COMMENT: U.K.’S BINDING SAY-ON-PAY AND ITS SEMI-BINDING NATURE ON THE U.S.

Allison J. McCowan†

I. HISTORY OF EXECUTIVE COMPENSATION IN THE
UNITED STATES ........................................................................ 208

II. INTERNATIONAL APPROACHES TO EXECUTIVE
COMPENSATION AND SAY-ON-PAY ................................. 213
   A. UNITED KINGDOM .................................................... 213
   B. EUROPE ...................................................................... 215
      1. European Commission’s Non-Binding Vote ............. 216
      2. European Countries with Binding Votes ................. 216

III. UNITED STATES’ TAKE ON EXECUTIVE
COMPENSATION REFORM IN THE 21ST CENTURY .......... 218
   A. SAY-ON-PAY RULES UNDER THE TROUBLED
      ASSET RELIEF PROGRAM ........................................ 218
   B. SAY-ON-PAY RULES UNDER THE DODD-FRANK
      WALL STREET REFORM AND CONSUMER
      PROTECTION ACT ...................................................... 219
   C. PRACTICAL IMPLICATIONS OF SAY-ON-PAY UNDER
      DODD-FRANK .......................................................... 221

IV. MOVING FORWARD ....................................................... 223
   A. UNITED KINGDOM .................................................... 223
   B. MANDATORY BINDING STOCKHOLDER VOTES IN
      THE UNITED STATES ................................................... 226

V. CONCLUSION ................................................................. 227

† J.D. candidate (2013) Wake Forest University School of Law; B.A., Psychology
(summa cum laude), Norwich University (2008). The Author would like to give a
special thanks to her family and friends for their continuing love and support, as this
would not be possible without them. Additionally, the Author would like to thank
the editors and staff members of the Wake Forest Journal of Business and
Intellectual Property for their many hours of hard work to prepare this Comment for
publication.
INTRODUCTION

“One of the great, as-yet-unsolved problems in the country today is executive compensation and how it is determined.”


The growing concern surrounding executive compensation and the amount that executives get paid is rarely out of the media’s focus. In 2008, the collapse of major financial institutions run by extraordinarily well-paid executives brought intense focus and scrutiny on executive compensation. From the viewpoint of investors and the public, Chief Executive Officers (“CEOs”) pursued excessively risky strategies or investments that put corporations on thin ice, all the while they were paying themselves hefty paychecks. The prevailing view is that excessive compensation runs rampant, and boards of directors frequently award overly generous compensation packages to executives and officers with no regard for the interests of the corporation.

Executive compensation will never be the same for financial institutions following the financial crisis of 2008. Due to the crisis in the world’s financial markets, the world of executive compensation will not likely be the same for any publicly traded corporation. Many media outlets and governments around the world sought to blame the near collapse of the world’s financial institutions on the compensation policies and practices of financial institutions. In response to the financial crisis, restrictions and limitations on executive compensation became a central part of the legislation proposed and adopted. This Comment explores the history of executive compensation and argues that the current legislation is inadequate to prevent further abuse of the compensation system. While the United States took proactive and positive steps in drafting and passing the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), there are gaps in its enforcement and implementation that could render all of the hard work null and void. The practices of countries in Europe—the Netherlands and the United Kingdom—may seem extreme. However, their application presents a more systemic solution than that currently used in the United States, and their use as a regulatory device is valuable for achieving the intended goals of Dodd-Frank and executive compensation reform.

Part I examines the history of executive compensation in the United States including the call for reform. Part II presents United Kingdom and European legislation enacted to curtail obscene executive compensation, including the drafting history of the

regulations on both general and specific executive compensation reform. Part III presents situations from the United States that exemplify the problems and pitfalls in the executive compensation reform. Furthermore, Part III presents solutions that the United Kingdom has enacted to prevent the problems from happening again. Finally, this Comment concludes that the executive compensation reform enacted in the Netherlands and the United Kingdom is not an extreme solution, determines that the current reform in the United States is inadequate to address real world concerns, and demands a change in the present executive compensation climate.
I. HISTORY OF EXECUTIVE COMPENSATION IN THE UNITED STATES

While executive compensation may seem like a current hot topic, the attention surrounding it is not a new concept in the United States. An examination of the history of executive compensation in the United States in order to understand its problems. The executive compensation trends from the past can shed some light on possible solutions for the future.

Originally, in the 1800’s, the majority of business organizations were run by individuals who owned a large percentage of the organization and had a personal interest in how the organization was run. This type of proprietary management meant low executive pay and an extremely close connection between an organization and its leaders.

In the early 1900’s, around the time of the railroad boom, the United States began seeing great changes in the structure of business organizations. Small, family-run companies combined with each other to form new, giant industrial corporations. By 1904, over 1,800 small business organizations combined to form 157 large corporations. At this point, the senior and mid-level management positions, which were once held by owners of the organization, began to be held by executives with no interest or relationship to the business organization. Many scholars, academics, and analysts recognized this change in managerial positions and identified the disconnect between the separation of ownership and control of the corporation.

In response to these theories, business leaders implemented bonus programs that paid senior and upper-level employees bonuses specifically linked to firm profits and success.

In the 1920’s, executive bonus plans flourished and were widely implemented in corporate structures. While every firm evaluated its bonus programs differently, most organizations used a formula that placed a percentage of earnings into a bonus pool to be distributed to

---

2 Harwell Wells, “No Man Can Be Worth $1,000,000 A Year”: The Fight Over Executive Compensation in 1930s America, 44 U. RICH. L. REV. 689, 695 (2010).
3 Id. at 695-96.
4 Id.
5 Id. at 696.
7 Wells, supra note 2, at 696-97.
9 Wells, supra note 2, at 697-99.
10 Id. at 700.
the top management. The primary reason for the implementation of executive bonus plans was the problem of the separation of ownership and control. However, there were other reasons for the new bonus scheme, such as persuading talented executives to work for the company, incentivizing executives to work for the firm instead of themselves, and curing the split between labor and capital. With these new bonus programs, executive compensation in the early 1900’s increased by dramatic numbers.

The development of executive compensation and bonus schemes did not mean the same development of executive compensation law. During this time, there was relatively no law dictating disclosure or executive compensation rates. However, in the early 1930’s, the Great Depression hit its peak and things began to change. Undoubtedly, the Great Depression was the most dominant factor in shaping public disclosures of executive compensation schemes. Through a series of government investigations and stockholder suits, executive compensation became a highly public issue. The disclosures made through various lawsuits and government investigations shocked the public and stockholders, encouraging them to take action.

With such strong public outrage, Congress realized that it must take action to curb the ever-growing executive compensation problem. Politicians with various motives for executive compensation reform found that the most popular and effective response turned on disclosure. The national push for greater disclosure and compensation reform found its way into the Securities Act of 1933 and the Securities Exchange Act of 1934. These two acts required corporations to disclose senior officers’ pay. Because of the 1933 and 1934 Acts, beginning in 1935, public corporations were required to disclose the compensation of officers making more than $20,000 per year, including bonus payments. These amounts were required

---

11 Id.  
12 Id. at 701.  
13 Id.  
14 Id. at 702.  
15 Id. at 709.  
16 Id.  
17 Id. at 737.  
information on the public corporation’s annual Form 10-K.\textsuperscript{21}

In light of the information that the government collected, multiple news sources used the information to create comprehensive lists of high-paid corporate executives.\textsuperscript{22} For example, \textit{The New York Times} annually published lists of highly compensated executives compared to the pay figures of average workers in the executive’s industry.\textsuperscript{23} These figures only infuriated the public more.\textsuperscript{24} By the mid 1930’s, outcry over executive compensation was bubbling over. Shockingly, the public outcry and additional disclosure requirements did little to change the fundamental executive compensation practices.

World War II ushered in a new era of executive compensation, which was characterized by declines in executive compensation and slower growth of executive compensation plans.\textsuperscript{25} The war allowed corporations and executives to improve their negative images, and by the end of the war, any remnants of strong anti-corporation emotions had almost disappeared.\textsuperscript{26} While executive compensation faded from the forefront of major public issues, the composition of compensation began to change.

Following the end of World War II, compensation packages began including “fringe” benefits, such as health and life insurance, retirement plans, stock options, and other various benefits.\textsuperscript{27} These benefits, specifically stock options, got favorable tax treatment.\textsuperscript{28} They were used by firms as a tool to tie executives’ economic fates to the company’s.\textsuperscript{29} In the 1960’s the majority of publicly traded corporations offered stock options plans to their executives.\textsuperscript{30} Stock options plans supplemented executives’ traditional salaries; however, during this time corporations did not give their executives large stock option grants, instead corporations kept the lowered executive compensation plans.\textsuperscript{31}

\begin{footnotesize}
\begin{enumerate}
\item<2> See Salaries Synthesized, \textit{TIME}, July 20, 1936, at 65.
\item<4> See Pay of Executives Found Moderate, \textit{N.Y. TIMES}, July 6, 1936, at 23.
\item<6> Id. at 12.
\item<7> Id. at 13.
\item<8> Id.
\item<9> Id.
\item<10> Id. at 14.
\item<11> Id.
\end{enumerate}
\end{footnotesize}
Once stock options became popular, they attracted a steady stream of commentary from courts and legal scholars. Courts imposed stricter guidelines on stock options than on other forms of executive compensation. 32 Scholars and courts made strong attempts to understand and clarify executive compensation and the new stock option plans.33

During this era, traditional theories of corporate governance depicted senior executives and the CEO as working under, and controlled by, the board of directors and the stockholders.34 These theories advanced the idea that executive compensation was completed during an arms-length transaction between the executives and the corporation’s board of directors.35 Although the traditional theory was widely accepted, it did not provide a complete answer to executive compensation and had wide, unexplained gaps.36 Critics of the traditional theory postulated that the reality of the traditional theory was actually true—the board of directors served at the pleasure of the CEO and other senior executives.37 These critics doubted any meaningful distance between the CEO and the board of directors.38 They believed that the CEO actually set his own salary with no regard to the board of directors.39 Proponents of this “new” theory thought that an executive could increase and control his own compensation by simply increasing sales instead of increasing overall profitability.40 Even with the academic chatter, executive compensation remained a minor issue, possibly due to its slow growth.41

Around the mid 1970’s, executive compensation began growing at a faster rate. For example, in 1965, a CEO was paid approximately twenty-four times more than the average worker; however, by 1979, the figure rose to thirty-five times more.42 This trend still continues. In 1999, a CEO was making about 299 times more than the average worker’s pay.43 The average worker’s pay in the United States has become stagnant since the 1970’s, which only widens the gap between

32 Id.
33 Id. at 15.
34 Id.
35 Id. at 15-16.
36 Id. at 16.
37 Id.
38 Id.
39 Id.
40 Id.
41 Id.
42 Josh Bivens, CEOs Distance Themselves from the Average Worker, ECON. POLICY INST. (Nov. 9, 2011), http://www.epi.org/publication/ceo-ratio-average-worker/.
43 Id.
executive and average worker pay.\textsuperscript{44}

The executive compensation path from the 1970’s forward could be described like a roller coaster track, going up and down. In the 1970’s, executive compensation began growing at a quicker pace than the 1960’s and previously.\textsuperscript{45} In the 1980’s, the rising executive compensation gained new and powerful scrutiny.\textsuperscript{46} This new scrutiny focused on broad economic problems due to the discovery of widespread illegal corporate donations, corporate scandals, shortcomings in corporate governance, and newly formed doubts regarding the competency and integrity of CEOs and boards of directors.\textsuperscript{47} In sum, the attack on executive pay was viewed as a way to reform the corporate economy as a whole.\textsuperscript{48} Scrutiny as well as public criticisms increased during this time.\textsuperscript{49} Public hostility erupted when many CEO compensation packages surpassed the million-dollar-a-year threshold.\textsuperscript{50} Executive compensation tied to takeovers drew similar criticism.\textsuperscript{51} Following the media coverage of merger industries, the public was outraged that failing CEOs were not harmed due to the new “golden parachutes” that the corporation had enacted in the face of a merger or business combination.\textsuperscript{52} During the 1980’s, the amount of compensation grew and the composition of pay packages evolved away from an amount rewarded for corporation positive performance.\textsuperscript{53}

In 1992, to counteract public discontent with executive pay, Congress and the Securities and Exchange Commission (“SEC”) adopted new measures to refocus and rein in executive compensation.\textsuperscript{54} Congress used its power to change United States tax rules concerning compensation by preventing publicly traded corporations from deducting compensation over $1,000,000, unless the compensation was both “performance-based” and part of a plan approved by stockholders.\textsuperscript{55} The SEC created new disclosure requirements that mandated more detailed disclosure of policies used


\textsuperscript{45} Wells, supra note 25, at 17.

\textsuperscript{46} Id. at 18.

\textsuperscript{47} Id.

\textsuperscript{48} Id.

\textsuperscript{49} Id.

\textsuperscript{50} Id.

\textsuperscript{51} Id. at 19.

\textsuperscript{52} Id.

\textsuperscript{53} Id. at 20.

\textsuperscript{54} Id. at 21.

\textsuperscript{55} Id.
in setting compensation.\textsuperscript{56} The good intentions and practical implications behind the SEC’s and Congress’ actions could not curb executive compensation and did little to stall the overall growth of compensation.

At the start of the new century, in 2000, the Internet bubble burst, which led to a sharp decrease in CEO pay from 2001 to 2003.\textsuperscript{57} Following the bubble’s bursting, Enron and other major American corporations collapsed, which inspired public hope that executive compensation would once and for all be restrained.\textsuperscript{58} Unfortunately, executive compensation only continued to increase.

\section*{II. International Approaches to Executive Compensation and Say-on-Pay}

The United States was not unique in its executive compensation problems. As industries grew and companies became more complex, countries around the world developed problems with CEO and executive pay.

\subsection*{A. United Kingdom}

In 2002, the United Kingdom became the first country to pass mandatory, non-binding say-on-pay requirements.\textsuperscript{59} These executive compensation reforms were the first of their kind and set the tone for executive compensation reform.\textsuperscript{60} Although the United States does not have the exact market structure and size as the United Kingdom, the United States modeled its say-on-pay rules off the United Kingdom’s 2002 regulations.\textsuperscript{61} In order to fully understand the United Kingdom’s regulations it is imperative to take a comprehensive look at

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{56} Id.
\item \textsuperscript{57} Id. at 25.
\item \textsuperscript{58} Id.
\item \textsuperscript{60} See Delman, \textit{supra} note 59, at 591.
\end{itemize}
\end{footnotesize}
the United Kingdom’s situation at the time surrounding the adoption of the regulations.

The United Kingdom experienced executive compensation outrage similar to that of the United States. In the 1980’s, during the rule of Margaret Thatcher, the United Kingdom privatized the majority of the country’s utilities, including water, electricity, and gas.62 Following the privatization of these utilities, the compensation of the senior officers skyrocketed for essentially doing the same job in the same way.63 The public outrage surrounding these new utility corporations and their seemingly overpaid senior officials lead to the beginning of government regulation of compensation.64

In 1998, the London Stock Exchange adopted an industry-sponsored code referred to as the “Greenbury Code.”65 Without substantial change, the London Stock Exchange included a large part of the Greenbury Code in its Listing Rules as part of the Combined Code on Corporate Governance (“Combined Code”).66 The new Combined Code required public corporations to establish a remuneration committee of independent directors to evaluate and set executive compensation, and to disclose additional compensation information and policies through audited reports.67 The boards of public corporations were obligated to annually “consider” seeking stockholder approval for compensation decisions.68 Although the majority of public corporations complied with the Combined Code, executive compensation levels rose and only a small number of firms held stockholder votes on compensation schemes.69

This legislation missed the mark on executive compensation reform. Therefore, in 2002, the United Kingdom amended the U.K. Companies Act and adopted a radical amendment, titled the Directors Remuneration Report Regulations (“DRR Regulations”).70 The DRR Regulations expanded disclosure of executive compensation above the then-current requirements of the London Stock Exchange and U.K.

63 Id.
64 Id. at 341-42.
66 Gordon, supra note 62, at 341-42.
67 Id. at 342.
68 Id.
69 Id.
70 DRR Regulation, supra note 59, at art. 1.
Companies Act. Most importantly, the new legislation required an advisory stockholder vote on the Director’s Remuneration Report (“DRR”), a company’s disclosure report of executive compensation. Specifically, the 2002 DRR Regulations require that the DRR include specific disclosure of the types of compensation paid to the senior executives as well as a statement of the company’s overall compensation policy. The stockholder vote required under the DRR Regulations is a mandatory vote on the DRR by stockholders for every public company. This yearly mandatory vote requires the stockholders to “approve” executive pay; however the vote itself is not binding on the corporation. Essentially, the stockholders can vote “no” for a proposed executive compensation scheme and the board of directors can ignore the stockholder vote and adopt the compensation scheme, and the company would technically suffer no repercussions or adverse effects. Under the DRR Regulation, a board of directors can only be held liable or fined if it completely fails to satisfy the requirements mandated under the DRR, but not if it ignores the stockholder vote.

In addition to the advisory stockholder vote, the DRR Regulations require that each company submit a statement of the company’s overall compensation policy that includes an analysis of the company’s performance compared to its peers. Additionally, the statement must be signed by remuneration committee members and further independently audited by an outside source. The DRR Regulations radically improved the hopes of executive compensation reform on a global level.

B. Europe

The United Kingdom can be a helpful tool in understanding executive compensation reform due to the fact that it was the first country to enact a stringent compensation-targeted regulation. However, other countries in Europe were quick to follow the United Kingdom’s lead and these countries began adopting their own compensation reform. Some of these compensation reforms mirrored

---

71 Gordon, supra note 62, at 342.
72 DRR Regulation, supra note 59.
73 DRR Regulation, supra note 59, at art. 10, § 234B(2), (3).
74 DRR Regulation, supra note 59, at art. 7, § 241A(1), (6).
75 DRR Regulation, supra note 59, at art. 7, § 241A.
76 DRR Regulation, supra note 59, at art. 7, § 241A(6), (8).
77 DRR Regulation, supra note 59, at arts. 3, 7, §§ 234B, 241A(9), (10).
78 DRR Regulation, supra note 59, at art. 3, §§ 234B(2), (3).
79 DRR Regulation, supra note 59, at art. 3, § 234C.
the United Kingdom’s approach while others were much more drastic.

1. European Commission’s Non-Binding Vote

In 2004, only two years after the United Kingdom adopted the DRR Regulations, the European Commission (“EC”) recommended that all European Union countries submit their remuneration policy to the stockholders for an advisory vote. The EC’s recommendation allowed for stockholders to opt-in to a say-on-pay regime so long as a sufficient number of stockholders chose to opt-in. In other words, companies could decide to adopt the stockholder advisory vote only if stockholders holding a minimum of a quarter of the stocks requested it. In 2009, following a study conducted by the EC that showed that stockholders in the majority of member states had a say in determining the remuneration of the board of directors but not a vote on executive compensation, the EC issued sharply-worded recommendations aimed at improving stockholder oversight. This latest communication from the EC demonstrates its serious intent to forcefully direct member states to empower stockholders to have a stronger voice when it comes to executive compensation. Additionally, the forceful nature of the EC could mean that the EC is willing to accept diverging models of stockholder voting. Germany has followed in the EC’s footsteps and adopted a similar compensation regime.

2. European Countries with Binding Votes

The Scandinavian countries (Denmark, Sweden, and Norway) and the Netherlands have enacted very radical regulations that not only required a mandatory stockholder vote on executive compensation, but required that the mandatory vote be binding on the corporation.

In 2003, the accounting scandal at Ahold, a large Dutch retailer, led to a revelation that the incoming CEO was guaranteed fixed

---

81 Id. at art. 4.2 (suggesting that the vote can be “held only if shareholders representing at least 25% of the total number of votes held by shareholders present or represented at the annual general meeting request it”).
83 Delman, supra note 59, at 594.
bonuses. 84 A few high-profile cases of “pay-for-failure” only
magnified the intense negative public response. 85 In addition to the
public outcry, Dutch trade unions, which form an integral part of the
Dutch corporate model, pointed out that compensation for executives
was growing roughly eight to ten times faster than wages for average
workers. 86 The public disdain, coupled with the trade union’s power,
influenced the Dutch government to form the Corporate Governance
Committee (“Tabaksblat Committee”). 87 The Tabaksblat Committee
crafted a code of best practices similar to the United Kingdom’s
Greenbury Code. 88 The Netherlands adopted the Tabaksblat Code in
2004 and made it mandatory for every corporation to comply with its
corporate governance principals. 89 Similar to the United Kingdom’s
model, and in conformity with its overarching regulatory approach, the
Netherlands had a “comply or explain” model for compliance with the
Tabaksblat Code. 90 The provisions of the Tabaksblat Code were
applied unconditionally or required a persuading explanation for any
departure of the code. 91

There are three key differences between the Netherlands approach
and the DRR Regulations from the United Kingdom. First, in the
Netherlands, the stockholder vote is only on the principles that will be
used to devise the compensation package, but not on the amount and
compensation package itself. 92 Second, the stockholder vote in the
Netherlands does not have to be annual. 93 Under the Tabaksblat Code
the stockholders only vote on policy when the corporation has changed
its pay policy. 94 Third, and possibly the most drastic departure of the
United Kingdom rules, the stockholder vote is completely binding on
the corporation. 95 For example, if the stockholders vote down a new
compensation policy, the former approved policy will stay in effect

84 Id. at 592.
85 Id.
86 Id.
87 See CORPORATE GOVERNANCE COMM., THE DUTCH CORPORATE
GOVERNANCE CODE (Dec. 9, 2003), available at
http://www.ecgi.org/codes/documents/cg_code_nl_en.pdf [hereinafter TABAKSBLAT
CODE].
88 Id.
89 CORPORATE GOVERNANCE CODE MONITORING COMM., REPORT ON
COMPLIANCE WITH THE DUTCH CORPORATE GOVERNANCE CODE 4 (2005), available
90 TABAKSBLAT CODE, supra note 87, at Preamble 6.
91 Id.
92 Delman, supra note 59, at 593.
93 Id.
94 TABAKSBLAT CODE, supra note 87.
95 Delman, supra note 59, at 593.
until the stockholders approve a new one.

In response to their own corporate scandals, rising executive pay, and public anger, the Scandinavian countries soon enacted similar Dutch binding vote models instead of following the United Kingdom’s DRR Regulations model. All three countries require a mandatory, binding stockholder vote on prospective pay policies. However, Sweden and Norway mandate the stockholder vote to be annual, even when there is no change in compensation principles.

III. UNITED STATES’ TAKE ON EXECUTIVE COMPENSATION REFORM IN THE 21ST CENTURY

A. Say-On-Pay Rules Under the Troubled Asset Relief Program

As discussed in Part I, public outrage raised concerns over excessive pay to executives employed at failing or failed companies. As a result, the federal government enacted several restrictions as a condition to receiving federal stimulus funds. In 2008 and 2009, Congress passed the Emergency Economic Stabilization Act (“EESA”) and the American Recovery and Reinvestment Act (“ARRA”) to combat the growing concern. These statutes imposed new obligations on boards of directors and compensation committees in an unprecedented area of compensation not previously regulated by federal law. In addition to the EESA and the ARRA, the federal government enacted the Interim Final Rules for Troubled Asset Relief Program (“TARP”) entities to become effective June 15, 2009. The TARP regulations implement and enforce the executive compensation provisions of the EESA and the ARRA.

The TARP statutes only apply to corporations that received governmental financial assistance under the TARP program and only if these corporations have outstanding federal debt. In these cases, any TARP funds recipient must permit a separate stockholder vote to

96 Id. at 594.
97 Id.
98 Id.
100 EESA Regulations, supra note 99; ARRA Regulations, supra note 99.
101 TARP Regulations, supra note 99.
approve the compensation of executives.\textsuperscript{103} The TARP stockholder vote is not binding on the corporation or its board of directors and cannot be construed to create or imply any additional fiduciary duties.\textsuperscript{104} The say-on-pay provision requires the corporation to adopt a plan that would give the corporation’s stockholders the ability to vote on executive compensation that it will employ in the future.\textsuperscript{105} These say-on-pay rules provide the foundation of contemporary executive compensation reform in the United States.

### B. Say-On-Pay Rules Under the Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was a massive overhaul of financial regulations in the United States following the financial crisis of 2008. President Barack Obama stated that the Dodd-Frank legislation is “the toughest financial reform since the ones we created in the aftermath of the Great Depression.”\textsuperscript{106} The Obama Administration believed that a federal law authorizing “say-on-pay” for all public corporations could “help restore investor trust by promoting increased shareholder participation and increasing accountability of board members and corporate management.”\textsuperscript{107}

Dodd-Frank, which passed on July 15, 2010, requires executive compensation packages to be submitted to stockholders for a mandatory, non-binding advisory vote at least once every three years.\textsuperscript{108} More specifically, Dodd-Frank contains a variety of provisions concerning the mechanisms for enacting the say-on-pay vote.\textsuperscript{109} First, regarding the timing of when the vote must occur, Dodd-Frank requires:

> Not less frequently than once every 3 years, a proxy or

\textsuperscript{103}ARRA Regulations, supra note 99, at 519.
\textsuperscript{104}Id.
\textsuperscript{105}Id.
\textsuperscript{109}Id.
consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to approve the compensation of executives . . . . 110

Additionally, in order to determine the frequency of the stockholder advisory vote to approve the executive compensation package, Dodd-Frank states:

Not less frequently than once every 6 years, a proxy or consent or authorization for an annual or other meeting of the shareholders for which the proxy solicitation rules of the Commission require compensation disclosure shall include a separate resolution subject to shareholder vote to determine whether votes on the resolutions required under paragraph (1) will occur every 1, 2, or 3 years. 111

Dodd-Frank not only requires disclosure of the proposed executive compensation scheme, it requires disclosure for “golden parachutes” agreements used to compensate executives in the face of terminated employment. 112 A “golden parachute” is an agreement between a company and an executive specifying that the executive will receive specific, significant benefits in the event that the company is acquired, consolidated, or sold. 113 Dodd-Frank requires that these golden parachute agreements be disclosed, specifically identifying any named executive and describing the aggregate total of parachute payments that may be paid to each executive. 114 In addition to this disclosure, the company must provide a stockholder advisory vote to approve any parachute payment. 115

The stockholder vote on executive compensation and golden parachute agreements are non-binding on the directors. 116 Specifically, Dodd-Frank requires that the votes may not be construed: (1) to overrule a decision by the board of directors or the company; (2)

111 Id. § 78n-1(a)(2).
112 Id. § 78n-1(b)(1).
115 See id. § 78n-1(a)(1), (b)(2).
116 See id. § 78n-1(c).
to create or imply changes to fiduciary duties; (2) to create or imply additional fiduciary duties; or (4) to limit stockholders’ ability to make executive compensation proposals in proxy materials.  

C. Practical Implications of Say-On-Pay Under Dodd-Frank

Under Dodd-Frank there are generally three different scenarios following a stockholder say-on-pay vote. The most positive scenario, for both the corporation and its stockholders, is that the stockholders would vote “yes” for the executive compensation package. Under this scenario, the board would enact the stockholder-approved compensation scheme and hopefully everyone would be happy. Another possible scenario would be for the stockholder to vote “no” for the proposed executive compensation plan. Under scenario two, the board of directors would consider the stockholder’s advisory vote and change the proposed compensation scheme to more reasonable compensation. The final scenario would be if the stockholders voted “no” and the board of directors ignored the vote and enacted the stockholder-rejected compensation scheme.

While stockholders are generally satisfied and content under the first two scenarios, the third scenario leaves stockholders and boards of directors in an oppositional position. Since its inception in 2010, the advisory say-on-pay rules have seen their fair share of time in the courtroom under the third scenario.

On March 15, 2011, stockholders brought a derivative suit in Georgia state court claiming that the board of directors of Beazer Homes breached its fiduciary duties to the stockholders by violating the corporation’s “pay-for-performance” policy when it increased the CEO’s and top officials’ executive pay despite massive corporate losses. These substantial compensation increases came after the company lost a total of $34 million dollars in 2010 and stockholder returns were down by 17%. Under the newly enacted Dodd-Frank regulations regarding say-on-pay, Beazer Homes conducted its first advisory stockholder vote to determine the upcoming compensation package for its executives. Despite a unanimous recommendation from the board, almost 54% of stockholders voted against the proposed compensation scheme. Despite the negative vote, Beazer

---

117 See id. § 78n-1(c)(1)-(4).
119 Id.
120 Id.
121 Id. at 11.
Homes’ board of directors still awarded the proposed executive pay to
the senior executives and CEO.\textsuperscript{122}

The substance of the disgruntled stockholders’ claim is that the
board’s decision to increase compensation in the face of a negative
vote and corporate loses was “disloyal, unreasonable and not the
product of a valid exercise of business judgment.”\textsuperscript{123} Moreover, the
stockholders alleged that the executive compensation scheme offered
was a clear violation of the company’s own “pay-for-performance”
compensation policy.\textsuperscript{124} Overall, the Beazer Homes’ stockholders
concluded that the executive compensation packages in question were
not in the best interest of the corporation or the stockholders, and were
in violation of the company’s stated policy.\textsuperscript{125}

In defense of its actions, Beazer Homes argued that although
Dodd-Frank requires companies to conduct a say-on-pay vote
regarding the company’s compensation for top executives, that
advisory vote “shall not be binding” on the board and “may not be
construed” to imply or create fiduciary duties owed by the company’s
board.\textsuperscript{126} Beazer Homes asserted that the purpose of the say-on-pay
provision is only to allow the stockholders to express their views on
executive compensation without binding the hands of the board when
the board is making compensation decisions.\textsuperscript{127}

On September 16, 2011, a Georgia Superior Court granted Beazer
Homes’ motion to dismiss the stockholders’ derivative claim,
reasoning that a stockholder “no” vote does not require the corporation
to rescind or re-evaluate the compensation package.\textsuperscript{128} The court
found that the stockholders did not demonstrate that the board acted in
bad faith or without an honest belief that its decisions concerning the
2010 executive compensation were best for the corporation.\textsuperscript{129}

Just four days after the Georgia court dismissed the case in Beazer
Homes, an Ohio federal court ruled in favor of allowing a similar
stockholder derivative suit to continue.\textsuperscript{130} In \textit{NECA-IBEW Pension
Fund v. Cox} (“Cincinnati Bell”), unhappy stockholders argued that

\textsuperscript{122} \textit{Id.} at 1.
\textsuperscript{123} \textit{Id.}
\textsuperscript{124} \textit{Id.}
\textsuperscript{125} \textit{Id.}
\textsuperscript{126} Teamsters Local 237 Additional Sec. Benefit Fund et al. v. McCarthy et al.,
Sept. 16, 2011).
\textsuperscript{127} \textit{Id.} at *11.
\textsuperscript{128} \textit{Id.} at *2.
\textsuperscript{129} \textit{Id.} at *19.
senior executives and the CEO were being handsomely rewarded in the face of poor company performance in the previous year.\textsuperscript{131} The \textit{Cincinnati Bell} case features similar claims as the \textit{Beazer Homes} case. The big difference between these two cases lies in the analysis of the judges. The Ohio federal court judge held that the business judgment rule was properly rebutted.\textsuperscript{132} The plaintiff demonstrated sufficient facts to rebut the rule by showing that the corporation ignored both written company policy and the express will of the stockholders in granting raises that were disproportionate to the company’s profits.\textsuperscript{133} The judge found that the plaintiff “pled specific facts to give reason to doubt that the directors could make unbiased, independent business judgments.”\textsuperscript{134} The board could not be depended upon to give a fair review of the charges considering that it already voted to approve the unpopular compensation plan, which was in violation of company policy and against the will of stockholders.\textsuperscript{135}

While the courts in \textit{Beazer Homes} and \textit{Cincinnati Bell} are technically correct in their statement of current law, the differences in the state court findings pose a major problem for stockholders and the legislators who enacted the say-on-pay provision of Dodd-Frank. By examining these two cases there is one large area of concern: in what circumstances will the advisory vote constructively bind the corporation?

\section*{IV. Moving past Advisory Say-On-Pay}

\subsection*{A. United Kingdom}

The United Kingdom’s success under the 2002 regulations did not come easy; however, proponents of the say-on-pay regulations have claimed that the new disclosure requirements were a victory.\textsuperscript{136} GlaxoSmithKline experienced the first “no” vote under the new United Kingdom say-on-pay regulations.\textsuperscript{137} In May 2003, during the first year the DRR Regulation was in effect, the stockholders of GlaxoSmithKline rejected the CEO’s large golden parachute

\textsuperscript{131} Id.
\textsuperscript{132} Id. at *3.
\textsuperscript{133} Id. at *3-4.
\textsuperscript{134} Id. at *4.
\textsuperscript{135} Id.
\textsuperscript{136} Paul Hodgson, \textit{A Brief History of Say on Pay}, IVEY BUS. J. (Sept./Oct. 2009), http://www.iveybusinessjournal.com/topics/leadership/a-brief-history-of-say-on-pay#.URQvBWcGVvQ.
\textsuperscript{137} Id.
agreement by a vote of 50.72%. Following this rejection, GlaxoSmithKline met with stockholders and discussed a more appropriate and acceptable golden parachute agreement with the CEO.

The United Kingdom say-on-pay scheme stayed relatively quiet from 2003 until 2009, with the majority of the advisory stockholders voting in favor of the compensation plans and golden parachute agreements. The financial crisis of 2008 radically shook the atmosphere in the United Kingdom and ushered in a slew of upset stockholders. In 2009 and 2010, the number of stockholders who disagreed with their corporation’s executive compensation schemes rose dramatically. For instance, in 2009, 59% of the stockholders of Royal Dutch Shell (“Shell”) rejected the corporation’s compensation package for 2008 to protest the payment of bonuses in the face of the corporation’s failed performance goals. Shell’s bonus policy dictated that executives would not receive bonuses if Shell ranked fourth or lower in a group of its peers. In 2008, Shell was ranked fourth on the annual list; however, Shell’s remuneration committee decided to maintain its original compensation package. Some scholars argue that the increase of stockholder “no” votes is only a positive outcome of the say-on-pay regulations because it demonstrates the open communication lines between the board of directors and stockholders.

While some contend that the United Kingdom DRR Regulations proved successful, evidenced by both “yes” and “no” votes on executive compensation schemes, empirical evidence shows that executive pay has only increased since 2002 and the enactment of the DRR Regulation. Due to this perceived failure of the DRR

---

138 Id.
139 Id.
140 Id.
142 Id.
144 Herron, *supra* note 143.
145 Id.
146 Id.
Regulations, the United Kingdom government announced a package of new measures to address and reinvigorate the 2002 regulation.

On June 27, 2012, the government of the United Kingdom announced a new proposal setting out new standards for corporate DRR. The new changes included three key points. First, and most importantly, the proposed changes require that each company put its director remuneration policy (executive compensation package) to an annual binding stockholder vote. The only way for a company to avoid this yearly binding vote is to leave its policies unchanged each year; nevertheless, a company is then required to conduct a binding stockholder vote every three years. Second, the new regulation would require the “continuation of an annual advisory vote on how each company’s remuneration policy was implemented in the previous year,” including the amount of compensation that the company had previously paid to executives. Third, the proposed regulation would require a higher level of disclosure for executives and their termination packages. Although the proposed legislation is being debated by Parliament, it is overwhelmingly expected to be enacted and applied to United Kingdom companies around October 2013.

The first proposed change, the forward-looking report, would inform a binding vote by stockholders on the executive compensation package and would be included in the annual report. The compensation scheme would require the affirmative vote of 50% to pass and the vote would be required to be conducted annually unless the corporations decide to leave their remuneration policy unchanged. If a corporation decides not to change its remuneration policy, the mandatory binding stockholder vote is only required to be conducted every three years. Any proposed change to the remuneration policy requires stockholder approval, even if the stockholders already voted once that year. In the event that the stockholders vote “no,” the corporation must keep using the last

---

149 Id.
150 Id.
151 Id.
152 Id.
153 Id.
154 Id.
155 Id.
156 Id.
157 Id.
compensation policy approved by stockholders until the stockholders approve a new plan.\footnote{Id.}

The second proposed change, the backwards-looking implementation report, gives an explanation to the stockholders of how the remuneration policy was implemented in the previous year.\footnote{Id.} The report on the previous year’s policy is required to include specific details of actual payouts and awards made to senior executives and the CEO.\footnote{Id.} The figures included in this annual report should reflect the actual remuneration earned as compared with the potential remuneration not yet earned by the end of the year.\footnote{Id.} In compiling these reports, corporations are advised to be more proactive in their reporting techniques as well as in reporting whether directors and senior executives have met their annual performance goals.\footnote{Id.}

The third proposed change specifically involves the disclosure of termination payments to directors.\footnote{Id.} This proposal is a direct response to the perceived problem of “rewards for failure.”\footnote{Id.} The proposal requires United Kingdom corporations to set out their approach to exit payments as part of the remuneration policy report—subject to the binding stockholder vote.\footnote{Id.} The remuneration policy report should contain all necessary facts and elements that will be used when calculating exit payments for directors and senior executives.\footnote{Id.} Once a director leaves and the corporation pays the director an exit payment, the proposed change would require the corporation to promptly publish a statement describing in detail the termination payments made.\footnote{Id.}

**B. Mandatory Binding Stockholder Votes in the United States**

The United States would be keen to keep an eye on the binding say-on-pay in the United Kingdom. The regime proposed in the United Kingdom could have a significant impact on United States pay practices. These new regulations allow flexibility for directors, permit a stronger voice for stockholders, and impose a healthy divide of power and legal considerations for United States corporations.

\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}\footnote{Id.}
Advisory stockholder voting has opened the window for advanced regulation and discussion. While corporations might not have liked the idea of an advisory stockholder vote on executive compensation, the majority of corporations listened to what the stockholders wanted and responded appropriately. Whether out of fear of market punishment or embarrassment of a “no” vote, in the cases where stockholders have voted “no,” boards have been quick to devise a more suitable compensation plan, accepted by all. However, as say-on-pay advisory votes become more commonplace, there is a risk that boards will treat those votes as non-events, even when stockholder dissent reaches higher levels. The recent cases highlight this phenomenon, and the instances of corporations disregarding negative votes have increased with the number of years that say-on-pay has been around.

The indifference of boards of directors can be curbed by adopting a mandatory binding stockholder vote on executive compensation. To start, requiring a mandatory binding stockholder vote on a corporation’s compensation package would place the power back in the corporate owner’s—the stockholders—hands. Historically, boards of directors were entrusted to manage the corporation’s assets and business; but unlike the contemporary view, boards do not have open-ended power. There are positive reasons for the allocation of power between boards and stockholders. The checks and balances that these two positions have on each other are worth noting. Additionally, because the stockholders are the “owners” of the corporation, they should be given rights at the expense of other corporate constituents. The stockholders would be more involved in the performance and risks of the company.

If mandating an advisory say-on-pay under Dodd-Frank seemed radical in 2010, mandating binding say-on-pay may seem out of the this world; but, stockholders have had a strong voice when it comes to executive compensation for a while. For example, in accordance with 2003 SEC stock exchange regulations, stockholders are required to approve any stock option plan.\textsuperscript{168} Essentially, under this rule, all equity-compensation plans or revisions to the terms of such plan are subject to stockholder approval.\textsuperscript{169}

\textbf{V. Conclusion}

Under the current Dodd-Frank regulatory regime, executive compensation laws in the United States miss the mark of adequate

\textsuperscript{169} Id.
reform. If executive compensation reform is the accurate goal of these regulations, there must be some sort of checks and balances system in place to keep a lid on boards’ and senior executives’ decisions. The current regulations and debate surrounding executive compensation and say-on-pay in the United States have not paid enough attention to the additional options that are available. In particular, the new United Kingdom binding stockholder vote and the older Netherlands approach provide a good framework for constructing binding say-on-pay legislation. Although the United Kingdom’s 2012 regulations have not been put into force yet, the Netherlands has collected data demonstrating the positive effects of its binding say-on-pay legislation.

Without any credible source of liability or ouster, directors are unlikely to heed to an advisory non-binding vote seriously. As say-on-pay becomes more prevalent on a global scale and in the United States, the stockholder votes should be binding. Whatever form of say-on-pay the United States ends up taking in the future, it is clear that the current reform is not enough to bind pay-for-performance, which is the ultimate goal of executive compensation reform. To that end, other reforms should be closely studied and monitored in conjunction with the United States’ ideals and executive compensation goals.