTHIAS HORNBERG, DIE REGELUNGEN ZUR BEAUFSICHTIGUNG DER GESCHÄFTSFÜHRUNG IM DEUTSCHEN UND BRITISCHEN CORPORATE GOVERNANCE KODEX [THE RULES FOR SUPERVISION OF MANAGEMENT IN GERMAN AND BRITISH CORPORATE GOVERNANCE] 62 (2005).

135. *Id.* at 64–65.

136. *Id.* at 66. Thanks to this rapport, there was a direct influence of the Anglo-American model on the report.

stressed bettering the mechanisms that make information available to the *Aufsichtsrat*, increasing the negative consequences of failure in their duties, and rendering *Vorstand* compensation more transparent through the development of a corporate governance code.[137] Accordingly, a Government Commission (*Regierungskommission Deutsche Corporate Governance Kodex*) was established in September 2001 with the express purpose of drafting precisely such a document[138] and it was adopted by the government on February 26, 2002, and signed into law in July of that same year.[139]

An understanding of the German Corporate Governance Code (the "Code") and its history is important because the Code continues to set the tone for corporate governance in Germany. The themes identified by the Corporate Governance Commission not only served as the centerpiece of the final Code, but also run through corporate governance and reform attempts to this day, including the VorstAG.[140] The Code provides comprehensive corporate governance guidance by both restating applicable law already in force in the corporate governance arena and adding new material in the form of sixty-eight recommendations and sixteen suggestions, which are aimed at improving transparency and heightening the trust of international investors.[141] The Code is made up of seven chapters: a foreword, a chapter on shareholders and the annual meeting, a chapter on cooperation between the *Vorstand* and *Aufsichtsrat*, and separate chapters on the *Vorstand* and *Aufsichtsrat*, transparency,

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137. *Id.* at 66–67. Interestingly, these general themes not only helped mould the German Corporate Governance Code, but also seem to serve as guiding principles that continue to influence the development of further corporate governance mechanisms in Germany. The VorstOG and VorstAG run very much along these lines.

138. Dr. Gerhard Cromme, Chairman of the Gov't Comm'n on the German Corporate Governance Code, Address at the Press Conference Following the Handing over of the German Corporate Governance Code (Feb. 26, 2002), *available at* http://www.corporate-governance-Code.de/eng/news/rede-cromme-20020226.html.

139. *German Corporate Governance Code*, COMM'N OF THE GERMAN CORPORATE GOVERNANCE CODE, http://www.corporate-governance-code.de/index-e.html (last visited Dec. 30, 2012).

140. Hornberg, *supra* note 134, at 66–67.

141. *See* Alexander Bassen et al., Behind Broad Corporate Governance Aggregates 2 (Apr. 23, 2008) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=965355.

and financial statements.[142] The recommendations within the Code themselves are technically not binding, but rather function on a "comply-or-explain" basis.[143] That is, under Section 161 of the *Aktiengesetz*, publicly traded companies must disclose annually the extent to which they have complied with the recommendations in the Code and describe the reasons for any non-compliance.[144] The failure to comply with suggestions, on the other hand, need not be addressed.[145] This mechanism was chosen because it was deemed to allow companies whose structures did not necessitate certain rules the ability to deviate from them. With flexibility being one of the guiding points for the Code, the idea was not to corset companies into inflexible structures.[146] An additional advantage of the comply-or-explain

142. *Id.* The German Corporate Governance Code is available in its entirety in DEUTSCHER CORPORATE GOVERNANCE KODEX [GERMAN CORPORATE GOVERNANCE CODE], Feb. 26, 2002 (Ger.), *translated in German Corporate Governance Code*, COMM'N OF THE GERMAN CORPORATE GOVERNANCE CODE (May 15, 2012), http://www.corporate-governance-code.de/eng/download/kodex_2012/D_CorGov_final_May_2012.pdf.

143. Bassen, *supra* note 141, at 2.

144. Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I at 1089, last amended by Gesetz [G], Aug. 24, 2004, BGBL. I at 2198, § 161 (Ger.); *see also* GERMAN CORPORATE GOVERNANCE CODE §1. Under the Green Paper on "The EU Corporate Governance Framework," companies may in the future also be required to explain why they did not comply. GRUNDMANN, *supra* note 19, at 328. However, many of the DAX 30 already engage in this practice.

145. GERMAN CORPORATE GOVERNANCE CODE §1. From a U.S. perspective, the "comply or explain" approach is a bit odd: American corporate governance provisions are mandatory with dire consequences that include delisting from an exchange (for example, per SEC and NASDAQ rules) or paying excise and other taxes (for example, per Section 162(m) or 280G of the Tax Code). For a discussion with respect to the SEC and NASDAQ rules, see *Frequently Asked Questions*, NASDAQ OMX LISTING CENTER, https://listingcenter.nasdaqomx.com/Show_Doc.aspx?File=FAQsContinued.html (last visited Dec. 30, 2012). For a discussion of the tax consequences under 162(m) and 280(G), see generally *Section 162(m): Requirements, Implications and Practical Concerns*, EXEQUITY, Sept. 2008; Christian McBurney, *Golden Parachute Planning a Key in Acquisitions of Public Companies*, NIXON PEABODY TAX ALERT, Nov. 2003, *available at* http://www.nixonpeabody.com/linked_media/publications/TA_11002003.pdf, respectively.

146. *See* Cromme, *supra* 138. For a discussion as to whether the Code actually provides this flexibility, see generally Paul Sanderson et al., *Flexible or Not? The Comply-or-Explain Principle in UK and German Corporate Governance* (Ctr. for Bus. Research, Univ. of Cambridge, Working Paper No. 407,

method is that theoretically it allows the market to be the ultimate arbitrator.[147] In other words, shareholders will vote with their feet should they deem corporate governance provisions insufficient.[148]

The problem with comply-or-explain, however, is that it assumes there are active shareholders who are informed about the different provisions in the Code and disclosure levels in general. It further assumes that disclosure levels would trump other considerations such that a particular company with a very low disclosure level would make investment so unattractive to these active, informed shareholders that they would be willing to sell their shares because the company has not complied with a Corporate Governance Code provision, even when the company might otherwise be doing well. The German government has thus taken an approach to corporate governance that might best be described as "recommendation plus." Whenever companies are not sufficiently following recommendations or suggestions in the Code, the government tends to turn them into binding law. A prime example deals with the disclosure of individualized compensation figures. In 2002, it was a suggestion. In 2003, it became a recommendation.[149] Finally, due to high levels of noncompliance, the VorstOG made it binding law in 2005.[150] The reports of the group in charge of administering and updating the Code read like a preview of coming attractions, with contentious items or provisions with low levels of compliance later the subject of mandatory regulation.[151] In a

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2010), *available at* http://www.cbr.cam.ac.uk/pdf/wp407.pdf. By way of example, comply-or-explain provisions would greatly alleviate the controversy surrounding the mean salary disclosure requirement in Dodd-Frank.

147. *See* Cromme, *supra* 138.

148. *See id.*

149. Joerg-Markus Hitz & Jörg R. Werner, Why Do Firms Resist Individualized Disclosure of Management Remuneration? 6 (Oct. 4, 2012) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1588186. According to a press release from March 11, 2005, in 2004, only 9 of the DAX 30 companies had published individualized executive compensation disclosure. *Commission of the Corporate Governance Code Press Release*, http://www.corporate-governance-Code.de/eng/archiv/index.html.

150. Hitz & Werner, *supra* note 149, at 5.

151. *See, e.g.*, Press Release, German Comm'n of the German Corporate Governance Code, Statement by Dr. Gerhard Cromme on Disclosure of Management Board Compensation (Mar. 11, 2005), *available at*

press release dated March 11, 2005, for example, the chair of the Government Commission mentioned that the ability of a member of the *Vorstand* to accede directly to the *Aufsichtsrat* upon his retirement from the former remained a hotly debated topic. Few careful readers should have been surprised, then, when the definitive answer to this question came as part of the VorstAG three years later.[152]

2. European-Level Governance Initiatives

In 2013, it is impossible to speak of the corporate governance environment and developments in Germany without addressing the broader European picture.[153] The European Union[154] has long been active in the realm of business law—indeed, one of the motivations driving unification was the desire to harmonize business law to help Europe compete with the United States as an attractive location for merger and acquisition activity.[155] Since 2000, the European Union has become increasingly active in corporate governance, a natural extension of its business law activism. On some level, corporate governance is about the decisions in a market economy that matter most for the public at-large, which includes investors.[156] Corporate governance measures, therefore, are of key importance for investors, providing some level assurance that the company into which they are sinking their money will be run according to certain accepted principles. What better way to win the global competition for investment than by using unified corporate

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http://www.corporate-governance-code.de/eng/download/11_03_2005_14_Uhr_PM_Zypries_EN.pdf.

152. Under the VorstAG, such a transition is only possible following a two-year cooling-off period, absent shareholder approval to the contrary. Press release, Commission on German Corporate Governance Kodex, Regierungskommission passt Kodexbeschlüsse im Zuge des Gesetzes zur Angemessenheit der Vorstandvergütung an (June 19, 2009), *available at* http://www.corporate-governance-code.de/ger/download/PM_Kodexanpassungen_VorstAG.pdf.

153. Indeed, it is now possible to speak of European company law as a body of company law applicable to companies headquartered in the EU. For more on European Company Law as a field and its advent, through the implementation of Directives and otherwise, see generally GRUNDMANN, *supra* note 19.

154. European Union here refers to the European Union as well as the European Commission, as the entity was called prior to the Treaty of Lisbon.

155. *See generally* GRUNDMANN, *supra* note 19, §29.I.

156. *Id.* at 321.

governance measures as a way to appeal to foreign investors, who might otherwise be wary of determining which provisions apply in a particular country?

The EU signaled its entry into the corporate governance fray in 2003. In that year the European Commission ("EC"), the forerunner of the EU, published an Action Plan on "Modernising Company Law and Enhancing Corporate Governance," the template for future corporate governance reform initiatives.[157] Like the German Code, the Action Plan was based on a report by high-level European company law experts.[158] That the EC's Competitiveness Counsel had commissioned the report further lent support to the idea that global competition for investors was a key concern.[159] The Action Plan formed the standing European Corporate Governance Forum, the body essentially tasked with carrying out the Action Plan, particularly with respect to encouraging coordination of national corporate governance codes.[160] Its role is essentially to track corporate governance measures and reforms by publishing and commissioning corporate governance evaluations of member countries.[161] These reports exert indirect pressure on governments, as they make it very clear to potential investors which countries comply with which rules and which countries have better or worse track records.[162]

Despite the plethora of corporate governance institutions, the EC/EU has historically produced little in the way of broadly

157. *See Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*, COM (2003) 284 final (May 21, 2003).

158. *Id.* at 4.

159. *See id.*

160. *Id.* at 16–17. For more on the role of the European Corporate Governance and their past activities, see *European Corporate Governance Forum*, EUROPEAN COMMISSION, http://ec.Europa.eu/internal_market/company/ecgforum/index_en.htm (last visited Dec. 30, 2012).

161. *European Corporate Governance Forum*, *supra* note 160.

162. *See*, *e.g.*, Commission Staff Working Document, *Report on the Application by the Member States of the EU of the Commission Recommendation on the Role of Non-Executive or Supervisory Directors of Listed Companies and on the Committees of the (Supervisory) Board*, SEC (2007) 1021 (July 13, 2007). Independent studies have also been done that track reform efforts. *See*, *e.g.*, EUGENIA UNANYANTS-JACKSON, DIRECTORS' REMUNERATION: A PAN-EUROPEAN PERSPECTIVE, (Alan Brett ed., 2006), *available at* http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=642651.

applicable, binding executive compensation regulation.[163] Efforts to date have yielded only one binding directive related to remuneration,[164] Directive 2010/76/EU, which requires financial institutions to implement "remuneration policies and practices that are consistent with effective risk management."[165] Aside from this directive, the EC/EU has typically handled remuneration matters by recommendation, which unlike directives, are not required to be implemented by member countries.[166] The first recommendation on director's pay came in 2004, shortly after the EC began to step up its corporate governance efforts.[167] This non-binding recommendation suggested that companies release a statement on general remuneration policy, include the matter in the agenda for the shareholders meeting, disclose individual executive remuneration, and require shareholder approval of share-based remuneration plans.[168] Additional recommendations were issued in 2009, in the wake of a 2007 report discussing compliance with the 2004 recommendation and the financial crisis.[169] These new recommendations were far more precise and showed a more nuanced understanding of executive compensation and how it needed to be reformed, with eight separate recommendations that addressed the structure of directors' remuneration as well as the process of setting the remuneration.[170] The recommendations

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163. For a history of the European Commission's involvement with remuneration, see *Remuneration Policies*, EUROPEAN COMMISSION, http://ec.Europa.eu/internal_market/company/directors-remun/index_en.htm (last visited Dec. 30, 2012).

164. *Id.*

165. European Parliament and Council Directive 2010/76, 2010 O.J. (L 329) 3, 3 *available at* http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:329:0003:0035:EN:PDF [hereinafter Directive 2010/76].

166. *See Remuneration Policies*, *supra* note 163.

167. Press Release, European Union, Directors' Pay–Commission Sets Out Guidance on Disclosure and Shareholder Control (Oct. 6, 2004), *available at* http://Europa.eu/rapid/pressReleasesAction.do?reference=IP/04/1183&format=HTML&aged=0&language=EN&guiLanguage=en.

168. *Id.*

169. *See Commission Recommendation on Remuneration Policies in the Financial Services Sector*, at 2, 3, SEC (2009) 580 (April 30, 2009).

170. Press Release, European Union, Directors' Pay: Commission Sets Out Further Guidance on Structure and Determination of Directors' Remuneration, (Apr. 29, 2009), *available at*

suggested, among other things, clawbacks, increasing the link between pay and performance, requiring a balance between fixed and variable pay, and a number of other targeted measures.[171] Some might question whether the VorstAG was influenced by this latest round of recommendations, which was made public on April 29, 2009, only a few months before the passage of the VorstAG.[172] However, this seems unlikely. While the VorstAG was not yet in force when the recommendations were published, it had already been proposed, with comments well underway, none of which reference the new European recommendations.[173] It is also worth remembering that much of what became law in the VorstAG had existed in the German Corporate Governance Code, a document that the EC/EU policies took into account when framing their recommendations.[174]

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http://Europa.eu/rapid/pressReleasesAction.do?reference=IP/09/673&format=HTML&aged=0&language=EN&guiLanguage=en.

171. *Id.*

172. *Id.* This is not also the first time that Germany has overtaken EU initiatives, essentially preempting EU directives on specific matters. The *Gesetz über die aufsichtsrechtlichen Anforderungen an die Vergütungssysteme von Instituten und Versicherungsunternehmen*, Germany's post-financial crisis banking law, which also contained restrictions on banking remuneration, for example, was initially proposed in the Fall of 2009 and finally became effective in its entirety on July 27, 2010. A description of the German law is available at http://www.ihk-berlin.de/servicemarken/branchen/Dienstleistungen/banken/Recht_/820436/Verguetung.html. The EU's related directive, Directive 2010/76/EU is dated November 24, 2010. Directive 2010/76, *supra* note 165.

173. Indeed the Green Party was already submitting comments about the proposed law before it was even officially introduced by Angela Merkel's government. *See Antrag der Abgeordneten Chrintine Scheel et al und der Fraktion BÜNDNIS 90/DIE GRÜNEN*, Deutscher Bundestag, März 4, 2009, Drucksache 16/12112, dipbt.bundestag.de/dip21/btd/16/121/1612112.pdf. The FDP issued such a commentary in late 2008 along similar lines: *Antrag der Abgeordneten Mechthid Dyckmans et al und der Fraktion der FDP*, Deutscher Bundestag, Nov. 12, 2008, Drucksache 16/10885, dipbt.bundestag.de/dip21/btd/16/108/1610885.pdf.

174. An antecedent to the VorstAG's requirement of a two-year pause between membership on the *Vorstand* and the *Aufsichtsrat*, for instance, was already present in the 2007 version of the German Corporate Governance Code, which stated that there should be "special reasons" to justify direct accession to the *Aufsichtsrat* upon exit from the *Vorstand*. DEUTSCHER CORPORATE GOVERNANCE KODEX [GERMAN CORPORATE GOVERNANCE CODE], Feb. 26, 2002, as amended June 14, 2007, § 5.4.4 (Ger.), *translated in German Corporate Governance Code*, COMM'N OF THE GERMAN CORPORATE GOVERNANCE

In short, with the EU refraining from binding general compensation directives, executive compensation laws and reforms in Germany are German at heart and respond to German problems from a German perspective.

C. VorstAG

1. Background and Components of the Law

By December 2007, it was clear that executive compensation was on Angela Merkel's agenda. In that month, she singled out exorbitant executive salaries in her speech to the annual meeting of the Christian Democratic Union ("CDU"), the historically conservative political party that she leads as Chancellor, criticizing "payouts in the realms of fantasy."[175] The business community was outraged, implying that she had endangered economic recovery.[176] Her spokesman denied that she was planning any kind of legislation to curb executive pay, while the opposition, the Social Democrats ("SPD"), who regarded executive pay and its reform as a staunchly liberal issue, were amused and dismissive of what they perceived as hypocrisy, since their previous calls for legislation had fallen on deaf ears.[177] But Merkel proved the SPD wrong. Executive compensation remained a constant, if not strident, theme for her throughout the next year. In May 2008, Merkel's office underlined that, in the past, she had repeatedly made clear "that there was 'little comprehension' for managers departing with large severance packages after their companies had shown a

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CODE (June 14, 2007), http://www.corporate-governance-code.de/eng/download/E_Kodex_2007_final.pdf.

175. *Executive Pay Debate revived in Germany,* DEUTSCHE PRESSE AGENTUR, Jan. 4, 2008, *available at* http://www.expatica.com/fr/finance_business/business/Executive-pay-debate-revived-in-Germany_11148.html. Coming on the heels of the Wiedeking scandal, Merkel noted, "Just because an American car executive makes a thousand times what an employee earns, it seems a German car manager should also get the kind of rise he would never grant his workers." Bertrand Benoit, *Merkel in Attack on US-Style Pay Awards*, FIN. TIMES UK (Dec. 4, 2007, 2:00 AM), http://www.ft.com/cms/s/0/a04f5c50-a20b-11dc-a13b-0000779fd2ac.html'axzz1ZowebpvY.

176. *See Letter from Berlin*, *supra* note 20.

177. *Id.*

loss,"[178] and she supposedly arranged for a special task force to review executive compensation late that summer.[179] Just a few months later, a CDU member and one of Merkel's most important allies, Peter Müller, backed an SPD proposal similar to section 162(m).[180] At the G20 summit, Merkel was expected to, and did, raise executive compensation reform as part of the new, sound financial architecture for which she advocated.[181] Given that it was already an important theme of her chancellorship, and with the increased scrutiny worldwide placed on executive compensation in the aftermath of the financial crisis, it is unsurprising that Angela Merkel proposed a new executive compensation law in March of 2009.[182] After a comment period, during which various governmental factions as well as outside experts submitted their views, the Bundestag passed the law on June 28, 2009, and became effective in full on August 5, 2009.[183]

The three main objectives of the VorstAG were to better align remuneration schemes with incentives for sustainable growth in the long-term, to strengthen the independence of the *Aufsichtsrat* and heighten its accountability, and to increase transparency of executive remuneration.[184] The VorstAG at-

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178. *Germany's Social Democrats Take On Executive Pay*, DEUTSCHE PRESSE AGENTUR, May 1, 2008, *available at* http://www.expatica.com/de/news/local_news/Germany_s-Social-Democrats-take-aim-at-executive-pay-_42635.html.

179. *Executive Pay—Is Intervention Required?*, LEADER.CO.ZA (Aug. 2, 2008), http://www.leader.co.za/article.aspx?s=1&f=1&a=825.

180. *See* Hugh Williamson, *Merkel Ally Backs Curbs on Executive Salaries*, FIN. TIMES UK (May 22, 2008, 3:00 AM), http://www.ft.com/intl/cms/s/0/f201e98c-2799-11dd-b7cb-000077b07658.html'axzz1ZowebpvY.

181. James Quinn, *Merkel and Sarkozy in Last Push on Regulation*, TELEGRAPH (Sept. 24, 2009), http://www.telegraph.co.uk/finance/g20-summit/6228132/Merkel-and-Sarkozy-in-last-push-on-regulation.html.

182. *See Kabinett billigt schärfere Regeln für Managergehälter*, FRANKFURTER ALLGEMEINE (March 11, 2009), http://www.faz.net/aktuell/wirtschaft/wirtschaftspolitik/gesetzentwurf-kabinett-billigt-schaerfere-regeln-fuer-managergehaelter-1922930.html.

183. Björn Gaul & Alexandra Janz, *Wahlkampgetöse im Aktienrecht: Gesetzliche Begrenzung der Vorstandsvergütung und Änderungen der Aufsichtsratstätigkeit*, NZA 809 (2009).

184. ISS, *Corporate Governance in Germany*, GOVERNANCE EXCHANGE WEBINAR (Feb. 28, 2011, 9:30 AM), http://www.issproxy.com/webcasts/CorporateGovernanceinGermany2011.

tacks the compensation issue mainly by trying to make existing control instruments and mechanisms, particularly the *Aufsichtsrat* but also the shareholders, a more effective check on the *Vorstand*. Using sustainability as its philosophical starting point,[185] the VorstAG attempts to overhaul the perspective from which the *Aufsichtsrat*, the organ responsible for negotiating *Vorstand* remuneration, approaches the remuneration-setting procedure for public companies.[186] Under the VorstAG, *Vorstand* compensation must be sustainable and must be appropriate with respect to *Vorstand* performance and should not surpass the typical compensation awarded in the respective industry without a special reason.[187] In the event that the company's financial position worsens significantly, the *Aufsichtsrat* can exercise a clawback right, regardless of whether any exists in the employment agreement or other contractual arrangements, which will reduce the compensation of current members of the *Vorstand* as well as members of the *Vorstand* who have left the company within the past three years. In keeping with the trend of increasing the professionalization of the *Aufsichtsrat* to make it a more effective control on the *Vorstand*,[188] compensation can be approved only by the entire *Aufsichtsrat*, as opposed to simply a human resources committee, and the members of the *Aufsichtsrat* are also personally liable in the event that the compensation is deemed to be inappropriately high. The *Vorstand* also faces a higher penalty for wrongdoing. Should the company's director & officer liability ("D&O") insurance be triggered, the offending member of the *Vorstand* must pay a deductible equal to 10% of the damages, but in no event greater than 1.5 times his or her annual base salary. The VorstAG seeks to heighten the *Aufsichtsrat*'s control by increasing the distance between the *Vorstand* and the *Aufsichts-*

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185. Gaul & Janz, *supra* note 183.

186. The VorstAG's applicability to only those companies traded on the stock exchange is guaranteed by its incorporation into the *Aktiengesetz*, the law which regulates share-based companies.

187. For a general explanation of the new VorstAG measures, the following articles are very useful: Beck, *Angemessenere Vorstandsgehälter: Bundestag verabschiedet VorstAG*, BECKLINK 283784; Dr. Holger Fleischer, *Das Gesetz zur Angemessenheit der Vorstandsvergütung (VorstAG)*, NZG 801 (2009). For more on the development of the VorstAG, see *Bearbeitungsstand des VorstAGs*, May 5, 2009 (on file with author).

188. *Antrag der Abgeordneten Mechthid Dyckmans*, *supra* note 173.

rat through a mandatory two-year "cooling off" period before the former member of the *Vorstand* can join the *Aufsichtsrat*.[189] The shareholders are also given a non-binding say-on-pay vote with respect to the *Vorstand*'s earnings, though at the company's discretion.

2. Initial Reaction

Though the initial reactions to the VorstAG were varied, they tended to be blasé or negative, albeit not necessarily overtly. It was cynically noted that the entire law went from proposal to fait accompli with unusual speed, pressed through before the onset of the summer break while politicians were still out getting votes for reelection.[190] These commentators implied it was all a political stunt with no bite, and some seemed animated by a feeling of a missed opportunity to achieve true reform. Others felt the entire exercise was misguided. One commentator noted that focusing on a multi-year performance measurement period did nothing to hinder the spiraling executive bonuses that contribute to the destabilization of management pay.[191] Another attorney practicing in the field in Düsseldorf was surprised that the VorstAG did not include changes to a company's ability to fire its executives, noting that this threat was far more effective in obtaining good behavior than clawbacks or extending performance review over multiple years.[192] The law in-

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189. Prior to the passage of the VorstAG, this kind of shift was fairly common, the argument being that the former member of the *Vorstand* was intimately acquainted with the business and could provide helpful information in this regard. It is also helpful to remember that the Vorstand contains not only CEO- and CFO-type positions, but can contain the Chief Technology Officer or heads of important departments who could indeed offer advice from his or her very specific area.

190. *See* Joachim Jahn, *Das VorstAG: Neue Vorschriften gegen "unangemessene" Managerbezüge*, GWR 283394 (2009); Jürgen van Kann & Anjela Keiluweit, *Das neue Gesetz zur Angemessenheit der Vorstandsvergütung* [*The New Law on the Appropriateness of Board Members' Fees*], 31 DEUTSCHES STEUERRECHT [DSTR] 1587, 1587 (Ger.) (2009).

191. *See* Hermann J. Stern, One Page Commentary on the Unrecognized Core Problem with Executive Pay Today, (June 12, 2010) (unpublished manuscript), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1624223; Pressemitteilungen, Fachnews, *Anhörung: Experten im Rechtausschuss streiten über Neurgelung der Managervergütung*, BECKLINK 282389.

192. Hans-Hermann Aldenhoff, *Abschaffung des Kündigungsschutzes für Spitzdenverdiener*, NZA 800 (2010).

cludes no salary cap, as pointed out by the Green Party during the proposal period, which in its view is a major flaw.[193] Lawyers early on bemoaned a lack of precision—with key concepts, like "sustainable compensation," left undefined—making compliance difficult and, perhaps, even dangerous.[194] Others were less overtly negative, noting that many of the provisions already existed in the Corporate Governance Code and that the law therefore had little practical and certainly no revolutionary impact.[195]

But the reactions were not all bad, not least because the government had in fact shown extraordinary responsiveness in acting quickly to try to do something about an issue that many thought needed to be addressed.[196] In defending her government's law to the critics, Germany's then-Minister of Justice, Brigitte Zypries, went on the offensive, insisting that far from being hastily cobbled together, the VorstAG had been drafted by calm minds intent on doing what made sense rather than caving to populist demands.[197] The powers awarded to the *Aufsichtsrat* were championed because, in the spirit of the Code, they provided structure without limiting the flexibility necessary to run a successful business, and the *Aufsichtsrat* now had a greater arsenal of tools with which to combat a rogue *Vorstand*.[198] The law also resolved a key ambiguity. In the Mannesmann era, the *Aktiengesetz* required only that compensation be reasonable, without defining what was reasonable. Under the VorstAG, however, the concept of reasonable became more concrete, specifying that reasonable was to be de-

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193. *Antrag der Abgeordneten Chrintine Scheel*, *supra* note 173.

194. *Stellungnahme des Deutschen Anwaltvereins durch den Handelsrechtsausschuss zum Entworf eines Gesetzes zur Angemessentheit der Vorstansvergütung (VorstAG)*, Stellungnahme nr. 32/2009, Apr. 2009, http://anwaltverein.de/interessenvertretung/archiv-2009. Germany has no agency rulemaking processes like those existing in the United States, with the exception of the BaFin for banking law and capital market law, leaving attorneys to interpret the law on its face themselves.

195. *See, e.g.*, Kahn & Keiluweit, *supra* note 190, at 1587.

196. Jahn, *supra* note 190; Marcus Lutter, *Stellungnahme im Rahme der VorstAG*, May 20, 2009, http://www.jura.uni-duesseldorf.de/dozenten/noack/rechtspolitik/; Ulrich Siebert, *Das VorstAG – Reglungen zur Angemessenheit der Vorstandsvergütung und zum Aufsichtsrat*, 32 WM 1489 (2009).

197. Siebert, *supra* note 196.

198. *Id.*

fined on a peer group basis and then further defining how that peer group basis should be set.[199] The say-on-pay advisory vote also had a positive reception.[200] In place in England since 2002, say-on-pay had been shown to have a positive, if not game-changing, effect on executive compensation, punishing and therefore ultimately minimizing so-called "pay for failure," like the kind highlighted by *Disney* in the United States.[201]

These were only the initial reactions, however, and by the next year, the press and the government were focused on the next corporate governance issue *du jour*, which was increasing the percentage of women sitting on the male-dominated *Aufsichtsrat*s and *Vorstand*s.[202] The executive compensation issue had relatively quickly disappeared from the headlines, but the question remaining is, why? Had the corporations learned? Had they changed? To assess this question, it is useful to examine the primary material itself: the compensation disclosures made by the DAX 30, primarily in their annual reports.

III. ANALYSIS

A. Methodology

For an outsider, there is no better source of information for executive compensation than a company's annual report.[203] Each annual report contains a section that describes the com-

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199. Jahn, *supra* note 190.

200. Gunther Friedl et al., *DSW-Studie zur Vorstandsvergütung 2009*, DSW, http://www.dsw-info.de/DSW-Studie-zur-Vorstandsvergue.1576.0.html (last visited Feb. 11, 2013).

201. *See* Ferre & Maber, *supra* note 82, at 1–4.

202. *See* Katrin Bennhold, *Women Nudged Out of German Workforce*, N.Y. TIMES (June 28, 2011), http://www.nytimes.com/2011/06/29/world/europe/29iht-FFgermany29.html?_r=1. The reaction has not necessarily been positive. *See, e.g.*, Nikolaus Doll & Olaf Gersemann, *"Von der Leyens Frauenquote ist weltfremd"*, DIE WELT (Nov. 13, 2011), http://www.welt.de/dieweltbewegen/article13714704/Von-der-Leyens-Frauenquote-ist-weltfremd.html.

203. While a company may also issue press releases in response to compensation developments, that kind of disclosure remains rare in Germany. Of the DAX 30 companies, for example, only a few issued a press release in connection with the VorstAG, which itself only served as a preview of coming attractions of sorts.

pany's general executive compensation policy as well as the remuneration of the top executives.[204] In the United States, this section is referred to the CD&A, a term this Article will use as shorthand to refer to both German and U.S. compensation disclosures. The CD&A not only reveals hard facts about who was paid how much in a given year, but also offers an insight into how a company handles the very tricky issue of revealing just how much it paid its top officers. Disclosures vary, of course. Some are helpful, with charts and clearly laid out principles that allow the average stockholder to form a picture of how exactly the company comes up with the sums its executives walk away with, while others present only a cursory explanation. Some group the information about compensation together, while others may force the reader to search through the various footnotes to piece together a compensation picture that is sketchy at best. Nevertheless, disclosures are generally helpful to ascertain changes over time. A company with the same cookie-cutter disclosure year after year might not be as concerned with executive compensation as one that updates and refines its presentation over time. The development of a company's CD&A over time also shows how it reacts to a new law or requirement. This is especially true for the VorstAG—what better way to show good faith and compliance with an issue of great importance to shareholders than to lay related compliance mechanisms bare in the annual report?

To properly assess the impact of the VorstAG, it is illuminating to examine annual reports from 2008, 2009, and 2010. Because there were no other executive compensation-related rules passed during this time, it is fair to assume that any changes made to the CD&A were the result of the VorstAG requirements or the indirect result of companies having their compensation reports come under new scrutiny. The 2008 reports should serve as a control group for pre-VorstAG compensation

204. In the United States, this requirement stems from the SEC's CD&A requirements, which many law firms lay out very helpfully for their clients in order to enable them to comply. *See, e.g.*, Memorandum, Paul, Weiss, Rifkind, Wharton & Garrison LLP, SEC Adopts Changes to Compensation Disclosure Rules (Dec. 22, 2009), *available at* http://www.paulweiss.com/media/1093957/22dec09erisa.pdf. For a good description of the requirements in Germany, as well as whether they were triggered by European initiatives, see Simon Leuring, *Offene Fragen zur Offenlgung der Vorstandsvergütung*, NZG 945 (2005).

structure and disclosure; the 2009 reports should chronicle the beginnings of the implementation of various VorstAG provisions; and the 2010 reports should reflect a complete picture of compensation strategy following the full effectiveness of the VorstAG. In particular, the analysis in this Article is centered on the reports of the DAX 30, the premier stock index in Germany composed of blue chip companies traded on the Frankfurt stock exchange, including the likes of Deutsche Bank, Siemens, BMW, and Lufthansa.[205] Since, as public companies, the DAX 30 were all affected by the VorstAG, this group includes the companies that were most visible and thus had the most to lose by not complying with the VorstAG.

I reviewed these annual reports on two levels: qualitative and quantitative. On the qualitative level, my goal was to determine whether the VorstAG had caused a shift in the companies' executive compensation strategies or the manner in which they were disclosed. With regard to strategies, as further described below, I assessed the extent to which the annual reports discussed the VorstAG itself and whether they had included VorstAG concepts in the CD&A. If they had been included, was it purely on a cosmetic level, adding a few buzzwords here and there, or had companies seriously revamped their compensation systems to try to comply with the new law? With regard to the manner of disclosure, I looked to benchmarks like how long the CD&A section became and whether descriptions became clearer or the section differently organized. On the quantitative level, I looked at how *Vorstand* compensation was apportioned. In other words, what percentage of compensation was paid out as base salary, as bonus, etc., and how did those percentages change from year to year? I calculated the percentages by dividing the amount paid to the entire *Vorstand* in any given category—such as salary, benefits, or long-term incentive compensation—by the total compensation they were all paid. In the few cases where the company did not provide an overall compensation amount, I totaled the numbers from the various categories to arrive at this

205. As of March 2011, the full DAX 30 consisted of the following companies: Adidas, Allianz, BASF, Bayer, Beiersdorf, BMW Commerzbank, Daimler, Deutsche Bank, Deutsche Börse, Deutsche Post, Deutsche Telekom, E.ON, Fresenius Medical Care, Fresenius SE, HeidelbergCement, Henkel, Infineon, K+S, Linde, Lufthansa, MAN, Merck, Metro, Munich Re, RWE, SAP, Siemens, ThyssenKrupp, and Volkswagen.

amount.[206] I tried to remain as true as possible to the categorizations chosen by the company, which tended to fall into the following: salary, benefits (together with salary, "fixed compensation"), bonus or short-term incentive pay, long-term incentive pay, and occasionally medium-term incentive pay. I did not question any individual company's assignation of values, nor did I try to evaluate whether programs were correctly labeled as long-, medium-, or short-term. I also tried to control potential distortions, omitting cases of non-reporting from my averages. I did, however, include compensation numbers where a company decided not to make a certain payment or executives decided to forgo it in a particular year, because this is as much a part of compensation strategy as making a payment. In short, I tried to put myself in the place of the informed shareholder looking to cast my vote on remuneration at any one of these given companies. Several questions were key: In what direction was the remuneration going? Were there any perceptible direct changes that resulted from the VorstAG? Would the reader of the annual reports be sufficiently or at least better informed as a result of the changes?

B. Substantive (Qualitative) Changes

The 2010 compensation discussion sections were very different from their 2008 predecessors, with disclosure that was both better than and different from the typical level in 2008. What is especially interesting about the VorstAG is that its provisions contain both very precise requirements—for example, requiring a deductible for D&O insurance policies—as well as more general requirements—for example, that compensation policies be "sustainable." Thus companies had to show in their disclosure sections that they were complying not only with specific rules, but also with more general principles.

Companies were clearly eager to show they had complied with the letter of the law by including specific references to the VorstAG. Over 70%[207] of the companies in either or both of

206. The companies and years in question were Deutsche Bank in 2007 and 2008, and Deutsche Post in 2008, 2009, and 2010. I note that while Deutsche Bank started reporting aggregate numbers in 2009, Deutsche Post provided no compensation numbers at all for 2007 in the 2008 Annual Report.

207. Percentages have been rounded to the nearest whole percentage, generally speaking, unless otherwise indicated.

their 2009 and 2010 compensation discussions included a discussion of the VorstAG, including Allianz, BASF, and Daimler, which each issued a specific, separate press release acknowledging the VorstAG and the compensation structure decisions being made with respect to it. Over 70% of the companies explicitly framed their compensation in "sustainable" terms or described the spirit of their compensation structure in words that, if not directly lifted from the VorstAG itself, very clearly reflected the philosophy of the new law, emphasizing sustainability and appropriateness. Companies in the former category included Metro and RWE, which respectively noted in 2009, for the first time, that "[t]he remuneration structure is geared towards sustainable corporate growth,"[208] and "the compensation structure will be brought more in line with sustainable business development."[209] Those whose disclosures reflected the spirit of the VorstAG tended to include statements, such as that made by Deutsche Post, that the "remuneration of the Board of Management for 2009 is in line with standard market practice, appropriate to the tasks involved and designed to reward performance; it comprises fixed and variable elements as well as long-term incentives,"[210] or otherwise made clear that the company was calculating risk in order to create a compensation package that was appropriate and rewarded (only) good business results.[211]

90 percent of the DAX 30 companies thoroughly reexamined and, in many cases, completely overhauled their compensation schemes, according to their annual reports. Of this 90%, 85% stated that their re-evaluation came as a direct result of the VorstAG (including, among others, Commerzbank, BMW, E.ON and HeidelbergCement). Given the lack of other executive compensation regulations during this time, it is safe to assume that even those companies who did not explicitly mention the VorstAG as the driving force behind their compensation restructuring were reacting to the VorstAG as well. A significant portion of the companies—over 36%—indicated that they hired a compensation consultant to review their pay structures and ensure they complied with the new law. More impressive, how-

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208. METRO, 2009 ANNUAL REPORT 103 (2010).
209. RWE, 2009 ANNUAL REPORT 124 (2010).
210. DHL, 2009 ANNUAL REPORT 114 (2010).
211. *See* DEUTSCHE TELEKOM, 2009 ANNUAL REPORT 43, 213 (2010).

ever, is the growth of this figure. While only one company mentioned having engaged a compensation consultant in 2008, eleven companies indicated in 2010 that they had hired a compensation consultant. This is an interesting contrast with the number of companies that mentioned the use of vertical and horizontal peer grouping,[212] directly or indirectly, which went up much less—up to twenty-two companies in 2010 from sixteen in 2008, an increase of less than 40%.[213] Interestingly, firms generally did not explicitly state in their CD&A whether they implemented a new D&O deductible payment policy. Instead their compliance or lack thereof was indicated through a different section, that of the degree to which they complied with the Code. Some changes, on the other hand, were almost universal. Before the VorstAG, nearly all of the companies had compensation committees that made all decisions regarding compensation. After the VorstAG, these committees continued but only in an advisory role.

While new compensation disclosures indeed reflected the specific requirements set forth in the VorstAG, it is far more interesting to see how they reflected the general principles, which, it turns out, clearly heightened the quality of the disclosure.[214] The disclosures were clearer and more descriptive, enabling the intelligent reader to form an idea of how the companies' compensation setting and payment processes work, including what components are considered, and how and why the compensation packages are structured as they are.

This increase in disclosure is reflected in the increase in page numbers, beginning in 2009. For instance, SAP increased the

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212. Horizontal peer grouping compares salaries of executives at a particular company to those at a company deemed similar in terms of size and industry, while vertical peer grouping looks at the differences in salary internally at different levels of the company, comparing the amount earned by management, for example, to the amount earned by managers.

213. Both the hiring of external consultants and peer grouping are means by which a company will "legitimize" their compensation policy; the implication is that it has been "blessed" either by a compensation professional, whose job it is to know the compensation market, or by direct comparison to the market itself. U.S. CD&As tend to use both. That more companies, both as a percentage and a hard number, opted for one of these methods of legitimization over the other, is interesting.

214. Better here in the sense that poor disclosure renders the information opaque and is of little use to the average investor, the target audience of these disclosures.

compensation-related section of its disclosure from sixteen pages in 2008, to eighteen in 2009, to twenty in 2010;[215] Munich Re from nine in 2008, to seventeen in 2009 and 2010;[216] and Deutsche Börse from seven in 2008, to ten in 2009, to twelve in 2010.[217] That this increase in page numbers is due to the general requirements of the VorstAG and not the actual description of VorstAG-related programs is indicated by the fact that already in 2009, before many companies had implemented specific policies targeted to respond to the VorstAG, many companies surveyed had longer compensation disclosure sections to try to provide more insight into their existing programs and comply with the spirit of transparency of the VorstAG. Over 75% of the companies had increased the length of their compensation report by 2010 as compared with 2008.

Compensation discussions were also easier to find. Of the companies that had split up their compensation information, relegating the actual amounts paid to the footnotes, 50% opted to form a more cohesive section, moving their compensation numbers into the same section as their compensation philosophy description. Deutsche Bank even went so far as to create a separate compensation booklet to give the shareholder a better understanding of their structures, obviating the need to go to the trouble of pinning down the information in the annual report.[218] In addition, the two companies that prior to the Vorst AG had refused to disclose certain compensation information, changed their decisions to withhold that information in 2010. As discussed in detail below, only one company, HeidelbergCement had voted not to describe its compensation philosophy or reveal anything beyond aggregate numbers. In 2010, however, HeidelbergCement's annual report included a compensation disclosure section whose detail and length made

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215. SAP, 2008 ANNUAL REPORT 40–55 (2009); SAP, 2009 ANNUAL REPORT 36–53 (2010); SAP 2010 ANNUAL REPORT 40–59 (2011).

216. MUNICH RE, 2008 ANNUAL REPORT 44-52 (2009); MUNICH RE, 2009 ANNUAL REPORT 56-72 (2010); MUNICH RE, 2010 ANNUAL REPORT 50-66 (2011).

217. DEUTSCHE BÖRSE, 2008 ANNUAL REPORT 66–72 (2009); DEUTSCHE BÖRSE, 2009 ANNUAL REPORT 43–52 (2010); DEUTSCHE BÖRSE, 2010 ANNUAL REPORT 58–69 (2011).

218. As a bank, Deutsche Bank is subject to additional compensation rules as of July 27, 2010 under the *Gesetz über die aufsichtsrechtlichen Anforderungen an die Vergütungssysteme von Instituten und Versicherungsunternehmen*. Hence, their updated compensation disclosure may not be the result of the VorstAG alone.

clear that they had no intent to hide the ball. The other company, Merck, had refused to disclose nearly all compensation information, stating that its corporate structure necessitated that such information could be disclosed only by the company's general partner. Like HeidelbergCement, though, Merck changed its tune in 2010, publishing information that it had hitherto deemed unnecessary to disclose in its annual report. Furthermore, companies became more forward-looking in their disclosures, offering a preview of coming attractions in compensation changes. In 2008, 7% had this feature, compared with 63% in 2009, and back down slightly, though still up overall, to 43% in 2010.

Not only did compensation disclosures increase in their number of pages and become easier to find, but the descriptions also changed from year to year in a way that indicated that companies were rethinking their compensation structures, or at the very least, rethinking the disclosure of their compensation structures, by avoiding boilerplate copies of the same information. Indeed over 40% added more graphics and 66% added additional sections. The one section that showed a clear tendency to remain exactly the same year after year was the severance section. 60 percent of companies kept their severance sections essentially or exactly the same, with their usual boilerplate language (sometimes featuring superficial alterations), and in general this language was far less informative than the remainder of the compensation disclosure section. This may reflect the fact that, of all the portions of compensation disclosure, severance was the least affected by the VorstAG in the time period examined, as the VorstAG did not apply to existing compensation contracts, but only to those entered into after the law became effective.[219] Nevertheless, it is interesting to note that sixteen companies—over half of the DAX 30—indicated they had begun to amend existing agreements, in whole or in part, to comply with the provisions of the VorstAG or the new compensation system developed under the VorstAG, despite the "out" the law had given them. At Deutsche Telekom, where the option to update was voluntary, seven out of nine executives agreed to have their contracts amended. Since this

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219. It is worth noting that most German executives do not have at-will contracts as in the United States, so the law anticipated contracts needing to be re-signed in, at most, a few years that would reflect all of its provisions.

amendment generally cannot be done unilaterally and requires the consent of the executive in question, it makes sense that most of the companies that amended their executives' existing contracts also showed improvement in their disclosures, be it a marked improvement like RWE's, or even a modest improvement to an already highly informative disclosure regime, like Siemens'. Companies also implemented clawbacks in their performance payments. Many had classical clawbacks for poor behavior, although there was an increasing number of performance-based clawbacks, under which payments were to be awarded only in the event that certain benchmarks going forward were reached.

The biggest qualitative change in the DAX 30's compensation disclosures, however, was the quality and the scale of their elaboration. 77 percent of companies more completely disclosed performance related practices, and 67% discussed percentage targets necessary to earn certain amounts of money. Indeed, in their 2010 disclosures, an astounding 86% of companies elaborated more fully how their compensation structures functioned in real time.

The best example to show the depth and breadth of the compensation changes is to look at how one particular company, HeidelbergCement, changed its compensation disclosure from 2008 to 2010. HeidelbergCement perhaps showed the greatest improvement in its compensation disclosure following the implementation of the VorstAG. In sum, whereas in 2008, HeidelbergCement provided only a few pro forma paragraphs that were, truthfully, of little interest or help to the average shareholder, in 2010, it not only described its new compensation structure in great detail, but it also did so in a way that was helpful and readily accessible to the average shareholder.

In 2008, HeidelbergCement's annual report was one of the worst among the DAX 30, for both its paucity of information and highly superficial discussion of remuneration. It devotes less than a page to *Vorstand* remuneration, of which half described the compensation strategy in very generalized terms. The variable component of compensation, for example, was described as "depend[ing] on the achievement of specific financial goals set by the Personnel Committee of the Supervisory Board at the beginning of the financial year (target net profit)."[220] The

220. HEIDELBERGCEMENT, 2008 ANNUAL REPORT 33 (2009).

company announced aggregate compensation numbers for the *Vorstand* in paragraph form, far more difficult to read than in chart form, and stated merely amounts paid for fixed and variable remuneration and perks. Since it did not disclose amounts paid as bonus, nor provide any further detail on payment structure to determine, for example, which sum included the bonus, the numbers had little to no value. The 2008 report also noted that "the 2006 Annual General Meeting exercised their right to exempt the Company from the obligation to publish the remuneration of each individual member of the Managing Board," without even giving a basis for why they had decided to seek shareholder approval to avoid this disclosure, as required under the VorstOG.[221] In short, the annual report gave the average shareholder virtually no concept of how compensation was actually earned or the benchmarks upon which it depended, let alone the actual amounts individuals were earning.

The 2009 annual report began to show signs of improvement. Remuneration was detailed in a "remuneration report" just over a page long, and compensation was described as not only taking into account compensation at peer companies deemed comparable via the peer grouping process, but also set with an eye to internal company pay structure, thus making horizontal as well as vertical comparisons.[222] The company also added a sentence, clearly influenced by the VorstAG, to emphasize that "[t]he remuneration structure is fundamentally already geared, and independent of future developments, towards the sustainable development of the Group."[223] While not brimming with detail, HeidelbergCement's 2009 annual report marked a clear effort to better describe the various portions of the company's compensation package. For example, shareholders learned for the first time that the company paid two types of bonuses. The first, a regular variable bonus, "depends on the achievement of specific financial goals set by the plenary session of the Supervisory Board [*Aufsichtsrat*] at the beginning of the financial year (Group share of profit after taxes and minorities)."[224] Thus, not only was the term "target net profit" from the 2008 Annual Report further elaborated as "(Group share of profit

221. *Id.* at 34.
222. *See* HEIDELBERGCEMENT, 2009 ANNUAL REPORT 43 (2010) [hereinafter HEIDELBERG CEMENT, 2009 ANNUAL REPORT].
223. *Id.*
224. *Id.*

after taxes)", but the new structure of decision-making mandated by the VorstAG was also reflected, with the *Aufsichtsrat* rather than an HR committee setting financial goals that needed to be met for a payout to the Vorstand to occur. The second bonus was a medium-term bonus paid in 2009 and 2008.[225] The 2009 report further noted that additional compensation measures were being tied to the firm's successful refinancing, *i.e.*, to the ongoing health of the firm.[226] This feature is a crowd-pleaser because it aligns payments with VorstAG principles and shows shareholders that executives are not simply rewarded at the expense of the company, as the company will only make payments if financing is successful.

While still in paragraph form and boasting no individual remuneration amounts, the section describing how much compensation the company paid also improved. Instead of merely listing the amounts paid out in 2009 and 2008, the report describes whether they rose or sank and why. There was also a paragraph indicating that "[i]t is intended to review the remuneration system for the members of the Managing Board [the *Vorstand*] in the second half of 2010, especially regarding changes to regulatory provisions, and to develop it further if necessary. Experiences of other German companies with multinational exposure will be taken into consideration."[227] Though the company does not credit the VorstAG by name for the review, the motivation is clear.

It is in 2010, however, that a sea change comes to HeidelbergCement's compensation disclosure; indeed, the section is unrecognizable. The 2010 remuneration report was elevated to the status of a proper section and ran nine pages long.[228] Remuneration of the Managing Board, which used to be the only subsection, was further subdivided into 2010 versus 2011 remuneration.[229] Though the 2010 remuneration section, in substance, is very similar to the 2009 section, its subdivision into "principles," "remuneration elements," and "amount of remuneration" allows the average shareholder to parse better the information he is receiving.[230] The remuneration section for

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225. *Id.*
226. *See id.*
227. *Id.* at 44.
228. HEIDELBERGCEMENT, 2010 ANNUAL REPORT 128–36 (2011).
229. *Id.* at 128–29.
230. *Id.*

2011 on, however, is not only better organized, but displays a remarkably high level of detail on compensation components and structures. The section begins with an entire subsection discussing how the company intends to implement the VorstAG, which includes the following:

> [H]igher weighting of variable remuneration compared with fixed remuneration, higher weighting of long-term bonus with a multi-year assessment base compared with the annual bonus, linking of long-term bonus with the various key financial ratios as well as the relative development of the HeidelbergCement share compared with the DAX 30 Index and the MSCI World Construction Materials Index and the absolute development of the HeidelbergCement share; [and the] obligation for all members of the Managing Board to maintain a fixed number of HeidelbergCement shares as an individual investment.[231]

This description—only a part of the 2010 report—is far more detailed than anything previously published by the company and demonstrates a clear commitment to the principles of the VorstAG. The company noted that the new system was developed in accordance with a renowned remuneration expert and that the compensation system "[was] geared even more than before towards the sustainable development of the Group,"[232] an impressive change from two years before, when there was no mention of sustainability whatsoever. The company then devoted four complete pages to outlining the components of its new compensation system (*i.e.*, fixed annual salary, variable annual bonus, variable long-term bonus with long-term incentive, fringe benefits, and pension promises).[233] Further, the company provided a graph showing how the various compensation components stacked up against one another and a pie chart showing the proportion of fixed to variable compensation. It also described the contents of the pie charts in words, giving the average shareholder multiple ways in which to visualize and understand which portion of compensation is paid out in what form.[234] In addition, the company broke down each of the compensation components, showing exactly how each would be

231. *Id.* at 129.
232. *Id.*
233. *Id.* at 130–33.
234. *Id.* at 130.

calculated. The annual bonus, the disclosure explains, is a combination of the target value, key performance indicators (which in turn rely on both company-wide and individual targets), and the target achievement range. A sample calculation was even provided to show how the tabulations play out.[235] The company went through the same exercise for the long-term bonus.[236] Finally, the company decided to forego its shareholder-granted privilege of disclosing only aggregate, as opposed to individual, compensation figures. HeidelbergCement made clear that individual disclosure was part of its new compensation system and even disclosed the individualized figures for 2011.[237] It also interestingly noted that the Supervisory Board "still ha[d]" the option to adjust the variable remuneration elements by plus or minus 25% in accordance with "the personal performance of the individual members of the Managing Board and/or for exceptional circumstances."[238] Although it is unclear from this wording whether this was a power the Supervisory Board had always wielded, the answer is to some degree irrelevant for the shareholder who never even knew it existed until after the VorstAG.

Not all compensation reports changed as much as HeidelbergCement's in the wake of the VorstAG, but then again, most of them started out with slightly better disclosure in the first place. Regardless, the elements of change evident in the annual reports of HeidelbergCement from 2008 to 2010 were present in other DAX 30 reports from the same time period. The reports reveal a new, clear standard and a new, clear winner: the shareholder, who is now in a far better position to make a judgment as to the health of the compensation practice—and, arguably, the corporate governance culture itself—than he was in 2007.

C. Quantitative Changes

While many quantitative changes in compensation were evident from the annual reports examined, in many ways it was simply too early to discern their significance. Given the market

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235. *Id.* at 130–31.
236. *Id.* at 131–32.
237. *Id.* at 134.
238. *Id.*

fluctuations since 2007,[239] stock-based compensation that companies had originally designed to award might have turned out to have a great deal less value by year's end. In addition, in light of the financial crisis, executives at certain companies, particularly banks, agreed to forego portions of their compensation packages, such as bonuses or other variable compensation.[240] Lastly, the numbers alone could not tell the whole truth, as the payout of some of the awarded compensation disclosed might have been contingent upon future performance and subject to being clawed back. This would mean that certain variable pay components might appear higher than they were in reality.

Despite the above disclaimers, certain trends seemed to emerge that are worth mentioning. As with the qualitative changes, there was a tendency to disclose more information. For example, HeidelbergCement, as discussed above, had previously taken a vote allowing it to bypass the VorstAG's requirement to disclose board members' compensation, but chose to forego this privilege going forward; Volkswagen, for the first time, in 2009, explicitly identified its "variable" payment as a short-term bonus payment;[241] and Merck, also as previously mentioned, disclosed the individual earnings of its executives in 2010 rather than using a technicality allowing them to be disclosed in a separate report as they had in both 2008 and

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239. Because Annual Reports typically list salary for the year of the report and the year prior, I was able to analyze salary percentages from 2007 to 2010.

240. Typically, an executive's compensation is made up of three components: base salary (fixed compensation); short-, medium-, and long-term incentive pay (variable compensation); and perks. The annual bonus is an example of short-term variable pay. Variable compensation tends to be paid out under a written compensation plan that the company will have in place for the executives only. Subject to the company and/or the executive meeting certain milestones, a certain amount of pay is awarded, and a certain amount vests, that is to say, belongs to the executive. Vesting can be used as an incentive over time. In other words, to keep an executive in a certain position longer, you might have his incentive pay vest only after four years at the company. Other provisos can also be added. For example, an executive may be required to forfeit certain payments if the company's financial goals are not met. Provisions that mandate a return of money already paid to the executive in this way are called "clawbacks".

241. VOLKSWAGEN, 2008 ANNUAL REPORT 102–05 (2009); VOLKSWAGEN, 2009 ANNUAL REPORT 113 (2010).

2009.[242] Furthermore, adding a medium-term compensation component seemed to be increasingly appealing in the wake of the VorstAG. While in 2007 only three of the thirty DAX companies included a medium-term variable compensation component in their disclosures, the number more than doubled, totaling seven, in the 2010 reports.[243]

Trends were also evident in the structural breakdown of executives' compensation—that is, in the percentages of their total pay coming from bonuses versus base salaries, etc.[244] Generally, the 2010 *Vorstand* received a greater proportion of its salary in the form of base salary and long-term variable pay, and a lesser proportion in bonuses and perks, than the 2007 *Vorstand*.[245] More specifically, base salary accounted for 24% of the *Vorstand*'s salary on average in 2007, 31% in 2008, 35% in 2009, and 30% in 2010. The peak in 2009 might be due to the fact that the shares granted as variable compensation that year were subject to significant market volatility and were worth less than anticipated at the time the grants were determined. Despite the decreased value of the shares, the *Aufsichtsrat* was unwilling to compensate the executives by awarding more shares to make up the difference in value, thereby artificially inflating the salary to be a greater percentage of total compensation. But even setting aside 2009, that companies reallocated 7% of total pay to base salary in 2010 as compared with 2007 remains a significant phenomenon. Total fixed income, on average, also rose significantly, from 28% in 2007 to 39% in 2009, although it declined to 32% in 2010.[246] Long-term variable

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242. *Compare* MERCK, 2008 ANNUAL REPORT 67 (2009), *and* MERCK, 2009 ANNUAL REPORT 84 (2010), *with* MERCK, 2010 ANNUAL REPORT 111–13 (2011) [hereinafter MERCK, 2010 ANNUAL REPORT].

243. The three companies from 2007 were Allianz, Fresenius Medical Care, and Siemens. In 2010, Allianz, Fresenius Medical, Deutsche Bank, Deutsche Post, RWE, SAP, and ThyssenKrupp had compensation structures explicitly featuring medium-term variable components.

244. I note that here I used the total amount of compensation paid out to the *Vorstand*. In other words, I did not calculate the numbers for each individual, but rather used the aggregates provided by the company, unless otherwise indicated. See *supra* note 206 and accompanying text.

245. Although I was only looking at annual reports from 2008 to 2010, each annual report lists the compensation information from the prior year as well. Thus, I was able to compare salary information from 2007 through 2010.

246. Since different companies reported different types of compensation, the average percentages do not line up because they are averages of a different

compensation[247] generally also rose steadily, from 26% in 2007 and 2008, to 27% in 2009, and 29% in 2010. This means that long-term variable pay plus base salary now equal approximately 60% of the pay of a member of the *Vorstand*, up from just under 50% in 2007. These changes are perfectly in line with the VorstAG's emphasis on sustainable pay.

Perks, meanwhile, fell from their 2007 level of nearly 5% by about 2 percentage points, despite a sharp increase in 2008 to roughly 7%. This overall trend, however, is logical—perks are never popular with shareholders and can be particularly bad for the image of a company. The other percentage clearly on the decline was the bonus. While companies paid the *Vorstand*, on average, nearly 51% of their income as a bonus in 2007, it declined to 47% in 2008, and 40% in 2009, before increasing again slightly to 43% in 2010. This overall decrease is in line with the VorstAG, which targeted a move away from short-term variable compensation—in other words, the bonus. The trajectory of bonus payments as a percentage of overall income should prove interesting and vital to future assessment of the VorstAG as a reform.

One might argue that averages hide the picture, but a look at the numbers for individual companies confirms the trends identified above. Over half of the companies decreased their bonus percentages, but maintained or increased fixed salary percentages, in 2010 as compared with 2007. Similarly, over half of the companies that reported the information awarded a greater percentage of salary as long-term compensation. Still, there was a remarkable variety in the numbers, even within similar industries. In the auto industry, for example, BMW offered no medium- or long-term variable compensation on the view that it was not helpful in motivating executives. Thus, BMW paid 20% of compensation as fixed salary in 2010 (compared with 17% in 2007) and 80% in the form of a bonus (down from 82% in 2007). Daimler, on the other hand, while still awarding over half of income in the form of a bonus in 2010 (a figure up slightly from 2007's 49%), had a robust long-term performance program, which accounted for 29% of the *Vorstand*'s

number of companies. Volkswagen, for example, reported total fixed salary, but did not report how much was paid as a base salary and how much as perks.

247. This includes both long-term compensation and, for those companies who have it, medium-term compensation.

income in 2010 (interestingly, down slightly from 2007's figure of 31%). The comparison with Volkswagen was perhaps too early to draw from these reports—it restructured its compensation in the period examined and also chose not to award bonuses in 2007. Bearing that in mind, Volkswagen changed from a 38/62 fixed income to performance income structure in 2007, to a 30/70 fixed income to bonus structure in 2008 and 2009, to essentially 20/50/30 fixed income to bonus to long-term incentive structure for 2010 and beyond. As these extreme differences highlight, even within market competitors, drawing significant conclusions from changes in percentages beyond that of general trends would seem premature.

Given that the eternal complaint of executive compensation critics is that sums are too high, the pink elephant in the room is, of course, whether the VorstAG impacted the actual raw numbers paid out as salary. Again, the results were mixed. Overall pay rose by a maximum of 77% at Lufthansa and dropped by a maximum of nearly 60% at Commerzbank from 2007 to 2010. For that same time period, of the twenty-five companies that reported salary information for both years, 40% saw an overall increase and 60% saw an overall decrease. Here the general economic situation is of little help: Germany remained, for the most part, economically stable throughout this period.[248]

IV. EVALUATION

The VorstAG had lofty goals, but was it able to achieve what it set out to do? This section addresses that question on three fronts: first, by evaluating the changes in the annual reports against the law's own goals; second, by checking whether people's predictions of the impact of the law proved to be accurate; and third, by asking whether the law brought about a new era in which executive compensation is both better structured, with an eye to the long term, and more transparent.

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248. For one of many articles on the continuous stability of the Germany economy, even in the face of the recent global recession and ongoing Eurozone turmoil, see Richard Anderson, *German Economic Strength: The Secrets of Success*, BBC NEWS (Aug. 15, 2012), http://www.bbc.co.uk/news/business-18868704.

A. The VorstAG Measured Against Itself

The goals of the VorstAG, broadly put, were three-fold: (1) to increase transparency, (2) to make compensation structure more sustainable, and (3) to emphasize the long-term view in structuring compensation.

First, with regard to increasing executive compensation transparency, the VorstAG has more than reached its goals. As discussed in Part III above, the VorstAG has had a clear and significant impact. Not only are compensation discussions longer, they are clearer and offer a more in-depth description of how performance factors work, as well as how the ultimate payouts are calculated. Even companies that started out with relatively informative disclosure practices, like Siemens in 2008, produced a 2010 report that was significantly clearer and explained in-depth what the new changes were, why the company had decided to make the changes, and what precisely it was about the changes that made the new system preferable, placing more of an emphasis on the long-term. K+S, whose 2008 disclosure was already above average for its informative nature, updated its disclosure to provide a sample calculation of how compensation would be paid out under the new structures. Given that one of the problems with disclosure is that it tends to overwhelm the reader, breaking out a sample calculation allows the reader to visualize exactly what the descriptions and performance metrics mean in terms of the cash that the executive actually takes home.

It is true that transparent disclosure is far from reigning supreme. Approximately 13% of the DAX 30 saw no increase in elaboration between 2008 and 2010. One company, Man, even had worse disclosure in its 2010 annual report than in 2008, providing a less complete picture of compensation and removing some compensation summaries in tabular form that had proven useful in years prior. But even some of the most reticent companies displayed signs of an awareness that they were living in a world where new compensation disclosure norms were required. Merck, for example, after offering no disclosure in 2008 or 2009 on the grounds that it could be done in a different company's annual report, making it more difficult for shareholders to find, included a limited amount of disclosure in 2010. Its amount of compensation disclosure, however, was less interesting than the pains it took to justify the lack of disclosure. In its 2010 report, Merck went into far more detail than it did in years prior to describe what precisely it was about its corporate structure that entitled the company to bypass the disclosure rules required by the VorstOG before offering up limited compensation disclosure for the first time. It further went to great lengths to emphasize that all of the disclosure was voluntary.[249] HeidelbergCement, on the other hand, after years of non-disclosure by virtue of a shareholder vote permitting that approach, simply threw in the towel, coming out in 2010 with some of the clearest and best disclosures in the DAX 30. Clearly, the VorstAG imposed expectations of a new level of transparency, and those who do not comply might worry about reprisals from the market, their shareholders, or both, if they fall below these new VorstAG-inspired norms.

In the second category, sustainability,[250] the review was more mixed, and more time is likely needed for a full assessment. From a substantive perspective, the focus on sustainability was clear. Almost 75% of the DAX 30 either referenced sustainability as a new guiding principle for compensation in the wake of the VorstAG, or discussed their updated compensation plans in the sustainable terms that the VorstAG set out, or both.[251] But the numbers do not necessarily support the idea that sustainable compensation structures are here to stay. The single largest piece of evidence for this concern is the continued prominence of the most vilified and unsustainable portion of compensation—the annual bonus. Based on achieving short-term incentives in the year in question, the annual bonus, one could argue, does nothing to encourage sustainable growth, particularly when it forms such an important portion of the compensation package.

And indeed, annual bonuses clearly still do constitute a major portion of executive compensation. In 2010, bonuses, for the companies that reported them (and not including those companies where executives chose to forego them), still accounted on average for 43% of compensation paid to the *Vorstand*. While

249. MERCK, 2010 ANNUAL REPORT, *supra* note 242, at 111.

250. Sustainability here as elsewhere refers generally to the stakeholder concept. The company has to be run such that it continues to be a going concern for the benefit of all those who have a stake in its operations, from employees to shareholders to business partners, rather than maximizing one aspect of the company at the expense of another. The details of how a compensation plan is to be made "sustainable" is left to individual companies.

251. *See supra* notes 208–211 and accompanying text.

the figure was down from nearly 51% in 2007, it still accounted for the single largest factor in the *Vorstand*'s compensation packages.[252] The bonus percentages for individual *Vorstand*s do vary, of course: in 2010, five companies awarded less than 30% of total compensation as bonuses, eight awarded between 30% and 39%, six between 40% and 49%, six between 50% and 59%, three between 60% and 69%, and one over 70%. It is hard to see how a compensation structure meets the VorstAG's goal of sustainability when it consists in such large part of annual bonuses—for example, when the members of the *Vorstand*, such as that at Henkel, earns 69% of their income in bonus form, 6% as long-term performance variable compensation, and 25% as base salary. When any one person earns such a significant portion of his or her pay as a reward for short-term decisions that look no further than the end of next quarter, it quickly becomes clear why and how these structures could have contributed to the financial crisis and remain a hindrance to sustainable growth. Thankfully, however, the picture once again is not so bleak. For every Henkel in the DAX 30, there are also companies like SAP, which have more than halved the percentage of compensation that gets paid as a bonus, down to 34% from about 71% in 2007. It is also interesting to note that there is no necessary correlation between companies that display spectacularly improved disclosure that hews closely to the VorstAG's principles and the percentage of compensation paid as a bonus. SAP, for example, while showing improved disclosure, came nowhere near the helpfulness of Deutsche Bank's disclosure. However, companies that continued to pay a significant percentage out as a bonus often sharply increased the quality of their disclosure, perhaps seeking to justify this high proportion through the additional information.

With respect to the VorstAG goal of fostering more attention in compensation structures to the longer term, again the results were mixed, in part because of changing compensation systems and in part because of stock market fluctuations. It is true that the portion of compensation paid out as long-term incentive pay is increasing, and the number of companies offering

252. I should note here that Commerzbank has not paid a bonus to its *Vorstand* since 2007. In 2008, neither Deutsche Bank nor Deutsche Post paid any bonus, and in 2009, Mann SE and ThyssenKrupp elected not to pay bonuses.

medium-term compensation has doubled. However, so few companies were using medium-term compensation as part of their plans in 2007 that doubling this number still leads to a rather unimpressive figure—less than 25% of the DAX 30 were using medium-term compensation programs as of 2010. In addition, the bonus issues discussed above remain problematic. The amounts being paid out as long-term compensation for the most part pale in comparison to what is being paid out as bonuses.[253]

B. Evaluating Initial Reactions

As discussed in Part II, many people made a variety of predictions about the VorstAG and its ultimate impact. On the one hand, those who reacted negatively believed the law would be more or less useless—they predicted that it would not have any kind of real impact nor would it stop executive compensation from spiraling increasingly out of control. On the other hand, those who saw the VorstAG positively believed that it would better allow the *Aufsichtsrat* to control the *Vorstand*. Two especially positive features were thought to be defining the peer group and adding say-on-pay to help lessen instances of "pay for failure," those highly publicized incidents such as *Disney*, where disgraced executives receive monumental sums as they leave the company.

The critics were at least partially wrong. As discussed in Part IV.A, the VorstAG did have a significant impact, both on compensation disclosure and, as far as can be ascertained from the earlier description, on compensation structure as well. The increased disclosure, the in-depth descriptions, the hiring of compensation consultants, and the inclusion of additional charts and graphs are all a result of the VorstAG, as are the reevaluations of compensation structure. As for the question of whether the VorstAG will provide any kind of pushback against the spiraling salaries that receive such significant media attention, the annual reports examined are inconclusive,

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253. The significant exceptions are Commerzbank (paying no bonus), Infineon (paying significantly more as long-term compensation than as bonus), and Deutsche Bank and Fresnius (essentially paying an equal percentage of both long-term compensation and bonus). Here, the new compensation regulations for financial institutions may be at play, revealing an even larger problem.

and it might be too early to tell. While some companies did see salary increases as compared with 2007, of the twenty-five DAX 30 that actually reported compensation in both 2007 and 2010, 60% reported an overall decrease, by anywhere between 4% and 60%. Again, the remaining salaries rose, and some very steeply, during this time—Lufthansa's compensation increased the most drastically, by 77%. Causation is particularly tricky to infer with respect to salary amounts because there are so many other factors at play and the VorstAG does not deal openly with the question of salary in terms of a cap. But the VorstAG does require that compensation be appropriate with respect to the peer group and imposes liability on the *Aufsichtsrat* if compensation is higher than appropriate relative to peer companies without sufficient justification. So while it is unclear whether we are seeing the effects of slightly more cautious *Aufsichtsrats*, the correlation should be noted.

Evaluating whether the champions of the VorstAG were right proves to be more difficult. For example, one of the key aspects of the VorstAG that advocates found so alluring was that it gave the *Aufsichtsrat* more control over a rogue *Vorstand*. Given that we are in the first few years of the VorstAG's application, combined with a political and economic climate that has produced the Occupy Wall Street movement fuelled by anger at bankers and other high-earning individuals, it would seem unlikely that members of the *Vorstand* would be inclined to make outrageous compensation demands during this time. Short of misbehavior by the *Vorstand*, it is difficult to evaluate the degree of *Aufsichtsrat* control over the *Vorstand*. But one can see some signs of the *Aufsichtsrats* preemptively flexing their muscles: though the VorstAG only applies to employment contracts entered into after its effective date, members of a significant number of *Vorstands* have agreed to change their existing employment agreements to comply with the new VorstAG requirements, even though they are not required to do so until the end of their contracts.[254] *Vorstands* where some or all members have agreed to this change constitute a majority of the DAX 30, though barely, and include BASF, BMW, Munich

254. I note here that this will mainly affect base salary—usually awards from option compensation plans and the amount of bonus awarded is sufficiently discretionary as laid out in the employment agreement that its payment would reflect the VorstAG.

RE, and ThyssenKrupps. In addition, more companies are offering a preview of "coming attractions" of sorts in their compensation disclosure, indicating where the company might tend toward in the future. This is perhaps a sign that the *Aufsichtsrat* is taking more control of compensation strategy and development or at least eager to show shareholders that they are taking the matter seriously, possibly even looking to test market reactions to their tentative plans. The most significant, but not the only, examples of this were the previews and subsequent changes in light of the VorstAG itself. Linde, BASF, and Deutsche Börse were among the nineteen companies that started to discuss their VorstAG changes before fully implementing them, or gave a glimpse into what they would be discussing the following year. This trend continues, and is an interesting one. The idea that the *Aufsichtsrat* can be proactive with respect to compensation policy rather than simply reactionary is very much within the spirit of the VorstAG. Another benefit championed by the supporters of the VorstAG was that defining a peer group could avoid a situation where outsized and disproportionate payments are made, as was the perception with the Mannesmann affair. Again, only time will tell, but in their disclosures more companies are emphasizing their horizontal and vertical comparison process per the VorstAG, as mentioned in Part III above. Interestingly, no companies chose to publish which other companies they used to establish their horizontal peer group in their CD&A section, as is done in the United States.[255]

Proponents of the law were also excited about the inclusion of the say-on-pay, which has been shown to decrease instances of pay for failure in England.[256] Whether it will have the same effect in Germany remains to be seen. However, despite its optional nature, it is indeed being used by companies as a corporate governance tool and seems to be fully integrated into cor-

255. Cisco's 2009 annual proxy, for example, includes a list of their initial peer group, their then-current peer group, and an explanation of why there was a change in these peer groups over time. *See* CISCO, 2009 PROXY STATEMENT 50–52 (2009), *available at* https://materials.proxyvote.com/Approved/17275R/20090914/NPS_46091/HTML2/default.htm.

256. *See German Companies Engage on Pay Ahead of First Say-on-Pay Votes*, MANIFEST (Jan. 15, 2010, 5:02 PM), http://blog.manifest.co.uk/2010/01/2802.html.

porate governance best practice standards,[257] with most DAX 30 companies giving their shareholders an advisory say-on-pay vote in 2010.[258] Several companies also reported this shareholder approval in their 2010 annual reports, including K+S, RWE, ThyssenKrupp, and Volkswagen, by either noting the precise shareholder vote margin or indicating that the plans were approved by "a large majority," or similar wording.[259] It seems, too, that apprehension about the result of the vote has not necessarily prevented companies from allowing the vote to happen. In January 2010, both Siemens and ThyssenKrupp met with shareholders ahead of time to address pay concerns out of worry about the results of the vote.[260]

C. A New Era?

The final evaluative question is whether the VorstAG has changed the game. Has it ushered in a new standard? Do people think about compensation differently? Based upon the annual reports, the answer would be "yes," albeit in a limited fashion. Executive compensation and disclosure appears to involve a new strategy following the VorstAG, as evidenced by the new market standard in disclosure discussed above. Executive compensation strategies have been rethought and compensation packages rearranged. Companies also seem to be embracing the opportunity to positively affect their corporate governance image. Siemens, for example, used the say-on-pay to help rebuild its image after its telecom bribery scandal that was settled in 2008,[261] and HeidelbergCement went from nonexistent disclosure to one of the best in the DAX 30. In any case, it is clear that the German government no longer views

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257. Friedl et al., *supra* note 200.

258. *See Cleaning the Augean tables*, THE ECONOMIST (June 23, 2011), http://www.economist.com/node/18867298.

259. K+S, 2009 ANNUAL REPORT 3233 (2011); RWE, 2010 ANNUAL REPORT 143 (2011). ThyssenKrupp and Volkswagen even state the approving percentage, which is above 99% in both cases. THYSSENKRUPP, 2010 ANNUAL REPORT 67 (2011); VOLKSWAGEN, 2010 ANNUAL REPORT 133 (2011).

260. *See German Companies Engage on Pay Ahead of First Say-on-Pay Votes*, *supra* note 256; Daniel Schäfer & Richard Milne, *Siemens Awaits Investor Vote on Executive Pay*, FIN. TIMES UK (Jan. 26, 2010, 2:00 AM), http://www.ft.com/intl/cms/s/0/90b9530e-0a19-11df-8b23-00144feabdc0.html#axzz1eLVepcNi.

261. *See* David Gow, *Record US Fine Ends Siemens Bribery Scandal*, GUARDIAN, Dec. 16, 2008, at 24.

executive compensation as a top priority—the corporate governance issue *du jour* beginning in the fall of 2010 was the matter of female representation on the *Aufsichtsrat*. In short, there is a new platform for executive compensation reform. How far the reform eventually reaches is something only time—or perhaps the next compensation scandal—will tell.

V. APPLICABILITY

A. Lessons for Germany

It is important not only to assess the VorstAG on its own terms as a success or failure, but also to see what can be learned from the early VorstAG experience and implementation with respect to Germany's future corporate governance efforts. The modest success of the VorstAG to date would seem to endorse the German recommendation-plus approach to corporate governance: voluntary compliance with the Code provides a barometer, allowing the government to see which measures companies will comply with on their own while highlighting areas where government intervention may be needed. This trend, previously discussed in the context of the VorstOG above, continued with the VorstAG to some degree, for example with the requirement that responsible executives bear some of the cost themselves in the event that the company's D&O liability insurance is triggered. Female representation on the *Aufsichtsrat* would seem to be the next portion of the Code that is set to be transformed into law due to poor levels of compliance.[262] The cries of impending doom at the thought of compensation reform, evidenced for example in a letter from the coalition of businessmen to Angela Merkel before enactment of the VorstAG have proven to be merely bluster;[263] the German economy, up until the middle of 2012, weathered the financial crisis and Great Recession rather well as compared with other EU nations or the United States.[264] In addition, Germany

262. Peter Wollmert et al., *Deutscher Corporate Governance Kodex—eine Bilanz*, CFOWORLD.COM (July 28, 2011), http://www.cfoworld.de/deutscher-corporate-governance-kodex-eine-bilanz?page=3.

263. *See Manager Protestieren bei* Merkel, *supra* note 23.

264. Even in the throes of the European Debt Crisis in Fall 2011, German unemployment fell and the country generated "surprisingly good retail data." AFP, *German Jobs, Retail Sales Offer Rare Eurozone Cheer*, THE LOCAL (Nov. 30, 2011), http://www.thelocal.de/money/20111130-39207.html. It has only

proved that speedily enacted regulation is not necessarily toothless.

One might argue that Germany could, and indeed should, be more aggressive—that the regulations in the VorstAG do not go far enough, and that Germany missed an opportunity to go even further. But given the nature of the development of German regulations to this point, such calls are unrealistic. Germany has emphasized flexibility and transparency from the beginning with the development of the Code. Because of the various cultural and structural factors at play as discussed in Part II, this approach has been unproblematic and, in fact, effective. Germany's approach is a hands-on hands-off one, which is to say that corporate governance is *laissez faire* until it is not. Perhaps the German corporate governance approach ultimately works precisely because companies recognize that they in essence exist on the brink. They will always be given some flexibility to set their own corporate governance measures, but how much flexibility they will be given and for how long is, in reality, always an open question. Rather than wait and find out, the lesson from the VorstAG is that companies themselves can be proactive, with a result that both they and the government can learn to love.

B. Lessons for the United States

The lessons for the United States from the implementation of the VorstAG are broader than those for Germany. This is in large part because the German compensation reform system seems to be working, though perhaps not as radically as some critics might like. There was a perceived problem, a regulation was enacted within a year, and within a short period of time it seems to have achieved moderate success. The United States, on the other hand, took over a year longer than Germany to pass an act containing executive compensation reforms and six months to begin the rulemaking process, which is far from complete. It would seem that a few lessons learned from Germany's experience might help change the parameters of the debate and ease the gridlock in the United States, opening up room to discuss some new approaches to this problem in the

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been as the debt crisis in Europe stretches into its second year that some cracks are beginning to show.

country where, by most accounts, the problem is at its worst. Four points in particular are worth mentioning.

1. Quick, Effective Reform is Possible

One of the most remarkable things about the VorstAG was the speed with which it went from political topic to written law. As previously discussed, Chancellor Merkel mentioned the topic in passing on a handful of occasions in the year before the bill became law, and the time between its initial proposal in March and passage by the Bundestag in June was a mere four months. During those four months, the ruling coalition took comments on the law from a variety of sources, including academics and political parties, and also made major reforms to the initial proposal.[265] By contrast, the initial proposal that became Dodd-Frank was announced by Obama in June 2009, took more than a year for the bill to become law, and was still far from being implemented in its entirety more than a year later. The VorstAG was in effect by the beginning of August 2009 and had already started to impact compensation structure and disclosure in 2009, as evidenced by press releases from Daimler on December 16, 2009, and BASF on November 10, 2009,[266] as well as annual reports that had already started to preview upcoming changes.[267] As discussed in Parts III and IV, the law proved to be relatively effective, changing compensation disclosure and largely meeting the goals it had set for itself. This is a major achievement, one which none of the U.S. compensation laws have, until now, equaled. U.S. executive compensation measures have, at worst, led to unintended and unfortunate consequences and tend to fall short of expectations. One could argue this is because executive compensation regulations are more advanced in the United States than in Germany—Germany is only just now taking care of the basics of its corporate governance, while the United States is already at a stage of handling more complicated things. But this argument is complicated by the fact that the latest legislation in the United

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265. *VorstAG Bearbeitungsstand 11.05.2009*, on file with author.

266. Press Release, BASF, BASF Implements Law on Executive Compensation (Nov. 10, 2009); Press Release, Daimler, Daimler: Supervisory Board Confirms System of Board of Management Remuneration (Dec. 16, 2009).

267. For examples, see ALLIANZ, 2009 ANNUAL REPORT 5 (2010); HEIDELBERG CEMENT, 2009 ANNUAL REPORT, *supra* note 222, at 43–44; INFINEON, 2009 ANNUAL REPORT 54 (2010).

States and Germany has an important feature in common, the say-on-pay.

2. Control at the Board Level is Key

Many of the rules in the VorstAG focused on ensuring that the *Aufsichtsrat* took its supervision powers seriously and on preventing or discouraging undue influence on it or potential collusion with it by the *Vorstand*. The VorstAG, contributing to the increased professionalization of the *Aufsichtsrat*, made the *Aufsichtsrat* more responsible by holding its members personally liable for excessive compensation. It gave the *Aufsichtstrats* increased guidelines to go by as to what was appropriate and what was inappropriate compensation and also provided them with the power to drastically reduce compensation in the event that the company suffered a severe economic setback. As a result, an *Aufsichtsrat* has to be more actively involved—the rules provide many oversight responsibilities without setting forth a one-size-fits-all regulation that allows the *Aufsichtsrat* to simply check boxes. The *Aufsichtsrat is* left to determine what exactly is appropriate and when, if ever, it should use its extraordinary power to claw payments back. The two-year break imposed on any member of the *Vorstand* who wishes to become a member of the *Aufsichtsrat* absent shareholder approval further reinforces the distance that should exist between the two organs on a theoretical level, while preserving or even heightening actual shareholder control via the vote. It is also worth noting that no DAX 30 company has dared to request such shareholder approval in the wake of the VorstAG. Again, this approach seems to have worked, yielding, if nothing else, a more active *Aufsichtsrat* that pays attention to compensation structure and disclosure and evaluates them in light of the VorstAG.[268]

Naturally, Germany has a different corporate structure in place than does the United States. The U.S. one-board system means that, of necessity, inside and outside directors must be part of the same organ and approve the same items. This is not to say that some boundaries cannot be drawn between these two groups, as Dodd-Frank has begun trying to do. A professionalization of the Compensation Committee, for example, might be in order, similar to the changes in the requirements

268. *See supra* Part IV.B.

for Audit Committees following Enron. For example, anyone who reads the *Disney* case is struck by the fact that Sidney Poitier was a member of the compensation committee that approved those payments that shareholders took issue with.[269] Despite his talents as an actor, Mr. Poitier's expertise on appropriate levels of compensation for someone who is not even in his line of work seems insufficient on its face. There could also be additional measures imposed on all outside directors, such as liability for excessive compensation. This concept of liability for directors in some capacity is not new. Under SOX, CEOs and CFOs face personal liability for incorrect annual statements.[270]

3. Salary Caps are Not Necessary

When people think of compensation reform, they often firmly believe a cap is necessary. After all, one of the best ways to curb spiraling salaries, a main complaint about executive compensation, would seem to be to limit them. In reality, however, such caps prove difficult to structure and can have serious unintended consequences. Section 162(m) of the Tax Code, as discussed in Part I above, provides a vivid example: the cap becomes the new, government-sanctioned normal.[271] Nevertheless, advocates of salary caps press on. It is worth noting that in both Germany and the United States, there were effective caps on executive salaries at the banks and insurance companies that tapped into government bailout funds.[272] But these limits, at least in the United States, were highly unpopular

269. *See In re* The Walt Disney Co. Derivative Litig., 906 A.2d 27, 39–40 (Del. 2006).

270. *See* Allen Bernard, *Sarbanes-Oxley Could Send You to Jail*, CIO UPDATE (June 16, 2005), http://www.cioupdate.com/insights/article.php/3513481/Sarbanes-Oxley-Could-Send-You-to-Jail.htm.

271. *See* Joseph E. Bachelder III, *Executive Pay Continues to Rise Despite "Pay Reforms,"* N.Y. L.J. (Mar. 29, 2007), http://www.newyorklawjournal.com/PubArticleNY.jsp?id=900005477320.

272. *See* Brill *supra* note 11; George Frey & Patrick Mcgroarty, *Germany Approves Bailout Terms, Sets Salary Cap*, USA TODAY (Oct. 20, 2008), http://usatoday30.usatoday.com/money/economy/2008-10-20-259607219_x.htm.

In the United States, the limits were approached with more nuance, managed by the pay czar, Kenneth Feinberg, but they were nevertheless there. *See* Brill *supra* note 11.

with the companies themselves, and many banks rushed to repay their support if only to be allowed more freedom with their funds.[273] Caps also have their restrictions. Given the general freedom of contract in the United States, the federal government can only impose caps when it has a jurisdictional basis, which for the most part tends to be when a company is public and therefore subject to the Securities Act and the Exchange Act.[274] Some have therefore argued that a cap would simply push highly paid executives out of the public system and into the private, thereby transferring the problem to an industry that is not regulated from a compensation perspective, at least so far as the federal government is concerned.

One of the VorstAG's most important, and indeed most promising, lessons is that regulation can be effective without a cap. As discussed above, only a minority of the DAX 30 *Vorstand*s saw their compensation rise in the wake of the VorstAG. By restructuring salary, imposing vesting periods, and imposing more strictly monitored performance-based goals, one can truly tie pay with performance. Whether the restructurings described in the annual reports will lead to long-term dividends has yet to be seen. The short-term message is clear, though: caps do not have to be a part of effective reform.

4. A Comprehensive Approach Yields Unexpected Dividends

Above all else, the VorstAG is animated by a philosophy of imposing sustainability on executive compensation practices, and this may indeed be its greatest contribution. The notion of sustainability was not born overnight. It has long been an animating principle of the Code and corporate governance in Germany. Despite the lack of rulemaking processes that exist in

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273. *See* Brill, *supra* note 11.

274. *See* Roberta S. Karmel, *Will Convergence of Financial Disclosure Standards Change SEC Regulation of Foreign Issuers?*, BROOK. J. INT'L L. 485, 489 (2000). This is evidenced by the number of governance regulations enacted under the SEC and their variety, particularly in comparison with a place like Germany. The rules the SEC promulgated on July 10, 2009, with respect to compensation and disclosure, provide examples. *See SEC Releases Proposed Rules on Corporate Governance, Executive Compensation and Proxy Solicitation*, CORP. & SEC. L. ALERT (Bass, Berry & Sims, PLC, New York, N.Y.), July 15, 2009, at 1, *available at* http://www.bassberry.com/communicationscenter/newsletters/ (follow July 15, 2009 hyperlink).

Germany, companies essentially have a fallback interpretation position, because the German government has made clear the kind of regulatory direction it expects companies to take via the approach they have taken to corporate governance implementation. The *Vorstand* and *Aufsichtsrat* are expected to run the company for all of the shareholders, employing a responsible and indeed sustainable management style. The VorstAG made it clear that compensation packages are an important part of this approach by focusing on sustainability and payment appropriateness as key criteria. By laying out general requirements without defining them down to the letter, the German government simply provided guideposts on the spirit and transparency which was to animate companies' compensation structures. How companies should put in place appropriate structures and how companies could best show they were indeed attempting to make their compensation sustainable and appropriate under the VorstAG was up to the companies themselves. Nearly all of the most interesting changes and developments came as a result of these guiding themes as companies tried to figure out what the VorstAG meant. Hence, some companies included model calculations, others opted to expand their substantive descriptions, some revamped their compensation structures, and others undertook serious evaluations of their compensation and wound up staying essentially where they were when they began. Regardless, it is the thought process involved in and the disclosure necessitated by compliance that is important. From the evidence, it would seem that the German government did not foresee just how much the VorstAG would change company disclosure of compensation—the government simply asked companies for greater transparency, and significant substantive change was the ancillary result of companies grappling to conform with the spirit of the law.

In the United States, an open-ended law like the VorstAG would be unlikely. Our administrative law procedures are different and arguably more cumbersome, resulting in volumes of regulations that define in precise detail the applicable requirements.[275] Had the VorstAG as such been passed in the United States, the SEC would likely have defined "appropriate"

275. The books of U.S. tax code regulations, longer than the code itself, vividly illustrate this phenomenon.

and "sustainable" in a far more rigorous way than they were under the VorstAG. On the one hand, such definitions would insure uniformity and a minimum understanding of compliance from all parties.[276] On the other hand, precisely defining every word removes space for innovation and the opportunity to let companies (and ultimately the market) decide what works well. This kind of open-ended reform is critical for triggering the self-reflection needed to determine how to best translate these general principles into practical measures. This kind of self-reflection, in turn, is in and of itself vital. For if, as companies say, the one-size-fits-all solution is too constraining, then they are in the best situation to determine which solutions work best for them. Why not, then, put them in the driver's seat as they request? The destination could be mandatory and clearly defined, but each company's path slightly less prescribed.

C. Lessons for an International Framework

Despite the talk of international executive regulations at G20 summits, with executive compensation being a thorny issue that defies intra-national agreement, cobbling together regulation that the international community as a whole can support can at times seem like a pipe dream. If one country with, at the very least, a legal system and culture in common cannot agree on executive compensation reform, how are countries like those in the G20, with their differing legal systems, structures, and cultures, supposed to arrive at any sort of a consensus? How would one even begin such a discussion?

Again, the German experience with the VorstAG is helpful to rebut the skeptics because it shows that a simple and relatively open-ended rule can go quite a long way. The VorstAG's focus on sustainability and appropriateness, as discussed above, is one of its most important contributions, and also the one that could be most easily and successfully applied across international boundaries. With sustainability already a buzzword in other contexts, it is a concept recognized the world over. Furthermore, it is not particularly revolutionary—few if any corporate founders, no matter their nationality or cultural background, start companies expecting them to end like Enron. On the contrary, their company's goal is to grow, thrive, and be-

276. However, only a minority of the DAX 30 left their disclosure largely unchanged in response to the VorstAG.

come established. Executive compensation is an expense like any other, and any good businessman knows that expenses must be worth their cost. Making executive compensation "sustainable" captures precisely that balance: compensation should not bankrupt the company, but rather should be an incentive to grow the company in productive ways. "Sustainable" is also open-ended enough that it would allow for cultural flexibility and sensitivity. Adopting a resolution at a G20 annual meeting to urge public companies to implement sustainable compensation practices worldwide would therefore seem feasible.

Some could argue that an emphasis on sustainability would sideline shareholder value and mean the death of the shareholder's importance. But as mentioned in Part I, it is in shareholder-primacy cultures like the United States where, some argue, the most change is needed. In the United States, change is already underway, for while the shareholder remains the most important concern in the corporate model, the assumptions about the shareholder in question are changing. No longer are we prioritizing the man who is in for a quick dime, or the woman who is only interested in profits at the end of the quarter. With the proliferation of 401(k) plans, in addition to pension fund holdings, the United States has become a nation of stockholders, dependent for their long-term wealth on the stock market. Most shareholders are not in the game for the quarterly results *qua* quarterly results, but rather the overall performance of their funds over time. This fact has been unofficially recognized in legislation—Dodd-Frank, among other legislative efforts, tries to force companies to take a long-term perspective. In the United States, shareholders, as the principals in the principal-agent relationship, will always remain central. What is changing in practice, though it remains unrecognized, is this shift in the identity of the shareholder and the time horizons of his investment.

CONCLUSION

Executive compensation and its reform has long been a thorn in the sides of politicians. It seems to be the eternal problem to which there is no solution: the fox is in the henhouse, and it is the government's job, from the outside, to try to at least forestall disaster and, at best, manage this tricky relationship. The Occupy Wall Street movement in the United States has been only the latest demonstration of dissatisfaction with compensation structures, protesting against the richest 1% of Americans who benefit from them.[277] It is interesting here to note that though the Occupy movement is global, its aims are not the same all across the world. Occupy Berlin, for example, has broader targets, protesting capitalism in general, but not compensation in particular.[278] There are certainly many reasons for this difference, but to understand them, we might do well to look not only to the compensation laws and structures in place, but also to the government responses.

Here is where the chief difference lies. The German government was highly responsive to an issue that was particularly important to voters in light of the Great Recession. Faced with public anger, it acted quickly to try to address the broader qualms about opaque and poorly structured executive compensation. Critics will argue that the VorstAG did not definitively solve the problem, and though they are not wrong, they are missing the point. The important thing is that the German government actually tried to do something about the problem, unlike every other leading economic power at the time. Their reforms, though modest, have had some very tangible results, and the issue has now faded from importance in Germany—it rarely appears in newspapers, and Germany is tackling other corporate governance problems.

The United States has been characterized throughout its history as the land of opportunity, the place where change and innovation drive businesses and, indeed, the national mindset. Part of the United States' success in the twentieth century derived from using this innovation to its advantage, from the assembly line to the New Deal to the Berlin Airlift to Silicon Valley. But in matters of executive compensation reform, and political reform generally, the United States these days seems less capable of the quick, decisive, and innovative action that gave birth to the VorstAG. To break the stalemate, the United States might do well to look across the Atlantic to the EU's most reluctant superpower, and just try something, even if it

277. Albert R. Hunt, *Occupy Protests Seen from Left and Right*, N.Y. TIMES (Oct. 23, 2011), http://www.nytimes.com/2011/10/24/us/24iht-letter24.html.

278. In Germany, the focus was simply directly on banks. Teresa Dapp & Stefan Engelbrecht, *"Occupy Berlin": 8000 Bankenkritiker umzingeln das Regierungsviertel*, DIE WELT (Nov. 13, 2011), http://www.welt.de/regionales/berlin/article13715208/8000-Bankenkritiker-umzingeln-das-Regierungsviertel.html.

seems unambitious. The results might amount to more than expected.