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Comparing CEO Employment Contract Provisions: Differences between Australia and the U.S.

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Abstract

This study compares CEO employment contracts across two very different common law countries. In order to do our comparison, we create pairs of U.S. and Australian firms that are matched on a number of dimensions including firm size and industry. We find that Australian CEOs have significantly greater base salaries than their U.S. counterparts, while U.S. CEOs are more likely to be compensated with restricted stock and stock options than the Australians. More striking is the fact that U.S. CEO employment contracts tend to last longer than Australian contracts, and are more likely to have arbitration provisions, change-in-control provisions, tax gross ups, do not compete clauses, and SERPs.

Keywords: Executive Pay, Compensation, Australia-U.S. Comparison

JEL Classifications: G30, G32, G38, J33, J41, J44, K1, K22, M52, N3, N20

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Introduction

Executive compensation has been front page news throughout the world in the wake of the global financial crisis. The soaring rhetoric about excessive pay to ungrateful bank employees, coupled with personal attacks on CEOs and other executives, have revealed a strong public anger toward the highly paid employees of public companies. Frequently missing from the discussion are basic facts surrounding the terms and conditions of the managers' relationships with their firms, especially their companies' *ex ante* contractual obligations to these executives. While several recent studies in the United States have begun to fill in some of the details surrounding the American contracts, or the lack thereof,[1] none have fully captured the U.S. experience, especially from a legal perspective, or even touched on Australian CEOs' contractual employment relationships.

The regulatory regimes of the United States and Australia enjoy many comparable features. Indeed, in 2008 the U.S Securities and Exchange Commission ("SEC") selected Australia as the pilot jurisdiction for a trial mutual recognition program,[2] which was based on a "comparability assessment" of each country's regulatory system.[3] There are, however, also interesting differences between the two jurisdictions in terms of capital market and regulatory structures.

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1 *See* section II for a review of the recent literature.

2 *See* Mutual Recognition Arrangement Between the United States Securities and Exchange Commission and the Australian Securities and Investments Commission, Together with the Australian Minister for Superannuation and Corporate Law, (August 25, 2008), http://www.sec.gov/about/offices/oia/oia_mututal_recognition/australia/framework_arrangement.pdf. For discussion of the relationship between globalization and the strategy of mutual recognition, see Ethiopis Tafara and Robert J. Peterson, *A Blueprint for Cross-Border Access to U.S. Investors: A New International Framework*, 48 HARV. INT'L L.J. 31 (2007); James D. Cox, *Coping in the Global Marketplace: Survival Strategies for a 75 Year Old SEC*, 95 VA. L. REV. 941, 943-946 (2009).

3 *See* Press Release, SEC Chairman Cox, Prime Minister Rudd Meet Amid U.S.-Mutual Recognition Talks, No. 2008-52 (March 29, 2008).

For example, capital markets in Australia differ markedly from the classic U.S. dispersed model of share ownership.[4] Although Australia is often assumed to have a pattern of diffuse shareholding, empirical studies show that this is not in fact the case. Such studies demonstrate that, in addition to high levels of institutional investment, Australia's listed corporate sector contains a significant proportion of controlling blockholder ownership.[5]

Debate has raged in the United States on the issue of whether executive compensation is efficient and determined at arm's length, or skewed due to a power imbalance between managers and shareholders.[6] A comparative analysis of the kind undertaken in this paper provides an additional perspective on the optimal contracting and managerial power models of executive pay in U.S. academic literature.[7] Even if one accepts that a particular model has greater explanatory power in the U.S, context, this will not necessarily be the case in other jurisdictions, such as Australia.

In this paper, we are the first to compile, compare and statistically analyze CEO employment contracts for both U.S. and Australian CEOs.[8] We find that there are many statistically significant differences between the provisions of these agreements, some of which reflect underlying differences in the legal and regulatory environment, while others are not so easily explained. For instance, many more American CEOs have change-in-control provisions in their employment agreements than Australian CEOs, but this difference may well stem from more stringent stock exchange listing requirements of the Australian Securities Exchange (ASX). Vast

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4 Note, however, that the traditional image of the United States as a dispersed shareholder jurisdiction has been challenged in recent times. *See* Clifford G. Holderness, *The Myth of Diffuse Ownership in the United States*, 22 REV. FIN. STUD. 1377 (2009).

5 *See, e.g.*, Geofrey P. Stapledon, *Shareholder Ownership and Control in listed Australian Companies*, 2 CORP. GOV.: INT. REV. 2 (1999) (showing almost half of Australian listed companies had a non-institutional shareholder with a stake of 20% or more). *See also* Asjeet S. Lamba and Geofrey P. Stapledon, *The Determinants of Corporate Ownership Structure: Australian Evidence* 2002 U. MELB, PUB. L. RES. PAPER NO. 20 (2002). For recent patterns of Australian share ownership, see AUSTRALIAN SECURITIES EXCHANGE (ASX), 2008 AUSTRALIAN SHARE OWNERSHIP STUDY (2009); Grant Fleming et al., *Agency Costs and Ownership Structure in Australia*, 13 PAC.-BASIN FIN. J. 26.

6 *See*, *e.g.*, Randall S. Thomas and Harwell Wells, *Executive Compensation in the Courts: Board Capture, Optimal Contracting and Officer Fiduciary Duties,* MINN. L. REV. (forthcoming 2010). John Core, Wayne Guay and Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142 (2005); Lucian Bebchuk and Grinstein, *The Growth of Executive Pay*, 21 OXF. REV. ECON. POL'Y 283 (2005).

7 Thomas and Wells, *supra* note 6.

8 For an interesting analysis of the characteristics of the modern chief executive officer, see Marianne Bertrand, *CEOs*, 1 ANN. REV. ECON. 121 (2009).

differences in the use of arbitration provisions though cannot be explained so easily by legal rules, but may instead reflect cultural differences in that arbitration has historically been employed in Australia as a dispute resolution device in labor union relations with their employers.

We begin with a brief comparative overview of the regulatory frameworks for executive pay in the two countries. We also consider regulatory responses to the issue of executive compensation arising from the Enron scandal and, more recently, the global financial crisis. We then provide a literature review of existing empirical studies in the United States of various contracts between the American CEO and his/her firm. In Section III, we lay out our empirical analysis, beginning with a detailed description of our data and finishing with our multivariate regression analysis. We conclude with some brief remarks about the implications of our findings.

I. The Regulatory and Corporate Governance Framework for Executive Pay in the United States and Australia

Historically, both the United States and Australia have tended to allow market mechanisms to operate on executive pay with limited legislative intervention.[9] In spite of this basic approach, however, a range of regulatory constraints now affect executive compensation in these jurisdictions.[10] Australia has a "twin peaks" model of financial regulation, which the U.S. Department of Treasury proposed as a possible model for the United States in 2008.[11] Under the Australian version, one regulator, the Australian Prudential Authority ("APRA") is responsible for prudential regulation of financial institutions, and another distinct regulatory authority, the Australian Securities and Investments Commission ("ASIC") is responsible for business conduct and consumer protection.

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[9] *See generally* Kym Sheehan, *The Regulatory Framework for Executive Remuneration in Australia*, 31 SYD. L. REV. 273 (2009).

[10] For an overview of the regulatory framework relating to executive compensation in Australia, see generally *id.*; AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, Ch. 5 (Dec. 19, 2009).

[11] *See* DEPT. OF THE TREAS., BLUEPRINT FOR A MODERNIZED FIN. REGULATORY STRUCTURE 3, 13-14, 143 (March 31, 2008).

Traditionally, English and Australian courts have been reluctant to scrutinize the level of director and executive remuneration to determine whether it is excessive,[12] and there has been a paucity of case law on this issue.[13] Nonetheless, an expanding array of controls relating to executive pay now exist in Australia under a complex mix of "black letter" law and principles-based "soft" law.[14]

The first of these is the Corporations Act 2001 (Cth) ("Corporations Act"), which is the principal statutory basis for corporate regulation in Australia.[15] Many sections of the Corporations Act are relevant to executive compensation, including general corporate governance provisions concerning the duties of directors and rights of shareholders, and specific provisions concerning, for example, remuneration of officers and termination payments. Secondly, Australian listed companies are bound by the Australian Stock Exchange (ASX) Listing Rules, which include a number of executive pay related requirements.[16] Thirdly, Australian financial institutions are now subject to prudential guidelines on executive remuneration promulgated by APRA.[17] In addition to these constraints, soft law exists in the form of the ASX Corporate Governance Council corporate governance principles and

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12 *See Re Halt Garage (1964) Ltd* [1982] 3 All E.R. 1016. *Cf.* however if the payments cannot be characterised as remuneration, but are simply gratuitous distributions (*id*, 1042).

13 The U.K. case, *Guiness plc v Saunders* (1990) 2 A.C. 663, for example, concerned, not the issue of whether remuneration of £5.2 million paid to a former non-executive director for services in connection with a takeover was *reasonable,* but whether the committee purporting to contract on the company's behalf had authority to do so. The court held that no such authority existed.

14 *See* Julia Black, *Forms and Paradoxes of Principles-based Regulation*, 3 CAPITAL MRKTS. L. J., 425, 426 (2008) (outlining the perceived benefits and downsides of principles-based regulation over rules-based regulation); Lawrence A. Cunningham, *A Prescription to Retire the Rhetoric of 'Principles-Based Systems' in Corporate Law, Securities Regulation and Accounting*, 60 VAND. L. REV. 1411, 1426-1435 (2007) (criticizing the characterization of entire legal systems as either rules-based or principles-based).

15 Although Australia technically has a State-based system of corporations law, the Corporations Act is federal legislation, as a result of a referral by each State of its powers relating to corporations to the federal government. *See* Corporations Agreement 2002 (as amended), Commonwealth of Australia, 2006. This broad referral of powers was an attempt to unify and harmonize corporate law rules in Australia. Whereas State competition has been viewed as valuable contributor to efficiency in U.S. corporate law, in the Australian context, it was considered to have the opposite effect.

16 *See* Corporations Act, 2001, § 793A (Austl.)

17 *See, e.g.*, APRA, PRUDENTIAL PRACTICE GUIDE, PPG 511 – REMUNERATION (November 30, 2009), *available at* http://www.apra.gov.au/ADI/upload/PPG511_REM_revised-Dec-09.pdf.

recommendations ("ASX corporate governance principles").[18] These ASX principles operate on a flexible "comply or explain", or "if not, why not", basis.[19] Other examples of soft law include some influential industry-based codes on corporate governance and executive remuneration,[20] including guidelines issued by institutional investor organizations,[21] proxy advisers,[22] and business groups.[23]

In Australia, unlike in the United States, there is no requirement to disclose full CEO contracts. There are, however, a number of provisions affecting disclosure of information about executive pay. Section 300A of the Corporations Act requires listed companies to disclose specified information concerning the compensation of key management personnel in a dedicated section of the annual directors' report – the remuneration report.[24] The disclosure requirements were strengthened in the 2004 post-Enron reforms,[25] to address concerns that executive pay in

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[18] ASX CORPORATE GOVERNANCE COUNCIL, CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS (2d. ed. 2007). The ASX corporate governance principles were first introduced in 2003. *See* ASX CORPORATE GOVERNANCE COUNCIL, PRINCIPLES OF GOOD CORPORATE GOVERNANCE AND BEST PRACTICE RECOMMENDATIONS (2003). The principles have been the subject of ongoing assessment and consultation since that time, and the revised second edition, which included a change in title, was released in 2007. At the time of the introduction of the ASX corporate governance principles, the Managing Director and CEO of the ASX stated that "[t]hrough a disclosure based approach, the ASX is keen to avoid a U.S. style *Sarbanes-Oxley* legislative solution". *See* Richard Humphry, *"If Not, Why Not?"*, Address to the Australian Institute of Company Directors Forum, Sydney (April 2, 2003).

[19] The "if not, why not" approach requires listed companies to disclose deviations from the principles under ASX Listing Rule 4.10.3. *See* Humphry, *supra* note 18; ASX CORPORATE GOVERNANCE COUNCIL, RESPONSE TO THE IMPLEMENTATION REVIEW GROUP REPORT (2004).

[20] *See generally*, Australian Government Productivity Commission, Productivity Commission Inquiry Report No. 49, *Executive Remuneration in Australia*, 19 December 2009, 126-127; Sheehan, *supra* note 9, 283-285.

[21] *See*, *e.g.*, AUSTRALIAN COUNCIL OF SUPER INVESTORS ("ACSI"), A GUIDE FOR SUPERANNUATION TRUSTEES ON THE CONSIDERATION OF ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE RISKS IN LISTED COMPANIES (October 2009); ACSI, CORPORATE GOVERNANCE GUIDELINES: A GUIDE FOR SUPERANNUATION TRUSTEES TO MONITOR LISTED COMPANIES (2009); INVESTMENT AND FINANCIAL SERVICES ASSOCIATION ("IFSA"), CORPORATE GOVERNANCE: A GUIDE FOR FUND MANAGERS AND CORPORATIONS (5th ed., 2004); IFSA, GUIDANCE NOTE CIRCULAR: NON-BINDING SHAREHOLDER VOTE ON REMUNERATION REPORTS (2005); IFSA, EXECUTIVE EQUITY PLAN GUIDELINES (2007).

[22] RISKMETRICS (AUSTL.) PTY LTD, ASSESSING REMUNERATION REPORTS FOR ASX-LISTED COMPANIES (2008).

[23] *See* Australian Institute of Company Directors (AICD). *See, e.g.*, AICD, EXECUTIVE REMUNERATION: GUIDELINES FOR LISTED COMPANY BOARDS (2009).

[24] *See* Corporations Act, 2001, § 300A (Austl.)

[25] Changes under the CLERP 9 Act 2004 in this regard included, for example, broadening the scope of § 300A of the Corporations Act to encompass disclosure of group managers' pay, and to require more detailed

Australian listed companies was insufficiently linked to performance[26] and that the disclosure regime was inadequate.[27]

Section 300A of the Corporations Act is augmented by Principle 8 of the ASX corporate governance principles[28] and accounting standard requirements.[29] There is a strong focus on the correlation between performance and executive compensation in these disclosure provisions.[30] Another regulation, however, § 211 of the Corporations Act, provides that remuneration to officers is prima facie prohibited, unless it is "reasonable" or approved by shareholders.[31] Although this section could potentially require the courts to scrutinize levels of executive compensation, there have been few cases to date.[32]

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information concerning the link between pay and corporate performance. *See generally The BWD Guide to CLERP 9: Practical Guide to the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Blake Dawson Waldron), 2004, at 2, 7-9, *available at* http://www.eqt.com.au/pdf_files/clerp9guide.pdf; Richard Alcock and Carl Bicego, *CLERP 9 and Executive Remuneration* (Allens Arthur Robinson), Oct. 14, 2003, *available at* http://www.findlaw.com.au/articles/326/clerp-9-and-executive-remuneration.aspx.

[26] *See* Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, Bills Digest No. 166 2003-04, Main Provisions – Executive Remuneration.

[27] The disclosure regime had been the subject of a major overhaul in 1998. For analysis of the pre-1998 disclosure regime for director and executive compensation, see Jennifer G. Hill, *What Reward Have Ye? Disclosure of Director and Executive Remuneration in Australia*, 14 COMP. & SEC. L.J. 232 (1995); Michael Quinn, *The Unchangeables – Director and Executive Remuneration Disclosure in Australia*, 10 AUST. J. CORP. L. 89 (1999); For discussion of some of the defects in Australia's pre-2004 disclosure regime for executive compensation, see ***id.***

[28] *See* ASX CORPORATE GOVERNANCE COUNCIL, REVISED CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, Principle 8 (2d ed. 2007). *See generally* David Ablen, *Remunerating 'Fairly and Responsibly': The Principles of Good Corporate Governance and Best Practice Recommendations of the ASX Corporate Governance Council*, 25 SYD. L. REV. 555 (2003).

[29] *See* AUSTRALIAN ACCOUNTING STANDARDS BOARD ("AASB"), STANDARD 124, RELATED PARTY DISCLOSURE (Dec 2009). *See also* AASB, STANDARD 119, EMPLOYEE BENEFITS (Feb 2010).

[30] *See* Andreas Schoenemann, *Executive Remuneration in New Zealand and Australia*, 37 VICTORIA U. OF WELLINGTON L. REV. 31 (2006) (examining the extent to which Australian and New Zealand law ensure "pay for performance".

[31] *See generally* Andrew Defina, Thomas C. Harris and Ian M. Ramsay, *What is Reasonable Remuneration for Corporate Officers? An Empirical Investigation into the Relationship Between Pay and Performance in the Largest Australian Companies*, 12 COMP. & SEC. L.J. 341 (1994).

[32] The issue of whether remuneration was reasonable was, however, addressed in Forge v ASIC (2004) NSWCA 448. *See also* Mott v Mount Edon Goldmines (Aust.) Ltd (1994) 2 ACSR 658; Dome Resources NL v Silver (2008) NSWCA 322, which also relate to § 211 of the Corporations Act (and its predecessor § 243K), but do not directly deal with the concept of reasonableness.

A significant proportion of Australia's regulatory framework for executive compensation, including the introduction of the ASX corporate governance principles in 2003,[33] and important reforms to the Corporations Act in 2004,[34] constituted a direct response to Enron and some contemporaneous Australian corporate scandals.[35] One of the most controversial of these reforms was the introduction of § 250R (2), of the Corporations Act.[36] This provision requires shareholders of an Australian listed company to pass an annual non-binding vote, indicating whether they adopt the directors' remuneration report.[37] The explicit goals of this provision were to provide shareholders with greater voice concerning remuneration issues,[38] and to encourage more consultation and information flow concerning compensation policies between directors and shareholders.[39] It is also worth noting that under the Corporations Act, shareholders in Australian public companies possess considerably stronger rights than their U.S. counterparts in a range of corporate governance scenarios, such as initiating alterations to the constitution, convening company meetings, and appointment/removal of directors from office.[40]

Several ASX Listing Rules affect executive compensation, and often employ shareholder consent as a regulatory device.[41] Rule 10.14, for example, requires shareholder consent for the

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33 ASX Corporate Governance Council, *supra* note 18.

34 The main Australian legislative response to Enron and analogous Australian corporate collapses was the Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004 ("CLERP 9 Act 2004"), which amended the Corporations Act. *See* Jennifer G. Hill, *Regulatory Responses to Global Corporate Scandals*, 23 WISC. INT'L. L.J. 367, 374 (2005).

35 *See generally* Sheehan, *supra* note 9, 275-76; Hill, *supra* note 34.

36 Corporations Act, 2001, c. 2G, § 250R(2) (Austl.). *See also* Corporations Act, 2001, c. 2G, §§ 249L(2), 300A (Austl.). Section 250R(2) was based upon an analogous UK provision introduced in 2002, which is now found in § 439 of the U.K. Companies Act 2006. *See* Companies Act, 2006, c.46, § 439 (U.K.).

37 *See generally* Larelle Chapple & Blake Christensen, *The Non-Binding Vote on Executive Pay: A Review of the CLERP 9 Reform*, 18 AUSTL. J. CORP. L. 263 (2005).

38 Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill, 2003, Austl. H.R. Bill, Explanatory Memorandum ¶¶ 5.434-5.435 (2003),

39 *Id.* at ¶¶ [4.353], [5.413].

40 For a detailed comparison of shareholder rights in these areas under U.S. and Australian corporate law, see Jennifer G. Hill, *The Rising Tension Between Shareholder and Director Power in the Common Law World*, 18 CORP.GOV.: AN INT. REV. 344 (2010)); Jennifer G. Hill, *Subverting Shareholder Rights: Lessons from News Corp.'s Migration to Delaware*, 63 VAND. L. REV. 1 (2010).

41 For a list of all ASX Listing Rules affecting executive compensation, including those requiring shareholder approval, see AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, 132, Box 5.3 (Dec. 19, 2009).

issue of securities to directors under an employee incentive scheme.[42] Rule 10.18 prohibits a senior executive from receiving termination benefits due to a change in control of the company, however, in practice, it is possible to draft around this proscription to avoid characterization of certain payments as "termination benefits."[43] Another important listing rule, Rule 3.1, embodies Australia's continuous disclosure regime for listed companies.[44] The continuous disclosure regime[45] is particularly strict by international standards. It requires a corporate entity, on becoming aware of information that a reasonable person would expect to have a material effect on its securities, to immediately inform the ASX.[46] In 2003, the ASX announced that it expected companies announcing the appointment of a new CEO to disclose a summary of the key terms and conditions of the relevant employment contract to the ASX in compliance with the continuous disclosure regime.[47]

Finally, soft law found, for example, in Principle 8 of the ASX corporate governance principles[48] and various business group guidelines, addresses the structure of executive pay and the process by which it is determined. Recently announced amendments to the ASX corporate governance principles will strengthen provisions relating to remuneration committees and their composition, and the obligations to report departures from the standards.[49] Also, in a shift from

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[42] Australian Securities Exchange, ASX Listing Rule 10.14. It has been reported that a number of protest votes against the directors' remuneration report were recorded at companies using exemptions or ASX waivers to avoid the need for shareholder consent under this listing rule. *See* Stuart Washington, *Executive Rewards Wake a Sleeping Giant*, SYD. MORNING HERALD, Nov. 12, 2007, at 19.

[43] "Termination benefits" are defined in Chapter 19 of the ASX Listing Rules as "payments, property and advantages that are receivable on termination of employment, engagement or office, except those from any superannuation or provident fund and those required by law to be made".

[44] For background to Australia's continuous disclosure regime, which was introduced in 1994, see Mark Blair, *Australia's Continuous Disclosure Regime: Proposals for Change*, 2 AUST. J. CORP. L. 54 (1992); Peta Spender, *The Legal Relationship Between the Australian Stock Exchange and Listed Companies*, 13 COMP. & SEC. L.J. 240, 268-274 (1995).

[45] The continuous disclosure regime receives statutory backing under § 674 of the Corporations Act.

[46] ASX Listing Rule 3.1. In spite of the apparent breadth of the continuous disclosure requirement, Rule 3.1 contains important exemptions or carve-outs from the general obligation to disclose material information.

[47] *See* ASX COMPANIES UPDATE 03-03, CONTINUOUS DISCLOSURE AND CHIEF EXECUTIVE OFFICER REMUNERATION (May 1, 2003). *See also* ASX Corporate Governance Council, *supra* note 18, at Principle 9.

[48] *See* ASX Corporate Governance Council, *supra* note 28.

[49] The ASX 300 are the 300 largest listed companies on the Australian Stock Exchange. For a discussion of the new rule, see ASX MEDIA RELEASE, CHANGES TO CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS (June 30, 2010). *See also* ASX, MARKED UP AMENDMENTS DATED 30 JUNE 2010 TO THE

soft to hard law, changes to the ASX Listing Rules will now introduce a mandatory requirement for ASX 300 companies to have a remuneration committee, comprised exclusively of non-executive directors.[50]

The Australian Institute of Company Directors (AICD) Guidelines on Executive Pay[51] constitute another example of soft law. These guidelines focus on the process for determining executive remuneration,[52] and the terms and structure of executive contracts and compensation packages.[53] For example, the AICD guidelines distinguish between three possible types of employment contract - pure fixed term; maximum term; and indefinite term contracts.[54] They recommend against adoption of pure fixed term CEO contracts, which can only be terminated for misconduct, in view of the logistical difficulties and costs of early termination by the board.[55]

Several other areas of Australian law are also relevant to executive remuneration. The first of these is superannuation.[56] A radical change in the picture of Australian superannuation occurred in 1992, with the introduction of superannuation guarantee legislation,[57] which made occupational employer funded superannuation compulsory for the first time.[58] This legislation

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SECOND EDITION AUGUST 2007 OF THE CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, amendments to Recommendation 8.2.

50 See ASX, LISTING RULE AMENDMENTS – NEW REQUIREMENTS FOR A REMUNERATION COMMITTEE AND A COMPANY TRADING POLICY, 1-12 (Apr 22 2010).

51 AICD, EXECUTIVE REMUNERATION: GUIDELINES FOR LISTED COMPANY BOARDS (2009).

52 *Id.* at 9-15.

53 *Id.* at 16-25. In addition, the guidelines discuss "Reviewing arrangements" (*id.* at 26-28) and "Other matters" (*id.* at 29-32), such as the need to gauge public sentiment concerning executive remuneration (*id.* at 30) and consider whether remuneration packages are publicly defendable and affect corporate reputation (*id.* at 29, 31).

54 *Id.* at 20.

55 *Id.*

56 The three pillars of retirement funding in Australia are voluntary superannuation and private savings; compulsory superannuation; and the tax-payer funded age pension. For an overview of Australia's superannuation system, see SUPER SYSTEM REVIEW FINAL REPORT, PART ONE, OVERVIEW AND RECOMMENDATIONS, 69 (June 2010) ("Cooper Review"), Appendix B, *available at http://www.supersystemreview.gov.au/content/downloads/final_report/part_one/Final_Report_Part_1_Consolidated.pdf*. *See also* Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, *57* BROOK. L. REV. 1, 9-10 (1991).

57 Superannuation Guarantee (Administration) Act, 1992 (Austl.).

58 The level of compulsory employer funded superannuation guarantee contributions was targeted to rise gradually from an initial rate of 3% to 9% by the year 2000. *Id.* at ???. Current reforms under the Australian

was described as "perhaps unique by world standards… a curious combination of compulsory but private sector located funding".[59] Since the introduction of this retirement funding system in Australia, superannuation savings have risen steeply to a current level of over one trillion dollars.[60] The employers of 88% of all Australian workers, including executives, are now required to make superannuation contributions into a scheme on their employees' behalf.[61] Superannuation is therefore a significant and valuable component of pay in Australia.

The second intersecting legal field is labor law. One doctrine in particular, the unfair contracts jurisdiction under state labor law, proved relevant to executive remuneration and created an exception to the general dearth of litigation in this area. The unfair contracts jurisdiction is contained in §106 of the *Industrial Relations Act* 1996 (N.S.W.).[62] Although originally intended to provide protection for vulnerable and low paid workers,[63] by the beginning of this decade the provision had come to be described as a "corporate executive cornucopia".[64] Many of the largest awards to executives under §106 related to loss of performance bonuses and share options under incentive-based compensation schemes.[65] Emblamatic of such cases is *Canizales v Microsoft Corp.*,[66] where the Industrial Relations Commission of N.S.W. made an award of A$14 million to a former Microsoft executive, who

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government's *Stronger and Fairer Superannuation System Reforms* will raise the superannuation guarantee further to 12%. *See* Minister for Financial Services, Superannuation & Corporate Law & Minister for Human Services, Media Speech No 009, *A Stronger and Fairer Superannuation System*, 26 May 2010.

[59] *Id.* at 589 (citing Evidence of Association of Superannuation Funds of Australia representative, Senate Select Committee on Superannuation, 643).

[60] This is predicted to grow to $6.1 trillion by 2035. Super System Review Final Report, *supra* note 56, at 5.

[61] *Id.* at 71 (citing the findings of ABS AUGUST 2009, EMPLOYEE EARNINGS, BENEFITS AND TRADE UNION MEMBERSHIP, catalogue no 6310.0, 10 May 2010). In the words of the Cooper Review, a major recent review of superannuation, "Australians have contributions made to their super funds whether they like it or not". *Id* at 1.

[62] For an overview of the operation of § 106 and its initial availability to high income earners, see Joellen Riley, *Unfair Contracts Review: Unfair Favouritism for High Flyers?: A Review of the Proposal to Amend § 106 of the Industrial Relations Act 1996 (NSW)*, 16 COMMERCIAL L. Q. 15, 16-17 (2002).

[63] *See* JEFFREY PHILLIPS AND MICHAEL TOOMA, LAW OF UNFAIR CONTRACTS IN NSW 1 (Thomson Law Book Co., 2004).

[64] *See* Riley, *supra* note 62.

[65] *See generally* Phillips and Tooma, *supra* note 63, at 3.05-3.100.

[66] (2000) NSWIRComm 118 (September 1, 2000). Peterson J. describes the facts of Canizales v Microsoft Corporation as constituting "a current zenith in cases of this type". *Id.* at 2. For a discussion of the case, see generally Riley, *supra* note 62, at 19-20; Phillips and Tooma, *supra* note 63, at 3.70.

was retrenched two months prior to the vesting date of a valuable tranche of stock options.[67] By 2006, however, this avenue of redress for executives had been severely curtailed, firstly by state legislation responding directly to the Canizales decision,[68] and subsequently by broad federal workplace relations reforms.[69]

Finally, taxation laws have been important in shaping the contours of executive salary packages in Australia.[70] Historically, certain components of salary packages received concessional tax treatment.[71] Concessions applied, for example, to fringe benefits or perks; superannuation; and employee share schemes. The tax narrative has, however, been one in which the noose has gradually tightened over time, reducing the benefits of salary packaging weighted in favor of particular remuneration components. This began with the Fringe Benefits Act 1986, which dampened earlier enthusiasm for perks in executive contracts. More recently, in 2009, amendments to the law relating to employee share schemes[72] had a comparable effect on equity-based payments, which had become an increasingly popular component of executive compensation in Australia.[73] A particularly contentious aspect of the 2009 tax amendments was

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67 It was significant to a finding of unfairness that there was a lack of consideration given to the future vesting of the options. *See* Canizales, [2000] NSWIRComm 118, [152] (September 1, 2000). Peterson J. held that the executive was entitled to two months notice prior to dismissal, and should therefore be treated as if he were still an employee at the vesting date and therefore entitled to A$14 million. *See* Riley, *supra* note 62, at 20.

68 *See* Phillips and Tooma, *supra* note 63, [3.70] (citing the second reading speech introducing the Industrial Relations (Unfair Contracts) Amendment Bill 2002 for this proposition). As a result of the State reforms, the operation of the unfair contracts jurisdiction was restricted (in the case of employment contracts) to contracts with annual remuneration of less than $200,000. *See* Industrial Relations Act, 1996, § 108A.

69 Workplace Relations Amendment (Work Choices) Act 2005 (Cth). These federal reforms overrode all State industrial legislation dealing with unfair employment contracts in respect of employers who are trading and financial corporations.

70 For a detailed analysis of the extent to which Australian tax laws affect executive compensation levels and structure, see AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, 325-353 (Dec. 19, 2009). Also, a comprehensive review of Commonwealth and State tax laws was released in 2010 in KEN HENRY ET AL., AUSTRALIA'S FUTURE TAX SYSTEM: REPORT TO THE TREASURER, (May 2010).

71 For an overview of salary packaging, and its tax implications, in Australia, see GRAEME COOPER, RICHARD KREVER & RICHARD VANN, INCOME TAXATION: COMMENTARY AND MATERIALS, 260-263 (Thomson Reuters, 6th ed., 2009).

72 *See* Tax Laws Amendment (2009 Budget Measures No. 2) Act 2009; Assistant Treasurer, Press Release No. 103, *Passage of Budget Bill Delivers $835 Million to Bottom Line*, 2 December 2009.

73 A policy justification for reforms to the taxation of employee share schemes was the need to ensure that taxpayers are taxed consistently irrespective of the form of the relevant compensation. *See* AUSTRALIAN

the point of time at which employee share plans should be taxed. The 2009 Australian legislation uses cessation of employment as an automatic tax trigger, in spite of arguments that this could conflict with emerging best practice in structuring executive pay to include deferred holding periods for equity compensation to reduce risk and short-termism.[74]

In the United States, as in Australia, director and executive compensation was traditionally been treated as a matter of internal management, in which the courts were notoriously reluctant to interfere and relatively few constraints existed.[75] Nonetheless, judicial review of executive compensation has received greater prominence in the United States as result of the Walt Disney saga,[76] which proceeded through the Delaware Court of Chancery[77] and Supreme Court[78] earlier this decade. Obiter dicta in the 2003 proceedings raised the specter that directors approving executive compensation packages might in certain circumstances lose the protection of the business judgment rule and exoneration clauses in corporate charters.[79] The final outcome of the Disney litigation was, however, comforting to directors, confirming that,

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GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, 329 (Dec. 19,2009).

[74] *See id.* at 337-339. Some critics of the requirement to pay tax on equity-based payments at the point of termination of employment also suggested that it would induce employers to increase other components of executive compensation, such as short-term incentives or base pay. *Id.* at 337.

[75] Randall S. Thomas and Kenneth J. Martin, *Litigating Challenges to Executive Pay: An Exercise in Futility?*, 79 WASH. U.L.Q. 569 (2001). *See also* Charles M. Yablon, *Overcompensating: The Corporate Lawyer and Executive Pay*, 92 COLUM. L. REV. 1867, 1869 (1992) ("[e]xecutive compensation is another area in which corporate managers have been pretty much free, as a matter of traditional corporate law doctrine and practice, to do whatever they liked").

[76] For a succinct summary of the background facts relating to the notorious hiring, and firing, of Michael Ovitz, see *Recent Cases*, 119 HARV. L. REV. 923, 923-926 (2006). *See also* Jennifer S. Martin, *The House of Mouse and Beyond: Assessing the SEC's Efforts to Regulate Executive Compensation*, 32 DEL. J. CORP. L. 481 (2007).

[77] *See*, *e.g.*, In re the Walt Disney Company Derivative Litigation, 825 A.2d 275 (Del. Ch., 2003); In re The Walt Disney Co. Derivative Litig., 2005 WL 2056651 (Del. Ch., 2005).

[78] *See*, *e.g.*, Brehm v Eisner, 746 A.2d 244 (2000); In re the Walt Disney Co. Derivative Litig., 906 A.2d 27 (2006).

[79] *See*, *e.g.*, General Corporation Law, DEL. STAT. TIT, 8, § 102(b)(7) (Lexis 2010). According to Chancellor Chandler, the circumstances where this could occur were if the directors had "*consciously and intentionally disregarded their responsibilities*, adopting a 'we don't care about the risks' attitude". *See* Walt Disney, 825 A.2d at 289.

absent bad faith or waste,[80] directors have little to fear from judicial review.[81] The case demonstrated there is wide gap between aspirational best practice in determining executive pay and legally enforceable duties.[82] A recent decision of the Delaware Supreme Court, *Gantler v Stevens*,[83] which recognizes that corporate officers have the same fiduciary duties as directors, could provide an alternative judicial route to challenging executive compensation, by allowing courts to examine a CEO's conduct in the negotiation process.[84]

Disclosure rules and tax law have both had an influential role in the regulation of executive pay in the United States. In 1992, the SEC introduced landmark changes to its executive compensation disclosure rules, which were designed to improve the transparency, and comparability, of executive pay packages.[85] These reforms have been described as "perhaps the best known changes in policy regarding executive pay, at least among economists".[86] In the tax realm, the introduction of IRC §162(m)[87] in the mid-1990s had a major impact on the structure of U.S. pay packages. The provision, which disallows corporate tax deduction for remuneration exceeding $1m per annum unless it is performance-based, resulted in relatively low levels of fixed pay compared to variable pay in U.S. executive compensation package.[88]

Post-Enron reforms in the United States arguably paid less attention to executive compensation than comparable Australian reforms. Only two provisions of the Sarbanes-Oxley

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80 *See*, *e.g.*, Rogers v Hill, 289 US 582, 591-592 (1933) (stating "If a bonus payment has no relation to the value of services for which it is given, it is in reality a gift in part and the majority stockholders have no power to give away corporate property against the protest of the minority").

81 *See generally* Jennifer G. Hill, *Regulating Executive Remuneration: International Developments in the Post-Scandal Era,* 3 EURO. COMP. L. 64 (2006).

82 *Id.*

83 965 A.2d 695 (Del. 2009).

84 *See* Thomas and Wells, *supra* note 6.

85 *See generally* Hill, *supra* note 27.

86 Ian L. Dew-Becker, *How Much Sunlight Does it Take to Disinfect a Boardroom? A Short History of Executive Compensation Regulation*, 55 *CESIFO ECON. STUD.* 434 (2009). For background to the SEC disclosure rules, see also Martin, *supra* note 76.

87 I.R.C. § 162(m) (1995).

88 *See* Meredith R. Conway, *Money for Nothing and the Stocks for Free: Taxing Executive Compensation*, 17 CORNELL J.L. & PUB. POL'Y 383, 396 (2008), discussing the history of § 162(m). *See also* Ryan Miske, Note, *Can't Cap Corporate Greed: Unintended Consequences of Trying to Control Executive Compensation Through the Tax Code*, 88 MINN L. REV. 1673 (2004).

Act of 2002 ("Sarbanes-Oxley Act")[89] dealt directly with pay-related issues. The first was § 304. This was a statutory claw back provision, permitting recovery of bonuses, incentive-based or equity-based compensation received by the CEO or chief financial officer ("CFO"), if the corporation is required to restate earnings due to material non-compliance with financial reporting requirements as a result of misconduct.[90] In spite of the plethora of financial restatements in US corporations since the introduction of § 304,[91] successful actions under the provision have been rare.[92] Secondly, § 402 of the Sarbanes-Oxley Act prohibited the granting of personal loans to directors or executive officers. It appears that this was previously a widespread practice, which figured prominently in the Enron and WorldCom scandals.[93] Also, new stock exchange listing standards were adopted in 2003 that introduced a range of mandatory corporate governance requirements[94] and expanded the scope of the shareholder approval requirement for equity compensation.[95]

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89 Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201-7266 (LEXIS 2010)

90 Omari Scott Simmons, *Taking the Blue Pill: the Imponderable Impact of Executive Compensation Reform*, 62 SMU L. REV. 299, 347-349 (2009).

91 *See* Richard E. Schwartz, *The Clawback Provision of Sarbanes-Oxley: An Underutilized Incentive to Keep the Corporate House Clean*, 64 BUS. LAW. 1, 2, 13-15 (2008).

92 *Id.* (noting that six years after the introduction of the *Sarbanes-Oxley Act*, the SEC had successfully obtained claw backs only twice). A range of factors have compromised the effectiveness of § 304. For example, private claw back actions have been proscribed. *See* Jeffrey N. Gordon, '*Say on Pay': Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-In,* 46 HARV. J. ON LEGIS. 323, 334, n 39 (2009). Also, it was unclear whether the requisite "misconduct" under § 304 must be directly attributable to the officer against whom reimbursement is sought. Note now, however, SEC v Jenkins, No. CV 09-1510 – PHX-GMS (D. Ariz., June 9, 2010); John Savarese, *Sarbanes-Oxley "Clawback" Develpments*, THE HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG., June 24, 2010, *available at* http://blogs.law.harvard.edu/corpgov/2010/06/24/sarbanes-oxley-clawback-developments/.

93 Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance*, 114 YALE L.J. 1521, 1538 (2005).

94 *E.g.*, the corporate governance rules under § 303A of the Stock Exchange's Listed Company Manual. NYSE, Inc., Listed Company Manual § 303A (2003) provided, with some limited exceptions, that listed companies must have a majority of independent directors (*Id.* at § 303A.01) and must have a nominating/corporate governance and compensation committee composed entirely of independent directors. *Id.* at §§ 303A.04-05. For background to the NYSE corporate governance rules, see Hill, *supra* note 34, 383 n. 89.

95 *See* NYSE, Listed Company Manual, § 303A.00, at § 303A.08; Order Approving NYSE and Nasdaq Proposed Rule Changes Relating to Equity Compensation Plans, 68 Fed. Reg. 39,995 (July 3, 2003). It has been argued, however, that the listing standards were structurally flawed in requiring only that shareholders vote on the broad outline of a proposed plan, and not on individual executives' stock option packages. *See Developments in the Law - Corporations and Society*, 117 HARV. L. REV. 2169, 2218-2120 (2004).

Enron and analogous scandals also raised concerns about taxation and disclosure. Related changes were made to federal tax law, the most significant being § 409A of the Internal Revenue Code, which became effective in 2005. This provision limits the ability of executives to defer compensation and to accelerate payments.[96] In the disclosure area, although the SEC disclosure rules had been regarded as comprehensive at the time of their introduction in 1992,[97] the scandals exposed flaws and deficiencies in the rules. The SEC responded to these problems in 2006 by announcing the introduction of stricter disclosure rules for executive pay to close existing loopholes in relation to undisclosed executive perks.[98] The same year, a new scandal, concerning back-dating of stock options, surfaced in the United States.[99] There has, to date, been no counterpart to this scandal in Australia.

If the post-Enron regulatory response to the issue of executive pay was somewhat muted in the United States, the same cannot be said in relation to the global financial crisis. U.S. reforms responding to the crisis originally focused on a narrow, specialized group of U.S. corporations, namely those receiving government bail-out funding.[100] However, from mid-2009 onward, reform proposals expanded beyond the bail-out sector, and encompassed not only executive pay,

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96 *See generally* Steven J. Arsenault and W. R. Koprowski, *The Policy of Regulating Deferral: A Critique in Light of Internal Revenue Code Section 409A*, 7 HOUSTON BUS. & TAX J. 243 (2007).

97 The NACD Blue Ribbon Commission on Director Compensation, for example, praised the 1992 SEC rules as making it "virtually impossible to conceal any form, or meaningful amount" of executive compensation. SEC *Report of the NACD Blue Ribbon Commission on Director Compensation: Purposes, Principles, and Best Practices*, June 1995, 19.

98 *See* Press Release, *SEC Votes to Propose Changes to Disclosure Requirements Concerning Executive Compensation and Related Matters* (17 January 2006); Joann S. Lublin and Kara Scannell, *They Say Jump: SEC Plans Tougher Pay Rules*, WALL ST. J., Jan. 11, 2006, at C1. For discussion of potential deficiencies of the disclosure-based regulatory scheme, particularly in the light of relatively weak shareholder rights in the United States, see Simon C. Y. Wong, *Failings of U.S. Disclosure-Based Regulation: Talking Head*, FIN. TIMES, Mar 1, 2010, at 06; Martin, *supra* note 76.

99 *See generally* M. P. Narayanan, Cindy A. Schipani and H. Nejat Seyhun, *The Economic Impact of Backdating of Executive Stock Options*, 105 MICH. L. REV. 1597 (2007); Jesse M. Fried, *Option Backdating and Its Implications*, 65 WASH. & LEE L. REV. 853 (2008).

100 *See generally* John E. Core and Wayne R. Guay, *Is There a Case for Regulating Executive Pay in the Financial Services Industry?*, (Working Paper, Jan. 25, 2010) *available at* http://ssrn.com/abstract=1544104; Jennifer G. Hill, *New Trends in the Regulation of Executive Remuneration*, in DIRECTORS IN TROUBLED TIMES 106-107 (R. P. Austin and A. Y. Bilski eds., Ross Parsons Centre of Commercial, Corporate and Taxation Law, University of Sydney 2009). Reforms tied to federal bail-out funding included the Emergency Economic Stabilization Act of 2008; the American Recovery and Reinvestment Act of 2009; and the appointment of a Special Master for TARP compensation (*see* 31 C.F.R. § 30.16 A-16: *What is the Office of Special Master for TARP Executive Compensation, and what are its powers, duties and responsibilities?*).

but also shareholder empowerment and corporate governance generally.[101] It has been suggested that the global financial crisis ostensibly introduced a new policy rationale for shareholder empowerment, namely the need to restore market trust.[102] These reform initiatives have recently culminated in significant changes to executive compensation and shareholder powers under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, including the introduction of a say-on-pay requirement.[103]

The global financial crisis has also produced a wide range of regulatory responses to executive compensation in Australia.[104] For example, in December 2009, the Australian Productivity Commission issued a report on executive remuneration,[105] which made seventeen recommendations for reform.[106] The most controversial of these relates to strengthening the non-binding shareholder vote, through the introduction of a "two strikes" rule, under which consecutive "no" votes could activate a separate "re-election" resolution.[107] Also, Australia

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[101] *See* Hill, *supra* note 40.

[102] *See* William W. Bratton and Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 656-657(2010).

[103] Other executive compensation related amendments under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 include: independence requirements for compensation committees and their advisers; disclosure re pay disparity within the firm and the relationship between pay and performance; and claw back requirements. *See generally Memo re: Dodd-Frank Bill: Some Executive Compensation Action Items* (Wachtell, Lipton & Katz) Aug 2, 2010.

[104] These have included a review of executive compensation in financial institutions by APRA; a report by the Australian Productivity Commission; guidelines on executive pay by the Australian Institute of Company Directors; and a policy statement on executive remuneration by the Australian Shareholders Association. *See generally* Hill, *supra* note 100. Also, in May 2010, the Australian government provided a reference to the Corporations and Markets Advisory Committee ("CAMAC") to advise on revisions to the reporting requirements in § 300A and remuneration reports, which could reduce complexity. *See* CAMAC, EXECUTIVE REMUNERATION: INFORMATION PAPER (July 2010).

[105] AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA (Dec. 19, 2009).

[106] In April 2010, the Australian Government responded to the Productivity Commission, supporting virtually all its recommendations. *See* Joint Media Release, Minister for Financial Services, Superannuation & Corporate Law & Minister for Human Services, Government Responds to the Productivity Commission Report on Executive Remuneration (April 16, 2010). The same month, the ASX Corporate Governance Council released proposed amendments to its corporate governance principles, in response to some of the Productivity Commission's recommendations. *See* ASX CORPORATE GOVERNANCE COUNCIL, PROPOSED AMENDMENTS TO THE ASX CORPORATE GOVERNANCE COUNCIL CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS, 7.1-7.4 (April 22, 2010).

[107] *See* AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, Recommendation 15, id, XL, 294ff (Dec. 19, 2009). Under this proposed reform, a 25% "no" vote on the remuneration report would trigger a formal obligation on the

adopted new legislation[108] dealing with "golden handshakes" in 2009.[109] The previous law on termination pay[110] had been strongly criticized as overly generous to executive officers,[111] and potentially delivering "rewards for failure."[112] A key aspect of the 2009 Act is that it caps a senior officer or director's termination pay at one year's average base salary – a significant reduction from the previous seven year total compensation threshold - unless shareholder approval is obtained.[113]

The regulatory responses of the U.S. and Australian governments to the global financial crisis suggest that executive compensation is perceived as a serious problem in both jurisdictions. How do levels of executive compensation in the US and Australia compare? Executive compensation in the US steadily increased since the mid-1970s,[114] but skyrocketed during the 1990s. Between 1993 and 2003, the average CEO compensation at S&P 500 firms rose by a

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board to explain how shareholder concerns are being addressed. Two consecutive "no" votes of 25% or more would activate a separate re-election resolution, which, if successful, would require all elected directors who signed the remuneration report to submit to re-election at an extraordinary general meeting to be held within 90 days. *Id*. at XXXII.

[108] *See* the Corporations Amendment (Improving Accountability on Termination Payments) Act 2009, which received Royal Assent on November 23, 2009.

[109] *See* Bills Digest No 6 2009-10, Corporations Amendment (Improving Accountability on Termination Payments) Bill 2009, available at http://www.aph.gov.au/library/pubs/BD/2009-10/10bd006.htm), "Purpose". For an overview of key policy issues relating to termination pay, see Geofrey P. Stapledon, *Termination Benefits for Executives of Australian Companies*, 27 SYD. L. REV. 683 (2005).

[110] *See*, *e.g.*, Sheehan and Fenwick, "Seven: The *Corporations Act 2001* (CTH), Corporate Governance and Termination Payments to Senior Employees", 32 MELB. U. L. REV. 199 (2008); RiskMetrics Group, Press Release, *Shareholders Pay the High Cost of Failure: Average CEO Gets $3.4 Million to Walk*, Nov. 26, 2008.

[111] Under Part 2D.2 of the Corporations Act (former § 200F), shareholder consent was only required if termination benefits exceeding seven times a director's annual remuneration package. See, *e.g.*, Dean Paatsch and Martin Lawrence, *Money for Nothing*, BUS. SPECTATOR, Jul. 17, 2008, *available at* http://businessspectator.mobi/bs.nsf/Article/Money-for-nothing-GL32H?OpenDocument&src=is (describing Part 2D.2 of the Corporations Act "in reality a dead letter").

[112] *See generally* Stapledon, *supra* note 109.

[113] A number of changes were made during the passage of the Corporations Amendment (Improving Accountability on Termination Payments Bill 2009. For a summary of differences between a May 2009 Exposure Draft of the Bill and the actual Bill, which was introduced into the House of Representatives on 24 June 2009, see *Limits on Termination Payments: Bill Introduced into Parliament* (Freehills), Jun. 26, 2009; *Government Introduces Executive Termination Payment Laws into Parliament* (Mallesons Stephen Jacques), Jun. 24, 2009.

[114] Thomas Piketty and Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, 118 *Q.J. Econ.* 1 (2003); Carola Frydman and Raven E. Saks, *Executive Compensation: A New View from a Long-Term Perspective, 1936-2005*, (NBER Working Paper No. 14145, June 2008).

146%.[115] There has also been a significant escalation in CEO pay packages in Australia. From 2001-2007, both the median fixed remuneration (ie non performance-based elements of Australian CEO pay) and the median total remuneration had increased by around 96% in total.[116] A 2008 industry report shows that average CEO pay in the top 100 listed Australian companies increased from A$3.77 million in 2005 to A$5.53 million in 2007.[117] A common explanation for this steep rise in executive pay is the fact that increasingly Australian companies need to compete internationally, and now appoint executives from a "mobile worldwide executive talent pool".[118] Another potentially relevant factor is firm size.[119]

Nonetheless, U.S. CEOs tend to receive higher levels of total remuneration than their counterparts in other jurisdictions, including Australia.[120] The 2008 annual reports of Australia's top fifteen companies reveal that, excluding share-based compensation, the CEOs earned approximately 135 times more than the average Australian employee.[121] In the U.S., the average executive manager in the largest fifteen U.S. firms earned around 500 times more than an average employee in 2007.[122]

For our project, it is important to be conscious of the underlying differences in these two national legal systems. Executive employment contracts, or service agreements as they are called in Australia, are written against the backdrop of these specific rules and regulations, but also with the underlying regulatory culture in mind. As we will see in the subsequent sections, many of the differences in the contracts we examine may well be directly related to differences

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115 *See* Bebchuk and Grinstein, *supra* note 6. Average CEO compensation at S&P 500 firms rose from US$3.7 million to US$9.1 million between 1993 and 2003. The average compensation of the top five executives increased 125% from US$9.5 million to US$21.4 million during this period. *Id*.

116 Media Release, ACSI, Top 100 CEO Pay Research Released (Oct. 17, 2008).

117 *Id.*

118 Deborah Tarrant, *Payday Paralysis*, 79 *INTHEBLACK* 28 (2009).

119 See, *e.g.*, Frydman and Saks, *supra* note 114, 1, 3, 17; Xavier Gabaix and Augustin Landier, *Why Has CEO Pay Increased So Much?*, 123 Q.J. ECON. 49 (2008).

120 Randall S. Thomas, *Explaining the International CEO Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171, 1173-1175 (2004).

121 Tarrant, *supra* note 118.

122 INTERNATIONAL LABOUR ORGANIZATION AND INTERNATIONAL INSTITUTE FOR LABOUR STUDIES, WORLD OF WORK REPORT 2008: INCOME INEQUALITIES IN THE AGE OF FINANCIAL GLOBALIZATION, Executive Summary 3 (2008).

in the background legal rules. At the same time, there are many similarities between the contracts from the two countries even though the two legal systems are different. We turn next to a brief overview of the prior literature.

II. Literature Review

Theorists have discussed contracting between firms and their executives extensively over the years,[123] but only recently, and largely in the U.S., have the actual agreements been examined by empiricists. Researchers have found a complex set of contracts that govern the relationships between American CEOs and their publicly held firms, most of which are publicly disclosed in various degrees of detail because of Securities and Exchange Commission (SEC) requirements. Outside the U.S., however, it is rare to see disclosure of any information concerning these contracts, although in 2003 the ASX made it clear that disclosure of summaries of certain key agreements, such as the CEO's employment contract, is generally required under the Australian continuous disclosure regime.[124] The dearth of consistent Australian data relating to executive remuneration was also noted by the Productivity Commission in its December 2009 report on executive remuneration.[125] Given the lack of data, we believe that we are the first paper that compares U.S. and Australian CEO employment contracts. There are, however, a number of earlier empirical studies of U.S. CEO employment contracts and other contractual agreements with their firms. We summarize the most relevant ones of these below.

A. Employment Contracts

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123 *See generally*, KEVIN F. HALLOCK AND KEVIN J. MURPHY, THE ECONOMICS OF EXECUTIVE COMPENSATION, VOLUME 1 (1999), Part 1.

124 *See, e.g.*, ASX Corporate Governance Council, *supra* note 18, at Principle 9. (where the following comments were made in relation to continuous disclosure: "Entering employment agreements with key executives, or obligations under these agreements falling due, may trigger a continuous disclosure obligation under ASX Listing Rule 3.1. Where this is the case, disclosure to the market should include a summary of the main elements and terms of the agreement, including termination entitlements.")

125 AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, 11 (Dec. 19, 2009).

Schwab and Thomas conduct a legal and empirical analysis of American CEOs' employment contract terms.[126] After providing an overview of the process by which these agreements are negotiated, they examine the key legal characteristics of 375 employment contracts. In addition to reporting descriptive statistics on these legal features, they also compare the employment contract provisions with those found in a sample of 121 change-in-control agreements. They find several significant differences between these two types of contracts.

A second paper examining CEO employment contracts is Gillan, Hartzell and Parrino.[127] They ask why firms enter into explicit as opposed to implicit employment contracts with their CEOs. They examine all of the firms in the S&P 500 as of January 1, 2000. They find that of these firms, 184 have explicit CEO employment contracts, 41 firms disclose the existence of such an agreement but the researchers cannot find it, and 269 firms have no written agreement with their CEO. They find that explicit employment agreements are more common for firms: operating in risky business environments; with "outside" CEOs that come in to the job from another firm; and with CEOs that have more to lose if the firm breaches the contract because they have higher abnormal compensation levels or larger fractions of their pay in the form of incentive-based pay. Moreover, they show that the length of a CEO contract depends on the same set of factors as the decision to award an explicit contract, so that longer contracts are awarded to outside CEOs and to those CEOs more at risk of having their firm renegotiate the terms of their contract.

B. Severance Agreements

A second set of studies examine severance pay and agreements for American CEOs. Yermack's article on severance pay for dismissed or retired executives asks whether there is any correlation between the existence of formal severance contracts and the award of severance

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[126] Stewart J. Schwab and Randall S. Thomas, *An Empirical Analysis of CEO Employment Contracts: What do Top Executives Bargain For?*, 63 WASH. AND LEE L. REV. 231 (2006). For a model form executive employment contract, see Joan MacLeod Heminway and Trace Blankenship, *Executive Employment Agreements in Tennessee: An Annotated Model Tennessee Executive Employment Agreement*, 10 TENN. J. OF BUS. L. 141 (2009).

[127] Stuart L. Gillan, Jay C. Hartzell, and Robert Parrino, *Explicit versus Implicit Contracts: Evidence from CEO Employment Contracts*, 64 J. OF FIN. 1629 (2009).

pay.[128] He finds that more than half of a sample of 179 CEOs of Fortune 500 companies who left firms between 1996 and 2002 receive severance pay with a mean value of $5.4 million, although this is less than one year's average CEO compensation. However, the large majority of these payments (83%) are paid at the discretion of the board and not pursuant to a previous employment agreement. CEOs that are dismissed are much more likely to be paid separation payments than those that retire voluntarily and they receive much larger amounts of pay.

Rusticus studies the relationship between severance agreements and CEO turnover.[129] Using a sample of 305 newly hired CEOs at S&P 1500 firms between 1994 and 1999, he finds that about half of them have severance agreements and the median amount paid is two years cash compensation. He finds that severance agreements' presence is positively correlated with uncertainty about the CEO's abilities as measured by their number of years with the firm before becoming a CEO, the degree of uncertainty about the firm's operating environment, and higher amounts of compensation awarded to the executive. The dollar amount of the payments is correlated with the size of their annual cash compensation, firm size and whether the CEO is an outsider.

A contemporaneous paper by Sletten and Lys uses a sample of 150 CEOs that started in their position between 1992 and 2003.[130] They find that 50% of these executives have formal ex ante severance agreements, while 65% of all these CEOs receive separation payments at their departure. The mean payments are $5.37 million in 2003 dollars. They argue that ex ante severance agreements offer payments as a form of insurance to executives joining riskier firms, outside CEOs, and CEOs whose predecessors were forced to leave the firm, all of whom contract for higher severance payments. They also find support for the claim that CEOs with confidentiality agreements are more likely to contract for higher ex ante severance, although not so for CEOs with non-competition agreements.

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[128] David Yermack, *Golden Handshakes: Separation Pay for Retired and Dismissed CEOs*, 41 J. ACCT. AND ECON. 237 (2006) (golden handshakes refer to separation packages awarded to CEOs when they retire or are dismissed).

[129] Tjomme O. Rusticus, *Executive Severance Agreements* (Wharton School of Business Working Paper, February 21, 2006).

[130] Ewa Sletten and Thomas Lys, *Motives for and Risk-Incentive Implications for CEO Severance* (Kellogg School of Management Working Paper, March 30, 2006).

Rau and Xu analyze 2,192 severance agreements for 1,788 high level executives at 862 firms listed on the COMPUSTAT database in 2004.[131] They define severance agreements to cover both change-in-control agreements as well as employment contracts that provide for termination with good reason/without cause. They find that severance pay increases as firm risk increases, particularly for small firms and firms that are likely takeover targets. Change-in-control agreements lead to significantly higher severance pay and are more common at firms with high institutional ownership levels if the executive is a CEO or Board Chairman.

C. Bonus Agreements

Bonus contracts have been examined by several different researchers. Murphy has an early study of the use of performance standards in executive bonus contracts using proprietary data on 177 plans collected by a compensation consulting firm.[132] He finds that "internal" performance standards, which are based in large part on management's actions or performance in the current or prior year, are of one of two types: either they are tied to prior-year firm performance or they are based on the company's business plan or budget. Eighty-nine percent of companies rely on internal standards for their bonus plans. The remainder of the plans use "external" standards based on measures such as the performance of external peer companies. Companies are more likely to choose external measures when prior year performance is a noisy measure of current performance. He also finds that income smoothing is prevalent at companies using internal standards, but not in companies using external standards.

Carter, Lynch and Zechman look at the impact of the Sarbanes-Oxley Act on bonus agreements, hypothesizing that firms would place greater emphasis on bonus arrangements after financial reporting discretion decreased following the passage of the Act and other reform bills.[133] Using prior year earnings as the target for the bonus contracts, and an estimated weight on the change in earnings as a proxy for the effort incentive provided to managers, they find that firms place significantly more weight on earnings changes in the bonus contract post-Sarbanes-

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131 P. Raghavendra Rau and Jin Xu, *Getting Rich by Getting Fired? An Analysis of Severance Pay Contracts* (Krannert Graduate School of Business Working Paper, December 2008).

132 Kevin J. Murphy, *Performance Standards in Incentive Contracts*, 30 J. ACCT. AND ECON. 245 (2000).

133 Mary Ellen Carter, Luann J. Lynch and Sarah L.C. Zechman, *Changes in Bonus Contracts in the post-Sarbanes-Oxley Era*, 14 REV. ACCT. STUD. (2009).

Oxley than in prior years and that the relationship with bonuses and earnings increases is significantly greater in the post-Sarbanes-Oxley period as well.

Kim and Yang document the different characteristics of annual incentive bonus plans for CEOs using the SEC's newly mandated disclosures that became effective on December 15, 2006.[134] Their sample includes all of the S&P 500 firms for the three years after the reporting change occurred. They report that the five main performance measures are earnings per share (EPS), revenue, operating income, net income, and free cash flow. They find that EPS targets are consistently set below the level of expected EPS, that EPS targets are below the levels projected by analysts and are lower than historical growth levels for the firms. Moreover, they find that actual bonus payouts are 114% on average of target payouts.

D. Stock Option Awards and Plans

Stock options' features differ substantially across countries. For example, performance-based vesting conditions have traditionally been uncommon in the U.S., although widespread in Australia. Bettis, Bizjak and Coles study a sample of 983 of U.S. stock option awards that include either accelerated or contingent-vested provisions based on firm performance.[135] Contingent-vesting awards require one or more performance hurdles to be met for the grant to vest, whereas with accelerated-vesting options, the award vests early if the specified performance condition is met. They find that most performance-vesting grants have significant hurdles for vesting, such as stock price increases, or another event leading to accelerated vesting to occur and that firms that award them have significantly better operating performance than control firms. The likelihood of using performance-vesting options is positively related to the proportion of outsiders on the board and the presence of a new CEO, and negatively related to prior stock performance.

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[134] Daniel Sungyeon Kim and Jun Yang, *Beating the Target: A Closer Look at Annual Incentive Plans* (AFA 2010 Atlanta Meetings Paper, December 18, 2009) *available at* http://ssrn.com/abstract=1361814.

[135] Carr Bettis, John Bizjak, and Jeffrey Coles, Stock and Option Grants with Performance-Based Vesting Provisions (AFA 2008 New Orleans Paper, October 2008) *available at* http://ssrn.com/abstract=972424.

Dahiya and Yermack study sunset provisions for modifying the terms of company stock option plans when managers retire, die or resign from their firms.[136] Using data for companies in the S&P 500 index in the Fall of 2005, they study 389 firms' option plans or term sheets to find whether the expiration date of options changes when an executive leaves the firm or whether the vesting or exercisability terms change at that point. They find that managers who retire face stronger sunset rules (and suffer larger value losses) at firms with strong growth opportunities. Such firms exhibit lower management turnover. Executives that resign face harsh sunset rules, and are generally accorded very short periods of time to exercise their options. Given the relatively short time period for employment of many corporate executives, their results are consistent with the claim that a majority of option exercises occur after the executive has left the company with a substantial loss in their value being experienced by the executive.

E. Retirement Plans and Pensions

Pensions and retirement plans normally comprise an important subset of the contracts between a firm and an executive. Although many of the key terms of such plans are not publicly disclosed, Bebchuk and Jackson estimate the annual value of pension benefits for CEOs that left their firms in 2003 and the first five months of 2004.[137] They find that pension benefits constitute a large portion of total executive compensation for many executives. They discover that these benefits are not performance-sensitive because they are largely tied to base salary, or other fixed compensation measures, in the years preceding the executive's departure.

Gerakos focuses on CEOs' potential tradeoff between pension benefits and other forms of compensation.[138] His sample is comprised of 442 CEOs from S&P 500 companies as of 2005. He finds that U.S. CEOs trade off 48 cents of cash compensation and equity grants for every dollar of additional pension benefits they receive from their firms. As this is less than a dollar

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136 Sandeep Dahiya and David Yermack, *You Can't Take It with You: Sunset Provisions for Equity Compensation When Managers Retire, Resign or Die* (NYU Working Paper FINJ-06-016, Dec 15, 2007), *available at* http://ssrn.com/abstract=1300766.

137 Lucian A. Bebchuk and Robert J. Jackson, Jr., *Executive Pensions*, 30 J. CORP. L. 823 (2005).

138 Joseph Gerakos, *Chief Executive Officers and the Pay-Pension Tradeoff* (Working Paper, December 2008), *available at* http://ssrn.com/abstract=1166145.

for dollar tradeoff, he argues that it is consistent with CEOs having a degree of power over their boards of directors.

Kalyta uses a sample of the 60 largest firms on the Toronto Stock Exchange to examine supplemental executive retirement plans (SERPs).[139] He finds that while more transparent forms of compensation (salaries, bonuses and stock options) appear to be driven by economic variables at firms, SERP benefits, which are very difficult to observe, are closely related to an executive's power with respect to the firm's board of directors. He further finds that where managers' SERP benefits are contingent on firm performance, the company will have lower R&D expenditures in the last few years prior to the executive's retirement, which is consistent with managerial behavior aimed at maintaining higher current earnings at the expense of future returns.

F. Other Contractual Clauses

There are a wide variety of other provisions that are part of the contractual web between executives and their firms. The enforcement of non-competition provisions or agreements represents another type of restriction that has been examined in a paper by Garmaise.[140] Using a random sample of 500 Execucomp firms, he finds that 70.2% of these firms use these agreements. He analyzes differential enforcement patterns across states for non-competition agreements and finds that stronger enforcement makes it more likely that a firm will employ such agreements. Increased enforceability is also correlated with reduced executive mobility, reduced R&D expenditures and lower capital expenditures per employee.

Finally, Thomas, O'Hara and Martin study the use of arbitration provisions in CEO employment contracts.[141] With a sample of 551 contracts, they find that only approximately one half of these contracts contain arbitration clauses. Arbitration provisions are more likely to appear in contracts of CEOs at firms in industries that are experiencing rapid levels of change or

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[139] Paul Kalyta, *Compensation Transparency and Managerial Opportunism: A Study of Supplemental Retirement Plans*, 30 STRATEGIC MGMT. J. 405 (2009).

[140] Mark J. Garmaise, Ties That Truly Bind: Non-competition Agreements, Executive Compensation and Firm Investment, J. LAW, ECON. AND ORG. (forthcoming 2010).

[141] Randall S. Thomas, Erin O'Hara and Kenneth Martin, *Arbitration Clauses in CEO Employment Contracts: An Empirical and Theoretical Analysis*, 63 VAND U. L.REV. 959 (2010).

that are less profitable. They do not find that arbitration clauses are more likely at firms where the executive has a greater amount of power.

III. Data

The biggest challenge in this project was to collect comparable sets of employment contracts in the two countries. While the U.S. disclosure rules have for many years required registered firms to disclose all material contracts with their executives, Australian rules are less demanding. They do not require firms to disclose the full contracts. As noted in section I, it was only after 2003 that ASX listing rules recognized that Australian firms had an obligation, as part of their continuous disclosure regime, to disclose information about these contracts at the time of entering employment contracts with key executives.[142] However, the level of disclosure required is well short of providing the actual agreements and instead companies provide a summary of the contract's terms. Similarly, although the Australian Corporations Act mandates that listed companies must disclose specific information concerning the remuneration of key management personnel in the annual directors' report,[143] it does not require full disclosure of executive contracts. As we explain below, this made the data collection process a major challenge.

A. U.S. Data Collection

With the U.S. data, we used the EDGAR, 10-K Wizard and LiveEdgar databases to locate all employment contracts for chief executive officers at S & P 1500 companies from 1995 to 2008. Each of these databases contains all SEC filings made by American registered companies under the federal securities laws. The EDGAR database is maintained by the SEC, while 10K Wizard and LiveEdgar are privately managed. Under existing securities law disclosure requirements, U.S. companies are required to disclose on EDGAR their CEOs' employment agreements.

We located these CEO employment contracts using a variety of search techniques. First, we examined each company's definitive proxy statements for each sample year. In the

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142 *See* ASX Corporate Governance Council, *supra* note 18, at Principle 9.

143 *See* Corporations Act, 2001, §300A (Austl.).

compensation section of these filings, companies are required to discuss any material contracts that exist between them and their senior officers. We relied on these disclosures to reveal all CEO employment contracts for these companies during this time period. However, as we proceeded in our search, we quickly realized that very few contracts were attached to firms' proxy statements and that we needed to search through the firms' other SEC filings in order to find the contracts. We therefore supplemented our initial search by checking SEC filings whose filing dates were close to the date of the contract. In many cases, this resulted in finding the contract.

However, if we still could not find the contracts, then we used key word searches of SEC filings made by each company. We searched the following phrases: employment contract, employment agreement, executive agreement, and any title for a contract that was listed in the company's proxy statement.[144] Using these search terms, we found a number of additional contracts attached to a wide variety of different SEC filings. Companies did not appear to systematically use any particular type of filing for disclosing these contracts, although we frequently found them attached to 10-K's, 10-Q's, 8-K's and for companies issuing stock for the first time, S-1's. We were generally unable to find contracts that predated the beginning of the subject companies' EDGAR filings, usually in 1996, and in a limited number of cases, we were unable to find contracts that were disclosed in the company's proxy statements even after the company commenced filing its disclosure documents because the contracts did not appear to be attached to any of the company's SEC filings.[145]

We read the companies' proxy statements whenever they discussed their CEOs' employment contracts. While companies provided extensive disclosures concerning the contents of these employment contracts, once we compared these disclosures with the contracts themselves, we found that there were frequently discrepancies. Therefore we determined that it was necessary to code the contracts themselves in order to ensure greater accuracy in our data. We wrote a coding manual for the contracts so that each variable that we were interested in could

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[144] For example, if the proxy statement stated that the company's CEO had an "Employment Understanding Agreement," we would specifically search using that term.

[145] Given that we exhaustively searched through every filing made, we suspect that these contracts either were not filed with the SEC, or that the document that they were attached to was not available on EDGAR. In light of its decision to require the contracts' disclosure, the SEC should instruct companies where to attach the documents to facilitate public access to this information and to permit it to monitor their compliance with the disclosure requirement.

be systematically collected. We collected a comprehensive set of important contract information, including basic compensation information, severance, perquisites and various legal constraints on the CEO and the firm. For example, we generally collect severance information from an employment contract under the sub-section, "Compensation after termination of employment/Company obligations after termination of employment/Severance Payments."

We augmented this with data from the Execucomp database, where we extracted further information on CEO compensation details, especially bonuses, CEO age, and CEO tenure and appointment date. In addition, we extracted information on stock daily returns from the CRSP database to calculate daily return standard deviations and extracted GICS industry codes and book value of assets from the Compustat database.

B. Australian Data Collection

We started by deciding to study the sample of firms in the ASX 200, the foremost Australian stock index. This stock index covers the largest publicly listed firms based in Australia and listed on the Australian Securities Exchange (ASX), Australia's primary stock exchange. To assemble our sample of firms, we began by obtaining a list of the ASX 200 firms in 2003 and tracked forward in time to obtain new additions, deletions, and name changes and their dates. This represents the Australian firms in our sample. We also searched for whether any of these firms were cross listed on a major US stock exchange at the CEO contract start date as explained below.

To obtain CEO employment contracts of firms in the ASX200, we first contacted each firm individually, requesting a copy of their current CEO's employment contract subject to the terms of a non-disclosure agreement, if they requested one. Using this process, we obtained 34 CEO employment contracts from 31 Australian firms. Next, we examined whether any of our sample firms made filings with the Australian Securities and Investment Commission (ASIC) that included their CEO's employment contract. We did the same type of search for the firms cross-listed in the U.S. and looked for this information in Securities and Exchange Commission filings. We obtained a number of additional contracts in this manner.

As mentioned earlier, in 2003 Australian listed companies were advised by ASX Corporate Governance Council that firms were required to report current contract details and details on any new contracts entered into when CEOs are renewed or replaced ("The Summary

Terms of Employment"). [146] CEO employment contract summaries include compensation details such as salary, bonuses, restricted stock and stock options, as well as long term performance incentives and severance agreements. Also, under §300A of the *Corporations* Act, listed companies must also disclose certain information concerning the remuneration of key management personnel in the directors' report section of the company's annual report.[147] Although this provision requires disclosure of only specific information, some corporations include full employment contracts in their appendices to the annual reports. However, the degree of completeness of these contract summaries and information provided under the disclosure requirements of s 300A of the *Corporations Act* varies greatly and therefore we were only able to use those summaries that included compensation and severance details. For the purposes of coding these contracts' primary features, we used a detailed coding manual modified from our original employment contract manual used for coding US employment contracts.

In addition, we used the Fin Analysis database, maintained by Huntleys' Investment Information Pty. Limited (a wholly owned subsidiary of Morningstar, Inc.), to locate the ASX Announcement of CEO/ Managing Director Appointment and the change/ renewal of employment agreement. The Summary Terms of Employment was usually attached to the Announcement of Appointment which is categorized under "Company Administration."

The Summary Terms of Employment does not specify all the employment terms, in particular the terms which were disclosed as standard employment policy such as Long Term Incentive Payment Schedule and Trading Policy of equity base rewards. We therefore supplemented the Summary Terms of Employment by retrieving the relevant information from the Annual Report of the respective financial year. We also ran the key phrase searches through the web search engines, Google.com.au and Bing.com. The search phrases were "CEO employment contracts", "CEO terms of employment" and "CEO appointment announcement." By going through the first 20 pages of search results of both search engines, we found an additional 14 Summary Terms of Employment of CEO.

To obtain information on which stocks are cross listed, we used two databases. One is the EDGAR database to locate the forms of registration and deregistration filed by the Australian

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146 *See* ASX Corporate Governance Council, *supra* note 18, at Principle 9.

147 *See* Corporations Act, 2001, § 300A (Austl.).

companies. We identified cross listed firms using the SEC's Form List Forms F-3, F-1 and 425, which are related to registration of foreign company, and Form 15F for deregistration. We then searched the EDGAR database in two ways: first, using the "EDGAR Full-Text Search" to search the full text of EDGAR filings from the last four years of the Australian companies; and second, we looked in the "Historical EDGAR Archives" which allows us to retrieve the record of filings from 1994 through 2010. The second database that we used is the Australia database "Fin Analysis." We searched the Archives of Announcements to locate the announcements of registration and deregistration in the U.S. exchange markets.

To obtain information about Australian CEOs nationality, and particularly whether they are U.S. citizens, we used a number of data sources including the ASX Announcement of Appointment, the Annual Report, Company websites and other online databases, such as, Reuters, BusinessWeek, Wikipedia, Who's Who, Bloomberg, Newsweek, and Hoovers-People. To obtain the initial appointment dates of CEOs, we used multiple data sources including the Fin Analysis database, the Dat Analysis database, as well as our CEO employment contracts, their summaries and any news reports about our sample companies.

To obtain daily stock returns for the year prior to the contract start date, we used Datastream to download the daily closing price (adjusted) in the last 8 years of the current ASX200 companies. For the delisted companies, we downloaded the daily closing price (adjusted) of the year prior to the contract start date from Morningside's Dat Analysis database and converted these into daily returns. We then used the daily returns for the prior year to calculate return standard deviations. We obtain daily Australian-US dollar foreign exchange rates on the Australian contract start date and the fiscal year end prior to the Australian contract start date, which is the date of the book value of total assets, from the Federal Reserve Bank of St Louis website http://research.stlouisfed.org/fred2/categories/94.

Our Australian employment contract data is by necessity a combination of full CEO employment contracts and contract summaries taken from two sources: the reports required to be disclosed in annual reports: and company releases to the ASX at the time new CEO contracts are signed. Although the summaries and press releases contain data on major contract features, we want to do further analysis on the reliability of this information. Our concern is that an implicit assumption of the Australian disclosure regime is that the summaries and press releases are

adequate for supplying investors and securities analysts with the details of the economically important elements of the CEO contracts, but that this is an empirically untested proposition.[148]

As an initial approach to assessing the adequacy of the Australian firm disclosures, we had two research associates separately code this subsample of CEO employment contracts, one using the actual employment contract and the other using only the company summaries coming from the press releases and remuneration reports. We then compared Australian contract features based on the two different data sources. We find that the summaries are generally fairly accurate. However, for contract features that are not required to be disclosed, namely items that are not included in CEO compensation or severance agreements, the summaries are not always complete. This means that for these contract features, we may be unavoidably undercounting occurrences of some of these contract elements. Of course, this comparison is far from definitive since firms that are willing to voluntarily release their CEOs' full employment contracts may also be more forthcoming in their contract summaries. On the other hand, it is also possible that even with this potential bias, we may still find that the required summary information is less than adequate when it comes to obtaining a clear picture of the CEO's economic incentives.

C. Methodology

In comparing Australian and U.S. firms that are publicly listed and represented on the ASX 200 and the S&P 1500, it is immediately obvious that the distribution of firms by industry and by firm size are drastically different, with Australia having a relatively larger number of mining and finance firms and many fewer firms in technology intensive and large scale manufacturing industries. Australia also has far fewer firms generally and the typical size of these firms is much smaller. With these differences in mind, we concluded that comparing the full populations of firms in the two countries was highly problematic, even in a multivariate regression context, because we would need a great deal of confidence about the correct specifications of the model to control for such large scale differences in basic characteristics. It also requires adequate controls for industry differences that could have a dynamic component,

[148] It is interesting that, although the Australian Productivity Commission specifically commented on the lack consistent data relating to executive remuneration in Australia in its December 2009 report on executive remuneration, the Commission did not recommend full contract disclosure. *See* AUSTRALIAN GOVERNMENT PRODUCTIVITY COMMISSION, PRODUCTIVITY COMMISSION INQUIRY REPORT NO. 49, EXECUTIVE REMUNERATION IN AUSTRALIA, 11 (Dec 19, 2009).

which industry fixed effects are unlikely to fully control for. As a result of these considerations, we concluded that it would be necessary to use matched pairs based on a few key firm characteristics (firm size and industry). We also decided that we needed to roughly match contract start dates, since there is a clear temporal trend in certain key contract features, particularly compensation levels.

D. Matching Procedure for U.S. and Australian Contracts

Our approach to matching the contracts is as follows. We exploit the fact that there is a much larger population of U.S. firms to attempt to select a good match for each Australian contract that we have sufficient information on. To match on industry, we require U.S. firms to be drawn from the same 2 digit GICS industry classification. To match on calendar time, the contract start dates must be within 2 calendar years of each other. Finally, to match on firm size, we require the firms' book values closest to the contract date (or averaged across the two adjacent fiscal years) to be within 300% of each other.

We match on firm size because recent U.S. empirical research suggests that, since the mid-1970s,[149] American CEO pay levels have been strongly correlated with increases in market capitalization.[150] In Australia, this correlation appears to exist as well,[151] and there has been a dramatic increase in the market capitalization of a number of corporations over the last decades. The current market capitalization of BHP Billiton, for example, is $200 billion, compared to $16 billion in 1989.[152]

This matching process is complicated by two considerations: first, we need to value all dollar denominated contract features in a single currency, which we accomplish by converting Australian dollars into US dollars on the date of the Australian CEO contract start date and the Australian firm's fiscal year-end; and second, we need to adjust for the fact that Australian firms generally have fiscal year-ends that fall on June 30, while US firm fiscal year-ends typically fall

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149 Frydman and Saks, *supra* note 114, at 1, 3, 17.

150 See, *e.g.*, Gabaix and Landier, *supra* note 119. According to the authors, six-fold increases in CEO pay in the United States from 1980-2003 can be correlated with identical increase in market capitalization of large US corporations during this period.

151 Australian Government Productivity Commission, *supra* note 148, at 429.

152 *Id.* at XVIII.

on December 31. To adjust for these calendar differences, we use the Australian total assets for the fiscal year just prior to or on the contract start date. We then take the two U.S. fiscal year-ends that bracket the Australian fiscal year-end and average them and use this to match with the exchange rate adjusted Australian total assets.

After this matching process is completed, we then assess how closely the firms matched in terms of size and start dates and find that the differences are reasonably small. We started with 139 contracts by 94 Australian firms listed on the ASX 200, where we are able to find a close matching U.S. firm. This Australian sample of contracts includes firms with more than one CEO contract across our sample period. Specifically, we have 1 firm with five contracts, 1 firm with four contracts, 3 firms with three contracts and 25 firms with two contracts and 61 firms with single CEO employment contract. Most of these cases of multiple contracts involve different CEOs. We report in Table 1 below, the means, medians and standard deviations for the Australian and U.S. firms' contract start dates and their total assets.

Table 1: Asset Size and Contract Start Dates - Matches Assessment

	Australian Mean Value	U.S. Mean Value	T Statistic for Mean Difference	Australian Median Value	U.S. Median Value	Wilcoxin Z value	Australian Standard Deviation	U.S. Standard Deviation
Asset Size	15039	10573	0.823	2126	1926	0.088	51317	33217
Contract Start Date	25/10/05	03/02/05		16/03/06	15/06/05			

Table 1 shows that the differences in the typical contract start dates are quite small, with a mean difference of 8 months. Likewise, the difference in the mean and median size of Australian and US firms, measured by total assets is also small. A standard *t* test for the difference in mean size of assets is insignificant, as is a Wilcoxon test for the difference in

median asset size. We interpret these findings as evidence that we have achieved a good match between our contracts.

IV. Empirical Evidence

A. Univariate Analysis of Major Contract Features of Australian and US Corporations

We break our descriptive analysis into three major tables that summarize key features of the CEO employment contracts.[153] Table 2 covers major direct CEO compensation elements, Table 3 covers deferred compensation features and contract length, while Table 4 reports on a number of other contract features such as non-compete clauses.

In Table 2, we present data on starting salaries in U.S. dollars (US $), while the other compensation variables are all presented in frequencies as to whether they are mentioned in the employment contract or contract summary. The data are presented in this manner because many of the contracts only specify dollar amounts for the initial salary level with all other compensation parameters being determined in the U.S. by each company's Compensation Committee, or in Australia, by the firm's Remuneration Committee, or in some cases by the full board of directors.

[153] Another interesting difference that is not shown in these tables is that all Australian CEOs have written contracts according to one distinguished Australian lawyer that handles executive employment arrangements at many public companies. Thomas interview transcript with Attorney 1, at 1-2. By comparison, earlier work has found that in the U.S. less than one half of CEOs in the S&P 500 as of 2000 had written employment contracts. Gillan, *et al.*, *supra* note 127, at 1629; Schwab and Thomas, *supra* note 126.

Table 2: CEO Compensation Features: Base Salary and Frequency of Other Features

		Salary (US $)	Bonus Plan	LT Incentive Plan	Restricted Stock	Stock Options
Australian	Mean (%)	885,253	95	69	12	38
	Median (%)	723,840				
US	Mean (%)	693,497	95	50	55	77
	Median (%)	700,000				
Difference	Mean (%)	191,756	0	19	-43	-39
	T Statistic	2.303	0.255	3.112	-8.357	-6.946
Difference	Median (%)	23,840				
	Wilcoxon Z	2.029				

The data reveal a number of interesting variations between the two countries. First, for our matched firms, the Australian CEOs are paid greater amounts of base salary than American CEOs even after converting the Australian currency into U.S. dollars and excluding the cash equivalent value of Australian perquisites, which tend to be included in cash compensation. Furthermore, the mean/median differences are statistically significant. The American contracts are significantly more likely to include various forms of equity based compensation, specifically restricted stock and stock options compared to Australian contracts, but both groups of firms are equally likely to have contracts that include annual bonuses and these are extremely common in both countries (95% of both samples). Another extremely important difference in these contracts that is hidden by these basic descriptive statistics is that almost all of the Australian contracts that employ restricted stock or stock options include one, two, or as many as three, performance hurdles that must be met before the stock or option compensation can be paid. This is in addition to the requirement of continued employment with the firm, which is generally the only requirement that needs to be met in the U.S. contracts.

It might at first appear surprising to see higher base salary figures for the Australian firms. Features of both the Australian and U.S. regulatory environments would seem to be relevant in explaining this somewhat usual fact. In several interviews of Australian corporate governance participants conducted by one of us we inquired about possible explanations for this

difference. One corporate attorney explained that in Australia, perquisites were generally rolled into salary, instead of being separately listed in the contract because of the higher fringe benefit tax rates that applied to perquisites under Australian tax law.[154] Australian contracts also allow the CEO to allocate some of their fixed compensation to superannuation or non-cash components such as a car.[155] However, we have extracted out the value of these payments from CEO's cash compensation figures.[156] By comparison, in the United States, a major regulatory factor explaining the relatively low base pay in US companies is taxation. In the mid-1990s, the US introduced an important tax provision, IRC s 162(m), disallowing corporate tax deductions for remuneration exceeding $1m per annum, unless it is performance-based.[157] So it appears that legal differences may largely explain some of these basic variations in employment contract terms across the Australian and U.S. landscapes.

Table 3 examines contract length, deferred compensation, and change-in-control features of these contracts. The contract length variable is in years, while all of the other variables are in frequencies. Again we use frequencies because calculating the dollar values for the deferred compensation variables requires examining other data sources besides the contracts themselves.

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[154] Thomas interview transcript with Attorney 1, at 10-11.

[155] This allocation is disclosed in the Remuneration Report contained in the Directors' report to the company's shareholders. These are publicly available sources of this information which do not relate to any of our contracts or the firms that provided them. For instance, a search for a random ASX 200 firm yielded a copy of Quantas Airlines 2009 Directors' Report that showed on page 74, that the Company's CEO has allocated his fixed annual remuneration to several categories of short term employee benefits.

[156] We used the Remuneration Reports contained in each sample company's securities filings to calculate these values.

[157] *See* I.R.C. §162(m) (1995). *See also* Henderson, *Executive Compensation: New Section 162(m) Limits Excessive Remuneration*, 21 J CORP TAXATION 195 (1994); Joshua A. Kreinberg, Note, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 DUKE L.J. 138, 156-157 (1995); Miske, *supra* note 88; Conway, *supra* note 88, at 396.

Although it appears that Congress' intention in enacting this provision was "to rein in excessive executive compensation" (*id.*) the outcome of the legislation was quite different. Rather than reducing executive pay in the US, § 162(m) merely led to the restructuring of remuneration packages, to include a far greater proportion of compensation in the form of stock options. For a general discussion on the potential gap between motivation and outcome in regulatory reform, see Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817 (2007).

Table 3: Contract Length and Frequencies of Deferred Compensation Features

		Length (Years)	Pension	Profit Sharing	SERP	Change in Control	Gross-Up
Australian	Mean (%)	2.32	72	6	6	31	24
	Median (%)	1.00					
US	Mean (%)	2.87	31	18	31	82	41
	Median (%)	3.00					
Difference	Mean (%)	-0.55	41	-12	-25	-51	-17
	T Statistic	-2.868	6.606	-2.157	-4.219	-7.460	-1.928
Difference	Median (%)	-2.00					
	Wilcoxon Z	-3.028					

In closely examining Table 3, we see a number of very interesting differences in the contract features. U.S. contracts are notably longer than the Australian contracts with the median length of an Australian contract being one year, while in the U.S. it is three years. Thus, U.S. CEOs generally have longer contracts than their Australian counterparts. U.S. contracts are significantly more likely to include participation in profit sharing plans as well as supplemental executive retirement plans (SERP). American CEO employment contracts are also significantly more likely to contain change-in-control protections and a tax gross-up provision to cover the tax liabilities associated with the change-in-control payment. The data show that change-in-control provisions are about three as frequent and tax gross-up provisions nearly 50% more frequent in U.S. contracts. By contrast, Australian CEO employment contracts are more than twice as likely to discuss the CEO's pension funding. All of these differences in frequencies are statistically significant.

In some instances, there are underlying legal rules that may explain several of these differences. The higher prevalence of pension plans in Australia likely reflects the mandatory nature of company contributions to superannuation plans that would be mentioned in most Australian contracts.[158] Furthermore, the Australian corporation code and ASX listing rules

[158] Thomas interview transcript with Attorney 1, at 13.

may explain the relatively low incidence of change-in-control provisions. Under section 200B of the Australian Corporations Act, shareholder approval is required if a company pays its CEO or other directors more than a specified threshold level of benefits/remuneration in connection with their leaving office. Prior to 2009, the threshold level was "seven times the average annual [remuneration] over the preceding three years."[159] However, this portion of the Corporations Act was amended to apply to all contracts introduced or amended after November 23, 2009. The new code provision requires shareholder approval of all termination payments above one year's base salary for all key management personnel. Furthermore, ASX listing Rule 10.18 "prohibits a senior executive [from] receiving a termination payment due to a change in the control of the company."[160] Given these rather stringent rules, it is not surprising that we see fewer change-in-control provisions in the Australian contracts.[161] In fact we wonder why we observe any change-in-control provisions whatsoever in the Australian contracts and how this was legally accomplished.

Table 4 presents summary information on other important features of our employment contract sample. The table includes data on Do-Not-Compete (DNC) clauses, mandatory arbitration provisions and several important limitations on a CEO's restricted on the sale, contingent sale or hedging of stock or stock options. All of these variables are measured by the frequency with which they appear in the contracts.

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159 Kym Sheehan and Colin Fenwick, *Severance: The Corporations Act 2001 (CTH), Corporate Governance and Termination Payments to Senior Employees*, 32 MELB. L. REV. 199, 212 (2008).

160 Australian Government Productivity Commission, *supra* note 148.

161 In practice, Australian lawyers put in "material diminution" clauses into the termination provisions of the CEO's contract to take the place of a change-in-control provision. These clauses specify that the CEO's loss of management authority constitutes a termination without cause, and when combined with other commonly included actions that also trigger a termination without cause, they provide the same protections as a change-in-control provision.

Table 4: Frequencies of Other Important Contract Features

		DNC	Arbi-tration	Stock Hedge Constraints	Stock Pledge Limits	Stock Sale Constraint	Other Restric-tions
Australian	Mean (%)	69	2	21	2	2	7
US	Mean (%)	85	47	2	3	2	4
Difference	Mean (%)	-16	-45	19	-1	0	3
	T-Statistic	-2.666	-9.617	2.256	-0.589	-0.269	0.811

Table 4 shows that DNC clauses appear frequently in both Australian and U.S. contracts, although U.S. contracts are significantly more likely to have such clauses than the Australian agreements. Arbitration clauses are also quite common in American contracts, but are nearly non-existent in Australian contracts. Hedging, pledging, sale and other restrictions on the sale of restricted stock and stock options are not popular in either country, although constraints on hedging stock are significantly more common in Australian contracts, occurring in roughly 21% of Australian CEO contracts. However, the differences in stock selling and pledging clauses across Australian and the U.S. are not statistically significant. Overall, the Australian contracts appear to reflect a greater shareholder concern and determination to restrain a CEO's desire to hedge the risk associated with stock-based compensation, possibly because shareholders have greater power in Australia through more concentrated institutional ownership.

Hedging provisions are likely to become much more common in Australia due to recent regulatory developments. Principle 8 of the revised ASX corporation governance principles[162] alludes to such practices indirectly in the context of disclosure, asserting that the corporate governance statement of a listed company's annual report should include a summary of the

[162] *See* ASX CORPORATE GOVERNANCE COUNCIL, REVISED CORPORATE GOVERNANCE PRINCIPLES AND RECOMMENDATIONS (2d ed. 2007) (Austl.).

firm's policy on prohibiting entry into transactions that "limit the economic risk of participating in unvested entitlements under any equity-based remuneration scheme."[163] The Productivity Commission has recently recommended that companies should be required to prohibit their executives from hedging unvested equity remuneration or vested equity subject to holding locks.[164] In its response to the Productivity Commission report, the Australian Government recognised that hedging was mechanism designed to "de-link" remuneration from corporate performance. The government agreed with the proposal to prohibit executives from engaging in such practices, but considered that the scope of such a prohibition should be expanded.[165]

Australian corporate lawyers interviewed by one of us offered the following insights into why some of these contract differences exist. For instance, when asked about the absence of arbitration provisions, one well-known Australian corporate lawyer that has drafted many of these agreements stated: "… we have a very strong labor union movement history here and arbitration has industrial connotations. …[G]entlemen wouldn't engage in that sort of business basically. It's just not considered desirable."[166] However, a second experienced attorney was less emphatic when asked if CEO employment contracts ever contained an arbtration provision, saying: "Yes, [but] not all that common. But there is a reasonable incidence of it where there is a dispute, it will be subject to arbitration…"[167] A third potential explanation offered by commentators on this paper was more straightforward: arbitration is viewed as costly and cumbersome, and a poor alternative to using the regular litigation system.[168]

B. Regression Analysis

While we have found some notable differences in the typical contract features found in Australian and U.S. matched firms, this could easily be due to differences in other firm, CEO and

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163 ASX Corporate Governance Council, *supra* note 28

164 *See* Australian Government Productivity Commission, *supra* note 148, at Recommendation 5.

165 *See* AUSTRALIAN GOVERNMENT RESPONSE TO THE PRODUCTIVITY COMMISSION'S INQUIRY ON EXECUTIVE REMUNERATION IN AUSTRALIA, 10 (April 2010).

166 Thomas interview transcript with Attorney 1, at 8.

167 Thomas interview transcript with Attorney 2, at 18.

168 Audience comments, University of Sydney Law School Workshop for this paper, June 28, 2010.

contract characteristics of the two samples. Thus, to further refine our analysis, we move beyond mean and median differences in contract characteristics to multivariate ordinary least squares (OLS) regressions where we can control for a number of key CEO employment contract features in our matched sample of Australian and U.S. contracts. In addition to the key explanatory variable, an Australian firm indicator, we use as explanatory variables the log of total assets and its squared value to further control for firm size differences, prior return standard deviation to control for firm risk borne by senior managers, CEO tenure to partially control for potential CEO influence on compensation, an indicator of a newly appointed CEO to control for more potential CEO negotiating power and prior ROA to take account of prior CEO performance.[169]

Following the existing literature, we begin our analysis of these CEO contracts by focusing on CEO base salary. The key question is whether the existing differences in salaries have a national component or whether differences in salary levels are explained by other differences in firm, CEO and contract characteristics. Differences in CEO salary across the two countries could be due to systematic differences in corporate governance, share ownership patterns, corporation and securities laws, tax codes, accounting methods, or other differences across countries. Since Australian disclosures often include the cash value of contractual obligated perquisites as part of cash compensation, we took particular care to exclude these non-salary figures to avoid an upward bias in the Australian salary figures.

Table 5 summarizes the results of our regression analysis of the log of CEO salary. We take the logs of salary to partially overcome the severe asymmetry in salary levels across firms, which in part reflects a more severe asymmetry in the distribution of firm size. Given that the dependent variable is bounded below by zero, the estimation is based on a Tobit regression specification. Qualitatively similar results are obtained when we use an OLS regression specification.

Our key finding is that on average Australian firms pay higher fixed salaries than U.S. firms, even after controlling for a wide array of differences in firm characteristics including firm size, its squared value, U.S. CEOs, U.S. cross-listed firms, market to book ratio, leverage, CEO tenure, new CEOs, stock return volatility and prior firm performance, measured by ROA. Of these control variables, we find that CEO tenure is positively related to CEO salaries. We also

[169] We also examined the usefulness of several other firm characteristics such as market-to-book ratio and leverage, but found that they had no statistical significance.

find that firm size and prior firm performance have significant positive effects of CEO salary, which are consistent with the existing literature. Interestingly, we find strong evidence that the positive firm size effect on CEO cash compensation is diminishing as firm size increase (indicated by a negative firm size squared effect). The remaining control variables have statistically insignificant effects on CEO salary.

Table 5: Tobit Regressions of log CEO Salary

The dependent variable is the log of CEO annual cash salary. The sample includes both Australian and US observations where the Australian contract can be matched with a similar US CEO contract in terms of the firm's industry, asset size and contract start date. The sample period for contract start dates is 1998-2008. The variable definitions are found in the appendix.

Variable	Estimate	t-value	Estimate	t-value	Estimate	t-value
	(1)		(2)		(3)	
AU Firm	0.130	2.28	0.150	2.29	0.126	2.06
US CEO			0.004	0.04	0.098	1.05
US Listed			-0.264	-1.95	-0.253	-1.88
CEO Tenure	0.009	0.92	0.011	1.10	0.029	2.39
New CEO					0.203	2.42
Log Firm Size	0.490	5.81	0.458	5.33	0.425	5.86
Log Firm Size*2	-0.018	-3.59	-0.016	-3.14	-0.014	-3.15
Std Deviation	0.016	0.41	0.002	0.04		
ROA	0.743	2.49	0.806	2.70	0.565	2.23
Intercept	10.620	26.37	10.759	25.89	10.762	37.23
	Pseudo R^2 =		Pseudo R^2 =		Pseudo R^2 =	
	N =	220	N =	193	N =	207

In the second regression, we add indicators for Australian firms that have U.S. CEOs and stock that is cross-listed in the U.S. The cross-listing indicator has a significant negative effect on CEO base salary, while the indicator for U.S. CEOs has a statistically insignificant positive effect. One possible reason for the insignificance of these two indicators is that all the U.S. firm observations are zero by definition. In the third regression, we add an indicator for new CEOs and find that the new CEO indicator is very significant and that CEO tenure becomes more significant, while the Australian indicator weakens somewhat, but remains statistically significant. In summary, the regression evidence shows that Australian firms tend to pay their CEOs higher base salaries than U.S. firms, even after controlling for a number of differences in firm characteristics found in the prior literature to affect CEO compensation. Thus, our earlier matched sample univariate analysis is further borne out in the regression analysis. We also tried using the market to book ratio, the debt to total asset ratio and standard deviation of prior stock returns as additional independent control variables, but they were statistically insignificant.

Given the importance of the question of whether Australian CEO compensation is affected by international labor market competition, we re-estimate our prior regressions of the log of CEO salary using only Australian subsample of CEO employment contracts. We estimate the model on this restricted sample since, as noted above, by definition CEOs in U.S. firms have zero values for the U.S. CEO and U.S. cross-listed indicators. Again, we use a Tobit regression given that the dependent variable is bounded below by zero.

In other results, not displayed in a table, we observe several interesting findings. First, Australian firms that cross-list their shares in the U.S. have significantly lower salaries, consistent with the pattern we observe for U.S. firm CEO salaries. Second, we find an insignificant effect on salary when an Australian firm employs a U.S. CEO. This result is surprising, but it may reflect at least two possibilities. First, we may simply have too few observations where the Australian firm has hired a U.S. national to be CEO. Second, it may be that the U.S. national has been working in Australia so long that he or she no longer views the U.S. labor market as a good alternative due to the strong personal, business and financial ties that the CEO has developed in Australia. We hope to explore further this result in future research.

We next examine the frequency of other important components of compensation to assess how similar these elements are different in Australia and the U.S. We start by examining the frequency that CEO employment contracts include restricted stock and stock options in the next

two tables. Table 6 presents estimates of the likelihood that a firm includes restricted stock in its CEO compensation package using a probit regression specification since the dependent variable is binary. The estimates show that restricted stock is much less common in Australian firms' CEO employment contracts than in U.S. firms' CEO contracts, after controlling for other important differences in CEO and firm characteristics used in the prior table. The coefficient on the Australian firm indicator is large in both economic magnitude and statistical significance.

Table 6: Probit Regressions of the Likelihood of Restricted Stock in Australian and US CEO Employment Contracts

The dependent variable is an indicator that takes a value of one when the contract specifies restricted stock and is zero otherwise. The sample includes both Australian and US observations where the Australian contract can be matched with a similar US CEO contract in terms of the firm's industry, asset size and contract start date. The sample period for contract start dates is 1998-2008. The variable definitions are found in the appendix.

Variable	Estimate	*Wald Chi Sq.*	Estimate	*Wald Chi Sq.*	Estimate	*Wald Chi Sq.*
	(1)		(2)		(3)	
AU Firm	-1.334	38.16	-1.586	31.60	-1.664	35.54
US CEO			-0.272	0.33	-0.236	0.24
US Listed			1.398	8.56	1.476	9.22
CEO Tenure	-0.020	0.32	-0.013	0.13	0.062	2.14
New CEO					0.648	3.62
Log Firm Size	0.508	1.99	0.740	3.53	0.721	3.74
Log Firm Size*2	-0.015	0.48	-0.029	1.61	-0.028	1.60
Std Deviation	0.150	1.09	0.111	0.50		
ROA	0.374	0.16	0.188	0.04	0.201	0.05
Intercept	-3.185	3.60	-3.964	4.64	-4.223	7.29
	Pseudo R^2 = .26		Pseudo R^2 = .30		Pseudo R^2 = .32	

	N =	226	N =	199	N =	215

In examining these control variables, we find that larger firm size increases the likelihood that CEOs will be awarded restricted stock, but at a diminishing rate, as indicated by the negative coefficient on firm size squared. In the second regression, we see that Australian firms with U.S. listing are more likely to use restricted stock than other Australian firms, which appears to reflect the influence of U.S. executive compensation patterns, possibly due in part to the firm having major U.S. operations, stockholders or customers. In the third regression model, we find that restricted stock is more likely to be paid to new CEOs and to CEOs with longer tenure. The remaining control variables including prior firm performance are not significantly related to the likelihood of restricted stock.

In Table 7, we estimate the likelihood of stock option grants being in CEO employment contracts across major US and Australian firms. We again use a probit regression model since the dependent variable is again binary. In our earlier univariate matched pair comparisons, we find that Australian contracts were significantly less likely to include stock options in CEO employment contracts. We now revisit this issue where we control for other major CEO and firm characteristics.

Table 7: Probit Regressions of the Likelihood of Stock Options in Australian and US CEO Employment Contracts

The dependent variable is an indicator that takes a value of one when the contract specifies stock option compensation and is zero otherwise. The sample includes both Australian and US observations where the Australian contract can be matched with a similar US CEO contract in terms of the firm's industry, asset size and contract start date. The sample period for contract start dates is 1998-2008. The variable definitions are found in the appendix.

Variable	Estimate	*Wald Chi Sq.*	Estimate	*Wald Chi Sq.*	Estimate	*Wald Chi Sq.*
	(1)		(2)		(3)	
AU Firm	-1.052	27.86	-1.262	28.37	-1.357	37.87
US CEO			0.716	4.52	0.572	3.19
US Listed			0.392	0.83	0.542	1.68
CEO Tenure	0.208	2.78	0.055	2.24	0.078	2.54

New CEO					**0.223**	**0.54**
Log Firm Size	**-0.172**	**0.36**	**-0.173**	**0.31**	**-0.122**	**0.23**
Log Firm Size*2	**0.005**	**0.09**	**0.004**	**0.04**	**-0.000**	**0.00**
Std Deviation	**0.168**	**1.65**	**0.225**	**2.43**		
ROA	**0.616**	**0.40**	**0.812**	**0.61**	**0.821**	**0.91**
Intercept	**1.222**	**0.82**	**1.181**	**0.65**	**1.306**	**1.77**
	R^2 = .19		**R^2 = .22**		**R^2 = .21**	
	N = 226		**N = 199**		**N = 215**	

Across all three of our probit regression specifications, we find that CEOs in U.S. firms are more likely to have stock option as part of their compensation. In model 1, we also find that stock options are more likely as CEO tenure rises, which may be an effort on the board's part to offset the increased risk aversion of a CEO who is aging. We also see that stock options are more likely when the firm has more volatile stock returns, which may be an effort to lower the CEO's risk aversion in an otherwise very risky firm. In models 2 and 3, we find that CEOs of Australian firms who are U.S. citizens are more likely to have stock option compensation, possibly because of more intense labor market competition for these particular executives. The remaining control variables including the new CEO indicator, firm size and prior firm performance are not significant. An important difference between typical U.S. and Australian employment contracts, which is not captured by our statistical model, is that in nearly all Australian contracts, restricted stock and stock options are not paid unless the firm meets at least one performance hurdle, while in the U.S., performance hurdles are much less common.[170]

The results of our comparison of US and Australian contracts offer some interesting contrasts with several earlier studies that compare U.S. and U.K. CEO compensation.[171] In those prior studies, the authors conclude that U.S. CEOs' compensation is significantly higher than U.K. CEOs' compensation. What is interesting about our initial results is that U.S. CEOs clearly

[170] J. Carr Bettis, John M. Bizjak, Jeffrey L. Coles, and Swaminathan L. Kalpathy, *Stock and Option Grants with Performance-Based Vesting Provisions*, (AFA 2008 New Orleans Meeting Paper, March 2010), *available at* http://ssrn.com/abstract=972424.

[171] Martin J. Conyon and Kevin J. Murphy, *The Prince and the Pauper? COE Pay in the United States and United Kingdom*, 110 Econ. J. F640 (2000); Martin J. Conyon, John Core and Wayne Guay, *Are U.S. CEOs Paid More Than U.K. CEOs? Inferences from Risk-Adjusted Pay*, (Working Paper, Apr 6, 2009).

do not have higher base salaries in comparison to Australia. On the other hand, U.S. contracts are much more likely to include restricted stock and stock option features, which generally require payment after a CEO remains at the firm a fixed number of years, typically without imposing any performance requirements. Thus, it is unclear, whether the total pay package of Australian CEOs is higher than that of U.S. CEOs, especially when we recognize that stock options can be out-of the money when they expire, which we have frequently observed in recent years. But what is clear is that U.S. CEOs have much stronger stock based compensation, while Australian firms have significantly less frequent stock based compensation. In addition, when stock based pay included in Australian CEO pay packages, their compensation is also conditional on meeting performance hurdles, which should further motivate Australian CEOs to perform at a high level. This performance hurdle is much less common in the U.S., though it appears to offer CEOs stronger incentives to perform well. We hope in follow up research to analyze whether U.S. compensation packages on average are greater than their Australian counterparts and how the structure of severance contracts, bonus plans and restricted stock and stock option plans differ between CEO employment contracts in Australia and the U.S.

V. Conclusions

In summary, we find a number of similarities between CEO employment contracts in the U.S. and Australia. We also find some interesting differences in contract provisions, not only in terms of compensation, but also with respect other contract terms such as contract length and restrictions on CEO actions that can be viewed as more shareholder friendly. Some of these differences, such as the relative infrequency of change-in-control provisions in Australian contracts, appear to be explained by clear differences in the legal and regulatory environments. Other differences may reflect substitution of one form of performance based compensation for another. However, there remain contract features, such as contract length, that are not so easily explained in this way. In these cases, it is interesting to speculate whether other institutional differences such as tax codes, takeover protections, institutional share ownership levels and the relative power of shareholders and boards in the two countries can help explain these remaining contract differences.

Appendix: Definitions of Variables

Salary	CEO base salary. Sources: US – Execucomp, SEC filings, employment contracts and DEF 14A, AU – Contract or Contract Summary
Bonus	Accounting based cash bonus. Sources: US – Execucomp, SEC filings, employment contracts and DEF 14A, AU - Contract or Contract Summary
Restricted stock	Stock grants that involve vesting made at the contract start date. Sources: US – Execucomp, SEC filings, employment contracts and DEF 14A, AU - Contract or Contract Summary
Stock options	Stock option grants that involve vesting made at the contract start date. Sources: US – Execucomp, SEC filings, employment contracts and DEF 14A, AU - Contract or Contract Summary
LT performance incentives	Compensation plans based on LT stock and accounting hurdles, where payment can be in cash, stock or options. Sources: US – Execucomp, SEC filings, employment contracts and DEF 14A, AU - Contract or Contract Summary
CEO age	Age at the contract start date. Sources: US – Execucomp, AU-
CEO tenure	CEO initial contract start date minus the CEO current contract start date. Sources: US - CEO employment contract, AU – employment contract and contract summary.
New CEO indicator	CEO start date is less than 6 months before the contract start
AU indicator	Australian headquartered company listed on ASX 200
Firm size	Book value of assets at the fiscal year-end closest to the Australian CEO contract start date and for the US matching firm the average of the two year-end figures that bracket the Australian fiscal year-end. Sources: AU -
Stock volatility	Stock daily return standard deviation over the year prior to the contract start date. Sources: US returns - CRSP, AU returns – Datastream.
Stock return performance	One year cumulative return over the year prior to the contract start date. Sources: US returns - CRSP, AU returns – Datastream.
CEO start date	CEO's Initial appointment date. Sources: US – Execucomp, AU - Fin Analysis database, Dat Analysis database, as well as CEO employment contracts and their summaries and news reports.

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