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# The International Scope of Say on Pay

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## Abstract

Shareholders have long complained that top executives are overpaid by corporate directors irrespective of their performance. Largely powerless to stop these practices, in 2002, they prevailed upon the U.K. Parliament to adopt legislation requiring public companies to permit their shareholders to have a mandatory, non-binding vote on the compensation of their top executives ("Say on Pay"). Since that time, there has been a wave of such legislation enacted in countries around the world, including the U.S., Australia, Belgium, the Netherlands, and Sweden, while Switzerland, Germany and France appear to be moving rapidly in the same direction. In this article, we ask what is the justification for adopting these rules? For countries where most corporations have dispersed ownership structures, like the U.S., the U.K. and Australia, proponents claimed that these votes would allow shareholders to more stringently monitor management and thereby reduce the agency costs of the separation of ownership and control in public companies. In concentrated ownership countries, such as the Netherlands, Germany, Sweden, France and Belgium, the existence of controlling shareholders at most companies in these countries means that there already is close supervision of pay levels by a concentrated owner with strong incentives not to overpay executives. However, we argue that there are other compelling reasons why Say on Pay has been enacted in these nations. We find several other reasons for these changes: movements at larger public companies toward increased dispersion of ownership in several of these countries that are opening up a need for an alternative monitor of executive pay; strong support of such legislation by foreign institutional investors whose ownership interests in firms from these countries has increased dramatically in recent years; social pressures in many of these countries against rising levels of income inequality; political responses by left-leaning parties to these social pressures by introduction of Say on Pay legislation; and the presence of important state-owned enterprises in some of these countries that allows the state to play an important role in the regulation of executive pay using different techniques, including Say on Pay. On balance, these arguments have carried, or seem likely to carry, the day in each of the countries we examine. We conclude by examining existing evidence on the effects of Say on Pay votes and how it is likely to evolve over time.


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# The International Scope of Say on Pay

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## Introduction

Shareholders have long complained that top executives are overpaid by corporate directors irrespective of their performance.[1] Largely powerless to prevent these perceived abuses, investors lobbied for a way to gain greater influence over directors' compensation decisions. While many governments responded by increasing the level of corporate disclosures on compensation packages and policies, and occasionally tinkering with tax policies in efforts to reduce pay levels, none of these tactics has had much impact.[2] Shareholders remained outside the board room while directors determined compensation with little investor input.

However, investors continued to put pressure on governments to change the status quo. In 2002, this led the U.K. to adopt legislation requiring public companies to permit their shareholders to have a mandatory, non-binding vote on the compensation of their top executives ("Say on Pay").[3] Since that time, there has been a wave of such legislation enacted in countries around the world, including the U.S., Australia, Belgium, the Netherlands, and Sweden, while Switzerland, Germany and France appear to be moving rapidly in the same direction. In this article, we examine these rules carefully, the reasons why they are so widely adopted and their likely effectiveness in constraining executive pay as well as providing shareholders with greater input into the pay setting process.[4]

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[1] One good example is LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004). For a conflicting view, see John E. Core, Wayne R. Guay & Randall S. Thomas, *Is U.S. CEO Compensation Inefficient Pay Without Performance?*, 103 MICH. L. REV. 1142 (2005).

[2] In fact, some commentators claim that these regulatory initiatives have generally been ineffective or counterproductive. Kevin J. Murphy, *The Politics of Pay: A Legislative History of Executive Compensation, in* THE RESEARCH HANDBOOK OF EXECUTIVE PAY 11, 11 (Randall S. Thomas &Jennifer G. Hill eds., 2012).

[3] Fabrizio Ferri & David A. Maber, *Say on Pay Votes and CEO Compensation: Evidence from the U.K.*, 17 REV. OF FIN. STUD. 527 (2013). For an early article debating the merits of Say on Pay that preceded the U.K. adoption, see Brian R. Cheffins & Randall S. Thomas, *Should Shareholders Have A Greater Say Over Executive Pay?: Learning from the U.S. Experience*, 1 J. OF CORP. L. STUD. 277 (2001).

[4] We are more precise about these issues than some other recent empirical studies. *See, e.g.*, Riccardo Correa & Ugur Lel, *Say on Pay Laws, Executive Compensation, CEO Pay Slice, and Firm Value Around the World* (Working Paper 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2243921 (incorrectly claiming that Switzerland had adopted Say on Pay legislation as of June 2013); Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There, in* HANDBOOK OF THE ECONOMICS OF FINANCE 115, 115 (George Constantinides, Milton Harris & Rene Stulz eds., 2012) (incorrectly stating that France has enacted a binding Say on Pay vote).

What is the justification for adopting these rules? We argue that the answer to this question turns in large part on the prevailing share ownership structure of corporations in the country in question. For countries where most corporations have dispersed ownership structures, like the U.S., the U.K. and Australia, proponents claimed that these votes would allow shareholders to more stringently monitor management and thereby reduce the agency costs of the separation of ownership and control in public companies.[5] Advocates argued that institutional investors, assisted by third party voting advisors, would overcome collective action problems, would inform themselves about corporate performance and would intelligently evaluate the executive pay packages being proposed by corporate boards for top managers. Boards would, in turn, respond by better engaging with their investors, providing them with more information, tie pay more closely to performance and show greater restraint in the compensation awards.[6] Opponents of Say on Pay denied that any of these possible benefits was likely to occur, and instead claimed that the entire effort was misplaced.[7]

In concentrated ownership countries, such as the Netherlands, Germany, Sweden, France and Belgium, we believe that the story is more nuanced. The existence of controlling shareholders at many companies in these countries means that there already is close supervision of pay levels by a concentrated owner with strong incentives not to overpay executives.[8] Thus, at first blush, there seems to be little reason for these countries to have adopted Say on Pay voting requirements. However, on closer examination, we find several other reasons for these changes: movements at larger public companies toward increased dispersion of ownership in several of these countries that are opening up a need for an alternative monitor of executive pay; strong support of such legislation by foreign institutional investors whose ownership interests in firms from these countries has increased dramatically in recent years; social pressures in many of these countries against rising levels of income inequality; political responses by left-leaning parties to these social pressures by introduction of Say on Pay legislation; and the presence of

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[5] Randall S. Thomas, Alan R. Palmiter & James F. Cotter, *Dodd-Frank's Say on Pay: Will it Lead to a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213, 1232 (2012) [hereinafter Thomas et al., *Say on Pay*].
[6] *Id.*
[7] Stephen M. Bainbridge, *Is Say on Pay Justified?*, 32 REG. 42 (2009).
[8] Lucian A. Bebchuk, Jesse Fried & David Walker, *Managerial Power and Rent Extraction in the Design of Executive Compensation*, 69 U. CHI. L. REV. 751 (2002); Randall S. Thomas, *Explaining the International Pay Gap: Board Capture or Market Driven?*, 57 VAND. L. REV. 1171 (2004) (arguing that international pay gap rests on market driven factors).

important state-owned enterprises in some of these countries that allows the state to play an important role in the regulation of executive pay using different techniques, including Say on Pay. On balance, these arguments have carried, or seem likely to carry, the day in each of the countries we examine.

The overall effects of Say on Pay votes are harder to summarize as they vary more across nations. Several general statements can be made though. First, shareholders vote to approve the pay levels, pay composition, and pay policies, at almost all companies by very wide margins, often by over 90% support levels. Second, third party voting advisors pay a crucial role in informing institutional investors about executive compensation practices and packages, especially at firms that deviate substantially from the median levels of compensation and performance. These advisors' recommendations for, or against, a company's pay plan carry very substantial weight with their institutional clients, and can dramatically change the outcome of a vote. Third, Say on Pay voting may have slowed the rate of growth of executive pay overall, but its strongest effects have been felt most at companies that exhibit poor performance with relatively high levels of pay.[9] Fourth, corporate directors have responded to low levels of shareholder support by contacting their investors to better explain their policies, thereby shifting the corporate governance dynamic around executive pay and giving shareholders greater input into its determination. Diverging corporate behavior attracts shareholders' and investors' interest, and hence it can be expected that companies adhere to (unwritten) shareholders' and proxy advisors' opinions and (national) "best practice" standards as to avoid scrutiny.

Overall, Say on Pay seems like it is here to stay. In fact, if the recent experience of the Swiss popular referendum in favor of a binding vote on executive compensation is any gauge, then it seems likely to appear in more countries over time. In the final section of the paper, we hypothesize that if boards continue to increase pay levels over time, then countries with advisory votes will move to make them binding votes. This already has been the case in the U.K. and Australia. Moreover, some legislatures will feel it necessary to impose hard law regulations on compensation practices, either directly on pay levels and composition as the EU already did,[10]

[9] Correa & Lel, *supra* note 4.
[10] *See* Directive 2010/76/EU, of the European Parliament and of the Council of 24 November 2010 Amending Directives 2006/48/EC and 2006/49/EC as regards Capital Requirements for the Trading Book and for Re-securitisations, and the Supervisory Review of Remuneration Policies, Annex I, 2010 O.J. (L 329) 1, 3–35.

and is further threatening to do, on banks, or indirectly as the Australians have done by attaching severe consequences to boards' failure to respond to high levels of shareholder dissent in a Say on Pay vote.[11] We also suggest that the adoption of Say on Pay votes at most of the major EU countries may lead other EU nations to consider the issue more closely.

This article proceeds as follows. In Section I, we provide an overview of the current state of Say on Pay legislation in the U.S., U.K., Australia, Belgium, France, Germany, Sweden and the Netherlands. Section II of the paper distills the experiences of these nations to develop a set of explanatory factors for why Say on Pay legislation has been adopted, or seems likely to be adopted, in these countries. The final section of the paper contains our predictions about the future of Say on Pay in these and other countries.

## I. Description of the Say on Pay Regimes: Legal Rules and Voting Outcomes

While Say on Pay has been the topic of several empirical studies at both the national and international level, these papers do not generally offer clear definitions of what they define as Say on Pay. This is important because different kinds of shareholder votes coexist and it is a serious mistake to treat them all as equivalent.[12] In our study, we define Say on Pay as: *(1) a recurring, mandatory,[13] (2) binding or advisory shareholders' vote, (3) provided by law,[14] that (4) directly or indirectly through the approval of the remuneration system, remuneration report or remuneration policy, (5) governs the individual or collective global remuneration package of*

[11] See *infra* section I.C for further discussion of the Australian rules on Say on Pay.
[12] One recent study correctly identified 11 European countries with some kind of say on pay regulations. Roberto Barontini, Stefano Bozzi, Guido Ferrarini & Maria-Cristina Ungureanu, *Directors' remuneration before and after the crisis: measuring the impact of reforms in Europe, in* BOARDS AND SHAREHOLDERS IN EUROPEAN LISTED COMPANIES, tbl.1 (2013). However, Correa and Ler included only 6 of these countries in their empirical analysis of say on pay. Correa & Lel, *supra* note 4, at tbl.1. This study included Switzerland as a country with a say on pay regime as of 2013, but not Germany, while in both countries the Parliament is discussing a mandatory say on pay vote. But only the German Parliament has already approved the bill (waiting to be executed), while the Swiss bill must still be approved by their legislature (as of July 15, 2013).
[13] Our definition excludes legal provisions that give companies the option of providing shareholders a vote on the remuneration of directors (as is the case in Germany).
[14] This means that we exclude a shareholder vote that might be undertaken as the result of an - even mandatory - comply or explain corporate governance code, which is not law (as in the case of France).

*the executive or managing directors of the corporation*.[15] As we will see, not all countries that permit shareholder votes on executive remuneration issues, provide those investors with Say on Pay vote?

We begin with a detailed discussion of the Say on Pay regimes adopted, or proposed, in eight of the most important industrialized countries in the world: the U.S., the U.K., Australia, Belgium, France, Germany, Sweden and the Netherlands. While there has been some research conducted in the first three countries mentioned, there is almost nothing that has been written about the experiences of the Continental European countries[16]. As a result, much of the statistical evidence that we report on these five countries is derived from data that we have hand collected and put into tables.

## A. Say on Pay in the U.S.

### 1. Development

Say on pay in the U.S. grew out of precatory shareholder-sponsored proposals submitted to public companies for inclusion on their proxy statements under Rule 14a-8.[17] Beginning in the 2006 proxy season, the American Federation of State, County, and Municipal Employees (AFSCME) started submitting these proposals, which recommended that the corporate boards at the targeted companies give shareholders a nonbinding vote on the companies' pay polices for its top executives.[18]

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[15] Under our definition, shareholder approval of only a part of the executive's remuneration package, like the granting of options, is not a Say on Pay vote.

[16] A notable exception is the comparative work is Barontini et al., *supra* note 12 (providing both empirical data on the development of executive pay in large European companies and the general state of the art on say on pay rules in European countries).

[17] Thomas et al., *Say on Pay*, *supra* note 5, at 1218.

[18] Charles Nathan, *"Say on Pay" Shareholder Advisory Votes on Executive Compensation: The New Frontier of Corporate Governance Activism*, LATHAM & WATKINS M&A COMMENT. (November 2007), http://www.lw.com /upload/pubContent/_pdf/pub2039_1.pdf. *See also* Sandeep Gopalan, *Say on Pay and the SEC Disclosure Rules: Expressive Law and CEO Compensation*, 35 PEPP. L. REV. 207, 220–21 (2008).

These early say-on-pay shareholder proposals were uniformly opposed by management but received significant shareholder support.[19] Management opposed the proposals arguing that the board of directors, not shareholders, was responsible for setting executive compensation. In their eyes, shareholder input would only impede the board's ability to act effectively. Initially, boards ignored say-on-pay proposals; even those supported by a majority of shareholders,[20] but before long, some companies voluntarily sponsored say-on-pay votes. The level of shareholder voting support for these proposals ranged from 10 to 50% depending on the company and type of request made in the proposal.

In 2008, in response to public concerns about the financial crisis, Congress put Say on Pay on its legislative agenda. The Emergency Economic Stabilization Act of 2008 (EESA) required TARP fund recipients to provide their shareholders with an advisory vote on the pay for the company's executives.[21] In 2009, the financial stimulus plan continued the Say on Pay requirement for financial firms with outstanding TARP debts.[22]

To implement this new legislation in 2009 the SEC adopted new rules.[23] Amending its proxy rules, the SEC required an advisory shareholder vote on executive pay packages of TARP recipients. During the 2010 proxy season, about 280 financial firms held Say on Pay votes.[24] The EESA Say on Pay mandate for financial firms receiving TARP money broadened the shareholder say-on-pay movement, already targeting certain financial firms' executive pay policies.[25]

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[19] Thomas et al., *Say on Pay*, *supra* note 5, at 1219–20.
[20] *Companies Ignore "Say on Pay" Votes*, DIRECTORSHIP (July 23, 2008), http://www.directorship.com/companies-ignore-say-on-pay-votes.
[21] The Troubled Assets Relief Program, established by the Emergency Economic Stabilization Act of 2008 (EESA), required that companies with outstanding funds provide an advisory vote to their shareholders. *See* EESA § 111(e), 12 U.S.C. § 5221(e).
[22] The American Recovery and Reinvestment Act of 2009, while amending some aspects of EESA, left intact the "say on pay" requirements. Pub. L. No. 111-5, 123 Stat. 1115 (2009). Thus, financial companies with outstanding TARP funds are required to submit executive pay to a shareholder vote under both TARP and Dodd-Frank. The SEC has made clear that only one vote, however, is necessary to satisfy both statutory requirements. *See* SEC Final Rule, 17 C.F.R. pts. 229, 240, 249 (2011), http://www.sec.gov/rules/final/2011/33-9178.pdf (vote under EESA is "effectively" the same as required by Dodd-Frank). Given that TARP recipients are required to conduct a "say on pay" vote annually, the SEC has exempted them from a vote on the frequency of "say on pay." *See id.* at 57–58.
[23] *See* Shareholder Approval of Executive Compensation of TARP Recipients, 17 C.F.R. pt. 240 (2010) (adopting Rule 14a-20 to require TARP recipients to provide a separate non-binding shareholder vote to approve compensation of executives whenever shareholders vote at an annual meeting involving election of directors).
[24] Ted Allen, *TARP Firms to Face Pay Votes*, RISK & GOVERNANCE BLOG, (Feb. 23, 2009, 11:21 A.M.), http://blog.issgovernance.com/gov/2009/02/tarp-firms-to-face-pay-votessubmitted-by-ted-allen-publications.html.
[25] Thomas et al., *Say on Pay*, *supra* note 5, at 1223.

The EESA mandate increased the number of firms subject to advisory say-on-pay votes beyond those shareholders identified as having "bad" compensation.[26] Not surprisingly, shareholder-voting support for these mandatory say-on-pay proposals increased.[27] The 2010 proxy season saw shareholders at TARP-funded firms vote in support of management-sponsored say-on-pay proposals with an average support level of 88.7%.[28] This high level of shareholder support for executive pay policies is interesting since in 2010 most of the say-on-pay votes were held at financial firms that had fared poorly during the financial crisis.

2. Legislation and Implementation

Section 951 of the Dodd-Frank Act requires shareholders at public companies have an advisory vote either approving or disapproving the pay of named executives for the prior fiscal year.[29] The Act also requires a shareholder advisory vote on golden parachutes granted in any merger or acquisition.[30] However, none of these mandated votes are binding or alter directors' duties to shareholders.[31] New Section 14A of the Securities Exchange Act of 1934 requires that management present "a separate resolution subject to shareholder vote to approve the compensation of executives", though the vote "shall not be binding on the issuer or the board of directors."[32]

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[26] *Id.* at 1224.

[27] *Compensation Structure and Systemic Risk: Hearing Before the H. Comm. on Financial* Services, 111th Cong. 52–53. (June 11, 2009) (testimony of Professor Verret), *available at* http://www.gpo.gov/fdsys/pkg/CHRG-111hhrg52398/pdf/CHRG-111hhrg52398.pdf. In testimony before Congress during the hearings on Dodd-Frank, Professor Verret stated:

> The average vote was a 60 percent vote against say-on-pay by the shareholders. At financial companies it is even higher. 70 percent was the average vote against say-on-pay at financial companies. So shareholders have at least—shareholders at the majority of companies in a very strong majority way have expressed dissatisfaction with say-on-pay proposals.

[28] Thomas et al., *Say on Pay*, *supra* note 5, at 1242 tbl.2.

[29] Dodd-Frank Act, *supra* note .

[30] Exchange Act § 14A(b).

[31] Exchange Act § 14A(c)(1), (c)(2).

[32] Exchange Act § 14A(a)(1), (a)(2). In addition, affected companies must hold an advisory vote at least every six years on whether the say-on-pay vote will occur every one, two, or three years. Exchange Act § 14A(a)(2).

Under section 951, the SEC provided detailed requirements that identify both the form of the say-on-pay proposal and the executive officers whose compensation is subject to a shareholder vote.[33] Say-on-pay votes are required at shareholder meetings held after January 21, 2011 at public companies with a $75 million public equity float or more.[34]

Only the pay packages of a company's CEO and the four other executive officers named in the company's proxy compensation table are subjected to shareholder's Say on Pay.[35] The vote is up or down as to the overall compensation package as described in the Compensation Discussion and Analysis (CD&A) section of the proxy statement,[36] and does not allow shareholders to directly voice an opinion on specific elements of executive compensation (such as bonuses, stock options, retirement pay, performance incentives).[37]

Within four business days after the shareholders' meeting, the results of the shareholder vote must be disclosed on Form 8-K.[38] the Company must also disclose -- in the next year's CD&A -- whether and how the shareholders' Say on Pay vote affected directors in making any decisions.[39]

3. Impact of Say on Pay

[33] Thomas et al., *Say on Pay*, *supra* note 5, at 1225.
[34] SEC Final Rule, *supra* note 22. Smaller reporting companies become subject to the say-on-pay voting requirement for annual meetings after January 21, 2013.
[35] *See* Exchange Act Rule 14a-21(a) ("say on pay" vote required at annual shareholder meetings at which directors are elected for named executives whose compensation is disclosed pursuant to Item 402 of Regulation S-K). The compensation of directors is not subject to a mandatory "say on pay" vote. *See* SEC Final Rule, *supra* note 22 , at 18.
[36] The SEC rule does not require that the management-submitted "say on pay" proposal be phrased in a particular way, though it must indicate that the proposal seeks a shareholder vote "to approve the compensation of executives as disclosed pursuant to Item 402 of Regulation S-K." SEC Final Rule, *supra* note 22 , at 19. A suggested proposal calls on shareholders to approve "compensation paid ... as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion." *Id.* at 19 n.68. A vote to approve only compensation policies and procedures would not pass muster. *Id.* at 19–20.
[37] *See* Exchange Act Rule 14a-21(a). In addition, the SEC added a comment to Rule 14a-8 that companies will be allowed to exclude shareholder-submitted proposals under the rule if the shareholder proposes a "say on pay" vote with "substantially the same scope the say-on-pay vote required by Rule 14a-21(a)."
[38] *See* Item 5.07, Form 8-K; *see also* SEC Final Rule, *supra* note 22, at 49 (changing disclosure on shareholder vote on "say on pay" frequency, but not shareholder votes on "say on pay" resolution).
[39] SEC Final Rule, *supra* note 22, at 23 (amending Item 402(b)(1) to disclose how company "considered the results of previous shareholder [say on pay] votes ... in determining compensation policies and decisions and, if so, how that consideration has affected its compensation policies and decisions." The disclosure is limited to the company's response to the most recent "say on pay" vote.

In the 2011 proxy season, the inaugural year for Say on Pay, shareholders voted on these management proposals at about 2,200 US public companies.[40] Briefly, the results showed several clear trends. First, shareholders strongly supported existing pay practices at most firms with say-on-pay votes garnering on average 91.2% support. Second, these proposals were voted down only 1.6% of the time[41] mostly based apparently on by pay-for-performance concerns. Third, shareholder votes were highly correlated to company share returns and CEO pay, with low returns and high CEO pay resulting in lower say-on-pay support. Fourth, negative say-on-pay recommendations by third party voting advisors, ISS and others, prompted many companies to modify their disclosure filings or to change their pay practices (sometimes retroactively) to win support.

The 2011 proxy season was claimed by some to be a watershed event in U.S. corporate governance.[42] In the eyes of its supporters, Dodd-Frank's mandated shareholder votes focused management on shareholders concerns, increased shareholder participation in corporate governance, and opened lines of communication between management and shareholders (and proxy advisory firms) regarding executive compensation.[43]

One thing that did not happen during the 2011 proxy season, however, was a shareholder backlash at increasing levels of executive pay. While some third party voting advisors' recommend that say-on-pay proposals be evaluated, in part, to determine whether inappropriate "peer group benchmarking" had led to the upward spiral of executive pay, shareholders seem to have largely ignored the suggestion.[44]

Management at many companies made changes to the substance and disclosure of their pay programs in an attempt to more clearly align pay to performance.[45] Furthermore, many companies revised the content of the CD&A filed with the annual meeting proxy materials. At

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[40] *Preliminary 2011 U.S. Postseason Report*, ISS, at 2. (updated Aug. 8, 2011). Equilar, a leading provider of data on executive pay, counted 2,252 from the Russell 3000 as of June 30, 2011. Equilar, *An Analysis of Voting Results and Performance at Russell 3000 Companies* (July 2011), http://www.equilar.com/knowledge-network/research-articles/2011/pdf/Equilar-Voting-Analytics-July2011.pdf.
[41] *Russell 3000 Index*, RUSSELL INVESTMENTS (updated July 31, 2013), http://www.russell.com/indexes/data/fact_sheets/us/russell_3000_index.asp (an index representing the 3000 largest US public companies by market capitalization and representing 98% of the US public equity market).
[42] Thomas et al., *Say on Pay*, *supra* note 5, at 1227.
[43] Luis A. Aguilar, Comm'r, U.S. Sec. & Exch. Comm'n, Speech to Social Investment Forum (June 10, 2011).
[44] Thomas et al., *Say on Pay*, *supra* note 5, at 1257.
[45] *Id.*

many companies whose pay programs received negative say-on-pay recommendations by proxy advisory firms, management at some such companies connected with shareholders following an "against" recommendation.[46]

At many companies management is becoming more responsive to negative shareholder votes on pay policies.[47] For example, two companies that voluntarily put Say on Pay on the ballot in 2010 (Occidental Petroleum and KeyCorp) changed their pay practices following majority vote opposing their policies.[48] As a result, shareholders rewarded management with significantly more support to the revised pay policies in 2011. However, in 2011, not all companies with failed say-on-pay votes have chosen to change their pay practices, and blame proxy advisory firms for the policies negative shareholder reception.[49]

4. Empirical Research and Implications

One empirical study of the 2011 say-on-pay voting results used multiple regression analysis to examine what factors influence the percentage shareholder vote in favor of Say on Pay.[50] It looked at the following independent variables: (1) negative ISS recommendation, (2) excess CEO pay, (3) percentage change in CEO pay, and (4) an interaction term for companies that are both in the highest quintile for excess pay and the lowest quintile for total stock return (that is, the worst performing companies with the most excessively-paid CEOs). The study found that all of these independent variables are negative factors in say-on-pay votes and statistically significant, except for percentage change in CEO pay -- which was insignificant. However, an ISS "against" recommendation is much more relevant to shareholder voting than – and even dwarfs in predictive value -- the "excess" pay and combined low TSR/high excess pay. This analysis suggests that the ISS may be identifying the principal factors that shareholders find relevant in their say-on-pay votes -- or that shareholders believe the ISS has done this for them.

[46] *Id.*
[47] Thomas et al., *Say on Pay*, *supra* note 5, at 1260.
[48] At Occidental the company cut CEO long-term incentive opportunities by 70%, expanded peer benchmarks, and reduced award opportunities for other executives.
[49] Thomas et al., *Say on Pay*, *supra* note 5.
[50] James F. Cotter, Alan R. Palmiter & Randall S. Thomas, *The First Year of Say-on-Pay Under Dodd-Frank: An Empirical Analysis and Look Forward*, 81 GEO. WASH. L. Rev. 967 (2013).

The analysis also suggests that shareholders on their own – though to a lesser extent than the ISS – identify some "outlier" companies based on their independent analysis of "excess" pay and its interaction with TSR. In all, the ISS identification of "outlier" companies through an "against" voting recommendation and the further identification of such companies by shareholders (beyond that contained in a negative ISS recommendation) based on company "excess" pay/TSR seem to explain how Say on Pay was used in its inaugural year to identify and discipline pay practices at "outlier" firms. Nonetheless, these factors were less than fully explanatory of say-on-pay voting in the first year under Dodd-Frank and other factors may have been influential.

The first year of Say on Pay under Dodd-Frank confirmed that executive pay is on the minds of shareholders in U.S. companies. Led by the ISS, shareholders showed their concern – though not mechanically -- about pay packages that rewarded CEOs despite weak company stock performance or with excess pay compared to that at similar companies.[51] More than any factor, though, being targeted by the ISS for "outlier" pay practices was relevant to shareholder say-on-pay voting. However, excess compensation levels and poor corporate performance are also important triggers for negative stockholder votes.

Changes in corporate governance behavior – such as more complete disclosure of pay-for-performance policies and the reversal of specific, controversial pay practices -- inaugurated by Say on Pay in 2011 appear to be continuing apace and maybe even gathering strength in 2012. It appears that shareholder scrutiny of corporate pay practices in 2011 will not be a passing phenomenon.

## B. U.K. Say On Pay

### 1. Early Legislation

[51] Thomas et al., *Say on Pay, supra* note 5, at 1255 (showing ISS recommended negative shareholder votes at companies far more often than such companies experienced a failing shareholder vote).

Decades of perceived "fat cat" pay and "rewards for failure" led to the evolution of Say on Pay legislation in the U.K.[52] Effective August 1, 2002, the U.K. became the first country to adopt mandatory non-binding shareholder votes on director compensation (Say on Pay), through the Directors' Remuneration Report (DRR) Regulations.[53] Specifically the regulations require that:

> [Companies] publish a directors' compensation report as part of their annual reporting cycle; disclose within the report details of individual directors' compensation packages, the company's forward-looking statement on the compensation policy, and the role of the board and compensation committee in this area; and put the compensation report to a non-binding (or advisory) shareholder vote at the Annual General Meeting (AGM) of the quoted company.[54]

Importantly, a negative vote merely acts as a tool for showing shareholder dissatisfaction since it does not legally affect existing compensation.[55]

In 2003, the first year of mandatory advisory votes in the U.K., shareholders at GlaxoSmithKline became the first to vote down their company's compensation report, by the slim margin of 50.72 percent.[56] Specifically, shareholders objected to an estimated $35 million golden parachute for the Philadelphia-based CEO.[57] Hailing it a "landmark in corporate governance," "[s]omen British activists think it may mark the moment when British capitalism decided to stop converging with its American counterpart."[58]

However, in the overwhelming number of cases, shareholders vote in favor of management-presented compensation reports. One study suggests less than 10 percent of shareholders abstain

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[52] Fabrizio Ferri & David A. Maber, *Say on Pay and CEO Compensation: Evidence from the UK* 1 (2011).
[53] Walid M. Alissa, *Boards' Response to Shareholders' Dissatisfaction: The Case of Shareholders' Say on Pay in the UK* 7 (2009); STEPHEN DEANE, WHAT INTERNATIONAL MARKETS SAY ON PAY: AN INVESTOR PERSPECTIVE 7 (2005); Ferri & Maber, *supra* note 52, at 1. The regulations become an amendment to the U.K. Companies Act. Jeffery N. Gordon, *'Say on Pay': Cautionary Notes on the UK Experience and the Case for Shareholder Opt-In*, 46 HARV. J. ON LEGIS. 323, 342 (2009); Cheffins & Thomas, *supra* note 3.
[54] Alissa, *supra* note 53, at 7.
[55] § 241A(8) of the U.K. Companies Act (1985) states that "no entitlement of a person to remuneration is made conditional on the resolution being passed by reason only of the provision[s]" of the regulations.
[56] DEANE, *supra* note 53, at 5.
[57] Gordon, *supra* note 53, at 342.
[58] DEANE, *supra* note 53, at 5.

from or vote against compensation reports.[59] In fact, between 2003 and 2009, only nine companies had their Say on Pay proposal defeated, and all but the Royal Bank of Scotland and GlaxoSmithKline were relatively small.[60] Furthermore, between 2002 and 2007 only 64 of 596 reporting companies received dissent of more than 20 percent.[61]

2. The Effects of Non-Binding Say on Pay in the U.K.

Since its enactment in 2002, the Directors' Remuneration Report (DRR) regulations have been the subject of much academic scholarship.[62] Generally, empirical studies suggest that no change in the growth rate occurred after the adoption of the UK regulations.[63] However, the "Say on Pay" regulation may have a "moderating effect on the level of CEO compensation *conditional upon poor performance*."[64] Shareholders' dissent more where CEO compensation is above the "average excess compensation"[65] and where pay is not closely tethered to performance.[66] Studies suggest, however, that board's responsiveness to such shareholder dissent is mixed.[67]

Empirical results further show that overall, Say on Pay regulation "was accompanied by positive stock price reactions at firms with controversial pay practices and, more specifically, practices that weaken penalties for poor performance, consistent with investors perceiving Say

[59] *See* Martin J. Conyon et al., *Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK* 5 (2009).
[60] Jeremy Ryan Delman, Note, *Structuring Say-on-Pay: A Comparative Look at Global Variations in Shareholder Voting on Executive Compensation*, 2010 COLUM. BUS. L. REV. 583, 588, 610 (2010).
[61] *Id.*
[62] *E.g.*, Alissa, *supra* note 53; Mary Ellen Carter & Valentina Zamora, *Shareholder Remuneration Votes and CEO Compensation Design* (2009); Martin J. Conyon et al., *Shareholder Voting and Directors' Remuneration Report Legislation: Say on Pay in the UK* (2009); Ferri & Maber, *supra* note 52; Kym Sheehan, *Say on Pay and the Outrage Constraint* (Working Paper Updating 2007 Study, Sept. 20, 2010), *available at* http://ssrn.com/abstract=1679622.
[63] Ferri & Maber, *supra* note 52, at 22; *see also* DEANE, *supra* note 53, at 9 ("Despite these pay-for-performance successes, observers in . . . the U.K. . . . note that executive pay levels are still ratcheting upward.").
[64] Ferri & Maber, *supra* note 52, at 23.
[65] *See* Alissa, *supra* note 53 (indicating firms reduce compensation more often when such firms are the average excess compensation).
[66] Carter & Zamora, *supra* note 62, at 24.
[67] *See* Alissa, *supra* note 53, at 35 (arguing boards are more responsive at levels of above average excess compensation); Carter & Zamora, *supra* note 62, at 23 (acknowledging lag in responsiveness). *But see* Conyon et al., *supra* note 62, at 29 ("There is little evidence that shareholder say on pay has consequences for subsequent CEO compensation practices.").

on Pay as a value-creating governance mechanism."[68] This suggests shareholders view the new regulation as a "value enhancing monitoring mechanism."[69]

However, even with most reports receiving over a 90 percent shareholder approval rate, compensation reports attract the single highest dissention rate among shareholders when contrasted with shareholder voting patterns on any other similar proposals.[70] Significantly, votes against DRR exceed those shareholder votes against the reelection of directors of firms.[71]

Studies do seem to suggest that, at the margin, shareholders use their votes on DRR to convey their dissatisfaction with excessive pay practices.[72] One paper by Alissa suggests that shareholders are in dissention when pay and performance are "mismatched."[73] Moreover, this paper recognizes a statistically significant correlation in excess compensation and dissenting shareholder votes.[74] Similarly, the Carter and Zamora study indicates shareholder disapproval is highest when CEO salary is higher, there is weaker pay-for-performance sensitivity in bonus pay, and there is greater potential dilution from stock-based compensation, particularly in stock option pay.[75] Sheehan similarly concludes her U.K. study by noting that "institutional investors use the *threat* of a negative vote to enforce compliance."[76]

Evidence regarding boards' responsiveness to shareholders' non-binding votes is mixed. Ferri and Amber found that firms did respond to high shareholder dissention by "removing

[68] Ferri & Maber, *supra* note 52, at 10.
[69] *Id.* at 27.
[70] Conyon et al., *supra* note 62, at 21–22. The study contrasted DRR dissention with negative shareholder votes on ten other resolutions regarding: director elections, major acquisitions or disposals, appointing or approving auditors' remuneration, equity decisions, the company generally (e.g., name change, wind up, delisting, or donation authorization), dividend distribution, articles of association amendments, more specific remuneration issues, contingent votes, and accepting other reports or accounts. *Id.* at 16.
[71] *Id.* at 22. For example, amidst the 2003 GlaxoSmithKline shareholder voting drama regarding the pay of CEO Dr. Grenier, shareholder dissent for the first time exceeded 50 percent as to a DRR resolution, but the re-election of the CEO attracted 75 percent shareholder support. *Id.* at 20–21. Illustrating "shareholders are prepared to signal dissatisfaction by voting against pay, but not to the degree of removing directors." *Id.* at 21.
[72] *See* Sheehan, *supra* note 62, at 29 (offering evidence that shareholders are more likely to vote against DRR resolutions than board election as evidence that "DRR is a way to signal shareholder dissatisfaction to the firm about pay"); Alissa, *supra* note 53, at 23 (offering her study as evidence that shareholders disapprove mismatches between pay and performance such that "[t]he higher the mismatch, the greater the dissatisfaction expressed by shareholders").
[73] Alissa, *supra* note 53, at 23.
[74] *Id.* at 16, 23–24 (expressly ruling out the possibility shareholders vote based on pure "level of compensation" such that "higher overall levels of total compensation would result in greater shareholders dissatisfaction").
[75] Carter & Zamora, *supra* note 62, at 19–24.
[76] Sheehan, *supra* note 62, at 19–20.

controversial provisions criticized as rewards for failure, such as long notice periods and retesting provisions for option grants."[77] Furthermore, their study found a "significant increase in the sensitivity of CEO pay to poor performance," especially where firms experienced high shareholder dissention at a first vote and at firms with excess CEO pay before the Say on Pay regulation.[78] Consistent with the other relevant studies, however, Ferri & Amber confirm that after controlling for performance, there is no change in the growth rate of CEO pay.[79]

Providing a somewhat more tempered result, Carter and Zamora indicate, "When given the contractual opportunity . . . boards do respond with lower [compensation] increases than other firms."[80] Their paper claims that when executives respond they "curb [] salary increases and dilution from stock option grants" thereby improving CEO bonus PPS links.[81]

While Alissa finds "no evidence for the hypothesis that the board responds to shareholders' dissatisfaction by changing excess compensation," Alissa's results do indicate however, that where CEO excess pay is above the mean boards respond by reducing excess compensation.[82] Alternatively, the second prong of Alissa's study suggests that boards similarly respond to shareholder pressure and dissatisfaction by "forcing" the CEO out of office.[83] Therefore, this bifurcated test leads Alissa to conclude that boards are responsive to shareholders' votes.[84]

Conversely, the skeptical Conyon, et al. study shows "little evidence of a relation between CEO pay and shareholder dissent on the directors' remuneration report."[85] Furthermore, the study states no evidence exist that CEO pay is negatively correlated with previous shareholder voting dissent in firm's greater "excess pay."[86] However, Ferri and Maber offer an interesting insight (predicted by many) to rebut this negative view of board's responsiveness,

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[77] Ferri & Maber, *supra* note 52, at 27 (the authors do not that their evidence is the result of a study done only from changes in disclosed provisions of compensation contracts and therefore may not capture the "full effect of say on pay compensation practices").
[78] *Id.*
[79] *Id.* at 24.
[80] Carter & Zamora, *supra* note 62, at 24.
[81] *Id.*
[82] Alissa, *supra* note 53, at 26–27.
[83] *Id.* at 27–29 (defining "forcing out of office" and providing results).
[84] *Id.* at 35.
[85] Conyon et al., *supra* note 62, at 25.
[86] *Id.*

suggesting that "many firms removed this provision *ahead* of the vote, presumably in an attempt to avoid voting dissent and consistent with institutional investors' preference for 'bargaining in the shadow.'"[87]

3. Likely New Legislation To Implement Binding Say On Pay

Even after the enactment of non-binding Say on Pay, world events brought executive compensation to the front page of newspapers and enraged the public in the U.K. and the EU more broadly.[88] In June 2012, the U.K.'s Department for Business Innovation & Skills responded, releasing a consultation proposing compensation reporting regulations and implementation of binding Say on Pay in the U.K. for companies with shares on the Financial Services Authority's Official List[89] as well as all U.K. companies listed on the NYSE, the NASDAQ, or with shares listed in another EEA state, beginning in October 2013.[90]

Initial reports indicate the government's proposal will be included as part of the Enterprise and Regulatory Reform Bill currently being debated in Parliament, which not only calls for a binding shareholder vote on compensation policies but also increases disclosure requirements.[91] If it is enacted, U.K. companies will now be required to put to an annual binding shareholder vote its "director remuneration policy, including its termination payments."[92] Interestingly, the government considered, but ultimately decided against, requiring companies to report a ratio comparing CEO pay to the median employee pay.[93]

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[87] Ferri & Maber, *supra* note 52, at 17.
[88] Marissa Anne Pagnattaro & Stephanie Greene, *"Say on Pay": The Movement to Reform Executive Compensation in the United States and European Union*, 31 NW. J. INT'L L. & BUS. 593, 614 (arguing Europe as a whole experienced a "corporate governance wake-up call," following Dutch company Royal Ahold's overstated earnings, France's Vivendi's pay out of €21 million in CEO severance pay, and billions left unaccounted at Italy's Parmalat).
[89] Danielle Harris, *UK Reform on Director Pay*, GOVERNANCE, Sept. 2012, at 8 (noting that it is irrelevant if the shares have a premium or standard listing).
[90] *Id.*; DEP'T FOR BUSINESS INNOVATION & SKILLS, DIRECTORS' PAY: CONSULTATION ON REVISED REMUNERATION REPORTING REGULATIONS 15 (June 2012).
[91] *Id.*; Pagnattaro & Greene, *supra* note 88.
[92] *Id.* at 8.
[93] *Id.* (providing evidence and support that say on pay regulation is less about linking pay to performance and more about concerns regarding absolute levels of CEO compensation).

If a company fails a binding vote on compensation, "it must continue using the last policy approved by shareholders until a revised policy is approved."[94] The new proposal's expanded disclosure requirements require companies to set out their exit payment approach in the compensation policy report, subject to the binding shareholder vote.[95] This proposal[96] was recently enacted into law.[97]

### C. Say on Pay in Australia

#### 1. Overview

Executive pay in Australia grew greatly between 1993 and 2008, showing the largest growth between the mid-90s and 2000.[98] This growth in executive compensation is largely attributable to increases in incentive pay.[99] However, even as Australian pay rates increased significantly, absolute CEO pay level remained well below Australia's U.S. and U.K. peer groups, aligning with many smaller European countries.[100] In 2008–09, CEOs at the top 20 companies averaged approximately $7.2 million in total compensation, which was 50% higher than the next 20 largest companies and equaled 110 times average wages.[101]

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[94] *Id.*

[95] Pagnattaro & Green, *supra* note 88.

[96] Draft Statutory Instrument: the Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013, Mar. 13, 2013, *available at* https://www.gov.uk/government/publications/draft-statutory-instrument-on-directors-remuneration-the-large-and-medium-sized-companies-and-groups-accounts-and-reports-amendment-regulations-2013 (last visited June 15, 2013).

[97] Enterprise and Regulatory Reform Act, 2013, c. 24, (Eng.) *available at* http://www.legislation.gov.uk/ukpga/2013/24/enacted; Enterprise and Regulatory Reform Act, 2013, c. 24, § 79 (Eng.) *available at* http://www.legislation.gov.uk/ukpga/2013/24/part/6/crossheading/payments-to-directors-of-quoted-companies/enacted (displaying the remuneration portion of the Act).
*Id.*

[98] PRODUCTIVITY COMM'N, EXECUTIVE REMUNERATION IN AUSTRALIA xv–xvi, xvi fig.1 (2009) (showing likelihood executive compensation at Australia's largest public companies grew by as much as 300%).

[99] *Id.* at xvii (noting the "long-term" incentives tripled between 2004 and 2007).

[100] *Id.* at xix–xx, 41.

[101] *Id.* at xvi, 41. Interestingly, multi-million dollar compensation packages nearly disappear for companies ranked 150–200, and the average total compensation for the smaller of Australia's 2000 publically listed companies is about $260,000. *Id.* at xvi.

In response to shareholders and other market participants "general unease" about executive pay, the Australian government inserted section 250R(2) into the Corporations Act 2001 (Cth).[102] This section required a nonbinding shareholder vote on all listed company's remuneration report, at the annual general meeting (AGM).[103] The relevant changes to this prior remuneration framework made in section 250R of CLERP 9 read as follows:

> (2) [Vote on remuneration report]
>
> At a listed company's AGM, a resolution that the remuneration report be adopted must be put to the vote."
>
> Note: Under subsection 249L(2), the notice of the AGM must inform members that this resolution will be put at the AGM.
>
> (3) [Effect of resolution]
>
> The vote on the resolution is advisory only and does not bind the directors or the company.[104]

Dr. Kym Sheehan of Melbourne completed two studies providing an initial analysis of the Australian experience during 2005 to 2008.[105] Dr. Sheehan used voting data from 109 companies listed on the S&P/ASX 200.[106] She concluded that Australia's data showed a progressively higher rate of shareholder dissention over the years studied. This is consistent with data in the 2009 Productivity Commission Report.[107] The Productivity Commission Report acknowledges the global financial crisis as a leading cause of high negative votes at companies,

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[102] Larelle Chapple & Blake Christensen, *The Non-Binding Vote On Executive Pay: A Review Of The Clerp 9 Reform*, 18 AUSTL. J. CORP. L. 263, 263 (2005).
[103] *Id.* (section 250R(3) speaks to the "nonbinding" nature of the vote).
[104] CLERP 9, *Corporations Act*, ss 250R(2)–(3) (Austl.).
[105] Kym Sheehan, *Say on Pay and the Outrage Constraint*, THE EXECUTIVE REMUNERATION REP. (Sept. 20, 2010)[hereinafter Sheehan, *Say on Pay*], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1679622; Kym Sheehan, *Is the Outrage Constraint an Effective Constraint on Executive Remuneration? Evidence from the UK and Preliminary Results from Australia*, THE EXECUTIVE REMUNERATION REP. (Mar. 18, 2010) [hereinafter Sheehan, *Outrage Constraint*], *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=974965&download=yes.
[106] Sheehan, *Say on Pay*, *supra* note 105, at 19.
[107] PRODUCTIVITY COMM'N, *supra* note 98, at 278–86.

which "typically receive overwhelming support."[108] This is supported by evidence, which suggests that the average level of "against" votes doubled between 2006 and 2008.[109]

After the financial crisis, Australia's Productivity Commission reviewed the history and regulatory framework of Australia's executive remuneration regulations, and made several important recommendations.[110] On June 20, 2011, the Australian Senate passed the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011,[111] which included substantial changes to prior Say on Pay provisions.

2. Say on Pay: The Two-Strike Rule

An explanatory memorandum, released by the Australian Parliament, weighed the positive and negatives of a continuing a non-binding shareholder vote. The memorandum recognized that non-binding shareholder votes might provide benefits, such as "foster[ing a] more productive engagement between shareholders and boards."[112] Furthermore, it openly acknowledged evidence that "some boards are responsive to the non-binding vote, and that the opportunity for shareholders to put forward their views is having a positive impact on remuneration policies."[113] Still, the Australian Parliament was uncomfortable with existing

[108] *Id.* at 282.
[109] *Id.*
[110] *Id.* at xxxiv (providing a table summarizing recommendations and with the targeted benefits of each).
[111] *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011* (Cth) (Austl.) [hereinafter *Corporations Act 2011*], *available at* http://www.comlaw.gov.au/Details/C2011A00042. For a helpful summary of the legislation, see Ernst & Young, *New Director and Executive Remuneration Legislation Passed by Parliament* 1 (June 2011), *available at* http://www.ey.com/Publication/vwLUAssets/New_director_and_executive_remuneration_legislation/$FILE/Corporations%20Amendment_Improveration%20Bill%202011%20-%20FINAL.pdf. The private opinions submitted to the Treasury may be found at the treasury's archived site, http://archive.treasury.gov.au/contentitem.asp?ContentID=1960.
[112] *Explanatory Memorandum, Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011* (Cth) 5 (Austl.), *available at* http://archive.treasury.gov.au/documents/1925/PDF/Explanatory_Memorandum.pdf.
[113] *Id.*

legislation that imposed no penalty on nonresponsive boards in the face of a negative non-binding shareholder vote (except of course the "nuclear option" of director removal).[114]

Australia similarly recognized significant deficiencies in the alternative—binding shareholder votes. Specifically, the memo noted that binding shareholder votes had the potential to "absolve directors of their responsibility to shareholders" regarding executive compensation, thereby undermining the broad authority of the board to make decisions. Interestingly, it also addressed a fear that a binding shareholder vote would "affect the competitiveness of Australian companies and their ability to attract and retain top executives."[115] After weighing its options, Australia purports to settle somewhere in between, resisting moving to a mandatory binding shareholder vote the new regulations purport to strengthen a mandatory non-binding vote with the "Two-Strike Rule."[116]

The Two-Strike Rule provides shareholders of listed companies an opportunity to "spill the board" if the company remuneration report receives negative reception at two consecutive AGMs.[117] The "first strike" occurs when a company receives a "no" vote of 25% or more of the shareholder votes cast on its remuneration report.[118] Following a first strike, the company's subsequent remuneration report must explain the board's response and proposed action or inaction.[119]

At the next AGM, upon receiving a second consecutive "no" vote of 25% or more of the shareholder's votes cast on the remuneration report (the "second strike"), the shareholders will be required to vote on a "spill resolution," at the same AGM.[120] This spill resolution will determine whether the company's directors will need to stand for re-election at a "spill

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[114] *Id.*

[115] *Id.*

[116] *Id*. The Productivity Commissions inquiry concluded practical difficulties and risks precluded adoption of binding shareholder votes on pay. *Id.* The commission identified the uncertainty and delay stemming from the inability of finalizing executive contracts and certain possible operational disruptions, as two such risk. *Id.*

[117] Blake Dawson (Ashurst), *Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Act 2011*, at 3 (2011), *available at* www.ashurst.com/doc.aspx?id_Content=6930.

[118] *Corporations Act 2011* (Cth), ¶ 300A(1)(g); *see also Explanatory Memorandum*, *supra* note 112, at 6; Ernst & Young, *supra* note 111, at 2.

[119] *Corporations Act 2011* (Cth), ¶ 300A(1)(g); *see also Explanatory Memorandum*, *supra* note 112, at 6; Ernst & Young, *supra* note 111, at 2.

[120] *Explanatory Memorandum*, *supra* note 112, at 7.

meeting."[121] If the spill resolution receives 50% or more of the eligible shareholder votes cast, the separate spill meeting must be held within 90 days.[122]

The second strike and the spill resolution were intentionally separated to ensure that shareholders are not *discouraged* from voting against the remuneration report for fear of director removal.[123] Furthermore, it is provides a free expression and clear signal of shareholders' views on the company remuneration report.[124]

Notice plays an important role in the new regulations. To ensure the effectiveness of the spill resolution, following the first strike, in a company's meeting papers for their next AGM, a company must provide notice of the potential for a spill resolution at that AGM, in case a second strike triggers such a resolution.[125] Furthermore, following a passage of the spill resolution, a company must still provide the minimum notice period required by both the Corporations Act's and any self-imposed notice period set out in the company constitution to ensure shareholder's ability to nominate and endorse board candidates at the special re-election meeting (spill meeting).[126]

At the spill meeting, all of the directors, except the managing director,[127] serving "when the resolution to make the directors' report" was considered, must stand for re-election. Furthermore, such directors cease to hold office at that time unless they are re-appointed by the shareholders.[128] However, if a vacating director is re-appointed, their term continues as though it were uninterrupted.[129] Such surviving directors serve the duration of their appointment from the

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[121] Ernst & Young, *supra* note 111, at 2.

[122] *Corporations Act 2011* (Cth), s 250V; *see also Explanatory Memorandum*, *supra* note 112, at 6; Ernst & Young, *supra* note 111, at 2.

[123] *Explanatory Memorandum*, *supra* note 112, at 7.

[124] *Id.*

[125] *Corporations Act 2011* (Cth), ss 249L(2); *see also Explanatory Memorandum*, *supra* note 112, at 7 (to clarify, the AGM that requires notice of the spill resolution is the AGM following the first strike AGM, at which the second strike vote would occur).

[126] *Corporations Act 2011* (Cth), s 250W; *Explanatory Memorandum*, *supra* note 112, at 6–7.

[127] *Corporations Act 2011* (Cth), ss 250V(1); *see also Explanatory Memorandum*, *supra* note 112, at 7 (ASX listing rules permit managing directors to hold office indefinitely and without re-election).

[128] Dawson, *supra* note 117, at 3. However, if the directors that are up for re-election do not remain in office until the spill meeting or the (potentially) ninety days preceding it, then the meeting need not be held. *Id.* This is true whether or not the vacating directors positions have been filled. *Id.* at 8.

[129] *Id.* at 4.

date that they were last appointed to the board.[130] Also, at the spill meeting shareholders will vote on resolutions to appoint persons to the vacated positions.[131]

Section 250X disallows a complete board spill, requiring that at least the managing director and the two people receiving the highest portion of the votes, though not necessarily a majority, remain.[132] If two or more individuals have the same percentage of votes, the remaining director(s) may choose which of the candidates is appointed as a director, but this appointment must be approved at the company's next AGM.[133]

If the spill meeting does not convene by the end of the ninety-day period, each director in office at the end of such period is strictly liable.[134] "Section 249CA of the Corporation's Act empowers any director of a listed company to call a meeting of the company's members," thus ensuring every director has the practical ability to avoid the offense.[135] Section 250U has a re-setting mechanism that only allows consideration of a spill resolution at every second AGM.[136]

This rule applies to remuneration report votes held after July 1, 2011, allowing a spill resolution to be triggered only where both strikes occur after that date.[137]

### 3. Initial (Mixed) Reactions to the Two-Strike Rule

One year after the enactment of the Two-Strike Rule, 28 companies (approximately 9%) of ASX 200 companies,[138] and 106 ASX companies overall,[139] received a first strike making

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[130] *Corporations Act 2011* (Cth), s 250Y. This provision prevents directors from receiving a "fresh start through re-election vote as providing directors a fresh start. Explanatory Memorandum, *supra* note 112, at 9.

[131] Dawson, *supra* note 117, at 3.

[132] *Id.* at 4.

[133] *Corporations Act 2011* (Cth), s 250X; *see also Explanatory Memorandum*, *supra* note 112, at 8–9.

[134] *Corporations Act 2011* (Cth), ss 250W(5); *see also* Dawson, *supra* note 117, at 4. A single exception applies for directors who are appointed after the last date on which notice may be given for the spill meeting under §249HA. *See also Corporations Act 2011* (Cth), ss 250W(5) & (8).

[135] *Explanatory Memorandum*, *supra* note 112, at 8.

[136] Dawson, *supra* note 117, at 4.

[137] Ernst & Young, *supra* note 111, at 2 (a no vote after July 1, 2011 results in the *first* strike); *Explanatory Memorandum*, *supra* note 112, at 9.

them susceptible to a dangerous strike two this proxy season.[140] These numbers generated a wide range of responses from commentators with investor groups "warmly welcoming" the new bill, while the Australian Institute of Company Directors referred to it as "'heavy-handed black letter law approach' that would produce unnecessary red tape."[141]

A recent survey of the Australian-based law firm Allens Linklaters's listed company clients shows 72% express disapproval of the Two-Strike Rule suggesting "significant (AGM) reform" is necessary, with a majority believing the rule should be scrapped entirely. [142] Similarly, the Sydney-based law firm Mallesons Stephen Jaques publicly renounced the effectiveness of the Two-Strike Rule in an annual publication based on its experience and November 2011 client director surveys.[143] The firm summarizes the common critique of the reform stating:

> The reforms appear to have drawn the attention of boards away from matters of greater strategic value to organizations and have largely been used as a punitive mechanism by disgruntled shareholders frustrated by challenging market

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[138] Matt Orsagh, *"Say on Pay" in Australia: Two Strikes and You're Out*, CFA INSTITUTE (Sept. 26, 2012), http://blogs.cfainstitute.org/marketintegrity/2012/09/26/say-on-pay-in-australia-two-strikes-and-youre-out/.

[139] Greg Dooley of Computershare Investor Services reports, 106 ASX companies received a first strike on their 2011 remuneration report, 14 of which he reports were ASX200 with 4 in the ASX100. *See* Greg Dooley, *2011 AGM season – Providing Clues to What Lies Ahead*, KEEPING GOOD COMPANIES 86–87 (Mar. 2012), *available at* http://www.computershare.com/au/Investor%20Services/CSA_Mar2012_AGM_Season.pdf.

[140] Several different estimates are in other reports. Mallesons Stephen Jaques, *Directions 2012: Current Issues and Challenges Facing Australian Directors and Boards* 14 (2011), *available at* http://www.mallesons.com/Documents/Directions_2012.pdf (stating that *at least* 60 companies total received a first strike during the 2011 proxy season); Henry Davis York, *Two Strikes Rule Enters its Second AGM Season* 1 (Aug. 2012), http://www.hdy.com.au/Media/docs/HDY_Insight_Corporate%20Advisory_Aug%2012-bf5a0c01-fca6-485b-9e79-62f254bcdeb0-0.pdf (reporting over 100 listed companies received their first strike during the 2011 proxy season attracting over 25% negative votes against company remuneration reports). For a chart enumerating S&P and ASX 300 with a first strike on their 2011 remuneration report, see also DANIEL J. SMITH & MICHAEL CHANDLER, ISS, 2012 VOTING SEASON PREVIEW: AUSTRALIA AND NEW ZEALAND (2012), http://www.issgovernance.com/files/private/AustraliaNZPreview2012.pdf.

[141] *See Australian Shareholders to Get More Say on Pay*, BUS. INSIDER (Mar. 3, 2011), http://articles.businessinsider.com/2011-03-03/markets/30035966_1_shareholders-remuneration-responsible-investor.

[142] ALLENS LINKLATERS, ALLENS LISTED CLIENT SURVEY: CAMAC REVIEW OF ANNUAL GENERAL MEETINGS 2 (2012), http://www.allens.com.au/pubs/pdf/CAMACAllensListedClientSurveyReport.pdf; *see also* Matt Orsagh, *supra* note 34 (citing Susannah Moran, *Call to Overhaul AGMs Puts 'Two Strikes' Rule on Remuneration in the Firing Line*, AUSTRALIAN (Aug. 8, 2012), http://www.theaustralian.com.au/business/companies/call-to-overhaul-agms-puts-two-strikes-rule-related-to-remuneration-in-the-firing-line/story-fn91v9q3-1226445141935 (subscription required)). For a specific articulation of management's disapproval of the Two-Strike Rule (and other provisions) see the IAG's submission in opposition of the Treasury's Exposure Draft Bill, *available at* http://iag.com.au/news/gov_submissions/docs/20110309_SUB.pdf and Kym Sheehan's similarly submitted opposition, *available at* http://docsfiles.com/pdf_submission_to_exposure_draft_corporations_amendment_further.html.

[143] Mallesons, *supra* note 140, at 1.

> conditions, rather than as a means of communicating shareholders' assessments of executive remuneration. In the words of one survey respondent, *"the reforms ... only add compliance costs and provide a larger voice to activist minority shareholders*."[144]

On the other side of the issue, a 2012 Melbourne Institute and Global Proxy Solicitation study indicates 53.2% of shareholders report being "[m]ore likely to vote against" a remuneration report this year if their company received a first strike at the 2011 AGM.[145] The same study shows 68.4% of shareholders report being more likely to vote against the board's re-election following its second strike.[146]

In 2012, Australian companies and executives have forgone bonuses, raises, and incentive compensation perhaps due in some part to weak shareholder returns and fear of the Two-Strike Rule.[147] Several Australian companies have already promised to restrain pay policies even despite their rising earnings,[148] in what some have called "high-profile displays of remuneration 'austerity.'"[149] Other CEOs and boards have enforced cuts and freezes to fixed salaries for top executives.[150] The ISS claims these actions show "a burgeoning trend among some captains of industry to blunt allegations of runaway executive remuneration."[151] However,

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[144] *Id.* at 13.
[145] UNIV. OF MELBOURNE, FACULTY OF BUSINESS & ECONOMICS, THE GLOBAL PROXY—MELBOURNE INSTITUTE SHAREHOLDER CONFIDENCE INDEX 3 (2012), http://www.melbourneinstitute.com/downloads/macro/2012/GPS/GPS_MI_Report_Aug2012.pd; *see also* SMITH & CHANDLER, *supra* note 36.
[146] *Id.* at 3.
[147] Matt Orsagh, *supra* note 138 (citing Matt Orsagh, *Corporate Governance Roundup* (Aug. 31, 2012), http://blogs.cfainstitute.org/marketintegrity/2012/08/31/corporate-governance-roundup-aussie-bosses-give-back-turkeys-new-code-manu-a-bad-investment-director-defenestration-in-u-s/); *see also* SMITH & CHANDLER, *supra* note 140, at 6; Jane Wardell, *Australian CEOs Sacrifice Bonuses, Wary of Powerful Shareholders* (Aug. 23, 2012), http://www.trust.org/trustmedia/news/australian-ceos-sacrifice-bonuses-wary-of-powerful-shareholders/ (discussing Australian CEOs forgoing bonuses).
[148] Matt Orsagh, *supra* note 138 (noting announcements by ANZ Bank CEO Mike Smith and Commonwealth Bank CEO Ian Narev).
[149] SMITH & CHANDLER, *supra* note 140, at 6.
[150] *Id.*
[151] *Id.* at 7.

some law firms remain skeptical of the benefits of the two strike rule and have urged that it be overturned.[152]

## D. Belgium

### 1. Regulatory framework for Shareholder Approval of Executive Remuneration Arrangements

The Belgian public limited liability company (Naamloze vennootschap-société anonyme) is in most circumstances directed by a board of directors comprising three or more members.[153] The general meeting of shareholders must elect these board members for a term of no more than six years.[154]

The legal rules relating to compensation are straightforward: the company's articles of association or, if they are silent, the general meeting of shareholders, determine both whether the directors shall be remunerated[155] and, if they are to be paid, the remuneration package. Alternatively, the shareholders at the general meeting could indirectly decide to pay the directors by approving the company's accounts in which the remuneration is included (as a cost).[156] The general meeting of shareholders' decision about the remuneration of the directors only relates to the total amount granted to the board of directors. The board of directors will decide how this total compensation package will be divided between the directors.

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[152] Stephanie Daveson & Annetter O'Hara, *Executive Remuneration: Results of Spill Meetings Put Effectiveness of Two Strikes in Question*, CORRS CHAMBERS WESTGARTH (Mar. 7, 2012), *available at* http://www.corrs.com.au/thinking/insights/executive-remuneration-results-of-spill-meetings-put-effectiveness-of-two-strikes-in-question/.

[153] In case there the public limited liability company has only two shareholders, a board of directors of two members is allowed.

[154] A majority voting rule is applicable. This means that a director is elected if: votes "for''/(votes ''for''+votes ''against'') > 50%.

[155] The Belgian director can, but does not have to be, remunerated. COMPANIES CODE art. 517 (Belg.).

[156] D. Willermain, *Le statut de l'administrateur de sociétés anonymes: principes, questions et réflexions*, REVUE DES SOCIÉTÉS 2008, nr. 6983, at 236 n.95.

In 2002, the statutory creation of a modified two-tier board structure in the Belgian Companies Code affected the director remuneration rules.[157] Firms now have the option through their articles of association to empower the board of directors to delegate some of its powers to a management committee. If a company selects this structure, the duties of the board continue to include those that the Companies Code explicitly reserves to it, as well as the establishment of the general policy of the company and the monitoring of the management committee.

In the event that the company's articles of association do not to provide rules for setting the compensation of the management committee members, the board of directors is empowered to set the remuneration package.[158] The board of directors has the power to set the pay of the corporate senior officers, such as the members of the management board and/or officers empowered to execute the day-to-day management of the company. The duties of the executive board members are therefore split between board membership and providing their services as executives. Should the remuneration package of a (executive) board member need to be renegotiated,[159] the director is considered to have a conflict of interest which is mitigated via the application of a special procedure.[160]

Shareholders' powers to determine executive compensation at Belgian companies were increased after the financial crisis and the national and international debates regarding excessive remuneration of top executives. The law of April 6, 2010 altered the corporate governance rules for executive pay for listed and state-owned companies. [161] As a result, in their annual reports Belgian firms must now include a corporate governance statement,[162] as well as a detailed remuneration report. Moreover, they must establish a remuneration committee, set criteria for the variable part of the executive remuneration and have generous golden parachutes approved by the shareholders.

In addition, the general meeting of shareholders must every year vote on the company's remuneration report, a "Say on Pay" vote. According to the Companies Act, the remuneration

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[157] Law of Aug. 2, 2002, Moniteur Belge [M.B.], Aug. 22, 2002 (Belg.).
[158] COMPANIES CODE art. 524 (Belg.).
[159] This is not the case for candidate-directors, as the procedure is only applicable in case the individual is already elected as director.
[160] COMPANIES CODE art. 523 (Belg.).. The conflict is discussed in the board of directors and only and excerpt is published in the annual report of the company and the auditor's report.
[161] Law of April 23, 2010, Moniteur Belge [M.B.], April 23, 2010 (Belg.).
[162] Council Directive 78/660/EEC, art. 46a, on the annual accounts of certain types of companies, inserted by Council Directive 2006/46/EEC, 2006 O.J. (L 224) 1.

report must provide detailed information on eleven remuneration items: (i) the process the board used in developing the remuneration policy, (ii) a statement of how the directors applied the remuneration policy during the accounting period, (iii) the remuneration package of each individual non-executive board member, (iv) the remuneration that senior executive officers receive for their role as directors, (v) the criteria and procedure to grant performance related pay to executive board members and senior executive officers, (vi) a detailed description of the individual remuneration package of the chief executive officer, (vii) a detailed description of the global remuneration package of the other senior executive officers, (viii) the number and main characteristics of shares, options and other rights granted, vested and/or executed, (ix) severance pay commitments, (x) the applied severance pay in case an executive board member or senior executive officer departed, and (xi) claw back provisions for variable pay based on misleading financial information.[163]

The shareholder vote is advisory so that the company is not obliged to revise any contractual engagements with its executive board members, or senior executive officers, if the remuneration report is disapproved by the general meeting of shareholders. Nor does the disapproval of the remuneration report affect the validity of the company's financial statements. However, if the shareholders disapprove the remuneration report, the board of directors is likely to revise the company's remuneration policy.[164]

The law of April 6th, 2010 amended the Belgian Companies Code to give shareholders further power to restrict the structuring of the variable remuneration package and the share-based remuneration of the executives. It now requires a shareholder vote, or a facilitating article of association,[165] if the remuneration package of an executive board member or a senior executive provides for variable remuneration of which more than half is based on performance criteria of one year or less, or grants more than one quarter of the variable remuneration based on performance criteria measured over less than two years, or awards more than one quarter of the variable remuneration based on performance criteria measured over less than three years.[166]

Furthermore, the Belgian Companies Code now also requires shareholder approval, or a facilitating article of association, to deviate from a minimum "vesting period" for shares and

[163] COMPANIES CODE art. 96, § 3 (Belg.).
[164] Belgian House of Representatives, 2336/001, at 18 (Dec. 22, 2009).
[165] For which the general meeting of shareholders need to provide in the amendment of the articles of association.
[166] COMPANIES CODE art. 520ter, § 2 (Belg.). This provision is not applicable if the variable part of the remuneration is less than 25 percent of the total remuneration.

share-based remuneration. Shares must not be vested earlier than three years after they are granted, while share options or other share-based benefits must not be exercisable earlier than three years after they are granted.[167] These two rules are the cause of many practical problems.[168] Finally severance pay arrangements with executive directors and senior executive officers that exceed the amount of 12 months[169] remuneration[170] require the pre-approval of the general meeting of shareholders.[171]

2. Assessment of Shareholder Voting Power on Executive Remuneration Agreements in Belgium

The new Belgian Corporate Governance Code with both a mandatory 'comply or explain' requirement, and a mandatory requirement to provide a remuneration report, greatly increased the amount of information disclosed concerning the remuneration of directors and executives and corporate remuneration practices. Previously most corporate boards did little to insure that shareholders had much say on executive remuneration policies. For example, in 2011, the last year before the new Say on Pay law came into operation, only 40 percent of the companies had the total gross remuneration package of the board of directors, or of a newly elected director, explicitly approved by the general shareholder meeting. The remaining companies had the directors' pay automatically approved with the approval of the financial statements.

At that time, only a small minority of the companies (13%) voluntary applied the new Say on Pay requirements and asked shareholders to approve their remuneration report. In these companies, all of the remuneration reports received overwhelming support of the shareholders: all but two large companies had their reports approved with more than 98% of the votes, and these two were approved with 92% and 97% of shareholders voting in favor.

[167] COMPANIES CODE art. 520ter, § 1 (Belg.). This provision is not applicable in case the variable part of the remuneration is less than 25 percent of the total remuneration.
[168] See for an overview and analysis Hans De Wulf, Christoph Van der Elst & S. Vermeesch, *Radicalisering van corporate governanceregelgeving: remuneratie en transparantie na de wet van 6 april 2010*, TBH 2010, 909-962.
[169] In the legal doctrine it is debated whether the legislation requires the approval of the general meeting of shareholder from 12 months onwards (Hans De Wulf, Christoph. Van der Elst & S. Vermeesch, *Radicalisering van corporate governanceregelgeving: remuneratie en transparantie na de wet van 6 april 2010*, TBH 2010, 946) or from 18 months onwards (M. Wyckaert & T. Boedts, *Remuneratie van 'leiders' van genoteerde vennootschappen na de wet van 6 april 2010*, TIJDSCHRIFT ESTATE PLANNING 2010, 306).
[170] The Dutch wording in the law is "wage."
[171] The *next* general meeting of shareholders must *pre*-approve this severance pay arrangement. The arrangement is null and void in case this procedure is not applied.

In 2012, once the new Say on Pay law went into effect over 90% of the companies put the item "remuneration report" on the agenda of the general meeting of shareholders.[172] Once again, companies' remuneration reports received high approval ratings from shareholders, although lower on average than in 2011. In Bel 20 companies,[173] the mean approval rate for companies' remuneration reports was 90.6%. A broader set of companies showed an even higher approval rate of 95.3%. In both instances, the median approval rates were even higher.

However, these figures conceal some companies where shareholder opposition was significant. For example, the shareholders of Agfa approved the company's remuneration report by a bare minimum with only 50.3% of the votes cast in favor, while the AGM of EVS approved its report with 64%, and only 69% of the Delhaize shareholders approved its report. Importantly, all three companies have a relatively dispersed ownership structure, and the other agenda items for the AGM, including the remuneration of the board members, were overwhelmingly approved. Nevertheless, these votes clearly signaled discontent amongst these firms' shareholders with the board's remuneration policy.[174] Recently, at the 2013 general meeting of the government controlled telecom operator Belgacom the shareholders disapproved the remuneration report. The government held a large stake and withheld its votes, while over 70 percent of the remaining shareholders[175] voted against the report because it contained overly generous remuneration packages for the managers and directors.[176]

For 30 Belgian companies[177], the shareholders annual general meeting had to approve both the total remuneration for the board of directors and the remuneration report. Using the voting turnouts of the 30 companies for which both the voting results of the total board fees and those for the remuneration report are available, we conducted a paired-samples t-test to compare the results of votes for the remuneration fee with those for the remuneration report. We found that the average vote in favor of the total board fees was 98.99% (SD=2.7), while only 94.14% of all

[172] The other companies did not comply with the law.
[173] Bel 20 is an index of the twenty Belgian blue chip stocks.
[174] Christoph Van der Elst, *The Belgian Shareholder Meetings 2012 and the Way Forward to Stewardship* 24 (Working Paper 2012).
[175] Only 5 percent of the attending shareholders supported the remuneration report.
[176] The remuneration of the directors was supported by a large majority of the shareholders but the government withheld its votes. The minutes of the meeting are available at http://www.belgacom.com/assets/content/mbimport/%7B6B2D2E46-9049-46DA-8C21-1BB1DCAF3C1A%7D?transformationID=CustomContent&contentType=content/custom&previewSite=cow (last visited May 3, 2013).
[177] 119 Belgian companies are listed of which 80 percent disclosed all relevant reports and 30 of these companies organized a general meeting that approved both the remuneration report and total board remuneration.

shareholders voted to approve the remuneration report (SD=7.2). These means are statistically significantly different at the 1% level of significance. These results suggest that shareholders are more likely to vote against the remuneration report than the directors' remuneration itself.

The difference does not come as a surprise. In general, institutional investors and proxy advisors support the remuneration of non-executive directors as long as the compensation is fixed and unrelated to corporate performance.[178] Belgian companies generally adhere to this principle. For remuneration reports, however, many issues are taken in consideration. Expert Corporate Governance Service (ECGS), third party proxy voting advisors,[179] assesses the executives' level of base salary, the targets for annual bonuses, the targets for long term incentive pay, as well as the relationship between long term performance and strategy.[180]

A remuneration report highlights many features of executive remuneration that can deviate from the proxy advisors', as well as many investors', positions. These can lead to the Pensions Investment Research Consultants (PIRC)[181] and ECGS opposing, or issuing an "abstain vote" recommendation on, the company's remuneration report. Many investment managers follow these recommendations.[182] This is the likely explanation of the significant higher shareholder opposition for the remuneration report. However, as many Belgian companies are block holder controlled, and these block holders support management, institutional investors' opposition does not lead to too big a drop in overall shareholders support levels.

## E. Say on Pay in France

### 1. Regulatory framework for Shareholder Approval of Executive Remuneration Arrangements

[178] Although sometimes high fees are opposed: Pirc opposed the increase of the non-executive fee of Solvay and ECGS voted against the remuneration of the chairman of the board of Bekaert in 2012.
[179] For more information about this proxy advisor see http://ecgs.com:8080/.
[180] They believe that executive contracts should not include severance payments. Expert Corporate Governance Service, *ECGS Corporate Governance Principles* at 14–15 (2012), *available at* http://www.europroxy.com/divers/2012%20public%20principles_ecgs%20LT.pdf (last visited Nov. 11, 2012).
[181] Pirc is an independent research and advisory consultancy. For more information see http://www.pirc.co.uk/.
[182] Voting instructions of Rebeco, SPDR, Rabobank, Axa and TD Asset Management are on file with the authors.

French public limited liability companies ("société anonyme") are free to choose between the one tier board structure and a two tier board structure in the articles of association. A large majority of the companies adopt the one tier-board structure. The French commercial code requires the one tier board of directors to elect a chairman,[183] either separating or combining this position with that of the chief executive officer.[184]

In companies that have opted for a two tier board structure, the general meeting of shareholders elects the members of the supervisory board[185] which supervises the members of the management board. The members of the management board and its chairman are elected by the supervisory board[186] but they can be dismissed by the general meeting of shareholders, or by the supervisory board, if the articles of association authorize it.[187] If the employees hold more than 3% of the shares, the general meeting of shareholders elects one or more employee-shareholders as supervisory board members.[188]

The French commercial code empowers the general meeting of shareholders to approve the total annual directors' fees for a one tier board and a total annual supervisory board fees for a two tier board.[189] This amount is paid for their services as board members[190] and not as executive officers. The shareholders must approve these payments, or the directors cannot be remunerated. The company can also provide directors with travel allowances and reimburse their business expense[191] and pay directors additional amounts for performing specific duties.[192] While the shareholders approve the total amount of director compensation, only the board of directors, or the supervisory board at a two tiered board company, can allocate specific amounts of compensation to the individual directors.

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[183] CODE DE COMMERCE [C. COM.] art. L 225-47 (Fr.).
[184] CODE DE COMMERCE [C. COM.] art. L 225-51-1 (Fr.). This option is provided to the board in 2001. Loi 2001-420 du 15 mai 2001 sur les Nouvelles Régulations Economiques [Law 2001-420 of May 15, 2001 on the New Economic Regulations], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], May 16, 2001, p. 7776.
[185] CODE DE COMMERCE [C. COM.] art. L 225-75 (Fr.).
[186] CODE DE COMMERCE [C. COM.] art. L 225-59 (Fr.).
[187] CODE DE COMMERCE [C. COM.] art. L 225-61 (Fr.). Members of the supervisory board cannot also be members of the management board.
[188] CODE DE COMMERCE [C. COM.] art. L 225-23, 225-71 (Fr.). In some cases, the general meeting chooses among the employee-shareholders who are members of the supervisory board of an investment trust which holds shares in the company as (supervisory) board member.
[189] CODE DE COMMERCE [C. COM.] art. L 225-47, 225-83 (Fr.).
[190] This is the "attendance" fee for meetings of the board of directors.
[191] CODE DE COMMERCE [C. COM.] art. R 225-33 (Fr.).
[192] Board members can enter into employment agreements with the company.

For many years, the shareholders' only power with respect to director pay was their approval over the total remuneration for the board. More recently, beginning in 1995, the French legislature has focused on the transparency of the remuneration package of directors and executives; however, it has not empowered the shareholders to have an overall "Say on Pay."[193]

Instead, initially in 2005, and subsequently reinforced in 2007, French law provides that the general meeting of shareholders must approve two parts of a "common" remuneration package of executive directors and officers: termination agreements and additional retirement agreements.[194] The 2005 Breton Law[195] determined that for these two types of payment, any agreements entered into are subject to the same strict approval requirements as those applied to related party transactions.[196] These strictly regulated agreements are only valid if they get prior approval by the Board, the chairman of the board sends a notice to the auditors, the auditors issue a report, and they are approved by the general meeting of shareholders.[197] Directors of companies that "failed or directors that personally failed" cannot receive any kind of termination fee.[198]

Under the 2005 law, shareholders can reject termination agreements and additional retirement benefits. However, the remaining pieces of an executive's remuneration package are

[193] Ivan Tchotourian, *Une décennie d'excès des dirigeants en matière de rémunération. Repenser la répartition des pouvoirs dans l'entreprise: une solution per se porteuse de risques, in* RISQUES D'ENTREPRISES: QUELLE STRATÉGIE JURIDIQUE?, at 44–48 (L. Nurit-Pontier & S. Rousseau eds., 2011).

[194] AMF, *Fiche presse: LES REMUNERATIONS DES DIRIGEANTS*, at 2 (Dec. 8 2009), *available at* http://www.amf-france.org/documents/general/9219_1.pdf (last visited Nov. 5, 2012). The French corporate governance code forbids termination agreements from awarding more than two years of the sum of fixed and variable remuneration.

[195] Loi 2005-842 du 26 juillet 2005 pour la confiance et la modernisation de l'économie [Law 2005-842 of July 26, 2005 on the Trust and Modernization of the Economy], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], July 27, 2005, p. 12160.

[196] These are defined to include agreements between the company and its CEO, one of its Managing Directors, one of its directors, a shareholder holding a fraction of the voting rights in excess of 10 % or the controlling company entered into directly or through an intermediary. CODE DE COMMERCE [C. COM.] art. L 225-38 (Fr.). This is the authorized agreements and commitments provision.

[197] These approvals are required every time the agreement is renewed.

[198] Association Française des Entreprises Privées, *Corporate Governance Code of Listed Corporations,* Recommendation 20.2.4 (Apr. 2010), *available at http://www.alstom.com/Global/Group/Resources/Documents/About/Code%20AFEP-MEDEF%20-%20April%202010.pdf*. The Code does not provide much guidance as to what is considered as a personal failure of the director ("des dirigeants qui sont eux-mêmes en situation d'échec"). The Code indicates the "demanding" (individual) performance requirements must have been met unless the departure is due to a change of control or change in strategy.

not subject to shareholder approval.[199] Next, since 2005 the French commercial code requires that the shareholders vote to give the board the power to grant (free) restricted stock[200] and stock options[201] to the employees and the executive directors.[202] More recently, under the 2007 TEPA Law,[203] the board of directors must disclose two reports related to any termination agreement: one that describes how the directors determined the performance conditions and the second detailing how those conditions are achieved.[204]

Like other countries, France has a mandatory "comply or explain" corporate governance code, called the AFEP-Medef Corporate Governance Code of Listed Corporations ("French Corporate Governance Code"). Companies in France are free to adopt this code's principles, but are not required to do so if they explain why they do not comply.[205] This code emphasizes the importance of full disclosure of the remuneration packages of the executive officers and board members. However, it did not contain a specific "Say on Pay" shareholder vote on the overall executive compensation package until June 2013.

In June 2013, the French Corporate Governance Code introduced a "Say on Pay" vote for shareholders with companies choosing either to comply by providing the vote or to explain why

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[199] CODE DE COMMERCE [C. COM.] art. L 225-40 (Fr.).
[200] CODE DE COMMERCE [C. COM.] art. L 225-197-1 (Fr.). The provision was inserted by Loi 2004-1484 du 30 décembre 2004 de finances pour 2005 [Law 2004-1484 of December 30, 2004 Relating to the Financing 2005], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Dec. 31, 2004, art. 83, p. 22459.
[201] The procedure for granting stock options was already introduced in the late 1980s. CODE DE COMMERCE [C. COM.] art. 225-186-1 (Fr.) (*introduced by* Loi 87-416 du 17 juin 1987 sur l'épargne [Law 87-416 of June 17, 1987 on Savings], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], June 18, 1987, art. 19).
[202] The persons to whom the restricted stock and options can be granted are the chairman of the board of directors, the chief executive officer, the executive members of the board and the management board members in a two tier board structure.
[203] Loi 2007-1223 du 21 août 2007 en faveur du travail, de l'emploi et du pouvoir d'achat [Law 2007-1223 of August 21, 2007 to Support Work, Employment and Purchasing Power], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], Aug. 22, 2007, p. 13945, *available at* http://www.amf-france.org/en_US/Espace-presse/Dossiers-et-fiches-presse/Les-remunerations-des-dirigeants.html.
[204] Loi 2008-448 du 7 mai 2008 pris pour l'application des articles L. 225-42-1 and L.225-90-1 du code de commerce et relative à la publicité des rémunérations différées [Decree 2008-448 of May 7, 2008 Regarding the Application of the Articles L. 225-42-1 and L.225-90-1 of the Commercial Code and Related to the Publication of the Deferred Remuneration], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], May 11, 2008, p. 7831. The board of directors must also submit a specific resolution relating to severance pay arrangements for the approval of the general meeting of shareholders.
[205] Gerard Charreaux & Peter Wirtz, *Corporate Governance in France* 3, *available at* http://www.virtusinterpress.org/additional_files/book_corp_govern/sample_chapter04.pdf.

they did not do so. Companies that comply are required by Principle 24.3 "to present" [206] to the general meeting of shareholders for an advisory vote the individual remuneration packages of the executive directors (i.e. the corporate officers). They must disclose both fixed and variable compensation on an annual and where necessary multi-year basis. The disclosures must state any exceptional remuneration, share options, performance shares or other long term pay for performance, golden parachutes, retirement benefits and in-kind benefits.

Shareholders vote separately on the remuneration package of the CEO and the other executive board members. If the shareholders vote against the pay packages, called providing "a negative advice," the board of directors must at one of its next meetings, and after being advised by the remuneration committee, "deliberate" about the implications of the shareholder vote, then publish on the company's website the actions it intends to take, if any, in response to the shareholders' concerns.

Enactment of the comply or explain principle in the French Corporate Governance Code avoided – at least temporarily – the introduction of a statutory "Say on Pay" requirement. According to Reuters, the government supports the comply or explain rule.[207] However, the French government is also working on a new tax regime for the "rich," indirectly addressing what they consider excessive remuneration packages. Furthermore, at state controlled enterprises, including (large) listed companies like EDF and Aeroports de Paris, the government has mandated limits on the remuneration of the members of the board of directors to 450,000 euros.[208] Clearly there is more to come for executive pay regulation in France.

2. Assessment of Shareholder Voting Power on Executive Remuneration Agreements in France

[206] At the time of this writing, the English version of the Code was not yet available.
[207] Leila Abboud, *Ad Agency Publicis Brings Say on Pay to France*, REUTERS, http://uk.reuters.com/article/2013/05/29/publicis-pay-idUKL5N0EA2AG20130529?feedType=RSS&feedName=rbssFinancialServicesAndRealEstateNews (last visited May 29, 2013). We presume that the new edition of the French corporate governance code with "say on pay" convinced the French government that – at the moment – no legislative action is required and that the mandatory comply or explain regime of the code with respect to provide in a say on pay of individual director's remuneration is sufficient.
[208] Loi 2012-915 du 26 juillet 2012 relatif au contrôle de l'Etat sur les rémunérations des dirigeants d'entreprises publiques [Decree 2012-915 of July 26, 2012 on the Government Control of the Remuneration of the Directors of Government Controlled Companies], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], July 27, 2012, p. 12283.

In this section, we assemble data to assess the shareholders' voting power on executive compensation arrangements at French companies. To the best of our knowledge, this has not been done by any other researchers.[209]

a. Voting on Total Board Pay

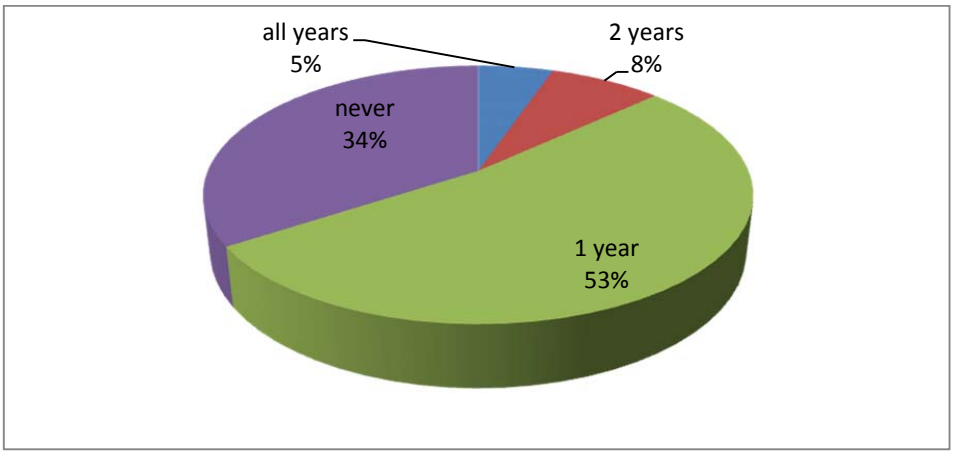
As discussed above, the shareholders vote to authorize directors' fees for French corporations.[210] However, companies only need to hold such a vote if they seek to increase these fees. Our analysis of the CAC-40[211] companies' minutes of the general meetings for the three year period 2010, 2011 and 2012 shows that only slightly more than one half of these companies (53%) sought shareholders' approval of directors' fees once during these three years.[212] More frequent approval was quite unusual: just 3 companies put the item on the agenda twice, and only two companies sought approval three times. Figure 1 illustrates these data. We also note that one out of three companies did not seek shareholder approval of these fees during these three years.[213]

Overall, and consistent with other countries, there is no significant opposition against the directors' for French board members. Only three boards experienced opposition of more than 5% of the votes, with highest dissenting vote (almost 20%) at Société Générale in 2011.[214] According to ISS research, in 2010 the shareholders approved the remuneration of the directors

[209] ISS and AFG provide in a general overview of voting issues. ISS, *2012 Proxy Season Review: World Markets*, at 15–25, http://www.issgovernance.com/files/private/2012CombinedPostseasonReport.pdf (last visited July 15, 2013); AFG, *Exercice des droits de vote par les sociétés de gestion en 2012*, at 16 (Mar. 2013)
[210] M. COZIAN, A. VIANDIER & F. DEBOISSY, DROIT DES SOCIÉTÉS 303, nr. 541 (2012).
[211] 38 large companies are in the sample. One company is registered in Belgium, the other in the Netherlands. Those two companies were excluded from the list.
[212] Only one AGM approved the fee in 2012, in all other cases the approval was equally split between the AGM 2010 and the AGM 2011.
[213] Some companies do not change the board fee for even longer periods and hence do not ask for any shareholder approval. The latest say on board pay of Saint Gobain was in 2006 and of Total it was in 2007. The fee of the board of Vivendi remained unchanged between 2000 and 2008, of Lafarge between 2001 and 2010, of LVMH between (at least) 2004 and 2012, and at L'Oreal between 2005 and 2011.
[214] This disapproval rate already dropped from 27% in 2009.

with 98.4 percent and in 2011 with 97.3 percent.[215] The approval rates of 2012 do not differ significantly from those of earlier years.[216]

Figure 1: Approval of the total board attendance fee at Cac-40 companies' AGMs 2010-2012




b. Strength of Shareholder Voting on Other Elements of Executive Pay

ISS data shows an increase in the numbers of shareholders voting on executive remuneration elements at French general meetings.[217] In particular, they find that votes that are directly or indirectly related to compensation, like the vote to authorize the board to grant restricted stock to employees and executive directors, and the vote to authorize termination agreements, can run into significant opposition.

One measure of shareholder views on executive compensation is how they vote on share incentive plans. In 2010, ISS found that the mean shareholder dissent rate for these plans was 14.2 percent, which dropped to 12.5 percent in 2011.[218] In both years, approximately 10 percent of these plans were rejected by shareholders.[219] We note that France is the only Continental

[215] ISS, *2010 Voting Results Report Europe* at 23, tbl.12 (Sept. 16, 2010); ISS, *2011 Voting Results Report Europe* at 16, tbl.12 (Sept. 12, 2011).
[216] Authors' calculations based on the minutes for the meetings of CAC-40 companies (on file with authors).
[217] ISS noted an increase in the attendance rates from 64.5 percent in 2008 to 68.8 percent in 2011 for France.
[218] ISS, *2010 Voting Results Report Europe* at 23, tbl.12 (Sept. 16, 2010); ISS, *2011 Voting Results Report Europe* at 16, tbl. 12 (Sept. 12, 2011).
[219] *Id.*

European country where these plans are regularly disapproved. However, it is unclear why shareholders fiercely oppose these particular stock plans. One plausible explanation could be that the board of directors is viewed being given too much discretionary power in the plans: the board sets the performance conditions, select the beneficiaries, the allotment terms etc.[220]

For 2012, we collected data on shareholder voting for all agenda items of CAC-40 companies and selected remuneration related agenda items: severance payment arrangements, authorization of the board to allot restricted stock, authorization of the board to grant stock options on shares and retirement plans. The results are summarized in Table 1.

Table 1: Agenda items of general meetings 2012 of CAC-40 companies related to remuneration[221]

| | Number of items voted on | Number of companies holding votes | Mean shareholder approval rate | Remarks on Outcome of Voting by Shareholders |
|---|---|---|---|---|
| Termination agreement | 16 | 11 (29%) | 66.60% | 1 rejected |
| Restricted stock | 14 | 13 (34%) | 83.81% | 1 rejected/1 withdrawn |
| Share Options | 4 | 4 (11%) | 92.26% | |
| Retirement plan | 3 | 3 (8%) | 80.37% | 1 rejected |

Table 1 shows that termination agreements are an agenda item at 29 percent of the companies and that shareholder opposition to them is relatively high: the average approval rate was only 66.6 percent. Looking more carefully at the data, we see that two thirds of the termination agreements received more than 25 percent shareholder opposition and that more than

[220] The notice of the general meeting 2012 of Sanofi provides: "[the general meeting] resolves that the vesting of the shares will be subject to performance conditions which will be set by the Board of Directors concerning a period of at least three years".

[221] Based on 38 of the companies in the CAC-40. Two CAC-40 companies, Solvay and EADS, have their registered seat outside of France, although they are listed on the French stock exchange. We have excluded these companies from the analysis as they are not subject to the French voting rules.

40% of shareholders voted against seven such agreements. However, only the agreement of the CEO of Safran was disapproved. The shareholders also rejected the retirement plan of Safran's CEO, but the two other retirement plans were both approved by more than 98 percent of the votes.

Stock option plans are generally considered as appropriate methods for incentivizing the executive board and management. Table 1 displays data illustrating that none of these plans garnered more than 15 percent opposition. Finally, shareholders were generally less enthusiastic about performance share plans. For example, the board of directors of France Telecom chose to withdraw this agenda item from the general meeting, while shareholders at other companies supported the authorization with less than 86 percent of the votes.

## F. Germany

### 1. Regulatory framework for Shareholder Approval of Executive Remuneration Arrangements

#### a. The Two Tier Board Structure

The mandatory two-tier board model is a core feature of the German stock corporation: the management board is responsible for running the business[222], while the supervisory board must supervise the management board. The supervisory board can also be asked to approve specific types of transactions.[223] Directors that sit on one board cannot also sit on the other board at the

[222] Aktiengesetz [AktG] [Stock Corporation Act], § 76, ¶ 1. The management board is composed of at least one natural person with full legal capacity. If the capital of the company is more than 3 million Euros, the management board must comprise at least two members unless the articles of association allows a management board of one member. Aktiengesetz [AktG] [Stock Corporation Act], § 76, ¶ 2.
[223] Aktiengesetz [AktG] [Stock Corporation Act], § 11, ¶ 5.

same company. [224] The management board must manage and represent the company jointly unless the articles provide otherwise.[225]

The supervisory board elects and dismisses the members of the management board for a term of up to five years. Members of the management board can only be removed for cause, like breach of duty or a vote of no confidence of the shareholders.[226] The members of the supervisory board are elected for maximum terms of four years. The supervisory board elects a chairman from among its members.[227] The size of the supervisory board depends on the value of the company's capitalization.[228] Further, the composition of the supervisory board is determined in part by different co-determination requirements. In 2010, there were 282 German stock corporations and 11 European companies (based in Germany) that had supervisory boards with 50 percent shareholder representatives and 50 percent employee representatives.[229]

b. Shareholder Approval Requirements for Executive Remuneration

As early as 1937, the German stock corporation act required that the supervisory board had to make sure that the compensation of the management was reasonable, reflecting both the duties of the management board as well as the financial condition of the company.[230] The 1965 version of

[224] Aktiengesetz [AktG] [Stock Corporation Act], § 105, ¶ 1; Klaus Hopt & P. Leyens, *Board Models in Europe. Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy* at 6 (ECGI Law, Working Paper No. 18/2004).
[225] Aktiengesetz [AktG] [Stock Corporation Act], § 77, ¶ 1, § 78, ¶ 2.
[226] Aktiengesetz [AktG] [Stock Corporation Act], § 84, ¶ 3.
[227] Aktiengesetz [AktG] [Stock Corporation Act], § 107, ¶ 1.
[228] Aktiengesetz [AktG] [Stock Corporation Act], § 95. The supervisory board must be composed of at least three members, all natural persons. The articles of association can provide in a higher number but the number must be divisible by three, unless the co-determination laws provide otherwise. The maximum number of supervisory board members depends on the share capital of the company. Capital up to 1.5 million Euros allows for a board of nine members, capital of more than 1.5 million Euros up to 10 million Euro allows for a board of fifteen members and capital higher than 10 million Euros allows boards up to 21 members
[229] Hans Böckler Stiftung, *Statistiken zur Mitbestimmungslandschaft*, http://www.boeckler.de/38347.htm (last visited Dec. 6, 2012).
[230] Brigitte Haar, *Executive Compensation under German Corporate Law: Reasonableness, Managerial Incentives and Sustainability in Order to Enhance Optimal Contracting and to Limit Managerial Power, in* RESEARCH HANDBOOK ON EXECUTIVE PAY 490 (Randall S. Thomas & Jennifer G. Hill eds., 2012).

this Act confirmed this reasonableness requirement. However, case law on the assessment of the reasonableness of the remuneration is scarce.[231]

Under this regime, shareholders had no voting rights on executive pay as it was the supervisory board's responsibility to make this determination. The one exception was for share option schemes. The German stock corporation act had very strict rules regarding the issuance of shares and share related instruments to protect the incumbent shareholders against dilution. Prior to 1998, share options for the management board were only legally possible with the issuance of convertible, or warrant, bonds which required the approval of a ¾ majority vote of the shareholders at a general meeting where more than 50 percent of the capital of the company was represented.[232] In 1998, the Control and Transparency Act ("KonTraG") explicitly allowed the general shareholders meeting to authorize management to buy back stock to use in stock option plan for members of the management board, significantly increasing the use of variable pay at German companies.

In 2009, the German Parliament enacted a new law, the Law on the Appropriateness of Director Compensation (the "Aktiengesetz"), which changed the executive remuneration system in Germany. The new law has three main features for listed companies: (i) compensation packages must consider individual performance as well as the sustainable development of the company, while the variable part of the compensation must have multi-year criteria;[233] (ii) the supervisory board can reduce the compensation awarded if the company underperforms so that the remuneration is no longer reasonable;[234] and (iii) for stock exchange listed companies, the general meeting of shareholders can be (but does not have to be) provided an advisory vote of the remuneration system of the management board.[235]

The German Corporate Governance Code copied these new requirements, providing an option for the shareholders to approve the remuneration system for management board directors,

[231] The regional court of München stated in 2007 that the remuneration can be reasonable even if it is not in line with common practice (Landgericht München I, 29 March 2007, *Die Aktiengesellschaft* 2007, at 458).
[232] For a detailed analysis of all the difficulties to issue share (option) schemes for the management board see Theodor Baums, *Aktienoptionen für Vorstandsmitglieder*, *in* FESTSCHRIFT FÜR CARSTEN PETER CLAUSSEN 3–48 (1997).
[233] Aktiengesetz [AktG] [Stock Corporation Act], § 87, ¶ 1.
[234] Aktiengesetz [AktG] [Stock Corporation Act], § 87, ¶ 2.
[235] Aktiengesetz [AktG] [Stock Corporation Act], § 120, ¶ 4. The law only facilitates that the company allows the general meeting to vote on the remuneration system of the management board, there is no mandatory requirement.

but also stating that the supervisory board must determine the total compensation of an individual member of the management board.[236] For supervisory board members, the general meeting of shareholders, or the articles of association of the corporation, may set the amount of its members' compensation.[237] The supervisory board members' remuneration must be related to the duties of the supervisory board and the condition of the company. The German corporation act also provides as an option that supervisory board members can be paid a short term bonus tied to the profits of the company.[238]

### 2. Assessment of Shareholder Voting Power on Executive Remuneration Agreements in Germany

#### a. Executive Remuneration in Germany

The development of the remuneration package of the German management board is relatively well-mapped, partially due to the litigation after Vodafone's acquisition of Mannesmann in 2000 over an award of golden parachute severance agreements. As part of the deal underlying those cases, the CEO of Mannesmann, Klaus Esser, received a bonus payment of around $17 million. This was challenged as an illegal payment under German law and the members of the compensation committee of Mannesmann were criminally charged for advising these bonus payments, although they were acquitted.[239] This case made executive remuneration a front page topic in Germany for years.

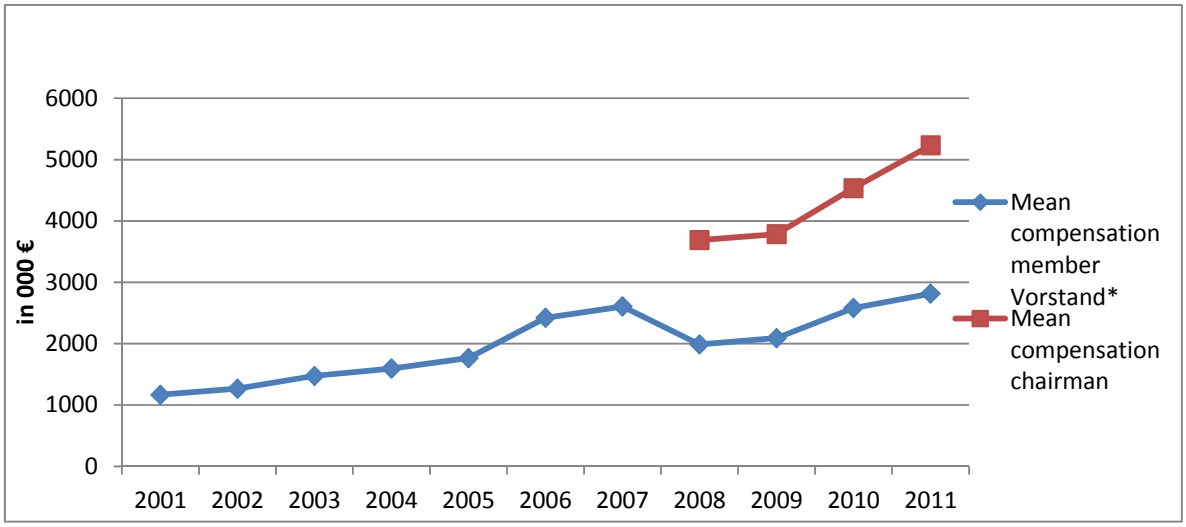
German executive compensation packages have grown substantially in the interim. From 2001 to 2011, the mean remuneration of an average member of the management board

[236] Government Commission, *German Corporate Governance Code*, §§ 2.2.1, 4.2.2 (May 2012).
[237] Aktiengesetz [AktG] [Stock Corporation Act], § 113, ¶ 1. As neither the articles of association nor the general meeting foresee in a remuneration, the member of the supervisory board must provide the services for free.
[238] Aktiengesetz [AktG] [Stock Corporation Act], § 113, ¶ 3.
[239] See for a short overview of the case Mark Landler, *Corporate Pay Case Ends in Acquittal*, N.Y. TIMES, July 23, 2004, *available at* http://www.nytimes.com/2004/07/23/business/corporate-pay-case-ends-in-acquittal.html?ref=klausesser (last visited Dec. 10, 2012).

("Vorstand") of the thirty largest German public companies listed on the DAX more than doubled from less than 1.2 million Euros to more than 2.8 million Euros (see Figure 2). As Figure 2 illustrates, this increase resembles a kinked curve. Between 2001 and 2007, the remuneration package jumped significantly. However, in 2008, during the Financial Crisis, the compensation of a member of the Vorstand decreased by almost 30%. Since 2008, the Vorstand members' pay packages have increased again, surpassing their 2007 levels in 2011.

The CEO receives a much higher compensation than the other members. During this period, the mean compensation of the CEO soared from 3.7 million to 5.2 million euros. At the highest end, the remuneration package of the CEO of Volkswagen reached 17.46 million euros.

Figure 2: Evolution of the total remuneration of an individual member of the management board




2001-2010: Deutsche Schutzvereinigung für Wertpapierbesitz e.V.(DSW), Studie zur Vergütung der Vorstände in den DAX-und MDAX-Unternehmen im Geschäftsjahr 2010, 2011, sheet 7, http://www.dsw-info.de/uploads/media/DSW_Verguetungsstudie_Vorstaende_2011_alle_Charts.pdf, last accessed 10 December 2012; 2011: P. Wilke and K. Schmid, *Entwicklung der Vorstandsvergütung 2011 in den DAX-30-Unternehmen*, Arbeitspapier 269 Hans Böckler Stiftung, September 2012, at 19 and 29; *: the remuneration does not take into account pension contribution.

### b. Results of Shareholder Voting on Executive Remuneration[240]

[240] The data of this section are derived from the publication of DSW (http://www.dsw-info.de/fileadmin/downloads/Grafiken_Verguetungsvotum.pdf (last visited Jan. 25, 2013)) and the authors' own research related to the minutes of the 2012 meetings of all of the DAX companies.

While not mandatory,[241] all DAX companies have had their management board remuneration system approved at least once by their general meeting of shareholders since 2010. The general shareholders meetings at three firms, BMW, Beiersdorf and Munich Re approved the system every year between 2010 and 2012, even though the pay system of these companies was not changed in each of those years. Smaller companies are less keen to provide in a shareholder vote: in 2009 and 2010, 78 percent of the general meetings of M-DAX companies approved the remuneration system, only 42 percent of the meetings of S-DAX companies and 63 percent of the TecDAX companies.[242]

Over this time period, fewer companies have put their executives' pay practices up for a shareholder vote each year. Thus, while 90 percent of the DAX general meetings voted on the remuneration system in 2010, this dropped to 47 percent in 2011, and fell even further to 33 percent in 2012.[243]

At the same time, at DAX companies, the average shareholder approval rate for the compensation systems decreased between 2010 and 2012 from 91.6 percent to 89.9 percent. In the same vein, in 2010 and 2011, over 75 percent of compensation systems were approved by over 95 percent of company shareholders. However, by 2012, only 40 percent of companies' compensation systems were approved by more than 95 percent of the shareholder votes.[244]

In one important example, in 2010, the shareholders at Heidelberger Cement rejected the remuneration system of the company. Several other companies have experienced strong opposition to their proposed remuneration system, including Deutsche Bank in 2010 (42 percent opposed), [245] Deutsche Börse (47 percent opposed) in 2010, Merck (30 percent opposed) in 2011 and SAP (35 percent opposed) in 2012.

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[241] *See* section 1.B. Shareholder approval requirements.
[242] The M-DAX, S-DAX and TecDAX are the indexes with 50 companies (M-DAX and S-DAX) or 30 companies (TecDAX) that are representative for the German mid-sized, small-sized and technology companies.
[243] *See supra* note 240 for sources.
[244] These data are based on calculations of the DSW reported approval rates for 2010 and 2011 (DSW, *Studie zur Vergütung der Vorstände in den DAX-und MDAX-Unternehmen im Geschäftsjahr 2010, 2011* at Sheet 11, *available at* http://www.dsw-info.de/uploads/media/DSW_Verguetungsstudie_Vorstaende_2011_alle_Charts.pdf); and authors' own research on all minutes of the meetings 2012 of DAX companies.
[245] ISS argued that the opposition at Deutsche Bank was due to the significant increase of the base salary and would reduce the variable remuneration with the same amount but failed to specify any details on the target levels. ISS, *2010 Voting Results Report Europe* at 25 (Sept. 16, 2010). Further, the annual report shows that the total remuneration of the management board increased from 4.5 million in 2008 to 39 million in 2009.

As a result, Deutsche Bank, Heidelberg Cement and Merck resubmitted their remuneration systems for shareholder approval at subsequent general shareholder meetings. In response Deutsche Bank's efforts to make its remuneration system more transparent (but only modestly changing the system itself)[246], its shareholders cast 94 percent of their votes in favor of the plan in 2012. Similarly, Heidelberger Cement developed a new remuneration system,[247] and over 96 percent of its shareholders approved the revised system in 2011. Ironically, Merck added a long-term variable compensation component[248] that actually increased the size of its executives' compensation, but its shareholders' support for the remuneration system went from 70 percent in 2011 to 87 percent in 2012.

Overall, the visible influence of German shareholders' votes on management remuneration systems is modest. Say on Pay is optional, although widely employed. When given the chance, shareholders generally approve of the remuneration systems and companies that experienced significant shareholder opposition against their remuneration system did not necessarily change their systems. There were more medium and long term incentive schemes,[249] resulting in more generous remuneration packages,[250] which are less transparent.[251] Whether the low levels of shareholder opposition are the result of companies having private consultations with major institutional investors, as reported in the financial press,[252] is not clear.

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[246] The 2012 general meeting notice of Deutsche Bank stated that the minor changes were due to new legal requirements (as a result of the transposed European Capital Requirement Directive III) (Deutsche Bank, *Tagesordnung Hauptversammlung 2012* at 4, *available at* https://www.deutsche-bank.de/ir/de/download/HV2012_Tagesordnung_de_2304.pdf).

[247] It moved from a variable bonus based on a specific financial goal and a medium term bonus towards a market competitive short term bonus based on share of profit and individual targets as KPI's and a long-term bonus based for 50 percent on the three year EBIT and ROIC and 50 percent on the four year total shareholder return related to two indices.

[248] Merck is organized as a limited partnership with a board of partners that has to approve the compensation system and which has delegated its power to a "personnel committee."

[249] Aktiengesetz [AktG] [Stock Corporation Act], § 87, ¶ 1.

[250] Deloitte, *Informationen für Aufsichtsrat und Prüfungsausschuss* at 2 (2012), *available at* http://www.deloitte.com/assets/Dcom-Germany/Local%20Assets/Documents/13_FocusOn/Center%20fuer%20Corporate%20Governance/2012/CGF%203-2012_safe.pdf.

[251] P. Wilke & K. Schmid, *Entwicklung der Vorstandsvergütung 2011 in den DAX-30-Unternehmen*, Arbeitspapier 269 Hans Böckler Stiftung at 46 (Sept. 2012).

[252] Steve Johnson, *Good Governance Delivers Good Value*, FIN. TIMES, Jan. 27, 2013, at 4. In this interview with the head of corporate governance of Legal & General Investment Management, Sacha Sadan it is noted that many corporate governance issues are discussed with this institutional investor before the agenda of the general meeting is prepared.

In February 2013, in its latest proposed amendments to the corporate governance code, the German Corporate Governance Commission proposed that the supervisory board set a cap on the amount of total compensation awarded to individual management board members as well as a cap on the components of this remuneration.[253] Some commentators have suggested tying management pay growth to the level of increases in the employees' pay of the company.[254] The German government has also prepared a new proposal that will make Say on Pay binding for listed companies.[255]

## G. Sweden

### 1. Regulatory framework for Shareholder Approval of Executive Remuneration Agreements

Swedish public limited liability companies must have both a board of directors and a managing director. The board of directors must be comprised of three members or more.[256] More than half of the members of the board of directors must be elected by the general meeting of shareholders. The articles of association can provide for other bodies to elect the remaining directors, but this power cannot be delegated to the board of directors or one of its members.[257] Large listed Swedish companies commonly have all members of their board of directors elected

[253] Government Commission, *Explanatory Comments on the Changes Proposed by the Code Commission from the Plenary Meetings held on 9 and 31 January 2013* at 6 (Feb. 2013), *available at* http://www.corporate-governance-code.de/eng/download/konsultationsverfahren_2013_02_05/Explanatory_comments_on_the_changes_proposed_by_the_Code_Commission_from_the_plenary_meetings.pdf (last visited May 5, 2013).
[254] P. Wilke & K. Schmid, *Entwicklung der Vorstandsvergütung 2011 in den DAX-30-Unternehmen*, Arbeitspapier 269 Hans Böckler Stiftung at 45–46 (Sept. 2012).
[255] *Vernunft und Maß bei Managerbezahlung*, Die Bundesregierung (May 8, 2013), http://www.bundesregierung.de/Content/DE/Artikel/2013/05/2013-05-08-kabinett-aktiengesetz.html (last visited July 3, 2013); Deutscher Bundestag, *Beschlussempfehlung und Bericht* (June 26, 2013), *available at* http://dip21.bundestag.de/dip21/btd/17/142/1714214.pdf (last visited July 3, 2013).
[256] Swedish Companies Act § 8:46.
[257] Swedish Companies Act § 8:8.

by the shareholders.[258] In addition to the members elected by the general meeting of shareholders, the trade unions representing the firm's workers get to elect two or three directors to the board.[259]

The board of directors of public limited liability companies elects a managing director,[260] who is responsible for the day-to-day management of the firm under the guidance of the board of directors. [261] The managing director may also take extraordinary actions if they must be done so quickly that she cannot wait for a decision of the board of directors.[262] The managing director is empowered to represent the company in its dealings with third parties[263] and to pick her own management team.

The general meeting of shareholders determines the remuneration of the board of directors. Since 2006, unlike in France and Belgium, the general meeting of shareholders for Swedish companies sets individual director's fees separately,[264] although individual directors are generally paid about the same. Like in France and Belgium, the directors receive a fixed director's fee with an additional fee for committee work and a flat fee if they serve as chairman of the board.

In addition, since 2006, the general meeting of shareholders of Swedish listed companies casts a binding vote, a "Say on Pay" vote, for or against the board of directors' proposed remuneration guidelines for determining the remuneration of the managing director and the

[258] A quick scan of the articles of association of Investor, Tele2, Telia Sonera, Volvo, Swedish Match, Electrolux, Securitas proved that none of these companies had other directors that were not elected by the general meetings of shareholders or were not employee representatives (Nov. 15, 2012).
[259] The right to elect two directors is provided to the unions if the company (or group) employs 25 employees or more. If the group employs more than 1000 employees, the Unions can elect three directors. Private Sector Employees (Board Representation) Act, § 4.
[260] OECD, BOARD PRACTICES: INCENTIVES AND GOVERNING RISKS 100 (2011), *available at* http://dx.doi.org/10.1787/9789264113534-en. In private companies a managing director is an optional feature (Swedish Companies Act § 8:27).
[261] According to the Swedish Companies Act the board must develop instructions dividing the allocation of power between the board of directors and the managing director (Swedish Companies Act 8:7).
[262] Swedish Companies Act §§ 8:50, 29. Legal doctrine recognizes the difficulties to separate the powers of the board of directors and the managing director (C. Hemstrom, *Corporations and Partnerships in Sweden,* Alphen aan den Rijn, Kluwer at 84 (2012)).
[263] Swedish Companies Act § 8:36.
[264] Swedish Companies Act § 8:23(a). The board of directors is not permitted to divide a lump sum fee. R. Skog & C. Fäger, THE SWEDISH COMPANIES ACT 63 (Norstedts Juridik 2007).

company's senior management.[265] The general meeting of shareholders must vote annually on the guidelines to be applied in the current accounting period.

The Swedish Companies Act provides a number of rules regulating the content of the remuneration guidelines. First, the guidelines must be forward looking but limited to the period until the next general shareholders' meeting.[266] Salary and all other types of compensation must be addressed, including the granting and vesting of options and any future payment in securities. When the exact amount of the remuneration cannot be predetermined, the guidelines must contain information on the nature of the compensation as well as the estimated total cost to the company.[267] Further, the company has to disclose information on the remuneration that has been approved by the board but is not yet payable. Also, the guidelines can provide that the board of directors has the right to deviate from these guidelines in individual and specific circumstances.[268]

Conversely, the Companies Act indicates that when the compensation package requires the company to issue shares, convertibles or warrants for the members of the board, or the managing director, no further guidelines must be provided.[269] The Companies Act itself provides the shareholders the right to approve this type of issuance by a supermajority of 90 percent of the represented votes and shares.[270] The report of the board of directors must also provide information about the issuance, including the allotment of the shares.[271]

The Swedish Companies Act states that three weeks before the general shareholders meeting, the company's auditors must provide a report certifying that the company complied with the guidelines approved by the AGM at the prior general meeting.[272] If the auditors opine that the company did not comply, their report must provide the reasons thereof.

The Act provides little guidance about the appropriate level of detail that must be disclosed in the guidelines submitted to shareholders. However, some things can be inferred from the Swedish Corporate Governance Code. For example, the Code defines executive pay as: "(i) fixed salary or fee, (ii) variable remuneration, including share- and share-price-related incentive

[265] Swedish Companies Act § 7:61.
[266] Swedish Companies Act § 8:51.
[267] Swedish Companies Act § 8:52.
[268] Swedish Companies Act § 8:53.
[269] Swedish Companies Act § 8:51.
[270] Swedish Companies Act § 16:2.
[271] Swedish Companies Act § 16:10.
[272] Swedish Companies Act § 8:54.

programs, (iii) pension schemes, and (iv) other financial benefits."[273] The corporate governance code also stresses the appropriate composition of the remuneration committee and the relationship of variable pay and performance. It requires the general meeting to approve every kind of allotment of shares to executives, executive share-price related incentive schemes, and urges the company to provide detailed information on these schemes.[274]

At public companies, the shareholders also have the right to vote on the issuance of shares, warrants or convertible instruments to the board of directors, the managing director or employees that involve the suspension of the preemption rights of the incumbent shareholders. Such plans require the approval of 90 percent of the votes at a shareholders' meeting where at least 90 percent of the shareholders are present.[275] This rule makes it difficult to use most share-based incentive schemes, although many companies make use of alternative mechanisms, like phantom stock.

The Swedish Companies Act provides mandatory "Say on Pay" rights for shareholders.[276] There have been some efforts to reduce the level of shareholder input on executive remuneration. In 2009, a governmental inquiry recommended changing the mandatory "Say on Pay" requirements into a less intrusive regulatory comply-or-explain regime, but no action has been taken to implement this recommendation thus far.[277]

2. Assessment of "Say on Pay" in Sweden

CEO pay is considered moderate in Sweden. In 2005, the average CEO's pay was below $1 million, less than half of their American counterpart. The pay package was skewed towards salary, bonus and social security contributions, with long term incentives providing less than 10 percent of the total remuneration package.[278] Since then, pay has increased, but a recent survey

[273] Swedish Corporate Governance Board, SWEDISH CORPORATE GOVERNANCE CODE § 9, n.10 (2010).
[274] Swedish Corporate Governance Board, SWEDISH CORPORATE GOVERNANCE CODE § 9.7 (2010).
[275] This rule was introduced because it was found that some issues were taken place in violation of the then applicable company law. Carl Hemstrom, CORPORATIONS AND PARTNERSHIPS IN SWEDEN 41 (2012).
[276] Furthermore, each shareholder has the right to put an item on the agenda of the general meeting. The item can relate to any topic with the exception of the reserved powers of the board or managing director.
[277] Per Lekvall, *Say on Pay – Pro or Con Good Governance? Some Reflections Based on the Swedish Experience*, BOARDVIEW 47–49 (2012).
[278] Randall S. Thomas, *International Executive Pay: Current Practices and Future Trends* 9–10 (Vanderbilt Law and Econ., Working Paper No. 08 -26, 2008).

estimated the average pay of the CEO's at the 23 largest companies at around 13.5 million Swedish krona (SEK), or less than $2 million, of which only 1/3 consisted of a variable short and long term incentive pay.[279]

According to the OECD, several large listed Swedish companies with substantial foreign share ownership have discussed remuneration issues with these investors.[280] They found that many foreign investors did not want to be involved in the setting of the remuneration package of individual executives and therefore relied on proxy advisory firms for advice on how to vote their shares. In order to stimulate voter turnout and the approval of remuneration policies, Swedish companies have been urged to invite foreign investors to participate directly (for example through conference calls). Overall, it does not appear that Say on Pay led Swedish shareholders to become more actively engaged with their companies.[281]

We examined the remuneration packages of the board of directors, the managing director and the top executives of OMX Stockholm 30 companies over 2011-2012.[282] In 2011, the chairman of the board at these firms received an average payment of 1.784 million SEK[283] (median = 1.655 million SEK), with a minimum compensation of 227,000 SEK and a maximum of 5.454 million SEK.[284] The remaining members of the board of directors elected by the shareholders[285] were remunerated with a mean directors' fee of 615,000 SEK (median = 587,000 SEK). One company paid 1.130 million SEK to each individual director, while the average director of one large bank only received 91,000 SEK.[286]

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[279] OECD (2011), *Board Practices: Incentives and Governing Risks*, Corporate Governance, OECD Publishing, *available at* http://dx.doi.org/10.1787/9789264113534-en.

[280] *Id.*

[281] OECD (2011), *Board Practices: Incentives and Governing Risks*, Corporate Governance, OECD Publishing, *available at* http://dx.doi.org/10.1787/9789264113534-en.

[282] There are 26 companies in our sample. Nokia, ABB and Astra Zeneca are considered as foreign companies, Atlas Copco counts as two in the index (shares A and B). For these companies, the average number of board members is 11 with a mean of 8.9 directors elected by the shareholders and 2.1 directors elected by the employees.

[283] The mean values include the additional remuneration for memberships and chairmanships of committees in the board.

[284] The chairman of Skania is also senior executive of Volkswagen and is not remunerated for his chairmanship of Skania.

[285] With the exception of the chief executive officer who generally does not receive a remuneration as director.

[286] Employee directors are not separately remunerated.

All companies have a managing director (CEO) and a team of senior executive managers. This group is composed of a mean of 10.8 members, including the CEO and a median of 10 other members. However, there is significant variation with one oil company having a team of only 4 members, while the CEO of a bank was assisted by 20 senior executives.

In 2011, the remuneration package of the mean CEO totaled 18.8 million SEK. This ranged from a maximum of 38.54 million SEK for the CEO of a medical technology company to a minimum of 1.751 million SEK for the CEO of an oil company. On average, half of the remuneration package is the fixed wage (median 46 percent), while the short term bonus contributed just under 20 percent of the total pay (both mean and median). Average pension contributions are considerable with a mean of 21 percent of total pay and a median of 18.5 percent. Company disclosures do not split the costs of long term benefits, but the total amounts of long term benefits vary between 0 SEK and 8 million SEK.

These data show that in Sweden the cross-company differences in pay packages are relatively low in comparison with other countries. The absolute amounts are nearly as high as those paid in some other countries. Perhaps as a consequence, shareholder opposition to company's remuneration guidelines, or the individual remuneration package of directors, is relatively modest. According to ISS, shareholder approval rates for the remuneration guidelines were 89.1% in 2010 and 99.3% in 2011. For share incentive schemes, the approval rates were 98.4% in 2010 and 99.8% in 2011. By comparison, the average approval rates in other European countries are generally lower.[287]

The one exceptional case arose in 2010 when the Swedish government voted its 37 percent block of shares in TeliaSonera against the company's remuneration guidelines because they contained a variable pay element.[288] As a result of the Swedish government's actions, the

[287] ISS, *2010 Voting Results Report Europe* at 22–23 (Sept. 16, 2010): ISS, *2011 Voting Results Report Europe* at 15–16 (2011). The exception is 2010 when the European average was 93.3%. In that year, the lower average outcome for Sweden is due to the disapproval of the remuneration guidelines of TeliaSonera.
[288] The Swedish government had banned the use of variable executive pay in wholly owned and partially owned Swedish companies in 2009.

voting guidelines of TeliaSonera were rejected by 52 percent of its shareholders and the TeliaSonera board of directors had to renegotiate all of its executive employment contracts.[289]

While Swedish companies give detailed disclosures of their directors' remuneration in the minutes of the general meeting of shareholders, they provide little information about shareholder turnout and the voting results at the meeting. The minutes of the meeting seldom contain the number of shareholders that were present and the number of votes cast at the meeting. Companies only disclose that the agenda items were approved with the required majority, which is generally 50 percent. An exception to this rule is Londin, which discloses in the appendices of its report the voting record of all shareholders. In its case, the remuneration of the board of directors as well as the remuneration guidelines were approved by a large majority of the shareholders, although a number of foreign pension funds and some asset managers voted against them.[290]

## H. The Netherlands

### 1. Regulatory framework of the Dutch Board Structure and Remuneration Arrangements

Since January 1, 2013 Dutch public limited liability companies are free to choose between a one-tier and a two tier board.[291] Before the enactment of this law, large Dutch companies had to provide a two tier board structure with a management board and a supervisory board. While there is already a trend visible towards the one tier board structure,[292] the large

[289] For a more detailed analysis of this case see Per Lekvall, *Say on Pay – Pro or Con Good Governance? Some Reflections based on the Swedish Experience*, BOARDVIEW 47 – 49, n.4 (2012).
[290] *Minutes Recorded at the Annual Gneeral Meeting of Shareholders* (Lundln Petroleum, Stockholm, Sweden), May 10, 2012, *available at* http://www.lundin-petroleum.com/Documents/ot_AGMminutes2012_eng.pdf (last visited Dec. 5, 2012).
[291] Wet van 6 juni 2011 tot wijziging van boek 2 van het Burgerlijk Wetboek in verband met de aanpassing van regels over bestuur en toezicht in naamloze en besloten vennootschappen [Law of June 6, 2011 changing book 2 Civil Code related to the amendments of the rules on governance and supervision of public and private limited liability companies], STAATSBLAD VAN HET KONINKRIJK DER NEDERLANDEN [OFFICIAL GAZETTE OF THE NETHERLANDS], no. 275, 2011, p. 1.
[292] According to Eumedion, 9 Dutch listed companies have opted for the one tier board structure at the end of June 2013 (*Nieuwsbrief*, EUMEDION, July 2013, at 6, *available at*

majority of the Dutch stock exchange listed companies still have two tier boards. Consequently, we briefly address the remuneration arrangements of companies with a two tier structure first and then discuss the differences for the one tier board structure.

a. The Two Tier Board Structure

Dutch listed corporations typically have a two-tier board structure.[293] The management board is responsible for the day-to-day business and affairs of the company.[294] This includes the strategic decision making process, the preparation and execution of the corporate policy, the governance of the capital of the company, the internal governance of the company, the execution of decisions of other corporate bodies and the representation of the company.[295]

The supervisory board's role is to supervise and advise the management board as well as to monitor the general course of the company's affairs.[296] In addition, the supervisory board chairs the general meeting of shareholders and is charged with hiring and firing the members of the management board.[297]

The general meeting of shareholders appoints the members of the supervisory board. The supervisory board must disclose its composition, size and the required expertise of its members.[298] Furthermore, the employees' council[299] has the binding right to nominate 1/3 of the members of the supervisory board. Supervisory board members are elected for a term of four years.

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http://www.eumedion.nl/nl/public/kennisbank/nieuwsbrieven/2013/nieuwsbrief_2013-06.pdf (last visited July 10, 2013). Companies with dual listings or internationally operating companies, like Unilever or Kardan opted for the one-tier board structure, as well as Douwe Egberts after the division from Sarah Lee, the American parent company.

[293] Only for a number of (large) companies this two tier structure was mandatory, as the old regime provided in exemptions for companies with mainly international activities. Many companies opt(ed) voluntarily for the two tier structure. An analysis of the different types of two-tier structures goes beyond the purpose of this contribution.

[294] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 129, ¶ 1. Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 129 ¶ 1.

[295] W. Slagter, *Ondernemingsrecht* 313 (Kluwer 2005).

[296] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 140.

[297] In fact, in a two tier board, the appointment of a management director takes three steps. The general meeting is informed of the proposed appointment. The employee's council is requested to provide an opinion and the supervisory board appoints the director.

[298] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 158, ¶ 3.

[299] Companies that employ at least 50 employees must establish an employees' council. This council is composed of employees' representatives. The number of representatives lies between 3 and 25, depending on the total number of employees. Article 6 of the Wet op de Ondernemingsraden van 28 januari 1971 [Law of 28 January 1971 on the Employees Council], Stb. 1971, p. 1.

b. One tier board structure

Under the One Tier Board Act, companies, including those that previously had the two tier structure, are allowed to select in their articles of association whether they want to have a one-tier board and a two-tier board. If a company selects a one tier board, that board must be composed of both non-executive and executive members. Whether a particular candidate will be elected as non-executive, or as executive, board member is decided by the general meeting of shareholders.[300]

The Dutch Civil Code provides that the non-executive members of the board must monitor the performance of the executive members. Further, the chairman must be a non-executive member of the board of directors. In matters related to the executive compensation, all of the executive members of the board are prohibited from being involved in the decision making process as well as in the setting of their remuneration.[301]

2. Executive Remuneration

Article 135 and article 145 of Book 2 of the Dutch Civil Code details which decision makers determine the amounts of executive remuneration and the company's remuneration policies.[302] Article 135 requires companies to develop a remuneration policy for the management board. The law does not indicate which corporate body must develop this remuneration policy. In the Dutch corporate governance code, it is considered a best practice that the supervisory board drafts the remuneration policy.[303] Companies are allowed to depart from this practice but if they do so,

[300] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 132.
[301] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 129a.
[302] Since 2004, Dutch listed companies must include in their annual report a description of the application of the Dutch Corporate Governance Code provisions. Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 391, ¶ 5.
[303] It remains unclear who should draft the remuneration policy in case the company is organized with a one-tier board. The 2012 corporate governance report of the Corporate Governance Commission (at 14) clarifies that "the provisions that apply to supervisory directors should be immediately applied to non-executive directors in one-tier boards, with no prejudice to the other responsibilities of these non-executives." It leaves the question whether the

they must explain the reasons therefore.[304] The proposed remuneration policy is also sent to the employees' council. The employees' council may provide the general meeting of shareholders with its opinion on the policy at the general meeting of shareholders.[305] The policy is then voted on at the general meeting of shareholders, which must approve it in order for it to become effective.[306]

If the remuneration policy for management board directors is to be amended, it must be reapproved by the general meeting of shareholders. Unfortunately, the law is silent on what constitutes an "amendment," which has led to debates about what changes are significant enough to require shareholder approval.[307] The law is also silent about whether the general meeting of shareholders has the power to amend the proposed remuneration policy itself.

The general meeting of shareholders must approve the individual remuneration packages of each management board member unless the articles of association delegate this power to another decision maker. Commonly, the articles of association delegate this power to the supervisory board so that it is unusual for individual remuneration packages to be voted on by the general meeting of shareholders.

However, the general meeting of shareholders is often involved in determining parts of the individual pay packages for management board members. For example, if the individual director's compensation package contains any share-based remuneration, this item of the individual remuneration proposal must be submitted for shareholder approval.[308] In addition, the proposal must provide information on the maximum number of shares or options that can be granted to the board as well as the criteria for granting. Notwithstanding the shareholder

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provisions that apply to the supervisory board, like developing the remuneration policy, should be applied by the non-executive directors jointly acting or by the board of directors including the executive directors.

[304] CORPORATE GOVERNANCE CODE MONITORING COMMITTEE, DUTCH CORPORATE GOVERNANCE CODE II.2.12 (2008), *available at* www.commissiecorporategovernance.nl.

[305] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 135, ¶ 2.

[306] The Dutch corporate governance code prescribes as a best practice that the supervisory board provide a "scenario analyses carried out and with due regard for the pay differentials within the enterprise" when it determines "the level and structure of the remuneration of the management board members" and must "analyze the possible outcomes of the variable remuneration components and how they may affect the remuneration of the management board members" before drafting the remuneration policy. Dutch corporate governance code, Best practice provision II.2.1 and II.2.2.

[307] *See* EUMEDION, EVALUATIE AVA-SEIZOEN 9–10 (2012), *available at* http://www.eumedion.nl/nl/public/kennisbank/ava-evaluaties/2012_ava-evaluatie.pdf (last visited July 10, 2013).

[308] Burgerlijk Wetboek [CIVIL CODE] [BW], Book 2: 135, ¶¶ 4–5.

meeting's approval right, the corporate body that contracts with the candidate-director can validly represent the company even if the approval is missing or the granting is disapproved.

Furthermore, there is a pending legislative proposal to provide for claw back provisions for bonus awards. Under the terms of this bill, the general meeting of shareholders, or another body specified in the articles of association, will have the right to modify the bonus if it is determined to be unreasonable and unfair.[309] This provision is already incorporated in the corporate governance code as a best practice.[310]

Finally, article 145 Book 2 of the Dutch Civil Code provides that the general meeting of shareholders can fix the compensation of the members of the supervisory board. It is common practice that the supervisory board proposes a fixed, flat cash compensation payment for each member of the board, which is then submitted to the company's general meeting of shareholders for approval.

### 3. Assessment of Say on Pay

Since 2005, the general meeting of shareholders must approve the company's remuneration policy and any amendments to this policy.[311] Using this vote, shareholders can exert substantial influence on a listed company's remuneration policy. The intensity of shareholder consideration of remuneration policies is revealed in the minutes of the meeting of many companies. These minutes show that corporate remuneration policies, as well as individual management director remuneration packages, are regularly and heavily debated, although actual rejections of either of them are rare.

[309] Proposal 32512 to Provide the Power to Modify or Claim Back Bonuses of Board Members and Other Executive Managers (Sept. 22, 2010).
[310] CORPORATE GOVERNANCE CODE MONITORING COMMITTEE, DUTCH CORPORATE GOVERNANCE CODE II.2.10 (2008), *available at* www.commissiecorporategovernance.nl.

[311] The version of article 135 that requires the general meeting of shareholders to approve the remuneration policy was enacted by Wet van 9 juli 2004 tot wijziging van boek 2 van het Burgerlijk Wetboek in verband met aanpassing van de structuurregeling. Law of 9 July 2004 to Amend Book 2 of the Civil Code Related to the Structure Regime, Stb. 2004, p. 1.

Every year, Eumedion[312] reports on the developments at general meetings of shareholders. The remuneration policy is one of the governance items that Eumedion regularly addresses in its reports to its institutional investor clients. Since 2008, Eumedion has identified several trends in the participation of shareholders in the remuneration debate.[313]

First, shareholders generally do not strongly oppose companies over their remuneration policies. Table 2 shows the 11 remuneration votes that generated the highest levels of shareholder opposition at general meetings of AEX companies between 2008 and 2012.[314] Generally, it appears that shareholders consider company-specific arguments when voting. In particular, when the performance criteria for variable pay are insufficiently detailed, or perceived by shareholders to be too generous, many shareholders will vote against the remuneration policy, or the remuneration item.

Since 2011, Eumedion also reports the recommendations of the third party voting advisor ISS, and additionally in 2012 those of a second proxy voting advisor, Glass Lewis. As Table 2 shows, there were three remuneration issues where ISS issued a negative recommendation on the proposal. However, Eumedion reports that, in 2012, in 31 out of 46 highly contested agenda items (67%) both ISS and Glass Lewis supported the companies' proposals, while an additional 9 (19.5%) more were only opposed by one of these proxy advisors. Based on these results, Eumedion argues that the impact of the proxy advisors' voting recommendation does not appear to determine the outcome of the shareholder vote.[315]

Table 2: Remuneration items amongst top 10 opposition items at AEX AGMs 2008-2012

| **Company** | **Year** | **Voting item** | **Against** | **W/hold** | **Result** | **ISS rec.** |
|---|---|---|---|---|---|---|
| Philips | 2008 | change LTIP | 57.8 | 5.2 | rejected | |
| Shell | 2008 | granting retention bonus | 23.5 | 25.9 | accepted | |
| SBM Offshore | 2008 | changing remuneration policy | 41.1 | 4.5 | accepted | |

[312] Eumedion represents approximately 70 institutional investors, managing more than €1000 billion in assets and its major goals is to enhance corporate governance, environmental and social performance and strategy. For more information see *Corporate Governance Forum*, EUMEDION, www.eumedion.nl.
[313] EUMEDION, EVALUATIE AVA-SEIZOEN, *available at* http://www.eumedion.nl/nl/public/kennisbank/ava-evaluaties/2012_ava-evaluatie.pdf (last visited July 10, 2013).
[314] These are taken from Eumedion's yearly top 10 lists of opposed items.
[315] EUMEDION, EVALUATIE AVA-SEIZOEN 13 (2012), *available at* http://www.eumedion.nl/nl/public/kennisbank/ava-evaluaties/2012_ava-evaluatie.pdf (last visited July 10, 2013).

| | | | | | | |
|---|---|---|---|---|---|---|
| Shell | 2009 | remuneration report | 57.1 | 3.9 | rejected | |
| ASML | 2009 | right to issue 'sign on' shares | 41.1 | 0.3 | accepted | |
| ASML | 2009 | right to issue 'sign on' options | 0.8 | 28.7 | accepted | |
| Heineken | 2010 | changing remuneration policy | 17.6 | 0.4 | accepted | |
| Heineken | 2010 | changing LTIP | 16.6 | 0.4 | accepted | |
| ING | 2011 | changing remuneration policy | 43.2 | | accepted | against |
| Aegon | 2011 | changing remuneration policy | 30.3 | | accepted | against |
| TNT Express | 2012 | remuneration superv. Board | 30.1 | | accepted | against |

Source: Eumedion, *Evaluatie AVA Seizoen*, 2008, 2009, 2010, 2011, 2012. (www.eumedion.nl).

Table 2 emphasizes the remuneration items that experienced significant opposition. However, the general level of voting disapproval of the remuneration policy is much lower. We studied all remuneration related issues at the general meetings of AEX companies in 2010, 2011 and 2012. These results are in Table 3.

Table 3: Approval of remuneration items at AGMs of AEX companies in 2010, 2011 and 2012

| | **2010** | **2011** | **2012** | **all** |
|---|---|---|---|---|
| Avg. Approval Rate | 96.58 | 86.42 | 87.97 | 91.46 |
| Remuneration policy | 95.58 | 83.00 | 88.97 | 89.52 |
| Other Pay issues | 97.25 | 89.41 | 86.71 | 92.88 |
| Total number items | 20 | 15 | 9 | 44 |

Source: Authors' research based on the minutes of the general meetings of AEX companies

The 2010 results are distorted by the 2008 changes to the Dutch corporate governance code that led many companies' boards to reconsider their remuneration policy in 2009, which then had to be approved at the 2010 AGM. As the amended policies were changed only to reflect new best practice amendments, shareholder approval rates were unusually high.

The amendments of remuneration policies in 2011 and 2012 are more representative as they involved company specific factors. For these years, we see higher levels of shareholder

opposition, although the mean opposing rate is still significantly lower than the disapproval levels that were reported in Table 2. In results not tabulated, we find that there are no statistically significant differences between the approval rates of corporate remuneration policies versus those for all other remuneration items, like the approval of long term investment plans, bonus shares, etc.

What these tables do not show are several remuneration agenda items that have been withdrawn before a shareholder vote. Eumedion provides evidence that many (institutional) shareholders perform a detailed study of the agenda of the meeting, including the proposal to change the remuneration policy, or other remuneration related proposals, and then contact the company before the general meeting takes place to express their displeasure. In cases where the management board of directors and supervisory board believe that the shareholder opposition against the item is very significant, the board may withdraw the item from the shareholder meeting's agenda. Eumedion believes that this practice creates a healthy dialogue between the remuneration committee and the shareholders that helps to identify the sensitivity of remuneration items earlier, so that the company can avoid having to withdraw highly opposed agenda items.[316]

Dutch law contains some ambiguities on the appropriate Say on Pay framework that require some further legislative consideration. First, as we discussed above, material changes to a company's remuneration policy must be approved by the shareholders. There remains significant debate as to the meaning of "material". For example, one company asked its AGM to approve a change of its peer group that it used in determining the short and long term management bonuses, while another company decided that the supervisory board could make changes to the composition of the peer group without asking their shareholders.[317] Second, many shareholders complain that companies need to disclose more information, particularly about performance-based remuneration packages and the discretionary power of the supervisory board over how it will execute an approved policy.

[316] EUMEDION, EVALUATIE AVA-SEIZOEN 10 (2008).
[317] EUMEDION, EVALUATIE AVA-SEIZOEN 5 (2008); EUMEDION, EVALUATIE AVA-SEIZOEN 9 (2012), *available at* http://www.eumedion.nl/nl/public/kennisbank/ava-evaluaties/2012_ava-evaluatie.pdf (last visited July 10, 2013).

Finally, remuneration policies need regular modifications to reflect changes in circumstances. For example, while during the beginning of the 2000's many companies used total shareholder return as the most important performance measure for bonuses, recently they have moved to more general performance-based measures like corporate social responsibility, sustainable development, etc.[318] This change in metrics will necessitate a new remuneration policy vote.

New regulatory or legislative initiatives may also create a need to modify remuneration policies. This would be the case for banks as they needed to amend their remuneration policies to align the short and long term bonus schemes with the transposed provision of the Capital Requirements Directive III. Another example would be that many companies introduced claw back provisions for bonuses into their policies to comply with best practices as set forth in the Dutch corporate governance code.[319]

## I. Summary of Countries' Different Features

Table 4 below summarizes the board structures and overall shareholder voting rules for the eight countries discussed above. We can see several important differences. First, board structure matters: in countries with two tier boards, historically the supervisory board usurped a number of powers generally assigned to the shareholders in a one tier board structure. Most importantly for our purposes, is that one of the assigned powers to the supervisory board was the setting of the remuneration of management board members. Recent developments in the two tier regime countries seem to reassign the power to set the remuneration (policy) back to the shareholders.

Second, the contours of "Say on Pay" vary significantly across countries. The gamut of regimes runs from setting the individual pay package of (executive) directors in the U.S. to advising the remuneration policy in Sweden, and on to voting on the remuneration report in the U.K. and Belgium. In this setting, shareholders of Swedish companies set the future in corporate

[318] EUMEDION, EVALUATIE AVA-SEIZOEN 10 (2011).
[319] EUMEDION, EVALUATIE AVA-SEIZOEN 5–6 (2010).

pay packages, while the British shareholders must be satisfied with the approval of "past" remuneration schemes.

Third, in most countries, shareholder votes on executive remuneration matters advise the board of directors in its development of appropriate incentivizing schemes of executive directors, while other countries empower the general meeting of shareholders to bindingly set the remuneration (policy). Fourth, "Say on Pay" sometimes means "Say on Individual Pay" while in other countries it means "Say on Group Pay." For example, French shareholders can only determine the total remuneration package of the board of directors, and are not permitted to individualize the amounts of pay for particular officers or directors. Finally, "Say on Pay" is not always an annual experience: under American law, it can take up to three years before a shareholder can have her say, whereas in the Netherlands, it can even take longer if the previously approved policy remains unchanged.

The many differences between the different "Say on Pay" regimes complicate the choices facing policy makers in the individual countries. The development of a European "Say on Pay" regime illustrates the difficulties. For non-financial companies, the European regulatory framework is evolving at a slow pace. In April 2011, the European Commission issued a green paper on the future of the EU corporate governance framework.[320] One of questions that was raised concerned "Say on Pay." It asked: "Should it be mandatory to put the remuneration policy and the remuneration report to a vote by shareholders?" This question offered only limited degrees of differentiation for respondents since it was limited to a mandatory vote on both the corporate remuneration policy and the remuneration report. A small majority of the respondents to the questionnaire supported holding a mandatory vote, but only of an advisory nature.[321] Their answers unfortunately provided no indication as to whether they preferred forward looking Say on Pay (a vote on the remuneration policy) or backward looking Say on Pay (a vote on the remuneration report).

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[320] European Commission, *Green Paper, The EU Corporate Governance Framework*, at 23, COM (2011) 164 final (Apr. 5, 2011). The Action Plan follows on two Commission's recommendations and follow-up reports on the remuneration of the board of directors in which a vote on say on pay was recommended. Commission Recommendation of 14 December 2004 Fostering an Appropriate Regime for the Remuneration of Directors of Listed Companies, 1990 *OJ* nr. L 385, December 29, 2004, 55-59 and European Commission, Commission Recommendation 2009/384/EC on remuneration policies in the financial services sector, O.J. (L 120), at 22–27.

[321] European Commission, *Feedback Statement – Summary of Responses to the Commission Green Paper on the EU Corporate Governance Framework*, at 10 (2011).

In its December 2012 Communication,[322] the European Commission revealed that it will make a shareholder vote on both the remuneration report and the remuneration policy mandatory,[323] probably through a modification of the Shareholder Rights Directive.[324] At the same time, the Commission will enhance the accountability of the shareholders vis-à-vis the company through the introduction of disclosure requirements for institutional investors.[325] Also, it will assess if the institutional investor's use of proxy advisor's voting services can sufficiently take into consideration the idiosyncratic characteristics of European listed companies in particular regarding the remuneration policy.[326] At the present, no proposal for a European Directive has been issued.

[322] European Commission, *Communication of the Commission: Action Plan: European Company Law and Corporate Governance - A Modern Legal Framework for More Engaged Shareholders and Sustainable Companies*, at 18, COM (2012) 740 final (Dec. 12, 2012).
[323] *Id.* at 9.
[324] Directive 2007/36/EC, of the European Parliament and of the Council of 11 July 2007 on the Exercise of Certain Rights of Shareholders in Listed Companies, 2007 O.J. (L 184), at 17–24.
[325] *Id.* at 8.
[326] *Id*. at 10.

| Table 4: What Do Shareholders Vote On? | **Belgium** | **France** | **Germany** | **The Netherlands** | **Sweden** | **UK** | **US** | **Australia** |
|---|---|---|---|---|---|---|---|---|
| Board type | One tier | One or two tier | Two tier | One or two tier | One tier | One tier | One tier | One tier |
| Vote to determine compensation of board membership | Binding | Binding | N/A | Yes but can be delegated (expected to be common) | binding | N/A | N/A | N/A |
| Vote on compensation of management directors for their executive duties (only for one tiered boards) | N/A | Advisory (after 2014) | N/A | Yes but can be delegated (expected to be common) | binding | N/A | Mandatory, Advisory | N/A |
| Frequency of Vote | Yearly | Yearly | Not defined | When policy is changed | Yearly | Yearly | At least every three years | Yearly |
| Vote to approve remuneration policy of the board | N/A | N/A | N/A | Yes | Yes | N/A | N/A | N/A |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Vote to approve the remuneration report | Mandatory Advisory | N/A | N/A | N/A | N/A | Mandatory advisory | N/A | Mandatory, advisory |
| Vote to approve the remuneration package of executive board members (two tiered board) | N/A | Advisory | N/A | Yes but can be delegated (common) | N/A | N/A | N/A | N/A |
| Vote to approve of the remuneration system of the management board (only for two tiered boards) | N/A | N/A | Yes, advisory | N/A | N/A | N/A | N/A | N/A |
| Vote to determine compensation of supervisory board (only for two tiered boards) | N/A | Yes, mandatory | Yes, mandatory | Yes, mandatory | N/A | N/A | N/A | N/A |

## II. Why is Say on Pay Being Adopted?

### A. Diverse Versus Concentrated Ownership Patterns

One factor that may influence the adoption of Say on Pay in a country is whether the predominant form of ownership structure is diverse or concentrated. At publicly traded corporations with highly dispersed share ownership, managers may take actions which are not in the best interests of shareholders.[327] Managerial agency costs are an important problem, but dispersed shareholder monitoring has historically been weak because shareholders face significant collective action problems. These managerial agency costs may be reduced if we can align managers' incentives with those of shareholders through the use of stock options and long term incentive pay whose value fluctuates with the company's stock price. For this reason, investors in the U.S. and the U.K. have, at least until very recently, strongly advocated the use of pay for performance in executive compensation.[328]

The United States, the U.K., and to a lesser extent Australia, are good examples of dispersed ownership systems. Cheffins notes that U.S. and U.K. firms rely on incentive pay systems to more closely align the interests of managers and shareholders.[329] Australian executives also receive substantial amounts of restricted stock and stock options.[330]

From the perspective of corporate executives, however, substituting stock options or restricted stock for other forms of fixed compensation increases the riskiness of their pay package, especially if there are stringent corporate performance requirements attached to these awards. In response to the greater risk, managers discount substantially the value of performance based pay awards.[331] To keep pay levels at a specified amount, companies must, for example, offer more stock options to compensate for the higher risks of little or no return if the options fail

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[327] Cheffins & Thomas, *supra* note 3, at 308, 312.
[328] Cheffins & Thomas, *supra* note 3, at 308.
[329] Brian R. Cheffins, *Current Trends in Corporate Governance: Going From London to Milan via Toronto*, 10 DUKE J. COMP. & INT'L L. 5, 14–15, 17 (1999).
[330] Randall S. Thomas, *Lessons from the Rapid Evolution of Executive Remuneration Practices in Australia: Hard Law, Soft Law, Boards and Consultants*, *in* RESEARCH HANDBOOK OF EXECUTIVE COMPENSATION 341, 350–51 (Randall Thomas & Jennifer Hill eds. 2012).
[331] *See, e.g.*, Brian Hall & Kevin J. Murphy, *Stock Options for Undiversified Executives*, 33 J. ACCT. & ECON. 3, 4–5 (2002); Lisa K. Muelbroek, *The Efficiency of Equity-Linked Compensation: Understanding the Full Cost of Awarding Executive Stock Options*, FIN. MGMT., Summer 2001, at 5.

to pay off. Reflecting their views on the tradeoff between improved alignment of incentives and higher costs, shareholders in American and U.K. firms have generally been content to see executive pay rise substantially so long as the increase has been incentive-oriented.[332] In the post-financial crisis era, however, institutional investors have become more critical of executive pay levels at firms that are performing poorly, raising more stringent objections to high pay.[333]

Say on Pay voting systems give these investors a mechanism for drawing attention to their concerns about excess, or poorly structured incentive, pay. If corporate boards make pay awards that are out of line with corporate performance, or with those given to executives at comparable firms in similar industries, the firm risks a "failed" Say on Pay vote and the resulting negative attention that is focused on its directors in the aftermath of such a vote. This is clearest in Australia where boards face the possibility of removal if they ignore adverse shareholder Say on Pay votes for more than two annual meetings. The U.K. is moving in this direction as well as it shifts from an advisory vote to employing a binding Say on Pay vote. However, even in the U.S. which still uses the advisory vote, recent research shows that boards of directors, when faced with a failed Say on Pay vote, or even relatively low levels of shareholder support, may alter executive pay packages, issue supplemental disclosures and engage in extensive outreach to their shareholders.[334] In extreme cases, a board's failure to respond appropriately to a weak Say on Pay vote may also attract the attention of an activist hedge fund, as it may have recently done at Hess Oil.[335]

In other major industrial countries, such as Continental Europe, where concentrated share ownership was, or is, the norm, Say on Pay may be less important as a means of mobilizing shareholder opposition against high executive pay levels. In these countries, firm control is concentrated in the hands of a control shareholder, or control group, which therefore can effectively discipline disloyal or ineffective managers.[336] Concentrated shareholder monitoring is an alternative method of aligning shareholder and manager interests, so that incentive pay

[332] Cheffins & Thomas, *supra* note 3, at 294, 312 (noting that British shareholders might be more prepared to take a stand against high pay arrangements than American investors).
[333] Thomas et al., *Say on Pay*, *supra* note 5.
[334] Cotter et al., *supra* note 50.
[335] Daniel Gilbert & Joann S. Lublin, *Board Pay Fuels Hess Battle*, WALL ST. J., Mar. 26, 2013, at B8.
[336] Brian R. Cheffins, *Minority Shareholders and Corporate Governance*, 20 COMPANY L. 41 (2001).

systems are less important and executive pay levels are correspondingly lower.[337] Overall pay for performance levels will be lower, and the use of stock options less common, we would therefore anticipate in concentrated ownership economies than in dispersed ownership countries. Studies by Brunello,[338] Ramaswamy, Veliyath and Gomes,[339] and Park, Nelson and Torabzadeh,[340] provide empirical evidence from Canada, India and Italy, respectively that supports these claims.

If ownership concentration levels should decline, however, it is likely that executive pay levels and performance-based compensation will increase in the future. This is particularly likely if the cause of increased dispersion is growing levels of foreign portfolio investment by U.S. and U.K. institutional investors.[341] Consistent with this thesis, Thomas finds some evidence that over time shareholder ownership in Sweden and Germany has become less concentrated and executive pay levels are rising.[342]

For instance, traditionally corporate control in Sweden has been heavily concentrated in the hands of one or two family shareholders.[343] Empirical data show that, as of 1998, in listed Swedish companies, on average, the largest shareholder controlled 38 percent of the voting rights, which in practice implied operational control of the company.[344] However, in recent years, share ownership in Sweden has become more dispersed. This has occurred as a result of increased foreign investment as well as a new Swedish pension model that has created large state-controlled and corporatist pension funds that have invested heavily in Swedish firms.[345] Foreign investment has increased dramatically in the past twenty years with data showing that although in the early 1990's, foreign investors owned less than 10 percent of Swedish listed

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[337] TODD T. MILBOURN, FINANCIAL SYSTEMS AND CORPORATE GOVERNANCE 170, 174 (1998).
[338] Giorgio Brunello et al., *Executive Compensation and Firm Performance in Italy*, 19 INT'L J. INDUST. ORG. 133, 141, 155 (2001).
[339] Kannan Ramaswamy et al., *A Study of the Determinants of CEO Compensation in India*, 40 MGMT. INT'L REV. 167, 182–83 (2000).
[340] Yun W. Park et al., *Controlling Shareholder and Executive Incentive Structure: Canadian Evidence*, 17 CAN. J. ADMIN. SCI. 245, 246 (2000).
[341] William W. Bratton & Joseph A. McCahery, *Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference*, 38 COLUM. J. TRANSNAT'L. L. 213, 234 (1999); Mary O'Sullivan, *Corporate Governance and Globalization*, 570 ANNALS AM. ACAD. POL. & SOCIAL SCI. 153, 167 (2000).
[342] Randall S. Thomas, *International Executive Pay: Current Practices and Future Trends*, *in* LAB. & EMP. L. & ECON. 197–98 (Kenneth G. Dau-Schmidt, Seth D. Harris & Orly Lobel 2009).
[343] Magnus Henrekson & Ulf Jakobsson, *The Swedish Model of Corporate Ownership and Control in Transition*, *in* WHO WILL OWN EUROPE? THE INTERNATIONALISATION OF ASSET OWNERSHIP IN EUROPE (Harry Huizinga, Lars Jonung eds., 2005), *available at* http://ssrn.com/abstract=998256.
[344] *Id.* at 27. In 34 percent of the firms, the controlling owner had more than 50 percent of the votes, while in 82 percent of the firms, there was a well-defined owner holding more than 25 percent of the votes.
[345] *Id.* at 1.

companies' stock, by 2012 foreign ownership of Swedish shares rose to 40.3 percent of all shares.[346] Amongst the foreign investors, American institutions were the largest single group, with roughly 29 percent of the total equity of Swedish companies. As a result, Henrekson & Jakobsson predict that Swedish firms' formerly concentrated family ownership model will likely give way to more dispersed ownership by foreign owners and state or corporate pension funds.[347]

Executive pay is likely to be affected by these changes. While previously concentrated ownership reduced the level of CEO compensation in Swedish and Norwegian firms, because 'large owners are better monitors of CEO pay,'[348] moving towards a more dispersed ownership in public corporations will be one factor that could lead to increased remuneration. This suggests a potential need for new monitoring mechanisms for shareholders in Sweden. Perhaps this is why, as ownership concentration levels have dropped, and executive pay levels have escalated, Sweden has enacted the binding Say on Pay legislation discussed in section I.

German public companies have experienced similar shifts in its shareholder composition over the last decade. In the past, the largest German companies were controlled by domestic investors, banks, insurance companies and families.[349] In addition, the state controlled important German companies, such as the Deutsche Post and Deutsche Telekom.[350] Today things have changed: 53 percent of the shares on the DAX, the stock index for the 30 largest German companies, are in foreign hands.[351] Moreover, there has been a significant decrease in ownership concentration levels since 2000: the largest shareholder's average voting block at a DAX-30

[346] Officiella Statistik, *Aktiägande i Bolag Noterade pa Svensk Marknadsplats* (Dec. 2012), *available* at http://www.scb.se/Statistik/FM/FM0201/2012H02/FM0201_2012H02_SM_FM20SM1301.pdf.
[347] Henrekson & Jakobsson, *supra* note 343, at 34.
[348] Lars Oxelheim & Trond Randøy, *The Anglo-American Financial Influence on CEO Compensation in Non-Anglo-American Firms*, 36 J. INT'L BUS. STUD.. 470 (2005).
[349] WOLFGANG STREECK & MARTIN HÖPNER, *ALLE MACHT DEM MARKT? FALLSTUDIEN ZUR ABWICKLUNG DER DEUTSCHLAND AG* 118 (Martin Höpner ed., 2003).
[350] *Id.* at 118.
[351] Randall S. Thomas, *International Executive Pay: Current Practices and Future Trends, in* LABOR & EMPLOYMENT LAW & ECONOMICS 198 (Kenneth G. Dau-Schmidt, Seth D. Harris & Orly Lobel eds., 2009). The DAX measures the performance of the Prime Standard's 30 largest German companies in terms of order book volume and market capitalization. DEUTSCHE BÖRSE GROUP, http://deutsche-boerse.com/dbag/dispatch/en/isg/gdb_navigation/home?active=overview&timespan=1d&wpbpl=&wp=DE0008469008&foldertype=_Index&wplist=DE0008469008&module=InOverview_Index.

company decreased from 26.4 percent in 1999 to 20.4 in 2012.[352] This resembles the ownership concentration levels found in the UK.[353] Finally, only four companies are still majority controlled while one half of the DAX companies have no shareholders owning more than 10 percent of the voting rights.[354]

Concentrated ownership by banks, all other things being equal, is associated with lower levels of CEO compensation at German companies.[355] Interestingly, family ownership of German firms increases compensation,[356] perhaps because families use it as a mechanism for diverting value to themselves. Pay for performance sensitivities are very low and concentrated ownership reduces them still further.[357] Conversely, as ownership concentration disperses, we should expect to see higher levels of executive compensation. As an example, the mean compensation of a member of the management board of a DAX company soared from €1.2 million in 2001 to over €2.8 million in 2011, an increase of over 240%, whereas the average annual wage for workers increased only 18 percent during the same period.[358]

As ownership concentration levels have dropped in Germany, the country has also moved to give shareholders more "say" about executive pay. The Law on the Appropriateness of Director Compensation states that the general meeting of shareholders can be provided an advisory vote of the remuneration system of the management board of listed companies.[359] Further, institutional investors make use of the advisory Say on Pay to signal their worries over pay increases and discuss the imbalance between higher staff pay and shareholder dividends.[360]

Recently, in the aftermath of several pay scandals, as well as Switzerland's popular referendum in support of a mandatory Say on Pay vote for Swiss firms, there has been strong

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[352] Christoph Van der Elst, *The Influence of Shareholder Rights on Shareholder Behavior*, CORP. FIN. & CAP. MARKETS L. REV. 56 (2010); own research based on companies annual reports and websites (May 2013).
[353] In 2007, the average voting block of a sample of UK companies was 19.3 percent of the votes. C. Van der Elst, *Shareholder Mobility in Five European Countries, in* CORPORATE MANAGEMENT: SHAREHOLDER RIGHTS 211 (L. Padmavathi ed., 2009).
[354] Authors' own research based on companies annual reports and websites (May 2013), on file with the authors.
[355] Alfred Haid & B. Burcin Yurtoglu, *Ownership Structure and Executive Compensation in Germany* 15, 19 (Working Paper 2006), *available at* http://ssrn.com/abstract=948926,.
[356] *Id.*
[357] *Id.*
[358] *OECD.StatExtracts*, ORGANISATION FOR ECONOMIC CO-OPERATION & DEVELOPMENT (2013), http://stats.oecd.org/# (last visited May 28, 2013).
[359] Aktiengesetz [AktG] [Stock Corporation Act], at § 120, ¶ 4. The law only facilitates that the company allows the general meeting to vote on the remuneration system of the management board, there is no mandatory requirement.
[360] Madison Marriage, *Hermes Attacks Deutsche Pay Levels*, FIN. TIMES, May 27, 2013, at 1.

pressure on the government to introduce a binding Say on Pay vote in Germany. The German government wants to move "Say on pay for listed companies to a mandatory system [that will be]… binding for the supervisory board."[361] For some members of the German Parliament, these new proposals are insufficient: they want to limit directly executive pay to a maximum of a fixed multiple of the ratio of the total pay of a member of the management board to the average remuneration of the employees of the company. This cap would be binding, and would have to be determined by the supervisory board and disclosed in the company's annual report to its shareholders.[362] France experienced a similar ownership development. In 1999, the companies in the CAC-40 index had a major shareholder with an average voting block of 28.1 percent. Gradually, the ownership structure of the largest companies became more dispersed. In 2005, the voting block of the largest shareholder dropped to 25.6 percent, then in 2007, decreased further to 22.2 percent, and most recently was at 21.1 percent by the end of 2012.[363] At the same time as control blocks were shrinking or even disappearing, the French government first in 2005, and later in 2007, empowered the general meeting of shareholders with the right to vote on the termination payments to be made to an executive board member, as well as the vote on whether to permit a corporate board to grant stock options. The French also introduced a maximum remuneration cap for government-controlled companies. Finally, France is expected to introduce a more general and mandatory Say on Pay vote on the entire compensation package of top executives.[364]

While it would be a mistake to draw too broad conclusions from the experience of these three countries, and as we discuss below, there are undoubtedly other factors that have influenced countries' decisions to implement Say on Pay voting, it does appear that shifts in ownership concentration levels, in particular at large listed companies, and the greater need for mechanisms to facilitate shareholder monitoring in dispersed ownership economies, are

[361] Free translation of "Say on pay" soll für börsennotierte Aktiengesellschaften zu einem obligatorischen und für den Aufsichtsrat verbindlichen Element ausgebaut warden." *See* ***Vernunft und Maß bei Managerbezahlung***, DIE BUNDESREGIERUNG (May 8, 2013), http://www.bundesregierung.de/Content/DE/Artikel/2013/05/2013-05-08-kabinett-aktiengesetz.html) (last visited May 28, 2013).
[362] *SPD will Managereinkünfte Beschränken*, DEUTSCHER BUNDESTAG (May 16, 2013), http://www.bundestag.de/presse/hib/2013_05/2013_273/04.html.
[363] Christoph Van der Elst, *The Influence of Shareholder Rights on Shareholder Behavior*, CORP. FIN. & CAP. MARKETS L. REV. 56 (2010); Authors' own research based on companies annual reports and websites of these companies (May 2013).
[364] See section above for further discussion.

important factors behind at least some countries' adoption of the shareholder vote on executive pay levels and/or practices.

### B. The Effects on Executive Compensation of Increased Stockownership by Institutional Investors

Closely related to the effects of shifts in stockownership patterns that we discussed in section I, we turn next to the cross border effects arising out of the institutionalization of stock ownership. Particularly in the U.S. and U.K., institutional share ownership has greatly evolved in the past several decades, and as the size of institutional investors has grown, they have expanded their portfolios to include large quantities of foreign equity securities. In addition, the abolishment of national stock ownership restrictions, and the globalization of international markets, has provided investors with many new investment opportunities and a large shift towards international stock.[365] As a result, in most countries, the shareholder base of large public companies internationalized.

Table 5 illustrates this shift. In most of the countries covered by the table, the share of stock in hands of foreign shareholders more than doubled between 1995 and 2010, although the financial crisis of 2007 partly reversed this trend. In 2010, foreign investors' ownership share ranged from a low of 13 percent of the shares of American companies to a high of 65 percent of the shares of Dutch companies. This represents a marked increase from the number in 1995 (U.S. 6 percent; Dutch 37 percent). More generally, in countries like France, Sweden, Belgium and the UK, foreign shareholders control close to 40 percent of the shares in more recent years. This trend is a result of institutional investors' growth in size and diversification of their portfolios and has led to their acquisition of major voting blocks in large foreign companies.

Table 5: Evolution of stock in the hands of foreign shareholders

| | 1995 | 2000 | 2005 | 2007 | 2010 |
|---|---|---|---|---|---|
| Belgium | 22,9% | 31,1% | 36,2% | 38,7% | |

[365] For a detailed analysis of the globalization of a number of capital markets see Maurice Obstfeld & Alan M. Taylor, *Globalization and Capital Markets*, in GLOBALIZATION IN HISTORICAL PERSPECTIVE 122–87 (Michael D. Bordo, Alan M. Taylor & Jeffrey G. Williamson eds., 2003).

| | | | | | |
|---|---|---|---|---|---|
| France | 24,9% | 38,8% | 40,5% | 41,1% | 38,7% |
| Germany | 8,2% | 12,5% | 18,4% | 21,3% | |
| The Netherlands | 37,0% | | 75,0% | 71,0% | 65,0% |
| Sweden | 29,6% | 39,0% | 35,3% | 38,0% | 37,8% |
| UK | 16,3% | 35,7% | 36,3% | 40,0% | 41,2% |
| US | 5,7% | 8,4% | 9,9% | 11,0% | 13,3% |

Sources for Table 5: Belgium, France, Germany: FESE, Share Ownership Structure in Europe, 2008, at 112; France 2010: AFG, Contribution des OPCVM aux fonds propres des entreprises, 2011, at 6; The Netherlands: 1995 and 2005: R. Abma, Het aandeelhoudersvergaderingenseizoen 2006: feiten en trends, Tijdschrift voor Ondernemingsbestuur, 2006 nr. 5, 169; 2007, FESE; 2010: own calculations based on Nyenrode Business Universiteit, Naleving Nederlandse Corporate Governance Code 2012, at 36; Sweden: SCB, Aktieägarstatistik, 2013 at 24; UK (data 1994, 2004, 2006 instead of 1995, 2005, 2007): ONS, Ownership of UK Quoted Shares 2010; US: Census table 1201.

To try to examine these effects more closely, we look at German data. Many German companies regularly investigate their shareholder base and disclose information of the importance and region of these investors. This information is split in a regional breakdown of the ownership of the shares, and the relative importance of institutional investors and private investors (and sometimes other classes). We used these companies' investigations to estimate the importance of the institutional investors coming from the different regions in the world.[366] Our data are of December 2012 to April 2013. According to our survey of 24 DAX companies,[367] institutional investors control between 7 percent[368] and 93 percent[369] of their shares, with a mean stake of almost 68 percent.[370] Approximately 19 percent of their stock is held by German institutional investors while another 50 percent is in the hands of foreign institutional investors. American and UK institutional investors are the most important kind of foreign shareholders

[366] The estimation provides only a first, rough indication: it is assumed that private investors and institutional investors are proportionally spread over the different regions.
[367] The other six companies did not disclose the ownership structure or only disclosed very general data.
[368] Volkswagen.
[369] Deutsche Börse.
[370] Majority controlled companies like Beiersdorf and Merck do not disclose detailed information of the region of the investors. This explains this high percentage.

with American institutions controlling 19 percent and U.K. firms controlling another 11 percent of these German companies' shares.[371]

Data collected by one of the authors shows the relative importance of certain types of institutional investors: banks, investment funds, and hedge funds/private equity funds. As shown in Table 6, foreign investment funds, private equity and hedge funds became important shareholders of Belgian, French and German companies and they consolidated their positions in UK companies in the last decade. [372]

Table 6: Relative importance of foreign investment funds, hedge funds, private equity funds and banks in four Western European countries

| 1999 | Belgium | France | Germany | UK |
|---|---|---|---|---|
| investment funds | - | 2,31% | 2,18% | 8,96% |
| hedge funds/ private equity | - | - | - | - |
| banks | - | 1,73% | - | 2,03% |
| | | | | |
| 2007 | Belgium | France | Germany | UK |
| investment funds | 7,14% | 14,75% | 3,77% | 8,71% |
| hedge funds/ private equity | | 2,19% | 4,56% | 0,11% |
| banks | 0,48% | 1,64% | 2,18% | 4,95% |

Source: C. Van der Elst, Are Shareholder Rights Appealing to Foreign Shareholders?, in *Festschrift für Klaus Hopt*, Berlin, W. De Gruyter, 2010, 636.

Many of these investors have either a legally mandated duty, or at least a fiduciary duty, to vote their shares (the institutional investors) or want to actively make use of their voice in the investee companies (particularly the activist hedge funds). Institutional investors are also likely to have retained ISS or another proxy voting advisor to give them information/voting advice

[371] Many companies do not distinguish between US and Canadian institutional investors and British and Irish institutional investors.

[372] Christoph Van der Elst, *Are Shareholder Rights Appealing to Foreign Shareholders?*, *in* FESTSCHRIFT FÜR KLAUS HOPT 629–44 (2010).

about the Say on Pay vote to help solve the collective action problem. These third party voting advisors provide valuable information about the various items that shareholders vote on as well as voting recommendations that may assist the institutional shareholders in casting their ballots. To the extent that these third party voting advisors have promulgated corporate governance or compensation guidelines that shape their voting recommendations, they may have an independent additional effect on executive pay levels and composition. Evidence from the U.S. suggests that ISS voting recommendations have a significant impact on the outcome of Say on Pay votes.[373]

The financial markets encourage these foreign institutional investors to become "stewards" of the company and actively strive for long term performance. An important instrument thereto is the monitoring of pay for performance which they support. As noted in section I, executive performance based pay is considered an important remedy for agency problems and long-term incentive pay for senior managers can serve as the best proxy for the alignment of the interests of shareholders and management. We would expect institutional investors to generally support pay for performance, and therefore potentially higher levels of executive pay. Compensation packages significantly increased in many countries and especially a number of large companies' executives were provided with performance based pay, including stock options. If remuneration schemes are appropriately designed to reflect (long-term) shareholder value, it could result in better shareholder returns. However, in the period following the financial crisis, it became clear that incentive contracting can also be part of the agency problem at companies with poor corporate governance practices, as witnessed by overly generously designed packages, backdating of stock options and the sometimes modest connections between better performance for high pay. If shareholders are provided with Say on Pay, they can monitor incentive arrangements and remuneration packages by using this mechanism to tell management their views on pay issues.

C. Social Intolerance of Income Inequality

[373] Cotter et al., *supra* note 50.

Cultural differences,[374] or more particularly differences in the level of social tolerance for high levels of pay disparities, may exist between different countries.[375] For example, Americans may be more tolerant of income inequality that is perceived to arise out of differences in "effort, talent or entrepreneurial risk taking,"[376] so that investors in the U.S. may accept the need for high levels of pay for performance as part of executive pay packages.[377] By contrast, in other countries, a stronger sense of egalitarianism could suppress high CEO pay,[378] and conspicuous displays of wealth. Even in dispersed ownership countries like the U.K. , [379] and Canada,[380] which supposedly have adopted the American business culture,[381] may be influenced by this factor. Similarly, in Australia, the comparatively modest managerial pay arrangements in that country may be influenced by concerns about out of line pay arrangements.[382] If culture is important, it could lend strength to claims that shareholders need to have a vote on executive remuneration arrangements in order to keep pay disparities for getting out of touch with social values.

Of course, there are other legal forces that can substitute for, or complement, shareholder voting. In Germany, the *Mannesmann* case provides a good example. In those proceedings, Germany's highest appellate court referred to local compensation norms in rejecting the need for a special payment to top executives, noting: "The size of the special payment for the accused Dr. Esser, which was uncommon for the German business locale..."[383] Similarly, when it was announced that Maurice Lévy, the CEO of Publicis, a large French company received in 2012

[374] Culture can be defined as a society's shared values, understandings, and assumptions. HELEN DERESKY, INTERNATIONAL MANAGEMENT: MANAGING ACROSS BORDERS AND CULTURES 015 (3d ed., 2000).
[375] Herbert A. Henzler, *The New Era of Eurocapitalism*, HARV. BUS. REV., July-Aug. 1992, at 57, 60.
[376] Martin J. Conyon & Kevin J. Murphy, *The Prince and the Pauper? CEO Pay in the United States and the United Kingdom*, 110 ECON. J. F640, F667 (2000).
[377] James Cox, *US Success Draws Envy, Protests*, USA TODAY, Aug. 3, 2000, at B1; Michael Crawford, *Peanuts for Elephants*, CAN. BUS., July 1994, at 16; Maria Slade, *NZ Executives Pay Third World Salaries*, INDEP. BUS.WKLY., Sept. 26, 1997, at 23. For anecdotal evidence consistent with this view, see David Leonhardt, *Executive Pay Drops Off the Political Radar*, N.Y. TIMES, Apr. 16, 2000, at Week in Review 5.
[378] Shirley Fung, *How Should We Pay Them?*, ACROSS THE BOARD, June 1999, at 36, 39; Tara Parker-Pope, *Culture Clash: Do US-Style Compensation Plans Make Sense in Other Countries?*, WALL ST. J., Apr. 12, 1995, at R7.
[379]Martin J. Conyon & Kevin J. Murphy, *The Prince and the Pauper? CEO Pay in the United States and the United Kingdom*, 110 ECON. J. F640, F667-668 (2000); Martin Van der Weyer, *Too Much Cream*, INDEP., Aug. 16, 1998, at 16.
[380] Michael Crawford, *Peanuts for Elephants*, CAN. BUS., July 1994, at 16.
[381] On business culture typologies, see DERESKY, *supra* note 374, at 117–18.
[382] Maria Slade, *NZ Executives Pay Third World Salaries*, INDEP. BUS.WKLY., Sept. 26, 1997, at 23; Florence Chong, *Salary Secrets: What Companies Have to Fear*, BUS. REV. WKLY., June 5, 1987, at 50; Lyons, *supra* note 277; Julie McBeth, *Who Pays the Top Salaries*, BUS. REV. WKLY., Nov. 25, 1988, at 60.
[383] Bundesgerichtshof [BGH] [Federal Court of Justice] Dec. 21, 2005, 3 StR 470/04 (Ger.) ("Die Höhe der Sonderzahlung für den Angeklagten Dr. Esser, die für den Wirtschaftsstandort Deutschland außergewöhnlich war.").

a bonus of 16 million euro, the French president - then presidential candidate - Mr. Hollande declared: "There are still inequalities that are not sustainable in our country, and we cannot accept; these bosses do not have to lecture us on the competitiveness of the French economy"[384]. He announced he would introduce a taxation threshold of 75% for remunerations above 1 million euro. Thus, in Continental Europe other legal rules may lead those who run companies to limit their compensation demands.

Even where there are no legal restrictions on pay levels, public opinion against high pay levels can be an important force counseling self-restraint. In 2007, for instance, it was disclosed that Wendelin Wiedeking, the CEO of Porsche AG, had earned approximately $90 million in the previous year.[385] There was a huge public outcry against this pay package.[386] This revelation could have major policy consequences because of strong worker resentment of large pay inequities within society.[387] This example illustrates both the importance of the equalitarian norm, and its limitations as a check on executive pay.

In Sweden, a strong egalitarian culture has had an important effect on CEO pay.[388] The Swedish media's intensive coverage of the "unreasonably high" levels of executive pay, and their poor connection, at certain companies led the Swedish government set up the special committee that ultimately determined that executives' remuneration must be reasonable in relation to a company's result and growth.[389] The depth of public support for this sentiment was shown when the Confederation of Swedish Enterprise, an organization of prominent business members, stated in issuing their influential guidelines for Remuneration of Company Directors and Senior Management Personnel in 2004 that, "the debate has chiefly centered on the remuneration of managers of the very largest listed companies, where the amounts have been

[384] *Bonus de 16 Millions du Patron de Publicis Maurice Levy: Concert de Critiques, de Hollande à Dupont- Aignan,* HUFFINGTON POST (Mar. 28, 2012), http://www.huffingtonpost.fr/2012/03/28/maurice-levy-publicis-bonus-millions-critiques-reactions_n_1386197.html (last visited June 20, 2013) ("Il y a quand même des inégalités qui ne sont pas supportables dans notre pays, qu'on ne peut pas accepter et ce ne sont pas ces patrons-là qui vont nous faire la leçon sur la compétitivité de l'économie française.").
[385] Mike Esterl, *In Germany, Scandals Tarnish Business Elite*, WALL ST. J., Mar. 4, 2008, at A1, A14.
[386] *Id.*
[387] *Id.*
[388] Lars Oxelheim & Trond Randøy, *The Anglo-American Financial Influence on CEO Compensation in non-Anglo-American Firms*, 36 J. INT'L BUS. STUD. 470 (2005); Peter Högfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS 19 (R. Morck ed. 2005).
[389] Proposition [Prop.] 2005/06:186 Ersättning till ledande befattningshavare i näringslivet, at 27 [government bill] (Swed.).

considered at times to be excessive and hard to explain. In certain cases, completely unreasonable levels of remuneration have been paid that – justifiably – have been condemned and that have undermined confidence in the business community".[390]

Social resistance to high pay may lead to corporate self-discipline[391] if directors suffer reputational harm when they authorize large pay packages.[392] Pay packages outside of the social norm may be more difficult for CEOs slow to ask for, and for directors to approve.[393] If directors and managers fall to show self-control, then social pressure against high levels of income inequality may function as a catalyst for legislative reform, too. For example, the U.S. tax code was amended in 1992 to exclude deductions for managerial pay over $1 million in response to public pressure. Similarly, in the U.K. growing disquiet over executive pay motivated the U.K.'s Greenbury Committee to tackle executive pay and thereby avoid tough statutory regulation.[394] Pressures from the public could well lead to the implementation of Say on Pay legislation for the same reasons.

Cultural values can evolve as well thereby creating scope for change in executive pay practices. This certainly seems to have been the case in the U.K. Up through the 1970s, top British executives were paid less well than their counterparts in all other major industrial countries,[395] perhaps because the British managerial culture was very egalitarian and U.K. firms reflected this in their pay structures.[396] However, throughout the 1980s, Britain's political scene shifted dramatically, as its ruling Conservative party espoused strong free-market ideologies. Coincident with this political and cultural shift there were dramatic increases in executive compensation. The gross pay of CEOs in large, publicly traded U.K. firms rose nearly 600

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[390] CONFEDERATION OF SWEDISH ENTERPRISE, GUIDANCE FOR REMUNERATION OF COMPANY DIRECTORS AND SENIOR MANAGEMENT PERSONNEL 3 (2004).

[391] BRIAN R. CHEFFINS, COMPANY LAW: THEORY, STRUCTURE AND OPERATION 699 (1997) [hereinafter COMPANY LAW].

[392] Lucian Bebchuk *et al.*, *Executive Compensation in America: Optimal Contracting or Extraction of Rents*, 69 U. CHI. L. REV. 751 (2002) [hereinafter *Rent Extraction*]; Alex Brummer, *Failing Brakes on Boardroom Pay*, GUARDIAN, June 1, 1996, at 38.

[393] Bebchuk et al., *Rent Extraction*, *supra* note 392. For an example of this process, see Tara Parker-Pope, *Culture Clash: Do US-Style Compensation Plans Make Sense in Other Countries?*, WALL ST. J., Apr. 12, 1995, at R7.

[394] CHEFFINS, COMPANY LAW, *supra* note 391, at 655–56.

[395] Hugh Parker, *The Effective Executive: What is He Worth?*, MCKINSEY Q. 22, 27–28 (Winter 1976).

[396] CHRISTEL LANE, MANAGEMENT AND LABOUR IN EUROPE: THE INDUSTRIAL ENTERPRISE IN GERMANY, BRITAIN AND EUROPE 131–32 (1989); Andreas Budde et al., *Corporate Goals, Managerial Objectives, and Organizational Structures in British and West German Companies*, 3 ORG. STUD. 1, 27 (1982).

percent between 1979 and 1994.[397] By the mid-1990s, British CEOs were among the best paid in the world.[398] This suggests that the public's willingness to implement Say on Pay legislation may change over time to reflect social views on the importance of income inequality.

D. Political party enacting the legislation

Most of the countries studied in this analysis can be classified as "social democracies". While social democracies value the basic principles of capitalism and recognize its strength for producing growth and wealth,[399] they also recognize its tendency to concentrate wealth in the hands of the few. Excessive wealth concentration can hinder democracy "if: 1) the private right of disposal enjoyed by some over the means of production leads to an unequal distribution of wealth which is inconsistent with 'equal freedom' and participation in society; 2) the balance of power in society is weighted so far in favor of employers, as against employees, that it denies the latter any opportunity to live their lives on the basis of self-determination; 3) owing to the pursuit of profit by some, market capitalism stands in the way of the welfare of all; 4) which can be ensured only by the democratic principle; and 5) the state's sole function is to provide for peace and order."[400] At the same time, the social democratic state must not unnecessarily obstruct capitalism by substantially curtailing freedom of enterprise using democratic decision-making; or by democratic state interference by the expropriation of private property in favor of the public at large, thereby jeopardizing the development and freedom of the individual.[401]

Contrary to the beliefs of communists, social democrats recognized that capitalism seemed to be able to overcome some of its major weaknesses like the exploitation of workers, unemployment and unequal distribution of wealth.[402] However, social democracy believes that

[397] David Goodhart, *In Search of Wages that Work*, FIN. TIMES, June 27, 1994, at 14.
[398] John M. Abowd & David S. Kaplan, *Executive Compensation: Six Questions That Need Answering*, 13 J. ECON. PERSP. 145, 146 (1999).
[399] Sheri Berman, *Understanding Social Democracy, in* OCCASIONAL PAPERS, FRIEDRICH EBERT FOUNDATION 22 (2005).
2005, at 22
[400] T. Gombert, *Foundations of Social Democracies*, FRIEDRICH EBERT STIFTUNG 58 (2009).
[401] T. Gombert, *Foundations of Social Democracies*, FRIEDRICH EBERT STIFTUNG 59 (2009).
[402] Encyclopedia Britannica, *Social Democracy*, http://www.britannica.com/EBchecked/topic/551073/social-democracy (last visited July 4, 2013).

capitalism needs a visible hand, and opposes too much deregulation[403]. The most famous protagonist of social democracy, Eduard Bernstein "argued that success for socialism depended not on the continued and intensifying misery of the working class but rather on eliminating that misery.[404]" To this aim, "capitalism might be necessary to insure an ever-increasing economic pie, but it had to be carefully regulated by states so that its negative social and political consequences could be kept in check.[405]" This regulation should balance the interests of private property with the interests of weaker parties in society. "Increasingly, social democracy adopted the goal of state regulation, but not state ownership, of business and industry as sufficient to further economic growth and equitable income.[406]"

In countries with social democracy, the government takes into account distributional considerations reducing excess wealth accumulation. Wealth maximization is only accepted as far as it stimulates growth and cannot be interpreted as, or even given the appearance of, exploiting any other (corporate) constituents. For many years, this underlying philosophy has dampened the level and composition of executive remuneration in countries with strong social democratic parties.

This form of democracy conflicts with the typical "Berle and Means" corporation. In these firms, diffuse shareholders prefer shareholder-wealth maximization and managers are encouraged to put shareholders' interests first. In corporations with dispersed ownership, managers must be made more loyal to shareholders. The corporate governance mechanisms that serve that goal are *incentivizing compensation*, hostile takeovers and transparent accounting.[407] These instruments have been underdeveloped in the continental Western European social democracies historically.

Take Germany as an example. In Germany, as noted in section  above, it took until 1998 before the issuance of share options was legally facilitated. Hostile takeovers were highly

[403] For an analysis of party politics and ideology see Irwin, Douglas & Randall Kroszner, *Interests, Institutions, and Ideology in Securing Policy Change: The Republican Conversion to Trade Liberalization after Smoot-Hawley*, J.L. & ECON. XLII 643–73 (1999).
[404] Encyclopedia Britannica, *Social Democracy*, http://www.britannica.com/EBchecked/topic/551073/social-democracy (last visited July 4, 2013).
[405] Sheri Berman, *Understanding Social Democracy*, *in* OCCASIONAL PAPERS, FRIEDRICH EBERT FOUNDATION 22 (2005).
[406] Encyclopedia Britannica, *Social Democracy*, http://www.britannica.com/EBchecked/topic/551073/social-democracy (last visited July 4, 2013).
[407] Mark Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 553, 553–60 (2000).

exceptional until 2000[408] with the acquisition of Mannesmann by Vodafone and with 85 percent of the companies having a block holder owning more than 25% of the shares.[409] Finally, the German accounting system diverged significantly from the US counterpart by stressing low earning volatility.[410]

Since the end of the last millennium, all of these instruments became common practice in most European countries. Corporate managers are heavily incentivized using stock options, the European Takeover Directive[411] has harmonized large parts of the national take-over procedures including hostile take-over bids, and the International Financial Reporting Standards (IFRS) have been introduced for the consolidated accounts of stock exchange listed companies[412]. These developments went hand in hand with the globalization of the stock exchanges and the shift towards institutional investors' ownership.[413]

Continental European pay practices have also moved toward US style practices. Since 2006 German listed companies must disclose the remuneration package of the individual management board members,[414] thereby providing employees, politicians and society easy access to information about the remuneration packages of board members of large German companies. The financial press regularly reports (indignantly) on these pay packages of top managers.[415] The number of public corporations with dispersed ownership has increased and the American style shareholder wealth maximization norm has become more common.

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[408] Mayer and Franks reported three hostile bids. Julian R. Franks & Colin Mayer, *Ownership and Control of German Corporations* (Sept.25, 2000), *available at* SSRN: http://ssrn.com/abstract=247501 or http://dx.doi.org/10.2139/ssrn.247501).

[409] *Id.*

[410] For an analysis of the differences in reporting with an application of the DaimlerChrysler case, see Ray Ball, *Corporate Governance and Financial Reporting at Daimler-Benz (DaimlerChrysler) AG: From a "Stakeholder" toward a "Shareholder Value" Model*, *in* THE ECONOMICS AND POLITICS OF ACCOUNTING: INTERNATIONAL PERSPECTIVES ON RESEARCH TRENDS, POLICY, AND PRACTICE 32–57 (Christian Leuz, Dieter Pfaff & Anthony Hopwood eds., 2004),

[411] Directive 2004/25/EC of the European Parliament and of the Council of 21 April 2004 on Takeover Bids, 2004 O.J. (L 142) 12.

[412] Regulation 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the Application of International Accounting Standards, 2002 O.J. (L 243) 1 (EC).

[413] See section  above for further discussion.

[414] Gesetzes über die Offenlegung der Vorstandsvergütungen [Vorstandsvergütungs-Offenlegungsgesetz – VorstOG] [Law about the Disclosure of the Remuneration of the Management Board],Aug. 3, 2005, GERMAN OFFICIAL JOURNAL Aug. 10 2005, at 2267.

[415] *See, e.g.*, Chris Bryant, *VW Adds Impetus to Executive Pay Debate*, FIN. TIMES, Mar. 12, 2012, *available at* http://www.ft.com/intl/cms/s/0/47c96cd6-6c25-11e1-8c9d-00144feab49a.html#axzz2YO3VeIT8 (last visited July 5, 2013).

At the same time, income inequality increased in many Western European countries.[416] This conflicts with the basic principles of wealth distribution in social democracies. A social democratic response was needed, but straightforward mandatory executive pay caps are unacceptable because they conflict with the idea of private property in a democracy and smack of communism. The result was Say on Pay, a "democratic" voting system for executive pay packages and/or policies.

These policies were overwhelmingly instituted by social democratic parties. This is illustrated in Table 7, which summarizes for the five Continental European countries in our analysis, the political parties that initiated the different kinds of "say on pay". The approval of the remuneration system and remuneration report in the UK (2002), Germany (2009) and Belgium (2010) was initiated and approved by social democrats. In Germany, the recent development towards a mandatory "Say on Pay" is initiated by the Christian democrats preventing more harsh proposals of the social democrats. In France, the approval rules for termination agreements stem from the more liberal oriented government in 2005 and 2007 but these approval rights are not envisaging an overall Say on Pay. Only in the Netherlands was the Say on Pay system initiated by a Christian democrat member of Parliament and not by the social democrats. In this regard, we note that the Christian democrats are in many European countries in the middle of the political spectrum, providing legal initiatives that are welcomed by more liberal, or more socialist parties, depending on the topic and political coalitions at the moment of launching the initiative. Overall, we can conclude that the social democrats and other left wing parties are keener to issue Say on Pay regulations.

Table 7 : Political "Wing" Introducing "Say on Pay" Laws

| | date | topic | Type of Say on Pay | introduced | who | Political party |
|---|---|---|---|---|---|---|

[416] According to OECD data the Gini-coefficient increased in Germany from 0,264 in 2000 to 0,286 in 2010. The Gini-coefficient is "a standard measure of income inequality that ranges from 0 (when everybody has identical incomes) to 1 (when all income goes to only one person)." OECD, AN OVERVIEW OF GROWING INCOME INEQUALITIES IN OECD COUNTRIES: MAIN FINDINGS 22 (2011).

| | | | | | | |
|---|---|---|---|---|---|---|
| Belgium | April 6, 2010 | remuneration report | advisory vote | December 2009 | government | Liberals, Christian democrats, French speaking socialists |
| Netherlands | July 9, 2004 | remuneration policy | mandatory | 16 May 2003 (via amendment) | Jan De Vries Blok Geskes | Christian democrats |
| UK | July 25, 2002 | The Directors' Remuneration Report Regulations 2002 | advisory vote | | government | labour |
| France | July 26, 2005 | termination agreements | mandatory | 13 April 2005 | T. Breton (government) | center right political party |
| | August 1, 2007 | disclosure criteria termination agr. | | 29 June 2007 | government | center right political party |
| Germany | July 31,2009 | remuneration system | advisory vote | 17 March 2009 | SPD/CDU | Socialists, Christian democrats |
| | pending | remuneration system | mandatory voting | 26 June 2013 | CDU/FDP* | Christian democrats, liberals |

*overruling the far-reaching proposals of the socialists

E. State Ownership of major enterprises

Executive remuneration levels at companies where the government is a major shareholder in large public companies ("State Owned Enterprises or SOEs) are a politically sensitive topic in many countries. While different countries have deployed different approaches, in 2005, the OECD issued a corporate governance code for state owned entities.[417] In it, the OECD emphasized the role of the government as shareholders in setting the appropriate remuneration policies. The remuneration scheme of directors of SOE's must "foster the long term interest of the company and can attract and motivate qualified professionals." The Code requires the disclosure of the remuneration policy as well as the disclosure of the remuneration levels of

[417] OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 9 (2005).

board members and key executives on an individual basis. The remuneration disclosure should include the termination and retirement provisions.

While the OECD Code is useful, it does not solve many of the problems facing governments in deciding what to pay SOE executives. Governments in countries with many SOE's have generally followed one of two options: direct regulation of the remuneration package of directors and/or top managers; or indirect regulation using their voting power and some kind of "say on pay". One example of direct regulation is the French cap on the total remuneration of executive directors of SOE's. The French government issued in July 2012 a decree to set the maximum remuneration of 450,000 euro.[418] This level was said to approximate twenty times the average pay package of the least paid workers at French SOE's.[419] While previously the SOEs' board of directors determined the remuneration, subject to approval by two government ministers, the new rules forbid the Ministers from approving remuneration packages that exceed the maximum threshold.

This type of cap has indirect effects on other corporations as well. If there are no checks on pay levels at private sector firms, then the cap on remuneration for publicly listed SOE's will result in a large gap between the two sectors' executive compensation levels. This in turn will put pressure on the government to institute an indirect form of regulation by enlisting shareholders as monitors some kind of "Say on Pay" vote on executive remuneration. As we discuss in section  above, this appears to be what is happening in France today.

Belgium is a good example of a country where the government has relied on indirect regulation of SOE executive compensation via the introduction of an advisory shareholder vote on the remuneration report in 2010. This vote is applicable to both the "autonomous government undertakings" (SOEs) as well as the listed entities. This system provides more flexibility, particularly when new developments occur such as those arising at Belgacom, the largest listed Belgian SOE illustrates. In that case, only days before the general meeting of shareholders, the minister in charge opined that the remuneration of the top management of the company was too

[418] Loi 2012-915 du 26 juillet 2012 relatif au contrôle de l'Etat sur les rémunérations des dirigeants d'entreprises publiques [Law 2012-915 of July 26, 2012 on the Government Control of the Remuneration of the Directors of Government Controlled Companies], JOURNAL OFFICIEL DE LA RÉPUBLIQUE FRANÇAISE [J.O.] [OFFICIAL GAZETTE OF FRANCE], July 26, 2012, p. 12283.

[419] *See* Les Rémunérations des Patrons d'entreprises Publiques Plafonnées à 450 000 €, LEGIPOLE DROIT SOCIAL, http://www.droit-social-legipole.fr/les-remunerations-des-patrons-dentreprises-publiques-plafonnees-a-450-000-e (last visited July 8, 2013).

generous and the government withheld its vote at the AGM.[420] Consequently, the majority of the minority shareholders rejected the remuneration report leading the board of directors to reassess the remuneration policy of the company.

However, mandatory Say on Pay votes must be employed carefully by governments at SOEs, as the Swedish TeliaSonera case illustrates. There, the Swedish government's rejection of the company's variable remuneration based on share options caused significant renegotiation costs for all executive management contracts.[421] Ultimately, shareholders bore these additional costs.

## III. Predictions About the Future of Say on Pay

Having examined the different legal regimes that have been used to implement Say on Pay in many countries around the world, and analyzed the common factors that may have led to its creation in those countries, in this last section we turn to the implications of these new rules for future of executive compensation, corporate governance and legal doctrine. We see several areas where Say on Pay is likely to have an impact on these three important topics.

Many supporters of Say on Pay hoped that it would have a strong effect on absolute executive compensation levels, or their rate of growth.[422] While the U.S. experience suggests that their aspirations have not been realized,[423] as research shows that only a small fraction of companies "fail" their Say on Pay votes in the U.S.,[424] a recent study of the international experience suggests otherwise. Correa and Lel use a large cross-country sample from 39 countries and find that Say on Pay laws are associated with a lower level of CEO compensation.[425] They further find that the companies that are most affected are ones with poor performance. This is consistent with U.S. evidence that poor performance and high levels of pay lead third party voting advisors to issue negative voting recommendations on their Say on Pay proposals because the companies deviate far from the average levels of all

[420] *See* section *supra* for further discussion.
[421] *Id.*
[422] Thomas et al., *Say on Pay*, *supra* note 5.
[423] Jesse Eisinger, *In Shareholder Say-on-Pay Votes, Whispers, Not Shouts*, N.Y. TIMES (June 27, 2013), at B5.
[424] Eisinger, *supra*, at B5; Cotter, Palmiter &Thomas, *supra* note 50.
[425] Correa & Lel *supra* note 4, at 2.

companies. Thus, abnormal levels of high pay coupled with relative bad performance trigger high levels of no votes.[426]

If this is correct, and public pressure continues to mount to rein in executive pay levels, then one possible policy move would be to implement binding shareholder votes in Say on Pay legal regimes. The logic for such a move might be run as follows: shareholders' concerns about directors being captured by management in dispersed ownership systems, or public pressure to keep pay inequities limited, coupled with the failure to rein in increasing levels of executive compensation, means that legal rules need to increase the power of the AGM to further determine compensation policy, and define the individual packages for executives through their influence with the board's remuneration committees. Correa and Lel find that the introduction of Say on Pay results in lower internal pay inequities within firms as well as higher firm value.[427] This "internal" corporate solution will be preferable to most managers and directors than having direct regulation of executive compensation levels, such as that experienced in the financial sector during and after the financial crisis. The recent experiences in the U.K., Australia and Switzerland, suggest that this could be a wave of the future.

By itself, we are pessimistic that Say on Pay will accomplish this result. To see why, it is important to remember that most companies use a benchmarking process to set their executive compensation levels: they select a group of "comparable" companies from their industry, calculate the median level of pay at those firms, and then tie pay to that median. If we remember from the previous point that shareholders only vote in large numbers against the outliers in Say on Pay votes, then companies that benchmark their pay levels to the median level of firms within their industry sector are unlikely to fail their Say on Pay votes. Since the practice of benchmarking is widely acknowledged to "ratchet up" the level of executive compensation, we should not expect the growth of executive pay levels to slow

[426] Cotter et al., *supra* note 50.
[427] Correa & Lel, *supra* note 4, at 2.

until an alternative method of setting pay is adopted.[428] In other words, even mandatory Say on Pay by itself is unlikely to stop the growth of executive compensation.[429]

But that does not mean that Say on Pay has not had an important effect on corporate governance practices. The existing evidence strongly suggests that companies that experience significant levels of shareholder opposition against their Say on Pay proposals, enhance the level of engagement between directors and shareholders.[430] This is most apparent in the dispersed ownership companies where management now engages in much greater outreach to shareholders over compensation issues.[431] Whereas previously the shareholders were only contacted concerning votes on major transactions like mergers and acquisitions, or contested board elections, shareholders are now engaged about pay packages. This represents a significant change in prior corporate governance practices that shows shareholders have greater input at many companies on pay issues.

Yet, more shareholder engagement without substantive changes to pay practices may be unsatisfying in countries where there is intensive pressure to reign in executive pay levels. Since even mandatory Say on Pay votes have had little apparent effect on pay levels, or even pay growth rates, in some countries this raises the possibility of hard law regulations on corporate pay in the future. One example where such regulations have been adopted in recent years is the financial sector in the EU and at least temporarily after the TARP legislation in the U.S. at bailout recipients. Another example is at state owned enterprises in certain countries, such as France .[432] These hard law regimes introduce pay caps, mandate certain forms of pay and directly involve governments in the boardroom on pay issues. However, we cannot predict with any certainty that such regulations will occur, nor what form they will take, only that there will be growing pressure particularly in Continental Europe to implement direct regulation of executive compensation.

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[428] Charles M. Elson & Craig K. Ferrere, *Executive Superstars, Peer Groups, and Overcompensation: Cause, Effect, and Solution*, 38 J. CORP. L. 488 (2013); John Bizjak, Michael Lemmon & Thanh Nguyen, *Are All CEOs Above Average? An Empirical Analysis of Compensation Peer Groups and Pay Design*, 100 J. FIN. ECON. 538 (2011).

[429] There is an important caveat to this conclusion though. If boards face other sanctions for failing their Say on Pay votes, such as those imposed in Australia's two strike system discussed in section above, then they may be sufficiently deterred by the prospect of those consequences that they will adopt a different pay setting system.

[430] Thomas et al., *Say on Pay*, *supra* note 5; Cotter et al., *supra* note 50.

[431] *Id.*

[432] For further discussion of French SOEs, see section *supra*.

For the EU, we can also predict with some confidence that more countries will adopt Say on Pay regulations. The pressure to do so is already apparent in Germany with a new legislative proposal and in France with a new corporate governance provision, and has carried the day in Switzerland recently. As these major European countries adopt new rules and the European Commission is considering this issue too, it is more than likely to trigger pressure for changes in other EU countries that consider the issue.

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